Marketing material

April 2023

MARKET REVIEW

Cat bonds (insurance-linked securities)

April is typically a very busy month for new cat bond transactions as insurers and reinsurers are preparing their portfolios for the upcoming hurricane season. And this year, April proved indeed to be an extremely active months, with no less than eight new cat bond programs presented to investors, and a total issuance of close to USD 2bn of notional volume:

- Nakama Re – Series 2023-1 issued on behalf of Zenkyoren for Japan earthquake (USD 225m)
- Cape Lookout Re – Series 2023-1 issued on behalf of the North Carolina Insurance Underwriting Association (NCIUA) for hurricane events in the state of North Carolina (USD 350m)
- Gateway Re II – Series 2023-1 issued on behalf of Safe Port / Safe Choice Insurance for US hurricane in a defined number of states, yet excluding Florida (USD 125m)
- Alamo Re – Series 2023-1 issued on behalf of the Texas Windstorm Insurance Association (TWIA) for Texas hurricanes and severe thunderstorms (USD 500m)
- Ursa Re – Series 2023-1 issued on behalf of the California Earthquake Authority (CEA) for California earthquake (USD 200m)
- Purple Re – Series 2023-1 issued on behalf of Slide Insurance for Florida and South Carolina hurricane (USD 100m)
- Merna Re II – Series 2023-1/2 issued on behalf of State Farm Insurance for US hurricanes and earthquake (total of USD 550m across both tranches)
- First Coast Re IV –Series 2023-1 issued on behalf of Security First Insurance for US hurricanes (USD 100m)

Towards the end of April, several repeat sponsors such as the USAA (US Automobile Association) and Citizens Property Insurance Corporation of Florida approached the market and announced their 2023 cat bond placements. Whilst the marketing and placement phase for these deals was still ongoing at the writing of this report, we understand that the notional volume of these placements alone will be in excess of USD 500m. We therefore expect May to be an equally active month in the primary cat bond market.

Investor interest also seems to be returning, likely on the back of the attractive spread levels of the new placements. And, in the wake of this revived interest, the secondary market has also seen an increase in demand for outstanding bonds, and secondary market pricing on several deals has seen a healthy recovery. However, the market remains to be somewhat split between 'clean' cat bonds which are confirmed loss-free from the events of the previous year (such as hurricane Ian in September and the 'Christmas Blizzard' in December); such clean deals are trading at stable levels. However, a small handful of transactions issued on behalf of insurers that were exposed to these 2022 catastrophes continue to show a notable bid-ask spread required to compensate investors for the uncertainty around a potential pay-out. However, the sponsors of these deals are expected to release their updated loss reports soon, and the market will thus gain clarity around the actual loss levels. We would therefore expect for these volatilities to level out (and for some of these bonds to potentially show an improved price indication, subject to the ultimate loss levels).

Overall, the market continues to offer attractive yield levels and a fundamentally positive outlook.

Collateralized reinsurance investments (CRI)

In April, the Japanese insurance market has gone through its traditional contract renewal round. The Japanese market has been battered with a series of catastrophe events in the years 2018 and 2019, and has already gone through a fundamental de-risking and re-pricing following these events. As such, price levels are already at a (much) higher level compared to the period before 2018. And whilst Japan has not seen a significant event impact in 2022, the global 'harder' market environment also impacted the recent Japan renewal negotiations: Japanese reinsurance programs have seen further (albeit mild) premium increases, and most notably a general *improvement of terms and conditions*, such as the reduction of capacity offered for so-called 'aggregate' transactions and an increase in attachment levels, forcing Japanese carriers to retain more risk on their own balance sheet.

At LGT ILS, we were able to successfully renew and optimize our allocation to Japanese reinsurance programs, in line with our risk and capacity appetite. The attractive premium levels in Japan paired with the diversification benefits vis-à-vis US exposed transactions are supporting the running yield and portfolio composition for the CRI allocation within our portfolios.

Meanwhile, the market started to shift focus to the important renewal round of June and July, where US-based insurance companies, especially Florida carriers, buy reinsurance cover ahead of the US hurricane season. This year's June renewals promise to be interesting: Many reinsurance programs of domestic US carriers were affected by catastrophe events over the previous years; in addition, the inflation seen in the US over the last 18 months has led to increases in the total insured values, forcing US carriers to buy more protection compared to the previous year, to meet the regulatory capital requirements. In short, we expect for the demand for catastrophe risk capacity to remain strong, which is further stabilizing premium levels and likely leading to improved terms and conditions on individual transactions.

MAJOR EVENTS

- 31 March to 5 April: A widespread outbreak of severe convective weather affected multiple states in the Midwest of the United States. Storms generated several deadly tornadoes and strong wind gusts that claimed at least 37 lives, injured hundreds of others, and caused a notable material damage across the region. Additional damage

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was incurred due to widespread hail, non-tornadic winds and localized flooding as a result of isolated intense precipitation. Due to a widespread nature of the outbreak and severe structural damage from multiple tornadoes. Total economic and insured losses are likely in the hundreds of millions USD.

- 1 April: Just at the close of the 'official' part of the European windstorm season, which saw well below-average losses, a mid-sized windstorm affected parts of France, Germany, and Switzerland in early April. The event was named *Mathis* by Météo-France and resulted in notable losses for the insurance industry. The storm claimed two victims in France and led to multiple injuries in Switzerland due to an overturned train.
- 12 April: A historic rainfall event prompted major flash flooding in southern Florida, particularly in Fort Lauderdale. Severe flooding affected thousands of people and caused notable traffic disruptions.
- 13 April: Tropical Cyclone *Ilsa* made landfall over Australia's western coast as an equivalent to Cat 4 hurricane, setting a new record for hurricane-force winds in the region. Despite its strength, the storm did not generate notable material damage as it passed over a sparsely populated area.
- April (full month): Record-setting temperatures engulfed the Iberian Peninsula, particularly Spain, in mid to late April. The extremely warm weather further enhanced wildfire conditions, and Spain suffered from a series of such fires; at the writing of this report, close to 80,000 hectares were already destroyed. The weather led to severe drought conditions, causing massive insurance losses in the important agricultural sector.

FUND PERFORMANCE

April was a rather quiet month with regards to catastrophe activity, and none of the above listed event has notably affected the performance of our funds and mandates. As mentioned earlier in this report, the secondary market for cat bonds is starting to see a recovery and rebound after the strong market correction in Q4 2022, on the back of the revived investor interest. The improved price indications in the market had the corresponding positive impact to the performance of our funds and mandates. We are now expecting the current price levels to hold firm, and to show some recoveries as transactions are reaching their respective maturities ('pull-to-par effect').

The CRI allocation has delivered its seasonal share of the annual premium income, albeit the contribution to the overall performance is typically rather low in April.

Overall, we can thus report a positive performance in USD, in line with the long-term targets of our funds.

OUTLOOK

Market outlook

Despite the large number of new cat bonds presented in the primary market, all new deals were placed smoothly; this is a clear indication that investor demand is again increasing – likely on the back of the strong return outlook and the attractive characteristics of the asset class, with its low correlation to movements in the financial market, and the limited exposure to interest rates, inflation, and credit risk. We are expecting another series of new cat bond transactions presented to the market in May and June, before the industry will traditionally become quieter after the start of the hurricane season.

In the CRI market, the April renewals for Japan have presented investors with attractive conditions. The renewal round for the US and especially Florida is in full swing – and it is truly a seller's market, with reinsurers and ILS managers dictating terms, especially for programs which were loss affected over the previous years.

In short, market dynamics continue to present investors with favorable terms, and the outlook for the CRI market and the ILS market overall remains very positive.

Performance outlook

As stated in this report, the ILS market is showing attractive premium levels across all market segments, and we plan on fully deploying our capacity at the upcoming renewal, before the start of the hurricane season. The running yield and the anticipated premium income connected to the seasonality of hurricane risk is expected to result in strong return contributions as we are moving into the second half of the year.

We will continue to optimize the diversification and investment levels, both through allocations in cat bonds and an increased deal count in CRI allocations, in anticipation of the upcoming US hurricane season. Overall, we expect a steady, positive performance in the coming months – as always subject to the occurrence of any large insurance events.

Risk factors

Potential investors should carefully consider the product's risks as detailed in the Offering Memorandum. The risks related to alternative investments generally include, without limitation:

- **Event risks:** the event risk is a prominent feature of insurance-linked investments. This is in contrast to (corporate) bonds, where the risks are primarily dependent on the issuer quality. If an insured event occurs and the defined thresholds are exceeded, the value of an individual investment may be reduced substantially with the possibility of a total loss.
- **Model risks:** the event probability of occurrence of insurance-linked instruments is based on risk models. These models are constantly being revised and further improved and developed, but they necessarily only represent an approximation of reality. The results of these risk models may have uncertainty and errors. Consequently, event risks can be significantly under- or overestimated.
- **Default risks**: the product may enter into transactions with one or more counterparties. If a counterparty becomes insolvent, it may no longer be able to fulfil, in whole or in part, its obligations to the product.
- **Credit risks:** the product may invest part of its assets in debt securities or equivalent securities. The issuers of such securities may become insolvent which would cause the securities to lose all or a major part of their value.
- **Country risks**: the product may invest part of its assets in countries whose political, economic or social situation is uncertain. This can lead to unexpected developments, which may have a negative effect on the performance and/or liquidity of the investment.
- **Liquidity risks**: the product may invest part of its assets in financial instruments that are, by their nature, sufficiently liquid, but may drop to a relatively low level of liquidity under certain circumstances. It may prove difficult to find a buyer for such securities at short notice. This may increase the risk that the redemption of units will be suspended.
- **Valuation risks:** the product's investment exposure may include a large proportion of OTC instruments, which are subject to valuation risks. The lack of an active public market for securities and debt instruments as well as other investments held by the product pursuant to the investment restrictions will render the product's valuation process and net asset value calculation more difficult and subjective. Furthermore, the valuation of the relevant portfolio and the production of the net asset value calculation will be a complex process, which might in certain circumstances require certain assumptions in order to produce the desired output. Such assumptions may subsequently prove incorrect and require the value of certain positions to be adjusted as more information becomes available.

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