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Strategic Asset Allocation (SAA) Optimization: An Insurance-Centric Perspective

Strategic Asset Allocation optimization is the disciplined process of determining the optimal long-term allocation across asset classes for an insurance balance sheet. For small to mid-sized insurers, this decision is especially consequential: investment returns must be earned while honoring policyholder obligations, regulatory constraints, and accounting realities.

Historically, many insurers have relied on Investment Committee or Board intuition to determine high-level allocations—often

defaulting to broad categories such as investment-grade bonds and U.S. equities. While experience and judgment are valuable, intuition alone rarely captures the full opportunity set of asset classes available today, nor does it quantify how diversification can improve risk-adjusted outcomes.

When external investment managers are asked to assist with asset allocation, additional challenges arise. Managers naturally emphasize asset classes they manage, while those

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- Fiscal tailwinds from the One Big Beautiful Bill Act (OBBBA) should sustain US economic momentum into 2026.
- Corporate credit fundamentals remain solid; defaults are well below long-term averages, and the technical backdrop is supportive.
- Ongoing easing, large fiscal deficits, and inflation uncertainty should continue driving the yield curve steeper, supporting our defensive positioning which includes an emphasis on higher credit quality.

2025 was a year of notable change. The Trump administration returned

to an economy with 3% inflation and softening growth, and the tension in the Fed's dual mandate led it to be on "hold" pending clarity on the administration's new fiscal initiatives, mainly tariffs and landmark tax legislation. By fall, "better than feared" outcomes allowed the Fed to resume cutting overnight rates. Ten-year Treasury rates declined from 4.8% in January to below 4.2% by year-end. At the same time, economic growth defied expectations and accelerated as 2025 progressed.

The Fed's policy is approaching what it has long held as the

neutral rate of interest (around 3%). We believe that action is appropriate, given that inflation and unemployment are both heading gradually in the wrong direction. However, the labor market may be stronger than headlines suggest. With immigration enforcement contributing to suppressed labor supply, approximately 50,000 jobs created per month may be enough to maintain a stable unemployment rate compared to the 250,000-300,000 run-rate once needed.

Politicians, consumers, and

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responsible for portfolio management and investment research. His areas of specialization include investment analysis within the securitized products sector. Additionally, Christian communicates the fixed income team's investment strategy, performance, and outlook with external clients and prospects. Christian joined the firm in 2017 and contributes more than 20 years of industry experience. Prior to joining Calamos, he worked at Wells Fargo as a fixed income portfolio manager and at Mercer Investment Consulting as a manager research consultant for fixed income. Previously, he also held roles at William Blair and Lehman Brothers Asset Management. Christian earned a BS in Finance from the University of Illinois Urbana-Champaign and an MBA from Cornell University.

investors all have slightly different reasons for wanting lower interest rates and the incoming Fed chair will undoubtedly lean dovish. Nonetheless, the OBBBA is poised to provide strong fiscal support to both households and businesses. This robust fiscal tailwind could slow the progress of further rate cuts, especially if affordability remains problematic or long-term rates rise. We believe true consumer weakness—e.g., from a weakening labor market or declining equity market—will be needed to justify rates substantially below neutral.

Corporate credit fundamentals remain solid in both the investment-grade and high-yield markets. Trailing 12-month defaults are significantly below the long-term average. After reaching a post-Covid low of 3.9x in early 2023, market leverage climbed back to 4.4x and is just above the 25-year average. Interest coverage, which had been declining in the face of increasing interest costs, appears to have leveled off at a healthy 4.2x. While we expect default rates to increase modestly in 2026, they remain well below long-term averages.

The technical backdrop for corporate debt markets remained strong throughout 2025. High-yield issuance rose sharply to \$331 billion in 2025, a 15% increase year-over-year. Anecdotally, we continue to see strong demand for deals in the market despite the increase in supply. Rising stars continued

to outpace fallen angels.

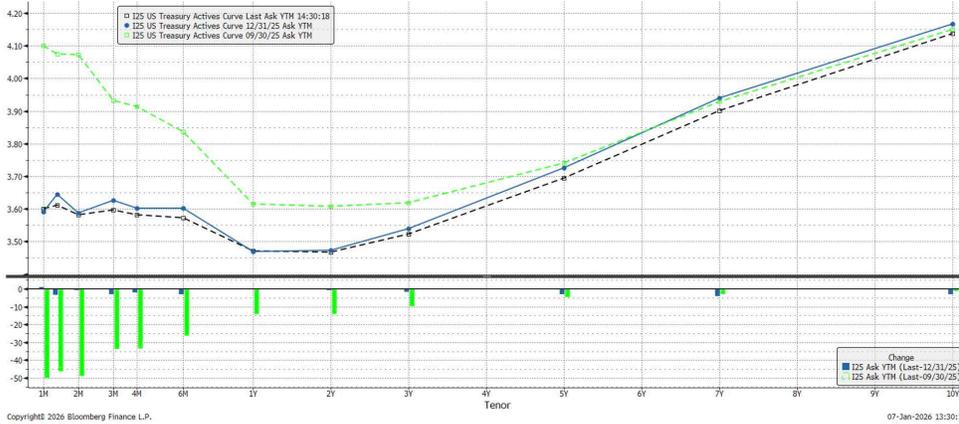
Despite the solid backdrop, several areas face structural headwinds. Among them, the chemical and paper-and-packaging industries include several stressed and distressed companies struggling with operational challenges such as elevated raw material costs, excess capacity, and increased international competition. However, we do not anticipate widespread weakness, as hard consumer data shows resilience despite weak consumer confidence survey results. The combination of healthy albeit gradually deteriorating fundamentals and a strong technical backdrop has kept credit spreads low and in a tight range throughout the year. We anticipate this environment to continue well into 2026. The next 50-basis-point move in high-yield spreads is likely wider, but tight trading environments can persist for years before material widening occurs.

We expect record investment grade debt supply in 2026 as technology firms borrow to build out digital infrastructure. Some market estimates reach as high as \$2.25 trillion. This is an immense number, several hundred billion ahead of this year's record \$1.65 trillion pace. Spreads in tech industries may face headwinds as a result, but are unlikely to be based on fundamental balance sheet risks. (Consider that AI hyperscalers can issue \$700 billion of additional debt without raising their collective leverage measure above 1x.)

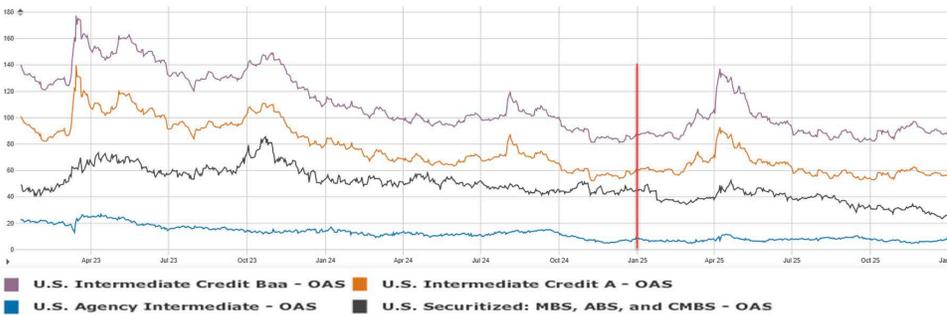
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TREASURY YIELD CURVE MOVEMENT DURING 4Q25



OPTION-ADJUSTED SPREADS (OAS) FOR INTERMEDIATE INDEX COMPONENTS



Past performance is no guarantee of future results. Source: Barclays Live - Chart.

INTERMEDIATE AGGREGATE INDEX PERFORMANCE BY ASSET CLASS (EXCESS RETURN VS. TREASURIES)

	1Q25		2Q25		3Q25		4Q25		YTD	
	Total Return	Excess Return								
U.S. Treasury: Intermediate	2.49	-	1.46	-	1.26	-	1.15	-	6.51	-
US Aggregate: Government-Related Interm	2.45	0.10	1.77	0.38	1.59	0.33	1.16	0.00	7.15	0.82
Intermediate Corporate	2.27	(0.29)	2.12	0.70	2.04	0.75	1.29	0.15	7.95	1.31
U.S. Securitized: MBS, ABS, and CMBS	3.00	(0.08)	1.18	0.19	2.38	0.84	1.68	0.70	8.49	1.65
Bloomberg Interm U.S. Aggregate	2.61	(0.08)	1.51	0.22	1.79	0.43	1.35	0.25	7.45	0.82
Bloomberg Tax-exempt Muni 1-10yr Blend	0.70	N/A	1.04	N/A	2.33	N/A	0.98	N/A	5.14	N/A
Bloomberg Municipal Intermediate Taxable	2.47	N/A	1.59	N/A	1.91	N/A	1.43	N/A	7.60	N/A

Source: Clearwater Analytics, Bloomberg Indices, ICE Bank of America Indices, and client data

Past performance does not guarantee or indicate future results. Current performance may be lower or higher than the performance quoted.

Intermediate Treasury Yield Curve Continues to Steepen During Fourth Quarter

12-month and shorter Treasury yields declined 15 to 50 basis points during the quarter in reaction to two 25 basis point cuts in Fed Funds Rate. Yields for 2 to 5-year maturities declined 5 to 15 bps, while yields between 5 to 10-year maturities were mostly unchanged.

Intermediate Corporate option-adjusted spreads (OAS) widened by 4 bps over the quarter to finish the year 1 bps tighter. A-rated corporate OAS widened from 54 bps to 57 bps during the quarter to finish the year 4 bps tighter and BBB-rated corporate OAS widened from 83 bps to 88 bps during the quarter to finish the year 2 bps wider.

4Q25 Sector Performance

Structured Securities, Intermediate Corporates, and Agencies, outperformed duration-matched Treasuries by 70, 15 and zero basis points, respectively, during the quarter driven by spread tightening and yield advantage.

Intermediate Taxable Municipal Bonds delivered a total return of 1.91% for the quarter, beating Treasuries by approximately 50 bps. The yield-to-worst (YTW) of the Bloomberg Intermediate U.S. Aggregate Index decreased from 4.21% to 4.12%.

Investment Strategy – Maintain Portfolio Quality and Conservative Stance

The Fed faces an unusual challenge: Both sides of its dual mandate are under stress simultaneously. These circumstances clearly increase the

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chances of a policy error (at least in hindsight). Even so, the ongoing easing cycle and questions about Fed independence—coupled with large fiscal deficits and persistent inflation uncertainty—should continue driving the yield curve steeper.

Technical tailwinds should constrain credit spreads to narrow ranges in the near term. Spread compression across the rating spectrum has presented a tactical window to maintain an up-in-quality bias while largely preserving their income characteristics. Our defensive

positioning will persist until the relative value in lower-tier credits improves sufficiently to merit taking on increased risk.

In response we have positioned portfolio duration approximately $\frac{1}{4}$ year longer than benchmarks. With credit spreads at historically tight levels, we are keeping overall portfolio risk conservatively positioned until relative value becomes more compelling.

We continue reinvesting maturing BBB-rated, bank subordinated debt bonds, originally issued with

3% to 4% coupons, into new issues with 6% to 7% coupons and yields. We are also re-investing maturing municipal bonds with 1% to 3% coupons into 4.5% to 5.25% coupons. This improves both the market and book yield of the portfolio. □

Opinions, estimates, forecasts, and statements of financial market trends based on current market conditions constitute our judgment and are subject to change without notice. The views and strategies described may not be suitable for all investors. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations.

Strategic Asset Allocation (SAA) Optimization: An Insurance-Centric Perspective

outside their product lineup receive little attention. Even well-intentioned recommendations can embed subtle economic incentives that influence allocation weights. These biases are often invisible to Boards and can materially affect portfolio efficiency over time.

A Proper Framework for SAA Optimization

A robust SAA optimization must be quantitative, liability-aware, and insurance-specific. At a minimum, the model should incorporate:

- The insurer's liability profile and duration characteristics
- Board- and IC-defined risk tolerance and investment objective
- Regulatory and domicile constraints
- Statutory and GAAP accounting considerations

Models that explicitly integrate all of these insurance-specific factors are rare—particularly in the small to mid-sized insurer market.

CapVisor's SAA model was built expressly to address this gap. It is grounded in the asset allocation framework, specifically Dynamic Financial Analysis (DFA), developed by the Casualty Actuarial Society and was designed by a practicing P&C actuary, ensuring that capital efficiency, surplus volatility, and liability alignment are central—not afterthoughts.

The Objective of SAA Optimization

The goal of SAA optimization is straightforward but powerful:

- Maximize expected return

for a given level of risk, or

- Minimize risk for a required return target

This foundational concept was first formalized by Harry Markowitz in 1952, work that later earned him the Nobel Prize in Economics and gave rise to Modern Portfolio Theory (MPT).

Key Benefits of an Optimized Investment Program

An optimized SAA delivers tangible fiduciary benefits:

- Risk Reduction Through Diversification: Combining asset classes with low correlation reduces total portfolio volatility without sacrificing expected return.
- Improved Risk-Adjusted

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Returns: Optimization seeks to maximize the Sharpe ratio by identifying the most efficient balance between risk and return.

- **Data-Driven Governance:** Quantitative analysis replaces ad hoc or emotional decision-making with repeatable, defensible methodology.
- **Policy-Consistent Constraints:** Minimum and maximum asset class weights can be explicitly aligned with the Investment Policy Statement and regulatory limits.

The Efficient Frontier and Portfolio Efficiency

The efficient frontier represents the set of portfolios that offer the highest expected return for each level of risk. Portfolios that fall below the frontier are inefficient—they take more risk than necessary for the return they generate.

In practice, most insurance

portfolios that have not undergone a recent SAA optimization reside below the efficient frontier, leaving return on the table or carrying excess risk without compensation.

Modern Portfolio Theory in Practice

Modern Portfolio Theory demonstrated that portfolio risk is driven not only by the risk of individual asset classes, but by how those asset classes move together.

CapVisor’s SAA framework operationalizes MPT through:

1. **Correlation-Based Diversification:** The model calculates a full correlation matrix across asset classes (using JP Morgan LTCMA data) to identify diversification benefits unavailable through intuition alone.
2. **Explicit Risk–Return Tradeoff Analysis:** Insurers can

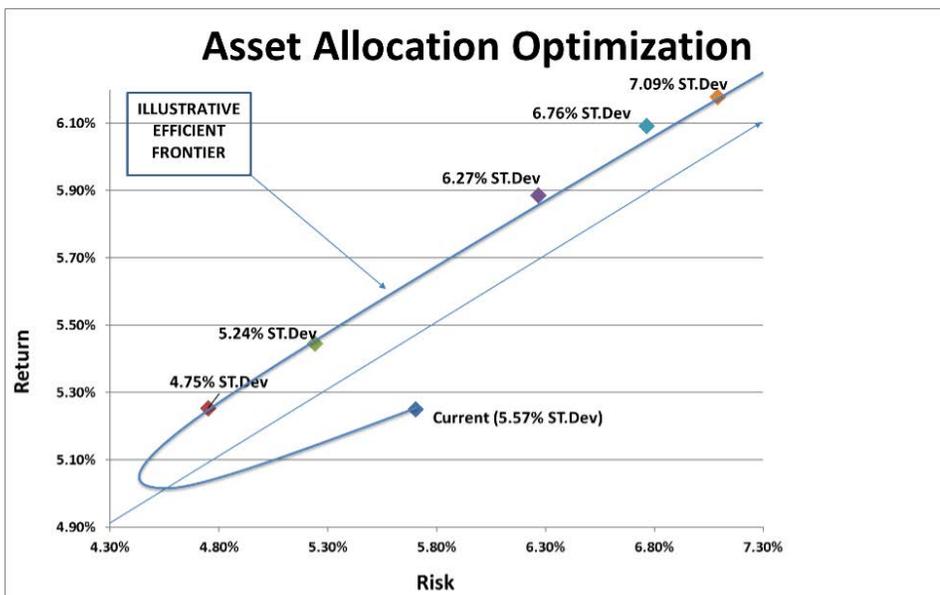
identify their optimal position along the efficient frontier based on surplus volatility tolerance and return objectives.

3. **Practical Market Assumptions:** While MPT assumes rational investors and efficient markets, it remains a highly effective framework for long-term insurance portfolio construction when applied with actuarial discipline.

Validation Scenario-Complete Strategic Asset Allocation Framework

To validate optimization results, CapVisor employs a framework that produces the full distribution of balance-sheet outcomes across all relevant market scenarios, including tail risk, without the complexity and cost of full Monte Carlo DFA, usually reserved for multi-billion dollar portfolios. While not a full Monte Carlo simulation, it delivers the same decision-relevant distributional insight in a simpler, transparent way to:

- Visualize the full feasible risk–return space
- Confirm that optimized portfolios genuinely maximize Sharpe ratios
- Demonstrate how allocation changes impact volatility and return
- Illustrate the efficiency gap between optimized portfolios and random—or legacy—allocations
- Approximates RBC implications for proposed allocations (for admitted carriers and RRGs)



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Strategic Asset Allocation (SAA) Optimization: An Insurance-Centric Perspective

This step provides Boards and regulators with clear, intuitive evidence of why optimization matters.

CapVisor Summary

Strategic Asset Allocation optimization is NOT a theoretical exercise—it is a fiduciary imperative for insurers. When executed with insurance-specific rigor, it transforms asset allocation from a subjective judgment call

into a repeatable, defensible, and surplus-efficient discipline.

If your investment program has not undergone a recent (within the last 3 years), insurance-specific SAA optimization, it is highly likely it's operating below the efficient frontier, i.e. leaving value on the table. Now is the time to reassess your strategic allocation with a framework designed specifically for small to

mid-size insurance companies and their balance sheets. □

Academic Foundations

CapVisor's SAA model is informed by well-established academic research, including:

- Markowitz (1952), Portfolio Selection
- Sharpe (1964), Capital Asset Prices
- The Black-Litterman Model
- Post-Modern Portfolio Theory

Time for Some Soothsaying



J. Joseph Veranth, CFA, Chief Investment Officer and Portfolio Manager - Joe joined Dana Investment Advisors in 1994

and is currently the Chief Investment Officer and a Portfolio Manager. He is involved in setting firm wide investment policy and allocation decisions for all Dana investment strategies. Prior to Dana, he spent ten years at the Bank of New York as an Investment Liaison and Relationship Manager in the Master Trust and Investment Technology departments. He has appeared on Bloomberg television and radio, CNBC, and has been quoted in the New York Times and the Boston Globe. He has served as Treasurer of Holy Communion Church and as President of the Racine Symphony Orchestra. He is currently a Trustee and Treasurer of The Prairie School. Joe graduated from Northwestern University with a BA in Humanities in 1984 and earned an MBA in Finance and International Business from the Stern School of Business at New York University in 1991.

December 12, 2025
Dow: 48,458

Otherwise known as our predictions for 2026. We love to take credit for correct predictions and rationalize away the poor ones. This prediction exercise helps us develop a framework for thinking about the markets and the economy for the coming year. These calls don't just go into the forgotten file at the end of the year; next month we will review our 2025 predictions.

No 10% S&P correction – We had a correction of almost 19% for the S&P 500 Index in early 2025, as worries swirled around tariffs. With strong capital investment and growth in AI use cases, markets should rebound before declining 10% in 2026. An accommodative Fed and lower inflation should also support the stock market.

The S&P 493 will perform – We are not calling for the non-

Magnificent 7 portion of the S&P 500 Index to outperform the Big 7, but they should do a better job of keeping up, performance wise. There will be AI uses across the 493, and their valuation levels leave room for upside performance.

Private Debt Problems – We have called for a correction here for the last two years, and it hasn't happened. It is still a case of far too much money being pumped into an area with little oversight and a high fee structure, along with low liquidity and low transparency on prices. This is usually a recipe for eventual disaster. Retail products are available that are backed by illiquid loans. Signs of repayment stress are emerging, but money flowing in still covers potential problems, until that positive flow reverses.

Inflation drifts lower – Both the dollar and commodity prices have stabilized in the second half of the

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year. The labor market is showing some softness. There does not seem to be a driver of inflation on the horizon, so over 2026 it should continue to drift down from around 3% to the mid to low 2% range.

Fed about done – The economy has demonstrated that it can withstand rates above 3%, so the Fed Funds rate should stay between 3% and 4% through the year. The two-year Treasury yield is near the Fed Funds rate, indicating that little change is expected from here in short-term rates. Rates moving either significantly higher (inflation) or significantly lower (recession) would mean there is a problem.

No recession – We probably should have put this call up in the #1 spot, since it is the main nemesis of capital markets. Over the last few decades, it seems as if large companies are more conservative in their production and investment considerations, avoiding some of the boom/bust cycles that have affected markets and employment in the past.

Little movement in rates – Mainly because of the previous three predictions, we would expect little movement in the Treasury yield curve in 2026. Contained inflation and no recession should anchor the long end of the yield curve, and limited Fed rate changes should anchor the short end of the yield curve.

GDP will strengthen – GDP growth will be about 2% in 2025, factoring in import gyrations due to tariffs. GDP was actually negative in the second quarter of 2025. We expect

a reasonably strong economy in 2026. With decent productivity gains, partially due to new AI technology and investment, we expect GDP will be closer to 3% in 2026.

Job Growth Sluggish – It is difficult to read because of the lack of data and delays due to the government shutdown, but employment growth has slowed in the second half of 2025. We would expect some rebound in 2026, but not back to the 200K or higher job growth that is representative of a very strong economy. We would expect growth to average 100-150K per month. Enough to keep the economy growing without inflation and allow reasonably strong growth in productivity.

“ The economy has demonstrated that it can withstand rates above 3%, so the Fed Funds rate should stay between 3% and 4% through the year. ”

U.S. stock market outperforms Europe – We think the outperformance of the European stock markets was an anomaly this year. The weaker dollar boosted returns for Americans investing in Europe. Investors in European equities still face the problems of a bloated bureaucracy, high taxes, and poor demographics (an aged population). These problems have no easy solutions. Investors in U.S.

equities should again be rewarded for operating in a more favorable investing climate.

Warren Buffet, likely the greatest investor of our time, retires at the end of 2025. Here are two of the many, many, insightful and pithy things he has said over the years:

“Risk comes from not knowing what you’re doing.”

“Price is what you pay, value is what you get.”

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