QUARTERLY REPORT

OFFICES OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Richard Madaleno
Chief Administrative Officer

October 1, 2021

Members of the Montgomery County Council

I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended June 30, 2021. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of the Montgomery County Code.

History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and employees who elect to participate in the Guaranteed Retirement Income Plan ("GRIP"). There were approximately 6,215 ERS and GRIP active members and 6,638 retirees participating in the ERS as of June 30, 2021

Performance Results

The total return achieved by the ERS' assets for the quarter was a gain of 8.06%, 294 basis points ahead of the 5.12% gain recorded by the policy benchmark. For the one-year period ending June 30, 2021 the ERS' gross return (before fees) was a gain of 26.97%, 593 basis points ahead of the 21.04% gain recorded by the policy benchmark. The one-year gross return places the ERS' performance slightly below the median of the universe of comparable pension funds constructed by the Board's consultant, NEPC. Our annualized performance of 12.74% for the three-year period ranked top quartile while the 11.87% for the five-year period ranked second quartile, or better than 50% of our public fund peers. The ten-year annualized return of 9.70% ranks in the top quartile. The asset allocation on June 30, 2021 was: Domestic Equities 14.5%, International Equities 13.1%, Global Equities 2.7%, Fixed Income 15.8%, Emerging Market Debt 1.3%, Inflation Linked Bonds 13.1%, Public Real Assets 11.3%, Private Equity 12.9%, Private Real Assets 6.2%, Private Debt 2.3%, Opportunistic 4.5%, and Cash 2.3%. We estimate that the funded status of the ERS was 116% based on a market value of assets and 103% on an actuarial (smoothed) value of assets as of June 30, 2021. The actual funded status will be affected by the ERS' membership experience, as well as demographic and economic changes and may be higher or lower when calculated by the actuary during the next valuation.

Major Initiatives

During the quarter, the ERS committed $18 million to Banner Ridge IV, L.P., a private debt manager. Polunin, an emerging markets manager, and Acadian, an emerging markets small cap manager, were hired within the public equity portfolio during the quarter.

QUARTERLY REPORT

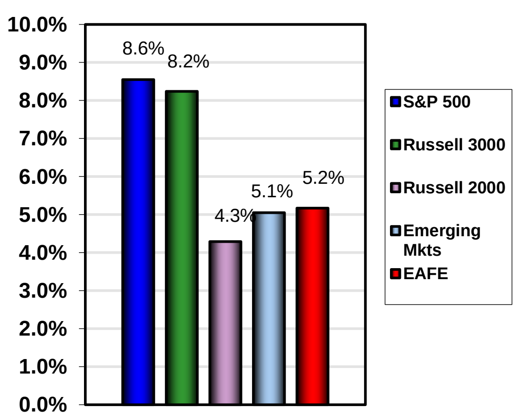
Capital Markets and Economic Conditions

Second quarter GDP for 2021 grew at 6.5% rate, which was well below the 8.4% estimate from the Dow Jones economist survey. While the growth rate disappointed expectations it did point to an economy that continues to recover from the large economic contraction seen during the depths of the pandemic. The sectors that disappointed were a decline in private inventory and residential investment, rising imports, and a decline in the rate of government spending. Consumer spending, which represents 69% of the economy, continues to recover well, with nearly 12% growth during the quarter. The unemployment picture continues to improve as nonfarm payrolls increased 850,000 in June versus an estimate of 706,000. However, the unemployment rate increased from 5.6% to 5.9%, primarily due to an increase in the number of people seeking employment. While the unemployment rate is still well above the 3.5% level immediately before the pandemic, the rate has fallen precipitously from the 14.8% level in April of 2020.

The consumer price index (CPI) rose 5.4% from a year ago, well above expectations, and the largest monthly gain since August of 2008. Core CPI, which excludes the impact of food and energy, recorded an increase of 4.5%, which represents the largest increase in 30 years. Inflation has been rising due to many factors, most notably pandemic-induced supply chain bottlenecks and year-over-year comparisons that included the impact of global economic shutdowns. Used car and truck prices have increased by 45%, which is an unprecedented rise. Gasoline prices have also risen at a significantly high rate of 45% over the last one year. Food prices continue to climb higher but the increase in prices is more muted with a 2.4% increase over the last year. Housing was mixed for the quarter as new housing starts dropped slightly while median home values continue to climb significantly.

Public Equity Markets: Equities advanced on continued monetary and fiscal stimulus along with increased vaccination rates that led to economic reopening efforts across the U.S. Growth stocks within larger capitalization outperformed while value outperformed within smaller capitalization stocks. All of the S&P 500 sectors, except utilities, advanced during the quarter with real estate, IT, and energy leading the returns. Our combined domestic equity performance was a gain of 7.89%, underperforming the 8.24% gain of the Russell 3000 Index.

Index Return-Quarter Ending 06/30/21



International developed markets also advanced but continued to trail their domestic counterparts. Denmark and Austria were the strongest performing developed international markets during the quarter while New Zealand continued to be a bottom performer. Accelerating vaccine efforts, the economies reopening, and stimulus programs, also provided a tailwind to international markets. In Europe, investors were encouraged by the recovery in global export demand and trade flows. For instance, the German economy, that is sensitive to global exports and is dependent on the recovery of the automotive sector, showed positive signs during the quarter. Meanwhile, the majority of the emerging markets posted positive returns. Brazil and Poland were the top performing markets while Chile was a bottom performer. Our combined international equity performance was a gain of 5.80%, outperforming the 5.60% return recorded by the benchmark. Our global equity allocation recorded a gain of 7.96%, outperforming the 7.39% gain of the MSCI ACWI Index.

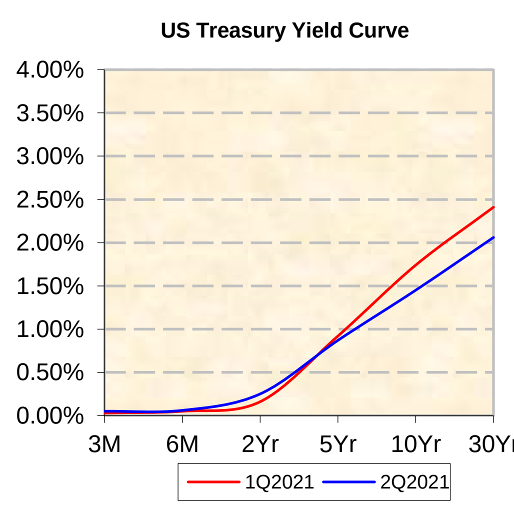
Private Equity: During the second quarter, a total of 673 private equity funds reached their final close, securing $288.0 billion in commitments, well above the $224.9 billion raised in the first quarter. The amount of capital raised by global private equity funds represents a quarterly record and indicates that both general and limited partners view the economic slowdown driven by the COVID-19 pandemic to largely be a thing of the past. Relative to Q1, the number of funds raised increased 6%, the aggregate capital raised increased 28%, and the average fund size increased 22%. North America continued to dominate the fundraising landscape, representing 66% of the funds raised and 53% of the capital raised. U.S. buyout deal activity was mixed during the quarter as the number of deals consummated decreased by 1% to 803, aggregate deal value increased by 83% to $99.0 billion, and the average deal value increased by 60% to $1.4 billion. Buyout multiples continue to expand in the U.S., averaging 13.0x Enterprise Value-to-EBITDA during the first quarter. The primary driver of the expansion was the continued recovery of the debt markets, which were willing to fund up to 7.0x of EBITDA on the median U.S. buyout deal. Buyout activity was balanced by sector in terms of number of deals with technology, consumer, healthcare, and business services being roughly equal. However, in terms of aggregate deal value, the healthcare sector dominated, representing 43% of deal value in Q2. This surge was felt across all sectors of healthcare but most notably in the healthcare provider space. Buyout exit activity continued at a rapid pace as the number of exits increased 18% to 379, aggregate exit value increased 51% to $151 billion, and the average exit size increased 27% to $1.3 billion. Both the number of exits and aggregate exit value represented quarterly records in the buyout space.

Relative to Q1, venture fundraising activity was mixed as the number of funds raised increased by 25% to an all-time record of 277 funds, aggregate funds raised was flat at $33.0 billion, and the average fund size decreased by 21% to $124 million. Despite the average venture deal size increasing 19%, both the number of deals and the aggregate deal value decreased in Q2, with 17% and 1% drops, respectively. Venture exit activity was also mixed as the number of exits dropped by 19%, while the aggregate exit value and average exit size both saw roughly 20% increases.

During the quarter, our private equity managers called a combined $32.6 million and paid distributions of $55.8 million. Our current allocation to private equity is 12.9%, with a market value of $669.5 million. From its 2003 inception through March 31, 2021, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 13.5% versus an 13.7% return for the dollar-weighted public market equivalent (the Russell 3000 Index plus 300 bps). The direct private equity program, which began in 2009, has generated a 24.8% return versus 18.5% for the benchmark.

Hedge Funds: For the quarter, industry wide hedge funds advanced 4.1% based on the Composite Index. On a sub-strategy basis, the Event-Driven Index advanced 4.0%, the Relative Value Index gained 2.8%, the Macro Index gained 4.0%, and the Equity Hedge Index gained 4.8%. The System's diversifying hedge funds recorded a gain of 1.64% versus a gain of 1.83% for the Conservative Index. The diversifying portfolio underperformance is primarily attributable due to an overweight to multi-strategy managers with a corresponding underweight to event driven and equity hedge strategies. The System's directional hedge funds recorded a gain of 3.72% compared to the 4.28% return for the Strategic Index. The directional underperformance is primarily attributable to the System's underweight to event driven and equity hedge strategies.

Fixed Income: The yield curve flattened dramatically as longer dated maturity bond yields moved lower. The yield on the 10- and 30-year bonds declined by 29 and 35 bps during the quarter, respectively. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, flattened by 38 bps to 120 bps, as yields on the 10-year maturities declined while yields on the 2-year maturities rose on anticipation that the Federal Reserve could begin raising short-term interest rates earlier than expected. For the quarter, the 10-year Treasury yield was 1.45% whereas the 30-year Treasury yield was 2.06%. The high yield portfolio's performance for the quarter was a gain of 3.21%, outperforming the Merrill Lynch High Yield II Constrained Index by 44 bps. The long duration portfolio's return for the quarter was a gain of 6.65%, outperforming the custom long duration benchmark by 21 bps. The emerging market debt portfolio gained 4.64%, outperforming the JPM EMBI Global Diversified benchmark by 58 bps. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a gain of 7.40% net of fees, outperforming the custom benchmark by 170 bps. The overlay was responsible for most of the excess returns, driven by the strong performance of the strategy's alphas in equities, inflation-linked bonds, and emerging markets FX.



Private Debt: Private debt fundraising increased as 55 funds raised $48.2 billion during Q2 versus 49 funds that raised $39.8 billion in Q1 2021. The global fundraising increase was partially attributed to growth in Europe where ten funds raised $22.7 billion in the second quarter. North America led fundraising with 36 funds and $23.8 billion aggregate capital raised with an average fund size of $767M. Direct lending strategies secured the bulk of the capital as it is usually considered the safest category in private debt. 22 direct lending funds reached a final close, raising an aggregate $25.7 billion during the quarter. At the end of the quarter, there were 693 funds in the market, targeting an aggregate $289.3 billion, which has been driven by the continued fundraising success of direct lending vehicles that represent a majority of both the number of funds in market and capital targeted, at 53% and 56%, respectively. Dry powder in September 2021 was $365.1 billion, similar to the December 2020 level, with a large percentage of that allocated to direct lending.

During the quarter, our private debt managers called a combined $5.3 million and paid distributions of $14.9 million. Our current allocation to private debt is 2.3%, with a market value of $119.6 million. From 2013 through March 31, 2021, the private debt program generated a net internal rate of return of 11.5% versus an 9.7% return for the dollar-weighted public market equivalent benchmark (ICE BofA Merrill Lynch High Yield Master II Constrained + 300 bps).

Private Real Assets: During the Q2 2021, private real estate fundraising continued to face significant headwinds with only 59 funds reaching a final close, raising $19 billion of aggregate capital. The number of fund and dollar amount figures represented the lowest quarterly fundraising period over the last five years (both numbers are nearly a 50% decrease relative to the five-year quarterly average). In particular, the office sector continues to struggle from a capital raising perspective as the emergence of new COVID variants are putting additional pressure on occupancy rates. Within the natural resource sector, the number of funds closed declined for a second consecutive quarter with only 25 funds reaching a final close, representing a 34% decline from Q2 2021. However, the amount of capital raised posted a more modest decline quarter-over-quarter, and more than doubled to $27 billion from a $13 billion level in Q2 2020. The lower ratio of number of funds closed to aggregate capital commitments suggests that manager consolidation in this sector is continuing to take hold. During the quarter, our private real asset managers called a combined $4.6 million and paid distributions of $9.0 million. Our current allocation to private real assets is 6.2%, with a market value of $323.5 million. From its 2006 inception through March 31, 2021, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 4.6% versus a 6.6% gain for the long-term benchmark CPI plus 500 bps.

Public Real Assets: Global listed real estate securities, as measured by the FTSE EPRA/NAREIT Developed Index posted a strong gain of 9.17% in Q2, outperforming global equities and significantly outperforming bonds. REITs also benefitted from a 30bps decrease in treasury bond yields during the quarter, which was a reversal from the last two quarters. Real estate also benefitted from renewed inflation concerns as investors generally view property owners as having the ability to pass on inflation to tenants. North America was, once again, the top performing region in the index given the quicker pace in vaccination and continued re-opening momentum. Europe's performance nearly matched North America as vaccine uptake grew significantly across the continent and most countries had low COVID-19 infection levels, which allowed commercial activity to recover. Asia was the worst performing region as the emergence of the Delta variant and the re-imposition of lockdown for many countries (e.g., Australia) weighed on performance. While the prior two quarters clearly favored "re-opening trade" sectors such as hotels, malls, and shopping centers, the second quarter was more mixed with self-storage, residential, and malls performing well while healthcare and hotels lagged.

Listed infrastructure securities increased by 6.88% for the quarter as measured by the Dow Jones Brookfield Global Infrastructure Index, underperforming broader global equities. This current period represents the longest and most severe stretch of underperformance for listed infrastructure relative to equities since before the Global Financial Crisis. Sector dispersion continues to be high as energy and communications rallied while utilities and transportation lagged. Unlike prior quarters, cyclicality was not the driving factor of sector dispersion as a cyclical sector like transportation lagged while energy thrived and a more defensive sector like communications posted strong gains while utilities underperformed. Communications, particularly cell phone tower operators, rallied in Q2 as market sentiment around leasing and customer churn issues shifted positively. Utilities were mixed with European companies performing well while U.S. utilities posted losses, despite the ladder's more favorable fundamental performance.

Regional dispersion was wide for the quarter as North America posted an 8.1% gain while Asia experienced a 0.7% loss. Europe performed well, only slightly underperforming North America with a return of 7.5%.

For the quarter, the public real asset portfolio returned 7.69%, underperforming the custom benchmark gain of 8.03% by 30 bps due to the underperformance of our Global Listed Infrastructure manager. Our Global REIT manager outperformed the benchmark during Q2.

Additions

The primary sources of additions for the ERS include contributions from members and employers and investment income. The following table displays the source and amount of additions for the quarter ending June 30, 2021 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 6/30/2021	Fiscal YTD
Employer Contributions	$ 19.1	$ 70.7
Member Contributions	6.9	30.8
Net Investment Income	479.8	1,141.1
	$ 505.8	$ 1,242.6

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, and administrative expenses.

Employees' Retirement System
Deductions by Type (millions)

	Qtr 6/30/2021	Fiscal YTD
Benefits	$ 66.6	$ 260.9
Refunds	5.7	16.3
Administrative Expenses	1.0	3.0
	$ 73.3	$ 280.2

Outlook

During the second quarter of 2021, growth in the U.S. economy accelerated further on the back of increased COVID-19 vaccination rates and continued government stimulus. Strong consumer demand led to increased business spending and investment as companies raced to re-open supply changes and ramp up production. However, that dynamic, in conjunction with a still very accommodative monetary policy and expansive fiscal measures is causing the build-up in inflationary pressures which have not been seen for many years. While the Fed believes that these inflationary pressures are transitory in nature, should inflation rise faster and longer than anticipated, how the Feds reacts with potential policy changes and benchmark interest rate increases will be a major driver of financial markets going forward.

Euro zone GDP expanded by approximately 2% over the previous quarter and over 13% from the same quarter one year ago. However, economic conditions and outlooks remained very disparate across the 19-member countries, as many have seen a large wave in new infections associated with the COVID-19 delta variant. While euro zone officials believe that economic growth will continue in future quarters, risks remain that new cases of the delta variant will curb consumer behavior activity and force countries to enact more strict lockdown measures again.

Japan's economy also showed growth of 1.3% annualized in the second quarter of 2021, which represented a reversal from the first quarter of this calendar year when GDP growth was negative. While consumer consumption and business capital expenditure finally began to drive meaningful growth, the Japanese economy is still lagging other developed nations as the country has struggled to contain the COVID economic fallout. Japan's outlook remains relatively mixed, as the forces of strong consumer demand collide with the government's new state of emergency measures put in place to control keep citizens at home longer to control the spread of the virus.

Sources: BlackRock, Bloomberg, Bridgewater, Eagle, FRM, Gryphon, International Monetary Fund, JP Morgan MSCI, NCREIF, Northern Trust, Oil & Gas Investor, PE Hub, Private Equity Analyst, Pitchbook, Preqin, PwC Deals, Real Capital Analytics, RE Alert, RVK, S&P, Schroders, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Wilshire Associates, The World Bank, European Central Bank, Bank of Japan.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION

June 30, 2021

Assets	
Equity in pooled cash and investments	$ 1,245,201
Investments:	
Northern Trust	5,282,946,744
Aetna	608,475
Fidelity - Elected Officials Plan	702,863
Fidelity - DRSP/DROP	16,660,362
Total investments	5,300,918,444
Contributions receivable	7,006,025
Total assets	5,309,169,670
Liabilities	
Benefits payable and other liabilities	13,197,148
Net position restricted for pensions	**$ 5,295,972,522**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

For the Quarter Ended June 30, 2021

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 19,133,636	$ 70,740,597
Member	6,916,479	30,848,249
Total contributions	26,050,115	101,588,846
Investment Income	485,277,859	1,167,356,604
Less investment expenses	5,507,955	26,305,725
Net investment Income	479,769,904	1,141,050,879
Total income	505,820,019	1,242,639,725
Deductions		
Retiree benefits	50,552,476	196,764,112
Disability benefits	13,476,269	53,924,544
Survivor benefits	2,573,529	10,243,634
Refunds	5,749,913	16,237,419
Administrative expenses	966,269	2,999,015
Total deductions	73,318,456	280,168,724
Net Income	**432,501,563**	**962,471,001**
Net position restricted for pensions		
Beginning of period	**4,863,470,959**	**4,333,501,521**
End of period	**$ 5,295,972,522**	**$ 5,295,972,522**