INDUSTRY TIMELINESS: 24 (of 97)

The Property/Casualty Insurance Industry continues to be ranked in the top quartile of all sectors under our coverage. This doesn't come as much of a surprise to us, given that many insurers are posting banner results in 2021, as we continue to fight the COVID-19 pandemic. While challenges remain, we are cautiously optimistic that the secular good times in the insurance market can persist, at least through the current year.

Recent Industry Fundamentals

When assessing the health of the insurance market the first thing we like to zero in on is net premiums earned, which is the "top line" for insurers. Many insurers are achieving solid gains in net premiums earned due to new business wins and solid rate increases on policy renewals. Last year, it should be noted, was a fairly active one regarding catastrophes across the industry. Such events, it should be noted, are a bit of a double-edged sword for insurers. On one hand, they cut into earnings as claims are paid out. However, they also give insurers greater bargaining power during policy renewal season. A recovering U.S. economy has also given insurers the ability to raise rates without conceding much regarding policy terms & conditions.

Another line item that bears watching is the combined ratio, which is the sum of the loss and expense ratios. The expense ratio, which is basically the operating expenses for insurers, can be a tad easier to manage. For the most part, the expense ratios for insurers have trended downward in recent times, thanks to cost-containment measures, along with higher net premiums earned, which allows costs to be spread across a higher top-line base. The loss ratio is much harder to project and manage, as this is largely based on weather-relate patterns, which, of course are difficult to predict. While there certainly have been some harmful events this year, including severe storms, flooding, and other weather-related disturbances, catastrophes, thus far, have been roughly on par with recent historical averages. Of course, we haven't entered the peak of the hurricane season, which is roughly mid-September.

One area that hasn't been in insurer's favor thus far in 2021 is net investment income. Insurers make money on float, which is the premiums they take in minus their immediate expenses. Also worth noting, is that insurers keep the lion's share of their portfolios in fixed-income securities due to their conservative bent. Interest rates are currently at or near historical lows, due to a relatively dovish stance by the Federal Reserve. Hence, bond reinvestment rates are low, which curtails net investment income. Some insurers have gone outside of the box and increased exposure to equities, limited partnerships, and other investments. While such a strategy can certainly boost total returns, it also adds a measure of risk.

Will The Good Times Continue?

One of the primary factors that affects pricing conditions in the insurance industry is aggregate capacity. Indeed, when supply conditions are held in check, and balanced with demand, insurers are generally able to raise rates. However, when supply floods the market and exceeds demand, pricing pressure may ensue. As mentioned earlier, insurers are currently enjoying rate increases across most product lines and geographic segments. We look for these conditions to continue, assuming that industrywide capacity remains in check. This year's hurricane season is a factor that bears close watching, as one or two severe storms might well give insurer's more bargaining power during next year's renewal season.

Net investment income growth will likely remain a challenge, at least through 2021. It appears unlikely that the Federal Reserve will begin raising interest rate until at least the end of next year, or 2023. Hence, insurers' fixed-income investments will likely continue to be pressured by low bond reinvestment rates. However, increased invested assets, largely reflecting increased premiums earned, ought to lend a helping hand to investment income in the near term. Also, insurers with equity market and other non-fixed-income exposure might continue to see above-average gains relative to the industry average. Of course, their risk exposure is above average, too.

Long-Term Considerations

While it's difficult to gauge the long-term fortunes of the insurance industry, we are cautiously optimistic regarding the 3 to 5 years ahead, given the current baseline. Over that period, we look for interest rates to trend higher, which would be a shot in the arm for profits. As mentioned earlier, subscribers ought to keep a close eye on industry capacity levels, which is a key variable regarding pricing. Assuming the COVID-19 pandemic is largely under control by 2024-2026, a mending economy should also work in insurers' favor when it comes to setting rates.

Conclusion

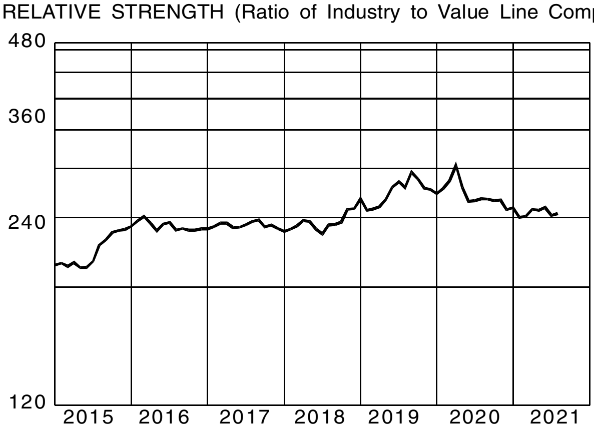
We advise that investors carefully study the individual reports on the following pages to identify those stocks that offer the best risk/reward prospects for their portfolios, both for the year ahead and over the 3- to 5-year pull.

Insurance companies tend to pay a decent dividend and, in many cases, the yields are above the *Value Line* median. What's more, from time to time, some insurers pay out a special dividend. While not a certainty, this can provide a nice bonus for investors.

Alan G. House

Insurance (Property/Casualty)

RELATIVE STRENGTH (Ratio of Industry to Value Line Comp.)



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