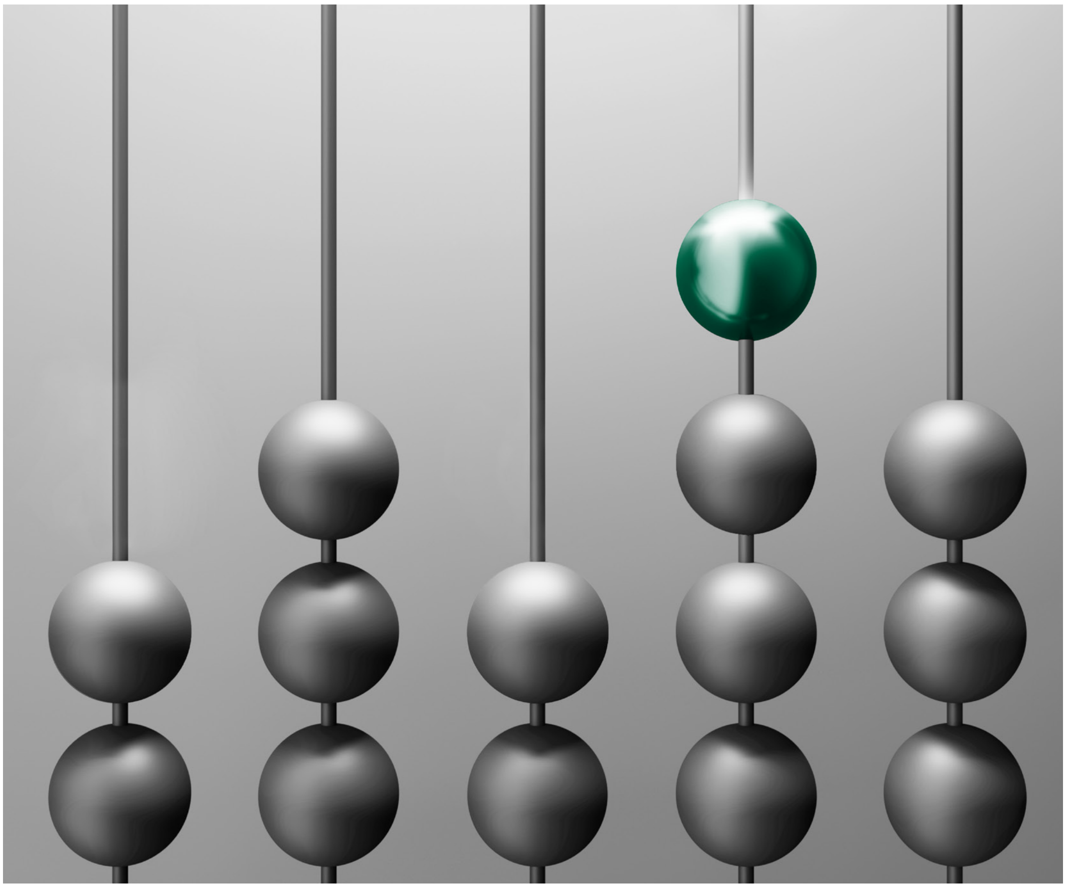
HIGHER RATES
HIGHER VOLATILITY

Q1 2022



HABIB BANK AG ZURICH
PRIVATE BANK
SWITZERLAND

Authors

- Dr. David Wartenweiler, Chief Investment Officer
  (d.wartenweiler@habibbank.com)

- Stefan Wüthrich, Senior Portfolio Manager, Fixed Income
  (s.wuethrich@habibbank.com)

- Karim Sebti, Senior Investment Advisor, FX and Commodities
  (k.sebti@habibbank.com)

Group Wealth Management

- Salman Haider, Chief Executive Officer
  (salman.haider@habibbank.com)

Contact for Switzerland

- Leonardo Castillo, Head of Private Bank Switzerland
  (l.castillo@habibbank.com)

Editing

- Michael Craig Communications (communications@active.ch)

TABLE OF CONTENTS

WHAT A START TO THE YEAR!

Dear Reader,

When the US Federal Reserve adopted a hawkish stance on interest rates in December, equity markets took the news in stride and continued to rally. Since January, everything has been different: US equity markets are in turmoil and Treasury yields at levels last seen before the pandemic. Clearly, we are set for another eventful year.

Economic growth actually will, by most estimates, remain solid as the pandemic continues to recede. Inflation, one of the main reasons for the current ructions, should peak by mid-year. Opposing these constructive fundamentals are two major headwinds for financial markets: rising policy rates and high valuations. The combination can be toxic and hence requires some action in portfolios. First, short duration remains indicated in order to limit excessive drawdowns in fixed income; and second, the equity allocation should be tilted away to some extent from the most exposed markets and sectors—mainly the US and growth stocks—toward a more diversified global exposure where, for example, emerging markets offer more reasonable valuations.

In our Special topic, we turn our attention to uranium. An odd choice, some may think, but in the context of climate change and energy transition, nuclear power is about to make a comeback and with it its fuel: uranium.

We are pleased to share with you the first issue of our Investment Quarterly for 2022 and look forward to a lively exchange over the course of the year.

Yours sincerely

Dr. David Wartenweiler CFA
Chief Investment Officer

MACRO:
Normalization underway

The pandemic has yet to end, but surging inflation has forced the hand of many central banks to embrace tighter monetary policy. But thanks to robust consumer demand and corporate spending, less accommodative monetary—and fiscal—policy will not derail the recovery and expansion.

Key points

- Fed tightening not to derail US expansion
- Europe poised for another year of strong growth
- India to outgrow China in 2022

US economy to weather tighter Fed policy

The surge of inflation will peak sometime during the first half of the year as some of the causes continue to abate and powerful base effects kick in. Nevertheless, fears of long—term damage both to its reputation and the country's economic fabric forced the Fed to change track in December. Out went the word "temporary" to describe current price pressures, and in came accelerated taper and rate hikes. Currently markets expect at least four 25–bps steps during the course of the year, probably starting in March.

If the Fed's change in communication and anticipated actions have the desired effects, the overall economic impact should be limited despite the simultaneous withdrawal of fiscal support. Pandemic—related pressures in particular on the supply chain appear to have peaked and should fade further as the year progresses. Leading indicators such as the ISM surveys suggest that continued robust consumer demand and expanding corporate spending should make up for the less accommodative monetary and fiscal conditions.

Europe set to enjoy another year of strong growth

Once again, Europe was particularly hard hit by the latest waves of the pandemic, but this time governments, as a rule, refrained from imposing blanket restrictions. The recovery is therefore set to continue even though growth may take a pause during the first quarter. The ECB will resist calls to hike rates and at most will reduce some of its asset purchases. Sustained accommodative monetary and fiscal conditions will support robust growth for the year.

China focused on stability

The Chinese government has a particularly busy agenda in 2022, but maintaining economic stability will remain the top priority. Having eased twice already last year, the People's Bank of China may loosen the reins further if the current economic slowdown does not bottom out after Lunar New Year. The harsh measures in place to eradicate the pandemic could also give way to a more rational approach once the Winter Olympics, to which the authorities attach disproportionate importance, are out of the way. Solid Chinese growth will be important to support the rest of Asia and the emerging world. The much more insular India should, however, steal the crown as the fastest growing large EM economy.

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

	2021E	2022F	2023F	Short-term trend
United States	5.6	3.8	2.5	↘
Eurozone	5.1	4.1	2.5	↘
Germany	2.7	4.0	2.5	↘
United Kingdom	7.0	4.6	2.2	↘
Japan	1.7	2.9	1.4	→
China	8.0	5.2	5.3	→
India	9.4	7.6	6.2	→
Russia	4.2	2.6	2.1	↘
Brazil	4.8	0.7	2.1	↗

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

	2021E	2022F	2023F	Short-term trend
United States	4.7	4.6	2.4	→
Eurozone	2.5	3.0	1.6	→
Germany	3.2	3.0	1.8	↘
United Kingdom	2.6	4.5	2.1	↗
Japan	-0.2	0.8	0.7	↗
China	1.0	2.2	2.2	↗
India	5.4	5.0	4.5	↗
Russia	6.7	6.2	4.1	→
Brazil	8.3	5.8	3.7	↘

INVESTMENT STRATEGY:

Embracing higher yields and volatility

Tighter Fed policy and higher market yields will dominate much of the first half of the year. Navigating the ensuing challenges will be the main task for investors. The higher market volatility offers opportunities for trading but also welcome entry points for long—term investors.

Key points

- Repricing has some room to run
- Volatility creates opportunities
- Diversification remains key

Markets set to digest reduced liquidity

With the Fed committed to acting against inflation, monetary conditions will change materially over the coming quarters in the US and globally. While the terminal rate of the unfolding rate cycle will be well below past peaks—at some 2% to 2.5%—the anticipation of higher rates and lower liquidity has already impacted financial markets. In fact, from late 2021 onward, highly valued growth sectors, and in particular tech stock, have been under pressure, and since the beginning of the year equities in general. Long—duration fixed—income assets have also started to feel the pinch of higher rates with a sell—off from government bonds to emerging—market (EM) sovereigns. In market speak this is called repricing, and usually ends after a painful but limited period of adjustment. Unless the economic backdrop starts deteriorating fundamentally, this should be the case this time around as well. For long—term investors these are drawdowns that can be easily digested and offer opportunities to buy assets at more attractive levels. EM equities, which had a rotten year, stand out as one asset class worth considering. Tactically, the current market context continues to argue for shorter duration in the fixed—income allocation and bias toward equity markets and sectors with lower valuations and lower sensitivity to higher rates. Higher financial market volatility, finally, provides attractive conditions for more trading—oriented strategies and structured products which can offer compelling risk—adjusted returns.

Our positioning

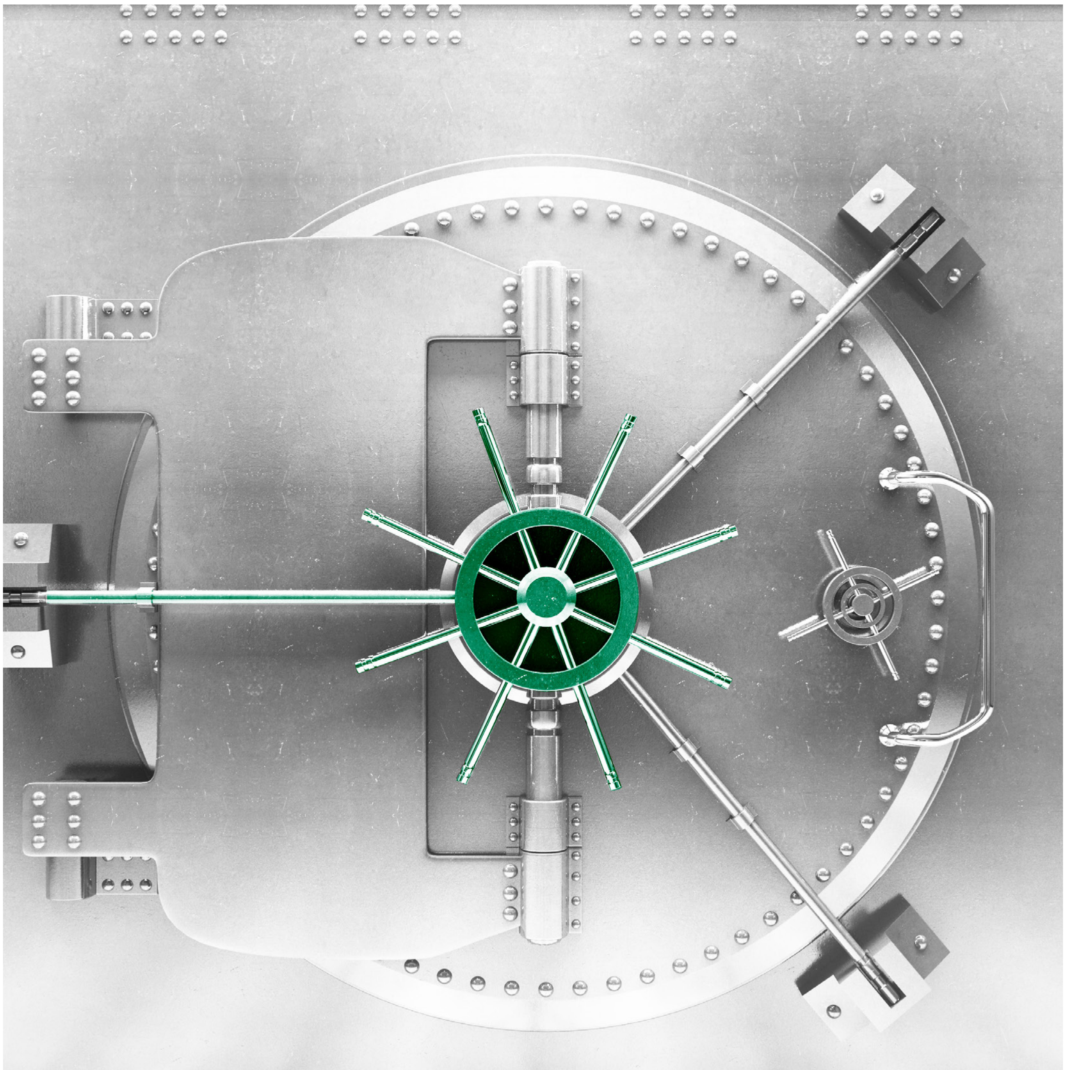
We maintain two core convictions at the beginning of the year: an underweight and short—duration position in fixed income, and a modest overweight in equities with a somewhat reduced footprint in the US. Alternative investments remain an important part of a well—diversified portfolio, and include gold as a hedge against possible USD weakness.

What to watch

Earnings remain our key gauge of equity markets, and if markets were to start missing forecast repeatedly and consistently, our constructive view of equities would probably change. Higher inflation for a longer period would necessitate a similar reassessment. The tensions around Ukraine have emerged as the most salient political risk, as we expect China to focus on domestic stability in an important political year.

FIXED INCOME:
Keep duration short

Since the beginning of the year, US yields have risen sharply, and the performance of most longer—duration fixed—income assets has suffered accordingly. While keeping duration short, investors should focus on credit such as EM corporate and subordinate financials, but also non—directional strategies.



Key points

- CoCo bonds offer attractive risk—adjusted premiums
- EM corporates and senior loans fit into most fixed—income portfolios
- Non—directional strategies to deal with rising rates

Earn a premium with CoCo bonds

Spreads of investment—grade bonds are tight by historical measures. This is partly justified by a constructive outlook for credit fundamentals, but also reflects abundant global liquidity, which has investors in search of yield. At this point we do not see much value left in this segment considering the poor return prospects amid expectations of higher US interest rates. However, investment—grade companies also issue lower—ranked debt in the form of subordinated or corporate bonds. Investors receive a respectable yield pickup for only a moderate increase in their risk. In this space, especially contingent convertibles or so—called CoCo bonds, which are deeply subordinated bonds, still offer decent value. The nature of these bonds is that they can be converted into equity or written off if key capital ratios breach certain trigger levels. When originally issued following the 2008 Great Financial Crisis, many banks had extremely weak capital positions, but after years of balance sheet repair they have become much better capitalized and more resilient. Today, the capital ratios of quality issuers in this space are well above the trigger levels, making the risk of conversion extremely low and such bonds an attractive investment.

Focus on EM corporate bonds and senior loans

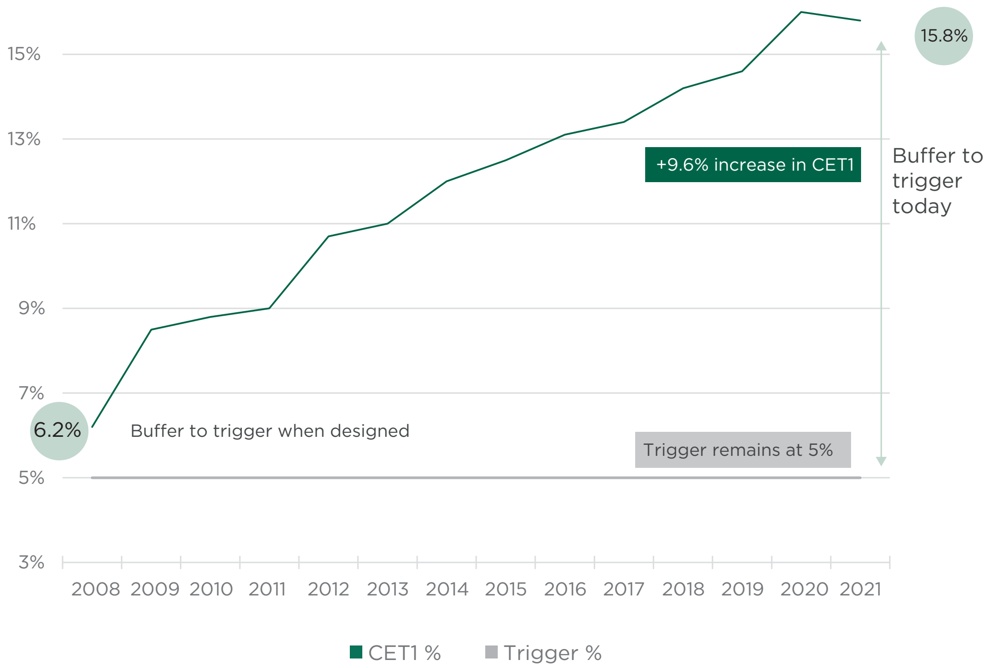
In the current environment, emerging—market corporate bonds and senior loans should be part of any diversified fixed—income portfolio. Compared with EM sovereign bonds, EM corporates tend to be much less interest—rate—sensitive owing to the fact that their duration is shorter on average, while their yields remain compelling. Another interesting space is senior loans, which combine relatively high coupons with a floating rate structure and hence low duration. Unlike floating—rate notes (FRNs), senior loans are not listed securities but credits originated by banks. However, the market for senior loans is significantly deeper and more liquid, and thus offers more opportunities to build robust portfolios around them.

The return of total return?

In the environment of rising interest rates, a valid option can be non—directional fixed—income strategies such as absolute or total return, which seek positive performance independently of the cycle. However, sourcing the right strategy and manager is not trivial, and is best left to the professionals.

The Common Equity Tier 1 (CET1) ratio compares a bank's core equity capital to its total risk—weighted assets and is a measure of a bank's financial strength and hence its ability to withstand financial stress and remain solvent. A predefined level of this ratio is used in many contingent convertibles (CoCo) bonds as the trigger of the conversion mechanism.

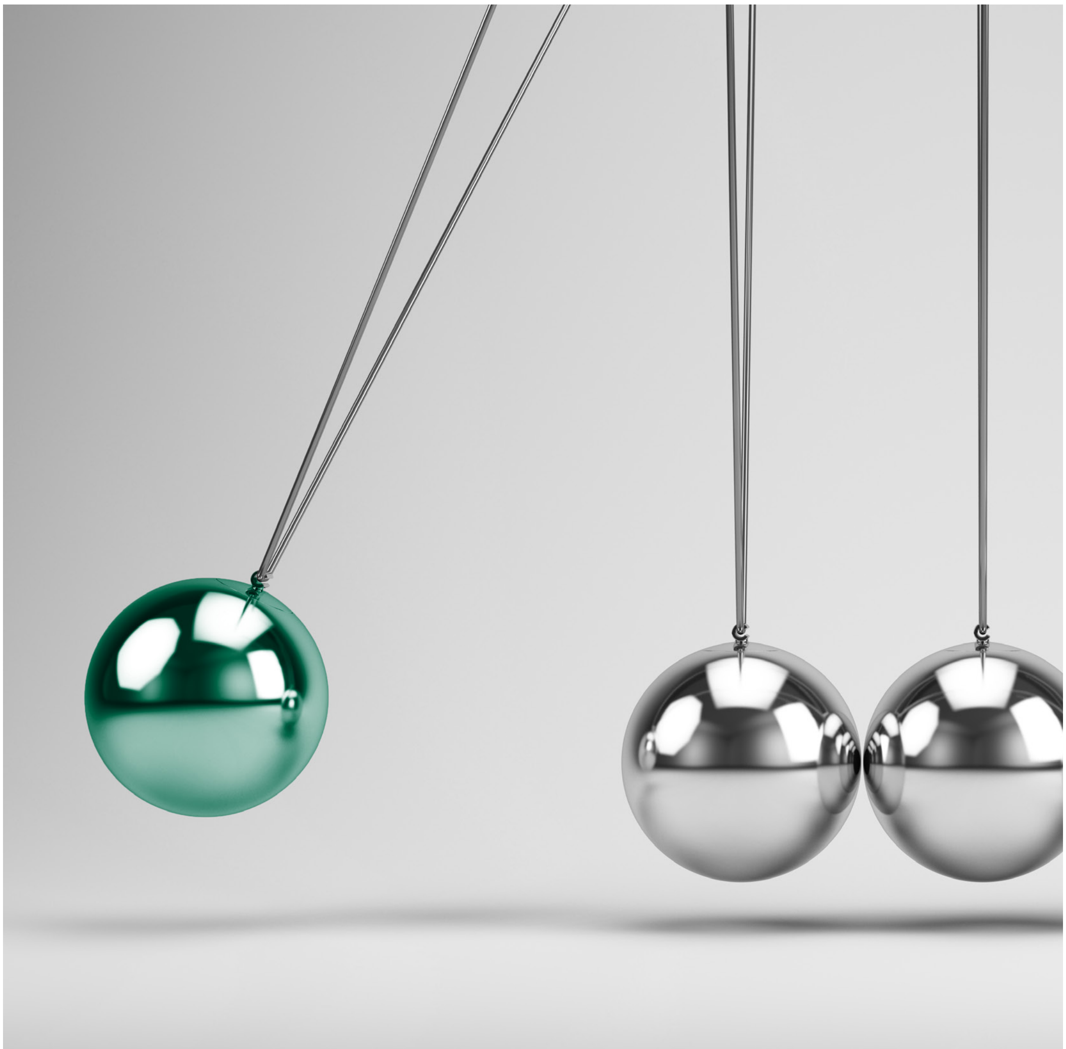
CoCo bonds: healthy buffers after years of capital build—up



Source: BlueBay Asset Management, HBZ (indicative only)

EQUITIES:
The big rotation

Equity markets have started the new year with a big rotation. Almost nothing is as it was last year: Value is outperforming growth, emerging markets are outperforming developed markets, and the NASDAQ Composite Index is at the bottom of the pile. Signs of things to come?



Key points

- US outperformance about to fade?
- Emerging markets off to a better start
- Record M&A as the proverbial canary in the coal mine?

How far will it go?

High inflation figures forced the Federal Reserve to change its policy stance late in 2021. This year, the Fed will raise interest rates as well as reduce and eventually start reversing its asset purchases. Stock markets have reacted strongly to this. The relative losers of recent years have so far this year been the winners. Since the beginning of 2022 the stock indices in Brazil and Hong Kong have been among the best in the world. The UK's FTSE 100 index also gained in January. The major US indices are all down, with the NASDAQ bringing up the rear. To put things in perspective: The market capitalization of all US stocks is over USD 41tn, while the stocks of all other countries combined are valued at USD 19tn. Meanwhile, the US economy accounts for about 20% of the world's GDP. Even adjusting for what is arguably higher profitability, the gap between US stocks and those of the rest of the world has grown too big. We are thus revisiting our positioning in the US, as we believe the interest rate turnaround could have a sustained impact on performance. On the other hand, after a dismal 2021, we are starting to see opportunities in emerging—market equities, where we may increase our allocation.

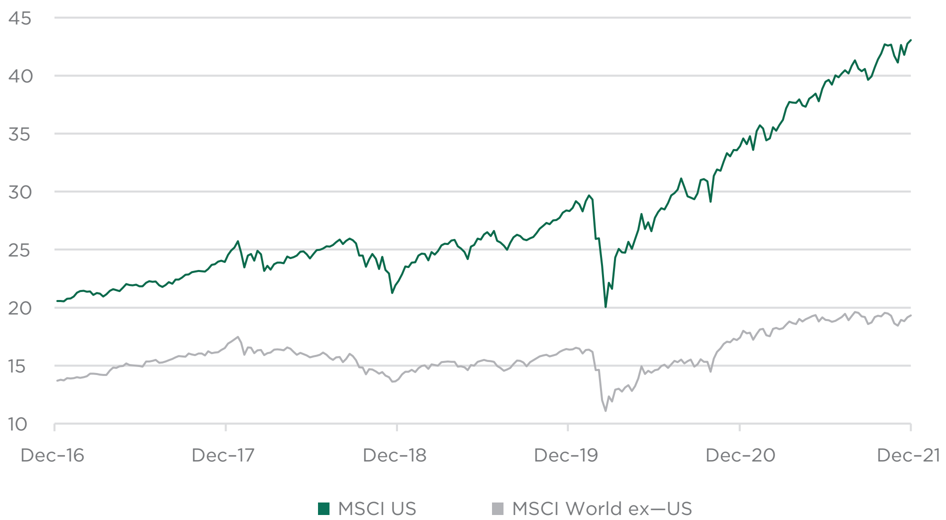
Sector rotation in full swing

Sector performance has also changed, with the exception that energy and financial stocks continue to lead the way. For the remaining sectors, the message is simply this: Last year's outperformers are this year's underperformers. Furthermore, a sector performance dispersion of 31%—energy stocks up 22% while IT stocks are down 9%—is extreme for a period of only five weeks. The market reaction to the earnings season will be crucial to gauging how much farther this rotation has to run.

Global M&A at record levels

Merger & acquisition (M&A) volumes last year topped USD 5tn for the first time in history, thanks to a combination of cheap funding and booming stock markets (the previous high was set in 2007 at USD 4.6tn). And 2022 is already off to a good start. Microsoft announced the acquisition of video game giant Activision in an all—cash deal: USD 70bn for a company expected to generate a net income of USD 3bn in 2022. For reference, only nine German companies have a market capitalization higher than USD 70bn. Another sign of irrational exuberance?

US stock market captialization in perspective (in USD tn)



Source: Bloomberg, HBZ

COMMODITIES & FX:

Supply squeeze supports commodity complex

Fundamentals for energy and metals are supportive, with demand robust and inventories at low levels. The commodity cycle is alive and solid. The US dollar continues to dominate currency markets even after a weaker start to the year. In the event of unexpected USD weakness, gold could serve as a hedge.

Key points:

- Oil demand to exceed pre—pandemic levels
- Dawn of a new metal cycle
- Gold as a hedge against USD weakness

Continued upside risks in energy markets

Commodity prices are at their highest level since 2014, and the energy complex in particular exhibits strong fundamentals. Winter storms in North America are pushing up demand for US natural gas while, on the other side of the Atlantic, gas prices have surged owing to low supplies and stockpiles. Russia, moreover, where Europe sources a third of its supply, is blatantly using the supply of gas in the context of its conflict with Ukraine. At the same time, OPEC+ has so far not lifted output to meet strong demand. Even if the share of oil in the energy mix is poised to decline over time, it will not do so in absolute terms for now. The upside risks will thus remain in place in 2022, especially as governments have discouraged investments in fossil fuels before sufficient renewable capacity has become available.

Bullish pattern for base metals

The base metal complex (copper, aluminum, nickel, and zinc) should also see strong demand, and we are still far from the price levels reached during the previous super—cycle (2003–08). Photovoltaic plants, wind farms, and electric vehicles, as well as infrastructure investments, require huge amounts of metals and mineral resources. Lithium, nickel, cobalt, manganese, and graphite are crucial to battery performance, longevity, and energy density. Rare earth elements are essential too. Tight supply will drive volatility and prices higher. Increased mining, which is notoriously energy—intensive, could add additional upside to energy prices.

Gold as a hedge against USD weakness

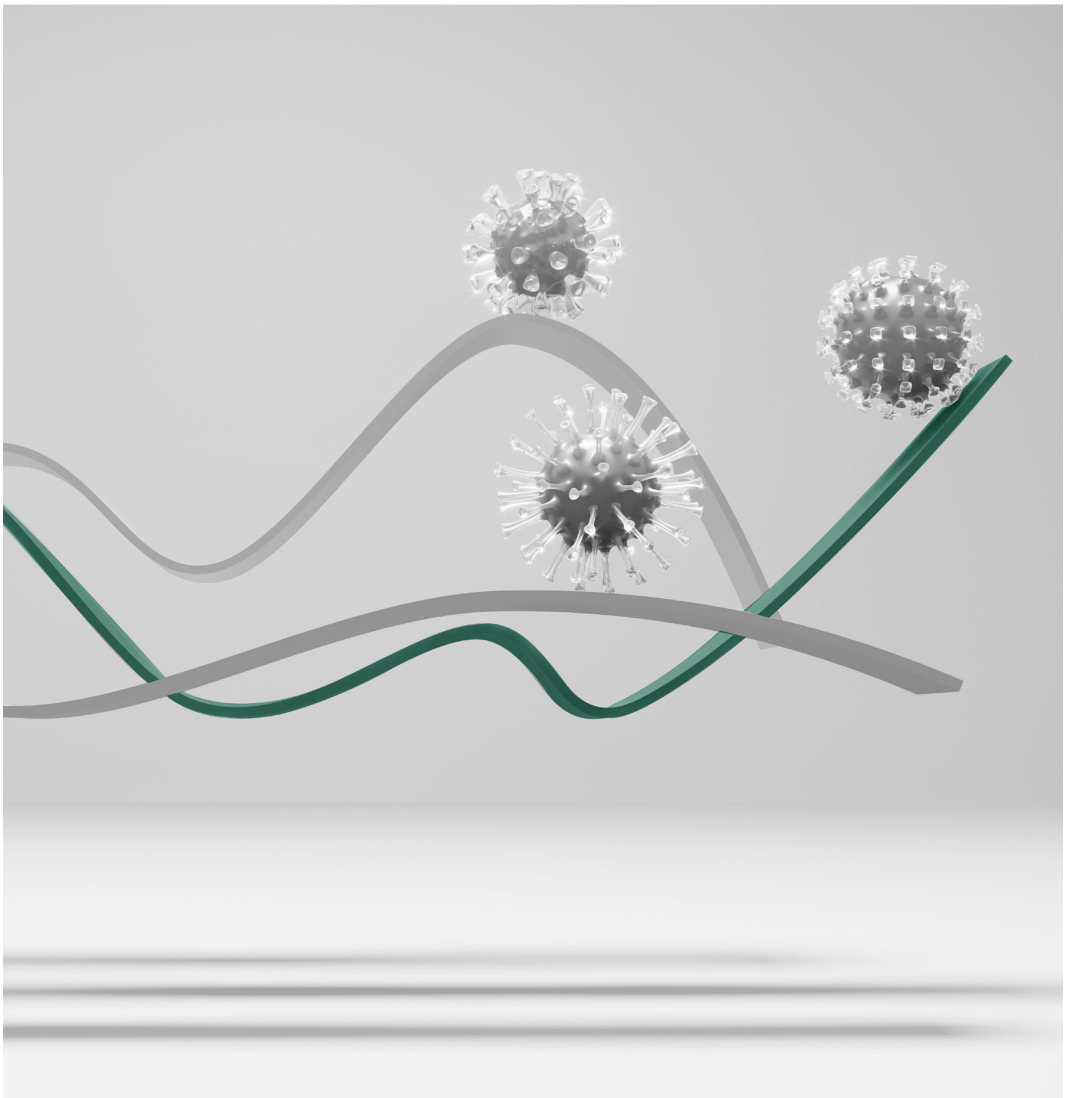
Currently the USD remains well supported by fundamentals, but its relatively high valuation limits the upside against most crosses. Gold can provide an alternative to investors concerned about possible USD weakness. Historically, rising US real rates have been negative for gold, but this correlation appears to have broken down recently. This could herald further gains unless the old relationship reasserts itself. Gold also offers other properties which make it an attractive asset: It is a good risk diversifier in periods of higher expected volatility and geopolitical tensions. Moreover, unlike the untested and grossly misnamed crypto—currencies, gold has been considered a store of value since time immemorial. While not the best hedge against inflation, as a physical asset gold could come into its own if concerns about currency debasement have investors looking once again for an alternative to fiat currencies.

The next super—cycle for metals?

Source: Bloomberg, HBZ

KEY MARKETS:
Emerging from the pandemic

Like the rest of the world, our key markets have started to emerge from the worst of the pandemic, but will continue to battle many of its consequences. Nevertheless, the growth outlook for 2022 remains robust even though, also as a result of the pandemic, the level of uncertainty is unusually high.



Key points

- Higher State Bank rates will not derail growth in Pakistan
- UAE to enjoy robust growth in 2022
- No excessive tightening by the Bank of England

Pakistan: Headwinds will not choke off growth

The latest variant of the Covid–19 virus created yet another headache for Pakistan's economy, which is already battling on many fronts. Double—digit inflation, fueled mainly by high commodity prices, may force the State Bank to continued tightening, and the resumption of the currently stalled IMF program will require unpopular fiscal discipline. The combined monetary and fiscal headwinds should not, however, derail the recovery altogether, as agriculture and service sector activity is expected to remain strong. Ongoing investments under CPEC will help address some of the most pressing needs for the country's creaking transport and power infrastructure. The external accounts continue to be overextended, but there is no imminent sign that funding the deficit could become a problem near—term. Remittances in particular held up well, and should on their own cover some 70% of the trade deficit. Moreover, the sharp depreciation in the currency in 2021 should eventually slow the rate of import growth and support exports.

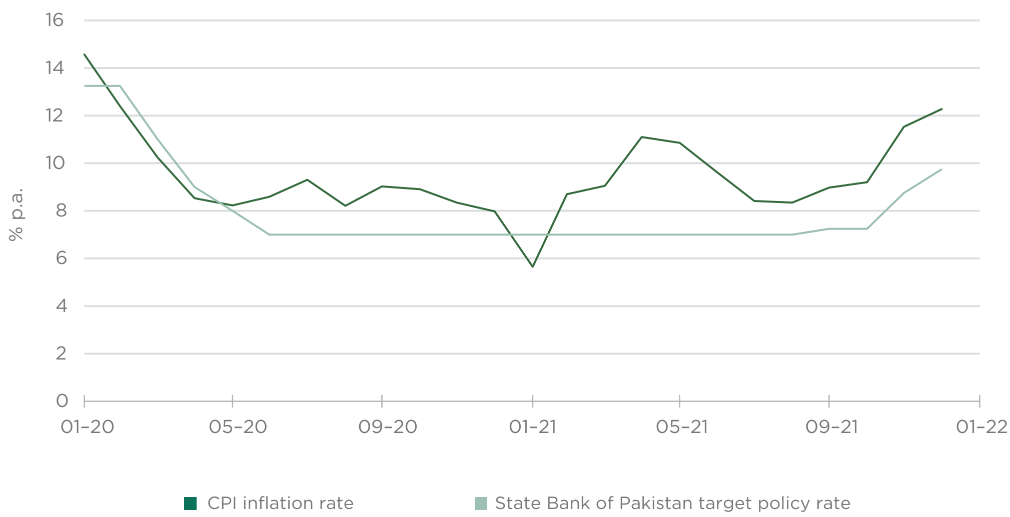
UAE: Solid backdrop for 2022

The UAE enjoyed a strong end to 2021, with activity boosted by Expo 2020, returning tourists, and higher oil prices. These factors should also underpin growth this year, although the level of uncertainty remains unusually high. Higher global interest rates in particular will leave their mark, but the reform efforts of the past years should boost investments and generally allow a more balanced growth model. The Emirates remain ideally positioned to benefit from the ongoing global recovery.

UK: An uneven recovery

As elsewhere, Omicron has impacted the UK economy at the start of the year, and the next material bounce of activity may now be delayed until the end of winter. However, the reduced lethality of the new variant has allowed the government to lift most of the remaining Covid restrictions, which will provide an important boost. While persistent inflation will see the Bank of England raise rates a few more times over the course of the year, monetary policy will not turn overly restrictive. Even higher taxes from April onward should not prevent a solid, if uneven, recovery for the year as a whole. The prospects for the GBP, which has fully recovered from the pandemic-induced sell—off, remain uncertain.

Pakistan: More upside for policy rate



Source: Bloomberg, HBZ

SPECIAL TOPIC:
Uranium—another leg up?

The price of uranium has risen over 150% over the past four years, and the World Uranium Total Return stock index has increased over 250%. And yet, until recently, financial markets have largely ignored the industry and its shares. Some recent news items have now piqued investors' interest.

Key points

- European Union likely to label nuclear energy as green
- Worldwide reactor fleet to expand significantly in the coming years
- ETFs to play a significant role

Recent news flow

Last year, a Canadian asset manager launched an exchange—traded fund (ETF) that invests directly in uranium and which in a short period of time has already amassed some USD 2bn in assets, or about a quarter of the element's annual volume. In October 2021, EU countries, led by France, called on Brussels to label nuclear energy as a green energy source. During the same month, the UK announced that its net—zero emissions plan relies on nuclear power. Then, earlier this year, unrest in Kazakhstan—the country produces more than 40% of the annual global supply of uranium—caused the price to spike further to more than USD40/lb.

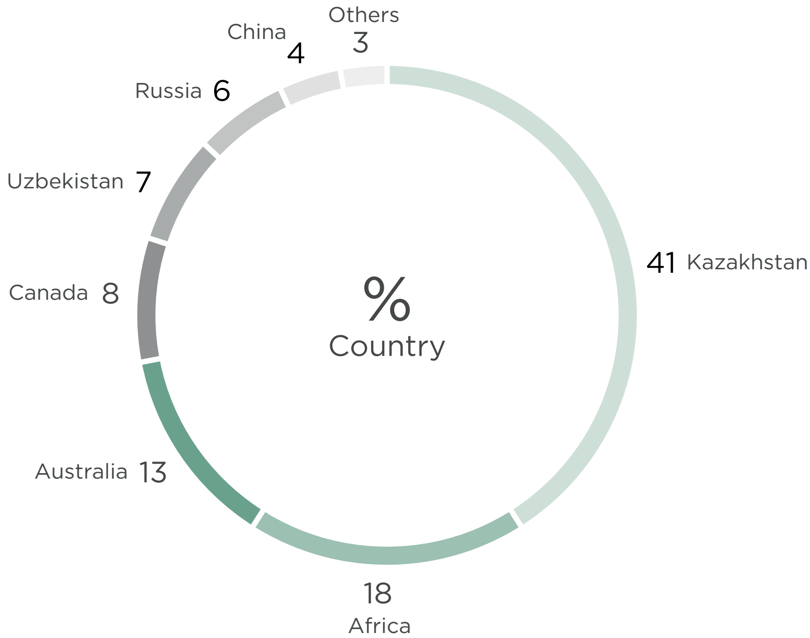
Demand exceeding supply

There are currently 440 nuclear power plants in operation worldwide, which produced just over 10% of the world's electricity in 2020. Similarly, 57 new power plants are planned or under construction worldwide. Global demand for uranium was about 177m pounds in 2020 and is expected to increase to about 188m pounds by 2025. Meanwhile, supply has actually declined over the past few years to 156m pounds, as mine operators shut down loss—making mines. For the next four years, analysts expect a deficit of up to 10% of annual demand. Capital flows from investment funds are also likely to start playing an important role in this market.

Capex finally rebounding

Mining operators also see the environment as, once again, more positive after the long lean period. In any case, budgets for exploration rose for the first time in 2020 after falling for ten years in a row. Companies were already spending 10% more on exploration in 2020 than they did in 2019, but budgets are still ten times lower than at the peak of the last cycle, which ended in 2008. If operators remain disciplined and production capacity does not increase too quickly, the uranium price should have further upside potential. We will continue to monitor the situation.

World uranium production 2020 (% of total)



Source: World Nuclear Association, HBZ

MARKET DATA SUMMARY

As of 25 January 2022

Equity indices	Last	-3M %	YTD %	-3Y %
MSCI World USD	9,076.6	-4.6	-7.0	57.7
S&P 500	4,410.1	-3.4	-7.5	65.5
EuroStoxx 50	4,082.5	-2.5	-5.0	29.1
FTSE 100	7,357.9	1.9	-0.4	8.1
SMI	11,963.4	-0.8	-7.1	34.1
Nikkei	27,131.3	-6.8	-5.8	30.6
MSCI EM USD	603.6	-5.4	-0.8	26.7
Sensex 30	57,858.2	-5.7	-0.7	60.6
KSE 100	44,887.8	-1.2	0.7	11.5
Hang Seng	24,243.6	-6.9	3.6	-12.1
Russia RTS	1,312.1	-31.6	-17.8	10.1
Brazil Bovespa	107,937.1	-0.7	3.0	10.5

Bond indices	Last	-3M %	YTD %	-3Y %
FTSE US Gov	1,650.90	-0.8	-1.4	11.2
FTSE US Corp	2,589.38	-2.1	-2.6	20.1
FTSE US HY	1,219.44	-0.9	-1.9	20.6
FTSE Euro gov	249.33	-0.6	-0.3	6.3
FTSE Euro Corp	253.58	-0.7	-0.5	7.1
FTSE EM Sov	904.14	-2.9	-3.2	10.3
DB EM Local USD	162.07	-3.0	0.4	-1.0

Equity indices	Last	-3M %	YTD %	-3Y %
DXY	95.92	2.6	0.6	0.5
EUR	1.13	-2.9	-0.9	-1.2
CHF	0.91	0.0	-0.8	8.1
GBP	1.35	-2.2	-0.6	2.0
JPY	113.75	-0.3	0.9	-3.9
AUD	0.71	-4.8	-1.9	-0.7
CAD	1.27	-2.0	-0.1	4.5
ZAR	15.36	-4.0	4.1	-11.1
INR	74.57	0.4	-0.6	-4.8
PKR	176.32	-1.0	0.1	-20.7
Gold oz	1,838.56	1.8	0.6	41.0

Interest rates	3M Interbank %	10Y Government %
USD	0.27	1.77
EUR	-0.54	-0.08
GBP	0.57	1.18
CHF	-0.75	0.01
JPY	-0.02	0.14
AUD	0.06	1.94
CAD	0.78	1.80
ZAR	3.90	9.79

DISCLAIMER

This report 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 report nor any copy thereof may be sent, taken into or distributed in the United States or to any U.S. person. The information contained herein has been prepared from sources believed reliable but is not guaranteed by Habib Bank AG Zurich (HBZ) and is not a complete summary of statements of all available data. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial and/or tax situation or specific needs of investors. Employees of HBZ or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed within this report. HBZ and/or its employees involved in the preparation or the issuance of this report may have positions in the securities or options of the issuer/s discussed or recommended herein. Securities identified herein are subject to availability and changes in price. They may not be eligible for sale in all jurisdictions or to certain categories of investors. For additional information on investment risks (including, but not limited to, market risks, credit ratings and specific securities provisions), contact your HBZ financial advisor. The information and material presented in this research note are provided for information only and are not to be used or considered as an offer or solicitation to buy, sell or subscribe to any securities or other financial instruments. This note does not take into consideration the specific investment objectives, financial situation or particular needs of any person who may receive this note and invest in any financial instrument. HBZ has not taken any steps to ensure that the securities referred to in this document are suitable for any particular investor. This brochure is not to be relied upon in substitution for the exercise of independent judgment. HBZ strongly recommends to interested investors to independently assess, with a professional advisor, the specific financial, legal, regulatory, credit, tax and accounting consequences prior to any investment decision. The value and income of any of the securities or financial instruments mentioned in this document can go up as well as down. The market value may be affected by changes in economic, financial or political factors, time to maturity, market conditions and volatility, or the credit quality of any issuer or reference issuer. Many factors may affect the value of a financial instrument, and accordingly, investors effectively assume all risk and may receive back less than they had originally invested. Any investors interested in buying a financial instrument should conduct their own investigation and analysis of the instrument as to the risks involved with transactions on such instruments. Past performance should not be taken as an indication or guarantee for future performance. In Switzerland, this report is distributed by Habib Bank AG Zurich, authorized and regulated by the Swiss Financial Market Supervisory Authority (FINMA). In the United Arab Emirates, this report is distributed by Habib Bank AG Zurich, UAE Branches, authorized and regulated by the Central Bank of the United Arab Emirates. In the United Kingdom, this report is distributed by Habi Bank Zurich Plc, authorized by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Habib Bank AG Zurich
Private Banking
Weinbergstrasse 59, P.O. Box 225, CH—8042 Zurich.
Tel: +41 44 269 45 00, fax: +41 44 269 45 18

HABIB BANK AG ZURICH
PRIVATE BANK
SWITZERLAND

WWW.HABIBBANK.COM