The Insurance *perspective*

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PARKWAYADVISORS

6550 Directors Parkway Abilene, TX 79606 800.692.5123

www.parkwayadvisors.com/

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Economic Commentary

Trevor Rupe, CFA
Chief Investment Officer

2023 presented itself to be a very different year from what many market participants expected. Many analysts and economists alike had sounded the recession alarm amid elevated interest rates, lingering inflation and concerns over the consumer. This year proved to be a humbling experience for many as the year progressed and the "expectation vs. reality" adage played out as we not only avoided a recession but saw impressive gains on equities in conjunction with continued elevated yields on fixed income.

Domestic Fixed Income Markets

After a substantial increase in yields across 2022, as inflation ticked higher, many expected yields to level off and begin to fall during 2023. Futures markets had even priced in cuts from the Fed in the second half of 2023. However, yields remained relatively stable through most of 2023, with the 10-year hovering around 3.5% through the first half of the year. However, as inflation began to trend higher in the third quarter, we saw yields hit new highs, with the 10-year rallying to 5% in October before wrapping up the year at 3.88%, coincidentally where it began the year. The yield curve remains largely inverted, with the highest yielding Treasury, the 2-month, finishing the year at 5.4% compared to 4.76% on the 1-year, 3.85% on the 5-year, 3.88% on the 10-year and 4.03% on the 30-year long bond. As mentioned before, this does point to the market's expectation of lower yields in the future, so while shorter duration bonds appear more attractive in the near term, adding some duration to lock in current higher yielding bonds may prove to be a prudent strategy for the future.

Domestic Equity Market

After a tumultuous 2022, the outlook for equity returns was broadly muted for 2023 with many people calling for negative or single digit returns for the year. The biggest surprise came from the consumer, who weathered through inflation and dwindling savings to continue spending thus supporting the consumer driven economy. As a result, the S&P wrapped up the year with an impressive 26.25% return in 2023. The most notable performance occurred during the fourth quarter, after dovish language from the Fed indicated potential cuts on the horizon, which led to a meaningful rally heading into year end. The S&P returned over 11.67% in the fourth quarter alone. While small caps struggled for most of the year, only returning 2.51% through the third quarter, they saw a remarkable return of over 14% in the final quarter ending at a 16.88% return for the year. The most notable return comes from the NASDAQ, which returned over 55.1% during 2023, marking the highest return since the dot-com bubble of the late 90's. The year-end rally certainly leaves the market more than richly valued, fueled by AI enthusiasm and the expectation of rate cuts, wrapping up the year at a 19.5 forward price to earnings multiple compared to a 30-year average of 16.5x earnings.

Federal Reserve

The market has certainly put a lot of weight on the Fed, particularly looking for reasons to rally. After holding the Fed Funds rate steady throughout the year, despite initial expectations of cuts, Powell stated in the December meeting that historic tightening of monetary policy is likely over as inflation has fallen faster than expected and the discussion of cuts in borrowing costs coming "into view." This obviously led to a substantial decline in yields at the end of the year on the expectation of cuts occurring sooner rather than later. More specifically, at the beginning of the fourth quarter, the Fed futures market had priced in a 20% chance of another hike at the December meeting before cuts in July of 2024. After Powell's comments in December, Futures were pricing in an 84% chance of the first cut occurring in March of 2024, with a total of 6 cuts expected in 2024, which would bring the Fed Funds rate to the 3.75-4% range. It is important to remember the Fed has remained focused on economic data, with the goal of bringing inflation back down to their long term 2% target while trying to accommodate a "soft landing" scenario, which has played out thus far.

Summary

Over the past couple of years, expectations on the direction of yields have been substantially different from what has occurred. At the end of 2021, the markets had priced in 3 hikes for 2022 and there was the equivalent of 17. At the end of 2022, the market expected cuts in the second half of 2023 and for the Fed Funds rate to end in the 4.25-4.5% range, yet we ended the year with zero cuts and in the 5.25-5.5% range. Heading into 2024, it appears yield expectations are more in line with the Fed narrative, but with the recent step up in inflation in December, it is very possible the Fed does not cut to the degree the market is pricing in for the next year. Couple that with elevated valuations on the equity front as the economy continues to slow, we are anticipating volatility in equity markets in 2024. While fixed income yields will likely continue to trend lower through the next year, yields remain at attractive levels relative to the past 15 years, thus appear to offer a better risk/return tradeoff compared to equities at this time.

Industry Insight

Navigating Bond and Equity Investments in Presidential Election Years

Introduction: Presidential election years often bring heightened uncertainty to financial markets, impacting the investment landscape for both bonds and equities. Investors face the challenge of navigating through political and economic turbulence to make informed decisions. While it is natural to question how the market will perform under various presidential candidates, historical evidence suggests that it largely irrelevant. Furthermore, it is generally unwise to position portfolios on the promises of campaigns. As the well-known adage states, "Candidates campaign in poetry, yet govern in prose."

Market Trends: Historical data reveals distinct patterns in market behavior during presidential election years. The pre-election period can witness heightened volatility as investors grapple with policy uncertainties and potential shifts in economic priorities. However, post-election periods often see a return to stability, driven by clarity in leadership and policy direction. Additionally, historical data suggests that regardless of which political party is in the White House, neither can generate material excess return for equities.

Bond Investments: Government bond yields are particularly sensitive to election cycles. Investors tend to seek the safety of government bonds during periods of uncertainty, leading to fluctuations in yields. Corporate bonds, on the other hand, may experience shifts based on industry expectations tied to potential policy changes. While corporate bond spreads can be volatile during election cycles, these typically normalize as the political craze eases. Furthermore, the Federal Reserve drives the interest rate environment on sovereign debt, not the President, as the FED is an independent institution. As a result, it is unlikely that a new President would materially alter the interest rate path we are in.

Equity Investments: Stock markets can experience short-term volatility in the lead-up to elections, driven by investor sentiment and speculation about the potential impact of political outcomes. However, long-term investors are often rewarded post-election as markets stabilize. What could make this election cycle more volatile for equities will be the candidate's response to foreign diplomacy, notably the

Ukrainian war and the Israel-Palestinian conflict. For these reasons, it is essential for investors to focus on the underlying fundamentals of the companies in their equity portfolios and resist making impulsive decisions based solely on short-term market fluctuations or promises from the podium, especially for an insurance company.

Conclusion: Navigating bond and equity investments during a presidential election year requires a combination of vigilance, strategic planning, and a long-term perspective. By understanding historical trends, staying informed about economic indicators, and implementing effective risk management strategies, investors can position themselves to weather the uncertainties and capitalize on opportunities presented by election cycles. To summarize succinctly, investing in an election year should look essentially the same as in any other period; investors should seek good opportunities in companies they trust and maximize return while mitigating risks.

SAPWG's Refined Approach to Investment Income Disclosure

Andre Laster
Investment Accountant

The SAPWG (Statutory Accounting Principles Working Group) has recently implemented revisions to SSAP No. 34, Investment Income Due and Accrued, with a specific focus on improving the disclosure of paid-in-kind (PIK) interest aggregates. These changes, effective as of December 31, 2023, aim to provide clarity on how paydowns and disposals influence PIK interest within the cumulative principal balance, ensuring a consistent application of the guidance without altering existing disclosure requirements.

These revisions, originating from agenda item 2022-17 on March 22, 2023, introduce additional disclosure requirements within SSAP No. 34. The updated standard now mandates disclosure of gross, non-admitted, and admitted interest income due and accrued. Furthermore, it includes requirements for reporting aggregate deferred interest and cumulative paid-in-kind interest within the current principal balance.

Regulators can now effectively identify admitted interest income that has been deferred beyond the original payment date, provided the terms and conditions allow for its non-past due classification. Noteworthy clarifications, such as specifying that gross interest income should equal Assets Page Line 14 Column 1, have been incorporated based on constructive feedback from interested parties.

Despite disagreements on limiting Note 7C to bonds only, the NAIC staff emphasizes that SSAP No. 34 covers all asset types, extending beyond bonds. Additionally, staff underscores that interest income due and accrued over 90 days past due is non-admitted, except for mortgage loan interest income, which is subject to a different threshold. For mortgage loans in default, as per contractual terms, interest income due and accrued is not admitted if it is 180 days past due and collectible.

To illustrate the practical implications, consider the following breakdown:

A. Due and accrued income was excluded from surplus on the following bases:

- All investment income due and accrued with amounts that are over 90 days past due, with the exception of mortgage loans in default.

B. Total Amount Excluded:

- $__________

C. Interest Income Due and Accrued:

- Gross: **

- Non-admitted:

- Admitted:

D. Aggregate Deferred Interest:

- $__________

E. Cumulative PIK Interest Included in the Current Principal Balance:

- $__________

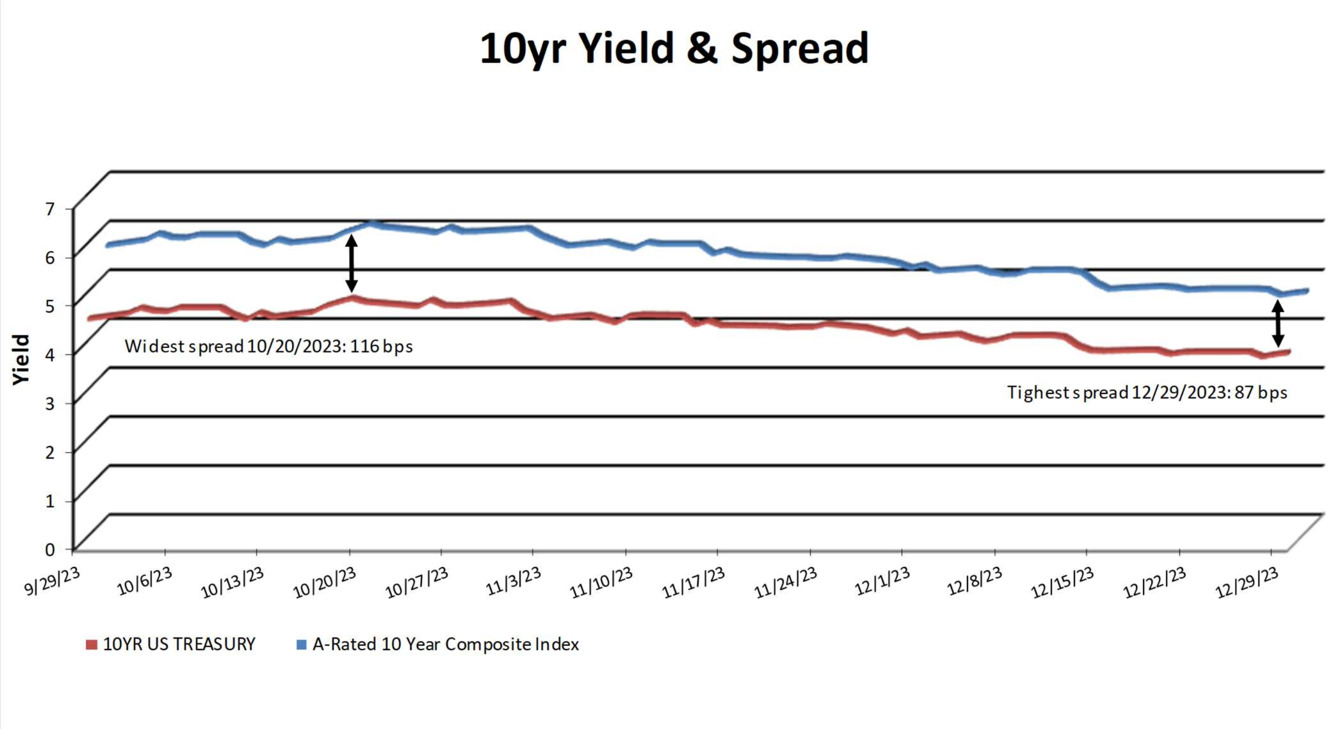
These enhancements in disclosure requirements provide stakeholders, including regulators, and underline the commitment to transparency and accuracy in financial reporting, contributing to a more robust regulatory framework.

Interest Rate Spreads

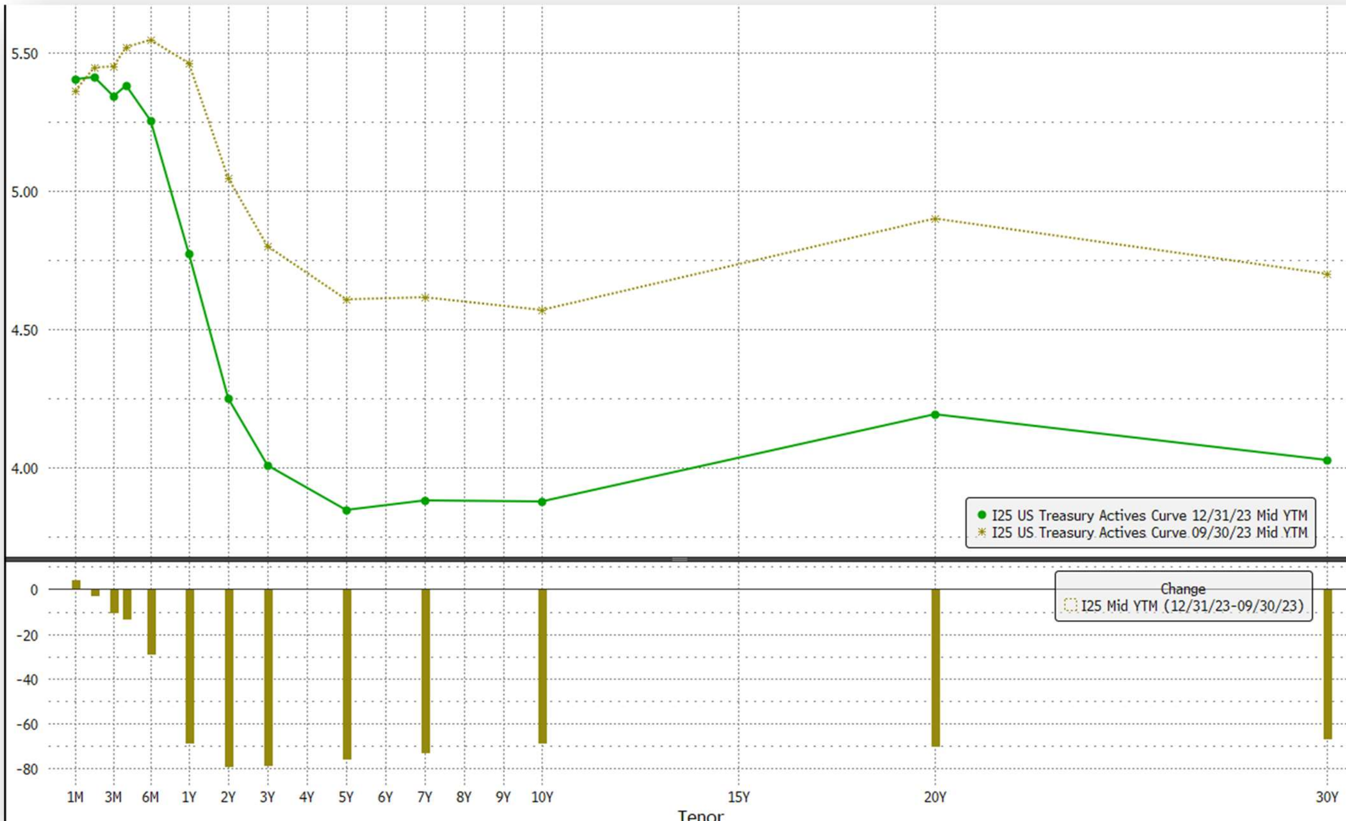
As of: 12/31/2023

Term	Treasury Yield	US Composite BVAL AA Curve Yield	US Composite BVAL AA Curve Spread	US Composite BVAL A Curve Yield	US Composite BVAL A Curve Spread	US Composite BVAL BBB Curve Yield	US Composite BVAL BBB Curve Spread	US Composite BVAL BB Curve Yield	US Composite BVAL BB Curve Spread
1yr	4.79	4.999	0.209	5.1345	0.3445	5.5676	0.7776	5.776	0.986
2yr	4.23	4.5505	0.3205	4.7079	0.4779	5.1773	0.9473	5.714	1.484
3yr	4.01	4.3225	0.3125	4.5133	0.5033	5.0113	1.0013	5.7382	1.7282
5yr	3.84	4.2183	0.3783	4.4415	0.6015	4.9497	1.1097	5.9111	2.0711
7yr	3.88	4.2806	0.4006	4.5418	0.6618	5.0587	1.1787	6.1322	2.2522
10yr	3.88	4.449	0.569	4.7505	0.8705	5.2243	1.3443	6.357	2.477
20yr	4.2	4.8426	0.6426	5.1352	0.9352	5.5561	1.3561	6.7423	2.5423
30yr	4.03	4.8376	0.8076	5.0252	0.9952	5.3916	1.3616	6.5135	2.4835

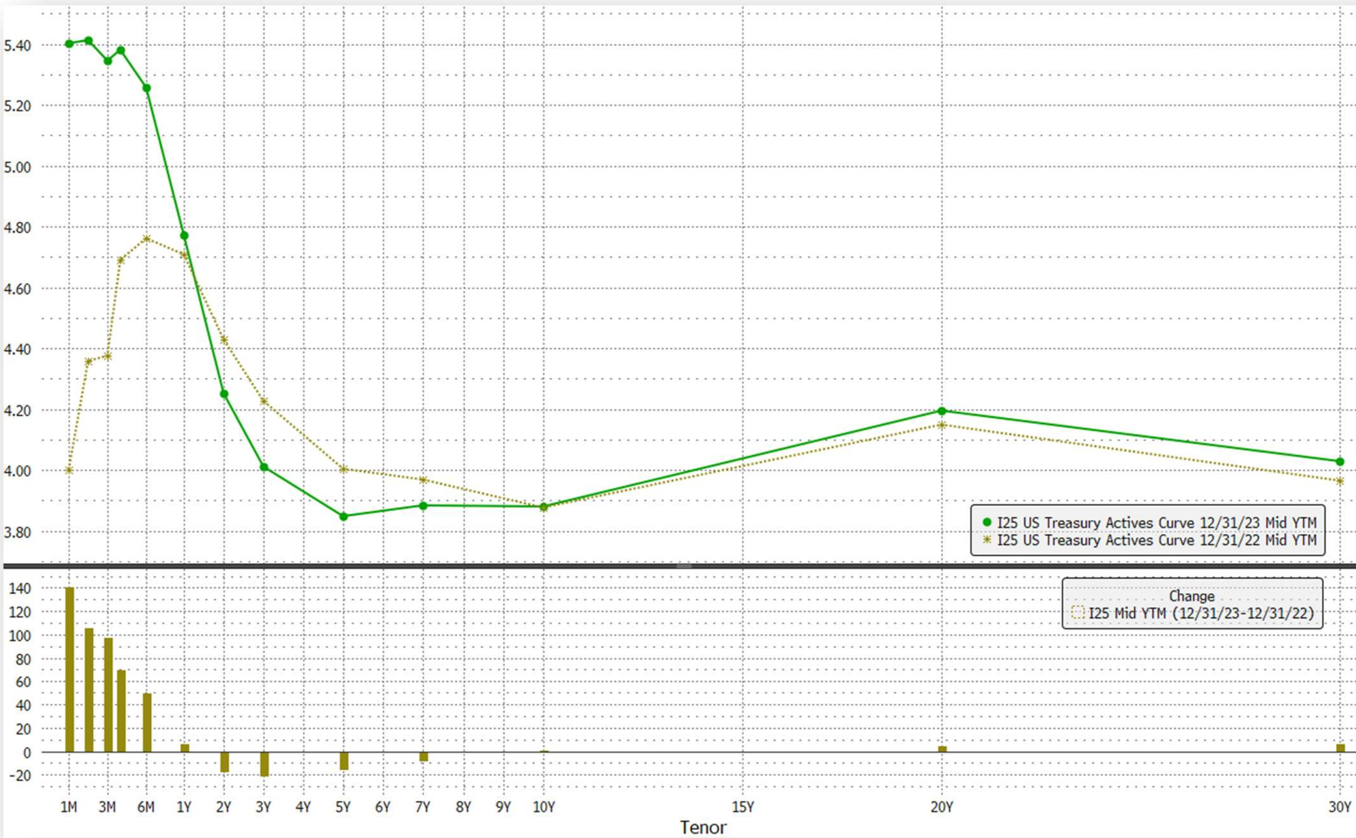
Disclosures: This material is for your use only and is based upon information which we consider reliable, but we do not represent that it is accurate or complete and should not be relied upon as such. Information was obtained from Blooomberg and represents the respective Bloomberg US Composite BVAL and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


10yr Yield & Spread
7
6
5
4
3
2
1
0
Yield
Widest spread 10/20/2023: 116 bps
Tighest spread 12/29/2023: 87 bps
9/29/23
10/6/23
10/13/23
10/20/23
10/27/23
11/3/23
11/10/23
11/17/23
11/24/23
12/1/23
12/8/23
12/15/23
12/22/23
12/29/23
10YR US TREASURY
A-Rated 10 Year Composite Index

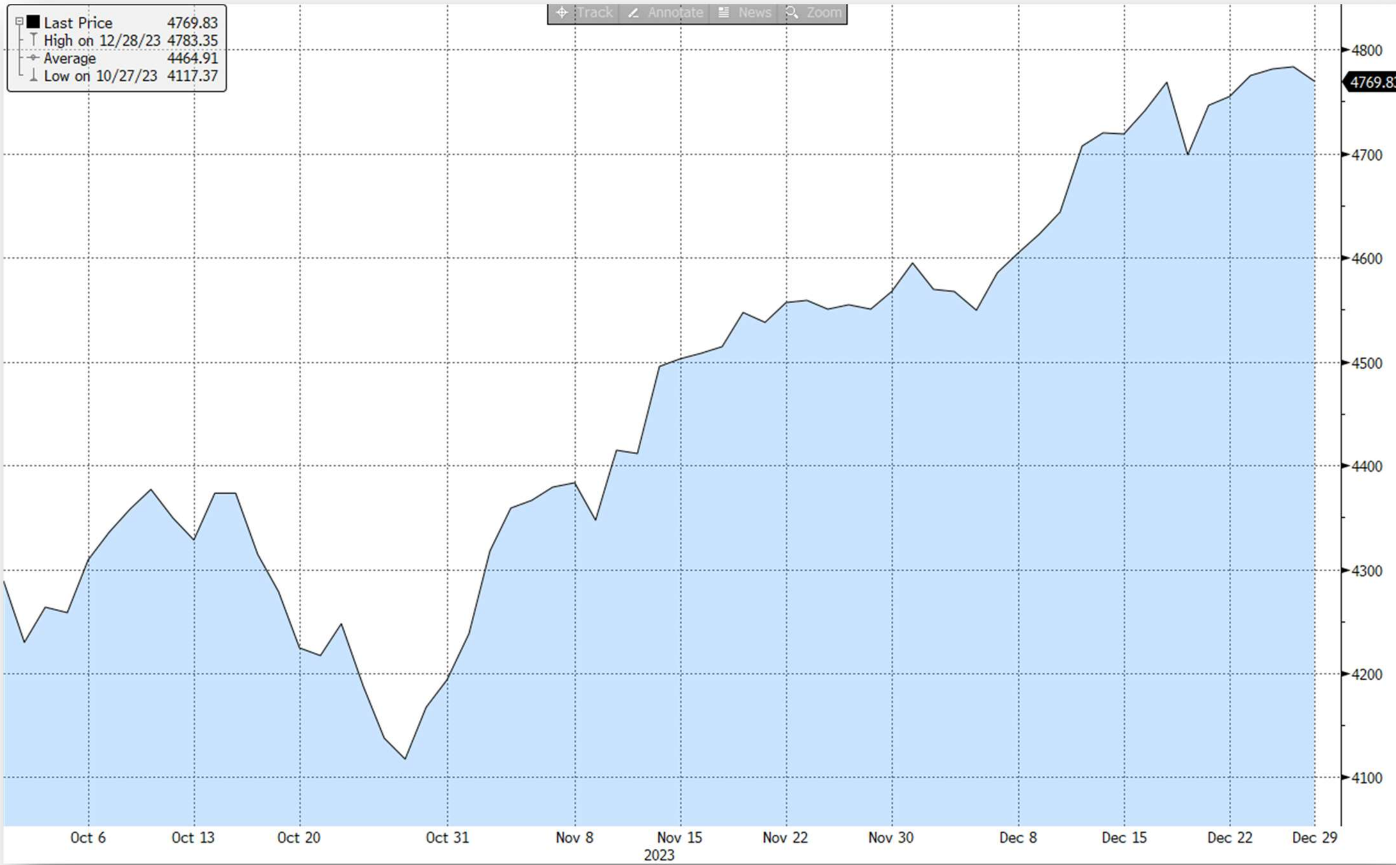
US Treasury Yield Curve 4th Quarter



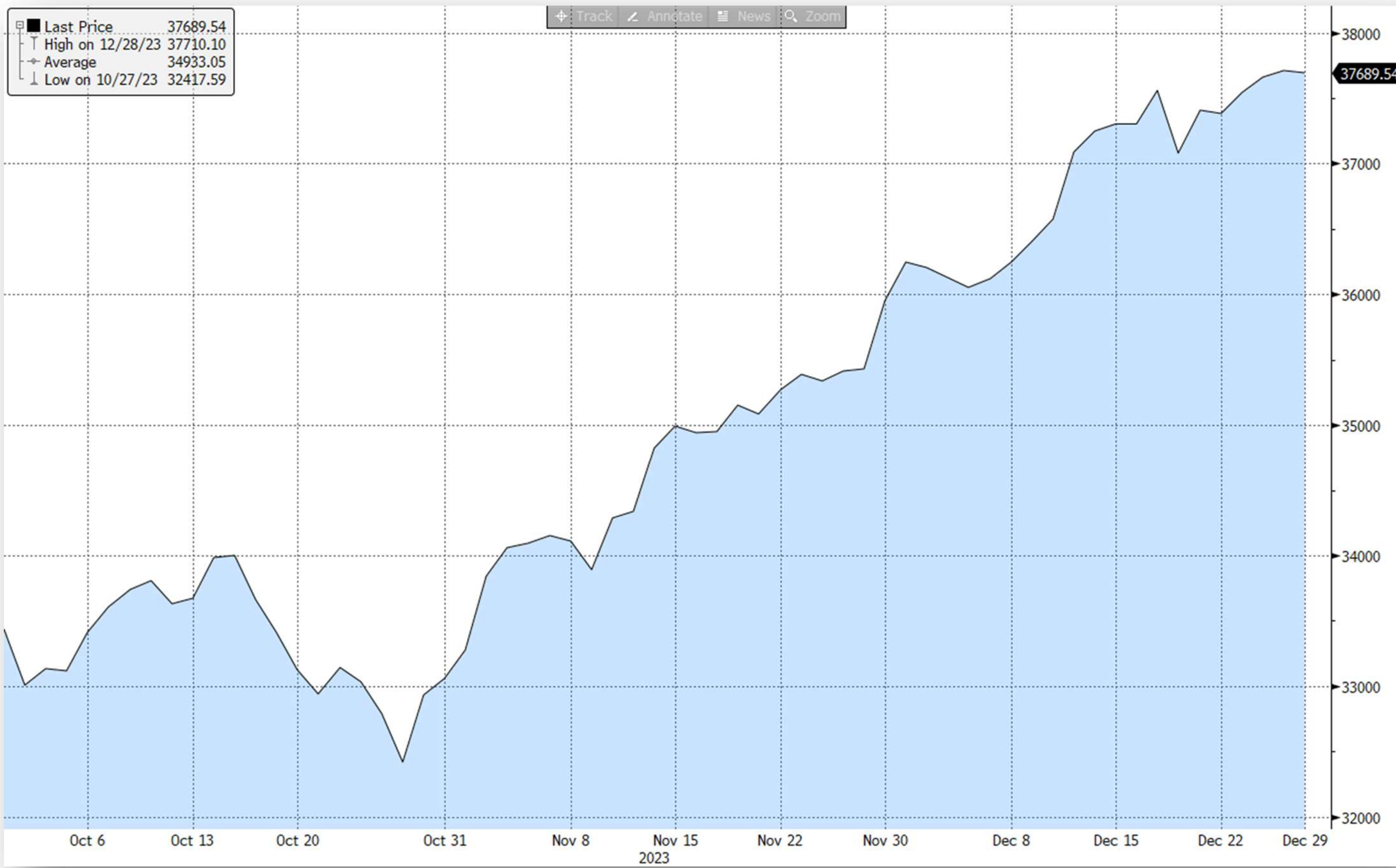
US Treasury Yield Curve YTD



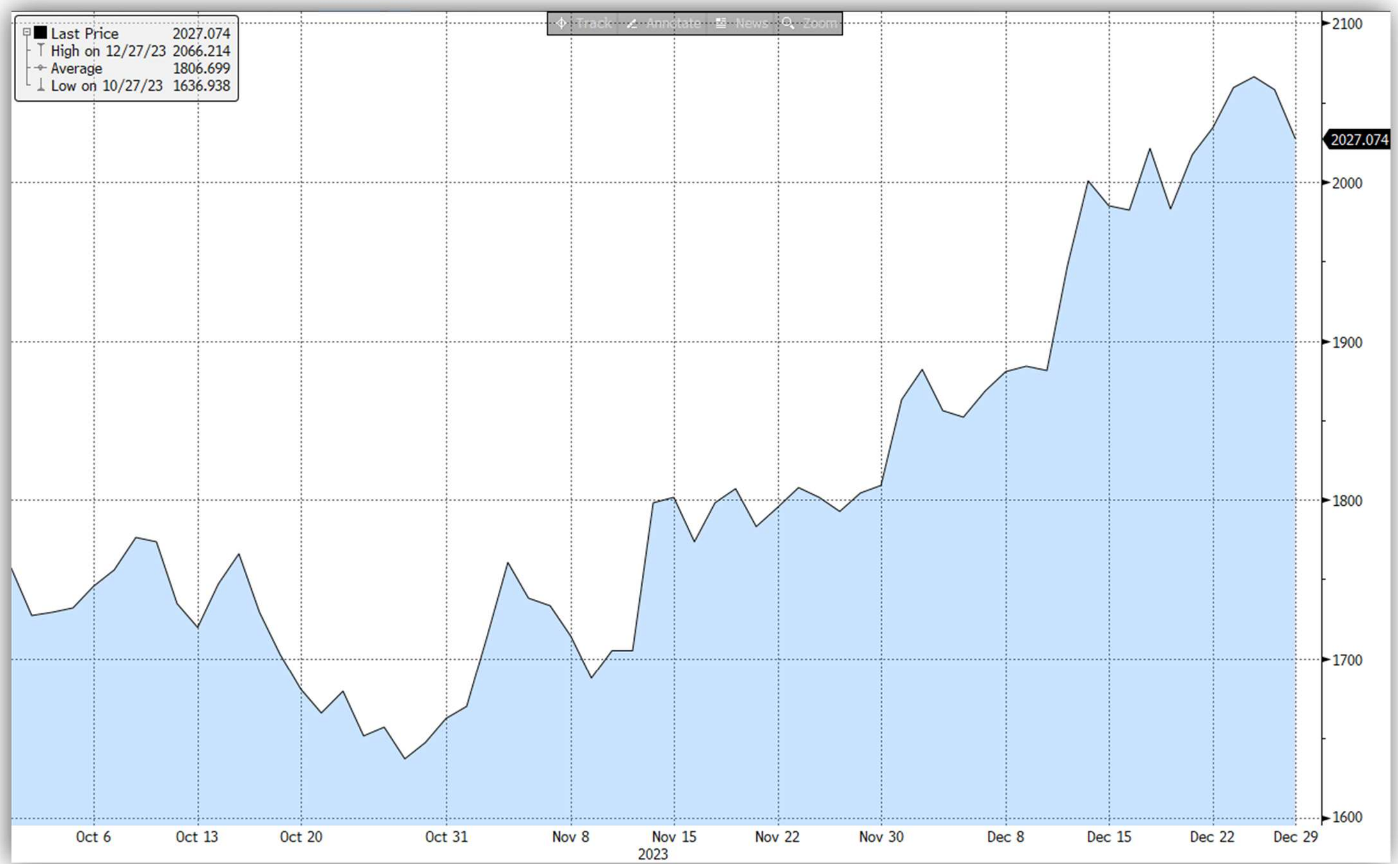
S&P 500 Index


Last Price 4769.83
High on 12/28/23 4783.35
Average 4464.91
Low on 10/27/23 4117.37
Track
Annotate
News
Zoom
4800
4769.83
4700
4600
4500
4400
4300
4200
4100
Oct 6
Oct 13
Oct 20
Oct 31
Nov 8
Nov 15
2023
Nov 22
Nov 30
Dec 8
Dec 15
Dec 22
Dec 29

Dow Jones Industrial Average



Russell 2000 Index



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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.com