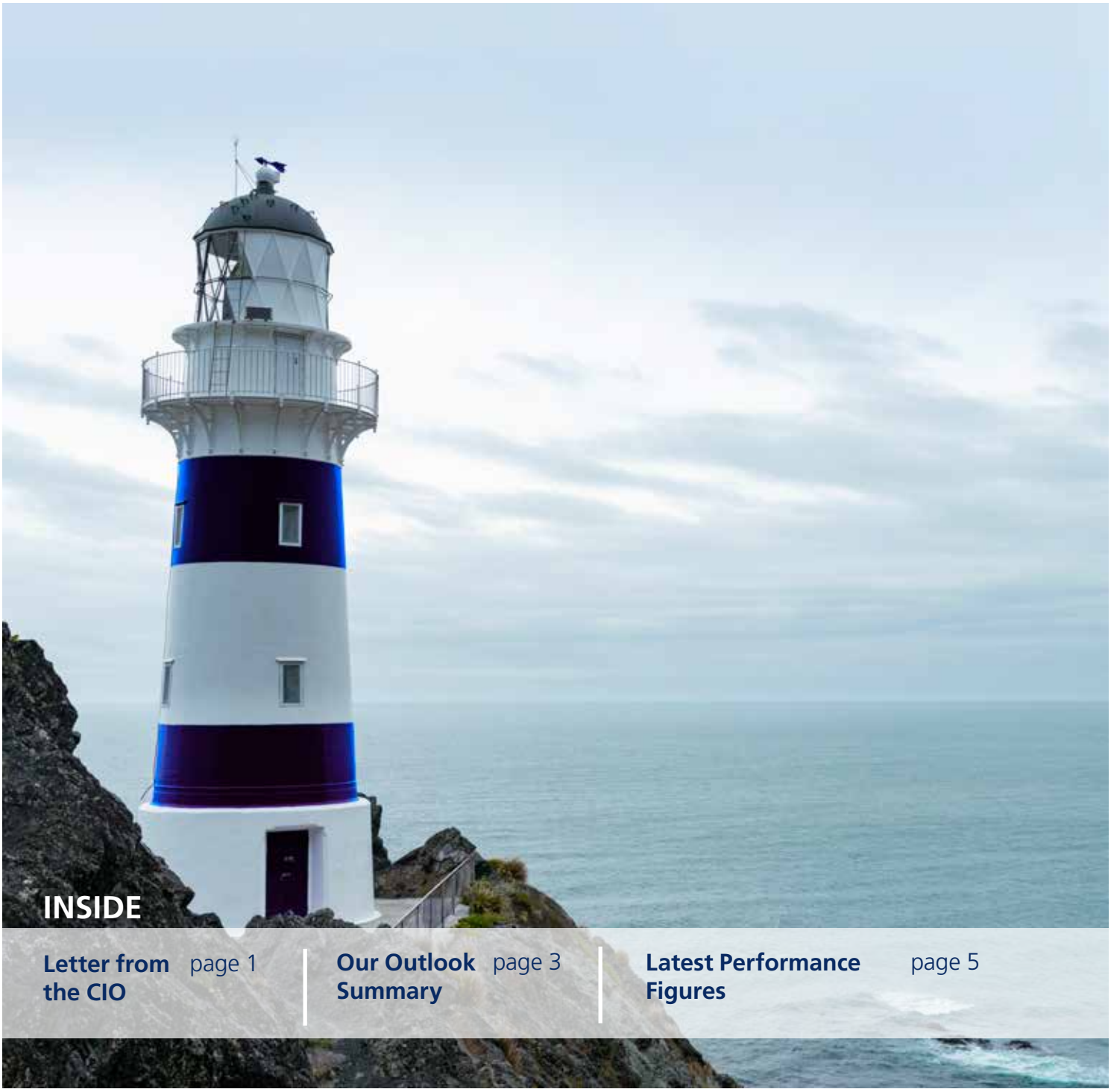
Risks, Opportunities and Unintended Consequences

Investment Outlook July 2020



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World Review of 2020



Source: Zurich Life International Equity Fund Performance, 30 June 2020

Key Highlights

Equities - Medium to longer term positives remain intact; near term policy support is vital given the economic cycle risks.

Fixed Income - Ultra-low interest rates continue to make sovereign fixed income a very unattractive investment; selective credit exposures are more attractive. Inflation expectations remain low; policy support mitigates deflation risks.

Key risks relate to the virus, policy action, consumer and corporate behaviour; the likelihood of unintended consequences underpins the need for an active and flexible approach.

‘It’s almost inevitable that there will be unintended consequences from the huge policy moves’...



Reading the equivalent piece from our January Investment Outlook is somewhat surreal. As it happens things initially panned out as we had anticipated. There was more optimism about an extension or improvement in the economic cycle and financial markets were behaving accordingly.

We all know what happened next. When we spoke at the webinars and podcast during the worst point of the market turbulence we said we were maintaining equity positions at close to maximum positions we held prior to the dramatic collapse in economic activity and risk asset prices. That view was based on the virus-crisis being short lived (without us giving a specific timeline) and governments and central banks providing large policy support. The first was part of the general market narrative at the time – driven by the experience of China in appearing to successfully get to grips with the virus – and the second by extrapolating a pattern of intervention in markets and economies that began a long time ago.

In January the IMF projected global economic growth for 2020 at 3.3%. It now projects a fall of just under 5%. Such an outcome would be far worse than the collapse in growth experienced in the Great Financial Crisis of 2008-2009. If the forecast growth recovery of 5.4% for 2021 materialises it would mean that economic activity would still be 6.5% below its pre-Covid-19 projections. The US federal deficit will be somewhere between 10% and 20% of GDP this year, in Japan somewhere between 20% and 40%. Europe’s response is smaller in comparison to the enormity of the others, but is still several percentage points of GDP. The scale and the speed of the response from governments and central banks to the collapse in economic activity has been breathtaking.

The response has matched the enormity of the problem and is a key reason why, for example US equities – at the time of writing - are on track for the best three month period in 50 years. However from the point of view of the IMF and other observers ‘the extent of the recent rebound in financial market sentiment appears disconnected from shifts in underlying economic prospects – raising the possibility that financial conditions may tighten more than assumed in the baseline’.

For us this is a key question – have markets gone too far too quickly? Are they detached from reality, just looking at the policy positives, ignoring the near-term and potentially longer-term damage to the global economy? Our current answer to that question is no and we believe that the underlying structural equity bull market is still intact. Valuations can, and will likely be, stretched further in a world of zero or exceptionally low nominal and real long term interest rates. Tactically we are likely to lower equity weightings at some stage in the weeks or months ahead – if the gap between risk and reward supports that – but ultimately the bias in the medium term is positive towards equities on an absolute and relative basis.

Equity prices reflect a stream of future profits, cash-flows, and dividends. As the discount rates that are used to value equities move lower, models place a greater emphasis on future streams and thus reduce the importance of short term profit, cash-flow and dividend streams. That’s one of the reasons why investors have been looking past the likely awful earnings’ data for 2020 into an economic recovery in 2021 or 2022. In addition, policy support has put an implicit floor under many asset prices and this reduces the risk premium that investors require to hold risky assets.

But risks still abound and the ones we have previously referred to – mountains of debt, the fractious nature of US/China relations, Eurozone instability – remain very much intact. Meanwhile the Covid-19 crisis has brought new energy to some of the discussions surrounding economic equality and whether nations can combine to address global health and climate issues. It has reinforced the notion of a liquidity-driven equity market bubble – one we don’t necessarily share – but one that has persisted for some years now.

But the crisis has also highlighted and will likely accelerate trends in technology that will give us - as active and flexible investors - the opportunities to generate good outcomes through judicious stock picking. We have already seen this somewhat materialise during the crisis. Finally, it’s almost inevitable that there will be unintended consequences from the huge policy moves that have been undertaken in such a rapid timescale. We will maintain an active and flexible approach, combined with conviction, to keep on the right side of these developments.

David Warren
Chief Investment Officer



2020 – Review

Equities started the year on a solid footing and were up over 8% as they hit an all-time high in mid-February, however, driven by fears over the Covid-19 virus, what followed was the fastest bear market in history, taking just 16 trading days to fall 20% from the peak. Markets fell another 12% to hit a low on 20 March. Unprecedented policy intervention, both in terms of size and speed, emerged from a monetary and fiscal perspective, and markets moved sharply higher towards the end of March in anticipation of a recovery. The rally continued throughout the 2nd quarter with markets ending the first half of the year in positive territory. Our own International Equity Fund closed the half year point with a return of +0.4%, a figure that masks the volatility that we have seen so far this year.

There was large divergence at a sector level with technology, healthcare and consumer discretionary all outperforming, while the likes of financials and energy were still down over 20% in the six months to the end of June.

Eurozone sovereign bonds saw yields move lower on the back of the flight to safety which occurred during the market stress. Interest rates globally fell further as a result of the emergency response to the pandemic. Corporate bonds also saw volatile trading with spreads widening as concerns over balance sheet resilience hit companies during February and March. However, central bank intervention, most notably from the Federal Reserve, helped spreads tighten and debt issuance expanded significantly in Q2.

Commodities had an extremely volatile first half of the year with the oil price down over 80% at one point, as oversupply hit the market just as the pandemic prompted a demand shock. Gold enjoyed a positive period as its safe haven was utilised. The precious metal did suffer in early March as investors rushed to liquidity but finished at the half year mark up approximately 17% in euro terms.

Source: Zurich Life, 30 June 2020

For the Bulls:



- The economic recovery surpasses expectations
- Pent up consumer demand & cheap credit drive economic growth
- A readily available vaccine emerges sooner than expected
- Further policymaker action spurs markets on

For the Bears:



- US China tensions continue to escalate
- Geopolitical concerns gain prominence (US elections & Brexit)
- Eurozone leaders fail to build consensus on recovery plans
- A sustained ‘second wave’ of infections emerges

Outlook

We maintain our current asset allocation, which favours equities and credit over sovereign debt and cash. Key risks to the recovery are present and we remain alert to the potential for further downside. Our positive structural view towards equities persists, but if excessive optimism is evident in the markets' price action we may look to reduce our equity weighting on a short term, tactical basis. In addition we are mindful of the risks of a slower economic rebound or a second wave of the virus, both of which would dent the current narrative dominant in the market. Flexibility and an active approach remain essential.

Equities Outlook

Equities have the potential to be supported by continuing policymaker action and the lower funding and risk-free rates evident within the financial system. The depressed outlook for other asset classes coupled with the relatively high cash balances held by investors currently could also lift equity prices as the cycle progresses. Overall, investor sentiment remains muted and is not displaying signs of irrational exuberance. Global equities do not appear cheap in absolute terms versus history. However this fails to tell the full story with large divergences in outlook at a sector level.

Sector divergence has been a key theme across markets throughout 2020 and we are attempting to capitalise on long term structural trends within sectors such as Technology, Consumer Discretionary & Healthcare. While we remain cautious overall on some sectors, investment opportunities have further emerged in the form of structurally sound individual companies in some of the hardest hit parts of the economy.

Our geographical preferences are a function of both our views on localised growth prospects, valuations, and the sectoral makeup of the stock market. We favour Eurozone and Asia Pacific including Japan currently. Our underweight exposure to North America is primarily a function of a zero allocation to the resource and bank heavy Canadian market. Our U.S. equity exposure is a small underweight on an overall basis, however we have strong conviction across specific sectors within the U.S market, including Technology.

We remain cognisant of the key risks to equity markets, volatility will be evident throughout the second half of the year, and our geographical and sector weightings are subject to change in the short term as market conditions dictate.

Fixed Income Outlook

The onset of a global pandemic and the ensuing policymaker action sent interest rates lower, and sovereign bond prices higher, across much of the market. Monetary policy action has been swift and much quicker than in times of market stress within previous economic cycles. Money supply globally continues to grow and there is a number of potential options available to policymakers, from both a monetary and fiscal perspective. There is little appetite from the major central banks for more restrictive financial conditions and, even in the event of a sharp economic bounce, it is unlikely that the Federal Reserve or the ECB would raise interest rates. Realised inflation is muted within the developed world and expectations remain subdued while substantial policy support mitigates the risk of deflation.

Financial conditions continue to improve and spreads continue to narrow. Central bank stimulus effects remain in place and are being accentuated by sustained fiscal actions across the globe. Within the eurozone, sovereign spreads have contracted over the second quarter of 2020, with the ECB PEPP programme still a key driver of markets. The low levels of bond yields globally and in the Eurozone in particular makes Sovereign Fixed Income expensive from a valuation perspective with low and in many cases negative prospective returns both in nominal terms and, more importantly, on an inflation adjusted or 'real yield' basis. We continue to be underweight eurozone sovereign debt across our multi-asset funds and the duration of the bonds is below average. Throughout 2020 we have rotated our bond portfolios out of short sovereign and corporate debt into medium term corporate debt.

Within the corporate bond market investment grade activity has picked up significantly as companies, supported by ECB actions, moved quickly to shore up their balance sheets amid the market uncertainty. By the end of June, non-financial investment grade issuance was over 50% higher than 2019. In general, the supply has been well absorbed by the market, with most new deals significantly oversubscribed reflecting healthy investor appetite. Defaults globally are expected to rise but they are likely to be sector specific. Spreads continue to narrow and central bank activity remains supportive. Overall, we are constructive, but selective across investment grade credit. Dispersion in performance is likely, therefore fundamental credit analysis, issuer selectivity and an active management approach are key.

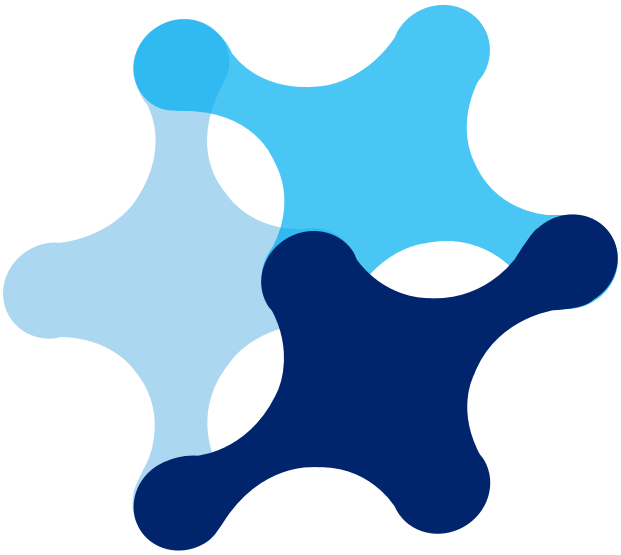
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Zurich Insurance Group is committed to investing responsibly and is a signatory to the United Nations Principles for Responsible Investment. As an investment manager, Zurich Life in Ireland is conscious of the need to ensure that we invest policyholder and shareholder funds responsibly. For us, responsible investment is grounded in an economic approach and is all about 'doing well and doing good'.

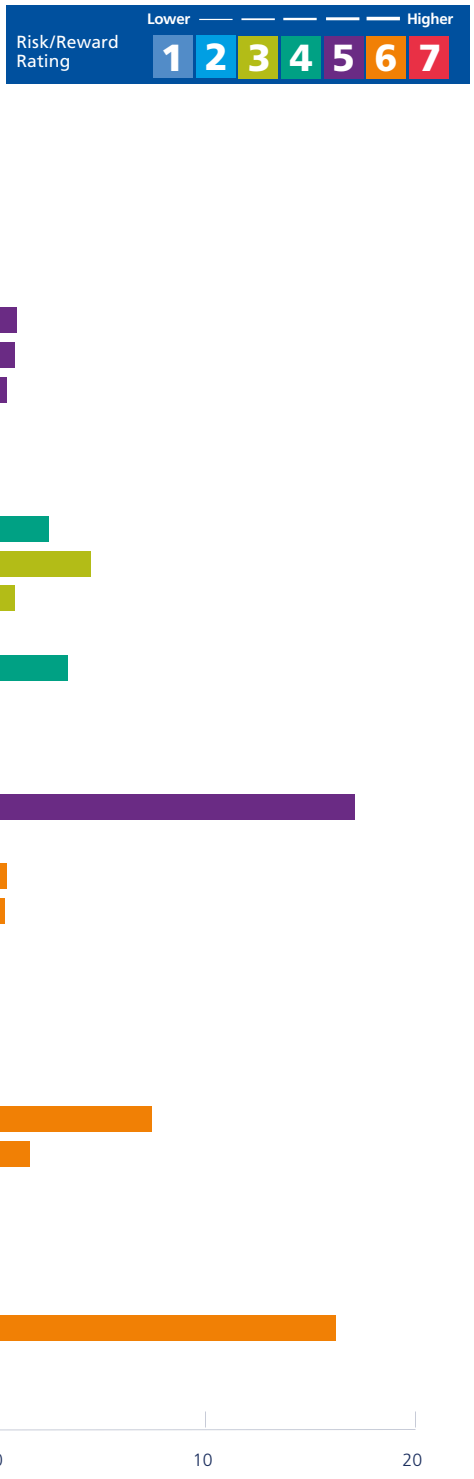
'Doing well' reflects a belief that being a responsible investor through integrating Environmental, Social and Governance (ESG) factors into our investment process can also create financial value, i.e. better investment returns. On a day-to-day basis, these are issues that we explore when we meet with investee company representatives. We also engage with the companies we invest in by voting on key management resolutions which we view as an important part of being an active, rather than passive, owner of assets. This should help to promote sustainable investment and longer term investment returns to the benefit of all stakeholders.

'Doing good' means that through our investments we can have a positive impact on society and the environment. We consider that positive impact as non- financial value; value that cannot be directly or immediately translated in dollars and cents. Active ownership helps to make it clear that non-financial metrics are part of our assessment of a company's performance and allows us to encourage those companies.

For more information on Responsible Investment with Zurich Life please do not hesitate to get in touch or log on to www.zurich.ie/responsibleinvestment



2020 Performance



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. ESMA Ratings as at 31/03/20.

Source: Zurich Life as at 30/06/20.

Warning: Past performance is not a reliable guide to future performance.
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Warning: Benefits may be affected by changes in currency exchange rates.
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The Zurich Investment Outlook is produced twice yearly by the team at Zurich Investments, based in Dublin, Ireland. This publication provides an in-depth insight into our current thinking and positioning, and expands on the reasons behind our economic views to our clients and customers.

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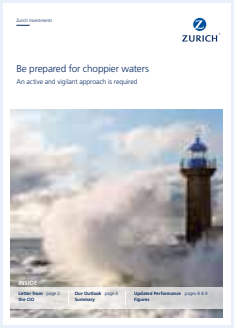
H1 2020



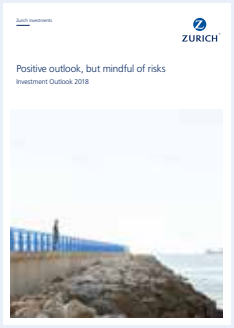
H2 2019



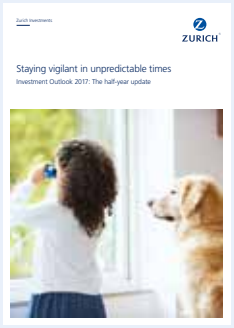
H1 2019



H2 2018



H1 2018



H2 2017

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