

MINNESOTA STATE BOARD OF INVESTMENT

2015 Annual Report

Environmental Trust Fund

The Environmental Trust Fund was established in 1988 by the Minnesota Legislature to provide a long-term, consistent and stable source of funding for activities that protect and enhance the environment. On June 30, 2015, the market value of the Fund was \$893 million.

By statute, the State Board of Investment invests the assets of the Environmental Trust Fund. The Legislature funds environmental projects from a portion of the market value of the Fund.

Investment Objective

The Environmental Trust Fund's investment objective is long-term growth in order to produce a growing level of spending within the constraints of maintaining adequate portfolio quality and liquidity.

A constitutional amendment passed in November 1998 continues the mandate that 40 percent of the net proceeds from the state lottery be credited to the Fund through 2025.

The amendment provides for spending 5.5 percent of the Fund's market value annually. The amendment eliminated accounting restrictions on capital gains and losses and the provision that the principal must remain inviolate.

Asset Allocation

After the constitutional amendment was adopted in November 1998, SBI staff worked with the Legislative Citizen Commission on Minnesota Resources to establish an asset allocation policy that is consistent with the Commission's goals for spending and growth of the Fund. The allocation positions the Fund for the best long-term

growth potential while meeting the objective of the Fund to produce a growing level of spending.

The current long term asset allocation targets for the Fund are:

Domestic Stocks	70%
Domestic Bonds	28
Cash	2

Figure 41 presents the actual asset mix of the Fund at the end of fiscal year 2015.

Investment Management

SBI staff internally manages all assets of the Environmental Trust Fund. Management by SBI staff is considered to be the most cost effective at this time.

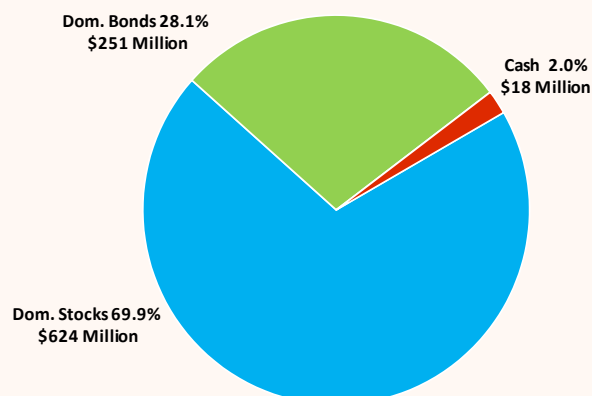
Stock Segment

The stock segment of the Fund is passively managed to track the performance of the S&P 500.

Bond Segment

The bond segment is actively managed to add incremental value through sector, security and yield curve decisions, and its performance is measured against the Barclays Capital Aggregate Bond Index.

Figure 41. Environmental Trust Fund Asset Mix as of June 30, 2015



Environmental Trust Fund

Investment Performance

During the fiscal year, the *stock* segment underperformed its benchmark by 0.1 percentage point.

The *bond* segment outperformed its benchmark by 0.6 percentage points during the fiscal year, primarily due to the overweight to the corporate sector and a short duration position relative to the benchmark.

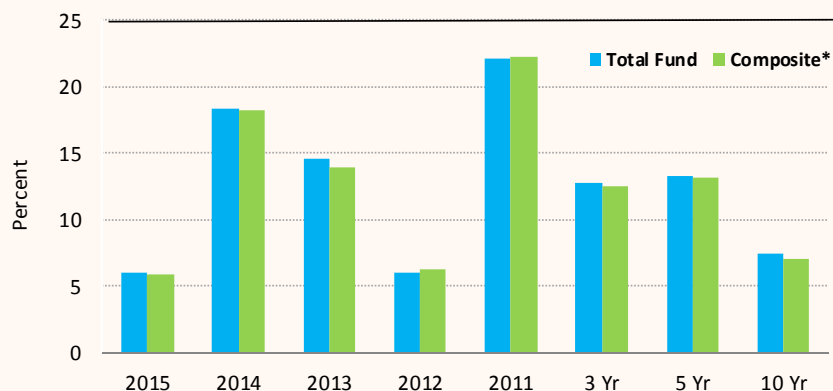
Overall, the Environmental Trust Fund provided a return of 6.0% for fiscal year 2015 and outperformed its composite index by 0.2 percentage point. The Fund outperformed its composite index over the most recent three, five and ten years due to the incremental value added by bonds.

Performance results are presented in Figure 42.

Spendable income generated by the Fund over the last five fiscal years is shown below:

<u>Fiscal Year</u>	<u>Millions</u>
2011	\$26
2012	\$25
2013	\$25
2014	\$34
2015	\$34

Figure 42. Environmental Trust Fund Performance For Periods Ending June 30, 2015



	2015	2014	2013	2012	2011	3 Yr. Annualized	5 Yr. Annualized	10 Yr. Annualized
Total Fund	6.0%	18.3%	14.6%	6.0%	22.1%	12.8%	13.2%	7.4%
Composite*	5.8	18.2	13.9	6.3	22.2	12.5	13.1	7.0
Stock Segment	7.5	24.5	20.5	5.5	30.8	17.3	17.4	8.0
S&P 500	7.4	24.6	20.6	5.4	30.7	17.3	17.3	7.9
Bond Segment	2.5	5.0	1.4	6.5	4.3	3.0	3.9	5.1
Barclays Agg.	1.9	4.4	-0.7	7.5	3.9	1.8	3.3	4.4

* Weighted 70% S&P 500/ 28% Barclays Capital Aggregate/ and 2% 3 month T-Bill.

MINNESOTA STATE BOARD OF INVESTMENT

2016 Annual Report

Environmental Trust Fund

The Environmental Trust Fund was established in 1988 by the Minnesota Legislature to provide a long-term, consistent and stable source of funding for activities that protect and enhance the environment. On June 30, 2016, the market value of the Fund was \$924 million.

By statute, the State Board of Investment invests the assets of the Environmental Trust Fund. The Legislature funds environmental projects from a portion of the market value of the Fund.

Investment Objective

The Environmental Trust Fund's investment objective is long-term growth in order to produce a growing level of spending within the constraints of maintaining adequate portfolio quality and liquidity.

A constitutional amendment passed in November 1998 continues the mandate that 40% of the net proceeds from the state lottery be credited to the Fund through 2025.

The amendment provides for spending 5.5% of the Fund's market value annually. The amendment eliminated accounting restrictions on capital gains and losses and the provision that the principal must remain inviolate.

Asset Allocation

After the constitutional amendment was adopted in November 1998, SBI staff worked with the Legislative Citizen Commission on Minnesota Resources to establish an asset allocation policy that is consistent with the Commission's goals for spending and growth of the Fund. The allocation positions the Fund for the best long-term growth potential while meeting

the objective of the Fund to produce a growing level of spending.

The current long term asset allocation targets for the Fund are:

Domestic Stocks	70%
Domestic Bonds	28%
Cash	2%

Figure 45 presents the actual asset mix of the Fund at the end of fiscal year 2016.

Investment Management

SBI staff internally manages all assets of the Environmental Trust Fund. Management by SBI staff is considered to be the most cost effective option at this time.

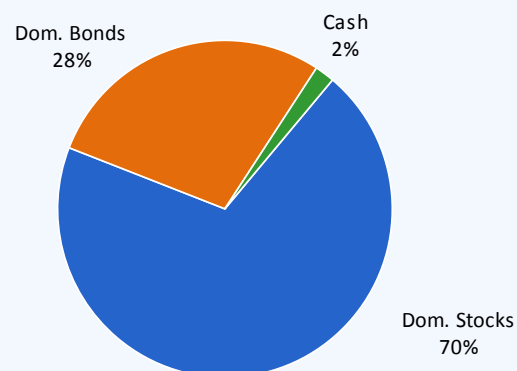
Stock Segment

The stock segment of the Fund is passively managed to track the performance of the S&P 500 (see page 43).

Bond Segment

The bond segment is actively managed to add incremental value through sector, security and yield curve decisions, and its performance is measured against the Barclays Capital Aggregate Bond Index (see page 44).

Figure 45. Environmental Trust Fund Asset Mix as of June 30, 2016



Investment Performance

During the fiscal year, the *stock* segment tracked its benchmark.

The *bond* segment underperformed its benchmark by 0.3 percentage points during the fiscal year, primarily due to the overweight to the corporate sector and a short duration position relative to the benchmark.

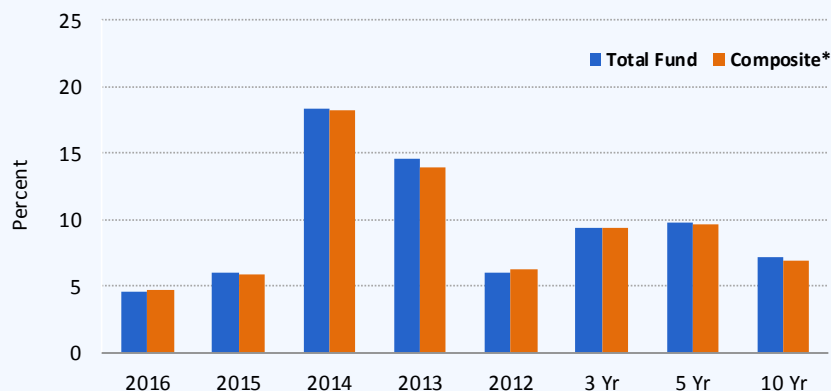
Overall, the Environmental Trust Fund provided a return of 4.5% for fiscal year 2016 and underperformed its composite index by 0.2 percentage point. The Fund tracked its composite index over the three year time period and outperformed over the five and ten year time periods.

Performance results are presented in Figure 46.

Spendable income generated by the Fund over the last five fiscal years is shown below:

<u>Fiscal Year</u>	<u>Millions</u>
2012	\$25
2013	\$25
2014	\$34
2015	\$34
2016	\$46

Figure 46. Environmental Trust Fund Performance For Periods Ending June 30, 2016



	2016	2015	2014	2013	2012	Annualized		
						3 Yr.	5 Yr.	10 Yr.
Total Fund	4.5%	6.0%	18.3%	14.6%	6.0%	9.4%	9.7%	7.2%
Composite*	4.7	5.8	18.2	13.9	6.3	9.4	9.6	6.9
Stock Segment	4.0	7.5	24.5	20.5	5.5	11.7	12.1	7.5
S&P 500	4.0	7.4	24.6	20.6	5.4	11.7	12.1	7.4
Bond Segment	5.7	2.5	5.0	1.4	6.5	4.4	4.2	5.6
Barclays Agg.	6.0	1.9	4.4	-0.7	7.5	4.1	3.8	5.1

* Weighted 70% S&P 500/ 28% Barclays Capital Aggregate/ and 2% 3 month T-Bill.