

October 2023 – Market Outlook

PhiloSmith was up 11.5 percent in the first ten months of 2023, outperforming the 4.9 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 9.2 percent in the same period. Ten-month performance reflected portfolio concentration in companies and sectors with significantly improving fundamentals. Importantly, life and annuity, insurance brokers, and specialty sectors accounted for half of the portfolio and were up 23 percent on average.

Arch Capital was up 38.1 percent and accounted for roughly one third of overall performance. That performance reflects the market’s view of the hardening in the primary insurance and property reinsurance markets. Primerica, which focuses on the sale of term life insurance to the middle-income market, was up 34.8 percent, adding a significant contribution to overall performance.

The Portfolio

Life insurance holdings had the greatest impact on overall performance. Life stocks accounted for 16 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, as a reflection of improving fundamentals and higher investment income. Life and annuity company holdings all focus on the underserved middle class, which is significantly underinsured. PhiloSmith continues to believe these holdings are excellent companies that will generate above average returns over the long term. COVID related deaths have subsided, although mortality remains up slightly as people seeking medical care uncover lingering untreated problems. Most industry participants believe we will continue to see steady improvements in mortality. The general population clearly views mortality as a material risk resulting in strong sales and persistency. 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. 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 a few 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. The increase in claims costs is material as 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. First half cats were above the ten-year average, but third quarter cats were less costly than expected. 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. 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 operating environments in many years. With the pandemic in the rear-view mirror, claims frequency has normalized as driving patterns have returned to historical levels. Many of the largest personal lines carriers are no longer writing new business in difficult markets such as California and Florida. The reduction in insurance availability is causing insurance departments to become more flexible approving rate increases. PhiloSmith does not have much exposure to personal lines P&C.

Outlook and Strategy

The long-term outlook for insurance and reinsurance is good. Economic growth is stronger than expected. The increase in short-term interest rates is a positive as new investment rates of return are now noticeably above the roll-off yields of maturing bonds. Net investment income is rising across the board and becoming a more material contributor to overall earnings. 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	4.72%
Beta	0.80
Standard Deviation	4.56%
Sharpe Ratio	0.78
R-Squared	56.71%

