Investment Outlook July 2025

ZURICH

Uncertainty Resolved?

Distinguishing signal from noise

2025 Review – The year so far

If we'd shown you today's stock market prices at the beginning of the year, you could have been deceived into believing that the first half of 2025 had been unremarkable. In reality, this couldn't be further from the truth. The modest overall movements year-to-date disguise the extreme noise and volatility that have characterised the year so far.

A chief driver of this volatility has been the administration change in the US. Scepticism surrounding The White House's policies and extensive tariff plans overcame the preceding optimism of Artificial Intelligence (AI). Market movements for much of the first 10 weeks of the year were dictated by AI, including the emergence of Chinese firm DeepSeek. However, stock prices fell throughout March and April as investors fled US assets in favour of other markets. A weakening dollar compounded negative returns for international investors. By the end of June, the dollar was down -10.7% compared to major trading partners, its worst first half to a year since 1973.

Europe was a key beneficiary, with local equity prospects already burnished by a series of interest rate cuts and fiscal reforms. Bond markets weren't immune from volatility either; European yields jumped on news of the same fiscal reforms, while US treasury yields priced in fears of widening deficits and ballooning national debt.

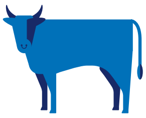
Similar to recent editions, our review of the past six months is unfortunately overshadowed by geopolitical strife. Conflicts in the Middle East and between Ukraine and Russia have continued unabated. In this environment, safe haven assets such as gold have flourished, while the price of oil has swung with each escalation and reprieve.

The arrival of 'DeepSeek', China's low-cost answer to ChatGPT, in late January led investors to scrutinise the spending of US tech firms, temporarily throwing cold water on the enduring AI rally. Amid growing doubts of continuing 'American exceptionalism', the new US administration looked to address what they saw as exceptionally contentious: America's trade deficit. With optimism waning, markets reacted poorly to the mooted details of the tariff impositions. Worries culminated on 'Liberation Day' on 2nd April, which led to precipitous falls and one of the most volatile weeks in US stock market history. However, subsequent tariff pauses, and mooted trade agreements spurred a recovery that was just as quick as the downturn. As the bellwethers of the AI surge, the 'Magnificent Seven' underperformed the broader market in the initial downdraught and while they have recovered strongly, they are still modestly behind the broader US markets year to date.

European equities fared better, having been supported by both monetary and fiscal expansion. Germany – Europe's largest economy – reformed their debt brake in early March, in addition to announcing €500 billion in infrastructure investment. Germany plans to spearhead increased defence spending across the EU, which has driven both beneficiary stocks and bond yields higher, the latter driven by concerns around the fiscal impact on bond supply.

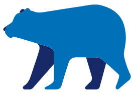
With US tariffs raising more growth than inflation concerns in the eurozone, and with reported inflation dipping back below the 2% target, the European Central Bank (ECB) was able to deliver four consecutive 0.25% rate reductions. This is a luxury that has not yet been afforded to Fed Chair Jerome Powell, with US investors now pricing in just two 0.25% rate cuts this year.

For The Bulls



- Tariff uncertainties dissipate as trade agreements are reached
- Deregulation and tax cuts in the US fuel innovation and growth
- German-led fiscal reform contributes to economic growth in the Eurozone
- Corporate earnings continue to support higher valuations

For The Bears



- US tariffs lead to the re-emergence of inflationary pressures
- The lagged effects of hawkish monetary policy cause a recession
- China continues to experience stagnating growth
- Geopolitical tensions continue to escalate

Outlook Summary

We are still maintaining perspective for the second half of 2025, as we attempt to distinguish between material policy and market signals and shorter-term trading noise. Investors hope that policy uncertainty dissipates in the months to come, and markets are priced for broadly economy-friendly outcomes without long-lasting negative inflation outcomes. That may be the case even if the path to it is erratic. The long-term implications of the quite profound developments across the globe in the first half of the year have yet to be fully digested and it's possible that some of these – positive and negative – may have market-moving potential even in the short run.

At present, we hold a slightly underweight stance towards equities – which we sold after the sharp rise in May - and are overweight in shorter-dated fixed income, reflecting a more cautious stance towards longer-dated bonds for now. We think that some of the existing market thematics have further to play out – and these are reflected in our various equity portfolios - but in the short term we're adopting a slightly cautious stance on equities from an asset allocation perspective as we think that markets are overbought and, at minimum, due a pause. As we have done in the face of the market and policy volatility so far this year, we'll continue to be controlled and measured regarding overall risk taking.

From a global economic perspective, recession fears have dissipated since the 90-day tariff pauses came into effect. Inflation has continued to broadly trend lower, but not without some 'stickiness'. Central banks have been able to hold or even lower rates despite the head-spinning tariff policies of the US administration. Long-term expectations remain anchored as they have broadly done for some time now – and this is a key necessary condition for us to remain medium positive on risk assets. We will continue to keep a close eye on US and European labour markets and capital expenditures to see how tariffs and fiscal policies impact on the real economies in the shorter term.

Also on the radar will be the impact of possible deregulation efforts in the US and any signs – in whatever economic region – that higher technology spending on artificial intelligence is having noticeable impacts on economy-wide productivity or price developments.

As we have said many times over the years, the structural decline in inflation was driven by globalisation, central bank independence and technological improvements. Some of those factors have frayed somewhat in recent times but there is an optimistic view that new technologies – which have already had material direct impacts on the makers of the new 'plumbing' – will have profoundly positive overall-economy impacts through higher growth & productivity and lower inflation. It remains to be seen how quickly some of these positive impacts will be felt but we will monitor closely.

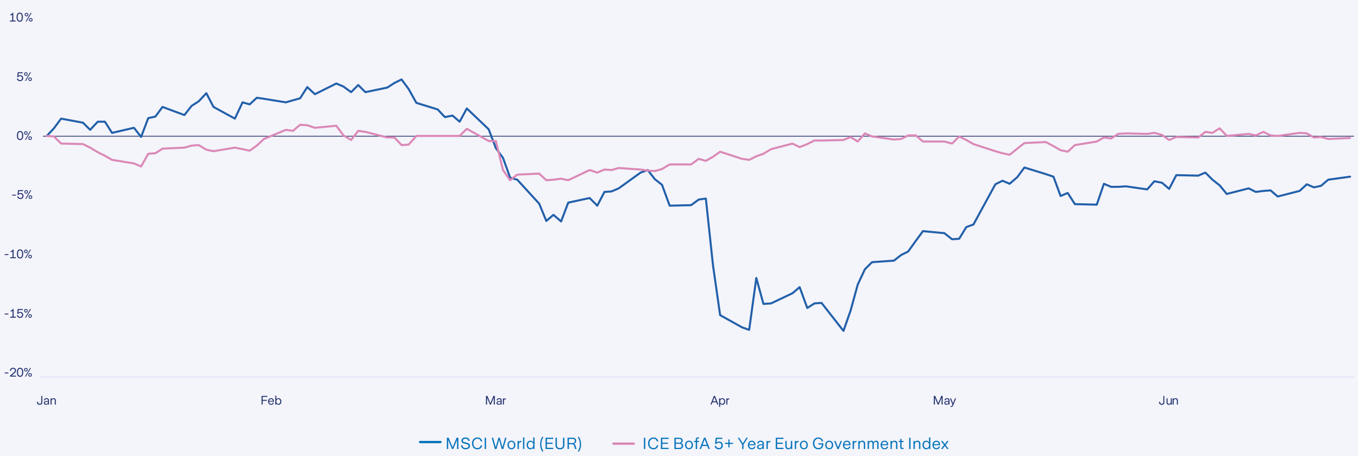
In the interim we have somewhat higher risks to bond yields from higher government deficits and debt – not just in the US, even if that has been the most recent centre of attention. High debts have not been a material issue to date because private sector debt expansion has been modest enough to not clash with higher government borrowing. But there are limits to this nonetheless and materially higher real bond yields – if they were to emerge – would likely undermine risk assets. This is not our central scenario for now, but we judge the risks to have risen since the start of the year.

Geopolitical issues have been a depressing feature of the landscape again in 2025 albeit with modest market impacts. Oil price volatility has only had short-lived impacts and perhaps the market impact here will dissipate structurally over time as energy sources in aggregate become more diffuse. We are holding a high Gold weighting for now – where permitted- as we expect the positive structural factors underpinning its rise to date to play our further. Included amongst those is the desire of China to pivot away, as much as possible, from a US-centric global trading, payments and financial system.

The extent of the market recovery is certainly reassuring from an investor perspective, even if a substantially stronger euro has completely distorted a euro-based investor's view of global equities so far this year and has highlighted that even if the US remains at the centre of innovation that its attractiveness as a locus of capital have been tempered somewhat by the new political and policy dynamics at play in the US.

In conclusion we are maintaining a flexible outlook in the face of policy uncertainty that is not fully resolved yet. Medium term inflation expectations, which remain anchored for now, and reasonable growth dynamics are positives for risk assets. Structural factors – both negative or positive for bonds and risk assets – will battle out in the periods ahead and will present opportunities.

Bonds have outperformed Equities so far in 2025



Source: Bloomberg, 31.12.2024 – 30.06.2025

Equities

The dramatic fall and subsequent recovery in global equities this year leaves the market in a peculiar scenario: global indices are trading near all-time highs, yet there's still a prevailing sense of precariousness. This can be partly attributed to the US administration's unpredictability on issues of trade - the sequence of tariff impositions and pauses a prime example. However, the market, for now, views the majority of announcements on trade as negotiation tactics rather than policy announcements. The swift tariff reprieve following the bond market's negative reaction to 'Liberation Day' may have offered insights into the rules of the game.

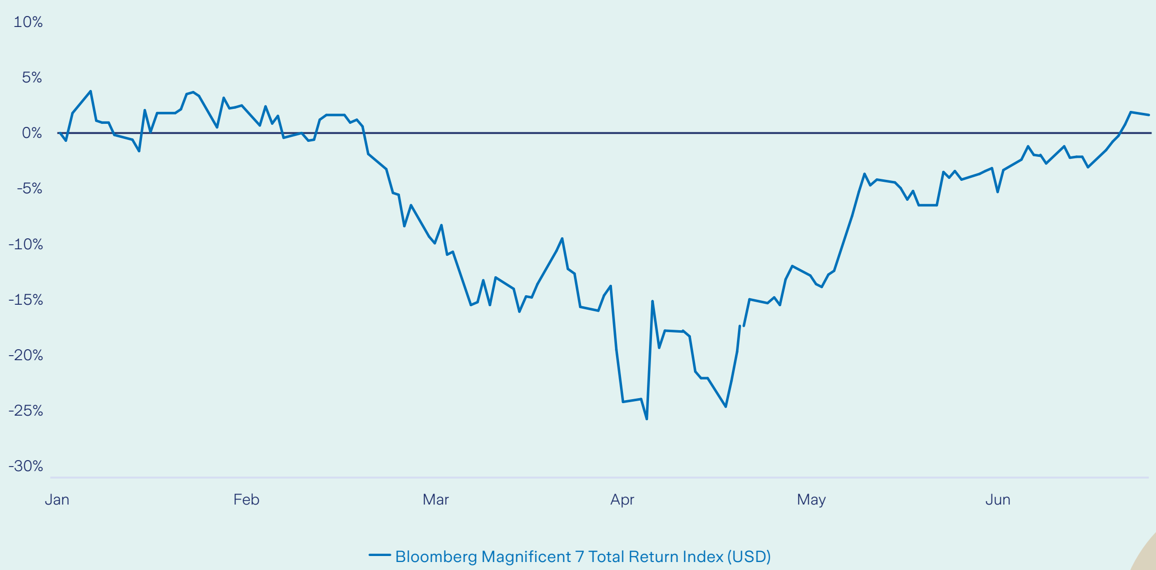
World equities have recovered from their troughs in early April. However, global equities in euro terms have been oscillating in a tight range since late May. We have witnessed a wider breadth in regional performance compared to recent years, with shares in Europe, UK, and Hong Kong all outpacing the US on aggregate. Although, from a sectoral perspective, the market's recovery has been led by familiar players: Big Tech and the 'Magnificent Seven'. This concentration at a sector level contrasts somewhat with the encouraging geographical breadth. If a bull market is to be sustained in the future, it is imperative that growth sectors participate.

Our current position is modestly underweight equities. Within our allocation we remain focused on cyclical and growth sectors such as Information Technology and Financials. On a geographical basis we are slightly underweight the US, with a preference for European and Asia Pacific regions. Thematically, our active approach has taken advantage of secular trends such as AI, and its derivative effect on areas such as the energy, defence, and aerospace sectors.

While the market's recovery was reassuring in its speed, it is reasonable to question how vulnerable it is to further corrections. From a technical perspective, a short-term correction would not be surprising. However, this was tested when both Israel and the US commenced offensive strikes on Iran just days apart. If the positive market sentiment indeed lacked resolve, these two events provided the perfect excuse for a sell-off. Instead, what we saw was a muted reaction. While some have likened this response to a deer in headlights, others have equated it to a more healthy and resilient market. Moreover, valuations have been justified by strong fundamentals, as company earnings have impressed in the face of economic uncertainty.

Looking forward, global equity markets will be reliant on whether long-term trends can be sustained. Chief among them is AI, which has reemerged in recent months as the speed and extent of its integration has become more apparent - particularly in the US. Added traction in AI growth would also benefit overseas markets such as China, which has been making its own AI breakthroughs. In Europe, as the ECB's easing cycle comes to an end, fiscal expansion will be pivotal if share prices

The (Not-so) Magnificent Seven



Source: Bloomberg, 31.12.2024 – 30.06.2025

Fixed Income

We currently have a preference for credit over sovereign bonds. Within our eurozone government bond portfolios, we have a modest short duration position and have a broad geographical preference for so-called 'periphery' over 'core' issuers, such as Italy and Spain. Our view is that global bond yields remain in a multi-year consolidation phase and are now experiencing an upward bias.

Eurozone bond yields have risen during the period. This was prompted by European leaders' plans to drastically increase defence spending after the US threatened to withdraw from NATO. The European Commission's strategic 'ReArm Europe' plan targets a total of €800 billion in defence investment across the European Union, and member states will look for budgetary leeway to reach this target. This is expected to add to fiscal deficits, which will apply upward pressure on government bond yields.

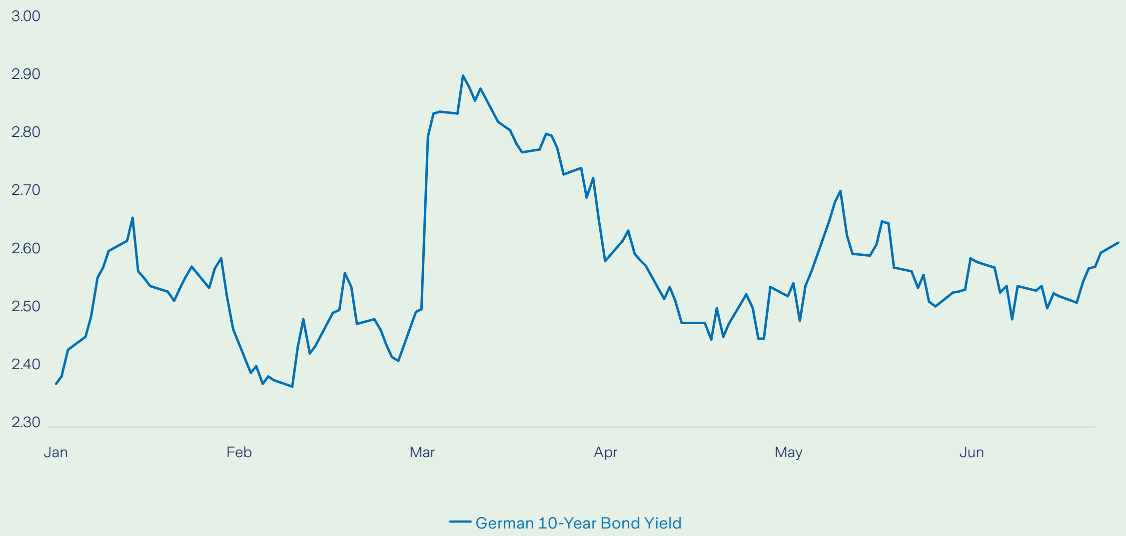
Eurozone inflation has continued to gradually fall, and the ECB have implemented four 0.25% rate cuts so far in 2025, bringing the deposit facility rate down to 2.0%. Germany led the way of fiscal expansion plans across the continent. The new government and Chancellor, Friedrich Merz, reformed the debt brake which had been in place since 2009, and promised higher government spending. This marked a major pivot from typical German fiscal conservatism. 10-year German bund yields have risen from 2.37% to 2.61% in response, and the Italy-German spread is close to multi-year lows.

Within the US market, yields are still close to the high levels at which they began the year, propped up by investors' expectations of widening deficits under The White House's expansionary fiscal policies. The benchmark 10-year treasury yield has experienced precipitous movements in response to political decisions but has ultimately moved lower as inflation expectations have softened. However, the yield curve overall has steepened materially in 2025.

The US national debt remains a long-term risk which deserves attention. Moody's downgraded the US credit rating in May, although it didn't materially affect market demand for treasury notes. Furthermore, the weighted average maturity of the US government debt market is lower than that of other G7 countries, meaning they will be forced to refinance at the presently elevated rates sooner rather than later. While this is not currently a focus, it does increase the risk of volatility in sovereign bond markets.

After briefly widening during the tariff turmoil in early April, credit spreads have since narrowed close to historically tight levels. Credit returns have been positive this year, and investment grade yields are high compared to the last decade. However, corporate balance sheets are generally healthy, with concerns about debt more evident in government bond markets. High yields mean that despite the possibility of capital price losses, coupons payments now contribute to a positive real return. Within our corporate bond holding, we are relatively balanced from a duration viewpoint.

European fiscal reform leads to bond yield volatility



Source: Bloomberg, German 10 year Government Bond Yield 01.01.2025 – 30.06.2025

Currencies & Commodities

The dollar has weakened considerably due to diminished investor confidence in the US economy and fears of future instability. The important EUR/USD currency pair is now trading above 1.17, near four-year highs. We have removed the partial USD hedge across our funds, however there may be further hedging opportunities in the second half of 2025. Central bank rhetoric and actions will be keenly watched, as will political developments on both sides of the Atlantic. With the European Central Bank close to the end of its easing cycle, the euro has strengthened. The EUR/GBP currency pair has moved from 0.83 to 0.86, as the new UK government struggles to boost economic growth.

The dollar's loss has been gold and silver's gain. Central banks of developing nations looking to diversify their reserves away from the dollar have pushed gold demand higher. The yellow metal is now the world's second largest reserve asset. Where applicable, we are overweight in exposure to alternatives. This is despite reducing our gold allocation during the period, taking profit from its rally as momentum began to wane. Volatility in oil prices and geopolitical unrest have grown in tandem, and oil currently trades around -20% for the year in EUR terms. Barrel prices are intrinsically linked to tensions in the Middle East, particularly relating to Iran, which is OPEC's third largest producer.

Dollar having historically weak year

Source: Bloomberg, 01.01.2025 – 30.06.2025

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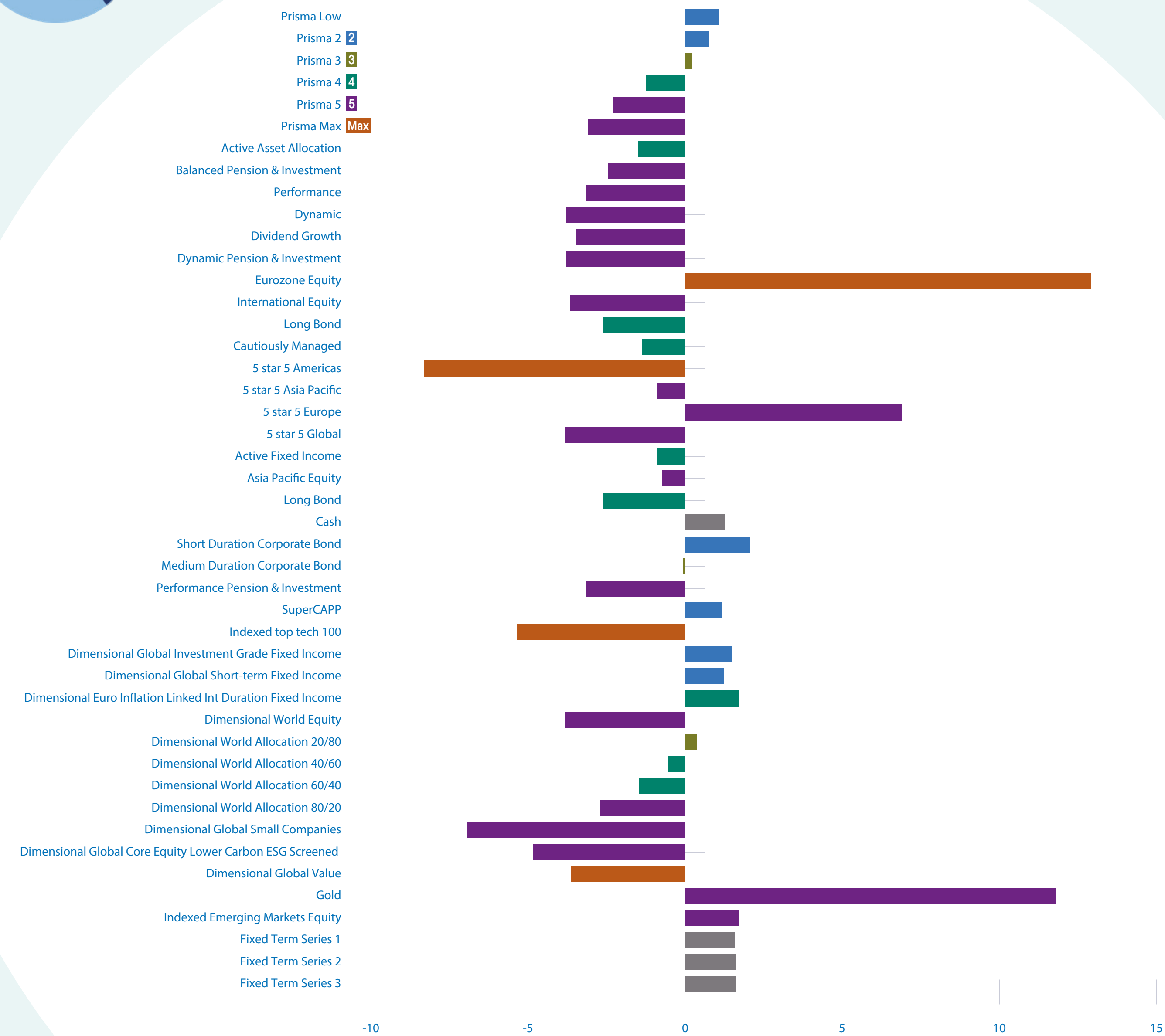
2025 Performance

year to date

Risk/Reward Rating Lower — — — — — Higher 1 2 3 4 5 6 7



Notes: Annual management charges (AMC) apply. The fund performance shown is before the full AMC is applied on your policy. Returns are based on offer/offer performance and do not represent the return achieved by individual policies linked to the fund. Risk Ratings as at 31/03/2025.

Source: Zurich Life 02/01/2025 – 01/07/2025.

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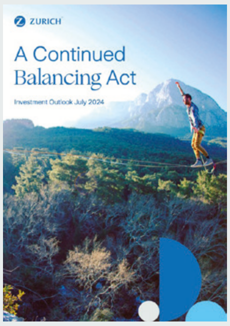
H2 2024



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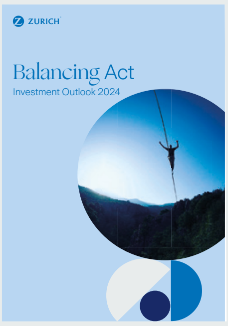

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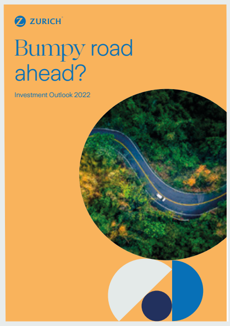

H1 2022

Zurich Life Assurance plc
Zurich House, Frascati Road, Blackrock, Co. Dublin, A94 X9Y3, Ireland.
Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurich.ie

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