Investment Outlook
2011

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Overall

On balance, for 2011, investors expect stable to gently rising bond yields and earnings-fuelled gains in equities. But expect another volatile period ahead, even if the net result is relatively benign.

Downside risks to outlook:

- Eurozone debt crisis induces bond and equity market volatility.
- Policy error from the ECB or Chinese authorities.
- Growth remains strong but investors focus instead on the *rate* of growth peaking.

Upside risks to outlook:

- Private demand gains further traction in the US.
- US house prices stabilise/begin to rise.
- Chinese ease policy as food-price driven inflation dissipates.

Economic Growth

Could global economic growth surprise again on the upside?

- The continuation of economic stimulus measures introduced during 2009, together with further policies introduced in 2010, such as QE2, has helped to keep mature economies on an upward, though tentative, path.
- Authorities in much of the emerging world have been taking steps to ensure more measured growth. Interest rates are on the rise in countries such as China, Australia, India and Korea.
- A two-tiered economy has developed in Europe. The larger, core economies such as Germany and France have seen growth accelerate, while peripheral areas such as Ireland, Greece, Portugal and Spain are grappling with the effects of austerity budgets.
- Recent economic indicators from the US would suggest an upturn in economic activity, though the housing market remains weak and unemployment remains stubbornly high.

Equity Markets

While policy error remains a risk, equities could progress further on the back of stronger economic growth.

- Strong Asian economies and stabilised-to-improving developed economies provide the backdrop for better corporate earnings.
- While the current consensus is for above trend earnings' growth of around 15% for 2011, better economic momentum and earnings' revisions may provide positive surprises.
- Merger & acquisition activity, which picked up in the latter half of 2010, could provide additional support during 2011.
- Equity markets may be challenged by policy adjustments and political risk in Europe, meaning that volatility could re-emerge.
- Policy errors might result in rising long-term interest rates or premature withdrawal of liquidity.

Interest Rates & Bonds

Eurozone interest rates are not expected to rise until Q1 2012, with peripheral weakness offsetting core economy strength.

- The current view is that UK and eurozone base rates are not expected to rise until Q1 2012. The US is expected to move on rates during Q4 2011.
- In peripheral eurozone countries fiscal challenges remain acute. This has been reflected in dramatic yield spread widening over core country bonds, a situation that is unlikely to resolve itself in the near-term.
- Yields in core eurozone bond markets, especially Germany, and the US Treasury market have risen recently, reflecting improving economic data. This is a trend that could continue should the economic recovery momentum be sustained.
- Inflation pressures overall remain modest, reflecting weaker data in developed economies, while stronger readings in emerging economies and Asia, especially China, have led to interest rate rises.

Currency & Commodity Markets

Will the euro remain weak in 2011?

- The US dollar strengthened versus the euro during 2010, despite the US pursuing a weaker dollar policy through quantitative easing. It closed the year quite a distance from the perceived equilibrium level, versus the euro, of 1.18. Expectations would be for the dollar to trade towards this equilibrium level in 2011.
- Euro weakness in 2010 was largely driven by severe economic turmoil in peripheral countries. These issues remain in the short-term and will continue to impact on the currency but, in the longer-term, a healthy euro will depend on strong political will, particularly from Germany.
- Soft and hard commodity prices are expected to rise further in 2011 on the back of China's growing strength, along with weak currency policies being pursued by central banks around the world. Gold could rise further, with increased financial uncertainty fuelling investors' flight into perceived safe-haven assets.
- The oil price continued its ascent in 2010 amid improving economic fortunes. Prices could rise further in 2011, provided the global economic recovery continues as projected.

This outlook of potential investment market developments in 2011 does not constitute an offer and should not be taken as a recommendation from Zurich Life. Advice should always be sought from an appropriately qualified professional.

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