

SENATE FINANCE COMMITTEE
January 23, 2018
9:03 a.m.

[9:03:25 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Anna MacKinnon, Co-Chair
Senator Click Bishop, Vice-Chair
Senator Peter Micciche
Senator Donny Olson
Senator Gary Stevens
Senator Natasha von Imhof

MEMBERS ABSENT

None

ALSO PRESENT

Angela Rodell, CEO, Alaska Permanent Fund Corporation; Bill Moran, Chair, Alaska Permanent Fund Corporation Board of Trustees.

SUMMARY

^OVERVIEW: ALASKA PERMANENT FUND

[9:04:28 AM](#)

Co-Chair MacKinnon acknowledged the earthquake near Kodiak that occurred in the morning. She remarked that many people were concerned about safety, but she understood that most people were safe from the earthquake.

[9:06:00 AM](#)

ANGELA RODELL, CEO, ALASKA PERMANENT FUND CORPORATION, (APFC) introduced herself.

Ms. Rodell discussed the presentation, "Overview: Alaska Permanent Fund" (copy on file).

Ms. Rodell looked at slide 2, "The Alaska Constitution":

Over four decades ago, in 1976, Alaskans in an historic vote amended the Constitution of the State of Alaska by a margin of 75,588 to 38,518 and created the Alaska Permanent Fund.

Alaska Constitution Article IX, Section 15

Section 15. Alaska Permanent Fund At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

Ms. Rodell highlighted slide 3, "APFC's Vision":

"to deliver sustained, compelling investment returns as the United States' leading sovereign endowment manager, benefitting all current and future generations of Alaskans"

- Reflects statutory language and intent as well as Board and staff aspirations.
- Emphasizes maximizing returns in a fully sustainable manner.
- Underscores the intention for the Fund to be a perpetual resource for the State of Alaska.
- Embodies core values of Integrity, Stewardship, and Passion.

Ms. Rodell addressed slide 4, "APFC's Strategic 5-Year Plan":

Strategic Priorities FY17-FY21

- Gain greater control of resource allocations
- Optimize APFC's operational processes and use of financial networks and resources

- Develop best-in-class investment management capabilities, partnerships, and geographic reach to maximize investment returns
- Enhance talent and staff across APFC

Ms. Rodell highlighted slide 6, "How the Fund Works." She stated that the slide was a summary of all the in-flows and out-flows of the fund, and where the controls happened for those funds. She noted that any inflation-proofing appropriations and other appropriations would flow into the principal, which was constitutionally protected under Article 9, Section 15 of the constitution. She remarked that the money was invested along side on a pro-rata share with any amounts in the Earnings Reserve Account (ERA). The ERA was the receptacle for all the dividends, income, and gains made from the investments.

[9:10:05 AM](#)

Senator Micciche requested the mechanism by which an unrealized gain became a realized gain. Ms. Rodell replied that realizing the gains occurred through natural financial mechanisms. She stated that the value would be unrealized until the stock was sold. She remarked that the gains from the sale, would be attributable to the ERA.

Senator Micciche surmised that there was a formal balance change of realized gains or losses; and an annual true up. He queried the time of the annual true up. Ms. Rodell replied that it occurred on June 30 of each year.

Co-Chair MacKinnon explained that the number in the ERA was not "real money", so it was best to differentiate between realized and unrealized gains. Ms. Rodell agreed. She explained that there was a change to the accounting rules to include unrealized gains in the concept of "income."

Co-Chair MacKinnon queried the unrealized number as of June 30, 2017. Ms. Rodell replied that she agreed to provide that information.

Co-Chair MacKinnon surmised that it was approximately \$2 billion.

Ms. Rodell addressed slide 9, "Assets Under Management in billions."

She stated that \$12.8 billion was in the ERA. She shared that the unrealized gains in the ERA was approximately \$3 billion. The unrealized gains in the principal was approximately \$8 billion.

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Co-Chair MacKinnon stressed that the gain was only realized when the asset was sold.

Senator von Imhof stressed that unrealized earnings did not automatically become realized each year, because it was based on investment decisions. Ms. Rodell agreed. She furthered that there could also be unrealized losses that were not recognized in the portfolio.

Co-Chair Hoffman queried the legislative appropriation, which was above the statutory requirement. Ms. Rodell replied that there was approximately \$16 billion deposited into the principal, attributable to royalties. She shared that there was an additional \$16 billion appropriated through the inflation-proofing mechanism, and an additional \$7 billion in other appropriations made by the legislature over the years to the principal.

Co-Chair Hoffman surmised that it was a total of \$23 billion. Ms. Rodell agreed.

Senator Micciche remarked that the legislature had seen the importance of saving the excess of the fund.

Senator Stevens queried the source of the \$7 billion. Ms. Rodell responded that upon creation of the fund and dividend, the mechanism was that any additional moneys left behind after the dividend were "swept" into the corpus. She stated that would constitute those additional appropriations. She also stated that the legislature may have determined a portion of the excess revenues into the fund.

Co-Chair MacKinnon remarked that the state paid back the constitutional budget reserve (CBR) after an increase in revenue.

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Ms. Rodell looked at slide 7, "Invested as One Fund":

Alaska Permanent Fund Corporation: Investment and Management of the Fund

One Target Asset Allocation: Stocks, Bonds, Real Estate, Alternatives

Pro Rata Shares of Each Investment: Principal, ERA

Ms. Rodell discussed slide 8, "Statutory Net Income AS 37.13.140":

- Pursuant to state law (AS 37.13.140), at the end of each fiscal year APFC calculates and reports on the net realized gains accounted for during the fiscal year.
- These net realized gains and investment income are the funds in the ERA that are subject to appropriation by a simple majority of the Alaska Legislature.
- Net realized gains = realized gains accumulated during the fiscal year (-) minus realized losses accounted for during the year.
- Unrealized gains earned by Principal are part of Principal, only until realized at which time they are transferred to the ERA.

Ms. Rodell addressed slide 9, "Assets Under Management in billions." She stated that the principal had stayed fairly steady at between \$45 billion and \$48.7 billion, which included the unrealized portion of the principal. The ERA had grown from \$6 billion in FY 14 to more than \$15 billion through December 31, 2017.

Ms. Rodell highlighted slide 10, "Principal":

The Principal is built through:

royalty deposits; inflation proofing; and other special appropriations.

Ms. Rodell discussed slide 11, "Inflation Proofing":

- The Board of Trustees emphasized the importance of inflation proofing by unanimously adopting Resolution 17-01 during their September 2017 Annual Meeting.
 - Directing APFC to identify and pursue legislative support for inflation proofing the

Principal of the Alaska Permanent Fund to preserve the purchasing power for all generations as stated in AS 37.13.020.

- AS 37.13.145 (c) provides the inflation proofing mechanism which is calculated at the end of the fiscal year. Historically, the Legislature has included an estimated amount in the language of the operating budget to fulfill this statutory obligation.
- The following amounts remain unappropriated at this time, and have been included in the Governor's proposed FY19 operating budget:
 - o FY16 \$ 47 million
 - o FY17 \$ 501 million
 - o FY18 \$ 903 million (estimated)
 - o FY19 \$ 943 million (estimated)

Vice-Chair Bishop wondered whether the trustees had educational training. Ms. Rodell replied that there was a requirement for annual education. She furthered that there was not a requirement for the trustees. She stated that there was an attempt to provide an education session at each quarterly meeting. She deferred to Mr. Moran.

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BILL MORAN, CHAIR, ALASKA PERMANENT FUND CORPORATION BOARD OF TRUSTEES, explained that there was a joint annual education between the APFC Board and the Alaska Retirement Management (ARM) Board. He remarked that the training had been extensive in a variety of areas. He shared that Callan had provided training related to a range of issues from the investment to governance of the fund. He stated that there were some of the top organizations in the country to periodically attend the meetings of the board of trustees, with comprehensive sessions on a range of subjects at the board's request.

Senator Micciche looked at slide 9, and noted that it reflected assets under management realized and unrealized gains. He remarked that there would not be a change in the principal without the inflation proofing, which did not occur in FY 16, FY 17, and FY 18. He stressed that, if it were not for inflation proofing, he felt that the balance of the corpus would not change. Ms. Rodell replied that it would change slightly because of the royalty deposits. She stated that the royalty deposits had been between \$200 million and \$300 million in the previous couple of years.

She stated that it would continue to slightly increase because of the royalty deposits.

Senator Micciche surmised that all gains and losses are realized in the ERA. Ms. Rodell agreed.

Senator von Imhof wondered whether there were any other endowment funds in the country that separated the principal from a separate earnings account. Ms. Rodell replied that there was no other fund in the world that separated the funds. She stressed that it was a unique construct due to the constitutional language.

Senator von Imhof felt that the separation of accounts would permeate the remainder of the presentation.

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Co-Chair MacKinnon remarked that there was a frequency of turnover of long-term board members. She queried the longevity of the current board members. Ms. Rodell replied that the longest serving trustee was Carl Brady, who had been on the board since 1994. She stated that his four-year term was appointed in 2015, and would expire June 30, 2019. She shared that the second longest serving board member was Bill Moran, who had ten years of service which would expire June 30, 2018. She stated that there was a new public member, Craig Richards, who would attend his first board meeting in February. She stated that the other public member was Marty Rutherford, who was appointed in 2016 and her term would expire June 30, 2020.

Co-Chair MacKinnon wondered whether he would be reappointed to the board by the current administration. Mr. Moran replied that he had not been told whether or not he would be reappointed to the board. He furthered that it was not uncommon for a governor to replace the entire board. He stated that during the Frank Murkowski administration, it was found that it was not prudent to appoint an entirely new board.

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Co-Chair MacKinnon remarked that Alaskans wanted to ensure that the corpus of the fund was protected by those in control. She remarked that Mr. Richards had served on the board through the administration, when he worked directly

for Governor Walker, but had now been appointed as the public member. She remarked that Mr. Richards had testified in regard to advancing the natural gas pipeline. She wondered if there was a good foundation for training to ensure that there was an acceptable risk to the corporation. Mr. Moran replied that there had been a complete review and revision of the corporation's governance process. He stated that within the best practices, there was a broad array of investment policies and procedures for the board of trustees and the staff. He stressed that all of the trustee activities related to asset allocation and investment supervision were against a background of a strong policy base that was regularly used to determine exposures and investments in a variety of areas.

Co-Chair Hoffman wondered how much the board relied on the chief investment officer of APFC. Mr. Moran replied that the chief investment officer was one of the critical positions in the organization. The board took care in the vetting of the process. He explained that typically the executive director would bring a series of candidates before the board when there was a needed change in the board. He stated that as they worked into the organization, they were closely supervised to ensure that there was an understanding of the board's directions and expectations. He remarked that it was realistic to assume that positions like the chief investment officer were mobile positions. The investment officers had international exposure, and there were always opportunities. He stated that it was not realistic to expect that the position would be filled by the same person for 10 or 20 years. There would be a fair amount of turnover in those positions.

Co-Chair Hoffman was please to hear that the chief investment officer was critical to the health of a solid permanent fund corporation.

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Ms. Rodell displayed slide 13, "Board of Trustees":

As the fiduciaries, the Trustees have a duty to Alaskans in assuring that the Fund is managed and invested in a manner consistent with legislative findings: AS 37.13.020

- The Permanent Fund should provide a means of conserving revenue from mineral resources to benefit all generations of Alaskans.
- The Permanent Fund's goal should be to maintain safety of principal while maximizing total return.
- The Fund should be used as a savings device managed to allow the maximum use of disposable income from the Fund for the purposes designated by law.

Ms. Rodell highlighted slide 14, "Investment Oversight":

Board of Trustees

As Fiduciaries of the Fund, Full Authority to Make Investment Decisions.

- Provide Authority to Invest Within Set Bands
- Approve Target Asset Allocation
- Adopt Investment Policy

Chief Executive Officer

Assures Strategies Adopted by the Board are Successfully Implemented

Chief Investment Officer

Makes Strategic and Tactical Allocations to Allow the Fund to Grow in Value

Portfolio Managers

Responsible for the Investment and Performance

Ms. Rodell addressed slide 15, "The Portfolio \$64.0 Billion as of FY18 Q2." She informed that the pie chart on the graph represented the board's target allocation of the fund.

Ms. Rodell looked at slide 16, "Asset Allocation Structure":

Growth

Tradable/Liquid

Public Equities (stock)

Illiquid

Private Equity
Absolute Return
Allocation Strategies

Income

Tradable/Liquid

Fixed Income Plus (Bonds)
Cash

Illiquid

Real Estate
Infrastructure

Ms. Rodell detailed that allocation strategies were strategies that overlay the entire portfolio.

Ms. Rodell highlighted slide 17, "Management of the Fund":

The Board of Trustees continue to work towards an optimal mix of in-house versus external management capabilities based on resources and opportunities.

Vice-Chair Bishop queried the difference in savings of in house and out of house. Ms. Rodell replied that it was a difficult number to "pin down", because the fund had grown so much over the previous two years. Therefore, money had to be deployed. She stated that external managers had increased balances, so it was difficult to determine that delta. She remarked that there was a continual examination of the high-cost investments. She remarked that private equity had higher fees associated than public equity. She stressed that private equity was an important asset class for investment. She remarked that there was an examination of whether the corporation should grow its ability to do due diligence and direct investing on private equity and eliminate the higher fees, than to hire public equity traders in Juneau.

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Senator von Imhof wondered whether the hiring of external managers would increase the probability or possibility for the permanent fund to co-invest with other large funds who were also customers of the same external managers. Ms. Rodell replied that the external managers provided interesting opportunities for the fund.

Ms. Rodell looked at slide 18, "Management of the Fund by Asset Class":

- o Publicly traded securities, internally managed means that APFC investment staff directly buys and sells the publicly traded securities.

- o Private Markets, an investment is considered internally managed if APFC investment staff directly conduct the investment and legal due diligence for the investment and make the decision to invest.

Ms. Rodell looked at slide 20, "Fiscal Year 2017 Performance: Realized Unrealized Gains." She noted that the total fund, over the previous five years, had returned 8.85 percent. She stated that it had beaten the passive index benchmark by 1.7 percent. She shared that the passive index benchmark was all liquid, a 60 percent tilt toward public equity (as opposed to the permanent fund, which had a 40 percent tilt to public equities in terms of the target), and it was what would be generated if a computer was managing the fund. She stated that it showed the amount of difference of the active management of the corporation had provided in additional return to the permanent fund. She stated that there was also a performance benchmark, which was the individual asset class performance benchmark that were accumulated to match the target asset allocation. She stated that the performance benchmark was beat by 70 basis points. She stated that it showed the active management of corporate staff and portfolio managers had generated additional return over the previous five years. She noted that the board of trustees had a total fund return objective of CPI or inflation plus 5 percent. She stated that 5 percent plus inflation for the five-year period was calculated at 6.32 percent.

[9:50:27 AM](#)

Ms. Rodell highlighted slide 21, "Asset Class Performance." She stated that the slide was intended to give a sense of

where the returns were driven over the fiscal year, three-year, and five-year. She noted that the US domestic equities was a "big push" at 14.6 percent over the five-year period. She remarked that there were significant returns from the private equity class at 18.3 percent. She noted that infrastructure provided another 15 percent in return to the fund. She stated that the private market asset classes continued to be an important contributor to the overall performance of the fund.

Ms. Rodell addressed slide 22, "Callan's Capital Markets Forecast." She stated that each year Callan developed a capital markets forecast, which calculated a ten-year return forecast for each asset category. She shared that Callan also developed an annualized standard deviation. She remarked that the annualized standard deviation was the forecast of how much band width there was around that number. She shared that there was a ten-year projection of public global equities of 7 percent with a plus or minus of 18.5 percent. She stressed that it was a volatile type of asset. She compared that asset to the cash equivalence, which were projected to earn over the ten-year period 2.7 percent, with only a difference of plus or minus 0.9 percent. She explained that Callan then used all of the returns against the board's adopted target asset allocation to come up with a projected total return over the following ten years based on the board's adopted asset allocation. She stated that for 2018 the total return forecast was expected to be 6.5 percent for the next ten years.

Senator von Imhof noted that inflation was 2.25 percent, and wondered whether Callan considered a standard deviation. She asked about a range for inflation. Ms. Rodell replied that there was no range provided by Callan for inflation. She looked at slide 20. She remarked that since the fund's inception, there was a total fund return objective of CPI plus 5 percent at 7.67 percent. She stated that over the 40 years of the fund, inflation had averaged 2.67 percent. She remarked that, over the past five years, inflation had averaged 1.32 percent. She remarked that it was known that there was a low inflation environment, and given high unemployment rates and high valuations on assets, there was a sense that inflation would start increasing again.

Vice-Chair Bishop wondered whether the US Treasury inflation-protected securities were "t-bills." Ms. Rodell

replied that they were not "t-bills", but they were a security issued by the US Treasury that was designed to move with inflation. She explained that they would lose value when inflation was low, because they were considered a hedge against inflation.

[9:55:26 AM](#)

Vice-Chair Bishop queried some investment examples of the Global Real Estate Investment Trust.

Vice-Chair Bishop announced that the response could be provided at a later date. Ms. Rodell replied that Global Real Estate Investment Trust referred to those real estate investment trusts that had exposure to real estate around the world, not only in the United States. She stated that they were traded securities, so the exposure was through a liquid market, without buying into actual properties directly. She stated that one would buy into the trust that owned underlying properties. She stated that a Global Real Estate Investment Trust could hold assets around the world.

Ms. Rodell looked at slide 24, "What are the stress tests?"

- At the request of the Board Chair, Bridgewater, one of our partners with expertise in portfolio management, developed and presented stress scenario analyses to the Board of Trustees.
- These analyses demonstrate the effects of stressful economic conditions on the Fund under assumed draws:
 - 5.25 percent years 1-2, and 5 percent years 3-10
 - 5.25 percent years 1-2, and 4.5 percent years 3-10.
- The stress analyses estimate the returns required to achieve assumed draw outcomes, and compare these return hurdles to the range of returns implied by forward-looking Bridgewater assumptions, Callan estimates, and historical returns (adjusted for today's cash rates).

Ms. Rodell looked at slide 25, "Bridgewater's Observations":

- Total returns for savers are likely to be historically low over the next decade.

- Forecasting future returns is inherently imprecise; however, there is confidence that low cash rates will be a drag on all assets for the medium term.
- This development presents a significant challenge to investors whose spending plans are based on higher expected returns than are now likely.

Ms. Rodell addressed slide 26, "Methodology":

For each draw assumption two stress tests were conducted - distinguished by whether the current stock of unrealized gains are used as an additional lever to support the balance in the Earnings Reserve.

Stress Test 1

Make payments according to distribution plan (5.25 percent to 5 percent or 5.25 percent to 4.5 percent) until Earnings Reserve is exhausted (less than 13B starting buffer)

- This stress test is conservative with respect to potential distributions (i.e., should represent a lower-bound for expected payments from the fund).

Stress Test 2

Make payments until overall plan surplus (Earnings Reserve + Current Unrealized Gains) is exhausted (less than 20B starting buffer)

- This stress test is less conservative with respect to distributions (i.e., the worst case distribution outcomes will be less severe, though the worst case ending fund size will be more severe).

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Ms. Rodell highlighted slide 27, "Assumptions":

Draws

Scenario 1:

Distributions are Calculated as 5.25 percent of the 5-Year Average of the Total Fund Size in years 1-2, and 5.00 percent in years 3-10.

Scenario 2:

Distributions are Calculated as 5.25 percent of the 5-Year Average of the Total Fund Size in years 1-2, and 4.50 percent in years 3-10.

Distributions

Limited by either the size of the ERA (Stress Test 1) or the ERA plus current unrealized gains (Stress Test 2).

Prioritized over inflation proofing payments - partial payments allowed.

ERA can be drawn to zero, but never have a negative balance.

Inflation Proofing

Assessed on the Principal Fund Balance, excluding any unrealized gains.

2.25 percent Annual Inflation (unless otherwise noted).

Ms. Rodell discussed slide 28, "Scenario 1":

5.25 percent years 1-2 and 5.00 percent years 3-10

Ms. Rodell displayed slide 29, "Required Return."

Co-Chair MacKinnon wondered whether Ms. Rodell was familiar with the Monte Carlo runs that the governor did on his initial proposal almost three years prior, which painted somewhat of a different picture for the committee. Ms. Rodell replied that she was not familiar it.

Co-Chair Hoffman wondered whether the 1 in 20 percent, meant that 1 out of every 5 years it could earn 3.3 percent. Ms. Rodell asked for a repeat of the question.

Co-Chair Hoffman noted that that there was a 20 percent probability for the 3.3 percent annual rate of return. Ms. Rodell agreed. She explained that the odds of falling short and missing that target was 20 percent, or 80 percent that target would be beat.

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Co-Chair Hoffman surmised that the probability for that occurrence was one out of five years. Ms. Rodell agreed.

Senator Micciche felt that each year had the same odds, so the years should be examined individually. He noted that SB 26 was not moved in a vacuum. He felt that the evaluation

did not consider the Monte Carlo approach, which had a much lower probability of failure. He felt that the presentation was unnecessarily pessimistic. He noted that any consideration on a POMV required an evaluation every three years on the actual performance of the fund. He wanted to see the background data on the level of conservatism in one year, versus the discussion from the year prior.

Senator von Imhof shared that she had attended the Bridgewater presentation. She noted that there was some discussion about separating out the ERA, and how it would affect the stress test. She wondered, to what degree, would separating the ERA from the Corpus affect the stress test. She noted that other foundations had managed to pull 5 percent a year in perpetuity, and yet managed to be an ongoing concern. She stressed that no other fund in the world separating an ERA from the Corpus.

Ms. Rodell looked at slide 30, "Stress Test Example: 2007-2016(5.25 percent to 5.00 percent Scenario)." She stated that the slide only showed the stress scenarios. She remarked that Bridgewater had developed a database over 100 years of securities activity. She stated that there were models to create proxies for asset classes that did not exist 100 years prior. She remarked that there was a robust database to draw the conclusions. She stated that each grey line represented a different ten-year period applied to the target asset allocation of the fund passed by the board of trustees. She announced that it assumed that the board made no changes as a result of what was happening in the market; it assumed that the trustees make no changes based on what requirements came to them in terms of use of the fund. She stressed that the slide showed a scenario of what could happen if there was a requirement to make the draw. She noted that the blue line highlighted what had happened to the markets from 2007 to 2016. She stated that applying that market activity to the current target asset allocation generated the shown results. She explained that it meant that, in 2019, the losses of 30 percent would wipe out the ERA. She stated that the fund continued to stay invested, and made 27.9 percent, but it had not recouped an amount available for a contribution out of the ERA. She noted that starting in 2021, those contributions continued to be made going forward through 2027. She stressed that it was designed to gain parameters.

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Co-Chair MacKinnon looked at slide 20, and noted the previous years and the since-inception returns that were much higher than the scenario. She outlined the details of the returns of the various years, which had beat the market projections. She wondered whether the run scenario based the permanent dividend draw in current state statute in the underlying model calculations for removal of money from the fund and interest. Ms. Rodell replied that it did not speak to the amount for dividend or other purposes. She stressed that it said that pulling 5.25 percent stepping down to 5 percent. She stressed that what happens to the draw amount was not in the analysis. She explained that the analysis was saying that if one only earned 4.5 percent per year for the next ten years, one would exhaust the ERA. She furthered that earning more than 4.5 percent, one would be in the triangle space between the 4.5 percent line and the 6.3 percent line. She stated that earning 6.3 percent or better in each of those years, one would not use any of the ERA. She stated that it also assigned probabilities to the odds of falling short. She explained that the odds of having a year with less than 6.3 percent was one in two, or precisely 48 percent. She stated that the odds of having one year of less than 3.3 percent or lower was 20 percent.

Co-Chair MacKinnon looked at inflation proofing, and whether it was included in the underlying structure that was not on the risk analysis. She wondered whether there was a calculation of moving from the ERA to the corpus inflation proofing. Ms. Rodell replied in the affirmative, and stated that it imbedded in the annual return, which imbedded a 2.25 percent inflation amount calculated moving into the corpus. She stated that it would make the draw second to the contribution of the 5.25 percent.

Co-Chair MacKinnon wondered whether that number was available in totality in terms of billions of dollars that was used in the underlying. Ms. Rodell looked at slide 30, and noted that in 2027 there would be cumulative distributions to the state in the stress test of \$22.6 billion. She furthered that there would be missed inflation proofing payments of a negative \$2.6 billion, because it was the second priority. She explained that there would be a real value of the principal at that point of approximately \$41 billion.

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Co-Chair MacKinnon noted that there was a significant amount of time to reach a \$10 billion total value. She remarked that moving from \$10 billion to \$30 billion seemed like a long period of time. She recalled that there had been a range of value at \$34 billion, and she noted that the value was currently doubled. She queried what was anticipated under the current assumptions that the board of directors had placed on asset allocation in the doubling process. Ms. Rodell replied that looking at the fund values in the economic crisis in the 2008 to 2009 timeframe, the total assets under management were approximately \$29 billion. She stressed that in the recent ten years the state was sitting at approximately \$65 billion of assets under managements. She noted that the markets had done well since the financial crisis, but there were some flat years. She looked at 2015 as a flat return year. She stressed that the most significant contributor to fund growth was removing the allowed list of investments that occurred in 2005 and 2006. She stated that it gave the trustees the full "plate" of investments to choose from, and using the prudent investor rule as its guideline. The board had put together a diversified asset allocation, and allowed to invest in private equity that had contributed 18 percent over the last five years in terms of return and fund value.

Vice-Chair Bishop wondered whether the stress test took into consideration Senator Micciche's comments about the three-year built in adjustment. Ms. Rodell replied in the negative. She explained that it assumed a straight-forward draw of 5.25 percent stepping down to 5 percent.

Vice-Chair Bishop remarked that the disclaimer on slide 30 looked "in the rear-view mirror." He felt that the committee was wise to include the three-year lookback average. H

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Co-Chair Hoffman wondered why there was no addendum to examine the versions from the legislature, and their impact on the stress tests. He felt that the results would not be as "bleak" as what was displayed on slides 29 and 30. Ms. Rodell replied that APFC did not ask for a specific bill to be modeled.

Co-Chair Hoffman noted the assumption in the Bridgewater report filtering through to 2019, and having a 30 percent asset portfolio was substantial. Ms. Rodell replied that the analysis applied a specific time period of actual results on balances going forward.

Senator von Imhof felt that there was a sidetrack from the real conversation. She wondered how other foundations differently managed their assets, and successfully have a 5 percent on a perpetual basis while manage to maintain as an ongoing concern. Ms. Rodell did not know, but she explained that looking at the Yale Endowment, which was considered a premier endowment to be modeled after. The calculation of 5 percent was based on 5 percent of spending. She stated that the spending was adjusted based on the amount of the draw, and was not based on 5 percent of the value of the endowment. She remarked that there were many different rules, depending on which endowment was considered. She did not have a solid answer on the best way forward. She stated that the analysis was designed to give information about what could happen if there was a "retched" set of market circumstances.

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Senator Micciche felt that the fund was healthy because of the objectives of maximum returns and conservative management of state assets. Ms. Rodell agreed.

Senator Micciche understood that he was grateful for the proper objectives, and be careful to not stress the growth of the corpus of the fund.

Senator von Imhof noted that she was fond of Ms. Rodell personally, and wanted to do right by the state. She was concerned, because there was \$13 billion in the ERA, and wanted to protect the permanent fund. She wanted to examine a structured draw that was controlled, predictable, and sustainable over time. She noted that in 2004 the board recommended that the ERA be collapsed into the corpus to make one large fund. She stated that having the entire fund be able to capture the excess income helped the fund grow. She felt it was like "super inflation-proofing." She noted that there would be years the fund returns would be negative.

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Co-Chair MacKinnon appreciated the conservative look to protect the corpus, which was the goal of the administration and all legislators. She noted that everyone experienced the economic crisis. She wondered how the state was prepared for a bear market, and whether there was an emergency plan. Ms. Rodell responded that the challenge was not knowing when or where the "bear" comes. She stated that there was a hedge fund strategy that was counter cyclical to the activities in the market, which would protect from the downside.

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Co-Chair MacKinnon felt that there was current volatility in oil and gas production, and also volatility in investment earnings over time. She appreciated the cautionary note in the previous scenario.

Co-Chair Hoffman felt that House and Senate had passed versions of SB 26, and the payout in the Senate version was conservative. He felt that it would reduce the stress test, because it was a 4.5 percent to 4.75 percent draw. Ms. Rodell replied that she would address that question in the next scenario.

Co-Chair MacKinnon recalled the move to take all the money from the ERA to fund government. She queried how that affected the management. Ms. Rodell replied that there was discussion about how to use the fund. She stressed that \$1 billion of cash was available to meet capital calls. She remarked that the debate about the ERA, there seemed to be consensus building around the \$2.5 billion to \$2.75 billion draw that would be in SB 26. She stated that the cash reserves were moved to the \$3.5 billion mark, to include \$2.5 billion for the state. She explained that the cash would not be deployed into an illiquid asset class, such as private equity, because it could not be used to turn over to treasury. She stated that there would be a short-term duration of use of the fund, which argued for using it into liquid fixed income securities that would not lose value. She remarked that the amount moved up closer to \$5 billion, and then resulted in a total draw of approximately \$725 million. She stated that then there was an immediate deployment of the excess into the public equities and fixed income, and moved into private asset as they become available.

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Co-Chair MacKinnon noted a conversation about advance funding a portion of the budget. She recalled the possibility of deploying money managers on behalf of Alaskans in the case of a government shutdown. She stressed that she wanted to protect retirement and benefits. She believed that the statutory authority was needed to maintain operations. Ms. Rodell replied that an appropriation was required to operate the permanent fund. The appropriation paid for both the corporate operations and the external manager contracts. There were provisions made with the custodial bank, which would come into effect in the event of a shutdown.

Ms. Rodell highlighted slide 31, "Scenario 2: 5.25 percent years 1-2 and 4.50 percent years 3-10." The scenario recognized the glide into an ongoing draw.

Ms. Rodell addressed slide 32, "Required Return (5.25 percent to 4.50 percent Scenario)." She stated that the required annual return decreased, because the required amount was stepped down. She stated that in order to maintain the \$13 billion in the ERA, and the \$7 billion in the unrealized gain, an annual return of 5.9 percent was required over the following ten years.

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Senator von Imhof wondered how the risk profile would shift if it stayed at 5 percent. Ms. Rodell replied that there may be slight shifts up and down, and meet somewhere between the 5.9 percent and 6.3 percent.

Senator von Imhof queried whether the "shock" at the beginning of 5.25 percent would have an effect to shift down in risk. Ms. Rodell replied in the negative, because eliminating the shock in the first two years, but increasing the distribution requirement in years 3 through 10 from 4.5 percent to 5 percent.

Ms. Rodell continued to discuss slide 32. She noted that the odds of falling short would also reduce. She stated that the odds of maintaining the 5.9 percent annual return would be 56 percent.

Co-Chair MacKinnon wondered whether more staff would be required to manage more volatility or liquidity. Ms. Rodell replied that the staffing levels were affected more by the plan.

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Ms. Rodell discussed slide 33, "Stress Test Example: 2007-2016 (5.25 percent to 4.50 percent Scenario)." She remarked that the cumulative distributions were lower, and was expected because there was a less take at 4.5 percent, with the same effect of a large market selloff in the second year of 30 percent with a 20 percent recovery the following year.

Ms. Rodell highlighted slide 34, "Summary Comparison." She noted that the two were fairly close, but provided a range of outcomes. She explained that at the end of ten years, based on Callan's capital market forecast, there would be a distribution under the base case a total of \$31.521 billion. She noted that it was different than the stress case. She remarked that it was under the median outcomes. She remarked that the reduced distribution was \$29 billion. The fund would have grown to \$75.3 billion, or \$78.2 billion under the lower 4.5 percent draw. The ERA would continue to accumulate at \$14.3 billion. She furthered that there would be "built up" unrealized gain, because there would be no rebalancing, therefore the unrealized gains would be allowed to accumulate to \$21.4 billion, with no missed inflation-proofing payments.

Co-Chair MacKinnon noted that the additional legislative appropriations would be taken as "more" rather than "inflation-proofing", because of the statutory language. Ms. Rodell agreed. She furthered that the legislature also appropriated specific inflation-proofing payments.

Ms. Rodell stated that the Appendix was provided for informational purposes.

Co-Chair Hoffman remarked that there was a \$2.5 billion deficit in the governor's budget. He remarked that there was a short funding of credits that may not happen if the bonds were not sold. He stated that the deficit may actually be \$2.7 billion to \$2.8 billion. He noted that there was an additional \$2.3 billion that the governor

wanted to "backfill" the inflation proofing from the ERA. He stated that the total was above \$5 billion, at a "hit" to the ERA. He queried that scenario's impact on the fund. Ms. Rodell looked at slide 11. She stated that the draw was roughly \$2.6 billion. She remarked that adding that amount to inflation proofing rolled into the corpus, and was invested in the fund's earnings.

[10:55:28 AM](#)

Co-Chair Hoffman noted that the governor declared a \$2.5 billion deficit, but there was no inclusion of credits.

Co-Chair MacKinnon wondered whether the ERA was identically invested to the permanent fund. Ms. Rodell replied in the affirmative.

Co-Chair MacKinnon surmised that the \$2.3 billion of possible inflation proofing would be a technical book entry, versus a reallocation of asset. Ms. Rodell agreed.

Co-Chair MacKinnon surmised that the draw from the markets, without bill passage, would be instability in drawing the current budget shortfall. She noted that the governor's proposal had a smaller draw on the CBR, which may not be the best way to use the remaining assets.

Senator Micciche announced that it might be \$2.2 billion.

Co-Chair MacKinnon she stressed that there was a continued issue of the CBR.

Senator Micciche noted the difference in earnings from last year. He remarked that \$5 billion in savings at 12 percent, there would be an additional \$600 million. Ms. Rodell agreed.

Senator Micciche felt that the management of the CBR had cost many billion dollars over the years. He queried a better way to manage the CBR, while managing the need for some liquidity. He noted that liquidity had a bottom line. He felt that the expectation of liquidity was a very expensive way to manage the liquid assets. Ms. Rodell replied that the subaccounts provided a challenge for many DOR commissioners, because there was a recognition that some investments were lost. She recognized that the money was relied upon.

11:01:20 AM

Senator Micciche felt that there could be an in between. He stressed that there was a desire for maximum return in the asset allocation, and what could be done with the CBR in the past. He felt that there could be a focus on a greater return with a level of conservatism. Ms. Rodell replied that there was a challenge because the returns on the investments were at historic lows with cash rates at 1.3 percent versus the 3 percent in the past. She felt that there was a struggle because risk was required to see any return. She remarked that DOR was bound by statute based on what was in the CBR.

Co-Chair Hoffman stated that the CBR was classified as a "rainy day fund." He noted that the question should be "when is it raining?"

Co-Chair MacKinnon queried comments on the current bills that may affect the management of the permanent fund. Mr. Moran emphasized that it would be a mistake to underestimate the importance of the annual inflation proofing to the funds. He stated that the change in purchasing power over time had a compounding effect. He stressed that the goal of managing for future generations.

Senator Olson wondered there was a confirmation of fears that in the near future there would be hyperinflation. Mr. Moran replied that no one could predict the future.

Senator Olson felt that the double digit hyperinflation was almost inevitable. Mr. Moran responded that he was not an expert, but understand the compounding effect. He noted that small changes in the purchasing power resulted in large dollar amounts over the long term.

Co-Chair MacKinnon wondered whether the board's resolution that the people should vote on a percent of market value draw would be the right way to manage the assets. Mr. Moran replied that the board was still in favor of that approach to the distribution to the fund.

Co-Chair MacKinnon discussed the week's schedule.

ADJOURNMENT

11:06:59 AM

The meeting was adjourned at 11:06 a.m.