The NAIC Capital Markets Bureau monitors global capital markets developments and analyzes their potential impact on the investment portfolios of U.S. insurance companies. Previously published NAIC Capital Markets Special Reports are available via the Capital Markets Bureau web page and the NAIC archives (for reports published prior to 2016).

Year-End 2024 Capital Markets Update

December 2024
Analysts: Jennifer Johnson and Michele Wong

Executive Summary

- The global economy remained resilient in 2024 as inflationary pressures continued to ease amid decreasing interest rates.
- The Federal Reserve lowered the federal funds rate for the first time this year in September and followed with additional rate cuts in November and December, resulting in a full percentage point reduction for the calendar year.
- After reaching a four-decade high in June 2022, inflation continues to ease toward the Fed's 2% target, and it was 2.7% in November 2024.
- Since reaching a 16-year high of 5% in late October 2023, the U.S. 10-year Treasury yield has decreased to approximately 4.2% as of mid-December.
- The Treasury yield curve finally reverted to positive territory in August 2024, after being inverted since July 2022, implying that investors are more optimistic about future economic prospects.
- Credit spreads hit multi-year lows in 2024, reflecting investor confidence in economic stability and corporate earnings growth amid moderating recession risks.
- The bull market in equities has continued into 2024, with U.S. stock indices posting double-digit returns and closing at record highs multiple times throughout the year.
- The price of oil has declined well below a multi-year high of around $120 per barrel in June 2022 to approximately $69 per barrel mid-December—relatively unchanged from a year prior.

Decreasing Interest Rates in a Resilient Economy

U.S. economic activity continues to be relatively resilient, evidenced by almost 3% in annualized growth as of the third quarter of 2024 and a decline in inflation, according to the International Monetary Fund World Economic Outlook (IMF WEO) dated October 2024. The lowering of the federal funds rate by the Federal Reserve contributed to decreasing inflation as intended, meaning that inflation, as measured by the Consumer Price Index (CPI), increased 2.7% for the 12 months ended November 2024, which was down significantly from a high of 9.1% in June 2022 and relatively close to the Federal Reserve's 2% target. Note that omitting the volatile food and energy sector, core prices rose 3.3%, the lowest increase since April 2021.

Notwithstanding, the U.S. unemployment rate was 4.1% in October 2024, having increased from the mid-3% range it had maintained since March 2022, suggesting a weakening labor market. In addition, geopolitical turmoil continues between Russia and Ukraine, Israel and Gaza, and tensions continue to persist between the U.S. and China. All of these global tensions have resulted in some pressures on global economic growth and financial market stability.

According to the IMF WEO, global growth is expected to decrease to 3.2% in 2024 from 3.3% in 2023 (refer to Table 1) and remain at 3.2% in 2025. Global economic activity has moderated, while inflation has continued to slow, but it has also been impacted by ongoing geopolitical turmoil. A slow recovery instead of a stalled recovery, however, demonstrates the global economy's resilience based in part on how individual countries have implemented fiscal and monetary policies. In the U.S., gross domestic product (GDP) for 2024 is expected to decrease slightly to 2.8% from 2.9% in 2023 and decrease further to 2.2% in 2025. However, for the Euro area, GDP growth is expected to double to 0.8% in 2024 from (0.4%) in 2023 due to better export performance of goods, and Euro area growth is also expected to rise further to 1.2% in 2025. Future financial stability, however, may be impacted by elevated economic and geopolitical uncertainty amid ongoing military conflicts and the uncertain future policies of newly elected governments.

Table 1: The IMF's Global and Regional Growth Forecasts (% Change)

Overview of the *World Economic Outlook* Projections
(Percent change, unless noted otherwise)

		Projections		Difference from July 2024 WEO *Update*[1]		Difference from April 2024 WEO[1]	
	2023	2024	2025	2024	2025	2024	2025
World Output	**3.3**	**3.2**	**3.2**	**0.0**	**-0.1**	**0.0**	**0.0**
Advanced Economies	**1.7**	**1.8**	**1.8**	**0.1**	**0.0**	**0.1**	**0.0**
United States	2.9	2.8	2.2	0.2	0.3	0.1	0.3
Euro Area	0.4	0.8	1.2	-0.1	-0.3	0.0	-0.3
Germany	-0.3	0.0	0.8	-0.2	-0.5	-0.2	-0.5
France	1.1	1.1	1.1	0.2	-0.2	0.4	-0.3
Italy	0.7	0.7	0.8	0.0	-0.1	0.0	0.1
Spain	2.7	2.9	2.1	0.5	0.0	1.0	0.0
Japan	1.7	0.3	1.1	-0.4	0.1	-0.6	0.1
United Kingdom	0.3	1.1	1.5	0.4	0.0	0.6	0.0
Canada	1.2	1.3	2.4	0.0	0.0	0.1	0.1
Other Advanced Economies[2]	1.8	2.1	2.2	0.1	0.0	0.1	-0.2

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during July 30, 2024–August 27, 2024. Economies are listed on the basis of economic size. The aggregated quarterly data are seasonally adjusted. WEO = *World Economic Outlook*.

[1] Difference based on rounded figures for the current, July 2024 WEO *Update*, and April 2024 WEO forecasts. Global and regional growth figures are based on new purchasing-power-parity weights derived from the recently released 2021 International Comparison Program survey (see Box A2) and are not comparable to the figures reported in the July 2024 WEO *Update* or the April 2024 WEO.

[2] Excludes the Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

Source: IMF WEO, October 2024

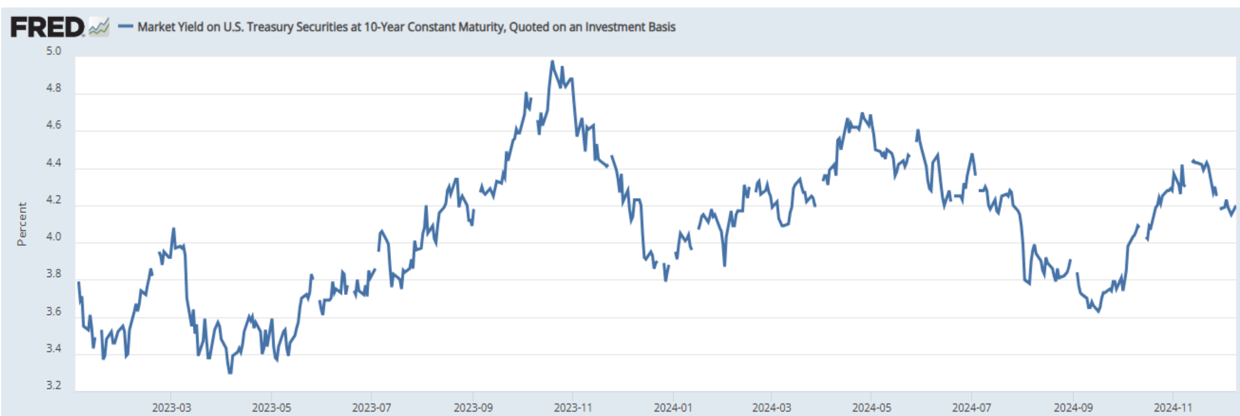
The benchmark federal funds rate is currently between 4.25% and 4.5%, a two-year low, having been lowered by 50 basis points (bps) in September 2024, followed by another 25 bps rate cut on each of Nov. 7 and Dec. 18. While the Fed currently projects two additional rate cuts in 2025, the size and timing of the rate cuts will depend on several economic factors, including the direction of inflation as well as the status of the labor market.

U.S. Treasury Yields Decline and the Yield Curve Enters Positive Territory

U.S. Treasuries are considered a safe haven by investors, and they are attractive during times of economic stress. As the Fed raised interest rates to combat inflation, the 10-year U.S. Treasury yield reached a 16-year high of 5% in October 2023, but it has since declined to approximately 4.2% as of mid-December 2024 (refer to Graph 1).

The decrease in interest rates will take time to impact insurers' investment returns, possibly resulting in reaching for yield and taking on incremental risk if they pursue more complex, less traditional investments. This may be demonstrated as insurers increase exposure to private credit investments.

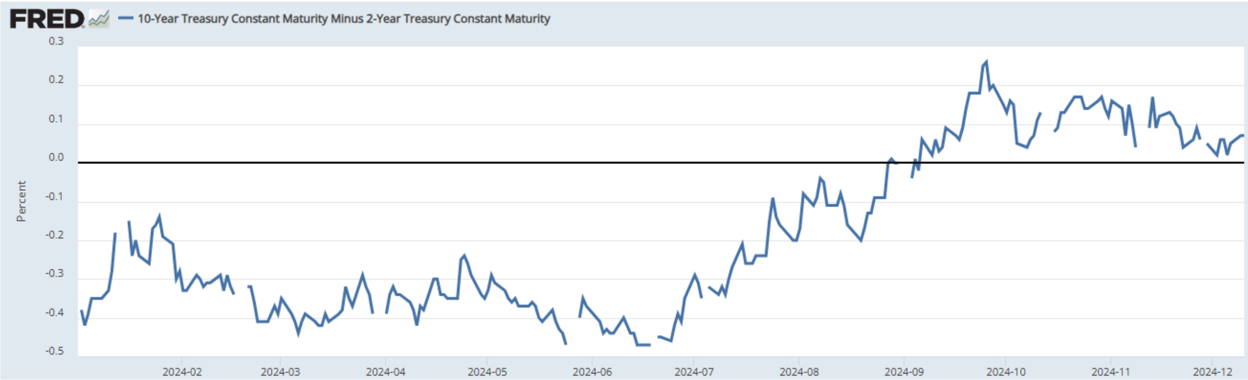
Graph 1: U.S. 10-Year Treasury Yields, January 2023 – Mid-December 2024



Source: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System (U.S.)

From July 2022 to the end of August 2024, the spread between the two-year and 10-year U.S. Treasuries (i.e., the yield curve) was negative, meaning investors earned less interest on long-term investments. In mid-December 2024, the spread between the two-year and 10-year U.S. Treasuries was 7 bps, having increased from -38 bps at the beginning of January 2024. (Refer to Graph 2.) The shape of the Treasury yield curve generally provides insight into the market's expectations for interest rates and economic activity. A negative spread indicates the likelihood of an economic downturn and a pessimistic view about future economic activity. And when an inverted yield curve returns back to "normal" (i.e., long-term rates are higher than short-term rates), it means that investors are becoming more optimistic about future economic prospects.

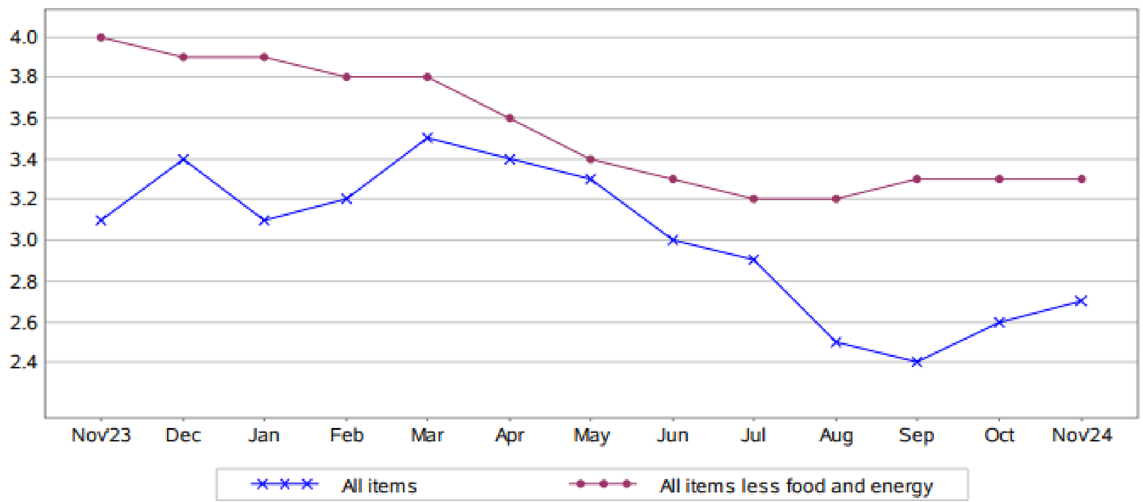
Graph 2: U.S. Treasury Yield Curve, January 2024 – Mid-December 2024



Source: Source: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System (U.S.).

The CPI rose 2.7% for the 12 months ending November (refer to Graph 3), down from 3.1% in January and a significant drop from a 9.1% peak in June 2022. The core CPI, which excludes energy and food prices, rose 3.3% in November from a year ago, easing from a 4.0% gain in January.

Graph 3: 12-Month Percent Change in CPI – November 2023 – November 2024



Source: Bureau of Labor Statistics

U.S. mortgage rates are closely tied to the U.S. 10-year Treasury yield. The 30-year fixed U.S. mortgage rate was about 6.7% as of early December 2024, according to data from Freddie Mac, and it has ranged between 6.1% (September) and 7.2% (May) throughout the year. The S&P CoreLogic Case-Shiller National Home Price Index reached an all-time high in June 2024, which continued into July. In addition, existing home sales increased 3.4% nationally in October, compared to 2.9% in October 2023, according to the National Association of Realtors.

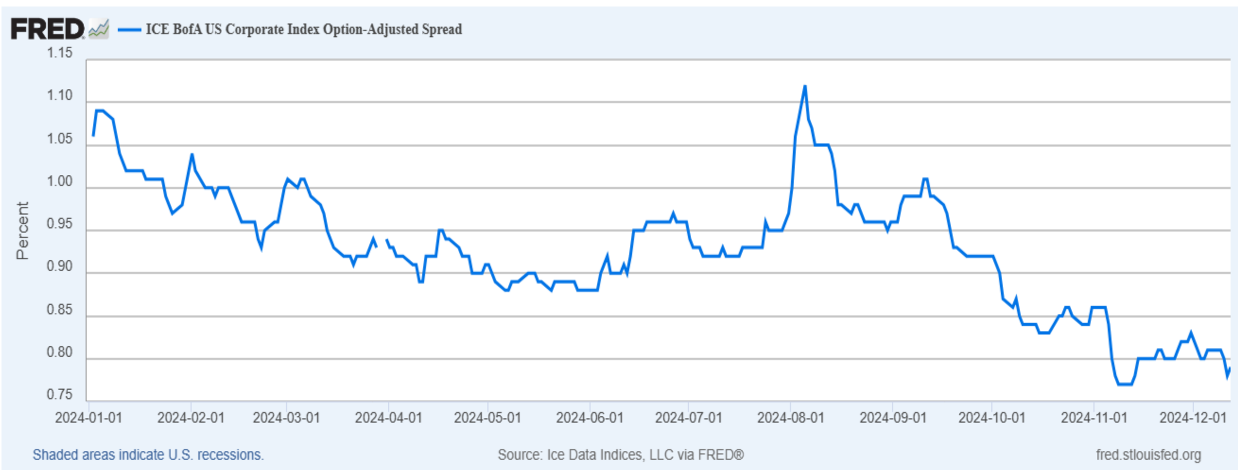
U.S. insurers' exposure to U.S. government bonds across various maturities totaled $346.6 billion at year-end 2023 (almost 4% of total cash and invested assets and 7% of total bonds), up from $322.8 billion at year-end 2022.

Credit Spreads Near Historical Lows

Corporate bond spreads tightened in 2024, falling to levels not seen in decades. The resilient U.S. economy and the Fed's rate cut cycle supported investor optimism, with interest rates beginning to decline gradually as inflation rates have stabilized.

Investment grade spreads started the year at 104 bps and trended lower for the first half of the year. Spreads were below 100 bps for most of the period and touched 88 bps in May, a level last seen in 2021. (Refer to Graph 4.) Soft economic data in early August led to recession fears and a short-lived market turmoil, with spreads spiking and reaching a high of 112 bps on Aug. 5. Nevertheless, they recovered relatively quickly as the economy continued to show signs of strength and resiliency. Within approximately three months, investment-grade spreads rallied and hit a low of 77 bps on Nov. 8, a level not seen in over 25 years when they fell to the low-70s in 1998. They closed mid-December at 79 bps—25 bps lower than the beginning of the year and near the multi-decade low.

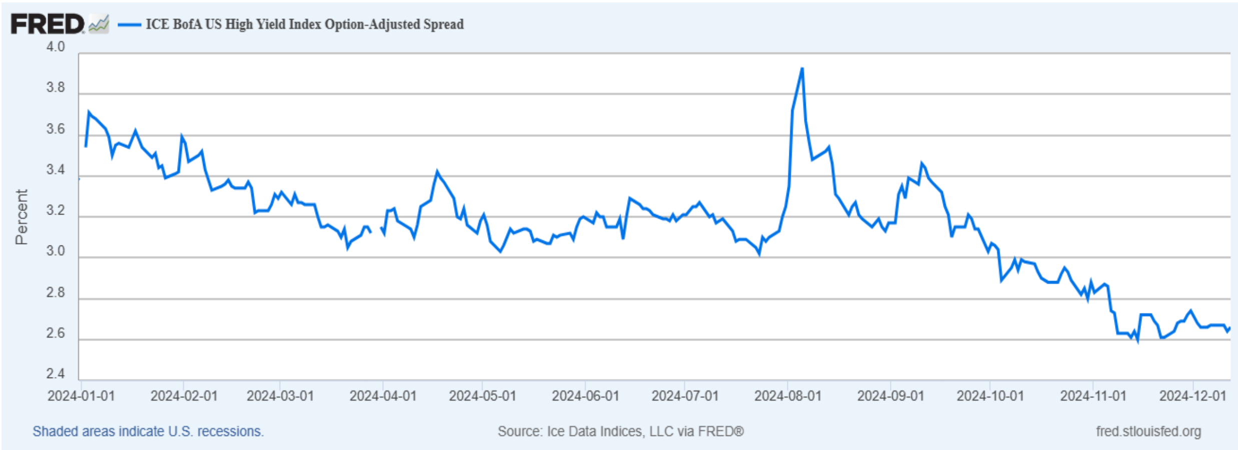
Graph 4: Investment Grade Corporate Spreads, January 2024 – Mid-December 2024



Source: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System (U.S.)

High-yield spreads have experienced a similar trend as investment-grade spreads. They generally trended lower for the first seven months of the year, trading above 300 bps. In early August, however, heightened market volatility driven by renewed recession concerns drove spreads significantly wider, and they spiked to almost 400 bps—the widest level year to date. (Refer to Graph 5.) They recovered quickly soon after, falling to a 17-year low of 260 bps in mid-November. High-yield spreads have since remained near this multi-year low and closed in mid-December at 266 bps, or 73 bps lower than the beginning of the year. The tightening spreads signal greater investor confidence in the economic outlook and a higher tolerance for risk.

Graph 5: High-Yield Corporate Spreads, January 2024 – Mid-December 2024



Source: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System (U.S.)

As the Fed gradually lowers interest rates, borrowing costs will also ease. Credit defaults should, therefore, decline after having peaked amid the higher interest rate environment. The U.S. speculative-grade corporate default rate rose to 4.4% as of September 2024 from less than 2% in early 2023. Under its base case scenario, S&P Global Ratings expects the U.S. trailing 12-month speculative-grade corporate default rate to fall to 3.25% by September 2025.[1] While the Fed is on a path to normalizing interest rates, they are likely to remain higher than the near-zero rates of recent years. The "higher-for-longer" interest rates could pose significant challenges for some borrowers with higher debt and weaker cash flows that need to refinance maturing debt.

The U.S. insurance industry's exposure to corporate bonds totaled about $2.9 trillion, or 34% of total cash and invested assets, as of year-end 2023. High-yield bonds, or those with reported NAIC 3 designations and below, decreased to 5% of total bond exposure in 2023 from 5.3% in 2022. Investment grade bonds, or those with reported NAIC 1 or NAIC 2 designations, accounted for 95% of total bonds, a slight increase from 94.7% at year-end 2022. As of year-end 2023, the credit quality of the corporate bond portfolio has recovered to pre-pandemic levels.

Equity Markets Reach Record Levels

After recording solid returns in 2023, the U.S. equity market continued its bull run in 2024 with another year of significant positive performance. The market's strong performance was driven by a combination of factors including strong corporate earnings, resilient economic growth, and the start of the Fed easing cycle. All three major U.S. equity indices achieved multiple new highs throughout the year. The S&P 500 has recorded almost 60 record closings, and it has posted a year-to-date return of approximately 27% as of mid-December. The Nasdaq Composite closed at an all-time high on Dec. 11, surpassing the 20,000 mark for the first time in history. It has recorded a year-to-date return of more than 33% through mid-

[1] S&P Global Ratings, *Default, Transition, and Recovery: U.S. Speculative-Grade Corporate Default Rate to Fall Further to 3.25% by September 2025*, Nov. 15, 2024

December and posted more than 35 record closing highs throughout the year. While the Dow Jones Industrial Average weakened in December, its YTD return was approximately 17% as of mid-December, and it surpassed a record level of 45,000 in early December. (Refer to Graph 6.)

Graph 6: U.S. Equity Market Indices Performance, YTD Mid-December 2024, % Returns

Source: *The Wall Street Journal*

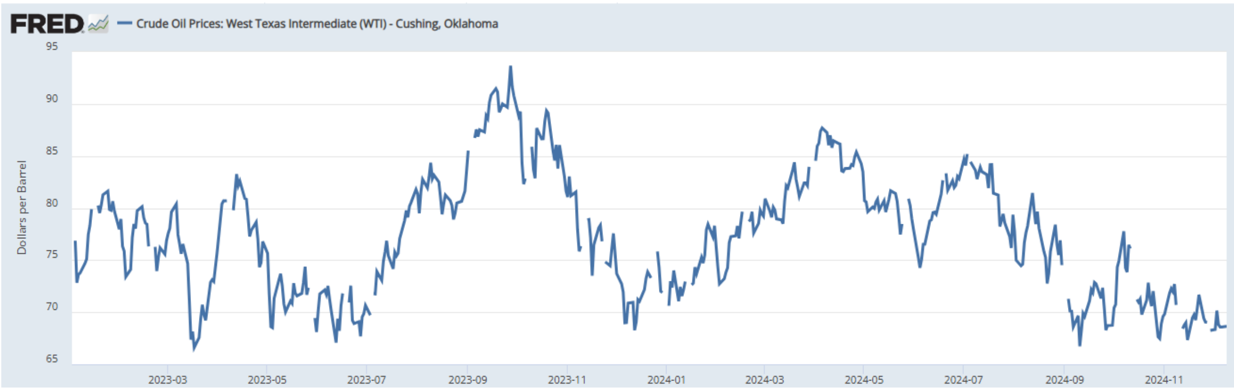
The NAIC Capital Markets Bureau performs a monthly analysis on U.S. insurers' unaffiliated publicly traded common stock exposure at year-end 2023 (which totaled $538.9 billion book/adjusted carrying value [BACV]), and year to date as of November 2024, it experienced a weighted average increase of 22.5%. Property/casualty (P/C) insurance companies (which have a higher relative equities exposure compared to other insurers) and insurers whose equity exposure is a significant percentage of total capital and surplus should generally benefit from the strong equity market performance in 2023 and 2024.

All 11 S&P 500 sectors experienced positive returns year to date as of mid-December. The communication services sector, the information technology (IT) sector, and the consumer discretionary sector posted the largest gains at approximately 45%, 38%, and 36%, respectively. The communication services sector includes entertainment, social media, and wireless and streaming companies, among others. The recovery in advertising spending post-pandemic, as well as growing demand for content streaming services, have been major contributors to the sector's performance. The information technology sector has been fueled by continued growth in artificial intelligence (AI), cloud computing, and semiconductor demand. The communication services and IT sectors include several of the so-called Magnificent Seven stocks. Consumer resilience and strong demand in retail, travel, and leisure have driven robust returns in the consumer discretionary sector.

Oil Prices Remain Below $100 Per Barrel

Oil prices, as measured by the West Texas Intermediate (WTI) crude oil price, reached a multi-year high of $120 per barrel in June 2022 due in part to the Russia-Ukraine crisis but have since declined significantly, reaching about $69 per barrel in early December 2024—a similar rate from the year prior. Oil prices were approximately $73 per barrel at the beginning of 2024 and ranged between $66 and $88 per barrel throughout the year. (Refer to Graph 7.) Energy companies experienced a 7% increase year to date according to the S&P 500 Index as of mid-December. U.S. insurers' investment in oil and gas companies at year-end 2023 was estimated to be about $149 billion in bonds and $43 billion in common stock, representing about 2% of the industry's total cash and invested assets.

Graph 7: Crude Oil Prices – West Texas Intermediate, 2023 – Mid-December 2024



Source: Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System (U.S.)

The Capital Markets Bureau will continue to monitor trends in the capital markets and report on any developments as deemed appropriate.

Questions and comments are always welcome. Please contact the NAIC Capital Markets Bureau at [CapitalMarkets@naic.org.](mailto:CapitalMarkets@naic.org)