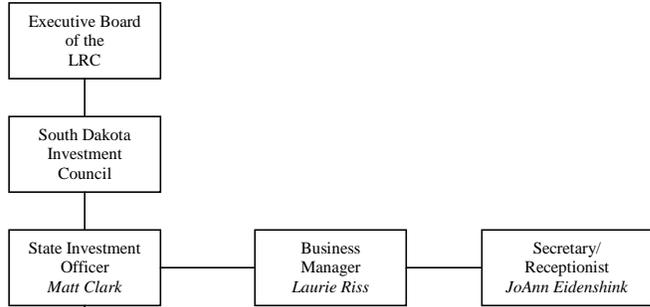

Joint Committee on Appropriations

South Dakota Investment Council
February 2, 2009

Exhibit 1

CURRENT COUNCIL MEMBERS:
 Curt Johnson, Watertown, (Chair)
 Paul Livermore, Sioux Falls
 Haven Stuck, Rapid City
 Joseph A. Anglin, Spearfish
 Wesley G. Tschetter, Brookings
 Jarrod Johnson, S&PL Commissioner
 Vern Larson, State Treasurer
 Rob Wylie, SDRS Administrator

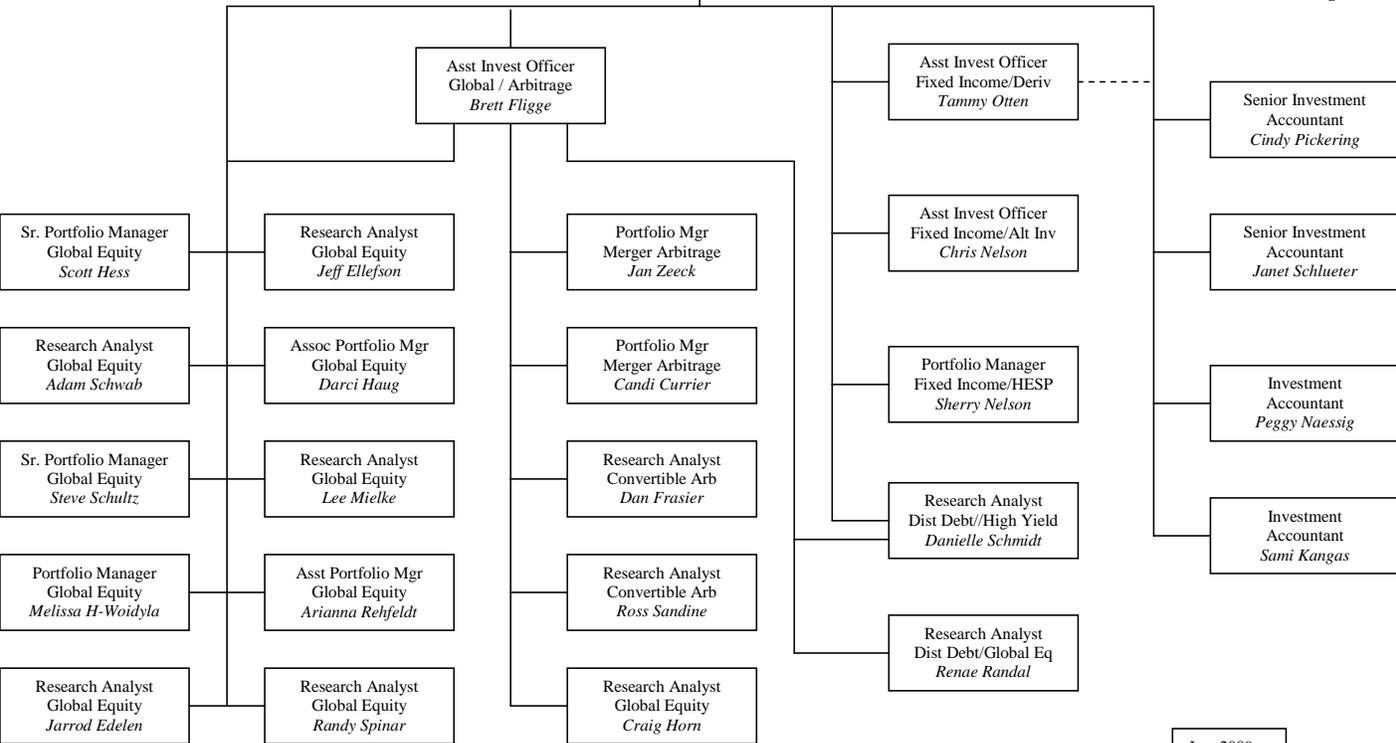


Global Equity

Arb/Distressed

Fixed Income

Investment Accounting

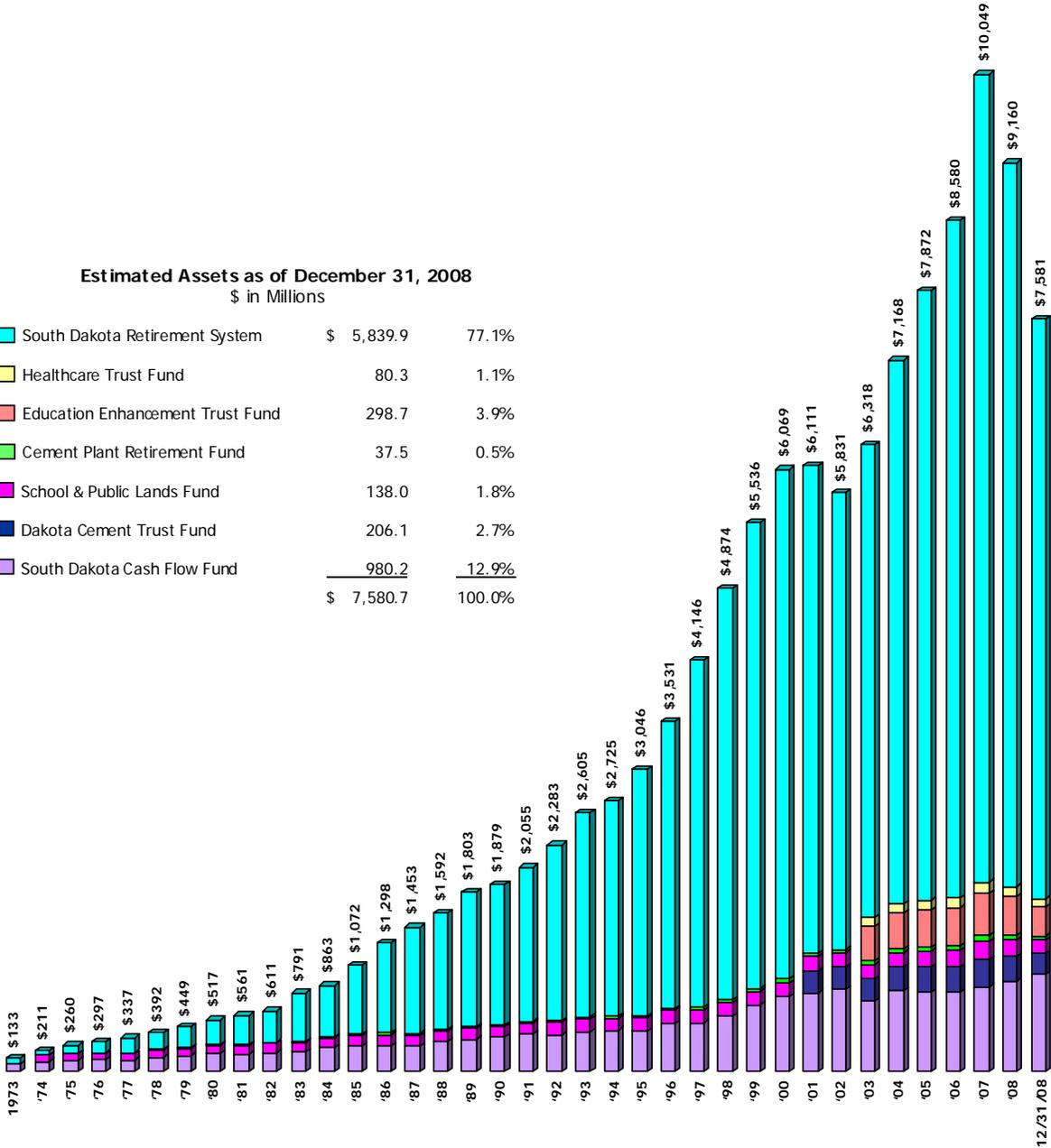


Jan, 2009

South Dakota Investment Council Assets Managed Fiscal Years 1973 to 2008 and Fiscal Year 2009 through 12/31/08 (Estimate)

Estimated Assets as of December 31, 2008
\$ in Millions

	South Dakota Retirement System	\$ 5,839.9	77.1%
	Healthcare Trust Fund	80.3	1.1%
	Education Enhancement Trust Fund	298.7	3.9%
	Cement Plant Retirement Fund	37.5	0.5%
	School & Public Lands Fund	138.0	1.8%
	Dakota Cement Trust Fund	206.1	2.7%
	South Dakota Cash Flow Fund	<u>980.2</u>	<u>12.9%</u>
		\$ 7,580.7	100.0%



SOUTH DAKOTA INVESTMENT COUNCIL

Budget Process & Long-Term Plan

- I. Investment Council Budget Process
 - A) Budget approved by LRC Executive Board before presenting to Bureau of Finance and Management and Appropriations Committee - SDCL 4-5-22
 - B) Budget deducted from assets under management - no general fund appropriation - SDCL 4-5-30

- II. Developed Long-Term Plan – began in 1987
 - A) Recommended by Appropriations Committee to encourage internal management and recognize the potential need for outside management
 - B) Supported by LRC Executive Board

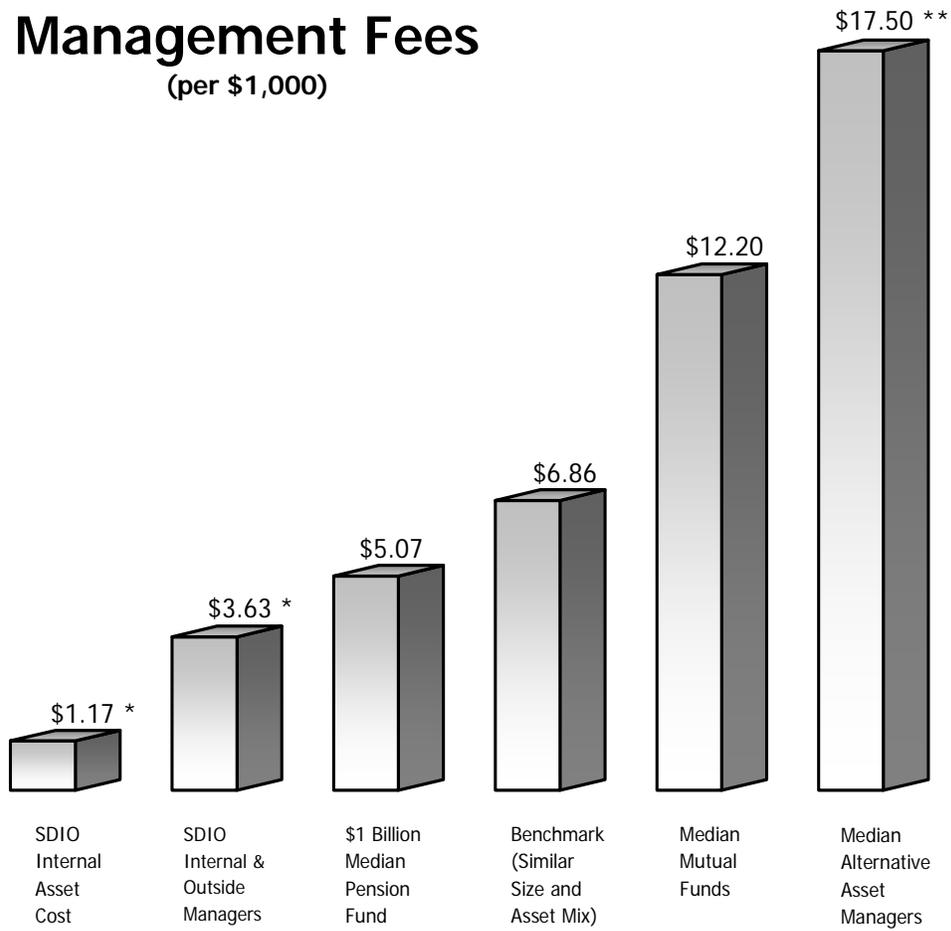
SOUTH DAKOTA INVESTMENT COUNCIL
Long-Term Plan
Executive Summary

	<u>FY 2010</u>	<u>FY 2015</u>	<u>FY 2019</u>
INVESTMENT OFFICE BUDGET			
Personal Services			
Number of Employees	[28]	[29]	[30]
Base Salaries	3,347,703	5,230,476	7,128,186
Intern	19,884	23,051	25,944
Council	7,875	7,875	7,875
Longevity	6,580	10,597	15,515
Incentive Maximum	2,792,453	4,303,202	6,140,641
Benefits	1,008,971	1,564,588	2,176,187
Total Personal Services	7,183,466	11,139,788	15,494,348
Operating Expenses			
Contractual - Investment Services	1,074,271	1,369,719	1,588,309
Contractual - Administrative Services	526,885	639,249	754,492
Travel	73,000	92,285	117,559
Office Supplies & Postage	14,148	17,886	23,116
Capital Assets	31,380	54,099	63,767
Total Operating Expenses	1,719,684	2,173,238	2,547,244
Total Investment Council Budget	8,903,150	13,313,026	18,041,593
ASSET SUMMARY *			
Internal Assets	7,620,512,351	9,936,310,709	12,355,036,266
External Assets	2,540,170,784	3,312,103,570	4,118,345,422
Total Retirement System Assets	8,299,933,318	11,254,658,764	14,359,473,447
Total Assets	10,160,683,134	13,248,414,278	16,473,381,689
EXPENSE SUMMARY			
Internal Expenses	8,903,150	13,313,026	18,041,593
External Manager Fees	27,941,879	36,433,139	45,301,800
Total Expenses	36,845,028	49,746,165	63,343,392
UNIT COST SUMMARY			
Internal Expenses as % of Internal Assets	0.117%	0.134%	0.146%
Internal Exp as % of Internal Assets (1/2 assumed incentives)	0.099%	0.112%	0.121%
Internal Expenses as % of Total Assets	0.088%	0.100%	0.110%
Total Expenses as % of Total Assets	0.363%	0.375%	0.385%

* Projections based on long-term assumed returns applied to 6/30/08 assets. Updated each June 30.

Management Fees

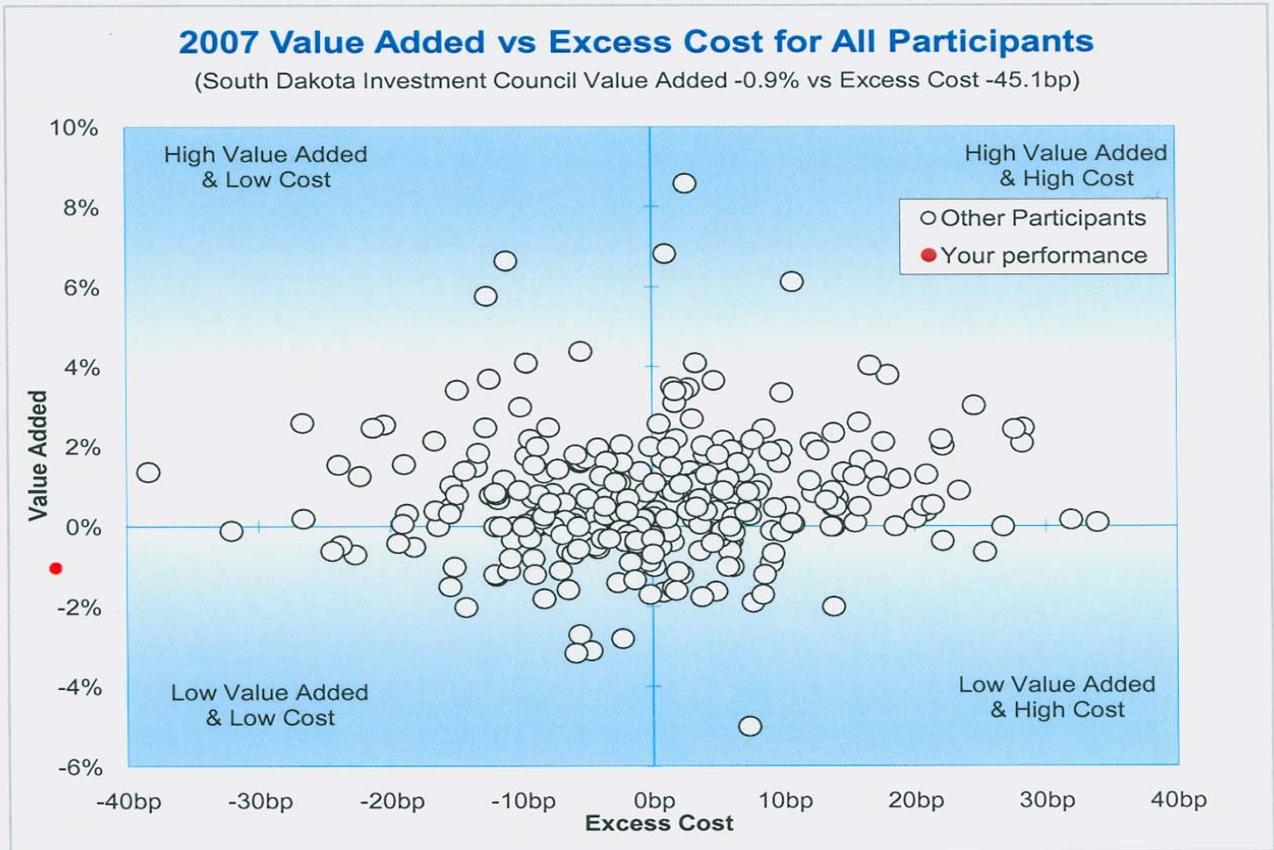
(per \$1,000)



* Using fully budgeted maximum incentives.

** Plus 20% participation in all profits after a preferred returned to the investor.

Cost Effectiveness Ranking



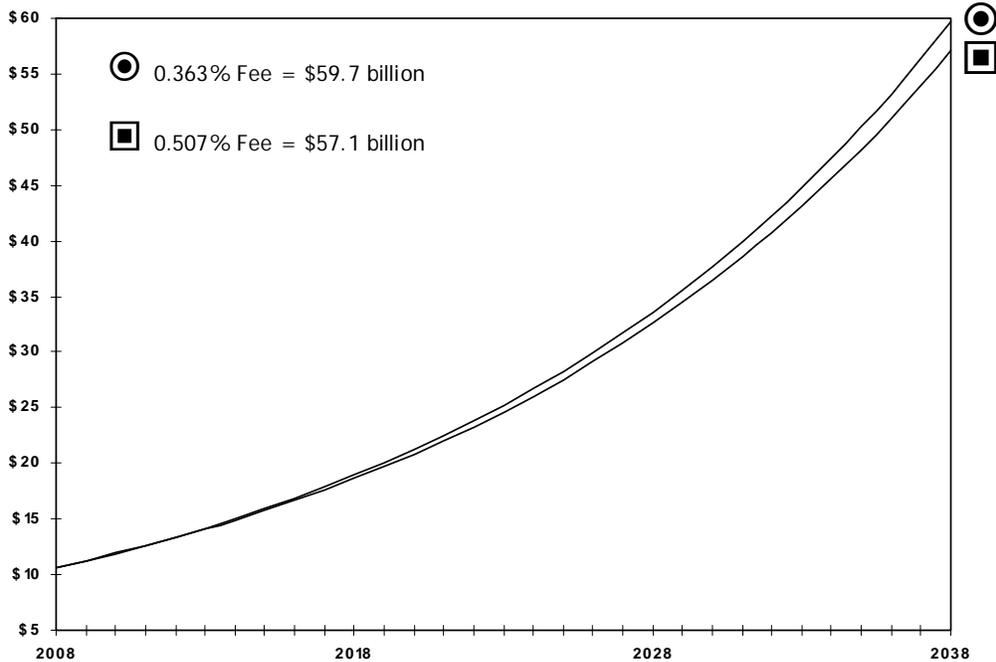
Being high-or low-cost is neither good nor bad. The more important question is, are you sufficient value for your Excess Cost? At the macro level, we provide insight to this by combining your value added and your excess cost to create a snapshot of your 2007 Cost Effectiveness performance relative to that of the survey universe. Your performance is denoted by the red dot; the performance of all other participants is denoted by the white dots.

For the 2007 year, your fund ranked in the low value, low cost quadrant.

In an ideal world, the more you pay (i.e., the higher your excess cost) the more you would get (i.e., the higher your value added). If this was true, you would see an upward sloping relationship in the above graph. Clearly, this is not the case in the above chart. Our research over the past 17 years has shown that there is no consistent relationship between what funds pay and the value added they achieve.

Wealth Accumulation

6.3% return* - different fees



Even without considering the potential for continuing superior Council performance, future wealth grows an extra \$2.6 billion by keeping costs low!

* 7.8% return less 1.5% net withdrawals

**SOUTH DAKOTA INVESTMENT COUNCIL
BUDGET REQUEST SUMMARY
Fiscal Year 2010**

- ◆ Overall FY 2010 budget request is a 8.16% increase.
- ◆ The unit cost for internally managed assets is budgeted at \$1.17 per \$1,000 of assets for FY 2010 compared to a median industry cost of \$5.07 per \$1,000 of assets.
- ◆ **Personal Services:**

NOTE: The Personal Services items in the budget request and this summary reflect the budget approved by the Investment Council in June of 2008 and the LRC Executive Board in August of 2008. The Investment Council has discussed the need to reflect the difficult environment in compensation. Discussions will continue at Council meetings through June. At this point, we expect no salary increases for senior investment staff and support staff positions and commensurately reduced increases for newer to intermediate investment positions to reflect promotional adjustments.

Salary budget. The salary budget increases 7.51%. The increases are in accordance with the Long-Term Plan which include: 4.8% increase for senior level investment positions; 8% to 20% for newer to intermediate level investment team members which will allow for continuation of significant salary increases to reflect the steep learning curve as investment team members transition from entry level to senior investment team members, 5% to 6% increases for two of the investment accountants to reflect their newly acquired CPA designation; and 3% for the remaining two investment accountants, business manager and secretary.

The Investment Council established new target compensation levels for investment positions upon completion of an independent compensation analysis by Deloitte Consulting in April, 2006. The new levels attempted to balance the desire to get a good deal for South Dakota (quality results and low cost) with the risk of losing the good deal if we cannot keep our people.

Incentive compensation: Investment Performance incentives reward outperformance of capital market benchmarks and the private sector corporate universe and range from 0% to a maximum of 100% of base salary. Incentives are paid only if earned by superior performance. The unearned incentive funds are not spent. They remain part of the cash balance and are used to offset the next year's budget authorization. Typically, due to historically superior performance, the average earned incentive across all positions in total has averaged 40% to 60% of the maximum.

Employee benefits: Benefits were increased according to the calculations provided by the Bureau of Finance and Management.

- ◆ **Operating Expenses:** The overall operating budget is slated to increase by 2.46%. Within the operating budget, travel is decreasing by \$7,000 as a result of moving those dollars to Contractual registration fees. Contractual services are increasing by \$49,044 or 3.16% primarily from the \$7,000 moved from travel, expected increases of \$30,231 for several of the research services, and an increase of \$8,053 for Legislative Audit fees. No increase is being requested for Office Supplies, and Capital Assets is decreasing by \$820. The major purchases in Capital Assets will include computer upgrades, replacement chairs and Chartered Financial Analyst books.
- ◆ The long-term business plan continues to provide an excellent roadmap.
 - Provides excellent foundation for stability of South Dakota's professional investment function.
 - Continues the long-term focus on low unit cost management.
 - A key ingredient to long-term superior investment performance.

STATE TREASURER

3210 Investment of State Funds

MISSION:

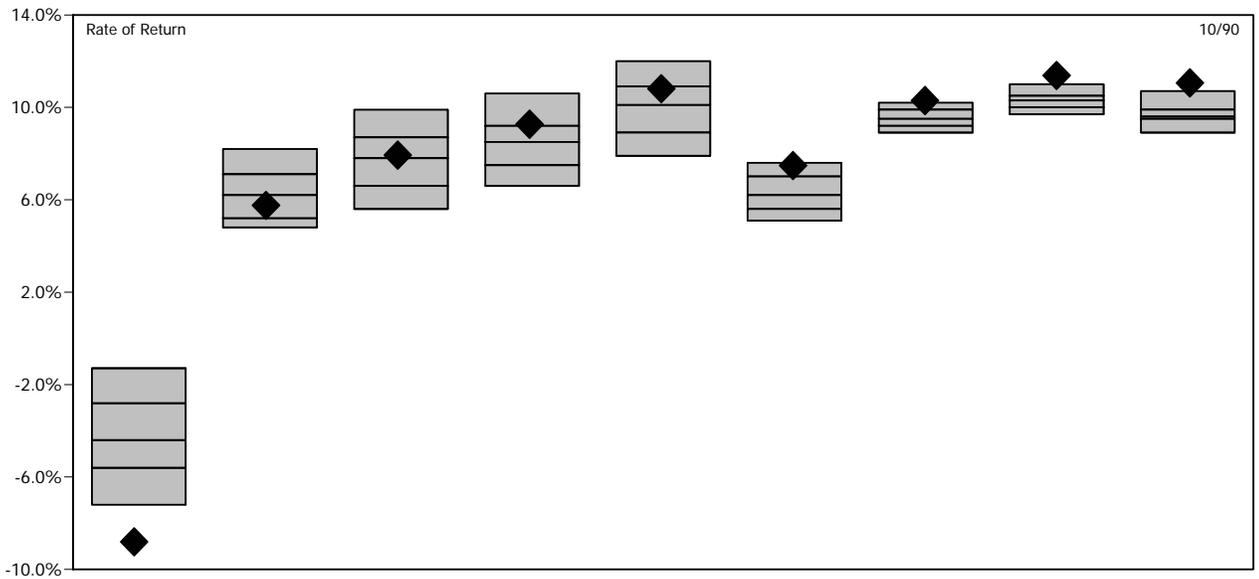
To professionally manage the South Dakota Retirement System and South Dakota Cement Plant Retirement Fund portfolios in order to obtain long-term maximum total returns consistent with prudent risk; to professionally manage the state's cash flow fund in order to obtain long-term maximum total returns consistent with the liquidity needs of the fund, the legal list and prudent risk; to professionally manage the investment portfolio of the School and Public Lands Fund to obtain the highest risk adjusted return over the long term to offset inflation and provide income on a yearly basis to South Dakota's school districts; to professionally manage the Dakota Cement Trust to obtain a rate of return within a risk framework established by the South Dakota Investment Council with the long-term goal to provide the greater of a 5% or \$12 million annual distribution to the general fund and to grow the fund over time; to professionally manage the Health Care Trust Fund and the Education Enhancement Trust Fund to obtain a rate of return within a risk framework established by the South Dakota Investment Council with the long-term goal to provide a 4% annual distribution to the general fund and to grow the funds over time; to oversee the Higher Education Savings Plan per SDCL 13-63-1 to 13-63-31 by establishing the program and monitoring the selected program manager, Allianz Global Investors Distributors LLC; and, to comply with the requirements of SDCL 4-5-12 to 4-5-39, "Investment of State Funds Law".

	ACTUAL FY 2008	BUDGETED FY 2009	ORIGINAL RECOMMENDED FY 2010	REVISED RECOMMENDED FY 2010	CHANGE FROM FY 2009 BASE	CHANGE FROM ORIGINAL RECOMMENDED
FUNDING SOURCE:						
General Funds	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Federal Funds	0	0	0	0	0	0
Other Funds	5,690,048	8,231,813	8,905,584	8,903,148	671,335	(2,436)
Total	\$ 5,690,048	\$ 8,231,813	\$ 8,905,584	\$ 8,903,148	\$ 671,335	(\$ 2,436)
EXPENDITURE DETAIL:						
Personal Services	\$ 4,476,932	\$ 6,553,353	\$ 7,185,900	\$ 7,183,464	\$ 630,111	(\$ 2,436)
Operating Expenses	1,213,117	1,678,460	1,719,684	1,719,684	41,224	0
Total	\$ 5,690,048	\$ 8,231,813	\$ 8,905,584	\$ 8,903,148	\$ 671,335	(\$ 2,436)
Staffing Level FTE:	28.0	28.0	28.0	28.0	0.0	0.0

**SOUTH DAKOTA INVESTMENT COUNCIL
FY 2010 Budget Request**

	Received FY 2009	Request FY 2010	
PERSONAL SERVICES			
Total Salary Budget	3,113,739	3,347,701	7.51%
Total Intern, Council, Longevity	32,499	34,339	
Total Incentive Maximum	2,474,311	2,792,453	
Personal Benefits	932,804	1,008,971	
TOTAL PERSONAL SERVICES	6,553,353	7,183,464	9.62%
OPERATING EXPENSES			
Contractual - Investment Services			
Consultant/Performance Eval/Comp Analysis	150,000	150,000	
Pension Fund Data Exchange	3,250	3,250	
IDC - S&P 1200	10,000	10,000	
Portia	50,000	50,000	
Stone McCarthy	4,000	4,305	
Bloomberg	125,640	138,537	
KDP High Yield	20,000	20,000	
Eq Quote Sys (Thomson One)	27,500	31,600	
Thomson Analytics (First Call)	60,000	60,000	
Quote Fees (incl. Bloomberg/Thomson One)	68,500	75,846	
Research Insight (S&P Compustat & S&P 1200)	75,000	75,000	
Center for Financial Research & Analysis	40,200	27,783	
PCS Securities-Global Mergers & Acquisitions	12,600	12,600	
Credit Sights	24,000	42,000	
Indie Research-Insider Score	14,000	14,000	
PCS Securities - Merger Insight & European Res	28,350	28,350	
Gimme Credit FI Research	25,000	25,000	
Citigroup Yield Book / BB Index	10,000	10,000	
Vista Research	60,000	60,000	
Flexibility - From Brokerage to Independent Research	236,000	236,000	
Total Contractual-Investment	<u>1,044,040</u>	<u>1,074,271</u>	
Contractual - Administrative			
Office Rent	99,732	101,542	
Bond/Liability Insurance	6,840	6,840	
Telephone	10,000	10,000	
Office Equip Rental/Maintenance	6,000	6,000	
Bureau of Info & Telecommunications (BIT)	33,000	34,950	
State Central Services	9,000	9,000	
Legislative Audit	28,000	36,053	
Custodial Fees - Global	288,750	288,750	
Seminars/Educational Programs	22,750	29,750	
Business Publications	4,000	4,000	
Total Contractual-Administrative	<u>508,072</u>	<u>526,885</u>	
Contractual Total	1,552,112	1,601,156	
Travel	80,000	73,000	
Office Supplies & Postage	14,148	14,148	
Capital Assets	32,200	31,380	
TOTAL OPERATING EXPENSES	1,678,460	1,719,684	2.46%
TOTAL BUDGET	8,231,813	8,903,148	8.16%

Annualized Total Fund STATE FUND UNIVERSE Ending June 30, 2008



	1 year	2 years	3 years	4 years	5 years	10 years	20 years	25 years	35 years
Median	-4.4%	6.2%	7.8%	8.5%	10.1%	6.2%	9.5%	10.3%	9.6%
◆ SDRS Total Fund Return	-8.7%	5.3%	7.8%	9.2%	10.6%	7.4%	10.2%	11.3%	11.0%
% Ranking	100	71	48	26	29	12	18	1	1

DOLLAR & PERCENTAGE IMPACT of INVESTMENT PERFORMANCE

Total Returns

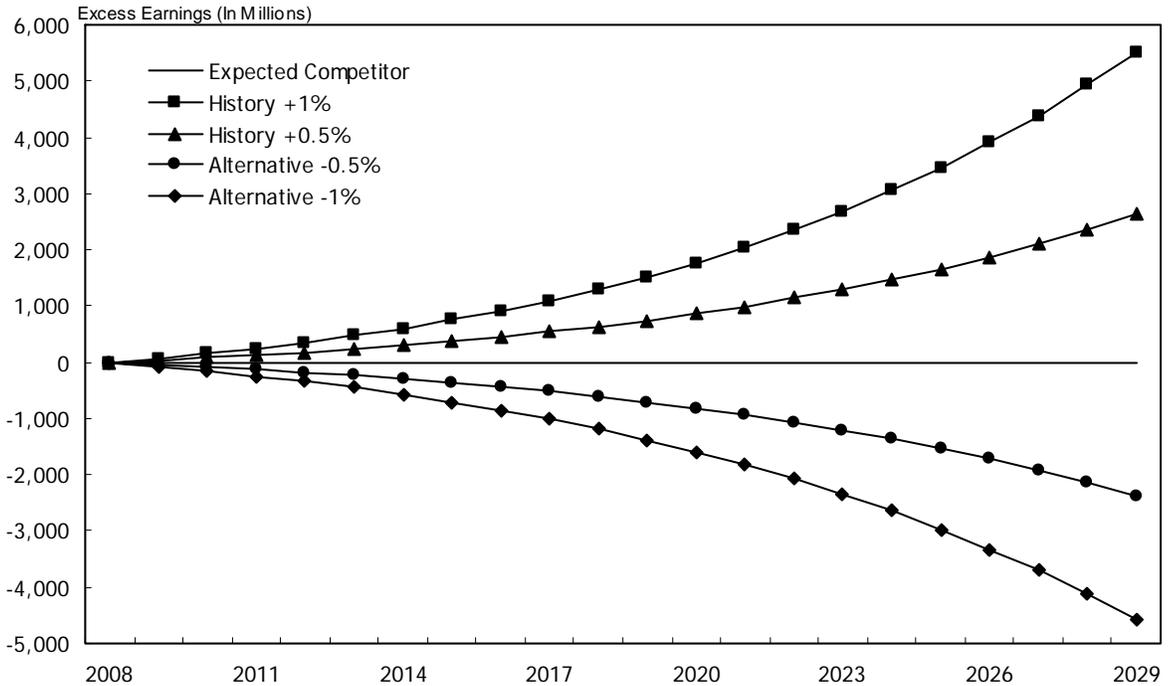
	<u>FY 2008</u>	<u>4 Years Annualized FY 05 – 08</u>	<u>10 Years Annualized FY 99 – 08</u>
SDRS Total Fund	-8.65%	9.19%	7.39%
Mellon Analytics Billion \$ Corp Plan	-5.02%	8.01%	6.45%
% Difference	-3.63%	1.18%	.94%
Capital Market Benchmark	-4.20%	8.13%	6.33%
% Difference	-4.45%	1.06%	1.06%
State Fund Universe	-4.40%	8.50%	6.20%
% Difference	-4.25%	.69%	1.19%
SDRS Beginning FY08 Assets		\$8.146 billion	
SDRS Ending 6/30/08 Assets		\$7.301 billion	

EARNINGS

- Total SDRS dollars earned Fiscal Year 2008: \$-692.8 million
- Total SDRS dollars earned last 4 years: \$2.279 billion
- Total SDRS dollars earned last 10 years: \$4.004 billion
- **Extra earnings** resulting from last 1, 4 and 10 years of performance:

	<u>1 year</u>	<u>4 years</u>	<u>10 years</u>
➤ vs. Mellon Analytics Corporate:	\$-296 million	\$273 million	\$659 million
➤ vs. Capital Market Benchmark:	\$-363 million	\$249 million	\$550 million
➤ vs. State Funds:	\$-346 million	\$144 million	\$544 million

Potential Excess Earnings Historic Versus Average Returns



Historically, our outperformance for the last 35 years has been 0.75% annualized versus our benchmark. This table illustrates the excess earnings that would be produced with a 1% outperformance. Our goals going forward must be more modest because of greater market efficiencies and intensive competition from all peer groups. Superior returns of even 0.5% make an extraordinarily large difference as illustrated by additional earnings of \$2.63 billion by the year 2029 versus average returns. A 1% outperformance would produce an extra \$5.51 billion where as a 1% underperformance would cost the retirement systems \$4.57 billion relative to average performers.

SUMMARY OF TRUST FUND VALUE AND ASSET ALLOCATION

12/31/2008 ESTIMATE UNAUDITED

Health Care Trust

Principal as of 12/31/08		\$	85,631,024
Principal as of 12/31/08 adjusted for inflation		\$	100,720,368
Fair Value as of 12/31/08	EST.	\$	80,300,000
Difference - FV less principal		\$	(5,331,024)
Difference - FV less infl. adj. principal		\$	(20,420,368)
Fiscal year to date return	EST		-16.50%
Longterm expected mean return			7.16%
Payout of 4% plus expected inflation of 3%			7.00%
Expected return cushion/shortfall			0.16%

Distribution for FY 09 (July 1, 2008) **3,896,329.68**
 Projected Distribution for FY 10 (July 1, 2009) 0.00

<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Global Equity	45%	48%
Private Equity	2%	2%
Real Estate	8%	5%
Fixed Income-IG	34%	33%
Fixed Income-HY	3%	5%
Fixed Income-Tips	6%	5%
Money Market	<u>2%</u>	<u>2%</u>
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

Principal as of 12/31/08		\$	329,329,930
Principal as of 12/31/08 adjusted for inflation		\$	387,936,889
Fair Value as of 12/31/08	EST	\$	298,700,000
Difference - FV less principal		\$	(30,629,930)
Difference - FV less infl. adj. principal		\$	(89,236,889)
Fiscal year to date return	EST		-18.60%
Longterm expected return (lower due to tax exempts)			6.74%
Payout of 4% plus expected inflation of 3%			7.00%
Expected return cushion/shortfall			-0.26%

Distribution for FY 09 (July 1, 2008) **15,453,421.83**
 Projected Distribution for FY 10 (July 1, 2009) 0.00

<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Global Equity	45%	48%
Private Equity	3%	2%
Real Estate	9%	5%
Fixed Income-IG	0%	3%
Fixed Income-tax ex	39%	30%
Fixed Income-HY	3%	5%
Fixed Income-Tips	0%	5%
Money Market	<u>1%</u>	<u>2%</u>
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

Dakota Cement Trust

Principal as of 12/31/08		\$	238,000,000
Principal as of 12/31/08 adjusted for inflation		\$	286,811,538
Fair Value as of 12/31/08	EST	\$	206,100,000
Difference - FV less principal		\$	(31,900,000)
Difference - FV less infl. adj. principal		\$	(80,711,538)
Fiscal year to date return	EST		-16.60%
Longterm expected mean return			7.16%
Payout of 5% plus expected inflation of 3%			8.00%
Expected return cushion/shortfall			-0.84%

Distribution for FY 09 (June 2009 to Gen. Fund) **12,000,000.00**
 Distribution for FY 09 (June 2009 to be appropriated) **1,522,942.52**

<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Global Equity	45%	48%
Private Equity	3%	2%
Real Estate	9%	5%
Fixed Income-IG	33%	33%
Fixed Income-HY	3%	5%
Fixed Income-Tips	6%	5%
Money Market	<u>2%</u>	<u>2%</u>
Total	100%	100%

Pays out 5% of average balance with \$12 million always paid. Education money distributed as long as principal not violated as of June 30 each year

School & Public Lands

Inflation protection mandated by Constitutional Amendment - (payout is reduced by inflation to extent inflation not offset by realized gains)

Fair Value as of 12/31/08	EST	\$	134,700,000
Fiscal year to date return	EST		-16.30%
Longterm expected mean return			7.16%
Distribution for FY 09 (paid in Feb 2009 to K-12 schools)			10,996,684
Distribution for FY 08 to Board of Regents (June)			1,948,721

<u>Asset Allocation</u>	<u>Current</u>	<u>Benchmark</u>
Global Equity	45%	48%
Private Equity	3%	2%
Real Estate	8%	5%
Fixed Income-IG	31%	33%
Fixed Income-non-mk	3%	
Fixed Income-HY	3%	5%
Fixed Income-Tips	6%	5%
Money Market	<u>2%</u>	<u>2%</u>
Total	100%	100%

Pays out all received income after inflation adjustment