

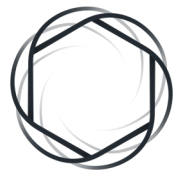


S.P. HINDUJA

BANQUE PRIVÉE

House View

JANUARY 2023



Thoughts of the CEO

“As we face the headwinds, let’s also prepare for the pivots and the opportunities.”

A new year always brings with it hope and the instinct to look ahead, and this is certainly what we will do here. A new year also carries with it reflections of the insights gained.

Regular readers of our House View will be aware that we try to take a longer-term view of the data and developments shaping our world. One key insight from the past year is that the performance of the classical 60/40 portfolio of equities and bonds has had its worst performance since the 1930s. One key reason for this is that during previous periods of underperformance of the 60/40 portfolio, central banks feared deflation and dramatically cut interest rates. Accordingly, high-quality government bonds appreciated in value and performed their typical shock-absorber role in the portfolio. Yet in 2022, we experienced the opposite: central banks feared high inflation and raised interest rates. High-quality government bonds declined in value, compounding the pain of equity losses.

Central banks were prepared to raise rates into slowing growth because the fight against inflation took precedence last year, or as the Fed put it in the minutes of their September Federal Open Market Committee meeting: “the cost of taking too little action to bring down inflation likely outweighed the cost of taking too much action”. This is medicine that is well known in the emerging markets world, and it was also the standard remedy against inflation in more developed economies in the last century. This is also the template we have inherited as 2023 gets under way: central banks are continuing to tighten into slowing growth.

Central banks are prepared to even trigger a recession to get inflation back onto the trajectory towards 2 per cent. And here the monetary authorities are not focused on 2 per cent headline inflation, which is what is typically reported in the media, but on 2 per cent core inflation, which excludes volatile energy and food prices.

We are still far from a core rate of 2 per cent. We illustrate what it will take in a chart on the next page by comparing core inflation with capital market rates. We show that capital market interest rates in the US have been below the core inflation rate for two years now. We find the same unusual constellation in the EU, the UK, Japan and Switzerland. As we said in the July House View edition, since 1955, the Fed has never been able to tame inflation rates greater than 5 per cent without having to raise the Fed Funds rate above the core inflation rate. In particular, the 1970s inflation in the US was resolved with a rise in interest rates that eventually led to a sustained fall in both economic growth and stock markets. This is the paradigm we currently find ourselves in: rising rates into slowing growth, until the evidence is sufficient that inflation is on a trajectory to 2 per cent core. The phrases we are hearing from central banks now include “more evidence” and “staying the course”. This fight will not be over quickly.

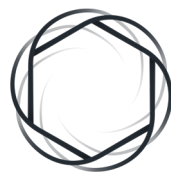
On a more positive note, the world is big and 2023 will still see growth in many regions and in many sectors. China’s sudden opening after three years of lockdown will impact many businesses. 2023 is also the year that India officially becomes the world’s most populous country. Its economy is also on a trajectory to grow on average much faster than the global average for quite some time – also in 2023.

As we face the headwinds, therefore, let’s also prepare for the pivots and the opportunities.

Yours Sincerely,

Karam Hinduja





Investment positioning

The dominating paradigm in the start of the new year continues to be one of central banks raising interest rates into slowing economic growth. The aim is to get core inflation back on target, which means that markets will be focused on the evidence of that trajectory. However, getting core inflation back on track will likely mean capital market rates settling above core inflation. This will take time. We, thus, continue to recommend a defensive positioning.

Interest rates too low, inflation too high

In our view, a fundamental imbalance is still weighing on financial markets. Capital market interest rates, measured by the maturity yields on long-term government bonds, are significantly below inflation rates in all industrialised countries. In the US, the 10-year yield to maturity in the opening trading days of January was 3.7 per cent, while the core inflation rate was approximately 6.0 per cent. In Germany, the difference is similarly high with a core inflation rate near 5.0 per cent and the 10-year maturity yield of 2.3 per cent. This is problematic because it is not a stable equilibrium. In fact, in the US, which dominates global financial markets, a similar gap has occurred only once in the last fifty years, between 1973 and 1975, as the chart in Fig. 1 shows. At that time, the imbalance was resolved after the Fed aggressively hiked rates above the inflation rate. Within two years (by late 1977), the inflation rate had fallen so far and the maturity yield had risen so

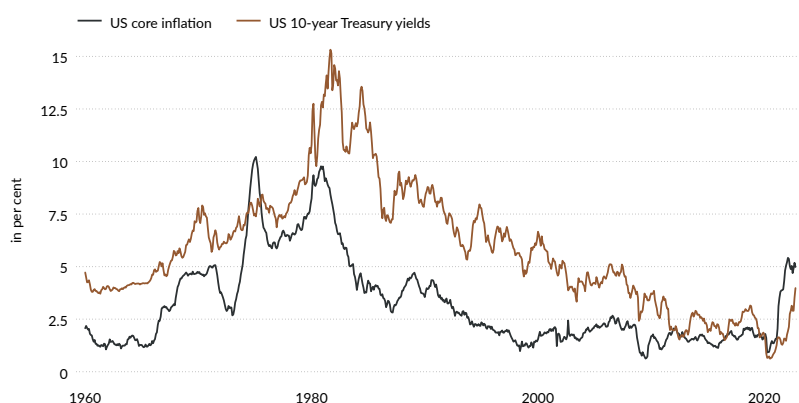
much that capital market yields were once again above the core inflation rate. This did restore equilibrium. In the meantime, however, the leading index, the Dow Jones Industrial, had lost about 45 per cent of its value.

Economic slowdown as a solution

Of course, it would be desirable for this imbalance to be resolved as quickly as possible through a decline in the inflation rate. This is exactly what the financial markets have been hoping and betting for in the past year. Most recently, the decline in the US core inflation rate has fuelled hopes for such a scenario. However, robust American labour market figures with continued, albeit moderating wage growth have dashed these hopes again. That inflation rates will magically fall significantly in the new year remains a wishful scenario. Without a strong economic slowdown, this is unlikely to materialise. And for this to happen, the central banks will have to keep turning the interest rate

Fig. 1: Highly unusual: US capital market rates lower than core inflation

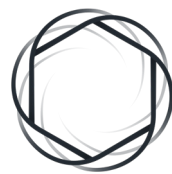
US core inflation compared with US 10-year Treasury yields



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

Capital market interest rates in the US have already been below the inflation rate for two years. In the EU, the UK, Japan and Switzerland we find the same unusual constellation. In the US, this imbalance was resolved in the 1970s with a simultaneous rise in interest rates and a fall in inflation, which weighed on economic growth and stock markets.





screw or at least keeping rates higher for longer than the market currently expects. Only if companies moderate their price demands and employees moderate their wage demands will core inflation also settle at a lower level again.

Cautious positioning, therefore

In our view, the market environment thus argues in favour of a higher cash ratio than prescribed by the usual investment strategy. We expect fixed income to outperform equities on a risk-adjusted basis in 2023, but we expect volatility to remain elevated in both asset classes. We expect earnings to be under pressure, and believe that valuations, particularly in developed markets, are yet to reflect this. Within Emerging Markets (and even Europe), we think the generalised selloffs in 2022 have led to stocks being priced for most of the known macro troubles set to unfold in 2023 and look increasingly attractive. Specifically, within Emerging Markets, we continue to have a preference for faster-growing India and its positioning in the geopolitical landscape, despite stretched valuations.

We also maintain our bullish view on gold, as we expect it to react well when rates normalise, and to provide protection to portfolios should risks of recession and/or inflation continue to build up.

Global earnings no longer growing

A look at the development of corporate earnings shows that they are no longer growing worldwide. However, there are

no signs of a global recession yet in corporate earnings. So far, earnings have only declined significantly in a few countries. These include some emerging countries, especially China and South Korea. In the developed countries, it is mainly Swiss stocks that are showing a slightly declining profit dynamic. In the US and Europe, the high profits of energy companies have helped to support average earnings growth. Energy stocks, for example, account for around 9 per cent of the French stock market, almost twice as much as in the MSCI World Index.

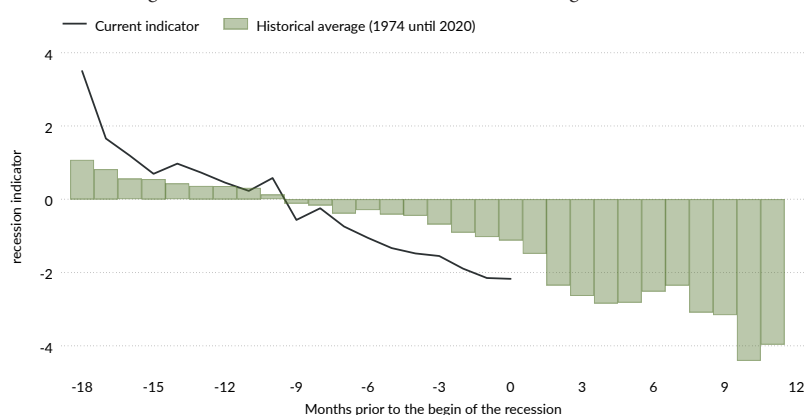
Fixed income outlook

We expect inflation will be slower in its downward trajectory than most investors anticipate. We, therefore, believe the Fed is unlikely to reverse its hiking cycle as fast as the market currently expects (May-July 2023). Nevertheless, it is our expectation that fixed income assets will again offer the diversification benefits they lost in 2022, making them more attractive to hold, both in absolute terms and relative to risk assets.

That said, the main risk for fixed income in our opinion, is a higher-than-expected inflation that would trigger the start of a second hiking cycle of interest rates. We, therefore, continue to have a more favourable view on short-duration bonds, and only going further out in the duration curve selectively and being careful to match maturities with one's expected liquidity needs and liabilities.

Fig. 2: US recession indicator

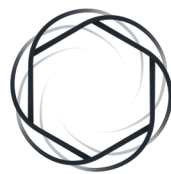
Historical average of the difference in the indication of a looming recession and its current trajectory



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

The chart shows the course of a recession indicator for the US relative to the officially determined start of the recession. Plotted is the historical average of the difference in the indicator between the value that indicates a coming recession and its current trajectory. For the latter, we have assumed that its lead is at the previous historical average of nine months. Accordingly, the current downturn is within the historical range of previous recessions.



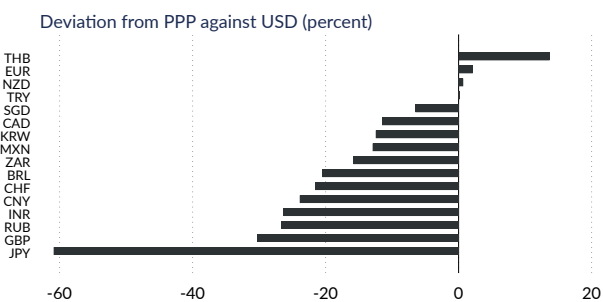
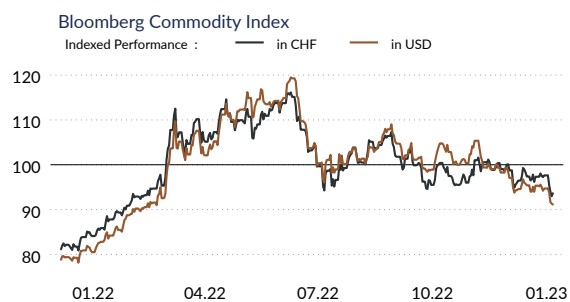
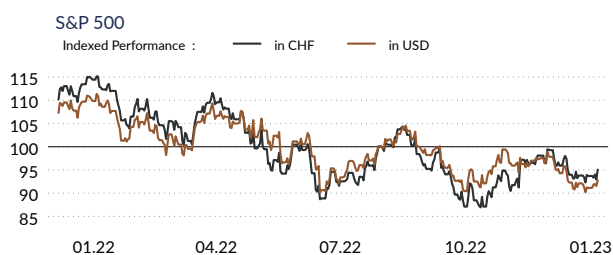
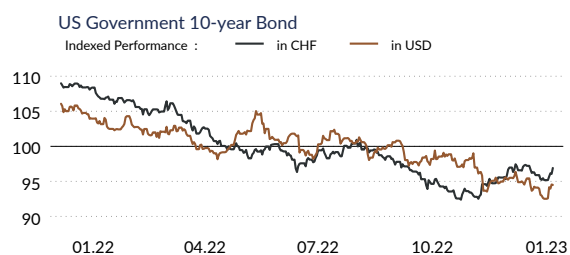


Macroeconomic estimates (in %)

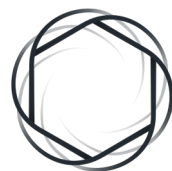
	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2022E	2023E	2022E	2023E	Q1 2023	y/y 12/2022
USA	1.6	1.2	0.4	6.2	4.0	4.5	-1.8
Eurozone	1.0	2.2	0.2	8.4	5.0	2.0	2.6
UK	1.7	2.5	0.4	8.9	5.5	3.5	3.6
Switzerland	1.4	2.1	0.5	2.8	3.6	1.0	0.6
Japan	1.1	1.5	1.0	2.3	2.0	-0.1	5.0
China	4.5	3.2	3.8	2.0	2.2	4.35	4.6
Brazil	1.2	1.5	1.2	8.9	4.2	13.75	-4.1
India	5.0	6.5	6.0	6.9	5.0	6.25	10.1
Russia	1.0	-4.0	-4.0	14.0	10.0	7.5	20.1
World	2.9	3.0	1.8	7.0	5.0	–	–

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

Financial Markets



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

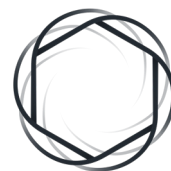


Global Asset Allocation Preferences – January 2022

Asset Class	View	Constituents	We favour	We avoid	Commentary
Cash	++				Temporarily increase cash in times of heightened uncertainty and risk aversion. Money market instruments becoming more attractive to generate yields, particularly in USD.
Fixed Income	+	Segments	Treasuries, investment grade credit.	Convertibles, High Yield, Emerging Markets.	It is our expectation that inflation will normalise in 2023, and rates will reach a peak in the first half of the year. While the Fed is unlikely to reverse its hiking cycle as fast as the market currently expects (May-July 2023), we expect fixed income assets to again offer the diversification benefits they lost in 2022, making them more attractive to hold, both in absolute terms and relative to risk assets.
		Duration	Short- / medium-term.		We favour US curve “steepeners”, short- to medium-duration US government bonds, and investment grade credit. Risks for these asset classes include higher-than-expected inflation that would trigger the start of a second hiking cycle of interest rates.

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



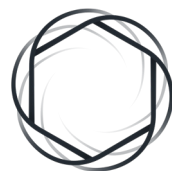


Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Equities	–	Markets	Within regions, we favour an approach of being selective in sectors/stocks, as discussed in Commentary section.	See Commentary section.	Higher rates for longer should benefit value stocks relative to growth. As risks of margin contraction (currently at all-time highs) across sectors continue to increase, we expect companies with strong earnings resilience featuring pricing power, high margins, and low leverage to fare better. Economic activity surprising to the upside would benefit cyclicals, such as energy and financials.
		Themes	Quality value. Dividends. Consumer staples, healthcare and agricultural stocks.	Highly levered, long duration and cyclical equities.	Within the US, we continue to favour quality stocks. Within Europe and Emerging Markets, we think the generalised selloffs in 2022 have led to stocks being priced for most of the known macro troubles set to unfold in 2023 and look increasingly attractive. Specifically within Emerging Markets, we continue to have a preference for faster-growing India and its positioning in the geopolitical landscape, despite stretched valuations.

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Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Alternatives	+	Selected real estate investments, listed infrastructure, gold.		Distressed debt, Private debt, Consumer lending	<p>High inflation, energy transitions and growing digitisation of the economy keep on being valid arguments to favor infrastructure as an alternative. In real estate, higher rates have significantly diminished capital values. However, the impact is quite dissimilar depending on the market (location), sector and asset quality. We prefer multifamily in the US and warehouses and residents for students/elderly versus office, hotel and retail.</p> <p>We expect gold to do well as rates normalise, and risks mount of recession and/or inflation staying above central banks' official targets for longer.</p> <p>We remain neutral on carbon credits, but believe that pullbacks in carbon prices could offer opportunities in the medium term.</p>

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



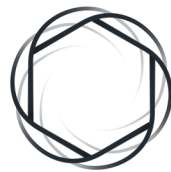


Figure of the Month

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Five days to reach a million users. That's what it took for a new artificial intelligence chatbot, called ChatGPT, to reach one million users. For comparison, it took Instagram 2.5 months to reach the same number of users, 10 months for Facebook, 24 months for Twitter, and 41 months for Netflix. While lauded for its creative answers, we tested it on the outlook for 2023, and it disagreed with our inflation view (it was more optimistic). But the bigger point is that, in our digital age, fantastic reach and uptake are possible at an accelerating pace it seems, with the right digital products.

S. P. Hinduja Banque Privée – A family-owned Swiss Bank with Indian roots.

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.

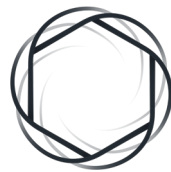
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