



Asset Allocation

South Dakota Trust Funds

Dakota Cement Trust
Education Enhancement Trust
Health Care Trust
School & Public Lands

JUNE 13, 2024

Discussion Topics

- Fund Overviews
 - Dakota Cement Trust
 - Education Enhancement Trust
 - Health Care Trust
 - School & Public Lands
- Benchmark Risk Overview
- Expected Return and Volatility
- Proposed FY25 Capital Markets Benchmark

Dakota Cement Trust Fund

Fund Source

- ▶ \$238m from the sale of the South Dakota Cement Plant in Rapid City in 2001

Investment Considerations

- ▶ SD Const. Art. XIII § 20: allows for stocks, bonds, mutual funds and other financial instruments as provided by law
- ▶ SDCL 4-5-47: applies the prudent person standard

Distributions

- ▶ Transfer to general fund in support of education
- ▶ SD Const. Art. XIII § 21: changed distribution calculation to 4% of the lesser of the 16-quarter average or the Dec. 31 market value, from prior \$12m or 5% if higher
- ▶ Not limited by principal balance
- ▶ Paid prior to June 30

Education Enhancement Trust Fund

Fund Source

- ▶ Established in 2001 with annual payments of South Dakota's share from the 1998 national tobacco lawsuit settlement plus some youth at risk funds.
- ▶ In 2002, fund increased substantially from securitization of future annual tobacco lawsuit settlement payments

Investment Considerations

- ▶ SD Const. Art. XIII § 20: allows for stocks, bonds, mutual funds and other financial instruments as provided by law
- ▶ SDCL 4-5-47: applies the prudent person standard

Distributions

- ▶ Transfer to state general fund to be appropriated by law for education enhancement programs
- ▶ SDCL 4-5-29.2: 4% of the 4-year average fair value of the fund, as of Dec. 31, distributed on July 1 of the following year as appropriated by the Legislature
- ▶ SD Const. Art XII § 6: 4% distribution contingent upon the Dec. 31 fair value being above the principal of the fund (est. principal as of 3/31/24: \$444m)

Health Care Trust Fund

Fund Source

- ▶ Established in 2001 with proceeds from federal money for Medicare and Medicaid repayments to nursing home patients
- ▶ Additional funds from state tobacco tax in 2007, and \$50m from SD Legislature in 2021

Investment Considerations

- ▶ SD Const. Art. XII § 5: allows for stocks, bonds, mutual funds and other financial instruments as provided by law
- ▶ SDCL 4-5-47: applies the prudent person standard

Distributions

- ▶ Transfer to state general fund to be appropriated by law for health care related programs
- ▶ SDCL 4-5-29.1: annual distribution is 4% of the 4-year average fair value of the fund, as of Dec. 31, distributed on July 1 of the following year as appropriated by the Legislature
- ▶ SD Const. Art. XII § 5: 4% distribution contingent upon the Dec. 31 fair value being above the principal of the fund (est. principal of 3/31/24: \$136m)

School & Public Lands Fund

Fund Source

- ▶ Proceeds from sales of school lands provided at statehood and other designated amounts

Investment Considerations

- ▶ SD Const. Art. VIII § 11: Amended in 2000 - allows stocks, bonds, mutual funds and other financial instruments as provided by law
 - ▶ Previously, investments were limited to government fixed income investments, including SBA & other non-marketable securities
- ▶ SDCL 5-10-18 references the prudent man standard applies
- ▶ SD Const. Art. VIII § 12: Governor may disapprove any investment
 - ▶ BFM is notified prior to committing to illiquid investments

Distributions

- ▶ Transfer to public K-12 schools and state universities annually
- ▶ SD Const. Art. VIII § 3: all interest and income to be faithfully used and applied each year for the benefit of the public schools of the state after the principal is increased by an amount equal to the rate of inflation from realized gains or investment income.
- ▶ SDCL 5-10-18.3(4) allows the inflation offset to be satisfied by realized net capital gains if available, otherwise income

Benchmark Risk Overview

- Equity-Like Risk (ELR) targeted at 90% of SDRS
 - ELR increase phase in began near 20% of SDRS and reached 80% prior to '08 crisis (GFC)
 - During GFC, ELR was increased to 90%
 - Intend to propose an increase to 100% during next significant market downturn
- Bond-Like Risk is commensurately higher

Trust Funds Capital Markets Benchmark

Proposed FY25

		Primary Asset Categories					Secondary Asset Categories ⁴			Other Categories ⁵	
		<u>Equity Like Risk</u>	<u>Public Equity</u> ¹	<u>Real Estate REIT/Core</u> ²	<u>HY Corp Debt</u>	<u>Investment Grade Debt</u> ¹	<u>Cash</u> ³	<u>Private Equity</u>	<u>Opportunistic Real Estate</u> ²	<u>HY Real Estate Debt</u>	
Minimum		36%	18%	0%	0%	13%	0%	0%	0%	0%	0%
Maximum		77%	75%	20%	15%	60%	45%	11%	14%	10%	5%
Proposed 2025 BM		63%	50.1%	11%	7%	30%	1.9%				
Benchmark Index			(3/4) custom MSCI ACWI IMI ex Real Estate + (1/4) custom MSCI USA IMI ex Real Estate	MSCI US REIT	FTSE US High Yield Market	FTSE US BIG Bond	FTSE US 3-mo Treasury Bill				
Benchmark History											
	2023-2024		50%	11%	7%	30%	2%				
	2016-2022		51%	10%	7%	30%	2%				

1. Buffer for market drift of 1% for public equity and 1/2% for debt (example: Investment Grade debt minimum of 13% can drift to 12.5%)

2. Real Estate(RE) min/max applies to REITS/Core RE and Opportunistic combined. Opportunistic RE counts 1.3x against RE max. Projected base case allocation used for partnerships

3. Cash to provide liquidity for benefits payments and rebalancing

4. Since 2015, secondary asset categories have not been included in the BM. This change allowed the BM to consist solely of well fitting, investable indexes. These categories continue to have a permitted range to invest in opportunistically.

5. Other categories, such as TIPS, Commodities, and Arbitrage have been considered or used in the past. They are not in the BM. Future use would be limited to 5% or less.

Trust Funds Return and Volatility Analysis

Using South Dakota Inputs

	Expected Return	Est. Volatility*
Public Equity	6.1%	21%
Hedge Funds	4.0%	11%
Investment Grade Debt	4.7%	8%
Cash	3.3%	2%
High Yield Debt	5.3%	12%
REITs	6.7%	25%
Private Equity	6.6%	30%
Real Estate Opportunistic	8.3%	33%

	Public Equity	IG Debt	Cash	HY Debt	REITs	Expected Return	Est. Volatility (1yr)*
100:0 Equity/Debt	100%					6.13%	21.00%
70:27:3 Equity/Debt/Cash	70%	27%	3%			5.66%	14.84%
add REITs					11%	5.75%	14.94%
add High Yield Debt				7%		5.75%	14.93%
Benchmark FY25 (proposed)	50.1%	30%	1.9%	7%	11%	5.65%	13.56%

* Standard deviation is a measure of volatility. There is a 68% chance of being within +/-1 standard deviation and a 95% chance of being within +/-2 standard deviations. This measure has been adjusted to better reflect frequency and magnitude of adverse events.