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December 31, 2025

ILS Total Returns 2026? – not just a Cat Conundrum?

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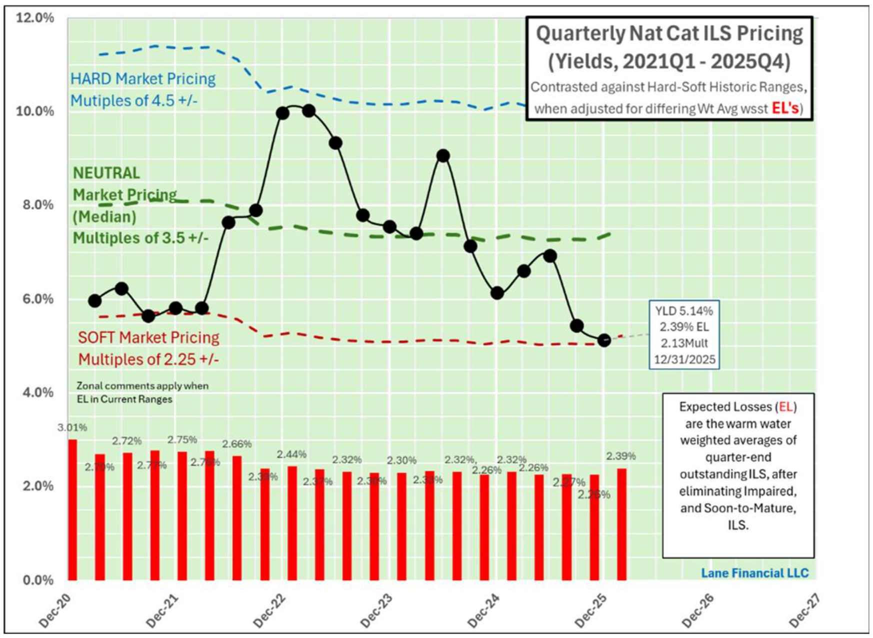
Total returns for ILS investors in 2023, 2024, and 2025 have been high and in double digit annual percentages. This has come about because of three factors:



a) a "hard" reinsurance market at the beginning of 2023,
b) historically low natural disaster losses in 2024 and, more so, in 2025, and,
c) relatively high USTR interest rates providing a good floating rate return.

All of these factors are different at the beginning of 2026:

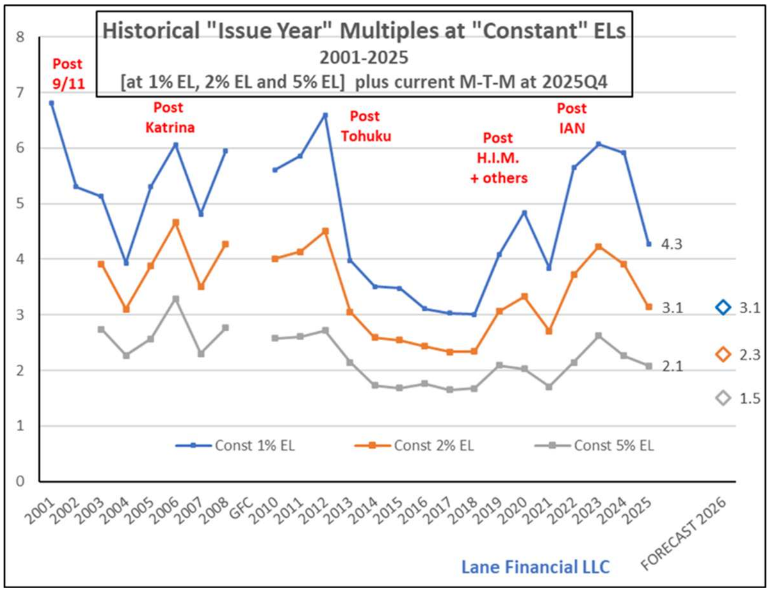
a) 2026 begins with a historically "soft" market,
b) Natural Disaster losses, while unpredictable, will likely revert to their mean, and,
c) US Interest rates will likely fall further.

In short, the most reliable forecast for 2026 is that at year-end total returns for the ILS market will NOT be in double digit annual percentages.

We discuss each factor in turn.

The Soft Market

The soft market is not a surprise to those who have been watching the market. Simple multiples have been dropping all year. Just how soft it is now is demonstrated by some familiar updated graphics.



The first graph on Page 1 shows the Quarterly marks at their lowest in three years – since the first half of 2022. This view might encourage the view that the soft market might not last very long.

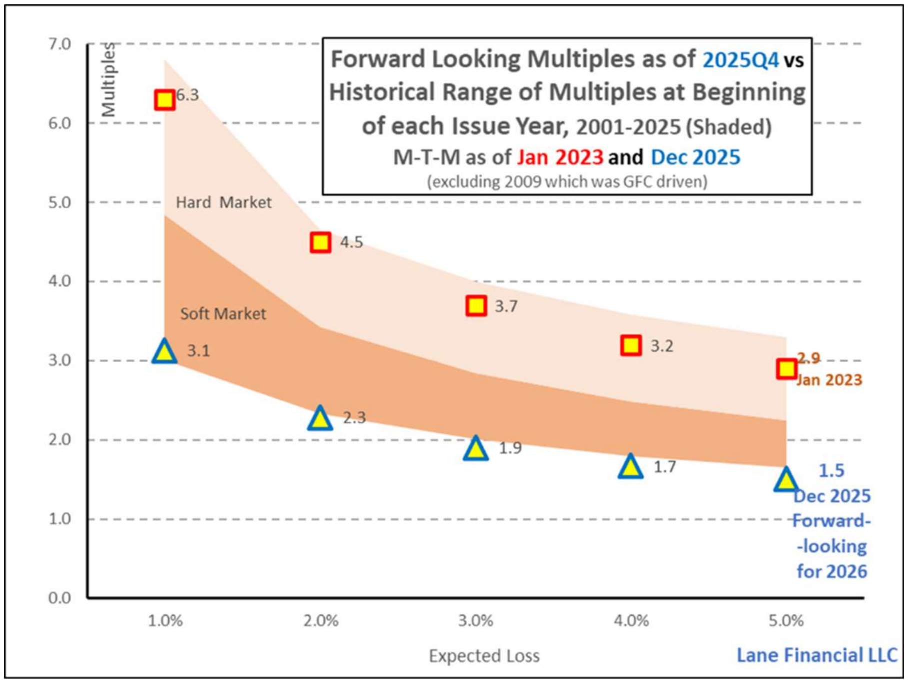
However, history (see alongside) shows that the soft market post "9/11" lasted for about four years (2002-2005) and the post Tohoku soft market also lasted about four years (2013-2017). In contrast, hard markets tend to be shorter – two to three years. There is no particular reason that cycles arise the way they do. Mother nature is in control of frequency and severity, Nevertheless, the historical record is interesting.

The third graph shows that the curve of multiples at differing levels of EL shows the end of year multiples at the lowest or lower than the cone of past experience (shaded area) for the last 25 years.

Expected Natural Catastrophes for 2026

Putting these observations together and assuming, i) a normal year of natural catastrophes, i.e., reversion to the mean EL, and ii) issuance in the coming year duplicating the character of all 2025, i.e., a weighted mean EL 2.56%, and further assuming iii) that the soft year-end multiple of 2.13% persists, then the expected underwriting return for 2026 stacks up as follows.

EL of the 2025 issues	2.56%	
Spread of	5.45%	(using a year-end Multiple of 2.13)
Underwriting Margin	2.89%	



If the floating USTR rate was just over 4% (it is not, of which more below) this might make for a comfortable 7%-ish expected total return. The underwriting margin is vulnerable to wide swings. Consider, the double digit return of 2025 was achieved because the year-end prices of non-impaired outstanding ILS stood at $102.9. It was that $2.9 premium that pushed the total return over 10%. It was the reason we updated our beginning-year forecast in mid-year to the double-digit level.

If in 2026, the market softens even more (beyond historic experience) there may be a premium at the end of 2026 which will push up the assumed underwriting margin. If the market lingers in its current soft market position the underwriting margin will hold. However, if the market hardens for any reason then outstanding prices will fall below par, say to $99 or $98, and the underwriting margin will be eroded or could disappear.

The Floating Rate

The floating rate component of total return is even more uncertain. Since most ILS use the USTR or close-equivalent for the custody rate, the focus here is on the Federal Reserve. The Fed still sees inflation as a bigger threat than employment weakness (each part of its dual mandate). Even so, it has given a nod in that latter direction with its latest cut – currently at 3.75%-3.5%.

The president will appoint a new Chair of the Fed early in the new year and that is likely to precipitate further cutting to conform to the president's wishes. Perhaps as much as 50 basis points with more to follow. Against this political background the current Chair has reappointed all the regional governors and so the president's desire may meet further resistance – especially if the inflation rate continues to press upward.

Too drastic a cut will, in our opinion, cause the Gold market to continue on its run. And, more consequentially, cause the longer bond market to fall – increasing the cost of government borrowing. Remember, the Fed only controls the short end; markets control the long end. We believe next year will provide more robust political/financial drama.

In the end, we would guess that the downward pressure would be sticky after 3% but could easily see rates stabilizing at 3.25% to 3.00% - call it 3.125% for a single number.

Adding this to the above underwriting margin of 2.89% and the expected total return for the ILS market in 2026 is just at 6.0%. But, as we have tried to stress, it is associated with a larger than usual standard deviation.

Soft/Hard Market Strategies

Our intention in writing these market commentaries is to observe the market, not to recommend strategies for investment. In other words, to inform rather than advise. However, with the coming end of the reign of Warren Buffet at Berkshire Hathaway it is hard not to reflect on the underwriting strategy of Berkshire, surely as important to its success as its asset side acumen.

The reinsurance activity of Berkshire has been under the direction of Ajit Jain and its small, excellent staff for many decades. And the strategy, boiled down to its essence, is to write in hard market (or at a minimum write at hard market prices) and to step away from soft markets (or soft market pricing). It has worked brilliantly and its emulation has been attempted by many an admirer. In our opinion the trick is two-fold. First, recognize when prices are hard or soft relative to a well-gauged estimate of risk. Second, be able to step away in the soft markets. And it is the second that causes others to fail rather than the former. Most franchise businesses cannot step away when times are tough – in this context soft prices. They would lose their priority position when the good times return, or they would lose their funds under management. For most, surviving the soft market is the price to be paid to be at the table when the hard market returns. But, in doing so mediocre returns dilute the high return years over the long run. Besides, insurance markets are not that easy to jump in and out of.

The “stay away from poorly priced risks” is not a unique strategy. It is manifest in the well-known Kelly principle of investing. It is enshrined in the bond market mantra “there is no such thing as a bad bond, just bad prices”. Or in the maxim “Buy straw hats in winter”. It is even embedded within the dedicated discipline of “card counters”. The principle is well understood. It is the execution that is difficult. Warren Buffet and Ajit Jain have executed it very well indeed.

So, is there anything that ILS funds can do to follow the principle, while staying in the game? A few things and we would expect to see them manifest in the next year or so. First, funds can stay invested in the soft market, but shortening their risk, by favoring the low EL and earlier maturity deals and avoiding the high ELs. Conversely, they would favor longer, high ELs when markets are hard. This is the analog of bond market traders shortening or lengthening their maturity as they become more bearish or bullish.

A more dramatic strategy during a soft market would be to hedge the riskier parts of their existing portfolio by becoming a reinsurance buyer or, its equivalent, being an ILS issuer themselves covering their current portfolio’s tail risk. Some hedge funds have done that in the semi-public ILS market in the past, while others have also done it, but privately.

We would expect to see more evidence of this behavior in 2026. After all, if you don’t like the soft market prices from an investment point of view – use them for protection.