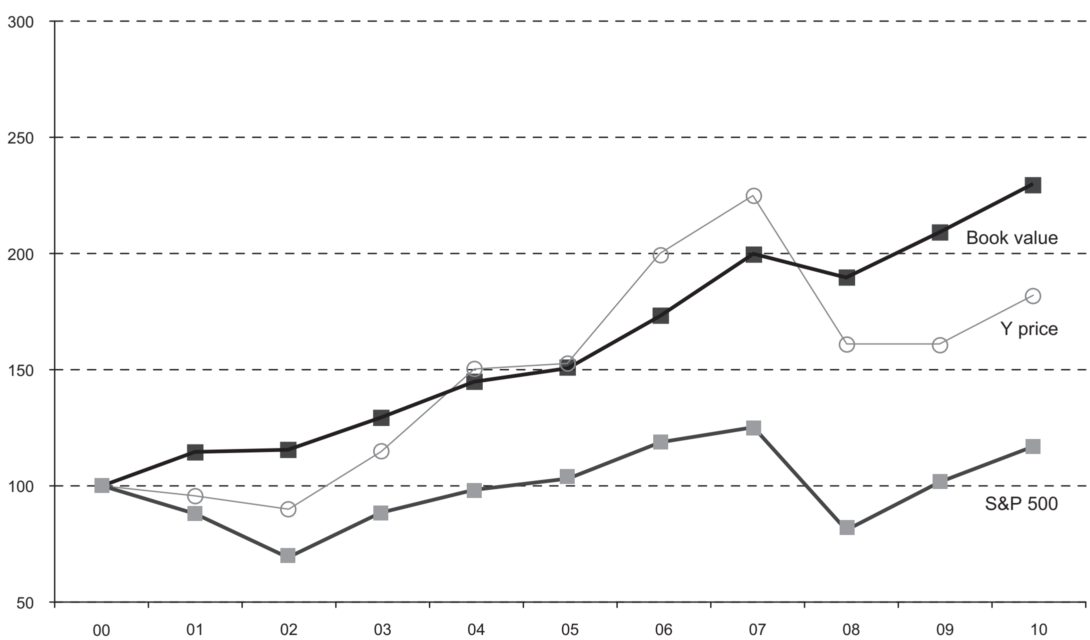
To Our Stockholders

Alleghany's common stockholders' equity per share at year-end 2010 was $331.81, an increase of 10.3% from common stockholders' equity per share of $300.69 at year-end 2009, adjusted for stock dividends. For 2010, Alleghany reported net earnings to common stockholders of $198.5 million, or $22.29 per share. For the five years ended December 31, 2010, Alleghany's common stockholders' equity per share increased at a compound annual rate of 8.9%, compared with a compound annual rate of return of 2.3% for the S&P 500 over the same time period.

The chart below summarizes Alleghany's longer-term performance, with all values indexed to December 31, 2000. For the ten years ended December 31, 2010, Alleghany's common stockholders' equity per share increased at a compound annual rate of 8.7%, compared with a compound annual rate of return of 1.6% for the S&P 500 over the same time period. Alleghany's share price appreciated at a 6.2% compound annual rate of return over the decade (adjusted for stock dividends). The rate of return to our stockholders has been less than the compound annual growth rate in common stockholders' equity per share due to a contraction in Alleghany's price-to-book multiple, a phenomenon common to many companies in the property and casualty insurance industry.

Alleghany Corporation
Indexed Performance 2000=100



The table below summarizes the change in common stockholders' equity in 2010 ($ millions):

Net earnings before items below	$143.2
Net realized capital gains	63.3
Other than temporary impairment losses	(8.0)
Net earnings available to common stockholders	$198.5
Repurchases of common stock	(83.1)
Unrealized appreciation and other	75.9
Increase in common stockholders' equity	$191.3

The table shows that, absent repurchases of common stock (all of which were made at a discount to book value per share), common stockholders' equity would have increased by $274.4 million in 2010 ($191.3 million plus $83.1 million). Slightly over half of this increase was due to earnings from operations (investment income and underwriting profits), while slightly less than half of the increase was due to realized and unrealized investment gains.

Our performance in 2010 was mixed. Despite competitive market conditions, RSUI once again posted strong underwriting results, due in part to another mild catastrophe season. The Capitol Insurance Companies had strong surety results, but its property and casualty results were disappointing. PacificComp (formerly Employers Direct) had another operating loss as it ran off its direct business and made investments necessary to re-emerge as a brokerage carrier in 2011. On the investment side of the house, our bond portfolio produced moderate positive returns, while our equity portfolio once again produced very strong returns.

The Great Recession Ends ... What's Next?

After a rocky start, the economic recovery that began in mid-2009 now appears to be on a self-sustaining path. The current economic recovery was made possible by significant fiscal and monetary stimulus, as well as continued economic growth from emerging markets. Headline GDP growth of 3% or so, however, has not yet produced a meaningful recovery in employment, leading to concerns that the recovery could eventually stall — especially if consumers lose confidence and go into a retrenchment mode again.

Of perhaps even more concern, however, is the fact that the deflationary forces prevalent in mature economies due to the unwinding of a quarter century of rapid growth in debt have only been arrested through the creation of massive government deficits. The US federal government, for example, is projected to spend roughly $1.5 trillion more than it collects in tax revenue in the current fiscal year. In addition, state and municipal governments are facing unprecedented deficits in 2011. It is likely that state and municipal governments will take drastic actions to close these deficits through increased taxes and reduced spending, both of which will act as a headwind to economic growth.

For the US economy, we do not see significant incremental aggregate demand coming from either the government or consumer (household) segments of the economy. This leaves capital investment and net exports to drive economic growth. It appears that the Federal Reserve has tacitly tried to encourage a weaker US dollar to support both of these sources of aggregate demand; however, a weaker US dollar is already feeding through into commodity prices, including most importantly the price of food and energy. Should the price of food and energy rise much more from recent levels, the beneficial effects of a weaker US dollar on net exports and US industrial competitiveness could be offset by a contracting consumer sector.

In addition, there is the question: against what currencies can the US dollar weaken? As we have noted before, the real issue behind global imbalances is the relationship between the US dollar and pegged currencies, not the other floating OECD currencies such as the Euro and Yen. So for now, we continue to be in an unstable state of affairs in which China continues to manage its exchange rate at a level that reflects past significant devaluations. The most significant devaluation, it should be remembered, was in 1994. Today, China enjoys a virtually unassailable manufacturing cost advantage, partly due to exchange rates. At the same time, China's past practice of managing its exchange rate has required that its central bank print local currency as it buys US dollars received from Chinese exporters. This practice appears to be igniting inflationary pressures that the country is aggressively trying to control.

We don't know whether the US government can continue to fund a $1+ trillion annual deficit without seeing rising interest rates. Rising interest rates, of course, would make the deficit worse unless offset by very rapid economic growth; in addition, some have argued that rising interest rates could imperil the Federal Reserve's solvency, given the extraordinary amount of leverage employed by that institution. Either could ultimately lead to much higher inflation, although such a scenario does not appear likely at present. It is interesting to note that by some estimates[1], the Federal Reserve's open market purchases of Treasury securities under so-called "QE2" has already effectively resulted in over half of the federal government's funding being provided by Federal Reserve purchases, even if indirectly. We believe that because the vast majority of the Federal Reserve's profits (almost $80 billion last year) are returned to the Treasury, an expanding Federal Reserve balance sheet effectively allows the federal government to fund fiscal deficits at an extremely low cost—as if the Treasury could issue longer-term debt with a negligible interest rate. This "printing of money" can go on as long as foreign creditors allow it to go on.

An additional factor to be considered is the cost of energy. Oil prices are again approaching $100 per barrel, and retail gasoline prices are over $3 per gallon. Rising oil demand from industrialization in emerging markets appears to once again be colliding with the reality of finite supplies of cheap oil. It remains to be seen whether or not the Federal Reserve can engineer a weaker dollar to offset debt deflation forces while at the same time keeping food and energy prices at affordable levels.

It should be clear from all of the above that the global economy remains in a very fragile state, and that there are significant risks to economic growth, continued low interest rates, and risk asset values. We are most concerned about the following:

1. The Federal Reserve keeps interest rates low for too long, resulting in soaring commodity prices which eventually break the consumer and cause the economy to return to recession.

[1] Gonzalo Lira, (2011, January 4), Is the Federal Reserve Really Purchasing Over 60% of 2011's Fiscal Deficit? In A Word, Uh ... Yeah. [Web log comment]. Retrieved from http://gonzalolira.blogspot.com/2011/01/is-federal-reserve-really-purchasing.html.

2. The Federal Reserve tightens prematurely, contributing to another leg down in the housing market and the add-on effects on financial institutions, credit growth, and confidence.
3. Sovereign risk issues reemerge in 2011, causing a flight to safety and a sell-off in risk assets.
4. China overshoots in its efforts to contain domestic inflation.
5. Political instability in the Middle East.

Our investment strategy in this environment is first and foremost to aim to protect the value of our capital. Our fixed income portfolio is high in quality (average credit rating of AA+) and relatively short in duration (approximately four years). In order to grow capital, however, we have approximately $1.5 billion of our consolidated investment portfolio invested in equity securities. We continue to have a large exposure to energy investments, as well as certain mining companies, as a counterbalance to the large fixed income portfolios that our insurance subsidiaries are required to hold.

A Word on the Economy

Much of what we read in the business news reflects a view of the world that has been institutionalized in the mature Western economies—a framework generally referred to as "neoclassical economics." This world view is based upon a number of assumptions and holds that the "free market" left unfettered will produce the best result for the economy. In 2008, however, the "free market" essentially drove us off a cliff. An interesting alternative view has been articulated by Professor Richard A. Werner of the University of Southampton in his 2005 book entitled *New Paradigm in Macroeconomics: Solving the Riddle of Japanese Macroeconomic Performance*. Given the fact that the US economy is struggling to transition to a self-sustaining recovery, it would seem important to understand what happened in Japan and its relevance for the outlook in the US and Europe today. Professor Werner demonstrates that neoclassical economics failed to explain why Japan was so successful in the 1980s and why its economy has not responded to neoclassical prescriptions for recovery ever since.

Professor Werner's work starts with the acknowledgment that money is created by banks out of nothing through the process of extending credit, and only banks (and their central banks) can create money. Other financial institutions simply move money from one holder to another. When a business or a government spends money by borrowing in the capital markets, no money is created, as funds spent are offset by funds raised through a debt or equity issue. This being the case, money growth must come through expansion of the banking system. When banks expand credit and therefore expand the supply of money, the result can be:

1. Inflation, if money is used to fund consumption in an economy that is capacity constrained;
2. Asset bubbles, if money is used to speculate on real estate and or other financial assets; or
3. Economic growth, if money is used for productive investments.

Professor Werner notes that when the banking system is left to its own devices to make these critical money allocation decisions, it may make the wrong decisions. It may fuel an expansion in credit card debt that is used to expand non-inflationary consumption due to the capacity of the Chinese economy; or it may lead to a massive misallocation of capital into the real estate sector, with the result being idle capital stock in empty houses and buildings. Neoclassical economics explains that the price of money—interest rates—can be used to regulate the intersection of the demand/supply functions for credit. Professor Werner's alternative view is the quantity of money is always supply constrained due to imperfect information and frictional costs in the banking system. Accordingly, interest rates rise and fall *in reaction to* changes in economic activity, and do not for the most part control the banking system's willingness to extend credit.

Japan's economic "miracle" in the 1980s, China's recent economic success, and the strong economic performance of Germany all share one common attribute: state capitalism. Tightly controlled lending to productive activities (infrastructure and production) appear to result in a rapidly growing economy. In our opinion, the ideological underpinnings of American free market capitalism since the early 1980s have generally resulted in what can only be called "Banks Gone Wild"—and we now have an oversized banking system that has sub-optimally allocated capital. For these reasons, we continue to be somewhat bearish on the prospects for the economy until we see bank lending move to a more productive role.

As an aside, Professor Werner offers several common sense solutions for how to recover from a banking crisis. Because a banking crisis results in depleted capital, as well as calls for retribution by politicians, banks become constrained in their ability to extend credit. Moreover, efforts by the accounting profession to implement "mark to market" accounting only make things worse. The solution is for the central bank to purchase bad assets from the banking system at par, coupled with banking reform to force lending into more productive activities. This has generally not happened in the United States post the Great Recession. As an alternative, Professor Werner suggests that the federal government fund its expenditures by borrowing from banks (thereby creating money from nothing), as opposed to by borrowing in the capital markets at interest. A third alternative, which *is* being pursued, is to monetize deficit spending. Deficit spending without monetization, according to Professor Werner's view, does nothing to stimulate the economy. Perhaps the Federal Reserve's program of *Quantitative Easing* will help.

Investments

Because our insurance subsidiaries are exposed to significant economic loss in the event of a sharp, rapid increase in inflation, we have structured our investment portfolio in an effort to protect capital in an environment of rising inflation. At year-end 2010, we had consolidated cash and invested assets of approximately $4.9 billion, or $4.6 billion net of parent company long-term debt. Of this $4.6 billion, approximately $1.5 billion, or one-third, was invested in equity securities, with the balance of $3.1 billion, or two-thirds, invested in cash and fixed income securities.

On a consolidated basis, Alleghany's equity portfolio returned 17.1% in 2010, slightly ahead of the 15.1% total return on the S&P 500. For the five years ended December 31, 2010, our equity portfolio has produced an average annual return of 6.2%, compared with an annual average return of 2.3% for the S&P 500. We invest in equity securities with a 3-5 year investment horizon, in part to counterbalance the substantial amount of fixed income securities that our insurance subsidiaries hold as an integral part of their insurance operations.

In most years, investing in equities has enhanced the total return on our investment portfolio relative to the alternative of investing exclusively in bonds, as illustrated below:

Year	Alleghany Total Return[1]	Barclays Index[2]	Excess (Shortfall)
2004	13.2%	3.7%	9.5%
2005	10.8	2.0	8.8
2006	6.8	4.6	2.2
2007	9.4	7.0	2.4
2008	(4.1)	4.9	(9.0)
2009	11.4	6.5	4.9
2010	8.7	6.2	2.5
Cumulative	70.3%	40.5%	29.8%
Annualized	7.9%	5.0%	2.9%

RSUI Group, Inc.

RSUI is a leading participant in the commercial specialty insurance market, writing complex insurance products exclusively through wholesale insurance brokers. The company's strategy is to be a "reactive market," meaning it will write more business when prices, terms, and conditions are attractive and less business when the market is highly competitive and may be setting the wrong price or offering terms and conditions that are too generous when considering the risk insured. The company has been highly successful with this strategy. Since Alleghany acquired the company in mid-2003, RSUI has produced almost $1 billion of underwriting profits.

RSUI had a good year in 2010 despite an increasingly competitive marketplace. Underwriting profits totaled $159.9 million after $31.0 million of net catastrophe losses and $33.9 million of favorable prior year casualty reserve development. The combined ratio was 73.1%. In 2009, RSUI produced $189.8 million of underwriting profits after only $6.7 million of net catastrophe losses and $38.4 million of favorable prior year casualty reserve development. Underwriting profits before catastrophe losses (which fluctuate from year-to-year) and prior-year casualty reserve development totaled $157.0 million, which approximated 2009 despite a 6% decrease in net premiums earned.

RSUI ended 2010 with cash and invested assets of $2.6 billion and $1.35 billion of stockholder's equity. At the end of 2010, RSUI provided Alleghany with a $100 million dividend. Adding this dividend back to RSUI's 2010 year-end stockholder's equity would result in RSUI producing a total return on book value of approximately 16% in 2010.

Capitol Insurance Companies

The Capitol Insurance Companies focus on small commercial insurance and surety bonds. Capitol's commercial property and casualty business is sold through family-owned general agencies and selected wholesalers, while its surety bond business is sold through specialized surety agencies. Although the company produced a $1.5 million underwriting profit in 2010, property and casualty production was below expectations as a weak economy and very

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1 Alleghany's total return on cash and invested assets, including both fixed income and equities.

2 Barlays Intermediate Aggregate Bond Index.

competitive market conditions resulted in a decline in premium volume. Capitol's surety business, by contrast, had a very good year, taking advantage of a shortage of bonding capacity for difficult risks.

The Capitol Insurance Companies ended 2010 with cash and invested assets of $563 million and stockholder's equity of $323 million. In early 2010, Capitol provided Alleghany with a $25 million dividend. If this dividend is subtracted from Capitol's beginning stockholder's equity, the company's book value grew by 7% in 2010.

Pacific Compensation Corporation

In 2009, our California workers' compensation company exited the direct distribution channel and in 2010 rebranded itself as PacificComp. Management spent most of 2010 repositioning the company to be able to distribute workers' compensation insurance in California through independent insurance brokers. This involved developing a brokerage marketing strategy, identifying appropriate brokers, designing a new broker contract, appointing key brokers, making investments in new systems, and adjusting rate filings where necessary. I am pleased to report that PacificComp is now open for adequately priced business through independent brokers and has a compelling systems and service offering.

In our judgment, the industry continues to charge inadequate rates considering the sharp acceleration in claims costs evident over the past few years. Rates are increasing, however, and should the economy begin to improve, it is possible that PacificComp will be able to write adequately priced business in 2011. Time will tell.

PacificComp produced an operating loss in 2010, as its operating expenses exceeded investment income on reserves and capital. The company ended 2010 with cash and invested assets of $298 million, and stockholder's equity of $156 million.

Alleghany Properties

Alleghany Properties owns approximately 320 acres of land in Sacramento, California. As mentioned last year, development activities in the Sacramento market are temporarily on hold due to flood control issues in the Sacramento basin. In addition, the economy has been extremely weak in the Sacramento area, reducing demand for land development. In 2010, our operating management was able to make a small investment in low income housing tax credits, leveraging their local real estate expertise. In addition, they were successful in recovering certain fee credits from the City of Sacramento, resulting in a small profit in 2010. We continue to believe that Alleghany Properties' holdings of land have potential long-term value, and we are working with management at Alleghany Properties to be positioned to realize that value once market and regulatory conditions allow for a resumption of development activities.

Alleghany Capital Partners

In 2010 we continued to grow Alleghany Capital Partners, an investment group that manages Alleghany's public equity portfolio and makes private investments in high-potential companies. We made several small private investments in 2010, and continue to work on uncovering additional private opportunities in which we can provide companies with long-term, patient capital in exchange for an equity participation in their business.

Other Investments

Alleghany has an approximately 33% interest in Homesite Insurance Group, a specialist in providing homeowners, renters, and condominium owners insurance in 47 states, distributing through partnerships with other personal lines carriers. In 2010, the company grew its top-line in excess of 20%, reflecting increased penetration of key strategic relationships and a broadening of the number of relationships. Underwriting results, however, were weak, largely due to elevated hail and storm loss activity. Homesite's management has taken significant underwriting and pricing actions to reduce the chances that weather-related loss activity exceeds pricing assumptions in the future.

The year just ended was an important one for ORX Exploration, a Louisiana-based oil and gas exploration and production company in which we have an approximately 38% ownership interest. ORX is developing deep, on-shore sub-salt oil and gas resource opportunities by utilizing seismic imaging technology to identify the resource potential. In late 2010, the company formed a strategic relationship with a subsidiary of a major international oil company to jointly develop various sub-salt prospects. ORX and its partners will commence exploration of the first prospect (Garden Island Bay) in 2011. The agreement with Repsol provides ORX with a cost recovery and option fee to explore some of its prospects; in addition, ORX will retain a portion of the future production, if any, that results from the exploration efforts.

Balance sheet, liquidity, and risk management

In 2010, we issued approximately $300 million of 10-year debt securities at an all-in cost of less than 6%. This opportunistic financing transaction added to our available capital resources, and effectively acts as a way to reduce our exposure to rising interest rates. The 10-year Treasury yield at the time the debt was issued was 2.72%; today it is approximately 3.65%.

At year-end 2010, approximately $2.0 billion of our total capital of $3.2 billion was represented by our investments in wholly-owned operating subsidiaries and our associated companies, with the balance (approximately $1.2 billion) consisting of invested assets either at the parent company or intermediate holding companies which is available to support the needs of our operating subsidiaries and to fund acquisitions.

Each of our subsidiaries has its own set of risk management issues. We encourage the operating management of our subsidiaries to consider carefully what can go wrong, and have a plan to deal with unlikely scenarios. Each of our subsidiaries is conservatively capitalized, supplemented by a parent company with copious capital resources and ample liquidity. Our strategy is to maintain a comfortable cushion of excess capital, not only to protect against unlikely but possible loss scenarios, but to be able to capitalize on opportunities that may emerge from economic dislocations or liquidity crises. Our low level of financial and operating leverage contributes to a very low cost of equity capital, making the returns mentioned above particularly noteworthy on a risk-adjusted basis.

Corporate developments

Following our annual meeting in 2011, Robert M. Hart, our Senior Vice President—Law, will retire from Alleghany. It is hard to overstate the contribution that Bob has made to Alleghany's success over the past four decades, not only as an officer of Alleghany but in his former capacity as outside counsel. On behalf of the Alleghany Board of Directors, I want to thank Bob for his many important contributions to Alleghany's long-term success.

Outlook

Approximately two-thirds of Alleghany's common stockholders' equity is deployed in the commercial property and casualty insurance industry. This industry is notoriously cyclical, with 2006-2007 marking the peak of the most recent profit cycle. Since then, insurance prices have been falling, reflecting declining demand due to a weak economy and an industry with excess capacity. With the possible exception of California workers' compensation insurance, we do not see any prospect for a change in commercial insurance market conditions in 2011. Because written premium volume has declined at RSUI and The Capitol Insurance Companies in 2010, it is likely that underwriting results will deteriorate in 2011, especially considering the fact that RSUI once again had a light catastrophe loss year.

Our investment income continues to be under pressure from low interest rates and our past decisions to keep the fixed income portfolio relatively short in duration with a high quality profile. Unless interest rates rise sharply (which would reduce the value of our bond portfolio), we will continue to reinvest maturing bonds and new cash flow at interest rates that are below the embedded portfolio yield. An improving economy, of course, holds out the prospect of positive returns on the equity portfolio, although predicting near-term returns in the stock market is a futile exercise in management's opinion.

Our two large strategic company investments—Homesite Insurance Group and ORX Exploration—produced accounting losses in 2010, as we recognize our equity interest in their net results. However, developments at both companies are encouraging and could result in one or both of them making positive contributions to our results in 2011 and beyond.

Our opportunistic approach to acquisitions has not resulted in a major acquisition in the past few years. Each year we look at a number of acquisition opportunities, with the expectation that most of them will not be consummated. Moreover, the institutionalization of the private equity industry, easy money and robust credit markets make it unlikely that we will be successful in making a large acquisition of a company that is "for sale" in a formal auction process, as other buyers are more willing to employ higher levels of debt to make these acquisitions work. For this reason, we are spending much more time looking at early-stage opportunities, where the right business proposition can benefit from our capital and management resources. Such investments are likely to take longer to produce results, but often have the advantage of a very favorable reward/risk ratio.

Until market conditions in our core industry improve, management's principal objective is to preserve capital and to be positioned to fully participate in any eventual rebound in the commercial property and casualty industry. The nature of this industry is that market participants are seldom able to accurately predict what will cause conditions to change, but they always do. We are also focusing our efforts on deploying our discretionary capital in investments that offer superior return potential in relation to the risk of loss.

Yours sincerely,

Weston M. Hicks

Weston M. Hicks
President

February 24, 2011