

June 2023 – Market Outlook

PhiloSmith was up 5.8 percent in the first half of 2023, slightly outperforming the 3.8 percent gain of the three-index benchmark against which we measure performance. The S&P 500, helped by strong gains from technology stocks, was up 15.9 percent in the same period. The first half performance of PhiloSmith reflected the bounceback of insurance stocks in the second quarter after first quarter underperformance. Primerica, which focuses on the sale of term life insurance to the middle-income market, was up 39.4 percent in the first half and accounted for more than half of the overall performance.

A noticeable change this period was the poor performance of several of the best performing holdings last year. Those swing stocks were in several different sectors and so there is no commonality to explain the relative underperformance other than the market likely believed the stocks got ahead of themselves last year and some correction was necessary. It is our view that these businesses are still performing well and the stocks will perform well over the long term. Valuations across most insurance sectors are still below long-term averages.

The Portfolio

Life insurance holdings had the greatest impact on overall performance. Life stocks accounted for 17 percent of the portfolio. This sector's gains were largely driven by the rebound of Primerica, which reported improved mortality as well as strong agent recruiting. Life insurance stocks had strong performance in the first half, as a reflection of improving fundamentals and higher investment income. PhiloSmith continues to believe these holdings are excellent companies that will generate above average returns over the long term. COVID related deaths have subsided significantly so there is optimism material losses are largely behind the industry. Life Insurance sales are up, particularly in populations with low sales penetration such as younger people. At the same time, policy lapses are down significantly as a further recognition of the need for these products. Capital positions remain strong. Insurance broker holdings also performed well. With the tailwinds of GDP growth and rate increases supplemented by organic growth, brokers are showing strong revenue gains. Leading brokers continue to pressure smaller competitors that can't provide industry specialization and technical support. M&A activity is strong, although private equity-backed buyers have pulled back in the face of rising interest rates.

Commercial property casualty insurance is in the midst of a hard market as carriers continue to increase premium rates, but at a slower pace. At this point it is clear inflation, both economic and social, is not going away. In the aggregate, margins should continue to expand as pricing gains earn in faster than claims cost inflation. With steady economic growth and rate increases, commercial lines growth is strong. Reinsurers have instituted rate increases of at least 25 percent and in many cases more than 50 percent on all renewals. Reinsurers have bumped up deductibles and are now excluding many secondary perils such as flood or earthquake coverage that were previously included. Social inflation, most noticeably evidenced by rising jury awards, has made it clear additional rate as well as tougher underwriting standards are necessary going forward.

Personal lines carriers have been experiencing one of the more difficult markets in many years. As the economy returns to a more normal post pandemic environment, claims frequency has normalized as driving patterns approach traditional norms. Carriers are increasing rates aggressively, but it is not clear if the increases will cover the sharp increase in claims costs. PhiloSmith does not have much exposure to personal lines P&C.

Outlook and Strategy

The long-term outlook for insurance and reinsurance is good. Significant catastrophe losses and last year's stock market decline continue to drive property casualty insurers and reinsurers to refocus on underwriting profits as the key to return on equity. In the current environment only those insurers implementing rate increases by enough to offset social and economic factors are increasing profit margins. The absolute and relative valuations PhiloSmith's holdings are near the middle of their long-term ranges.

PhiloSmith's Key Statistics & Sector Breakdown

Based on a trailing 10-year period

Alpha	3.74%
Beta	0.82
Standard Deviation	4.61%
Sharpe Ratio	0.82
R-Squared	58.38%

