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

TO: Kristin Clouser, Secretary of Administration, and the
Higher Education Subcommittee of the Prekindergarten-16 Council

FROM: Beth Pearce, State Treasurer

RE: Annual Report on the Higher Education Trust Fund

DATE: January 4, 2023

Below is the State Treasurer's annual report on the Higher Education Trust Fund ("the Fund") to the Secretary of Administration and the Higher Education Subcommittee ("Subcommittee") of the Prekindergarten-16 Council.

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, the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885).

Performance Summary

This was a difficult year and I wish I could provide you better news. As many of you are aware, the markets have been extremely volatile, but with a downward trend, especially during the last quarter of fiscal year. Rapid inflation, supply chain difficulties and the actions by the Fed, have all worked to feed negative performance.

During fiscal year 2022, the Fund's investment return was -12.5% net of fees.

5% Distribution Based on Fiscal Year 2022 Balances

The statute provides that in each fiscal year, the State Treasurer is to distribute up to 5% of the 12-quarter moving average of the Fund's assets equally between the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation (VSAC); however, the amount distributed cannot exceed the sum that would bring the fund balance below total contributions made to the principal balance. Principal contributions through June 30, 2022, totaled \$33,134,015. Since the balance if a distribution was to be made is less than that amount, the full 5% distribution is not available. **Chart #1** displays the principal contributions to date.

2% Distribution based on Available Fiscal Year 2021 Balances

No distributions are available. As a matter of background, Vermont statutes (16 V.S.A. § 2885) further provide that, the Secretary of Administration and the Council may authorize the State Treasurer to make an additional distribution of up to 2% of the Fund's 12-quarter moving average of assets to the University of Vermont and the Vermont State Colleges. This distribution is contingent on meeting two criteria. First, the amount distributed cannot exceed an amount that, in addition to the 5% distribution, would bring the fund balance below the total accumulated contributions to principal. Second, the distribution is contingent upon the institution's match of private donations of at least twice the 2% amount and certification to the Commissioner of Finance and Management that the institution received private donations in the requisite amount, and that the funds will indeed be used to create or increase a permanent endowment. As the first criteria has not been met, the second does not come into play. **Chart #2** provides a history of authorized distributions.

Fund Distributions

Chart #3 of this report presents the components of the entire Trust Investment Account (TIA), of which the Higher Education Trust Fund, with a balance of \$31.3 million accounts for 20% of the total. The Teacher and State Employees' Other Post-Employment Benefits (OPEB) funds comprise 70% of the TIA, or \$110.1 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.

While the OPEBs comprise the vast majority of the TIA assets as of June 30, 2022, most of these dollars have been transferred to the two OPEB funds. During this past legislative session, legislation was enacted to prefund OPEBs. These funds will be accumulating assets and will be invested in fund structures similar to pensions.

Fund Balances

The fund balance at the end of fiscal year 2022 totals \$31,428,584. An accounting of the fund balance is provided below:

Ending balance FY 2021	\$38,100,187
FY 2021 Contributions received in FY 202022	\$0
Opening balance FY 2022	\$38,100,187
Distributions FY2022	
5%: <i>University of Vermont</i>	(\$528,318)
<i>Vermont State Colleges</i>	(\$528,318)
<i>Vermont Student Assistance Corp.</i>	(\$528,318)
2%: <i>University of Vermont</i>	(\$309,040)
<i>Vermont State Colleges</i>	(\$309,040)
Income earned FY 2022	\$721,733
Accrued Unclaimed Property 2022	\$109,960
Appreciation (Depreciation) FY 2022	(\$5,296,189)
Fees and Other Charges FY 2022	(\$4,064)
Principal Balance June 30, 2022	\$31,428,594
Statutory Distributions Available ¹	
5% of 12-Quarter Moving Average as of June 30, 2022	(\$1,646,350)
2% of 12-Quarter Moving Average as of June 30, 2022	(\$658,540)
Total Projected Statutory Distribution Potentially Available	(\$2,304,890)
Projected Balance After Potential Statutory Distribution	\$29,123,704
Threshold for Distributions (Contributions Accrued as of June 30, 2022)	\$33,134,015
Principal Balance Shortfall After Projected Statutory Distribution	(\$4,010,311)
Actual Distributions for FY 2022	
5% Distribution Adjusted	\$0
2% Distribution Adjusted	\$0
	\$0
Principal Balance after distributions	\$31,428,594
<i>Numbers may not add due to rounding</i>	

Asset Allocation, Investment Managers and Performance

The TIA's target asset allocation is 50% fixed income securities and 50% equities, with the equity allocation being comprised of Large Cap US Equities (25%), International Equities (18.75%) and Emerging Market Equities (6.25%). As of June 30, 2022, the TIA's actual allocation was 52% fixed income and 48% equities. Given market volatility these are within a reasonable degree of tolerance and are rebalanced on a periodic basis as needed.

TIA currently utilizes four Vanguard index 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 changed this past year from 40% equities and 60% fixed income to mirror a more global market index in fiscal year 2021 of

50% Bloomberg Aggregate Bond Index and 50% ACWI IMI Index. **Chart #4** presents a review of historical performance for TIA for each index fund.

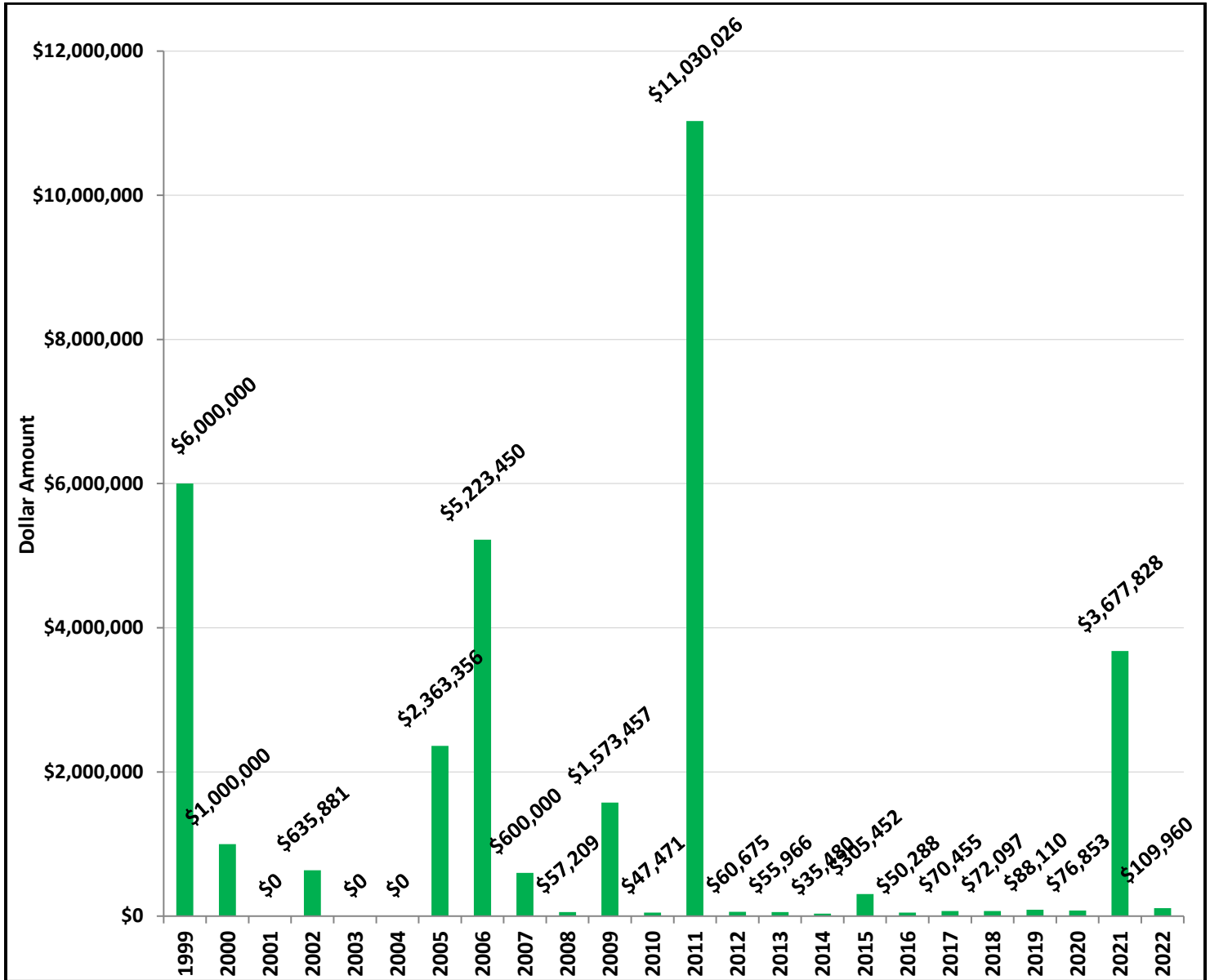
Bond index funds are an important part of a diversified portfolio such as the TIA. They provide a reliable source of income and generally have less volatility than equities. For the most part they have historically provided a buffer or downside protection. That was not the case this past year. Historically low interest rates were followed by rapid rises in inflation. In fact, looking back at various bond indices, the current performance, continuing into this past Fall, is likely the worst in history of these markets. While there are some indications that calendar year 2023 may see some improvement, a great deal is dependent on what is in store with inflation. The short term outlook is that volatility will continue in the whole range of financial markets. The Treasurer's Office will weigh minor changes in asset allocations, but maintaining a diversified portfolio remains the best practice.

Fund Management Philosophy

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

cc: Adam Greshin, Commissioner of Finance & Management
Catherine Benham, Joint Fiscal Office
Rebecca Wasserman, Legislative Counsel

Chart #1
**Higher Education Trust Fund
Contributions by Fiscal Year ***



*Beginning with the 2021 report, contributions from prior year reports were 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

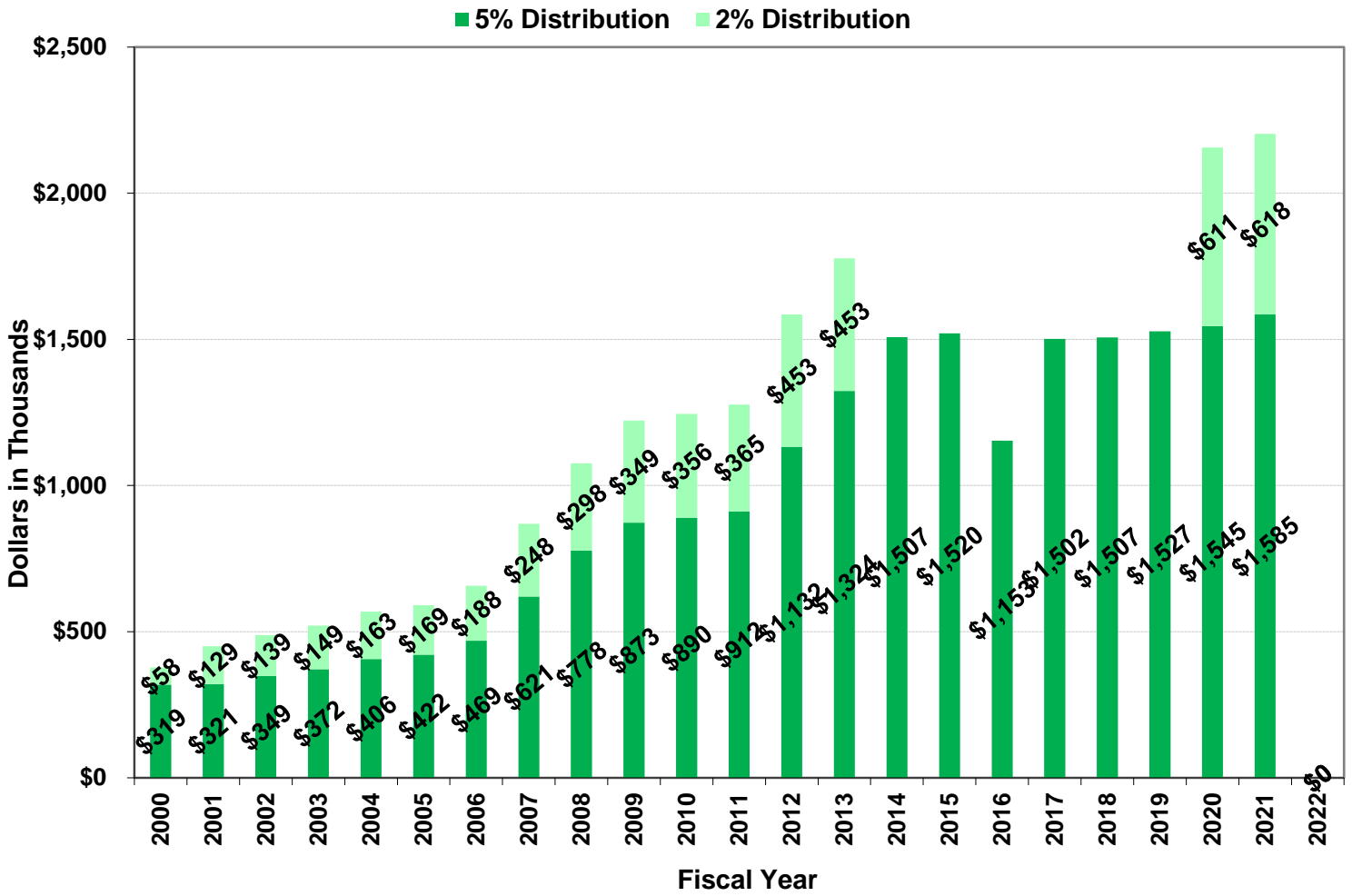
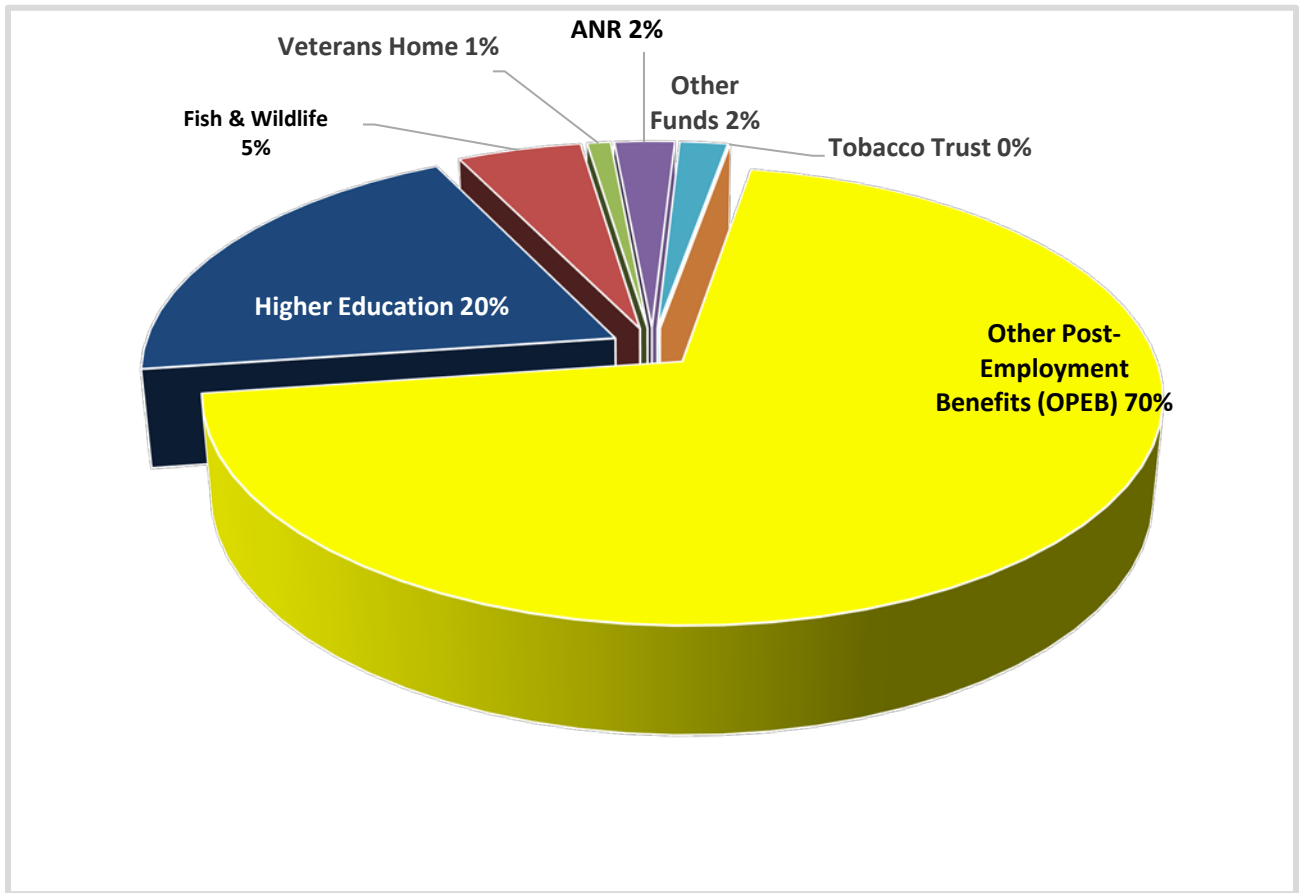


Chart #3
Trust Investment Account Fund Composition
As of June 30, 2022



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

Chart #4 Trust Investment Account Performance

TRUST INVESTMENT ACCOUNT (current as of June 2022)

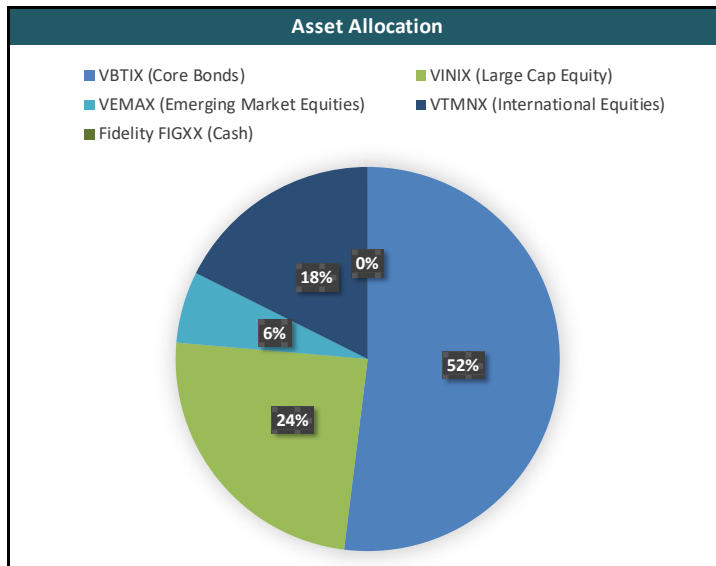
		Trailing Annualized Returns														
Actual_RT	MTD	Prev Qtr	Fiscal YTD	1 YR	3 YRS	5 YRS	7 YRS	10 YRS	Std Dev ⁺	2022	2021	2020	2019	2018	2017	
Actual_RT	-4.9%	-9.7%	-12.5%	-12.5%	2.2%	3.5%	3.8%	4.4%	8.6%	-12.5%	14.9%	6.2%	6.9%	4.1%	6.7%	
VTMNX	Vanguard Developed Markets Index	-9.6%	-14.0%	-18.1%	-18.1%	2.1%	2.7%	3.1%	6.1%	18.4%	-18.1%	35.8%	-4.2%	0.0%	7.3%	18.0%
VINIX	Vanguard Institutional Index	-8.3%	-16.1%	-10.7%	-10.7%	10.6%	11.3%	11.1%	12.9%	18.4%	-10.7%	40.8%	7.5%	10.4%	14.3%	17.9%
VEMAX	Vanguard Emerging Markets Stock Index	-4.4%	-9.2%	-21.1%	-21.1%	2.0%	3.1%	2.8%	3.2%	17.5%	-21.1%	38.7%	-2.9%	3.2%	6.3%	18.9%
VBTIX	Vanguard Total Bond Market Index	-1.5%	-4.7%	-10.4%	-10.4%	-0.9%	0.9%	1.4%	1.5%	4.7%	-10.4%	-0.4%	8.9%	7.9%	-0.5%	-0.4%

* Past performance is no guarantee of future results

** Net fiscal returns for Vanguard Funds

***10/2013 - 11/2013 were transitional periods during a TIA restructuring period

+ Standard Deviation calculated from trailing 36-month fund returns



Portfolio Characteristics

Net Assets	\$157,272,877
Fixed Income (\$)	\$81,729,828
Equities (\$)	\$75,539,022
Cash (\$)	\$4,027
Current Fee	0.05%
Rolling 12m Return	-12.5%
Rolling 12m Std Dev	8.7%