S&P Capital IQ

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AXIS Capital Holdings Limited NYSE:AXS

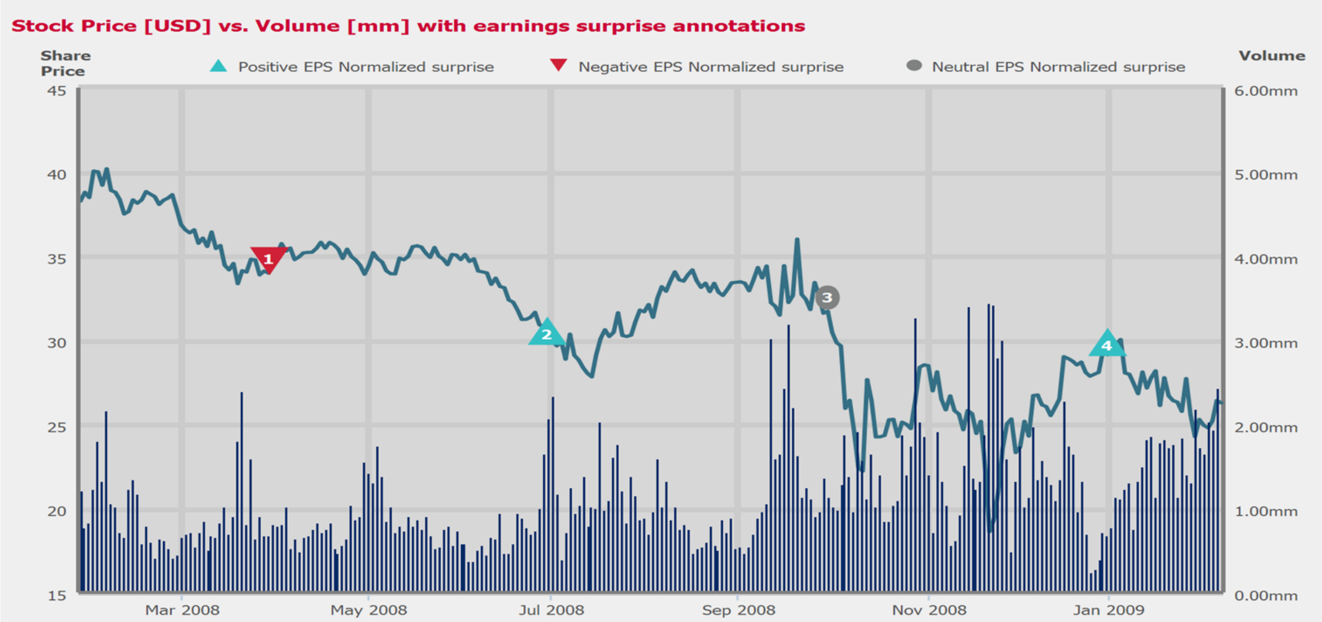
FQ1 2009 Earnings Call Transcripts

Tuesday, April 28, 2009 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2009-			-FQ2 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.11	1.05	(5.41 %)	1.20	4.23	4.55
Revenue (mm)	1115.25	1162.30	4.22	684.60	2754.22	2903.98

Currency: USD
Consensus as of Apr-28-2009 12:02 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2008	1.39	1.28	1 (7.91 %)
FQ2 2008	1.36	1.45	2 6.62 %
FQ3 2008	(0.97)	(1.22)	NM
FQ4 2008	0.99	1.09	3 10.10 %

Call Participants

EXECUTIVES

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Linda Ventresca

ANALYSTS

Joshua David Shanker
Citigroup Inc, Research Division

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Presentation

Operator

Welcome to the Q1 2009 AXIS Capital Holdings Ltd. Earnings Conference Call and webcast. [Operator Instructions] Now I would like to turn the conference over to Linda Ventresca. Ms. Ventresca?

Linda Ventresca

Thank you, Nikki [ph]. Good morning, ladies and gentlemen. I'm happy to welcome you to our conference call to discuss the financial results for AXIS Capital for the first quarter ended March 31, 2009. Our earnings press release, financial supplement and quarterly investment supplement were issued yesterday evening after the market closed. If you would like copies, please visit the investor information section of our website, www.axiscapital.com. We've set aside an hour for today's call, which is also available as an audio webcast through the Investor Information section of our website. An audio replay will also be available through May 9. The toll free dial-in number for the replay is (877)344-7529 and the international number is (412)317-0088. The conference code for both replay dial-in numbers is 429424. With me on today's call are John Charman, our CEO and President; and David Greenfield, our CFO.

Before I turn the call over to John, I will remind everyone that statements made during this call including the question-and-answer session which are not historical facts may be forward-looking statements within the meaning of the U.S. Federal Securities Laws. Forward-looking statements contained in this presentation include but are not necessarily limited to information regarding our estimate of losses related to catastrophes and other lost events, general economic, capital and credit market conditions, future growth prospects and financial results, evaluation of losses and loss reserves, investment strategies, investment portfolio and market performance, impact to the marketplace with respect to changes in pricing model and our expectations regarding pricing and other market conditions. These statements involve risks, uncertainties and assumptions, which could cause actual results to differ materially from our expectation.

For a discussion of these matters, please refer to the risk factors section in our most recent Form 10-K on file with the Securities and Exchange Commission. We undertake no obligation to update or revise publicly any forward-looking statements whether as a result of new information, future events or otherwise. In addition, this presentation contains information regarding operating income, which is a non-GAAP financial measure within the meaning of the U.S. Federal Securities Laws. For a reconciliation of these items to the most directly comparable GAAP financial measure, please refer to our press release, which can be found on our website. With that, I'll now turn the call over to John.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, Linda and good morning, everyone and thank you for joining our call. I'm pleased to report that we have delivered good quality growth during this first quarter of 2009. Contributing to this improved performance relative to the last few quarters of 2008 was the very welcome stabilization on asset valuations for our fixed maturity portfolio and improvement in liquidity in the credit markets overall. This is the first quarter since the unprecedented events of the second half of last year that we have been able to report a total return on our investment portfolio that is, at last, moving toward positive territory.

Included in our financial results this quarter are proactive reserving actions taken in the quarter. These are consistent with our actions in 2008, which we believe are prudent in the light of the continued global economic downturn. Even with these actions, our combined ratio was 86.6%. This underwriting result is a very respectable result in light of the conservatism embedded in our underwriting and reserving philosophies, especially given our belief, that in 2009, we are at the bottom of the earnings cycle across all lines.

Now I would like to turn the call to David who will discuss the financial results for the quarter. Following David's review of our financial results, I will discuss some underwriting portfolio license on market conditions in a bit more detail. David?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

Thank you, John and good morning, everyone. As John mentioned, we're pleased with our results for the quarter. Despite the challenges of the current economic environment, we were able to deliver an annualized return on equity of 11.6% for the quarter and a 2% increase in diluted booked value per share to $26.35 at quarter end. Net income for the quarter was $116 million or $0.78 per diluted share compared with $238 million or $1.48 per diluted share for the first quarter of 2008. Approximately 80% of the change in net income is attributable to year-over-year movements in net realized investments gains and losses and foreign exchange gains and losses.

After-tax operating income excluding foreign exchange gains was $155 million or $1.04 per diluted share compared with $186 million or $1.16 per diluted share for the first quarter of 2008. Turning to our top line, our consolidated gross premium is written for $1.3 billion, up 5% from the first quarter of 2008. This growth was driven by our reinsurance segment where we saw better opportunities for growth than we did in our insurance segment. Gross premium is written in our reinsurance segment for $1 billion this quarter, up 16% from the first quarter of last year. The increase was driven by significant rate increases on our U.S. Property Catastrophe Renewal business together with attractive new business opportunities and increased share with our professional lines, liability and credit and bond reinsurance businesses.

Gross premiums is written in our insurance segment were $364 million, down 16% from the prior year quarter. The decrease was driven by a reduction in our credit and political risk business. We are not yet seeing the return of significant global lending in trade activity that we expect will create attractive opportunities for us. In addition, we reduced our catastrophe closure within our property lines of business this quarter as well as rebalanced the global property portfolio in our insurance segment. In the quarter, consolidated net premiums written and net premiums earned increased 6% and 1% respectively. This primarily reflects the impact of the previously mentioned increase in gross premiums written.

Moving on to our underwriting results, total underwriting income for the quarter was $97 million compared with $139 million in the first quarter of 2008. Our combined ratio for the quarter was 86.6% versus 81.2% in the prior-year quarter. The increase in the combined ratio was driven by an increase in our loss ratio from 54.9% in the first quarter of 2008, to 58.3% in this quarter. This was driven by higher accident year loss ratios relative to the same period last year. Our consolidated current accident year loss ratio for the quarter, up 71% compared to 68.3% in the first quarter of 2008.

There are few items to note here. Our insurance segment's current acting year loss ratio of 68.4% decreased 30 points from the prior-year quarter driven by a lower frequency and severity of property risk losses. Partially offsetting this was claims activity on our credit and political risk insurance line of business this quarter. John will provide some additional color on this in his commentary on credit exposures from our underwriting activities.

Our reinsurance segment's current accident year loss ratio increased 7.2 to 72.8%, predominantly reflecting our actions to ensure that we are prudently reserved in our trade credit and bond reinsurance book with the extreme effects of the global economic downturn. Our reinsurance segment's current year loss ratio was also impacted by catastrophe losses this quarter including European Windstrom Klaus and Australian bushfires. During the quarter, our estimate of net reserves from prior accident years continue to develop favorably with prior year reserves reduced by $84 million this quarter. Of this amount, $36 million was from our insurance segment representing a positive impact of 13 points on the segment's loss ratio.

Our reinsurance segment posted $48 million in net favorable prior period reserve development, representing a positive impact of 12.4 points on the segment's loss ratio. The majority of the net favorable reserve development this quarter was generated from our short-tail alliance. The balance was primarily from the accident years extending from 2003 to 2005 in our professional lines insurance and reinsurance businesses.

We did add to prior period reserves in the quarter. Specifically, we added $32 million to our reserves related to trade credit and bond reinsurance for accident year 2008. This action was taken to prudently address updated information about accident year 2008 loss activity. Meanwhile, on the earlier accident years for the same line, we recognized $17 million of net favorable reserve development as loss experienced was better than expected for these years. Our acquisition costs increased one point to 15.3% this quarter relative to the prior-year quarter largely reflecting changes in business make. Also contributing to the increase were sliding scale commissions associated with favorable prior period reserve development incurred in our reinsurance segment. Our underwriting results in the quarter were negatively impacted by a $10 million reduction in the fair value of an insurance derivative contract related to a life settlements portfolio. This change in fair value is recorded as part of other insurance related income in our insurance segment.

Turning to our G&A expenses, our G&A ratio was 13% compared to 12% in the first quarter of 2008. Our G&A cost of $87 million this quarter are in line with our previous comments. The increase, quarter-over-quarter is larger attributable to our continued investment in IT and operational infrastructure. G&A cost this quarter represent an appropriate quarterly run rate for 2009, absent any performance related compensation adjustment.

Moving on to investment results, for the quarter, we recorded $99 million of net investment income. A welcome increase of $14 million over the prior-year quarter and significantly improved relative to the $26 million loss recorded in the fourth quarter of last year. Our fixed maturity investments produced $92 million of net investment income this quarter, a decline from 105 million in the prior quarter, primarily due to lower interest rates and our deliberate maintenance of higher cash balances through much of the quarter. This interest income decline was offset by net investment income produced by our other investments portfolio during the quarter of $7 million, as compared with the $36 million loss from these assets in the first quarter of 2008.

Improvement in the bank loan market which contributed to positive performance from our credit funds accounted for most of this increase from our other investment. As we stated during our last call, we believe this credit funds which are primarily comprised of senior secured loans has significant return potential from the current valuations. Our hedge fund investments also contributed positively to net investment income for the quarter despite the general decline of global equity markets during the period.

Net realized investment losses totaled $41 million in the quarter includes the above other than temporary impairment charges of $30 million. The OTTI charge primarily relates to hybrid securities of European and U.S. financial issuers. We also recorded impairments on a small number of subprime and Alt-A related holdings. The remaining net realized investment losses were sales of financial corporate securities.

In aggregate, total recurrent from our investment portfolio was posted nil for the quarter. To summarize, net investment income of $99 million was offset by net realized losses of $41 million and an increase in net unrealized losses from available-for-sale securities of $59 million. The increase in net unrealized losses is primarily related to our holdings in medium-term notes which were negatively impacted by the continued weakness in the euro credit markets in hybrid securities of financial institutions. We reduced our cash positions reporting during last quarter's call from 17% to 13% of total cash and investments. Much of this reduction occurred towards the end of the quarter. These reallocated funds were invested in U.S. government in agency debt holdings, U.S. agency mortgage-backed securities and corporate issues with FDIC guarantees. We will continue to maintain a conservative portfolio which remains well diversified, highly liquid, high quality and short duration. Our investment grade at fixed maturity portfolio has a current duration of 2.4 years with an average quality of AA+. In light of current conditions, over half of our investible assets are in cash and U.S. Treasury and agency obligations.

Going forward, we're continuing to shift our fixed maturity portfolio towards U.S. government guaranteed issues and U.S. agency past dues [ph]. At the moment, we are maintaining our modest exposure to hedge funds and long-only equity strategies and are monitoring opportunities in the event we choose to increase our exposure in these areas. For additional information on our investment portfolio, we've provided an investment supplement which is available on our website. With respect to foreign exchange, during the quarter, changes in exchange rates and changes in net currency exposure resulted in negligible gains compared to the net gains of $20 million in the prior-year quarter. Our capital resources and liquidity remained very strong. Cash flows from operations this quarter was $245 million. We remain strongly capitalized for the risks we hold and the risks we are targeting.

Total capitalization at March 31, 2009 was $5 billion including $500 million of long-term debt and $500 million of preferred equity. Common shareholders' equity increased $32 million to $4 billion during the quarter. In our quarterly financial supplement, we have updated information about PMLs as of August 1 for the AXIS group at various return periods for peak industry cat zones. We've also provided estimates of industry losses at these return periods. The only significant change of note relates to the industry losses for Japanese earthquake and wind which chained as a result of vendor model refinement.

With that, I'd like to turn the call back to John.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Thank you, Dave. Before I move on to my forward-looking comments, I would like to further update you on elements of our underwriting portfolio currently affected by the credit crisis and the global economic downturn. These are professional lines insurance and reinsurance, trade credit and bond reinsurance and credit and political risk insurance. First, I would like to specifically discuss loss activity in the various impacted lines. In professional lines insurance and reinsurance, we continue to believe the 2007 and 2008 years will be the most heavily impacted by the subprime and credit crisis. We have consistently taken prudent reserving actions since the onset of the crisis, culminating in what we believe to be among the strongest reserve positions in the industry for the 2007 and 2008 years. In trade credit and bond reinsurance, we've recognized that the global economic downturn has persisted through this first part of 2009, and that the risk management actions taken by our cedents to manage their way through the unfolding credit crisis may take some time to have full effect. For the most part, loss activity is being characterized by high frequency not high severity.

Based on our ongoing monitoring, we believe lost customers have been well monitored by the trade credit insurers and broad rush measures have been taken to target the high loss frequency experienced with small to middle-sized customers. By now, you likely have also seen extensive press coverage about measures trade credit insurers have taken to mitigate exposure emanating from the credit crisis and global economic downturn. We fully expect these measures as well as complimentary government support to gain full direction in mitigating potential future loss. We ultimately expect a positive inflection point late in 2009. In the meantime, we have taken prudent reserving actions with respect to 2008 and reserving the 2009 accident year at approximately twice the level of incurred losses observed in the 2004 through 2006 period.

Moving on to our political risk and credit insurance line, we have perceived only three notifications of loss in the first quarter of 2009. One of these notices relates to a transaction rated by a major rating agency and is being [indiscernible] by that agency by our insured bank and by us to have high prospects for recovery. Although we expect the other two notices to resolve favorably later in the year, we nevertheless have conserved [indiscernible] simply reserved these cases in the quarter based on relatively unfavorable possible outcomes. Finally, we remain comfortable with the reserves we established for the 2008 claims activity that I have discussed during our last earnings call. The overall performance of this portfolio thus far, is good. In summary, we have received no new information or claims activity that has caused us to materially change our view that any net losses resulting from the credit crunch all chained with the deterioration in the economic environment are within expected annual earnings.

Stepping back, we have also analyzed extremely stress scenarios across our credit and political risk insurance portfolio as well as our trade credit and bond reinsurance portfolio. This stress scenario assumes extreme correlation amongst countries and economically or politically linked regions. They also assume higher defaults on lower recovery rates than those experienced in the past. We have already noted the fact that trade credit insurers take significant measures to mitigate downside during these types of stressed situations, coupled with the small scale of that trade credit reinsurance business relative to our overall portfolio, means that the trade credit and bond reinsurance portfolio is not a significant loss driver to our overall expected results. Our analysis supports our position that in extreme downside scenarios, we do not expect net losses from our credit and political risk insurance portfolio to exceed annual earnings. This portfolio is catastrophe-like in its loss characteristics. But when putting to the context of our overall business, we believe that natural perils risk remains by far our main exposure for extreme events.

Now I will provide an overview of the underwriting markets. For sometime, we have said that any hardening in the market would initially be led by the reinsurance market. We continue to believe that there will be a broad hardening and at this point, we are participating in the sustained improvement across the reinsurance market. We are experiencing a stabilizing insurance market.

However, the biggest question remains, one of timing of pricing recovery across our business lines. We believe the lag in the insurance sector is not likely to continue beyond this year and for many reasons, which I will cover later. Demand for reinsurance is strong and in our opinion, opposition in the reinsurance market place is as bouncing as reinsurance buyers are recognizing the relative strength and consistency of AXIS as a reinsurance partner. This is beneficial as the reinsurance market more broadly continues to show discipline, with terms and conditions remaining firm.

On a positive note, market intelligence suggest that certain startup operations with ambitious business plans are not receiving broad support from the reinsurance market. Reporting from our cedents indicates that the rates of decline in the insurance pricing has slowed and in the case of property business, pricing is increasing. Stronger and more professional cedents are targeting and writing the business, which is migrating away from troubled insurance carriers. The gradually shifting landscape in the insurance markets is an important structural dynamic we expect will accrue most immediately to the benefit of the reinsurance market and in time to the benefit of the industry overall.

Rates in both the property and cash with the excessive loss reinsurance lines in which we participate are attractive. As we have noted in the past, we have a strong bias towards writing and reinsurance business on an excessive-loss basis. We believe this generally offers better margin for the risk assumed than proportional reinsurance business. However, we still look for opportunities in proportional reinsurance business, particularly with good quality, well-run specialty insurance companies that require continuity in their reinsurance purchasing as an important capital source. At this time, with the exception of a few lines, we do not believe margins in proportional reinsurance business, in particular, first on our proportional reinsurance business are compelling and after that overall bias in accessory would move away from excessive loss reinsurance business.

This has implications only when comparing top-line growth amongst reinsurers. As we indicated last quarter, we believe we are achieving margin expansion in accessory overall during 2009. As discussed in our last earnings call in property, the line of business where prices increase meaningfully to attractive levels is property catastrophe reinsurance. Meanwhile, non-catastrophe property reinsurance pricing is generally stable. For property catastrophe reinsurance business, we believe that the pricing at mid-year renewals which are heavily influenced by peak wind zones in the U.S. will be as attractive if not more attractive than the pricing that cleared the market at mid-year renewals following the active 2005 hurricane season.

Unlike the period following the 2005 hurricane season, there is strong evidence that prices increased in from California earthquake peril. Various market dynamics supports sustained hardening including the negative impact of changes in exchange rates on Lloyd's capacity, the lack of new entrants and sources of cat capacity in the capital markets demanding rates of return much higher than those demanded in 2006. Also, reforms to the Florida Hurricane Cat Fund's Temporary Increase in Coverage Limits, otherwise known as TICL, could boost demands significantly for increased limits of indemnity from the traditional reinsurance market at mid year. Recognizing all of this, cedents needing certainty, are coming to the market much earlier to secure cat coverage. Overall, our risk appetite in targeted business in the property reinsurance line remains unchanged.

We remain extremely cautious about providing reinsurance coverage, the cedents [indiscernible] have solvency issues following a major sharp loss. This represents one of the primary reasons we are not a significant reinsurer of Florida rending [ph] property reinsurance business. Our property catastrophe reinsurance portfolio remains biased toward national carriers and super regional carriers, though we believe are more strongly capitalized and therefore more resilient. Moving on to the insurance market place, more volatile, most affected lines such as those with cat exposure in financing institution business are experiencing rate increases. Other commercial lines are flat or continue to decline albeit rate decline has slowed materially relative to 2008.

Financial institutions' DNO [ph] is the only line that assume rates directly and positively impacted by the economic turmoil. Promotional DNOs under the most pressure in the primary and lower layers where there is no shortage of markets available to compete for business moving away from troubled carriers. It feels a bit like a land grab before the peace treaty is signed. With the competition focused on primary and lower excess layers, we believe the higher excess layers are able to maintain better pricing. We are seeing a similar effect in casualty with excess casualty relatively more attractive than primary casualty. Certain property insurance classes demonstrate the accelerated improvement in pricing toward the end of the first quarter. This was particularly true of the 14,000 North American Cap exposed [ph] placements. Non-U.S. property insurance business continues to disappoint, this seems to be driven by diversification of market away from peak cat size. While offshore energy pricing continues to improve, clients with strong balance sheets are buying less Windstorm covering the Gulf of Mexico. And the energy industry's construction activity has abated with the reduction in the price of oil.

We viewed the most optimistic case at this time in the insurance segment as hardening across all lines towards the end of the turmoil. Importantly, insurance carriers have significantly diminished ability to hide behind the fig leaf [ph] for the investment returns and favorable prior-year reserve development. They are also facing significantly higher risk retentions. More than ever now, prospective returns to shareholders will depend on real underwriting profits being made. With this in mind, we would like to emphasize as we did last quarter the transitional nature of 2009. As you can see in this quarter's results, substantially lower yields are pressuring investment income. Losses have been near-term negative, it ultimately supports the need for the industry to continue to focus on pure underwriting profitability.

Any resolution of fundamental structural issues in the insurance markets, namely government involvement in the provision of cheap capacity on a non-monitored basis will go a long way towards allowing efficient and appropriate market behavior. There are indications at least some of this may be addressed in the near term. And we believe this must happen to ensure a healthy, transparent insurance marketplace.
We would like to remind you that we remain broadly defensive throughout our underwriting and investment activities. Whilst we assume the green root shoots of recovery, we do not believe the risk revolved characteristics have sufficiently swung in our favor to mobilize ourselves for a full offensive.
We believe by year end, our market leading diversification by product and geography, together with our strong underwriting skills in risk management framework will be fully mobilized to deliver high-quality out performance. Now, I would like to open the lines for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Matthew Heimermann of JP Morgan.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Question on the political risk side, as we just going forward with respect to how we should think about underwriting margins in that segment, is it fair to say that really at this point it would be specific project related, defaults or slowdowns that really is going to drive volatility in the loss ratio rather than general increases in provisions for reserves?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

If you're talking about our future activity, we have been very conservative as the market has slowed substantially in producing project-finance activity in the emerging markets, so have we. And quite frankly, what we wanted to do is to step back a little bit and because there's a definite time repricing of credit taking place globally and what we wanted to do is to make sure that the very valuable product that we put into those markets was repriced accordingly. So we're waiting for the activity to pick up, we thought it would probably be picking up by the end of the first quarter, sharing signs but spotty signs, but it's not there yet. But we are very comfortable about being able to take advantage in that area once that activity comes through. In terms of the loss activity, we have a very substantial unearned premium on this portfolio. And so the first quarter is always a very difficult quarter for an insurance business because a company like ours has not a huge amount of premium volume going through in the first quarter, and it tends to normalize as we go through the rest of the year. But I'm very comfortable with where we stand without provisions and I think we've been very prudent and we should be at times of great economic distress globally.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

Just to summarize, I think maybe I could have asked the question about better. On the reserve side, it sounds like it would be severity around specific claims that would drive variants in reserves going forward rather than anything else?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Yes, certainly.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

And then with respect to the premium, I understand its linked loss activity and you think that potentially second half you could see activity go up and you could start writing business again, would the opportunity be so dramatic that you would be comfortable ramping this business back up to kind of the premium models you saw in '07? I'm just trying to get a gauge of it when opportunities do come back, just how significant that is.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I've always said this is a very important part of our business, it's a very important part of a very diversified portfolio. Everybody's very sensitive to it at this moment in time. I just remind you that since we started writing this business back in 2002, our loss ratio is under 15%. And the loss activity you would naturally expect to occur in an unprecedented global economic meltdown, but I think we've demonstrated with the diversity of the portfolio we have in both the credit and political business. But we've managed that very well and we will continue to do so. And I would expect us to benefit strongly from an upturn in trade activity.

Matthew G. Heimermann
JP Morgan Chase & Co, Research Division

With respect to the insurance segment with continued reductions in the property side, is that, I guess, at what point would you feel better about risk reward in the insurance segment, I get that it makes more sense to use aggregate in the reinsurance segment at this point, but do you see an inflection point for that business as well?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

We've digressed [ph] the insurance side, Matt, from a cat point of view because the risk reward, we just don't see us as getting there yet. And I think a lot of underwriting businesses are deluding themselves if they're loading up. We believe that will change but we don't see it certainly before the 1st of July, not to the level but we believe that we require for the sort of returns that we need. We have not moved capital to our reinsurance business. We've held average insurance PMLs to the same level but we believe as I said in my commentary, that we're able to get much better risk reward margin on our reinsurance side than we're currently seeing on the insurance side. And we're seeing margin expansions, just to remind you, on the reinsurance side. But the primary side will get there, but I don't believe it will get there before one seven. And this is not a year to throw margin away.

Operator

Our next question comes from Josh Shanker of Citi.

Joshua David Shanker
Citigroup Inc, Research Division

You might have saw that I'm not as yet sold on the hard market situation and I was trying to figure out, at what point does the industry's capital start getting used and to what extent do you think that the markets would allow capital to be raised to a scale of that situation?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Firstly, let me deal with your point about you're not sold on the hard market. There are always different views of what is a hard market, what constitutes a hard market and at what levels. But let me tell you, after three years of a soft market, we're in a hardening market substantially. And even on the primary insurance side, over the last four or five weeks, there has been significant hardening across a number of lines. But it still has a long way to go, but you know that we've maintained that the reinsurance side has hardened. It did at the year end and it will continue to harden through this year. And if you are talking about real use of any surplus capital that's left in the industry, I think inevitable, it will be shown next year.

Joshua David Shanker
Citigroup Inc, Research Division

Do you believe that you have enough capital now that giving your projections, you would not want to raise capital given that opportunity?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

We are very sufficient about our capital to undertake the underwriting activity that we want to. If see an extraordinary situation, Josh, because these things you never really know what's around the corner. But our balance sheet is in great shape, our reserves are really strong, very conservative. We're on top of our underwriting both in the insurance side and the reinsurance side. It's been a very frustrating three years and in fact, we're waiting for this moment. But if the opportunity becomes exponentially greater, then we could go out and raise capital and we're in a position to be able to do so. Debt-to-equity ratio is good, it's light, the balance sheet is strong, we are well regarded and we put it to good use, but only if we saw an extraordinary opportunity.

Joshua David Shanker
Citigroup Inc, Research Division

And for the industry, not AXIS in particular, if stripping out extraordinary cats [ph] , how many years do you think the industry reports an underwriting loss before we get back up to a general level of underwriting profitability?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think it will be a pretty short term situation. The well must be running dry for a lot of these guys,Josh, if you don't mind me saying so.

Operator

Our next question comes from Vinay Misquith of Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

On the credit and bond insurance, just a follow-up to Matt's question actually, do you expect that your loss picks for the rest of this year would be on the high side as on the premiums on that business?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I'm very confident, as I said, Vinay. I'm very comfortable about the reserving actions we've taken. We're very close to our cedents. We like that business, we know that business. We took a strategic decision because we've been very cautious with that business and the growth of our European reinsurance portfolio, which I think will show unique opportunity for us and maybe one or two other reinsurers to have a much more strategic relationship with the three major credit and bond insurers which we took. And I'm very comfortable without our reserving position in the lights of the global downturn. And I'm also very comfortable about the actions that these people have taken. And don't forget, Vinay, these guys have got a lot of skill in the game. It's not as if they're reinsuring the vast majority of their business, they have a lot of retained business here, they have a very strong vested interest as much as we do in getting this matter sorted out quickly, getting it addressed, getting it repriced, getting the treaty conditions changed in our favor, the risk would always come back in our favor. So I feel pretty comfortable inspite of all the doom and gloom that's around out there.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

My question was that actually more based on, was reserving action this quarter sort of a true up? How do you expect this higher run rate to settle the end of this year and the next year that to fall off because of the actions taken by the primary insurers to increase pricing and to reduce risk?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

If you're looking at our historical loss ratio across the entire company or the entire businesses, we tend to reserve earlier in the year during higher loss ratios and they drop off as the year matures. That would be consistent with this line of business as well. However, in the environment that we're dealing with and the market conditions that are out there, I wouldn't use this year as a year to apply our prior experience to it. And I think as we've said in our comments, as John has elaborated on, we've been highly conservative or prudent in the way we're reserving this line and I don't think that I would anticipate changes in that approach for the rest of the year.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And looking at the net investment income, the yield really dropped off quite significantly this quarter versus the last quarter, do you anticipate changing your mix of assets in the future and do you expect this low level of yield to last for the next few quarters or do you expect it to go up maybe later this year or early next year?

David B. Greenfield
Former Chief Financial Officer and Executive Vice President

A couple of things here, just to comment on, first of all, the yield is down as I said in my remarks. If you look at what occurred within the quarter, we held a very substantial amount of cash into the end of '08 and through much of the first quarter. And the yields on cash dropped significantly as you know over the last six or eight months, and that drove down the yield to a degree. In addition, we have invested in a very safe, if you will, investments, government-guaranteed issues, FDIC-backed issues. So our current philosophy has been to look for the safe areas of the market which have a slightly lower yield at the moment, but we do generate very significant amounts of cash flow. We are looking at the portfolio very regularly and I wouldn't say that we'll continue the same approach throughout the rest of the year or we wouldn't look at other opportunities. So I think this could be a pressure on investment income returns throughout the year as we've said, but we are going to look for whatever opportunities the market will have for a yield improvement.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Why do you think that the market has not significantly hardened in primary insurances yet? And secondly, if pricing were to rise 5%, would that really lead to margin expansion because loss cost trends are also rising in the 5% area?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

I think our actually less well managed than the reinsurance businesses. They're less focused, their management tends to be more distant and tends to rely on actuarially-driven numbers to manage their business, whereas we at AXIS are completely the opposite business model. We're down in the cold phase every damn day, and throughout all of our product lines. Secondly, it's even more interesting that primary market hasn't reacted because as I've been saying now for a year, the reinsurance market does not soften in the same way that the primary market had. And so the margin erosion in a lot of these primary underwriting businesses must be significantly greater than they are reporting, and I strongly stand by that. And I just think that there's a lag between the management of this primary businesses getting any reserve redundancy out of their books, flushing any credits they can find. My instinct tells me it’s happening now, the world is pretty dry. And as I said earlier to Josh, over the last four or five weeks, we've started to see indications more broadly about changing underwriting behavior, especially when you consider those underwriting businesses that allow our underwriters to take into account investment returns as part of their pricing strategy especially on the longer-term businesses. We've never allowed our underwriters to do that for now, as you know. Our underwriters have to make underwriting profits. Those underwriting models that incorporated investment returns, again I have to be fundamentally changed for obvious reasons. So I'm pretty comfortable about the second half of this year, actually on the primary side. It will be a bit spotty but it's going to happen.

Operator

Our next question comes from Brian Meredith of UBS.

Brian Robert Meredith

UBS Investment Bank, Research Division

John, can you talk about how much do you think the economy is actually impacting on the softening market, and by that I mean customers more willing to accept potentially lower credit quality for a lower price right now, and do you think if the economy improves maybe that will have a positive impact on pricing as these companies can afford to pay for credit quality?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Our industry is pretty -- I've always said it, it's completely contra-cyclical, in all the years that I've been in it and after 38 years. And throughout the cycles, I've worked for shipping [ph] back in my much younger days and more rebellious days. And so, I was used to buying insurance on the other side. And at the time when the global economy has tends to gloom, our businesses within the primary insurance markets tend to under price and over compete. It's just something that traditionally just happen. And then as we get ourselves into trouble as an industry with low returns, we are forced then to set about a repricing, a broad repricing of our product lines at the time when the global industry tends to be going into some sort of recessional downturn. And of course there is an impact in the fact that there are a number of clients who obviously had a very substantive six-year run of high profitability, may be covenant light, because they're debt free or they've reduced their debts. And so their reliance on insurance products is lessened. But that works its way through balance sheets because risk is risk and losses occur and these guys think that they can run it against the cash on their balance sheets. But within a year or two, they are back at fully buying because they've used a lot of their cash. And I think the insurance market place is still the most efficient use of spelling risk into and the most price sensitive too. So, I don't agree -- there's a lot of short-term action taken by finance directors, not risk managers, the risk managers in a lot of these Fortune 2000 businesses are recommending coverage to be purchased. The finance directors, because they're on tight budgets against decline in revenues, are actually reducing some of their buying, but that's more than offset quite frankly, by the market repricing and having been around for a long, long time. I know what historic pricing is all about and the margin that markets needs to make up even from 2002 levels is very substantial and it's across the board. So there'll be more than a compensating impact by a hardening market against the back flow of decline in demand.

Brian Robert Meredith
UBS Investment Bank, Research Division

A quick follow up here on the political risk business, perhaps John, and without getting specific, can you describe a claim on the political risk business, what a typical claim would be, and why you said a number of cases, some of these claims that you've had, you believe you'll have a favorable outcome to them, why do you believe that?

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

That's because that's our history and that's our experience, the proven experience. When we underwrite these types of individual risk, we are very cautious that the front end in working with our banking partners to make sure that there's an economic viability to the project. These are sort of project finance structures in the emerging markets, so there has to be strong viability, and we take a great deal of care, with a due diligence that we go into when we're actually assessing risk. And I'd like to think AXIS is well known throughout the industry for its risk selection and the quality of its underwriting. And we have as good a quality of underwriting in that line of business as we have every other line of business. We've been writing this business for year after year for 25 years in different guises. And don't forget that also that we insist that our banking partners have substantial skin in the game alongside us. So we're not shedding their risk to us, we are partnering with them. We also are involved in senior secured positions where we have highly-collateralized positions. Now the value of that collateral, the liquidity of it may change during extreme circumstances but at the end of the day, we have significant ability to recover the amount of insurance -- we're providing an insurance policy, don't forget, that we can recover. Now I come back to our experience and the fact that we have proven time and time again that we're able to recover and renegotiate, it's not only a matter of recovery because it's a matter of renegotiating some of these situations. And we're at the table during those renegotiations as well. So we're not being presented with a fait accompli. It's very difficult because each one of these transactions is different, it stands on its own two feet and it is extremely well underwritten. I have taught myself blue in the face so because we've been going all about the political risk business quite appropriately for probably a year now. But I would hope that we have demonstrated that this is a very carefully-run business and it's a very valuable business to us in the company.

Operator

At this time I would like to turn the conference back over to John Charman, CEO, for any closing remarks.

John R. Charman
Former Director, Chairman of Axis Re and Chairman of Axis Specialty Europe

Well, thank you from taking the time. I know you've had a very busy 24 hours with a number of other earnings call, but we very much appreciate you coming along and listening to us. And I'll just remind you that I'm very upbeat, and my tone is extremely positive. Thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.