Insurers get an edge from hedge funds in 2021

By Editorial Staff *Fri, Jun 3, 2022*

The life/annuity segment saw its dollar exposure to hedge funds rise in 2021 by 14.0%, to $6.1 bn, and the property/casualty segment by 0.9% to $6.7 bn, following several years of declines, according to AM Best.

The GameStop short squeeze notwithstanding, insurance companies allocated nearly $1 billion to new hedge fund investments in 2021, according to a new AM Best report.

Book-adjusted carrying value (BACV) rose to $13.1 billion in 2021 from $12.3 billion in 2020, the second consecutive year that BACV increased after multiple years of divesting holdings in hedge funds, said the ratings agencies in the report, “Favorable Hedge Fund Returns Lead to Book Value Increases for Insurers.”

“Hedge funds generally have been perceived as an unfavorable asset class given volatile returns and fee structure,” said Jason Hopper, associate director, industry research and analytics, AM Best.

“During the pandemic, however, hedge funds offered several advantages to mitigate the adverse effects of COVID-19, including less drawdown and volatility and largely independent of stock market trends, thus lowering correlations with broader markets.”

The insurance industry’s hedge fund exposure, which is highly concentrated among a small population of insurers, grew by 6.5% in 2021, with an additional $834 million in holdings. Insurers’ hedge fund investments grew to 861 holdings in 2021, from 811 in 2020.

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Despite favorable returns, the hedge fund industry still had trouble in 2021, according to the report; in particular, the short squeeze initiated by retail investors in GameStop and over heavily shorted companies, which resulted in over $10 billion in losses and led to the collapse of Archegos Capital.

Additionally, stock market volatility toward the end of the year led some insurers to reduce their long/short equity positions, a strategy favored by insurers.

The first quarter of 2022 marked the largest allocation of new capital in a quarter since

2015, largely driven by the uncertainty surrounding commodity prices, geopolitical tensions and the rising levels of inflation. These factors contributed to global macro-strategies being among the most popular for the quarter.

While these economic and geopolitical challenges are generally negative, the uncertainty can bring advantages to the hedge fund market due to their lack of correlation with other typical asset classes. Ultimately, the lingering effects of the pandemic and ongoing market uncertainty will determine if the hedge fund market will continue to see renewed interest and greater exposures.