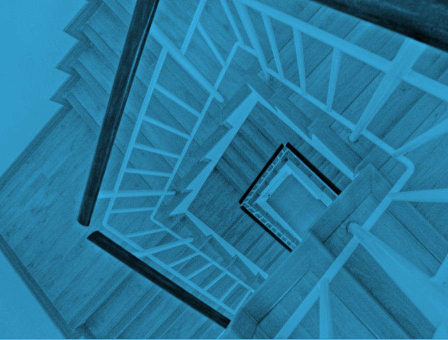

NEAM VANTAGE POINT

Perspectives

JULY 2024

OUR VIEW ON INSURANCE CAPITAL MANAGEMENT TOPICS

IN THIS ISSUE ►

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2023 P&C Industry Investment Highlights: Treading the Upward Path!

Following a significant increase of 64 basis points (bps) in book yield in 2022, the P&C insurance industry's book yield climbed another 54 bps and reached a new high of 3.85% in 2023.

EXECUTIVE SUMMARY

Asset allocations within the U.S. Property and Casualty (P&C) insurance industry have remained largely consistent, with bonds, equities, and Schedule BA assets representing the top three sectors. In 2023, the industry's holdings in cash and short-term investments surged to an unprecedented 8.3%, a trend likely driven by attractive short-term interest rates.

In 2023, the industry's allocation to risk assets saw a decrease, primarily due to a reduction in Schedule BA investments by a large insurer. This reduction negatively impacted the overall P&C industry's net investment income for that year. On the other hand, the allocation to equities reached a new high in 2023.

The fixed income book yield experienced an increase of 64 bps, while the portfolio's overall credit profile improved, and its duration shortened marginally. The allocation to tax-exempt municipal bonds has steadily declined in recent years and has been replaced by increased allocations to corporate bonds and asset-backed securities (ABS).

NET INVESTMENT INCOME (NII) DROPPED, THANKS TO ALTERNATIVES

Table 1 highlights the total cash and investments of the P&C industry, as well as the earned investment income on both a gross and net basis. The decline in NII observed in 2023 was driven by a large insurer[1] that moved its Schedule BA (alternatives) assets from the insurance entities to the holding company. Excluding the impact of this large insurer's Schedule BA assets, the insurance industry experienced an increase in its net investment income (%).

Table 1. Earned Investment Income $ Billion and Percentage

Category	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Total Cash/ Investments($)	2,286.8	2,144.7	2,175.0	1,954.8	1,820.0	1,653.0	1,638.3	1,534.9	1,472.1	1,470.0
Gross Earned Investment Income($)	73.5	76.3	60.7	57.6	60.5	61.4	53.4	51.0	51.8	57.8
Investment Expenses ($)	6.8	6.2	5.9	5.6	5.6	5.5	5.0	4.8	4.7	4.6
Net Investment Income($)	66.7	70.1	54.8	52.0	54.9	55.9	48.4	46.2	47.1	53.2
Net Investment Income(%)	3.01%	3.25%	2.65%	2.76%	3.16%	3.40%	3.05%	3.07%	3.20%	7.23%

Source: NEAM, S&P Capital IQ Pro

We further examine the contribution of the industry's earned investment income from major asset classes in Table 2. In 2023, the contribution from alternatives fell significantly due to the impact of a large insurer. The same year, the contribution from taxable bonds to earned investment income reached a new high of 54%. Another noteworthy observation is the contribution from cash/short-term investments, which reached 11% in 2023, representing a similar level of contribution to earned investment income as that of equities or Schedule BA assets.

Table 2. Earned Investment Income Contribution by Asset Class

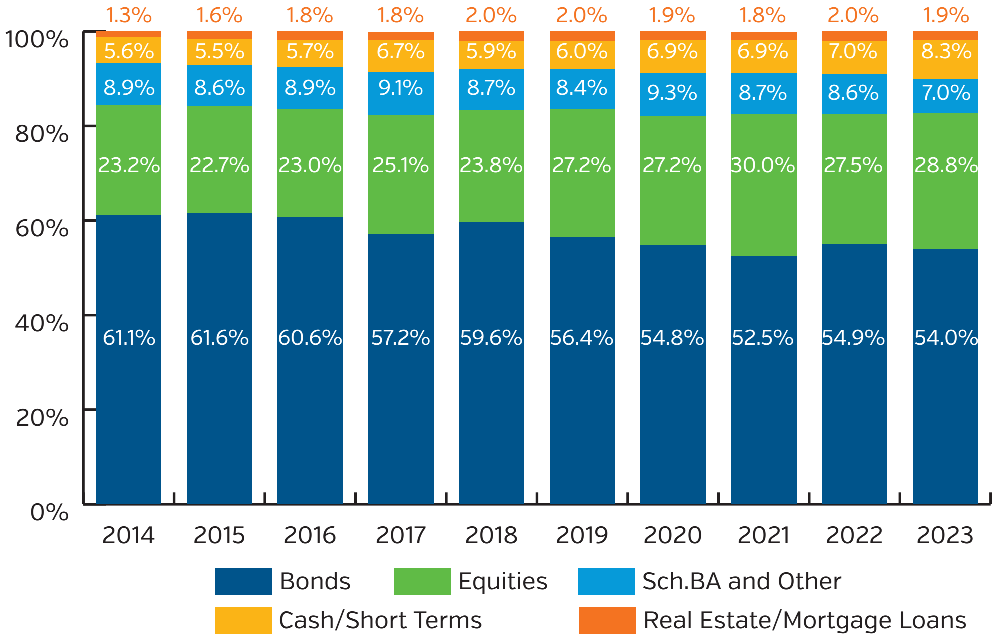
Asset Class/Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Taxable Bonds	54%	39%	43%	47%	46%	40%	41%	42%	41%	37%
Tax-Exempt Bonds	7%	7%	10%	11%	12%	13%	17%	19%	20%	18%
Equities	11%	17%	20%	18%	17%	20%	16%	19%	16%	26%
Sch. BA (Alternatives)	11%	29%	20%	17%	15%	19%	18%	14%	17%	14%
Mortgage/Real Estate	5%	4%	5%	5%	5%	5%	5%	5%	4%	4%
Cash/Short-Term	11%	2%	0%	1%	4%	3%	2%	1%	0%	0%
All Other	0%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Total Gross Earned	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: NEAM, S&P Capital IQ Pro

BOND ALLOCATION REMAINED THE MAJORITY, ALTHOUGH TRENDING DOWNWARD

Chart 1 illustrates the industry's statutory asset allocation across broad sectors over the past decade. Bonds continued to constitute the majority of total invested assets, although the allocation decreased from 61.1% to 54.0% over the last decade. Equities, the second largest sector, saw their allocation rebound from 27.5% in 2022 to 28.8% in 2023, reflecting changes in equity valuation. A significant observation for 2023 was the record high cash and short-term holdings, likely a result of attractive interest rates offered on short-term maturities.

Chart 1. Broad Sector Asset Allocation

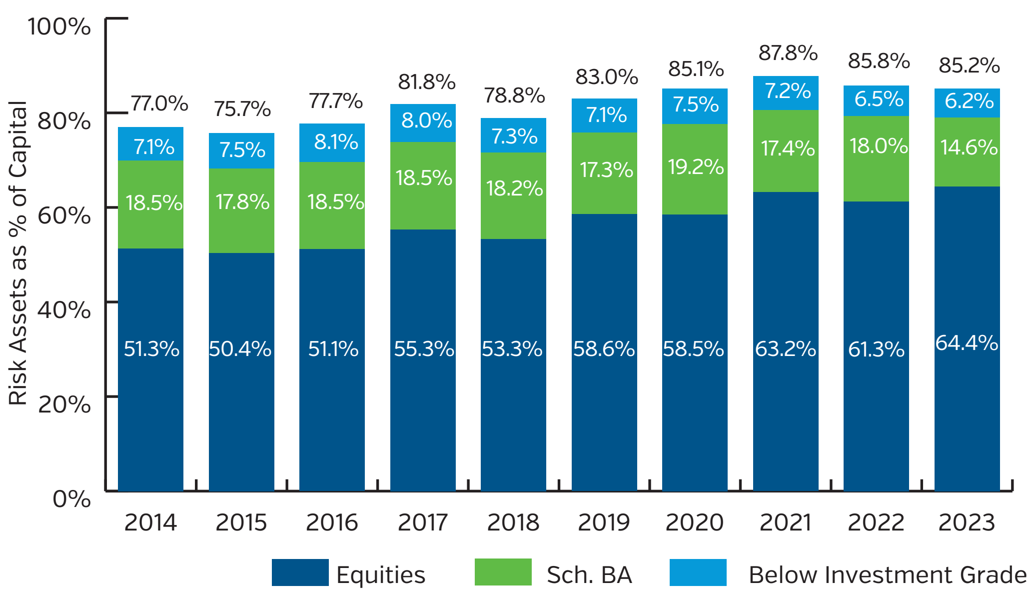


Source: NEAM, S&P Capital IQ Pro

RISK ASSET ALLOCATION DECLINED, DRIVEN BY ALTERNATIVES

The industry's allocation to risk assets, reported as fair/market value under statutory accounting, continued to decline after reaching its peak (87.8% of surplus) at the end of 2021 (as shown in Chart 2). The decrease in 2023 was mainly due to a large insurer's reduced allocation to Schedule BA assets. The same year, below investment grade bonds hit their lowest level, while the allocation to equities reached its highest.

Chart 2. Risk Asset Allocations



Source: NEAM, S&P Capital IQ Pro

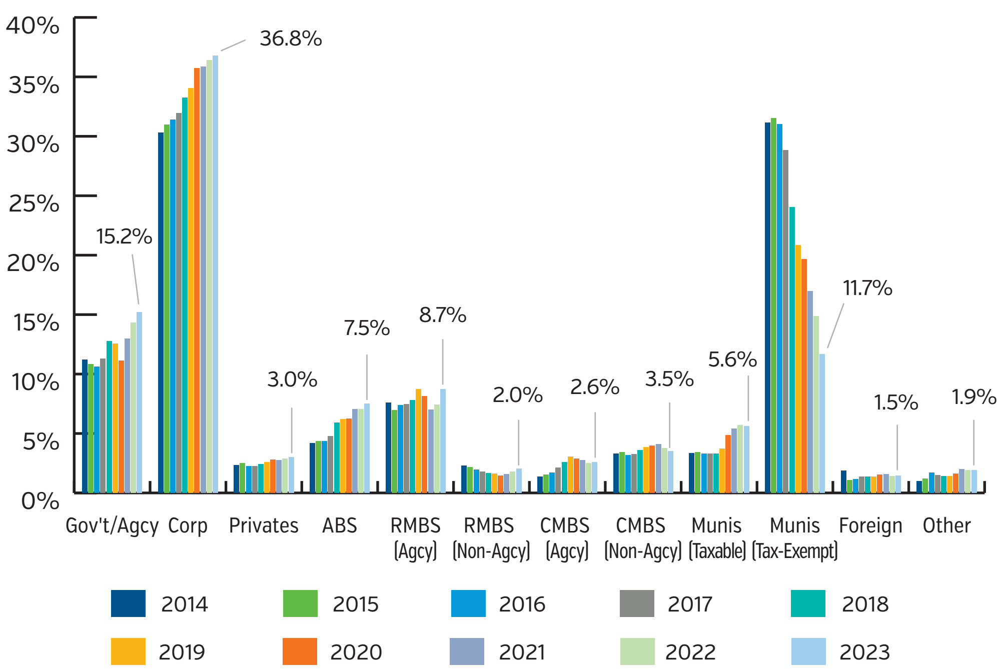
FIXED INCOME ALLOCATION: GROWTH IN CORPORATE AND ASSET-BACKED SECURITIES, DIMINISHING TAX-EXEMPT MUNICIPAL

Chart 3 displays secular trends in fixed income sector allocations over the past decade. Corporate allocations have continued to grow, accounting for more than one-third of the industry's fixed income holdings at the end of 2023. The tax-exempt municipal sector, on the other hand, has exhibited a steady decline, with reductions accelerating since the tax law changes in 2018. The industry now has one-third of the allocations it had a decade ago.

Within structured securities (i.e., ABS, RMBS, and CMBS), the ABS sector has continued to grow over the last decade, reaching a new high of 7.5% in 2023. Conversely, the commercial mortgage-backed securities (CMBS) sector has remained range-bound, while the residential mortgage-backed securities (RMBS) sector has shown an upward trend over the past three years.

Taxable municipal allocations have shown steady increases and represent more than five percent of the industry's fixed income holdings at the end of 2023. Government and agency allocations rose again in 2023 and have exceeded the level of tax-exempt municipal allocations.

Chart 3. Fixed Income Sector Allocation 2014-2023



Source: NEAM, S&P Capital IQ Pro

ANOTHER YEAR OF SIGNIFICANT BOOST IN BOOK YIELD

The industry's book yield continued to improve in 2023, aided by generally higher levels of interest rates. By the end of the year, it reached 3.85%, the highest level over the last decade. This follows a significant increase of 64 bps in the book yield seen in 2022 (refer to Table 3). Furthermore, the book yield across all sectors rose in 2023, with ABS leading the way with an increase of 109 bps.

Conversely, the elevated market yield translated into lower fair/market values of current holdings, which have remained below their statutory book values since 2022. In exchange for locking in the higher market yields, the industry realized losses in 2022 and 2023 (refer to Table 4). To understand the trade-offs and implications between yield pickup and realizing losses, we encourage insurers to utilize a holistic enterprise framework that incorporates underwriting characteristics and business profiles in their asset allocation analysis; this is especially relevant as insurers continue to navigate the insurance market cycle and economic volatilities.

Table 3. Fixed Income Book Yield (%)

Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Gov't/Agcy	2.97	2.24	1.33	1.64	2.23	2.39	1.94	1.80	1.92	1.99
Corp	4.03	3.56	3.09	3.39	3.71	3.76	3.57	3.67	3.72	3.77
ABS	5.68	4.59	2.13	2.54	3.40	3.58	2.99	2.82	2.55	2.42
RMBS - Agcy	3.63	2.83	2.12	2.29	3.01	3.24	3.00	2.98	3.15	3.25
RMBS - Non-Agcy	4.71	3.82	2.92	3.60	4.21	4.95	5.29	6.50	4.87	5.61
CMBS - Agcy	3.00	2.67	2.57	2.74	2.90	2.96	2.66	2.59	2.69	2.59
CMBS - Non-Agcy	4.21	3.73	2.75	3.02	3.39	3.50	3.32	3.42	3.45	3.59
Munis - Taxable	3.35	3.10	2.86	3.09	3.81	4.11	4.10	4.18	4.28	4.40
Munis - Tax-Exempt	3.11	3.05	2.99	3.05	3.18	3.22	3.20	3.30	3.52	3.71
Privates	5.43	4.79	4.21	4.90	4.84	5.22	5.08	5.04	4.90	4.89
Foreign	3.13	2.33	1.73	1.95	2.31	2.39	2.27	2.17	2.48	3.05
Grand Total	**3.85**	**3.31**	**2.67**	**2.96**	**3.32**	**3.42**	**3.25**	**3.32**	**3.41**	**3.49**

Source: NEAM, S&P Capital IQ Pro

Table 4. Industry's Bonds Book Value and Fair Value ($ Billion)

P&C Industry Bonds	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Book Value ($)	1,236.0	1,179.5	1,143.1	1,070.7	1,027.1	985.9	937.6	930.3	906.6	897.7
Fair Value ($)	1,183.3	1,092.5	1,181.3	1,142.2	1,067.6	986.8	958.8	945.3	930.4	936.0
Fair Value - Book Value ($)	(52.7)	(87.0)	38.2	71.6	40.4	0.9	21.2	15.0	23.7	38.4
Realized Capital Gain/Loss ($)	(6.2)	(7.6)	3.7	7.2	3.8	(1.0)	2.2	2.8	2.7	4.2

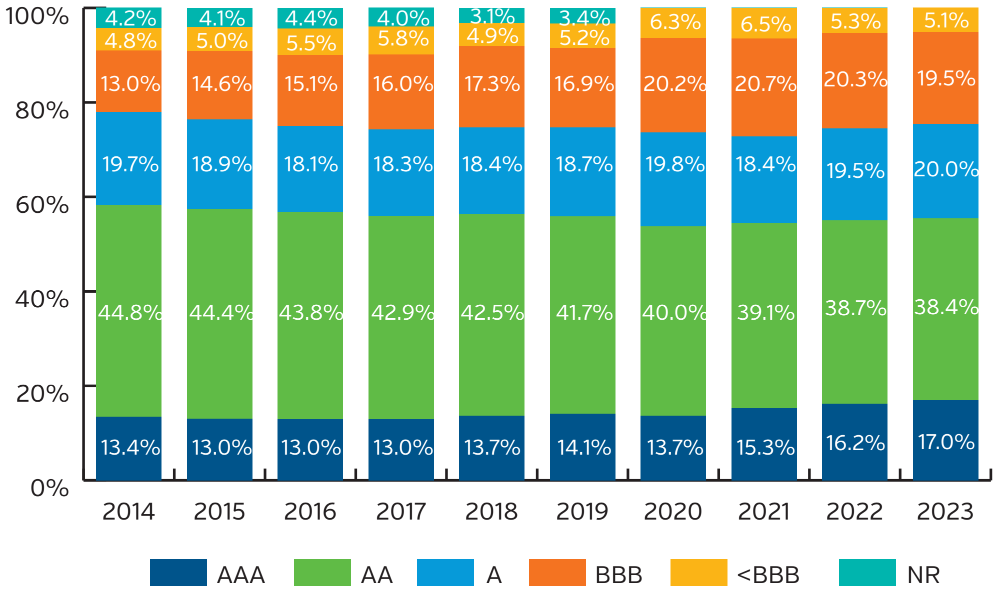
Source: NEAM, S&P Capital IQ Pro

CREDIT QUALITY IMPROVED

Chart 4 displays trends in fixed income credit quality. Prior to 2022, the low-interest rate environment led the industry to increase credit risk, as evidenced by rising allocations to BBB and below investment grade bonds. Allocations peaked in 2021, a trend that has since reversed.

Starting in 2022, with the Federal Reserve's aggressive tightening policy, the industry began to capitalize on elevated interest rates. It improved its credit profile by increasing allocations to AAA and A securities, while reducing allocations to BBB and below investment grade bond holdings. The increased allocations to government/agency, ABS, and Agency-RMBS sectors, as shown in Chart 3, contributed to this overall improvement in the credit profile.

Chart 4. Fixed Income Credit Quality



Source: NEAM, S&P Capital IQ Pro

DURATION SHORTENED MARGINALLY

Table 5 presents the option-adjusted duration (OAD) by fixed income sector. These OAD statistics are derived from CUSIP level holdings, which are extracted from Schedule D statutory filings. This data excludes any bonds held at the holding company level, derivatives, and private placement securities. The industry's aggregate OAD has remained relatively stable since 2018. In 2023, there was a slight reduction in the aggregate OAD, which was driven by a marginal duration shortening observed across most sectors.

Table 5. Fixed Income Option Adjusted Duration (Years)

Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Gov't/Agcy	4.1	4.0	4.4	4.1	4.2	3.9	4.2	4.4	4.3	4.3
Corp	4.6	4.7	5.0	4.9	4.5	4.5	4.6	4.5	4.5	4.4
ABS	2.4	2.8	2.5	2.3	2.4	2.5	2.8	2.1	3.0	2.1
RMBS - Agcy	5.6	6.4	4.8	3.8	4.4	5.1	5.0	5.4	4.1	4.2
RMBS - Non-Agcy	5.0	5.1	3.6	2.9	3.4	3.3	3.4	3.4	2.0	2.7
CMBS - Agcy	3.9	4.4	4.7	4.8	5.2	5.2	4.9	4.6	4.7	4.5
CMBS - Non-Agcy	3.2	3.5	4.0	4.1	4.3	4.4	4.7	4.8	4.5	4.0
Munis - Taxable	6.5	6.9	7.1	7.0	5.6	5.0	5.4	6.0	6.2	6.5
Munis - Tax-Exempt	5.8	6.0	4.9	5.8	5.7	6.4	6.8	6.6	6.2	5.8
Foreign	3.0	2.9	3.1	3.5	3.4	3.4	3.6	3.8	3.8	3.8
Grand Total	**4.6**	**4.8**	**4.7**	**4.8**	**4.6**	**4.8**	**5.1**	**5.2**	**5.0**	**4.8**

Source: NEAM, S&P Capital IQ Pro

KEY TAKEAWAYS

- In 2023, the P&C industry experienced a decline in its net investment income (%) driven by a large insurer's Schedule BA allocation. When excluding this large insurer, the remaining industry's NII experienced a significant increase.
- Bonds continue to represent the majority of total invested assets, although they are trending downward. Equities, the second-largest sector, reached their peak as a percentage of surplus in 2023. A notable observation for 2023 was the record-high allocation to cash and short-term holdings, likely a result of favorable short-term rates.
- Within the fixed income portfolio, the tax-exempt municipal allocation has been steadily declining and currently represents one-third of its level from a decade ago. On the other hand, allocations to corporate bonds and ABS are on an upward trend.
- The industry's book yield saw a significant increase of 64 bps in 2022, followed by another substantial increase of 54 bps in 2023. During this period, the portfolio's overall credit profile improved, and its duration shortened.

Please contact us if you would like to receive a customized enterprise comparative assessment, which facilitates in-depth comparisons and contrasts of asset and liability characteristics of your company relative to peer organizations. The assessment supports decisions with enterprise risk preferences and investment strategies.

ENDNOTES

[1] The significant reduction in Schedule BA's contribution to the industry's earned investment income was driven primarily by Berkshire Hathaway, whose Schedule BA investments decreased from $56.2bn in 2022 to $26.6bn in 2023. Excluding Berkshire Hathaway, the net investment income (as a percentage) for the industry increased from 2.70% in 2022 to 3.33% in 2023.

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