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Executive summary

- *The performance of insurance-linked securities, including catastrophe bonds, is linked to low-probability but high-severity events. As a result, their performance generally has a low correlation to traditional financial markets.*
- *The reinsurance industry has existed for over 150 years, and its benchmark, the Swiss Re Global Cat Bond Index, has delivered positive returns in 20 of the past 21 years¹.*
- *A supply/demand imbalance for reinsurance, compounded by recent events over the past several years, may have significantly increased the investment opportunity, and we expect these trends to continue into the foreseeable future.*

Catastrophe (cat) bonds, a subcategory of insurance-linked securities (ILS), are outcome-oriented investments with low correlation to the broader capital markets. They are structured securities through which insurers or reinsurers transfer specific risks, typically those associated with severe events such as catastrophes or natural disasters, to capital market investors. These bonds were first introduced into the capital markets as a result of Hurricane Andrew in 1992, which caused record insured losses and challenged the solvency of several insurance companies. As a result, cat bonds and other ILS instruments were created to strengthen reinsurance companies' balance sheets and foster a more resilient industry.

Why add cat bonds to a diversified portfolio?

Because catastrophe bonds do not move in line with traditional financial stocks, these instruments provide potential opportunities for investors to diversify² their portfolios. In addition, they have offered more attractive risk/return characteristics over the past 10 years (see Exhibit 1) than have many traditional asset classes. In an index or broad portfolio of cat bonds, exposure is diversified across perils and regions. Regional exposure comes mostly from developed countries, since many emerging markets do not have much need for reinsurance coverage.

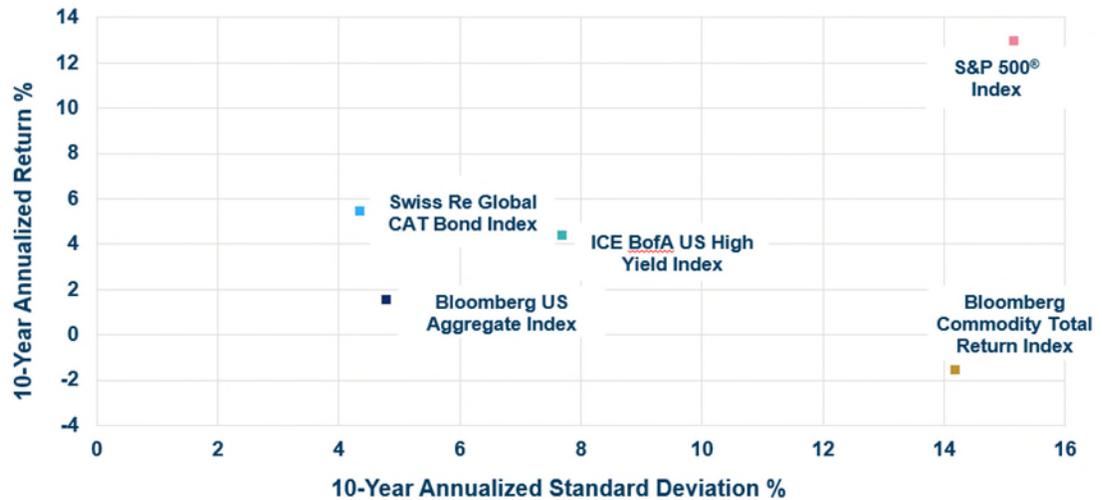
We believe that including cat bonds within a broader asset allocation can potentially have powerful diversification² benefits while also offering total return potential. Portfolio returns for cat bonds are not driven by economic factors such as gross domestic product growth, interest rates, and corporate profitability. Instead, performance is driven by the occurrence of low-frequency, high-severity natural events such as earthquakes and hurricanes. This key distinguishing feature has resulted in the low correlation of cat bonds to other asset classes.

Although cat bonds are floating-rate securities and offer high levels of liquidity, investors may wish to use them as part of a strategic asset allocation with a long-term investment horizon, as all investments are subject to risk and possible loss of principal. Given these characteristics, we believe ILS and cat bonds may fit well within the fixed income or alternative asset class portion of an investor's portfolio. Portfolio-level volatility may be reduced by diversifying exposures across geographic regions and perils.

¹ See Exhibit 2 for Swiss Re Global Cat Bond Index return data.

² Diversification does not guarantee a profit or protect against a loss.

Exhibit 1: Over the past 10 years, cat bonds offered higher returns with lower realized risk than many other asset classes



Source: Morningstar as of 3/31/2024. Data is based on past performance, which does not guarantee future results. Data is not meant to represent the performance of any Amundi US portfolio. Commodities are represented by **Bloomberg Commodity Total Return Index**. Event-linked (catastrophe) bonds are represented by the **Swiss Re Global CAT Bond Index**, which tracks the aggregate performance of all USD, EUR and JPY denominated CAT bonds, capturing all ratings, perils and triggers. US stocks represented by the **S&P 500 Index**, a commonly used measure of the US Stock Market. US aggregate bonds are represented by the **Bloomberg US Aggregate Index**. High yield corporate bonds are represented by the **ICE BofA US High Yield Index**. Indices are unmanaged and their returns assume reinvestment of dividends and do not reflect any fees or expenses. It is not possible to invest directly in an index.

Why now? Current market opportunities

Some long-term investors are now looking to take advantage of the potentially favorable uncorrelated sources of risk, return, and liquidity offered by ILS.

Amundi US is encouraged by the continuation of trends we are seeing in the industry and we remain constructive on this low-correlated source of attractive returns. We believe the primary drivers for a favorable 2024 and beyond could include the continued elevated pricing achieved at the January 1 renewal for almost all the perils and geographies, combined with the continued capital supply/demand imbalances.

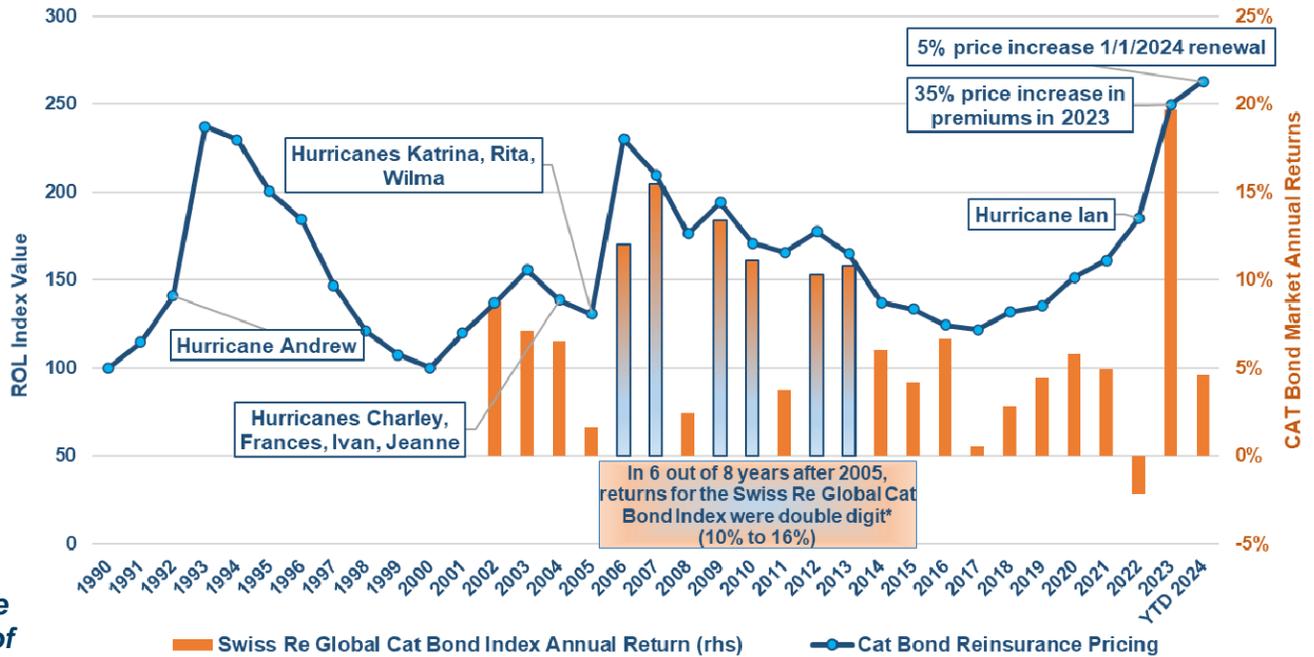
As a result of ongoing high demand for reinsurance, the low correlation of catastrophe bonds to traditional markets has continued to exhibit itself as we start 2024, and as we observed throughout 2023 and 2022, especially when compared to the volatility in nearly all traditional asset classes.

As reinsurance companies continue to seek non-traditional capacity, ILS and cat bonds become an increasingly important component for their reinsurance protection programs and capital planning. This has been evidenced by the strong pipeline for all ILS formats, including cat bond issuances, as well as the number of new sponsors who came to the market to seeking ILS capacity.

In addition to the relative importance of the ILS market, we believe overall demand will continue to grow, driven by the impact from inflation, concerns about climate change, volatility of carriers' investment portfolios, and pressure from rating agencies. Florida, which accounts for the largest portion of cat bond reinsurance demand, has begun to see some favorable effects from the property insurance legislative reforms passed in 2023, leading to a healthier marketplace and certain carriers planning to grow their businesses in Florida.

As a result, these carriers will likely need more reinsurance capacity in their 2024 mid-year renewals. We believe these trends may benefit the overall reinsurance industry and ILS marketplace.

Exhibit 2: Highest pricing levels for cat bonds in more than 30 years



We believe the combination of the continued elevated pricing, combined with the ongoing demand for reinsurance, may present an attractive investment opportunity throughout the remainder of 2024 and into 2025.

Source: Artemis, Guy Carpenter as of January 1, 2024 (updated quarterly). Past performance is no guarantee of future results. Guy Carpenter's US Property Catastrophe Rate-on-Line (ROL) index is a measure of the change in dollars paid for coverage year-on-year on a consistent program basis.

Conclusion

As a structurally uncorrelated source of risk and return, we believe cat bonds and ILS may permit investors to build more diversified and resilient portfolios. The rate on line (premium) for private ILS formats and the cat bond market spread remains elevated and could provide attractive total yield potential.

We believe the combination of continued elevated pricing, combined with the ongoing demand for reinsurance, may present an attractive investment opportunity throughout the remainder of 2024 and into 2025.

Index and Term Definitions

- Catastrophe bonds: High-yield debt instruments designed to raise money for insurance companies in the event that specific natural disasters, such as earthquakes or tornados, occur.
- Correlation: Measures the degree to which two variables move in relation to each other. A positive correlation signifies similar movements; negative correlation indicates opposite movement.
- Insurance-linked securities: Financial instruments that allow investors to speculate on a variety of events, including catastrophes such as hurricanes, earthquakes and pandemics.
- Longevity risk: The chance that life expectancies and actual survival rates exceed expectations or pricing assumptions, resulting in greater-than-anticipated cash flow needs on the part of insurance companies or pension funds.
- Mortality risk: The risk associated with the variability in liability cash flows due to the incidence of death, resulting in greater-than-anticipated cash flow needs on the part of insurance companies or pension funds.
- Rate on line: The ratio of premium paid to loss recoverable in a reinsurance contract.
- Reinsurance: The insurance that an insurance company purchases from another insurance company or investor to insulate itself from the risk of a major claims event.
- Standard deviation: A measure of the amount of variation of a set of values. A low standard deviation indicates that the values tend to be close to the mean, while a high standard deviation indicates that the values are spread out over a wider range.

Important information

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