This is Alleghany

Our objective is to create value through owning and managing operating subsidiaries and investments, anchored by a core position in property and casualty reinsurance and insurance. We are managed by a small company staff which seeks out attractive investment opportunities, delegates responsibilities to competent and motivated managers, sets operating subsidiary goals, assists managers in the achievement of these goals, defines risk parameters and appropriate incentives and monitors progress against long-term objectives. Our operating subsidiaries function in an entrepreneurial climate as quasi-autonomous enterprises.

Conservatism dominates our management philosophy. We shun investment fads and fashions in favor of acquiring relatively few interests in basic financial and industrial enterprises that offer the potential to deliver long-term value to our investors.

Our primary operating subsidiaries include:

- ***Transatlantic Holdings, Inc.*** — a leading global reinsurer
- ***RSUI Group, Inc.* —** a national underwriter of property and liability specialty insurance coverages
- ***CapSpecialty, Inc.* —** an underwriter of commercial property, casualty and surety insurance coverages
- ***Pacific Compensation Corporation* —** an underwriter of workers' compensation insurance primarily in California
- ***Roundwood Asset Management LLC* —** manager of our public equity investments
- ***Alleghany Capital Corporation* —** manager of our private capital investments

Financial Highlights *Alleghany Corporation and Subsidiaries*

(in millions, except for per share and share amounts)

	Year Ended December 31,		
	2014	2013	2012
Revenues	$ 5,231.8	$ 4,971.7	$ 4,753.2
Net earnings available to Alleghany stockholders	$ 679.2	$ 628.4	$ 702.2
Basic earnings per share of common stock available to Alleghany stockholders			
Operations[1]	$ 33.05	$ 30.16	$ 38.96
Security gains[2]	8.35	7.28	6.52
Net earnings available to Alleghany stockholders[1]	$ 41.40	$ 37.44	$ 45.48
Common stockholders' equity available to Alleghany stockholders per share[1]	$ 465.51	$ 412.96	$ 379.13
Average number of shares of common stock outstanding[1]	16,405,388	16,786,608	15,441,578

(1) 2012 per share figures reflect the impact of the Transatlantic Holdings, Inc. merger, including a $494.9 million gain on bargain purchase and the issuance by Alleghany Corporation of 8,360,959 shares of its common stock.

(2) Includes net realized capital gains and other than temporary impairment losses.

Per Share Net Earnings (Losses)

Year Ended December 31,

	Reinsurance and Insurance Segments	Corporate Activities	Total
2014			
Operations	$36.89	$ (3.84)	$33.05
Security gains[1]	7.67	0.68	8.35
Total	$44.56	$ (3.16)	$41.40
2013			
Operations	$29.33	$ 0.83	$30.16
Security gains[1]	5.95	1.33	7.28
Total	$35.28	$ 2.16	$37.44
2012[2]			
Operations	$12.26	$26.70	$38.96
Security gains[1]	4.84	1.68	6.52
Total	$17.10	$28.38	$45.48

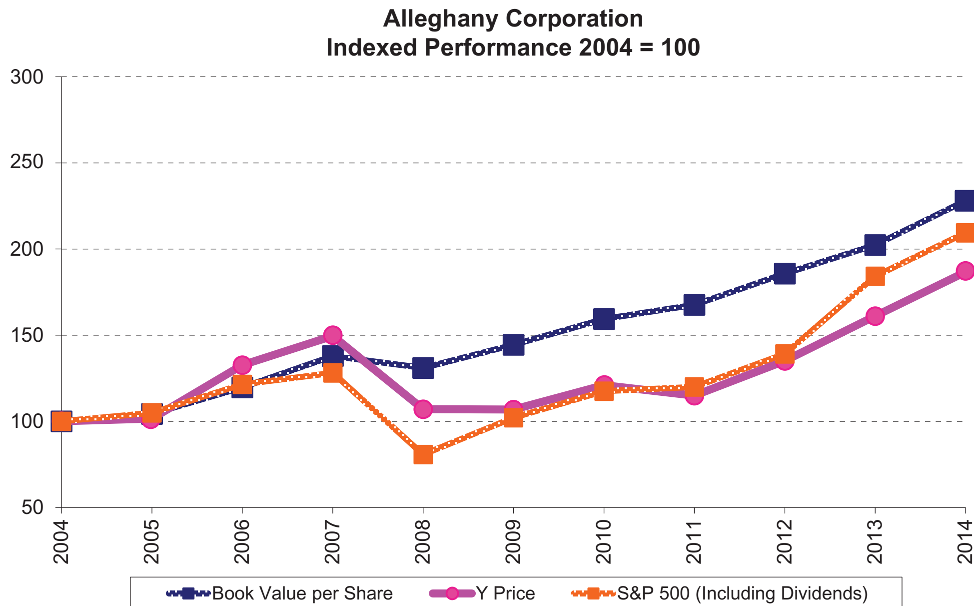
(1) Includes net realized capital gains and other than temporary impairment losses.

(2) 2012 per share figures reflect the impact of the Transatlantic Holdings, Inc. merger, including a $494.9 million gain on bargain purchase and the issuance by Alleghany Corporation of 8,360,959 shares of its common stock.

To Our Stockholders

Alleghany's common stockholders' equity per share at year-end 2014 was $465.51, an increase of 12.7% from common stockholders' equity per share of $412.96 at year-end 2013. For 2014, Alleghany reported net earnings to common stockholders of $679 million, or $41.40 per share. For the five years ended December 31, 2014, Alleghany's common stockholders' equity per share increased at a compound annual rate of 9.6%, compared with a compound annual rate of return of 15.5% for the S&P 500 over the same time period. The 5-year annual rate of return of the S&P 500 is affected by a depressed starting value, which was down approximately 28% from the index's 2007 high, and may also reflect an elevated ending value – time will tell.

The chart below summarizes Alleghany's longer-term performance, with all values indexed to December 31, 2004. For the ten years ended December 31, 2014, Alleghany's common stockholders' equity per share increased at a compound annual rate of 8.6%, compared to a compound annual rate of return of 7.7% for the S&P 500 over the same time period. Alleghany's share price appreciated at a 6.4% compound annual rate of return over the past decade (adjusted for stock dividends). Alleghany's share price performance lagged the growth in book value per share because the share price was 122% of book value on December 31, 2004, and was 100% of book value on December 31, 2014.



The S&P 500 is a challenging benchmark because it is not a static population of companies. Losers are kicked out of the index, and vibrant, growing companies are

added. It also represents America's leading companies, including a number of companies that dominate their industries. By contrast, the New York Stock Exchange Composite index is more representative of the average company. In 2014, the NYSE Composite returned 6.9%, and has returned about 6.9% a year over the past decade.

The table below summarizes the change in stockholders' equity attributable to Alleghany common stockholders in 2014 ($ in millions):

	Amount	% of Beg. Equity
Net earnings before items below	$ 542	7.8%
Gains on equity securities and other	86	1.2
Gains on fixed income securities	274	4.0
Share repurchases	(301)	(4.3)
Foreign exchange	(40)	(0.6)
Other items, net	(11)	(0.2)
Increase in common stockholders' equity	$ 550	7.9%

Strong underwriting results, primarily at TransRe and RSUI, appreciation in our investment portfolio and accretive share repurchases all contributed to double-digit growth in book value per share -- above our current goal of 7-10% annual growth. We attribute a good deal of the excess to good fortune: there were no major domestic catastrophe losses in 2014 and global, as well as U.S. catastrophe losses, were about half of their respective 10-year average amounts.

In 2014, we repurchased $301 million of Alleghany shares, all at a discount to book value per share at the time of purchase. Had we not repurchased any shares, book value would have increased by 12.3% ($550 million plus $301 million divided by $6,924 million). Shares outstanding began the year at 16.77 million and ended the year at 16.05 million, a decrease of 0.72 million shares, or 4.3%. Because of this capital management initiative, the 12.3% increase in common stockholders' equity before share repurchases became a 12.7% increase in common stockholders' equity per share. If we continue to grow, the accretion from share repurchases only gets greater.

The table below summarizes our 2014 growth in book value per share in more detail ($ in millions):

	TransRe	RSUI	Other[1]	Total
Beginning Equity	$ 4,486	$ 1,598	$ 840	$ 6,924
Net Earnings	523	194	(38)	679
Other Changes	124	20	27	171
Capital Transactions	(3)	(225)	(73)	(301)
Ending Equity	$ 5,130	$ 1,587	$ 756	$ 7,473
ROE	10.8%	12.2%	(4.5)%	9.4%
Growth in Book Value[2]	14.4%	13.4%	(1.1)%	12.3%
Growth in Book Value Per Share				12.7%

TransRe and RSUI, which together account for 90% of our consolidated stockholders' equity, again produced double-digit returns on equity. TransRe's growth in book value (adjusted for capital contributions and dividends) was 14.4%, while RSUI's growth in book value (again adjusted for dividends) was 13.4%. In a low inflation/deflationary environment we consider these growth rates to be very strong.

As the table above shows, we had net assets of $756 million at the end of 2014 in addition to the equity of TransRe and RSUI. It is important to understand the components of this figure, and its prospects for future returns. The table below summarizes the major items comprising the $756 million ($ in millions):

Parent cash & invested assets[3]	$ 822
Parent debt	(997)
Parent debt, net of cash & invested assets	$(175)
Investment in Ares Management, LP	232
CapSpecialty and PacificComp[4]	333
Alleghany Capital Corporation investments	362
Alleghany Properties	36
Other items, net	(32)
Total	$ 756

[1] CapSpecialty, PacificComp, corporate assets, and Alleghany Capital Corp. investments, net of holding company debt.

[2] Dividends and share repurchases added back to ending equity.

[3] Includes investments of Alleghany Insurance Holdings LLC. Excludes investments held at Transatlantic Holdings, Inc.

[4] Shown net of intercompany eliminations. Gross combined equity of these two companies is $407 million.

Only the parent invested assets above are carried at market value. All of the other investments reflect our share of each company's results and in some cases with purchase accounting adjustments.

In the case of Ares, the value of our holdings based on the quoted price of Ares Management, LP is currently slightly above our carrying value. We are currently receiving a dividend yield of approximately 5% on this position, with an expectation that the dividend will increase over time.

2014 was an important year for our two smaller insurance subsidiaries. CapSpecialty and PacificComp made significant progress in reducing underwriting losses, while improving their capabilities and competitive positioning. Although CapSpecialty and PacificComp did not help our growth in book value in 2014 (the combined book value of these two companies increased only 1%), we believe that both companies have the potential to improve their results in 2015 and beyond.

We also made progress in building Alleghany Capital Corporation's portfolio of non-financial businesses, and expect these businesses to begin producing an increasing amount of cash flows to the parent company in the years ahead. To date, the earnings and cash flow of Jazwares, Bourn & Koch, and Kentucky Trailer have been more than offset by planned development losses at Stranded Oil and ORX Exploration. These businesses are discussed in more detail later in this letter.

Due to an existing development moratorium pending improvement in Sacramento's levee system, Alleghany Properties has had little opportunity to realize the potential value of its 300+ acres in Natomas, California. This should change in 2015, and the company will have the opportunity to again dispose of real estate that is carried at a low value per acre.

Our corporate administration costs ($31 million after-tax in 2014) are presented in the table above as part of the "other" column, when in fact they relate to the entire organization. Excluding these costs, the aggregate growth in book value of the "other" column would have been slightly positive. Clearly, with growth at Ares, better performance from CapSpecialty and PacificComp, and the maturation of some of our investments in the energy industry, the contribution from our capital invested in these operations should improve.

Alleghany's consolidated debt to total capital ratio, which was 21% at the beginning of the year, declined to 19% at the end of the year, a result of the growth in stockholders'

equity. As shown above, on a parent company-only basis, we have little net debt. We expect the consolidated debt to capital ratio to continue to fall in 2015, and currently expect the ratio to be in the mid-teens by the end of the year.

Reinsurance and Insurance Subsidiaries

Early in my career as a security analyst following the property and casualty industry, an insurance executive at the time explained the business to me as follows: "The property and casualty business is a simple business: prices follow loss costs with a lag, usually about two to three years." Over the past two years, the property and casualty industry has experienced low levels of natural catastrophe losses and casualty claims have generally emerged at lower-than-expected levels. The result has been that reserves established in prior periods have proven to be more than what is needed, resulting in "favorable reserve development" in the current period.

We do not know – and never know with any degree of certainty – what the future trend in claims will be. Accordingly, at Alleghany we try to use conservative assumptions, trending past loss emergence even if the "loss curve" is flattening.

At the writing of this letter, we are focused on the potential significant issues surrounding "deflategate." Deflategate, of course, is our "term of art" which describes the deflationary pressures that seem to be the dominant force on a macro-level right now. If you had to pick a business that will hold its value in a deflationary environment, a property and casualty company would be high on the list. On the left side of the balance sheet you have, for the most part, high quality bonds. As interest rates fall, the value of these bonds increases. At the same time, if economic conditions are deflationary, the ultimate liabilities of a property and casualty business should shrink. The net effect of the two is a leveraged increase in equity. And although prices ultimately fall, they tend to lag the actual trend in loss costs. In a deflationary environment, property and casualty companies should hold their value.

It should be no surprise that insurance and reinsurance prices, after increasing for the past several years, have stopped increasing and in some cases – large property exposures in particular – have begun to decrease. Among our insurance and reinsurance subsidiaries, price decreases are most pronounced in the global property catastrophe reinsurance business, and to a lesser extent, the U.S. primary property business. Casualty rates as of this writing are more or less stable, with the exception of California workers' compensation and some specialty casualty lines, where rates continue to increase -- primarily because they have been deficient in the aggregate relative to loss costs.

While mild deflation is positive for the net asset value of the property and casualty industry, it is negative for prospective returns. Our industry is being challenged by the extremely low nominal interest rate environment, both in terms of direct and indirect effects. Because a large portion of the industry's economic return comes from investment returns generated on capital and float, lower nominal interest rates result in lower industry returns. With hindsight, one might even conclude that the industry for many years enjoyed "excess returns" because embedded portfolio returns were significantly above a declining rate of inflation. These are the direct effects. Indirect effects include increased and new competition from so-called "alternative capital" providers, including pension funds, hedge funds, and the like. According to Guy Carpenter, approximately 18% of global reinsurance catastrophe limits are now provided by alternative capital. Following six years of an appreciating stock market, the industry itself is flush with capital, resulting in excess industry capacity.

Faced with these environmental challenges, the industry is consolidating. In order to generate reasonable returns, companies must be as efficient as possible, avoid underwriting mistakes, and add value where possible through the investment function. A company that is successful on all three of these items will still likely generate lower nominal returns, but real returns can remain attractive.

TransRe

TransRe's results in 2014 were strong. Mike Sapnar and his team not only produced profitable top-line growth in a challenging and competitive market, but oversaw an all-time company record for underwriting profitability. TransRe produced underwriting profits of $345 million, and a combined ratio of 89.6%. We are fortunate to be associated with such an outstanding organization.

The global reinsurance industry continued to consolidate in 2014 and early 2015, and several of our competitors placed important strategic bets on the future development of the industry. Reinsurers exclusively or predominantly focused on property catastrophe reinsurance began to diversify, either buying on-shore primary insurance companies or broadening their product offerings organically and through acquisition.

We believe that TransRe is well positioned for this changing environment. As we have noted before, TransRe has a highly diversified reinsurance business, both geographically and by product line -- property catastrophe reinsurance accounted for only 16% of the company's worldwide gross written premium in 2014. TransRe has a long-standing presence in every major reinsurance market in the world, pre-dating in many cases the formation of many of its competitors.

Many of TransRe's larger clients are seeking to bundle their reinsurance purchases, retaining relatively predictable volatility while buying protection against more extreme loss scenarios. In order to have a seat at the table with these clients, a reinsurer must bring a broad range of capabilities and have sufficient scale. In 2014, despite a competitive reinsurance market, TransRe was able to grow its gross written premiums by 5%, in part due to increasing its position with key clients. Single-product reinsurers, or smaller reinsurers, may not have been so fortunate. With over $5 billion of equity capital at the end of 2014 and a well-diversified in-force book of $3.4 billion, TransRe has sufficient scale to compete.

2014 will be remembered as the year in which alternative sources of reinsurance capital became more mainstream. By alternative capital, we are referring to managed catastrophe funds, catastrophe bonds, hedge fund reinsurance vehicles, and sidecars. Here too, TransRe has been quietly expanding its capabilities. Actions taken to date include a significant expansion in the company's sidecar facilities and the growth and development of Pillar Capital Management, Ltd.

In the fourth quarter of 2014, Alleghany contributed slightly less than $300 million to TransRe in order to fund the early retirement of approximately half of the company's debt securities maturing in late 2015. We currently expect to retire the rest of this debt later this year through TransRe's retained cash flow.

Alleghany acquired TransRe in March of 2012 for total consideration valued at $3.5 billion. At the end of 2014, TransRe's stockholder's equity was approximately $5.1 billion, and the company has paid dividends to Alleghany, net of a capital contribution, of $140 million since acquisition. As of the end of 2014, TransRe's book value plus the net dividends we have received from the company exceed our purchase price by approximately $1.8 billion.

RSUI

RSUI had another strong year in 2014, completing nine consecutive years of underwriting profits. Since we formed RSUI in July of 2003, it has produced almost $1.4 billion of cumulative underwriting profits, a truly outstanding result by any measure.

RSUI is among the leading specialty insurers in the wholesale insurance market, setting the standard for much of the industry. The company's strategy, while simple to describe, is exceedingly difficult for most companies to implement in practice. It consists of 1) an exclusive focus on the wholesale brokerage community as the

distribution source; 2) a compensation system that rewards underwriters for underwriting profit, not growth; 3) a culture that perpetuates a high level of customer (read: wholesaler) service; and 4) the maintenance of a professional staff of the highest quality. When in perfect balance, these strategic elements allow the company to produce underwriting profits and growth at the appropriate time.

In 2014, standard market carriers began to get more competitive. This resulted in risks moving from the excess and surplus lines market back to the standard market, usually at lower prices and broader terms and conditions. Such movement was particularly noticeable in the property market. As a consequence of these market conditions, RSUI's Property Department gross written premiums shrank by 12% in 2014. We'd be concerned if they didn't. Excluding the Property Department, gross written premiums for the rest of RSUI grew by approximately 7%. With the decline in Property Department premium and growth in most of the other departments of RSUI, Property Department premium was less than 40% of the total in 2014, and about a third of the company's fourth quarter gross written premium.

With Property Department premium declining, and with RSUI having purchased more reinsurance earlier in the year for extreme loss scenarios, the capital intensity of the company is declining. In late 2014, RSUI paid Alleghany a special dividend of $100 million, in addition to earlier dividends paid by the company in 2014. RSUI remains very well capitalized after this special dividend.

In the aggregate, RSUI's gross written premiums decreased 1.5% in 2014, and the company produced underwriting profits of $180 million, for a combined ratio of 78.3%. This is the company's highest absolute amount of underwriting profit in the past five years. Every product line produced an underwriting profit in 2014. While these results are gratifying, we have to acknowledge that it is unlikely that the company will produce results at this level in 2015.

RSUI is led by Dave Leonard, a seasoned insurance executive who has a deep understanding of the wholesale excess and surplus lines market, property and casualty underwriting, and the use of reinsurance to build capacity. RSUI's management team is extremely stable, providing assurance to Alleghany that underwriting judgments will reflect experience and expertise.

Notwithstanding this management stability, the head of RSUI's Property Department, David Norris, retired from the company in 2014. He is succeeded by Andrew Whittington, an experienced and skilled property underwriter. David Norris was instrumental in repositioning RSUI's property book following hurricane Katrina in

2005. I cannot overstate the contribution that David made to RSUI's success since that time, and by implication, Alleghany's success. On behalf of the Alleghany executive team and the board of directors, I want to thank David for his contributions over the past decade and wish him a happy and healthy retirement.

Alleghany acquired RSUI in July of 2003 for an initial investment of $628 million. Since then, our investment has been reduced to approximately $4 million through net upstream dividends. At year-end 2014, RSUI's stockholder's equity was approximately $1.6 billion, or approximately 2.5-times our initial investment. Over the past eleven years, RSUI's stockholder's equity has compounded in excess of 10% per year, adjusted for dividends and capital contributions.

CapSpecialty

Significant progress was made in upgrading CapSpecialty's capabilities in 2014 and strengthening the company's management team. CapSpecialty now has a clear focus on three areas: Traditional Property and Casualty (59% of 2014 net written premiums), Professional Liability (14%), and Surety (27%). Over the past year, under Stephen Sills' direction, we have changed most of the company's executive team. The property and casualty underwriting function has been regionalized for clearer accountability, and underwriting guidelines have been simplified to make it easier for agents to do business with the company. Stephen has put every product line and every business process through a complete reassessment. As a result, the company has exited several insurance lines (mono-line commercial auto and workers' compensation in particular) where it lacked scale, initiated several important business process changes, and commenced systems initiatives that will improve the company's ability to effectively serve its agents. As part of this reassessment initiative, Stephen made the difficult decisions required to improve the company's expense structure.

Property and Casualty consists primarily of binding authority business written on both admitted and non-admitted basis covering restaurants, taverns, hotels and motels, barber shops and beauty parlors, and daycare centers, among others. Surety consists primarily of standard and non-standard commercial surety risks. In 2014, the company exited the large construction contract surety market -- a market that we have concluded is best left to our competitors. Professional Lines includes Miscellaneous E&O, Professional E&O, Environmental, and Miscellaneous Health Care risks.

In a welcomed development, we did not need to adjust the company's reserves related to its discontinued program business segment in 2014. These reserves appeared adequate at the end of 2014 on a declining claims base.

One of the more important management changes at CapSpecialty in 2014 was the leadership of the surety division. Rick Allen, who has headed the division since 2002, decided to retire and pursue a lifelong dream of an extended sailing trip. I tried to talk Rick out of this by suggesting he go see *All Is Lost* starring Robert Redford, but had no luck.[5] Rick is another example of the people in our organizations who have made a huge contribution to Alleghany. Over the past decade, Rick's surety operations have produced $62 million of underwriting profit on $499 million of net earned premium, for an average combined ratio of 88%. The surety operations have been profitable in every single year over this time period, and recent accident years have been conservatively reserved. Well done Rick, and thank you!

CapSpecialty had weak property results in 2014, with most of the losses occurring in the first half of the year. Management tightened underwriting standards in this product line and exited certain classes of risk, and by the fourth quarter results had improved. Returning the property line to underwriting profitability is one of several key levers for profitability improvement at CapSpecialty.

The long-term plan for CapSpecialty is to preserve the company's favorable loss ratio while lowering its expense ratio through a combination of profitable growth and better operational execution. The vision is to make CapSpecialty the preferred specialty insurance company in the industry for small and mid-sized businesses in the U.S.

Alleghany acquired Capitol Transamerica Corporation in January of 2002. Including our investment in Platte River Insurance Company, which was combined with Capitol Transamerica for management purposes, our initial investment was $242 million. Since then, CapSpecialty as we now call it, has returned approximately $130 million in dividends to Alleghany, reducing our net investment to $112 million. At the end of 2014, CapSpecialty had stockholder's equity of approximately $309 million.

PacificComp

PacificComp continues to make progress in repositioning itself for profitability. Jan Frank has been working hard at building a high quality organization with a culture of accountability and performance. She has changed the company's geographic focus from the Los Angeles basin, where competition is intense and losses are volatile, to the rest of the state where we believe profitability is more realistically achievable. This has required that PacificComp establish new distribution relationships and compete effectively against other insurance carriers.

[5] If you haven't seen this film, suffice it to say that it will cure most people of wanting to take a sailboat into the open ocean on an extended journey …

PacificComp is making progress toward its goal of underwriting profitability. Annualized premium in force has increased from $25 million at the end of 2012 to $49 million at the end of 2013 to $75 million at the end of 2014. As the business grows, the company's expense ratio is coming back down to earth, falling from 72.0% in 2013 to 43.2% by the fourth quarter of 2014. Investment income is now growing at PacificComp, and underwriting losses are shrinking. Underwriting losses decreased by 41% in 2014, falling from $33 million in 2013 to $20 million in 2014. We believe that Jan has set the company on a course toward profitability in the not-too-distant future.

* * * * *

Investments

Alleghany's equity portfolio returned 5.6% in 2014, well behind the return of the S&P 500 (13.7%) and the NYSE Composite (6.9%). Earlier in the year, we also made a large allocation to treasury strips, which added our fixed income investment returns in the first half of the year. Our equity portfolio consists of 20-30 large capitalization, high quality companies that are likely to produce attractive long-term returns with a low risk of a permanent loss of capital. Strong returns from some of our large positions in technology and health care were offset by weak returns on consumer discretionary, energy, and industrial holdings.

For the past five years or so, financial markets have "walked a tightrope" between inflationary and deflationary pressures. In late 2014 and early 2015, it appeared that deflation has become the dominant force. We see evidence of "good deflation" in the U.S., brought on by technological change and innovation, but outside of the U.S. there appears to be great risk of "bad deflation" – excessive leverage, credit problems, mal-investment, and so on. Against this backdrop the U.S. stock market appears to be fully- if not over- valued, especially considering the fact that many companies are producing little revenue growth and continue to enjoy record profit margins. Equities appear to offer attractive returns only in comparison to the sub-2% interest rates offered on U.S. government bonds. We worry also that many large capitalization equities are in a self-perpetuating levitation cycle due to the dramatic shift of investment fund flows into passive investment strategies and the reduction in active management flows since the 2008 financial crisis.

Financial markets are floating on a sea of liquidity provided predominantly by the U.S. Federal Reserve. Large scale asset purchases by central banks have offset the deflationary pressures endemic to a highly leveraged world economy. The question on most investors' minds has been "what will happen when the Fed unwinds its Quantitative Easing initiatives?"

As the money printing baton is passed from the U.S. Federal Reserve to foreign central banks and monetary authorities, the U.S. dollar has appreciated against the Yen and the Euro. Whether or not this will continue depends upon U.S. economic growth in 2015 as compared to current growth expectations. Since the financial crisis, the Fed's balance sheet has expanded from $900 billion to $4.5 trillion; this appears to have prevented the U.S. from entering an outright deflationary bust, but may have made economic conditions in Japan and the Eurozone worse due to a weaker U.S. dollar. Now these countries are firing up their own asset purchase programs. A strengthening dollar (weakening Yen and Euro) may help foreign economies, but it will put increasing pressure on emerging market economies that have borrowed in U.S. dollars. According to the Bank for International Settlements, there is approximately $9 trillion of non-financial U.S. dollar debt outside of the U.S. Some foreign entities that have borrowed in dollars will likely experience severe financial stress due to dollar appreciation. Moreover, the collapse in oil prices adds to international financial stress as fewer dollars – up to $1.5 trillion on an annual basis – are sent into the world economy (a function of lower prices and fewer oil imports). There is a significant risk, in our view, that the economic consequences of a stronger dollar may be greater than the benefits to the U.S. consumer which – when all is said and done – accounts for less than 20% of the world economy. As one investment strategist noted, if oil prices stay where they are now, it is equivalent to the average middle class family getting a 1.5% raise.[6] As another of our advisors recently reminded us, declining oil prices represent a transfer of wealth – not an increase in wealth – but mostly from "bad guys" to "good guys."[7]

Economist Paul Kasriel of Econtrarian, LLC has shown that the growth rate in "thin-air credit" – a reference to money that is created out of "thin air" through central bank and commercial bank credit expansion – is bound to slow in 2015 as the Fed's balance sheet stops growing. Most of this money creation has found its way into asset prices, so slower growth in central and commercial bank credit is likely to contribute to a more difficult investment environment.

We continue to make investment decisions based on a macro view that starts with the recognition that the advanced economies remain highly leveraged in the aggregate and that the world economy suffers from inadequate demand. There are many factors contributing to this state of affairs, including demographics (low OECD population growth and aging populations), technology improving productivity but eliminating jobs, income inequality, and most importantly, continuing high levels of financial leverage among a large percentage of households. Despite over five years of central

[6] Michael Goldstein, Empirical Research Partners, "The U.S. Consumer: Research and Results January 2015."
[7] Charles Gave of GavKal Dragonomics.

bank money printing, the amount of non-financial debt in the U.S. as a percentage of GDP remains higher than it was before the financial crisis. This suggests to us that we have reached the end game of economic growth through credit expansion.

If mature economies can't grow through debt expansion, and if aggregate demand remains soft due to weak income growth, then it is hard to see the prospect for a strong global economy. And let's not forget about China, which is beginning the process of transitioning from an investment-led economy to a more balanced economy with a higher amount of domestic consumption. Such transitions are rarely quick or smooth.

Energy Markets in Turmoil

The Thanksgiving Massacre in oil prices – following OPEC's late-November announcement to maintain production quotas in the face of an apparent global supply/demand imbalance of over one million barrels per day (bpd) – continued through December and into early 2015. Although the imbalance is relatively small in relation to projected consumption of roughly 93 million bpd, it has been enough to cause oil prices to go into a free fall. Oil production is a high fixed cost business and as a result, a supply/demand imbalance can (and does) cause prices to fall rapidly toward marginal costs, which are a small portion of total costs for most of the supply curve.

In our opinion, the collapse in oil prices was caused by three factors. First, the approximately 50% increase in U.S. production over the past three years, together with a recovery in Libyan production, contributed to excess supply. Second, central bank policies have contributed to a stronger U.S. dollar, which is fundamentally deflationary. Finally, and we will never know for sure, Saudi Arabia's decision to continue to produce over nine million bpd in the face of excess world supply may in part have geopolitical objectives. In any event, the combination has created a situation in which oil prices are now at levels that make new sources of high cost supply (deep water, oil sands, the Arctic, and less productive shale plays) uneconomic.

This is a serious long-term issue, because although the shale revolution has, for now, resulted in excess oil supply, this condition may not persist for any great length of time. The International Energy Agency projects that worldwide oil demand will rise by over 10 million bpd over the next 25 years. The only way that world oil producers can increase production by this amount is through significant ongoing capital investment. However, much of the marginal supply of oil is uneconomic at current prices.

The cost of energy acts as a governor (in the sense of a device limiting the speed of a machine) on world GDP growth. With abundant cheap energy, the natural growth rate

of an economy is higher. Excessive leverage in the world economy makes the whole situation potentially more volatile. Our best guess (and it is only a guess) is that in time, oil prices will recover to a price that is supported by most of the supply cost curve. 2015 will probably be a year of capacity contraction in the oil industry, to be followed by a recovery in future years, barring a collapse in global economic activity.

This of course is not the first time the energy industry has experienced this kind of volatility. Each time the industry has seen a collapse in prices, it has caused a reduction in capacity (with a lag) and ultimately a price recovery. Often the collapses last for the greater part of a decade. If we mark 2008 as the most recent peak in prices, we are now in the seventh year of the correction. Over the past eleven years, with the exception of 2008, global oil consumption has increased each and every year, averaging slightly over 1% growth per year. A 1% increase in global oil consumption, without any supply increases, will correct the current supply/demand imbalance in a little over a year. It is for this reason that absent a global recession – which seems unlikely at this point – oil prices are likely in our view to rebound to levels that will support some higher cost capacity within the next couple of years. If we had to guess, we would say $70-$80/bbl is a reasonable target.

What does this mean for Alleghany? In our public equity portfolio, our energy exposure was slightly over $300 million at the end of 2014, or about 4% of our consolidated stockholders' equity. Some of this exposure relates to natural gas infrastructure, where equity returns are only loosely correlated with oil prices.

Our private portfolio includes two energy investments – ORX, which is relatively small, and Stranded Oil, which is larger. In the case of ORX, the collapse in oil prices is likely to delay some of the company's projects. With regard to Stranded Oil, we believe that the changed energy environment could prove to be a net positive for this investment. The price of resource opportunities is likely to fall (and availability is likely to increase), and we do not expect the company to begin significant amounts of production until late 2015 and continuing into 2016, when oil prices could well be higher. Even at current oil prices, we believe that Stranded Oil's projects can generate attractive returns on capital under expected production scenarios.

Alleghany Capital Corporation

ACC oversees our private capital investments in non-financial companies. Our strategy is to provide capital to family-owned businesses where management and ownership is aligned and the owner-managers are seeking long-term, patient capital. In addition, ACC makes growth capital investments in more speculative ventures where we believe entrepreneurs have a high-return opportunity that requires capital and operating support. A brief update on each of ACC's major investments is shown below:

- **Bourn & Koch** is a Rockford, Illinois-based manufacturer and remanufacturer / retrofitter of precision machine tools. The company also has a profitable replacement parts business for legacy machine tool products that produces consistent profits throughout the economic cycle. Alleghany purchased an 80% interest in Bourn & Koch in April 2012, for approximately $55 million[8]. The company's performance since our acquisition has been in line with expectations. In 2014, Bourn & Koch saw a slowdown in shipments but an increase in order backlog which augers well for improved results going forward. At the end of 2014, our net investment in Bourn & Koch was $42 million.

- **Kentucky Trailer** is the leading manufacturer of custom trailer and truck bodies for the moving and storage industry and other niche markets. At the end of 2014, Alleghany owned approximately 80% of the common equity of Kentucky Trailer. In 2014 Kentucky Trailer completed two tuck-in acquisitions, expanding their mobile medical trailer manufacturing capability and broadening their service capabilities. This is a good example of how ACC can add value to its portfolio companies by assisting them in executing transactions. Our cumulative investment in Kentucky Trailer is approximately $44 million.

- **Jazwares** is a Sunrise, Florida-based toy licensing company founded by Judd Zebersky. ACC acquired a 30% interest in the company in July, 2014. Jazwares is a highly creative and innovative company at the forefront of using technology and new media to disrupt the established toy industry. We acquired our interest for approximately $60 million. The company showed very strong growth in 2014.

In 2014, Bourn & Koch, Kentucky Trailer, and Jazwares, together, produced total earnings before income taxes of $13 million, and EBITDA (excluding acquisition

[8] The $55 million purchase price included an estimated contingent consideration of $8.0 million based on future profitability.

accounting charges), or “Adjusted EBITDA[9],” of $24 million (our share), assuming our investment in Jazwares was made at the beginning of the year.

- **Stranded Oil** was formed in 2011 to acquire legacy oil fields and apply innovative enhanced oil recovery techniques. In 2014, Stranded Oil completed the construction of its first major underground oil recovery facility in Fredonia, Kansas, and expects to begin modest amounts of oil production from this project in 2015. In addition, Stranded Oil continues to acquire additional resource opportunities that will support additional oil recovery projects in other locations. We have an economic interest of approximately 80% of Stranded Oil, and have invested approximately $156 million in the company as of the end of 2014. In 2014, Stranded Oil had negative EBITDA of $15 million, as start-up costs exceeded a small amount of revenues from legacy oil production.

- **ORX** is a Louisiana-based oil and gas exploration company in which Alleghany owns an approximate 40% interest. The company has secured and developed a number of on-shore, sub-salt oil and gas resource opportunities called “the Louisiana Heritage Play.” We carry ORX at $32 million.

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Outlook

The year just passed marked my tenth year as CEO of Alleghany Corporation. Over the past decade, we have compounded our book value per share at almost 9% per year, at the upper end of our stated objective of 7-10% annual growth over the long-term. This period has included a major financial crisis (when a number of financial institutions suffered a permanent capital loss), as well as a number of significant natural catastrophes that challenged our insurance business. We have accomplished the above from a starting point of having the majority of our capital in passive investments, and while being a U.S. taxpayer.

Following the transformational acquisition of TransRe in 2012, our capital is now for the most part, fully-employed. We have a modest amount of capital invested in ACC businesses which have the potential to produce very attractive returns over time, but to this point have largely been in an investment phase. Moreover, GAAP accounting is somewhat unfriendly to these investments, as purchase accounting requires us to write-

[9] Refer to “Comment on Non-GAAP Financial Measures” at the end of the Letter for further information concerning Adjusted EBITDA.

up the value of acquired assets and amortizes intangibles after acquisition. In the case of Stranded Oil, we have been in an investment phase for the past two years, with operating expenses for this investment mostly offsetting the earnings of the other ACC business. This relationship should begin to change in 2015 and beyond.

The vast majority of our capital is invested in two high-performing businesses (TransRe and RSUI), and while each of them will face their respective competitive challenges, we are confident that they are positioned to navigate the future successfully.

Yours sincerely,

Weston M. Hicks
President

Comment on Non-GAAP Financial Measures

Our analysis of our financial condition and results of operations is based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States, or "GAAP." Our results of operations have been presented in the way that we believe will be the most meaningful and useful to investors, analysts, rating agencies and others who use financial information in evaluating our performance. This presentation includes the use of adjusted earnings before interest, taxes, depreciation and amortization expense, or "Adjusted EBITDA," which is a "non-GAAP financial measure" for certain of our non-insurance operating subsidiaries and investments, as such term is defined in Item 10(e) of Regulation S-K promulgated by the SEC. Adjusted EBITDA represents other income less certain other expenses, and does not include: (1) depreciation expense; (2) amortization of intangible assets; (3) interest expense; (4) certain acquisition accounting impacts; (5) certain adjustments related to our investment in Jazwares; (6) net investment income; (7) net realized capital gains; and (8) other than temporary impairment. We use Adjusted EBITDA as a supplement to earnings before income taxes, the most comparable GAAP financial measure, to evaluate the performance of certain of our non-insurance operating subsidiaries and investments, and believe that Adjusted EBITDA provides useful additional information to investors regarding performance. A reconciliation of Adjusted EBITDA to earnings before income taxes is provided below for 2014.

	Corporate Activities	Total Segments	Consolidated
		(in millions)	
Revenues (expenses) for Corporate Activities:			
Adjusted EBITDA for Bourn & Koch, Kentucky Trailer and Alleghany's investment in Jazwares, combined	$ 23.7		
Add: depreciation expense for Bourn & Koch and Kentucky Trailer (a component of other operating expense)	(3.5)		
Add: amortization of intangible assets for Bourn & Koch and Kentucky Trailer	(0.3)		
Add: interest expense for Bourn & Koch and Kentucky Trailer	(0.7)		
Add: acquisition accounting impacts for Bourn & Koch and Kentucky Trailer[1]	(3.5)		
Add: earnings before taxes attributable to noncontrolling interest for Bourn & Koch and Kentucky Trailer	2.7		
Deduct: adjustments to equity in earnings of Jazwares[2]	(5.8)		
Subtotal, earnings before incomes taxes of Bourn & Koch, Kentucky Trailer and equity in Jazwares' earnings	12.6		
Add: interest expense for all other entities within corporate activities	(42.5)		
Add: corporate administration	(45.8)		
Add: other income (losses)[3]	(6.1)		
Subtotal, earnings before incomes taxes of corporate activities	(81.8)		$ (81.8)
Revenues (expenses) for Reinsurance and Insurance Segments:			
Net premiums earned	—	$ 4,410.6	
Net investment income	—	448.9	
Net realized capital gains	—	230.0	
Other than temporary impairment losses	—	(36.3)	
Other income	—	4.0	
Net loss and loss adjustment expenses	—	(2,494.5)	
Commissions, brokerage and other underwriting expenses	—	(1,421.3)	
Other operating expenses	—	(85.7)	
Corporate administration	—	(1.3)	
Amortization of intangible assets	—	6.1	
Interest expense	—	(46.8)	
Subtotal, earnings before incomes taxes of total segments	—	1,013.7	1,013.7
Earnings before income taxes	$(81.8)	$ 1,013.7	$ 931.9

(1) Reflects the increase in the cost of goods sold arising from the valuation of inventory at fair value as of the acquisition date.
(2) Reflects the removal of Alleghany's portion of Jazwares' Adjusted EBITDA prior to Alleghany's investment on July 31, 2014, and adjustments for depreciation, amortization and interest expense.
(3) Includes other revenues less other operating expenses, amortization of intangible assets and interest expense associated with Alleghany Properties and Alleghany Capital Corporation's other private capital investments and subsidiaries, including Stranded Oil, among others, and investment activity for Alleghany Corporation.