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AFG.N - Q4 2022 American Financial Group Inc Earnings Call

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OVERVIEW:

AFG reported full-year 2022 core net operating EPS of $11.63. Co. also reported 4Q22 core net operating EPS of $2.99, net EPS of $3.24. Expects 2023 core net operating EPS of $11.00-12.00.

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PRESENTATION

Operator

Thank you for standing by, and welcome to the American Financial Group 2022 Fourth Quarter and Full Year Results Conference Call. (Operator Instructions) As a reminder, today's conference call is being recorded.

I would now turn the conference to your host, Ms. Diane Weidner, Vice President of Investor Relations. Please go ahead.

Diane P. Weidner - *American Financial Group, Inc. - VP of IR*

Thank you. Good morning, and welcome to American Financial Group's Fourth Quarter 2022 Earnings Results Conference Call.

We released our 2022 fourth quarter and full year results yesterday afternoon. Our press release, investor supplement and webcast presentation are posted on AFG's website under the Investor Relations section. These materials will be referenced during portions of today's call.

I'm joined this morning by Carl Lindner III and Craig Lindner, Co-CEOs of American Financial Group, and Brian Hertzman, AFG's CFO.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Some of the matters to be discussed today are forward-looking. These forward-looking statements involve certain risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website.

We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or in responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

And finally, if you are reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy, and as a result, it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

Now I am pleased to turn the call over to Carl Lindner III to discuss our results.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, good morning.

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We're pleased to share highlights of AFG's 2022 fourth quarter and full year results, after which Craig and Brian and I will respond to your questions.

AFG's financial performance during the fourth quarter was excellent, and a strong finish to an outstanding year. Core operating return on equity topped 21% and nearly all of our Property & Casualty businesses grew during the year, establishing a record level of premium production for the company. We are also very pleased to report record full year underwriting profit and investment income in our Specialty Property and Casualty business.

Our compelling mix of specialty insurance businesses, an entrepreneurial culture, disciplined operating philosophy and an astute team of in-house investment professionals collectively have enabled us to outperform many of our peers over time. Craig and I thank God, our talented management team, and our employees for helping us to achieve these exceptionally strong results.

I'll now turn the discussion over to Craig to walk us through AFG's fourth quarter results, investment performance and our overall financial position at December 31.

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Thanks, Carl.

As you'll see on Slide 3, AFG's core net operating earnings were $11.63 per share for the full year 2022, generating a core operating return on equity of 21.2%, which was even better than the excellent 18.6% core ROE achieved in 2021. The earnings power of our operations, coupled with efficient capital management, allows AFG to produce returns on equity in excess of most of our peer property and casualty insurers.

Understanding that capital management is a critical component of delivering top-tier ROEs, we make capital management one of our highest priorities. Returning capital to our shareholders is an important component of our capital management strategy and reflects our strong financial position and our confidence in AFG's financial future.

Carl and I are pleased that we returned $1.23 billion to shareholders during 2022, including just over $1 billion or $12.00 per share in special dividends and $197 million in regular common stock dividends. Our quarterly dividend was increased by 12.5% to an annual rate of $2.52 per share beginning in October of 2022. We're proud of our track record of value creation.

During 2021 and 2022, we returned a total of $3.9 billion in capital to shareholders in the form of dividends and share repurchases. In addition to deploying the excess capital created from the sale of our annuity business, we've continued to generate and deploy excess capital through AFG's strong property and casualty operations. Growth in adjusted book value per share plus dividends was an impressive 18.5% in 2022.

Turning to Slides 4 and 5 you'll see that the fourth quarter of 2022 core net operating earnings per share of $2.99 produced an annualized fourth quarter core return on equity of 22.3%. Net earnings per share of $3.24 included after-tax non-core realized gains on securities of $0.25 per share, which include fair value changes on securities that we continued to hold at the end of the quarter.

Now I'd like to discuss the performance of AFG's investment portfolio, financial position and share a few comments about AFG's capital and liquidity.

The details surrounding our $14.5 billion investment portfolio are presented on Slides 6 and 7. Pretax unrealized losses on AFG's fixed maturity portfolio were $630 million at the end of the fourth quarter, reflecting the increase in market interest rates and widened credit spreads compared to year-end 2021. As we entered 2022, the duration in our fixed maturity portfolio was at its lowest in recent history.

Over the course of the year, we acted on opportunities presented by the increasing interest rate environment and extended the duration of our P&C fixed maturity portfolio, including cash and cash equivalents, from approximately 2 years at December 31, 2021, to approximately 3 years at December 31, 2022. In the current interest rate environment, we're able to invest in high quality, medium-duration fixed maturity securities at yields of approximately 5.5%, which compare favorably to the 4.15% yield earned on fixed maturities in our P&C portfolio during the fourth quarter of 2022.

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In addition to the favorable impact of higher reinvestment rates, as we look forward, we expect our portfolio of floating rate securities, most of which are tied to 1-month or 3-month indices, to benefit from additional increases in short-term interest rates. Altogether, we expect the yield earned on P&C fixed maturity portfolio to increase by 20 basis points by the fourth quarter of 2023 compared to 4.15% earned for the fourth quarter of 2022.

Looking at the results for the quarter, for the three months ended December 31, 2022, Property & Casualty net investment income was 19% lower than the comparable 2021 period. These results included an annualized return on alternative investments in the fourth quarter of 2022 of approximately 5.3% compared to an exceptionally strong 26.3% return for the fourth -- for the 2021 fourth quarter. The average annual return on AFG's alternative investments over the five calendar years ended December 31, 2022, was approximately 14%.

Excluding the impact of alternative investments, net investment income in our Property & Casualty insurance operations for the three months ended December 31, 2022 increased 64% year-over-year as a result of the impact of rising interest rates, enhanced by the strategic positioning of our portfolio coming into 2022 and higher balances of invested assets. For the 12 months ended December 31, 2022, P&C net investment income was approximately 3% higher than the comparable 2021 period and included a return on investments on alternative investments of 13.2% for 2022 compared to the remarkably strong 25.3% earned on alternative investments in 2021.

We're very pleased with the double-digit return on alternative investments earned in 2022 in a challenging investment environment. Excluding alternative investments, net investment income in our property and casualty insurance operations for 2022 increased 29% year-over-year as a result of the impact of rising interest rates and higher balances of invested assets.

As we look forward to 2023, our guidance for the year reflects a return of approximately 7% on our $2.1 billion portfolio of alternative investments as an assumed high single-digit return on our multi-family housing-related investments is anticipated to be partially offset by somewhat weaker performance of traditional private equity investments.

Please turn to Slide 8, where you'll find a summary of AFG's financial position at December 31, 2022. Our excess capital was approximately $1.4 billion at December 31, 2022. This number included parent company cash and investments of approximately $876 million.

During the quarter, we returned $224 million to our shareholders through the payment of a $2.00 per share special dividend and our regular $0.63 per share quarterly dividend. Yesterday, we announced a special dividend of $4.00 per share payable on February 28, 2023. This special dividend is in addition to the Company's regular quarterly cash dividend of $0.63 per share most recently paid on January 25, 2023.

Even with the $4.00 per share special dividend declared yesterday, we expect our operations to generate significant excess capital in 2023 to the point where we could deploy in excess of $500 million of excess capital for share repurchases or additional special dividends through the end of 2023.

As you may recall, the portion of our excess capital that we view as available for special dividends and share repurchases is limited by our internal total debt-to-cap target of 30%, and that capital number is impacted by unrealized gains and losses on fixed maturities. However, it's important to note that each dollar of debt repurchased frees up approximately $2 of excess capital for distribution to shareholders.

For the three months ended December 31, 2022, AFG's growth in book value per share plus dividends was 8.7%. For the 12 months ended December 31, 2022, AFG's book value per share plus dividends increased by 4.8%, reflecting very strong earnings partially offset by the increased unrealized losses on fixed maturities from the impact of rising interest rates and widened credit spreads.

Excluding unrealized losses related to fixed maturities, we achieved growth in adjusted book value per share plus dividends of 6.3% during the fourth quarter, and 18.5% for the full year. The short duration of our fixed maturity portfolio and somewhat limited exposure to publicly traded common stocks when compared to some peer companies helped our performance in 2022.

I'll now turn the call back over to Carl to discuss the results of our P&C operations and our expectations for 2023.

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Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Thank you, Craig.

Please turn to Slides 9 and 10 of the webcast, which include an overview of fourth quarter results.

Our Specialty Property & Casualty businesses closed out 2022 on a strong note, producing record full year underwriting profit and record full year pretax Property & Casualty core operating earnings. I'm especially pleased that each of our Specialty Property & Casualty sub-segments produced combined ratios of 90% or better for the fourth quarter, despite elevated industry catastrophe losses. We set new records for premium production in 2022 and are meeting or exceeding targeted returns in nearly all of our businesses.

When we look at a year-over-year comparison of our Property & Casualty results for the fourth quarter, it's easy to lose sight of the strong fourth quarter results in 2022, especially noting the average crop results achieved in 2022, following the extremely strong results reported in our crop business in the comparable prior year period. As you'll see on Slide 9, the fourth quarter 2022 combined ratio was an excellent 86.6%, although 5.9 points higher than the exceptional 80.7% reported in the comparable prior year period.

If we put our crop business to the side, our combined ratio for the fourth quarter was comparable to the 2021 fourth quarter results. Results for the 2022 fourth quarter include a modest 0.9 points in catastrophe losses, despite elevated industry catastrophe losses during the quarter. By comparison, catastrophe losses in the 2021 fourth quarter added 1.8 points to the combined ratio. Fourth quarter 2022 results included 3.6 points of favorable prior year reserve development, compared to 5.0 points in the fourth quarter of 2021.

Gross and net written premiums increased 6% and 5%, respectively, in the 2022 fourth quarter compared to the prior year quarter. Year-over-year growth was reported within each of the Specialty Property and Casualty groups during the fourth quarter as a result of a combination of new business opportunities, increased exposures and a good renewal rate environment.

The drivers of growth vary considerably across our portfolio of specialty P&C businesses. In the aggregate, year-over-year growth in gross written premium for the full year in 2022, excluding crop insurance, is about half attributable to new business opportunities and change in exposures and half attributable to rate increases.

Average renewal pricing across our Property and Casualty Group, excluding workers' comp, was up approximately 6% for the quarter, and up approximately 5% overall, in line with renewal rate increases reported in the prior quarter. The renewal rate environment has remained relatively consistent throughout the year, and has enabled us to meet or exceed targeted returns in nearly all of our specialty P&C businesses.

We've been focused on achieving adequate pricing for some time and have achieved overall rate increases across our entire specialty book for 26 straight quarters. We feel very good about the level of rate increases that we continue to achieve and importantly, the impact of cumulative rate increases over time, which have enabled us to stay ahead of prospective loss ratio trends and help us to feel even more confident in the adequacy of our reserves.

Given the focus on the reinsurance pricing and capacity, I wanted to provide an update on our reinsurance renewals. In January, we successfully renewed our 2023 property cat and property per risk treaties within a challenging reinsurance market. Our other divisional January 1 renewals have gone very well, and were executed with terms similar to 2022.

Talking about our property cat, our property cat coverage has traditionally attached at levels that are relatively low compared to similar-sized peers. Having long-standing, trusted relationships with reinsurance partners who understand our underwriting discipline and risk appetite and an existing catastrophe bond attaching at $125 million provided a solid foundation as we entered renewal discussions.

We placed $75 million of coverage in excess of a $50 million per event primary retention for the vast majority of our U.S.-based operations. This new structure provides for an increase in our per occurrence retention from $20 million to $50 million and collapses our treaty tower to one layer

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of $75 million excess of $50 million, which covers us up to the attachment point of our catastrophe bond. Our cat bond provides coverage of 94% up to $325 million for catastrophe losses in excess of our $125 million property cat tower and expires in December 31, 2024.

Our management teams always consider reinsurance costs and higher retentions and ensure that these factors are reflected in the pricing of our primary property coverages. The terms, pricing and retentions of our reinsurance arrangements, including the higher per occurrence retention in our property cat coverage, is factored into our 2023 guidance.

Now I'd like to turn to Slide 10 to review a few highlights from each of our Specialty Property and Casualty business groups. Lower year-over-year underwriting profit in the Property and Transportation Group was primarily the result of average underwriting profitability in our crop insurance operations when compared to the exceptionally strong crop results reported last year. Excluding crop, the fourth quarter calendar year combined ratio in this group improved 2.8 points year-over-year, reflecting improved results in the majority of the businesses in this group.

Catastrophe losses in this group, net of reinsurance and inclusive of reinstatement premiums, were $7 million in the fourth quarter of 2022, compared to $15 million in the comparable last year period, and were primarily attributable to Winter Storm Elliott.

Fourth quarter 2022 gross and net written premiums in this group were up 8% and 1%, respectively, when compared to the 2021 fourth quarter, primarily due to higher winter wheat commodity prices and new business opportunities attributed to crop products with higher cessions. Overall renewal rates in this group increased 7% on average for the fourth quarter of 2022, accelerating from the 5% rate increase reported in the third quarter. Pricing for the full year for this group was up 6% overall.

Now in our specialty Casualty Group, higher year-over-year underwriting profits in our excess and surplus lines and excess liability businesses were more than offset by lower underwriting profitability in our workers' comp businesses. Though the underwriting profitability in our workers' comp businesses continued overall to be excellent.

The businesses in the Specialty Casualty Group achieved an outstanding 81.3% calendar year combined ratio overall in the fourth quarter, 3.3 points higher than the exceptionally strong 78.0% achieved in the comparable prior year period. And fourth quarter 2022 gross and net written premiums both increased 4%, when compared to the same prior year period, with the vast majority of businesses in this group reporting growth during the quarter.

Factors contributing to year-over-year premium growth included new accounts and strong account retention in our social services business, increased exposures from payroll growth and new business in our workers' comp businesses, and additional business opportunities in our E&S operations. The growth was partially offset by lower premiums in our mergers and acquisitions liability and executive liability businesses.

The majority of the businesses in this group achieved strong renewal pricing during the fourth quarter. Renewal pricing for this group, excluding workers' comp, was up 6% in the fourth quarter and was up 4% overall, with both measures down about 1% from the renewal pricing in the previous quarter. Average renewal rates in this group for the full year, excluding comp, were up 7%, and up 5% overall.

Now the finance -- Specialty Financial Group continued to achieve excellent underwriting margins and reported an 83.1% combined ratio for the fourth quarter of 2022, an improvement of 2.4 points over the prior year period. Higher year-over-year underwriting profit was primarily the result of the favorable impact on underwriting results from lower than previously estimated reinstatement premiums related to Hurricane Ian. Catastrophe losses for this group, net of reinsurance and inclusive of the adjusted reinstatement premiums from Ian, had a favorable impact of $3 million in the fourth quarter, compared to losses of $6 million in the prior year quarter.

Fourth quarter 2022 gross and net written premiums were up 12% and 15%, respectively, when compared to the prior year period due primarily to the growth in our financial institutions and commercial equipment leasing business. In addition, lower than previously estimated reinstatement premiums from Hurricane Ian contributed to higher year-over-year net written premiums.

Renewal pricing in this group was up 4% for the fourth quarter, consistent with rate increases in the previous quarter. Renewal pricing in this group was up 5% for the full year of 2022.

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Now if you'd please turn to Slide 11, where you'll see a full-page summary of our initial guidance for 2023. Overall, we continue to expect an ongoing favorable property and casualty market, with opportunities for growth arising from both continued rate increases and exposure growth. We expect AFG's core net operating earnings in 2023 to be in the range of $11.00 to $12.00 per share, which produces a core return on equity of over 20% at the midpoint. Our guidance reflects an average crop year and our expectations and assumptions regarding investment income, including an estimated return on alternative investments of 7% in 2023 compared to 13.2% achieved last year.

Core net operating earnings at the midpoint of our 2023 guidance, excluding income from alternative investments would increase 10% year-over-year from 2022's results on a similar measure. As we consider the outlook for our Specialty Property and Casualty operations, we expect a 2023 combined ratio for the Specialty Property and Casualty Group overall between 86% and 88%.

Net written premiums for 2023 are expected to be 3% to 5% higher than the $6.2 billion reported in 2022, and excluding crop, we expect growth in the range of 4% to 6% in what we expect to be a more challenging economic environment.

Looking at each sub-segment: We expect Property and Transportation Group combined ratio to be in the range of 89% to 93%. Again, our guidance assumes average crop earnings for the year. We estimate growth in net written premiums for this group to be in the range of 1% to 3%. Our premium growth guidance factors in the impact of commodity futures pricing and volatility on crop premiums, which at current levels, would negatively impact premiums and related exposure year-over-year in our crop business. Based on current commodities futures pricing, we expect net written premiums in our crop insurance business to be down 3% year-over-year. Excluding crop, growth in net written premiums in this group is expected to be in the range of 3% to 5%.

Our Specialty Casualty Group is expected to produce a combined ratio in the range of 80% to 84%. Our guidance assumes continued calendar year profitability in our workers' comp businesses overall, and we're estimating growth in net written premiums in a range of 4% to 8%. Premium growth will be tempered by rate decreases in our workers' comp book, which are the result of favorable loss experience in this line of business. So excluding workers' comp, we expect premiums in this group to grow in the range of 6% to 10%.

Now we expect the Specialty Financial Group's combined ratio to be in the range of 83% to 87%, with all businesses in this group projected to produce strong underwriting margins, and we expect growth in net written premiums for this group to be in the range of 4% to 8%, based on projected growth in nearly all the businesses across this group.

We expect renewal rates overall to increase between 2% and 4% in our Specialty Property and Casualty operations overall and excluding comp, we expect renewal rate increases to be in the range of 3% to 5%.

Craig and I are very pleased to report these exceptionally strong results for the fourth quarter and full year, and we're proud of our proven track record of long-term value creation. Our insurance and investment professionals have executed well in a dynamic insurance industry and uncertain economic environment, but their work positions us very well as we begin 2023.

We will now open the lines for the Q&A portion of today's call. And Craig and Brian and I would be happy to respond to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Paul Newsome from Piper Sandler.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Good morning. Thanks for the call. Congratulations on the year. I was hoping you could just kind of reassess a little bit the competitive environment for the variety of your specialty businesses. It felt like it got a little bit more competitive in 2022. I don't know if that's a fair thing as the year went

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by, and it maybe seems like it's not really tailing off, despite some of the volatility inflation and the higher reinsurance prices. Is that a fair assessment? Or am I obviously probably oversimplifying it?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, we have 30 or so specialty businesses. And I'd say we felt that there was more competition in certain of our businesses -- for sure in California workers' comp and higher excess layers on national excess liability types of risk, and clearly in the public D&O arena. There seemed to be -- particularly in those two -- last two areas I mentioned, there seemed to be more competitors that were in that market and certainly was more competitive in that.

I think in most of our other businesses, it's probably pretty status quo with maybe marginally more competitive in that. But I think the social inflation, the increased property cat pricing and a slowing economy and those factors, I think, have kept the majority of our business in a reasonably competitive environment.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Makes sense. Maybe a few thoughts on sort of the talent pool as you're trying to grow it. It doesn't seem like you added a ton of new teams or new segments in a while, other than maybe a couple here and there. Is this just a sign of how competitive it is in the environment? Or is it philosophically you're trying to be more careful and more conservative in how you think about new products and new businesses?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, last year, we grew 11%. So I think that coming -- certainly during COVID and coming out of COVID, the talent market was tighter in all businesses pretty much. Ours wasn't any exception. But I think our HR department and our group did an outstanding job in attracting the talent necessary to grow our business in that. So I didn't see that as too much of a limiting factor. I think what we have going for us is we're a very successful company. We've created a culture and values and incentives that people really like to work with within our industry, and we have a reputation for that.

So I don't see talent as being a limiter on growth or a limiter in what we want to do. I think it's more -- I think we're always looking and have room to expand geographically in all of our businesses and in some sub-niches. It's always more difficult to find the right additional opportunities in businesses to grow your business or to find acquisitions that are not only accretive but, in our case, our hurdle is we want to earn double-digit returns on equity over time in the M&A side. It's a piece of cake being accretive with interest rates as low as they've been in that, but we're about adding businesses and investing capital at double-digit returns.

Jon Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great, always appreciate the help. Thanks for the call.

Operator

Our next question comes from the line of Michael Zaremski of BMO.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Hey, good afternoon. First question on the outlook in terms of the decel in average renewal rates outlook, 2% to 4% year-over-year. I think hearing some of the color in the prepared remarks, some of it might be coming from workers' comp, but maybe you can kind of elaborate if there's any other lines of business you'd like to call out, maybe even some moving higher, some moving lower in terms of expectations?

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Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Yes, Mike, good question. I think certainly, in workers' comp, there continues to be some rate give up tied to positive results in that. I think it's kind of a good news, bad news. The prior year accident year for the industry and for us have turned out better generally over the last couple of years than what was expected. So I do think that is a factor. That said, I think in some of our comp businesses, we're going to be growing in that. And our comp businesses continue to have excellent results.

Our pricing guidance ex comp is 3% to 5%. And when you look at kind of the prospective loss ratio trends excluding comp, they're right around 5%. So I think the -- where we're not quite getting to where we want to be on our rate increases or in some of the lines I just mentioned. Public D&O is more competitive than what it should be. The higher excess liability business, particularly among Fortune 1000. I think as a business, we're not going to get to the -- to a prospective loss ratio trend. Although I do think -- I want to be careful because I do think that in our case, we've had really strong cumulative multi-year increases in our book, and we're running in an 87% combined ratio this year. And some of our businesses are higher than that. Some of our businesses are better than that. And in our case, we look at each one of the businesses and what the strategy should be in each one. So anyhow, that would be my perspective on things.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Okay. That's helpful. I admit I'll have to reread the transcript a bit on the good reinsurance renewal color. But I think I heard that retention went up materially. And if that is correct, should we be just thinking about anything in our models in terms of seasonality now or cat load or something?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

I think what we've tried hard to do every year when we give guidance is to bake everything into our guidance. And I think we've tried to reflect that. I think one thing, in our case, I think retention went from $20 to $50, we probably should have been at $50 anyhow because when you look at the rate online, we had to pay and the amount of premiums that we had to pay for that lower layer, you could argue that we probably should have kept it anyhow. And that -- so you have -- it's not $30 million of extra exposure, it's really $30 million -- I would guess, we probably paid $15 million or something like that.

So it's not really the full amount of the retention that really impacts us, if you understand what I'm saying.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Okay. Yes, now that helps put it in context. Okay. And maybe I appreciate that there's lots of different lines of business, but there's been a lot of discussion on some of your competitors' calls about loss trend maybe creeping up a bit for some, particularly not just on the property side, but a bit on the casualty side. Some have talked about the transportation segment that you guys have one of the most profitable transportation segments of publicly traded insurers. But any changes that you'd like to call out you're seeing on the margins on loss trends?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

I don't think so. I think in past calls, I've kind of mentioned when we look at prospective loss ratio trends and the numbers that we're using for those, they -- I think we've been pretty conservative or tried to stay with what the trends are for instance. And I think I've talked about commercial auto liability not being where we want it to be, probably at around breakeven underwriting profit. We took about 9% rate and our prospective loss ratio trend for that we're using about 7%. We think that's pretty good.

And I think I mentioned in the past on some of the excess liability, that part of our business, how we're using, depending on what the business is 10% to almost 14% in prospective loss ratio trend as we set our pricing, as we look at our reserving and that. So I don't think that's really changed. I think we've kind of been in that mode for pretty much for the year.

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Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Okay. And just lastly, just switching gears on the investment portfolio and maybe this was already answered. But in terms of the alternative guide of 7%, does that imply a weaker 1Q '23? Or is just -- it's been a great run and trying to bake in some -- maybe some more lower returns given the macro environment, although interest rates are up. So just trying to -- how to think about that. Thanks.

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Yes. This is Craig. I'll tell you how we arrived at the 7% number. As you know, about 60% of the alternatives are invested in multi-family. We've had just an incredible run in multi-family returns the last couple of years, as I recall, were something in the neighborhood of 20%. We were able to push the renewal rates at extraordinary levels. And we also had some sales of properties. So I'd say our view is that we're back to a more normal environment now. We still really like the asset class. We still like our positioning there. But we're back to a more normal environment instead of getting the double-digit type increases in rental rates. We're now -- I mean we would guess that this year, it will be somewhere between 3% and 5% increases in the rental rates. So that will drive the NOI.

We think that the marks on the portfolio are reasonably conservative. The average cap rate at the year-end market value was right around 5%. And the strong growth markets that we're in, we're not seeing transactions above 5%. So we like our positioning there. We don't see the really large increases in mark-to-market, and we don't see ourselves selling properties like we have the last couple of years. So anyway, looking for a high single-digit return on the multi-family piece, the real estate piece which is about 60% of the portfolio.

The balance of the alternatives, the 40% that is in more traditional private equity is the piece that's much tougher for us to value. Last year, we substantially outperformed the market. I think the S&P was down some 18% and our private equity was up, I believe around 6% or so. As you know, private equity marks typically are done on a lag basis. So we're just being a little more cautious on our outlook for the -- that traditional private equity piece. It's -- that's the piece though that's much harder for us to value. I hope it comes in -- given the strength of the market early in the year, I hope that the returns on that piece are stronger than what we're assuming. But that's how we arrived at the 7% number on the $2.1 billion of alternatives.

Michael David Zaremski - *BMO Capital Markets Equity Research - MD & Senior Equity Research Analyst*

Very helpful. Thank you.

Operator

(Operator Instructions) Our next question comes from Meyer Shields of KBW.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Thanks. A quick question, I guess, to start with. I think it's more of a modeling question than a reality question. But the Other Specialty segment had some adverse reserve development in every quarter in 2022. And I was hoping you could talk about what's going through that.

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

Sure. This is Brian. So the Other Specialty is primarily our internal reinsurance facility. So that's where we take on more of our business corporately than we do in the individual business units. So what we're seeing there is adverse development in some of the social inflation exposed lines, the excess liability type of lines where we have participated in the reinsurance above the business unit. So social inflation is driving the number there.

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We obviously are -- as you know, we're conservative in our reserving. So we are -- we feel like we're in a good place now, but that's what's driving the $13 million in the quarter and the $40 million for the year as an adverse development coming out of the social inflation exposed businesses that would be part of our Specialty Casualty segment going into that reinsurance facility.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. That's helpful. And then one other question. Can you give us a sense as to the macroeconomic growth that underpins your net written premium growth expectations for 2023?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

I'm not sure we really have kind of underpinned based off of a given GDP number versus more of -- each of our businesses are so different than the other with kind of their own mini economic environments in that, whether it's equine mortality or workers' comp in that. But clearly, we've couched our premium guidance in an economy that has slowed down and slowing down in some cases. And whether it's impact on payroll or sales or things that premiums are based off in different businesses. That definitely has an impact in that.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. Understood. Like the source of the question is just that the delta between pricing and net written premium growth is 1%, which seems fairly conservative.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well as I mentioned before, we try to -- the crop business is going to -- it's a fairly -- we're projecting that to be down 3%. We won't know for sure until the average of soybean and corn futures prices for the month of February. So we'll know more at the end of February exactly what that is. I think that has an impact. And then I mentioned earlier on the call, some of the competition that doesn't make any sense in things like public D&O and in high excess liability, where I think new entrants have jumped in trying to establish a position. That will come back to haunt at some point, particularly -- those are two businesses that have social inflation exposure in that. So I have no doubt about that.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Yeah, I share your pessimism on that one. Anyway, I'm all set. Thank you very much.

Operator

Thank you. I'm showing no further questions at this time. I will just turn the call back over to Diane Weidner for any closing remarks.

Diane P. Weidner - *American Financial Group, Inc. - VP of IR*

Thank you all for joining us this morning. This concludes our prepared remarks and Q&A session, and we look forward to talking with you all again next quarter. Thank you.

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Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may now disconnect. Have a great day.

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