U.S. Insurance

All investment portfolios are not created equal: Arch and Progressive shine in 3Q23

Industry Overview

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Equity
United States
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The fastest growing investment yields have more to go

As interest rates have surged over the past couple of years, a number of investors with whom we spoke have described the P&C insurance market as an opportunity to own stocks that would benefit from higher interest rates. Investment yields for the peer group have notably risen, but, comparing investment income for those who have already reported 3Q23 with their 3Q21 investment yields (before the interest rate market turned), it generally seems like investment income has organically grown by 30-40% over the past two years looking at most of the peers: Chubb, Cincinnati Fin'l, CNA Fin'l, Hartford and Travelers. With shorter investment durations, Everest and W.R. Berkely have better than doubled their investment income over the two years.

Arch Capital is a conspicuous outlier in investment income

Arch's investment income is up 205% comparing 3Q23 to 3Q21. If one calculates it as "net" net investment income (investment income less interest expense and preferred coupons adjusted to reflect sharecount decline), Arch's net investment income has risen 506% in the past two years. (Arch gets a boost relative to peers by not paying a common stock dividend.) Further, it is not a function of disproportionally cramming cash into sub-1 year paper, as allocation to short-duration investments is just 8% (down from 15% on September 30, 2021). In 3Q23 vs. 2Q23, Arch's investment income grew by 11% (or by 13% on a "net" net basis). With a fixed income portfolio duration of 2.97 years on September 30, 2023 and an investment portfolio yield of 3.41% in 3Q23, Arch's portfolio would roll over more quickly than peer companies and has much higher to go in this 4-5% U.S. Treasury yield environment.

Progressive's investment portfolio in enviable position

Progressive's investment income is up 144% comparing 3Q23 to 3Q21 or 191% on a "net" net basis. Progressive, with just 3% of its investment portfolio in short-term securities, hasn't really taken advantage of the steeply inverted yield curve. In 3Q23 alone, Progressive's investment income grew by 12% on a sequential quarter basis (or by 13% "net" net). With a fixed income portfolio duration of 2.9 years at September 30, 2023 and an investment portfolio yield of 3.36% in 3Q23, Progressive, like Arch, is also poised to enjoy a faster compounding of investment income growth relative to peers as it rolls maturating securities into higher yielding investments.

Material room for expansion

Historically, both Arch and Progressive have tended to maintain the most conservative investment portfolio orientation within the peer group, and that is currently boosting income. In our high-on-the-Street EPS forecasts for Arch and Progressive, we have further substantial growth in investment income modeled. We forecast 37% and 24% investment income growth in 2024 and 2025, respectively. For Progressive, those numbers are 41% and 31%. We would also look for similar leverage/benefit to rising interest rates at RenaissanceRe, which has yet to report 3Q23 (after market close on November 1), as it closes its acquisition of AIG's Validus Re likely later this month.

Refer to important disclosures on page 6 to 9. Analyst Certification on page 5. Price Objective Basis/Risk on page 2. 12619942

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Exhibit 1: Relative performance of investment portfolios for P&C insurers who have reported 3Q23 results

There appears a wide gap between the benefit rising interest rates have had on Arch Capital, Everest, Progressive and W.R. Berkley's investment returns relative to the other peers who have longer investment portfolio durations and/or already have investment returns well into the 4-5% yield range.

	Change in net investment income						Duration (years)		% in short-term		Investment yield
	As reported		Less interest expense		+ sharecount adj.						
	vs. 3Q21	vs. 2Q23	vs. 3Q21	vs. 2Q23	vs. 3Q21	vs. 2Q23	3Q21	3Q23	3Q21	3Q23	3Q23
ACGL	**205%**	**11%**	**478%**	**13%**	**506%**	**13%**	2.68	2.97	15.3%	7.9%	**3.41%**
CB	51%	14%	52%	15%	62%	16%	4.1	4.7	4.1%	6.1%	4.27%
CB (est. organic)	35%	7%	34%	7%	43%	8%					
CB P&C	44%	11%	44%	12%	53%	13%					
CB P&C (est. organic)	**35%**	**5%**	**34%**	**5%**	**43%**	**6%**					
CINF	26%	2%	28%	2%	33%	3%	4.8	4.7	4.5%	3.7%	3.68%
CINF P&C	**31%**	**3%**	**33%**	**3%**	**38%**	**4%**					
CNA	8%	-4%	7%	-5%	7%	-5%	6.7	6.3	3.5%	5.5%	4.97%
CNA excl. alts	20%	4%	20%	3%	21%	3%			3.6%	5.8%	4.72%
CNA P&C	23%	-3%	23%	-3%	23%	-4%	5.1	4.6	3.6%	6.8%	4.70%
CNA P&C excl. alts	**37%**	**6%**	**37%**	**6%**	**37%**	**5%**			3.7%	7.0%	**4.78%**
EG	39%	12%	34%	13%	21%	12%	3.3	2.9	6.4%	12.0%	4.76%
EG excl. alts	**169%**	**11%**	**176%**	**12%**	**149%**	**10%**			7.1%	13.8%	**4.45%**
HIG	-8%	11%	-8%	12%	4%	13%	4.5	4.1	6.9%	6.5%	4.49%
HIG excl. alts	34%	3%	43%	4%	43%	3%			7.3%	7.2%	4.34%
HIG P&C	-6%	11%	-5%	12%	-5%	12%	4.5	3.9	3.7%	4.7%	4.53%
HIG P&C excl. alts	**38%**	**3%**	**48%**	**3%**	**48%**	**3%**			3.9%	5.1%	**4.34%**
PGR	**144%**	**12%**	**191%**	**14%**	**191%**	**13%**	2.7	2.9	2.6%	3.2%	**3.36%**
TRV	0%	8%	-2%	8%	6%	8%	4.3	4.5	6.3%	6.1%	3.68%
TRV excl. alts	**40%**	**8%**	**46%**	**9%**	**58%**	**8%**			6.6%	6.4%	**3.47%**
WRB	51%	11%	65%	12%	70%	13%	2.3	2.4	9.4%	7.8%	4.22%
WRB excl. alts	**141%**	**8%**	**217%**	**10%**	**228%**	**10%**			10.4%	8.6%	**4.26%**

We have made some modest assumptions to account for how investment income growth is skewed by a) the impact of the 2Q23 equity raise at Everest, b) the impact of Chubb's 3Q22 Cigna life/A&H acquisition and c) the consolidation of Huatai into Chubb's 3Q23 financial reporting.

Source: Company reports

BofA GLOBAL RESEARCH

Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
ACGL	ACGL US	Arch Capital	US$ 87.29	B-1-9
CB	CB US	Chubb Ltd	US$ 214.88	B-3-7
CNA	CNA US	CNA Financial	US$ 40.22	B-2-7
EG	EG US	Everest Group LTD	US$ 396.14	B-1-7
PGR	PGR US	Progressive Corp	US$ 158.23	B-1-7
RNR	RNR US	RenaissanceRe	US$ 219.01	B-1-7
HIG	HIG US	The Hartford	US$ 73.06	B-1-7
TRV	TRV US	Travelers Cos	US$ 168.36	B-3-7
WRB	WRB US	W.R. Berkley	US$ 67.38	B-1-7

Source: BofA Global Research

Price objective basis & risk

Arch Capital (ACGL)

Our price objective is $94 is based on 110% of the large-cap P&C peer year-ahead P/E multiple (10.1x) on our 2024 EPS forecast. While there is no impact from a Bermudian income tax in 2024, we are also reducing the multiple by the impact we expect such a tax to have in 2025. This is a premium to the historical trading range (90% of the peer group P/E) given Arch's above-average growth, margin outlook and tactical capital management strategy.

Downside risks are depression-like scenarios leading to a collapse in homeownership rates, however, Arch does have $3 billion of collateralized reinsurance protection, partly mitigating this material risk. While Arch had been generally under-exposed to natural catastrophe losses in recent years, the company has been recently increasing its exposure to such events as the price of underwriting that risk has been increasing.

Chubb Ltd (CB)

We arrive at a price objective of $203 based on 10.3x 2024E P/E, which is in line with large-cap commercial lines peers, reflecting the historical trading range.

Upside risk is posed by a material improvement in underwriting margins. The company has been experiencing meaningful price increases in 2020, but these have not translated into meaningfully improving margins so far. Downside risk is presented by the pressure from lower interest rates causing a decline in earnings power and potentially leading the company to miss our EPS expectations. The volatility associated with catastrophes also creates risk of missing or exceeding our EPS outlook. Likewise, reserve adequacy is a bi-directional risk to our price objective.

CNA Financial (CNA)

Our price objective of $37 is based on 80% of the average consensus large-cap P&C peer P/E multiple (10.1x), compared with a 75-100% range where it has traded in the past. We think the discount is appropriate given the overhang associated with its closed-block long-term care book and its general inability/aversion to repurchasing its own shares, even when trading at a discount to perceived fair value. Trading history around a range validates this relative multiple.

Upside risks include sustained higher interest rates which ameliorate the reserve pressures on the LTCi book and allow the company to earn more income on its investment float. Additional upside risk could come from majority owner Loews buying the remaining limited float trading today. Downside risk is presented by a return to the low interest rate environment, causing a decline in earnings power and potentially leading the company to miss our EPS expectations. The volatility associated with catastrophes also created the risk of missing and exceeding our EPS outlook. The company's recent premium growth could be indicative of adding less/unprofitable clients to its book of business, thus adversely impacting future earnings and increasing the probability of a future reserve charge serves as an additional downside risk.

Everest Group LTD (EG)

Our price objective of $484 is based on 80% of the year-ahead multiple for large cap property and casualty (P&C) peers (10x). The 20% discount is based on a reversion to the relative multiple where RE has traded in the past, which we also find likely/appropriate given the greater earnings volatility associated with the reinsurance subsector. While there is no impact from a Bermudian income tax in 2024, we are also reducing the multiple by the impact we expect such a tax to have in 2025.

Downside risks are pressure from lower interest rates causing a decline in earnings power and potentially leading the company to miss our EPS expectations, volatility associated with catastrophes also creates the risk of missing or exceeding our EPS outlook, and lawmakers enacting what the industry sees as a retrospective change in coverage to insurance contracts, enfranchising virus-triggered business interruption.

Progressive (PGR)

Our $199 price objective is based on the current S&P 500 P/E multiple for 2025 of 16.1x on our 2025E EPS forecast. Due to quickly accelerating EPS ahead of the market growth rate, as seen in 2016-2019, we believe Progressive shares should trade at a premium to market as its earnings accelerate. However, given a multiple valuation two years out, we only assume parity due to the necessarily decreased certainty in an out-year forecast.

Downside risks to our PO are 1) presented by the pressure from lower interest rates, causing a decline in earnings power and potentially leading the company to miss our EPS expectations, 2) the volatility associated with catastrophes, which also creates the risk of missing and exceeding our EPS outlook, 3) the impact of material pricing changes by major competitors, 4) the long-term impact of emergent technologies, such as ride-sharing applications and autonomously driven automobiles.

RenaissanceRe (RNR)

Our $289 PO is based on 80% of the large cap P&C year-ahead P/E multiple (10x) on our 2024E EPS forecast. While there is no impact from a Bermudian income tax in 2024, we are also reducing the multiple by the impact we expect such a tax to have in 2025. We believe that RenaissanceRe, because it is uniquely constrained to reinsurance markets, may be disadvantaged from a valuation standpoint. Once it traded at a premium, but currently reinsurance is viewed as a derivative market with less upside in an improving market for P&C underwriting margins.

Downside risk is presented by the pressure from lower interest rates causing a decline in earnings power and potentially leading the company to miss our EPS expectations. The volatility associated with catastrophes also creates the risk of missing or exceeding our EPS outlook.

The Hartford (HIG)

Our price objective of $88 is based on 90% of the large-cap P&C peers' multiple (10.1x) on our 2023E EPS estimate. We continue to value Hartford's earnings at a 10% discount to the peer group, noting its sub-scale personal lines business..

Risk to our PO comes from the risk of loss cost inflation in years to come. Further, given many claims against it for COVID19, Hartford seeks greater clarity as to whether or not the industry receives court assurance that it is not responsible for many categories of virus claims. Additionally, catastrophe losses remain a key factor in earnings volatility and, in a low catastrophe year, could cause the EPS results to exceed our forecasts. Prior year reserve adequacy risk is also bidirectional. Currently, spiking auto accident frequency and broad personal lines severity could put pressure on this segment.

Travelers Cos (TRV)

Our $188 price objective is based on 105% of the large-cap P&C peer group's next-year P/E multiple (currently 2024E), which currently stands at 11x. The modest premium in the multiple is due to our view of Travelers as the benchmark in terms of quality and scope of disclosure among commercial P&C insurers. The company's transparency aids in establishing investor confidence in its reserving methodology and underwriting discipline.

Upside risks to our price objective are the potential that commercial loss reserves established during the COVID19 period do not evolve into paid claims and instead create earnings in the form of net prior-year favorable reserve development. Additionally, high loss cost trend has muted the impact of rate improvements. Should loss costs decelerate, the company's underlying margins would expand more quickly. Downside risks are workers' comp claims could accelerate as back-to-work trends post-pandemic trend toward full employment. Catastrophe losses remain a key factor in earnings volatility and could prevent the company from achieving our price objective. The risk of inflation remains a longer-term concern that would likely weigh materially on results or improve results in an extended disinflationary period.

W.R. Berkley (WRB)

Considering our 2024E EPS estimate, we arrive at a price objective of $85, valued at 140% of the large-cap P&C peers' P/E multiple of 10x. Berkley has traditionally enjoyed a sizable premium to peer multiple valuation likely due to its long-term compounding of equity in excess of other best-in-class peers. As the premium valuation has dissipated to be being arguably negligible, this gives investors an opportunity to own a premium franchise at no premium. We would expect the stock can re-rate upward from here. That said, book value growth has been material dependent on realized investment gains during an equity bull market, which could persist as long as the bull market lasts, but also presents a risk, should those conditions change.

Upside risk comes from recent price gains manifesting themselves as widening underwriting margins in excess of our expectations. Downside risk presented by the pressure from lower interest rates causing a decline in earnings power and potentially leading the company to miss our EPS expectations. The volatility associated with catastrophes also created the risk of missing and exceeding our EPS outlook. Additionally, the state of Berkley's loss reserves, be they deficient or redundant, creates a bi-direction risk for the stock.

Analyst Certification

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US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	Aflac	AFL	AFL US	Joshua Shanker
	Allstate Corp.	ALL	ALL US	Joshua Shanker
	American International Group	AIG	AIG US	Joshua Shanker
	Arch Capital	ACGL	ACGL US	Joshua Shanker
	Assurant	AIZ	AIZ US	Grace Carter, CFA
	Axis Capital	AXS	AXS US	Joshua Shanker
	BRP Group, Inc.	BRP	BRP US	Joshua Shanker
	Cincinnati Financial Corporation	CINF	CINF US	Grace Carter, CFA
	Corebridge Financial	CRBG	CRBG US	Joshua Shanker
	Everest Group LTD	EG	EG US	Joshua Shanker
	Intact Financial	YIFC	IFC CN	Grace Carter, CFA
	Intact Financial	IFCZF	IFCZF US	Grace Carter, CFA
	MetLife	MET	MET US	Joshua Shanker
	Progressive	PGR	PGR US	Joshua Shanker
	RenaissanceRe	RNR	RNR US	Joshua Shanker
	The Hartford	HIG	HIG US	Joshua Shanker
	Voya	VOYA	VOYA US	Joshua Shanker
	W.R. Berkley	WRB	WRB US	Joshua Shanker
NEUTRAL				
	Aon	AON	AON US	Joshua Shanker
	CNA Financial	CNA	CNA US	Joshua Shanker
	Lincoln National	LNC	LNC US	Joshua Shanker
	Marsh McLennan	MMC	MMC US	Joshua Shanker
	Principal Financial Group	PFG	PFG US	Joshua Shanker
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	Travelers Cos	TRV	TRV US	Joshua Shanker
	Willis Towers Watson	WTW	WTW US	Joshua Shanker

Disclosures

Important Disclosures

Equity Investment Rating Distribution: Financial Services Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	156	53.24%	Buy	94	60.26%
Hold	79	26.96%	Hold	52	65.82%
Sell	58	19.80%	Sell	32	55.17%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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