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Earnings Call

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Call Participants

EXECUTIVES

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Executive VP & CFO

Joseph Patrick Lacher
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Matthew Andrew Hunton
Executive VP & President of Kemper Auto

Michael Anthony Marinaccio
Vice President of Corporate Development

ANALYSTS

Andrew Scott Kligerman
TD Cowen, Research Division

Brian Robert Meredith
UBS Investment Bank, Research Division

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Jon Paul Newsome
Piper Sandler & Co., Research Division

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Kemper's First Quarter 2024 Earnings Conference Call. My name is Ina, and I will be your coordinator today. [Operator Instructions] As a reminder, this conference call is being recorded for replay purposes.

I would now like to introduce your host for today's conference call, Michael Marinaccio, Kemper's Vice President of Corporate Development and Investor Relations. Mr. Marinaccio, you may begin.

Michael Anthony Marinaccio
Vice President of Corporate Development

Thank you, operator. Good afternoon, everyone, and welcome to Kemper's discussion of our first quarter 2024 results. This afternoon, you'll hear from Joe Lacher, Kemper's President and Chief Executive Officer; Brad Camden, Kemper's Executive Vice President and Chief Financial Officer; and Matt Hunton, Kemper's Executive Vice President and President of Kemper Auto.

We'll make a few opening remarks to provide context around our first quarter results, followed by a Q&A session. For any interactive portion of the call, our presenters will be joined by Chris Flint, Kemper's Executive Vice President and President of Kemper Life; Duane Sanders, Kemper's Executive Vice President and Chief Claims Officer, P&C; and John Boschelli, Kemper's Executive Vice President and Chief Investment Officer.

After the markets closed today, we issued our earnings release, filed our Form 10-Q with the SEC and published our earnings presentation and financial supplement. You can find these documents in the Investors section of our website, kemper.com.

Our discussion today may contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, the company's outlook and its future results of operation and financial condition. Our actual future results and financial condition may differ materially from these statements. For information on additional risks that may impact these forward-looking statements, please refer to our 2023 Form 10-K and our first quarter earnings release.

This afternoon's discussion also includes non-GAAP financial measures we believe are meaningful to investors. In our financial supplement, earnings presentation and earnings release, we have defined and reconciled all non-GAAP financial measures to GAAP where required in accordance with SEC rules. You can find each of these documents in the Investors section of our website, kemper.com.

Lastly, all comparative references will be to the corresponding 2023 periods unless otherwise stated.

I will now turn the call over to Joe.

Joseph Patrick Lacher
Chairman, CEO & President

Thank you, Michael. Good afternoon, everyone, and thanks for joining us today. I'll start by noting that overall, we're pleased with our results and the progress we've made this quarter. We continue to deliver significantly improved profitability in our Specialty P&C business where we're now exceeding target margins. While as expected, policies in force continued to decline, we initiated our new business expansion activities and are on track to return to more typical new business rates by midyear.

As pricing loss trend and new business levels return to a more normal balance, our underlying competitive advantages are becoming more visible. With our story and results becoming clearer and simpler, we believe the underlying strength and long-term value creation of the franchise will be consistently apparent.

Let's move to Page 4 and jump into results. Overall, we delivered $71 million of net income and annualized ROE over 11% and a tangible ROE of over 17%. We are once again achieving our -- or exceeding our target returns. Specialty P&C generated a 93.6% underlying combined ratio. That is a 4.6-point improvement sequentially, a 14.4-point improvement year-over-year and the fourth consecutive quarter of underlying improvement. We're pleased that once again, we're exceeding our target combined ratio of 96% in this business.

Let me acknowledge that historically, we've only provided a long-term consolidated ROE target and not a specific Specialty P&C target combined ratio. We recognize this has caused some confusion, and we're fixing that now. Brad is going to comment further on that a little later.

Relative to our life business, while demonstrating modest quarterly volatility, we continue to deliver consistent returns. I'll spend more time talking about this later in the call.

Shifting to Specialty P&C production. We're acutely aware that PIF growth or rather lack thereof is the most significant issue on investors' minds at the moment. We made significant progress in this area during the quarter. On that, we'll dig into this in much greater detail. I'm going to hit a few highlights and offer an overriding perspective.

Throughout 2023, we committed to a nearly exclusive focus on restoring underwriting profitability, deliberately foregoing new business and potential growth. As we discussed last quarter, we did not rev the new business engine, if you will, until we delivered a sub-100 combined ratio. When it was clear that this had been accomplished with fourth quarter results and we had optimism about the margin outlook, we initiated our new business expansion.

This decision was made in late January. There are 2 key points that will help you interpret our numbers and see why we have confidence in our ability to stabilize PIF quickly. First, since the execution of the new business expansion began in mid-February, only half the quarter realized the benefit. And second, consider the prudent nature of the expansion we're utilizing. We did not turn new business on similar to flipping on a light switch and going from 0 to 100% immediately. We're expanding new business more analogously to driving a stick shift. You don't go from first gear to fifth gear without stalling. The first quarter represented perhaps moving through first and early second gear.

This resulted in new business apps written, growing by nearly 2.6x the fourth quarter of 2023 volume. For the month of April, we wrote about as many new business apps as we did in all of the first quarter. On a run rate basis, this suggests the second quarter approaching roughly 3x the first quarter volumes. This might be characterized as the new business engine moving through third and perhaps fourth gear.

The takeaway, we have confidence that PIF will stabilize midyear. Growth will follow subject to traditional seasonality patterns. In the 6 quarters prior to the pandemic disruption, this business generated unit growth between 6% and 13%. We expect our competitive advantages will allow us to deliver similar results for 2025 and beyond.

For a short time, we're going to profile a new more responsive metric, new business apps, to help you measure the speed of PIF stabilization. Matt is going to go through more detail on Slides 9 and 10. As discussed last quarter, the bulk of the strategic initiatives we've been profiling have either been completed or require less frequent updates given their long-term nature, so there's not much to discuss on those this quarter.

I'll leave you with one last thought. We remain committed to delivering an overall low double-digit ROE throughout the cycle. Within our Specialty P&C business, we're targeting a 96 combined ratio and then growing the business as much as possible. We've successfully corrected a major profitability challenge and are now exceeding our target combined ratio. We're addressing declining PIF and expect it to stabilize midyear. We hope you leave today sharing our confidence that we will return to a more traditional consistent long-term profitable growth profile by early next year.

With that, I'll turn it over to Brad.

Bradley Thomas Camden

Executive VP & CFO

Thank you, Joe. I'll begin on Page 5 with our consolidated financial results. Before reviewing our first quarter results, I want to take a moment to review the metrics we use to evaluate our performance and reaffirm our guidance. If you recall from prior presentations, we strive to deliver a low double-digit return on equity, grow book value per share and generate premium growth in line with the market or higher. These metrics have not changed. For 2024, we've guided to return on equity of 10% or higher, and we are reaffirming this metric.

As Joe mentioned for the Specialty P&C business, we have not historically provided a target combined ratio. To help simplify our messaging, we are now providing a target combined ratio of 96 for that business. Do not interpret this as guidance but rather how we will run the business over the long term. Our goal is to achieve our target combined ratio or better and maximize growth.

Moving to first quarter results. As Joe highlighted, we delivered a fourth consecutive quarter of underlying business improvement and a second straight quarter of solid operating and underwriting profits. Rate actions and the realized benefits of several completed strategic initiatives, such as our cost structure optimization program, led to this positive outcome.

For the quarter, we had net income of $71.3 million or $1.10 per diluted share and adjusted consolidated net operating income of $69.7 million or $1.07 per diluted share. Annualized return on equity was 11.2%, a strong first step towards achieving the 2024 ROE guidance of 10% or better. Specialty P&C's 4.6-point sequential improvement in the underlying combined ratio helped drive improvements in our consolidated results. This business benefited primarily from the earned rate within PPA of approximately 9 points offset by seasonally normal loss trends. Frequency trended favorably while severity remained elevated.

Moving to the preferred P&C business, which is reported below the line as noncore operations, generated net income of $5 million, including approximately $12 million in current year catastrophe losses.

And lastly, Specialty P&C adverse prior year development was $5.3 million related to several specific litigation matters.

Turning to Page 6. Our insurance companies are well capitalized and have significant sources of liquidity. At the end of the quarter, parent company liquidity was approximately $1.1 billion consisting of revolver capacity, intercompany lending capacity and holding company cash and investments. Our healthy liquidity balances allow us to pay holding company dividends and interest payments and support our operating subsidiaries as needed.

Our life business continues to be well capitalized, and the P&C business continues to improve its capital ratios. Operating profit and the preferred business wind-down are helping to improve P&C capital levels. As we previously mentioned, we anticipate over $130 million of capital to be released from the preferred business exit this year. Over $45 million of capital was released in the first quarter.

We continue to focus on improving our balance sheet metrics and reducing our debt-to-capital ratio. As we mentioned in late 2022, we expect to pay down at least $150 million of debt when we address our $450 million February 2025 debt maturity to help reduce our leverage ratio.

Moving to Page 7. Net investment income for the quarter was $100 million, and our pretax equivalent annualized book yield was 4.3%. Lower returns on our alternative investment portfolio reduced net investment income from the prior quarter. We continue to maintain a high-quality investment portfolio that generates stable income to support our operating businesses and is aligned with our liabilities.

I'll now turn the call over to Matt to discuss the Specialty P&C business.

Matthew Andrew Hunton
Executive VP & President of Kemper Auto

Thank you, Brad, and good afternoon, everyone. Moving to Page 8 in our Specialty P&C business. I'll start with overall comments for both private passenger auto and commercial vehicle. For the segment, we closed the first quarter with an underlying combined ratio of 93.6%, representing a 4.6-point improvement sequentially and a 14.4-point improvement year-over-year. This resulted in an outperformance against our target of 96%. Once again, the cumulative benefit of our profit actions exceeded incremental loss trend.

Our PPA business reported a strong underlying combined ratio of 93.5%. We have additional unearned rate, which will remain a tailwind. Our CV business generated an underlying combined ratio of 93.8%. Our specialization and underwriting discipline continue to create value.

Turning to production. Our explicit near-term goal is to stabilize PIF levels. There are several factors that will help to support this goal. First, customer and agent demand for our products is strong. Second, policy retention remains stable. And finally, the most impactful opportunity comes from re-expanding our new business availability.

In an effort to provide more insight into PIF and new business level changes, we've temporarily added 2 new slides. The last 2 years have uncharacteristically dramatic swings in our new business volumes. We believe multiple metrics can be helpful in identifying and evaluating periods of change. Page 9 details policy-in-force trends. Year-over-year change in PIF is a valuable metric in relatively stable times because it accounts for seasonality. It's a rolling 4-quarter measure of activity and therefore acts as a trailing indicator.

In periods of significant change, it masks the underlying dynamics. Year-over-year PIF decline in the quarter and the fourth quarter of 2023 were effectively constant at approximately 32%. The sequential quarter trend is a more responsive measure of how our policy-in-force base is evolving. It measures 1 quarter's activity. As noted, our sequential quarter PIF decline slowed by 3.4 points from 8.9% in the fourth quarter to 5.5% this quarter. On an annualized basis, this represents an improvement from minus 31% to minus 20%. Progress is more clearly visible here. It was driven by our new business expansion.

Let's turn to Page 10 for more detail. Here, we highlight how new business apps are trending. In this chart, the bar shows new business apps. As Joe highlighted, the re-expansion of new business writings is underway. Apps have increased by greater than 2.6x our fourth quarter volumes, and in the month of April, new business apps were approximately equal to the total of Q1. On a run rate basis, the second quarter is on pace to be about 3x Q1.

This trajectory demonstrates the pace of our reopening. The line on the chart represents new business relative to the beginning of quarter PIF or new business rate. As you can see, the first quarter and the run rate of the second quarter are approaching 4Q 2020 levels. This gives us great confidence in stabilizing PIF by midyear. Given seasonally lower activity late in the year, app volumes will likely level off. We don't expect significant sequential unit growth until the early part of 2025.

Let's shift gears and bring this back up a level. Our long-term goal is to achieve a 96 or better combined ratio and to maximize growth. We remain confident in our competitive advantages. These advantages position us to effectively navigate the ongoing market environment. Both the profile and loss performance of our new business writings are in line or better than expectations.

In conclusion, despite a quarter where PIF continued to decline, we're happy with our overall progress and are confident in achieving PIF stabilization by midyear.

I'll now turn the call over to Joe to cover the life business and closing comments.

Joseph Patrick Lacher
Chairman, CEO & President

Thanks, Matt. Turning to our life business on Page 11. Net operating income was $12 million for the first quarter. Mortality was in line with pre-pandemic levels. As expected, the inflationary environment continued to place modest pressure on this business. Although overall persistency remained in line with historical trends, new business levels were down slightly compared to the first quarter of last year.

Turning to Page 12. In closing, to reiterate our highlights for the quarter, overall profitability improved and exceeded targets, led by the Specialty P&C underlying combined ratio of 93.6%, and we delivered our fourth consecutive quarter of underlying business improvement with more rate to earn in over the next few quarters. The new business expansion we initiated midway through the quarter is delivering solid results. We expect to see PIF stabilize midyear as new business rates continue to ramp up throughout 2024. Lastly, our life business continues to produce stable earnings.

While we're pleased with the results for the quarter and our ability to achieve target profitability, we're clearly continuing to focus on stabilizing PIF. Effective execution of our profit improvement actions, combined with the successful completion of several strategic initiatives, has enabled Kemper to weather the storm and come out a stronger company, dedicated to delivering on our promises of providing attractive long-term intrinsic growth to our shareholders and value to all our stakeholders. This could not have been accomplished without the strong efforts and dedication of our entire Kemper team.
Operator, I'll now turn it back to you to take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Gregory Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Thanks for the additional color on new business apps. I was just -- I guess as I'm looking at the charts and digesting the information you provided, the quarterly run rate being 3x what it was in the first quarter, I'm trying to reconcile that with the fact that you expect PIF to stabilize in the first half. It seems like with that type of production that we might actually pivot to actually being up in PIF. So maybe you can help me with some of the math there.

Joseph Patrick Lacher
Chairman, CEO & President

Yes, sure, Greg. Thanks for the question. And this is Joe. I'll start, and Matt, you jump in too. The issue you get in specialty auto is a relatively significant amount of seasonality relative to new buyers. If you think about the first quarter, it might be -- if you started at x, the second quarter is probably 25% bigger, the third quarter is a hair smaller, and the fourth quarter is maybe 1/3 or 40% smaller than that first. So there's definitely a surge in the second quarter and a bigger than quarterly average in the first compared to the third and fourth.

So what will happen is we will write new business at a greater rate. We will write maybe more of the available new business apps in the marketplace, but it may be about the same amount of new business apps at the -- there's a seasonality element. That's one of the reasons we've historically looked at the year-over-year PIF, because you get a rolling 4 quarters in that process, so it tamps out the seasonality effect.

Right now, with the change that's going on, you really very much need to look at the sequential PIF and you need to look at the increase of new business apps. What we were trying to give you a comfort with is that as you saw that April annualized, it was up significantly, that may be -- and to use our analogy, might be late second, early third gear. As we continue to move through the gears, we'll have an increasing percentage of the available new business, maybe a comparable count number. So that may just wind up holding steady for the fourth quarter.

What you're going to see is in the second quarter, direct written premium will be up low double digits. It will be up much higher than that for the second half of the year. You'll see PIF count growing in the first quarter next year and earned premium growing in the first quarter next year. So this new business app look should give you a view -- particularly as you look at that line on Page 10, not the bars but the line, you can see that new business relative to the policies in force at the beginning of the year is a very comparable rate to where it had been in late 2020. Premiums are going to be growing next quarter, written premiums, significant written premium growth in the back half of the year and then PIF and earned premium in the first quarter of next year. Does that help?

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

That does. And as you were talking, I was actually looking at the chart that you have on Page 10. As further just clarification or reconciling the different moving pieces, you're running your specialty auto at target margins, you're going to start growing your new business, and typically, there's some sort of new business penalty that's associated with that.

So I guess the first question, any negative surprises inside when you've started opening up the markets again? And two, how should we think about new business penalties as you open up your marketing and new business spigot?

Matthew Andrew Hunton
Executive VP & President of Kemper Auto

This is Matt. I'll take the first part of that question and then flip it to Joe for the second. In terms of the re-expansion of new business, as we mentioned to you guys that we're taking a methodical approach in terms of how we're reopening to ensure that we're understanding the market dynamics, the loss dynamics as they come through. As we're priming the pump, so to speak, we're working through normal as expected operational efforts, working that through.

In terms of profile, in terms of volumes, in terms of loss performance, everything is coming in in line or better than expectation. So nothing to note there, no surprises, absolutely no surprises. Everything is coming in right in line with what we would have expected to see at this point in time.

Joseph Patrick Lacher
Chairman, CEO & President

Yes. And the second piece, I'll 100% reiterate with Matt, absolutely, no negative surprises at all on what we're seeing. The team is very thoughtfully moving through that expansion to protect from that. I think what I might suggest to you, Greg, is the aggregate new -- the aggregate benefit we got from slowing down new business was maybe 3 or 4 points on the overall combined ratio. So the aggregate penalty that will come back in on the aggregate combined ratio is probably roughly of the same order over -- when we get to full new business. So it's not going to happen all this calendar year. It will happen as that expands.

What -- again, the good news that came off will be the bad news that comes on. We're running at a 93-plus combined ratio right now. We have an additional 15 points of earned rate that we'll earn in over the year against 3 quarters of a year of a loss trend that's running roughly 7% or 8%. There is absolutely more than enough room inside of the margins we're at right now and that rate to cover that.

That reversal, if you will, or the re-adding the new business penalty is 100% contemplated in what we described as reversing some of those non-rate actions. It's contemplated in the rate we took. It's contemplated in how the earned rate comes in. And it's contemplated with our confidence that we will meet or exceed that 96 combined target over the course of this year and into next year as we do that.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. I guess just the final question and I'll let others ask is just on geography. Any -- as you're opening up new business, is there any skewing of geography? Or does it match what the legacy book is running at on a percentage basis?

Matthew Andrew Hunton
Executive VP & President of Kemper Auto

Yes. This is Matt again. As we reopen, I think we talked about it's going to be a little bit lumpy as we turn things back on. And so there's -- in one state, we may see production increase that's maybe outside of normal percentage distributions. And then as we get other states up and running, they come back in line.

But generally, over the course of the next few quarters, we're expecting distribution to be very similar in terms of what we've seen in our historical patterns, and we'll continue to look for further geographic diversification opportunities as we work. Short term, lumpy; long term, similar patterns to what we've seen in the past.

Operator

And your next question comes from the line of Paul Newsome from Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Maybe a little bit of additional focus on retention. Is there any reason why the retention rate would be different or changing given the change in the non-rate actions and the increase in new business as we prospectively go forward? I was a little bit surprised that it's been as stable as it has been given all of the changes in the company over time. But any thoughts there that would be helpful would be great.

Joseph Patrick Lacher
Chairman, CEO & President

Sure, Paul. And this is Joe. I'll give you a high-level overall answer then I'll double-click on it once. Overall, we're seeing a fairly consistent stability in retention. That's how it's performing. That's what we'd expect going forward. Now I'm going to double-click slightly on it. Imagine, if you will, a couple of different segments of the book of business we have. Some parts of this business have a very short-term tenure. They might be somebody trying to get an SR-22. They might run the policy for 3 months, 4 months and then lapse. Some parts of this business tend to have a much longer policy life. It might be 2, 3, 5 years. A lot of times, people think of nonstandard auto as only being stuff that's around for 6 or 8 months. There's parts of our business that stays around longer.

As we -- and each of those -- think of those almost as segments. Each segment is running a retention very consistent to what we would have expected for the long term. In this environment, when we reduce new business, some of those that churn a little faster as a mix of the total are not in the book and some of those that hang around a little longer, they're a bigger percentage of the book. So that will change slightly in total, but the segments are operating as exactly as we expect them and very consistent.

In hard markets and soft markets, you tend to get slightly different views. In a hard market, you see retentions go up. In a soft market, you see them go down. This is very much a hard market right now. So we're seeing the benefits of the hard market. We're seeing the benefits of the mix change. What we fully expect as we roll forward over the next 18, 24 months is what I would describe as generally consistent, recognizing there's going to be a modest mix, but we're measuring that for you in PIF, not in retention, and the benefits of a hard market.

Jon Paul Newsome
Piper Sandler & Co., Research Division

A second question, maybe some more on the competitive environment. The big states are California and Texas. Goosehead was out earlier talking about State Farm being extremely competitive -- well, some other mutuals. I realize that's probably more standard business, but I don't know, they write everything in the world. With California, it's obviously a new feature. Maybe you could talk about sort of whether or not there's more -- within the -- particularly the non-standard business, there's more or less competition. And obviously, lots of folks are raising rates, but not everyone is raising rates as much. And just how you are thinking about that as you contemplate the expectations you've laid out today.

Matthew Andrew Hunton
Executive VP & President of Kemper Auto

This is Matt. Yes, obviously, the texture there varies quite a bit by state. Think about our -- one of our larger markets, California, as companies are getting more rate adequate there and taking a little bit longer potentially, we're seeing fewer competitive dynamics in that marketplace, especially the larger players, a little bit less supply than what we normally would have seen in that market, creating more hard market opportunity. That said, as the carriers are getting their rates approved and adequacy is coming back in line, we expect that market to continue to get more competitive over the outlook.

A Florida, which is a big state for us, and a Texas, which is a large state but to a lesser degree, they've been relatively competitive over the last few quarters as the carriers there are more adequate and more confident in their new business price. And so we see Florida operating not very dissimilar to how we would have seen Florida operate pre-pandemic. It's an elastic marketplace. It's a competitive marketplace. And Texas is very similar, along with our smaller states.

So it's a bit -- it varies a bit by state. But generally, across the board, we would characterize the market as hard for us but with a bit of texture that sits underneath by state.

Operator

[Operator Instructions] Your next question comes from the line of Andrew Kligerman from TD.

Andrew Scott Kligerman
TD Cowen, Research Division

Maybe help me out with Slide 8 a little bit. I think on the -- in the remarks, you've mentioned that you've earned rate in the quarter of 9%. As I look at the -- as I look at the graph in the right-hand corner, it would imply to me that there's maybe another 11, 12 points to go in the year.

But then I think, Joe, you mentioned 15 points. So I guess part A is, can you clarify that differential? And then part B of the question is, what do you see as the kind of cadence of that rate earning in over the next 3 quarters? And maybe I'll even throw in a C. Are you filing for new rate increases as we speak? And could you quantify that?

Bradley Thomas Camden
Executive VP & CFO

This is Brad. Happy to help, and if I miss something, the 3-part question, 1A, B, C, let me know. Looking at the upper right-hand chart on Slide 8, for the year, for 2024, we have a total of 24 rates to earn in. We earned in about 9 points of that rate in the first quarter, and then that means we've got 15 points for the rest of the year.

I would tell you, about half of that rate, we'll earn in the second quarter, and then the remaining of that, we'll earn in Q3 and Q4. Does that answer your question?

Andrew Scott Kligerman
TD Cowen, Research Division

That's perfect, Brad. And then just are you filing for new rate? And could you quantify that?

Bradley Thomas Camden
Executive VP & CFO

We're always looking to find rate adequacy and keep up with loss trend. When we look at our indications, certain states say we have, we need to file for additional rate, we'll continue to do so as part of normal course. But the big part where we're trying to -- where earned rate was trying to catch up with loss trend, we've done that, and you're seeing that gap now close. And that's indicative of what's going on and what I just told you, right? We had 9 points in the first quarter, 7 in the second and a little trend smaller in the back half of the year. And then we'll file for rate as we need and as our states indicate.

Joseph Patrick Lacher
Chairman, CEO & President

I think -- Andrew, this is Joe. The way I might encourage you to think about it is we're filing what I might describe as the maintenance rate going forward. And what that would mean is we're trying to get rate that matches what loss trend is and hold ground on the profit margins as a result. So we believe what we've displayed for you in Page 8 shows the rate required to rebalance the organization to get rate in excess of loss trend to allow us to adjust the non-rate actions and to get things back at a sub-96 or below combined and growing.

The rate actions going forward will be just designed to keep that in balance and shouldn't be materially moving profit margins around. They should be holding them in that spot and allowing us to grow and staying that way because, if you told me 6 months from now, loss trend was a point, we'd have one view. If you told me 6 months from now, loss trend was 7 points, we'd have another. But if it was 1, we'd be looking for 1. If it was 7, we'd be looking for 7.

Andrew Scott Kligerman
TD Cowen, Research Division

Got it. That makes sense. And just to wrap up, on Slide 15, you've got a chart showing severities. And it looks like first quarter was indeed somewhat significant. So the question is -- or what you were just answering, maybe there is some rate that you need to keep up with that trend. And are you always pricing to 96%? You said that number a few times.

Joseph Patrick Lacher
Chairman, CEO & President

So a couple of things. Slide 15 is price indices of certain components of loss trend. Those are there informationally. They're not in and of themselves intended to be pure items that you can go to loss trend or intended to give you some sense of how they're moving. What I would describe to you is on an annualized basis, we're seeing severities -- continue to see severity increase annualized that are high single digits.

That's roughly consistent with what we saw and described last quarter. There's always some normal modest volatility around that, plus or minus a point. They're generally there. That varies somewhat by coverage, it varies somewhat by state, but it aggregates to roughly that level.

And we're not -- I'm trying to remember exactly how you phrased the second part of your question. You were asking, are we always pricing to a 96?

Andrew Scott Kligerman
TD Cowen, Research Division

Yes.

Joseph Patrick Lacher
Chairman, CEO & President

What we're pricing to is to make economically astute equations with that being a target or better. There are times when it might be astute to let it run to a 96.5. There will be times when it might be astute to let it run to a 92. If as an example, the fastest we could grow and still hire enough claim people might be x percent of PIF, and we were at a 92 combined, there would be no reason to actually get more price competitive and try to write more new business. We couldn't operationally handle it. That would actually produce a bad answer. You deteriorate the profitability, provide a bad customer experience, bad customer service, something else.

If we were shrinking 2% and running at 92, that's a bad long-term economic answer. We should move back towards the 96. So we're going to be good long-term operators and managers on that. What we've been trying to describe in the last couple of years is a shock to the system and how we got the system out of shock and back rebalanced. And what I'd tell you, the conversation we probably would have had with you in '18, '19, early '20 would have been, we're trying to get to roughly a 96 and grow as much as possible. And that moves around a little bit depending on where the market conditions or environment are. Does that help?

Andrew Scott Kligerman
TD Cowen, Research Division

Perfect.

Operator

And your next question comes from the line of Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I'm just curious, I didn't hear any comments about the reciprocal and kind of the progress there. And I'm just wondering, Joe, maybe you can comment on the fact that you're actually increasing new business, I know you can only put new business to reciprocal, could that actually accelerate that process on?

Joseph Patrick Lacher
Chairman, CEO & President

Sure, Brian. In theory, we could put something other than new business in there. We could populate the reciprocal with reinsurance. Our strategy is to populate it with new business. So there are ways to accelerate the process. I don't think that's prudent, and that's not what we're trying to do, and I'm not sure that's the best way for us to populate it given all the various things we're trying to balance in that.

It is continuing to operate. We're continuing to write some new business there. This is in the category of, it's going to have a long-term view before this is going to see it. Not much is going to change quarter-to-quarter for at least 3, 4, 5 quarters. There's going to be a little bit of increasing volume. Because it's new business, it's likely to have a new business penalty. It may not be making -- it's likely not to be making an underwriting profit. It's got to actually get some of those renewing before they produce a little bit -- the second renewal produces some underwriting profit. The new business that comes on doesn't.

This thing sort of hovers on neutral for a little while until it gets some volume and grows. And the analogy I was fussing with is it's a little bit like having kids. They suck resources for a little while then they get a little bit of job and make some money, then eventually they're productive and move on. This is going to take a little while to get going there, and it really just isn't conducive to a lot of 90-day updates. We'll continue to give them to you, but it's a good question. I understand the interest. We're moving as quickly as we reasonably can but trying to keep all of those pieces in balance.

Brian Robert Meredith
UBS Investment Bank, Research Division

And then my second question, I guess given what's happened with policies in force, and now we're going to get ramping things back up, does it give you or are you thinking about kind of reshaping the portfolio geographically, as a result, maybe having some more restrictions possibly in California to make sure that's not so heavy in your portfolio going forward? How are you doing that? Is that something you're thinking about?

Joseph Patrick Lacher
Chairman, CEO & President

Sure. Great, great question. I'm going to give you 3 thoughts. I'm going to echo what Matt said earlier, remind you of some history and then point you where we're going forward. And I'll do this in a little bit of an order.

If you go back in the not-too-distant past when this team got here, I think in 2016, we were 90-some percent in California in our specialty auto business. When the pandemic hit, we were 50%. We have been systematically geographically diversifying the portfolio and actually very rapidly. And we were doing that not by shrinking California but by growing other geographies more rapidly. That is a backwards look.

Forward, we will continue to operate with the thought process of finding a reasonable geographic balance, not because we're trying necessarily to shrink something but because we think there's other opportunities to grow in other places, and that will naturally result. Our best guess is maybe California ends in that 30%, 35% range overall.

Now the middle bucket, which is what Matt said before, and this echoes what we said last quarter. As we're re-expanding new business and reopening items and as there's the lumpiness with different competitive pieces in markets, you may see California growth -- write more new business and recover faster than a Florida or Texas. You may see Florida or Texas go a little faster than California. And that may actually change month-to-month.

We actually have watched it over the course of the last 60 days sometimes change week-to-week in terms of how that's moving in. That is normal, a little chop in the harbor, if you will, that we expect while we're rebalancing. So we're not going to give you any kind of target monthly or quarterly or really any kind of picture of that profile over the next 6 months while we're trying to get the system reprimed and rebalanced.

As we work our way through '25 and '26, I would fully expect it to look very similar to what we described to you pre-pandemic. And I'd expect that top right corner of Page 8 to going back to something that was showing some growth in California, some growth faster than that in Florida and Texas and some growth even faster than that in the other geographies, which effectively was diversifying us away from California by growing other places more rapidly.

Operator

And your next question comes from the line of Gregory Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. So I get to -- I have 2 follow-ups. One, I know it's discontinued, but the progress on the runoff preferred business. And then the second question would be around the alternative investment portfolio results in the first quarter. Just wondering if what we saw in the first quarter, is that the type of result we should expect out of that portfolio for the balance of the year?

Bradley Thomas Camden
Executive VP & CFO

This is Brad. On the preferred business, the runoff is going as planned, if not a little bit quicker than expected. So the $130 million we indicated this year is on track, maybe a little bit better, so $85 million plus left to go this year. On the alternative investment portfolio, I think that that's on Page 22 of the supplement. If you look there, there's a -- I think it was down about $5.7 million Q4 to Q1 in average returns. That's related to a few investments. I don't expect that to be the run rate going forward.

The other thing I'd point out, though, the core of the portfolio, the high-quality fixed income has been very stable in that $98 million, $99 million a quarter range.

Operator

There are no further questions at this time. I'd like to turn the conference back to Mr. Joe Lacher for closing remarks.

Joseph Patrick Lacher
Chairman, CEO & President

Thank you, operator, and thank you, everybody, for your questions today. Hopefully, you're, as we described, feeling a little bit better about where the direction of the PIF is going and the speed with which it's recovering. I know we're enthusiastic and excited about it and think it's moving in the right direction, albeit it's a little bit of work to do. And with that, look forward to speaking with you all again next quarter. Thanks.

Operator
Thank you. And that does conclude our conference for today. Thank you for participating. You may all disconnect.