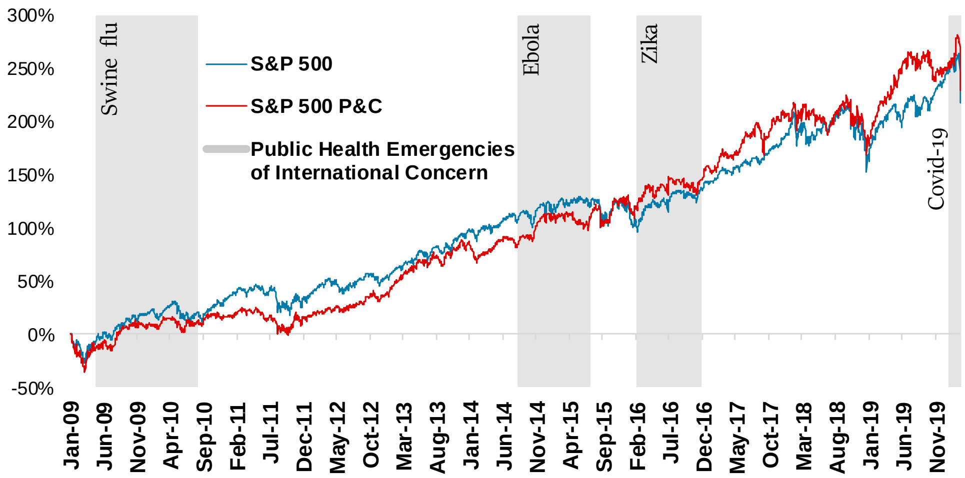
Market plunge drags down P&C stocks

Stocks and Public Health Emergencies since 2009



Last week, the global spread of the coronavirus spooked investors, causing a sharp drop in risk assets globally. The one-week correction wiped out all the stock market gains from the past five months. The fact that the drop followed a sustained rally despite a soft macroeconomic backdrop led to several records being broken.

To name a few, the world's biggest stock markets - US and Europe – had the worst weekly declines since global financial crisis, the long-term US treasury yields fell to all-time lows, pushing real yields further into negative territory, the volatility index or so-called "fear index" closed at the highest level since 2011, corporate bond spreads jumped by the most since 2008, and junk bond ETFs had their biggest outflow ever, to name but a few.

Unsurprisingly, the broader market moves served as the main driver for P&C stocks, outweighing sector-specific forces that have included Q4 results, updates on rate and loss trends, and the 1/1 renewals. Since the start of the year P&C stocks are down 9.2% versus the 8.6% loss on the S&P 500, as only two stocks out of 36 in our P&C composite (Inside P&C Select) had positive stock returns on YTD basis. Both P&C and the broader stock market are down 13% from the mid-February highs.

So far, most of the action in P&C stocks seems to be simply "beta" driven. However, importantly, there could be real transmission mechanisms from these financial market shocks into the earnings of P&C companies – even before factoring in the impact to the real economy - including losses from equities and NII pressures from lower yields.

We briefly theorized about what can go wrong last week, outlining what a worst of all worlds scenario looks like, as carriers look to fight loss cost pressures and investment income declines at the same time. Though we are not predicting this outcome, it seems incrementally more likely, which could create a challenging environment for P&C stocks in 2020. This is particularly the case due to elevated valuations as a starting point and likely less than smooth sailing on underwriting results as carriers continue to play catch up on reserves and loss picks on liability lines, and face mean reversion pressures in big high performing lines like workers' comp and auto.

As we pointed out last week, the recent volatility has wiped out the stock price gains of the Inside P&C Select since August 2018. Of course, this recent bout of volatility could reverse as quickly as its come. But if these macro forces remain intact, any sector specific headwinds on top of this could make things look pretty ugly indeed.

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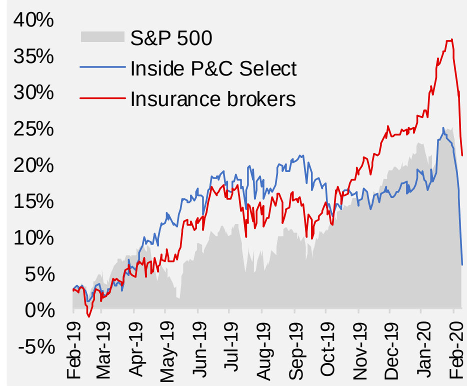
Composite	YTD px chg.	P/B
Large comm.	(11.9)%	0.9x
Regional	(12.4)%	1.5x
Specialty	(4.3)%	1.7x
Personal	(3.3)%	1.9x
Bermuda	(8.5)%	1.3x
Florida	(21.1)%	1.0x
Brokers	(2.3)%	-
IPC Select	(9.1)%	1.2x
S&P 500 Fin.	(13.8)%	-
S&P 500	(8.6)%	-

Day's best performer	FNHC -1.0%
Day's worst performer	UFCS -7.4%

1YR Price Peformance



A sea of red

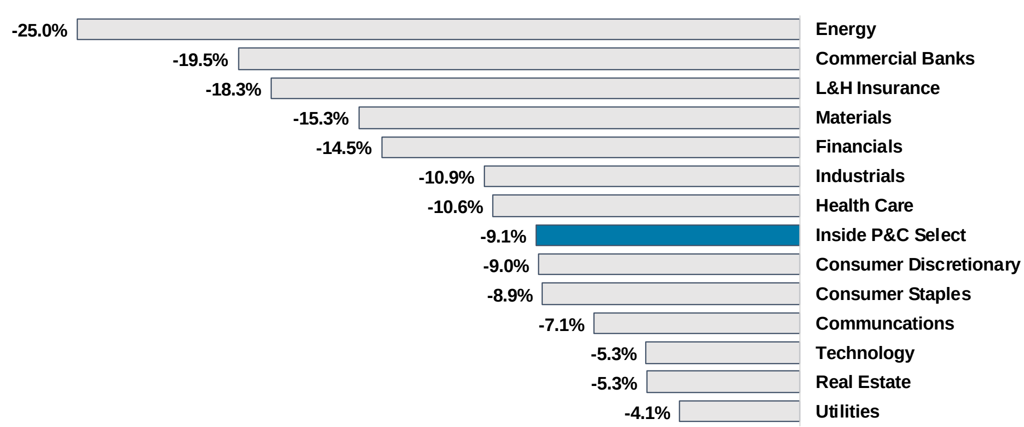
- ***P&C stocks are down 13% from the mid-February high and down 9.1% YTD***
- ***34 out of 36 Inside P&C Select stocks are in negative YTD***
- ***21 out of 36 stocks wiped out 1-year's worth of gains***
- ***P&C outperformed most financials but lagged defensive stocks***

Since the beginning of the year P&C stocks proxied by the composite of our select of P&C stocks are down 9.2% versus down 8.6% on the market. The first two months of 2020 were a roller coaster for P&C stocks driven by the mixed Q4 earnings and macro events. During the two months, the composite reversed a 7.1% gain to close the month of February at a 9.1% loss, with all stocks experiencing large swings.

Below is the summary of main drivers of P&C stocks in the first two months of 2020:

- **Virus fears**. The first cases of the novel coronavirus were detected as early as December. However, the market's reaction to the disease remained muted until the highly pathogenic nature of the virus was discovered as the disease quickly spread around the world. It is only during the last week of February when the virus actually spooked the global markets and business communities sharply scaled down risk appetite. Exacerbating the selloff has been the timing of the virus outbreak, as remarkably complacent investor sentiment switched to the panic mode within just few days, wiping out at least 5-month worth of gains on the market in a matter of week.
- **All-time low yields**. The virus fears heightened the demand for safe haven assets leading long-term US yields to new historic lows below 1.2%. It is hardly surprising that in the times like these yields experience additional pressures from increased Fed rate cut expectations, a lower economic outlook and deflation fears on weaker demand. As to be expected, financial stocks were among the hardest hit. However, P&C stocks where earnings volatility is mainly caused by underwriting operations did a better job at weathering the interest rate headwind. That said, if current interest rate trends persist for a sustained period there, will be significant pressure on net investment income of P&C carriers (70-80% of P&C earnings) as the lower new money yields make their way into income statements.

Exhibit: Inside P&C Select vs. S&P sector and subsector YTD performance
Source: SNL, Inside P&C



- **Q4 results**. Unlike in Q3, when the reserve charges and social inflation worries led to downgraded EPS outlooks across the board, Q4 results were rather balanced. Some large names, e.g. Chubb and WR Berkley, released strong results with evidence of benefitting from the challenging environment, whereas other reports, e.g. AIG and Travelers, included somewhat disappointing guidance and/or continued pressures from the challenging tort environment.

Beneath the headline numbers, the difference in the stock performance between the P&C peer groups largely stem from the Q4 earnings results. The positive earnings released by Markel and WR Berkley weathered the YTD stock losses for the specialty peer group, while in personal lines Progressive's better-than-expected December results—partly offset by disappointing January results—aided the peer group's performance.

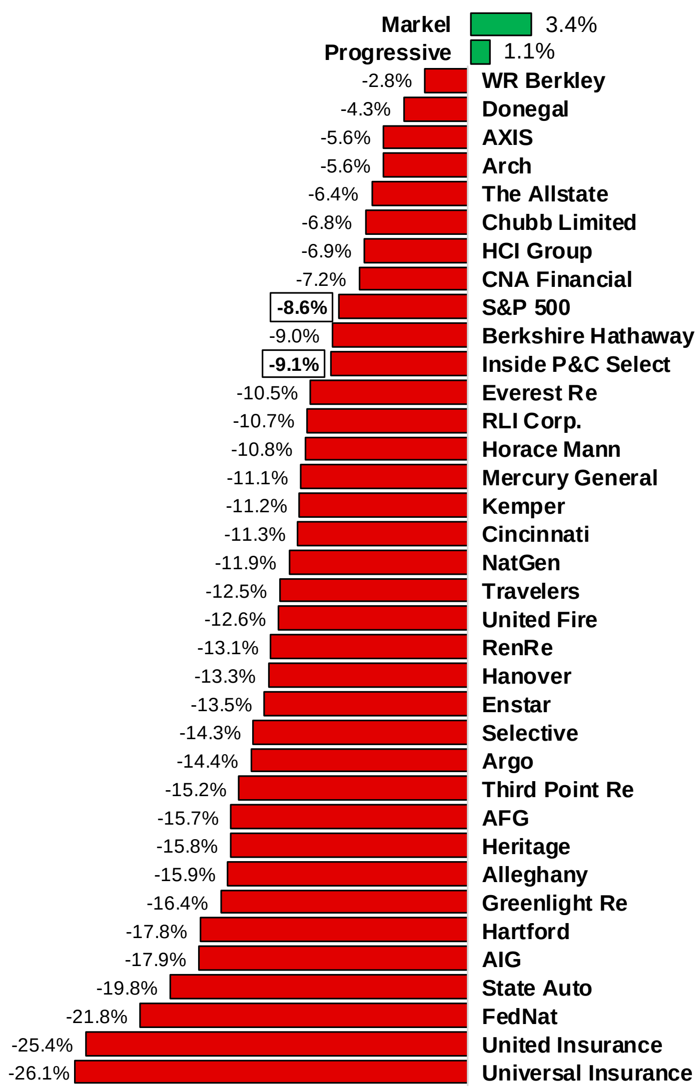
Exhibit: P&C performance by peer groups

Source: SNL, Inside P&C

	MTD	YTD	1 year	3 years
Inside P&C Select	-9.9%	-9.2%	2.0%	3.2%
Large commercials	-9.7%	-11.9%	-0.8%	-15.1%
Regionals	-12.6%	-12.4%	-1.6%	21.1%
Specialty	-7.1%	-4.3%	12.1%	22.8%
Personal	-10.1%	-3.5%	1.1%	41.5%
Bermuda	-9.7%	-8.4%	16.3%	16.4%
Florida	-11.2%	-21.6%	-38.4%	-23.5%

Exhibit: YTD P&C stock performance by firms and selected indices

Source: SNL, Inside P&C



Personal lines

In personal lines, **Progressive** rallied in late January as the firm beat estimates on December results that included a "leap week" which followed 7 back-to-back months of results that negatively impacted the stock. The relief rally was then partly offset by weaker February results and the broader market correction last week. Progressive is up 1% YTD, which is the second-best performance among Inside P&C Select stocks where 34 out of 36 stocks are down since the start of the year.

Allstate was down 6.4% YTD, better than most peers, as investors weigh-in on the transformative growth plan broadly discussed on the last earnings call.

Exhibit: 1-year and YTD stock performance for personal carriers

Source: SNL, Inside P&C

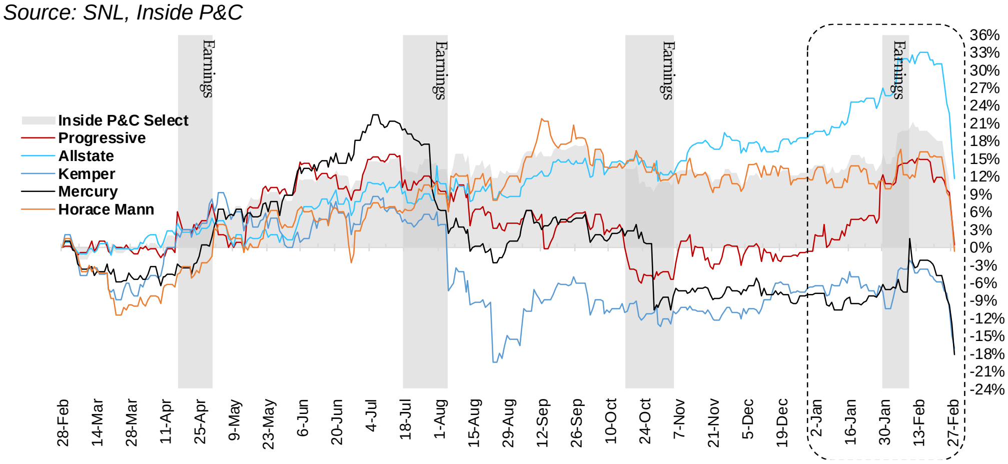
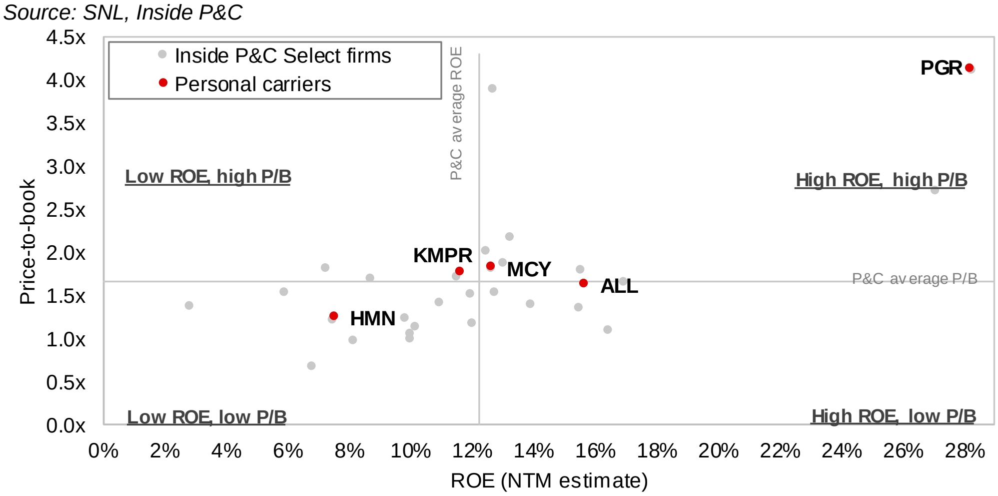


Exhibit: PB over ROE versus P&C industry

Source: SNL, Inside P&C



Large commercials

The stock performance for large commercial carriers was mixed, with the differences largely arising from the price reactions to Q4 earnings.

Chubb outperformed the peer group and the broader market as its Q4 results provided compelling evidence that the carrier is emerging as a cyclical winner amidst market disruption, with accelerating growth, strong underwriting results and a capital position that leaves it with plenty of option value on market opportunities as stress continues to emerge at competitors. Chubb's stock is down 7% YTD.

Following a third consecutive solid quarterly EPS beat in the year in Q4, **AIG** disappointed on 2020 guidance reversing a 4% gain on the stock that closed down 6% on release day. AIG's life insurance exposure likely pressured the stock too, as fixed income yields hit new lows in February. AIG's stock is down 18% YTD.

Travelers' Q4 results included continued margin pressure across commercial and personal products due to challenging tort environment. Travelers' stock is down 13% YTD.

Exhibit: 1-year and YTD stock performance for large commercial carriers

Source: SNL, Inside P&C

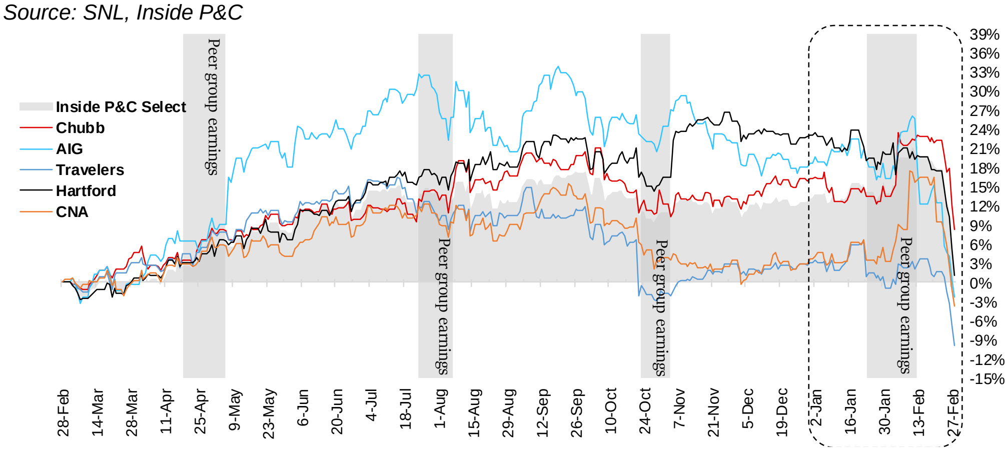
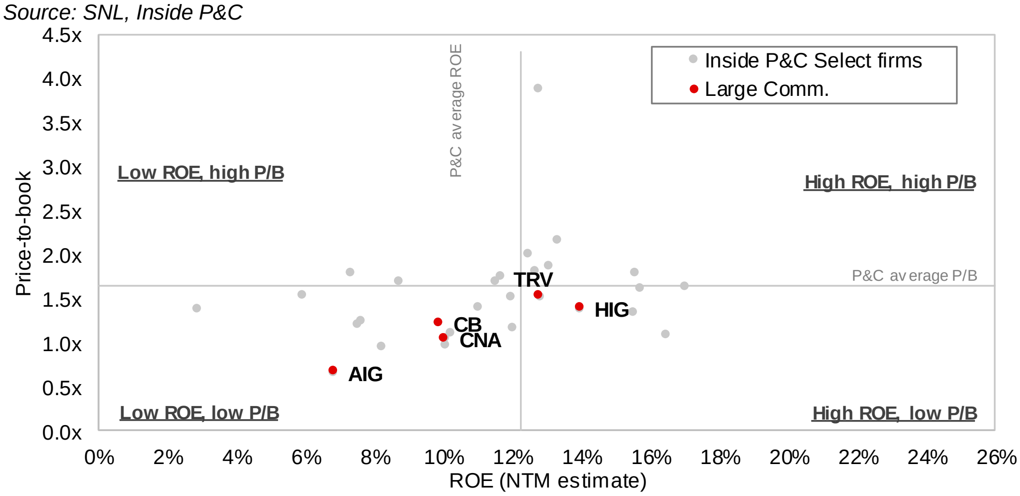


Exhibit: PB over ROE versus P&C industry

Source: SNL, Inside P&C



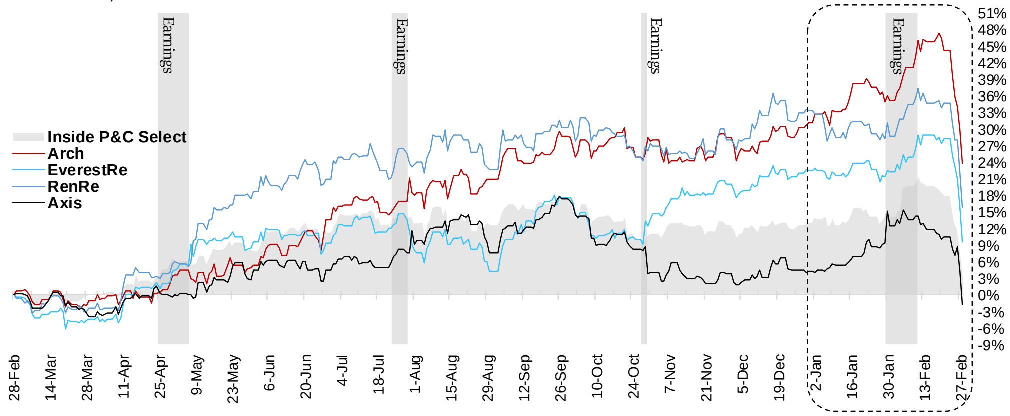
Bermuda

Bermuda stocks were all down YTD as fairly balanced Q4 results were outweighed by the market selloff.

The stocks in the peer group are down 6% to 14%.

Exhibit: 1-year and YTD stock performance for Bermuda carriers

Source: SNL, Inside P&C



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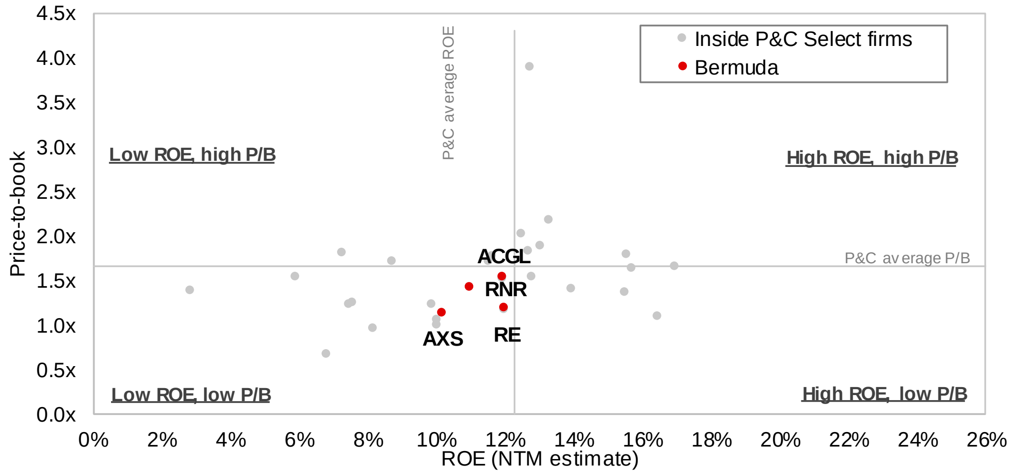
Source: SNL, Inside P&C



Florida and Regionals

Florida stocks struggled throughout 2019 despite a relatively benign cat year for the Sunshine State, and continued lagging the P&C composite in 2020.

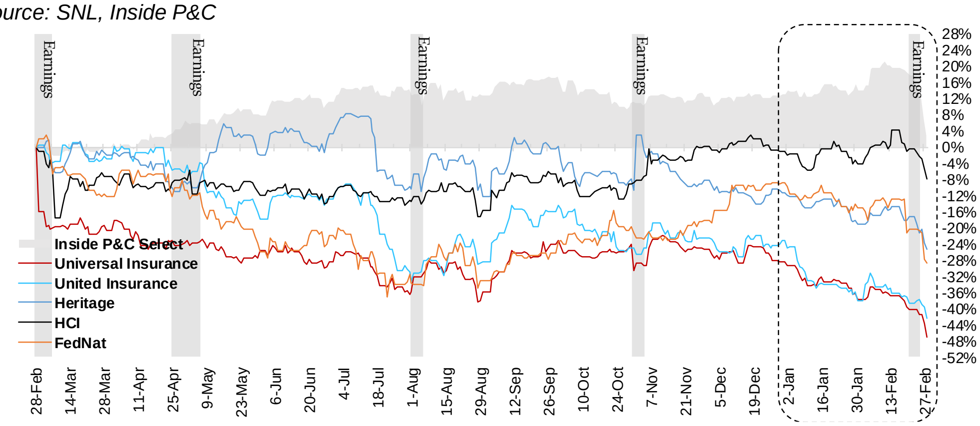
United Insurance badly missed Q4 EPS estimates on weaker underlying margins, increased severity on fire and liability losses. United Insurance is down 25% YTD.

FedNat similarly took a hit (down 22%) after missing analyst estimates, despite pre-announcing a reserve charge and current-accident year true-ups.

Heritage's somewhat balanced Q4 earnings coincided with the market selloff complicating the assessment of the stock's reaction to the report. Heritage is down 16% YTD.

HCI Group (down 7%) reports Q4 results later this week.

Exhibit: 1-year and YTD stock performance for Florida carriers
Source: SNL, Inside P&C



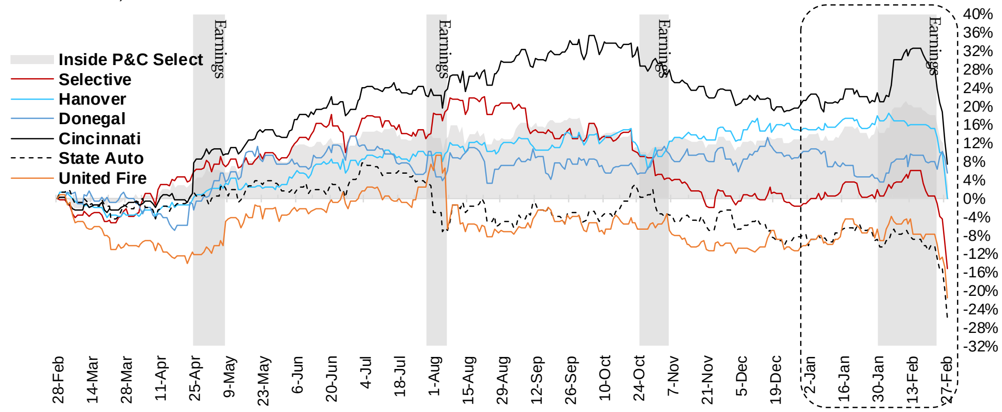
Most of the **Regional** carrier stocks were down double-digits YTD.

Donegal is the best performer among the peer group with a 4% loss on the stock amid the market selloff, due to positive Q4 results.

On the contrary, State Auto has been the peer group's laggard in 2020 with a 20% decline in the stock price. State Auto Q4 earnings fell far off the street consensus on significantly higher underlying loss ratio within personal auto. Following the disappointing results, the firm announced measures to fix the margins through improvements in pricing and operational changes.

Exhibit: 1-year and YTD stock performance for regional carriers

Source: SNL, Inside P&C



Specialty

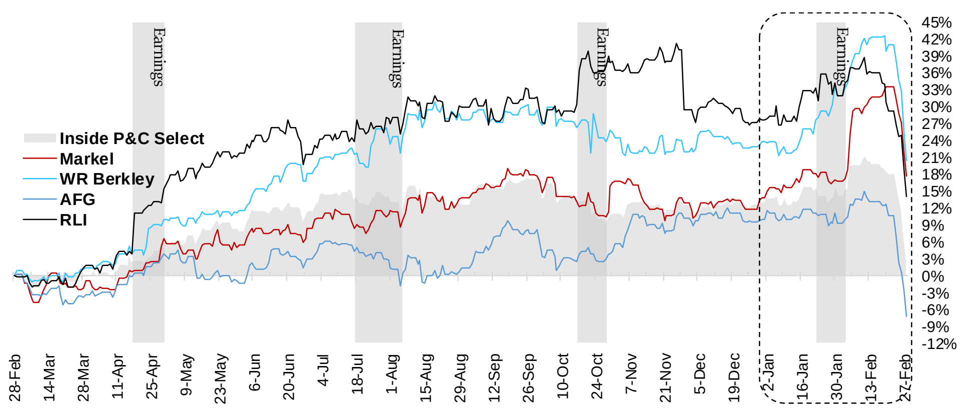
The specialty peer group weathered broader market losses in 2020 on positive Q4 results by Markel and WR Berkley.

Markel's Q4 results included solid growth across most businesses, positive remarks on the alternative capital market and a decade+ low quarterly expense ratio.

Similarly, WR Berkley put up a positive Q4 release with below-trend expenses and positive commentary on growth opportunities and pricing.

Exhibit: 1-year and YTD stock performance for specialty carriers

Source: SNL, Inside P&C



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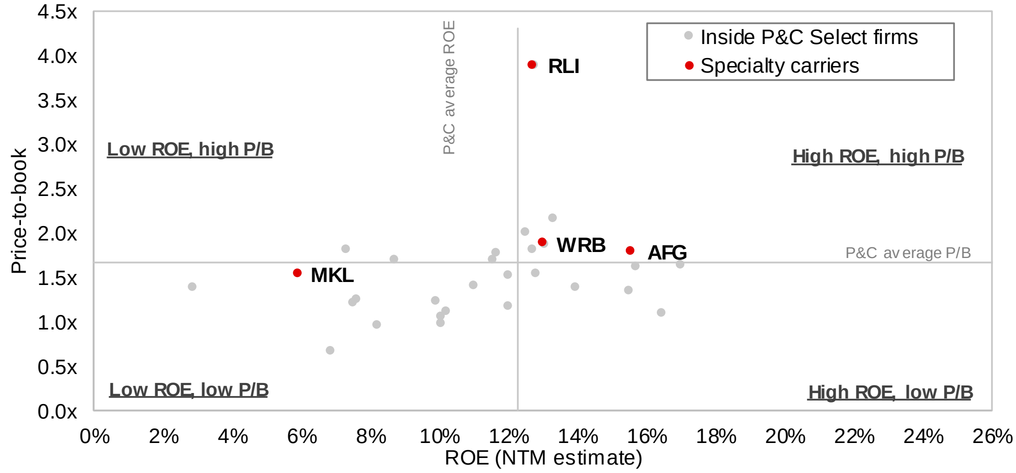


Insurance brokers

Insurance brokers significantly outperformed both the broader market and P&C stocks in the two months of 2020. The strong performance followed another pile of solid quarterly results by the insurance intermediaries that included above-trend organic growth (particularly in P&C operations) and strong healthy margin expansion.

Aon is flat YTD as strong Q4 results that included a long-time record organic growth and margins helped weather the severe market selloff.

Marsh & McLennan's stock is down 6%, outperforming the market but underperforming the peer group after the balanced Q4 results that included an upgraded guidance on the JLT expense synergies, counterweighted by revenue headwinds.

Similarly, Willis Towers Watson's stock is down 6%, as the broker's strong Q4 growth and margins were offset by disappointing guidance on margins and free cash flow.

Brown & Brown is up 8.9% YTD after posting remarkable organic growth in Q4 in the brokerage segments.

AJ Gallagher is up 2.4% YTD after a positive surprise on margin expansion and another quarter of solid organic growth in Q4.

Exhibit: 1-year and YTD stock performance for insurance brokers
Source: SNL, Inside P&C

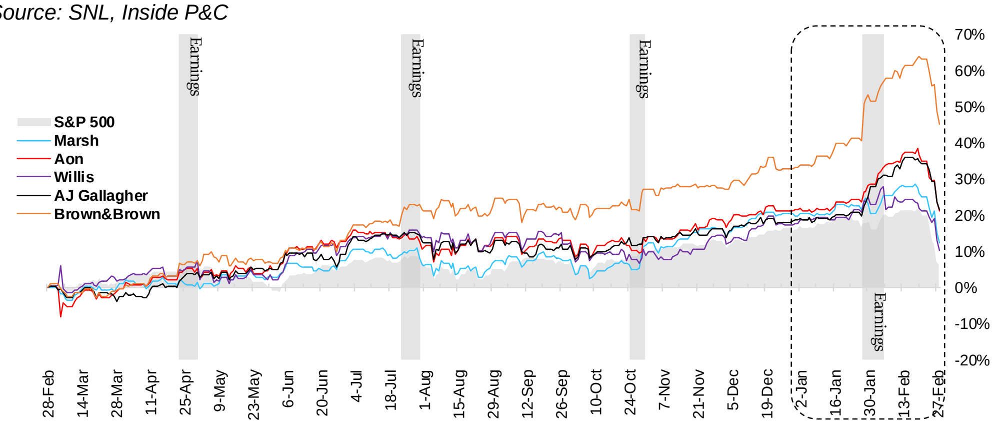
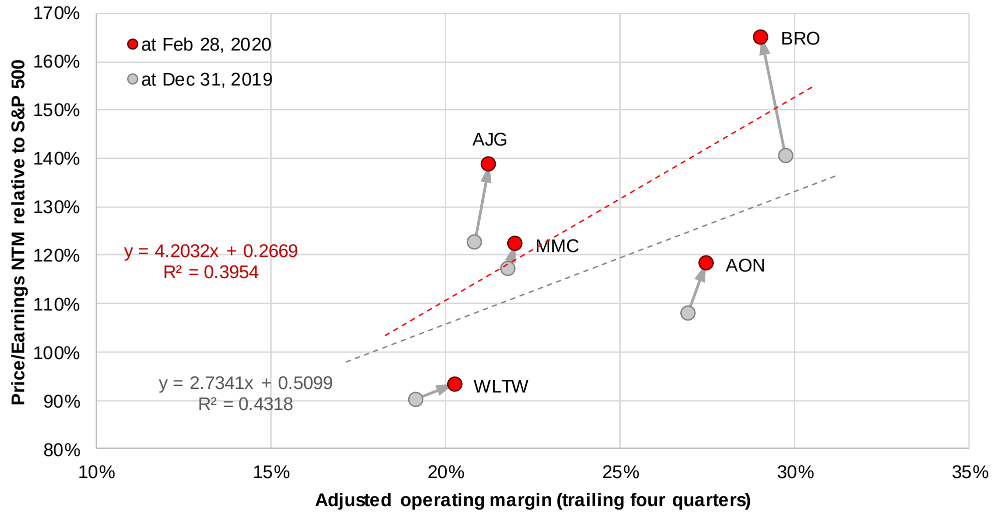


Exhibit: Forward P/E versus operating margins for insurance brokers
Source: SNL, Inside P&C



This research report was written by Insider Publishing's Research team which includes Gavin Davis, James Thaler, Gianluca Casapietra, and Dan Lukpanov.

The content of this report includes opinions based on publicly disclosed financials and management commentary.