

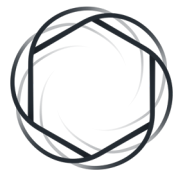


S.P. HINDUJA

BANQUE PRIVÉE

# House View

AUGUST 2022



# Thoughts of the CEO

“The probability of a global recession has increased, creating opportunities for some.”

The beginning of the second half of the year has seen rising recession worries seemingly displace interest rate concerns. Since my last letter, the investor mood has become even more cautious. What has changed in the market narrative is the realisation that central banks seem willing to remain on the path of hiking interest rates, despite a worsening global growth outlook. One by one, leading central banks have now formally and openly distanced themselves from their previous gradualist forward guidance. Central banks are now deliberately signalling that they do not actually know what will happen to the interest rate trajectory. This means that, as investors, we need to be prepared for more volatility and a wider range of outcomes.

As investors assess the prospects of the world's three large economic engines – the US, China and Europe – it is the latter which currently appears more vulnerable. Europe is viewed as more vulnerable because the large euro area is fragmented on the fiscal side: each member state has its own ministry of finance. We are seeing this well-known structural issue now worrying debt markets, both for government and corporate debt.

Credit spreads on corporate bonds have been rising since the beginning of the year. As with equity investments, rising capital costs and increasing fears of recession have affected this asset class. What is striking, however, is the significantly stronger increase in credit spreads for euro bonds than for corporate bonds in US dollars. Credit spreads on euro-denominated corporate bonds are almost at the level they reached at the height of the Corona crisis.

This divergent pattern between euro and US dollar corporate bonds was last seen eleven years ago during the European debt crisis. Investor confidence in European assets seems to be crumbling once again. In this context, investors will be keeping a watchful eye on the spreads of eurozone

government bonds. While the European Central Bank has announced a new monetary tool to fight excessive spread widening between eurozone government bonds, markets are nervous about this untested tool in the current high inflation context.

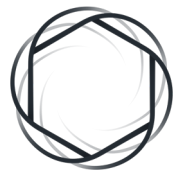
The weakness of the euro against the US dollar also reflects the eurozone's vulnerabilities. Reliance on Russia for a large chunk of natural gas has contributed to the eurozone's much higher producer price inflation than in the US (36% vs. 11%). The textbooks tell us that this big differential must eventually be reflected in the exchange rate, which is exactly what we saw. Given the sharper rise in European gas prices and the prospect of real shortages in the winter months, we must expect European inflation rates to remain stubbornly high. The first interest rate hike by the ECB in July cannot yet change this trajectory. For any sustainable turn in the euro's fortunes, we need to see sustainably lower eurozone inflation.

Our investment conclusions, which we explain in more detail in the following pages, include the advice to temporarily hold more cash than usual and to continue to underweight equities. And in fixed income, we have an even stronger preference now for shorter-term US Treasury bonds. For investors with a long-term investment horizon and a greater tolerance for volatility, we would be happy to discuss selected opportunities with you.

Yours sincerely,

Karam Hinduja





## Risk of continued rising interest rates

Capital market interest rates are still far below inflation rates and thus the risk of continued rising interest rates has not yet disappeared. We, therefore, continue to recommend our clients to temporarily hold more cash than usual, to underweight their broader equity positions in the portfolio, and in fixed income to prefer the short end of US Treasuries. We take some profits on carbon credits because a potential recession would reduce industrial activity and, thus, the need for corporations to bid for credits. We also recommend some exposure to gold.

While higher interest rates have been the main reason for the correction on the stock markets since the beginning of the year, fears of a recession have dominated recently. In the US, consumer dynamics are clearly in the recessionary range and in Europe, too, the dynamics continue to deteriorate. The stock markets reacted to this with a largely negative performance. In mid-June, the S&P 500 was officially in bear market territory with a correction of around 22 percent from the January peak. It reversed some of these losses in July.

### China's response has been somewhat different

The only regional exception has been China. The Chinese stock market recovered thanks to the easing of Corona lockdown measures as well as fiscal policy support announcements. Monetary policy in China also appears to have more headroom as a result of lower inflation than in the US or Europe. This partially reflects greater use of price

controls in China. The recent reimposition of new lockdown measures in some of the major Chinese cities has, however, already put a new damper on the market and is a reminder of the volatile situation we are in.

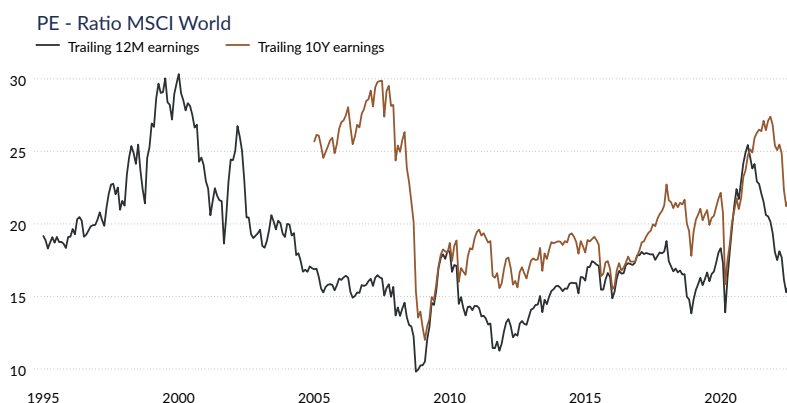
### Carbon credits: weaker in a recessionary context

We have become neutral on carbon credits over the short term. While higher coal use in Europe is resulting in higher emissions and should contribute to keep the price of carbon credits around current levels, a potential recession would reduce industrial activity and, therefore, the need for corporations to bid for credits. This would, in turn, be a negative factor for European carbon prices.

Over the longer term, we continue to believe that higher carbon prices are essential for Europe to achieve its emission reduction targets. As such, investors who want to be exposed to the European carbon credits market need to be prepared for potential price corrections and elevated volatility.

**Fig. 1: World equities still not cheap if the reference is a recession**

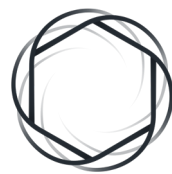
Development of the price-earnings-ratio of the MSCI World Index since 1995



SOURCE: REFINITIV, WPULS

The deteriorating corporate sentiment is increasingly reflected in corporate earnings. Meanwhile, equity market valuations have also come back – not only on the basis of current earnings, but also those based on earnings over the past 10 years. Although the equity markets thus appear more attractive in terms of valuation, they are still expensive compared to earlier recession phases.





### Gold's characteristics in recessions

We have turned more positive on gold, particularly as a portfolio diversifier and as a potential insurance against the erosion of economic, political, and social trust. Earlier this year, demand for gold was boosted from USD 1,799 in January to USD 2,040 in March, then corrected significantly in response to the tightening from central banks and the strong dollar, bringing the year-to-date performance of gold to negative territory. Our improved view on gold is underpinned by the higher risk of a recession in the US and Europe, which would be felt in emerging markets as well, and a slower pace of interest rate increases by central banks at some point in the next 12-18 months. This scenario should at some point prompt a further defensive rotation out of equities into bonds and gold.

Over several decades, there has been a positive correlation between flows into gold and flows into higher-quality government bonds as these two asset classes have, since 1986, never underperformed stocks during months with strong negative stock performance. In addition, we believe the role of gold as a portfolio diversifier could be more important in the current higher inflationary context than in recent recessionary cycles, if the positive correlation we have seen so far this year between stocks and bonds reappears more frequently.

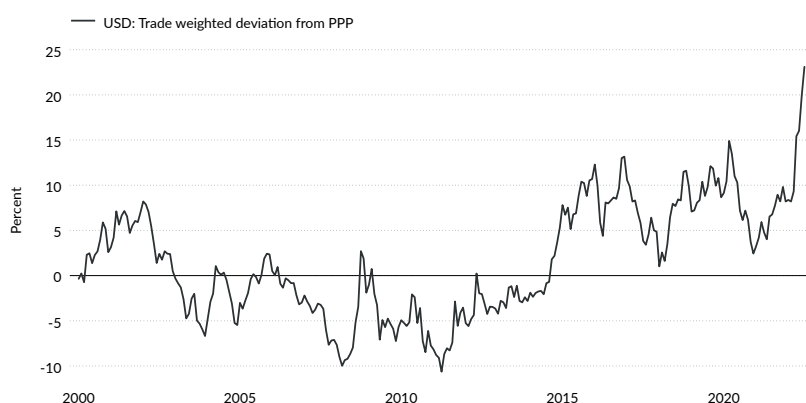
That being said, we must note that gold is not immune to sell-offs in the wake of economic shocks. One reason for this is that investors needing liquidity tend to first sell the

liquid assets that have maintained their value relative to other assets. Despite this, the historical data show that, during past recessionary periods, gold outperformed equities. Moreover, on average, the higher the price losses of the S&P 500, the stronger gold performed.

All in all, if recession fears persist or materialize while the pace of interest rate hikes slows down, either as a result of a moderation in inflation or as a result of central banks' failure to raise rates past a certain level, then demand for gold should, in our view, start to build a bullish momentum.

### Fig. 2: The US dollar has become even more overvalued

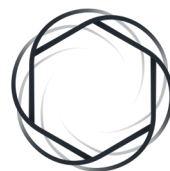
Trade-weighted US dollar, relative to its purchasing power parity



SOURCE: REFINITIV, WPULS

The overvaluation of the US dollar continued to increase this year. According to our purchasing power parity calculations based on producer prices, the fair exchange rate is significantly lower.



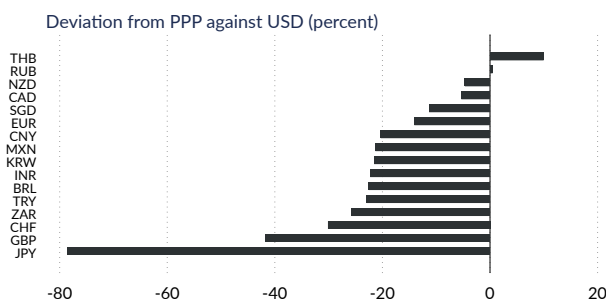
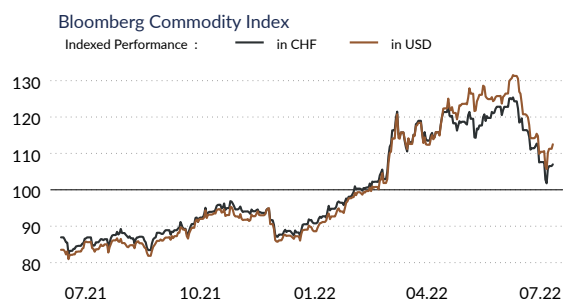
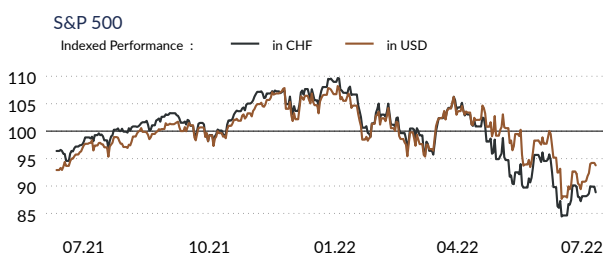
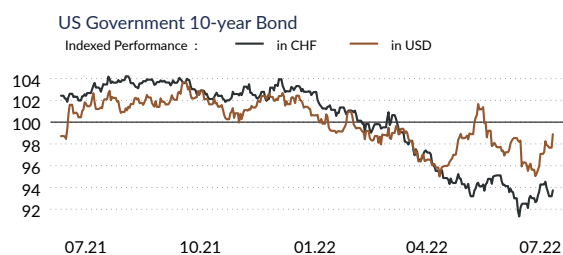


## Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2021	2022E	2021	2022E	Q3 2021	y/y 7/2022
<b>USA</b>	1.6	5.7	2.0	4.7	7.0	2.5	7.2
<b>Eurozone</b>	1.0	5.3	2.0	2.6	7.0	0.50	8.1
<b>UK</b>	1.7	7.4	3.0	4.0	8.5	1.25	7.7
<b>Switzerland</b>	1.4	3.7	2.2	0.6	3.5	-0.25	3.3
<b>Japan</b>	1.1	1.7	1.5	-0.2	2.0	-0.10	5.6
<b>China</b>	4.5	8.1	4.0	-1.6	2.5	4.35	5.8
<b>Brazil</b>	1.2	4.6	0.0	8.3	10.0	13.25	0.8
<b>India</b>	5.0	8.3	6.5	5.1	7.0	4.9	12.2
<b>Russia</b>	–	–	–	6.7	–	8.0	4.3
<b>World</b>	2.9	6.1	2.5	4.7	7.0	–	–

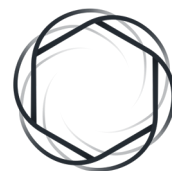
SOURCE: REFINITIV, WPULS

## Financial Markets



SOURCE: REFINITIV, WPULS





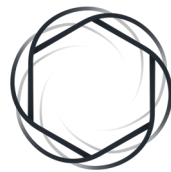
## Global Asset Allocation Preferences – August 2022

“Defensive – as the probabilities for a global recession have increased significantly.”

Asset-Class	View	Constituents	We favour	We avoid	Commentary
<b>Cash</b>	+				Temporarily increase cash for defensive profiles in times of heightened uncertainty and risk aversion.
<b>Fixed Income</b>	+	Segments	Treasuries, investment grade credit.	Convertibles, High Yield, Emerging Markets.	Aggressive rate hikes by central banks increase risk of economic slowdown or recession. Nominal rates likely to top out in the near-term, making fixed income investments look attractive relative to risk assets.
		Duration	Short term.		Avoid long duration as we expect aggressive interest rate increases and persistent inflationary pressure. For investors with specific income targets, we are starting to see attractive yields in the medium part of the curve. Reach out to us for advice on how to balance duration risk and income generation in your portfolios.
		Markets	US, China	Europe, Emerging Markets.	Continued uncertainty from Russia-Ukraine conflict and rising risk of economic downturn and energy crisis. Heightened uncertainty warrants reduction in exposure to risk assets.
<b>Equities</b>	-	Themes	Quality value. Dividends. Consumer staples, health-care and agricultural stocks.	Highly levered, long duration equities. Avoid cyclicals.	Focus on companies with robust pricing power. Value stocks generating real cash flow. Dividend growth.
<b>Alternatives</b>	+		REITS, listed infrastructure, gold.	Illiquid alternatives.	Uncorrelated assets, hedged from inflation, limited risk of earnings downgrade. We are becoming neutral on Carbon credits as we weigh the positives (more use of coal) and the negatives (increased risk of recession, leading to lower energy use).

VIEW: ++ VERY ATTRACTIVE + ATTRACTIVE = NEUTRAL - UNATTRACTIVE -- VERY UNATTRACTIVE





## Figure of the Month

# 1

Last month, the Swiss franc broke through parity against the euro, meaning that it cost less than one Swiss franc to buy one euro. The main reason for the appreciation remains Switzerland's lower inflation relative to the euro area. As long as the Swiss National Bank does not credibly explain that it is aiming for higher inflation than in the euro area, the franc's strength will continue.

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S.P. Hinduja Banque Privée S.A. is an innovative Swiss bank with roots in India, offering wealth management and investment advisory services to entrepreneurial clients. We partner with clients to create exponential economic and social impact, as our family has aspired to do for over 100 years.

Founded in Geneva in 1994 by Srichand Parmanand Hinduja with a vision to provide clients with a bridge between East and West, our institution remains the only Indian-owned Swiss bank in history. With an active presence in Switzerland, India, UAE and the UK, S.P. Hinduja Banque Privée offers its clients the reliability of Swiss regulatory oversight, while providing specialized access to high-growth markets.

We are a private bank with an entrepreneurial spirit, embracing collective action and building creative solutions that advance the world, economically and socially.

*The future of banking is emerging at the intersection of profit and purpose.*

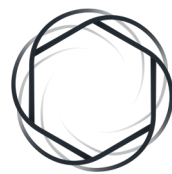
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EDITORIAL DEADLINE: AUGUST 9, 2022

