Alleghany Scorecard

($ in millions, except per share amounts)

	Book Value Per Share[1]	Book Value % Change	% Change in S&P 500 with Dividends Included	Market Price Per Share	Market Price % Change	Market Price to Ending Book Value	10-year Treasury Yield End of Year	Common Stockholders' Equity
2000	$ 135.49	15.3%	-9.1%	$ 165.28	13.0%	1.22	5.11%	$ 1,191
2001	162.36	19.8%	-11.9%	157.88	-4.5%	0.97	5.05%	1,426
2002	162.75	0.2%	-22.1%	148.52	-5.9%	0.91	3.82%	1,413
2003	182.18	11.9%	28.7%	189.90	27.9%	1.04	4.25%	1,600
2004	204.08	12.0%	10.9%	248.33	30.8%	1.22	4.22%	1,800
2005	212.80	4.3%	4.9%	252.18	1.6%	1.19	4.39%	1,894
2006	244.25	14.8%	15.8%	329.32	30.6%	1.35	4.70%	2,146
2007	281.36	15.2%	5.5%	371.39	12.8%	1.32	4.02%	2,485
2008	267.37	-5.0%	-37.0%	265.74	-28.4%	0.99	2.21%	2,347
2009	294.79	10.3%	26.4%	265.28	-0.2%	0.90	3.84%	2,718
2010	325.31	10.4%	15.1%	300.36	13.2%	0.92	3.29%	2,909
2011	342.12	5.2%	2.1%	285.29	-5.0%	0.83	1.88%	2,926
2012	379.13	10.8%	16.0%	335.42	17.6%	0.88	1.76%	6,404
2013	412.96	8.9%	32.4%	399.96	19.2%	0.97	3.03%	6,924
2014	465.51	12.7%	13.7%	463.50	15.9%	1.00	2.17%	7,473
2015	486.02	4.4%	1.4%	477.93	3.1%	0.98	2.27%	7,555
2016	515.24	6.0%	12.0%	608.12	27.2%	1.18	2.44%	7,940
2017	553.20	7.4%	21.8%	596.09	-2.0%	1.08	2.41%	8,514
2018	527.75	-4.6%[2]	-4.4%	623.32	4.6%	1.18	2.69%	7,693
2019	611.00	15.8%	31.5%	799.57	28.3%	1.31	1.92%	8,777
2020	623.57	2.1%[3]	18.4%	603.69	-24.5%	0.97	0.92%	8,756

CAGR								
5-years	5.1%		15.2%	4.8%				3.0%
10-years	6.7%		13.9%	7.2%				11.6%
15-years	7.4%		9.7%	6.0%				10.7%

CAGR - Including Special Dividends								
5-years	5.9%		15.2%	5.6%				3.8%
10-years	7.1%		13.9%	7.7%				12.1%
15-years	7.7%		9.7%	6.3%				11.1%

(1) Adjusted for stock dividends.

(2) (2.8%) when adjusted for the impact of a $10.00 per share special dividend payment on March 15, 2018.

(3) 4.5% when adjusted for the impact of a $15.00 per share special dividend payment on March 16, 2020.

Book value per share and common stockholders' equity relate to Alleghany stockholders.

To Our Stockholders

Alleghany's common stockholders' equity per share at year-end 2020 was $623.57, an increase of $12.57, or 2.1% from common stockholders' equity per share of $611.00 at year-end 2019. Including the $15 special dividend that Alleghany paid early in the year, the growth rate was 4.5%, assuming no return on the dividend after date of payment. These results are net of $23 per share (3.7% of beginning book value) of reinsurance and insurance losses related to the Pandemic[1]. For 2020, consolidated adjusted revenues[2] increased from $8.4 billion to $9.0 billion, or 7.8%, and we recorded adjusted earnings[3] attributable to Alleghany stockholders of $227.9 million, or $15.98 per share, compared to $344.6 million, or $23.82 per share in 2019.

Over the past five years, the growth rate in book value per share plus dividends was 5.9% per year, below our long-term goal of 7-10% per year. Needless to say, this has been disappointing to me. Five years is a long time, so a fair question is: why did we come up short? There are two principal reasons:

- Over the past five years, we have incurred approximately $2.4 billion of natural catastrophe losses, and in 2020 we also incurred approximately $0.4 billion of losses related to the Pandemic. These combined losses of $2.8 billion are over twice what we would consider "normal" as defined by catastrophe models and/or trailing averages in relation to premiums. Even ***with*** climate change. This will be discussed in more detail later in this letter.
- Also over this period, we largely wrote-off our investment in Stranded Oil Resources Corporation. This cost us $219 million after-tax. In 2020, we sold all of our remaining operations and we have now completely exited this investment.

To paraphrase George Washington, "I ask our stockholders to forgive any failures that may have occurred in my service to them … they were due to my own weaknesses and by no means intentional!"

Adjusting for these two items – excess catastrophe losses and SORC losses – our growth rate in book value per share plus dividends over the past five years would have been over 8% per year. Moreover, this period included very challenging competitive conditions in the insurance and reinsurance markets, and the build-out of Alleghany Capital, which as I've explained before, has costs to us in the short-run. It also includes the highly challenging year of 2020 from an economic and operational point of view.

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Alleghany's re/insurance companies collectively produced an underwriting loss in 2020, with Pandemic-driven underwriting losses at TransRe, a modest underwriting profit at RSUI, and a small underwriting loss at CapSpecialty. Claims directly related to the Pandemic cost us $415 million, or 6.9% of consolidated net premiums earned. Excluding losses related to the Pandemic, the combined ratio was 95.2% ***after*** 6.5%-points of other natural catastrophe losses. Our insurance operations produced double-digit growth in gross premiums written (25.5% at RSUI and 10.6% at CapSpecialty), while TransRe's growth in gross premiums written was 5.9%.

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[1] COVID-19 will be referred to throughout this document as the Pandemic.

[2] Consolidated revenues excluding change in the fair value of equity securities, net realized capital gains, and change in allowance for credit losses on available for sale securities.

[3] Net earnings attributable to Alleghany stockholders excluding change in the fair value of equity securities, net realized capital gains, change in allowance for credit losses on available for sale securities, and amortization of intangible assets, all net of tax.

The table below summarizes our after-tax earnings by source over the past three years. The decline in investment income was a significant headwind to adjusted earnings in 2020 (the associated appreciation in bonds does not flow through earnings). Net investment income also suffered from our decision to maintain above-normal operating liquidity in the first half of the year when there was significant uncertainty surrounding the economic impact of the Pandemic. Consolidated net investment income after-tax fell 11% in 2020, to $399 million from $449 million in 2019. Non-Pandemic natural catastrophe losses were $305 million after-tax in 2020, roughly in line with expectations despite an extremely active catastrophe year. In addition, however, we incurred $328 million of after-tax losses related to the Pandemic.

On a positive note, our underwriting results before cats improved significantly in 2020, to $532 million after-tax from $342 million in 2019, an increase of 56%. In addition, our earnings from Alleghany Capital in 2020 set a new record, primarily due to record earnings from Jazwares and strong earnings at W&W|AFCO Steel. The comparison was also helped by the increase in our ownership of Wilbert Funeral Services at the beginning of the second quarter, along with their very strong earnings in 2020.

($ millions)	2018	2019	2020
Investment income	$ 417	$ 449	$ 399
Underwriting profit before cats	392	342	532
Catastrophe losses	(520)	(316)	(305)
Pandemic losses	-	-	(328)
Alleghany Capital	47	73	89
Interest expense	(72)	(79)	(70)
Other items, net	31	3	12
Subtotal	$ 295	$ 472	$ 329
Re/insurance long-term compensation	(39)	(68)	(63)
Corporate administration	(13)	(59)	(38)
Adjusted earnings	$ 243	$ 345	$ 228
Change in fair value of:			
Fixed income and Other	(201)	383	244
Equities	(181)	561	(87)
Market value changes to investments	$(382)	$ 944	$ 157
Other non-operating items, net	(36)	(62)	(1)
Change in book value before capital transactions	$(175)	$1,227	$ 384

As we consider what the future may look like, there are a number of positive trends. First, the growth in Alleghany's re/insurance businesses in 2020 will result in higher investment balances. Higher investment balances should begin to relieve the pressure on investment income. Second, we achieved meaningful price increases in 2020 on a net premiums written basis. These price increases should result in better core loss ratios from underwriting in 2021 and beyond. Third, improving premium growth will continue to help margins due to the expense leverage at TransRe and both of our insurance companies. In 2020, the expense ratio of Alleghany's re/insurance operations declined by over 2%-points. Fourth, because TransRe has already achieved significant price increases on property catastrophe business and because it has reduced its aggregates, there is a good chance that natural catastrophe losses will be less disruptive in the years ahead. Finally, the eventual normalization of the economy should help Alleghany Capital produce meaningful growth in earnings, as several of the portfolio companies had depressed earnings in 2020. It should also increase opportunities for additional acquisitions.

In recognition of this outlook – and our view that our stock price does not reflect the long-term intrinsic value of our business portfolio – we spent $195 million in 2020, largely in the second half, to repurchase 333,393 shares of Alleghany stock at an average price of $584.18, or roughly 94% of year-end book value per share. Including the special dividend paid early in the year, total distributions to shareholders were $410 million in 2020.

Over the past three years, market value changes in investments have added over $700 million (after-tax) to our growth in book value. As will be discussed in more detail later in this letter, equities appear to be expensive (implying lower future returns or risk of a correction) and interest rates are about as low as they can get. We do not expect such contributions in the future.

The table below summarizes our 2020 growth in book value by major operating unit:

($ millions)

	TransRe	RSUI	Cap Specialty	ACC	Other	Total
Beginning equity	$ 5,243	$ 1,874	$ 395	$ 901	$ 364	$ 8,777
Adjusted income[4]	73	93	8	89	(35)	228
Amortization	-	-	-	(35)	-	(35)
Investment gains (losses)	65	23	(1)	-	(171)	(84)
Other comprehensive income	206	52	12	-	11	281
Capital transactions	(210)	(225)	-	154	66	(215)
Treasury stock activity	-	-	-	-	(195)	(195)
Ending equity	$ 5,377	$ 1,817	$ 414	$ 1,109	$ 40	$ 8,757
Growth rate before amortization	6.6%	9.0%	4.8%	9.9%	nm	4.8%
Adjusted return on average equity	1.4%	5.0%	2.0%	8.8%	nm	2.6%
Adjusted ROE – ex-Pandemic	7.2%	5.9%	2.6%	8.8%	nm	6.3%

The following points can be observed from the previous table:

- TransRe had an adjusted ROE of 1.4% in 2020, but without the direct impact from the Pandemic the adjusted ROE would have been 7.2%. We believe this is a respectable result considering it was an active catastrophe year and it may mark the bottom of the U.S. casualty reinsurance cycle.

[4] Net earnings attributable to Alleghany stockholders excluding change in the fair value of equity securities, net realized capital gains, change in allowance for credit losses on available for sale securities, and amortization of intangible assets, all net of tax.

- RSUI had an adjusted ROE of 5.0% in 2020, but without the direct impact from the Pandemic the adjusted ROE would have been 5.9%. As a major property insurer in the Southeast, RSUI saw a number of landfalling hurricanes right in its backyard.

- CapSpecialty's returns were low due to an uncompetitive expense ratio. We are working on it (see discussion of CapSpecialty later in this letter).

- Alleghany Capital produced an adjusted ROE of 8.8%, and as I will discuss later in this letter, the ROE was closer to 10% after considering purchase accounting "noise." This was a terrific performance in a very difficult year.

- "Other" is everything else. Early in 2020, oil prices collapsed due to the Pandemic on top of chronic excess supply. We decided to exit our investment in Stranded Oil Resources Corporation. Operating losses and impairment charges contributed to the large negative result in 2020.

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In 2020, our three re/insurance subsidiaries reported $453 million of investment income. This investment income was generated on approximately $18.2 billion of average invested assets, for a pre-tax return of 2.5%. Following the collapse in interest rates in 2020, our new money investment rate on fixed income securities is currently approximately 1.5%. This means that if nothing changes, the $19.0 billion of invested assets that existed at the end of 2020 will ultimately earn $285 million, or about 63% of the 2020 actual when they mature and are reinvested at today's interest rates.

The decline in interest rates is forcing property and casualty insurers and reinsurers to improve their underwriting margins. With approximately $6 billion of net premiums earned in 2020, we need to improve our underwriting margins by about 2.8%-points ($168 million / $6 billion) to produce the same margin as we did before interest rates fell. A lower expense ratio will go a long way to offsetting the impact of lower interest rates.

Of course, there is no guarantee that interest rates will remain as low as they were at the end of 2020. The impact of lower market interest rates on our annual income statement is gradual, with each future year's investment income a function of both earnings on net new underwriting cash flow and the reinvestment of portfolio maturities. We ***do*** expect that the total investment balances will increase in 2021 and beyond as positive underwriting cash flow is added to the portfolio. Finally, while we achieved significant rate increases in the year just ended, it takes time for these higher rates to show up in improved underwriting margins: first through a lower expense ratio and later through a lower loss ratio.

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On growth in book value as a financial objective

Conventional wisdom in the insurance and reinsurance industry is that book value per share growth (or growth in tangible book value per share) is the ***only thing*** that matters in this industry for long-term value creation. While there are many aspects of this scorecard that have merit, what happens when more and more of the growth in book value is coming from asset appreciation on passive investments rather than attractive returns on equity on a reasonable amount of capital and free cash flow? It would appear that the result is a compression in valuation. It's not difficult to see why.

To take an extreme example, assume a property and casualty company has a very small business and a huge capital account, 100% invested in publicly-traded common stocks. The "franchise value" of the company (which justifies a premium to book value) will reflect the returns that the company can generate on the capital required to run the business. To the extent that there is excess capital, investors will ultimately value this excess capital like a closed-end investment fund – i.e. at book value or less.

After multiple years of strong investment returns that are retained by the corporation, reported operating returns on equity will decline and along with them the valuation of the company. In such a scenario, the returns of the company's stock will trail the growth in book value (and likely the market return as well).

Over the past five years, we have distributed to shareholders $369 million in special dividends and $915 million through share repurchases. We have used share repurchases when we believe that from a long-term point of view, our stock was trading below intrinsic value, and we have used special dividends when executing on our repurchase plan was not feasible. We remain very well capitalized, with ample resources to support our existing operations and to execute on our strategy.

Our decision to return almost $1.3 billion of capital to stockholders rather than to retain this capital and invest it in total return investments has not been helpful to our growth in book value per share over the short run relative to the S&P 500. Whether or not this is true in the long-run depends on how our businesses perform going forward and the expected future returns on public equities. Our book value per share is clearly lower than it would have been had we retained the cash and invested it in equity securities because the stock market has produced exceptional returns recently. However, this does not necessarily mean our shareholders are worse off; rather, had they simply invested in the stock market over this time period they would have enjoyed the returns of the S&P 500 without the tax friction that exists when we invest on their behalf. If a shareholder had taken the special dividend of $15 per share that was paid on March 16, 2020 and invested it in Alleghany shares, he or she would have had $17.94 at the end of the year. This extra "value" of $2.94 per Alleghany share does not show up in our performance.

Our approach will continue to be to maintain the appropriate amount of capital that we believe is necessary for our existing businesses and projected growth, with a comfortable margin of safety. To the extent we accumulate more capital than we need, we are likely to continue to return it to shareholders in the most efficient manner possible. Our focus going forward is to *improve the operating returns* of TransRe and CapSpecialty, support RSUI as it continues to execute on its highly successful strategy, and to direct funds to Alleghany Capital where we have the potential to earn double-digit returns on equity on a sustained basis.

Some investors emphasize growth in ***tangible*** book value rather than stated book value. In our case, the vast majority of our goodwill and intangible assets relate to Alleghany Capital, where we have purchased businesses at values greater than the value of *their* tangible assets. Because we have significantly expanded the size and scale of Alleghany Capital over the past five years, our growth in tangible book value really doesn't mean a whole lot. The table below summarizes the composition of our goodwill and intangible assets:

($ millions)

	Total Company	Alleghany Capital	Re/insurance & Corp Activities
Stockholders' equity	$8,756	$1,109	$7,647
Goodwill	614	557	57
Intangible assets	788	646	142
Goodwill and intangibles	$1,402	$1,203	$ 199
Tangible stockholders' equity	$7,354	$ (94)	$7,448

At the end of 2020, Alleghany Capital had consolidated fixed assets (property, plant and equipment) of $215 million and net working capital of $558 million. The sum of these two figures ($773 million) was mostly financed by non-recourse long-term debt ($590 million). Alleghany Capital's companies in total generated $200 million of adjusted earnings before interest and taxes on net tangible assets of $773 million in 2020, or a pretax return of 26%.

What is the value of the goodwill and intangibles related to Alleghany Capital? One reference point is that in 2020, Alleghany Capital's portfolio companies generated $233 million of adjusted EBITDA[5] and $166 million of adjusted earnings before taxes. These figures are on a 100% basis as consolidated in our financial statements and before Alleghany Capital corporate overhead expenses. In order for the goodwill and intangibles to be recoverable (in the aggregate), the sum of Alleghany Capital portfolio companies' goodwill and intangibles plus attributable debt net of cash implies an enterprise value on the financial statements of roughly $1.8 billion, or 7.8x EBITDA. As a reference point, at the end of 2020 the Russell 2000 Index had a forward EV/EBITDA ratio of approximately 17x. We plan to spend more time in 2021 and beyond highlighting the quality and earnings power of the Alleghany Capital portfolio in our investor communications.

One final point: we have increasingly been allocating capital to our non-insurance operations because the economic returns look to be higher. I stress ***economic*** returns because purchase accounting tends to depress accounting results post-acquisition due to amortization of intangibles and other adjustments (more on this later). For these businesses, growth in book value may be less relevant to how we think about the value that they are creating for us.

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The Pandemic

In early 2012, three men in southern China became severely ill with a "viral pneumonia" after shoveling guano out of a copper mine shaft. Although all three men died, no one who treated them or was near them got sick. Samples of the retrieved virus were sent to a virology lab in Wuhan, China, where scientists studied it and performed so-called "gain of function" research. Somewhere along the way this bat virus acquired airborne transmissibility, and escaped into the city of Wuhan. At least that's a theory. Or maybe it was naturally occurring. Perhaps we will never know.[6]

The Pandemic was highly disruptive to our operations and had significant financial consequences. I would like to briefly review how the Pandemic affected us, and how we have responded.

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[5] Earnings before income taxes, depreciation expense, amortization expense (including from intangible assets), net realized capital gains, change in allowance for credit losses on available for sale securities, and merger & acquisition fees.

[6] "The Lab Leak Hypothesis" by Nicholson Baker, *New York Magazine*, January 4-17, 2021.

Impact on insurance and reinsurance businesses

Direct insurance and reinsurance losses related to the Pandemic totaled $415 million in 2020. At TransRe, which accounts for approximately 94% of the losses, these primarily resulted from reinsurance of event cancellation insurance and business interruption losses and also included increased provisions for potential losses from a variety of casualty and specialty lines. At RSUI and CapSpecialty, property policies generally excluded business interruption losses caused by the presence of pathogens or viruses, but at RSUI there were some policies that did not have such specific exclusions. This occurred when RSUI participated in large "shared and layered" placements and the primary insurance policy was issued by another carrier.

In the United States, TransRe did an excellent job of avoiding excessive exposure to business interruption losses caused by the Pandemic. Most of TransRe's property business interruption losses came from the United Kingdom and continental Europe, where outright virus exclusions were not market convention. Reinsurance coverage issues are complex, and are likely to continue to be negotiated in 2021. However, based on our knowledge of underlying treaty exposures and coverage issues, we believe that TransRe's exposure is reasonably reserved and manageable going forward.

Impact on Alleghany Capital

All of Alleghany Capital's businesses were impacted one way or another by the Pandemic, but the diversification of the portfolio allowed the group to produce record earnings despite many challenges. The Pandemic also essentially shut down the market for new acquisitions. Jazwares and W&W|AFCO Steel both had strong earnings despite operational disruptions. Three of our businesses – Concord Hospitality, Kentucky Trailer, and Precision Cutting Technologies – saw reduced sales due to a drop in demand for their products and services, but each remained profitable as they implemented prudent expense management initiatives. IPS-Integrated Project Services also saw a disruption of normal business activities, but played a critical role behind the scenes in assisting major pharmaceutical companies with their vaccine rollouts. Finally, Wilbert Funeral Services, as might be expected, was a beneficiary of the unfortunate circumstances of the Pandemic, producing a record year providing products and services to funeral homes.

Impact on investments

Our investment returns were hurt by the Pandemic as well. In addition to the collapse of interest rates – which reduced investment income on reinvested cash flow – we also decided early in the year to significantly increase liquidity at our re/insurance subsidiaries. Although the decline in interest rates caused our bonds to appreciate in value, this increase does not flow through earnings and in fact is transitory unless we sell the bonds. Because short-term interest rates were close to zero, our conservative liquidity posture was an expensive but necessary insurance policy. Finally, the collapse in oil prices in the second quarter negatively impacted results at Stranded Oil, and resulted in a write-down of our remaining assets prior to sale.

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Alleghany Capital

Alleghany Capital's consolidated revenue grew 8%, to $2,478 million in 2020 from $2,289 million in 2019, while earnings before income taxes grew 31% to $146 million in 2020 from $111 million in 2019, and adjusted earnings before taxes grew 8% to $154 million in 2020 from $143 million in 2019[7]. Adjusted earnings growth was driven by a decline in corporate costs and an increase in the Industrial segment, which grew 10% year over year, offsetting a 1% decline in the Non-Industrial segment. As I highlighted in last year's letter, because of the seasonality of our businesses, particularly Jazwares, the vast majority of Alleghany Capital's earnings were expected to be generated in the second half of 2020. This seasonal pattern was accentuated further by the Pandemic, which had a particularly significant negative impact on all of our business during the second quarter.

The increase in adjusted earnings before taxes in the Industrial segment in 2020 was driven primarily by growth at Wilbert Funeral Services, which positively impacted results — not only because our ownership increased from 45% to approximately 100% in April, but because its overall business increased due to the nationwide increase in mortality rates. W&W|AFCO Steel also performed admirably, with adjusted earnings before taxes increasing 15% despite numerous productivity challenges caused by the Pandemic. The decline in adjusted earnings before taxes in the Non-Industrial segment was primarily the result of weakness at Concord Hospitality, caused by the sharp and unprecedented decline in hotel occupancy nationwide and, to a lesser degree, at IPS-Integrated Project Services, due to client site closures and operational inefficiencies related to remote working. These declines offset 9% growth at Jazwares, where two recent acquisitions helped mitigate a tough comparison with a major license launch in 2019 as well as supply chain inefficiencies and retailer hesitancy driven by the pandemic.

In a promising development for the future, backlogs at both W&W|AFCO Steel and IPS-Integrated Project Services reached record levels, and not by just a little – by a lot. W&W|AFCO Steel's backlog of active plus verbally committed projects stood at $1.4 billion at the end of 2020, up from $0.8 billion at the end of the previous year. And IPS-Integrated Project Services' backlog plus sold projects increased to $1.1 billion, more than twice the level at the end of 2019. It should be noted that these backlogs will not all be realized in 2021, though they are a positive sign of future business activity in relation to how these companies entered 2020.

Alleghany Capital focuses on investing in companies run by entrepreneurial founders or managers who share our values and long-term approach to business, are committed to capturing developing opportunities in their industries, and have a clear strategy and nimble operating mindset that will drive future growth through various market cycles (though none of us expected the cycle we all experienced in 2020!). We look for companies that have an opportunity to accelerate growth within their markets by leveraging our ability to support accretive follow-on investments in both organic and acquisition growth initiatives. Unlike private equity funds, which generally invest the capital of limited partners for short periods, Alleghany Capital does not have a predetermined investment time horizon based on a fundraising life-cycle and intends to own its companies indefinitely.

Alleghany Capital's business model is built to support sustainable, long-term growth. As a consequence, we don't "asset strip" or aggressively cut costs as a prelude to a sale and a quick return. We expect our portfolio companies to intelligently balance the needs of employees, customers, suppliers, and the communities and environments in which they operate with the goal of also achieving attractive *risk-adjusted* long-term investment returns. Our companies are capitalized with modest amounts of financial leverage, and we work with our partners to make the investments necessary to ensure that each company is positioned for *long-term* success.

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[7] 100% basis.

Our current portfolio is comprised of companies that hold #1 market positions in niche markets or are rapidly gaining share in large fragmented markets. At the end of 2020, Alleghany Capital had seven platform businesses, the same number as last year as no new platform acquisitions were made. We disclose these businesses in two groupings: four in the Industrial segment and three in the Non-Industrial segment.

Industrial Businesses

W&W|AFCO Steel, headquartered in Oklahoma City, Oklahoma, provides fabricated steel for use in bridges and overpasses in North America as well as large structural construction projects, including commercial, industrial, and public structures. The company also erects steel (primarily its own fabrications) in select markets. At the end of 2020, Alleghany owned approximately 80% of W&W|AFCO. Rick Cooper and his team were able to grow earnings solidly over the prior year and grow the company's backlog significantly, a major accomplishment given various customer site closures and plant inefficiencies created by physical distancing measures. Revenue and earnings were driven by delivery of various projects for companies in the e-commerce, electric vehicle, and semiconductor sectors, execution on its bridge backlog, and a variety of other public and private projects, including the unique *MSG Sphere*, which promises to be an exciting venue when completed. W&W's national presence, unique capabilities on large complex projects, and the ability to serve a diversified set of end markets paid off in 2020 and should benefit the company in 2021. The potential for a new public infrastructure program may yield a further tailwind for the company and its industry.

Wilbert Funeral Services, headquartered in Overland Park, Kansas, is a provider of products and services for the funeral and cemetery industries as well as pre-cast concrete markets. The company, through owned locations as well as a large licensee network, has a leading distribution system serving its customers. In April, Alleghany Capital increased its ownership from 45% to approximately 100% pursuant to a contractual arrangement made at the time of our original investment in the company in 2017. Following this increase in ownership, Wilbert has been accounted for on a consolidated basis, similar to the rest of Alleghany Capital's companies. Wilbert's revenue and earnings grew significantly during 2020 as a result of increasing mortality rates and the tireless efforts of Wilbert's employees and licensees in serving their local communities. Results also benefited from the successful integration and margin improvement at Astral Industries, a domestic casket producer acquired in June 2019. In July, as part of scheduled succession planning, Mark Bates, a former Wilbert licensee and Board member since 2016, was promoted to President and Chief Executive Officer. Mark has hit the ground running and we are confident in his ability to continue the strong growth track record established by Joe Suhor and Dennis Welzenbach.

Kentucky Trailer, headquartered in Louisville, Kentucky, is a manufacturer of custom trailers and truck bodies for the moving and storage, mobile medical, express package delivery, animal feed, and other specialty markets. The company has the leading market position in most of its niche markets. At the end of 2020, Alleghany owned approximately 77% of the common equity of the company. Kentucky Trailer, led by Gary Smith, had a very challenging year in 2020 with earnings falling significantly as the company was beset by numerous obstacles. Not only did the Pandemic result in lower capital spending from certain customers, but productivity and margins were hurt by increased employee absenteeism and turnover as well as physical distancing measures. If that was not enough to deal with, one of Kentucky Trailer's facilities also suffered a temporary plant shutdown due to damage from a severe storm in the Midwest (the August 2020 Midwest Derecho). As Kentucky Trailer enters 2021, its backlog is recovering, with particular signs of strength in its global mobile medical business. Longer-term, Kentucky Trailer is well- positioned as the Pandemic has accelerated the growth in e-commerce and package delivery and increased interstate moving trends, which normally leads to increased demand for moving and storage truck bodies and trailers.

Precision Cutting Technologies, headquartered in Rockford, Illinois, is a holding company formed in June 2019 to house Alleghany Capital's investments in the machine tool and consumable cutting tool sectors. At the end of 2020, Alleghany owned 100% of PCT. PCT's three operating segments are: (i) Bourn & Koch, Inc., a provider of precision machine tool solutions with a significant spare parts business; (ii) Diamond Technology Innovations, Inc. a manufacturer of consumable diamond orifices and nozzles for the waterjet and other markets; and (iii) CID Performance Tooling, LLC and Supermill LLC, providers of high-performance solid carbide end mills with a focus on the aerospace market. Supermill was acquired in March 2020. PCT's consumable cutting tool, spare parts, and service businesses all suffered from Pandemic-driven client site closures as well as declines in demand, especially in the aerospace end market. Despite the Pandemic, PCT, led by Terry Derrico, finished a multi-year research and development project and launched its new MT3 product line, which is expected to drive sales in the years to come.

Non-Industrial Businesses

Jazwares, headquartered in Sunrise, Florida, is a global leader in consumer products including toys, plush, action figures, collectibles, and musical instruments, with both a licensed and owned brand portfolio. At the end of 2020, Alleghany owned approximately 76% of Jazwares. Led by Judd and Laura Zebersky, Jazwares had an impressive year in 2020, especially considering the lockdowns in China that impacted the global toy supply chain early in the year and then the temporary closure of many retailers around the globe as the Pandemic spread globally. Jazwares' earnings grew based on the contribution of a diverse group of properties as well as synergies from the Kelly Toy and Wicked Cool Toys acquisitions. This performance is even more notable given the tough comparison to a record launch year for Jazwares' *Fortnite* license, which bolstered 2019 results. Jazwares has solid momentum entering 2021 based on a diverse group of licensed and owned brands and we continue to be excited about the company's ability to grow as a platform in the fragmented global toy market. For example, the Kellytoy acquisition, which closed in April 2020, made Jazwares a leading supplier in the global plush market, leveraging both Kellytoy's *Squishmallows* and Jazwares' *Russ Berrie* brands.

IPS-Integrated Project Services, headquartered in Blue Bell, Pennsylvania with offices around the world, provides clients with design, engineering, procurement, construction management, and validation services for technically complex research and development, manufacturing, packaging, and warehouse facilities, primarily for the pharmaceutical industry. At the end of 2020, Alleghany owned approximately 85% of IPS. Despite closures of various client sites around the world due to the Pandemic, IPS's earnings were only slightly lower than last year's. More importantly, however, IPS managed to successfully deliver for its clients, while at the same time more than doubling its pipeline of future work. Led by Dave Goswami, IPS's dedicated team played a critical role assisting numerous clients in the biopharmaceutical industry, including several of the developers and manufacturers of the earliest approved vaccines and therapeutics, including those produced by Pfizer Inc. and Moderna Inc. Through a tremendous effort, the biopharmaceutical industry is delivering on a very aggressive goal of developing vaccines for COVID-19 in record time. The team at IPS was a critical resource for the industry in this endeavor, and we are tremendously proud of their efforts. Outside of the Pandemic, IPS continues to expand its business with new and existing clients in additional locations around the world, pursuing a successful growth strategy that has been in place for years.

Concord Hospitality Enterprises, based in Raleigh, North Carolina, is a manager and developer of full-service and upscale select-service hotel properties throughout the U.S. and Canada. At the end of December 2020, Concord operated 126 hotels representing approximately 19,337 rooms, managing properties for leading brands such as Marriott, Hilton, Hyatt, Choice, and IHG, as well as independent hotels. Alleghany owns approximately 85% of Concord. Unsurprisingly, Concord had a particularly challenging year with the impact of Pandemic-related travel restrictions and stay-at-home orders resulting in record industry-wide declines in hotel occupancy and many temporary hotel closures. Despite this difficult industry backdrop, due to the significant efforts of Mark Laport and his team, Concord maintained a healthy level of earnings, though down significantly from 2019 and original expectations for this year. The team, especially front line managers and employees at numerous hotels, did an impressive job keeping hotels open, often providing safe places to rest for first responders and hospital workers who did not want to risk returning to their homes in the early days of the Pandemic. As the industry enters 2021, trends are improving, although there remains a way to go. Occupancy troughed at roughly 13% of 2019 levels in Q2 and recovered to slightly over 50% by Q4. Concord's earnings should recover as hotel industry occupancy continues to rebound, but the team is not simply waiting for this to happen. The company continues to add to its portfolio of managed properties and is seeing many opportunities to grow as the industry consolidates post the shock of the Pandemic.

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As highlighted last year, it should be noted that several of Alleghany Capital's businesses (particularly, W&W|AFCO Steel, IPS, and Concord) operate in industries that incur meaningful levels of pass-through revenue. As an example, for companies such as IPS that provide construction management services to clients, the costs of subcontractor labor, equipment and material that are procured on behalf of clients appear as revenue on the construction manager's income statement. In most cases, these costs are passed through with a minimal or no profit margin. Likewise, in the third-party hotel management industry, the costs of hotel employees that are ultimately reimbursed by hotel owners flow through income statements as revenue, with an equal and offsetting cost. Pass-through revenue results in lower reported margins, and the variation in pass-through revenue can favorably or unfavorably impact reported margins between periods without there being a fundamental change to the underlying business.

Alleghany Capital's focus in 2020 was supporting its companies in adapting to the unique safety, community, and business challenges created by the Pandemic and its resultant impact on the economy. Although all of our companies tightened their belts during the year to address the uncertain business climate, Alleghany Capital encouraged its companies to also plan for a recovery and take a long-term view, especially with regard to supporting their employees. We expect these investments in people will aid in a recovery and create new opportunities over time. As Alleghany Capital and its companies focused inwards, overall middle-market deal flow for both platform and add-on acquisitions also slowed dramatically industry-wide, though it began to pick up in the fourth quarter and expectations are for a significant increase in market-wide M&A activity in 2021. In particular, the team believes it will see a material increase in founder-held businesses coming to market in 2021, as private owners with large embedded capital gains look to transition ownership ahead of potential tax law changes. Alleghany Capital's business model resonates well with founder-owners and the team is looking forward to capitalizing on new opportunities.

Overall, Alleghany Capital is positioned well for continued growth in 2021, reflecting a rebound from recent Pandemic-driven challenges, organic growth initiatives at each of its companies, improving backlogs entering the year, and a rebuilding platform and add-on acquisition pipeline. Due to the seasonal nature of some of the group's larger businesses, we expect over two-thirds of Alleghany Capital's earnings in 2021 will be in the second half of the year.

We have spent the last decade building Alleghany Capital from an idea to a portfolio of seven non-financial businesses with collective revenue of almost $2.5 billion. In the past five years, the earnings power of the portfolio has started to emerge, despite the headwinds of the Pandemic. At the end of 2020, the carrying value of Alleghany Capital's subsidiaries and investments was approximately $1.1 billion.

The table below summarizes Alleghany Capital's results over the past five years:

($ millions)

	2016	2017	2018	2019	2020	Growth '16-'20
Portfolio adjusted EBT[8]	$ 43	$ 64	$ 93	$ 161	$ 166	40%
ACC corporate expenses	(10)	(14)	(10)	(18)	(12)	6
Adjusted EBT	$ 33	$ 50	$ 83	$ 143	$ 154	47%
Attributable income taxes[9]	13	20	21	37	40	32
Adjusted earnings before NCI	$ 20	$ 30	$ 62	$ 106	$ 114	55%
Non-controlling interests	4	11	15	33	25	61
Adjusted earnings	$ 16	$ 19	$ 47	$ 73	$ 89	53%
Average equity	$348	$555	$774	$ 881	$1,005	30%
Return on equity	4.6%	3.5%	6.0%	8.3%	8.8%	
Capital contributions	$140	$248	$176	$ 50	$ 159	
Cash distributions from portfolio[10]	(28)	(31)	(33)	(108)	(78)	
Net cash capital contributions	$112	$217	$143	$ (58)	$ 81	

The table shows adjusted earnings of $89 million in 2020, and a return on equity of 8.8%. As I have discussed in past years, certain purchase accounting adjustments and other items distort the true underlying profitability of this portfolio of businesses. As a reminder, most of Alleghany Capital's businesses are pass-through entities rather than C-corporations. As a result, their tax obligations flow through to the owners, with Alleghany Capital being the controlling owner and our founder or management partners being minority owners. This structure complicates the presentation of results on Alleghany's financial statements. Nevertheless, here goes …

Several items depressed Alleghany Capital's results in 2020. For simplicity, I will only review the impact to 2020, but would note that there has been a consistent negative impact from purchase accounting in each and every year. They are summarized below:

($ millions)

	100% basis	Attributable to Alleghany[11]
M&A fees at portfolio companies	$ 2	$ 1
M&A fees at ACC corporate	3	2
Embedded profits charge	12	9
Non-controlling interest accretion	2	2
Total	$ 19	$ 14

[8] Before amortization, 100% basis.

[9] Assumed tax rate of 40% in 2016 and 2017 and 26% thereafter.

[10] Includes tax distributions.

[11] After an assumed effective tax rate of 26%.

When an Alleghany Capital ***portfolio company*** makes a "bolt-on" acquisition, it incurs legal and advisory fees. All of these fees are expensed. Alleghany's share of these fees on its income statement is proportional to its ownership interest. By contrast, if ***Alleghany Capital*** acquires a new platform company, it incurs legal and advisory fees, and 100% of these fees are our expense. In 2020, Alleghany incurred an "embedded profits charge" (sort of being punished for doing well!) that is a total creation of purchase accounting. Essentially this accounting policy says if you buy a company that has $100 of inventory that will sell for $120, you have to write-up the inventory at the time of acquisition, resulting in a lower reported gross profit going forward. The net impact is to effectively eliminate profits from existing inventory on the books of the new owner. Finally, when the fair value of redeemable non-controlling interest changes, we incur an expense that has little meaning from an economic earnings perspective. The accounting says that because your companies are earning more, the value of the share that is owned by non-controlling interests is worth more, and you have to recognize that the future put/call obligation that is in place relating to the redeemable non-controlling interests is worth more. Got that?

In plain English, Alleghany Capital reported adjusted earnings of $89 million in 2020, after $14 million of charges related to purchase accounting. From an investment point of view, we see the ROE of the group – which reflects both the underlying economics of each portfolio company as well as the prices that we paid for them – as 10.0% instead of the 8.8% reported on an "adjusted" basis.

One last point: we also amortize intangible assets. For purposes of the presentation above, we have excluded the $44 million pretax amortization ($35 million after-tax) from the presented results. This amortization was a drag on our growth in book value of a little less than 0.5% in 2020.

We believe that the value of the ACC portfolio in today's equity market is well in excess of our carrying value. The price-earnings ratio of the Russell Small Cap Index (excluding unprofitable companies) was approximately 17-times at the end of 2020. Applying this multiple to our underlying earnings would imply a value of approximately $1.75 billion, or $650 million above our carrying value. The excess amounts to roughly $46 per Alleghany share.

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TransRe

TransRe is a highly diversified reinsurer with significant exposure to original rate movements through proportional reinsurance, which is roughly two-thirds of its business. The majority of its business is casualty and specialty reinsurance, with property (including property cat) accounting for a little less than one-third of premiums. This diversified platform – along with a stable employee base with significant underwriting expertise and experience – allows the company to effectively adjust its underwriting appetite in relation to competitive conditions. Prior to 2020, weak market conditions caused TransRe to shed certain classes of risk but maintain the top-line by adding less volatile, but lower-margined business. This began to change in 2020, and TransRe's underwriters are now seeing increased opportunity for profitable growth, especially in North American casualty business.

For the fourth consecutive year in 2020, TransRe produced an underwriting loss. Excluding losses related to the Pandemic, however, TransRe would have produced an underwriting profit of $225 million and a combined ratio of 95.2%. While the Pandemic-related losses are real, looking at the results excluding these losses is useful to provide a perspective on the underlying profitability as we move into an improving market. The 2020 Atlantic hurricane season was very active, with multiple land-falling hurricanes[12]. Worldwide insured catastrophe losses (both natural and man-made) were approximately $83 billion in 2020, up from $63 billion in 2019 and a trailing 10-year average of approximately $79 billion[13]. In this environment, excluding pandemic-related losses, TransRe produced reasonably good results.

Earlier in this letter, I discussed how our catastrophe losses were roughly double what we expected over the past five years. While it is tempting to blame this on climate change (and many do), it appears that we are in an active phase of the Atlantic hurricane cycle and it is difficult, if not impossible, to conclude from such a limited sample of years that the secular trend has changed, especially when one takes a ***global*** perspective. In past years, I have shown that the primary cause of increased insured catastrophe losses is the growth in the value of catastrophe exposed property and increased coastal development.

TransRe uses catastrophe models and proprietary tools to quantify the nature of its risk, and adjusts its exposure and pricing accordingly. Because reinsurance by its nature absorbs large, infrequent losses, "average" or "expected" losses are seldom the norm. Rather, actual losses will be below average some of the time, and significantly above average other times.

[12] Interestingly, *global* tropical cyclone activity was about average in 2020.
[13] Source: Swiss Re *Sigma*.

The table below summarizes North American insured catastrophe losses from 2010 through 2020 in current dollars:

($ billions)	Amount	Multiple of Median
2010	$ 22.7	0.57
2011	55.7	1.41
2012	71.5	1.81
2013	26.8	0.68
2014	25.3	0.64
2015	25.0	0.63
2016	34.1	0.86
2017	137.4	3.47
2018	62.0	1.57
2019	39.6	1.00
2020	67.0	1.69
Average	$ 51.6	
Median	39.6	

Source: Insurance Information Institute, Aon, Munich Re.

When North American natural catastrophe losses are above the average level, it is a safe bet that they will fall disproportionately on the reinsurance industry. This was certainly the case with 2012 (Super Storm Sandy) and 2017 (Hurricanes Harvey, Irma and Maria).

TransRe incurred elevated losses in 2017 when Hurricanes Harvey, Irma, and Maria produced significant losses for the entire industry; in addition, in 2019, when North American natural catastrophe losses were in line with expected levels, TransRe had above-average exposure to Japan, which suffered record losses from Typhoons *Faxai* and *Hagibis* in its worst tropical cyclone season in the past 25 years. And finally, as previously mentioned TransRe had unexpected losses from the Pandemic. These factors explain the bulk of the difference between expected and actual catastrophe losses.

For several years now, I have discussed the emergence of the alternative capital market and its relationship to traditional property catastrophe reinsurance. In 2020, there were approximately $11 billion of cat bonds issued, which slightly exceeded the amount of cat bonds that matured in 2020 ($10 billion)[14]. Cat bonds therefore remain an important part of how catastrophe risk, especially for very large events, is transferred from insurers and reinsurers to the capital markets. But a net increase of $1 billion in cat bonds outstanding, or a 2% increase in supply, is a much slower growth rate than the industry saw in the past. From 2005-2015, cat bonds outstanding grew at roughly 16% per year. The ILS (Insurance Linked Securities) market remains at about $85-$90 billion, with effective capital (i.e. excluding so-called “trapped capital”) in the $70-$75 billion range. Alternative capital, both cat bonds and ILS facilities, produced low- to mid-single digit returns to their investors in 2020.

Climate change is likely contributing to the financial risk associated with natural catastrophes due to the ***size*** and ***characteristics*** of major hurricanes. In his 2019 book called *The Geography of Risk: Epic Storms, Rising Seas, and the Cost of America’s Coasts*, author Gilbert Gaul reviews how massive coastal development in areas of the country that are highly exposed to hurricanes and convective storms — such as Houston, Tampa, Miami, Jacksonville, Charlotte, and the New York metropolitan area — has resulted in there being far more property exposed to natural disasters than ever before. The author describes how storms of 50 years ago or more (even before meaningful climate change) would produce significant damage and disruption today due to excessive coastal development since then. While many want to see more “resilient” cities, we may have long passed the time when this was an easily attainable objective, even without climate change-induced increases in damage potential.

[14] Source: Dowling & Partners.

Steadily rising sea levels, combined with large, slow moving hurricanes that dump enormous amounts of rainfall in a short timeframe, have resulted in widespread damage to many of these cities over the past decade. Moreover, the potential cost of a major hurricane hitting Miami or Tampa, for example, is so great that it may be beyond the capacity of the private insurance industry to profitably offer a viable risk financing solution. The result has been that the insurance industry – and its reinsurers – are absorbing less and less of the cost of major storms, as flooding risk is largely retained by the government (state, local, and federal). On a worldwide basis, the insurance industry absorbed less than 40% of total natural catastrophe losses in 2020.[15]

And as an aside, the two largest states with no personal income tax – Florida and Texas – are continuing to attract more and more residents, and with them, more catastrophe-exposed property. This is even being encouraged by a national tax policy that severely limits federal tax deductions for state and local income taxes, encouraging people to move to low- or no-tax states. ***Over the past 25 years, Florida, Texas and Louisiana accounted for over 60% of total insured natural catastrophe losses in the United States.***[16]

TransRe's strategy in this new reality has been to selectively work with alternative capital (including issuing catastrophe bonds, maintaining its Pangaea side car facility, and its new strategic relationship with Integral ILS), and to purchase traditional retrocessional coverage when it is economically attractive. Following large losses in Japan from tropical cyclones in 2019, TransRe saw a significant, but insufficient increase in pricing for major Japanese wind and flood placements. TransRe elected to reduce its catastrophe exposure on these accounts, with premium rate changes offsetting exposure reductions. TransRe took a similar approach in Florida as well. As TransRe has reduced its peak zone exposure, its excess capital position has increased. Improving pricing, terms, and conditions in casualty reinsurance may absorb some of this excess capital in the years ahead.

In 2020, approximately 70% of TransRe's net premiums written was from North America, with 18% from Europe, 7% Asia Pacific, and 5% Latin America. The table below summarizes the company's 2020 net premiums written by risk class compared to 2019:

($ millions)	2019	2020	% change
Standard Casualty	$ 613	$ 816	33
Professional Liability	579	765	32
Personal Auto/Motor	573	474	(17)
Total Casualty	$1,765	$2,055	16
Other Property	773	845	9
Catastrophe	279	314	12
Total Property	$1,052	$1,159	10
A&H	301	280	(7)
Guaranty	287	244	(15)
Marine & Energy	151	171	13
Aviation	81	98	21
Engineering	51	48	(6)
Other	116	113	(1)
Total Specialty	$ 987	$ 954	(3)
Structured	691	677	(2)
Total	$4,495	$4,845	8

[15] According to Munich Re, worldwide natural catastrophe losses were approximately $210 billion, of which only $82 billion was insured.

[16] Source: Insurance Information Institute.

Professional Liability primarily consists of D&O, E&O, and Medical Malpractice. Most of the underlying coverage in these classes is written on claims-made policy forms, contrasted with Standard Casualty (General Liability, Workers' Compensation, Other Traditional Casualty), where the underlying coverage is mostly on occurrence policy forms. Auto and Motor is mostly personal lines and is generally shorter-tail and less volatile than Standard Casualty. Guaranty is comprised of Credit, Mortgage Guaranty and Surety.

Reinsurance renewals on January 1, 2021 were positive. Loss affected accounts saw significant rate increases, especially for regional property and casualty insurers, while national property cat placements saw high-single-digit rate increases. U.S. casualty excess of loss treaties saw rate increases in excess of 20%. Moreover, while ceding commissions on proportional casualty improved modestly, the underlying rate movement at the insurance company level was robust. Finally, TransRe was able to obtain differentiated terms from the overall market placement terms on a number of accounts, as clients and brokers valued the company's participation on the program.

The table below summarizes TransRe's results since Alleghany acquired it on March 6, 2012:

($ millions)

Year	Net Earned Premiums	Underwriting Profit (Loss)	Net Cat Losses	Combined Ratio
2012	$ 2,916	$ 267	$ 278	90.9
2013	3,279	334	92	89.9
2014	3.331	345	47	89.6
2015	3,116	327	32	89.5
2016	3,845	261	139	93.3
2017	3,809	(263)	581	106.9
2018	3,939	(213)	500	105.4
2019	4,327	(41)	301	100.9
2020	4,645	(167)	566	103.6
Total	$33,207	$ 850	$2,536	97.4

Under Alleghany ownership, TransRe has produced cumulative underwriting profits of approximately $850 million, with the last four years being underwriting losses. After several very profitable years, elevated catastrophe losses (and, in 2020 losses from the Pandemic) and a highly competitive market have recently challenged TransRe's ability to produce attractive underwriting results. Over the entire period of Alleghany's ownership, however, TransRe has produced an average combined ratio of about 97.4%. As you can glean from the table above, under Alleghany's ownership TransRe has had five good underwriting years (2012-2016), followed by four more challenging years. If history is any guide, the next few years should be better.

RSUI

RSUI is a specialty commercial insurance underwriter that focuses on insuring severity-exposed risks. By using best-in-class underwriters and claims professionals supported by proprietary technology, it has been able to consistently generate underwriting profits while providing wholesale brokers with responsive and timely service. RSUI's "wholesale-only" focus gives it a largely variable cost structure that allows the company to shrink and grow depending upon market conditions. Since Alleghany acquired the company in 2003, it has demonstrated that this strategy works. Since July of 2003, RSUI has produced book value growth plus dividends of almost 10% per year.

The company operates primarily out of its main office in Atlanta, Georgia with a satellite office in Los Angeles, California. Approximately 85% of its business is written out of Atlanta, with the balance being produced out of Los Angeles. The company firmly believes that having most of its employees in one location allows for better underwriting control, collaboration, and a strong culture of service.

The table below shows 2020 gross premiums written by department, with the year-over-year growth rate:

($ millions)

	2019	2020	Change
Property	$ 578	$ 702	21%
Casualty	252	324	29%
Management Liability	215	355	65%
Professional Liability	154	174	13%
Binding Authority	127	120	(5)%
Alternative Structures	41	39	(6)%
Total	$1,367	$1,714	25%

RSUI produced double-digit growth in its core product lines in 2020. Binding Authority gross premiums written declined 5% as the company initiated actions to improve results in this highly competitive line. This resulted in a decrease in premium volume in 2020 but a better-priced book of retained business. Alternative Structures premium volume also declined modestly.

In property, RSUI manages risk accumulations through the use of proprietary models that track and aggregate limits exposed to hurricanes, earthquakes, severe convective storms, and wildfires, with consideration given to construction and property type as well as granular geographic risk concentrations and the attachment profile. RSUI avoids excessive reliance on probabilistic models, which are used however to complement the deterministic approach.

RSUI leverages its capital base through the use of reinsurance, which allows it to provide meaningful support to its customers over the course of a cycle. Because RSUI is focused exclusively on underwriting profitability, it tends to expand its exposure when industry conditions allow for better pricing, terms and conditions, and it shrinks its exposure when the market gets excessively competitive. Gross premiums written declined for three consecutive years from 2014-2016, was flat in 2017, and begin to increase again in 2018. As market conditions continue to improve, RSUI's overall premium growth has accelerated, and grew 25% in 2020.

Dave Leonard has ably led RSUI for over eight years now. In addition to providing exceptional leadership and underwriting oversight, he has thoughtfully mentored and developed the next generation of RSUI's leaders. Professional knowledge at RSUI is increasingly being institutionalized, making the company even more valuable. Reporting to Dave are three talented and seasoned executives: Phillip McCrorie (President), Andrew Whittington (Executive Vice President) and Lee Sjostrom, the company's Chief Financial Officer. The management team at RSUI is stable, and there is a deep bench of talent.

The following table summarizes RSUI's results over the past nine years:

($ millions)

Year	Net Earned Premiums	Underwriting Profit (Loss)	Net Cat Losses	Combined Ratio
2012	$ 656	$ 5	$ 192	99.2%
2013	764	151	59	80.2
2014	828	180	44	78.3
2015	810	158	26	80.4
2016	755	138	81	81.6
2017	722	(57)	232	107.9
2018	747	44	155	94.1
2019	824	101	96	87.7
2020	1,009	44	230	95.6
Total	$7,115	$764	$1,115	89.3

CapSpecialty

Jack Sennott has been in charge of CapSpecialty since July 1, 2019. Since becoming CEO, Jack has initiated a number of actions to improve the company's long-term performance. In 2019, he strengthened the management team with the addition of a new Chief Financial Officer and a new general counsel. The company also decided to exit certain classes of business that were contributing to an unsustainably high expense structure, and began the difficult process of designing a more efficient systems environment. At the same time, we decided to increase the conservatism in the company's current year estimates of ultimate loss ratios, and since then actual claims incurred have been emerging at or below the levels assumed in these new loss ratio selections.

In 2020, CapSpecialty began implementing many of the changes decided in the second half of 2019. The company closed two small offices that were supporting certain classes of admitted business to allow for the ultimate shut-down of legacy systems that were expensive and that only supported admitted business. CapSpecialty also exited Binding Authority business in Florida and New York City habitational risks. A number of unprofitable Binding Authority agencies were also eliminated. At the same time, CapSpecialty has continued to grow its specialty business (professional liability), both organically and by adding additional classes, such as Architects & Engineers, when competitor dislocation allowed for a new entrant.

The table below summarizes CapSpecialty's 2020 Gross Premiums Written by class:

P&C Package	24%
Commercial Surety	14%
Subtotal	38%
Healthcare	24%
Specialty Casualty	19%
Professional lines	19%
Subtotal	62%

Of the above groupings, P&C Package and Commercial Surety are CapSpecialty's original businesses. The company entered Professional lines in 2009, and Healthcare and Specialty Casualty (construction and environmental risks) in 2013. Distribution is now exclusively wholesale except for commercial surety, which is generally distributed through agents that specialize in surety coverage.

The transformation of CapSpecialty has been aided by improving pricing conditions in 2020. A little over a year ago, rate monitoring systems were implemented so that the company can track renewal pricing (because of the systems environment, this was more difficult than one would like). Rate changes steadily improved in 2020, and averaged 10%.

Looking forward to 2021, we expect CapSpecialty to realize some efficiencies from the transformation, but this will be a year of elevated systems investment that will largely offset these efficiencies in the short run. After 2021, we expect meaningful progress in the company's expense ratio.

($ millions)

Year	Net Earned Premiums	Underwriting Profit (Loss)	Pre-tax Income	Combined Ratio
2012	$ 149	$ (21)	$ (10)	114.2%
2013	171	(31)	(21)	119.7
2014	192	(11)	(2)	105.8
2015	221	(5)	3	102.6
2016	250	5	14	97.9
2017	271	4	15	98.3
2018	306	7	18	97.7
2019	345	(27)	12	108.4
2020	347	(6)	8	101.7
Total	$ 2,252	$ (85)	$ 37	103.8%

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Insurance accounting: room for improvement

Over the past several years, insurance and reinsurance companies have had extremely volatile earnings on a quarterly and annual basis. Large catastrophe losses have caused earnings expectations to change radically from quarter to quarter. I believe that the insurance accounting framework contributes to this problem and it needs to change.

In most aspects of accounting, a basic principle is that expenses should be matched with revenues. In liability lines of insurance and reinsurance, for example, companies make estimates of ultimate losses related to the premiums that have been earned for a specific time period. Very few of these losses are actually reported to the insurer or the reinsurer in the period that the premium is earned; in fact, most of them are reported in future periods, and they change over time as estimates of their ultimate cost change. The fact that they are difficult to estimate, and these estimates are usually wrong, does not absolve a company from the requirement to book a reasonable provision for these claims. An entire profession has evolved to systematically and mathematically estimate these future claims so they can be accrued in the current period. So-called reserves for "incurred but not reported" losses are an essential part of how the industry operates to help its clients deal with risk and loss uncertainty.

The concept has an analogue in commercial banking, as banks employ complex macroeconomic models to try to predict future credit losses and incorporate the results of these models in their accounting for loan loss reserves. In 2020, for example, several major banks reported large losses at the end of the first and second quarter, only to reverse some of the loan loss provisions in the fourth quarter.

When it comes to property insurance, however, the rules are different. Even though we know through extensive hurricane records that there is a probability that a hurricane will occur each year (and in recent years they have occurred with some regularity), and we have a pricing expectation for the "average loss" for a portfolio of risks, ***we are not allowed to book these losses until the loss event actually occurs.*** Because of this, insurance and reinsurance companies ***overstate*** their earnings when they earn a premium for property catastrophe risk and no loss event occurs, and similarly they ***understate*** their earnings in the period when it actually does occur.

It would make much more sense – and would result in financial statements that are more meaningful for investors – if insurers and reinsurers could book expected losses based on their exposure and catastrophe models on a consistent basis from period to period. This would result in companies having reserves that could be drawn on when the event actually occurs, and would better "match" revenues and expenses. Annual results could disclose two loss items: expected losses (based on models) on the income statement and the actual losses that occurred.

It would also change the apparent economics of the industry, improving reported returns on equity. Why? If an insurer or a reinsurer had reserves for expected catastrophe losses, it would no longer be necessary to keep such a large amount of capital in relation to premiums. Today, companies effectively have reserves for future catastrophe losses in their capital account, resulting in depressed returns on equity and low stock market valuation in relation to book value.

In some European countries, insurers and reinsurers used to be able to accrue "equalization reserves" which were tax deductible. We can dream, can't we? As one European reinsurance executive once told me, "we have reserves for not-yet-incurred-and-not-reported losses!"

Monetary policy is out of gas … fiscal policy to take over

Beginning in the early 1980s, when the Federal Funds rate approached 20%, interest rates began a long-term, secular decline. After "breaking the back" of inflation, the Federal Reserve responded to each subsequent economic dislocation by lowering interest rates, which acted to stimulate private sector borrowing by consumers and in so doing move future consumption to the present. Following the Great Financial Crisis of 2008, however, lower interest rates have had less and less efficacy, and in the current environment monetary policy is officially "pushing on a string." In Europe and Japan, interest rates turned negative. The stock of negative-yielding debt rose to a record $18 trillion in 2020.

Conventional wisdom has generally held the view that budget deficits should cause interest rates to rise, but clearly the opposite has happened. The table below shows the 10-year treasury yield at the end of each year in five-year increments:

Year	10-year Treasury	Deficit to GDP
1995	8.08%	2.1%
2000	5.11%	(2.3)%
2005	4.39%	2.4%
2010	3.29%	8.6%
2015	2.27%	2.4%
2020	0.92%	17.9%

Perhaps larger government deficits actually cause lower interest rates? As outlined in her 2020 book, Stephanie Kelton notes that "when the government is spending more than it's taxing away, it leaves the banking system with a larger quantity of reserve balances. In other words, fiscal deficits increase the *aggregate supply* of reserve balances." She goes on to note that "the purpose of selling bonds is not to 'finance' government expenditures (which have already taken place) but to prevent a large infusion of reserves from pushing the overnight interest rate below the Fed's target level."[17]

The Chinese experience is worth reviewing. For decades, China has spent money that it "doesn't have" to build *productive capacity*, thereby creating the fastest economic development of a major country ever. China also used currency controls to increase global competitive advantage and jump start economic development through an export-led economy. Recently however, this may be changing. As recently pointed out by Stephanie Pomboy of MacroMavens[18], China is now letting its currency rapidly appreciate (up almost 10% against the U.S. dollar since June of 2020), letting large state-owned enterprises default on their debt, and transitioning the economy from an export powerhouse to an export powerhouse with strong domestic consumption as well. Chinese purchases of U.S. treasuries peaked several years ago and over the past couple of years China has been shrinking its holdings of U.S. treasuries, while buying massive amounts of copper, steel, and (yes) crude oil. Although China's official holdings of gold are relatively small, it may own more than it is letting on. And more recently, China may be positioning itself to be an alternative to the United States as a home for global excess capital.

The effect of deficit spending on inflation and interest rates would therefore seem to depend on how the money is spent. Significant expenditures toward infrastructure and productivity-enhancing investments can lead to noninflationary growth. By contrast, deficit spending that largely funds transfer payments may ultimately prove to be inflationary.

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[17] *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy* by Stephanie Kelton.
[18] *Quiet. Too Quiet*. MacroMavens, December 23, 2020.

It has often been observed that the Fed sets short-term interest rates while the market sets long-term interest rates. Long-term interest rates have been falling over the past three decades due to declining inflation expectations ***and*** accommodative central banks since the Great Financial Crisis. It is possible that inflation expectations could change in the future due to Pandemic-caused supply disruptions as well as an increased mandate for the federal government to expand deficits for non-productive investments. In early 2021, inflation expectations were already rising. A strengthening Chinese currency will also add to inflationary pressure.

It is our view that although interest rates will remain low by historical measures, they are more likely to rise than fall from here due to gradually rising inflationary pressures. Continued intervention by the Federal Reserve will likely cause real interest rates to remain negative. If inflation, for example, were to rise to 3%, the 10-year treasury could well rise to 2% and real yields would still be negative. However, it seems unlikely that the economy and the U.S. government can sustain interest rates much above 2% or so on the 10-year treasury, and we expect that the Federal Reserve will not hesitate to implement so-called yield curve control to make sure that long-term interest rates don't rise too far.

As also pointed out by Luke Gromen, the U.S. government's expenditures on entitlements, defense spending and interest payments are approximately 140% of total tax revenues. Given demographic trends, entitlement spending is accelerating. The only practical way for the U.S. government to manage this situation is to ensure that nominal interest rates remain below nominal GDP growth. Total U.S. government debt ended fiscal 2020 at $27 trillion ($21.6 trillion held by the public), up from $23 trillion at the end of 2019. The Federal deficit was $3.1 trillion in fiscal 2020, and is projected at roughly the same level in 2021. Given the massive funding requirements implied by these numbers, and the inability of the Federal government to afford higher interest rates, it is likely in our view that the Fed will be a major buyer of incremental treasury debt and real interest rates will remain negative. Since the Great Financial Crisis of 2008, central bank balance sheets[19] have increased from $4 trillion to almost $25 trillion at the end of 2020. Recent discussions by Washington thought-leaders suggest that the Federal Reserve will continue to be required to manage increasing deficits for the next several years. The alternative – either fiscal discipline or higher interest rates – would likely crash the economy and financial markets.

Over the past 30 years, the world's developed economies have enjoyed a "great moderation." Economists Charles Goodhart and Manoj Pradhan, in their 2019 book *The Great Demographic Reversal: Ageing Societies, Waning Inequality and an Inflation Revival* make an excellent case that over the intermediate term, the forces that led to this great moderation – a huge global increase in the working age population, led by demographics in the developed world and the entry of China and Eastern Europe into the world economy, have run their course. In their words, the "great reversal" is now starting, and the "sweet spot is turning sour". They project an absolute decline in the size of the labor force in a number of important countries including Japan, China, most of North Asia and several major countries in continental Europe. In addition to these demographic trends, a slowing of globalization and an explosion in the size of the senior population will likely lead to more inflation and gradually higher interest rates. Given the pressures on developed economies, the economists believe that it will become increasingly difficult for central banks to remain completely independent of governments. We are seeing the beginning of these pressures in the form of large scale asset purchases by central banks.

Our investment strategy at this point therefore anticipates the possibility of a gradual regime change. We expect that as the pressures of the Pandemic fade, economic growth will accelerate in 2021, and inflation will accelerate. The disinflationary environment that followed the Great Financial Crisis of 2008 is likely ending. As Charles Gave of Gavekal Research has so clearly described, we may be moving into an "inflationary boom" environment.

[19] Sum of Bank of Japan, ECB, Federal Reserve, Bank of England, and Swiss National Bank.

We believe that due to the fiscal position of the U.S. government – and the change in the political landscape – the Federal Reserve will have little choice but to limit the rise in interest rates by continuing to massively expand its balance sheet. In mid-to-late 2020, we built a large position in gold miners and gold streaming companies. We believe that this investment allocation will so protect our balance sheet against rising inflationary pressures and a weaker U.S. dollar in the years ahead. We continue to own large positions in America's technology leaders, despite their apparent "rich" valuation, in part because we are now sitting on large unrealized gains. While they may not produce the returns in the future that they have in the past, we do believe that leading technology growth companies will continue to generate reasonable returns from current prices over the long-term.

Oil: can't live with it, can't live without it

Approximately 50 years ago, President Nixon abandoned the gold standard. From 1971 onward, the U.S. dollar would be backed only by the government's promise to pay, and demand for dollars was assured by the fact that almost every country in the world depended upon imported oil that was priced in U.S. dollars. As a consequence of this, U.S. treasuries became an essential reserve asset of foreign central banks.

Ever since this change, the U.S. was able to run significant trade deficits, with foreign creditors accepting U.S. dollars as payment for goods. These dollars were invested in U.S. treasuries, as the federal government issued debt that was purchased by (among others) foreign central banks. Beginning in 2014, foreign central banks stopped adding to their holdings of U.S. treasuries. Russia in particular began to significantly add to its gold holdings. And while China's official holdings of gold are relatively small as a percentage of the total at present, nothing China does is small. Today, U.S. dollars account for slightly over 60% of global currency reserves. The emergence of the shale revolution post-2008 – made possible in part by a highly accommodative Federal Reserve, which made it possible for oil companies to continue to invest capital for shale development despite negative cash flows – made the United States the world's largest oil producer and significantly reduced exports of U.S. dollars for oil. At the same time, China became a growing importer of oil, and Europe remained dependent upon Russia for natural gas.

This brings us to the present. The Pandemic has broken the shale industry, and a collapse in domestic oil and gas investment will result in a continuing decline in U.S. production, and with it, the potential for more oil imports and more U.S. dollar exports. The world's oil supply is increasingly controlled by governments rather than free markets, a situation that is only going to get worse due to significant decreases in investment in new production by the oil and gas industry, partly for economic reasons and also in response to pressure from investors who want to see a more rapid transition to wind, solar, and other sources of energy.

At the same time, Russia seems to be effectively selling oil and natural gas for gold (it receives U.S. dollars and Euros for oil and exchanges them for gold), while China seems content to spend RMB if the seller will accept it, or Euros that it receives from world trade.

Where does this all end? Again to quote Luke Gromen: "USTs cannot continue to serve as the primary global reserve as they have in the post-1971 USD-centric system; it appears gold may serve as the new primary global reserve asset, perhaps after a large revaluation higher."[20]

[20] Luke Gromen, *The Forest For The Trees*, December 4, 2020.

And for those who think the U.S. will no longer need oil due to electric vehicles, experts such as Daniel Yergen have observed that there are 280 million cars in the United States today, and 279 million of them are gasoline-powered. He believes that oil demand won't peak until 2030[21]. There are approximately 1.4 billion vehicles today that are powered by oil. Rapid technological change in battery technology, of course, will ultimately make EV's increasingly competitive with internal combustion engines; the question is the pace of energy transition. One forecast projected that 30 years from now, there will still be 1.4 billion cars that run on oil products, and electric vehicles will total approximately 600 million.[22]

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Equity markets enter uncharted territory

The equity market has had a significant long-term recovery from the 2008 Great Financial Crisis. After hitting a low of 666 in March of 2009, the S&P 500 began almost a decade-long climb to new highs, fueled by multiple rounds of central bank asset purchases, which contributed to steadily declining interest rates. In 2018, the Federal Reserve began to try to unwind a decade of quantitative easing. By the end of 2018, it was clear that this was not going to be easy, as the stock market sold off sharply in reaction to a Federal Reserve attempt to tighten monetary policy, although it appears the Fed now pleads temporary insanity.

Barry Bannister of Stifel has illustrated the increasing volatility that emerged since the beginning of 2018:

Date	SPX	% change
01/26/18	2873	
02/08/18	2581	**- 10.2%**
09/20/18	2931	+13.6%
12/24/18	2351	**- 19.8%**
02/19/20	3386	+44.0%
03/23/20	2237	**- 33.9%**
12/31/20	3756	+67.9%

He also notes that negligible interest rates have probably contributed to a massive revaluation of long duration growth stocks including the technology, consumer discretionary (including AMZN and TSLA), and communications sectors, while shorter duration stocks including financials, industrials, utilities, energy, consumer staples, and real estate have at best not participated in this revaluation and in some cases have suffered.

In 2020, the S&P 500 returned 18.4%. If technology and communications and services are excluded, the S&P 500 returned 4.8%. Most of the performance of the market leaders was due to an expanding price-earnings ratio rather than earnings growth. Investors see significant long-term opportunity from the digital transformation of the economy, amplified by record low interest rates.

But what happens if, due to a shifting political landscape, inflation picks up and with it nominal interest rates?

[21] Daniel Yergen, CNBC, December 23, 2020.

[22] *The New Map: Energy, Climate, and the Clash of Nations* by Daniel Yergin.

At the end of 2020, the S&P 500 was trading at a reported price-earnings ratio of 29-times, and, as has been pointed out by Jim Grant[23], is estimated to have a true price-earnings ratio of 38-times if the ratio is market capitalization weighted. In other words, some large companies have ***very*** high price-earnings ratios. The U.S. equity market capitalization to GDP is at an all-time high of 170%, and the cyclically-adjusted price-earnings ratio ("CAPE") is at 33-times. Other objective measures of valuation are at or near all-time highs (median enterprise value to sales, median enterprise value to EBITDA, etc.).

Extremely low and negative real interest rates, coupled with widespread mobile access to new trading platforms and increased participation by retail investors in equity markets may be contributing to an unsustainable valuation paradigm. Time will tell. For those of us trained in fundamentals and security analysis, it is axiomatic that markets with these characteristics are destined to provide lower prospective long-term returns. But then each year goes by and the market hits new highs.

While our first reaction to a high market price-earnings ratio is to be cautious, it is worth considering arguments that would support an alternative view. Probably the most compelling argument against the stock market being overvalued is the problem of averages; the current market price-earnings ratio is a combination of highly valued growth companies and less exciting valuations of traditional business. Large technology companies with outstanding fundamentals and superior long-term growth prospects are trading at above-average multiples – in some cases justifiably – while other parts of the market have seen a significant disruption to their earnings, also leading to a high price-earnings ratio. At the same time, the Pandemic has radically reordered the economy, creating huge winners and losers.

The table below shows the valuation of the Russell 1000 Growth (RLG) and Value (RLV) indices as of late 2020[24]:

	RLG	RLV
Price-earnings ratio	41.2	20.7
Price-book ratio	12.1	2.4
Price-to-sales ratio	4.9	1.9
Dividend yield	0.8%	2.3%

Investors seem to be discounting the impact that technology and disruption are having not only on the winners in the Pandemic but on the losers as well. But in our opinion, it is hard to argue that either group is priced to generate attractive long-term returns from current levels.

One explanation of what may be transpiring comes from the work of Michael Green of Logica Capital Advisors, LLC. He notes how the growing dominance of index funds and passive investors in the equity market has distorted valuations, as inflows into passive vehicles, which buy no matter what the price, continuously bid up the values of constituent companies, ***especially those with revenue and earnings momentum***. Passive flows may be acting as an amplifier to growth and momentum stocks whose prices are being bid up by enthusiastic active managers and retail investors. The longer that this continues, the more investors are becoming convinced that index funds offer better returns with less risk. In addition, central bank policies that have contributed to lower interest rates have also increased the theoretical value of long-duration equities over short-duration equities. Book value is out; revenue growth is in.

Green also observes that ***active*** investors are disproportionately older investors and index fund investors are disproportionately younger investors. The shifting flows away from active managers to passive investors is resulting in forced sales by active managers and relentless buying of the equities of companies by the index funds with ***no*** regard for valuation or price.

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[23] "Hallucinations? No, valuations" *Grant's Interest Rate Observer*, December 11, 2020.

[24] The Gloom, Boom, and Doom Report, January 1, 2021.

Want to "play" solar energy? Buy TAN. Battery technology? Buy LIT. Electric Vehicles? Buy DRIV. These ETFs all allow investors to participate in investment themes without any thought as to valuation or financial fundamentals. One influential market observer has noted that the rise in speculation in the stock market has occurred just as sports betting hit a lull due to the Pandemic.[25] In addition, speculation may have been encouraged by government stimulus programs.

Our equity strategy in this environment has been to balance a continuing exposure to long duration technology stocks – in part because we are now sitting on substantial unrealized gains and a sale would trigger a significant tax obligation – with selected industrial and health care companies and a large position in gold miners and gold streaming companies. We expect that this portfolio will lag the market if the current upside momentum continues, but it should provide some downside protection in the event of a correction.

The table below summarizes our largest individual positions at year-end. These eight stocks account for roughly 45% of our portfolio:

($ millions)

Shares	Company	Cost	Value
48,285	Amazon.com Inc.	$ 66.6	$ 157.3
1,251,000	Franco-Nevada Corp.	171.7	156.8
692,215	Microsoft Corp.	52.9	154.0
308,020	Roper Technologies	49.5	132.8
2,189,000	Newmont Corp.	139.0	131.1
912,621	JPMorgan Chase & Co.	95.3	116.0
5,005,000	Barrick Gold Corp.	137.2	114.0
512,555	VISA Inc.	42.1	112.1
	Other (21 positions)	1,112.3	1,439.1
	Total equities	$1,866.6	$2,513.2

The first half of the 1960s were characterized by very low inflation (about 1% a year), which may have contributed to a decade of growth stock leadership and the famous "Nifty Fifty." By the late 1960s there was widespread social unrest and political turmoil. Richard Nixon had defeated George McGovern in November 1972 and the Dow Jones Industrial Average approached 1,050 by the end of that year. By the fall of 1973 however, Congress initiated impeachment proceedings, culminating in Nixon's resignation in 1974. From the peak in 1972 to the bottom in 1974, the Dow Jones Industrial Average fell by over 40%, as inflation began to emerge with a vengeance. In 2020 there was widespread social unrest, growth stock leadership, and a threatened impeachment. Will history repeat?

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Some thoughts on management compensation

A changing market structure due to the rise of indexing and passive investment strategies may be contributing to a valuation paradigm that is unsustainable. Fundamental investors who buy or sell stocks based on price and value are becoming a smaller and smaller portion of trading volume. Market indexes are increasingly dominated by a handful of mega cap stocks.

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[25] Jim Cramer, CNBC, December, 2020.

In addition to the above, public company executives are increasingly taking on the challenge of addressing multiple objectives that have an uncertain correlation with their stock price over short-term periods. Actions to address long-term environmental priorities, diversity, equity and inclusion, and even social justice objectives will no doubt produce better long-term outcomes for society, but may not be reflected in how a company's stock performs relative to mega cap technology companies over the short run.

For all of these reasons, linking management compensation to total shareholder return "TSR" over relatively short time periods such as 1-3 years is increasingly looking like something out of an old movie like *Wall Street* with Gordon Gekko declaring "Greed is good!". Clearly, the executive compensation paradigm has not kept pace with the rapidly-changing world of corporate governance.

Alleghany's compensation structure has always been based on our fundamental performance relative to an objective alternative such as inflation or the risk-free return on bonds. In a world of a ~1% 10-year treasury yield, we think our return objective should be reasonably achievable – otherwise management will strive to take on unwanted risks, which is certainly not a sustainable or desirable long-term strategy. Having reasonable objectives also allows management to balance short-term financial goals with longer-term objectives now being formalized under the framework of Environmental, Social, and Governance.

In 2020, the Compensation Committee of the Alleghany Board of Directors, working with management, took a fresh look at our long-term incentive plan. This initiative was taken for two reasons: first, to be responsive to the perspective being advanced by proxy advisory firms, and second, in recognition that recent results have caused long-term incentive payouts to be low relative to earlier years. I have discussed some of the reasons this happened earlier in this letter. After extensive analysis and consideration, the committee concluded that the book value growth metric with a payoff matrix around 7% growth continued to make sense and would be retained. Our most recent planning process has reaffirmed that a growth objective of 7-10% remains achievable, despite the fact that recent results have fallen short of this range.

It should be noted that the long-term compensation amounts shown in our annual proxy statement represent the ***potential*** values that executives may receive ***if*** growth in book value objectives are achieved. For the most recent four-year period, for example, awards paid out at below-target levels (with the potential range being 50% to 200%) and the year before they didn't pay out at all. When our results are strong, payouts are higher; when they are less robust, payouts fall. We feel the pain.

Our Corporate Purpose

Alleghany Corporation is an investment-oriented holding company[26] with diverse interests in insurance and reinsurance and a number of non-financial businesses. When we think about *purpose* – or why Alleghany Corporation exists – it is primarily to navigate the intersection between producing fair and sustainable long-term returns for our shareholders by being a capital partner for our operating businesses, each of which has its own purpose.

Over the past few years, our role has expanded to provide appropriate oversight of our key subsidiaries with respect to Environmental, Social, and Governance matters. In 2020, we began the process of establishing an ESG process at each of our companies that will dovetail with our overall corporate mission and purpose with respect to ESG matters. For example, we are in the process of forming a corporate diversity and inclusion function, and we are planning to publish our first sustainability report in the spring of this year.

[26] Not to be confused with an "investment holding company."

In addition to providing reasonable long-term returns for our shareholders, Alleghany's re/insurance subsidiaries play a critical role in the economy by helping businesses and individuals to manage risks and volatility and communities to recover after natural and other disasters. In the case of Alleghany Capital, we provide a sustainable home for non-financial businesses and their employees by allowing them to focus on long-term outcomes that are rewarding for both shareholders ***and*** employees. Each of ACC's companies has its own purpose, including building essential infrastructure, creating innovative play experiences for children, and enabling pharmaceutical companies to produce and deliver essential drugs and vaccines. In the aggregate, Alleghany provides employment for over 10,000 people and plays critical roles in the economy and in the communities in which it operates.

The following list summarizes some of the specific purposes of our key subsidiaries:

- TransRe provides insurance companies worldwide with protection against volatility, underwriting perspective and expertise, and timely capital when needed.

- RSUI is a specialty underwriter that provides wholesale insurance brokers with a consistent market for difficult-to-place risks.

- CapSpecialty seeks to be the premier insurer for small and mid-sized businesses and a reliable provider of commercial surety bonds for agents and brokers.

- Jazwares provides customers with innovative and creative toys for younger children.

- W&W|AFCO Steel provides developers, governments, and businesses with essential steel fabrication and erection services.

- IPS-Integrated Project Services provides essential engineering and project management services to allow pharmaceutical companies to produce and deliver essential drugs and vaccines. IPS played a pivotal role in supporting the rapid delivery of COVID-19 vaccines in 2020.

Re/insurance companies and climate risk

Corporations are increasingly taking a proactive role in the fight against climate change. The investment managers representing many of our stockholders are looking for companies to measure and mitigate their exposure to ***climate risk.*** These actions are already having a significant impact on how businesses manage their environmental footprint with respect to the production of carbon dioxide, the use of water resources, and the use of petroleum-derived products such as single-use plastics. Some observers of the insurance and reinsurance industries have struggled to place our industry into this framework, with one even criticizing Alleghany for "its exposure to hurricanes."

We believe that this perspective is misguided. Our ***clients*** are exposed to hurricane risk; insurers and reinsurers are the last line of defense to protect them against the consequences of loss from these events. ***Risk is endemic to our business.*** Our role is to price these risks properly so that markets have the right price for the risk, not to eliminate them *per se*. We are the machinery that will allow the economy to adjust to changing risk due to climate change and excessive coastal and hazardous development.

Simply put, society would cease to function without a vibrant and financially strong insurance and reinsurance industry.

Final Thoughts

In the midst of the Pandemic, an Idaho potato worker named Nathan Apodaca was unable to get to work because his truck with 320,000 miles on it had finally broken down. Undeterred, he grabbed his skateboard from the flatbed and began rolling down a hill toward work. On an impulse, he turned on his TikTok account and began filming a video of himself singing along to Fleetwood Mac's famous 1977 song "Dreams":

Now here you go again
You say you want your freedom
Well, who am I to keep you down?
It's only right that you should
Play the way you feel it
But listen carefully to the sound
Of your loneliness
Like a heartbeat, drives you mad
In the stillness of remembering what you had
And what you lost
And what you had

The short video quickly went viral and became one of the top Internet memes of 2020. Viewers were inspired by the resilience of the front-line worker, the power of the human spirit, and his dedication to work. And the lyrics to the song captured the loneliness that many feel as a result of the Pandemic.

A year ago at this time, Alleghany's stock price was at an all-time high. Market conditions in our core insurance businesses were improving, and we were excited about the prospects for the Alleghany Capital portfolio. And then the truck wouldn't start.

Many have had it much worse than we have. In 2020, in addition to the actions of its employees, Alleghany Corporation made a special contribution to the New York Community Trust COVID Relief Fund and also supported several local food banks. More than ever, it is important that we all step up to help the less fortunate.

We made significant progress in 2020 laying the groundwork for improved results in 2021 and beyond. We have meaningfully improved the expected future profitability of our insurance and reinsurance businesses through rate increases and operational improvements, and Alleghany Capital's portfolio enters 2021 with improving momentum. Alleghany's balance sheet remains strong; our re/insurance subsidiaries are well-capitalized and prudently reserved; and we have over $1 billion of liquid, parent company investments to support the continued growth and development of all of our businesses.

Now it's time for us to grab our skateboard and get going. There's work to do, and the Pandemic *will* eventually end.

Yours sincerely,

Weston M. Hicks

Weston M. Hicks
President

Comment on Non-GAAP Financial Measures

Our analysis of our financial condition and results of operations is based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the U.S., or "GAAP." Our results of operations have been presented in the way that we believe will be the most meaningful and useful to investors, analysts, rating agencies and others who use financial information in evaluating our performance.

This presentation includes the use of adjusted earnings, adjusted revenue and related measures, and underwriting profit, which are "non-GAAP financial measures" as defined under regulations promulgated by the Securities and Exchange Commission. The presentation of these financial measures is not intended to be considered in isolation or as a substitute for, or superior to, financial information prepared and presented in accordance with GAAP. Also note that these measures may be different from non-GAAP financial measures used by other companies, limiting their usefulness for comparison purposes. A discussion of our calculation and use of these financial measures is provided below.

Adjusted earnings. This presentation includes the use of adjusted earnings and related measures, which we believe are useful to help explain changes in stockholders' equity attributable to Alleghany. A reconciliation of adjusted earnings and related measures to net earnings attributable to Alleghany stockholders is presented below.

	For the Year Ended December 31, 2020	2019
	($ in millions)	
Net earnings attributable to Alleghany stockholders	$ 101.8	$ 857.8
Adjustments to net earnings attributable to Alleghany stockholders:		
Change in the fair value of equity securities	(110.5)	709.7
Net realized capital gains	3.1	(6.5)
Change in allowance for credit losses on available for sale securities	(8.0)	(19.7)
Amortization of intangible assets	(44.2)	(33.8)
Income tax effect of adjustments	33.5	(136.5)
	(126.1)	513.2
Adjusted earnings	$ 227.9	$ 344.6

Adjusted revenues. This presentation includes the use of adjusted revenues, which we believe are useful to show revenues excluding certain volatile investment-related activity. A reconciliation of adjusted revenues to revenues is presented below.

	For the Year Ended December 31, 2020	2019
	($ in millions)	
Alleghany consolidated revenue	$ 8,896.8	$ 9,040.6
Adjustments to Alleghany consolidated revenue:		
Change in the fair value of equity securities	(110.5)	709.7
Net realized capital gains	3.1	(6.5)
Change in allowance for credit losses on available for sale securities	(8.0)	(19.7)
	(115.4)	683.5
Adjusted revenues	$ 9,012.2	$ 8,357.1

Underwriting profit. This presentation includes the use of underwriting profit, which is a non-GAAP financial measure for our reinsurance and insurance segments. Underwriting profit represents net premiums earned less net loss and loss adjustment expenses and commissions, brokerage and other underwriting expenses, all as determined in accordance with GAAP, and does not include: change in the fair value of equity securities; net investment income; net realized capital gains; change in allowance for credit losses on available for sale securities; noninsurance revenue; other operating expenses; corporate administration; amortization of intangible assets; and interest expense. We use underwriting profit as a supplement to earnings before income taxes, the most comparable GAAP financial measure, to evaluate the performance of our reinsurance and insurance segments and believe that underwriting profit provides useful additional information to investors because it highlights net earnings attributable to our reinsurance and insurance segments' underwriting performance. Earnings before income taxes may show a profit despite an underlying underwriting loss, and when underwriting losses persist over extended periods, a reinsurance or an insurance company's ability to continue as an ongoing concern may be at risk. A reconciliation of underwriting profit to earnings before income taxes is presented within Note 13 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, "Financial Statements and Supplementary Data" of our Report on Form 10-K for the year ended December 31, 2020.