Insurance Investors and Advisors Since 1962

Beware of Headlines

November 2009- Market Outlook

We do not expect all financial stocks to fare well over the next several quarters. For example, in the Offshore partnership we have shorted certain bank stocks likely to see higher-than-expected provisions for commercial real-estate exposure, and many large cap insurance stocks could see top lines dwindle given the need to sell a broad mix of products that include both winners and losers.

Big and Bad: Unfortunately, the media tends to report on the large companies, the large products, and the large problems. As a result, it is the health of the financial sector's largest companies, etc. that shapes the perception of the entire sector. Our view is that larger companies are at a current disadvantage given the product mix, and the regulatory pressure. Regardless, the larger companies, and the products sold, generate the headlines read by investors. For example, based on the headlines one is correct to conclude the price of P&C products has continued to drift down for longer than expected. But the "pricing cycle" reported by the media reflects an aggregate of many products, and what gets lost is that within this aggregate are some products – and companies that sell the products – that have benefitted from decent price increases.

Small /Mid Cap: Some of the smaller insurance stocks appear well positioned for two reasons. First, small size allows for product focus. We look for companies with a business mix focused mainly on products with favorable pricing trends, and steady demand. To support the point favorable pricing trends are important, consider 74% of the portfolio companies have reported 3Q results ahead of expectations. Second, as a testament to the capital position of these smaller companies, many of them have announced dividend increases, and/or share repurchases. We don't generally like share repurchases (kind of a weak form of capital deployment), but it would seem to support a case for a strong capital position.

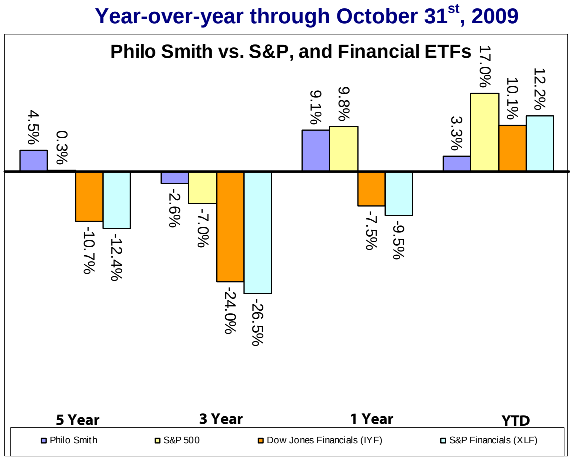
Reversal of Fortune: The run-up in a handful of large-cap stocks we viewed as risky – and so frustrated us last month – turned and did a complete reverse in October. Several of these names were down 20%-40% during October alone. Despite October, the YTD double and triple in stock price for a few of these companies has not helped our fund's relative performance. We do not hold long positions in these names, but we do own call options on two names in the Offshore account.

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.

E. Stewart Johnson
Portfolio Manager

Performance

Year-over-year through October 31st, 2009



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