ZURICH

Markets at important Juncture?

Investment Outlook July 2023



2023 Review – The Year so Far

2023 has proven to be positive so far. Equity markets rebounded strongly into bull-market territory, brushing off much of the turmoil experienced throughout 2022 and absorbing further short-term interest rate increases. Declining inflation – albeit slower than the ideal pace of decline – plus the stabilisation of long term interest rates has underpinned risk assets. Corporate profits have also been better than feared. This backdrop has been favourable for Zurich's more positive position towards risk assets, such as equities, since the start of the year.

The re-emergence of growth sectors, following a poor 2022, has been a feature of equity markets year to date. So-called 'equity market breadth' has been narrow for much of the year, with the returns of major equity markets being more weighted towards large technology and growth stocks. This has made many commentators concerned about the health of equity markets, a view we disagree with. 2023 has also seen the emergence of a new secular theme in technology sectors through artificial intelligence. In the second quarter of the year many of the technology companies connected to this theme out-performed significantly.

In early 2023 we witnessed China, the world's second largest economy, reopen after a prolonged period of strict covid lockdowns. Investors were poised for a resurgence of growth in Asia as a result. The ensuing upswing in economic activity however has been more muted as the country was faced with weaker than expected export demand and internal demand that fizzled out quickly; negative sentiment in the property sector continues to weigh on consumer confidence. In Europe, a mild winter mitigated the worst effects of energy scarcity and some of the more pessimistic predictions were not realised. European gas prices are now below pre-war levels which has helped lesson inflationary pressure somewhat. A mild technical recession did ensue over the turn of the year, nonetheless.

In March we saw the emergence of turmoil in the banking sector. The collapse of California based Silicon Valley Bank caused short-term nervousness amongst investors. While in Europe, the investment bank Credit Suisse endured a last-minute rescue when an acquisition was brokered by the Swiss authorities with local rival UBS. Fears of contagion into other sectors of the economy fortunately did not materialise given the swift action by policymakers and regulators and the crisis failed to dampen the overall upward trajectory of markets.

The first half of 2023 saw global central banks continue to hike rates. While inflation rates have slowed central banks have been unhappy with the pace of that slowing. Labour markets have remained strong and this has emboldened central banks to continue to increase interest rates. In June the Federal Reserve did pause its rate hikes after over a year of consecutive increases but we may still have a small amount of further tightening before they finish this cycle of monetary tightening. In Eurozone the ECB remained hawkish, as despite a 3.1% reduction in inflation, prices remain elevated.



Whether this translates into a recession in the US and another one in the Eurozone is of less concern to us than whether we get a deep and prolonged recession. Markets are not priced for this – correctly in our view."



For The Bulls



- A recession is avoided, or is shallower than feared
- China loosens policy and boosts growth
- Developed world consumers prove unexpectedly resilient
- Positive secular trend in technology sector

For The Bears



- Inflation remains unduly sticky
- Central banks overtighten
- High public debt levels become a market focus
- Geopolitical tensions are stoked once more

Outlook Summary

The view that a recession is inevitable has been a very pervasive viewpoint in markets throughout 2023. In our view a lot of the bad news had been discounted in the market action seen in 2022, so we were not overly concerned being positive towards equities at the beginning of this year. In fact, given the strong returns for equities so far this year we are well off the lows of 2022, and we are now in a new bull market.

Investors are still portraying a more cautious outlook however, notwithstanding the gains experienced so far this year. Investor sentiment, amongst other metrics, can be a useful indicator to inform our short-term asset allocation stance. Such metrics are currently indicating that we are far from full blown exuberance or euphoria.

Inflation expectations remain a key input into forming our views on medium-term risk asset expectations for equities and the current readings continue to suggest a supportive medium-term backdrop. We maintain a broadly constructive viewpoint on equities as we enter the second half of 2023.

Volatility will likely persist and we are always cognisant of risks to our broadly benign stance. We have moved from one monetary policy regime to another quite quickly and shocks have occurred as generally expected; the banking problems that we referenced earlier being good examples of this.

Economic indicators suggest weakness in manufacturing across many regions and potential weakness to come in the more labour-intensive service sectors. Whether this translates into a recession in the US and another one in the Eurozone is of less concern to us than whether we get a deep and prolonged recession. Markets are not priced for this – correctly in our view.

One concern we do have however is that markets are pricing in interest rate reductions in the US and Eurozone for 2024 which we think is premature. Inflation is on a downward path but slower than central banks would like. Central banks have a tricky path to tread and there remains a greater risk of over-tightening in our view than of them being too cautious on the interest rate front.

For this reason, 'higher interest rates for longer' may emerge as a theme for the second half of 2023. This would likely induce choppiness into equity markets but within what we see still as a broadly positive trajectory. With that in mind, we are cautiously optimistic and will maintain a broad buy on dip mentality in relation to equities for now.

Equities

Equities have shrugged off thoughts of an imminent recession in the US. Economies may be slowing down and this is reflected in leading indicators such as the Purchasing Managers Index data. We do not believe that any recession if it does emerge, will be particularly severe or lengthy. This supports a more quality and growth orientated equity portfolio at this time.

On a rate of change basis, the higher interest rate environment is now less of a headwind i.e. once rates reset to a higher level, it is less of an issue for equities. Furthermore, a more normal monetary environment can help provide certainty for individual firms. As is often the case, companies with solid cash flow and manageable debt levels appear attractive, and those with strong pricing power could fare better as inflation continues to cool. In what is now a clearly positive interest rate world, investors may prefer a more selective approach to capital allocation at an equity level.

We did prefer European over US equities as we entered 2023, but during the second quarter shifted back into the US in line with the market focus on quality/growth sectors. Artificial Intelligence (AI) has developed into an important equity market theme and the ensuing positive impact on growth stocks, including the mega cap tech giants, disproportionately benefits US equities. At a sector level, it is a bifurcated market however. Sectors which positively surprised from an earnings perspective so far this year have been duly rewarded by the market but investors remain discriminating and intolerant of earnings' disappointments.

In the US, whilst leadership/market breadth has been narrow, there are signs that this is beginning to broaden out into other areas. This creates opportunities for us as active managers to participate in the widening of potential leadership sectors. Whilst the discussion surrounding AI advancements has partly fuelled the market in recent months, we have trimmed some of our exposures to the main beneficiaries in recent weeks, as they may well pause for breath following the recent strong run up in prices.

Fixed Income

We have seen a regime change in terms of both inflation and central bank policy and this has impacted both bond yields and prices. Real rates are now positive, which gives us more opportunities within fixed income allocations from both a single asset and multi-asset fund perspective.

Much of the supply chain dislocation that emerged during COVID has been resolved and central banks have tightened policy very significantly. It is worth noting that whilst rate hiking is not complete, there is a lag between when a rate rise occurs and when its full impact is felt in the economy and in subsequent data. Conversely, it seems that the period of greatest inflationary pressure has passed, and despite a slow start, central banks such as the ECB are now in a much better policy position than before. Therefore, our outlook on bonds is more positive than it has been for some time. Whilst this is not fully reflected in absolute allocations given our preference for equities, it is evident within the duration of bond portfolios.

Within portfolios, since the end of 2022 we have progressively been moving from shorter duration bonds (less sensitive to interest rate expectations) to a more neutral longer position. This reflects the significant increases in bond yields to what is now a much more sustainable level of real yields, which in turn represents much better value for bonds on a medium-term basis.

For example, the German ten-year bond yield has been more range bound in recent months, following its sharp move higher. This means that capital or price returns have become more stable, but at levels where positive yields accrue to returns at a fund level; a sharp contrast to what we have seen for much of the last decade.

On a geographical basis, we are observing a more unified and supportive approach from the European Union in relation to supporting countries on the periphery (such as Italy). Therefore, we have been able to capitalise on this scenario by picking up additional yield in those markets, and also additional capital gains as yield spreads have compressed.

We are more cautious at the shorter end of the yield curve at this time. However, this area will benefit during bouts of volatility, which will undoubtedly materialise at times throughout the market cycle. A key risk at this stage is the potential for central banks to maintain higher short term interest rate for longer than markets currently expect, thereby disappointing current market expectations. However, overall, we are much more constructive on bonds than in recent years.

Currencies & Commodities

As we enter the second half of 2023, we maintain our partial hedge on the EUR/USD currency pair, expressing a moderately positive view on the Euro. Whilst the ECB continues its tightening path, we believe the Euro has the potential to strengthen further from this point.

In relation to commodities, the outlook for oil is more balanced given the relatively calm (versus 12 months ago) geopolitical backdrop. As mentioned previously, economies continue to expand but at a slower pace which reduces the demand for oil. However key OPEC members such as Saudi Arabia, in conjunction with non-OPEC players such as Russia, may continue to attempt to put a floor under prices via production cuts. In relation to soft commodities, geopolitical forces will be a key influence. For example, any non-renewal of the Russian-Ukraine grain export deal would likely push prices higher.

Overall, despite a somewhat unclear outlook for several key commodities, we continue to materially allocate to alternatives such as gold and a wider basked of commodities within our Prisma multi-asset funds.



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(Zurich.com, July 2023)

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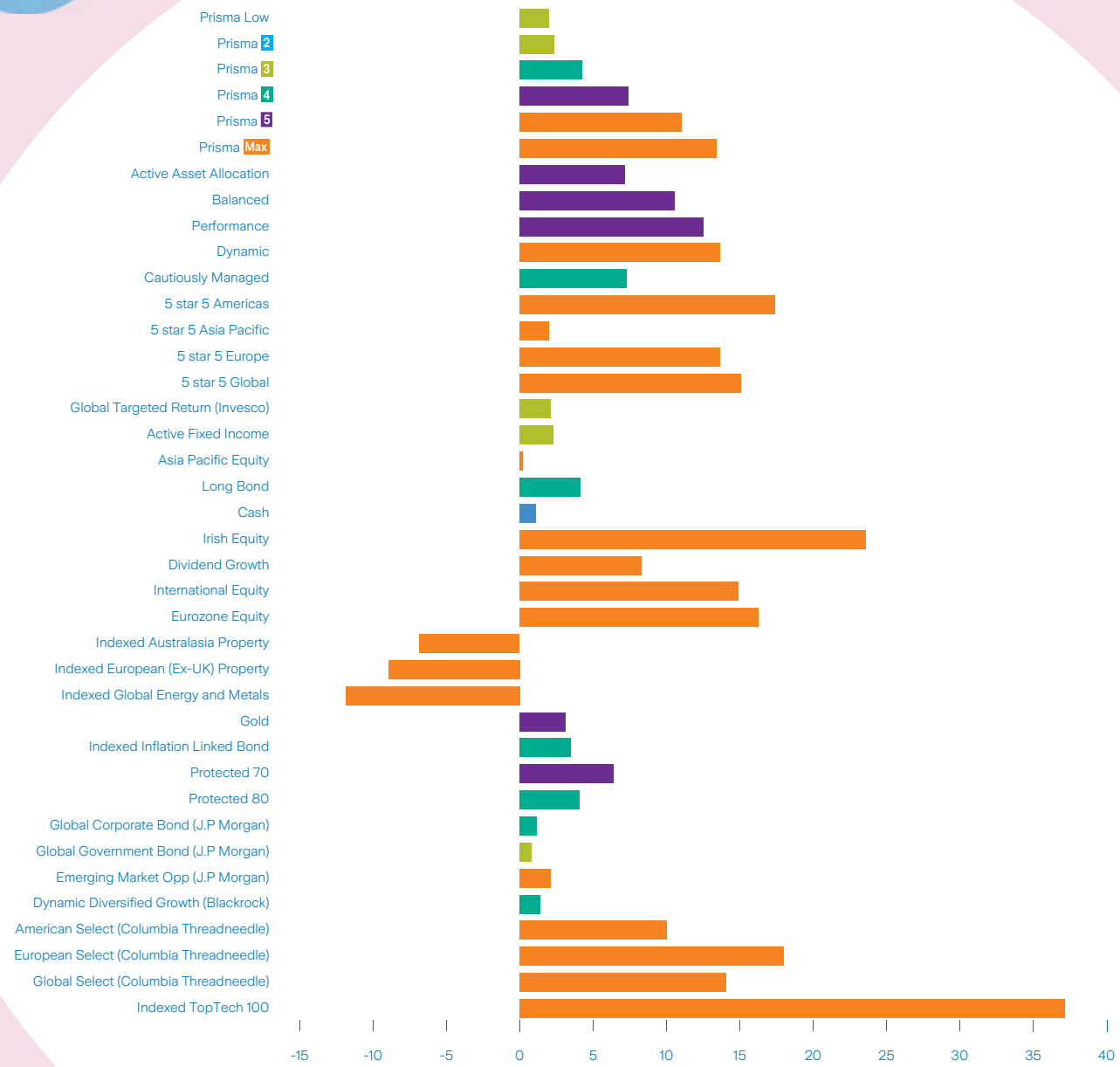
2023 Performance

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. ESMA Ratings as at 01/07/23.

Source: Zurich Life as at 01/07/23.

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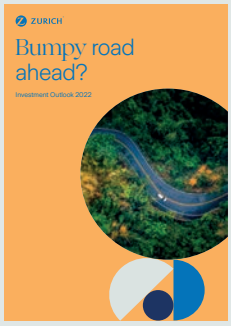
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H1 2023



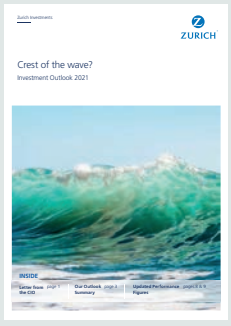
H2 2022



H1 2022



H2 2021



H1 2021



H2 2020

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Intended for distribution within the Republic of Ireland.

GR: 7979 Print Ref: ZL IB 182 0723

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