AAM
Insurance Investment Management

Renewed Market Volatility – AAM's Perspectives

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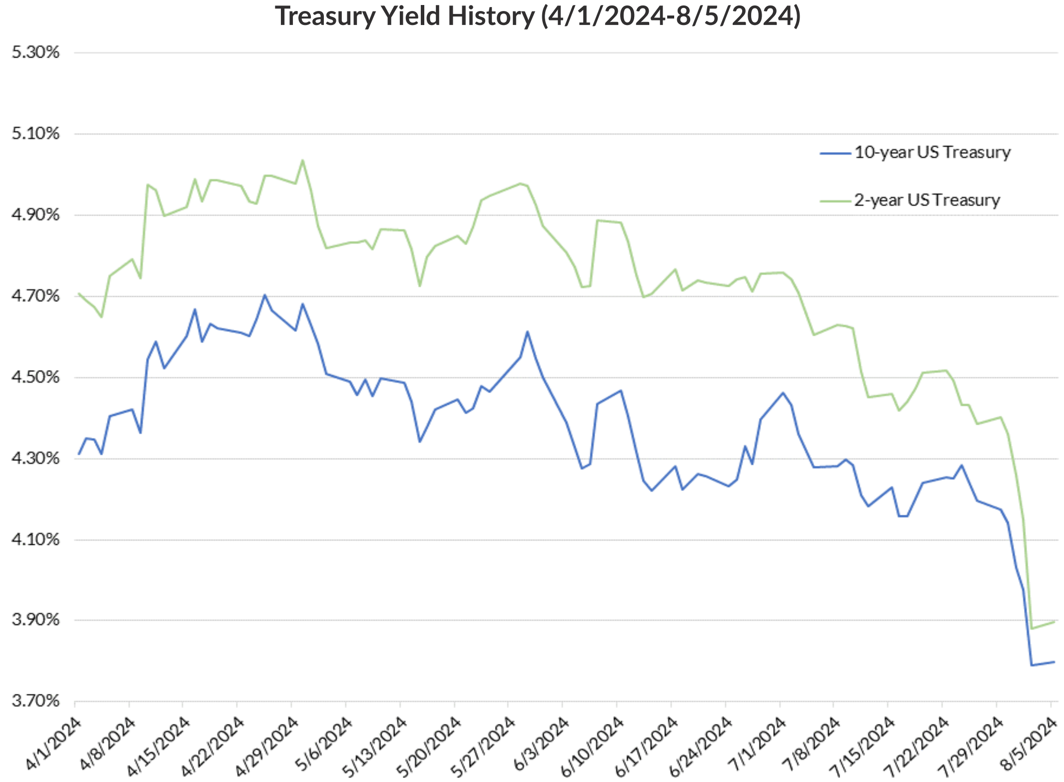
Treasury yields plummeted last week and again, briefly this morning, as markets re-price for weaker economic conditions and a more aggressive sequence of Fed Funds Rate cuts on the horizon. The yield curve (2s/10s) is closing in on a positive slope and futures markets reflect expectations for a target rate of 3.9% at year-end, more than 125 basis points of accumulated cuts in 2024[1].



1 Bloomberg L.P., Bloomberg Index Series data

While AAM had forecast a slowing economy and modestly lower rates as the Federal Reserve normalizes policy, markets have re-priced quickly and led to increased discussion surrounding recession risks. Volatility in market indicators, including the 2-year Treasury note yield, Corporate bonds spreads, and crude oil are reflecting increased risks of recession, but absolute levels are inconsistent with a base case expectation of this outcome in the near term.

The earnings season at a sub-sector level has been mixed with financials, technology and noncyclical sectors outperforming those related to the consumer and industrial segments of the economy. We are hearing firms talk about a higher level of uncertainty in months ahead. With all this said, earnings are generally beating estimates and fundamental growth remains intact. The Russell 3000 Index remains within approximately 8% of the all-time high, set on July 16th and is up more than 8% year-to-date. Our research teams note that falling rates should support areas of the economy that had been under pressure, such as real estate (residential and commercial) and banking. At the same time, modest economic growth and lower rates should support increased capital spending and weaken the USD, aiding the lagging manufacturing and industrial sectors.

We observe ongoing value within fixed income for insurance investors. Intermediate duration Corporate Bonds, Residential / Commercial MBS, and Asset Backed Securities continue to offer yields near 4.75%, still a full percentage point above the Property & Casualty industry's 3.68% book yield on bonds[2]. The current environment remains one that should support investment income growth in the quarters ahead as new money yields exceed run-off book yield. For Life Insurance & Annuity writers, a steeper yield curve and widening credit curves have resulted in a less dramatic shift lower in yields.

Reinvestment yields in long duration, public market sectors generally range between 5% and 6% depending upon issuer, industry, and quality. The rate decline has been material enough, however, to trigger a review of annuity product rate commitments which likely need to be lowered to preserve margins in this lower rate environment.

Should the 'risk-off' trade continue or economic conditions change meaningfully, our team will keep you informed of our views for opportunism. We have positioned portfolios for rate & spread volatility and the ability to shift investments in an effort to optimize income & return potential as market pricing evolves. Please reach out to your portfolio management team or business development contact should you have any questions.

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