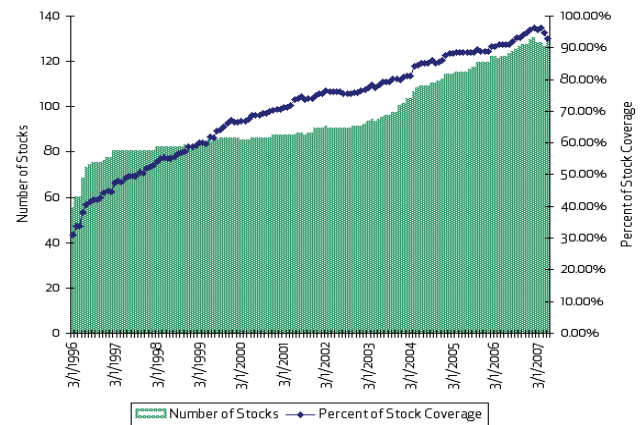


Investment Recipe for Insurance

The development of the Insurance Model reinforces Markit's ideology of leveraging specialty datasets to develop customized stock selection models across sectors and industries. The Insurance Model is the fourth industry specific model in Markit's suite of customized industry specific models, the earlier ones being the Equity REIT Model, the Retail Model, and the Bank and Thrift Model. It was developed to address the demands of the investment managers who have traditionally encountered difficulties in analyzing the financial information of companies. The financial statements of insurance companies are loaded with technical jargons and idiosyncrasies, which has been a major obstacle in fundamental equity analysis.

Markit's Insurance Model is designed to model the inherent differences in the presentation of accounting information between insurance companies and other financial services entities. The model provides a robust platform to help clients enhance their stock selection processes by allowing end users to compare the relative performance of insurance companies on a consistent valuation framework designed to identify stocks with significant alpha generating potential.



Graph 1

THE CASE FOR INSURANCE COMPANIES

The number of publicly traded insurance companies in the U.S. has increased dramatically since the wave of demutualization in the late 90's. Even as late as 1999, two of the largest life insurance companies in the United States, Prudential Financial and MetLife, were mutual insurance companies. The wave of demutualization saw a host of prominent insurers, such as Principal Financial Group, John Hancock, Phoenix Companies Inc and Equitable Cos transforming themselves to publicly traded entities.

Markit's Insurance Universe, which currently consists of 130 stocks, tracks all publicly traded insurance securities listed at NYSE, NASDAQ, Amex and covered by SNL Financials insurance database.

The universe excludes ADR's and Insurance brokers. The graph on the left displays the evolution of the Markit insurance universe over the last 11 years. The number of stocks in the universe has increased three fold from 40 in 1996 to 130 in December 2006.

Table1 (see Page 2) describes the composition of the Markit Insurance universe in terms of market cap and the GICS Sub-Industry classification.

Market Cap Statistics of the Markit Insurance Universe on 8/31/07	Number of Statistics	% of the Universe
Large Cap (Market Cap > 5 Bn)	30	23%
Mid Cap (Market Cap between 1.0 Bn and 5 Bn)	48	37%
Small Cap (Market Cap between 300 Mn & 1 Bn)	31	23%
Micro Cap (Market Cap less than 300 Mn)	23	17%
Mean Market Cap (In Billions of Dollars)	7.02	
Mean Market Cap (In Billions of Dollars)	1.53	

GICS Sub-Industry Classification	Number of Securities	% of the Universe
Life and Health Insurance (GICS Code = 40301020)	25	19%
Multi-Line Insurance (GICS Code = 40301030)	12	9%
Property and Casualty (GICS Code = 40301040)	77	58%
Reinsurance (GICS Code = 40301050)	18	14%

Table 1

LITERATURE REVIEW

Due to the differences between financials and other firms (in terms of GAAP Accounting Rules), many academic studies exclude the financial sector. For example, Fama and French's seminal 1992 paper "The Cross Section in Expected Stock Returns" documenting the size and book-to-market effects excluded the financial sector. A subsequent study done by Barber and Lyon (1997) documented that size and value premium effect on the cross-section of financial firms is similar to the one observed with non-financial entities.

Despite the exclusions mentioned in the previous paragraph, there are a plethora of academic studies that focus on security returns of insurance companies. Staikouras (2007) documented the positive effect on shareholders wealth due to the proliferation of bank-insurance joint ventures. Using a global Bank-Insurance sample, the findings reveal significant abnormal returns especially when firms' performance is compared against the industry index. A control sample using financial institutions that do not pursue Bank-Insurance deals shows negative abnormal returns with much higher magnitude in absolute terms. Further the author examined the impact of Bank-Insurance divestments and documented substantial negative returns for both entities post divestment indicating the market's preference for hybrid structures.

Poloncheck and Miller (1999) study the valuation effects of multiple security offerings by insurance securities. The authors reported a significant negative market reaction to equity, debt and preferred stock issuances by insurance companies post announcement and the magnitude of the negative returns was more than double the returns reported by commercial banks. The authors argue that the negative returns are consistent with market's expectation of adverse selection of investment managers to manage the insurance company's asset portfolio.

Beaver and McNichols (1998) study on "Characteristics and Valuation of Loss Reserves of Property and Casualty Insurers" documents substantial serial correlation in loss reserve development consistent with management exercising discretion over reported loss reserves. The authors document that loss reserve development one year after the balance sheet date has significant explanatory power for firm value and investors can use this information to adjust firm values accordingly.

Brenda, Larry and Gaver (1995) studied the pattern of deployment of free cash flow by life insurers. The authors point out that life insurance companies make sub-optimal use of excess free cash flow by investing in unprofitable projects to the detriment of shareholders and policyholders.

THE MARKIT INSURANCE MODEL

Markit's Insurance Model combines academic insights, data from specialty data provider, broad stock selection themes and practitioners stock picking methodologies to create a unique model for the insurance sector. The seven components or building blocks of the model are described below

Management Quality

The Management Quality component (25% of the overall model) comprising of traditional profitability indicators like Return on Equity, Return on Average Assets, Return on Invested Capital and Growth in Sustainable Revenues measures management's ability to make profitable use of existing capital and assets and achieve above average growth in the topline and bottom-line numbers. The profitability ratios are the key performance indicators for value creation. While consistent Return on Equity and Return on Assets are affected by accrual accounting concepts, Return on Invested capital (ratio of Net Operating Profit after Tax to Invested (capital) eliminates non- value creating components from the financial statements and includes value drivers from other areas of the financial statements. It is a more conservative measure of profitability. There is a trade-off between profitability ratios and financial strength. Companies seeking additional capital to enhance their financial strength or claims paying ability, which is important for consumers, often report lower profitability numbers because the excess capital is invested in high investment- grade bonds which generally have a single-digit after-tax returns. The fourth factor "Growth in Sustainable revenues "measures the Year over Year change in recurring revenues.

Earnings Momentum

The Earnings Momentum component (25% of the overall model) incorporates analyst's expectations for a stock's earnings, the changes in those expectations, the dispersion in the analyst forecast, the earnings surprises and net premium income relative to those expectations. The earnings momentum composite has been one of the best performing factors in the back test yielding an average monthly long-short spread of 200 bps in the Markit Insurance Universe.

Valuation Composite

The Valuation Composite (20% of the overall model) is comprised of five sub- factors and measures the price the market is willing to pay for the insurer's tangible assets, policy revenues, operating incomes, cash flows and estimated earnings for the next fiscal year. One of the factors in the model is Economic Book Value per Share, which draws the analogy from Economic Value Added (EVA) Methodology or also known as Residual Income Models. The valuation composite has done reasonably well in the back tests yielding an average monthly long-short spread of 78 bps

Price Momentum

The Price Momentum component (10% of the overall model) measures long-term price reversal, short term price reversal and medium term Price Momentum along with recent trading volume data to identify those stocks with positive price related sentiment. The Price Momentum composite yielded 142 bps during the back tests in the Markit insurance universe.

Earnings Quality

Earnings Quality component (5% of the overall model) differs across the Insurance universe. The components of this factor include EPS Growth from Capital Gains Derived from the Investment Portfolio, EPS Growth from Adjustments to Policy Reserves and Change in the Level of Reinsurance. These factors seek to identify the effect of window dressing of financial statements and a short -term shift in the operating risk profile to manage the bottom-line numbers and meet the consensus earnings numbers. This factor is intended to identify value traps; therefore it is not an alpha generating factor.

Investment Recipe

Underwriting Performance factors (5% of the overall model) are used to evaluate an Insurer's underwriting performance. The underlying factors in this model are Loss Ratio, Operating Expense Ratio and Combined Ratio. These factors seek to identify companies with good cost structures and conservative underwriting practices. The combined effect of these two attributes should result in above-average operating margins and thereby justify higher valuation multiples. The underwriting composite yielded a long-short spread of 124 bps in the backtesting period over the Markit Insurance Universe.

Investor Sentiment

The Investor Sentiment composite (10% of the model) measures the level of short interest and changes in the amount of short positions held by investors. The objective is to gauge the market's perception of the company's future stock price performance. Factors include: Historical Short Interest Relative to the Trading Activity, Short Interest Level and change in Short Interest Level. The composite reported an average long-short spread of 105 bps in the back-testing period over the Markit insurance.

Composite Model Results & Conclusions

The Insurance Model composite rank is an amalgamation of the seven sub-components discussed in the preceding paragraphs. One of the cardinal rules in model construction is to ensure that the sub-components have low correlation; this ensures that alpha is generated from a diverse set of factors and the volatility of the alpha is controlled.

The rank correlation matrix of the seven sub-components i.e. the building blocks of the model is given in Table 2

	Earnings Momentum	Earnings Quality	Investor Sentiment	Management Quality	Price Momentum	Underwriting Quality	Valuation
Earnings Momentum	1	-0.11	0.12	0.01	-0.17	0.12	-0.08
Earnings Quality	-0.11	1	-0.02	0.09	0	0.03	0.07
Investor Sentiment	0.12	-0.02	1	0.05	-0.05	-0.01	0.08
Management Quality	0.01	0.09	0.05	1	-0.2	0	0.08
Price Momentum	-0.17	0	-0.05	-0.2	1	0	0.13
Underwriting Quality	0.12	0.03	-0.01	0	0	1	0.08
Valuation	-0.08	0.07	0.08	0.08	0.13	0.08	1

Table 2

The sub-components and the model composite were backtested from March 1996 through May 2007. SNL Financials Insurance database was the primary source of GAAP and statutory related data, Compustat was used in those instances where some specific accounting or earnings related data items were not available in SNL's database. The model was controlled for look-ahead bias by lagging the quarterly data items by 45 days and annual data items by 90 days. Analyst estimates were taken from SNL, IBES and First Call.

Table 3 highlights the key statistics of the model.

Insurance Composite Summary Statistics	
Back Testing Period	March 1996 - May 2007
Average 1-Month IC	0.089
Hit Rate for the Information Coefficient	72.39%
Information Ratio	0.65
Average Monthly Long-Short Spread	1.87%
Average Monthly Excess Return Long-Only	0.96%

Historically Backtested Results over the Markit Insurance Universe 3/1/1996 to 5/31/2007 Equally Weighted Portfolios: Monthly -Rebalancing

Table 3

Table 4 highlights the performance of the five quintiles. Quintile 1 consists of the best ranked stocks (long portfolio) and quintile 5 consists of the worst ranked stocks.

Quintile	Average Issues	Ann Avg Returns	Ann Volatility	Sharpe Ratio	Ann Avg Turnover	Avg Quintile Hit Ratio
1	19	26.40%	16.11%	1.64	66.49%	70.37%
2	19	17.44%	14.43%	1.21	123.56%	65.19%
3	19	21.76%	20.30%	1.07	134.29%	66.67%
4	19	13.28%	18.01%	0.74	120.10%	57.78%
5	18	4.28%	13.98%	0.31	59.60%	53.33%

Table 4

The annualized long-short spread is 22.12% for the period March 1996-May 2007.

Graph 3 highlights the performance of the quintiles over the back-testing period.

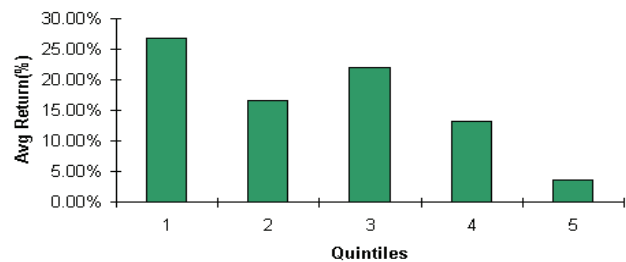
Graph 4 highlights the long-short performance for each calendar year during the backtesting period. With the exception of 1999, when the model was flat, the spreads have been positive and significant emphasizing the alpha generation power of the model.

Graph 5 highlights the predictive power of the model across different holding periods. The Information Coefficient (IC) tends to increase with the holding period and the 6-month holding period has the highest average IC over the backtesting period

We also compared the Insurance model to other multi-factor models developed by Markit. We looked at the average cross-sectional correlations of the Insurance model with four other composite models maintained by Markit over the backtesting period; the models were Value Momentum Model (QVM), Earnings Momentum (EMM), the Relative Value Momentum (RVM) and the Growth Analyst (QGA). The average correlations were 0.32 for QVM, 0.28 for EMM, 0.48 for RVM and 0.30 for QGM indicating that the model achieves the core objective of low cross-sectional correlations, discovering incremental sources of information that are powerful alpha drivers and providing unique insight into the insurance industry.

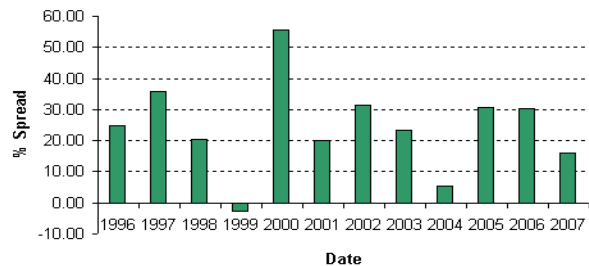
Finally, the Insurance Model has been running live since June 2007. The model has done well in the last 7 months (June 2007 - December 2007). The model has delivered an average monthly long-short spread of 135 bps with a hit rate of 71% and a risk-reward ratio of 1.73

Annualized Average Active Return Across Quintiles



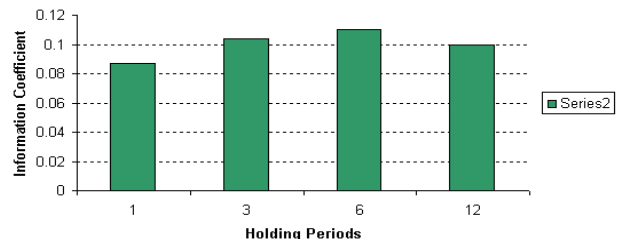
Graph 3

Yearly Top-Bottom Long-Short Spread



Graph 4

Information Coefficient Across different holding periods



Graph 5

(annualized). These numbers have to be seen in the backdrop of a turbulent period in the financial markets due to the sub-prime meltdown and the global credit crunch in the banking industry. The oversell sentiment for the insurance sector has been negative driven by fears and concerns about the solvency of monoline insurance companies and the exposure of insurance companies to CDO's and mortgage-backed securities. The volatility of the spreads, as measured by standard deviation, has been relatively high at 3.55% per month (12.29% annualized) for this period but this again needs to be viewed against the VIX Index, the barometer of market volatility, which spiked up 76% during this period.

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The company provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency.

Its client base includes the most significant institutional participants in the financial marketplace.

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