

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

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