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Life-Annuity Investment Strategies: Bracing for Change

Presented by CONNING®

July 20th, 2022 | 1:00 - 2:00 PM ET

Life-Annuity Investments: Bracing for Change

Presented by CONNING®

Brian Bayerle

Senior Actuary

American Council of Life Insurers

WEBINAR SERIES

July 20, 2022 | 1:00 - 2:00 PM ET

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Life-Annuity Investments: Bracing for Change

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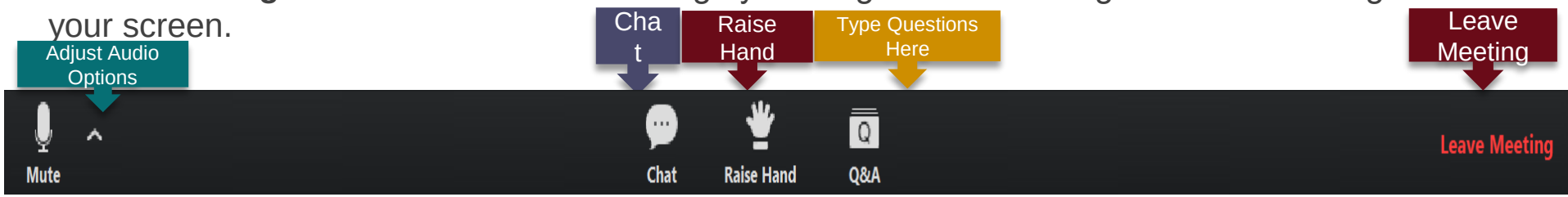

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Cindy Beaulieu

Managing Director & Portfolio Manager

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Asset Management Sales
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Agenda

I. **Life-Annuity Investment Trends**

II. **Life-Annuity Investment Opportunities**

About Conning

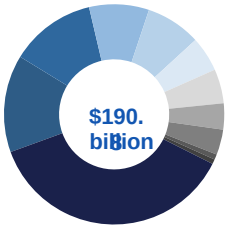
Conning Overview

- Founded in 1912; offices in Asia, Europe, and North America
- 486 employees with 165 investment professionals[1]
- PRI signatory as of 2012, with an integration of ESG factors into our investment process[2]
- 178 insurance clients

Recent Developments

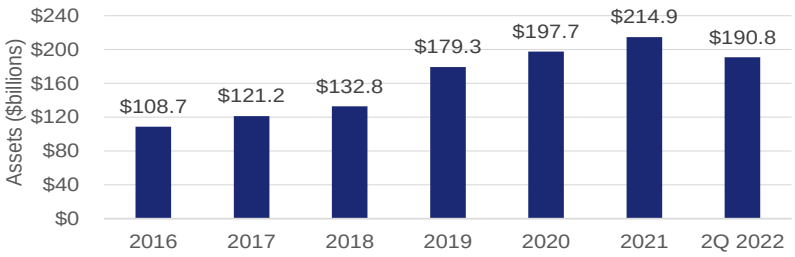
- In 2016, Conning acquired a controlling interest in Octagon Credit Investors, LLC, a specialty manager with expertise in collateralized loan obligations (CLOs) and bank loans
- In 2020, Conning acquired a majority interest in Global Evolution, a specialty manager with expertise in emerging market debt strategies

Assets by Asset Class[3]



37.0%	Investment Grade Corporate Bonds[4]
14.3%	Bank Loans[5]
12.6%	Equities
8.8%	Structured Securities[6]
8.1%	Emerging Markets Debt[7]
5.1%	Governments and Agencies[8]
5.0%	Balanced & Other Funds[9]
3.8%	Municipal Bonds[10]
3.7%	Cash[11]
0.8%	Private Placements
0.7%	High Yield Corporate Bonds

Assets Under Management[3]



(1) Excludes SITE
(2) https://stpublic.blob.core.windows.net/pri-ra/2022/Investor/Public-TR/(Merged)_Public_Transparency_Report_Conning_2022.pdf
(3) As of June 30, 2022, represents the combined global assets under management for the affiliated firms under Conning Holdings Limited (CHL) and Cathay Securities Investment Trust Co., Ltd. (SITE). SITE is a separate entity under Cathay Financial Holdings Co., Ltd which is the ultimate controlling parent of all CHL controlled entities. The CHL CEO sits on the Board of SITE and helps oversee the business.
(4) Includes Convertible Securities.
(5) Includes Bank Loans held in managed CLO funds.
(6) Includes Mortgage-backed Securities, Asset-backed Securities, CLO Debt and CLO Equity.
(7) Includes Emerging and Frontier Markets.
(8) Includes Treasurys, Supranational and Sovereigns.
(9) SITE ILP Funds, Funds of Funds and other Mutual Funds.
(10) Includes Taxable Municipals and Tax-Exempt Municipals.
(11) Includes Short Term.

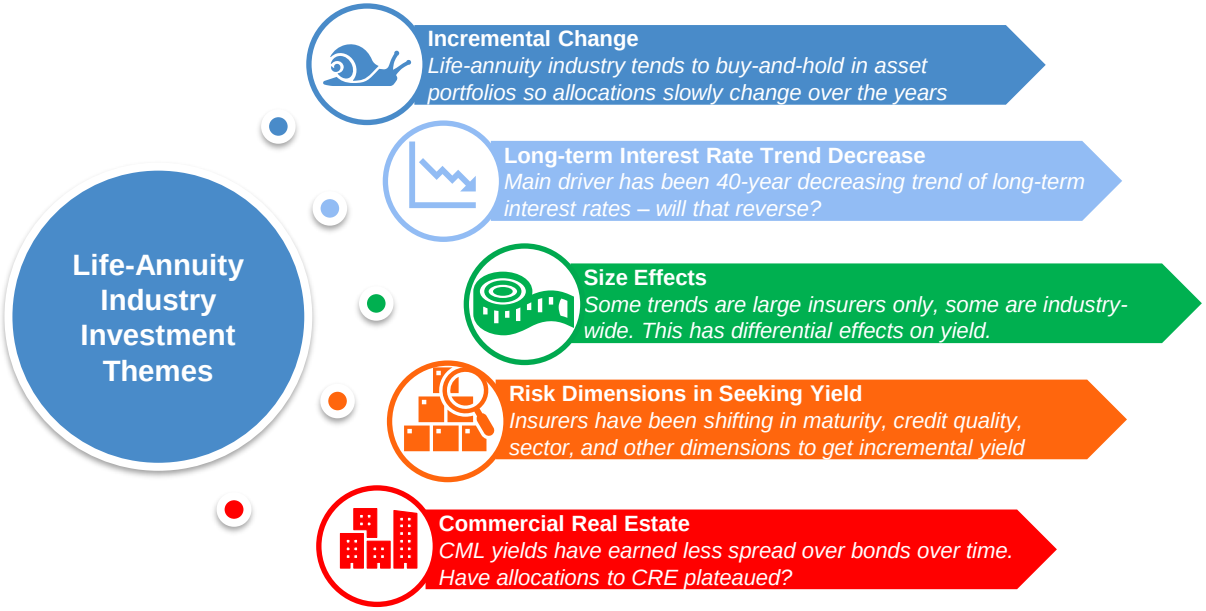
Mary Pat Campbell
Vice President,
Insurance Research

LIFE-ANNUITY INVESTMENT TRENDS

Section I

Overview of Key Life-Annuity Investments Themes

Seeking Yield In a Challenging Environment



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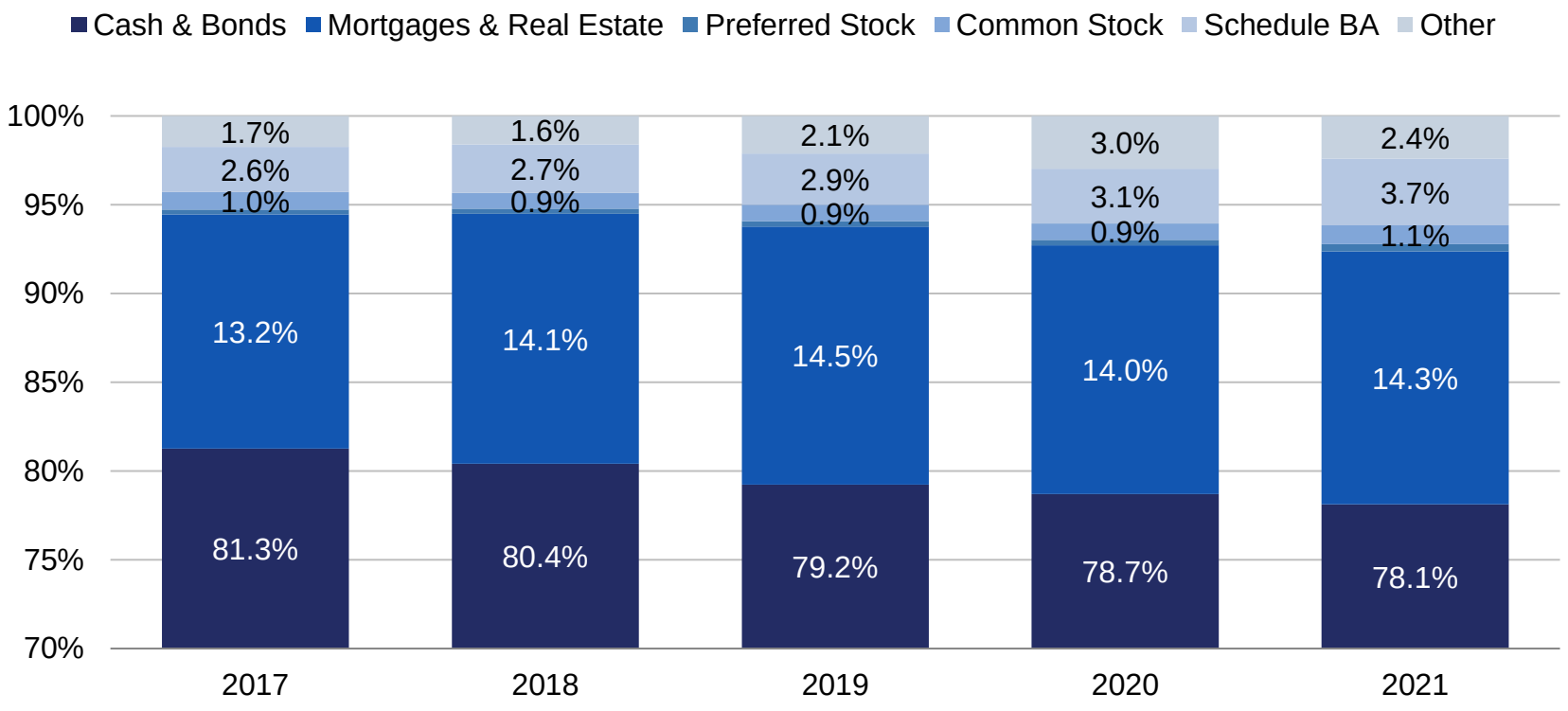
Allocations Continue to Shift Away from Bonds, Into Schedule BA

Allocation by Asset Class
As % of Investable Assets



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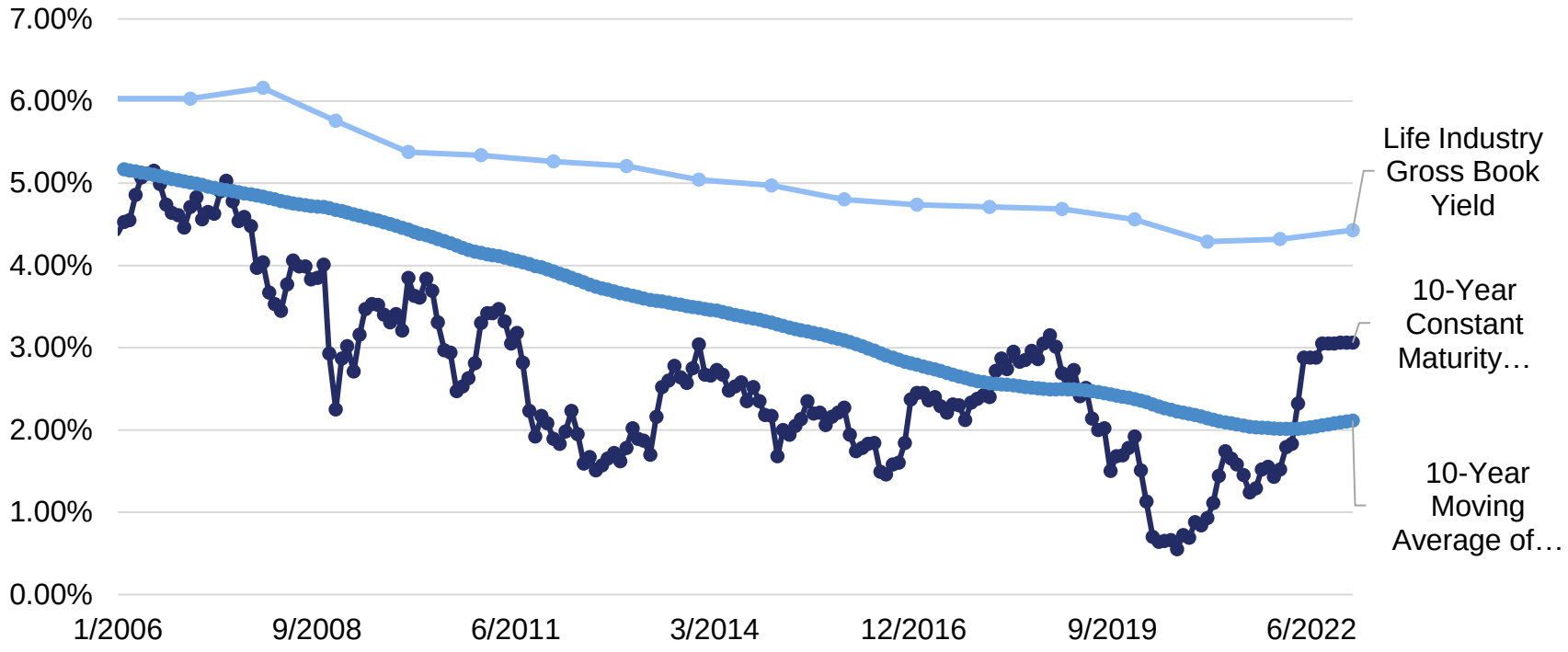
Gross Book Yield Increased 3 Basis Points, Forecast to Increase in 2022

10-Year Treasury Rates Compared to 10-Year Moving Average, Gross Book Yield, Actual and Projected

Gross Book Yield as % of Average Investable Assets



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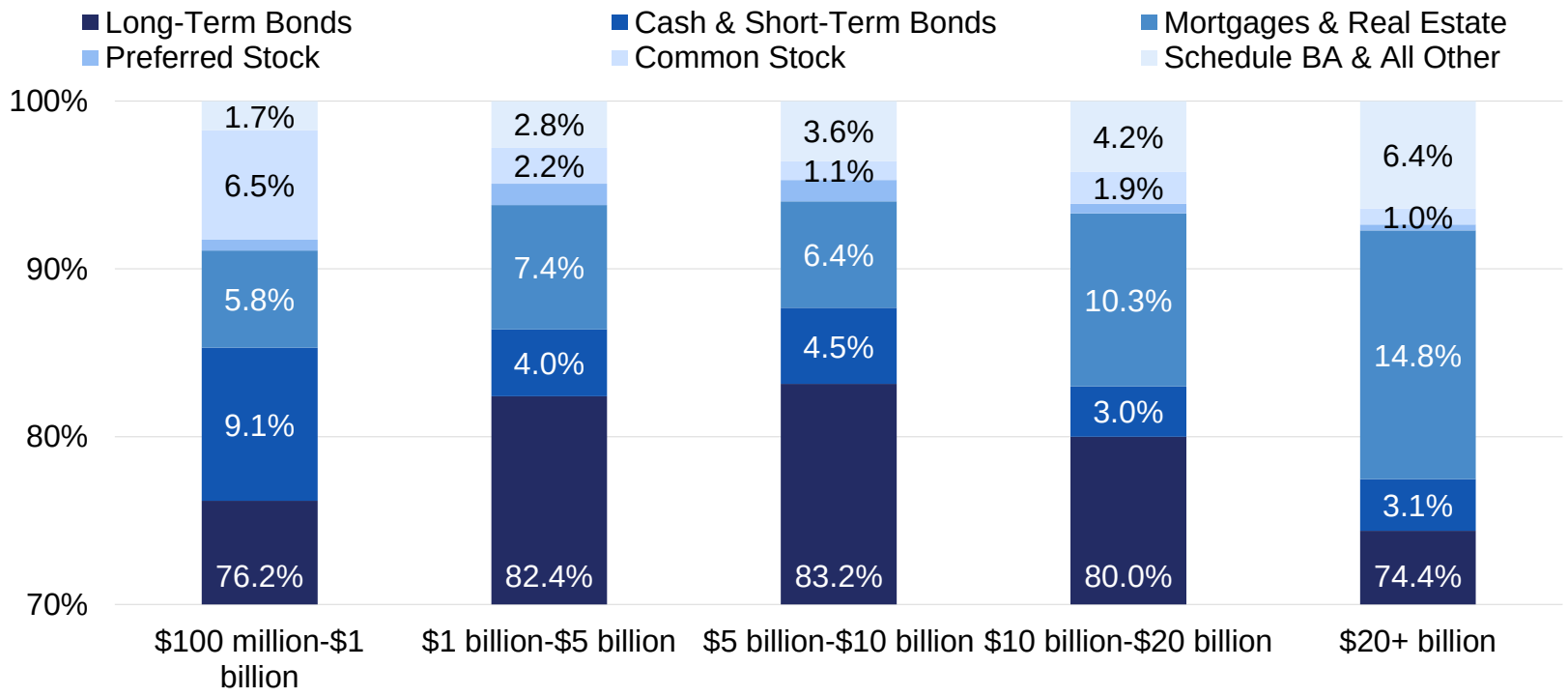
INSURER SIZE EFFECTS

Mortgages Used More by Largest Insurers, Cash by Smallest

Allocations to Major Asset Classes in 2021 by Insurer Size

As a % of investable assets



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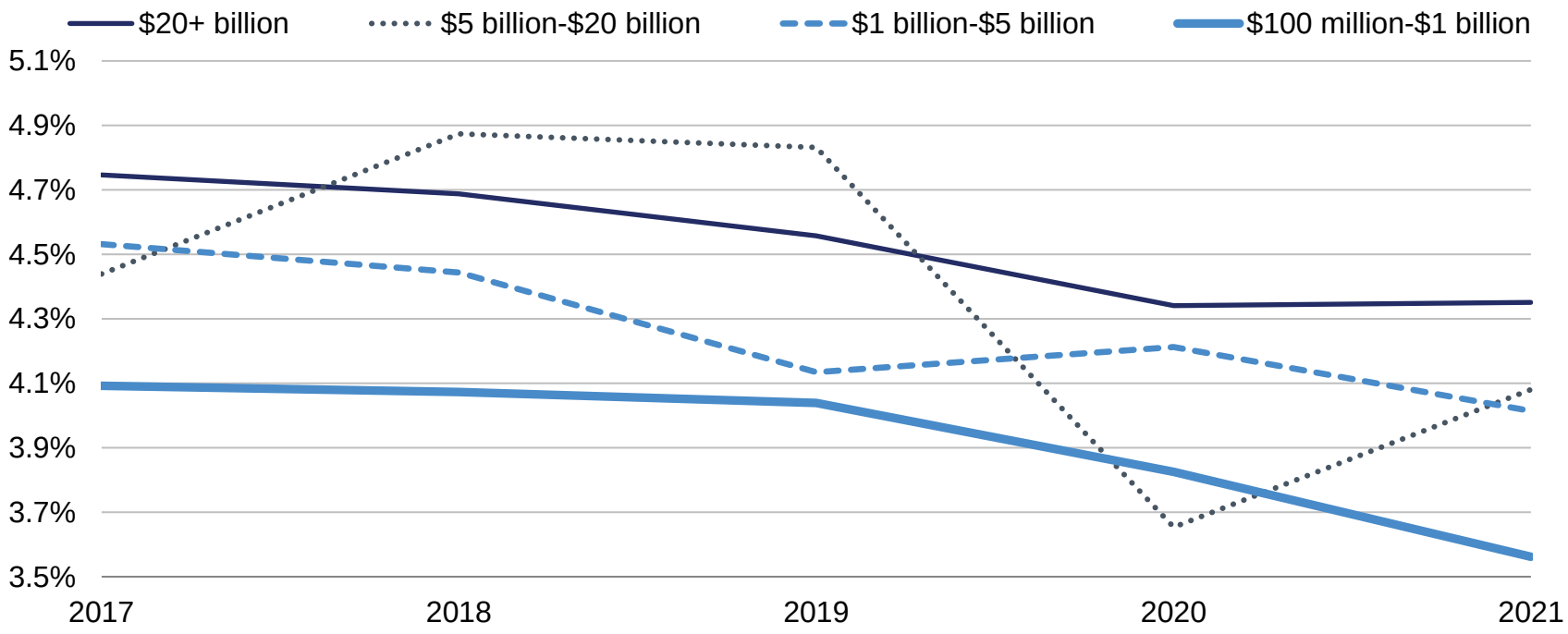
Book Yield a Harder Challenge for Smaller Insurers

Gross Book Yield by Insurer Size

As a % of average investable assets



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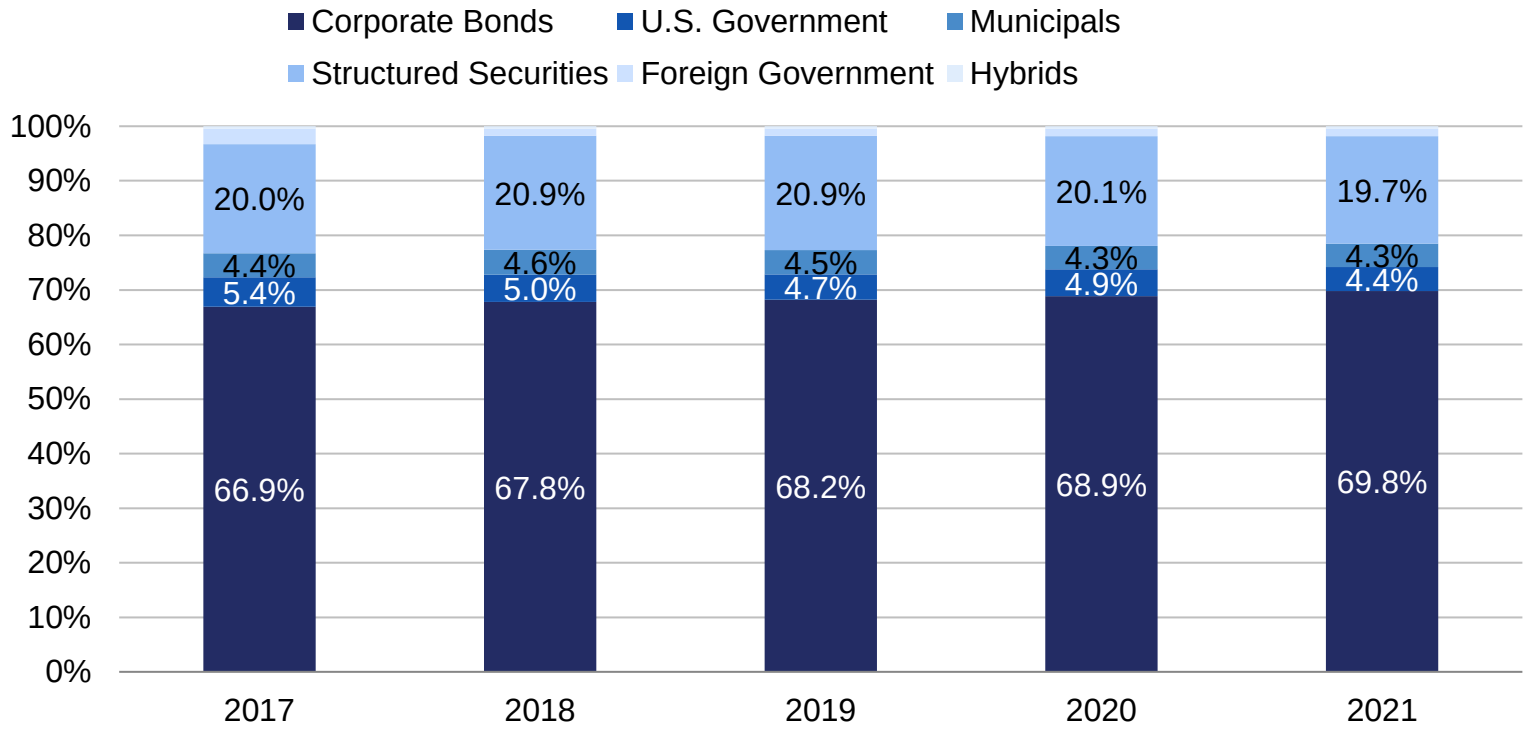
BONDS

Allocations to Corporate Bonds Increasing, Government Bonds Decreasing

Distribution of Bond Holdings by Type

As % of total bonds



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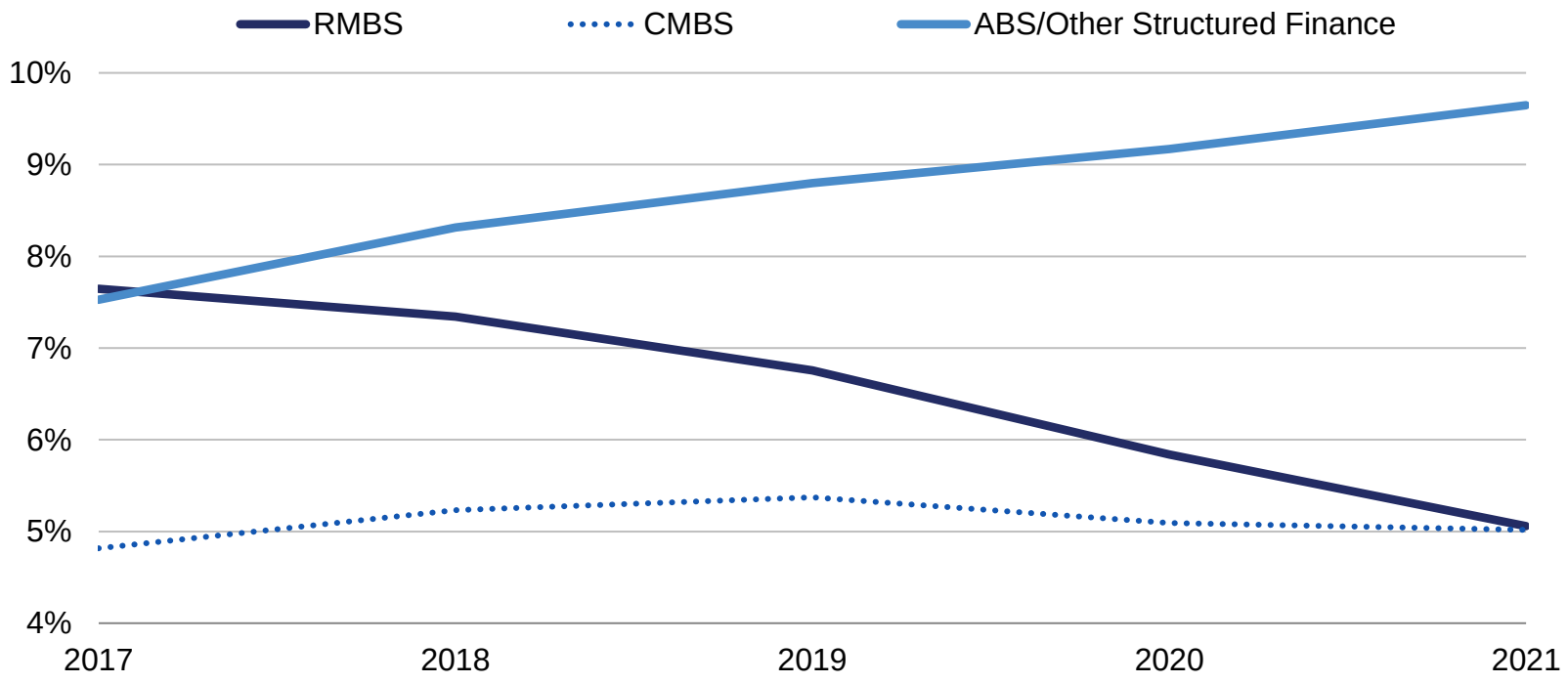
ABS Holdings Increased, RMBS Decreased, and CMBS Steady

Distribution of Structured Securities by Type

As % of total bonds



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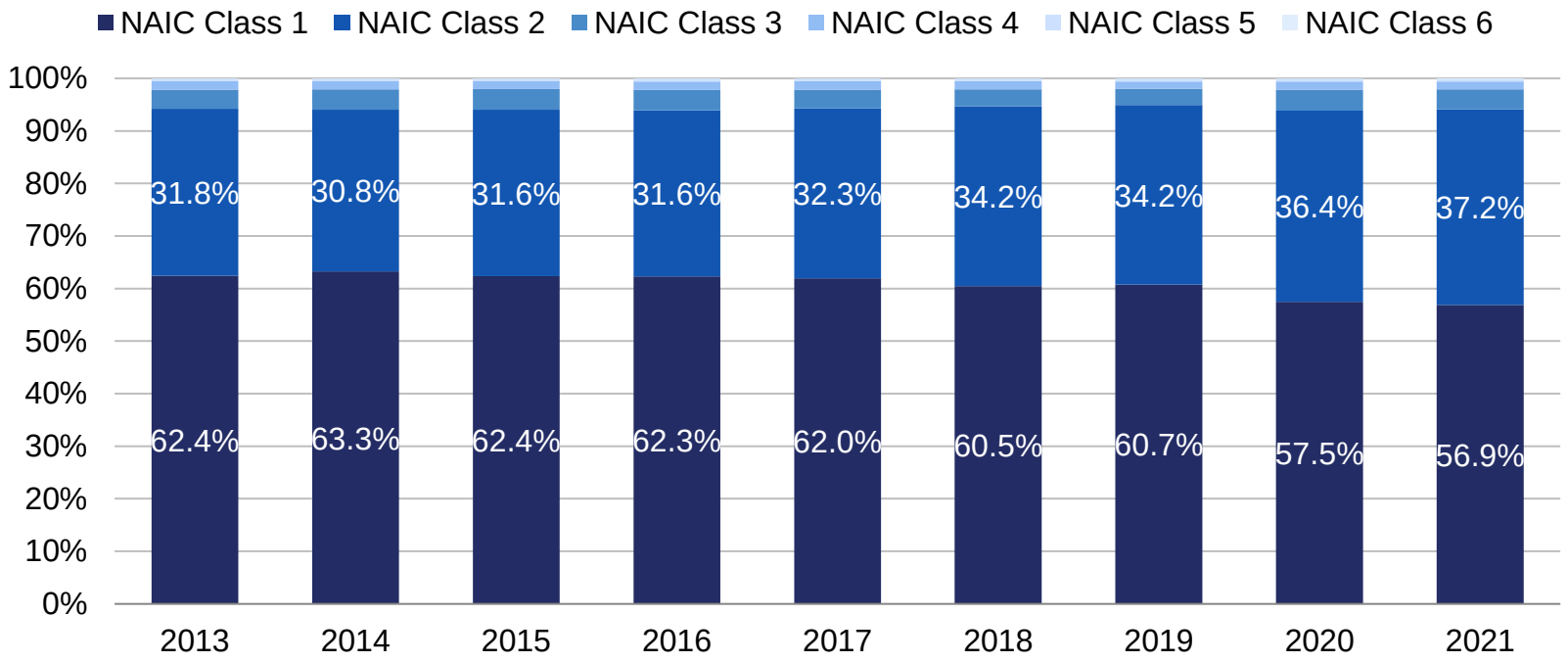
Shifting Credit Quality in the Bond Portfolio to BBB-Rated Bonds

Bond Quality Distribution
As % of Total Bonds



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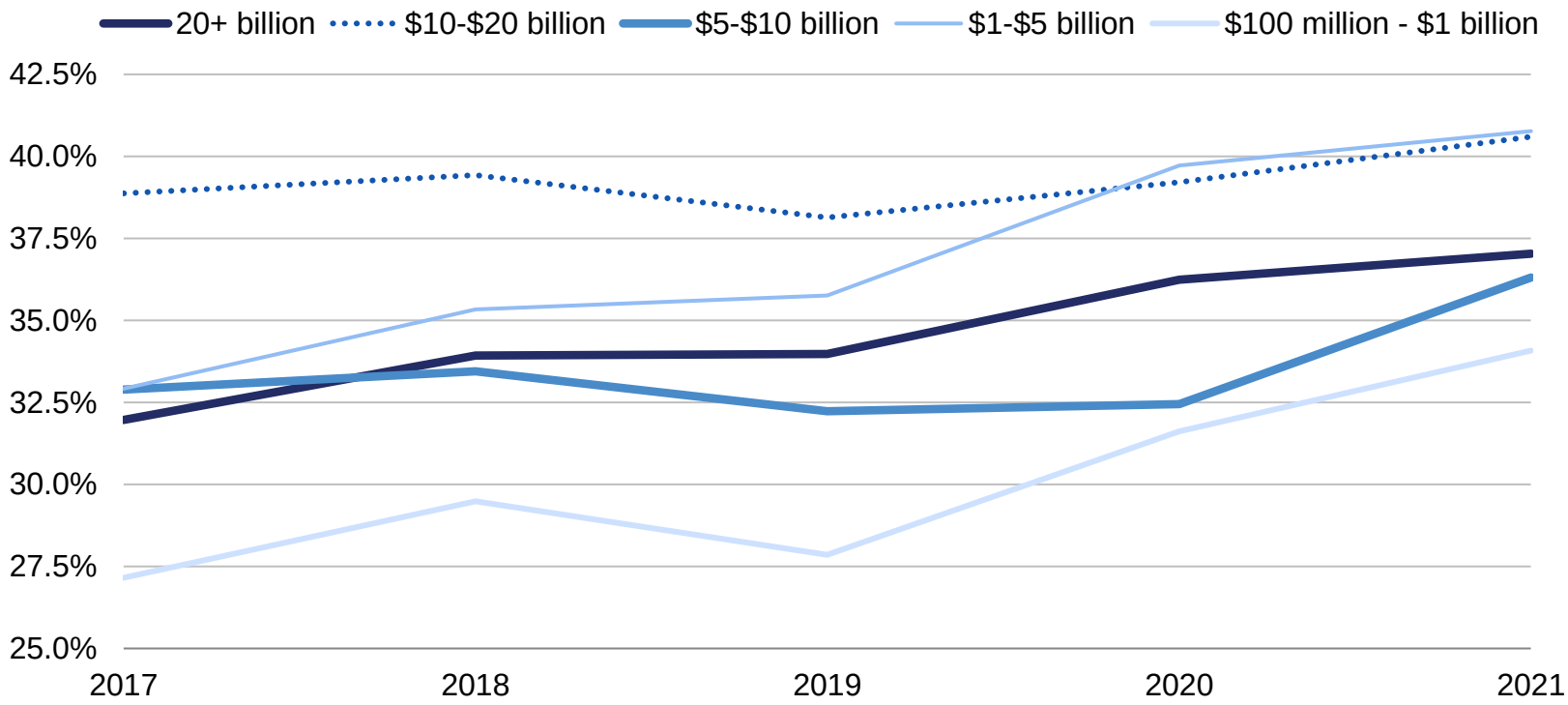
Shifting to BBB-Rated Bonds has Affected Insurers of All Sizes

BBB-Rated Bond Allocation by Insurer Size

As % of Total Bonds



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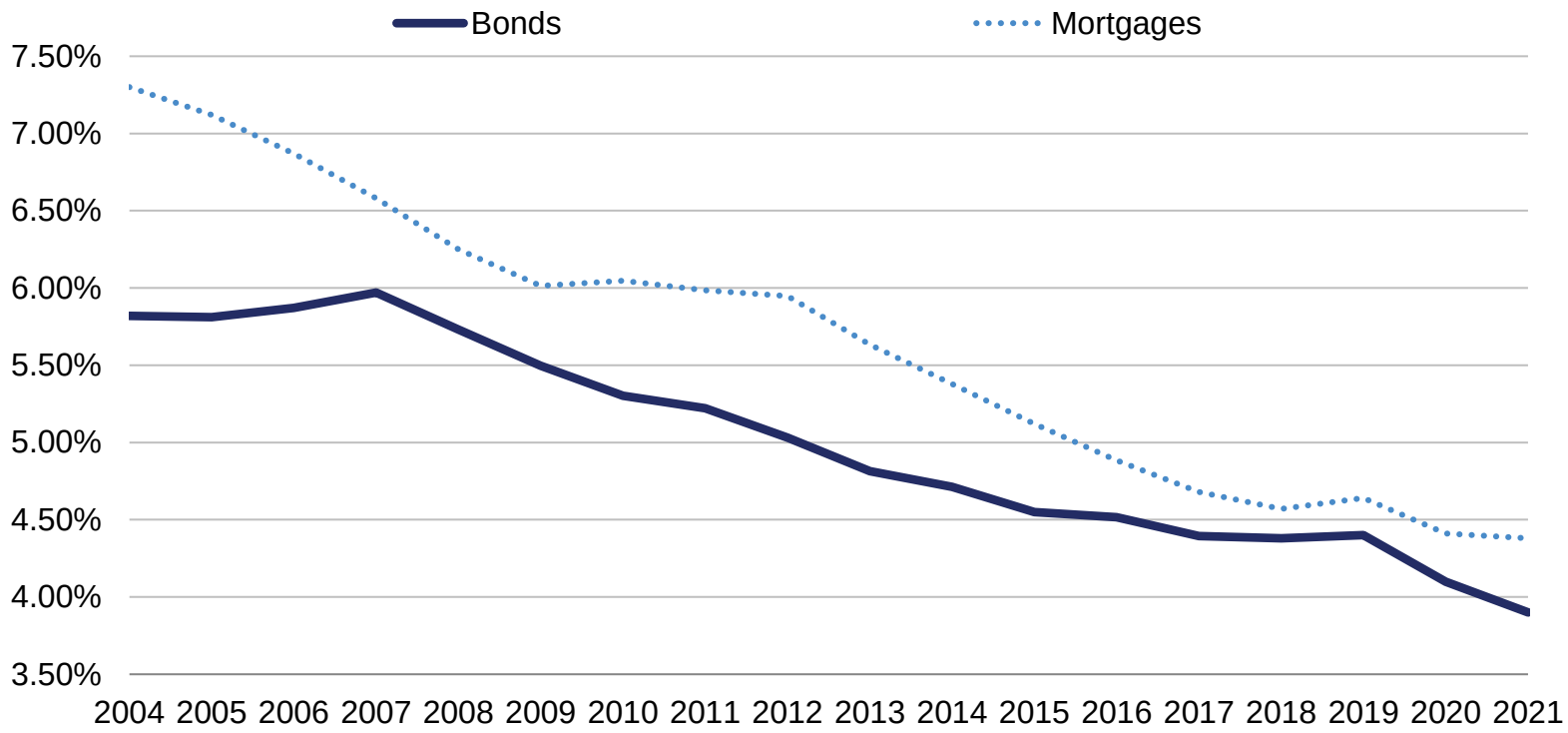
MORTGAGES AND COMMERCIAL REAL ESTATE

Mortgages Yield Higher Than Bonds, but Less Spread Over Time

Gross Book Yields, Bonds vs. Mortgages

As a % of average underlying investable assets



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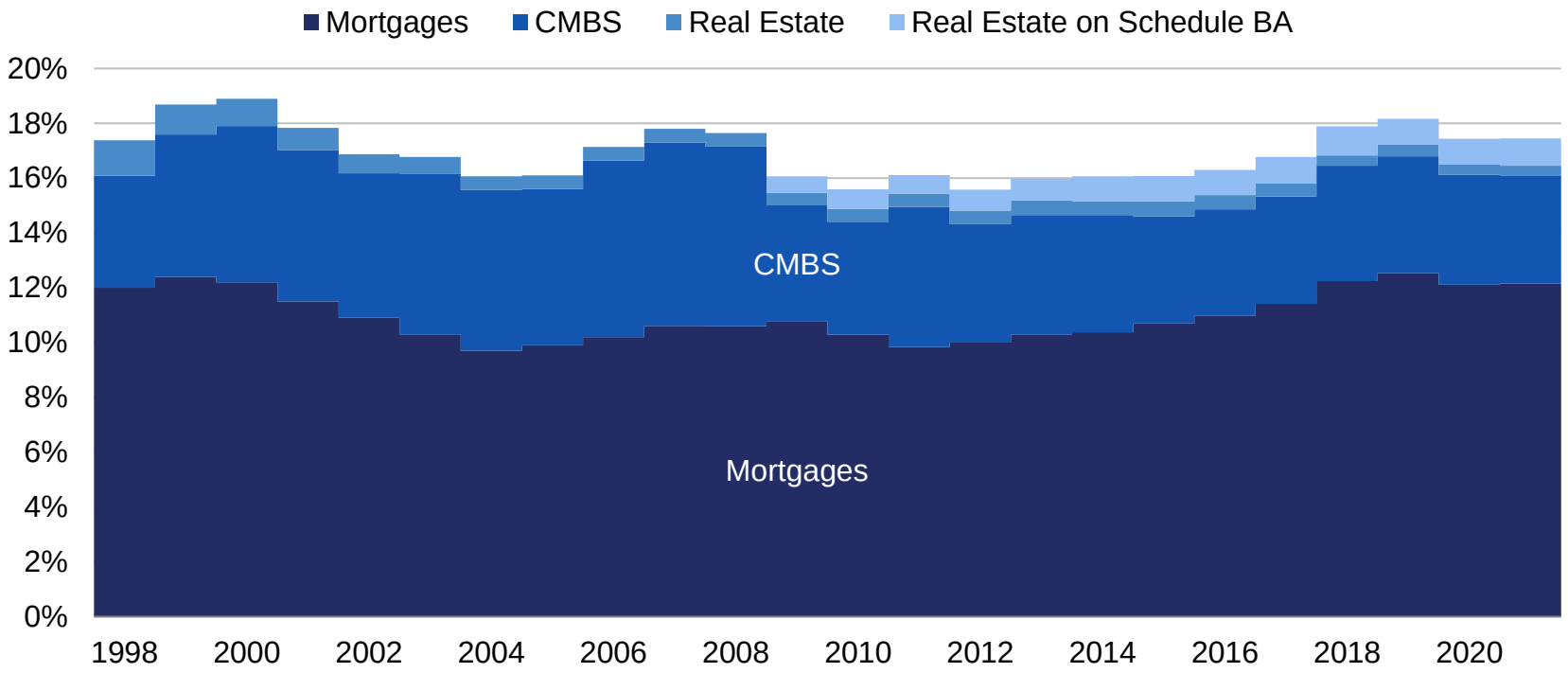
Has Commercial Real Estate Exposure Plateaued?

Approximate Direct and Indirect Investment in Commercial Real Estate

As a % of investable assets



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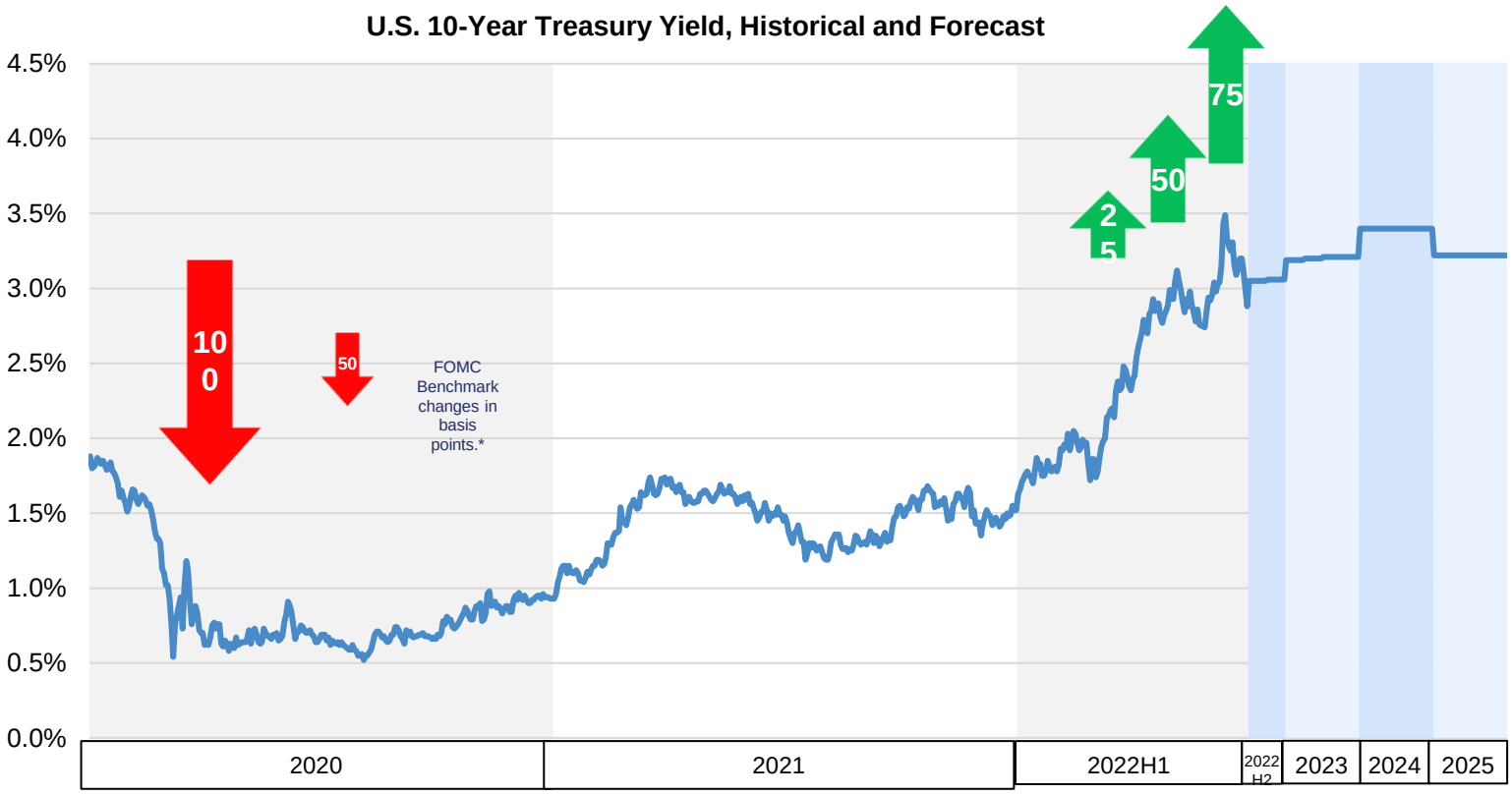
Cindy Beaulieu
Chair of Investment Policy Committee

LIFE-ANNUITY INVESTMENT OPPORTUNITIES

Section II

10-Year Rate Climbing in 2022….But Will It Stall Out?



*FOMC = Federal Open Market Committee of the Federal Reserve
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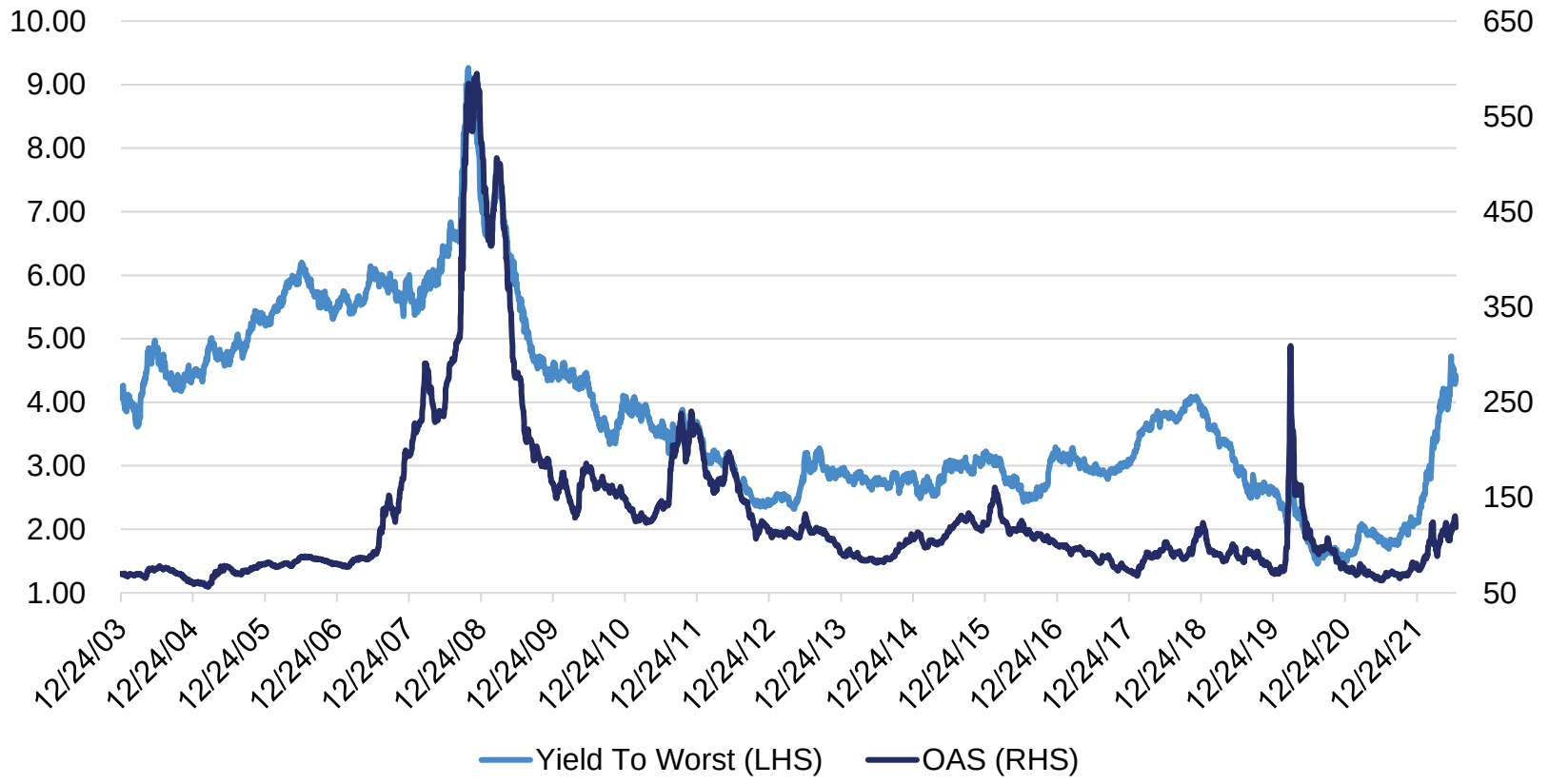
Single A Corporate Index: OAS and YTW



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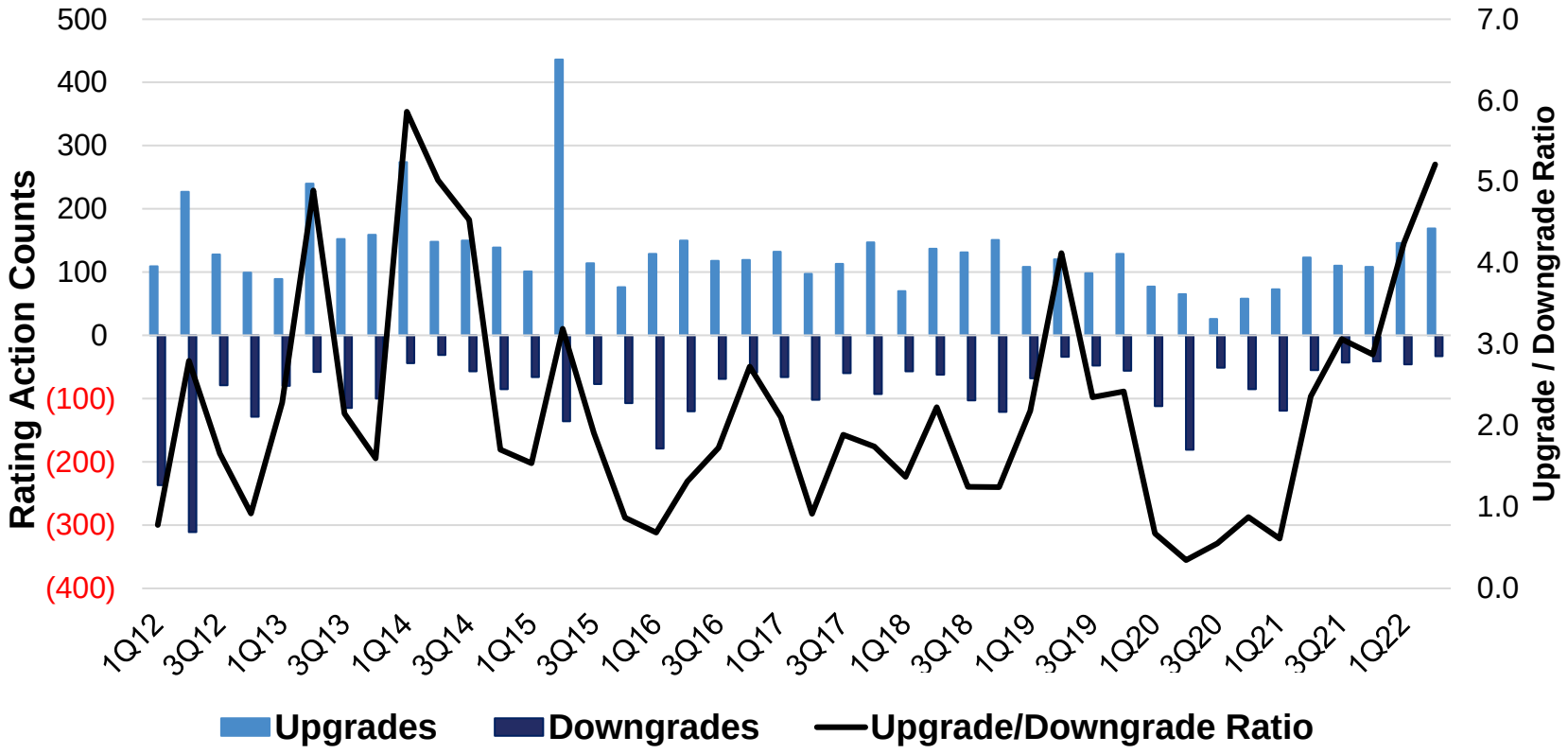
Investment Grade Corporates – Ratings Trends



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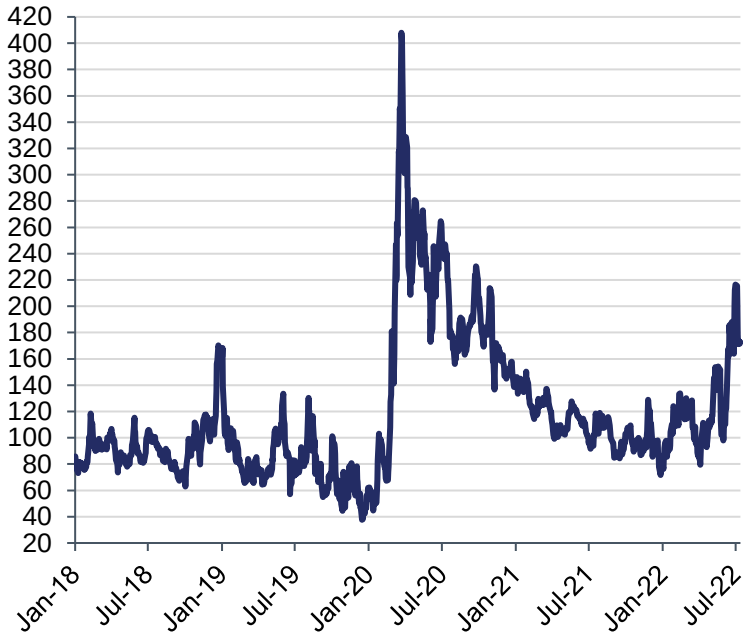
High Yield – BBs Attractive vs BBBs

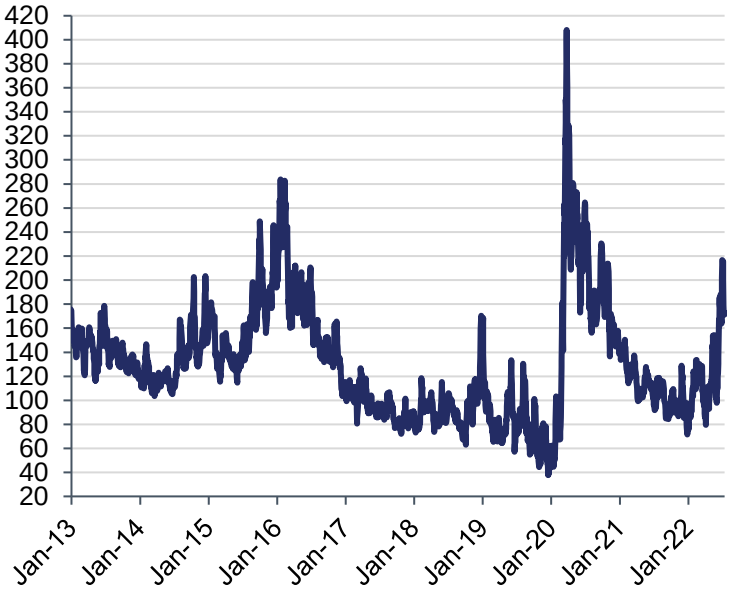
OAS: BB-BBB (5 year)

Percentile Rank: 88th percentile



OAS: BB-BBB (10 year)

Percentile Rank: 84th percentile



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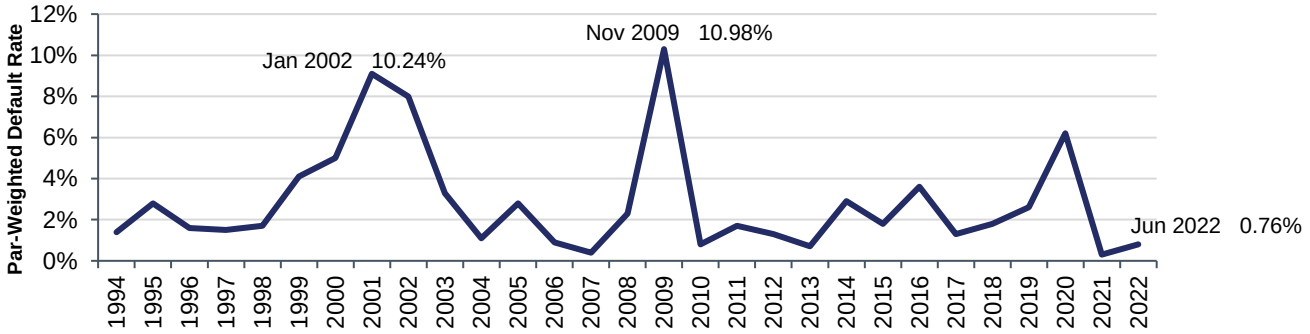
High Yield – Defaults and Recoveries

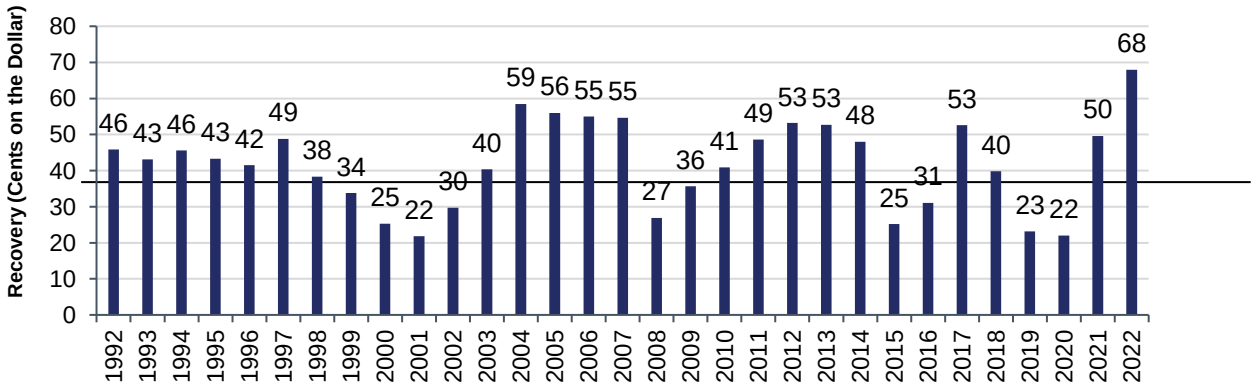
LTM Default Rate

Based on par amount



Bond Issuer-Weighted Recovery Rates

25 Year Average = 39.9%



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Opportunities in Non-Agency RMBS

Type	Rating	Spread	Yield	Duration
Non-QM	AAA	+240	5.45%	2.0
Prime Jumbo	AAA	+245	5.52%	4.5
RPL	AAA	+165	4.75%	3.0

Types of Non-Agency RMBS:

Non-Qualifying Mortgage (Non-QM)

- Loans made to borrowers who do not qualify for Agency financing requirements for various reasons, including debt to income, credit score, and proof of income
- Borrowers refinancing, once qualifying for an agency mortgage, at a future date creates stable prepay rates

Prime Jumbo

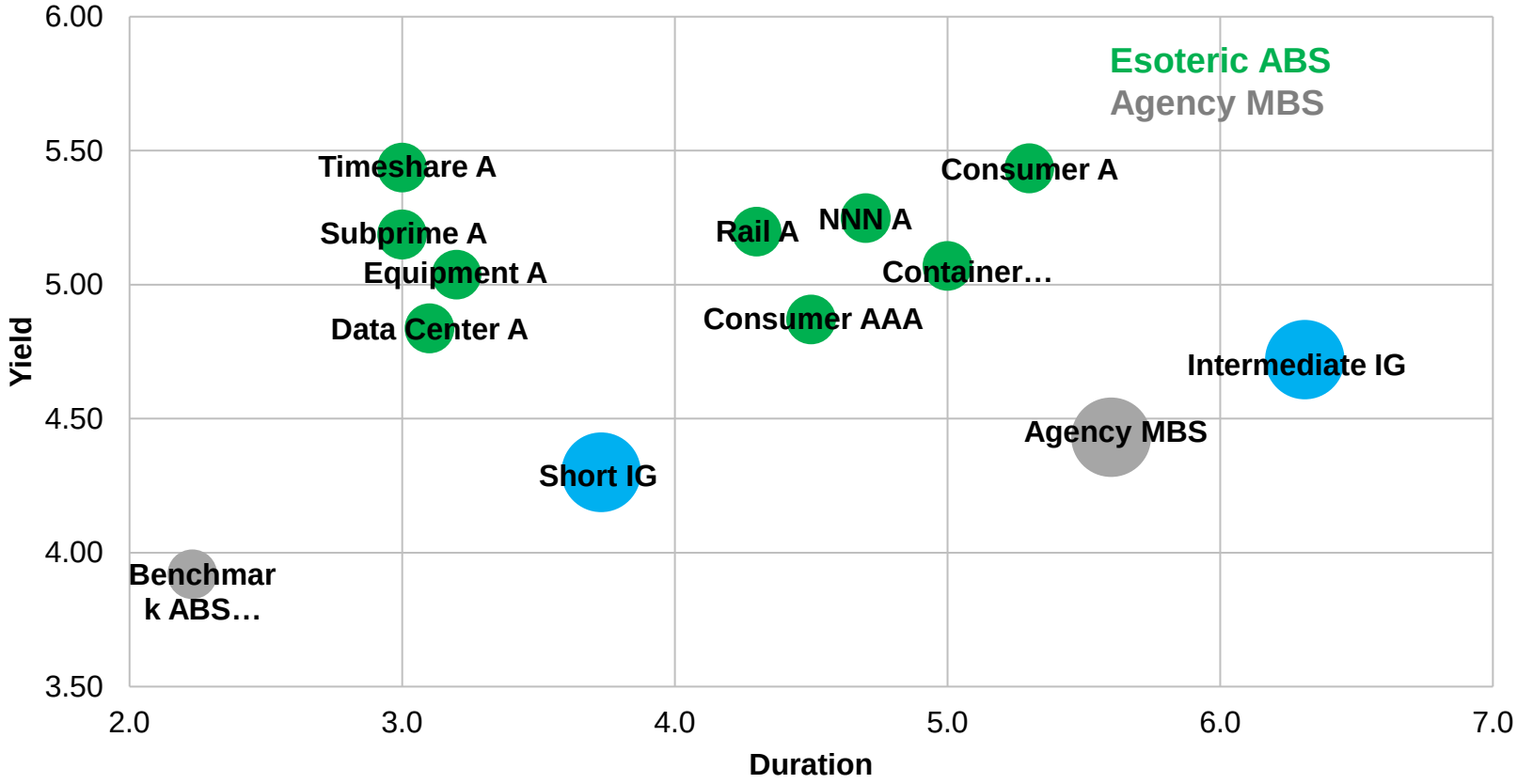
- Borrowers with high prime FICO scores and loan balances too large to qualify for an Agency mortgage
- Typically have high prepayment volatility highly correlated to interest rates

Re-performing Loan (RPL)

- Previously modified loans typically from the GFC timeframe with the borrower performing per the revised terms. Once the borrower has cured their credit after a period of time, a refinance of the loan with the agencies is likely
- The credit curing refinance results in a stable prepayment profile for RPL RMBS despite varying interest rate environments

Conclusion: Non-QM offers an attractive yield for a AAA cash flow with reduced extension versus Agency MBS due to the natural refinancing as borrowers qualify.

Esoteric ABS – Relative Value



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Past performance is not a guarantee of future results.

Esoteric ABS – Representative Securities

Sub-Sector	Rationale
CFO	Diverse exposure to private equity funds, strong structural protections
Data Center	Geographically diversified, mission-critical data centers on medium to long term leases with corporate credits.
Triple Net Lease	Commercial real estate secured by properties secured by long term leases with the tenant responsible for all property expenses and annual rent escalators.
Recurring Revenue	Low leverage first lien loans to software companies, no credit losses, significant credit enhancement
Royalties	Diverse exposure to music royalties, stable seasoned portfolio with strong enhancement
Timeshare	A mostly prime consumer backed loan used to finance the purchase of a time share, typically issued by corporate entities which provide an additional layer of credit protection.
Venture	Senior secured to life sciences and healthcare companies, strong ownership, long track record

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Benefits of Investing in Municipal Bonds

Municipal bonds have historically provided enhanced risk-adjusted returns with less correlation than IG Corporates.

	Bloomberg US Taxable Municipal Index	Bloomberg Municipal Bond Index	Bloomberg US Corporate Index
Yield to Worst	4.29%	3.19%	4.70%
Duration	8.4	5.8	7.6
Index Rating	AA3	AA3	BAA1
Volatility	2.06%	1.27%	3.29%
Sharpe Ratio	0.03	0.02	-0.01

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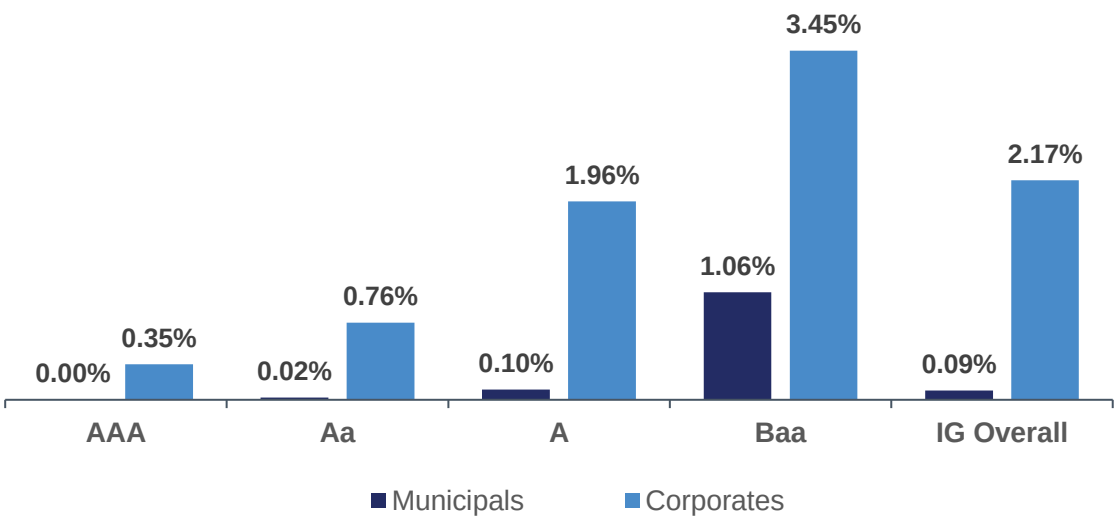
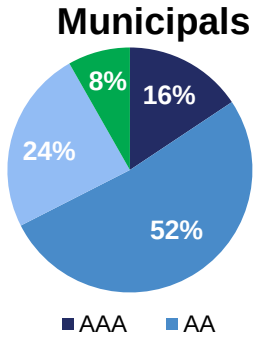
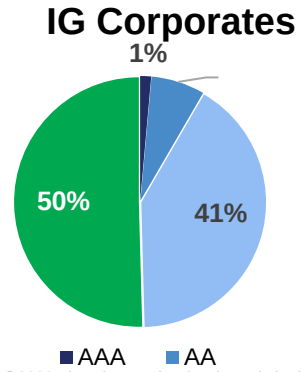
Benefits of Investing in Municipal Bonds

Municipal bonds historically exhibited a lower default rate versus similarly rated IG corporates with a higher average credit quality.

Average 10-Year Cumulative Default Rate (1970 – July 2021): Municipals vs. IG Corporates[1]







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SUMMARY

Summary

- Long-term decline in interest rates driving life-annuity firms to shift away – slowly – from heavy reliance on bonds and cash and into riskier assets.
- Smaller firms have been more risk-averse and will be challenged to improve book yields.
- Bond portfolios on average are increasing corporate holdings and taking on greater risk as BBB exposures rise.
- Interest rates are turning upward – but no certainty in how long this rebound lasts.
- Opportunities may be found in less traditional asset classes, including:
  - High yield bonds (higher quality - BB)
  - Non-agency RMBS
  - Esoteric ABS
  - Municipal bonds.

Thank you!

Questions?

For additional information, please contact Sunny Wadhwa at
sunny.wadhwa@conning.com
860.299.2248

Help Protect Our Families Twitter Chat

Millennials & Life Insurance

Wednesday, July 20, 2022
2:00 p.m. EDT

Hosted by ACLI and LIMRA

Join with #GettingMillennialsInsured

LIMRA Navigate With Confidence

ACLI Financial Security for Life

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DISCLOSURES

Primary Risks of investment Strategies

Corporate Bonds

- Market Risk - Market, or systematic, risk is the risk that individual securities may be correlated with general market downturns regardless of the particular business conditions and outlook for the individual companies
- Credit Risk – eroding fiscal health in issuing companies resulting in inability to meet debt obligations
- Inflation Risk - Inflation erodes the purchasing power of future cash flows from investments. In times of high inflation the value of securities may be reduced
- Liquidity Risk - Liquidity risk can occur when market conditions do not allow transactions to be made in a quick and orderly fashion in relation to indicative market prices

Structured Credit

- Investment Risk - The potentially complex structure of the security may produce unexpected investment results not based on default or recovery statistic
- Valuation Risk - Valuation of structured credit products are provided by third parties, based on models, indicative quotes, and estimates of value, in addition to historical trades. There is inherent difficulty in valuing these assets, and there can be no assurances the assets can be disposed of or liquidated at the valuations established, or that published returns will be achieved
- Underlying Asset Credit Risk - During periods of economic uncertainty and recession, the incidence of modifications and restructurings of investments may increase, resulting in impairments to the underlying asset value
- Economic Risk - Changing economic, political, regulatory or market conditions, interest rates, general levels of economic activity, the price of securities and debt instruments and participation by other investors in financial markets may affect the value of the structured security and all other asset classes

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