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Equity Research

INSURANCE RESEARCH

Ira L. Zuckerman June 26, 2003

MONTHLY INSURANCE REVIEW

FIRST QUARTER RESULTS

The Insurance Information Institute just reported the property-liability industry's first quarter results. Results are summarized on page 2. Premium growth continued strong and underwriting results improved, following the trends that were evident in the second half of last year. The strong two plus years of commercial price increases, as well as the rate increases in personal auto and homeowners lines are beginning to have a salutary effect.

Loss and loss adjustment expenses rose modestly during the quarter, although such increase was somewhat less than the increase in earned premiums, so that the industry's loss ratio declined by about two points. Expenses also rose at a slower rate than premiums, producing a lower expense ratio as well. In addition, companies continue to trim expenses to remain competitive. Although catastrophe losses were higher in the quarter and **Hartford Financial Services (HIG - $46.54)** added $2.3 billion to its asbestos reserves, (adding over two points to the industry's loss ratio) underwriting results improved substantially. In addition, companies continue to trim expenses to remain competitive. The industry reported a combined ratio below 100% for the first time since the last cycle in 1997.

U.S. PROPERTY-LIABILITY INDUSTRY
($ MILLIONS)

	First Quarter		
Property-Liability Operations	2003A	2002A	% Change
Premiums Written	$101,329	$89,874	12.7%
Premiums Earned	93,600	82,427	13.6%
Change in Unearned Premiums	7,729	7,447	
Loss and Loss Expense	69,956	63,185	10.7%
Underwriting Expense	24,768	22,529	9.9%
Policyholder Dividends	337	357	-5.6%
Statutory Underwriting	(1,461)	(3,644)	
Change in DPAC	1,932	1,862	3.8%
G.A.A.P. Underwriting	471	(1,782)	
Underwriting After-tax *	306	(1,158)	
Tax Rate on Underwriting	35.0%	35.0%	
Net Investment Income	8,984	9,007	-0.3%
Investment Inc. After-tax *	6,612	7,423	-10.9%
Effective Tax Rate	26.4%	17.6%	
Pre-tax Income	9,455	7,225	30.9%
Taxes	2,537	960	164.3%
Operating Income	$6,918	$6,265	10.4%
Realized Gains	703	224	213.3%
Net Income	$7,621	$6,489	17.4%
Catastrophe Losses	$1,500	$615	143.9%
Dividends Paid	1,900	1,300	46.2%
Reserves	$403,567	$371,283	8.7%
Cash Flow	$20,501	$10,719	91.3%
Surplus	$289,167	$294,377	-1.8%
Premiums/Surplus	1.3	1.1	
Operating Return on Ave. Equity	9.6%	8.5%	
RATIOS			
Loss Ratio	74.7%	76.7%	
Expense Ratio	24.4%	25.1%	
Combined Ratio	99.2%	101.7%	
P.H.D. Ratio	0.4%	0.4%	
Combined Ratio After P.H.D.	99.5%	102.2%	
Catastrophe Losses (% of E.P.)	1.6%	0.7%	

* Estimated
SOURCE: Insurance Services Office and Nutmeg Securities, Ltd. Estimates.

Commercial underwriting results continued to improve, while we surmise that private passenger results also improved, as claim frequency declined further in the first quarter. Homeowners result should have also improved. Although there was a higher incidence of catastrophe losses, both the impact of last year's substantial rate increases and an apparent decline in new mold claims benefited this line. Statutory underwriting produced a modest loss of $1.5 billion compared to the $3.6 billion loss last year, and we estimate that the industry earned a G.A.A.P underwriting profit of $0.5 billion compared to the $1.8 billion loss last year.

The industry's investment income continued to decline modestly during the quarter. Interest rates have continued to decline to the lowest levels in 45 years, and the lower yields on new and reinvested assets are offsetting the overall increase in invested assets resulting in further declines in investment income. In addition, a greater emphasis on taxable investments, as opposed to tax-exempt bonds and equities, resulted in even steeper declines in after-tax results. Cash flow has been increasing and invested assets have been further enhanced by the significant capital raised by the industry over the past year. Realized capital gains increased slightly, as insurers continue to harvest old gains, even though the stock market continued to decline, and we think that bonds, rather than equities provided the bulk of any gains. Unrealized gains still remain substantial, and surplus increased to $289 billion, up from a year ago, but well below peak levels. The increase in the stock market in the second quarter will boost the levels in the second quarter report. At current levels, the industry is still significantly under-leveraged, accounting, in part, for the overall returns being below the average for the stock market as a whole.

SECOND QUARTER OUTLOOK

We expect second quarter results to further improve over first quarter results with some improvement over year ago results. There should be further double-digit growth in premiums written, as the result of last year's (and the first quarter's) strong commercial rate increases, as well as some personal line rate increases. Private passenger auto remains highly competitive, although **State Farm's** willingness to absorb underwriting losses to rebuild its lost market share apparently has finally abated. Many companies are reporting rate increases of 7-8%, which is somewhat faster than rate of increases in loss costs. Those companies such as **Progressive Corp. (PGR - $72.04)** and **GEICO** that addressed the auto problems with significant rate increases in 2001, are now reaping the benefits in the form of much better underwriting ratios and increased new business, as other insurers are finally increasing their rates. Most auto insurers are reporting that rate levels appear adequate, and that they are benefiting from the declining auto claim frequency, and that they are not expecting more than moderate increases going forward.

Most companies have also addressed the problems in homeowners' insurance, with significant rate increases as well as tightened terms and conditions. Because homeowner's insurance is generally written on an annual basis, changes are somewhat slower than in the semi-annual auto business. While commercial rates have risen by double digits for the last thirteen quarters, we expect middle-market commercial rates to continue to rise by 10-15% plus for the quarter. Commercial lines still have a long way to go to repair the damage from seven years of rate cuts, totaling as much as 50%, and to return the business to a reasonable rate of profit. In addition, a substantial portion of rate increases are paying for the significant increases in reinsurance costs.

We expect loss ratios in the quarter to be further improved both from a year ago and from the first quarter. The cumulative impact of past commercial rate increases will have an strong impact on results. Catastrophe losses in the second quarter have been significantly higher than a year ago, with the Texas hail storms in April and tornadoes in May, already costing the industry more than $2.5 billion, compared to the $2 billion reported in the second quarter last year. However, this still represents a below normal catastrophe loss activity, (in 2001 the industry reported losses of $5.9 billion). **We still expect that the industry's underwriting results will continue to improve significantly in the second half of the year.**

Investment income results show further slight declines in line with the first quarter results, with the lower long-term bond interest rates offsetting from the substantial increase in written premiums and further capital increases. With the industry's underwriting results improving, it is ironic that the rating agencies are requiring companies to increase capital to cover the increased nominal premiums. With rates increasing sharply, insurers are getting more premium per risk, thereby needing the same or less capital, as many companies have shed significant amounts of under-performing accounts. With the stock market improving in this quarter, we expect some increase in realized gains this quarter from both the bond and equity accounts. Many insurers are reducing their equity exposure and selling stocks that were purchased decades ago at much lower prices. The industry's surplus should, therefore, show further gains from first quarter levels. **Surplus at current levels still represent a substantial excess over that necessary to support the business**.

HURRICANE FORECAST

The hurricane season, generally running from June 1 to November 1, has begun. The hurricane forecast is for above-average hurricane activity. Predictions are based on such diverse factors as the mid-Atlantic Ocean surface temperature, the rainfall in the Sahel, the re-emergence of El Nino and climatological factors from as far away as Singapore. The current prediction from the hurricane guru, Professor William Gray of Colorado State University, is for eleven named storms, including seven hurricanes, three of them severe. In comparison, while last year's hurricane activity was also predicted to be above average, actual activity was below average with no significant catastrophe losses. The current predictions are for two hurricanes to make U.S. Landfall and one to hit in the Caribbean. The major unknown, of course, is the exact location of any hurricane strike. As an example, hurricane Andrew in 1992, which caused $16 billion in insured losses ($33 billion in total losses in current dollars), would have produced $50+ billion (current dollar) in total losses, if it had gone through Miami, rather than Homestead, given the lower values of insured and total property in Homestead.

ASBESTOS

Congress is currently considering a bill that would create a trust for asbestos claims, taking such claims out of the courts and into an administrative solution in a manner similar to the "Black Lung" trust for the coal industry. The current proposal calls for a trust fund of approximately $100+ billion to be established, with the insurance industry contributing about $45 billion. The current close division in Congress, especially in the Senate, will make passage of the bill difficult. In addition, the insurance industry will have extreme difficulty apportioning its share of any settlement. Many insurers, such as **American International Group (AIG - $57.77),** have little current exposure to asbestos, having written insignificant business when asbestos liability was not excluded from coverage. AIG appears reluctant to make any significant contribution to any settlement, and while other companies, in similar situations will also not want to pay, while the insurers with asbestos exposure will want to spread out the settlement. In addition, getting the reinsurers to pay out may also prove to be difficult. Although passage of a bill would remove the uncertainty form the current open-ended situation, we do not expect passage. If a bill were to be passed, then we would make investment decisions to be based on the relative amounts each company pays into the fund and its current reserve for asbestos as opposed to the current method of guessing as to each company's actual exposure.

MERGERS & ACQUISITIONS

Deal activity in the insurance industry is still lethargic, with only a few transactions. **Prudential (PRU - $33.54)** appears to the most active company, recently agreeing to sell the balance of its personal lines operations. The transactions, expected to close in the third quarter are at a discount to book value. The company appears to be willing to take a significant loss to shed these low return operations, freeing up significant capital at the parent company level to be used for other acquisitions and stock repurchase.

Also recently, **Met Life (MET - $27.93)** announced the purchase of the group life operations of **John Hancock Financial (JHF - $30.30)**. The transaction is not likely to have any major near-term impact on either company but continues the consolidation trend. Group life remains a highly competitive line of business, given the large amount of premium per policy, and the razor-slim margins. Tthis merger will attempt to wring-out some expense savings, at the cost of a significant number of jobs.

Chubb Corp. (CB - $63.83) was the latest insurer to raise significant new capital. The company recently raised over $1.2 billion including approximately $800 million in common stock and about $400 million in hybrid securities (3 year 7% notes with attached stock purchase contracts), in an extremely short period of time. Although the offering is dilutive, the company reiterated it earnings guidance, indicating that underwriting and new business growth are exceeding their original targets. **We maintain our Outperform rating and our estimates of $4.90 for this year and $6.50 for next year.**

STOCK PRICE PERFORMANCE

The general market increased again in May, as the post-war rally continued. The broad averages are now positive for the year as a whole, even with the first quarter's decline. However, the market still remains well below the levels of early 2002. Insurance stocks generally performed well, with the positive underwriting climate driving the property-liability stocks. The life insurance stocks also benefited from the positive stock market, as the positive stock market increased assets under management and fees and reduced the pressures for further increases in both GMDB reserves and DAC write-offs.

Although many of the stocks in the insurance group have performed well recently, most still sell at well below market multiples and are significantly below their 2001-2 highs. We continue to recommend the high quality companies in the property-liability group, given that the industry is expected to produce above-average earnings growth through at least 2004 and that the best managed companies will likely prosper when the underwriting cycle encounters its next down leg. We generally view the life insurance industry unfavorably. The current interest rate climate is making the sale of new life and annuity products difficult, and the recent changes in the tax law will make the products even more difficult to sell; the life insurance industry has reported significant decreases in new life sales so far this year. In addition, the low interest rate environment is putting pressures on product margins in both the life and fixed annuity lines. While the recent stock market improvement may make variable annuities somewhat easier to sell, that product will also be affected by the tax law changes.

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Given the changes in research practices, we will in the future be ranking the companies we cover in terms of relative performance to their peer companies, with rankings of outperform (O), market perform (M) and under-perform (U). We base these rankings on the expectation of the performance of the stock, relative to its peers over a 12-18 month time period.

Disclosure

I, Ira L. Zuckerman, certify that (1) the views expressed in this report reflect my personal views on all of the subject companies and securities and (2) my opinions are not affected by my compensation which is derived solely from brokerage trade commission(s) which may or may not be of securities discussed in this report.

INSURANCE STOCK PRICE PERFORMANCE

COMPANY	SYMBOL	12/31/2001	12/31/2002	4/30/2003	5/30/2003	% CHANGE MONTH	% CHANGE Y-T-D	% CHANGE 17 MOS.
MULTI-LINE								
Aetna, Inc.	AET	$32.99	$41.19	$49.76	$57.38	15.3%	39.3%	73.9%
Allmerica Financial	AFC	44.55	10.01	15.35	17.53	14.2%	75.1%	-60.7%
CIGNA	CI	92.65	41.11	52.25	55.96	7.1%	36.1%	-39.6%
Met Life	MET	31.68	27.01	28.76	27.93	-2.9%	3.4%	-11.8%
Prudential Financial	PRU	33.19	31.60	31.97	33.54	4.9%	6.1%	1.1%
Average						**7.7%**	**32.0%**	**-7.4%**
PROPERTY-LIABILITY								
Allstate Corp.	ALL	$33.70	$36.91	$37.81	$36.12	-4.5%	-2.1%	7.2%
American International Group	AIG	79.40	57.54	57.84	57.77	-0.1%	0.4%	-27.2%
Chubb Corp.	CB	69.00	52.24	53.07	63.83	20.3%	22.2%	-7.5%
CNA Financial	CNA	29.17	25.40	24.11	24.27	0.7%	-4.4%	-16.8%
Hartford Financial Services	HIG	62.83	45.35	40.66	46.54	14.5%	2.6%	-25.9%
Ohio Casualty	OCAS	16.05	13.02	12.51	12.65	1.1%	-2.8%	-21.2%
SAFECO Corp.	SAFC	31.15	34.59	38.50	36.02	-6.4%	4.1%	15.6%
St. Paul Cos.	SPC	43.97	33.89	34.31	36.49	6.4%	7.7%	-17.0%
Travelers Property & Cas.	TAP.A	18.50	14.57	16.15	16.19	0.2%	11.1%	-12.5%
Average						**3.6%**	**4.3%**	**-11.7%**
INSURANCE BROKERS								
Aon Corp.	AOC	$35.52	$18.70	$22.16	$25.65	15.7%	37.2%	-27.8%
Crawford & Co. "B"	CRDB	11.72	5.07	4.87	5.40	10.9%	6.5%	-53.9%
Gallagher (Arthur J.)	AJG	34.49	29.27	24.96	27.18	8.9%	-7.1%	-21.2%
Marsh & McLennan	MMC	53.73	46.08	47.71	49.90	4.6%	8.3%	-7.1%
Average						**10.0%**	**11.2%**	**-27.5%**
LIFE INSURERS								
Jefferson-Pilot	JP	$46.27	$38.09	$40.07	$42.09	5.0%	10.5%	-9.0%
John Hancock Finl.	JHF	41.30	27.91	29.03	30.30	4.4%	8.6%	-26.6%
Lincoln National	LNC	48.57	31.62	32.04	34.79	8.6%	10.0%	-28.4%
Torchmark	TMK	39.33	36.59	38.72	38.74	0.1%	5.9%	-1.5%
Average						**4.5%**	**8.7%**	**-16.4%**

INSURANCE STOCK PRICE PERFORMANCE

COMPANY	SYMBOL	12/31/2001	12/31/2002	4/30/2003	5/30/2003	% CHANGE MONTH	Y-T-D	17 MOS.
SPECIALTY LIFE INSURERS								
AFLAC Corp.	AFL	$24.56	$30.11	$32.72	$32.92	0.6%	9.3%	34.0%
Nationwide Fin'l. Svc.	NFS	41.46	28.40	28.14	31.86	13.2%	12.2%	-23.2%
UnumProvident Corp.	UNM	26.51	17.45	11.50	12.92	12.3%	-26.0%	-51.3%
Average						**8.7%**	**-1.5%**	**-13.5%**
REINSURERS								
Everest Re	RE	$70.70	$55.01	$69.59	$73.04	5.0%	32.8%	3.3%
PartnerRe	PRE	54.30	51.62	53.42	53.10	-0.6%	2.9%	-2.2%
PXRE Corp.	PXT	17.64	24.21	21.56	20.10	-6.8%	-17.0%	13.9%
Transatlantic Holdings	TRH	91.00	66.43	67.90	69.04	1.7%	3.9%	-24.1%
Average						**-0.2%**	**5.6%**	**-2.3%**
SPECIALTY PROPERTY/LIABILITY INSURERS								
ACE, Ltd.	ACE	$40.15	$29.30	$33.09	$36.58	10.5%	24.8%	-8.9%
Argonaut Insurance Group	AGII	19.57	14.95	10.04	12.60	25.5%	-15.7%	-35.6%
Berkshire Hathaway "B"	BRKB	2,525.00	2,430.00	2,331.00	2,370.00	1.7%	-2.5%	-6.1%
Cincinnati Financial	CINF	38.15	37.62	36.71	37.05	0.9%	-1.5%	-2.9%
Mercury General Corp.	MCY	43.66	37.60	44.11	47.30	7.2%	25.8%	8.3%
NYMAGIC, Inc.	NYM	16.09	19.55	22.00	20.34	-7.5%	4.0%	26.4%
Old Republic Int'l.	ORI	28.01	28.06	30.59	34.44	12.6%	22.7%	23.0%
Progressive Corp.	PGR	49.77	49.81	67.76	72.04	6.3%	44.6%	44.8%
RLI Corp.	RLI	22.50	27.91	29.49	29.49	0.0%	5.7%	31.1%
Selective Insurance Group	SIGI	21.73	25.37	24.96	26.00	4.2%	2.5%	19.7%
21st Century InsuranceGrp.	TW	19.45	12.50	13.53	14.14	4.5%	13.1%	-27.3%
XL Capital Ltd.	XL	91.36	77.25	82.39	86.79	5.3%	12.3%	-5.0%
Zenith National Corp.	ZNT	27.94	23.88	25.60	27.36	6.9%	14.6%	-2.1%
Average						**6.0%**	**11.6%**	**5.0%**
S & P 500	**SPAL**	**1,148.08**	**879.82**	**916.92**	**963.59**	**5.1%**	**9.5%**	**-16.1%**
DOW JONES 30	**INDU**	**10,021.57**	**8,341.63**	**8,480.09**	**8,850.26**	**4.4%**	**6.1%**	**-11.7%**