POLAR CAPITAL



Higher yields, strong underwriting and an attractive entry point

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Why should investors care about insurance?

Given the non-life insurance sector is only a small part of equity market indices, it is a valid question to ask whether investors should care. Insurance is a challenging sector and, in aggregate, barely makes its cost of capital. However, if done well it can produce spectacular results over time – just ask Warren Buffett, who built Berkshire Hathaway on a bedrock of insurance, especially in the earlier decades.

What I did not fully appreciate in my early days working in the insurance industry was just how important insurance is to the functioning of the world economy. All too often people's perception of insurance, especially in the UK, is influenced by meerkats in TV adverts, poor personal experience with an insurance claim or a story about how some family member lost their shirt at Lloyd's of London. However, nothing much happens without insurance. Planes would not fly, ships would not sail, your Amazon package would not be delivered and – to be a bit more topical – your data centre would not get built. Insurance really is the oil that greases the wheels of world trade. However, its importance gets lost somehow with the industry suffering from a 'communications gap'. When someone says they work in insurance often what follows is a yawn with eyes glazing over.

For me, it is a fascinating industry that helps individuals, businesses and society manage uncertainty and transfer risk. It is a 'first responder' when something bad happens in the world, whose job is to restore the unfortunate back to their prior state. The industry provides capital after catastrophes, accidents and other unexpected events, helping communities and economies rebuild. When the industry prices risk it positively influences behaviours and nudges society to respond to threats such as climate change. We live today in an 'Age of Risk' which includes climate change, wars, pandemics, deglobalisation, AI and technological exponential change. There is an abundance of opportunities for the specialty insurers in which we invest.

The opportunities for investors

As you might hope, I have learned a thing or two along the way during my quarter of a century working on the Fund. Back in February, for the Polar Capital Investor Conference, I did a 10-minute talk giving 25 lessons from my first 25 years. I subsequently recorded a more polished version that is available on the Polar Capital website.

I will not dwell on the messages here but many of the lessons come back to the premise that all we have tried to do is deliver steady performance for clients, in more a 'get rich slow' compounding of returns story than some of the more exciting alternatives available to investors. If our companies can deliver double-digit book value growth and assuming Fund performance follows, we could potentially double client money in about seven years. It is likely that a double-digit return will beat the stock market indices over time. Only the S&P 500 has delivered that level of return over my 25 years, helped by the recent tech boom. We are more than happy quietly compounding returns and delivering outperformance, which usually comes in more challenging markets given the defensive characteristics of the non-life insurance sector and so we are delivering that outperformance exactly when our clients need it the most.

The impact of rising bond yields

Our companies take on underwriting risk so the last thing they want to do is double up on risk by having exciting things within their investment portfolios. They have very boring balance sheets stuffed with cash and short-dated bonds, because you need liquidity to be able to pay claims that can happen at any time.

The increase we have seen in short-term bond yields this year, notably in the third quarter, has meaningfully increased the earnings power of our companies. Our companies generally earn an investment return equivalent to the 2-year US Treasury plus 50-100bps. This year that 2-year US Treasury has risen from around 3.5% to 4.9% at the end of September and it remains around current levels for any significant amount of time, we expect our

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companies should conservatively earn 5-5.5% on their investment portfolios. This is sufficient to generate 10-11% of book value growth after tax before considering any underwriting profit.

What we do not know today is whether the meaningful bond yield rise we have seen in 2026 will persist. Consequently, when thinking about the next 12-month book value growth estimate we give for the Fund, we have increased our investment return assumption by only a prudent 25bps to 4.5%. Given materiality we have left our 16%+ estimated book value growth outlook unchanged from what we said back in July ahead of the second-quarter results. There is now a much larger margin of safety in our estimate.

The tailwind from investments is also occurring at a time when underwriting profitability remains at excellent levels. We have embedded in our current 16%+ book value growth assumption an after-tax contribution from underwriting profits of around 10%. Hence even if these underwriting margins were to weaken a little from here, current earnings power is still materially above historical averages.

An attractive entry point

Fund companies' book value growth since inception in 1998 has been around 11%, which has been sufficient to deliver strong outperformance of the Fund against most equity market indices over this period. Today, we believe, roughly that level of book value growth is achievable from the investment earnings alone.

The Fund's price to book at the end of September was about 160%. This is only modestly above the long-term average of 145% despite demonstrably much higher current earnings power that we believe is around 50% higher than the historical average achieved over the past 27+ years of the Fund.

You do not have to take my word for it. We are seeing increasing M&A across the sector. This year we have seen two of our holdings acquired, Beazley and Bowhead Specialty, both at c.240% tangible book or roughly 50% higher than the current valuation of the Fund.

Our management teams are also taking action with share buybacks averaging 2% of outstanding shares a quarter since the fourth quarter of 2025, an annualised rate of over 8%. These repurchases have been done at compelling valuations and are therefore extending the runway of excellent book value growth we can see in the years ahead.

The outlook

Should valuations just remain steady at current levels and our companies achieve our expected strong mid-teens or better book value growth, we believe we are poised for a period of strong Fund performance in the coming years. We believe the market is currently discounting a 12-13% book value growth trajectory for the US industry, which strikes us as a very prudent outlook for the next few years. We could of course be wrong but given the investment return is largely driven by short-term bond yields any error is most likely to come from us being too optimistic on underwriting margins.

We think that it is not unreasonable to assume that sustained bond yields at today's levels are likely to inevitably pressure underwriting pricing over time, and – with a lag – underwriting profits, although this is likely to be a few years away. However, even if you assumed a halving of our current expected underwriting margins, a very unlikely scenario in our view, expected book value growth would remain in the mid-teens given the strength of investment earnings. This would be a more than satisfactory outcome and most likely result in strong investor returns.

13 October 2026



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Find out more

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Risk Considerations

- **Capital is at risk and there is no guarantee the Fund will achieve its objective. Investors should make sure their attitude towards risk is aligned with the risk profile of the Fund before investing.**
- **Past performance is not a reliable guide to future performance. The value of investments may go down as well as up and you might get back less than you originally invested as there is no guarantee in place.**
- The value of a fund's assets may be affected by uncertainties such as international political developments, market sentiment, economic conditions, changes in government policies, restrictions on foreign investment and currency repatriation, currency fluctuations and other developments in the laws and regulations of countries in which investment may be made. Please see the Fund's Prospectus for details of all risks.
- The fund is exposed to Sustainability risks which are environmental, social and governance factors that could have an actual or potential material negative impact on the value of the Fund and its risk factors.
- The Fund invests in the shares of companies and share prices can rise or fall due to several factors affecting global stock markets.
- The Fund uses derivatives which carry the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as failure amongst market participants.
- The Fund invests in assets denominated in currencies other than the Fund's base currency. Changes in exchange rates may have a negative impact on the Fund's investments. If the share class currency is different from the currency of the country in which you reside, exchange rate fluctuations may affect your returns when converted into your local currency.
- The Fund invests in a relatively concentrated number of companies and industries based in one sector. This focused strategy can produce high gains but can also lead to significant losses. The Fund may be less diversified than other investment funds.

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The Fund promotes, among other characteristics, environmental or social characteristics and is classified as an Article 8 fund under the EU's Sustainable Finance Disclosure Regulation (SFDR). For more information, please see the Prospectus and relevant Fund Supplement.

ESG and sustainability characteristics are further detailed on the investment manager's website: - https://www.polarcapital.co.uk/ESG-and-Sustainability/Responsible-Investing/.

A summary of investor rights associated with investment in the Fund can be found here.

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Benchmark

The Fund is actively managed and uses the MSCI Daily TR World Net Insurance Index as a performance target and to calculate the performance fee. The benchmark has been chosen as it is generally considered to be representative of the investment universe in which the Fund invests. The performance of the Fund is likely to differ from the performance of the benchmark as the holdings, weightings and asset allocation will be different. Investors should carefully consider these differences when making comparisons. Further information about the benchmark can be found here. The benchmark is provided by an administrator on the European Securities and Markets Authority (ESMA) register of benchmarks which includes details of all authorised, registered, recognised and endorsed EU and third country benchmark administrators together with their national competent authorities.

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