LRC Executive Board

Investment Council Update

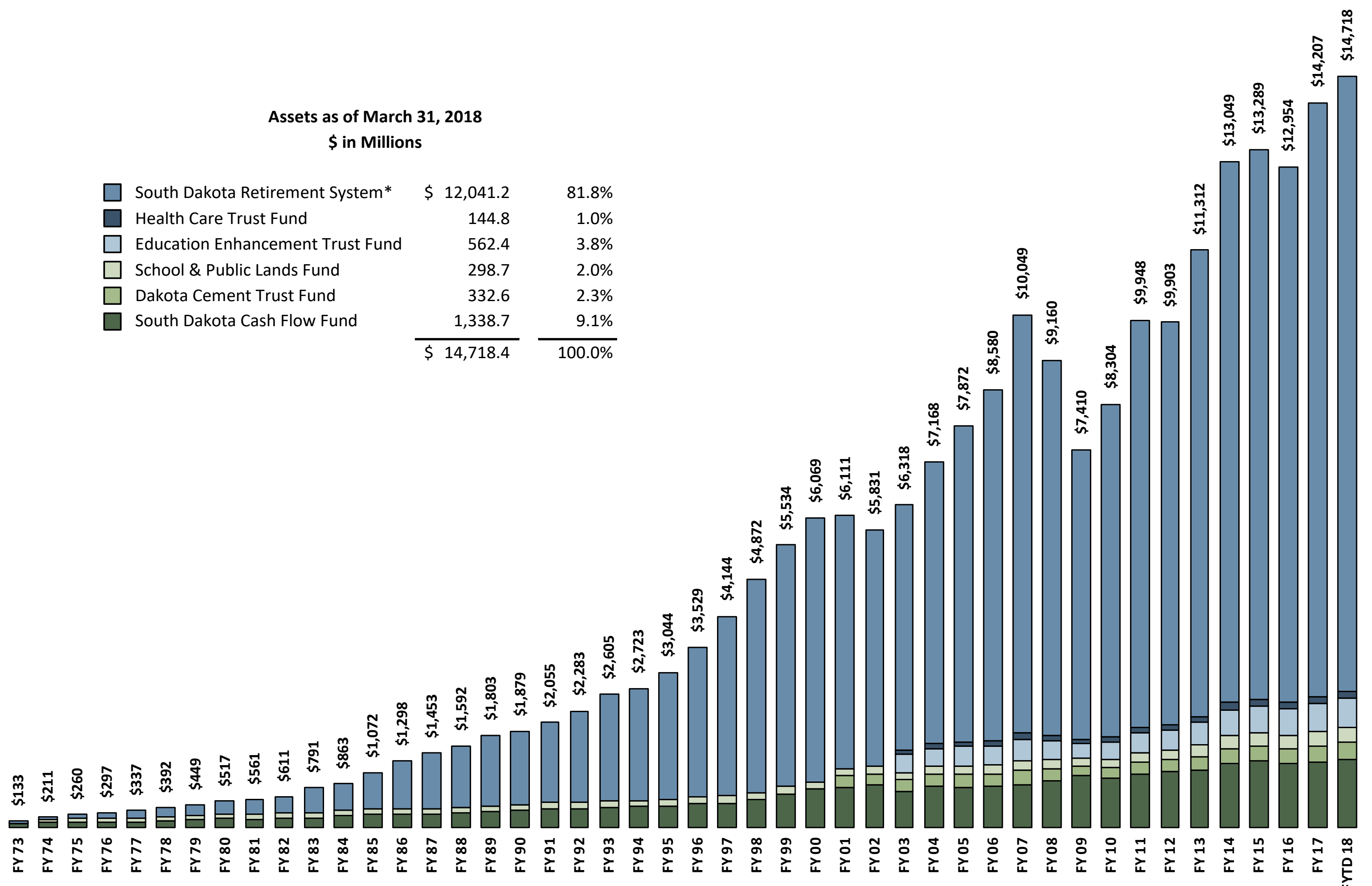
May 21, 2018

- Assets managed
  - SDRS – FY 2018 return through 3/31/18 = 5.7%
  - Trust Funds – FY 2018 returns through 3/31/18 range from 5.08% to 5.17%
- 529 Scholarship Update – Transfers to Dakota Corps Scholarship Program
  - Last year (July 2017) transfer $ 1,722,012
  - Cumulative transfers since Sept 2007 $13,399,510
  - Estimated transfer for July 2018 $ 1,200,000
  - Allianz contract with another state was discontinued causing most of the decline from FY 2017
- Council Role & Selection
- Investment Officer FY 2019 Compensation
- Compensation Methodology

Assets

Assets as of March 31, 2018
$ in Millions

South Dakota Retirement System*	$ 12,041.2	81.8%
Health Care Trust Fund	144.8	1.0%
Education Enhancement Trust Fund	562.4	3.8%
School & Public Lands Fund	298.7	2.0%
Dakota Cement Trust Fund	332.6	2.3%
South Dakota Cash Flow Fund	1,338.7	9.1%
	$ 14,718.4	100.0%



* The South Dakota Cement Plant Retirement Fund (CPRF) was consolidated into the South Dakota Retirement System (SDRS) on April 1, 2014, per SDCL 3-12-217. For purposes of this exhibit, CPRF Assets for Fiscal Years 1973 - 2013 are included with SDRS.

Trust Funds
As of 3/31/18 (unaudited)

Health Care Trust (established April 2001)

Principal as of 3/31/18	$ 85,631,024
Principal as of 3/31/18 adjusted for inflation	$ 117,928,773
Fair Value (FV) as of 3/31/18	$ 144,825,065
Difference - FV less principal	$ 59,194,041
Difference - FV less infl. adj. prin.	$ 26,896,292
Fiscal year to date return	5.08%
Longterm expected mean return	5.86%
Payout of 4% plus expected inflation of 3%	7.00%
Expected return cushion/shortfall	-1.14%
Distribution for FY 19 (July 2, 2018)	**5,414,856**
Distribution for FY 18 (July 3, 2017)	5,214,739

Asset Allocation	Current	FY 18 Benchmark
Global & Private Equity	33%	51%
Real Estate	7%	10%
Fixed Income-IG	19%	30%
Fixed Income-HY	6%	7%
HY RE Debt	4%	0%
Money Market	31%	2%
Total	100%	100%

Law allows up to 4% of the 16 quarter average to be distributed as long as principal is not violated as of December 31 each year.

Education Enhancement Trust (established April 2001)

Principal as of 3/31/18	$ 366,546,780
Principal as of 3/31/18 adjusted for inflation	$ 493,216,119
Fair Value (FV) as of 3/31/18	$ 562,421,108
Difference - FV less principal	$ 195,874,328
Difference - FV less infl. adj. prin.	$ 69,204,989
Fiscal year to date return	5.10%
Longterm expected return (lower due to tax-exempts)	5.81%
Payout of 4% plus expected inflation of 3%	7.00%
Expected return cushion/shortfall	-1.19%
Distribution for FY 19 (July 2, 2018)	**20,430,221**
Distribution for FY 18 (July 3, 2017)	19,377,842

Asset Allocation	Current	FY 18 Benchmark
Global & Private Equity	34%	51%
Real Estate	7%	10%
Fixed Income-IG	9%	20%
Fixed Income-tax ex	8%	10%
Fixed Income-HY	4%	7%
HY RE Debt	6%	0%
Money Market	32%	2%
Total	100%	100%

Law allows up to 4% of the 16 quarter average to be distributed as long as principal is not violated as of December 31 each year.

Trust Funds
As of 3/31/18 (unaudited)

Dakota Cement Trust (established April 2001)

Principal as of 3/31/18	$ 238,000,000
Principal as of 3/31/18 adjusted for inflation	$ 335,814,231
Fair Value (FV) as of 3/31/18	$ 332,548,926
Difference - FV less principal	$ 94,548,926
Difference - FV less infl. adj. principal	$ (3,265,305)
Fiscal year to date return	5.08%
Longterm expected mean return	5.86%
Payout of 4% plus expected inflation of 3%	7.00%
Expected return cushion/shortfall	-1.14%
Distribution for FY 18 (June 2018 to GF)	**12,442,947**
Distribution for FY 17 (May 2017 to GF)	11,981,721

Asset Allocation	Current	FY 18 Benchmark
Global & Private Equity	33%	51%
Real Estate	7%	10%
Fixed Income-IG	19%	30%
Fixed Income-HY	4%	7%
HY RE Debt	6%	0%
Money Market	31%	2%
Total	100%	100%

Constitution allows 4% of the lesser of 1) the 16 quarter average balance or 2) the current December 31 fair value, be distributed by June of the following year.

School & Public Lands

Inflation protection mandated by Constitutional Amendment -
(payout is reduced by inflation to extent inflation not offset by realized net gains)

Fair Value as of 3/31/18	$ 298,711,517
Fiscal year to date return	5.17%
Longterm expected mean return	5.86%
Distribution for FY 18 K-12 (2/7/18)	11,282,477
Distribution for FY 17 Board of Regents (6/8/17)	2,409,329
TOTAL	**13,691,806**

Asset Allocation	Current	FY 18 Benchmark
Global & Private Equity	33%	51%
Real Estate	7%	10%
Fixed Income-IG	17%	30%
Fixed Income-HY	4%	7%
HY RE Debt	6%	0%
Money Market	34%	2%
Total	100%	100%

Investment Council Role

- Select State Investment Officer
- Maintain a bottom-line oriented non-political environment
- Establish investment policy
  - Benchmarks and asset allocation guidelines
  - Oversight of investment methodology
  - Oversight of external partners
- Monitor compliance
  - Audit committee
  - Conflict of Interest Policy
- Approve annual budget and long-term plan (then goes to Executive Board, Governor, Appropriations)
  - Compensation committee approves compensation framework
  - Recommend Investment Officer compensation to Executive Board of the LRC

Importance of Council Selection

- Council patience and steadfast support is essential to allow the investment team to maintain a long-term focus and persevere through difficult periods
- Essential to select Council members that believe in a long-term approach
- Council success also depends on patience of all South Dakota policy-makers
- Selection of highly respected Council members can help inspire confidence in the Council's oversight of the investment team and budget

Investment Officer FY 2019 Compensation

Investment Council Motion 4/19/18

Recommendation to LRC Executive Board for Investment Officer FY2019 Compensation:

> Lorin Brass moved, seconded by Rob Wylie, that the Investment Council recommend to the LRC Executive Board that total compensation for the State Investment Officer payable in FY 2019 be comprised of the FY 2018 base salary adjusted for state salary policy and continuation of the investment performance incentive plan, with any earned incentive to be paid following completion of the audit. Motion passed unanimously.

Compensation Overview

- Long-term results have significantly exceeded benchmarks
  - Added over 35% beyond benchmark to SDRS assets in the past 19 years
- Continued success dependent on high caliber team
  - Internal management & internal research aids performance and cost efficiency
- Future team depends on retention of talent pipeline and trainers
  - Develop internally as cannot compete for top tier experienced talent
- Compensation plan aligned with goal of adding value over long term
  - Incentives for added value motivate performance and aid retention of successful staff
- Compensation plan updated every 3-4 years, most recently 2016
  - Council target is 70% of cost of living adjusted median industry pay to balance getting a good deal for South Dakota without losing the good deal if we cannot keep our people
  - Incorporates performance incentives (range of 0% to 200%) including LT and stretch
  - Incentives expected to average 80% with continuation of historical performance

Investment Performance Incentives

Aligns compensation with goal of adding value

- Encourage superior performance
  - Counters underperformance career risk that can discourage efforts to add value
  - Multiyear timeframes encourage investing for the long term
- Encourage retention of successful staff
  - Team is most attractive to other organizations when winning
  - Shifts compensation higher when people more sought after and down when losing
- Incentives paid only for added value
- Important to encourage adding value in good and bad markets
  - Added value in down markets more important than in up markets
  - Encourages adding value by reducing risk when markets expensive

Target Discount Rationale

- Need top caliber people long term
  - Unsuccessful people or job hoppers always available but no bargain, even if free
  - Compensation is too low to recruit veteran high-performers from elsewhere
  - Must develop team internally by training cream of crop local University graduates
  - Takes 15 to 20 years to fully develop seasoned talent
  - If lose talent pipeline or trainers, will jeopardized handoff to next generation
- Our past history and observation of others suggest 70% target
  - No way to know for sure how large discounts can be without damaging team
  - 50% discount levels in past led to difficulties
  - 30% discount believed significant relative to other high-end professionals
  - Industry subject to intense performance measurement with significant consequences for winning and losing which impacts sensitivity to financial security
  - Discounts for top SDIC performers may be much larger as industry pay for top quartile performers can be double the median