Capital Markets Special Report

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 Volatility Update: March 2013 to Mid-August 2013

Periodically, the NAIC Capital Markets Bureau reviews the performance of various market indices to note trends as they pertain to U.S. insurer investments. Since our last update in March 2013, the Federal Reserve (Fed) indicated that it would begin to curtail its $85 billion-a-month bond buying program (which was intended to stimulate the economy), resulting in increasing bond yields in May and June (and, therefore, decreasing bond prices). In general, the economy has been trending in a positive direction, give or take a few temporary disruptions along the way. Municipal bond yields reached a two-year high following Detroit's bankruptcy filing on July 18, 2013, and the 10-year U.S. Treasury yield reached its highest level since July 2011. Stock market indices for the most part achieved gains, corporate bonds continued to perform well, and a popular crude oil index made advances, exceeding $100 a barrel.

Included below are graphs obtained from Bloomberg showing changing levels within selected capital markets indices for the five months since March 2013. The graphs include price indices for government bonds, equity markets, the euro, municipal bonds, corporate bonds, residential mortgage bonds and a crude oil index. In general, the U.S. economy has been growing — albeit at a slow pace — due, in part, to the Fed's monetary policy stimulus programs, along with other economic influences, including a declining national unemployment rate. Nevertheless, occasionally there have been events that caused the markets to have a temporary reactionary dip.

Government Bonds

Ten-Year U.S. Treasury Bond

Since the end of April 2013, the yield on the 10-year U.S. Treasury bond has been steadily increasing, reaching a high of 2.7% in early July, and then reaching its highest level since July 2011 at almost 2.8%. Despite some dips along the way, the increasing yield indicates reduced demand and lower prices. This is due to investors being more confident in the status of the economy, and, therefore, willing to move away from the "safety" provided by government bonds and into more risky investments. This trend is also due to concerns about the Fed unwinding its bond buying program, which would cause the market value of holdings to decline, especially for longer duration exposures. Recently, the U.S. has recorded the highest consumer confidence levels in years due to optimism relative to the improving employment rate, increasing home values and a rising stock market. Previously, investors sought safety in U.S. Treasuries as fears regarding the Eurozone debt crisis had resurfaced. Recently, however, the Eurozone has shown some signs of emergence from recession. As of year-end 2012, the U.S. insurance industry had $244.7 billion invested in U.S. government bonds.

Ten-Year U.S. Treasury Bond

<u>Twelve-month U.S. Treasury Bond vs. the 30-year U.S. Treasury Bond</u>

The shape of the yield curve provides an indication of the market's expectations for interest rates, as well as economic activity, in the future. The current yield curve is positively sloping, meaning that yields increase as the time to maturity increases. On Aug. 15, 2013, the generic 12-month U.S. Treasury bond was yielding 0.11%, and the generic 30-year U.S. Treasury bond was yielding 3.8%. The spread, or the differential, between these two yields represents the slope of the yield curve. The steepness of the yield curve increased to 380 basis points (bps) over the past five months, starting out at a low during this period of approximately 280 bps in early May. Note that the yield curve had been even flatter a year prior; in July 2012, it was 228 bps. Because of the long-term nature of their liabilities, life companies in particular benefit from a steeper yield curve.

Shape of the Yield Curve: 12-month U.S. Treasury Bond and 30-year U.S. Treasury Bond

<u>Spanish 10-year Government Bond</u>

A recent indication of growth in industrial output in the Eurozone – particularly in Germany — has attracted some investment in the debt of these countries, and in turn, the yield on the government debt of these countries — in particular yields on the sovereign debt of Spain and Italy — has decreased. For example, the yield on the 10-year Spanish government bond was 4.4% as of Aug. 14, 2013, after reaching a high of 5.1% in June 2013. Spain is the Eurozone's fourth-largest economy. Economic recovery in the Eurozone is expected to be slow and sporadic; unemployment rates are still high, and bank lending continues to decline. Although the governments of these nations are still trying to narrow their budget deficits, they have been doing so at a slower pace. As of year-end 2012, the U.S. insurance industry invested in only $140 million of Spanish sovereign bonds.

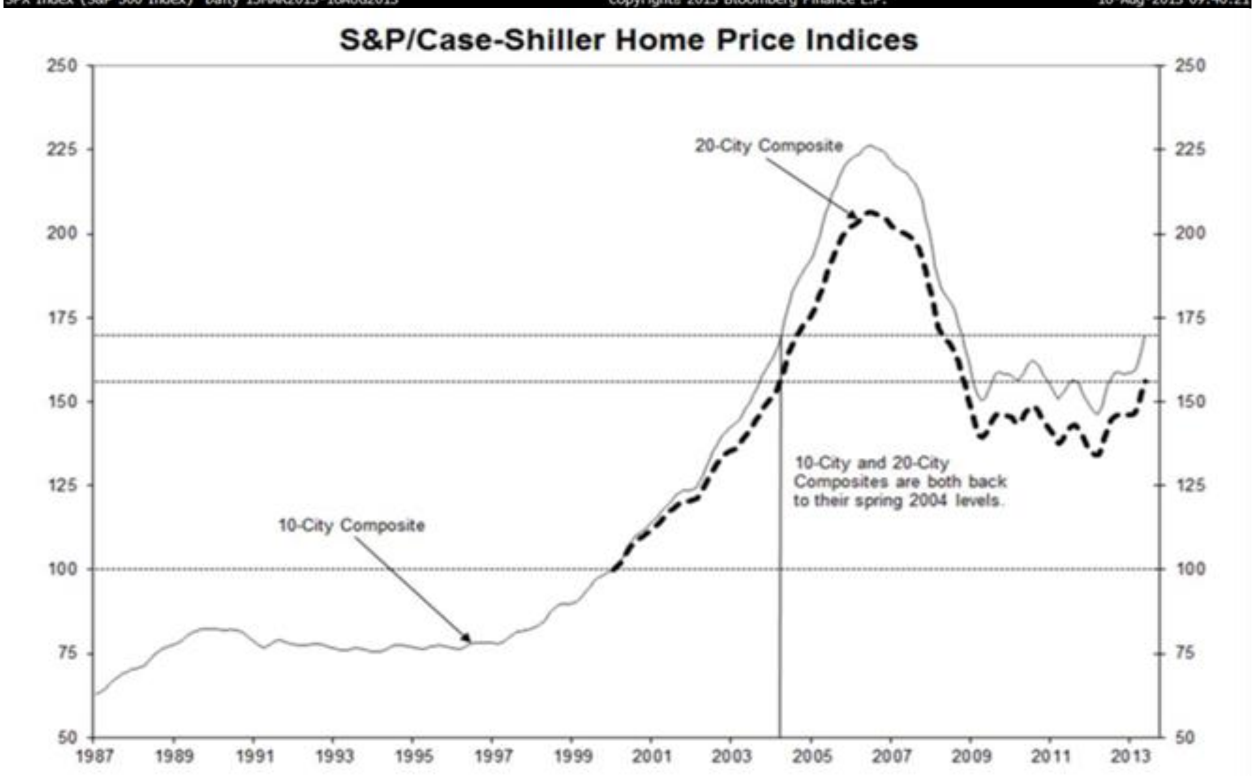
Spanish 10-year Government Bond

Equity Markets

Standard & Poor's 500 Index (S&P 500)

In mid-June 2013, the S&P 500 increased sharply, leveling off around mid-July with relatively small fluctuations since then. Lately, consumer confidence levels have been reportedly high. As of Aug. 15, 2013, the S&P 500 was 1,661.32 — an increase from a low of 1,541.61 as of April 18, 2013, but lower than its all-time high of 1,709.67 on Aug. 2, 2013. The U.S. economy continues to recover, with the national unemployment rate decreasing from 7.9% in January 2013 to 7.4% in July. Consequently, over the past four months, consumers have been boosting retail purchases. In addition, home values have been increasing, evidenced by the S&P/Case-Shiller Home Price (S&P/Case Shiller) Indices. For the 12 months ended May 2013, the S&P/Case-Shiller indices improved more than 12%, a significant positive, even though the indices are still far below their peak in 2007. The continued low interest-rate environment has also caused investors to seek higher returns in this market. According to data compiled by Bloomberg, monetary stimulus has contributed to the S&P 500 growth by more than 150% from its "bear-market low" in 2009.

U.S. S&P 500 Index (SPX)



<u>STOXX Europe 600 Index (SXXP)</u>

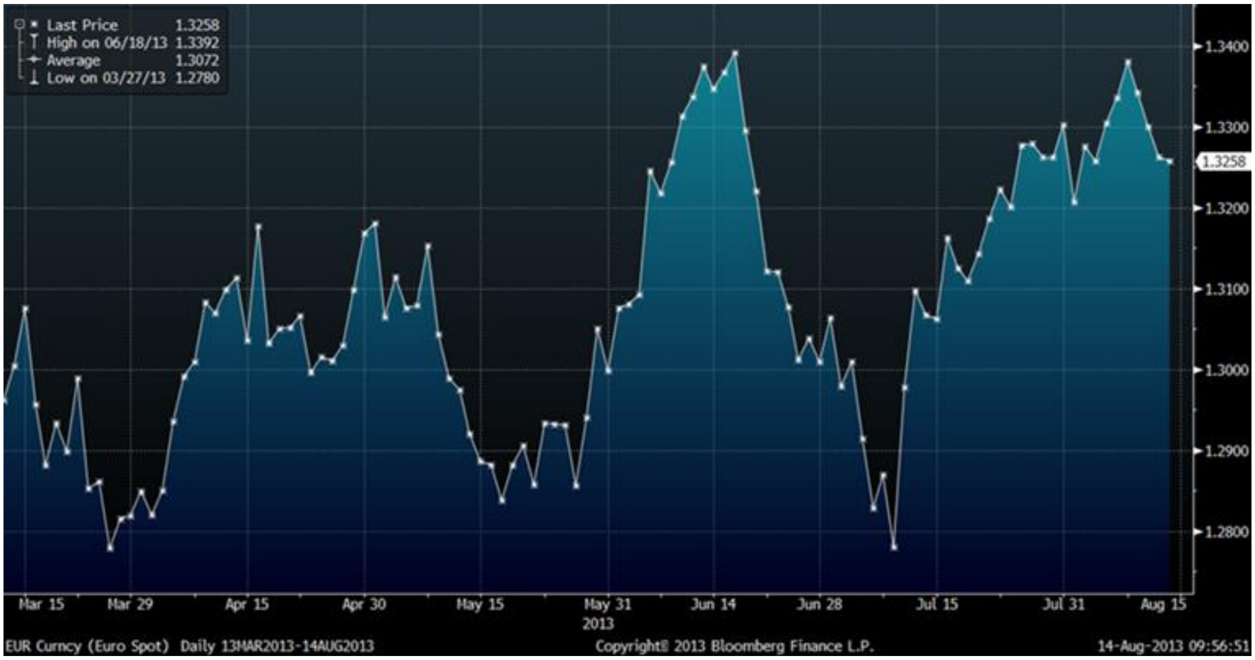
The STOXX Europe 600 Index (SXXP) experienced a notable, steep decline from a high of 310.59 in May 2013 to a low of 275.66 on June 24. In early June, there were debates within the European Central Bank regarding ways to channel funds to suffering Eurozone businesses, as recovery was weak and unemployment in the region reached a record high of 12.2%. Also at this time, tensions were roused between the European Union, the European Central Bank and the International Monetary Fund (IMF) regarding policies that were believed to have resulted in an economic slump for some parts of the area. In mid-June, European Union finance ministers met to negotiate ways to rescue or close failing banks, which was considered crucial to fostering financial stability within the region. Since the SXXP's low point in mid-June, the index reversed its decreasing trend, and it has been on a relatively steady, steep increase, reaching 304.88 as of Aug. 15, 2013, due to the improvements in central Europe cited above (i.e., relative to industrial output), which, in turn, has benefited Eurozone equity markets.

STOXX Europe 600 Index (SXXP)

Currencies – Euro

The euro has fluctuated over the five-month period ended mid-August 2013 due to ongoing developments globally and within the Eurozone. It reached a high of $1.33 on June 18, 2013, and a low of $1.27 on March 27, 2013 (and July 9, 2013). For the most part, the 17-nation currency has ranged between $1.32 and $1.33 from mid-July to Aug. 14, 2013. The rising trend is due mostly to recent data indicating that the Eurozone is emerging from recession, which, in turn, has attracted investors back into the 17-nation currency. Concerns about a possible breakup of the common currency have also greatly diminished. Note, however, that economists and other market participants believe that the Eurozone's financial crisis is far from over, as unemployment continues to remain high, particularly in Spain, Portugal, Italy and Greece, and these aforementioned countries also continue to face political challenges.

Euro



Commodities – Oil

According to the West Texas Intermediate (WTI) crude oil index, the price of oil has, for the most part, been rising steadily for the five months ended mid-August 2013, reaching a high of $108.05 per barrel on July 19, 2013. The WTI has been increasing due, in part, to improving economic recovery in the United States (evidenced by a decrease in the national unemployment rate). The index has increased 17% so far this year due to monetary stimulus implemented by the Fed. The upward trend has also been influenced by unrest in Egypt, which has, in turn, generated concern regarding potential oil supply cuts in the Middle East due to the increased turmoil. According to the International Energy Agency data, the Middle East accounted for 35% of global oil output in the first quarter of 2013. Most recently, the WTI oil price was $107.36 a barrel as of Aug. 15, 2013.

WTI Crude Oil Spot Price

Municipal Bonds

S&P Municipal Bond Index

The S&P Municipal Bond Index is a broad but comprehensive market value-weighted index that tracks the prices of tax-exempt municipal bonds. During the five months ended mid-August 2013, the S&P Municipal Bond Index reached a high of $210.9 on May 5, 2013. Since a sharp drop to the period's $198.1 low on June 24, 2013, the S&P Municipal Bond Index has since increased and leveled off in the $200–$202 range. As of Aug. 14, 2013, it was $198.7. As prices move inversely to yields, this means that, overall, yields have increased from March 2013 to mid-August 2013. Nevertheless, investors have withdrawn funds from long-term municipal mutual funds for 23 weeks straight — the longest stretch in two years — according to Lipper U.S. Fund Flows data. Municipal bond yields also reached a two-year high due, in part, to concerns over the Fed curtailing its $85 billion-a-month bond purchase stimulus program, followed by Detroit's bankruptcy. In addition, according to Standard & Poor's, Detroit's Chapter 9 bankruptcy filing on July 18, 2013, has cost the local debt market approximately $13.8 billion through Aug. 7, 2013. And, according to Bloomberg data, the yield for a benchmark 30-year municipal bond (4.64%) is at its highest level since May 4, 2011. As of year-end 2012, the U.S. insurance industry had $478.2 billion invested in municipal bonds; $1.4 billion was invested in Detroit municipal bonds.

S&P Municipal Bond Index

Corporate Bonds

The Markit CDX North America Investment Grade Index (CDX IG Index) consists of 125 investment-grade entities domiciled in North America. For the five-month period analyzed, the CDX IG Index has been somewhat volatile. Since achieving a high of 75.150 bps on June 24, 2013, the spread has trended downward, reaching 54.120 bps as of Aug. 15, 2013 (though this was still higher than the period's low of 49.5 bps on May 7, 2013). For the most part, the spread on the CDX IG Index has been hovering in the low 50s since mid-July 2013. The continued low interest-rate environment in the United States continues to compel investors to search for higher-yielding alternatives rather than investing in U.S. Treasuries. Consequently, strong investor demand for investment-grade corporate bonds has led to tighter spreads. As of year-end 2012, the U.S. insurance industry invested approximately $1.9 trillion in corporate bonds, the majority of which were investment grade.

Markit CDX North America Investment Grade Index

The Markit CDX North America High Yield Index (CDX HY Index) is composed of 100 non-investment grade corporate entities domiciled in North America. Unlike the CDX IG Index, which trades on spread, the CDX HY Index trades on price. Price moves inversely to yield and spread. The CDX HY Index has also benefitted from investor demand for higher-yielding assets, as its price has been on an upward trend since a downward spike toward the end of June 2013. Since mid-July, the index has leveled off, ranging between 107% to 108% of notional. Signs of improvement related to U.S. economic recovery, including an improvement in joblessness, have also positively influenced movement of the CDX HY Index.

Markit CDX North America High Yield Index

Structured Securities

The Markit ABX.HE Index is comprised of reference obligations in 20 non-agency residential mortgage-backed securities (RMBS) issuers. As the graph below indicates, in the five-month period analyzed, RMBS prices spiked in May 2013 but then sharply decreased mid-June 2013. This is likely a reaction to the Fed’s indication that it would be slowing its monthly bond purchasing program. The increase in prices may be attributed to the seasonality of the mortgage loans that are included in the RMBS pools within the ABX index. The U.S. housing market is recovering from having been the center of the recent financial crisis, with borrowing costs increasing from near record lows and improved employment helping to fuel demand for existing property listings. In addition, in recent months, home values have been increasing. The U.S. insurance industry had $117 billion invested in private label RMBS as of year-end 2012.

Markit ABX.HE Index

Summary

Over the past few months, the U.S. financial markets have been favorably influenced by domestic economic improvement, including a drop in jobless claims in early August 2013 to the lowest level since October 2007. Nevertheless, the markets continue to be affected — usually temporarily — by any news that arises from the Eurozone regarding the financial crisis, as well as by economic events that occur domestically, such as the Detroit bankruptcy filing. The NAIC Capital Markets Bureau will continue to monitor market volatility and publish additional research on this topic as deemed appropriate.

August 16, 2013

Major Insurer Share Prices

			Change %			Prior		
		Close	Week	QTD	YTD	Week	Quarter	Year
Life	Aflac	$60.54	(1.7)	4.2	14.5	$61.58	$58.12	$52.89
	Ameriprise	88.23	(2.1)	9.1	41.3	90.12	80.88	62.45
	Genworth	12.59	(1.6)	10.3	68.1	12.80	11.41	7.49
	Lincoln	43.55	0.5	19.4	69.0	43.34	36.47	25.77
	MetLife	48.28	(3.0)	5.5	47.4	49.79	45.76	32.76
	Principal	42.48	(0.9)	13.4	49.7	42.87	37.45	28.38
	Protective	42.70	(1.0)	11.2	50.0	43.15	38.41	28.47
	Prudential	79.61	(1.2)	9.0	50.0	80.60	73.03	53.09
	UNUM	29.61	(2.4)	0.8	42.8	30.33	29.37	20.73
PC	ACE	$89.55	(0.3)	0.1	12.6	$89.81	$89.48	$79.50
	Axis Capital	42.70	0.1	(6.7)	23.9	42.65	45.78	34.46
	Allstate	49.39	(2.4)	2.6	23.3	50.62	48.12	40.05
	Arch Capital	53.42	(1.1)	3.9	21.9	54.04	51.41	43.82
	Cincinnati	47.76	(1.8)	4.0	22.6	48.63	45.92	38.95
	Chubb	84.98	(0.6)	0.4	13.3	85.52	84.65	75.01
	Everest Re	138.18	3.5	7.7	26.0	133.52	128.26	109.67
	Progressive	25.14	(2.2)	(1.1)	19.7	25.71	25.42	21.01
	Travelers	81.10	(1.2)	1.5	13.4	82.06	79.92	71.53
	WR Berkley	41.80	0.3	2.3	11.2	41.68	40.86	37.59
	XL	30.43	(1.4)	0.4	22.0	30.87	30.32	24.94
Other	AON	$68.39	(1.0)	6.3	23.4	$69.10	$64.35	$55.41
	AIG	47.10	(1.9)	5.4	33.5	48.00	44.70	35.28
	Assurant	55.23	0.0	8.5	60.2	55.21	50.91	34.48
	Fidelity National	24.44	(0.6)	2.6	3.6	24.59	23.81	23.58
	Hartford	30.84	(1.6)	(0.3)	37.7	31.34	30.92	22.39
	Marsh	41.72	(0.4)	4.5	21.6	41.90	39.92	34.30
Health	Aetna	$62.15	(2.7)	(2.2)	34.6	$63.86	$63.54	$46.17
	Cigna	77.36	(1.3)	6.7	45.2	78.40	72.49	53.29
	Humana	91.53	(1.9)	8.5	33.8	93.31	84.38	68.43
	United	71.43	(2.0)	9.1	32.0	72.90	65.48	54.12
	WellPoint	86.05	(1.5)	5.1	41.7	87.34	81.84	60.73
Monoline	Assured	$21.33	(5.6)	(3.3)	51.1	$22.59	$22.06	$14.12
	MBIA	12.40	(2.6)	(6.8)	56.6	12.73	13.31	7.92
	MGIC	7.19	(6.3)	18.5	166.3	7.67	6.07	2.70
	Radian	13.06	(6.7)	12.4	112.4	14.00	11.62	6.15
	XL Capital	30.43	(1.4)	0.4	22.0	30.87	30.32	24.94

August 16, 2013								
Major Market Variables			**Change %**			**Prior**		
		Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Dow Jones Ind		15,081.47	(2.2)	1.2	15.1	15,425.51	14,909.60	13,099.80
S&P 500		1,655.83	(2.1)	3.1	16.4	1,690.88	1,606.28	1,422.10
S&P Financial		269.49	(2.0)	2.8	21.8	275.04	262.06	221.17
S&P Insurance		256.78	(1.4)	4.1	28.6	260.36	246.78	199.67
US Dollar $			**Change %**			**Prior**		
	/ Euro	$1.33	(0.1)	2.5	1.0	$1.33	$1.30	$1.32
	/ Crude Oil bbl	107.75	1.6	11.6	17.6	106.04	96.53	91.62
	/ Gold oz	1,373.30	4.5	11.3	(17.9)	1,313.80	1,233.50	1,673.70
Treasury Ylds %		**%**	**Change bp**			**%**	**%**	**%**
	1 Year	0.12	0.01	(0.03)	(0.03)	0.11	0.15	0.14
	10 Year	2.83	0.26	0.34	1.07	2.58	2.49	1.76
	30 Year	3.85	0.21	0.35	0.90	3.63	3.50	2.95
Corp Credit Spreads -bp			**Change %**			**Prior**		
	CDX.IG	34.09	4.5	(14.9)	(40.2)	32.61	40.05	57.04

August 16, 2013										
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	$128.78	($1.68)	3.00%	116	6	(12)
	Ameriprise	5.300%	3/15/2020	$113.32	($1.57)	3.05%	88	(0)	(30)
	Genworth	6.515%	5/15/2018	$112.65	($1.45)	3.59%	204	6	(186)
	Lincoln National	8.750%	7/15/2019	$128.81	($1.76)	3.30%	139	4	(45)
	MassMutual	8.875%	6/15/2039	$143.92	($4.00)	5.63%	194	0	(54)
	MetLife	4.750%	2/15/2021	$108.95	($1.66)	3.38%	104	(2)	(5)
	New York Life	6.750%	11/15/2039	$122.27	($2.59)	5.19%	145	(10)	(18)
	Northwestern Mutual	6.063%	3/15/2040	$116.17	($0.24)	4.96%	124	(20)	(21)
	Pacific Life	9.250%	6/15/2039	$138.19	($0.46)	6.25%	252	(23)	(79)
	Principal	6.050%	10/15/2036	$112.90	($4.18)	5.09%	155	4	(27)
	Prudential	4.500%	11/15/2020	$106.82	($1.65)	3.43%	111	(1)	(30)
	TIAA	6.850%	12/15/2039	$123.93	($0.05)	5.17%	146	(22)	(24)
P&C	ACE INA	5.900%	6/15/2019	$118.10	($1.48)	2.53%	64	1	(13)
	Allstate	7.450%	5/15/2019	$125.95	($1.13)	2.56%	70	(6)	(41)
	American Financial	9.875%	6/15/2019	$129.45	($1.72)	4.13%	220	2	(92)
	Berkshire Hathaway	5.400%	5/15/2018	$114.98	($1.22)	2.06%	55	3	(8)
	Travelers	3.900%	11/15/2020	$105.63	($1.89)	3.02%	68	3	4
	XL Group	6.250%	5/15/2027	$110.33	($2.47)	5.19%	204	(12)	(37)
Other	AON	5.000%	9/15/2020	$109.71	($0.81)	3.45%	117	(11)	(15)
	AIG	5.850%	1/15/2018	$112.94	($1.42)	2.71%	136	12	16
	Hartford	5.500%	3/15/2020	$111.60	($1.48)	3.52%	132	(4)	(41)
	Marsh	9.250%	4/15/2019	$129.32	($1.48)	3.49%	155	(2)	(42)
	Nationwide	9.375%	8/15/2039	$138.01	($2.32)	6.36%	267	(6)	(55)
Health	Aetna	3.950%	9/15/2020	$102.85	($1.77)	3.49%	119	2	(1)
	CIGNA	5.125%	6/15/2020	$109.01	($1.90)	3.62%	137	2	(7)
	United Healthcare	3.875%	10/15/2020	$103.81	($1.60)	3.27%	103	0	6
	Wellpoint	4.350%	8/15/2020	$105.30	($1.75)	3.49%	123	1	(15)

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