

Loving Life, While P&C Catalyst Takes a Back Seat

April 2010- Market Outlook

Our portfolio return of 4.2% in March was boosted by recently-added names in the life insurance sector. We remain weighted towards P&C stocks, but lightened exposure to reinsurance in favor of life stocks. Brokerage stocks got interesting soon after our last writing, *Please Turn Down the Volume*. Our focus was concern with noise out of Washington, and the potential for a detrimental impact on certain financial stock valuations due to regulatory uncertainty. The most recent noise (screams) created a fantastic opportunity to add to brokerage positions that, in our view, could benefit from the challenges faced by competitors now in the cross hairs.

Loving Life: Life stock valuations have steadily improved as capital concerns diminish, yet many life stocks still trade at attractive price-to-book values relative to return on equity. We're particularly fond of life companies with both protection and asset accumulation businesses.

P&C Catalyst: Investing is all about relative opportunity, and right now P&C stocks take a back seat. Investor perception is that multi-year cuts in the price charged for many P&C insurance coverages will soon yield enough profit strain that companies will change course and increase the prices charged, which would improve stock valuations. For now we've deemphasized P&C exposure in favor of certain life/brokerage stocks, but will continue to monitor P&C reserve releases, overall capital levels, and broker feedback for a sign that a turn in pricing is imminent.

P&C Exception: We still like specialty insurance, and remain busy traveling, reading, and analyzing in an effort to uncover fresh specialty insurance stock ideas that are positioned to benefit from favorable pricing trends within niche business lines. Niche businesses often give a company the ability to achieve premium price increases, despite the well-publicized, downward price cycle (see above). Our expectation is that higher-than-expected premium growth will translate into surprise earnings growth.

Currency Comment: Our offshore partnership has most recently seen a favorable impact vs. February from its GDB/USD hedge strategy, which reflects part of the fund's objective to adapt a short USD bias. GDB seems to have regained its footing vs. USD, but during the month of February GBP depreciated vs. USD close to -5%, which offset the offshore fund's favorable equity returns. Our view is that perception of the British Pound was hurt by fear of 1) double dip potential for the UK economy, 2) possible economic instability attributed to dangerously high UK Government debt relative to GDP, and 3) increased potential for a ratings downgrade.

If you have questions regarding the financial services sector, or would like to discuss our investment approach, please contact us at the phone number below, or visit our website. (www.PhiloSmith.com)

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