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London Borough of Merton Pension Fund

Q2 2022 Investment Monitoring Report

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Executive Summary

The Fund's assets returned -9.1% during the second 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 -3.5% (top left chart). We have also shown performance against the Fund's actuarial target (top right chart), on the 3-year measure the Fund is slightly behind with relative returns of -0.6% p.a.

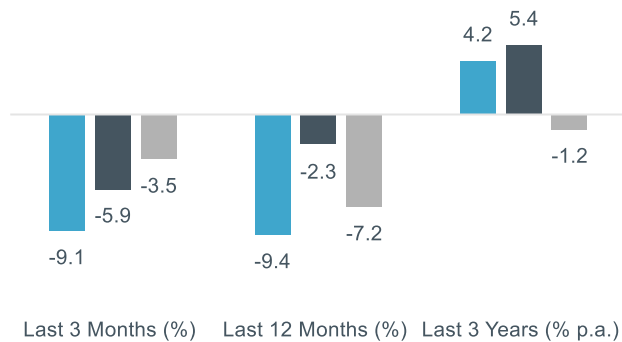
Overall, the Fund's assets decreased by £86.8m from £927.7m to £840.9m. The second quarter of the year saw global markets contract as the impact of the Russia-Ukraine conflict was fully felt coupled with spiralling global inflation which saw central banks respond with a series of interest rate rises.

Property and infrastructure assets bucked this trend. Gilt implied inflation dropped as real yields improved due to the Bank of England tightening monetary policy.

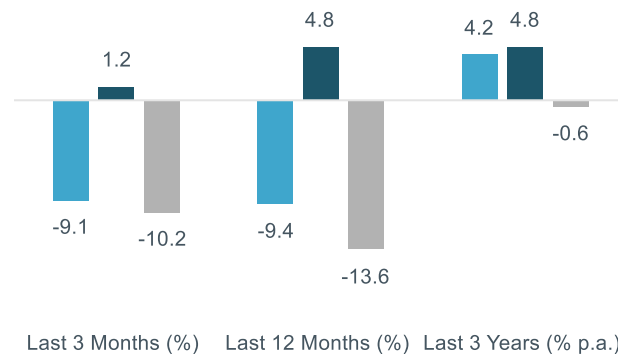
From a Fund asset class perspective:

- Equity funds all negatively detracted from overall performance
- The diversified growth funds both struggled.
- Real assets contributed positively to performance.
- The Risk Management Framework contributed negatively to performance as Sterling depreciated relative to EUR and USD. A rise in gilt yields also punished assets held as backing collateral for hedging.

Fund performance vs benchmark/target



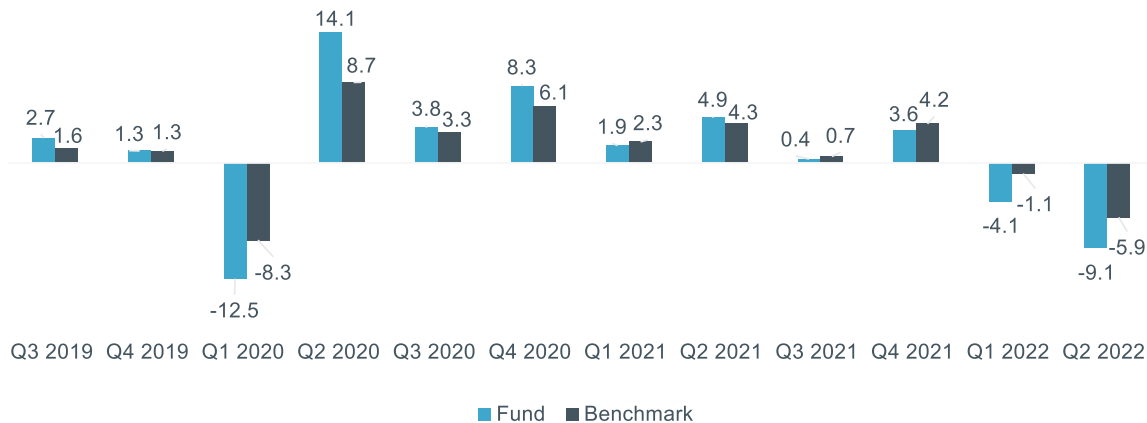
Fund performance vs actuarial target



■ Fund ■ Benchmark ■ Relative

■ Fund ■ Benchmark ■ Relative

Relative quarterly performance vs benchmark/target



■ Fund ■ Benchmark

Asset Allocation

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.

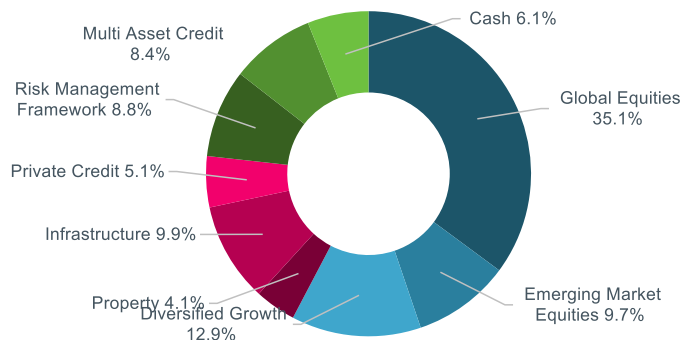
The Fund made its first investment to the newly appointed Henley Secure Income Property Fund II which focuses on social housing projects.

There were a few divestments completed during the quarter, £4.5m of equities were sold across the UBS Alternative Beta mandates. Each of the diversified growth funds had £28m sold in preparation for funding upcoming manager commitments.

Mandate	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q1 22	Q2 22			
UBS Alternative Beta	52.3	44.8	5.3%	10.0%	-4.7%
LCIV RBC Sustainable Equity Fund	91.3	83.3	9.9%	10.0%	-0.1%
LCIV Baillie Gifford Global Alpha Growth Fund	79.5	69.9	8.3%	10.0%	-1.7%
BlackRock World Low Carbon Equity Tracker	109.3	97.4	11.6%	10.0%	1.6%
Global Equities	332.4	295.4	35.1%	40.0%	-4.9%
UBS GEM HALO	50.7	48.4	5.8%	5.0%	0.8%
LCIV JP Morgan Emerging Market Equity Fund	35.5	32.9	3.9%	5.0%	-1.1%
Emerging Market Equities	86.1	81.3	9.7%	10.0%	-0.3%
LCIV Ruffer Absolute Return Fund	89.9	58.3	6.9%	5.0%	1.9%
LCIV Baillie Gifford Diversified Growth Fund	85.8	50.2	6.0%	5.0%	1.0%
Diversified Growth	175.7	108.5	12.9%	10.0%	2.9%
UBS Triton Property Fund	20.4	20.7	2.5%	2.5%	0.0%
BlackRock UK Property Fund	9.0	9.2	1.1%	2.5%	-1.4%
Henley Secure Income Property Fund II	0.0	4.5	0.5%	0.0%	0.5%
Property	29.4	34.4	4.1%	5.0%	-0.9%
MIRA Infrastructure Global Solutions II L.P. Fund	15.0	15.8	1.9%	3.0%	-1.1%
Quinbrook Low Carbon Power LP Fund	14.3	16.1	1.9%	1.5%	0.4%
Quinbrook Net Zero Power Fund	33.9	33.1	3.9%	0.0%	3.9%
JP Morgan Infrastructure Fund	17.3	18.1	2.1%	3.0%	-0.9%
Infrastructure	80.5	83.1	9.9%	7.5%	2.4%
Permira Credit Solutions IV Fund	22.4	22.7	2.7%	4.5%	-1.8%
Churchill Middle Market Senior Loan II Fund	17.7	20.0	2.4%	3.0%	-0.6%
Private Credit	40.1	42.7	5.1%	7.5%	-2.4%
Allspring RMF Fund	101.3	73.8	8.8%	10.0%	-1.2%
Risk Management Framework	101.3	73.8	8.8%	10.0%	-1.2%
LCIV CQS / PIMCO MAC Fund	76.7	70.6	8.4%	10.0%	-1.6%
Multi Asset Credit	76.7	70.6	8.4%	10.0%	-1.6%
Cash	5.2	51.1	6.1%	0.0%	6.1%
Total Fund	927.3	840.9	100.0%	100.0%	

At the time of writing, latest quarterly information in respect of mandate held with MIRA and Permira are unavailable. We have lagged reporting by 3 months, therefore the valuations shown are as at Q4 2021 and Q1 2022 respectively. The FX rate used is lagged and at each of these dates also.

Asset class exposures



Manager performance

The second quarter of 2022 saw the Fund return absolute returns of -9.1% underperforming the composite benchmark with relative returns of -3.5%.

Over longer timer periods shown, this trend has continued with relative returns of -7.2% and -1.2% p.a. for 12-months and 3 years respectively.

Despite the equity and diversified growth funds (“DGF”) contributing negatively to overall performance, investments in less liquid asset such as property, infrastructure and private credit provided some resilience with the majority recording positive absolute returns.

Of the two DGFs, Baillie Gifford was the main detractors this quarter with absolute returns of -8.8%. Its directional style suffered as broader markets fell.

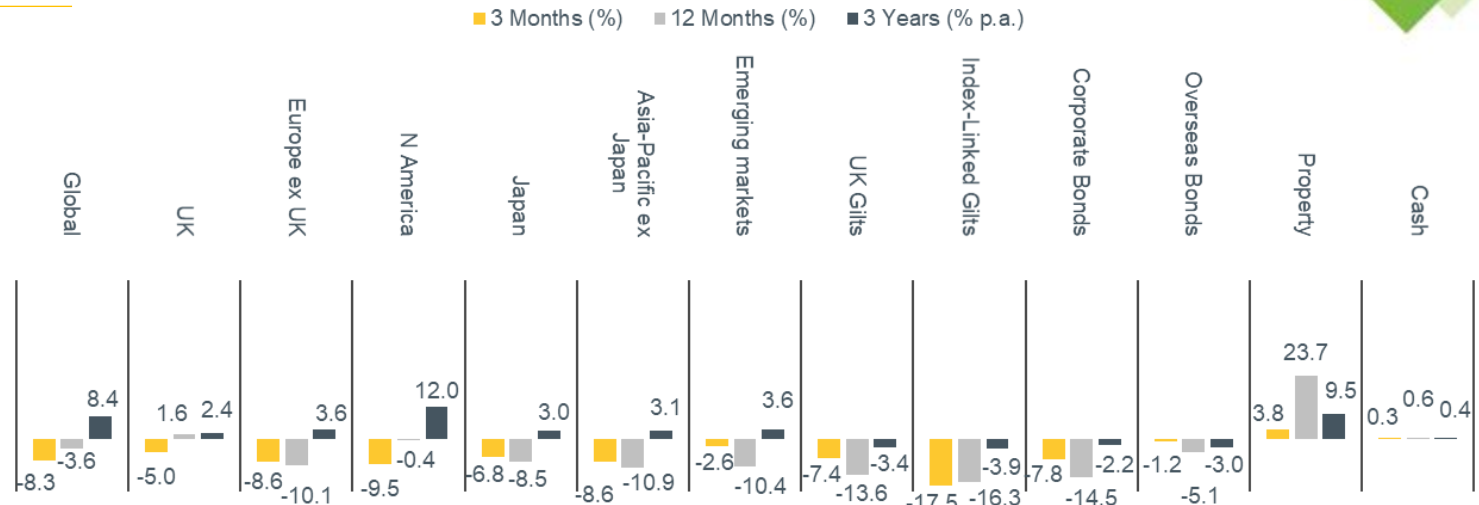
The Risk Management Framework was the largest detractor to performance. Rising yields coupled with a depreciating pound-sterling saw this framework struggle in raw performance terms.

At time of writing, Henley, MIRA and Permira reporting information was unavailable. For performance reporting purposes we have lagged performance and valuations shown within our report by 3 months. We expect, given the illiquid nature of these mandates, this will be a regular occurrence.

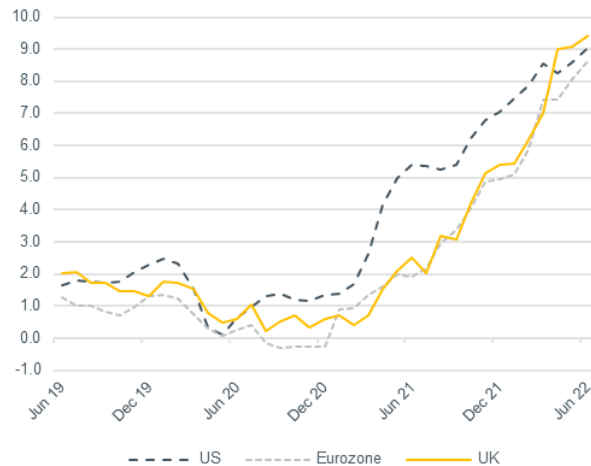
Mandate	Last 3 Months (%)			Last 12 Months (%)			Last 3 Years (% p.a.)			Since Inception (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
UBS Alternative Beta	-6.1	-6.2	0.0	2.8	2.7	0.2	5.1	5.1	0.0	1.1	1.1	0.0
LCIV RBC Sustainable Equity Fund	-8.8	-8.7	-0.1	-8.7	-1.1	-7.7	9.0	9.2	-0.2	9.4	7.4	1.9
LCIV Baillie Gifford Global Alpha Growth Fund	-12.1	-8.4	-4.0	-23.4	-2.7	-21.3	5.6	8.8	-2.9	6.2	7.3	-1.1
BlackRock World Low Carbon Equity Tracker	-11.0	-10.4	-0.7	-3.7	-3.9	0.3	8.6	8.8	-0.1	11.8	11.9	-0.1
Global Equities												
UBS GEM HALO	-4.6	-4.0	-0.6	-22.1	-15.0	-8.3	0.1	2.1	-1.9	3.8	4.5	-0.7
LCIV JP Morgan Emerging Market Equity Fund	-7.0	-3.4	-3.7	-19.2	-13.4	-6.7	-	-	-	2.1	2.1	-0.1
Emerging Market Equities												
LCIV Ruffer Absolute Return Fund	-4.2	1.0	-5.1	2.1	3.3	-1.2	-	-	-	5.2	3.3	1.8
LCIV Baillie Gifford Diversified Growth Fund	-8.8	1.1	-9.8	-10.1	3.9	-13.5	0.1	3.9	-3.6	0.7	3.5	-2.8
Diversified Growth												
UBS Triton Property Fund	3.0	3.9	-0.9	23.4	23.3	0.2	10.1	9.2	0.8	2.0	1.8	0.2
BlackRock UK Property Fund	2.9	3.9	-1.0	21.4	23.3	-1.5	8.5	9.2	-0.7	3.7	4.0	-0.3
Henley Secure Income Propety Fund II	-	-	-	-	-	-	-	-	-	0.0	0.0	0.0
Property												
MIRA Infrastructure Global Solutions II L.P Fund	2.7	1.8	0.9	10.6	7.4	3.0	-	-	-	5.4	6.0	-0.5
Quinbrook Low Carbon Power LP Fund	3.8	1.8	1.9	15.2	7.4	7.2	7.3	7.4	-0.1	7.7	6.9	0.8
Quinbrook Net Zero Power Fund	-10.0	1.5	-11.3	-	-	-	-	-	-	0.5	4.6	-3.9
JP Morgan Infrastructure Fund	1.6	2.5	-0.9	6.9	10.4	-3.2	-	-	-	5.8	9.4	-3.3
Infrastructure												
Permira Credit Solutions IV Fund	1.5	1.7	-0.2	7.3	7.0	0.3	-	-	-	5.1	5.6	-0.5
Churchill Middle Market Senior Loan II Fund	0.4	1.7	-1.3	4.0	7.0	-2.7	2.8	6.8	-3.7	3.9	6.4	-2.4
Private Credit												
Allspring RMF Fund	-28.6	-28.6	0.0	-32.7	-32.7	0.0	-	-	-	-5.9	-5.9	0.0
Risk Management Framework												
LCIV CQS / PIMCO MAC Fund	-7.8	1.3	-9.0	-7.5	4.8	-11.8	0.0	4.7	-4.4	1.0	4.3	-3.2
Multi Asset Credit												
Cash	-	-	-	-	-	-	-	-	-	-	-	-
Total Fund	-9.1	-5.9	-3.5	-9.4	-2.3	-7.2	4.2	5.4	-1.2	6.0	5.2	0.8

Note: Q2 2022 performance figures for MIRA and Permira are lagged by 3-months due to lack of manager information at the time of writing (see comment on left). As such, the performance shown is reflective of Q1 2022.

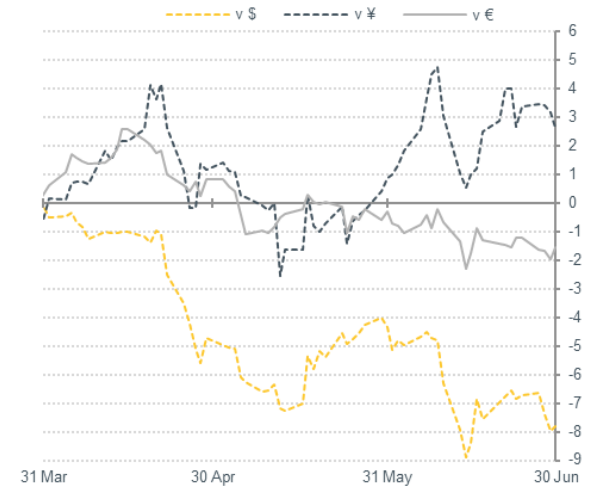
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



Soaring inflation and higher borrowing costs have continued to squeeze consumer's real incomes, with consumer confidence surveys plunging as a result. The persistence of these inflationary pressures, coupled with the prospect of tighter financial conditions, has given rise to fears of recession, and has resulted in revised consensus forecasts for global growth of 2.9% in 2022 and 2.8% in 2023 (down from 4.1% and 3.2%, respectively, at the start of the year.)

While headline inflation continues to rise across developed markets, year-on-year US and UK core inflation, which excludes volatile energy and food prices, eased slightly, but remained elevated, at 6.0% and 5.9%, respectively. While US and UK inflation pressures look more broad-based, a large proportion of eurozone inflation still owes to volatile energy and food prices, with Eurozone core CPI increasing to 3.8% year-on-year.

Despite severe supply side issues and risks to growth, central banks appear determined to bring down inflation. The Bank of England rose rates for the fifth consecutive time and the Fed delivered a bumper 0.75% p.a. increase, taking their base rates to 1.25% p.a. and 1.75% p.a., respectively. The European Central Bank have indicated a first rate hike is likely in July, and the end to negative rates by the end of Q3 2022.

Government bond yields rose as markets moved to price in significant further increases in interest rates, with UK 10-year gilt yields increasing 0.6% p.a. to 2.2% p.a. UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, fell 0.8% p.a., from 4.4% p.a. to 3.6% p.a. as real yields rose more than their nominal counterparts.

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, ICE BofA Global Government Index, MSCI UK Monthly Property; UK Interbank 7 Day

With both inflation and growth concerns weighing on credit markets, global investment-grade credit spreads rose 0.5% p.a., to 1.8% p.a.; while US and European speculative-grade spreads both rose 2.4% p.a., to 5.9% p.a. and 6.4% p.a., respectively.

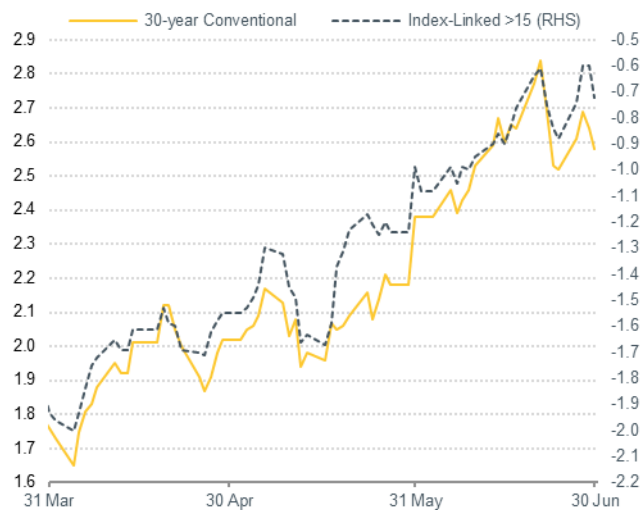
Commodity prices fell over the quarter, with expectations of lower demand leading to a fall in industrial metals prices as rising real yields weighed on precious metal prices.

Despite ongoing upwards revisions to consensus analyst earnings forecasts, global equities fell 8.3% over the quarter, as increases in expectations for the path of interest rates extended the recent decline in equity market valuations. The technology sector notably underperformed on the back of rising rates while returns within the consumer discretionary sector were impacted by a weakening consumer outlook. In contrast, consumer staples outperformed, as investors perhaps placed a premium on the sector's inherent pricing power.

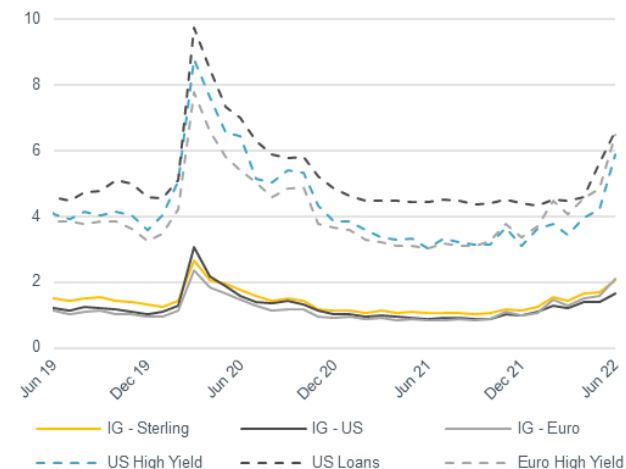
North America underperformed, owing to its large exposure to the technology sector. Meanwhile, above-average exposure to energy, metals, and miners, saw the UK continue its recent outperformance. The easing of lockdown restrictions in China provided some relative support to Emerging and Asian markets equities.

Property remained a relative bright spot, with the MSCI UK IPD total return index rising 9.6% year-to-date; largely owing to a 11.9% rise in industrial capital values. Return on the all-property index, including income, was 23.7% in the 12 months to end-June.

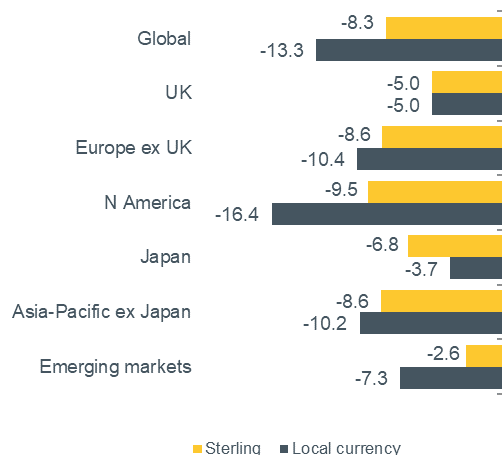
Gilt yields chart (% p.a.)



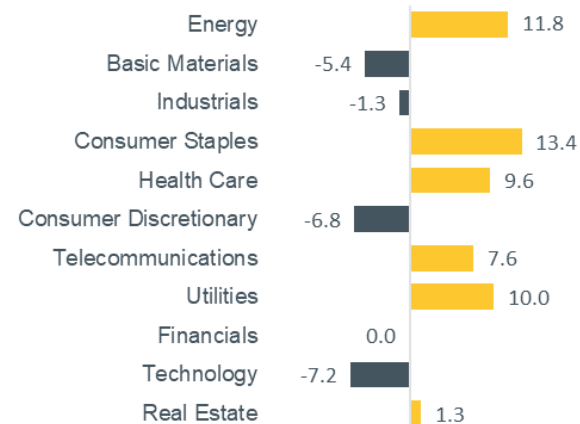
Investment and speculative grade credit spreads (% p.a.)



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:

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

Some industry practitioners use the simpler arithmetic method as follows:

$$\text{Fund Performance} - \text{Benchmark Performance}$$

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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