



THE STATE  
*of* **ALASKA**  
GOVERNOR MIKE DUNLEAVY

# Power Cost Equalization Fund

## Investment Summary



May 2023

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Alaska Department of Revenue

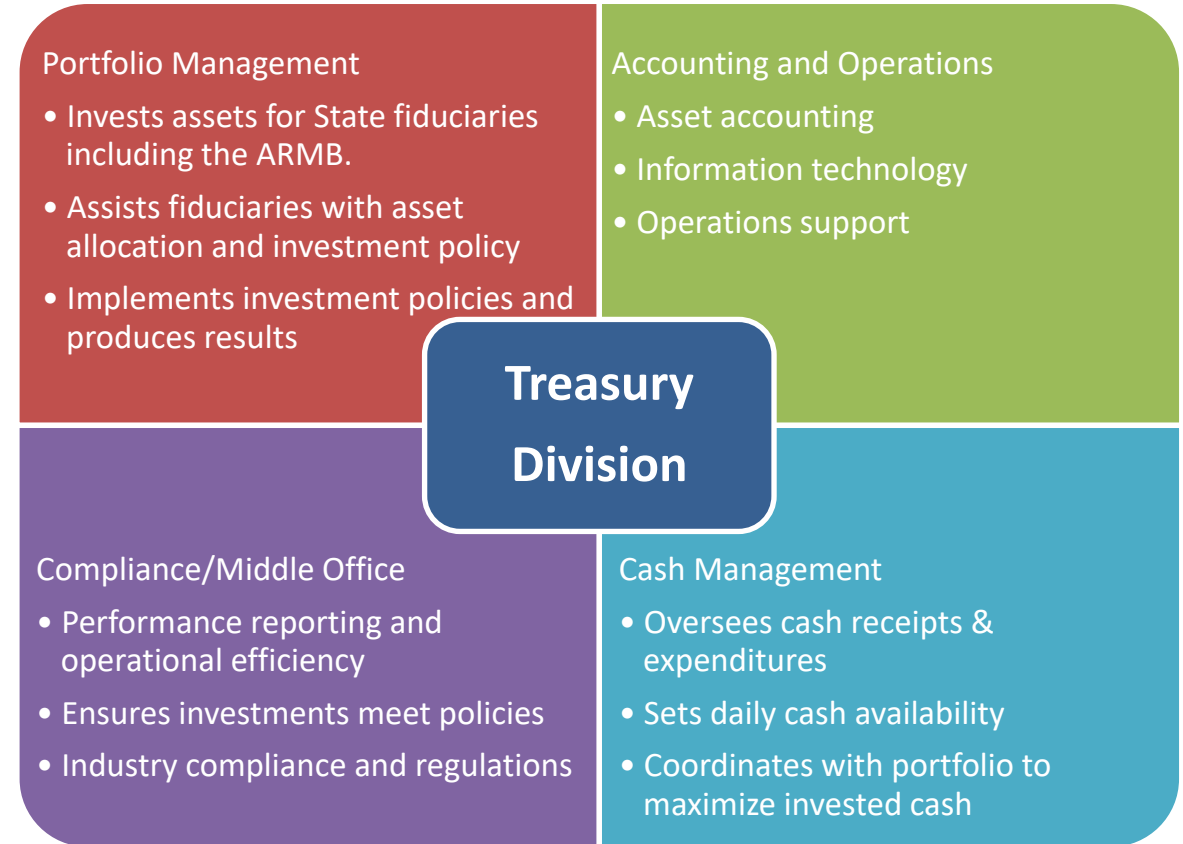
# Power Cost Equalization Investment Discussion

## Treasury Division:

- The Treasury Division is managed by 40 professionals in portfolio management, accounting, operations, compliance, and cash management
- The Division helps state fiduciaries achieve investment objectives and manage risks
- \$49 billion in assets managed as of 3/31/23:
  - Alaska Retirement Management Board - \$39.5 Billion
  - Commissioner of Revenue/SOA - \$9.4 Billion

## Power Cost Equalization Investment Discussion Agenda:

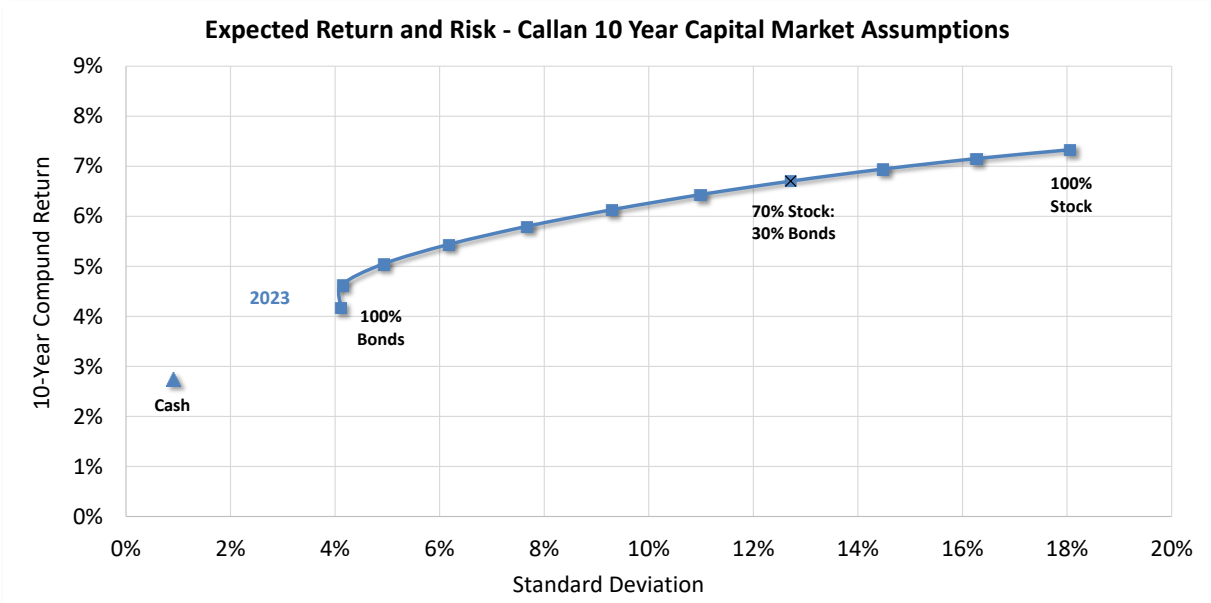
- Investment Policy and Asset Allocation
- Investment Performance through March 31, 2023
- Summary



# State Investment Policy and Asset Allocation Process

- The Commissioner of Revenue is the fiduciary for over \$9 billion in state assets across 100+ accounts pooled into 26 funds with similar assets or mandates.
- Setting investment policies and asset allocations are key fiduciary duties for these funds.
- Treasury staff reviews and makes recommendations on the investment policy and asset allocation of each fund at least annually.
- Each investment program is designed to balance fund investment objectives, risk tolerance, and other attributes:
  - Time horizon
  - Nominal or real return objectives
  - Cashflows, liquidity, and income needs
  - Capacity for loss or volatility over short, medium, and longer time horizons
- **Performance, investment policy, and asset allocations are discussed quarterly in a transparent process with an independent investment advisory committee.**

Fund - Account	Assets (3/31/23)	Risk Tolerance
Short-Term Funds	\$166,162,708	Low ↓
CBRF - AY19	\$2,586,837,529	
GeFONSI - AY01	\$1,754,167,850	
International Airport - AY04	\$175,637,757	
GeFONSI II - AY3F	\$1,629,558,666	
Retiree LTC - AY11	\$733,267,140	High/Endowment
PCE Endowment - AY13	\$978,815,684	
Public School Trust Fund - AY08	\$735,385,732	
AK Higher Education - AY3L	\$366,532,446	
Illinois Creek Mine - AY9J	\$1,324,961	
Education Endowment - AY3G	\$988,439	
Total	\$9,128,678,912	



# PCE Investment Policy is Based on Statute

- By statute, the DOR Commissioner is directed to:
  - Apply the prudent-investor rule.
  - Invest the assets of the fund considering the preservation of purchasing power over time.
  - Maximize the expected total return.
- PCE uses 3-year asset smoothing to dampen spending volatility.
- Investment objectives and risk assessment:
  - PCE can adopt a high risk-tolerance since it has a long time-horizon and liquidity needs are manageable.
  - To maximize total expected return and consider the preservation of purchasing power, Treasury staff recommends targeting the level of risk of a 70% domestic equity, 30% core bond portfolio.
- FY2024 asset allocations are in the process of being finalized. PCE is likely to have a ten-year expected return of 6.8% and an expected real return after inflation of 4.3%. Both are similar to historical PCE performance.

**AY13: FY2024 PCE Endowment Investment Policy Statement**

AS 42.45.080 as amended, directs the commissioner to apply the prudent-investor rule and invest the assets of the fund considering preservation of the purchasing power of the fund over time while maximizing the expected total return from both income and appreciation.

Investment Topic	FY24 Draft Policy																		
Investment Objective	Returns require relatively high exposure to principal loss in return for higher expected longer-term returns. Moderate current income requirement. Long-term inflation protection expectation.																		
Risk Tolerance	High																		
Policy Risk/Loss Range	>10%																		
Time Horizon	Long																		
Asset Allocation	<table><tr><td>Broad U.S. Equity</td><td>39%</td><td>± 5%</td></tr><tr><td>International Equity</td><td>25%</td><td>± 5%</td></tr><tr><td>U.S. REITs</td><td>5%</td><td>± 3%</td></tr><tr><td>Core U.S. Fixed Income</td><td>30%</td><td>± 5%</td></tr><tr><td colspan="3"><i>*may include up to 7% in tactical fixed income</i></td></tr><tr><td>Cash Equivalents</td><td>1%</td><td>- 1%/+2%</td></tr></table>	Broad U.S. Equity	39%	± 5%	International Equity	25%	± 5%	U.S. REITs	5%	± 3%	Core U.S. Fixed Income	30%	± 5%	<i>*may include up to 7% in tactical fixed income</i>			Cash Equivalents	1%	- 1%/+2%
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Cash Equivalents	1%	- 1%/+2%																	
Expected Return - Long-Term	6.83%																		
Expected Return - Real/After Inflation	4.33%																		
Risk - Standard Deviation	12.65%																		
Probability of Loss - 1 Year	29.5%																		
10% Probable Downside Return	15.4%																		



# Capital Market Performance Update

- Investment performance was challenging for both stocks and bonds in 2022.
- U.S. Fixed Income was down 13% and U.S. Equities were down 19%, in 2022, which led to historically difficult conditions for balanced stock and bond portfolios.

Asset Mix	2022 Return
Cash Only	1.5%
<b>U.S. Bonds Only</b>	<b>-13.0%</b>
20% Stock/80%Bond	-14.2%
40% Stock/60%Bond	-15.5%
60% Stock/40%Bond	-16.7%
<b>70% Stock/30%Bond</b>	<b>-17.3%</b>
80% Stock/20%Bond	-18.0%
<b>U.S. Stocks Only</b>	<b>-19.2%</b>

- Losses were concentrated in the first half of the year and markets rebounded modestly in the second half – particularly in the 4<sup>th</sup> quarter.
- Most asset classes continued to recover in the first quarter of 2023 led by equity investments.

2018	2019	2020	2021	2022	2022-Half1	2022-Half2	FY23 YTD	2023-Q1
Cash Equivalents 1.9%	Broad U.S. Equity 31.0%	Broad U.S. Equity 20.9%	REITs 41.3%	Cash Equivalents 1.5%	Cash Equivalents 0.1%	High Yield 3.5%	International Equity 10.0%	Broad U.S. Equity 7.2%
Core U.S. Fixed Income 0.0%	REITs 28.7%	TIPS 11.0%	Broad U.S. Equity 25.7%	High Yield (11.2%)	TIPS (8.9%)	International Equity 3.0%	Broad U.S. Equity 9.7%	International Equity 6.9%
TIPS (1.3%)	International Equity 21.5%	International Equity 10.7%	International Equity 7.8%	TIPS (11.8%)	Core U.S. Fixed Income (10.3%)	Broad U.S. Equity 2.4%	High Yield 7.2%	High Yield 3.6%
High Yield (2.1%)	High Yield 14.3%	Core U.S. Fixed Income 7.5%	TIPS 6.0%	Core U.S. Fixed Income (13.0%)	High Yield (14.2%)	Cash Equivalents 1.3%	Cash Equivalents 2.4%	TIPS 3.3%
REITs (4.0%)	Core U.S. Fixed Income 8.7%	High Yield 7.1%	High Yield 5.3%	International Equity (16.0%)	International Equity (18.4%)	Core U.S. Fixed Income (3.0%)	TIPS 0.0%	Core U.S. Fixed Income 3.0%
Broad U.S. Equity (5.2%)	TIPS 8.4%	Cash Equivalents 0.7%	Cash Equivalents 0.0%	Broad U.S. Equity (19.2%)	REITs (19.2%)	TIPS (3.2%)	Core U.S. Fixed Income (0.1%)	REITs 1.7%
International Equity (14.2%)	Cash Equivalents 2.3%	REITs (5.1%)	Core U.S. Fixed Income (1.5%)	REITs (24.9%)	Broad U.S. Equity (21.1%)	REITs (7.1%)	REITs (5.5%)	Cash Equivalents 1.1%

# PCE Performance Through March 31, 2022

- PCE performance has rebounded since the first half of 2022 with fiscal-year-to-date performance of 6.3% through March 2023.
- Longer-term performance for PCE has been strong despite a challenging 2022.
- The State's asset class building blocks have all performed within expectations with most providing modest excess returns.

Annualized Returns 3/31/23	3 Months	FYTD	1 Year	2022	3 Years	5 Years	7 Years	10 Years	11 Years
<b>PCE Endowment Fund</b>	<b>5.58%</b>	<b>6.34%</b>	<b>-5.14%</b>	<b>-14.95%</b>	<b>6.63%</b>	<b>3.79%</b>	<b>5.54%</b>	<b>6.18%</b>	<b>6.70%</b>
Benchmark	5.50%	6.06%	-5.28%	-15.20%	6.51%	3.79%	5.54%	6.03%	6.50%
Excess Return	0.08%	0.28%	0.14%	0.24%	0.12%	0.00%	0.01%	0.16%	0.19%

## DOR Commissioner's Report: Net Pool Performance for Month Ending 3/31/2023

<u>Pool Performance (Net of Fee)</u>	1 Month	3 Month	FYTD	1 Year	3 Year	5 Year	7 Year	10 Year
Broad Market Fixed Income Pool	2.28%	3.11%	0.53%	-4.07%	-2.19%	1.22%	1.14%	1.56%
Domestic Equity*	2.68%	7.17%	9.80%	-8.52%	18.51%	10.44%		
Intermediate-term Fixed Income Pool	1.43%	1.56%						
Internally Managed REITs	-1.74%	1.74%	-5.46%	-19.37%				
International Equity*	2.42%	6.88%	9.98%	-5.02%	11.84%	2.53%		
Short-term Fixed Income Pool	0.40%	1.15%	2.67%	2.80%	1.09%	1.55%	1.41%	1.07%
Tactical Bond Pool	1.51%	3.36%	3.33%	-4.03%				
<u>Benchmark Performance</u>	1 Month	3 Month	FYTD	1 Year	3 Year	5 Year	7 Year	10 Year
Broad Market Fixed Income Pool	2.54%	2.96%	-0.09%	-4.78%	-2.77%	0.91%	0.88%	1.36%
Domestic Equity*	2.67%	7.18%	9.75%	-8.58%	18.48%	10.45%		
Intermediate-term Fixed Income Pool	1.63%	1.59%						
Internally Managed REITs	-1.74%	1.74%	-5.52%	-19.40%				
International Equity*	2.44%	6.87%	10.03%	-5.07%	11.80%	2.47%		
Short-term Fixed Income Pool	0.43%	1.07%	2.40%	2.50%	0.89%	1.41%	1.21%	0.87%
Tactical Bond Pool	2.54%	2.96%	-0.09%	-4.78%				
<u>Relative Performance (Net of Fee)</u>	1 Month	3 Month	FYTD	1 Year	3 Year	5 Year	7 Year	10 Year
Broad Market Fixed Income Pool	-0.26%	0.15%	0.62%	0.72%	0.58%	0.31%	0.25%	0.20%
Domestic Equity*	0.01%	-0.01%	0.05%	0.06%	0.03%	-0.01%		
Intermediate-term Fixed Income Pool	-0.20%	-0.03%						
Internally Managed REITs	0.00%	-0.01%	0.07%	0.03%				
International Equity*	-0.02%	0.02%	-0.06%	0.05%	0.05%	0.05%		
Short-term Fixed Income Pool	-0.03%	0.08%	0.27%	0.29%	0.20%	0.14%	0.19%	0.20%
Tactical Bond Pool	-1.03%	0.40%	3.42%	0.75%				

# PCE Cashflow History

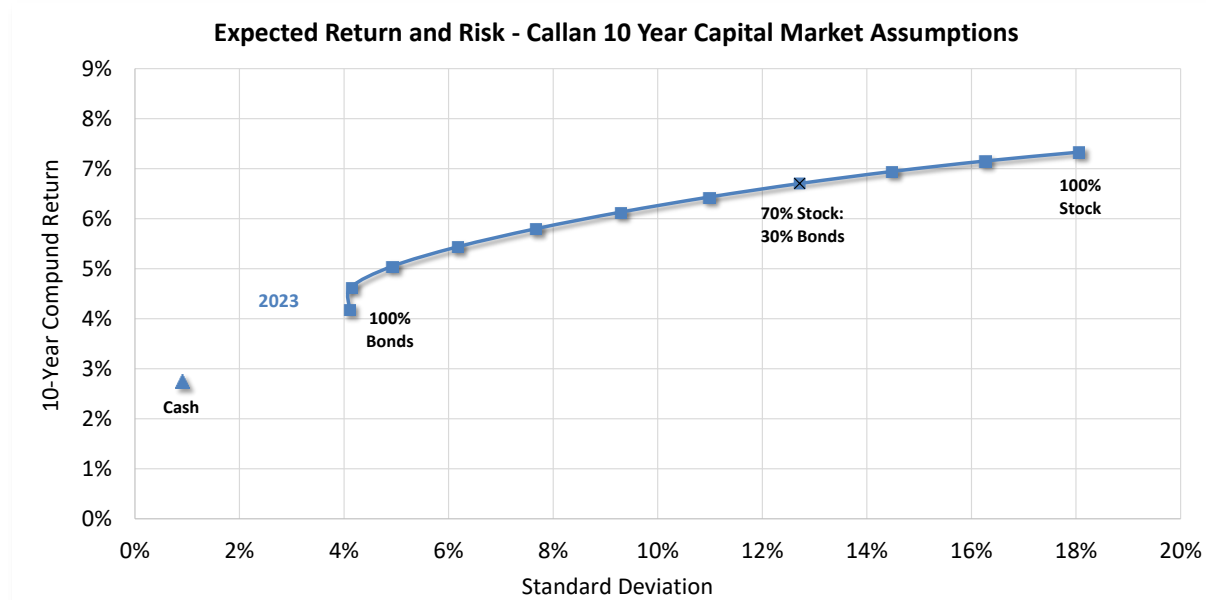
- Despite a challenging 2022, the PCE investment program has met earnings expectations over the past 10+ years. Overall earnings have been \$661 million and have averaged 6.8%, which has supported withdrawals of \$467 million – an average 4.3% spending rate.

Period Ended	Deposits		Earnings		Withdrawals		Net Gain/(Loss)		Ending Balance	Percent of Begin. Balance	
										Earnings	Withdrawals
Jun-12	\$	400,000,000	\$	10,947,889	\$	(23,696,811)	\$	(12,748,922)	\$	751,780,453	
Jun-13			\$	111,487,778	\$	(23,053,356)	\$	88,434,422	\$	840,214,875	14.8%
Jun-14			\$	171,111,667	\$	(33,459,175)	\$	137,652,492	\$	977,867,367	20.4%
Jun-15			\$	33,192,304	\$	(41,670,240)	\$	(8,477,936)	\$	969,389,431	3.4%
Jun-16			\$	8,912,404	\$	(31,363,776)	\$	(22,451,372)	\$	946,938,059	0.9%
Jun-17			\$	112,330,514	\$	(35,702,909)	\$	76,627,605	\$	1,023,565,664	11.9%
Jun-18			\$	76,602,411	\$	(26,789,663)	\$	49,812,748	\$	1,073,378,412	7.5%
Jun-19			\$	74,141,548	\$	(74,694,579)	\$	(553,030)	\$	1,072,825,381	6.9%
Jun-20			\$	48,303,424	\$	(42,971,946)	\$	5,331,478	\$	1,078,156,859	4.5%
Jun-21			\$	150,299,199	\$	(79,290,610)	\$	71,008,589	\$	1,149,165,449	13.9%
Jun-22			\$	(143,841,594)	\$	(37,908,189)	\$	(181,749,783)	\$	967,415,665	-12.5%
Dec-22			\$	7,104,777	\$	(16,718,997)	\$	(9,614,220)	\$	957,801,445	-3.3%
Totals:			\$	660,592,322	\$	(467,320,251)	\$	193,272,070	Averages:	6.8%	-4.3%
			Pre-2022 Averages:							9.2%	-4.4%

- Forward expectations for PCE are consistent with this historical performance.

# Summary

- The Department of Revenue has a comprehensive, transparent, and independent process to implement State investment policies.
- PCE's asset allocation is designed to use the funds long time-horizon to achieve the statutory goals of prudently maximizing total return while considering the preservation of purchasing power over time.
- Long term results for PCE, including a difficult 2022, have met or exceeded expectations and the current asset allocation positions the portfolio to deliver similar results.





# Questions?



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