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QUARTERLY REPORT

OFFICES OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Andrew W. Kleine
Chief Administrative Officer

March 27, 2020

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 December 31, 2019. 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 6,070 ERS and GRIP active members and 6,710 retirees participating in the ERS as of December 31, 2019.

Performance Results

The total return achieved by the ERS' assets for the quarter was a gain of 3.59%, 1 basis points ahead of the 3.58% gain recorded by the policy benchmark. For the one-year period ending December 31, 2019 the ERS' gross return (before fees) was a gain of 18.54%, 21 basis points behind the 18.75% gain recorded by the policy benchmark. The one-year gross return places the ERS' performance at median of the universe of comparable pension funds constructed by Wilshire Associates. Our annualized performance of 10.30% and 8.00 for the three and five-year periods, respectively, ranked in the top quartile. The asset allocation on December 31, 2019 was: Domestic Equities 14.8%, International Equities 12.9%, Global Equities 2.8%, Fixed Income 20.5%, Inflation Linked Bonds 12.1%, Public Real Assets 13.1%, Private Equity 10.0%, Private Real Assets 5.7%, Private Debt 2.0%, Opportunistic 4.7%, and Cash 1.4%. We estimate that the funded status of the ERS was 99.1% as of December 31, 2019. 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 following commitments were made: Private Equity - $12 million to Crest Rock Fund I, $23 million to Clearlake Capital Partners VI, and $12 million to Graycliff Private Equity Partners IV; Private Debt - $17 million to Banner Ridge Secondary Fund III; Private Real Assets - $15 million to Phoenician Resources Fund III and $19 million to Tailwater Energy Fund IV. A futures overlay manager, NISA, was hired during the quarter.

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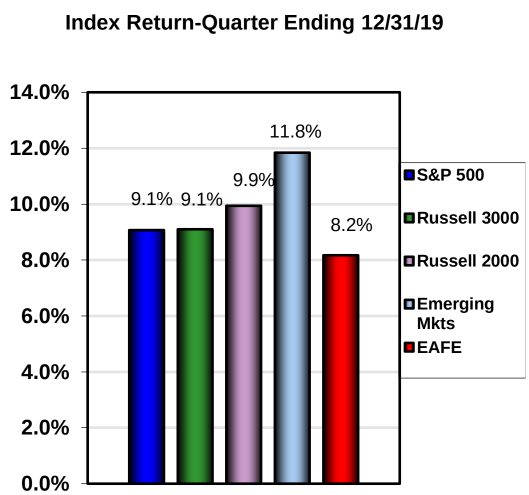
QUARTERLY REPORT

Capital Markets and Economic Conditions

Economic data reflected that GDP increased at an annualized rate of 2.1% in the fourth quarter of 2020, matching consensus expectations and the growth rate from the third quarter. GDP for the 2019 calendar year advanced 2.3%, its slowest pace in three years. Consumer spending, which accounts for over two thirds of the U.S. economy, advanced 1.8%, while government consumption expenditures and gross investment increased by 2.7%. Net exports positively contributed to GDP amid the U.S. and China tariff war, reflecting a 1.4% rise in exports and 8.7% drop in imports. The largest detractor to growth during the quarter was a 6.1% decrease in gross private domestic investment, driven by non-residential investment in structures and equipment. The economy added 593,00 jobs during the quarter, a decrease from the third quarter's 609,000 gain. The U.S. unemployment rate ended the fourth quarter at 3.5%, the same level as the preceding quarter. Inflation increased 2.3% in 2019, the largest annual advance since 2011, driven by an increase in energy prices and health care costs. U.S. housing starts and sales of existing homes increased for the quarter, as low mortgage rates have increased buyer demand, resulting in an increase in median home prices and a reduction of supply of homes for sale.

Public Equity Markets: Domestic equities rallied during the quarter with the S&P 500 Index advancing 9.1% for the quarter and 31.5% for the year which was the best annual performance for the index since 2013. Optimism about the economy improved following potential trade developments and on signals the Fed would hold rates steady for an extended period. Growth continued to outperform value across the capital spectrum while smaller cap stocks outperformed large cap stocks during the quarter. The S&P 500 was led by economically sensitive sectors such as technology, health care and financials while real estate was the only declining sector. Our combined domestic equity performance was a gain of 8.99%, slightly underperforming the 9.10% gain of the Russell 3000 Index.



International developed markets advanced on strong global economic data and improving trade negotiations between the U.S. and China. Ireland and New Zealand were the strongest performers within developed markets. In Europe, the UK rallied 10% on more certainty surrounding Brexit and Germany gained 10% on improved economic data. Emerging market equities outperformed both the U.S. and international develop markets on the progress related to trade relations and a weaker USD. Within the emerging markets, the tech-heavy Taiwan and Russia were among the strong performers. Our combined international equity performance was a gain of 10.85%, outperforming the 9.20% gain recorded by the benchmark. Our global equity allocation recorded a gain of 7.97%, underperforming the 8.95% performance of the MSCI ACWI Index.

Private Equity: During the fourth quarter, a total of 353 private equity funds reached a final close, securing $185 billion in commitments, surpassing the $163 billion raised in the prior quarter. While the number of funds closed increased from Q3, it represented a sharp drop from Q4 of 2018 where 566 funds closed. The trend towards larger funds being raised continued in Q4 as the average fund raised $592 million, which is the second highest quarterly level on record. Fundraising continues to be strong for private equity managers as the average fund in Q4 raised 106% of the stated target, which is the highest level since before the global financial crisis. North America continued to dominate the fundraising landscape, representing 55% of the number of funds raised and 60% of the total assets raised during the fourth quarter.

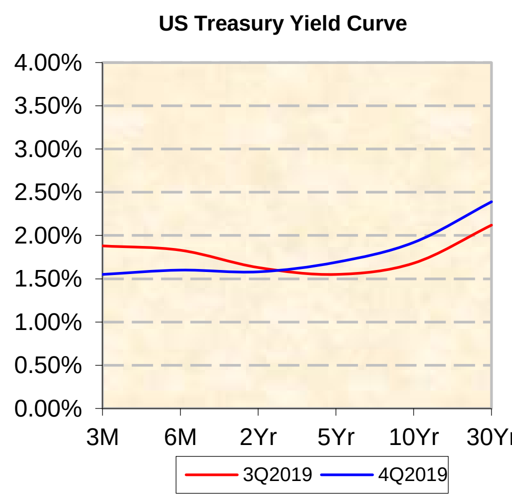
Within this sector, buyout deals decreased by 15% in the 4th quarter relative to Q3, larger deals were prevalent, which led to an aggregate deal value of $98.3, representing a 5% uptick relative to the prior quarter. For the full year, 5,268 buyout deals were executed for an aggregate deal value of $393.3 billion. These figures represent sharp decreases relative to 2018, where 6,509 deals were executed for an aggregate deal value of $497.6 billion. Market participants cite elevated purchase price multiples as the primary driver for the decrease in deal activity. Buyout multiples finished 2019 down slightly relative to 2018, decreasing from 11.5x EV/EBITDA to 10.9x, which is a level well above long-term averages. Exit activity was down considerably in Q4 relative to Q3 and Q4 of 2018 with 360 exits totaling $58.1 billion.

Similar to the buyout space, Q4 venture capital deal activity decreased in terms of number of deals but saw an increase in aggregate deal volume relative to Q4 of 2018 as 3,926 deals were consummated for an aggregate deal value of $71.1 billion. Exit activity also decreased year-over-year with the number of exits decreasing 3% to 282 and the aggregate deal value decreasing 17% to $29.7 billion. Many investors attribute the slowdown in activity to the failed initial public offering for WeWork, a fast growing shared office space company.

During the quarter, our private equity managers called a combined $11.3 million and paid distributions of $26.9 million. Our current allocation to private equity is 9.95%, with a market value of $441.0 million. From its 2003 inception through June 30, 2019, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 11.7% versus a 12.4% 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 22.1% return versus 15.6% for the benchmark. Fundraising time continues to shorten as managers are taking advantage of the high demand for private equity funds and shortening the time the funds are in the market. In Q4, the average fund that closed spent 16 months in the market, which is the lowest level since 2008.

Opportunistic: On a sub-strategy basis, the HFRI Event-Driven Index rose 0.3%, the HFRI Relative Value Index gained 0.6%, the HFRI Equity Hedge Index advanced 3.5%, and the HFRI Relative Value Index was up 1.1%. During the fourth quarter, the System's Diversifying hedge fund portfolio returned a gain of 0.8% underperforming the 1.9% gain for the HFRI Fund of Funds Conservative Index. The System's Directional hedge fund portfolio returned a gain of 1.4%, underperforming the 4.6% gain posted by the HFRI Fund of Funds Strategic Index. The underperformance is primarily since the System's Directional hedge funds have less equity beta than the index and will generally lag in periods of strong equity market performance.

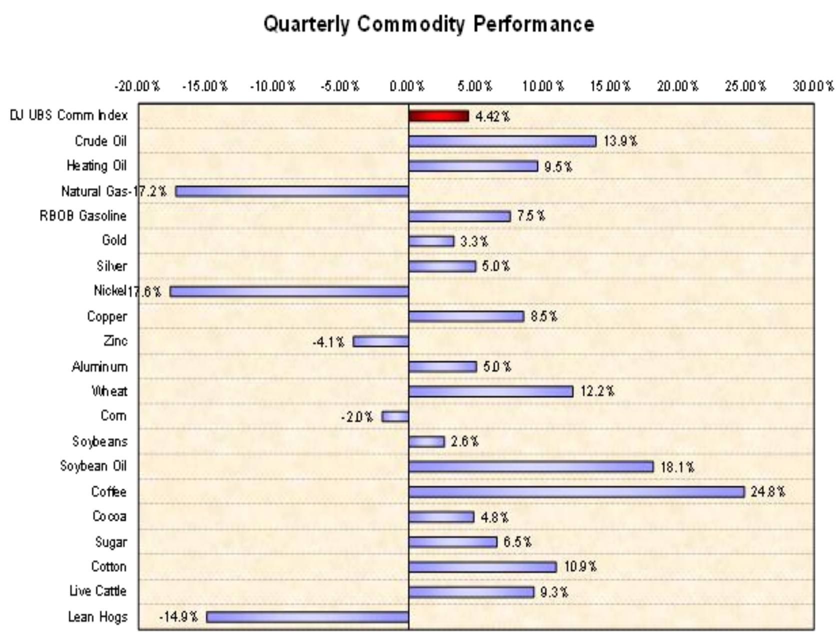
Fixed Income: The yield curve steepened as longer maturity bond yields moved higher. Concerns around an imminent global recession were alleviated due to modestly positive economic data and subsiding geopolitical fears. The yield on the 30-year bond increased by 27 bps during the quarter and ended the period at 2.4%. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, loosened by 29 bps to 34 bps, as yields across the intermediate part of the curve steepened. For the quarter, the 2-year Treasury yield ended flat at 1.6%, while the 10-year Treasury yield increased by 24 bps to 1.9%. The high yield portfolio's performance for the quarter was a gain of 2.9%, outperforming the Merrill Lynch High Yield II Constrained Index by 29 bps. The long duration portfolio's return for the quarter was a loss of 1.2%, underperforming the Barclays Long Govt/Credit Index by 5 bps. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a loss of 3.3%, outperforming the custom benchmark's loss of 3.5%.



Private Debt: After reaching an all-time-high in 2017, private debt fundraising declined to $107 billion in 2019, the lowest annual total since 2015. At the end of the 2019, only 152 funds have reached a final close versus more than 200 funds having closed in each of the last four years. Dry powder dropped from $292 billion at the end of 2018 to $261 billion a year later. Despite these difficulties, fund managers continued to launch new vehicles with the private debt fundraising marketplace becoming more crowded than ever. The ten largest funds closed in 2019 raised 36% of total capital, an increase of seven percentage points in comparison to the previous years, highlighting the existence of capital consolidation as investors are increasingly drawn to larger, more established fund managers. At the start of 2020, there were 436 funds seeking a total of $192 billion from investors versus 399 funds that sought $168 billion at the start of 2019. First-time fundraising made up 9% of total capital raised in private debt in 2019, which was 7% higher versus the prior year. Worldwide, China's economic transformation has been creating new opportunities for distressed debt investors. Non-Performing Loans, which can offer stable returns with downside protection, are increasing as Chinese companies grapple with an economic slowdown that has impacted their cash flows and reduced their ability to repay debt. During the quarter, our private debt managers called a combined $20.9 million and paid distributions of $8.2 million. Our current allocation to private debt is 2.0%, with a market value of $90.4 million. From 2013 through September 30, 2019, the private debt program generated a net internal rate of return of 8.9% versus an 8.7% return for the dollar-weighted public market equivalent benchmark (ICE BofA Merrill Lynch High Yield Master II Constrained + 300 bps).

Private Real Assets: Real estate deal volume slowed by 18.2% versus the prior quarter. However, on a total dollar basis, the decline from Q3 2019 was a more modest 5.8%. The slowdown in activity can be primarily attributed to a challenging operating environment with ongoing geopolitical tension and a decline in flows across countries. Although the amount and dollar size of transactions slowed in Q4, private real estate funds enjoyed a strong fundraising year, and dry powder remains near record highs. Fundraising in the natural resources sector continues to be difficult due to a large slowdown in the upstream energy M&A market. During the quarter, our private real asset managers called a combined $24.1 million and paid distributions of $8.1 million. Our current allocation to private real assets is 5.7%, with a market value of $253.7 million. From its 2006 inception through June 30, 2019, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 5.8% versus a 6.7% gain for the long-term benchmark CPI plus 500 bps. From 2008, when we began investing in direct funds, the private real assets program has generated a 10.2% return versus 6.7% for the benchmark.

Public Real Assets: The Bloomberg Commodity Index increased 4.4% for the quarter as strong gains in crude oil and agriculture were more than able to offset sharp drops in natural gas and nickel. Crude oil prices rallied nearly 14% as OPEC announced production cuts to limit oil supply and news of a trade deal between the U.S. and China boosted the demand outlook. Despite colder than usual temperatures in November, natural gas prices tumbled 17% in the quarter due to reports indicating record production levels. Agricultural commodities posted gains, with coffee prices rising almost 25% due to concerns over supply disruptions in Brazil. Nickel was a notable laggard in Q4, due to Indonesia lifting their export ban and weak demand figures.



Global listed real estate securities as measured by the FTSE EPRA/NAREIT Developed Index advanced by 1.8% in Q4. Europe was the strongest region in the index as favorable currency moves for the pound and Euro explained half of the benchmark's 12% gain. Within Europe, the U.K. was the standout performer, gaining 20.9% due to diminishing uncertainty over Brexit. Continental Europe returned 9.1% following a dovish ECB announcement in addition to improving economic data. Asian REITs were positive for the quarter at +1.9% but lagged their European counterparts as Hong Kong and Japanese REITS underperformed. The U.S. was the worst performing region as equity markets surged and investors rotated away from defensive sectors such as REITs into more cyclical sectors such as technology and financials. Globally, the office, industrial, and hotel sectors performed well while retail underperformed.

Listed infrastructure increased by 4.0% for the quarter as measured by the Dow Jones Brookfield Global Infrastructure Index. Unlike prior quarters, gains were led by the more cyclical sectors such as airports, toll roads, and energy pipelines while communication and utilities lagged. The cyclical sectors benefitted from a sharp increase in risk appetite among equity investors globally. All regions were positive for the quarter with Europe gaining 7.3%, which outperformed Asia-Pacific and North America, which posted 4.0% and 2.8% returns, respectively.

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For the quarter, the public real asset portfolio advanced 3.6%, outperforming the custom benchmark return of 2.8% by 81 bps due to outperformance from our REIT and infrastructure managers.

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 December 31, 2019 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 12/31/2019	Fiscal YTD
Employer Contributions	$ 24.0	$ 48.3
Member Contributions	6.6	15.1
Net Investment Gain	138.4	207.1
	$ 169.0	$ 270.5

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 12/31/2019	Fiscal YTD
Benefits	$ 67.3	$ 131.0
Refunds	0.9	5.5
Administrative Expenses	0.9	1.7
	$ 69.1	$ 138.2

Outlook

During the fourth quarter of 2019, the U.S. Federal Reserve ("Fed") made the decision to lower the target range for the Federal Funds rate by an additional 25 bps to 1.50% - 1.75%. This decision was supported by the Committee's view of uncertainties of global economic output as well as muted inflation pressures. The U.S. economy is generally considered to be healthy per most leading economic indicators; however, growth is projected to marginally slow from the current levels in 2020 and beyond as a direct effect of the ongoing global trade wars. The Fed expects that the U.S. unemployment rate will remain suppressed under their long-term target of 6.7% for the foreseeable future, while inflation is projected to move up slightly as a result of the Fed's recent lowering of interest rates.

Real GDP growth in Europe was relatively subdued in calendar year 2019 and is expected to remain low in the near-term. Overall, the European Central Bank ("ECB") is projecting real GDP growth to decline slightly in 2020 to 1.1% before increasing again in the subsequent years, buoyed by more supportive fiscal and monetary policies globally. The ECB's lowering of near-term growth estimates is primarily due to uncertainties related to global trade, a prolonged slowdown in China, and a no-deal Brexit. Based on current projections made in the fourth quarter, the Bank of Japan ("BOJ") expects the economy to grow 0.7% in 2020. The BOJ did, however, leave open the possibility of revising this estimate upwards to 1%

after their January 2020 review and assessment of the impact from the government's latest stimulus measures.

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

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION

December 31, 2019

Assets		
Equity in pooled cash and investments	$	3,426,658
Investments:		
Northern Trust		4,431,808,210
Aetna		753,662
Fidelity - Elected Officials Plan		426,604
Fidelity - DRSP/DROP		10,762,914
Total investments		4,443,751,390
Contributions receivable		7,572,394
Total assets		4,454,750,442
Liabilities		
Benefits payable and other liabilities		5,860,088
Net position restricted for pensions	**$**	**4,448,890,354**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

December 31, 2019

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 23,968,569	$ 48,255,319
Member	6,588,778	15,143,692
Total contributions	30,557,347	63,399,011
Investment income	143,261,712	216,757,291
Less investment expenses	4,796,918	9,634,218
Net investment income	138,464,794	207,123,073
Total additions	169,022,141	270,522,084
Deductions		
Retiree benefits	50,688,854	98,538,685
Disability benefits	13,525,608	27,090,602
Survivor benefits	3,125,775	5,387,770
Refunds	950,591	5,578,410
Administrative expenses	855,960	1,672,550
Total deductions	69,146,788	138,268,017
Net increase	**99,875,353**	**132,254,067**
Net position restricted for pensions		
Beginning of period	**4,349,015,001**	**4,316,636,287**
End of period	**$ 4,448,890,354**	**$ 4,448,890,354**