Pete Miller

Episode 203: Shifts and Opportunities in Insurance Asset Allocation with Invesco's Pete Miller

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com podcast. My name's Stewart Foley, I'll be your host. Welcome back. And I have to say it's great to be back, back from a little time off and in a brand new location. The InsuranceAUM.com podcast is coming to you from none other than Dripping Springs, Texas. And today's topic is strategic asset allocation for insurance companies with Pete Miller. Pete is the Head of Insurance Solutions, Multi-Asset Strategies with Invesco. You hold a CFA and an FSA. Both of those are high hills to climb. Pete, welcome. We're thrilled to have you. I've known you for a long time and just now getting you on the podcast. So welcome.

Pete Miller: Yeah, thanks very much, Stewart. Great to be with you.

Stewart: So can you talk a little bit about what you do at Invesco in particular, because you are a media figure. I mean, you were just on with the NASDAQ in the last day or so. So can you talk a little bit about your role before we get going into the SAA portion of the program?

Pete Miller: Yeah, yeah, absolutely, Stewart. So my role here at Invesco, within our insurance solutions effort, it really spans a lot of things. So one of the things that I love about it is I do get the ability to work on both what I think of as the institutional balance sheet side of the insurance house, but also the annuity, retail, if you think of that wayside of the house. So we work on mandates where we're managing general account assets for our clients. It could be fixed income, could be real estate, could be public equity, it could be any number of things. But then the other side of that coin is a lot of the especially annuity business in the last several years has really been indexed products, indexed annuities, fixed, FIAA, RILA, et cetera.

So we've really, last couple of years, made a lot of great strides at building out custom indices for our clients and being involved in that part of the business. So really it's just, for me personally, it's really interesting, but it's an opportunity to kind of sit in the middle of our investment teams, our client-facing teams and just help the firm get an idea from its inception to practice. And it's been a lot of fun.

Stewart: And this is a very small community, very tight-knit, a lot of great people in this business. And I mean, I think the work is extraordinarily complex, but the people, at least the people are smart and nice. So that makes it a whole lot better. Before we get going too far, I want to cover my usual ground, which is: what is your hometown? Where did you grow up? What was your first job? Not the fancy one either. And what makes insurance asset management so cool?

Pete Miller: I love these questions by the way. So I grew up in Omaha, Nebraska. No, I do not know Warren Buffett. I wish I could say that I did, but I grew up there. I went to school at Nebraska, so I'm a Cornhusker through and through. My first job, I had a bunch of random odd jobs in high school and college, which really make me appreciate what I do now. But the first one, I worked at this huge wholesaling warehouse, basically this massive warehouse where every day at six in the morning I'd be in there. It's like assembly lines, you're picking items from these boxes, packaging things for shipping. Very, very not interesting, but definitely a good lesson in terms of showing up and putting in the time and a good lesson in what I didn't want to do forever. So as I said, I'm very happy with what I do now.

Stewart: A precursor to Amazon, it sounds like. And, what makes insurance asset management so cool? I say this and sometimes people laugh, but hopefully you agree with me that you think it actually is cool.

Pete Miller: I absolutely do. And what I immediately thought of when you were asking the question was the people side of it. I just think back through my whole career, I've worked with not only really smart people, but really just fun people to work with and be around and obviously you spend so many of your waking hours at work that it's been really interesting, really intellectually challenging. I've gotten to see and do a lot of different things, even though my whole career has been within insurance and insurance asset management, there's still a huge variety of things that I've had exposure to, which has been great. And I think investing in finance is interesting on its own, but then you incorporate the extra technical challenges that come with insurance and accounting considerations, asset liability management, capital considerations, all that stuff that a lot of our clients that are pensions or endowments or others maybe have different considerations. I just find it really interesting. And so I do think it's fun and I do think it's cool.

Stewart: Yeah, it is. And one side note, I will tell you, I went to Mizzou and it was during the time when Nebraska won seemingly every game every year, and I think we lost to Nebraska 31 years in a row or something. But whenever you go to Lincoln, everyone was so nice. I mean, your fans were the nicest people. And I was at a home game where Nebraska came to Mizzou and somehow or the other one of our students set one of your RVs on fire. So I just want to say publicly that I'm sorry for that, and I'm sorry for that experience. I feel somehow oddly responsible. I'm not sure why, but…

Pete Miller: Well, yeah, I appreciate that.

Stewart: Yeah, I mean it was a very different crowd at Mizzou at those days, but part of the program here we're trying to do is we want to talk to people about how their backgrounds fit into what they're doing today. And in your case, you worked for an insurance company, The Hartford, and one of the questions I have is what did you do there and how did that influence your experience in your role now with Invesco?

Pete Miller: Yeah, well, as you mentioned in the intro, I'm an actuary by training, I started my career at The Hartford. In a more traditional, I would say, actuarial role. And it was on the life insurance side. So I started there in a rotational program, and it was really my second rotation where I moved to the investments team. At the time, it was supposed to be on a temporary basis, and I loved the work, I loved the people, and I decided that I wanted to stay as a part of that team permanently. And I did eventually still have a variety of roles within the investment function at The Hartford. So I did a lot of work on the general account, so both from the portfolio management side, working with that team, managing the balance sheet assets. I did some work with more of the risk management side of the house, and I did a lot of work on the variable annuity business. Again, both liability side, so looking at modeling of GMWBs and GMDBs, and then also on the hedging, the derivative hedging side of things.

So even just at one insurance company and even just within the investment function at one insurance company, I had the opportunity to see a lot of different things and do a lot of different things and get exposure to a lot of different people. And that was just invaluable because that has certainly come in useful here at Invesco. I did a stint at PIMCO, which a lot of the stuff that I learned was extremely valuable there as well. And I think of course the technical stuff is sort of the foundation of what I do now at Invesco, and my solutions are all here. But more than that, I think is the kind of... for lack of a better term, the softer skills.

So learning how to present and modulate a message depending on the audience. You're talking to somebody who's in the weeds and can really nerd out on every last detail, or you're talking to somebody who's never heard of this topic and has 30 minutes and you need to really distill that. Those sorts of lessons, professional lessons have been really helpful. And nowadays, as I said the technical stuff really serves me well because I can genuinely say I've walked the walk, I've lived in our client's shoes, and I've done and faced a lot of the same issues myself from their perspective at one point or another in my career. So I think that really, it helps both in terms of relating to clients, but then also articulating to our management here, why we should do this, why this is important, why we need to be very flexible, all those sorts of things. So really all of my experience at The Hartford has really proved to be just super, super helpful.

Stewart: I want to geek out with you for a second because when you first started talking about variable annuities, you threw out a couple of acronyms and I'm not sure what they mean. So can you for our audience, unpack those two, please?

Pete Miller: Yeah, GMWB. So guaranteed minimum withdrawal benefit or DB for death benefit. I mean, those were two that were, this was going back to the... I hate to date myself, but early 2000s, and this was around the time that withdrawal benefits in particular were very new and posed a very novel challenge in terms of hedging the exposure. So you think about, again, it's guaranteed. The insurance company is making a guarantee to its customer saying, in the case of a GMWB, regardless of your investment performance, you're going to get at least X percent in withdrawals for life.

And so obviously that means by making that guarantee the insurance company is taking on some risk and how do you hedge that? How do you hedge it efficiently and cost-effectively? That was a big part of what I did there, but certainly still relevant today. As I mentioned, a lot of that business has moved to more of an indexed kind of product lineup, but still those guaranteed products are absolutely still present in the marketplace too.

Stewart: Yeah, that's super cool. Thank you. So a key theme that's coming up is a trend toward alternative assets. Where do you see the most opportunities in that space? And I mean, first of all, I guess I would say, do you agree that there's a trend to alternatives? And if so, where?

Pete Miller: Yeah, absolutely I agree. And I think that's probably, at this point, pretty well established that there's been a very noticeable trend really going back to the financial crisis. And with rates being just super, super low for so many years. Not only insurers, but really all investors and in particular institutional investors clearly had a very strong demand, insatiable demand for returns, and hence this kind of multi-year trend towards more private market exposures and alternative investment strategies. And I do think it'll continue. One of the things that comes up a lot now. Clearly the last year or two, rates particularly in the US have backed up a lot. And that means on the one hand, public markets are offering returns that really haven't been available for such a long time. And I think one natural inclination is to assume, well, okay, so that's going to kind of reduce the interest in alternatives.

And I think that's just not the case. For one, private markets, it takes time to build up a program. There's not just the asset allocation decision, but then there's implementation, manager selection. There's so many things that go into it that you have to really be committed to it and you have to be up for a multi-year journey. And so I think that will absolutely continue even if rates stay at their current, if you want to think of it as elevated levels, and I guess specifically we still like private credit. There's been a lot of ink spilled around how much capital has piled into the space, and there's potentially some risk on the horizon. And I think that's fair. But the flip side of that is you're still getting pretty attractive all-in returns and spreads that are in large part compensation for illiquidity, not necessarily just pure default risk, especially first lane type of exposure. So I think for us, we still think you're being compensated for that risk. And now especially with the fed on pause, maybe likely to embark on an easing cycle again here in the coming quarters, let's say, that could be constructive for private credit when you think about spurring some more deal flow, some more activity. And also from the borrower's standpoint, that will naturally ease some of the pressure that may have been building up in terms of interest coverage and creditworthiness. And so for us, we still think private credit is very attractive from that standpoint.

And then I would also say for us, I mean we have a big real estate, private real estate and public real estate franchise at Invesco, but I would say specifically for our insurance clients, commercial real estate debt is something that we are talking a lot about and really focused on because understandably, I'll just paint with a broad brush, real estate has been maligned in recent years and there's very valid reasons for that. But I think with debt in particular, you've got security, you still have very attractive returns. We might be kind of at a turning point or at least nearing a turning point in the cycle. And especially for insurance companies and lifers in particular, it's a pretty capital-efficient way to get return and yield. And so I would say those two within alternatives are where we spend a lot of our focus on a lot of our time with our clients.

Stewart: I think we have a budding data business and certainly based on our proprietary market intelligence, the demand for private credit is strong. Absolutely. I would even get on my soapbox a little bit and say really financing those kinds of businesses are really a great fit for an insurance company's balance sheet. I mean, you don't have the liquidity, the risk of a run on the bank that you do in the regional banking sector. And there just seem to be a lot of very valid reasons of why this shift is taking place and looks by all indications to continue to take place going forward. So I'm with you on that one. So aside from alternatives, what other asset allocation shifts or trends have you noticed with your clients and other insurance companies over the past couple of years?

Pete Miller: I think there's been a lot of trends, not just in terms of the macro backdrop, but even things like regulatory activity, accounting changes, all of those things that we talked about earlier that make insurance investing interesting and fun, there have been so much activity in the last few years, more so than I can remember from decades prior, really, at least for my whole career. It feels like the last couple years have been exceptionally active across all these different dimensions. I would say some of the other stuff that we're talking about a lot, now more in the public market space, we talked about alternatives a little bit, but public markets, Invesco is a global firm, so we are working with our insurance clients around the world. And one of the things that's been topical recently in public markets in Europe in particular has been munis because there is still demand for safe, high-quality yields, public market yield, but something that's diversified to a degree from corporate credit, which I think is still the predominant exposure in probably every insurance portfolio.

And in particular, with Europe, I think another tailwind or another driver of that demand has been some of the regulatory changes where that's considered or treated as though it's infrastructure, which is essentially an advantage from a capital standpoint where there's some kind of enhanced relief, if you think of it that way, which makes it all the more attractive for our European insurance clients. So that's been something that's been quite topical of late. And then something that I like right now and we're encouraging clients to look at would be within EM debt, hard currency that is, so just thinking about corporate spreads still being pretty tight on a historical basis, relative basis.

And again, I think most insurers, they don't really need a lot of additional corporate bond exposure, but EM is something that arguably is still underrepresented in a lot of insurance portfolios and you do see pretty attractive spreads and absolute yields for, again, for hard currency exposure, investment grade type credit risk. I think that's something that more insurers should probably take a look at. And it aligns with our house views and tactical views from our solutions team as well. So I think that's something else that we've been talking a lot about.

Stewart: You mentioned Invesco being a global firm, and you have a global team at Invesco that works with insurance clients in North America, Europe, and Asia. What have you noticed or is there a noticeable trend that's different in the US versus non-US insurers?

Pete Miller: Yeah, there are certainly differences. And I would say at the core there are probably more similarities than differences. I mean, there are the same types of considerations no matter if you are a US insurance company, a German insurance company, a Taiwanese insurance company, everyone to a degree is trying to solve for maximizing their returns subject to regulatory capital constraints, internal risk constraints, accounting, tax, et cetera. So, understandably, that's going to drive a lot of behavior no matter what part of the world you're located in. But I think a lot of the differences in behavior stem from maybe different treatments in different jurisdictions. So you'll certainly see more appetite for structured credit in the US than you'll see in Europe because it's not, frankly, penalized as much in the US from a capital standpoint. Or just from a macro interest rate environment standpoint, you'll see more demand for US exposure simply because even after hedging in many cases, it's still more attractive for a non-US insurer to buy US bonds.

So some of those things are fairly widespread. I would say one obvious thing, which is probably clear to most folks, a clear difference, ESG is something that is just well ingrained in Europe and Asia at this point, I would say much more so than the US. And so I find it very interesting and fascinating how different the political landscape is and the sort of social appetite for ESG philosophies to make their way into investment decisions. It's pretty much fully accepted and acknowledged in most parts of the world outside the US. And here it's still very much a controversial topic. It is definitely not something that you see in every insurance portfolio. And if we were having this conversation two years ago, I probably would've predicted that the US would catch up and by 2024, the US would be more like Europe in that regard. But we're not, we're still much further behind and maybe that'll always be the case. So that's a big difference that stands out to me.

Stewart: That's super helpful. I agree with you. I was just in Europe in November and I was surprised to learn that traveling to an event like an insurance asset management event is really frowned upon. And one person told me that travel had to be approved by the CEO, that that's how seriously they take their carbon footprint, which I felt like we certainly have a different way of looking at things here. I mean, folks are still traveling and so forth. So when it comes to taking advantage of these opportunities, how do you go about benchmarking and modeling public versus private market strategies and exposures? That's a really hard question and it has a lot of facets to it, but at a takeaway level that our audience can grasp. Can you talk about the high points around how you view benchmarking in public and private?

Pete Miller: Well, you're right, it's definitely a topic that we could spend a lot of time on. So I'll try to be relatively brief. I mean, one thing you mentioned in the question, benchmarking and modeling, and I kind of in some respects separate those two. So I think of benchmarking in many cases as just measuring performance, you have an objective, how do you gauge whether you've succeeded or failed versus that objective? And so when it comes to performance, we, like many managers and many investors, really look at things as a mosaic, we'll look at many different things. I don't think there is a single right way or best way to do it. So looking at things as absolute return objectives, did you meet that yes or no? Over what timeframe are you interested in those sorts of things? And then relative, there are some private market benchmarks or indices or proxies that you can use as bogies if you want to think of it that way. But there tend to be a lot of flaws with those.

And I think the inevitable comment that we hear from portfolio managers all the time is, well, that's not representative of what we're doing or what we're buying or what we're seeing. And I think that's even that is more genuine or valid, I think in the private market space where it is very idiosyncratic. So a lot of times it'll be maybe looking at a private market index or public market index plus a spread as your performance bogey. But when it comes to modeling, that's where, particularly when we're talking about asset allocation, I think this is a topic that I love talking about. I spent a lot of my early years here at Invesco doing a lot of work in this space, trying to capture how do we model private assets alongside public assets? How do we give a true representation to our clients? How do we present things in an intellectually honest way to help them make asset allocation decisions?

And there's a lot of debate around, for example, most alternative assets are not marked, certainly not daily, sometimes not even monthly, or maybe even quarterly. So you have very infrequent valuations that can make it very difficult to measure risk or quantify risk. And arguably that might mask some underlying risk. And we just think it's important to acknowledge that. And again, from a modeling standpoint, use a combination of things, kind of a mosaic approach where you're not just basing all of your decisions on this one metric or this one framework. So we'll look at things when we're modeling, we'll look at historical realized risk and correlation versus public markets, but then we'll also look at more of a kind of a desmoothed or more of a mark to market sort of framework. We'll compare and contrast, we'll acknowledge, both have limitations, both are going to be imperfect, but it at least helps you triangulate to a more rigorous final answer. And you can kind of get a sense for directionality.

Are we underexposed or overexposed to something? I'm not going to get too wrapped up in whether the allocation to this should be 4% or 6%, but does it need to be higher or lower than it is today? I think that's really the crux of how we think about it.

Stewart: And it's interesting because there's been a ton of activity in the insurance regulatory landscape. In fact, we're, I'm actually having a call with the NAIC commissioner immediately after this podcast. We're going to have them on to talk about some of the regulatory landscape changes. But from your perspective, what have been the most impactful changes or discussions currently taking place?

Pete Miller: Well, I mentioned earlier there has been so much going on the last two to three years that honestly is mind-boggling. And I mean, you could say that just about the US but then when you look at the UK, the PRA has been making some adjustments to their Solvency II implementation and lots of stuff going on in Asia, which there are a lot of commonalities in different countries in Asia, but there are some nuanced differences too. So there's just no shortage of things to be watching out for. But I'm based in Boston. I focus my own individual time mostly on the US. And there's been so much going on here and you guys have stayed on top of that. I think you guys are a great resource. I look to InsuranceAUM for a lot of help in sort of synthesizing a lot of what's going on, but to me, the most impactful, it's hard to pick one because residual tranches has been a big topic lately in capital treatment there.

Just things like definitions of bonds, where do they appear on different schedules? The increased involvement of alternative managers owning insurance companies. Bermuda, looking at, let's say, updating their framework to kind of, let's say find the right balance between commercial viability and interests, but also policyholder protection. And one of the things that personally, it's certainly getting a lot of attention, but I'm surprised maybe not more attention, in the US, is a lot of the discussion around ratings, credit ratings, and the possibility that the NAIC may, let's say, move away a little bit from the historical approach of just simply mapping to rating agency for their designations and having a little more discretion. That could be massively consequential to how the industry operates, how resources get utilized and deployed, and then could certainly filter through to actual investment decisions.

So I'm personally most interested to see how that plays out. And I mean, certainly, it's a topic that's gotten a lot of attention and a lot of initial response, but frankly, I would've expected even more. And so it'll be interesting to see how the next several months or probably quarters play out on that topic.

Stewart: All right, so this is the last question, then we're going to get a couple of fun ones in and then we'll run out the door. So looking ahead, where are you expecting to see the greatest challenges and opportunities for general account portfolios and how, or what adjustments are you making or if you're making any to take advantage of those?

Pete Miller: So to me, that goes back to the alternatives topic. I think there's two sides to that coin. It's going to be a challenge because the last 10, 15 years have seen so much capital flow into private markets broadly. And a lot of things that were, not that long ago, very cutting edge and niche or maybe not widespread, are now very widespread and almost to the point of commoditized. And so the challenge is how do you find the next thing? How do you find the next opportunity that no one else has yet uncovered, or at least not many have yet uncovered.

And I think the opportunity there is not only identifying the investment opportunity, but then being willing and able to act quickly, to move before others do. And maybe that means pushing the envelope sometimes around, we just talked about the regulatory side, so maybe it's taking a bit of a leap of faith that, okay, here's how we think it should be treated. We're going to go for it, we're going to work with the regulators to make sure everyone understands what this is and everyone's on the same page, but we're not going to wait. We're not going to ask for permission and wait around for months or quarters or years. We're going to act on what we think is the right economic decision and then maybe adjust later.

So I think that's the opportunity, those who are nimble, maybe bold, willing to act because I'm sure, especially thinking about all the technology and innovation that's happening, I would imagine there will be a lot of opportunities for insurance investors to harness a lot of that in ways that we haven't even really seen up until this point.

Stewart: Very cool. I've really learned a lot today and had a great conversation with you. I've got a couple of fun ones for you out the door, you can answer either or both, most of our guests answer both, no pressure. What's a great piece of advice that you've gotten in your career or what piece of advice would you give? And the second piece of that is if you could have lunch with anyone, even a table of four, alive or dead, who would it be?

Pete Miller: Well, I love both these questions and as an avid listener, I was ready for them. So I'll take a crack at both. On the advice topic, I've been really lucky. I've had a lot of great mentors and managers and colleagues over the years. But I think the number one thing that now when younger people ask me for suggestions and advice, the thing that I always come back to is, just get over yourself and don't hesitate or be afraid to ask questions. I mean, I definitely suffered really in my career from this fear of looking like the dumb guy and fear of asking a question that I should know the answer to this already. And it took me probably longer than it should have to fully internalize this notion that everybody has to learn something for the first time at some point. You didn't start your career fully formed knowing everything right out of the gates.

And now I think about it from the flip side. If somebody asks a question of me that they might think is a basic question they should know, there's no judgment at all. I'm fully understanding of where they are. So I think more people would benefit from just asking questions. Don't be nervous, don't be shy. And if nothing else, there's some self-interest there. Aside from just learning answers, it shows you're interested, it shows you to be intellectually curious. All those things are, even if you know the answer, maybe you tactically ask questions to show that you're paying attention, right? So I think that's a really helpful piece of advice that I got, and I try to use that every day now.

Stewart: That's cool. What about lunch?

Pete Miller: Yeah, the lunch one, I mean, it's not going to be original, but I have to say Abraham Lincoln is somebody that I've been obsessed with since I was a kid. One of my favorite books that I ever read was Team of Rivals, and I would love to, of course, his role in our country's history is massive, but I think he was a really funny person, a really folksy kind of sense of humor. And I would just love to hear some of the kind of inside scoops and anecdotes, and especially dealing with such heady stuff. How did he deal with these personalities? How did he get stuff done? How did he strategically cajole or entice or encourage people to come around to his way of thinking? Because it's just interesting from a historical standpoint. And then also I think there would be some really good life lessons in there. So I know it's probably not the most original answer, but that's number one far and away from me.

Stewart: That's super cool. I mean, where I recently moved from is the land of Lincoln, and so I have a friend who does paper restoration, and she was working on a battlefield letter that he had written and folded in fours and shoved in his pocket, and I was in their shop, and it was one of these things that you normally, there's a piece of glass between you and that thing. It was amazing to see it up close where you could actually just… it's incredible. I think that's such a great answer. I've learned so much today. Pete, thanks for coming on. Thanks for being the first guest back after a little time off. We've been joined today by Pete Miller, CFA, FSA, Head of Insurance Solutions, Multi-Asset Strategies with Invesco. Pete, thanks for taking the time.

Pete Miller: Thanks so much, Stewart.

Stewart: Thanks for listening. We certainly appreciate you as we approach 70,000 podcast downloads, so we're happy and appreciative of our audience. Very much so. If you have ideas for podcasts, please shoot me a note. It's stewart@insuranceaum.com. My name is Stewart Foley, and this is the InsuranceAUM.com Podcast.