Attachment - A-2
02/07/2025

QUARTERLY REPORT

OFFICES OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Richard Madaleno
Chief Administrative Officer

February 7, 2025

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, 2024. 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

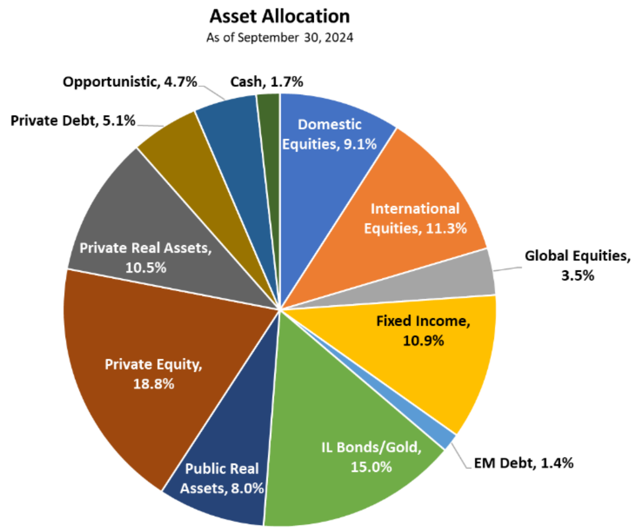
The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after 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 7,207 ERS and GRIP active members and 6,816 retirees participating in the ERS as of September 30, 2024.

Performance Results

The ERS' gained 4.36% for the quarter— lagging the performance of the policy benchmark by 1.52%. The ERS was up 16.57% for the twelve-month period ending September 30, 2024, trailing the policy benchmark by 1.98%, which was up 18.55%. The one-year gross return places the ERS' performance in the third quartile of comparable pension funds constructed by the Board's consultant, NEPC. The Fund had an annualized 3.88% return over the last three-year period and 8.26% for the five-year period (ending September 30, 2024)—the Fund was in the fourth and second quartile vs. the peer universe for the three and five-year periods, respectively. **Over the longer term, the Fund has delivered first-quartile annualized returns of 7.91% over the last ten-year period.**

We estimate that the funded status of the ERS was 95.0% based on a market value of assets and 96.3% on an actuarial (smoothed) value of assets as of September 30, 2024. 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.

The following chart displays the asset allocation for the ERS' on September 30, 2024.



Major Initiatives

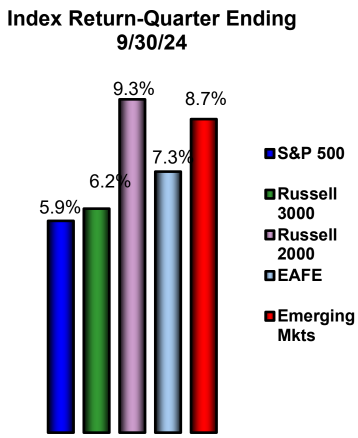
During the quarter, the ERS closed one infrastructure co-investment, a private equity co-investment fund, and three private debt funds.

Capital Markets and Economic Conditions

Third quarter GDP for 2024 increased at an annual rate of 3.1%, according to the third estimate released by the Bureau of Economic Analysis, higher than the 3.0% in the previous period and above the second estimate of 2.8%. The update primarily reflected an upward revision to exports and consumer spending. Compared to the last quarter's growth rate, the acceleration in the third quarter primarily reflected an upturn in exports, consumer spending, and federal government spending. A downturn in residential fixed and private inventory investments partly offset these movements. By the end of Q3 2024, the unemployment rate had remained flat at 4.1% compared to the prior quarter. In September, nonfarm payrolls increased by 254,000, higher than the average monthly gain of 203,000 over the previous 12 months.

The consumer price index (CPI) rose 2.4% from a year ago, the smallest year-over-year increase since the 12 months ended February 2021. Core CPI, which excludes volatile food and energy prices, rose 3.3% from a year ago, primarily driven by the increased pricing in non-energy services, such as shelter. Prices for shelter increased 4.9%, accounting for over 65 percent of the total increase in Core CPI prices. Energy prices decreased by 6.8% with wide variations within the energy complex. Gasoline and fuel oil prices declined by 15.3% and 22.4%, respectively, whereas electricity and natural gas prices increased by 3.7% and 2.0%, respectively. Housing starts for single-family homes finished the quarter at a seasonally adjusted rate of 970k units for September, a 3.4% decrease from the previous quarter. In contrast, Housing starts for multifamily homes finished the quarter at a seasonally adjusted rate of 337k units for September, a 4.5% increase from the previous quarter. The median existing-home sale price at the end of the third quarter was $420,400, up 3.1% from last year's period.

Public Equity Markets: U.S. equities continued their strong performance, albeit with a change in leadership, as small-cap stocks outperformed their large-cap counterparts and the value factor beat the growth factor. This marked a significant change from the first two quarters of the year when market returns were dominated by U.S. large-cap growth stocks—particularly the Magnificent Seven group of stocks. All sectors aside from energy posted positive returns, but top performing sectors included utilities and real estate, while information technology posted only a small advance. Our combined domestic equity portfolio posted a gain of 6.7%, outperforming the 6.2% return of the Russell 3000 Index.



International developed markets led their U.S. counterparts, advancing 7.3% for the quarter. In Europe, stocks advanced, led by the real estate, utilities, and healthcare sectors, as the prospect of lower interest rates saw investors reassess some previously out-of-favor parts of the market. Energy and information technology were the main laggards, delivering negative returns for the quarter. Japanese equity market generated a negative return of 6.0% in local terms but turned positive after the sharp appreciation of the Japanese yen, impacted by weaker US economic data and the Bank of Japan's (BoJ) action in raising interest rates. Singapore was the best-performing market in Asia ex-Japan.

EM equities posted positive returns for the quarter, ahead of developed market equities. Performance was mixed across countries. Thailand was a top performer over the quarter, with returns supported by currency strength and a new government stimulus package. China also posted double-digit returns as investors responded positively to the announcement of monetary stimulus measures and the potential for fiscal stimulus down the road. Brazil underperformed due to the central bank reversing recent monetary easing by raising rates to contain inflation. Taiwan also lagged amid a wider global sell-off in technology-related stocks. Turkey was the worst-performing index market due to local currency depreciation, some weaker-than-expected second-quarter earnings, and foreign equity outflows. Our combined international equity performance was up 5.6%, underperforming the 7.9% return recorded by the benchmark. Our global equity allocation posted a 5.1% gain, underperforming the 6.6% return of the MSCI ACWI Index.

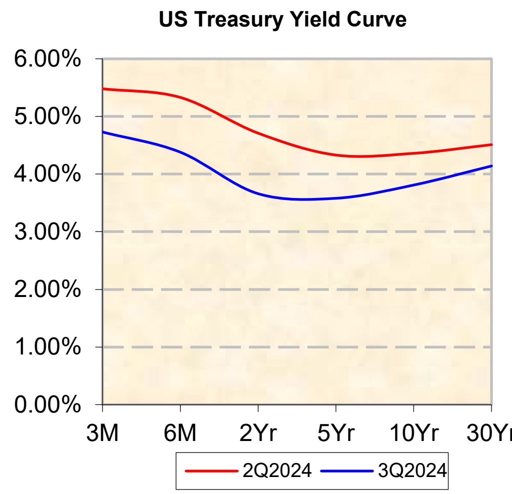
Private Equity: During the third quarter, a total of 581 funds reached their final close, securing $171 billion in commitments. Relative to the prior quarter the number of funds raised remained consistent, while the amount of aggregate capital raised declined 21%. North America's domination of the fundraising landscape continued, representing 67% of global aggregate capital raised and 57% of the number of funds raised. After rebounding in the prior quarter, U.S. buyout deal activity remained consistent during the third quarter. The number of U.S. buyout deals fell 2% to 1,083, deal volume increased 1% to $109 billion, and the average deal size rose 7% to $840 million. Information technology was the most robust sector during the quarter, representing 32% of U.S. buyout deal value. Buyout exit activity for the quarter increased relative to the prior quarter with the number of exits increasing 11% to 252 and both the aggregate exit value and average exit size jumping 27% to $61 billion and $1.13 billion, respectively. The global private equity sector has $2.6 trillion in dry powder and, while it has slightly trended downwards, continues to hover around historical highs.

U.S. venture fundraising activity in Q3 decreased relative to the prior quarter. The number of funds raised fell 7% to 167 and the aggregate capital raised declined 8% to $17 billion, while the average fund size increased 3% to $120 million. Similarly, U.S. venture dealmaking activity decreased throughout the quarter as the number of deals fell 10% to 1,505, the aggregate deal volume dropped 21% to $32 billion, and the average deal size declined 8% to $28 million.

During the quarter, our private equity managers called a combined $33.7 million and paid distributions of $18.9 million. Our current allocation to private equity is 18.8%, with a market value of $952.5 million. From its 2003 inception through June 30, 2024, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 13.6% versus a 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 21.8% return versus 17.3% for the benchmark.

Hedge Funds: For the quarter, industry-wide hedge funds rose by 1.0% based on the HFRI Composite Index. On a sub-strategy basis, the Event-Driven Index gained 4.4%, the Relative Value Index advanced 2.8%, the Equity Hedge Index increased 4.0%, and the Macro Index declined by 3.1%. The System's diversifying hedge funds recorded a gain of 2.0% versus a gain of 1.6% for the Conservative Index. The diversifying portfolio outperformance is primarily attributable to strong selection within the equities and global macro sectors. The System's directional hedge funds recorded a gain of 1.1% compared to the positive 3.2% return for the Strategic Index. The directional underperformance is primarily attributable to the credit sector where an overweight position and manager selection both detracted from returns.

Fixed Income: The yield curve shifted down as Treasury yields decreased. The yield on the 2-year note maturities decreased by 105 bps to 3.7%, while the 10- and 30-year bond maturities decreased by 55 and 37 bps, respectively. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, steepened and ended the quarter at 15 bps. By the end of the quarter, the 10-year Treasury yield was 3.8% whereas the 30-year Treasury yield was 4.1%. The high-yield portfolio's performance for the quarter was a gain of 5.3%, in line with the Merrill Lynch High Yield II Constrained Index. The long-duration portfolio's return for the quarter was a gain of 8.0%, outperforming the custom long-duration benchmark's 7.9% gain. The emerging market debt portfolio gained 6.4%, outperforming the 6.2% performance of the JPM EMBI Global Diversified benchmark. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a gain of 5.0%, underperforming the custom benchmark's 7.9% return. The underperformance was driven by the overlay and was attributable to the strategy's alphas in currencies and interest rates.



Private Debt: Private debt funds raised $50.5 billion from 37 funds in Q3 2024, the strongest since Q4 2023. The average fund size increased from $1.1 billion in the second quarter to $1.4 billion in the third quarter of 2024. Out of the total fundraising activity in the quarter, North America-focused funds raised $37.2 billion, representing 74% of the total. The average fundraising across 20 funds in North America was $1.9 billion, while in Europe it was $1.2 billion across nine funds, which indicates that North America attracted more capital from each fund than Europe. Direct lending funds raised $38.7 billion among 20 funds, followed by four special situation funds with $7.6 billion. Some of the largest funds closed during the quarter were the $16.4 billion Ares Capital Europe VI and the $15.3 billion, both direct lending strategies. Dry powder as of January 2025 was $432.7 billion, which was the third highest in the last five years.

During the quarter, our private debt managers called a combined $28.3 million and paid distributions of $13.1 million. Our current allocation to private debt is 5.1%, with a market value of $235.2 million. From 2013 through June 30, 2024, the private debt program generated a net internal rate of return of 11.5% versus an 8.0% 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, private real estate prices stabilized due to the income component and private real assets increased due to resilient infrastructure cash flows. Infrastructure fundraising slowed as 20 funds raised $18.1 billion compared to 27 funds raised $19.1 billion in the prior quarter. The average return for an infrastructure fund for the quarter was 3.8%. Real estate prices were up 0.8% consisting of 1.2% from income and -0.4% from negative property appreciation. All property sectors were able to produce positive returns during the quarter except for office properties. Office properties declined by 0.9%. Hotels, Retail, Industrial, and Residential advanced by 2.7%, 1.9%, 1.1%, and 1.1%, respectively. Fundraising declined as 147 funds raised $21 billion compared to 219 funds raised $42.4 billion in the prior quarter.

During the quarter, our private real asset managers called a combined $19.9 million and paid distributions of $13.8 million. Our current allocation to private real assets is 10.5%, with a market value of $528.2 million. From its 2006 inception through June 30, 2024, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 6.8% versus a 7.7% 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 staged a comeback in the third quarter, posting a gain of 16.1%, strongly outperforming bonds (Barclays Global Aggregate, 1.7%) and global equities (MSCI World, 6.5%). Rate-sensitive global REITs benefitted from the start of rate cuts from many developed market central banks, including the United States Federal Reserve. During the quarter, Europe was the strongest region as weak economic data spurred further rate cuts. Outperformance came from more highly leveraged regions such as Germany, France and the Nordics. United Kingdon fell behind as stickier inflation has led to a slower pace of rate cuts. The Americas were the weakest region, amidst currency headwinds where coming rate cuts pressured the U.S dollar. Cyclical office stocks in the U.S. and Canada were amongst the best performers, while single-family was the weakest. Asia was supported by strong rallies in Hong Kong and Singapore – both regions are direct beneficiaries of the large stimulus plan announced in China. Japan was the weakest in the region due to BoJ's rate hike and a concern that the incoming Prime Minister may push for further rate hikes.

Listed infrastructure securities surged for a gain of 14.4% during the quarter as measured by the Dow Jones Brookfield Global Infrastructure Index, outperforming global equities (MSCI World, 6.5%) and bonds (Barclays Global Aggregate, 1.7%). Overall, for the quarter communications, European regulated utilities, pipeline companies, other utilities, and electricity transmission & distribution outperformed the index, while ports, airports, toll roads, diversified, gas midstream, gas distribution utilities and water & waste underperformed. All listed infrastructure subsectors exhibited positive absolute performance for the period. The strong performance for the quarter can be attributed to a combination of central bank easing and resilient corporate earnings. Stimulus measures announced by China also helped boost sentiment during the period.

For the quarter, the public real asset portfolio gained 14.7%, below the custom benchmark's gain of 15.2% primarily due to underperformance by our Global REIT manager.

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 2024 and the fiscal year to date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 9/30/2024	Fiscal YTD
Employer Contributions	$ 20.9	$ 20.9
Member Contributions	17.7	17.7
Net Investment Income (Loss)	208.4	208.4
	$ 247.0	$ 247.0

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 9/30/2024	Fiscal YTD
Benefits	$ 83.5	$ 83.5
Refunds	7.0	7.0
Administrative Expenses	1.2	1.2
	$ 91.7	$ 91.7

Outlook

Global growth is expected to remain stable yet underwhelming relative to the pre-pandemic average. At 3.2 percent in 2024 and 2025, the growth projection is virtually unchanged from the IMF's July 2024 World Economic Outlook. However, notable revisions have taken place beneath the surface, with upgrades to the forecast for the United States offsetting downgrades to other advanced economies. In emerging markets, disruptions to the production and shipping of commodities, conflicts, civil unrest, and extreme weather events have led to downward revisions to the outlook for the Middle East and Central Asia, and for sub-Saharan Africa. These have been partially offset by upgrades to the forecast for emerging Asia, where surging demand for semiconductors and electronics has bolstered growth. Persistent structural headwinds, including aging populations and weak productivity, are dampening potential growth in many economies.

Global headline inflation is expected to fall from an annual average of 6.7 percent in 2023 to 5.8 percent in 2024 and 4.3 percent in 2025, with advanced economies returning to their inflation targets sooner than emerging markets. Goods prices have stabilized, but price inflation in services remains elevated in many regions, pointing to the importance of understanding sectoral dynamics and calibrating monetary policy accordingly.

In the U.S., the IMF has revised projected growth for 2024 upward 2.8 percent, which was 0.2 percentage points higher than their July forecast. The upgrade was the result of stronger reported numbers for consumption and nonresidential investment. The resilience of consumption is largely the result of robust increases in real wages (especially among lower-income households) and wealth effects. Growth is anticipated to slow to 2.2 percent in 2025 as fiscal policy is gradually tightened and a cooling labor market slows consumption. With GDP growth lower than potential, the output gap is expected to start closing in 2025. Economic data continues to point towards a soft landing, but recession risks remain because while inflation is declining, wage growth is moderating, and labor market pressures are cooling.

Growth in the Eurozone area is expected to pick up to a modest 0.8 percent in 2024 because of better export performance. In 2025, growth is projected to rise further to 1.2 percent, helped by stronger domestic demand. Rising real wages are expected to boost consumption, and a gradual loosening of monetary policy is expected to support investment. However, persistent weakness in manufacturing weighs on growth expectations for countries such as Germany and Italy. German growth is expected to be further weighed down by the strain from fiscal consolidation and a sharp decline in real estate prices.

In the UK, investors remain optimistic about the Bank of England's (BoE) continued easing. In August, the BoE delivered its first interest rate cut in four years. One major headwind to this optimism is discussions of potential tax increases and budget cuts from the newly elected Labour Party government, which swept the Conservative Party in the July 2024 general election. The IMF is projecting an acceleration in growth to 1.1 percent in 2024 and 1.5 percent in 2025 as falling inflation and interest rates stimulate domestic demand.

The IMF expects Japanese growth to decelerate in 2024, with the slowdown reflecting temporary supply disruptions and fading of one-off factors that boosted activity in 2023, such as the surge in tourism. An acceleration to 1.1 is predicted in 2025, with growth boosted by private consumption as real wage growth strengthens. Investors remain vigilant of the Japanese Yen, as appreciation/depreciation against the U.S. dollar can have material impacts on exporters.

In Emerging markets (EM), growth appears to be robust but cooling. Headline inflation has returned to central banks' targets across a growing number of EMs. However, resilient labor markets and volatility in food prices and exchange rates are now slowing the pace of disinflation in some economies. While this has caused the EM easing cycle to pause, EM rate cuts are likely to broaden as the Fed eases. Compared with their report in July, the IMF revised EM growth upward by 0.1 percentage point for 2024, reflecting upgrades for Asia (China and India) that more than offset downgrades for sub-Saharan Africa and for the Middle East and Central Asia. Their forecast of 4.1 percent growth for 2025 remained unchanged.

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, The International Monetary Fund, European Central Bank, Bank of Japan, The Organization for Economic Cooperation and Development, Russell, Albourne, MSIM, Principal, JP Morgan, Goldman Sachs, Preqin, Pitchbook, Federal Reserve, Marathon Asset Management, Schroders, Standard and Poor's.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION

September 30, 2024

Assets	
Equity in pooled cash and investments	$ 1,069,899
Investments:	
Northern Trust	5,055,079,826
Aetna	511,401
Fidelity - Elected Officials Plan	980,537
Fidelity - DRSP/DROP	9,862,601
Total investments	5,066,434,365
Contributions receivable	7,445,264
Total assets	5,074,949,528
Liabilities	
Benefits payable and other liabilities	4,299,785
Net position restricted for pensions	**$ 5,070,649,743**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

For the Quarter Ended September 30, 2024

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 20,881,837	$ 20,881,837
Member	17,730,643	17,730,643
Total contributions	38,612,480	38,612,480
Investment Income	212,366,032	212,366,032
Less investment expenses	3,944,029	3,944,029
Net investment Income	208,422,003	208,422,003
Total income	247,034,483	247,034,483
Deductions		
Retiree benefits	64,423,777	64,423,777
Disability benefits	15,779,259	15,779,259
Survivor benefits	3,323,223	3,323,223
Refunds	7,025,775	7,025,775
Administrative expenses	1,170,796	1,170,796
Total deductions	91,722,830	91,722,830
Net Income	**155,311,653**	**155,311,653**
Net position restricted for pensions		
Beginning of period	**4,915,338,090**	**4,915,338,090**
End of period	**$ 5,070,649,743**	**$ 5,070,649,743**