

**Commentary**

**Oil and Segregated Funds**

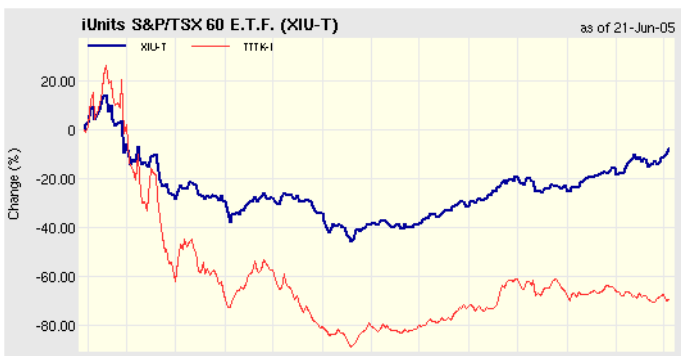
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In the late 1990's insurance companies with segregated fund guarantees had increasing exposure to technology stocks as their stock prices soared. Nortel Networks in particular grew to have an unsettling large weighting in the S&P/TSX 60 index (over 30%) and ultimately crashed from over \$120 a share to penny stock status. Segregated funds that had significant technology exposure had their guarantees of return on principal go into the money and set-up the insurer for potential payouts.

Graph 1 shows that while the market index (S&P/TSX 60) has nearly come back to its value from 5 years ago, the technology index (S&P/TSX Capped Info Tech) still has a long way to go (needs to gain 200%; this is capped which doesn't show the full impact of the Nortel meltdown).

The timing of the insurer's income hit for losses on segregated fund guarantees is unclear given the method of reserving and the manner in which insurers have moved from one end of the range of acceptable accounting practice to the other end.

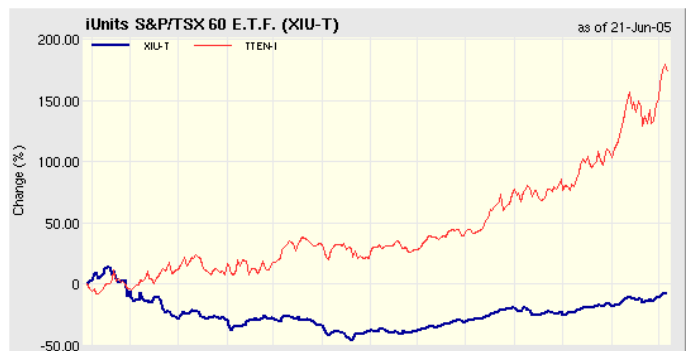
**Graph 1**  
 S&P/TSX 60 (XIU-T, blue) vs. S&P/TSX Capped Info Tech (TTTK-I, red), 5 years ending 21-Jun-05



source: Bell Globemedia Inc.

The current bull market in the energy sector is of interest in assessing the segregated fund business of insurers. With the upward movement in the energy sector stock prices, the market weighting of this sector has increased. The Globe & Mail reported on June 21, 2005 (source National Bank Financial) that the energy sector currently composes 24% of the S&P/TSX 60 and is moving to 28% once income trusts are incorporated into the index. While Nortel Networks and the rest of the technology sector ramped up in the 1990's and crashed in the last 5 years, the opposite has happened with the energy sector. Graph 2 shows the energy sector nearly tripling in the last 5 years (S&P/TSX Capped Energy) and doubling in the last 2 years (see Graph 3). Energy income trusts have also had an impressive run (doubled in the last 5 years, see Graph 4).

**Graph 2**  
 S&P/TSX 60 (XIU-T, blue) vs. S&P/TSX Capped Energy (TTEN-I, red), 5 years ending 21-Jun-05



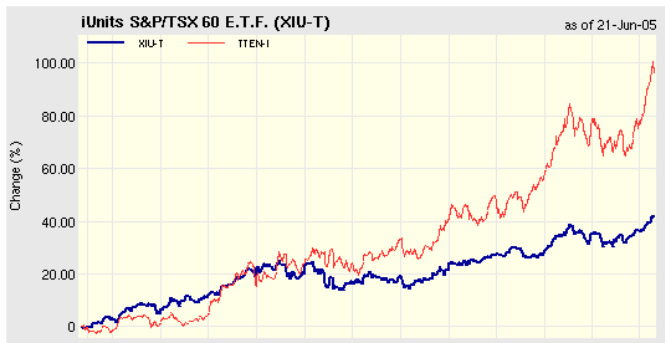
source: Bell Globemedia Inc.

If energy were in a bubble phase then the energy sector might continue to go up and exposure to the sector would increase. The inevitable crash would occur and insurers who are exposed to this sector through their segregated fund guarantees might be

set-up for the same type of hit that the technology bubble delivered. This time the catalyst would be the price of oil rather than the price of Nortel Networks shares; still a one-factor driver.

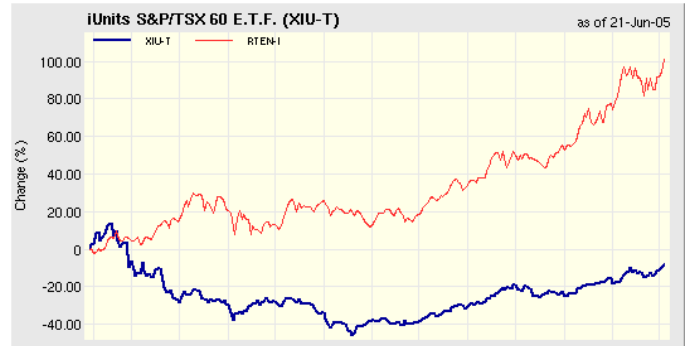
A troubling scenario for insurers would be if the energy bubble burst before the old guarantees expired. That is, if an energy bubble has been a prop for segregated fund values but it bursts then the old technology trauma might resurface; an energy bubble would risk the guarantees that were set circa year 2000 that have largely come back out of the money, going back into the money as they approach maturity. Of course, such a scenario would also leave an energy headache to fester for new money that comes in and for guarantee resets that occur around the apex of an energy bubble.

**Graph 3**  
 S&P/TSX 60 (XIU-T, blue) vs. S&P/TSX Capped Energy (TTEN-I, red), 2 years ending 21-Jun-05



source: Bell Globemedia Inc.

**Graph 4**  
 S&P/TSX 60 (XIU-T, blue) vs. S&P/TSX Capped Energy Trust (RTEN-I, red), 5 years ending 21-Jun-05



source: Bell Globemedia Inc.

