Insurance Solutions
Q1, 2023

AEGON **INSIGHTS**

Alternatives for cash management in volatile times

In our previous update we considered the challenges facing European insurers during the market volatility of 2022. Whilst there are still economic challenges to navigate in 2023, valuations are now offering investors a more attractive entry point, particularly within fixed income markets. This provides an opportune time for European insurers to review their cash and liquidity policy, assess their objectives, and consider whether there are alternative asset classes that offer a more attractive risk-return profile.

Inflation outlook

As we look ahead to 2023, we expect inflation to moderate as pressures from higher mortgage rates and household energy costs begins to reduce demand within the economy. The Bank of England (BoE) also predicts inflation to fall over the next two years but acknowledges that there is considerable uncertainty attached to these forecasts

Policy rate vs inflation

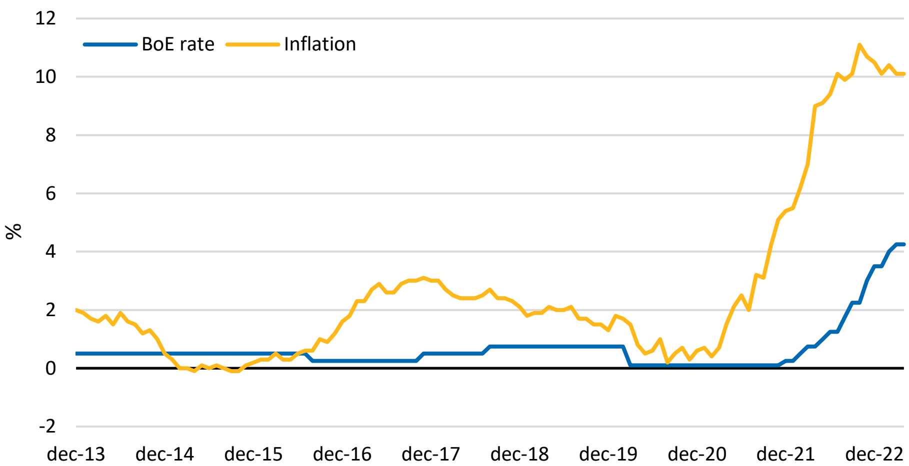

Figure 1: ECB deposits rate and annual inflation rate (% change). Inflation is Euro area MUICP all items YoY NSA Index. Source: Aegon AM & Bloomberg, as at 30-Apr-2023.

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Russell Baird is responsible for delivering investment solutions and strategic asset allocation advice to clients with a strong focus on their liabilities and financial regulations.

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However, so far, markets have tended to underestimate inflationary pressures, and there is the potential for this to repeat itself. The tight labour market and continued high levels of excess savings may keep the demand side of the economy stronger than many expect, which could mean that inflation remains above the BoE's target for longer.

We understand that each insurer faces different circumstances and will therefore impact the way in which they invest. However, generating an attractive return on investments will continue to be a focus, with many insurers looking for their cash allocation to 'work harder'.

At Aegon AM we manage approximately £100 billion in assets under management across 195 insurance clients and accounts.[1] We have been working with insurers against this market backdrop, and asking three key questions:

1. **Does my current cash allocation meet my investment goals?**
2. **Can I allocate more to higher yielding assets to avoid a cash drag?**
3. **What alternative asset classes can offer me a more attractive risk-return profile?**

More compelling opportunities for Insurers in 2023

For most insurers, managing liquidity will remain a priority, but increasingly they will also look for their assets to deliver some additional return in order to keep pace with inflation. This was a challenge for all investors in 2022 as inflation surged at a time when yields were offering little value. However, the recent re-pricing within bond markets now makes this a more realistic target for investors into 2023.

Investors are now much better rewarded for taking risk. Yields on global investment grade bonds were increased around 300 basis points during 2022. Similarly, we have seen a material rise in yields across Aegon AM fixed income strategies as highlighted by the yields in the green box.

Of course, we must also be mindful of the economic outlook. As recession odds increase, investors typically grow concerned about defaults. In this type of environment, active management becomes particularly important in helping to manage default risks. Whilst there are a number of challenges to navigate, corporate fundamentals start the year on solid footing. Corporate leverage ratios are healthy and cash balances remain high, providing a cushion if we do begin to see a weaking in fundamentals.

Overall, we believe insurers are well compensated at current yield levels and believe this is an attractive entry point for investing in fixed income markets.

[1] as of December 31st, 2022

Solutions for a range of risk appetites

We believe it is helpful for insurers to think about their investment portfolios in three distinct categories.

Cash & money market	These assets are used to meet ongoing cash flow requirements. Given the uncertainty around timings and cash flow amount, these assets should be very liquid and low risk. These types of investments would typically have a time horizon of less than one year.
Cash plus	Portion of the portfolio used for medium-term cash flows but that could also be used to meet unexpected large cash flows over the shorter term. Again, low risk investments with good liquidity are important but these asset classes should also offer a return enhancement relative to cash. These types of investments would typically have a time horizon of one to four years.
Longer term strategic investments	Portion of the portfolio which is expected to be held for the longer term, typically over four years. Higher yielding assets, which provide a level of income but also offer materially higher expected returns relative to cash over the longer term.

At Aegon AM, we offer a range of investment solutions for insurance companies across these categories. We carry out thorough liquidity analysis across all our portfolios, including analysing liquidity under stressed market conditions to make sure that liquidity is available when needed. We illustrate some of these strategies in Table 1.

Table 1: Cash-plus

Capability	SCR*	Yield	Description and attractiveness for insurers
Absolute return bonds	5.8%	7.55%	The Aegon Absolute Return Bond strategy has a return target of cash plus 2-3% p.a. over rolling three-year periods (net of fees). It aims to deliver positive absolute returns, while limiting volatility and preserving capital in all market conditions. This low-risk strategy has a **low correlation to fixed income markets and has capital preservation at its core**. The strategies market neutral approach and short duration (~1 year) contribute to its **attractive solvency capital requirements**, and favorable attributes in a rising rates environment.
Insured Trade Finance	2.0%	6.44%**	Insured trade finance provides a strong alternative to cash. Our strategy is centered around insured receivables with a duration < 1 year and transactions fully insured by A- or better rated insurers. Provides an **attractive return-on-capital** and possibility to further decrease capital requirements via risk mitigation techniques under **Solvency II**.

Capability	SCR*	Yield	Description and attractiveness for insurers
Short-dated investment grade credit	2.9%	5.33%	The Aegon Global Short Dated Climate Transition strategy invests predominately in investment grade bonds, on a global basis, with less than four years to maturity and with low carbon intensity portfolios. The strategy targets a return of cash plus 1.25% p.a. over rolling one-year periods (gross of fees) and offers **strong capital preservation** characteristics and an **attractive yield relative to cash**, for little additional risk. ESG and climate transition analysis is fully integrated.
Short-dated high yield credit	8.2%	4.46%	The Aegon Short Dated High Yield Global Bond strategy aims to deliver attractive risk-adjusted returns by investing primarily in high bonds with less than five and half years to final legal maturity. Our actively managed portfolios offers investors **strong capital-preservation** characteristics and attractive yields with low duration.

Source: Aegon Asset Management. Yield to worst and after expected losses, unless otherwise specified. * Standard formula Spread risk factors for bonds and loans under Solvency II. Source: EU (2015), Article 176/2. ** Strategy has a target of ~200bps above swaps.

In the chart below, we show the relative attractiveness of these asset classes versus the SCR for spread risk on the standard model basis as of 31 March 2023.

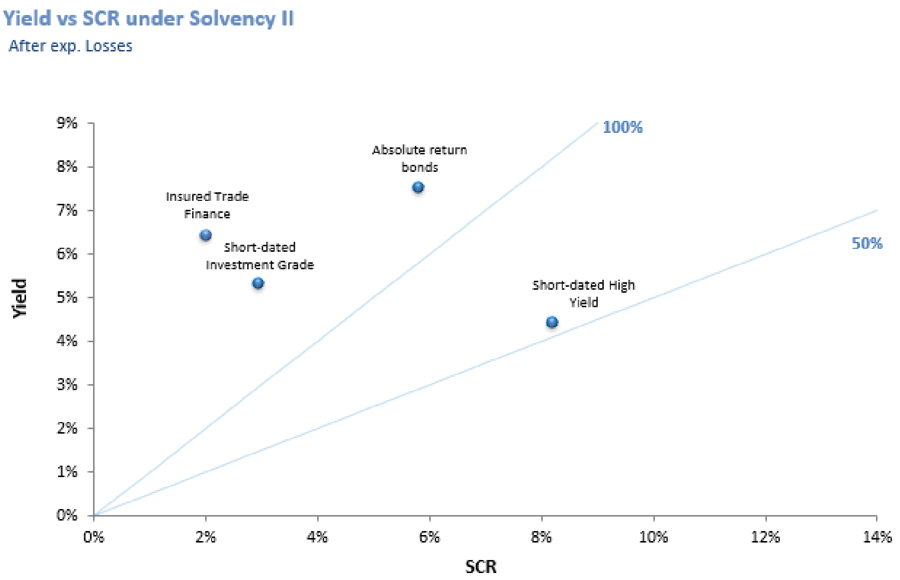

Figure 2: Cash and cash plus solutions. Source: Aegon Asset Management, Bloomberg. Aegon Asset Management as at 31 March 2023. For illustrative purposes only. For more details get in touch with us. The thin blue lines represent return-on-capital zones.

Responsible investment

We have a long history of responsible investing. We launched our range of ethical capabilities in 1989 based on client-led exclusions. Over time we have built on this foundation to become the active and responsible investor that we are today.

We have a 20-strong global responsible investment team[2] which is a company-wide resource for responsible business and ESG investment practices. The team actively collaborates with research analysts and portfolio managers across asset classes.

We believe responsible investing creates opportunities to generate value and can contribute to long-term outperformance. As a result, we integrate ESG factors into our bottom-up research process across all investment platforms and strategies.

By integrating ESG considerations with economic factors, our research teams seek to identify financially material ESG factors and arrive at an independent, holistic view of an investment.

Our ESG Integration process

Serving our clients

Given our insurance heritage and position as the in-house asset manager of a global insurance company, we are well positioned to understand the importance of your asset manager appointment and engagement to fully supporting the growth and profitability of your business. Our dedicated insurance portfolio managers and analysts understand the bespoke nature of insurance companies and the challenges you face. We have built an infrastructure from a process and reporting standpoint that allows us to directly address the unique capital and regulatory concerns of our individual insurance clients. This infrastructure is designed to meet the investment objectives of our clients, which in turn helps them achieve higher levels of success.

Aegon AM manages £100* billion on behalf of 195 insurance clients globally

* as of December 31st, 2022

[2] As at 31-Mar-2023

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Data sources for chart on page 1: Bloomberg, Aegon Asset Management, La Banque Postale Asset Management. March 31, 2023. The bullets in the chart are for illustrative purposes and do not represent exact calculations. Only Solvency II spread risk module standard formula is taken into account (except for Dutch Mortgages, where counterparty risk applies). Eur Sovereign are AAA/AA with a duration of ~8.9 years. EUR

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