The HOT SPOT

Market Update: A Turbulent Start to 2016 (01/19/2016)

The financial markets began 2016 with a bumpy ride, mostly to the downside, as weakness in China's economy, equity and currency markets—along with commodity price declines—continue to spur concerns of a global economic slowdown. The following table provides a snapshot of the performance for select market indicators for 2015 and the first two weeks in 2016.

			2015			As of	Change vs.		
	Open	High	Average	Low	Close	01/15/16	12/31/14	2015 High	12/31/2015
S&P	2,058.90	2,130.82	2,016.06	1,867.61	2,043.94	1,880.33	-8.67%	-11.76%	-8.00%
Shanghai	3,234.68	5,166.35	3,719.57	2,927.29	3,539.18	2,902.22	-10.28%	-43.82%	-18.00%
FTSE	6,566.09	7,103.98	6,590.18	5,874.06	6,242.32	5,804.10	-11.60%	-18.30%	-7.02%
Oil - WTI	60.18	64.46	53.02	35.81	37.04	29.70	-50.65%	-53.92%	-19.82%
10 Yr Treasury	2.17	2.49	2.13	1.64	2.27	2.03	-6.45%	-18.31%	-10.57%
HY CDX	357.18	522.76	381.48	299.13	469.90	555.45	-35.70%	-5.89%	-15.40%
IG CDX	66.33	96.33	72.86	60.10	88.24	109.99	-39.70%	-12.42%	-19.77%
EUR/USD	1.21	1.21	1.11	1.05	1.09	1.09	-10.17%	-10.21%	0.06%
USD/CNY	6.21	6.49	6.28	6.19	6.49	6.58	-5.69%	-1.31%	-1.31%

After ending 2015 flat versus 2014, the Standard & Poor's (S&P) 500 Index (S&P 500) has declined 8.4% to 1871.43 in the first 10 trading days of the year, with significant (or greater than 1%) declines in six of those days. On Jan. 13, the S&P 500 tested its 12-month low of 1867.61 reached on Aug. 25, 2015, after declining 2.5% for the day to close at 1890.28, its steepest decline since September 2015 and resulting in a 7.5% drop since year-end 2014. It then recovered strongly—with the price of crude oil climbing above $31 per barrel and boosting energy shares, a solid earnings report from JPMorgan, and comments from James Bullard of the Federal Reserve easing rate-hike expectations in the U.S.—the following day, increasing 1.7% to 1921.84. With the Shanghai Composite Index closing 3.5% lower and the price of crude oil falling below $30 per barrel on Jan. 15, those gains were erased with the S&P 500 sinking 2.1% to 1880. At this level, the U.S. equity market is 11.8% below the high reached in May 2015—resulting in the market being in a "correction," or a decline of 10% or more from a recent peak. As investors sought safety in high-quality investments, the 10-year Treasury rallied to a yield of 2.03%.

The credit markets are also feeling pressure, with both investment grade and high-yield credit experiencing significantly wider spreads. From a March 5, 2015, tightest credit spread point of 60 basis points (bps), the Markit CDX Investment Grade (IG) Index reached its widest spread for the prior 12-month period of 110 bps on Jan. 15. High-yield credit spreads also widened to their highest spread in the period of 555 bps the same day, after trading in a range of 299 bps to 523 bps in 2015. Although credit spreads have widened significantly, they have, in part, retraced the tightening seen in early 2015; however, evidence of credit deterioration is beginning to materialize. According to S&P Ratings Services, the number of global corporate ratings on negative outlook relative to positive outlook at Dec. 31, 2015, was at its highest level since June 2010. In addition, it said "global creditworthiness has declined slightly since the onset of the [global financial] crisis" with the "average long-term corporate credit rating [falling] by about half a notch to between 'BB+' and 'BB' compared with 'BB+' at end-2008." S&P estimates that the U.S. trailing 12-month speculative grade corporate default rate was 2.8% in December 2015, the highest level since 2012. It expects the rate to rise to 3.3% by Sept. 30, given persistently low oil prices, slower global growth and the beginning of interest rate hikes by the Federal Reserve.

As of Dec. 31, 2014, the U.S. insurance industry held common stock investments and corporate bond investments totaling $684 billion (or 11.9% of total invested assets)—including affiliated holdings—and $2.1 trillion (or 35.8% of total invested assets), respectively. P/C insurers' exposure to common stocks was $497 billion (or 28.5% of total invested assets), whereas life companies' exposure was $149 billion (or 4% of total invested assets). However, because insurers' aggregate exposure to common stock is relatively modest compared to other assets such as bonds, the expected impact of a significant stock market sell-off on their capital and surplus is limited. Nonetheless, the common stock exposure of individual insurance companies relative to total capital and surplus, in particular for P/C insurers, can vary greatly and should be monitored closely. Life insurers typically have significantly more exposure to corporate bonds (61% of year-end 2014 bond investments) than P/C companies (34% of year-end 2014 bond investments). Despite the material exposure to corporate bonds, almost 95% of the holdings were investment grade. Because their exposure to high-yield bonds is relatively small, adverse developments in high-yield credit should only affect insurers at the margin, unless those developments spill over into the broader corporate market.