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Guide to Mercer's investment strategy research ratings

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A business of Marsh McLennan

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Introduction

This is a guide to the investment strategy research ratings (herein referred to as rating[s]) produced by Mercer's Investments business (herein referred to as "Mercer" or "we" or "our").

The guide describes what the ratings are intended to mean and how they should and should not be interpreted.

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What do the ratings signify?

Mercer's ratings generally signify our forward looking opinion of an investment strategy's prospects for meeting its expected performance objectives, over a relevant timeframe. This may be either outperforming a suitable benchmark or achieving other specific performance objectives over a time frame appropriate for that particular strategy. Expected performance objectives and timeframes are those deemed by Mercer's investment researchers to be relevant to the product category in which the strategy being assessed resides. These objectives will differ across asset classes, and will be specified in the relevant research report.

The rating is recorded in the strategy's entry on the Global Investment Manager Database (GIMD™) or MercerInsight®, an Alliance with Nasdaq.

Ratings are normally assigned to investment strategies, rather than to specific funds or vehicles within traditional markets, and to specific investment offerings (vehicles) within alternatives. In traditional markets, the term "strategy" refers to the capability, typically with no view given on the vehicle(s) used for implementation. In alternatives our ratings apply to how a "strategy" is implemented via a specific investment offering. Given the vintage-specific nature of private markets, the rating conveys our conviction in a manager's "strategy" at a particular point in time.

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What do the ratings not signify?

This section contains important exclusions and warnings - please read it carefully.

Past and Future Performances

The rating assigned to a strategy may or may not be consistent with its past performance. Although the rating reflects our expectations on future performance over a time frame appropriate for the particular strategy, we do not guarantee that these expectations will be fulfilled.

Creditworthiness

Unlike those of credit rating agencies, our ratings are not intended to imply any opinions about the creditworthiness of the manager providing the strategy.

Vehicle-specific Considerations for Traditional Asset Classes

In traditional asset classes our ratings are normally assigned to strategies rather than to specific investment vehicles. Potential investors in specific investment vehicles should consider not only our ratings for the strategies being offered through those investment vehicles but also any investment vehicle-specific considerations. These may include, for example, frequency of dealing dates and any legal, tax, or regulatory issues relating to the type of investment vehicle and where it is domiciled. Our ratings are provided solely for informational purposes and do not constitute individualized investment advice relating to any particular circumstances.

Management Fees

Our ratings in the area of alternatives follow market practice with respect to consideration of management fees and reflect performance expectations on a net-of-fees basis. For traditional asset classes, where market practice varies with respect to consideration of management fees, and fees will differ between vehicles, our ratings reflect performance expectations on a gross-of-fees basis. However, in both cases, we will consider fees broadly in our assessment of whether a strategy is likely to deliver value to our clients.

Operational Assessment

Our manager research process and ratings do not include an evaluation of a manager's custodian, prime brokerage, or other vendor relationships, or an assessment of the manager's back-office operations, including any compliance, legal, accounting, or tax analyses of the manager or the manager's investment vehicles. Our manager research process is generally limited to the overall investment decision-making process used by managers. In some alternatives strategies there may be a desktop operational risk review and limited background checks, and this will be noted in the report. In forming a rating, our investment researchers do not generally perform corporate-level operational infrastructure due diligence on a manager and do not perform financial or criminal background checks on investment management staff. Unless our investment researchers are aware of material information to the contrary (such as a view expressed by a manager's auditors or Mercer Sentinel®; see section 9), they assume that the manager's operational infrastructure is reasonable. Operational weaknesses that our investment researchers discover during their analysis of the four factors outlined in section 4 will be noted and, where appropriate, taken into account in determining ratings.

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Factors considered in forming a rating

In order to determine the rating for most strategies, our investment researchers review a strategy on the basis of four specific factors. These factors vary somewhat between the various asset classes we cover. Each factor is assigned a score representing one of four assessments: negative, neutral, positive or very positive.

Actively managed liquid strategies (traditional & hedge funds)	Passive (including index ETFs)	LDI	Private markets
Idea Generation encompasses everything that the investment manager does to identify investments for inclusion in the portfolio. This includes the investment philosophy, process, as well as the team and resources available.	**Implementation and Risk Management** considers the team responsible, and the suitability of the approach used for indexation. Also the efficiency of systems used for trading, and risk procedures.	**Physical Asset Management** evaluates the ability to manage nominal and inflation-linked government bonds and cash. It considers macro awareness and implementation capabilities, as well as the appropriateness of any liquidity or cash collateral funds used. It may also include the manager's investment grade credit capability.	**Alignment** seeks to measure the degree of mutual interest between fund managers and investors. Terms for the fund under evaluation and changes from previous fund(s) are examined.
Portfolio Construction refers to how the manager translates investment ideas into a portfolio. Looking at how well active bets reflect conviction, risk management and alignment with investment objectives.	**Cost & Fees** includes management fees, transaction costs and transition costs. Also factors such as income from stock lending as well as the efficiency of the market for the ETF product(s).	**Derivatives market experience** evaluates the ability to manage derivatives, most commonly interest rate swaps, repo and TRS. It considers collateral management, market access, counterparty relationships, implementation efficiency, and risk management.	**Strategy** looks at the investment focus and process, value creation/protection capabilities, fund size and the relevance of track record for the investment strategy.
Implementation refers to how the portfolio decisions are executed, including	**Stewardship** refers to voting (where applicable) and engagement policies,	**Client servicing** looks at the quality and consistency of the service offered to LDI	**Track record** examines the sourcing and allocation of capital; investment

trading/dealing resources, capacity management, and turnover of positions. Fees (where relevant) are also considered.	processes, and prioritization across ESG topics. Also includes resources, skill sets of the team responsible for stewardship, outcomes, as well as other firm-wide initiatives including external collaboration with other investors and regulatory bodies.	clients/consultants. It considers strength of resourcing, quality and speed of responses to information requests, and transparency and flexibility of reporting.	pacing; return components and the realized and unrealized track record.
Business management refers to the overall stability of the firm, firm resources, and overall operations. This factor is relevant for all asset classes we cover, and the view of a firm and its score is consistent across our Manager Research team. For each firm we assign one investment researcher as firmwide lead and they assign the score, in collaboration with any other investment researchers who cover the firm's strategies.			

We believe managers that undertake these activities well should have strong prospects of achieving the relevant investment objectives. A strategy's overall rating is not determined as a weighted average of the four factor scores, and no prescribed calculations are made to arrive at the four-factor score or the overall rating. Instead, for each strategy, our investment researchers identify which factors we believe are most relevant to a manager's investment process, on a forward-looking basis, and place weight on the factors accordingly. Example considerations include:

- Our confidence in the manager's ability to generate value-adding ideas.
- Our view on any specified objectives.
- The opportunities available in the relevant market(s) to achieve the specified objectives.
- An assessment of the risks taken to try to achieve the specified objectives.
- An assessment of the strategy relative to peer strategies.
- An assessment of the manager's business management and its impact on particular strategies.

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Our rating scale (effective September 2023*)

A	Mercer has a high degree of confidence that the strategy will** meet its expected performance objectives, over a relevant timeframe.
B+* **	Mercer has a moderate degree of confidence that the strategy will meet its expected performance objectives, over a relevant timeframe. However, there are specific factors (documented in our research) that prevent it from earning our highest rating.
B	Mercer has a limited degree of confidence that the strategy will meet its expected performance objectives, over a relevant timeframe. Specifically, Mercer believes that the strategy has only average performance prospects.
C	Mercer has no confidence that the strategy will meet its expected performance objectives, over a relevant timeframe. Specifically, Mercer believes it has below average performance prospects and material risks.
N/no rating	Strategy is not currently rated.
R	The R rating is applied in two situations: • Where we have carried out some research but have not completed our full investment strategy research process. • We have in the past carried out our full investment strategy research process on the strategy, but we are no longer maintaining full research coverage.

* All ratings assigned prior to September 2023 follow our former ratings definitions which can be found in the appendix at the end of this guide.

**In traditional markets, the term “strategy” refers to the capability, with no view given on the vehicle(s) used for implementation. In alternatives our ratings apply to how a “strategy” is implemented via a specific investment offering. Given the vintage-specific nature of private markets, the rating conveys our conviction in a manager’s “strategy” at a particular point in time.

Expected performance objectives and timeframes are those deemed by Mercer’s investment researchers to be relevant to the product category in which the strategy being assessed resides. These objectives will differ across asset classes, and will be specified in the relevant research report.

*** B+ ratings may only be utilized in some product categories.

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Supplemental indicators

Provisional (P)

If the strategy rating is followed by a (P) supplemental indicator — for example, A (P) or B+ (P) — the rating is “provisional” — meaning, there is temporary uncertainty about the rating, but it is expected that this will soon be resolved. For example, when an individual who is a key idea generator leaves the firm and we are concerned that this may impact one of the four factor assessments, this uncertainty may be highlighted by modifying the strategy rating from A to A (P) (see section 6.3 on specific assignments of a (P) or (W) indicator). (P) indicators are intended to be temporary and should normally last for no more than two months. However, there may be some instances where this remains in place for longer. As soon as the temporary uncertainty has been resolved, or if it becomes apparent that this uncertainty is unlikely to be resolved quickly, the (P) indicator will be removed and the rating confirmed or changed, or the strategy will be assigned the indicator “watch” (W), respectively.

Watch (W)

If the strategy rating is followed by a (W) supplemental indicator – for example, A (W) or B+ (W) — the rating is on “watch” — meaning there is some uncertainty about the rating and resolution is not expected soon, but we believe there is a low probability that the resolution of this uncertainty will lead to a change in the strategy’s rating. (W) indicators are typically issued when there is an expectation of long-term uncertainty surrounding the rating — for example, a change, or potential change, in a manager’s ownership.

Specifically assigning (P) and (W) supplemental indicators

(P) and (W) supplemental indicators are assigned — and removed — by the regular ratings review process described in section 10; however, there are circumstances where organizational or reputational issues that affect a manager warrant the specific assignment of a (P) or (W) indicator to all of the particular managers' strategy ratings. In such circumstances, the decision to apply — or remove — a (P) or (W) indicator can be taken by two senior members of the leadership group of the Manager Research team. These occasions are rare, and the relevant investment researchers will contribute to any discussions before a (P) or (W) indicator is assigned or removed.

High tracking error (T)

If the strategy rating is followed by a (T) supplemental indicator — for example, A (T) or B+ (T) — the strategy is considered to have the potential to generate a tracking error substantially higher than the average for the relevant product category. In this context, “tracking error” refers to the variability of performance relative to the nominated benchmark for the strategy. A strategy may be assigned the (T) indicator because the potential for high tracking error has been demonstrated by the strategy’s past performance and/or because the nature of the investment process is such that a significantly higher than average tracking error could be expected. The absence of a (T) following a rating does not guarantee that the strategy’s tracking error will not be higher than the average for the relevant product category.

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ESG integration

We will consider ESG issues in our investment due diligence process where relevant. Each sub-asset class is marked high/medium/low based on relevance of ESG to the risk/return to the asset class. Integration will be reflected through a binary ESG integration indicator, “integrated or not integrated”. The ESG integration indication does NOT mean that a strategy is sustainable. It means that we have assessed whether portfolio managers are capturing the financial ESG risks that they believe could impact the value of an investment in their due diligence and valuations. This means that an integrated strategy could continue to hold what may be considered controversial because they have weighed the trade-offs and believe they are being adequately compensated for holding the investment.

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Research indications – indicative view

For strategies where we have conducted some initial research, we may apply Research Indications. Our Research Indications are an indication of whether a strategy merits deeper / further due diligence. This indication is shown by an assigned indicative view, identified as a color. A Research Indication does not necessarily result in future research. All Research Indications are assigned an R rating.

- **Red** – further research has “below average” prospects of resulting in an A rating
- **Amber** – further research has “average” prospects of resulting in an A rating
- **Green** – further research has “above average” prospects of resulting in an A rating

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Operational risk assessment

Operational risk assessments (ORAs) are separate and distinct from investment research (covered by this guide) and are performed by a different group at Mercer. Mercer Sentinel® performs ORAs to assess a manager’s operations and implementation risk profiles and other areas related to operational risk.

ORAs are not performed on all strategies for which we provide research; however, if an ORA is performed and concludes with an unsatisfactory rating (namely, a “Review” rating), Manager

Research will normally apply a (P) rating for all of that manager's relevant rated strategies. Discussions will follow and if there is a subsequent change in investment rating it will be ratified by the standard Manager Research process.

Contact your consultant for more information.

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Ratings review committees

We have a process for reviewing and ratifying all ratings proposed by individual investment researchers. Strategy ratings are reviewed regularly by one of several Ratings Review Committees (RRCs). These committees are composed of professionals from Mercer's investment research, portfolio management and consulting groups. The role of the RRCs is to review the research from a quality-control perspective and ensure consistency of treatment across strategies within a product category.

Prior to the proposal of a rating to RRCs, the majority of universes have an assigned group of individuals debating ratings and making decisions on which strategies should be proposed to the RRC as an A or B+. This group, called Lead Research Committee (LRC) is accountable for all rating changes (to/from A or B+) and confirmations of A or B+, and therefore will be held accountable for the value-add of the relevant universe(s). They will also make decisions on the composition of the universes (e.g. number of A ratings required, whether there is sufficient breadth to suit all client types).

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Confidentiality of our ratings

Our ratings, along with all other information and reports relating to Mercer's opinions on managers and the investment strategies they offer, represent our confidential and proprietary intellectual property and are subject to change without notice. The information and reports are intended for the exclusive use of the parties to whom they were provided by Mercer and may not be modified, sold, or otherwise provided, in whole or in part, to any other person or entity (including managers) without our prior written permission.

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Further questions

If you have any questions or would like more information about specific topics after reading this guide, please contact your Mercer consultant or click "Contact us" on our website www.mercer.com.

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Appendix

Our former rating scale (until August 2023)

A	Strategies assessed as having “above average” prospects of outperformance.
B+	Strategies assessed as having “above average” prospects of outperformance, but with some reservations.
B	Strategies assessed as having “average” prospects of outperformance.
C	Strategies assessed as having “below average” prospects of outperformance.
N/no rating	Strategy is not currently rated.
R	The R rating is applied in two situations: a. Where we have carried out some research but have not completed our full investment strategy research process. b. We have in the past carried out our full investment strategy research process on the strategy, but we are no longer maintaining full research coverage.

Our former ESG rating scale (until May 2025)

ESG1	The highest ESG rating is assigned to strategies that we believe to be leaders in integrating ESG and active ownership into their core processes, and that provide clear evidence that ESG overall, or a particular ESG theme, is core to idea generation and portfolio construction.
ESG2	The second highest rating is assigned to strategies that, in our view, include ESG factors as part of decision making, with a strong level of commitment made at the firmwide level and some indication that data and research are being taken into account by the managers in their valuations and investment processes.
ESG3	The penultimate rating is assigned to strategies for which, in our view, the manager has made some progress with respect to ESG integration and/or active ownership, but for which there is little evidence that ESG factors are taken into consideration in valuations and investment processes.
ESG4	The lowest ESG rating is assigned to strategies for which, in our view, little has been done to integrate ESG and active ownership into their core processes.

For passive strategies, we apply an ESGp1 through to ESGp4 scale. The focus is on Stewardship, with some consideration of how well ESG research is integrated into the firm more broadly, and an assessment of firm wide commitment to sustainability and stewardship.

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Research ratings

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

Ratings are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of investment products, asset classes, or capital markets discussed. Past performance does not guarantee future results.

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Conflicts of interest

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer universes

Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen time frame. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.