

Habib Bank AG Zurich

Private Bank

# RESILIENCE TESTED

Q1 2026



HABIB BANK AG ZURICH  
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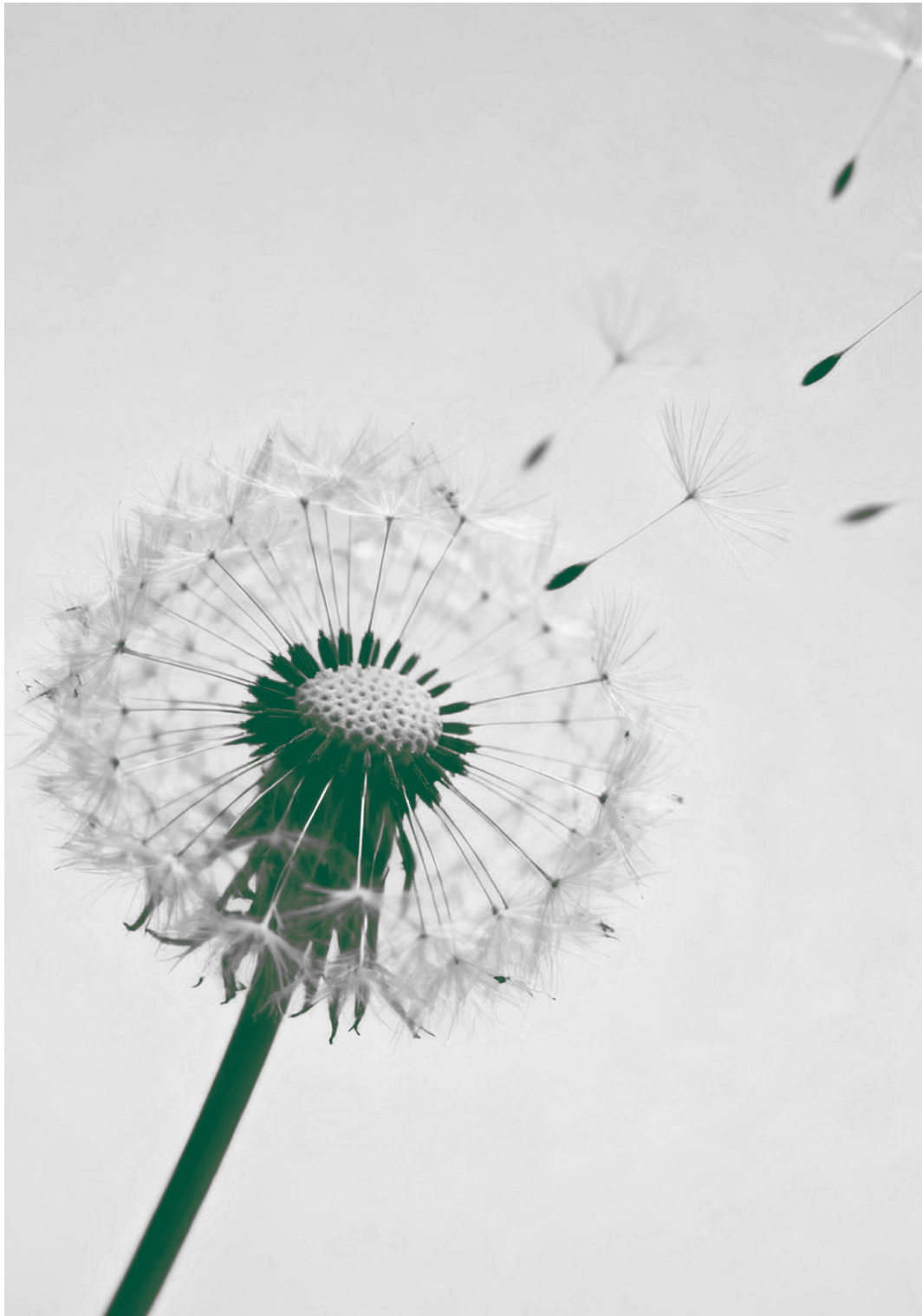
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Dear Reader

The year has barely started and we already have sufficient news to fill an entire annual chronicle! As investors, though, we have to see through the noise and focus on what's relevant and consequential for markets. Focusing on the fundamentals, we are constructive for 2026, with plenty of tailwinds supporting growth and corporate earnings. Misses and setbacks are a normal part of the story, but let's not forget that the natural state of economies and markets is to expand. If we learned anything in 2025, it's not to underestimate their resilience in the face of adversity.

The tried-and-tested way of dealing with the vagaries of our world is diversifying across asset classes, markets, sectors, and currencies. We therefore recommend spreading exposure broadly – maybe even more than usual to take account of the new geopolitical realities. Despite high valuations in some markets, opportunities abound elsewhere. Europe and emerging markets come to mind, not just for equities but also for fixed income and currencies.

Credit is an important part of most diversified portfolios. What do we make of the record-low credit spreads? Turn to our Special Topic to learn how we think about this sector.

We hope you had a good start to the year and look forward to discussing our views with you. There's nothing like a spirited exchange among friends!

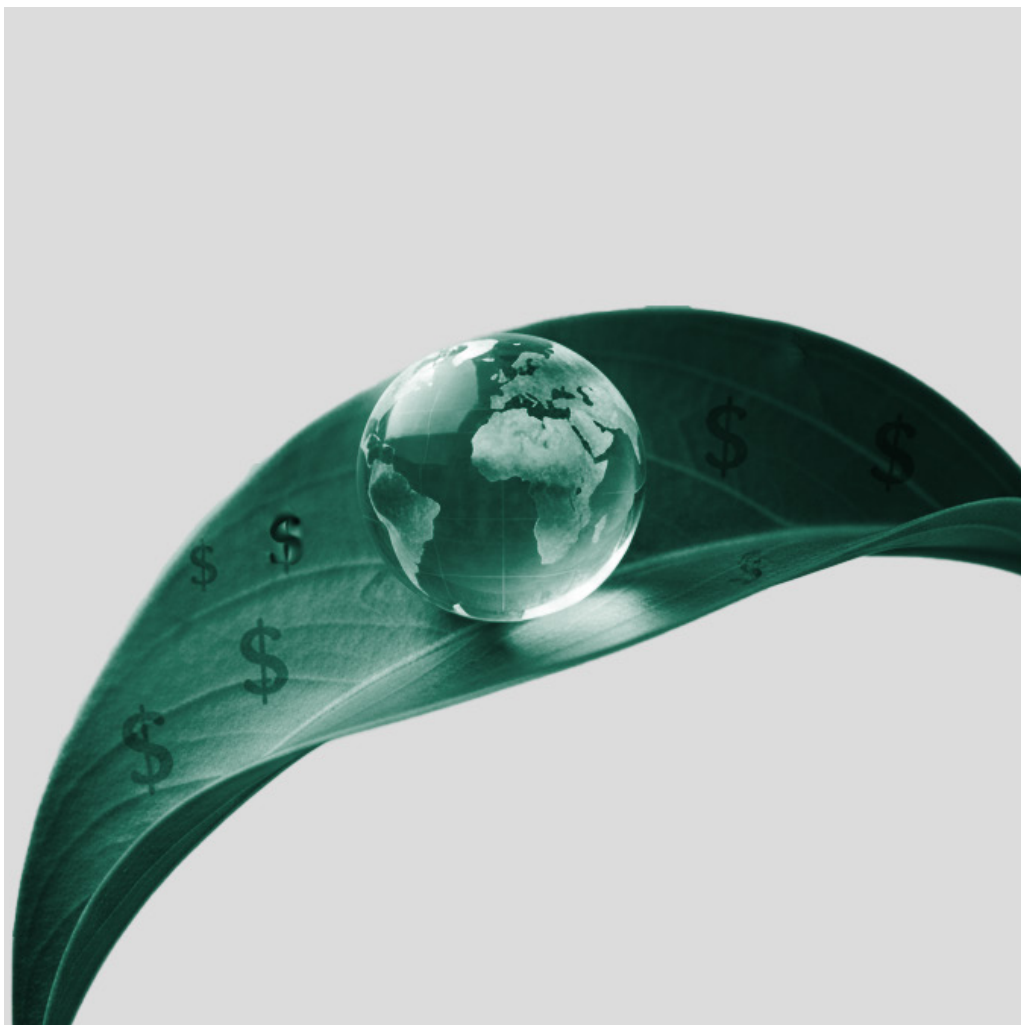
Yours sincerely

**Dr. David Wartenweiler, CFA**  
Chief Investment Officer

# THE MACRO BACKDROP

## Resilience or else

The global economy just capped another solid year of growth, proving remarkably resilient. Going into 2026, tailwinds including lower interest rates, low oil prices, and a weaker US dollar mean that we're constructive despite a challenging global political context.



### Key points

- Resilience of global economy to be tested
- Momentous US Supreme Court decision pending
- EM set to outgrow the developed world once again

## US: resilience tested

The US economy stands to benefit from lower interest rates, a weaker USD, and lower tax rates. The US budget should also provide some additional stimulus, and with the mid-term elections looming, the president may seek even more. However, the key risk for the US economy at this stage is not overreliance on AI and related investments or a softer employment market. The main threat is Trump with his institutional overreach and blatant attempt to align Fed policy with his own political and – dare we say it – personal interests. Add to this his utter contempt for the country's allies and admiration of strong men unbound by rules or laws, and it's easy to see why some claim that the US is facing an existential crisis. Two factors may temper this risk. The Supreme Court has yet to decide on tariffs or the government's ability to dismiss a sitting Fed governor "for cause." The rulings on either case will have momentous consequences. The other factor is financial markets. When confronted with a steep equity sell-off following Liberation Day in April 2024, Trump quickly changed tack. It could well be the same now.

## Europe: trade the Achilles heel

Lower interest rates and a significant increase in German fiscal spending portended well for European growth going into the new year. Meanwhile, the latest spat with the US left the old continent in a highly uncomfortable situation, caught between a hostile US and a flood of Chinese imports, which could wreak further havoc on the tradable sector and manufacturing. The ECB might have to step in once more, especially if services weaken contrary to expectations.

## Emerging markets set to lead global growth

If we're to believe the official numbers, China once again hit the government's growth target in 2025. We can be sure this will also be the case this year. Does it matter? Yes, because China will want growth to be sufficiently high to keep its population from turning even gloomier and, importantly, its birth rate from cratering further. Other emerging market (EM) countries, including India, the world's fastest-growing large economy, will benefit from lower inflation, lower rates, and a moderate oil price. Overall, EM will outgrow the developed world once more, gaining in the process an ever-larger share of global GDP.

**Table 1: Real GDP growth (y/y in %)**

|                | 2025E | 2026F | 2027F | Short-term trend |
|----------------|-------|-------|-------|------------------|
| United States  | 2.2   | 2.4   | 2.0   | ↘                |
| Eurozone       | 1.4   | 1.2   | 1.4   | →                |
| Germany        | 0.3   | 1.0   | 1.5   | →                |
| United Kingdom | 1.4   | 1.0   | 1.4   | ↘                |
| Japan          | 1.2   | 0.8   | 0.9   | ↗                |
|                |       |       |       |                  |
| China          | 5.0   | 4.5   | 4.4   | ↘                |
| India          | 6.4   | 7.5   | 6.5   | ↘                |
| Russia         | 0.8   | 1.0   | 1.3   | ↘                |
| Brazil         | 2.3   | 1.8   | 2.0   | →                |

**Table 2: Consumer price inflation (y/y in %)**

|                | 2025E | 2026F | 2027F | Short-term trend |
|----------------|-------|-------|-------|------------------|
| United States  | 2.7   | 2.7   | 2.4   | →                |
| Eurozone       | 2.1   | 1.8   | 2.0   | →                |
| Germany        | 2.3   | 2.0   | 2.1   | →                |
| United Kingdom | 3.4   | 2.4   | 2.1   | ↘                |
| Japan          | 3.2   | 1.9   | 2.0   | ↘                |
|                |       |       |       |                  |
| China          | 0.0   | 0.7   | 1.0   | →                |
| India          | 4.6   | 2.2   | 3.9   | ↘                |
| Russia         | 8.8   | 5.5   | 4.5   | ↘                |
| Brazil         | 5.0   | 4.0   | 3.9   | ↘                |

Source: Bloomberg, HBZ



# INVESTMENT STRATEGY

## News vs. noise

An old investment adage recommends buying the rumor and selling the fact. By extension, we should do the same with noise and news. Or should we? As investors, we're advised to follow facts and only facts in our decision making. Noise creates volatility and blurs the signal.



### Key points

- Reduced US predictability argues for diversification into Europe and EM
- Maintain neutral exposure to equities
- Focus on fundamental and systemic pillars

## Dealing with unpredictability

The news vs. noise dichotomy is particularly important in today's world with its 24-hour news cycle and nonstop online commentary. Only a fraction of what's reported and discussed is news in the true sense and warrants discounting in asset prices. Actually, most of what runs across our screens is noise, and a lot of the market commentary is just that as well. Paradoxically, noise is a source of market volatility, which makes it tradable in the short term. For investors, however, it's neither noise nor volatility that matters but predictability or the lack thereof. Investment is a probabilities game after all. When behavior and outcomes become unpredictable, investors should cut their exposure and seek alternative investments. In a telling statement, no less an authority than global investment powerhouse PIMCO blames the unpredictability of US policy for its decision to reduce exposure to US assets. "Sell America," however, is too simplistic, unless one believes that Trump and his acolytes will succeed in changing the country forever. Rather, investors need to weigh opportunities in other markets against the risks in the US, where valuations are generally high, yields are under upward pressure, and politics are unpredictable. Reducing some US investments and adding European or EM assets will be the appropriate course of action for most investors with global portfolios.

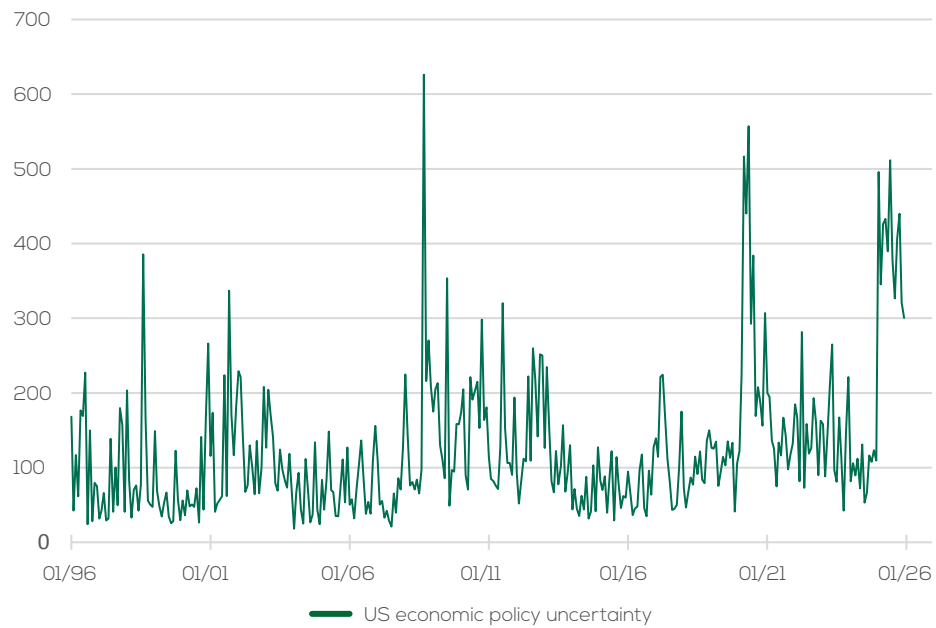
## Our current positioning

We maintain a constructive outlook for the world in 2026. However, considering the heightened uncertainty – or low predictability – we stick to our neutral allocation for equities, with a risk overlay on top to mitigate drawdown risks. In fixed income, we are wary of exceedingly tight credit spreads and see more value, if any, in rates. Finally, we stick to gold as a tried-and-tested hedge against political risks and a weaker USD.

## What we are watching

While we can't ignore the political news flow, we're focusing on three themes in particular: earnings and their quality, economic activity (especially signs of unexpected weakness), and institutional resilience – in the US mainly in the form of Fed independence, and in Europe the efficacy of concerted actions in the face of multiple challenges coming from the US, China, and within.

## High uncertainty argues for reduced US exposure



Source: Bloomberg, HBZ

# FIXED INCOME

## The imperative of diversification

Growing political and fiscal uncertainty in the US is raising questions about long-term stability, even as inflation continues to ease. While yields remain attractive, the balance of risks argues for a less US-centric approach to fixed income. Selective duration and diversification matter.



### Key points

- US policy uncertainty makes the case for global fixed income diversification
- Selective duration extension attractive compared with cash
- Tight credit spreads favor quality

## US policy uncertainty reshapes risk balance

Concerns about Fed independence have resurfaced amid political pressure to lower borrowing costs. Any perception of policy interference risks lifting inflation expectations and term premia, potentially offsetting the benefits of rate cuts. At the same time, inflation continues to trend lower, allowing the Fed to retain a cautious easing bias. US fiscal uncertainty and elevated issuance remain relevant, but the Treasury's emphasis on short-dated funding has helped limit upward pressure on long-term yields. Long-term rates appear to reflect known fiscal risks, suggesting that political uncertainty is more likely to increase volatility than trigger a sustained sell-off of government bonds.

## Duration attractive compared with cash

As policy rates gradually decline, the case for reallocating out of cash remains intact. A steeper yield curve has improved carry opportunities beyond the front end, particularly in intermediate maturities where income generation and interest-rate risk are better balanced. While the long end remains sensitive to shifts in inflation expectations, selective duration extension remains appropriate in a moderating inflation environment.

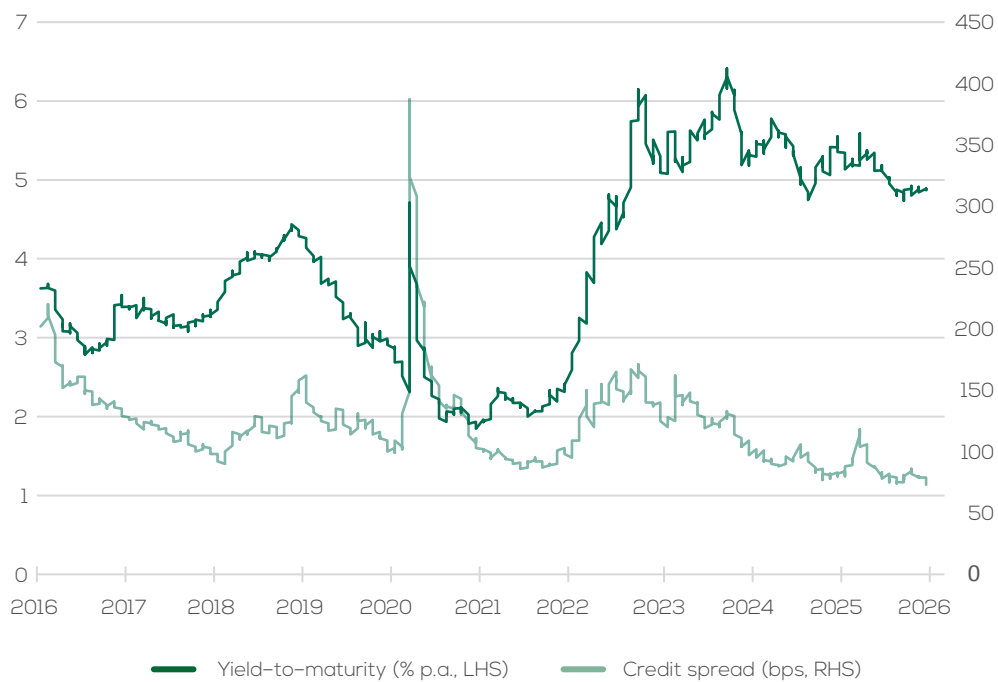
## Credit quality and selectivity remain essential

Credit spreads remain tight across most segments, limiting protection should growth or risk sentiment deteriorate. Investment-grade credit continues to offer attractive carry relative to government bonds, supported by generally resilient fundamentals, but issuer and sector selection is important. High-yield valuations leave little margin for error, arguing against material exposure. Sector allocation should be tilted towards more defensive industries with stable cash flows.

## Diversification beyond the US

Outside the US, diversification opportunities remain compelling. In Europe, subdued growth and political uncertainty support selective duration exposure, although credit valuations appear less attractive. Emerging markets stand out as a key diversifier, including in local-currency debt, where higher yields and easing cycles provide multiple positive return drivers. In Japan, fiscal policy, issuance dynamics, and the behavior of long-term yields must be watched, given the potential spillover effects into global fixed-income markets.

## Investment-grade yields attractive even if spreads are not



Source: Bloomberg, HBZ

# EQUITIES

## Between solid fundamentals and elevated valuations

The main market themes are still earnings momentum, monetary and fiscal support, and prospects of earnings beyond the mega-cap stocks. Market leadership is expected to widen, increasing the importance of regional, sector, and style allocation.



### Key points

- Earnings growth will drive 2026 returns, led by tech and AI leaders
- Broadening of market leadership, with financials, industrials, and materials poised to benefit
- Diversification across regions, sectors, and styles remains key, with selective hedges to mitigate drawdowns

## Global equity market backdrop

Global equities closed 2025 on a strong footing, underpinned by solid economic growth, robust earnings, and easing inflationary pressures. European equities outperformed their US peers, supported by more attractive valuations and an improving growth outlook. Looking ahead, we expect earnings growth to remain a key support for markets. Although valuations – particularly in the US – are elevated, ongoing productivity gains driven by AI and resilient domestic demand should continue to underpin positive returns. Hyperscalers and AI adopters are likely to remain beneficiaries, while market performance is expected to broaden beyond the mega-cap segment.

## Near-term drivers and regional positioning

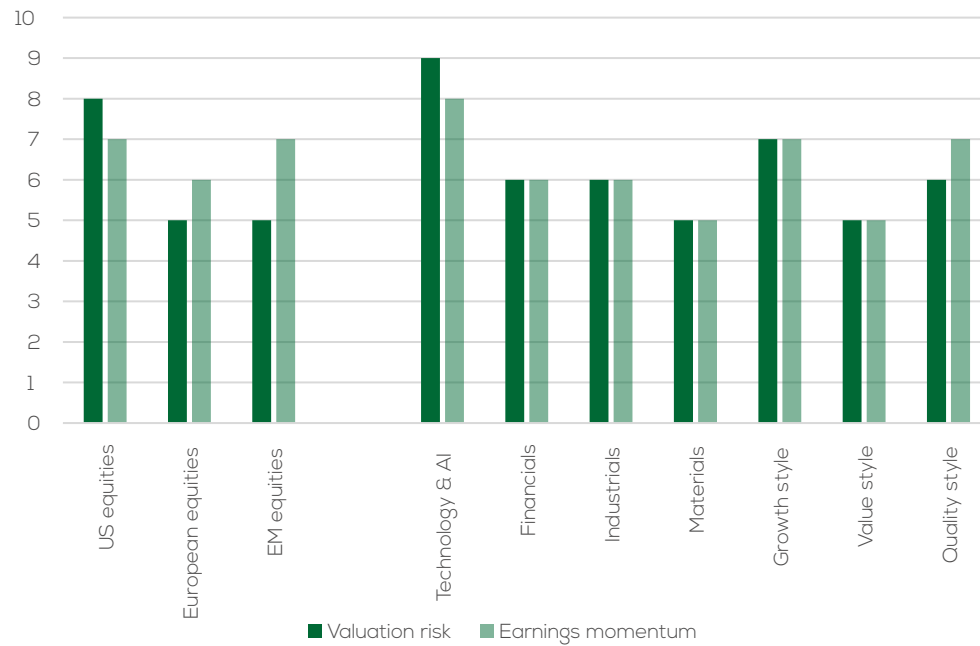
In Q1, earnings growth is expected to exceed forecasts and remain the main driver of returns, as further multiple expansion appears limited. Technology and AI infrastructure should remain long-term leaders, though gains may be less linear. With stretched valuations, typical of the late business cycle, the bar is high, especially for tech stocks, and simply meeting the consensus forecasts may actually trigger short-term selling. Financials and industrials are positioned to benefit from easing financial conditions and increased capex, while materials offer upside linked to global growth. However, the weakening of institutions, including Fed independence, poses risks that could trigger volatility in equities and rates. In Europe, a selective recovery is anticipated. Lower inflation, supportive monetary policy, and fiscal spending tend to aid financials and cyclicals, though structural headwinds – such as low-cost Chinese imports – may limit overall returns compared with the US. We remain constructive on emerging market equities, which benefit from attractive valuations, improving earnings momentum, and a weaker dollar, although we cannot dismiss geopolitical risks.

## Style and portfolio Implications

From a style perspective, growth remains structurally supported, though relative performance may narrow. Value is expected to benefit as investors become more price-sensitive. Quality remains attractive amid rising dispersion and volatility. Overall, we favor a balanced, diversified equity allocation with selective tilts toward regions and sectors with broadening earnings momentum, alongside targeted hedges to mitigate potential drawdowns.



## EM and quality stocks with valuation and earnings advantage (1 to 10 = lowest to highest)



Source: Bloomberg, HBZ

# COMMODITIES AND FX

## The new resources game

On fundamentals alone, the US dollar downside should be limited. However, fiat currencies are a sovereign asset, and if trust in the sovereign declines, so will its money. USD weakness is only part of the story behind the strength of certain commodities. The other is a global scramble for raw materials.



### Key points

- USD suffering from a loss of trust
- Precious metals the main winners for now
- Control of commodities for political ends

## USD with Trump discount

Interest-rate parity posits that the currency with the higher interest rate will depreciate against the one with the lower rate. This theory tends to hold in the long run, but it is not the only explanation for currency moves. Real growth differentials and the productivity and profitability of assets also play a role, as do levels of debt. Hence the point about fundamentals supporting the USD. However, trust is another key ingredient in a currency's fortunes. When trust is lost, so is the appeal of a currency. Dollar weakness now reflects a fundamental questioning of the trustworthiness of the US and its institutions. As long as President Trump continues to break conventions and rules at will and with relish, the dollar has further to fall.

## The winner is...

The flip side of the loss of confidence in the USD has been the surge of gold and, more recently, of the entire precious metal complex. The desire to diversify alone no longer explains the latest price moves and the speculative frenzy already hit a first reality check. While there is industrial demand for silver, nothing can justify a near-quadrupling in less than three years in an otherwise adequately supplied market. In the broader context, though, there is a case for more upside for many commodities.

## The broader context

Until the US turned its back on a rules-based global order, there was no undue need to control access to raw materials. What was not available domestically could be bought on international markets. However, in a more confrontational world – a world, moreover, dominated by technologies reliant on numerous metals and rare earth elements – access to and control of these commodities has become a geopolitical priority. Their weaponization in the US-China trade conflict is a stark case in point. So are many of the more recent US foreign policy actions. Iran, Venezuela, and Greenland all have a commodity nexus, which matters greatly in a world of resource nationalism. Oil in this context is of particular importance, as its price can have a significant impact on inflation in consumer countries. With the US midterms in November, the Trump administration has every incentive to bring US consumer prices lower. For this, it needs more oil on the market.

## Commodities decoupled from USD



Source: Bloomberg, HBZ

# KEY MARKETS

## Seeking stability

External conditions may have become less predictable, but our key markets remain on their path to greater stability: Pakistan is sticking to fiscal discipline, the UAE is navigating regional tensions, and the UK is adhering to its budget rules.



### Key points

- Pakistan posts robust growth despite floods
- Increased oil output supporting UAE
- UK finds fiscal headroom and limits borrowing needs

## Pakistan: steady hands

Despite the toll taken on the country's agricultural sector by the recent floods, Pakistan delivered a resilient fiscal 2025. Near-consensus policymaking and stronger policy implementation were reflected in the robust economic activity and stricter fiscal discipline. The sense of stability at the helm trickled down into business confidence, with surging exports and remittances translating into the country's first fiscal-year current account surplus in over a decade. Lower global oil prices were an important factor behind lower inflation, allowing the central bank to cut rates further. The country also made progress on privatization, completing, for example, the auction of the national flag carrier. With sustained remittances and the latest disbursement from the IMF, central bank reserves climbed to over USD 16 billion. This is after the nation met its debt obligations, albeit with some creative measures such as the sale of a stake in a major conglomerate to the UAE rather than an outright cash repayment. Despite the drag on growth caused by the floods, the outlook remains positive, with real growth expected to increase between 3.25% and 4.25% for the current fiscal year.

## UAE: progressing with care

With a favorable mix of circumstances, the UAE has continued to play its economic hand well. Following a gradual reversal of crude output cuts and sustained momentum in non-oil sectors, the country expects GDP to grow by 5% in 2026. Real estate transaction activity saw another strong year, with volumes expected to hold as financing is expected to be cheaper with lower benchmark rates. Along with this, tourism, aviation, and related sectors continue to show strength, with only geopolitical tensions causing unease, if any. Tensions between Saudi Arabia and the UAE in Yemen were a departure from the norm, triggering a prompt retreat. Potential instability in Iran could also affect conditions at home.

## UK: measured steps

After a solid start to the year, growth remained sluggish over the course of 2025. While the autumn budget delivered only limited support, the government has so far remained committed to its fiscal rules, with measures taken to ease inflation in the near term. The Bank of England may thus have room to cut rates some more.

## Pakistan shows resilience of external accounts



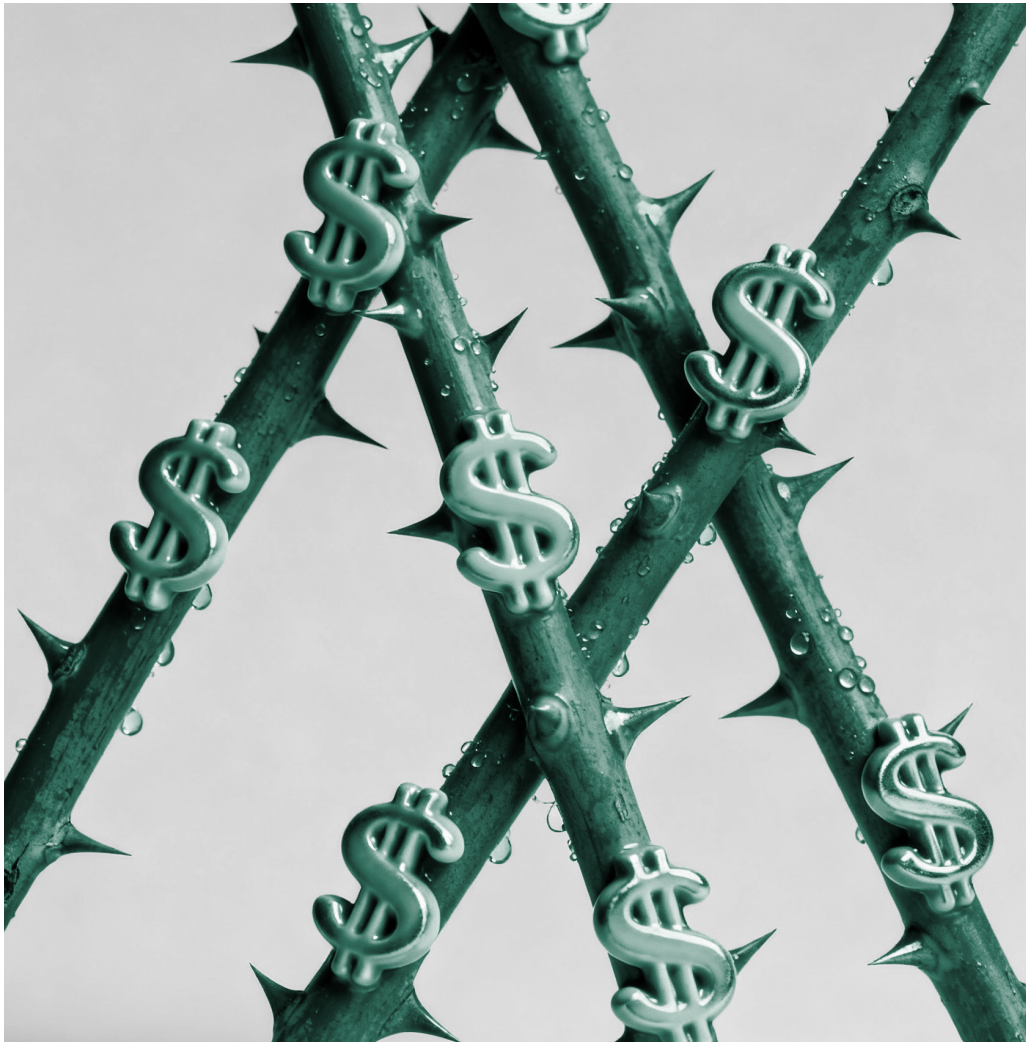
Source: Bloomberg, HBZ



# SPECIAL TOPIC

## Are credit markets complacent?

Credit spreads, a measure of risk compensation for funding corporates, are near all-time lows. Such limited risk premia beg the question of whether credit investors have become complacent about the inherent risk of their investments. Let's put the data in context.



### Key points

- Credit spreads should compensate for issuer risk
- High-yield most at risk in times of credit market stress
- Quality, selection, and diversification the key success factors



## What are credit spreads?

As investors in credit, buyers assume certain risks that may materialize over the life of their investment. The risk premium above the underlying risk-free rate (the yield of the corresponding government bond) is compensation for taking these risks. Bonds are binary instruments, and the worst-case is, of course, that an issuer will temporarily or permanently cease to service and/or repay its outstanding debt and thereby enter into default. Tight credit spreads such as those currently observed across all major credit markets usually have two main reasons: either a very benign macro-economic environment, which reduces the probability of default for most, if not all, issuers, or a market context where investors search for yield at almost any price.

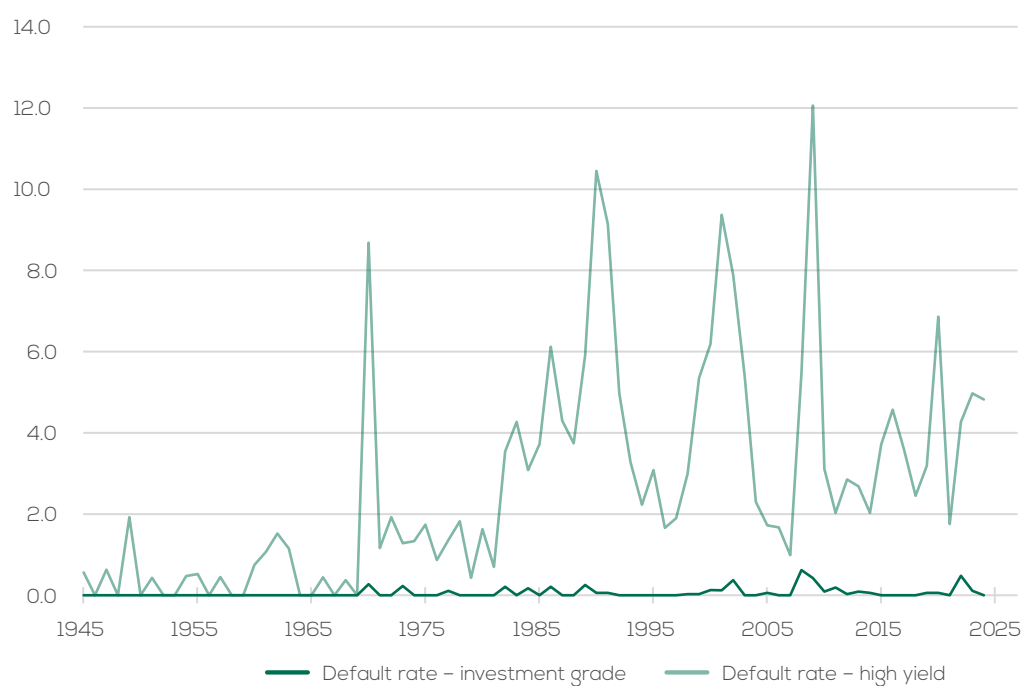
## Why quality matters

Investors who wish to maximize their return will not automatically reach for the highest yield. They will also want adequate compensation for the risk they take on. In today's world, this is a difficult task, and risk mitigation is becoming even more important. We know all too well from history what happens when credit cycles turn. Not only will the lowest credit quality underperform, but default rates will spike and with them credit losses. In 2009, during the Great Financial Crisis, the aggregate default rate jumped to almost 5%, more than four times the long-term average. For companies rated as non-investment grade, that percentage actually rose to 12% and, for the weakest credits, it reached more than 26%. Meanwhile, investors in quality bonds still faced a default rate of below 0.5%. Other periods of credit stress, such as the one following the bursting of the dotcom bubble, show similar default rates by credit category. Considering these default rates and the fact that the current credit spread for US corporate high yield is only about half the historic average, investors should think twice before chasing yields further down the rating scale.

## Selection and diversification

Beyond quality, it is selection and diversification that determine success for corporate bond investors. Given the nature of credit, bond portfolios require more individual positions than equity portfolios to diversify the issuer or idiosyncratic risks. At the same time, relatively small minimum sizes allow this to be achieved without having to deploy large amounts of capital.

## Investment-grade with low default rates even in stressed credit markets (%)



Source: Moody's, HBZ

# MARKET SUMMARY DATA

As of 26 January 2026



### Equity indices

|                | Last      | -3M<br>% | YTD<br>% | -3Y<br>% |
|----------------|-----------|----------|----------|----------|
| BBG World USD  | 2,906.7   | 3.9      | 2.4      | 64.3     |
| S&P 500        | 6,915.6   | 1.8      | 1.0      | 70.3     |
| EuroStoxx 50   | 5,941.7   | 4.7      | 2.6      | 42.4     |
| FTSE 100       | 10,146.1  | 5.2      | 2.2      | 30.7     |
| SMI            | 13,108.1  | 4.3      | -1.2     | 15.8     |
| Nikkei         | 52,885.3  | 7.3      | 5.1      | 93.3     |
| BBG EM USD     | 2,177.3   | 7.5      | 6.3      | 50.4     |
| Sensex 30      | 81,537.7  | -3.8     | -4.3     | 37.4     |
| KSE 100        | 188,357.9 | 15.2     | 8.1      | 361.1    |
| Hang Seng      | 26,765.5  | 2.3      | 4.4      | 18.6     |
| Brazil Bovespa | 178,858.5 | 22.4     | 11.0     | 56.6     |

### Bond indices

|                 | Last     | -3M<br>% | YTD<br>% | -36M<br>% |
|-----------------|----------|----------|----------|-----------|
| BBG US gov      | 2,432.54 | -0.3     | -0.1     | 8.5       |
| BBG US Corp     | 3,555.31 | -0.1     | 0.3      | 15.3      |
| BBG US HY       | 2,933.91 | 1.7      | 0.7      | 29.1      |
| BBG Euro gov    | 248.20   | -0.1     | 0.4      | 6.9       |
| BBG Euro Corp   | 266.75   | 0.1      | 0.4      | 14.3      |
| BBG EM Sov      | 459.61   | 2.1      | 0.2      | 29.7      |
| DB EM Local USD | 195.03   | 4.7      | 2.2      | 28.6      |

### Currencies vs. USD

|          | Last     | -3M<br>% | YTD<br>% | -3Y<br>% |
|----------|----------|----------|----------|----------|
| DXY      | 97.07    | -1.9     | -1.3     | -4.7     |
| EUR/USD  | 1.19     | 1.9      | 1.0      | 9.1      |
| USD/CHF  | 0.78     | 2.5      | 2.0      | 18.7     |
| GBP/USD  | 1.37     | 2.5      | 1.6      | 10.5     |
| USD/JPY  | 153.74   | -0.4     | 1.9      | -15.2    |
| AUD/USD  | 0.69     | 5.6      | 3.7      | -2.4     |
| USD/CAD  | 1.37     | 2.3      | 0.3      | -2.3     |
| USD/ZAR  | 16.02    | 7.6      | 3.5      | 7.5      |
| USD/INR  | 91.96    | -4.5     | -2.3     | -11.5    |
| USD/PKR  | 279.81   | 0.5      | 0.1      | -11.1    |
| Gold oz. | 5,093.61 | 23.8     | 17.9     | 164.4    |

### Interest rates

|     | 3M interbank<br>% p.a. | 10Y government<br>% p.a. |
|-----|------------------------|--------------------------|
| USD | 3.67                   | 4.21                     |
| EUR | 2.04                   | 2.88                     |
| GBP | 3.71                   | 4.49                     |
| CHF | -0.06                  | 0.30                     |
| JPY | 0.39                   | 2.24                     |
| AUD | 3.80                   | 4.82                     |
| CAD | 4.97                   | 3.41                     |
| ZAR | 6.72                   | 8.10                     |

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