

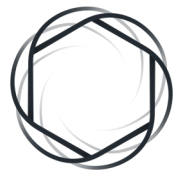


S.P. HINDUJA

BANQUE PRIVÉE

House View

August 2023



Thoughts of the CEO

“Further progress on inflation boosts hope for a gradual slowing of growth in major developed markets.”

Over the past month, there has been further progress on the inflation front in many countries. Crucially, this applies also to stickier core inflation, which excludes volatile energy and food prices. It is this measurement that central banks say they are targeting. This progress suggests that policy rates may be close to their respective ceilings for now.

Counterintuitively, instead of the expected slowdown in US GDP from 2 per cent in Q1 to 1.8 per cent in Q2, the advanced estimate showed an acceleration to a quarterly annualised 2.4 per cent. If these numbers are not revised down, it implies that the US economy has been stronger than expected. As our US recession indicator on the next page shows, the data has, indeed, been pointing for several months now to a lower probability of a US recession.

Despite stronger US growth, US inflation numbers have been helped also by what is happening elsewhere in the world. China's post-Covid growth rebound has been unexpectedly mild. Given that China is the world's largest economy when measured in purchasing parity power terms (USD33 trillion this year, according to the IMF, compared to USD27 trillion for the United States), it matters to the world economy that Chinese headline inflation fell to zero year-on-year in June. And China's core inflation rate slowed to just 0.4 per cent. The data, therefore, indicates that China may be on the verge of deflation.

China's vanishing inflation suggests that the challenges to regain a faster growth trajectory are greater than initially expected. The reasons for this are evident from domestic and external data. Domestically, we see still weak demand for construction and weak domestic consumption. Externally, we see weak manufacturing sentiment from many countries. This is obviously negatively impacting the world's biggest manufacturing hub.

Another indicator of domestic economic weakness is that China's unemployment rate (5.2 per cent in June) continues to be higher than pre-Covid levels (below 4 per cent). Particularly worrying is the Chinese youth unemployment rate: 21.3 per cent in June compared to 13.6 per cent in early 2021. This is the opposite trend seen in the United States, where the unemployment rate of 3.6 per cent is comparable to the immediate pre-Covid rate, and where a youth unemployment rate of 7.5 per cent in June is the lowest since the 1950s. The world's two largest economies thus signal opposite policy priorities: the one struggling to boost growth and avoid deflation, the other trying to drive inflation down by slowing growth.

China is thus exporting disinflation to the rest of the world. In the first seven months of the year, the renminbi weakened against the US dollar, the euro and a broad range of other currencies. This gave foreign importers the benefit of lower Chinese inflation reinforced by a cheaper Chinese currency. China also helped to keep global commodity prices lower. Brent ended July down 16 per cent year-on-year and the prices for a broad range of commodities (the CRB index) ended July almost flat year-on-year.

What happens to the growth/inflation mix in China is also relevant for growth and inflation far beyond China. The Chinese authorities have recently signalled that policy help could be on the way for the ailing real estate sector, but there seems to be a reluctance to launch a bold, large-scale stimulus to reinvigorate the economy, at least for the moment.

Yours Sincerely,

Karam Hinduja



Investment Positioning

Our base case is that of economic growth further slowing or even a recession in major developed markets, as the lagged effects of last year's tightening increasingly bite. Despite more visibility in the normalisation of rates, the continuing resiliency of economies might force monetary authorities to tighten further. This scenario still recommends keeping a cautious stance in portfolios. Our major overweight is fixed income, and we maintain our underweight in equities. Please see our detailed recommendations on pages 6, 7 and 8.

The next phase: getting from 5 to 2

Despite the disinflationary developments outlined on the previous page, we still believe that services inflation remains too high in the major advanced economies for central banks' comfort. Inflation is falling in most economies, but this has been concentrated in goods prices. Weaker wage growth and higher unemployment may be needed to drive services inflation down. We are of the view that central banks are unlikely to ease until they see clear evidence of this.

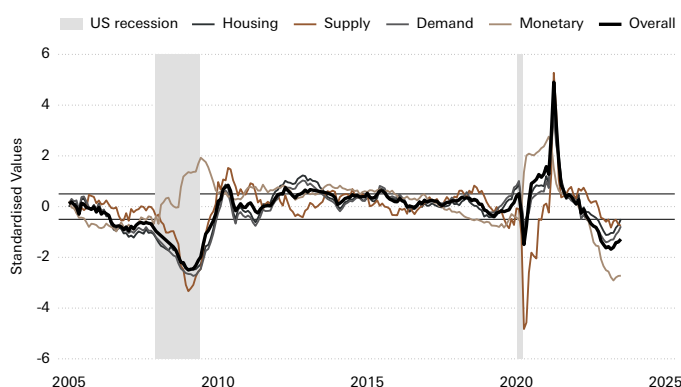
While the US has managed to bring core inflation down from a peak of 6.6 per cent in September 2022 to 4.8 per cent in July 2023 without apparently damaging the labour market, the next stage from nearly 5 per cent to the magic 2 per cent might prove more difficult. We have a similar picture in the euro area: core inflation peaked at 5.7 per cent in May this year and was still only at 5.5 per cent in July.

The disinflation help from China, discussed on the previous page, will trigger measures to boost Chinese

growth. This would make the renminbi appreciate, raising costs in foreign currencies. And a faster-growing China would likely consume more commodities, raising those benchmark prices globally.

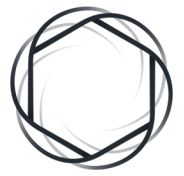
Hence, we do not rule out some inflation volatility over the coming months as the global disinflationary trend becomes less powerful and the base effect becomes less favourable. We are of the view that any improvement in inflation is unlikely to be a one-way street to 2 per cent while unemployment rates in the US and Europe remain at multi-decade lows. This scenario supports the idea that the intention of central banks is to sustain disinflation towards their target, and that requires keeping interest rates high enough to slow growth sufficiently, to generate a mild recession even. The lack of a signal to indicate further substantial tightening suggests to us that central banks deem the current stance as sufficiently restrictive to deliver that outcome.

Fig. 1: US recession indicator has been showing a reduced risk of a US recession



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

This chart shows that leading and coincident indicators that typically signal a US recession have turned more positive in recent months. This suggests a lower probability of a near-term recession. It might also mean that central banks keep rates "higher for longer" to support their inflation objectives.



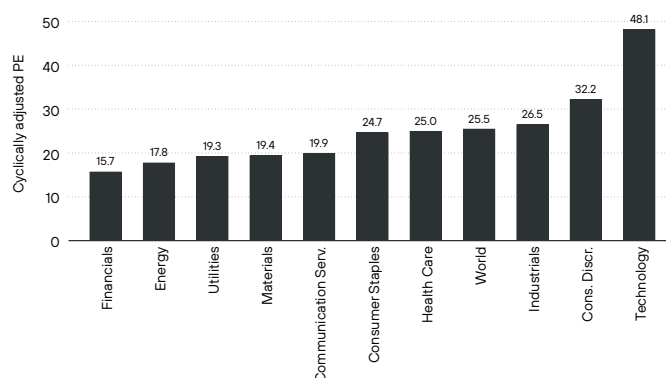
On tech earnings...

Mega-cap tech stocks have driven the surprising rally in risk assets during the first half of the year. We should be cautious when reading that the tech industry will emerge as a countercyclical sector if the economy further weakens in the second half of the year. The tech sector's resilience during and after the pandemic can, in our view, be explained by the transition to remote working. We believe big, profitable tech companies are not immune to the broader earnings weakness if a decline in consumer and business spending crystallises. Insofar as the year-to-date return of the tech sector has been exclusively driven by a re-rating, current valuations leave little space for disappointing earnings.

Sector preferences

Accordingly, we favour defensives over cyclicals. Health care, consumer staples, utilities, food producers and food retailers are preferred sectors. We show no preference between US/Europe, but a bottom-up approach respecting quality should be a main decision tool. We are slightly positive on Japanese value given the different but supportive stage of the macro-cycle in terms of inflation and rates. China, despite the slow start, and India are preferred emerging markets.

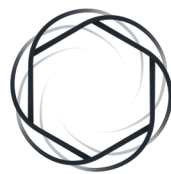
Fig. 2: US equity sector valuations



This chart shows the cyclically adjusted PE by sector. The technology sector stands out for its high valuation.

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS



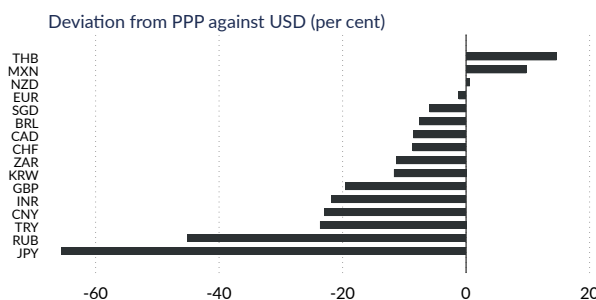
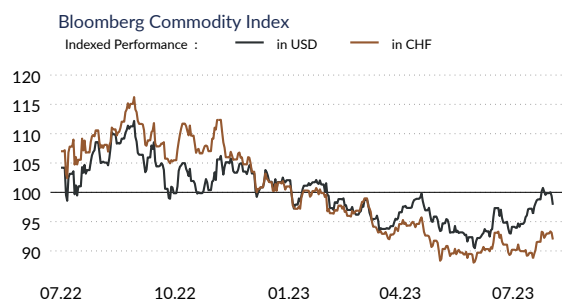
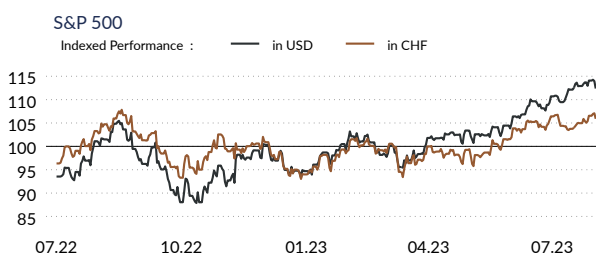
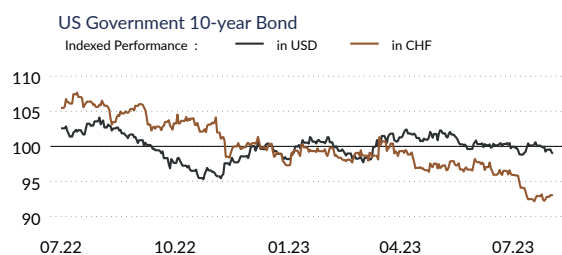


Macroeconomic estimates (in %)

	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023E	2024E	2023E	2024E	Q2 2023	y/y 06/2023
USA	1.6	1.4	1.2	4.3	3.5	5.50	-10.2
Eurozone	1.1	0.4	1.4	5.0	4.0	3.75	-8.0
UK	1.7	0.2	1.0	7.5	5.0	5.00	-6.0
Switzerland	1.3	0.8	1.2	2.5	2.2	1.75	-13.6
Japan	1.1	1.3	1.0	3.0	2.0	-0.10	4.3
China	4.5	4.5	4.5	1.5	2.0	4.35	3.2
Brazil	1.4	1.5	1.4	5.0	4.0	13.25	-3.4
India	5.0	6.0	6.5	5.0	4.5	6.50	7.6
Russia	1.0	-1.0	0.0	6.0	5.0	8.50	32.9
World	3.0	2.5	2.8	5.0	4.0	-	-

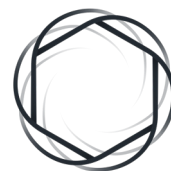
SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

Financial Markets



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS



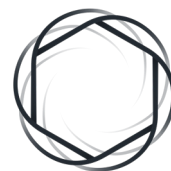


Global Asset Allocation Preferences – August 2023

Asset Class	View	Constituents	We favour	We avoid	Commentary
Fixed Income	++	Segments	US Treasuries and developed market investment-grade credit	Convertibles, High Yield, Emerging-Market debt	<p>Inflation dynamics do certainly look more supportive for fixed income, regardless of whether the Fed is behind the inflation curve or not. We may have seen the peak for market rates in the US. Accordingly, with the upside risk to rates more subdued in the period ahead, it may make sense to extend duration in portfolios at some point. However, we still see a lot of value at the front-end of the yield curve. The market is currently signalling a first Fed funds rate cut of 25 bps for March 2024. Though this may look reasonable, the real question is how bad a recession the US will be dealing with, as this will ultimately dictate the extent of rate cuts. US Treasuries tend to outperform in the event of a fixed income rally. However, the normalization in rate volatility and signals from the Fed that the tightening cycle may be over is a good playground for fixed income to perform well. We favour developed markets investment grade (IG) and corporates in non-cyclical sectors. Current IG yields are compelling and provide a valuation cushion.</p>
		Duration	Medium-term		

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



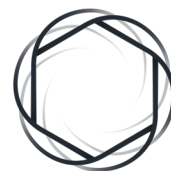


Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Equities	–	Markets	US, selective Asia ex-Japan	Latin America	An inverted yield curve, tighter credit conditions and lacklustre corporate earnings keep fears of economic contraction pretty alive. A reacceleration of inflation constitutes a main risk for the remainder of the year. Other concerns relate to the lack of market breadth and China's reopening failing to drive EPS up. We, therefore, maintain a cautious stance on risk assets and remain underweight.
		Sectors	Quality, value. Dividend growers. Consumer staples, healthcare, utilities and agricultural stocks.	Construction, Autos, Tech Hardware, Consumer discretionary, Industrials, Commercial REITs	We favour quality and dividend stability within the asset class. Strength of balance sheet, good management and earnings resilience on solid competitive advantages are top selection criteria. We favour defensives over cyclicals. Health care, consumer staples, utilities, food producers and food retailers are preferred sectors. We show no preference between US/Europe, but a bottom-up approach respecting quality should be a main decision tool. We are slightly positive on Japanese value given the different but supportive stage of the macro-cycle in terms of inflation and rates. Selectiveness in emerging markets. China, despite loss of momentum, and India are preferred emerging markets.

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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	We continue defending our skew towards gold. Sub-trend global economic growth, a weaker USD and central banks approaching terminal rates and accelerating gold purchases, should provide support for gold outperformance, in our view.
					High inflation, the energy transition and growing digitization of the economy keep on being valid arguments to favour infrastructure as an alternative. In real estate, renewed downside risks exist in the form of writedowns and defaults. The sector is highly exposed to the new headwinds stemming from tightening lending standards. We thus avoid listed real estate. Industrial real estate, storage and students' residences are preferred segments for direct investments.
Cash	+				Despite current disinflationary moves, risks of economic slowdown/recession are still present. We move from major overweight to overweight on lower recession odds. Cash offers attractive returns in USD for the next 12 months.

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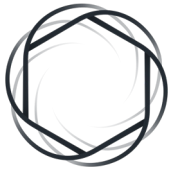


Figure of the Month

783

This is the number of people, in millions, experiencing hunger last year according to the International Fund for Agricultural Development. This represented every tenth person in the world and was significantly higher than before the pandemic. Inflation has made matters worse. Climate change is adding new challenges. To meet global goals to end hunger, food security must be addressed from the rural hinterlands to the city centres. One way to do this is by building climate-resilient infrastructure and increased connectivity between small-scale producers and regional, national and international markets, so that more people can have access to healthier, nutritious diets.

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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.

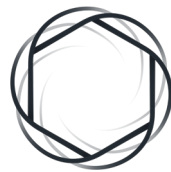
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S.P. HINDUJA
BANQUE PRIVÉE



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