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Catastrophe Bond Markets Total Return 11% in 2013.

The total return of the outstanding catastrophe bond market in 2013 has beaten the long-term average for the second year running, with the 2013 total return reaching a very healthy 10.9%, as measured by the Swiss Re Global Cat Bond Performance Total Return index.

The 2013 total return of the catastrophe bond market of 10.9% beats last years figure of 10.3% and is 2.5% above the long-term average from 2002 to the end of 2012 of 8.4%. 2013 saw cat bond total returns on an almost consistent upward trajectory, resulting in strong investment performance for catastrophe bond focused ILS funds and qualified investors directly buying cat bonds in 2013.

The performance of the cat bond market total return index once again underscores the attractiveness of an investment in a diversified portfolio of catastrophe bonds and helps to explain the continued interest in the asset class from new institutional investors such as pension funds.

The attractive potential returns offered by an investment in catastrophe bonds is just part of the attraction though. The diversifying nature of investments in catastrophe risk, the fact that as assets they are largely uncorrelated with broader financial markets and because, as an asset class, cat bonds exhibit extremely low volatility compared to other assets, further explains the attraction for investors.

More broadly, ILS funds look set to average returns of approximately 7.5% in 2013, judging from the returns reported by the Eurekahedge ILS Advisers Index to date. This is just below the average returns of the wider hedge fund market, which Eurekahedge reported as 8.02% for 2013.

This shows that ILS, as an alternative asset class, is keeping up with other alternative assets, even during a year where pricing of new issues has decreased. Catastrophe bonds, insurance-linked securities (ILS) and other reinsurance-linked investments look set to maintain their attraction for investors in 2014, with the range of options available to invest in this asset class getting broader all the time.

So, let’s have a look at the Swiss Re Global Cat Bond Indices and how they ended 2013. We start with the Swiss Re Global Cat Bond Performance Price Return index, tracking the price return for all outstanding USD denominated cat bonds. Over the course of 2013 the price return index gained 2.2%, finishing the year at an index value of 96.77.

The chart below shows the last year for the price return index and you can clearly see the seasonal movements as well as the effect that high levels of issuance have on this index. In particular the way the index declined from mid-April, due to high levels of capital interest in the asset class, through to when spread tightening from the U.S. hurricane season took effect, is particularly evident. As is the tailing off of prices in October as the market realised that the U.S. hurricane season was looking particularly benign in 2013.

This second chart provides a longer term view of the price return index over three years. Particularly evident in this chart are the declines caused by the Tohoku earthquake and tsunami and hurricane Sandy, demonstrating how catastrophe events impact price returns across the secondary catastrophe bond market.

Now let's look at the Swiss Re Global Cat Bond Performance Total Return index, which tracks the total return of a basket of natural catastrophe bonds. This index saw almost constant gains in 2013, with only a couple of weeks of very small declines possibly caused by calculation adjustments rather than any potential impact to the market.

The solid growth of near 11%, ending the year at an index value of 267.01, experienced by the total return index in 2013, as well as the consistent upwards trajectory, shows that 2013 saw little in the way of threats to catastrophe bonds from loss events.

Also evident from this longer term view of the total return of the catastrophe bond market is the fact that excellent returns are available from a long-term, diversified portfolio of cat bonds (or indeed catastrophe reinsurance risk). Since 2002 when Swiss Re began tracking the total return of the cat bond market, up to the end of 2013 its index has seen an average annual return of approximately 8.6%.

The Swiss Re Global Cat Bond Total Return index launched at 100.00, at the end of 2013 it stood at 267.01. That is a gain of 167.01% which is extremely impressive growth.

This data shows why catastrophe bonds, insurance-linked securities (ILS) and catastrophe reinsurance-linked investments have grown in popularity and become a widely appreciated alternative asset class. The attractive returns, low volatility, low correlation and portfolio diversification features continue to attract new investors and increasing levels of capital to the asset class.

This trend is expected to continue through 2014, investor appetite seems as strong as ever even taking into account recent declines in pricing. The asset class continues to prove its worth to institutional investors globally and while losses remain scarce the returns on offer from an investment in catastrophe bonds and ILS will remain an attractive prospect.

Click here for charts & graphs:

http://www.artemis.bm/blog/2014/01/03/catastrophe-bond-markets-total-return-11-in-2013/

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