WRCIC
WESTERN REGION CAPTIVE INSURANCE CONFERENCE, LLC

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2022 ANNUAL CONFERENCE • JUNE 27-29, 2022 • THE COSMOPOLITAN OF LAS VEGAS • LAS VEGAS, NV

CAPITAL MARKETS – AND NOW FOR SOMETHING COMPLETELY DIFFERENT: REGIME CHANGE, VOLATILITY AND EMERGING TRENDS

WHAT EVERY INVESTMENT COMMITTEE SHOULD BE CONSIDERING

Gregory H. Cobb
Director / Insurance Solutions
Sage Advisory Services

Travis Terzer
Senior Associate
CapVisor Associates

Elizabeth Urish Walton
Director
Steel Tower Investments

Tuesday, June 28th | 11:00 AM – 12:00 AM

westerncaptiveconference.org

1

Panelists: Investment Professionals

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2

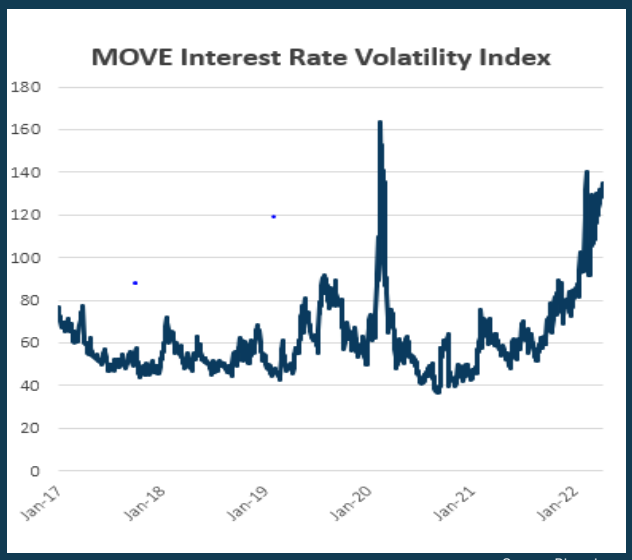
Investments: Conversations in the Desert

- 2022: Regime Change and the Repricing of Risk
- Risk Management: A Layered Approach
- Asset Allocation: THE Starting Point
- Role of Fixed Income: An Asset Class Reborn
- Alternatives: Not So Alternative Anymore
- ESG: Almost as Easy as ABC
- Outside Investment Management: The Whys and Whats

3

2022: Regime Change in the Markets

- Emerging endemic phase of COVID in the West
- Waning effects of fiscal policy
- Tightening of monetary policy
- Global inflation unleashed
- Geopolitical aggression

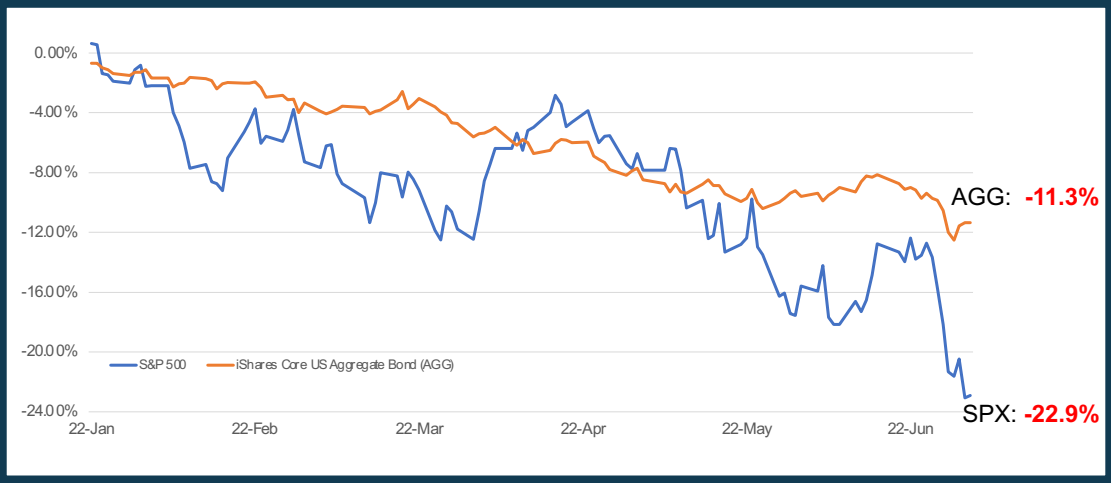


Source: Bloomberg

4

2022: Uncomfortable Repricing of Risk

US Equities & Bond Returns: YTD



Source: Koyfin, Data Range; 1/1/2022-6/17/2022

5

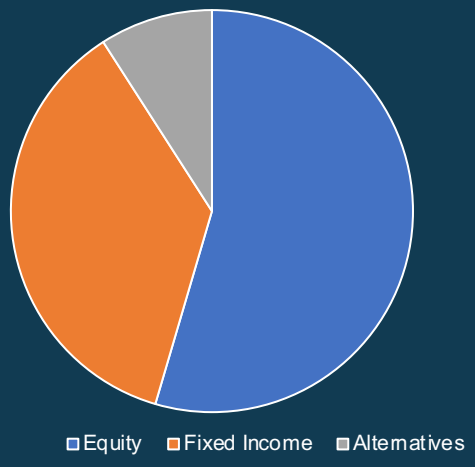
Risk Management: A Layered Approach

- Enterprise Risk Management (ERM)
  - Measuring/correlating balance sheet risk
  - Connectivity between parent and captive
- Asset / Liability Management (ALM)
  - Correlating cash flow and duration to liabilities
- Asset / Investment Risk: The Art and Science of it All
  - How do you define risk
  - What measures do you use to quantify risk
  - How do you budget risk

6

Asset Allocation: THE Starting Point

- Cornerstone of portfolio construction
- Optimize allocations through rigorous quantitative approaches
- Explains the majority of returns
- Effectively manages portfolio risk
- Do NOT "Set & Forget "
  - Tactical vs. Strategic
  - New asset classes can be introduced as sophistication grows
  - With growth of surplus, a captive's risk budget may increase



7

Asset Allocation: Never a Dull Moment

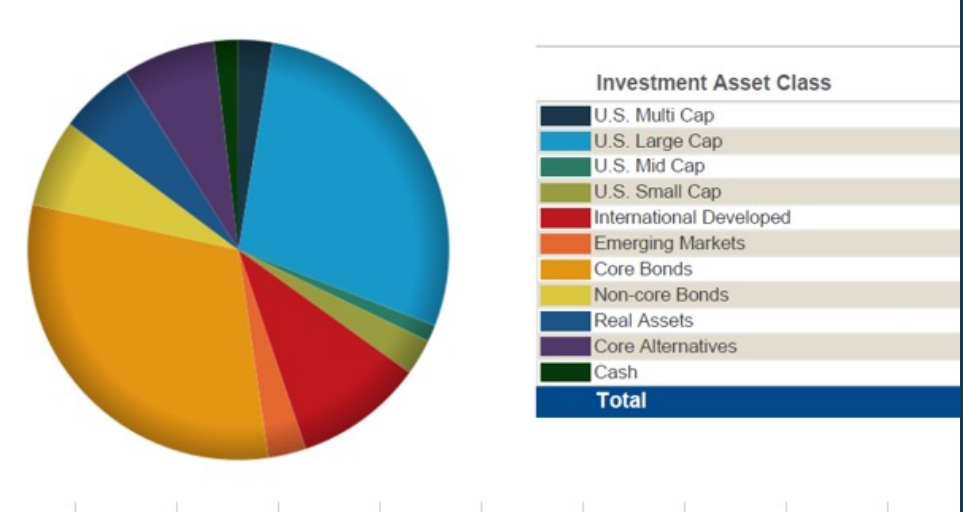
Asset Class Returns: 2012-2021

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
19.74% Real estate	41.31% Small cap stocks	30.19% Real estate	5.52% Large cap growth	26.56% Small cap stocks	27.44% Large cap growth	1.82% Cash	31.93% Large cap value	33.47% Large cap growth	46.19% Real estate
17.88% Mid cap stocks	33.50% Mid cap stocks	14.89% Large cap growth	4.68% Real estate	20.74% Mid cap stocks	27.19% International stocks	0.01% Investment grade bonds	31.49% Large cap stocks	18.40% Large cap stocks	32.01% Large cap growth
17.68% Large cap value	32.75% Large cap growth	13.69% Large cap stocks	1.38% Large cap stocks	17.40% Large cap value	21.83% Large cap stocks	-0.01% Large cap growth	31.13% Large cap growth	13.66% Mid cap stocks	28.71% Large cap stocks
16.83% International stocks	32.39% Large cap stocks	12.36% Large cap value	0.55% Investment grade bonds	17.13% High yield bonds	16.24% Mid cap stocks	-2.08% High yield bonds	29.01% Real estate	11.29% Small cap stocks	26.82% Small cap stocks
16.33% Small cap stocks	31.99% Large cap value	9.77% Mid cap stocks	0.03% Cash	11.96% Large cap stocks	15.36% Large cap value	-2.15% International bonds	26.20% Mid cap stocks	10.65% International stocks	24.90% Large cap value
16.00% Large cap stocks	15.29% International stocks	5.97% Investment grade bonds	-1.97% Small cap stocks	6.89% Large cap growth	13.23% Small cap stocks	-2.22% Real estate	22.78% Small cap stocks	10.11% International bonds	24.76% Mid cap stocks
15.81% High yield bonds	7.44% High yield bonds	5.76% Small cap stocks	-2.18% Mid cap stocks	4.50% International stocks	10.85% Real estate	-4.38% Large cap stocks	21.51% International stocks	7.51% Investment grade bonds	7.82% International stocks
14.61% Large cap growth	1.60% Real estate	2.45% High yield bonds	-3.13% Large cap value	3.39% Real estate	10.51% International bonds	-8.48% Small cap stocks	14.32% High yield bonds	7.11% High yield bonds	5.28% High yield bonds
4.21% Investment grade bonds	0.05% Cash	0.02% Cash	-4.47% High yield bonds	2.65% Investment grade bonds	7.50% High yield bonds	-8.95% Large cap value	8.72% Investment grade bonds	1.36% Large cap value	0.04% Cash
4.09% International bonds	-2.02% Investment grade bonds	-3.08% International bonds	-5.66% International stocks	1.49% International bonds	3.54% Investment grade bonds	-11.08% Mid cap stocks	5.09% International bonds	0.54% Cash	-1.54% Investment grade bonds
0.08% Cash	-3.08% International bonds	-3.87% International stocks	-6.02% International bonds	0.26% Cash	0.82% Cash	-14.20% International stocks	2.21% Cash	-2.17% Real estate	-7.05% International bonds

Source: Morningstar

8

Asset Allocation: Diversification is Key



9

Asset Allocation: Connecting the Dots

- Diversification is key
- Spreads risk across different types of investments
- Tends to increase risk-adjusted returns
- Only real free lunch in finance

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	YTD	Ann.	Vol.
EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Comdty. 25.5%	Large Cap 10.6%	REITs 23.2%
Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Cash 0.0%	Small Cap 8.7%	EM Equity 22.9%
DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	Asset Alloc. -3.9%	REITs 7.5%	Small Cap 22.5%
Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	Large Cap -4.6%	High Yield 6.6%	Comdty. 19.1%
Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 15.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.5%	REITs -5.3%	Asset Alloc. 5.7%	DM Equity 18.9%
Large Cap 5.5%	Comdty. -35.6%	Large Cap 21.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	High Yield -5.7%	EM Equity 4.8%	Large Cap 16.9%
Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	DM Equity -5.8%	DM Equity 4.1%	High Yield 12.2%
High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	Fixed Income -5.9%	Fixed Income 4.1%	Asset Alloc. 11.7%
Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	EM Equity -6.9%	Cash 0.8%	Fixed Income 3.3%
REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	Small Cap -7.5%	Comdty. -2.6%	Cash 0.7%

Source J.P. Morgan

Source J.P. Morgan

10

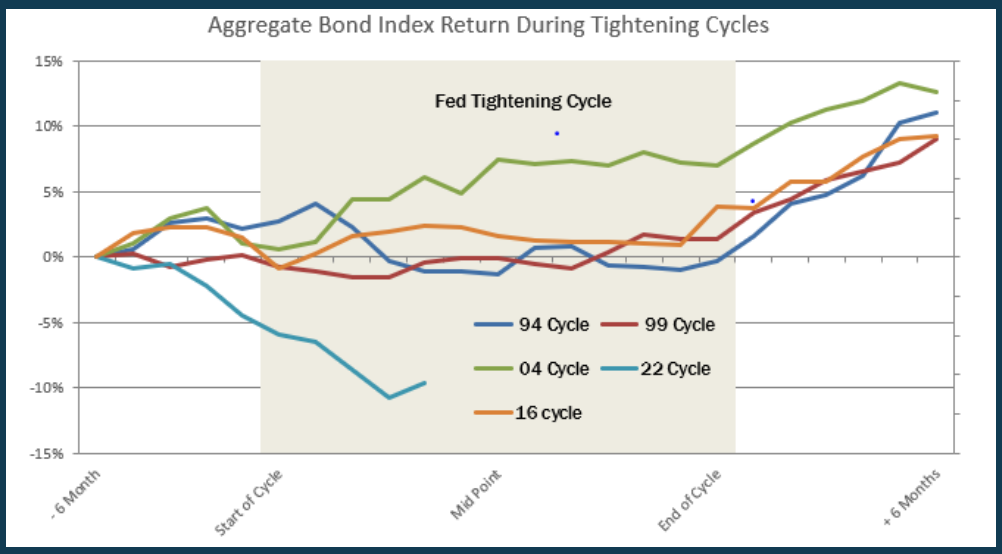
Fixed Income: The Forgotten Asset Class

Benefits of Fixed Income

- Income generation
- Efficient source of liquidity
- Capital preservation
- Inflation protection
- Diversification vs. equity exposures

11

Fixed Income: An Asset Class Reborn (?)



Source: Bloomberg, Sage

12

Fixed Income: Income (and Return)

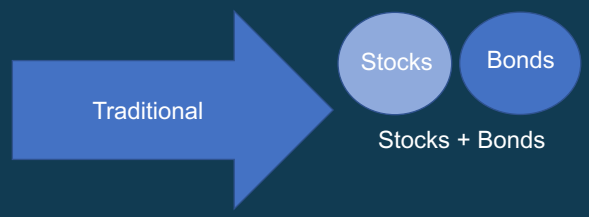
Opportunities in the Corporate Sector

Source: Bloomberg

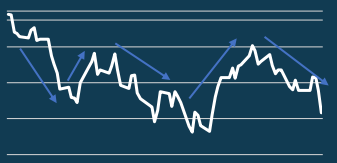
Corporate Spreads	150bp	175bp	200bp
% of days at this level	28	16	10
Average 1yr forward total return	8%	9%	10%
% of instances with positive return	91	88	85
Average 18m forward total return	13%	14%	16%
% of instances with positive return	98	99	100

13

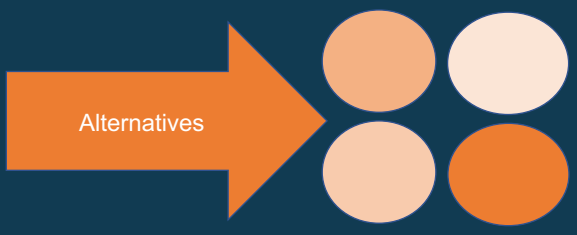
Alternatives: Not So Alternative Anymore



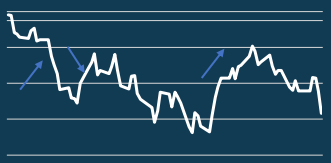
- Publicly Traded
- Highly Liquid
- Highly correlated
- Long Only



Dependent on market direction



- Focus on Inefficient Markets
- Unconstrained trading strategies
- Low correlation
- Less Liquid
- May be held in private markets

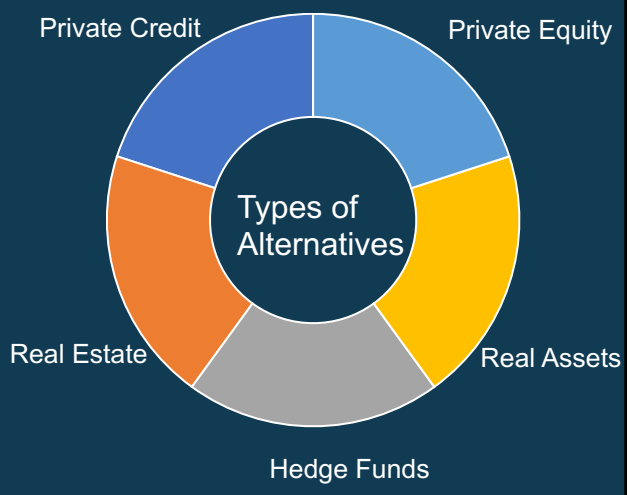


Independent of market direction

14

Alternatives: That Was Then. This is Now.

- Influx of Assets
  - Assets expected to double to $26 trillion over next 5 years*
- Time to Embrace Alternatives
  - Muted returns and higher volatility forcing investors elsewhere
  - Multiple asset classes / strategies
  - Improve diversification
  - "Retailization" enhances access

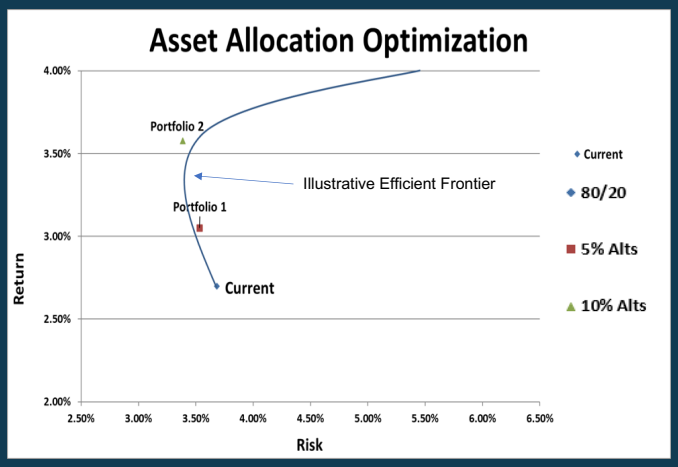


* Source: S&P Global Market Intelligence

15

Alternatives: But It's Never Easy

- Benefits
  - Multiple strategies
  - Absolute Return approaches
  - Improved risk-adjusted returns
  - Gaining traction w/ captives
- **Considerations**
  - **Complexity**
  - **Liquidity**
  - **Regulatory scrutiny**



Hypothetical portfolios represented by S&P 500 (equity) iShares Core US Aggregates Bond (fixed income) and equal –weighted blend of alternatives comprised of HFRX and Barclays Managed Futures Index. Source: Bloomberg, June 2002- April 2022

16

ESG: Almost as Easy as ABC (kinda sorta)

17

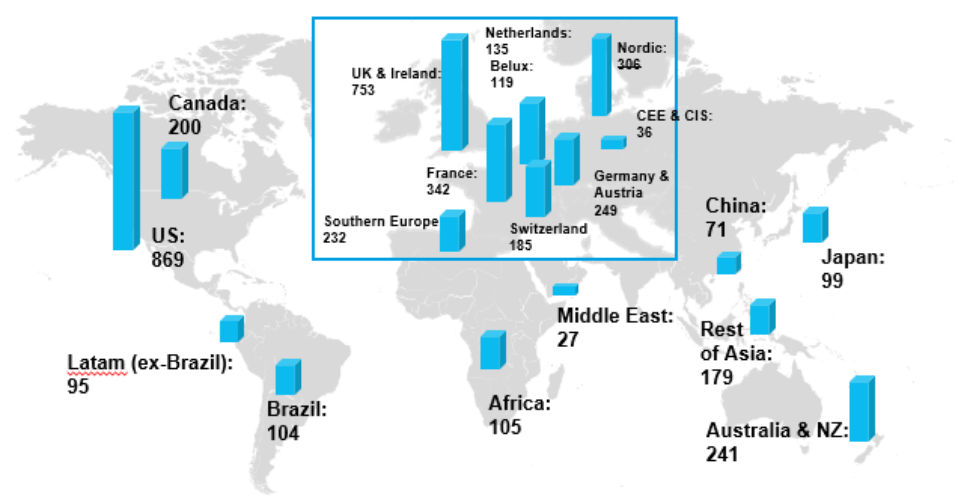
ESG: Factor Analysis

Environment	Social	Governance	
		Companies	Funds
• Climate change • Environmental policy • Sustainability best practice • Environmental management • Water supply • Sustainable transport • Waste	• Consumer rights • Supply chain management • Health and safety • Product safety • Labour relations, inc. relationship with unions • Community/ stakeholder relations	• Board structure • Independent directors • Chairman/CEO split • Exec. pay • Shareowner rights • Accounting/audit • Business ethics • Conflicts of interest	• Fund governance • Advisory Committee powers and composition • Valuation issues • Fee structures

18

ESG: Not a Passing Fad

4,300 Signatories to the PRI (Principles for Responsible Investing)



Source: PRI

19

ESG: Regulatory Momentum

Something wicked this way comes …

- NAIC (National Association of Insurance Commissioners)
- SIF (Sustainable Insurance Forum)
- IAIS (International Association of Insurance Supervisors)
- CDI (California Department of Insurance)
- NY-DFS (New York Department of Financial Services)
- Bermuda
- Guernsey

20

ESG: How Many Wins in a Win-Win?

Benefits of even partial adoption of ESG factor analysis

1. More defined culture of risk
2. Stronger corporate governance
3. Robust ERM practices
4. Reduce potential reputational risk
5. Differentiating, branding and marketing benefits
6. Get out in front of the regulators
7. Get out in front of the rating agencies
8. Greater alignment with the reinsurers
9. First-mover in the reallocation of capital
10. Opportunities for better risk-adjusted returns

21

Outside Investment Management: The Whys

Why an outside professional investment management?

- General expertise not available internally
- Access to resources not available internally
- Challenge of meeting income/performance goals
- Complexity of investment management issues
- Credibility with regulators and rating agencies
- Trifecta: Income, Capital Efficiencies, Surplus Protection

22

Outside Investment Management: The Whats

What to look for in a professional investment manager?

- Demonstrated knowledge of insurance industry – “insurance fluent”
- Insurance-dedicated resources
- Ability to effectively integrate with staff, senior management
- Unique industry insights and perspectives
- Delivery of enterprise-wide solutions
- Investment expertise
- Cost-effective delivery

23

Investments: Vegas Takeaways

- Risk Profiles
  - Understand what risk means to you and for you
  - Quantify risk at very level
- Asset Allocation
  - Seek proper alignment with business and growth objectives
  - Review investment policies / expand the opportunity set
- ESG
  - Start the process and avoid delayed and disruptive outcomes
  - Invest well and do good

24

Questions or Comments?

25