Habib Bank AG Zurich

(Incorporated in Switzerland 1967)

HABIB BANK AG ZURICH
PRIVATE BANK SWITZERLAND

MARKET OUTLOOK 2023

A NEW WORLD IN THE MAKING

We have to go back to the 1970s to find a historical precedent for the events which unfolded in financial markets during 2022. The most extraordinary confluence of events led to negative returns for all major asset classes. The adjustments, brought about by monetary policy and geopolitics, have created a new context as we enter 2023 with not only risks, but also opportunities aplenty.

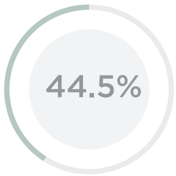
- The global economy could hit stall speed as many countries and regions face recession
- Monetary policy normalization is well advanced, but the US Federal Reserve and most other central banks in the developed world will retain a tightening bias for at least the first half of the year
- Fixed income stands out as the most attractive asset class, but not across all sectors

Table 2022 in review - performance of major asset classes

Market index			Year-to-date
Equity All Countries World		USD	-15.4%
Equity World		USD	-15.0%
	S&P 500	USD	-14.8%
	EuroStoxx 50	EUR	-5.2%
	FTSE 100	GBP	5.2%
	Swiss Market Index	CHF	-10.8%
	Nikkei 225	JPY	-1.0%
Equity Emerging Markets		USD	-18.8%
	China - CSI 300	USD	-25.2%
	India - SENSEX	INR	9.0%
	Pakistan - KSE-100	PKR	-7.1%
USD Investment Grade		USD	-11.2%
	US Treasury	USD	-10.4%
	US Investment grade	USD	-13.2%
	US High yield	USD	-8.8%
Emerging Market Sov USD		USD	-16.4%
Gold		USD	-2.2%
Oil (Brent)		USD	13.3%
USD (trade weighted)		USD	8.7%
	EUR	1.060	-6.4%
	GBP	1.216	-8.5%
	CHF	0.931	-1.5%

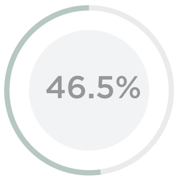
Source: Bloomberg as of 15 December 2022

Table recommend portfolio allocation
(indicative positioning of USD global balanced mandate)



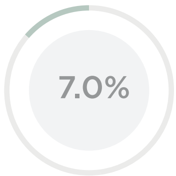
EQUITY

Region/Sector	Allocation
US	24.7%
Europe	3.9%
Japan	0.9%
EM	5.3%
Global	9.7%



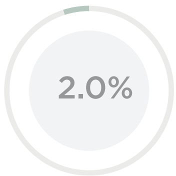
FIXED INCOME

Region/Sector	Allocation
Treasury/ABS	19.0%
Investment Grade	9.0%
Subordinated Bonds	5.5%
High Yield	2.0%
Emerging Markets	11.0%



ALTERNATIVES

Region/Sector	Allocation
Gold	2.0%
Direct Lending/Volatility	5.0%



LIQUIDITY

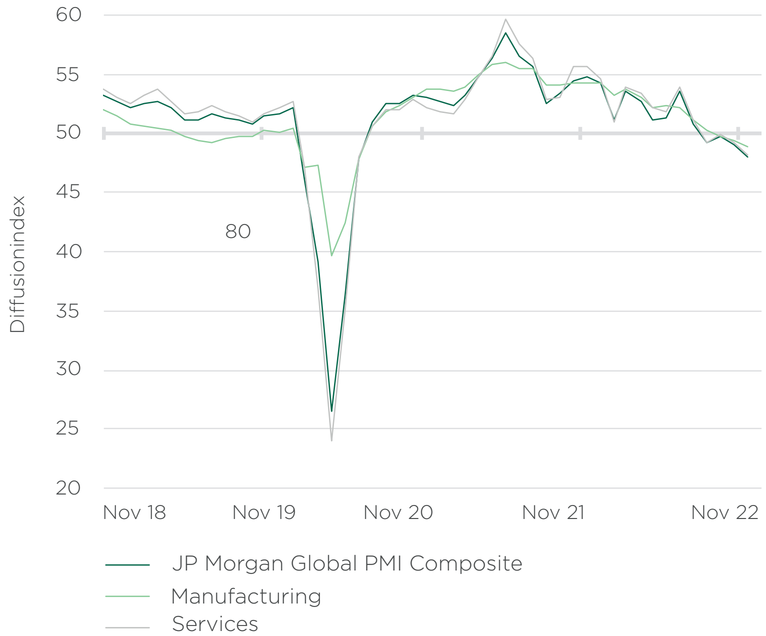
Region/Sector	Allocation
Cash	2.0%

OUR BASE CASE SCENARIO:
low growth with recession risks

Driver	Comment	Trend	Risk Implications		
			on	neutral	off
Global GDP growth	Recession likely in many major economies	↘			•
Global inflation	Inflationary pressure to persist in 2023	→		•	
Global policy rates	Terminal rates, once reached, maintained for longer	↗			•
Global liquidity	Fed, ECB to reduce their balance sheets materially	↘			•
USD trade-weighted	USD highly valued but supported by fundamentals	→		•	

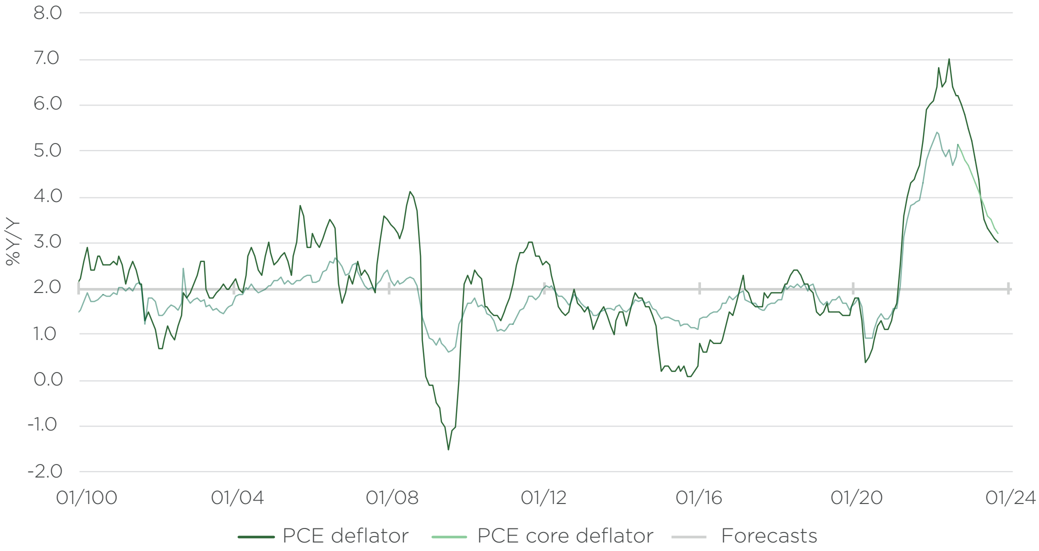
The global economy has suffered multiple shocks since the Covid-19 pandemic struck in 2020. At the beginning of the year, we were hopeful that some of these shocks would dissipate. Some of them did, such as the widespread supply chain tensions. However, other, more powerful ones emerged and, as a result, growth in many economies fell well short of expectations for the year. **Global growth forecasts thus declined from 4.4% to less than 3.0% for 2022 and from 3.6% to 2.0% for 2023, still with ample downside risk.** The main culprits were relentless inflationary pressures, which sapped real disposable income and forced central banks to tighten policy much more than expected, as well as the repercussions of Russia's attack on Ukraine, which upended commodity markets. As we enter 2023, we expect most central banks to retain their tightening bias. We also expect growth to decelerate further as the impact of these shocks' ripple through economies. Inflationary pressures should recede, but higher wage growth and the reversal of years of globalization of production will prevent CPI measures from falling back to target quickly.

Global: PMI surveys point to further weakness



Source: Bloomberg, HBZ

US: Inflation too high for a Fed pivot



Source: Bloomberg, HBZ

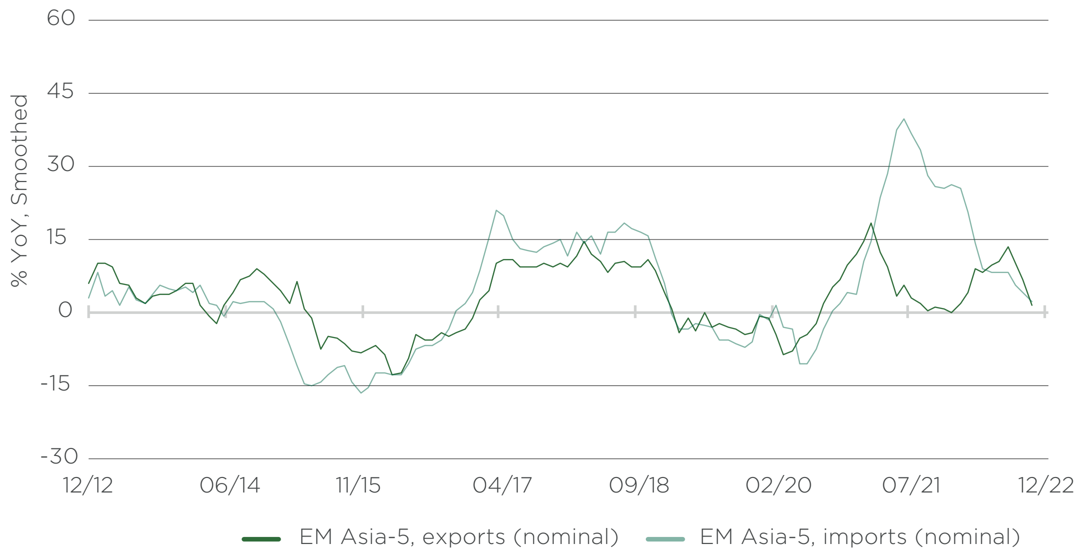
Despite the multiple headwinds which buffeted the US economy throughout most of 2022, US activity levels were relatively robust across sectors, with the notable exception of housing, where building permits and housing starts fell by almost 20%. **Pent-up demand and high savings rates of households accounted for much of the economic resilience. These factors will weigh much less positively in 2023,** and the lowest CEO confidence level in more than five years bodes ill for corporate investment. **The Fed has singled out bringing inflation back to target as its paramount objective for this cycle.** In our opinion, this implies a terminal rate of at least 5%, if not higher. The unbroken strength of the jobs market will probably require more rather than less Fed tightening, and rates will have to stay at high levels for longer to rebalance the economy and the financial system. Restrictive monetary policy, coupled with the end of the post-pandemic reopening effects on aggregate demand, will most probably result in a recession whose duration and severity remain extremely hard to gauge.

At the time of writing, **Europe probably has already entered a recession.** Slowing global growth, but mainly surging energy prices, broke the back of the recovery. The UK faces the prospect of up to a year of GDP contraction. This period may be shorter for the eurozone, although this will depend on the prevailing temperatures during the winter months. The **loss of cheap Russian gas as an energy source and feedstock** will also have longer-lasting effects forcing energy-intensive industries to revisit the case for Europe as a production hub. Double-digit inflation rates leave the ECB no room to end its tightening cycle early.

Eurozone: GDP contraction under way

Source: Bloomberg, HBZ

EM: Asian trade to rebound in 2023?



Source: Bloomberg, HBZ

China's performance on both the economic and political fronts contributed materially to the subpar global growth recorded in 2022, and the conditions are not yet in place for this to change anytime soon. China's actions to deleverage the fragile property sector were sensible and timely. However, combined with the highly restrictive management of the pandemic, this led to a sharp deceleration of activity from which the economy has yet to recover. **For 2023, an economic rebound is an undisputed imperative for the Chinese leadership,** as the population has started to grow restless. Policymakers have already indicated their willingness to provide more policy support and gradually lift Covid-related restrictions. The less confrontational approach in relations with the US since the Bali G20 Summit also gives grounds for muted optimism. That said, the open-ended leadership of Xi Jinping enshrined at the 20th Chinese Communist Party Congress suggests that ideology will trump economic pragmatism in the years ahead.

The mixed fortunes of China amplified the challenges for many emerging market (EM) economies in 2022. For the coming year, **EM economies are still expected to outgrow their developed market peers.** Similar factors as in 2022 will determine their overall performance, including a still-strong dollar, higher US interest rates, and volatile commodity prices. India is set to remain on its successful growth path, and should China manage to shake off its outlived pandemic regime, Emerging Asia would also be poised to deliver relatively robust growth. The pain, however, will continue for highly indebted nations, and the risk of debt restructuring remains high for many of them. Oil producers in the Middle East are among the major beneficiaries of the geopolitical turmoil the world has experienced since February 2022, and many of the related developments will remain in place to support their economies in 2023 as well.

OUR RISK SCENARIOS
From better to much worse

Theme/Topic	Comment	Risk Implications		
		on	neutral	off
Growth/Inflation	Soft landing and broad-based easing of inflation pressures	•		
Global Liquidity	Accelerated reduction of global liquidity due to QT and strong USD			•
Growth/Earnings	Deeper recession due to monetary tightening, energy price shock			•
Political Risk	Russia's war against Ukraine - belligerent China (Taiwan)			•

Heading into a recessionary phase of the global economic cycle leaves the **main risk scenario** - almost by definition - **centered on a better-than-expected outcome.** Indeed, the **global economy would likely respond well to a more rapid decline in inflation and hence lower terminal rates** as well as a robust pick-up in investments, for example with the help of government programs to support energy transition such as the Biden administration's USD 370bn green program. However, there are also s**ome material downside scenarios,** such as **much tighter global liquidity conditions** as the central bank actions taken over the course of 2022 start to unfold their aggregate effects. This could lead to a **much deeper and prolonged recession** affecting virtually all major economies. Finally, geopolitical risks have been on the rise for several years, culminating in the new cold war with Russia, but also with tensions with China about the future of Taiwan. Either of these hotspots has the potential to gravely affect the global economic backdrop were they to escalate - in the case of Russia's war on Ukraine into a direct confrontation with NATO, and in the case of Taiwan, a Chinese attempt to settle the matter militarily.

INVESTMENT IMPLICATIONS

Yield is back

Driver	**Comment**	**Trend**	**Risk Implications**		
			on	neutral	off
Equity Valuations	Valuations reflect higher rates but not lower EPS growth	↘			•
Equity earnings	earlings growth to fall	↘			•
Credit Spreads	High yield at risk, investment grade with attractive Yields	↗		•	

The perfect storm financial markets endured in 2022 rattled but did not shatter many long-held investment assumptions. Diversification, the very cornerstone of modern portfolio theory, failed spectacularly for much of the year, but we are convinced that this was an outlier. So, our first and primary recommendation for the coming year is to stick with robustly diversified portfolios. Back in late 2021 we agreed that bonds offered limited value; however, we did not foresee that the adjustment would come so soon or be so violent. The **resulting normalization of yields has created value where there was little or none before. For this reason alone, we will start the year on a more solid footing.** Risks still abound, of course, but we are confident that there will be no repeat of 2022, at least in the quality segment of fixed income. The story may be different for risk assets such as equity and high-yield credit, but some recovery could materialize once the global cycle has hit bottom.

Should one or several of the risks highlighted above materialize, the investment consequences could turn out to be diametrically opposed: a massive risk rally in the case of a soft landing or an extended bear market in the case of a deep and prolonged recession, devastating lower-rated credit in the process.

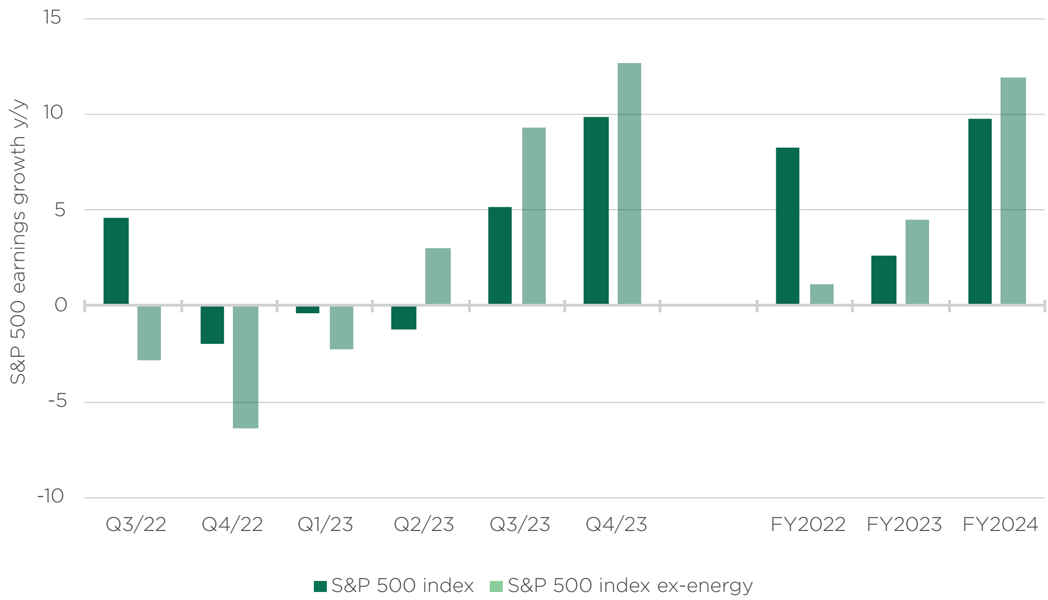
FIXED INCOME
Quality credit and less fear of duration

Short duration and quality credit were two factors that saved fixed-income investors from more painful drawdowns in 2022. We still recommend focusing on quality across the fixed-income spectrum for 2023, but we have become more comfortable with lengthening duration. The current yield levels for quality bonds are attractive by most standards, and after a very long time once again provide a margin of safety to absorb the inevitable bouts of market volatility. So where to invest? We like **investment-grade bonds with low to medium duration from quality issuers,** both in USD and EUR (on a hedged basis). Many **quality issuers, especially from the financial sector, also offer subordinated debt.** In 2022, this type of debt behaved at times like equity and hence suffered severe markdowns. At current levels, however, it offers great value. Any improvement in risk sentiment will deliver equity-like returns in this segment. We remain cautious on EM bonds, although they have benefited greatly from the recent decline in US Treasury yields. However, many EM countries face very challenging fundamentals domestically and tougher funding conditions internationally, and any EM debt investments should therefore focus on quality, both in the sovereign and the corporate space. Finally, US Treasuries with a maturity of up to ten years should be part of any diversified portfolio, as they will respond positively to both the end of the Fed tightening cycle and recessionary conditions.

Bonds: bonds beat equities on yield

Source: Bloomberg, HBZ

Equities: earnings forecast still too optimistic



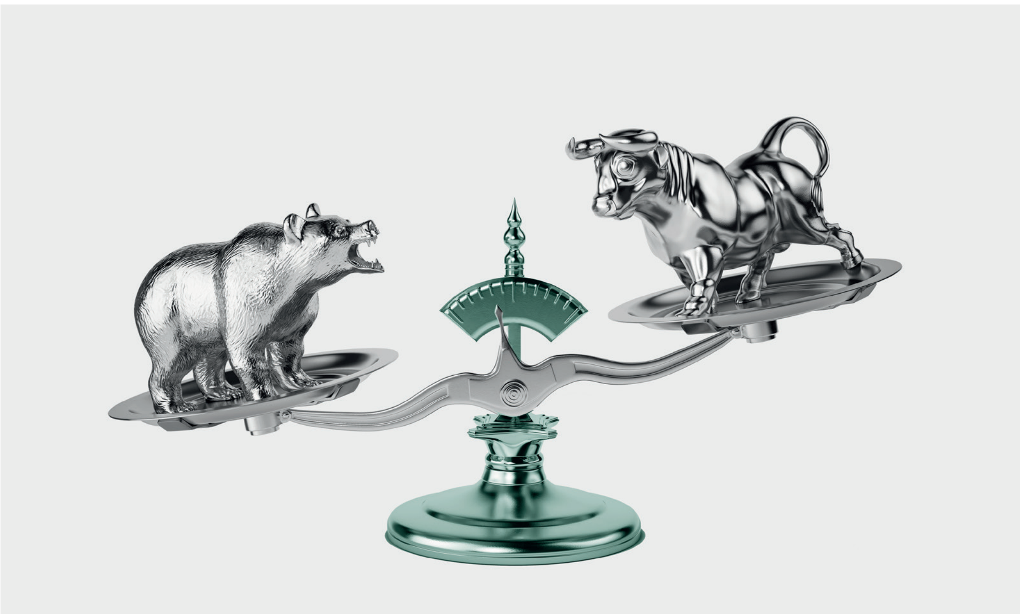
Source: Bloomberg, HBZ

EQUITIES

Focus on resilient earnings and robust business models

Stocks are for the long run and therefore belong in any diversified portfolio with a reasonable investment horizon. While on a risk-adjusted basis quality nvestment-grade bonds are more attractive at this stage of the cycle, equity valuations have become more appealing in their own right and no longer represent the hurdle they did a year ago. We are not in the bullish camp and fear another down-leg, largely driven by earnings. However, we are convinced that investors should **think about accumulating quality shares, starting with more defensive sectors** such as health care or consumer staples, which tend to outperform during recessionary periods. The value style started a comeback and should continue to outperform growth as long as interest rate risks remain material. The energy sector continues to offer high dividend yield at very compelling valuations and a hedge against possible supply issues. Finally, higher rates and above-average volatility still are arguments for choosing equity-linked solutions to generate cash flow or for gaining exposure without putting capital at risk.

Historically, the US tended to outperform in bear markets, but relative valuations and the S&P 500's growth bias argue for a **lower US allocation** at this stage. Instead, portfolios should be tilted, albeit in moderation, toward European markets including the UK. By increasing the allocation to value stocks, this bias will happen almost automatically, also adding a healthy dose of Japanese stocks in the process. Emerging markets also offer attractive valuations (relative and absolute) and upside once the global cycle picks up. We continue to favor EM Asia, as this region remains a core center of global growth.



CURRENCIES & COMMODITIES
After the USD peak

The US dollar surged earlier in 2022 before correcting from a new 20-year high (on a trade-weighted basis). **The USD is not done yet, but the writing is on the wall:** Once the Fed ends its rate-tightening cycle, a more lasting correction is bound to set in. A steepening of the yield curve would be another bearish sign for the USD. In turn, G-10 currencies, including the EUR and even the GBP, are cheap at present and stand to benefit. EM currencies should also rise, especially if a US dollar weakness is accompanied by a recovery in global growth.

Like most asset classes, commodities also experienced wild gyrations in 2022. Looking ahead to next year, we fear that many causes of this volatility remain in play. For this reason, we are sticking with two commodities where we expect positive trends to prevail: gold and oil. **Gold remains our favored hedge against US weakness,** especially if this weakness occurs in the context of what is still relatively high inflation. In our opinion, **oil is supported by the various cross-currents affecting the global crude market,** and after the recent correction once again offers an attractive entry point.

A WORD ON PRIVATE MARKETS

One way or the other, public markets will remain volatile during the coming 12 months. **Professional investors with a longer investment horizon can contemplate allocating part of their portfolios to private markets** to cushion portfolios from the impact of daily mark-to-market. More importantly, they can access the attractive risk premiums associated with private markets. We consider private equity attractive following the correction of valuations over the past year, and 2023 vintages are likely to deliver above-average returns over their lifetime. Another area is private debt such as direct lending or trade finance. Such investments tend to be shorter-dated and collateralized and less correlated with public markets. Hedge funds, which span the public/private market divide, are also a good source of portfolio diversification, since they enjoy a greater degree of freedom than more conventional investments.

ANALYST CERTIFICATION

I, David Wartenweiler, certify that the specific recommendations or views expressed in this research report accurately reflect my personal views about the subject securities or issuers, and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report.

Risk Disclosure

Habib Bank AG Zurich («HBZ») has prepared this document and the information contained herein are provided solely for information and HBZ marketing purposes.
It is not to be regarded as a sales prospectus, an offer or solicitation of an offer to enter into any investment activity. Please note that HBZ reserves the right to change the range of services, the products, and the prices at any time without notice. All information contained herein, including without limitation benchmarks, asset classes, asset allocation, and investment instruments, and opinions indicated are subject to change.

In the event of figures being included, these may refer to past or simulated past performance. Past performance is not a reliable indicator of future results. Some figures may be forecasts only and forecasts are not a reliable indicator of future performance. Any charts and/or performance figures may not be based on complete 12-month periods, which may reduce their comparability and significance. If the currency of a financial product or financial service is different from the currency of your home country, the return may increase or decrease as a result of currency fluctuations. Fees may not be included and these will reduce future performance accordingly.

Products and services described in this document are generic in nature and do not consider specific investment objectives, financial situations or your particular needs.
Therefore, you should not regard this document as a substitute for the exercise of your own judgment. All investments carry a certain degree of risk and your attention is hereby drawn to such risk, which can be substantial. Please be aware that the markets in certain securities may be illiquid and that valuing the investment and identifying the risks may therefore be difficult. Some investments may be subject to sudden and large falls in value and on disposition may pay back less than invested. You should consult your HBZ Relationship Manager on the nature of such investment and carefully consider whether such investment is appropriate for you. Unless otherwise expressly agreed, HBZ does not act as your financial advisor or fiduciary in any transaction.

Tax treatment depends on your specific circumstances and may be subject to change in the future. HBZ does not provide legal or tax advice. Nothing in this document shall be considered as a representation regarding the tax treatment of assets or investment returns, either in general or with reference to your specific circumstances and needs. HBZ suggests that prior to investing you seek independent legal and tax advice on the implications of the products/services in the respective jurisdiction and the suitability of products and services.
This information material is for distribution only under such circumstances as may be permitted by applicable law. It is expressly not intended for persons who, due to their nationality or place of residence, are not permitted access to such information under local law. Neither this document nor any copy thereof may be sent, taken into or distributed in the United States or to any U.S. person, nor may this document be distributed in jurisdictions where its distribution by HBZ would be restricted.
In Switzerland, this document is distributed by HBZ, authorized and regulated by the Swiss Financial Market Supervisory Authority (FINMA) (located at Laupenstrasse 27, 3030 Berne, Switzerland). In the United Arab Emirates, this document is distributed by Habib Bank AG Zurich, UAE Branches, authorized and regulated by the Central Bank of the United Arab Emirates. In the Dubai International Financial Centre (DIFC), this document is distributed by Habib Bank AG Zurich (DIFC Branch), authorized and regulated by the Dubai Financial Services Authority. This document is intended for Professional Clients only.
Without the prior permission of HBZ, reproduction of this document in whole or in part is prohibited. HBZ does not accept any liability whatsoever for the actions of third parties in this respect. HBZ makes no representation or warranty relating to any information herein which is derived from independent sources.

HBZ does not accept any liability for any loss or damage arising out of the use of all or any part of this document.

Habib Bank AG Zurich's registered head office is at Weinbergstrasse 59, 8006 Zurich, Switzerland.

In case of any questions, do not hesitate to contact your Relationship Manager.

HBZ 11.2022

HABIB BANK AG ZURICH
PRIVATE BANK
SWITZERLAND

WWW.HABIBBANK.COM