London Borough of Merton Pension Fund

Q3 2022 Investment Monitoring Report

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Executive Summary

The Fund's assets returned -2.4% during the third 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 ahead of the benchmark by -1.1% (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 behind with relative returns of -2.2% p.a.

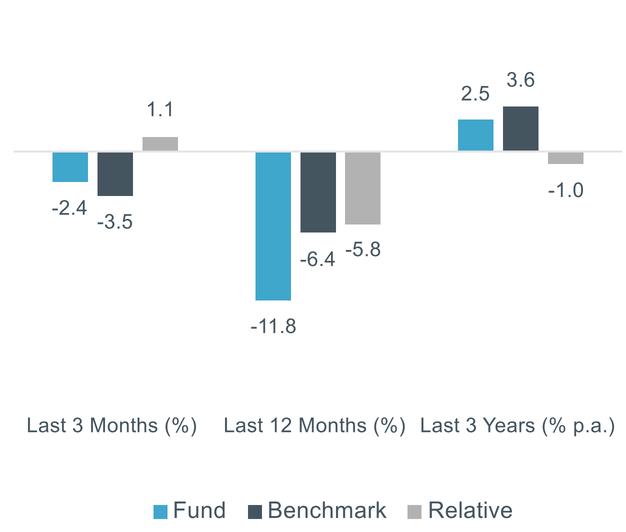
Overall, the Fund's assets increased by £13.1m from £838.3m to £851.4m.

The third quarter of the year saw higher and forecast inflation. Further economic tightening occurred as central banks continued to raise interest rates. Equity markets rallied early in the quarter before losing earlier gains. Across all other asset class, performance was more mixed. UK bonds, gilts, suffered following a sell off due to the former Chancellor's "mini budget" causing chaos in markets.

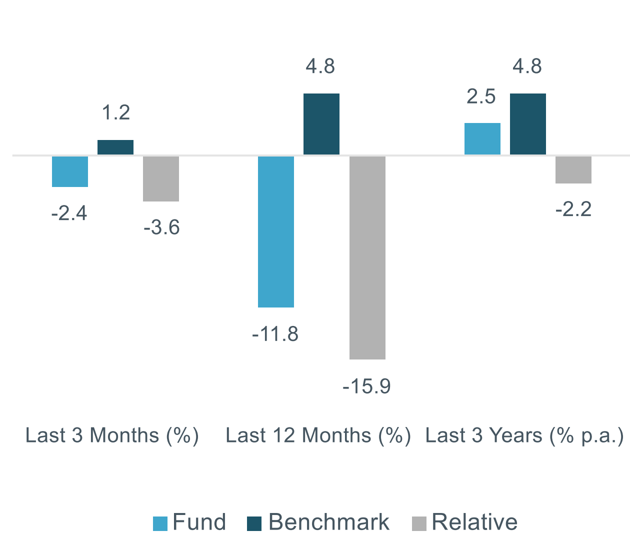
From a Fund asset class perspective:

- The equity allocation recorded positive returns
- The diversified growth funds recorded mixed performance
- The UK property funds struggled due to capital value declines
- The Risk Management Framework suffered as currency contract values and yields moved against the mandate

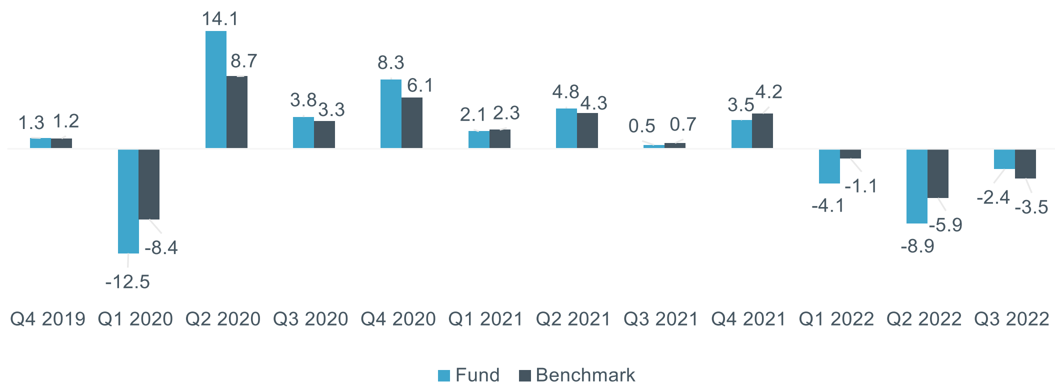
Fund performance vs benchmark/target



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.

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

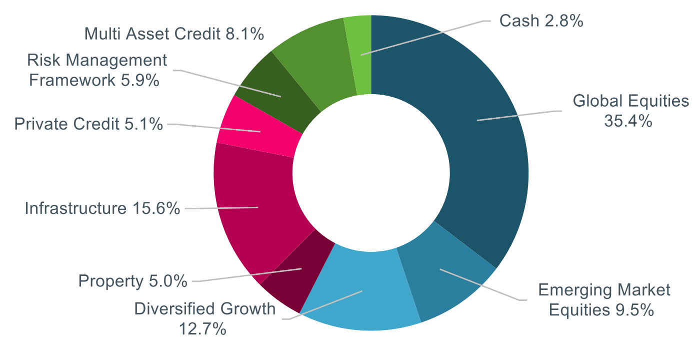
The JP Morgan Infrastructure fund drew the additional c$54m commitment during the quarter, funded by sales from the two DGF's during the previous quarter.

Asset Allocation

Mandate	Valuation (£m) Q2 22	Valuation (£m) Q3 22	Actual Proportion	Benchmark	Relative
UBS Alternative Beta	44.8	45.1	5.3%	5.0%	0.3%
LCIV RBC Sustainable Equity Fund	83.3	84.5	9.9%	10.0%	-0.1%
LCIV Baillie Gifford Global Alpha Growth Fund	69.9	0.0	0.0%	0.0%	0.0%
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	0.0	70.4	8.3%	10.0%	-1.7%
BlackRock World Low Carbon Equity Tracker	97.4	101.1	11.9%	10.0%	1.9%
Global Equities	**295.4**	**301.1**	**35.4%**	**35.0%**	**0.4%**
UBS GEM HALO	48.4	47.5	5.6%	5.0%	0.6%
LCIV JP Morgan Emerging Market Equity Fund	32.9	33.3	3.9%	5.0%	-1.1%
Emerging Market Equities	**81.3**	**80.8**	**9.5%**	**10.0%**	**-0.5%**
LCIV Ruffer Absolute Return Fund	58.3	59.4	7.0%	5.0%	2.0%
LCIV Baillie Gifford Diversified Growth Fund	50.2	48.5	5.7%	5.0%	0.7%
Diversified Growth	**108.5**	**107.9**	**12.7%**	**10.0%**	**2.7%**
UBS Triton Property Fund	20.7	19.8	2.3%	2.5%	-0.2%
BlackRock UK Property Fund	9.2	8.7	1.0%	2.5%	-1.5%
Henley Secure Income Propety Fund II	4.5	13.6	1.6%	1.0%	0.6%
Property	**34.4**	**42.2**	**5.0%**	**6.0%**	**-1.0%**
MIRA Infrastructure Global Solutions II L.P Fund	15.8	18.9	2.2%	2.0%	0.2%
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%	3.0%	0.9%
JP Morgan Infrastructure Fund	18.1	64.9	7.6%	5.0%	2.6%
Infrastructure	**82.1**	**133.0**	**15.6%**	**11.5%**	**4.1%**
Permira Credit Solutions IV Fund	22.7	23.5	2.8%	4.5%	-1.7%
Churchill Middle Market Senior Loan II Fund	17.7	20.0	2.4%	3.0%	-0.6%
Private Credit	**40.3**	**43.5**	**5.1%**	**7.5%**	**-2.4%**
Allspring RMF Fund	73.8	49.9	5.9%	10.0%	-4.1%
Risk Management Framework	**73.8**	**49.9**	**5.9%**	**10.0%**	**-4.1%**
LCIV CQS / PIMCO MAC Fund	70.6	68.9	8.1%	10.0%	-1.9%
Multi Asset Credit	**70.6**	**68.9**	**8.1%**	**10.0%**	**-1.9%**
Cash	51.8	24.1	2.8%	0.0%	2.8%
Total Fund	**838.3**	**851.4**	**100.0%**	**100.0%**	

At the time of writing, latest quarterly information in respect of mandates held with MIRA, Quinbrook, Permira and Churchill are unavailable. We have lagged reporting by 3 months, therefore the valuations shown are as at Q2 2022 respectively. The FX rate used is lagged and at each of these dates also.

Asset class exposures



Source: Investment Managers

During Q3 2022, the Fund recorded an absolute return of -2.4%. Measured against it aggregate benchmark, the fund outperformed with relative returns of 1.1%.

Over the longer time periods of 3 years and since inception, performance for the Fund in absolute terms is positive. Relative returns are more varied, with returns of -1.0% p.a. and 1.1% p.a. respectively.

Performance from the Fund's equity mandates were positive albeit relatively benign during the quarter. The exception was the actively managed UBS GEM HALO mandate which delivered negative absolute and relative returns.

The two UK property funds both recorded negative performance during the quarter, albeit have performed strongly during the past 12-months.

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, however, the framework is working as intended and offsetting some of the currency risk.

At time of writing, MIRA, Quinbrook LCP & NZPF, Permira and Churchill 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.

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	0.5	0.6	**-0.1**	1.4	1.4	**0.0**	4.8	4.8	**-0.0**	1.1	1.1	**0.0**
LCIV RBC Sustainable Equity Fund	1.5	2.3	**-0.7**	-9.7	-1.3	**-8.5**	9.1	8.7	**0.4**	9.3	7.6	**1.6**
LCIV Baillie Gifford Global Alpha Growth Fund	10.5	7.6	**2.7**	-14.9	3.1	**-17.5**	8.9	10.2	**-1.2**	8.2	8.7	**-0.4**
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	-	-	-	-	-	-	-	-	-	-8.6	-5.6	**-3.2**
BlackRock World Low Carbon Equity Tracker	3.9	2.8	**1.0**	-3.7	-3.6	**-0.1**	8.5	8.3	**0.2**	12.1	11.9	**0.2**
Global Equities												
UBS GEM HALO	-2.1	-3.8	**1.8**	-18.1	-13.2	**-5.6**	-0.5	1.2	**-1.6**	3.0	3.2	**-0.2**
LCIV JP Morgan Emerging Market Equity Fund	1.4	-3.2	**4.7**	-15.4	-11.0	**-4.9**	-	-	-	2.4	0.8	**1.6**
Emerging Market Equities												
LCIV Ruffer Absolute Return Fund	1.8	1.1	**0.6**	3.3	3.7	**-0.4**	-	-	-	5.5	3.5	**2.0**
LCIV Baillie Gifford Diversified Growth Fund	-3.2	1.4	**-4.6**	-14.0	4.5	**-17.6**	-1.7	4.0	**-5.5**	-0.1	3.7	**-3.7**
Diversified Growth												
UBS Triton Property Fund	-4.1	-4.0	**-0.1**	14.7	13.2	**1.3**	8.2	7.6	**0.6**	1.8	1.6	**0.2**
BlackRock UK Property Fund	-4.5	-4.0	**-0.5**	11.8	13.2	**-1.3**	6.8	7.6	**-0.8**	3.0	3.3	**-0.3**
Henley Secure Income Propety Fund II	0.0	0.0	**0.0**	-	-	-	-	-	-	0.0	0.0	**0.0**
Property												
MIRA Infrastructure Global Solutions II L.P Fund	1.2	1.8	**-0.6**	8.2	7.4	**0.8**	6.6	6.8	**-0.3**	5.4	5.6	**-0.2**
Quinbrook Low Carbon Power LP Fund	3.8	1.8	**1.9**	15.2	7.4	**7.2**	7.3	7.4	**-0.1**	6.7	6.6	**0.1**
Quinbrook Net Zero Power Fund	-	-	-	-	-	-	-	-	-	0.5	4.6	**-3.9**
JP Morgan Infrastructure Fund	2.2	2.5	**-0.3**	7.5	10.4	**-2.6**	-	-	-	5.5	9.5	**-3.7**
Infrastructure												
Permira Credit Solutions IV Fund	-0.6	1.7	**-2.2**	3.3	7.0	**-3.4**	-	-	-	4.1	5.2	**-1.1**
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**	3.6	5.9	**-2.2**
Private Credit												
Allspring RMF Fund	-35.9	-35.9	**0.0**	-55.7	-55.7	**0.0**	-	-	-	-19.2	-19.2	**0.0**
Risk Management Framework												
LCIV CQS / PIMCO MAC Fund	-2.4	1.5	**-3.9**	-10.8	5.2	**-15.2**	-1.0	4.8	**-5.5**	0.4	4.4	**-3.9**
Multi Asset Credit												
Cash	-	-	-	-	-	-	-	-	-	-	-	-
Total Fund	-2.4	-3.5	**1.1**	-11.8	-6.4	**-5.8**	2.5	3.6	**-1.0**	5.2	4.0	**1.1**

Note: Q3 2022 performance figures for MIRA, Quinbrook LCP & NZPF, Permira and Churchill 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 Q2 2022.

**The LCIV Baillie Gifford Global Alpha Growth Fund 3 month performance figure is part-quarter only due to the asset transition completed mid-quarter to the LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund.*

^There has some repricing of the Quinbrook Net Zero Power Fund assets over the course of the last two quarters which are captured in the Since Inception figures.

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

Market Background

Higher current and forecast inflation, and subsequent expectations of tighter monetary policy, are weighing heavily on consumer and business sentiment, with growth forecasts continuing to see downwards revisions. Recessions are now forecasts in several key European economies and the US economy also expected to slow substantially, increasing global recession risks.

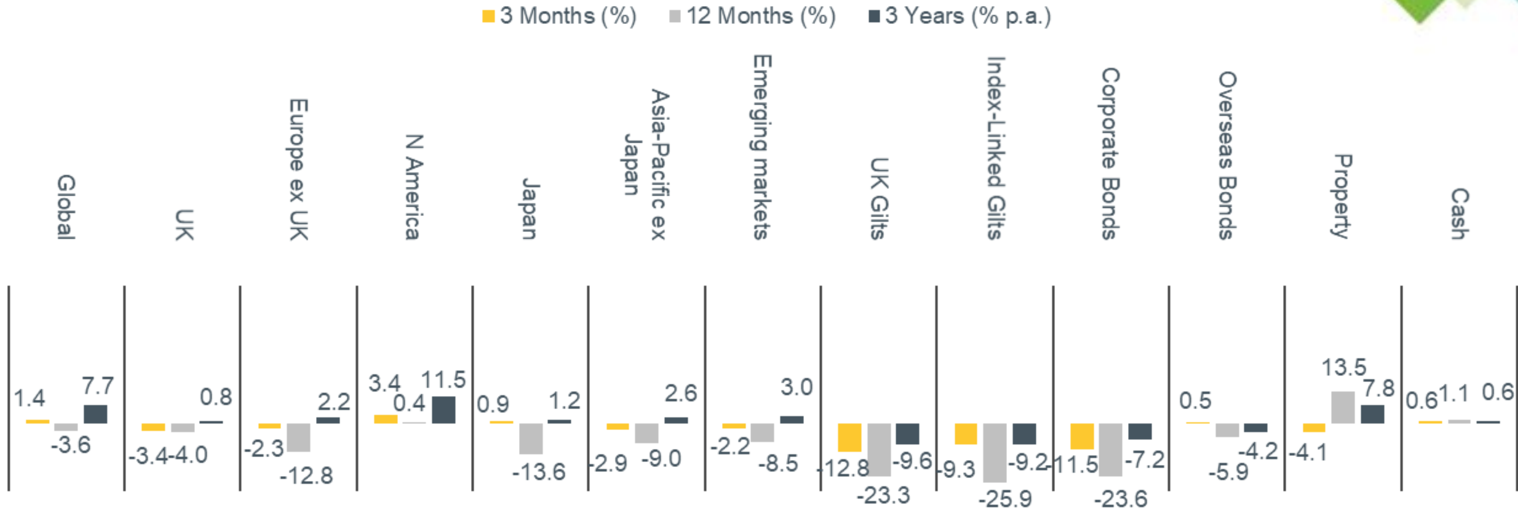
Year-on-year headline CPI inflation is running at 9.9%, 8.3%, and 9.1%, in the UK, eurozone, and US, respectively. Of more concern to central bankers, core inflation, which excludes food and energy prices, is also well above target, at 6.5%, 6.6%, and 4.8% in the UK, US, and eurozone, respectively.

Growing concerns about sustained high inflation were met with more aggressive messaging and action by central banks. The Fed raised interest rates by a cumulative 1.5% p.a. in Q3, while the Bank of England and the ECB raised rates by a total of 1% p.a. and 1.25% p.a., respectively.

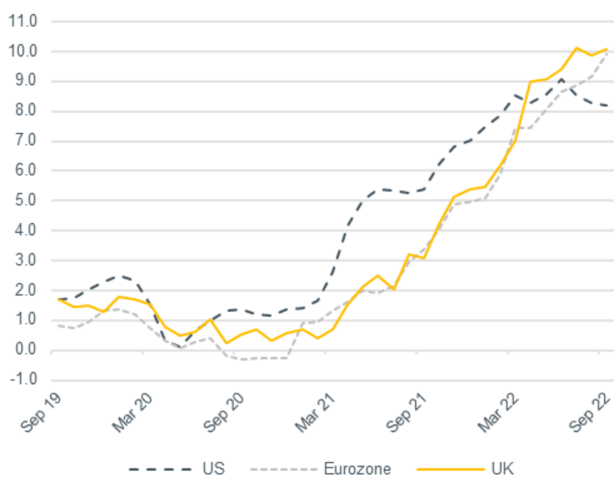
Against a global backdrop of high inflation and rising interest rate expectations, increases in UK government bond yields accelerated as the government unveiled a substantial unfunded fiscal package in late September. 10-year gilt yields ended the quarter at 4.1% p.a., 1.9% p.a. above end-June levels, while equivalent US and German yields both rose 0.8% p.a. over the same period, to 3.8% p.a. and 2.1% p.a., respectively.

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose 0.4% p.a. to 4.0% p.a. Equivalent US implied inflation fell 0.2% p.a., to 2.2% p.a.

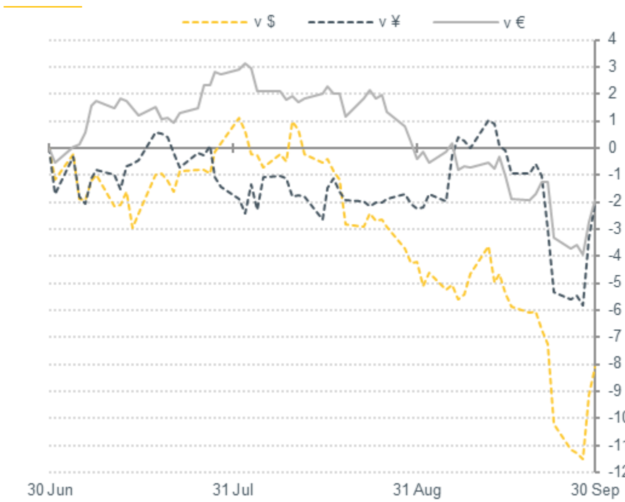
Historic returns for world markets [1]



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

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Global investment-grade spreads ended the quarter slightly wider, while UK investment-grade credit spreads rose 0.4% p.a., to 2.4% p.a., as rising government bond yields saw pension schemes liquidate liquid assets to meet collateral calls on their interest-rate hedging programmes. US and European speculative grade credit spreads ended the quarter 0.4% p.a. and 0.2% p.a. below end June levels, at 5.4% p.a. and 6.3% p.a., respectively.

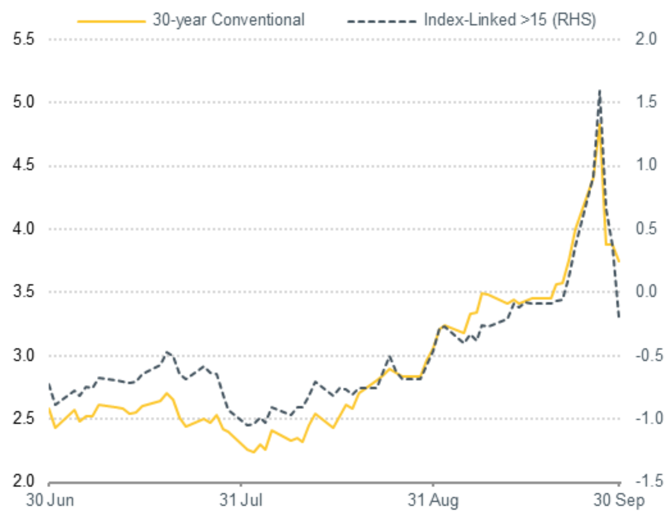
Despite a rally in July, global equities fell sharply in the second half of the quarter as high inflation, and subsequent higher interest rate expectations, weighed on both equity valuations and the fundamental outlook. The FTSE All World Index fell 4.8% (in local terms). Depreciation of sterling over the period resulted in a 1.4% return to unhedged UK investors. Performance was varied between cyclicals and defensives with telecoms, technology, and healthcare underperforming, while the energy and consumer discretionary sectors notably outperformed.

Regionally, Japanese and UK markets outperformed, both supported by currency weakness flattering the international earnings profile of their markets, and the UK also benefitting from an above-average exposure to the energy sector. Emerging and Asian markets once again underperformed.

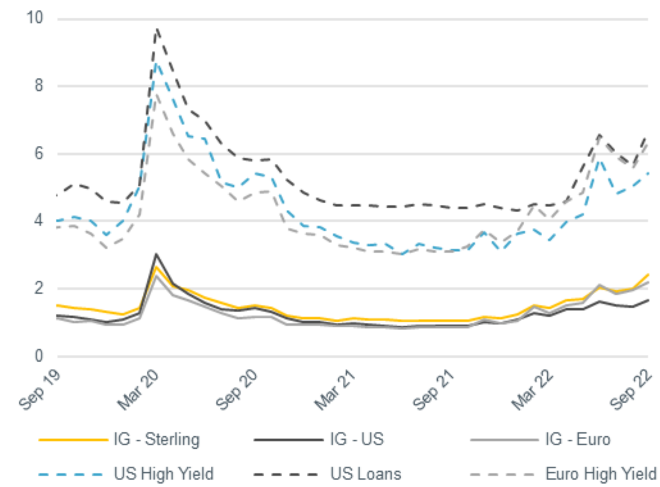
Global growth concerns were reflected in commodity markets, where energy and industrial metals prices led declines.

The MSCI UK Monthly Property Index has returned 13.5% in the 12 months to the end of September, although monthly returns entered negative territory in the third quarter. Capital value declines have been observed across the three main commercial sectors but have been more pronounced in the industrial sector.

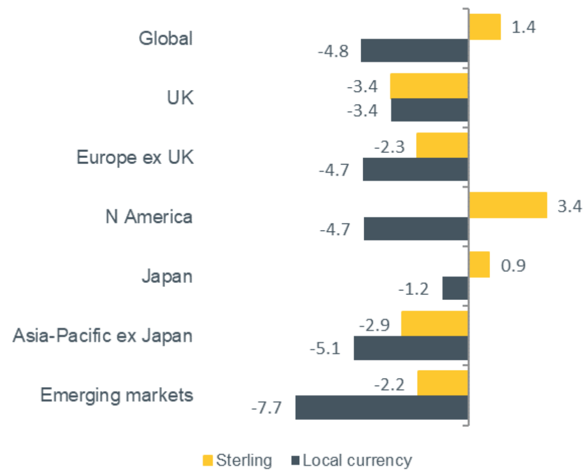
Gilt yields chart (% p.a.)



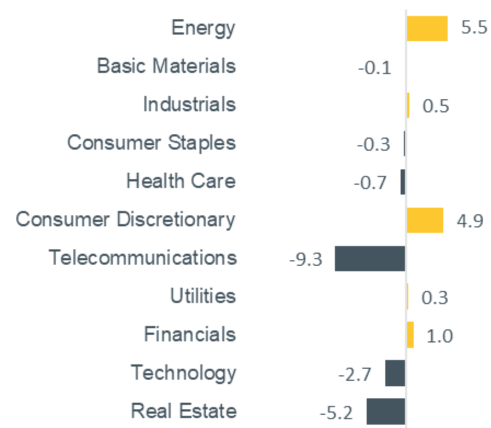
Investment and speculative grade credit spreads (% p.a.)



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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