

Minnesota State Board of Investment

20% Annual Report

**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, 2010, the market value of the Fund was \$461 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.

Investment Constraints

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 SBI uses a 70%

stock, 28% fixed income and 2% cash asset allocation for 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.

Figure 35 presents the actual asset mix of the Fund at the end of fiscal year 2010. The current long term asset allocation targets for the Fund are:

Domestic Stocks	70%
Domestic Bonds	28
Cash	2

Investment Management

SBI staff internally manages 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.

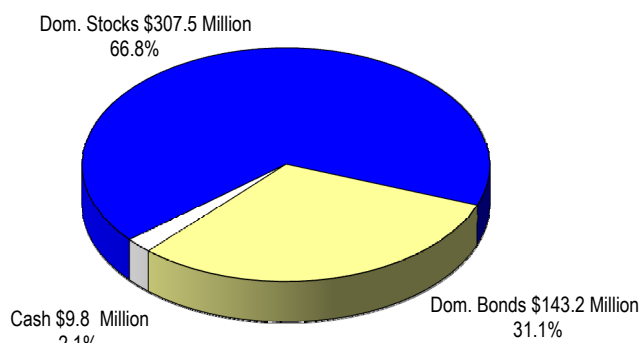
Bond Segment

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

Investment Performance

During the fiscal year, the *stock* segment underperformed its S&P 500 benchmark by 0.2 percentage point. 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

Figure 35. Environmental Trust Fund Asset Mix as of June 30, 2010



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

Environmental Trust Fund

to the benchmark subject to keeping trading costs at a minimum.

The *bond* segment outperformed its benchmark by 0.2 percentage points during the fiscal year; primarily due to an overweight to the commercial mortgage backed securities sector.

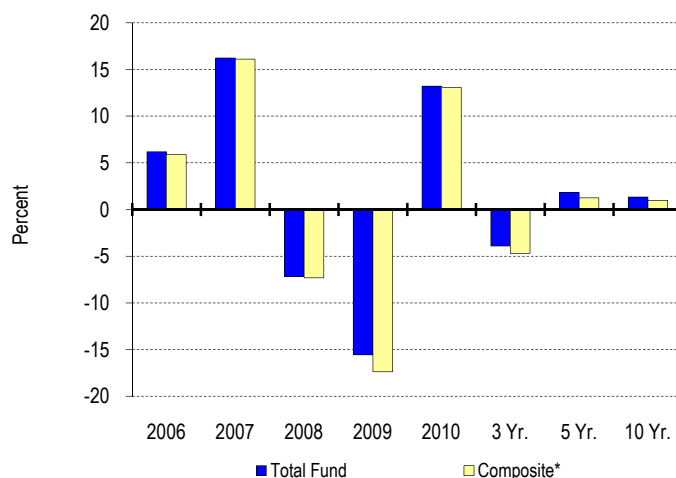
Overall, the Environmental Trust Fund provided a return of 13.2% for fiscal year 2010, outperforming its composite index by 0.1 percentage point. For the most recent three-year period, the Fund trailed its composite benchmark by 0.8 percentage point. The Fund experienced modest outperformance over the last five and ten years due to the incremental value added by both the stock and bond segments.

Performance results are presented in Figure 36.

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

Fiscal Year	Millions
2006	\$19
2007	\$19
2008	\$23
2009	\$23
2010	\$26

Figure 36. Environmental Trust Fund Performance FY 2006-2010



	2006	2007	2008	2009	2010	3 Yr.	5 Yr.	10 Yr.
Total Fund	6.2%	16.2%	-7.2%	-15.6%	13.2%	-3.9%	1.8%	1.3%
Composite*	5.9	16.1	-7.3	-17.4	13.1	-4.7	1.3	1.0
Stock Segment	8.7	20.6	-13.1	-25.8	14.2	-9.7	-0.7	-1.5
S&P 500	8.6	20.6	-13.1	-26.2	14.4	-9.8	-0.8	-1.6
Bond Segment	0.5	6.2	7.0	8.3	9.7	8.3	6.3	7.0
Barclays Agg.	-0.8	6.1	7.1	6.0	9.5	7.5	5.5	6.5

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