Swiss Re

Market recap

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Industry developments

U.S. reinsurer results for the first quarter of 2004 show underwriting diligence is paying off with the members of the Reinsurance Association of America (RAA) posting a combined ratio of 94.0%. This compares with 96.4% in the first quarter of 2003. Premiums were actually lower in the first quarter of this year, with gross written premiums of US$11.7 billion (Q1 2003: US$12.6 billion), and net earned premiums of US$6.9 billion (Q1 2003: US$7.5 billion). But the industry's loss ratio dropped over the period to 67.6% from 71.3% a year ago, partially offset by a 1.3% increase in the expense ratio. The industry's investment gain in the first quarter of 2004 was a whopping US$188 million, up substantially from the US$8.9 million underwriting profit posted in the first quarter last year.
(Canadian Underwriter - May 30, 2004)

Heavily outclassed in the global arena, and propped up by overseas parent companies, U.S. reinsurers remain on a negative ratings outlook, according to a report by Standard & Poor's Ratings Services. "From a global perspective, the U.S. market is where all the problems are coming from," said Standard & Poor's credit analyst Laline Carvalho. "A lot of companies have disappeared, many have gone into runoff." Stephen Searby, in Standard & Poor's London office, agrees. "The adverse development in the U.S. has been so significant that it has dragged down the results for the global industry," he said. "The only reason we don't have more negative outlooks on U.S. reinsurers is because they bring support from overseas." At first sight, the prospects for U.S. reinsurers may appear bright, with members of the Reinsurance Association of America (RAA) achieving near breakeven performance on a pure underwriting basis in 2003 and an overall return on revenue (ROR) of 17%. But a deeper look reveals disturbing trends. Stripping out the results for National Indemnity Co., which significantly distort industry figures, losses and expenses outstripped premium income for the RAA group by 6 % in 2003, and ROR was 11.6%. The U.S. reinsurance industry has managed an average ROR of just 2.5% over the past 10 years, and a 14-year average of 4.2%. "That's fairly poor for the risk and volatility inherent in the reinsurance business," said Carvalho.
(Standard & Poor's - June 14, 2004)

In a research note June 10, Lehman Brothers downgraded the p&c sector to neutral from positive, citing increasing evidence of soft-market conditions in the commercial and reinsurance sub-sectors. Analyst Chris Winans said the commercial lines sector is suffering from weakness in rates with the Council of Insurance Agents and Broker's quarterly rate survey indicating that rates for midsized accounts in the first quarter were flat with the comparable period one year earlier, while large commercial rates were down 2.3%. Winans said that a dropoff in rates, combined with increasing anecdotal evidence from intermediaries that there will be increasingly competitive pricing behavior resulting in "inadequate" rates over the next two to five years. He said that property and directors and officers insurance lines are clearly showing softness while property catastrophe insurance and environment coverages remain stable. Morgan Stanley also weighed in, with analyst William Wilt saying that the industry itself will be under pressure as premium rates fall, interest rates are expected to rise and underwriting margins approach peak levels.
(Dow Jones Newswires - June 10, 2004)

Industry developments

The percentage of commercial real estate owners that purchased terrorism insurance rose in the first quarter to the highest level since enactment of the Terrorism Risk Insurance Act in 2002, according to new data compiled by insurance broker Marsh Inc. The data, released June 16, show that 52% of commercial real estate owners purchased the insurance in the first quarter, up from 28.1% in the fourth quarter of 2003. Overall, 44.2% of U.S. businesses obtained coverage in the first quarter of 2004, also the highest take-up rate since the act was signed into law, according to Marsh. The figures include renewals and initial purchases of coverage.
(The Wall Street Journal - June 16, 2004)

Rhode Island has become the latest U.S. state to allow insurers to exclude terrorism from certain commercial risks in its standard fire policy. The move has been welcomed by insurers who described Rhode Island's previous system as "antiquated" and said the system created conflict with provisions in the federal Terrorism Risk Insurance Act (TRIA). Both houses of the legislature in Rhode Island passed the new rules at the beginning of June, bringing the state into line with Louisiana, Michigan, Minnesota, Nebraska, New Hampshire, Oklahoma and Virginia, which have passed similar laws.
(Insurance Day - June 15, 2004)

The Treasury Department said June 18 it will extend a provision requiring insurance companies to offer coverage for losses due to acts of terrorism. The requirement would have expired at the end of the year. The department, which had until September 1 to determine whether to continue the provision, said it was acting now to avoid any potential disruption to the terrorism-risk insurance market. Treasury is currently gathering information for a congressionally required study of the law's overall effectiveness, the department said. "By extending the 'make available' provision, we ensure that our overall evaluation of the program's success is based on information and assumptions that are consistent and that there's no changing of the rules in the middle of the game," Treasury Secretary John Snow said.
(Associated Press - June 18, 2004)

Bucking the trend of recent years, U.S. homeowners' insurance rates are expected to rise by just 2.8% in 2004, according to the Insurance Information Institute (III). This represents the smallest increase in five years, with 2003 seeing a 7.4% hike in rates. In fact, this year average rates should be US$608, up from US$591 in 2003. This is based on data from the U.S. Bureau of Labor's consumer price index. "Small decreases in the frequency and cost of claims have helped improve insurer financial performance, resulting in a significant moderation in the cost of homeowners' insurance in 2004," says Robert Hartwig, chief economist for the III. The recent jump in homeowners' insurance rates came as a result of several factors – high numbers of new home owners, mold litigation, and catastrophe losses. In 2003, homeowners' insurers paid out $1.03 in claims on every premium dollar collected, coming on top of underwriting losses in the homeowners' line of US$13.5 billion between 2000 and 2002. Natural disasters exacted a heavy toll last year, resulting in US$13 billion in claims. Many homeowners remain underinsured. Almost two-thirds of Americans are underinsured by an average 27%. Insurers are looking at ways to better calculate home values, but also urge consumers to look at "inflation-guard" endorsements which take into account annual growth in building and reconstruction costs.
(Canadian Underwriter Online - June 2, 2004)

Lawsuits and liability insurance cost American businesses $128.8 billion each year. An estimated 4.4 million U.S. small businesses, with annual sales between $1 million and $4.9 million, pay more than half of those costs, according to a study released June 8 by

the U.S. Chamber of Commerce. Small businesses pay about $75.8 billion of the total bill, with larger corporations paying the other $53 billion, said the study by NERA Economic Consulting. Lisa Rickard, president for the chamber's legal-reform institute, emphasized at a press conference on Capitol Hill June 8 that lawsuits and litigation insurance are quickly outpacing other costs that business owners face, such as health care. "What's important to note is that 44% of these costs to small businesses are paid out-of-pocket" as opposed to paying through insurance, she said. Larger companies, with annual sales of $10 million, have an average tort bill of $150,000 while small businesses with less than $1 million in annual sales have an average bill of $17,000 each year, the study said.
(The Washington Times - June 9, 2004)

Early results for 2004 show European reinsurers sticking to their guns on price, with premium income dropping but profits rising. In a new report from Benfield Group, the first-quarter results of Converium, SCOR, Munich Re and Hannover Re (the only European reinsurers who report quarterly), show an average 17% drop in premium income, indicating the race for marketshare is not yet back on. Converium was the only insurer to increase premium income for the quarter, up 10% over the same period a year ago, although some of this was owed to favorable currency translation as the reinsurer reports in U.S. funds. Benfield notes that pricing trends remain favorable through April 1 renewals, despite analyst fears of an early return to price competition. "Senior management of the European reinsurers are adamant that they will maintain underwriting discipline as the cycle turns, and are prepared to sacrifice volume for profitability," the quarterly report notes. Losses were not a significant factor in the early part of 2004, despite an uptick in large losses but an absence of major catastrophes. Investment returns were flat or lower overall for the group, although the report suggests the recovery of stock markets did increase the potential for realized gains. Converium, Munich Re and Hannover Re each saw realized gains grow significantly. Despite strong results, and a notable lack of rating agency downgrades in the first quarter, Benfield says the industry is unlikely to return to its former "AAA" rating status. "The industry has become more concentrated around the current average rating of approximately 'AA-'."
(Canadian Underwriter Online - June 22, 2004)

Despite much talk of the need to "tame the insurance cycle", buyers should prepare themselves for continuing fluctuation in the price and availability of insurance, John T. Sinnot, senior advisor, Marsh & McLennan Cos. told delegates to the World Insurance Forum in Bermuda June 8. "Past prediction declaring the cyclical nature of our business has gone away have always been wrong." Sinnott says. "Risk is a dynamic rather than a static element in our society." This has been no more evident than in the changing picture of risk seen since 9/11, not only with increasing awareness of the potential severity of man-made catastrophes such as terrorism, but also in the rising aspect of asbestos litigation and corporate governance. Taken as a whole, he says, "you have the ingredients for continued volatility in adverse directions in claims trends. Bottom-line, cycles are something we're going to have to manage our way through."
(Canadian Underwriter Online - June 8, 2004)

Profits for Canada's p&c industry soared in the first quarter of the year, with federally registered companies reporting income of $895 million, five times the $176 million earned in first-quarter 2003. Insureds paid $6.7 billion in premiums, $1.3 billion or 25% more than the year-earlier period, and insurers paid out 14% more for loss claims and expenses. According to Mark Yakabuski, Ontario region vice president for the Insurance Bureau of Canada, "As people renewed in the first quarter, we were seeing a stabilization or actual decline in average premiums per insured auto, home and

commercial property." Already, he said, average premiums for Ontario motorists renewing policies were about 6.7% lower in late March than last November.
(The Toronto Star - June 2, 2004)

Standard and Poor's has upgraded its outlook for Canada's insurance industry, thanks to a dramatic turnaround in financial performance last year and a 20% rise in auto insurance premiums. The property and casualty business as well as the life insurance sector have been upgraded to "stable" from "negative," S&P said. Canadian property and casualty insurers generated a return on equity of 11.3% in 2003, compared with 1.7% a year earlier. "The key reasons for the improved results were an increase in premiums, which rose by about 20% during the year; reduced claims experience; and improved investment income." The strong performance also came despite a big loss by the Facility Association. The report noted that while the prospects for 2004 are positive, the property and casualty insurance industry continues to face substantial uncertainty. Several provincial governments have introduced rate roll-backs for auto insurance in return for changes to claims procedures. The full effect of those cuts will likely hit insurers in 2005. "There is much to be optimistic about for the [property and casualty] insurance industry; however, uncertainty about the industry's long-term profitability still remains," the report said. "Earnings and underwriting profitability will continue to be volatile."
(The Globe and Mail - June 21, 2004)

Legal developments

On June 2, a California jury ordered Ford Motor Co. to pay at least $122 million in compensatory damages to a woman paralyzed in a rollover accident, the first setback in a string of lawsuits involving the Ford Explorer, after it had previously won 11 rollover lawsuits involving the popular SUV. The trial involved a January 2002 accident east of San Diego. Driver Benetta Buell-Wilson swerved to avoid a metal object and lost control of her 1997 Explorer, which rolled 4-1/2 times. Buell-Wilson, a 49-year-old mother of two, was permanently paralyzed from the waist down when the roof collapsed on her neck. Dennis Schoville, Buell-Wilson's attorney, said Ford declined to follow its engineers' suggestions to widen the Explorer's wheel track or to lower its centre of gravity - costly changes that would make the vehicle more stable. Concern about costs also kept Ford from sufficiently reinforcing the Explorer's roof to protect passengers in a vehicle "they know is going to roll over," he said. On June 3, the jury awarded the woman an additional $246 million in punitive damages, making the award one of the biggest ever against the automaker.
(CBC - June 2, 2004)

German chemicals-to-drugs conglomerate Bayer AG has reached out-of-court settlements in 2,710 cases related to its Baycol anti-cholesterol drug, which it pulled from the market in August 2001. Bayer said 8,563 lawsuits are still pending, lower than the 8,895 figure given in its May update. A spokesman later said the cases settled so far have cost the company $1.04 billion. In March, Bayer reached an agreement with most of its insurers, securing $1.2 billion in insurance coverage for the litigation.
(Dow Jones Newswires - June 16, 2004)

The Ontario Court of Appeal has ordered a Vancouver man to pay Barrick Gold Corp. $125,000 in damages for conducting an Internet libel campaign involving voluminous postings on numerous stock market chat Web sites. When Barrick first launched its suit against George Lopehandia in the fall of 2002, Justice Katherine Swinton found that though Mr. Lopehandia's postings were defamatory, they were unlikely to be taken seriously because of their "emotional, often incoherent" content. She ordered Mr.

Lopehandia to pay damages of $15,000. But in a judgment issued June 4, the appeal court set aside that decision, arguing that "the Internet is one of the most powerful tools for communications ever invented" and that in the hands of Mr. Lopehandia it became a potent weapon. The appeal court ordered general damages of $75,000 and punitive damages of $50,000.
(The National Post- June 8, 2004)

Settlement Class Counsel announced June 11 that Ontario recipients of Dow Corning Breast Implants will be eligible to receive payments under a settlement reached with Dow Corning, in the first class action ever certified in the province of Ontario. The action was certified on August 26, 1993 and settled in 1998, but implementation of the settlement had been delayed during legal appeals and other matters surrounding Dow Corning's complex and only recently concluded bankruptcy proceedings in the United States. Under the Agreement, $24.2 million will be paid out over the next seven years to compensate Ontario women who received breast implants manufactured by Dow Corning. Compensation will also be available for women who received implants containing raw materials manufactured by Dow Corning and some eligible family members of breast implant recipients.
(Canada Newswire - June 11, 2004)

Accidents and natural catastrophes

Eighty-three tornado sightings left scattered damage in eight states and one person dead in the hardest hit community, a southern Indiana town. A powerful band of severe storms stretched from Texas to the Great Lakes on Sunday, May 30, sweeping eastward from Missouri to Kentucky, smashing homes and downing trees and power lines. At least seven tornadoes were reported in and near Indianapolis, the National Weather Service said. A string of twisters also ravaged north-central Kentucky and southern Indiana as weather officials scrambled to issue warnings. The Weather Service had issued tornado warnings from eastern Texas up into Wisconsin and Minneapolis and east to Ohio, and from the Middle Mississippi Valley to the Ohio River Valley. Storm damage also was reported in the St. Louis area and in Louisville. A tornado touched down about 4 p.m. in Ballardsville, Kentucky, just north of Louisville. In Harrison County, Kentucky, witnesses in the storm's path reported wind damage and debris.
(CNN - May 31, 2004)

Wind gusting to 70 mph and hail the size of baseballs pounded the Texas Panhandle June 22, smashing almost all of the windows on one end of a six-story hospital in Amarillo, where one patient was injured by flying glass. About 30 rooms in the 410-bed hospital were affected and about 100 patients had to be moved to other rooms. Homes and vehicles were damaged by hail up to baseball size. Windows also were smashed on cars on some dealers' lots, and a Wal-Mart Super Center closed because its skylights were shattered. Heavy rain flooded some underpasses and rural roads. Storm spotters reported several twisters in the Amarillo area, including one along Interstate 40.
(Associated Press - June 22, 2004)

The death toll from a strong earthquake in northern Iran May 28 rose to 45 by June 1, with over 200 wounded. Fearing another earthquake, many Iranians spent the night in nearby parks hours after the 6.3 magnitude quake jolted their homes about 70 kilometres (45 miles) north of Tehran. The quake was centered between the capital and the Caspian Sea. Iran's state-run news agency, IRNA, reported at least 64 aftershocks shook the region for 12 hours after the initial quake. It was the first major quake to hit Iran since last December's 6.6 magnitude event that virtually destroyed the ancient city of Bam, killing more than 25,000 people. Friday's quake was centered much deeper than the Bam quake — 26 km (16 miles) instead of a relatively shallow 10 km (6 miles). (CNN - June 1, 2004)

British Columbia firefighters have been battling over three times as many fires this year as compared to last year, said the B.C. Forest Service. On the morning of June 24, there were 313 fires in the province, compared with about 100 the same time last year, fire information officer Cynthia Mann said. She attributes the increase to the dry and warm weather conditions, lightning activity, and fires started by people. Of the 323 fires that occurred by early June of this year, 292 were caused by people.
(The Globe and Mail - June 24, 2004)

News from Swiss Re

On July 1, Swiss Re successfully completed the bookbuilding process for its offering of three year mandatory convertible securities. The offering is expected to generate proceeds of €640 million. The transaction will refinance maturing debt and further increases Swiss Re's financial strength. The instrument will rely on share capital already approved in 2001. Ann Godbehere, Chief Financial Officer of Swiss Re, comments: "With this successful €640 million transaction, Swiss Re continues to improve its financial strength by moving from senior debt to hybrid capital." Swiss Re experienced strong demand for the mandatory convertible securities from a diversified investor base and the issue was heavily oversubscribed. The exercise price was set at CHF 80.41. The securities will automatically convert into Swiss Re shares in three years. The mandatory convertible securities will pay a coupon of 6.125%. Swiss Re will participate in any future share price appreciation of up to 20% of the exercise price. No additional Swiss Re shares will be required to support the mandatory convertible securities. Underlying shares previously committed to Swiss Re's convertible bond issued in 2001 have been reallocated to support the July 1 transaction. The reallocation was made possible by the purchase of call options which offset the exposure to deliver Swiss Re shares under the 2001 convertible bond. The increase in conditional capital approved by the Annual General Meeting of Swiss Re in May 2004 has not been used for this transaction. The mandatory convertible securities will be issued by a non-Swiss fully owned subsidiary and will be fully guaranteed by Swiss Reinsurance Company. Trading on SWX Swiss Exchange is expected to begin around July 23, 2004. The mandatory convertible securities are expected to be rated AA by Standard & Poor's.
(Swiss Re release – July 1, 2004)

Swiss Re, the world's largest life and health reinsurer, announced July 1 it is to acquire the shares of Life Assurance Holding Corporation Limited (LAHC), including its life insurance subsidiary Windsor Life Assurance Company Limited, for £333 million in cash. The transaction will provide additional scale and infrastructure for Swiss Re's Admin Re℠ business in the United Kingdom. The acquisition, which is subject to regulatory approvals, will be the second of Swiss Re's Admin Re℠ transactions in the UK after successfully concluding the acquisition of Zurich Life in 2003. Windsor Life administers more than 800,000 policies with total assets of approximately £5.2 billion. Part of the purchase price of £333 million will be held in escrow and released in accordance with the terms of sale. Admin Re℠ is a service provided by Swiss Re involving the acquisition of books of life and health policies that have been, or will be, placed into run-off. John Fitzpatrick, Head of Swiss Re's Life & Health Business Group commented: "Swiss Re's competitive advantage of a strong capital base and proven experience with managing life business in run-off enables us to offer this solution to the UK's consolidating primary marketplace. With our Admin Re℠ offering, we continue to

see growth opportunities to put our capital to work at attractive rates of return." Jonathan Meggs, Chairman of LAHC and Head of JPMorgan Partners in Europe commented: "I am delighted that LAHC will become part of the Swiss Re Group. LAHC has enjoyed considerable growth and success in its UK life run-off insurance strategy." Jonathan Yates, Chief Executive of LAHC, added: "This transaction is positive news for LAHC, its employees and other stakeholders." The administration under this agreement will be handled by Computer Sciences Corporation. CSC provides administration services for the majority of Swiss Re's Admin Re℠ portfolio in the United States and is Swiss Re's outsourcing provider in the United Kingdom. Swiss Re was advised on the transaction by its wholly-owned subsidiary Fox-Pitt, Kelton (FPK). LAHC was advised on the transaction by JPMorgan.
(Swiss Re release – July 1, 2004)

On July 6, Swiss Re announced that it has been granted a reinsurance branch licence from the Taiwan Ministry of Finance. Swiss Re is the first international reinsurance company to operate a branch in Taiwan. The branch, located in Taipei, will provide comprehensive reinsurance services to clients throughout Taiwan in the property and casualty as well as life and health sectors. Judith CHEN has been appointed General Manager, and will also head the non-life business in Taiwan. POH Chee Kok will lead the life & health business in Taiwan. Swiss Re opened a liaison office in Taipei in 1995.
(Swiss Re release – July 6, 2004)

Miscellaneous

The breast milk of Canadian women contains the second-highest levels in the world of a compound used as a flame retardant in computer casings and household furniture, according to a new survey compiled by Health Canada. The highest amounts of the contaminants, known as polybrominated diphenyl ethers, or PBDEs, were detected in the milk of nursing U.S. mothers. But women in Canada had levels about five to 10 times those in other advanced industrial countries, such as Japan, Sweden, and Germany. The amounts in U.S. women were double those in Canada, and exceptionally high compared to those elsewhere in the world.
(The Globe and Mail - June 5, 2004)

Federal reserve selected interest rates

Instruments	May	June
Federal funds	1.00	1.03
Commercial paper		
Non-financial		
1 month	1.00	1.13
2 month	1.04	1.22
3 month	1.07	1.34
Financial		
1 month	1.02	1.15
2 month	1.08	1.26
3 month	1.16	1.39
CDs (secondary market)		
1 month	1.05	1.21
3 month	1.20	1.46
6 month	1.46	1.76
Bank prime loan	4.00	4.00
Discount window borrowing	2.00	2.01
U.S. gov't securities		
T-bill (secondary market)		
4 week	0.89	1.02
3 month	1.02	1.27
6 month	1.31	1.60
Treasury constant maturities		
1 month	0.91	1.05
3 month	1.04	1.29
6 month	1.33	1.64
1 year	1.78	2.12
2 year	2.53	2.76
3 year	3.10	3.26
5 year	3.85	3.93
7 year	4.31	4.35
10 year	4.72	4.73
20 year	5.46	5.45
Inflation indexed		
5 year	1.34	1.41
7 year	1.77	1.80
10 year	2.09	2.15
Interest rate swaps		
1 year	2.03	2.36
2 year	2.90	3.17
3 year	3.53	3.71
4 year	3.98	4.10
5 year	4.33	4.40
7 year	4.79	4.83
10 year	5.21	5.22
30 year	5.76	5.80
Corporate bonds		
Moody's seasoned		
Aaa	6.04	6.01
Baa	6.75	6.78
State and local bonds	5.07	5.05
Conventional mortgages	6.27	6.29

Swiss Re

US economic outlook

July, 2004

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The Fed will likely raise rates in 25bp steps.

The US economy continues to grow at a robust pace. This, coupled with the rise in inflation over the past six months, will keep the Federal Reserve Board tightening monetary policy well into next year. The federal funds rate is now projected to rise to 2.25% by the end of this year and 4.0% by end-2005. The Fed's "measured" pace probably means that it intends to raise rates by 25 basis points for each of the next 11 or so Federal Open Market Committee meetings. If growth or inflation rises sharply, however, the Fed will get more aggressive. Conversely, if growth and inflation moderate, the Fed may skip raising rates at some FOMC meetings. Though employment growth was disappointing in June, with a gain of only 112,000, this is unlikely to be sufficient to deter the Fed — more bad news is needed plus a slowdown in inflation. Real Gross Domestic Product (GDP) is expected to increase 4.6% this year, but higher interest rates will slow growth to 3.7% next year. Rising rates should also dampen inflationary pressures and keep inflation near 2%. In short, the Fed's tightening is expected to successfully lower growth and moderate inflation.

Concerns over a US housing bubble are overblown.

US housing prices are only about 10% higher than should be expected, according to estimates by Swiss Re Economic Research & Consulting (ER&C). The estimate is derived from the determinants of housing prices — income, stock prices and interest rates. Because most people view their homes as assets, declines in interest rates and stock prices through the end of 2002 explain much of the rise in housing prices. Both of those trends have reversed, so the ascent of housing prices will likely slow over the next 12 months. A 10% overvaluation for housing is not a major problem for the US

US Forecast Summary

	History		Forecast →					Annual Data			
	03Q4	04Q1	04Q2	04Q3	04Q4	05Q1	05Q2	2002	2003	2004	2005
Real GDP, % Change, SAAR	4.1	3.9	4.0	4.7	4.2	3.5	3.4	2.2	3.1	4.6	3.7
% Change, Year Ago	4.3	4.8	5.0	4.2	4.2	4.1	4.0				
CPI, % Change, SAAR	0.7	3.6	3.9	1.0	1.5	1.4	2.1	1.6	2.3	2.3	1.9
% Change, Year Ago	1.9	1.8	2.6	2.3	2.5	2.0	1.5				
Core CPI, % Change, SAAR	1.0	1.8	2.9	1.2	1.4	1.5	2.4	2.3	1.5	1.7	1.9
% Change, Year Ago	1.2	1.3	1.8	1.7	1.8	1.8	1.7				
			End of Period					End of Period			
Fed Funds Rate (Target)	1.00	1.00	1.25	1.75	2.25	2.75	3.25	1.25	1.00	2.25	4.00
5-Year Treasury Note	3.3	2.8	4.0	4.3	4.5	4.7	4.9	2.8	3.3	4.5	5.1
10-Year Treasury Note	4.3	3.9	4.9	5.1	5.2	5.3	5.4	3.8	4.3	5.2	5.5

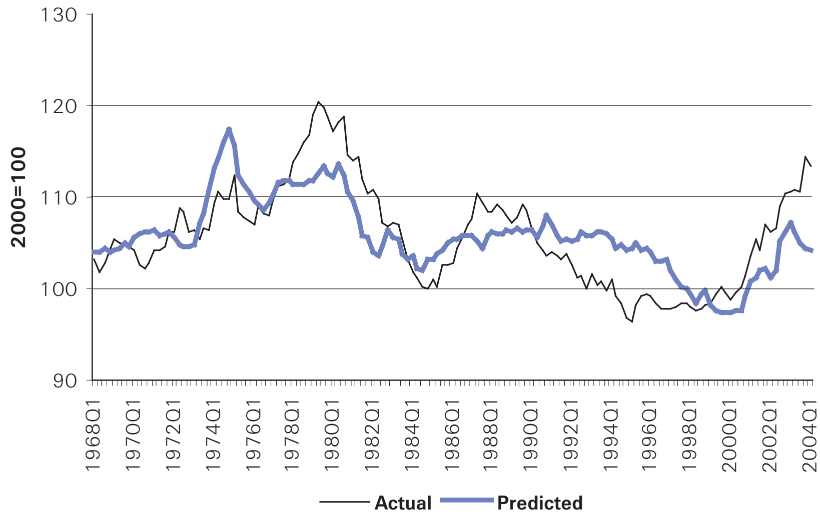
Forecast prepared by Swiss Re Economic Research & Consulting, New York economy. If housing prices fell 10% tomorrow and stayed down, real GDP growth would slow by about 0.3% this year and next, assuming that consumers decrease their spending by four cents for every dollar decline in wealth.

The stock market is fairly valued, making a crash less likely.
Newly published research by Swiss Re ER&C concludes that the stock market was "fairly" valued at the end of 2003, making a stock market crash less likely. The report, "The US equity risk premium: framing reasonable expectations," (available upon request) uses four distinct approaches to estimate the equity risk premium (ERP), the difference between the expected return on stocks and the return on cash. Though the ERP averaged 6.5% from 1950-2003, it is near 3% today. The annual expected return to stocks over the next decade is 6 to 7%, assuming inflation averages 2.5% and real S&P 500 earnings increase at their historical average of 1.7%.
US Forecast Summary

Home sales soared but auto sales soured.
New and existing home sales reached record levels in May, confounding pundits who expected the 82 bp March-to-May rebound in mortgage rates to slow sales. Existing home sales rose 3% to a 6.80 million unit annual pace, while new home sales surged 15% to a 1.37 million pace. Vehicle sales, by contrast, were a major disappointment, falling from a 17.8 million unit pace in May to 15.4 million in June – their poorest showing in five years. Chain store sales have also softened, with year-over-year growth slipping in recent weeks from 5.5% to 4.2%, the lowest growth rate since late January.

Manufacturing continues to expand and confidence has picked up.
The manufacturing sector continues to grow rapidly. Manufacturing output rose a healthy 0.9% in May after a 0.7% gain in April and is up 6.3% year-over-year.

Actual and predicted ratio of real housing price to real income per household .



The gap between actual and predicted is similar to 1978 gap and will likely narrow over the next few years as interest rates rise.

This momentum carried into June. The ISM index registered 61.1 which, though down slightly from 62.8 in May, was its eighth consecutive month above 60. Consumer confidence is rebounding on the strength of job gains. The Michigan index rose from 90.2 in May to 95.6 in June, while the Conference Board index leapt from 93.1 to 101.9, its highest level in two years.

All-items inflation will ease as oil prices moderate.
Core inflation, which excludes food and energy prices, subsided a bit in May, rising only 0.2%, compared to increases of 0.4% and 0.3% in March and April. Though oil prices have eased recently, they are still up from late last year, so the fourth quarter y-o-y inflation of the all-items index should be 2.5% this year and moderate to 2.1% next year.

The outlook for the federal deficit continues to improve.
The twelve-month moving average of federal budget deficits fell in May to $428 billion from $455 billion in April. If this trend continues, the deficit could be close to $400 billion this fiscal year, which ends in September.

The yield on the 10-year Treasury note will reach 4.9% to 5.4% by year-end.
With solid growth, increasing inflation and a rising Fed funds rate, the yield on the 10-year Treasury note will mostly range between 4.3% and 4.8% for the next couple of months. The Fed funds rate will likely be 2.25% by year-end 2004 and close to 4.0% by the end of next year, depending on the strength of the economy and the tameness of inflation. The yield on the 10-year note is closely linked to trend growth (3.1% or more) and expected inflation (about 2%), plus some premium for the federal deficit. Hence, while the Fed is moving to "neutral" on the Fed funds rate, estimated to be 4.0%, the yield on 10-year T-note will climb to 4.9% to 5.4% by year-end 2004 and 5.3% to 5.8% by the end of 2005. As the entire yield curve flattens, the spread between the 10-year and 5-year Treasury notes will gradually narrow to within 50 bp by the end of 2005.

Swiss Re

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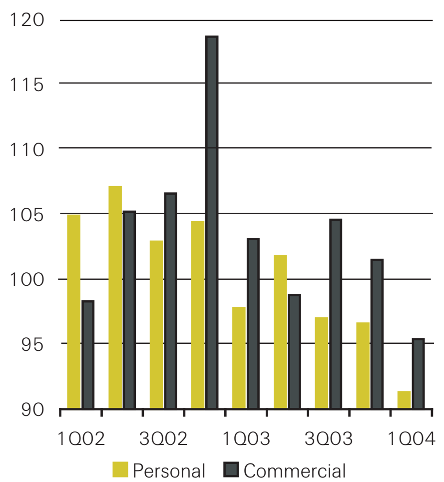
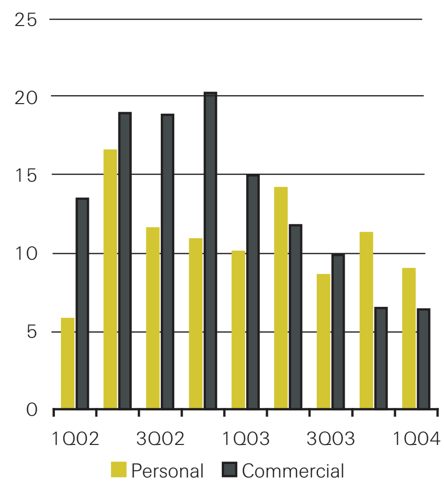
NPW is expected to grow 6-7% this year.
The property/casualty industry reported improved first quarter 2004 profitability with an annualized ROE of 16%. Industry 1Q 2004 net income was $13 billion, up 108% from a year ago, due to significant improvements in technical profitability (a 1Q 2004 combined ratio of 93.3), 5% growth in investment income, and realized capital gains that more than tripled. P&C 1Q 2004 net premiums written grew 7% after 13% growth in 2003. Commercial lines premium growth slowed, while personal lines maintained their momentum. According to A.M. Best, 2003 personal lines 1Q 2004 NPW were up 9%, compared to 10% a year earlier. Meanwhile, commercial lines NPW grew by 6%, down from 15% in the previous year. For 2004 we expect total net premiums written to grow by 6 to 7%, mainly driven by commercial casualty and personal lines.

The combined ratio will improve to 99 for the full year 2004.
The 1Q 2004 combined ratio fell to 93.3 from 97.8 in the previous year, helped by a low incidence of cat losses. Underwriting results improved as premium growth outpaced growth in losses. Charges for adverse development continued to wind down and were not a significant factor for 1Q 2004 earnings. The personal lines 1Q 2003 combined ratio was 91.3, down from 97.8 in the previous year while the commercial lines combined ratio was 95.4, down significantly from the previous year's 103.5. We don't expect the rest of the year to be as profitable, since the best technical results usually occur in the first quarter. Nevertheless, for the full year 2004 we expect the combined ratio to improve further versus 2003, to around 99.

US insurerrs' combined ratio (A.M. Best)



NPW growth, y-o-y (A.M. Best)



Investment returns improved in 1Q 2004 and net income doubled.
Current investment income was up 4.8% from a year ago. Realized capital gains tripled to $3.4 billion in 1Q 2004, compared to $1.1 billion last year. With both underwriting and investment results improving, net income after taxes doubled to $13.3 billion in 1Q 2004 from $6.2 billion a year earlier. Although one cannot expect the same performance for the next three quarters, we expect improvement in full-year 2004 net income compared to 2003. Earnings growth will be fueled by improvements in both underwriting and investment results. The 2004 ROE should be in the 11 to 12% range.

Investment yields bottomed out in 2003.
Investment results continued to improve, boosting first quarter profitability. Interest rates bottomed in July 2003, with a 10-year Treasury yield around 3.2%, and have risen to a range around 4.6% since. With growth strong and inflation ticking up, the Federal Reserve Board will likely raise rates by about 25 basis points at most of the next FOMC meetings, taking the Fed funds rate to 2.25% by the end of 2004 and 4% by the end of 2005. The yield on 10-year treasuries is expected to reach 5% by the end of the year and to about 5.5% by the end of 2005. Rising interest rates will cause capital losses but improve future investment yields. Hence, we expect the benefits of rising yields to manifest themselves after 2005. Global stock markets cannot be expected to contribute similar capital gains to the bottom line as they did in 2003. Total investment income and realized capital gains will rise roughly in line with NPW growth. The continuation of a low-yield environment will limit the temptation to return to cash flow underwriting habits.

The surplus grew by 25% year-over-year, fueled by operating profits and capital gains.
The industry is rapidly rebuilding its balance sheet. According to A.M. Best, the industry's 1Q 2004 statutory surplus rose by 25% or $72 billion, reaching $361 billion, from $291 billion in 1Q 2002. Additions to surplus were driven by $37 billion in net income after taxes and $30 billion in unrealized capital gains on investments, reflecting the strong recovery in equity markets. The other factors were $12 billion in new funds, $3 billion in miscellaneous surplus changes, and a payout of $9 billion in dividends to investors. Strong operating earnings will continue to grow surplus in the rest of 2004, though, at a slower pace than in 2003 since we do not expect a repetition of last year's stock market performance. First quarter 2004 unrealized capital gains were only $3 billion compared to $11 billion in the fourth quarter of 2003. The inflow of fresh capital is also expected to be significantly lower than in previous years. Paid in capital in 1Q 2004 was only $500 million, comparable to the first quarters of previous years. Financing activities are usually low in the first quarter and not indicative of the full year.

Rating agencies have switched their commercial lines outlook to neutral.
Solvency trends in the industry have improved due to significant increases in insurance rates, balance sheet strengthening, and rebounding financial markets. Consequently, Standard & Poor's has changed its outlook for the US commercial lines sector to neutral. Rating agencies maintain their cautionary stance, with a negative outlook for US reinsurance, albeit approaching stability. They do not consider the improvements in the combined ratio sufficient, given the state of the cycle. Profitability is still subdued by the low-yield investment environment. Given the increased focus on profitability by shareholders, rating agencies, industry analysts, and regulators, we expect the hard market to continue through 2005.

Property/Casualty Industry		Quarterly data (1)					Annual data (2)				
		1Q03	2Q03	3Q03	4Q03	1Q04	2000	2001	2002	2003	2004F
Loss ratio	%	74.7	74.9	76.5	72.6	68.2	81.2	88.4	81.3	74.7	73.2
Expense ratio	%	24.4	24.8	24.5	25.9	24.8	27.8	26.4	25.3	24.9	25.0
Policyholder dividend	%	0.4	0.3	0.2	1.1	0.3	1.2	0.8	0.6	0.5	0.8
Combined ratio	%	99.5	100.0	101.3	99.5	93.3	110.2	115.6	107.2	100.1	98.9
Total investment result	in % of NPE	10.8	13.2	10.9	11.0	12.7	19.4	14.2	12.6	11.7	11.6
Net profit after tax	in % of NPE	6.8	8.4	7.7	7.8	13.3	7.0	-2.2	3.3	7.8	10.2
Net premium written	% change y-o-y	12.2	11.2	10.3	10.0	4.6	4.4	8.9	15.3	9.0	6.8
Surplus	% change y-o-y	-2.0	10.5	17.1	21.6	24.9	-4.5	-8.0	-1.5	22.6	7.5

[1] Source: ISO; [2] Source: A.M. Best; [3] Preliminary / Forecasts by Economic Research & Consulting;