Difficult terrain ahead?

Investment Outlook July 2022

2022 Review – The Year so Far

Equity markets hit a record high on 3 January 2022 but have fallen steeply since. The first quarter saw a focus on the escalating tensions in Ukraine which culminated in the Russian invasion in late February. In turn, energy and commodity prices soared adding fuel to an existing post-Covid inflation spike. This was a rare combination of supply-driven and demand-led inflation pressures that resulted in central banks rethinking interest rate policy and investors re-pricing risk assets. The result was falling equity and bond prices, with little room to hide in the overall investment universe, albeit that cash and commodities did help support multi-asset funds with such exposures.

For equities, the global market returned approximately -20% in local currency terms. The fall in the euro over the period was material and this cushioned the fall for a euro-based investor, such that global equities in euro terms were down by 13.5% with Hong Kong (+0.8%) and Ireland (-25.7%) the best and worst performing geographical regions respectively. More growth orientated sectors were hit hardest, with consumer discretionary (-25.9%) and technology (-23.6%) both performing poorly on a sectoral basis. Energy was the star performer in the equity landscape, driven by the sharp rise in oil and gas prices following the Russian invasion. Sector divergence (the difference between the best and worst performing sectors) so far in 2022 is one of the highest on record.

Within fixed income markets, bond yields have moved higher in line with interest rate expectations, which pushed bond prices sharply lower. Longer maturity sovereign bonds were particularly impacted and the benchmark over 5 year euro government bond index has returned -16.9% for the first six months of 2022. Consumer confidence has been negatively affected by the rising cost of living and the squeeze on real disposable incomes. Partly as a result of this factor towards the end of the period recession fears rose putting some safe-haven demand back into the sovereign bond markets.

The wider commodities' arena – not just energy - saw strong price rises throughout the first half of 2022, predominately as a result of the Russian invasion of Ukraine. Russia produces one third of the natural gas and a quarter of the oil consumed in Europe, so actions such as boycotts, sanctions or supply restrictions were bound to have large impacts. Similarly, given the critical role of Ukraine in the global wheat supply – the price of many so-called 'soft' commodities also surged following the invasion, driving current prices higher and stoking fears of physical shortages in the future. The broad commodity index ended June up 36%, led by oil up 56% in euro terms. Gold also enjoyed a positive six months as its diversification benefits and safe-haven status once again came into play.

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For The Bulls

- Inflation and interest rate expectations plateau
- Economic growth accelerates and recession fears subside
- Chinese manufacturing growth exceeds expectations and fuels regional growth
- Consumer confidence improves post peak inflation; savings drive consumption higher

For The Bears

- Inflation, particularly within services, remains stubbornly high
- Economic growth tapers and a recession becomes a reality
- A marked increase in COVID cases leads to lockdowns
- Earnings growth falters and valuations rise

Outlook Summary

Our January outlook was titled 'Bumpy Road Ahead?', and such a journey materialised. We did not predict nor forecast a Russian invasion of Ukraine, and whilst the stubborn nature of inflation was not the market's base case, policy action in response has followed a more conventional path. This has created challenges for multi-asset portfolios, as both equities and bonds are displaying a strong positive correlation within a negative market environment.

Notwithstanding this scenario, for now, we continue to favour equities over other asset classes for now. In the near term this preference may shift, as markets continue to react to economic data and the subsequent policymaker response. Therefore, there may be times when selling into equity strength represents the best course of action. Recognising that inflation is the key factor for policymakers and for all asset classes, if medium term inflation expectations remain reasonable, that raises the probability that the underlying equity trend remains intact. Equally, we are prepared to pivot in a different direction if our judgement is that inflation expectations have not stabilised at a reasonable level.

Our stance towards fixed income, namely sovereign bonds, remains more cautious. It does now seem that the multi-decade bull market for fixed income has ended, and that a decade long period of loose monetary policy is ending. We have maintained our prior exposures to investment quality corporate bonds with the duration (or sensitivity to changes in interest rate expectations) towards the shorter end of the curve across all relevant portfolios. We do not believe that we are there yet, but there may come a level where sovereign bonds represent a more compelling investment opportunity, and we maintain the flexibility to reposition our portfolios for such a scenario.

Equities

Within our equity portfolios we are more neutrally positioned from a sectoral point of view than we have been in recent years, and we stand ready to react to market inflection points through the lens of our top-down investment process.

Whilst equity valuations, for example price/earnings ratios, have contracted materially year to date, this has mainly been from equity prices falling rather than earnings expectations. The latter may change if companies have to contend with a materially weaker economic environment as a result of lower real disposable income, higher input costs and tighter monetary policy. We have yet to see much by way of lower guidance from businesses, but that fear has been one of the factors already pushing equities lower, and investors will be very focused on company statements from now on in that regard. Flows into equity markets have continued to be positive this year, despite the negative returns and poor sentiment from certain parts of the investor universe. Continued flows like these would normally be viewed as a positive but may turn out to be more a sign of complacency.

Certain valuation metrics are now at more attractive levels than previously. For example, the price/earnings ratio in the US market is now under 16 times, which puts it below both the five year and the ten year averages. However, lower absolute valuations are tempered by higher discount rates (higher bond yields) which reduce the relative attractiveness of equities. Sector dispersion is likely to continue, as certain sectors will have more scope to pass on price increases and preserve profit margins in a higher interest rate environment. Therefore, opportunities in more defensive sectors, or within those who benefit from higher rates, have emerged, and will continue to do so over the rest of the year. In conclusion, the themes of inflation and the subsequent monetary response plus earnings' concerns will be the key drivers of the equity markets for the second half of the year.

Fixed Income

Inflation in developed markets has hit 40 year highs and it has led the Federal Reserve, Bank of England, and several other prominent central banks to hike interest rates quicker than previously forecast. For example, the Federal Reserve hiked interest rates 0.75% in mid-June (the biggest hike since 1994) to bring the headline rate to 1.75%, the European Central Bank (ECB) has not yet moved rates higher, but has indicated that it intends to in both July and September, and respective bond buying programmes have been scaled back. How the ECB navigates a path of higher interest rates without causing large divergence in individual member borrowing costs remains a key policy challenge.

Whilst market-based real yields, which take account of investors' inflation expectations, have risen in the US they remain firmly in negative territory within the eurozone. Therefore, despite the 10 year German Bund yield's move back above 1% for the first time since 2015, the risk/return trade off within eurozone sovereign bond markets remains challenging. However, given the move higher so far in yields, bonds are at least more credible as an investment than they have been for some time during the period of negative rates.

In relation to credit markets, our focus remains on the shorter end of the overall yield curve. There has been some widening of spreads as inflation, interest rate expectations and subsequent recession fears have grown. However, we believe there continues to be opportunities from issuers of higher quality within an overall defensive posture on fixed income assets.

Currencies & Commodities

Commodities have enjoyed strong price returns in 2022 as a result of the war in Ukraine and enduring supply chain issues. However, we have seen weakness in certain commodities throughout June as concerns over an economic slowdown emerge. Energy security remains a key issue, particularly within Europe. Positive developments in relation to the conflict in Ukraine would likely see supply pressures ease, and prices fall. However, the situation remains difficult to forecast. Allocations within our alternatives sector will continue to be adapted on a tactical basis.

The euro has weakened materially versus the US dollar in 2022, as US interest rate expectations shifted sharply higher and the dollar's status as the global reserve currency was reinforced during bouts of volatility. This has proved to soften the negative returns experienced by euro investors in global equities. With the EUR/USD rate moving closer to parity, we could see a reversion in the trend of a weaker euro, as ECB policy moves more in line with that of the Federal Reserve.

Four pillars of Responsible Investment at Zurich

At Zurich we aim to create sustainable value for customers, shareholders, our people, and broader society. This is core to how we do things; we focus on long-term success over short-term gains. Our approach to Responsible Investment is fully integrated with and complements our active top down investment process. We intend to continue to play our part in supporting a more sustainable world.

1. Environmental, Social and Governance (ESG) Integration

- As an active investment manager, many of the aspects of ESG have always been part of our approach to analysing investee companies.
- All our portfolio managers are formally trained in relation to both the theory of ESG factors and the interpretation of the data. We also partner with Morgan Stanley Capital International (MSCI) as our provider, and this is integrated fully into our front office systems.

When we are analysing companies, ESG information is readily available alongside other more traditional data such as P/E ratios, earnings forecasts, and balance sheet metrics.

2. Active Ownership

- This is an area where we strongly believe that active investment managers have a clear advantage over passive counterparts. At Zurich, active ownership incorporates both exercising our voting rights as shareholders, and also engaging with investee companies.
- We partner with Glass Lewis, who provide a shareholder proxy voting advisory services to formulate our overarching policy. Here in Ireland, we are in our fourth year of full proxy voting, and our proxy voting policy is publicly available on our website, in keeping with the Shareholders Right Directive II.

Full voting records of Zurich for every investee company is also publicly available on our website.

3. Exclusions

- At Zurich, there are specific activities that we see as irreconcilable with our purpose, values, sustainability strategy and pose a high reputation risk. For these activities detailed exclusion criteria are defined. Zurich will not consider any investee companies affected by those criteria.
- Our exclusion policies cover business activities in thermal coal, oil sands and oil shale, and the percentage threshold in these areas has been reduced from 50% to 30% in recent years, which reflects the constant evolution of Zurich's approach to Responsible Investment.
- We also do not invest in banned weapons and will not invest in companies that produce, stockpile, distribute, market, or sell banned cluster munitions or anti-personnel landmines.

While we have a strong preference for ESG integration and engagement, there are certain areas where we believe strict exclusions for certain activities are justified.

4. Carbon Ambition

- In 2022, Zurich has introduced a carbon reduction ambition across its internally managed equity and credit portfolios. The aim is to reduce the carbon intensity of equity and credit portfolios in our multi-asset funds by 25% by 2025 vs 2019 levels.
- This will be pursued within the framework of Zurich's existing top-down active investment process. In order to support this ambition, we will monitor the carbon intensity of our portfolios versus a trend line, and report to existing internal oversight groups and committees.

We intend to achieve this by continuing and enhancing our existing use of environmental, social and governance (ESG) data, and by active voting and engagement with investee companies.

Interested in finding out more on Responsible Investment with Zurich?
Visit: zurich.ie/responsibleinvestment.

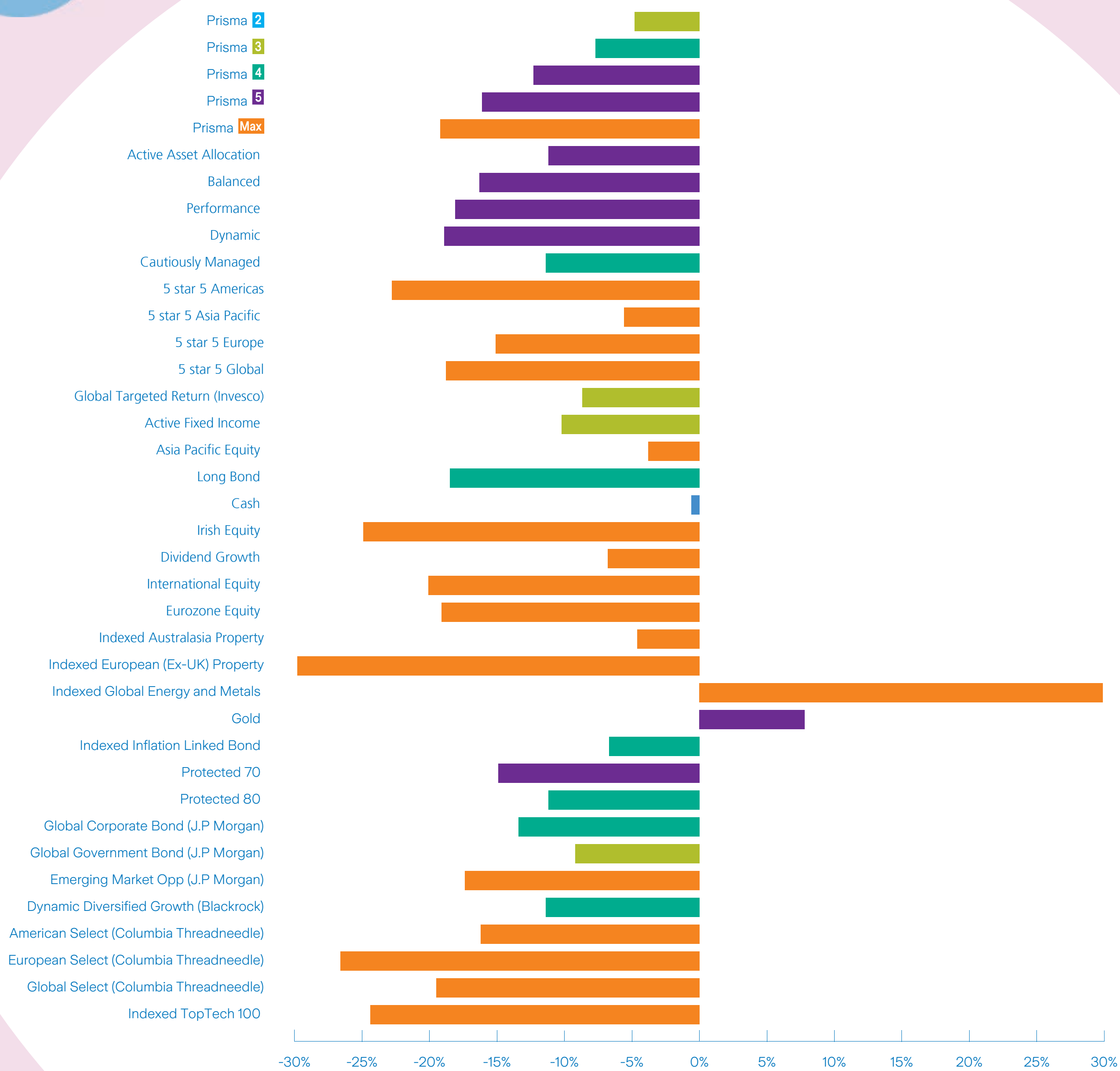
2022 Performance

year to date

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 31/03/22.

Source: Zurich Life as at 01/07/22.

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Warning: If you invest in this product you may lose some or all of the money you invest.

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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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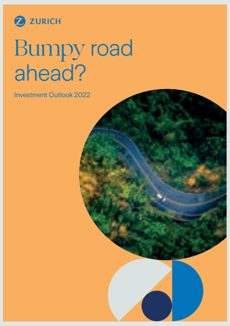

H1 2022

H2 2021

H1 2021

H2 2020

H1 2020

H2 2019

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