



**Final**  
**Investment Performance FY 2024 (unaudited)**  
**and**  
**Budget Request FY 2026**

PRESENTED TO  
LRC EXECUTIVE BOARD  
AUGUST 2024

# Organizational Structure

- **LRC Executive Board**
- **South Dakota Investment Council**
- **State Investment Officer**
  - **Investment Management**
    - Senior Investment Manager (6)
    - Senior Portfolio Manager (8)
    - Portfolio Manager (4)
    - Associate Portfolio Manager II (6)
    - Associate Portfolio Manager I (0)
    - Trader/Systems Analyst (1)
    - Research Analyst (2)
  - **Investment Accounting**
    - Chief Financial Officer (1)
    - Senior Investment Accountant (2)
    - Investment Accountant (2)
  - **Legal Services**
    - General Counsel (2 part-time)
  - **Administration**
    - Business Manager (1)
    - Assistant Business Manager (1)

## **South Dakota Investment Council – FY 2025**

Appointed by LRC Executive Board:

- Loren Koepsell, Chair, Sioux Falls
- Steve Pietila, Vice Chair, Yankton
- Kelly Meiners, Winner
- Taylor Thompson, Rapid City
- Cathy Clark, Sioux Falls

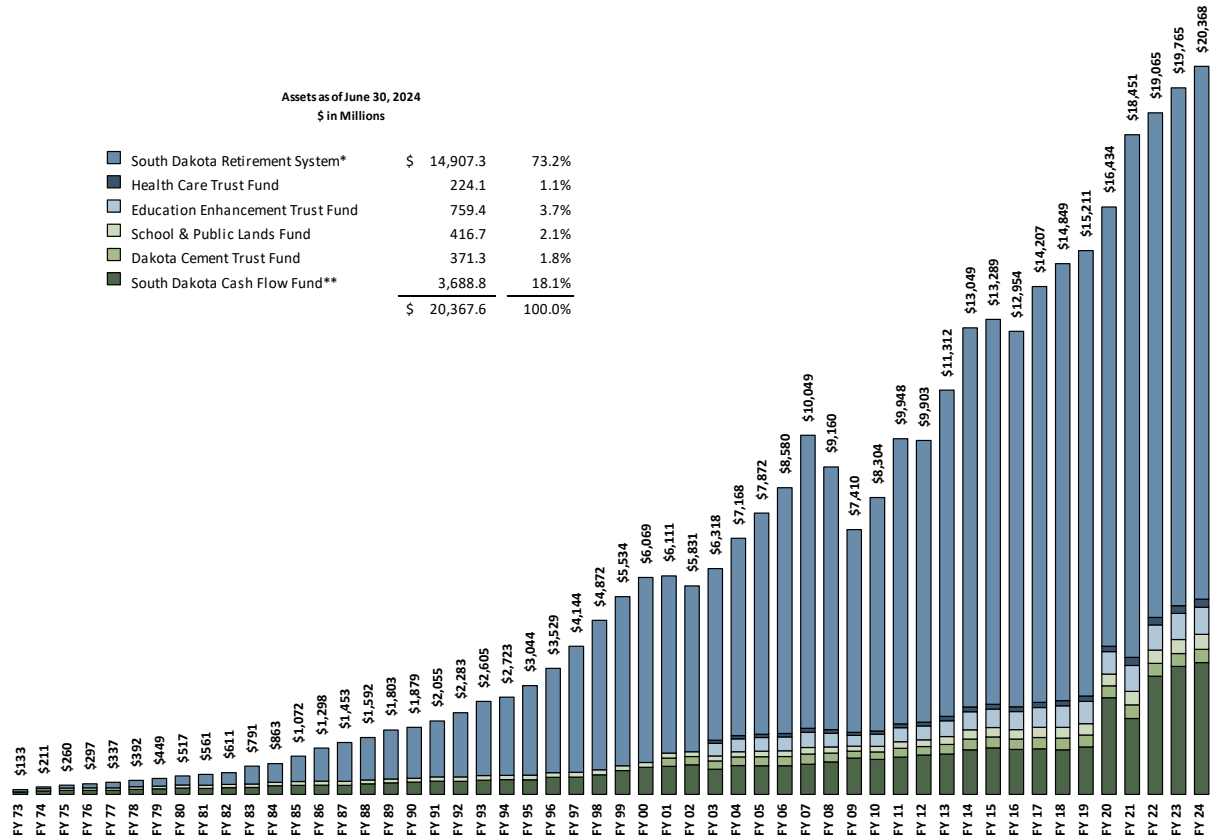
Ex-Officio Members:

- Travis Almond, SDRS Executive Director
- Brock Greenfield, S&PL Commissioner
- Josh Haeder, State Treasurer

## **Distribution of Investment Management Staff by Asset Category:**

- Global Equity - 13
- Small/MidCap Equity - 4
- High Yield - 6
- Fixed Income/Alternatives/Derivatives - 4

# 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.

\*\*South Dakota Cash Flow Fund assets include Coronavirus Relief Fund for Fiscal Years 2020 - 2024.

# Investment Performance

Returns vs. Benchmarks (unaudited)

	<u>FY 2024</u>	<u>5 years Annualized FY 20-24</u>	<u>10 years Annualized FY 15-24</u>	<u>20 years Annualized FY 05-24</u>
SDRS Total Fund*	6.02%	6.68%	6.40%	7.88%
Capital Markets Benchmark	13.81%	7.52%	6.85%	7.16%
Added Value	-7.79%	-0.85%	-0.45%	0.72%
State Universe **	9.26%	8.50%	7.60%	7.41%
Beginning FY 2024 SDRS Assets	\$14.49 billion			
Ending FY 2024 SDRS Assets	\$14.91 billion			

\*Time-weighted rates of return are net of fees FY 14-24 and gross of fees FY 04-13

\*\* Preliminary

# Investment Performance

Returns vs. Benchmarks (unaudited)

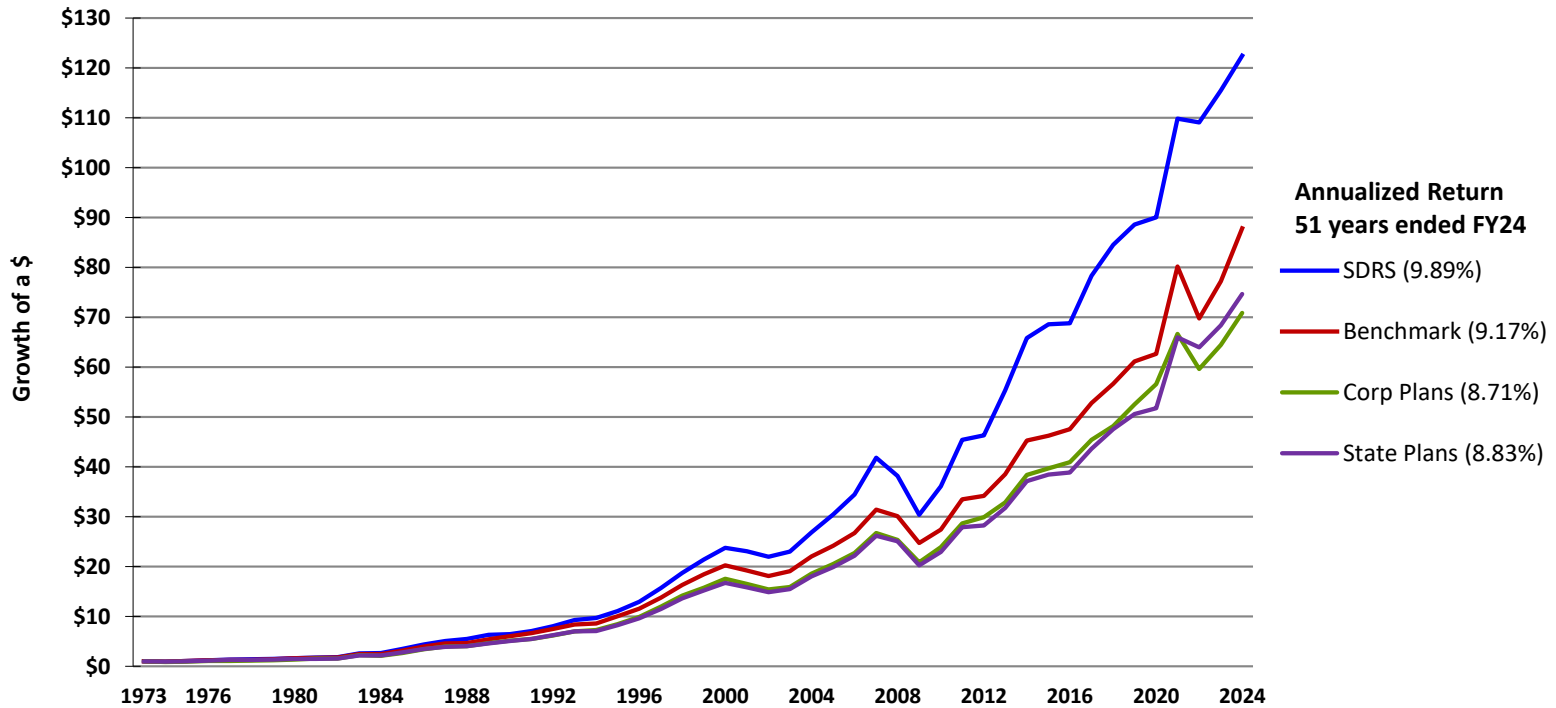
Total SDRS dollars earned Fiscal Year 2024	\$916 million
Total SDRS dollars earned last 5 years	\$4.71 billion
Total SDRS dollars earned last 10 years	\$8.28 billion
Total SDRS dollars earned last 20 years	\$15.16 billion

**Extra** dollars from performance vs. benchmark  
(including compounding)

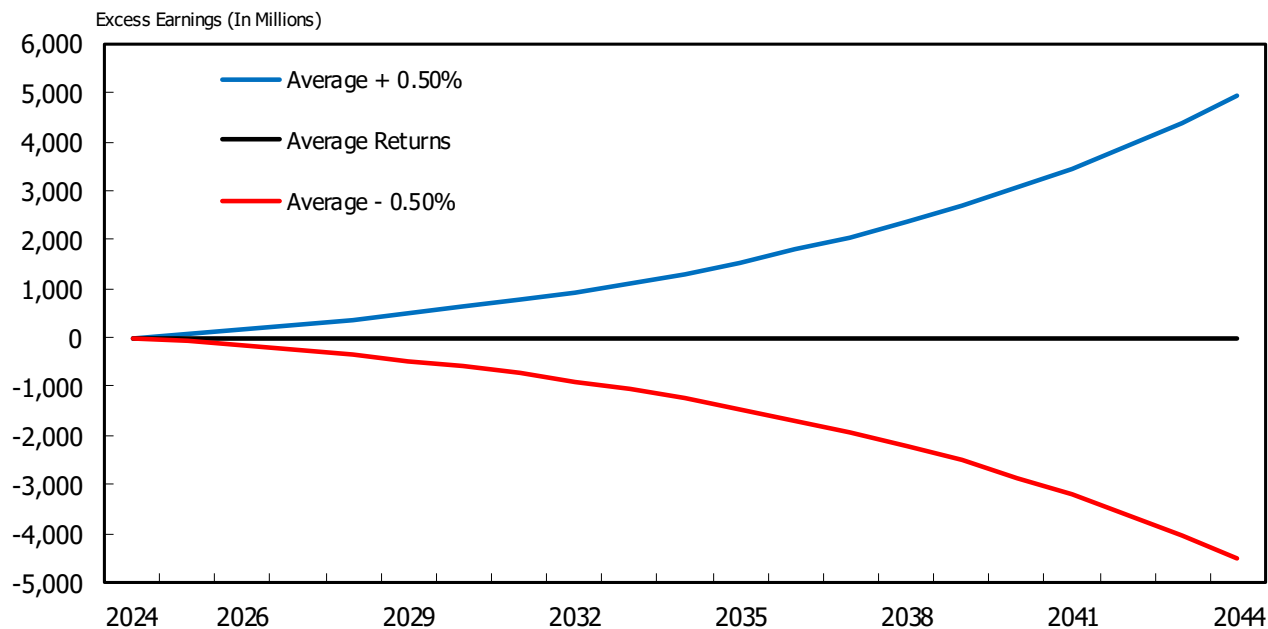
	<u>1 year</u>	<u>5 years</u>	<u>10 years</u>	<u>20 years</u>
vs. Capital Markets Benchmark	- \$1.13 billion	- \$693 million	- \$850 million	\$3.13 billion

# Superior returns add up over time

Cumulative returns for SDRS, Benchmark, Corporate Plans, and other States



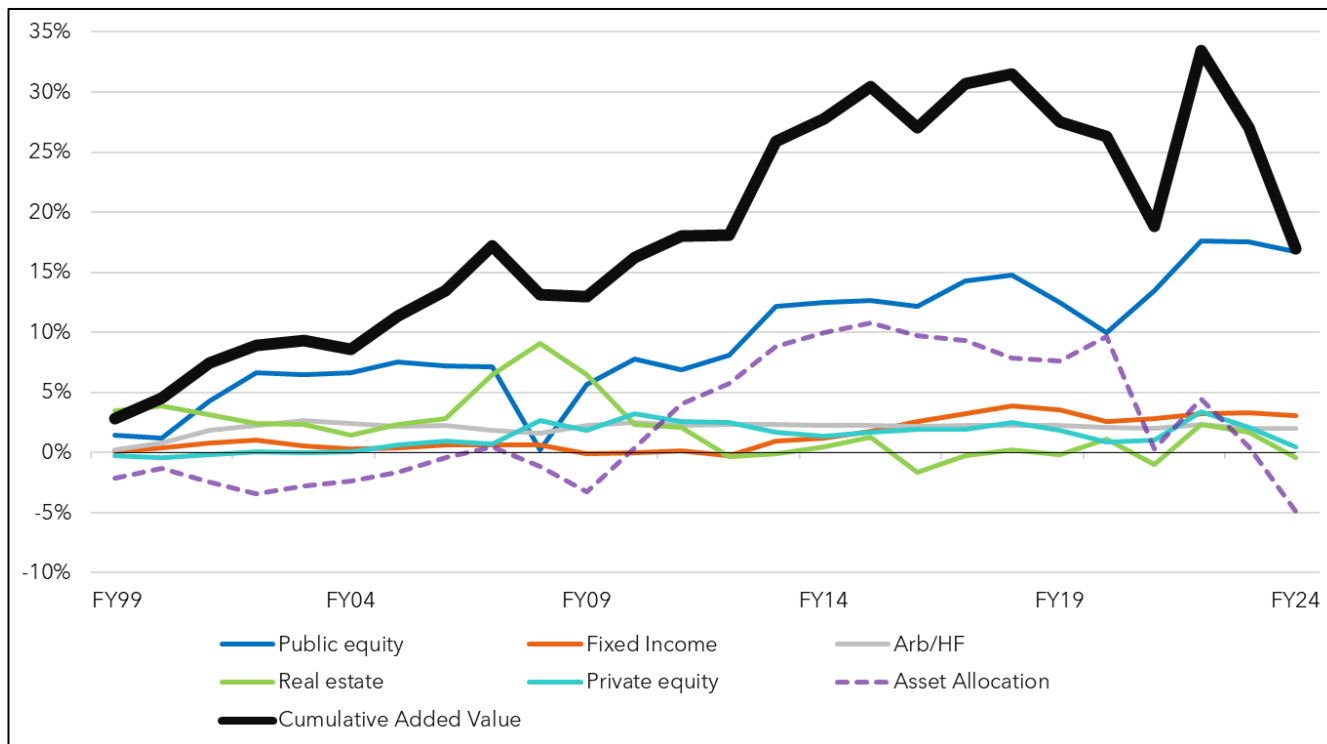
# Potential Excess Earnings



- SDRS preliminary 51-year outperformance = 0.7% annualized vs. benchmark
- Outperformance of .5% next 20 years = extra \$4.9 billion
- Underperformance of .5% = cost to retirement system of \$4.5 billion.

# Many pistons contribute

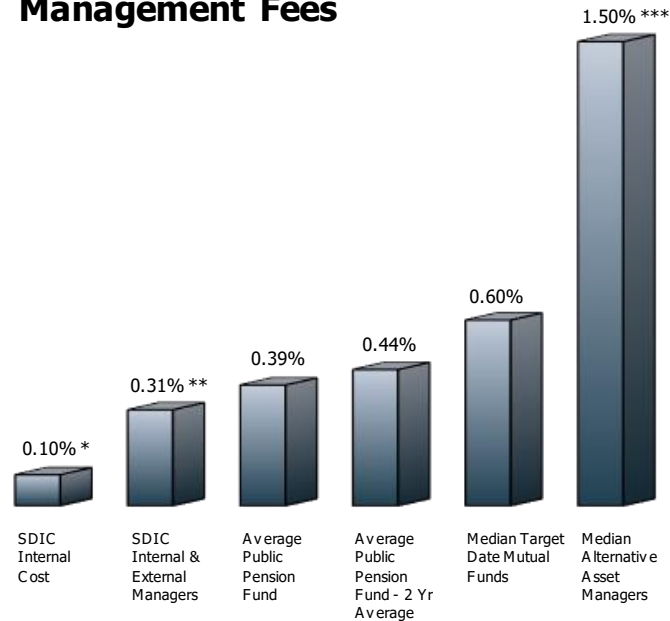
## Cumulative Added Value by Source (Est for FY24)





# Cost Efficiency

## Management Fees



Difference between SDIC cost of .31% and average public pension fund 1 yr. cost of .39% and 2 yr. average cost of .44% is \$16.28 million and \$26.45 million respectively per year, estimated based on Fair Value estimates as of 7/31/24.

\* SDIC projected expenses for FY 2026 using adjusted assets and expected average performance incentives.

\*\* Includes estimated external management fees based on average expected investment amounts. Does not include typical 20% profit participation after preferred return for investment partnerships.

\*\*\* Does not include typical 20% profit participation after preferred return for investment partnerships.

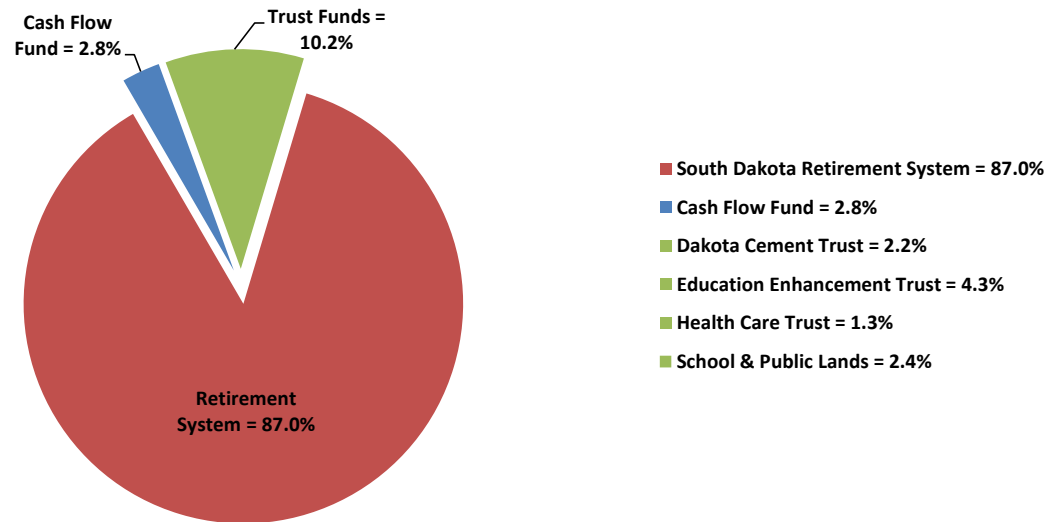
# Compensation Overview

- Long term results have significantly exceeded benchmarks
- Cost efficient due to internal management capabilities
  - Securing team to preserve internal capabilities is best chance to remain cost efficient
  - Internal cost .1% with expected average incentives
- Continued success dependent on high caliber team
  - Internally manage most assets using internally generated research
- 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
  - Motivate superior long-term performance and retain successful staff

# Compensation Overview, cont'd

- Compensation target
  - 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
  - Compensation study updated approximately every three years
- Compensation study 2013
  - Study showed compensation had fallen to 55%
  - Expanded incentive compensation plan as opposed to adjusting base compensation
  - Incentives expanded to include longer term and stretch incentives and expected to average 80% (0% to 200%) -- This reached 95% of 70% target
  - Incentives aligned with the goal of adding value and only paid if add value
- Compensation study 2016 and 2019
  - Indicated moderate slippage, but not sufficient to request adjustment
- Compensation study 2022
  - Indicated further slippage to 10% threshold just sufficient to request adjustment
  - Increased incentive maximum to 225% focusing on 10 yr. performance including stretch component – This reduced shortfall by half

# Budget Funding Sources



Budget funded by assets under management

0% General Fund appropriation

Note: S&PL share of SDIC expenses paid from earnings of Cash Flow Fund

# Long-Term Plan Executive Summary

## Projected LTP Budget

<b>INVESTMENT COUNCIL BUDGET</b>	<b><u>FY 2026</u></b>	<b><u>FY 2031</u></b>	<b><u>FY 2036</u></b>
<b>Personal Services</b>			
Number of Employees	35	35	35
Base Compensation - Total Staff	8,121,209	9,800,323	12,073,851
Student Interns	43,651	49,387	55,877
Investment Council	12,247	13,856	15,677
Flexibility funds-Retirements & Resignations	216,705	245,182	277,401
Investment Incentive Maximum	15,603,604	18,815,972	22,985,886
Benefits	3,210,072	3,936,702	4,883,613
Total Personal Services	27,207,488	32,861,422	40,292,305
<b>Operating Expenses</b>			
Contractual Services	3,018,485	3,335,384	3,681,039
Travel	88,681	100,334	113,519
Office Supplies & Postage	5,000	5,657	6,400
Capital Assets	40,520	43,794	50,057
Total Operating Expenses	3,152,686	3,485,170	3,851,015
<b>Total Investment Council Budget <sup>(1)</sup></b>	<b>30,360,174</b>	<b>36,346,592</b>	<b>44,143,319</b>
<b>ASSET SUMMARY <sup>(2)</sup></b>			
Internal Assets	17,325,388,712	22,226,401,335	27,141,969,290
External Assets	4,605,483,075	4,233,600,254	4,789,759,286
Total Assets	21,930,871,787	26,460,001,589	31,931,728,576
<b>EXPENSE SUMMARY</b>			
Internal Expenses	30,360,174	36,346,592	44,143,319
External Manager Fees	50,660,314	46,569,603	52,687,352
Total Expenses	81,020,488	82,916,195	96,830,672
<b>UNIT COST SUMMARY <sup>(3)</sup></b>			
Internal Expenses as % of Total Assets	0.10%	0.10%	0.10%
Total Expenses as % of Total Assets	0.31%	0.26%	0.25%

<sup>(1)</sup> FY 2026 amounts differ from the actual final budget request. To reflect all costs, the LTP includes an assumed salary policy of 2.5% and an additional 1.50% increase for investment positions. The salary policy is not included in the budget request as any salary policy is added afterward.

<sup>(2)</sup> Projections based on long-term assumed returns applied to 6/30/24 estimated assets. Updated each June 30.

<sup>(3)</sup> Unit Cost Summary uses assumed average investment performance incentives

# FY 2024 Budget and Actual

	<b>Expended FY 2024</b>	<b>Received FY 2024</b>	<b>Unexpended FY 2024</b>
<b>PERSONAL SERVICES</b>			
<b>Total FTEs</b>	33.00	35.00	
<b>Base Compensation</b>			
Base Compensation - Investment Staff	5,988,057	6,694,725	706,668 *
Base Comp - Admin, Acct, Legal, Longevity	665,596	794,708	129,112
<b>TOTAL STAFF - FULL TIME</b>	<b>6,653,653</b>	<b>7,489,433</b>	<b>835,780</b>
Part-Time - Legal & Interns	15,293	97,005	81,712
Investment Council	2,025	7,927	5,902
Retirement & resignation flexibility funds	0	203,288	203,288
Benefits	1,131,579	1,462,228	330,649
<b>Total Base Compensation</b>	<b>7,802,550</b>	<b>9,259,883</b>	<b>1,457,333</b>
<b>Investment Performance Incentives</b>			
Maximum Potential Investment Perf Incentive	5,837,628	14,612,825	8,775,197
Benefits	369,834	1,816,569	1,446,735
<b>Total Investment Performance Incentives</b>	<b>6,207,462</b>	<b>16,429,394</b>	<b>10,221,932</b>
<b>TOTAL PERSONAL SERVICES</b>	<b>14,010,012</b>	<b>25,689,277</b>	<b>11,679,265</b>
<b>OPERATING EXPENSES</b>			
Contractual Total	2,319,535	2,706,949	387,414
Travel	41,262	86,431	45,169
Office Supplies	3,386	7,000	3,614
Capital Assets	71,909	40,520	(31,389)
<b>Total Operating Expenses</b>	<b>2,436,092</b>	<b>2,840,900</b>	<b>404,808</b>
<b>TOTAL BUDGET</b>	<b>16,446,103</b>	<b>28,530,177</b>	<b>12,084,074</b>

\*Includes \$67,455 Virtus reimbursement & unused compensation

Note: Budget is funded as needed and ended year with a cash balance of \$2,949,332.01 which is credited against FY 2025 authorized budget

# FY 2026 Budget Request

## Summary

	<u>Received FY 2025</u>	<u>Request FY 2026</u>	<u>% change</u>
<b>PERSONAL SERVICES</b>			
<b>Total FTEs</b>	35.00	35.00	
<b>Base Compensation</b>			
Base Compensation - Investment Staff	7,178,312	7,141,002	-0.52%
Base Comp - Admin, Acct, Legal, Longevity	844,120	800,038	-5.22%
<b>TOTAL STAFF - FULL TIME</b>	<b>8,022,432</b>	<b>7,941,040</b>	<b>-1.01%</b>
Part-Time - Legal & Interns	42,586	42,586	0.00%
Investment Council	11,948	11,948	0.00%
Retirement & resignation flexibility funds	211,420	211,420	0.00%
Benefits	1,542,752	1,531,393	-0.74%
<b>Total Base Compensation</b>	<b>9,831,138</b>	<b>9,738,387</b>	<b>-0.94%</b>
<b>Investment Performance Incentives</b>			
Maximum Potential Investment Perf Incentive	15,063,132	15,603,604	3.59%
Benefits	1,578,713	1,653,297	4.72%
<b>Total Investment Performance Incentives</b>	<b>16,641,845</b>	<b>17,256,901</b>	<b>3.70%</b>
<b>TOTAL PERSONAL SERVICES</b>	<b>26,472,983</b>	<b>26,995,288</b>	<b>1.97%</b>
<b>OPERATING EXPENSES</b>			
Contractual Total (see next page for further details)	2,904,042	3,018,484	3.94%
Travel	88,681	88,681	0.00%
Office Supplies	5,000	5,000	0.00%
Capital Assets	40,520	40,520	0.00%
<b>Total Operating Expenses</b>	<b>3,038,243</b>	<b>3,152,685</b>	<b>3.77%</b>
<b>TOTAL BUDGET</b>	<b>29,511,227</b>	<b>30,147,973</b>	<b>2.16%</b>
<b>UNIT COST SUMMARY *</b>			
Internal Expenses as % of Total Adjusted Assets	0.102%	0.100%	
Total Expenses as % of Total Adjusted Assets	0.336%	0.335%	

\* Unit cost based on total assets adjusted to long-term value, expenses using assumed average investment performance incentives, long-term average of retirement & resignation flexibility funds, and an assumed 2.5% salary policy for FY26.

# FY 2026 Budget Request

## Contractual services detail

	<u>Received</u> <u>FY 2025</u>	<u>Request</u> <u>FY 2026</u>	<u>% chng</u>
<b>CONTRACTUAL SERVICES</b>			
<b>Investment Services</b>			
Consulting Services	180,000	180,000	0.00%
Investment Accounting, Performance Benchmarking	427,905	388,730	-9.16%
Investment Databases, Newsfeeds & Quote Fees	827,100	886,133	7.14%
Investment Research Services	496,179	493,121	-0.62%
Flexibility - From Brokerage to Independent Research	225,000	225,000	0.00%
<b>Total Investment Services</b>	<u>2,156,184</u>	<u>2,172,984</u>	<u>0.78%</u>
<b>Administrative Expenses</b>			
Office Rent	168,605	168,605	0.00%
Bond/Liability Insurance	8,385	8,600	2.56%
Telephone	18,000	24,336	35.20%
Office Equip Rental/Maintenance/Misc	7,800	7,800	0.00%
Bureau of Info & Telecommunications (BIT)	114,103	178,813	56.71%
State Central Services	14,994	16,023	6.86%
Legislative Audit	70,579	74,814	6.00%
Janitorial	3,730	3,730	0.00%
Custodial Fees - Global	305,162	311,280	2.00%
Seminars/Educational Programs	35,000	50,000	42.86%
Business Publications	1,500	1,500	0.00%
<b>Total Administrative Expenses</b>	<u>747,858</u>	<u>845,501</u>	<u>13.06%</u>
<b>TOTAL CONTRACTUAL SERVICES</b>	<u>2,904,042</u>	<u>3,018,484</u>	<u>3.94%</u>



# Trust Funds (unaudited)

## Health Care Trust (established April 2001)

Principal as of 06/30/24	\$ 135,631,024
Principal as of 06/30/24 adjusted for inflation	\$ 207,100,432
Fair Value (FV) as of 06/30/24	\$ 224,083,489
Difference - FV less principal	\$ 88,452,466
Difference - FV less infl. adj. prin.	\$ 16,983,057
Fiscal year to date return	6.90%
Longterm expected mean return	6.90%
Payout of 4% plus expected inflation of 2.5%	6.50%
Expected return cushion/shortfall	0.40%
Distribution for FY 25 (July 1, 2024)	7,925,672
Distribution for FY 24 (July 3, 2023)	7,276,454
Distribution for FY 23 (July 1, 2022)	6,612,325

<u>Asset Allocation</u>	FY 24	
	<u>Current</u>	<u>Benchmark</u>
Global & Private Equity	30%	50%
Real Estate	11%	11%
Fixed Income-IG	14%	30%
Fixed Income-HY	4%	7%
HY RE Debt	0%	0%
Money Market	41%	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 06/30/24	\$ 454,009,133
Principal as of 06/30/24 adjusted for inflation	\$ 720,290,586
Fair Value (FV) as of 06/30/24	\$ 759,429,174
Difference - FV less principal	\$ 305,420,041
Difference - FV less infl. adj. prin.	\$ 39,138,588
Fiscal year to date return	6.66%
Longterm expected mean return	6.90%
Payout of 4% plus expected inflation of 2.5%	6.50%
Expected return cushion/shortfall	0.40%
Distribution for FY 25 (July 1, 2024)	27,383,330
Distribution for FY 24 (July 3, 2023)	26,389,450
Distribution for FY 23 (July 1, 2022)	25,277,997

<u>Asset Allocation</u>	FY 24	
	<u>Current</u>	<u>Benchmark</u>
Global & Private Equity	30%	50%
Real Estate	11%	11%
Fixed Income-IG	13%	30%
Fixed Income-HY	4%	7%
HY RE Debt	0%	0%
Money Market	42%	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 (unaudited)

## Dakota Cement Trust (established April 2001)

Principal as of 06/30/24	\$ 238,000,000
Principal as of 06/30/24 adjusted for inflation	\$ 421,412,115
Fair Value (FV) as of 06/30/24	\$ 371,315,177
Difference - FV less principal	\$ 133,315,177
Difference - FV less infl. adj. principal	\$ (50,096,938)
Fiscal year to date return	6.28%
Longterm expected mean return	6.90%
Payout of 4% plus expected inflation of 2.5%	6.50%
Expected return cushion/shortfall	0.40%
Distribution for FY 24 (May 15, 2024)	14,668,289
Distribution for FY 23 (May 15, 2023)	14,369,135
Distribution for FY 22 (May 16, 2022)	13,982,377

<u>Asset Allocation</u>	FY 24	
	<u>Current</u>	<u>Benchmark</u>
Global & Private Equity	28%	50%
Real Estate	12%	11%
Fixed Income-IG	14%	30%
Fixed Income-HY	4%	7%
HY RE Debt	0%	0%
Money Market	42%	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 if inflation not offset by realized net gains)

Fair Value as of 06/30/24	\$ 416,674,467
Fiscal year to date return	6.86%
Longterm expected mean return	6.90%
Distribution for FY 24 K-12 (February 6, 2024)	12,809,869
Distribution for FY 24 Board of Regents (June 17, 2024)	3,644,797

<u>Asset Allocation</u>	FY 24	
	<u>Current</u>	<u>Benchmark</u>
Global & Private Equity	30%	50%
Real Estate	11%	11%
Fixed Income-IG	13%	30%
Fixed Income-HY	4%	7%
HY RE Debt	0%	0%
Money Market	42%	2%
Total	100%	100%

# Investment Performance Incentive – FY 2024 (unaudited) State Investment Officer

Return-linked compensation maximum is 200% on base compensation of \$604,942 payable in FY 2025.  
Performance Period is the one year, four year, and ten year annualized fiscal years.

## I. 60% OF PLAN BASED ON TOTAL FUND vs CAPITAL MARKET BENCHMARK (CMB) RESULTS

<u>Period</u>	Basis Points		<u>% Payout</u>	<u>\$ Payout</u>
	<u>Outperformance</u>			
1 year	0.00	0%	\$	<b>0.00</b>
4 year	0.00	0%	\$	<b>0.00</b>
10 year	0.00	0%	\$	<b>0.00</b>
4 yr stretch	0.00	0%	\$	<b>0.00</b>
10 yr stretch	0.00	0%	\$	<b>0.00</b>

## II. 40% OF PLAN BASED ON AGGREGATE PORTFOLIO MANAGERS' RESULTS

Performance measurement based on the aggregate return-linked compensation of the senior investment managers and investment staff divided by the aggregate potential return-linked compensation for the performance period, based on 1 year, 4 years, 10 years, 4 years stretch, and 10 years stretch.

	<u>Maximum Potential Compensation</u>	<u>Earned Return-linked Compensation</u>	<u>% Payout</u>	<u>\$ Payout</u>
Inv Staff	\$ 11,746,548.70	\$ 5,227,348.02	44.5011%	
SIO	\$ 483,953.60		44.5011%	\$ <b>215,364.87</b>
<b>TOTAL EARNED RETURN-LINKED COMPENSATION</b>				\$ <b>215,364.87</b>
		<b>Percentage of Salary</b>		<b>35.601%*</b>

\*before reduction for support staff incentive

# Appendix

- Investment performance incentives
- Target discount rationale
- FY24 Budget and Actual - Contractual Services details

# Investment Performance Incentives

## Align 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 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 jeopardize handoff to next generation
- Our past history and observation of others suggest 70% target
  - Only way to know for sure how large discounts can work is to risk 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 intensifies desire for financial security
  - Discounts for top SDIC performers may be much larger as industry pay for top quartile performers can be double the median

# FY24 Budget and Actual

## Contractual services detail

	<b>Expended</b> <b><u>FY 2024</u></b>	<b>Received</b> <b><u>FY 2024</u></b>	<b>Unexpended</b> <b><u>FY 2024</u></b>
<b>CONTRACTUAL SERVICES</b>			
<b>Investment Services</b>			
Consulting Services	37,287	180,000	142,713
Investment Accounting, Performance Benchmarking	304,160	251,377	(52,783)
Investment Databases, Newsfeeds & Quote Fees	761,507	802,063	40,556
Investment Research Services	435,633	450,911	15,278
Flexibility - From Brokerage to Independent Research	0	225,000	225,000
<b>Total Investment Services</b>	<b>1,538,587</b>	<b>1,909,351</b>	<b>370,764</b>
<b>Administrative Expenses</b>			
Office Rent	168,604	168,605	1
Bond/Liability Insurance	8,571	8,385	(186)
Telephone	21,607	18,000	(3,607)
Office Equip Rental/Maintenance/Misc	20,772	7,800	(12,972)
Bureau of Info & Telecommunications (BIT)	138,770	169,285	30,515
State Central Services	15,103	14,828	(275)
Legislative Audit	66,540	65,351	(1,189)
Janitorial	0	3,682	3,682
Custodial Fees - Global	299,028	305,162	6,134
Seminars/Educational Programs	41,216	35,000	(6,216)
Business Publications	737	1,500	763
<b>Total Administrative Expenses</b>	<b>780,948</b>	<b>797,598</b>	<b>16,650</b>
<b>TOTAL CONTRACTUAL SERVICES</b>	<b>2,319,535</b>	<b>2,706,949</b>	<b>387,414</b>