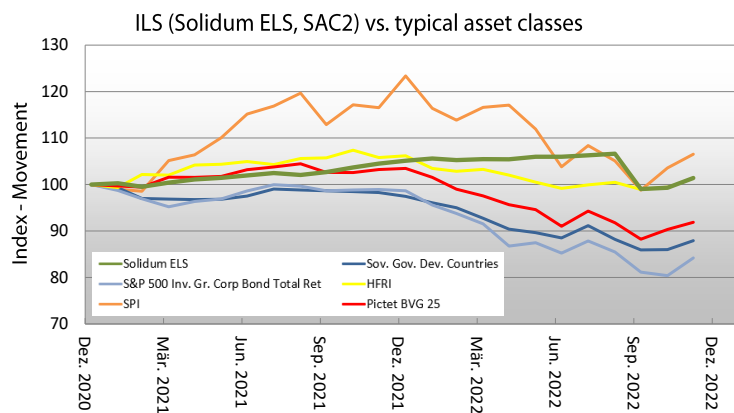


## Insurance Linked Securities – Market Update December 2022

The year 2022 continues to be a challenging one for investors. With the Covid crisis having affected mainly Europe and the USA in the beginning, this year China sent whole cities into a strict lockdown, with severe impacts on local economy and global supply chain flows. Russia's attack of the Ukraine increased global uncertainties and led to questions regarding energy security and pricing in Europe. Inflation rates are at long time highs, and central banks respond with rate increases that affect the high levels of liquidity to which the markets got addicted during the last decade.

In consequence the markets saw a general re-pricing of risk in nearly all areas. The elevated yield potential came at the price of painful devaluations in most asset classes. In this environment,

insurance linked securities held their value quite impressively, even though the new level of return expectations affected the cat bond market as well. The Swiss Re Global Cat Bond Price Index lost 3.64% over the first seven months of the year, and most ILS funds lagged behind initial return expectations. Still, compared to what was going on in other sectors, ILS proved their value as a stabilizing diversifier in a broader portfolio, as evidenced by the still positive performance until mid of September. ILS, being a form of 'market-neutral high-yield fixed income' investment, are generally interesting in an environment of elevated inflation, as they do not devalue with increasing interest rates due to their short duration, but pass the enhanced money market interest rates on to the investor.



*Insurance Linked Securities, as exemplified by the Solidum Event Linked Securities Fund, SAC Fund 2, performed with a high degree of independence during the turmoil of the markets in 2022.*

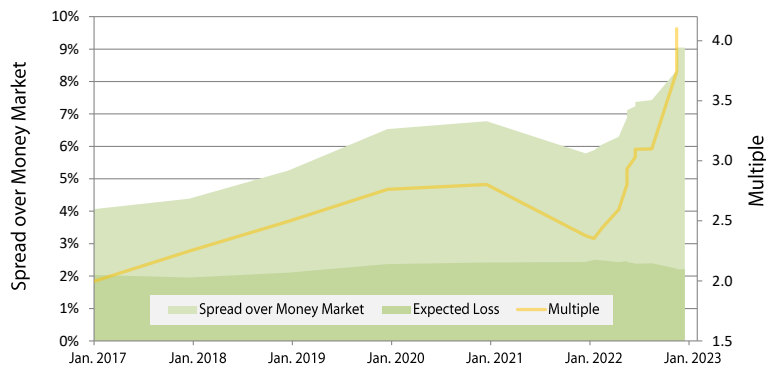
Insurance Linked Securities, as exemplified by the Solidum Event Linked Securities Fund, SAC Fund 2, performed with a high degree of independence during the turmoil of the markets in 2022.

The landfall of hurricane Ian during the last days of September unfortunately led to a loss for the ILS asset class as well. The graphic above shows that the impact was in the order of what the equity markets, too, lost during September. Two months on, the picture clears somewhat and recent reports point in the direction of an initial overreaction of the market to this event. However, the pricing of cat bonds still carries a significant 'fear' component related to Ian, and recoveries are behind what theory suggests and still lie in the future.

### Re-Pricing of Risk

The yield increase in the ILS market that materialised until Hurricane Ian improved the running yield of the cat bond market to the highest level since the end of the credit crisis in 2014. After a contraction of yields during the year 2021, the issue size-weighted spread to maturity (over money market, MM in the following) of the market rose by close to 30% until September 2022. As attractive as this sounds, the ILS market still stood in competition with other asset classes, of which the return expectations went up as well. It shall be emphasised, though, that the ILS market achieved such yield increases without i) the massive devaluations seen on other assets and ii) the enhanced risks that hide in the

unstable geopolitical situation and the general uncertainty of the economic environment which both have the potential of severely crashing the party in other asset classes.



*Spread of the cat bond market: Based on mid-spreads over MM-rate, various pricing sources, issue weighted, exclusion of «pathological» cases and short maturities (<1y, seasonality effects)*

Hurricane Ian changed the picture again. The reinsurance market rapidly hardened further in the expectation of a significant undersupply of capacity. Bonds exposed to risk in Japan or Europe, completely unaffected by Ian, nearly doubled their yield, and a parallel movement is observed for US risks. As a consequence the average yield of the cat bond universe over MM increased further, as can be seen in the final spike of the market yield. The

multiple of the market, a simple measure of its attractiveness defined as the ratio of running yield to expected loss, rose from 3.1 to 4.1 due to this development.

A few early candidates of the 2023 renewals shall highlight this development. USAA, one of the the largest personal lines insurer in the US, brings a repeating offering to the market, issued always on November 30. The current class 3 tranche of the program pays a 10% coupon over MM. The identical layer of last year's vintage pays 5.18%. Allstate Insurance Company just sponsored a top-layer transaction covering the US excluding Florida, paying 6.25% over MM. Last year's bond, while being junior to the 2022 issuance, paid 3.25%. This bond has a modelled expected loss of 0.66%, bringing its multiple to 10. Such levels have not been seen in the market for probably a decade.

### Concluding Remarks

In 2022 a re-pricing of risk has taken place in most asset classes, and similarly so in the ILS market over the first three quarters of the year. As a consequence, future earning expectations rose globally. Contrary to other asset classes however, in which an increased level of risk can be perceived that is linked to the global situation of the economy, in the ILS market the underlying risks did not change, and the expansion of yields is not caused by running a higher uncertainty in the portfolio.

The occurrence of hurricane Ian gave an additional boost to this situation and increased the attractiveness of ILS further, above the level that was in line with other markets. The value proposition of ILS will be seen as the 2023 new year renewals will consolidate this picture.

With kind regards

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