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Responsible and Sustainable Funds Update

Mercer Investment Funds

Quarter ending 31 March 2025

A business of Marsh McLennan

Introduction

Welcome to the March 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.

Mercer responsible and sustainable investment fund name changes

During the quarter the Mercer Ethical Leaders Funds changed their names as follows:

Previous fund name	New fund name
Mercer Ethical Leaders Balanced Fund	Mercer Sustainable Balanced Fund
Mercer Ethical Leaders NZ Shares Fund	Mercer Responsible Trans-Tasman Shares Fund
Mercer Ethical Leaders Global Shares Fund	Mercer Responsible Global Shares Fund
Mercer Ethical Leaders Hedged Global Fixed Interest Index Fund	Mercer Responsible Hedged Global Fixed Interest Index Fund

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. The Sustainable Investment Policy has been updated and published on 28 February 2025.

RIAA certification

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

International engagement

Engagement reporting by Schroder Investment Management Australia Limited

The Schroders Quantitative Equity Products (QEP) investment team works in close collaboration with the Schroders' Sustainable Investment team to facilitate its engagement activity. Schroders' 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.

Social issues continue to be an important area of focus. For example, Schroders engaged with Howmet Aerospace on their supply chain and human rights risks. The company confirmed they use Ecovadis, an independent sustainability risk consultant, for supplier audits to help identify and mitigate such risks. The company is also broadening its product safety disclosures and will be incorporating a new materiality map in their ESG reports to improve communication of their sustainability risks. Schroders encouraged the company to continue expanding their disclosures and welcomed current developments which emphasize improving safety standards. Finally, Howmet confirmed they have grievance mechanisms for stakeholders and actively report on community grievances raised, primarily related to dust and noise pollution as a result of its operations.

Schroders also engaged with Toyota on our blueprint theme of climate change as well as select governance topics. They discussed the company's increased move into hybrid and electric vehicles given growing demand in this space and their efforts towards achieving carbon neutrality.

Toyota confirmed that they have already met their SBTi 2030 targets in their heavy freight trucks division and continue to focus on improving carbon emission reductions across their broad supply chain. The company noted the constant communication in place with suppliers regarding achieving their emission reduction targets. They also highlighted their commitment to reskilling their R&D staff, with a particular focus on software reskilling to further improve automation.

Schroders took the opportunity in this engagement to discuss the transformation of the Board of Directors and implementation of a new corporate governance model at Toyota. The company reduced the Board of Directors from 16 to 10, with an increased presence of outside directors, and Schroders will continue to monitor further developments in this area.

The stewardship process extends to a proactive voting programme. Schroders make considered use of voting rights and vote on all resolutions unless specifically restricted from doing so, with all voting carried out by Schroders' corporate governance specialists. 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 first quarter of 2025, it voted at over 230 meetings on almost 2,500 resolutions for companies held across the QEP desk.

Around 11% of votes were not with management and focused on compensation plans, the election of directors or were auditor related. For example, Schroders voted against Italian bank Unicredit's remuneration proposal given another significant increase without reasonable justification to support this. They also voted against Costco's board proposal on gender diversity grounds with the Costco board lacking women on their executive committee.

New Zealand engagement

Engagement reporting by Harbour Asset Management

Engagements with companies over the quarter were largely part of more general post result meetings with senior management teams. Sustainability considerations such as climate change, customer hardship and iwi relations were key issues discussed in these meetings.

On climate change, Harbour engaged with companies from the power generation/retailer sector as part of interim results meetings. Security of energy supply has been a priority issue across the board given the unexpected challenges last winter that is impacting the short- and medium-term climate strategies of these companies. For example, there may be more reliance on coal-based generation in the coming year given the shortage of gas supply and renewables uncertainty but over the longer term an accelerated timeline of new renewables and biomass.

In other sectors, Harbour was encouraged by conversations with large emitting companies like Fletcher Building which, despite the recent environmental, social governance (ESG) backlash, were still committed to emissions related targets and making good progress towards them.

Social issues such as customer hardship, iwi relations and diversity, equity and inclusion (DEI) were also discussed in these meetings. Although many consumers have been struggling with the elevated costs of living in recent years, there has been hardship related support provided by electricity retailers which has helped minimise customer disconnections.

Another issue discussed was relationships with iwi, particularly in light of the Government’s new fast track consenting regime. Conversations revealed that even though the approvals for some new generation projects were being sped up, this was not coming at the expense of proper consultation with iwi, with constructive relationships maintained.

Regarding DEI, despite the backtracking of these policies in the US, there has not been any evident impact for New Zealand companies based on Harbour’s engagements where Mercury Energy, for example, has just refreshed its DEI strategy.

Industry engagement over the quarter focused on climate disclosures and sustainable finance. On climate disclosures, Harbour participated in the consultation from the Ministry of Business, Innovation and Employment on proposing changes to the regime, particularly the eligibility thresholds for listed issuers and asset managers, as well as director liability settings.

In terms of sustainable finance, Harbour continued to contribute to the development of the taxonomy project through its involvement in the technical expert group established to oversee the strategic direction and overall framework of the taxonomy.

Overall, engagement so far this year has mostly been about climate strategy especially considering the global political landscape which is seeing some backlash with respect to sustainability considerations. Despite this backdrop, Harbour’s conversations with materially exposed companies revealed they remain committed to their climate ambitions and targets with no plans to change course based on the sentiment overseas. This also extended to other social issues such as DEI with no evidence of backtracking from companies thus far.

However, Harbour have also been cognisant of the risk of social impacts resulting from domestic policy developments such as from the Government’s fast track consenting regime and noise around the Treaty Principles Bill creating tension with iwi which will be an ongoing issue to monitor. In addition, it will continue to assess and engage companies on the second round of mandatory climate disclosures that are expected to contain more forward-looking information as requirements for transition plans kick in this year.

Proxy voting activity was limited over the quarter given the lack of AGMs at this time of the year. None of the resolutions voted on were considered particularly contentious and were all supported in line with management and Harbour’s proxy adviser recommendations.

Market environment

Market summary

- The first quarter of 2025 was marked by considerable economic, geopolitical, and market instability in the United States. A combination of slowing economic indicators, escalating global tensions, and rising policy uncertainty has led to a reversal of the equity strength seen following Trump's election win. This has resulted in heightened market volatility, declining US Treasury yields, and corrections in the US equity markets.
- The uncertainty has intensified as the US Federal Reserve (the Fed) remains inactive, and the administration prioritises funding (ie lower interest rates) over the wealth effect (ie stock market performance).
- After achieving a remarkable 57.8% cumulative return over the previous two years, the S&P 500 experienced a correction of over 10% in the latter half of Q1, resulting in its worst quarterly performance since the peak of the interest rate hike cycle in Q3 2022.
- However, many international economies remained resilient in Q1, aided by fiscal and monetary stimulus and a weakening US dollar. China's stimulus efforts included wage hikes for government workers, increased bond issuance, a consumer goods trade-in programme, and a record-high budget deficit.
- In Europe, rising fiscal spending was partly driven by a renewed focus on national defence amid uncertainties regarding US leadership and NATO commitments. In addition, Germany looked to reform its longstanding debt rules and lift its 'fiscal break'.
- In New Zealand, data released in March indicated that economic activity rose 0.7% in Q4 2024, coming in above expectations and pulling New Zealand out of a technical recession. The largest industry contributors were rental, hiring and real estate, with a push from tourism and international visitors leading to increased activity during the quarter.

Significant developments

- Since the start of the year the Reserve Bank of New Zealand (RBNZ) has only made one policy announcement, cutting the Official Cash Rate (OCR) by a further 50 bps (for the third time in a row). Inflation lifted higher to 2.5% but remains within the target band as economic activity remains subdued while the economy continues to recover.
- Consumer Price Inflation in New Zealand is anticipated to be unstable in the short term, influenced by a declining exchange rate and rising fuel prices. The overall impact of upcoming trade policy changes on inflation remains uncertain.
- Throughout Q1, tariffs dominated discussions as the US government implemented a wide range of new tariffs. These affected goods such as steel, aluminium, and automobiles. The shifting expectations surrounding the severity of tariff announcements (in April 2025) led to fluctuations in market sentiment, with investors closely monitoring for signs that uncertainty is affecting US economic activity. This concern was highlighted by a recent decline in capital expenditure intentions reported in small business surveys.

Market outlook

- Looking ahead, the financial landscape appears poised for continued volatility as considerable uncertainty remains around the ultimate form of tariffs imposed by the Trump Administration and the impacts that they may have. While a 90-day pause has been announced on tariffs announced on 'Liberation Day', subsequent communications around the level of tariffs, stages of negotiations with other jurisdictions and carve outs that may or may not apply have boosted this uncertainty.
- From a Monetary Policy standpoint, the Fed has maintained its neutral position noting that given the uncertainty in the economic outlook, it believes it is well placed to cut rates if required. With President Trump publicly announcing his desire for cuts to the Federal Funds Rate and his dissatisfaction with Fed Chair Jerome Powell, markets reacted to the possibility of a new Chair to be appointed to the Fed. To maintain an appearance of political neutrality, the Fed is likely waiting for a clear mandate (increasing unemployment and/or soft economic data) before announcing cuts.
- Highlighting the uncertain market environment, Corporate Earnings releases have been marked by company executives refraining from providing forward guidance as the business environment over the near term can change with a social media post.
- In New Zealand, a second 25 bps cut to the OCR is expected this quarter, bringing the OCR to 3.25% by mid-year. Christian Hawkesby was appointed Governor of the RBNZ for a six-month term while the recruitment process for a new Governor takes place, following the departure of Adrian Orr. Meanwhile, Australia approaches a critical election on May 3, with the potential for significant political shifts.

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	12.5	13.0	-0.5
Socially responsible overseas shares*	36.3	39.0	-2.7
Property (listed and unlisted)	3.3	3.0	+0.3
Infrastructure (listed and unlisted)	4.9	5.0	-0.1
Growth total	**57.0**	**60.0**	**-3.0**
Overseas sovereign bonds	11.3	11.0	+0.3
Socially responsible global credit	10.7	10.0	+0.7
Short term bonds	5.3	5.0	+0.3
NZ sovereign bonds	11.3	10.0	+1.3
Cash	4.4	4.0	+0.4
Defensive total	**43.0**	**40.0**	**+3.0**
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 31 March 2025

March 2025 quarter	%
Fund return	-1.77
Benchmark return	-1.21
Relative performance	*-0.56*

Average annual returns (%)

Periods ending 31 March 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	4.22	4.42	8.44	6.33	8.00
Benchmark return	6.78	4.84	8.47	6.54	7.72
Value added	*-2.56*	*-0.42*	*-0.03*	*-0.21*	*0.28*

Fund commentary

- The Mercer Sustainable Balanced Fund produced negative returns in the March quarter and underperformed its benchmark. The Fund also underperformed over both one- and three-year periods. However, the Fund has performed in line with its benchmark over five and seven years.
- The main contributors towards relative performance over the quarter was security selection in overseas and New Zealand sovereign bonds. Detractors included security selection in international and Trans-Tasman shares, and the allocation to passive and low risk overseas shares.
- Performance for the year reflects four months (up to 31 July 2025) of the Fund's previous sector weights and returns, followed by eight months (1 August to 31 March 2025) of the new underlying Mercer Socially Responsible Balanced Portfolio returns.
- Over the last 12 months, security selection in overseas shares and listed infrastructure detracted from relative performance. Security selection within unlisted property and infrastructure, NZ and global fixed interest, along with the allocation to passive and low risk overseas shares, contributed positively.

New Zealand shares

Market review

Investor risk tolerance fell over the period with the new Trump led US Government more willing to engage in trade tariff and US government spending resets than the market had previously expected.

Higher growth shares were particularly impacted by the drop in investor confidence, which dragged on funds' absolute and relative performance. The increase in global uncertainty then fed through to the New Zealand and Australian share markets.

Despite signs of gradual recovery in the domestic New Zealand economy, the S&P/NZX 50 share market benchmark fell over the March quarter as a worse than expected profit reporting season and capital raisings/ block sell downs that required funding dragged on market returns. Weakness in the healthcare, financial (which includes Infratil) and industrial sectors led the New Zealand market lower.

The Australian S&P/ASX 200 benchmark also fell over the quarter, as a weaker than expected company profit result season and capital raisings dragged on Australian market returns, offsetting a change to an easier monetary policy tone by the Reserve Bank of Australia (RBA) and relatively solid Australian economic data. The information technology, healthcare, and real estate sectors led the Australian market down.

Mercer Responsible Trans-Tasman Shares Fund

Fund performance

As at 31 March 2025

March 2025 quarter	%
Fund return	-7.33
S&P/NZX 50 Gross Index with Imputation Credits	-6.18
Relative performance	*-1.15*

Average annual returns (%)

Periods ending 31 March 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	5.12	2.21	8.22	10.09	11.95
Benchmark return	2.11	1.27	5.39	8.73	10.74
Value added	*3.01*	*0.95*	*2.83*	*1.37*	*1.21*

Fund manager

Harbour is the investment manager for the Mercer Responsible Trans-Tasman Shares Fund.

Fund commentary

Fund performance was negative and underperformed the benchmark for the quarter. The Fund returned -7.33% over the quarter, underperforming the benchmark by -1.15%.

Over the quarter, relative fund performance was negatively impacted from being overweight in underperformers Ryman, Mainfreight, Goodman Group, and Summerset, and being underweight outperformer Fletcher Building. Fund performance benefited over the quarter by being overweight outperformers Vista, a2 Milk, Telix, and Scales, and being underweight in underperformer Spark NZ.

Capital markets have gone from pricing in perfection at the end of December 2024 to pricing in a degree of chaos at the end of March 2025. Policy uncertainty is currently the dominant factor in capital markets. Markets are increasingly positioned for a tough first year of policy uncertainty from the new US Government – businesses and investors may need to work under the assumption of higher tariffs and/or prolonged policy uncertainty at least for the next 18 months.

The following few years of the Trump Government may be less challenging, but they may continue to throw up tail risks for investors. The New Zealand and Australian markets may be relative growth asset safe havens for investors in this environment.

Harbour's strategy remains to be patient, position for a range of scenarios and to be selective, focusing on quality growth. It continues to focus on companies delivering earnings per share growth, particularly where that earnings growth has the potential to be higher and last for longer than consensus expectations allow for.

The portfolio is overweight relative to the benchmark in investments with secular tailwinds in the defensive growth healthcare sector and the higher growth information technology sector. It continues to have a bias to quality, well-capitalised businesses that are positioned to fund value adding growth opportunities, and remains underweight in the lower growth utilities, telecommunications, infrastructure and real estate sectors.

Global shares

Market review

Even before the stark initial adverse reaction to Trump's tariffs in early April, it had been a challenging start to the year for global equity markets, particularly in the US where both the S&P 500 and Nasdaq experienced their worst quarterly performance since 2022. The S&P 500 also trailed the rest of the world by the widest quarterly margin in over a decade.

The pro-growth trades that emerged around the US election went into reverse as initial hopes for deregulation and tax cuts gave way to increasing concerns about tariffs and their potential economic impact. Guided by Trump's first term, this was not the order of policy priorities that investors had expected from the new administration.

The prior market darlings were at the forefront of the selling in the first quarter. All but Meta out of the Magnificent 7 stocks suffered double digit declines amid growing concerns about a slowdown in AI-spend. They were clearly the obvious source of profit taking as uncertainty spread. As such, market breadth continued to recover with around 60% of stocks outperforming in both the US and developed markets while the equally weighted S&P 500 outperformed the standard cap weighted index by 3.6%.

The main beneficiary of the apparent reversal in American exceptionalism was Europe, particularly after Germany changed its constitution to permit a significant ramp up in defence spending. According to MSCI, European equity markets gained by 10.5% in the first quarter in dollar terms compared to a 4.6% decline in the US.

Emerging markets benefited from a significant retreat in the US dollar but only managed to eke out a gain of 2.9% as China's strong performance was offset by weakness heavy Taiwan and, to a lesser extent, India.

While the period was notable for significant short-term swings in sentiment, the preference for defensiveness was clear. Staples, utilities and healthcare performed well but it would be wrong to characterise the first quarter's price action as a rush for the hills as cheaper cyclical stocks in financials and resources also gained.

The broader trend was a rotation away from the dominant themes of last year (AI/tech), which were rich for profit taking, towards better value areas which also offered diversification. MSCI's World Value index gained as much as 4.8% while its sister Growth index declined almost 8%. It was also a poor quarter for sustainability focused investors as aerospace and defence stocks rallied by over 15% while tobacco was up by 21%.

Mercer Responsible Global Shares Fund

Fund performance

As at 31 March 2025

March 2025 quarter	%
Fund return	-3.23
MSCI World Index* (69% hedged to NZD)	-2.72
Relative performance	*-0.51*

Average annual returns (%)

Periods ending 31 March 2025	1 year	3 years	5 years	10 years	Since inception
Fund return	7.33	10.38	15.95	9.62	8.12
Benchmark return	9.00	10.04	15.68	10.27	7.81
Value added	*-1.67*	*0.34*	*0.27*	*-0.65*	*0.31*

Fund manager

The Mercer Responsible Global Shares Fund invests into the Mercer Socially Responsible Overseas Shares – Low Active Risk Fund.

Schroders Investment Management is the current investment manager of the Fund.

Fund commentary

Following early-year optimism, global equity markets saw volatility return in the first quarter of 2025 on trade wars and geopolitical risks. As investors sought safe havens, there was a flight to perceived defensives alongside the defence industry on expectations of more government spending.

Against this backdrop, the portfolio finished the first quarter of 2025 modestly behind its benchmark. This was more than accounted for by the headwinds coming mainly from the strategy’s avoidance of tobacco and underexposure to defence stocks. A key impact was from not owning the largest index names in tobacco such as Phillip Morris, which benefited from both strong earnings and rising risk aversion.

Elsewhere, underexposure to European defence names was a drag on performance as the sector rallied hard on German plans to ramp up spending. This was partially offset by the impact from holdings in US counterparts,

and exposure to traditional defensives also offered support. Overweight positions in healthcare, telecoms and utilities were all beneficial over the quarter.

Net changes to positioning over the quarter followed several high-level themes: taking profits in the US across technology, rotating exposure into discounted quality cyclicals in Europe and increasing exposure to stable quality in appreciation of potential turbulence.

Strong price moves and richer multiples encouraged profit taking in US technology, driven mainly by trimming names in application software which had performed exceptionally well on the back of recent AI driven enthusiasm. Profits were rotated into several areas across Europe and the UK. In Europe, the strategy increased its exposure to diversified financials, including global banks with strong balance sheets alongside investment exchanges, which tend to benefit from periods of heightened volatility.

Within industrials, positioning was rotated away from the US and into Europe, with a focus on high quality manufacturing, construction and business & environmental services. Exposure was bolstered within defensives, with the broad view being a more volatile year ahead, and adding to staples, communications and healthcare. More specifically, the quarter saw increased exposure to European and UK telcos, pharmaceuticals, staple retailers and food manufacturers.

Elsewhere, having previously neutralised a prior underweight to utilities, the strategy continued to add to higher quality European names and is now overweight the sector for the first time in many years.

At the end of the quarter, the largest portfolio over-weights were within communications, financials and utilities. The focus remains on targeting the best-in-class quality opportunities that trade on attractive valuations. Conversely, a key underweight in the strategy is within consumer discretionary, with more modest underweights within real estate and staples where exposure is highly selective. While trimming across technology, the strategy remains overweight the benchmark, focusing on companies with strong fundamental characteristics where valuations are still palatable.

From a regional perspective, the main increase in exposure was to Europe funded from a reduced allocation to the US, having taken profits following a stellar run over the prior two years. The strategy finished the quarter with Europe as the largest overweight alongside emerging markets, with underweights to the UK, Japan and the US.

Global fixed interest

Market review

In global bond markets, increasing recession risks resulted in a 2.9% return from US Treasuries. In contrast, in Europe, expectations of significantly higher issuance to fund new government spending programmes negatively impacted sovereign bond returns, with German Bunds finishing the quarter down 1.6%.

Japanese government bonds were particularly weak, declining by 2.4%, as recent data highlighted rising inflationary pressures.

Mercer Responsible Hedged Global Fixed Interest Index Fund

Fund performance

As at 31 March 2025

March 2025 quarter	%
Fund return	1.16
Bloomberg MSCI Global Aggregate SRI Select ex Fossil Fuels Index* (100% hedged to NZD)	1.20
Relative performance	*-0.04*

Average annual returns (%)

Periods ending 31 March 2025	1 year	3 years	5 years	10 years	Since inception
Fund return					
Benchmark return					
Value added					

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 1.16% over the March 2025 quarter, slightly below the benchmark return of 1.20%.

*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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