OFFICES OF THE COUNTY EXECUTIVE

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October 10, 2017

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 June 30, 2017. 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 5,741 ERS and GRIP active members and 6,509 retirees participating in the ERS as of June 30, 2017.

Performance Results

The total return achieved by the ERS' assets for the quarter was a gain of 3.02%, 70 basis points ahead of the 2.32% gain recorded by the policy benchmark. For the one-year period ending June 30, 2017 the ERS' gross return (before fees) was a gain of 12.12%, 316 basis points ahead of the 8.96% gain recorded by the policy benchmark. The one-year gross return places the ERS' performance slightly below median of the universe of comparable pension funds constructed by the Board's consultant, Wilshire Associates. Our annualized performance of 5.53% for the three-year period and 8.93% for the five-year period ranked at the median of the universe for both time periods. The annualized return for the ten-year period was 6.36%, and ranks in the first quartile of Wilshire's Large Public Funds Universe. The asset allocation at June 30, 2017 was: Domestic Equities 19.2%, International Equities 16.2%, Global Equities 3.2%, Fixed Income 22.8%, Inflation Linked Bonds 11.6%, Public Real Assets 9.5%, Private Equity 7.6%, Private Real Assets 4.9%, Private Debt 1.0%, Opportunistic 2.9%, and Cash 1.1%. We estimate that the funded status of the ERS was 95.4% as of June 30, 2017. The actual funded status will be affected by the ERS' membership experience, as well as demographic and economic changes and may be higher or lower when calculated by the actuary during the next valuation.

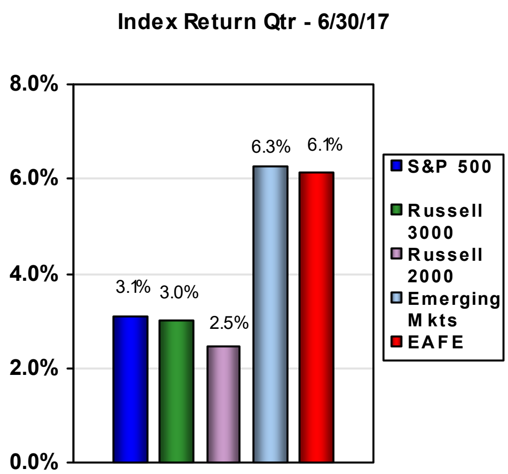
Major Initiatives

During the quarter, the following commitments were made: $10 million to 2017 Franklin Park International Series, a private equity fund-of-funds, $10 million to Franklin Park's 2017 Venture Series, a private equity fund-of-funds, $15 million to Whitehorse, a private debt fund, and $19 million to BV Investment Partners, a private equity fund.

Capital Markets and Economic Conditions

Economic data reflected that the GDP increased at an annualized 2.6% rate in the second quarter of 2017, matching market expectations. This reflects the 96th month of growth since the Great Recession and marks the third-longest economic expansion in U.S. history. GDP growth reflected increases in both consumer spending on goods and services as well as increases in business investment, exports, and federal government spending. Consumer spending was led by increases in housing and utilities, health care, recreational goods and vehicles. Business spending benefited from increases in structures, equipment, and intellectual property products. The 8.2% increase in equipment spending was the fastest in nearly two years and the third straight quarterly increase. In contrast, residential fixed investment declined and both exports and nonresidential fixed investment slowed. The 6.8% decline in investment on homebuilding was the worst decline in seven years. Meanwhile, auto production declined for a third straight quarter. Wage growth decelerated to 0.5% in the second quarter versus 0.8% in the first quarter, despite an unemployment rate that averaged 4.4% during the second quarter, which was not seen since pre-crisis 2007. CPI was subdued in the second quarter, with the price index excluding food and energy increasing at a 0.9% rate, which was the slowest rise in more than two years following a 1.8% increase in the first quarter.

Public Equity Markets: U.S. equities continued their strong performance in Q2, advancing to all-time highs as the market was supported by positive economic reports as well as a solid corporate earnings season. Benign global economic conditions remained supportive for equities, resulting in exceedingly low volatility. The weakening U.S. dollar created a more favorable environment for growth and large cap equities, as these companies tend to be more exposed to international markets. U.S. markets were led by Health Care, Industrials, Financials, and Technology while Energy and Telecom experienced losses. Health Care stocks posted robust gains in Q2 as the Senate proposed an industry-friendly plan to reform the U.S. Health Care system. Additionally, over 80% of Health Care stocks beat earnings estimates. Telecom was the worst performing sector due to weak top-line growth of the two largest telecom providers, AT&T and Verizon. Our combined domestic equity performance was a gain of 3.39%, outperforming the 3.02% gain of the Russell 3000 Index. Manager selection was positive but our overweight to small cap negatively impacted performance



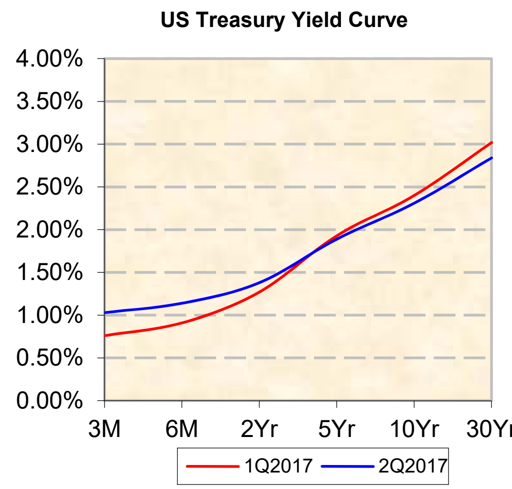
International and developed equity markets maintained their momentum relative to U.S. markets as the trade-weighted U.S. Dollar Index dropped by 1.5% during Q2. France was the strongest performer for the quarter as markets were relieved by Emmanuel Macron's victory over Marine Le Pen in the presidential election. Within developed markets, Europe outperformed Asia as France, Switzerland, Spain, and the UK delivered strong performance. Japan performed well while weakness in the natural resources sector proved a headwind for Australia. Much like their U.S. counterparts, the top performing sectors were Health Care, Industrials, Technology, and Financials while the worst performing sectors were Energy and Telecom. Emerging markets generated gains during the quarter led by China, which saw large technology companies like Tencent and Alibaba post returns north of 20%. Russia and Brazil suffered losses during the quarter due to weakness in the commodity sectors. Our combined international equity performance was a gain of 7.50%, outperforming the 5.83% gain recorded by the benchmark index. Our global equity allocation returned 6.22%, outperforming the 4.27% gain of the MSCI ACWI benchmark.

Private Equity: Buyout funds raised $88 billion which was the largest amount of any second quarter in the last five years. The aggregate value of buyout deals was higher for North America and Asia while Europe and the rest of the World saw declining values versus the previous quarter. Four of the five largest buyout deals of Q2 2017 were for companies in North America – the largest transaction was the public-to-private acquisition of Staples. There was a 9% decline in exit activity versus the previous quarter, totaling 381 exits for an aggregate of $59B, representing the lowest quarterly number since Q2 2010. The downward trend of PE exits is driven by the cyclical nature of the industry and a return to normalcy (e.g. after the M&A activity reached a record level in 2016 by strategic acquirers). Venture funds have seen the lowest number of funds (92) closed since 2013, as well as the smallest amount ($16B) of capital raised in the last three years. The North America focused venture capital fundraising accounted for 74% of capital raised during the quarter. The aggregate value of venture deals ($47B) in the quarter was 26% higher (a five-year high) than the previous quarter. Meanwhile the number of venture capital deals (936) in North America fell for the eighth consecutive quarter, the lowest number since 2009. Venture capital exit activity continued to gradually decline from historical levels as companies stayed private longer due to favorable late-stage capital availability.

During the quarter, our private equity managers called a combined $22.4 million and paid distributions of $19.9 million. Our current allocation to private equity is 7.37%, with a market value of $288.1 million. From its 2003 inception through March 31, 2017, the total private equity program (including fund-of-funds) has generated a net internal rate of return of 9.5% versus a 12.1% return for the dollar-weighted public market equivalent (the Russell 3000 Index plus 300 bps). The direct private equity program generated a 17.8% return versus 16.9% for the benchmark since inception (2009).

Opportunistic: Hedge funds, as measured by the HFRI Fund Weighted Composite Index, gained 1.05% in the second quarter. On a sub-strategy basis, the HFRI Event-Driven Index rose 1.06%, the HFRI Relative Value Index gained 0.59%, the HFRI Equity Hedge Index advanced 1.97%, and the HFRI Macro Index was down 0.33%. The opportunistic portfolio returned 0.89% in the second quarter, trailing the 1.23% gain of the HFRI Fund of Funds Index primarily due to underperformance from the portfolio's equity long/short market neutral manager.

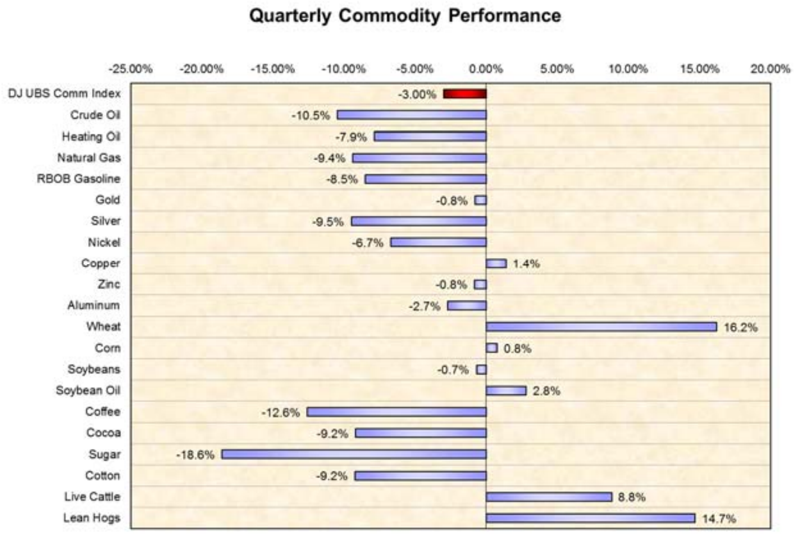
Fixed Income: The yield curve flattened during the quarter, as the Fed raised short-term rates by another 25 bps, citing the relatively steady growth of the economy and the desire to return to normalized interest rate levels. However, the long end of the yield curve declined, as inflation remained persistently low and below the Fed's target of 2%. Long-term yields also reversed after a sharp rise in Q4 2016, as prospects for tax reform, deregulation, and fiscal stimulus by the new administration have subsequently faded. The yield on the 30-year bond decreased by 18 bps during the quarter, and ended the period at 2.84%. The spread between 2-year and 10-year Treasuries, the main gauge of the yield curve, narrowed by 20 bps to 93 bps. For the quarter, the 2-year Treasury yield ended at 1.38%, up by 11 bps from the prior period, while the 10-year Treasury yield moved down by 9 bps to 2.31%. For the quarter, the Merrill Lynch High Yield II Constrained Index rose by 2.14%, the Barclays Aggregate was up 1.45%, and the Barclays Long Govt/Credit Index recorded a gain of 4.39%. The fixed income portfolio's performance for the quarter was a gain of 3.09%, in-line with the custom benchmark's gain of 3.07%. Our global inflation-linked bond portfolio, combined with a portable alpha overlay, recorded a loss of 2.30% for the quarter, underperforming the custom benchmark's loss of 0.95%.



Private Debt: Private debt fundraising in the second quarter saw 28 funds reach a final close, securing a total of $16 billion in capital commitments from investors. This was a slight reduction in the pacing of recent fundraising activity, as quarterly fundraising since 2013 has seen an average of 37 funds close on $22 billion in aggregate capital. Direct lending and distressed debt vehicles made up 75% of the capital secured by private debt funds during the second quarter, closing on $6.4 billion and $5.5 billion, respectively. Of the 28 funds who reached a final close, 19 of them are North American focused. During the quarter, our private debt managers called a combined $8.8 million and paid distributions of $2.9 million. Our current allocation to private debt is 0.96%, with a market value of $37.6 million. From inception through March 31, 2017, the private debt program generated a net internal rate of return of 12.1% versus a 8.5% return for the dollar-weighted public market equivalent benchmark (BofA Merrill Lynch High Yield Master II Constrained + 300 bps).

Private Real Assets: U.S. real estate returns have continued to remain stable and modest. The NCREIF Property Index (NPI), a measure of private commercial real estate properties in the U.S., gained 1.8% in the second quarter 2017, up from 1.6% last quarter, but below the 2.0% returned in the same quarter a year ago. The 1.8% total return consisted of a 1.2% income component and 0.6% appreciation. The Industrial sector continues to lead performance by property type with total returns of 3.1% in the second quarter. Apartments had the lowest return at 1.5% reflecting the lowest income return across property types at 1.1%. Within the upstream oil and gas sector, there was a significant drop in total upstream M&A spending due to a lack of transactions in the Permian Basin during the quarter as investors focused on cheaper basins. During the quarter, our private real assets managers called a combined $11.8 million and paid distributions of $23.3 million. Our current allocation to private real assets is 4.8%, with a market value of $187.2 million. From its 2006 inception through December 30, 2016, the private real assets program (including fund-of-funds) has generated a net internal rate of return of 5.5% versus a 6.6% gain for the long-term benchmark CPI plus 500 bps. Underperformance is primarily due to real estate commitments prior to the financial crisis of 2008 and a private oil and gas fund in 2010.

Public Real Assets: The Bloomberg Commodity Index fell 3.0% as weakness in the energy markets offset gains in grains and livestock sectors. Energy prices declined due to an increasing U.S. rig count, rising U.S. output and recovering production from Libya and Nigeria. Grain prices rallied as the result of adverse weather conditions in key global producing regions. Industrial metals were unchanged, except for nickel, which declined due to a relaxation of the Indonesian export ban. Precious metals declined due to an increase in the U.S. federal funds target rate and waning demand. Livestock advanced on strong demand for meat and resumption of beef exports to China.



Global listed real estate securities as measured by the FTSE EPRA/NAREIT Developed Index advanced 2.7% led by the strong performance of Germany, Sweden, France, Netherlands and the UK. Following the elections in France, the risk of rising populism in continental Europe has eased and improving economic conditions are reflected in higher office occupancy levels in major European cities. U.S. retail REITs lagged as investors have been wary of store-closings and negative sentiment around brick and mortar retail sales relative to e-commerce. Returns in Japan were below average as JREITs were hurt by investment fund outflows.

Master Limited Partnerships (MLPs), as measured by the Alerian MLP Total Return Index, declined 6.4% as lower petroleum prices are negatively impacting investor sentiment and MLP prices.

For the quarter, the public real asset portfolio declined 0.26%, underperforming the custom benchmark by 55 bps due to underperformance by the active 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 June 30, 2017 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 6/30/2017	Fiscal YTD
Employer Contributions	$ 20.6	$ 95.4
Member Contributions	10.0	27.9
Net Investment Gain	113.5	400.9
	$ 144.1	$ 524.2

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 6/30/2017	Fiscal YTD
Benefits	$ 59.8	$ 235.1
Refunds	1.4	6.5
Administrative Expenses	1.0	3.2
	$ 62.2	$ 244.8

Outlook

The Federal Reserve increased the federal funds rate to 1.0% from 0.75% at their June meeting, representing the second rate increase in 2017 and the fourth rate increase since the financial crisis. The Fed also provided guidance on how it plans to unwind its $4.5 trillion balance sheet, which has expanded significantly since 2008 and includes treasuries, mortgage-backed securities, and government agency debt. They indicated that they would begin allowing $6B per month of maturing treasuries to run off their balance sheet without reinvesting and that this level will increase by $6B per quarter until reaching a level of $30B per month. For agency and mortgage debt, they will allow $4B per month to run off initially until allowing it to reach $20B per month. The Fed's growth expectations increased slightly since March, increasing from 2.1% to 2.2%. Inflation expectations have decreased as the Fed is now projecting a 1.6%-1.7% increase, which is down from the 1.8%-1.9% forecast in March. The 10-year breakeven inflation rate also decreased by roughly 25bps during the quarter.

In June, the Bank of England (BOE) kept its benchmark interest rate unchanged at 0.25% but the market was surprised that 3 BOE officials called for higher interest rates. These officials have become concerned with increasing levels of inflation as the Brexit vote has weakened the pound, increasing import prices. Real GDP growth has also decreased during the year due to weak consumer spending as well as higher than expected inflation. The European Central Bank (ECB) left its benchmark interest rate unchanged at 0% during their June meeting, which was expected by market participants. ECB President, Mario Draghi, also indicated that he expects rates to remain at 0.0% into their foreseeable future but that the ECB would be ready to extend their quantitative easing program if needed. The Bank of Japan (BOJ) kept its benchmark rate unchanged at -0.1% as inflation expectations decreased from 1.4% to 1.1%.

The domestic economy is likely to continue to grow at a moderate pace in the 2.0-2.5% range over the remainder of 2018.

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

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2017

Assets		
Equity in pooled cash and investments	$	86,255
Investments:		
Northern Trust		3,923,106,610
Aetna		919,081
Fidelity - Elected Officials Plan		605,269
Fidelity - DRSP/DROP		7,604,407
Total investments		3,932,235,367
Contributions receivable		7,025,652
Capital assets		900,043
Less depreciation		900,043
Net capital assets		0
Total assets		3,939,347,274
Liabilities		
Benefits payable and other liabilities		5,841,863
Net position restricted for pensions	**$**	**3,933,505,411**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
June 30, 2017

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 20,563,911	$ 95,398,957
Member	10,003,909	27,940,416
Total contributions	30,567,820	123,339,373
Investment income	118,716,057	418,734,994
Less investment expenses	5,221,163	17,822,045
Net investment income	113,494,894	400,912,949
Total additions	144,062,714	524,252,322
Deductions		
Retiree benefits	44,582,185	175,048,758
Disability benefits	12,800,379	50,741,385
Survivor benefits	2,384,355	9,334,089
Refunds	1,365,974	6,473,277
Administrative expenses	1,023,347	3,178,718
Total deductions	62,156,240	244,776,227
Net increase	**81,906,474**	**279,476,095**
Net position restricted for pensions		
Beginning of period	**3,839,172,235**	**3,641,602,614**
End of period	**$ 3,921,078,709**	**$ 3,921,078,709**