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Global Reinsurance

The Global Basket: Favor Bermuda Over Europe

What's New: After placing the global reinsurance group on a common analytical framework, the US and London analysts have traded places. We comment on the other team's reinsurers, and identify the best region and most compelling stocks.

Conclusion: Weight Bermuda over Europe. Following the biggest year in history for insured losses, investors in reinsurance should be looking for c.20% ROEs. There are several candidates for this in Bermuda, but only Hannover Re in Europe is seemingly able to compete at this level.

The Ones to Buy: The solution for those able to invest cross border —- go with a global reinsurance basket. For gearing to the hardening property markets, the US team suggests adding RenaissanceRe and/or IPC Holdings, with Axis Capital a sensible complement to either stock. The London team likes the prospects of Hannover Re, the only European to offer Bermuda-like returns, but with more diversified, durable earnings.

The Ones to Sell: Steer clear of SCOR and Montpelier Re. SCOR offers uninspiring single-digit ROEs and the turnaround story is now more than priced in. Montpelier has seemingly earned back the confidence of investors after a disastrous performance in 2H05. We prefer the risk/reward tradeoff of other reinsurers.

The Framework: On ROE gearing — the Bermudians score big with more upside leverage to cyclically peaking markets. The Bermudians also score well on our 'secret sauce' investing metrics. But for the quality trade and lower catastrophe exposure, the more diversified European reinsurers come out ahead.

GICS Sector: Financials

Strategist's Recommended Weight	24.5%
S&P 500 Weight	21.0%

Companies Featured

Company	Rating
Axis (AXS, $30.87)	Overweight
Aspen (AHL, $23.60)	Equal-weight
IPC Holdings (IPCR, $26.69)	Overweight
Montpelier Re (MRH, $17.52)	Underweight
Max Re (MXRE, $24.90)	Equal-weight
PartnerRe (PRE, $60.53))	Overweight
RenaissanceRe (RNR, $43.86)	Overweight
Everest Re (RE, $99.18)	Equal-weight
Converium (CHRN.S, SFr 14.45)	Underweight
Hannover Re (HNRGn.DE, €31.51)	Overweight
Munich Re (MUVGn.DE, €113.88)	Equal-weight
SCOR (SCOR.PA, €2.00)	Underweight
Swiss Re (RUKN.VX, SFr 96.30)	NA

Please see analyst certification and other important disclosures starting on page 19.

Investment Case

Defining the Universe. Before summarizing our main takeaways from this analysis, we need to present our universe of reinsurance names:

Exhibit 1

The Global Reinsurance Coverage Universe

Bermuda	Ticker	Curr	2/21/05 Price	MS Rating	P Target	MS 2006e	MS 06e ROE
Axis	AXS	USD	30.87	Overweight	37	4.70	22.9%
Aspen	AHL	USD	23.60	Equal-Weight	NA	3.75	17.8%
IPC Holdings	IPCR	USD	26.69	Overweight	33	4.35	19.4%
Montpelier	MRH	USD	17.52	Underweight	NA	2.85	21.9%
Max Re	MXRE	USD	24.90	Equal-Weight	NA	3.65	17.3%
PartnerRe	PRE	USD	60.53	Overweight	71	8.00	16.7%
RenaissanceRe	RNR	USD	43.86	Overweight	52	7.05	25.6%
EverestRe	RE	USD	99.18	Equal-Weight	NA	12.15	17.6%
Europe							
Converium	CHRN.S	CHF	14.45	Underweight	SFr 12.17	1.22	8.2%
Hannover Re	HNRGn.DE	EUR	31.51	Overweight	€ 37	4.14	16.6%
Munich Re	MUVGn.DE	EUR	113.88	Equal-Weight	NA	12.43	11.7%
SCOR	SCOR.PA	EUR	2.00	Underweight	€ 1.78	0.16	8.5%
Swiss Re	RUKN.VX	CHF	96.30	NA	NA	9.60	12.2%

Note: Swiss Re EPS is ex-Goodwill and is standalone, does not include impact of GE Insurance Solutions acquisition.
Source: Company data, Morgan Stanley Research

Through a series of summary tables and supporting charts and graphs, we look at the global reinsurance group on a variety of macro-investing frameworks, from disaggregated ROEs to our US strategist Henry McVey's 'secret sauce' (growth and returns), to the quality trade and more.

Overweight Bermuda

Exhibit 2

Summary of Main Observations — Winners and Losers

	Best Region	Winners	Losers
ROE Gearing	**Bermuda**	IPCR, HNR	MXRE, SCOR
Secret Sauce	**Bermuda**	AXS, HNR	MRH, CHRN
Quality Trade	**Europe**	PRE, RUKN	MRH, CHRN
Paying for Growth	**Bermuda**		
Cat Exposure	**Europe**	MXRE, CHRN	MRH, HNR

Source: Company data, Morgan Stanley Research

With all of the European reinsurers except Hannover Re offering uninspiring ROEs in 2006 when the rate/pricing opportunity should be as good as it gets, we feel that the investor opportunity lies mostly in Bermuda.

In Bermuda — high risk and reward
We empathize with investors who ask "Aren't the Bermudians simply a weather play?" Our response — Not entirely.

To be sure, the weather holds large sway over the Bermudians' returns, and investors should construct their (re)insurance portfolios with this in mind. But, to help assuage the doomsday views that the Bermudians are set to lose massive amounts of equity in the 2H06 storm season, we offer a few observations:

- Let's first remember just how anomalous the 2H05 storm season was — at some $70-$80 billion of insured losses compared to an annual average of $8-$10 billion from 1995-2004.
- Rates have increased substantially, with more to follow. Recent anecdotes from CNA and Zurich confirm the cost of property catastrophe reinsurance has roughly doubled for the large national companies. We think it likely more increases will follow.
- Reinsurers have made substantial progress in pushing volatility back down to their primary counterparts. Retentions have increased and the catastrophe component of per risk treaties has been substantially decreased.

Still not comfortable? Diversified Bermudian reinsurers such as PartnerRe (PRE, Overweight) and Everest Re (RE, Equal-weight) enjoy gearing to the hardening property markets, carry double-A credit ratings, and have proven track records of building shareholder value.

In Europe, only Hannover Re is compelling in our view
On Munich and Swiss Re, yes, they are more diversified than the Bermudians and earnings are more durable, but investors are only getting around 12% ROEs (13-14% ROEVs) coupled with the volatility of catastrophe risk. Big-cap European investors may as well look towards a stock like Axa in Europe, which delivers ~17%+ ROEVs with limited catastrophe gearing or reserving risk. **Thus, in Europe we recommend Hannover Re due to our view that the company will comfortably outperform guidance for 2006 of at least a 15% ROE.**

Location, Location, and Gearing
The average ROEs for Swiss, Munich and Hannover Re over 2006-07e roughly equate to 70% of the Bermudian average (curiously similar to the latter's island-domiciled tax advantage). Given the syndicated nature of reinsurance, where pricing differentiation is difficult to achieve, we think investors should focus on 1) Location - as in the reinsurer's domicile; 2) Location - as in how well diversified is the company's business; and 3) Gearing - is the company producing primarily underwriting or investment income … aim for the former.

The Global Basket

As we have advocated in the past for the Bermudians, a basket approach is our recommended strategy for the reinsurers as investors can lock in strong ROEs from the 2006 rate rises whilst reducing single-stock risk.

Exhibit 3
Our Key Global Picks

The Longs	The Shorts
RenaissanceRe and/or IPC Holdings: Both stocks stand to benefit from dislocations in the global property markets. While RNR has a higher valuation and prospective ROE, IPCR might appeal to more valuation and risk sensitive investors.	**SCOR**: We think that the turnaround story has now been overdone. The stock is now on 1.2x EV (the same as Munich Re), but offers uninspiring 9% ROEs with little balance sheet flexibility.
Axis Capital: AXS offers the advantages of the classic Bermudian (high ROE, property gearing, no legacy liabilities) with the added advantage of a rapidly diversifying book of business (both by product and geographically)	**Montpelier Re:** While maybe less of a short from current levels, we remain underweight on MRH and would not be buyers of the stock on weakness. Trading above average, we think there are better risk/reward choices out of Bermuda with similar gearing to the upside in prop cat reinsurance.
Hannover Re: Delivering Bermuda-like returns but with better diversification and more durable earnings. We expect consensus estimates to rise as Hannover demonstrates its earnings power over the course of the year.	**Converium:** The need to carry excess equity on the balance sheet in order to keep rating agencies happy is slowing down returns and with the stock now back at book value it is no longer cheap.

The Analytical Framework

In the sections following, we place the Bermudian and European reinsurers on a common analytical framework. Sections include sections on disaggregated ROEs, the 'secret sauce', growth premiums, catastrophe exposure and more. In each section, the U.S. and European teams trade places, commenting on one another's companies. The language employed is - at times - a bit sharper than usual. Nevertheless, the U.S. and London teams remain on good working terms (mostly anyway).

US Non Life Insurance Industry View: Attractive. Key ingredients for cyclical improvements in pricing have fallen into place, we believe. With limited risks to multiple compression, for the time being, we think investors could enjoy the bulk of pro forma ROEs in the 15%+ range. Uncertainties surrounding losses from Katrina and a perilous legal environment present both risks (to book value) and the catalyst to bolster pricing, in our view.

European Insurance Industry View: In Line. We are cautious about life growth, non-life pricing, disclosure and regulatory change.

ROE Gearing

Looking through different accounting regimes and across business models can be challenging. Thankfully, we have a useful framework for breaking down those barriers. By pulling the ROE disaggregation out of our toolkit, we can answer cross border questions including:

Which reinsurers bring the highest gearing to underwriting?

Which companies have the most efficient capital structures?

What levers can companies pull to influence their ROE and hopefully their stock price as well?

Exhibit 4

Where is the ROE Gearing? Bermuda v. Europe

		% of ROE Contribution from:			
Rank	**Company**	**U/W**	**NII**	**Other**	**Fin'cl Lev.**
1	IPCR	66.7%	24.1%	1.2%	8.1%
2	MRH	61.2%	22.5%	-2.0%	18.3%
3	AHL	56.7%	34.4%	-2.0%	11.0%
4	AXS	55.8%	27.9%	0.6%	15.7%
5	RNR	55.5%	23.2%	-0.2%	21.5%
6	RE	33.4%	54.6%	-0.6%	12.5%
7	PRE	31.2%	50.1%	0.3%	18.4%
8	MXRE	30.4%	45.1%	18.2%	6.4%
9	Hannover Re	16.7%	56.2%	3.4%	23.7%
10	Swiss Re	15.8%	39.0%	33.8%	11.4%
11	Munich Re	13.9%	38.7%	37.7%	9.7%
12	Converium	-1.3%	98.5%	-3.3%	6.1%
13	SCOR	-6.7%	118.8%	-28.3%	16.2%

Source: Company data, Morgan Stanley Research

The US perspective on European reinsurers

- Want to invest in a stream of earnings backed by investments? Buy a mutual fund - it'll be more efficient and you won't have to worry about legacy liabilities consuming some chunk of your principal. The European reinsurers draw an extraordinarily levered NII.

  The European view: *Exhibit 4 is a little simplistic, and it understates the 'underwriting gearing' element for the Europeans, as it is reliant upon nominal as opposed to economic combined ratios. A nominal property combined ratio of 84% (equivalent to an economic combined ratio of 82%) would score well in Exhibit 4. However, an equivalent economic combined ratio in casualty would translate into a nominal combined ratio of 96% (due to the longer 6-7 year tail) and so would not score well. Thus, the Bermudians benefit from having a shorter-tail property focus. Ultimately, underwriters make pricing decisions based on returns on capital, not on what the nominal combined ratio will look like on the face of the P&L.*

- The Bermudian reinsurers are the most levered and efficient (low expense ratio) way to play the underwriting cycle. Investors can use a basket approach to gain exposure to the cyclically firm operational environment while mitigating single-stock risk.

  The European view: *We agree that the 'play the cycle' opportunity is more clearly defined in Bermuda. However, for investors looking to benefit from rising rates whilst avoiding the Bermudian book value threats seen in 2005, we would suggest looking at Hannover Re. Hannover has the efficiency with a 'best in global class' expense ratio of around 23%, whilst also delivering Bermuda-like returns with less catastrophe gearing.*

- While on the topic of NII, most Bermudians have shortened the duration of fixed income portfolios to just ~3 years. As interest rates rise, we think the investment income of the Bermudians will rise faster than that of the Europeans.

  The European view: *The Europeans are closely matched. We remember from last year that Swiss Re's shortening of its portfolio in anticipation of a steepening yield curve led to eventual disappointment as the curve continued to flatten.*

The European perspective on Bermudian reinsurers

- Given the very high underwriting gearing and concentrated property catastrophe exposures of the Bermudians, to what extent can investors believe that these companies are more than just a 'weather play'?

  The US view*: Weather will, of course, continue to be a major factor in determining the earnings and intrinsic value of the Bermudians. Investors unable to gain comfort with the potential volatility caused by the hurricane season should probably look to invest elsewhere, or use defensive investment tactics to manage weather risks. Notably, the reinsurers have taken substantial underwriting measures to distance themselves from the volatility seen in 2005.*

- With the move to 'Solvency 2' in Europe leading to an increase in the issuance of hybrid debt, the Europeans have the opportunity to leverage-up and improve ROEs. Would the Bermudians be given the same amount of leeway on this front, as the 'Bermuda model' is surely less tolerant of leverage in the eyes of the rating agencies?

  The US view: *The incremental debt capacity of several Bermudians has probably been tapped, at least for 2006. However, we are not convinced that the European companies, with their single-minded focus on maintaining or recapturing double-A status (a sometimes questionable value proposition for shareholders) will heed the call to "lever up".*

- The minimal contribution from 'Other' shows that the Bermudian reinsurers really are pure-play P&C. They have not followed their European counterparts' move to diversify away from the cycle by investing in areas such as life reinsurance. Does this lack of diversification make the Bermudians less compelling to long-term investors?

  The US view: *Investors can diversify on their own. An investment in the Bermudian reinsurers brings risk - to be sure - but a thoughtful collection of stocks with different gearings, valuations and credit ratings can be part of a prudent investment strategy in non-life insurance.*

Reconciliation and Conclusion
Most of the Bermudians are more clearly levered to the underwriting cycle. However, we will not downplay the risks to book values posed by this period of intense weather - irrespective of the underwriting changes taking place at January 1 renewals (with more volatility being pushed down to the primary commercial insurers).

Secret Sauce

Exhibit 5

Look For Rising ROEs, True Growth and Rising Payout Ratios

Stretegy Screen	Rising ROEs			EPS Growth > 15%		Rev Growth > 8%		Div Yield 2-4%			Rising Payout Ratios	
FIG Sub Sector Average	ROE (%) 2005	ROE (%) 2006	ROE (%) 2007	MWare EPS Growth 2006/2005	MWare EPS Growth 2007/2006	Op Rev Growth 2006/2005	Op Rev Growth 2007/2006	Div yld (%) 2005	Div yld (%) 2006	Div yld (%) 2007	Div payout ratio (%) 2006	Div payout ratio (%) 2007
Bermuda Average	**(16.7%)**	**19.9%**	**17.9%**	**194.2%**	**8.6%**	**1.5%**	**7.2%**	**5.8%**	**1.7%**	**2.0%**	**11.4%**	**13.3%**
Aspen	(10.5%)	17.8%	17.5%	(262.6%)	12.0%	16.1%	11.0%	2.5%	2.5%	2.8%	16.2%	16.4%
Axis	3.4%	22.9%	19.6%	534.0%	2.3%	5.2%	6.9%	1.9%	2.1%	2.4%	12.8%	13.5%
Everest Re	(6.0%)	17.6%	15.3%	(397.9%)	1.2%	4.1%	9.8%	0.4%	0.5%	1.0%	3.9%	11.4%
IPC Holdings, Ltd.	(40.2%)	19.4%	17.5%	(135.2%)	5.8%	17.1%	13.5%	3.6%	2.3%	2.6%	13.9%	14.6%
Max Re	0.7%	17.3%	15.8%	2,483.5%	7.0%	(0.5%)	2.0%	0.7%	0.8%	0.9%	5.5%	7.3%
Montpelier Re	(56.5%)	21.9%	19.2%	(126.5%)	22.7%	(43.3%)	(3.0%)	33.2%	1.6%	2.1%	9.1%	12.0%
PartnerRe Ltd.	(9.0%)	16.7%	15.5%	(281.1%)	6.3%	6.9%	7.4%	2.3%	2.4%	2.5%	18.6%	20.2%
RenaissanceRe	(15.9%)	25.6%	23.0%	(260.9%)	11.3%	6.7%	10.0%	1.7%	1.7%	1.9%	11.2%	11.3%
European Average	**5.5%**	**11.5%**	**10.7%**	**596.9%**	**(0.6%)**	**(0.1%)**	**3.0%**	**1.6%**	**3.3%**	**3.6%**	**32.4%**	**36.3%**
Converium	1.1%	8.2%	7.2%	695.9%	(8.6%)	(27.2%)	0.3%	0.7%	2.8%	3.5%	32.8%	44.9%
Hannover Re	0.9%	16.6%	15.7%	2,163.3%	(2.6%)	5.6%	0.1%	0.0%	5.4%	5.3%	40.0%	40.0%
Munich Re	11.8%	11.7%	10.6%	10.8%	(1.6%)	4.2%	3.5%	2.8%	2.9%	3.1%	25.6%	27.2%
SCOR	6.8%	8.5%	8.9%	36.9%	10.7%	10.6%	7.2%	2.0%	2.5%	3.0%	32.2%	34.9%
Swiss Re	7.1%	12.2%	11.1%	77.6%	(1.0%)	6.4%	3.8%	2.6%	2.8%	3.1%	31.4%	34.6%

* Our Swiss Re estimates are 'stand-alone' and do not factor in the potential impact of the acquisition of GE Insurance Solutions
Source: Morgan Stanley ModelWare, Morgan Stanley Research

Secret Sauce: Our US strategist Henry McVey's 'secret sauce' framework includes investing in companies with 1) rising ROEs, 2) 'true growth', or EPS growth above 15% and revenue growth above 8% (also, free cash flow above 10%, though we have not included that metric), and 3) rising payout ratios.

The US perspective on European reinsurers

- Bermuda Fish Chowder or Swiss Cheese? With higher steady state (think 2007) ROEs, better prospects for revenue growth, and the likelihood of improving payout ratios (from an admittedly lower base), we think Bermuda Fish Chowder is fundamentally more appealing.

  The European view: *Having seen more than enough volatility in the seemingly less volatile Europeans, we struggle to jump to the other end of the spectrum into a RenRe, IPCRe, or a Montpelier. Instead, we like the concept of strong ROEs and seemingly more durable earnings; hence, based on the Secret Sauce metrics we are attracted to Axis, Hannover Re, and Everest Re, with PartnerRe coming in close behind.*

- Reconciling Revenue disparities: The more property-oriented Bermudians may have another leg up on pricing conditions in 2007 - albeit modestly compared with the 2006/2005 comparison. The more diversified Bermudians such as RE and PRE may grow in the mid single digits - more akin to the Europeans.

  The European view: *Clearly the property focused business mix of the Bermudians favors them over the Europeans for the 2007 renewal season. However, with the $10 bn of new start-up capital raised on the island really coming to market in 2007, we would expect the growth rate beyond 2007 to fall back to levels nearer the Europeans.*

The European perspective on Bermudian reinsurers

- The 2005 negative ROEs demonstrate the 'boom and bust' risks of investing in the 'Bermuda model'. It is interesting to note that even in the worst year on record on the catastrophe front, all of the Europeans remained profitable, unlike most of their Bermudian cousins.

  The US view: *Had we reached back a few years in the data we'd also see the flaws in the European model, including excessive equity investments coupled with an under-appreciation for the complexities of the US legal system (think adverse reserve development - lots of it).*

- Combining the lightweight payout ratios in Bermuda with the entrance of the *'Class of 2005',* we feel that it is likely to be Bermuda that leads the market downwards on the pricing front. Consequently, we feel that US investors may be a little over-optimistic in terms of revenue growth in 2007.

***The US view**: Talk about the pot calling the kettle black…we can't think of the last time 'rate discipline' and European reinsurers were credibly referenced in the same paragraph.*

- Our European payout ratio estimates do not reflect potential capital return via share buyback or special dividend. With Munich Re a likely candidate for such a move (and Converium over the longer-term), we would be interested to note who are the likely candidates for similar moves in the US, particularly given the threat to pricing of over-supply of capital in the short-term.

  ***The US view**: Part of the secret sauce is 'rising' payout ratios. At just one-third of the European average, we would suggest the Bermudians have room to gradually improve. Investors should realize the increase is likely to be gradual, as the Bermudians balance risk and capital management in the context of increasingly severe weather patterns. Considering its low base, Everest Re (RE) probably has the most room to improve on this metric. As a more diversified reinsurer, it may also be less directly (and adversely) affected by rising rating agency capital standards - thus providing it greater financial flexibility.*

Reconciliation and Conclusion

In the spirit of fairness, we can agree that each business model has exhibited its share of warts over the past decade. The European companies believed at one point that asset markets only went up while the rising tide of US lawsuits was somehow everyone else's problem. The Bermudians - well, what can be said: neither investors, rating agencies nor management teams believed they would lose one-third of their BV (on average) in one storm season.

All in, we think that Bermuda is the winner on the Secret Sauce metric due to more likely EPS growth as their property focus puts them 'higher up' the cycle and the low payout ratios (coupled with improving risk management, we believe) provide them better opportunity to construct sensible capital management policies (that is, steadier payouts rather than the boom/bust witnessed during 2005).

Quality Trade

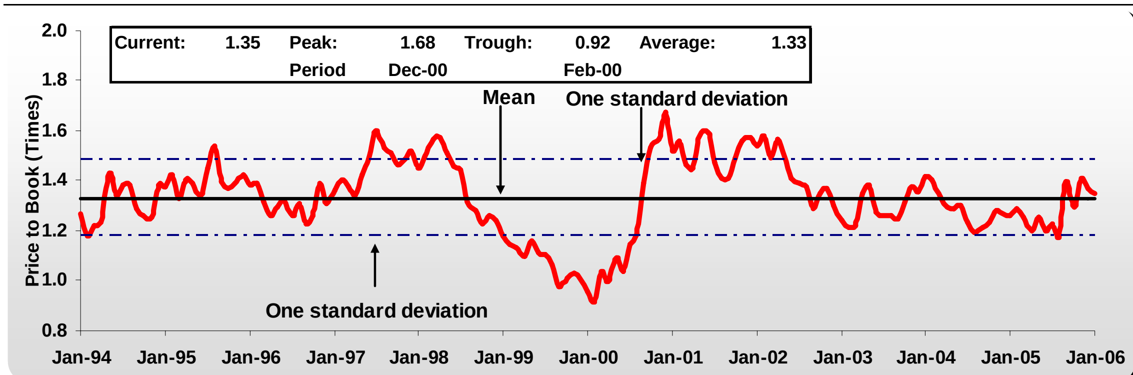
What does 'quality trade' mean to us? Simply put, if investors can invest in shares of companies that carry equivalent or higher relative credit quality at lower absolute, or at least relative valuations - why not do it? The facts are rarely that straightforward, but we don't see that as a reason to slow us down.

Exhibit 6
Financial Strength Ratings Remain Important

	FSR		Watch List/Outlook	
	A.M. Best	S&P	A.M. Best	S&P
Bermuda				
AXS	A	A	Stable	Stable
AHL	A/A-	A	Neg/Sta	Negative
IPCR	A	A	Stable	Negative
MRH	A-	A-	Negative	Negative
MXRE	A-	--	Stable	--
PRE	A+	AA-	Stable	Stable
RNR	A	A+	Rev/Neg	Stable
RE	A+	AA-	Stable	Stable
Europe				
Converium	B++	BBB	Stable	Stable
Hannover Re	A	AA-	Rev/Neg	Negative
Munich Re	A+	A+	Negative	Stable
SCOR	B++	A-	Positive	Stable
Swiss Re	A+	AA	Rev/Neg	Rev/Neg

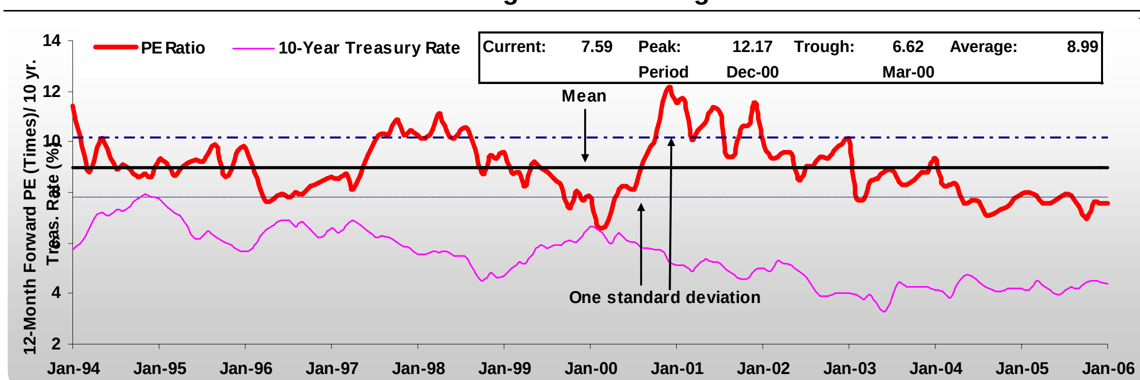
Source: © A.M. Best Company--used by permission, S&P, Morgan Stanley Research

Exhibit 7
US Reinsurers Price-to-Book Ratio



Stocks included: AHL, ENH, RE, ICPR, MXRE, ORH, PRE, RNR, MRH, TRH, PTP, QNTA
Source: FactSet, Morgan Stanley Research

Exhibit 8
US Reinsurers Forward Price-to-Earnings Ratio v. Long-term Interest Rates



Stocks included: AHL, ENH, RE, ICPR, MXRE, ORH, PRE, RNR, MRH, TRH, PTP, QNTA
Source: FactSet, Morgan Stanley Research

Exhibit 9

Current, Average and Standard Deviation of P/B and P/E Multiples

	2/21/05 Price	Current P/B	Avg PB	Std Dev PB	Current P/E	Avg PE	Std Dev PE
Bermuda							
Axis	30.87	1.64	1.44	0.22	6.6	8.1	2.2
Aspen	23.60	1.22	1.26	0.12	6.3	NM	NM
IPC Holdings	26.69	1.19	1.12	0.20	6.1	8.1	1.4
Max Re	24.90	1.21	1.01	0.18	6.8	11.2	4.2
Montpelier Re	17.52	1.48	1.41	0.13	6.2	8.1	0.9
Partner Re	60.53	1.32	1.16	0.16	7.6	8.7	1.8
Renaissance Re	43.86	1.69	1.65	0.29	6.2	7.5	1.8
Everest Re	99.18	1.54	1.38	0.27	8.2	10.1	2.4
Avg		**1.41**	**1.30**	**0.20**	**6.7**	**8.8**	**2.1**
Europe							
Converium	14.45	0.98	1.27	0.66	11.7	8.7	2.6
Hannover Re	31.51	1.54	1.41	0.13	7.6	7.7	0.9
Munich Re	113.88	1.15	1.36	0.15	9.4	9.8	3.3
SCOR	2.00	1.15	0.96	0.16	13.1	6.3	2.8
Swiss Re	96.30	1.40	1.44	0.12	10.0	10.0	1.4
Avg		**1.24**	**1.29**	**0.24**	**10.4**	**8.5**	**2.2**

Source: FactSet, Morgan Stanley Research

The US perspective on European reinsurers

- Ratings don't matter! Alright, we're exaggerating some. But the broader point is that not only are the ratings of the Bermudian and Europeans broadly similar, but the Bermudians are far less likely to advantage the bond holders over the equity holders by dogmatically focusing on retaining, or maintaining their double-A ratings.

  The European view: *None of the Europeans had to ask their shareholders for equity following the worst catastrophe year in history, and all will finish 2005 with more capital at the end of the year than they had at the beginning. European balance sheets are much more robust.*

- And by the way…weren't those European ratings triple-A not too long ago? Whose business model is broken?

  The European view: *Clearly, there is only going to be one 'AAA' rated reinsurer for the foreseeable future. However, with most of the reinsurers operating in brokered markets, surely the rating is a key driver of product differentiation. Hannover Re reported a notable increase in demand for its 'AA' paper in the January renewals with its US signings at an all-time high of 87% (92% for Property).*

- Earnings are up and down, and the European companies smooth them over anyway. Measured on book value, Hannover and Swiss trade similarly to Everest and PartnerRe - probably sensible similarities. To our London colleague - what's the deal with Munich?

  The European view: *With Munich Re possessing more Goodwill and Intangible Assets, most European investors would strip these out when valuing Munich Re (whose adjusted Price/EV is closer to 1.25x). Nonetheless, over the long term, we think there could be some element of multiple expansion as management becomes more pro-active in managing the capital base.*

The European perspective on Bermudian reinsurers

- The European 'blow-ups' (companies that lost around 50% of book value) of SCOR and Converium were subsequently punished by investors with P/B multiples of less than 1 for long periods, reflecting questions over the underlying book value, as well as concerns on their 'BBB' ratings and future returns. We acknowledge that the likes of Montpelier Re will deliver far superior ROEs into the future (assuming normal weather) than a SCOR or a Converium. However, we feel that the P/B multiples of the likes of Montpelier Re may not have been suitably 'punished' by the market, particularly given the increased book value risk as catastrophe modelling agencies 'ratchet up' their storm frequency and severity forecasts.

  The US view: *We won't disagree with the perspective that investors should differentiate between the valuations placed on Bermudians with (apparent) differences in risk management skills. Why MRH trades where it does is a mystery to us.*

- The US/Bermudians may look cheap on current earnings but surely this is a reflection of the fact that 2005 has shown us that not only future earnings, but also current shareholders' equity could be wiped out. Is this not fair, particularly given the scientific soundings for a busy decade on the storm front?

  The US view: *Bermudian reinsurers lost an average of about one-third 2Q05 BV during the 2H05 storms. Much has changed over the past few months (higher prices for reinsurance, important underwriting changes that shifted volatility to the primary companies) but we do not have a crystal ball: Buyer Beware!*

Reconciliation and Conclusion

From the Quality Trade perspective, Europe comes out on top. The European reinsurers have historically enjoyed higher credit ratings, and the diversification in the business models of Swiss, Hannover and Munich Re make their long-term future more certain than that of several Bermudians (what if a Category 5 hurricane hits Miami in 2006?).

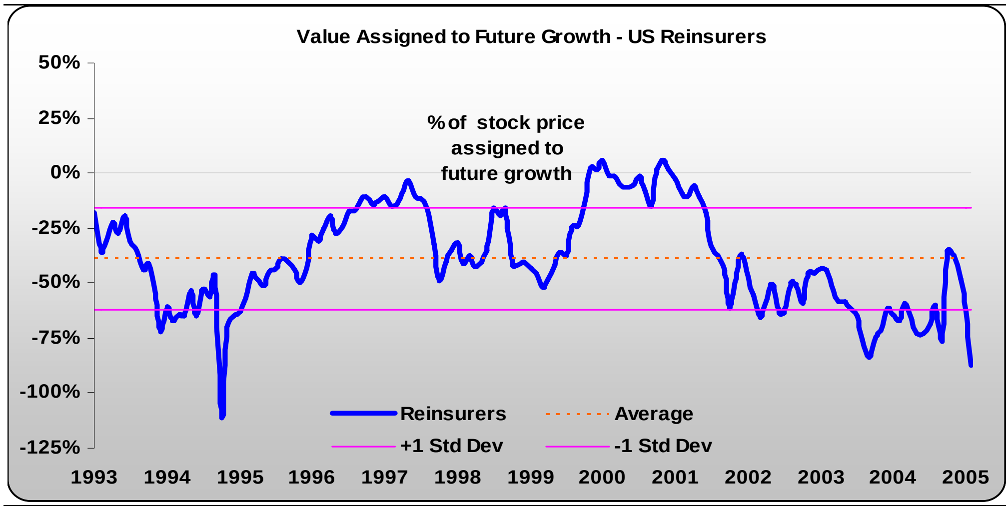
From the perspective of diversification, we see some rationality in the markets when reinsurers such as Everest and PartnerRe are valued similarly to Hannover and Swiss Re (though that leaves many differences - such as prospective ROEs - unaccounted for).

Out of London - we do see certain stocks as being ‘cheap for a reason’. This includes Converium and until recently SCOR. From New York - stocks like MRH that are expensive for reasons we cannot comprehend are among our least favorite. All three of the foregoing carry Underweight recommendations.

Paying for Growth?

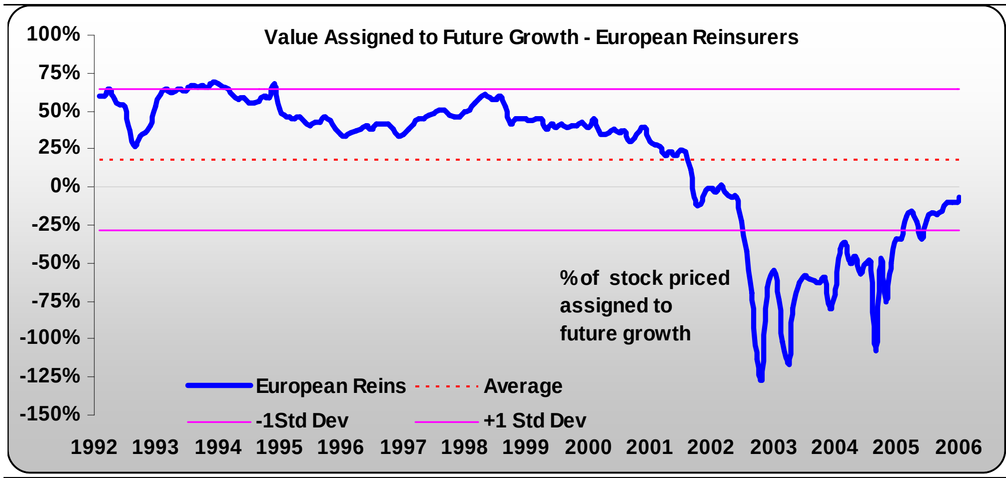
We borrowed our US strategist's technique for assessing the percentage of a stock price ascribed to future growth opportunities (simply, the difference between the current stock price and the capitalized value of next year's earnings expressed as a % of the stock price).

Exhibit 10
US Reinsurers



Reinsurers: AHL, AXS, IPCR, MRH, MXRE, PRE, RE, RNR
Source: FactSet, Bloomberg, Morgan Stanley Equity Research

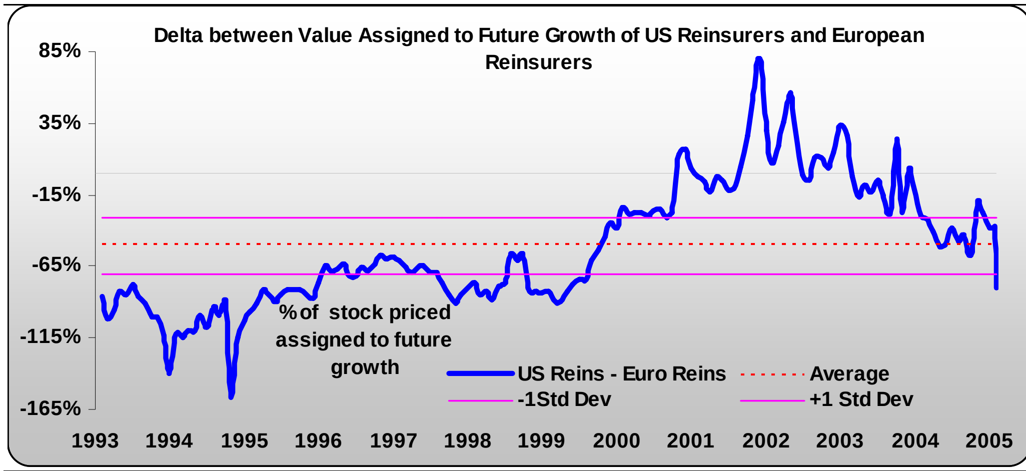
Exhibit 11
European Reinsurers



European Reinsurers: Swiss Re, Hannover Re, SCOR, Converium, Munich Re
Source: FactSet, Bloomberg, Morgan Stanley Equity Research

Exhibit 12

US Reinsurers - European Reinsurers



Reinsurers: AHL, AXS, IPCR, MRH, MXRE, PRE, RE, RNR; European Reinsurers: Swiss Re, Hannover Re, SCOR, Converium, Munich Re.
Source: FactSet, Bloomberg, Morgan Stanley Equity Research

The US perspective on European reinsurers

- The elephant in the room…not talking about it won't make it go away. All signs suggest the growth premium being paid for Bermudian reinsurers is one standard deviation below average on both an absolute and relative (to the Europeans) basis.

  The European view: *A pullback in the Bermudian growth premium was inevitable given the flaws in the 'Bermuda model' that were exposed in 2005.*

- Why the recent rise in the European growth premium? We're not aware that market share is flowing back to the Europeans(?).

  The European view: *Despite recent accusations of aggressive pricing from Munich Re and Swiss Re (coming from competitors and reinsurance brokers as usual) we do not see market share shifting towards Europe.*

The European perspective on Bermudian reinsurers

- The historical trend for the Bermudians would suggest that few investors have believed that the Bermudian reinsurers can deliver periods of sustained earnings growth. Does this not show a lack of faith in the Bermuda model? And to what extent have the Bermudians proved investors wrong with periods of sustained growth?

  The US view: *Predicating a view on the Bermudian model based on the historical growth premium paid for European reinsurers may be flawed. From our perspective, the above-average growth premium paid for the European reinsurers throughout most of the 1990s was not because of their underwriting prowess. Instead, investors paid a premium for "growth" in assets, not underwriting earnings, as European reinsurers were really a proxy for the investment markets at that time.*

- The Bermudians may look cheap on this metric, but where is the growth coming from, given that 2006 is increasingly looking like the peak of the cycle?

  The US view: *Capital will flow to the locations where it can be used most efficiently. Is the rise of Bermuda at the expense of London, Continental Europe and (yes) the US a mistake? We don't think so. There are lines of business where it is necessary to be close to the source of underwritten business (e.g., many casualty classes). In those instances the pure "Bermuda model" will not produce superior returns. Alternatively, companies including RE and PRE are diversified, with growth opportunities as good or better (owing to more efficient capital domiciles) than their European counterparts.*

Reconciliation and Conclusion

We think that the growth framework provides supplementary (rather than primary) evidence supporting the Bermuda case. It is clear that shares of European reinsurers have rebounded in this framework, while the Bermudians are still struggling.

Catastrophe Exposure

This section needs little introduction or explanation. We reviewed losses in 2H05 as a % equity, along with the impact of three plausible storm loss scenarios on EPS, BV, and valuation.

Exhibit 13

2H05 Cat Losses and Development Scenarios

	Curr	MS Estimate 2H06 Storms After Tax	% 2Q05 Equity	Additional Net Loss Incurred Adverse Storm Development Scenarios 2%	5%	10%
Avg			**6.3%**			
Bermuda						
AHL	USD	507	31.5%	10	25	51
AXS	USD	1,011	31.9%	20	51	101
IPCR	USD	857	49.2%	17	43	86
MRH	USD	1,116	76.3%	22	56	112
MXRE	USD	159	15.6%	3	8	16
PRE	USD	797	26.9%	16	40	80
RE	USD	962	23.6%	19	48	96
RNR	USD	887	38.2%	18	44	89
Europe						
Converium	CHF	77	4.6%	2	4	8
Hannover Re	EUR	575	20.0%	11	29	57
Munich Re	EUR	1,540	7.2%	31	77	154
SCOR	EUR	63	3.7%	1	3	6
Swiss Re	CHF	1,750	8.0%	35	88	175
Avg			**8.7%**			

Source: Company data, Morgan Stanley Research **Losses as reported by Bermuda reinsurers with 4Q05 results, European losses reflect most recently released company estimates (the Europeans have not reported 2H06 results at the time of this report)

Exhibit 14

Storm Development Scenarios: EPS and BV Impact

	Incremental Negative EPS Impact Adverse Storm Development Scenarios 2%	5%	10%	% 4Q05e BVPS Impact Adverse Storm Development Scenarios 2%	5%	10%
Bermuda						
AHL	0.10	0.26	0.52	1%	1%	3%
AXS	0.13	0.32	0.64	1%	2%	3%
IPCR	0.27	0.67	1.33	1%	3%	6%
MRH	0.25	0.63	1.25	2%	5%	11%
MXRE	0.05	0.13	0.26	0%	1%	1%
PRE	0.28	0.70	1.41	1%	2%	3%
RE	0.31	0.78	1.57	0%	1%	2%
RNR	0.25	0.61	1.23	1%	2%	5%
Europe						
Converium	0.01	0.03	0.05	0%	0%	0%
Hannover Re	0.09	0.24	0.47	0%	1%	2%
Munich Re	0.13	0.33	0.67	0%	0%	1%
SCOR	0.00	0.00	0.01	0%	0%	0%
Swiss Re	0.11	0.27	0.54	0%	0%	1%

Source: Company data, Morgan Stanley Research

Exhibit 15

Valuations Tend Not to be Meaningfully Impacted

	Price to 4Q05e BVPS	Price to 4Q05e BVPS Adverse Storm Development Scenarios 2%	5%	10%
Bermuda				
AHL	1.22	1.22	1.23	1.25
AXS	1.64	1.65	1.67	1.70
IPCR	1.19	1.20	1.22	1.26
MRH	1.48	1.51	1.56	1.65
MXRE	1.21	1.21	1.22	1.22
PRE	1.32	1.33	1.34	1.36
RE	1.54	1.55	1.56	1.58
RNR	1.69	1.71	1.73	1.78
Europe				
Converium	1.00	1.00	1.00	1.00
Hannover Re	1.54	1.55	1.56	1.58
Munich Re	1.12	1.12	1.13	1.13
SCOR	1.13	1.13	1.13	1.13
Swiss Re	1.40	1.41	1.41	1.42

Source: FactSet, Company data, Morgan Stanley Research

The US perspective on European reinsurers

- True, the European companies reported losses at a lower % of BV than the Bermudians. But, the operative word here is *reported.* Munich more than doubled its loss estimate for Katrina et al. in late December. How can an investor take confidence in the book values the companies are reporting? A scan of US statutory filings reveals a high frequency of European names as reinsurers of primaries with sizable ceded loss estimates. Are the Europeans finished upping estimates?

__The European perspective:__ At this stage, additional material increases from Munich and Hannover would be disappointing. If anything, Hannover was ahead of the curve as it set up a separate €200m buffer for likely deterioration on Marine losses into 2006, following the experience of Hurricane Ivan, which deteriorated into the early quarters of 2005. Recent results reported by Everest Re, XL and PXRE with deteriorating losses would support this view.

Swiss Re must be at some risk of having to top-up reserves given that it has not updated the market since November 2. However, to some extent this threat is offset by the company's 'Gross for Net' underwriting approach, which should lead to less volatility around the calculation of the ultimate reserving position.

- What's that coming across the wires? Why, it's a press release with the European companies reporting their 2006 storm losses. The Europeans lost credibility reporting their losses way too soon after Hurricane Katrina.

  The European perspective: *We agree. Albeit that they were not the only parties to blame, with the cat-modelling agencies also racing each other to an early conclusion.*

- Q: What is virulent, airborne, and potentially devastating to reinsurers? A: Well, yes, we could be referring to a barrel of PCBs propelled by Hurricane Katrina. Rather, we were thinking of the Avian flu virus and the potential for a global pandemic à la the Spanish influenza outbreak of 1918. Doesn't a huge percentage of the world's mortality risk lie with the European reinsurers?

  The European perspective: *The Europeans would respond by saying that 'trend risk' (adverse development) as opposed to 'shock risk' is the main threat in life reinsurance given its closer 'proximity'. They would state that an outbreak of Avian flu could be manageable as the most affected populations (the young and old) would not necessarily match the insured population. But then, they would say that wouldn't they…The impact is still clearly very difficult to quantify and would be further complicated by additional factors such as state intervention and the likely business interruption cost, which would hurt the P&C reinsurers. We await detailed analysis from the companies and external parties on this one.*

The European perspective on Bermudian reinsurers

- Everest Re and PartnerRe (two of the less property cat geared Bermudian reinsurers) reported lesser/similar hits to book value as Hannover Re, yet Hannover will still finish the year with a profit. With better ROE's going into the future, a similar P/E, and more diversification, we know where we'd be putting our money!

  The US view: *Everest Re has grown its BV by an 11% CAGR (excluding equity issuance) since 2000, while PRE is a somewhat lower 6%.*

- With Swiss Re, Munich Re, and Hannover Re being truly global reinsurers, we feel that their losses are representative of the potential impact of similar-sized disasters in different regions across the globe. SCOR and Converium no doubt benefited from their much reduced US franchises. To what extent would the Bermudian losses have been less had the losses arisen out of a European windstorm or Asian typhoon?

  The US view: *Based on what we know, RMS is updating its European windstorm model concurrently with its updated views on US hurricanes - both due out this spring. We were told this past year that whereas Atlantic basin hurricanes were undergoing a cyclical (and maybe secular rise), European windstorms are on no such trajectory. While difficult to gauge the relative attractiveness of property catastrophe business in the US versus Europe, we do think it makes sense for investors to consider the underlying geographic dispersion in their portfolios - hence the merits of a global basket.*

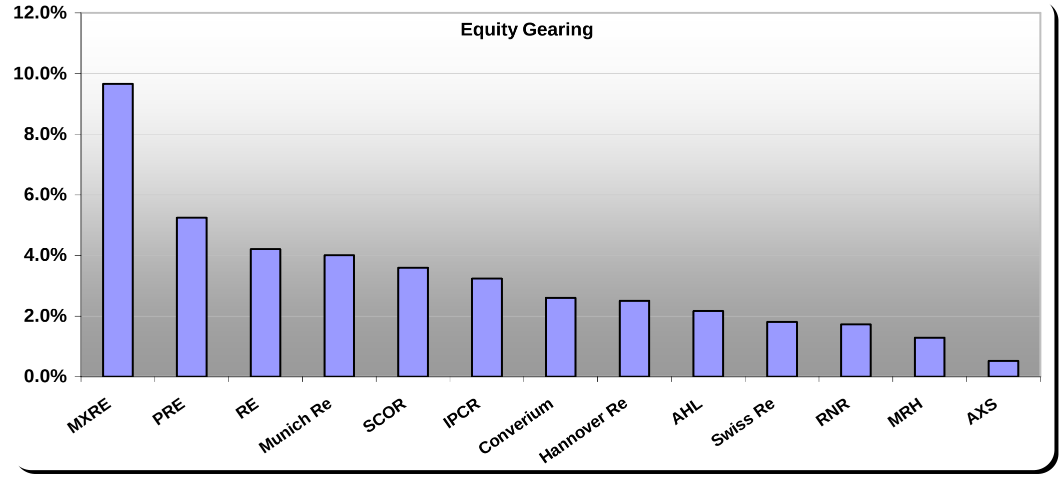
Reconciliation and Conclusion

With 'in-house' catastrophe modelling capabilities, Swiss and Munich Re would claim that their capital models are far more robust than their Bermudian competitors that rely on the external modelers. While the Bermudians would be quick to counter that they do not simply rely on external models, the facts remain: The size and diversification of the European balance sheets make them clear winners on this metric.

Investment Gearing

Exhibit 16

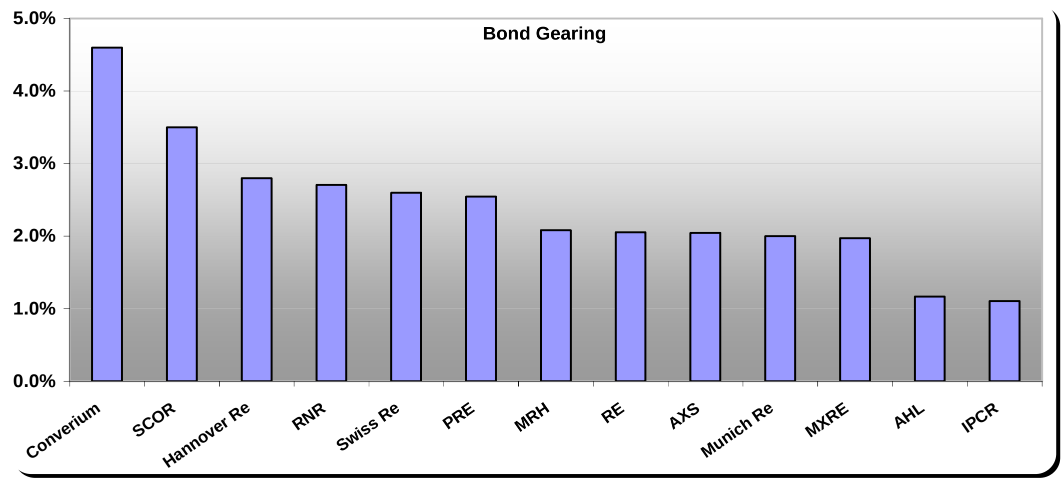
Equity Gearing - impact of a 10% rise in the value of equities



Source: Company Data, Morgan Stanley Equity Research

Exhibit 17

Bond Gearing - impact of a 1% rise in the value of bonds.



Source: Company Data, Morgan Stanley Equity Research

The US perspective on European reinsurers

- Good or Bad? As companies age, their long-tailed liabilities grow and the mix of income becomes skewed toward investment income. This simple fact of life is catching up with the likes of PRE and RE in Bermuda, as it has with the European companies. From an investment and valuation perspective, however, intuition suggests that investors will reward generation of underwriting income more dearly than production of investment income.

***The European view**: We struggle to disconnect underwriting and investment income given that the two are intrinsically linked, and investment strategies are essentially neutral (bond focused). Instead, we believe that the market is paying more for the short-tail property cat writers at the moment as they should clearly be producing the highest returns (assuming normal weather).*

- The charts above harken back to the tables showing disaggregated ROEs (Exhibit 4). Converium and

SCOR score highly on this measure because they make so little money underwriting insurance risks.

The European view*: The high bond gearing of Converium and SCOR is due to their credit rating situations (SCOR regained its 'A-' with S&P in the second half of 2005). Both companies had to switch a large amount of their equities into bonds in order to satisfy rating agency demands.*

The European perspective on US/Bermudian reinsurers

- We can see from Exhibit 16 above that the excessive equity gearing of the European reinsurers is a thing of the past. However, Max Re seems to be particularly highly geared - do our US colleagues find this concerning?

  The US view*: Max Re began life ~1999 with the view that it would sell reinsurance to generate investable funds - with much of that targeted to alternative assets. Since that time, the company has been steadily reducing its alternative asset portfolio (now at 30% of investments, should be down to ~25% by year end) for the very reason noted earlier - investors tend not to reward reinsurers for their investment prowess.*

- Given the low equity and bond gearing of the likes of Aspen and Axis, we would be interested to know if these stocks (or others) have any unusual approaches within their investment portfolios. Or is this low gearing a reflection of short-tail liabilities and hence a relatively smaller investment float?

  The US view: *As relatively new companies (with healthy doses of short-tailed claims in their product portfolio), neither has accumulated the asset leverage of more established peers. In the case of AXS, anyway, investors seem happy to reward the company with a healthy ~1.6-1.7x BV multiple because of its underwriting and risk management skills.*

Reconciliation and Conclusion

The Europeans have learned the hard way about the risks of high and concentrated equity exposures. Equity and bond gearing in Europe is now more in-line with the Bermudians. On the whole, we do not foresee management teams on either side of the Atlantic getting greedy with their equity positions in the short term.

Valuation Methodology and Risks to Target Price

Europe. For the European reinsurers, our valuation methodology consists primarily of our sum of the parts approach based upon traditional embedded values and divisional returns. We incorporate expected valuation multiples (TrEVE and capital) depending on expected returns, growth and quality factors. We also reference historical valuation multiples and adjust for current market conditions.

The primary risks to our price targets include: 1) combined ratios do not emerge as expected; 2) non-life reserves (legacy or catastrophe) prove to be inadequate, resulting in charges through the P&L, 3) changes to existing credit ratings that may tarnish the company's franchise; 4) further negative regulatory or legal developments, particularly in the area of financial reinsurance.

Bermuda. For the Bermudian reinsurers, our valuation methodology includes our residual income model and expected price to book multiple approaches. We incorporate historical and relative valuation multiples, expected returns on equity (ROE), growth and quality factors, as well as our price to book / return on equity regression analysis, among other factors, to determine our forward book multiple levels.

The primary risks to our price targets include: 1) adverse reserve development from recent catastrophes, 2) industry pricing gains may not materialize to the extent we envision, 3) more stringent rating agency requirements could prevent (re)insurers from expanding operational leverage, resulting in less premiums and a lower ROE than we model, 4) risks that profit margins in new business lines develop adversely and 5) ongoing regulatory dealings and investigations could intensify and create an uncertainty overhang.

Morgan Stanley
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ModelWare EPS illustrates the approach. It represents ModelWare EPS as ModelWare net income divided by average fully diluted shares outstanding. ModelWare net income sums net operating profit after tax (NOPAT), net financial income or expense (NFE) and other income or expense. ModelWare adjusts reported net income to improve comparability across companies, sectors and regions. Among these adjustments: We exclude goodwill amortization and items deemed by analysts to be "one-time" events; we capitalize operating leases where their use is significant (e.g., in transportation and retail); and we convert inventory to FIFO accounting when LIFO costing is used. For more information on these adjustments and others, as well as additional background, please see *Morgan Stanley ModelWare (ver. 1.0): A Road Map for Investors*, by Trevor Harris and team, August 2, 2004.

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(as of January 31, 2006)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**764**	**36%**	**283**	**40%**	**37%**
Equal-weight/Hold	**946**	**45%**	**336**	**47%**	**36%**
Underweight/Sell	**388**	**18%**	**91**	**13%**	**23%**
Total	**2,098**		**710**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

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Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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Industry Coverage: Insurance - Property & Casualty

Company (Ticker)	Rating (as of)	Price (02/21/2006)
William Wilt		
The Chubb Corporation (CB.N)	U (04/07/2005)	$94.88
Everest Re Group, Ltd. (RE.N)	E (06/10/2004)	$99.18
XL Capital Ltd. (XL.N)	E (09/13/2005)	$66.37
ACE Limited (ACE.N)	O (09/26/2005)	$55.12
Aspen Insurance Holdings Ltd. (AHL.N)	E (12/01/2005)	$23.60
American Int'l Grp (AIG.N)	O (04/04/2005)	$67.26
Assurant, Inc. (AIZ.N)	E (02/16/2005)	$44.45
Allstate Corporation (ALL.N)	E (08/10/2005)	$53.81
Aon Corporation (AOC.N)	E (03/18/2002)	$38.98
Axis Capital Holdings (AXS.N)	O (08/03/2005)	$30.87
W.R. Berkley Corp. (BER.N)	E (10/09/2003)	$55.49
CNA Financial Corporation (CNA.N)	E (11/16/2005)	$30.80
Marsh & McLennan (MMC.N)	O (12/01/2005)	$29.49
Montpelier Re Holdings, Ltd. (MRH.N)	U (11/10/2005)	$17.52
PartnerRe Ltd. (PRE.N)	O (04/07/2005)	$60.53
RenaissanceRe Holdings Ltd. (RNR.N)	O (11/10/2005)	$43.86
St. Paul Travelers Companies (STA.N)	E (04/07/2005)	$42.77
IPC Holdings, Ltd. (IPCR.O)	O (09/26/2005)	$26.69
Max Re Capital Limited (MXRE.O)	E (03/03/2005)	$24.90
The Progressive Corporation (PGR.N)	U (09/26/2005)	$106.54
SAFECO Corporation (SAFC.O)	E (10/09/2003)	$52.10

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