

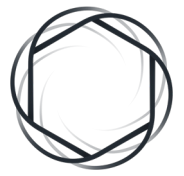


S.P. HINDUJA

BANQUE PRIVÉE

House View

SEPTEMBER 2022



Thoughts of the CEO

“The markets are hoping for a good inflation/growth outcome.”

While the summer of 2022 in the northern hemisphere gave us many record-breaking hot, sunny days, the financial markets have been subject to large fluctuations. Market sentiment was so negative in June that the first half of the year ended with the biggest stock market losses for a comparable period since the financial market crisis of 2008. By the start of the second half of the year, however, the storm clouds over the financial markets seemed to have cleared. Share prices rose strongly since the beginning of July, led by technology stocks. Bonds also had one of their best months in July.

The good news on inflation is that core inflation rates, which exclude volatile food and energy prices, seem to be close to their cyclical peak. Moreover, the oil price should contribute less to the overall inflation trend in the coming months, if oil prices did not change much. At the same time, the gap between core inflation and interest rates gives markets a gauge to assess where rates need to go.

Significantly less supportive scenarios are, unfortunately, just as likely, though. In the industrialised nations, the economy continued to weaken in the summer. The US recorded another quarter of negative growth. In China, renewed Corona measures, together with continuing weakness in the real estate sector, dampened economic activity. In Europe, sentiment deteriorated against the backdrop of the Russian war.

We are rather sceptical about the assessment that the economic downturn will have no consequences for companies. Indeed, if we look at analysts' assessments, it is clear that they still expect corporate profits to rise over the next twelve months. This seems richly optimistic to us, given the deteriorating leading economic indicators, further interest rate hikes and energy supply bottlenecks. What the historical data shows is that US companies have reported declining profits in all recessions since 1960. On average, profits fell 15.5 per cent during those periods.

Thus, an economic slowdown or a recession without costs would be new and unusual. We maintain a cautious stance, therefore.

There is also a geopolitical backdrop. The manoeuvres around Taiwan have once again shown the world that the potential for conflict with China remains very high. In Ukraine, an end to the war does not seem to be in sight. And the outcome of the snap Italian elections on September 25th could further weaken Europe politically.

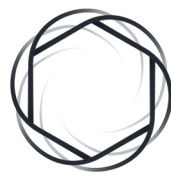
One takeaway from these many moving parts is to also regularly revisit our strategic portfolio allocations. The unusual pattern we saw so far this year of a strong positive correlation between US equities and US Treasuries is a reminder that the relationship between asset classes is not stable.

In this regard, we already pointed out in last month's House View that the US dollar had reached multi-year highs in trade-weighted terms. Due to high US inflation, the US currency has appreciated even more in real terms over the same period. In fact, when we look at the US dollar's purchasing power parity relative to the US's most important trading partners, we find that the deviation is higher than it has been for forty years. This makes the dollar vulnerable to setbacks. On the other hand, political and economic risks in Europe still make the US dollar the most popular refuge currency for big shifts. This is a good opportunity to take a look at the currency exposure in portfolios.

Yours sincerely,

Karam Hinduja





Investment Positioning

The financial markets are hoping for the best possible economic scenario: an economic slowdown that curbs high inflation while causing as little damage to the economy as possible. We remain sceptical in view of the leading economic indicators, and remain underweight riskier assets.

Our preferences are keeping cash above usual levels, overweight fixed income in the defensive spectrum of this asset class, profit taking on equity rallies and keep hedging high inflation via alternatives.

The financial markets started the second half of the year seemingly less concerned about the prospects of a recession. One way to gauge this is to look at the implied recession probability in US corporate bond yields. As shown in Fig 1, the interest rate premium that companies have to pay relative to government bonds in the US increases significantly during recessions. The change in the risk premium can thus be used to calculate the probability of a recession from a market perspective. Currently it is only 20 per cent.

Another way to interpret this low probability is that the market believes that any slowdown or recession will be mild, and will thus not substantially weaken corporate profits. Figure 2, however, shows that US corporate profits have shrunk in all recessions since 1960. On average, profits plummeted by 15.5 per cent, most severely during the global financial crisis when we saw a 30 per cent decline. At the time of writing this, analysts expected profit growth of around 8 per cent for the next twelve months (Refinitiv). So, they were

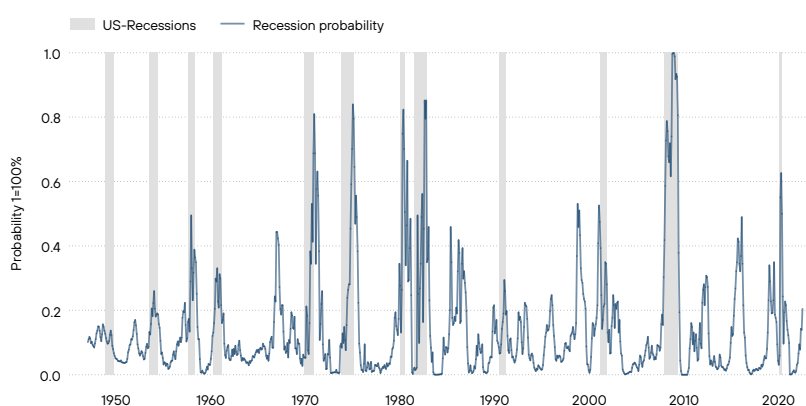
not expecting a recession in the US. We believe EPS consensus estimates have further to fall. The leading indicators we track suggest more caution, though, and we expect the global economy and financial markets to face several headwinds.

Starting with monetary policy, a turnaround (easing) in 2023 on a scale that would have a marked impact on the economy hardly seems possible in view of the current very high inflation rates. With almost 6 per cent core inflation in the US and money market rates of not even 3 per cent, an additional economic stimulus by the central bank is hardly possible. Monetary policy easing which happens too early might even have the opposite, unintended effect of leading to higher capital market rates. Central banks thus now have much limited flexibility to ease in a big way.

We also have lower flexibility with regard to fiscal policy. The massive stimulus programs we saw during the global financial crisis and during the pandemic cannot easily be repeated now. Thus, the overall outlook for riskier assets re-

Fig. 1: Implied recession probability in US corporate bond yields

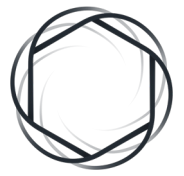
Interest rate premium of US corporate bonds relative to US government bonds



The figure is based on the interest rate premium that companies have to pay relative to government bonds in America. This risk premium increases significantly during recessions. The change in the risk premium can be used to calculate the probability of a recession from a market perspective. Currently the implied recession probability in US corporate bond yields is only 20 per cent.

SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS, WELLERSHOFF & PARTNERS





mains difficult against the backdrop of a slowing economy. We are, therefore, sticking to our recommended caution in taking financial risks. We are aware that only the onset of recession will show us how deep the traces of the economic slowdown will actually be in corporate profits and whether inflation rates will really be as regressive as the financial markets currently assume. So, even if we do not know the exact course of the global recession that has now become more likely, the expectations of the financial markets for the immediate future seem to reflect a rather unlikely, overly optimistic scenario, in our view. We also feel that the market is very optimistic about medium-term expectations. Where the valuations of the financial markets will ultimately settle depends very much on the future development of inflation. We think it unlikely that we will see core rates of 2.5 per cent in the United States and 1.5 per cent in the eurozone in the next eighteen months, which is the speed that money markets seem to be expecting. From this we conclude that financial markets continue to face headwinds until there is greater clarity on the path ahead for core inflation.

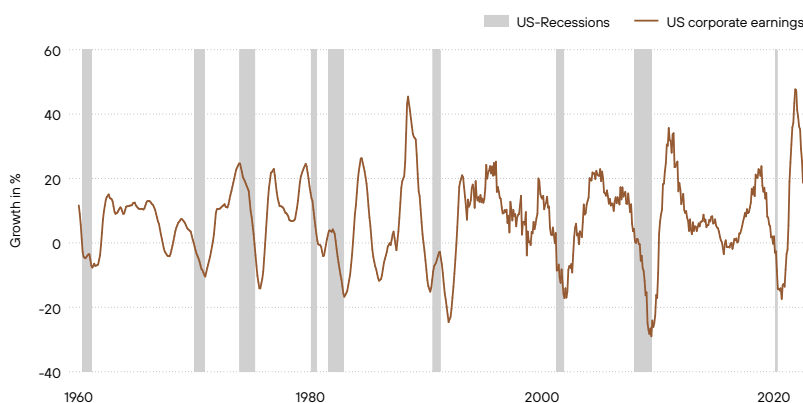
India's premium

The stark difference in performance between Indian and Chinese equities in the first seven months of 2022 is a reminder of the differences in the characteristics of these two big economies and their respective equity markets. While Indian equities were down 7 per cent in US dollar terms as of the end of July, China was down almost 20 per cent. One

reason for this difference is that China has been pursuing a zero-Covid policy, restricting the normal functioning of its economy. This year, India is expected to grow notably faster than China, 6.5 per cent vs. 4 per cent, helping its equities market. The trailing P/E ratio of MSCI India stood at 23.5 at the end of July, compared to 14.5 for China. The average for the emerging markets was 12.5. The premium valuation of Indian equities is also a reflection of the sector mix. IT companies make up 16 per cent of the Indian index, whereas the equivalent for China is 6 per cent; financials: 25 per cent and 15 per cent, respectively. The index for China also has a larger share of state-owned enterprises (24 per cent) than is the case for India (6 per cent). Given that private companies tend to trade at a higher valuation than state-owned companies, this would be an additional differentiator. Other factors behind the Indian market premium are a more entrenched rule of law principle, a stronger tradition of IP protection and growing competitiveness in manufacturing sectors.

Fig. 2: Development of US corporate earnings

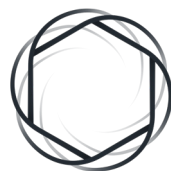
Growth of US corporate earnings since 1960



US corporate profits have shrunk in all recessions since 1960. On average, profit growth plummeted by 15.5 per cent during recessionary periods, most severely during the financial crisis with a 30 per cent decline. Analysts expect profit growth of 8 per cent for the next 12 months. So they do not expect a recession in the USA yet.

SOURCE: REFINITIV, ROBERT J. SHILLER (DATA PRIOR 1990), WELLERSHOFF & PARTNERS



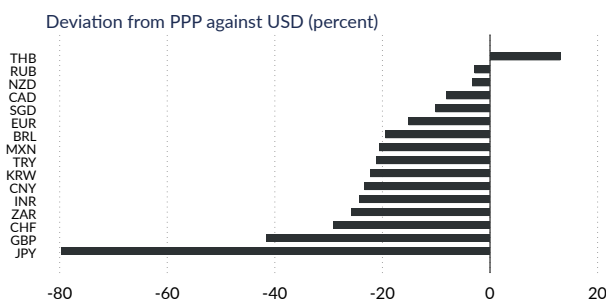
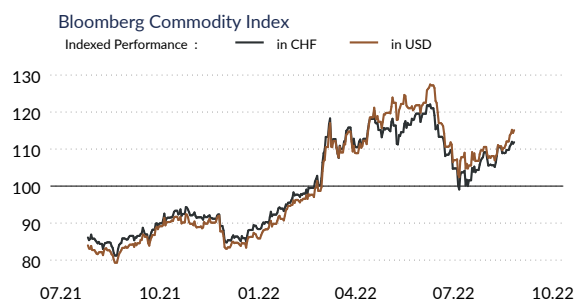
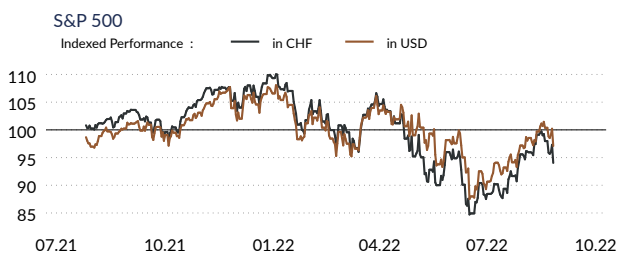
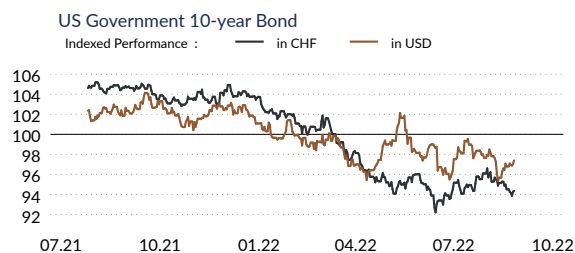


Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2021	2022E	2021	2022E	Q3 2021	y/y 8/2022
USA	1.6	5.7	2.0	4.7	7.0	2.5	6.4
Eurozone	1.0	5.3	2.0	2.6	7.0	0.0	7.4
UK	1.7	7.4	3.0	4.0	8.5	1.75	7.6
Switzerland	1.4	3.7	2.2	0.6	3.5	-0.25	3.0
Japan	1.1	1.7	1.5	-0.2	2.0	-0.10	5.5
China	4.5	8.1	4.0	-1.6	2.5	4.35	5.8
Brazil	1.2	4.6	0.0	8.3	10.0	13.75	-1.2
India	5.0	8.3	6.5	5.1	7.0	5.4	11.8
Russia	-	-	-	6.7	-	8.0	8.0
World	2.9	6.1	2.5	4.7	7.0	-	-

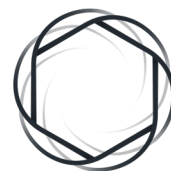
SOURCE: REFINITIV, WPULS

Financial Markets



SOURCE: REFINITIV, WPULS





Global Asset Allocation Preferences – September 2022

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

Asset-Class	View	Constituents	We favour	We avoid	Commentary
Cash	+				Temporarily increase cash for defensive profiles in times of heightened uncertainty.
Fixed Income	+	Segments	Treasuries, investment grade credit	Convertibles, High Yield, Emerging Markets	Continued tightening by central banks keep fueling the risk of recession. Nominal rates likely to remain high in the near-term, making better-rated fixed income investments look more attractive relative to risk assets.
		Duration	Short term		Avoid long duration as we expect both continued interest rate and 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.
Equities	-	Markets	US	Europe, Emerging Markets	The Fed's determination to bring down inflation increases the odds of recession in the U.S. Continued uncertainty from Russia-Ukraine conflict. Rising energy costs to hit European households and corporations. Within EM, we have a preference for faster-growing India.
		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.
Alternatives	+		REITS, listed infrastructure, gold	Distressed debt, Consumer lending	Looking for potentially uncorrelated assets, hedges from inflation, limited risks of earnings downgrade. We recommend holding some gold in the portfolio. We are neutral on carbon credits.

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



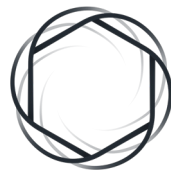


Figure of the Month

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The percentage annual GDP growth rate in China in the second quarter of this year came in at just 0.4 per cent. Chinese consumer sentiment remains weak, hence only a slow recovery can be assumed at present. The real estate market in particular remains in a difficult situation and the price interventions to keep inflation down are leading to losses at state-controlled enterprises. On the positive side, the real depreciation of the yuan is helping exporters.

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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.

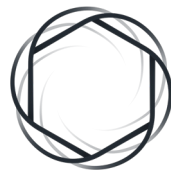
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