

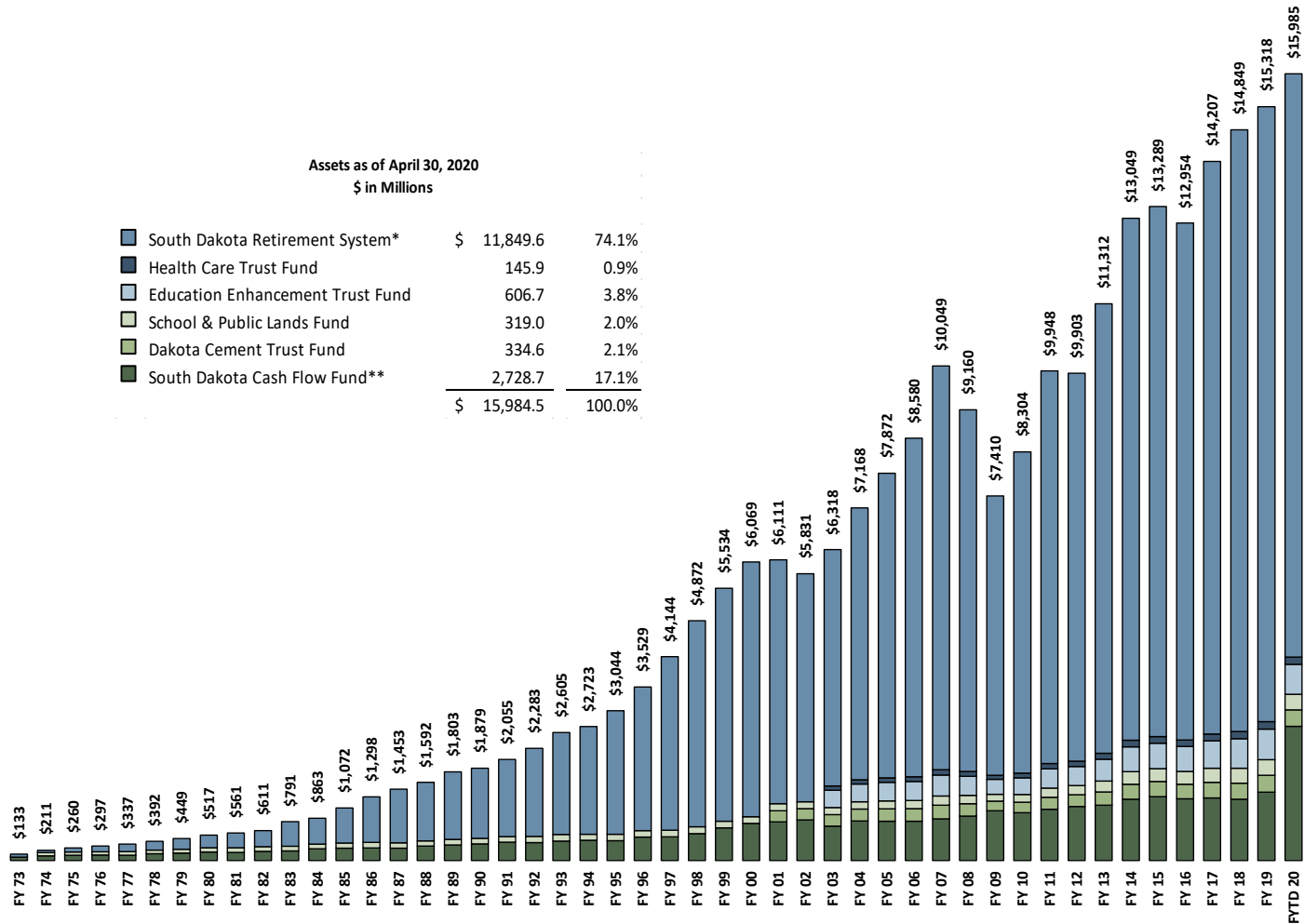
# LRC Executive Board

## Investment Council Update

June 8, 2020

- Assets managed
  - SDRS – FY 2020 estimated return through 5/31/20 = .5%
  - Trust Funds – FY 2020 estimated return through 5/31/20 range from 1% to 2%
  
- 529 Scholarship Update – Transfers to Dakota Corps Scholarship Program
  - Last year (July 2019) transfer \$ 1,187,352
  - Cumulative transfers since Sept 2007 \$15,792,539
  - Estimated transfer for July 2020 \$ 1,075,000
  
- Council Role & Selection
  
- Investment Officer FY 2021 Compensation
  
- Compensation Methodology

# Assets



\*The South Dakota Cement Plant Retirement Fund (CPRF) was consolidated into the South Dakota Retirement System (SDRS) on April 1, 2014, per SDCL 3-12C-1642. For purposes of this exhibit, CPRF Assets for Fiscal Years 1973 - 2013 are included with SDRS.

\*\*Includes Coronavirus Relief Fund

# Trust Funds

## As of 4/30/20 (unaudited)

### Health Care Trust (established April 2001)

Principal as of 4/30/20	\$ 85,631,024
Principal as of 4/30/20 adjusted for inflation	\$ 120,973,170
Fair Value (FV) as of 4/30/20	\$ 145,879,876
Difference - FV less principal	\$ 60,248,852
Difference - FV less infl. adj. prin.	\$ 24,906,706
Fiscal year to date return	0.78%
Longterm expected mean return	6.06%
Payout of 4% plus expected inflation of 2.25%	6.25%
Expected return cushion/shortfall	-0.19%

Distribution for FY 21 (July 1, 2020)	<b>5,676,706</b>
Distribution for FY 20 (July 2, 2019)	5,520,073

### Education Enhancement Trust (established April 2001)

Principal as of 4/30/20	\$ 410,923,760
Principal as of 4/30/20 adjusted for inflation	\$ 551,072,196
Fair Value (FV) as of 4/30/20	\$ 606,694,395
Difference - FV less principal	\$ 195,770,635
Difference - FV less infl. adj. prin.	\$ 55,622,199
Fiscal year to date return	-0.10%
Longterm expected return (lower due to tax-exempts)	6.00%
Payout of 4% plus expected inflation of 2.25%	6.25%
Expected return cushion/shortfall	-0.25%

Distribution for FY 21 (July 1, 2020)	<b>22,515,469</b>
Distribution for FY 20 (July 2, 2019)	21,334,593

Asset Allocation	FY 20	
	Current	Benchmark
Global & Private Equity	35%	51%
Real Estate	8%	10%
Fixed Income-IG	22%	30%
Fixed Income-HY	4%	7%
HY RE Debt	6%	0%
Money Market	<u>24%</u>	<u>2%</u>
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.

Asset Allocation	FY 20	
	Current	Benchmark
Global & Private Equity	36%	51%
Real Estate	8%	10%
Fixed Income-IG	10%	22%
Fixed Income-tax ex	7%	8%
Fixed Income-HY	4%	7%
HY RE Debt	5%	0%
Money Market	<u>30%</u>	<u>2%</u>
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 4/30/20 (unaudited)

### Dakota Cement Trust (established April 2001)

			FY 20	
		<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Principal as of 4/30/20	\$ 238,000,000	Global & Private Equity	35%	51%
Principal as of 4/30/20 adjusted for inflation	\$ 344,483,462	Real Estate	8%	10%
Fair Value (FV) as of 4/30/20	\$ 334,583,350	Fixed Income-IG	22%	30%
Difference - FV less principal	\$ 96,583,350	Fixed Income-HY	4%	7%
Difference - FV less infl. adj. principal	\$ (9,900,112)	HY RE Debt	6%	0%
Fiscal year to date return	0.74%	Money Market	<u>24%</u>	<u>2%</u>
Longterm expected mean return	6.06%	Total	100%	100%
Payout of 4% plus expected inflation of 2.25%	6.25%			
Expected return cushion/shortfall	-0.19%			
Distribution for FY 20 (May 2020 to GF)	<b>13,004,590</b>			
Distribution for FY 19 (June 2019 to GF)	12,682,857			

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)

			FY 20	
		<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Fair Value as of 4/30/20	\$ 319,016,557	Global & Private Equity	37%	51%
Fiscal year to date return	1.79%	Real Estate	8%	10%
Longterm expected mean return	6.06%	Fixed Income-IG	19%	30%
Distribution for FY 20 K-12 (2/4/20)	12,694,914	Fixed Income-HY	4%	7%
Distribution for FY 20 Board of Regents (6/9/20)	<u>3,426,000</u>	HY RE Debt	5%	0%
TOTAL	<b>16,120,914</b>	Money Market	<u>26%</u>	<u>2%</u>
		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

# Compensation Overview

- Long-term results have significantly exceeded benchmarks
  - Added more than 25% beyond benchmark to SDRS assets in the past 21 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 late 2019
  - 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