VALUES WORTH SHARING

Investorama

Trends and developments
in the financial markets

Edition 3/2021

Risk factors

Prior to investing, investors should carefully consider the risks associated as detailed in the offering document. The value of an investment can fall and the originally invested amount may never be recovered. Investors should consider the following risks, without limitation:

- Market risk: The risk of losses in positions arising from movements in market prices.
- Currency risk: The risk of losses arising from currency fluctuations, in case the currency of an investment is different from the investor's reference currency.
- Liquidity risks: Adverse effects created by the situation where the fund must sell assets where insufficient market demand exists and lower price levels must be accepted to execute a transaction.
- Operational risks: The fund may suffer losses as a result of insufficient internal processes or systems, misbehavior of employees or external circumstances.
- Political and legal risks: Investments are exposed to changes in the rules and standards applied by the country under the respective jurisdiction. This includes restrictions on currency convertibility, the imposition of taxes or transaction controls, limitations on property rights or other legal risks. Investments in less developed financial markets may expose the fund to increased operational-, legal- and political risk.
- Derivative risk: The risk of losses arising from the usage of derivatives, which can be highly sensitive to price movements of the underlying asset and can result in increased leverage.
- Credit risks: Risk characterized by the failure of counterparties to meet contractual financial obligations.
- Master-Feeder risks: The performance of the Fund may deviate from the performance of the Master-Fund.

Contents

The armed robber as a sentiment killer

Concerns about inflation have increasingly been dominating the headlines in the financial press again recently. In a recent Bank of America Merrill Lynch survey, 35% of respondents ranked higher-than-expected inflation as the top threat to financial markets. Why is the fear of increasing prices so great?

Economic theory provides us with an answer: loss aversion. Loss aversion implies that most people lack the rationality that any economist should have. People usually and irrationally have stronger feelings when they lose something than when they gain the same thing. The pain of losing 1000 Swiss francs will therefore outweigh the joy of gaining the same amount of money. Even an annual inflation rate of the 2% targeted by the central banks is enough to halve the purchasing power of money every 35 years. Former US President Ronald Reagan therefore considered inflation to be "as frightening as an armed robber". In other words, fear of inflation has recently become a potential killer of upbeat sentiment in financial markets.

> "For example, all the major emerging markets are now integrated into the global economy, which means that one driving force behind the long-standing disinflation will no longer figure in the future."

Paul Volcker, the very tall chairman of the US Federal Reserve in the Reagan era and an inflation-tamer in the early 1980s, successfully fought inflation, which was rampant at the time, with massive interest rate hikes. The Volcker shock ushered in a decades-long period of falling inflation rates and less pronounced real economic shocks. Expectations have long since been adjusted accordingly, and year after year the proportion of the population that has grown up in an environment free of inflation worries has been growing. However, the fact that inflation has been in steady retreat since the 1980s is not solely attributable to the Volcker shock but also to a number of structural supply-side developments. The integration of Eastern Europe, China, and other emerging economies into

the world trading system expanded the global labor force by about one billion workers in the 1990s almost overnight. Combined with labor market reforms in industrialized countries, the decline in the clout of trade unions, and the spread of new technologies in general, this has created downward pressure on the prices of labor, goods, and services in large parts of the global economy. Moreover, the period was marked by a retreat of the state through privatization and deregulation. While technologization continues to gain ground and has even received a strong boost from the recent crisis, other disinflationary forces are weakening. For example, all major emerging markets are now integrated into the global economy, which means that one factor driving the long-standing disinflation will no longer figure in the future. On the contrary, in recent years the pace of globalization of ever longer value chains has actually slowed and the pendulum may even have swung back. Moreover, national states are once again increasingly taking action ("big government").

> "The collective experience of prolonged periods of low inflation caused the dangers of inflation to be insidiously forgotten, leading to ever more rash and ultimately entirely reckless financial behavior on the part of state institutions."

All this does not per se point to an increase in inflationary pressures, but the structural forces driving ever cheaper prices have weakened. Moreover, a look further back into the past shows that phases of low inflation or even deflation have been followed by longer periods of high inflation. Obviously, there were specific reasons for each of these episodes. These include the monetization of government deficits from war financing, the destruction of production capacity during wars, or the shying away from the political and social consequences of anti-inflationary measures. Often, the change between these phases was also associated with a change in monetary policy regimes, such as the introduction or abandonment of the gold standard or Bretton Woods. In the end, however, it was also the collective experience of prolonged periods of low inflation that made people gradually forget about the dangers of inflation and led to increasingly rash and ultimately completely reckless financial behavior on the part of state institutions. Today, for example, the increasingly unholy alliance between central banks and governments, as well as initial tendencies towards a softening of inflation targets, harbor long-term inflation risks.

The risk of higher and economically damaging inflation should therefore prompt prudent investors to take inflation scenarios into account in their investment decisions. For example, adding gold or inflation-linked bonds helps to diversify the portfolio. Inflation-linked bonds are securities whose payouts are effectively linked to consumer prices and therefore provide protection against inflation risks. They also offer higher expected returns than nominal bonds in future scenarios with rising inflation expectations. In general, adding gold and inflation-linked bonds to an investment portfolio improves robustness and keeps inflation as a sentiment killer at bay.

Marcel Dillier
Co-Head Key Account Management

Recession gone, pandemic overcome?

Dr Alex Durrer

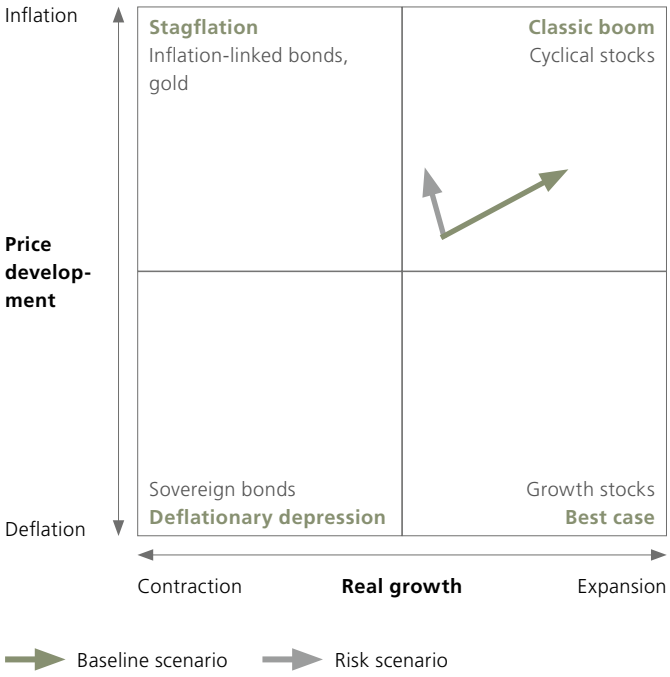
What one year ago would have been considered a bold hope or a best-case scenario has become a welcome state of affairs. For a large part of the global economy, the coronavirus recession is now history. Occurring after the imposed narcotization of social life, it has gone down in history as the most severe recession of all time, but also the shortest thanks to huge monetary rescue injections. Despite the V-shaped recovery, the vexed issue of the coronavirus pandemic will continue, however, to affect financial markets for some time to come. The reason for this is that infection rate trends remain unpredictable, and the causal relationships between epidemiological variables and political decisions are complex.

There is a contrasting picture in the economic outlook. A strong catch-up boom is emerging in many regions. China has all but overcome the pandemic and is "back on track" in terms of economic growth. In the US, the economy is being revved up to full speed with government infrastructure programs, a fact vouched for not least by Treasury Secretary and former Federal Reserve Chairwoman Janet Yellen. Only in Europe is the return to the previous trend growth still somewhat further in the future. Nevertheless, this has not prevented any of the affected exchanges from drawing a perfect V – which does not seem irrational given the still extremely low interest rates across the maturity spectrum, where even income accruing in the very distant future is discounted.

In line with cyclical trends, inflation, until recently hardly imaginable, is once again becoming an issue: In lockstep with the recovery (which has progressed to varying degrees in different regions), the combination of supply-side restrictions (keyword: de-globalization) and a resurgence in demand is increasing price pressure. It remains to be seen how temporary this phenomenon – often downplayed as an "inflation hump" – really is. The break-even inflation rates, currently at the upper edge of their long-term sideways band, have not provided a conclusive answer yet. Nonetheless, all major central banks are far from seeking monetary normalization; on the contrary, coronavirus may even serve as a welcome excuse to perpetuate a policy that was thought up a long while ago.

In our main scenario, the strong recovery will remain intact. Nevertheless, there is no end in sight to the biggest fiscal and monetary stimulus in history. In view of this situation, we recommend a tactical positioning with a slightly above-average equity component, combined with a substantial gold position.

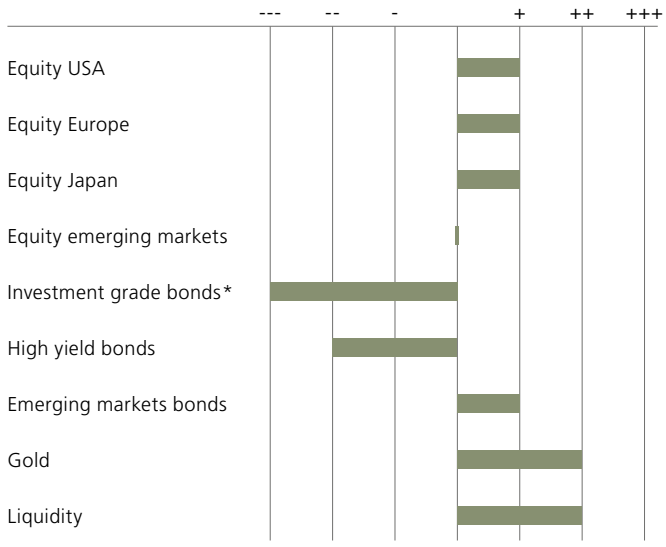
Global macroeconomic landscape*



* The macroeconomic landscape has a time horizon of 3-6 months

Source: LGT

Overview investment policy as per June 28, 2021



* Includes global government, inflation-linked, and corporate bonds

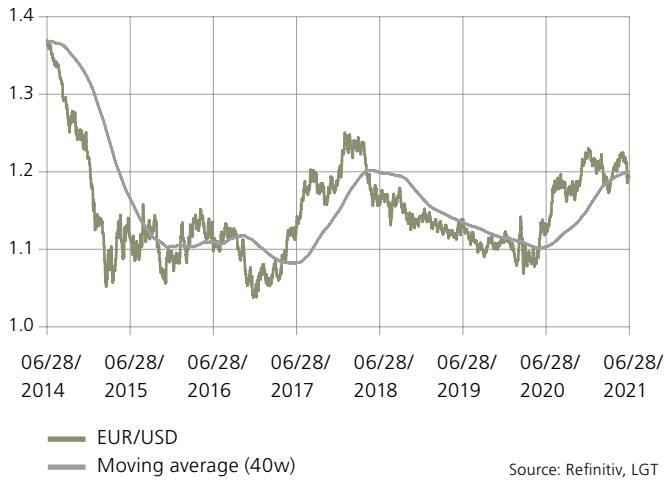
EUR/USD: premature swan song for the US dollar

Johannes Oehri

The euro has gained strongly against the US dollar since the low point of the pandemic. At the same time, there have been ever more prophecies of doom, suggesting that the enormous expansion of money supply and the record high twin deficits would lead to an even stronger devaluation of the greenback. But, once again, it is premature to talk of the swan song for the US dollar. In fact, it should appreciate again against the euro over the course of the year.

The US economy has already largely recovered from the pandemic and is posting the strongest momentum among the major currency areas. Nevertheless, the Biden administration continues to be extremely generous. Therefore, the recent sharp rise in inflation is unlikely to be entirely temporary. This is in stark contrast to the eurozone, where production factors will continue to be underutilized for some time despite the economic upswing. Inflationary pressures will therefore be low. Thanks to the recently softened inflation target, the US monetary watchdog will be able to stand calmly by and watch higher inflation for a little longer. But the time when the central bank will have to take its foot off the accelerator is approaching faster on the other side of the Atlantic than on this side. This is not least because the European Central Bank will continue to shield the finance ministers of the highly indebted euro countries from the disciplinary pressure of the markets. US government bond yields should therefore continue to rise faster than those in the euro area, something which should benefit the US dollar. ◆

EUR/USD



Source: Refinitiv, LGT

Overview of currencies as per June 28, 2021

Currencies	Exchange rate	Year-to-date	Medium-term trend	Comment
EUR-USD	1.19	-2.5%	↘	The ECB, dominated by doves, will not tighten the monetary reins for a long time
GBP-USD	1.39	1.6%	↗	Brexit doom and gloom seems to have been overcome
USD-JPY	110.63	7.1%	→	Kuroda's BoJ likely to rank among last to seek normalization
USD-CHF	0.92	4.0%	↗	Fed's thinking about policy normalization strengthens the greenback
AUD-USD	0.76	-1.9%	→	The AUD has moved away from "down under", but remains trapped in a sideways trend
USD-CAD	1.23	-3.2%	↘	The rise in commodity prices helped the loonie to new heights
USD-SGD	1.34	1.6%	↘	SGD bulls continue to struggle to recapture the support at 1.32
USD-KRW	1130.25	4.0%	↘	KRW shows weakness and provides positive impetus for the export economy
USD-CNY	6.46	-1.3%	↘	The appreciation trend in the CNY remains intact
USD-MXN	19.78	-0.7%	→	MXN remains in search for a clear direction, but benefits from cyclical tailwinds
USD-RUB	72.20	-2.4%	→	The energy complex remains an important pillar of support for the RUB
EUR-CHF	1.10	1.4%	→	Expansionary fiscal policy and the ultra-loose ECB prevent a significant EUR appreciation
EUR-SEK	10.16	1.1%	↘	Rising global demand is likely to create upward pressure on the SEK
EUR-NOK	10.18	-2.9%	↘	A positive growth outlook and a hawkish Norges Bank support the NOK

Government bonds: Inflation – here to stay?

Ewald Duer

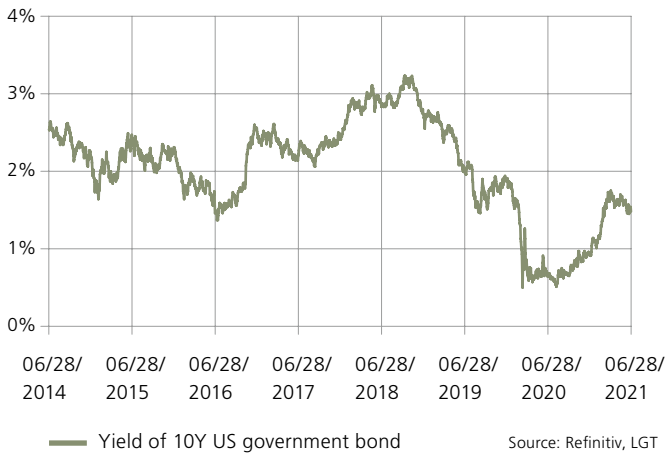
The fact that inflation is rising should hardly come as any surprise. After consumers' coronavirus-induced "restraint", there is now some pent-up demand. With commodity prices also surging, rising prices are almost inevitable. In Germany, inflation is likely to rise to over 3% this year and in the US to over 5% even. Structural changes such as the probable tax increases after the German federal elections, demographic trends, increasing de-globalization, and protectionism are also weighing on prices.

Yet, the ECB and Fed, etc. are never tired of calling the rise in inflation only temporary and are continuing to flood the markets with billions. This is a clear break from earlier times, when central banks reacted sharply and prophylactically to even the slightest threat of inflation. Criticism is growing louder that central banks are independent on paper only. Indeed, the politicization of monetary policy and fiscal dominance have increased markedly. At the ECB, the posts of President (Christine Lagarde) and Vice-president (Luis de Guindos) have been filled by former politicians. Fed Chairman Jerome Powell also used to work at the Treasury Department. And his predecessor at the Fed – Janet Yellen – was appointed US Treasury Secretary. So, accusations of political influence cannot be dismissed out of hand.

For big-spending governments, central banks have mutated into saviors and a life-long source of money. For example, ECB President Christine Lagarde recently confirmed that, despite an improving economic outlook and rising consumer prices, purchases under her multi-billion-dollar PEPP crisis bond-buying program will continue to be more extensive than at the beginning of the year. The central bank had already significantly increased the pace of purchases in the spring compared with the early months of the year. The ECB is already financing the euro countries' entire new debt with its money creation. The monetary guardians want to (completely officially) prevent funding conditions for companies and countries from becoming more expensive (e.g. the yield on the five-year Greek government bonds rated BB speculative was in fact negative for the first time in June 2021).

At the moment, we are still in an uncertain situation. We do not know whether the specter of inflation will soon disappear – but neither do the central banks. In any case, given the continuing economic recovery such a monetary policy increases the risk of inflationary dynamics persisting.

Yield of US government bonds



Overview policy rates and yields on 10y government bonds as per June 28, 2021

Economy	Policy rate	Trend	Comment	10y yield	Trend	Comment
USA	0.125%	→	No rate increase in foreseeable future	1.48%	↗	Rising inflation dominates events
Eurozone (DE)	0.00%	→	No rate increase in foreseeable future	-0.23%	→	Unchanged loose ECB helps to keep yields low
Japan	-0.10%	→	No rate increase in foreseeable future	0.05%	→	Kuroda buys and supports Nippon's bonds
UK	0.10%	→	No rate increase in foreseeable future	0.76%	→	Struggling to break away from the sideways trend
Switzerland	-0.75%	→	No rate increase in foreseeable future	-0.19%	→	Swiss yields remain negative but in demand
Brazil	4.25%	↗	Gradual tightening	9.11%	↗	Remains on a northward course
China	3.85%	→	No rate increase in foreseeable future	3.10%	→	Positive but slowing growth

Inflation-linked bonds: From base effect to reopening impact

Dieter Gassner

Global inflation data continues to exceed expectations. In the US, May consumer prices rose sharply for the second month in a row. Year on year, the increase is 5% and marks the highest level since 2008, with the core rate excluding energy and food even jumping to a 29-year high of 3.8%. Following the base effect on energy prices used in the calculation of annual inflation due to the COVID-19 economic slump, reopening-sensitive categories are now driving inflation. With the return to the "new normal" underway, prices of airline tickets, rental cars, accommodation, and eating out are surging. In addition, the higher cost of goods, influenced by supply constraints and the substitution reaction, are continuing to make an extraordinary contribution to the inflation rate.

Only time will tell whether this development is just temporary in nature or whether, with the end of the pandemic, truly structural changes in price trends can be identified. For the time being, the market is also supporting the central banks' view that it is best to remain calm in the face of monetary policy tightening. For example, US real yields fell sharply on the release of May data and inflation expectations showed little reaction, dragging down nominal yields as a result. We see structural developments indicating that long-term inflation risks have clearly increased. Worth mentioning here are the extreme support measures with the blurring of the boundaries between monetary and fiscal policy, the increase in state influence, and a weakening of disinflationary forces due to de-globalization. In addition, a generation whose experience has been marked by sharply falling interest rates and a prolonged period of low inflation is coming of age.

Since inflation scenarios are inevitable in longer-term investment decisions and we do not have a crystal ball to determine the economic development, we have decided to mix inflation-linked bonds into our portfolios. This diversification will help us to be more robustly positioned and prepared for future inflation surprises. ◆

Corporate bonds: Almost too good to be true

Ikram Boulfernane

Like equities, credit markets have been on the fast track over the past few months. This has been aided by the positive macro environment. It is true that economic growth, which is running hot in the US in particular and is widely anticipated, harbors increased potential for disappointment. But the macro engine is still humming, giving corporate bonds the green light.

Monetary policy remains another supportive factor as central banks are refraining from changing track. The ECB continues to go full throttle – emergency bond purchases under the PEPP purchase program will not be reduced and the end of the CSPP program remains a distant prospect. The US Federal Reserve intends to sell the "junk" ETFs and bonds acquired in the SMCCF context by the end of the year. But this should not cause market dislocation for Corporate America's high-yield bonds. The size of the SMCCF portfolio is too small and investors' hunt for yields too great to distort the market significantly. Moreover, market participants are rightly confident that the central bankers from Constitution Avenue will take the interventionist steering wheel back into their hands if market turbulence grows too strong.

Corporate fundamentals are also providing a tailwind for credit markets. The accumulated debt may be high, but so are cash positions. Debt ratios are coming down and interest coverage ratios are going up – across all rating segments and on both sides of the Atlantic. The volume of "falling angels" has already peaked, as have default rates, which are now expected to be in the low single digits by the end of the year.

It is a nice starting position for credit markets – and almost too good to be true! And indeed it is. Credit spreads still have to overcome one major obstacle on the macroeconomically, monetarily, and fundamentally well-paved roads towards tightening: valuation. Credit spreads are historically extremely expensive and it is precisely this that is significantly slowing down the upside potential. Corporate bonds now have to maneuver where these opposing forces crash against each other. As a result, their credit spreads should neither widen nor narrow markedly in the coming months. ◆

Equities US: Conflicting priorities

Manfred Hofer

Stock market records have continued in 2021. Since mid-April, however, upward momentum has stalled somewhat. One reason for this is likely to be the issue of inflation, which has dominated market discussions of late.

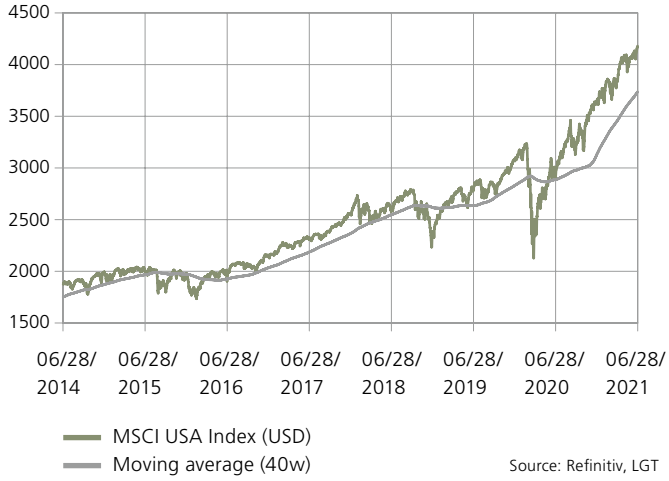
The US Federal Reserve is holding to its expansionary monetary policy for now, but is thinking more strongly about a turnaround, foreseeable for 2023. According to statements by Federal Reserve Chairman Powell, the discussions about unwinding the massive stimulus measures have begun. For the time being, however, the key interest rate in the US remains at a record low.

The dynamic US economic recovery is not likely to be disrupted and markets should be cautiously prepared for a turnaround. Background: Ultra-loose monetary policy fueled a rise in valuations of equity markets, which did not make things any easier for investors. They are having to navigate the conflicting priorities of high valuations for risky assets and a lack of attractive alternatives.

The situation on the stock markets – analyzed from a behavioral finance perspective – has hardly changed since the last issue of Investorama in April. It is worth reading the commentary again. Back to the current analysis: Some short-term parameters are pointing to overconfidence in the markets. One example of this is our "News" indicator, which taps into the sentiment of both online and print media. The market consolidation that has been taking place since mid-April – so far more in the form of a sideways movement – is likely to continue until the corresponding indicators have cooled off. Until then, markets will remain vulnerable and any unexpected negative news will have an easy ride.

At the same time, important medium-term indicators have stabilized or improved. In addition, the footing of stock exchanges, the market structure, is proving to be stable. All of this points to intact "buy the dip" investor behavior. In other words, a potential period of weakness in equity markets is likely to be followed by another rally attempt. Fundamentally, the tension between "overconfidence" and "buy the dip" is supporting the seasonal pattern in equity markets. Initially, this does not indicate a clear trend, but rather a back and forth. ◆

Equities US



Source: Refinitiv, LGT

Overview of equity markets as per June 28, 2021

Stock market (MSCI indices)	year-to-date	since 06/28/2020	since 06/28/2016*	Trend	Comment
United States (USD)	14.5%	46.0%	18.2%	↗	Upwards trend
Eurozone (EUR)	15.9%	32.2%	11.0%	↗	Upwards trend
Japan (JPY)	9.9%	28.3%	12.6%	↗	Upwards trend
United Kingdom (GBP)	11.9%	18.2%	6.3%	↗	Upwards trend
Germany (EUR)	13.0%	27.1%	9.5%	↗	Upwards trend
Switzerland (CHF)	14.9%	21.9%	11.8%	↗	Upwards trend
China (CNY)	2.8%	27.1%	17.5%	↗	Upwards trend
Emerging markets (USD)	7.9%	41.0%	14.0%	↗	Upwards trend

* annualized

Source: Refinitiv, LGT

Equities Europe: Significant recovery in earnings already priced in!

Ralf Piersig

European equities are increasingly in demand among investors. Although global benchmark indices have risen only slightly since our last article (in local currency terms), European stocks have gained almost 5% on average and have thus also performed better than we expected. The main reasons are likely to be the progress of vaccination programs and the related reopening steps, central banks' accommodative monetary policy, and a better-than-expected corporate reporting season for the first quarter. With the exception of the latter, however, these developments are not new in our view and should already have been priced in by markets since the beginning of the year. For example, operating profit estimates for 2021 are up 13.5% and are 16% above pre-crisis 2019 levels.

At the same time, however, we see that rising material costs are increasing pressure on profit margins and that the paths towards reducing significantly increased government debt are completely unclear. We therefore see an increasing risk that the euphoria of the unblemished recovery will be accompanied by undesirable side effects. We are tactically sticking to our more cautious stance. ◆

Equities Europe

Source: Refinitiv, LGT

Equities Japan: Another lockdown for the Olympics

Mikio Kumada

Asia has generally had a pretty unsuccessful track record over the last few months. Vaccination campaigns against COVID-19 are proceeding much more slowly everywhere than in Western countries, delaying the full reopening of economies. In Japan, only about 15% of the population has received at least one vaccine dose, compared with more than 50% in the US. Because the Olympic Games are due to start in Tokyo in July, the government was again forced to declare a state of pandemic emergency in many places in April.

Aside from this prescriptive consumer restraint, the industrial economic engine is, however, humming merrily along in Japan, too, thanks to the global cyclical recovery. Japan's exports rose 16%, 38%, and 50% year on year in March, April, and May, respectively. However, the stock market has recently been reflecting Asia's disappointing lockdown performance rather than Japan's cyclical recovery. With a gain of roughly 1% in the last three months, the MSCI Japan significantly lagged behind the US (4.5%) and Europe (5%), although it still performed better than the MSCI China (-5.4%) or the MSCI AC Asia ex Japan (-1.7%), for example. ◆

Equities Japan

Source: Refinitiv, LGT

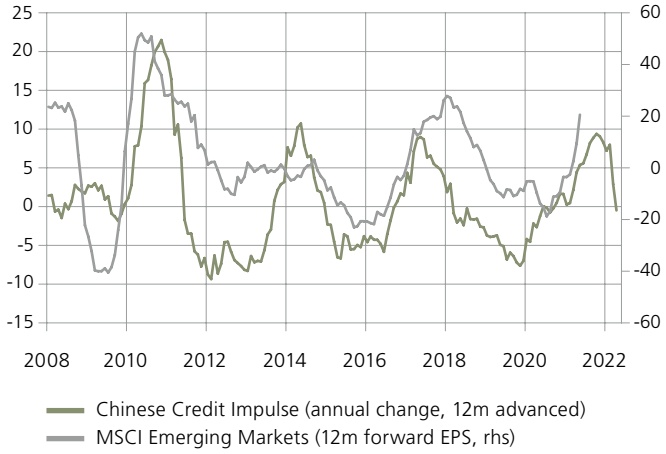
Emerging markets equities: In the wake of the Chinese super tanker

Michel Roth

The swift recovery in Chinese demand provided major support for the coronavirus-stricken global economy last year. In the wake of the Chinese super tanker, other Asian economies with similar pandemic policies in particular recovered. But with the end of the crisis, the old problems also returned to the Middle Kingdom. First and foremost is the high level of corporate debt. In order to prevent financial imbalances, the leadership in Beijing has been restricting lending again for several months after it increased as a result of the crisis. The tailwind for emerging market equities is therefore likely to subside.

Chinese equities account for around 40% of the emerging market index. In addition, companies from other important emerging markets such as South Korea or Taiwan generate a significant share of their profits in mainland China. Therefore, when the credit impulse declines, the profits of emerging market companies typically follow suit with a lag of about 9-12 months. While it is true that the expansive macro policies in developed economies are currently reducing these braking effects caused by China, most emerging markets are still unlikely to fully escape the wake of the Chinese super tanker after all. ◆

Chinese stimulus and emerging market earnings growth



Source: Refinitiv, LGT

Emerging markets local currency bonds: It is worth expanding the country universe

Sven Lang

When people talk about local currency bonds in emerging markets, they usually mean those 19 countries that are in the most popular benchmark. Established emerging markets such as China, Brazil, and South Africa have the greatest weightings. This universe of countries has produced disappointing risk-adjusted returns for a number of years. Instead of avoiding the asset class now, investors should add local currency bonds from frontier countries. Frontier countries have not yet achieved emerging market status and are less advanced economically. Countries such as Uzbekistan and Ghana are mentioned as examples.

At first glance, this would suggest that they are more risky. In recent years, however, the opposite has been true. Although the majority of established local currency bonds were under pressure, frontier bonds and currencies performed much better with less risk as measured by volatility. There are various reasons for this state of affairs, and these are surprising at first glance. Although the economies of frontier countries are still less developed, their economic growth rates are stronger and therefore also offer greater earnings opportunities.

At the same time, these are countries that still receive little attention from international investors and, accordingly, local capital markets are much less driven by the fluctuating sentiment of these investors and are dominated by local, long-term market participants. As a result, in recent years, the risk-adjusted returns on these supposedly riskier bonds have been very favorable.

With a carefully selected portfolio of local currency bonds from frontier countries, it is still possible to achieve a yield to maturity of 10–12% in the current global low interest rate environment. Since these countries require in-depth research, it makes sense to leave the selection to experts who have been investing in these countries for several years. It is definitely worth looking beyond traditional local currency bonds. ◆

Real estate: Long covid for the office?

Boris Pavlu

The end of the pandemic is in sight, but hardly anyone wants to go back to the office. Or at least not completely, but with the option of combining office attendance with the now well-tested working from home set-up. The results of the countless surveys of employees are clear on this point, and employers are therefore eager to plan flexible deployment models for the future.

What is less clear is what this means for the traditional office market itself. More working from home is likely to structurally reduce demand for office space, but only to a lesser extent than the proportion of home-based work. This is because there are organizational and logistical limits to desk sharing and co-working spaces, while at the same time demand on office workplace equipment has tended to increase. Experts therefore assume long-term savings of a maximum of 20% of floor space and 10% of real estate-related costs – not a tidal change for most knowledge-based companies in terms of total costs.

Nevertheless, this would have far-reaching consequences for the office market: Rising vacancy rates and pressure on rents would be a global issue for many years to come, despite the ongoing boom. Rating agencies are working through these scenarios by looking at the creditworthiness of collateralized bonds. Analysts have also trimmed net asset values of office companies by about 10% to account for the perceived long-term impact of the pandemic. Financial markets seem to have already priced in such a scenario: Real estate stocks with a focus on office space are still trading at a discount to their pre-pandemic levels, while the broad indices have long since touched new highs, buoyed by the robust housing market and the in-demand IT-specialty space. ◆

Insurance-linked securities: Positive premium trend in all key regions for 2021

Siti Dawson

This year, the reinsurance market including the ILS market successfully pushed not only for higher premiums in all key regions, but also negotiated improved contractual terms such as higher retention levels (higher pay-out threshold) and stricter exclusions, especially with regards to communicable diseases ("pandemic risk").

April is the renewal date for Japanese reinsurance programs. Japan was battered with a series of typhoons in 2018/2019 and as a result, the major shift in premiums already happened last year. The attractive premiums paired with the diversification benefits vis-à-vis US exposed transactions are clearly beneficial for the composition of a well-balanced ILS portfolio. In June and July, the market is now shifting its focus towards the US, as insurance carriers buy reinsurance cover ahead of the US hurricane season, which is expected to be slightly above average. Unlike prior years, the market is seeing a slight reduction of available capacity for Florida programs this year, which is having a notable positive impact on premiums.

In summary, the current market dynamics are presenting investors with very favorable terms and a positive outlook for the asset class. ◆

Premium development 2021

Region/peril	Change (YoY)	Renewal date
European and Global[1]	Flat to +15%	January
Japan	0% to +5%	April
US and Australia	+5% to +20%	June/July

Source: LGT ILS Partners

[1] "Global" refers to globally active, primary insurance companies of significant size; premium development is based on LGT ILS Partners' market assessment; lower end of estimated premium change relates to "loss-free" transactions, upper end of estimated premium change relates to "loss affected" transactions

LGT's core competencies in asset management

LGT's investment center is a specialist for multi asset solutions as well as alternative investments. Our core competencies include:

Asset Allocation

Carefully planned asset allocation is the foundation for successful asset management and performance. LGT's long-standing experience and disciplined investment approach enable us to offer our clients traditional and alternative investments as an integrated, comprehensive package and to go to our clients as an authority in this regard. Our transparent investment process covers portfolio construction and implementation in line with our clients' needs as well as continual monitoring of specific risks. The aim of our asset allocation investment solutions is to optimize the long-term risk-return profile. It is important to ensure that our investment solutions participate in market upturns, while offering stability and capital preservation in difficult market periods. The cornerstones of our Asset Allocation expertise are:

- A comprehensive global universe of listed and non-listed investments
- Broad diversification in and between asset classes, segments, styles, specialists and currencies
- A systematic, disciplined process based on a balanced blend of qualitative and quantitative elements

The long-term strategic asset allocation requires a look at the future. But because predicting future developments is possible only to a very limited extent, we use scenario analysis. The knowledge of past developments in economics, politics and the financial markets gives us a basis for our scenarios. Academics and practitioners add their own expert knowledge in certain thematic areas. We then use this array of information to develop various future scenarios. These are either baseline scenarios (high probability of occurring) or alternative scenarios (low probability of occurring). We set the optimum portfolio weighting for each scenario. We then work out investment solutions that we think can bring robust returns for our clients across several scenarios.

Through our tactical asset allocation we take advantage of medium-term inefficiencies and fluctuations. In a quarterly process we reconsider our active positioning also taking into account our findings from economic and market information along with behavioral finance.

Sustainability

Our long-term direction and ESG investment principles are a core element of our corporate culture. We are convinced that we can only invest successfully for our clients by following a long-term approach that contains a strong awareness of environmental, social and governance (ESG) principles. This also applies to investment solutions that we offer our investors as well as to our overall business activities. On the following pages, we will demonstrate how LGT Capital Partners integrates these principles into its business activities.

ESG in our investment and monitoring process

Compliance with ESG criteria is a fixed component of our investment process. It is structured so that it meets the United Nations-supported Principles for Responsible Investment (UN PRI). Our investment teams are responsible for due diligence for potential investments. Every investment opportunity we pursue is examined based on these criteria. These assessments are important information for portfolio managers and the Investment Committee when it comes to making an investment decision. We monitor a broad spectrum of risks, against the background of ESG criteria as well. We work closely with our external managers and offer them advice on how ESG criteria can be integrated even more extensively. For some clients, we check the portfolios according to specific ESG guidelines.

We have developed processes to integrate ESG principles in line with the requirements of the various investment categories and structures. In the context of our private equity, hedge fund and multi-manager long-only portfolios, for example, we focus on the assessment of ESG practice of our external and internal managers, and work with them to raise standards in this area. In our equity and bond portfolios, we rely on

individual stock selection. This way, we can benefit from the fact that substantially more information is available for an ESG assessment. We have therefore developed an internal tool, the ESG cockpit, which enables us to analyze and evaluate the ESG risks and opportunities of every position in these portfolios.

Compliance with international agreements on controversial weapons

Apart from carrying out our own ESG analyses, we are cooperating with Global Engagement Services (GES) and applying their guidelines to avoid investing in companies involved in the manufacture of controversial weapons such as land mines, cluster bombs and ammunition as well as ABC weapons. This way, we can develop portfolios that meet the requirements of international agreements on controversial weapons.

Our definition of ESG

When analyzing managers and companies, we check the following environmental, social and governance factors:

- Environment: greenhouse gas emissions, energy efficiency, water consumption, waste disposal, use of resources and other factors
- Social: refers to subjects such as controversial weapons, human rights issues, labor standards, employee fluctuation, health and safety, training and professional development as well as other factors
- Governance: quality of the board of directors, clear separation between the role of the CEO and president of the board of directors, accounting practices, reporting/transparency, management incentives, shareholders' rights, bribery and corruption as well as other factors

In choosing countries of potential issuers of government bonds, we concentrate on the degree of freedom, democracy, political and civil rights that prevail in the respective country as well as on the level of corruption and the rule of law. This is enhanced by further analyses that illustrate how a country deals with natural resources and the status of social development.

Integration of alternative investments

To achieve robust portfolios, there needs to be as much integration as possible of many uncorrelated return sources. It has been shown that alternative investment classes can make a valuable contribution in particular. LGT Capital Partners has been investing in private market investments and liquid alternative investment classes for 20 years. We have a global network and therefore access to experienced managers in this area, as well as direct investment competence. Investments in private markets can improve the risk-reward ratio of an investment portfolio. They offer investors the opportunity to achieve higher returns while at the same time diversifying their portfolio. With an investment horizon of more than ten years, private equity requires a long-term commitment and readiness to accept reduced liquidity and unexpected capital flows. The returns are also highly dependent on the investor's ability to gain access to the managers with the best performance, as returns from funds in the upper and lower quartile vary enormously from one another. Liquid alternative investments such as alternative risk premia, hedge funds or insurance-based investments play a large part in broader diversification of a portfolio. The integration of these strategies into a portfolio requires in-depth analysis that takes account of investors' aims and requirements. This calls for the relevant analysis tools, as well as for long-term experience.

Overview LGT Funds

LGT Funds	ISIN	Launch date	Price as per 05/31/2021		Performance 2021	Performance -3 years p.a.	Performance -5 years p.a.
Multi asset class							
LGT Alpha Indexing Fund (CHF) B	LI0101102999	30.04.2009	CHF	1745.62	3.68%	3.83%	3.58%
LGT GIM Balanced (CHF) B	LI0108469029	31.01.2010	CHF	13746.69	5.89%	4.72%	4.17%
LGT GIM Balanced (EUR) B	LI0108469169	31.01.2010	EUR	15415.98	5.60%	5.37%	4.49%
LGT GIM Balanced (USD) B	LI0108468880	31.01.2010	USD	16356.18	5.93%	7.61%	6.68%
LGT GIM Growth (CHF) B	LI0108469268	31.01.2010	CHF	15352.14	8.18%	5.75%	5.62%
LGT GIM Growth (EUR) B	LI0108469318	31.01.2010	EUR	17488.55	7.83%	6.41%	5.96%
LGT GIM Growth (USD) B	LI0108469250	31.01.2010	USD	18296.20	8.15%	8.69%	8.16%
LGT Sustainable Strategy 3 Years (CHF) B	LI0350494782	10.11.1999	CHF	1092.62	1.62%	2.47%	2.42%
LGT Sustainable Strategy 3 Years (EUR) B	LI0008232162	10.11.1999	EUR	1878.28	1.39%	3.14%	2.90%
LGT Sustainable Strategy 3 Years (USD) B	LI0350494840	30.04.2010	USD	1212.11	1.73%	5.20%	4.99%
LGT Sustainable Strategy 4 Years (CHF) B	LI0350494907	10.11.1999	CHF	1156.01	4.41%	4.22%	4.04%
LGT Sustainable Strategy 4 Years (EUR) B	LI0008232220	10.11.1999	EUR	1961.70	4.13%	4.94%	4.58%
LGT Sustainable Strategy 4 Years (USD) B	LI0350494998	30.04.2010	USD	1282.64	4.49%	7.07%	6.66%
LGT Sustainable Strategy 5 Years (CHF) B	LI0350495169	01.10.2004	CHF	1201.91	6.72%	5.33%	5.20%
LGT Sustainable Strategy 5 Years (EUR) B	LI0019352926	01.10.2004	EUR	2083.43	6.42%	6.07%	5.70%
LGT Sustainable Strategy 5 Years (USD) B	LI0350495227	30.04.2010	USD	1332.81	6.78%	8.18%	7.77%
Money market							
LGT Money Market Fund (CHF) B	LI0015327682	19.01.1998	CHF	1069.70	-0.35%	-0.83%	-0.82%
LGT Money Market Fund (EUR) B	LI0015327740	19.01.1998	EUR	690.43	-0.26%	-0.48%	-0.42%
LGT Money Market Fund (USD) B	LI0015327757	19.01.1998	USD	1546.60	0.00%	1.25%	1.12%
Bonds							
LGT Bond Fund EMMA LC (CHF) B	LI0133634688	30.09.2011	CHF	1107.24	-0.66%	-1.59%	1.22%
LGT Bond Fund EMMA LC (EUR) B	LI0133634662	30.09.2011	EUR	1227.53	-2.30%	-0.16%	1.34%
LGT Bond Fund EMMA LC (USD) B	LI0133634670	30.09.2011	USD	1117.27	-2.38%	1.38%	3.25%
LGT Sustainable Bond Fund EM Defensive (CHF) B	LI0183910038	30.06.2012	CHF	976.38	-1.35%	0.25%	0.61%
LGT Sustainable Bond Fund EM Defensive (EUR) B	LI0183910012	09.07.2012	EUR	1015.74	-1.18%	0.73%	1.10%
LGT Sustainable Bond Fund EM Defensive (USD) B	LI0183909998	15.12.2011	USD	1147.16	-0.83%	2.92%	3.25%
LGT Sustainable Bond Fund Global Inflation Linked (CHF) B	LI0148578045	17.04.2012	CHF	937.61	0.18%	0.05%	-0.47%
LGT Sustainable Bond Fund Global Inflation Linked (EUR) B	LI0017755534	10.05.2004	EUR	1176.11	0.36%	0.55%	0.07%
LGT Sustainable Bond Fund Global Inflation Linked (USD) B	LI0148578037	30.09.2010	USD	1098.25	0.64%	2.62%	2.07%
LGT Select Bond Emerging Markets (USD) B	LI0026536628	31.12.2000	USD	3901.63	-2.06%	3.78%	4.46%
LGT Select Bond High Yield (USD) B	LI0026564604	31.08.2000	USD	2958.25	1.80%	6.55%	6.38%
LGT Select Convertibles (CHF) B	LI0132437745	31.08.2011	CHF	1645.09	2.13%	7.36%	5.86%
LGT Select Convertibles (EUR) B	LI0132437737	31.08.2011	EUR	1710.09	2.34%	7.77%	6.19%
LGT Select Convertibles (USD) B	LI0102278962	31.07.2006	USD	2214.14	2.75%	10.32%	8.70%
LGT Sustainable Fixed Income Global Opportunities (EUR) B	LI0008232030	10.11.1999	EUR	1689.94	0.71%	0.71%	0.20%
LGT Sustainable Bond Fund Global (EUR) B	LI0106892909	30.11.2009	EUR	1551.48	-2.08%	2.05%	0.62%
LGT Sustainable Bond Fund Global Hedged (CHF) B	LI0148577955	22.10.1996	CHF	1053.69	-2.74%	0.87%	-0.55%
LGT Sustainable Bond Fund Global Hedged (EUR) B	LI0148577948	22.10.1996	EUR	1101.94	-2.65%	1.28%	-0.11%
LGT Sustainable Bond Fund Global Hedged (USD) B	LI0015327872	22.10.1996	USD	3038.66	-2.24%	3.58%	2.09%
LGT Quality Funds – Sustainable Short Duration Corp. Bond Fund Hedged (CHF) B	LI0183909808	30.06.2012	CHF	982.52	-1.02%	-0.04%	-0.75%
LGT Quality Funds – Sustainable Short Duration Corp. Bond Fund Hedged (EUR) B	LI0183909782	30.06.2012	EUR	1029.24	-0.85%	0.47%	-0.22%
LGT Quality Funds – Sustainable Short Duration Corp. Bond Fund Hedged (USD) B	LI0183909790	30.06.2012	USD	1146.91	-0.51%	2.60%	1.78%

LGT Funds	ISIN	Launch date	Price as per 05/31/2021		Performance 2021	Performance -3 years p.a.	Performance -5 years p.a.
Equities							
LGT Select Equity Emerging Markets (USD) B	LI0026536354	31.12.2000	USD	5913.21	8.86%	9.83%	14.05%
LGT Select Equity Enhanced Minimum Variance (USD) B	LI0337486141	25.11.2016	USD	1452.33	7.94%	6.91%	n.a.
LGT Sustainable Equity Fund Europe (EUR) B	LI0015327906	30.09.2000	EUR	1544.09	13.67%	8.63%	6.55%
LGT Sustainable Equity Fund Global (CHF) B	LI0148540441	17.12.2012	CHF	2767.61	14.62%	11.34%	11.05%
LGT Sustainable Equity Fund Global (EUR) B	LI0106892966	31.12.2009	EUR	3593.65	12.72%	12.95%	11.19%
LGT Sustainable Equity Fund Global (USD) B	LI0148540466	17.12.2012	USD	2824.36	12.63%	14.70%	13.28%
LGT Sustainable Quality Equity Fund Hedged (CHF) B	LI0183907844	30.06.2012	CHF	2337.91	8.97%	15.49%	11.19%
LGT Sustainable Quality Equity Fund Hedged (EUR) B	LI0183907836	09.07.2012	EUR	2324.01	9.16%	15.88%	11.62%
LGT Sustainable Quality Equity Fund Hedged (USD) B	LI0183907802	30.06.2012	USD	2897.27	9.64%	18.71%	14.20%
Insurance-linked investments							
LGT (Lux) I – Cat Bond Fund (CHF) B	LU0816333040	30.11.2010	CHF	109.85	0.19%	-0.06%	-0.09%
LGT (Lux) I – Cat Bond Fund (EUR) B	LU0816332828	30.11.2010	EUR	114.59	0.29%	0.27%	0.25%
LGT (Lux) I – Cat Bond Fund (USD) B	LU0816332745	30.11.2010	USD	129.59	0.66%	2.46%	2.33%
Alternative investments							
LGT Crown Listed Private Equity (EUR) B	IE00B7T8CN06	25.02.2013	EUR	309.14	25.70%	17.14%	16.17%
LGT Crown Listed Private Equity (USD) D	IE00BJVWTR76	28.07.2014	USD	227.83	25.61%	18.96%	18.37%
LGT Alpha Generix UCITS Sub-Fund Class O (USD)	IE00B7VFVC16	01.10.2012	USD	1057.55	2.51%	3.66%	1.55%
LGT Alpha Generix UCITS Sub-Fund Class P (EUR)	IE00B82ZPK32	01.10.2012	EUR	942.55	2.04%	1.42%	-0.60%
LGT Alpha Generix UCITS Sub-Fund Class Q (CHF)	IE00B46N8H32	01.10.2012	CHF	900.30	1.96%	1.03%	-1.06%
LGT Dynamic Protection UCITS Sub-Fund Class F (USD)	IE00BD365334	20.04.2017	USD	1025.54	-1.38%	2.51%	n.a.
LGT Dynamic Protection UCITS Sub-Fund Class G (EUR)	IE00BD365441	30.04.2017	EUR	949.16	-1.72%	0.43%	n.a.
LGT Dynamic Protection UCITS Sub-Fund Class H (CHF)	IE00BD365557	30.04.2017	CHF	931.92	-1.76%	-0.04%	n.a.

Sèvres Porcelain Manufactory (founded in 1740); Pierre Huard, detail from "12-piece dejeuner for Pauline Borghese," 1812

A genuine alternative with natural returns

Investors around the world have a big problem: they are faced with a challenging environment where traditional asset classes are highly correlated with each other, making efficient portfolio diversification difficult. Investors have been dealt a bad hand! Uncorrelated sources of return are in high demand, and insurance-linked securities have what it takes to fill this gap.

In the mid-1990s, the insurance and reinsurance industry was confronted by a rise in the incidence of catastrophic events, such as storms, earthquakes and floods. Covering the resulting billions in claims was a challenge that resulted in the birth of insurance-linked securities. These instruments are used to transfer to the financial markets insurance risks relating to events that combine high potential losses and a low probability of occurrence.

This enables insurers and reinsurers to access additional capital in order to settle certain predefined claims should they materialize. If the insured events do not materialize, investors' capital is redeemed at maturity. The reward for the investment risk taken is a relatively high return. There have been very few defaults on individual bonds since the asset class came into being, making total losses a rarity to date. In addition, insurers and reinsurers have to pay up first before investors are asked to put their hands in their pockets.

Catastrophe bonds – cat bonds for short – are probably the best-known insurance-linked securities. The interest rate on these fixed-interest securities, which have a defined maturity and can be traded at any time, consists of a variable component linked to the money market and a fixed component. The latter reflects the insurance premium, which depends mainly on the probability of occurrence of the insured loss event. The other category of insurance-linked securities are individual collateralized reinsurance contracts between a single financial investor and an insurer or reinsurer. Unlike cat bonds, these cannot be traded during the contractual term. Institutional investors have the opportunity to participate in the insurance-linked securities market through these two kinds of financial instruments.

Tragic events such as natural disasters and pandemics are not dependent on events on the financial markets. Insurance-linked securities therefore offer the great advantage that the returns have an extremely low correlation with traditional and alternative asset classes. They provide natural diversification for the portfolio and optimize the return potential. In the fixed-income segment, where low and even negative interest rates are the order of the day, they are trump cards because they represent a genuine alternative. The low volatility and relative stability of income add further to the attractiveness of this asset class. It is therefore unsurprising that insurance-linked securities are a firmly established part of the Princely Strategy. ◆

LGT (Lux) I – Cat Bond Fund (USD) B

Fund description

The fund invests in a broadly diversified portfolio of insurance-linked bonds referred to as cat bonds. These bonds are issued by insurance and reinsurance companies to hedge against events giving rise to claims. The risk assumed by the investor therefore is tied to clearly defined disasters (e.g. earthquakes, hurricanes). Potential counterparty or credit risks are to a large extent eliminated through the structure. The fund aims to achieve a stable return that is higher than the risk-free interest rate, with a low correlation to fluctuations in financial markets, and a low fixed interest rate exposure due to the variable interest rate component. Currency risks are hedged against the share class currency.

Why invest in the LGT (Lux) I – Cat Bond Fund?

- Efficient opportunity to participate in the performance of insurance-linked securities.
- LGT Group has more than 15 years of experience with insurance-linked securities.

Opportunities

- Pure insurance (event) risks have very limited correlation to traditional asset classes such as equities or bonds.
- Natural disasters and impact from COVID-19 have put (re-) insurers' balance sheets under pressure, which has led to higher yields for investors. Underlying risk factors of insurance-linked securities, however, remain unchanged.
- Limited interest rate risk due to the floating rate component of insurance-linked investments.

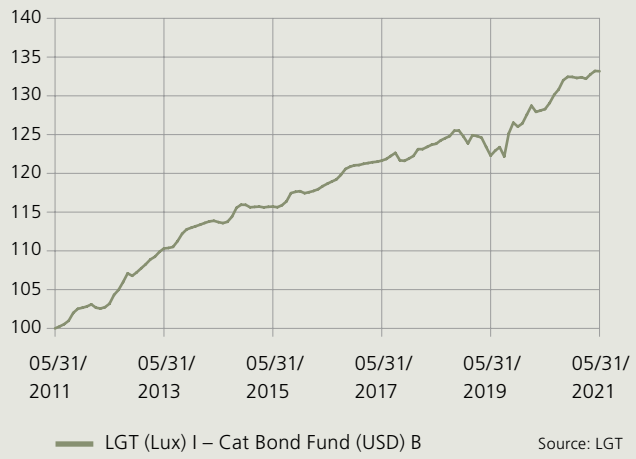
Risks

- **Market risks:** The risk of losses in an investment arising from adverse movements in market prices.
- **Liquidity risks:** The risk that fund is unable to meet short term financing demands or has to sell investment securities at lower price levels under the condition of reduced market demand.
- **Operational risks:** The risk of the Fund incurring losses as a result of inadequate or failed processes, people or systems failures, or from external or force majeure events.
- **Political and legal risks:** The risk of change in rules and standards applied in the jurisdiction of an asset of the Fund. This includes restrictions on currency convertibility, the imposition of taxes or transaction controls, limitations on property rights or other legal risks. Investments in less developed financial markets may expose the Fund to increased operational, legal and political risk.
- **Credit/counterparty risks:** The risk that a counterparty fails to meet contractual financial obligations on a timely basis.
- **Currency risks:** The risk of losses arising from currency fluctuations in case the currency of an asset is different from the Fund and/or investor's investment currency.
- **Risks due to insurance events:** The risk of losses of an insurance-linked investment due to the occurrence of an insured event and the defined threshold being exceeded.

Fund data

Inception	November 30, 2010
Fund domicile	Luxembourg
ISIN	LU0816332745
Distribution	None, retains profits
Reference currency	USD
Management fee p.a.	1.50%
Performance fee	No
Total fund assets	USD 497.38 m (as of May 31, 2021)
Public distribution	AT, CH, DE, LI, LU

Performance (net of LGT fees)



Source: LGT

Past performance is not a guarantee, nor an indication of current or future performance. Returns may increase or decrease as a result of currency fluctuations.

Investors are predestined to be reinsurers

With the North Atlantic hurricane season having recently started and the COVID-19 pandemic still holding sway, attention has increasingly turned back to insurance-linked securities (ILS) once again. In this interview, Siti Dawson, Product Specialist at LGT ILS Partners, explains the advantages that this asset class offers and the challenges facing the ILS market.

Investorama: What advantages does the ILS asset class bring in a portfolio context, and what risks need to be borne in mind?

Siti Dawson: ILS investments offer a degree of protection against inflation, as the risk premium provides a generous buffer and the yields on the investments held as collateral for cat bonds and reinsurance contracts also increase as interest rates rise.

The diversification effect of ILS investments was particularly evident early last year, when the equity and bond markets plummeted on the back of burgeoning concerns about the global pandemic. While equities shed more than 20% of their value, ILS investments achieved a positive return over the same period.

The so-called event risk is, by its nature, the largest risk associated with insurance-linked securities. It relates to the materialization of one or more insured events, resulting in total or partial loss of the invested capital. The risk premium compensates investors for taking on this risk. Event risk can be managed most effectively by building a well-diversified portfolio of different ILS instruments so that the impact of a single extreme event is reduced.

Which type of investor is the ILS asset class particularly suited to?

The ILS investment universe is very broad these days, and there are suitable investment solutions for private as well as institutional investors alike. For private investors, the focus is on products with a high proportion of instruments that can be traded daily (cat bonds) and have a conservative risk profile. Mixed portfolios of cat bonds and reinsurance contracts are suitable for institutional investors with lower liquidity needs and a higher risk tolerance. Compared with cat bond-only portfolios, these have the advantage that a broader range of risks and regions can be covered, reducing the event risk described earlier. To make optimum use of this asset class' diversification effect, Swiss pension funds invest around 3% to 5% of their total allocation in ILS.

The coronavirus crisis has left its mark on the financial markets across virtually all asset classes. How has it impacted the ILS asset class?

Primary insurers and reinsurers were hit hard by the effects of the pandemic, especially in the business segments "business interruption" and "travel and event cancellation". Claims and reserves for COVID-19 of the world's largest reinsurer, Swiss Re, amounted to around USD 4 bn. The total loss to the insurance industry from the pandemic is estimated to be as high as USD 50 bn.

However, only a very small portion of these losses were passed on to the ILS market, as the main focus of the asset class is on the reinsurance of natural catastrophe risks. At the same time, the weakened balance sheets of many insurance companies led to a large surge in demand for reinsurance cover, with an extremely positive effect on premiums in the reinsurance market and by extension in the ILS market too. In fact, premiums, and therefore return prospects, for ILS are more attractive than they have been in a long while.

The Atlantic hurricane season recently began. Is an extremely active season expected, or are low insurance losses on the cards?
Early forecasts point to a rather above-average active season for hurricanes in the North Atlantic. It is interesting to note, however, that the number or intensity of hurricanes per season alone does not predict the size of insured losses or the performance of insurance-linked securities. Last year was a case in point. With 30 storms and 17 hurricanes, storm activity in the North Atlantic was twice the long-term average, but insured losses were only slightly above the long-term mean. A counterexample is the year 1992, when Hurricane Andrew was the only hurricane of the season but also the second most expensive loss event in the history of the insurance industry. Our portfolios are constructed to reduce extreme risk for our investors, regardless of how active the hurricane season is.

Do investors tend to prefer catastrophe bonds or collateralized reinsurance contracts?
Cat bonds offer the advantage of being very liquid. Although direct reinsurance contracts usually run for just 12 months, they cannot be traded during their term. Some investors therefore appreciate the weekly or at least monthly liquidity of cat bond-only portfolios, especially as these are often also available in a UCITS format. However, most institutional investors prefer direct reinsurance contracts because of the higher expected returns and better diversification opportunities.

What developments are there in the ILS market at present, and what challenges will ILS have to face as an asset class in the future?
The issue of climate change has, of course, been preoccupying the ILS market for some time, as the asset class is heavily exposed to weather-related natural catastrophe events. In addition, more and more insured assets are located in regions affected by climate change. If weather-related insurance claims now increase, the associated premiums will also go up to compensate for the higher risk. In turn, this price dynamic provides incentives for homeowners, businesses and governments to take appropriate protective measures, making buildings and infrastructure less vulnerable to damage. The (re)insurance market, including ILS, is therefore playing a significant role in helping society adapt to a changing climate.

Is there an ideal time to enter the market?
In principle, an investment in ILS should be made with a long-term investment horizon, as classic "market timing" is not possible. That said, premiums tend to go up significantly in years following a year with unusually high insurance claims, which of course benefits investors. New money is most easily placed in the first half of the year, as the big renewal rounds in the reinsurance market take place in January, April and June. Conversely, it makes little sense to enter the market in the middle of the peak season for hurricanes and typhoons, as no new ILS instruments come onto the market during this period anyway. ◆

Siti Dawson is a product specialist at LGT ILS Partners. In this role, she is responsible for communicating the investment strategy, portfolio activities and performance. Prior to joining the team at LGT in June 2012, Ms. Dawson was with Clariden Leu's Insurance-Linked Investments team. Before that, she was a fund analyst at VZ Vermögenszentrum, where her responsibilities included the selection and monitoring of the ILS allocation. Ms. Dawson holds an MA in economics from the University of Zurich and is a certified Financial Risk Manager (FRM).

From shipping loans to insurance-linked securities

Risks have had to be hedged since time immemorial. But millennia passed before insurance-linked securities were developed as an asset class.

"Humans are social creatures and therefore depend on being part of a group and on relationships with others," says Matthias Grundmann, a professor at the Institute of Sociology at University of Münster. It is unsurprising, therefore, that people understood themselves early on as a precautionary and risk community, in which risk was borne not by the individual, but by a group. An early example is the shipping loans issued by the ancient Greeks, which date back at least to the fifth century BC and often included, in addition to a loan, insurance for a vessel's round trip.

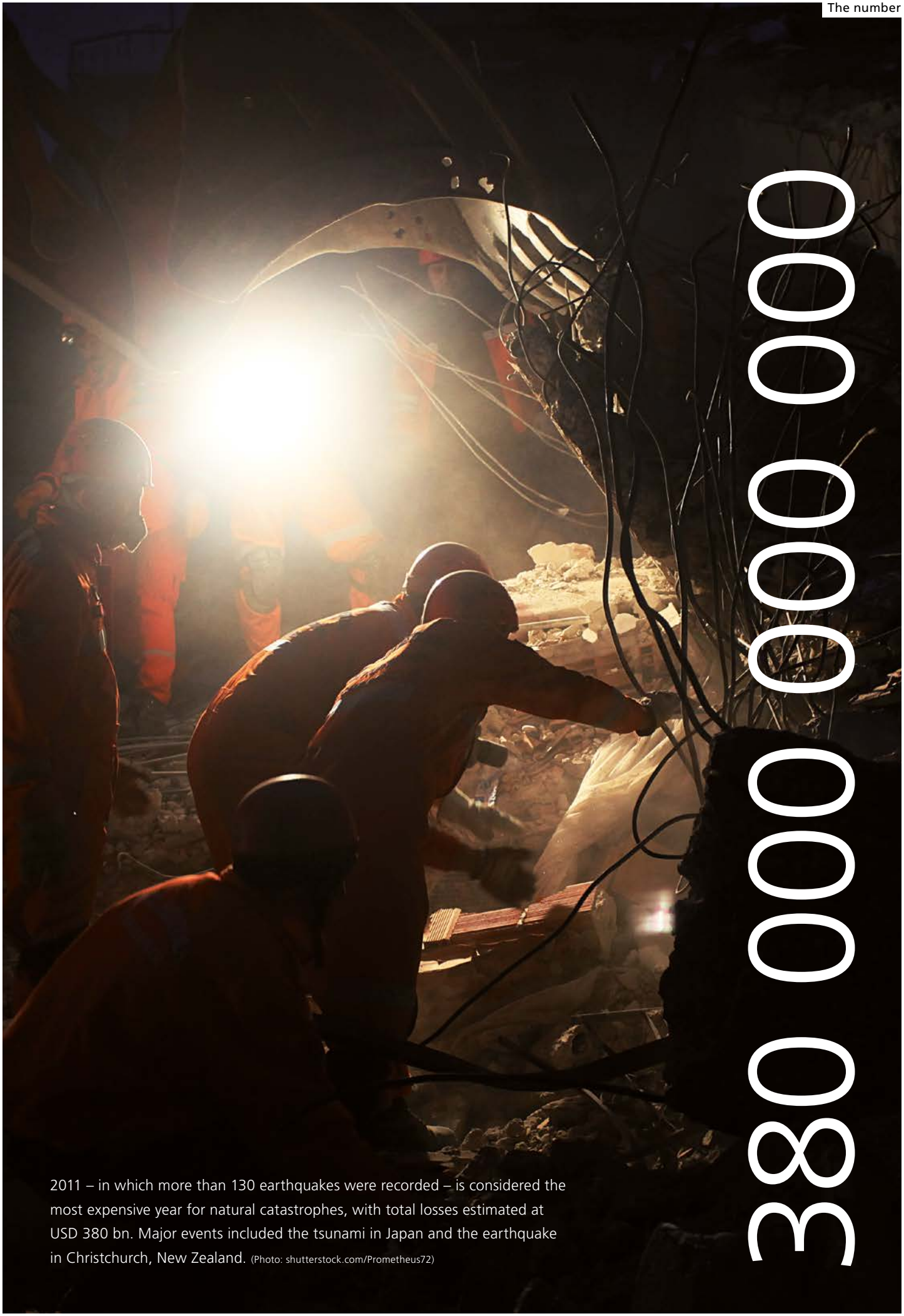
As this example illustrates, insurance is based on protection against catastrophes – a feature it has in common with the insurance-linked securities (ILS) asset class. The insurance industry evolved in several steps before these instruments were developed in the 1990s. In ancient Rome, poorer sections of society set up funeral funds – "collegia funeratica" – to cope with the costly ceremonies. The first registered life insurance policy was taken out in England in 1583, and the Hamburg fire insurance fund, which claims to be the oldest insurance company in the world, was established in 1676. In the 1880s, Otto von Bismarck introduced a full insurance package consisting of health, accident and pension insurance. Reinsurance companies also came into being around the world in the mid-19th century, after it became plain to insurers that they needed to spread risks more effectively. In 1907, the Hungarian timber merchant Max von Engel made his idea of luggage insurance a reality, and in the mid-1990s, long-term state care insurance was introduced in Germany, becoming the newest form of insurance.

ILS were developed around the same time, bridging the gap back to the early days of insurance. The Gabler insurance lexicon explains succinctly that ILS are used to transform insurance risks into fixed-interest securities, which are then transferred to the capital market and traded. Catastrophe, or cat, bonds are the best-known form of these securities. They were first traded after Hurricane Andrew, which devastated the US state of Florida in 1992, and the Northridge earthquake of 1994. The latter caused damage as far as 125 km away from the epicenter and is still one of the most expensive natural disasters to hit the USA, with estimated property damage of USD 20 bn. ◆

Photo: shutterstock.com/TK Kurikawa

Tōhoku earthquake

The world's most severe natural disaster occurred in Japan in 2011. An earthquake measuring nine on the Richter scale triggered a tsunami and severely damaged the nuclear power plant in Fukushima. About 20 000 people lost their lives, and another 450 000 or so were made homeless. The economic losses, including the Fukushima nuclear disaster, totaled USD 335 bn. Only around USD 40 bn was estimated to be covered by the reinsurer, Munich Re.



380 000 000

2011 – in which more than 130 earthquakes were recorded – is considered the most expensive year for natural catastrophes, with total losses estimated at USD 380 bn. Major events included the tsunami in Japan and the earthquake in Christchurch, New Zealand. (Photo: shutterstock.com/Prometheus72)

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Imperial Porcelain Manufactory Vienna, Sorgenthal Era (1784–1805), detail from "Cup and saucer with cornflower blossoms on a pale blue background," around 1802

A look inside the Princely Collections: The Princely Collections are known in particular for their paintings and sculptures, but also include a large number of porcelain pieces. Once part of the furnishings of the family's castles and palaces, these fragile works not only reflect the diverse relationships between lifestyle and dynastic interests. They also provide us with insights into the ideas and the artistic development during the respective period.

For more than 400 years, the Princes of Liechtenstein have been passionate art collectors. The Princely Collections include key works of European art stretching over five centuries and are now among the world's major private art collections. The notion of promoting fine arts for the general good enjoyed its greatest popularity during the Baroque period. The House of Liechtenstein has pursued this ideal consistently down the generations. We make deliberate use of the works of art in the Princely Collections to accompany what we do. For us, they embody those values that form the basis for a successful partnership with our clients: expertise, reliability and a long-term perspective.

Cover image: Imperial Porcelain Manufactory Vienna, detail from "Déjeuner Solitaire in the original leather casket," around 1807

www.liechtensteincollections.at

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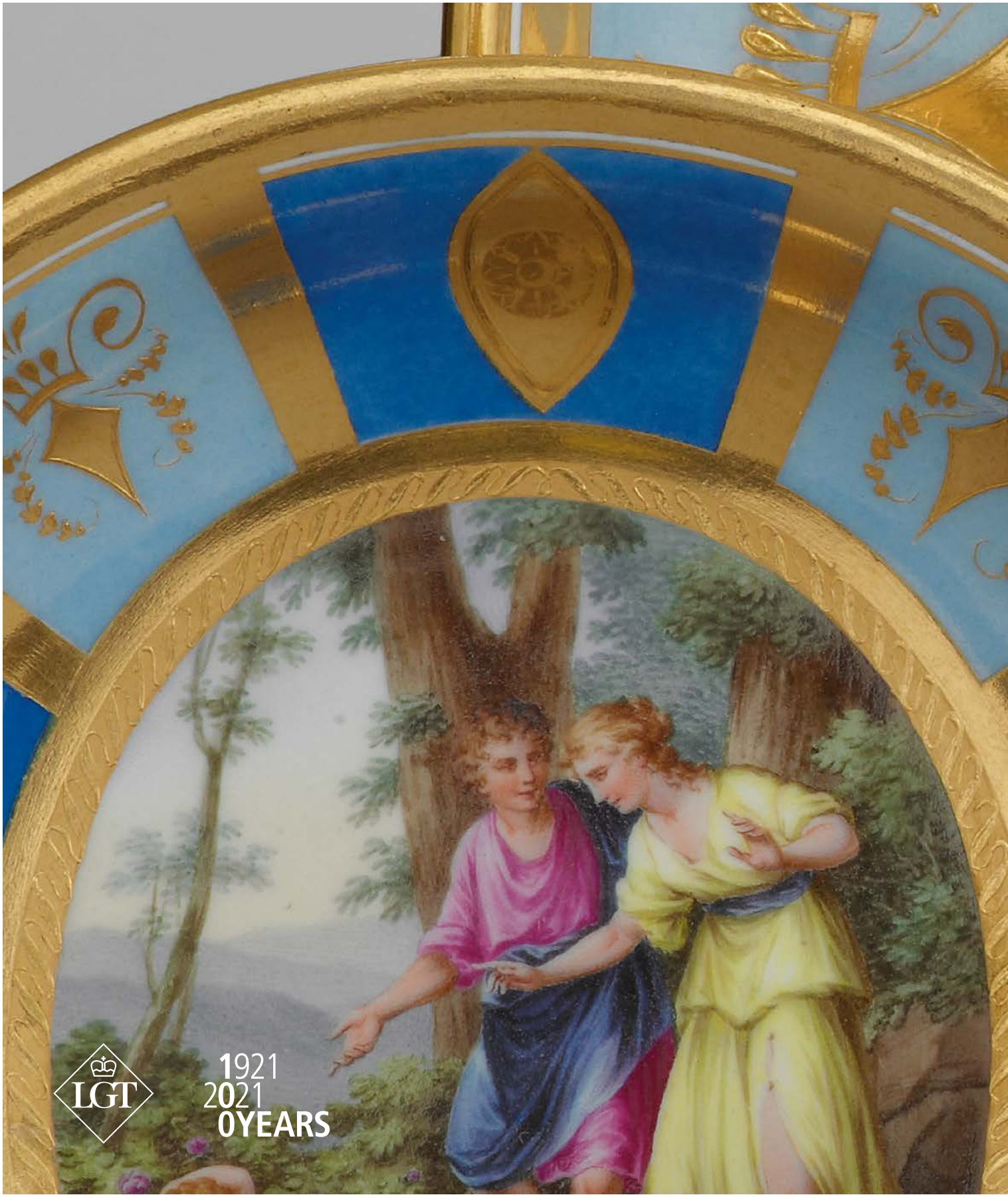

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