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Responsible and Sustainable Funds Update

Mercer Investment Funds

Quarter ending 30 June 2025

A business of Marsh McLennan

Introduction

Welcome to the June 2025 quarterly update for the Mercer Responsible and Sustainable investment funds. In addition to quarterly fund commentary and performance updates, the objective of this report is to provide insights into, and promote a greater understanding of, sustainable investment. We also report on key engagements over the last quarter.

Manager

Mercer (N.Z.) Limited is the manager of the Mercer Responsible and Sustainable investment funds.

Sustainable Investment Policy

The Mercer Responsible and Sustainable investment funds are governed by the Mercer NZ Sustainable Investment Policy and accompanying exclusions and additional exclusions criteria.

RIAA certification

The Mercer Responsible and Sustainable funds have been certified by the Responsible Investment Association of Australasia (RIAA).

International engagement

International engagement reporting is provided by the investment manager of the Mercer Socially Responsible Overseas Shares – Low Active Risk Portfolio.

The Manager's Quantitative Equity Products (QEP) investment team works in close collaboration with its Sustainable Investment team to facilitate engagement activity. The engagement blueprint includes six priority engagement themes capturing issues relating to environmental (climate change, natural capital & biodiversity), social (human rights, human capital management, diversity & inclusion) and corporate governance.

Climate issues continue to be an important area of focus. The Manager engaged with Taiwan Semiconductor Manufacturing Company (TSMC) on their decarbonisation strategy and encouraged them to pursue a science-based targets approach. TSMC has ambitious targets as it aims to position itself as a sustainability leader in the semiconductor industry. These environmental targets include achieving 60% renewable energy usage by 2030 and 100% by 2040.

TSMC also confirmed they are looking to hit peak emissions this year. The Manager will monitor and look to engage with the company on this in the future and encouraged TSMC to improve transparency in their ESG requirements regarding suppliers. The company communicated that they have started to promote water positive initiatives to improve conservation given the high volumes used in their operations. They have also started to include ESG metrics in their compensation structure.

The Manager also engaged with Mercado Libre on climate related issues, specifically discussing the company's strategy to reduce carbon emissions and promote sustainability. The company confirmed their emphasis is on emission reduction, managing waste and transitioning to renewable energy sources. They are testing various initiatives such as the use of electric vehicles, biofuel trucks and bikes for transportation and aim to recapture close to 100% of any waste generated.

The company is transitioning to renewables with a target to achieve 100% renewable energy usage by 2035. In addition, Mercado Libre is continuing to explore different avenues to sustainable logistics and is committed to incorporating sustainability considerations into its decision-making processes.

The Manager's stewardship process extends to a proactive voting programme. It aims to vote on all resolutions unless specifically restricted from doing so with, with corporate governance specialists carrying out all voting activities.

In the second quarter of 2025, the Manager voted at over 1,200 meetings on over 18,000 resolutions for companies held across the QEP desk. Around 14% of votes were not with management and focused on compensation plans, the election of directors or were auditor related.

For example, the Manager voted against North American healthcare equipment provider Danaher's executive remuneration proposal given significant one-time/ retention awards granted that are not subject to performance conditions. They also voted against Shopify's board proposal due to concerns around diversity on the board and its overall composition.

New Zealand engagement

During the quarter, the investment manager for the Mercer Responsible Trans-Tasman Shares Fund was replaced with investment into the Mercer Socially Responsible Trans-Tasman Shares Portfolio (the Portfolio) in the Mercer Investment Trusts New Zealand.

The Portfolio has three underlying investment managers. Engagement reporting is provided by the two active managers, while the third is a passive strategy, so no engagement reporting is provided.

One of the managers reported that engagement with companies over the quarter was increasingly governance related given the growing number of AGMs and the contentious resolutions associated with them. ESG issues discussed included topics such as remuneration, board composition and health and safety.

Governance related engagements were primarily focused on remuneration concerns. Discussions with Oceania Healthcare resulted in commitments to improve bonus scheme disclosure and introduce performance targets, while discussions with Vista Group centred on supporting CEO compensation increases but advocating for higher long-term incentive proportions with more ambitious performance hurdles.

Director-related matters included constructive dialogue with Scales Corporation about director fee reductions and appropriate headroom levels. There was also engagement with AoFrio regarding a director's attendance record, where explanations about competing board commitments and subsequent resignation from another board informed the voting decision.

On the social front, health and safety concerns were addressed with Ryman Healthcare following media reports about dementia care incidents. The company attributed the issues to Ministry of Health assessment classifications rather than internal care failures.

Industry engagement over the quarter has been primarily through our continued participation in the technical expert group for the development of a Sustainable Finance Taxonomy in New Zealand. This will be an important classification system aimed to help define activities that are sustainable and contribute to the country's environmental objectives while accounting for cultural and social considerations. The RIAA conference in Australia also gave some useful insights on the key issues facing investee companies in that region.

Overall, engagement so far this year continues to focus on climate change given ongoing efforts in the energy transition and the mandatory reporting regime still in its infancy. These have been complemented by a growing number of governance conversations, especially on executive and director remuneration. Looking forward, the August company reporting season will be another catalyst for engagement, particularly if there are any lagging areas highlighted in the disclosures.

There were only a handful of AGMs for companies held in the portfolio over the quarter given the time of the year. The following resolutions were deemed contentious:

- One of the managers abstained from voting on contentious AGM resolutions for AoFrio in relation to poor attendance records, and Life360, citing improvements in governance and pay practices.
- For AoFrio, a manager engaged with the company regarding a contentious AGM resolution to re-elect one of its directors. The abstention was due to poor attendance and the positive action taken by the director to resolve the issue.
- For Life360, a manager abstained from voting on the resolution to re-elect the Chair, noting unresolved investor feedback but recognising the improvements the board has made in pay practices since last year.
- One of the managers also voted against the re-election of an independent director at Telix Pharmaceuticals due to corporate governance concerns related to auditor fees.

One of the managers met with the Chair of Board of Directors of Channel Infrastructure and covered a wide range of governance, strategic, and operational issues facing the company and its board. A key focus was the evolving composition of the board, with two directors stepping down and a reduction from eight to six members. This raised concerns about skill coverage, prompting discussion around updating the skills matrix to reflect current capabilities and gaps.

Among operational matters discussed, governance matters included the upcoming board evaluation (pending director departures), CEO remuneration review, and concerns over two unsupported director nominations ahead of the Annual Shareholders Meeting – both advocating for reopening the refinery, a proposal the current board sees as unviable and time-consuming.

The manager also met with the Director of Ryman Healthcare and discussed key issues regarding the company's performance. The company's financial reporting had been notably poor, prompting a concentrated effort to elevate it – a necessary foundation before broader strategic focus can resume. Leadership confidence is high in the new CEO Naomi James. A major concern was Ryman's capital allocation strategy, having simultaneously pursued 13 capital-intensive projects, an approach deemed unsustainable. Looking ahead, growth is anticipated, with Australia positioned as the more favourable region for future investment, pending a more refined strategic direction.

Market environment

Economic review

- Geopolitical tensions in the Middle East escalated in June, with Israel and the US launching a military strike on Iran following failed negotiations over Iran's nuclear programme. Crude oil prices jumped 23.4% to US$79 a barrel after the military strikes on Iran but dropped back to about US$67 after the US announced a ceasefire.
- US President Trump's "One Big Beautiful Bill Act", extends the tax cuts from his first term and introduces additional reductions. A modified version was approved by the Senate and will now return to the House of Representatives for another vote.
- In April, President Trump announced reciprocal tariffs, which were later delayed for 90 days. He implemented a universal 10% tariff on all US imports, along with higher tariffs on about 60 nations, raising the average tariff rate to over 20%.
- The Court of International Trade tried to block these tariffs, but the US Court of Appeals put that decision on hold while the case is appealed, so tariffs remain in effect.
- The US Federal Reserve (the Fed) left interest rates unchanged at 4.25-4.5%, while lowering the 2025 GDP growth forecast to 1.4% and inflation forecast to 3.1%. The European Central Bank (ECB) cut rates a further two times in Q2 2025, lowering the deposit rate by 0.5% to 2%.
- New Zealand's Q1 2025 GDP rose by 0.8% quarter-on-quarter, surpassing the expected 0.7%. Annual GDP stands at -0.7% year-on-year. This indicates ongoing recovery from recession. However, these figures precede more recent declines in confidence and may not reflect latest economic developments.
- Over the quarter, the ANZ Business Outlook survey showed NZ business confidence falling. The survey showed a 20.9 point drop over April and May, with the June reading recovering 9.4 points. This drop is thought to be influenced by global events, including the tariffs introduced in the United States.
- New Zealand's unemployment remained steady at 5.1% in Q1 2025, better than the expected rise to 5.3%. While there have been recent improvements in economic growth, unemployment remains elevated due to the recession and persistent trade uncertainties, contributing to ongoing ambiguity about the direction of monetary policy.

Market summary

- Despite the trade war and other geopolitical tensions, overseas shares (hedged) rose over the quarter. The 'Magnificent 7' shares experienced a strong quarter, increasing by 21%. New Zealand shares rose by 2.8% in Q2 2025, underperforming the returns seen in international markets.
- At the beginning of the quarter, President Trump's 'Liberation Day' announcements caused a sharp steepening of yield curves around the world. A temporary tariff pause calmed markets but concerns over US public finances and Moody's downgrade led to renewed upward pressure on yields in May.
- In June, market sentiment shifted again in favour of rate cuts, as indications of a weakening labour market prompted policymakers to suggest that rate reductions might be restarted.

Performance

Diversified

Mercer Sustainable Balanced Fund

Underlying investment portfolio

The Mercer Sustainable Balanced Fund invests into the Mercer Socially Responsible Balanced Portfolio within the Mercer Investment Trusts New Zealand. The Portfolio invests in a mix of investments using a multi-manager approach.

Asset allocation

Sector weights (average)	Actual (%)	SAA (%)	Tilt (%)
Trans-Tasman shares	12.9	13.0	-0.1
Socially responsible overseas shares*	38.5	39.0	-0.5
Property (listed and unlisted)	2.9	3.0	-0.1
Infrastructure (listed and unlisted)	4.9	5.0	-0.1
Growth total	**59.2**	**60.0**	**-0.8**
Overseas sovereign bonds	10.6	11.0	-0.4
Socially responsible global credit	9.7	10.0	-0.3
Short term bonds	3.0	5.0	-2.0
NZ sovereign bonds	10.6	10.0	+0.6
Private debt	1.8	0.0	+1.8
Cash	5.0	4.0	+1.0
Defensive total	**40.7**	**40.0**	**+0.7**
Total	100.0	100.0	0.0

*Includes hedged and unhedged active, low active risk and passive socially responsible overseas shares.

Fund performance

As at 30 June 2025

June 2025 quarter	%
Fund return	3.77
Benchmark return	3.78
Relative performance	*-0.01*

Average annual returns (%)

Periods ending 30 June 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	7.21	8.47	7.30	6.56	8.12
Benchmark return	10.55	9.35	7.09	6.86	7.85
Value added	*-3.34*	*-0.88*	*0.22*	*-0.29*	*0.27*

Fund commentary

- The Mercer Sustainable Balanced Fund produced positive returns in the June quarter and performed in line with its benchmark. It also outperformed the benchmark over five years. However, the Fund has underperformed over 1, 3 and 10-year periods.
- The main contributors towards relative performance over the quarter was security selection in overseas shares and overseas sovereign bonds. Detractors included security selection in global credit, and the allocation to hedged overseas shares.
- Performance for the year reflects one month (up to 31 July 2024) of the Fund's previous sector weights and returns, followed by 11 months (1 August 2024 to 31 June 2025) of the underlying Mercer Socially Responsible Balanced Portfolio returns.
- Over the last 12 months, security selection in overseas shares and listed infrastructure, and the allocation to overseas shares (hedged and unhedged) detracted from relative performance. Security selection within unlisted property and infrastructure, NZ and short term bonds, along with the allocation to passive and low risk overseas shares, contributed positively.

New Zealand shares

Market review

During the quarter, the New Zealand share market delivered a positive return but underperformed relative to most global markets. This lag was primarily due to a sluggish economic recovery and ongoing earnings forecast downgrades among cyclical companies.

In contrast, the Australian share market experienced a strong quarter, supported by rate cuts, declining unemployment rates, and stable commodity prices.

Mercer Responsible Trans-Tasman Shares Fund

Fund performance

As at 30 June 2025

June 2025 quarter	%
Fund return	2.35
S&P/NZX 50 Gross Index with Imputation Credits	2.79
Relative performance	*-0.44*

Average annual returns (%)

Periods ending 30 June 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	8.60	7.33	4.60	10.56	11.91
Benchmark return	8.35	5.91	2.71	9.20	10.76
Value added	*0.25*	*1.42*	*1.89*	*1.36*	*1.15*

Fund manager

The Fund's investment manager, Harbour Asset Management, was replaced with investment into the Mercer Socially Responsible Trans-Tasman Shares Portfolio in the Mercer Investment Trusts New Zealand (MITNZ), effective 16 June 2025.

Fund commentary

Fund performance was positive but underperformed the benchmark for the quarter. The Fund returned 2.35% over the quarter, underperforming the benchmark by -0.44%.

The Fund's underperformance relative to the benchmark was primarily due to negative stock selection effects in the healthcare and utilities sectors, as well as an underweight position in the communications sector.

Positive contributors to relative performance included stock selection within the industrials sector and an overweight position in financials.

At the stock level, the largest contributors were overweight positions in Napier Port and Life360, along with an underweight in Vulcan Steel and Auckland Airport. The largest detractors were overweight positions in Ryman Healthcare and CSL, as well as an underweight in Spark.

Ryman continues to face challenges, including significant asset devaluation and weak earnings results following a substantial capital raise earlier in the year.

Spark's share price partially recovered from the steep decline experienced in the first quarter, supported by management's efforts to seek external capital to fund data centre developments, which could potentially enhance return on capital.

Global shares

Market review

Despite geopolitical tensions, overseas shares (hedged) increased by 9.5% in Q2 2025. Overseas shares (unhedged) were up 4.0%.

The Magnificent 7 shares (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla) experienced a strong quarter, increasing 21%. The information technology sector was the best performer for the quarter, up 22.8%, followed by industrial, up 12.9%.

Emerging market shares (unhedged) rose 4.5%, mainly because the Korean and Taiwan share markets performed strongly. MSCI considered, but decided against, adding Korea to its developed market indices due to ongoing barriers for foreign investors.

Mercer Responsible Global Shares Fund

Fund performance

As at 30 June 2025

June 2025 quarter	%
Fund return	8.88
MSCI World Index* (69% hedged to NZD)	7.64
Relative performance	*1.24*

Average annual returns (%)

Periods ending 30 June 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	13.67	17.17	14.85	10.05	8.52
Benchmark return	14.58	17.51	14.09	10.72	8.14
Value added	*-0.90*	*-0.34*	*0.75*	*-0.67*	*0.38*

Fund manager

The Mercer Responsible Global Shares Fund invests into the Mercer Socially Responsible Overseas Shares – Low Active Risk Portfolio. Schroder Investment Management Australia Limited is the current investment manager of the Fund.

Fund commentary

The portfolio outperformed during a volatile quarter dominated by US policy and heightened geopolitical tensions. At a high level, contributions to outperformance were broad based across both regions and sectors.

The strategy's focus on higher quality was rewarded during the early quarter market turbulence. Meanwhile, preferred structural growth names and higher beta pockets supported performance across May and June as markets made a 'V-shaped' move back towards all-time highs.

Holdings in technology (application software) and industrials (manufacturing) were additive, driven by positive stock selection. Exposure within more defensives was also beneficial in the healthcare, consumer staples and utilities sectors. Avoiding weakness in health providers and food manufacturers was rewarded.

Detractors were muted over the quarter, though the exposure to financials was a small drag as investors shifted focus to higher beta areas.

Leading into the third quarter, the largest portfolio overweights were within technology, industrials and financials. The focus remains on targeting the best-in-class quality opportunities that trade on attractive valuations. The key underweights in the strategy are now within consumer discretionary (across autos and apparel) and staples (food manufacturing) with more modest underweights within materials.

While the strategy trimmed across technology in the first quarter, it finished the second quarter with the sector holding the largest overweight, focusing on companies with strong fundamental characteristics where valuations have become more palatable.

From a regional perspective, the main increase in exposure was to the US, funded from a reduced allocation to Europe, having bought into US weakness following the early-quarter volatility. The strategy finished the quarter with overweights in the US and Europe alongside emerging markets, with underweights to the UK and Japan.

Global fixed interest

Market review

Overseas sovereign bonds were up 0.9% for the quarter. US government bond yields rose 2 basis points and yields finished the quarter at 4.23%, even as US economic data weakened over the quarter. Most other countries' government bond yields fell.

Mercer Responsible Hedged Global Fixed Interest Index Fund

Fund performance

As at 30 June 2025

June 2025 quarter	%
Fund return	1.29
Bloomberg MSCI Global Aggregate SRI Select ex Fossil Fuels Index* (100% hedged to NZD)	1.24
Relative performance	*0.05*

Average annual returns (%)

Periods ending 30 June 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	5.14	2.43	-0.54	N/A	1.30
Benchmark return	5.16	2.43	-0.53	N/A	1.32
Value added	*-0.02*	*0.00*	*-0.01*	*-*	*-0.02*

Fund commentary

The Fund is a passively managed international fixed interest portfolio that is designed to track the return of the Bloomberg MSCI Global Aggregate SRI Select ex Fossil Fuels Index*, fully hedged to the NZ dollar.

The Fund returned 1.29% over the June 2025 quarter, slightly ahead of the benchmark return of 1.24%.

*Source: MSCI. The MSCI data is comprised of a custom index calculated by MSCI for, and as requested by, Mercer (N.Z.) Limited. The MSCI data is for internal use only and may not be redistributed or used in connection with creation or offering any securities, financial products or indices. Neither MSCI nor any other third party involved in or related to compiling, computing or creating the MSCI data ("The MSCI Parties") makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and the MSCI Parties hereby expressly disclaim all warranties or originality, accuracy, completeness or fitness for a particular purpose with respect to such data. Without limiting any of the foregoing, in no event shall any of the MSCI Parties have any liabilities for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

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