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Marketing material for professional/qualified investors only **25 March 2022**

Letter from the CIO – Current Market Situation

"Geopolitical tensions intensified in Eastern Europe, culminating with the invasion of Ukraine by Russia and the humanitarian crisis that followed. The fundamental strength of the insurance sector remains unchanged. Our view is supported by insurers' diversified exposures and robust capital positions."

Dr. Urs Ramseier
Founding Partner & Group CIO

The ongoing conflict in Ukraine has contributed to the current volatility in financial markets. Investors have been wondering about the potential losses for the insurance sector, and the consequences for the different asset classes managed by Twelve Capital. We are confident that insurers' direct exposures to Russia and Ukraine will have a minor impact for credit and equity investments and no consequences for our Cat Bond and Private ILS offering. Moreover, we believe that the current market dislocation represents an interesting entry point for investors.

Supporting our views is the fact that:

- Direct investments in Russian and Ukrainian assets are typically modest (at worst, a mid-single digit percentage of shareholders' equity) given insurers' conservative asset allocations.
- Western groups' insurance subsidiaries in Russia and Ukraine are typically small relative to the size of their parent. We would assume in most case a wind-down of these businesses with modest repercussions.
- Insurance lines of business that could face losses include political risk covers, cyber, aviation and cargo. We expect to see some losses albeit these will likely represent an earnings' event rather than materially erode capital. These potential losses should be concentrated at Lloyds insurers and global reinsurers.

Secondary effects of the ongoing conflict include inflationary pressures driven by the higher commodities prices. While the impact of inflation is generally manageable for shorter-duration insurance lines (such as motor damage or property), expectations of non-transitory inflation have contributed to higher interest rates that, in turn, had negatively affected bond prices.

Insurance Credit

Twelve Capital believes that Insurance Bonds play an important diversification role in fixed income portfolios while generating an attractive and dependable income for investors.

The creditworthiness of the insurance sector remains strong. The issuers under our coverage hold, on average, twice as much capital than what is needed to cover their regulatory requirements. This supports investment grade ratings for 95% of outstanding Insurance Bonds. Moreover, the sector has a long-term track record of navigating well across challenging macro and geopolitical backdrops, while showing default rates amongst the lowest in the debt markets.

However, increasing interest rates and geopolitical tensions have translated in negative performance for Insurance Bonds in the first quarter of 2022, similarly to what happened for the broader corporate markets.

The current market dislocation and attractive spreads present an interesting opportunity for investor to start or to increase their allocation to Insurance Bonds. Moreover, we highlight that the sector's creditworthiness is positively correlated to higher interest rates, as these translate into higher solvency excess capital and earnings generation.

Insurance Equity

Twelve Capital currently considers any potential downside on insurance stocks to be limited compared to the broader financial markets. Valuations for the sector remain compelling, underpinned by average price/earnings ratio (P/E) well below the long-term average since the financial crisis. Moreover, strong balance sheets and cash flows support not only sustainable dividend yields, but also incremental capital returns to shareholders.

Investors are now able to discount the fact the Federal Reserve and other Central Banks have begun their rate hiking cycle. Investors' focus on fundamentals is likely to return and notably earnings estimates for insurers are still rising since the beginning of the year.

We believe the market is leaning/pricing towards a favourable outcome for the conflict in Ukraine, such as a cease fire, although no developments suggest an end is now in sight. This is attested by the SXIP[1] being slightly up year-to-date (as at 23.03.2022). Still, solid fundamentals for insurance are likely to lead to continued resilience during any further periods of Equity market volatility.

Insurance-Linked Securities

Cat Bonds and Private ILS transactions have performed well in the current environment. The favourable pricing conditions for new deals continue and the ILS market demonstrates again its low correlation to financial markets. The primary market continues to be active, with the vast majority of recent transactions focused again on US peak perils. Pricing continues to be attractive and more supply is expected until at least the middle of the second quarter.

This stronger than expected new issue activity, together with strong FX movements, have facilitated the deployment of new capital compared to what is typically observable at this time of the year, while lowering cash levels for Cat Bond managers.

The selling activity in the secondary market has also led to some weakness in pricing. As a result, the Twelve UCITS Cat Bond strategies now exhibit a spread of almost 550bps above money market. This is a material increase of almost 80bps from just a few weeks ago.

We expect these market conditions to be temporary and they represent a rare chance to deploy larger capital amounts within a short period of time. This could represent one of the best entry opportunities into the Cat Bond asset class that we have seen in many years.

[1] This index has a fixed number of 600 components representing large, mid and small capitalisation companies among 17 European countries, covering approximately 90% of the free-float market capitalisation of the European stock market (not limited to the Eurozone).

Strategy Portfolio – Twelve Capital

Traditional Strategies

Alternative Strategies

Debt		Insurance-Linked Securities (ILS)		Equity		
Insurance Bonds (UCITS)	Insurance Enhanced Credit (SICAV-SIF)	Cat Bonds (UCITS)	Private ILS (SICAV-SIF)	Private Equity (InsurTech) (tbc)	Climate Sustainability (UCITS)	Insurance Equities (Multi-Asset)

Multi-Asset Strategies (UCITS and Mandates)		
Insurance Bonds	Cat Bonds	Insurance Equities

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About Twelve Capital

Twelve Capital is an independent investment manager specialising in insurance investments for institutional clients. Its investment expertise covers the entire balance sheet, including Insurance Bonds, Insurance Private Debt, Catastrophe Bonds, Private Insurance-Linked Securities and Equity. It also composes portfolios of its Best Ideas. It was founded in October 2010 and is majority-owned by its employees. It has offices in Zurich, London and Munich.

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