



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

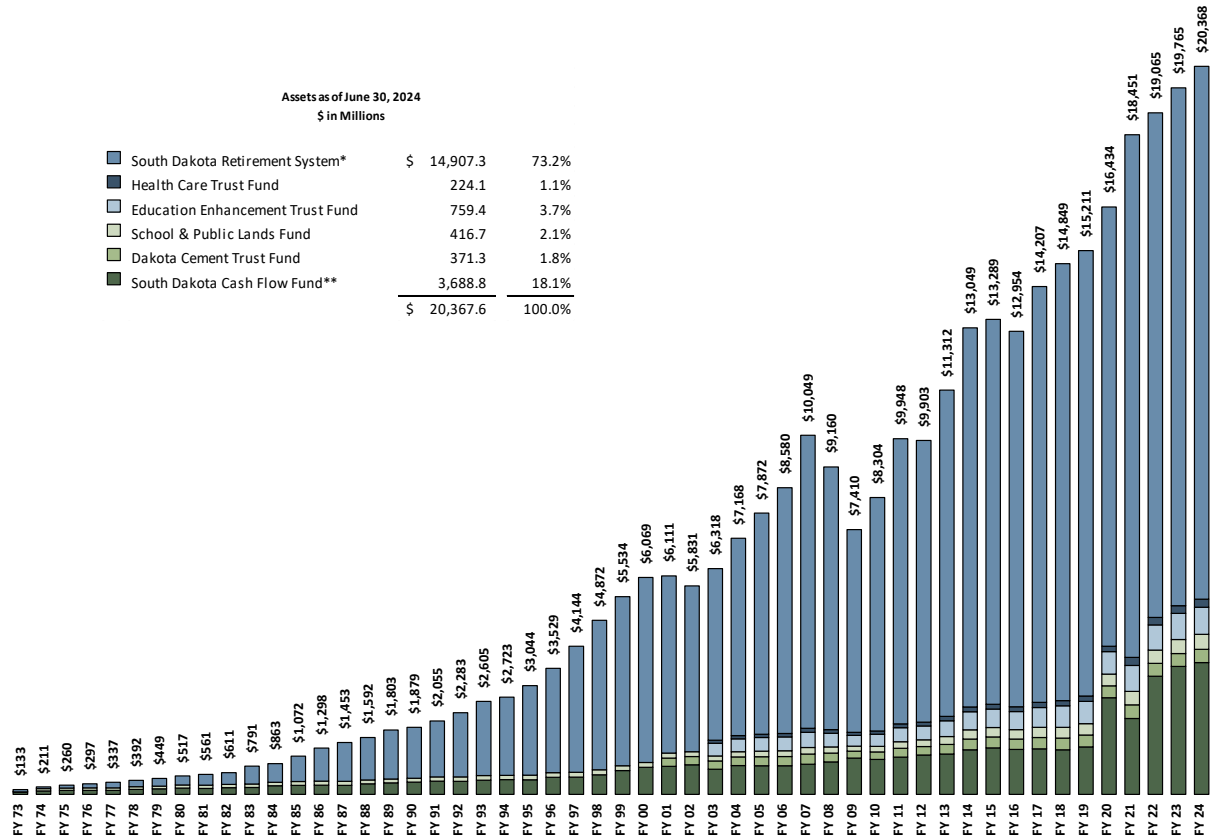
Ex-Officio Members:

- 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)

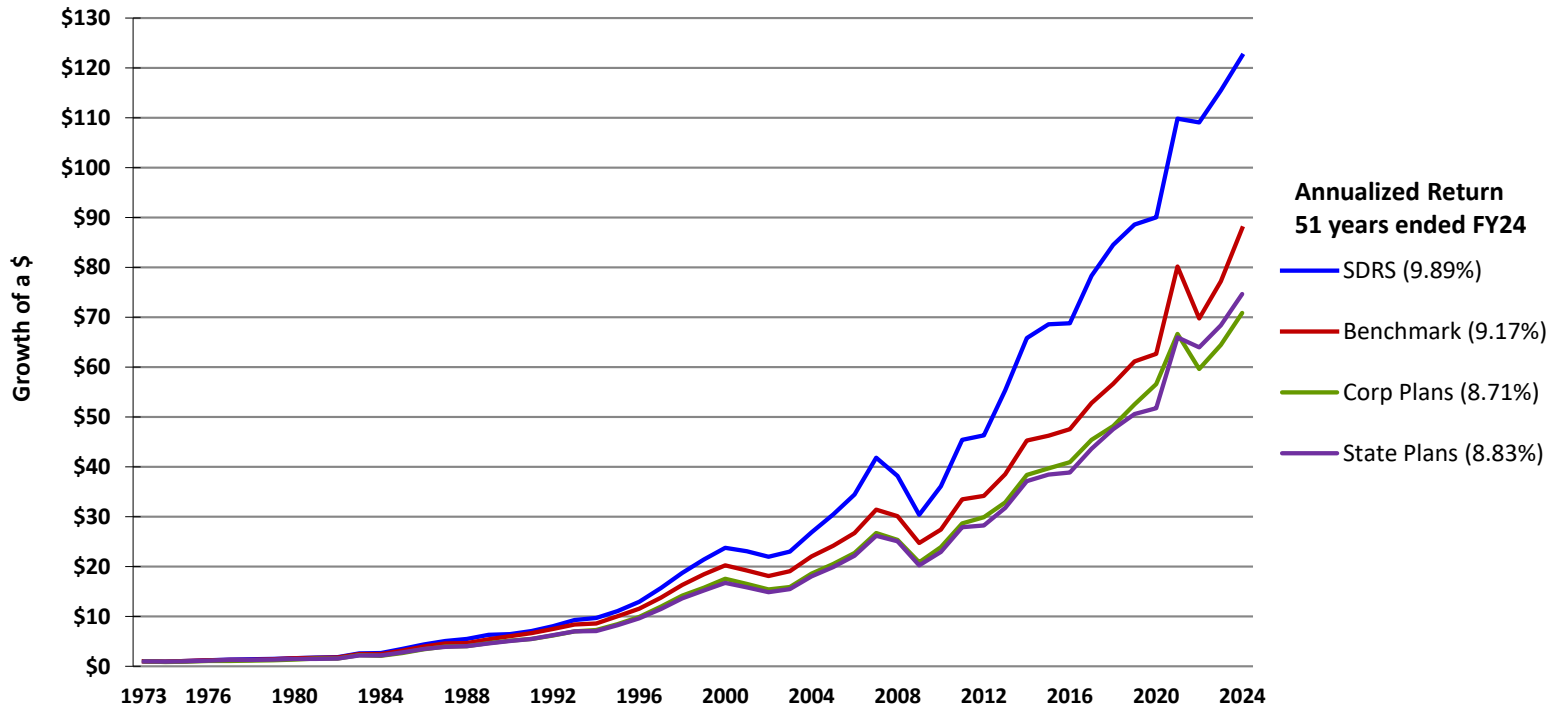
Total SDRS dollars earned Fiscal Year 2024	\$916 million
Total SDRS dollars earned last 5 years	\$4.71 billion
Total SDRS dollars earned last 10 years	\$8.28 billion
Total SDRS dollars earned last 20 years	\$15.16 billion

Extra dollars from performance vs. benchmark
(including compounding)

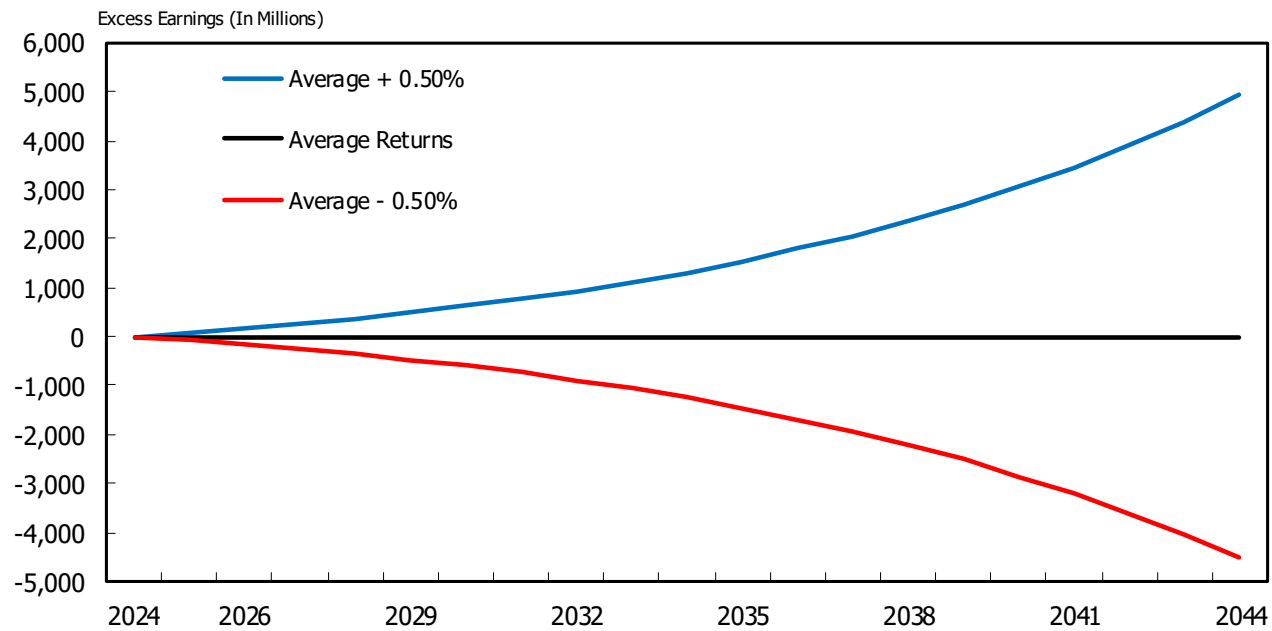
	<u>1 year</u>	<u>5 years</u>	<u>10 years</u>	<u>20 years</u>
vs. Capital Markets Benchmark	- \$1.13 billion	- \$693 million	- \$850 million	\$3.13 billion

Superior returns add up over time

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



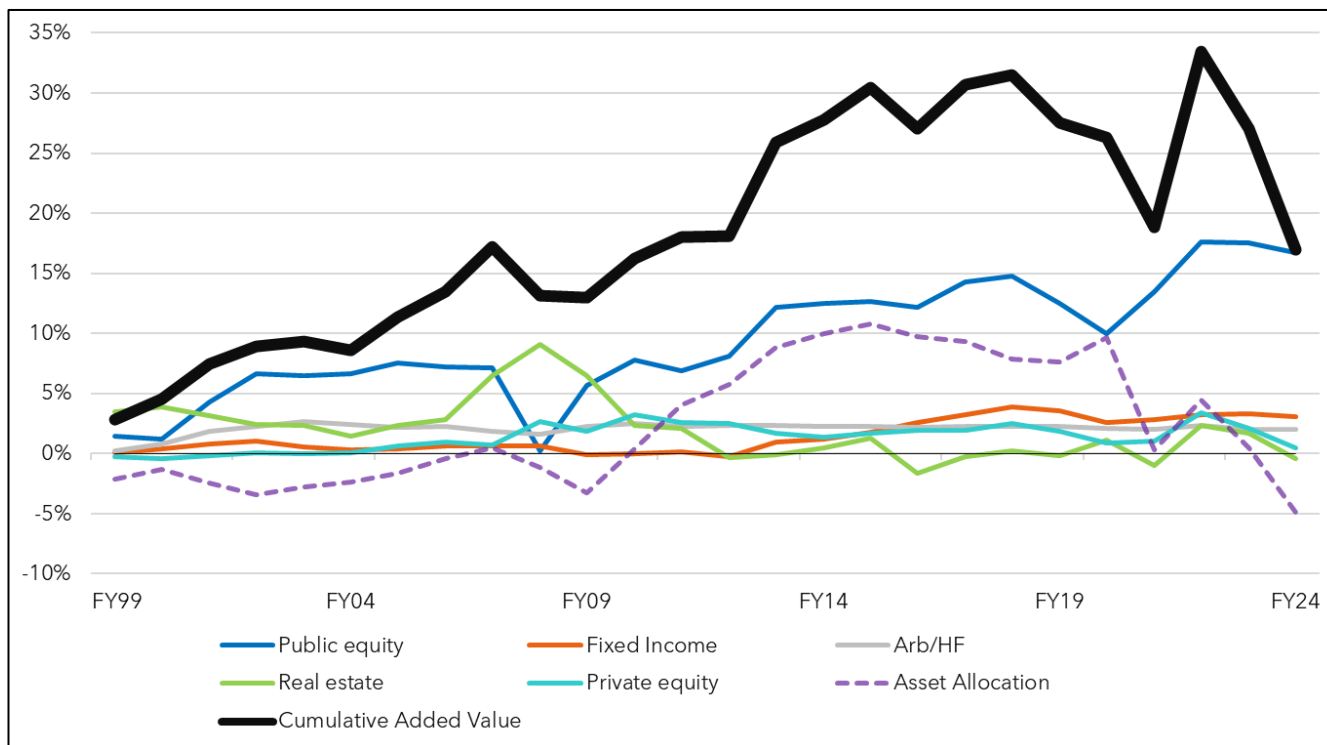
Potential Excess Earnings



- 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.

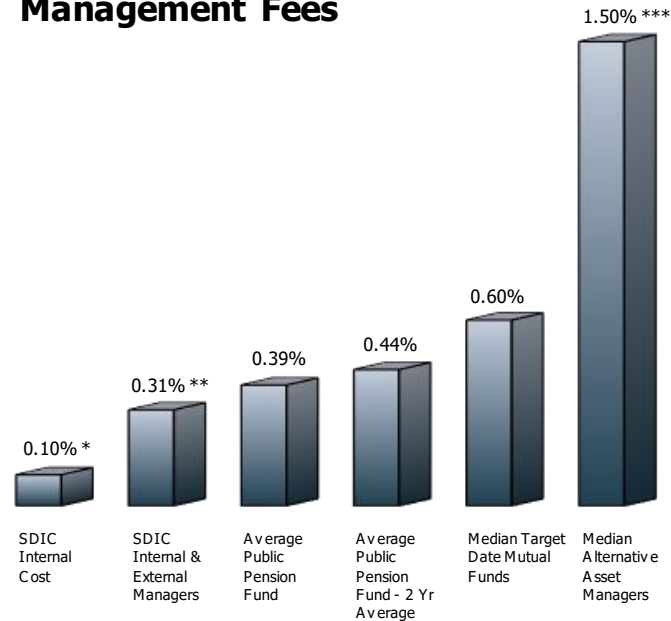
Many pistons contribute

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.

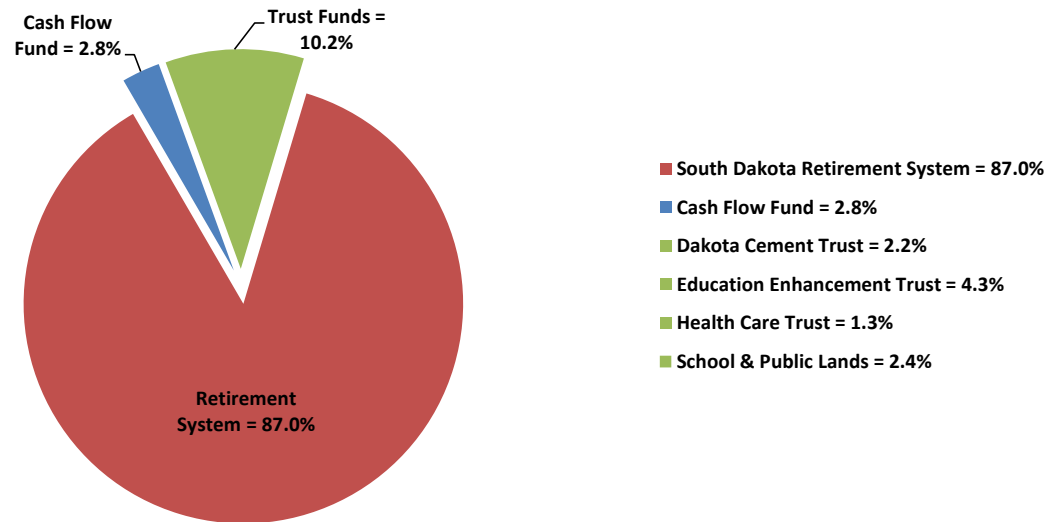
Compensation Overview

- 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

INVESTMENT COUNCIL BUDGET	<u>FY 2026</u>	<u>FY 2031</u>	<u>FY 2036</u>
Personal Services			
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
Operating Expenses			
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
Total Investment Council Budget ⁽¹⁾	30,360,174	36,346,592	44,143,319
ASSET SUMMARY ⁽²⁾			
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
EXPENSE SUMMARY			
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
UNIT COST SUMMARY ⁽³⁾			
Internal Expenses as % of Total Assets	0.10%	0.10%	0.10%
Total Expenses as % of Total Assets	0.31%	0.26%	0.25%

⁽¹⁾ 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.

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

⁽³⁾ Unit Cost Summary uses assumed average investment performance incentives

FY 2024 Budget and Actual

	Expended FY 2024	Received FY 2024	Unexpended FY 2024
PERSONAL SERVICES			
Total FTEs	33.00	35.00	
Base Compensation			
Base Compensation - Investment Staff	5,988,057	6,694,725	706,668 *
Base Comp - Admin, Acct, Legal, Longevity	665,596	794,708	129,112
TOTAL STAFF - FULL TIME	6,653,653	7,489,433	835,780
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
Total Base Compensation	7,802,550	9,259,883	1,457,333
Investment Performance Incentives			
Maximum Potential Investment Perf Incentive	5,837,628	14,612,825	8,775,197
Benefits	369,834	1,816,569	1,446,735
Total Investment Performance Incentives	6,207,462	16,429,394	10,221,932
TOTAL PERSONAL SERVICES	14,010,012	25,689,277	11,679,265
OPERATING EXPENSES			
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)
Total Operating Expenses	2,436,092	2,840,900	404,808
TOTAL BUDGET	16,446,103	28,530,177	12,084,074

*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>
PERSONAL SERVICES			
Total FTEs	35.00	35.00	
Base Compensation			
Base Compensation - Investment Staff	7,178,312	7,141,002	-0.52%
Base Comp - Admin, Acct, Legal, Longevity	844,120	800,038	-5.22%
TOTAL STAFF - FULL TIME	8,022,432	7,941,040	-1.01%
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%
Total Base Compensation	9,831,138	9,738,387	-0.94%
Investment Performance Incentives			
Maximum Potential Investment Perf Incentive	15,063,132	15,603,604	3.59%
Benefits	1,578,713	1,653,297	4.72%
Total Investment Performance Incentives	16,641,845	17,256,901	3.70%
TOTAL PERSONAL SERVICES	26,472,983	26,995,288	1.97%
OPERATING EXPENSES			
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%
Total Operating Expenses	3,038,243	3,152,685	3.77%
TOTAL BUDGET	29,511,227	30,147,973	2.16%
UNIT COST SUMMARY *			
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>
CONTRACTUAL SERVICES			
Investment Services			
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%
Total Investment Services	<u>2,156,184</u>	<u>2,172,984</u>	<u>0.78%</u>
Administrative Expenses			
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%
Total Administrative Expenses	<u>747,858</u>	<u>845,501</u>	<u>13.06%</u>
TOTAL CONTRACTUAL SERVICES	<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%	\$	0.00
4 year	0.00	0%	\$	0.00
10 year	0.00	0%	\$	0.00
4 yr stretch	0.00	0%	\$	0.00
10 yr stretch	0.00	0%	\$	0.00

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%	\$ 215,364.87
TOTAL EARNED RETURN-LINKED COMPENSATION				\$ 215,364.87
		Percentage of Salary		35.601%*

*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

	Expended	Received	Unexpended
	<u>FY 2024</u>	<u>FY 2024</u>	<u>FY 2024</u>
CONTRACTUAL SERVICES			
Investment Services			
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
Total Investment Services	1,538,587	1,909,351	370,764
Administrative Expenses			
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
Total Administrative Expenses	780,948	797,598	16,650
TOTAL CONTRACTUAL SERVICES	2,319,535	2,706,949	387,414