

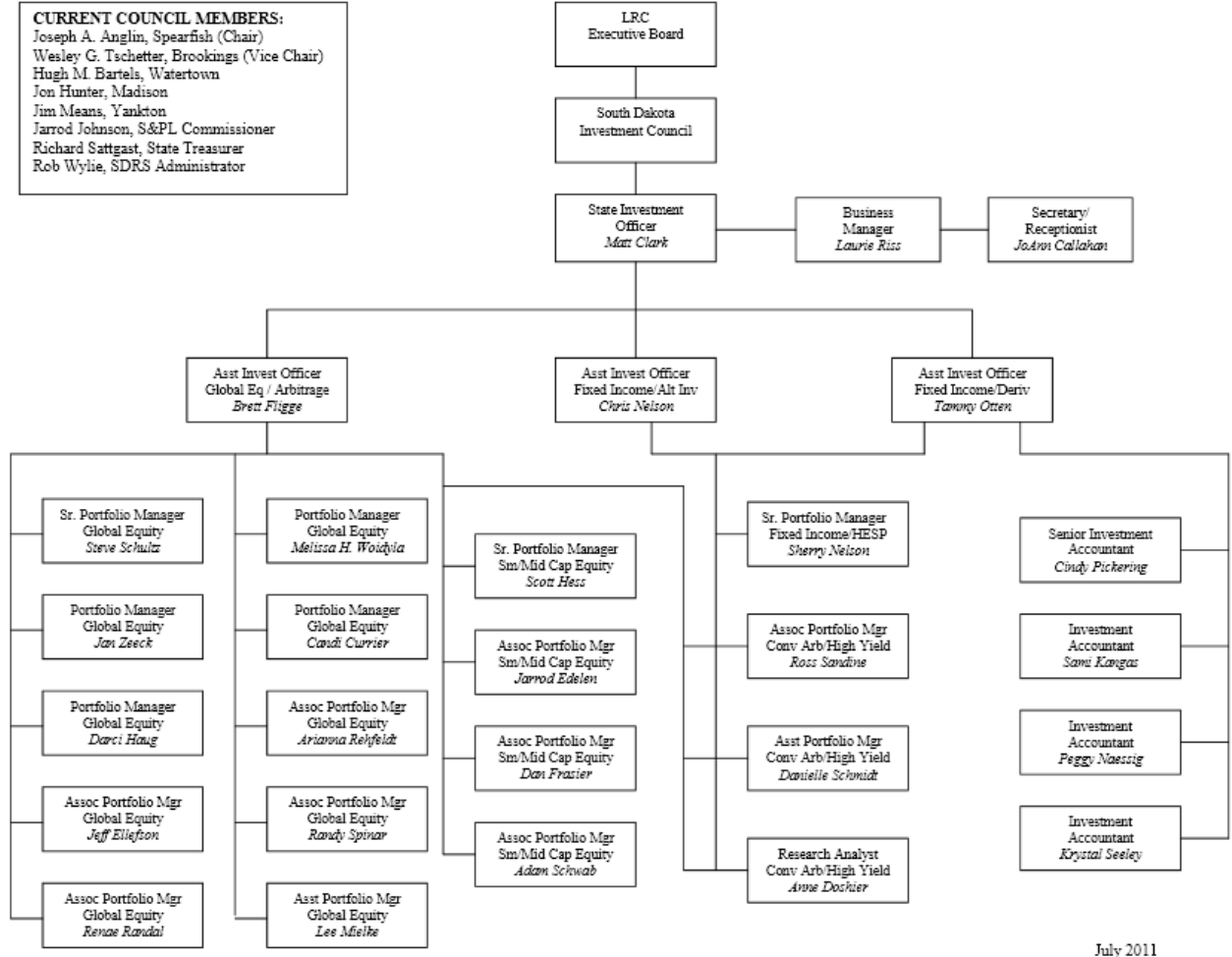
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Joint Committee on  
Appropriations  
Fiscal Year 2013

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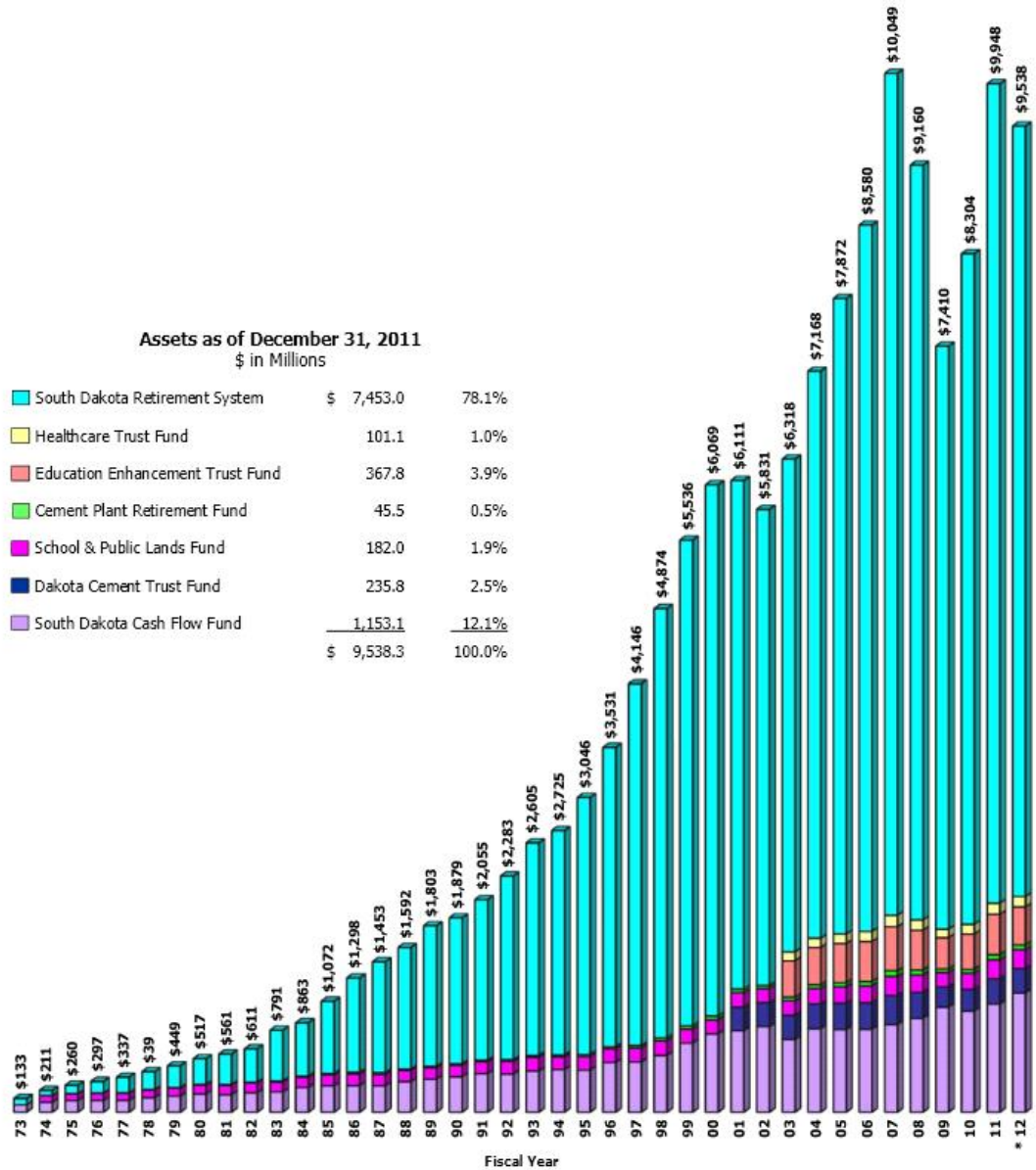
South Dakota Investment Council  
February 8, 2012

**CURRENT COUNCIL MEMBERS:**  
 Joseph A. Anglin, Spearfish (Chair)  
 Wesley G. Tschetter, Brookings (Vice Chair)  
 Hugh M. Bartels, Watertown  
 Jon Hunter, Madison  
 Jim Means, Yankton  
 Jarrod Johnson, S&PL Commissioner  
 Richard Sattgast, State Treasurer  
 Rob Wylie, SDRS Administrator



July 2011

# South Dakota Investment Council Assets Managed Fiscal Years 1973 to 2011 and Fiscal Year 2012 through 12/31/11



\*Fiscal Year as of 12/31/11

## **SOUTH DAKOTA INVESTMENT COUNCIL**

### **Budget Process & Long-Term Plan**

- I. Investment Council Budget Process
  - A) Budget approved by LRC Executive Board before presenting to Bureau of Finance and Management and Appropriations Committee - SDCL 4-5-22
  - B) Budget deducted from assets under management - no general fund appropriation - SDCL 4-5-30
  
- II. Developed Long-Term Plan – began in 1987
  - A) Recommended by Appropriations Committee to encourage internal management and recognize the potential need for outside management
  - B) Supported by LRC Executive Board

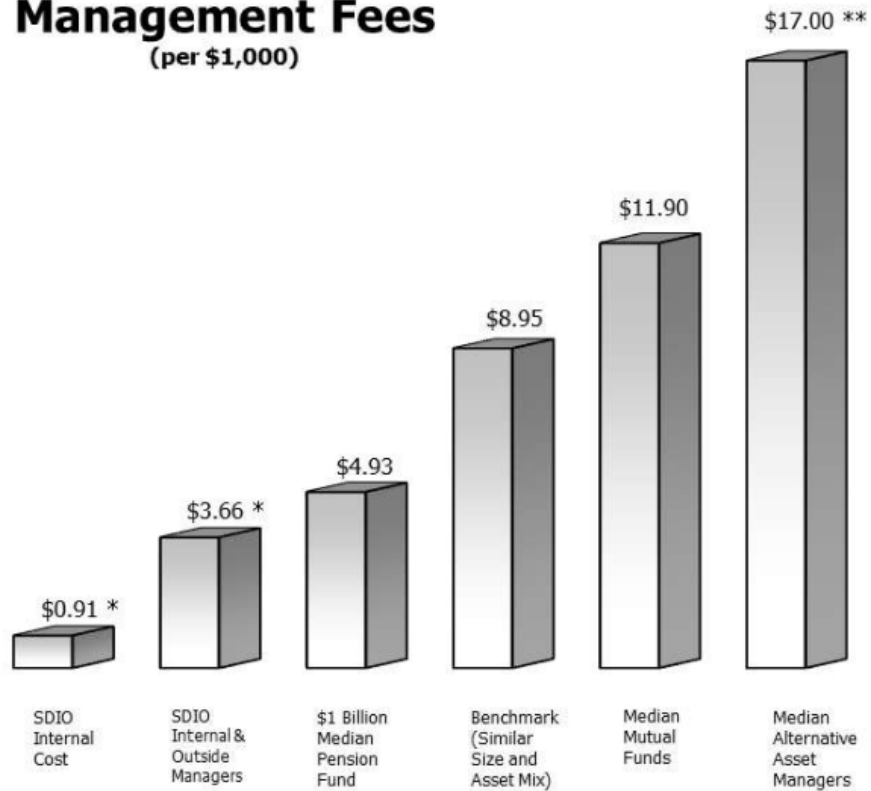
**SOUTH DAKOTA INVESTMENT COUNCIL  
Long-Term Plan  
Executive Summary**

	<u>FY 2013</u>	<u>FY 2018</u>	<u>FY 2023</u>
<b>INVESTMENT OFFICE BUDGET</b>			
<b>Personal Services</b>			
Number of Employees	[28]	[30]	[30]
Compensation w/0% Investment Performance Incentive	3,949,267	6,109,015	8,289,744
Total Maximum Potential Investment Perf Incentive	3,280,528	5,164,900	7,223,883
Compensation w/100% max potential Invest Perf Incentive	7,229,795	11,273,915	15,513,627
Intern	20,481	23,743	27,524
Council	7,875	7,875	7,875
Longevity	7,508	12,091	19,473
Benefits	1,187,208	1,849,300	2,543,893
Total Personal Services	8,452,866	13,166,923	18,112,391
<b>Operating Expenses</b>			
Contractual - Investment Services	956,400	1,253,019	1,568,182
Contractual - Administrative Services	514,897	623,795	757,534
Travel	73,000	97,457	123,202
Office Supplies & Postage	12,733	17,246	21,803
Capital Assets	28,242	41,240	50,018
Total Operating Expenses	1,585,272	2,032,757	2,520,738
<b>Total Investment Council Budget</b>	<b>10,038,138</b>	<b>15,199,681</b>	<b>20,633,129</b>
<b>ASSET SUMMARY *</b>			
Internal Assets	8,270,546,085	10,767,420,148	14,125,727,313
External Assets	2,756,848,695	3,589,140,049	4,708,575,771
Total Retirement System Assets	8,997,377,074	12,165,670,834	16,455,797,703
Total Assets	11,027,394,781	14,356,560,197	18,834,303,084
<b>EXPENSE SUMMARY</b>			
Internal Expenses	10,038,138	15,199,681	20,633,129
External Manager Fees	30,325,336	39,480,541	51,794,333
Total Expenses	40,363,474	54,680,221	72,427,463
<b>UNIT COST SUMMARY</b>			
Internal Expenses as % of Total Assets	0.091%	0.106%	0.110%
Internal Exp as % of Total Assets (1/2 assumed incentives)	0.076%	0.088%	0.090%
Total Expenses as % of Total Assets	0.366%	0.381%	0.385%

\* Projections based on long-term assumed returns applied to 6/30/11 assets. Updated each June 30.

6/2011

## Management Fees (per \$1,000)



### *By Keeping Costs Low...*

*The cost difference between SDIO's \$3.66 and the Benchmark (similar size and asset mix) of \$8.95 is approximately \$52 million per year. Compounded over 30 years at projected asset growth, future wealth grows an EXTRA \$7 billion by keeping costs low!*

**SOUTH DAKOTA INVESTMENT COUNCIL  
FISCAL YEAR 2011  
Year End Budget Summary**

	Received FY 2011	Actual Exp FY 2011	Unexpended
<b>PERSONAL SERVICES</b>			
Compensation with 0% Invest Performance Incentive	3,314,440	3,253,787.54	60,652.46 *
Total Maximum Potential Incentive	<u>2,808,345</u>	<u>1,575,352.85</u>	<u>1,232,992.15</u>
Compensation w/100% max potential Invest Perf Incent	6,122,785	4,829,140.39	1,293,644.61
Intern	19,884	0.00	19,884.00
Council Compensation	7,875	2,550.00	5,325.00
Longevity	6,335	6,335.00	0.00
Personal Benefits	<u>1,016,685</u>	<u>839,125.76</u>	<u>177,559.24</u>
<b>Total Personal Services</b>	<u>7,173,564</u>	<u>5,677,151.15</u>	<u>1,496,412.85</u>
<b>OPERATING EXPENSES</b>			
Contractual Services <i>(see next page for line item details)</i>	1,625,790	1,211,444.42 **	414,345.58
Travel	73,000	46,276.65	26,723.35
Office Supplies & Postage	14,148	10,925.63	3,222.37
Capital Assets	<u>31,380</u>	<u>22,727.87</u>	<u>8,652.13</u>
<b>Total Operating Expenses</b>	<u>1,744,318</u>	<u>1,291,374.57</u>	<u>452,943.43</u>
<b>TOTAL BUDGET</b>	<u>8,917,882</u>	<u>6,968,525.72</u>	<u>1,949,356.28</u>

\* \$47,689.17 Allianz reimbursement & delayed promotion increases for investment accountants

\*\* An additional \$6,692.13 in Bloomberg fees were incurred but waived due to securities transactions executed through their trading system.

**FISCAL YEAR 2012  
Budget Funding (SDCL 4-5-30)**

FY 2012 AUTHORIZED BUDGET	8,699,288.00
LESS FY 2011 CASH BALANCE	<u>(1,949,356.28)</u>
REMAINING FY 2012 BALANCE TO BE FUNDED	<u>6,749,931.72</u>

	Received FY 2011	Actual Exp FY 2011	Unexpended
<b>CONTRACTUAL SERVICES</b>			
<b>Investment Services</b>			
Consulting Services			
Consulting/Comp Analysis/Asset Alloc/etc.	80,000	0.00	80,000.00
Consultant-Steve Myers (March, 2010 - June, 2011)	50,000	55,530.95	(5,530.95)
Subtotal	130,000	55,530.95	74,469.05
Investment Accounting, Performance, Benchmarking			
BNY/Mellon Performance & Risk Analysis	20,000	20,000.00	0.00
S&P 1200	12,000	12,000.00	0.00
S&P 1000	0	0	0.00
S&P 1200 - Add'l - Iran free	0	8,000.00	(8,000.00)
Portia	50,000	38,559.33	11,440.67
Subtotal	82,000	78,559.33	3,440.67
Investment Databases, Newsfeeds & Quote Fees			
Bloomberg	146,475	115,201.21 **	31,273.79
Factset	160,315	164,669.04	(4,354.04)
Reuters Fundamental Index	24,000	25,188.00	(1,188.00)
Quote Fees (incl. Bloomberg/Factset)	54,086	44,323.07	9,762.93
Dow Jones News Service	34,804	35,946.00	(1,142.00)
Subtotal	419,680	385,327.32	34,352.68
Investment Research Services			
KDP High Yield	20,000	15,600.00	4,400.00
Stone McCarthy	4,305	4,140.00	165.00
Gimme Credit FI Research	25,000	23,153.00	1,847.00
Citigroup Yield Book / BB Index	10,000	0.00	10,000.00
PCS--Wall Street Access & European Research (cancelled)	28,350	12,000.00	16,350.00
PCS--American Mergers (cancelled)	12,600	0.00	12,600.00
PCS--Asia Pacific Mergers (cancelled)	0	5,000.00	(5,000.00)
Credit Sights	42,000	45,000.00	(3,000.00)
Indie Research-Insider Score	14,000	16,800.00	(2,800.00)
Gerson Lethman (cancelled)	40,000	0.00	40,000.00
Morningstar Equity	30,000	46,375.00	(16,375.00)
The Markets.com	13,260	13,554.84	(294.84)
First Rain	14,000	0.00	14,000.00
Value Line	0	6,100.00	(6,100.00)
Management CV	0	15,000.00	(15,000.00)
Flexibility - From Brokerage to Independent Research	206,000	0.00	206,000.00
Subtotal	459,515	202,722.84	256,792.16
<b>Total Investment Services</b>	<b>1,091,195</b>	<b>722,140.44</b>	<b>369,054.56</b>
<b>Administrative Expenses</b>			
Office Rent	101,542	101,541.84	0.16
Bond/Liability Insurance	7,020	0.00	7,020.00
Telephone	10,000	4,441.08	5,558.92
Office Equip Rental/Maintenance	6,000	4,721.91	1,278.09
Bureau of Info & Telecommunications (BIT)	37,448	42,946.41	(5,498.41)
State Central Services	9,000	7,974.15	1,025.85
Legislative Audit	37,135	31,605.60	5,529.40
Custodial Fees - Global	288,750	275,499.92	13,250.08
Seminars/Educational Programs	33,500	16,919.00	16,581.00
Business Publications	4,200	3,654.07	545.93
<b>Total Administrative Expenses</b>	<b>534,595</b>	<b>489,303.96</b>	<b>45,291.02</b>
<b>TOTAL CONTRACTUAL SERVICES</b>	<b>1,625,790</b>	<b>1,211,444.42</b>	<b>414,345.58</b>

\*\* An additional \$6,692.13 in Bloomberg fees were incurred but waived due to securities transactions executed through their trading system.



**SOUTH DAKOTA INVESTMENT COUNCIL  
BUDGET REQUEST SUMMARY**

**Fiscal Year 2013**

- ◆ The Investment Council concurs with the Governor's recommended FY 2013 budget, Version A in the following exhibits. Version B is provided for informational purposes as the originally approved budget by the Investment Council in June 2011 and the LRC Executive Board in August 2011.
- ◆ Overall FY 2013 budget request is a 1% increase.
- ◆ The unit cost for internally managed assets is \$0.80 per \$1,000 of assets for FY 2013 compared to a median industry cost of \$4.93 per \$1,000 of assets.
- ◆ **Personal Services:**  
Total Personal Services increases 4.57%

- ◇ **Compensation Study:** The Deloitte compensation study, updated in the spring of 2010, suggested compensation for investment positions had fallen to a 35% discount after cost-of-living adjustments. The Council's target in our long-term plan is a 30% discount in an attempt to balance the desire to get a good deal for South Dakota (quality results and low cost) with the risk of losing a good deal if we cannot keep our people. The reductions in investment position salaries in FY2012, together with expected moderate increases in industry pay for such positions, pushes the discount to more than 40%. The compensation study is expected to be updated again in the spring of 2013.
- ◇ **Compensation:** Total compensation for investment positions is expected to consist of two-thirds in the form of base compensation and one-third in return-linked incentive compensation (assuming a 50% average incentive over time). The total maximum incentive budget is funded at 85%.

Base salaries include a 4.8% increase for the 22 investment positions according to the long-term plan, and a 3% increase for the accounting and administrative positions. In addition: The newer and intermediate level team members increase an additional 1% to 15.2% for promotion increases as they continue transitioning through the steep learning curve from entry level to senior investment team members. The investment accounting positions are increasing an additional 2% to 3% to more closely reflect industry compensation levels for accountants with CPA designations and their increased years of experience.

- ◇ **Return-linked incentive compensation:** Investment Performance incentives encourage outperformance of capital market benchmarks and the private sector corporate universe and range from 0% to a maximum of 100% of base salary. Incentives are paid only if earned by superior performance. Typically, due to historically superior performance, the average earned incentive across all positions in total has averaged 40% to 60% of the maximum.
- ◇ **Employee benefits:** Benefits were increased according to the calculations provided by the Bureau of Finance and Management.
- ◆ **Operating Expenses:**  
The overall operating budget decreases by 12.69%. Within the operating budget, no increases or decreases are being requested for travel, supplies and capital assets.

Changes within the contractual services budget net to a decrease of 13.48%. The primary changes include:

- ◇ Consulting fees decrease by \$20,000 leaving \$30,000 for consulting fees for compensation analysis or other issues as determined by the Investment Council board members.
- ◇ Contractual Services for all investment research services net to an increase by \$53,364. Investment research services are renewed or replaced depending on price negotiations and availability of better price or quality product.

- ◇ Computer services increasing by \$5,668 per expected costs provided by BIT.
  - ◇ Legal fees of the Attorney General's office budgeted at \$16,000. Have used the legal services of the AG's office for many years, but have agreed to begin paying for their legal assistance, primarily with respect to limited partnership agreements.
  - ◇ Bank fees decreasing by \$288,250. In our FY2012 budget, we increased this item in anticipation of a significant increase of our bank custodian fees with BNY/Mellon. Successful re-negotiations of their fee schedule resulted in a decrease of their fees.
- ◆ The long-term business plan continues to provide an excellent roadmap.
    - ◇ Provides excellent foundation for stability of South Dakota's professional investment function.
    - ◇ Continues the long-term focus on low unit cost management.
    - ◇ A key ingredient to long-term superior investment performance.

#### Joint Committee on Appropriations Supplemental Questions

1. What current activities are you going to stop doing? *None*
2. What activities are you going to change? *None*
3. What new activities are you going to initiate? *None*
4. With regards to the budget adjustments that occurred last year, will your agency be able to sustain them on a long-term basis? *There is concern about the long-term sustainability of the compensation adjustments last year. It is hoped that the announced plans for a one-time payout this year and FY13 compensation increases will buy us some time, at least until the planned update to the compensation study in the spring of 2013.*
5. What initiatives for improving efficiency of operations are planned in FY 13? *We already use technology intensively to maximize efficiencies of investment research, portfolio management and accounting activities. No specific initiatives are planned for FY 13.*
6. What are the standards of performance or metrics by which you judge the success and efficiencies of your agency's outcomes? *The exhibits in the SDIC presentation illustrate the standards of performance by which we judge the success and efficiencies of our outcomes. With regard to success, the most specific exhibits can be found on pages 12 and 13, and with regard to efficiencies, pages 4 through 7.*
7. What funds from FY12 are planned to be applied to FY13 activities? Are these amounts in addition to amounts contained in the Governor's FY13 budget? *None. SDCL 4-5-30 established process for funding budget. Any cash balance remaining in a fiscal year offsets the following year budget authorization. No funds are carried over in addition to budget authorization.*
8. What are your plans regarding amending the FY12 General Bill? *None. If the Legislature approves a one-time 5% additional compensation payout in FY12, it can be funded within the existing budget authorization by using unspent investment incentive funds if we are directed to do so.*
9. A. What reductions in federal programs administered by your agency, if any, could develop in FY13?  
B. What amounts of General Funds and/or Other Funds have been proposed in the Governor's budget to match any such federal funds at risk? *We have no federal programs or funds.*

**SOUTH DAKOTA INVESTMENT COUNCIL  
FY 2013 Budget Request**

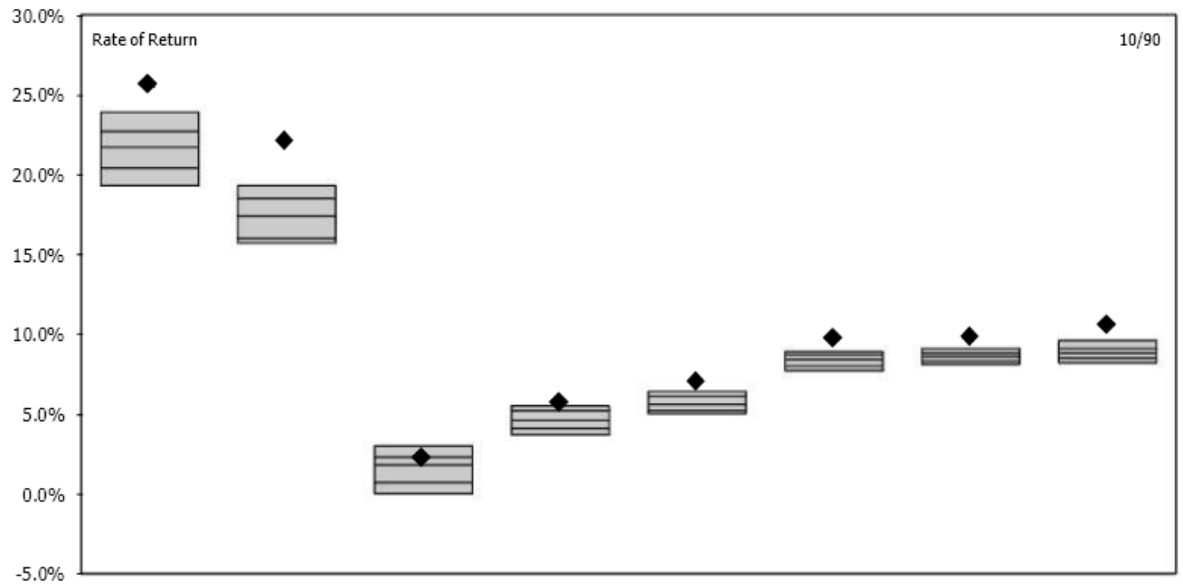
	Received <u>FY 2012</u>	Version A Gov/BFM Recommended*		Version B Original-SDIC & Ex Brd Approved	
		<u>FY 2013</u>	% Change	<u>FY 2013</u>	% Change
<b>PERSONAL SERVICES</b>					
Compensation with zero Invest Performance Incentive	3,343,185	3,612,529	8.06%	3,657,616	9.41%
Total Maximum Potential Incentive	2,553,557	2,548,621	-0.19%	2,698,540	5.88%
Compensation with total max potential Invest Perf Incent	5,896,743	6,161,151	4.48%	6,356,156	7.79%
Total Intern, Council, Longevity	17,890	17,890	0.00%	20,160	12.09%
Personal Benefits	975,770	1,025,925	5.14%	1,052,970	7.91%
<b>TOTAL PERSONAL SERVICES</b>	<b>6,890,403</b>	<b>7,204,966</b>	<b>4.57%</b>	<b>7,429,286</b>	<b>7.82%</b>
<b>OPERATING EXPENSES</b>					
Contractual Total (see attached for line item details)	1,702,210	1,472,742	-13.48%	1,471,297	-13.57%
Travel	65,700	65,700	0.00%	73,000	11.11%
Office Supplies & Postage	12,733	12,733	0.00%	12,733	0.00%
Capital Assets	28,242	28,242	0.00%	28,242	0.00%
<b>TOTAL OPERATING EXPENSES</b>	<b>1,808,885</b>	<b>1,579,417</b>	<b>-12.69%</b>	<b>1,585,272</b>	<b>-12.36%</b>
<b>TOTAL BUDGET REQUEST</b>	<b>8,699,288</b>	<b>8,784,383</b>	<b>0.98%</b>	<b>9,014,558</b>	<b>3.62%</b>
<b>UNIT COST SUMMARY</b>					
Internal Expenses as % of Total Assets		0.080%		0.082%	
Internal Expenses as % of Total Assets (with 50% avg Inv Perf Incent)		0.065%		0.067%	
Total Expenses as % of Total Assets		0.355%		0.357%	

\* Version A: SDIC concurred with this recommendation at their 12/9/11 meeting. Includes Long-Term Plan (LTP) percentages applied to lowered FY2012 base compensation, and maximum potential incentives funded at 85%—same as FY2012 (previously always funded at 100%)

Version B: Movement toward LTP levels, and maximum potential incentives funded at 90%

OPERATING EXPENSES	Received	Version A		Version B	
	FY 2012	Gov/BFM Recommended*	% Change	Original-SDIC & Ex Brd Approved	% Change
<b>Contractual - Investment Services</b>					
Consulting Services					
Consulting/Comp Analysis/Asset Alloc/etc.	50,000	30,000	-40.00%	30,000	-40.00%
Subtotal	50,000	30,000	-40.00%	30,000	-40.00%
Investment Accounting, Performance, Benchmarking					
BNY/Mellon Performance & Risk Analysis	0	20,000	100.00%	20,000	100.00%
S&P 1200	12,000	12,000	0.00%	12,000	0.00%
S&P 1000	0	2,000	100.00%	2,000	100.00%
S&P USA	0	10,000	100.00%	10,000	100.00%
IDC - S&P 1200 - Add'l - Iran free	10,000	0	-100.00%	0	-100.00%
Portia	50,000	50,000	0.00%	50,000	0.00%
Subtotal	72,000	94,000	30.56%	94,000	30.56%
Investment Databases, Newsfeeds & Quote Fees					
Bloomberg	146,475	132,111	-9.81%	132,111	-9.81%
Factset	181,632	188,022	3.52%	188,022	3.52%
Reuters Fundamental Index	25,462	26,630	4.59%	26,630	4.59%
Quote Fees (incl. Bloomberg/Factset)	54,066	45,125	-16.57%	45,125	-16.57%
Dow Jones News Service	34,804	42,984	23.50%	42,984	23.50%
Subtotal	442,459	434,872	-1.71%	434,872	-1.71%
Investment Research Services					
KDP High Yield	20,000	20,000	0.00%	20,000	0.00%
Stone McCarthy	4,305	4,305	0.00%	4,305	0.00%
Gimme Credit FI Research	25,000	25,000	0.00%	25,000	0.00%
Citigroup Yield Book / BB Index	10,000	10,000	0.00%	10,000	0.00%
PCS--Wall Street Access & European Research	28,350	0	-100.00%	0	-100.00%
PCS--American Mergers	10,000	0	-100.00%	0	-100.00%
PCS--Asia Pacific Mergers	11,000	0	-100.00%	0	-100.00%
Credit Sights	39,900	47,250	18.42%	47,250	18.42%
Indie Research-Insider Score	14,000	17,640	26.00%	17,640	26.00%
Gerson Lehman	30,000	30,000	0.00%	30,000	0.00%
Morningstar Equity	44,000	75,000	70.45%	75,000	70.45%
The Markets.com	13,260	14,233	7.34%	14,233	7.34%
First Rain	16,000	0	-100.00%	0	-100.00%
Value Line	0	4,100	100.00%	4,100	100.00%
Management CV	18,000	0	-100.00%	0	-100.00%
Flexibility - From Brokerage to Independent Research	74,762	150,000	100.84%	150,000	100.84%
Subtotal	358,577	397,528	10.88%	397,528	10.88%
<b>Total Contractual - Investment</b>	<b>923,036</b>	<b>956,400</b>	<b>3.61%</b>	<b>956,400</b>	<b>3.61%</b>
<b>Contractual - Administrative</b>					
Office Rent	101,542	101,542	0.00%	101,542	0.00%
Bond/Liability Insurance	7,020	7,020	0.00%	7,020	0.00%
Telephone	10,000	10,000	0.00%	10,000	0.00%
Office Equip Rental/Maintenance	6,000	6,000	0.00%	6,000	0.00%
Bureau of Info & Telecommunications (BIT)	36,036	41,704	15.73%	40,259	11.72%
State Central Services	8,741	8,741	0.00%	8,741	0.00%
Legislative Audit	37,135	37,135	0.00%	37,135	0.00%
Attorney General's Office - Legal Services	0	16,000	100.00%	16,000	100.00%
Custodial Fees - Global	538,750	250,500	-53.50%	250,500	-53.50%
Seminars/Educational Programs	29,750	33,500	12.61%	33,500	12.61%
Business Publications	4,200	4,200	0.00%	4,200	0.00%
<b>Total Contractual - Administrative</b>	<b>779,174</b>	<b>516,342</b>	<b>-33.73%</b>	<b>514,897</b>	<b>-33.92%</b>
<b>CONTRACTUAL TOTAL</b>	<b>1,702,210</b>	<b>1,472,742</b>	<b>-13.48%</b>	<b>1,471,297</b>	<b>-13.57%</b>

## Annualized Total Fund STATE FUND UNIVERSE Ending June 30, 2011



	1 year	2 years	4 years	5 years	10 years	20 years	25 years	38 years
<b>Median</b>	21.7%	17.4%	1.8%	4.6%	5.6%	8.4%	8.6%	8.8%
<b>◆ SDRS Total Fund Return</b>	25.8%	22.2%	2.1%	5.7%	7.0%	9.7%	9.8%	10.6%
<b>% Ranking</b>	2	1	36	7	5	1	1	1

**INVESTMENT PERFORMANCE**  
**PERCENT RETURNS & DOLLARS**

**Returns**

	<u>FY 2011</u>	<u>7 Years Annualized FY 05 – 11</u>	<u>10 Years Annualized FY 02 – 11</u>
SDRS Total Fund	25.84%	7.80%	7.01%
Mellon Analytics Billion \$ Corp Plan	19.68%	6.56%	5.93%
% Difference	<b>6.16%</b>	<b>1.24%</b>	<b>1.08%</b>
Capital Market Benchmark	22.06%	6.17%	5.72%
% Difference	<b>3.78%</b>	<b>1.63%</b>	<b>1.29%</b>
State Fund Universe	21.70%	6.20%	5.60%
% Difference	<b>4.14%</b>	<b>1.60%</b>	<b>1.41%</b>
SDRS Beginning FY11 Assets		\$6.488 billion	
SDRS Ending 6/30/11 Assets		\$7.926 billion	

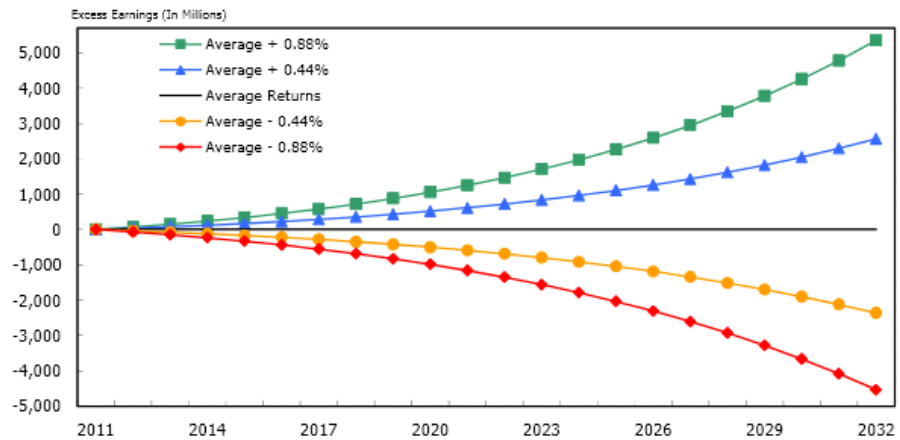
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**Dollars**

- Total SDRS dollars earned Fiscal Year 2011: \$1.654 billion
- Total SDRS dollars earned last 7 years: \$3.505 billion
- Total SDRS dollars earned last 10 years: \$4.276 billion
- **Extra earnings** resulting from last 1, 7 and 10 years of performance:

	<u>1 year</u>	<u>7 years</u>	<u>10 years</u>
➤ vs. Mellon Analytics Corporate:	<b>\$400 million</b>	<b>\$713 million</b>	<b>\$840 million</b>
➤ vs. Capital Market Benchmark:	<b>\$245 million</b>	<b>\$751 million</b>	<b>\$828 million</b>
➤ vs. State Funds:	<b>\$269 million</b>	<b>\$639 million</b>	<b>\$758 million</b>

## Potential Excess Earnings



SDIC outperformance for the last 38 years has been .88% annualized versus benchmark. By the year 2032, a continued .88% outperformance would earn an extra \$5.4 billion. Outperformance of even half that amount would make a large difference by additional earnings of \$2.6 billion. In contrast, a .88% underperformance would cost the retirement systems \$4.5 billion relative to average returns.

## FY 2011 Performance

### Compensation & Return-Linked Incentive Methodology Review

- FY2011 SDRS investment return was 25.84%
  - Large pension fund peer universe median return was 19.68%  
Outperformance of 6.16% resulted in \$400 million of added value
  - Investment Council's capital market index benchmark return was 22.06%  
Outperformance of 3.78% resulted in \$245 million of added value
  - Average added value over the Council's 38 year history is .88%
  - Council long-term return continues to rank 1st for its full history
- The 25.84% return = \$1.654 billion earnings for SDRS
- Added value (1&4 yr periods) results in a 67.65% payout for return-linked portion of compensation for the Investment Officer
  - Payout is approximately 1/15<sup>th</sup> of 1% of the added value vs. peer universe
  - Payout is approximately 1/10<sup>th</sup> of 1% of the added value vs. capital markets benchmark
- Compensation based on private sector pay for comparable positions after adjusting for cost of living difference and a further 30% discount to balance the desire to get a good deal for South Dakota (through quality results and low cost) with risk of losing the good deal if we cannot keep our people. The discount has increased to more than 40%.
  - Retaining value added staff long term is helpful to the Council sticking with its long term investment strategies during difficult periods
  - Internal staff development model and the ten to twenty year timeframe for staff to become fully experienced increases need to retain staff long term
- Council believes portion of compensation should be linked to added value to motivate performance and to retain staff when performance is superior
  - Investment team more attractive to competitors when outperforming, thus pay higher when adding value and lower when not adding value
  - Incentives focused primarily on multi-year timeframes to encourage investing long term with some on the one year to always have something at stake
  - Important to encourage adding value in difficult markets, not just up markets
  - Total Compensation includes base salary portion for two-thirds and return-linked portion for the other third consisting of an assumed average payout of 50% of base
  - Payout can range in any year from 0% to 100% depending on size of outperformance versus benchmarks
  - To average a 50% payout requires added value consistent with the long term track record



**SUMMARY OF TRUST FUND FAIR VALUE AND ASSET ALLOCATION**  
12/31/2011 (Unaudited)

**Health Care Trust (established April 2001)**

Principal as of 12/31/11	\$ 85,631,024
Principal as of 12/31/11 adjusted for inflation	\$ 107,190,656
Fair Value (FV) as of 12/31/11	\$ 101,151,012
Difference - FV less principal	\$ 15,519,988
Difference - FV less infl. adj. prin.	\$ (6,039,644)
Fiscal year to date return	-2.62%
Longterm expected mean return	6.39%
Payout of 4% plus expected inflation of 3%	7.00%
Expected return cushion/shortfall	-0.61%

<u>Asset Allocation</u>	<u>Current</u>	<u>FY 12 Benchmark</u>
Global Equity	52%	52%
Private Equity	3%	2%
Real Estate	11%	6%
Fixed Income-IG	26%	28%
Fixed Income-HY	2%	5%
Fixed Income-Tips	5%	5%
Money Market	1%	2%
Total	100%	100%

Distribution for FY 13	<b>3,825,385</b>
Distribution for FY 12 (July 1, 2011)	3,876,298

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 12/31/11	\$ 329,329,930
Principal as of 12/31/11 adjusted for inflation	\$ 412,858,001
Fair Value (FV) as of 12/31/11	\$ 367,821,426
Difference - FV less principal	\$ 38,491,496
Difference - FV less infl. adj. prin.	\$ (45,036,575)
Fiscal year to date return	-2.26%
Longterm expected return (lower due to tax exempts)	5.98%
Payout of 4% plus expected inflation of 3%	7.00%
Expected return cushion/shortfall	-1.02%

<u>Asset Allocation</u>	<u>Current</u>	<u>FY 12 Benchmark</u>
Global Equity	49%	52%
Private Equity	3%	2%
Real Estate	12%	6%
Fixed Income-IG	0%	0%
Fixed Income-tax ex	32%	30%
Fixed Income-HY	2%	5%
Fixed Income-Tips	1%	3%
Money Market	1%	2%
Total	100%	100%

Distribution for FY 13	<b>14,052,700</b>
Distribution for FY 12 (July 1, 2011)	14,469,388

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

**Dakota Cement Trust (established April 2001)**

Principal as of 12/31/11	\$ 238,000,000
Principal as of 12/31/11 adjusted for inflation	\$ 305,236,346
Fair Value (FV) as of 12/31/11	\$ 235,771,870
Difference - FV less principal	\$ (2,228,130)
Difference - FV less infl. adj. principal	\$ (69,464,476)
Fiscal year to date return	-2.67%
Longterm expected mean return	6.39%
Payout of 5% plus expected inflation of 3%	8.00%
Expected return cushion/shortfall	-1.61%

<u>Asset Allocation</u>	<u>Current</u>	<u>FY 12 Benchmark</u>
Global Equity	51%	52%
Private Equity	4%	2%
Real Estate	13%	6%
Fixed Income-IG	25%	28%
Fixed Income-HY	2%	5%
Fixed Income-Tips	5%	5%
Money Market	1%	2%
Total	100%	100%

Distribution for FY 12 (June 2012 to Gen. Fund)	<b>12,000,000</b>
Distribution for FY 12 for education	0

Pays out 5% of average balance with \$12 million minimum paid. Education money distributed as long as principal not violated as of June 30 each year

**School & Public Lands**

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

Fair Value as of 12/31/11	\$ 181,989,503
Fiscal year to date return	-2.75%
Longterm expected mean return	6.39%

<u>Asset Allocation</u>	<u>Current</u>	<u>FY 12 Benchmark</u>
Global Equity	51%	52%
Private Equity	3%	2%
Real Estate	11%	6%
Fixed Income-IG	25%	28%
Fixed Income-non-mk	1%	
Fixed Income-HY	2%	5%
Fixed Income-Tips	5%	5%
Money Market	3%	2%
Total	100%	100%

Distribution for FY 12 (Feb 1, 2012 to K-12)	<b>7,433,191</b>
Distribution for FY 1 to Board of Regents (EST)	<b>1,500,000</b>
<b>TOTAL</b>	<b>8,933,191</b>