

September 2014 - Market Outlook

PhiloSmith was down 0.8 percent in the first 9 months of 2014, slightly ahead of the 1.3 percent decline of the three-index benchmark against which we measure performance. The S&P 500 was up 6.7 percent in the period. The performance of PhiloSmith was the result of good returns by several of the core holdings, offset by declines of a few long term holdings that had excellent performance in 2012 and 2013. Property casualty reinsurance holdings were up. Other sectors were mixed, while life and annuity companies underperformed.

PhiloSmith's results in the first three quarters of 2014 reflected the positive performance of all reinsurance holdings, up four percent on average, as well as securities brokers, which were up three percent on average. The performance of the other sectors; specialty and standard property casualty, title insurers, insurance brokers did not reveal any trend. In those three sectors, half of the holdings were up and half were down. The sector with the most significant impact on overall performance in the first nine months was reinsurance. The holdings were all up and up in a relatively tight 1-6 percent band. For the most part, PhiloSmith's holdings have not been impacted by capital in the form of alternative capacity that is flowing rapidly into both the property insurance and reinsurance, which has led to reductions in premium rates. The next best performing sector, securities brokers, also shared gains in all of the holdings.

The Portfolio

Reinsurance companies account for 16 percent of PhiloSmith's holdings. Performance in that sector was helped by solid underlying operating results, the lack of major catastrophes, and stock buybacks. As a rule, PhiloSmith holds stocks of companies that have some form of competitive advantage. These advantages allowed some portfolio companies to report good growth, while others were able to obtain greater shares of more attractive placements from primary insurance companies. Specialty companies comprise 32 percent of the portfolio. Performance of specialty companies were good except for a few holdings, such as RLI and Hiscox, where performance appeared to reflect a correction from recent exceptional performance. The third largest sector, property casualty companies, shared a wide range of performance, BF&M, the largest insurer in the Caribbean, was up 10 percent as a reflection of continued market share gains and a nice bump from a relatively low valuation. Horace Mann, on the other hand, was down 10 percent after a couple of years of exceptional market performance and despite solid operating results.

Outlook and Strategy

PhiloSmith's portfolio companies are engaged in a wide range of sectors and lines of business. However portfolio companies have real competitive advantages. The superior attributes of these companies will allow them to enhance their operations, which will in turn translate into above-average growth and profitability. In addition, the return on equity of holdings is projected to improve. PhiloSmith's property casualty companies are focused on underwriting earnings and will see the benefits of premium rates gains and economic growth, but still trade at discounts to book value. Today specialty companies trade at a slight premium to book value, but remain at material discounts to long-term average valuations. Portfolio company results remain strong, and in many cases, continue to improve. The competitive advantages of portfolio companies should allow them to thrive in the changing markets going forward.

Performance through September, 2014

