London Borough of Merton Pension Fund

Q3 2021 Investment Monitoring Report

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Executive Summary

The Fund's assets returned 0.5% during Q3 2021. To provide context, we have assessed total returns against a composite benchmark - a weighted average of the underlying manager benchmarks. Against the comparator, the Fund was marginally behind benchmark with relative returns of -0.2% (top left chart). We have also shown performance against the Fund's actuarial target (top right chart).

Overall, the fund grew marginally from £926.1m to £932.9m.

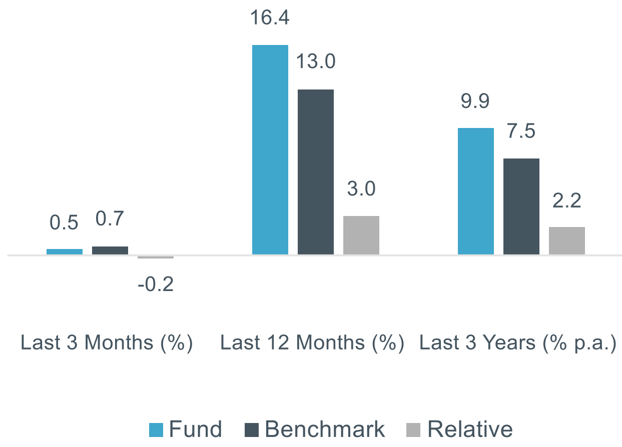
In markets, growth expectations were more muted than in previous quarters, and global equity markets returned 1.5% during the period. Inflation volatility continued to cause concern, with many expecting central banks to raise interest rates multiple times over the next 12 months. Despite this, property markets continued to rebound as restrictions continued to ease.

Across fixed income markets, gilt implied inflation pushed higher at shorter durations, reflecting the current supply demand imbalance and rising cost of goods.

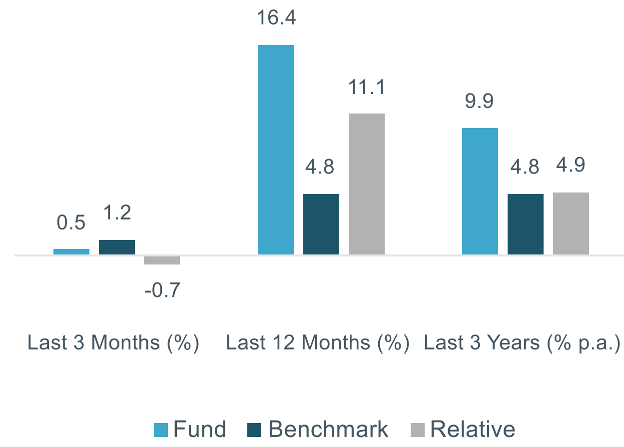
From a fund mandate perspective:

- The equity mandates delivered modest positive absolute returns.
- Both diversified growth funds retained a cautious stance.
- Property was the largest net contributor on a purely asset class basis.
- The Risk Management Framework detracted from performance as the pound depreciated despite rising inflation.

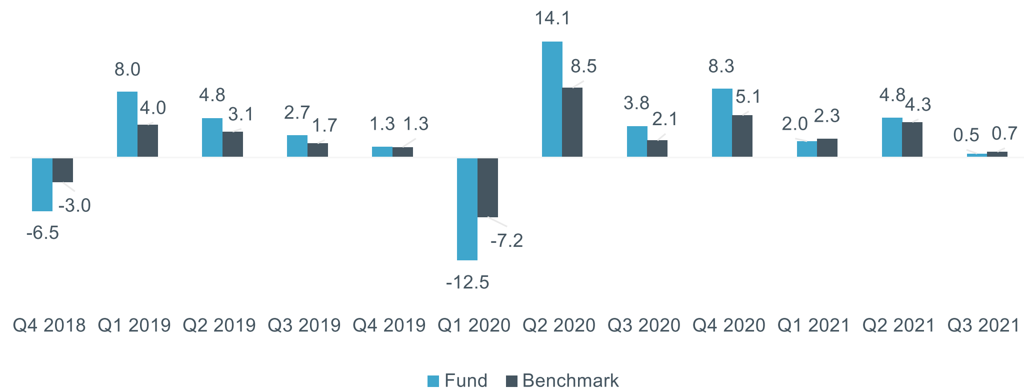
Fund performance vs benchmark/target



Fund performance vs actuarial target



Relative quarterly performance vs benchmark/target



Following the 2019 strategy review the agreed long-term target allocation for the Fund is as follows:

Global equities: 30.0%
Emerging market equities: 10.0%
Diversified growth fund: 8.0%
Property: 5.0%
Private credit: 6.5%
Infrastructure: 11.5%
Social Impact: 5.0%
Multi-asset credit: 9.0%
Risk management framework: 15.0%

In time the Fund will transition towards this target allocation. As it does, the benchmark (as agreed with Officers) shown in the table and used in the benchmark performance calculation on the next will be gradually updated to reflect progress to date.

Commitments to infrastructure and private credit investments continued to be drawn down over time. A manager selection exercise for the Fund's allocation to social impact investment is currently under way.

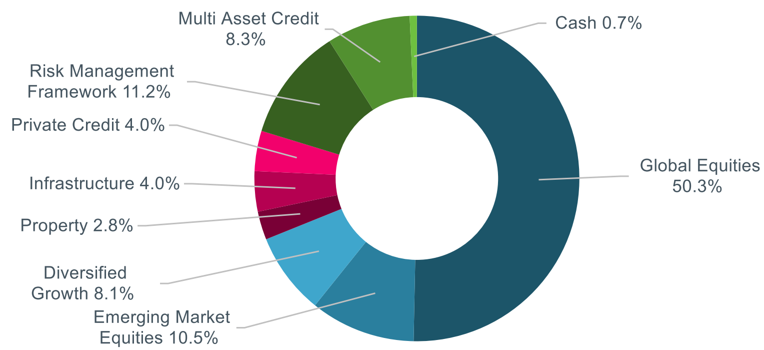
In the meantime, to manage the level of risk within the Funds asset allocation, at the September Panel meeting members agreed to undertake a degree of rebalancing that would see the Fund's equity allocation reduced in favour of holding the monies assigned for private market deployment within the two diversified growth mandates. Fund Officers will be carrying out this agreed rebalancing over Q4 2021.

Asset Allocation

Mandate	Valuation (£m) Q2 21	Valuation (£m) Q3 21	Actual Proportion	Benchmark	Relative
UBS World Equity Tracker Fund	36.5	32.3	3.5%	0.0%	3.5%
UBS Alternative Beta	95.2	96.1	10.3%	10.0%	0.3%
LCIV RBC Sustainable Equity Fund	113.7	116.7	12.5%	10.0%	2.5%
LCIV Baillie Gifford Global Alpha Growth Fund	117.4	116.8	12.5%	10.0%	2.5%
BlackRock World Low Carbon Equity Tracker	101.1	105.0	11.3%	10.0%	1.3%
Global Equities	**463.8**	**466.9**	**50.0%**	**40.0%**	**10.0%**
UBS GEM HALO	61.8	57.6	6.2%	5.0%	1.2%
LCIV JP Morgan Emerging Market Equity Fund	40.8	39.5	4.2%	5.0%	-0.8%
Emerging Market Equities	**102.6**	**97.1**	**10.4%**	**10.0%**	**0.4%**
LCIV Ruffer Absolute Return Fund	37.6	37.9	4.1%	5.0%	-0.9%
LCIV Baillie Gifford Diversified Growth Fund	37.1	37.5	4.0%	5.0%	-1.0%
Diversified Growth	**74.8**	**75.4**	**8.1%**	**10.0%**	**-1.9%**
UBS Triton Property Fund	16.6	18.1	1.9%	2.5%	-0.6%
BlackRock UK Property Fund	7.8	8.0	0.9%	2.5%	-1.6%
Property	**24.3**	**26.1**	**2.8%**	**5.0%**	**-2.2%**
MIRA Infrastructure Global Solutions II L.P Fund	8.2	12.8	1.4%	3.0%	-1.6%
Quinbrook Low Carbon Power LP Fund	11.7	12.0	1.3%	1.5%	-0.2%
JP Morgan Infrastructure Fund	17.0	16.9	1.8%	3.0%	-1.2%
Infrastructure	**36.9**	**41.8**	**4.5%**	**7.5%**	**-3.0%**
Permira Credit Solutions IV Fund	14.8	20.4	2.2%	4.5%	-2.3%
Churchill Middle Market Senior Loan II Fund	16.7	17.1	1.8%	3.0%	-1.2%
Private Credit	**31.5**	**37.5**	**4.0%**	**7.5%**	**-3.5%**
Wells Fargo RMF Fund	108.2	104.3	11.2%	10.0%	1.2%
Risk Management Framework	**108.2**	**104.3**	**11.2%**	**10.0%**	**1.2%**
LCIV CQS MAC Fund	76.3	77.2	8.3%	10.0%	-1.7%
Multi Asset Credit	**76.3**	**77.2**	**8.3%**	**10.0%**	**-1.7%**
Cash	7.5	6.6	0.7%	0.0%	0.7%
Total Fund	**926.1**	**932.9**	**100.0%**	**100.0%**	

At the time of writing, latest quarterly information in respect of mandate held with MIRA is unavailable. Q3 2021 valuation is therefore based on Q2 2021 information and includes all known capital calls which occured during Q3 2021.

Asset class exposures



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Source: *Investment Managers*

Q3 2021 saw the Fund return 0.5% in absolute terms, underperforming its benchmark of 0.7% with relative returns of -0.2%. However, more importantly, over the longer time periods of 12 months and 3 years, the fund has outperformed benchmark with relative returns of 3.0% and 2.2% p.a. respectively.

Equities were the largest net contributor given the sizeable holding in this asset class. The BlackRock World Low Carbon Equity Tracker was the greatest contributor with absolute returns of 3.9%.

Emerging market equites struggled as increased regulator pressures in China weighed heavily on markets.

Both DGFs enjoyed positive absolute returns, however only the Baillie Gifford fund managed to outperform relative to benchmark.

The property mandates performed strongly over the period in absolute performance terms. As lockdown restrictions continued to ease, the pace of activity in this asset class continued to improve.

At time of writing, MIRA and Churchill reporting information was unavailable. For performance reporting purposes we have therefore assumed nil returns over Q3 2021. Once details are received, performance figures will be updated such that future reports reflect actual Q3 2021 movements for each.

Manager performance

Mandate	Last 3 Months (%)			Last 12 Months (%)			Last 3 Years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
UBS World Equity Tracker Fund	2.2	2.2	**0.0**	23.6	23.7	**-0.1**	-	-	**-**
UBS Alternative Beta	2.0	1.9	**0.0**	24.0	23.9	**0.1**	-	-	**-**
LCIV RBC Sustainable Equity Fund	2.6	2.5	**0.2**	25.3	23.5	**1.4**	16.0	11.9	**3.6**
LCIV Baillie Gifford Global Alpha Growth Fund	-0.6	1.5	**-2.1**	21.0	22.8	**-1.5**	17.4	12.0	**4.9**
BlackRock World Low Carbon Equity Tracker	3.9	2.5	**1.4**	24.6	23.9	**0.6**	-	-	**-**
Global Equities									
UBS GEM HALO	-6.9	-5.8	**-1.1**	9.6	13.3	**-3.3**	-	-	**-**
LCIV JP Morgan Emerging Market Equity Fund	-3.3	-5.8	**2.7**	16.8	13.3	**3.0**	-	-	**-**
Emerging Market Equities									
LCIV Ruffer Absolute Return Fund	0.6	0.8	**-0.2**	6.1	1.5	**4.5**	-	-	**-**
LCIV Baillie Gifford Diversified Growth Fund	1.1	0.9	**0.2**	11.7	3.6	**7.8**	4.9	4.0	**0.9**
Diversified Growth									
UBS Triton Property Fund	3.2	4.5	**-1.2**	12.7	13.2	**-0.4**	4.6	4.0	**0.6**
BlackRock UK Property Fund	3.7	4.5	**-0.8**	11.5	13.2	**-1.5**	3.5	4.0	**-0.4**
Property									
MIRA Infrastructure Global Solutions II L.P Fund	N/A	1.8	**-**	7.2	7.4	**-0.2**	-	-	**-**
Quinbrook Low Carbon Power LP Fund	0.1	1.8	**-1.6**	21.1	7.4	**12.7**	-	-	**-**
JP Morgan Infrastructure Fund	1.3	2.5	**-1.2**	6.0	10.4	**-3.9**	-	-	**-**
Infrastructure									
Permira Credit Solutions IV Fund	1.7	1.7	**0.0**	7.7	7.0	**0.6**	-	-	**-**
Churchill Middle Market Senior Loan II Fund	1.2	1.7	**-0.5**	6.1	7.0	**-0.8**	-	-	**-**
Private Credit									
Wells Fargo RMF Fund	-2.6	-2.6	**0.0**	7.7	7.7	**0.0**	-	-	**-**
Risk Management Framework									
LCIV CQS MAC Fund	1.2	1.1	**0.0**	11.0	4.4	**6.3**	3.9	4.7	**-0.7**
Multi Asset Credit									
Cash	-	-	**-**	-	-	**-**	-	-	**-**
Total Fund	0.5	0.7	**-0.2**	16.4	13.0	**3.1**	9.9	7.5	**2.2**

Note: 12-month performance for the LCIV Ruffer Absolute Return Fund is since inception on 13 January 2021. Furthermore, Q3 2021 performance figures for MIRA, Quinbrook, Permira and Churchill have been assumed flat due to lack of manager information at the time of writing (see comment on left).

Source: Fund performance provided by Investment Managers and is net of fees.
Benchmark performance provided by Investment Managers and DataStream

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Growth momentum continued to ease as the initial impact of re-opening late last year fades. However, the pace of growth in the major advanced economies is forecast to remain strong over the next couple of years, with consensus forecasts global growth of 5.7% in 2021 and 4.4% in 2022.

Global equities gave up earlier gains as strong earnings growth was offset by easing economic momentum and the prospect of fading monetary support. Strong rises in energy prices lifted the energy sector, while the prospect of higher interest rates buoyed the financial sector. The defensive growth characteristics of the technology and healthcare sectors saw them outperform while consumer discretionary, basic materials and industrials all underperformed in Q3.

Japanese markets materially outperformed, rallying on expectations of further stimulus and economic reopening as COVID cases declined. UK markets also outperformed, driven primarily by their above average exposure to the energy sector, while emerging markets were pulled lower by weak performance from China, where announcements of tighter regulation have been compounded by a slowdown in the Chinese property and manufacturing sectors, and high energy prices

The total return on the MSCI Monthly Property index was 13.4% in the year to September, which includes a 5.5% income return. A 7.5% rise in capital values over the 12 months to end of September is attributable to buoyant industrial sector where capital values have risen 24%.

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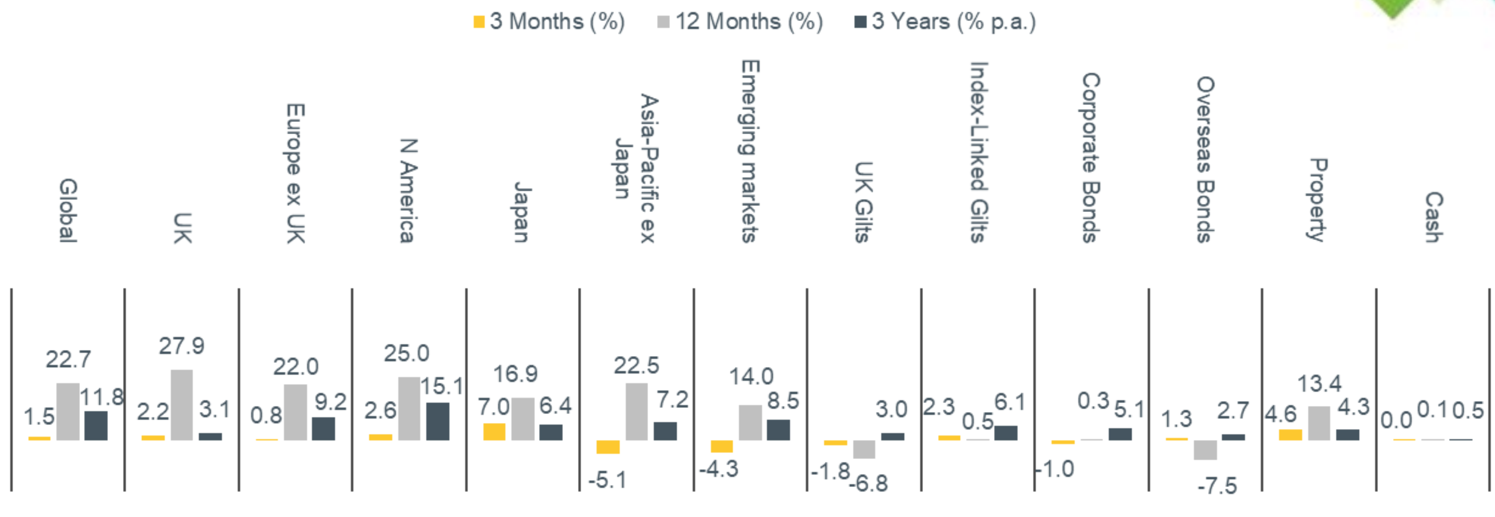
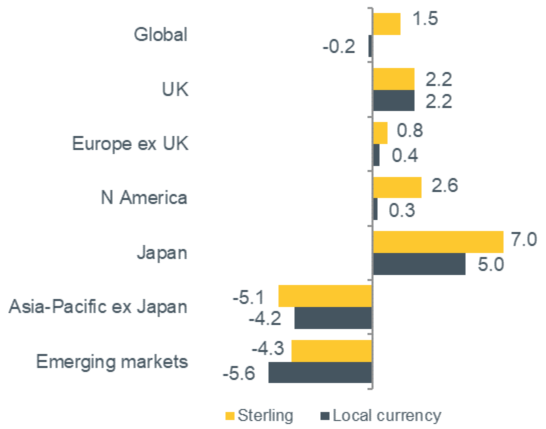
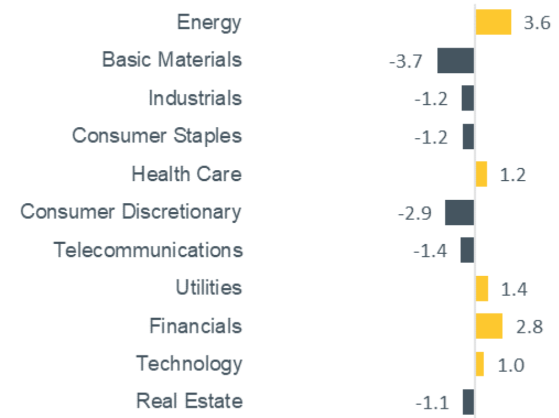
Historic returns for world markets [1]



Regional equity returns [2]



Global equity sector returns (%) [3]



Source: DataStream. [1] Returns shown in Sterling terms. Indices shown (from left to right) are: FTSE All World, FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, FTSE Emerging, FTSE Fixed Gilts All Stocks, FTSE Index-Linked Gilts All Maturities, iBoxx Corporates All Investment Grade All Maturities, JP Morgan GBI Overseas Bonds, MSCI UK Monthly Property; UK Interbank 7 Day. [2] FTSE All World Indices. Commentary compares regional equity returns in local currency. [3] Returns shown in Sterling terms and relative to FTSE All World. FTSE indices migrated to a new ICB structure in Q1 2021.

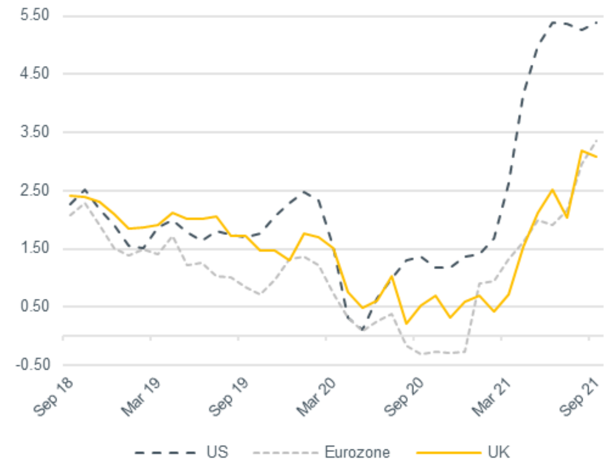
Global investment-grade spreads were little changed in Q3 and global developed market speculative-grade spreads rose 0.3% p.a. Defaults and leverage levels continue to fall, interest coverage is rising, and liquidity remains plentiful. Fears surrounding the potential default of Evergrande, a heavily indebted Chinese property developer, seem to have been contained within Chinese and Asian credit markets for now.

UK 10-year gilt yields rose 0.3% p.a., with steep rises coming in the wake of the Bank of England's September meeting. Having fallen earlier in the quarter, on the back of easing economic momentum, equivalent US and German yields rose back to end-June levels in September.

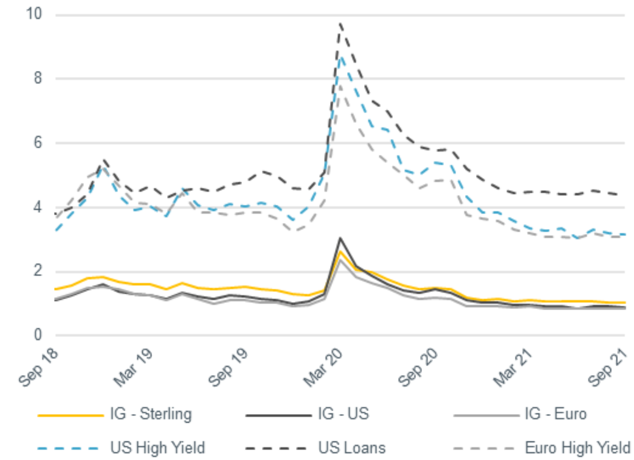
UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose from 3.5% p.a. to 3.9% p.a. as real yields fell and nominal yields rose. 10-year US implied inflation was little changed over Q3.

The trade-weighted dollar has risen around 1.5% while equivalent measures for the sterling and euro eased 0.9% and 0.4% respectively.

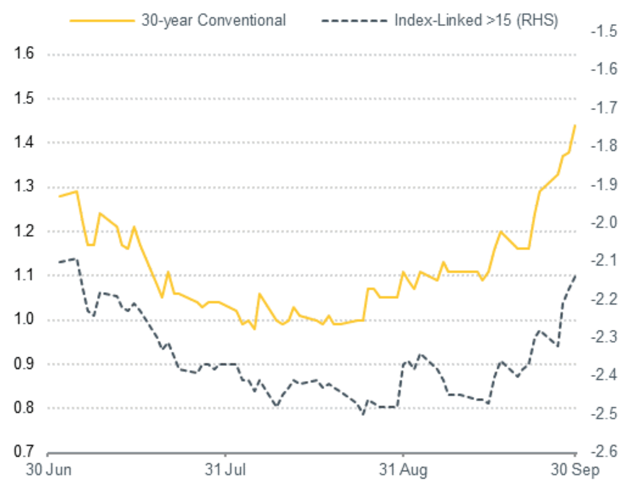
Annual CPI Inflation (% p.a.)



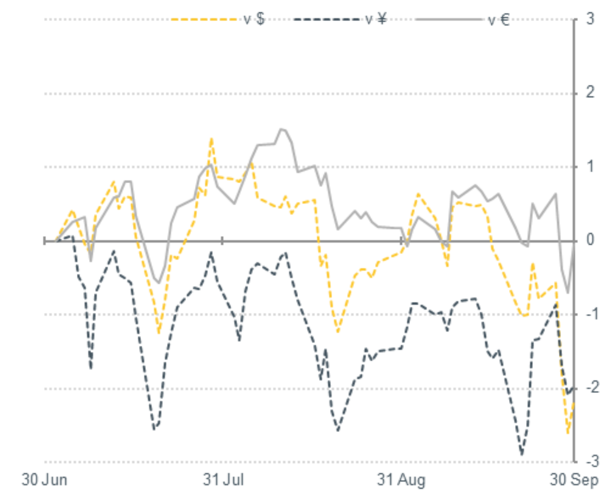
Investment and speculative grade credit spreads (% p.a.)



Gilt yields chart (% p.a.)



Sterling trend chart (% change)



Source: DataStream, Barings and ICE

Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

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Geometric v Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

$$\frac{(1 + Fund\ Performance)}{(1 + Benchmark\ Performance)} - 1$$

Some industry practitioners use the simpler arithmetic method as follows:

$$Fund\ Performance - Benchmark\ Performance$$

The geometric return is a better measure of investment performance when compared to the arithmetic return, to account for potential volatility of returns.

The difference between the arithmetic mean return and the geometric mean return increases as the volatility increases.

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