OFFICES OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

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Chief Administrative Officer

November 19, 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 September 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 6,217 ERS and GRIP active members and 6,743 retirees participating in the ERS as of September 30, 2021.

Performance Results

The total return achieved by the ERS' assets for the quarter was a gain of 2.65%, 73 basis points ahead of the 1.92% gain recorded by the policy benchmark. For the one-year period ending September 30, 2021 the ERS' gross return (before fees) was a gain of 22.98%, 376 basis points ahead of the 19.22% gain recorded by the policy benchmark. The one-year gross return places the ERS' performance in the second quartile of the universe of comparable pension funds constructed by the Board's consultant, NEPC. Our annualized performance of 12.88% for the three-year period and 11.49% for the five-year period both ranked in the top quartile, or better than 75% of our public fund peers. The ten-year annualized return of 10.65% ranked in the second quartile. The asset allocation on September 30, 2021 was: Domestic Equities 13.3%, International Equities 12.7%, Global Equities 2.7%, Fixed Income 15.6%, Emerging Market Debt 1.3%, Inflation Linked Bonds 13.5%, Public Real Assets 11.0%, Private Equity 13.9%, Private Real Assets 6.9%, Private Debt 2.5%, Opportunistic 4.5%, and Cash 1.3%. We estimate that the funded status of the ERS was 115% based on a market value of assets and 104% on an actuarial (smoothed) value of assets as of September 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 following private commitments were made: $22 million to Clearlake Capital Partners VII, L.P., a private equity fund and $21 million to Amulet Capital Fund II, L.P.

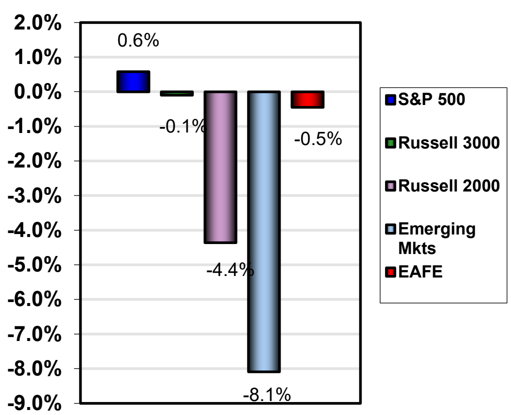
Capital Markets and Economic Conditions

Third quarter GDP for 2021 grew at a 2.0%, below the 2.6% estimate from the Dow Jones economist survey. The Q3 2021 GDP growth was the economy's worst since the recovery began in late 2020. The decline in GDP growth was driven primarily by a slowdown in consumer spending which dropped from 12% in Q2 to 1.6% in Q3. This deceleration in consumer spending, in turn, was the result of an increase in COVID-19 cases related to the emergence of the delta variant and the reduction in government assistance payments to individuals, businesses, and state and local governments. By the end of Q3 2021, the unemployment rate was 4.8%, but the economy only added 194,000 jobs in September, the lowest number since January 2021, with low hiring in bars, restaurants, and hotels the main culprits.

The consumer price index (CPI) rose 5.4% from a year ago, well above the 2.6% Dow Jones estimate. A surge in gasoline prices accounted for about half the gain, as gasoline prices were up 42.1% from a year ago. Food also rose by 4.6% for the year. Core CPI, which excludes volatile food and energy costs, rose 4.0%. The housing picture remained resilient as new housing starts finished the quarter at 1.55 million, 7.4% higher than a year ago. Home prices remained above average, with the median existing-home sales price ending the quarter at $352,800, a $10,000 drop from the historic highs reached in June 2021.

Public Equity Markets: Equities were slightly up with the S&P 500 Index finishing relatively flat. Concerns over a surge in COVID-19 infections along with high inflation, due to continued stimulus from the Fed and supply chain disruptions, were some of the factors that impacted investor sentiment. Large cap growth stocks generated modestly positive returns while small-cap and value stocks struggled. Within the sectors, financials, utilities, and communication services were the strongest performers while industrials and materials performed the worst. Our combined domestic equity performance was a loss of 0.18%, slightly underperforming the 0.10% loss of the Russell 3000 Index.

Index Return-Quarter Ending 09/30/21



International developed markets posted slight losses during the quarter. Smaller capitalization stocks outperformed their larger counterparts. Hong Kong and Belgium were bottom performers while Austria and Norway advanced the most in the quarter. The Eurozone economies benefited from the improved consumer spending due to the reopening efforts. Meanwhile, Japan continued to struggle, as the delta variant curbed consumer spending and supply chain disruptions impacted progress. Emerging markets experienced significant negative returns during the quarter, driven by market volatility in China due to its regulatory crackdown. China's regulatory actions were wide ranging, addressing everything from socioeconomic considerations to national security. Brazil and China led the decliner with over 20% losses while Argentina, Czech Republic, and India were some of the top performing markets. Our combined international equity performance was a loss of 1.48%, outperforming the 2.56% loss recorded by the benchmark. Our global equity allocation recorded a gain of 0.39%, outperforming the 1.05% loss of the MSCI ACWI Index.

Private Equity: During the third quarter, a total of 531 funds reached their final close, securing $139 billion in commitments, significantly below the record fundraising total from Q2 but roughly in line with the third quarter of 2020. Capital raising took a breather following three straight quarters of near record fundraising hauls. Relative to Q2, the number of funds raised in Q3 decreased 30% to 531, the aggregate capital raised decreased 52% to $139 billion, and the average fund size raised decreased 29% to $290 million. Q3 is typically the slowest fundraising quarter given summer vacations and these fundraising totals are roughly in line with the third quarter of 2020. North America continued to dominate the fundraising landscape, representing 46% of the aggregate capital raised and 69% of the total funds raised. U.S. buyout deal activity was mixed during the quarter as number of completed deals decreased 3% to 1,023, the aggregate deal volume decreased 20% to $110 billion, and the average deal size increased 3% to $1.2 billion. All of these metrics are hovering near all-time record highs for U.S. buyouts. Buyout multiples in the U.S. continue to expand given the recovering economy and ongoing monetary and fiscal support, averaging 12.5x

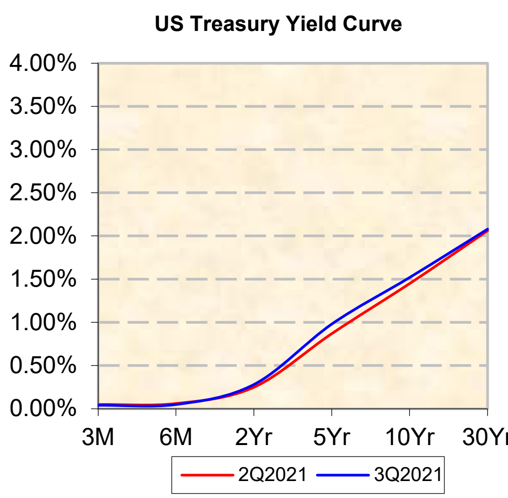
Enterprise Value-to-EBITDA during the third quarter. While not quite as dominant as during the depths of the pandemic, the technology sector continues to lead the way representing 25% of aggregate buyout deal value. Much like fundraising activity, buyout exit activity was down from the lofty levels seen during Q2 with the number of exits down 11% to 344, aggregate exit value down 23% to $112 billion, and the average exit value down 17% to $1.0 billion. The global private equity sector has $1.5 trillion in dry powder, which is a record high, which could serve to further support deal activity and valuations in the near future.

Relative to the near record fundraising haul in Q2, fundraising was down significantly in Q3 as the number of funds raised decreased 22% to 233, aggregate capital raised decreased 51% to $16.5 billion, and the average fund size raised decreased 38% to $75 million. Much like other sectors of private equity, the third quarter tends to be the slowest in terms of fundraising and deal activity. Venture deal making was down slightly for the quarter with the number of consummated deals down 0.2% to 5,812, aggregate deal value down 4% to $183 billion, and average deal size down 3% to $44 million.

During the quarter, our private equity managers called a combined $38.5 million and paid distributions of $43.6 million. Our current allocation to private equity is 13.9%, with a market value of $731.1 million. From its 2003 inception through June 30, 2021, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 14.0% versus an 14.0% 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 25.7% return versus 19.2% for the benchmark.

Hedge Funds: For the quarter, industry wide hedge funds declined by 0.4% based on the Composite Index. On a sub-strategy basis, the Event-Driven Index declined 0.3%, the Relative Value Index gained 0.8%, the Macro Index gained 0.7%, and the Equity Hedge Index declined 0.9%. The System's diversifying hedge funds recorded a gain of 0.7% versus a gain of 1.2% for the Conservative Index. The diversifying portfolio underperformance is primarily attributable due to poor fund selection within the macro sector. The System's directional hedge funds recorded a gain of 1.2% compared to the 0.5% return for the Strategic Index. The directional outperformance is primarily attributable to the System's co-investment strategies.

Fixed Income: The yield curve was relatively unchanged for the quarter. The yield on the 10- and 30-year bonds advanced by 7 and 2 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 124 bps. By the end of the quarter, the 10-year Treasury yield was 1.52% whereas the 30-year Treasury yield was 2.08%. The high yield portfolio's performance for the quarter was a gain of 0.8%, underperforming the Merrill Lynch High Yield II Constrained Index by 14 bps. The long duration portfolio's return for the quarter was a gain of 0.4%, outperforming the custom long duration benchmark by 8 bps. The emerging market debt portfolio lost 0.7%, in-line with the JPM EMBI Global Diversified benchmark return. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a gain of 4.6% gross of fees, outperforming the custom benchmark by 100 bps. The overlay itself added a fair amount of value due to the strong performance of the strategy's alphas in nominal bonds and equities.



Private Debt: Q3 private debt fundraising was significantly higher than the past two years. Private debt funds raised $41 billion in Q3 2020 versus the $14 billion and $28 billion in Q3 2020 and Q3 2019, respectively. Investors are willing to invest in private debt as economies started to return to normality, and the need for debt has been increasing. North America led fund-raising with $27 billion while fundraising in Europe attracted $12 billion. Direct lending has been the most attractive debt strategy due to the diversity and security of income that drives demand. During Q3, 19 direct lending funds reached a final close, raising $8 billion, which was more than any other category. The average private debt fund size declined from $692 million to $655 million. However, there are still 82 funds targeting more than $1 billion (e.g., Apollo Global Management is raising $12 billion in their latest fund). Those targeting in excess of $1 billion, represent

65% of aggregate capital despite making up only 18% of funds by number. Dry powder at the end of Q3 was $378 billion, the highest amount ever recorded by Preqin.

During the quarter, our private debt managers called a combined $9.4 million and paid distributions of $4.4 million. Our current allocation to private debt is 2.52%, with a market value of $132.9 million. From 2013 through June 30, 2021, the private debt program generated a net internal rate of return of 12.4% versus an 10.1% 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 quarter, the commodity sector experienced an impressive recovery following a volatile market in 2020. The energy market has experienced a strong recovery driven by both supply pressures by OPEC and demand shocks given the fiscal stimulus. The agriculture sector also experienced a strong recovery, especially corn and soybean prices, driven by higher export volumes as global economies re-open. The mining industry also outperformed, fueled by strong demand for aluminum and copper. Real estate transaction volumes noticeably picked up, especially in the Americas. Cap rates for all major sectors declined, except for hotels where demand has remained suppressed due to the rise of the Delta variant. During the quarter, our private real asset managers called a combined $9.9 million and paid distributions of $12.4 million. Our current allocation to private real assets is 6.9%, with a market value of $362.8 million. From its 2006 inception through June 30, 2021, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 5.8% versus a 6.9% 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 moderate loss of 0.9%, slightly underperforming global equities and performing in line with bonds. The rise in bond yields weighed on REIT sentiment as the sector tends to underperform, particularly in the short term, as yields rise. North America was the best performing region and the only region in the index to post gains in Q3 on the back of a stronger U.S. dollar. Europe finished flat in local terms but negative in dollar terms given currency headwinds. The United Kingdom performed well due to a rapid economic recovery as the country relaxes COVID-19 restrictions while Continental Europe lagged primarily due to retail properties lagging as weaker leasing activity news was announced. The apartment sector was the top performing for the quarter given robust private market demand in the space and much quicker recovery in rent than originally anticipated. The office and lodging sectors lagged due to delta variant headwinds, which led many businesses to delay the return to normal work and travel policies.

Listed infrastructure securities posted marginal losses of 0.9% during the third quarter as measured by the Dow Jones Brookfield Global Infrastructure Index, slightly underperforming global equities. Broadly, concerns over heightened interest rates weighed on the sector during the quarter. Infrastructure sector dispersion continues to be wide with the top performing sector, ports, outpacing the worst performing sector, gas distribution utilities by over 20%. Transportation was the standout sector due to the removal of restrictions around intercontinental travel, particularly for airport operators. Despite the continued upswing in commodity prices, energy infrastructure was flat for the quarter with gas midstream posting positive performance and pipeline companies finishing slightly negative. Utilities continue to post mixed performance with electricity transmission and distribution businesses generating moderate gains while European regulated utilities and gas distribution utilities suffered losses. Regional dispersion was fairly low in the quarter with North America and Europe generating minor losses and Asia posting small gains.

For the quarter, the public real asset portfolio declined by 1.1%, slightly underperforming the custom benchmark's loss of 0.9% by 20 bps due to the underperformance of our Global Listed Infrastructure manager. Our Global REIT managed slightly outperformed the benchmark.

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 September 30, 2021 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 9/30/2021	Fiscal YTD
Employer Contributions	$ 16.8	$ 16.8
Member Contributions	9.3	9.3
Net Investment Income	36.7	36.7
	$ 62.8	$ 62.8

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 9/30/2021	Fiscal YTD
Benefits	$ 68.0	$ 68.0
Refunds	3.0	3.0
Administrative Expenses	0.8	0.8
	$ 71.8	$ 71.8

Outlook

Following the rumors in recent months, the FOMC announced that it will begin reducing the monthly increases in its Treasury agency MBS holdings starting in mid-November. The Committee specified a $15 billion reduction of asset purchases in both November and December as an appropriate pace; however, it is prepared to adjust the pace of purchases if warranted by changes in the economic outlook. The Fed stated that they expect high inflation readings recently released to moderate, and it has to see further labor market improvement before raising rates. Economic data released after the quarter indicated that the economy gained strength as the late-summer wave of the delta variant eased. Factory orders increased 0.2% in September, slightly more than consensus expectations. The Labor department also commented that the economy gained 235,000 more jobs in August and September than it originally estimated.

The European Central Bank does not expect interest rates to rise as it believes the outlook for inflation over the medium term will remain subdued. In Japan, household spending fell in September amid consumers' continued caution due to the pandemic. The Bank of Japan (BOJ) is not expected to follow the U.S. Fed's dialing back of easing, given Japan's different circumstances as price momentum in Japan is much weaker than in other countries. The BOJ brought its forecast for the consumer price index to zero percent in fiscal year 2021. Japan's central bank is still committed to achieve its 2% inflation target and continue its yield curve control policy, which essentially entails keeping Japan's 10-year government bond yield at zero.

In the ongoing fight against COVID-19, the first antiviral oral pill to reduce the risk of hospitalization and death in people with mild to moderate COVID-19 was recently introduced. The U.S. is moving towards approving the vaccination of children ages 5 to 11. Meanwhile, the World Health Organization has warned that the European region has become the epicenter of the global pandemic, which could see another 500,000 deaths by February.

As the global economy is gaining traction after delta variant setbacks, some economies are facing severe energy shortages at a time when energy prices are up 70% since last year. The impacts are felt across Europe, which is facing shortages of natural gas. In China, which cut coal production to meet carbon emission initiatives, quickly reversed course as the cutbacks created shortages, leading to fears of moderating growth. In the U.S., fuel prices have more than doubled since last year on stronger demand and lower production levels. Meanwhile, supply chain concerns have reached a new high as skyrocketing demand has been overwhelming already strained supply chains, threatening to introduce a combination of high inflation and slowing economic growth. Companies are citing supply chain bottlenecks at every link - including labor shortages, backlogs at ports, increased delivery times and limited trucking availably - leading to increased input costs and concerns about impacts on corporate margins.

Sources: BlackRock, Bloomberg, Bridgewater, Eagle, FRM, Gryphon, GS, 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

September 30, 2021

Assets	
Equity in pooled cash and investments	$ 1,450,307
Investments:	
Northern Trust	5,264,870,986
Aetna	632,657
Fidelity - Elected Officials Plan	734,091
Fidelity - DRSP/DROP	18,963,921
Total investments	5,285,201,655
Contributions receivable	5,186,696
Total assets	5,291,838,658
Liabilities	
Benefits payable and other liabilities	4,907,932
Net position restricted for pensions	**$ 5,286,930,726**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

For the Quarter Ended September 30, 2021

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 16,751,364	$ 16,751,364
Member	9,313,592	9,313,592
Total contributions	26,064,956	26,064,956
Investment Income	41,275,889	41,275,889
Less investment expenses	4,554,191	4,554,191
Net investment Income	36,721,698	36,721,698
Total income	62,786,654	62,786,654
Deductions		
Retiree benefits	51,752,870	51,752,870
Disability benefits	13,913,891	13,913,891
Survivor benefits	2,342,459	2,342,459
Refunds	3,041,670	3,041,670
Administrative expenses	777,560	777,560
Total deductions	71,828,450	71,828,450
Net Loss	**(9,041,796)**	**(9,041,796)**
Net position restricted for pensions		
Beginning of period	**5,295,972,522**	**5,295,972,522**
End of period	**$ 5,286,930,726**	**$ 5,286,930,726**