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AAM
Insurance Investment Management

Budgeting Losses Can Buy Wins: "Moneyball" for Insurance Investing

Matthew Williams, CFA | Assistant Portfolio Manager

Michael Lewis' "Moneyball" highlights Billy Beane's impact on professional baseball, using data to prioritize baserunners instead of flashy home-run hitters. By leading the Oakland A's to the playoffs without a big-market budget, Lewis asks "How can you not be romantic about baseball?"

If I offered all 30 MLB managers guaranteed playoff success in 2030 and beyond, my guess is every skipper would sign on the dotted line - even if it required a few unpopular roster moves today. The insurance investment equivalent may be accepting capital losses today to improve long-term surplus.

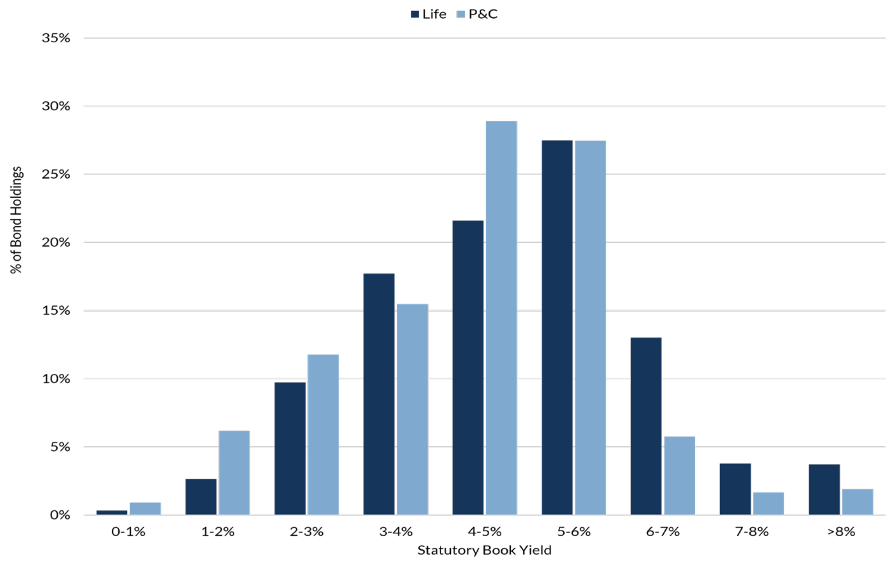
Below, we address an industry dilemma absent in recent years. Presented with higher Treasury rates, insurance investors win by maximizing the deployment of existing portfolio assets into higher-yielding opportunities that sustain book yield growth. We believe selling certain bonds at statutory losses can increase this deployment without elevating credit credit risk or injecting fresh capital. "How can you not be romantic about bond losses?"

"Walk Me Through the Board"

At first glance, statutory accounting can make it appear that bonds trading below book price have performed poorly. The economic story often differs. Bonds can still hold unrealized statutory losses after exhibiting positive performance. This can happen when the risk premium, or spread, over the risk-free rate falls.

A changing economic landscape overshadowed positive performance on bonds purchased before the Fed hiked rates in 2022. Although these bonds remain fundamentally strong, their low book yields constrain future statutory income. Exhibit A shows that more than 10% of industry-held bonds have statutory book yields of 3% or less[1].

Exhibit A: Industry Book Yield Distribution - December 2025



This is where entities can repurpose assets on the balance sheet. Like Brad Pitt's character met payroll restraints with Peter Brand's analytical approach, certain bonds may be more accretive to capital if they are sold. Still, many insurers do not want to realize statutory losses because doing so would reduce current-period net income. As a result, they capture the benefit of higher rates only gradually through reinvestment of principal and interest.

Raising book yield can lock in higher income for years, even when adjusting for a near-term reduction in book value. If interest rates remain "higher for longer," AAM believes today's market backdrop could help insurers accelerate core earnings growth. Nearly 40% of P&C filers reported that earned investment income contributed more to net income in 2025 than in 2024[1].

"Find Players with the Money That We Do Have"

Historically rich credit valuations are creating opportunities for insurers to realize losses in ways that can be accretive to capital. As insurers shift toward new asset classes, traditional markets such as corporate and municipal bonds offer less compensation for risk. Exhibit B measures spreads relative to U.S. Treasuries, showing these sectors near all-time expensive levels[2].

Exhibit B: Historical Spreads in the Investment-Grade Bond Universe

Investment-Grade Sector	Percentile Rank (20Yr Trailing)	20Yr Min Spread	Current Spread
Bloomberg U.S. Aggregate	1	24	26
Government	5	29	35
Corporates	1	71	74
Asset-Backed Securities	18	22	44
AAA CLOs*	39	23	120
Residential MBS**	35	60	107
Commercial MBS	7	56	65
Commercial Mortgage Loans***	30	119	180

Spreads reference monthly option-adjusted spreads from July 2006 through June 2026 unless noted below:
**Spread shown is floating spread of JPM US CLOIE AAA Index*
***Data based on nominal spread of current coupon Fannie Mae/Freddy Mac 30-year mortgage bonds relative to average 5/10-year treasury yield*
****Data based on quarterly nominal spread of ACLI fixed rate mortgage loans through March 2026*

1 Source: S&P Capital IQ
2 Source: Bloomberg/JP Morgan/American Council of Life Insurers ("ACLI"). Spread is shown in basis points.

In today's rich credit market, holding overvalued bonds may leave insurers with limited upside from further spread tightening and greater downside risk if spreads widen. Just like lineups change when a new pitcher takes the mound, asset managers should optimize investments as credit risk evolves. Accounting nuances may complicate decisions, but it does not mean the lineup should never change.

"We've Got to Think Differently"

All losses are not created equal – the same bond's unrealized loss can vary by purchase date across statutory financials. "Payback period" measures how long is necessary for income earned on an investment to outpace losses realized to fund the position. Longer payback periods dampen the income benefits experienced, while poorly designed swaps can cost a company income.

Beyond their long-term book value impact, trades must result in positions that fit the broader portfolio. In an industry increasingly backing policyholder contracts with private credit and data center-linked debt, adding yield with bond swaps cannot ignore risk and asset-liability management.

Since active portfolio trading may introduce risk and accounting questions from firm stakeholders, asset managers cannot execute these strategies in a vacuum. Company management must factor in underwriting expectations, tax implications, capital efficiency and shareholder goals. A tailored checklist can gauge whether an entity is positioned to execute trades without damaging competing priorities:

Exhibit C: Realized Loss Checklist Example

Property & Casualty

1. Can company surplus fall in the near-term for a benefit to be realized over the long-term?
2. Will policyholder dividend expectations still be fulfilled at a lower current net income?
3. Is there reasonable accuracy in current budgets in order to add a periodic loss allowance?
4. Does the asset manager understand the company's risk appetite and investment goals?
5. Are there unrealized gains in equities or other active strategies that could be realized to help manage tax implications?

Life & Annuity

1. Is there sufficient Interest Maintenance Reserve balance to smooth proposed realized losses over multiple periods?
2. How will changes in portfolio composition impact cash flow testing results?
3. Can crediting rates become more competitive due to growing book yields?
4. Will the portfolio retain enough sale candidates if future cash needs prompt more sales?

If management can answer these questions confidently, they should "call everyone to the mound" to discuss a realized loss budget. Addressing the conversation during broader budget planning ensures potential losses permitted are aligned relative to enterprise income expectations.

Company leadership may grant loss allowances by period (ex: $100,000 per quarter) or require trade-by-trade approval. By establishing guardrails beforehand, firms avoid unnecessary budget variance in the form of excessive turnover or transaction costs. Moreover, the right investment advisor will be selective in how each trade affects the portfolio and income statement.

Rethinking Investment Budgeting

Insurance leadership often pull many levers to grow their bottom line. By Partnering with an asset manager today, companies can boost book yield and long-term core earnings growth. Not only will this separate firms from peers, but it can also provide flexibility to other parts of the business.

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