NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research

Capital Markets Special Report

Each week The **NAIC's Capital Markets Bureau** monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the **index**.

Market Value Volatility in 2011. Short term Trends That May Impact Insurance Industry Investment Performance

Over the last several weeks, there has been a considerable degree of volatility across virtually every market. This has culminated with activity on the heels of the decision by Standard and Poor's (S&P) to downgrade the United States' long-term sovereign debt rating to 'AA+' from 'AAA' on Aug. 5, 2011. Market value volatility is not an unusual occurrence, either generally or in the investment portfolios of insurance companies. Since year-end 2010, various market and world events have influenced the performance of different benchmarks within the capital markets. Given recent events, the Capital Markets Bureau thought it would be appropriate to review trends of specific market indices from Jan. 1, 2011, to the current time, August 2011. Below are graphs obtained from Bloomberg showing changing levels of selected indices throughout the capital markets, from Jan. 1, 2011 (where possible) through the most current date available in August 2011. They include indices for the equities market, currencies, government bonds (domestic and foreign), corporate bonds, asset-backed securities, and an often-watched commodity index.

Continued stress in the U.S. financial markets, including within the housing sector, has resulted in persistent high unemployment rates, and a weak overall economy. In addition, global events—such as the March Japanese earthquake and tsunami, onset of and ongoing turmoil in Libya and other oil-producing nations, and the debt crisis among certain Eurozone nations—have in one way or another more specifically impacted the performance of many indices. Most recently, S&P's downgrade of the U.S.'s long-term sovereign debt rating has also caused some market indices to negatively react, citing anxiety over the status of the U.S. economy.

Equity indices

S&P 500

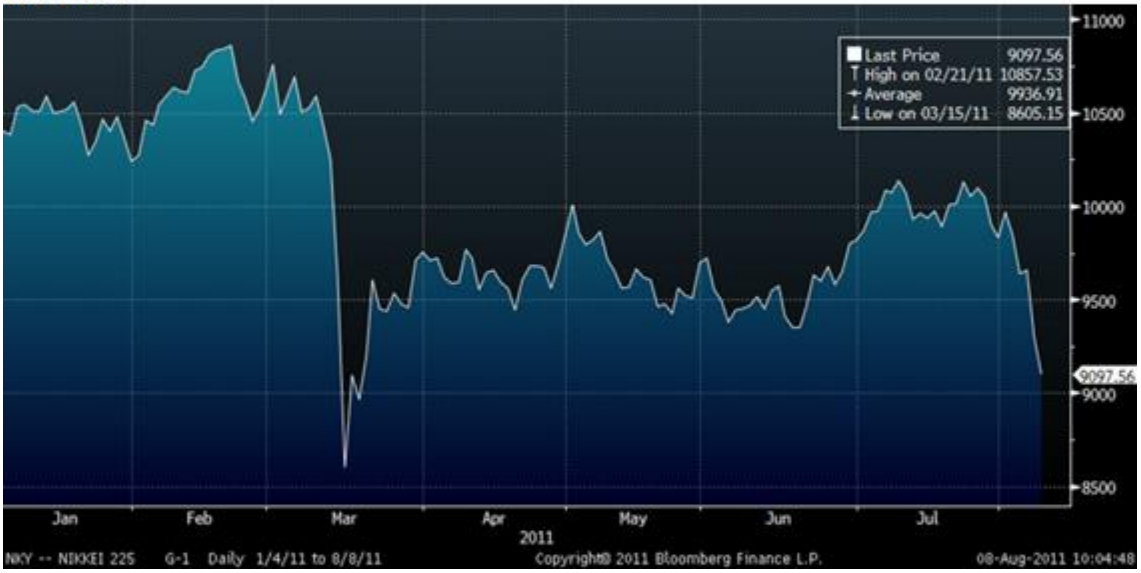
The Standard & Poor's 500 Index (S&P 500) experienced a significant price decline mid-March 2011 as well as during the month of June and again from July to August. As of the end of business on Aug. 8, 2011, the S&P 500 had dropped to its lowest point for the year from a peak in April 2011. As economic conditions have softened and concerns about earnings growth have risen, investors have pulled out of higher volatility assets in favor of safer havens, often referred to as a "flight to quality." This was punctuated by yesterday's market activity, after the U.S. rating downgrade by S&P had been announced. The S&P 500 tracks the prices of the most widely traded 500 stocks on the New York Stock Exchange and is considered a benchmark of the condition of the overall U.S. stock market. The variance of the peaks and troughs in the above graph perhaps is indicative of the volatility within the U.S. equity markets related to uncertainty surrounding the direction of U.S. economic recovery.

In comparison, neither the dip in March 2011, nor the decline through Aug. 8, are as low as the index had dropped during the worst of the market downturn for the duration of the financial crisis: from third quarter 2008 through second quarter 2009, as shown in the graph below.

S&P 500: Dec. 31, 2007-Dec. 31, 2009

As of year-end 2010, the insurance industry held almost $225 billion in U.S. common and preferred stock, which was approximately 4% of total insurance industry investments. Note that this only reflects the industry's direct exposure in general accounts and not any additional exposure through separate account products.

Nikkei 225



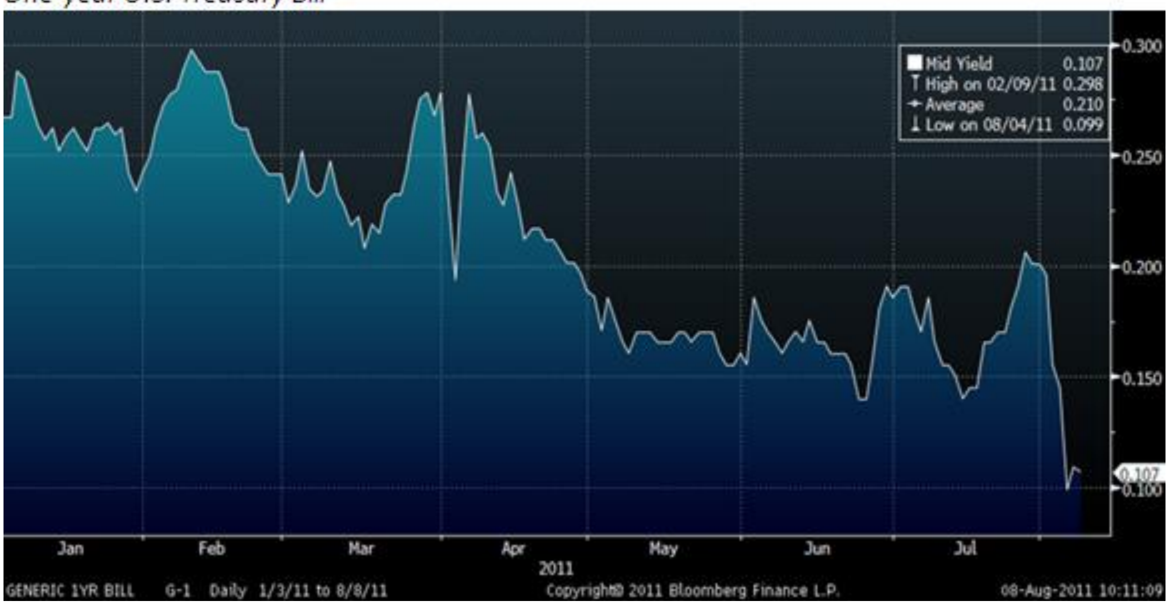
Asian equity markets are also commonly followed as a global financial indicator. The Nikkei 225 (Nikkei) is a price-weighted average of 225 top-rated Japanese companies listed on the Tokyo Stock Exchange. Naturally, the mid-March 2011 decline was related to the earthquake and tsunami. Due in part to subsequent financial assistance provided by the Bank of Japan, there was an immediate improvement in the Nikkei's performance. It remained relatively steady through July 2011 but declined again in August, as was the case with many domestic and foreign equity indices. As of year-end 2010, the insurance industry had $1.7 billion invested in Japan-domiciled equities.

Government Bonds

U.S. 10-year Treasury Bond

The yield on 10-year U.S. Treasury bonds began a declining trend in April 2011, which lasted through June and was followed by a small uptick before declining again, particularly at the beginning of August. While it may seem counterintuitive, prices on U.S. Treasuries actually increased after S&P announced its rating downgrade on U.S. long-term sovereign debt. As yields on U.S. Treasuries move in the opposite direction to price, in economically unstable times, the more risky other investments appear, the more investors flee to safety; that is, the more investors prefer to buy Treasuries, which then drives the price up and the yield down. As the graph above shows, the yield on the 10-year U.S. Treasury bond reached a high-point of 3.7% in February 2011 and a low-point on Aug. 4 at 2.4%. This is notwithstanding the end of the federal government's easing programs, referred to as Quantitative Easing (QE) and QE2. Insurance company exposure to U.S. Treasuries was $186.3 billion as of year-end 2010.

One-year U.S. Treasury Bill



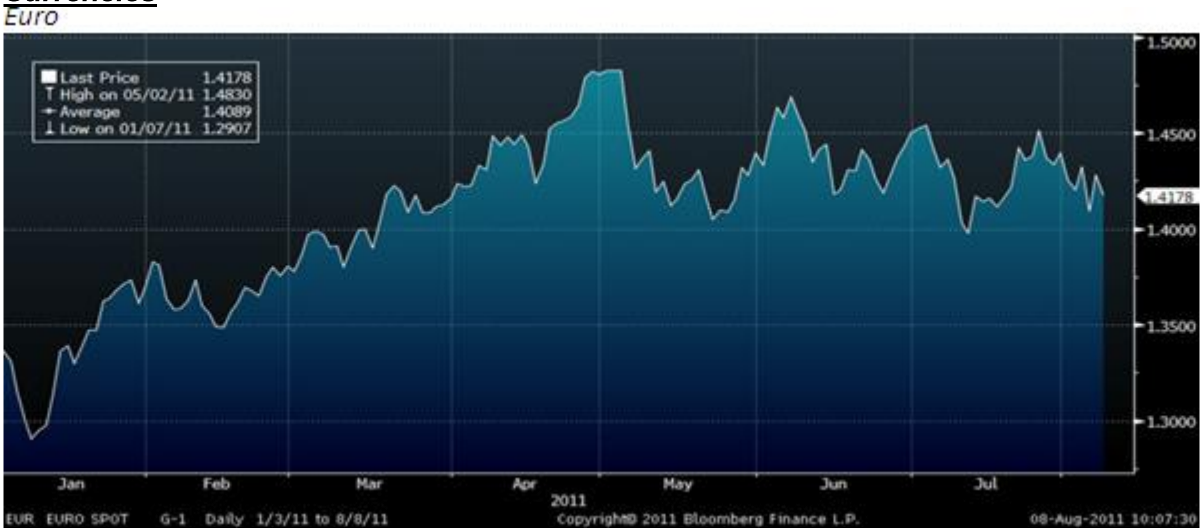
U.S. Treasury Bills (T-Bills) are short-term government investments whose yields, after a deep spike mid-March 2011, appear to have been on a declining trend, leveling off April through May and experiencing some volatility until the beginning of August, when the yield steeply declined to its lowest point in 2011 on Aug. 4. Similar to U.S. Treasury bonds, the yield on T-bills achieved a high in February 2011. Because of their short-term nature, T-Bills tend to be attractive investments during economically unstable times.

United Kingdom (UK) 10-year Treasury Bond

The yield on the UK 10-year Treasury bond appears to have been on a relatively steady decline since April 2011, with a short peak mid-June followed by a steep decline at the end of July. Similar to the U.S. 10-year Treasury, the UK 10-year Treasury reached a high in February and a low as of Aug. 8, 2011.

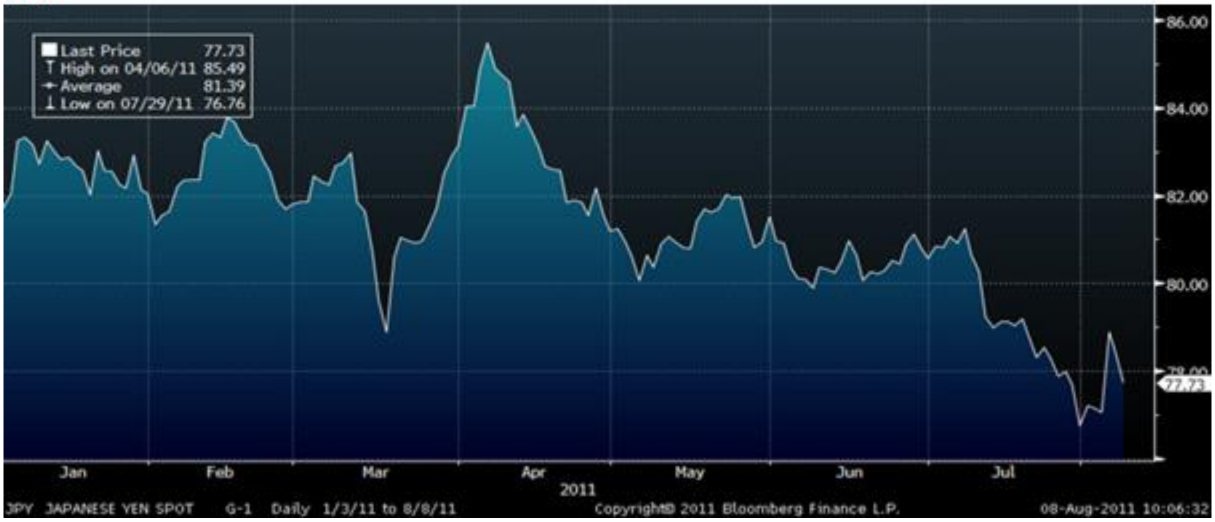
Currencies

Euro



The euro had been increasing in value relative to the U.S. dollar, but decreased in late April and leveled off due, in part, to reports of new financial aid for Greece being arranged by the International Monetary Fund. A cheaper euro relative to other currencies makes the 17-nation currency more affordable, and perhaps might assist with attracting investments toward the "PIIGS" countries within the eurozone (Portugal, Ireland, Italy, Greece and Spain) that are currently struggling financially. The euro does not seem to have been impacted by the current U.S. rating downgrade. Euro-denominated bonds represented approximately 16.4% of insurance company foreign currency investments as of year-end 2010, which totaled approximately $138 billion.

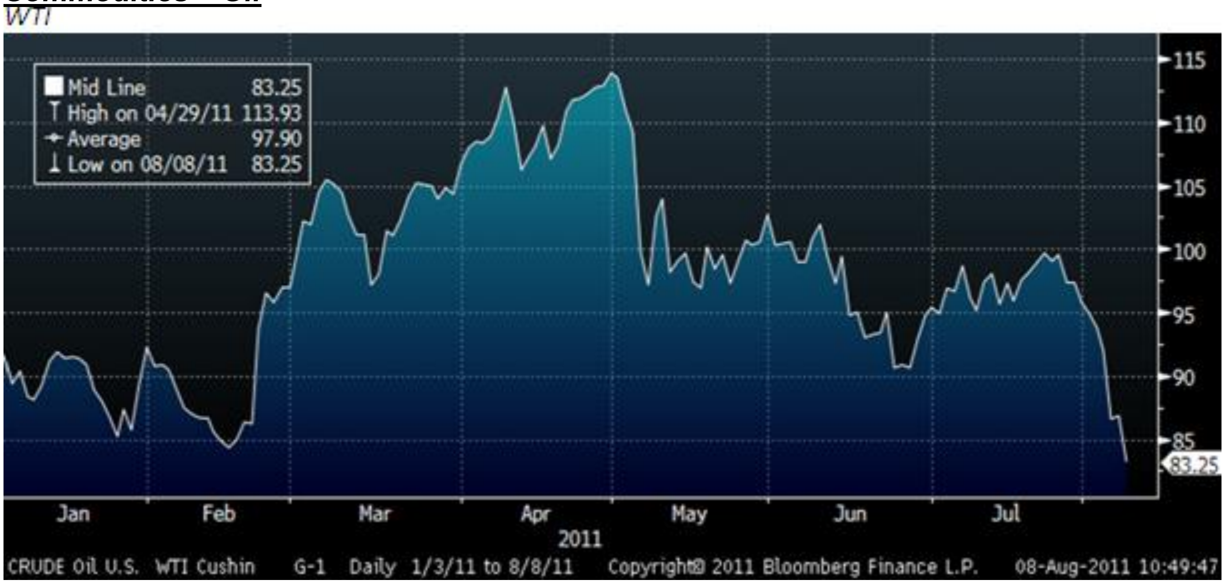
Yen



The Japanese yen took a deep dive as a result of the devastating earthquake and tsunami in March 2011, but then recovered, due in part to the Bank of Japan infusing capital into the Japanese financial system to bolster liquidity. The value of the yen declined again in April, perhaps negatively affected by factors related to the post-natural disaster consequences, such as the nuclear power plant difficulties and supply-chain disruptions. From May through early July the value of the yen appears to have leveled-off for the most part, but significantly declined once again into August, reaching a low for the year on July 29, before rising and falling once more at the beginning of August. As of year-end 2010, the insurance industry exposure to yen-denominated securities was $67.1 billion.

<u>Commodities – Oil</u>

WTI



The West Texas Intermediate Crude Oil Spot Price (WTI) is a benchmark that is used to price a light, sweet crude oil produced in the U.S. and delivered in Midland, Texas. Beginning in mid-February 2011, due in part to signs of economic recovery and an expectation that oil demand would increase, oil prices began to rise significantly, breaking $100 a barrel in early March 2011, around the time military action was taken on Libya. On April 29, 2011, a high of $113.93 a barrel on the WTI was reached. Since then, the price of oil has dropped again, most likely due to the weak U.S. economy, which has resulted in a reduced demand for oil. The WTI declined to the lowest level for the year at $83.25 a barrel on Aug. 8, 2011.

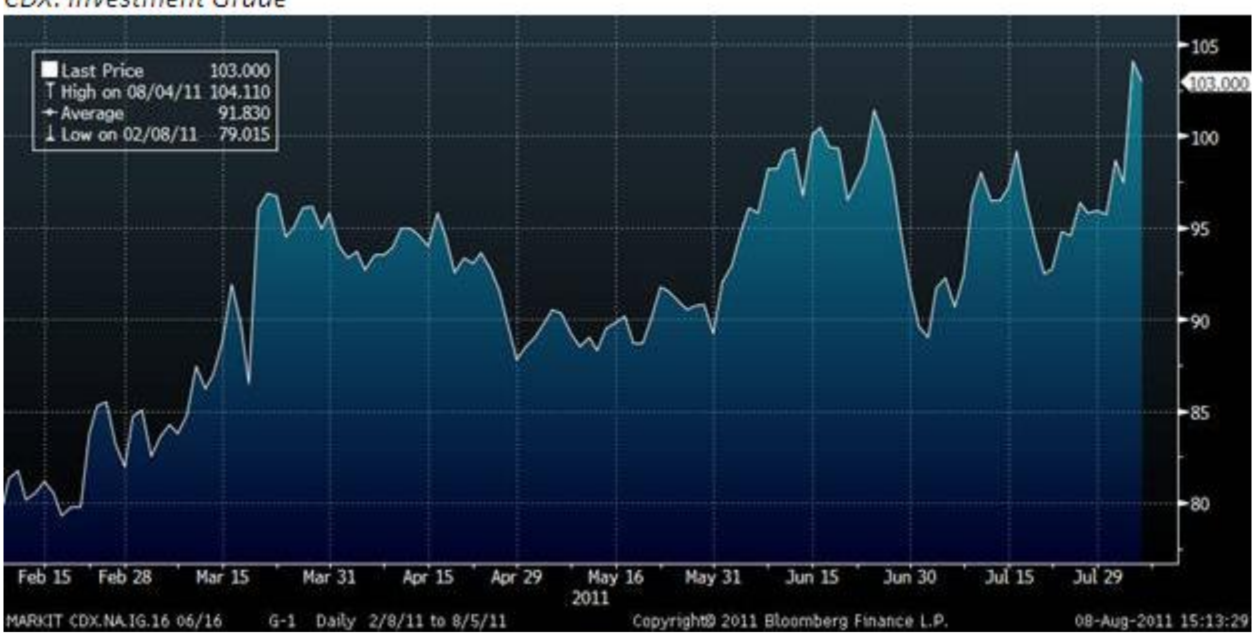
Corporate Securities

There are many commonly used measures of bond market activity, including numerous bond indices. One of the more recently developed is the CDX—an index-based credit default swap. Although used as a hedging tool and, therefore, driven by different market dynamics, the CDX provides a general sense of market sentiment.

CDX: High-Yield

The Markit CDX North America High Yield Index (CDX HY) is composed of 100 non-investment grade corporate entities domiciled in North America. As the graph above shows, the CDX HY price index experienced some volatility over the course of the year but dipped in June 2011 before decreasing to $96.76 by August 5, its lowest point of the year. Subsequently, the price dropped nearly four points on Aug. 8, reflecting a spread-widening of approximately 100 basis points. The driver behind this price decline is similar to that affecting the equity markets; that is, a desire to move away from more volatile assets and into safer havens.

CDX: Investment Grade



The Markit CDX North America Investment Grade Index (CDX IG) consists of 125 investment-grade entities domiciled in North America. Contrary to the CDX HY index and despite some volatility over the course of the year, the CDX IG price index increased over time, reaching a high of $104.1 on Aug. 4, 2011. Strength within the investment grade sector over the last few weeks demonstrated the inverse of activity in the CDX HY index. Market prices for the investment-grade index slipped modestly at the end of the week of Aug. 1, and significantly after S&P's U.S. rating downgrade, reflecting a 14 basis point widening.

Structured Securities – Residential Mortgage-Backed

ABX

The Markit ABX HE index is composed of reference obligations in 20 residential mortgage-backed securities (RMBS) issuers (note that these are non-agency RMBS). Given the continued weakness in the housing sector, this index has been on a steady decline for most of 2011 after a fairly dramatic recovery during 2010. Despite a spike at the end of June, it once again plummeted at the end of July. As of year-end 2010, the insurance industry had almost $130 billion invested in non-agency RMBS.

Summary

Financial markets have struggled and experienced significant volatility during 2011. Ongoing economic problems in Europe, difficult discussions with regard to the federal debt ceiling, and S&P's downgrade of the U.S. long-term sovereign debt rating have increased uncertainty. Simultaneously, an already weak U.S. economy continues its struggle to emerge from financial distress and make progress toward economic recovery. Unemployment remains high in the U.S.; the housing sector, a major driver of the U.S. economy, continues to suffer. At the same time, the commercial real estate market continues to be soft.

While market value volatility does require monitoring, for the vast majority of the insurance industry's invested assets, statutory accounting principles do not require that this be recognized in a company's financial statements, except where an Other Than Temporary Impairment exists. This appropriately reflects the long-term nature of the industry's investment strategies.

The Capital Markets Bureau will continue to monitor performance of the indices discussed in this article, as well as the markets in general, and the impact on insurance industry investments. We will report on any developments as deemed appropriate.

August 5, 2011								
Major Insurer Share Prices			**Change %**			**Prior**		
		Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Life	Aflac	$41.72	(9.5)	(12.0)	(26.1)	$46.08	$47.43	$56.43
	Ameriprise	47.18	(12.7)	(19.2)	(18.0)	54.04	58.39	57.55
	Genworth	6.78	(18.1)	(35.8)	(48.4)	8.28	10.56	13.14
	Lincoln	23.53	(11.0)	(19.3)	(15.4)	26.45	29.15	27.81
	MetLife	36.35	(11.5)	(18.1)	(18.2)	41.10	44.38	44.44
	Principal	25.33	(8.3)	(17.9)	(22.2)	27.63	30.87	32.56
	Protective	18.88	(11.2)	(19.9)	(29.1)	21.26	23.56	26.64
	Prudential	53.99	(8.0)	(16.6)	(8.0)	58.67	64.77	58.71
	UNUM	22.79	(6.5)	(12.1)	(5.9)	24.38	25.94	24.22
PC	ACE	$63.18	(5.7)	(4.6)	1.5	$67.00	$66.26	$62.25
	Axis Capital	29.37	(7.3)	(5.7)	(18.1)	31.70	31.13	35.88
	Allstate	26.29	(5.2)	(14.9)	(17.5)	27.72	30.90	31.88
	Arch Capital	32.69	(3.1)	0.4	11.4	33.73	32.56	29.35
	Cincinnati	25.97	(5.1)	(11.9)	(18.0)	27.38	29.47	31.69
	Chubb	59.62	(4.4)	(5.4)	(0.0)	62.39	63.03	59.64
	Everest Re	78.10	(5.0)	(4.5)	(7.9)	82.20	81.80	84.82
	Progressive	18.48	(5.9)	(13.8)	(7.0)	19.63	21.44	19.87
	Travelers	52.57	(4.6)	(11.1)	(5.6)	55.12	59.11	55.71
	WR Berkley	29.51	(4.1)	(9.9)	7.8	30.78	32.75	27.38
	XL	19.96	(2.6)	(10.5)	(8.5)	20.50	22.30	21.82
Other	AON	$44.89	(6.4)	(13.2)	(2.4)	$47.94	$51.71	$46.01
	AIG	25.10	(12.5)	(16.3)	(48.0)	28.67	29.98	48.27
	Assurant	33.82	(5.1)	(7.7)	(12.2)	35.62	36.64	38.52
	Fidelity National	15.68	(3.6)	(2.0)	14.6	16.27	16.00	13.68
	Hartford	20.57	(12.0)	(24.0)	(22.3)	23.38	27.05	26.49
	Marsh	28.27	(4.1)	(10.4)	3.4	29.49	31.54	27.34
Health	Aetna	$37.42	(9.5)	(17.3)	22.6	$41.35	$45.23	$30.51
	Cigna	45.19	(9.0)	(13.4)	23.3	49.68	52.20	36.66
	Humana	70.92	(4.8)	(14.7)	29.6	74.47	83.12	54.74
	United	45.56	(8.2)	(14.2)	26.2	49.63	53.13	36.11
	WellPoint	61.95	(8.2)	(23.3)	9.0	67.50	80.79	56.86
Monoline	Assured	$12.08	(14.3)	(28.2)	(31.8)	$14.09	$16.82	$17.70
	MBIA	7.48	(18.3)	(17.5)	(37.6)	9.16	9.07	11.99
	MGIC	3.18	(20.1)	(47.9)	(68.8)	3.98	6.10	10.19
	PMI	0.25	(74.7)	(77.1)	(92.3)	1.01	1.11	3.30
	Radian	2.76	(12.1)	(35.4)	(65.8)	3.14	4.27	8.07
	XL Capital	19.96	(2.6)	(10.5)	(8.5)	20.50	22.30	21.82

August 5, 2011							
Major Market Variables		**Change %**			**Prior**		
	Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Dow Jones Ind	11,444.61	(5.8)	(9.0)	(1.1)	12,143.31	12,582.77	11,577.51
S&P 500	1,199.38	(7.2)	(10.5)	(4.6)	1,292.30	1,339.67	1,257.64
S&P Financial	180.79	(9.2)	(14.1)	(15.8)	199.19	210.45	214.77
S&P Insurance	165.66	(6.6)	(12.4)	(12.0)	177.43	189.06	188.22
US Dollar $		**Change %**			**Prior**		
/ Euro	$1.43	(0.6)	(1.7)	6.7	$1.44	$1.45	$1.34
/ Crude Oil bbl	87.04	(9.3)	(8.3)	(5.6)	95.96	94.94	92.22
/ Gold oz	1,661.20	2.2	12.0	16.9	1,624.70	1,482.60	1,420.78
Treasury Ylds %	%	**Change**			%	%	%
1 Year	0.11	(0.09)	(0.08)	(0.16)	0.20	0.19	0.27
10 Year	2.57	(0.22)	(0.61)	(0.73)	2.79	3.18	3.30
30 Year	3.85	(0.29)	(0.54)	(0.49)	4.14	4.39	4.34
Corp Credit Spreads -bp		**Change %**			**Prior**		
CDX.IG	90.52	9.7	17.9	6.5	82.50	76.76	85.00

August 5, 2011
Major Insurer Bond Yields

	Company	Coupon	Maturity	Price			Spread	
				Current	Change	Yield	B.P.	Change
Life	Aflac	8.500%	5/15/2019	$127.52	$1.55	4.29%	209	(6)
	Ameriprise	5.300%	3/15/2020	$110.93	$1.24	3.80%	142	4
	Genworth	6.515%	5/15/2018	$93.49	($2.33)	7.77%	578	60
	Lincoln National	8.750%	7/15/2019	$130.27	$1.31	4.20%	200	5
	MassMutual	8.875%	6/15/2039	$149.15	$4.91	5.43%	162	1
	MetLife	4.750%	2/15/2021	$106.56	$1.68	3.92%	132	(1)
	Mutual of Omaha	6.800%	6/15/2036	$112.64	$3.70	5.83%	222	1
	New York Life	6.750%	11/15/2039	$124.28	$4.67	5.12%	129	1
	Northwestern Mutual	6.063%	3/15/2040	$115.08	$4.13	5.06%	120	3
	Pacific Life	9.250%	6/15/2039	$139.69	$5.00	6.23%	243	(1)
	Principal	6.050%	10/15/2036	$109.20	$2.09	5.38%	175	19
	Prudential	4.500%	11/15/2020	$104.37	$1.74	3.93%	139	(3)
	TIAA	6.850%	12/15/2039	$123.65	$4.59	5.24%	138	0
P&C	ACE INA	5.900%	6/15/2019	$117.19	$1.53	3.39%	114	(6)
	Allstate	7.450%	5/15/2019	$124.41	$1.62	3.79%	160	(6)
	American Financial	9.875%	6/15/2019	$128.19	$1.94	5.42%	318	(9)
	Berkshire Hathaway	5.400%	5/15/2018	$114.87	$0.95	2.96%	101	(1)
	Travelers	3.900%	11/15/2020	$100.95	$1.42	3.78%	125	3
	XL Group	6.250%	5/15/2027	$106.82	$3.33	5.59%	256	(7)
Other	AON	5.000%	9/15/2020	$107.47	$1.37	4.02%	149	(1)
	AIG	5.850%	1/15/2018	$105.58	($0.27)	4.83%	297	16
	Fidelity National	7.875%	7/15/2020	$106.69	($0.19)	6.86%	483	15
	Hartford	5.500%	3/15/2020	$105.97	$0.74	4.65%	225	8
	Marsh	9.250%	4/15/2019	$131.56	$1.53	4.37%	221	0
	Nationwide	9.375%	8/15/1939	$129.68	$4.08	6.95%	319	3
Health	Aetna	3.950%	9/15/2020	$103.59	$1.64	3.48%	100	0
	CIGNA	5.125%	6/15/2020	$110.97	$1.76	3.66%	119	(4)
	United Healthcare	3.875%	10/15/2020	$103.22	$1.75	3.46%	102	(2)
	Wellpoint	4.350%	8/15/2020	$106.79	$1.57	3.47%	100	0

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