London Borough of Merton Pension Fund

Q4 2021 Investment Monitoring Report

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Executive Summary

The Fund's assets returned 3.4% during the final quarter of 2021. 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 0.7% (top left chart). We have also shown performance against the Fund's actuarial target (top right chart) against which returns are favourable.

Overall, the Fund assets increased by £30m from £933.3m to £963.0m.

During the final quarter, markets rallied despite concerns over the spread of the Omicron variant with global equity markets returning 6.2%. Inflation remained a continued threat to real growth as many developed countries grappled with this headwind. Property markets, buoyed by the continued easing of lockdown restrictions, recorded another positive quarter.

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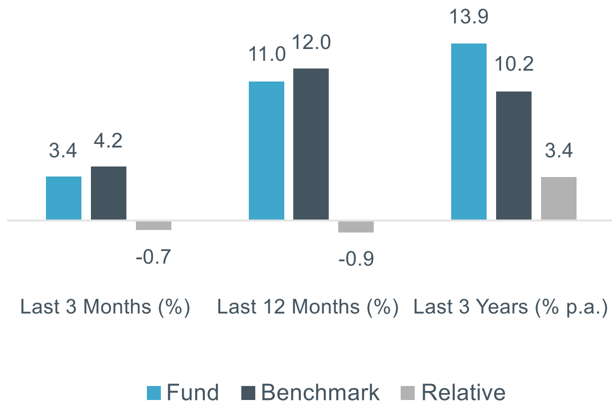
Gilt implied inflation pushed higher exceeding 6% at short durations.

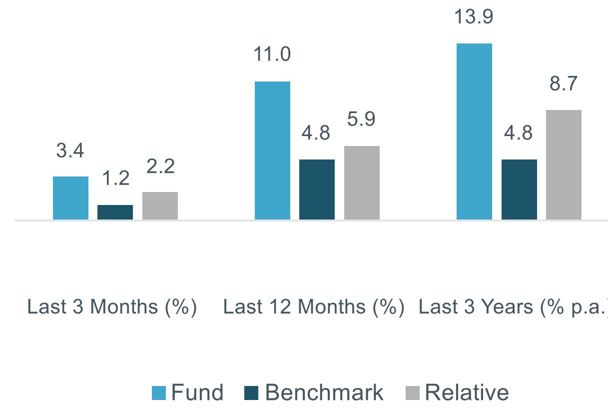
From a Fund mandate perspective:

- Most equity mandates delivered positive absolute returns.
- Both diversified growth funds recorded positive relative returns.
- Property again was the largest net contributor on a purely asset class basis.
- The Risk Management Framework contributed positively to performance as Sterling appreciated relative to EUR, USD and YEN.

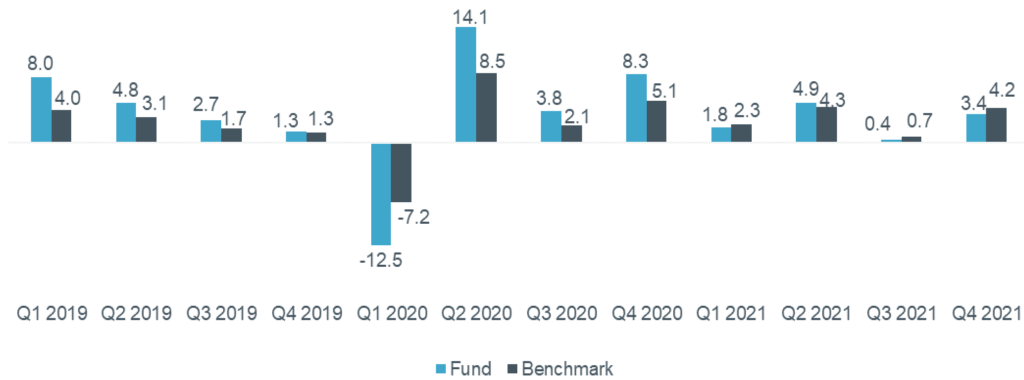
Fund performance vs benchmark/target



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. A manager selection exercise for the Fund's allocation to social impact investment is currently under way.

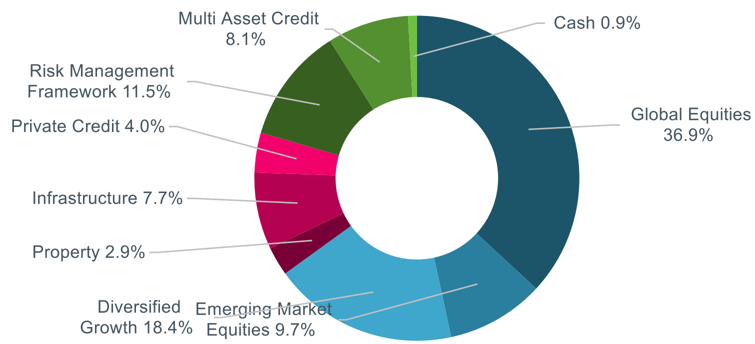
There were a number of transitions which occurred during the quarter. Notably, the UBS World Equity Tracker Fund was fully exited from and positions in Global Alpha Growth and Sustainable Equity funds trimmed. Proceeds were split equally between the two Diversified Growth funds and the new Quinbrook Net Zero Power Fund received it's full commitment of £30m. The Fund's commitment to the JP Morgan infrastructure fund was increased by £45m during the quarter but is yet to be drawn by the manager.

Asset Allocation

Mandate	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q3 21	Q4 21			
UBS World Equity Tracker Fund	32.3	0.0	0.0%	0.0%	0.0%
UBS Alternative Beta	96.1	52.4	5.4%	10.0%	-4.6%
LCIV RBC Sustainable Equity Fund	116.7	99.7	10.4%	10.0%	0.4%
LCIV Baillie Gifford Global Alpha Growth Fund	116.8	90.8	9.4%	10.0%	-0.6%
BlackRock World Low Carbon Equity Tracker	105.0	112.2	11.6%	10.0%	1.6%
Global Equities	**466.9**	**355.1**	**36.9%**	**40.0%**	**-3.1%**
UBS GEM HALO	57.6	56.0	5.8%	5.0%	0.8%
LCIV JP Morgan Emerging Market Equity Fund	39.5	37.8	3.9%	5.0%	-1.1%
Emerging Market Equities	**97.1**	**93.7**	**9.7%**	**10.0%**	**-0.3%**
LCIV Ruffer Absolute Return Fund	37.9	86.0	8.9%	5.0%	3.9%
LCIV Baillie Gifford Diversified Growth Fund	37.5	91.4	9.5%	5.0%	4.5%
Diversified Growth	**75.4**	**177.4**	**18.4%**	**10.0%**	**8.4%**
UBS Triton Property Fund	18.1	19.2	2.0%	2.5%	-0.5%
BlackRock UK Property Fund	8.0	8.5	0.9%	2.5%	-1.6%
Property	**26.1**	**27.7**	**2.9%**	**5.0%**	**-2.1%**
MIRA Infrastructure Global Solutions II L.P Fund	13.2	14.6	1.5%	3.0%	-1.5%
Quinbrook Low Carbon Power LP Fund	12.0	12.0	1.3%	1.5%	-0.2%
Quinbrook Net Zero Power Fund	0.0	30.3	3.1%	0.0%	3.1%
JP Morgan Infrastructure Fund	16.9	16.9	1.8%	3.0%	-1.2%
Infrastructure	**42.2**	**73.8**	**7.7%**	**7.5%**	**0.2%**
Permira Credit Solutions IV Fund	20.4	22.4	2.3%	4.5%	-2.2%
Churchill Middle Market Senior Loan II Fund	17.1	15.8	1.6%	3.0%	-1.4%
Private Credit	**37.5**	**38.2**	**4.0%**	**7.5%**	**-3.5%**
Wells Fargo RMF Fund	104.3	110.7	11.5%	10.0%	1.5%
Risk Management Framework	**104.3**	**110.7**	**11.5%**	**10.0%**	**1.5%**
LCIV CQS MAC Fund	77.2	78.0	8.1%	10.0%	-1.9%
Multi Asset Credit	**77.2**	**78.0**	**8.1%**	**10.0%**	**-1.9%**
Cash	6.6	8.4	0.9%	0.0%	0.9%
Total Fund	**933.3**	**963.0**	**100.0%**	**100.0%**	

At the time of writing, latest quarterly information in respect of mandate held with MIRA, Permira and Quinbrook Low Carbon Power Fund is unavailable. The Q4 2021 valuation shown mirrors the Q3 2021 valuations and includes an allowance for FX movements and for MIRA a capital call completed during the period.

Asset class exposures



Source: Investment Managers

The final quarter of 2021 saw the Fund deliver absolute returns of 3.4%, underperforming the composite benchmark with relative returns of -0.7%. Over the previous 12 months absolute performance has been strong. Over the longest time period shown of 3 years, the Fund has comprehensively outperformed its target with relative returns of 3.4% p.a.

Perhaps unsurprisingly, the Fund's largest net contributor was from the sizeable allocation to equities despite being trimmed substantially during the quarter. The UBS Alternative Beta strategy was the top contributor this quarter with returns of 7.3%.

Both emerging market mandates continued to struggle during the quarter.

Of the two DGFs, Baillie Gifford was again the stronger performer with quarterly returns of 3.8%. Its directional style benefited from the broader equity market gains.

Both property mandates performed well during both the quarter and the year in absolute terms, however returns trailed the benchmark for each.

At time of writing, MIRA, Permira and Churchill reporting information was unavailable. For performance reporting purposes we have therefore assumed nil returns over Q4 2021. Once details are received, performance figures will be updated such that future reports reflect actual Q4 2021 movements for each.

Manager performance

Mandate	Last 3 Months (%)			Last 12 Months (%)			Last 3 Years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
UBS World Equity Tracker Fund	6.5	6.5	**-0.0**	21.7	21.8	**-0.1**	19.1	19.2	**-0.1**
UBS Alternative Beta	7.3	7.3	**0.0**	23.6	23.5	**0.1**	10.3	10.3	**-0.0**
LCIV RBC Sustainable Equity Fund	6.6	7.8	**-1.2**	19.3	23.6	**-3.4**	23.6	19.4	**3.5**
LCIV Baillie Gifford Global Alpha Growth Fund	0.0	6.7	**-6.3**	8.9	20.7	**-9.7**	22.8	18.8	**3.3**
BlackRock World Low Carbon Equity Tracker	6.8	7.4	**-0.5**	23.5	23.2	**0.2**	20.4	20.2	**0.1**
Global Equities									
UBS GEM HALO	-3.1	-1.8	**-1.3**	-8.2	-1.7	**-6.6**	10.0	8.6	**1.3**
LCIV JP Morgan Emerging Market Equity Fund	-4.4	-1.1	**-3.2**	-4.7	-1.0	**-3.7**	-	-	**-**
Emerging Market Equities									
LCIV Ruffer Absolute Return Fund	1.4	0.8	**0.6**	7.6	3.1	**4.4**	-	-	**-**
LCIV Baillie Gifford Diversified Growth Fund	3.8	0.9	**2.9**	9.3	3.6	**5.5**	7.9	3.9	**3.8**
Diversified Growth									
UBS Triton Property Fund	6.9	7.5	**-0.5**	18.8	19.2	**-0.3**	6.4	6.2	**0.2**
BlackRock UK Property Fund	6.6	7.5	**-0.8**	16.1	19.2	**-2.5**	5.3	6.2	**-0.8**
Property									
MIRA Infrastructure Global Solutions II L.P Fund	0.0	1.8	**-1.8**	4.1	7.4	**-3.1**	-	-	**-**
Quinbrook Low Carbon Power LP Fund	0.0	1.8	**-1.8**	5.4	7.4	**-1.9**	-	-	**-**
JP Morgan Infrastructure Fund	2.1	2.5	**-0.4**	5.7	10.4	**-4.2**	-	-	**-**
Infrastructure									
Permira Credit Solutions IV Fund	1.9	1.7	**0.2**	7.1	7.0	**0.1**	-	-	**-**
Churchill Middle Market Senior Loan II Fund	1.4	1.7	**-0.3**	5.7	7.0	**-1.2**	-	-	**-**
Private Credit									
Wells Fargo RMF Fund	6.0	6.0	**0.0**	3.9	3.9	**0.0**	-	-	**-**
Risk Management Framework									
LCIV CQS MAC Fund	1.0	1.2	**-0.2**	6.4	4.6	**1.7**	4.9	4.6	**0.2**
Multi Asset Credit									
Cash	-	-	**-**	-	-	**-**	-	-	**-**
Total Fund	3.4	4.2	**-0.7**	11.0	12.0	**-0.9**	13.9	10.2	**3.4**

Note: 12-month performance for the LCIV Ruffer Absolute Return Fund is since inception on 13 January 2021. Furthermore, Q4 2021 performance figures for MIRA, Permira and Quinbrook have been assumed flat due to lack of manager information at the time of writing (see comment on left). UBS World Equity Tracker Fund 3 month performance is part quarter until termination on 21 December 2021.

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

Market Background

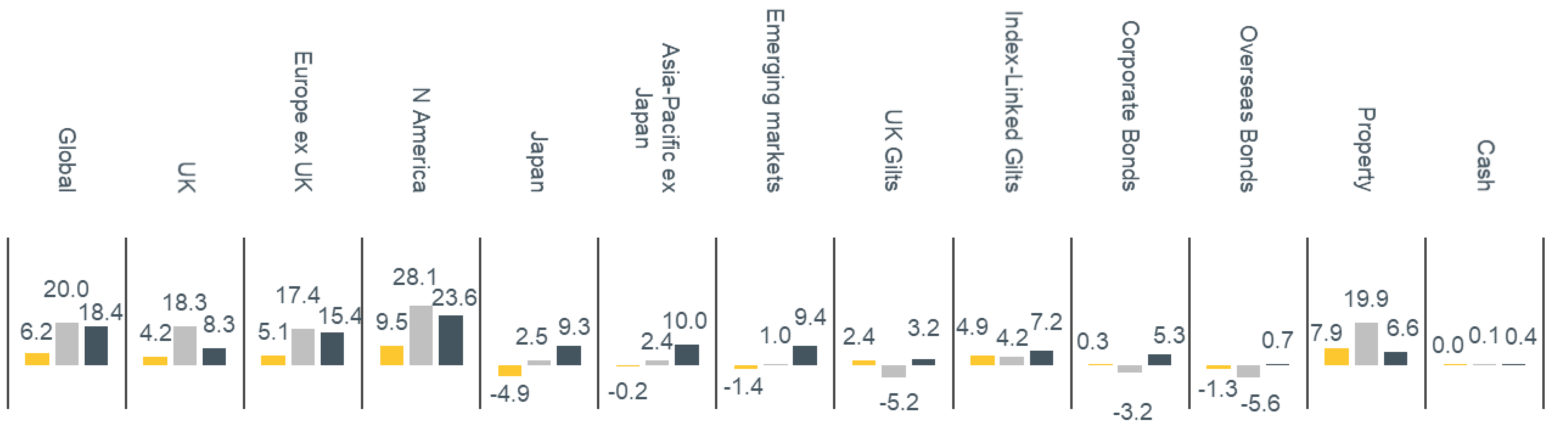
Economic momentum has slowed as rising COVID cases have led to a modest re-imposition of restrictions and increasing social distancing. This is expected to weigh on growth in Q4 2021 and Q1 2022, but we still anticipate above-trend growth in 2022.

There are signs that the strain on supply chains is easing, though the overall rate of price increases remains high. UK headline CPI inflation rose to 5.1% year-on-year in November whilst the equivalent US and eurozone measures rose to 6.8% and 4.9% respectively. In response, the Federal Open Markets Committee (FOMC) announced plans to accelerate the tapering of asset purchases, with the median FOMC member forecasting three rate hikes next year. The Bank of England raised rates to 0.25% p.a., with further rate hikes expected in 2022.

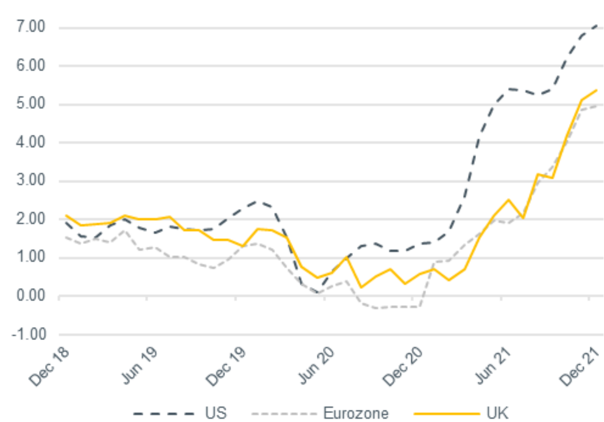
Trade-weighted sterling rose 1.7% through the quarter as markets adjusted for the earlier than expected rate rises. The US dollar rose 0.6% in trade-weighted terms, perhaps reflecting both safe haven appeal and slightly more hawkish messaging from the Federal Reserve.

US and UK bond yield curves flattened with short-term yields rising to reflect expectations of further interest rate hikes. Long-term yields remained largely unchanged. UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, ended the quarter a little higher at 3.9% p.a. whilst longer term implied inflation fell. US 10-year implied inflation rose 0.2% p.a. to 2.6% p.a

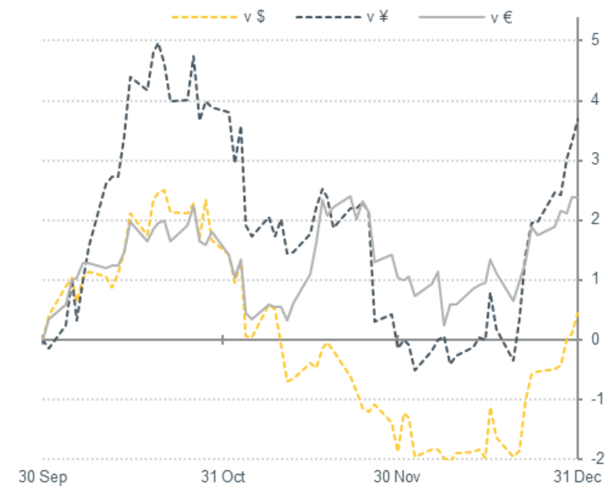
Historic returns for world markets [1]



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, JP Morgan GBI Overseas Bonds, MSCI UK Monthly Property; UK Interbank 7 Day.

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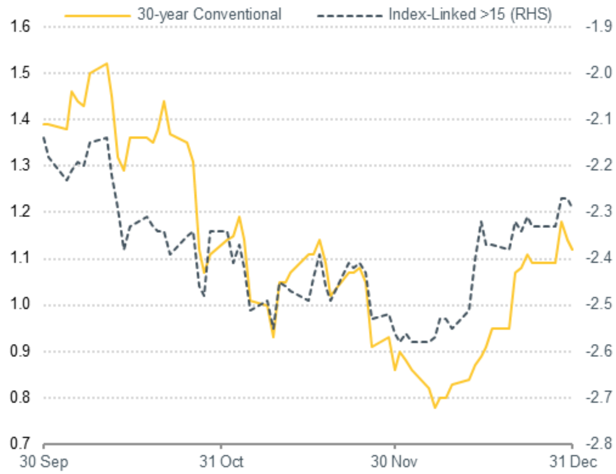
Global investment-grade spreads increased by 0.1% p.a. to 1.0% p.a., whilst speculative-grade spreads ended the quarter broadly in line with end-September levels at 3.7% p.a

Despite falling in November over Omicron variant concerns, global equities produced a total return of 7.0% in Q4, propelled higher by strong earnings growth. Sterling strength weighed on returns to unhedged UK investors delivering a 6.2% return in sterling terms. All sectors produced positive returns except telecoms, on an absolute basis. Outside telecoms, energy and financials were the main underperformers, weighed on by demand expectations and flatter yield curves, respectively. Technology was the notable outperformer, bolstered by strong earnings releases and the prospect of further lockdowns spurring demand for tech.

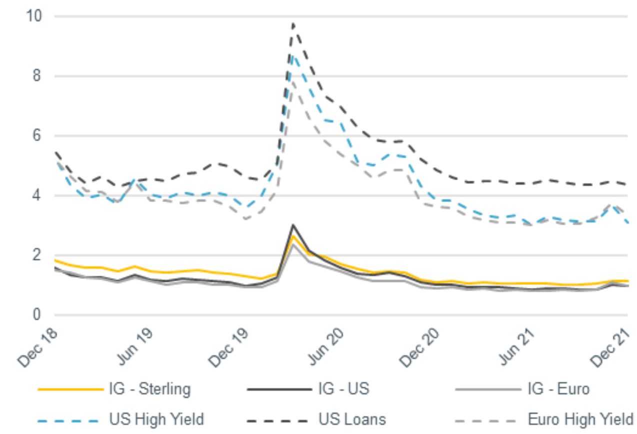
North America posted double digit returns on the back of tech outperformance. Japan, which reintroduced strict border restrictions shortly after the Omicron variant was made public, is at the bottom of the regional performance rankings over the quarter. Asian and emerging markets also continued their underperformance versus developed markets.

UK Monthly Property capital value index rose 13.9% over the 12 months to end December due to a buoyant industrial sector, where capital values have risen 32.5%. Retail capital values have risen by 6.9% over 12 months. There has been a flattening of the declines experienced in the office sector, delivering marginally positive capital growth of 0.1% over 2021. Total return on the index, including income, was 19.9% in the 12 months to end December.

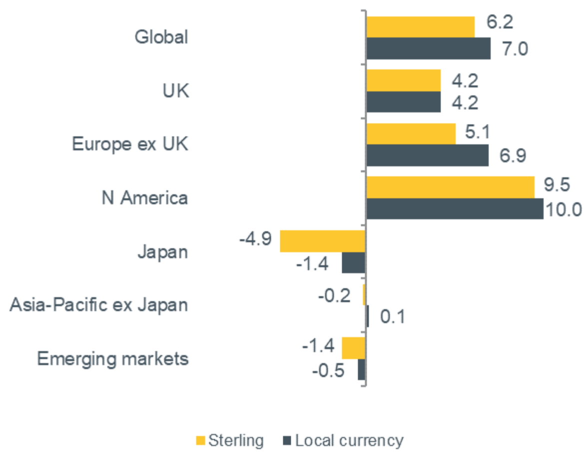
Gilt yields chart (% p.a.)



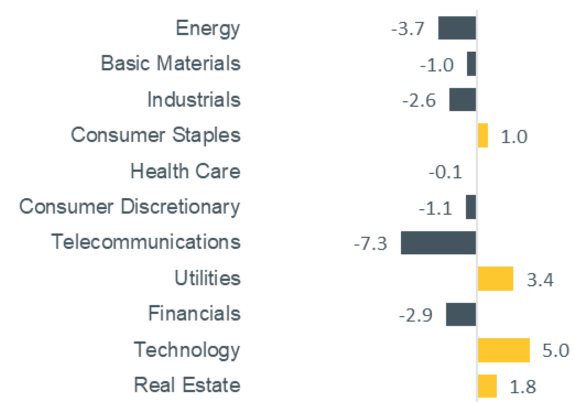
Investment and speculative grade credit spreads (% p.a.)



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. FTSE indices migrated to a new ICB structure in Q1 2021.

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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