

## Greece Fires and Oil Slicks

### May 2010- Market Outlook

Our portfolio was up 1.7% in April, which beat the market slightly. Recent investments in some of the life insurance stocks helped on the upside, but our ongoing de-emphasis of reinsurance stocks protected us on the downside, too. Very simply, our ongoing challenge (going on 40 years) is to maintain a fresh set of key macro issues, and then find companies for the portfolio that will either benefit (longs), or get hurt (shorts) by these issues.

**Macro Issues:** We constantly hunt for fresh macro issues that impact our portfolio. Current macro issues include 1) financial regulatory/accounting reform, 2) change in employment/unemployment, 3) level of 5-10 yr interest rates, 4) economic slowdown in Europe. Other, more subtle macro issues include the legal environment (tort reform), demographics (aging population), and even global warming (liability exposure).

**Macro Obvious:** Within our sector, Greece is particularly bad for financial stocks with businesses in Europe. The reason can be traced a potential domino effect sparked by the financial stress in Greece, which may (finally) usher in austerity measures not only for Greece, but across large economies in Europe. The thought is that severe cutbacks in euro government spending could crimp economic growth, which is likely to hurt sales/exports. In addition, as US companies' foreign profits are repatriated into US dollars the weakened Euro currencies (euro and sterling, for example) translate into a negative impact on US dollar denominated earnings.

**Macro Not-so-obvious:** Nothing new that catastrophes can actually be good for certain insurance stocks. The oil slick in the gulf coast is no exception. The event initially introduced uncertainty into reinsurance stocks, which sent stock prices down given the unknown of potential claims. However, the net impact is that prices charged for certain coverages appear to have increased. Not-so-obvious issues include a potential drop in future insurance premiums given public backlash against new offshore drilling activity, or costs to settle a step-up in lawsuits for business interruption (fishing, tourism, restaurant), and perhaps costs borne by insurance companies to retrofit existing wells with safety-oriented technology. Companies that escaped excessive claims appear positioned to benefit from favorable premium pricing.

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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