

# The Investment Environment for Property/Casualty Insurers

## *Impact of Volatility and Low Yields on P/C Insurer Investment Decisions*

**Insurance Information Institute**



**June 28, 2005**

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# *Presentation Outline*

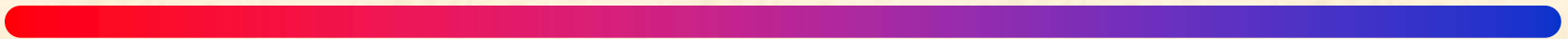
- **P/C Insurance Financial Overview**
  - **Profitability**
  - **Wall Street Perspective**
  - **Underwriting Performance**
- **Investment Performance:**
  - **The Low Yield Conundrum**

# INVESTMENTS:

**The Low Return Conundrum:**

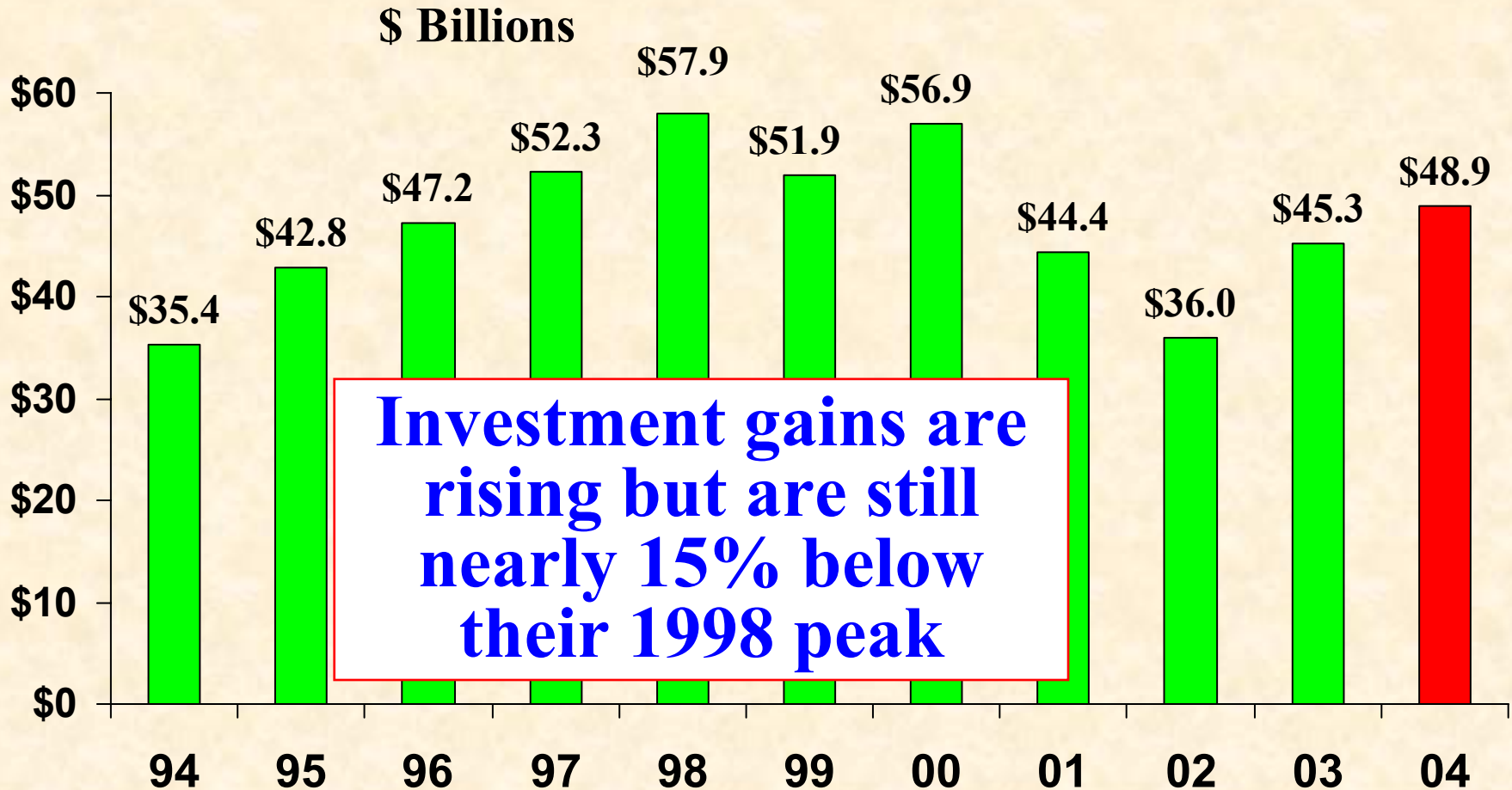
*Enforcer of Market*

*Discipline?*





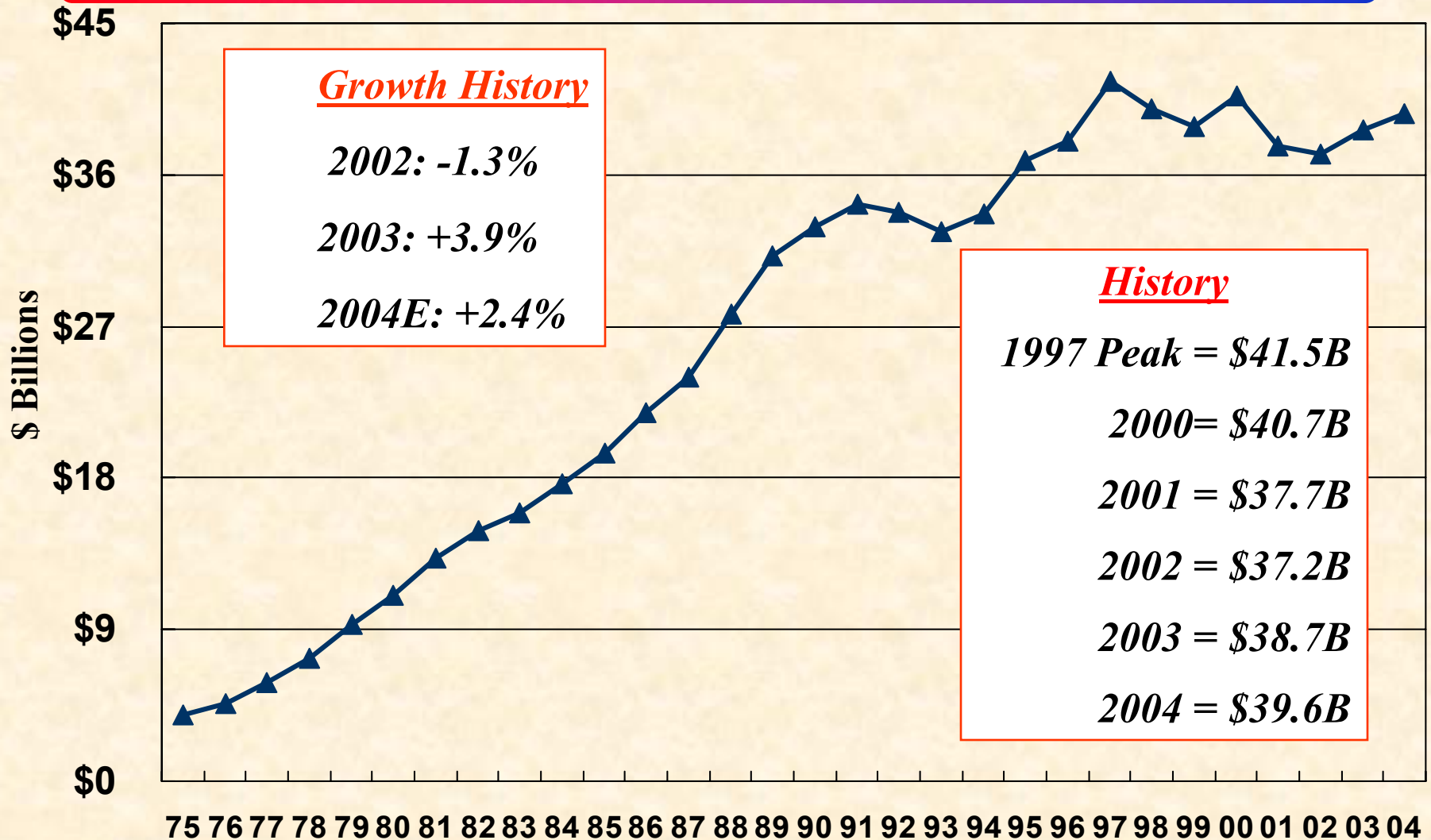
# Property/Casualty Insurance Industry Investment Gain\*



\*Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.  
Source: Insurance Services Office; Insurance Information Institute.



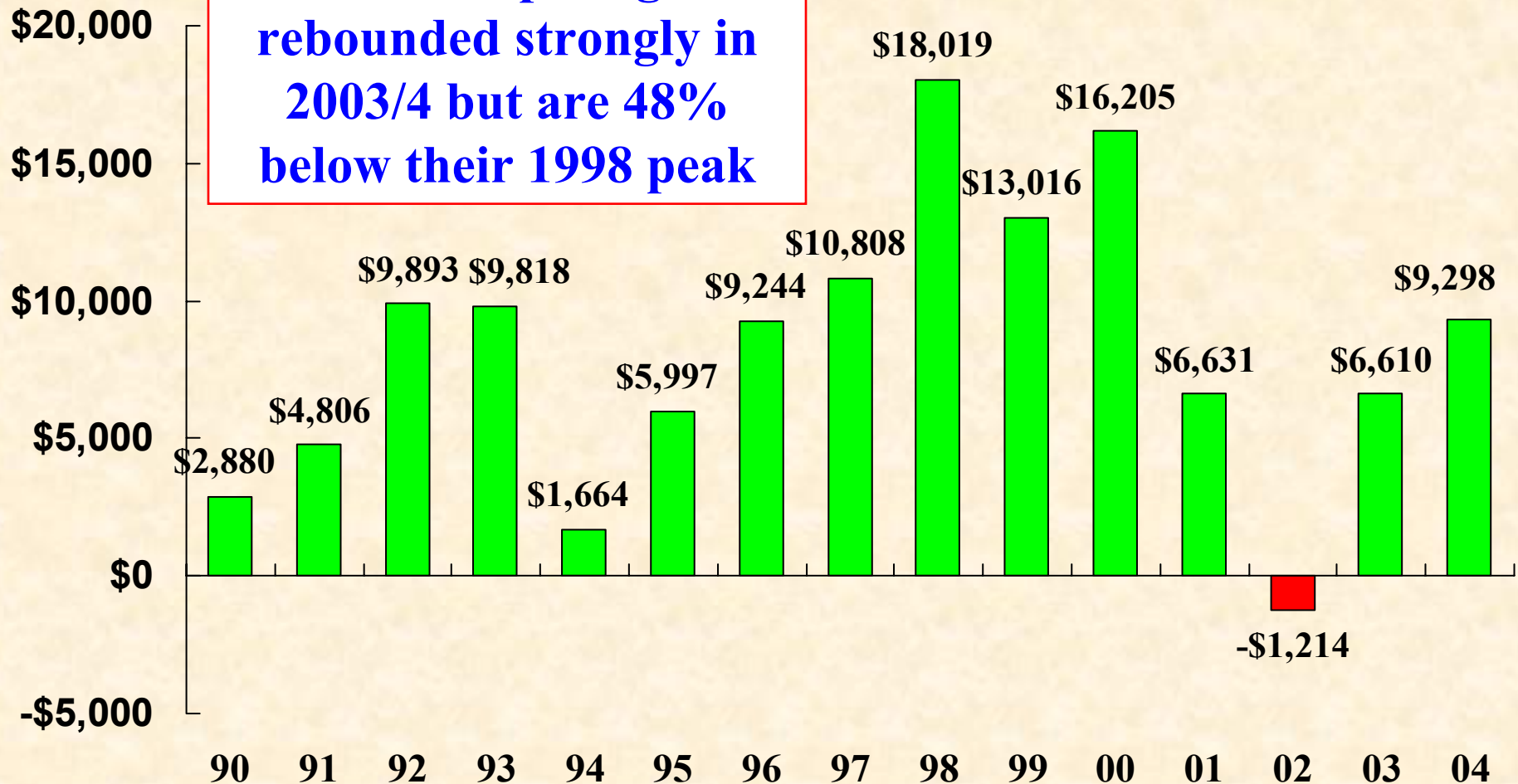
# Net Investment Income





# US P/C Net Realized Capital Gains, 1990-2004 (\$ Millions)

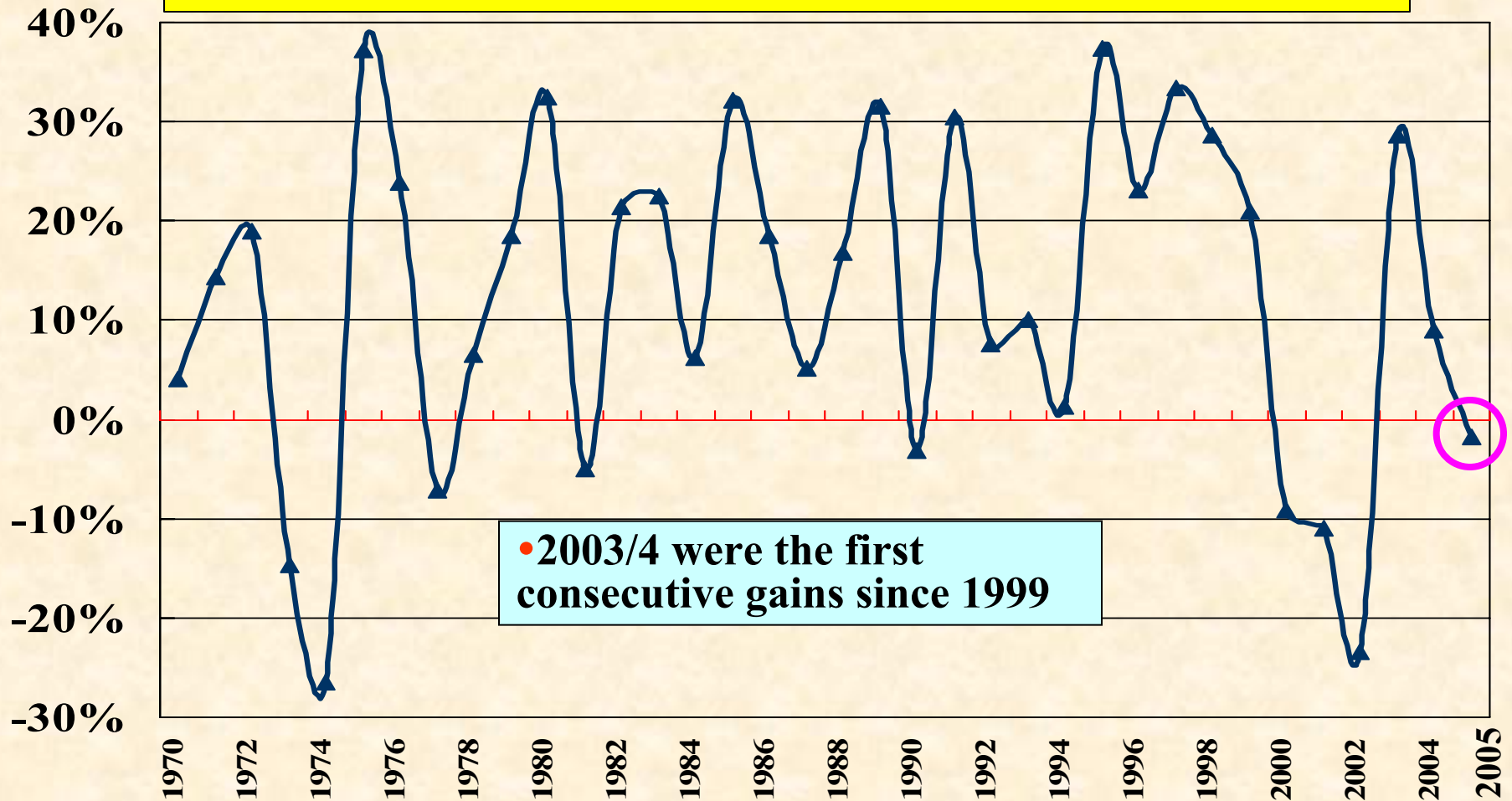
Realized capital gains rebounded strongly in 2003/4 but are 48% below their 1998 peak





# Total Returns for Large Company Stocks: 1970-2005\*

**S&P 500 was up 9% in 2004. Fears of higher interest rates, inflation, the falling dollar, resurgent oil prices are concerns in 2005**

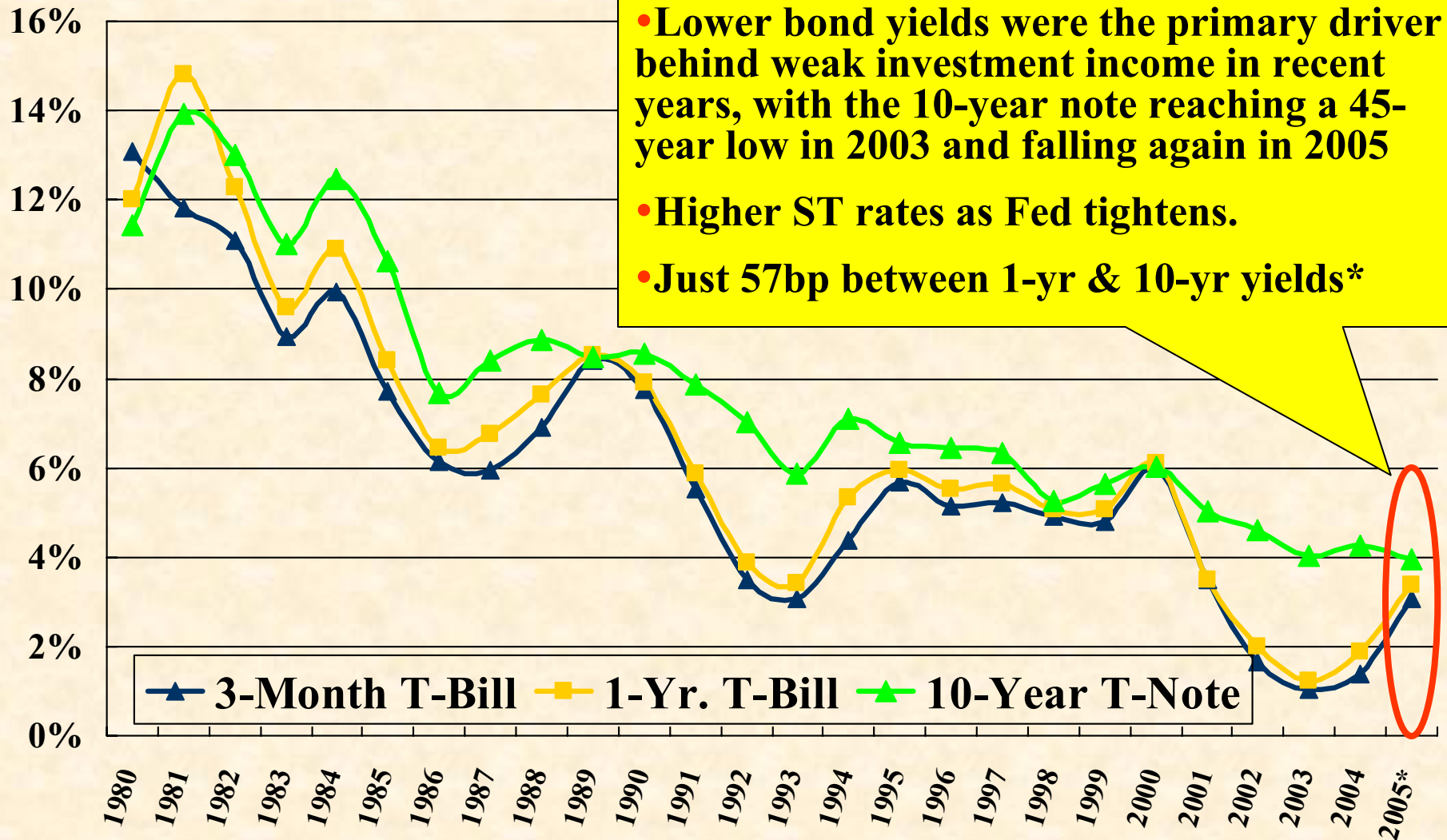


Source: Ibbotson Associates, Insurance Information Institute.

\*Through June 27, 2005.

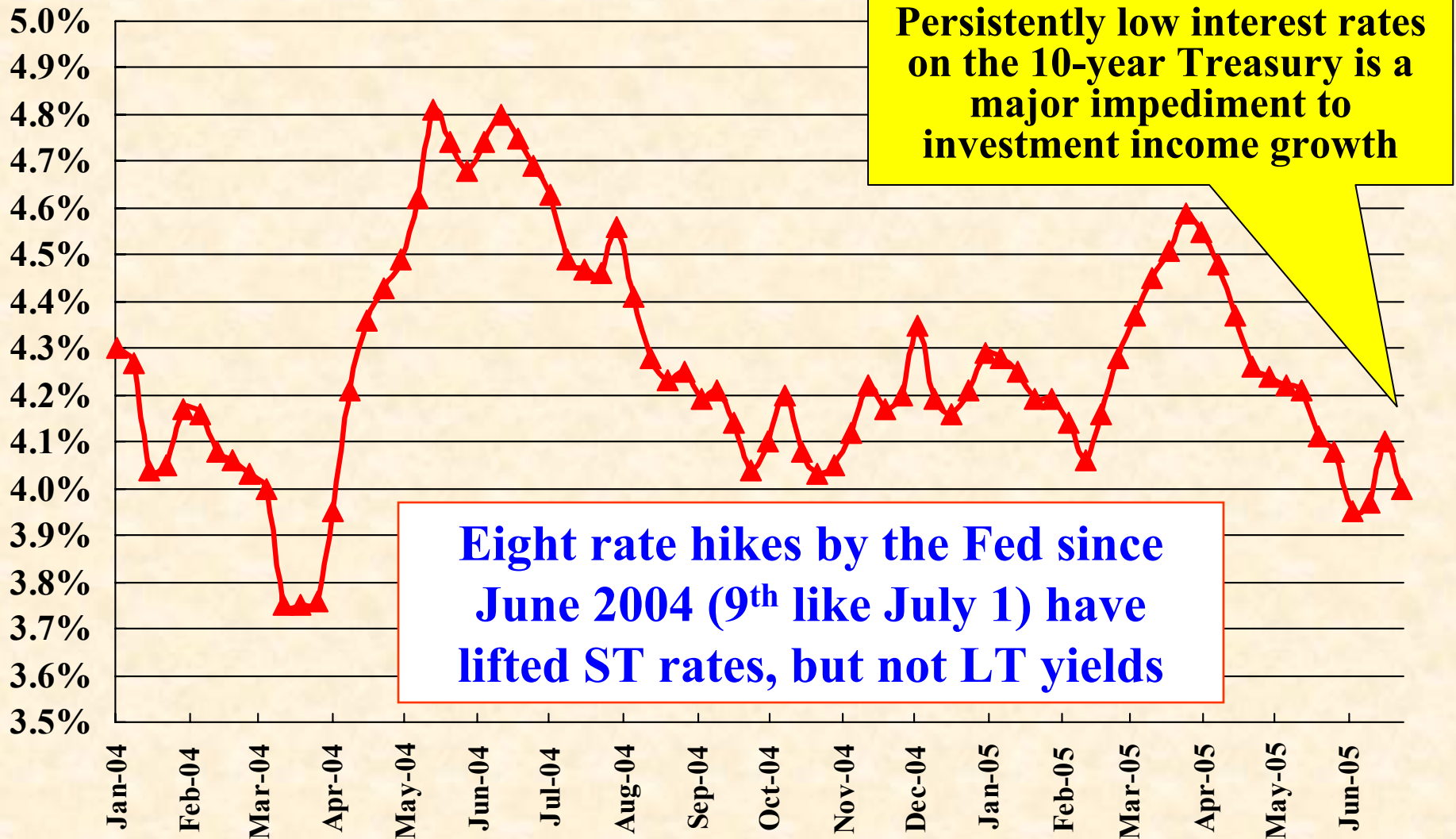


# *Interest Rates: Lower Than They've Been in Decades, But...*



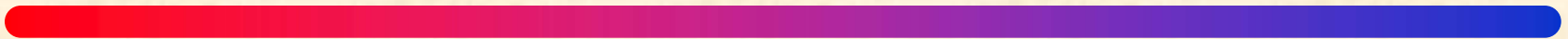


# *10-Year Treasury Yields Remain Low and Are Falling\**



# Portfolio Allocation

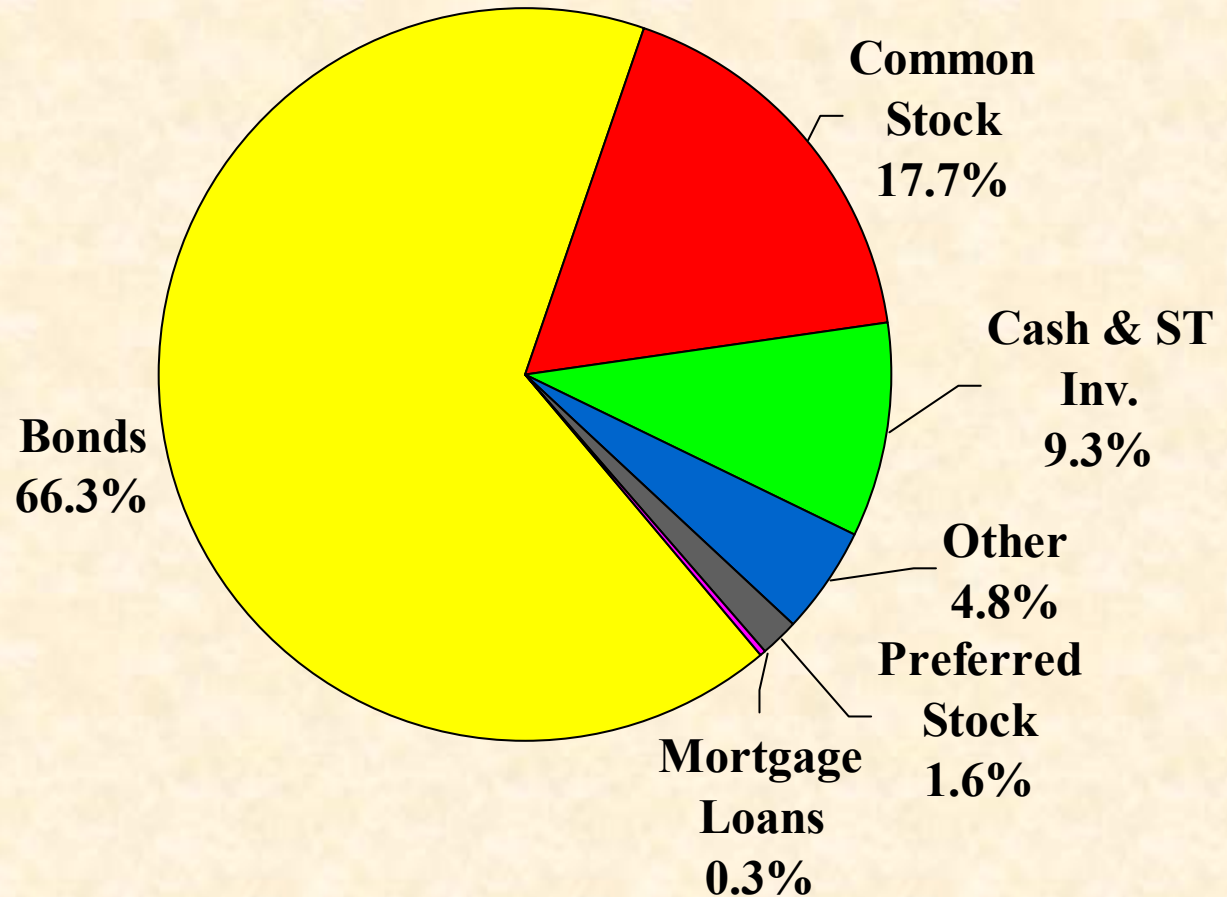
*Progressively More  
Conservative*





# P/C Insurance Industry Investment Portfolio, 2003

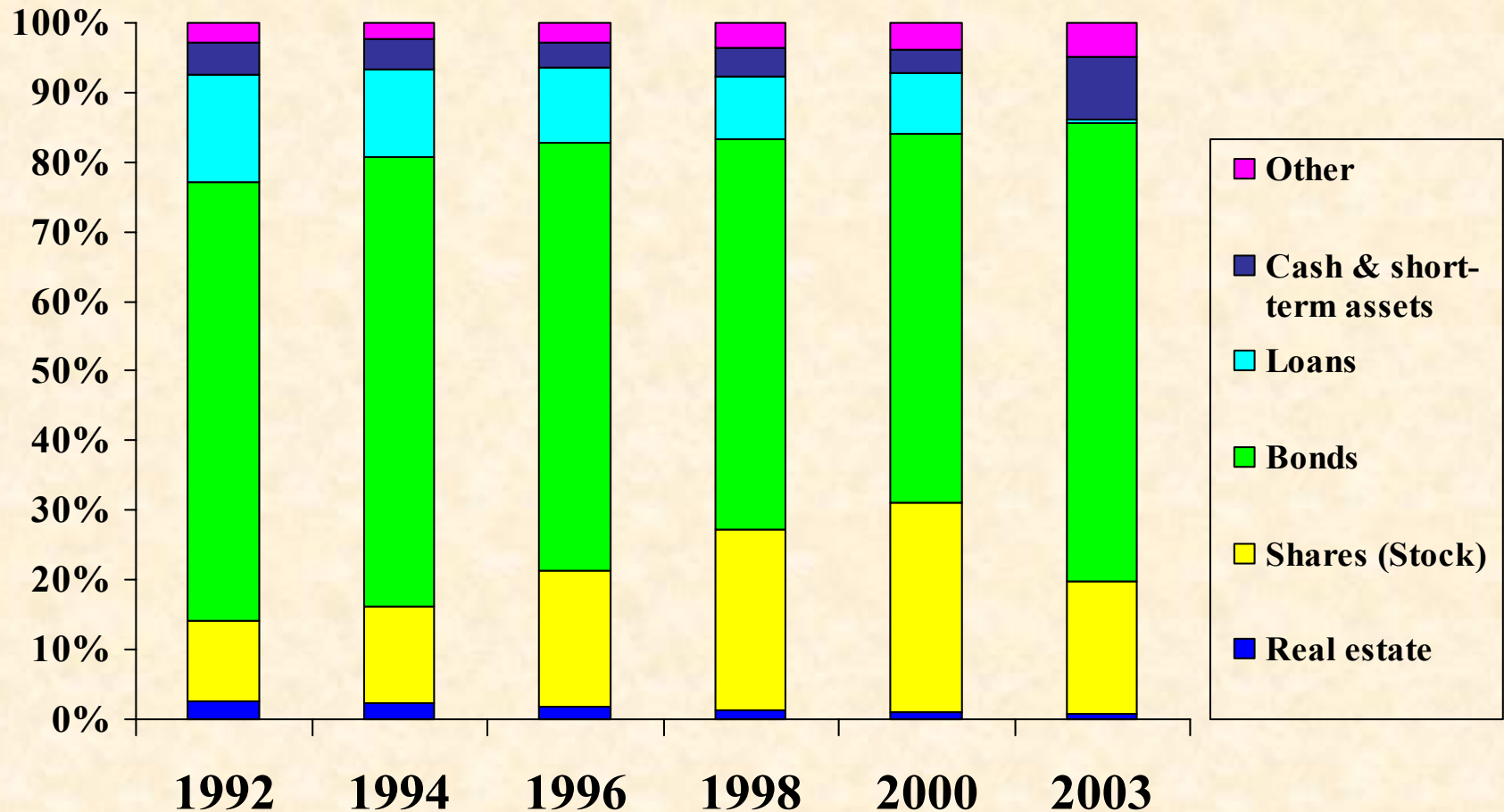
**P/C insurers portfolio is very conservatively invested, with 2/3 of invested assets held as bonds—mostly munis, high-grade corporate bonds and US Treasury securities**





# US Insurers' Asset Allocation, 1992-2003 (%)

Holdings of bonds and cash & short-term securities  
have increased substantially since 2000.

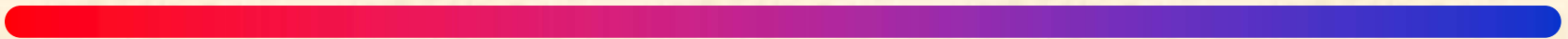


Includes separate accounts. "Loans" include mortgage loans.

Source: Swiss Re, Sigma No. 5/2002; 2005 P/C Fact Book, Insurance Information Institute.

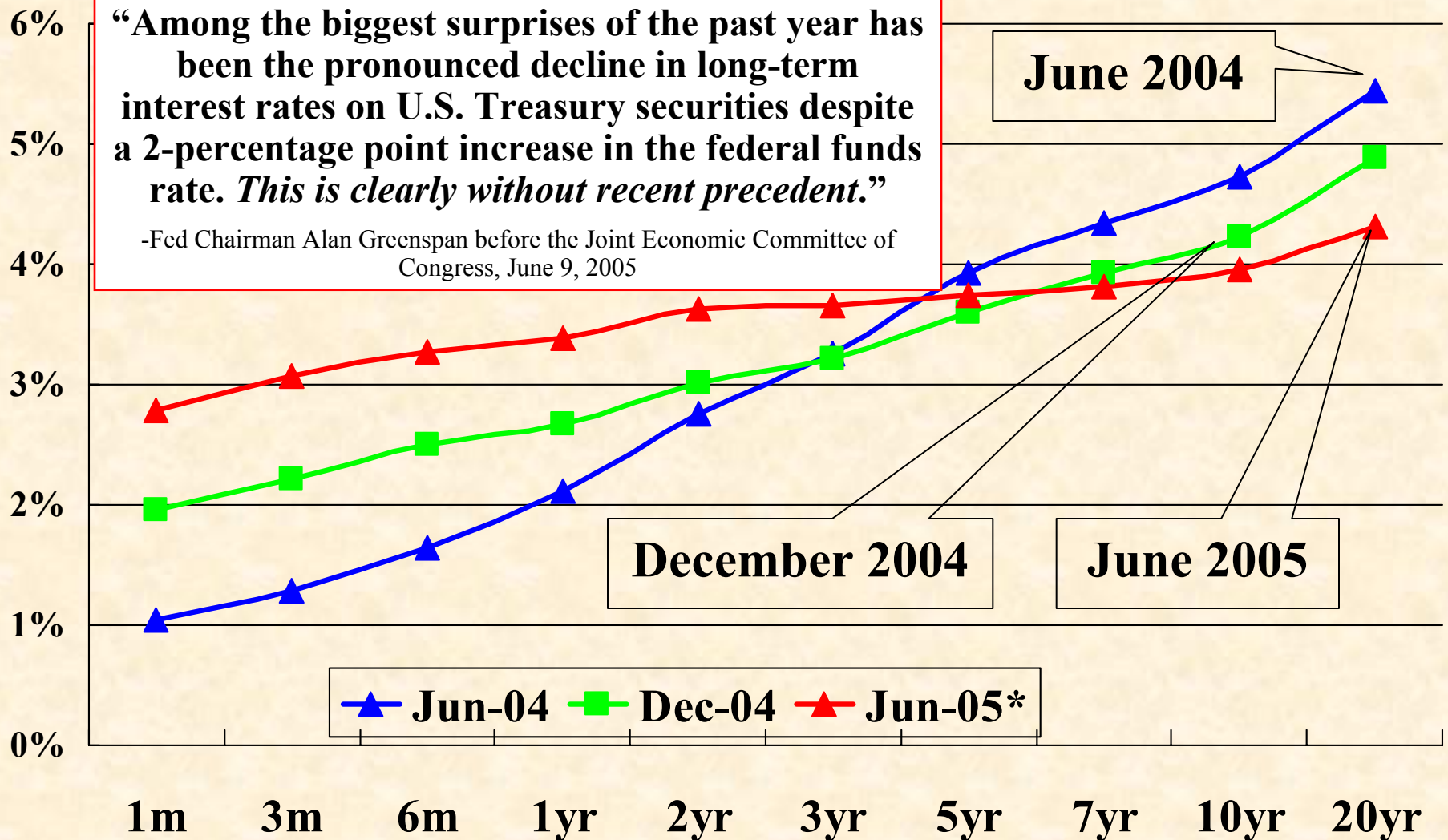
# Flat Yield Curve

*Insurers Are Marooned at  
Short End of Yield Curve*

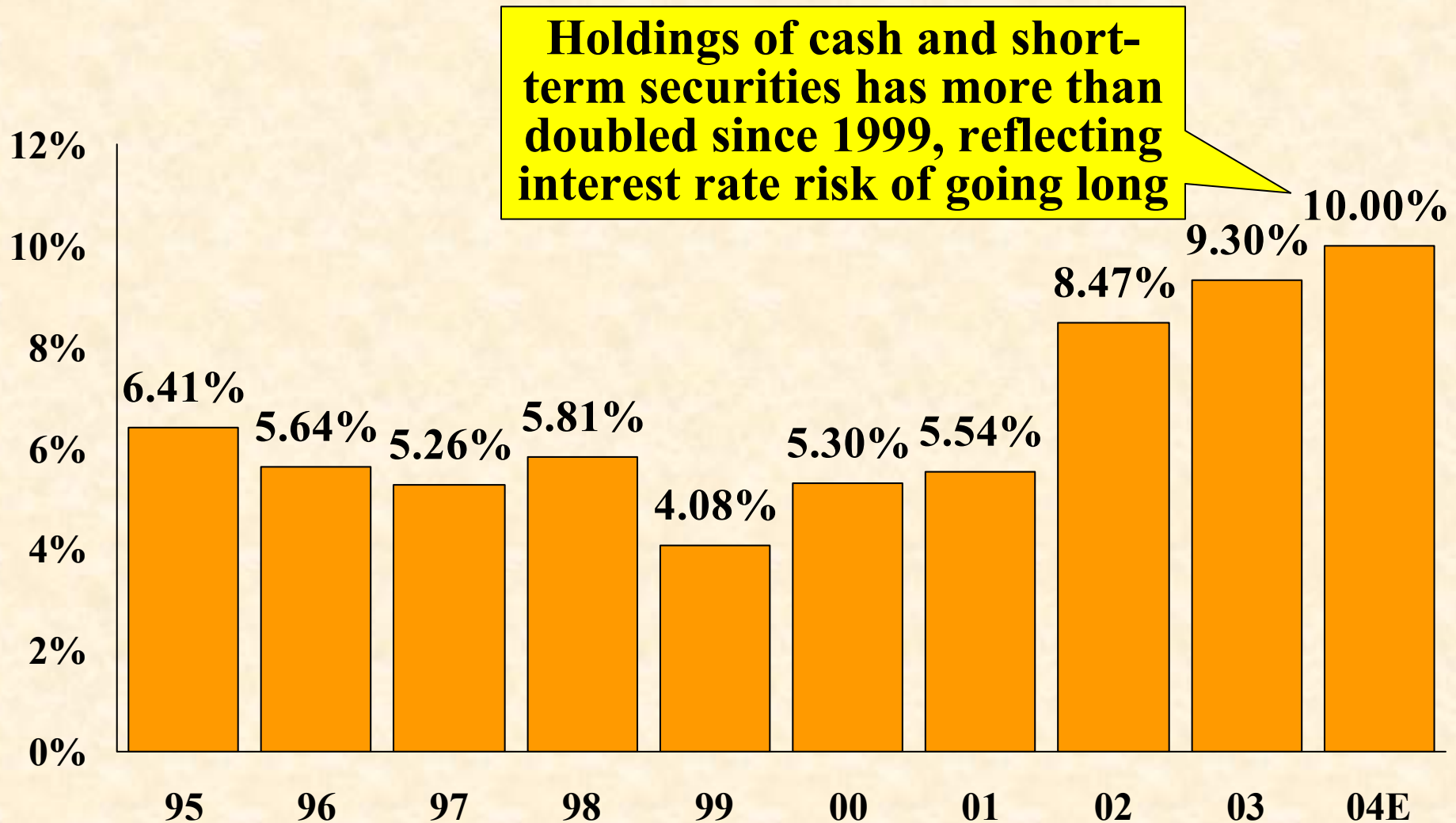




# The Treasury Yield Curve Has Become Very Flat

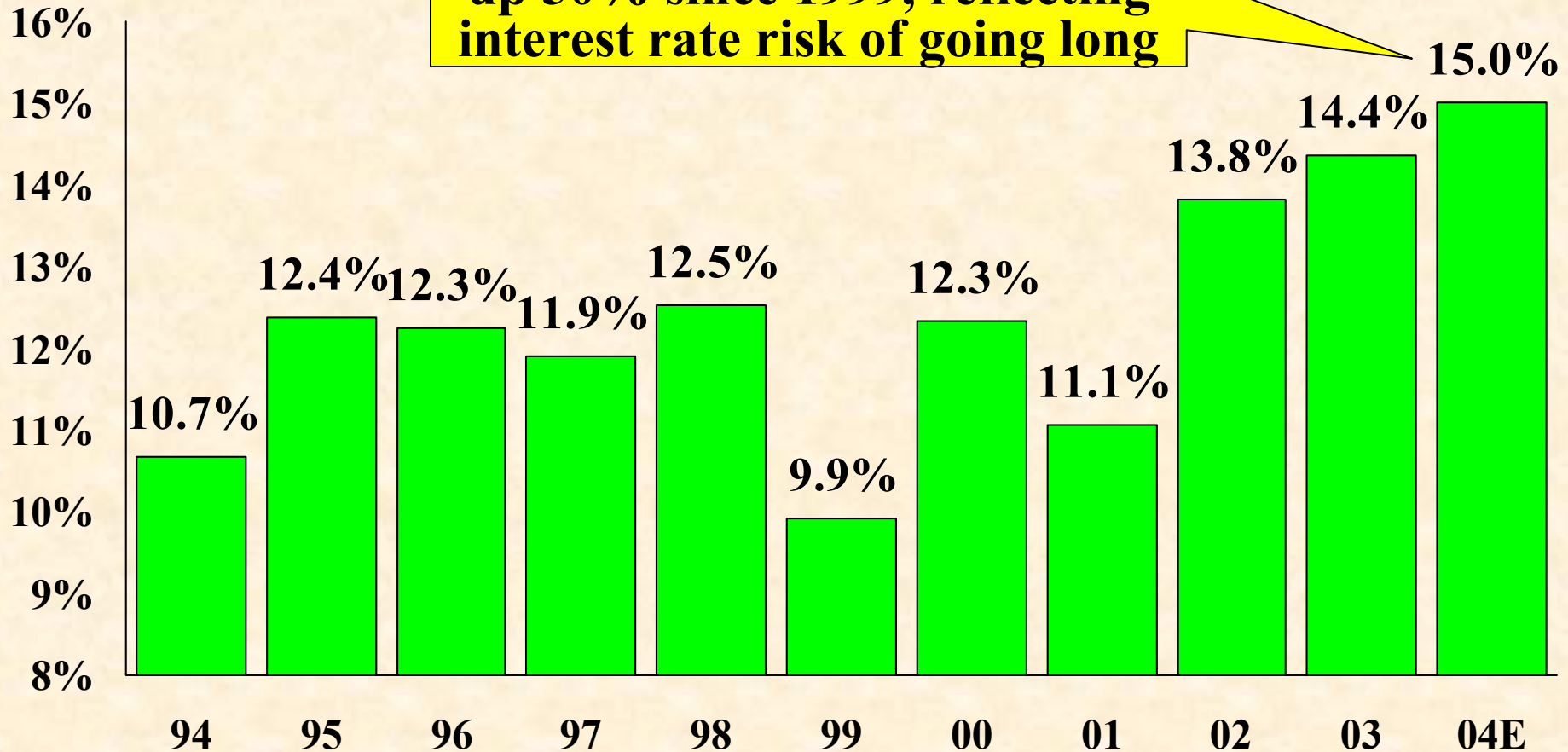


# *Proportion of P/C Portfolio Invested in Cash and ST Securities*



# *Proportion of P/C Bond Portfolio With Maturities of 1 Year or Less*

**Holdings of bonds with maturities of 1 year or less are up 50% since 1999, reflecting interest rate risk of going long**



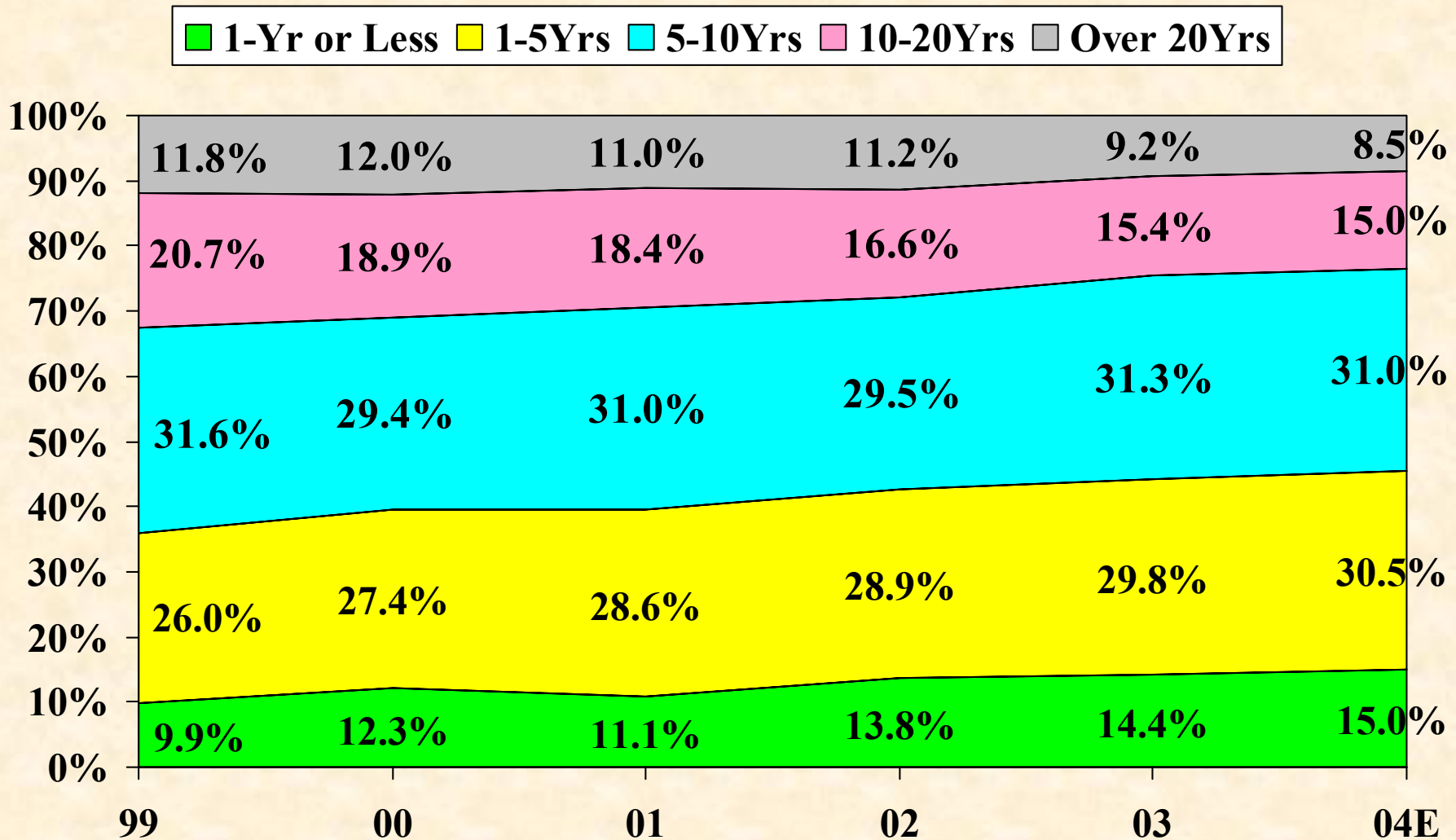
# *Proportion of P/C Bond Portfolio With Maturities of 10 to 20 Years*

**Holdings of bonds with maturities of 10-20 years is down by 27.5% since 1999 and 33.6% since 1994, reflecting interest rate risk aversion**





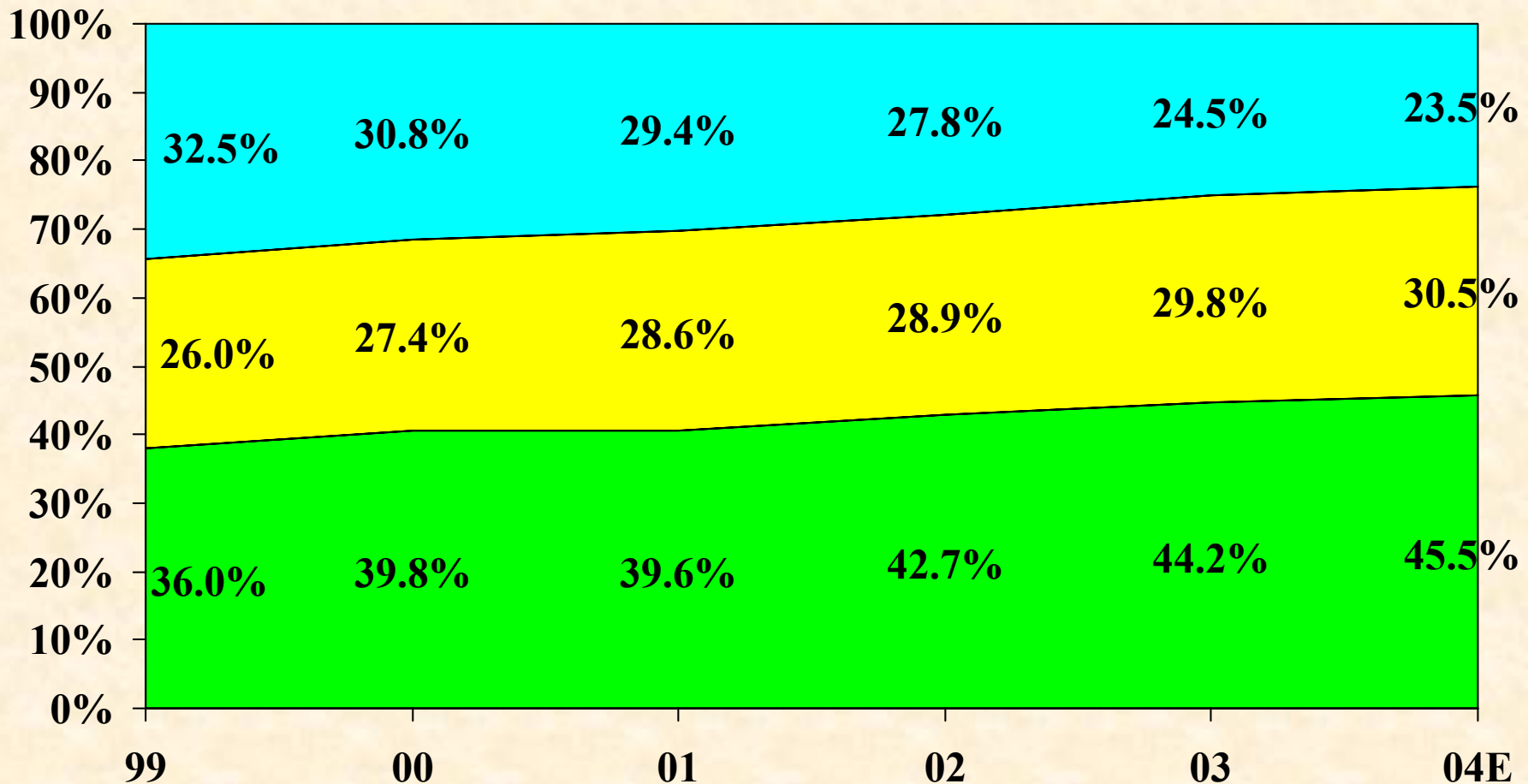
# Maturity Distribution of P/C Bond Portfolio, 1999–2004E





# *Maturity Distribution of P/C Bond Portfolio, 1999–2004E*

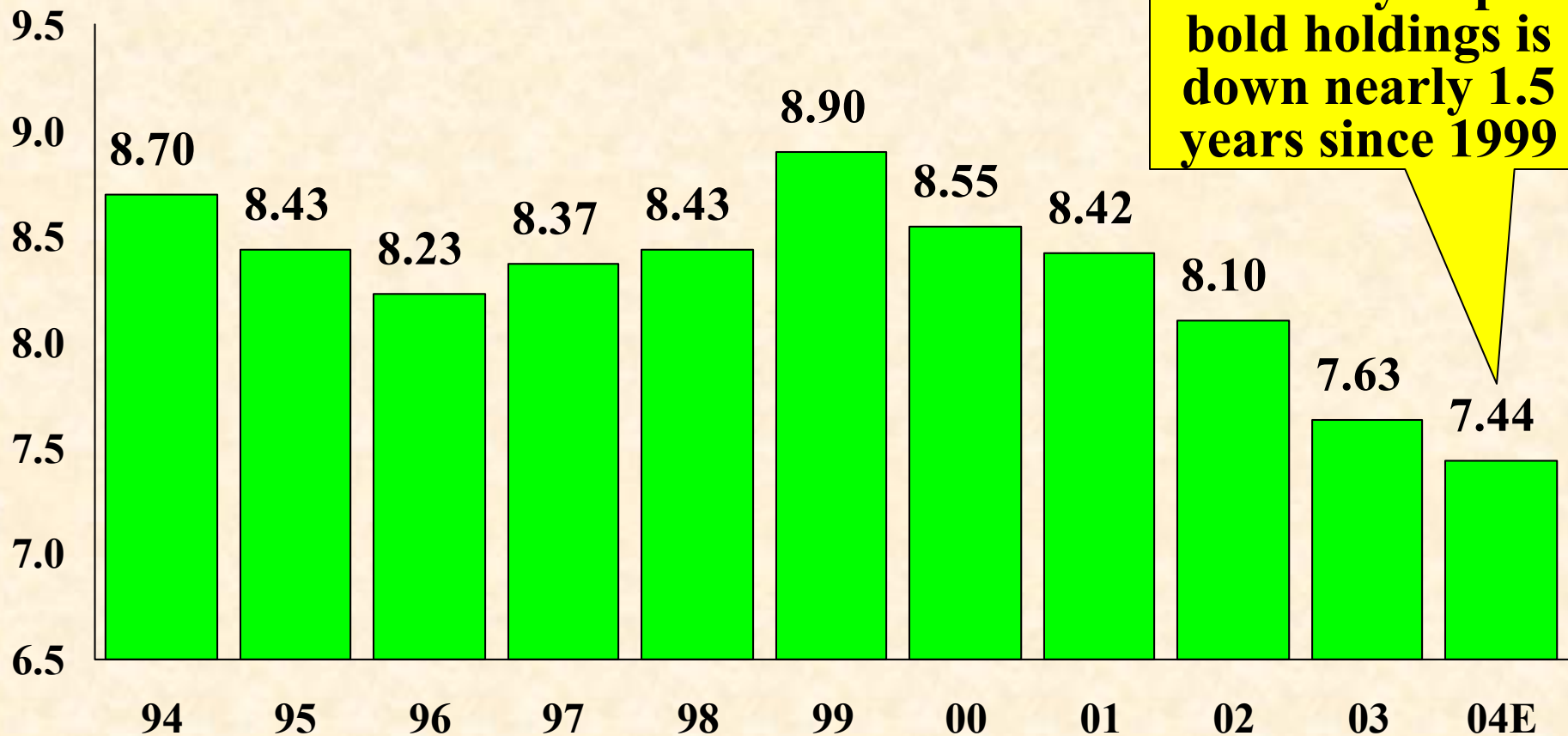
■ 5 Yrs or Less ■ 5-10Yrs ■ Over 10 Years





# Average Maturity of Bonds Held in P/C Portfolio, 1994-2004E\*

Average Maturity in Years



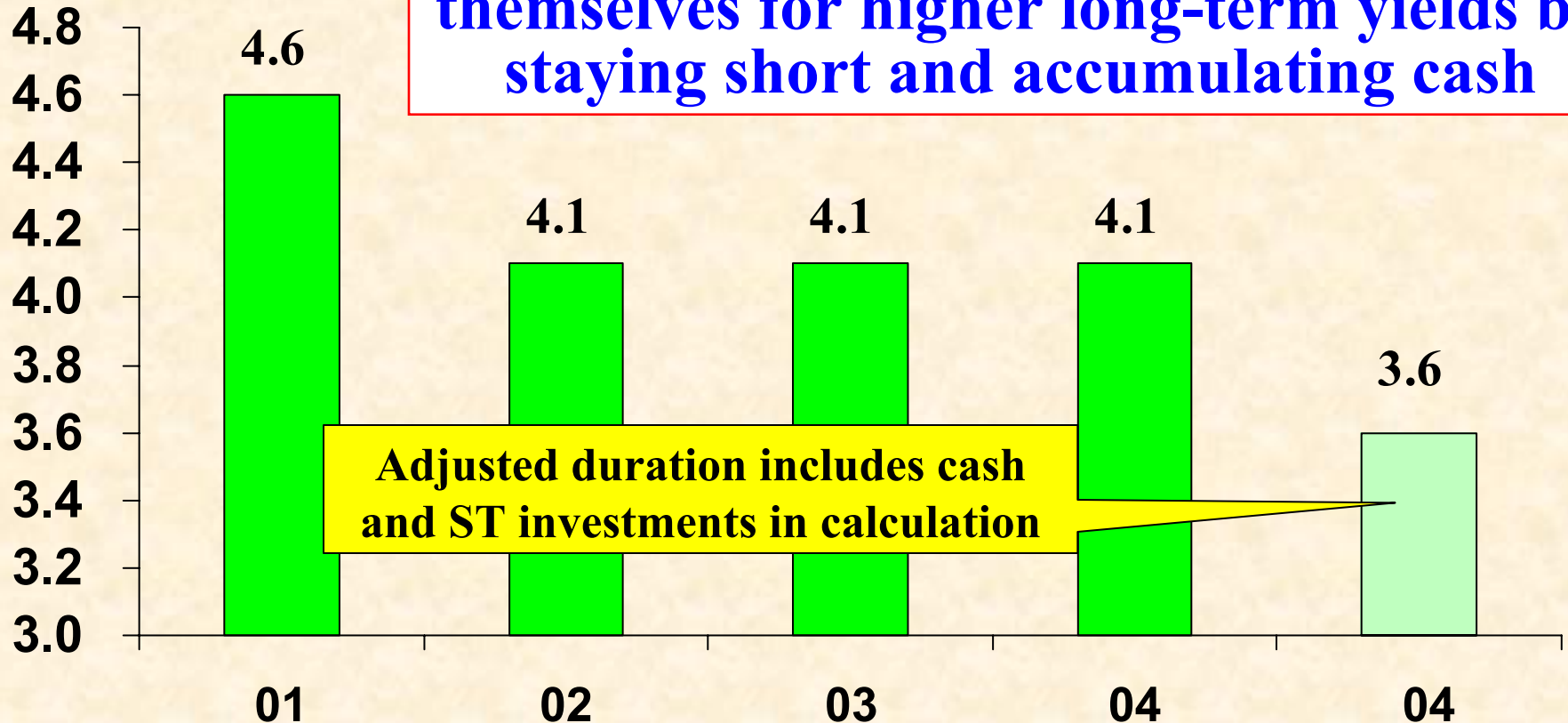
\*III estimate for 2004. Excludes cash and short-term securities.

Source: A.M. Best; Insurance Information Institute



# *Duration of P/C Fixed Income Portfolio, Selected Cos., 2001-2004\**

**Average duration is falling as insurers minimize interest rate risk and position themselves for higher long-term yields by staying short and accumulating cash**



\*As of Dec. 31 of each year. Based on sample of 50 p/c insurance companies.

Source: Credit Suisse First Boston.

(Adjusted)

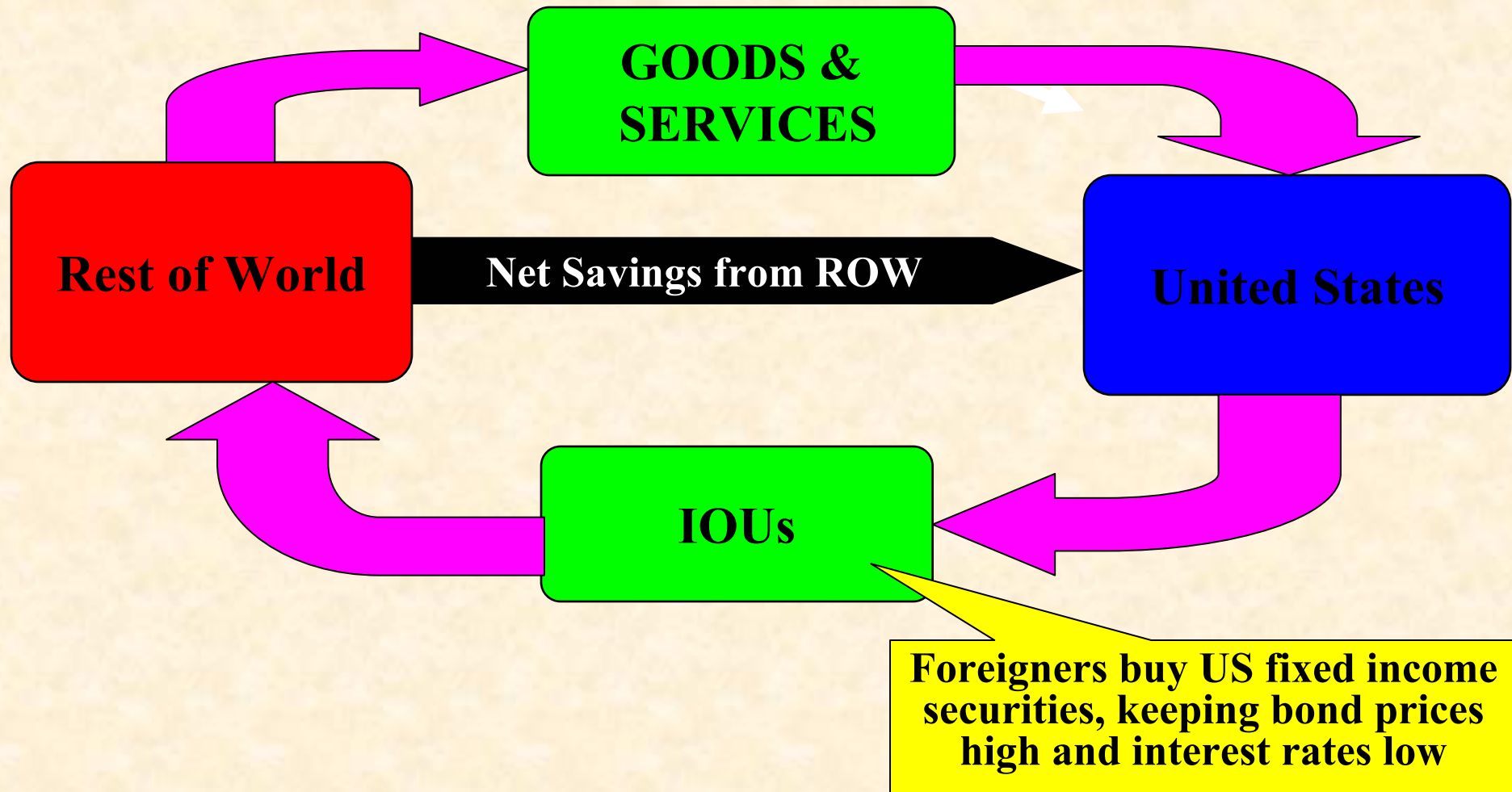


# *Reasons for Persistently Low Long-Term Interest Rates in the US*

- **Expectation of Future Economic Weakness**
  - Weakness may be global in scale
  - Inflation fears for the longer-term are therefore subdued
- **Foreign Central Bank Purchases of US Treasuries**
  - Especially China & other Asian central banks
- **Falling Interest Rates in Other Major Economies**
  - Other central banks cutting rates (or holding constant)
- **Excess of Savings Elsewhere in World Relative to US**
  - Direct result of massive US trade imbalances
  - Money comes back to US in form of purchases of US bonds
- **Weakness in Euro; Crisis of Confidence in EU**
  - Rotation out of Euro and back into the US dollar



# *US Current Account Deficit, Foreign Savings Help Keep US Interest Rates Low*



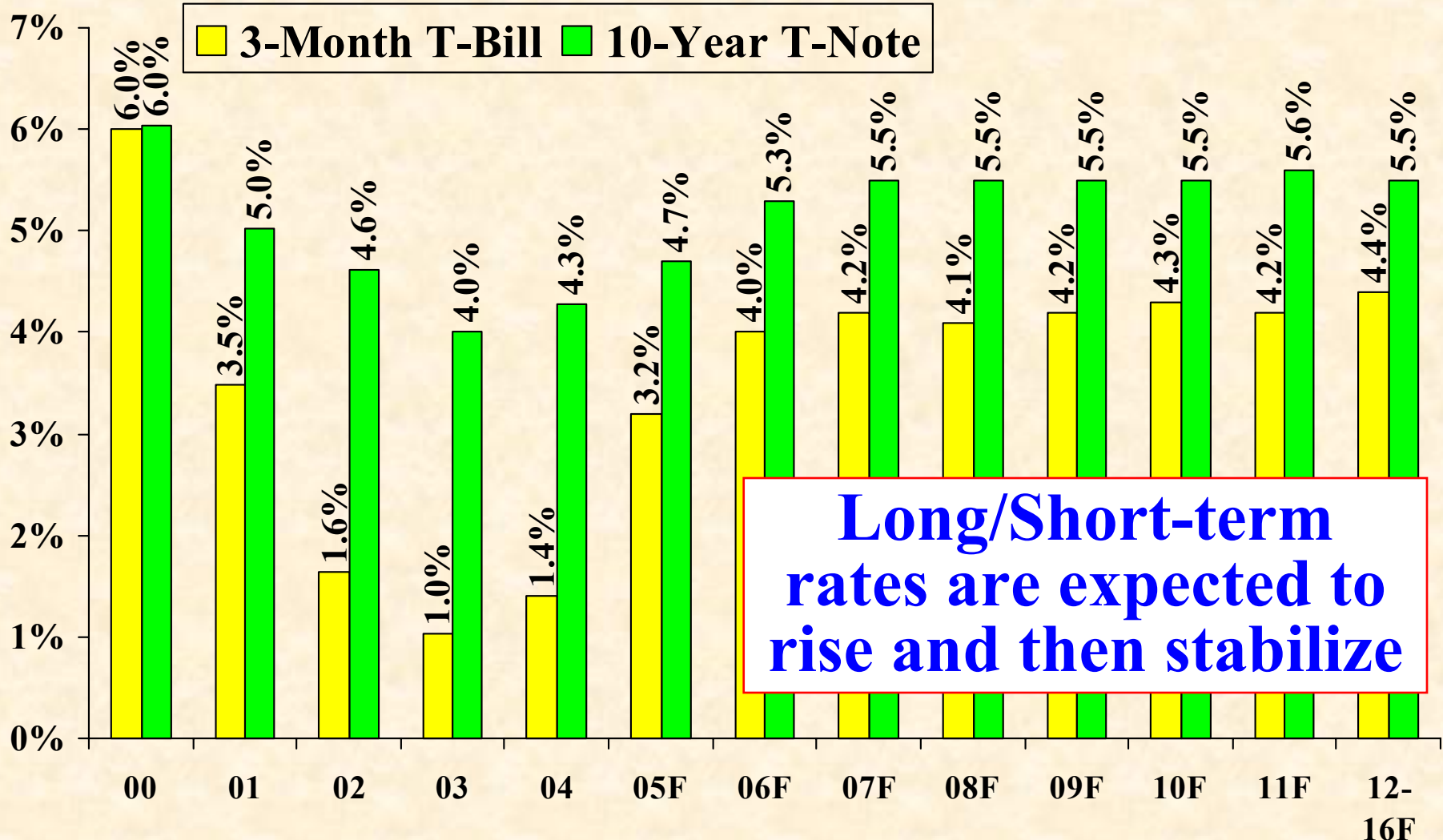


# *What Could Force US Long-Term Interest Rates Upward?*

- **Expectations of Stronger Economic Growth**
  - Currently no reason for such expectation in US or abroad
- **Building Inflationary Expectations**
  - Oil at \$60/barrel? \$100/barrel?
  - High global commodities prices
- **Rising Interest Rates Abroad**
  - **UNLIKELY:** Other central banks want to stimulate their economies
- **Reduction of Current Acct. Deficit (now more than 6% of GDP)**
  - Reduces flow of cash back to US in form of purchases of US bonds
- **Chinese Shift to Purchase of Real Assets**
  - Unocal, Maytag, IBM P/C; (Shift from Treasuries—currently hold \$660B)
    - Get readily for lots of China bashing & protectionism
- **End of Chinese Currency Peg**
  - Theoretically makes Chinese goods more expensive improving US trade situation
  - Conventional wisdom on impact is likely overblown



# *Interest Rate Forecast, 2005F-2016F*



Source: Board of Governors, Fed. Reserve System; Blue Chip Economic Indicators as of March 2005.



# *Insurance Information Institute On-Line*

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