Uncorrelated Strategies

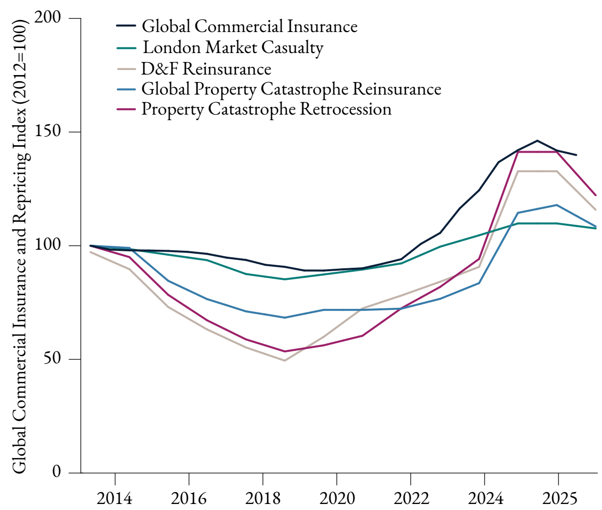
With interest rates remaining higher-for-longer, fundraising in uncorrelated strategies has slowed. This is likely to continue while less complex strategies offer compelling yields. The high growth in uncorrelated and more esoteric lending strategies in the early 2020s can be attributed to a reach for yield driven by the zero interest rate environment where there were few opportunities to generate attractive yields. With all-in yields in senior corporate direct lending remaining close to 10%, many uncorrelated strategies do not offer an adequate yield premium for taking on the additional complexity and higher expense burden. While we continue to view select uncorrelated strategies as complementary to Private Debt portfolios, offering attractive diversification, an alternative source of contractual returns, and, in some cases, material upside, we remain cognisant of the business risk that challenging fundraising conditions can create for those strategies, given what are often earlier stage or smaller managers. We remain highly selective about our exposures and maintain a high bar for manager investments.

2024 saw an increase in the number of investment managers in uncorrelated strategies adopting a fair valuation methodology for marking their portfolios. Valuations, including the strength and reliability of the valuation process, is an area of increasing focus for investors, auditors and regulators. Less easy-to-value strategies where assets might historically have been held at cost until reaching a milestone or an exit are now required to use a fair valuation which reflects the value of the assets were they to be sold at the valuation date. This better reflects the progress of the investment towards exit and ultimate crystallization of value, as well as a reasonable cost of capital. The move to this approach helps to mitigate the impact of the 'J-curve' which has affected longer-dated strategies such as clinical co-development and litigation funding, and smooths what were historically 'lumpy' return profiles, giving investors a more accurate assessment of value. Where we have seen secondary sales in uncorrelated strategies in the last year, the sale price has been in line with or slightly higher than the valuation implied by the fair valuation methodology, which gives some comfort that this valuation approach is valid. On the downside, this new approach can introduce a degree of interest rate exposure (via the use of discounted cash flow methodologies) and higher volatility in valuations as any change in potential future outcomes will immediately flow through to current valuations. This higher volatility in pricing may impact the sizing of allocations to these strategies and further constrain fundraising.

After a hardening in insurance markets in 2023, pricing moderated in 2024 on the back of increased capital availability (see Exhibit 1). We view property-catastrophe-related reinsurance strategies as challenging to underwrite given the disproportionate impact on pricing driven by the involvement (or not) of certain large market participants. While pricing has softened from the 2023 peak, there is evidence that reinsurers are becoming increasingly restrictive over the types of risks they will assume as losses to insurers from more frequent so-called 'non-peak' natural catastrophes (e.g. severe storms, floods, wildfires) continue to outstrip those from 'peak' events (tropical cyclones, earthquakes, European windstorms) (see Exhibit 2). This may result in pricing stabilizing at higher than historical levels over the longer term as reinsurers seek higher compensation for these less well-modelled risks. We continue to monitor the opportunity set but given the inefficiency inherent to the investment structures currently available we view this as a lower-priority opportunity.

Exhibit 1

Insurance pricing fell from a high base in 2024 across all categories

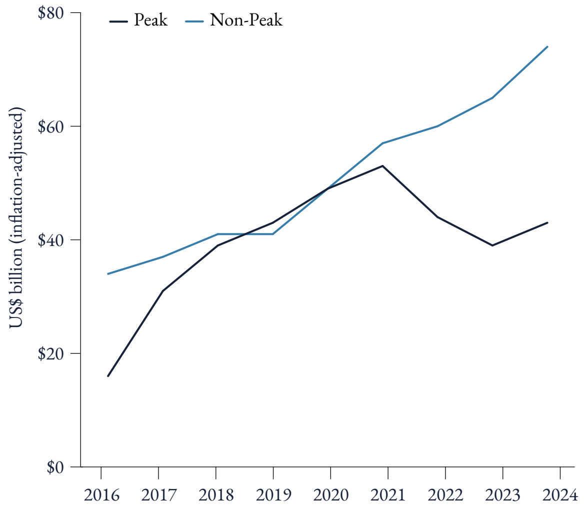


Source: Howden, NOVA

Uncorrelated Strategies
continued

Exhibit 2

Losses from non-peak natural catastrophes have outstripped those from peak losses each year since 2018



Source: Howden, NOVA

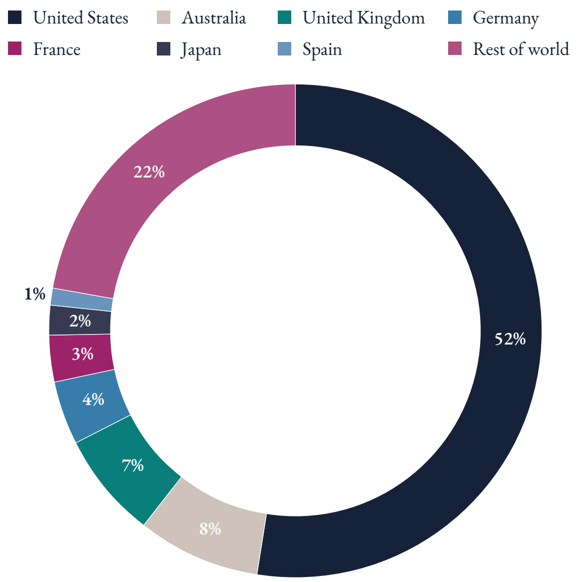
Other insurance categories provide easier-to-underwrite investment opportunities. Corporate liability and life run-off strategies can offer attractive uncorrelated returns with the benefit of embedded low-cost leverage. These opportunities are highly idiosyncratic and often best approached as co-investments alongside experienced market participants with differentiated sourcing capabilities.

Litigation-related investments have experienced strong recent performance. Within litigation-related assets, we allocate to both lending and direct single case investments. Litigation lending continues to offer additional compensation, even compared to other specialist lending strategies, targeting up to a 5%+ premium lending against a highly diversified collateral pool. Pricing has remained stable in all but the largest end of the litigation lending market, and it is our view that the excess yield and highly diversified nature of the collateral compensates for the idiosyncratic risk introduced by both duration extension within the collateral pool and the asset-light nature of the borrowers.

Single case funding has been, and remains, a core part of our litigation strategy. In common with other uncorrelated strategies, fundraising has remained challenging leading to stable pricing and a strong environment for long-term experienced LPs. Given our prominence and longevity as an LP in the space, we have become a strategic partner to our litigation GPs and achieve an average fee discount of c. 200 bps. Our experience within the market has also led us to refine our focus. The UK market, which is the third largest litigation funding market globally (Exhibit 3), is now structurally less attractive than other jurisdictions - it increasingly funds jurisdictionally or legally complex cases with long durations, has had regulatory issues with the recent PACCAR ruling, has demonstrably lower settlement rates and has seen legal costs increase significantly. By contrast, the US, Australia, Canada and, on a selective basis, Continental Europe remain attractive. We have significantly reduced our exposure to the UK market, concentrating our exposure in a predictable core of commercial cases whilst adding higher returning verticals such as intellectual property and class actions. We avoid long-duration, unpredictable portions of the market such as investor state arbitrations or uncompensated-for enforcement risks.

Exhibit 3

The US is the largest third-party litigation funding market, followed by Australia and the UK

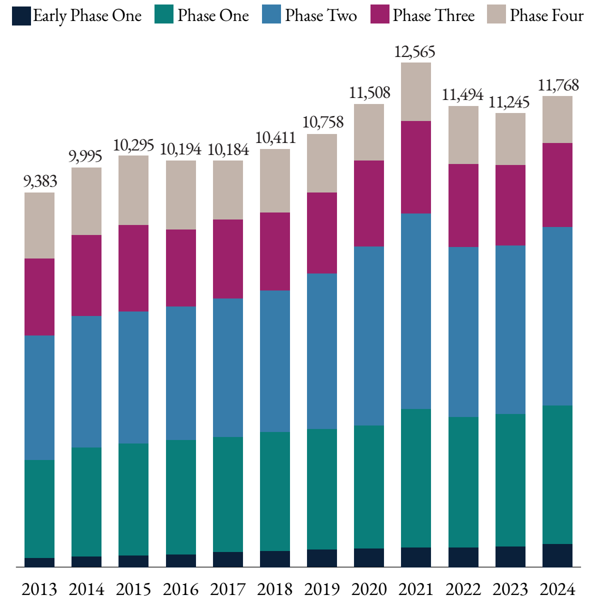


Source: Research Nester, Swiss Re Institute

Opportunities in life sciences continue to offer attractive risk-adjusted contractual returns and may benefit from a lower-regulation environment under the new US administration. In particular, we see an attractive opportunity set in clinical drug trial financing (clinical co-development). Global clinical trial starts have been negatively impacted (see Exhibit 4) by rising inflation and a rising cost of capital in recent years, with starts slowing in 2022 and 2023. This has made pharma and biotechnology companies open to alternative, non-dilutive (i.e., non-equity) sources of funding to allow them to fund trials and build out their asset pipeline. This opportunity set looks to be persistent, with the funding gap anticipated to be as much as $105B by 2028 (see Exhibit 5). Specialist funders that can provide significant operational support and clinical trial expertise can provide capital to close this gap in exchange for pre-agreed returns structured as fixed milestone payments, which have very limited correlation to broader markets, or royalty participations once a product receives FDA approval. This strategy meets our bar for uncorrelated strategies, generating returns at a premium to more conventional lending strategies in a sector with persistent secular drivers of growth.

Exhibit 4

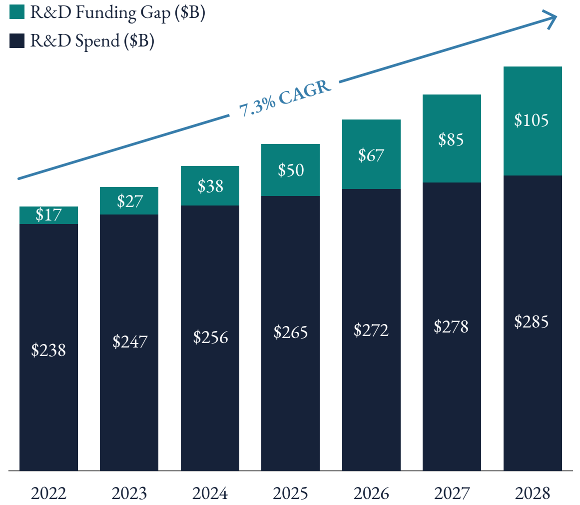
Global clinical trial study starts picked up in 2024 after declines in 2022 and 2023



Source: ClinicalTrials.gov

Exhibit 5

There is a growing funding gap in Pharmaceutical R&D, requiring alternative sources of capital



Source: Evaluate Pharma, October 2022

Golden Rules

1. Partner with specialist investors in niche strategies rather than opportunistic generalists: We believe a key differentiator in investment outcomes in uncorrelated strategies is manager expertise and familiarity in pricing niche assets. Generalists tend to suffer from adverse selection given their comparative disadvantage in sourcing and evaluation of transactions compared to specialists.

2. Establish close alignment not only with investment managers but also with other end-investors in those vehicles. In smaller, less liquid markets, a clear alignment of interests is essential and close relationships with other investors can deliver informational advantages that lead to better investment outcomes.

3. Seek contractual returns, rather than an equity exit: Limit investments where the ultimate return is contingent on an equity bid from a third party. Favour investments with a defined contractual return and embedded date of maturity.

4. Be sensitive to model risk: It is critical to fully understand the factors that influence investment pricing and to be sceptical of model-based valuation approaches.

Asset Class Investment Strategies

Uncorrelated Strategies
continued

Sub-Strategy Attractiveness

Litigation Finance and Intellectual Property: Favourable view. Financing portfolios of corporate litigation is an area that remains relatively underexploited and is attractive in our view. Companies are more likely to need to monetise their legal assets in an environment where interest rates are rising and financing options have narrowed. We also view opportunities in patent and IP litigation as offering attractive uncorrelated returns. Lending structures in litigation finance offer attractive opportunities given higher base rates and a spread premium to other specialist lending strategies.

Drug Trial Financing: Favourable view. Clinical co-development offers the opportunity to finance phase 3 drug trials in partnership with pharmaceutical companies, in exchange for a royalty stream or fixed cash payments. Given the specialisation required to assess trial outcomes, drug trial finance remains an underexploited opportunity with few participants. However, there are challenges in achieving deployment and adequate diversification, which mitigates our overall positive view of the strategy.

Pharmaceutical Royalties: Neutral view. Lending to life sciences companies continues to offer a premium to royalties in the current interest rate environment. However, pharmaceutical royalties are complementary to our healthcare lending and drug trial financing investments and can offer a low volatility, long-term source of realisable yield to our portfolios.

Life Insurance and Insurtech Strategies: Neutral view. Continued consolidation in corporate, life and health strategies offers potentially interesting opportunities, but natural catastrophe remains out of favour. Idiosyncratic corporate liability and life run-off opportunities can offer attractive potential for upside but are best accessed via co-investments.

Property and Natural Catastrophe Insurance Strategies: Negative view. We remain sceptical of catastrophe insurance strategies despite repricing given the binary nature of the strategy at the portfolio level (i.e., the high correlation of individual policies). We view the available investment structures to have significant drawbacks (specifically the trapped capital at the end of each investment period) and believe the risks of climate change to still be inadequately reflected in underwriting models.

Music Royalties: Negative view. Music royalties strategies have a high reliance on residual valuations to support expectations of forward-looking returns. It is our view that this is a more equity-driven strategy which currently does not generate contractual returns at a premium to conventional lending.

2025 Strategic Priorities

- **Invest only selectively in uncorrelated strategies given the more attractive opportunities in Private Debt investments.** We view many uncorrelated strategies as having insufficient expected return relative to traditional debt structures to compensate for the additional risk and complexity. We focus only on select uncorrelated strategies with attractive dynamics and investing in those alongside only the highest-quality specialist managers.
- **Complement specialist lending exposures with allocations to drug trial financing.** Pressure to expand product lines and the increasing funding gap for pharmaceutical and biotechnology companies are creating opportunities to generate contractual returns at a premium to conventional lending strategies with a lower correlation to the broader market.
- **Maintain allocations to litigation funding strategies.** An environment of constrained capital availability allows established specialist funders to generate attractive uncorrelated returns across a range of strategies and jurisdictions.

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continued

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Private Investment Fund Risk

Investors should be aware that investments in private investment funds involve a high degree of risk. Investors could lose the entire amount of their investment or recover only a small portion of their investment if the fund suffers substantial losses. The principal risk factors associated with an investment include the following. Please refer to Private Placement Memorandums of funds for full disclosure of risk factors:

Market & Economic Risk – Changes in factors like interest rates, inflation, monetary policy, economic growth, investor sentiment, time horizons and exogenous events (like terrorism or pandemic) can undermine the investment strategy temporarily or for a long period.

Currency Risk – Investors will be subject to currency market risks associated with fluctuations in the value of the foreign currencies in which their investments are denominated. Dramatic fluctuations could have an adverse impact on the profitability of the client account.

Availability of Investment Opportunities – Identification of investment opportunities involves a high degree of uncertainty and is based on a subjective decision making process and there is a risk that opportunities will not achieve targeted rates of return.

Counterparty Risk – Investor's assets may be exposed to the credit risk of the counterparties with which, or the dealers, brokers and exchanges through which, Partners Capital deals, whether in exchange-traded or off-exchange transactions.

Limited Operating History – Certain private funds have no operating or performance history for investors to consider and there is no guarantee the fund's investment strategy will be successful.

Limited Diversification – Private funds are not limited in the amount of capital that may be invested in one industry, sector, geography or similar category of asset class. Non diversification would increase the risk of loss if there was a decline in the market value of any security or category of asset class in which a private fund has invested a large percentage of their assets.

Limited Liquidity Risk – Many investments are not readily liquid, and may lock up capital for several years. Investors may be unable to dispose of investments at the most advantageous time because of limited withdrawal rights, which could result in significant loss of capital.

Limited Regulatory Oversight – Private companies are not likely to be Regulated Investment Companies. Investors may not be provided various protections offered to more regulated or registered funds.

Management Fraud – Investment managers can commit fraud It is our job to try and avoid those that appear to have the potential to commit fraud or otherwise misappropriate client funds but it is not always ascertainable from any amount of due diligence.

Operational and Organisational Risk – All asset managers bring some risk that they will fail to execute their investment strategies effectively. Past performance is not indicative of future results.

Multiple Level of Fees Risk – Paying excessive fees is a significant risk in any asset class. Investment management fees and performance fees are sometimes charged by both Partners Capital and the Manager used. Investors might bear multiple levels of fees.

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Private Investment Fund Risk
continued

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High Yield Securities – Funds may invest in high yield bonds that are more risky than investment grade bonds. Yields and prices of high yield securities may be more volatile. Lower rated securities may include securities that have the lowest rating or are in default, so involve risks in addition to those associated with higher-yield securities (i.e. high degree of credit risk).