

June 2013 - Market Outlook

PhiloSmith was up 17.8% in the first half of 2013, nicely ahead of the 13.8% gain of the S&P TR. Our performance was the result of above-average returns by many of the core holdings and was widespread across the sectors in which we invest. For example, forty percent of the total gain in the first half can be attributed to the top five performing stocks, each representing a different sector.

PhiloSmith's results in the first half of 2013 reflected continued strength in asset managers as well as specialty insurance and finance companies, property casualty, and insurance brokerage stocks. Asset managers were up 27% on average, reflecting financial market gains. Insurance brokerage stocks, up 26.4% on average, performed well largely as a reflection of strong internal growth. In addition, both Brown and Brown and Arthur J. Gallagher have been successful acquirers. On balance, Brown and Brown has made a few larger acquisitions in recent times. Arthur J. Gallagher has also acquired a few large brokers as well as a very large number of smaller ones. Finally, economic growth is having a measurable impact on insured values and therefore revenues for the brokers as well as property casualty insurers and reinsurers. Primary property casualty stocks played a meaningful role in performance. Property casualty revenues now reflect the compounding effect of year over year rises in premium rates. At the same time, low inflation is holding back increases in claims costs. The net effect is the expansion of both profit margins and return on equity. Despite the large losses sustained as a result of Superstorm Sandy, new capacity in the form of alternative structures is flowing rapidly into the property insurance marketplace so property rates are declining. Casualty rates continue to rise. The management teams of well-run property casualty underwriting companies, whether primary or reinsurance, are keenly aware of the need for underwriting profits in the low yield environment. Active capital management strategies, particularly stock buybacks and in some cases special dividends, have increased the ROE of many holdings.

The Portfolio

Specialty companies account for 28% of PhiloSmith's holdings. The performance of specialty stocks had the greatest impact on overall performance. Primary property casualty stocks, accounting for 17% of the portfolio, also reported strong gains. The Hanover Group, up 26.3% in the first half, 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. Market appreciation, of course, helps drive earnings growth. At the same time, both Ameriprise and Waddell & Reed gained market share in core markets. Both companies' strong recruiting efforts should allow continued gains in market share going forward.

Annuity writer American Equity Investment Life and life reinsurer Reinsurance Group of America were both up roughly 29% in the first half of 2013. American Equity's growth and gain in market share helped the stock trade up from a deep discount to book value. Reinsurance Group of America continues its successful global expansion.

Outlook and Strategy

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. By focusing on underwriting earnings as the key to profitability, portfolio companies have shown and are expected to continue to show strong financial results. PhiloSmith's property casualty holdings are seeing the benefits of premium rates gains and trade at discounts to book value. Specialty property casualty holdings trade at a small premium to book value, but at a material discount to long-term average valuations, which gives us continued optimism.

Performance through June, 2013

