



MarketStance version 8-1 release notes

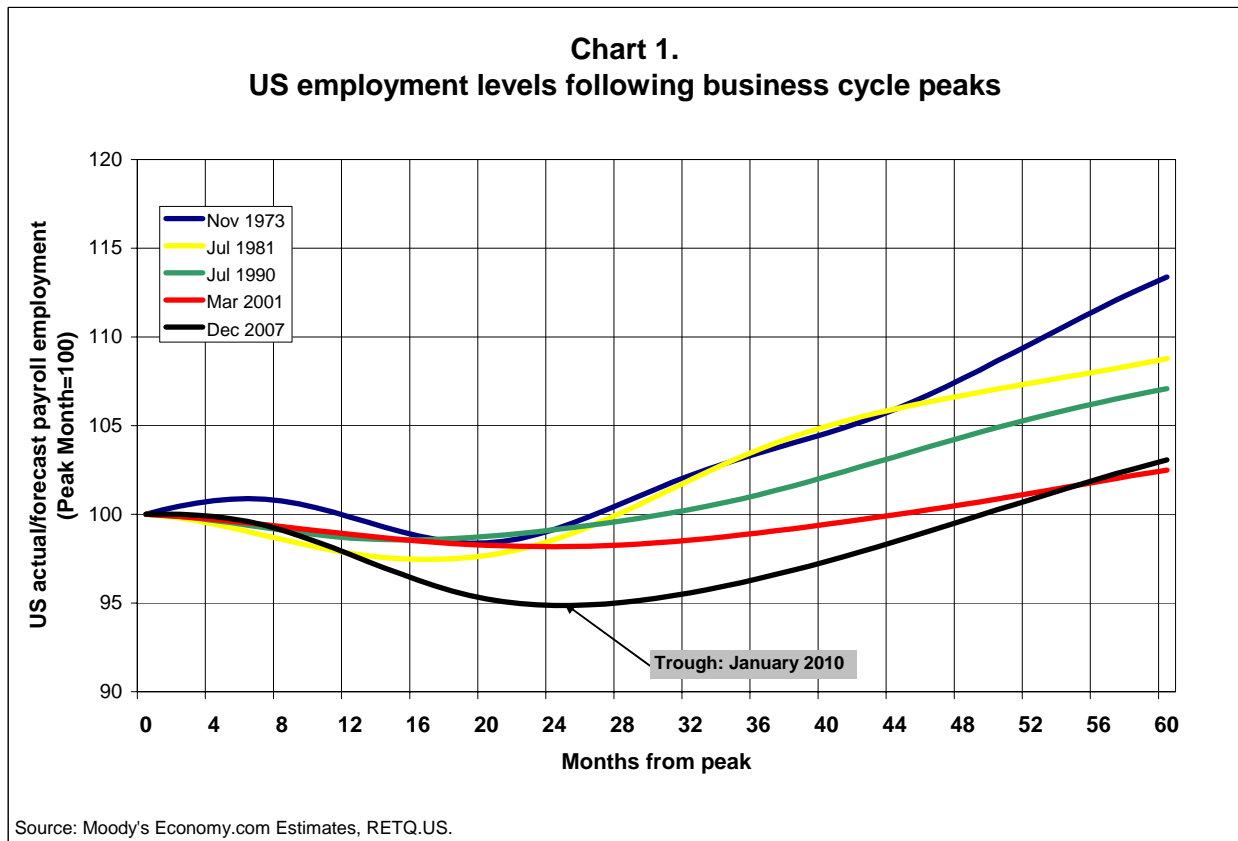
- 2011 employment below 2007 employment? Looks increasingly likely.
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March 16, 2009

2011 employment below 2007 employment? Looks increasingly likely.

The name of the game for carriers in 2009-2011 will be identifying the relative and absolute opportunities for growth—or at least stability and acting prudently in areas where growth prospects are proving dim. While this is always true, in a context where virtually all lights flash red—exposures diminishing faster than forecast, limited pricing power, equity returns declining by fifty percent and breaking through 2002 lows—the MarketStance commercial lines tools—data cubes, Express Reports, Express Leads, and customized solutions—provide carriers unparalleled powers to make smart plans.

As for the “bad news”: the most recent Moody’s Economy.com US forecast of employment, output, and wages (9 March release) predicts that the broad-based deterioration of the US economy will continue through January 2010. If the forecast is accurate, this will be a 24-month recession. From the peak employment level reached in January 2008, US payrolls will decline in total by 7.1 million jobs. Employers will eliminate about 1 in 20 payroll positions by January 2010. If the dire economic news over the first few months of 2009 continues, future forecasts conceivably could show a 30 or even 36 month business cycle, with aggregate job loss ranging from 9-11 million.



Forecasters are generally predicting a very slow recovery once the economy hits bottom. As Chart 1 above suggests, severe US business cycles dating from Nov 1973 and July 1981 tended to have a “V-shaped” job loss/job creation pattern: rapid loss of employment followed by a period of rapid gain. This “V” was even more pronounced in charts of earlier recessions such as 1948, 1953, 1958, and 1960 (not pictured).

The current forecast employment cycle, in contrast, will look a lot more like the 1990 and 2001 shallow “U-shaped” or “jobless” recoveries in Chart 1, where recovering companies boost output and sales mainly by exploiting productivity gains and extending the average hours worked of those already employed, and only secondarily boost output by increasing staffing.

On a monthly basis US employment will not reach the peak 2007 levels until January 2012. As is reflected in MarketStance 8-1 average annual employment in 2011 will be approximately the same as 2007, with future MarketStance releases to show average annual employment in 2011 substantially below 2007 levels (see Chart 2 and discussion below).

Volatile economy, volatile forecast for MarketStance 8-1 and beyond

As noted in the Release Notes accompanying version 8-0, MarketStance 8-1 presents a sharply reduced exposure growth forecast. Growth has slowed more rapidly than MarketStance projected back in November when releasing version 8-0.

The last year has proven to be a very humbling period for economic forecasters. Forecasts have been negatively shocked again and again by the severity of the deterioration now underway. The Moody's Economy.com county employment forecast—hence the MarketStance forecast rates of growth of insurable exposures on a county by employment size by 6-digit SIC basis—has been no exception. The economy's remarkable volatility has led to substantial revisions to both forecasts.

Based on the Moody's Economy.com US forecast data released after the production of version 8-0, MarketStance had previously projected version 8-1 US payroll employment would be substantially lower – about 135 million in 2009 and 140 million in 2011 – versus 137 million and 142 million respectively, as actually released in version 8-0. But as Chart 2 below indicates, version 8-1 actually reports 3 million fewer employed in 2009 (132 million) and 4 million fewer employed in 2011 (136 million) than previously projected (Chart 2).

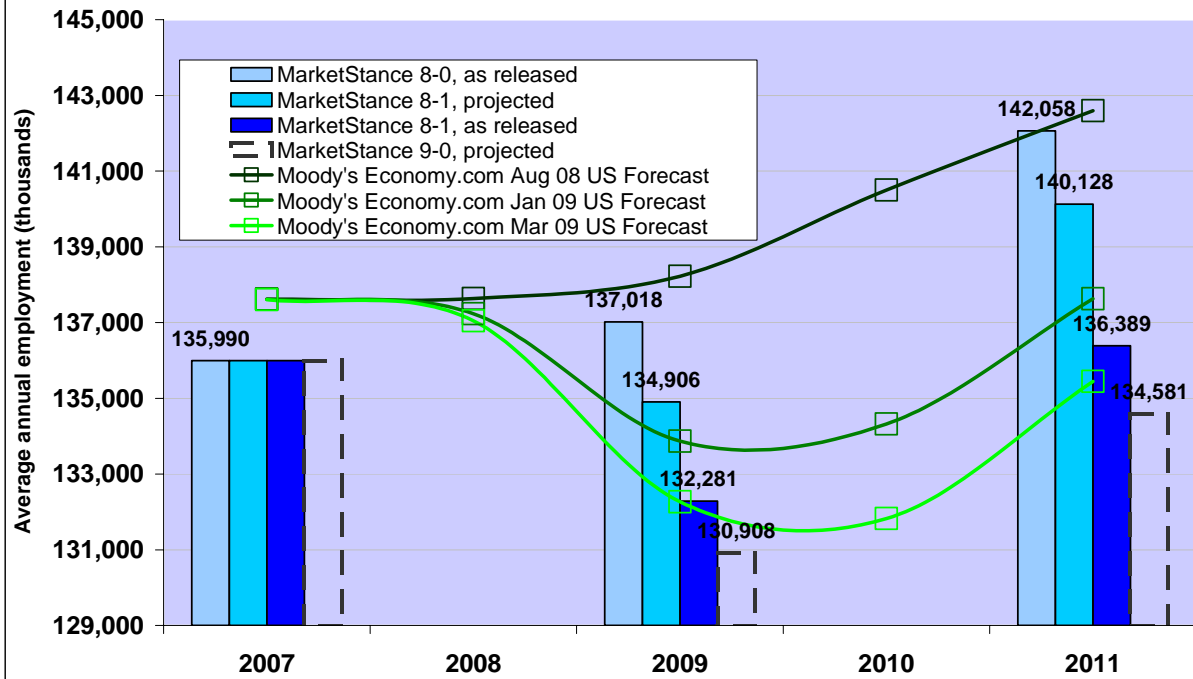
Why exactly did the forecast change? Most of the revision has to do with the near-term economic data.

The sheer magnitude of jobs lost in each month since November 2008 has far exceeded the Moody's Economy.com US employment forecast. Initially reported as around 600,000 the initial estimates of job loss were subsequently revised 10-20 percent higher by the US Bureau of Labor Statistics. The Bureau's measures show a pronounced diffusion of job losses starting in September 2008. This trend intensified beyond forecast expectations in the last three months of the year, with ever more businesses and entire business classes reporting accelerating job losses relative to the month prior.

Based on analysis of the most recent government employment data and March 2009 Moody's Economy.com US employment forecast, the MarketStance growth forecasts will be negatively revised in the future. Assuming no future shocks to the Moody's Economy.com US employment forecast, MarketStance version 9-0 will reflect lower projected average annual employment levels of 130,908 (2009) and 134,581 (2011) (see Chart 2).

If there are further substantial shocks to the Moody's Economy.com employment forecast, aggregate job loss over the business cycle could conceivably be in the range of 9-10 million jobs and the bottom of the cycle itself could extend into mid- or late-2010. MarketStance cannot over-emphasize to clients that this is a volatile economic context without recent precedent, with all of the risks located on the down-side of our forecast. Factors such as the large decline in fourth quarter 2008 US gross domestic product and continuing greater than expected declines in manufacturing, residential construction activity and house prices raise the odds of future negative revisions.

Chart 2.
Moody's Economy.com and MarketStance forecast revisions 2008-2009



Sources: Moody's Economy.com Industry Services, USEMP.DB (08/2008, 01/2009, 03/2009); MarketStance Establishment data and projections.

A look at small commercial exposure growth by Metro Area

As Table 1 and Figure 1 below indicate, when looking at small commercial markets by Metropolitan Statistical Area, forecast growth during the volatile 2007-2011 period is quite uneven. Several of the metro areas ranking in the Top 10 for employment growth in MarketStance version 8-0 have fallen out of the Top 10 in version 8-1, such as Las Cruces, Omaha-Council Bluffs, and Florence-Muscle Shoals, supplanted by others such as Wenatchee and Longview, WA and San Antonio, TX.

Though almost across the board the top metro areas in small commercial are growing more slowly than previously forecast, the second interesting point is that these areas are growing at all given the dire US macroeconomic environment.

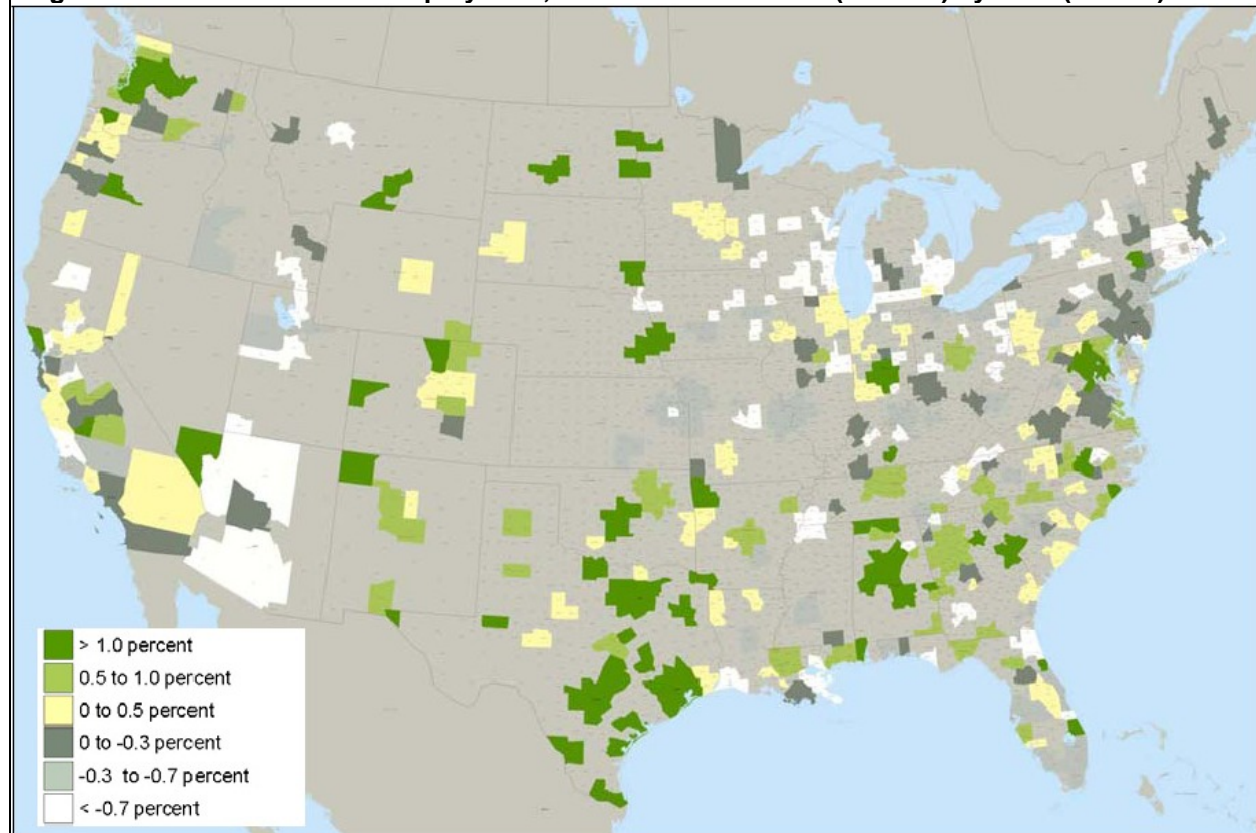
The number of counties encompassed in all metro areas in the US split about evenly between growers and non-growers—half are growing, half are shrinking, as measured by 4-year annual average employment. Perhaps most surprising when clients load the version 8-1 data will be the areas in small commercial where growth remains positive, such as Columbus, Ohio and Pittsburgh, PA and Indianapolis, Indiana, despite the widely advertised depressed conditions in each area when looked at on a statewide basis.

Table 1. Small commercial employment growth in fastest growing of 363 US metro areas, 2007-2011: MarketStance versions 8-1 and 8-0

Metro Area	VERSION 8-1		VERSION 8-0		Change
	Annual Growth (%)	Rank	Annual Growth (%)	Rank	
Longview, WA	5.6	1	1.0	206	4.7
Auburn-Opelika, AL	3.7	2	4.3	1	-0.6
Mcallen-Edinburg-Mission, TX	3.3	3	3.5	5	-0.2
College Station-Bryan, TX	3.1	4	3.8	2	-0.7
Austin-Round Rock, TX	2.7	5	3.4	6	-0.7
Huntsville, AL	2.5	6	3.5	4	-1.0
San Antonio, TX	2.4	7	2.8	23	-0.4
Wenatchee, WA	2.2	8	1.2	147	1.0
Dallas-Fort Worth-Arlington, TX	2.2	9	2.8	22	-0.6
Midland, TX	2.1	10	2.9	18	-0.7
Florence-Muscle Shoals, AL	1.8	21	3.6	3	-1.8
Montgomery, AL	1.3	34	3.3	7	-2.0
Mobile, AL	1.3	37	3.3	8	-2.0
Omaha-Council Bluffs, Ne-IA	1.3	38	3.2	10	-1.9
Las Cruces, NM	0.9	61	3.2	9	-2.3

Source: MarketStance Establishment Data

Figure 1. Small Commercial Employment, 4 Yr Forecast Growth (2007-11) by MSA (annual)



Source: MarketStance Establishment Data

An improved estimation process for SIC 871 / NAICS 541, Architects and Engineers

MarketStance 8-1 features improvements in exposure and premium estimates in three SICs and four 2002 NAICS classes of business in SIC 871 / 2002 NAICS 541: Engineering services (SIC 871100 / 2002 NAICS 541330), Architectural services (SIC 871200 / 2002 NAICS 541310) and Surveying services (SIC 8713 / 2002 NAICS 541360 & 541370).

The most significant change involved re-rating the special liability components of these classes, specifically the E&O component. Following a client inquiry, MarketStance decided to improve the accuracy of our estimates by modifying the rates and proportioning factors applied to these classes, resulting in a \$2.7 billion reduction of E&O/Prof Liability DWP in SIC 871 and an increase in the estimate of covered operating locations of about 62,000 establishments.

While the changes directly affected SIC 871 / NAICS 541, MarketStance wants clients to be aware that these changes resulted in small adjustments throughout the version 8-1 data.

Due to benchmarking the state-by-line premiums and losses to the A.M. Best state-by-line premium and loss data, any changes to rates or exposures in one class of business has a cascading "benchmarking effect" on the estimation model as it applies to direct written premium (DWP) estimates of all other classes. To state the effect in a very simple example, a \$10 billion reduction in DWP allocated in a new estimation procedure to a particular 6-digit business class would result in a \$10 billion increase in DWP allocated to all other business classes, and so forth.

As a result of the benchmarking effects there was also a very small \$125 million increase in premises and operations DWP in SIC 871.

While examining the rating bases for these classes, MarketStance also investigated the exposures and found reason to make further adjustments. MarketStance concluded that small increases were required in both the estimated number of production employees present at work-sites and the estimated number of vehicles in use in these classes. Clients will notice a substantial increase in the number of vehicles in SIC 871 and modest rise in Workers' Compensation and Commercial Auto DWP in MarketStance version 8-1: \$174.5 million and \$252 million respectively.

Due to benchmarking effects, slight reallocations occurred in all SICs outside SIC 871 / 2002 NAICS 541 in every standard line other than: Boiler & Mach, Inland Marine, and Farmowners Multi-Peril.

Related adjustments to the Alternative Markets component lines amounted to a -1.1 percent (\$770 million) reduction in the All Lines Alternative Markets Premium, most of this in Liability Alternative Premium.

In Summary

Despite the rather dampened *overall* market prospects presented in Version 8-1 and further anticipated growth deceleration to be reflected in future versions, MarketStance will continue to provide clients an unparalleled ability to identify profitable opportunities from the bottom up.

For questions related to this or any other MarketStance data release, please contact your MarketStance relationship manager or Katie Haberlandt in our client services department, (860) 704-6397 <khaberlandt@marketstance.com>.