

## Beware: Job Growth and Productivity

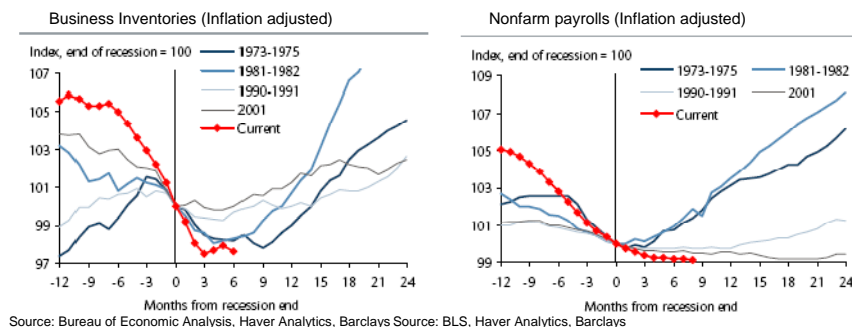
### February 2010- Market Outlook

Our equity portfolio was down slightly in January, which compared favorably to the larger downturn in the broad market. It seems as if a focus on jobs has (finally) begun to take hold. This month we will discuss jobs, and why a favorable flip to job creation – from current job losses – could mean double-digit upside for many of the insurance stocks in our portfolio.

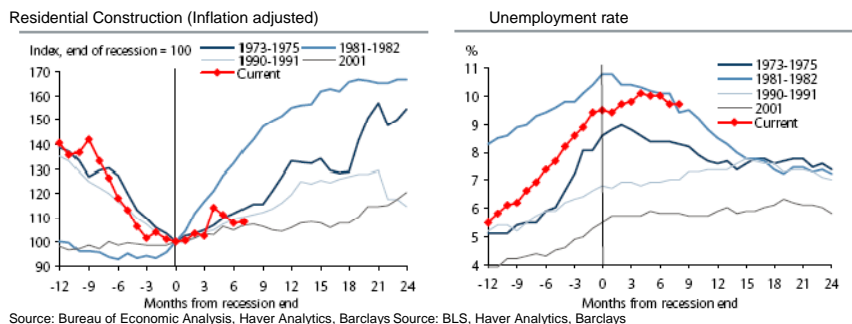
**First, Additions to Payrolls:** Two insurance companies in the portfolio collect premiums from corporate clients based on the number of workers employed (group insurance), so a pick-up in jobs leads to a direct pick-up in collected premium. The market value of these “group insurance companies” that sell benefits to corporations’ employees tends to be very sensitive to expected premium growth given the potential impact on the bottom line.

**Then, Simply More Jobs:** Another insurance company we own pays out checks to policyholders that have been injured, and are unable to work. In this case, the faster the injured policyholder re-enters the workforce, the faster the insurance company can stop paying claims checks. While minor injuries are generally followed by a return to the same job, a major injury (loss of limb, or sight) could require finding a completely new job. Importantly, these major injuries are big claims not because of medical costs, but due to the time required to return to work. Simply put, more jobs helps injured policyholders get back to work. For several reasons – only one was discussed above – the market tends to value “disability insurance companies”, in part, on the outlook for job growth.

**Jobs: Where are We Now?:** Several widely-followed economic indicators almost look encouraging when we plot where we are in the recovery stage vs. prior recessions. On some fronts we appear to be scraping along the bottom, which is good in a twisted sense because the indicators appear to have at least stopped getting worse, or the downward pace has merely slowed.

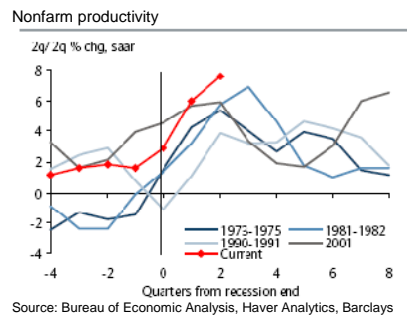


On other fronts, it appears we have turned a corner. True, we are nowhere back to normal, but some indicators seem to signal that the worst may be over.



Our conversations with company executives, insurance brokers, and other industry contacts indicate the environment for selling jobs-related insurance has actually improved slightly, and that we have moved past the point of skidding along the bottom. We expect 1Q conference calls will be the first time in at least a year that investors hear positive whispers related to an improvement in the jobs market.

**The Killer:** We worry about the possibility that gains in productivity could either delay job growth, or simply eliminate some level of job creation. For now, it appears to be the case that employees are not pushing for wage gains, and may even accept the additional responsibilities that – in normal times – would have been handled by an additional hire. Productivity is up, temp hiring is up, inventories are running down—something has to break. Our take is not if, but when, we see an improvement in jobs translate into sharp valuation gains of job-related insurance companies.



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](http://www.PhiloSmith.com))

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