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**

**Capital Markets Activity – Mid-March Through Early August 2014**

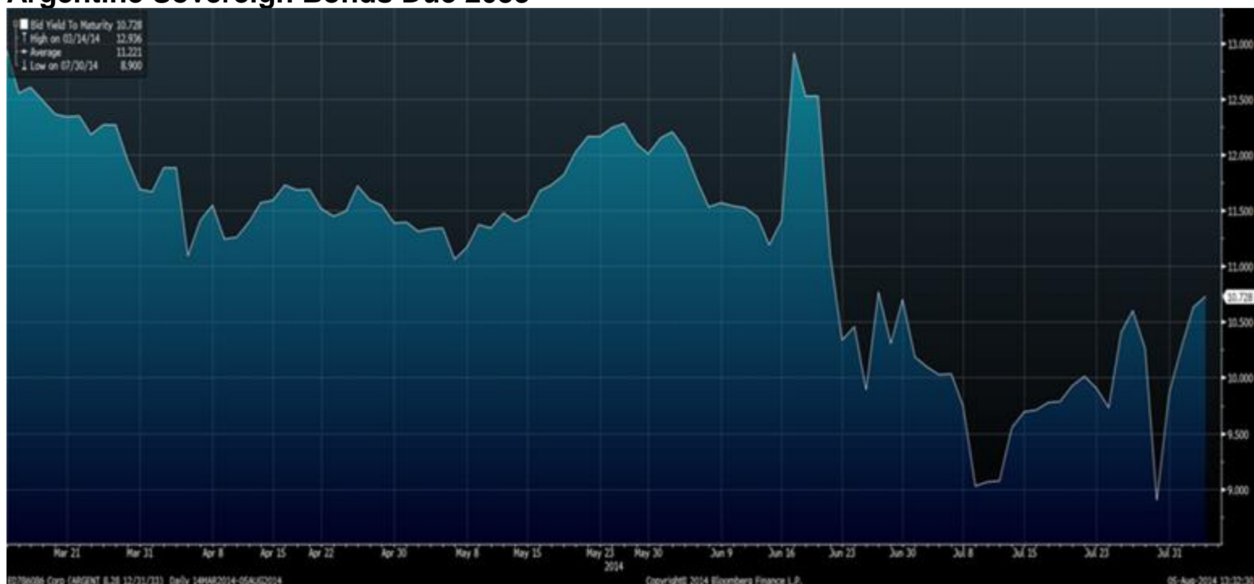
The NAIC Capital Markets Bureau periodically reviews the status of different market indices to comment on any noteworthy trends based on recent market events as they pertain to the U.S. insurance industry's investments. Since mid-March 2014, markets worldwide have continued to show reactionary short-term shifts to the ongoing turmoil between Russia and Ukraine; the default on Argentine debt on July 30; the eurozone's sluggish recovery; Federal Reserve decisions regarding the bond-buying program; and other U.S. domestic economic trends. In addition, during the last week of July, Portugal's second-largest bank (by assets) reported its largest quarterly loss, resulting in a significant drop in share prices as well as a two-hour trading suspension.

Volatility in the global financial markets has resulted in fluctuations in stock prices in the U.S., Europe and Asia. U.S. Treasury yields have also oscillated, although they have benefited because of investors' flight-to-quality instinct. As the struggle between Ukraine and Russia persists, prices on their respective government bonds have been negatively impacted, yet the default on Argentina's debt due 2033 did not severely impact the price of those bonds.

As indicated in the graphs below (extracted from Bloomberg), financial markets worldwide have reacted to events that have occurred between mid-March and early August:

Government Bonds

**Argentine Sovereign Bonds Due 2033**



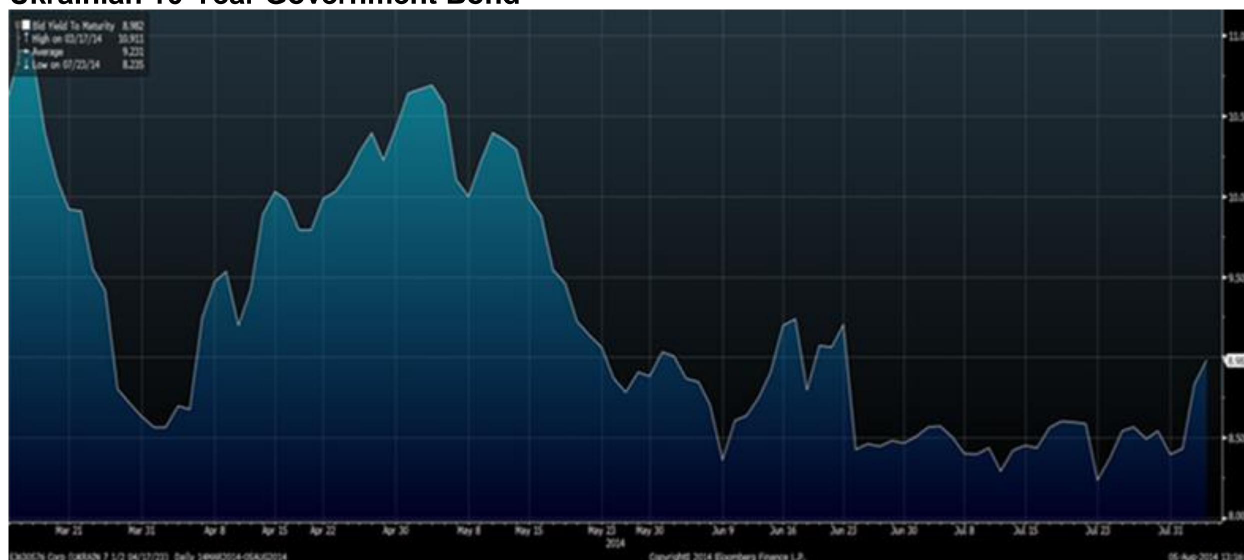

As of year-end 2013, the U.S. insurance industry had $172 million in book/adjusted carrying value (BACV) of Argentine bonds, 73% of which was sovereign. Within this sovereign exposure, approximately $56 million was in the 2033 bonds that defaulted July 30. Argentina defaulted on paying interest to the 2033 bondholders because of a ruling by the U.S. District Court that

blocked the country's attempt to transfer $539 million in interest due because it did not set aside amounts owed to "holdout" creditors related to Argentina's previous 2001 debt default. Argentina last defaulted on $95 billion in sovereign debt in 2001, most of which was swapped for new bonds in 2005 and 2010. Investors took a 70% loss on the principal, but 7% of the holders (the "holdout" creditors, which were hedge funds that purchased the bonds at significant discounts) rejected the restructuring terms and won a U.S. District Court ruling to reclaim 100% of all principal and unpaid interest. July 30 was the last day of a 30-day grace period for Argentina to pay interest due on the 2033 bonds.

The yield on the Argentine sovereign debt due 2033 has shown significant volatility between mid-March through early August, ranging from a high of 12.9% on March 14 to a low of 8.9% on July 30. The average yield on the Argentine debt for the mid-March to early August time period was 11.2%. Since July 30, the yield has increased and, as of Aug. 5, was more than 10%. As of July 29 and according to Bloomberg, the bonds due in 2033 were trading at 82% of par, which was above their 74% of par average over the past five years. The morning of July 30, the bonds were trading at 92.2% of par, due in part to confidence that the bonds would not default by day's end. However, by the close of business on July 30, Argentina defaulted on making payment on these bonds, and they have since been trading in the mid to high 80s.

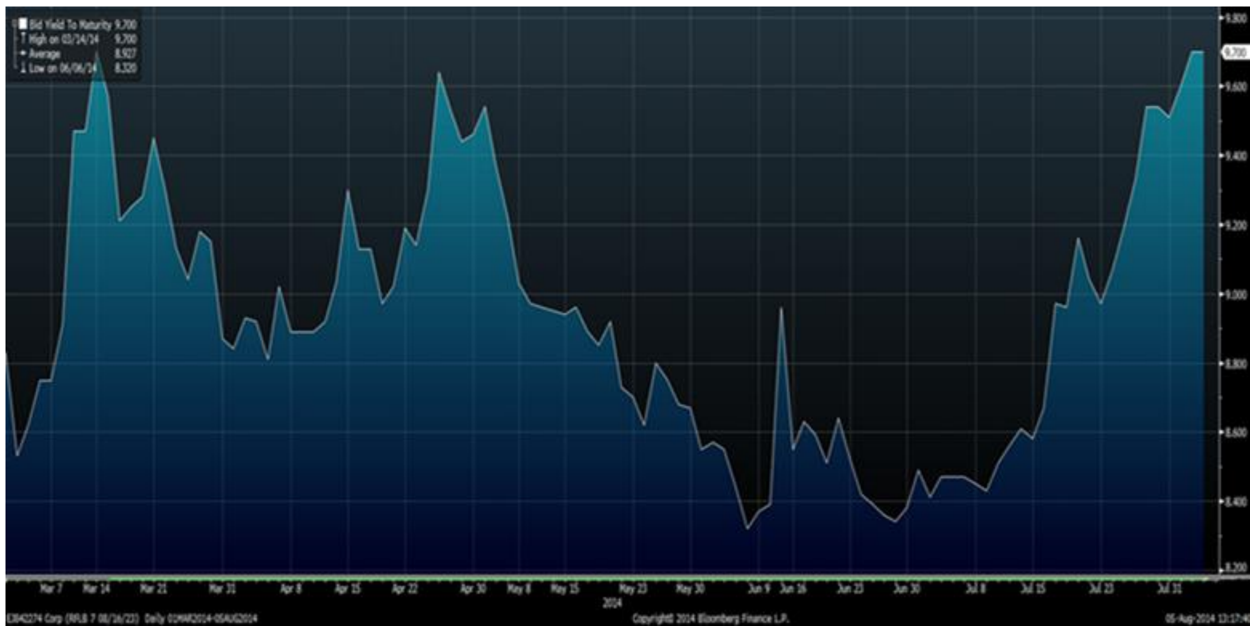
In addition, the International Swaps and Derivatives Association (ISDA) ruled that the default triggered a "failure to pay" credit event on credit default swaps (CDS) linked to Argentina's government debt. CDS contracts insuring a net $1 billion of Argentine debt were outstanding as of July 25, according to the Depository Trust & Clearing Corporation. U.S. insurers did not have CDS exposure related to Argentine bonds (either bought or sold).

**Ukrainian 10-Year Government Bond**



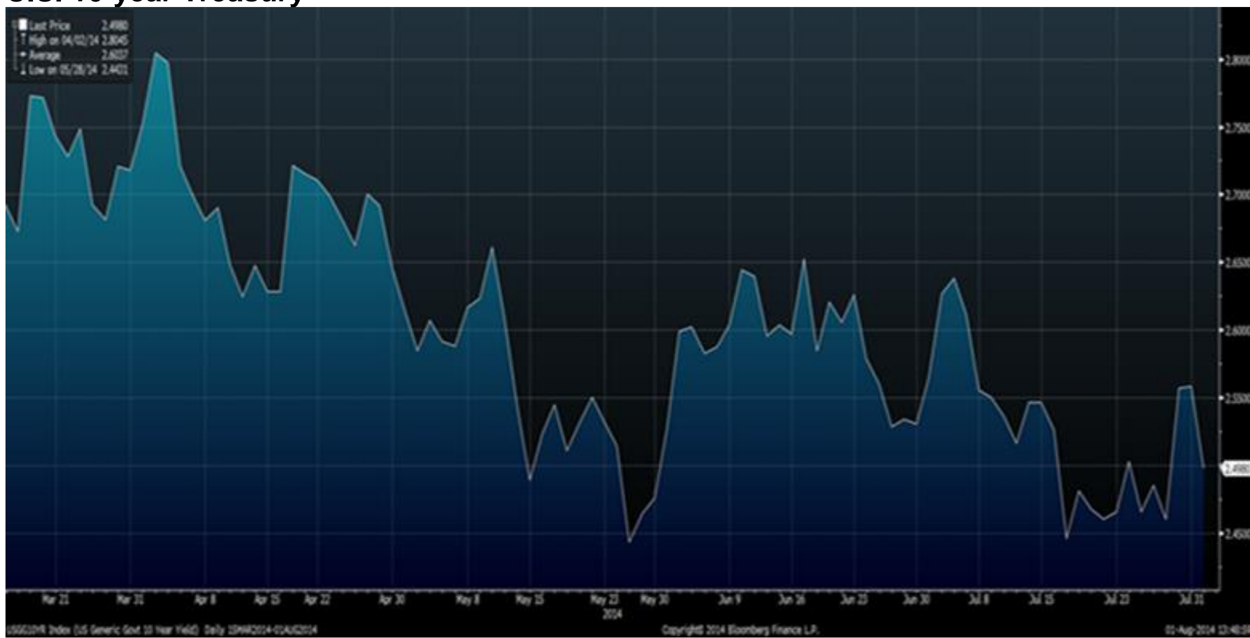

As of year-end 2013, the U.S. insurance industry held only $85.2 million in BACV of Ukrainian bonds, $70.5 million of which were sovereign debt. The yield on the 10-year Ukrainian U.S. dollar-denominated bond has been extremely volatile, ranging from more than 10.9% on March 17 to 8.2% on July 23. After reaching a year-to-date low on July 23, the yield on the Ukraine sovereign bond increased on news of the Ukraine premier's resignation and continuing controversy with Russia.

**Russian 10-Year Government Bond**




The U.S. insurance industry's exposure to Russia was about $785 million as of year-end 2013, most of which was government debt but also included approximately $8 million in Russian equities. The yield on the Russian 10-year government bond fluctuated from March through early August, reaching a high on March 14, with Crimea seceding from Ukraine intending to join Russia, and a low of 8.3% on June 6. Both the U.S. and Europe have imposed economic and financial sanctions on Russia and, as of early Aug. 5, the yield on the Russian 10-year government bond was back at 9.7%, a high for the period. Political turmoil between Russia and Western nations over Ukraine is expected to worsen as market fears heighten that Russia may actually directly intervene in Ukraine. In addition, in the first week of August, Russian President Vladimir Putin imposed a total ban on agricultural products from the U.S. and European Union in response to the escalating sanctions.

**U.S. 10-year Treasury**



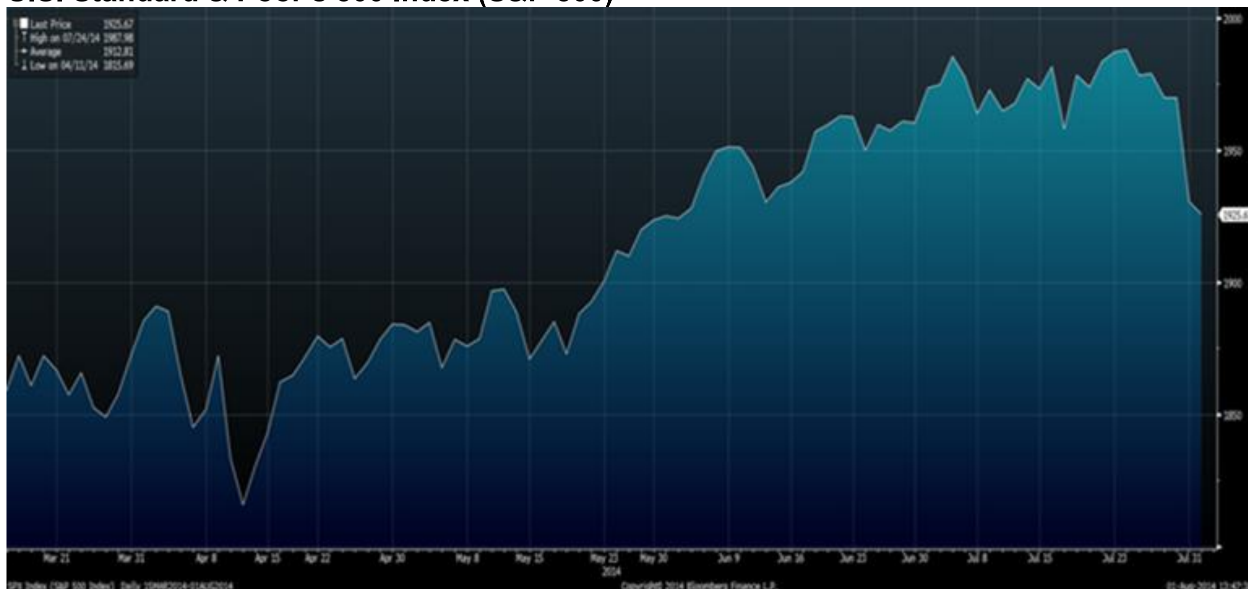

The yield on the U.S. 10-year Treasury has fluctuated for the period mid-March to early August, achieving a high of 2.8% on April 2. Note that, in April, the first U.S. sanctions against Russia

were announced and more were introduced in following months, including on July 29 by both the U.S. and, for the first time, the European Union. In addition, in its June meeting, the Federal Reserve agreed to reduce its bond purchase program incrementally at its next three policy meetings, whereby October would be the last month of bond buybacks. On May 23, the Federal Reserve announced it had no near-term plans to raise interest rates. Consequently, the Standard & Poor's 500 Index (S&P 500) increased above 1,900 while yields on U.S. Treasuries dipped to its low point for the period at 2.4% on May 28. The decrease in Treasury yield (and, in turn, the increase in price) evidences increased investor demand that usually occurs when there is a "flight to safety." The yield on the U.S. 10-year was 2.5% on Aug. 1, and it continues to fall for as long as investors seek safe-haven investments amidst economic and geopolitical turmoil. By Aug. 8, the U.S. 10-year Treasury had dropped below 2.4%, the lowest level since June 2013, but has since been trading near 2.4%.

During 2014, the Federal Reserve has been reducing its monthly U.S. Treasury and mortgage-backed securities bond-buying program in $10 billion increments, whereby the last monthly buyback is expected to be in October for $15 billion. Since the beginning of 2014, most economic data has generally shown signs of stability and growth in the U.S., which has resulted in the Fed's decision to taper this program. The Federal Reserve first announced its bond-buying program in late 2008; total holdings of bonds, loans and other asset types had grown from less than $900 billion to $4.4 trillion.

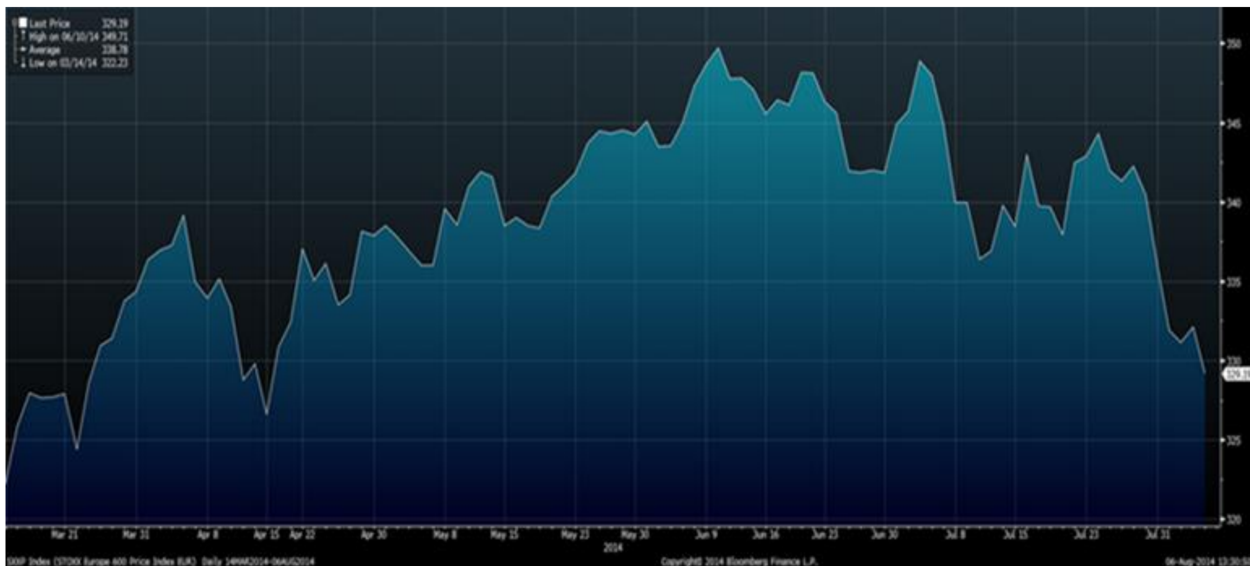
<u>Equities</u>

**U.S. Standard & Poor's 500 Index (S&P 500)**



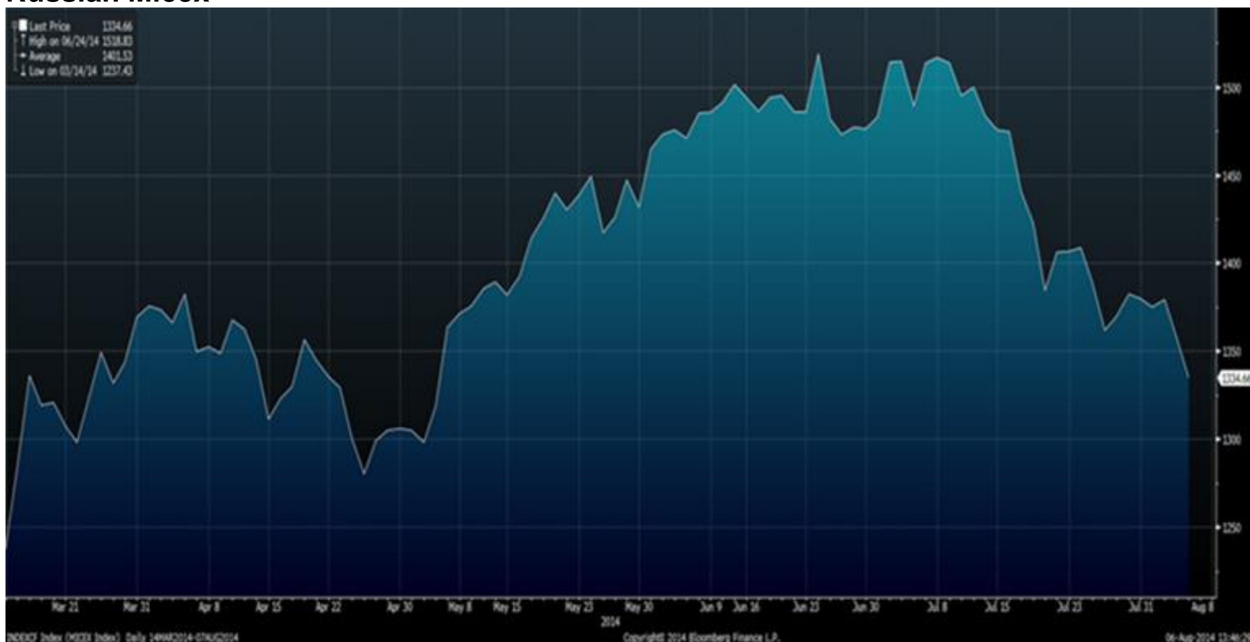

In terms of stock market volatility, for the period between mid-April and early August, the S&P 500 has reacted not only to domestic economic news but also to geopolitical events, such as the turmoil in Ukraine and the Argentine debt default. On April 11, the market reached a temporary low for the period, due in part to disappointing earnings by JP Morgan and a large sell-off by hedge funds of some well-performing stocks. It since rose relatively steadily, reaching a high on July 24. Fluctuations in between were the result of reactions to the downed Malaysian Airlines passenger jet on July 17, followed thereafter by what was a record close on July 23 due to strong domestic corporate earnings. On Aug. 1, the S&P 500 dropped due to concerns over the Argentine debt default and Portugal's Banco Espirito Santo SA's temporary trading suspension (due to its shares dropping more than 50%). The index was also negatively impacted by recent fears of Russia invading Ukraine.

**Stoxx Europe 600 Index (Stoxx 600)**



Similar to the S&P 500, the European stock market has reacted to geopolitical events, as well as its own European economic events. In mid-April, the Stoxx 600 dipped due to reports of Russian troops entering towns in Ukraine, along with data indicating that investor confidence in Germany — Europe's largest economy — had decreased due to a "dent in economic activity." Since then, the index has fluctuated, achieving a high for the period on June 10. However, the Argentine debt default and suspended trading of Banco Espirito Santo SA shares, along with a stalling eurozone recovery, have negatively impacted the index. In addition, there are renewed concerns regarding the crisis in Ukraine, as well as more recent news of Italy re-entering recession.

**Russian Micex**

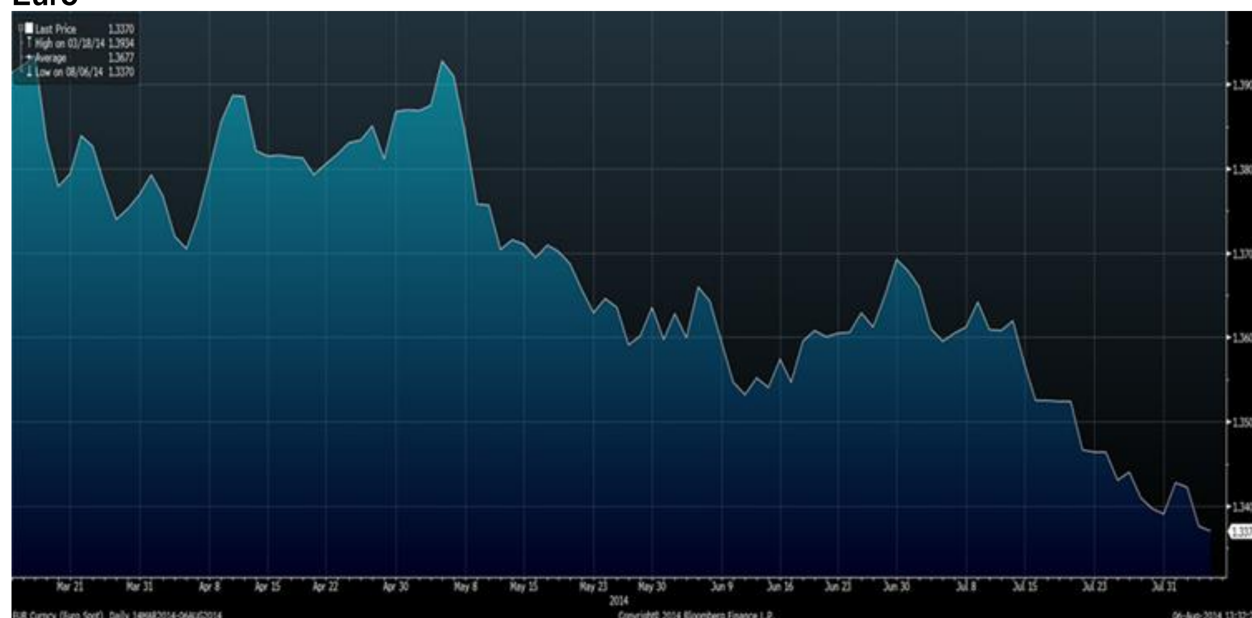


After closing near a four-year low on March 14 (due, in part, to what was a pending vote for Crimean secession), the Russian Micex experienced some volatility before beginning an increasing trend at the beginning of May. In early May, the Micex began a steady incline due to optimism that the conflict between Ukraine and Russia would be resolved diplomatically, based on a statement made by President Putin to pro-Russian separatists. After reaching a period high

on June 24 (upon Interfax reports that Russian parliament would approve Putin's request to rescind authorization for military force in Ukraine), the index declined, with a particular drop on July 17 coincident with the downed Malaysian Airlines jet.

<u>Currency</u>

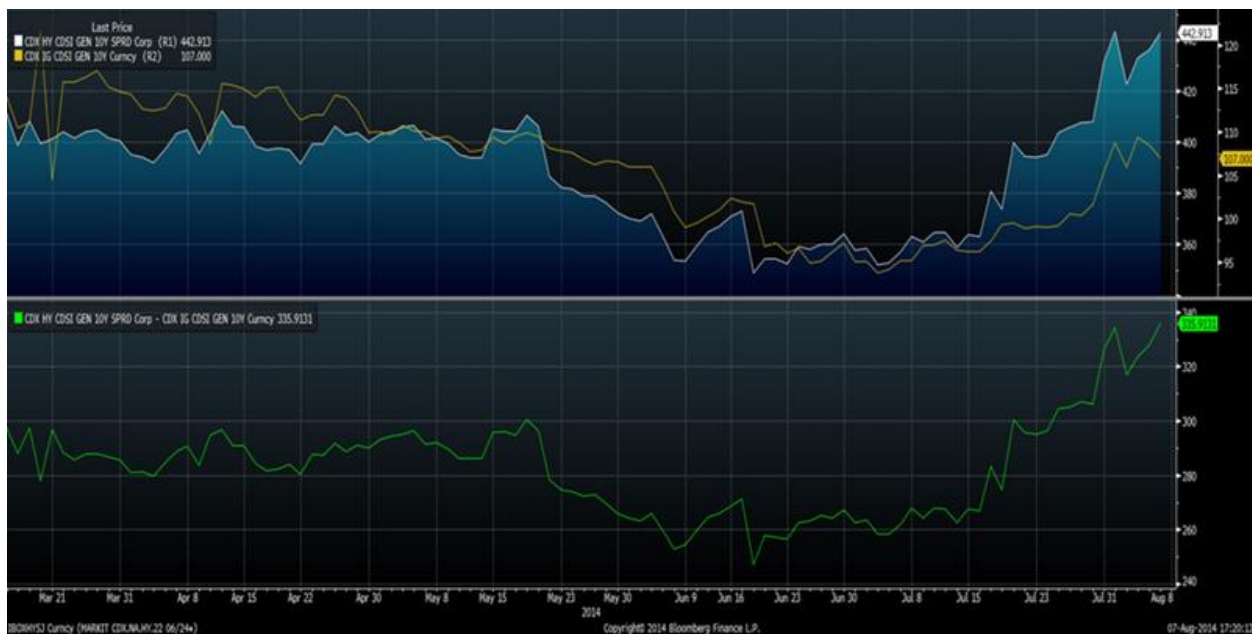
**Euro**




The euro has experienced some volatility between mid-March and early August, but has generally demonstrated a declining, weakening trend. The euro reached a high for 2014 so far on March 18 as investors disregarded the eurozone's downward revision of its inflation rate. Since then, eurozone recovery has slowed somewhat, evidenced by sluggish growth in France and Germany. In addition to a bailout of Portugal's largest bank, recent news indicates that, as of the second quarter, Italy regressed into its third recession since 2008. Peaks and troughs within the index represent short-term shifts due to global economic events, including European financial and trade sanctions against Russia. Note: The euro has traded in a relatively narrow range, between 1.33 and 1.39 during the time period analyzed.

<u>Investment Grade and High-Yield Bonds</u>

**Markit CDX High-Yield Index vs. Markit CDX Investment Grade Index**




In instances where the spread narrowed between the Markit CDX Investment Grade Index and the Markit CDX High Yield Index (such as from early June to mid-July), high-yield investors were receiving a much smaller amount of return in exchange for the additional risk taken. For the most part, the spreads have paralleled each other during the mid-March to early August time period, and demonstrated an increasing trend beginning mid-July due likely to the turmoil surrounding Ukraine and Russia as investors fled to the safety of Treasuries. In addition, there was large sell-off in high-yield bonds, evidenced by the widening spread in the graph above, also beginning mid-July.

Prices on the Markit CDX High-Yield Index reached a high of 110.9% of par on June 16 (for the time period analyzed). As prices are inversely related to yields reflected in the higher spreads, when prices increase, yields fall. In turn, according to data from Barclays, the average below-investment grade yield in June was at an all-time low of 4.8%. Prices began a steady decrease mid-July, as money flowed out of high-yield funds at a fast pace around the time the Malaysian Airlines jet was downed, and unrest in Israel heightened. High-yield bond prices then declined to a low of 103.8% on Aug. 1 (for the time period analyzed). Investors also began selling out of high-yield debt because of concerns regarding interest rate levels; that is, the potential for an unexpected rise in interest rates as the Federal Reserve continues to ease its economic stimulus program. While investors have been withdrawing money from investment grade debt, it has not been as accelerated as their exit from high-yield. In addition, some investors do not view the current low yields on high-yield bonds to be sufficient for the inherent risk. Going into August, investors continue to withdraw money out of high-yield funds due to liquidity concerns, reinvesting in “safer” assets.

In summary, since the last market volatility Special Report was published by the NAIC Capital Markets Bureau on March 25, 2014 (titled “Market Volatility – So Far in 2014”), various market indices have reacted to the ongoing tensions between Ukraine and Russia, the Argentine debt default, concerns over a large Portuguese bank, a slow eurozone recovery, as well as to economic events within the U.S. In particular, as the situation in Ukraine and Russia continues to remain unstable, indices worldwide will experience reactions based on investor sentiment. Economic data has shown that the U.S. economy has been improving (as measured by growth in the gross domestic product); it grew 4.0% in the second quarter of 2014 — accelerating more than expected (compared to an expected 3.2%). In addition, the national unemployment rate was 6.2% in July 2014, compared to 7.3% in July 2013.

The NAIC Capital Markets Bureau will continue to monitor market volatility and publish additional research as deemed appropriate.

| **August 8, 2014** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Major Insurer Share Prices** | | | **Change %** | | | **Prior** | | |
| | | **Close** | **Week** | **QTD** | **YTD** | **Week** | **Quarter** | **Year** |
| Life | Aflac | $59.19 | 0.1 | (6.1) | (11.4) | $59.11 | $63.04 | $66.80 |
| | Ameriprise | 118.56 | 0.3 | 7.7 | 3.1 | 118.23 | 110.07 | 115.05 |
| | Genworth | 12.91 | (1.2) | (27.2) | (16.9) | 13.07 | 17.73 | 15.53 |
| | Lincoln | 50.62 | (1.0) | (0.1) | (1.9) | 51.15 | 50.67 | 51.62 |
| | MetLife | 51.70 | (0.8) | (2.1) | (4.1) | 52.13 | 52.80 | 53.92 |
| | Principal | 50.20 | 2.1 | 9.2 | 1.8 | 49.17 | 45.99 | 49.31 |
| | Protective | 69.65 | 0.4 | 32.4 | 37.5 | 69.36 | 52.59 | 50.66 |
| | Prudential | 87.52 | 1.9 | 3.4 | (5.1) | 85.85 | 84.65 | 92.22 |
| | UNUM | 34.22 | 1.2 | (3.1) | (2.5) | 33.80 | 35.31 | 35.08 |
| PC | ACE | $100.32 | 0.1 | 1.3 | (3.1) | $100.21 | $99.06 | $103.53 |
| | Axis Capital | 45.30 | 3.0 | (1.2) | (4.8) | 44.00 | 45.85 | 47.57 |
| | Allstate | 59.67 | 2.6 | 5.5 | 9.4 | 58.14 | 56.58 | 54.54 |
| | Arch Capital | 54.60 | 0.4 | (5.1) | (8.5) | 54.37 | 57.54 | 59.69 |
| | Cincinnati | 46.90 | 2.1 | (3.6) | (10.4) | 45.92 | 48.66 | 52.37 |
| | Chubb | 88.34 | 1.6 | (1.1) | (8.6) | 86.98 | 89.30 | 96.63 |
| | Everest Re | 159.10 | 0.9 | 4.0 | 2.1 | 157.64 | 153.05 | 155.87 |
| | Progressive | 23.71 | 2.1 | (2.1) | (13.1) | 23.22 | 24.22 | 27.27 |
| | Travelers | 90.48 | 1.0 | 6.3 | (0.1) | 89.61 | 85.10 | 90.54 |
| | WR Berkley | 45.31 | 1.4 | 8.9 | 4.4 | 44.70 | 41.62 | 43.39 |
| | XL | 32.17 | (1.1) | 2.9 | 1.0 | 32.52 | 31.25 | 31.84 |
| Other | AON | $84.56 | 0.7 | 0.3 | 0.8 | $83.94 | $84.28 | $83.89 |
| | AIG | 52.45 | 0.8 | 4.9 | 2.7 | 52.05 | 50.01 | 51.05 |
| | Assurant | 64.19 | 1.1 | (1.2) | (3.3) | 63.48 | 64.96 | 66.37 |
| | Fidelity National | 28.01 | 0.9 | (10.9) | (13.7) | 27.77 | 31.44 | 32.45 |
| | Hartford | 33.99 | (0.1) | (3.6) | (6.2) | 34.03 | 35.27 | 36.23 |
| | Marsh | 51.39 | 1.6 | 4.2 | 6.3 | 50.60 | 49.30 | 48.36 |
| Health | Aetna | $76.74 | (2.5) | 2.4 | 11.9 | $78.73 | $74.97 | $68.59 |
| | Cigna | 90.60 | (0.2) | 8.2 | 3.6 | 90.76 | 83.73 | 87.48 |
| | Humana | 118.11 | (0.6) | 4.8 | 14.4 | 118.80 | 112.72 | 103.22 |
| | United | 80.12 | (1.7) | (2.3) | 6.4 | 81.49 | 81.99 | 75.30 |
| | WellPoint | 108.58 | (2.2) | 9.1 | 17.5 | 111.00 | 99.55 | 92.39 |
| Monoline | Assured | $22.70 | 1.5 | (10.3) | (3.8) | $22.37 | $25.32 | $23.59 |
| | MBIA | 9.34 | 0.0 | (33.2) | (21.8) | 9.34 | 13.99 | 11.94 |
| | MGIC | 7.90 | 7.5 | (7.3) | (6.4) | 7.35 | 8.52 | 8.44 |
| | Radian | 13.42 | 6.9 | (10.7) | (5.0) | 12.55 | 15.03 | 14.12 |
| | XL Capital | 32.17 | (1.1) | 2.9 | 1.0 | 32.52 | 31.25 | 31.84 |

| **August 8, 2014** | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Major Market Variables** | | **Change %** | | | **Prior** | | |
| | **Close** | **Week** | **QTD** | **YTD** | **Week** | **Quarter** | **Year** |
| Dow Jones Ind | 16,553.93 | 0.4 | 0.6 | (0.1) | 16,493.37 | 16,457.66 | 16,576.66 |
| S&P 500 | 1,931.59 | 0.3 | 3.2 | 4.5 | 1,925.18 | 1,872.34 | 1,848.36 |
| S&P Financial | 301.01 | 0.6 | (0.0) | 2.1 | 299.21 | 301.06 | 294.71 |
| S&P Insurance | 282.23 | 0.7 | 0.8 | (2.4) | 280.21 | 280.10 | 289.10 |
| US Dollar $ | | **Change %** | | | **Prior** | | |
| / Euro | $1.34 | (0.1) | (2.6) | (2.4) | $1.34 | $1.38 | $1.37 |
| / Crude Oil bbl | 97.65 | 0.0 | (3.9) | (0.8) | 97.63 | 101.58 | 98.42 |
| / Gold oz | 1,308.90 | 1.2 | 2.0 | 8.9 | 1,293.10 | 1,283.40 | 1,202.30 |
| Treasury Ylds % | **%** | **Change bp** | | | **%** | **%** | **%** |
| 1 Year | 0.09 | (0.02) | (0.02) | (0.02) | 0.11 | 0.11 | 0.11 |
| 10 Year | 2.42 | (0.07) | (0.30) | (0.61) | 2.50 | 2.72 | 3.03 |
| 30 Year | 3.23 | (0.05) | (0.33) | (0.74) | 3.28 | 3.56 | 3.97 |
| Corp Credit Spreads -bp | | **Change %** | | | **Prior** | | |
| CDX.IG | 17.20 | (7.7) | (1.0) | 29.6 | 18.63 | 17.37 | 13.27 |

| August 8, 2014 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Major Insurer Bond Yields | | | | Weekly Change | | | | | YTD |
| | | | | Price | | | Spread over UST | | Spread |
| | Company | Coupon | Maturity | Current | Change | Yield | B.P. | Change | Change |
| Life | Aflac | 8.500% | 5/15/2019 | $128.34 | $0.08 | 2.19% | 62 | (1) | (30) |
| | Ameriprise | 5.300% | 3/15/2020 | $114.52 | $0.21 | 2.50% | 71 | 0 | (10) |
| | Genworth | 6.515% | 5/15/2018 | $113.86 | ($0.55) | 2.63% | 138 | 14 | (25) |
| | Lincoln National | 8.750% | 7/15/2019 | $129.16 | $0.18 | 2.39% | 75 | (0) | (34) |
| | MassMutual | 8.875% | 6/15/2039 | $159.82 | ($0.02) | 4.75% | 167 | 4 | (9) |
| | MetLife | 4.750% | 2/15/2021 | $112.21 | $0.21 | 2.69% | 69 | 2 | (19) |
| | New York Life | 6.750% | 11/15/2039 | $134.90 | $1.45 | 4.44% | 139 | (2) | 11 |
| | Northwestern Mutual | 6.063% | 3/15/2040 | $124.22 | ($0.53) | 4.47% | 138 | 9 | 14 |
| | Pacific Life | 9.250% | 6/15/2039 | $156.40 | $3.08 | 5.19% | 213 | (11) | (21) |
| | Principal | 6.050% | 10/15/2036 | $123.61 | $1.05 | 4.38% | 141 | (2) | 3 |
| | Prudential | 4.500% | 11/15/2020 | $109.91 | $0.28 | 2.76% | 81 | 1 | 3 |
| | TIAA | 6.850% | 12/15/2039 | $133.13 | $0.15 | 4.62% | 154 | 4 | 21 |
| P&C | ACE INA | 5.900% | 6/15/2019 | $116.81 | $0.27 | 2.22% | 62 | (1) | (1) |
| | Allstate | 7.450% | 5/15/2019 | $123.77 | $0.12 | 2.17% | 56 | (1) | (7) |
| | American Financial | 9.875% | 6/15/2019 | $130.79 | $0.07 | 2.99% | 133 | (4) | (54) |
| | Berkshire Hathaway | 5.400% | 5/15/2018 | $113.77 | $0.11 | 1.61% | 40 | (1) | 1 |
| | Travelers | 3.900% | 11/15/2020 | $108.51 | $0.84 | 2.42% | 46 | (10) | (15) |
| | XL Group | 6.250% | 5/15/2027 | $119.93 | $1.28 | 4.21% | 160 | (3) | (21) |
| Other | AON | 5.000% | 9/15/2020 | $112.50 | $0.24 | 2.77% | 85 | 1 | (4) |
| | AIG | 5.850% | 1/15/2018 | $113.67 | $0.15 | 1.72% | 63 | (3) | (11) |
| | Hartford | 5.500% | 3/15/2020 | $114.37 | $0.45 | 2.73% | 92 | (5) | (13) |
| | Marsh | 9.250% | 4/15/2019 | $129.80 | ($0.02) | 2.46% | 90 | (1) | (35) |
| | Nationwide | 9.375% | 8/15/2039 | $155.94 | ($0.52) | 5.31% | 225 | 8 | (11) |
| Health | Aetna | 3.950% | 9/15/2020 | $107.70 | $0.06 | 2.57% | 64 | 4 | (22) |
| | CIGNA | 5.125% | 6/15/2020 | $113.08 | $0.32 | 2.69% | 84 | 1 | (13) |
| | United Healthcare | 3.875% | 10/15/2020 | $107.24 | $0.44 | 2.60% | 70 | (0) | 5 |
| | Wellpoint | 4.350% | 8/15/2020 | $109.11 | $0.04 | 2.70% | 81 | 5 | (18) |

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

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