
CAPTIVES Unleashed
MORE VALUABLE THAN EVER
April 15-17, 2024 · The Tulsa Club
Tulsa, Oklahoma
WRCIC
2024
WESTERN REGION CAPTIVE
INSURANCE CONFERENCE, LLC

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(UBS)

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Investment Director / Insurance
PNC Asset Management

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Economic Landings:
Touch-n-Go, Soft and Slow, or Something a Little More Interesting

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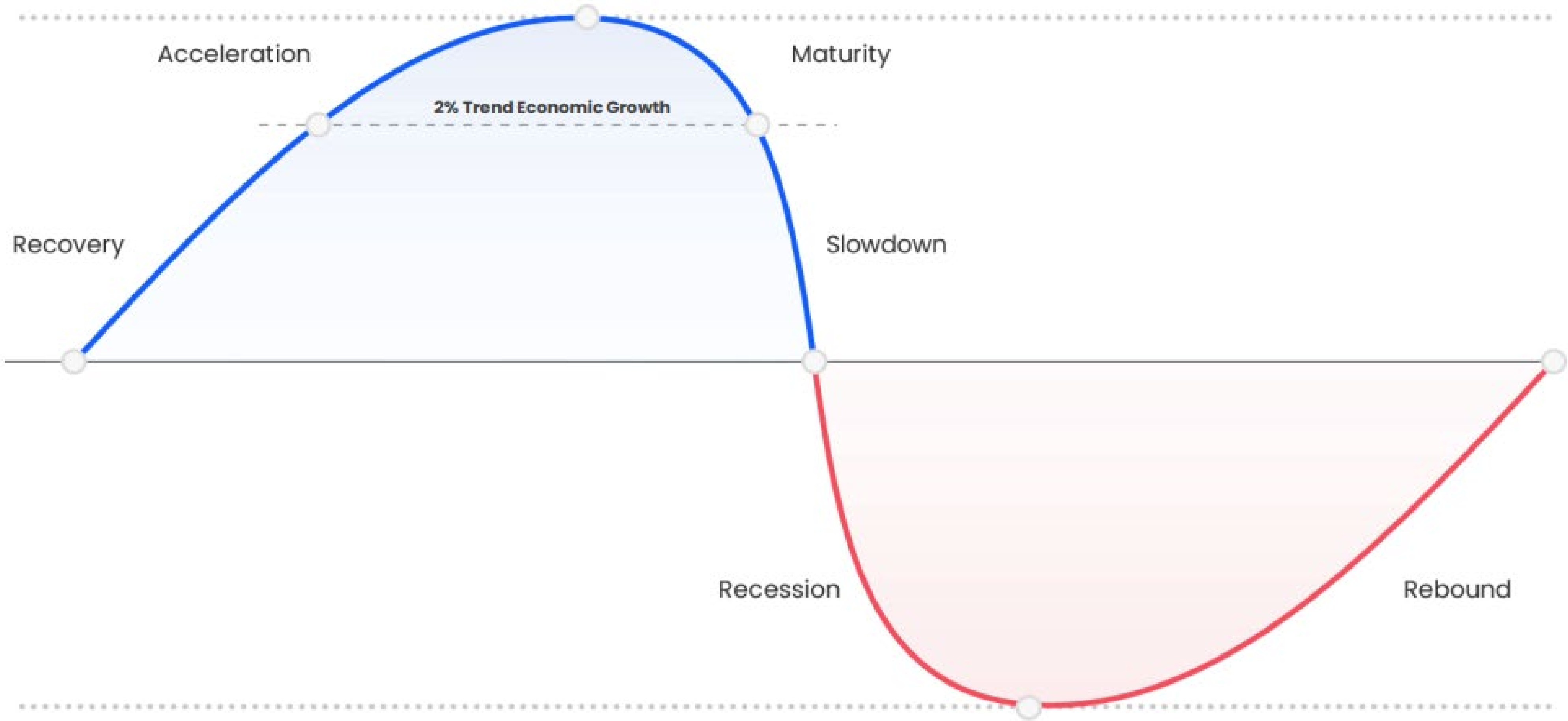
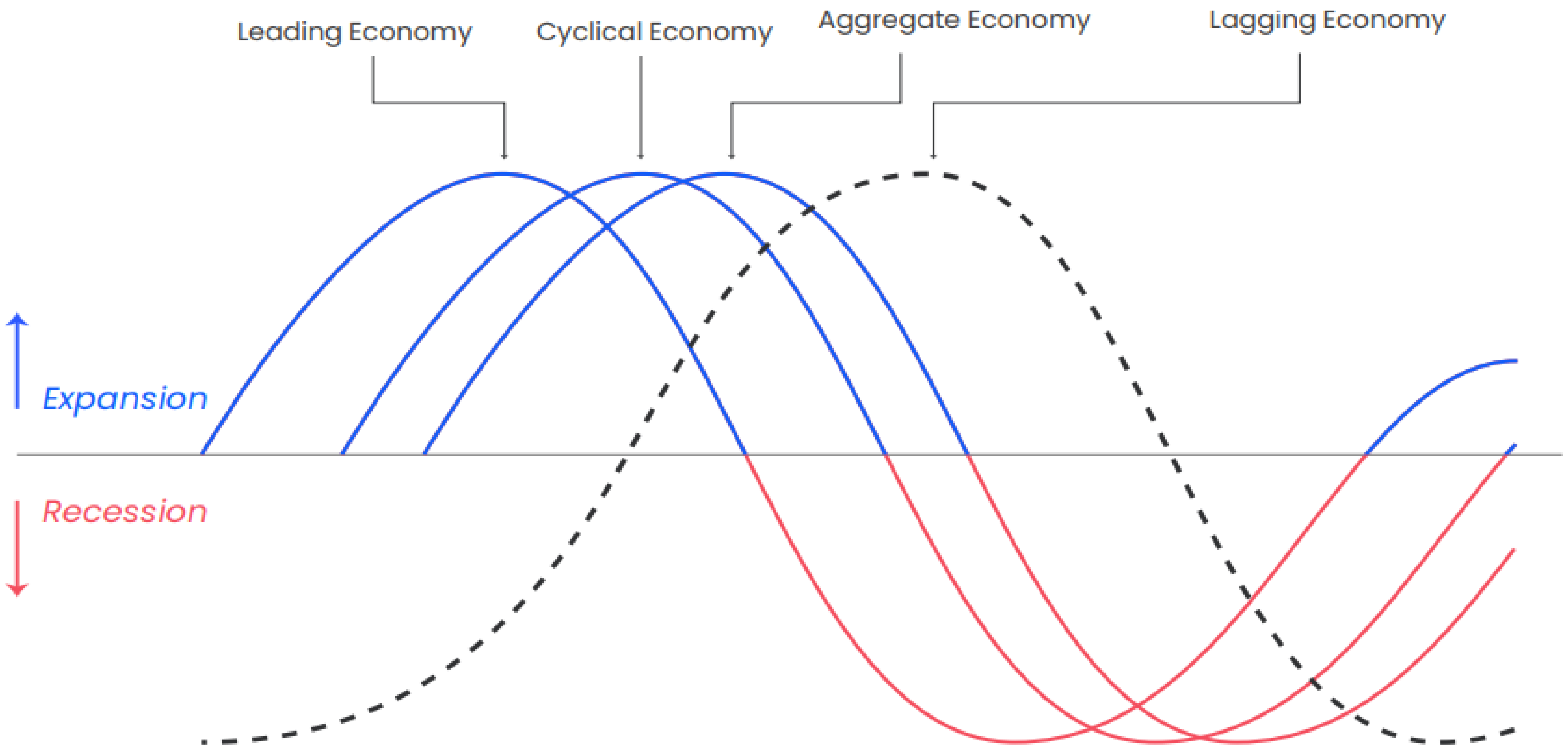
Takeaways From “The Oil Capital Of the World”

- The “Obvious” Recessionary Outcome (a little suspect)
- Turning the Business Cycle on Its Head (is it really different this time?)
- Probable Outcomes: Track 1 and 2 (but the list is growing)
- Risk Management: A Layered Approach (crosschecks)

Business Cycles: Cycle Is as Cycle Does



Business Cycles: The Rhythm of Long and Variable Lags



Obvious Recessionary Outcomes: Didn't See That Coming

- Inverted Yield Curve
- Conference Board LEI (Leading Indicators Indicators)
- GDI (Gross Domestic Income)
- Bank Lending Standards / Growth In Lending
- Manufacturing Indices
- Small Business Optimism (NFIB)
- Temporary Employees
- Full-Time Employees
- New Home Sales Prices
- Credit Card Delinquencies
- Bankruptcies
- Default Rates

Indicators of Recession: Broken or Just Bent? - The Yield Curve

The 2/10 yield curve has been continuously inverted since July 2022, exceeding a record 624 day inversion in 1978

Source: LSEG

Reuters Graphics

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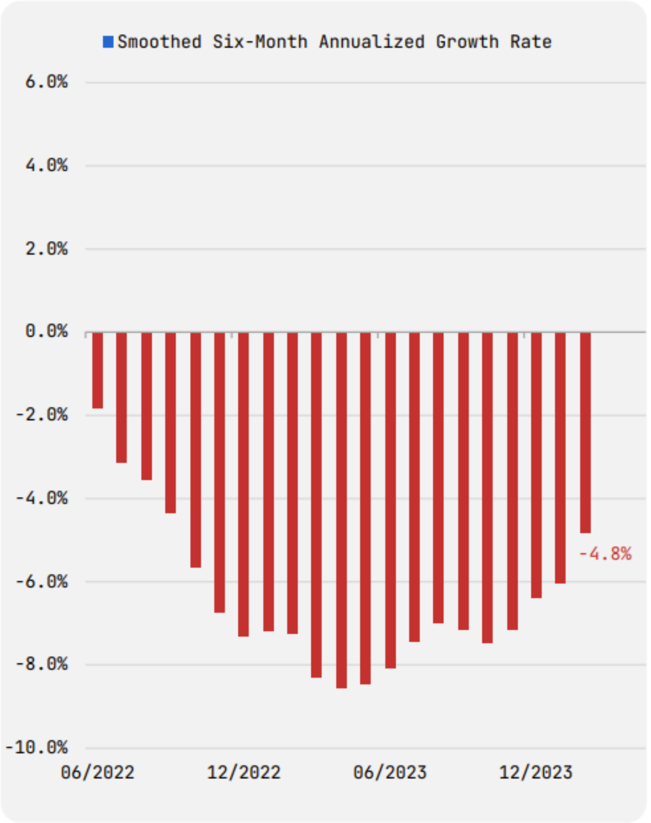
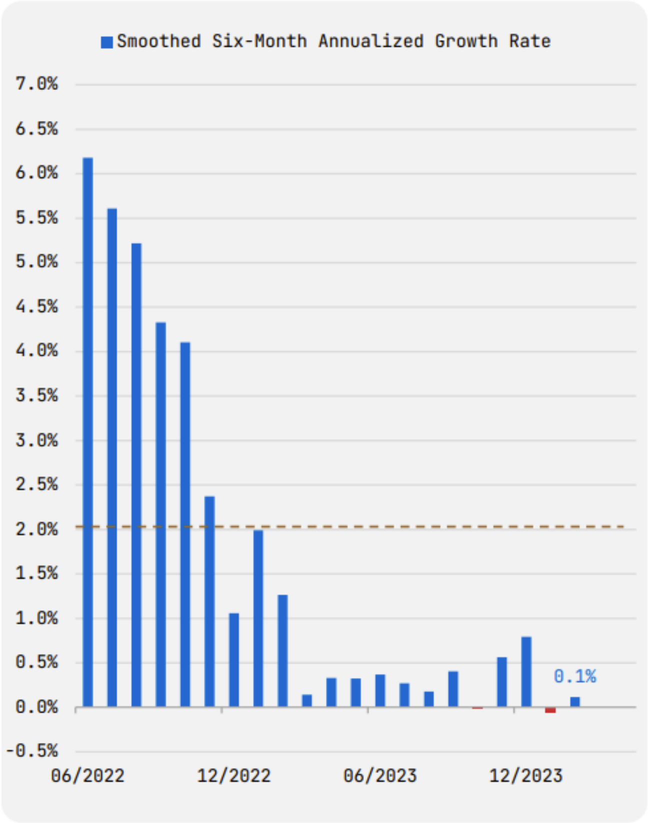
Indicators of Recessions: Broken or Just Bent? - LEI

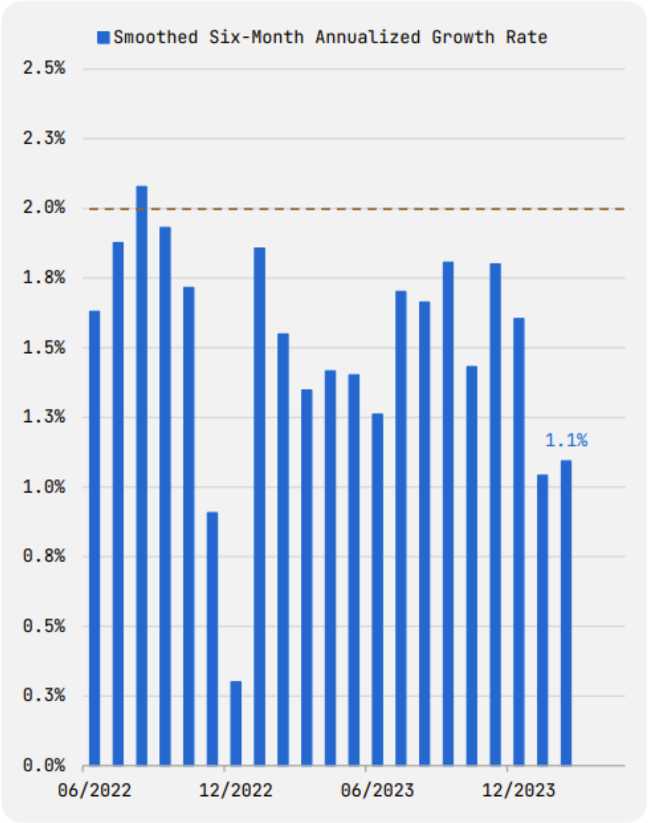
Leading Economy



Cyclical Economy



Aggregate Economy



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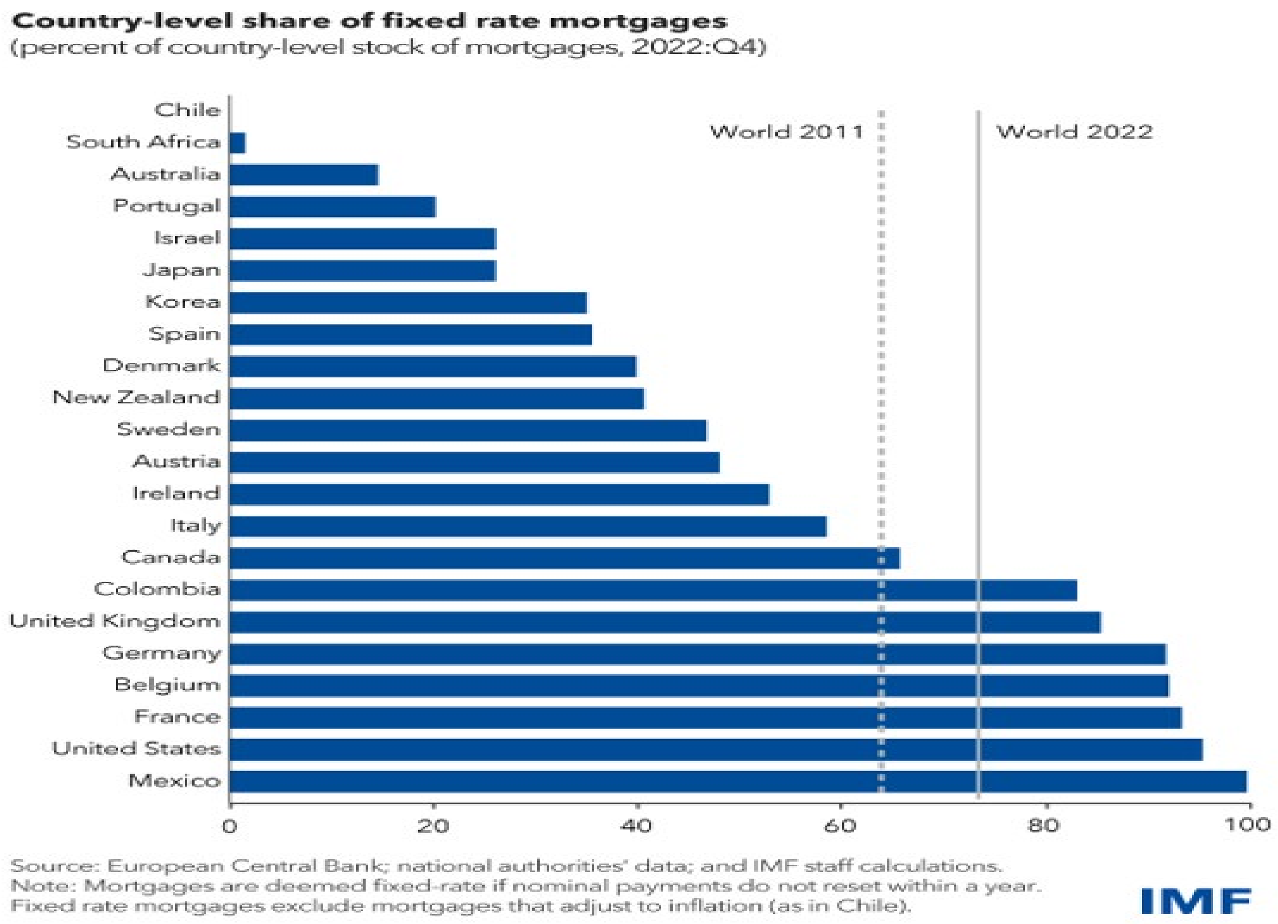
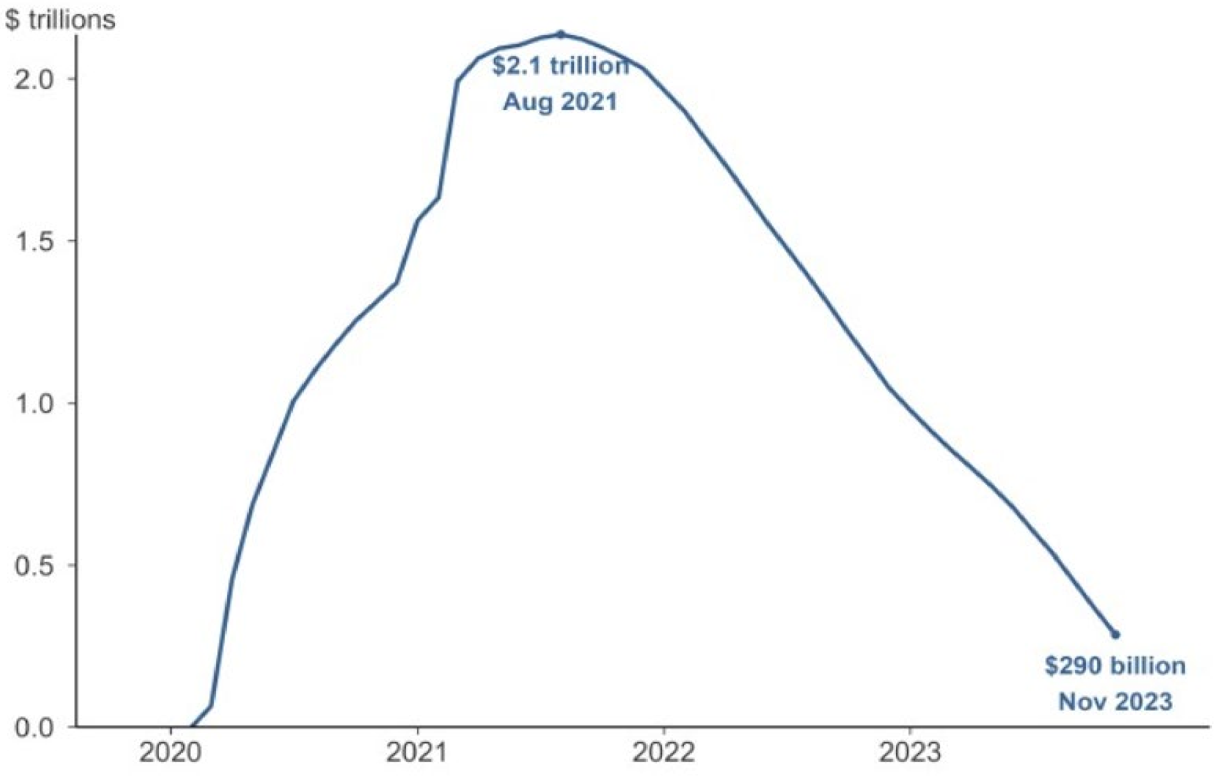
Why the Disconnect? - Interest Rate Sensitivity



Why the Disconnect? - Excess Savings

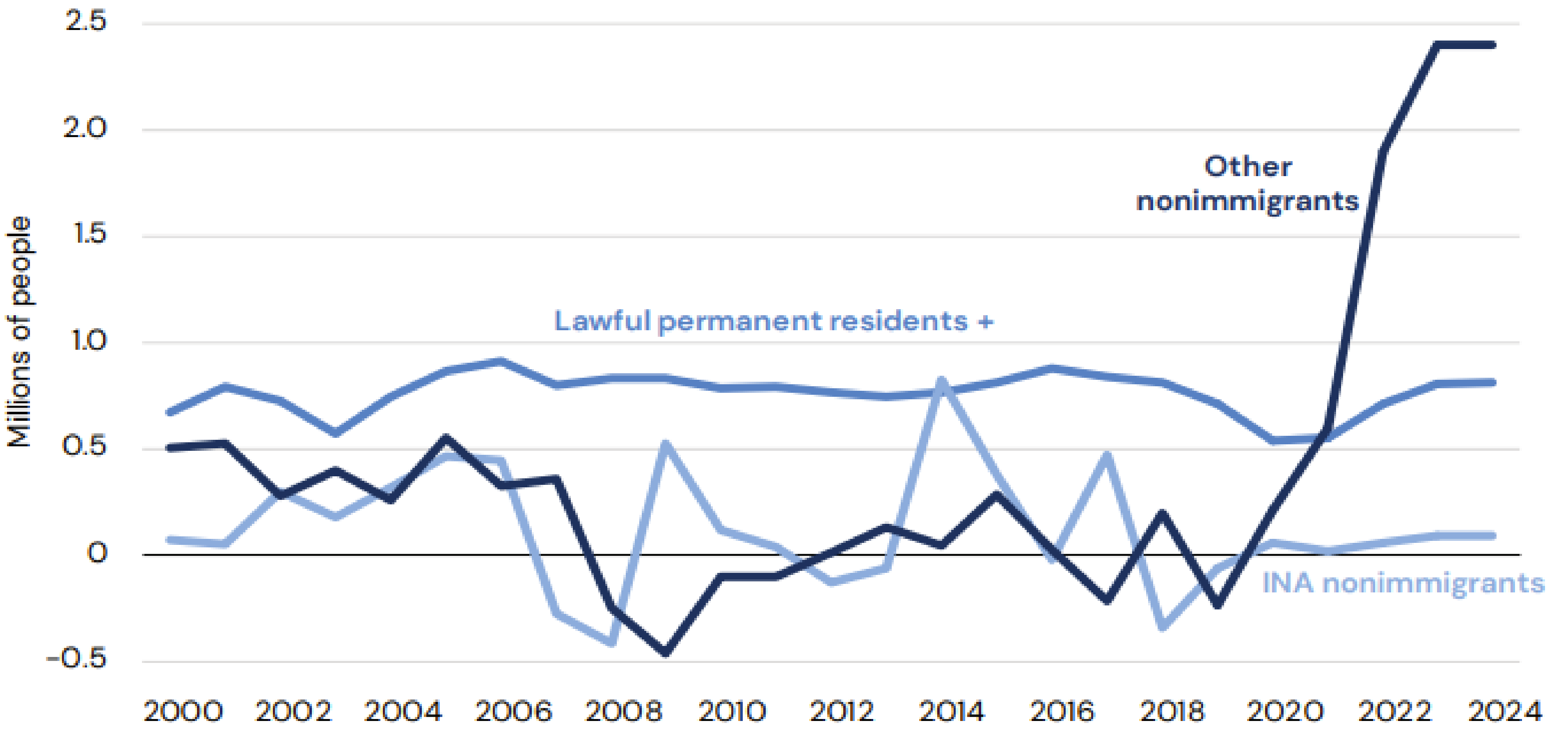
Chart 2: Cumulative aggregate pandemic-era excess savings



Source: Bureau of Economic Analysis and authors' calculations.

Why the Disconnect? - Labor Market Composition

CBO estimates of net immigration, by category, 2000–24



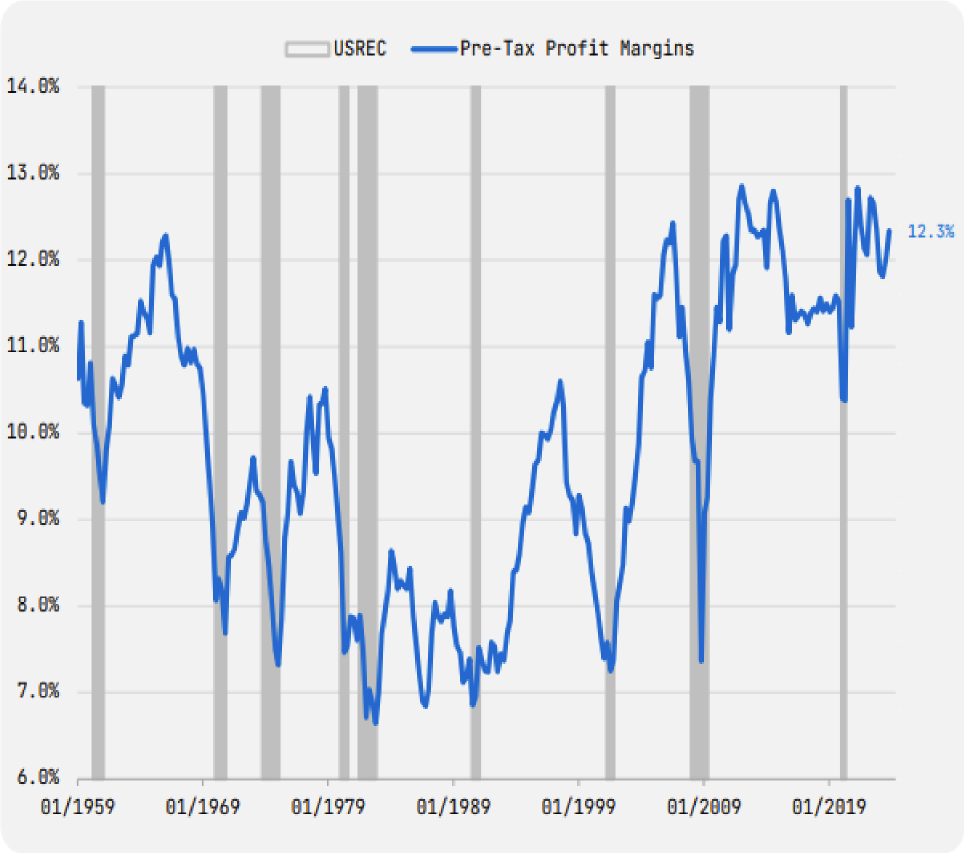
Source: CBO 2024.

Note: "Lawful permanent residents+" are lawful permanent residents (LPRs) and people who can apply for LPR status, such as refugees. "INA nonimmigrants" are Immigration and Nationality Act (INA) nonimmigrants, such as students and temporary workers. "Other nonimmigrants" (which CBO refers to as "other foreign nationals") are immigrants with a nonlegal or pending status.

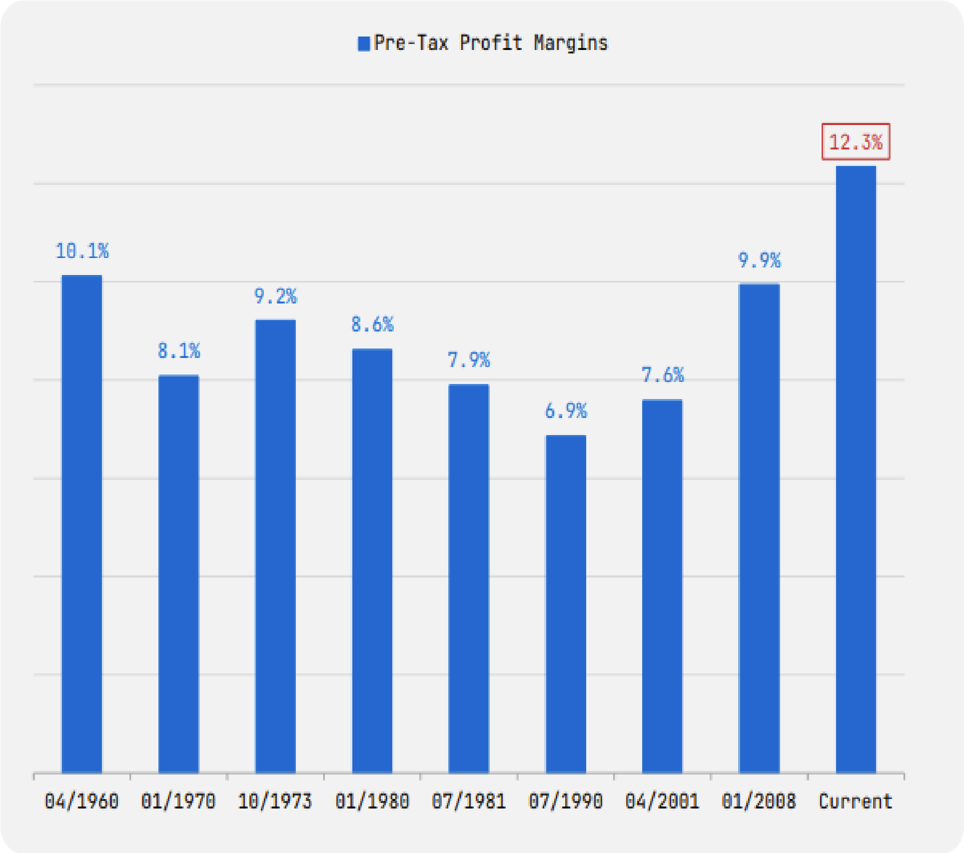
THE HAMILTON PROJECT
BROOKINGS

Why the Disconnect? - Labor Market Hoarding

Pre-Tax Corporate Profit Margins

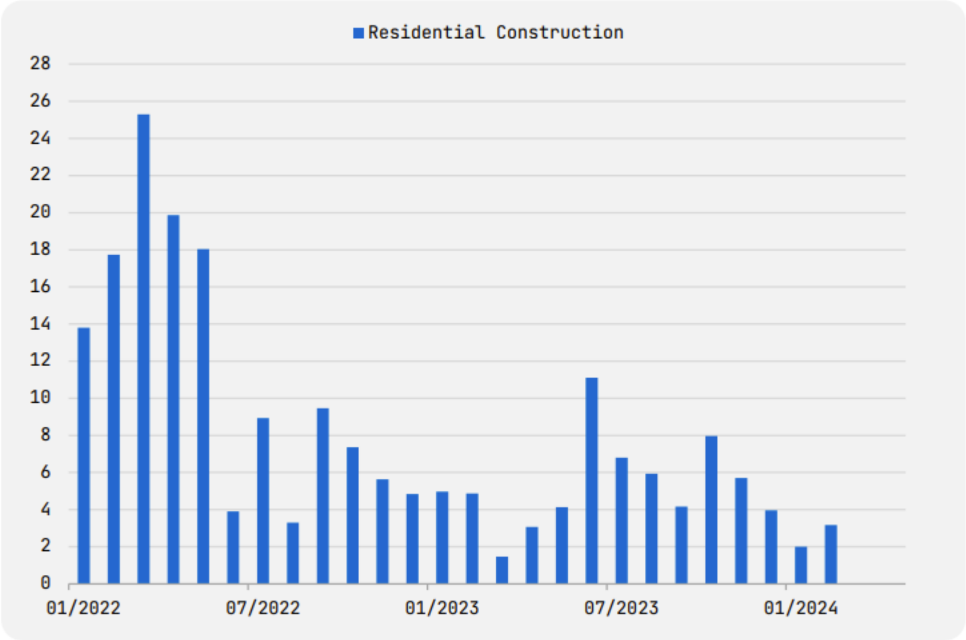


Pre-Tax Corporate Profit Margins At Recession Start Dates

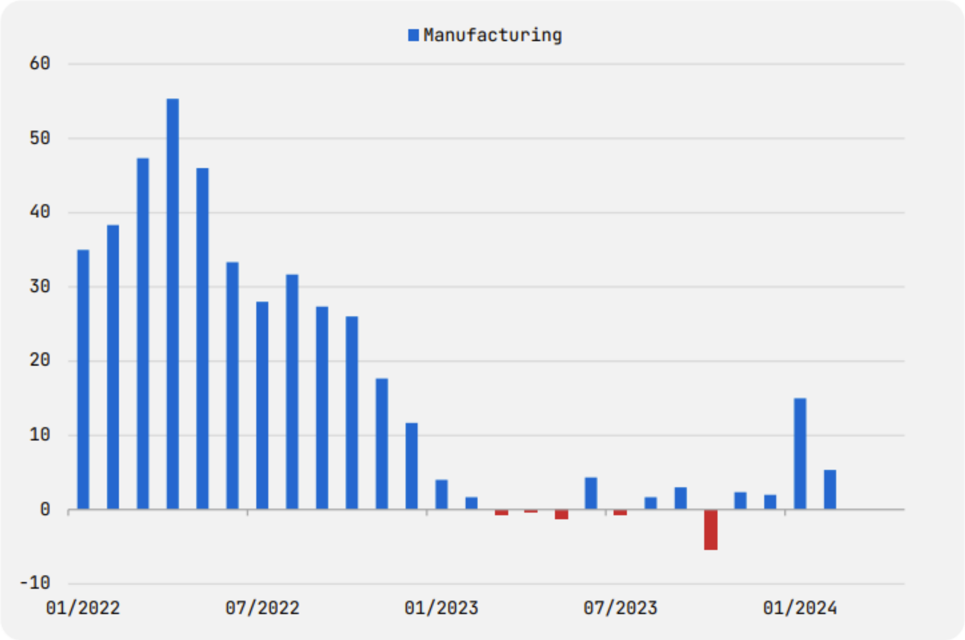


Why the Disconnect? - Labor Market Hoarding

Employment Change: Residential Construction (3MM)



Employment Change: Manufacturing (3MM)



Why the Disconnect? - In the End, Labor Market Strength

Coincident Employment Index Change Post 3M10Y Inversion:

The Coincident Employment Index has increased 1.4% in the 16 months since the 3M10Y spread inverted.

This increase is more than any past yield curve inversion.

The Leading Employment Index and other broad baskets of Leading Employment variables remain modestly weak which means we shouldn't expect explosive labor gains in the future, but the resilience of the labor market this deep into a yield curve inversion cannot be disputed.

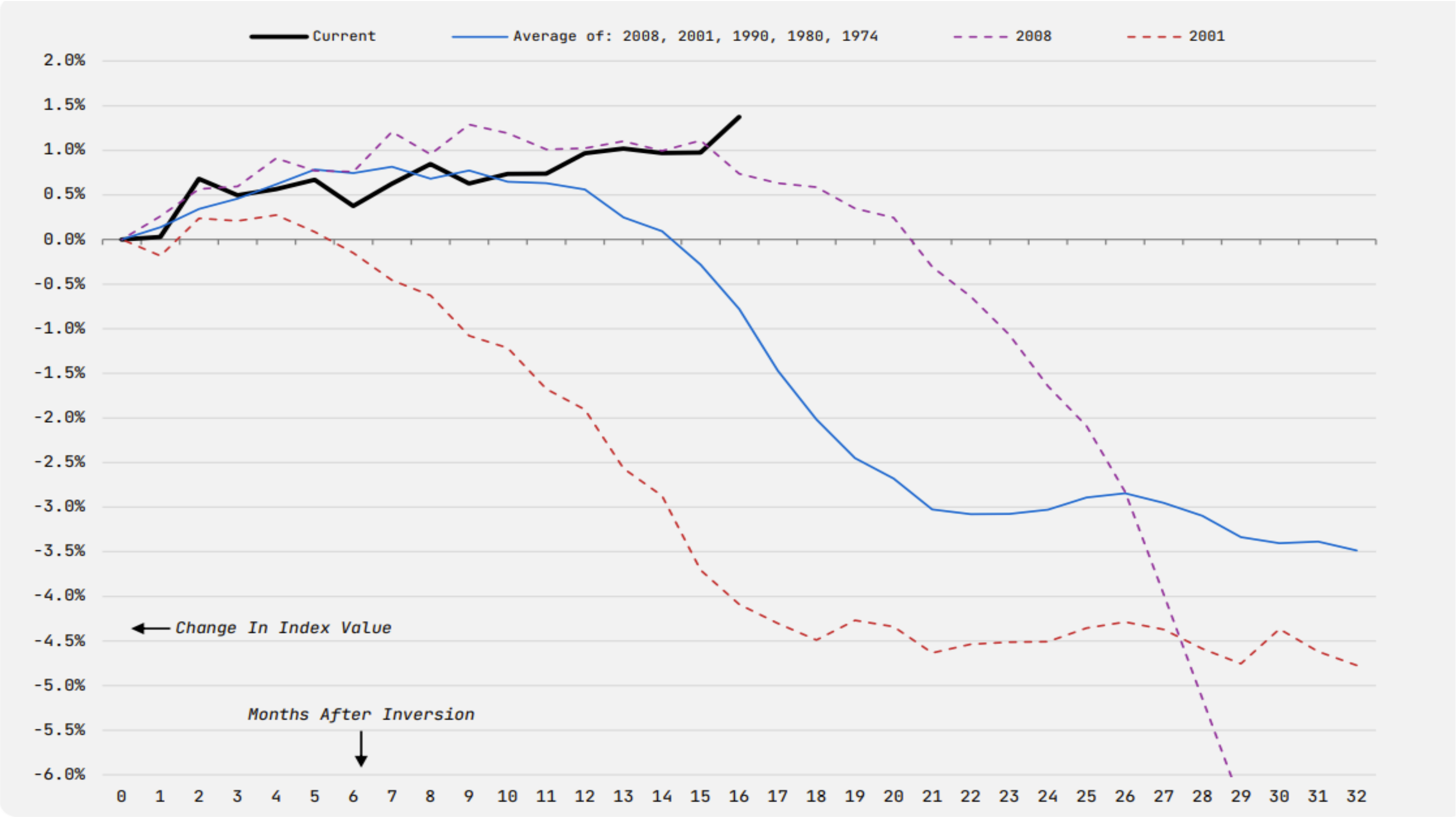
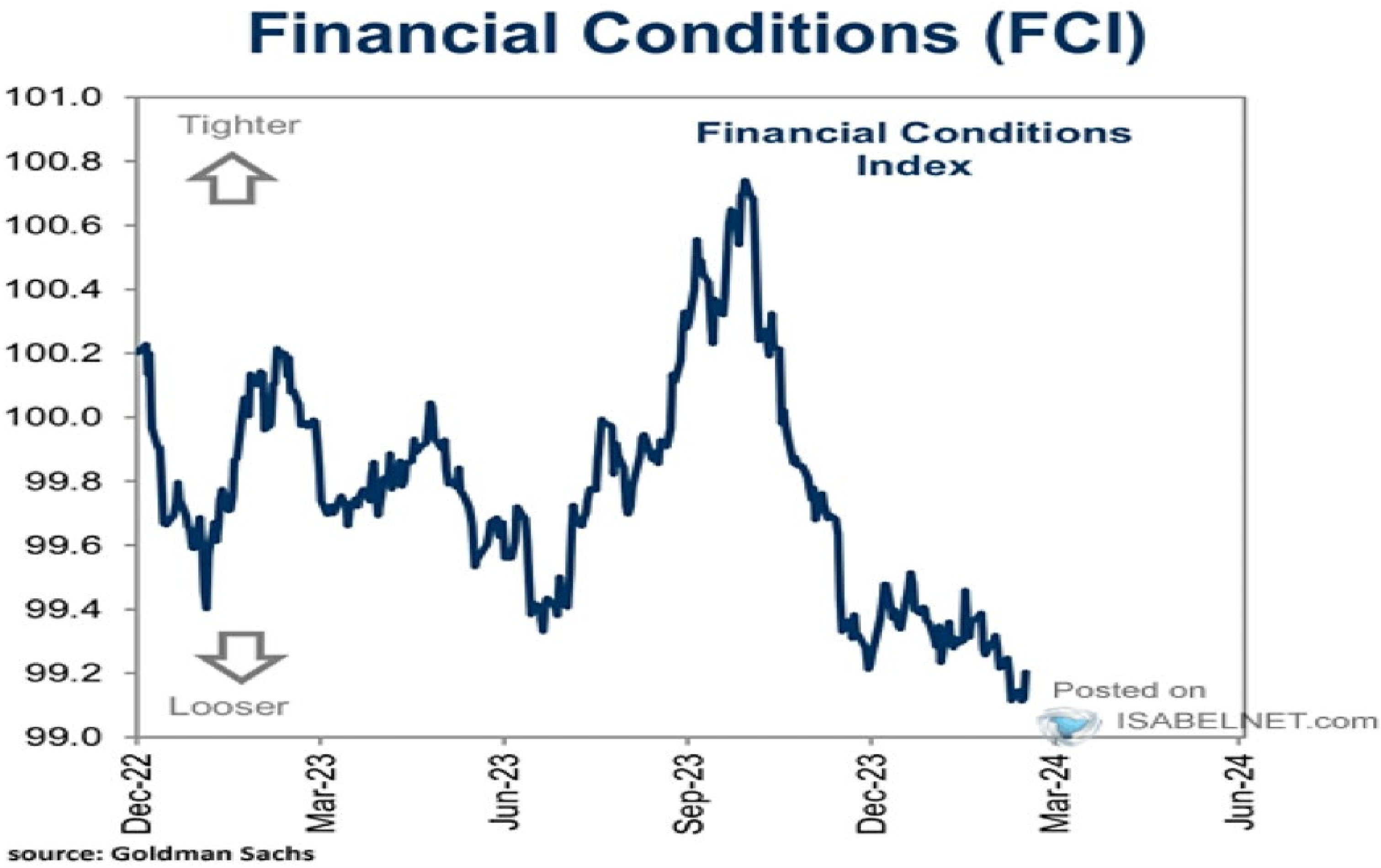


Chart: EPB Research • Source: Federal Reserve, BEA, BLS, Census Bureau, DOL

Why the Disconnect? – Adding Fuel to the Fire



Probable Outcomes: Track 1

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Key Themes: Macro and Markets

Macroeconomics

1. Easing monetary policy
2. Sticky inflation
3. Labor market strength

Markets

1. Narrow earnings growth
2. Narrow market leadership
3. Range-bound interest rates

The Good, The Bad and The Ugly

The Good

- Resiliency of U.S. consumer spending
- Labor market strength supports economy
- + Easing financial conditions
- Promising artificial intelligence innovation
- Positive inflation-adjusted wage growth
- Durability of quality investments
- Positive U.S. large cap earnings revisions

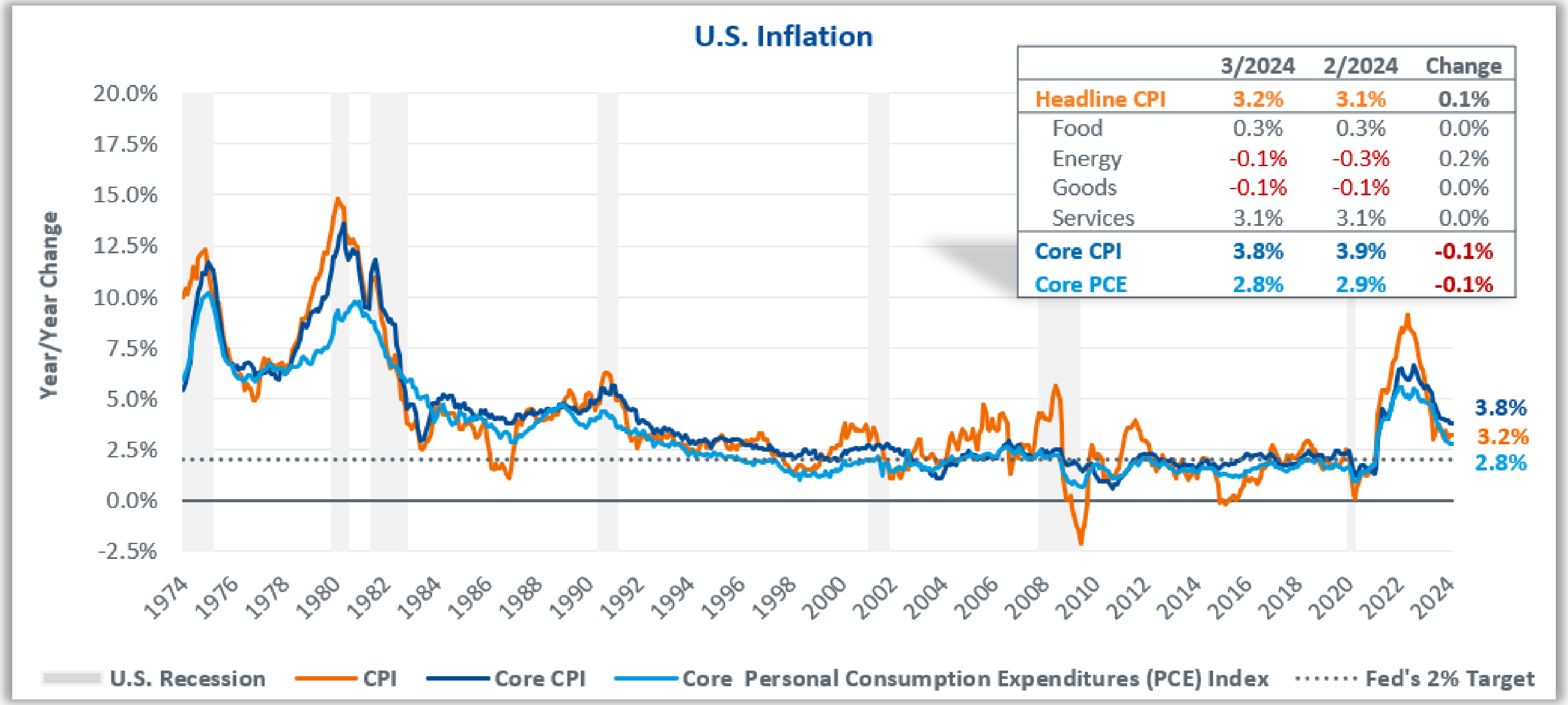
The Bad

- – Rising inflation expectations
- + Stabilizing Leading Economic Indicators
- Commercial real estate under pressure
- Tightening bank lending standards
- Inverted yield curve
- Global monetary policy risks
- Negative global earnings revisions
- Commodity supply / demand imbalances
- Weak business confidence surveys
- Underwhelming economic recovery in China
- Falling savings; rising credit delinquencies

The Ugly

- Global geopolitical conflicts
- Global deficits / debt levels
- Global populism and election risks
- U.S.-China power struggle
- De-globalization trends building

Inflation: Is the Trend Your Friend?



	3/2024	2/2024	Change
Headline CPI	**3.2%**	**3.1%**	**0.1%**
Food	0.3%	0.3%	0.0%
Energy	-0.1%	-0.3%	0.2%
Goods	-0.1%	-0.1%	0.0%
Services	3.1%	3.1%	0.0%
Core CPI	**3.8%**	**3.9%**	**-0.1%**
Core PCE	**2.8%**	**2.9%**	**-0.1%**

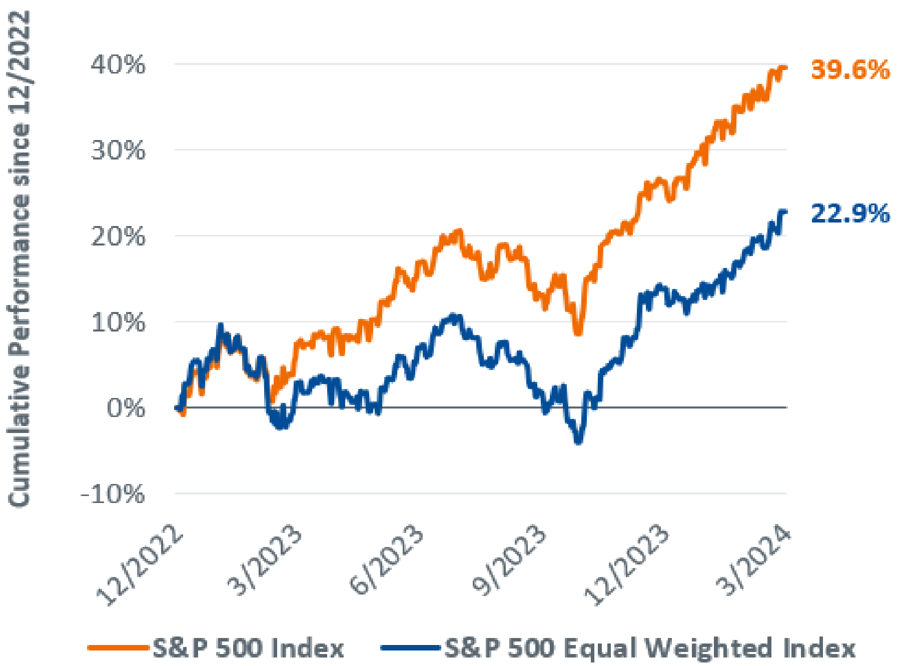
As of 3/31/2024. Source: Bloomberg L.P., PNC

Macro Outcomes: B-B-B Affairs

Factors	Base Case: Decelerating Growth	Bear Case: Economic Contraction	Bull Case: No Recession and Reacceleration
Inflation	Inflation decelerates at a manageable pace – not a straight line down – as global earnings growth contracts.	Stagflation of high inflation and low global employment sinks the economy into a recession.	Inflation falls rapidly, as a mid-cycle slowdown turns to a reacceleration of the business cycle.
Monetary Policy	Federal Reserve (Fed) policy shifts its focus to cut rates at an opportune time as economic growth slows mid-year.	Central banks ease financial conditions too soon, and inflation rebounds higher just as labor markets weaken, which limits the options of monetary policy to stimulate the economy.	Global central banks are able to ease monetary policy as lower inflation has been achieved without dipping into recession.
Geopolitics	Multiple global wars do not materially impact global markets; U.S. political landscape remains uncertain in a presidential election year.	Multiple global wars potentially lead to higher inflation, in addition to the probability of a longer-than-expected U.S. government shutdown in an election year.	Multiple global wars do not materially impact global markets, a U.S. government shutdown continues to be avoided as investors focus on the election.
Earnings Outlook	Net earnings revisions for 2024 decline modestly as decelerating inflation remains a headwind to corporate margins.	Net earnings revisions for 2024 decline meaningfully as an economic recession is not fully reflected in consensus estimates.	A mid-cycle reacceleration leads to positive earnings revisions.
2024 S&P 500 Earnings Growth Rate	4% to 7%	-5% to 0%	8% to 12%
Trough Forward P/E	16x - 18x	12x -15x	19x - 21x
Path of Long-Term Interest Rates	Volatile and modestly higher	Materially lower	Volatile and moderately lower

Equity Markets: All-Time Highs and a Widening Base

Largest Companies Leading the S&P 500

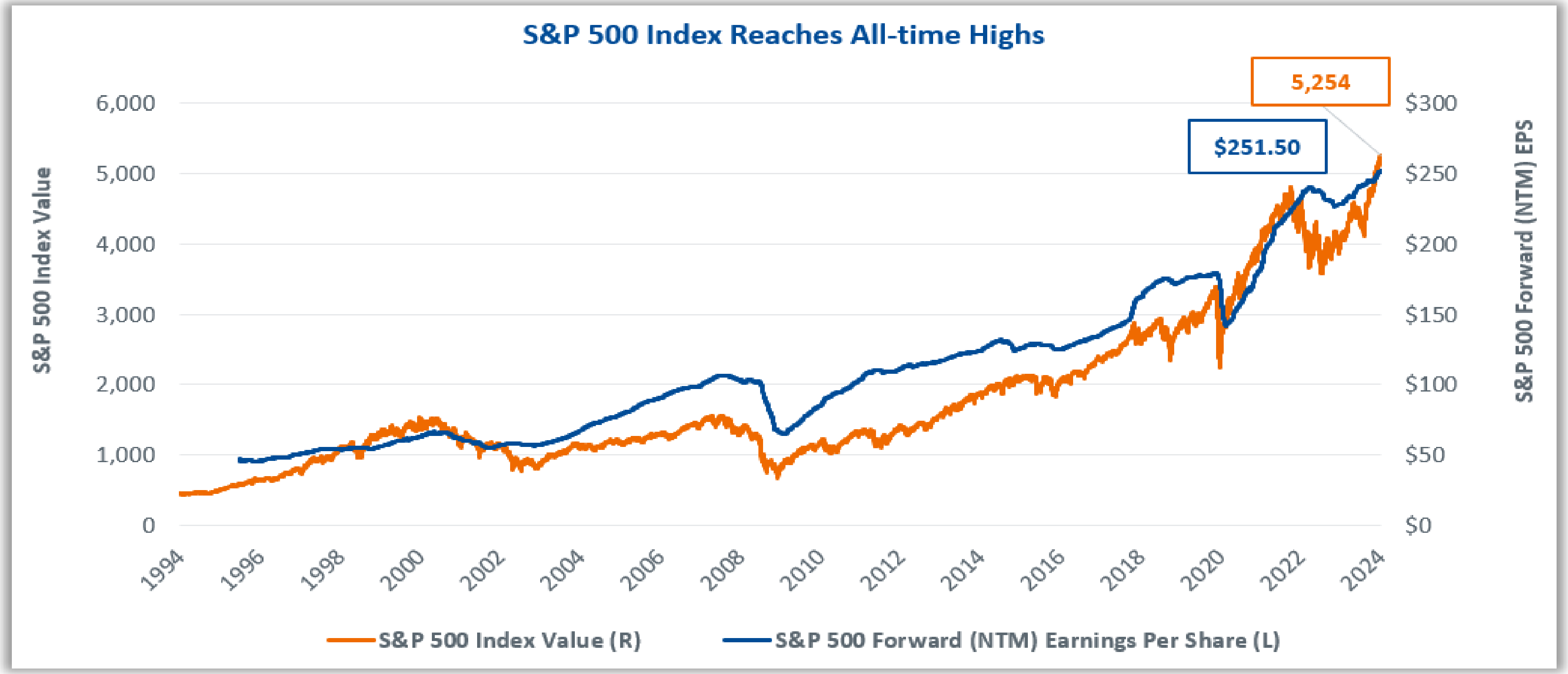


Equity Market Performance

Index	YTD Total Return
"Magnificent 7" (weighted average)	13.5%
S&P 500®	**10.6%**
Nasdaq Composite	9.3%
S&P 500 Equal Weight	7.9%
Median S&P 500 stock return	7.4%
Russell 2000	5.2%
MSCI World Ex USA	5.6%
MSCI Emerging Markets IMI	2.2%

As of 3/31/2024. Source: FactSet®, FactSet® is a registered trademark of FactSet Research Systems, Inc., and its affiliates.
Indices are unmanaged, not available for direct investment, and not subject to management fees, transaction costs or other types of expenses that an account may incur.

Equity Markets: S&P 500 and Forward Earnings



As of 3/31/2024. Source: FactSet®, FactSet® is a registered trademark of FactSet Research Systems, Inc., and its affiliates.
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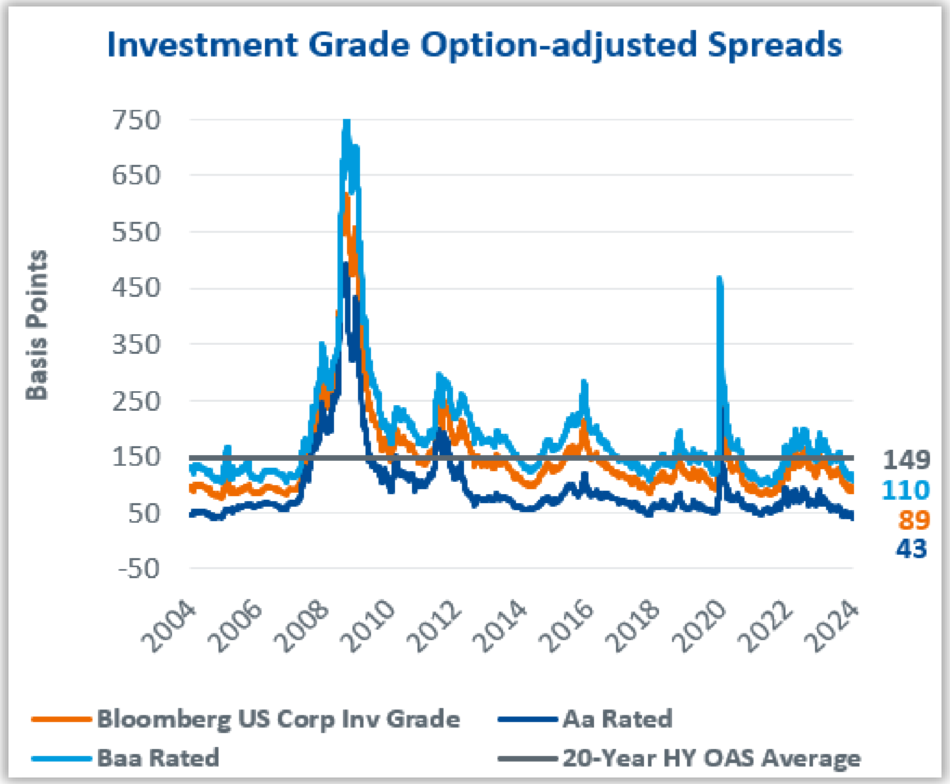
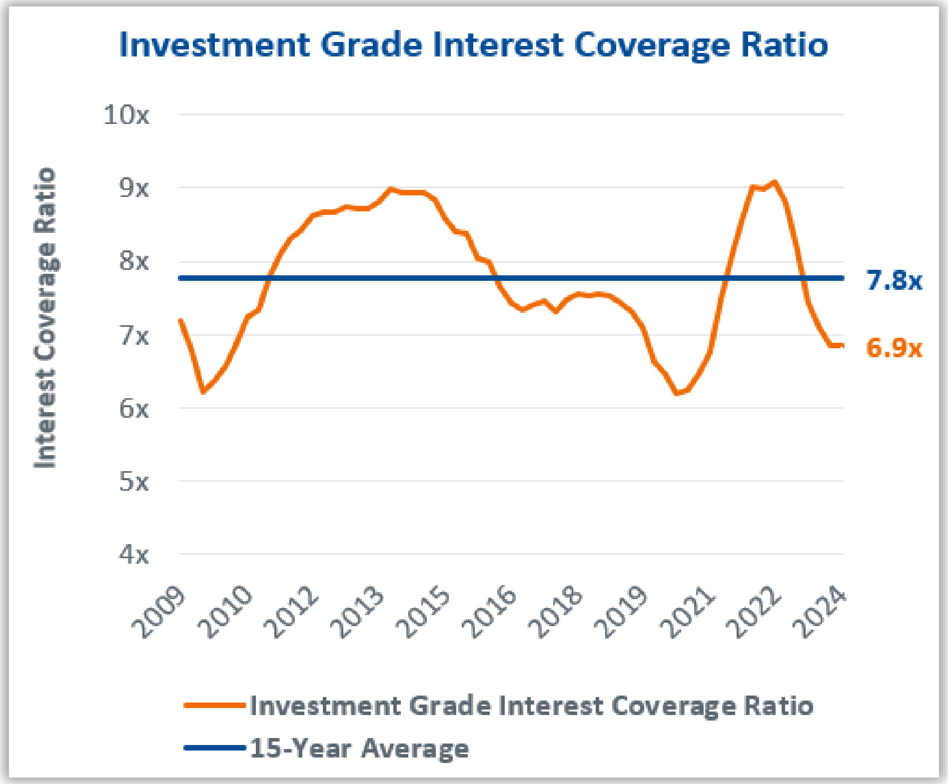
Equity Markets: Emphasis on Quality

Outlook *Consensus earnings estimates are optimistic as market leadership narrows*	We believe the anticipated economic slowdown is not yet fully reflected in consensus earnings estimates, which still imply positive growth for 2024.
Market cap *Sector composition is driving valuation differentials across the market cap spectrum*	Large-cap equity exposures are performing well relative to small- and mid-cap stocks (SMID), but favorable aspects of SMID include their relative U.S.-centric revenue exposure.
Factors *Emphasize quality over other factors*	When growth becomes scarce, we prefer quality growth companies with strong balance sheets, low leverage and those expected to grow faster than the overall market.
Geography *U.S. overweight and emerging market tilt*	The consistency and leadership of U.S. markets continues to support a favorable view relative to other regions. This is not a "domestic bias," but rather, the view that U.S. fundamentals remain strongest at this time.

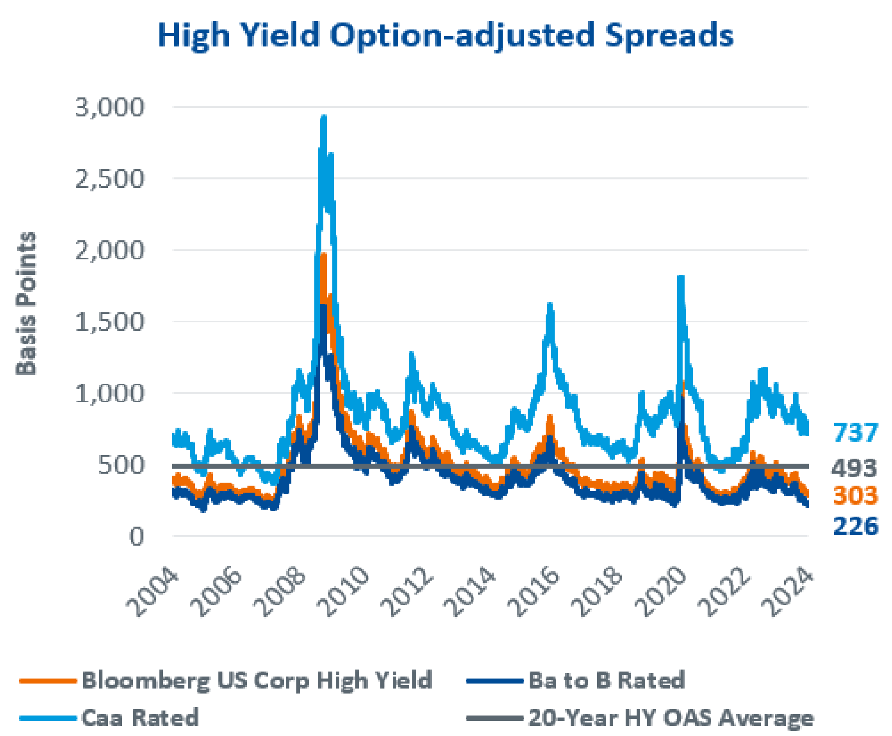
Fixed Income: Investment Grade

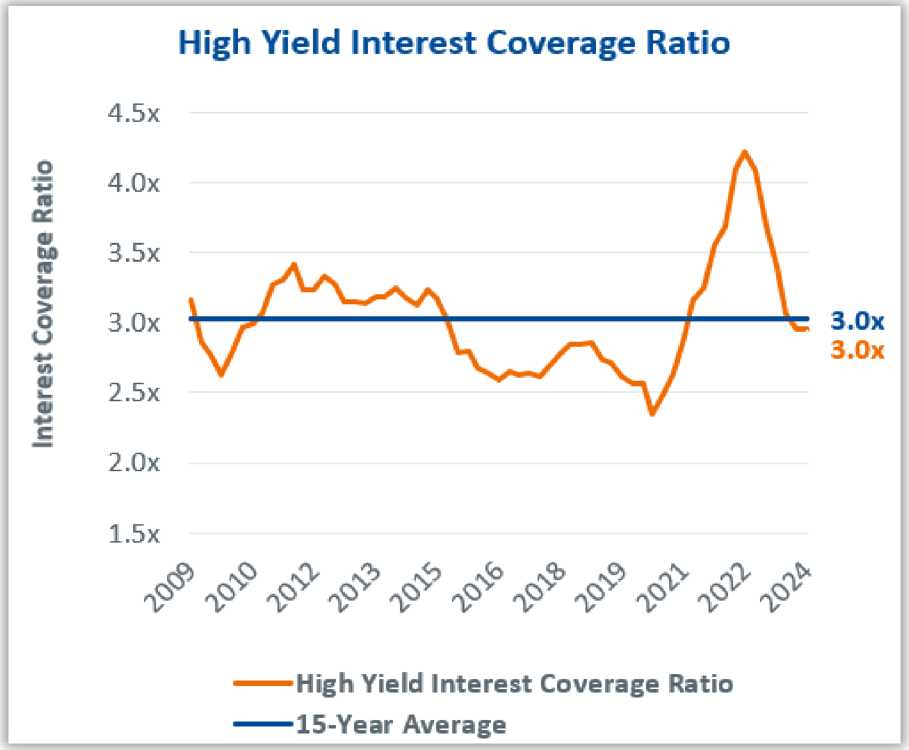




As of 3/31/2024. Source: Bloomberg L.P.

Fixed Income: High Yield





As of 3/31/2024. Source: Bloomberg L.P.

Fixed Income: Theme Song

Core fixed income *Maintain neutral duration, increase high-quality core allocation*	Investment grade corporate credit and securitized bonds maintain strong fundamentals despite slowing global economic growth.
U.S. high yield *Credit cycle remains tied to the earnings cycle*	Debt rollovers face significant interest rate risk in 2024 and 2025. We also believe consensus earnings estimates may overestimate the strength of fundamentals.
Emerging market (EM) debt *Valuations remain rich as macroeconomic headwinds mount*	EM debt offers an attractive yield pickup relative to core fixed income; however, credit spreads appear rich in our view.

Probable Outcomes: Track 2

Mike Hyzdu
Managing Director
3 Point Legacy Advisors
(UBS)

Macro Outcomes: On Track for a Soft Landing?

Macroeconomic Outlook

- **The US economy should slow in 2024, but maybe only modestly.** GDP grew 3.1% in 2023, above the ~2% trend rate, and the data hasn't slowed much so far in 2024. The recent easing of financial conditions may result in the economy continuing to run hot.
- **Fed rate cuts are coming, likely starting in May.** Recent Fed guidance implies that cuts won't start before May and their timing will be data dependent. Market pricing is down to 4.5 cuts in total this year, we expect 4. It's unlikely that the Fed doesn't cut because not doing so would make policy overly restrictive.

Operating Environment

- **Consumer spending should remain healthy.** A tight labor market and rising real incomes shoul combine for consumption growth at pre-pandemic rates. Even with labor demand cooling, lower supply growth relative to the past two years should keep the labor market from getting too loose.
- **Easier financing conditions by year-end.** Fed rate cuts with an easing bias should result in lowe borrowing costs for small firms, and lending conditions that will gradually ease. They are already getting less tight, and capital is available for most borrowers.

Markets & Deal Activity

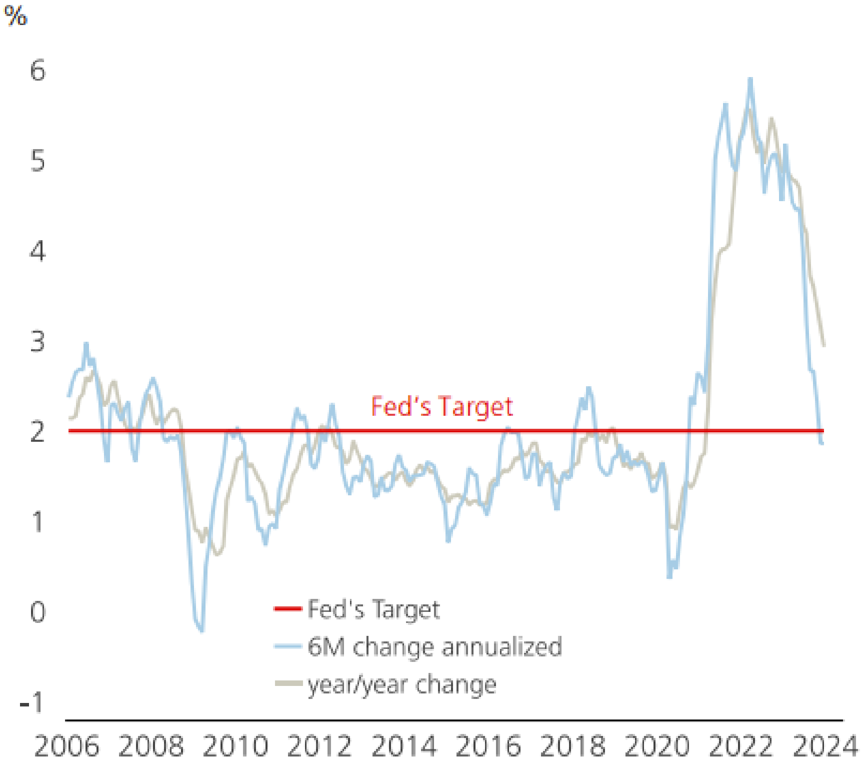
- **Goldilocks for equities, at least for now, with more market swings**. Solid growth, continued disinflation, and rate cuts are supportive for equities. Much of this good news is priced in and valuations look relatively expensive, but that doesn't prevent more upside.
- **M&A green-shoots could start to bloom once rate cuts are imminent.** Falling rates, rising confidence in the economy, and record dry powder point toward a rebound in M&A deals. The IPO market needs better performance from new issuers and increased investor interest in more speculative stocks, which requires lower rates, to open significantly.

Politics

- **A historic electoral year globally**. More than 60 countries representing about half of the world's population are having elections in 2024.
- **Major US fiscal policy changes require a "wave" outcome.** Control of the House and Senate is as important as the presidential outcome for passing significant fiscal legislation. Prediction markets are at 70% for the Dems to win the House, and a toss-up for the Senate. .

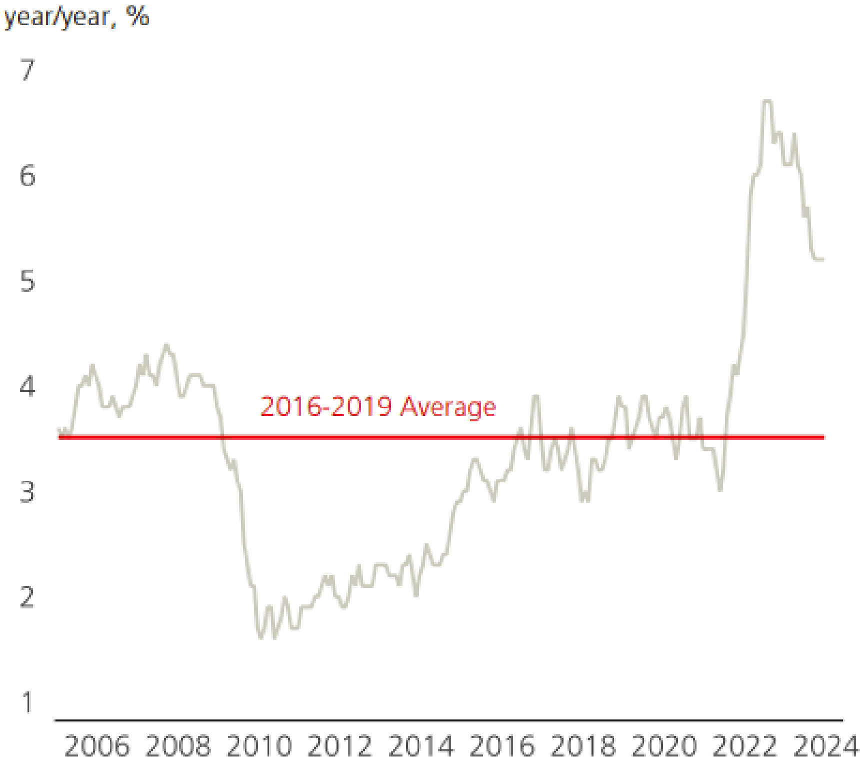
Inflation: 2%-ish on the Horizon?

Current pace of core PCE already below Fed's target



Source: BEA, UBS, as of 7 February 2024

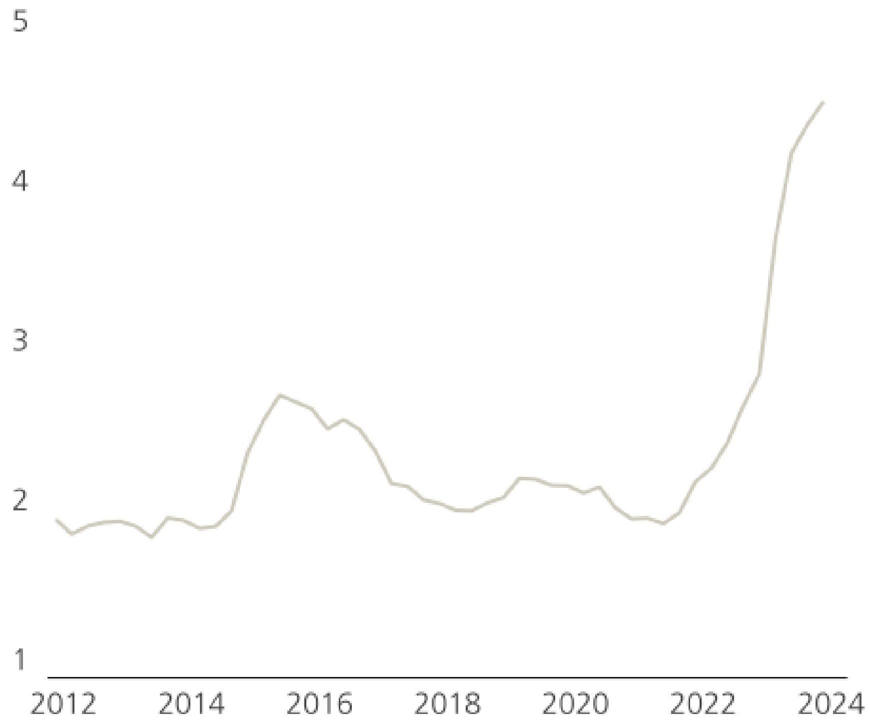
Atlanta Fed Median Wage Tracker still running at a fast pace



Source: BEA, UBS, as of 7 February 2024

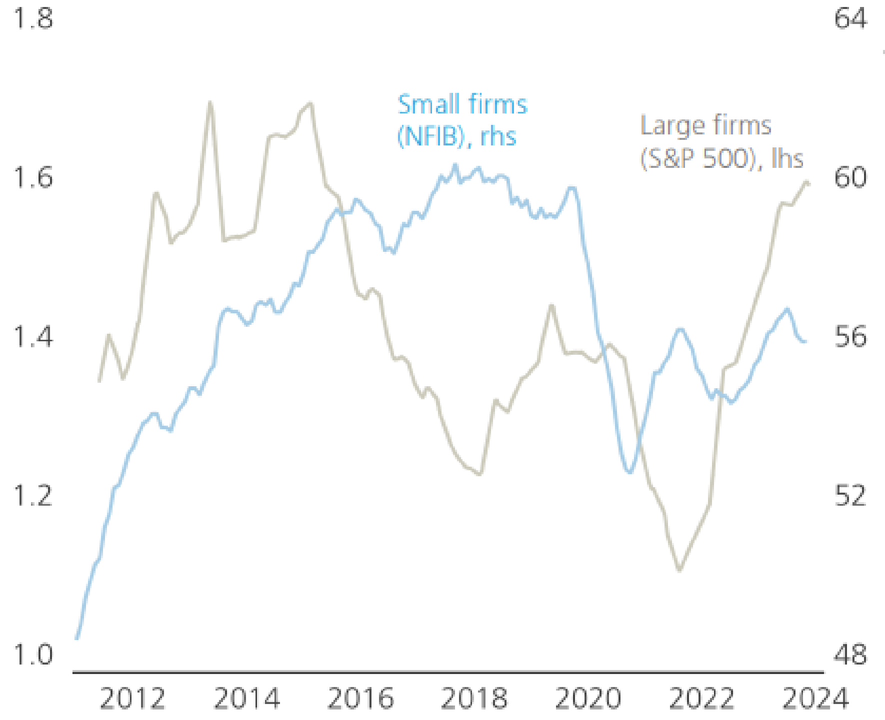
Economic Growth: The Upside Potential?

Manufacturing investment surges thanks to CHIPS Act
% Private Fixed Investment



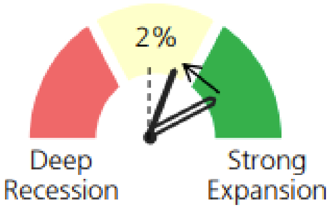
Source: BEA, UBS as of 7 February 2024

Larger firms leading smaller firms in capex intentions
S&P 500 capex to depreciation ratio & NFIB actual capex index



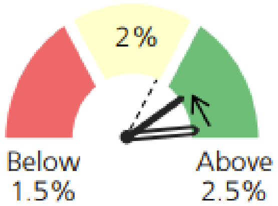
Source: Bloomberg, NFIB, UBS as of 7 February 2024

Let’s Go To The Board!!!!



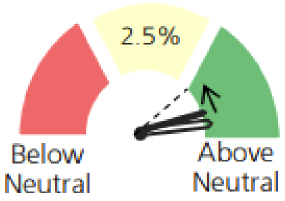
Growth

- 2H 2023 real GDP growth surprised to the upside thanks to consumer resilience; we expect a modest slowdown to around trend in 2024.



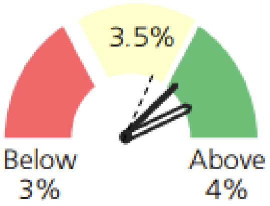
Inflation

- CPI and PCE show inflation around 3%, even lower for 6m annualized core PCE; leading indicators point to ongoing disinflation in 2024.



Fed funds rate

- The Fed ended its rate hiking cycle at 5.5%; we expect the first rate cut in May, and 100bps in total in 2024; the rate should gradually fall back to about 3.5%.

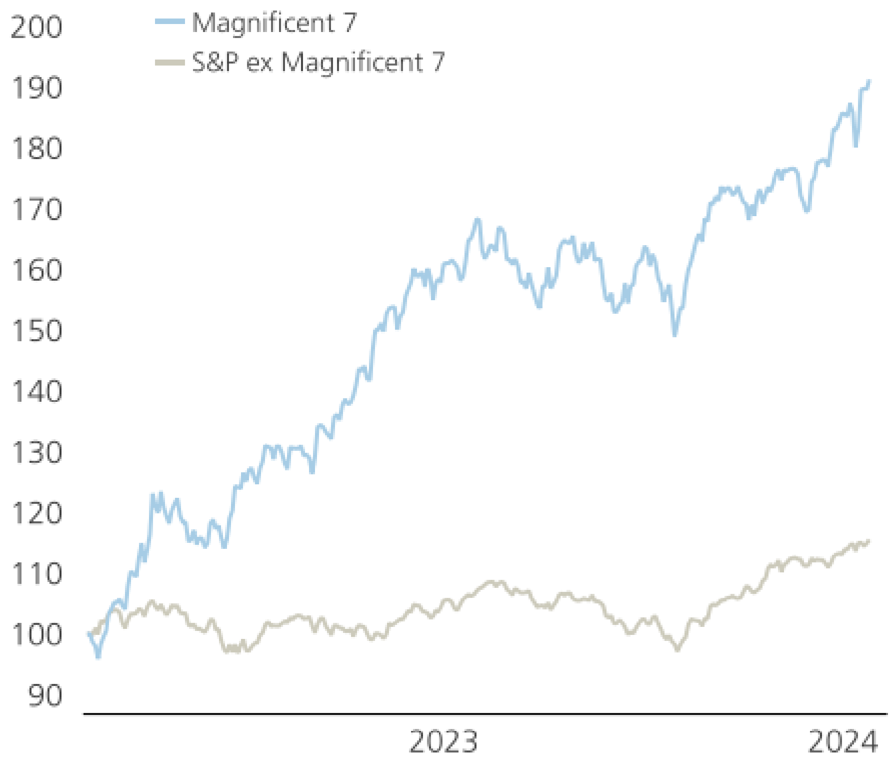


10-year yield

- After peaking at 5%, the 10-year yield should be range bound around 4%, falling later in the year once the Fed starts cutting rates.

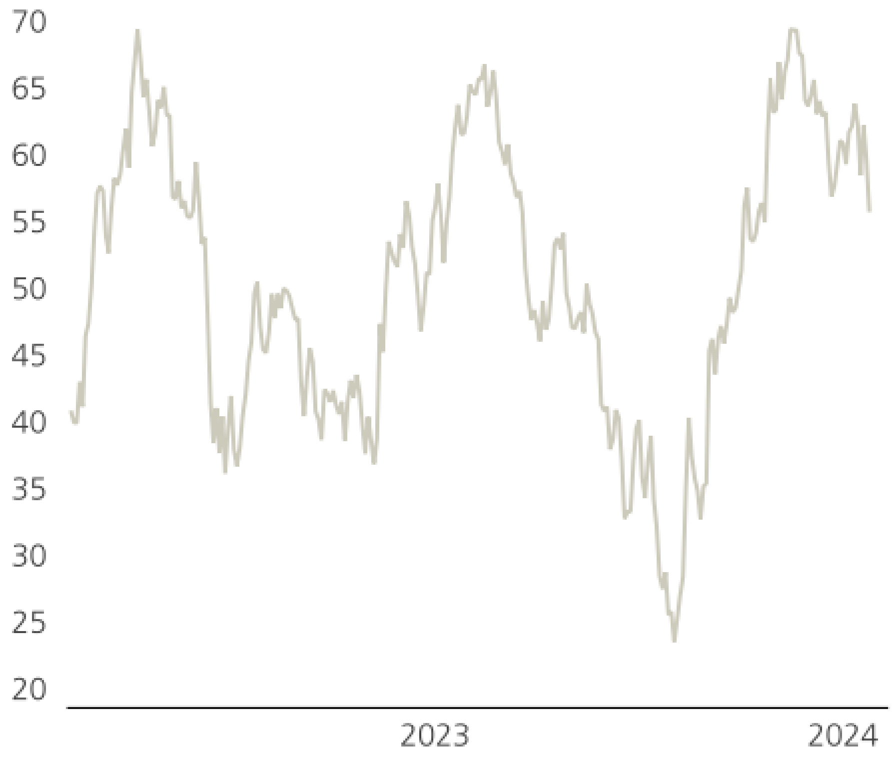
Equity Markets: Maybe It's Not Just the Magnificent 7

Two markets for most of the past year: Mag 7 and everything else
Mag 7 and SPX 493, index=100 as of 1 January 2023



Source: Bloomberg, UBS, as of 7 February 2024

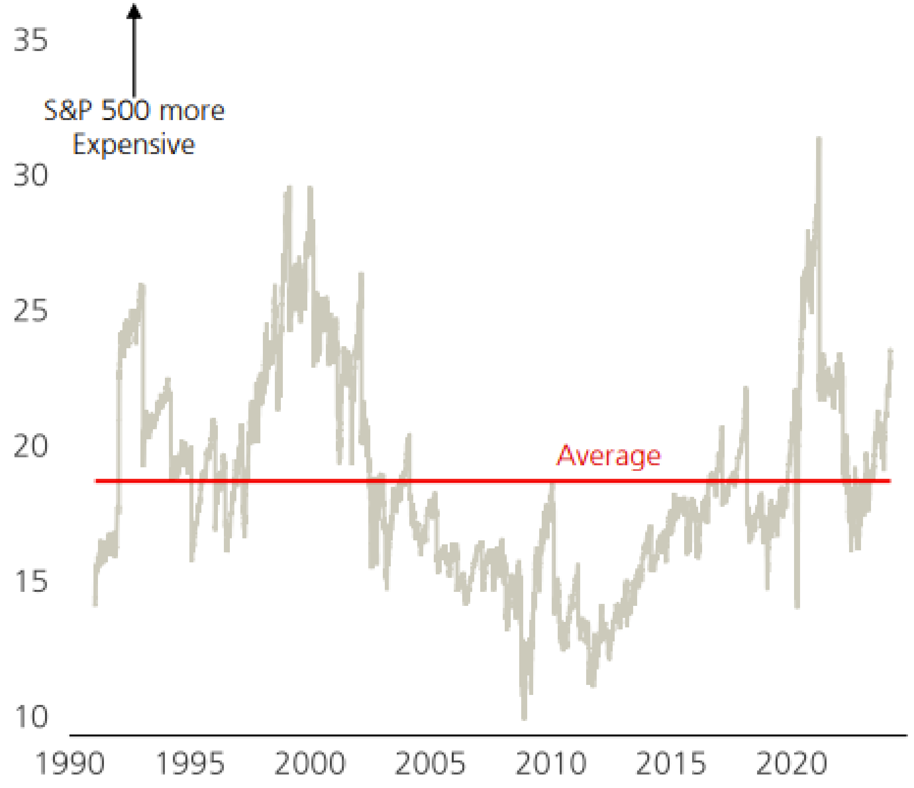
Market breadth rising towards the end of 2023 and into 2024
% of NYSE stocks > 200D moving average



Note: Source: Bloomberg, UBS, as of 7 February 2024

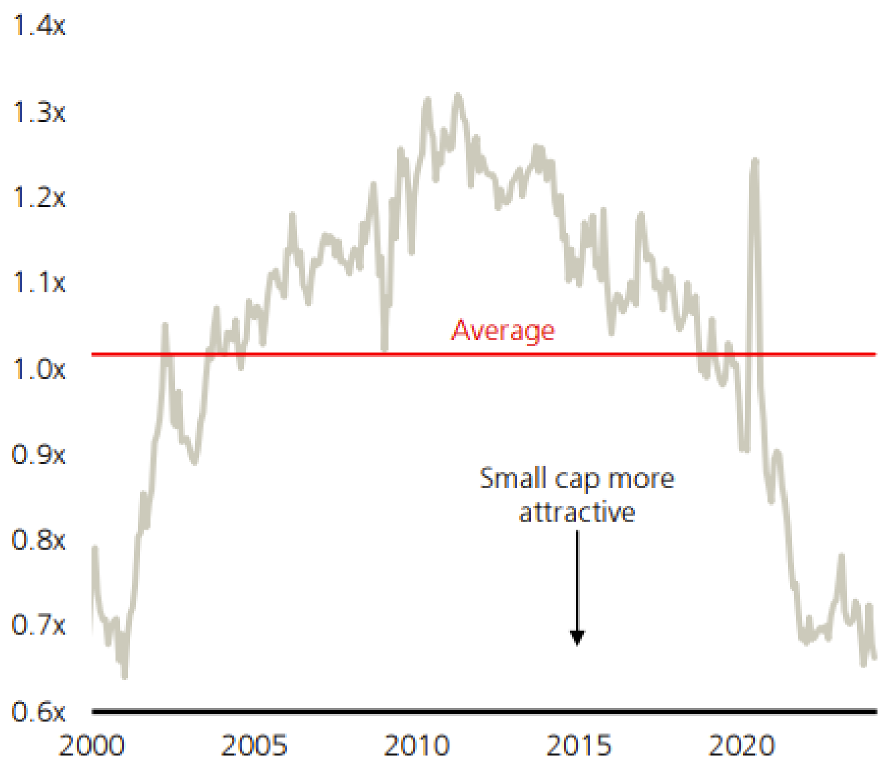
Equity Markets: Not Cheap but Maybe Not That Bad

S&P 500 P/E is about a standard deviation above its LT average
Forward P/E



Source: Bloomberg, UBS, as of 7 February 2024

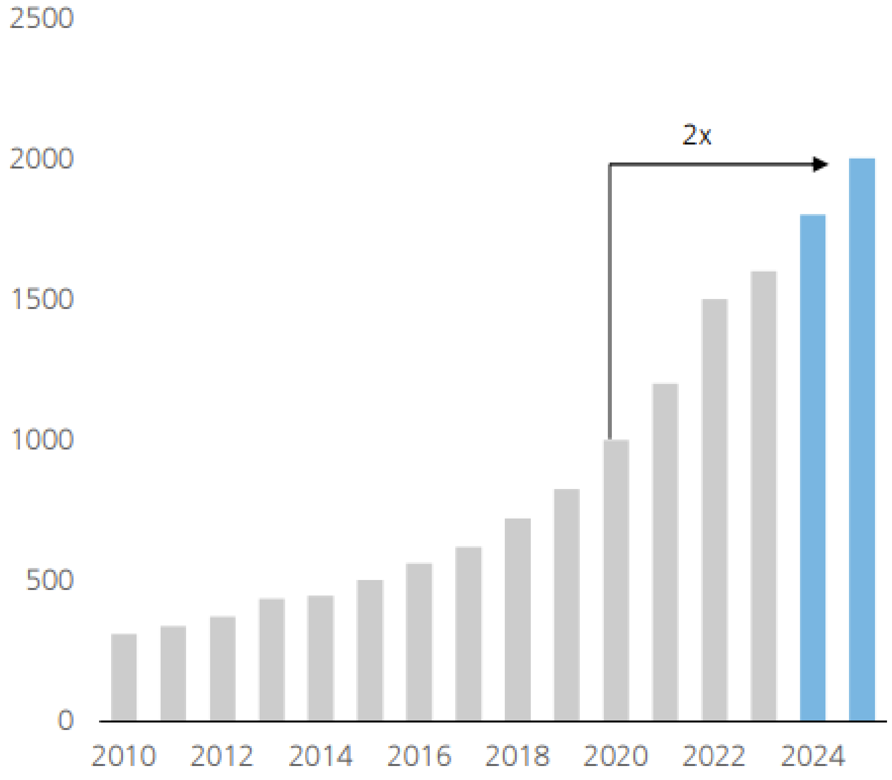
Small-cap stocks are very cheap relative to large-caps
Ratio of 12m forward P/E for S&P 600 Small-cap and S&P 500



Source: Bloomberg, UBS, as of 7 February 2024

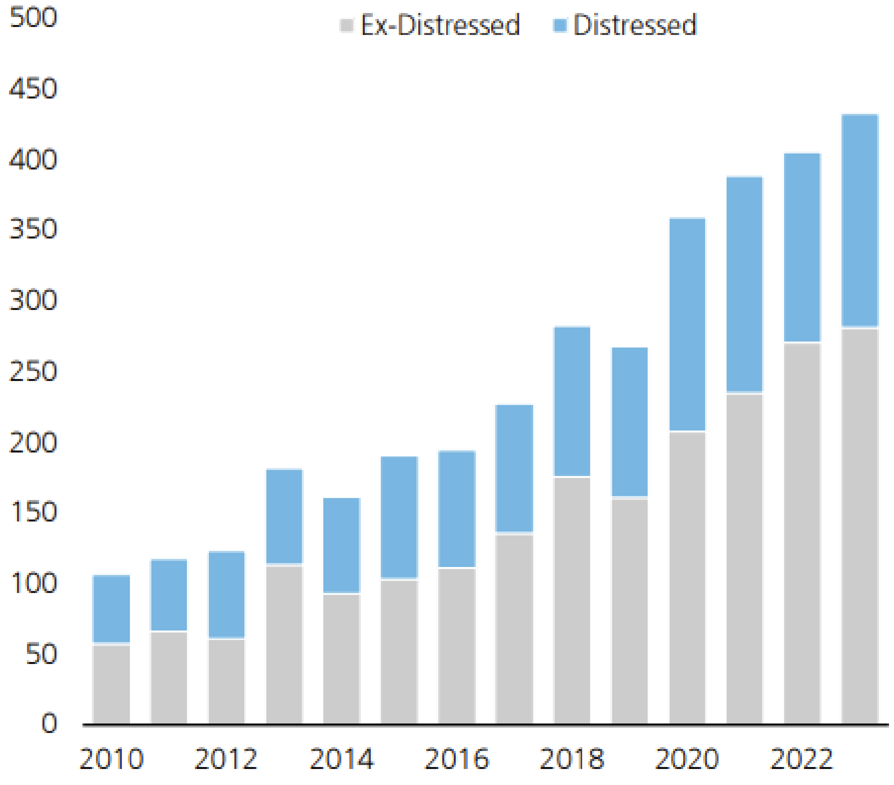
Private Credit: Time for a (measured) Look?

Private Credit AUM has expected to double by 2025
AUM, $B



Source: Preqin, UBS as of 7 February 2024

Private Credit Cry Powder
$ bn



Source: Blackstone, UBS as of 7 February 2024

Real Estate: Budding Road to Recovery?

Residential affordability is near the worst in decades. High prices and mortgage rates have priced out many potential buyers, especially first-timers. The pick-up in new home starts is a positive, but existing homeowners with low locked-in rates limits the market.

Office is very weak, the rest of commercial real estate (CRE) is okay. Even within office there is a big dispersion between Class A and the rest. But office is only about 15% of the CRE market. There's also significant capital ready to buy distressed assets and debt.

"At risk" geographies facing the highest insurance premiums. Premiums have spiked higher across the board, but especially for those in at-risk climate regions.

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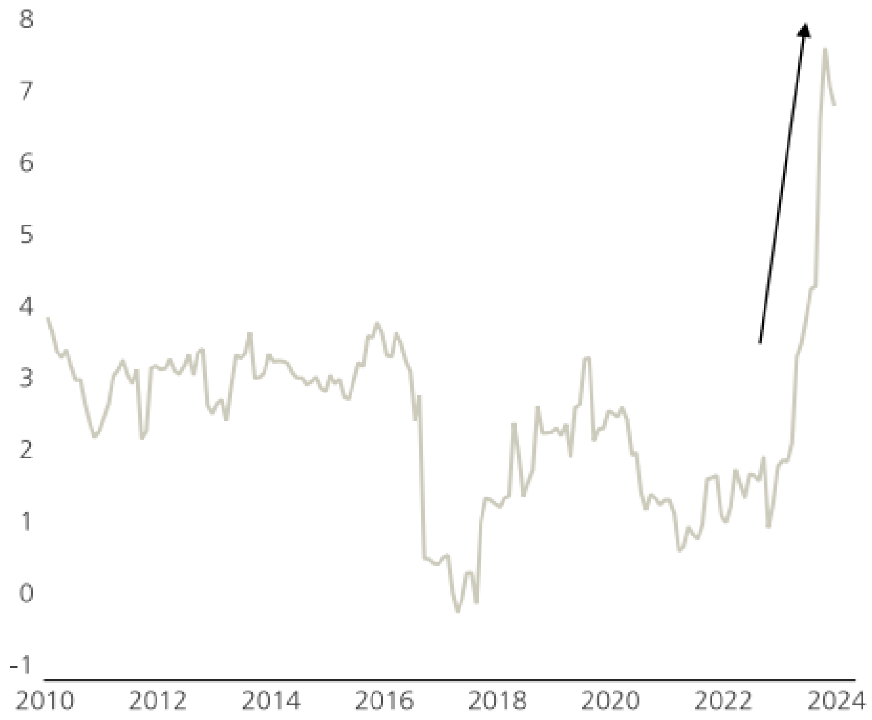
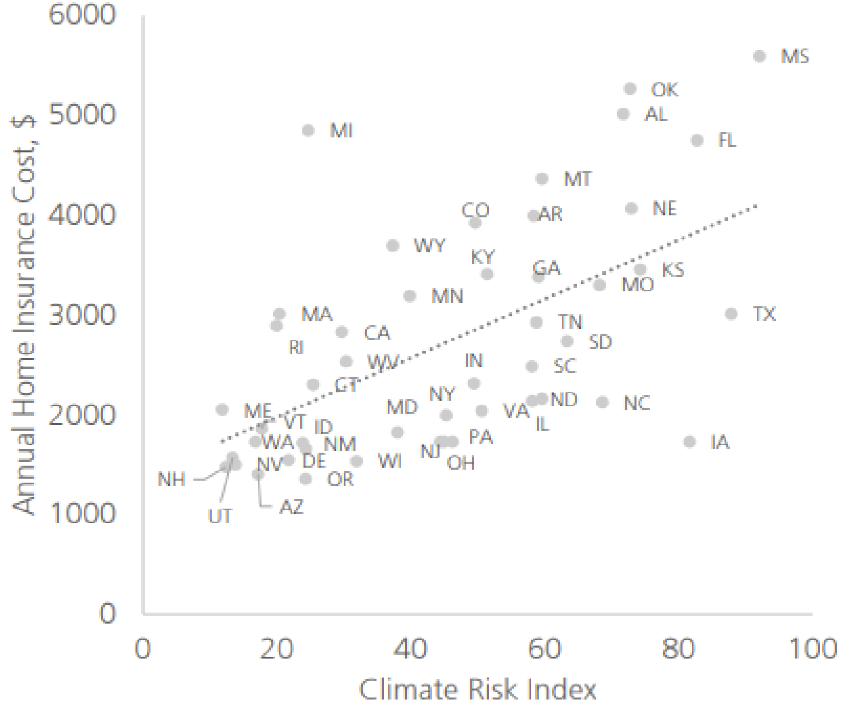
Real Estate: Price is Not Everything - Insurance Matters

Insurance premiums spike amidst 2023 global heat wave
y/y %



Source: BEA, UBS, 7 February 2024

With most expensive premiums related to climate risk
Annual home insurance cost, $ and Climate Risk index



Source: Insurify, OpenWallet, UBS, 7 February 2024

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CAPTIVES Unleashed

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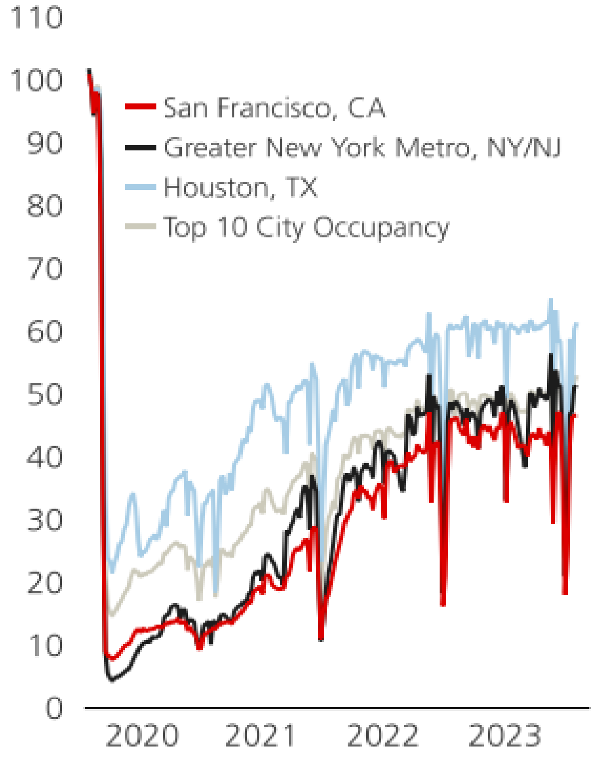
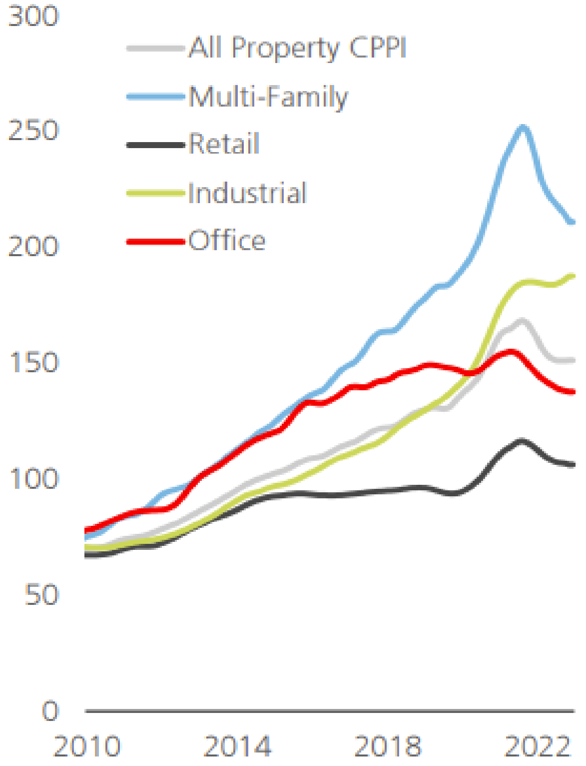
Real Estate: Rumors of Demise are Greatly Exaggerated

Occupancy level about half pre-pandemic
12/31/2019=100



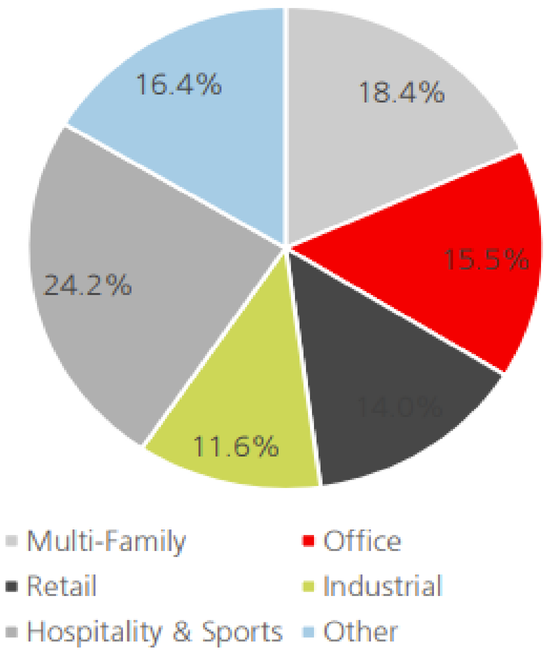
Source: Kastle, UBS, as of 7 February 2024

Moody's Commercial Property Price Index
12/2006=100



Source: MSCI Real Capital Analytics, UBS as of 7 February 2024

Value of office space < 16% total
% Total Commercial Property Value



Source: Nareit, UBS, as of 7 February 2024

WRCIC 2024
WESTERN REGION CAPTIVE
INSURANCE CONFERENCE, LLC

Risk Management: A Layered Approach

- **Enterprise Risk Management (ERM)**
  - Measuring/correlating balance sheet risk
  - Connectivity between parent and captive

- Asset / **Liability Management (ALM)**
  - Correlating cash flows and durations
  - Achieving a "reasonable match"

- **Asset / Investment Risk: The Art and Science of it All**
  - Define the relevant pools of risk (or "buckets" of funds)
  - Continually quantify risk within each pool and in aggregate
  - Budget risk to ensure proper alignment with enterprise objectives

Asset Class Performance: "It's a Real Dow Jones-er"

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD
EM 82.36	Small-Cap 26.85		EM 18.68				Small-Cap 21.31	EM 36.83		Large Value 31.93				Large Growth 30.03	
High Yield 58.21	Mid-Cap 26.64		Real Estate 18.59				Mid-Cap 20.74	Large Growth 27.44		Large Cap 31.49	Large Growth 33.47			Large Cap 26.29	
Mid-Cap 37.38	Real Estate 25.93		Mid-Cap 17.88	Small-Cap 38.82	Real Estate 24.91		Large Value 17.40	Intl Dev 24.21		Large Growth 31.13	Small-Cap 19.96	Real Estate 39.35		Large Value 22.23	Large Growth 12.75
Intl Dev 33.67	EM 19.90		Large Value 17.68	Mid-Cap 33.50	Large Growth 14.89		High Yield 17.13	Large Cap 21.83		Real Estate 27.62	Large Cap 18.40	Large Growth 32.01		Intl Dev 17.94	Large Cap 10.56
Large Growth 31.57	High Yield 15.12		Intl Dev 16.41	Large Growth 32.75	Large Cap 13.69		Large Cap 11.96	Mid-Cap 16.24		Mid-Cap 26.20	EM 18.39	Large Cap 28.71		Small-Cap 16.93	Mid-Cap 9.95
Real Estate 27.22	Large Value 15.10	Core Bond 7.84	Small-Cap 16.35	Large Cap 32.39	Large Value 12.36		EM 9.90	Large Value 15.36		Small-Cap 25.52	Mid-Cap 13.66	Large Value 24.90		Mid-Cap 16.44	Large Value 8.05
Small-Cap 27.17	Large Cap 15.06	High Yield 4.98	Large Cap 16.00	Large Value 31.99	Mid-Cap 9.77	Large Growth 5.52	Large Growth 6.89	Small-Cap 14.65		Intl Dev 22.49	Intl Dev 7.59	Mid-Cap 24.76		High Yield 13.44	Intl Dev 5.59
Large Cap 26.46	Large Growth 15.05	Real Estate 4.92	High Yield 15.81	Intl Dev 21.02	Core Bond 5.97	Large Cap 1.38	Real Estate 6.74	Real Estate 7.76		EM 17.65	Core Bond 7.51	Small-Cap 14.82		EM 11.67	Small-Cap 5.18
Large Value 21.18	Intl Dev 8.95	Large Growth 4.65	Large Growth 14.61	High Yield 7.44	Small-Cap 4.89	Core Bond 0.55	Intl Dev 2.75	High Yield 7.50		High Yield 14.32	High Yield 7.11	Intl Dev 12.62		Real Estate 10.61	EM 2.17
Core Bond 5.93	Core Bond 6.54	Large Cap 2.11	Core Bond 4.21	Real Estate 1.93	High Yield 2.45	Real Estate 0.21	Core Bond 2.65	Core Bond 3.54	Core Bond 0.01	Core Bond 8.72	Large Value 1.36	High Yield 5.28		Core Bond 5.53	High Yield 1.47
		Large Value -0.48		Core Bond -2.02	EM -1.79	Mid-Cap -2.18			Large Growth -0.01		Real Estate -5.57	EM -0.28	Large Value -5.22		Core Bond -0.78
		Mid-Cap -1.73		EM -2.20	Intl Dev -4.32	Intl Dev -3.04			High Yield -2.08			Core Bond -1.54	High Yield -11.19		Real Estate -1.41
		Small-Cap -4.18				Large Value -3.13			Large Cap -4.38				Core Bond -13.01		
		Intl Dev -12.21				Small-Cap -4.41			Real Estate -5.75				Mid-Cap -13.06		
		EM -19.49				High Yield -4.47			Large Value -8.95				Intl Dev -14.29		
						EM -13.86			Small-Cap -11.01				Large Cap -18.11		
									Mid-Cap -11.08				EM -19.83		
									Intl Dev -14.09				Small-Cap -20.44		
									EM -15.05				Real Estate -26.90		
													Large Growth -29.41		

POSITIVE RETURNS

NEGATIVE RETURNS

LEGEND

Large Cap	S&P 500®
Large Growth	S&P 500 Gro
Large Value	S&P 500 Valu
Mid-Cap	S&P 400®
Small-Cap	Russell 2000®
Intl Dev	MSCI World e USA
EM	MSCI EM
Core Bond	Bloomberg U Aggregate
High Yield	Bloomberg U Corp High Yie
Real Estate	MSCI USA IM Real Estate 25/5

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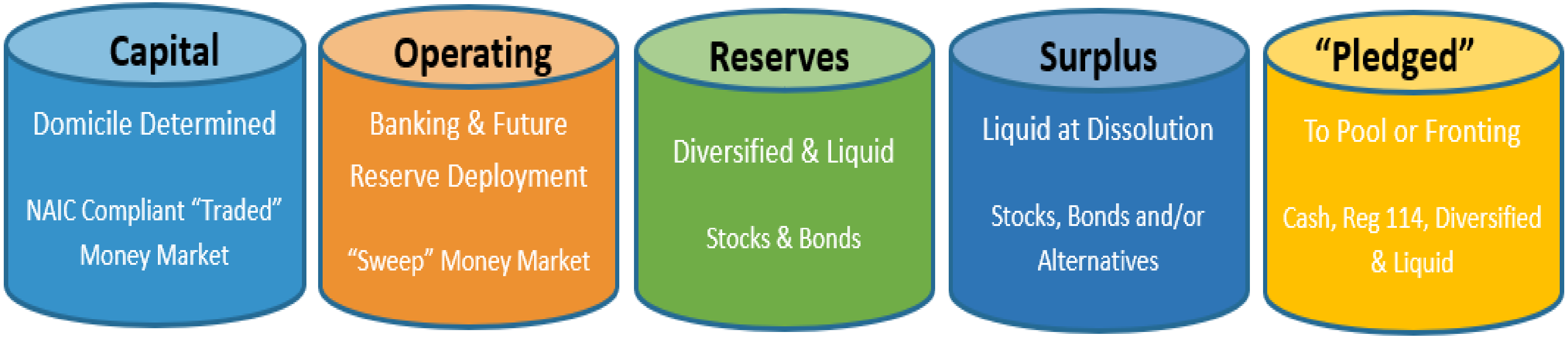
Risk Management: Captive Buckets of Fun(ds)



Match Short-Term and Long-Term Goals with Each Allocation