

June 2014 - Market Outlook

PhiloSmith was up 2.5 percent in the first half of 2014, behind the 7.1 percent gain of the S&P TR. Second quarter outperformance almost completely offset first quarter underperformance. The performance of PhiloSmith was primarily the result of above-average returns of specialty property casualty and reinsurance holdings, offset in part by negative returns in both insurance and securities brokers.

PhiloSmiths' results in the first half of 2014 primarily reflected strength in all three property casualty sectors; specialty, reinsurance, and standard line companies. Property casualty companies are benefitting from the confluence of several factors; increases in premium rates in excess of claims costs, reductions in reinsurance costs, and favorable reserve development. Property casualty revenues now reflect the compounding effect of several year over year rises in premium rates. As insurance companies increase rates faster than claims cost rise, profit margins expand. At the same time, benign inflation has held claims cost in check. The long, cold, and stormy winter notwithstanding, premium rates for property related risks are down. On the other hand, in the face of an abundance of capital, reinsurance costs for property risks are falling faster than primary rates. That allows primary companies to either improve profit margins for property risks or reduce net exposure for the same cost. PhiloSmiths' reinsurance holdings benefitted from generally good operating performance while strong capital positions has allowed for accelerated stock buybacks.

The Portfolio

Specialty companies, accounting for 34 percent of PhiloSmiths' holdings, are the largest sector. The performance of specialty stocks had the greatest impact on overall performance. Markel, an important long term holding, was up 13% benefitting in part by the successful integration of the Alterra acquisition. Reinsurance company stocks, up 6.6% on average in the first half, were the best performing sector. The core holdings of strong and well diversified reinsurers continue to gain market share as primary companies consolidate their reinsurance programs with the highest quality reinsurers. At the same time, well managed reinsurance companies are shifting product mix and geographies to offset competition from both the smaller reinsurers and alternative market participants. Primary property casualty stocks, accounting for 14 percent of the portfolio, also reported strong gains.

Outlook and Strategy

PhiloSmith's holdings continue to trade at reasonable valuations and are expected to generate above-average growth. PhiloSmith holds some of the highest quality companies. In a period of an uncertain economic picture, low interest rates depressing investment returns, and rate declines in some lines of business, well-managed companies with real competitive advantages stand to gain ground. Careful adherence to underwriting results will inevitably lead to above average financial performance. Portfolio companies have strong capital positions and are quick to buy back stock when appropriate. PhiloSmith's' property casualty holdings are seeing the benefits of premium rates gains and trade near book value. Specialty property casualty holdings trade at a small premium to book value, but at a discount to long-term average valuations, which gives us continued optimism.

Performance through June, 2014

