3rd June 2016

Sector View

Insurance

Reinsurance: natcats are normalising

	1 M	3 M	6 M	31/12/15
Insurance	1.0%	-0.2%	-15.4%	-12.2%
DJ Stoxx 600	0.9%	1.0%	-10.4%	-5.9%

*Stoxx Sector Indices

Companies covered

AEGON		**NEUTRAL**	**EUR6**
Last Price	EUR4.553	*Market Cap.*	EUR9,775m
ALLIANZ		**BUY**	**EUR180**
Last Price	EUR145	*Market Cap.*	*EUR66,265m*
AXA		**BUY**	**EUR29**
Last Price	EUR22.315	*Market Cap.*	*EUR54,203m*
CNP ASSURANCES		**NEUTRAL**	**EUR15**
Last Price	EUR15.085	*Market Cap.*	*EUR10,358m*
COFACE		**NEUTRAL**	**U.R.**
Last Price	EUR6.865	*Market Cap.*	*EUR1,080m*
EULER HERMES		**BUY**	**EUR99**
Last Price	EUR78.07	*Market Cap.*	*EUR3,329m*
HANNOVER RE		**SELL**	**EUR110**
Last Price	EUR99.86	*Market Cap.*	*EUR12,043m*
MUNICH RE		**SELL**	**EUR185**
Last Price	EUR163.45	*Market Cap.*	*EUR26,324m*
SCOR		**BUY**	**EUR38**
Last Price	EUR29.475	*Market Cap.*	*EUR5,659m*
SWISS RE		**NEUTRAL**	**CHF100**
Last Price	CHF87.95	*Market Cap.*	*CHF32,604m*
ZURICH INSURANCE		**NEUTRAL**	**CHF270**
Last Price	CHF237.6	*Market Cap.*	*CHF35,765m*

National Oceanic and Atmospheric Administration (NOAA) is forecasting a "near-normal" hurricane season (45% probability), suggesting we could see more hurricane activity than we have seen in the last 3 years, which were way below-normal. We calculate that normalised natcat levels, which started in Q2 2016 (earthquakes in Japan and Ecuador, Fort McMurray fire, current flooding in Europe) might lead to a c. EUR2.2bn overall lower operating profit pool for the 4 reinsurers we cover (c. 17% of total 2015 operating profit). Bottom line, the potential for good surprises is minimum on earnings and dividends, which makes the segment unattractive. Sell on Hannover Re and Munich Re, Buy on Scor.

ANALYSIS

- In its just-issued 2016 Atlantic hurricane season outlook, the US National Oceanic and Atmospheric Administration's (NOAA) Climate Prediction Center said this season (June-November) will most likely be near-normal (45%), and highlights that "uncertainty in the climate signals that influence the formation of Atlantic storms make predicting this season particularly difficult". More precisely, NOAA is predicting a 70% likelihood of 10 to 16 named storms (winds of 39mph or higher), of which 4 to 8 could become hurricanes (winds of 74mph or higher), including 1 to 4 major hurricanes (winds of 111mph or higher). These ranges are centered broadly in line with the 1981-2010 period averages of 12 named storms, 6 hurricanes and 3 major hurricanes.
- The probability of an above-normal season is 30%, the probability of below-normal is 25%.
- One of the main factors to predict a more active hurricane season is that El Niño is dissipating, and NOAA's Climate Prediction Center is forecasting a 70% chance that La Niña (which favors more hurricane activity) will be present during the peak months of the hurricane season (Aug.-Oct.).
- This near-normal prediction suggests we could see more hurricane activity than we have seen in the last 3 years, which were way below-normal. Of course, this outlook does not mean that the 2016 hurricane season will certainly have a higher impact on the reinsurers' claims experience. As we have seen in the past, it is not that simple, and even below-normal seasons can still produce catastrophic events, just like the 1992 season in which only 7 named storms formed, yet the first one was Andrew, a category 5 major hurricane that devastated South Florida (at the time of its occurrence in August 1992, Andrew was the costliest hurricane in US history, ranking #5 today). In the final analysis, claims costs also depend on where hurricanes hit (wealth concentration or not).
- True, Q1 2016 was once again way below natcat budgets (only 0.5 pt on average for the 4 reinsurers we cover). However, Q2 2016 should be more in line with budgets following the earthquakes in Japan and Ecuador, the Fort McMurray fire and the current flooding in Europe. Assuming Q3 is also in line with budget in a scenario of a near-normal hurricane season, the spread between FY 2015 (2.2 pt on average) and FY 2016 (6.5 pt expected on average) could lead to a c. EUR2.2bn overall lower operating profit pool (c. 17% of total 2015 operating profit), all other things being equal. Of course, this is already priced in by consensus, with 2016 earnings' expectations below 2015 levels, but this means that the potential for good surprise is minimum. Similarly, dividends are solid at last year's level, but the potential for good surprise is minimum.
- This would theoretically be good for natcat prices. The current unbalance between risk and capacity would require more than a normalised natcat claims experience to resolve.
- We remain cautious on reinsurers, with Sell recommendations on Hannover Re and Munich Re, and only Scor rated as Buy.

VALUATION

- The reinsurers we cover are trading with a 5-10% premium to major primary insurers,
- We expect the development of natcats overs the next few months to have an impact on the relative performance of both segments.

NEXT CATALYSTS

- No major identified catalysts prior to Q2 numbers (starting end-July).

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Distribution of stock ratings

BUY ratings 55.9%　　NEUTRAL ratings 34.3%　　SELL ratings 9.8%

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