

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL

Yankton, South Dakota

April 19, 2016

1) Roll Call

The meeting was called to order at 9 a.m. on April 19, 2016 by Chair Jim Means. Council members in attendance were Lorin Brass, Ryan Brunner, David Hillard, Steve Kirby, Laura McNally, Jim Means, Rich Sattgast and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Jeff Ellefson, Daniel Elmer, Melissa Hansen-Woidyla, Darci Haug, Lee Mielke, and Arianna Rehfeldt, and Laurie Riss from the Investment Office; Jane Beer, Michelle Mikkelsen and Travis Almond from the South Dakota Retirement System; and State Senator Arthur Rusch.

(Note: For sake of continuity, the following minutes are not necessarily in chronological order. Documents referenced are on file in the Investment Office, and public access is subject to the provisions of SDCL 1-27.)

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Investment Update – FY 2016
- 4) Iran Divestiture – Update
- 5) Internal Equity Presentation – Managed Healthcare Sector
- 6) Legislative Wrap-Up
- 7) Higher Education Savings Program Update
- 8) New Staff – Update
- 9) Internal Equity Presentation – Retail Sector
- 10) Audit Committee Update
- 11) Compensation Committee Update
- 12) New/Old Business
- 13) Future Meeting Dates
- 14) Adjournment

2) Minutes

DAVID HILLARD MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE MINUTES OF THE FEBRUARY 4, 2016 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Investment Update – FY 2016

Matt Clark reviewed the Motions and Actions Notes which included the staff actions taken on the Council motions made at the two previous meetings. He followed up with the Council on the due diligence regarding Lone Star's Hudson relationship.

Clark provided a performance update through April 14, 2016. He discussed current market volatility and the asset allocation valuation trigger points.

Brett Fligge gave an updated on the high yield area, as well as the total amount allocated to the distressed area.

4) Iran Divestiture – Update

Clark confirmed the Council received the Iran Scrutinized Companies List memo dated April 1, 2016. Staff recommended no changes to the current South Dakota scrutinized companies list.

5) Internal Equity Presentation – Managed Healthcare

Jeff Ellefson, Daniel Elmer, Darci Haug and Lee Mielke gave a presentation on the global equity modeling process and a review of the managed healthcare sector.

Lee Mielke, Global Equity Associate Portfolio Manager, presented an overview of the modeling process and listed each step, including company research, competitive advantage, management, risk rating, normalized earnings, long-term growth, and valuation. Mielke described the company research that goes into the modeling process. He then described Porter's 5 Forces model and how those forces affect the profitability and attractiveness of an industry. He concluded by discussing the factors used in determining a risk rating and a normalized sales growth rate.

Dan Elmer, Small/Mid-Cap Research Analyst, presented the normalized earnings process. He covered the adjustments that are made to the income statement and to the invested capital portion of the model. He also reviewed the return on assets and discussed incremental returns and normalized earnings.

Jeff Ellefson, Global Equity Portfolio Manager, presented on the managed care industry including enrollment and medical cost inflation trends. He then covered a diversified managed care firm, UnitedHealth, and discussed each of its divisions. He provided a summary of the analysis behind normalized inputs for the firm and the resulting intrinsic value.

Darci Haug, Small/Mid-Cap Portfolio Manager, presented an overview of the managed Medicaid market, including trends in enrollment and spending. She also gave an overview of a Medicaid company, Centene, and the valuation process behind it.

The Council asked a number of questions regarding Centene, United Healthcare, Europe healthcare and pharma, and the potential future political implications for managed care companies.

6) Legislative Wrap-Up

Clark reviewed the final legislative update. He discussed the ABEL legislation and the Investment Council's role in monitoring and communicating information on the availability of national programs for South Dakotans. Rob Wylie updated the Council on the legislation impacting the Retirement System including a new structure for future employees.

7) Higher Education Savings Program - Update

Clark confirmed with the Council that they received the asset report for the CollegeAccess529 Plan, the minutes of the most recent quarterly conference call, and the compliance schedule.

8) New Staff Update

Clark discussed the newer staff members and the areas in which they will be involved. He noted there will not be any student interns this summer in order to focus on training newer staff.

9) Internal Equity Presentation – Retail

Melissa Hanson-Woidlya and Arianna Rehfeldt presented the equity valuation process for the retail industry.

Melissa Hanson-Woidyla, Global Equity Portfolio Manager, began the presentation with an overview of the retail industry, the drivers of consumer spending and major changes occurring in the industry. She then gave a synopsis of Target's business and core customer.

Arianna Rehfeldt discussed the normal assumptions for Target, focusing on the company's risk rating, organic growth, and normalized earnings and returns. She included comparisons to past assumptions for the company and to Amazon. Finally, she reviewed Target's valuation and its relative attractiveness within the framework of portfolio management.

In response to Council questions, discussion continued on the retail sector, the use of equity models process, and the portfolio managers' use of OneNote for documenting research notes on individual companies.

10) Audit Committee Update

Steve Kirby, Chair of the Audit Committee, reported that Legislative Audit had completed their interim report for the quarter ended December 31, 2015. There were no exceptions reported as a result of the procedures.

11) Compensation Committee Update

David Hillard, Chair of the Compensation Committee, reminded the Council that at the last Council meeting, Matt Clark was asked to do an analysis of internal investment positions' compensations using McLagan data. Hillard noted that the Compensation Committee had met by conference call recently to review the analysis. He asked Clark to review his findings with the full Council.

Clark reviewed the outcomes of his analysis and explained how he arrived at his conclusions for each position.

Hillard noted that the Compensation Committee's recommendation to the full Investment Council is to approve a motion recommending to the LRC Executive Board that total compensation for the State Investment Officer payable in FY 2017 be comprised of a 4.5% increase in base salary and continuation of the investment performance incentive plan, with any earned incentives to be paid following completion of the audit.

The Council will meet by conference call to take action on the recommendation of the Compensation Committee.

12) New/Old Business Agenda Items

There were no new or old agenda items brought before the Council.

13) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on June 21 and 22, 2016. It was noted that the LRC Executive Board set their interim schedule, and the August 29, 2016 Investment Council meeting in Pierre is now confirmed.

14) Adjournment

Chair Means declared the meeting adjourned at 2:35 p.m.