The Insurance *perspective*

2019- Volume 14

PARKWAYADVISORS

6550 Directors Parkway Abilene, TX 79606 800.692.5123
www.parkwayadvisors.com/

Follow us on in

Economic Commentary

Kyle Timmermann,
Director of Insurance Consulting

What a decade! This was the first decade in U.S. history that we did not experience a recession. During this time, the S&P 500 rose by 256%! 2019 certainly helped solidify this decade of growth, despite corporate earnings being fueled by tax-cuts that accompanied ballooning debt-burdens. There is little doubt that the equity market gains were reliant on these two items.

US Bond Market – To no one's surprise, rates remain at extreme lows despite a sell-off throughout the fourth quarter. The quarter began with an inverted yield curve between the 1-month Treasury and 7- year U.S. debt, which is generally an indicator of recession as investors want to lock in rates on longer Treasuries as they expect rates to fall in the future. During the quarter, the yield curve normalized and the 30-year Treasury increased 28 basis points while the 10-year increased 25 basis points.

From a credit standpoint, insurers should be wary of the increased debt burden of corporations. While not necessarily imprudent for companies to increase financial leverage in a period of cheap financing costs, the long-term ramifications could be precarious. Over the past decade, non-financial corporations have increased their debt load from $3.6T to $6.5T, which accounts for debt securities only. Again, corporations capitalizing on cheap financing can be a positive, but when the economy inevitably slows, it is my opinion that these organizations could be pressed to meet their cash-flow obligations.

FOMC – On October 30, as in the previous Fed meeting, the decision was made to cut the Fed Funds Rate. The levels are now 1.5-1.75%. Furthermore, during October the Federal Reserve began purchasing Treasury bills at the rate of $60B a month. This may look similar to quantitative easing; however, Jerome Powell was adamant that this is not QE but a necessary function in order to stabilize their balance sheet and drive down short-term rates. The Fed was successful in driving down short-term rates as the 1-month T-Bill fell 43 basis points during the quarter. All that being said, Jerome Powell did not convince me that this is not the latest round of QE in order to artificially stimulate the economy.

US Stock Market – The S&P 500 rose 9.06% during the quarter and ended the year with a 32% gain. This is all quite astonishing given the fact the corporate profits have not increased by the same magnitude. Moreover, there is a clear parallel between the Fed's actions of expanding their balance sheet and the S&P 500 performance.

Future Predictions – While arguments can be made for various opinions and beliefs on the future of the economy, based on my analysis, I personally view the next several years with trepidation. I foresee interest rates to remain at historic lows for the foreseeable future and to be further depressed at times. I do not foresee a recession in 2020, and expect there to be modest gains in the equity markets throughout the year.

One of my worries for the next recession, whenever it may manifest, is the Fed's over-involvement in the economy over the past decade. It is my opinion that the monetary policy should be a short-term guiding hand to help correct the economy in times of struggle, not a prolonged crutch. Monetary policy is incredibly effective at dictating interest rates, inflation, and spurring on economic activity. However, this tool is only effective when interest rates are at equilibrium, not artificially depressed. My belief is that the next recession will be extreme as the Fed will not have monetary policy to fall back on. During the Great Recession, the Fed cut rates from 5.25% all the way down to 0%. During the next recession, we will likely be trying to cut rates from 1.5-2%, which obviously leaves the Fed with less ammunition to combat against an economic crisis.

2019 Changes to Annual Reporting

The NAIC made several changes to the annual statement effective for December of 2019. Below are some of these changes. For a full list of changes and more in-depth information on each please visit the NAIC website at https://content.naic.org.

AVR Factors

Factors for AVR were changed to be consistent with the RBC after tax factors, which were amended back in 2018 as a result of the Tax Cuts and Jobs Act. To view the new factors please refer to the NAIC Blanks 2018-24WG at https://store.naic.org/documents/cmte_e_app_blanks_related_adopted_mods_2018-24BWG.pdf. If you are interested in a more in-depth discussion on how the Tax Cuts and Jobs Act affected the RBC factors in 2018, you can view a document published by the working group entitled Interpretation of 2018 Life Risk-Based Capital Results in light of the 2017 Tax Cuts and Jobs Act. This publication discusses the effects as well as giving helpful examples to illustrate why the factor change was needed.

Preferred and Common Stock

The market indicators of RP and P that were previously listed in column 20 on schedule 2-1 will no longer be needed. Instead, Redeemable Preferred and Perpetual Preferred stock will be broken out and reported on separate lines. Other market indicators that will no longer be in use are A, J, K, L, U, and V. Two new categories, unit investment trusts and closed end funds, have been added to the common stock categories on Schedule D.

Elimination of Modified Filing Exempt

The task force has evaluated the impact of the modified filing exempt procedure since its adoption. Now that the markets have stabilized the need for modified filing exempt procedure no longer exists. It has been removed from the general instructions and will not be used in reporting.

Changes to the Summary Investment Schedule

The rows in the investment categories column on the Summary Investment Schedule have been updated to tie to the different investment schedules. New publicly traded and other categories for industrial and miscellaneous and parents, subsidiaries, and affiliates for common stock were added so that publicly traded common stock and non-publicly traded stock can be identified. Aggregate categories for mortgage loans available for use by property, health and title companies were removed.

Interest Rate Spreads

As of: 12/31/2019

	Treasury	US Composite BVAL AA Curve		US Composite BVAL A Curve		US Composite BVAL BBB Curve		US Composite BVAL BB Curve	
Term	Yield	Yield	Spread	Yield	Spread	Yield	Spread	Yield	Spread
1yr	1.59	1.773	0.183	1.855	0.265	2.103	0.513	2.565	0.975
2yr	1.58	1.738	0.158	1.859	0.279	2.16	0.58	2.788	1.208
3yr	1.62	1.795	0.175	1.931	0.311	2.257	0.637	2.979	1.359
5yr	1.69	1.999	0.309	2.146	0.456	2.531	0.841	3.536	1.846
7yr	1.83	2.216	0.386	2.383	0.553	2.826	0.996	4.102	2.272
10yr	1.92	2.483	0.563	2.67	0.75	3.173	1.253	4.684	2.764
20yr	2.25	3.077	0.827	3.373	1.123	4.01	1.76	5.991	3.741
30yr	2.39	3.216	0.826	3.359	0.969	3.839	1.449	6.071	3.681

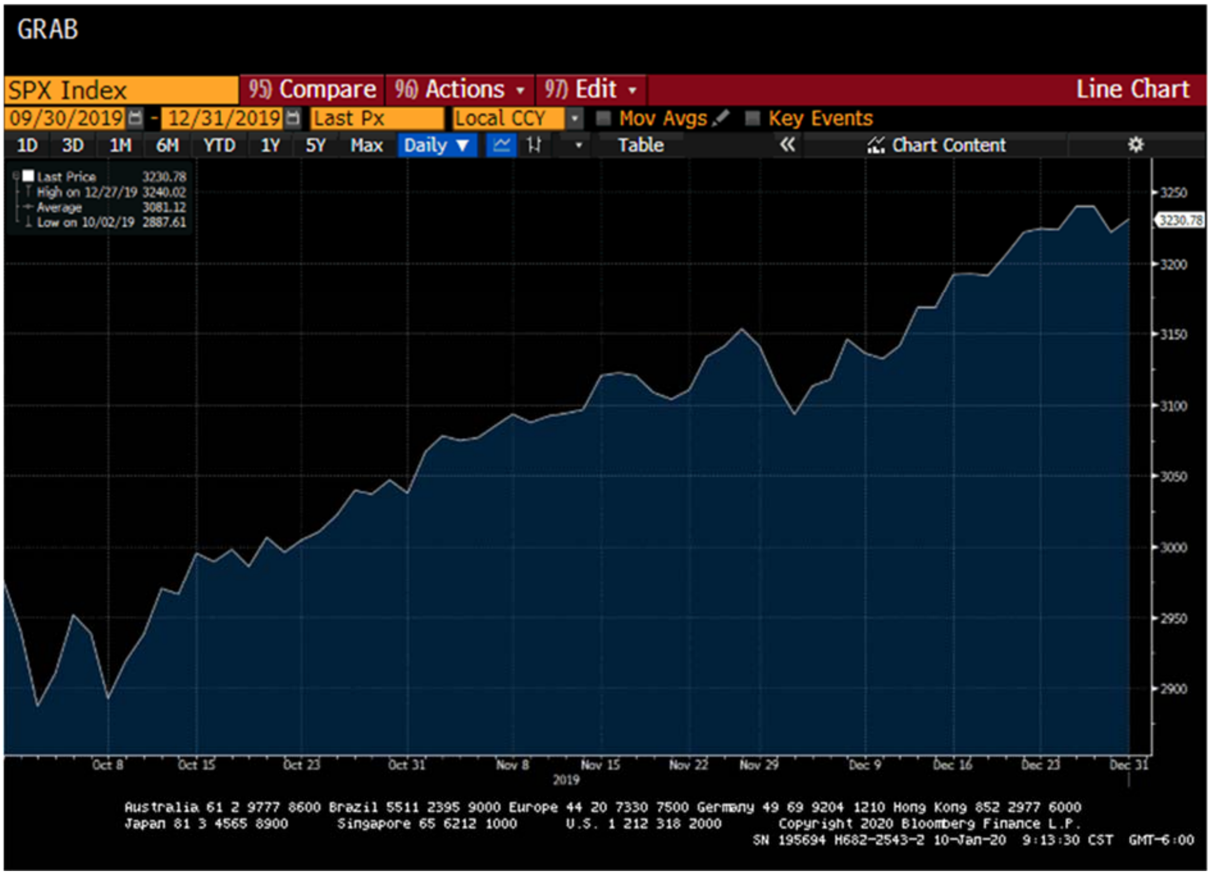
Disclosures: This material is for your use only and is based upon information which we consider reliable, but we do not represent that it is accurate or complete and should not be relied upon as such. Information was obtained from Blooomberg and represents the respective Bloomberg US Composite BVAL and Bloomberg Fair Value Composite Curves. Spreads are calculated off the Treasury yield for each term.

US Treasury Yield Curve

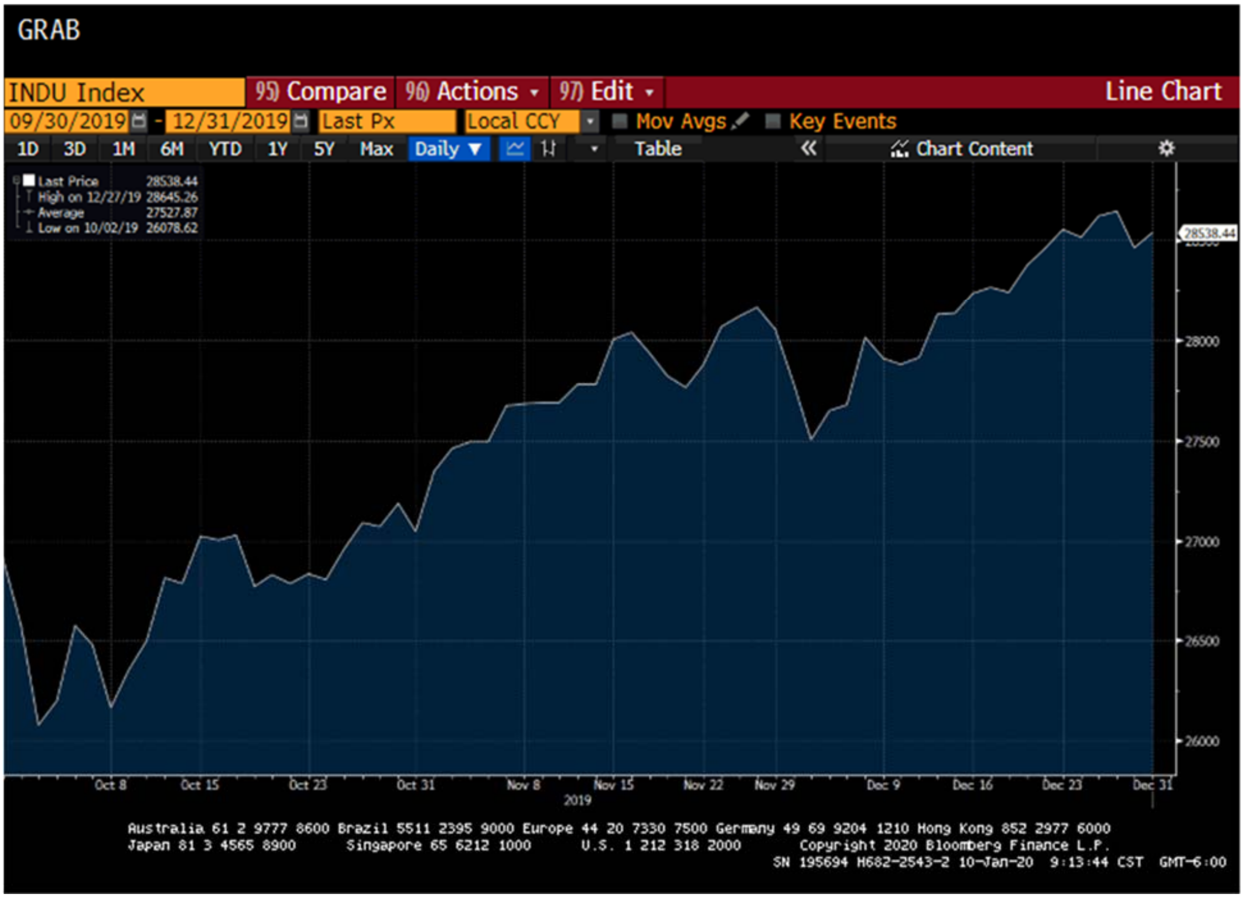
	Tenor	12/31/19	09/30/19	12/31/19-09/30/19
11)	1M	1.430	1.858	-42.8
12)	2M	1.503	1.848	-34.5
13)	3M	1.544	1.807	-26.4
14)	6M	1.578	1.813	-23.5
15)	1Y	1.566	1.745	-17.9
16)	2Y	1.569	1.622	-5.3
17)	3Y	1.609	1.560	4.9
18)	5Y	1.691	1.544	14.7
19)	7Y	1.831	1.613	21.8
20)	10Y	1.917	1.665	25.3
21)	30Y	2.390	2.111	27.9

*Graphs obtained from Bloomberg Professional Service

S&P 500 Index


GRAB
SPX Index
95) Compare
96) Actions
97) Edit
Line Chart
09/30/2019 - 12/31/2019
Last Px
Local CCY
Mov Avgs
Key Events
1D 3D 1M 6M YTD 1Y 5Y Max Daily
Table
Chart Content
Last Price 3230.78
High on 12/27/19 3240.02
Average 3081.12
Low on 10/02/19 2887.61
3250
3230.78
3200
3150
3100
3050
3000
2950
2900
Oct 8
Oct 15
Oct 23
Oct 31
Nov 8
Nov 15
Nov 22
Nov 29
Dec 9
Dec 16
Dec 23
Dec 31
2019
Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 4565 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2020 Bloomberg Finance L.P.
SN 195694 H682-2543-2 10-Jan-20 9:13:30 CST GMT-6:00

Dow Jones Industrial Average



Disclosures

Parkway Advisors, L.P. is an investment advisor registered with the Securities and Exchange Commission offering investment management, consulting, and statutory reporting services. This material is for your use only and is based upon information obtained from various sources which we consider reliable, but has not been independently verified and thus we do not represent that it is accurate or complete and should not be relied upon as such. Graphical and tabular information was obtained from Bloomberg and represents the respective Bloomberg US Composite BVAL and Bloomberg Fair Value Composite Curves. Spreads are calculated off the Treasury yield for each term. The opinions expressed are our opinions only. Past performance is no guarantee of future performance and no guarantee is made by this document.

About this Publication

The Insurance Perspective is a quarterly publication prepared by the staff of Parkway Advisors, L.P. Each issue focuses on the U.S. economy and specific insurance industry issues and/or concepts. Our clients and prospective clients enjoy Parkway's dedication and unique focus on the insurance industry.

For More Information

We welcome your inquiry and can be reached by mail at Parkway Advisors, L.P., P.O. Box 5225, Abilene, Texas 79608 or by phone at (800) 692-5123 or by fax at (325) 795-8521. A copy of our Form ADV, Part II is available upon request.

For more information, please email info@parkwayadvisors.com or visit www.parkwayadvisors.co