ZURICH

Market update from Zurich International Life

This update is designed to provide some information on trends in various areas which impact long-term investments. However, Zurich International Life (Zurich) does not provide investment advice and you should consult your relevant financial professional before making or changing your investment choices as all investment involves risk and past performance is not a guide to future performance.

Markets around the world

UK and Europe

Although the UK and continental Europe is not a region experiencing the rapid growth of markets in the far east, it presents interesting investment opportunities. Along with the US, the UK and Europe presents investors with one of the largest and most varied markets in the world. It is home to a range of quality companies and industries – from Swedish discount retailers to Spanish banks. Compared to the US, however, the large universe of European stocks is less well researched by brokers and investors, particularly those based in the Americas and Asia, and as a result companies can be inefficiently priced by the market. Europe's varied economic landscape offers a broad range of countries, from established markets, to the exciting opportunities in emerging markets like the new European Union (EU) entrants. Europe's variety can provide an attractive source of diversification for investors looking to expand beyond a portfolio of purely UK, US or Asia based investments.

US

As the largest stock market in the world, the US is the economic powerhouse of the global economy, often at the forefront of new developments and the driver of growth in other foreign markets. Conversely, its weight can be detrimental, hence the phrase 'when America sneezes the whole world catches a cold'. Investing in the US provides exposure to long-term growth opportunities and diversification away from the domestic markets. US brands such as Ford and Microsoft are among the most well-known in the world.

Japan

Japan's economy in the 1980s looked like a world beater. The country created massive wealth from exports as companies such as Sony became bywords for excellence and global success. The share market boomed, the yen set record highs and the world gasped as the Japanese bought everything from New York's Rockefeller Centre to priceless works of art. Then, in the early 1990s, the bubble burst. Even more stunning was the country's inability to right itself despite interest rates falling to almost zero and massive government spending.

But Japan's economy appears to have kicked off these 15 years of stop-start growth due largely to the implementation of significant structural reforms that dramatically altered its financial, commercial and regulatory landscape. Investors, of course, need to be aware of the risks when investing in an economy that has struggled since the early 1990s.

Asia and China

For many investors, Asia has become one of the most attractive destinations when looking to diversify their portfolio to countries beyond Europe and the UK. Several factors have combined to build a strong case for investing in Asian equities, including strong economic growth, improved levels of corporate governance and profitability, and attractive share prices.

Economies in the region are performing well due to a healthy mixture of robust export growth and strengthening domestic demand. On the export front, Asia's high degree of cost competitiveness and improving productivity are helping Asian companies increase their market share of global exports. Asia is an attractive destination for foreign direct investment because wage levels remain significantly lower than developed country levels and the workforce is well-educated. Also, Asia is no longer just an exporter of cheap goods, but an increasing number of the higher value computing and consumer electronics products we enjoy are designed and manufactured in Asia. This trend is firmly entrenched and is gaining momentum.

Another factor boosting the fortunes of the region is the rise of China. Following decades of rapid growth and modernisation, China has become a locomotive for growth in the region and is now the world's fourth-largest economy, behind the US, Japan and Germany and leapfrogging the UK. China's economy continues to grow rapidly and is now a more important trading partner than the US for several countries in the region.

Emerging markets

In Asia and Latin American emerging markets we are seeing a growing middle class and increasing population – a useful demographic trend to have. High savings rates also provide a good backdrop for robust growth in consumer spending. An increase in both wages and the quality of life is fostering consumer demand. Governments are improving their economic management. The improved stability of the regions has also led to an improvement in the credit rating of debt issued by these governments.

The market gains that we have seen in emerging markets have been underpinned by structural improvements to the local economies. With increasing political stability and improved government finances which are expected to translate into increased investment in infrastructure, the outlook for long-term growth rates looks good.

These markets are now made up of economies that are a lot more robust and able to weather a crisis than in previous years. However, despite the emergence of beneficial demographic trends and favourable political reforms it is important to understand the risks involved in investing in such regions. Political instability, currency fluctuation or a natural catastrophe can very quickly take its toll on a company's profitability and managers of funds that invest in specialist regions have to manage these risks. It is important to remember that emerging markets are considered high risk investments.

The importance of diversification and how diversification can help reduce the effects of inflation

The dangers of inflation – how it can erode the real value of your investment

Inflation is a general rise in prices across the economy which is distinct from a rise in the price of a particular service or goods. Individual prices rise and fall all the time in a market economy reflecting consumer choices, preferences, and changing costs but the inflation rate is a measure of the average change in prices across the economy over a specified period, most commonly 12 months i.e. the annual rate of inflation. If, say, the annual rate of inflation in January this year was 3%, then prices overall would be 3% higher than in January last year. So a typical basket of goods and services costing, say, USD100 last January would cost USD103 this January.

When prices were rising rapidly in Germany in the 1920s and inflation was rampant, people demanded to be paid several times a day, so they could quickly spend their wages before they fell in 'real' value. In the UK in the 1970s, the annual rate of inflation was more than 20% per year for a time – what GBP1.00 would buy was reduced by over a fifth in one year.

How safe is cash?

Typically considered as 'saving' rather than 'investing', most of us have some money earning interest in a deposit account or money market account. Money market accounts are straightforward, relatively safe and if not part of the pension you can usually access your money at short notice if you need to. However, this security comes at a price; the returns on a money market account are often relatively low compared to those of other asset classes, particularly when you take inflation into account. Real returns on assets are the returns over and above the rate of inflation.

The importance of diversification

Let's look at how holding a wide range of investments can help spread investment risk. If you look at any stock market performance, the main asset classes (e.g. bonds or equities) have performed differently over time and carry varying levels of risk and reward. For example, equities have historically outperformed bonds over the long-term, although this has gone hand in hand with a higher degree of volatility along the way. Volatility is the variance in the performance of an investment – the highs and lows in returns; generally the more volatile an investment is, the riskier it is.

What is diversification?

Diversification is spreading your investment amongst the different asset classes. By doing this you can reduce the combined risk of your investments even though the risks specific to each individual asset class remain unchanged. Put simply, diversification means holding a wide range of investments in order to limit your dependence on any one company, property or asset class.

Collective investment schemes also use diversification to help reduce risk. An investment fund can be invested in a single asset class or a combination of asset classes. Funds made up of a combination of asset classes can often carry a lower level of risk than their single asset counterparts. A major advantage of investing in a collective investment fund is that it enables you to diversify far more than you could as an individual investor.

Don't put all your eggs in one basket

Broadly speaking, the more diversified your investment portfolio, the less likely it is that you will be materially affected by the poor performance of one company's share price. Different asset classes do not usually respond in the same way to changing economic conditions and the aim therefore is to spread the investments over the asset classes so that potential losses in one asset class could be offset by gains in another. There is however no guarantee that this strategy can work all of the time as the effect of changing economic conditions is so complex.

Delays today could cost you tomorrow

Too many people underestimate how much money will be needed in retirement and over-estimate how much their savings will be worth in the future. Although retirement seems like a long way off when you start working, it is potentially the longest holiday of your life so to be able to enjoy it, you need to plan early. Making contributions to a pension scheme as soon as you start working makes a huge difference later on and paying additional contributions to your company scheme at any stage is also likely to have a positive effect on the final amount you have at retirement.

Going global

For many people, their first foray into stock market investing tends to be into their domestic market. However, as an investment portfolio grows in value it becomes important to diversify, to rescue it from being solely exposed to the fortunes of one market. This can be achieved by investing in stock markets around the world. By spreading your investments throughout different markets, you may reduce the risk of choosing the losers and missing out on the winners. Spreading your investments far and wide allows you to benefit from an unsurpassed choice of companies to invest in – from small service-oriented businesses to large manufacturers; from producers of commodities to organisations at the forefront of technological development.

As an investment portfolio grows in value it becomes even more important to diversify. Deciding to invest internationally may be a major change from your usual strategy, and you should bear in mind that while it can diversify your portfolio, it also has risks not associated with investing solely in your domestic market. International diversification can be achieved by investing in overseas companies through a pooled investment fund. Investing in stock markets around the world offers access to the growth potential of the major global economies such as the US, Europe and Japan, as well as the smaller but potentially higher return markets across Asia.

Mission impossible?

However, it can be difficult, if not impossible, to predict which markets will perform well, and which not so well. Stock markets and economies around the world don't follow the same cycles; while one market could be weak, another might be showing exceptional returns. Similarly, one economy may be in recession while another is booming. This is one of the many reasons that our managed funds offer clients actively managed exposure to a range of global markets.

Where do Managed funds fit in?

Blended asset, multi-asset, global managed – it is called many names, but the concept of a globally diversified portfolio, held over the longer term has stood the test of time. The rationale behind this is that global diversification reduces an investor's exposure to the risk of poor performance in any one market or sector and equally increases the chances of their investment participating in the growth of a market or sector that is performing well.

A common mistake amongst investors is not holding a balance of investments. Our managed funds benefit from the continuous asset allocation skills of Threadneedle and BlackRock Merrill Lynch. They know what is going on globally, know how this will affect different asset classes, and then adjust the managed fund portfolios accordingly in order to maximise returns within a specified risk constraint.

- By holding bonds in addition to equities there is the potential for protection from stock market volatility
- A blend of largely uncorrelated assets helps to protect on the downside and smooth returns on the upside
- Investing in global equity markets provides opportunities for returns and diversifies the risk of one particular region performing poorly
- Offer access to the major stock markets such as the US, Europe and UK as well as the smaller but potentially high return emerging markets
- Our managed funds aim to provide long-term capital growth from portfolios offering exposure to global bonds and equities and with ongoing active management.

You should note that investing in some of these markets could result in the possibility of large and sudden falls in the prices of your investments. The shortfalls when cashing your investments could be considerable. In other words, just because a fund has produced negative returns one year, does not mean it will do the same the next year. Alternatively, if a fund has performed well in one year it does not mean it will perform well the following year. The movements of world markets can have more influence in absolute terms than how the fund is managed.

Zurich's funds are suitable for investors wishing to invest over the medium to long term, who are prepared to accept the risks associated with investing in shares, bonds and other real assets, which can go down as well as up in value.

Full details of our funds and their charges are available in the 'Investments – Your guide' and 'Mirror funds – Your guide' both of which can be downloaded from www.zurich.com/international/unitedkingdom/literature/Investment+literature.htm

Lifestyling

Making the decision to invest for the future is an excellent first step to building your financial security. As time passes and your lifestyle changes, it is important to keep a regular check on your investments. It is likely that the balance of the investments in your portfolio will need to evolve, not only in line with changing market conditions, but also with factors such as your investment goals, personal circumstances and perhaps most notably, your age.

The level of risk you are prepared to take, along with your investment growth and income needs are likely to change throughout the different stages of your life – with each stage potentially requiring a different balance within your pension portfolio.

What is a solution to meeting evolving investment requirements?

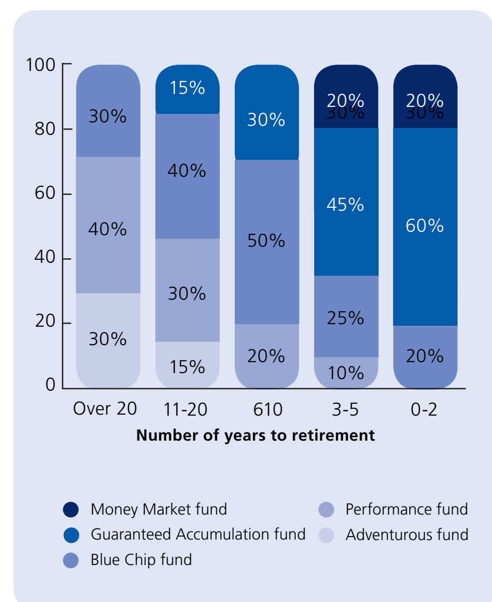
'Lifestyling' is an investment solution that allows you, to invest in growth assets such as equities during the early years of your policy, and moves you gradually into more secure assets such as fixed interest securities during the latter years.

Lifestyling works by initially investing your pension contributions in a combination of relatively high-risk funds, and at pre-determined periods, prior to the policy maturity date, progressively switching investments automatically to a combination of lower risk funds so the value of the policy is given greater stability. One of the lifestyling investment options available from Zurich is known as the retirement investment strategy (RIS).

How does RIS work?

RIS is a predetermined investment strategy that moves automatically changes over time. As you get nearer to your selected maturity date, the less volatile the investment selection becomes. Your savings are automatically switched from equity-based funds to cash and bond-based funds as they move closer to their policy maturity. This reduces their exposure to investment risk over time, as your policy becomes less exposed to large shifts in the equity markets, and helps to protect any gains made during the early years of your policy.

The chart below illustrates how this works. RIS reduces investment risk by automatically switching your pension policy through up to five investment portfolios, depending on how long is left until your policy's maturity date, each portfolio offering less exposure to risk than the previous portfolio.



For example, if you start your investment with a ten year term and select RIS, your money will initially be invested in the Performance, Blue Chip and Guaranteed Accumulation funds in the proportions shown in the chart overleaf. After five years it will be adjusted by switching into the Performance, Blue Chip, Guaranteed Accumulation and Money Market funds, eventually ending up in the Blue Chip, Guaranteed Accumulation and Money Market funds for two years prior to the policy end.

What are the features of RIS that may interest you?

Lifestyling not only reflects your changing attitude to risk as you approach policy maturity but also provides the following features:

Flexibility

You are able to switch out of the lifestyling option at any time without penalty.

Growth potential

Potential for growth in the early years of a policy. RIS provides investment in equity markets to maximise potential return.

Focusing on the longer-term

Offers a long-term strategy which can help to smooth the effects of short-term volatility associated with equity investment, providing the potential for a real return over cash and the rate of inflation.

Ongoing risk reduction

Portfolios offer a reducing exposure to equities the closer maturity gets, which can help to maintain policy value in later years.

Peace of mind

Minimal input from you is required with automatic switching throughout the policy term. There is no need for pro-active asset allocation decisions.

Efficient

There are cost and time efficiencies associated with Zurich International Life taking the responsibility for switching you to lower risk strategies, as your policy nears maturity.

Know the risks

Please understand that, as with any unit-linked investment strategy, unit prices are not guaranteed and can go down as well as up. As always, please remember that past performance is not a guide to the future. The value of any investment and income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Full details of Zurich International Life's funds and their charges are available in the 'Investments – Your guide' and 'Mirror funds – Your guide' both of which can be downloaded from www.zurich.com/international/unitedkingdom/literature/Investment+literature.htm

Your Plan

What can you do?

You benefit from membership of the IHG Plan as soon as you join, and it may be a good idea for you to think about your goals for your IHG Plan as you can make additional contributions from your salary in addition to the contributions IHG are already making on your behalf. You can pay regular or one-off additional contributions at any time, you can change the amount at any time and you can stop paying them altogether without any charge to your account. You can also make different investment choices for your voluntary contributions, thereby diversifying your investments within your IHG Plan. If you wish to make an additional contribution, you should contact your regional Plan administrator but before making any investment decisions, we recommend that you seek independent financial advice from your relevant financial professional.

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Registered in the Isle of Man number 20126C.

Registered office: 43-51 Athol Street, Douglas, Isle of Man, IM99 1EF, British Isles.
Telephone +44 1624 662266 Telefax +44 1624 662038 www.zurichintlife.com

Approved by Zurich International Solutions Limited, UK Life Centre, Station Road, Swindon, Wiltshire, SN1 1EL, United Kingdom.

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