Sector View

Insurance

Top Picks Q3: Blind spot

	1 M	3 M	6 M	31/12/15
Insurance	-17.2%	-14.5%	-25.4%	-28.4%
DJ Stoxx 600	-6.9%	-3.6%	-10.0%	-12.9%

*Stoxx Sector Indices

Companies covered

AEGON		**NEUTRAL**	**EUR6**
Last Price	EUR3.036	*Market Cap.*	EUR6,546m
ALLIANZ		**BUY**	**EUR180**
Last Price	EUR119.2	*Market Cap.*	*EUR54,474m*
AXA		**BUY**	**EUR29**
Last Price	EUR16.305	*Market Cap.*	*EUR39,527m*
CNP ASSURANCES		**NEUTRAL**	**EUR15**
Last Price	EUR12.375	*Market Cap.*	*EUR8,497m*
COFACE		**NEUTRAL**	**U.R.**
Last Price	EUR4.336	*Market Cap.*	*EUR682m*
EULER HERMES		**BUY**	**EUR99**
Last Price	EUR70.6	*Market Cap.*	*EUR3,011m*
HANNOVER RE		**SELL**	**EUR110**
Last Price	EUR89.35	*Market Cap.*	*EUR10,775m*
MUNICH RE		**SELL**	**EUR185**
Last Price	EUR141.2	*Market Cap.*	*EUR22,741m*
SCOR		**BUY**	**EUR38**
Last Price	EUR25.365	*Market Cap.*	*EUR4,870m*
SWISS RE		**NEUTRAL**	**CHF100**
Last Price	CHF80.55	*Market Cap.*	*CHF29,860m*
ZURICH INSURANCE		**NEUTRAL**	**CHF270**
Last Price	CHF226.6	*Market Cap.*	*CHF34,110m*

LOOKING BACK ON Q2 2016

The DJ Stoxx Insurance lost 11% over the quarter, underperforming the market by more than 800bps (DJ Stoxx600 down 2.3%). Companies we cover have lost 10% on average, and 5% including dividends. The top performers were Zurich, CNP, Swiss Re and Euler Hermes whereas the worst performers were Aegon, Munich Re, Coface and Scor.

Of course the major event of Q2 was market turbulence associated with Brexit, which overnight disrupted most financial markets around the world and created a massive flight to quality (lower rates on major benchmarks, stress on credit spreads and equities, higher volatility).

The strong market reaction by insurance stocks we cover was not based primarily on potential operating issues (UK is not a central part of the business of the companies we cover, basically between 5% and 10% of operating profit), nor due to FX (in most cases the potential negative impact of the drop in the GBP was more than offset by the rise in the USD, where the share of business is much higher, up to 45%), nor earnings (potential losses on assets are minimal at this stage), but due to solvency.

Indeed, flight to quality and stress on more risky assets represent a major stress scenario for solvency margins in a Solvency II environment, which only came into force a few months ago (i.e. still a limited market education and back-testing). And of course potential pressure on solvency margins means potential pressure on dividend prospects, which have acted as a powerful catalyst for the sector in the last years. Remember most insurance companies gave precise dividend guidance as long as their solvency margin remains in a comfort area. Should they break it, dividends might be at risk.

Considering Q1 solvency margins levels and Q2 market events, our view is that the impact on solvency margins is only limited, at this stage. But the more rates go down, the higher the pressure will be…

WHAT WE SEE FOR Q3 2016

Please tell me about financial markets… Q3 2016 is a particularly tough call in general, and more particularly for insurance, as it remains very sensitive to very nervous financial markets.

Since Brexit, we experienced a few days of intense market stress, followed by some relief (screaming buys, hope of central bank interventions…), and then another round of market pressure. In this context, the insurance sector should remain very volatile, which is consistent with the mountain of uncertainties we are currently facing. And we all know how scary financial markets could be during the summer …

On top of that, Q2 2016 results should come under pressure across the board. Underwriting results should suffer from i/ higher claims experience, mainly driven by higher natcats, with significant earthquakes in Japan and Ecuador, a devastating fire in Canada, and major flooding in western Europe and ii/ lower commissions on asset management and unit-linked products (S&P500 down only 1% yoy on average but Stoxx50 down 18% yoy on average). We may also see lower capital gains and some equity impairments.

CONCLUSIONS AND TOP PICKS

Considering poor short-term visibility, at least until companies report their Q2 numbers (starting end-July), we believe it is wise to restrain from any insurance companies in our quarterly Top Pick list.

For longer term investors, and provided the stress on financial markets does not increase too much, we believe current prices offer very attractive (re)entry points, especially for AXA and Allianz. On the other side, if the markets remain bumpy during the summer, reinsurers, Zurich and Allianz offer more defensive profiles than average.

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Stock rating

BUY
Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL
Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL
Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56.8% NEUTRAL ratings 33.8% SELL ratings 9.5%

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