The [illegible] monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the [illegible]

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Since the Capital Markets Bureau's last ***Capital Markets Update*** was published in March 2016, financial markets have experienced wide swings in temperament, from relatively brief episodes of extreme volatility triggered by geopolitical or economic events—most notably the "Brexit" referendum in the U.K. on June 23—to longer periods of extreme calm. Most major global debt and equity markets rebounded relatively quickly following the Brexit vote, and remain in positive territory year to date (YTD) as of Aug. 17. Oil and commodities also have improved YTD, although the near-term outlook for oil prices has been muddied by an inventory surplus. Table 1 and Table 2 show representative total returns for select fixed income and equity benchmark indices thus far in 2016.

[illegible]

Selected Bond Index Total Returns (%)						
Index	2015	Q1/2016	Q2/2016	H1/2016	Jul. 2016	2016 YTD
BAML US (IG) Corp & Gov Index	0.30	3.50	2.68	6.27	0.79	7.11
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Source: Bloomberg LP

[illegible]

[redacted]

S&P 500 (US)	1.37	1.35	2.46	3.84	3.69	0.58	8.29
S&P/TSX Composite (Canada)	(23.00)	11.40	5.04	17.02	3.18	2.39	23.64
STOXX Europe 600	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Source: Bloomberg LP

Ironically, the themes underlying both the relative calm of today's markets and the volatility in June and July are the same, and by now are familiar to most investors, including insurers:

- Global growth concerns, particularly with respect to China and the U.K., and ongoing price weakness of oil and most other commodities
- Continued monetary stimulus in Europe and Asia driving global bond yields ever lower, resulting in a rising proportion of negative-yielding government bonds
- Diverging expectations for short-term interest rates by region, albeit with an uncertain path for U.S. policy rates in the short term

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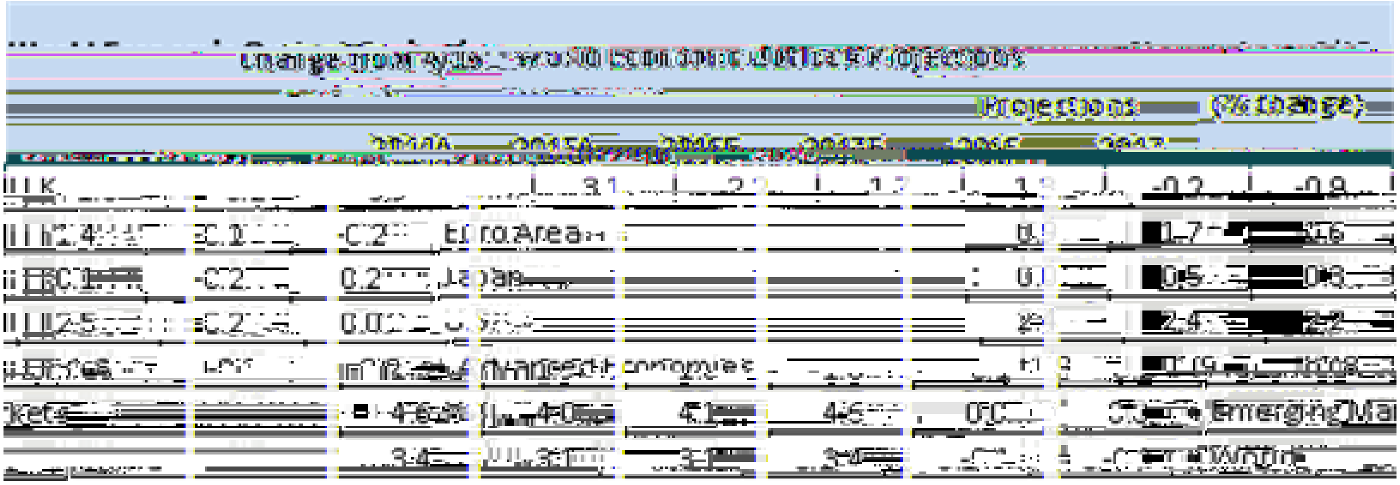
In a referendum held on June 23 [illegible]



Source: International Monetary Fund ***World Economic Outlook Update***, July 2016

The immediate investor reaction to the Brexit vote was swift and dramatic, causing a sharp spike in volatility as markets were surprised by the outcome. The British pound fell sharply against the major reserve currencies, the Yen—seen as a safe haven—strengthened against the pound, Euro and even the U.S. dollar, stock markets sold o , and safe-haven assets such as U.S. Treasury securities rallied. Volatility quickly subsided, however, and markets for risk assets—assets that carry risk and can fluctuate significantly in value, such as bonds, stocks, and real estate—generally have resumed their march higher, despite the fact that significant economic uncertainty remains.

To stimulate the persistently weak economic growth of recent years, economic policymakers have relied almost exclusively on monetary policy, with limited success and, arguably, diminishing returns,

[redacted]		
Austria*	-0.49%	-0.06%
Belgium*	-0.40%	0.11%
Cyprus*	-0.40%	NA
Denmark	-0.65%	0.07%
Estonia*	-0.40%	NA
Finland*	-0.40%	0.02%
France*	[illegible]	[illegible]
Germany*	[illegible]	[illegible]
Greece*	[illegible]	[illegible]
Hungary	[illegible]	[illegible]
Ireland*	[illegible]	[illegible]
Italy*	[illegible]	[illegible]
Japan	[illegible]	[illegible]
Latvia*	[illegible]	[illegible]
Lithuania*	[illegible]	[illegible]
Luxembourg*	[illegible]	[illegible]
Malta*	[illegible]	[illegible]

[illegible]	-0.40%	[illegible]	0.85%	Netherlands*
[illegible]	-0.43%	[illegible]	2.69%	Portugal*
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	Slovakia*	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	Spain*	[illegible]	[illegible]
[illegible]	[illegible]	Sweden	[illegible]	[illegible]
[illegible]	[illegible]	Switzerland	[illegible]	[illegible]
		*Euro area		

Source: Trading Economics

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Global influences on the U.S. bond markets have been significant. The U.S. economic recovery continues to gather steam, and the Federal Open Market Committee (FOMC) clearly has shifted to a tightening monetary policy stance, but the FOMC has not raised the federal funds target rate since its December 2015 meeting nearly nine months ago, and has modestly backed o its earlier projections for hikes in the fed funds rate due to global growth concerns. Table 5 shows the changes in median expectations for the fed funds rate and key U.S. economic indicators from this past March to June, as well as the probability of a rate hike by year's end, derived from futures markets. Market expectations of a rate hike by year's end have almost returned to pre-Brexit levels, as investors return their focus to the improving U.S. economy, but the consensus expectation is that the Fed will raise rates very gradually, remaining sensitive to global influences.

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[redacted]

Real GDP Growth (ann.)	2.0	2.0	2.0	2.0
March projection	2.2	2.1	2.0	2.0
Unemployment rate	4.7	4.5	[illegible]	4.8
March projection	[illegible]	[illegible]	4.7	[illegible]
Core PCE Inflation	[illegible]	[illegible]	[illegible]	[illegible]
March projection	[illegible]	[illegible]	1.6	1.8
Fed Funds rate	[illegible]	[illegible]	0.9	[illegible]
March projection	[illegible]	[illegible]	1.6	[illegible]

Source: Board of Governors of the Federal Reserve System

Yield curves around the w: B

				Q3'16	
[redacted]					
S&P 500 Index	1.37%	1.35%	2.46%	4.07%	8.06%

The CBOE Volatility Index, or VIX, which tracks investor expectations for stock market swings, based on the prices of S&P 500 options, closed at 11.39 earlier this month, its lowest level in the past 12 months.

Despite the U.S. stock market's strong performance YTD and the seeming calm indicated by low volatility, a number of high-profile hedge fund managers and investment luminaries have expressed strong negative views on U.S. stocks (and other risk assets), citing high valuations (the S&P 500's 12-month trailing P/E ratio recently reached 19.5, its highest level since 2010) driven by central banks' monetary policies. What these valuation metrics may mean for insurance companies and other investors is that equity returns in the years ahead may not measure up to that of recent years and might even be modestly negative, depending on the path of interest rates and economic growth.

Insurance Industry Impact

As of Dec. 31, 2015, the U.S. insurance industry held common stock i also the familiar concern that low or negative interest rates will persist for quite some time, as monetary stimulus seems to have limited e cacy, fostering a “lower for longer” interest rate scenario around the world that could depress investment yields for quite some time.

A third concern that has not been discussed as much–political risk–was brought to light by the Brexit vote. The forces that caused “leave” voters to prevail in the U.K. are not unique to the U.K.; they