

CPIC Market Update June 2, 2020

- We are experiencing a significant global recession and previously unseen volatility in the financial markets as a result of the COVID-19 global pandemic
- Since mid-March, more than 40 million Americans have filed for unemployment claims, effectively erasing more than a decade of job creation. In addition, industrial production has fallen, retail sales have declined at a record pace, and housing sales have slumped
- In April, total nonfarm payroll employment fell by 20.5 million, the labor participation rate decreased from 62.7% to 60.2%, and the unemployment rate increased by 10.3% to 14.7%. This is the highest rate and the largest over-the-month increase in the history of the series (seasonally adjusted data are available back to January 1948).
- In April, the number of unemployed persons rose by 15.9 million and the number of people looking for full-time work increased by 4.4 million. The sharp increases reflects the effects of the coronavirus pandemic and public health efforts to contain it. May's unemployment numbers will be released on Friday, June 5th, and we expect unemployment rate to increase to 16% before coming down in the third quarter to 12% as the economy reopens.
- In the United States, multiple federal stimulus packages in the total amount of approximately \$3T have been passed in an attempt to shore up the economic conditions and to mitigate the impacts on businesses and individuals and certainly we expect more stimulus to come potentially in the additional amount of \$1-1.5T.
- The U.S. Federal Reserve reduced its Fed Funds target from 1.50%-1.75% to 0.00%-0.25% in two cuts – the first cut on March 4th was 0.25% to a range of 1.25%-1.50% and the second cut on March 14th was 1.00% to a range of 0.00%-0.25%
- In addition, the Fed is also in full “QE Infiniti and Beyond” mode. Its current balance sheet is at \$7.1T as compared to \$4.2T on December 31, 2019 or an increase of \$2.9T over the last 5 months.
- Before the contraction due to COVID, U.S. GDP had grown nearly unimpeded since the Great Recession of 2007-2009. During the record expansion, the unemployment rate fell to a 50-year low of 3.5%, and the U.S. economy added jobs for 9.5 years in a row
- U.S. gross domestic product fell at a 4.8% annualized rate in the first quarter, which marks the official end to the U.S.'s longest economic expansion that started following

the Great Recession. Current-dollar GDP decreased 3.5%, or \$191.2 billion, in the first quarter to a level of \$21.54 trillion

- Real GDP is expected to decline by approximately 8% during the second quarter, equivalent to a decline at an annual rate of 32% for that quarter
- According to the CBO, on an annual basis, real GDP is projected to be -5.6% for 2020 and 2.8% for 2021. Our estimate is for “zero” net growth till the end of 2021 as we expect GDP to return to end of year 2019 levels by the end of 2021
- The equity market has also been very volatile but has recovered and stabilized partially due to Fed’s liquidity injection as well as economic recovery expectations in 2021. S&P500 is only down 5% for the year and DJIA is down 11% for the year
- Fixed income markets have seen interest rates crater to never before seen lows with the 30-year Treasury closing at 0.99% on March 9th and the 10-year Treasury rate went as low as 54 bps on March 9th. As of yesterday, 2 year Treasury was 16 bps and 10 year was 66 bps
- The 1-10 year yield curve is at almost historical low point or between 70% and 90% below its 5-year averages and 72% and 84% lower than its 10-year averages

U.S. Treasury Rates								
	1-Year	2-Year	5-Year	7-Year	10-Year	3Mo-5Yr Spread	10Yr Spread	2-10 Yr Spread
Current (5/29)	0.17	0.16	0.30	0.50	0.65	0.16	0.47	0.49
1-Yr Prior	2.21	1.95	1.93	2.03	2.14	(0.42)	(0.21)	0.19
2-Yrs Prior	2.28	2.47	2.74	2.85	2.89	0.82	0.79	0.42
5-Yrs Prior	0.29	0.73	1.75	2.16	2.41	1.72	2.33	1.68
5-Yr Average	1.34	1.49	1.84	2.05	2.19	0.71	0.95	0.70
10-Yr Average	0.76	0.95	1.58	1.95	2.29	0.98	1.62	1.34
Current as % Above / Below 5-Yr Average	-87%	-89%	-84%	-76%	-70%	-77%	-51%	-30%
Current as % Above / Below 10-Yr Average	-78%	-83%	-81%	-74%	-72%	-84%	-71%	-63%

- Corporate issuance is very strong, as of May 27, 2020, total investment grade corporate bond issuance is \$967 billion as compared to 2019 total issuance of \$1.06T – we expect corporate issuance to be over \$1.75T this year or 40% above record issuance of \$1.243T in 2017

Risk Transfer Market

- Reinsurance pricing conditions softened from 2015 through 2017, but the insurance industry has incurred approximately \$19 billion of losses from Hurricanes Irma and

Michael and is projected to ultimately incur approximately \$21 billion in losses. Globally there were over \$275 billion of insured losses from 2017 and 2019.

- Lloyd's predicts COVID will cost the non-life industry approximately \$200 billion in insured and investment losses (approximately \$107 billion in underwriting losses and approximately \$96 billion in investment losses), making it the largest single loss event ever experienced by the global market
- The risk transfer markets are currently disjointed and to some extent fragmented and expecting significant above normal return to recover prior year losses.
- Reinsurers are operating with an increased cost of capital as a result of increased retrocession costs and higher return expectations from third-party capital providers due to widening spreads in alternative markets such as the corporate bond market, as well as proactively trying to manage their potential risk to COVID claims – due to these factors, price increases are in the range of 15%-20% on average and 50%-100% in extreme cases

Florida Risk Transfer Market

- Loss creep and social inflation in Florida has ballooned for numerous carriers primarily due to the increases in litigation and assignment of benefits over recent years
- HB301 passed in 2019 and revised the FHCF LAE allowance from 5% to 10%, which removed approximately \$700 million of LAE risk from the private reinsurance market for 2019
- Average reinsurance rate increases in Florida were approximately 10%-20% in 2019, but loss affected layers and inefficient companies were seeing increases of greater than 30%
- For 2020, most renewals were priced in the range of 15%-35% increases, with the highest concentration in the 25%-30% bracket
- Florida reinsurance pricing in 2020 demonstrated an even greater amount of differentiation from reinsurers over the Florida companies they backed with those with accurate loss estimates, minimal adverse loss development and management of litigated claims receiving better pricing terms

- The coverage participation in the FHCF reflects the dynamics of the private reinsurance market and allows insurers to optimize their coverage based on market equilibrium
 - The average percentage coverage selection increased from 73.5% for the 2018-2019 contract year during softening private reinsurance market conditions to 81.6% for the 2019-2020 contract year and to 86.2% for the current contract year