

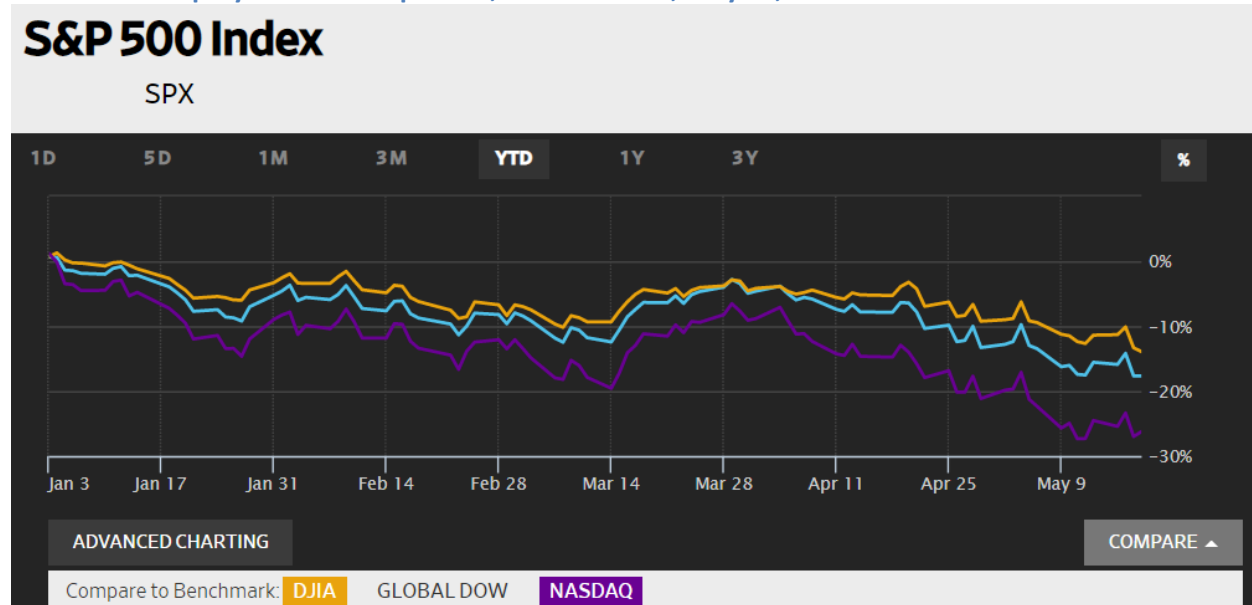


Equity Markets Plunge Near Bear Market Territory

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A risk-off sentiment has dominated the equity markets in 2022, with inflation concerns; geopolitical risks; and most recently, fears of an economic slowdown worrying investors. This has resulted in an equity selloff and heightened investment in government bonds, which are perceived as a safe haven during times of economic stress and uncertainty. On a year-to-date (YTD) basis, the S&P 500 Index (S&P 500) decreased by 17.7% as of May 18 (see Chart 1). In addition, the Dow Jones Industrial Average (DJIA) and the Nasdaq Composite (NASDAQ) declined by 13.3% and 27%, respectively, over the same period.

Chart 1: U.S. Equity Indices Comparison, % Return YTD, May 18, 2022



Source: Wall Street Journal

On May 19, the S&P 500 opened the day near bear market territory; i.e., at a 20% drop from a recent high. On May 18, the S&P 500 experienced a 4% decline—the largest single-day decrease since June 2020. The last time the S&P 500 entered bear market territory was in March 2020, albeit short-lived, as the market turned around and headed into a two-year rally that peaked in early January 2022.

The current equity market losses (and some corporate bond losses) are primarily the result of several factors: 1) earnings reports from large American retailers, including Walmart and Target, show evidence that the continued high inflation rate may be affecting consumer demand; 2) the war in Ukraine has added to inflationary pressures, prompting the Federal Reserve (Fed) to increase interest rates and reduce bond holdings; and 3) recent COVID-19 shutdowns in China have led to a slowdown in the world's second largest economy.



Earlier this month, the Fed increased the federal funds rate by half a percentage point to 0.75–1% as an attempt to control the four-decade high inflation rate. In addition, the Fed announced plans to begin reducing its \$9 trillion bond portfolio. The Fed’s recent moves are considered one of the most aggressive monetary tightening policies in decades to reduce rising price pressures. The Fed is also expected to continue raising rates in 50 basis point increments a few more times this year.

The yield on 10-year U.S. Treasuries has moved in expectation of Fed actions. It began the year at approximately 1.6%, climbed to more than 3% in early May, and closed at 2.88% on May 18. Current yields are at the highest levels since late 2018. While the rise in interest rates will benefit insurers’ new investment yields, the value of existing investments will decline, given that bond prices fall as yields rise. Having said that, insurers are generally buy-and-hold investors and can withstand the mark-to-market volatility.

At year-end 2021, U.S. insurer exposure to common equities was \$1,172 billion in book/adjusted carrying value (BACV), representing an 18% increase from year-end 2020. This was due, in part, to an increase in market valuations in 2021. However, the significant equity market declines thus far in 2022 will have a material impact on the BACV of U.S. insurer common stock holdings, particularly for property/casualty (P/C) insurance companies who own 76% of the industry’s common stock holdings.

Market volatility and uncertainty are likely to continue in the near term. The NAIC Capital Markets Bureau will continue to monitor market events and developments and report as deemed appropriate.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at CapitalMarkets@naic.org.

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