

Markets in Transition?

Investment Outlook July 2021



2021 Review - The Year so Far

The strong recovery in equity markets witnessed since March 2020 continued throughout the first half of 2021, with global stock markets up approximately 15% over the period. The year started in an optimistic fashion, with investors buoyed by positive developments in relation to COVID vaccinations, the continued supportive policy backdrop, and the green shoots of renewed economic growth. Whilst bouts of volatility did emerge, predominately driven by shifting US inflation expectations, the rise in equities continued across the six-month period.

On a geographical basis, the UK market bounced back strongly, helped by some of the wider sectoral trends evident on a global scale. However, all major regions (with the exception of Japan) have produced double digit positive returns so far this year. The sector rotation which began to emerge post the US election in early November 2020, continued into 2021, with some sectors (energy, financials, real estate) that had lagged throughout the post COVID recovery playing catch up over some more growth orientated sectors such as technology and consumer discretionary. So called 'bond proxy' sectors (utilities, consumer staples) have underperformed, particularly within the context of transitioning inflation expectations.

Eurozone bonds returned -5% over the six-month period, with the massive fiscal stimulus in the United States driving bond yields there, and elsewhere, upwards, causing bonds to lose value. The Federal Reserve cut its policy rate by 1.5% in March 2020 to the zero bound and has since announced a change in its inflation targeting, likely to keep rates unchanged far into the future. The ECB cut at its September 2019 meeting to -0.5% and has not moved since. The European Central Bank is implementing a €1.85 trillion Pandemic Emergency Purchase Programme which will run until at least 2022, which is helping to contain peripheral country bond spreads.

Industrial commodities such as oil and copper benefited from the rebound in economic growth expectations, with oil up over 50% and copper returning over 20% respectively over the period, albeit this rebound is from the marked lows seen in 2020. Gold endured a volatile period before finishing -3% in euro terms. On the currency markets the EUR/USD rate moved to 1.193 from 1.222, whilst EUR/GBP finished at 0.858 having begun the year at 0.894.

For The Bulls



- Fiscal and monetary policy continues to create positive investment conditions
- Inflation risks prove to be transitory
- Pent up consumer demand leads to better than expected economic growth
- US fiscal plans sees economic growth surpass pre COVID levels.

For The Bears



- Absolute equity valuations are expensive versus their history
- Rising inflation leads to a shift in central bank policy
- Global growth fails to live up to expectations
- COVID mutations reduce the efficacy of vaccination programmes



Outlook Summary

Equities and corporate bonds continue to be our preferred asset classes versus government bonds and cash. Policymakers globally, from both a fiscal and monetary perspective, remain supportive. Central Banks are generally committed to a low interest rate environment and asset purchase programmes continue. Fiscal policy in the US is expansionary and agreement on an infrastructure package is inching towards completion. The European Recovery fund is a helpful fiscal push for Europe. Global growth appears to have bottomed out in the second quarter of 2020 and has recovered since then. Overall, this policy backdrop is contributing to a positive outlook for risk assets, especially equities. A pattern in recent decades of central bank support in times of extreme market volatility has emerged – the so-called ‘fatal embrace’ – and there is no reason to believe that this backdrop will not persist. Our outlook in relation to sovereign bonds is more cautious as there are signs that we are transitioning away from the multi-decade trend of lowering interest rates, towards a new era for fixed income investing. Shifting inflation expectations and the ensuing impact on monetary policy, coupled with the possibility of global growth failing to meet current expectations for the rest of the year, are two of the main risks present currently for investors.

Equities



Pent up demand, as a result of COVID related restrictions, should be released into the economy as lockdowns continue to be eased as the vaccine rollout gains further pace globally. This should help the services sector, which has lagged manufacturing so far in the recovery, and provide the potential for further ‘catch up’ for the hardest hit sectors of the economy. Whilst COVID certainly remains on the agenda for equity markets, it no longer dominates the narrative.

Whilst pockets of over-exuberance have been evident in recent months we maintain a constructive view and are of the belief that the secular bull market remains intact. Given the strong and relatively steady positive returns seen so far this year, it would not be surprising to see pullbacks at times throughout the remainder of the year. Markets are expensive on an absolute basis and we have to be alert to the risks that such markets give rise to. Nonetheless our current stance is that potential instances of volatility could provide opportunities to add equities on a tactical basis, as the global economy continues to transition from the COVID induced recession to a period of above average economic growth.

Growth expectations in Europe and Japan should continue on an upwards trajectory and converge towards the level seen currently in the US. Our geographical preferences continue to be a function of our views on localised growth prospects, valuations, and the sectoral makeup of the stock market. We favour the eurozone, UK, and Asia Pacific (ex-Japan) regions currently. Our U.S. equity exposure is underweight on an overall basis; however, we have strong conviction across specific sub sectors within the U.S market, including software and internet/media companies. Sector rotation is evident in the market, but we don’t conform to a particular style bias, and are style agnostic. We are looking to invest, in both the debt and equity, of quality companies that can perform well, irrespective of style or sector.

Fixed Income



Sovereign fixed income markets in both Europe and the US have seen negative returns so far in 2021. Transitory inflation expectations, renewed optimism regarding economic growth, and enduring expansionary fiscal policy have all contributed to pushing yields higher, and therefore prices lower. Whilst bond yields have moved higher, it is worth noting that real yields (which take into account inflation) remain anchored in negative territory. This reduces the attractiveness of holding fixed income securities. Therefore, in terms of positioning, we are towards the lower end of ranges within multi-asset funds and the remaining bonds we own are of a shorter duration.

The shape of the US yield curve has garnered much attention in 2021, particularly as inflation expectations have been evolving. We believe that the yield curve could steepen again from its current position, and this will also impact sector positioning in the equity market.

Much of the recent focus has been on the actions and commentary of the US Federal Reserve. In our opinion, their actions in the last 18 months support the view that they will continue to help support risk assets. Having maximum employment as an objective, whilst allowing more flexibility in respect to inflation, points towards a very supportive policy backdrop. Overall, we believe that the Federal Reserve’s core viewpoint remains unchanged, and that they believe higher inflation is, on balance, more transitory than structural. Given the ongoing negotiations in the US, how fiscal policy evolves into 2022 may also start to inform monetary policy. This is of course an evolving situation, which we will monitor closely.

In relation to credit markets, we remain broadly constructive especially for short to medium dated exposures. There has been some widening of spreads in more riskier offerings, but overall spreads have been well behaved. We maintain our view that the corporate bond market contains a more attractive risk reward profile than eurozone sovereign bonds.

Currencies & Commodities



The US looks set to add further debt to fund the Biden Administration’s fiscal stimulus plans, which could see demand for US treasuries fail to keep up with rising supply. The US dollar could also weaken due to the return of robust economic growth which has seen a positive shift in sentiment towards the global economy. Therefore, we continue to have a hedge on a portion of our US Dollar assets.

Industrial metals look set to continue their uptrend given the supportive global economic backdrop. Some metals, including copper, have fallen back recently as questions have been raised about the sustainability of Chinese demand for raw materials. Oil has also rebounded strongly, but the longer term structural trends towards clean energy and ESG investing should be considered as part of any investment. Gold continues to perform a role as part of a well-diversified portfolio but the transition of inflationary pressures, and their potential impact on interest rate and currency pairs, could play a key role in the performance of gold for the rest of 2021.

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As an active investment manager, we are conscious of the need to invest our customers funds responsibly. When investing responsibly, we look to generate a positive impact whilst also aiming to generate positive returns.

Responsible Investment Engagement by Zurich Life



€10.6bn

equity assets that include an ESG consideration



12,000

resolutions we voted on



€1.8bn

corporate bond assets that include an ESG consideration



1,200

resolutions we voted against management on



8,300

companies covered by MSCI for ESG factors



380

380 company engagements across our equity regions

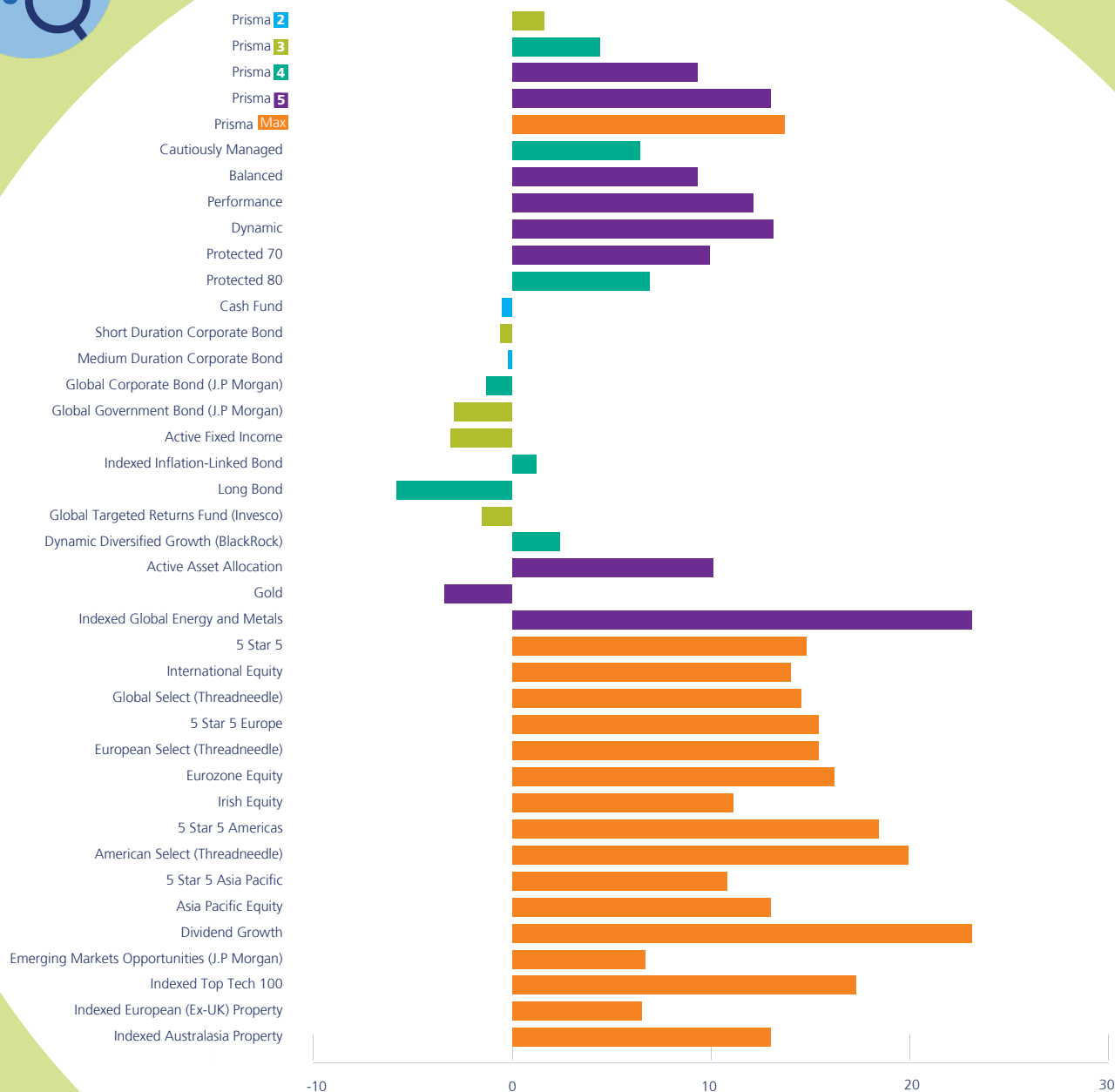
Source: Zurich, 31 December 2020.

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2021 Performance

Risk/Reward
Rating

Lower ——— Higher
1 2 3 4 5 6 7



Notes: A 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 31/03/21.

Source: Zurich Life as at 01/07/21.

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Zurich's Portfolio Builder helps you work with your financial broker to create an investment portfolio that is tailored to your individual risk profile and financial needs.

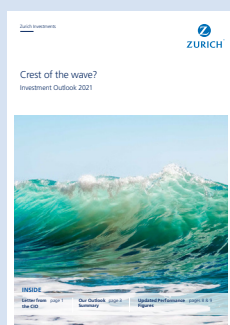


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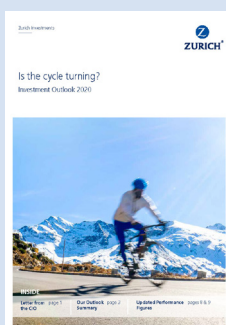
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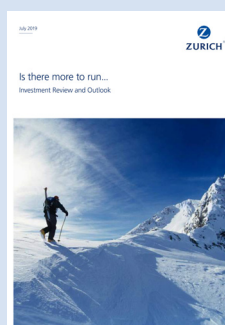
H1 2021



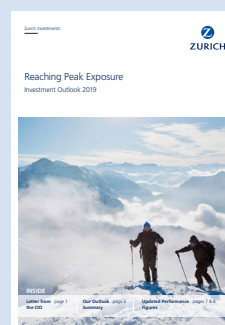
H2 2020



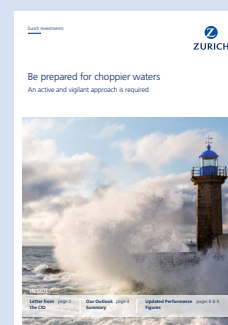
H1 2020



H2 2019



H1 2019



H2 2018

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