London Borough of Merton Pension Fund

Q1 2022 Investment Monitoring Report

Nick Jellema – Senior Investment Consultant
Kameel Kapitan – Investment Consultant
Jamie McLaughlan – Senior Investment Analyst

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Executive Summary

Fund assets returned -4.2% during the first quarter of 2022.

To provide context, we have assessed total returns against a composite benchmark - a weighted average of the underlying manager benchmarks. Against this comparator, the Fund was behind benchmark by 3.1% (top left chart). We have also shown performance against the Fund's actuarial target (top right chart) against which returns are favourable over longer time periods of 3 years. Overall, the Fund assets decreased by £40m from £968m to £928m.

During the first quarter, growth markets were impacted materially due to the slow down of global growth and also Russia's invasion of Ukraine. Rising inflation became a primary concern for developed countries – hindering growth. Real estate was buoyed by the lifting of Covid restrictions across the country.

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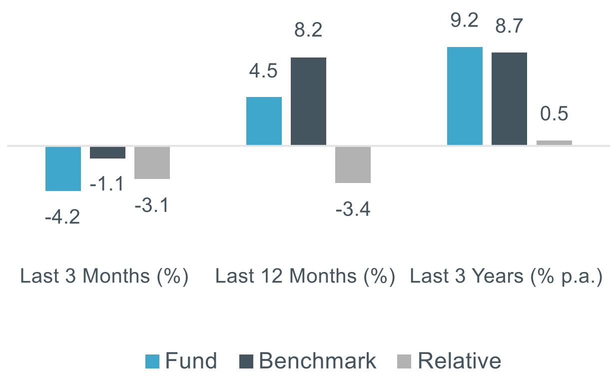
Gilt implied inflation pushed higher again - exceeding 9% at short durations.

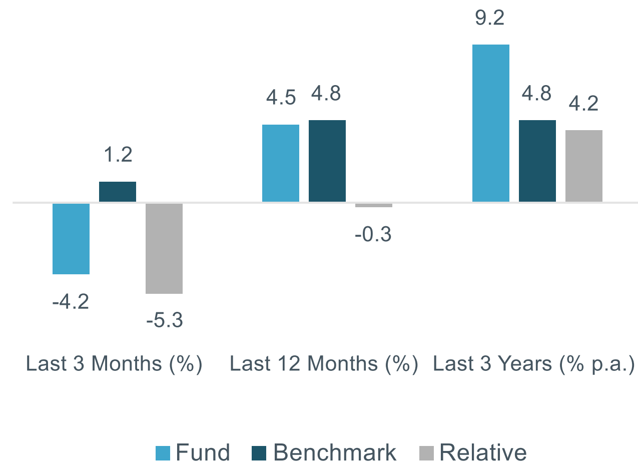
From a Fund mandate perspective:

- Most equity mandates delivered negative returns.
- The diversified growth funds diverged in performance with Ruffer providing some protection.
- Property continued to rebound following the negative impact of Covid for this asset class.
- The Risk Management Framework contributed negatively to performance as Sterling depreciated against major currencies.

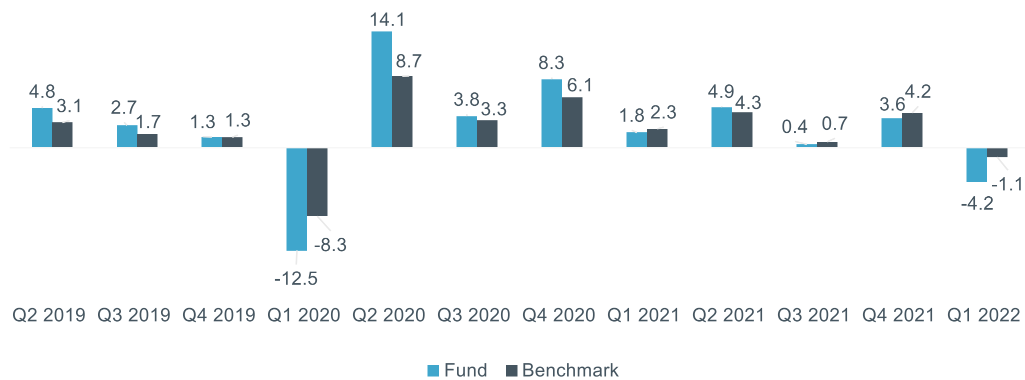
Fund performance vs benchmark/target



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 in 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. The $40m (broadly £30m) Quinbrook Net Zero Power fund, committed to in Q4 2021, was fully drawn during the quarter.

A manager selection exercise for the Fund's allocation to social impact investment was completed during Q1 2022 and manager appointed. The first capital commitment has since been drawn following quarter end.

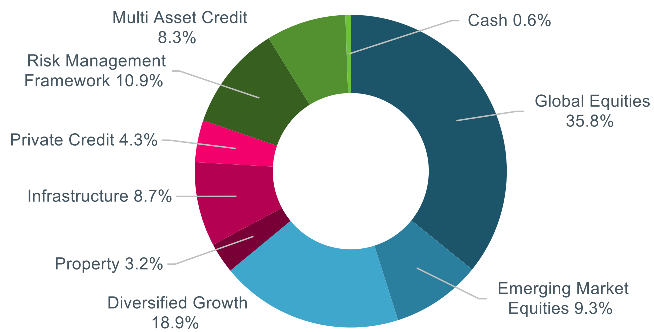
Looking ahead, the Fund should begin to consider how the asset allocation will help target a net zero future in the long term. We expect to provide additional resource to Officers on this important topic in the next 6 to 9 months.

Asset Allocation

Mandate	Valuation (£m) Q4 21	Q1 22	Actual Proportion	Benchmark	Relative
UBS Alternative Beta	52.3	52.3	5.6%	10.0%	-4.4%
LCIV RBC Sustainable Equity Fund	99.7	91.3	9.8%	10.0%	-0.2%
LCIV Baillie Gifford Global Alpha Growth Fund	90.8	79.5	8.6%	10.0%	-1.4%
BlackRock World Low Carbon Equity Tracker	112.2	109.3	11.8%	10.0%	1.8%
Global Equities	**354.9**	**332.4**	**35.8%**	**40.0%**	**-4.2%**
UBS GEM HALO	55.9	50.7	5.5%	5.0%	0.5%
LCIV JP Morgan Emerging Market Equity Fund	37.8	35.5	3.8%	5.0%	-1.2%
Emerging Market Equities	**93.7**	**86.1**	**9.3%**	**10.0%**	**-0.7%**
LCIV Ruffer Absolute Return Fund	86.0	89.9	9.7%	5.0%	4.7%
LCIV Baillie Gifford Diversified Growth Fund	91.4	85.8	9.2%	5.0%	4.2%
Diversified Growth	**177.4**	**175.7**	**18.9%**	**10.0%**	**8.9%**
UBS Triton Property Fund	18.9	20.4	2.2%	2.5%	-0.3%
BlackRock UK Property Fund	8.5	9.0	1.0%	2.5%	-1.5%
Property	**27.4**	**29.4**	**3.2%**	**5.0%**	**-1.8%**
MIRA Infrastructure Global Solutions II L.P Fund	15.0	15.4	1.7%	3.0%	-1.3%
Quinbrook Low Carbon Power LP Fund	13.4	14.3	1.5%	1.5%	0.0%
Quinbrook Net Zero Power Fund	34.1	33.9	3.7%	0.0%	3.7%
JP Morgan Infrastructure Fund	16.9	17.3	1.9%	3.0%	-1.1%
Infrastructure	**79.4**	**81.0**	**8.7%**	**7.5%**	**1.2%**
Permira Credit Solutions IV Fund	22.4	22.7	2.4%	4.5%	-2.1%
Churchill Middle Market Senior Loan II Fund	15.8	17.7	1.9%	3.0%	-1.1%
Private Credit	**38.2**	**40.3**	**4.3%**	**7.5%**	**-3.2%**
Wells Fargo RMF Fund	110.7	101.3	10.9%	10.0%	0.9%
Risk Management Framework	**110.7**	**101.3**	**10.9%**	**10.0%**	**0.9%**
LCIV CQS / PIMCO MAC Fund	78.0	76.7	8.3%	10.0%	-1.7%
Multi Asset Credit	**78.0**	**76.7**	**8.3%**	**10.0%**	**-1.7%**
Cash	8.4	5.2	0.6%	0.0%	0.6%
Total Fund	**968.1**	**928.0**	**100.0%**	**100.0%**	

At the time of writing, latest quarterly information in respect of mandate held with MIRA is unavailable. The Q1 2022 valuation shown mirrors the Q4 2021 valuation and includes an allowance for FX movements during the period.

Asset class exposures



Source: Investment Managers

A turbulent first quarter of 2022 saw the Fund return an absolute return of -4.2%. Relative performance wise, the Fund underperformed benchmark with a return of -2.4%. Over 12 months, performance has remained positive on an absolute basis but has failed to match benchmark. By contrast, longer term performance measured over 3 years has saw the Fund outperform benchmark with relative returns of 0.9% p.a.

Equity mandates bore the brunt of falling markets with the Global Alpha fund posting an absolute return of -12.4%. The UBS Alternative Beta mandate fared better, with absolute and relative returns of 0.1%.

The two emerging market mandates struggled due to inflationary concerns, which typically impact developing countries more severely.

The Ruffer diversified growth fund performed positively, due to its defensive nature and low correlation to capital markets.

Both property mandates were buoyed as Covid restrictions were lifted across the country.

At time of writing, MIRA reporting information was unavailable. For performance reporting purposes we have therefore assumed nil returns over Q1 2022. Once details are received, performance figures will be updated such that future reports reflect actual Q1 2022 movements for each.

Manager performance

Mandate	Last 3 Months (%)			Last 12 Months (%)			Last 3 Years (% p.a.)			Since Inception (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
UBS Alternative Beta	0.1	0.0	**0.1**	17.3	17.0	**0.2**	9.2	9.1	**0.0**	-	-	-
LCIV RBC Sustainable Equity Fund	-8.5	-2.0	**-6.7**	9.0	16.5	**-6.4**	15.1	15.0	**0.1**	12.7	10.4	**2.0**
LCIV Baillie Gifford Global Alpha Growth Fund	-12.4	-1.9	**-10.7**	-6.7	14.3	**-18.3**	13.0	14.3	**-1.1**	10.1	10.3	**-0.1**
BlackRock World Low Carbon Equity Tracker	-2.5	-2.6	**0.1**	16.1	15.5	**0.4**	15.8	15.4	**0.4**	16.6	16.4	**0.1**
Global Equities												
UBS GEM HALO	-9.6	-4.3	**-5.5**	-16.9	-7.1	**-10.5**	2.7	4.5	**-1.8**	5.5	6.1	**-0.5**
LCIV JP Morgan Emerging Market Equity Fund	-6.1	-3.7	**-2.5**	-10.4	-6.0	**-4.7**	-	-	-	5.6	3.9	**1.6**
Emerging Market Equities												
LCIV Ruffer Absolute Return Fund	4.5	0.8	**3.7**	7.3	3.1	**4.0**	-	-	-	10.1	3.2	**6.7**
LCIV Baillie Gifford Diversified Growth Fund	-6.1	1.0	**-7.0**	3.4	3.7	**-0.3**	3.6	3.9	**-0.3**	3.1	3.5	**-0.4**
Diversified Growth												
UBS Triton Property Fund	8.6	5.6	**2.9**	24.1	23.1	**0.8**	9.2	8.1	**1.1**	1.9	1.6	**0.3**
BlackRock UK Property Fund	6.7	5.6	**1.0**	21.3	23.1	**-1.5**	7.6	8.0	**-0.4**	3.4	3.6	**-0.1**
Property												
MIRA Infrastructure Global Solutions II L.P Fund	0.0	1.8	**-1.8**	7.7	7.4	**0.3**	-	-	-	5.0	6.4	**-1.4**
Quinbrook Low Carbon Power LP Fund	4.4	1.8	**2.5**	15.9	7.4	**8.0**	7.7	7.4	**0.2**	7.1	6.9	**0.2**
Quinbrook Net Zero Power Fund	-3.4	1.5	**-4.8**	-	-	-	-	-	-	11.7	3.0	**8.4**
JP Morgan Infrastructure Fund	1.8	2.5	**-0.7**	6.2	10.4	**-3.8**	-	-	-	5.7	9.3	**-3.3**
Infrastructure												
Permira Credit Solutions IV Fund	1.5	1.7	**-0.2**	7.3	7.0	**0.3**	-	-	-	5.6	5.5	**0.1**
Churchill Middle Market Senior Loan II Fund	1.0	1.7	**-0.7**	5.2	7.0	**-1.7**	4.4	6.8	**-2.3**	5.6	6.5	**-0.9**
Private Credit												
Wells Fargo RMF Fund	-8.6	-8.6	**0.0**	-4.2	-4.2	**0.0**	-	-	-	8.2	8.2	**0.0**
Risk Management Framework												
LCIV CQS / PIMCO MAC Fund	-1.8	1.1	**-2.9**	2.4	4.6	**-2.1**	3.4	4.6	**-1.2**	3.2	4.2	**-1.0**
Multi Asset Credit												
Cash	-	-	-	-	-	-	-	-	-	-	-	-
Total Fund	-4.2	-1.1	**-3.1**	4.5	8.2	**-3.4**	9.2	8.7	**0.5**	9.0	7.2	**1.7**

Note: Q1 2022 performance figures for MIRA 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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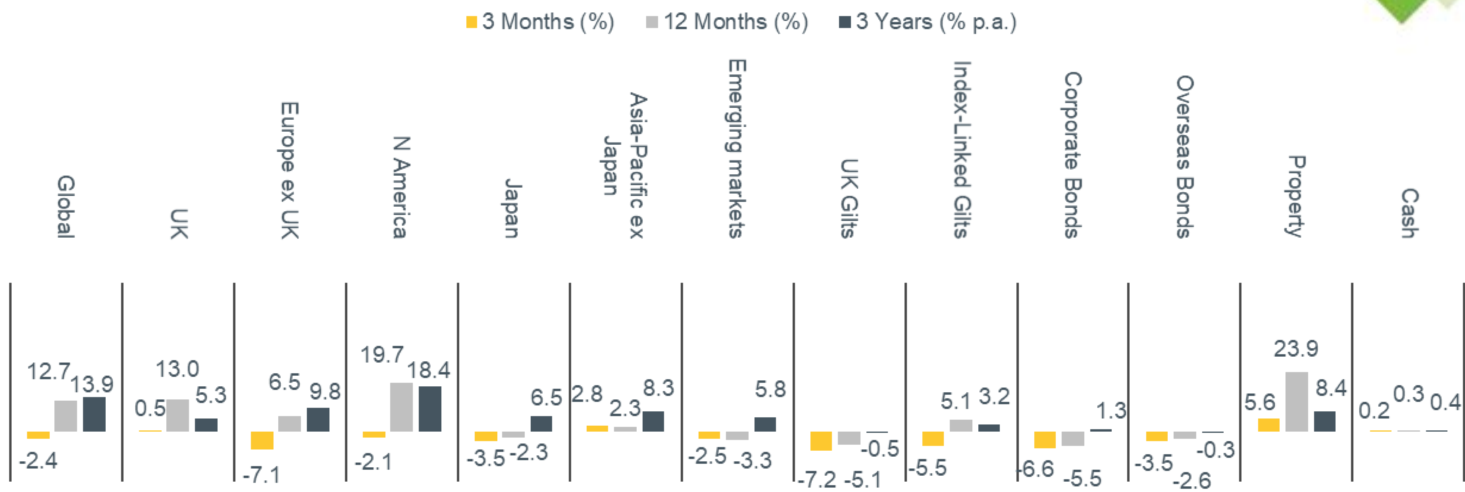
Physical disruptions and sanctions caused by the Russia-Ukraine conflict have triggered broad commodity price rises which, alongside existing inflationary pressures, are increasing input costs and weighing on consumer's real incomes. As a result, CPI forecasts have reached new highs while consensus forecasts for global growth have been revised downwards, but still point to a relatively robust pace of growth over 2022 and 2023 by post-Global Financial Crisis standards.

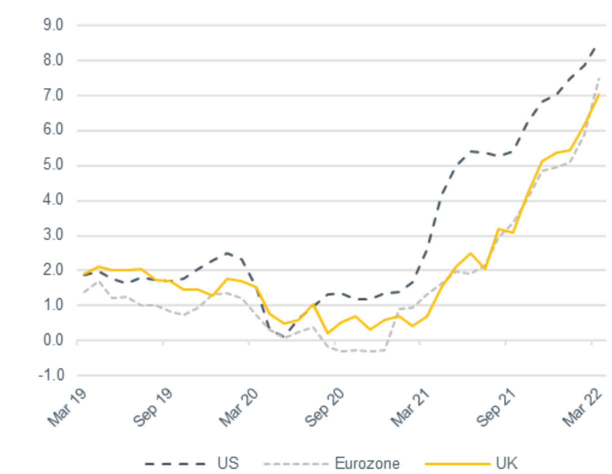
The inflation backdrop has seen central banks turn more hawkish this year, despite the potential downside risks to growth from higher commodity prices. After a first hike in December, the Bank of England raised rates twice in Q1, to 0.75% p.a. and, as expected, the US Federal Reserve raised rates by 0.25% p.a. in March, with the median voting member now expecting seven rate rises in 2022 and four in 2023. The European Central Bank confirmed its asset purchases will end this year, leaving the door open to an interest rate rise, while the Fed noted plans to reduce the size of its balance sheet.

Global sovereign bond yields rose significantly to reflect increased rate rise expectations with UK 10-year gilt yields rising 0.7% p.a., to 1.6% p.a. UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose 0.5% p.a., to 4.4% p.a., as real yields rose to a lesser extent then their nominal counterparts.

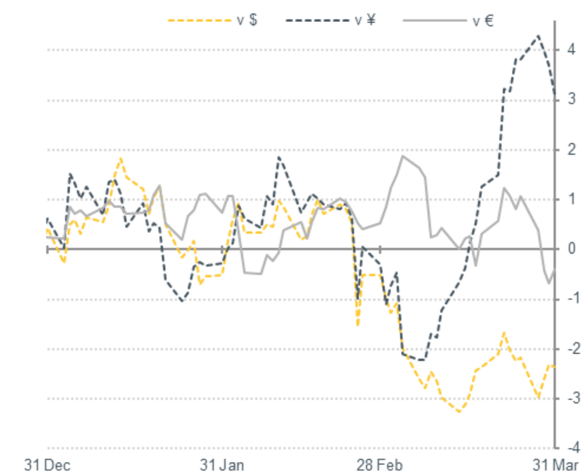
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



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.

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Market Background

Global investment-grade spreads increased by 0.3% p.a., while US and European speculative-grade spreads increased 0.3% p.a. and 0.7% p.a., respectively. Larger increases in European spreads perhaps allude to the greater exposure of European corporates and consumers to higher energy prices.

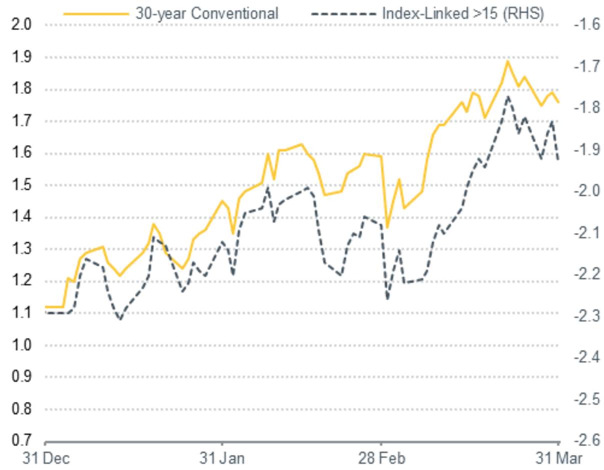
Commodity prices surged to extreme levels and faster expected monetary tightening in the US contributed to a rally in the dollar, whilst safe-haven appeal drove gold prices higher.

Concerns about central bank tightening, slowing earnings momentum, and the geopolitical situation have all contributed to global equities falling 4.6% this year, despite a bounce back in March. Value stocks narrowly outperformed growth stocks as rising yields weighed most heavily on the valuations of stocks with earnings growth further in the future, such as those in the technology sector. The consumer discretionary sector also underperformed as markets considered the impact of inflation on real consumer incomes. Surging oil and gas prices sees the energy sector lead the year-to-date performance rankings.

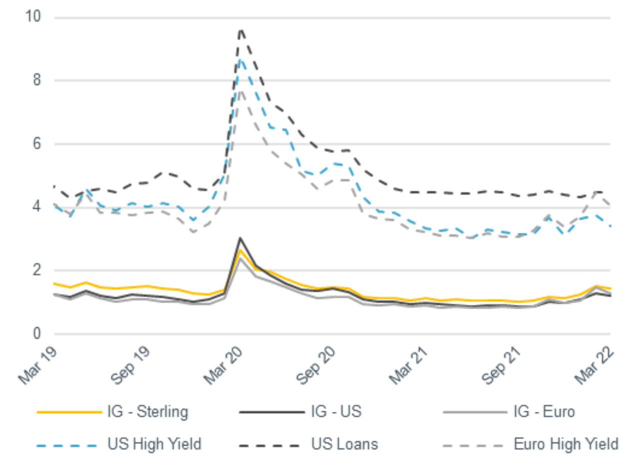
The UK was the only region to deliver a positive return, benefiting from above-average exposure to energy, metals, and miners. Europe fell to the bottom of the performance rankings, whilst Emerging Markets fell further as new COVID-19 lockdowns and broader geopolitical concerns weighed on Chinese markets.

A 18.0% rise in the MSCI UK IPD capital value index over the 12 months to the end of March is largely attributable to a 36.8% rise in industrial capital values. Return on the All-Property Index, including income, was 23.9% in the 12 months to end-March.

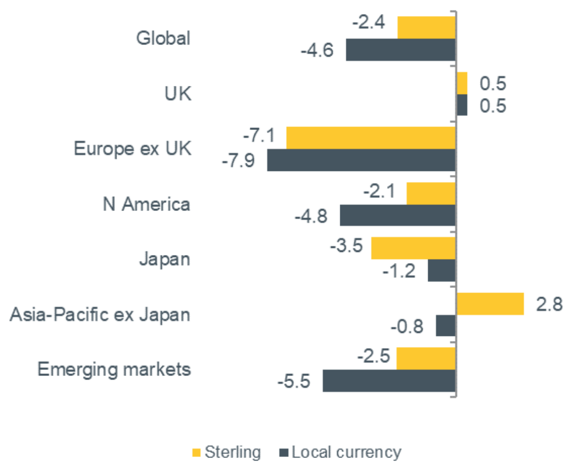
Gilt yields chart (% p.a.)



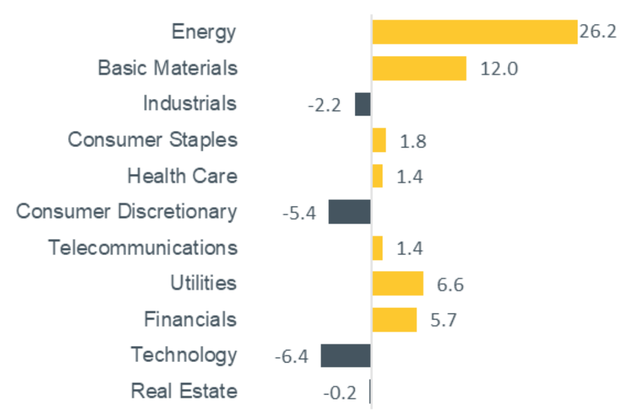
Investment and speculative grade credit spreads (% p.a.)



Regional equity returns [1]



Global equity sector returns (%) [2]



Source: DataStream, Barings, ICE [1] FTSE All World Indices. Commentary compares regional equity returns in local currency. [2] Returns shown in Sterling terms and relative to FTSE All World.

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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