

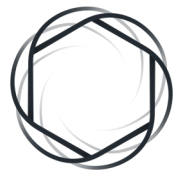


S.P. HINDUJA

BANQUE PRIVÉE

House View

September 2023



Thoughts of the CEO

“After the hottest summer, the market hopes for cooling.”

The one consistent topic this summer in the Northern Hemisphere was the heat. Despite the winter in the Southern Hemisphere, July 2023 was widely reported to have been the hottest month ever recorded on Earth.

There was also some heat in financial markets. The yield on the ten-year US Treasury bond touched a fifteen-year high of 4.3 per cent in August. Rising capital market rates can lead to significant reassessments of the valuations of almost every asset class. It was, after all, rising capital market rates that triggered last year's equity and bond volatility, and this year's unexpected banking crisis in the US.

One key reason for the recent rise in US long-term interest rates has been the resilience of the US economy to the much-anticipated cyclical downturn. Despite a fall in US leading indicators, which signal where the economy may be heading, the US surprised by delivering a solid Q2 growth number.

US economic strength also stands out relative to economic weakness elsewhere. China is facing growth headwinds after an initial post-Covid growth spurt. In Europe, leading indicators suggest that we should expect the region to move into recessionary territory this quarter.

Capital markets have also been reacting to the inflation dynamics. While China is in a category of its own, with very low inflation numbers (the latest core inflation number was 0.8 per cent year-on-year in July), the euro area has seen a sideways move in its core rate of 5.5 per cent (July). The US registered a slight slowdown in core from 4.8 per cent to 4.7 in July. But at that pace, it would take more than two years for inflation to hit the Federal Reserve's target rate.

Regular readers of our House View will be aware that we had pointed out that it would take time for core inflation to sustainably return to its target. So, while this is not a surprise to us, it is also a characteristic feature of the market to make

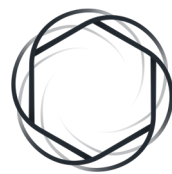
sharp shifts between "problem solved" and "no, not yet". Hence, we tend to look beyond single data points to the underlying trends.

How do we think the leading central banks view these trends? We think that they will continue to hope that the world economy continues to lose steam, causing the inflation outlook to moderate and not requiring them to hike into weakening growth. With the world's second-largest economy in a slowdown and the third-largest economic bloc on the brink of a recession, this remains the most likely global scenario, as long as interest rates remain around current levels.

But here we face a paradox for financial markets, though. If rates don't come down quickly enough, asset prices may suffer. Yet, if central banks do suddenly pivot to lower rates, without the inflation target having been achieved, that may reflect weakening fundamentals — an unhelpful backdrop for most asset classes. The best scenario, therefore, is the one where inflation is back in the target range, and the focus is no longer on inflation. That's what we had in the two decades before the pandemic. We need more evidence that we are returning to this paradigm. For now, investors should be aware that there are several potential scenario outcomes.

Yours sincerely,

Karam Hinduja



Investment Positioning

We see a conflicting outlook between market sentiment and leading fundamentals in the macroeconomic and corporate fields. Solid backward-looking growth data in the US tempers recession risks in the short-term, but they clearly remain beyond the immediate horizon. This backdrop keeps implying prudence in allocating assets. We remain overweight in fixed income on a more attractive risk-reward basis than equities. High cash rates are a hurdle to take a bold view in other asset classes. Please see our detailed recommendations on pages 7, 8 and 9.

The impact of higher yields on equities

Our conclusion on the previous page and our view expressed in our previous House View mentioned that the path to bringing core inflation down from around 5 per cent to 2 per cent will likely be more challenging than the fall from 10 per cent to 5 per cent.

Accordingly, we still see a case for inflation volatility in the coming months. Our view is informed by a series of data points. These include the stronger-than-expected US July retail sales, the recent volatility in the oil price (Brent up nearly 22 per cent from the end of June to the August peak), wages growing above the inflation rate, lower than expected jobless claims, unstable weather conditions (impacting food commodity prices), and the erosion of the helpful base effect. August showed us that sentiment towards long-term Treasury bonds weakened amid the conviction that the Fed may keep interest rates at current elevated levels for an extended period.

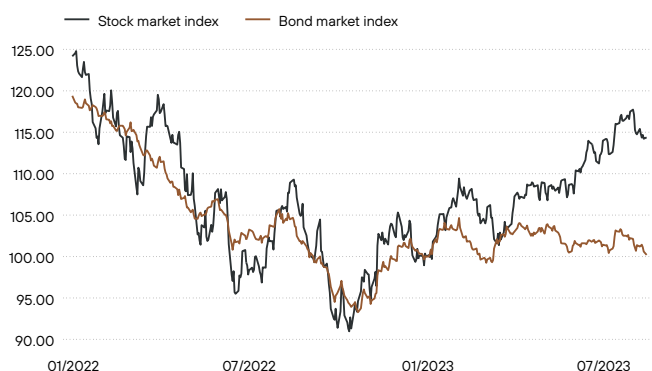
More recent data points from parts of Europe (Germany and Spain) also showed an uptick again in inflation — not by much, but by enough to signal that the fall to the 2 per cent target is not going to be a straight line down. And that implies that markets will need to wait longer for the evidence that rate cuts will follow.

The most direct implication for equities is that, all else being equal, (i.e. no material change in the 12m forward EPS outlook), the higher level of real yields should cap further multiple expansion in risk assets.

Our main scenario is an economic slowdown in developed markets as the lagged effects of monetary tightening gradually filter into the economy. Accordingly, we would expect yields to fall from current levels as growth slows.

We tend to think that a sustained period of high yields should benefit value-oriented equities. According to this rationale, sectors such as financials, industrials, energy and

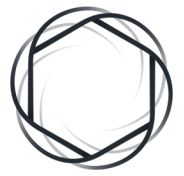
Fig. 1: A decoupling between bond and equity markets



The chart shows the development of the global equity and bond markets in US dollars using standardised indices. The two markets followed the same trend since the central banks adopted a more restrictive monetary policy in the spring of 2022. Recently, a decoupling can be observed. The sustainability of this decoupling will depend on corporates delivering on the upwardly revised earnings expectations.

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS





consumer staples should benefit. Historically, these sectors have shown positive correlations with bond yields. In terms of regions, Japan is one of the most value-oriented markets and it offers an interesting choice for investors.

Concern about the China growth engine

The economic data from China has continued to disappoint. The domestic economy, in particular, is a cause for concern. The ongoing crisis in the construction sector and negative real imports, just like in the United States, leave little room for optimism. Exports seem to be developing slightly better. Even though exports have fallen by 15 per cent in US dollar terms recently, this primarily reflects the impact of the depreciation of the yuan and the weak global goods economy (please see Figure 2).

Chinese inflation has also been the subject of much discussion over the past month. The annual rate of headline inflation was -0.3 per cent in July. The core rate, which policy makers globally tend to target, was 0.8 per cent, up from June's 0.4 per cent. Thus, while "deflation" does, indeed, seem like a realistic possibility, technically it has not yet happened, based on the most recent data points.

The monetary authorities allowed a depreciating yuan to try and stabilise the economy via higher export earnings. However, the authorities also appear concerned about creating the impression that the currency could become a one-way trading bet. The exchange rate is viewed as a signal of China's strength. We expect a combination of exchange

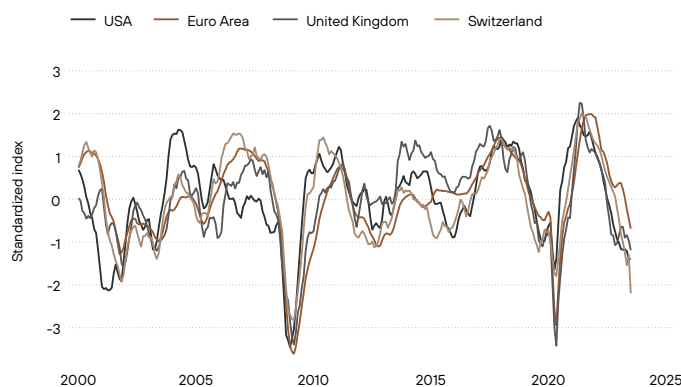
controls, FX intervention and interest rate tweaks to stabilise the currency. The risk is that Chinese authorities are pulling too many levers to try and offset too many countervailing forces. For example, tighter capital account controls take China further away from its stated goal of the internationalisation of the yuan. A currency that does not trade freely will struggle more to rival the US dollar.

What's wrong with Europe?

Global economic shocks tend to cause the business cycle to align globally. Whether it is an energy shock, a financial crisis or a pandemic, economic conditions that had hitherto been dependent on idiosyncratic characteristics and divergent economic policies over the years, suddenly succumb to contagion and spillover effects. This was particularly striking to observe during the pandemic. While the economic cycles in the United States, Japan, Europe, Britain and Switzerland were in a very different state before the pandemic, economic activity in all industrialised nations collapsed rapidly at practically the same time in the first quarter of 2020.

Fortunately, at least the short-term recovery in the second quarter was also historically large. Afterwards, however, the economies developed along noticeably different trajectories again. Thus, the upswing in the United States continued practically seamlessly, so that a steady economic situation was already achieved in the first quarter of 2021.

Fig. 2: Deteriorating sentiment among manufacturing companies



This chart shows the PMI data for companies in a standardised index. The data indicates that sentiment among manufacturing companies in the US, the euro area, Britain and Switzerland has been deteriorating for almost two years now. This reflects decreasing global goods demand and a corresponding weak business environment.

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS





But the economic situation in Europe was quite different. The restrictive Corona measures introduced by the European governments brought the upswing to a virtual standstill in the third and fourth quarters of 2020. Accordingly, a more stable economic situation was only recorded with a two-quarter delay and in the third quarter of 2021.

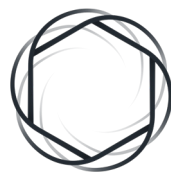
Developments in the two large European power houses, the UK and Germany, have been particularly sluggish and persistent so far. The UK was hit particularly hard by the combination of Brexit and Corona in 2020. At the same time, Britain recorded the highest and most persistent inflation figures among the major industrial nations in Europe, despite having its own supply of oil and gas secured at all times.

Germany's economic performance disappointed even the most pessimistic expectations. While growth in the eurozone outside Germany has accelerated rapidly, Germany was only able to generate very tentative growth in 2021. Since the newly elected coalition government took over at the beginning of 2022, there has been virtually no growth in

Germany. In fact, after three and a half years, economic activity there is just below the level the country had reached before Corona. By comparison, the rest of the eurozone is 4 per cent above this level, Switzerland 3.2 per cent and the US 6.2 per cent.

The deeper reasons for this development lie in the economic policy response to the Corona and climate crises. During Corona, policy makers increased budget deficits and the money supply with a "whatever it takes" approach. The result was the rise in inflation and the resulting loss of consumer purchasing power in virtually all industrialised nations in recent years. The Russian invasion of Ukraine merely exacerbated the inflation problem.

For both Germany and the UK, we cannot see any immediate starting points for improvement in economic policy. Coupled with a continuing weak global economy, we must expect Europe as a whole to slide into recession.

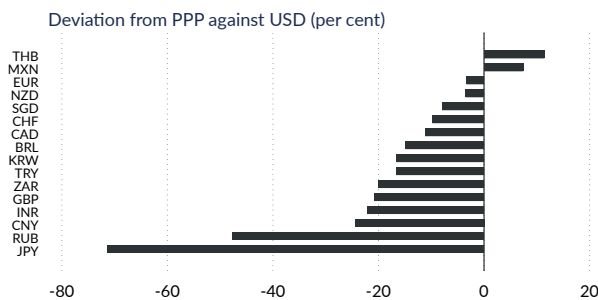
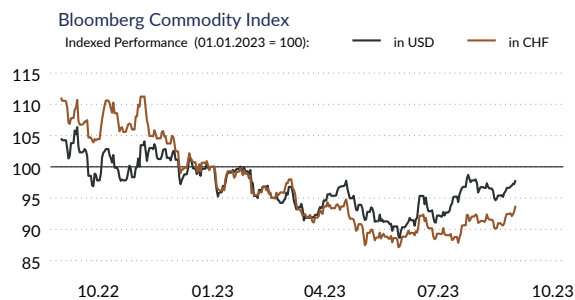
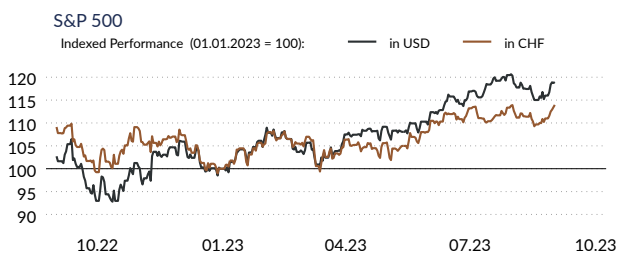
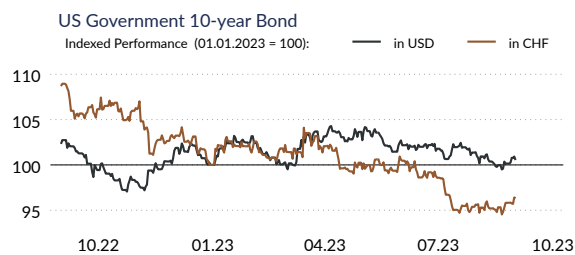


Macroeconomic estimates (in %)

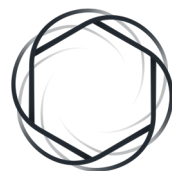
	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2023E	2024E	2023E	2024E	Q2 2023	y/y 08/2023
USA	1.6	1.8	1.2	4.0	3.6	5.50	-10.4
Eurozone	1.1	0.4	1.4	5.0	4.0	3.75	-9.3
UK	1.7	0.2	1.0	7.5	5.0	5.25	-6.8
Switzerland	1.3	0.7	1.2	2.3	2.2	1.75	-16.3
Japan	1.1	1.5	1.0	3.0	2.0	-0.10	4.1
China	4.5	4.5	4.5	1.3	1.8	4.35	2.3
Brazil	1.4	2.1	1.4	5.0	4.0	13.25	2.4
India	5.0	6.0	6.5	5.0	4.5	6.50	12.6
Russia	1.0	-1.0	0.0	6.0	5.0	12.00	31.5
World	3.0	2.6	2.8	4.6	4.0	-	-

SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

Financial Markets



SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

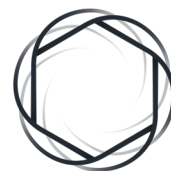


Global Asset Allocation Preferences – September 2023

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.	Central banks' determination to bring inflation down to 2 per cent targets present a strong case for downside potential for yields. In the context of a global economic slowdown leading to a rally of core fixed income, US treasuries usually outperform other non-US sovereigns. We also favour German bunds under a very likely recession scenario in the Eurozone, leading investors to buying safe assets. Overly tight monetary policy in the region also adds downward pressure on yields. We strongly recommend IG credit in developed markets over high-yield, preferably in non-cyclical sectors. Current IG yields look compelling and provide a valuation cushion.
		Duration	Medium-term.		

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



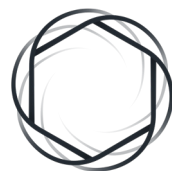


Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Equities	–	Markets	Selective in Europe and China. Japan.	Latin America.	Ongoing monetary tightening, higher rates for longer as the path to 2 per cent inflation will not be exempt of hurdles. Markets look complacent, in our view, with recession and credit risks. Equities remain vulnerable to declining earnings and the market lacks breadth. The negative outlook for global manufacturing PMI recommends us to favour non-cyclical sectors. We prefer defensives, quality factors on strong competitive advantages and visible/stable dividends.
		Sectors	Quality. Tilt to value. Dividend growers. Consumer staples, healthcare, utilities and agricultural stocks.	Construction, Autos, Tech Hardware, Consumer discretionary, Chemicals, Leisure and Travel.	We believe the rally is not sustainable in the US, although as long as the growth gap between the US and Europe persists, the current valuation gap will likely stay there. Europe offers more attractive entry points, though we strongly recommend a bottom-up fundamentals-based approach for opportunities. We like Japan, where macro fundamentals are improving and valuations are still attractive in absolute and relative terms. Longer term, we favour India – a likely correction in the short term is expected.

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





Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	We favour	We avoid	Commentary
Alter-natives	+		Selected direct real estate, listed infrastructure, gold	Distressed debt, Private debt, Consumer lending	<p>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.</p> <p>High inflation, the energy transition and growing digitization of the economy remain valid arguments to favour infrastructure as an alternative. In real estate, renewed downside risks exist in the form of writedowns and defaults. We avoid listed real estate. Industrial real estate, storage and students' residences are preferred segments for direct investments.</p>
Cash	+				<p>Though short-term recession risks have tempered, we see the risks beyond the immediate horizon. With 1-year treasury bills offering over 5 per cent, cash remains attractive, taking into account that equities and credit are underpricing risk, in our view.</p>

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



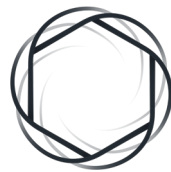


Figure of the Month

375

Investors are concerned about the headwinds being faced by China's real estate market and the potential contagion effects. According to Fitch Ratings, 375 billion US dollars of maturities from Chinese trusts invested in Chinese property are due from now until March 2024. This number underscores the heightened risk China's shadow banking still faces, even after reducing its exposure to the property sector over the past three years. The degree of exposure of commercial banks to entrusted investments is unclear, and investors should be aware that the risk of potential understatement remains, as the disclosure of these statements is limited.

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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.

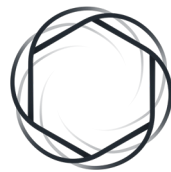
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