

## Breaking down the data

### Summary of findings from the 2023 Statutory Filings and investment considerations for U.S. insurers

While the Statutory Filings data represent the aggregate of insurance company general account assets invested in 2023, it is important to keep in mind what was taking place, both geopolitically and capital markets, that could have influenced some of the decision-making process. From 2022 into 2023, interest rates were increasing rapidly, inflation was spiking, supply chain issues remained, and geopolitical unrest mounting. This continued to play out for most of last year, with attention shifting to when the U.S. Federal Reserve was going to pivot on its interest-rate stance and if the United States was going to enter a recession.

#### Overall Highlights

Net investment income earned increased significantly in 2023, for both U.S. Life insurers and P&C insurers (ex-Berkshire Hathaway), up 9.6% (to a new high of \$225.25 billion) and up 27.7% (to \$59.1 billion), respectively.

A number of long-standing trends that began years earlier from the low interest rate environment remained prominent, namely allocations to certain less correlated alternative asset classes such as the move to Schedule BA assets, Structured Securities, and private markets in general.

Broadly speaking, from an overall allocation perspective among Life, P&C and Healthcare companies, insurers' weighting toward bonds marginally decreased, but nothing substantial. The more significant move, however, could be seen in duration and credit positioning. Our analysis indicates this can be attributed to how insurers have chosen to position portfolios in the rising-rate environment, either opting to increase cash holdings until determining when to extend duration or locking in higher yields by extending the duration with high-quality assets.

#### Fixed Income

Based on SNL year-end 2023 data

##### Summary

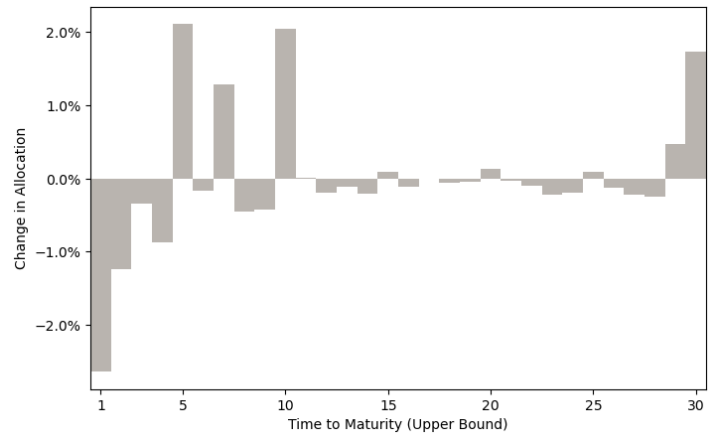
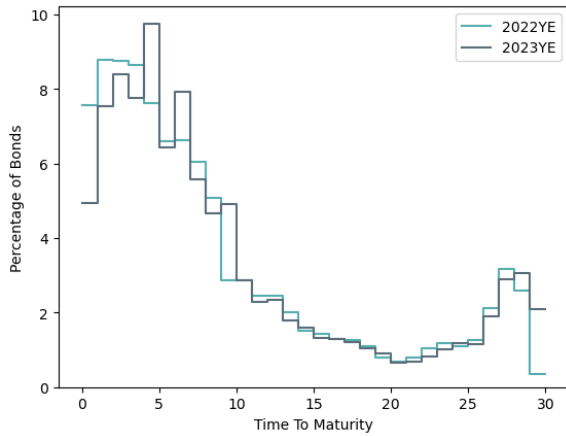
	P&C	Life	Health
Cash	▬	↑	↑
Duration ex Cash	↑	↑	↑
Credit Quality	↑	↑	↑
Biggest Increases	Agency RMBS Corporates ABS (excl. CLO)	ABS (excl. CLO) CLO	Agency RMBS Treasuries
Biggest Decreases	Municipals Treasuries	Corporates Non-Agency CMBS	Bond Funds Non-Agency CMBS

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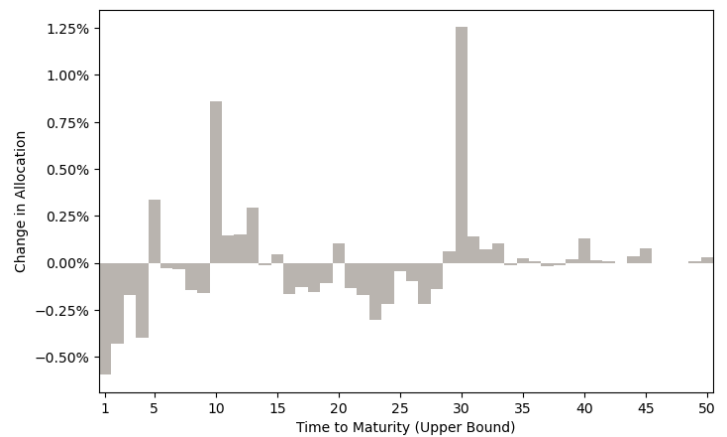
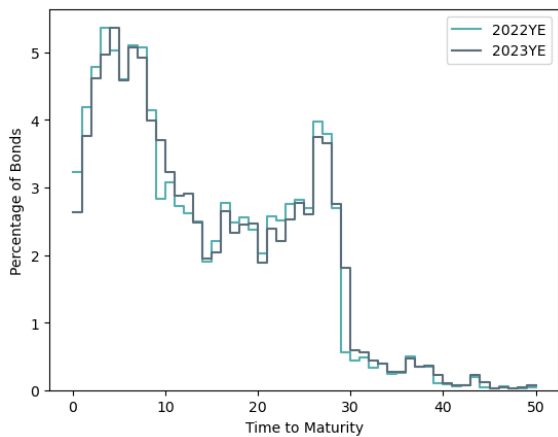
Looking at the fixed income securities bought and sold throughout 2023, we were able to identify certain similarities and differences across industries. On average, insurers increased the duration in their portfolios and enhanced the credit quality while still holding cash on the sidelines. Across industries, Agency RMBS was used mainly to increase the duration of the portfolio, picking up yield compared to Treasuries while possibly exposing the portfolio to convexity risks that would need to be managed. While the relative allocation in Agency RMBS for Life remained flat and allocation shifts from Corporates to Structured Securities, such as ABS and CLO, were duration neutral, P&C companies decreased their (since years falling) municipal bond allocation further and Health companies mainly decreased their (mostly short duration) bond fund holdings.

While the average maturity of bond portfolios increased, the maturity profile is very industry specific and can be seen in the graphs below. In general, we see most investments on the curve at 5-, 10- and 30-years, with P&C also utilizing the 7-year spot.

**Maturity Distribution ex-Cash for P&C**



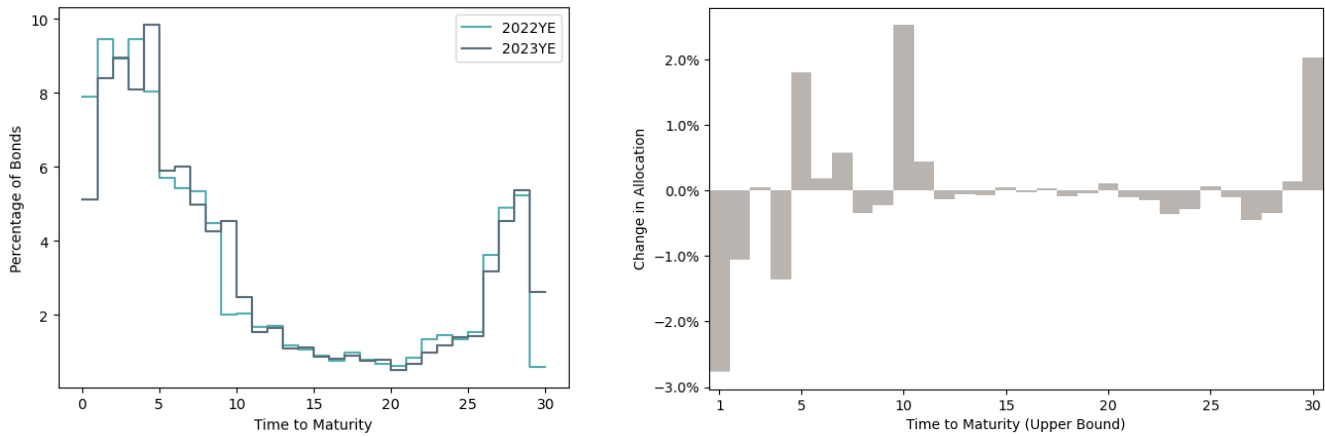
**Maturity Distribution ex-Cash for Life**



Source: SNL YE2023 Data

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Maturity Distribution ex-Cash for Health



Source: SNL YE2023 Data

Along these lines there also appeared to be a migration toward higher-rated investment-grade bonds with NAIC 1 designations, and away from NAIC 2 and below. While DWS thinks it is too early to signal this a “trend,” it is something worth watching especially if, and when, the Fed begins lowering interest rates and income profiles changes.

This general shift toward higher credit quality is implemented different across industries. While a reduction of BBB and below holds true for all industries, Health and P&C favor NAIC 1.A securities more than Life, which is a result of the increase in Agency RMBS allocations.

Allocation (vs. 2022YE)

	P&C	Life	Health
AAA (incl. U.S. Government)	40.2% (2.1%)	18.5% (0.0%)	44.3% (2.2%)
AA	15.5% (-1.6%)	11.3% (0.6%)	10.0% (-0.2%)
A	21.1% (0.3%)	28.9% (1.1%)	20.5% (-0.4%)
BBB	18.7% (-0.6%)	36.2% (-1.4%)	19.8% (-0.8%)
BB	2.2% (-0.2%)	3.2% (-0.3%)	3.3% (-0.3%)
B	1.8% (-0.1%)	1.4% (0.0%)	1.8% (-0.3%)
CCC & Below	0.5% (0.1%)	0.5% (0.0%)	0.3% (-0.3%)

Source: SNL Data 2023, based on NAIC designations

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## Real Estate

Within mortgage-backed securities, we observed a stable split between commercial and residential real estate, where commercial dominated residential for non-agency issues. However, in recent years we noticed a fast-increasing share of Residential Mortgage-Backed Securities compared to Commercial Mortgage-Backed Securities. The team views this in the context of the COVID office difficulties and see this as the industry becoming more discerning and savvy about the sectoral composition of the real estate market in both public and private assets. For private strategies, this might also mean exploring sector strategies even if they ultimately adhere to ODCE strategies (which, anecdotally, is something we are tending to hear from investors currently with the Office bottom potentially in sight). We remain cautious in the near-term as it relates to Office investments, however, our DWS Real Estate Research team is more optimistic toward Industrial and Retail sectors among commercial properties.

## Schedule BA

Another notable observation is among Schedule BA assets. While Life, P&C and Health companies all maintained allocations to private assets, the composition among different insurance types appears to be changing; another way to express that is certain private asset classes might be in vogue compared to others depending on insurance company type. And while the overall allocation to Schedule BA assets was steady when comparing 2023 to 2022, our view is that the momentum seen over the past few years was likely tempered due to the availability of public bond income in the market. Based on interactions with investors, however, we do not anticipate this reversing course. Despite relative spread benefits coming down, these investments still maintain high levels of diversification, positive accounting volatility benefits, and opportunities to participate in the origination process.

## Other trends that could remain in focus

For municipal bonds, the team thinks the downward trend (most notably in the P&C industry) will likely continue unless we see corporate tax increases, which currently seems unlikely. Taxable municipals can make sense in a portfolio context, especially to cover longer duration liabilities, but we do not foresee major increases in insurer portfolios.

The increase in Structured Products, mainly ABS, appears to have “more room to grow,” given their strong performance, attractive yields, and diversification benefits. CLOs were traditionally a growth driver for ABS allocations, but we saw stagnating, even slightly decreasing, allocations in P&C and Health portfolios, while Life insurers continued to increase their already larger allocation. It remains to be seen how future developments by the NAIC and economic impacts change the appetite for CLOs.

Also, the team believes credit positioning will continue to be important. High yield and BBB securities can potentially be beneficial for a portfolio, but there are increased opportunities to obtain yields with less risk currently. Additionally, the efficient frontier has not significantly steepened as spreads are comparably tight, which might lead insurers to re-evaluate their risk tolerance and invest more conservatively in their bond portfolios. Private alternatives however are “here to stay,” and we expect this area to grow, although more nuanced and not at the same rate as in previous years.

Duration positioning will likely remain a significant challenge especially as it pertains to when the market might see a Fed pivot. Higher interest rates for a longer period can have unintended consequences, including risks to financial stability, potentially leading to rapid rate cuts to support the economy. But if inflation remains high due to economic momentum, rate cuts may be delayed (there is always the possibility of an increase as well, although that is not being forecast). This makes positioning a nuanced topic, where liability structure, key rate durations, and convexities, especially when using securitized products to extend duration, should be considered. We will probably continue to see insurers adopting both approaches until the picture becomes clearer because right now it often implies an active bet on rates or at least an acceptance of downside risk.

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