

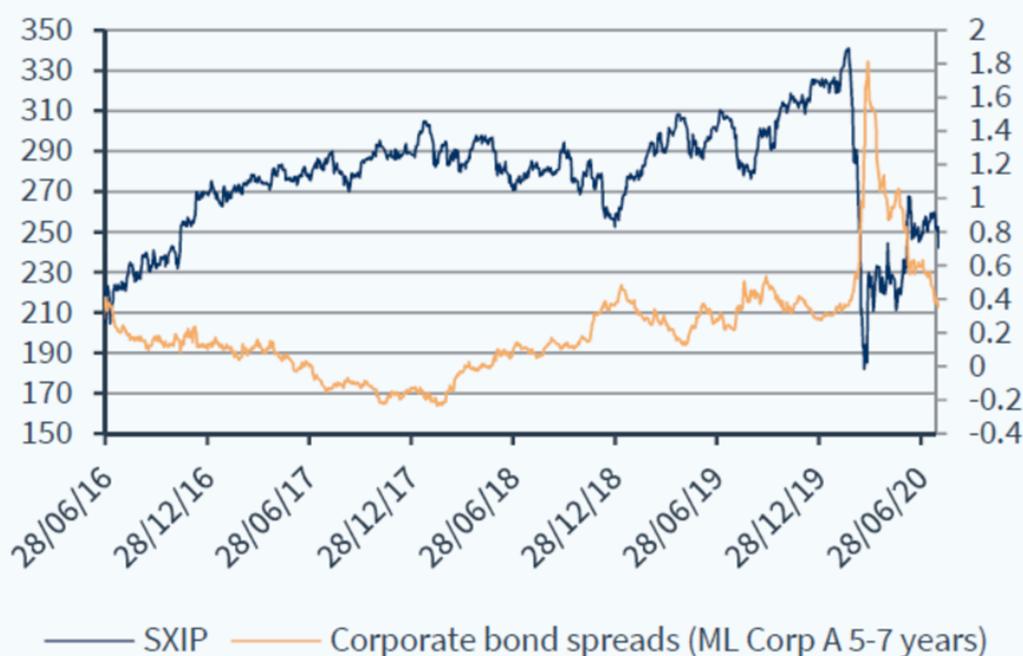


## Friday Morning Coffee

### Nr. 136 — Don't axe the AXA investment case

The stock-market performance of insurers has been historically tightly linked to the evolution of corporate spreads. In case of economic stress, spreads increase as investors want to be remunerated for the increased risk of corporate defaults. This is bad news for insurers who hold large bond portfolios and are heavily invested in corporates in their quest for yield. So it is not as surprise that the European insurance sector underperformed during the pandemic. But hold on a second : spreads have normalized in the meantime. However, stock prices of the insurers have not recovered as can be seen in the graph below from Kepler Cheuvreux. Is it time to have a second look at the sector ?

Chart 1: Sector performance is inversely correlated to spreads...



Source: Bloomberg, Kepler Cheuvreux

We firmly believe corporate spreads may actually matter less to the insurers than their stock price performance suggests. **Indeed, insurers will often hold their bond portfolio till maturity and should be fine for as long as the debtors pay interest and reimburse the principal. Therefore, default rates in corporates are much more relevant.** According to a model developed by Kepler Cheuvreux, a repeat of the 2008-2009 financial crisis and the peak of the Great Depression would have an impact of 1% to 3% on the solvency ratios of European insurers, indeed a very manageable situation.

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In our screenings, AXA stands out as one of the lowest valued European non-life focused insurers on price to earnings and price to book. Axa has indeed traded at a discount since the acquisition of XL Group, a specialist commercial insurance business. The de-risked life division is now smaller than non-life and it has built strong profitable franchises in asset management and health. Axa is today a well-diversified business across divisions and regions making the company more resilient. It has divested the more volatile US life business.

According to our modelling the current valuation implies the company will generate a return on equity of only 5% per year going forward into perpetuity. Over the past ten years the median ROE was 8.8% (source: Bloomberg). The stock trades at 6.9 times consensus 2021 earnings and 0.6 times book. Dividend yield 2021 is now estimated at 8%. In the short term there may be uncertainties around capital return due to regulatory pressure after the COVID-19 pandemic. However, for the long-term investors we are, we see an investment opportunity here and have built a position in our portfolios.

I wish you a nice weekend,

**Léon Kirch, CFA**  
*Partner & Chief Investment Officer*  
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