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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group Fourth Quarter 2018 Results Conference Call. (Operator Instructions) As a reminder, today's conference may be recorded. I'd now like to introduce your host for today's conference, Ms. Diane Weidner, Assistant Vice President, Investor Relations. Ma'am, please go ahead.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of Investors Relations*

Thank you, Liz. Good morning, and welcome to American Financial Group's Fourth Quarter 2018 Earnings Results Conference Call. I am joined this morning by Carl Lindner III and Craig Lindner, Co-CEOs of American Financial Group; and Jeff Consolino, AFG's CFO. Our press release, investor supplement and webcast presentation are posted on AFG's website. These materials will be referenced during portions of the call today.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Certain statements made during this call may be considered forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance. Investors should consider the 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 on AFG's filings with the AFG's -- with AFG Securities and Exchange Commission filings, 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 responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

If you are reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy, thus 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*

Good morning. We released our 2018 fourth quarter and full year results yesterday afternoon. If you'd turn to slides 3 and 4,of the webcast slides for an overview. Craig and I, we're pleased to report record AFG core operating earnings of $8.40 per share for the full year of 2018, up 28% from last year and generating a core return on equity in excess of 15%.

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. We paid $397 million in dividends during the year, representing $130 million in regular common stock dividends and $267 million in special dividends. And our quarterly dividend was increased by 14% to an annual rate of $1.60 per share beginning in October of 2018. AFG's 5-year total shareholder return, representing growth and share price plus dividends, was approximately 88%, exceeding the total return performance of the S&P 500, S&P Property and Casualty Index and the S&P Life & Health Index over that same period.

Turning to Slide 4. Fourth quarter core net operating earnings were $1.75 per share compared to $2.20 per share in the year ago quarter. The significant downturn in the financial markets in the fourth quarter tempered results in our Annuity segment, and profitability in our Property and Casualty segment was lower year-over-year. These results were partially offset by the benefit of a lower corporate tax rate. Fourth quarter 2018 annualized core operating return on equity was 12.6%. A net loss of $0.33 per diluted share in the fourth quarter included $2.08 per share in realized losses on securities. Accounting rules require that all equity securities are reported at fair value, so it's important to note that $2 per share of this amount related to holding losses on securities that AFG continued to own at December 31, 2018. Craig's going to -- will discuss this in more detail later in the call.

Craig and I thank God, our talented management team and our great employees for their work in helping us to navigate the challenges of market volatility and a heightened level of natural disasters across the industry. We have established initial 2019 core operating earnings guidance for AFG in the range of $8.35 to $8.85 per share, and Craig and I will discuss our guidance for each segment of our business in more detail later in the call.

Now I'd like to turn our focus to our Property and Casualty operations. Please turn to Slides 5 and 6 of the webcast, which include an overview of fourth quarter results. As you'll see, on Slide 5, gross and net written premiums in our Specialty Property and Casualty Insurance operations grew by 3% and 4%, respectively. A change in the timing of the renewal of 2 large transportation accounts from the third to fourth quarter impacted reported growth in the quarter. If you exclude those -- the timing of those policy renewals, overall, Specialty Property and Casualty gross and net written premiums grew by 1% and 2%, respectively, from the year ago quarter.

Property and Casualty operating earnings in the fourth quarter were 8% lower year-over-year, primarily related to higher catastrophes, which added 3 points to the combined ratio in the fourth quarter compared to 0.6 points in the prior year period. Overall renewal pricing in our Specialty Property and Casualty Group was up 2% during the fourth quarter and above our overall loss ratio trend, which is about 1.5%. Loss cost trends remain stable, and we're keeping an eye on inflation and interest rates. Now excluding our workers comp businesses, overall renewal pricing was up approximately 4% during the quarter. We're getting rate increases in the businesses where we need them to achieve our targeted returns.

Now if you turn to Slide 6 to review a few highlights from each of our Specialty Property and Casualty Groups. Property and Transportation Group reported an underwriting profit of $64 million in the fourth quarter of 2018 compared to $84 million in the comparable prior year period. Higher underwriting profits in our transportation, property and inland marine and ocean marine businesses were more than offset

(technical difficulty)

Our crop insurance operations reported strong profitability during the 2018 fourth quarter, albeit at lower levels than the very strong results reported in the prior year fourth quarter. Strong yields in the eastern corn belt helped to mitigate the impact of commodity price declines. Catastrophe losses for this group had a favorable impact of $10 million in the fourth quarter of 2018 compared to a favorable impact of $3 million in the 2017 fourth quarter with catastrophe losses reported from the previous quarter developing favorably in the fourth quarter of both those years. Fourth quarter 2018 gross and net written premiums in this group were 4% and 6% higher, respectively, than the comparable prior year period. The increase was largely the result of the change in the timing of the renewal of 2 large accounts mentioned previously. Excluding the impact of the timing of these policy renewals, both gross and net written premiums in this Group, were up about 1% year-over-year. Lower year-over-year premiums in our crop insurance business and underwriting actions on underperforming accounts in our Singapore branch, both tempered fourth quarter premiums. Our overall renewal rates in this group increased 3% on average in both the 2018 fourth quarter and for the full year.

Specialty Casualty Group reported an underwriting profit of $22 million in the fourth quarter compared to $58 million in the comparable 2017 period. Lower year-over-year underwriting profit within Neon was the primary driver of these results, specifically higher 2018 catastrophe losses and lower year-over-year favorable reserve development, due to the fourth quarter 2017 Neon reinsurance to close transaction. Lower profitability in our workers' comp businesses contributed to a lesser extent. Despite lower year-over-year profits in our workers comp operations, these businesses achieved excellent underwriting margins in the fourth quarter. Higher underwriting profit in our Excess and Surplus Lines in targeted markets partially offset these results. Last quarter, we shared our plans to acquire ABA Insurance Services, a market-leading provider of D&O and other complementary insurance solutions for banks, small businesses and nonprofit organizations with a long track record of underwriting success and profitability. We're pleased that the transaction closed at the end of November, and we welcome this business to the AFG family. Results for this business for the month of December are reported within the Specialty Casualty Group. Catastrophe losses for this group were $28 million in the fourth quarter of 2018 and $18 million in the comparable 2017 period. Gross and net written premiums increased 6% and 5%, respectively, for the fourth quarter of '18 when compared to the same prior year period. Higher year-over-year premiums within Neon resulting from the growth of its portfolio and targeted classes of business, along with the growth in several other businesses and the addition of ABA Insurance Services, were partially offset by lower premiums in our workers' comp businesses. Renewal pricing for this group was flat in the fourth quarter and was down approximately 1% overall for the year. Excluding our workers' comp businesses, renewal rates in this group were up approximately 4% in the fourth quarter and 3% for the year. And the Specialty Financial Group reported an underwriting profit of $20 million in the fourth quarter of 2018 compared to $19 million in the fourth quarter of 2017.

Lower year-over-year profitability in our financial institutions business, primarily the result of higher catastrophe losses was partially offset by higher profitability within our fidelity crime and our equipment leasing businesses and higher favorable reserve development in runoff businesses. All businesses in this group achieved excellent underwriting margins. Gross and net written premiums declined by 12% and 9%, respectively, in the 2018 fourth quarter when compared to the same 2017 period, primarily due to the timing of several new accounts in our lending and leasing businesses in the prior year. Renewal pricing in this Group was up 5% during the fourth quarter and for the full year of 2018. Now please turn to Slide 7 for a summary view of our 2019 outlook for the Specialty Property and Casualty operations. We expect a 2019 combined ratio for the Specialty Property and Casualty Group overall between 92% and 94%. The Specialty Property and Casualty Group's calendar year GAAP combined ratio has been between 92% and 94% in each of the 5 preceding years. Our expectations remain consistent with our past results. Net written premiums are expected to be flat to up 3% for the year. Looking at each segment, we estimate a combined ratio in the range of 92% to 96% in our Property and Transportation Group. Net written premiums in this group are estimated to be up 3% to 7% for the year. Our guidance assumes a normal level of crop earnings. We expect our Specialty Casualty Group to produce a combined ratio in the range of 91% to 95%. Net written premiums are expected to be down 2% to up 2%.

Net written premium guidance includes low

(technical difficulty)

in our workers' comp businesses, and these items will be offset by a full year premiums from ABA Insurance Services. Specialty Financial Group combined ratio is expected to be in the range of 86% to 90%. Our projection for growth in net written premiums is in the range of 3% to 7%. We expect modest growth across all of the businesses in this group and continued strong results. Net investment income is expected to be flat to up 4% year-over-year. As noted earlier, 2018 results were exceptionally strong, primarily due to the strong performance of limited partnerships and similar investments, which we don't expect to continue.

We expect overall Property and Casualty renewal pricing in 2019 to be flat to up 2%.

(technical difficulty)

the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

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

Thank you, Carl. I'll start with the review of our Annuity results for the fourth quarter beginning on Slide 8. Statutory annuity premiums were $1.48 billion in the fourth quarter of 2018, an increase of 63% from the prior year period, establishing a new record for premiums in a quarter. Significant growth in sales of FIAs in the broker-dealer and retail markets as well as higher year-over-year sales in our financial institutions channel contributed to these record results. I'm also pleased to report record sales of $5.4 billion for the full year, which we achieved while maintaining pricing discipline. Production in our retail and broker-dealer markets continues to be particularly strong, due to the launch of several new products and our efforts to expand our distribution within both of these channels.

Turning to annuity results. Pretax annuity earnings were $20 million in the fourth quarter of 2018 compared to $97 million in the fourth quarter of 2017. Pretax annuity earnings before fair value accounting for fixed indexed annuities and unlocking, were $71 million in the fourth quarter of 2018, down 36% from the prior year period.

The fourth quarter decrease in the S&P 500 had an unfavorable impact of $57 million on pretax annuity earnings compared to a favorable impact of $16 million in the fourth quarter of 2017. I'll review this in more detail as we discuss slides 9 and 10. On Slide 9, you'll find the components of pretax earnings before fair value accounting for FIAs and unlocking. The S&P 500 Index decreased 14% in the fourth quarter of 2018. This poor stock market performance adversely impacted pretax annuity earnings before fair value accounting for FIAs, particularly FIAs with guaranteed benefits by $30 million or $0.26 per share. If the stock market performance reverts back to our long-term expectation over the life of these policies, a substantial portion of this unfavorable impact would be expected to reverse. The components of fair value accounting for FIAs are shown on Slide 10.

Under GAAP rules, a portion of the reserves for fixed indexed annuities is considered to be an embedded derivative and is recorded at fair value based on the estimated present value of certain expected future cash flows. Assumptions used in calculating this fair value include: projected interest rates, option costs, surrenders, withdrawals and mortality. Variances from these assumptions as well as changes in the stock market will generally result in a change in fair value. Items such as changes in interest rates and the performance of the stock market are not economic in nature for the current reporting period, but rather impact the timing of reported results. The impact of fair value accounting for fixed indexed annuities includes an ongoing expense for annuity interest accreted on the FIA embedded derivative reserve. The amount of interest accreted in any period is generally based on the size of the embedded derivative and current interest rates. We expect both the size of the embedded derivative and interest rates to rise, resulting in continued increases in interest on embedded -- on the embedded derivative liability.

In the fourth quarter of 2018, the 14% decline in the S&P 500 Index contributed to a significant unfavorable fair value accounting impact of $27 million or $0.24 per share for the quarter. The majority of this impact is non-economic and is expected to reverse over time even in the absence of a stock market recovery. By comparison, in the fourth quarter of 2017, the benefit of a higher stock market resulted in a $9 million favorable impact. The fourth quarter of both years reflected lower-than-expected changes in interest rates, resulting in negative non-economic impacts on earnings.

I'm pleased that our Annuity segment earned an aftertax operating return on equity in excess of 12% for the full year of 2018, despite the impact of the poor stock market performance in the fourth quarter and the year. For additional analysis of fair value accounting, see our quarterly investor supplement, which is posted on AFG's website.

Turning to Slide 11. You'll see that AFG's quarterly average annuity investments and reserves grew approximately 12% and 10%, respectively, year-over-year. The benefit of this growth was partially offset by the runoff of higher-yielding investments.

Please turn to Slide 12 for a summary of the 2019 outlook for the Annuity segment. We expect annuity earnings before the impact of fair value accounting for FIAs and unlocking to be in the range of $435 million to $465 million. We estimate that pretax annuity earnings will be in the range of $365 million to $425 million. Finally, we expect that our 2019 full year annuity premiums will be down slightly from the $5.4 billion reported in 2018. Although our guidance reflects the introduction of new products and opportunities to grow our business and the registered indexed advisor in broker-dealer markets, we continue to emphasize earning the appropriate return on our new sales regardless of the competitive environment. Additional information on the Annuity segment earnings, premiums, investments and reserves can be found in AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 13 for a few highlights regarding our $48.5 billion investment portfolio. AFG reported fourth quarter 2018 net realized losses on securities of $188 million after tax and after deferred acquisition costs. This compares the net realized gains on securities of $4 million in the fourth quarter of 2017. Approximately $179 million of the realized losses recorded in the fourth quarter of 2018 pertain to securities that AFG continued to hold at December 31, 2018. Through January 29, 2019, the equity securities held at December 31, 2018, have increased in value by approximately $100 million after tax and after DAC, effectively reversing more than half of the fourth quarter loss.

As of December 31, 2018, net unrealized gains on fixed maturities were $83 million after tax and after DAC. As you'll see on Slide 14, our portfolio continues to be high quality with 91% of our fixed maturity portfolio rated investment grade and 98% with a NAIC rating of 1 or 2, its highest 2 categories. We've provided additional detailed information on the various segments of our investment portfolio in the Quarterly Investor Supplement on our website. I'll now turn the discussion over to Jeff. He will wrap up our comments with an overview of our consolidated fourth quarter 2018 results and share a few comments about capital and liquidity.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

Thank you, Craig. Slide 15 summarizes AFG's fourth quarter consolidated core operating earnings results. AFG reported core EPS of $1.75 in Q4 2018. Core net operating earnings in the quarter were $159 million. The year-over-year decrease in core earnings in the 2018 fourth quarter, from the record levels in 2017's fourth quarter, was primarily the result of lower operating earnings in our insurance businesses, which Carl and Craig have detailed for you earlier in the call. This is partially offset by lower interest and other corporate expenses and a lower effective tax rate.

Interest and other corporate expenses had a favorable variance of $18 million. Parent company interest expense decreased by $4 million year-over-year as a result of our 2017 debt refinancings. The impact of lower expenses, related to certain employee benefit plans, was the primary driver of a $14 million reduction in other expenses year-over-year. As a reminder, starting in Q1 of 2018, this line also includes income and expenses related to AFG's previously reported runoff lines of business. The impact of fair value accounting for FIAs is a notable item on this Page 15. And we have further enhanced our Investor Supplement for those of you who are making estimates in the quarter for the impact of fair value accounting. This appears in the supplement as a new Page 14. A general rule of thumb for a parallel shift in rates, each 10 basis point change in the average 5- and 15-year corporate A2 rate as compared to the expected change indicated by the forward curve at the outset of each month, impacts fair value accounting by $7 million pretax.

Another rule of thumb is that the impact of a 1% change in the S&P 500 impacts fair value accounting by approximately $2 million pretax. Applying these rules of thumb would allow our user to estimate those components of the fair value accounting adjustments attributable to changes in interest rates and changes in the stock market. In addition, we've also added a new supplement Page 13, which shows you the impact on annuity earnings of certain other variable items. Note there's an additional 1% stock market change rule of thumb that impacts annuity earnings before fair value accounting by an additional $1 million to $2 million. Bringing the total estimated rule-of-thumb impact on overall annuity earnings of a 1% change in the S&P 500 to a combined $3 million to $4 million. A portion before fair value accounting and a portion included within fair value accounting. We've also added a new Page 26 to the supplement, which analyzes investments marked to market through investment income and investments accounted for using the equity method. For example, fourth quarter 2018 Property and Casualty net investment income of $115 million exceeded our expectations due to the 13.8% annualized yield recorded from these investments in the quarter compared to our normalized assumption of 8% to 10% for these assets, which consist primarily of investments in limited partnerships and similar investments that invest in private equity, real estate and other opportunities and which are accounted for using the equity method.

Slide 16 provides a reconciliation of core net operating earnings to net earnings. AFG adopted ASU 2016-01, effective January 1, 2018, which requires holding gains or losses on equity securities to be recognized in net earnings. The impact to our income statement will vary each quarter depending on the performance of the securities held in our equity portfolio. In the fourth quarter of 2018, AFG recognized $188 million or $2.08 per share in net after tax realized losses.

Turning to Slide 17. AFG's adjusted book value per share was $54.86 as of December 31, 2018. Growth in book value per share plus dividends was a strong 10.8% for the full year 2018. We returned a $170 million to our shareholders in the fourth quarter with the payment of our regular quarterly dividend and a payment of $1.50 per share special dividend. Share repurchases totaled $6 million in the quarter. Parent cash was $160 million at the end of the fourth quarter. We maintain sufficient capital in our insurance businesses to meet our commitments to the rating agencies.

Our excess capital stood at approximately $690 million at December 31, 2018. Remember, we plan to hold approximately $200 million to $300 million as dry powder to maintain flexibility for opportunities as they arise. Our management team reviews all opportunities for deployment of capital on a regular basis. To wrap up, Page 18 shows a single page presentation of our updated 2019 core earnings guidance. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2019 core operating results exclude noncore items such as realized gains and losses and other significant items that may not be indicative of ongoing operations. Now we'd like to open the lines for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Greg Peters with Raymond James.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Thank you, good afternoon. Thank you for taking my questions. I had a couple of questions for you on the Property Casualty business and a question on the annuities. On Property Casualty, a number of companies have reported results so far for the fourth quarter and commercial auto seems to be quite topical. And whether it's Travelers, Old Republic or others have talked about achieving additional rate increases and continuing rate inadequacy in that line. I thought maybe you could spend a minute and talk about your experience in commercial auto.

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

Hi Greg, this is Carl. Happy to do that. Overall, we're very pleased with the performance of our commercial auto business and our transportation part of our business. National Interstate and Great American trucking are achieving our combined ratio targets and our return targets in that. Now we've been at it a while. We're -- 2018 was our seventh year of rate increase, and we're continuing to take rate. So hope that answers your question.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Okay. I know Jeff answered or addressed this a little bit in the third quarter call, but it's worth coming back and revisiting, looking at some of the disclosures from the supplements. The expense ratios for the Property, Transportation, Casualty and Specialty businesses are all up if you look at it year-over-year. And I'm wondering if 2018, the levels -- the expense ratio levels reported for the full year 2018 represent sort of the new normal going forward.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

Hey Greg, this is Jeff. Thanks for the question. As it relates to the expense ratio, if you look at it on an annual basis, there is a lot that goes into that, that is related to business mix. And I think we talked about it last quarter but Property and Transportation, the crop business was down slightly. And crop carries an inherently lower expense ratio. So that proportion of P&T represented by crop diminishes, the expense ratio tends to drift upwards. In the Specialty Casualty segment, Neon has grown. And Neon, by virtue of operating at Lloyd's has a higher expense ratio than the rest of our Specialty Casualty business. It tends to cause that expense ratio to rise. Summit has performed very well in the Specialty Casualty segment. Last quarter, we talked about how that means that policyholder dividends, which we book in the expense ratio, would tend to rise. And also some of the employee compensation accrual is there as well. And then finally, in financial institutions, that's generally stable, but it really depends on what the underlying loss ratio is because for Specialty Financial do tend to move in opposite directions. In terms of going forward, we've certainly projected our business mix. And as we look at it, that will migrate, but I think you're pretty much on solid ground if you stick at that level and as our business mix evolves, that certainly could cause things to change.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Alright, thank you for that color. Craig, real quickly, in your commentary and guidance. I would like to focus on just the sales results. It looked like you reported nice gains in most of the channels for the full year except for the financial institutions channel. So I was wondering if you could provide us some color about what's going on in that specific channel. And I recognize it was up quarter-over-quarter, but for the full year, it was down. And then you said as a sort of a launching pad, just give us some more perspective on why you're projecting sales to be flat to down slightly for 2019.

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

Sure, Greg. There clearly is more competition in the financial institutions channel as a result of a couple of things. Some of the -- a couple of the very large variable annuity players have now focused on indexed annuities and have recently entered the -- that market. And they're competing against us in the -- in some of the banks where we sell FIAs. I'm a little bit surprised, some of the banks have allowed a few lower rated companies that price very aggressively to sell through their channel. I was hoping that, that would not happen. But there are some lower-rated companies that are now selling in that bank channel. So I think it's the combination of those 2 things that is resulting in a bit more of a competitive environment in that channel. In terms of the overall guidance of -- down slightly, it's a couple of things. Mainly, we're comparing it to a fantastic premium year. Last year, the premiums were well beyond our expectation or original guidance. We benefited last year from a couple of things. We are a bit quicker to change pricing on our annuities than many of our competitors. We're very disciplined in maintaining pricing that results in what we considered to be appropriate -- profitability appropriate returns. So in a rising interest rate environment, like we experienced last year, we're quicker to make changes, which helps us competitively. That clearly helped the premiums last year. Who knows what interest rates are going to do this year. We're starting out with a slight decline in rates. And so we're just -- we're not assuming we're going to benefit again from rates that are increasing at a reasonable rate. But the main thing, Greg, is we're comparing to a year of extremely strong premiums. And look, I hope that we're up again this year, time will tell. But anyway, we thought it was prudent to assume that premiums are going to be down a little bit.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

I understand, it makes sense. With your discussion around increased competition, particularly in the financial institutions channel. And I guess you noted that it was maybe broader based in some of the other channels as well. And you mentioned in the commentary about your 12% return on equity. Is -- and clearly, you're focused on sustaining that. Do you think there's going to be longer-term structural downward pressure on returns like capital in this business as a result of the competition?

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

I don't think so Greg. I don't think so. I think -- I know we're going to be disciplined, and yes, we expect to continue to produce a very healthy level of premiums at the appropriate rate of return.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Fair enough, thanks for your answers.

Operator

Our next question comes from Christopher Campbell with KBW.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

I guess, my first question is just on the guidance. So you're finishing the year about $8.40, but the midpoint of the guidance -- of the new guidance is only about 2% higher year-over-year. So I guess just what's kind of limiting your ability to grow this more in 2019?

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

Chris, this is Craig. I mean, one of the things that is baked into guidance is, we're assuming a more normal return year on assets that are marked to market. Last year was extraordinarily strong, and we're assuming a more normal 8% to 9% return on the significant assets that were marked to market.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Got it. And just -- I guess -- like kind of -- this is another one for you, Craig, as it just -- I guess what interest rate and spread assumptions do you have baked into the current guidance?

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

So in the current guidance, we are assuming that there is a moderate rise in corporate A2 rates, a rise of 15 to 25 basis points from year-end levels, which is in line -- was in line with the forward curve when we'd put guidance in place. We are assuming a 7% increase in the S&P 500, 4% in the first quarter and then 1% in each subsequent quarter. And as I just mentioned, we're assuming returns on private equity and other investments that are marked to market of 8% to 9% versus a much higher number in 2018.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Great, that's very helpful. And then just -- oh, and then, I guess, on the P&C side. I don't know if it's Jeff or Carl, but I guess what pricing trends are you guys seeing at Lloyd's?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

First, Chris, welcome to our conference call. Great to have you. Pricing trends at Lloyd's are moving upwards. That's by design. Lloyd's has gone through a process designed to constrict capacity, and in many cases has caused syndicates to exit various lines of business. So in the fourth quarter, we saw a rate increase across our book of business of 8% at Neon, which we think is favorable. The market as a whole, though, needs to get more rates, and so we look forward to seeing appropriate rate increases (inaudible) to come through at Lloyd's. And Chris if I can double back on your guidance question. Two observations, I think you've you raised the question what's limiting our ability to grow. Now we certainly have ample capital to grow our business. So I don't really think that this is a growth limitation, per se. Bear in mind, I think you are focused on a point within the $0.50 range that we issued for the upcoming year. And so at this point in time, we assume things like a normal crop year, which you need to have a range of some scale to show how that goes. I think that also it's wise at this point to assume a normal catastrophe year for the business, which for us has tended to be about 1.5 points on a combined ratio over a very long period of time. And then given all the discussion we've had about fair value accounting and when you look at the guidance range at the Annuity segment just promulgated in the deck, it's wise to have a range for that. So we'll be able to be more specific about the range in subsequent quarters as we usually are. But right now, I would just point you to the fact that you can see in that range some upside. And you can -- overall though, it's -- one last observation, if we came in at the midpoint of that guidance, that's a 15.5% aftertax return on capital, which is consistent with this year. And we think that's very competitive in our industry and in our peer group.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Got it. That's very helpful. And then just, kind of, one final question on the share repurchases. I mean not a ton in the quarter, but I guess you guys were buying back about mid-$93, which it would be about a 1.7 multiple. I guess is it a fair assumption that, I mean, the price isn't much different now that we should think about modeling buybacks at these levels?

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

I mean what I would -- this is Craig, Chris. What I would say is, we are always evaluating different alternatives to put our excess capital to work and -- I mean, I think we -- with purchases indicated that we thought that was a pretty attractive value to repurchase shares. Having said that, we're always going to be comparing that to other opportunities to grow the business to make acquisitions and so forth.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

OK, great -- thanks for all the answers. Best of luck in 2019.

Operator

Our next question comes from Jay Cohen with Bank of America.

Jay Adam Cohen - *BofA Merrill Lynch, Research Division - Research Analyst*

Thank you. You know - almost all of my questions were answered. The only other thing I had was on the other earnings. I guess you talked about lower employee benefit costs. I guess, my assumption is that, that that was a temporary thing. We shouldn't assume that the number we saw in the fourth quarter continues going forward?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

Hi Jay, this is Jeff. And you're absolutely correct. When we look at that slide, the interest piece, that's the new run rate after the debt refinancings. So that's where we'll be. But in terms of when you look at the supplement, the previous quarter is more representative of a run rate than the fourth quarter. So we'd expect that to run somewhere in the $25 million to $28 million range per quarter.

Jay Adam Cohen - *BofA Merrill Lynch, Research Division - Research Analyst*

Got it. I guess one other question. And that is, when the U.S. corporate tax rate was reduced there was all kinds of theories of how that might affect the business. Are you seeing any repercussions from the corporate tax rate being reduced as far as the competitive environment goes?

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

This is Carl. I don't believe so. I think, again, we're -- when you look at our fourth quarter, we were able to take rate, actually, of 2%. We're maintaining the margins at pretty substantial returns on equity overall and within the Property and Casualty group. If anything, those competitors that lost the low tax advantage maybe have had to price a little bit forward in order to achieve even the same returns.

Jay Adam Cohen - *BofA Merrill Lynch, Research Division - Research Analyst*

Yes, and I had the same observation. It's interesting, again. A lot of theories going into this but we'll see if things change. But thanks for that insight. That's helpful.

Operator

Our next question comes from Paul Newsome with Sandler O'Neill.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior Insurance Analyst*

I think this is a little bit of a follow-up to the annuity returns on investment portfolio. If I look at the ratio of net investment income to your annuity benefits, it looks like it peaked in the third quarter and then sort of consistently fallen. But -- and I'm sort of scratching my head a little bit just because it -- if I look at some other folks, it's been more consistently up as people have rolled over into higher interest rates. Is that reflective of this sort of investment partnership income that you were talking about? Or are there other things in there? And are we kind of today at the run rate? Or is that run rate lower than it would normally be?

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

Paul, this is Craig. I'm going to have to take a look at that. I mean, obviously, assets are growing at a pretty good clip. Reserves are growing at a pretty good clip. So I'm going to have to take a look at that because I think the trend in investment income is going to be up. Now if you're looking quarter-by-quarter, you can get some swings as a result of different returns on marked-to-market assets and for the Annuity group. The returns, although they were still decent returns, they were lower in the fourth quarter than the previous 3 quarters. We give that in a schedule in the supplement. Let me just -- let me see if I have that here.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior Insurance Analyst*

I'm kind of looking at Page 16 of the supplement.

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

Yes. Go to Page 26 of the supplement for a minute. And you'll see that in the fourth quarter, the investments accounted for by using the equity method returned 7.1% in the quarter versus 12.4% for the full year. So higher numbers in previous quarters this year. Let me go to the schedule that you are talking about and see if I can figure it out.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior Insurance Analyst*

So I guess that would match up more or less with the schedule on 16?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

Yes, Paul, this is Jeff -- Yes, so, Paul, this is Jeff. I have to say it's always great to get somebody else's perspective because what you calculate as a ratio, we look at arithmetically not as a division. So that Page 16 presents investment income as a percent of investment and interest credited. And what you look at as ratio, we look at net spread. And so you're right, that ratio or that spread would've crested in previous quarters of 2018. But when you look at the interest credited, it's fairly stable. So all of the changes in that ratio or in that spread are driven by what Craig just went through, which is the changes underlying in investment income. So I think we've come to a conclusion on what you're looking at. And hopefully, that disclosure on the marked-to-market assets helps you look a little bit deeper as to what's going on there.

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

And Paul, if you'll look year-to-year, look at the comparison over on the right-hand side, it's a 4.73% versus a -- in 2018 versus a 4.63% in 2017.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research & Senior Insurance Analyst*

OK, this is helpful. Thank you very much.

Operator

Our next question comes from DeForest Hinman with Walthausen.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

You guys have been at this for a very long time on the Annuity side. Big-picture question, flat yield curve doesn't happen often, but in the course of your career, it has probably happened a couple of times. Can you kind of fill us all in in terms of how that might impact behavior in the Annuity business from a new product development surrender charges, surrender fees? I mean, why don't we start there?

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

Yes, this is Craig. First of all -- I'm Sorry, DeForest, this is Craig. First of all, our products generally are quite a bit shorter than many of our competitors. Our commissions that we pay are somewhat lower. I think on average, they're a point and a half lower than the average commission paid by our competitors. In terms of change in product development, I don't know that there is a big change we are -- there appears to be demand for even shorter products. We are rolling out -- we just rolled out a 3-year product that we think is going to sell pretty well. But I don't know if there's any huge change in product design frankly as a result of the current flattening of the yield curve.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

Okay. And maybe just a -- maybe different way of asking the same question. You guys have your own outlook -- once again, I might look at it a little bit differently than you, but I'd love to hear your opinion. Short-term CD markets, brokered CDs or seen some pretty attractive yields. Are we playing in a different space? Are we going to be competing with that same money when it comes to bank partners or some of our broker relationships where they maybe have more options than they've had in the past and is that factored into the outlook for annuity volumes into 2019?

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

Yes, it is factored into the -- our outlook and our guidance.

DeForest R. Hinman OK, thank you.

Operator

(Operator Instructions) Our next question comes from the line of Amit Kumar with Buckingham Research .

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Thanks and good afternoon. Just, I guess, 2 quick follow-ups. I know we are coming up on the hour. The first question goes back to the comment, I think, you made on the Singapore branch. I think you mentioned some reunderwriting actions, et cetera. And I just wanted to get some more color around it and how should we think about that piece going forward? That's question one.

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

Yes, we've -- in our Singapore -- this is Carl, Amit. Our Singapore branch is a start-up unit. It's in its early stages. We -- probably built the unit a little bit more rapidly and broader than we wanted initially. And we've had to backtrack some, which has caused the premiums to decline this past year, and as we've taken some actions both pricing- and underwriting-wise in that. And so our focus is on big improvement in that business going forward from an expense ratio standpoint, it is only a couple of years old so it takes you a while to get where you want when you have a start-up business like that. So we're working on it.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Okay, that's helpful. But the second question I had was -- I guess, just somewhat of beating a dead horse, going back to the discussion on commercial auto. And I was wondering if you could just revisit or maybe expand on the trend difference between smaller commercial and the long haul piece of it?

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

Amit, this is Jeff. Are you asking about the differential in competitive dynamics?

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

All for you, both. Both would be helpful.

Joseph E. Consolino - *American Financial Group, Inc. - Executive VP, CFO, Principal Accounting Officer & Director*

National Interstate and Great American trucking are our 2 primary units that operate in that space. The Great American trucking focuses on independent contractors and physical damage coverages. So that wouldn't really be a factor. And National Interstate, their secret sauce, if you will, is a captive model. 2/3 of the business there has ART element to it, which helps with risk selection. The history of National Interstate is they started in passenger transportation and do have a trucking component. But we feel like the ART, where you're banding together homogenous customers, who all have skin in the game and interest in good performance, kind of insulates us from that competitive dynamic. Bigger picture, by reputation, big fleet trucking, which is a low margin business has a reputation that is intensely competitive because every dollar spent on insurance cuts into those razor-thin margins. So we don't want to play where we don't have an edge or an opportunity to make adequate returns.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Got it, that's helpful. The final question I had was I know someone else had talked about the pricing component. And could you just sort of flush out, I guess, the comp piece of it? And how should we think about that pricing going forward? Thanks.

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

Yes, I mean, overall, very -- we're, obviously, very pleased with our combined workers' comp book. This past year had a very healthy accident year and a healthy calendar year on the business in that. Our perspective next year kind of built into guidance premiums will probably be down some.

Rates in Florida and in California, rates would probably -- with pricing changes, there could be another double-digit -- 10%-ish to 12%-ish price decline in California comp and in the Florida component of Summit in that. I think in '19, premiums will be down low single digit. And -- but I think we're still going to make a small accident year underwriting profit in a pretty healthy calendar year underwriting profit this year. Our businesses have a very nice strong reserve position, and so continue to be very pleased with workers comp.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Got it, thanks for the detail. I'll stop here. Thanks for the answers and good luck for the future.

Operator

And I'm showing no further questions in queue at this time. I'd like to turn the call back to Ms. Weidner for closing remarks.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of Investors Relations*

Thank you. And thank you all for joining us this morning as we reviewed our fourth quarter and full year results. We look forward to talking with you all again next quarter.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone, have a great day.
