Special Advertising Section

BEST'S REVIEW®

ISSUES & ANSWERS:

INVESTMENT & ASSET MANAGEMENT

Asset managers, advisers, systems providers and others examine how insurers can meet the unique challenges of insurance portfolio management.

Interviewed Inside:

Chip Clark
NEAM

Elizabeth Henderson
AAM

Ryan Nava
Nationwide

Peter Trochev
Nationwide

Mark Paris
Invesco

View past Issues & Answers sections at
www.bestreview.com/issuesanswersarchive.asp

Buyer Beware

Chip Clark, president of New England Asset Management Inc. (NEAM), said that in this most recent economic downturn the Fed is providing liquidity and supporting markets. "Just understand what you're buying and make sure you're getting paid for the risks you're taking. You can have asset price inflation that doesn't mirror the fundamentals in the market," he said. The following are excerpts of an interview.

NEAM
New England Asset Management®

- Customized asset management solutions.
- Over $70 billion assets under management.
- Headquarters: Farmington, Conn.

Chip Clark
President
New England Asset Management, Inc.

"Be very disciplined in this market and know it's OK to take risk, but just make sure you're getting paid for that risk."

Go to the Issues & Answers section at *bestreview.com* to watch an interview with Chip Clark.

What have asset managers learned from previous periods of economic uncertainty?

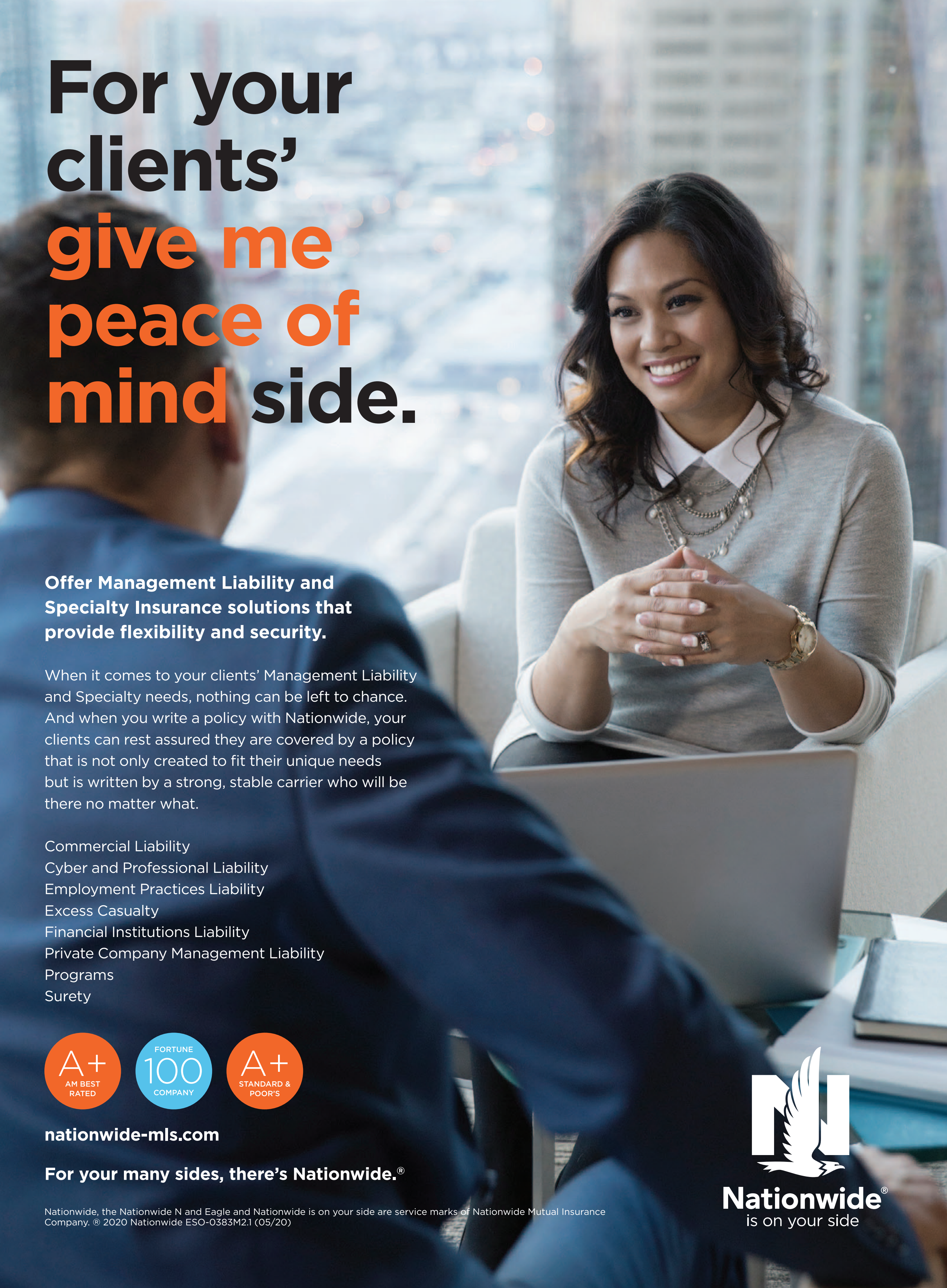
One of the things we've learned over the years is that periods of uncertainty and market dislocation generally create opportunities to buy high quality assets at attractive book deals. We think we're seeing that again today much like we saw in 2008/2009. During this crisis, we've been active buyers of spread product at levels that quite honestly we haven't seen in over a decade. We think we'll be rewarded for that as markets tend to oversell in periods of dislocation.

What have we learned about investing in a low rate environment?

You need to remain disciplined, but don't be complacent. In low rate environments, every basis point counts. As the book yield in your portfolio starts to decline as you're investing at lower new money rates, the natural inclination is to want to take more risk. Whether that's interest rate risk by extending duration, credit risk by going down in credit quality, increasing the allocation to structured product or potentially changing the mix of the equity versus fixed income allocations. We would tell insurance companies that this is a good time to take a hard look at how much risk you really want to take and is an opportune time to refresh the enterprise risk analysis that you're doing. This is a good time to remain disciplined. Don't be complacent. Don't step aside. There are opportunities here.

Do companies sometimes make mistakes in a volatile investment environment?

We've seen a couple of missteps over the years. One is the natural inclination to want to sell and de-risk a portfolio at the wrong time. Generally, people who are selling on that instinct are leaving money on the table. The second point is waiting to try to time the market. That's very, very difficult. What we typically like to do in periods like this is what we call "leg in thoughtfully." It's put money to work, but keep some powder dry. Typically, market dislocations will have what we call market rallies in bear markets and they can be a bit of a head fake. Leg in thoughtfully, keep some powder dry, you'll probably get another bite at the apple.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Brave New World

Ryan Nava, associate vice president, Financial Institutions at Nationwide, reported that the Management Liability market is carefully observing the economic impact of COVID-19, especially for companies directly affected by the pandemic. Peter Trochev, associate vice president, Financial Institutions at Nationwide, concurred, saying "our approach is to give every account the service that it deserves and determine how to best provide a solution." The following are excerpts of an interview.

Nationwide®

- Fortune 100 Company.
- AM Best rated A+ (Superior), FSC XV.

Ryan Nava
AVP, Financial Institutions
Management Liability and Specialty
Nationwide

Peter Trochev
AVP, Financial Institutions
Management Liability and Specialty
Nationwide

Go to the Issues & Answers section at *bestreview.com* to watch an interview with Ryan Nava and Peter Trochev.

Is the Fed policy during distressed times having an impact on insurers?

Nava: It's helping the economy overall for now. The Federal Reserve has taken a lot of action to slow the decline in the economy, which is a major part of why the Fed exists. Their actions are supporting the economy for now, however my concern is if this goes on for an extended period of time, those supports may not be enough.

Trochev: A business relying on commercial paper, repurchase agreement, or anything highly leveraged is going to have a hard time right now. With programs designed to help businesses sustain themselves, the Fed is implementing a round of quantitative easing the likes of which we have never seen.

Are you seeing an uptick in COVID-19-related claims?

Nava: We've seen some COVID-related claims come in, although more in the commercial space than in the financial institution space. We anticipate seeing more in the days ahead, but the bigger question is: will this pandemic result in major losses?

Trochev: We can't predict the future but financial strain on businesses could further stress the private equity space as portfolio companies see their supply chains disrupted.

What are you talking to clients about during these times?

Trochev: We ask what their exposure is and how they're performing. More importantly, what is their strategy or approach to mitigate the current risks in order to find a subsistence level.

Nava: We also ask how COVID-19 is affecting their relationship with their clients from an investment-adviser perspective. Are they still able to communicate with them effectively? Thankfully, technology has allowed the markets, work and life to go on, especially in the FI world. Technology has enabled this transition to be much, much smoother for everyone.

How is Nationwide meeting the challenge for clients through these trying times?

Trochev: We start with our mission statement, which is to protect people, businesses and futures with extraordinary care. We've been helping our members protect assets and prepare for their future for nearly 100 years. It's at the heart of who we are and it's what we'll continue to do in our work and in our service during this pandemic.

Nava: We went from 90% of our workforce in an office, to 98% work-from-home in the matter of a week without missing a beat or any material issues affecting our members. We look to be proactive, not reactive. No matter what challenges we face, we're prepared to continue to operate with our members' best interests at heart.

AAM

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Data as of 12/31/2019

Capital Strategy

Elizabeth Henderson, principal and director of corporate credit at AAM, said the company has increased its exposure to corporate bonds, preferring ‘A/AA’ quality issuers that are issuing today at levels historically associated with ‘BBB’ type credit risk. “We expect some turbulence in the underlying assets in the months to come, but see a number of opportunities in the deals with the strongest underwriting,” she said. The following is an excerpt of an interview.

Elizabeth Henderson

Principal and Director of Corporate Credit
AAM

“We recommend adding to higher quality below-investment-grade strategies (i.e., avoiding CCCs), and we are encouraging our clients to take advantage of attractive government related programs.”

Go to the Issues & Answers section at *bestreview.com* to watch an interview with Elizabeth Henderson.

What investment strategies do you recommend to take advantage of the broad sell-off in the capital markets?

As long-term investors, we strive to find investments that will provide a superior level of income and stability over the term of the investment. The significant selling across all markets associated with the COVID-19-related economic downturn was unprecedented. This distressed environment put a number of high quality investments at risk, but also created a number of opportunities. For example, corporations issued record amounts of debt in April to enhance liquidity at significant discounts, and the Federal Reserve announced programs to help jump-start the ABS and CMBS markets. The announcement that the Fed will buy credit instruments, including some high yield, put a backstop to the downside of these markets. Although the economic picture is cloudy with little certainty as to the strength of the recovery in the third quarter, these events have created great opportunities for long-term investors.

Should an insurance company consider drawing from the Federal Home Loan Bank to provide leverage for yield enhancement or arbitrage opportunities?

We have recommended that all of our insurance clients who have the ability to participate in FHLB programs take advantage of this opportunity. The strong market sell-off in March demonstrated why this membership is so important. In the event that liquidity was required for operational needs, the ability to draw from the FHLB at favorable rates allowed companies to avoid the panic and price deterioration across the bond markets. In addition, those clients that had adequate liquidity were able to draw from the FHLB and invest in high quality corporate, asset-backed and other structured product bonds on a matched-maturity program to generate significant yield enhancement or arbitrage opportunities. In particular, short-to-intermediate bonds offered similar yield spreads to longer maturity issues as the spread curves flattened. We were very opportunistic in approaching clients and executing these strategies both before and immediately after the Federal Reserve announced programs to stabilize these markets. Our ability to communicate and execute these strategies within a short period of time was recognized and appreciated by clients who took advantage of this opportunity.

How do you think the ratings agencies will react to the pandemic in structured products and corporate credit?

We think they’re going to be fairly aggressive in taking action against a broad variety of structured products, so they are not playing catch-up as they did in 2008-09. This has already occurred in the corporate bond sector. The agencies were very aggressive on the onset with sectors directly impacted by the virus. Subsequent to that, the agencies have revised their GDP forecasts lower, and they are now more conservative than the consensus. Hence, we expect more actions through the summer in other economically sensitive sectors, as optimistic assumptions fall short. We expect up to $500 billion of fallen angels in corporate credit by the time this is over.

Municipal Bond Considerations In the COVID-19 Era

Mark Paris, CIO and Head of Municipal Strategies for Invesco, said the COVID-19 crisis created significant volatility in the municipal bond market. "In response, Congress and the Federal Reserve began providing stimulus and liquidity facilities to the market, which should continue to have a positive impact overall on municipal credits," he said. The following are excerpts of an interview.

Mark Paris
CIO and Head of Municipal Strategies
Invesco

"Adding some selective high yield to a diversified high-grade portfolio can possibly add significant total return to a portfolio in our opinion."

Describe the current state of the municipal bond market.

Within high-grade municipal bonds, interest rates have stabilized, and new issue supply has improved, from March levels. However, despite this stabilization, municipal bond yields remain attractive compared to Treasuries as well as other high-quality credit sectors. This may present an opportunity for insurance companies and other investors seeking diversification from corporate credit risk. In particular, European insurers subject to the Solvency II regulatory regime and negative rates in their local bond markets may find municipals to be quite attractive considering their current yields and the fact that some infrastructure-related bonds may qualify for lower capital charges.

How have taxable municipal bonds fared and are they still an attractive asset class?

Taxable municipal bonds sold off alongside investment-grade corporates as COVID-19 weighed on the market. Although corporates and tax-exempts have stabilized, taxable municipal bond spreads remain elevated, widening over 100 basis points year-to-date, as of the end of April. We believe taxable municipal bonds are not only attractive on a spread basis versus corporate bonds but are also higher quality and experience fewer defaults with historically lower equity market correlations. We believe this represents a clear opportunity for institutional investors such as life insurers and pensions who, due to asset-liability management considerations, have a need for longer duration fixed income assets. Notably, most life insurers' and pensions' tax status means they do not enjoy the benefits of a tax-exempt municipal allocation, making the taxable space all the more compelling.

Where are you seeing the most attractive opportunities within the municipal sector?

Although the tone of the municipal market has improved, spreads within the high-yield market remain elevated. We believe there are attractive opportunities in larger liquid credits such as the transportation and hospital sectors. Relative to the high-yield corporate bond market, which could experience a surge in new entrants stemming from the significant current stock of BBB-rated bonds, the high-yield municipal space could be a more attractive way to utilize precious below-investment-grade budgets. With high yield also comes higher risk so we recommend being selective and relying on fundamental bottom-up credit research when investing in this asset class.