National Association of Insurance Commissioners & The Center for Insurance Policy and Research
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 Value Volatility Update: Trends for the First Half of 2012

The global markets continue to be impacted by the never-ending turmoil in the eurozone, and domestically, the U.S. economy appears to be weakening, evidenced by a housing sector that continues to be stressed, along with a weaker-than-expected job market. While the U.S. unemployment rate has decreased somewhat, the Federal Reserve recently reported that families' net worth in the U.S. decreased by 40% between 2007 and 2010, down to 1992 levels. On June 15, Moody's Investors Service (Moody's) lowered the ratings on the long-term debt of 11 European banks due in part to the challenging operating environment and continued deterioration in the creditworthiness of several European sovereigns. Moody's had also lowered Spain's long-term sovereign debt rating from A3 to Baa3 due to its increasing debt burden, its request for bailout funding and the weakening economy. Currently, Spain's sovereign debt is rated BBB by Fitch Ratings and by Standard & Poor's, with a negative outlook from the latter. Also, due partly to the anticipation of Greece's governmental election last weekend, and the possibility of a euro breakup, there was an increase in flight to the safe haven of U.S. Treasuries. Nonetheless, up to $1 billion has been estimated to have been recently withdrawn from Greek banks. According to the *Wall Street Journal*, Greek bank deposits have decreased by one-third since 2009. The 10 largest U.S. prime money market funds have also reduced their exposure to European bank debt by an aggregate $8.3 billion in May. To lend some comfort, the European Central Bank (ECB) announced that central banks would be ready to interject and assist with any financial markets turmoil resulting from the Greek elections, by supplying liquidity to solvent banks as deemed appropriate.

Domestically, the U.S. housing crisis continues to linger, and the U.S. national unemployment rate—which was 8.2% in May 2012—remains relatively high, though it is lower than the 9.0% as of year-end 2011. Financial markets perhaps are beginning to recover, evidenced somewhat by a record-setting first quarter of new issuance in U.S. high-yield corporate bonds, according to Fitch Ratings. This was driven not only by historically low borrowing costs but also by an increase in investor demand for both high-yield and investment-grade corporate bonds.

Lastly, production in the oil industry, and therefore, the price of oil, has also been impacted by global economic sentiment.

Government Bonds

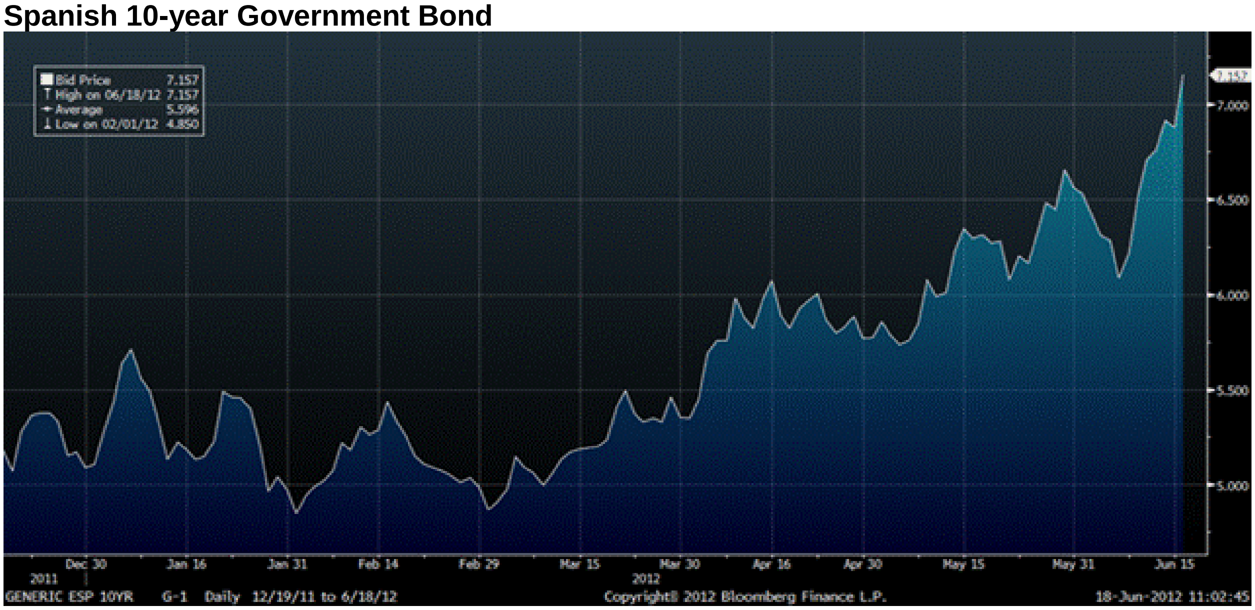
The Shape of the Yield Curve

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. Today's yield curve is positively sloping, where yields increase as the time to maturity increases. On June 20, 2012, the generic 12-month Treasury bond was yielding 0.17%, and the generic 30-year Treasury bond was yielding 2.73%. The spread, or the differential, between these two yields creates the slope of the yield curve. The shape of the yield curve is near its flattest level in the last 12 months, with the spread at 256 basis points (bps). Approximately one year ago, the yield curve was steeper, with the spread at more than 400 bps, and 30-year interest rates were above 4%. From September 2011 through April 2012, the spread was relatively steady at approximately 300 bps, and 30-year interest rates were approximately 3%. The combination of a flat yield curve together with low interest rates, especially for a prolonged period of time, could pose serious challenges to insurance companies in the long run. For example, a flat yield curve does not allow life insurers to differentiate their products from competing shorter-term products. Furthermore, a prolonged period of low interest rates could result in the erosion of investment yields, leading to pressure on profit margins and profitability.

10-year Treasury Bond

Yields on U.S. Treasuries move in the opposite direction to price. The yield on the U.S. 10-year Treasury bond has fluctuated since December 2011, peaking in March 2012 and dipping to a low point on June 1, when demand for Treasuries was high (and, therefore, prices increased) as a flight to quality ensued with continued concerns over the eurozone crisis, including concerns over the survival of the euro. France and the U.K. have increased their holdings of U.S. Treasuries by more than 26% since April, even though international demand for U.S. financial assets decreased. Subsequently, yields had increased due in part to a market reaction to GDP rising between January and March at an annualized 1.9%, which was lower than the 2.2% expected. This rise in yield is also likely attributed to a continued weak job market, as well as fears of a larger global slowdown that could eventually negatively impact domestic growth. The following spike in yield at the beginning of June was partly related to the agreement by global central banks to make efforts to boost struggling euro economies.

Spanish 10-year Government Bond



The yield on the Spanish generic 10-year government bond has been on a relatively steady incline since December 2011, reaching a high on June 18. Spain's banking sector is currently severely distressed, with 8.7% of loans held by Spanish banks (€152.7 billion) more than three months overdue for repayment in April (an increase from 8.3% in March), according to central bank estimates. Spain had requested aid from the European Union for its ailing banks, to which they responded with €100 billion ($124.5 billion) in bailout funds. This could hurt investor appetite for Spanish government bonds, which are needed as part of the country's financial plans that include issuing more than €30 billion of long-term debt in 2012.

Equity indices

S&P 500

The Standard & Poor's 500 Index (S&P 500), which tracks the most widely traded 500 stocks on the New York Stock Exchange, is indicative of the sensitivity of the U.S. equity markets to domestic and global economic events. As the graph above shows, the index generally rose from December 2011 through April 2012, reaching a peak on April 2. At the time, the European banking crisis was showing signs of easing, central banks had agreed to support economic growth, and, domestically, U.S. job gains were higher than expected, supporting that the U.S. economy was showing signs of recovery. Since then, a decline ensued, due in part to European economies' continued crises, and, in particular, Spain officially entering a recession. There was also renewed concern about economic recovery in the U.S., and a major U.S. bank announced 2,000 staff cuts.

More recently, the S&P 500 has regained some losses, increasing in June in part because of speculation that global banks would make efforts to support European economies—in particular, devising a support package for Spain. In addition, a Federal Reserve official in the U.S. stated that "further monetary actions to support the recovery will certainly need to be considered" with regard to domestic economic growth.

Stoxx Euro 600

The Stoxx Euro 600 (Price) Index is a broad-based capitalization-weighted index of European stocks that is designed to provide a broad, but liquid, representation of European region companies. It peaked mid-March 2012 due to optimism about global economic growth and diminishing concerns over eurozone sovereign debt. After that, it began a steady decline and dipped further at the end of May as Spain's banking sector crisis emerged.

Since early June, the index began to increase as investors became optimistic regarding central banks' efforts in stimulating the global economy. In addition, Greek government election results prompted the International Monetary Fund (IMF), which contributed to two of Greece's prior rescue packages, to state that it is "ready to engage with the new government" to help it reach goals of "restoring financial stability, economic growth and jobs."

Currencies

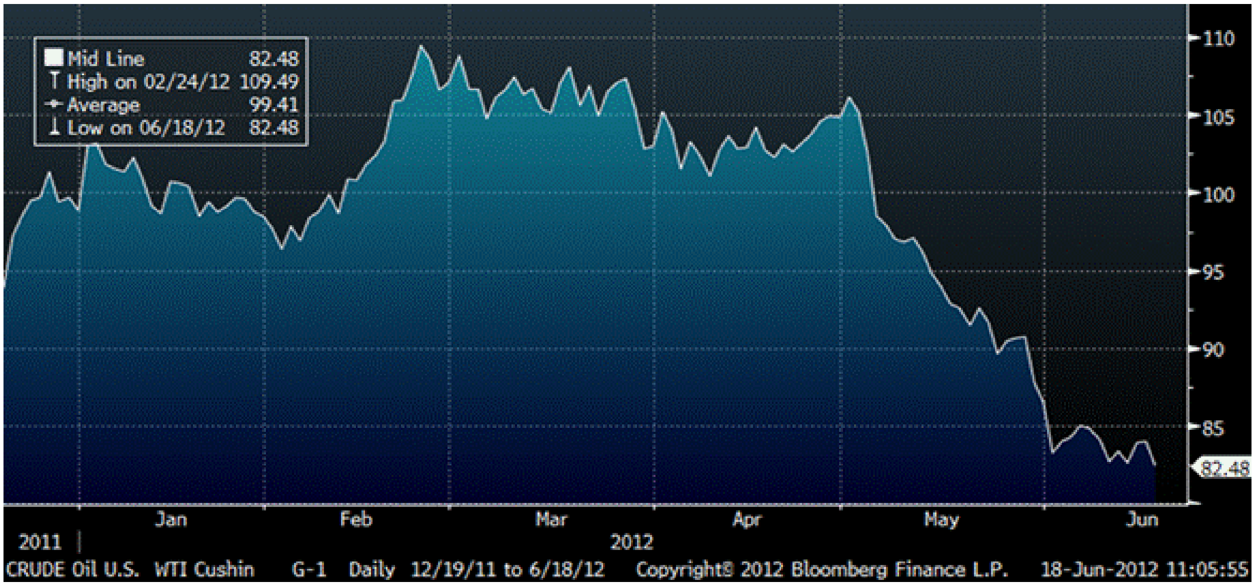
Euro

From December 2011 through mid-June 2012, the euro, as it is valued against the dollar, initially declined by mid-January 2012 but for the most part fluctuated, reaching a high in

February before declining to a low for this time period on May 31. Upon Spain officially entering a recession at the end of April, the low point was due most likely to fears about Spain not being able to save its distressed banks, which also sparked a sell-off in Spanish government bonds. Since then, Spain has requested and received a bailout offer from other European banks. While the results of the Greek government election suggest that Greece will remain in the European monetary union, the euro declined again somewhat recently, due in part to "fading optimism that Greece's election will calm the euro sovereign-debt crisis."

Commodities – Oil

WTI



The West Texas Intermediate Crude Oil Spot Price (WTI) is a benchmark used to price a light, sweet crude oil produced in the United States. It is not unusual for prices to increase in anticipation of higher demand during winter months. The decreases in oil prices are partly due to a strengthening U.S. dollar (which typically happens with commodities), as well as an expected decrease in demand, especially as the status of a U.S. economic recovery remains uncertain and turmoil continues among the eurozone nations. In addition, in a recent meeting among the Organization of Petroleum Exporting Countries (OPEC), which produces about one-third of the world's oil, discussions regarding a production ceiling have been overshadowed by the eurozone crisis which, according to Barclays research, has put OPEC in a "genuine data fog." The WTI decreased to a period low on June 18, at $82.48 per barrel.

Summary

Since our last report on volatility within the financial markets in October 2011, what remains consistent is volatility among the eurozone nations and uncertainty with respect to U.S. economic recovery. For a while there seemed to be signs of easing among the European sovereign debt turmoil; however, most recently, Spain entered a recession and is suffering with a banking sector crisis, which has in turn renewed fears over the stability of the European monetary union. For the time being, the recent Greek government election has eased concerns regarding Greece's exit from the euro. Nevertheless, resulting sentiment toward the sovereign debt crisis has impacted debt and equity markets worldwide.

Domestically, for the first half of this year, an unexpectedly weak jobs report, along with continued stress in the U.S. housing sector, suggests a weakening economy and further exacerbates uncertainty over the timing of a U.S. economic recovery.

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

June 21, 2012								
Major Insurer Share Prices			**Change %**			**Prior**		
		Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Life	Aflac	$41.07	2.0	(5.1)	(5.1)	$40.26	$43.26	$43.26
	Ameriprise	49.63	3.7	(0.0)	(0.0)	47.86	49.64	49.64
	Genworth	5.15	0.6	(21.4)	(21.4)	5.12	6.55	6.55
	Lincoln	20.64	0.8	6.3	6.3	20.47	19.42	19.42
	MetLife	29.71	0.1	(4.7)	(4.7)	29.69	31.18	31.18
	Principal	24.58	(0.4)	(0.1)	(0.1)	24.67	24.60	24.60
	Protective	27.60	3.3	22.3	22.3	26.73	22.56	22.56
	Prudential	46.82	(0.7)	(6.6)	(6.6)	47.17	50.12	50.12
	UNUM	19.17	(2.1)	(9.0)	(9.0)	19.58	21.07	21.07
PC	ACE	$71.41	(0.4)	1.8	1.8	$71.70	$70.12	$70.12
	Axis Capital	31.83	(1.5)	(0.4)	(0.4)	32.32	31.96	31.96
	Allstate	34.00	(0.2)	24.0	24.0	34.07	27.41	27.41
	Arch Capital	37.42	(1.9)	0.5	0.5	38.14	37.23	37.23
	Cincinnati	36.57	0.5	20.1	20.1	36.38	30.46	30.46
	Chubb	70.90	(0.1)	2.4	2.4	70.96	69.22	69.22
	Everest Re	102.76	0.3	22.2	22.2	102.49	84.09	84.09
	Progressive	20.61	(3.9)	5.6	5.6	21.45	19.51	19.51
	Travelers	62.58	1.4	5.8	5.8	61.71	59.17	59.17
	WR Berkley	37.02	(2.9)	7.6	7.6	38.12	34.39	34.39
	XL	20.03	(0.6)	1.3	1.3	20.16	19.77	19.77
Other	AON	$46.08	(0.5)	(1.5)	(1.5)	$46.29	$46.80	$46.80
	AIG	31.04	4.6	33.8	33.8	29.67	23.20	23.20
	Assurant	34.16	2.1	(16.8)	(16.8)	33.46	41.06	41.06
	Fidelity National	19.01	(1.1)	19.3	19.3	19.22	15.93	15.93
	Hartford	16.75	(0.2)	3.1	3.1	16.79	16.25	16.25
	Marsh	30.80	(2.7)	(2.6)	(2.6)	31.66	31.62	31.62
Health	Aetna	$40.76	(4.9)	(3.4)	(3.4)	$42.88	$42.19	$42.19
	Cigna	44.11	(1.0)	5.0	5.0	44.54	42.00	42.00
	Humana	78.48	(0.5)	(10.4)	(10.4)	78.87	87.61	87.61
	United	58.34	1.2	15.1	15.1	57.64	50.68	50.68
	WellPoint	69.46	0.4	4.8	4.8	69.17	66.25	66.25
Monoline	Assured	$12.28	4.5	(6.5)	(6.5)	$11.75	$13.14	$13.14
	MBIA	9.94	6.9	(14.2)	(14.2)	9.30	11.59	11.59
	MGIC	2.67	12.2	(28.4)	(28.4)	2.38	3.73	3.73
	Radian	2.75	12.7	17.5	17.5	2.44	2.34	2.34
	XL Capital	20.03	(0.6)	1.3	1.3	20.16	19.77	19.77

June 21, 2012								
Major Market Variables			**Change %**			**Prior**		
		Close	**Week**	**QTD**	**YTD**	**Week**	**Quarter**	**Year**
Dow Jones Ind		12,573.57	1.3	2.9	2.9	12,411.61	12,217.56	12,217.56
S&P 500		1,325.51	0.9	5.4	5.4	1,313.70	1,257.60	1,257.60
S&P Financial		191.46	2.9	9.3	9.3	186.12	175.23	175.23
S&P Insurance		176.39	0.8	3.7	3.7	174.99	170.17	170.17
US Dollar $			**Change %**			**Prior**		
	/ Euro	$1.25	0.5	(3.2)	(3.2)	$1.25	$1.30	$1.30
	/ Crude Oil bbl	78.26	(4.1)	(20.8)	(20.8)	81.57	98.83	98.83
	/ Gold oz	1,564.50	(2.1)	(0.1)	(0.1)	1,598.50	1,566.80	1,566.80
Treasury Ylds %		%	**Change**			%	%	%
	1 Year	0.17	0.00	0.07	0.07	0.17	0.11	0.11
	10 Year	1.62	0.02	(0.26)	(0.26)	1.60	1.88	1.88
	30 Year	2.69	(0.03)	(0.21)	(0.21)	2.72	2.90	2.90
Corp Credit Spreads -bp			**Change %**			**Prior**		
	CDX.IG	85.58	(10.0)	(24.8)	(24.8)	95.05	113.83	113.83

June 21, 2012									
Major Insurer Bond Yields				Weekly Change					
				Price			Spread	
	Company	Coupon	Maturity	Current	Change	Yield	B.P.	Change
Life	Aflac	8.500%	5/15/2019	$131.21	($0.39)	3.38%	221	(2)
	Ameriprise	5.300%	3/15/2020	$113.92	($0.56)	3.25%	197	(0)
	Genworth	6.515%	5/15/2018	$97.78	$1.69	6.98%	595	(39)
	Lincoln National	8.750%	7/15/2019	$126.90	($0.62)	4.27%	308	2
	MassMutual	8.875%	6/15/2039	$146.54	$0.64	5.53%	293	(2)
	MetLife	4.750%	2/15/2021	$111.27	$0.75	3.24%	178	(16)
	Mutual of Omaha	6.800%	6/15/2036	$111.98	($0.51)	5.86%	343	9
	New York Life	6.750%	11/15/2039	$131.88	$0.23	4.67%	204	(3)
	Northwestern Mutual	6.063%	3/15/2040	$123.19	$0.91	4.58%	195	(4)
	Pacific Life	9.250%	6/15/2039	$130.58	$0.82	6.77%	417	(5)
	Principal	6.050%	10/15/2036	$114.46	$1.01	5.01%	254	(5)
	Prudential	4.500%	11/15/2020	$105.37	($0.09)	3.75%	236	(4)
	TIAA	6.850%	12/15/2039	$130.85	$1.11	4.81%	218	(5)
P&C	ACE INA	5.900%	6/15/2019	$123.28	($0.40)	2.27%	109	(7)
	Allstate	7.450%	5/15/2019	$128.22	$0.05	2.90%	175	(6)
	American Financial	9.875%	6/15/2019	$126.83	$1.37	5.23%	396	(16)
	Berkshire Hathaway	5.400%	5/15/2018	$117.85	($0.05)	2.15%	119	(2)
	Travelers	3.900%	11/15/2020	$110.95	($0.50)	2.44%	100	1
	XL Group	6.250%	5/15/2027	$108.16	$0.37	5.44%	351	(5)
Other	AON	5.000%	9/15/2020	$111.67	($1.37)	3.37%	198	8
	AIG	5.850%	1/15/2018	$110.49	$0.76	3.74%	282	(21)
	Fidelity National	7.875%	7/15/2020	$110.12	($1.13)	2.46%	141	14
	Hartford	5.500%	3/15/2020	$104.63	$0.20	4.78%	347	(9)
	Marsh	9.250%	4/15/2019	$133.89	($0.60)	3.59%	247	11
	Nationwide	9.375%	8/15/1939	$130.56	$0.89	6.87%	429	(3)
Health	Aetna	3.950%	9/15/2020	$108.94	$0.25	2.72%	134	(9)
	CIGNA	5.125%	6/15/2020	$112.13	$0.64	3.38%	198	(19)
	United Healthcare	3.875%	10/15/2020	$108.50	$0.40	2.72%	132	(9)
	Wellpoint	4.350%	8/15/2020	$110.51	$0.01	2.89%	155	(4)

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