



Insurance-related investments strategy

Investment update to 30 September 2019

Our insurance-related investments strategy uses two managers: AlphaCat Managers Ltd (AlphaCat) and Mt Logan Re, Ltd (Mt Logan Re). The MLC Inflation Plus portfolios' and MySuper allocations to the insurance-related investments strategy are shown in Table 1. MLC Horizon portfolios also have an indirect allocation through their investment in the MLC Inflation Plus strategies.

Table 1: MLC Inflation Plus portfolios' and MySuper target allocations to insurance-related investments as at 30 September 2019

MLC MasterKey Super & Pension Fundamentals / MySuper	Insurance-related investments %	MLC Wholesale	Insurance-related investments %
MLC Inflation Plus Assertive Portfolio	3.0	MLC Wholesale Inflation Plus Assertive Portfolio	3.0
MLC Inflation Plus Moderate Portfolio	1.5	MLC Wholesale Inflation Plus Moderate Portfolio	1.5
MLC Inflation Plus Conservative Portfolio	-	MLC Wholesale Inflation Plus Conservative Portfolio	-
MySuper Growth Portfolio	2.0		
MySuper Conservative Growth Portfolio	2.0		

Source: MLC Asset Management Services Limited. Based on the portfolios' target allocations.

An explanation of how fees are deducted from returns is in Appendix 1.

What are insurance-related investments?

These are investments in natural catastrophe risks. Investors take on the role of an insurer. They receive a yield - effectively an insurance premium - for taking the risk of a particular natural catastrophe causing losses above a certain level.

As the occurrence of natural catastrophes has no expected correlation with share market movements, the strategy is an attractive source of diversification. For example, during the global financial crisis, shares fell but insurance-related investments performed well.

Investment objectives

The strategy seeks to provide our portfolios with sources of risk and return that are not correlated to mainstream asset classes.

Why invest in insurance-related investments?

These investments are expected to deliver a return that is between the more traditional assets of shares and fixed income. In addition, its significant diversification characteristics reduce total portfolio risk, which improves the risk-return efficiency of the portfolios.

Insurance-related investments are unusual because their returns are independent of the economic factors that influence the performance of most other investments. This makes them a rare and valuable source of returns that are largely 'uncorrelated' with returns from shares.

Another distinctive feature of these investments is the visibility regarding its risk-return profile. Unlike other asset classes, where generally the expected returns are higher when risks are higher, in reinsurance the risks of a catastrophe occurring does not change materially from year to year, but the pricing can. This provides us with the ability to dial up and down our portfolio exposure according to the relative attractiveness of the pricing.

Certain risks tend to get paid relatively better returns. This is because there is a large economic exposure in the US to densely populated areas with expensive real estate - Florida (hurricane) and California (earthquake) being prime examples – that also

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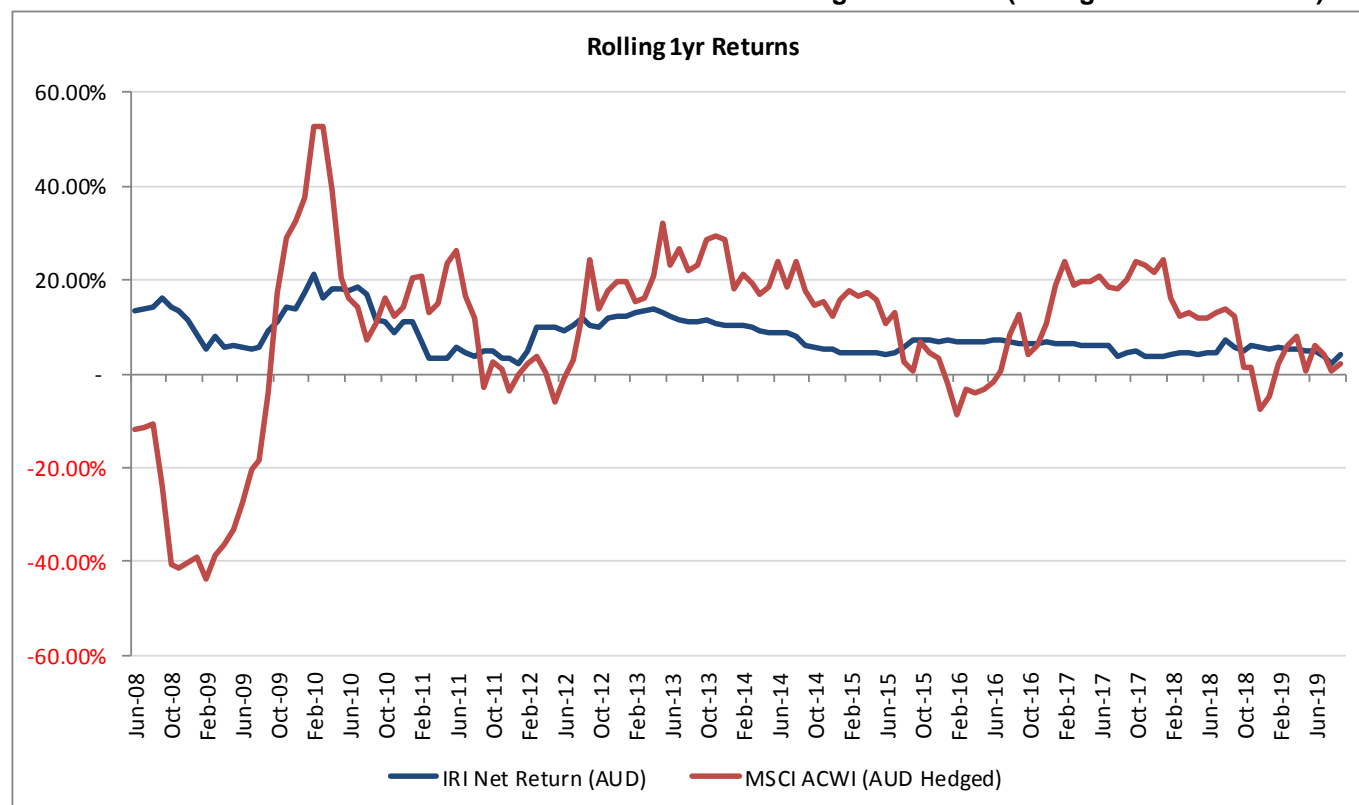
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happen to be exposed to major natural catastrophes. It therefore makes sense for the reinsurance industry to reduce some of their exposure to these risks, particularly the very low probability, high impact events (which could jeopardise their solvency). This enables MLC's investors to get paid well for taking these 'remote peak peril' risks, while also benefiting from the diversification benefits.

Performance

The insurance-related investments strategy has worked well for our portfolios, making an important contribution to real returns and helping to moderate risk. The strategy has low correlation to shares and has delivered 8.2% pa (hedged into Australian dollars and net of indirect costs) from July 2007 to 30 September 2019.

Chart 1: Performance of insurance-related investments relative to global shares (rolling 12 month returns)



Source: MLC Asset Management Services Limited. Insurance-related investment strategy returns are hedged into Australian dollars and net of indirect costs. Past performance is not a reliable indicator of future performance.

About the managers

We have appointed AlphaCat and Mt Logan Re to manage insurance-related investments due to each manager's investment experience and expertise in the management of natural catastrophe and weather-related reinsurance risk exposures.

Target manager allocations at the end of the September quarter remained unchanged with AlphaCat 67% and Mt Logan Re 33%.

AlphaCat

- AlphaCat was appointed by MLC to manage insurance-related investments in July 2015.
- Manages approximately A\$6.3 billion across the world (as at September 2019).
- AlphaCat's parent company, Validus Group (Validus), was established in 2005. In July 2018, AIG acquired Validus and AlphaCat is now 100% owned by AIG. AlphaCat is based in Bermuda and has managed insurance-linked securities since 2008.
- AlphaCat has a team of 19, and AIG has over 50,000 employees (as at September 2019).

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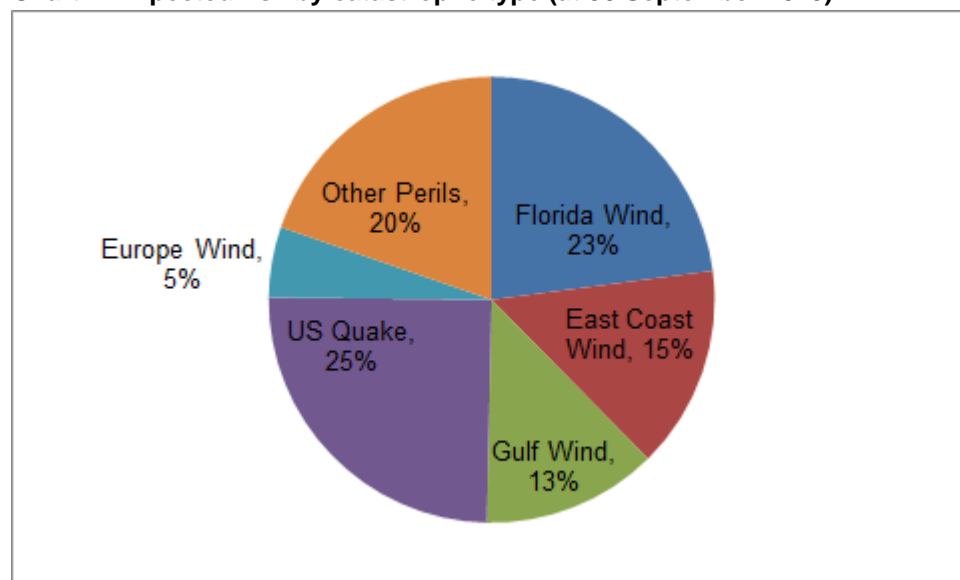
Mt Logan Re

- Mt Logan Re was appointed by MLC to manage insurance-related investments effective 1 January 2018.
- Manages over A\$1.35 billion (as at September 2019).
- Mt Logan Re's Bermuda-based parent company, Everest Re Group, Ltd (Everest Re Group) has a 47-year operating history. Mt Logan Re, also based in Bermuda, has managed insurance-related investments since 2013.
- Mt Logan Re has a team of 7, and Everest Re has over 1400 employees (as at September 2019).

Our insurance-related investments strategy consists of a combination of catastrophe bonds (~15%) as well as direct reinsurance. The direct reinsurance market is a much larger pool of exposures compared to the catastrophe bond market, which creates more opportunity. This is where investing through AlphaCat and Mt Logan Re is most advantageous to our investors. These managers and their parent companies are extremely well positioned to source and sift attractive risks from insurance companies and analyse these risks accurately. One example of this is the Validus Research team, which consists of 30+ people, including seismologists and weather experts, whose job is to accurately assess the risk of loss from various events. Importantly, Validus and Everest Re Group retains exposure to all the risks to which we are exposed, which creates a strong alignment of interest.

Risk exposure

Chart 2: Expected risk by catastrophe type (at 30 September 2019)



Source: MLC Asset Management Services Limited. Figures have been rounded to the nearest percent.

Current strategy positioning

Returns are net of indirect costs.

The strategy returned 2.3% (hedged into Australian dollars) during the September quarter and 4.1% for the 12 months ending 30 September 2019. The return for the third quarter was reflective of the seasonal peak in premium income for the strategy, which occurs during the peak of the US hurricane season. For the year, the strategy again strongly outperformed industry peers and peer indices for both reinsurance strategies and catastrophe bonds (being the EurekaHedge ILS Advisers Index and the Swiss Re Catastrophe Bond Index (AUD hedged)).

The September quarter saw catastrophe events in both the US and Japan which have impacted the strategy.

- In the US, after threatening to make landfall in the more populated Florida coast, Hurricane Dorian made landfall in the Carolinas in early September as a Category 2 hurricane.



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- In Japan, Typhoon Faxai made landfall in the Kanto and Chiba regions in mid-September, also as an equivalent Category 2 storm.

Preliminary estimates of insured losses for both events vary widely across modelling firms, but fall within a broad range of ~US\$5bn at the low end to US\$10bn at the high end. Both AlphaCat and Mt Logan Re made preliminary loss accruals at quarter end to reflect an initial estimate of the impact of these events on their respective portfolios. This had a combined ~-0.4% impact on the overall strategy's returns. These initial loss estimates are likely to be revised over time as additional realised loss information becomes available.

The overall strategy remains well diversified across both US and non-US reinsurance exposures, through a combination of traditional reinsurance contracts and to a lesser degree catastrophe bonds.

Appendix 1: Understanding fees that are deducted from returns in this investment update

As MLC Horizon and Inflation Plus portfolios invest in the insurance-related investments strategy and a range of other asset classes and strategies, only some of the fees disclosed in the Product Disclosure Statements (PDSs) relate directly to the management of the insurance-related investments strategy. Therefore, the insurance-related investments strategy performance is reported before deducting most of the fees and taxes disclosed in the PDSs. However, we have deducted from the insurance-related investments strategy's performance indirect costs where these costs directly apply to the management of insurance-related investments strategy's investments. The insurance-related investments strategy's indirect costs are incurred when it invests in external investment funds. They aren't additional fees retained by MLC.

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