

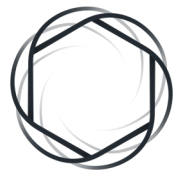


S.P. HINDUJA

BANQUE PRIVÉE

# House View

APRIL 2023



## Thoughts of the CEO

“In the current tug of war between inflation and financial stability, a careful consideration of a wider range of possibilities and outcomes becomes even more relevant.”

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The concluding sentence of my letter last month was that our investment portfolios should be designed for a range of outcomes. I had not, of course, expected the tumultuous developments in banking and financial markets that followed. My point at the time was simply based on the reality that uncertainty has been with us since the earliest concepts of investing. That is why I emphasise diversifying our investments according to the broadest and most uncorrelated ways we can think of.

Another theme I touched on last month was that markets were struggling to find a “narrative”. They’re still struggling. We saw this from the constant flipping of interest rate expectations. This year, the market has been gyrating from, on the one hand, the expectation of further interest rate hikes because inflation is too high against the backdrop of robust economic performance. And, on the other hand, flipping to pricing in interest rate cuts because of recession talk and financial stability concerns.

Instead of running after markets in search of a narrative, we have been advising to keep an eye on the core inflation rate. If interest rates are below core inflation, then monetary policy continues to be stimulative and is not doing enough to restrain inflation. The textbooks tell us that if the aim is to get inflation under control, then we need interest rates at least equal to or greater than core inflation. Given a core US inflation rate of 5.5 per cent in February and a Federal Funds rate of 4.75 to 5.0 per cent, the gap between the two is now no longer considerable. If core inflation heads rapidly lower, then that will be great news, of course. If it does not, and remains “sticky”, then interest rates will need to remain higher for longer.

While the market can get quite excited about a single data point, we would advise considering at least three data points for a better indication of the likely trend. The

monetary authorities will want to avoid a situation, which we saw in the 1970s, where inflation was not defeated, but kept returning, which required ever stronger measures.

The point to bear in mind here is that we appear to be in an era of inflationary pressures coming to us from several pressure points: 1) central banks waited too long to switch away from free money and we are now paying the price, 2) the post-Corona disorder and re-shoring of supply chains, 3) demographic factors, such as the baby boomers leaving the labour market earlier and contributing to labour shortages, and 4) “greenflation” — the cost of changing our lifestyles to address climate change is going up. We do not, therefore, appear to be in the typical monetary policy cycle that we got used to over the last four decades. Central banks face a bigger challenge this time. And now there is an added dimension: financial stability. That creates a new tug-of-war: Does a central bank ease monetary policy when inflation is not yet slain, or does it continue to focus on its inflation mandate?

Against this background, allow me to share in the following pages of the House View how we at S.P. Hinduja have approached the issue.

Yours Sincerely,

Karam Hinduja





## Investment positioning

The recent banking crisis has opened a new level of uncertainty. We do not know how this situation will play out, and this reality reinforces our prudent stance in portfolios. We believe our portfolios are well-diversified with a bias to investment-grade holdings. Tighter lending conditions ahead and deteriorating confidence should accelerate the erosion in corporate margins and hence earnings. We remain underweight in risk assets. Please see our asset class and sector preferences on pages 6, 7 and 8.

### Tighter credit conditions

Historically, there has been a link between tighter credit conditions for firms, on the one hand, and recessions on the other. Usually, credit conditions tend to tighten before a recession. We saw that in the recessions which started in 1990, 2001 and 2008. That was not the case, however, in the unusual recession which followed from the pandemic lockdowns. Even then, despite enormous government support and guarantees, lending conditions tightened sharply. Currently, the latest data shows a very significant tightening (Figure 1). This historical context suggests that an economic slowdown is likely to follow now. We cannot yet say what kind of slowdown or recession it will be, but the data suggests that this is a time for caution.

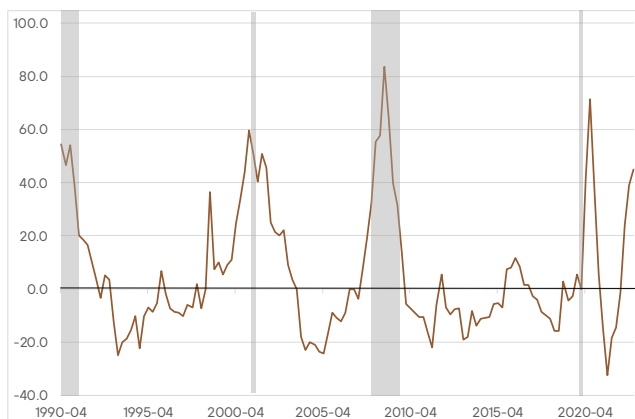
### Monitoring risk premiums

While tighter credit conditions typically feed into risk premiums, we have not seen any significant change in risk

premiums for medium-rated corporate bonds as of the end of March. Figure 2 shows that while the inverted US government bond yield curve signals a possible recession, the risk premiums for medium-rated corporate bonds had not increased. Or stated differently, the corporate bond market appeared to be more optimistic about the recession outlook. It is not unusual to get different signals from different asset classes — this is what makes a market, after all. We would note, though, that when the market makes up its mind, the price movements can be quick and sharp. Our investment approach with regard to credit, therefore, focuses on investment-grade holdings. Balance sheet metrics such as liquidity, short-term debt and refinancing risks are at the centre of our analysis. We avoid investing in bonds from issuers facing significant debt maturities in the short term and favour sectors with high liquidity and high cash flow headroom.

**Fig. 1: US banks tightening standards for loans to firms**

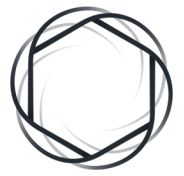
Net Percentage



The chart shows whether lending conditions in the US are tightening or easing. Historically, the periods of tightness coincided with recessionary phases.

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





### Assessment and outlook

The massive losses in the valuations of financial assets triggered by the interest rate hikes, which in hindsight are now recognised as having been initiated far too late, are putting the financial system under further stress.

Central banks are in a dilemma because there can be no stability in the financial markets as long as inflation remains above the interest rate level. We expect central banks to start giving greater weight to financial stability than to price stability, but they will probably not explicitly say so. In this context, unusual measures might be introduced. For example, even if short-term interest rates continue to be raised until the slowdown or recession is more obvious, central banks could provide emergency liquidity to depository institutions through temporary loans while maintaining capital market rates low and continuing to “roll off” maturing treasury bonds and mortgage-backed securities without replacing them (i.e. Quantitative Tightening), as the Fed is doing with the Bank Term Funding Programme.

### Increased recession risks reinforce cautious stance

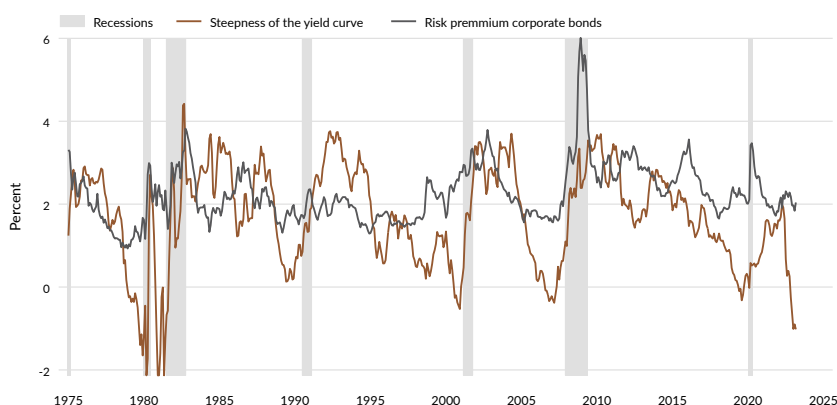
This has been the most anticipated recession in decades. But its prediction continues to face still resilient growth, particularly in the US. Recent events affecting the banking industry have left investors with even more unanswered questions than usual. Financial sector fragility would imply

not only tighter lending conditions but a higher and more immediate risk of recession. This means that volatility would stay with us for some time. Although concerns about the financial health of European banks have increased substantially, our view is that more stringent regulatory requirements in Europe make the region’s banks much more resilient. Unlike in the US, regardless of the size, European banks need to maintain a liquidity coverage ratio of at least 100 per cent. In addition, European banks have smaller bond portfolios on average, totalling around 20 per cent of deposits versus 31 per cent in the US (source: Bloomberg, Federal Deposit Insurance Corporation).

The increased recession risks lead us to reinforce our cautious stance. We anticipate growing negative consumer and hiring sentiment, filtering into a weaker labour market. We believe our portfolios are designed to cope with an average recession, but investors should be aware that history tells us that market dislocations can take a quick and aggressive form.

**Fig. 2: Risk percentage for US corporate bonds and the US yield curve**

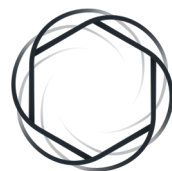
Percentage



This chart shows the steepness of the yield curve for US government bonds, measured as the difference between 10- and 2-year yields. Also plotted is the risk premium for medium-rated corporate bonds compared to US government bonds. While the steepness of the curve currently suggests a recession, the risk premiums have not increased.

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS



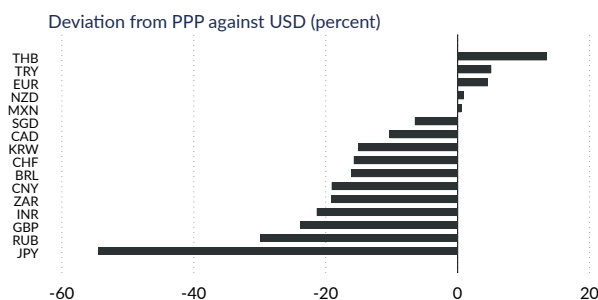
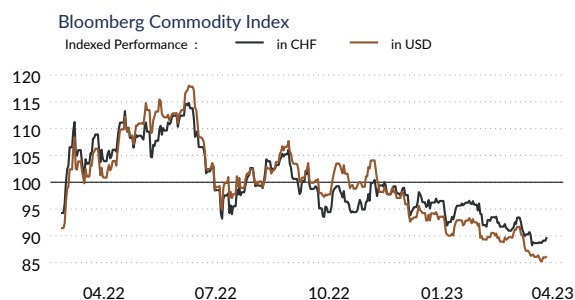
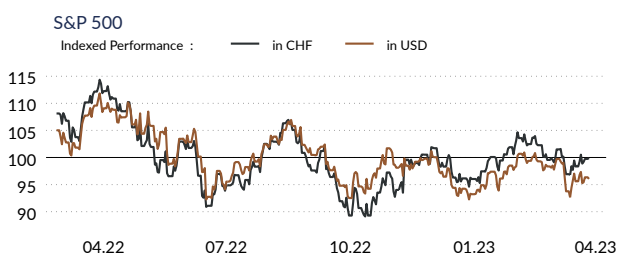
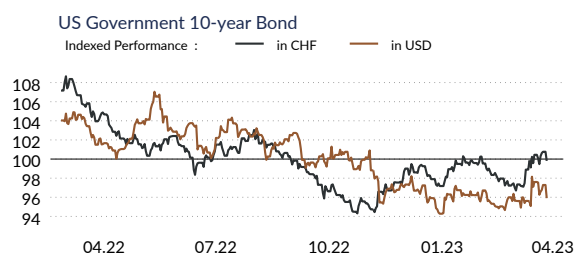


## Macroeconomic estimates (in %)

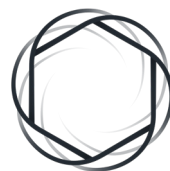
	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023E	2024E	2023E	2024E	Q1 2023	y/y 03/2022
<b>USA</b>	1.6	1.0	1.2	4.5	4.0	5.00	-4.6
<b>Eurozone</b>	1.0	0.4	1.4	5.0	4.0	3.0	-2.2
<b>UK</b>	1.7	0.0	1.0	5.5	5.5	0.63	1.2
<b>Switzerland</b>	1.4	0.6	1.2	3.0	2.5	-0.65	-6.7
<b>Japan</b>	1.1	1.4	1.0	3.0	2.0	-0.04	4.3
<b>China</b>	4.5	4.0	4.0	2.2	2.2	2.36	5.8
<b>Brazil</b>	1.2	1.2	1.4	4.2	4.0	6.52	-1.5
<b>India</b>	5.0	6.0	6.5	5.0	5.0	5.05	9.9
<b>Russia</b>	1.0	0.0	1.0	10.0	4.0	7.23	25.1
<b>World</b>	2.9	2.5	3.0	5.5	4.0	-	-

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

## Financial Markets



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

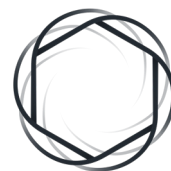


## Global Asset Allocation Preferences – April 2023

Asset Class	View	Constituents	We favour	We avoid	Commentary
<b>Cash</b>	<b>++</b>				We continue to hold more cash than in normal circumstances. Money market instruments becoming more attractive to generate yields, particularly in USD. Increasingly attractive as inflation recedes.
		Segments	Treasuries, investment grade credit.	Convertibles, High Yield, Emerging Markets.	The recent turmoil in the banking industry reinforces our positive stance on safer government bonds. Latest events also suggest that the scope to aggressively tighten policy has significantly narrowed and there is a reasonable probability that the tightening cycle will end later in the year.
<b>Fixed Income</b>	<b>++</b>				
		Duration	Short- to medium-term.		The investment approach in credit needs to focus on investment grade holdings. Balance sheet metrics such as liquidity, short-term debt and refinancing risks are at the centre of our analysis. We avoid investing in bonds from issuers facing significant debt maturities in the short term and favour sectors with high liquidity and high cash flow headroom.

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



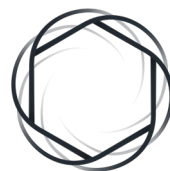


## Global Asset Allocation Preferences – continued

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.	Unprofitable growth, high debt/ refinancing risk sectors, commercial REITs	A deterioration of business and consumer confidence together with tighter credit standards will increase pressure on corporate margins and hence earnings. Regardless of a mild or deep recession ahead in the US and Europe, we favour quality names, strong balance sheets and cash generators. In a higher rate environment, we favour value (highly selective on financials) over growth and companies with strong earnings resilience featuring pricing power, high margins, and low refinancing risks to fare better.
		Themes	Quality, value. Dividend growers. Consumer staples, healthcare and agricultural stocks.	Highly levered, long duration, and cyclical equities.	Within US, we continue to favour quality stocks as we see the region more sensitive to growing risk aversion. Prefer more defensive sectors in Europe such as oversold utilities, health care and staples. As far as Emerging Markets are concerned, we continue to have a long-term preference for faster-growing India and more cautiously China as a tactical move to play the reopening. Neutral on Japan.

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





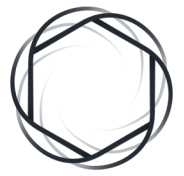
## Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Alternatives	+		Selected direct real estate, listed infrastructure, gold.	Distressed debt, Private debt, Consumer lending	<p>High inflation, energy transitions and growing digitization of the economy keep on being valid arguments to favour infrastructure as an alternative. In real estate, higher rates have significantly diminished capital values. The sector is highly exposed to the new headwinds stemming from tightening lending standards. Selected logistics, storage and students residences are preferred segments.</p> <p>We expect gold to do well as rates normalise and risks of recession mount.</p>

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







## Figure of the Month

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This is the inflation number in India and the United States. These two countries had headline inflation running at around 6 per cent as of February 2023. Whereas the Reserve Bank of India's policy rate is currently 6.5 per cent, the Fed's is 4.75 to 5.0 per cent. The recent global outbreak of inflation has tarnished the developed countries' traditional reputation for sound monetary policies and low inflation. This time round, several emerging market countries reacted to the first signs of inflation faster and more aggressively than the US or Europe. We are in a different inflation regime from the one that prevailed over the last four decades.

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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.*

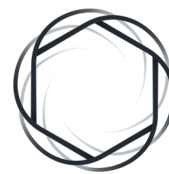
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