

Staying vigilant in unpredictable times

Investment Outlook 2017: The half-year update





Key Highlights



Equities are still the more attractive asset class on relative valuation grounds



Ultra-low bond yields
– an unattractive long-term investment?



Investment market
volatility to continue

Despite economic uncertainties, relative value still favours equities

Dear Investor,

We at Zurich maintain that we are not market forecasters and the tumultuous events seen in 2016 and into 2017 underscore that stance. Being in tune with market trends, having a flexible stance whilst maintaining conviction is our approach, and one we have persisted with for many years now. Historical patterns suggest to us that the remainder of 2017; and into 2018, could be another period of volatility. We believe that volatility presents opportunities for active managers, and the active asset allocation decisions that we made, in particular in the latter part of the 2016 and into 2017, has led to strong returns across the large majority of our funds.



We see two main trends continuing for the rest of 2017 – volatility across asset classes, and positive returns from equities. Dutch and French elections, the new US administration, and the formal signalling of Brexit were all highlighted by commentators as potential events to derail markets. However, many of the same commentators have been confounded by how quickly equity markets regained their poise and moved higher shortly after those events.

We remain focused on our top-down view of the world – where economic and market cycles drive asset allocation preferences – combined with a due regard for price trends and risk control. We feel that the balance of evidence backs our current market stance: namely heavy equity positions and low fixed income weightings. We are always alive to extremes of sentiment or valuation that might arise and recognise that some of our views are becoming consensus now. We firmly believe that active asset allocation is unavoidable and can provide significant benefits to investors. With this in mind we expect to get opportunities over the rest of the year to reposition our asset allocation or currency exposures, either tactically or for the longer term.

We increased our equity allocation by 6% in the Active Asset Allocation (AAA) Fund towards the end of April. The AAA Fund is potentially the best illustration of our house view, but this asset allocation change is implemented proportionately across all our multi-asset funds. Some of the reasoning behind this move included: the positive market reaction to the results of the first round of the French election, and positive data emanating from Europe, from both an economic and earnings perspective. Absolute valuations are not low, but are attractive versus competing asset classes such as fixed income. Political risks in Europe and across the globe have dissipated somewhat, and tax reform in the US has come back onto the agenda.

Looking forward into the rest of the year we will work hard to provide positive outcomes and to help people meet their investment objectives. Being able to consistently offer investors a positive, inflation beating performance is of great benefit, and we hope to continue to be able to offer this to all our investors. Thank you once again for your support so far in 2017, and indeed over the last 28 years.

A stylized, handwritten signature in blue ink, consisting of a large 'D' and 'W' connected together.

David Warren
Chief Investment Officer

The Year So Far...

Markets have been in an upward trajectory for over eight years and this trend has continued in 2017 on the back of improving economic data globally, good corporate earnings growth and the expectation of an expansionary economic policy by the new US administration. However, from a eurozone investor perspective, gains in international markets have been significantly eroded during 2017 by a strengthening euro currency.

Global growth expectations have been revised upwards, improved global growth prospects are evident and economic indicators are encouraging in the medium term.

- The US is experiencing one of the longest economic expansions in its history.
- In Europe we have seen consistently improving economic data.
- Monetary policy remains highly accommodative globally, and credit conditions continue to improve.

Despite political changes in the US, UK and France, the markets are now focused on structural factors that could drive more dynamism in those economies.

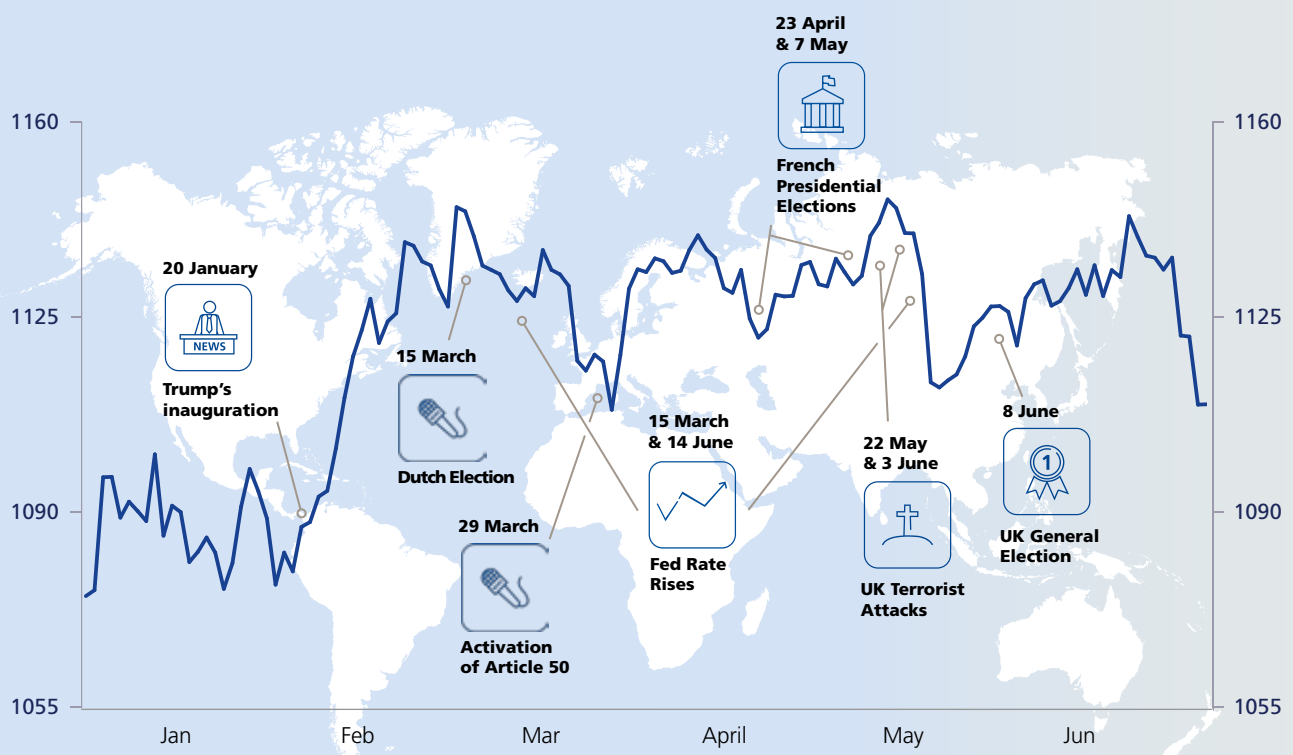
Equities are above fair value, but not excessively so, and remain attractive versus historically low bond yields.

Market action suggests the end of a multi-decade period of declining long term interest rates. We do not anticipate that equities will be undermined by a modest rise in long term interest rates. Opportunities will periodically emerge in currencies that have recently been weak.

Investors need to prepare for, but not be deterred by, volatility, which will remain a feature of the landscape for the period ahead, as investors adjust to the end of ultra-accommodative monetary policies.

World Review of 2017

Markets withstood geo-political shocks



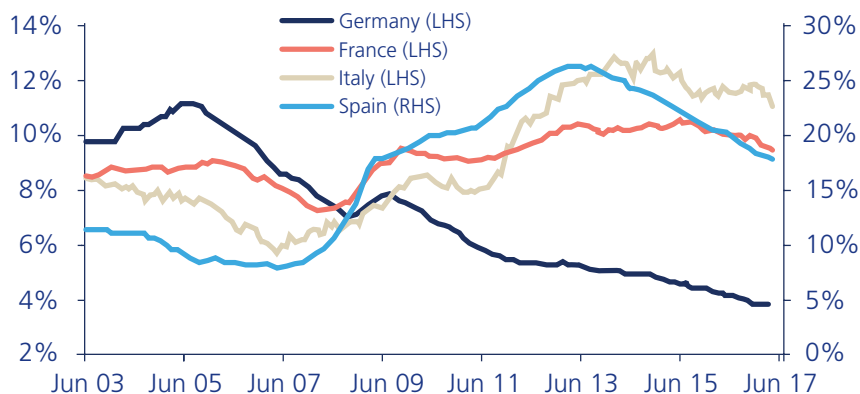
FTSE World index in euro terms. Source: Bloomberg 30/06/2017.

Equities

- Global GDP forecasts have continued to recover to around 3.6% this year with a further 3.5% in 2018 expected. This has been a positive back drop for equity markets, with Europe and Asia showing more positive economic data and recovery versus expectations at the beginning of the year.
- Earnings growth has been strong with good momentum in both the sales growth and earnings per share; particularly in Q1 where results came in well ahead of analysts' expectations and the outlook for Q2 earnings growth is also positive. So while equity valuations are not particularly cheap the strength we are seeing in company earnings is supportive of equity markets. Business and consumer confidence are continuing to improve and that also supports improving economic conditions.
- A diminished European political risk is now evident in the market. Prior to the French election, equities had marginally fallen and cyclical stocks had underperformed, whilst more defensive stocks had outperformed. However, once Emmanuel Macron won the preliminary election European equities rallied strongly as investors saw the opportunity to buy the economic recovery in Europe; now that political risk of a Eurozone breakup was reduced. The US equity market has also benefitted from the prospect of tax reform and fiscal stimulus under the US administration, albeit this has waned over the last few weeks.
- Equities remain the most attractive asset class from a relative valuation perspective, with projected global earnings growth of 14% for 2017.

Zurich has remained positive on equities since the beginning of the year with the equity content of the funds at the high end of their equity ranges. A preference for the US and Asia over Europe was held at the start of the year, in early March that was switched to a regional preference of Europe and Asia. Equities remain the favourite asset class from a relative valuation perspective.

Broad-based fall in unemployment rates across the Eurozone



Source: Bloomberg, July 2017



Fixed Income

- Bond yields have remained very low, particularly in Europe as the ECB has remained dovish emphasising that inflation remains low and wage inflation is subdued. The ECB has been reducing its level of quantitative easing but it is unlikely the ECB is going to increase rates in the near term which is keeping bond yields low. However, European sovereign bonds did come under further pressure towards the end of June and have generally moved to the top of their trading range.
- In the US, the Federal Reserve implemented a 0.25% interest rate rise on 15 March, with another more recently at the June FOMC meeting. The market currently expects one more rate rise this year, most likely in December.
- Zurich has remained cautious on bonds as yields remain towards their lows and fixed income valuations do not look attractive at these levels.

What's in store for the rest of the year?

Equities

Equities are still the more attractive asset class on relative valuation grounds

- On an absolute basis equity markets are more fully valued, and are above historical averages.
- A boost to earnings – in line with some modest improvement in global economic activity and perhaps a small lift to inflation from a low base – would be supportive.
- Relative to bonds – which remain on highly elevated valuations – equity markets are favourably valued.
- We still see equity markets still have further upside despite the broad gains in global markets over the past number of years. Earnings have been positive and supportive of the market, and could continue to be in the future.
- We do not yet see the signs of euphoria that would signal a cyclical or structural end to the equity bull phase.
- At some stage a shock to equities could emerge from an accelerated rise in bond yields or inflation.
- Consensus expectations for earnings growth in 2017 remain at approximately 14%.
- The structural backdrop in the eurozone is improving and some structural risks have been alleviated, although fears of a crisis could re-emerge. Asia and Japan should offer interesting opportunities for the remainder of the year. The US market arguably remains the 'cleanest' structural case for an equity investor, but we remain alert to its absolute size in the global markets, the need for diversification, and its fuller valuation.
- The dividend yield on pan-European equities at 3.3% offers an income uplift compared to existing government yields, whilst the US dividend yield at 2.0% is not as supportive.

Bonds

- ECB policy rates should remain low for an extended period of time due to low inflation, although clearer signs are emerging of a more hawkish ECB. The perception of deflationary risks has diminished and this could impact on ECB policy action.
- Valuations are not supportive of most European fixed income as a long-term investment.
- The volatility of the global bond market is consistent with the end of a multi-decade period of falling long term interest rates. This could be followed by a long period of choppy price action, but risks are skewed to the upside now.
- Inflation, although still at historically low levels, has seen a pick-up due to rising commodity prices and some upside wage pressures in the US. Since investors – and central bankers – have been focused on downside inflation risks for so long, it would not take much change on the upside to produce inflation concerns.
- Inflation expectations remain subdued, despite sitting below the historical average. Tapering from the ECB is moving more into focus.

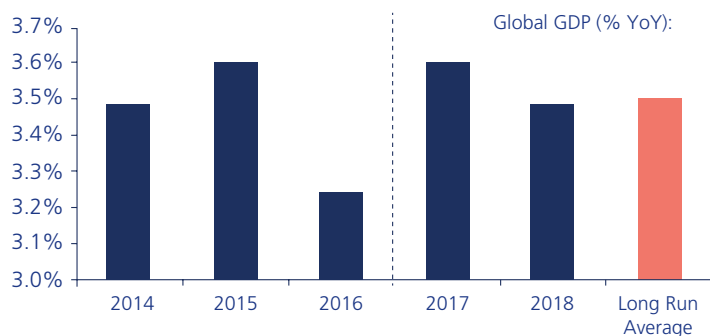
Upside risks to outlook

- Global growth accelerates, building on the momentum from the first half of the year.
- A sharp rebound in energy prices materialises, allaying deflationary fears.
- Monetary policies remain ultra-accommodative globally.
- Interest rate increases in the US are interpreted as a vote of confidence in the economy and a welcome return to normality.

Downside risks to outlook

- Economic growth peaks globally, after a prolonged upswing.
- Monetary policy tightens more than anticipated in the US; how will markets react?
- ECB policy action, by initiating a tapering of the QE programme, could weigh on markets.
- Upcoming elections in Germany, and potentially Italy, pose some political risks for Europe for the remainder of the year. Structural risks also remain; hard or soft Brexit?
- US – China relations deteriorate, where geopolitical clashes over North Korea and Taiwan, and further protectionist rhetoric could weigh on markets.

Global Growth Expectations



Source: ZIG, Consensus Economics, IMF, Bloomberg; Note: Calculated at PPP weights, July 2017

Preview of 2017



Important Central Bank Meeting Dates

- \$ The Federal Reserve
- € European Central Bank
- ¥ Bank of Japan

Currencies

- As we have said on many occasions no major country has the inflation justification for actively pursuing a stronger currency. The US has been able to shoulder a stronger currency as other economies such as the eurozone, Japan, and China have pursued weaker currencies actively, or as intended consequences from other policy measures. There are however limits to the US's tolerance of this.
- The Euro currently sits towards the top of its recent 1.05–1.15 trading range with the US dollar, and has strengthened over the course of Q2 on the back of stronger economic growth and more hawkish rhetoric from the ECB.
- Japan's preference for a weaker currency is offset by its strong external position and the limits of the global 'zero sum game' of currency manipulation.

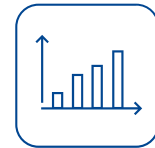
Commodities

- Oil has suffered over the course of 2017 as the market was caught between the expectation of further production cuts from OPEC and the re-emergence of US shale producers. The US decision to reverse its support for the Paris climate accord also weighed on oil prices.
- Economic growth tends to help commodities, and both Gold and Copper have enjoyed a positive first half of the year in local currency terms. The stabilisation of the oil price in the current range could lead to higher prices.



2017 Performance year to date

Delivering Positive Returns



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 31/03/17.

Source: Zurich Life as at 30/06/17.

Warning: Past performance is not a reliable guide to future performance.
Warning: The value of your investment may go down as well as up.
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Calendar Year Performance over 10 years

The Benefits of Diversification



	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Prisma 2	-0.5	1.6	1	3.3							
Prisma 3	0.0	4.1	2.6	7.1							
Prisma 4	0.8	8.5	4.9	14.2							
Prisma 5	1.1	11.3	6.2	16							
Prisma 6	2.7	9.8	7.9	7.4							
Active Asset Allocation	0.7	8.1	4.9	14.6	3.9	10.5	-1.8				
Balanced	2.7	6.7	10	15.3	16.1	13.1	-2	11.1	22.3	-30.4	0.8
Performance	3.7	6.9	10.9	16.1	17.2	12.6	-2.4	11.4	25.8	-35.2	-0.2
Dynamic	3.8	7.4	11.8	15.8	19	13.1	-3.4	12.9	28.1	-37.8	0.3
Cautiously Managed	1.2	5.1	6.3	18.6	6.7	12.3	3.6	5.3	12.7		
5★5 Americas	-2.7	14.1	11.8	28.8	24.7	10.2	-0.9	14.7	11.1	-22.9	5.9
5★5 Asia Pacific	14.6	10.4	5.7	9.2	2.6	16.7	-8.5	6.9	47.3	-49.6	20.2
5★5 Europe	9.6	4.8	17.5	8.6	23.6	28.8	-8	6.4	28.7	-43.9	4.6
5★5 Global	3.2	4.5	13.3	13.3	17.6	16.2	-6.4	12.3	18	-35.8	3.2
Invesco Global Targeted Return	2.2	2.1	1.6								
Active Fixed Income	-1.5	4.7	1	20.3	2.4	12.8	6.5	1	4.2	12.3	0.4
Asia Pacific Equity	12.1	11.4	0.8	10.5	1.6	19.6	-9.8				
Long Bond	-2.9	6.3	1.8	28.2	1.5	14.6	6.3	1.3	3.2	11.6	-2
Cash	-0.4	-0.8	-0.5	-0.3	-0.4	-0.5	0.4	-0.2	0.1	3.5	3.5
Irish Equity	5	-0.8	38.5	16	33.7	19.6	5.5	1.1	27.1	-63.8	-21.9
Dividend Growth	1.2	17.3	6	18	20.1	18.9	0	19.1	28	-39.7	-13.7
International Equity	3.4	10	10.7	17.7	20.6	13.5	-3.7	16.9	26	-36.1	3.7
Eurozone Equity	9.2	5	11.7	4.3	25.5	24	-12.9	7.7	32.3	-39.3	11.3
Fund of REITs	6.5	-11.2	27.4								
Indexed Australasia Property	0	11	2.4	26.1	-10.3	34.5	-14.9	28.2	68.1	-58.3	
Indexed Eurozone Ex UK Property	6.9	3.9	16.6	20.6	3.8	24.5	-13.2	20.9	36.5	-35.8	
Indexed Global Energy and Metals	-13.4	21.5	-20.2	-12.4	-5.3	-2.9	0.5	16.4	18	-48.9	19.5
Gold	-1.2	12.3	-2.3	12.8	-31.4	3.4	14	35.4			
Indexed Inflation Linked Bond	-2	3.4	0.1	4.6	-4.4	10.3	-1.8				
Protected 70	1.8	1.4	6.4	10.4	13.1	7.5	-6.5				
Protected 80	0.8	-0.3	4.2	7.1	9.3	4.4	-5.6				
Protected 90	-0.6	-2	1.3	2.6	2.7	0.8	-3.9				
JP Morgan Global Corporate Bond	2.2	3.2	-0.7	7.2	-0.2						
JP Morgan Global Government Bond	-0.1	1.3	0.6	8.1	-0.8						
JP Morgan Emerging Market Opp	13.1	17.1	-11.5	12.5							
Dynamic Diversified Growth	4	-2.5	-1.7	5.1	5.9	6.4					
Threadneedle American Select	1	17.5	9.9	21.3	24.5	15	5.3	20.6	31.7	-37.4	6.6
Threadneedle European Select	10.4	0.1	13.9	12.9	15.7	26.4	-1.1	26.1	29.9	-41.4	3
Threadneedle Global Select	5.4	9	12.1	17.1	20	13.8	-5.5	22	27.3	-38	5.8
Indexed Top Tech 100	7.7	9.8	21.4	34.7	29.9	15.5	6.2	27.6	49.1	-39.2	6.9

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