London Borough of Merton Pension Fund

Q2 2023 Investment Monitoring Report

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Executive Summary

The Fund's assets returned 1.1% during the second quarter of 2023. 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 the benchmark by 1.3% (top left chart). We have also shown performance against the Fund's actuarial target (top right chart), on the 3-year measure the Fund has slightly underperformed with relative returns of -0.1% p.a.

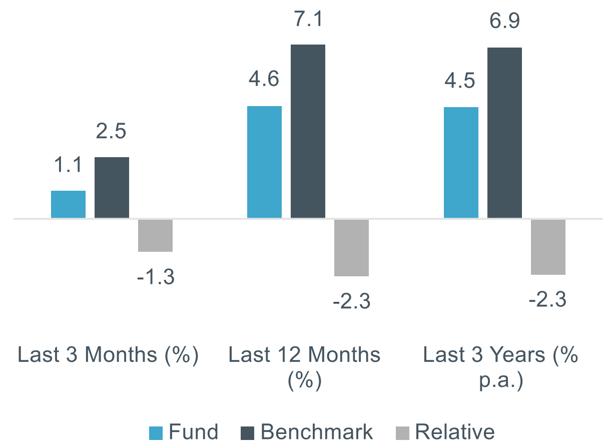
Overall, the Fund's assets decreased by £6.3m from £870.6m to £864.2m.

This year's unexpected economic resilience continued in Q2 amid strong labour markets and robust consumer spending. Meanwhile, core inflation fell much less than headline measures in the major advanced economies. Global equities rose around 7%, taking year-to-date gains to over 14%, and credit spreads fell, while sovereign bond yields rose in anticipation of higher-for-longer interest rates.

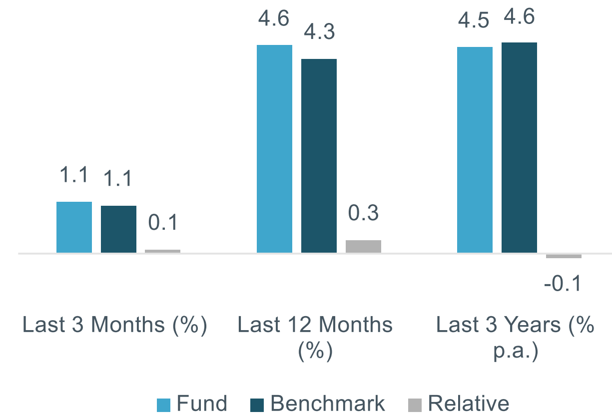
From an asset class perspective:

- In terms of absolute returns, global equity mandates contributed positively but EM equities detracted
- Both diversified growth funds contributed negatively to returns
- Property and infrastructure assets had a varied quarter
- The Risk Management Framework contributed positively.

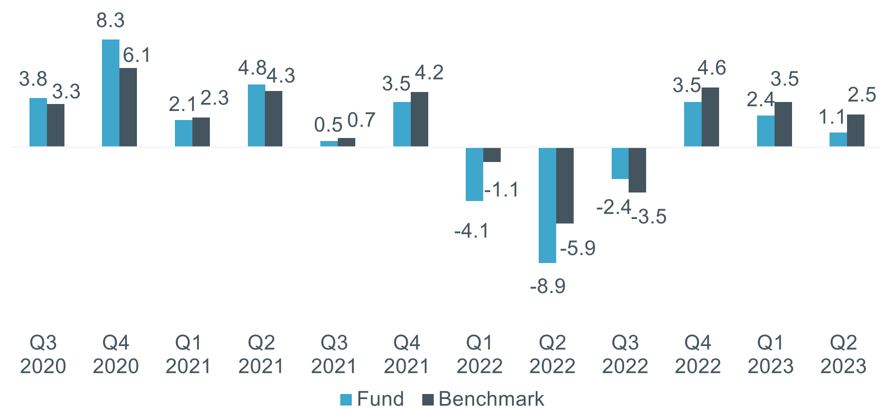
Fund performance vs benchmark/target



Fund performance vs actuarial target



Relative quarterly performance vs benchmark/target



Following the 2022 strategy review the agreed long-term target allocation for the Fund is as follows:

Global equities: 28.0%
Emerging market equities: 5.0%
Diversified growth fund: 5.0%
Property: 5.0%
Private credit: 6.5%
Infrastructure: 11.5%
Social Impact: 5.0%
Multi-asset credit: 9.0%
Risk management framework / Cashflow Driven Investment: 25.0%

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 page will be gradually updated to reflect progress to date.

Commitments to social impact, infrastructure and private credit investments continued to be drawn down over time.

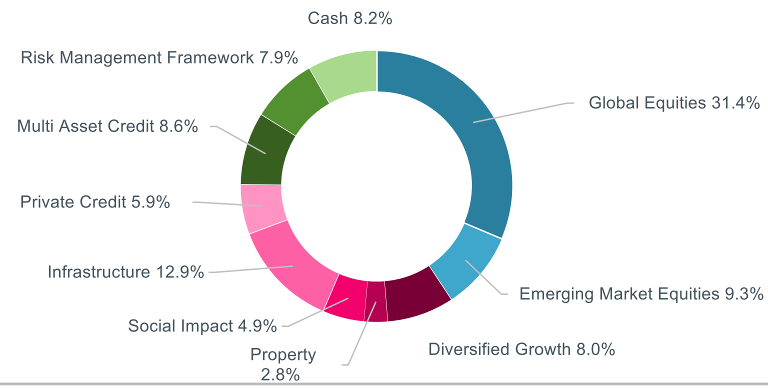
The Fund's UBS Alternative Beta mandate was fully redeemed on 30 June 2023, raising c.£50m in cash. As this transition was partway through the settlement cycle at quarter-end, we have included in "Cash" in the table. Proceeds were then invested in the BlackRock ACS World Multifactor ESG Equity Tracker Fund at the start of July.

Asset Allocation

Mandate	Valuation (£m) Q1 23	Valuation (£m) Q2 23	Actual Proportion	Benchmark	Relative
UBS Alternative Beta	49.0	0.0	0.0%	5.0%	-5.0%
LCIV RBC Sustainable Equity Fund	84.3	84.2	9.7%	10.0%	-0.3%
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	74.8	77.1	8.9%	10.0%	-1.1%
BlackRock World Low Carbon Equity Tracker	104.8	109.9	12.7%	10.0%	2.7%
Global Equities	**312.8**	**271.2**	**31.4%**	**35.0%**	**-3.6%**
UBS GEM HALO	47.4	46.6	5.4%	5.0%	0.4%
LCIV JP Morgan Emerging Market Equity Fund	35.0	34.1	3.9%	5.0%	-1.1%
Emerging Market Equities	**82.4**	**80.7**	**9.3%**	**10.0%**	**-0.7%**
LCIV Ruffer Absolute Return Fund	61.7	57.6	6.7%	5.0%	1.7%
LCIV Baillie Gifford Diversified Growth Fund	24.7	11.3	1.3%	5.0%	-3.7%
Diversified Growth	**86.4**	**69.0**	**8.0%**	**10.0%**	**-2.0%**
UBS Triton Property Fund	16.8	16.8	1.9%	2.5%	-0.6%
BlackRock UK Property Fund	7.4	7.3	0.8%	2.5%	-1.7%
Property	**24.2**	**24.1**	**2.8%**	**5.0%**	**-2.2%**
Henley Secure Income Property Fund II	30.2	42.4	4.9%	1.0%	3.9%
Social Impact	**30.2**	**42.4**	**4.9%**	**1.0%**	**3.9%**
MIRA Infrastructure Global Solutions II L.P Fund	21.1	20.9	2.4%	2.0%	0.4%
Quinbrook Low Carbon Power LP Fund	16.7	11.3	1.3%	1.5%	-0.2%
Quinbrook Net Zero Power Fund	17.3	16.4	1.9%	3.0%	-1.1%
JP Morgan Infrastructure Fund	64.1	62.8	7.3%	5.0%	2.3%
Infrastructure	**119.2**	**111.4**	**12.9%**	**11.5%**	**1.4%**
Permira Credit Solutions IV Fund	25.2	26.3	3.0%	4.5%	-1.5%
Permira Credit Solutions V Fund	5.2	6.2	0.7%	0.0%	0.7%
Churchill Middle Market Senior Loan II Fund	20.1	18.7	2.2%	3.0%	-0.8%
Private Credit	**50.5**	**51.3**	**5.9%**	**7.5%**	**-1.6%**
Allspring RMF Fund	66.0	68.3	7.9%	10.0%	-2.1%
Risk Management Framework	**66.0**	**68.3**	**7.9%**	**10.0%**	**-2.1%**
LCIV CQS / PIMCO MAC Fund	73.3	74.7	8.6%	10.0%	-1.4%
Multi Asset Credit	**73.3**	**74.7**	**8.6%**	**10.0%**	**-1.4%**
Cash	25.5	71.1	8.2%	0.0%	8.2%
Total Fund	**870.5**	**864.2**	**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 Q1 2023 respectively. The FX rate used is lagged and at each of these dates also.

Asset class exposures



Source: Investment Managers

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A generally positive second quarter saw the Fund record an absolute return of 1.1%. Despite this, it underperformed its aggregate benchmark by 1.3% for the period.

Over longer time periods shown, the Fund has recorded positive absolute returns, but however failed to match its benchmarks during 12 month and 3 year time periods.

Of the developed equity mandates, all recorded positive returns with the exception of LCIV RBC.

Both diversified growth funds detracted from overall performance.

Of the Fund's real assets, both BlackRock UK Property and Quinbrook LCP funds detracted.

All private credit funds contributed positively as credit spreads on speculative debt tightened.

The Allspring RMF contributed positively as GBP strengthened relative to currencies hedged (USD, EUR and YEN), increasing the value of the contracts held.

At time of writing, MIRA, Quinbrook LCP & NZPF, Permira IV & V 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	2.1	2.7	-0.6	11.4	12.1	-0.7	11.8	12.0	-0.2	1.5	1.5	-0.0
LCIV RBC Sustainable Equity Fund	-0.1	3.9	-3.9	1.1	14.9	-12.0	6.2	12.2	-5.4	7.8	8.8	-1.0
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	3.2	3.3	-0.1	-	-	-	-	-	-	-0.2	4.7	-4.7
BlackRock World Low Carbon Equity Tracker	4.8	4.7	0.1	12.9	11.4	1.4	10.7	10.2	0.5	12.1	11.8	0.3
Global Equities												
UBS GEM HALO	-1.9	-1.9	0.0	-4.4	-2.9	-1.6	-2.9	1.3	-4.2	2.0	2.9	-0.9
LCIV JP Morgan Emerging Market Equity Fund	-2.6	-1.9	-0.8	3.8	-1.0	4.8	3.1	2.6	0.4	2.5	1.2	1.3
Emerging Market Equities												
LCIV Ruffer Absolute Return Fund	-6.5	1.8	-8.2	-1.2	6.2	-7.0	-	-	-	2.5	4.5	-1.9
LCIV Baillie Gifford Diversified Growth Fund	-2.1	2.1	-4.1	-1.8	7.0	-8.2	0.3	4.8	-4.3	0.2	4.2	-3.9
Diversified Growth												
UBS Triton Property Fund	0.6	0.4	0.2	-16.7	-17.4	0.8	4.2	3.4	0.8	0.9	0.7	0.2
BlackRock UK Property Fund	-0.2	0.4	-0.6	-18.2	-17.4	-1.0	2.4	3.4	-0.9	1.0	1.4	-0.3
Property												
Henley Secure Income Property Fund II	-1.3	1.5	-2.7	-3.0	6.1	-8.6	-	-	-	-2.9	5.9	-8.3
Social Impact												
MIRA Infrastructure Global Solutions II L.P Fund	2.0	1.8	0.2	5.8	7.4	-1.5	8.2	7.4	0.7	5.5	5.9	-0.4
Quinbrook Low Carbon Power LP Fund	-0.7	1.8	-2.4	6.0	7.4	-1.3	13.9	7.4	6.0	6.1	6.7	-0.6
Quinbrook Net Zero Power Fund	2.3	1.5	0.8	-	-	-	-	-	-	0.6	6.0	-5.2
JP Morgan Infrastructure Fund	2.1	2.5	-0.4	15.7	10.4	4.9	9.6	10.4	-0.7	7.9	9.7	-1.6
Infrastructure												
Permira Credit Solutions IV Fund	2.2	1.7	0.5	4.8	7.0	-2.0	5.9	7.0	-1.0	4.7	5.5	-0.8
Permira Credit Solutions V Fund	2.2	1.7	0.5	-	-	-	-	-	-	4.3	3.4	0.9
Churchill Middle Market Senior Loan II Fund	2.3	1.7	0.6	6.6	7.0	-0.4	5.4	7.0	-1.5	4.4	6.1	-1.6
Private Credit												
Allspring RMF Fund	5.5	5.5	0.0	2.1	2.1	0.0	-5.1	-5.1	0.0	-3.7	-3.7	0.0
Risk Management Framework												
LCIV CQS / PIMCO MAC Fund	1.8	2.2	-0.4	5.7	7.8	-1.9	3.5	5.6	-2.0	1.9	5.0	-3.0
Multi Asset Credit												
Cash	-	-	-	-	-	-	-	-	-	-	-	-
Total Fund	1.1	2.5	-1.3	4.6	7.1	-2.3	4.5	6.9	-2.3	5.8	5.5	0.3

Note: Performance figures for MIRA, Quinbrook LCP & NZPF, Permira IV & V 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 Q1 2023.

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

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Consensus forecasts for 2023 global GDP growth saw further upwards revisions in Q2, given unexpected resilience in labour markets and consumer spending. Nonetheless, with higher interest rates likely to weigh on consumer and business activity in the second half of 2023 and into 2024, growth forecasts remain relatively weak.

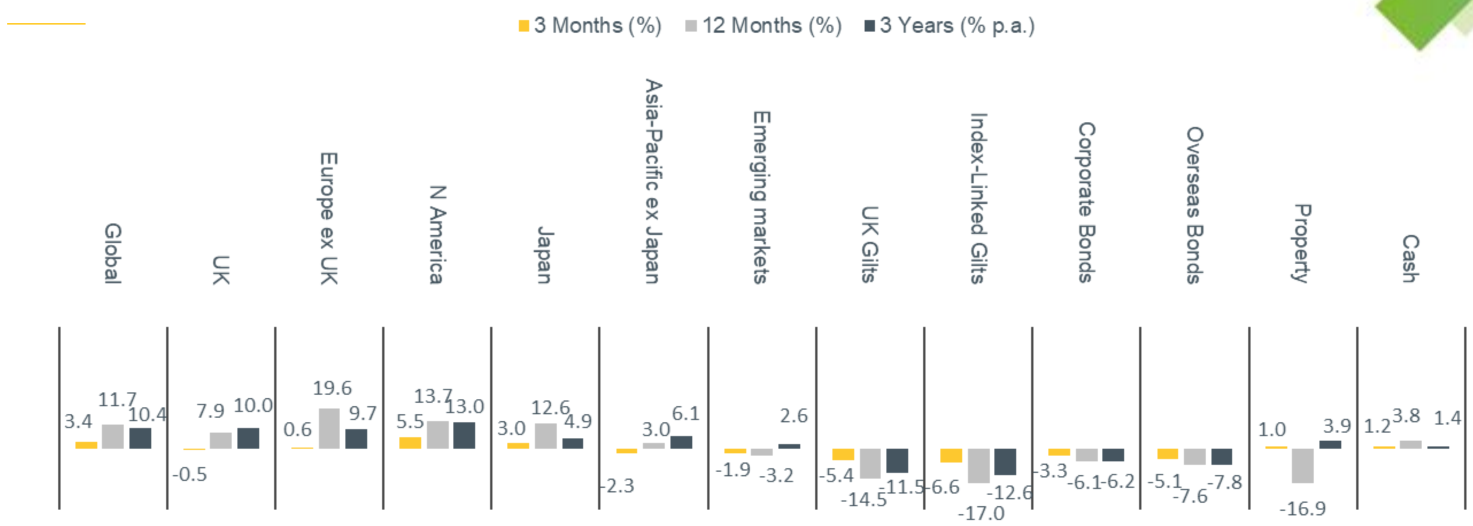
UK inflation data released during Q2 came in higher than forecasters expected. However, June's UK headline CPI inflation figure, released in July, fell more than expected, to 7.9% year-on-year and core inflation slipped back to 6.9% from 7.1%. Equivalent CPI inflation in the US and Eurozone fell to 3.0% and 5.5%, respectively, in June, and core inflation eased to 4.8% in the US, but rose to 5.5% in the Eurozone.

Responding to a run of higher-than-expected inflation, the Bank of England (BoE) raised rates by 0.75% p.a. in Q2, to 5.0% p.a., including a surprise 0.5% p.a. increase in June. The US Federal Reserve raised rates by 0.25% p.a., to 5.25% p.a., in May; pausing in June to evaluate the impact of prior tightening. The European Central Bank increased their deposit rate 3.5% p.a.

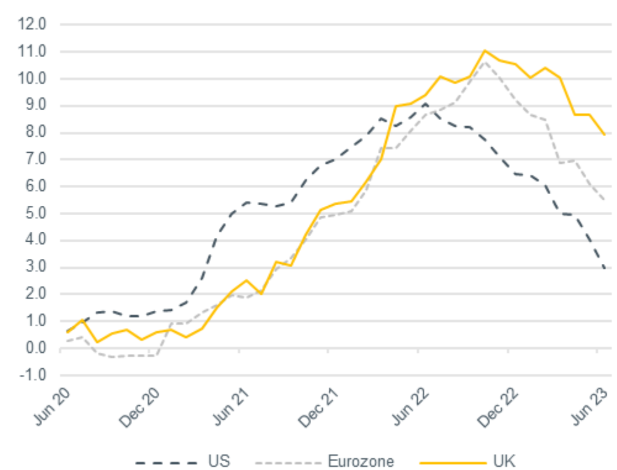
UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was unchanged at 3.6% p.a., as real and nominal yields rose by similar amounts.

UK gilt yields surged as disappointing inflation data was compounded by heavy issuance and BoE gilt sales. UK 10-year gilt yields rose sharply by 0.8% p.a. to 4.4% p.a., while US yields rose 0.2% p.a. to 3.8% p.a., and equivalent German yields rose 0.1% p.a., to 2.4% p.a.

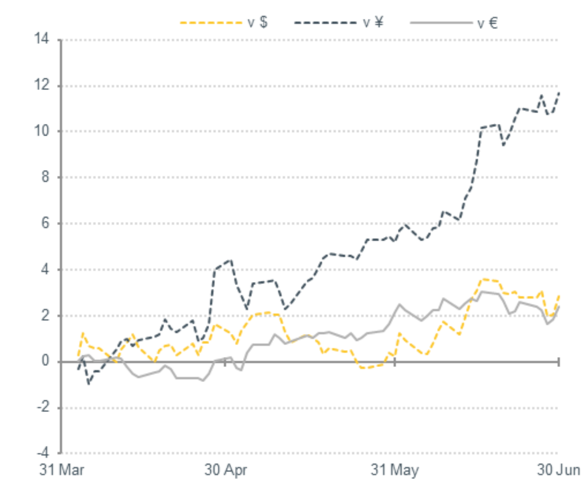
Historic returns for world markets [1]



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

Market Background

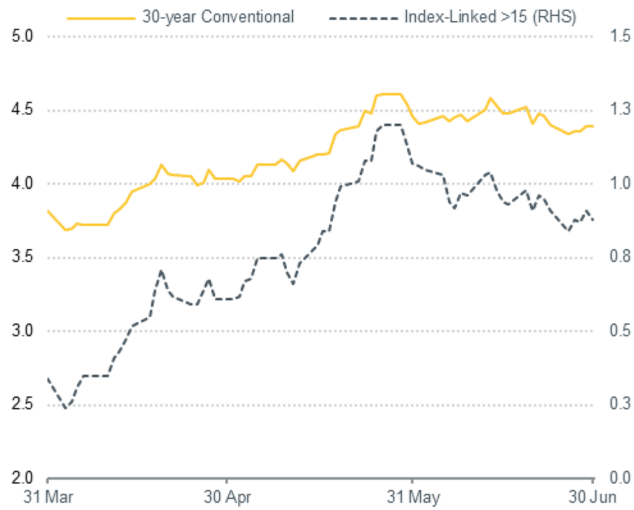
The UK investment-grade credit market recorded negative total returns as the rise in underlying gilt yields more than offset a fall in credit spreads. Global investment-grade credit spreads decreased by 0.1% p.a. to 1.4% p.a., and global speculative-grade credit spreads decreased by 0.5% p.a. to 4.5% p.a.

The FTSE All World Total Return Index rose 6.7%, buoyed by better-than-expected earnings and AI-inspired optimism around the technology sector. Japanese and North American equities outperformed, with the exporter-heavy index of the former benefitting from Yen weakness and the latter benefitting from its disproportionately high exposure to the technology sector. Disappointing Chinese activity data dragged down emerging markets and Asia Pacific ex-Japan. The UK was the worst performing region, as the basic materials and energy sectors underperformed amid commodity price declines and global manufacturing weakness.

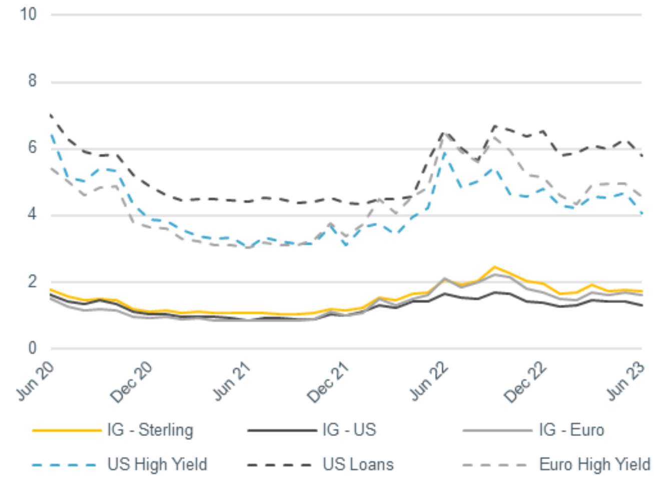
Sterling rose over 4.0% in trade-weighted terms as interest rate expectations soared. Meanwhile, equivalent US and euro measures rose 0.8% and 2.1%, respectively, while the yen measure fell more than 5%. The S&P GSCI Commodity Spot Price Index fell 5.8% in Q2, driven by declines in energy and industrial metal price.

UK commercial property values, as measured by the MSCI UK Property Index, had fallen by over 21% in the 12 months to end-June. Capital values have somewhat stabilised in recent months, though office values continued to decline in June. Alongside income, this led to a modest positive total return from the market over the quarter.

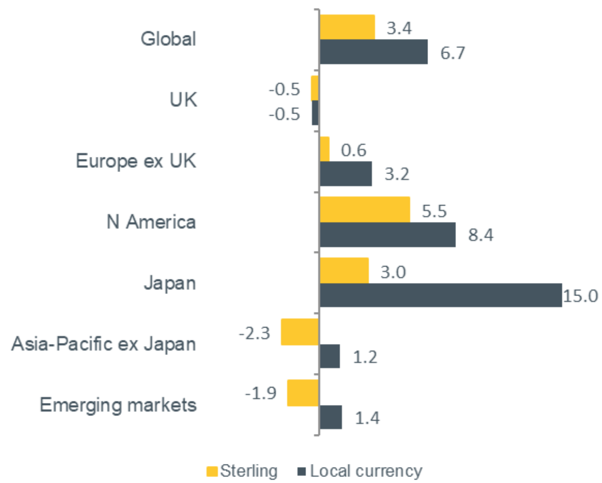
Gilt yields chart (% p.a.)



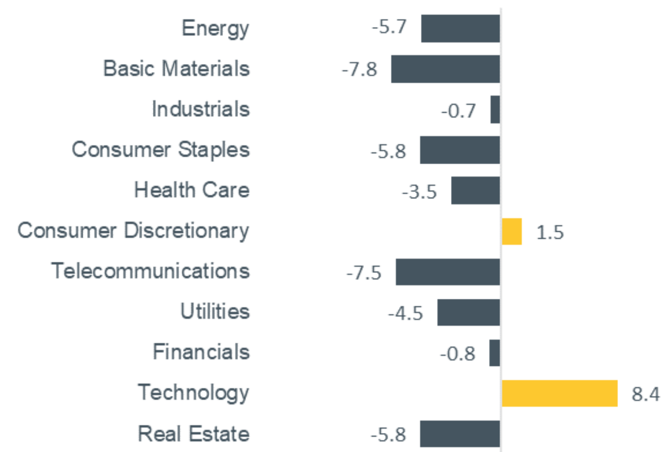
Investment and speculative grade credit spreads (% p.a.)



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.

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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.

Hymans Robertson LLP and our group companies have a wide range of clients some of which are fund managers, who may be parties in our recommendations to you in various circumstances including but not limited to manager selection, moving money to or from a manager or supporting retention of or disinvestment from a manager. We have a research team that advises on shortlisting fund managers in manager selection exercises and forming views on managers, which is separate from our client and other relationships with fund managers and therefore we do not believe there will be a conflict that would influence the advice given.

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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