

March 2013 - Market Outlook

PhiloSmith was up 15.4% in the first quarter of 2013, nicely ahead of the 10.6% gain of the S&P TR. Our performance was the result of above-average returns by many of the core holdings. Strong gains of a handful of the larger holdings also played an important role in the overall result.

PhiloSmith's results in the first quarter of 2013 reflected continued strength in core insurance holdings, particularly specialty property casualty and insurance brokerage stocks. Insurance brokerage stocks, up 22.5% on average, performed well in large part to successful internal growth. Brown & Brown's internal growth was well above-average, while Arthur J. Gallagher saw the benefits of its successful acquisition efforts of the last few years. Primary property casualty and reinsurance also played a meaningful role in performance. Property casualty underwriting results have paralleled the upswing in premium rates as low inflation exerted downward pressure on loss costs. Toward the end of last year, the abundance of capacity, both traditional and in the form of alternative structures, raised concerns about trends in premium rates, but Superstorm Sandy reinforced the general view that more premium rate increases are necessary. Market participants recognize that in a low interest rate environment, underwriting gains are necessary to sustain return on equity. Active capital management strategies, particularly stock buybacks, have increased the ROE of many holdings. Most of the holdings saw increases in regular dividends, sometimes supplemented by tax motivated special dividends prior to year end.

The Portfolio

At quarter end, specialty property casualty insurers account for 35% of PhiloSmith's holdings. At the same time, the performance of specialty property casualty stocks had the greatest impact on overall performance. Just about all of the holdings were up nicely. Primary property casualty stocks, accounting for 19% of the portfolio, also reported strong gains. The Hanover Group, up 28.2% in the quarter, is reaping the benefits of a more focused strategy as well as operational improvements.

Asset managers Ameriprise Financial and Waddell & Reed's above-average performance was supported by the strong financial markets. We believe their strong sales efforts will allow continued gains in market share going forward.

Outlook and Strategy

The property casualty market is in midst of a market upturn. PhiloSmith holds some of the highest quality companies and the real competitive advantages held by these companies will translate into above-average growth and profitability. In this period of low interest rates, underwriting profits are the key to returns. The holdings in the portfolio are undervalued relative to intrinsic value. Property casualty stocks, for example, continue to sell for book value or less. These valuations give us continued optimism.

Performance through March, 2013

