The big news coming out of the Property/Casualty Insurance Industry is Hurricane Harvey. After more than a decade of quiet hurricane seasons (June 1st through November 30th), Harvey has wreaked havoc on Texas. We will talk about the massive storm and its potential affects on the industry with more granularity below.

In aggregate the P/C Insurance Industry has gained 16 notches in Timeliness since our June review, though it still rests in the lower half of our universe.

Harvey's Impact

As noted, the past decade or so has seen little major hurricane activity outside of Hurricane Sandy, which ravaged the East Coast about five years ago. What resulted, from our perspective was steadily increasing industrywide capacity, which made rate increases difficult to come by across most product lines and geographic regions. Significant catastrophes can be a bit of a double-edged sword for insurers. On one hand, they, of course, cut into profits as claims are paid out. Conversely, if a catastrophe is large enough it could lessen industrywide supply, which might well give insurers the upper hand during policy renewal season.

At the time of this writing, it was too early to tell how much damage Hurricane Harvey will inflict. Initial indications by industry sources suggest that claims could cost the P/C industry upward of $20 billion (aggregate losses in excess of $100 billion), which would make it one of the 10 costliest hurricanes to ever hit American soil. Of course, these figures are somewhat speculative at present, and it may take weeks before a more definitive estimate is achieved.

What does this mean for the insurance industry? From a survival perspective, we believe the sector has the wherewithal to withstand claims related to the recent hurricane. This is based on two assumptions from our view. First, the past decade has been below average for hurricane-related activity. Hence, many companies under our perusal have boosted their reserves to comfortable levels, as significant claims payouts (as associated with huge events such as hurricanes) have been few and far between. Second, many insurers have learned from the past and are a bit more savvy with their underwriting standards. In the late 1990s, the industry was in the doldrums for quite some time, as many companies wrote business at any cost (without regard to margins) in order to garner market share. What transpired was several years of difficult conditions with many companies failing to make it out of the trenches. Hence, we think that the industry, in aggregate, has boosted its standards and thus is less likely to write business that will result in its demise or long-term futility.

At this juncture, we are unsure if Harvey is enough to move the needle in aggregate for P/C Insurance Industry pricing. We do believe that it will result in rate increases in the geographic regions directly affected by the catastrophic storm.

Other Things Of Note

The insurance industry had been constrained to an extent by lackluster investment income trends for quite some time. Indeed, insurers, in aggregate, keep the bulk of their investment portfolio in bonds due to their conservative nature. Fixed-income yields were at historically subdued levels, owing to low interest rates. In response, some insurers boosted their exposure to potentially higher-returning vehicles such as equities and limited partnerships, among other instruments. This, however, resulted in a greater risk profile for many companies.

Over the past several months interest rates have trended higher, thanks to tightening measures by the Federal Reserve.We look for the Fed to continue on this road, though the path at present isn't crystal clear, as inflationary and economic figures aren't cut and dry. Overall, this is good news for P/C insurers as it ought to result in higher bond reinvestment rates.

Though we believe that most insurers will have the funds on their balance sheets to pay out claims related to Hurricane Harvey, there may be some that have to take reserve-strengthening measures. This is noteworthy because such actions cut into net income

INDUSTRY TIMELINESS: 73 (of 97)

Long-Term Considerations

There are many factors that come into play when forecasting the long-term fortunes of the insurance industry. The economy, of course, plays a part, since it is easier to raise rates when times are good. Yields on investments are also vital, particularly since many insurers generate the lion's share of their profits from float, which can be defined as premiums taken in minus immediate expenses. However, the variable that seems to be the most important, especially when forecasting an industry downturn, is capacity. When supply levels are at unattractive levels, it becomes very difficult for insurers to raise rates. On the other hand, when capacity is limited, companies have the edge during policy renewal season.

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 distribution is above the *Value Line* median. What's more, from time to time, some insurers pay a special dividend. While not a certainty, this can provide a nice bonus for investors.

Alan G. House