QUARTERLY REPORT

OFFICES OF THE COUNTY EXECUTIVE

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April 26, 2024

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, 2023. 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

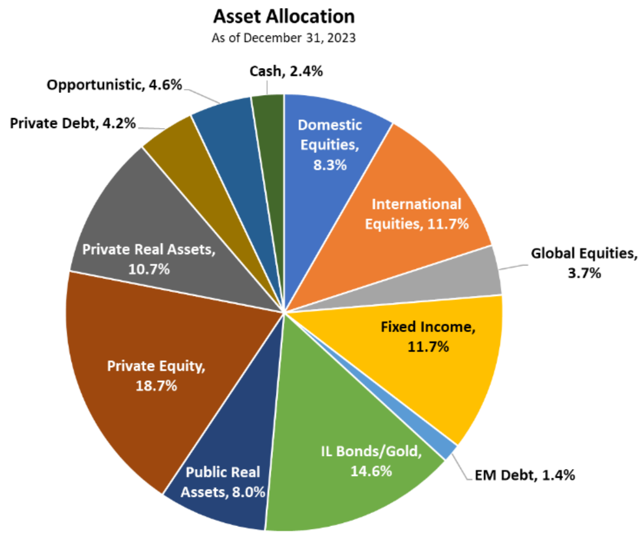
The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after 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 6,800 ERS and GRIP active members and 6,824 retirees participating in the ERS as of December 31, 2023.

Performance Results

The ERS' gained 6.52% for the quarter— which lagged the policy benchmark by 1.2%. The ERS was up 10.18% for the twelve-month period ending December 31, 2023, outpacing the policy benchmark by 2.14%, which was up 8.04%. The one-year gross return places the ERS' performance in the fourth quartile of comparable pension funds constructed by the Board's consultant, NEPC. The Fund had an annualized 4.94% return over the last three-year period and 9.23% for the five-year period (ending December 31, 2023)—the Fund was in the second and first 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 7.63% over the last ten-year period.**

We estimate that the funded status of the ERS was 93.6% based on a market value of assets and 98.0% on an actuarial (smoothed) value of assets as of December 31, 2023. 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 December 31, 2023.



Major Initiatives

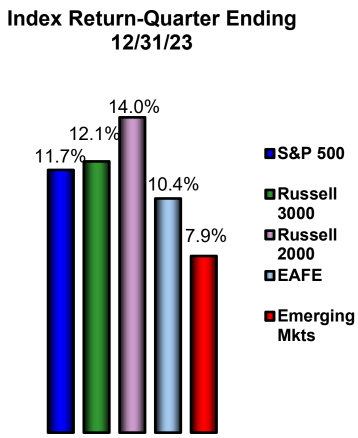
During the quarter, the ERS committed €16.9 million to MML Partnership Capital VIII, a private debt fund.

Capital Markets and Economic Conditions

Fourth quarter GDP for 2023 increased at an annual rate of 3.3% according to the advance estimate released by the Bureau of Economic Analysis, lower than the 4.9% in the previous period and above the market expectations of 2.0%. The estimate reflects increases in consumer spending, exports, state and local government spending, non-residential fixed investment, federal government spending, private inventory investment, and residential fixed investment; imports (which are a subtraction to GDP) increased. Compared to the previous quarter's growth rate of 4.9%, the deceleration in the fourth quarter reflected slowdowns in private inventory investment, federal government spending, residential fixed investment, and consumer spending; imports turned down. By the end of Q4 2023 the unemployment rate decreased to 3.7%, slightly below the 3.8% level seen at the end of Q3, but higher than the 3.5% level seen at the end of 2022. In December the economy added 216,000 jobs with gains occurring in government, health care, social assistance, and construction.

The consumer price index (CPI) rose 3.4% from a year ago, above the 3.2% consensus estimate. The largest changes year-over-year were drops in prices for energy and energy services, where were led by price decreases for utility gas services and fuel, which were down 13.8% and 14.7% respectively. This was partially offset by rising prices for food, which increased 2.7%. Core CPI, which excludes volatile food and energy prices, rose 3.9% from a year ago, largely driven by the increased pricing in non-energy services, such as transportation and shelter. Housing starts finished the quarter at a seasonally adjusted annualized rate of 1.46 million for December, up 7.6% from the same period last year. The median existing home sale price at the end of the fourth quarter was $385,800, down 2.9% from the end of the previous quarter.

Public Equity Markets: U.S. equities posted strong gains driven by expectations on imminent interest rate cuts. The S&P 500 Index finished the year just below its highest level that was seen in 2022. The interest rate sensitive real estate and IT sectors of the S&P 500 Index rallied the most while only the energy sector declined during the quarter. Small cap equities outperformed their larger cap counterparts, with value outperforming within small cap stocks. Our combined domestic equity portfolio posted a gain of 11.5%, trailing the 12.1% return of the Russell 3000 Index



International developed markets trailed their U.S. counterparts, advancing 10.4% for the quarter. In Europe, stocks rallied on softer inflation numbers, which raised hopes that interest rates may not only have peaked, but that cuts could soon be expected. Japanese markets ended the quarter in positive territory helped by the gains in November when investor sentiment improved due to expectations for interest rate cuts in the U.S. The appreciation in the yen, however, weighed on sentiment in December. Asia ex-Japan equities advanced on renewed investor appetite for risk assets across the region after hopes that U.S. interest rates may have peaked. Taiwan, South Korea, and India were the strongest index markets in the region.

Despite pressure early in the quarter, when rising bond yields and conflict in the Middle East weighed on emerging market (EM) returns, overall EM equities posted positive returns for the quarter, albeit behind developed market equities. Signs of a “soft landing” for the US economy and increased expectations for interest rate cuts in 2024 were supportive. However, China continued to be a drag on broad EM performance. Poland was the top performer over the quarter as markets welcomed the election of a pro-EU liberal coalition government. Peru, Egypt, and Mexico also posted strong double-digit returns. China and Turkey were the largest detractors. Mixed economic data from China continued to suggest a lackluster economic recovery and stimulus measures remained limited. The ongoing real estate crisis continued to weigh on sentiment while worries about pressure on tech companies from potential gaming regulation also had a negative impact later in the quarter. Despite an apparent shift to a more orthodox monetary policy given a number of interest rate hikes over the quarter, Turkey was the worst performing index market, with inflation still above 60%. Our combined international equity performance was up 10.3%, outperforming the 9.7% return recorded by the benchmark. Our global equity allocation posted an 11.5% gain, outperforming the 11.0% return of the MSCI ACWI Index.

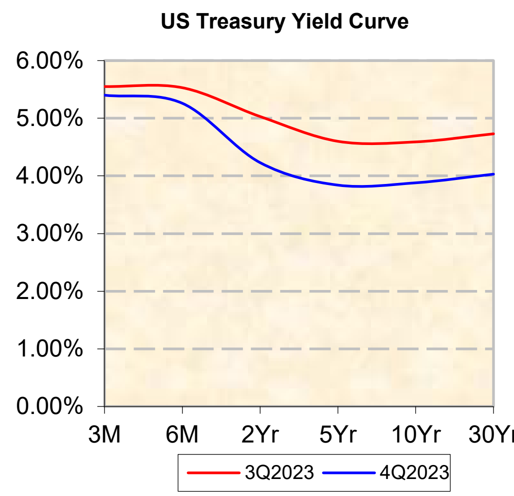
Private Equity: During the fourth quarter, a total of 465 funds reached their final close, securing $219 billion in commitments. The number of funds raised rose 7% relative to Q3, but declined 54% when compared to the same quarter a year prior. The aggregate capital raised in Q4 fell 3% relative to the prior quarter and 14% compared to the same period last year. North America dominated the fundraising landscape, representing 77% of the aggregate capital raised and 60% of the total number of funds raised, both increasing relative to the prior quarter. U.S. buyout deal activity increased relative to the prior quarter as the number of deals increased 8% to 1,109, the aggregate deal volume jumped 28% to $109 billion, and the average deal size rose 3% to $864 million. The buyout deal activity levels were roughly in line with those seen during the last quarter of 2022. Healthcare was the most robust sector during the quarter, representing 26% of aggregate U.S. buyout deal value. Buyout exit activity for the quarter continued to tick up with the number of exits increasing 8% to 219 and the aggregate exit values jumping 49% to $100 billion; the average exit size fell 9.9% relative to the prior quarter and 26% compared to the same period last year. The global private equity sector has $2.7 trillion in dry powder and continues to hover around record highs.

U.S. venture fundraising activity began to rebound in Q4, with the number of funds raised increasing 18% to 156, although still down 57% compared to the same period last year. The aggregate capital raised increased 125% to $16 billion and the average fund size increased 116% to $151 million, relative to the prior quarter. However, U.S. venture dealmaking activity decreased throughout Q4 with the number of deals consummated down 9% to 1,321, the aggregate deal volume sinking 20% to $29 billion, and the average deal size falling 11% to $28 million.

During the quarter, our private equity managers called a combined $24.7 million and paid distributions of $37.1 million. Our current allocation to private equity is 18.7%, with a market value of $897 million. From its 2003 inception through September 30, 2023, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 13.7% versus a 13.0% 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 22.7% return versus 15.6% for the benchmark.

Hedge Funds: For the quarter, industry-wide hedge funds rose by 4.2% based on the HFRI Composite Index. On a sub-strategy basis, the Event-Driven Index gained 5.5%, the Relative Value Index advanced 2.6%, the Equity Hedge Index increased 6.4%, and the Macro Index fell by 0.8%. The System's diversifying hedge funds recorded a gain of 2.3% versus a gain of 1.1% for the Conservative Index. The diversifying portfolio outperformance is primarily attributable to strong selection within the quant and global macro sectors. The System's directional hedge funds recorded a gain of 2.1% compared to the positive 6.5% return for the Strategic Index. The directional underperformance is primarily attributable to the credit sector where returns, though positive, lagged the performance of the overall index.

Fixed Income: The yield curve shifted down as both short and long dated Treasury yields moved lower. However, long-term Treasury bonds moved lower than shorter-dated Treasury bills. For example, the yield on the 3-month bill maturities moved down 15 bps to 5.4%, while the 10- and 30-year bond maturities decreased by 71 and 70 bps respectively. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, steepened and ended the quarter at -35 bps, 9 bps steeper than the previous quarter's level. By the end of the quarter, the 10-year Treasury yield was 3.88% whereas the 30-year Treasury yield was 4.03%. The high yield portfolio's performance for the quarter was a gain of 6.7%, underperforming the Merrill Lynch High Yield II Constrained Index by 0.3%. The long duration portfolio's return for the quarter was a gain of 13.1%, outperforming the custom long duration benchmark by 0.2%. The emerging market debt portfolio gained 10.5%, outperforming the JPM EMBI Global Diversified benchmark by 1.4%. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a gain of 8.5%, underperforming the custom benchmark by 3.9%. The underperformance was driven primarily by the overlay, where the strategy's alphas in equities, nominal long rates, long/short cash, and developed currencies detracted from results.



Private Debt: In Q4 of 2023, private debt funds raised $39.8 billion from 38 funds, which was a return to a weaker fundraising environment after a strong previous two quarters. Out of the total fundraising activity in the quarter, North America focused funds raised $20.4 billion, while the aggregate capital raised for Europe-focused funds totaled $12.0 billion. Special situations funds led fundraising with $11.4 billion (44.5% of the private debt capital raised during the quarter), followed by direct lending funds with $11.4 billion. Some of the largest funds closed during the quarter were the $6.6 billion Ares Pathfinder Fund II in Europe, and the $4.1 billion Kennedy Lewis Capital Partners Master Fund III in North America. In Asia, the SSG Capital Partners VI (managed by Ares SSG) closed at $2.4 billion. Dry powder as of December 2023 was $445 billion, which was the highest amount recorded by Preqin.

During the quarter, our private debt managers called a combined $20.8 million and paid distributions of $15.0 million. Our current allocation to private debt is 4.2%, with a market value of $203.9 million. From 2013 through September 30, 2023, the private debt program generated a net internal rate of return of 11.6% versus an 6.6% 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 declined due to supply and demand imbalances in the office, apartment, and industrial sectors, while private real assets increased due to strong inflation linked cash flows. Infrastructure fundraising picked up as 28 funds raised $68.3 billion compared to 15 funds raising $5.0 billion in the prior quarter. Real estate prices were down 3.0% for the quarter driven by a 5.4% decline in office values, 3.0% decline in apartments, and a 2.3% decline in industrial properties. The only sector to advance were hotels, which were up 1.8%. Fundraising picked as 106 funds raised $30.5 billion compared to 78 funds raising $27.6 billion in the prior quarter.

During the quarter, our private real asset managers called a combined $24.5 million and paid distributions of $6.2 million. Our current allocation to private real assets is 10.7%, with a market value of $511.9 million. From its 2006 inception through September 30, 2023, the total private real assets program (including fund-of-funds) has generated a net internal rate of return of 7.1% versus a 7.6% 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 gain of 15.6% for the quarter, outperforming bonds (Barclays Global Aggregate, 8.1%) and global equities (MSCI World, 11.5%). After a slow start to the quarter, the rate sensitive REIT sector noticeably outperformed. The rally was initially sparked by a more benign than anticipated US Treasury quarterly refunding announcement that slowed the pace of long-term debt issuance, a series of muted inflation readings and softer economic data. Dovish signals from the Fed's December FOMC meeting provided a second leg up for equities. During the quarter, Europe was the best performing region, aided by a meaningful currency tailwind. Weaker economic data in the region continued to pull forward expectations of a dovish central bank pivot. The more highly leveraged Nordics led the way and the US also performed strongly specifically in more cyclical sectors such as retail and hospitality. Asia continued to be held back by concerns over the tepidness of China stimulus and its degree of support for the ailing property sector.

Listed infrastructure securities posted a gain of 12.1% during the quarter as measured by the Dow Jones Brookfield Global Infrastructure Index, slightly outperforming global equities (MSCI World, 11.5%) and bonds (Barclays Global Aggregate, 8.1%). Overall, for the quarter, communications, toll roads, European Regulated utilities, and diversified equities outperformed the index, while other utilities, ports, gas midstream, gas distribution utilities, water & waste, and electricity transmission & distribution underperformed. Airports and pipeline companies performed almost in line with the index. For infrastructure, while the impact of a decline in interest rates was undoubtedly positive, there was a significant dispersion of returns at the underlying subsector level, some of which ran counter to a typical, lower interest rate environment. Notably, while all subsectors realized positive Q4 returns, the communications sector materially outperformed its defensive utility sector counterparts, despite the perception of utilities being some of the most interest rate sensitive equities. In terms of magnitude, communications advanced a strong 25.6% in the quarter, with most utility sub-sectors up only high single digit to mid-teen percentages.

For the quarter, the public real asset portfolio gained 13.6%, below the custom benchmark's gain of 13.8% primarily due to underperformance by our Global Listed Infrastructure 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 December, 2023, and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 12/31/2023	Fiscal YTD
Employer Contributions	$ 20.6	$ 34.9
Member Contributions	10.6	19.3
Net Investment Income (Loss)	291.2	155.1
	$ 322.4	$ 209.3

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 12/31/2023	Fiscal YTD
Benefits	$ 79.0	$ 156.7
Refunds	6.7	11.1
Administrative Expenses	1.0	2.0
	$ 86.7	$ 169.8

Outlook

The International Monetary Fund (IMF) projects global growth at 3.1% in 2024 and 3.2% in 2025, with the 2024 forecast 0.2% higher than that projected in the IMF's October 2023 forecasts. The improved projection is the result of greater-than-expected resilience in the United States and several large emerging markets, as well as fiscal support in China. Despite the improvement in forecasts, headwinds remain including elevated central bank policy rates to fight inflation, a withdrawal of fiscal support amid high debt weighing on economic activity, and low underlying productivity growth. Inflation is falling faster than expected in most regions, as supply-side issues and restrictive monetary policy unwind. Global headline inflation is expected to fall to 5.8% in 2024 and to 4.4% in 2025.

The likelihood of a hard landing has diminished given current disinflation and steady growth, with experts predicting two likely scenarios in the near-term. On the upside, faster disinflation could lead to further easing of financial conditions. Looser fiscal policy than assumed and necessary in the projections could imply temporarily higher growth, but at the risk of a more costly adjustment later on. Stronger structural reform momentum could bolster productivity with positive cross-border spillovers. On the downside, new commodity price spikes from geopolitical shocks—including continued attacks in the Red Sea—and supply disruptions or more persistent underlying inflation could prolong tight monetary conditions. Policymakers' near-term challenge is to successfully manage the final descent of inflation to target, calibrating monetary policy in response to underlying inflation dynamics and adjusting to a less restrictive stance.

In the U.S., most experts now agree that a soft-landing is within grasp and that the Federal Reserve should begin to cut rates in the near-term, but important headwinds remain. Monetary policy is restrictive as evidenced by the deeply inverted Treasury yield curve. The labor market needs to soften further to put the nail in the coffin of the inflation overshoot. Meanwhile, consumers—a source of strength in Q4—are depleting their excess savings, delinquency rates are rising, and budgets are being stretched with a shift in spending toward necessities and discounted brands. As a result of these concerns, the IMF is projecting U.S. growth will fall from 2.5% in 2023 to 2.1% in 2024 and 1.7% in 2025, with the lagged effects of monetary policy tightening, gradual fiscal tightening, and a softening in labor markets slowing aggregate demand.

In the eurozone, interest rate markets are pricing only 100 bps of ECB easing in 2024, which could dampen the area's recovery. Additionally, the region faces other headwinds such as a restrictive monetary policy, sluggish growth in China, and weak global trade. Growth in the euro area is projected to recover from its low rate of an estimated 0.5% in 2023 to 0.9% in 2024 and 1.7% in 2025. The recovery is expected to be driven by stronger household consumption as the effects of the shock to energy prices and inflation subside. Those numbers, however, continue to represent below-trend growth.

UK inflation also moderated more than expected over the period. Growth in the UK is projected to rise modestly from an estimated 0.5% in 2023 to 0.6% in 2024, as the lagged negative effects of high energy prices wane, then to 1.6% in 2025, as disinflation allows an easing in financial conditions and permits real incomes to recover.

Overall macroeconomic conditions in Japan remained resilient, as reports from the Bank of Japan (BOJ) showed continuous improvement in business sentiment for both the manufacturing and non-manufacturing sectors. In October, the BOJ took gradual steps to normalize its extraordinary monetary easing policy and continued to hint that they are likely to take further actions early 2024. Notwithstanding these positives, the IMF is projecting a decline in growth from an estimated 1.9% in 2023 to 0.9% in 2024 and 0.8% in 2025, reflecting the fading of one-off factors that supported activity in 2023, including a depreciated yen, pent-up demand, and a recovery in business investment.

In emerging markets (EM), signs of a soft landing for the U.S. economy and increased expectations for interest rate cuts in 2024 were supportive. Broadly, growth in these countries is expected to remain at 4.1% in 2024 and to rise to 4.2% in 2025. However, there could be significant divergence in growth across countries. EM ex-China equities have shown resilience in the face of elevated global interest rates, partly due to reforms, domestic consumption, and healthy balance sheets. Prior reforms have enabled India and Mexico to attract foreign investment and raise capital expenditure, benefits which should trickle down to households and businesses. Meanwhile, equities in South Korea and Taiwan appear likely to recover from an improving technology cycle. In China, fiscal policy should be a dominant factor through 2024 as the Chinese government continues with incremental new policies to support the economy. The property market will continue to be a watchpoint, and the potential for a global recession could weigh on exports. Inflation is likely to increase through the year but should remain below the government's target of 3%.

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

December 31, 2023

Assets	
Equity in pooled cash and investments	$ 446,898
Investments:	
Northern Trust	4,806,621,441
Aetna	527,839
Fidelity - Elected Officials Plan	1,101,472
Fidelity - DRSP/DROP	14,877,619
Total investments	4,823,128,371
Contributions receivable	3,898,455
Total assets	4,827,473,724
Liabilities	
Benefits payable and other liabilities	9,673,902
Net position restricted for pensions	**$ 4,817,799,822**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

For the Quarter Ended December 31, 2023

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 20,627,185	$ 34,895,276
Member	10,576,250	19,266,323
Total contributions	31,203,435	54,161,599
Investment Income	295,768,533	163,334,291
Less investment expenses	4,601,276	8,234,641
Net investment Income	291,167,257	155,099,650
Total income	322,370,692	209,261,249
Deductions		
Retiree benefits	60,538,211	119,901,836
Disability benefits	15,278,388	30,519,836
Survivor benefits	3,189,704	6,260,696
Refunds	6,690,893	11,076,237
Administrative expenses	979,431	1,971,711
Total deductions	86,676,627	169,730,316
Net Loss	**235,694,065**	**39,530,933**
Net position restricted for pensions		
Beginning of period	**4,582,105,757**	**4,778,268,889**
End of period	**$ 4,817,799,822**	**$ 4,817,799,822**