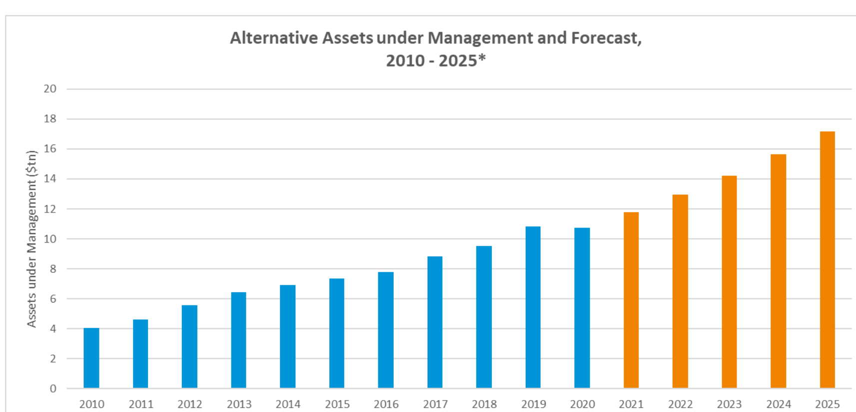
Anticipating Increased Volatility, Where to Look for Risk Mitigation

Conshohocken, PA, December 14, 2020 - Entering 2020 nobody would have predicted what an extraordinary year it would be. Central banks and governments around the globe worked in unprecedented synergies to save their economies in the face of a global pandemic and the debilitating shutdowns that ensued. Speaking of unprecedented, the S&P 500 has now returned in the low-teens year-to-date[1] despite being down over 30% during the first three months of the year. The influx of fiscal and monetary stimulus propelled risk assets into the stratosphere, but investors now must question what this means for future returns as companies, especially in the technology sector, will have to grow into these historic valuations.

With the markets so dependent on additional stimulus, we expect volatility to remain elevated for the foreseeable future. As such, investors' appetite for alternative investment strategies to help mitigate volatility is expected to increase significantly. According to Preqin, AUM in alternative investment strategies is expected to increase 70% over the next five years and top $17T in assets by 2025.[2]



While the need for risk mitigation tools is apparent, the question many wealth advisors are asking is where should they look for the greatest overall portfolio diversification? Hedge funds have been out of favor since the beginning of the Great Financial Crisis, as performance within these strategies, such as long-short equity have failed to deliver impressive returns. But the more appropriate question to ask if investors are utilizing these strategies for risk mitigation, is which alternative investment strategies truly provide uncorrelated return streams while also having the potential to deliver equity like return?

When comparing alternative investment strategies over the past approximately 15 years, one strategy that has stood out for its correlation benefits has been reinsurance, especially in area of natural disaster catastrophe reinsurance. Unlike other alternative investment strategies, reinsurance, as represented by the Eureka ILS Advisers Index, has delivered a near zero correlation to both equities and fixed income.

Hedge Fund and Tradable Alternative Investment Strategy Correlations[3]
January 2006 – September 2020

	BarCap Aggregate Bond Index	S&P 500 Total Return Index
Eureka ILS Advisers Index	0.09	0.11
HFRI Fund Wtd. Comp. Index	0.05	0.85
HFRI Equity Hedge Index	0.00	0.88
HFRI RV Index	0.10	0.71
HFRI ED Index	-0.04	0.80
HFRI Global Macro Index	0.22	0.27
NAREIT Index	0.26	0.74

Natural disaster reinsurance is also especially interesting in this market environment as there little to no exposure to COVID-19 sensitive areas like there is in other areas of insurance such as travel or event.

While headline risk for hurricanes, earthquakes and wildfires are the biggest stigmatism facing asset managers, the realties are that prudent reinsurance managers have been able to navigate 2020 and deliver strong high single digit returns to investors without any of the usual market volatility. 2017 and 2018 were two of the worst years on record within reinsurance and one of the biggest reasons why is because insurable events declined over the prior years and more capital entered the space. This led to premium declines and firms holding contracts that were not compensating them appropriately for the risk assumed. In contrast, the market today has shifted as reinsurers are demanding higher premiums. In addition, capital flows have declined from the ILS (Insurance Linked Securities) channel.

This dynamic has created much higher premiums in 2020 and with the record number of named storms this year, premiums are expected to increase even further. Because of these higher premiums, the better fund managers have been able to generate positive returns throughout the calendar year. While there have been a record number of named storms this year, most of the insurance losses have been relatively small per event and thus contained to the retention class and not second loss positions.

Natural event catastrophe reinsurance has been a staple of institutional portfolios for years. The strategy allows for equity like returns, but with return streams nearly completely uncorrelated to the financial markets. With markets back near all-time highs, an allocation to reinsurance can be a prudent diversifier as investors ponder where to look for both risk mitigation and return generation in a single investment.

For more information on how to access PPB's dedicated private lending strategy, please contact Frank Burke, CFA, CAIA, Chief Investment Officer, PPB Capital Partners, 484.278.4017 Ext. 108 or at fab@ppbadvisors.com.

About PPB Capital Partners, LLC

Launched in 2008, PPB Capital Partners, LLC (or "PPB" or "the Firm") brings premier alternative investment solutions and streamlined processing to the wealth advisor community. PPB Capital Partners provides a roster of alternative investment managers, as well as builds and operates feeder funds and customized fund of funds for wealth advisory firms.

Important Footnotes and Disclosures

1. Source: Bloomberg. S&P 500 Index as of December 10, 2020
2. Source: Preqin. 2020 figure is annualized based on data to October. 2021-2025 are Preqin's forecasted figures.
3. Source HFRI and Bloomberg

Index Definitions

Barclays Capital U.S. Aggregate Bond Index - An unmanaged index of investment-grade, U.S. dollar-denominated fixed income securities of domestic issuers having a maturity greater than one year.

The Bloomberg Barclays US Corporate High Yield Bond Index - measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Eurekahedge ILS Advisers Index - tracks the performance of participating Insurance Linked Investment funds. It is the first benchmark that allows a comparison between different insurance-linked securities fund managers in the insurance-linked securities, reinsurance and catastrophe bond investment space. The index is calculated and maintained by Eurekahedge. The index includes funds that allocate at least 70% of their assets in non-life risk.

HFRI Event Driven Multi-Strategy Index – These managers maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure. ED Multi-Strategy managers do not maintain more than 50% exposure in any one Event-Driven sub-strategy.

HFRI Equity Hedge Index - These strategies maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Equity Hedge managers would typically maintain at least 50% in equities and may in some cases be substantially entirely invested in equities, both long and short.

HFRI Fund Weighted composite Index - This index is a global, equal-weighted index of over 2,000 single- manager funds. Constituent funds report monthly net of all fees performance in U.S. dollars and have a minimum of $50 million under management or a 12-month track record of active performance. The index does not include funds of hedge funds.

HFRI Macro (Total) Index - Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom-up theses, quantitative and fundamental approaches and long and short-term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposes to EH, in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

HFRI Relative Value (Total) Index - Investment Managers who maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. RV position may be involved in corporate transactions also, but as opposed to ED exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

S&P 500 Total Return - This is an index of 500 stocks chosen for market size, liquidity, and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.