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Special points of interest:

- 5 year Sector performance
- Spread behavior
- Future expectations
- Considerations for positioning a small-mid sized insurance portfolio
- CapVisor conclusions

..insurers that maintained too conservative a posture... incurred a huge opportunity cost ...

Insurance Asset Management: 101

"An investment in knowledge always pays the best interest."--[Benjamin Franklin](#), American inventor, statesman

A look back...a look ahead

For those insurance companies willing to take on moderate credit risk in their investment portfolio, 2009 proved to be a banner year. Small to mid sized insurers that maintained too conservative a posture in their portfolios, perhaps understandable due to economic recession and a recent period of high market volatility, incurred a huge opportunity cost if they were fortunate and negative real returns or principle loss if not as fortunate. The chart below illustrates the atypical results experienced through the market turmoil.

	% Return by Year				
	2009	2008	2007	2006	2005
Fixed Income Sector					
Treasuries	-3.6	13.7	9	3.1	2.8
Treasury Inflation Protection Securities	11.4	-2.4	11.6	0.4	2.8
Mortgage-backed Securities	5.9	8.3	6.9	5.2	2.6
Corporate Bonds	18.7	-4.9	4.6	4.3	1.7
Barclays Aggregate	5.9	5.2	7	4.3	2.4
Municipal Securities	12.9	-2.5	3.4	4.8	3.5
High Yield Securities	58.2	-26.2	1.9	11.8	2.7
S&P 500	26.5	-37	5.5	15.8	4.9

Source: Russell, MSCI Inc., Dow Jones, Standard and Poors, Barclays Capital, J.P. Morgan Asset Management, CapVisor Associates

By observing five year return trends one can see the benefit of the smooth ride, through an unprecedentedly bumpy period, afforded by the Barclays Aggregate (AGG), which is really a diversified index of sectors. It's the beauty of diversification! Looking at sector returns over a longer time period clearly illustrates the additional compensation investors typically receive for investing in "other than riskless" securities, such as Treasuries. This longer period "normalizes" comparative returns and demonstrates the incremental yield pick-up expected for investments carrying various degrees of credit risk. For example, over the 10 year period ending in 2009, investors earned an average spread (excess return) over Treasuries of 30 BPs for an AGG portfolio. An average of 49 BPs and 60 BPs of excess return was earned for Corporate and MBS portfolios, respectively. These spreads also reflect compensation for additional risks inherent in the security types such as prepayment and reinvestment risks. Interestingly, "riskless" TIPS yielded a 189 BP average spread over Treasuries while also providing inflation protection! This is rather impressive since the inflation protection removes some risks that even Treasuries possess.

In the future, we expect a "reversion to the mean" of spreads. In other words, return relationships among sectors will more closely reflect their longer term averages. Near term, you may hear "spread



The management team... should have an understanding of fixed income sectors, their risk/reward profiles...

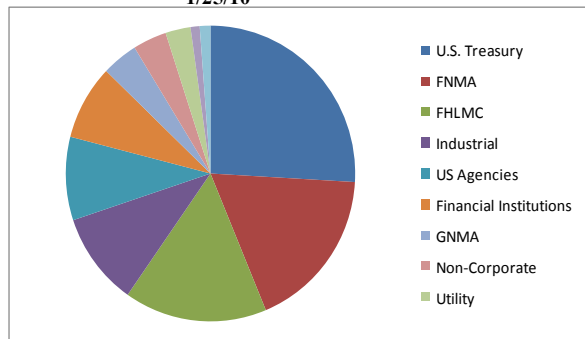
A look back...a look ahead

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narrowing” used to convey this concept. Indexes commonly used by insurers, such as the Barclays Agg,

benchmark/ index to assess your risk budget and aid in portfolio construction in accordance with your risk profile.

Barclays AGG sector allocation 1/25/10



the Intermediate Government Credit and the Short-Intermediate each offer degrees of diversification over the individual sector returns listed above. When properly selected or customized to closely match your company’s liability duration (asset liability matching), these indexes can serve as useful benchmarks for evaluating investment manager performance. In turn, investment managers can use an appropriately selected

process to be dependent, to various degrees, upon delivering excess return over the selected benchmark through sector rotation strategies. These strategies over- or under-weight sectors in your portfolio relative to the sectors’ weighting in the selected index. Investment managers seek to over-weight “cheap” sectors and under-weight

“expensive” sectors as determined by their “relative value” analysis. This quantitative and/or qualitative analysis evaluates the sector’s return as compared to Treasuries (the “spread”) of the same duration or maturity to determine if excess compensation or insufficient compensation is afforded to cover the sector’s various risks (these risks include: credit, pre-payment, downgrade, interest rate, reinvestment, currency, etc.) For example, if an investment manager’s relative value analysis determines that Corporates are “cheap”, they will carry a higher percentage of corporate bonds in your portfolio than are reflected in your benchmark in an attempt to outperform this index.



Conclusions

The management team of small to mid-sized insurers should have an understanding of fixed income sectors, their risk/reward profiles and investment manager sector rotation techniques. Insurance company portfolios should be constructed in a manner reflective of the captive management’s risk appetite represented by the benchmark. To gain diversification benefits, this benchmark should typically contain multiple sectors to provide a more predictable income stream and a better risk-adjusted investment result. Proper selection or customization of indices to be used as the performance benchmark is a critical task. The index’s sector allocations will loosely mirror the approximate weighting of sectors in your portfolio and therefore should be reflective of your risk profile. The benchmark selection criterion should also incorporate your overall investment objectives as it will serve as a guide for many of your investment managers decisions and directly impact your investment result.

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