

## VII. Assets & Liabilities

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*“a description of the assets and liabilities of the trust fund;”*

The following document is from the State Board of Investment 2007 Annual Report.





# **2007 Annual Report**

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**Minnesota State Board of Investment**

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# 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, 2007, the market value of the Fund was \$494 million.**

By statute, the State Board of Investment (SBI) 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.

### Investment Constraints

In November 1998, Minnesota voters passed a constitutional amendment to continue the mandate that 40 percent of the net proceeds from the state lottery be credited to the Fund through 2025.

The amendment also provides for spending 5.5 percent of the Fund's market value annually, since fiscal year 2000. The amendment eliminates the 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 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 SBI approved a 70% stock

and 30% fixed income asset allocation which was implemented July 1, 1999. 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.

Figure 38 presents the actual asset mix of the Fund at the end of fiscal year 2007. The current long term asset allocation targets for the Fund are:

Domestic Stocks	70%
Domestic Bonds	28
Cash	2

### Investment Management

SBI staff manage all assets of the Environmental Trust Fund. Given the unique constraints of the Fund, management by SBI staff is considered to be the most cost effective at this time.

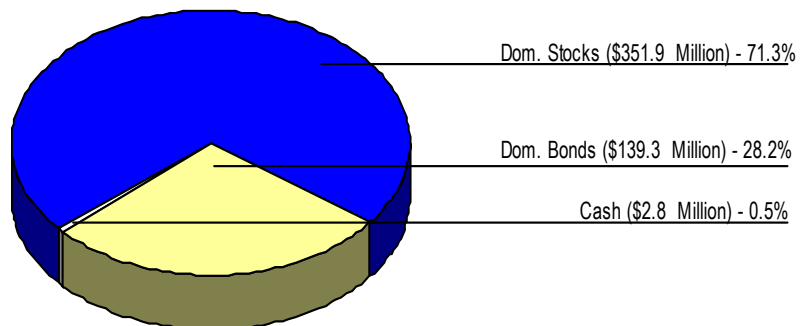
### Stock Segment

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 Lehman Brothers Aggregate Bond Index.

Figure 38. Environmental Trust Fund Asset Mix as of June 30, 2007



Note: Percentages may differ slightly due to rounding of values.

## Environmental Trust Fund

### Investment Performance

During the fiscal year, the *stock* segment matched its S&P 500 benchmark. By investing in all of the stocks in the benchmark at their index weighting, the segment attempts to track the benchmark return on a monthly and annual basis. The portfolio is periodically rebalanced to maintain an acceptable tracking error relative to the benchmark subject to keeping trading costs at a minimum.

The *bond* segment outperformed its benchmark by 0.1 percentage point during the fiscal year.

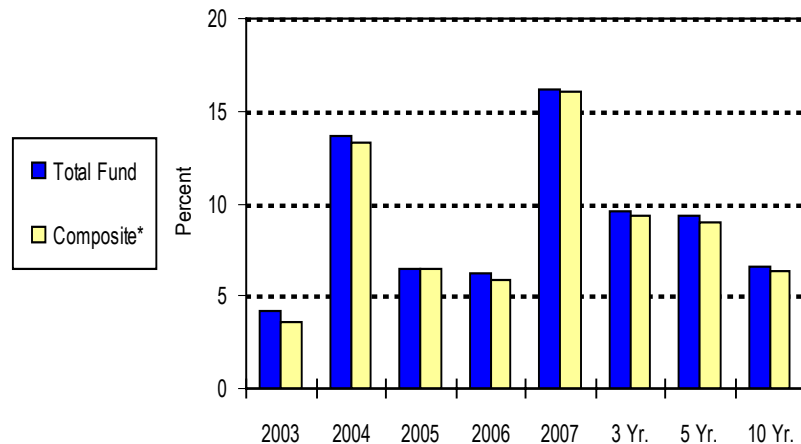
**Overall**, the Environmental Trust Fund provided a return of 16.2% for fiscal year 2007, outperforming its composite index by 0.1 percentage point. For the most recent three-year period, the Fund exceeded its composite benchmark by 0.2 percentage point. The Fund experienced modest outperformance over the last five and ten years due to the incremental value added by both the stock and bond segments.

Performance results are presented in Figure 39.

Spendable income generated by the Fund follows:

Fiscal Year	Millions
2003	\$17
2004	\$15
2005	\$15
2006	\$19
2007	\$19

Figure 39. Environmental Trust Fund Performance FY 2003-2007



	2003	2004	2005	2006	2007	3 Yr.	5 Yr.	10 Yr.
<b>Total Fund</b>	<b>4.2%</b>	<b>13.7%</b>	<b>6.5%</b>	<b>6.2%</b>	<b>16.2%</b>	<b>9.6%</b>	<b>9.3%</b>	<b>6.6%</b>
Composite*	3.6	13.3	6.5	5.9	16.1	9.4	9.0	6.3
<b>Stock Segment</b>	<b>0.7</b>	<b>19.2</b>	<b>6.3</b>	<b>8.7</b>	<b>20.6</b>	<b>11.7</b>	<b>10.8</b>	<b>7.2</b>
S&P 500	0.3	19.1	6.3	8.6	20.6	11.7	10.7	7.1
<b>Bond Segment</b>	<b>11.9</b>	<b>1.5</b>	<b>7.0</b>	<b>0.5</b>	<b>6.2</b>	<b>4.6</b>	<b>5.4</b>	<b>6.5</b>
Lehman Aggregate	10.4	0.3	6.8	-0.8	6.1	4.0	4.5	6.0

\* Weighted 50% S&P 500/ 48% Lehman Aggregate, and 2% 3 Month T-Bills through June 1999. Weighted 70% S&P 500/ 28% Lehman Aggregate/ and 2% 3 month T-Bill beginning July 1, 1999.