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September 17, 2024

FY 2025 Annual Investment Plan

Introduction

It is with pleasure that we present the fiscal year 2025 Annual Investment Plan. This year's plan is the thirteenth iteration of investment plans written since fiscal year 2013.

The investment plan uses a 7-10 year forward horizon in the development of the outlook for the economy, financial markets, and for the development of longer term investment themes and strategies. It is written with a ranging readership in mind. We focus discussion on the largest of economic and financial market variables -- economic growth, inflation, interest rates and the basic investment markets of stocks and bonds -- with as little industry terminology and jargon as possible. Financial analysis is simplified to the degree practical and presented in easy-to-read tables and charts. Investment plans for the individual asset classes are presented in a structured format, to ease understanding of expected investment activity across the full portfolio for the fiscal year.

This work is the organized accumulation of investment knowledge, thought and input across as many fund fiduciaries as possible: the Council, the Council investment committee, the investment office management group and investment staff, external investment consultants and external investment managers. It has the purpose of transparency of our investment process as a lead objective, and seeks to be informative, and educational where possible.

Executive Summary

In last year's Plan, we relayed our view of a potential recession this year, one that we felt could go a little harder on financial markets but a little easier on the 'real' economy. Most of the tried-and-true, no-miss indicators were flashing yellow or red, and we were in good company as many economists and investment strategists were predicting something similar.

But, it was not to be. Massive (continuing) Federal deficit spending, government-job creation at all levels of government and supportive financial conditions kept employment strong and the consumer willing to spend. The stock market performed reasonably well, albeit mostly on the backs of just seven tech/AI-related stocks—an unusual situation. These things have led to a pretty good year, with long-term-average investment returns accruing to our portfolios.

Little (to almost nothing) that we do on a daily basis in managing the investment portfolios depends on

accurate short-term economic and market views. Mainly because we don't think (and regularly observe the same) that short-term views can be reliably accurate over time. But we do spend time understanding current conditions and considering how things may change based on conditions and trends. In developing our strategies and asset allocations, however, we stick to longer-term thinking, mainly in the 7-10 year timeframe.

In that regard, our thinking remains 'cautious' for the forward 7-10 year period. As we will detail, we harbor some concerns. Our country—as well as many other large-population countries—are deeply divided politically and socially, which historically has always resolved, just not easily. Wealth inequality is near past peaks and we can't find times when that reversed smoothly, either. Debt loads across the economy—consumers, governments, corporations—are reaching and exceeding past records. Unfunded liabilities on governments—such as Social Security, Medicare and public pensions here in the U.S. and similar programs overseas—are massive. Government budgets are in tough shape (staying current with Congressional Budget Office--CBO--projections of the U.S. government's budget is one of the most miserable tasks we undertake on a regular basis). The scourge of inflation is back as the value of currencies globally slip relative to the value of the goods and services that they buy. Few think this won't continue to be a problem over the next several years and many recognize that inflation is a common way over-indebted economies deal with their over-indebtedness. All of this while the U.S. stock market is very highly valued with performance concentrated into just a handful of stocks.

While we are concerned about these things--and others--impact on the health and strength of the U.S. and large foreign economies and financial markets, the concerns do not defeat our broad optimism that collectively we're prepared for rougher waters. Many current Council members and State Investment Office staff managed through the demanding COVID period; several in the Office managed institutional investment portfolios through the Great Financial Crisis of 2008-2009; some through the bursting of the stock market bubble in 2000-2003; and one, even, through the volatile 1987-1991 period. Many in the Office have studied past difficult periods—the 1970s, the 1930s in particular—and have those knowledge tools in our toolkit. Two important lessons we've learned from those previous rough periods are the following:

1. ***Enter these periods with a highly diversified portfolio of investment assets and strong liquidity.*** Since about 2019, the Council has been highly focused on further diversifying our portfolios across a widely varied selection of assets to build portfolio resiliency, cash flow and improved (lower) correlation with any particular asset type (such as stocks or bonds) or particular market conditions. The result is a portfolio which has better protection from lower growth environments, higher interest rates, higher rates of inflation, weaker equity markets—all risks we see if we enter tougher times. Massive new inflows from the NM State Land Office and the NM Legislature since 2022 have raised liquidity levels across the funds enormously. If we are to enter tougher times in our forward 7-10 year strategic timeframe, we believe we are about as prepared as we can be.

2. ***Tough periods in the economy and financial markets create enormous future opportunities.*** The awful period of the Great Depression in the 1930s, which brought economic chaos and a nearly 3-year bear market that took stocks down more than 80% was followed by a 14-year period where stock gains averaged 17% annually. The late 1960s and early 1970s featured two large drawdowns. The first one lasted about a year and a half beginning in 1968 and took stocks down 30% before a 2.5 year rebound that saw stocks return 25% per year annualized. The second was a drawdown of 43% over almost two years before a massive 13-year run at 19% per year returns. The Dot.Com bubble crash in 2000-2002 took stocks down 44% followed by a 5-year recovery at 15.5% annualized. The Great Financial Crisis

drew stocks down more than 50% over about five quarters, only to see them run at an 18% annual pace though 2018. A 20% drawdown at the end of 2018 and the 30% COVID drawdown in the first quarter of 2020 saw similarly-sized annualized recoveries. Lesson #2 tells us to have the staying power of a diversified portfolio to weather tougher times combined with liquidity to position into risk assets when things look darkest and ahead of the profitable recoveries.

So with that, let us move into some of the details.

Economic Outlook

The Council begins work on developing our economic views with the International Monetary Fund's (IMF) popular twice-annual reports World Economic Outlook and the Global Financial Stability Report. The IMF does excellent work and digs deep (which delights us to no end as macroeconomic analysts and strategists). This forms a baseline from which we examine, challenge and verify every part, extensively tapping ranging resources to get to our views for our specific timeframe of 7-10 years forward (roughly the average length of a full economic cycle, historically).

For purposes of keeping the Annual Investment Plan reasonably short and readable, we limit our discussion of economic expectations and implications to the three major areas of growth, inflation, and interest rates.

Growth—Perhaps our longest-running theme in this series of Annual Investment Plans is that of 'low [economic] growth'. And we've been correct in that view, and we're sticking with it.

A structural growth slowdown is (and has been) underway across the world. We've recognized this for several years now, and it is worsening. According to the World Bank, globally, the potential economic growth rate—theoretically the maximum level of growth over the medium term that can be achieved without igniting inflation—is set to soon fall to the lowest levels of the past three decades and stay there over the rest of this decade. Last year we detailed this extensively, so for this year, given an unchanged outlook, we'll summarize:

- *Demographics*—The Council routinely discusses the world's worsening demographic picture and the outlook for this deteriorating picture to start having real effect in our forward 7-10 year timeframe. Simply put, the world is "short" on young people and "long" on older people, relative to optimal for our present economic system. Difficult demographics exist in some of the largest industrial economies, inclusive of China, Japan, South Korea, Germany. India and much of Africa are far better off demographically and have large populations but are hampered by lesser-to-poor access to growth-supportive economic basics of food and energy. Two thirds of the world's population live in countries with fertility rates below replacement levels—and nearly all of the economically-relevant countries have fertility rates below replacement--and are deteriorating further. This isn't an issue which will correct anytime soon. The U.S. is in relatively better shape, but even our country will see increasing economic pressure from older people in our country growing relative to younger people in our forward 7-10 year outlook period.
- *Productivity*—Several new and budding technologies are encouraging us to think that there's a path out of the low productivity that we've experienced over the last 15 years or so. Artificial intelligence (AI) continues to gain in application. Research resources and

investment capital are climbing for areas such as advanced manufacturing, fusion energy, 5G/6G communications, synthetic biology and others that have clear potential for positive impacts on productivity. Indeed, the Council has been making investments in these areas, such as our investment in the America Frontier Fund.

- *Risk Factors*—Other risks to overall economic growth include recessions, financial crises, tighter monetary and fiscal policy, excess inflation, social unrest, war (kinetic or other) and other related factors. The probability of these risks damaging economic output seems to be increasing, and we are building into our expectations many of these risks to play out in one degree or another in our coming 7-10 year expectations time horizon.

In all, the growth picture is not easy to contemplate, or to report. It will require us to continue to seek investments with lesser dependence on strong economic growth for the investments to succeed.

Inflation—Higher rates of inflation on average over the next 7-10 year timeframe seem almost 'baked into the cake' from the average of the last 7-10 years. Should (when) a recession appear(s) that will mean some short-term deflation, but we believe that a higher-inflation period is upon us for our outlook period.

Why? History, mostly.

Earlier we described our concerns around public debts in the U.S. (currently 120% of GDP and climbing), and just about everywhere else in the world. Government budget deficits are in worse shape—a deficit of 7% of GDP is being spent now in the U.S., at a time in the economic cycle when the U.S. government really should be running a surplus. We aforementioned the unfunded liabilities of Social Security, Medicare and other entitlements--which dwarfs the debt--and the anguish of reading the CBO's forecasts regarding the future.

It doesn't appear to us that there is a politically-acceptable way (and maybe no way at all) to get these debts and unfunded obligations paid down to a level that reasonable taxes on our national income and various collections of private wealth can appropriately support. When governments are faced with this kind of situation, they eventually/ultimately take one of two (and sometimes both) actions: they default, and/or inflate the currency.

There's many, many books detailing previous government defaults and inflation of currencies and how this gets done, and it is outside the scope of this writing to go down that path. We hope it is sufficient to say that we all should plan on higher inflation on average over the next 7-10 year period than we had in the previous 7-10 year period.

Interest Rates—With our expectation of low real economic growth combined with structurally higher inflation, we expect interest rates to firm but stay somewhat low relative to long history.

At first. But as bondholders start to catch on that inflation seems to stay firm and consistently "surprise to the upside", interest rate demands will follow.

This could bring some interesting effects. Bond returns could improve relative to the last several years with the higher rates and become somewhat less volatile as durations drop due to higher rates. But there will be the constant pressure on 'real' (ex-inflation) returns and greater default risk.

The permanent funds, over our analysis period of 7-10 years forward, find themselves in very good shape relative to these changes and risks. The funds, based on expected inflows (covered in a later section of this report) and distribution profiles, don't need to hold much in bonds in their asset allocations. As we remind ourselves and each other often: "you don't have to worry about or manage a risk you're not

exposed to".

Financial Market Implications

This is the "crystal ball" section, and we write it, each year, humbly.

Financial markets historically have handled higher inflationary periods—all except the most extreme—reasonably well. Bond prices adjust lower as yields increase but income increases over time and helps to earn it back as yields increase. Publicly-traded corporations have generally been able to keep up through a combination of increased prices, cost management and productivity increases. Rent and upward valuation revisions keep real properties making returns. And so forth.

We continue to keep in the back of our minds, however, that stocks—at least here in the U.S.—are historically highly valued. Rising interest rates will increase pressure on multiples. The expected low growth environment combining with inflation could push into a 'stagflationary' environment and most financial markets struggle in periods of stagflation. Some of our non-financial concerns (political/social divide, wealth inequality, etc.) very likely could weigh on markets. In all, we're not looking for better than average nominal returns and lower half in terms of 'real' (ex-inflation) returns in our forward period.

Broad Investment Strategy

In the longer run, as institutional investors of long-term growth portfolios, it is important to stay 'realistically optimistic', always be looking for opportunity, and stay invested in a well-considered portfolio of risk assets.

In the context of the above, our broad investment themes for the coming 7-10 year investment period are as follows:

- **We believe that 2022 marked an inflection point in the investment environment of the recent past and represents a shift to the environment we will be working in for the foreseeable future.**
    - 1982 to 2007 (25 years): an economic and market environment of falling interest rates, above-average economic growth, disinflation, massive increases in per-share corporate profits and rising equity market (and other) multiples.
    - 2008 to 2021 (14 years): an economic and market environment of dramatically falling growth rates, poor productivity growth, very low interest rates, low inflation. Extreme monetary policy (ZIRP, QE, massive expansion of the money supply) and fiscal policy (in the U.S., the federal government deficit-spent $16 trillion from June 2009 through September 2021) were used to try to stimulate the economy, and had the effect of distorting business investment, capital allocation, and sent investment market multiples to near-records.
    - 2022-2024/2025(?) a transition period.
    - 2025-2026 to 2032-2036 Our expectations regarding this new environment are for more-or-less a reckoning of the 2008 to 2021 period, and are detailed in the sections above. We allow ourselves some cautious optimism regarding the years toward the end of the period if we can gain some better control over debt, unfunded obligations and budgets in the period. But that is a definite wait-and-see.

- **We believe the U.S. will be better off than many parts of the world over our 7-10 year expectations horizon and provide a relatively better place to invest. We presently have and expect to maintain significant focus on U.S. dollar-denominated, U.S.-based investments.**
    - While our publicly-traded equity portfolio is diversified into global stock markets, the preponderance of investments in our private asset portfolios—private equity, real estate, real return, private credit—have a strong focus on U.S. dollar-denominated, U.S.-based assets.
    - There will continue to be good investment opportunities overseas, however, and we intend to continue to look overseas and make investments in the good opportunities we can find.
- **The projection of a 'game-changing' level of inflows into the funds for the next decade presents the Council with a rare opportunity in public fund investing to build asset allocations in our growth funds aimed at maximizing the compounding power of our returns. This translates into:**
    - Greater exposure to higher-returning 'risk-assets' over lower-returning 'risk-mitigating/liquidity' assets;
    - Greater exposure to private market assets over publicly-traded assets;
    - We would normally strongly favor equity over credit for compounding power, but given our economic growth concerns, a more balanced approach between these two 'risk-assets' is called for.

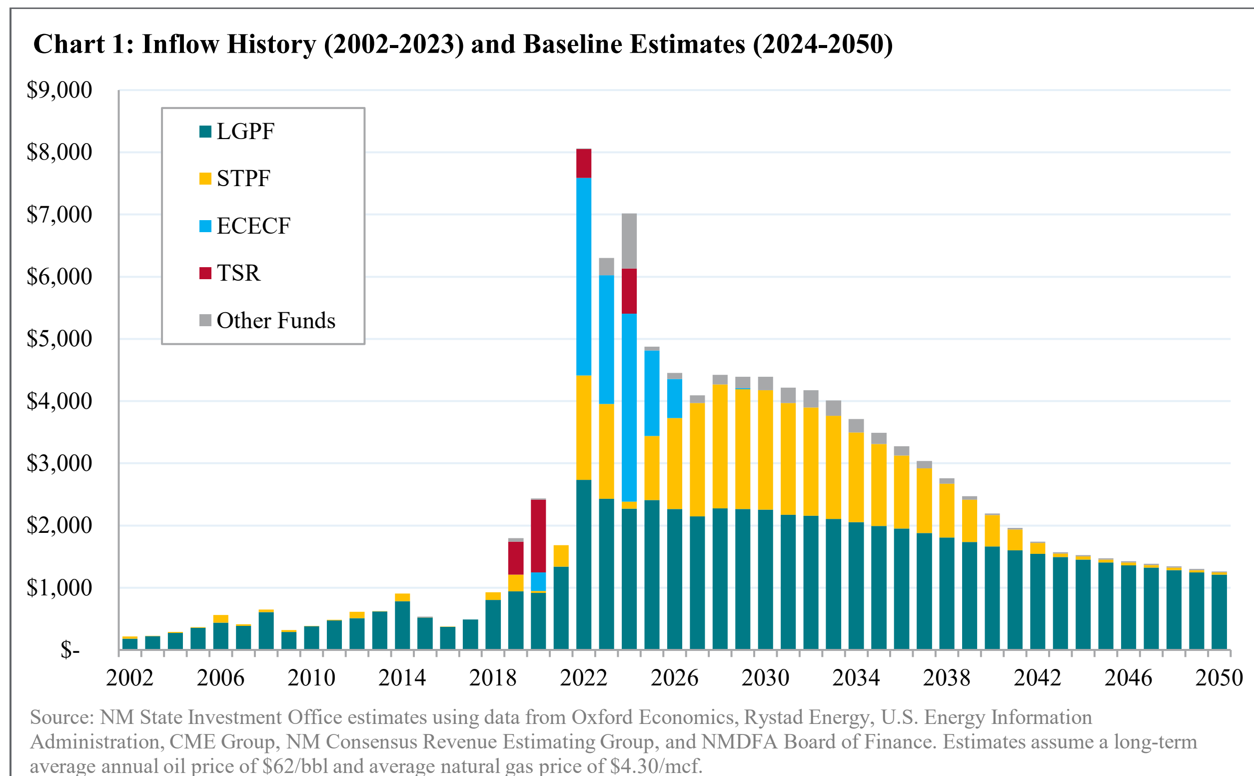
Part II: Inflows Analysis

Inflows across all NMSIC-managed funds were $6.3 billion in 2023, with cash coming into the funds reaching over $14 billion in the last two years alone. Current estimates suggest the funds could receive another $7 billion in 2024.

Our largest funds (LGPF, STPF and ECECF) primarily receive inflows from tax and royalty collections on oil and natural gas production in the state. New Mexico's production grew more than 75% between 2020 and 2023, and average annual oil prices have more than doubled in that same period. This creates a powerful combination for generating royalties and severance taxes. Assuming oil prices remain above $60/bbl, production in the state is expected to continue growing (albeit at a slower pace) over the next decade before potentially peaking by the early 2030s as the transition to alternative energy sources weighs on global fossil fuel demand.

As such, inflows are expected to gradually decline over time but remain at levels well above historical averages (see Chart 1 below). Given the inherent volatility of energy markets and sensitivity to shocks that cannot be predicted, these estimates are subject to considerable uncertainty. Many factors including supply and demand fundamentals, monetary policy changes, OPEC+ strategy, geopolitical tensions, and the pace toward global transition to renewable energies could ultimately change the outlook—for the better, or worse. We believe the estimates below serve as a reasonable guidepost to inform this year's Annual Investment Plan.

Chart 1: Inflow History (2002-2023) and Baseline Estimates (2024-2050)



Source: NM State Investment Office estimates using data from Oxford Economics, Rystad Energy, U.S. Energy Information Administration, CME Group, NM Consensus Revenue Estimating Group, and NMDFA Board of Finance. Estimates assume a long-term average annual oil price of $62/bbl and average natural gas price of $4.30/mcf.

Land Grant Permanent Fund Inflows – The Land Grant Permanent Fund (LGPF) receives royalty contributions from the State Land Office for mineral production on state trust lands. State Land Office contributions exceeded $2.4 billion in 2023, down slightly from the $2.7 billion received the year prior as oil and natural gas prices retreated from their 2022 highs. Looking forward, baseline estimates of future

energy prices and production continue to suggest royalty contributions from state trust lands could exceed $2 billion annually over the next 10 years. Again, given the volatile nature of the funds' revenue sources, these figures should only be used as a guide.

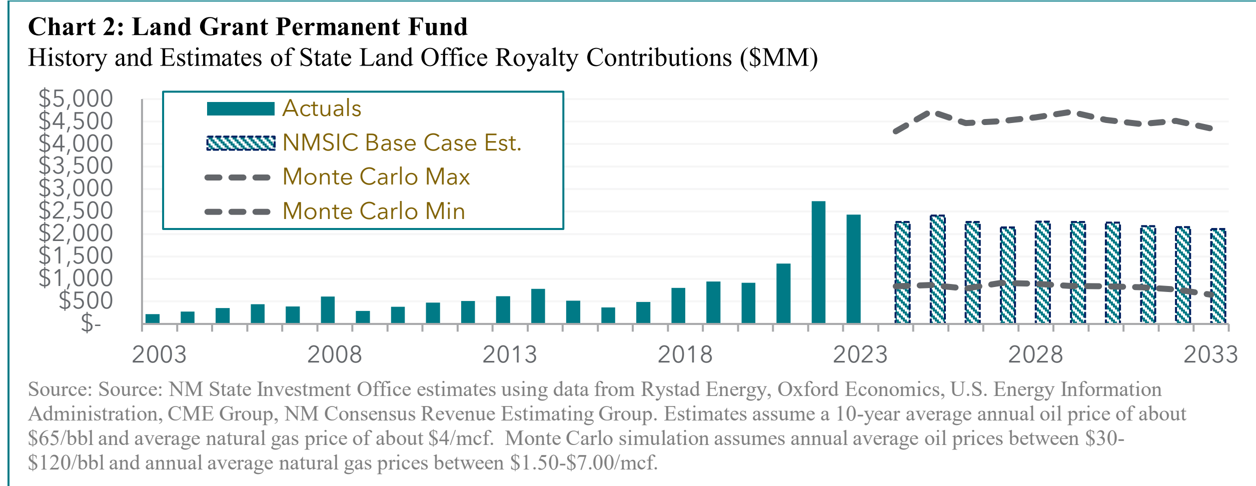


Chart 2: Land Grant Permanent Fund
History and Estimates of State Land Office Royalty Contributions ($MM)

Source: Source: NM State Investment Office estimates using data from Rystad Energy, Oxford Economics, U.S. Energy Information Administration, CME Group, NM Consensus Revenue Estimating Group. Estimates assume a 10-year average annual oil price of about $65/bbl and average natural gas price of about $4/mcf. Monte Carlo simulation assumes annual average oil prices between $30-$120/bbl and annual average natural gas prices between $1.50-$7.00/mcf.

Severance Tax Permanent Fund Inflows **–** The Severance Tax Permanent Fund (STPF) receives the portion of the state's severance tax revenues that is not used to bond for capital outlay projects. Growing severance tax collections combined with the statutory limits on state bonding capacity yet again resulted in large deposits into the STPF in 2023 – the fund received about $1 billion in 2023 from this mechanism. Additionally, the STPF received a $475 million appropriation from the state's general fund, bringing total inflows that year to $1.5 billion. Absent an unexpected energy market shock, we continue to expect meaningful contributions to the STPF from the bonding fund over the 7-10 year period, albeit at levels much lower than that of the last two years (see Chart 3).

However, the new statutory mechanism to send excess oil and natural gas revenues to the STPF[1] remains a potential "game-changer" for the fund. Based on the current revenue estimates and energy market outlook, those contributions could exceed $1 billion/year for at least the 7-10 outlook. Again, given the volatile nature of the funds' revenue sources, the same cautions as above apply.

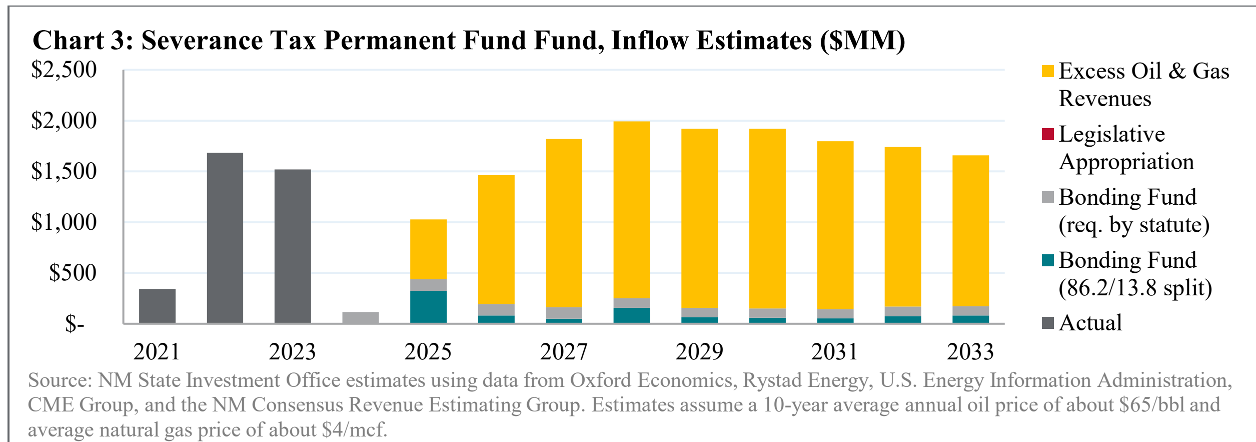
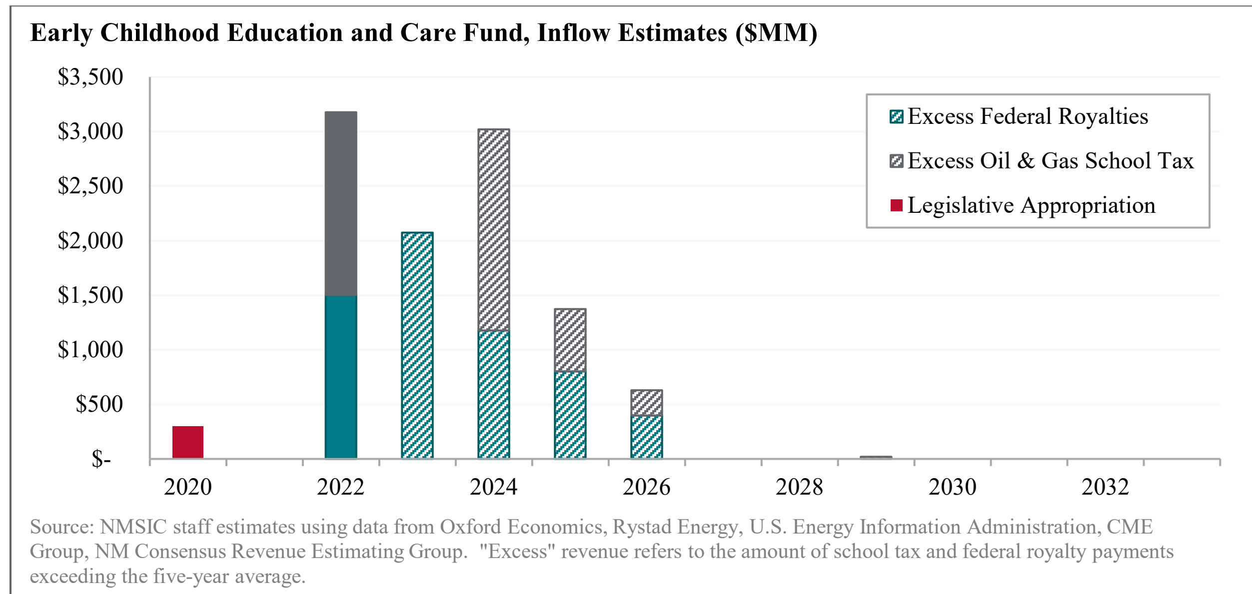


Chart 3: Severance Tax Permanent Fund Fund, Inflow Estimates ($MM)

Source: NM State Investment Office estimates using data from Oxford Economics, Rystad Energy, U.S. Energy Information Administration, CME Group, and the NM Consensus Revenue Estimating Group. Estimates assume a 10-year average annual oil price of about $65/bbl and average natural gas price of about $4/mcf.

[1] Senate Bill 26 (2023) sends any revenue above the amount the state general fund received in FY24 from the oil and gas emergency school tax and federal mineral leasing payments to the STPF. The distribution does not change the statutory allocations of these revenues to the Early Childhood Education and Care Fund or the Tax Stabilization Reserve.

***Early Childhood Education and Care Fund Inflows* –** The Early Childhood Education and Care Fund (ECECF) received large distributions of excess production tax collections and federal royalty payments in 2022 and 2023 as part of a statutory mechanism that invests windfall oil and gas revenues that otherwise flow to the state's general fund. Based on the state's most recent general fund revenue estimate and the current energy market outlook, the ECECF is expected to continue to receive large inflows over the next several years. Because contributions to the ECECF are based on amounts above a five-year average, the inflows are expected to decline over time as the five-year average increases. Again, given the volatile nature of the funds' revenue sources, the same cautions as above apply.



Source: NMSIC staff estimates using data from Oxford Economics, Rystad Energy, U.S. Energy Information Administration, CME Group, NM Consensus Revenue Estimating Group. "Excess" revenue refers to the amount of school tax and federal royalty payments exceeding the five-year average.

***New Funds and Other Inflows* –** The legislature recently made several new appropriations to existing funds under the Council's management and directed three new funds for the Council to invest. New one-time appropriations to existing funds include $300 million to the Conservation Legacy Permanent Fund, $50 million to the Water Trust Fund, and $2.5 million to the Rural Libraries Endowment Fund.

A newly created Higher Education Trust Fund (HETF) to be managed by the Council was seeded with a $959 million transfer from the Tax Stabilization Reserve (TSR) in May 2024. The TSR received an inflow of $724 million from the general fund operating reserve earlier in the fiscal year, which helped offset the transfer out of the fund to the new HETF (the net outflow from the TSR was $235 million).

Another new fund to be invested by the Council is the Workforce Development and Apprenticeship fund (WDAF), which received $30 million in a one-time appropriation from the general fund.

Lastly, a newly created Capital Development and Reserve Fund (CDRF) was established from a one-time distribution of $476 million in FY24 from excess cash remaining in the severance tax bonding fund at the end of the fiscal year. Beginning in FY25, the CDRF will receive annual distributions from the bonding fund consisting of savings generated by limiting long-term bond issuances to median state debt ratios, when such savings exist. This distribution should not affect STPF revenues from the bonding fund, since the statutory allocation of severance tax revenue available for bonding capacity was not changed in the legislation creating the CDRF.

Table 1: Summary of NMSIC Fund Inflows, 2019-2024 (dollars in millions)

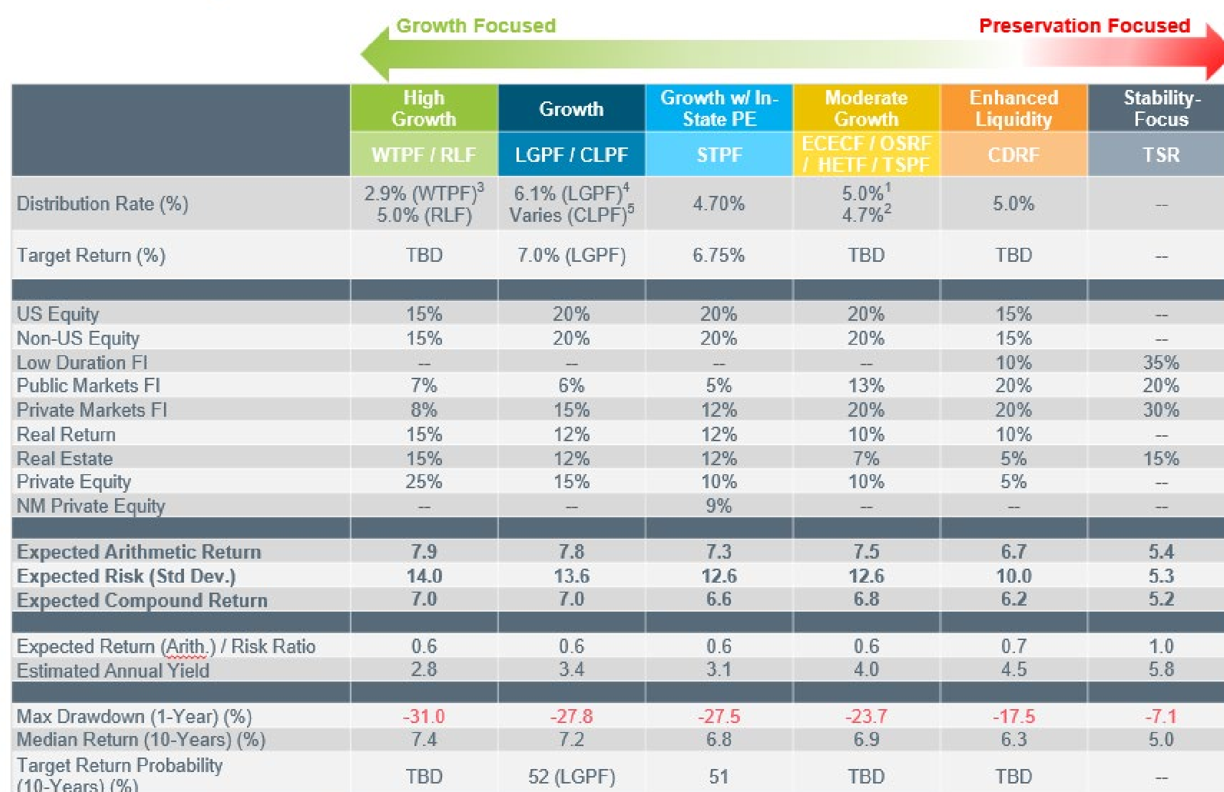
Calendar Year Fund Contribution	2019	2020	2021	2022	2023	2024 est.
Land Grant Permanent Fund	$ 941	$ 918	$ 1,340	$ 2,732	$ 2,433	$ 2,270
Severance Tax Permanent Fund	$ 271	$ 29	$ 342	$ 1,682	$ 1,519	$ 116
Early Childhood Edu. & Care Fund	$ -	$ 300	$ -	$ 3,176	$ 2,073	$ 3,020
Tobacco Settlement Perm. Fund	$ 75	$ 34	$ 36	$ 36	$ 25	$ 27
Tax Stabilization Reserve	$ 527	$ 1,167	$ -	$ 459	$ -	$ 724
Water Trust Fund	$ -	$ -	$ -	$ -	$ 100	$ 50
Rural Libaries Endow. Fund	$ 1	$ 2	$ -	$ 10	$ 15	$ 2.5
Conservation Legacy Perm. Fund	$ -	$ -	$ -	$ -	$ 50	$ 300
Opioid Settlement Reserve Fund	$ -	$ -	$ -	$ -	$ 86	$ -
Workforce Devel. & Appren. Fund	$ -	$ -	$ -	$ -	$ -	$ 30
Higher Education Trust Fund*	$ -	$ -	$ -	$ -	$ -	$ 959
Capital Development & Res. Fund	$ -	$ -	$ -	$ -	$ -	$ 476
Total*	**$ 1,815**	**$ 2,450**	**$ 1,719**	**$ 8,096**	**$ 6,300**	**$ 7,015**

Source: Investment Holdings Reports

* Note, Higher Edcuation Trust Fund inflow funded by a withdrawl from the Tax Stabiilization Reserve - amount not included in 2024 total

Part III: Portfolio Analysis

The chart below summarizes the asset allocations for funds under NMSIC management, illustrated on a spectrum of focus between growth and preservation.



Summary Matrix of NMSIC Funds

Growth Focused ← → Preservation Focused

	High Growth	Growth	Growth w/ In-State PE	Moderate Growth	Enhanced Liquidity	Stability-Focus
	WTPF / RLF	LGPF / CLPF	STPF	ECECF / OSRF / HETF / TSPF	CDRF	TSR
Distribution Rate (%)	2.9% (WTPF)[3] 5.0% (RLF)	6.1% (LGPF)[4] Varies (CLPF)[5]	4.70%	5.0%[1] 4.7%[2]	5.0%	--
Target Return (%)	TBD	7.0% (LGPF)	6.75%	TBD	TBD	--
US Equity	15%	20%	20%	20%	15%	--
Non-US Equity	15%	20%	20%	20%	15%	--
Low Duration FI	--	--	--	--	10%	35%
Public Markets FI	7%	6%	5%	13%	20%	20%
Private Markets FI	8%	15%	12%	20%	20%	30%
Real Return	15%	12%	12%	10%	10%	--
Real Estate	15%	12%	12%	7%	5%	15%
Private Equity	25%	15%	10%	10%	5%	--
NM Private Equity	--	--	9%	--	--	--
Expected Arithmetic Return	**7.9**	**7.8**	**7.3**	**7.5**	**6.7**	**5.4**
Expected Risk (Std Dev.)	**14.0**	**13.6**	**12.6**	**12.6**	**10.0**	**5.3**
Expected Compound Return	**7.0**	**7.0**	**6.6**	**6.8**	**6.2**	**5.2**
Expected Return (Arith.) / Risk Ratio	0.6	0.6	0.6	0.6	0.7	1.0
Estimated Annual Yield	2.8	3.4	3.1	4.0	4.5	5.8
Max Drawdown (1-Year) (%)	-31.0	-27.8	-27.5	-23.7	-17.5	-7.1
Median Return (10-Years) (%)	7.4	7.2	6.8	6.9	6.3	5.0
Target Return Probability (10-Years) (%)	TBD	52 (LGPF)	51	TBD	TBD	--

Estimated Annual Yield is based on asset class index yields as of 12/31/2023. Expected risk and return based on RVK's 2024 Capital Market Assumptions.
[1]ECE has a minimum distribution of $250 million. [2]TSPF distribution rate is 4.7%. [3]Annual WTPF distribution of $4M represents 2.7% of the May 2024 market value.
[4]LGPF distribution rate of 6.1% represents the aggregate rate of the permanent school fund distribution rate of 6.25% and the 5% rate of all other LGPF permanent funds.
[5]CLPF distribution is composed of prior fiscal year investment income in excess of $5M.

Land Grant Permanent Fund

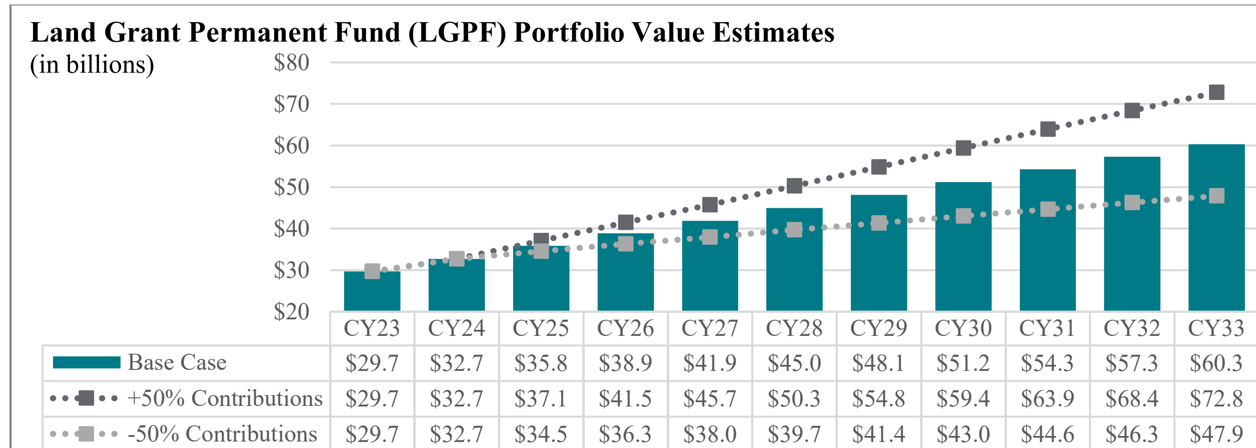
Discussion – The LGPF ended FY24 with a market value of $31.2 billion, up about $3.3 billion from FY23 thanks to continued strong inflows from the State Land Office and an investment return of 8.56% for the fiscal year.

Notably, 2023 marked the sixth consecutive year in which contributions to the LGPF exceeded distributions to the fund's beneficiaries, and our current estimates show inflows could continue to largely offset or exceed distributions for the 7-10 year horizon. The ability of inflows to cover all or more of the distributions for an extended period provides the opportunity to capitalize on the compounding power of returns and was the basis for several of the asset allocation changes the Council made in 2023.

Portfolio Value – With inflows poised to exceed distributions for much of the investment horizon, the financial model developed by investment office staff and consultant RVK for the LGPF projects the fund could grow to roughly $60 billion over the 7-10 year investment horizon, an annualized increase of 7.3%. This projection is based upon the long-term assumptions for investment return, estimated contributions from the New Mexico State Land Office outlined in the inflows analysis section above, and the

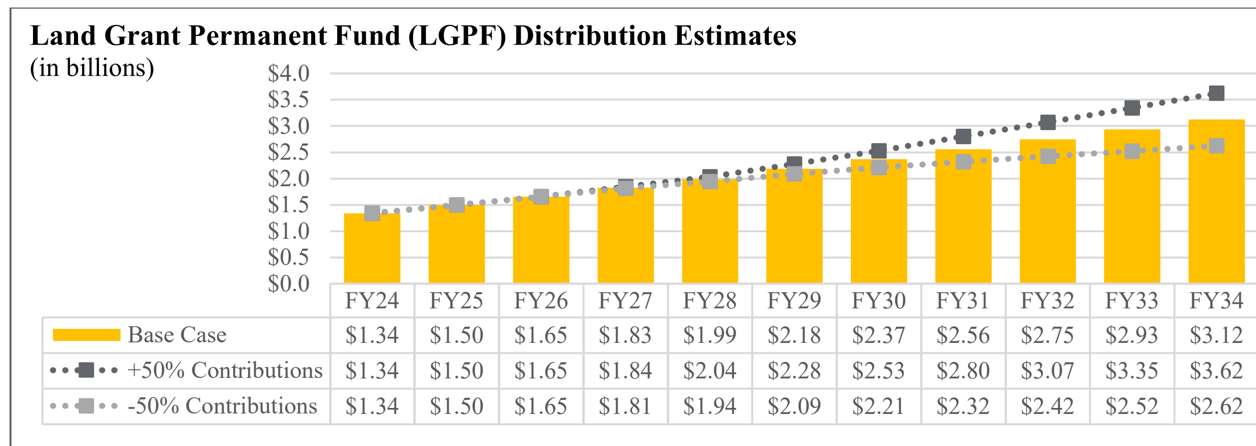
constitutional distribution policy used in the 25-year Intergenerational Equity Model for the LGPF. Given the increased uncertainty in the economy and financial markets, as well as potential volatility in energy-related fund contributions, these figures should only be used as a guide.

Strong inflows are a significant driver of the fund's projected growth over the investment horizon. To show the impact of the inflow estimates on the fund growth projections, the chart below illustrates the differences in expected portfolio value if contributions to the fund are assumed to be +/- 50% of the estimates in our base case.



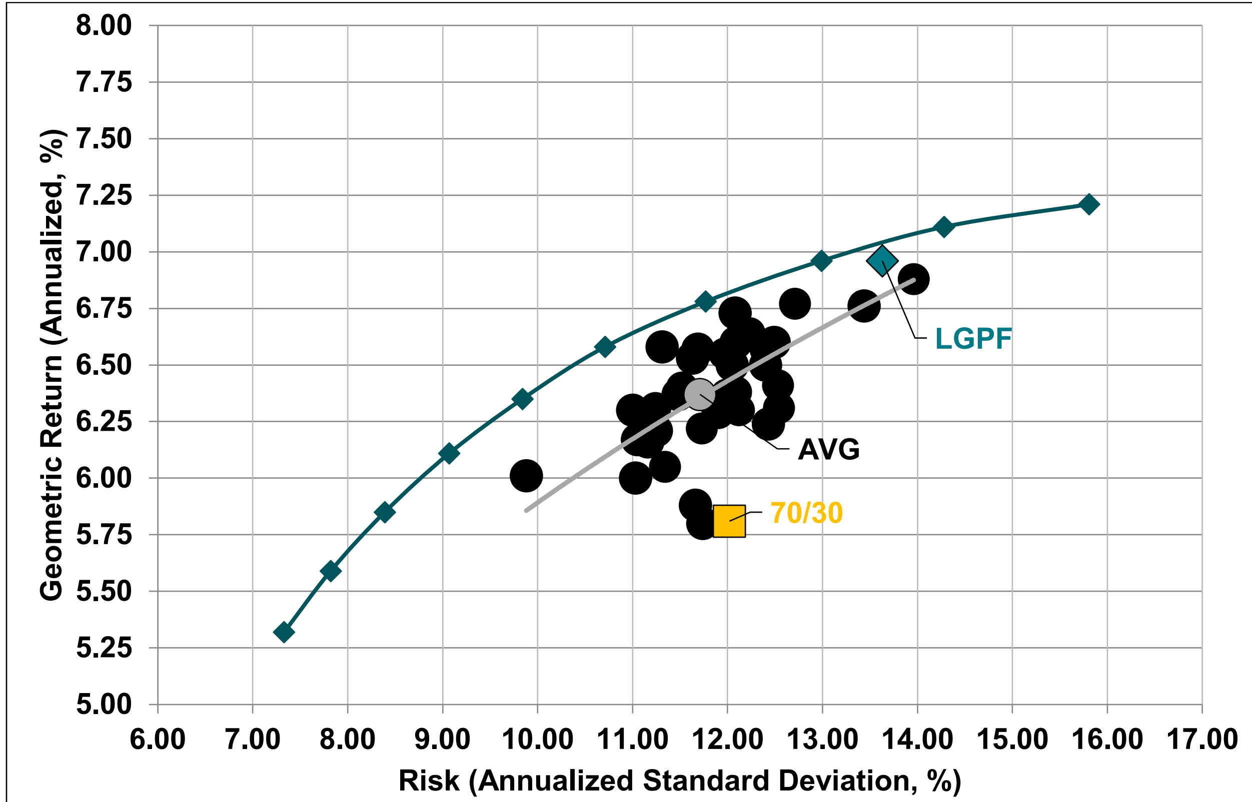
	CY23	CY24	CY25	CY26	CY27	CY28	CY29	CY30	CY31	CY32	CY33
Base Case	$29.7	$32.7	$35.8	$38.9	$41.9	$45.0	$48.1	$51.2	$54.3	$57.3	$60.3
+50% Contributions	$29.7	$32.7	$37.1	$41.5	$45.7	$50.3	$54.8	$59.4	$63.9	$68.4	$72.8
-50% Contributions	$29.7	$32.7	$34.5	$36.3	$38.0	$39.7	$41.4	$43.0	$44.6	$46.3	$47.9

Distributions – Using the same long-term (25-year Intergenerational Equity model) assumptions, annual distributions from the LGPF are projected to rise to roughly $3 billion by the end of the 7-10 year investment horizon. This equates to an annualized growth rate of about 8.8%. Again, the same cautions as above apply.



	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
Base Case	$1.34	$1.50	$1.65	$1.83	$1.99	$2.18	$2.37	$2.56	$2.75	$2.93	$3.12
+50% Contributions	$1.34	$1.50	$1.65	$1.84	$2.04	$2.28	$2.53	$2.80	$3.07	$3.35	$3.62
-50% Contributions	$1.34	$1.50	$1.65	$1.81	$1.94	$2.09	$2.21	$2.32	$2.42	$2.52	$2.62

Black Dot Analysis – The "Black Dot" analysis utilizes a custom peer group of 36 public investment funds as a point of comparison for the LGPF. Data for each institutional fund is collected from their respective annual reports, and the LGPF's asset allocation is compared with the projected returns and risk profiles of the peer group using RVK's capital market assumptions. As shown in the chart below, the LGPF is among the most efficiently allocated funds when compared to the Black Dot peers.



<u>Severance Tax Permanent Fund</u>

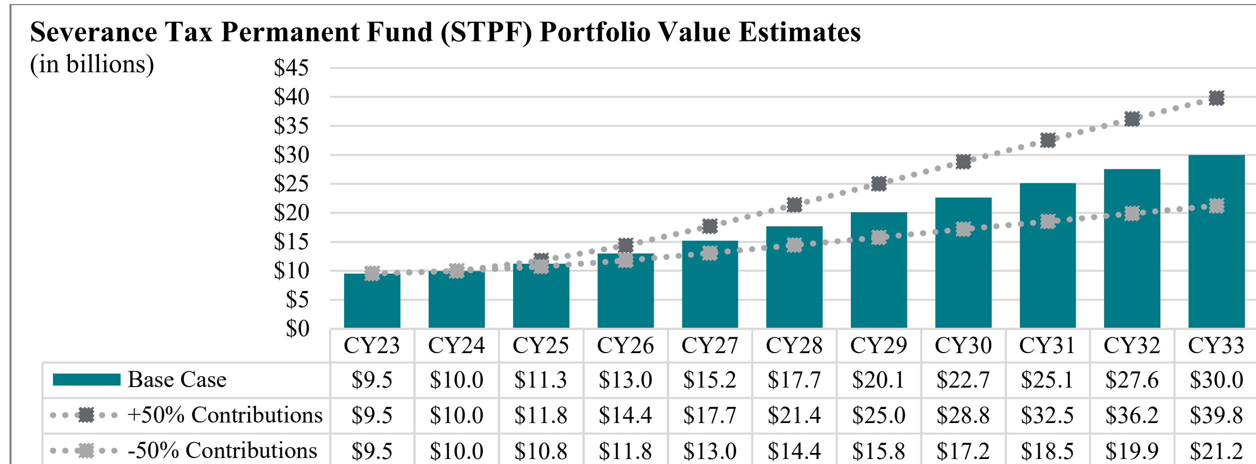
Discussion – The STPF ended FY24 at $9.7 billion, an increase of over $1.3 billion from FY23, driven by yet another year of strong inflows. The STPF returned 6.97% for the fiscal year, lower than that of the LGPF primarily due to the STPF's allocations to the New Mexico private equity program and in-state economically targeted investments, which both saw negative performance over the fiscal year.

With the STPF set to receive two new sources of oil and gas revenues in addition to severance tax receipts, contributions into the fund are expected to continue to exceed distributions from the fund for the investment horizon. This is rather extraordinary for the STPF, as contributions have exceeded distributions only four times over the last 23 years (and all of those only occurred in the last 5 years).

As with the LGPF, this 'game-changing' level of inflows into the STPF provides the opportunity to capitalize on the compounding power of returns and was the basis for several of the asset allocation changes the Council made in 2023.

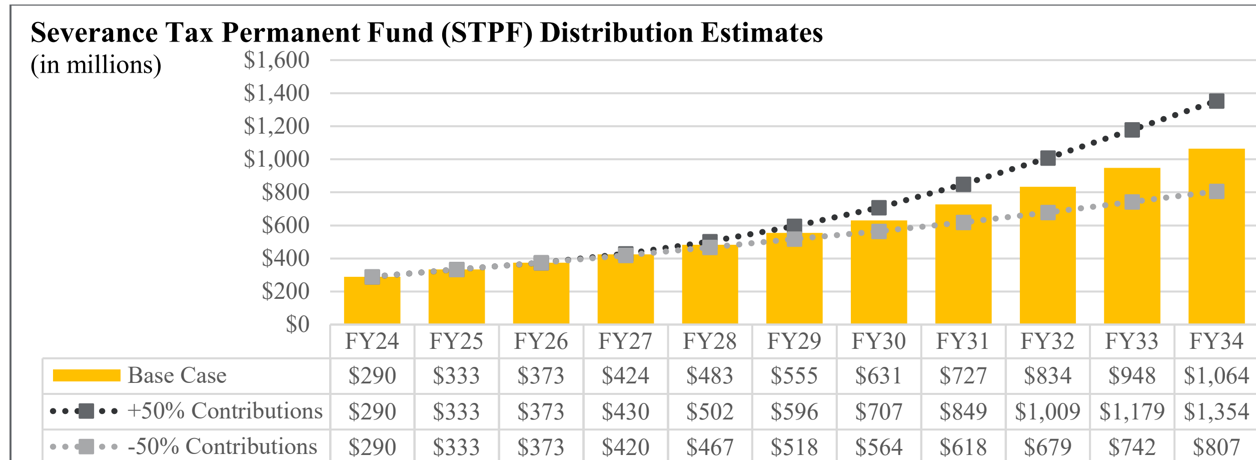
Portfolio Value – The STPF is also modeled in a manner similar to that of the LGPF and, given the new sources of inflows coming into the fund, the results are far more encouraging than in the past. The STPF is projected to grow to roughly $30 billion over the investment horizon, an annualized increase of 12.1%. This projection is based upon the long-term assumptions for investment return, estimated inflows from tax and royalty collections outlined in the inflows analysis section of this report, and the distribution policy used in the 25-year Intergenerational Equity model for the STPF. Given the uncertainty in the economy and financial markets, as well as potential volatility in energy-related fund contributions, these figures should only be used as a guide.

Because of their importance, it is worth reemphasizing that the new revenue sources into the fund are the primary driver of the STPF growth expectations illustrated below. These projections are heavily dependent on the assumption that no legislative changes to the statutory formulas for distributing tax and royalty collections to the STPF are made and that those tax and royalty collections are in line what we are expecting based on the current outlook for oil and natural gas prices and production trends in New Mexico. The chart below illustrates the differences in expected portfolio value if contributions to the fund are assumed to be +/- 50% of the estimates in our base case.



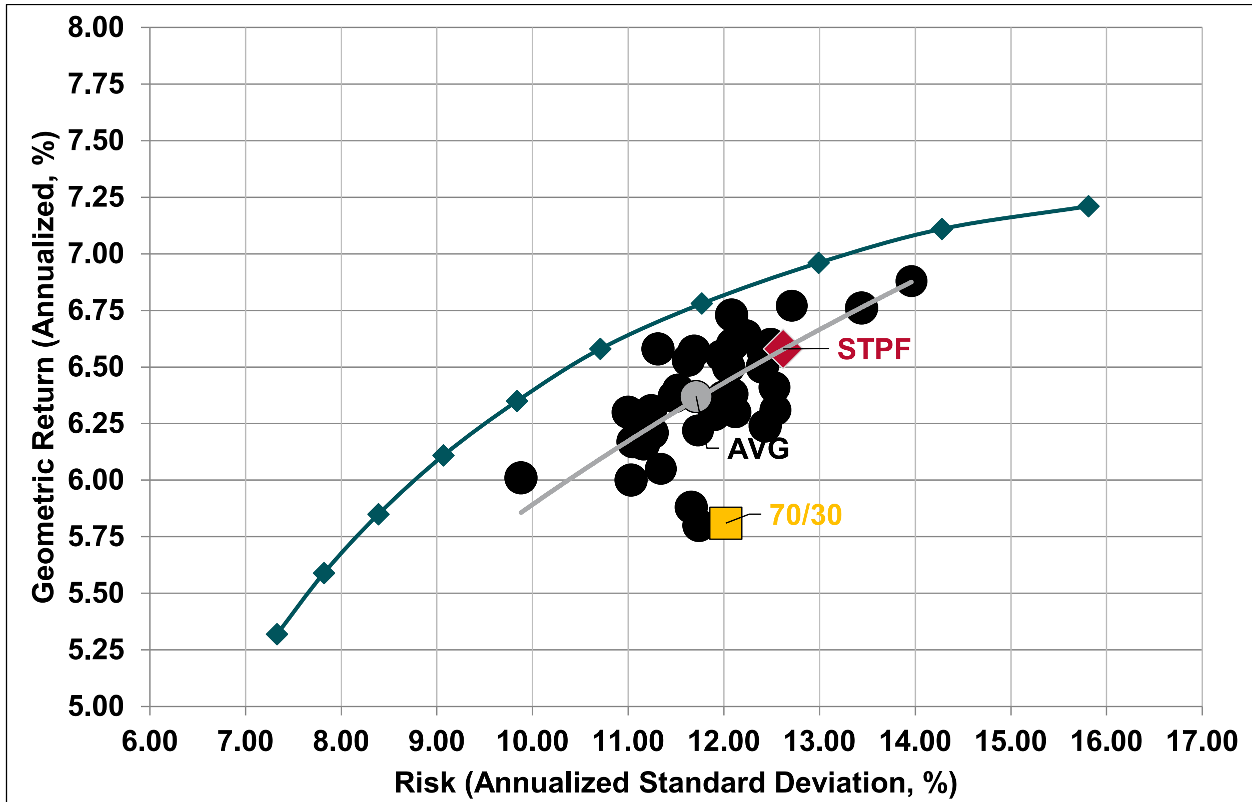
	CY23	CY24	CY25	CY26	CY27	CY28	CY29	CY30	CY31	CY32	CY33
Base Case	$9.5	$10.0	$11.3	$13.0	$15.2	$17.7	$20.1	$22.7	$25.1	$27.6	$30.0
+50% Contributions	$9.5	$10.0	$11.8	$14.4	$17.7	$21.4	$25.0	$28.8	$32.5	$36.2	$39.8
-50% Contributions	$9.5	$10.0	$10.8	$11.8	$13.0	$14.4	$15.8	$17.2	$18.5	$19.9	$21.2

Distributions **–** Using the same long-term (25-year Intergenerational Equity model) assumptions, annual distributions from the STPF are expected to rise to over $1 billion by the end of the 7-10 year investment horizon. This equates to an annualized growth rate of about 13.9%. Again, with these estimates heavily dependent upon the new sources of oil and gas tax and royalty contributions, the same cautions as above apply.



	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
Base Case	$290	$333	$373	$424	$483	$555	$631	$727	$834	$948	$1,064
+50% Contributions	$290	$333	$373	$430	$502	$596	$707	$849	$1,009	$1,179	$1,354
-50% Contributions	$290	$333	$373	$420	$467	$518	$564	$618	$679	$742	$807

Black Dot Analysis **–** Using the same "Black Dot" custom peer group of 36 public investment funds, the STPF's long-term asset allocation is compared with the projected returns and risk profiles of the peer group using RVK's 2024 capital market assumptions.



Early Childhood Education and Care Fund

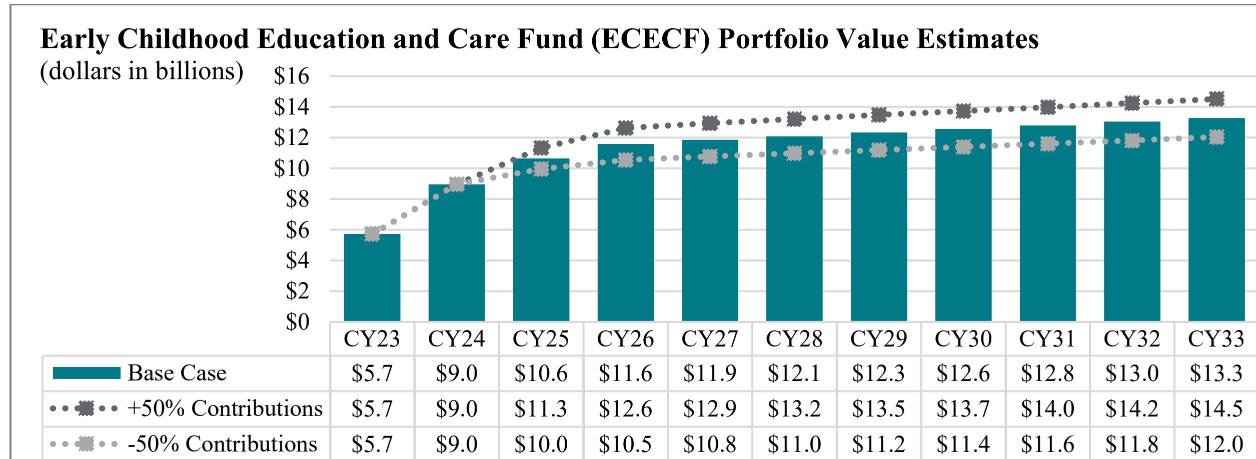
Discussion – The remarkable growth of the ECECF continued in FY24. The fund ended the fiscal year at $7.1 billion, up from $3.57 billion in FY23 due to massive contributions of windfall oil and gas tax and royalty revenues. With the fund on track to potentially receive billions more in revenue contributions over the next three-to-five years, the ECECF has even more potential for significant growth over the investment horizon if current inflow estimates are realized and markets perform as expected.

While estimated inflows have the potential to rapidly grow the size of the fund in the near- to medium-term, contributions into the fund are likely to dry up over time as the threshold for transfers to the fund (oil and gas tax and royalty revenues exceeding a five-year average) increases and becomes harder to beat. By the end of the forecast period, the fund will likely need to rely on investment returns to cover distributions, a prospect that underpinned many of the asset allocation decisions.

Portfolio Value – The ECECF is also modeled in a manner similar to that of the LGPF and, given the sizeable contributions that are expected over the next 3-5 years, the ECECF could exceed $13 billion over the 7-10 year investment horizon. This projection is based upon the long-term assumptions for investment return, estimated inflows from windfall oil and gas production taxes and federal royalties outlined in the inflows analysis section of this report, and the distribution policy used in the 25-year Intergenerational Equity model for the ECECF.

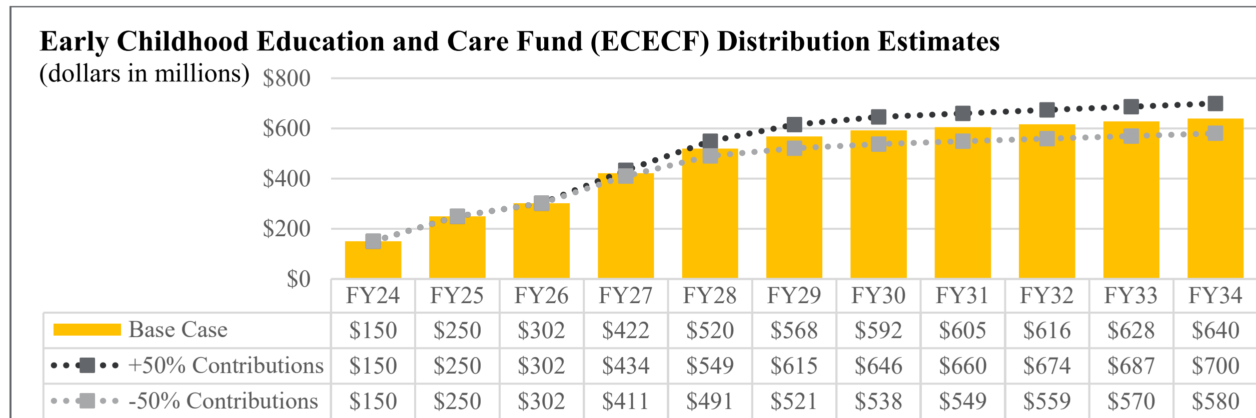
As with the STPF, we reiterate here that estimated revenue contributions into the ECECF are the primary driver of the expected fund growth. The ECECF is likely to receive about $3 billion in inflows in 2024, which would bring the size of the fund to roughly $9 billion by calendar year end. Thereafter, the projections

below are heavily dependent on the assumption that no changes to the statutory formula for distributing tax and royalty collections to the ECECF are made and that those tax and royalty collections will continue to exceed their five-year averages for the next few years (which we are expecting based on the current outlook for oil and natural gas prices and production trends in New Mexico). The chart below illustrates the differences in expected portfolio value if contributions to the fund are assumed to be +/- 50% of the estimates in our base case.



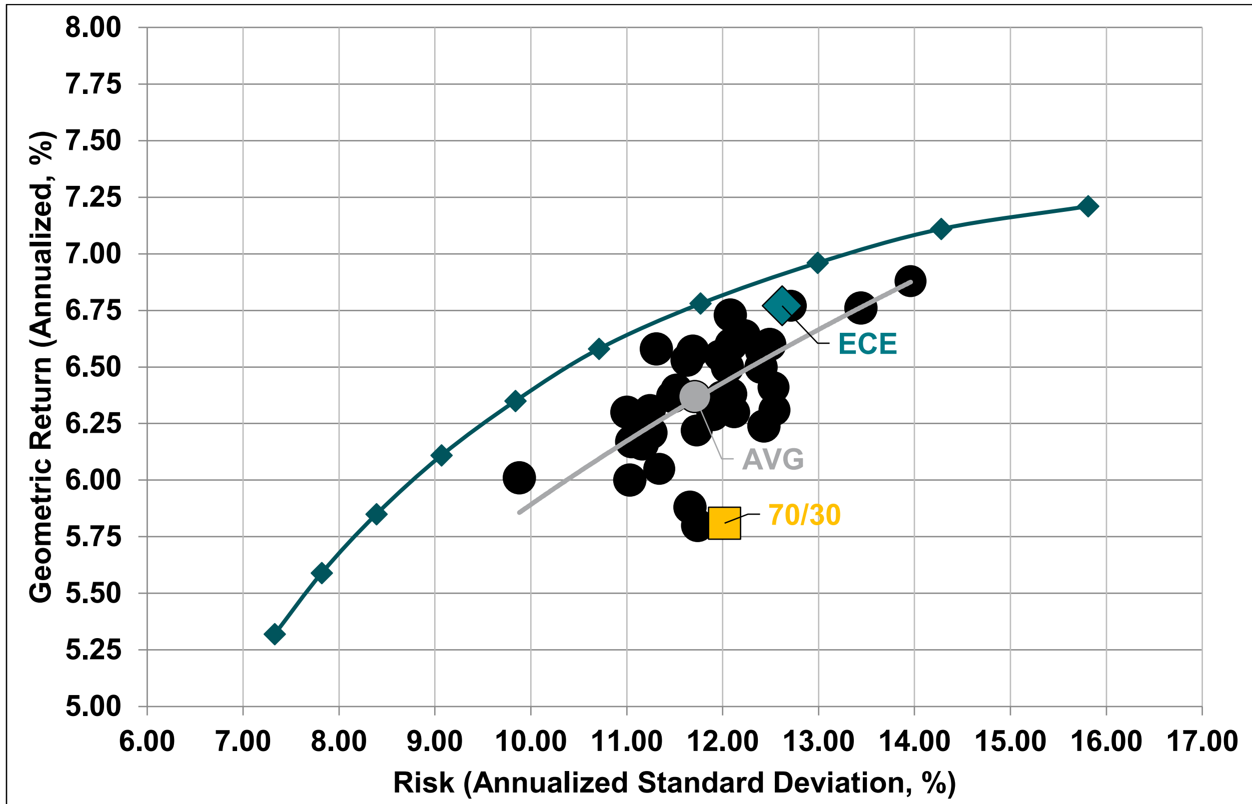
	CY23	CY24	CY25	CY26	CY27	CY28	CY29	CY30	CY31	CY32	CY33
Base Case	$5.7	$9.0	$10.6	$11.6	$11.9	$12.1	$12.3	$12.6	$12.8	$13.0	$13.3
+50% Contributions	$5.7	$9.0	$11.3	$12.6	$12.9	$13.2	$13.5	$13.7	$14.0	$14.2	$14.5
-50% Contributions	$5.7	$9.0	$10.0	$10.5	$10.8	$11.0	$11.2	$11.4	$11.6	$11.8	$12.0

Distributions – Using the same long-term (25-year Intergenerational Equity model) assumptions, annual distributions from the ECECF could rise to about $640 million by the end of the 7-10 year investment horizon. Again, with these estimates heavily dependent upon the size of oil and gas tax and royalty contributions, the same cautions as above apply.



	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34
Base Case	$150	$250	$302	$422	$520	$568	$592	$605	$616	$628	$640
+50% Contributions	$150	$250	$302	$434	$549	$615	$646	$660	$674	$687	$700
-50% Contributions	$150	$250	$302	$411	$491	$521	$538	$549	$559	$570	$580

Black Dot Analysis – Using the same "Black Dot" custom peer group of 36 public investment funds, the ECECF's asset allocation is compared with the projected returns and risk profiles of the peer group using RVK's capital market assumptions. The chart below shows the ECECF is among the most efficiently allocated funds when compared to the Black Dot peers, with above-average expected returns and below-average risk.

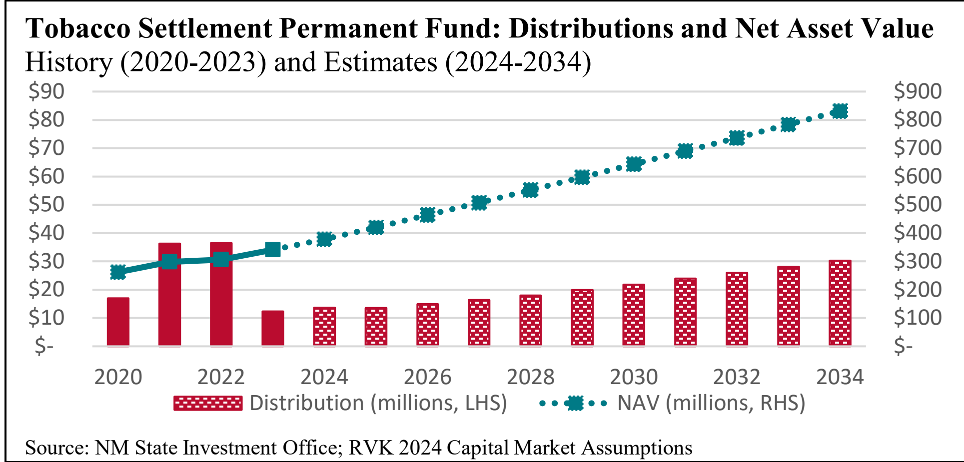


Tobacco Settlement Permanent Fund

Discussion, Portfolio Value & Distributions – The Tobacco Settlement Permanent Fund (TSPF) ended FY24 with a market value of $365 million, up nearly $25 million from FY23 and returning 6.7% for the fiscal year.

The Legislature made substantive changes to the TSPF during the 2024 legislative session – namely, removing the TSPF from general fund reserves and setting the distribution policy to 4.7% of the rolling 5-year average fund value. Historically, statute required 50% of tobacco settlement revenues to be deposited into the TSPF; however, the fund had only received settlement revenue inflows in four of the last 15 years as a result of statutory adjustments made during legislative sessions. This caused the fund to rely heavily on investment gains to grow the fund balance. The change in distribution policy will allow all settlement revenues to be deposited into the fund annually and makes spending from the fund a more stable percentage of a rolling average.

These recent changes prompted the Council to adjust the fund's asset allocation, allowing more equity exposure in the portfolio and reducing reliance on income-generating assets. The chart below illustrates potential growth of the TSPF and its distributions over the investment horizon following the recent legislative changes. This projection is modeled based on the long-term assumptions for investment return, estimated inflows from tobacco settlement revenues, and the fund's statutory distribution policy. Given the increased uncertainty in the economy and the financial markets, these figures should only be used as a guide.



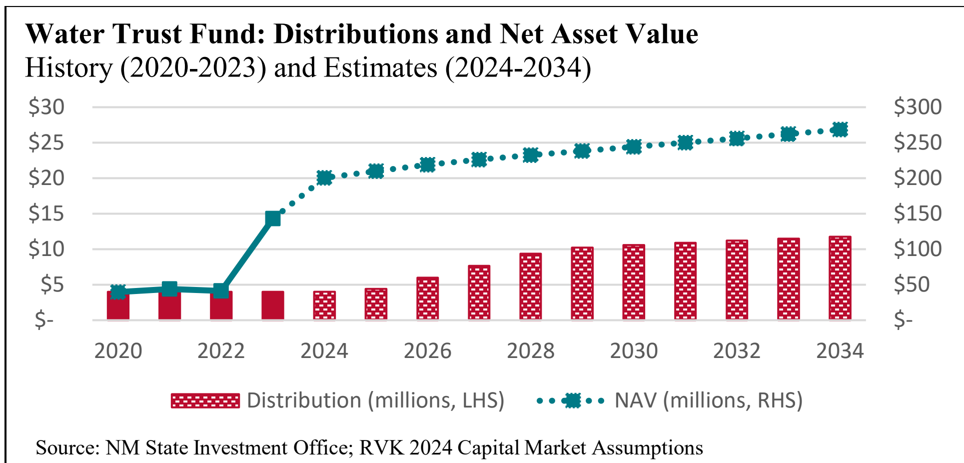
Water Trust Fund

Discussion, Portfolio Value & Distributions – The Water Trust Fund (WTF) ended FY24 with a market value of $148 million, up from $142.9 million at the end of FY23 and a 7.63% return over the fiscal year.

The WTF relies on one-time legislative appropriations for inflows, and the fund's spending policy is set in statute at $4 million/year, until the time in which a distribution of 4.7% of the rolling 5-year average would exceed that amount. The fund has historically only distributed the $4 million annually, since the aggressive spending policy relative to the fund's size hindered its ability to grow.

Fortunately, recent legislative appropriations (including an additional $50 million deposited in FY25) are expected to sustain the fund for many years to come. Additionally, these deposits are expected to speed up the timeline in which the fund can begin distributing more dollars via the 4.7% mechanism. We currently estimate the size of the WTF could trigger the new distribution policy as early as FY26.

The chart below illustrates potential growth of the WTF and its distributions over the investment horizon following the recent legislative appropriations. This projection is modeled based on the long-term assumptions for investment return, the fund's statutory distribution policy, and assuming no additional legislative appropriations. Given the increased uncertainty in the economy and the financial markets, these figures should only be used as a guide.



Tax Stabilization Reserve

Discussion, Portfolio Value & Distributions – The Council began managing the Tax Stabilization Reserve (TSR) in 2019 and since then the fund has grown from $527 million to a market value of $2.17 billion at the end of FY24. The rapid growth of the fund is primarily attributable to large inflows received in 2020 and again in 2022, totaling about $1.2 billion and $460 million, respectively. The TSR received another $724 million in excess operating reserve revenues at the beginning of CY24.

Prior to the 2024 legislative session, there were two statutory mechanisms that automatically contributed funds to the TSR:

1. Revenue in excess of the five-year average from the oil and gas emergency school tax is transferred to the TSR if total general fund reserve levels are below 25% of general fund appropriations (otherwise, when reserves are above 25%, this excess instead goes to the ECECF), and
2. Receives excess revenue from the general fund operating reserve if the operating reserve balance exceeds 8% of prior fiscal year recurring appropriations.

During the 2024 session, the Legislature removed the provision allowing the TSR to receive excess operating reserve revenues, which was responsible for over 80% of the fund's growth since 2019. With total general fund reserve balances currently sitting at healthy levels, we do not expect the TSR to receive any additional oil and gas tax revenue – therefore, we are not expecting any additional contributions into the TSR over the investment horizon.

Although the TSR does not have a regular distribution policy, as a reserve fund it is one of the first 'points-of-contact' to shore up the state budget should there be a shortfall of general fund revenue. Such occurrences are difficult to predict, but we recognize the possibility of unexpected drawdowns and have structured the fund's asset allocation with that understanding in mind.

Rural Libraries Endowment Fund

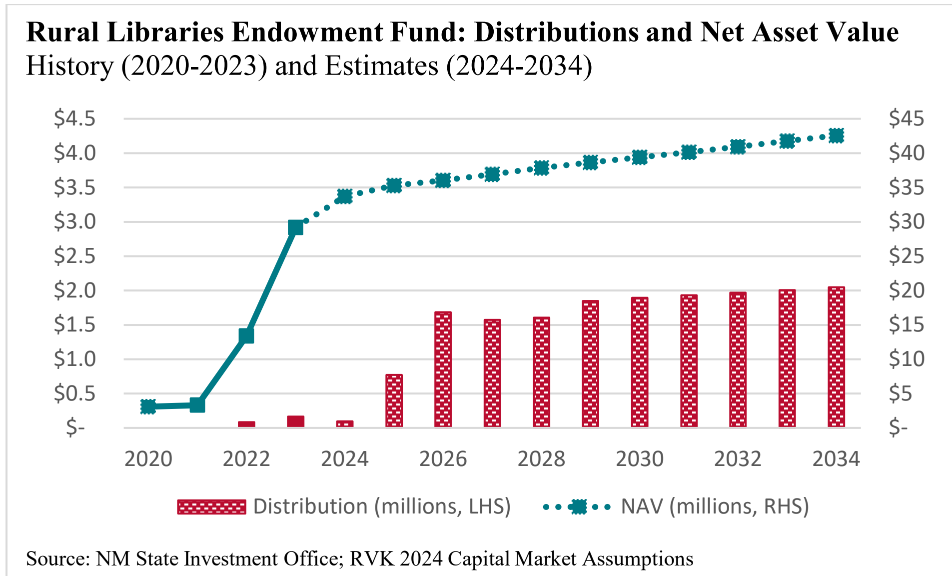
Discussion, Portfolio Value & Distributions – The Rural Libraries Endowment Fund (RLEF) as created in 2019, seeded with a $1 million appropriation and since receiving additional appropriations of $2 million, $10 million, and $15 million in 2020, 2022, and 2023 respectively. As of the end of the FY24, the fund was valued at $32.7 million and received another $2.5 million appropriation in FY25.

For FY22-FY27, the fund's spending policy is limited to the difference between investment income in the prior calendar year and all fund distributions, up to 5% of prior calendar year-end value. The RLEF distributed $94.2 thousand for rural libraries in FY24 and about $772 thousand in FY25. Beginning in FY28, the fund will distribute the average of fund investment income yielded in the prior five calendar years, up to 5% of prior calendar year-end value.

Like the Water Trust Fund, the RLEF relies on legislative appropriations for inflows, and given the fund's size and manageable spending policy, the Council has structured this fund to match the WTF's asset allocation with a high growth focus and larger allocations to private asset classes.

The chart below illustrates potential growth of the RLEF and its distributions over the investment horizon following the recent legislative appropriations. This projection is modeled based on the long-term assumptions for investment return, the fund's statutory distribution policy, and assuming no additional legislative appropriations. However, because the RLEF distributes investment earnings rather than a percentage of the fund's market value, distributions are entirely dependent on annual portfolio performance

and are likely to be more volatile than is illustrated below. Given the increased uncertainty in the economy and the financial markets, these figures should only be used as a guide.



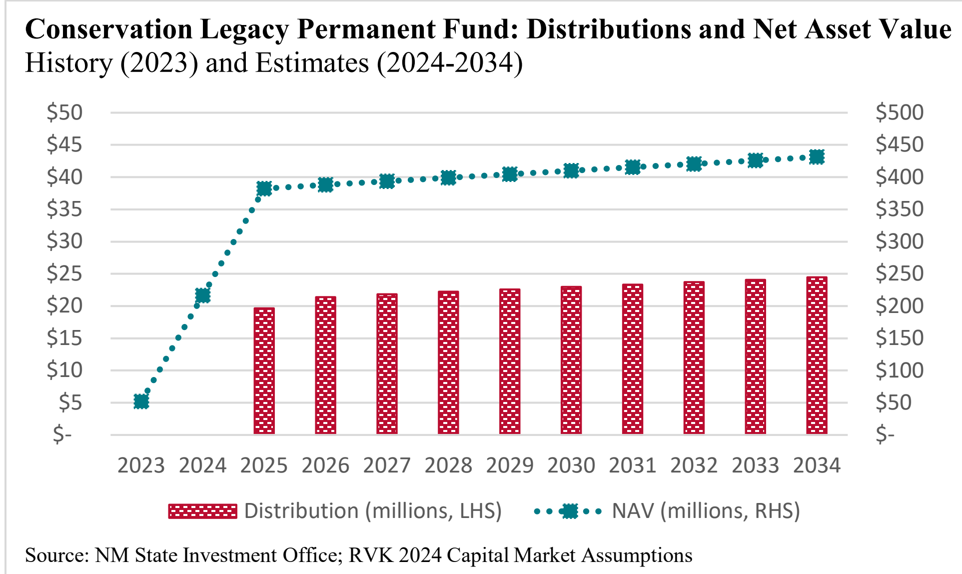
<u>Conservation Legacy Permanent Fund</u>

Discussion, Portfolio Value & Distributions – The Conservation Legacy Permanent Fund (CLPF) was created with a $50 million appropriation in 2023 and later bolstered with a $300 million appropriation in July 2024. Like many of the new funds under the Council's management, inflows to the fund are conditional upon one-time legislative appropriations.

The CLPF distributes any investment earnings exceeding $5 million from the previous fiscal year, if the balance of the fund on July 1 is more than $150 million. For FY24 and FY25, the fund was unable to satisfy both conditions and no distribution was made. Given the new appropriations into the fund, the CLPF is expected to begin making distributions in FY26, assuming investment earnings exceed $5 million for that fiscal year.

Since the fund distributes any investment earnings over $5 million, this also means growth of CLPF's market value is limited to a maximum of $5 million per year.

The chart below illustrates potential growth of the CLPF and its distributions over the investment horizon following the recent legislative appropriations. This projection is modeled based on the long-term assumptions for investment return, the fund's statutory distribution policy, and assuming no additional legislative appropriations. However, because the CLPF distributes investment earnings rather than a percentage of the fund's market value, distributions are entirely dependent on annual portfolio performance and are likely to be more volatile than is illustrated below. Given the increased uncertainty in the economy and the financial markets, these figures should only be used as a guide.

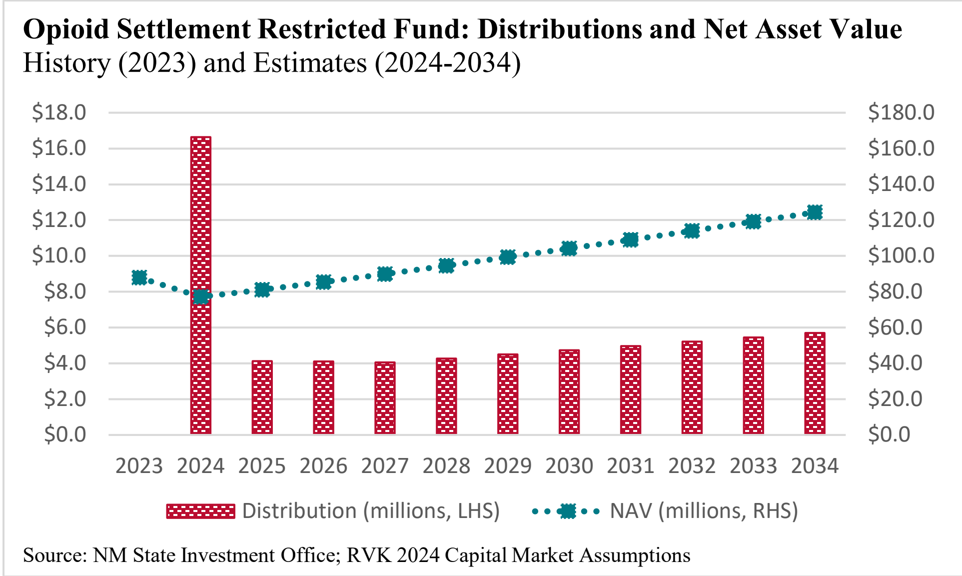


<u>Opioid Settlement Restricted Fund</u>

Discussion, Portfolio Value & Distributions – The Opioid Settlement Restricted Fund (OSRF) was created in 2023 through settlement dollars from opioid crisis litigation. The fund initially received $85.5 million in 2023 and ended FY24 with a market value of $78.7 million. The fund has the potential to receive ongoing settlement revenues; however, the size and timing of these potential inflows are currently unknown. The Legislative Finance Committee's fiscal impact report of the original bill creating the fund estimated the fund could receive about $3 million per year for 18 years.

The OSRF's distribution policy is 5% of the fund's three-year average market value. The Legislature appropriated $12.7 million in FY24 from the corpus of the fund for opioid crisis recovery programs, and the OSRF distributed $3.9 million in FY25 as part of its normal distribution policy.

To model potential growth in the portfolio value and distributions, we assume an inflow of $3 million per year for 18 years, distributions consistent with the statutory distribution policy, and investment returns consistent with our long-term capital market assumptions. However, given the increased uncertainty in the economy and the financial markets, as well as uncertainty regarding potential future appropriations from the corpus of the fund, these figures should only be used as a guide.

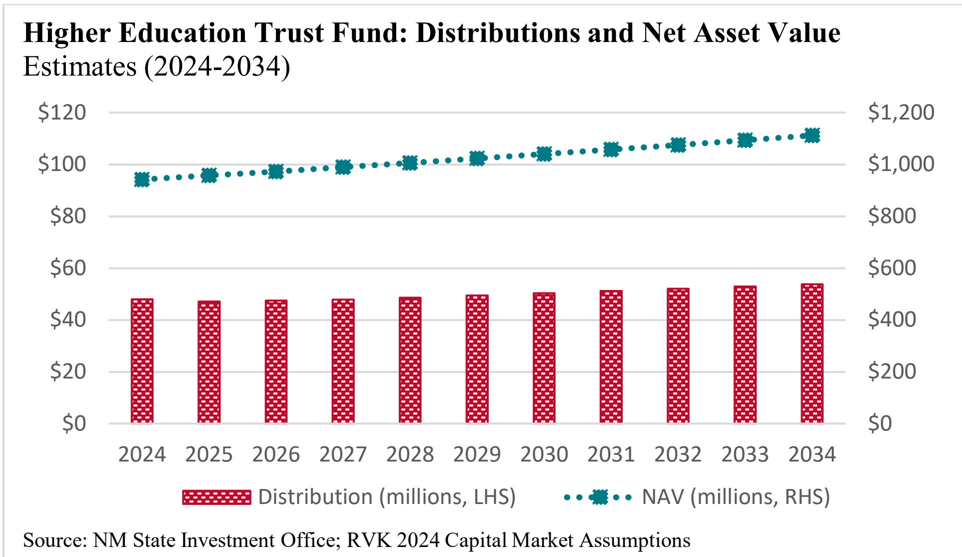


Higher Education Trust Fund

Discussion, Portfolio Value & Distributions – The Higher Education Trust Fund (HETF) was created in May 2024 through a $959 million transfer from the Tax Stabilization Reserve. Similar to other new funds under our management, the HETF relies on one-time legislative appropriations for inflows.

The trust fund made its first distribution in FY25 of $47.95 million as required by statute. Beginning in FY26, the HETF's distribution policy will be 5% of the rolling three-year average market value of the fund.

In May 2024, the Council approved an allocation for the HETF equivalent to that of the Early Childhood Education and Care Fund due to the similar characteristics of the two funds. The chart below illustrates potential growth of the HETF and its distributions over the investment horizon. This projection is modeled based on the long-term assumptions for investment return, the fund's statutory distribution policy, and assuming no additional legislative appropriations. Given the increased uncertainty in the economy and the financial markets, these figures should only be used as a guide.



Capital Development and Reserve Fund

Discussion, Portfolio Value & Distributions – The Capital Development and Reserve Fund (CDRF) was created in the 2024 legislative session through a one-time sweep of cash balances in the severance tax bonding fund in FY24 that totaled $475.8 million.

The CDRF has a statutory spending policy to distribute 5% of the rolling three fiscal year average on January 1 of each year. The fund's first statutory distribution will occur in 2025 in an estimated amount of $23.8 million.

In addition to the regular statutory distribution, the corpus of the CDRF is subject to unlimited appropriation by the legislature for capital projects. It is unclear whether and how often the legislature may exercise this authority; however, given that the fund is subject to full appropriation at any time, a high degree of liquidity is needed. Therefore, the Council approved an asset allocation for the CDRF that emphasizes liquidity while maintaining moderate exposure to higher-growth assets to support the 5% annual distribution rate.

The fund will receive inflows from the state's bonding fund, with the amount subject to bonding fund revenues and the state's debt ratios. Staff is working with the state's Board of Finance to develop inflow estimates for the fund, at which time we will be better able to model the potential future growth of the fund and its regular distributions (subject to the limitation of unknown future appropriations directly from the fund).

Workforce Development and Apprenticeship Trust Fund

Discussion, Portfolio Value & Distributions – The Workforce Development and Apprenticeship Trust Fund (WDAF) was created in the 2024 legislative session with a $30 million legislative appropriation. The fund has a statutory distribution policy of $5 million per year the first two years and the $3 million per year every year thereafter until the fund is exhausted. The first $5 million distribution was made in July 2024.

Given the annual distribution amount is expected to comprise a significant and growing proportion of the Fund balance over time (e.g. 17% of the initial fund appropriation amount will be distributed in year 1), the Council approved an investment strategy that uses a multi-tiered approach to emphasize liquidity of near-term distributions and supports a modest expected return for the balance.

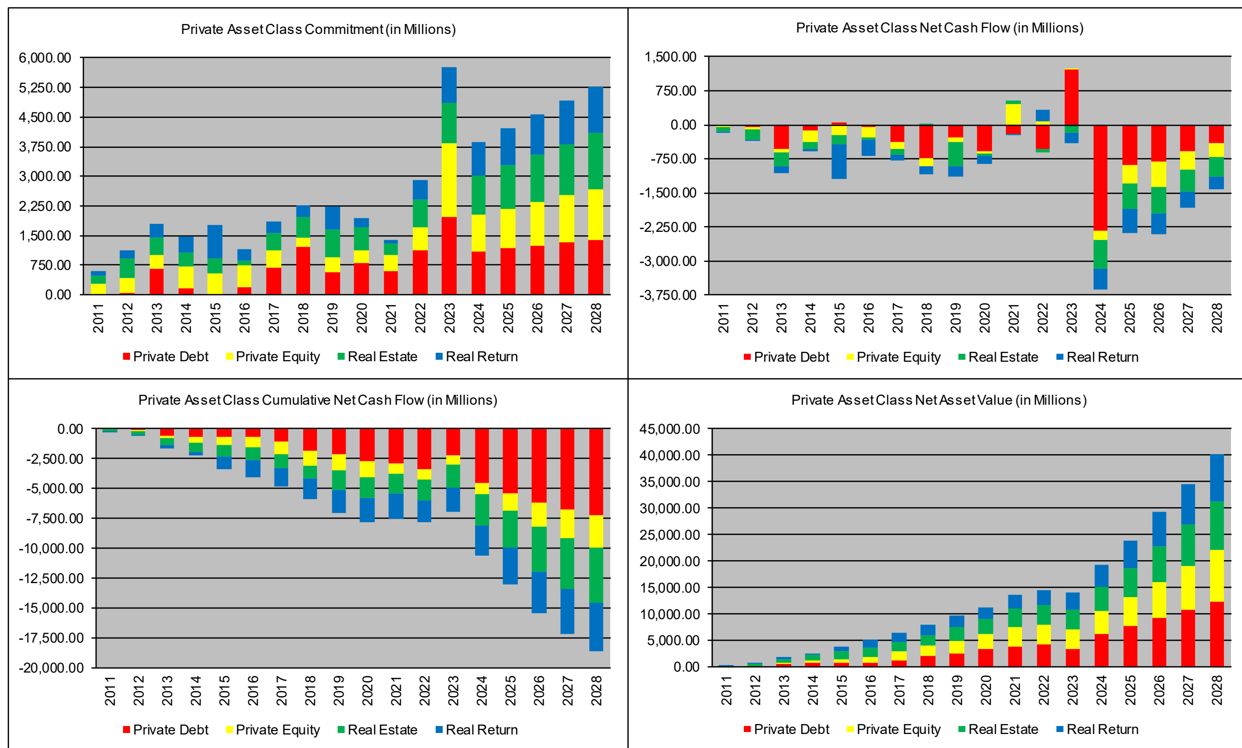
Without the benefit of investment earnings, the WDAF's spending policy would deplete the fund within 8 years. Under the approved asset allocation structure, the fund may be able to achieve an additional 1-3 years of distributions. However, the exact final year of distribution is highly dependent on the prevailing interest rates within the respective liquidity tiers.

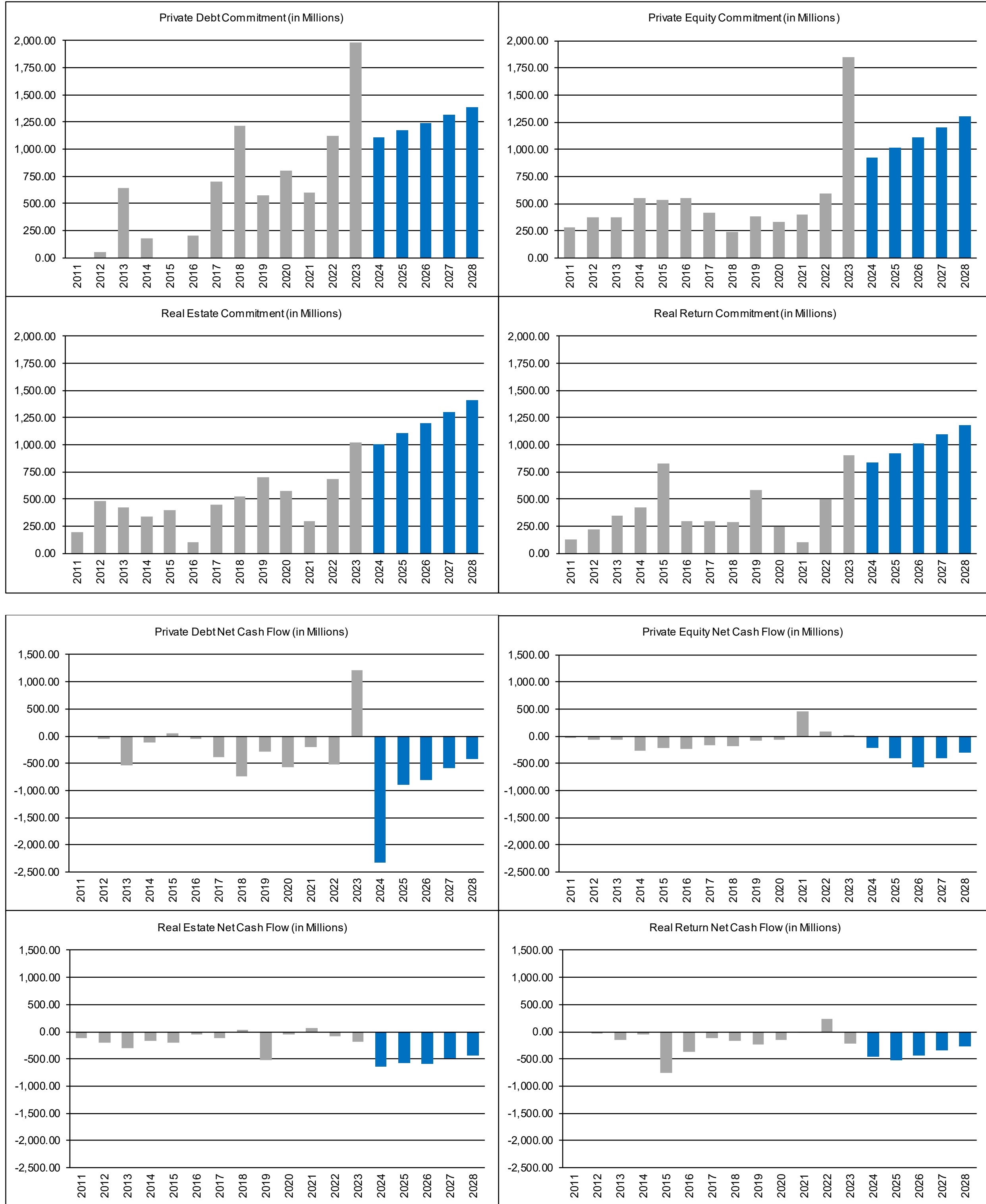
WDAF Asset Allocation		
Liquidity Tier	**Asset Class**	**Long-Term**
Tier I	Cash & Cash Equivalent	Current Year's Distribution Amount ($5M for 2024)
Tier II	Low Duration Fixed Income	Next Year's Distribution Amount ($5M for 2025)
Tier III	Public Market Fixed Income	50% of Remaining Amount (Credit Plus Pool)
	Private Market Fixed Income	50% of Remaining Amount
Asset allocation approved by the Council in June 2024.		

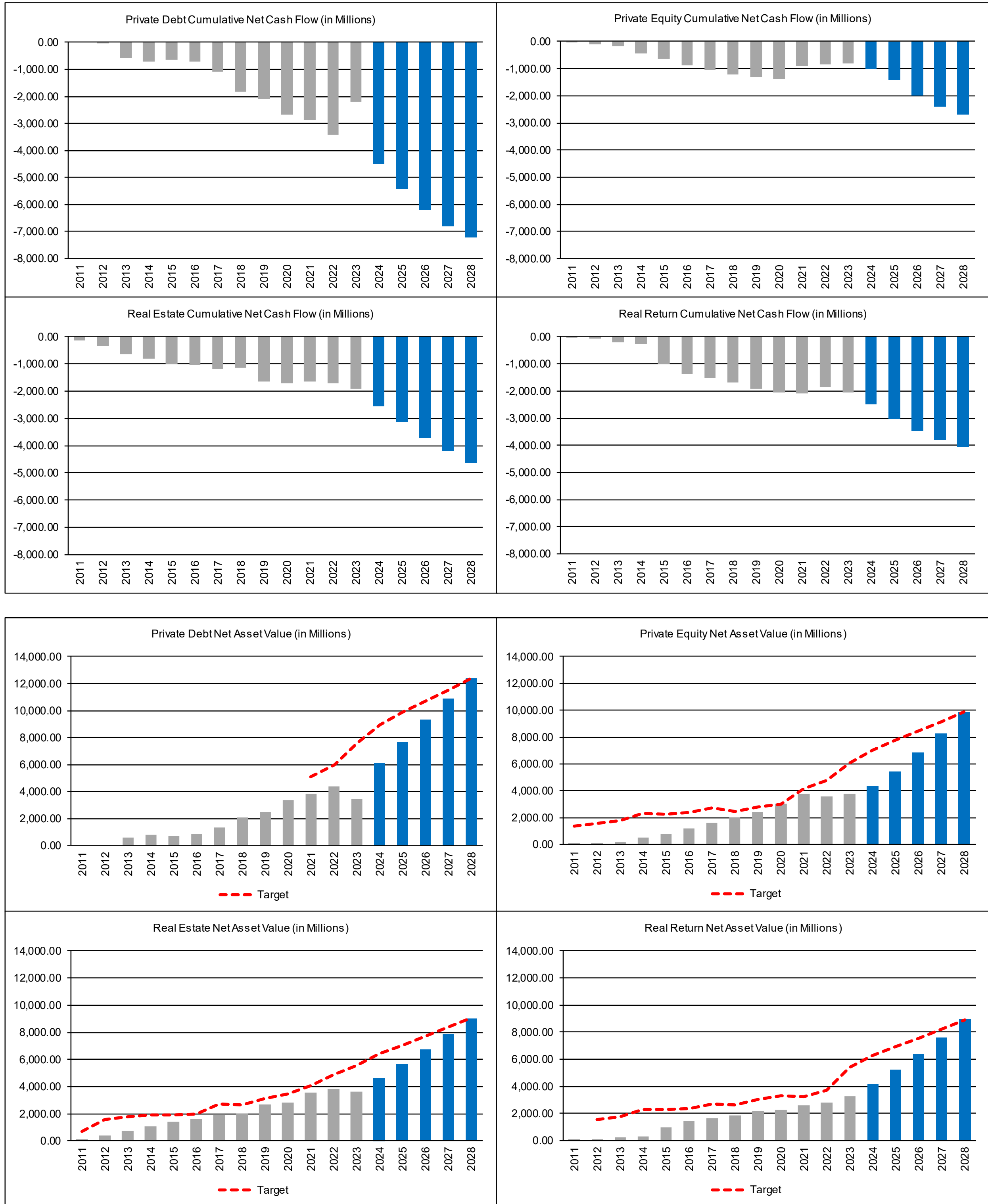
Part IV: Pacing Analysis

Our pacing models project the annual level of commitment needed to achieve the target allocation for private asset classes over a specified period. The models use multiple inputs to forecast contributions, distributions, and net asset values. These inputs are largely based on historical data, with a subjective overlay applied to incorporate our forward-looking expectations. The models are frequently updated with actual information to reflect current market conditions.

The charts below and on the following pages show the forecasted commitments, net cash flows, cumulative net cash flows, net asset values, and allocations since inception for each of the private asset classes. The conditions described throughout this plan have resulted in increasing levels of commitment. However, the contributions from these commitments have been lower than expected, as funds have taken longer to begin deploying capital. This has been offset by lower-than-expected distributions from earlier vintages, as funds have had difficulty selling investments in the current environment. Despite this, the contributions from increased levels of commitment have begun to inevitably overwhelm distributions, resulting in net cash flows either turning back or remaining negative for longer and deepening further. This should help to absorb some of our excess liquidity. The negative net cash flows result in a double dip of the j-curve, as evidenced by the cumulative net cash flows. By remaining deep into the j-curve, our capital can continue to compound. The target net asset values and allocations are achieved at the end of the period.




Private Debt Commitment (in Millions)
Private Equity Commitment (in Millions)
Real Estate Commitment (in Millions)
Real Return Commitment (in Millions)
Private Debt Net Cash Flow (in Millions)
Private Equity Net Cash Flow (in Millions)
Real Estate Net Cash Flow (in Millions)
Real Return Net Cash Flow (in Millions)



Private Debt Cumulative Net Cash Flow (in Millions)
Private Equity Cumulative Net Cash Flow (in Millions)
Real Estate Cumulative Net Cash Flow (in Millions)
Real Return Cumulative Net Cash Flow (in Millions)
Private Debt Net Asset Value (in Millions)
Private Equity Net Asset Value (in Millions)
Real Estate Net Asset Value (in Millions)
Real Return Net Asset Value (in Millions)
Target

Private Debt Allocation
Private Equity Allocation
Real Estate Allocation
Real Return Allocation
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028
Target

Part V: Asset Class Plans

Public Markets: Equity

Asset Class Summary — The publicly traded equity portfolio is one of the cornerstone investments of the Permanent Funds and the most liquid of the major allocations within the Funds. The role of this portfolio is to generate meaningful real returns through long-term capital appreciation and dividend income.

Equity exposure is achieved through a combination of low-cost passive investments and targeted active management. In more efficient markets, such as US large-cap stocks, the focus is increasingly on capturing market returns through the use of low-cost index strategies. In less efficient areas such as international markets and small cap stocks, greater focus is given to identifying skilled active managers that we believe can achieve superior risk-adjusted returns.

The Public Equity asset class has a target allocation of 40% of the Land Grant Permanent Fund and Severance Tax Permanent Fund total assets, with current US and ex-US target allocations of 20% each, or 50% of public equity assets each.

The table below shows the actual and target allocations of the public equity portfolio.

% of Public Equity Asset Class (12/31/2023)							
	Sub-Asset Class	Target (%)	Actual (%)	Target ($m)	Actual ($m)	Strategies (#)
Global					**$15,728,484,669**	
US		**50.0%**	**53.2%**	**$7,864,242,335**	**$8,371,497,023**	
	Active	16.0%	16.9%	$2,516,557,547	$2,651,193,771	4
	Passive	34.0%	36.4%	$5,347,684,787	$5,720,303,252	1
Ex-US		**50.0%**	**46.8%**	**$7,864,242,335**	**$7,356,987,646**	
	Active	45.0%	37.3%	$7,077,818,101	$5,868,254,098	8
	Passive	5.0%	9.5%	$786,424,233	$1,488,733,548	2

Portfolio strategy, markets, and recent performance — The publicly traded equity portfolios are primarily constructed to match the market sensitivity of the benchmark while focusing on the efficient deployment of active risk. In-depth studies have been undertaken by staff with the assistance of the general consultant (RVK) to identify market segments in which managers can more reliably generate long-term excess returns, with market-cap passive strategies receiving higher allocations in more informationally efficient segments. Active risk strategies have been evaluated and selected in the context of their respective US or ex-US composites, with the objective of maintaining idiosyncratic stock exposures, managing tracking error and factor risks. Individual active risk managers are expected to maintain portfolio exposures consistent with their mandates and established risk budgets, while generating positive excess returns against their respective

benchmarks, both in up and down-market conditions. This structure is intended to result in diversified exposures across size, style and geographic categories, allowing the publicly traded equity composite to consistently generate excess returns in all types of market environments.

Calendar year 2023 was very positive for stocks in the US and on a global basis. Following a deep correction in 2022, 2023 was a year characterized by earnings recovery and multiple expansion. The average forward P/E multiple in the US is ~20x, buoyed by growing, cash rich technology stocks that trade at high multiples. Ex-US the average forward P/E multiple is ~14x, hampered by weaker economic backdrops and lacking exposure to global tech leaders. Stocks are not cheap, but they are also not prohibitively expensive. Investors seem to be very sensitive to economic data points. It remains to be seen if inflation has been tamed, if the recovery can persist, and if interest rates will come down.

In the US the Russell 3000 Index returned 26%, bouncing back from poor performance in 2022, which was its worst year since 2008. The year was characterized by subdued volatility, very strong performance in a hand full of sectors, growth stocks outperforming value by a wide margin, and strong performance from the quality factor. There was a brief correction in the second quarter, but the market quickly rebounded to end at its high point for the year.

Sector dispersion was quite pronounced. The Technology and Communication Services sectors (Russell 3000) returned 66% and 64%. In contrast the worst performing sectors were Consumer Staples at -2% and Utilities at -8%. Both felt the bite of inflation and lacked pricing power. The much talked about Magnificent 7 returned 76% on an equal weighted basis. The Magnificent 7 includes Apple, Amazon, Google, Meta (Facebook), Microsoft, Nvidia and Tesla. After declining 40% in 2022 the Mag 7's 2023 bounce back was driven by very strong earnings growth, (+31%), and valuation multiple expansion. For reference on how big a driver the Mag 7 were for US market performance, the S&P 500 was up 24% including the Mag 7 and only 8% excluding the Mag 7.

International Markets also faired well in 2023. The MSCI All Country World Ex US Index returned 16%. Emerging Markets underperformed, only returning 6% for the year. In a break from what happened in the US, value stocks outperformed growth.

International sector performance was similar to the US, but with some key differences. Technology was a top performer, returning 37%. However, Industrials and Financials also had strong performance, returning 21% and 17% respectively. That performance along with the fact that Technology represents a smaller weight in the international index, is what led to value stocks outperforming growth, returning 18% vs 14%. For the twelve months ending December 29, 2023, the SIC portfolio volatility, tracking error, fees and relative performance were inline with peers and largely consistent with expectations. Performance for the US and ex-US composites was within expectations.

The US Portfolio's net of fees return was 27.07% versus 25.96% for the Russell 3000. The bulk of the outperformance can be attributed to the strong relative performance of the two actively managed large cap strategies.

The ex-US portfolio net of fees return was 14.98% versus 15.62% for its custom index. Underperformance was largely attributable to poor performance from one of the active emerging markets strategies, and one of the developed markets strategies.

Portfolio activity and forward-looking strategy — During the course of 2023 no changes were made to manager allocations in either portfolio. Both portfolios are due to have structure studies completed in 2024. Structure studies are completed every three years and include a deep dive into the purpose, goals, strategy, and individual investments in the portfolio. A structure study for the ex-US portfolio was presented to the

State Investment Council at the April meeting. The primary recommendations of the study were to maintain the current structure, expand the roster of active managers (primarily in the small/mid cap space), and to review underperforming managers with key personnel changes for potential replacement. The structure study was approved by the Council and RFP's (request for proposal) will be issued, initiating a comprehensive due diligence process.

SIC staff and RVK continue to monitor closely the active managers in the portfolio. Tracking results and attributes and conducting regular due diligence interviews (in person and via zoom). We do this with the goal of gaining greater understanding of the strengths and weaknesses of the manager, adherence to mandate, and potential for enhancements to the processes and investment teams at each firm.

Public and Private Markets: Fixed Income

Asset Class Summary – The objectives of debt investments are tied to the investment goals of the SIC's multi-asset class portfolio:

- Relatively predictable and consistent source of income
- Reliable liquidity to meet expected near-term and intermediate-term cash needs
- Diversification and mitigation of mark-to-market losses
- Maximization of returns within the asset class and multi-asset class portfolio

Debt portfolios seek to achieve these objectives by investing in a variety of government, corporate, and asset-backed debt across public and private markets. The primary macroeconomic drivers of performance are interest rates (combination of real rates and inflation), risk of default and liquidity. The portfolio is divided into Public Market and Private Market strategies.

Public Market Strategies – The Public Market allocation is a highly marketable, lower credit risk portfolio with the objective of providing liquidity in the event of a severe market dislocation. Consequently, the Public Market allocation is subdivided into Short Duration, Core, and Credit Plus pools, each with a specific purpose:

- *Short Duration Pool*: Provides both liquidity and lower sensitivity to changes in interest rates while generating income through exposure to short duration investment grade and short duration high yield strategies.
- *Core Pool*: Includes U.S. Treasuries for liquidity and intermediate term investment grade credit for income and real capital preservation.
- *Credit Plus Pool*: Enhances current income production with measured exposure to credit risk through investment grade and high yield strategies.

Private Market Strategies – The Private Market allocation's primary objective is to generate returns above those available in publicly traded securities while diversifying the portfolio and mitigating downside volatility of the equity exposures in the multi-asset class portfolio. The Private Market Strategies portfolio prioritizes the following:

- Yield as the primary driver of return
- Downside protection while opportunistically capturing upside
- Re-investing (capital and income) rather than taking distributions
- Greater collateral diversification
- Leveraging the SIC's size to drive improved economics
- Customized and evergreen structures

The SIC utilizes four primary strategy types in Private Markets to achieve the portfolio's objectives:

- *Direct Lending:* Enhances current income production with illiquid corporate credit exposure.
- *Asset-Based:* Improves diversification and current income production with structured exposure to consumer and business critical credit.
- *Special Situations:* Provides diversification and current income production while seeking alpha through complex and bespoke capital solutions.
- *Diversifying:* Increases diversification and current income production through a range of sub-sectors including Real Estate debt.

Current Exposures **–** The long-term target allocations for Public Market Strategies are 6% for the LGPF and 5% for the STPF. The long-term target allocations for Private Market Strategies are 15% for the LGPF and 12% for the STPF.

Sub-Strategy	Allocation 6.30.22	Allocation 12.31.22	Allocation 6.30.23	Allocation 12.31.23	Long-Term Target	Primary Purpose
Public Market Strategies						
Short Duration Pool	24%	31%	22%	20%	10% - 30%	Liquidity/ Duration mgmt.
Core Bonds Pool	40%	36%	40%	40%	20% - 40%	Interest rate exposure
Credit Plus Pool	36%	33%	38%	40%	25% - 65%	Interest rate and credit exposure
Private Market Strategies						
Asset-Based	3%	4%	4%	9%	20% - 30%	Structured credit exposure
Direct Lending	11%	11%	11%	19%	20% - 40%	Corporate credit exposure
Diversifying	20%	22%	23%	40%	10% - 20%	Credit/Alpha exposure
Special Situations	18%	19%	22%	26%	20% - 40%	Credit/Alpha exposure
Legacy	1%	<1%	<1%	<1%	---	---
Liquidating	47%	44%	39%	6%	---	---

Performance **–** The FY2024 debt market was characterized by "higher for longer" central bank interest rate policy, strong credit fundamentals, tight spreads, and uncertainty regarding the economic outlook. Higher base rates and an inverted yield curve created attractive opportunities in shorter duration assets while strong fundamentals provided select opportunities in credit amid a challenging spread environment.

The benchmark for the Public Markets Allocation is the Bloomberg U.S. Aggregate Bond Index which returned 2.63% over the fiscal year, while the SIC's Public Markets Strategies portfolio returned 4.82%, generating 219 bps of excess return. Shorter duration credit strategies were the best performing strategies. The Private Market Allocation underperformed its Credit Suisse Leveraged Loan Index +200 bps (1 Quarter lag) benchmark by 619bps while generating an absolute return of 6.14%. Cash generated a 5.25% return for the fiscal year.

Recent Activity and Forward-looking Strategy **–** The Debt Market portfolio's diversified array of strategies positions it to weather a broad range of economic and liquidity disruptions. Allocations approved by the SIC over the prior year ensure the SIC is positioned to be a liquidity provider. The table below summarizes commitments approved over fiscal year 2024:

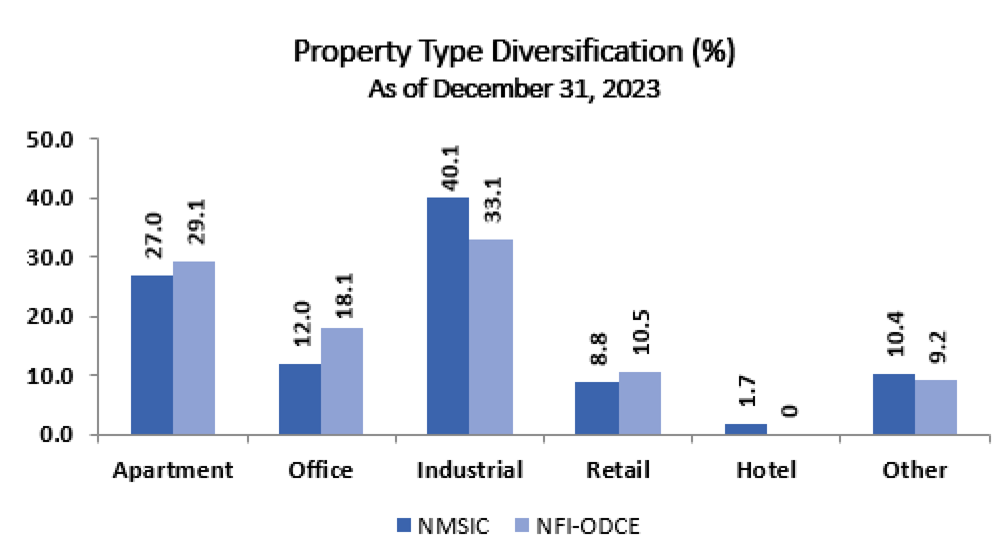
Fund Name	Sector	Strategy	Date Effective	Commitment
Newmarket IIFC IV, SCSp	Diversifying	Regulatory Capital	8/29/23	$150,000,000
AllianceBernstein	Short Duration	Liquid High Yield	9/2/23	$500,000,00
Silver Point Distressed Opportunity Institutional Partners II L.P.	Special Situations	Opportunistic	10/24/23	$250,000,000
Golub Direct Lending (separate account)	Direct Lending	Middle Market Senior Debt	11/28/24	$400,000,000
Strategy Transition[2]-- Shenkman Capital	Credit Plus	Short Duration Multi-Asset Credit	11/28/24	--
Oak Hill Advisors OLEND	Direct Lending	Upper Middle and Upper Market Senior Debt	1/23/24	$350,000,000
Commit Increase[3]-- Silver Point Specialty Credit Fund III L.P.	Direct Lending	Non-Traditional Middle Market	2/27/24	$150,000,000
Torchlight Debt Fund VIII	Diversifying	Real Estate Debt	2/27/24	$150,000,000
Ares Specialty Healthcare Fund	Direct Lending	Sector-Focused	3/26/24	$200,000,000
Commit Increase[4]-- Silver Rock Lobo	Special Situations	Tactical Opportunistic	3/26/24	$150,000,000
Commit Increase[5] -- ACORE Credit Partners II	Diversifying	Real Estate Debt	3/26/24	$100,000,000
Commit Increase[6] -- Strategic Value Capital Solutions Fund II	Special Situations	Capital Solutions	4/23/24	$150,000,000
AB CarVal Asset-Based Fund	Asset-Based	Specialty FInance	6/25/24	$200,000,000
FY2024 Total	**--**	**--**	**--**	**$2,250,000,000**

Staff recommended and SIC approved $2.25 billion across eleven private debt market commitments and one public market allocation in FY2024. Due to SIC growth, staff expects to continue making commitments on a regular basis, totaling about $2.0 billion in the Private Debt Market portfolio in FY2024. Staff also expects to add a multi-asset credit strategy to the Credit Plus Pool in the Public Debt Market portfolio in FY2025.

[2] Shenkman was previously managing a Short Duration High Yield Credit strategy. The strategy transitioned to a short duration multi-asset credit strategy to better the reflect the sub-investment grade investable universe.
[3] The SIC originally committed $150,000,000 to Silver Point Specialty Credit Fund III L.P. in FY2023. This commitment brought the SIC's total commitment to $300,000,000.
[4] The SIC originally committed $150 million to Silver Rock Lobo Fund Series '23 Tactical Allocation Strategy Fund of One in FY2023. This commitment brought the total commitment to $450 million.
[5] The SIC originally committed $150 million to ACORE Credit Partners II in FY2022. This commitment brought the total commitment to $450 million.
[6] The SIC originally committed $150 million to Strategic Value Capital Solutions Fund II in FY2023. This commitment brought the total commitment to $300 million.

Private Markets: Real Estate

Asset Class Summary — The Council's Real Estate portfolio has a target allocation of 12% of the Fund. As of CYE 2023 the Real Estate Portfolio's NAV was $3.6 billion, representing approximately 8.3% of the Fund's assets. The Real Estate Portfolio is well diversified by property type, risk profile, and geography. Relative to property type diversification, the portfolio is guided by the diversification of the National Council of Real Estate Investment Fiduciaries (NCREIF) Fund Index for Open-Ended, Diversified, Core Equity (NFI-ODCE), with a 15% plus or minus relative allocation. Within these bands, staff, working in concert with the Real Estate Consultant, may over- or under-weight property types to reflect views of operating fundamentals, valuations, or diversification benefits. As an example, below you will note that the portfolio is overweight to the "Other" category relative to NFI-ODCE. Staff and consultants believe that many of the property types that comprise the "Other" category are attractively valued and present a diversification opportunity since their return drivers are less correlated to GDP. The property type composition of the Real Estate portfolio is summarized in the table below:



Recent Performance, Markets and Portfolio Strategy — The Real Estate portfolio faced challenging market conditions for FY 2023, declining 9.9% on a net basis. Despite the negative absolute result, the portfolio beat the NFI-ODCE benchmark by 280 basis points. Over three year and longer horizons the portfolio continues to out-perform the benchmark. Rising rates, particularly through October 2023, drove borrowing rates higher, and pressured valuations as buyers withdrew from the market.

Fundamentals in industrial and residential property types remained strong. In both cases, vacancy rates stayed low driving rent and NOI growth throughout 2023. The single-family housing market has been characterized by continued price appreciation over the past two years, 5.6% and 5.7% in 2022 and 2023 respectively as measured by the Case Shiller National Home Price NSA Index. These trends continued into 2024. High home prices and rising mortgage rates have combined to drive home affordability below levels last seen in 1986, as measured by the National Association of Realtors. Home ownership and single or multi-family rentals are substitute goods. Low affordability of homes tends to reinforce demand for rental properties, although elevated levels of new unit delivery (supply) may soften the impact of high home prices on rental rates near term in many markets.

The office sector of the real estate market remains under pressure. Despite increased work from office mandates by employers, office space utilization is stuck below pre-COVID levels across many metropolitan markets. Excess space will take time to absorb and in the interim low occupancy, rising operating costs, and a challenging refinancing environment will likely pressure valuations. Bid-ask spreads are wide, and transactions are infrequent, causing difficulty in ascertaining valuations at which markets will clear. Anticipated rate cuts by the Federal Reserve could be a lubricant that brings buyers back to the market. In the year ahead, we expect that disciplined capital will find opportunities to acquire assets at compelling prices, particularly those in weak hands or needing to be refinanced.

Investors' interest remains focused on industrial and multi-family investments due to those segments' comparatively strong operating fundamentals and superior growth prospects. According to Green Street, apartment cap rates have reverted to near long-run averages and industrial cap rates have moved approximately 170 basis points above their multi-decade lows. These improved valuations should make this a more attractive environment into which to deploy fresh capital. Nevertheless, cap rate spreads compared to Baa credit remain tight, so valuations may remain a near-term headwind. We, like other institutional investors, continue to evaluate alternative property types to help achieve capital deployment objectives. These alternative property types include single family for rent; manufactured home communities; senior housing; student housing; self-storage; cold storage; data centers; and life sciences facilities.

The Federal Reserve's aggressive posture with respect to rates appears to have succeeded at reining in inflation that seemed at risk of spiraling out of control. Inflation expectations as measured by Five Year Inflation Swaps have been trending modestly downward for 18 months and are currently at 2.18%, near their 20-year average. Inflation can help the top line of real estate enterprises because of their ability to pass on inflation through their leases. Ignoring inflation escalators in lease provisions, most of the inflation benefit derives from the ability to capture a mark to market when leases roll. That can happen quickly for short duration assets like hotels where room rates can reprice daily and can take time in segments like office where lease durations are much longer. Additionally, over time inflation raises the replacement cost of assets and that effect will cause asset values to increase in nominal terms over time.

In liquid secondary markets like the one for REITs, the impact of rate driven valuation changes is much speedier than in the private markets. The Dow Jones US REIT Index, a broad proxy of REIT and real estate related public equities declined 25.2% in 2022 and, according to Green Street, traded at material discounts to private market values. The situation reversed in CY 2023 with the Dow Jones REIT index outperforming the ODCE by 24.4% and closing much of the performance gap opened since 2020. Staff believe that remaining valuation headwinds impacting ODCE will likely dissipate over the remainder of this year and that CY 2025 ODCE (NPI) returns will likely match aggregate NOI growth with some possible upside related to prospective rate cuts.

Recent Activity and Forward-Looking Strategy — The Townsend pacing model estimates approximately $1,000 MM of annual commitments, will be required to continue to push the invested NAV of the Real Estate portfolio toward the long-term target allocation of 12%. It is expected that deployments will deviate from modelled levels based on market conditions and the availability of attractive new offerings. For the year ended December 31, 2023, ten new Non-Core commitments were made totaling approximately $1,025MM:

1.	$100	MM	AEW Partners Real Estate X	(Non-Core)
2.	$100	MM	Almanac Realty Securities IX	(Non-Core)
3.	$100	MM	Alterra IOS Venture III	(Non-Core)
4.	$25	MM	Alterra IOS Venture III (Co-investment)	(Non-Core)
5.	$150	MM	Bain Capital Real Estate III	(Non-Core)
6.	$150	MM	Blackstone Real Estate Partners Europe VII	(Non-Core)
7.	$100	MM	KKR Real Estate Partners Americas IV	(Non-Core)
8.	$100	MM	NorthBridge Partners IV	(Non-Core)
9.	$25	MM	NorthBridge Partners IV (Co-investment)	(Non-Core)
10.	$150	MM	Oaktree Real Estate Opportunities IX	(Non-Core)

An additional $765 commitments were approved to four commingled funds through June 30, 2024.

Currently, the core component of the NMSIC real estate portfolio represents 63% of the total portfolio against a neutral point of the range at 55%. Appraisal-based valuations which are slow to adjust to major market shifts are an important feature of much of the core real estate market. Staff will likely favor non-core, closed end strategies for new capital deployments until core valuations fully reflect the new environment, a development that could take as much as six quarters from the bottoming of public real estate markets. Episodic gaps in the valuations between public and private assets is an argument for considering an intermediate term tactical allocation to a public REIT portfolio.

Staff and Townsend intend to rebalance the Core portion of the Real Estate Portfolio to ensure that position sizes align with conviction and that underlying sector exposures are appropriate. Noting that the ODCE is a US benchmark, and that the volatility of foreign currency exchange rates can be the same magnitude as ODCE returns, we will re-evaluate the roll of international managers in the core sleeve.

Using Green Street data, staff conducted an analysis of long-term sector returns and their relationship to growth in operating performance. The key take-away from this work was that cumulative improvements in NOI were the dominant driver of long-run returns, but the impact of valuation changes was material. This insight is reflected in our focus on sectors whose operating performance will likely benefit by long tailed secular themes. NMSIC expects to maintain under-weight positions in conventional retail and office and to over-weight industrial while seeking to increase exposure to multifamily. With respect to geographical distributions, NMSIC is currently evaluating the level and approach to international investment in both the Core and Non-Core portions of the portfolio. Currently, NMSIC's exposure to Europe is approximately 9% of the invested portfolio, while investments in Asia make up 6% of real estate. We recognize that major portions of the global real estate market are located outside the United States and that assets in other geographies present diversification opportunities. In pursuing opportunities outside of the United States, we must also be cognizant of generally weaker GDP and population growth, potentially less favorable tax regimes, and foreign currency risks.

Private Markets: Real Return

Asset Class Summary — The Council's Real Return portfolio is a multi-asset, multi-market portfolio constructed to generate returns based on factors different than those that drive returns of publicly-traded equity and traditional fixed income investments. NMSIC's Real Return portfolio consists of investments in infrastructure, energy (conventional and renewable), agriculture, timberland, and financial assets (cash flow yielding investments under-pinned by real assets). Income generation is expected to be a notable part of the total return. These assets are expected to be advantaged over equities and bonds in an economic and financial market environment where growth is a little slower than average and inflation and interest rates are rising.

The Real Return asset class is intended to comprise to 12% of the broad LGPF and STPF portfolios. As of CYE 2023, the Portfolio represents approximately 7.8% of the Fund on a NAV basis. Starting in 2011, the Council began building investments in Real Assets of timberland, energy, farmland, and infrastructure; and in Financial Assets via Master Limited Partnerships (MLPs). MLPs are companies that invest in oil and gas pipelines and related energy infrastructure, and their corporate structures resemble REITs. Historically, real asset debt strategies and liquid real assets have been held within the Financial Assets allocation. Because real estate debt strategies are not strong inflation hedges, and because of their similarities with other performing debt strategies, those investments have been moved to SIC's Private Credit portfolio.

Recent Performance, Markets and Portfolio Strategy — As of 6/30/2024, the Real Return program since inception IRR is 6.3%. This trails the public market equivalent benchmark (CPI+3%) that has a 6.4% IRR for the same period. Based on since inception IRRs, Infrastructure investments generally outperformed the PME benchmark while most other investments including agriculture, timber, and MLPs have lagged.

For the year ended 12/31/2023 nine new Real Return commitments were approved totaling $907.5 MM:

1. $150 MM CIP Infrastructure V (Infrastructure)
2. $37.5 MM CIP Infrastructure V (Co-Investment) (Infrastructure)
3. $160 MM EQT Infrastructure VI (Infrastructure)
4. $60 MM EQT Infrastructure VI (Co-Investment) (Infrastructure)
5. $100 MM IPI Partners III (Communications)
6. $50 MM IPI Partners III (Co-Investment) (Communications)
7. $150 MM LS Power Equity Partners V (Energy)
8. $100 MM Sandbrook Climate Infrastructure I (Energy)
9. $100 MM Sandbrook Climate Infrastructure I (Co-Investment) (Energy)

Since 12/31/2023 SIC has made additional commitments of approximately $900MM.

Recent Activity and Forward-Looking Strategy — Currently, SIC Staff's pacing model estimates that more than $800MM of annual commitments will be required to keep up with capital inflows and to migrate the invested NAV of the Real Return portfolio toward its long-term target allocation. This compares to the approximate pacing of $300 MM three years ago. It is expected that deployments will deviate from modelled levels based on market conditions and the availability of attractive new offerings.

Conventional energy has been a roller-coaster for the past couple of years. During CY 2023 WTI oil futures ranged in price from approximately $64 to as high as $81. Natural gas prices spent most of CY 2023 in the $2.00 to $3.60 range as natural gas prices returned to more normal levels following Europe's success in

weaning itself from Russian supplies in response to the invasion of Ukraine. Volatility, periodic poor returns, and uncertainty related to the path and timing of the energy transition have combined to effectively starve the US oil and gas value chain of capital. It is expected that this capital flight will present interesting opportunities for investors willing to consider the sector.

At the same time, investor interest in the renewables sector continues to grow as corporate and government mandates push for the development of clean energy sources. Heightened investor interest can pressure prospective returns. While renewable power generation is richly valued, there may be opportunities in supporting/enabling technology such as battery storage and power distribution infrastructure. For the first time in decades energy demands on the electric grid are growing, in part due to the computational demands of AI focused data centers. Firms able to triage distribution network pain points and to provide resources to resolve them are well positioned for success. Finally, the energy transition is likely to be a decades long process and helping to build natural gas infrastructure that enables the marginal substitution of gas for "dirtier" coal or oil is a benefit to the environment.

Infrastructure investments are valued for their resilience and inflation protection attributes. Core infrastructure investments focus on irreplaceable, long-life assets with inflation linked revenue streams, and ideally, volume characteristics that are minimally GDP dependent. Such assets can generate attractive current distribution yields with distributions that can grow over time, and asset values that should appreciate over time at least in line with replacement costs. Further, because infrastructure assets are long lived, they tend to be financed with long term fixed rate debt. This liability structure supports infrastructure fund NAVs in a rising rate environment. Representative infrastructure investments could include utilities, airports, ports, toll-roads, and railroads. The communications sector which includes towers, data centers, has been a strong performer and is fueled by rapid growth in demand for assets to move, process and store data. The growth, prospective returns, and other characteristics of communications businesses give this segment a risk profile that is more core-plus than core.

Returns in agriculture have been low but stable as measured by the NCREIF Farmland Index. Over the prior 5 years, the gross return has been approximately 3.2% annualized. Over longer periods with higher inflation, returns have compounded at low double-digit rates. The Farmland Index has generated negative quarters only three times since 1988. Although viewed as a relatively safe asset class with correspondingly low return expectations, agriculture investments can be exposed to risks from currency movements, sovereign political risks, commodity pricing, regulatory changes, ESG concerns, weather related events, unforeseen supply/demand shocks, consumer preference shifts and shifting geopolitics.

Timberland, as measured by the NCREIF Timberland Property Index, has achieved a 10.2% annualized gross return over the prior five years. Over the prior ten years, the gross return has been approximately 5.8% annualized Despite modest intermediate term performance, results for CY 2023 were 9.46%, continuing relatively strong performance in a higher inflation period as expected.

While returns in Timber and Agriculture over our investment period have been disappointing, both sectors benefit from strong investor interest due to historical inflation protection and environmental benefits such as carbon sequestration.

Staff is currently engaged, with Mercer's assistance, in a review the Real Returns Portfolio's design. Key deliberations will center on the role of natural resource investments and whether their inflation protection characteristics are sufficiently robust to justify the potential opportunity costs associated with failing to participate in potentially higher returning investments.

Broadly speaking, SICs Infrastructure investments, a group including communications, transport, social infrastructure, utilities, midstream oil and gas, and renewable and conventional power generation, have been our best performers with since inception IRRs of 7.93%. Natural resource investments spanning upstream oil and gas, agriculture and timber have, collectively, been our worst with a 3.85% IRR. Within this collection of natural resource investments oil and gas performed best with a 5.77% IRR and agriculture worst at 0.44%. This observation causes us to consider what are that right weights for these segments and whether there are manager/strategy selection lessons to be explored.

Our MLP portfolio, like its comparable benchmark the Alerian MLP Trust, has been a lethargic performer since NMSIC's inception in May of 2015. Portfolio results tracking the benchmark's strong returns in CY 2022 and CY 2023, up 33.7% and 23.8%, respectively, leave the Funds with a modestly positive lifetime IRR. Because MLPs are exposed to both the equity risk premium and commodity price risks, they tend to be volatile investments. The underlying assets held in MLPs closely resemble the midstream assets held elsewhere in the portfolio. Because of the shared fundamental drivers of these businesses, staff is contemplating a recommendation to consolidate all midstream exposures into a single energy infrastructure category within Real Assets. The comparative costs and benefits of owning midstream assets through the MLP will be a component of our strategy review.

In the year ahead, NMSIC's investment focus will be on making new commitments to traditional and energy transition focused infrastructure while exposure to conventional energy, particularly in the upstream portion of the value chain, will likely decline. We will seek to build positions in communications-oriented infrastructure including towers, fiber, spectrum, and non-US data centers where we believe the portfolio is under-represented. Finally, the anticipated growth in our Real Assets portfolio will probably require the addition of investments in Agriculture, Timber, and Metals/Mining/Non-Energy Minerals to maintain appropriate diversification of the portfolio.

Because of the strength of the funds' endowed inflows staff is in the enviable position of being able to invest when other institutional investors are constrained. We are constantly seeking opportunities to use this position of strength to demonstrate our value as long-term partners with GPs and to seek out arrangements that can be mutually beneficial. Separate accounts, co-investment programs, and secondary transactions should all play a role as we seek to efficiently deploy capital.

Private Markets: Private Equity

Asset Class Summary — The Private Equity portfolio (aka the National Private Equity Program) consists of four categories – Buyout, Growth Equity, Special Situations, and Venture Capital – and continues to serve an important role in enhancing overall portfolio return generation and diversification. This asset class, although correlated to public equity markets, often benefits as private equity managers are afforded additional flexibility to pursue operational excellence and improvement in their company investments, which will likely result in a value creation premium.

Recent Performance, Markets and Portfolio Strategy **—** The Private Equity portfolio produced a net IRR of 6.4% for the 12 months through December 31, 2023. This performance was slightly better than the 5.5% 1-year return of the Burgiss Global Private Equity Index.

Portfolio strategy has needed to evolve to reflect the [Funds'] increased inflows and AUM. To achieve our increased pacing objectives, we expect to take a balanced approach by increasing 1) the number of GP relationships, 2) the size of our fund commitments, and 3) our co-investment activity through a combination of an SMA with our private equity consultant Mercer and side-by-side co-investment vehicles with our GPs.

Recent Activity and Forward-Looking Strategy — Private equity consultant Mercer utilizes a pacing model to help guide the target range of annual commitments for the National Private Equity Program. The pacing model serves two main functions – 1) to ensure adequate vintage year diversification for the portfolio, and 2) to achieve and maintain our long-term target allocation over a reasonable time frame.

The current target allocation for the National Private Equity Program is 15% of LGPF and 10% of the STPF.

This excludes the 9% target allocation in the STPF for the New Mexico Private Equity Program. The total target allocation for private equity in the STPF is 19%, consisting of the 10% for the National Private Equity Program and the 9% for the New Mexico Private Equity Program.

At this time, the pacing model projects near-term annual commitments of at least $1.5 billion will be necessary to achieve our target for the National Private Equity Program over the intermediate term. The model is re-evaluated annually for potential enhancements.