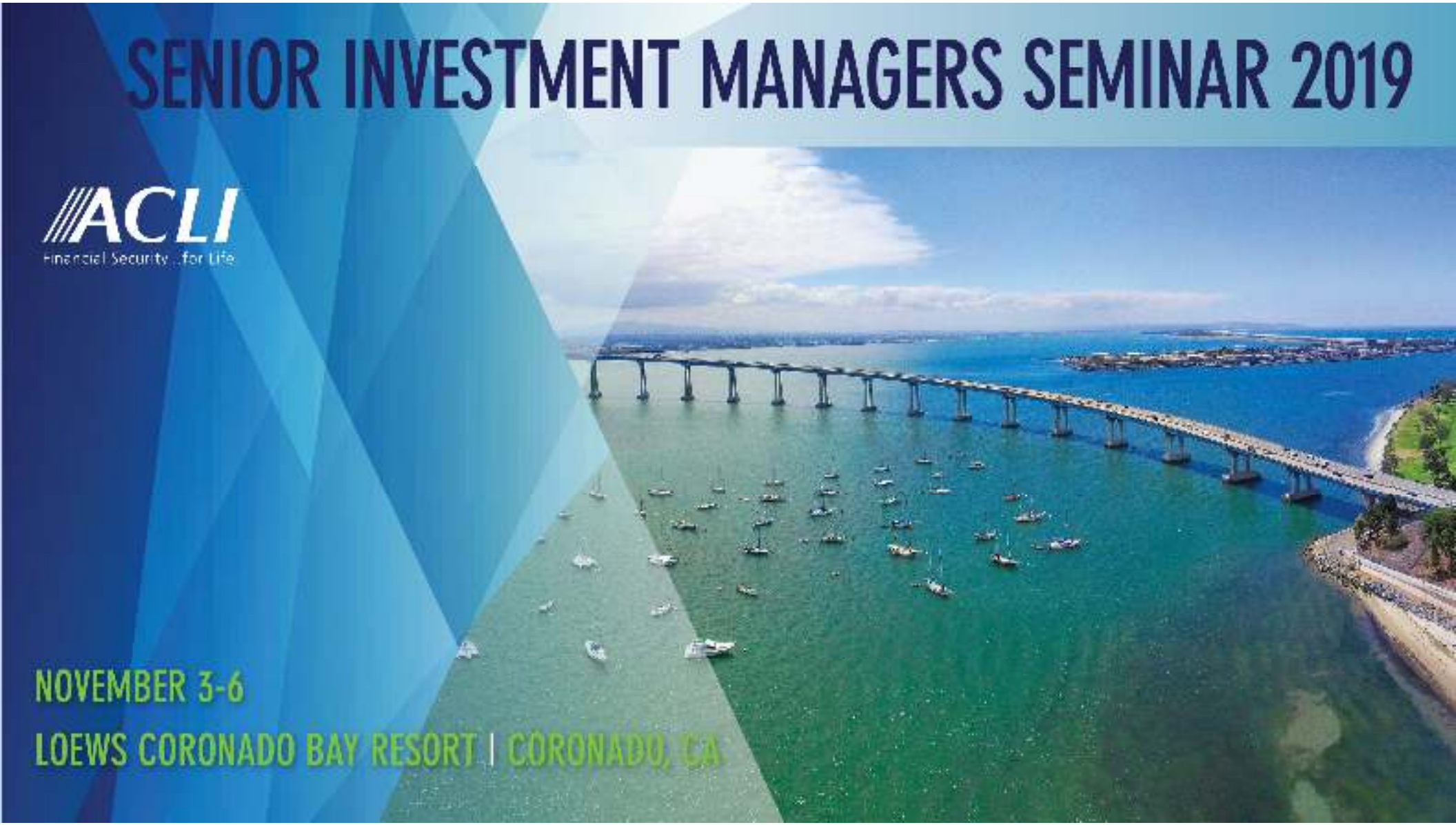
SENIOR INVESTMENT MANAGERS SEMINAR 2019

ACLI
Financial Security ...for Life



NOVEMBER 3-6

LOEWS CORONADO BAY RESORT | CORONADO, CA

Peter Gailliot

Global CIO of the Financial Institutions Group (FIG) and
Head of Fixed Income FIG Portfolio Management

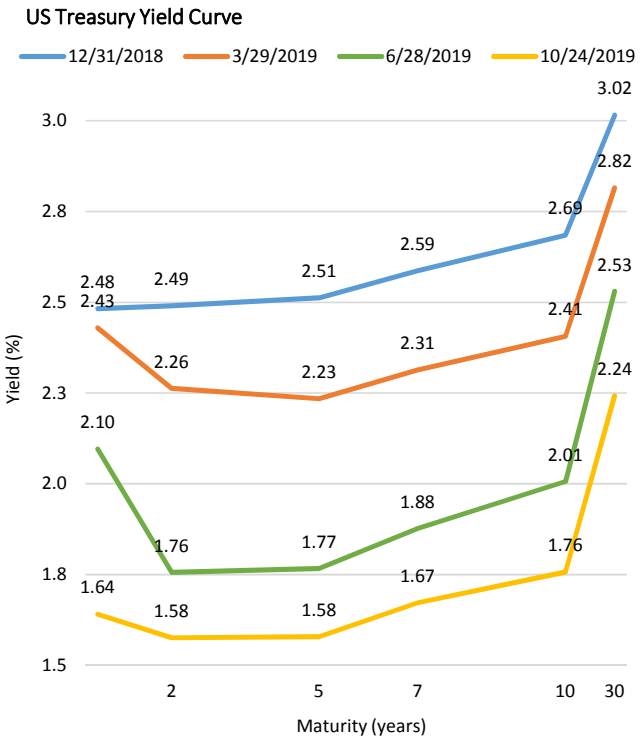
BlackRock

Market Outlook

Navigating the Late Cycle Environment

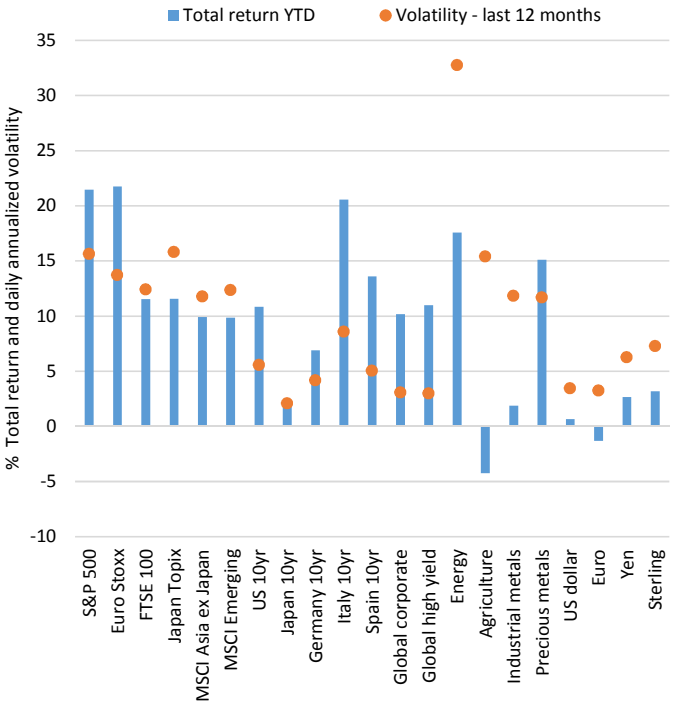
Key themes for markets

Interest Rates



Source: Bloomberg as of October 24, 2019. Past performance is not a guarantee of future results.

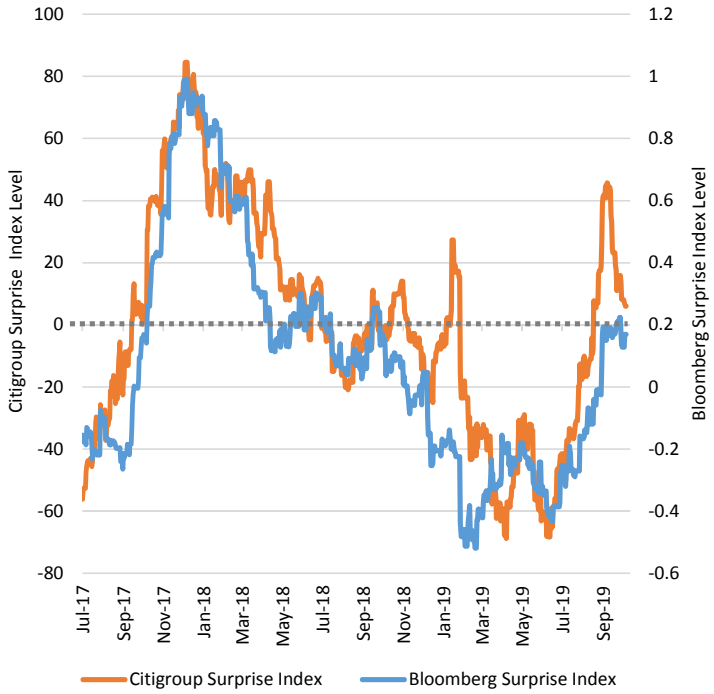
Asset Performance and Volatility



Source: Refinitiv Datastream, chart by BlackRock as of October 22, 2019. Note: The bars show the total return in local currency terms except for currencies, gold and copper which are the spot returns. Government bonds are 10-year benchmark issues. Index returns are shown for illustrative purposes only. It is not possible to invest directly in an index. Past performance is not indicative of future results.

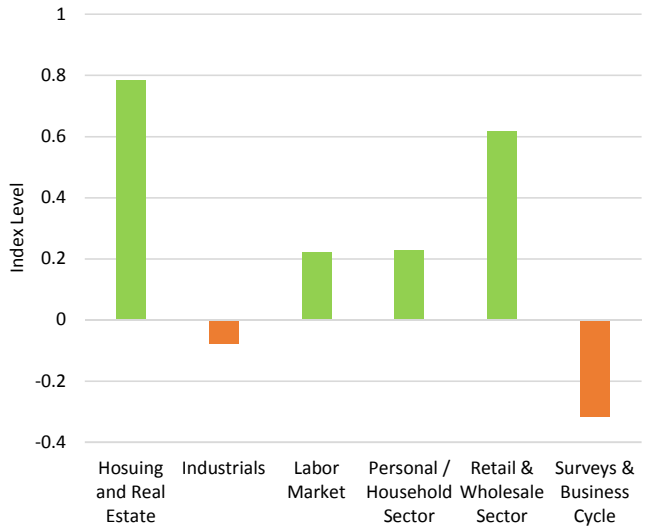
Surprise, Surprise

Economic Surprise Indices



Source for both charts: Bloomberg as of October 23, 2019. Past performance is not a guarantee of future results.

Economic Surprise Sector Snapshot

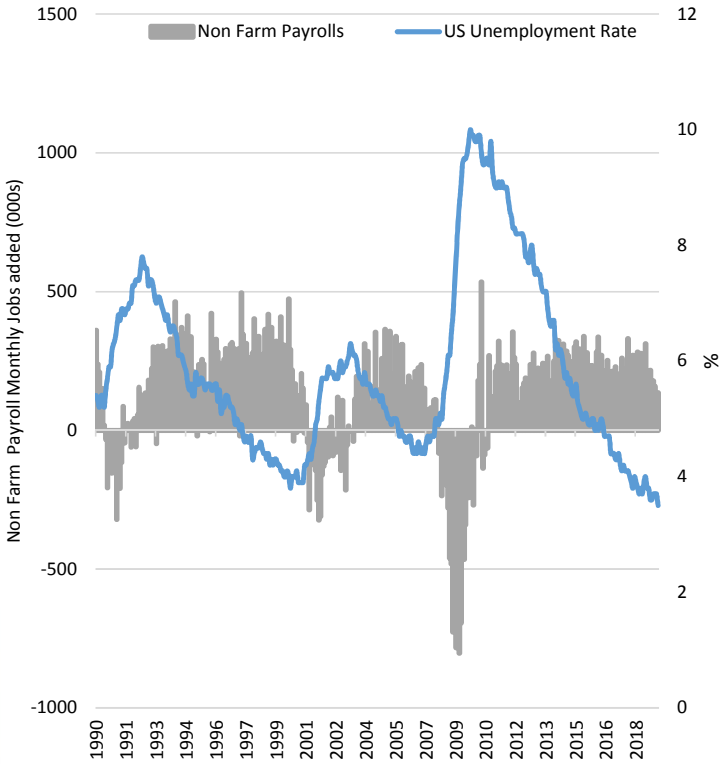


The **Bloomberg ECO Surprise Index** shows the degree to which economic analysts under-or over-estimate the trends in the business cycle. The surprise element is defined as the percentage (or percentage point) difference between analyst forecasts and the published value of economic data releases.

The **Citi Economic Surprise Indices** measure data surprises relative to market expectations. A positive reading means that data releases have been stronger than expected and a negative reading means that data releases have been worse than expected.

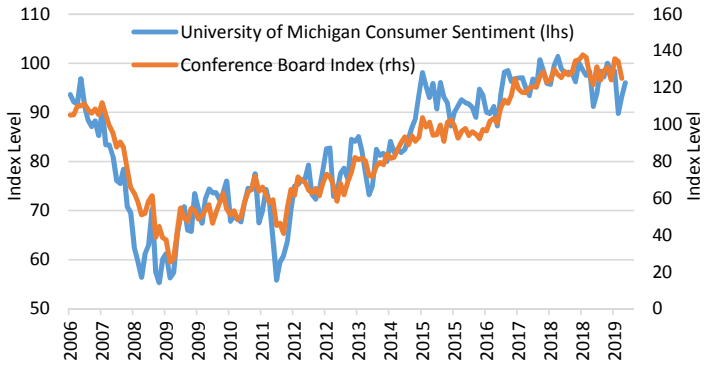
Surprise, Surprise

US Unemployment



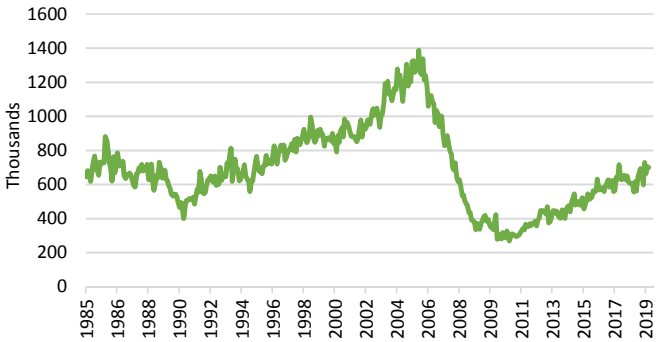
Source: Bloomberg; as of October 6, 2019

Consumer Sentiment



Source: Conference Board, Bloomberg; BlackRock as of October 24, 2019

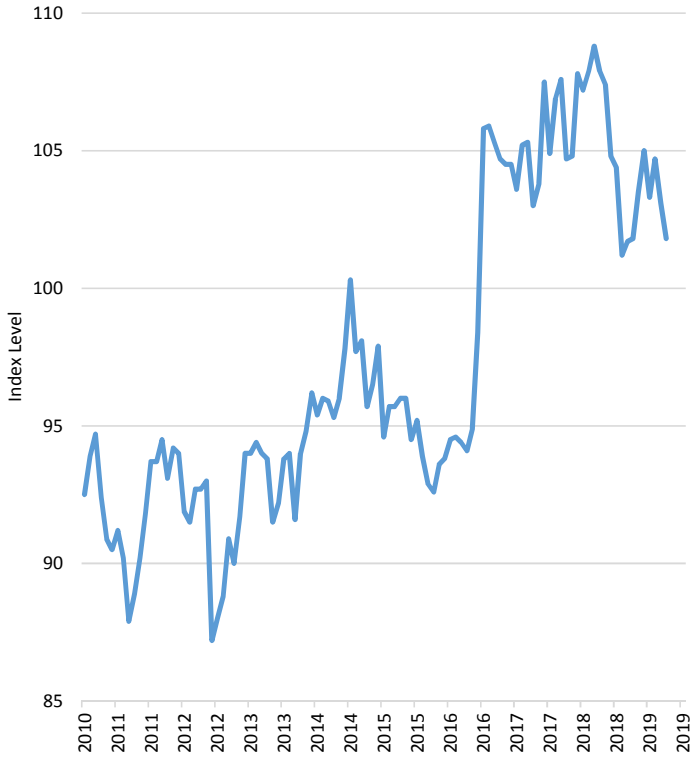
New Home Sales



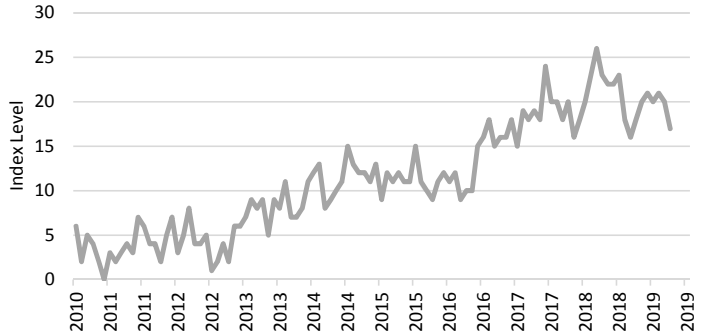
Source: Bloomberg; BlackRock as of October 24, 2019

Small Business

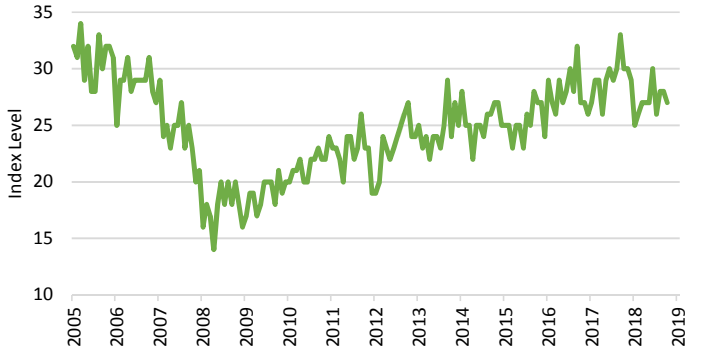
NFIB Small Business Optimism Index



NFIB Small Business Hiring Plans Index



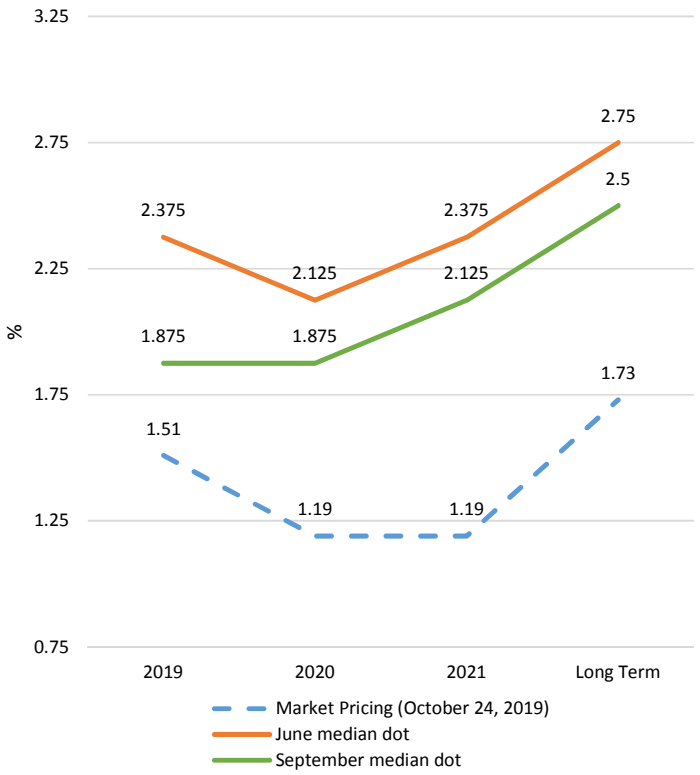
NFIB Small Business Capital Expenditure Plans Index



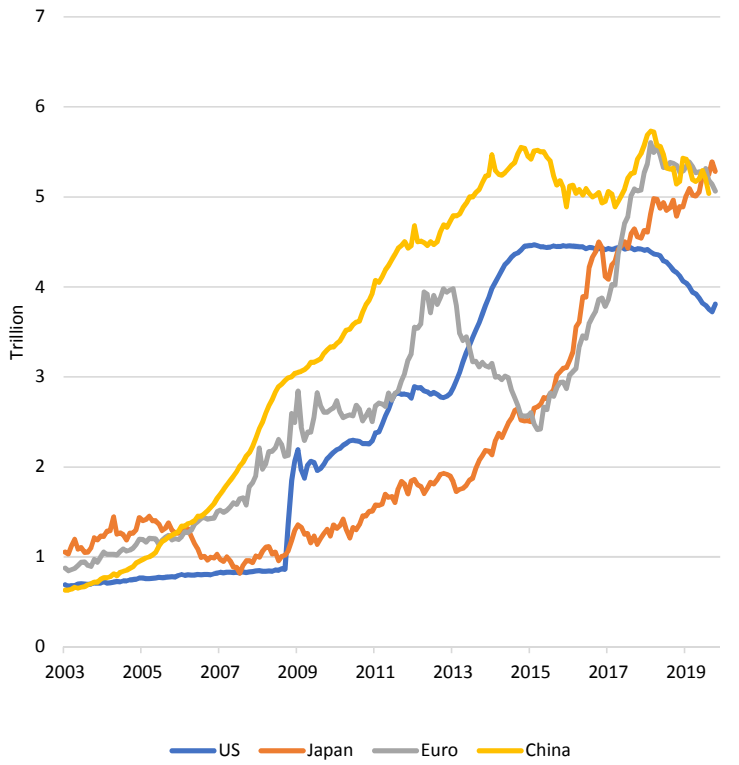
Source for all charts: Bloomberg, BlackRock, October 8, 2019

The Fed

Fed Dot Plot and Market Pricing



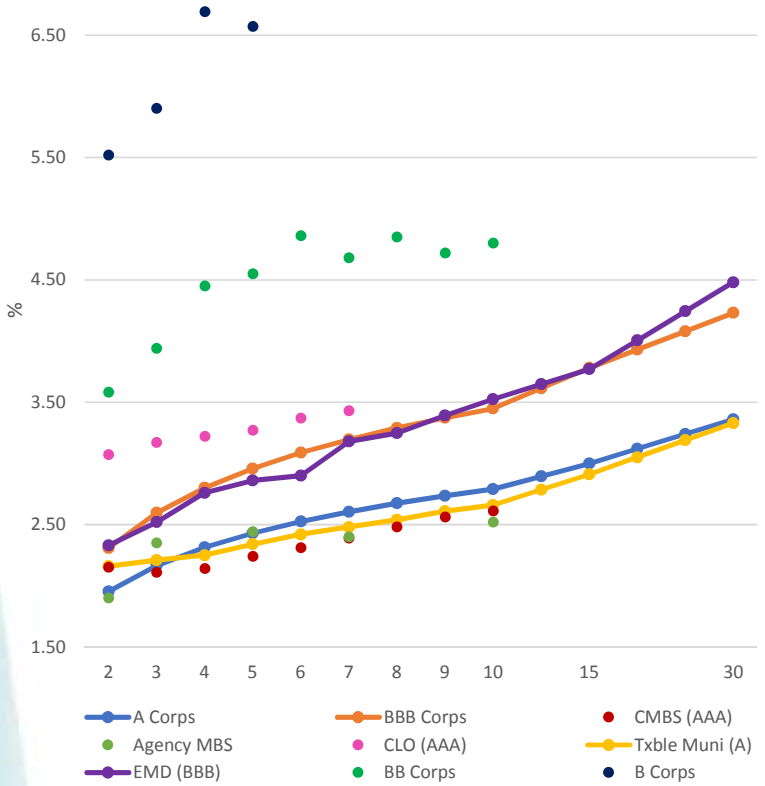
Central Bank Balance Sheets in U.S. dollars



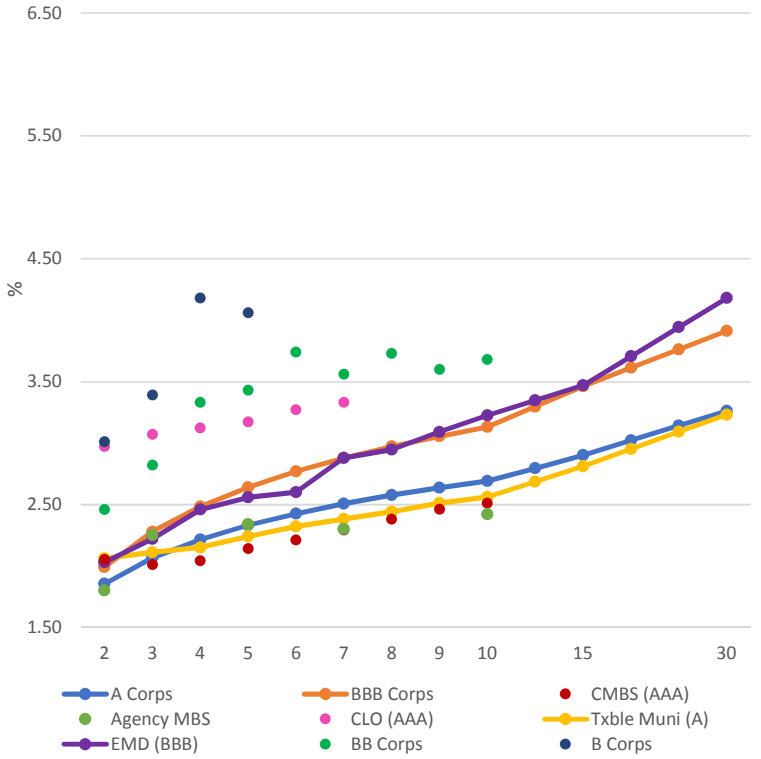
Source both charts: Federal Reserve, Bloomberg; as of October 24, 2019

Yields

Unadjusted Yields



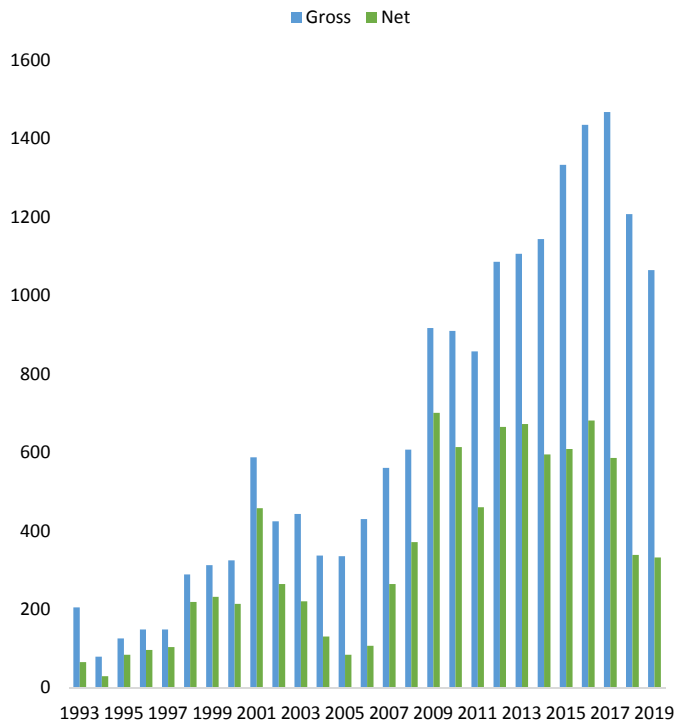
Capital Adjusted Yields



Source: Bloomberg, BlackRock as of October 8. 2019. Data sourced from Bloomberg Barclays Indices and BlackRock's proprietary database. Adjustments reflect NAIC RBC charges. Past performance is not indicative of future results.

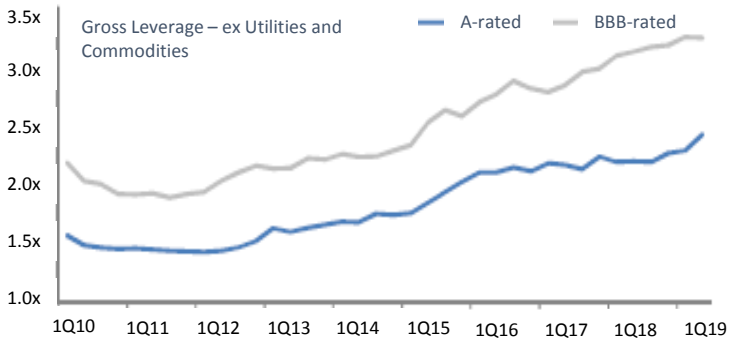
Corporates

Issuance



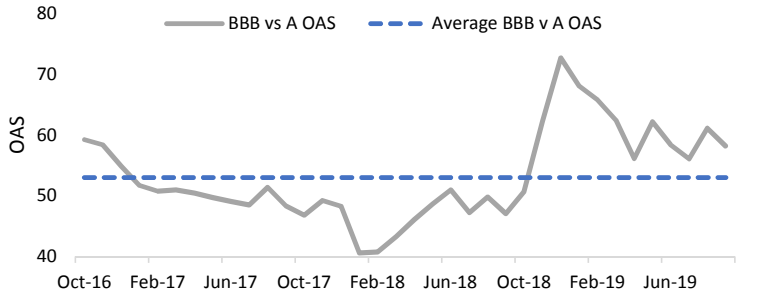
Source: Barclays as of October 4, 2019.

Leverage



Source: JP Morgan September 26, 2019

Spreads and Credit Quality



Source: Bloomberg, BlackRock as of October 23 ,2019. Data derived from the Bloomberg Barclays Corporate Credit Index. Past performance is not a guarantee of future results.. High Quality denotes A rated and above.

Credit Stress Migration

Background and Methodology: Insurers have been adding corporate credit and NAIC 2+ rated credit in search of yield. However, the early 2000's recession drove the worst recent period of Moody's credit rating downgrades.

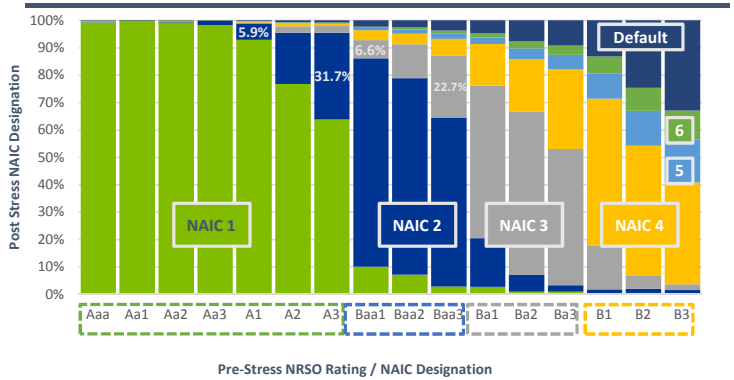
The **2001-2003 ratings migration experience** anchors a stress of YE2018 public and private credit to answer "what happens to credit quality" and "what are the implications for risk-based capital?" We observe:

- NAIC 1, **A3-rated bond is 5.4x more likely to get downgraded to NAIC 2** vs. an NAIC 1, A1-rated bond (31.7% vs. 5.9%)
- NAIC 2, **Baa3-rated bond is 3.4x more likely to get downgraded to NAIC 3** vs. a NAIC 2, Baa1-rated bond (22.7% vs. 6.6%)

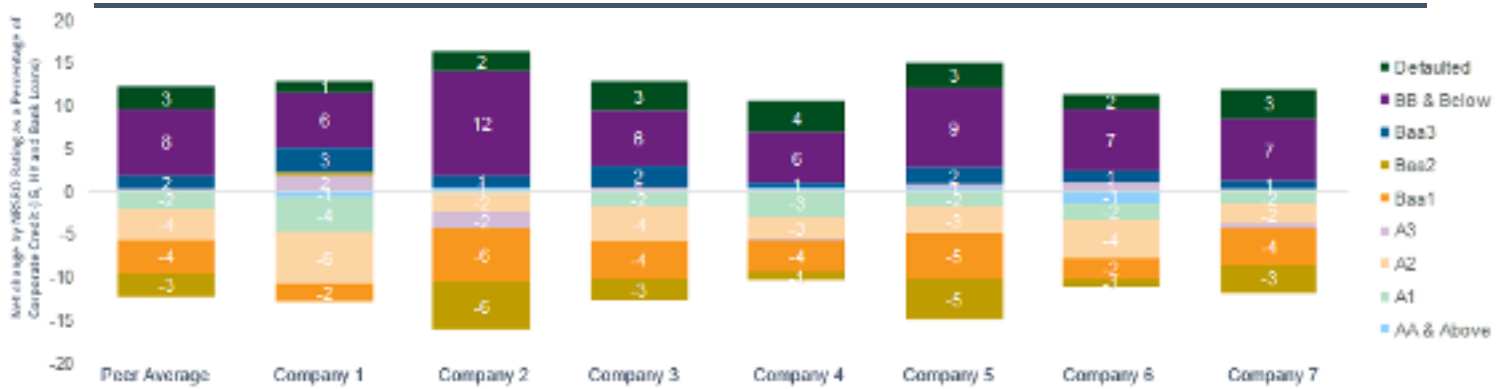
BlackRock's insurer portfolio stress model:

a) analyzes portfolio impact – ratings migration and expected losses
b) assess implications to RBC, including regulatory intervention
c) estimate capital infusion needed to restore pre-stress RBC

Corporate Credit – Cumulative Ratings Transition and Default Assumptions (Moody's 2001 -2003)



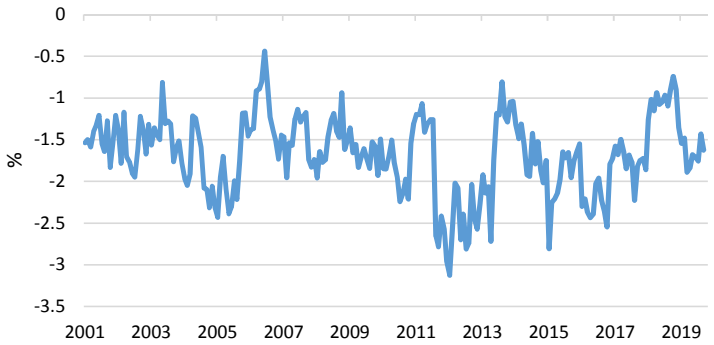
Applying Moody's 2001-2003 Cumulative Ratings Transition and Default Experience to YE 2018 Public Corporate Credit
Net change from pre-stress ratings mix to post-stress ratings mix for Public Corporate Credit (IG, HY and Bank Loan corporates)



Source: Moody's Annual Default Study: Corporate Default and Recovery Rates 1983-2001/2002/2003, BlackRock analysis. Assumes no change in price as a result of the downgrade; had price impacts been included the post-stress ratings mix would have changed, so the net change by rating would have changed.

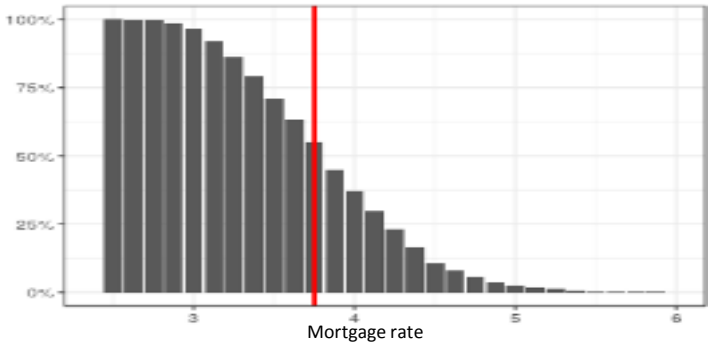
Agency MBS

Bloomberg Barclays MBS Index Convexity



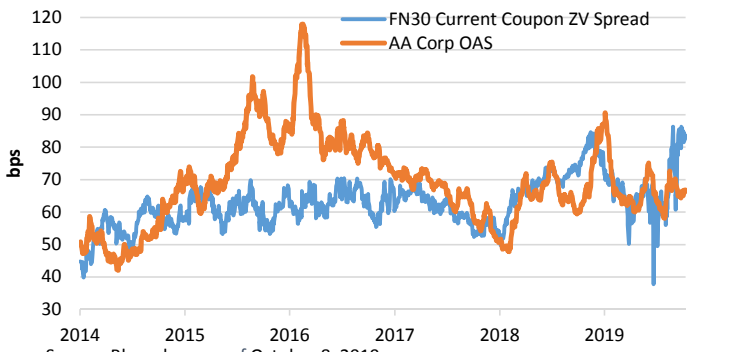
Source: Bloomberg as of October 3, 2019

% Mortgages in the money



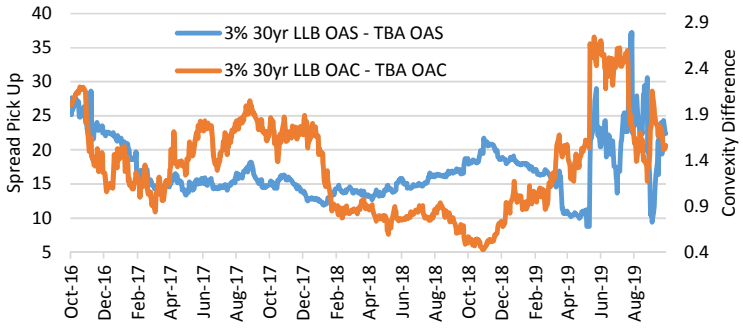
Source: Bloomberg as of August 2, 2019. Red line represents proportion of mortgages in the money (lhs)

Agency MBS spreads vs AA Corporates



Source: Bloomberg as of October 8, 2019

TBAs vs. Specified Pools

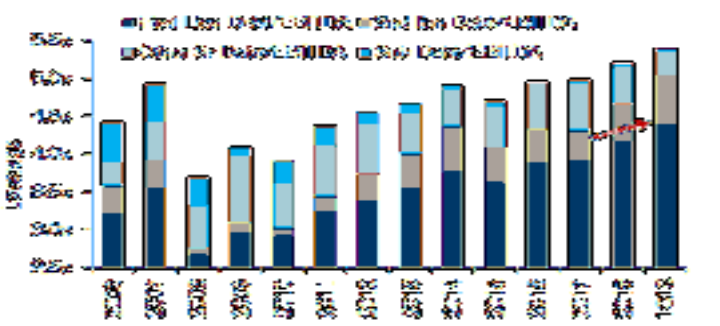


Source: Bloomberg as of October 8, 2019

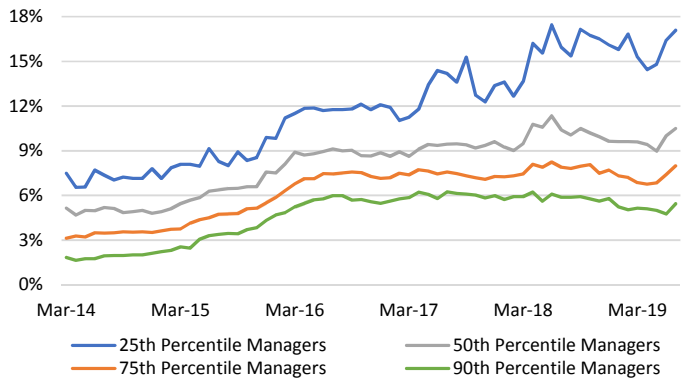
CLOs

Historical US Loan Default Rates[1]

Loan new issue leverage at all-time highs[2]



CLO CCC Exposure[3]



1. Source: Wells Fargo, LCD as of 8 October, 2019. 2. Source: Credit Suisse, S&P Loan Syndications and Trading Association as of 30 June, 2019. 3. Source: Kanerai as of July, 2019.