Equity Market Volatility Spikes to Start 2022

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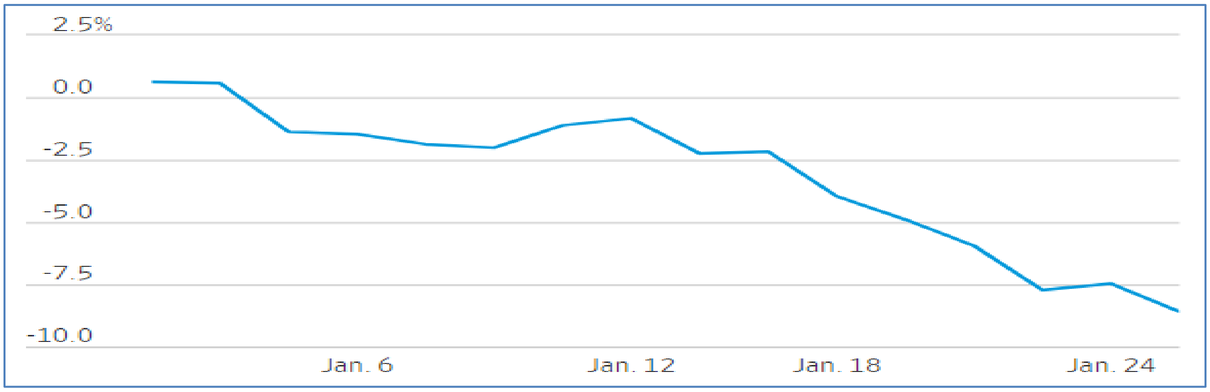
Both economic and geopolitical factors have caused some volatility in the financial markets, including a recent significant decline in equity markets into "correction territory," or a decrease greater than 10%. Equity markets have been declining over the last few weeks after reaching a record high at the beginning of 2022 when Standard & Poor's 500 Index (S&P 500) reached almost 4,800. On Jan. 24, the S&P 500 was down as much as 2% intraday, but it rebounded to finish the day up 0.3%. Volatility continued into the following trading day, with the index declining 1.2% on Jan. 25.

On a year-to-date (YTD) basis, the S&P 500 has decreased 8.6% as of Jan. 25 (see Chart 1). Despite the YTD decline and recent volatility, the S&P 500 has still achieved a one-year return of 13.2%.

Chart 1: S&P 500 Index, % Return YTD, Jan. 25, 2022



The decline is due, in part, to anticipation of the Federal Reserve's upcoming meeting, where its plans regarding staving the current high inflation rate may be exposed, including three possible rate hikes in 2022. The Federal Reserve has kept the federal funds rate at a 0% – 0.25% range since March 2020, in part, to encourage economic activity during the COVID-19 pandemic. In addition, the equity markets have been negatively affected by geopolitical tensions with Russia over its military buildup on the Ukraine border.

At year-end 2020, U.S. insurer exposure to common equities was about $993 billion in book/adjusted carrying value (BACV), representing a 7% increase from year-end 2019. This was due, in part, to an increase in market valuations. Assuming insurers' equity portfolio remained constant, with no acquisitions or dispositions in 2021, and based on overall equity market performance, it is estimated that U.S. insurers experienced an approximately 28% weighted average increase in the BACV of their common stock holdings as of December 2021. The significant equity market declines thus far in January 2022, and any continued declines, will have a material impact on the BACV of U.S. insurer common stock holdings, particularly for property/casualty (P/C) insurance companies who own 75% of the industry's common stock holdings.

The NAIC Capital Markets Bureau will continue to monitor market events pertaining to this topic and report as deemed appropriate.

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