CIO REPORT

MERS' Investment Philosophy

- Value investing philosophy
- Disciplined investment process
- Globally diversified
- May lag in periods of extended bull markets
- Focus on risk-adjusted returns

MERS' Office of Investments Goals

- Maintain adequate liquidity
- Minimize costs
- Exceed the actuarial rate assumption on a long-term basis
- Exceed the Policy Benchmark[1] on a long-term basis

Economic and Market Summary

Financial markets experienced slower momentum in the third quarter. The U.S. administration's evolving trade policy and a strong dollar continue to put pressure on EM markets, particularly those that are commodity and export dependent. With market and geopolitical volatility, U.S. economic data started to show some weakening. The Conference Board's US index of leading economic indicators declined slightly during the 3rd quarter, as signs of dwindling momentum are beginning to emerge. The monthly jobs report came in below expectations, with 136,000 jobs added in September versus expectations of 145,000. The economy remains at full employment and upward pressure on wages continued. The unemployment rate hit a 50-year low of 3.5%. Earnings per share growth expectations for the S&P 500 has decreased with just under 1% growth still expected for 2019. In fixed income, the Fed committed itself to a more dovish policy stance with a rate cut in August and also in September. Inflation continued to moderate with the Consumer Price Index remaining at 1.7% in September. Globally, the European recovery has begun to cool with Q2 GDP dropping to 1.2% YOY, well below the U.S. growth rate of 2.3% YOY. Instability related to uncertain U.S. trade policy may continue to weigh on markets and pose potential risks to global economic growth. Tensions between global powers in the Middle East and competition with China are also expected to add to volatility in the coming year.

Portfolio Performance Review

MERS' Total Portfolio returned 0.53% for the quarter and 8.82% year-to-date. The portfolio underperformed the Policy Benchmark for the quarter by 19 bps. The Fund has delivered strong absolute returns for the year but continues to maintain lower risk positioning across the portfolio which has detracted from relative performance. The portfolio underperformed the broad policy benchmark due to an underweight to equities, shorter duration fixed income positioning, and an overweight to international and emerging market equities. The Global Equity portfolio returned -0.96% on the quarter, underperforming the global equity policy blend by 126 bps. Relative returns were driven down by emerging market equities, which underperformed U.S. equites on a relative basis. Global Fixed Income returned 2.15% on the quarter, outperforming the global fixed income policy blend by 74 bps. U.S Core Fixed Income came in the strongest fixed income sub-asset class returning 2.57% for the quarter. The Private Assets portfolio returned 2.51%, led by the Private Equity portfolio which returned 4.51%. Commodities and Timber were also strong performers. Diversifying Strategies outperformed public markets, with a return of 1.71% on the quarter. MERS' Defined Benefit (DB) portfolio assets are $10.81 billion and MERS' total assets are $11.71 billion.

Risk and Trends

Economic Risks

- Escalating trade war tensions
- Monetary policy mistakes
- Corporate/government debt levels
- Eurozone instability

Medium-Term Trends

- Rise of populism
- Investment industry consolidation
- Rise of passive investing
- In-sourcing

Long-Term Trends

- Aging population/workforce
- Rising taxes/entitlement costs
- Aging infrastructure
- Competition for resources
- Rise of ESG

Projects and Initiatives

- Formally launching the Valuation Based Allocation (VBA) program on July 1, 2019
- Incorporating ETFs into the VBA program and internal strategies
- Researching the role of active management in sub-asset classes
- Custodial bank transition
- Enhancing internal equity portfolio models

1 The Policy Benchmark consists of: 45% Russell 3000, 20% MSCI ACWI ex USA IMI (net), 25% Bloomberg Barclays US Aggregate, and Bloomberg Barclays Global Aggregate ex US

Asset Class Valuation Summary

Value/Price Discrepancy[2]

Asset Class	Overvalued	Undervalued
US Equity	-43.20%	
Europe Equity		18.20%
Japan Equity		11.30%
EM Equity		25.90%
US Treasury	-8.80%	
EMD	-6.90%	
US IG	-16.40%	
US HY	-10.90%	

2 The value/price discrepancy is a ratio that compares the estimated fair value of an asset relative to its current market price. Overvalued assets have prices above estimated fair value and are expressed as a negative percentage and undervalued assets have prices below estimated fair value and are expressed as a positive percentage.

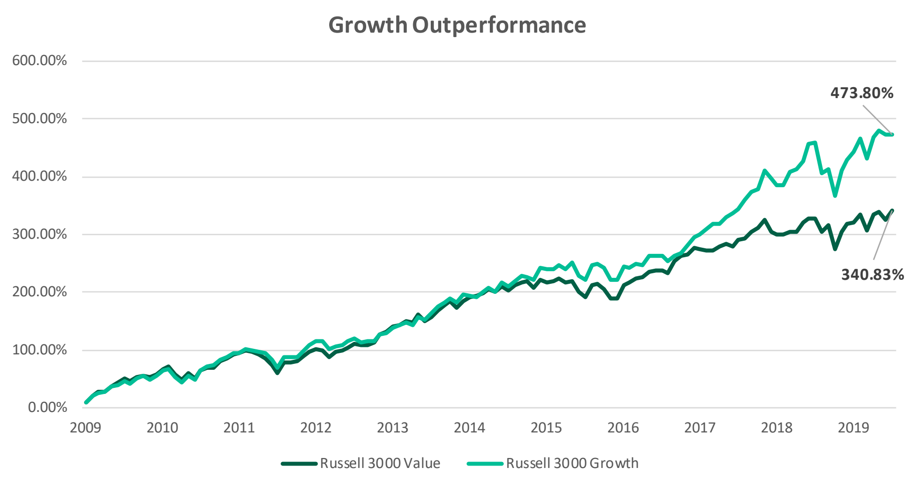
Equity Market Outlook

- Valuation multiples are elevated in the US and current earnings remain above estimated trend earnings as a result of cyclically high profit margins, low interest rates, and tax reform.
- Valuation multiples and earnings are expected to revert to long-term averages resulting in lower expected returns for US equities.
- Valuations are more favorable in Europe, Japan, and Emerging Markets
- European earnings are currently below trend which is expected to contribute to returns going forward as earnings recover to long-term cyclically-adjusted levels.
- In Emerging Markets, a modest recovery from current below-trend earnings and strong trend earnings growth is expected to drive long-term returns

Fixed Income Market Outlook

- All fixed income asset classes are overvalued due to current market interest rates being lower than MERS' long-term assumptions.
- U.S. Investment Grade Fixed Income and U.S. High Yield Debt are the most overvalued owing to the current historically low credit spreads in those asset classes.
- In MERS' view, these historically low credit spreads do not compensate investors for future defaults.
- Emerging Market Debt spreads are near fair value but the asset class is still overvalued as a result of low interest rates which are forecasted to rise

Chart of the Quarter



Since the end of the Global Financial Crisis in Q1 2009, US equity markets have seen a huge outperformance in growth stocks relative to value. Over time, this trend has shown to not persist. MERS Office of Investments believes this outperformance is unsustainable and value stocks should offer more compelling valuations and returns going forward. The portfolio is positioned to capitalize on this convergence back to value in the long-term.

Assets by Program