

N E W S

Invest

L E T T E R

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C N A Financial

High Current Income Bonds from a Chicago-Based Company

Greetings from LFS

Dear Clients and Friends:



Here is my quarterly newsletter, *Invest*. The goal of *Invest* is to keep you abreast of what is happening in the financial market, inform you about new investments and keep you informed about your current investments. I welcome any questions, comments or suggestions.

Sincerely,

Douglas Ruth

Invest

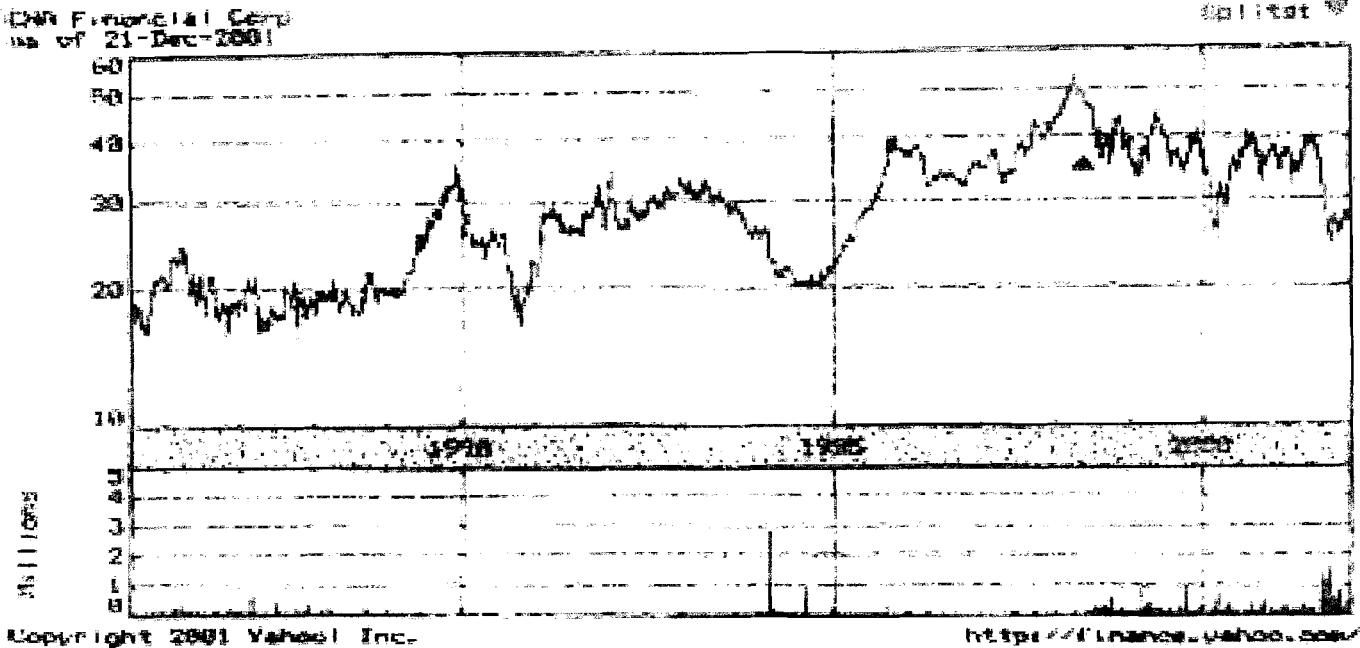
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C N A is the country's second largest commercial insurance writer, the eighth largest property-casualty company, and the thirty-sixth largest life insurance company. C N A's major subsidiaries include the Continental Insurance Company, incorporated in 1853, Continental Casualty Company, incorporated in 1897, and Continental Assurance Company, incorporated in 1911. The company operates in all 50 states as well as major international markets around the world.

C N A stock decreased in 2001 because claims related to the World Trade Center attack had to be paid. Also, the company has some claims related to the collapse of energy giant Enron. Finally, C N A increased its reserves in response to the likelihood of higher payouts arising from asbestos and environmental pollution resulting from prior year's claims.

Despite these problems, C N A's balance sheet remains strong. C N A's stock has declined because of these three problems. This is justified. The company will make less money in 2001 than it did in 2000.

The chart on the next page shows the performance of C N A Financial as of December 21, 2001.



The table below shows the capitalization of C N A. The company's bonds have an investment grade rating:

Debt, Equity and Debt as a % of Total Capitalization							
(in \$Millions except for %)							
	1995	1996	1997	1998	1999	2000	2001*
Debt	\$3,026	\$2,765	\$2,897	\$3,160	\$2,881	\$2,729	\$2,084
Equity	\$6,739	\$7,060	\$8,309	\$9,157	\$8,938	\$9,647	\$8,626
Total	\$9,765	\$9,825	\$11,206	\$12,317	\$11,819	\$12,376	\$10,710
Debt as a % of Total Capitalization	31.0%	28.1%	25.9%	25.7%	24.4%	22.1%	19.5%

*Sept. 30

You can see that the amount of equity decreased because of the problems discussed on the previous page. C N A has paid down debt, however, so the balance sheet remains strong.

C N A bonds also went down in value, along with the stock. This does not seem to be justified. C N A's ability to pay its bills long-term does not appear to have declined so it appears to me that the bonds should not have declined in value or they should not have declined as much as they have.

Insurance companies make money two ways: by selling insurance and by investing. The majority of C N A's investments are in the bond markets.

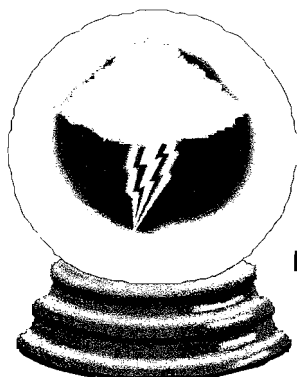
The company has a history of successful investing. For example, The company achieved large capital gains over one-half a billion dollars in 1999 and 2000 from two investments:

- Global Crossing LTD, a stock that trades on the New York Stock Exchange. The company is a provider of Internet and long distance services with an undersea digital fiber-optic cable network.
- Canary Wharf Group LLC is a publicly-traded holding company that operates the Canary Wharf Real Estate development in the London docklands.

The table below summarizes the capital gains from these two investments.

Capital Gains (in \$Millions)		
	1999	2000
Global Crossing LTD	\$171	\$103
Canary Wharf Group LLC	209	79
Total	\$380	\$182

C N A has done a good job selling insurance but profits have been elusive. It is important to realize that there can be wild fluctuations in the property and casualty insurance company's operating results, which are beyond the company's control. Severe weather can radically change the results from year to year.



In the third quarter of 1999, Hurricane Floyd created havoc and in the fourth quarter, France and Denmark experienced severe windstorm damage. C N A has generally been profitable on a yearly basis after combining the two functions of selling insurance and investing.

Going forward, the challenge is to do a better, meaning a more profitable, job of selling insurance.

Understanding the Insurance Transaction



In every business transaction, there are three distinct factions:

1. The customer who is looking to get value for his/her money.
2. The employee who is looking for a good job and perhaps a chance for advancement.
3. The owner/stockholder, who is looking for a good return on his/her investment.

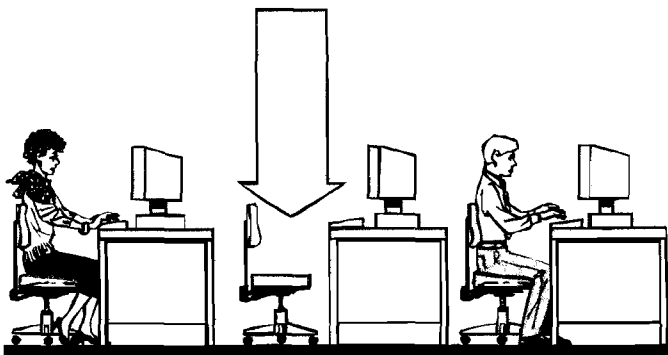
One of the rules of insurance is: There are no bad risks but there are sometimes bad premiums. This means that if an insurance company charges the correct amount for a policy even if the customer has claims, money can still be made.

What is happening with C N A is that the company is not charging customers enough for insurance. So the average customer buying insurance from C N A is getting a great deal. The company is, in effect, selling policies below cost. The stockholders are not getting a return on their investment. Instead, they are subsidizing the cost of the customers' insurance.

You can see this is true by looking at the return of C N A over the last 5 years. The stock has under performed other insurance companies and the S&P 500.

Comparison of C N A Financial Corp., S&P Index and Multi-Line Insurance						
	1995	1996	1997	1998	1999	2000
C N A Financial Corp	\$100.00	\$94.27	\$112.56	\$106.39	\$102.92	\$102.42
S&P Index	\$100.00	\$122.96	\$163.98	\$210.85	\$255.21	\$231.99
Multi-Line Insurance	\$100.00	\$126.80	\$193.41	\$213.07	\$271.47	\$381.92

Additionally, to help pay for the customers' insurance, C N A issued an additional 40,327,500 shares of stock at \$25 per share. The money raised from this transaction and money made from investing can be used to subsidize the customers' insurance. Longer term, C N A should be able to make money selling insurance.



The employees of C N A are not enjoying selling insurance below cost either. Also, it's questionable how "good" their jobs are. On December 5, 2001, the company announced that it is cutting employment by 1,850 jobs. After the cuts, the company will employ approximately 16,500 people.

All of this turmoil creates an opportunity for bondholders. Two of C N A's short-term bonds are mispriced in relationship to the broader bond market:

Bond 1 is a 6.25% coupon due 11-15-03; price \$973.20; yield to maturity, 7.76%. Bond 2 is a 6.5% coupon due 04-15-05; price \$916.50; yield to maturity, 9.5%. The C N A bonds are not especially interesting or exciting but offer high current income with a relatively short maturity.

A person who buys ten of Bond 1 now could expect the following events to occur:

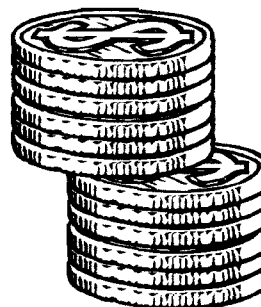
	Bond 1	
Purchase price	--	\$9,737.50
Interest payment	05-15-02	\$312.50
Interest payment	11-15-02	\$312.50
Interest payment	05-15-03	\$312.50
Bond matures	05-15-03	
Principal Payment	--	\$10,000.00

A person who purchases ten of Bond 2 with \$10,000 could expect similar events to occur:

	Bond 2	
Purchase price		\$9,165.00
Interest payment	04-15-02	\$325.00
Interest payment	10-15-02	\$325.00
Interest payment	04-15-03	\$325.00
Interest payment	10-15-03	\$325.00
Interest payment	04-15-04	\$325.00
Interest payment	10-15-04	\$325.00
Interest payment	04-15-05	\$325.00
Bond matures	04-15-05	\$10,000.00

Going forward: C N A management is going to try to reward stockholders. Over the last five years, results have been consistently inconsistent. Starting in August 1998, C N A tried to:

- Simplify business,
- Clarify company goals, and
- Apply renewed discipline and accountability to performance.

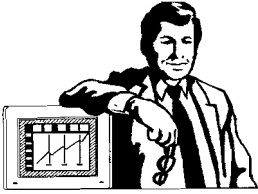


This is working to a degree. The company is still losing money selling insurance but it is not losing as much. The insurance losses are trending down.

Seven Operating Segments: C N A conducts its business through seven operating segments:

1. Agency Marketing Operations
2. Specialty Operations
3. C N A Re
4. Global Operations
5. Risk Management
6. Group Operations
7. Life Operations

1. Agency Marketing Operations: C N A uses independent agents to market a broad range of property-casualty insurance products and services to small and middle-market businesses. Business products include workers compensation, general and product liability, umbrella and commercial automobile insurance. The majority of the customers spend less than \$1 million in annual insurance premiums.



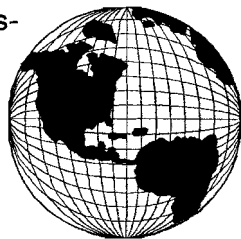
The Unisource division of the Agency Marketing Operations provide out-sourcing services and products that relieve businesses of many administrative tasks, allowing them more time to focus on their core business. Unisource provides Human Resources (HR), Information Technology (IT), payroll processing and professional employer organization services.

2. Specialty Operations: This segment provides a broad array of professional, financial and specialty property-casualty products and services through a network of brokers, managing general agencies and independent agencies. Specialty operations provides creative solutions for managing the risks of its clients which include architects, engineers, lawyers, healthcare professionals, financial intermediaries, and corporate directors and officers.

One of the most common products is Errors and Omissions insurance. Perhaps you personally or some in your family have bought an Errors and Omission policy for a business.

3. C N A Re: Insurance companies buy insurance from other insurance companies. If a company determines that it has too much risk tied to one event they will buy insurance from another to offset part of the risk.

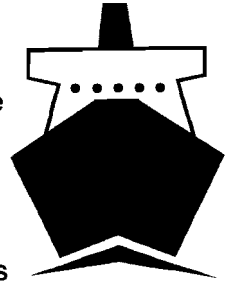
4. Global Operations: This business segment provides products and services to United States based customers and expands overseas to foreign customers as well.



The major product lines include marine, commercial and contract surety, warranty and specialty products, as well as commercial property and casualty coverages.

The Global Operations division is composed of five principal groups:

- **Marine**, through which the company offers hull, cargo, primary and excess marine liability, marine claims and recovery products and services.
- **Surety**, which consists primarily of C N A Surety Corporation. This corporation is traded on the New York Stock Exchange under the symbol SUR and is the largest publicly traded provider of surety bonds with approximately 8% of the market. C N A owns approximately 64% of C N A Surety.
- **C N A National Warranty Corporation** sells vehicle warranty services in the U. S. and Canada. This division is the fourth largest warranty underwriter in the U.S., providing extended service contracts, warranties and related products that protect the consumer or business from the financial burdens associated with the breakdown, under-performance or maintenance of a product.
- **C N A Global** is responsible for coordinating and managing the direct businesses of the foreign property-casualty operations of C N A. Global assists C N A customers doing business in foreign countries and also by trying to sell insurance in selected foreign markets. The company has offices in Europe, Latin America, Canada and Asia.
- **First Insurance of Hawaii** is the oldest and largest domestic property-casualty insurer in Hawaii dating back to 1911 and offers commercial and personal lines solely in that State. The products are distributed through 30 independent agencies. Historically, the business mix has been approximately 70% commercial and 30% personal lines. First Hawaii is owned 50-50 by C N A and Tokyo Marine and Fire Insurance Co. Ltd.



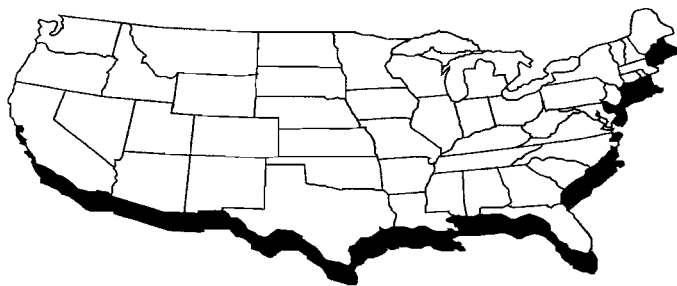
5. Risk Management: This business segment serves the property-casualty needs of large, domestic commercial businesses, offering customized strategies to address the management of business risks. Also, Risk Management provides total risk management services relating to claims, loss control, cost management and information services to the commercial insurance marketplace.

These services are similar to the Agency Market Operations. The customers, however, are much larger in terms of the amount of insurance they purchase. Risk Management works with Fortune 1,000 companies. These are essentially the 1,000 largest businesses in the U.S.

6. Group Operations: Providing a broad array of group life and health insurance products and services, Group Operations insures employees, affinity groups and other entities that purchase group insurance. Federal employees, and retirees and their families receive health insurance through Group Operations.

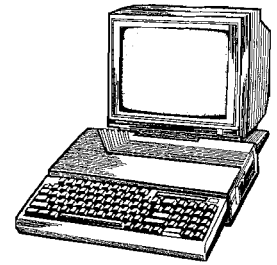
Group Operations includes four principal groups:

- **Group Benefits:** C N A sold its life insurance business on December 31, 2000.
- **Provider Markets**
- **Life Reinsurance**



- **Federal Markets:** The second largest provider of health insurance benefits to federal employees, Federal Markets insures approximately one million members under the Mail Handlers Benefit Plan.

7. Life Operations: C N A sells term and universal life insurance, long-term care insurance, annuities and other products.



The Life Insurance Operation is composed of four principal groups: Individual Life, Retirement Services, Long-Term Care, and Other Operations.

- **Individual Life:** C N A has been among the top five producers of term insurance in the market in each of the last three years.
- **Retirement Services:** This is the largest group, representing more than 50% of the revenues in calendar year 2000. Sales here tend to be large case institutional markets. These sales fluctuate dramatically from year to year.
- **Long Term Care:** C N A has had success marketing long-term care products to the public. Sales have grown substantially each year:

Sales in \$Millions			
1997	1998	1999	2000
\$251	\$299	\$343	\$398

Segment Reporting: The segment reporting allows an investor to see what is happening with C N A. The company is losing money selling insurance but it is off-setting that loss and making money through investing.


When you and I buy an insurance policy, the theory is that we pay our premium today and we may or may not have a claim tomorrow. "Tomorrow" can literally be tomorrow but it also could be next week, next month, next year, 20 years from now, or even never. The insurance company sets aside part of the premium we pay and invests it so it is available when we have a claim.

The business with the closest characteristics to an insurance company is a casino. As you probably know, the odds in most games of chance slightly favor the casino. Individually, some people will win, but if enough people play long enough, the casino will make money.

The table below shows the Segment Results for the year ending December 31, 2000:

Segment Results (in \$Millions)										
	Agency Market Operations	Specialty Oper- ations	C N A Re	Global Oper- ations	Risk Manage- ment	Group Oper- ations	Life Oper- ations	Corporate and Other	Elimin- ations	Total
Net earned premiums	\$3,331	\$799	\$1,089	\$1,089	\$647	\$3,675	\$876	\$24	\$ (46)	\$11,474
Claims, benefits, expenses	3,772	819	1,186	1,128	760	3,770	1,316	164	(46)	12,869
UNDERWRITING LOSS	(441)	(20)	(97)	(39)	(123)	(95)	(440)	(140)	-	(1,395)
Net investment income	604	216	195	136	163	142	601	23	-	2,080
Other revenues	151	26	5	116	318	49	192	55	(173)	739
Other expenses	185	35	14	123	324	46	99	282	(173)	935
Pre-tax optg income (loss)	129	187	89	90	34	50	254	(344)	-	489
Income tax (expense) benefit	(19)	(56)	(32)	(24)	(5)	(14)	(85)	128	-	(107)
Minority interest	-	-	-	(24)	-	-	-	(14)	-	(28)
Net operating income (loss) excluding realized invest- ment goals	110	131	57	42	29	36	169	(220)	-	354
Realized investment goals, net of tax, participating policyholders' and minority interests	268	141	80	78	96	55	22	-	-	860
NET INCOME (LOSS)	\$498	\$272	\$137	\$120	\$125	\$91	\$191	\$(220)	\$ -	\$1,214

Conclusion: C N A's bonds are attractive. They offer high current income and require a rather short investment period.



General Employment

On Tuesday, February 19, 2002 at 10 A.M. General Employment will be hosting its annual shareholders meeting at the Hilton Suites Hotel, 10 Drury Lane in OakBrook Terrace, IL.

I will be hosting a breakfast before the meeting at the same hotel. I hope you can attend. I will be sending an invitation to you soon.