London Borough of Merton Pension Fund

Q4 2023 Investment Monitoring Report

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Executive Summary

We assess total Fund returns against a composite benchmark - a weighted average of the underlying manager benchmarks.

During Q4 2023, the Fund's assets returned 5% slightly underperforming the benchmark by 0.1%. Over longer time periods of 12 months and 3 years, the Fund has underperformed, with relative returns of -3.4% and -3.4% p.a. respectively.

Compared to the actuarial target, the Fund has remained ahead of its actuarial target over 3 and 12 month periods, however lagged by 2.5% p.a. over 3 years.

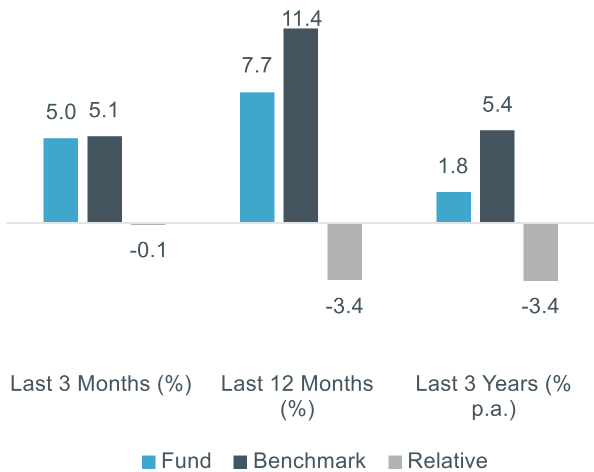
The Fund's assets increased from £846m to £907m, a gain of £61m.

Over Q4 global growth expectations eased to its slowest pace since the Global Financial Crisis. Despite this, US markets pushed higher in Q4 off the back of strong economic backdrop – aiding the Fund's US equity exposure.

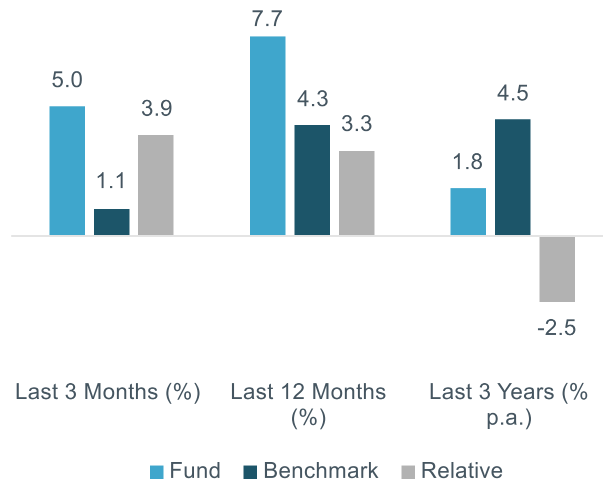
Positive momentum and expected easing of monetary policy saw bond yields fall materially during the quarter. From an asset class perspective:

- Equities and bonds were the main contributors to positive returns
- Private debt and multi-asset credit fared well
- Real assets (Social Impact, Infra. And Property) mostly struggled due to asset class specific concerns.

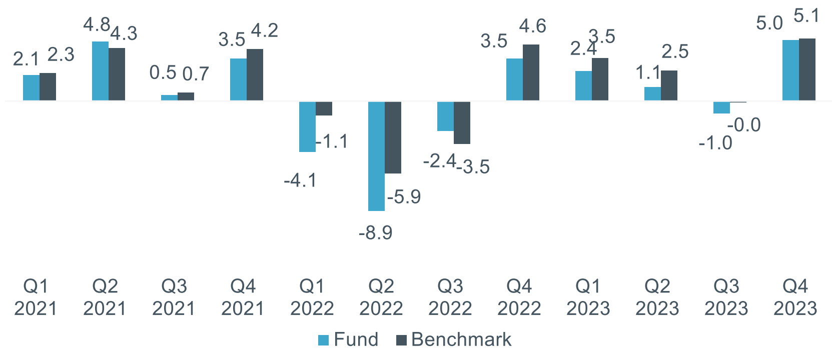
Fund performance vs benchmark/target



Fund performance vs actuarial target



Relative quarterly performance vs benchmark/target



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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: 25.0%

A 5% reduction to Emerging Market equities and 5% increase to RMF remains to be actioned.

The majority of asset classes remained close to their target weighting. The outliers were EM equities and property, both modestly underweight to their targets by c2%.

The Fund has issued an instruction to redeem units in the BlackRock UK Property Fund. Proceeds will be used to increase the UBS Triton allocation.

The Committee are currently considering allocating to a diversifying property strategy which will increase the allocation closer to the 5% target.

An additional top-up of the Allspring CT BnM fund is also being considering, funded by reducing the allocation to RMF.

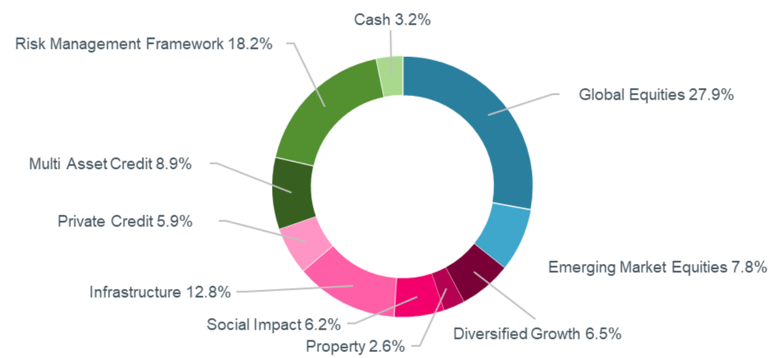
The cash holding includes a proportion of assets held in a money-market fund, earmarked for deployment in the illiquid mandates once called by the investment managers.

Asset Allocation

Mandate	Valuation (£m)		Actual Proportion	Benchmark	Relative
	30-Sep-23	31-Dec-23			
LCIV RBC Sustainable Equity Fund	61.0	64.3	7.1%	7.0%	0.1%
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	57.6	62.2	6.9%	7.0%	-0.1%
BlackRock ACS World Low Carbon Equity Tracker	65.2	70.2	7.7%	7.0%	0.7%
BlackRock ACS World Multifactor ESG Equity Tracker Fund	50.4	53.6	5.9%	7.0%	-1.1%
Global Equities	**234.1**	**250.4**	**27.6%**	**28.0%**	**-0.4%**
UBS GEM HALO	34.6	36.0	4.0%	5.0%	-1.0%
LCIV JP Morgan Emerging Market Equity Fund	33.5	34.2	3.8%	5.0%	-1.2%
Emerging Market Equities	**68.1**	**70.2**	**7.7%**	**10.0%**	**-2.3%**
LCIV Ruffer Absolute Return Fund	57.2	58.4	6.4%	5.0%	1.4%
Diversified Growth	**57.2**	**58.4**	**6.4%**	**5.0%**	**1.4%**
UBS Triton Property Fund	16.6	16.5	1.8%	2.5%	-0.7%
BlackRock UK Property Fund	7.2	7.1	0.8%	2.5%	-1.7%
Property	**23.8**	**23.6**	**2.6%**	**5.0%**	**-2.4%**
Henley Secure Income Property Fund II	46.3	55.6	6.1%	5.0%	1.1%
Social Impact	**46.3**	**55.6**	**6.1%**	**5.0%**	**1.1%**
MIRA Infrastructure Global Solutions II L.P Fund	20.7	21.1	2.3%	2.0%	0.3%
Quinbrook Low Carbon Power LP Fund	9.6	9.7	1.1%	1.5%	-0.4%
Quinbrook Net Zero Power Fund	17.1	20.2	2.2%	3.0%	-0.8%
JP Morgan Infrastructure Fund	63.7	63.9	7.1%	5.0%	2.1%
Infrastructure	**111.1**	**114.9**	**12.7%**	**11.5%**	**1.2%**
Permira Credit Solutions IV Fund	26.3	26.1	2.9%	2.5%	0.4%
Permira Credit Solutions V Fund	6.8	8.3	0.9%	2.0%	-1.1%
Churchill Middle Market Senior Loan II Fund	18.0	18.5	2.0%	2.0%	0.0%
Private Credit	**51.2**	**52.9**	**5.8%**	**6.5%**	**-0.7%**
Allspring RMF Fund	60.9	69.8	7.7%	10.0%	-2.3%
Allspring Climate Transition Buy and Maintain Fund	95.6	102.2	11.3%	10.0%	1.3%
Risk Management Framework	**156.5**	**172.0**	**19.0%**	**20.0%**	**-1.0%**
LCIV CQS / PIMCO MAC Fund	75.4	79.9	8.8%	9.0%	-0.2%
Multi Asset Credit	**75.4**	**79.9**	**8.8%**	**9.0%**	**-0.2%**
Cash	22.6	28.9	3.2%	0.0%	3.2%
Total Fund	**846.2**	**906.8**	**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 Q3 2023 respectively. The FX rate used is lagged and at each of these dates also.

Asset class exposures



Source: Investment Managers

The Fund recorded an absolute return of 5.0% during Q4 2023, underperforming its aggregate benchmark by 0.1%.

Over longer time periods shown, the Fund has recorded positive absolute returns, but underperformed relative to its performance benchmark over 12 month and 3-year time periods. The Fund remains 0.1% above its benchmark since inception.

Global Equities contributed positively to overall Fund returns. Across the four funds, LCIV RBC Sustainable Equity was the outlier – underperforming during the quarter. Both EM equity mandates were positive absolute contributors, however underperformed relative to their benchmarks.

Emerging market equity posted positive returns over the quarter, however underperformed relative to their benchmarks.

Property and Social Impact ‘real assets’ detracted from overall Fund performance.

Broadly speaking, all debt & bond mandates (Private Credit, Risk Management Framework and Multi-Asset Credit) recorded positive returns as credit spreads narrowed materially during the quarter, driven by falls in inflation expectations and markets pricing in base rate cuts.

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
LCIV RBC Sustainable Equity Fund	5.5	6.7	**-1.1**	4.5	17.4	**-10.9**	1.7	10.9	**-8.3**	7.9	9.4	**-1.3**
LCIV Baillie Gifford Global Alpha Growth Paris Aligned Fund	8.1	6.3	**1.7**	11.6	17.0	**-4.6**	-	-	**-**	2.3	8.6	**-5.8**
BlackRock ACS World Low Carbon Equity Tracker	7.7	7.5	**0.1**	17.3	16.8	**0.4**	9.5	9.1	**0.4**	12.6	12.3	**0.3**
BlackRock ACS World Multifactor ESG Equity Tracker Fund	6.4	6.1	**0.3**	-	-	**-**	-	-	**-**	7.8	7.5	**0.3**
Global Equities												
UBS GEM HALO	0.7	3.3	**-2.5**	-1.1	3.6	**-4.5**	-8.4	-2.9	**-5.7**	2.1	3.5	**-1.3**
LCIV JP Morgan Emerging Market Equity Fund	2.1	3.3	**-1.2**	0.4	4.3	**-3.7**	-4.7	-1.6	**-3.1**	2.3	2.2	**0.1**
Emerging Market Equities												
LCIV Ruffer Absolute Return Fund	2.2	2.1	**0.1**	-6.3	7.8	**-13.1**	-	-	**-**	2.6	5.1	**-2.4**
Diversified Growth												
UBS Triton Property Fund	-1.2	-1.2	**-0.1**	0.2	-1.4	**1.6**	2.7	2.1	**0.6**	0.8	0.6	**0.2**
BlackRock UK Property Fund	-2.1	-1.2	**-0.9**	-3.1	-1.4	**-1.7**	0.4	2.1	**-1.6**	0.7	1.1	**-0.5**
Property												
Henley Secure Income Property Fund II	-0.4	1.5	**-1.9**	-5.6	6.1	**-11.1**	-	-	**-**	-2.5	5.9	**-8.0**
Social Impact												
MIRA Infrastructure Global Solutions II L.P Fund	1.1	1.8	**-0.7**	9.9	7.4	**2.3**	7.6	7.4	**0.2**	5.5	6.0	**-0.5**
Quinbrook Low Carbon Power LP Fund	-2.3	1.8	**-4.0**	-4.3	7.4	**-10.9**	10.6	7.4	**3.0**	4.4	6.8	**-2.3**
Quinbrook Net Zero Power Fund	-0.4	1.5	**-1.9**	-	-	**-**	-	-	**-**	0.9	6.0	**-4.8**
JP Morgan Infrastructure Fund	3.4	2.5	**0.9**	11.2	10.4	**0.8**	10.6	10.4	**0.2**	8.4	9.8	**-1.2**
Infrastructure												
Permira Credit Solutions IV Fund	2.3	1.7	**0.5**	9.0	7.0	**1.9**	6.3	7.0	**-0.7**	5.1	5.7	**-0.5**
Permira Credit Solutions V Fund	2.5	1.7	**0.8**	8.6	7.0	**1.5**	-	-	**-**	6.4	5.2	**1.1**
Churchill Middle Market Senior Loan II Fund	2.9	1.7	**1.2**	10.7	7.0	**3.5**	6.9	7.0	**-0.0**	5.1	6.2	**-1.0**
Private Credit												
Allspring RMF Fund	13.8	13.8	**0.0**	17.2	17.2	**0.0**	-11.4	-11.4	**0.0**	-3.1	-3.1	**0.0**
Allspring Climate Transition Buy and Maintain Fund	8.5	8.5	**-0.0**	-	-	**-**	-	-	**-**	9.2	9.2	**-0.0**
Risk Management Framework												
LCIV CQS / PIMCO MAC Fund	5.8	2.4	**3.3**	11.3	9.4	**1.7**	2.9	6.6	**-3.5**	2.9	5.4	**-2.4**
Multi Asset Credit												
Cash	-	-	**-**	-	-	**-**	-	-	**-**	-	-	**-**
Total Fund	5.0	5.1	**-0.1**	7.7	11.4	**-3.4**	1.8	5.4	**-3.4**	6.0	5.9	**0.1**

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 Q3 2023.

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

Market Background

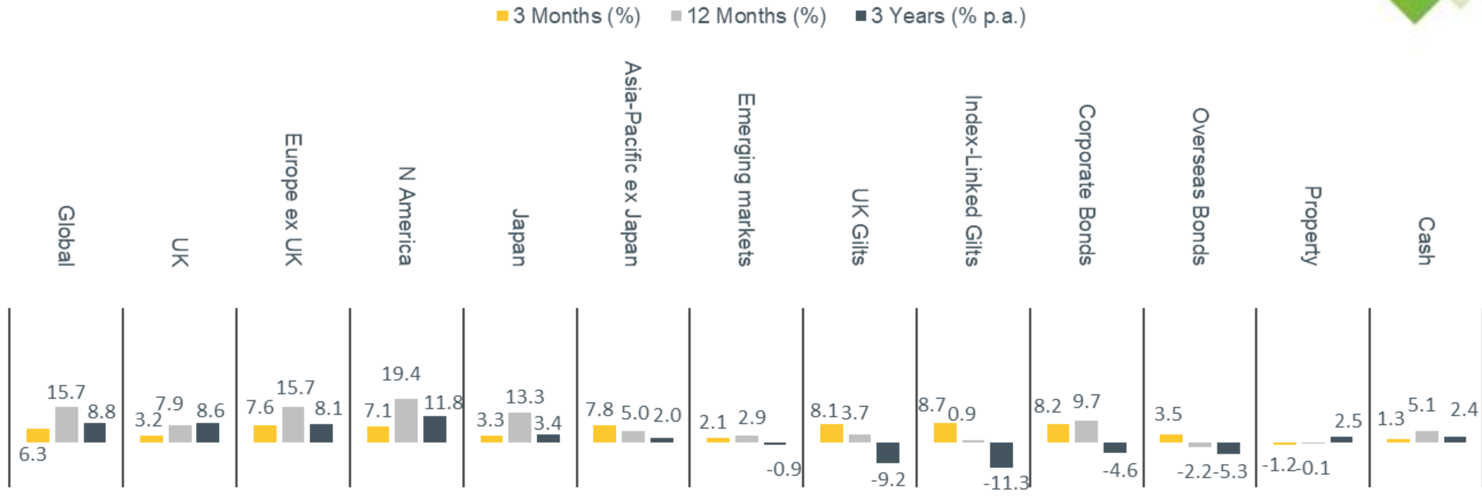
US GDP forecasts for 2023 and 2024 were again revised higher in Q4, given unexpectedly strong growth driven by consumer spending. Despite this, global growth is expected to ease to its slowest pace since the Global Financial Crisis (excluding 2020). However, it isn't expected to collapse.

Year-on-year CPI inflation in the major advanced economies fell more than expected over Q4, easing to 3.9%, 3.1%, and 2.4% in the UK, US, and eurozone in November, respectively. The main drivers were a decline in energy prices and a moderation in food prices. However, core inflation, which excludes both, also fell more than expected. The respective core measures are 5.1%, 4.0%, and 3.6% in the UK, US and eurozone.

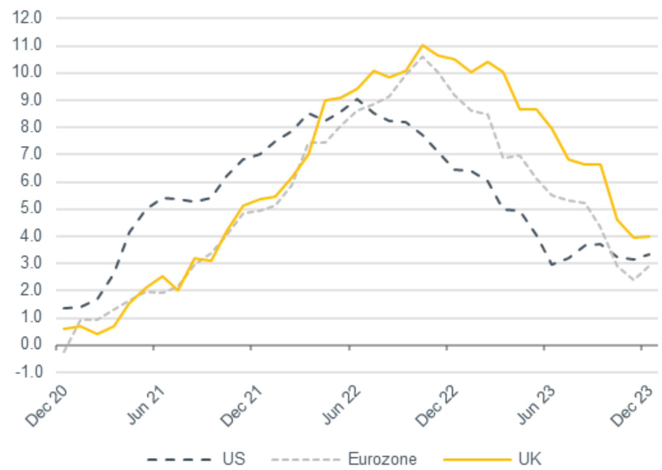
As expected, the major central banks left interest rates unchanged in Q4. Larger-than-expected falls in inflation prompted markets to price in earlier and larger rate cuts in 2024, reinforced by the Federal Reserve's mid-December revised policy projections. Despite the ECB and Bank of England reiterating a more cautious approach, markets expect a similar scale and timing of rate cuts in Europe and the UK.

Rate cut expectations and lower real yields contributed to a 3.1% fall in the trade-weighted US dollar. Equivalent sterling and euro measures rose 1.3% and 1.0%, respectively, while the equivalent yen measure strengthened 2.6% as expected interest-rate differentials with major economies narrowed.

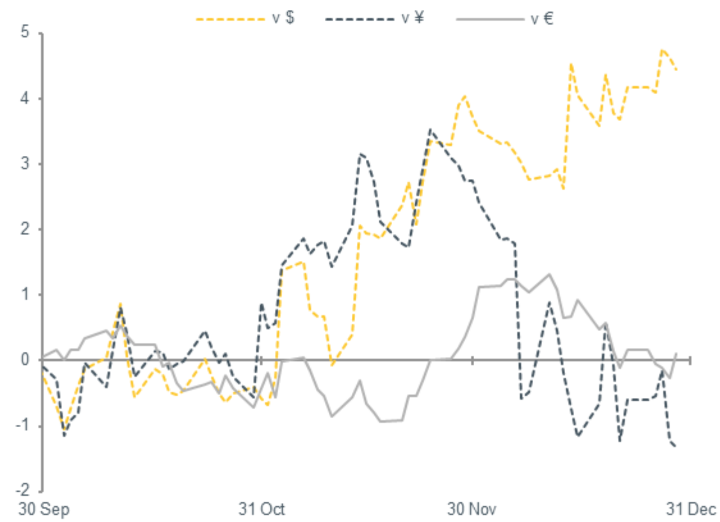
Historic returns for world markets [1]



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

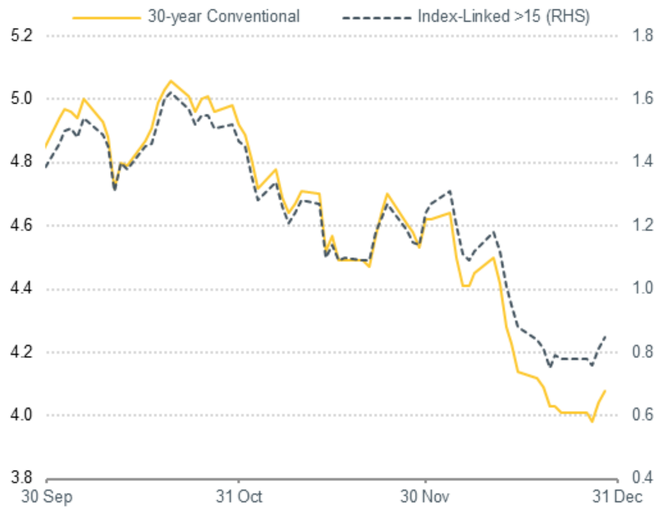
Amid expectations of larger – and sooner – rate cuts in 2024, bond prices rose and yields fell sharply. US 10-year treasury yields declined 0.7% pa over Q4 to 3.9% pa, while equivalent UK gilt yields fell 0.9% pa, to 3.5% pa. German bund yields fell 0.8% pa, to 2.0% pa. Japanese government bond yields fell less, by 0.2% pa to 0.6% pa, given potential divergence in monetary policy between Japan and the other major advanced economies.

Global investment-grade credit spreads declined 0.2% pa to 1.2% pa over Q4, while global speculative credit spreads declined by 0.6% pa to 3.8% pa. Despite a larger decline in speculative-grade credit spreads, the longer-duration investment-grade market outperformed.

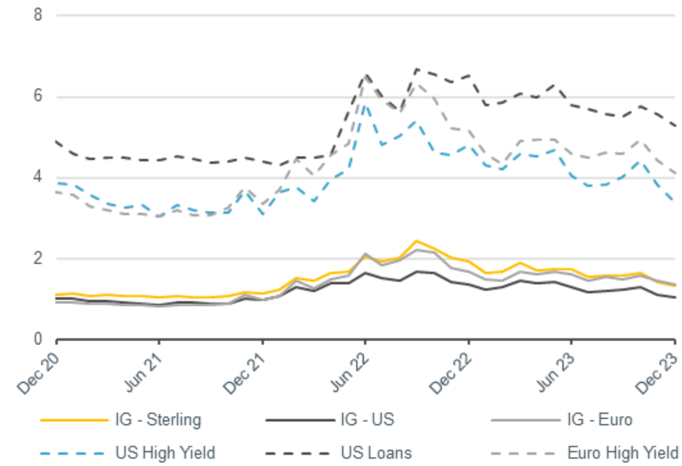
The FTSE All World Total Return Index returned 9.3% over Q4 in local-currency terms, as markets anticipated the positive impact on economic activity of rate cuts. Meanwhile, lower yields lent support to valuations. North American equity markets outperformed, given their exposure to the technology sector. All other regions underperformed, while still producing positive returns. Japan and the UK notably underperformed, given yen and sterling strength, which weighed on the high proportion of overseas earnings in both markets. UK stocks were also impacted by above-average exposure to the energy sector.

The MSCI UK Monthly Property Index fell 1.2% as income was offset by capital value declines. Values fell most sharply in the office and retail sectors, which are down 16.6% and 5.6%, respectively, over 12 months. Industrial values also declined 0.7% in Q4 following seven months of capital growth, resulting in flat growth over 12 months.

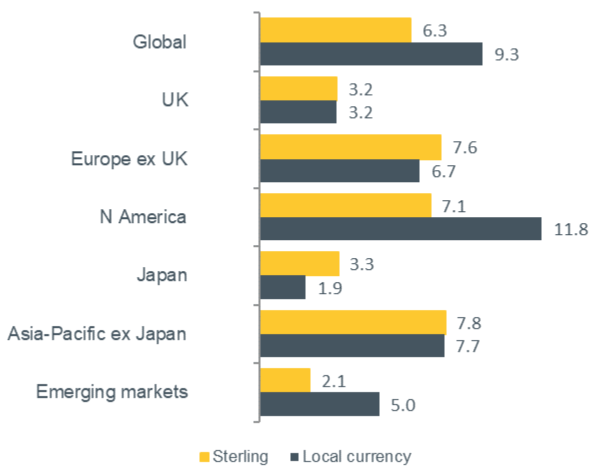
Gilt yields chart (% p.a.)



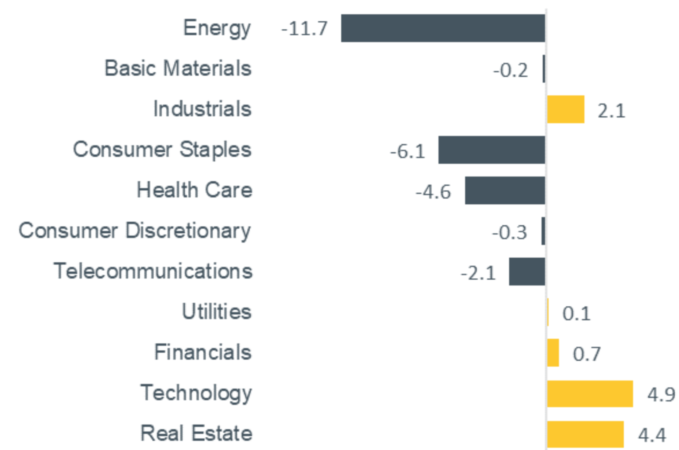
Investment and speculative grade credit spreads (% p.a.)



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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