S.P. HINDUJA

BANQUE PRIVÉE

House View

December 2023

Thoughts of the CEO

"2024: Looking for tech drivers of growth"

As we look back on 2023, the enthusiasm and unease of AI and creative destruction was everywhere: in stock prices, speeches, conferences, school homework, and in boardrooms and laboratories, as everyone took note of the increase in the speed of technological revolution and its implications.

In this spirit, a paper just published in Nature ("Scaling deep learning for materials discovery", 29 November 2023) revealed that Google DeepMind had predicted the structures for 2.2 million new materials, of which 736 candidates had already been created in a lab and are now being tested.

Thus, in the midst of all the gloom and doom of the past year, there are also many rays of light and hope.

The outcome of these developments is going to be noticeable in the numbers that reflect what is happening in our societies, economies and in our portfolios. While the global economy is facing uninspiring growth in the coming quarters — and, indeed, Europe is already in recession territory — we need to be mindful of what might not yet be evident in the numbers.

For example, while China's growth and investment landscape have disappointed, the authorities there are now looking to tech to boost productivity. In the following pages, my team provides insights on those proposed changes.

Of course, despite the promise of tech, we need to be mindful of looking through the hype to the realities on the ground. The business cycle has not yet been abolished. In this regard, as we look ahead to 2024, markets are attaching the highest probability to a first rate cut by the Fed in the current cycle in Q2 next year. This leaves us with the expectation of another half a year of high US rates and the puzzle of an inverted yield curve.

The puzzle is that an inverted yield curve is a typical recession sign — a sign of economic weakness ahead — but earnings expectations appear to see little weakness. In this House View, we also look at the most recent earnings numbers in more detail and explain why we advise investors to be selective on equities.

I wish you a good read, a good close for this year, and a good start for the new year.

Yours sincerely,

Karam Hinduja

Investment Positioning

Although short-term recession risks have moderated in the US, they are not yet completely ruled out (see Fig. 1). Accordingly, we see a longer period of at least sub-trend growth. With 6-month Treasuries yielding around 5.4 per cent, cash remains attractive and protects against the positive correlation between equities and bonds. The end of the hiking cycle is in sight, and as growth weakens and inflation falls, it should provide a tailwind for core fixed income. The risk-reward relationship has worsened again for risk assets. We believe the focus has shifted to earnings vulnerability in 2024. Remain cautious.

A preference for German Bunds...

With the Eurozone technically in a recession (see Figure 2), we also favour German Bunds. While the European Central Bank has lagged the US Fed in this hiking cycle, a likely shift in Europe's monetary policy in 2024, or the anticipation of such a shift, could enhance total returns in fixed income.

...and higher-quality credit

We prefer investment-grade credit in developed markets over high-yield, preferably in non-cyclical sectors. Current investment grade yields look compelling and provide a valuation cushion in a scenario of rising default rates. With interest rates peaking, extending the average duration in portfolios would make sense.

Be more selective in equities

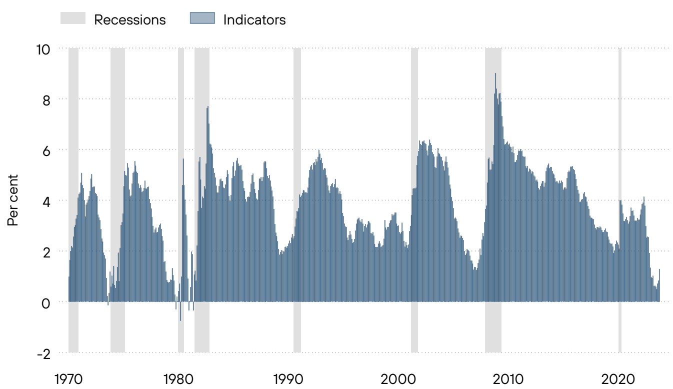
We believe the recent equity rally was essentially driven by the expectation of lower interest rates in the US. While we, too, expect lower rates, we are less optimistic than the market about the likely speed of this pivot.

If faster rate cuts were to materialise, then that would likely be due to a much weaker US economy. Either way, this makes equities less attractive than fixed income in our view.

Against this backdrop, we see the current S&P 500 EPS consensus estimate of 12 per cent (Bloomberg) as being quite optimistic in light of the expected real GDP growth rate of the US economy for 2024: +1.2 per cent.

Accordingly, we would advise equity investors to reinforce the bottom-up approach and be even more selective. Caution and enhanced diversification are our recommendations to set up a balanced equity exposure in portfolios over the next quarters.

Fig. 1: US credit markets signalling a recession



The chart shows the interest rate differential between long-term US corporate bonds in the medium-quality ratings range and the money market. At present, an investor in corporate bonds is not compensated for either the risk of a recession risk or for the maturity. Since 1970, such phases have always been followed by a recession.

SOURCE: LSEG, WELLERSHOFF & PARTNERS

Summary of Q3 2023 Earnings Results

- The most recent quarterly round of US corporate reporting is almost finished (with 94 per cent of S&P 500 companies having reported results), giving investors a vital insight into the current state of the US and global economy. Earnings largely came in better than expected for Q3, with 62 per cent of companies beating on sales and 82 per cent on earnings.
- The aggregate earnings surprise factor (actual vs. mean estimate on day of reporting) of 7.1 per cent is well-above both the prior four-quarter average of 4.8 per cent and long-term average of 4.1 per cent.
- Perhaps the most interesting takeaway is that the S&P 500 is set to notch its first quarter of earnings growth (currently estimated at 4.3 per cent), marking the first quarter of growth after three consecutive quarters of decline.
- At the sector level, cyclicals did better than non-cyclicals despite fears of an economic recession. This has been underpinned by some of the top mega-cap stocks in the information technology and communication space that have powered the market this year. On the other hand, the Energy, Real Estate and Healthcare sectors reported the largest year-over-year earnings decline.
- Looking ahead, analysts expect modest earnings growth of 2.9 per cent for Q4 2023, lower than the September 30 estimate of 8 per cent. For the full year 2023, analysts predict earnings growth of 0.6 per cent, slightly below the previous estimate. However, for 2024, analysts are forecasting more robust earnings growth of 11.6 per cent, which in our view remain overly optimistic.
- Europe is behind the US in its earnings season, but so far, overall earnings and revenue are expected to decrease by 11.4 per cent and 7.7 per cent year-over-year, respectively. European companies are citing weaker demand, indicating the softness in the economy.

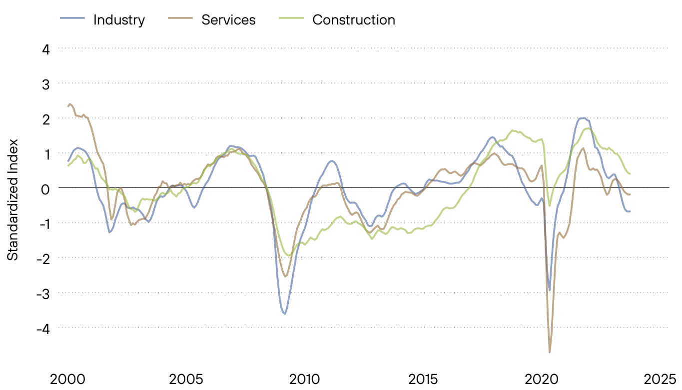
China: What to buy, what to avoid

The year 2024 is just around the corner and China continues to be a source of uncertainty for investors. Government reforms are seeking to place China in a new model of economic growth.

The objective of the authorities must be clear to us: future growth should be driven by technology and productivity gains rather than by investments in real estate and infrastructure. The transition is not free of uncertainty and what seems indisputable is that the new model will deliver less growth. Since 2020, the population census shows that the Chinese population is ageing at a faster rate than expected, and the authorities have decided to concentrate their efforts on increasing labour productivity.

Three major policy initiatives will drive China's growth in the next years: 1) Shift the pivot back to manufacturing at the expense of construction (real estate and infrastructure) and to a lesser extent services, 2) Boosting R&D investments in science and technology in particular in those sectors witnessing negative structural

Fig. 2: Deteriorating European sentiment in industry, services and construction



The chart shows a standardised index for European sentiment with regard to industry, services and construction. The outlook has deteriorated since summer.

SOURCE: LSEG, WELLERSHOFF & PARTNERS

changes, and 3) Implementing reforms in the factor market to build a more efficient, integrated national market. In all, we believe that China's long-term development will largely depend on its productivity.

The shift toward manufacturing should minimise China's inherent risks in the global supply chain in this new cold war era with the US. On the other hand, it should increase the productivity of the economy or at least abandon the low returns on capital invested in real estate and infrastructure.

Historical data in China shows that there has been a positive correlation between the size of the manufacturing sector and GDP growth over the last 20 years. Based on this, if manufacturing absorbs a good part of capital formation, this should lead to more stable growth and productivity.

We are more sceptical about China's ability to revolutionise the world's geopolitical-technological map through greater investments in science and technology. Without a doubt, this area will constitute an additional contribution to productivity, but we believe it will have less impact on economic growth.

Finally, the planned reforms in the factor market might have a bigger impact on growth. Labour mobility should be a priority and the removal of administrative distinctions between "urban" and "rural" should foster migration and productivity.

Plans to improve property rights and the elimination of subsidies for state-owned businesses should enhance free competition and business dynamism might improve if protection from local governments to local enterprises is lifted. Political factors will be the main hindrance for the implementation of these reforms.

The extent of a more supportive policy in China remains uncertain for 2024, and it is not expected that annual growth rates above 6 per cent will be achieved in the foreseeable future. China continues to be the second largest economic region in the world, and it now requires a new investment approach.

In terms of activity sectors, property-centric cohorts should be avoided, notably banks, where the latter's risk profile is on the rise as authorities require from them the provision of unsecured short-term loans to qualified property developers.

We prefer sectors linked to new energy, such as batteries and electric vehicles, telecommunication services and digital services. We are less optimistic on consumption as Chinese households will take years to deleverage.

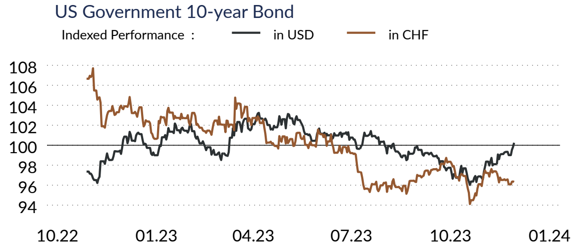
We believe the investment case in China should favour A-shares versus HK shares on the former's lower sensitivity to geopolitical and liquidity factors, and a better sector alignment to China's policy and growth objectives.

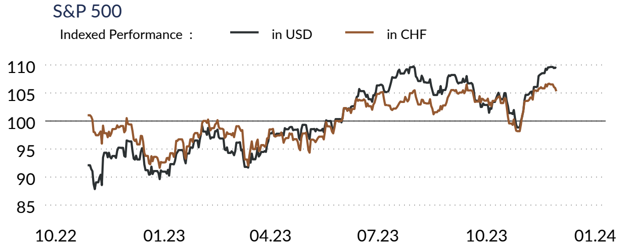
Macroeconomic estimates (in %)

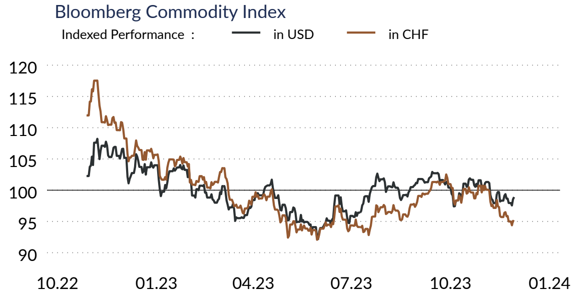
	GDP Growth Trend	GDP Growth 2023E	GDP Growth 2024E	Inflation 2023E	Inflation 2024E	Interest Rates Q4 2023	Money Growth M1 y/y 11/2023
USA	1.6	2.2	1.2	3.8	3.6	5.50	–10.1
Eurozone	1.1	0.4	1.1	5.5	3.5	4.00	–9.9
UK	1.7	0.2	1.0	7.5	3.5	5.25	–10.5
Switzerland	1.3	0.7	1.2	2.0	2.2	1.75	–17.7
Japan	1.1	1.8	1.0	3.0	2.0	–0.10	4.1
China	4.5	4.5	4.5	0.5	1.5	4.35	1.9
Brazil	1.4	3.2	1.7	5.0	4.0	12.25	–0.8
India	5.0	6.3	6.5	5.3	4.5	6.50	7.4
Russia	1.0	0.8	0.9	5.2	5.0	15.00	20.7
World	3.0	2.9	2.7	6.0	4.8	—	—

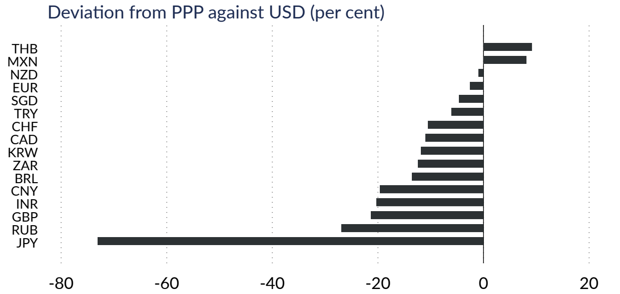
SOURCE: LSEG, WELLERSHOFF & PARTNERS

Financial Markets









SOURCE: REFINITIV, WELLERSHOFF & PARTNERS

Global Asset Allocation Preferences – December 2023

Asset Class	View	Constituents	Most Preferred	Least Preferred	Commentary
Fixed Income	++	Segments	US Treasuries and developed market investment-grade credit.	Convertibles, High Yield, Emerging Market debt.	The end of the hiking cycle is in sight and as growth weakens and inflation falls, it should provide a tailwind for core fixed income. US treasuries usually outperform in this scenario. We also favour German Bunds with the eurozone technically in a recession. A likely shift in Europe's monetary policy in 2024 should enhance total returns in fixed income. We prefer IG credit in developed markets over high-yield, preferably in non-cyclical sectors. Current IG yields look compelling and provide a valuation cushion in a scenario of rising default rates. With interest rates peaking, extending the average duration in portfolios would make sense.
		Duration	Medium-term.		

VIEW: ++ VERY ATTRACTIVE + ATTRACTIVE = NEUTRAL − UNATTRACTIVE −− VERY UNATTRACTIVE

Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	Most Preferred	Least Preferred	Commentary
Equities	–	Markets	US and Japan. Selective in Europe. India long-term	Latin America.	We believe the recent equity rally was essentially driven by lower interest rates expectations in the US. However, we still believe that rates will stay higher for longer, making equities less attractive than fixed income. Investors need to reinforce the bottom-up approach and become even more selective. Caution and enhanced diversification are our recommendations to set up a balanced equity exposure in portfolios. The US economy's soft-landing scenario gains momentum as the likely situation investors will face over the next few quarters. But this backdrop is not incompatible with a downward trend in corporate earnings' growth. We see the current S&P500 EPS consensus estimate of 12 per cent (Bloomberg) as being quite optimistic in light of the expected real GDP growth rate of the US economy for 2024: +1.2 per cent. We see US stocks as being rather expensive with some headwinds for 2024: a) less support from earnings growth, b) less support from the Magnificent 7's additional margin expansion, and c) higher refinancing risk. In Europe, valuations are historically attractive and especially compared to the US. Despite a recessionary environment, investors can find attractive opportunities in Europe.
		Styles/Sectors	High-quality. Value. Dividend growers. Defensive sectors.	Cyclicals, Consumer Discretionary. Small caps	

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Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	Most Preferred	Least Preferred	Commentary
Alter-natives	+		Selected direct real estate, Gold	REITs	The resumption of the positive correlation between equities and fixed income supports our overweight in Alternatives. At least for the near term, lower Fed rates will not be supportive to gold although this is mitigated by a weaker USD recently. However, hedging risk, positioning against currency devaluations and central bank buying constitute favorable arguments. High inflation, the energy transition and growing digitization of the economy remain valid arguments to favour infrastructure as an alternative. Avoid listed real estate. Write-downs and defaults are still a threat for real estate. Diversified commodities to enhance de-correlation.
Cash	+				Though short-term recession risks have tempered in the US, we see a longer period of sub-trend growth. With 6-month Treasuries yielding 5.4 per cent, cash remains attractive and protects against positive correlation between equities and bonds.

VIEW: ++ VERY ATTRACTIVE + ATTRACTIVE = NEUTRAL − UNATTRACTIVE −− VERY UNATTRACTIVE

Figure of the Month

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While we are happy for the resilience of the American consumer, we are also mindful of signs of potential weakness. This number is the current percentage delinquency rate on credit card loans in the US as of the third quarter of 2023. It continues to rise from the historical lows seen during the pandemic and is now the highest since Q1 2012. Rates are rising fastest for lower-income areas but for each income quartile area, rates are at or above their 2019 levels. The rate is rising particularly quickly for those with auto and student loans, and disproportionately driven by millennials. (Source: Board of Governors of the Federal Reserve System).

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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