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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 *Beth*

**RE:** Annual Report on the Higher Education Trust Fund

**DATE:** September 15, 2019

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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 2019, the Fund's investment return was 6.9% net of fees.

**5% Distribution based on Fiscal Year 2019 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 latter condition cannot be met, the distribution must be reduced accordingly. Principal contributions through June 30, 2019 totaled \$29,269,374. The total 5% distribution available this year is \$1,527,166 or \$509,055 each for UVM, the Vermont State Colleges, and VSAC. **Appendix A** to this report includes quarterly market values and distributions for fiscal year 2019, and **Chart #1** shows principal contributions to date.

**2% Distribution based on Fiscal Year 2019 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 September 14, 2018 meeting, the Secretary and the Subcommittee decided to forgo this 2% distribution for FY 2020 to UVM and the Vermont State Colleges, based upon recognition that lower expected returns in the near term did not support a total distribution of 7% from the Fund. The 2% distribution has been reinvested in the Fund to bolster the balance available for future distributions.

**Fund Balances**

After payments of \$1,527,166.44, the Fund balance at the end of fiscal year 2019 totals \$29,993,106. An accounting of the Fund balance is provided below:

<b>Ending balance FY 2018</b>	<b>\$30,937,547</b>
<hr/>	
FY 2018 Contributions received in FY 2019	\$72,097
<b>Opening balance FY 2019</b>	<b>\$31,009,644</b>
<b>Distributions FY2018</b>	
5%: <i>University of Vermont</i>	(\$502,266)
<i>Vermont State Colleges</i>	(\$502,266)
<i>Vermont Student Assistance Corp.</i>	(\$502,266)
2%: <i>University of Vermont</i>	\$0
<i>Vermont State Colleges</i>	\$0
Income earned FY 2019	\$1,086,447
Appreciation (Depreciation) FY 2019	\$934,722
Fees and Other Charges FY 2019	(\$3,741)
<b>Principal Balance June 30, 2019 <sup>3</sup></b>	<b>\$31,520,273</b>
<b>Statutory Distributions Available <sup>1</sup></b>	
5% of 12-Quarter Moving Average as of June 30, 2019	(\$1,527,166)
2% of 12-Quarter Moving Average as of June 30, 2019	(\$602,720)
<b>Total Projected Statutory Distribution</b>	<b>(\$2,129,886)</b>
Balance After Projected Statutory Distribution	\$29,390,387
Total Contributions Received as of June 30, 2019	\$29,269,374
<b>Principal Balance Shortfall After Projected Statutory Distribution</b>	<b>\$0</b>
<b>Adjustments to Distributions Due to Shortfall</b>	
5% Distribution Adjusted (0.00%)	(\$1,527,166)
2% Distribution Adjusted (0.00%) <sup>2</sup>	(\$602,720)
<b>Total Available Distribution Adjusted as needed to Maintain the Principal Balance Floor as Required by Statute</b>	<b>(\$2,129,886)</b>
<b>Actual Distributions for 2019</b>	
5% Distribution	\$1,527,166
2% Distribution <sup>2</sup>	\$0
	<b>\$1,527,166</b>
<b>Principal Balance after distributions</b>	<b>\$29,993,106</b>
Fundraising target for potential 2% distribution in 2021 <i>(Contingent on an institutional match in FY 2020 and Principal Balance greater than the total Contributions)</i>	\$610,867

<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 elected to forego the 2% distribution for the fiscal year

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

## **2% Distribution based on Fiscal Year 2019 balances to be voted on for FY 2020 fundraising**

All principal contributions to the Fund through June 30, 2019 total \$29,269,374, which also represents the minimum balance that must be maintained in the Fund. The 2% distribution proposed as a fundraising target for FY 2020 is \$610,867. 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 \$305,433 with a required match to be raised by each entity in FY 2020 of \$610,867. To re-emphasize, any distribution a year from now is dependent upon the Fund's balance being greater than \$29,269,374 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 \$31.5 million comprises approximately 46%. The State Employees' Other Post-Employment Benefits fund comprises 33% of the account, or \$23 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 2019. In examining the intermediate term period there is a tale of two halves. Fiscal years 2009-2011 were marked by large contributions and strong performance, which easily allowed for the 5% distribution to the systems. The years that followed, fiscal years 2012-2019, have experienced compressed fixed income returns due to global central banks' policies that have diminished overall return potential across all asset classes. As a result, given the 60% allocation to fixed income securities in the TIA asset allocation, the five-year annualized return during this period has dipped below the necessary 5% for a full distribution to the systems. These results are in line with broad global market performance. The office continues to assess the asset allocation prudently over time and in the near term anticipates the policy will remain unchanged.

## **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, 2019, 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 is 60% Bloomberg Aggregate Bond Index/40% S&P 500 Index.

Historically, the Account achieved modest positive returns in both FY 2008 and FY 2009, during some of the worst financial market conditions since the 1930s and has achieved adequate returns to fund required distributions. 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 while maintaining an appropriate risk profile. 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. **Appendix B** presents a review of performance during the past fiscal year.

In fiscal year 2019 domestic securities outperformed their international counterparts. Global growth slowed as trade tensions materialized. The Federal Reserve reacted by indicating a pause to its federal funds target rate increase program in late fiscal year 2019. Domestic fixed income securities experienced a boost as the markets had a flight-to-quality in November 2018 and the rally continued as the Treasury yield curve compressed on an expectation for a fed funds target rate reduction. Fixed income securities lower the Fund's risk profile given their historically low correlation to equity markets and low standard deviation relative to other asset classes. The fixed income allocation in the Fund is entirely domestic and over the last two fiscal years has faced headwinds as the Federal Reserve maintained a slow and steady rate increase program. The end of fiscal year 2019 saw a pause in this decision and the market priced in an expectation for a small Fed funds target reduction that boosted fixed income security prices. As noted in last year's report, geopolitical uncertainty and softness in a variety of global macroeconomic factors suggest that Central Banks worldwide are inclined to be cautious when increasing interest rates in the coming years. The domestic benchmark for fixed income securities, the Bloomberg Aggregate Bond Index, ended the fiscal year up 7.9%.

Similarly, after a sharp decline in December 2018, domestic equity securities increased steadily the second half of the fiscal year to finish up 10.4%. This rally was supported by domestic corporate earnings outpacing expectations and the increased probability for a Federal Reserve target rate reduction enabling corporations to continue to borrow at low rates. The Fund's exposure to international equities detracted from the total return for FY 2019; however, the exposure was additive in FY 2017 and FY 2018. Developed international countries experienced slow economic growth as a negative externality from the US/China trade tensions in FY 2019. This diversifying position is expected to help reduce the overall volatility in the Fund's equity allocation over the long run.

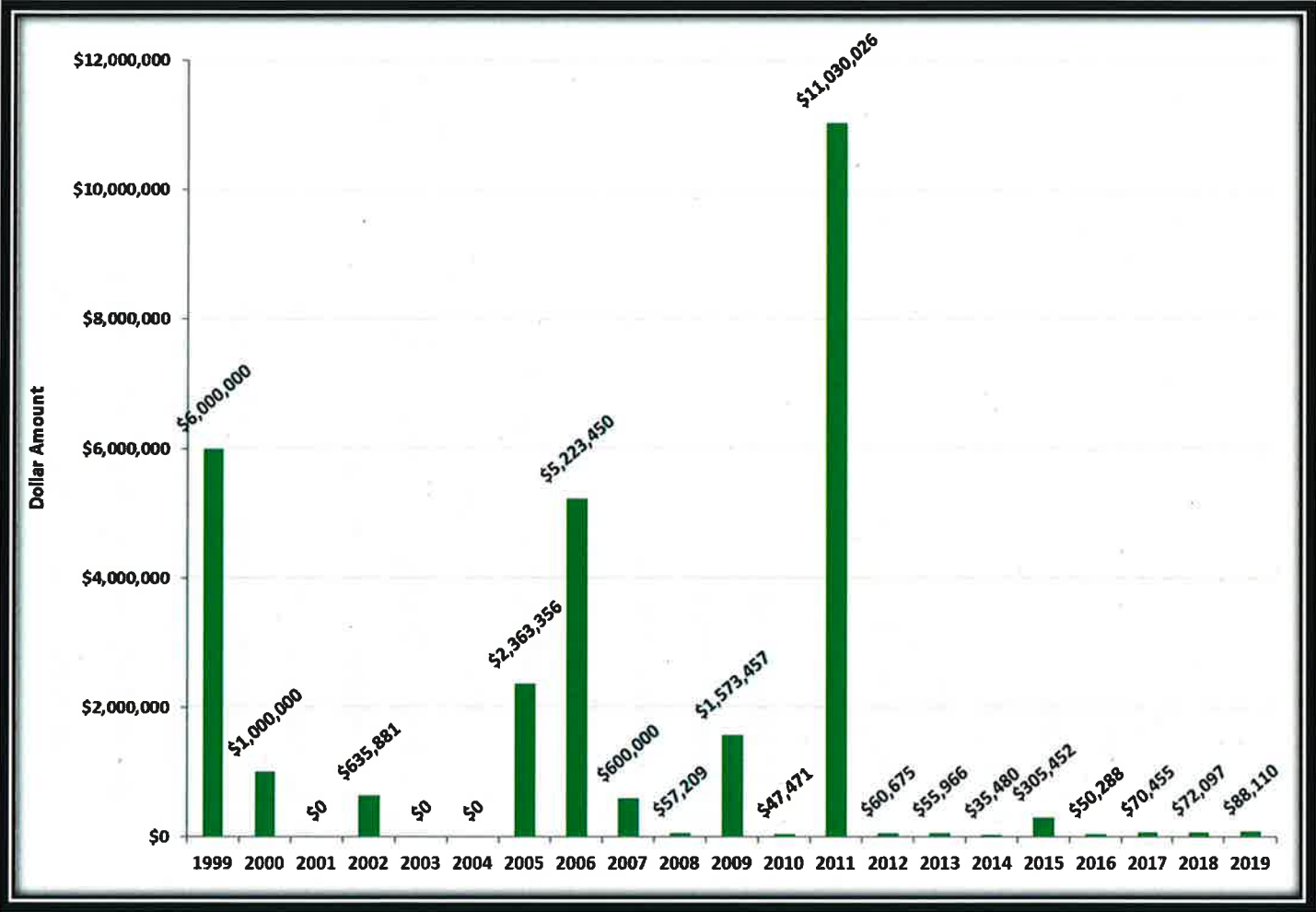
**Fund Management Philosophy**

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.

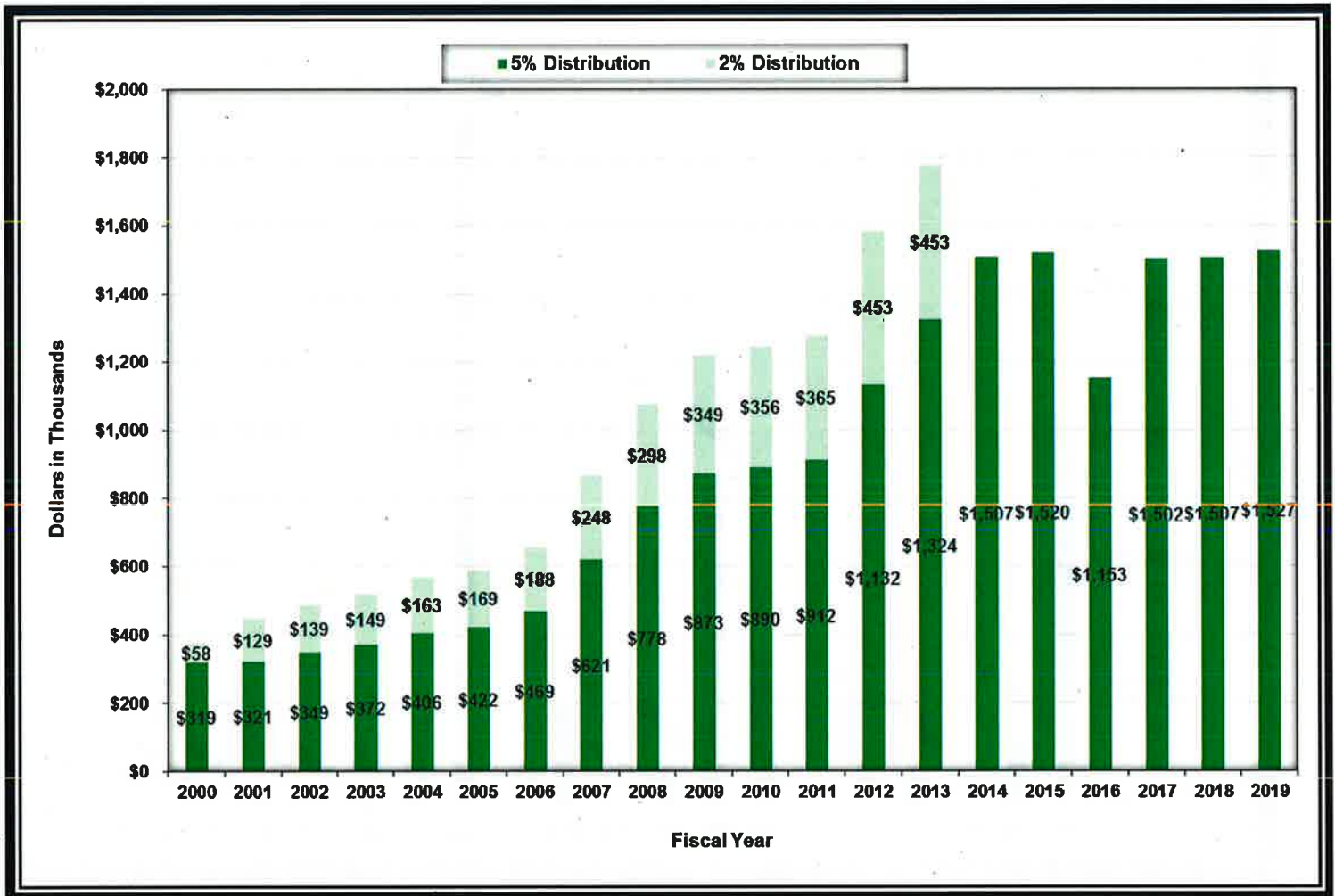
cc: Adam Greshin, Commissioner of Finance & Management  
Luke Martland, Director & Chief Legislative Counsel  
Rebecca Wasserman, Legislative Counsel

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

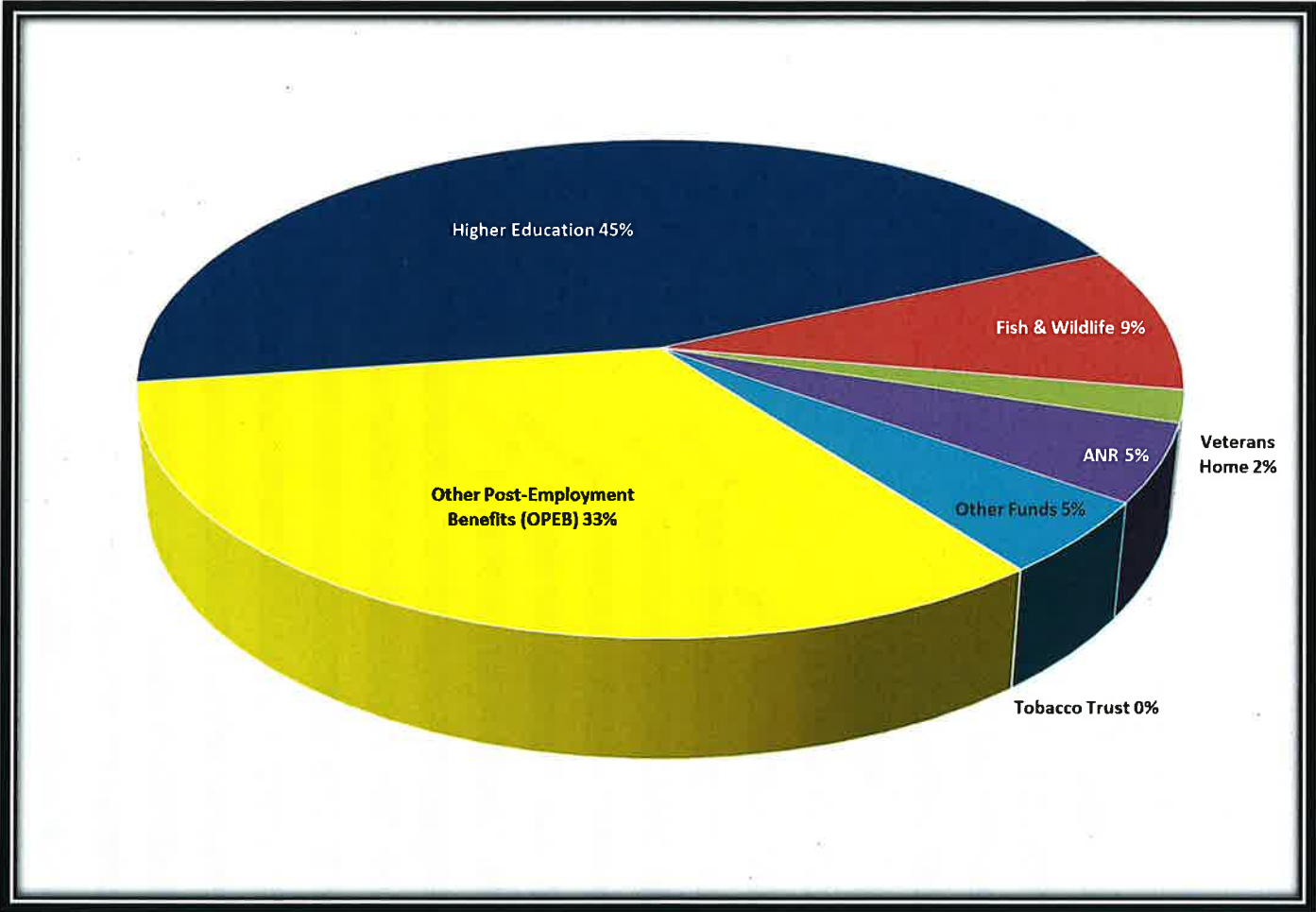


<sup>1</sup> In 2008, the 2% distribution was reduced by \$12,737 to the amount listed to maintain the principal balance above the total contributions.

<sup>2</sup> Due to the expected low market return environment, in years 2014 – 2018 the Sub-Committee 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.

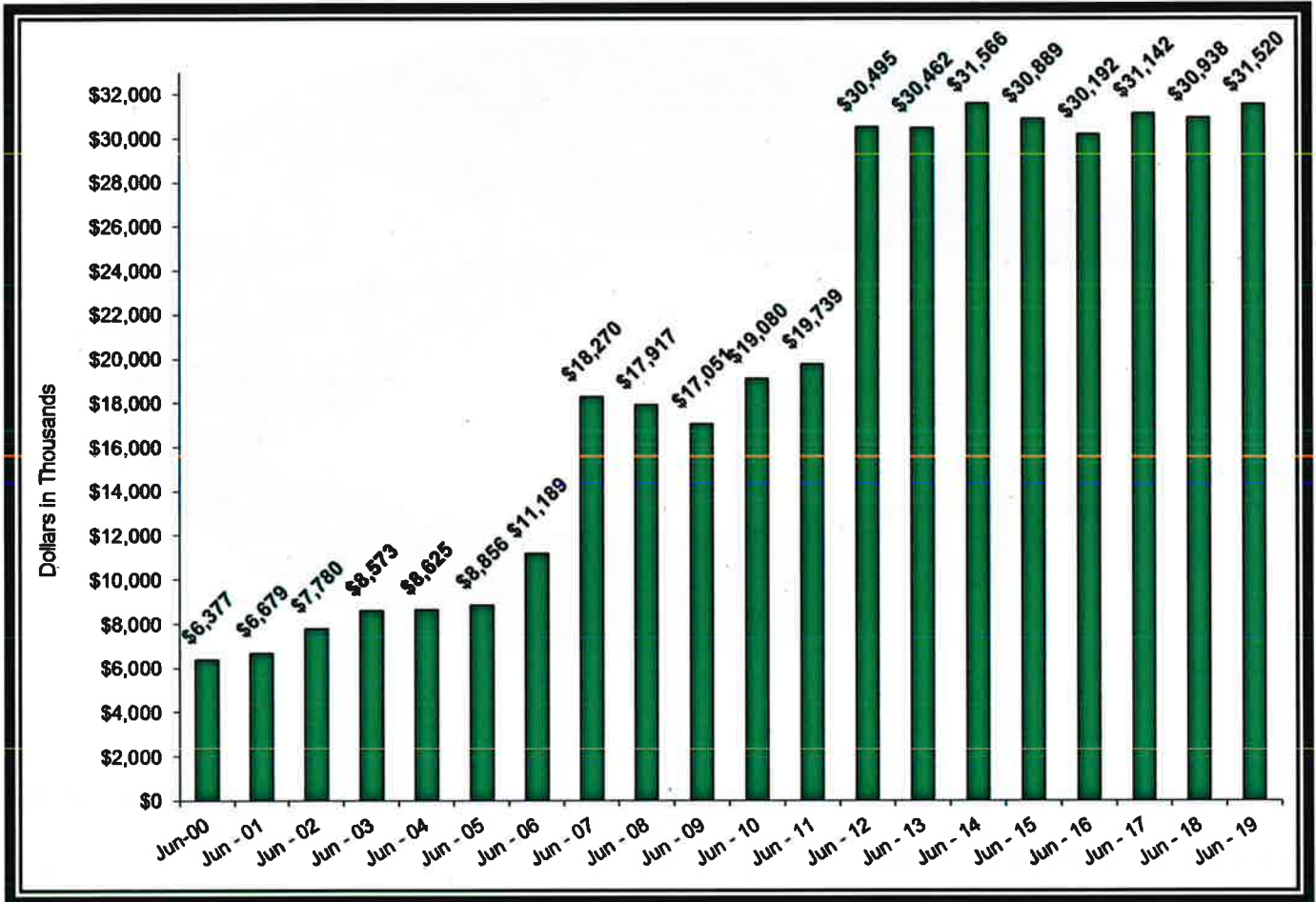


**Chart #3**  
**Trust Investment Account Fund Compositions**  
**As of June 30, 2018**



*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 6/30/2018**  
(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				
									2018	2017	2016	2015	2014
<i>Fund Return</i>	31,520,273		3.2%	6.9%	5.9%	4.5%	5.4%	6.1%	4.1%	6.7%	2.5%	2.4%	9.9%
<i>Vanguard Institutional Index Fund (VINIX)</i>	6,447,660	20%	4.3%	10.4%	14.2%	10.7%	14.0%	14.7%	14.3%	17.9%	4.0%	7.4%	24.5%
<i>Vanguard Developed Markets Index Fund (VTMNX)</i>	4,709,778	15%	3.3%	0.0%	8.2%	3.0%	7.8%	7.3%	7.3%	18.0%	-8.5%	-0.2%	23.5%
<i>Vanguard Emerging Markets Stock Index Fund (VEMAX)</i>	1,638,820	5%	0.7%	3.2%	9.3%	2.3%	3.6%	5.6%	6.3%	18.9%	-12.1%	-2.4%	14.1%
<i>Vanguard Total Bond Market Index Fund (VBTLX)</i>	18,724,226	59%	3.1%	7.9%	2.2%	2.9%	2.6%	3.8%	-0.5%	-0.4%	6.1%	1.7%	4.3%

\* As of 06/30/2019

Totals may not sum to 100% due to rounding.

