

LRC Executive Board

Investment Council Update

June 2, 2021

- Assets managed
 - SDRS – FY 2021 estimated return through 4/30/21 = 18.7%
 - Trust Funds – FY 2021 estimated return through 4/30/21 range from 14% to 14.6%

- 529 Scholarship Update – Transfers to Dakota Corps Scholarship Program
 - Last year (July 2020) transfer \$ 1,135,287
 - Cumulative transfers since Sept 2007 \$16,927,826
 - Estimated transfer for July 2021 \$ 1,045,000

- Council Role & Selection

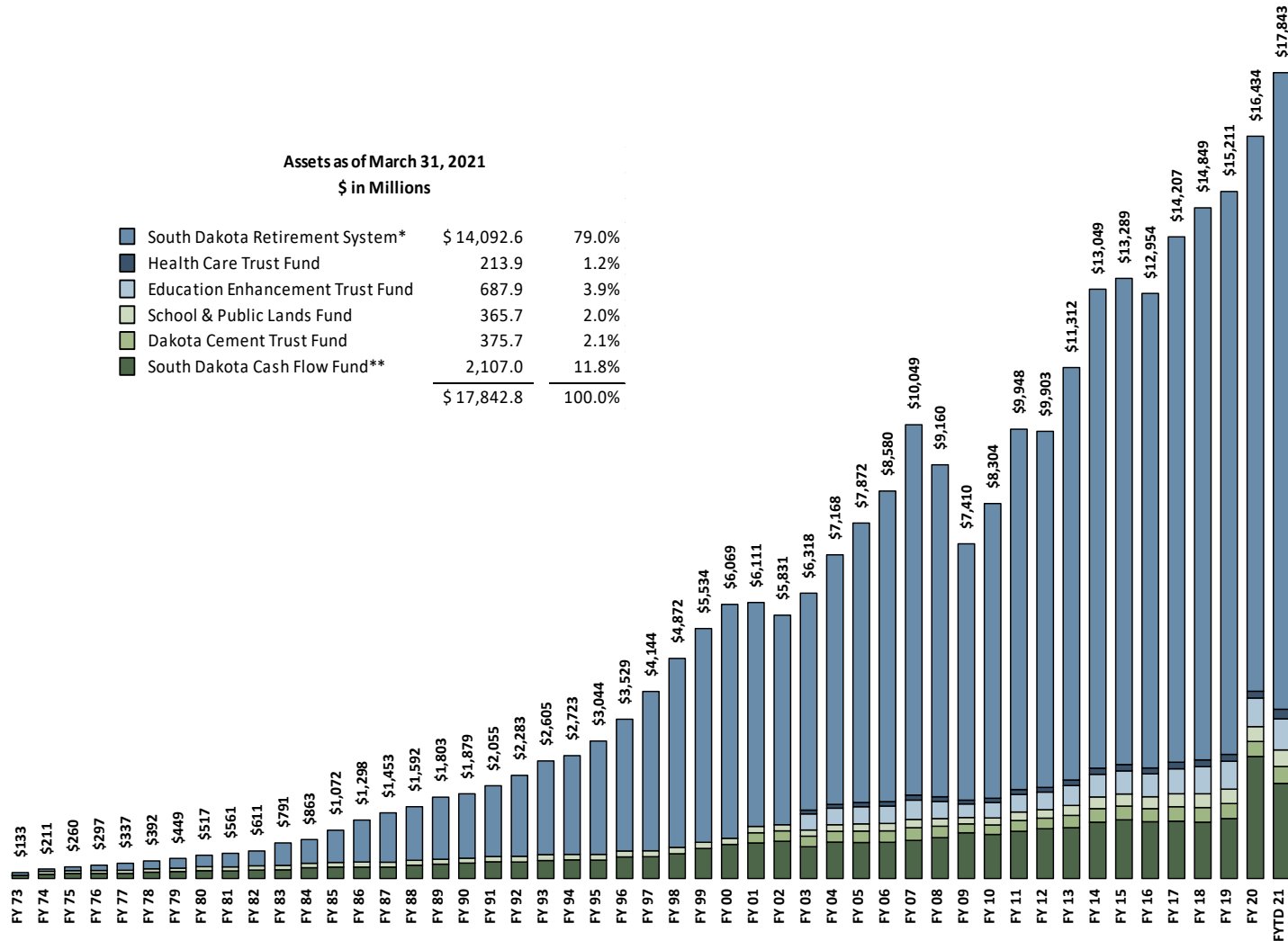
- Investment Officer FY 2022 Compensation

- Compensation Methodology

Assets

Assets as of March 31, 2021
\$ in Millions

| | | |
|----------------------------------|--------------------|---------------|
| South Dakota Retirement System* | \$ 14,092.6 | 79.0% |
| Health Care Trust Fund | 213.9 | 1.2% |
| Education Enhancement Trust Fund | 687.9 | 3.9% |
| School & Public Lands Fund | 365.7 | 2.0% |
| Dakota Cement Trust Fund | 375.7 | 2.1% |
| South Dakota Cash Flow Fund** | 2,107.0 | 11.8% |
| | <u>\$ 17,842.8</u> | <u>100.0%</u> |



*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 purpose of this exhibit, CPRF Assets for Fiscal Years 1973 - 2013 are included with SDRS.

**Includes Coronavirus Relief Fund

Trust Funds

As of 4/30/21 (unaudited)

Health Care Trust (established April 2001)

| | |
|--|----------------|
| Principal as of 4/30/2021 ESTIMATE | \$ 135,631,024 |
| Principal as of 4/30/2021 ESTIMATE adjusted for inflatio | \$ 176,525,153 |
| Fair Value (FV) as of 4/30/2021 ESTIMATE | \$ 217,077,100 |
| Difference - FV less principal | \$ 81,446,076 |
| Difference - FV less infl. adj. prin. | \$ 40,551,947 |
| Fiscal year to date return | 14.21% |
| Longterm expected mean return | 6.16% |
| Payout of 4% plus expected inflation of 2.25% | 6.25% |
| Expected return cushion/shortfall | -0.09% |

| | |
|---------------------------------------|------------------|
| Distribution for FY 22 (July 1, 2021) | 5,839,236 |
| Distribution for FY 21 (July 2, 2020) | 5,676,706 |

| <u>Asset Allocation</u> | <u>Current</u> | <u>Benchmark</u> |
|-------------------------|----------------|------------------|
| Global & Private Equity | 35% | 51% |
| Real Estate | 9% | 10% |
| Fixed Income-IG | 15% | 30% |
| Fixed Income-HY | 4% | 7% |
| HY RE Debt | 6% | 0% |
| Money Market | <u>31%</u> | <u>2%</u> |
| Total | 100% | 100% |

FY 21

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 4/30/2021 ESTIMATE | \$ 419,638,605 |
| Principal as of 4/30/2021 ESTIMATE adjusted for inflatio | \$ 584,491,318 |
| Fair Value (FV) as of 4/30/2021 ESTIMATE | \$ 705,421,968 |
| Difference - FV less principal | \$ 285,783,364 |
| Difference - FV less infl. adj. prin. | \$ 120,930,650 |
| Fiscal year to date return | 14.55% |
| Longterm expected return (lower due to tax-exempts) | 6.11% |
| Payout of 4% plus expected inflation of 2.25% | 6.25% |
| Expected return cushion/shortfall | -0.14% |

| | |
|---------------------------------------|-------------------|
| Distribution for FY 22 (July 1, 2021) | 23,673,657 |
| Distribution for FY 21 (July 1, 2020) | 22,515,469 |

| <u>Asset Allocation</u> | <u>Current</u> | <u>Benchmark</u> |
|-------------------------|----------------|------------------|
| Global & Private Equity | 37% | 51% |
| Real Estate | 8% | 10% |
| Fixed Income-IG | 9% | 22% |
| Fixed Income-tax ex | 6% | 8% |
| Fixed Income-HY | 5% | 7% |
| HY RE Debt | 4% | 0% |
| Money Market | <u>31%</u> | <u>2%</u> |
| Total | 100% | 100% |

FY 21

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 4/30/21 (unaudited)

Dakota Cement Trust (established April 2001)

| | | <u>Asset Allocation</u> | <u>Current</u> | <u>FY 21 Benchmark</u> |
|--|-------------------|-------------------------|----------------|----------------------------|
| Principal as of 4/30/2021 ESTIMATE | \$ 238,000,000 | Global & Private Equity | 36% | 51% |
| Principal as of 4/30/2021 ESTIMATE adjusted for inflatio | \$ 359,196,923 | Real Estate | 9% | 10% |
| Fair Value (FV) as of 4/30/2021 ESTIMATE | \$ 380,478,748 | Fixed Income-IG | 15% | 30% |
| Difference - FV less principal | \$ 142,478,748 | Fixed Income-HY | 5% | 7% |
| Difference - FV less infl. adj. principal | \$ 21,281,825 | HY RE Debt | 4% | 0% |
| | | Money Market | <u>31%</u> | <u>2%</u> |
| Fiscal year to date return | 13.99% | Total | 100% | 100% |
| Longterm expected mean return | 6.16% | | | |
| Payout of 4% plus expected inflation of 2.25% | 6.25% | | | |
| Expected return cushion/shortfall | -0.09% | | | |
| Distribution for FY 21 (May 2021 to GF) | 13,404,156 | | | |
| Distribution for FY 20 (May 2020 to GF) | 13,004,590 | | | |

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 if inflation not offset by realized net gains)

| | | <u>Asset Allocation</u> | <u>Current</u> | <u>FY 21 Benchmark</u> |
|--|----------------------|-------------------------|----------------|----------------------------|
| Fair Value as of 4/30/2021 ESTIMATE | \$ 370,796,885 | Global & Private Equity | 36% | 51% |
| | | Real Estate | 8% | 10% |
| Fiscal year to date return | 14.17% | Fixed Income-IG | 15% | 30% |
| Longterm expected mean return | 6.16% | Fixed Income-HY | 4% | 7% |
| | | HY RE Debt | 6% | 0% |
| Distribution for FY 21 K-12 (2/10/21) | 12,823,388 | Money Market | <u>31%</u> | <u>2%</u> |
| Distribution for FY 21 Board of Regents (6/8/21) | <u>3,230,000</u> est | Total | 100% | 100% |
| TOTAL | 16,053,388 | | | |

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 22 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