

# LRC Executive Board

## Investment Council Update

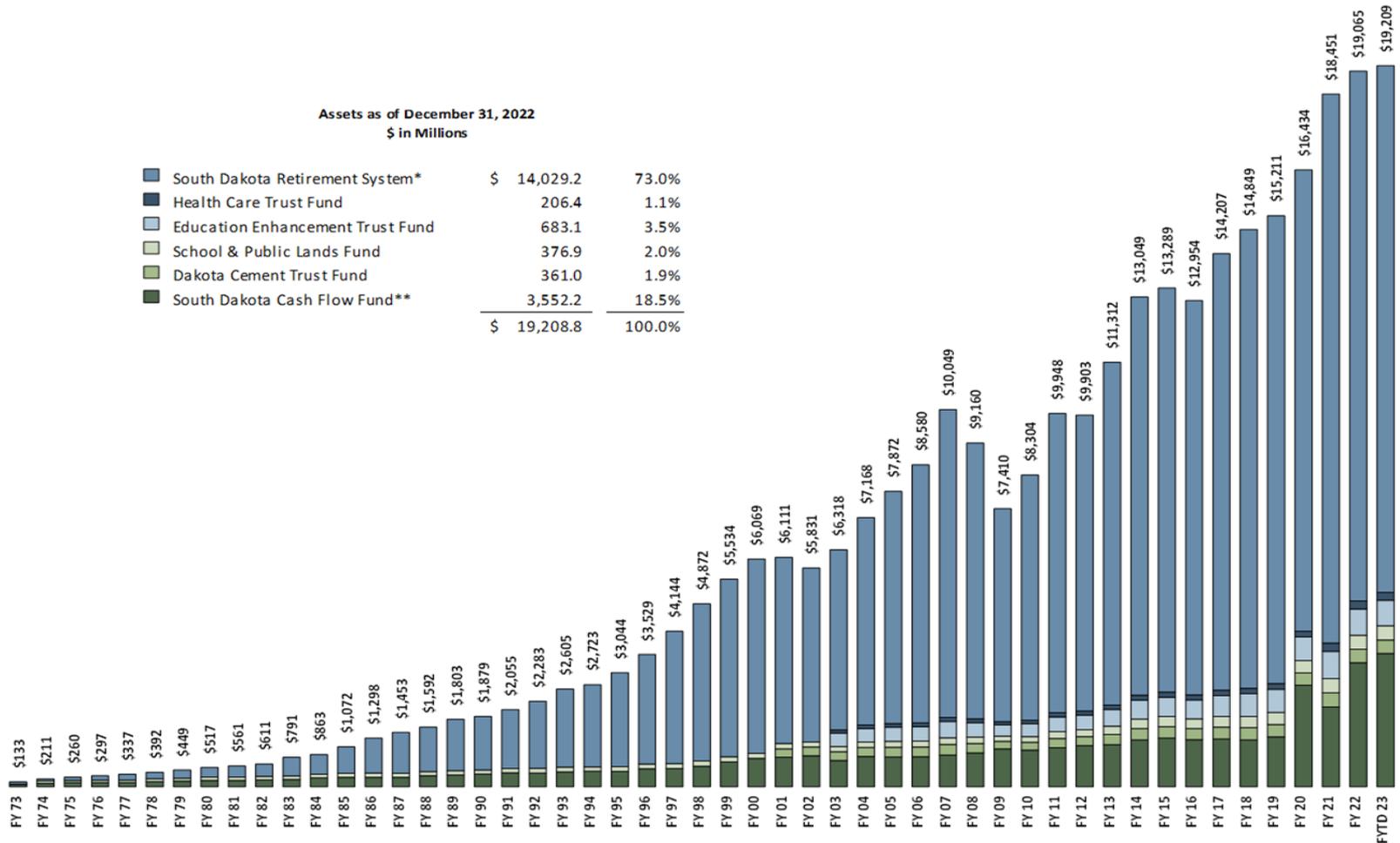
May 19, 2023

- Assets managed
  - SDRS – FY 2023 estimated return through 4/30/23 = 4.15%
  - Trust Funds – FY 2023 estimated return through 3/31/23 range from 3.07% to 3.45%
- 529 Scholarship Update – Transfers to Dakota Corps Scholarship Program
  - Last year (July 2022) transfer \$ 894,438
  - Cumulative transfers since Sept 2007 \$18,860,500
  - Estimated transfer for July 2023 \$ 845,000
- Council Role & Selection
- Investment Officer FY 2024 Compensation
- Compensation Methodology
- Leadership Development

# Assets

Assets as of December 31, 2022  
\$ in Millions

South Dakota Retirement System*	\$ 14,029.2	73.0%
Health Care Trust Fund	206.4	1.1%
Education Enhancement Trust Fund	683.1	3.5%
School & Public Lands Fund	376.9	2.0%
Dakota Cement Trust Fund	361.0	1.9%
South Dakota Cash Flow Fund**	3,552.2	18.5%
	<u>\$ 19,208.8</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 purposes of this exhibit, CPRF Assets for Fiscal Years 1973 - 2013 are included with SDRS.

\*\*South Dakota Cash Flow Fund assets include Coronavirus Relief Fund for Fiscal Years 2020, 2021, 2022 and FYTD 2023.

# Trust Funds

## As of 3/31/23 (unaudited)

### Health Care Trust (established April 2001)

		<u>Asset Allocation</u>	<u>Current</u>	<u>FY 23 Benchmark</u>
Principal as of 3/31/23	\$ 135,631,024	Global & Private Equity	31%	50%
Principal as of 3/31/23 adjusted for inflation	\$ 199,663,846	Real Estate	12%	11%
Fair Value (FV) as of 3/31/23	\$ 211,713,329	Fixed Income-IG	14%	30%
		Fixed Income-HY	4%	7%
Difference - FV less principal	\$ 76,082,305	HY RE Debt	0%	0%
Difference - FV less infl. adj. prin.	\$ 12,049,483	Money Market	<u>39%</u>	<u>2%</u>
		Total	100%	100%
Fiscal year to date return	3.28%			
Longterm expected mean return	5.98%			
Payout of 4% plus expected inflation of 2.25%	6.25%			
Expected return cushion/shortfall	-0.27%			
Distribution for FY 24 (July 1, 2023)	7,276,454			
Distribution for FY 23 (July 1, 2022)	6,612,325			
Distribution for FY 22 (July 2, 2021)	5,839,236			

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)

		<u>Asset Allocation</u>	<u>Current</u>	<u>FY 23 Benchmark</u>
Principal as of 3/31/23	\$ 431,659,484	Global & Private Equity	32%	50%
Principal as of 3/31/23 adjusted for inflation	\$ 672,497,749	Real Estate	11%	11%
Fair Value (FV) as of 3/31/23	\$ 699,609,046	Fixed Income-IG	8%	24%
		Fixed Income-tax ex	6%	6%
Difference - FV less principal	\$ 267,949,562	Fixed Income-HY	4%	7%
Difference - FV less infl. adj. prin.	\$ 27,111,297	HY RE Debt	0%	0%
		Money Market	<u>39%</u>	<u>2%</u>
Fiscal year to date return	3.43%	Total	100%	100%
Longterm expected return (lower due to tax-exempts)	5.95%			
Payout of 4% plus expected inflation of 2.25%	6.25%			
Expected return cushion/shortfall	-0.30%			
Distribution for FY 24 (July 1, 2023)	26,389,450			
Distribution for FY 23 (July 1, 2022)	25,277,997			
Distribution for FY 22 (July 1, 2021)	23,673,657			

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 3/31/23 (unaudited)

### Dakota Cement Trust (established April 2001)

		<u>Asset Allocation</u>	<u>Current</u>	<u>FY 23 Benchmark</u>
Principal as of 3/31/23	\$ 238,000,000	Global & Private Equity	31%	50%
Principal as of 3/31/23 adjusted for inflation	\$ 406,280,000	Real Estate	12%	11%
Fair Value (FV) as of 3/31/23	\$ 369,678,439	Fixed Income-IG	14%	30%
Difference - FV less principal	\$ 131,678,439	Fixed Income-HY	4%	7%
Difference - FV less infl. adj. principal	\$ (36,601,561)	HY RE Debt	0%	0%
		Money Market	<u>39%</u>	<u>2%</u>
Fiscal year to date return	3.07%	Total	100%	100%
Longterm expected mean return	5.98%			
Payout of 4% plus expected inflation of 2.25%	6.25%			
Expected return cushion/shortfall	-0.27%			
Distribution for FY 23 (May 2023 to GF)	14,369,135			
Distribution for FY 22 (May 2022 to GF)	13,982,377			
Distribution for FY 21 (May 2021 to GF)	13,404,156			

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 23 Benchmark</u>
Fair Value as of 3/31/23	\$ 382,800,084	Global & Private Equity	31%	50%
Fiscal year to date return	3.45%	Real Estate	11%	11%
Longterm expected mean return	5.98%	Fixed Income-IG	14%	30%
		Fixed Income-HY	4%	7%
		HY RE Debt	0%	0%
Distribution for FY 23 K-12 (2/8/23)	9,984,927	Money Market	<u>40%</u>	<u>2%</u>
Distribution for FY 22 Board of Regents (6/13/22)	2,870,629	Total	100%	100%

# Investment Council Role

- Select State Investment Officer
- Maintain a bottom-line oriented businesslike 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
- 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 2-3 years, most recently April 2022
  - 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 225%) 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