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What Catastrophe? It's Time to Buy Insurance Stocks

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Illustration by Tara Jacoby

Investors tend to dump insurance stocks at the height of a catastrophe, fearing how large losses will get. History suggests they should be buying instead.

Sure enough, shares of property and casualty, or P&C, insurers followed the familiar pattern as the coronavirus pandemic spread: The S&P 500's insurance components plummeted 45% from a 52-week high set in February, and remain down about 20% year to date. The decline reflects investors' fears that insurers might be forced to cover pandemic-related losses not included originally in policies.

These fears are reasonable but seem overblown, as any losses are likely to be far less than the $150 billion of market value wiped out at the depths of the recent selloff. The Society of Lloyd's, better known Lloyd's of London, estimates pandemic-related losses will total about $100 billion, while Willis Towers Watson, an industry broker and data provider, puts the industry's maximum estimated loss at $80 billion.

Therein lies opportunity for investors. Among P&C companies, Hartford Financial

Services (ticker: HIG) and Chubb (CB) look particularly well-positioned, given their balance-sheet strength and demonstrated ability to compound value over time. Shares of both are depressed based on price to book value, and could rally as Covid-19-related losses become clearer and as industry pricing improves.

Post-Catastrophe Plays

Chubb and Hartford are trading below historical multiples of earnings and book value. Both P&C insurers have strong balance sheets and a history of growth.

	Recent Price	**12-Mo Change**	**Maket Value (bil)**	**2022E EPS**	**2022E P/E**	**Price/Book**	**Divic Yield**
Chubb / CB	$123.71	-15.5%	$55.8	$11.11	11.1	1.1	2.5%
Hartford Financial Svcs / HIG	39.23	-25.2	14	5.54	6.9	0.9	3.4

E=Estimate

Source: Bloomberg

While most P&C losses stem from property damage or injury to people, that isn't the case with potential claims tied to the current pandemic. They relate, instead, to business interruption, mortgage nonpayment, employee disputes, and other losses that are harder to estimate and process.

Yet, there is reason for optimism: Insurance rates typically improve after a catastrophe, as the industry reassesses insured risks. For instance, 2011 was a big year for P&C losses. Hartford's stock fell almost 40%. But pricing rose 8% in 2012, compared with 4% the prior year, and Hartford's shares rebounded by 38%. They added another 61% in 2013.

"You want to pick up insurance stocks at the beginning of a pricing cycle," says Tony Scherrer, director of research and a portfolio manager at Smead Capital Management.

There have also been some positive developments on the legislative front that could help the stocks. Groups representing businesses decimated by the pandemic, such as restaurants, are working with the insurance industry and government to create a fund similar to national flood insurance that would pay business-interruption claims resulting from Covid-19, the disease caused by the coronavirus. The alternative could be litigating thousands of individual cases—a fear that has weighed on investor sentiment lately.

Hartford, for one, is still down 35% this year. But the company, which dates to 1810, has an investment-grade rating and a stable outlook. Hartford has $50 billion in total investments and $45 billion in insurance reserves, or money set aside to pay estimated

claims from policies written. Those are the liabilities eventually owed to policy holders.

The company has a market value of about $14 billion, and the book value of its equity—the cushion it has to pay claims above what has already been reserved—totals $15 billion. At around $39, Hartford trades for less than book value, compared with a historical multiple of 1.2 times book.

Hartford CEO Christopher Swift doesn't think Covid-19 will create an existential crisis for the industry or his stock. "There are a lot of unknowns still of how this crisis is going to play out," he said at a recent investor conference. "But I am confident about The Hartford's ability to manage the coming quarters."

Wall Street expects Hartford to earn $4.65 a share this year, down from $5.65 in 2019. But earnings could rebound to $5.54 or so by 2022 as pricing and underwriting margins improve. About 75% of analysts covering Hartford rate it the equivalent of Buy; analysts' average price target is about $50. MKM Partners analyst Harry Fong bases his $50 price target on a supposition that the shares will trade for book value in 2021.

Chubb, whose stock is down 21% this year to $124, provides commercial and personal P&C insurance and other products. It has $105 billion in total investments and $84 billion in insurance reserves. Chubb's market value is about $56 billion and the book value of its equity is $52 billion. Its shares trade for just over one times book value, versus a historical 1.3 times.

Chubb is expected to earn $9.72 a share this year, down from $10.11 in 2019. But analysts forecast earnings of $11.11 by 2022.

About 55% of Wall Street analysts covering Chubb rate the stock the equivalent of Buy, with an average price target of almost $135 a share. Raymond James analyst Gregory Peters has a price target of $130, based on his estimate that the shares will trade up to 1.1 times next year's estimated book value.

The SPDR S&P Insurance ETF (KIE) is another way to gain exposure to the sector. It is down 23% year to date. Stocks in the fund trade for about 10 times estimated 2022 earnings, a slight discount to its historical average.

There is no reason to fear insurance stocks. Just don't buy them at the wrong time.

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