

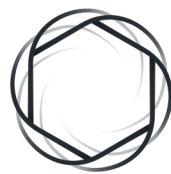


S.P. HINDUJA

BANQUE PRIVÉE

House View

DECEMBER 2022



Thoughts of the CEO

“What kind of recession might this be?”

Clients frequently ask me what kind of recession we might be heading to. Will it be mild or severe, long or short? One reason why this is so difficult to predict is because economists have long known that business cycles also reflect behavioural aspects, hence the Nobel Prize for economics in recent years going to experts in “behavioural economics”. This means that the most important business cycle indicators are not necessarily interest rates or exchange rates, but consumer and business sentiment. In other words, what people think is going to happen, matters a great deal.

What we are observing now is that sentiment is deteriorating notably. The textbooks teach that what should come next is a decline in investment and consumption spending. That would be the usual sequence.

And yet, in this pre-recessionary phase, consumers and companies are still consuming and producing at positive growth rates. Order books are full enough and work still seems plentiful – although apparently suddenly less so in some technology and communications services segments. It is only after the broader mood has clouded over for some time, that consumers begin to be more cautious in their spending, order backlogs at companies start to fall and corporate investment is scaled back. The recession then begins when spending falls (see Figure 1 on the next page).

Where do we currently stand relative to the theory? Since the spring, consumer sentiment has been falling across a broad front, and subsequently also business sentiment. We are still waiting for evidence that spending is falling. However, in view of the breadth of the deterioration in sentiment, the further rise in interest rates and the deterioration in construction activity in some areas (housing starts in the US, for example), it seems that the onset of a recession is now probably only a matter of time.

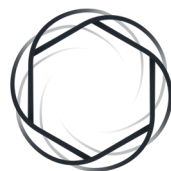
And what can be said about the duration and depth of the expected recession? The textbooks would advise us to look for evidence of offsetting or countervailing support from government policy. Are central banks cutting interest rates? Are taxes being cut? Are the support cheques in the post? Well, this time, no. This time, central banks might actually need a recession to help them get inflation back to their inflation targets. As for fiscal measures, after the generous support during the pandemic, governments in many places have maxed out on their ability to be too generous now. We saw that in last month’s policy U-turn in the UK. The fiscal support that has been in place so far this year has been earmarked with the purpose of cushioning energy price inflation rather than boosting the economy broadly. Without this counterbalancing role by the state, the textbook suggests that this time we are less likely to face a mild, and short recession.

What does this mean from an investment perspective? While one must prepare for a storm that the consensus is expecting, one should also be open to alternative scenarios. Unexpected factors can emerge to shift the consensus view. For example, Europe now suddenly has too much gas and unseasonably warm weather. This might bring inflation down faster and support growth by more than previously anticipated. As investors, therefore, we need to ensure that our portfolio is positioned for more than one main scenario.

Yours sincerely,

Karam Hinduja





Investment positioning

We have seen more signs indicating that headline inflation could have peaked and may be heading lower. However, we need to see declines also in the core rate to get a better sense of the likely ceiling in interest rates. US Treasury bond yields are currently more attractive than the yields offered by highly rated non-USD alternatives. As for equities, the investment environment remains challenging as corporate earnings growth turns negative. We, thus, continue to recommend a defensive positioning.

Insights from recent earnings numbers

Stock markets recorded a recovery rally in October, which continued into November. Shares gained strongly from their end-September lows, especially in the industrial, energy and financial sectors. As these sectors dominate the European stock markets, European stocks in particular made strong gains. At the same time, internet stocks such as Facebook, Amazon, Netflix and Google, lost a lot of value. Their corporate figures for business performance in the third quarter and their forecasts, some of which were pessimistic, were disappointing. In particular, companies whose business model depends on advertising revenue or streaming subscriptions warned of declining growth.

Signals from advertising revenues

In our view, this is an indication of two trends that are likely to weigh on the stock markets in the coming months. First, advertising revenues or subscriptions can be seen as early

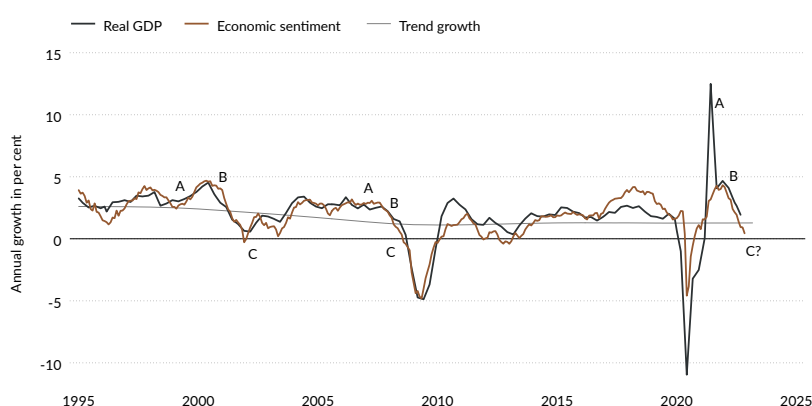
warning indicators, pointing to a likely earnings recession. While the US economy in particular has so far proven resilient, stagnant subscription numbers for these companies point to the limits of consumer growth given the loss of consumer purchasing power (see our “Figure of the Month” on page 8). Falling advertising spending is probably a sign that companies are now also becoming more cautious. This is an indication of what the sentiment surveys among producers and consumers are showing more and more clearly: the US economy is also facing a significant slowdown.

Analysts' profit expectations still seem too optimistic

Second, the performance of internet stocks in October also shows that stock markets had not yet priced in this decline in earnings and lower expectations. The price reaction of these stocks was correspondingly negative. It is true that analysts and listed companies in the developed markets have

Fig. 1: What we know from previous business cycles for the advanced economies

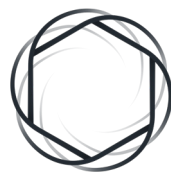
Phases of the business cycle in real GDP growth, business sentiment and trend growth



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

The figure shows real GDP growth, business sentiment and trend growth in the developed economies. “A” denotes the phases of exuberance before previous recessions. “B” stands for the deterioration in sentiment, and “C” for the onset of recessions. For now, we do not yet have evidence that we have actually entered phase “C”.





again reduced their earnings expectations in recent weeks. However, they still seem to be hoping for a mild and, above all, short profit recession.

The 500 largest US companies posted earnings growth of 2.2 per cent in the third quarter. For the fourth quarter, analysts expect the first decline in profits since the Corona recession in the first half of 2020 (-1 per cent year-on-year). Excluding energy, however, EPS was down 3.6 per cent year-on-year in Q322 (Source: Refinitiv as of 18 Nov. 2022). FactSet points to an EPS decline of 3.3 per cent for Q422.

However, profits are expected to grow again as early as the first quarter of 2023. According to the latest data from research and software firm FactSet, analysts expect a gradual increase in profit growth in 2023 to just under 10 per cent by the end of the year. On average, US companies' profits slumped about 15 per cent during a recession. The analysts' profit expectations thus still seem optimistic.

In our view, this does not go hand in hand with the picture painted by the central banks, first and foremost the US Fed. Monetary tightening is being continued and a recession is being deliberately accepted. And a reduction in key interest rates cannot be expected any time soon, even if the economy suffers as a result. After all, this is precisely what it will ultimately take to get a grip on stubborn inflation. A mild, technical recession is a possible scenario, but one that is not the most likely scenario in our view. In short, corporate earnings are likely to continue to disappoint in the coming quarters.

Gold and a weaker dollar

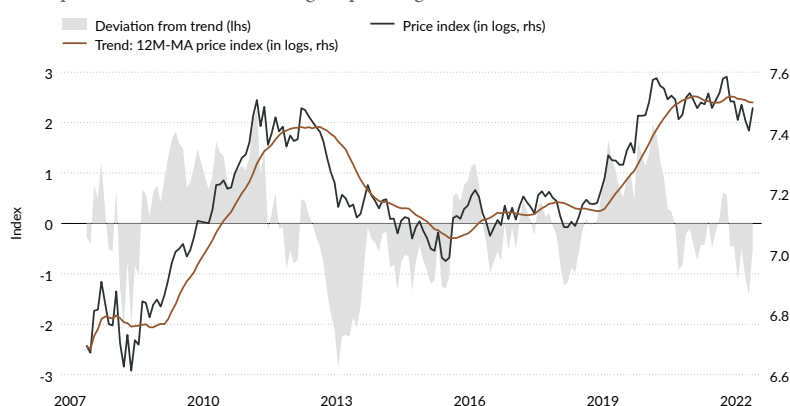
Gold in the portfolio has proven its worth in this difficult investment year. The gold price has also risen significantly since 2015 (Figure 2). The drastic monetary policy easing by central banks during the Corona pandemic gave the gold price another boost. To a certain extent, therefore, it appears that gold has anticipated the current inflation trend. The chart also shows how well gold performed for several years in the aftermath of the global financial crisis. From this we conclude that gold offers insurance characteristics, even if that insurance can appear expensive at times.

Accordingly, we maintain a supportive view on gold based on our expectation that recession will likely leave its mark across advanced economies. High energy costs and inflation, constrained household consumption, a deteriorating housing market and a pullback in corporate capex as a consequence of margin compression are all underpinning volatility in the equity market. And we have yet to see the lagging impact of the current monetary tightening on the economy. In this context, gold's insurance characteristics should continue to reappear from time to time.

We are, however, also mindful that one's reference currency also matters. In an environment where the US dollar is still close to multi-year highs, a weakening US dollar could result in a headwind for non-USD investors in gold if the investment is not hedged in the appreciating currency. Hence, while some gold in the portfolio makes sense, the performance of the dollar is crucial, too.

Fig. 2: Performance of Gold

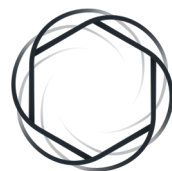
Gold price in U.S. dollars and the gold price log trend



SOURCE: REFINITIV, WPULS

This chart shows that the gold price has risen significantly since 2015. Drastic monetary policy easing during the Corona pandemic gave gold another boost. To a certain extent, therefore, it appears that gold has anticipated the current inflation trend. More recently, though, gold's price momentum has become more volatile in US dollar terms. Investors not benchmarked in USD, should take the currency's exchange rate into account.



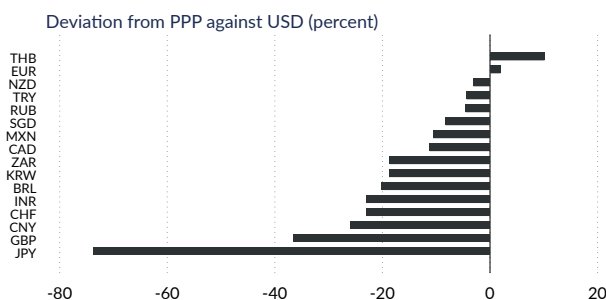
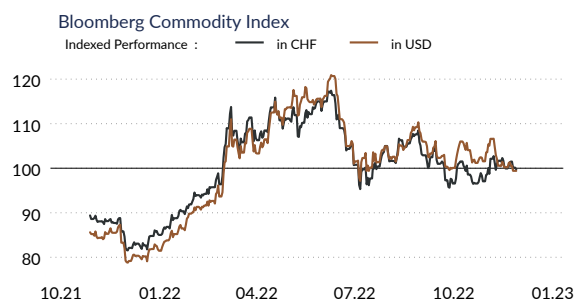
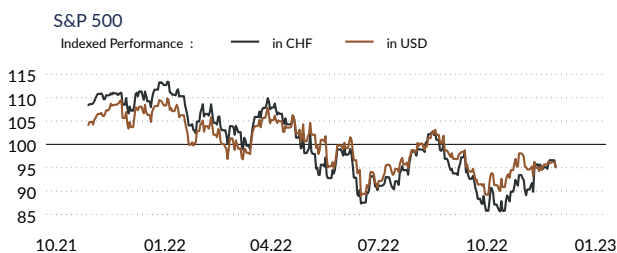
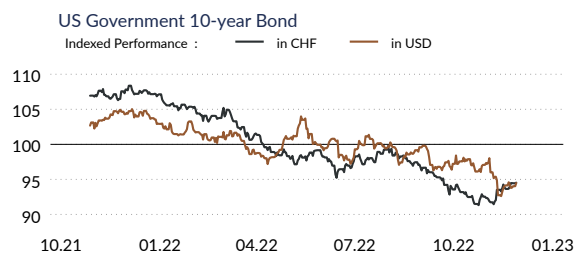


Macroeconomic estimates (in %)

| | GDP Growth | | | Inflation | | Interest Rates | Money Growth M1 |
|--------------------|------------|------|-------|-----------|-------|----------------|-----------------|
| | Trend | 2021 | 2022E | 2021 | 2022E | Q4 2022 | y/y 11/2022 |
| USA | 1.6 | 5.7 | 1.0 | 4.7 | 7.0 | 4.0 | 2.0 |
| Eurozone | 1.0 | 5.3 | 2.0 | 2.6 | 8.0 | 2.0 | 5.8 |
| UK | 1.7 | 7.4 | 2.5 | 4.0 | 9.0 | 3.0 | 10.7 |
| Switzerland | 1.4 | 3.7 | 2.2 | 0.6 | 2.5 | 0.5 | 1.5 |
| Japan | 1.1 | 1.7 | 1.5 | -0.2 | 2.0 | -0.1 | 5.3 |
| China | 4.5 | 8.1 | 3.5 | -1.6 | 2.5 | 3.65 | 6.4 |
| Brazil | 1.2 | 4.6 | 0.0 | 8.3 | 11.0 | 13.75 | -6.0 |
| India | 5.0 | 8.3 | 6.0 | 5.1 | 7.0 | 5.9 | 10.0 |
| Russia | - | - | - | 6.7 | - | 7.5 | 19.6 |
| World | 2.9 | 6.1 | 2.0 | 4.7 | 7.0 | - | - |

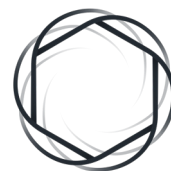
SOURCE: REFINITIV, WPULS

Financial Markets



SOURCE: REFINITIV, WPULS



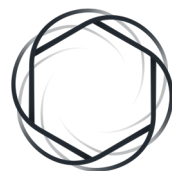


Global Asset Allocation Preferences – December 2022

| Asset Class | View | Constituents | We favour | We avoid | Commentary |
|--------------|------|--------------|--------------------------------------|---|--|
| Cash | ++ | | | | Temporarily increase cash for defensive profiles in times of heightened uncertainty and risk aversion. Money market instruments becoming more attractive to generate yields. |
| Fixed Income | + | Segments | Treasuries, investment grade credit. | Convertibles, High Yield, Emerging Markets. | While we expect volatility to continue in the short-term, our sentiment is that interest rates are approaching their peak in the current tightening cycle. 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- / medium-term. | | In view of higher yields, we are starting to develop a more constructive view on medium duration. 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. |

VIEW: ++ VERY ATTRACTIVE + ATTRACTIVE = NEUTRAL – UNATTRACTIVE — VERY UNATTRACTIVE





Global Asset Allocation Preferences – continued

| Asset Class | View | Constituents | We favour | We avoid | Commentary |
|--------------|------|--------------|--|--|---|
| Equities | – | Markets | U.S. | Europe, Emerging Markets. | Central banks' determination to bring down inflation increases the odds of a global recession. Europe more vulnerable given high energy costs. US less exposed to energy inflation and supported by strong USD. Within EM, we have a preference for faster-growing India and its positioning in the geopolitical landscape. |
| | | Themes | Quality value. Dividends. Consumer staples, health-care and agricultural stocks. | Highly levered, long duration and cyclical equities. | Focus on companies with strong earnings resilience featuring pricing power, high margins, and low leverage. Value stocks generating real cash flow. Dividend growth. |
| Alternatives | + | | | | Looking for potentially uncorrelated assets, hedges from inflation, and steady cash-flow. |
| | | | Selected REITS, listed infrastructure, gold. | Distressed debt, private debt, consumer lending. | We recommend holding some gold in the portfolio. We are neutral on carbon credits as we weigh the positives (more use of coal) and the negatives (economic slowdown, leading to lower energy use). |

VIEW: ++ VERY ATTRACTIVE + ATTRACTIVE = NEUTRAL – UNATTRACTIVE — VERY UNATTRACTIVE



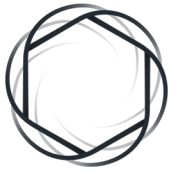


Figure of the Month

8:5

8:5 is not a football score, but the ratio of inflation to wage growth in the US. In the eurozone the ratio is 11:5. If we look at the ratio of core inflation to money market interest rates, we get 7:4 for the US and 5:2 in the eurozone. Why does this matter? If inflation eats away at the purchasing power of wages, the real economy cannot grow sustainably. And if interest rates are lower than inflation, the financial markets will not settle down.

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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.

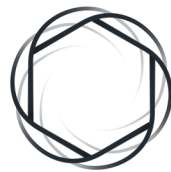
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S.P. HINDUJA
BANQUE PRIVÉE



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