ROCKMAN CAPITAL UPDATE

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8th of June 2023

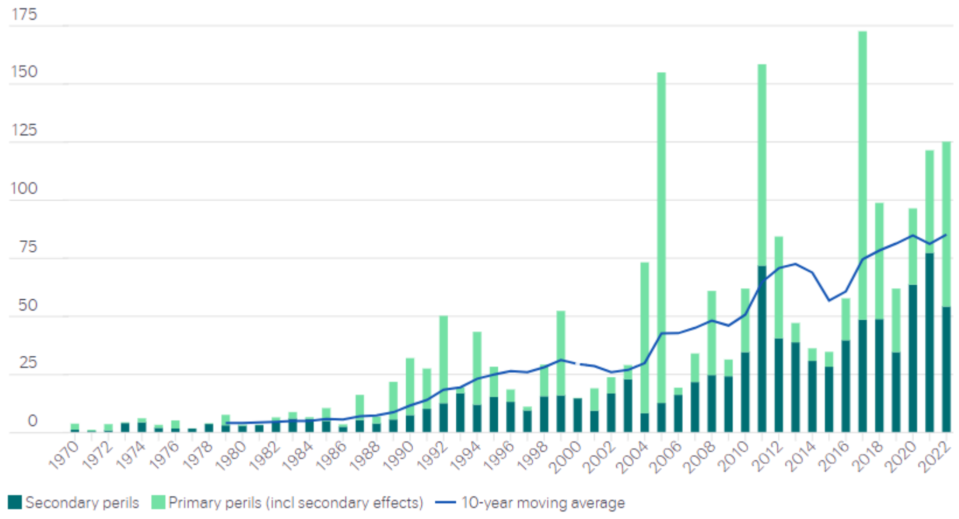
The Rockman Report

Re-Insurance Companies: How are they positioned?

At the end of 2022, the total global reinsurance risk was valued at USD 638 billon which is driven by a decline in the underlying global asset prices. Global insured losses from natural disasters increased to USD 125 billion in 2022 (See figure 1 below). Based on historical trends, it is expected that growth in insured risk will continue to grow at 5-7% per annum, for the next 3-5 years. This is dependent on factors including underlying global economic growth and continued urbanization (population growth, accumulation of asset values etc.). Since the start of the COVID-19 pandemic, exposures for insurance companies e.g. buildings, motors and other fixed assets, have grown faster than headline inflation.

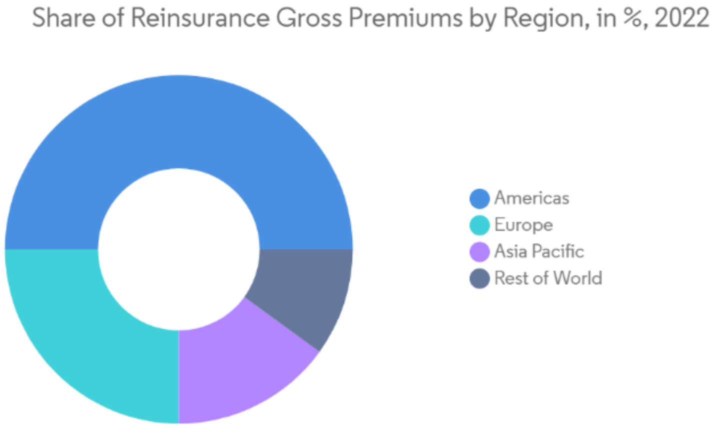
Figure 1: Insured natural catastrophe losses (USD bn)

Rollover/touch chart for details



The global reinsurance market grossed premuims of USD 421 billion in 2022 and is poised to achieve a compound annual growth rate (CAGR) of 3% for 2023. Premiums have been pushed higher in recent years, as the risk of losses have increased. On top of impacts from COVID-19 and increasing losses from natural catastrophes, the reinsurance industry is now confronted with issues including inflation, risk of recession, and geopolitical tensions. In 2022 we witnessed the reinsurance sector reporting strong premuim growth and underwriting profitability. However, the returns on equity and capital levels declined due to a fall in the market value of bonds (due to rising interest rates and widening credit spreads) and equities.

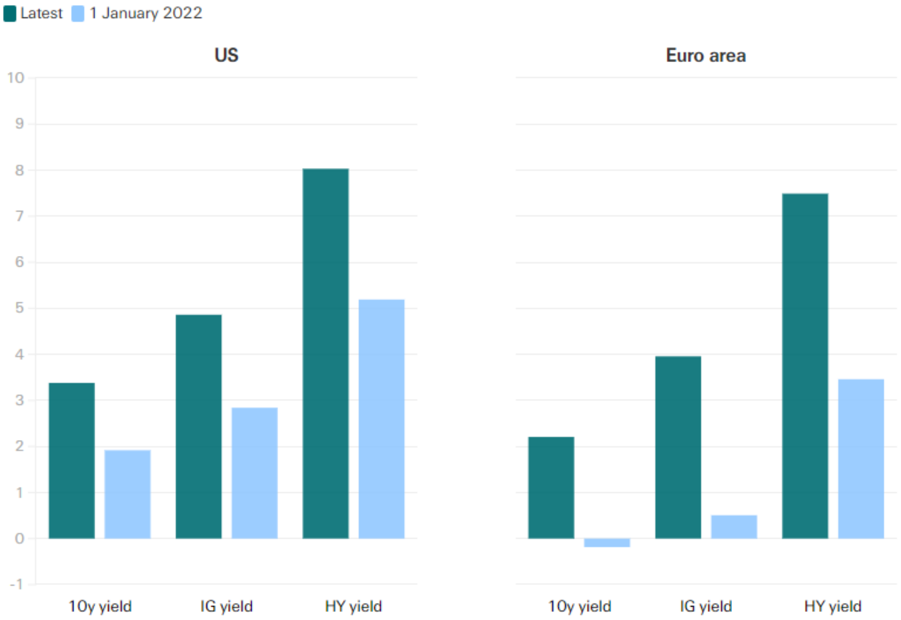
See below the geographic allocation of reinsurance premuims:



The future of the Insurers underlying earnings

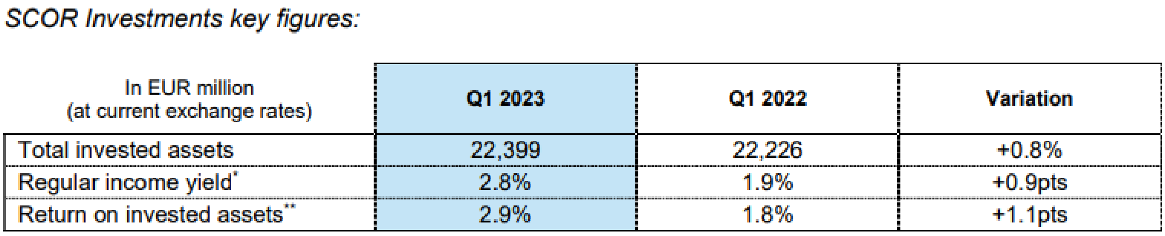
Before the recent rises in global interest rates, insurers and re-insurers alike, struggled to earn a meaningful return on their underlying assets and reserves (embedded value) held for regulatory purposes. Due to strict regulatory conditions and ongoing risk management, insurers are pre-dominately invested in defensive treasuries of varying maturies and money market funds.

Negative returns in the bond sector over the past couple of years have further hurt insurers' earnings (Investment income of European insurers is typically 30-70% of their earnings). However, as per the graph below, we have seen treasury and corporate yields rise, presenting a more stable earnings outlook.



By way of example, SCOR SE's (one of the reinsurance companies in Rockman Capital's investment universe) Q1 earnings, indicate improving returns on underlying assets. Their investment portfolio consists of high quality bonds that have an average rating of A+ and durations of 3,2 years. Their total allocation to fixed income is 81% of their underlying investments, highlighting the importance of this sector relative to the overall performance of the insurer.

**Extract from SCOR financial report Q1 2023*



SCOR Investments key figures:

In EUR million (at current exchange rates)	Q1 2023	Q1 2022	Variation
Total invested assets	22,399	22,226	+0.8%
Regular income yield*	2.8%	1.9%	+0.9pts
Return on invested assets**	2.9%	1.8%	+1.1pts

It is noteworthy that the income yields have increased 32% since Q1 2022 and are almost back to the level they were in Q4 2022 (3,1%).

Further catalysts improving investment sentiment within the sector, include:

- The positive Property and Casualty (P&C) reinsurance cycle, marked by a strong improvement in pricing conditions. This means that the pricing of their products are increasing, ultimately increasing their profitability. These positive market conditions are expected to remain in place against a backdrop of continued high natural catastrophe losses occuring globally.
- L&H (Life and Health) reinsurance claims have started to fall which is directly linked to the Covid-19 pandemic excess mortalilty rates dropping experienced during 2020 – 2022.

In conclusion, Rockman Capital is overweight in the financial and insurance sectors due to the favourable interest rate environment. However, we remain alert as higher yields are likely to have an effect on the broader economy and create further central bank intervention in capital markets. This ultimately will lead to market volatility. With clients having enjoyed a strong Q1 for 2023, we continue to take profits, downweighting luxury and ICT counters and allocating to sectors which are well placed to earn favourable returns from the present high interest rate environment, such as money market instruments (yielding 5% or higher) and the insurance sectors (with dividend yields of 5-7%).