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**STATE OF VERMONT  
OFFICE OF THE STATE TREASURER**

**TO:** Susanne Young, Secretary of Administration, and the  
Higher Education Subcommittee of the Prekindergarten-16 Council  
**FROM:** Elizabeth Pearce, State Treasurer  
**RE:** Annual Report on the Higher Education Trust Fund  
**DATE:** August 14, 2020

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I am pleased to present the Secretary of Administration and the Higher Education Subcommittee (“Subcommittee”) of the Prekindergarten-16 Council with the State Treasurer’s eighteenth annual report on the Higher Education Trust Fund (“the Fund”).

The General Assembly established the Fund in the Office of the State Treasurer in 1999 to provide non-loan financial aid to Vermont students attending the University of Vermont (UVM), the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885).

**Performance Summary**

During fiscal year 2020, the Fund’s investment return was 6.2% net of fees.

**5% Distribution based on Fiscal Year 2020 Balances**

The statute provides that in August of each fiscal year, the State Treasurer is to withdraw up to 5% of the 12-quarter moving average of the Fund’s assets and divide the amount equally among UVM, the Vermont State Colleges, and the Vermont Student Assistance Corporation (VSAC); however, the amount distributed cannot exceed an amount that would bring the Fund balance below total contributions to principal. If the later condition cannot be met, the distribution must be reduced accordingly. Principal contributions through June 30, 2020 totaled \$29,346,227. The total 5% distribution available this year is \$1,545,197 or \$610,867 each for UVM, the Vermont State Colleges, and VSAC. **Appendix A** to this report includes quarterly market values and distributions for fiscal year 2020, and **Chart #1** shows principal contributions to date.

**2% Distribution based on Fiscal Year 2020 balances**

16 V.S.A. § 2885 further provides that during the first quarter of each fiscal year, the Secretary and the Subcommittee may authorize the State Treasurer to make an additional distribution of up to 2% of the Fund’s average assets available to UVM and the Vermont State Colleges for the purpose of creating, or increasing, a permanent endowment fund. Similar to the 5% distribution,

the amount distributed cannot exceed an amount that would bring the Fund balance below total contributions to principal. Further, each institution is required to match the distribution by raising private donations of at least twice the distributed amount, to certify to the Commissioner of Finance and Management (“the Commissioner”) that it received private donations in the requisite amount, and that the funds will be used to create or increase a permanent endowment at the respective institution.

At their fall 2019 meeting, the Secretary and the Subcommittee decided to approve this 2% distribution for FY 2020 to UVM and the Vermont State Colleges. The 2% distribution is contingent on an institutional match in FY 2020.

**Fund Balances**

After payments of \$2,156,063.53, the Fund balance at the end of fiscal year 2020 totals \$29,798,090. An accounting of the Fund balance is provided below:

<b>Ending balance FY 2019</b>		<b>\$31,520,273</b>
	FY 2019 Contributions received in FY 2020	\$88,110
<b>Opening balance FY 2020</b>		<b>\$31,608,383</b>
	<b>Distributions FY2019</b>	
	5%: <i>University of Vermont</i>	(\$509,055)
	<i>Vermont State Colleges</i>	(\$509,055)
	<i>Vermont Student Assistance Corp.</i>	(\$509,055)
	2%: <i>University of Vermont</i>	\$0
	<i>Vermont State Colleges</i>	\$0
	Income earned FY 2020	\$769,513
	Appreciation (Depreciation) FY 2020	\$1,106,964
	Fees and Other Charges FY 2020	(\$3,541)
<b>Principal Balance June 30, 2020 <sup>3</sup></b>		<b>\$31,954,153</b>
	<b>Statutory Distributions Available <sup>1</sup></b>	
	5% of 12-Quarter Moving Average as of June 30, 2020	(\$1,545,197)
	2% of 12-Quarter Moving Average as of June 30, 2020	(\$610,867)
	<b>Total Projected Statutory Distribution</b>	<b>(\$2,156,064)</b>
	Balance After Projected Distribution	\$29,798,090
	Total Contributions Received as of June 30, 2020	\$29,346,227
	<b>Surplus Balance After Projected Distributions compared to the Total Fund Contributions <sup>4</sup></b>	<b>\$451,863</b>
	<b>Actual Distributions for 2020</b>	
	5% Distribution	<b>\$1,545,197</b>
	2% Distribution <sup>2</sup>	\$610,867
		<b>\$2,156,064</b>
<b>Principal Balance after distributions</b>		<b>\$29,798,090</b>
	Fundraising target for potential 2% distribution in 2022 <i>(Contingent on an institutional match in FY 2021 and Principal Balance greater than the total Contributions)</i>	\$618,079

<sup>1</sup> Assuming statutory levels (5% distribution & 2% distribution) without regard to statutory requirement to keep balance at or above the total principal contributions.

<sup>2</sup> Committee may elect to forego or match the 2% distribution for the fiscal year. In FY 2021, the Committee approved the 2%.

<sup>3</sup> Numbers may not add due to rounding

<sup>4</sup> This represents the surplus after the statutory required levels are distributed from principal above the total contributions since inception.

### **Potential 2% Distribution based on Fiscal Year 2020 balances to be voted on for FY 2021 fundraising**

All principal contributions to the Fund through June 30, 2020 total \$29,346,227, which also represents the minimum balance that must be maintained in the Fund. In the event that the Subcommittee approves the 2% distribution in September 2020, the fundraising target for FY 2021 would be \$618,079. It is possible that neither the 5% nor 2% distribution next year could be met in full unless returns during the next year are sufficient to cover these amounts. That said, if returns were sufficient to make the funds available and if the Secretary and the Subcommittee authorize this distribution, each institution's share would be \$309,039 with a required match to be raised by each entity in FY 2021 of \$618,079. To re-emphasize, any distribution a year from now is dependent upon the Fund's balance being greater than \$29,346,227 after the distributions have been made. The attached **Chart #2** provides a graphical depiction of authorized distributions.

### **Fund Distributions**

**Appendix B** to this report shows the total return of the entire Trust Investment Account ("Account"), of which the Higher Education Trust Fund, with a balance of \$32.0 million comprises approximately 32%. The State Employees' Other Post-Employment Benefits fund comprises 52% of the account, or \$51.6 million, and the remaining is made up of the ANR Stewardship fund, the Tobacco trust fund, Fish and Wildlife trust funds, Veterans' Home trust funds, and other small trusts. **Chart #3** displays the relative share of the Higher Education Trust Fund compared to the entire Trust Investment Account.

**Chart #4** presents the Fund's balances, inclusive of distributions, for fiscal years 2000 through 2020. In examining the long-term period there are a few themes. Fiscal years 2009-2011 were marked by large contributions and strong performance as the economy rebounded from the Great Financial Crisis, which easily allowed for the 5% distribution to the systems. Fiscal years 2012-2018 experienced muted contributions and compressed fixed income returns due to global central banks' policies that have diminished overall return potential across all asset classes. The five-year annualized return during the period dipped below the necessary 5% for a full distribution to the systems. The following years, fiscal years 2019-2020, were a period of market opportunity due to dislocation caused by geopolitical uncertainty and pandemic. Returns for the fund supported the 5% full distribution to the systems and after years of waiver of the 2% additional return to build up the corpus of the fund the Subcommittee approved it for fiscal year 2020. Contributions continued to be muted through this period. If the Fund earns only the 10-year expected return of 4.3% in FY 2021, the 2% distribution will have a shortfall of \$215,759 even with the remaining principal balance surplus above the total Fund contributions of \$451,863.

### **Asset Allocation, Investment Managers and Performance**

The Trust Investment Account's target asset allocation is 60% fixed income securities and 40% equities, with the equity allocation being comprised of Large Cap US Equities (20%), International Equities (15%) and Emerging Market Equities (5%). As of June 30, 2020, the Account's actual allocation was in line with this target.

The Account currently utilizes four Vanguard mutual funds: Institutional Index (VINIX), Developed Markets Index (VTMNX), Emerging Markets Stock Index (VEMAX) and Total Bond Market Index (VBTIX), creating exposures to three equity asset classes and a broad range of fixed income securities. Annual fees are 5 bps. The policy benchmark was altered to mirror a more global market index in FY 2020 of 60% Bloomberg Aggregate Bond Index/40% ACWI IMI Index.

The Treasurer's Office has been mindful of the need to balance the allocation's equity and fixed-income assets given the Fund's expectation for annual distributions of 5-7% while maintaining an appropriate risk profile that preserves the principal balance. In the past, the asset allocation structure has enabled the Fund to perform reasonably well in both adverse and positive markets, reinforcing the belief in the appropriateness of a diversified structure that incorporates a downside protection allocation. **Appendix B** presents a review of historical performance for the Fund.

In fiscal year 2020, the market experienced a deep dislocation due to the beginning of a pandemic in February and March that shuttered many companies globally. The market then recovered through June, as some economies began to reopen, and central banks reacted quickly with targeted market programs to provide liquidity and spur price discovery. The 60% allocation to domestic fixed income, the Fund's downside protection, helped protect the Fund's principal during the downturn as the market experienced a flight to quality creating a sharp rally in fixed income securities. The Bloomberg Aggregate Bond Index ended the fiscal year up 8.7%. Equities experienced a deep drawdown during the 3<sup>rd</sup> fiscal quarter and the ACWI IMI Index ended the fiscal year up 1.2% after the 4<sup>th</sup> quarter proved to be the best quarter for equities in three decades up 20%. The Treasurer's Office expects the 60% allocation to fixed income securities will be strategic to the Fund's preservation of principal and downside protection in FY 2021 given the remaining market uncertainty.

### **Fund Management Philosophy**

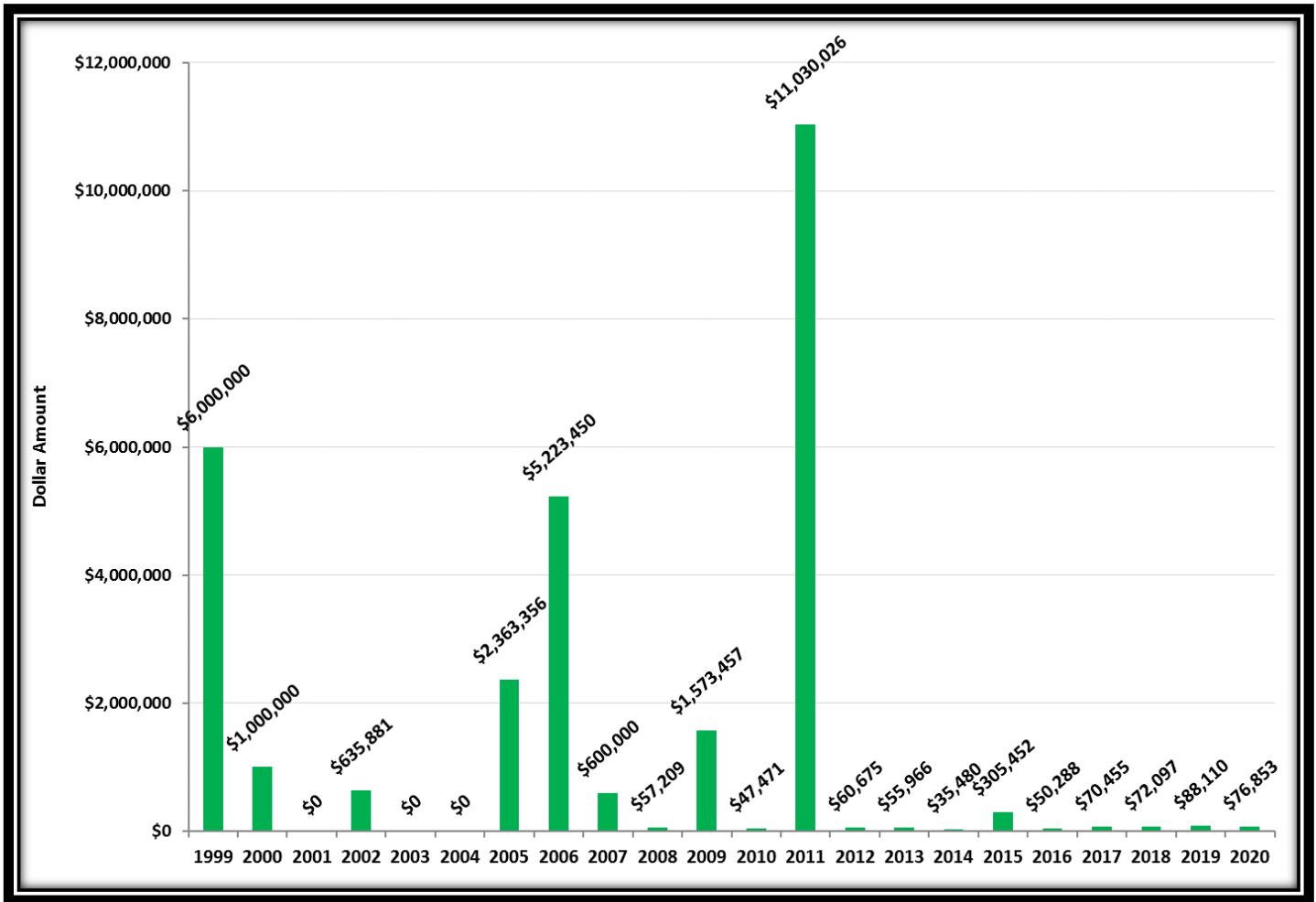
The Treasurer's office Staff believes that a dependence upon manager performance relative to benchmarks, or alpha, is counterproductive, especially for relatively established asset classes. We believe that administrative effort is better spent analyzing optimal portfolio allocations using total return, standard deviation, and correlation assumptions available from professional investment advisors, and then constructing a portfolio with the lowest expected risk relative to the Account's return objectives. This philosophy is reflected in the Fund by allocating to low-fee,

highly liquid indexing vehicles. This allows the Treasurer's Office to structure the portfolio in a manner best suited to meet the Fund's risk and return objectives.

Please feel free to contact me if you have any questions or concerns regarding this report.

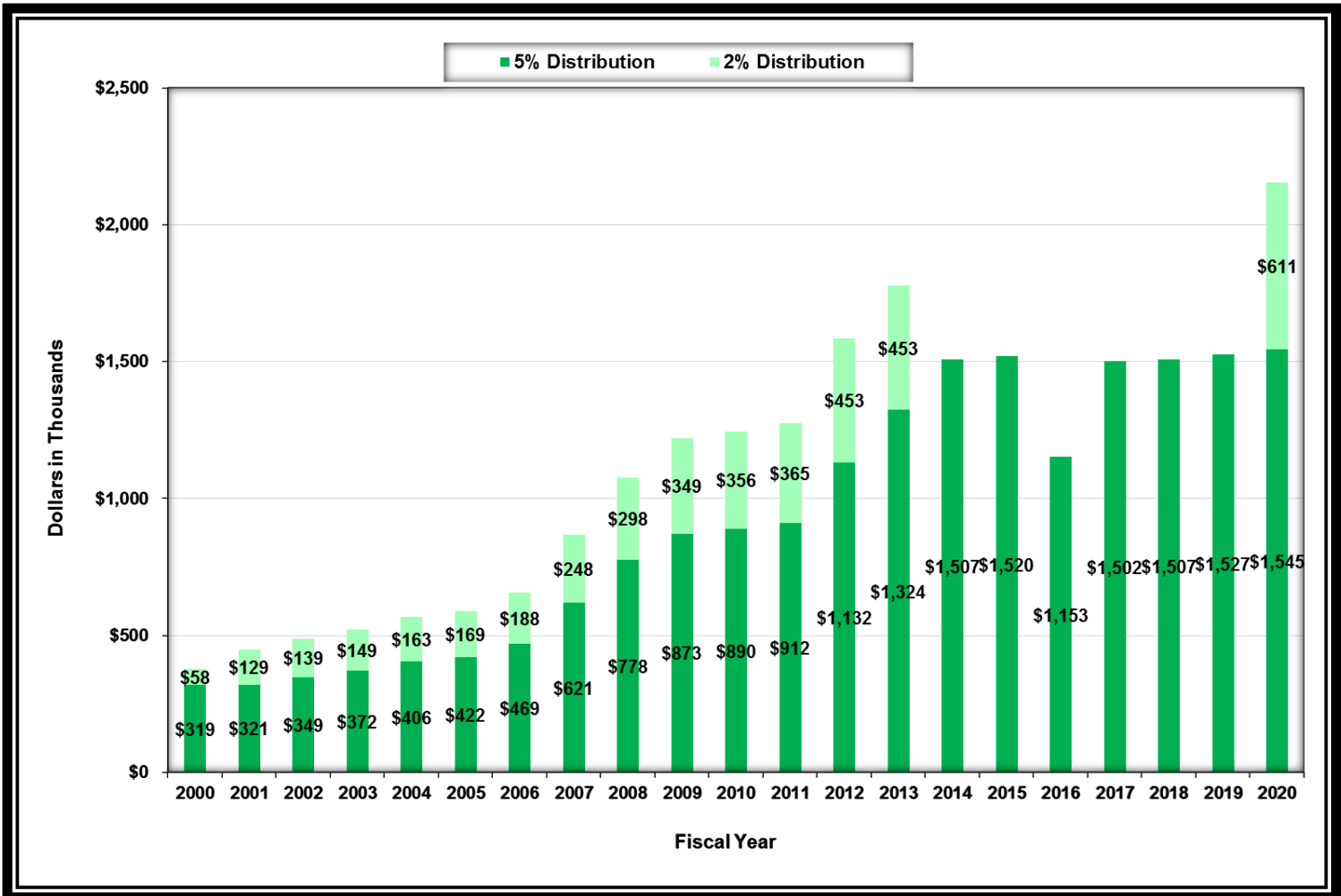
cc: Adam Greshin, Commissioner of Finance & Management  
Luke Martland, Director & Chief Legislative Counsel  
Rebecca Wasserman, Legislative Counsel

**Chart #1**  
**Higher Education Trust Fund**  
**Fund Contributions (fiscal years) \***



\* Amounts from prior year reports have been realigned by fiscal year on an accrual basis to correspond to fund operating results and may vary from cash transaction dates in previous reports.

**Chart #2**  
**Higher Education Trust Fund**  
**Authorized Distributions by Year and Type**

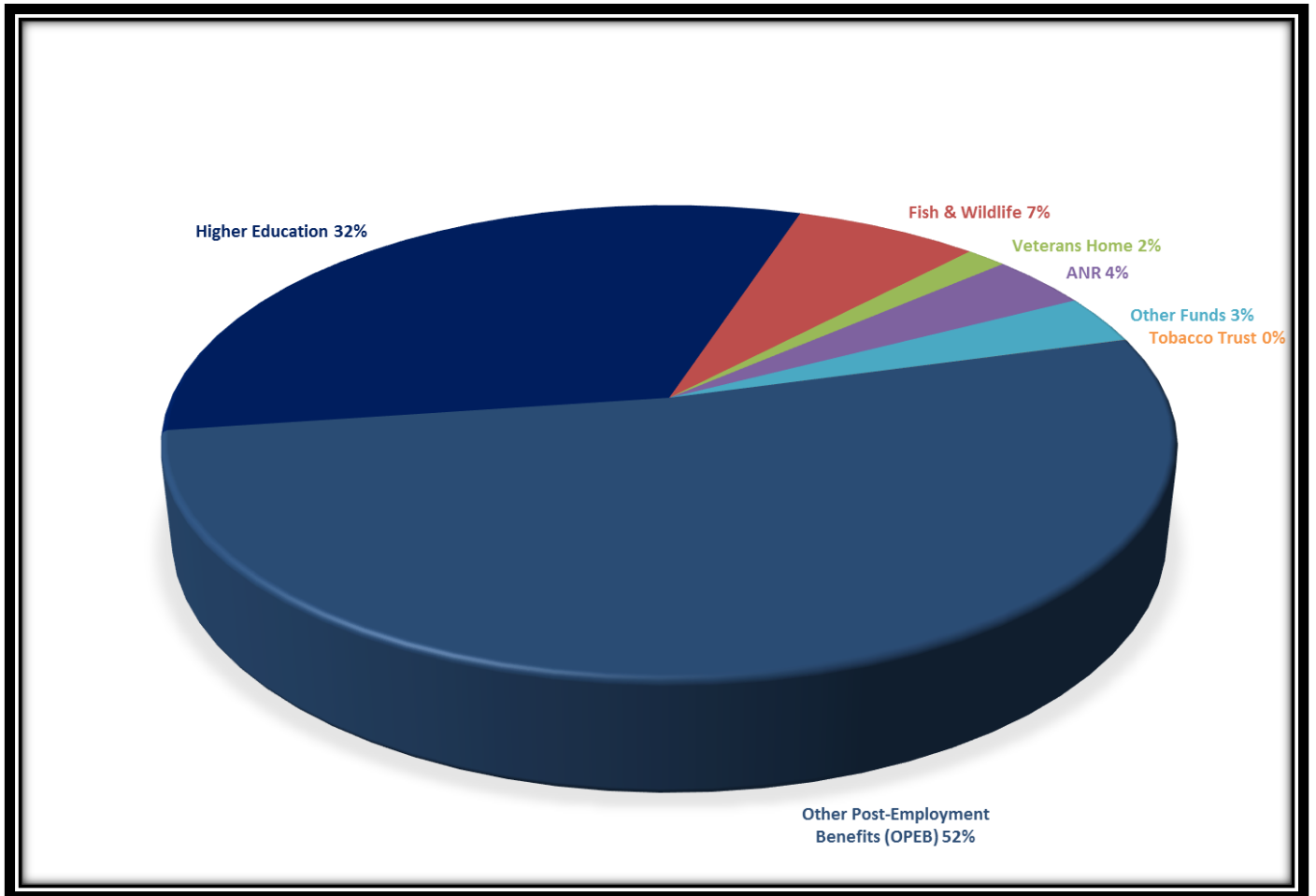


<sup>1</sup> In 2008, the 2% distribution was reduced by \$12,737 to the amount listed to maintain the principal balance above the total contributions.

<sup>2</sup> Due to the expected low market return environment, in years 2014 – 2019 the Subcommittee chose to withhold the 2% distribution and instead reinvest the funds into the principal balance to maintain a more consistent 5% distribution in the future.

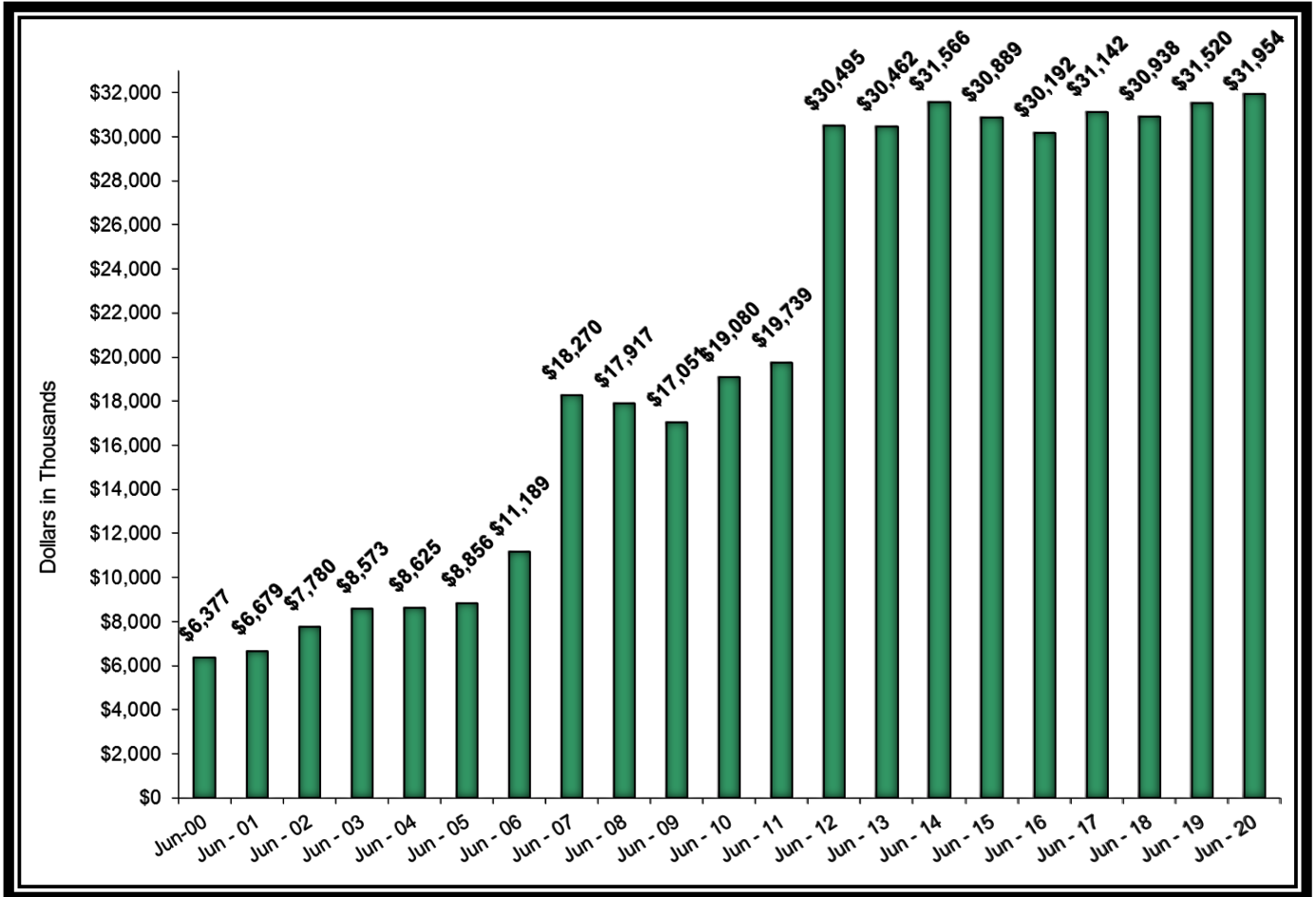


**Chart #3**  
**Trust Investment Account Fund Compositions**  
**As of June 30, 2020**



*Please note that chart totals may not sum to 100% due to rounding.*

Chart #4  
**Higher Education Trust Fund Asset Level**  
**6/30/2000 to 6/30/2020**  
(Includes Distributions)



**APPENDIX B**

Higher Education Trust Fund	Portfolio Value	Portfolio Allocation	QTD	1 Year	3 Year	5 Year	7 Year	10 Year	Fiscal Year End Returns				
									2019	2018	2017	2016	2015
Fund Return	31,954,154		8.8%	6.2%	5.7%	5.3%	5.5%	5.8%	6.9%	4.1%	6.7%	2.5%	2.4%
Vanguard Institutional Index Fund (VINIX)	6,610,691	21%	20.5%	7.5%	10.7%	10.7%	12.1%	14.0%	10.4%	14.3%	17.9%	4.0%	7.4%
Vanguard Developed Markets Index Fund (VTMNX)	4,723,961	15%	17.5%	-4.2%	0.9%	2.1%	4.6%	6.3%	0.0%	7.3%	18.0%	-8.5%	-0.2%
Vanguard Emerging Markets Stock Index Fund (VEMAX)	1,455,993	5%	19.9%	-2.9%	2.1%	2.2%	3.1%	3.2%	3.2%	6.3%	18.9%	-12.1%	-2.4%
Vanguard Total Bond Market Index Fund (VBTIX)	19,162,773	60%	3.0%	8.9%	5.3%	4.3%	3.9%	3.8%	7.9%	-0.5%	-0.4%	6.1%	1.7%

\* As of 06/30/2020

Totals may not sum to 100% due to rounding.