

Q2 EARNINGS PREVIEW: JUST A SLOW-MOTION CAR WRECK

A P&C paradox: Much has changed since last quarter, but little has changed from last year.

Last week featured the first new data points on Q2 earnings with Progressive and Truist reporting. But P&C earnings season really kicks off this week with the traditional frontrunners of WR Berkley, RLI and Travelers all set to report. See table below.

Q2 P&C earnings calendar

Source: Company reports, SNL

MO/YR	MON	TUES	WED	THURS	FRI	SAT
JUL 2020	13	14	15 Progressive	16 Truist	17	18
	20	21 WR Berkley	22 RLI	23 Travelers	24	25
	27	28	29	30	31	1
	Brown & Brown Cincinnati Donegal	Axis Chubb Hanover RenRe	Arch James River Selective Universal	AJ Gallagher Amerisafe Hartford Kinsale Marsh & McLen. Willis Towers Wat.	Aon	Berkshire Hath.
AUG 2020	3	4	5	6	7	8
	AIG Argo CNA Heritage Mercury	AFG Allstate Alleghany	Everest United Fire	HCI Kingstone State Auto		
	10	11	12	13	14	15
	17	18	19	20	21	22
Not announced: Blue Capital, Employers, Erie, Greenlight Re, HCI, Horace Mann, Intact, Kemper, Maiden, Markel, ProSight, Third Point Re, United Insurance, Wafford Re						

A lot has changed since Q1 earnings. Last quarter, the pandemic was poorly understood, the economy was in the early stages of lockdown and the insurance implications were far from clear.

More than anything, uncertainty reigned in every aspect, from the biological and economic to insurance exposures.

Since then, the crisis has changed in one important dimension.

The combination of governmental policy – from public health measures to fiscal stimulus and monetary policy – has “transformed the maturity” of the Covid-19 shock from an acute crisis to a more chronic challenge.

On the biological front, social distancing, other “mitigation” measures and improved treatment slowed the exponential growth and reduced case fatality rates, even if the combination of (a) high baseline case rates (b) modest >1 reproduction rates, and (c) reduced slack in healthcare systems is beginning to become more concerning in some hot spots.

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Composite	YTD px chg.	P/B
Large comm.	(27.5)%	0.8x
Regional	(34.3)%	1.3x
Specialty	(24.1)%	1.5x
Personal	(2.5)%	2.0x
Bermuda	(27.2)%	1.1x
Florida	(27.4)%	1.0x
Brokers	(3.7)%	-
IPC Select	(22.4)%	1.1x
S&P 500 Fin.	(25.4)%	-
S&P 500	(3.6)%	-

Top performer on the day **RNR +2.4%**

Bottom performer on the day **AIG -5.1%**

1YR Price Performance

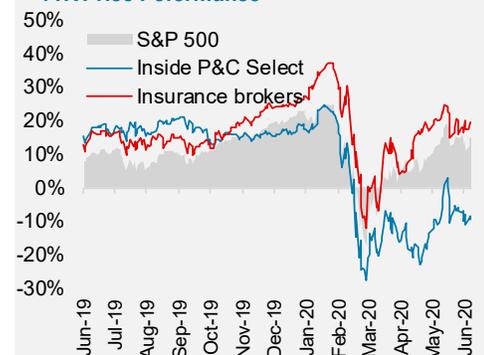
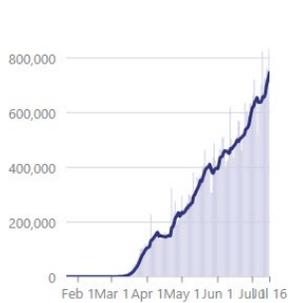


Exhibit: National Covid case statistics

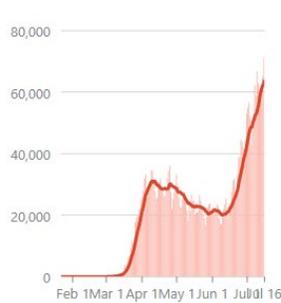
Source: The COVID Tracking Project

----- National 7-day average ——— 7-day average

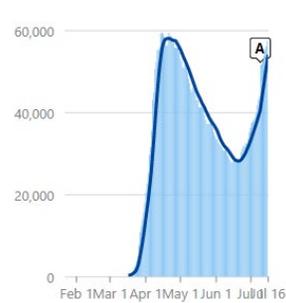
New tests



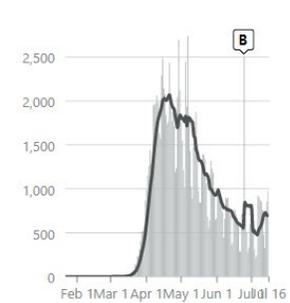
New cases



Current hospitalizations (Notes)



New deaths (Notes)



*A July 10th, Florida started reporting hospitalizations of people with a “primary diagnosis of Covid-19”

*B June 25th, New Jersey added ~2,000 probably deaths on June 25, which includes deaths from previous months

On the economy, the impact of fiscal policy and the nuclear-missile-sized “bazooka” fired by the Fed has reduced the tail risk of bankruptcy and default risks, dramatically reducing the asset risk for insurers and probability of an atypical two-sided balance sheet crisis for P&C.

And finally, on the insurance front, talk of a “largest ever loss” looks less likely. Though there is a wide range in the read-across from initial estimates (partly due to significant mix issues), it is clear that Covid-19 is not shaping up – based on current information – to be the earth-ending, mega crisis that some had predicted. Even the most pessimistic estimates have largely been driven by IBNR reserves, not an issue with paid claims causing liquidity stress and capacity shortages.

Q2 pre-announcements

Source: Company reports

	Total Q2 cat losses (inc. Covid)	Cat losses ex. Covid	YoY chg.	Covid losses	Civil unrest losses	Notes
Chubb	\$1,800mn	\$435mn	+58%	\$1,365mn	\$130mn	Within Covid losses, 44% - short-tail BI and A&H, 41% - liability, 8% - credit, 7% - uncertainty reserve
Travelers	\$968mn	\$854mn	+133%	\$114mn	NA	Op. EPS at \$0.20; alternative investment losses of \$234mn pre-tax; Covid losses were offset by favorable frequency
Hartford	\$499mn	\$248mn	+176%	\$251mn	\$110mn	Within Covid losses, 85% are BI claims and related LAE; op. EPS at \$1.22
CNA	\$301mn	\$119mn	+213%	\$182mn	\$61mn	\$50mn unfavorable PYD; underwriting loss of \$210mn
Cincinnati	\$296mn	\$231mn	+80%	\$65mn	\$29mn	P&C CR expected at 102%-104%
Arch	\$205-225mn	\$35-45mn	+525%	\$170-180mn	\$35-45mn	-
Hanover	NA	\$148mn	+148%	NA	NA	Expect lower ex-cat current accident year losses
WR Berkley	\$145mn	\$60mn	+135%	\$85mn	\$20mn	Q2 rates increased by 13%
Selective	NA	83	+181%	NA	NA	CR expected at 98%-99%; op. EPS at \$0.35-\$0.45, \$15mn favorable PYD
Argo	NA	NA	NA	\$10-20mn	NA	Alternative investment losses of \$20-24mn pre-tax

In short, the combination of a reduced asset stress on the one hand, and a slow-moving medium-sized loss on the other, does not leave balance sheets stressed in the near term in a manner likely to move the market on its own. Incremental insurance losses may change that, and further balance-sheet shock from wind season may too (and the high baseline losses coming into wind season make it a period of peak risk). Note Q2 appears to have been a significant quarter for traditional catastrophe losses, with pre-announced losses ex-Covid-19 way above 2019 levels.

Q2 natural catastrophe summary

Source: Aon Benfield

Dates	Catastrophes	Location	Structures/ Claims	Economic loss est.	Insured loss est.
United States					
04/06-04/09	Severe weather	Midwest, Plains, Southeast, Mid-Atlantic	165,000+	\$1.9bn+	\$1.5bn
04/10-04/14	Severe weather	Midwest, Plains, Southeast, Mid-Atlantic	Thousands	\$1.0bn+	\$1.0bn+
05/27-05/27	Severe weather	Plains, Southeast	Thousands	\$1.0bn+	Most
05/04-05/05	Severe weather	Midwest, Plains, Southeast	80,000+	\$975mn+	\$700mn
06/05-06/11	Severe weather	Midwest, Plains, Rockies	77,500+	\$800mn+	\$600mn+
05/16-05/21	Severe weather	Midwest, Plains, Southeast	Thousands	\$750mn+	Most wind and hail
05/02-05/03	Severe weather	Midwest, Plains, Southeast	55,000+	\$650mn+	up to \$500mn
05/13-05/15	Severe weather	Midwest, Plains, Northeast	Thousands	\$500mn+	100s of millions
05/20-05/24	Severe weather	Midwest, Plains, Rockies	Thousands	\$500mn+	100s of millions
06/02-06/04	Severe weather	Midwest, Plains, Northeast	55,000+	\$500mn+	Most
06/04	Severe weather	South Dakota	30,000+	\$380mn+	\$285mn+
06/06-06/11	Tropical Storm Cristobal	Southeast, Mississippi Valley, Midwest	20,000+	\$325mn+	-
06/19-06/22	Severe weather	Midwest, Plains, Southeast	35,000+	\$255mn+	Most
05/24-05/27	Tropical Storm Bertha	Southeast, Mid-Atlantic	15,000+	\$200mn+	-
05/07-05/08	Severe weather	Plains, Southeast	17,000+	\$150mn+	Most
04/18-04/20	Severe weather	Midwest, Plains, Southeast	Thousands	100s of millions	100s of millions
04/21-04/24	Severe weather	Plains, Southeast, Mid-Atlantic	Thousands	100s of millions	100s of millions
04/24-04/26	Severe weather	Midwest, Plains, Southeast, Mid-Atlantic	10,000+	100s of millions	100s of millions
04/27-04/29	Severe weather	Midwest, Plains, Southeast	10,000+	100s of millions	100s of millions
05/24-05/26	Severe weather	Midwest, Plains, Southeast	Thousands	100s of millions	-
05/05-05/20	Wildfire	Florida	500+	\$50mn+	-
05/15	Earthquake	Nevada	-	\$10mn+	-
05/30-05/31	Severe weather	Northeast	Hundreds	Millions	Millions
06/10	Severe weather	Midwest	Thousands	Millions	Millions
06/26-06/27	Severe weather	Midwest, Plains	Hundreds	Millions	Millions
Significant international cats					
06/13-06/14	Severe weather	Canada	70,000+	\$1.25bn+	\$0.9bn+

But on its own, the Covid-19 shock is starting to look like one factor among many pre-existing conditions driving P&C dynamics.

Indeed, as things stand, the impact of prolonged lower interest rates may ultimately do more to pressure the need for pricing than cash out the door on paid claims. This would indeed fit better with the real-time situation on pricing, which points to continued improvement but not wholesale dislocation. The market appears to continue its path on a rational correction, with added pressure from incremental insurance losses and lower forward NII. But it does not appear to support any rhetoric of a shock-driven game changer. Be wary of this self-serving rhetoric that simplifies multi-factor pressures into a simpler heuristic of: big loss → hard market.

Perhaps the best analogy for the current dynamic is an auto accident. Last quarter, the pandemic shock was beginning to look like the kind of five-car pile-up where you hit the vehicle in front of you before you've even seen it. This is the kind of event that moves markets in P&C.

The state of play now is more like a slow-motion car wreck at 30mph, with plenty of time to course correct, hit the brakes, steer into the skid and brace for impact, even if a collision can't be totally avoided. From re-underwriting (inc. exclusions on new business), to capital raising and terming out debt, to capital preserving reinsurance transactions, to slowing paid claims, to harvesting asset gains, there are plenty of levers companies can pull when given time to prevent a capital shortage that would lead to capacity withdrawals and a true, broad-based hard market.

Finally it would be remiss of us not to revisit our own track record of predictions on Covid-19's likely impact on insurance, and mark them to market for new information. Recall, last quarter, we made two counter-consensus predictions – one on carriers, one on brokers.

First, for carriers, [we argued](#) that too much attention was being placed on low probability but high-loss-potential issues, and not enough on the high-probability and likely very meaningful gains from reduced frequency. The mix of good and bad reported this quarter may depend on (a) portfolio mix and (b) tactical pressures around the timing of recognizing each (see [Meditations in an emergency – a five step Covid playbook](#) for background). But based on data reported to date, this take has aged pretty well.

Our second prediction was a [severe liquidity test for intermediaries](#). This was premised on a shorter but sharper impact to the economy, driven by strict lockdown enforcement to reduce community spread, and initially seemed plausible as even strong balance sheet companies like Aon pointed to urgent cash flow protection measures.

However, the “crisis maturity transformation” actions by government across multiple dimensions mentioned above dramatically reduced this risk, and this no longer seems likely. We'll eat the humble pie on getting this one wrong.

That said, we can't help but dig our heels in a little, and argue that the near-term relief rally in growth may come with its own cost. The rapid reopening that has made the short-term liquidity squeeze unlikely has also meant that community spread has remained high, reducing the likelihood of a return to “normal” and baseline economic activity any time soon. We think a lot of analysts are likely to see the rapid bounce in Q2 as a sign of a V-shaped recovery, but we're expecting the pace to decelerate and to look more like a Nike swoosh, plateauing at a sub-normal level in the next few quarters (in line with high-frequency real-time economic data). In many ways this was likely just a pull-forward of good news.

Finally, we should add our view that any broker commentary on rates offsetting volume declines should be printed out and taped to every CEO's head who tries to make the argument that their revenues are driven by the economy, not P&C cycles, next time the economy is strong but pricing is not.

[Details on Q2 consensus estimates below.](#)

Q2 YoY EPS change expectations

Source: FactSet

Company	Peer group	Q1-19 EPS	Q1-20E consensus	% chg	Est. #
AFG	Specialty	\$2.12	\$1.44	↓ -32%	3
AIG	Large Comm.	\$1.43	\$0.51	↓ -65%	16
Alleghany	Other	\$12.40	\$5.44	↓ -56%	3
Allstate	Personal	\$2.18	\$1.58	↓ -27%	16
Arch	Bermuda	\$0.77	-\$0.12	↓ -NM	13
Argo	Other	\$0.48	-\$0.01	↓ -NM	5
Axis	Bermuda	\$1.62	\$0.41	↓ -74%	10
Berkshire	Other	\$3755.41	\$3210.38	↓ -15%	4
Chubb	Large Comm.	\$2.60	-\$0.65	↓ -NM	15
Cincinnati	Regionals	\$0.85	\$0.38	↓ -56%	7
CNA	Large Comm.	\$1.08	\$0.46	↓ -57%	4
Donegal	Regionals	\$0.13	\$0.19	↑ 48%	3
Everest Re	Bermuda	\$7.85	\$1.22	↓ -84%	10
FedNat	Florida	\$0.44	-\$0.05	↓ -NM	3
Hanover	Regionals	\$1.88	\$1.32	↓ -30%	4
Hartford	Large Comm.	\$1.33	\$1.16	↓ -13%	17
HCI	Florida	\$0.81	\$0.53	↓ -35%	3
Horace Mann	Personal	\$0.17	\$0.41	↑ 139%	4
Kemper	Personal	\$1.38	\$1.12	↓ -19%	6
Markel	Specialty	\$10.42	\$6.67	↓ -36%	6
Mercury	Personal	\$0.74	\$0.78	↑ 5%	3
NetGen	Other	\$0.67	\$0.79	↑ 17%	3
RenRe	Bermuda	\$4.78	\$2.44	↓ -49%	11
RLI	Specialty	\$0.66	\$0.47	↓ -28%	6
Selective	Regionals	\$1.16	\$0.35	↓ -70%	8
State Auto	Regionals	-\$0.33	-\$0.01	↑ NM	3
Travelers	Large Comm.	\$2.02	-\$0.20	↓ -NM	14
United Fire	Regionals	-\$0.59	-\$0.42	↑ NM	3
United Ins	Florida	-\$0.08	\$0.06	↑ NM	4
WR Berkley	Specialty	\$0.74	\$0.13	↓ -82%	10

This research report was written by Insider Publishing's Research team which includes Gavin Davis, Gianluca Casapietra, and Dan Lukpanov.

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