S.P. HINDUJA

BANQUE PRIVÉE

House View

March 2024

Thoughts of the CEO

"Fundamentals are more supportive of equities now."

A range of incoming data continues to be supportive for an increased allocation to equities in an internationally diversified portfolio. Specifically, we would highlight recent data trends from the United States. The US Purchasing Managers' Index (PMI) for manufacturing has moved out of the "deterioration" zone (a number below 50): from 47.9 in December to 52.2 last month. PMIs are considered leading indicators of the likely direction of the associated GDP components. A similar improving trend has been noted with the Services PMI: a rise from 50.1 in October to 51.3 in January. This data has taken the US economy further away from the long-predicted recession that has, so far, failed to materialise.

In response to this and other data, we increased our tactical allocation to equities in portfolios, having upgraded our view from underweight to neutral.

While some investors may wonder why this shift comes after strong equity performances in several markets, the reason is that our views reflect the fundamental data and our assessments of that data. In this House View, we provide a detailed overview of the factors that underpin our shift.

Our more positive view on equities does not mean that we are not aware of the lagging impacts of the sharp increase in interest rates on certain sectors. We want to highlight the risks with commercial real estate (CRE) in particular. We would, therefore, recommend that our clients avoid exposure to listed international REITs, direct exposure to office and retail assets, and regional banks with high CRE exposure. On the other hand, some CRE sub-segments, such as working space for life science projects are proving safer and are fuelling the little growth that is being observed. Life sciences accounted for 28 per cent of all new office construction in 2023.

Elsewhere, the Chinese economy is going through a transformation phase. The authorities are looking for new sectors and technologies to take the baton from real estate. The visibility of investors remains limited, though, and any conviction will need some time to gain traction.

In Japan, as the Bank of Japan gets ready to increase interest rates, we take a closer look in this House View whether higher rates might be bad news for Japanese equities. Our view is that while higher rates may, indeed, eventually disrupt the link between a weak Japanese yen and strong earnings, we do not believe that this undermines the current broader investment case for Japanese equities. Historically, Japan tended to outperform global equities in US dollar terms when the Japanese yen was strong: FX gains used to offset the impact of weaker earnings. In the current context, we would advise investors to focus more on domestic sectors rather than exporters and to own Japanese equities unhedged to reap the benefit of a likely stronger Japanese yen. Longer term, we believe the depth of the Tokyo Stock Exchange reforms aiming at improving capital allocations and returns is a big step to accelerate the closing of the productivity gap versus other regions.

Yours sincerely,

Karam Hinduja

Investment Positioning

We have upgraded our view on equities from underweight to neutral. The improved outlook on the US economy and globally for 2024, in combination with lower inflation, raises the probability of a soft landing in the US, reducing the downside risk for equities. The positive trend in leading activity indicators and a clearer view on the likely direction of rates support our new neutral stance on equities. With inflation falling and the Fed signalling an end to the tightening cycle, we continue supporting duration and have become less enthusiastic on investment grade corporates after the 2023 rallys.

Moving Equities to Neutral

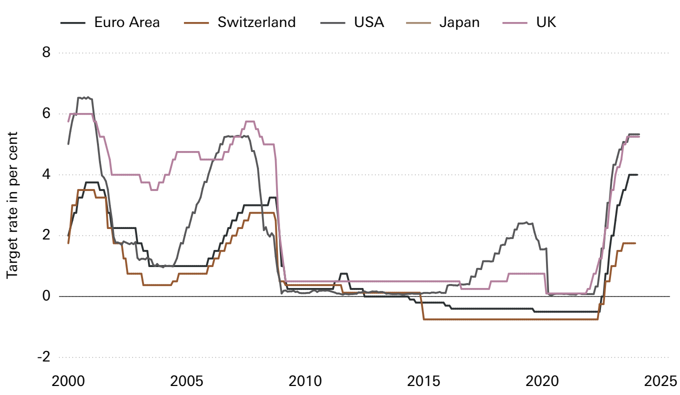
We have upgraded our view on equities in an internationally diversified portfolio from underweight to neutral. Despite sticky inflation components, the lower consumer price inflation and improved economic outlook reduce the probability of a hard landing or recession. The arguments that support our change of view are listed below:

- **Improved economic growth outlook:** US Q4 2023 GDP growth again surprised on the upside (3.3 per cent year-on-year vs. the 2 per cent consensus forecast). This has led to an improvement of both US and global economic growth prospects for 2024. The IMF now expects a US real GDP growth of 1.5 per cent (vs. 1 per cent before) and a global real growth of 3.1 per cent (vs. 2.9 per cent). This, combined with lower inflation (though yet sticky in some core components), raises the probability of a soft landing. An imminent or deep US recession near term now seems much less likely.

- **Improving leading indicators:** US main leading activity indicators (composite PMIs) have been improving over the last 4 months. Manufacturing has strongly rebounded in January 2024 and entered in expansion territory, and services have kept the expansionary upward trend initiated in October 2023. This reinforces the previous growth forecast.

- **Current dynamics improve sentiment on equities:** With falling inflation, markets believe that central banks already have scope to ease policy if growth eventually falters (see Fig. 1). This provides rates visibility into 2024. Even though we still believe

Fig. 1: Greater clarity on the likely next direction of rates



The chart shows that central policy rates appear to have reached a ceiling, reinforcing the view that the next move appears to be down. Central banks now also have more headroom to cut more aggressively if needed.

SOURCE: LSEG, WELLERSHOFF & PARTNERS

that corporate earnings estimates are unsteady, the less negative output gap will not exert the downward pressure on profit margins/earnings previously expected.

- **Market breadth:** This measure turned positive by the end of 2023 when S&P stocks moved above the 50-day moving average, a traditionally bullish indicator. Investors are shifting attention to the S&P in the search of companies that have not already gone up a lot, a good signal of positive market breadth.

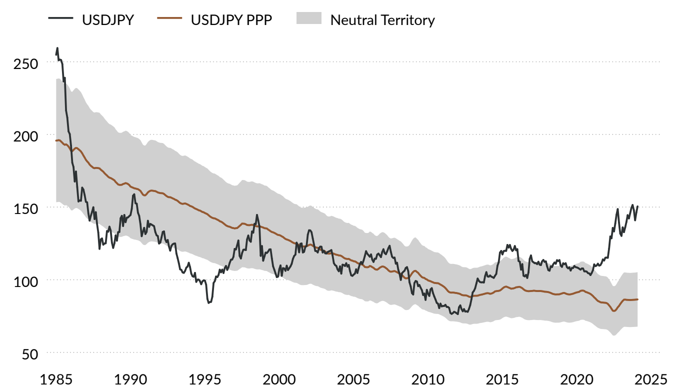
- **US general elections:** Investors are always trying to discern the link, if any exists, between US elections and the stock market. There may be some positive news. Every time since 1944, whenever an incumbent has been on the presidential ballot, equities have outperformed (an average 16 per cent performance). Normally, presidents can pull levers to boost the economy, at least over the short term and make the economy grow more than expected through increased capital spending. President Biden's levers include: The Infrastructure and Jobs Act, the CHIPS Act and the Inflation Reduction Act. A counter-argument is supportive too. It holds that even if Mr Biden were to lose, there will be enough money left from these budget allocations for the next president to hand out to preferred sectors. Regardless of whether these narratives were to hold this time, one number appears clear: a big fiscal stimulus is under way in the US, which is supportive. The US federal budget deficit is projected to widen from 5.3 per cent of GDP in 2023 to 6.1 per cent in both 2024 and 2025 (Source: US Congressional Budget Office, February 2024).

- **Asset class shifts:** Yet, lots of cash remains invested in money market instruments. Again, easing inflation and lower expected rates are already reducing allocations to cash to the benefit of risk assets.

Commercial Real Estate (CRE) rings the bell

Our tactical upgrade of equities does not mean that we are not mindful of the risks to the economy from a variety of factors. While headlines in the business press are focusing extensively on AI's ability to transform the growth profile of certain companies, there are stresses in the system about which investors must remain vigilant. We would like to highlight that a few alarms are sounding in the commercial segment of the real estate sector. Increasing defaults and write-downs have already hit lenders across three continents, including New York Community Bancorp, KKR Real Estate Finance Trust Inc., Deutsche Pfandbriefbank, Aozora Bank (Japan), and Julius Baer. Publicly available information suggests that many creditors

Fig. 2: Japanese yen remains very undervalued



The chart shows that a Japanese yen around 150 JPY per USD remains far weaker than our estimate of its purchasing power value of around 86. Hence our recommendation that investors should opt for Japanese equities unhedged to reap the benefit of a likely stronger Japanese yen.

SOURCE: LSEG, WELLERSHOFF & PARTNERS

have been impacted by just one single case in Europe, the real estate company Signa Holding.

This sector, in particular the segments of office and retail (which account for more than 55 per cent of commercial real estate), navigates one of the most difficult environments since its existence: new consumption patterns, increasing competition from e-commerce, foot traffic and occupancy rates falling, remote working increasing office vacancy rates to 20 per cent (Moody's Analytics, Q4 2023), weak surface demand, falling rents and higher interest rates. All these factors are having a strong negative impact on valuations. Besides, the lack of transactional volumes makes comparative identification more difficult. Assets in secondary locations and worse are suffering the most. Even CBD (Central Business Districts) office assets are witnessing 35 per cent lower valuations. It is very likely that this negative trend may accelerate throughout 2024.

Taking into account the close relationship between the real estate and financial sectors, we looked at how much debt from all sources is backed by US commercial real estate. The size is not negligible: USD 4.7 trillion. The bad news is that 21 per cent of this amount (USD 1 trillion) matures during 2024, and our view is that many real estate owners will not be able to pay off at maturity. Note that valuation uncertainties make refinancing deals more difficult to execute. The weakest link in the chain are the small and medium-sized regional banks. According to Bloomberg, US commercial real estate accounts for 30 per cent of assets in this group of banks, compared to 6 per cent in large banks. The volume of commercial real estate loans in small and medium banks is 2.3x higher than for large banks. According to the same source, 12 small and medium US banks currently exceed the regulators guidance on commercial real estate. The slowness in mark-to-market exercises is not sustainable, and investors should be aware of this unfolding backdrop. We recommend that our clients avoid exposure to listed REITs, direct exposure to office and retail assets and avoid high CRE exposure regional banks. Some CRE sub-segments, such as working space for life science projects, are proving safer and are fuelling the little growth that is being observed. Life sciences accounted for 28 per cent of all new office construction in 2023.

While it is natural for investors to want to connect the dots across an entire sector or across geographies, it is worth bearing in mind that there continue to be large differences in the movement of real estate prices across markets: Down −16.9 per cent in Germany in the year to Q3 2023, but +16.1 per cent in Greece. There are micro factors at play that reinforce the point that local knowledge matters. But, clearly, there are tectonic shifts under way in CRE.

Update on China

The annual meeting of China's National People's Congress, or parliament, was scheduled from 5 to 11 March 2024. At the time of completing this House View, markets were still evaluating the policy decisions.

The backdrop is that China's stock market has endured a three-year downturn, with prices having more than halved from their peak in early 2021. To counteract this trend, authorities have turned more aggressive with support measures: On 23 January, Bloomberg reported that Chinese authorities were considering a USD 319bn package of measures to stabilize the slumping A-share markets. On 24 January, the central bank (PBOC) lowered the reserve requirement ratio for the banking system by 50bps, estimated to release RMB1tn of liquidity into the market.

- Recent trading sessions have shown a resurgence in Chinese stocks. Nevertheless, market sentiment remains cautious amidst macroeconomic uncertainties, with hopes pinned on additional macro stimulus measures, such as increased fiscal spending.

- There are additional earnings uncertainties looming. Consensus is expecting 12 per cent to 15 per cent EPS growth for the MSCI China in 2024E/25E, a forecast that may prove overly optimistic, augmenting the chance of misses in the upcoming March reporting season.

- The unknown depth of the real estate crisis is a deterrent for investors and is having a meaningful negative wealth effect in Chinese households.

- The Chinese economy is going through a transformation phase. Authorities are looking for new sectors and technologies to take the baton from real estate. The visibility of investors remains limited, and any conviction will need some time to gain traction.

Overview of US Earnings Q4 2023

The S&P 500 Q4 2023 earnings season is showing good results, although the EPS growth rate is narrow at around 7 per cent year-on-year. This was essentially driven by the Magnificent 7 and, to a lesser extent, Discretionary. The surprise factor is running 6 per cent above year-end estimates, double the typical surprise rate. As of the end of February 2024, the number of companies issuing EPS guidance has been small (Source: FactSet). Negative guidance exceeded positive ones. We believe full-year 2024 EPS growth estimates will be revised down, despite the improved growth outlook in the US. Here are the key takeaways, with four fifths of the S&P 500 having reported:

- Up to 77.5 per cent of companies have reported earnings above analysts' estimates, compared to a 66.6 per cent long-term average.

- Earnings growth and beat were driven by widening margins of the Magnificent 7. Earnings growth remains narrow, driven by 6 of the Mag 7 stock net income was running 6 per cent above estimates, which is double the typical surprise rates. According to LSEG, earnings are expected to be +10 per cent year-on-year. Excluding the Energy sector, year-on-year earnings are expected to show +13.7 per cent.

- Net Income growth: Technology, Communications Services and Consumer Discretionary industries have generated effectively all of the earnings growth. The Mag 7 stocks have posted earnings growth of 53 per cent, 6 per cent above expectations. In contrast, the rest of the market is seeing earnings fall by 3 per cent. The Mag 7 stocks are effectively generating all of the earnings growth of the US market.

- In contrast to the rise in profits, aggregate sales revenues in Q4 are growing by 5 per cent year on year. Revenue growth has come from Financials and Healthcare, while Energy has been a large drag. Non-Fin ex-Commodity margins have widened to 8.6 per cent and are at the peaks seen during the post-Global Financial Crisis, pre-pandemic period. Corporate executives in America could be forgiven for believing that the earnings recession is behind them. Margins have widened across the broad market. Once Commodities are excluded, margins are returning to more normal levels.

- As far as Q1 2024 earnings estimates are concerned, most downgrades have been in the Consumer Staples, Energy, Industrials and Healthcare. The only sectors where earnings beats are leading to significant numbers of upgrades are Technology, Utilities and Financials. Examples of stocks that have beaten expectations and have been upgraded: Microsoft, Ford Motor, Airbnb. Overall, Q1 2024 earnings are expected to grow by 5.4 per cent year-on-year. According to LSEG, 2024 earnings are expected to grow by 9.5 per cent.

Japan: The end of negative rates, finally?

The Bank of Japan (BoJ) looks likely to end its negative rate policy in April when the outcome of this year's wage round will be known. Other unconventional monetary policies could also be phased out, but the hurdle to conventional tightening appears higher. It could require further evidence that inflationary behaviour is changing before interest rates move into positive territory.

While the BoJ appears to have seized upon the opportunity to phase out its unconventional monetary policies, it neither appears to be intent on normalising policy further nor will circumstances be quite as conducive to that objective, we believe. Instead, the BoJ is likely to move slowly, with any additional rate increases coming in response to better-than-expected economic outcomes and aimed at locking in a sustainably higher rate of inflation. It is likely to require firm evidence from inflation to raise interest rates materially.

Japanese Equities

The Nikkei 225 has finally surpassed its 1989 high, after 34 years. Recent returns have been driven by strong earnings on the back of a weak Japanese yen. But the macro backdrop may be shifting. Going forward, the investment case may shift to looking at unhedged returns and domestic sectors.

The current P/E on the overall market is just under 16x 12m trailing EPS compared to over 60x back in 1989. To be sure, the Nikkei 225 is a quirky, price-weighted index — the more representative TOPIX is still around 8 per cent below its 1989 peak.

But Japan has been an outperformer recently. In contrast to Global Equities, Japanese Equities' returns over the last year have been driven by earnings growth, not just higher P/E multiples. Just under half of the 34 per cent total return for the Japanese market over the last 12 months has come from earnings growth.

Japan has had the strongest earnings revisions of any of the major regions for the last 4 months. Longer term, the key driver will be improving profitability.

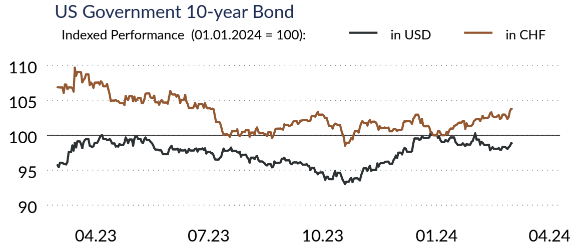
Are higher rates bad news for Japanese equities? Higher rates may eventually disrupt the attractive weak Japanese yen/strong earnings link, but we do not believe that this undermines the broader investment case for Japanese equities. Japan has tended to outperform global equities in US dollar terms when the Japanese yen is strong: FX gains have offset the impact of weaker earnings. Therefore, investors should focus more on domestic sectors rather than exporters and own Japanese equities unhedged to reap the benefit of a likely stronger Japanese yen (Fig. 2). Longer term, we believe the depth of the Tokyo Stock Exchange reforms aiming at improving capital allocations and returns is a big step to accelerate closing the productivity gap versus other regions.

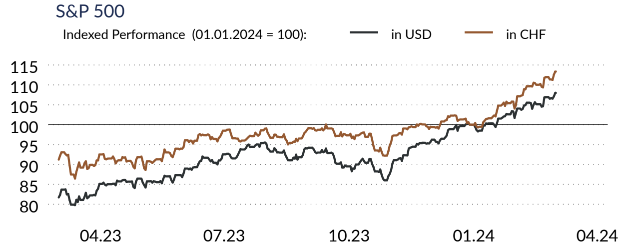
Macroeconomic estimates (in %)

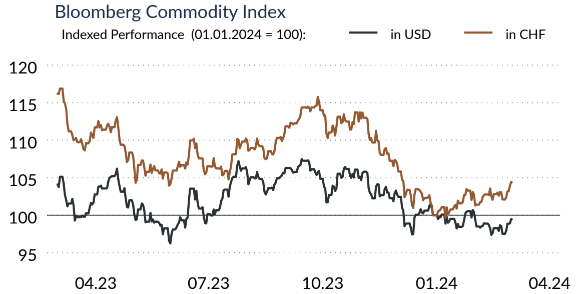
	GDP Growth			Inflation		Interest Rates	Money Growth M1
	Trend	2024*E*	2025*E*	2024*E*	2025*E*	Q1 2024	y/y 02/2024
USA	1.8	1.4	1.6	3.2	2.2	5.50	–8.8
Eurozone	1.1	0.6	1.4	3.2	2.4	4.00	–8.7
UK	1.7	0.6	1.5	3.8	3.0	5.25	–6.5
Switzerland	1.3	0.8	1.6	1.8	1.5	1.75	–17.0
Japan	1.1	1.0	1.2	2.0	1.5	–0.10	3.9
China	4.5	4.3	4.5	0.8	1.5	4.35	6.0
Brazil	1.4	1.8	1.8	4.0	4.0	11.25	2.6
India	5.0	6.3	5.5	4.5	4.5	6.50	7.1
Russia	1.0	1.5	1.0	5.0	4.0	16.00	12.9
World	3.0	2.8	3.1	4.6	3.8	—	—

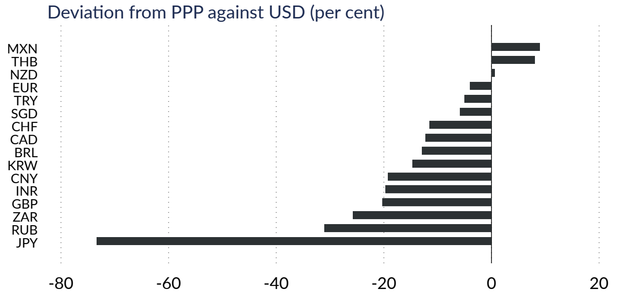
SOURCE: LSEG, WELLERSHOFF & PARTNERS

Financial Markets









SOURCE: LSEG, WELLERSHOFF & PARTNERS

Global Asset Allocation Preferences – March 2024

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.	Falling inflation, signs of a cooling labour market and a likely pivot in Fed and ECB policies add attractiveness to core fixed income. If growth falters, it is very reasonable to expect the Fed to cut even further. In this scenario, owning duration makes sense to capture greater total returns. We note that yields still look more attractive than they have in a decade. Spreads and yields have fallen significantly in the credit space. Valuations no longer appear cheap, though lower rates should still support corporate bonds. The risk/reward relationship has shifted after the 2023 rally. We are less optimistic about IG bonds.
		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	Fundamental macroeconomic data has improved both the growth outlook in the US and globally for 2024. This, in combination with lower inflation (though some stickiness in certain components remains), raises the probability of a soft landing for the US economy. An imminent or deep US recession is now much less likely. We are getting greater clarity on the likely direction in rates, and the fact that central banks now have more headroom to cut rates more aggressively if needed also supports our less cautious stance on equities. We move our opinion on equities from Underweight to Neutral.
		Styles/Sectors	High-quality. Value. Dividend growers. Defensive sectors.	Cyclicals. Small caps.	Furthermore, we still think the US offers more choice for quality stocks than Europe and have a preference for the former. Large caps over more interest-rate-sensitive small caps and a balanced combination of consolidated tech names and defensive sectors are recommended: Staples, Healthcare and attractively valued Utilities. Very selective in cycle-dependent Europe, playing quality and dividend clout to offset a negative earnings momentum. More positive developments are found in Asia-Pacific together with optimal earnings visibility. This is the case for India and Japan, two regions to look at for diversifying away from high US valuations.

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

Global Asset Allocation Preferences – continued

Asset Class	View	Constituents	Most Preferred	Least Preferred	Commentary
Alter-natives	–		Selected direct real estate, Gold.	REITs	Although US recession risks have decreased, macroeconomic uncertainties persist in certain parts of the world (e.g., UK, Germany and Japan are in a technical recession). Gold should benefit from an eventual rate cut by the Fed later in the year and by central banks' buying activity. High inflation, the energy transition and growing digitisation of the economy remain valid arguments to favour infrastructure as an alternative. Writedowns and defaults are still a threat to real estate. Avoid listed REITs with high exposure to commercial real estate.
Cash	=				Cash offering ~5% yield in USD and rates staying steady in the short-term supports this assest class.

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

Figure of the Month

6.1

This is the size of the US federal government budget deficit as a percentage of GDP, projected by the US Congressional Budget Office in February 2024 for both 2024 and 2025. This compares with 5.3 per cent in 2023, 5.2 per cent in 2022 and an average of 3.6 per cent from 1973 to 2022. This increased fiscal stimulus is one of the shorter-term reasons for our tactical upgrade of equities in the portfolio from underweight to neutral. Over the medium term, too much government debt means that the US faces rising interest rate costs and a deteriorating debt profile.

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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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