

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL June 13, 2024

1) Roll Call

The meeting was called to order at 8:30 a.m. on June 13, 2024 by Chair Loren Koepsell. Council members in attendance were Travis Almond, Josh Haeder, Mary Howard, Loren Koepsell, Kelly Meiners, Steve Pietila, and Taylor Thompson. Brock Greenfield was absent.

Others attending all or part of the meeting included Investment Council staff members Matt Clark, Chris Nelson, Sherry Nelson, Jan Zeeck, Darci Haug, Danielle Mourer, Anne Cipperley, Renae Randall, Lesyk Voznyuk, Jake Wehde, Sami Rains, Zach Nipp, Lee Mielke, and Sarah Rust; SDRS staff members Doug Fiddler and Michelle Mikkelsen; Derek Johnson from BFM; and Cathy Clark.

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

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes 4/4/24
- 3) Public Comment
- 4) Mary Howard Acknowledgement
- 5) Iran Divestiture Update
- 6) SDRS Actuarial Update
- 7) Asset Allocation
- 8) Investment Update – FY 2024
- 9) 529 Higher Education Savings Plan Update
- 10) Audit Committee Update
- 11) Compensation Committee Update
- 12) FY 2026 Budget Request
- 13) Equity Proxy Voting Overview
- 14) Election of Officers – FY 2025
- 15) New/Old Business Agenda Items
- 16) Future Meeting Dates
- 17) Adjournment

Chair Loren Koepsell welcomed Cathy Clark to the Investment Council. Cathy was appointed by the LRC Executive Board for a five-year term on the Investment Council to begin 7/1/2024.

2) Minutes

JOSH HAEDER MOVED, SECONDED BY KELLY MEINERS, TO APPROVE THE MINUTES OF THE APRIL 4, 2024 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Public Comment

There were no public comments.

4) Mary Howard Acknowledgment

Mary Howard will be completing her five years on the Investment Council effective June 30, 2024. Chair Koepsell and Matt Clark thanked Mary for her contributions to the Council. A plaque was presented to Mary in recognition and appreciation of her outstanding service. Howard shared her thoughts regarding serving on the Council.

5) Iran Divestiture Update

Sami Rains reported that since the last Council meeting, Florida updated the list used to determine the South Dakota list of Iran scrutinized companies. Staff recommended adding one company to the scrutinized list due to recently issuing bonds and removing two companies due to bonds maturing.

STEVE PIETILA MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE CHANGES TO THE IRAN SCRUTINIZED COMPANIES LIST AS PRESENTED. MOTION PASSED UNANIMOUSLY.

6) SDRS Actuarial Update

Doug Fiddler presented an update on the South Dakota Retirement System (SDRS). He provided a breakdown of SDRS membership as well as member/employer contributions and SDRS disbursements. He provided a comparison of annual benefits in pay to South Dakota residents by county. He also compared annual benefits in pay nationally by state.

Fiddler discussed the statutorily required SDRS contribution rates and corrective actions if SDRS falls below 100% funded. He outlined how the COLA is calculated and reviewed historical COLA ranges. Fiddler provided an overview of the current and historical inflation rates in comparison to SDRS COLAs for the last several years.

7) Asset Allocation

South Dakota Retirement System

Anne Cipperley and Darci Haug discussed the asset allocation process, importance, and application to SDRS. They discussed the recommended benchmark allocation and ranges, expected return and standard deviations. Renae Randall discussed valuation of the equity asset category, normal earnings, book value and return on equity. She also reviewed normal growth, equity expected return, and equity price to value. Jake Wehde discussed bond valuation, bond price to value, and real estate valuation. Lesyk Voznyuk reviewed discount rate revisions, high yield spread model, and high yield valuation model. Darci and Danielle Mourer discussed movement of category allocations within ranges based on valuation.

Cipperley discussed the Council's role in Asset Allocation to help meet the primary investment objective of achieving and exceeding over the long term the return of the Council's Capital Markets Benchmark. She discussed balancing long-term potential returns with drawdown risk in difficult markets. Charts of historic returns were shown noting the dominance of equity returns over the very long term and the diversification benefit during market downturns of mixing in some bonds. Cipperley also discussed the investment council staff's research and adjustments to standard measures of risk with a focus on downside risk. Statistical measures of risk, such as standard deviation and correlation, are adjusted to reflect higher real-world

frequency and magnitude of adverse outlier events.

Haug presented the recommended range for equity-like risk, bond-like risk and cash-like risk. She said the goal is to enter market downturns with below benchmark risk and increase toward maximum during the downturn to benefit from an eventual rebound. She added that after minimums or maximums are reached, markets will typically move further, which can be very painful and that it is essential to be patient for at least another three to five years.

Haug also discussed the lowering three years ago of the minimum level of equity-like risk and resulting reduction of absolute downside risk during a severe decline, but increased underperformance risk when very expensive markets continue to go up.

Haug discussed equity-like and bond-like risk mapping for all asset categories. She discussed specific asset categories to be included in the benchmark which are those that are significant and passively implementable. She also discussed other niche or skill-based categories which are not in the benchmark but have a permitted range. Haug presented the recommended FY2025 SDRS capital market benchmark allocations and minimum/maximum ranges for each asset category and compared to the benchmark allocations for prior years. She indicated this was for the benchmark which should represent what could be adhered to through thick and thin. The recommended benchmark and ranges were unchanged from the prior year.

Haug showed SDRS historical levels of equity-like allocation. She reviewed the asset allocation risk/return analysis. The first portion focused on long-term mean expected returns, expected standard deviations, and asset correlations provided by a leading investment bank asset management division as a proxy for conventional expectations. The incremental return and standard deviation impact of each asset class was shown. The analysis was shown again using internal asset category expected returns and internal adjusted risk measures.

Haug discussed additional risk measures and risk control. She reiterated that the focus is on equity-like risk and bond-like risk which includes embedded equity and bond risk for all categories. She discussed how risk is managed by broad diversification and by reducing amounts invested in expensive assets. Adequate liquidity is maintained to avoid liquidation of depressed assets in a crisis and to allow rebalancing. She stated that participation in the economic system is necessary to get the highest long-term rewards and that short-term ebbs and flows must be endured. She added that strength and determination are important to be able to handle tough markets and that strong funding built up in good markets and a flexible benefit design are very helpful.

Randall gave an overview of asset category valuation. She indicated that valuation of the Equity category is based on estimated future cash flows using normal earnings and growth rates and a risk impacted discount rate. She reviewed the process for normalizing earnings and invested capital and reviewed charts showing normal earnings back through time. She discussed normal growth and showed components of the expected equity return and measure of fair value back through time.

Jake Wehde discussed valuation of the bond category and showed the resulting valuation of the bond category back through time. He also discussed valuation of the real estate category. Lesyk Voznyuk discussed valuation of the high yield debt category. He discussed enhancements to the discount rate process and showed a chart including valuation of all the discussed asset categories back through time.

Mourer discussed the plan for adjusting allocations within permitted ranges based on valuation. She showed the asset allocation exposure monitor tool used to track allocations versus targets and limits and rebalancing thresholds. A matrix was shown indicating the process for tracking of valuations versus thresholds where allocation changes are triggered.

Haug discussed historical valuation model suggested allocations and historical added value. She then discussed the flurry of asset allocation changes during 2020 to illustrate implement of the process. Haug, Mourer, and Cipperley concluded with a discussion of evolution of implementation of the asset allocation process on time.

Trust Funds

Danielle Mourer and Darci Haug discussed asset allocation for the four trust funds: Dakota Cement Trust, Healthcare Trust, Education Enhancement Trust, and School and Public Lands Trust. The presentation reviewed the establishment of each fund, the Constitution and laws that direct the investment of the assets, and the annual distribution calculation.

The asset allocation analysis was reviewed which shows the long-term mean expected return and standard deviation for each fund. The analysis used the standard deviations and correlations with fat-tail adjustments. The expected return and standard deviation compared to select prior year benchmark allocations were shown.

There were two small, proposed changes for the FY2025 benchmark from the prior year. The Public Equity weight was increased to 50.1% (from 50% prior year), and the Cash weight was lowered to 1.9% (from 2% prior year). This was to bring the Equity-Like Risk closer to the 90% target of SDRS. It was recommended that the equity-like risk target for the four trust funds remain at 90% of the equity-like risk for SDRS.

There were questions from the Council and further discussion related to the asset allocation presentations including practicality of the minimum for equity-like risk; ability to adjust exposure to illiquid investments; and use of hedging instruments.

KELLY MEINERS MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE FISCAL YEAR 2025 CAPITAL MARKETS BENCHMARK WEIGHTS, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AS PRESENTED. MOTION PASSED UNANIMOUSLY.

TAYLOR THOMPSON MOVED, SECONDED BY STEVE PIETILA, TO APPROVE THE FISCAL YEAR 2025 CAPITAL MARKETS BENCHMARK WEIGHTS, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE DAKOTA CEMENT TRUST, HEALTH CARE TRUST, EDUCATION ENHANCEMENT TRUST, AND SCHOOL & PUBLIC LANDS AS PRESENTED. MOTION PASSED UNANIMOUSLY.

JOSH HAEDER MOVED, SECONDED BY KELLY MEINERS, TO APPROVE THAT ASSET ALLOCATION ADJUSTMENTS MAY BE IMPLEMENTED IN THE CASH MARKETS AND/OR FINANCIAL DERIVATIVES, INCLUDING INDEX-BASED FUTURES, EXCHANGE TRADED FUNDS, OR OPTIONS. MOTION PASSED UNANIMOUSLY.

8) Investment Update – FY 2024

Darci Haug reported the estimated fiscal year-to-date return of the SDRS portfolio. There were no finalized motions and resulting actions to report.

Danielle Mourer reviewed the upcoming distributions and contributions for the trust funds. She also provided an update and some history on the Bristow investment.

Jan Zeeck discussed the fiscal year-to-date performance of the equity portfolios, particularly the effect of energy and healthcare industry over-weights.

9) 529 Higher Education Savings Plan Update

Sherry Nelson reviewed the CollegeAccess 529 Plan summary of shareholder positions and accounts, the HESP Compliance Schedule, and minutes of the quarterly Virtus conference call. It was noted that Virtus has a new calling system that can track caller information and analyze caller complaints. There was also discussion regarding marketing of the program.

10) Audit Committee Update

Steve Pietila, Chair of the Audit Committee, reported that he received the audit report from the Department of Legislative Audit and there were no exceptions.

11) Compensation Committee Update

Matt Clark reviewed three memorandums dated June 11, 2024 that were provided to the Council. These memorandums detailed incentive plans for FY 2025 payable in FY 2026 for three investment team members. Clark explained that Arianna Rehfeldt is now part-time and will be switching her focus to the Core Portfolio. He noted that the plan put in place last year for Jake Wehde will continue for another year and the multiyear components will now have two years of history instead of one year. Connor Van Der Werff is newly eligible for the incentive plan, and he is training to take over a high yield portfolio.

MARY HOWARD MOVED, SECONDED BY STEVE PIETILA, TO APPROVE THE INCENTIVE PLAN AS PRESENTED TODAY AND DETAILED IN THE MEMORANDUM DATED JUNE 11, 2024 DETAILING THE FY 2025 INVESTMENT PERFORMANCE INCENTIVE PLAN FOR CONNOR VAN DER WERFF. MOTION PASSED UNANIMOUSLY.

TAYLOR THOMPSON MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE INCENTIVE PLAN CHANGES AS PRESENTED TODAY AND DETAILED IN THE MEMORANDUMS DATED JUNE 11, 2024 DETAILING THE FY 2025 INVESTMENT PERFORMANCE INCENTIVE PLAN CHANGES FOR ARIANNA REHFELDT AND JAKE WEHDE. MOTION PASSED UNANIMOUSLY.

12) FY 2026 Budget Request

Matt Clark reviewed the FY 2024 budget authorization received versus actual expenditures estimated through the rest of the fiscal year. He discussed the areas that made up the unexpended budget noting that those funds essentially revert back to the funds under management due to not having been drawn.

Clark reviewed the budget request for FY 2026 and the unit cost summary. He noted that the budget that will be submitted to the Executive Board, Governor/BFM and Appropriations will not include salary policy, as a general salary policy for the state will be applied at the end of the process. To reflect a total picture of expenditures, the unit cost summary does include an assumed salary policy.

Clark reviewed the personal services and operating portions of the FY 2026 budget request. He discussed the changes proposed in the contractual budget for investment and administrative services. He discussed the changes among investment research services and investment databases, noting an increase in pricing fees. No changes were proposed for travel, office supplies, or capital assets.

It was noted there was an increase in rates for Bureau of Information & Telecommunications (BIT). This updated rate information was received by the business manager after the FY 2026 budget request presentation was sent to the Council. After reviewing the updated rate sheet, it was determined to request an additional \$25,000 for BIT services in FY 2026.

STEVE PIETILA MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE FISCAL YEAR 2026 BUDGET REQUEST AS AMENDED, WITH \$25,000 ADDED FOR BUREAU OF INFORMATION AND TELECOMMUNICATIONS, AND WITH POTENTIAL MODEST ADJUSTMENTS TO BENEFITS CALCULATIONS ACCORDING TO THE BUREAU OF FINANCE AND MANAGEMENT. MOTION PASSED UNANIMOUSLY.

13) Equity Proxy Voting Overview

Zach Nipp and Lee Mielke presented an overview of equity proxy voting to the Council. Nipp discussed proxy basics and objectives as well as current proxy issues. He also cited the state law pertaining to proxies. Mielke reviewed the Investment Council's proxy policy administration and proxy purpose. There was Council discussion regarding contested proxies and social investment.

14) Election of Officers – FY 2025

JOSH HAEDER MOVED, SECONDED BY STEVE PIETILA, TO ELECT LOREN KOEPSSELL AS CHAIR OF THE INVESTMENT COUNCIL FOR FISCAL YEAR 2025. MOTION PASSED UNANIMOUSLY.

MARY HOWARD MOVED, SECONDED BY TAYLOR THOMPSON, TO ELECT STEVE PIETILA AS VICE CHAIR OF THE INVESTMENT COUNCIL FOR FISCAL YEAR 2025. MOTION PASSED UNANIMOUSLY.

15) New/Old Business Agenda Items

Matt Clark indicated that he planned to review and seek approval to continue the CD program at the next Council meeting.

16) Future Meeting Dates

The next Investment Council meeting will be held on August 15, 2024 in Pierre.

17) Adjournment

Chair Koepsell declared the meeting adjourned at 2:59 p.m.