QUARTERLY REPORT

OFFICES OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Richard Madaleno
Chief Administrative Officer

March 25, 2022

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, 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 6,161 ERS and GRIP active members and 6,714 retirees participating in the ERS as of December 31, 2021

Performance Results

The total return achieved by the ERS' assets for the quarter was a gain of 5.58%, 17 basis points behind the 5.75% gain recorded by the policy benchmark. For the one-year period ending December 31, 2021 the ERS' gross return (before fees) was a gain of 19.12%, 326 basis points ahead of the 15.86% gain recorded by the policy benchmark. The one-year gross return places the ERS' performance in the first quartile of the universe of comparable pension funds constructed by the Board's consultant, NEPC. Our annualized performance of 17.04% for the three-year period, 12.67% for the five-year period, and 10.74% for the ten-year period all ranked in the top quartile, or better than 75% of our public fund peers. The asset allocation on December 31, 2021 was: Domestic Equities 12.9%, International Equities 12.2%, Global Equities 2.7%, Fixed Income 15.1%, Emerging Market Debt 1.2%, Inflation Linked Bonds 14.0%, Public Real Assets 11.3%, Private Equity 13.6%, Private Real Assets 6.4%, Private Debt 2.4%, Opportunistic 4.3%, and Cash 2.9%. We estimate that the funded status of the ERS was 119% based on a market value of assets and 106% on an actuarial (smoothed) value of assets as of December 31, 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

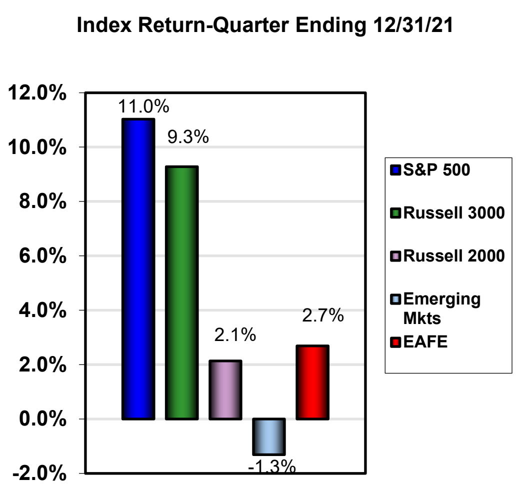
During the quarter, the ERS committed $22 million to Center Rock Capital Partners Fund II, L.P., a private equity fund, $17 million to Bison Capital Partners VI, L.P., a private debt fund, and $17 million to Clearlake Opportunities Partners III, L.P., a private debt fund. Segall Bryant & Hamill, a domestic small cap manager, was hired within the public equity portfolio during the quarter.

Capital Markets and Economic Conditions

Fourth quarter GDP for 2021 grew at a 6.9%, well ahead of the 5.5% estimate from the Dow Jones economist survey. This helped close the year with a 5.7% increase in annualized GDP, the strongest growth since 1984. The increase in GDP growth was driven primarily by an increase in private inventory investment, strong consumer activity, exports, and business spending. These helped offset some of the effects of the decrease in government spending. By the end of Q4 2021, the unemployment rate was 3.9%, with the economy adding 199,000 jobs in December as a result of an increase in hiring in leisure and hospitality, professional and business services, manufacturing, construction, and in transportation and warehousing.

The consumer price index (CPI) rose 7.0% from a year ago, in-line with the Dow Jones estimate. The annual change was the fastest increase since 1982. Food rose 6.3% for the year, while used vehicle prices rose another 3.5% in December, bringing the annual increase to 37.3%. While energy costs decreased 0.4% during the month, they were still up 29.3% from a year ago. Core CPI, which excludes volatile food and energy costs, rose 5.5%. The housing picture remained resilient as new housing starts finished the quarter at 1.88 million, 6.5% higher than a year ago. Home prices remained above average, with the median existing-home sales price ending the quarter at $358,000, almost $50,000 higher than a year ago.

Public Equity Markets: Equities were up with the S&P 500 Index rallying 11% for the quarter. Overall, gains were robust despite a weaker November, during which fears over rising cases of Omicron and the speed of the Fed's asset tapering weighed on markets. Risk sentiment was bolstered by robust equity inflows, strong corporate earnings, favorable economic data, and extremely accommodative financial conditions. Large cap growth stocks led the returns followed by small cap value stocks. Ten of the eleven sectors of the S&P 500 Index posted positive results with real estate and IT leading the index. Our combined domestic equity performance was a gain of 8.16%, underperforming the 9.28% gain of the Russell 3000 Index.



International developed markets advanced during the quarter with larger capitalization stocks outperforming their smaller counterparts. In Europe, robust corporate earnings and equity inflows helped to stem concerns about macroeconomic headwinds from the pandemic and surging inflation. Within the Pacific basin markets, Australia and Singapore were impacted by lockdowns and slowing economic growth. The Japanese market underperformed following a decline in third-quarter GDP, which was the first decline in seven quarters. Emerging markets experienced negative returns during the quarter, driven primarily by Turkey, where extreme currency volatility weighed on investor sentiment. Russia, Brazil, and China were all down more than five percent, while Egypt, Taiwan, and the UAE were some of the top performing markets. Our combined international equity performance was a gain of 0.18%, underperforming the 1.64% gain recorded by the benchmark. Our global equity allocation recorded a gain of 5.60%, underperforming the 6.68% gain of the MSCI ACWI Index.

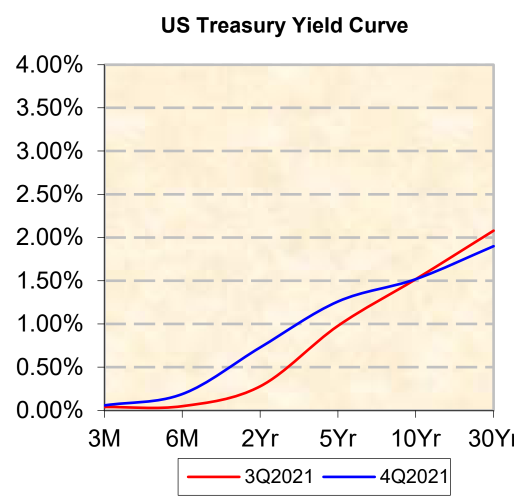
Private Equity: During the fourth quarter, a total of 500 funds reached their final close, securing $165 billion in commitments, down from the near record fundraising highs of the fourth quarter in 2020. Relative to Q3, the number of funds raised in Q4 decreased 12%, however, total capital raised increased 13%, representing a jump in average fund size. Q4 is typically the busiest fundraising quarter, but during 2021 was the least active. North America continued to dominate the fundraising landscape, representing 72% of the aggregate capital raised and 60% of the total funds raised. U.S. buyout deal activity was mixed during the quarter as the number of completed deals increased 28% to 1,380, the aggregate deal volume decreased 3% to $109 billion, and the average deal size decreased 15% to $618 million. Buyout multiples in the U.S. continue to remain elevated near peaks, with median entry multiples at 10.8x Enterprise Value-to-EBITDA. The technology sector continues to be the most robust representing 25% of aggregate U.S. buyout deal value. Buyout exit activity saw a record high 429 exits during the fourth quarter, with aggregate exit values increasing 17% from the third quarter, but the average deal size dropping 11% to $928 million. The global private equity sector has $2.2 trillion in dry powder, a record high, which could serve to support transactional activity.

Similar to private equity, U.S. venture fundraising activity was down in Q4 as the number of funds raised decreased 17% to 184, the slowest quarter of the year. However, aggregate capital raised increased 56% to $28 billion and the average fund size raised jumped 98% to $170 million. U.S. venture deal making increased for the quarter with the number of consummated deals up 9% to 2,063, aggregate deal value up 10% to $87 billion, and average deal size up 6% to $58 million.

During the quarter, our private equity managers called a combined $33.3 million and paid distributions of $100.3 million. Our current allocation to private equity is 13.6%, with a market value of $749 million. From its 2003 inception through September 30, 2021, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 14.4% versus a 13.8% 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 26.5% return versus 18.6% for the benchmark.

Hedge Funds: For the quarter, industry wide hedge funds rose by 0.4% based on the Composite Index. On a sub-strategy basis, the Event-Driven Index rose 1.0%, the Relative Value Index gained 0.2%, the Macro Index declined 0.3%, and the Equity Hedge Index rose 0.7%. The System's diversifying hedge funds recorded a gain of 1.2% versus a gain of 0.6% for the Conservative Index. The diversifying portfolio outperformance is primarily attributable to strong fund selection within the quant sector. The System's directional hedge funds recorded a loss of 0.3% compared to the 0.4% return for the Strategic Index. The directional underperformance is primarily attributable to poor fund selection within the equities-fundamental sector.

Fixed Income: The yield curve flattened noticeably for the quarter as short interest rates moved up in anticipation of Fed rate hikes while the long end remained flat or declined. The yield on the 10- and 30-year bonds was flat and declined 18 bps during the quarter, respectively. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, ended the quarter at 79 bps, 45 bps tighter than the previous quarter. By the end of the quarter, the 10-year Treasury yield was 1.52% whereas the 30-year Treasury yield was 1.90%. The high yield portfolio's performance for the quarter was a gain of 0.3%, underperforming the Merrill Lynch High Yield II Constrained Index by 33 bps. The long duration portfolio's return for the quarter was a gain of 2.5%, underperforming the custom long duration benchmark by 12 bps. The emerging market debt portfolio lost 1.1%, underperforming the JPM EMBI Global Diversified benchmark return by 62 bps. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a gain of 8.4% gross of fees, outperforming the custom benchmark by 175 bps. The overlay itself added a fair amount of value due to the strong performance of the strategy's alphas in nominal bonds and developed market currencies.



Private Debt: While the Q4 private debt fundraising was lower than the past two years, the $1.1 billion average fund size was the second highest after Q3 2021. 52 private debt funds raised $45.1 billion of aggregate capital in Q4 while 43 funds raised $65.2 billion in aggregate capital in the prior quarter. AUM for private debt funds rose to $1.2 trillion at the end of 2021, which is a 17% increase on the preceding year. The asset class continues to be dominated by larger funds, with the 20 largest accounting for nearly 60% of the total private debt capital raised in 2021. North America led fund-raising with $32.3 billion while fundraising in Europe attracted $11.9 billion. Direct lending continues to be the most attractive debt strategy due to the diversity and security of income that drives demand. During Q4, 27 direct lending funds raised $32.6 billion of capital, which was more than any other category. Dry powder at the end of Q4 was $405.3 billion, the highest amount ever recorded by Preqin.

During the quarter, our private debt managers called a combined $10.4 million and paid distributions of $24.3 million. Our current allocation to private debt is 2.41%, with a market value of $132.4 million. From 2013 through September 30, 2021, the private debt program generated a net internal rate of return of 12.6%

versus a 9.9% return for the dollar-weighted public market equivalent benchmark (ICE BofA Merrill Lynch High Yield Master II Constrained + 300 bps).

Private Real Assets: The asset class continues to experience tremendous change as many traditional energy managers are struggling to fundraise based on the environmental impact. Consequentially, many energy and infrastructure managers are launching energy transition funds targeting the societal move to a Green Economy. While fossil fuel prices continue to rebound as Covid-related restrictions ease, new drilling expansion remains muted as companies are feeling increased pressure to deleverage and increase cash flows. Further, banks have been curtailing their loans to the energy sector resulting in fund managers filling the void. The mining sector continues to experience a strong price rebound driven by inflation concerns, and green energy/infrastructure investments. The green economy has created an insatiable appetite for both strategic and industrial metals. The infrastructure sector continues to be mixed as ports, industrial rail, toll roads, and solar and wind renewable power projects are experiencing strong pricing and demand whereas airports, commercial rail, and car parks are still experiencing sharp drop-offs in user traffic and volumes. Within real estate, transaction volumes continue to increase with expected returns remaining unchanged. Debt is widely available at attractive pricing for senior loans on transitional assets. Opportunities are the greatest for adapting existing buildings for greater tenant use and flexibility.

During the quarter, our private real asset managers called a combined $19.0 million and paid distributions of $45.2 million. Our current allocation to private real assets is 6.4%, with a market value of $354.3 million. From its 2006 inception through September 30, 2021, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 6.3% versus a 7.1% 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 10.2% for the quarter, outperforming both global equities and bonds. Strong earnings reports and increased private market transaction activity supported the global listed real estate market. North America was the best performing region with strong pricing power reported from industrial, residential, and storage operators. Retail landlords also reported better-than-expected results driven by a strong retail sales environment. Europe trailed behind, though still positive returns led by the defensive self-storage and industrial sectors. Asia was the laggard as the market was in defensive mode and higher beta strategies such as Japanese developers weighed down the index heavily. Hotels, health care, and office lagged on omicron fears and comparatively weaker results.

Listed infrastructure securities posted gains of 7.5% during the fourth quarter as measured by the Dow Jones Brookfield Global Infrastructure Index, slightly underperforming global equities. Performance was led by more defensive sectors such as network utilities and communications, as well as a rebound in the transportation sector. Infrastructure sector dispersion continues to be wide with the top performing sector, European regulated utilities, outpacing the worst performing sector, airports by over 17%. Network utilities outperformed, with strength in European regulated utilities given UK network utilities' high correlation to inflation rates. Out of benchmark renewables underperformed due to the failure in Build Back Better legislation passing. Despite the continued upswing in commodity prices, energy infrastructure was flat for the quarter consolidating strong outperformance from earlier in the year. The communications sector continued their outperformance on strong sentiment and fundamentals. The transportation sector underperformed due mainly to weak traffic as a result of the pandemic. Regional dispersion was wide in the quarter with North America and Europe generating strong gains and Asia posting small losses.

For the quarter, the public real asset portfolio advanced by 8.0%, underperforming the custom benchmark's gain of 8.8% by 85 bps due to underperformance by both our Global Listed Infrastructure Global REIT 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, 2021 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 12/31/2021	Fiscal YTD
Employer Contributions	$ 16.7	$ 34.8
Member Contributions	8.0	16.0
Net Investment Income	286.9	323.6
	$ 311.6	$ 374.4

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 12/31/2021	Fiscal YTD
Benefits	$ 68.7	$ 136.7
Refunds	6.6	9.7
Administrative Expenses	0.9	1.7
	$ 76.2	$ 148.1

Outlook

As a result of a surge in inflation and further improvement in the labor market during the quarter, the Federal Reserve (Fed) announced in December that it would accelerate its taper program by reducing the monthly pace of net asset purchases by $30 billion, almost double the amount it had announced in November. During the same announcement, the Fed decided to keep the target range for the federal funds rate at 0 to 1/4 percent. Most economists expect the Fed to begin to increase rates once the tapering is completed sometime during the first half of 2022. The consensus is for 3 or 4 rate increases in 2022, with analysts predicting that 10-year treasury yields could exceed 2% by the end of 2022.

In Europe, economies and the labor market continued to improve, helped by significant policy support. In December, the European Central Bank (ECB) confirmed it would wind down its pandemic emergency purchase program (PEPP) by the end of March 2022 while temporarily expanding the asset purchase program (APP) to ensure a smooth transition. The ECB expects inflation to remain above 2% for most of 2022, but indicated they are unlikely to raise rates until 2023. In Japan, core consumer inflation ended the year at 0.8%, well below the Bank of Japan's (BOJ) target of 2%. As a result, the BOJ stated it would continue with its large-scale program of monetary easing.

In contrast to the U.S. and Europe, China's inflation rate remains relatively low, interest rates are normal, and they have not monetized government debt to support the economy. The country is coming out of an economic slowdown driven by policy-driven deleveraging and the side-effects from the fall of some overly indebted companies such as property giant Evergrande. As a result, the People's Bank of China (PBOC) introduced stimulative monetary and fiscal policies in December, including a 50 basis-points cut to the reserve requirement ratio and a 5 basis-points reduction in the Loan Prime Rate, with the expectation for further easing in 2022.

Globally, the International Monetary Fund (IMF) downgraded its global growth forecast for 2022 due to rising Covid-19 cases, supply chain disruptions, and rampant inflation. The IMF expects global GDP to decline from 5.9% to 4.4% in 2022. The decline is the result of GDP growth downgrades of 1.2% and 0.8% for the U.S. and China, respectively. The IMF forecasts that inflation will remain higher than previously anticipated but expects it to ease in 2022 as supply-demand imbalances decrease and countries continue to respond with sound monetary policies.

Sources: BlackRock, Bloomberg, Bridgewater, FRM, MSCI, NCREIF, Northern Trust, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, The World Bank, European Central Bank, Bank of Japan, Albourne, MSIM, Principal, JP Morgan, Goldman Sachs, Preqin, Pitchbook, Standard and Poor's.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION

December 31, 2021

Assets	
Equity in pooled cash and investments	$ 1,930,709
Investments:	
Northern Trust	5,504,146,610
Aetna	619,389
Fidelity - Elected Officials Plan	794,013
Fidelity - DRSP/DROP	18,805,244
Total investments	5,524,365,256
Contributions receivable	3,506,629
Total assets	5,529,802,594
Liabilities	
Benefits payable and other liabilities	7,487,884
Net position restricted for pensions	**$ 5,522,314,710**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

For the Quarter Ended December 31, 2021

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 16,711,206	$ 34,759,600
Member	7,978,321	15,994,883
Total contributions	24,689,527	50,754,483
Investment Income	293,049,220	334,325,109
Less investment expenses	6,106,352	10,660,543
Net investment Income	286,942,868	323,664,566
Total income	311,632,395	374,419,049
Deductions		
Retiree benefits	52,338,078	104,090,948
Disability benefits	14,002,159	27,916,050
Survivor benefits	2,346,466	4,688,925
Refunds	6,634,047	9,675,717
Administrative expenses	927,661	1,705,221
Total deductions	76,248,411	148,076,861
Net Loss	**235,383,984**	**226,342,188**
Net position restricted for pensions		
Beginning of period	**5,286,930,726**	**5,295,972,522**
End of period	**$ 5,522,314,710**	**$ 5,522,314,710**