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GREENWICH ASSOCIATES

Public Pension Funds Flash Report January 1996

Thank you most sincerely for participating in our recent research on the largest public pension funds in the United States. Here is a preliminary release of our findings, based on 325 personal interviews with fund officials across the country. You will receive your personal copy of the complete Greenwich Report in the near future.

Public fund investments in domestic common stocks increased from 40.1% of assets in 1994 to 42.0% in 1995. These funds expect a decline to 40.9% of assets by the end of 1998. International investments fell slightly last year, from 11.1% to 10.6%, as domestic security prices advanced sharply, but are expected to resume growth, reaching nearly 14% of assets by the end of 1998.

Domestic fixed-income investments bounced back last year, but are expected to resume their downward trend over the next three years.

Real estate equities have declined in recent years but are expected to bounce back sharply over the next several years.

Public funds' expected rates of return for international equities declined (from 11.3% to 10.2%), while those for domestic stocks (S&P 500) rose (from 9.2% to 9.8%). Return expectations for actively managed bonds (at 7.5%) and equity real estate (at 7.2%) rose modestly, while those for 90-day Treasury bills were unchanged at 4.7%. Inflation is expected to average 3.4% over this period.

Change in Projected Asset Mix

Type of Investment		1992 Actual	1993 Actual	1994 Actual	1995 Actual	1998 Estimated	1995-1998 Change
Common stocks	Active	24.4%	22.2%	22.8%	25.3%	23.2%	-2.1
	Passive	15.7	19.1	17.3	16.7	17.7	1.0
	Total	40.1	41.2	40.1	42.0	40.9	-1.1
International	Active stocks	3.2	3.5	6.5	6.4	7.9	1.5
	Passive stocks	1.2	1.7	2.1	2.2	3.6	1.4
	Bonds	1.2	1.5	2.5	1.9	2.2	0.2
	Total	5.6	6.8	11.1	10.6	13.7	3.1
Bonds	Active	33.6	31.6	29.3	32.3	28.7	-3.6
	Immunized or dedicated	2.6	1.7	0.8	0.9	2.3	1.5
	Other passive	4.4	6.3	4.1	2.4	2.7	0.2
	Total	40.6	39.6	34.1	35.6	33.7	-1.9
Equity real estate	4.2	3.8	3.8	3.4	4.4	1.0	
Real estate mortgages	—	—	3.2	2.8	2.5	-0.3	
Guaranteed investment contracts	0.4	0.4	0.7	0.3	0.3	*	
Cash and short-term securities	4.2	4.2	3.3	3.1	1.7	-1.5	
Other	5.0	3.9	3.6	2.2	2.8	0.6	

Note: Percents are dollar-weighted and projected to the Greenwich Associates universe of public funds.

Rate of Return and Inflation Expectations, by Plan Assets

Type of Investment	Public Funds				Over \$1,000 Million	\$251- 1,000 Million	\$101-250 Million	\$100 Million and Under
	1992	1993	1994	1995				
Base	(151)	(123)	(161)	(161)	(57)	(43)	(37)	(24)
90-day Treasury bills	5.0%	4.2%	4.7%	4.7%	4.4%	4.8%	5.1%	5.2%
Actively managed bonds	8.0	7.4	7.3	7.5	7.2	7.4	7.6	8.0
S&P 500 stock average	10.0	9.0	9.2	9.8	9.7	9.6	9.9	10.5
Equity real estate	6.1	6.6	7.1	7.2	8.4	6.8	6.4	5.8
International equities	11.0	10.7	11.3	10.2	10.4	10.2	9.5	10.2
Expected rate of inflation	—	—	—	3.4	3.2	3.6	3.5	3.4

Note: Mean percents for average annual rate of return and inflation expectations over the next five years.

Public funds' use of value stocks and growth stocks bounced back and is now over 80% for both types of investments. The proportion of funds using active international stocks has jumped sharply, from 40% in 1992 to 62% currently. Use of passive international stocks, international bonds, and small cap stocks has also risen. Half of public funds continue to use equity real estate. Looking ahead, one fifth of public funds plan to start using active international stocks, significantly more than any other investment type.

Actuarial assumptions have declined modestly. Expected returns on assets are down from 8.2% to 8.1%, and salary increase assumptions are off slightly more, from 5.7% in 1993 to 5.4% in 1995.

Monthly benefits paid to *all* retirees rose 7% last year, to \$977 per month. The typical public fund is 91% funded—up from 87% in each of the past two years. Funded pension assets of \$1,445 billion are available to meet total obligations of \$1,585 billion, with \$140 billion still *unfunded*.

Public Fund Demand for Different Types of Investments

Type of Investment	Now Use					Will Start Using				
	1991	1992	1993	1994	1995	1991	1992	1993	1994	1995
Active core equity	—	—	52%	56%	44%	—	—	1%	1%	1%
Value stocks—Total	89%	88%	79	78	83	*%	2%	3	1	6
Large cap	—	—	—	—	75	—	—	—	—	*
Mid-cap	—	—	—	—	39	—	—	—	—	2
Small cap	—	—	—	—	44	—	—	—	—	5
Growth stocks—Total	79	82	79	75	81	2	4	2	2	6
Large cap	—	—	—	—	71	—	—	—	—	1
Mid-cap	—	—	—	—	41	—	—	—	—	2
Small cap	—	—	—	—	50	—	—	—	—	2
Small cap stocks—Total	56	57	62	60	63	6	8	6	2	6
Passive domestic stocks	37	38	41	35	37	5	1	2	2	2
International stocks—Total	43	44	52	58	68	25	24	28	27	22
Active	42	40	48	54	62	23	22	26	23	20
Passive	16	20	20	20	25	7	8	7	6	4
Active or passive bonds—Total	95	95	93	95	92	14	12	17	13	8
Domestic	94	94	93	93	92	6	2	2	2	*
International	18	22	23	25	29	10	10	15	11	8
Balanced funds	—	28	28	26	17	—	1	1	1	0
Equity real estate	50	50	52	50	52	3	2	2	2	2
Tactical asset allocation	13	14	13	11	12	2	1	3	3	2

Actuarial Assumptions and Funding

	1993	1994	1995
Return on plan assets	8.2%	8.2%	8.1%
Salary increase assumptions	5.7	5.6	5.4
Monthly benefits paid to all participants	\$ 798	\$ 913	\$ 977
Unfunded obligation*	180	191	140
Funded assets*	1,222	1,252	1,445
Total obligation*	1,402	1,443	1,585
Funding ratio	87%	87%	91%

*In billions.

Mean fees paid by public funds to outside managers continue to rise modestly, from 32.4 basis points in 1993, to 34.0 in 1994, and to 35.1 in 1995, but remain nearly 20% below the 43 basis points paid by corporate and endowment funds.

Fees paid to domestic *stock* managers are only 11% higher, at 39 basis points, while fees paid to domestic *bond* managers are 18% lower, at 29 basis points.

The proportion of public entities offering retiree healthcare programs to employees continues to decline steadily, from 50% in 1993 to 48% in 1994 and to 46% in 1995.

However, 24% of public funds are prefunding benefits (up from 21%), and 33% plan to transfer surplus pension assets to accomplish this funding, up from 30% last year.

Change in Mean Fees Paid to Outside Managers

	All Outside Managers					Domestic Stock Manager		Domestic Bond Manager	
	1991	1992	1993	1994	1995	1994	1995	1994	1995
Corporate Funds	41.1	44.2	45.4	44.7	43.1	52.6	50.0	34.9	32.0
Over \$1 billion	35.8	38.2	37.3	33.3	40.4	42.9	46.4	25.5	28.9
\$101-1,000 million	44.0	42.6	47.1	47.2	44.2	56.0	52.5	36.4	34.0
\$100 million and under	40.2	51.3	50.4	50.3	43.4	54.9	48.6	43.6	31.6
Public Funds	31.0	33.3	32.4	34.0	35.1	37.2	38.9	25.3	28.8
State	26.0	29.0	30.5	28.8	26.8	30.2	31.1	18.9	20.5
Municipal	33.1	34.3	32.7	35.8	38.1	39.8	41.5	27.1	31.1
Over \$1 billion	24.8	28.8	31.5	29.7	27.3	33.4	31.2	20.0	19.6
\$101-1,000 million	34.7	35.1	33.7	35.8	38.0	39.8	42.7	25.9	31.3
\$100 million and under	31.1	35.4	30.9	36.7	40.6	37.4	41.7	31.5	35.4
Endowments	43.9	44.4	44.5	45.2	43.3	49.3	48.3	31.1	29.8
Over \$1 billion	42.4	39.3	37.5	39.7	42.8	42.3	39.9	27.8	23.0
\$251-1,000 million	41.2	41.6	44.5	44.0	42.1	46.1	47.6	29.0	27.7
\$250 million and under	47.7	48.6	46.8	47.4	44.8	54.2	51.5	34.3	33.6
Total Funds	37.6	39.6	39.5	40.1	39.7	44.9	44.8	29.7	30.0

Note: Excluding none and expressed in basis points.

Retiree Healthcare

Plan Assets	Have Program			Prefund Benefits for Program		Transferable Surplus Pension Assets	
	1993	1994	1995	1994	1995	1994	1995
Over \$1 billion	44%	42%	40%	31	40	29	41
\$251-1,000 million	46	46	42	17	22	57	50
\$250 million and under	57	55	54	17	16	17	9
Total Public Funds	50%	48%	46%	21%	24%	30%	33%

Public fund officials receive an average salary of \$65,200, up 0.6% from 1994. State fund officials receive an average salary of \$69,200, while municipal fund officials receive \$63,300. For the 9% of officials eligible to receive a bonus, it averages \$9,900 (15% of base salary)—up from \$8,200 last year.

Public funds are increasing internal *investment* staff. Total professional staff is up from 4.1 to 4.9—due to a big jump in staff managing internal investments (from 3.0 to 5.0). At the same time, *administrative* staff is down: Staff monitoring and evaluating managers is down from 2.9 to 2.3, while staff performing administrative functions is down from 2.6 to 2.2.

Change in Mean Total Compensation

	Salary				Bonus*			
	1992	1993	1994	1995	1992	1993	1994	1995
Corporate Funds	\$ 89.4	\$ 93.0	\$ 87.3	\$ 92.8	\$17.2	\$22.7	\$16.9	\$20.2
Over \$1 billion	104.9	101.7	94.3	106.0	22.5	25.6	19.2	25.8
\$501-1,000 million	92.8	92.5	92.7	96.5	17.9	19.1	22.2	20.1
\$251- 500 million	84.1	88.7	82.6	86.5	12.8	21.2	16.0	16.1
\$101- 250 million	84.5	90.8	83.5	89.7	15.8	21.7	14.1	19.5
\$ 51- 100 million	85.3	92.6	83.1	84.9	15.9	27.4	14.0	18.7
\$50 million and under	84.6	89.3	98.3	86.3	17.2	19.3	19.9	15.6
Public Funds	\$ 61.7	\$ 63.3	\$ 64.8	\$ 65.2	\$ 5.9	\$ 5.0	\$ 8.2	\$ 9.9
State	68.7	72.8	70.8	69.2	9.9	10.6	13.9	21.1
Municipal	58.6	59.7	61.6	63.3	1.8	1.8	2.9	5.0
Over \$1 billion	71.6	75.2	75.6	75.4	9.0	8.4	18.4	15.8
\$251-1,000 million	62.3	62.6	64.4	65.3	1.3	1.9	3.0	2.1
\$101- 250 million	56.4	56.6	61.1	56.9	2.8	2.5	1.5	1.5
\$ 51- 100 million	52.1	51.7	54.0	55.2	6.8	1.8	1.8	0.8
\$50 million and under	52.8	47.7	47.5	52.9	0.8	—	3.1	—
Endowments	\$ 91.1	\$ 91.3	94.6	\$100.4	\$18.0	\$17.0	\$ 16.1	\$13.5
Over \$1 billion	110.3	122.0	118.8	123.4	17.8	32.1	27.9	27.4
\$251-1,000 million	94.5	91.4	96.0	96.4	19.0	11.1	5.2	8.8
\$250 million and under	79.8	81.7	84.9	98.2	14.5	15.0	12.3	11.5
Total Funds	\$ 80.8	\$ 83.1	\$ 80.8	\$ 85.4	\$16.5	\$21.3	\$16.1	\$18.9

Note: In thousands and excluding none.

*Based on respondents eligible for a bonus.

Mean Number of Professionals Within Sponsor Organization

	Monitor Current Managers and Evaluate Prospective Firms		Perform Administrative Functions		Manage Internal Investments		Total Professionals	
	1994	1995	1994	1995	1994	1995	1994	1995
Public Funds								
State	3.5	2.8	3.1	2.7	3.8	5.6	5.5	6.8
Municipal	2.5	2.0	2.3	2.0	2.0	1.7	3.2	3.3
Over \$1 billion	3.5	3.0	3.4	2.8	4.2	7.1	7.4	8.6
\$251-1,000 million	2.7	2.2	2.3	2.4	2.0	2.0	3.0	3.7
\$101- 250 million	2.8	1.7	2.2	5	2.0	1.2	2.5	2.7
\$ 51- 100 million	2.3	2.1	2.3	2.1	2.0	1.0	2.3	2.5
\$50 million and under	3.5	1.4	2.0	1.6	—	—	3.5	2.4
Total Public Funds	2.9	2.3	2.6	2.2	3.0	5.0	4.1	4.9

Note: Excluding none.

(11)

HOUSE COMMITTEE REPORT

Date Referred to Committee: February 21, 1996

FURTHER REFERRALS:

Date of Committee Action: 3/1/96

The FINANCE Committee considered:

HB 525

HOUSE BILL NO. 525

PERMANENT FUND INVESTMENTS

"An Act designating certain permissible investments by the Alaska Permanent Fund Corporation in taxable municipal or state debt securities and corporate debt securities; changing the allocation limits on domestic and nondomestic government and corporate securities, nondomestic corporate promissory notes, domestic and nondomestic corporate stocks, and taxable government debt securities; and providing for an effective date."

recommends it be replaced with the following committee substitute [] the same title [] a new title

[] additional referral to _____ Committee [] attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept) APPROVES PREVIOUS: (Dept/Date) [] fiscal note(s) [] fiscal note(s)

[X] zero fiscal note(s) Rev. [] zero fiscal note(s)

Table with columns: SIGNING WITH RECOMMENDATIONS, DP, DNP, NR, AM. Rows include signatures and names like Hankey, Brown, Mulder, Martin, Parnell, Kohring, Grussendorf, and Foster.

CHAIR'S SIGNATURE Mark Hanley Richard Foster

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act designating certain permissible investments BRU: APFC
by the Alaska Permanent Fund Corporation... Component: APFC
 Sponsor: House Finance
 Recusor: House Finance COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts	III					
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

(See attached memorandum dated February 27, 1996 from Byron I. Mallott to the members, House Finance Committee.)

Prepared by: Byron I. Mallott, Executive Director Phone: (907) 465-2047
 Division: Alaska Permanent Fund Corporation Date: 2/27/96
 Approved by Commissioner: [Signature] Date: 2/28/96
 Agency: Department of Revenue

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Alaska Permanent Fund Corporation
P.O. Box 25500 Juneau, Alaska 99802-5500
(907) 465-2047

MEMORANDUM

DATE: February 27, 1996

TO: Members, House Finance Committee

FROM: Byron I. Mallott
Executive Director

SUBJECT: **Projected Effects of Passage of HB 525, Relating
to Permanent Fund Investments**

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

Permanent Fund Equities at Market Value

<u>Current Holdings</u>	<u>Maximum under HB 525</u>	<u>Difference</u>
\$8.665 billion	\$9.336 billion	\$671 million

If the Trustees were to allocate the maximum 50% to equities (given the Fund's current \$18.7 billion market value), they would be increasing the Fund's percentage holdings of an asset class which has an expected total return over the next five years ranging from 9.5% for U.S. large cap stocks, to 10.2% for non-U.S. stocks to 10.5% for U.S. small cap stocks. Simultaneously, the Fund would be decreasing its percentage holdings in an asset class with an expected total return over the next five years of 6.8% (fixed income). The difference in annual return for \$671 million earning 9.5% instead of 6.8% is \$2,300,000.

Impact of Increasing Permanent Fund Holdings of A- and Baa-Rated Corporate Debt Securities

Given the \$8.2 billion market value of the Fund's fixed-income portfolio as of January 31, 1996, the Trustees would have to increase the Permanent Fund's holdings in A-rated paper by \$240 million and Baa-rated paper by \$480 million to equal the percentage weighting in these investment-grade securities held in the corporate component of the Lehman Brothers Government/Corporate Index.

(Note: This is very much the type of flexibility being sought in this legislation. The Trustees would like to be able, through the Fund's in-house investment staff and/or the new external fixed-income managers, to take advantage of investment opportunities in this component of the investment-grade corporate universe, if and when they arise.)

In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

Increase in "A"	\$240 million	x	39 bp	=	\$936,000
Increase in "Baa"	\$480 million	x	111 bp	=	<u>\$5,328,000</u>
					\$6,264,000

The combined potential increase in income from increased holdings of equities and lower-rated investment grade corporate debt securities, given the above assumptions, would thus total \$8,564,000 (\$2,300,000 in stocks plus \$6,264,000 in bonds). Over five years, that total increase in income would amount to more than \$40 million.

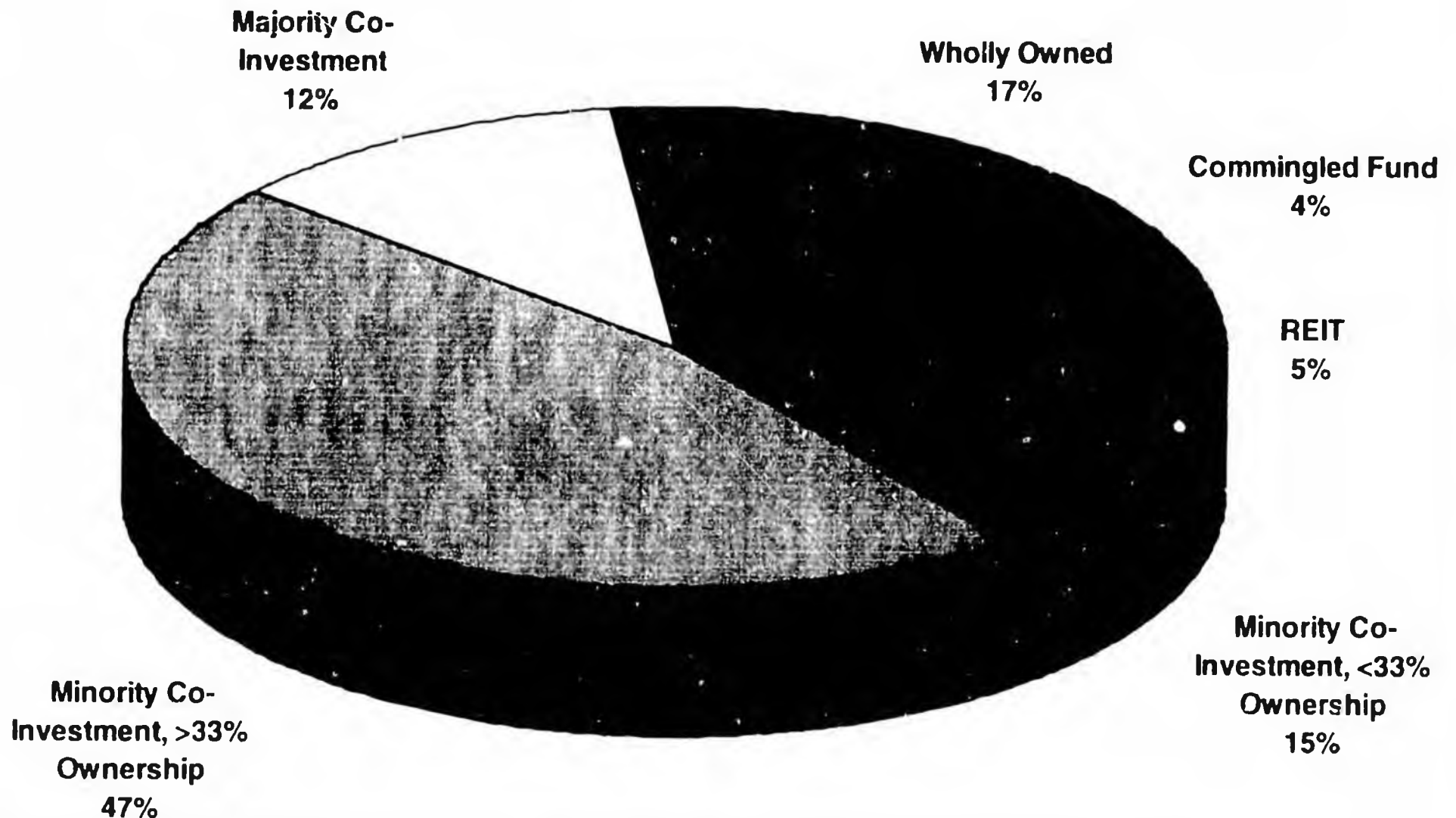
It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
February 27, 1996
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Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

Permanent Fund Real Estate

Ownership Interests as of December 31, 1995



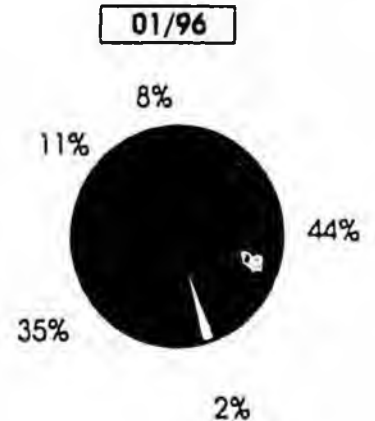
ALASKA PERMANENT FUND CORPORATION
INVESTED FUNDS SUMMARY
January 31, 1996

	<u>COST</u>	<u>%</u>	<u>MARKET</u>	<u>%</u>	<u>UNREALIZED GAINS(LOSSES)</u>	<u>YIELD</u>
CASH & PENDINGS	\$ 404,747,000	2.48%	\$ 404,747,000	2.16%	\$ -	5.19%
FIXED INCOME SECURITIES	7,829,648,000	48.03%	8,223,997,000	43.90%	394,449,000	6.94%
DOMESTIC EQUITIES	4,862,493,000	29.83%	6,664,345,000	35.58%	1,801,852,000	2.40%
NON-DOMESTIC EQUITIES	1,742,506,000	10.69%	2,001,006,000	10.68%	258,500,000	3.08%
REAL ESTATE	1,461,445,000	8.97%	1,438,304,000	7.68%	(23,141,000)	6.98%

INVESTED FUNDS	<u>\$ 16,300,739,000</u>	<u>100.00%</u>	<u>\$ 18,732,999,000</u>	<u>100.00%</u>	<u>\$ 2,431,660,000</u>	<u>5.13%</u>
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INVESTED FUNDS
ACTUAL & TARGET ALLOCATIONS

	01/95	06/95	06/98 TARGET	01/96
□ CASH	5%	5%	0%	2%
■ FIXED INCOME	47%	44%	45%	44%
■ DOMESTIC EQUITY	29%	33%	35%	35%
■ NON-DOM EQUITY	11%	10%	10%	11%
■ REAL ESTATE	8%	8%	10%	8%
TOTAL	100%	100%	100%	100%



ALASKA PERMANENT FUND CORPORATION
FIXED INCOME SECURITIES
January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
TREASURY NOTES/BONDS	\$ -	-	\$ -	-	\$ -	-
CORP. NOTES/BONDS	124,454,000	1.59%	126,121,000	1.53%	1,667,000	7.88%
TOTAL SHORT TERM MARKETABLE DEBT	124,454,000	1.59%	126,121,000	1.53%	1,667,000	7.88%
TREASURY NOTES/BONDS	4,003,943,000	51.12%	4,163,911,000	50.63%	159,968,000	6.72%
CORPORATE NOTES/BONDS	946,513,000	12.09%	993,261,000	12.08%	46,748,000	7.22%
OTHER US AGENCY	268,209,000	3.43%	274,685,000	3.34%	6,476,000	6.36%
YANKEE BONDS	78,847,000	1.01%	87,788,000	1.07%	8,941,000	8.57%
TOTAL INTERMEDIATE MARKETABLE DEBT	5,297,512,000	67.65%	5,519,645,000	67.12%	222,133,000	6.82%
TREASURY NOTES/BONDS	1,305,800,000	16.68%	1,410,213,000	17.15%	104,413,000	6.83%
CORPORATE NOTES/BONDS	632,304,000	8.08%	678,514,000	8.25%	46,211,000	7.26%
GNMA POOLS	128,137,000	1.64%	133,838,000	1.63%	5,701,000	8.11%
OTHER US AGENCY	171,403,000	2.19%	179,153,000	2.18%	7,750,000	6.82%
YANKEE BONDS	93,938,000	1.20%	100,513,000	1.22%	6,575,000	8.16%
TOTAL LONG TERM MARKETABLE DEBT	2,331,582,000	29.79%	2,502,231,000	30.43%	170,650,000	7.07%
TOTAL MARKETABLE DEBT SECURITIES	7,753,548,000	99.03%	8,147,997,000	99.08%	394,449,000	6.95%
ALASKA CD's	76,000,000	97%	76,000,000	.92%	-	5.44%
TOTAL FIXED INCOME SECURITIES	\$ 7,829,548,000	100.00%	\$ 8,223,997,000	100.00%	\$ 394,449,000	6.94%

ALASKA PERMANENT FUND CORPORATION
REAL ESTATE HOLDINGS
January 31, 1996

	<u>COST</u>	<u>%</u>	<u>MARKET</u>	<u>%</u>	<u>UNREALIZED GAIN(LOSS)</u>	<u>YIELD</u>
REIT	\$ 62,162,000	4.25%	\$ 68,115,000	4.74%	\$ 5,954,000	7.08%
COMMINGLED FUNDS	70,090,000	4.80%	58,045,000	4.04%	(12,045,000)	4.42%
RETAIL	463,840,000	31.74%	471,348,000	32.76%	7,508,000	6.38%
OFFICE	362,896,000	24.83%	342,838,000	23.84%	(20,058,000)	6.15%
INDUSTRIAL	179,932,000	12.31%	169,720,000	11.80%	(10,213,000)	8.19%
RESIDENTIAL	<u>322,078,000</u>	<u>22.04%</u>	<u>327,791,000</u>	<u>22.79%</u>	<u>5,714,000</u>	<u>8.67%</u>
TOTAL COMMERCIAL REAL ESTATE	\$ 1,460,998,000	99.97%	\$ 1,437,857,000	99.97%	\$ (23,141,000)	6.98%
MORTGAGES	447,000	.03%	447,000	.03%	-	-
TOTAL REAL ESTATE	<u>\$ 1,461,445,000</u>	<u>100.00%</u>	<u>\$ 1,438,304,000</u>	<u>100.00%</u>	<u>\$ (23,141,000)</u>	<u>6.98%</u>

EQUITIES
UNREALIZED GAINS AND LOSSES
January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)
DOMESTIC (INDEX)	\$ 1,000,623,000	15.15%	\$ 1,493,860,000	17.24%	\$ 493,236,000
DOMESTIC (ACTIVE)	2,311,132,000	34.99%	3,256,208,000	37.57%	945,076,000
NON-DOMESTIC (ACTIVE)	454,531,000	6.88%	568,073,000	6.56%	113,543,000
GLOBAL DOMESTIC (ACTIVE)	1,550,737,000	23.48%	1,914,278,000	22.09%	363,540,000
GLOBAL NON-DOMESTIC (ACTIVE)	<u>1,287,975,000</u>	<u>19.50%</u>	<u>1,432,933,000</u>	<u>16.54%</u>	<u>144,958,000</u>
TOTAL EQUITIES	<u>\$ 6,604,998,000</u>	<u>100.00%</u>	<u>\$ 8,665,352,000</u>	<u>100.00%</u>	<u>\$ 2,060,353,000</u>

DOMESTIC EQUITIES SECURITY GAIN (LOSS)	\$ 1,801,852,000
NON-DOMESTIC EQUITIES SECURITY GAIN (LOSS)	288,979,000
NON-DOMESTIC EQUITIES CURRENCY GAIN (LOSS)	(30,478,000)
	<u><u>2,060,353,000</u></u>

EQUITIES
CASH AND MARKET VALUE SUMMARY
January 31, 1996

	CASH & PENDINGS		EQUITIES		PORTFOLIO TOTALS		% OF TOTAL
	MARKET	%	MARKET	%	MARKET	%	
DOMESTIC PORTFOLIOS							
ALLIANCE	\$ 2,226,000	0.68%	\$ 323,216,000	99.32%	\$ 325,442,000	100.00%	3.61%
ARK	29,864,000	4.66%	611,295,000	95.34%	641,160,000	100.00%	7.11%
BANKERS TRUST	4,803,000	0.32%	1,493,860,000	99.68%	1,498,663,000	100.00%	16.61%
BRINSON	6,052,000	1.95%	304,917,000	98.05%	310,968,000	100.00%	3.45%
CHANCELLOR	14,044,000	1.71%	806,236,000	98.29%	820,280,000	100.00%	9.09%
CAPITAL GUARDIAN	18,027,000	5.45%	312,501,000	94.55%	330,528,000	100.00%	3.66%
GOLDMAN SACHS	7,239,000	2.89%	242,848,000	97.11%	250,087,000	100.00%	2.77%
INVESCO	35,989,000	5.02%	681,354,000	94.98%	717,343,000	100.00%	7.95%
LAZARD	12,462,000	3.32%	362,349,000	96.68%	374,811,000	100.00%	4.15%
RCM	89,487,000	6.50%	1,287,072,000	93.50%	1,376,558,000	100.00%	15.26%
SOCIETY	7,622,000	3.09%	238,698,000	96.91%	246,320,000	100.00%	2.73%
TOTAL DOMESTIC	\$ 227,815,000	3.31%	\$ 6,664,346,000	96.69%	\$ 6,892,160,000	100.00%	76.38%
NON-DOMESTIC PORTFOLIOS							
ALLIANCE	\$ 16,050,000	6.46%	\$ 232,282,000	93.54%	\$ 248,332,000	100.00%	2.75%
ARK	6,865,000	1.34%	503,614,000	98.56%	510,479,000	100.00%	5.66%
BRINSON	59,887,000	20.78%	228,341,000	79.22%	288,228,000	100.00%	3.19%
CAPITAL GUARDIAN	13,756,000	5.48%	237,483,000	94.52%	251,238,000	100.00%	2.78%
CLAY FINLAY	8,713,000	4.22%	197,633,000	95.78%	206,346,000	100.00%	2.29%
LAZARD	14,943,000	6.07%	231,213,000	93.93%	246,156,000	100.00%	2.73%
SCHRODER	4,676,000	1.86%	246,681,000	98.14%	251,357,000	100.00%	2.79%
UBS	5,310,000	4.11%	123,759,000	95.89%	129,069,000	100.00%	1.43%
TOTAL NON-DOMESTIC	\$ 130,200,000	6.11%	\$ 2,001,006,000	93.89%	\$ 2,131,205,000	100.00%	23.62%
TOTAL EQUITIES MGRS	\$ 358,015,000	3.97%	\$ 8,665,352,000	96.03%	\$ 9,023,365,000	100.00%	100.00%

DOMESTIC EQUITIES DETAIL
January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
INDEX DOMESTIC - BANKERS TRUST - S & P 500						
Cash and Pendings	\$ -	-	\$ -	-	\$ -	-
Cash Managed by APFC	4,803,000	0.48%	4,803,000	0.32%	-	5.28%
Domestic Equities	<u>1,000,623,000</u>	<u>99.52%</u>	<u>1,493,860,000</u>	<u>99.68%</u>	<u>493,236,000</u>	<u>3.53%</u>
Total	<u>\$ 1,005,426,000</u>	<u>100.00%</u>	<u>\$ 1,498,663,000</u>	<u>100.00%</u>	<u>\$ 493,236,000</u>	<u>3.54%</u>

TOTAL ACTIVE DOMESTIC MANAGERS

Cash and Pendings	\$ (5,990,000)	-0.24%	\$ (5,990,000)	-0.18%	\$ -	-
Cash Managed by APFC	150,371,000	6.50%	160,371,000	4.70%	-	5.28%
Domestic Equities	<u>2,311,132,000</u>	<u>93.74%</u>	<u>3,256,208,000</u>	<u>95.48%</u>	<u>945,076,000</u>	<u>2.16%</u>
Total	<u>\$ 2,465,513,000</u>	<u>100.00%</u>	<u>\$ 3,410,589,000</u>	<u>100.00%</u>	<u>\$ 945,076,000</u>	<u>2.37%</u>

ACTIVE DOMESTIC - RCM

Cash and Pendings	\$ 2,832,000	0.28%	\$ 2,832,000	0.21%	\$ -	5.28%
Cash Managed by APFC	86,655,000	8.63%	86,655,000	6.30%	-	5.28%
Domestic Equities	<u>914,872,000</u>	<u>91.09%</u>	<u>1,287,072,000</u>	<u>93.49%</u>	<u>372,200,000</u>	<u>2.02%</u>
Total	<u>\$ 1,004,359,000</u>	<u>100.00%</u>	<u>\$ 1,376,559,000</u>	<u>100.00%</u>	<u>\$ 372,200,000</u>	<u>2.31%</u>

ACTIVE DOMESTIC - INVESCO

Cash and Pendings	\$ -	-	\$ -	-	\$ -	-
Cash Managed by APFC	35,989,000	8.90%	35,989,000	5.02%	-	5.28%
Domestic Equities	<u>368,583,000</u>	<u>91.10%</u>	<u>681,354,000</u>	<u>94.98%</u>	<u>312,771,000</u>	<u>3.53%</u>
Total	<u>\$ 404,572,000</u>	<u>100.00%</u>	<u>\$ 717,343,000</u>	<u>100.00%</u>	<u>\$ 312,771,000</u>	<u>3.69%</u>

ACTIVE DOMESTIC - CHANCELLOR

Cash and Pendings	\$ (7,237,000)	-1.17%	\$ (7,237,000)	-0.88%	\$ -	-
Cash Managed by APFC	21,281,000	3.43%	21,281,000	2.59%	-	5.28%
Domestic Equities	<u>606,559,000</u>	<u>97.74%</u>	<u>806,236,000</u>	<u>98.29%</u>	<u>199,377,000</u>	<u>1.26%</u>
Total	<u>\$ 620,903,000</u>	<u>100.00%</u>	<u>\$ 820,280,000</u>	<u>100.00%</u>	<u>\$ 199,377,000</u>	<u>1.35%</u>

DOMESTIC EQUITIES DETAIL
January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
ACTIVE DOMESTIC - SOCIETY ASSET MANAGEMENT						
Cash and Pendings	\$ (1,608,000)	-0.75%	\$ (1,608,000)	-0.65%	\$ -	-
Cash Managed by APFC	9,230,000	4.28%	9,230,000	3.75%	-	5.28%
Domestic Equities	<u>208,068,000</u>	<u>96.47%</u>	<u>238,698,000</u>	<u>96.90%</u>	<u>30,630,000</u>	<u>2.34%</u>
Total	<u>\$ 215,690,000</u>	<u>100.00%</u>	<u>\$ 246,320,000</u>	<u>100.00%</u>	<u>\$ 30,630,000</u>	<u>2.44%</u>

ACTIVE DOMESTIC - GOLDMAN SACHS ASSET MANAGEMENT

Cash and Pendings	\$ 24,000	0.01%	\$ 24,000	0.01%	\$ -	5.28%
Cash Managed by APFC	7,215,000	3.28%	7,215,000	2.89%	-	5.28%
Domestic Equities	<u>212,750,000</u>	<u>96.71%</u>	<u>242,848,000</u>	<u>97.10%</u>	<u>30,098,000</u>	<u>2.74%</u>
Total	<u>\$ 219,989,000</u>	<u>100.00%</u>	<u>\$ 250,087,000</u>	<u>100.00%</u>	<u>\$ 30,098,000</u>	<u>2.82%</u>

NON-DOMESTIC EQUITIES DETAIL
January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
TOTAL ACTIVE NON-DOMESTIC MANAGERS						
Cash and Pending	\$ 18,699,000	3.95%	\$ 18,699,000	3.19%	\$ -	4.28%
Non-Domestic Equities	<u>454,531,000</u>	<u>96.05%</u>	<u>568,073,000</u>	<u>96.81%</u>	<u>113,543,000</u>	<u>2.81%</u>
Total	<u>\$ 473,230,000</u>	<u>100.00%</u>	<u>\$ 586,772,000</u>	<u>100.00%</u>	<u>\$ 113,543,000</u>	<u>2.87%</u>

ACTIVE NON-DOMESTIC - CLAY FINLAY INCORPORATED

Cash and Pendings	\$ 8,713,000	5.01%	\$ 8,713,000	4.22%	\$ -	3.14%
Non-Domestic Equities	<u>165,068,000</u>	<u>94.99%</u>	<u>197,633,000</u>	<u>95.78%</u>	<u>32,565,000</u>	<u>-</u>
Total	<u>\$ 173,781,000</u>	<u>100.00%</u>	<u>\$ 206,346,000</u>	<u>100.00%</u>	<u>\$ 32,565,000</u>	<u>-</u>

ACTIVE NON-DOMESTIC - SCHRODERS INTERNATIONAL CAPITAL MANAGEMENT

Cash and Pendings	\$ 4,676,000	2.58%	\$ 4,676,000	1.86%	\$ -	4.83%
Non-Domestic Equities	<u>176,517,000</u>	<u>97.42%</u>	<u>246,681,000</u>	<u>98.14%</u>	<u>70,164,000</u>	<u>2.52%</u>
Total	<u>\$ 181,193,000</u>	<u>100.00%</u>	<u>\$ 251,357,000</u>	<u>100.00%</u>	<u>\$ 70,164,000</u>	<u>2.58%</u>

ACTIVE NON-DOMESTIC - UBS INTERNATIONAL INVESTMENT

Cash and Pendings	\$ 5,310,000	4.49%	\$ 5,310,000	4.11%	\$ -	5.65%
Non-Domestic Equities	<u>112,946,000</u>	<u>95.51%</u>	<u>123,759,000</u>	<u>95.89%</u>	<u>10,813,000</u>	<u>3.27%</u>
Total	<u>\$ 118,256,000</u>	<u>100.00%</u>	<u>\$ 129,069,000</u>	<u>100.00%</u>	<u>\$ 10,813,000</u>	<u>3.38%</u>

GLOBAL EQUITIES DETAIL

January 31, 1996

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
GLOBAL MANAGERS SUMMARY						
Cash and Pendings-Dom	\$ 10,666,000	0.35%	\$ 10,666,000	0.30%	\$ -	5.28%
Cash and Pendings-Int'l	111,500,000	3.69%	111,500,000	3.16%	-	4.84%
Cash Managed by APFC	57,965,000	1.92%	57,965,000	1.64%	-	5.28%
Domestic Equities	1,550,737,000	51.38%	1,914,278,000	54.28%	363,540,000	2.37%
Non-Domestic Equities	1,287,975,000	42.66%	1,432,933,000	40.62%	144,958,000	3.17%
	<u>\$ 3,018,843,000</u>	<u>100.00%</u>	<u>\$ 3,527,342,000</u>	<u>100.00%</u>	<u>\$ 508,498,000</u>	<u>2.87%</u>

GLOBAL - ALLIANCE CAPITAL MANAGEMENT

Cash and Pendings-Dom	\$ -	-	\$ -	-	\$ -	-
Cash and Pendings-Int'l	16,050,000	3.18%	16,050,000	2.80%	-	4.98%
Cash Managed by APFC	2,226,000	0.44%	2,226,000	0.39%	-	5.28%
Domestic Equities	269,302,000	53.40%	323,216,000	56.33%	53,913,000	2.10%
Non-Domestic Equities	216,771,000	42.98%	232,282,000	40.48%	15,511,000	4.02%
	<u>\$ 504,349,000</u>	<u>100.00%</u>	<u>\$ 573,774,000</u>	<u>100.00%</u>	<u>\$ 69,424,000</u>	<u>3.03%</u>

GLOBAL - ARK ASSET MANAGEMENT

Cash and Pendings-Dom	\$ 14,594,000	1.43%	\$ 14,594,000	1.27%	\$ -	5.28%
Cash and Pendings-Int'l	6,865,000	0.67%	6,865,000	0.60%	-	3.73%
Cash Managed by APFC	15,270,000	1.50%	15,270,000	1.33%	-	5.28%
Domestic Equities	520,574,000	51.14%	611,295,000	53.08%	90,722,000	2.50%
Non-Domestic Equities	460,655,000	45.26%	503,614,000	43.72%	42,959,000	-
	<u>\$ 1,017,958,000</u>	<u>100.00%</u>	<u>\$ 1,151,638,000</u>	<u>100.00%</u>	<u>\$ 133,681,000</u>	<u>2.66%</u>

GLOBAL - CAPITAL GUARDIAN TRUST

Cash and Pendings-Dom	\$ 9,108,000	1.91%	\$ 9,108,000	1.57%	\$ -	5.28%
Cash and Pendings-Int'l	13,756,000	2.88%	13,756,000	2.36%	-	4.88%
Cash Managed by APFC	8,919,000	1.87%	8,919,000	1.53%	-	5.28%
Domestic Equities	250,514,000	52.40%	312,501,000	53.72%	61,987,000	2.13%
Non-Domestic Equities	195,777,000	40.94%	237,483,000	40.82%	41,706,000	2.23%
	<u>\$ 478,074,000</u>	<u>100.00%</u>	<u>\$ 581,767,000</u>	<u>100.00%</u>	<u>\$ 103,693,000</u>	<u>2.37%</u>

GLOBAL EQUITIES DETAIL

January 31, 1986

	COST	%	MARKET	%	UNREALIZED GAINS(LOSSES)	YIELD
GLOBAL - BRINSON PARTNERS						
Cash and Pendings-Dom	\$ (46,000)	-0.01%	\$ (46,000)	-0.01%	\$ -	-
Cash and Pendings-Int'l	59,887,000	11.85%	59,887,000	9.99%	-	4.82%
Cash Managed by APFC	6,098,000	1.21%	6,098,000	1.02%	-	5.28%
Domestic Equities	229,530,000	45.44%	304,917,000	50.89%	75,387,000	2.68%
Non-Domestic Equities	209,708,000	41.51%	228,341,000	38.11%	18,633,000	-
Total	\$ 505,177,000	100.00%	\$ 599,197,000	100.00%	\$ 94,020,000	3.17%

GLOBAL - LAZARD FRERES ASSET MANAGEMENT

Cash and Pendings-Dom	\$ (12,990,000)	-2.53%	\$ (12,990,000)	-2.09%	\$ -	-
Cash and Pendings-Int'l	14,943,000	2.91%	14,943,000	2.41%	-	5.24%
Cash Managed by APFC	25,453,000	4.96%	25,453,000	4.10%	-	5.28%
Domestic Equities	280,817,000	54.71%	362,349,000	58.35%	81,531,000	2.37%
Non-Domestic Equities	205,064,000	39.95%	231,213,000	37.23%	26,149,000	-
Total	\$ 513,287,000	100.00%	\$ 620,968,000	100.00%	\$ 107,680,000	2.63%

ALASKA PERMANENT FUND CORPORATION
UNREALIZED GAIN(LOSS) ANALYSIS
January 31, 1996

CURRENT MONTH

	December 31, 1995			January 31, 1996
	Unrealized Gain(Loss)	Less: Realized Gains(Losses)	Appreciation (Depreciation)	Unrealized Gain(Loss)
FIXED INCOME SECURITIES	\$ 425,084,000	\$ 35,378,000	\$ 4,743,000	\$ 394,449,000
DOMESTIC EQUITIES	1,615,693,000	37,153,000	223,312,000	1,801,852,000
NON-DOMESTIC EQUITIES	231,432,000	9,610,000	36,678,000	258,500,000
REAL ESTATE	<u>(22,954,000)</u>	<u>660,000</u>	<u>473,000</u>	<u>(23,141,000)</u>
TOTAL	<u>\$ 2,249,255,000</u>	<u>\$ 82,801,000</u>	<u>\$ 265,206,000</u>	<u>\$ 2,431,660,000</u>

FISCAL YEAR TO DATE

	June 30, 1995			January 31, 1996
	Unrealized Gain(Loss)	Less: Realized Gains(Losses)	Appreciation (Depreciation)	Unrealized Gain(Loss)
FIXED INCOME SECURITIES	\$ 262,726,000	\$ 108,977,000	\$ 240,700,000	\$ 394,449,000
DOMESTIC EQUITIES	1,292,543,000	524,367,000	1,033,676,000	1,801,852,000
NON-DOMESTIC EQUITIES	175,224,000	45,858,000	129,134,000	258,500,000
REAL ESTATE	<u>(23,866,000)</u>	<u>(2,115,000)</u>	<u>(1,390,000)</u>	<u>(23,141,000)</u>
TOTAL	<u>\$ 1,706,627,000</u>	<u>\$ 677,087,000</u>	<u>\$ 1,402,120,000</u>	<u>\$ 2,431,660,000</u>

ALASKA PERMANENT FUND

A Public Trust Investing For Alaska's Future



Monthly Financial Report
January 1996

TRUSTEES' REPORT TO ALASKANS

Permanent Fund Earned \$151 Million in January, \$1.146 Billion Fiscal Year-to-Date

During the month of January, the Fund earned \$151 million in net income. That compares to \$60 million for the same month one year ago. For the first seven months of this fiscal year, the net income totals \$1.146 billion, compared to \$511 million for the same period in fiscal 1995.

As of January 31, the cost value of funds under management totaled \$16.3 billion and the market value totaled \$18.7 billion. Unrealized gains totaled \$2.4 billion.

The extremely high returns the Fund has enjoyed this year (seven consecutive months of earnings in excess of \$100 million) are primarily

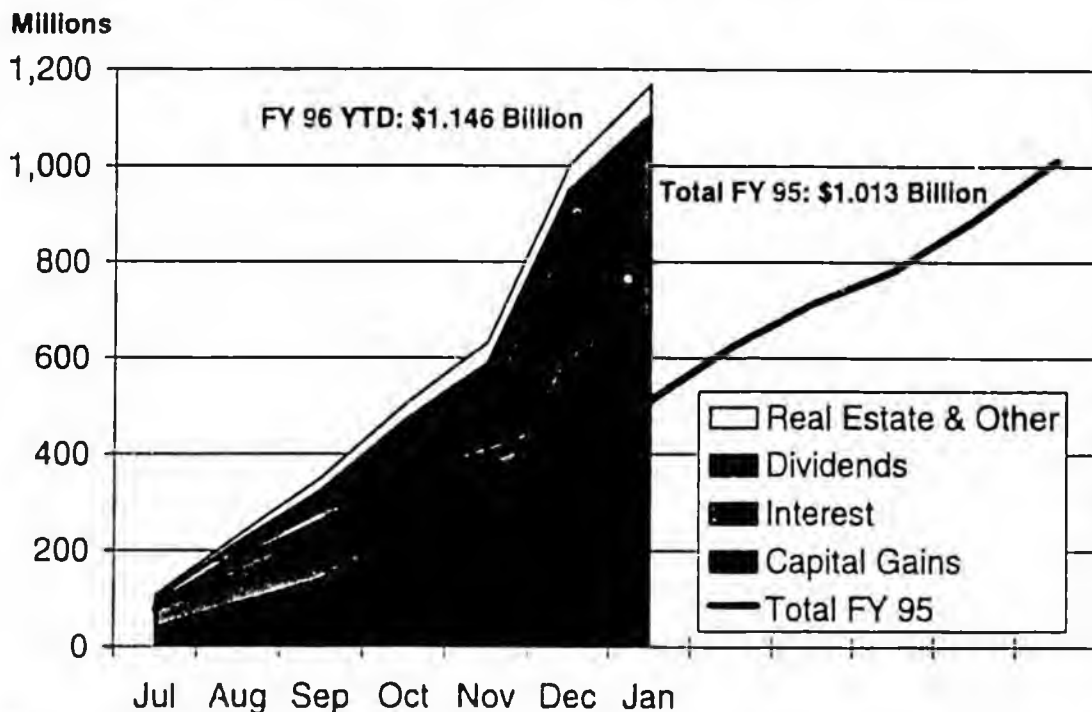
due to the extraordinary performance of the U.S. stock and bond markets. As a consequence, the Fund has already earned more net income in the first seven months of fiscal 1996 than was earned in all of fiscal 1995.

Board of Trustees Seek Passage of House Bill 525 to Expand the Permanent Fund's Investment Powers

On February 21, the House Finance Committee introduced House Bill 525 at the request of the Board of Trustees. The proposed changes are consistent with the prudent investor standard and would increase the power of the Corporation to invest in U.S. and non-U.S. stocks and in debt securities rated as investment grade by nationally recognized rating services. If the Fund is to keep

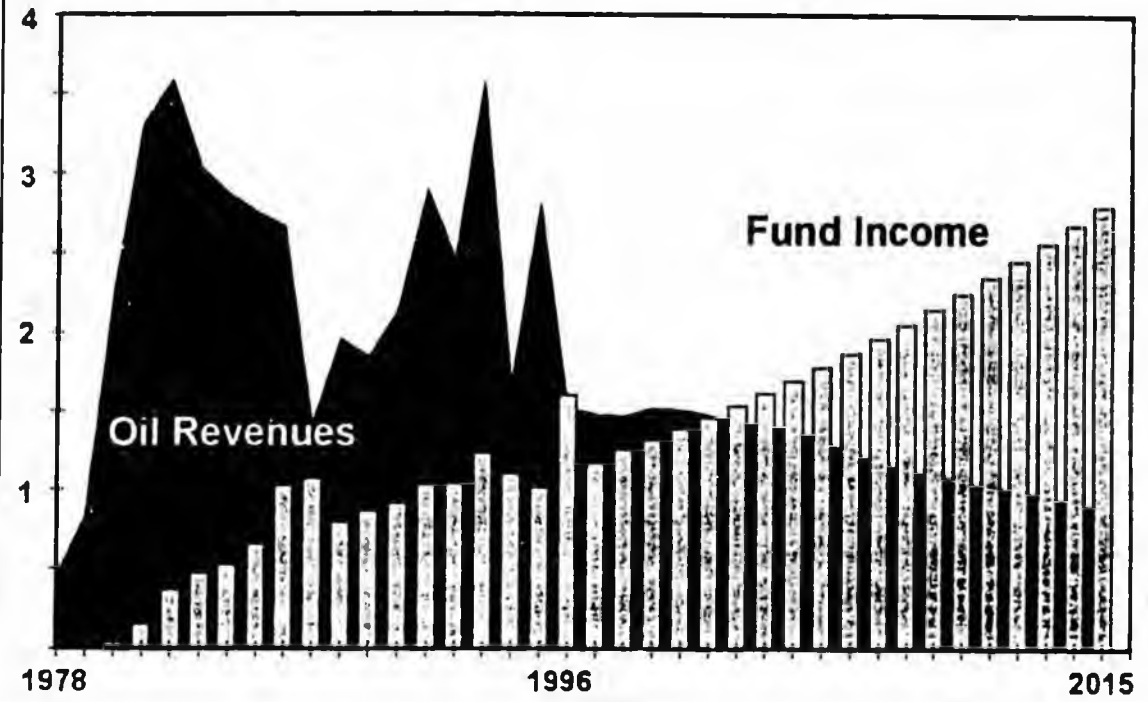
Cumulative Fund Net Income

Fiscal 1996 Year-to-Date Compared to Total Fiscal 1995



Permanent Fund Net Income and State Oil Revenues

Billions of \$



achieving returns that meet or exceed those available to other institutional investors, the Trustees must have the ability to allocate more to equities and to invest in a broader range of debt securities. This change will help the Trustees strike a prudent balance between slightly higher future returns and slightly higher risk.

1996 Inflation-Proofing Rate Set at 2.82 Percent

In accordance with AS 37.13.145 which requires the Corporation to compute annual inflation-proofing based on the calendar-year average change in the Consumer Price Index, the 1996 rate has been set at 2.82%. On June 30, 1996, the Corporation will multiply the cost value of Fund principal on that date by that 2.82% to determine how much of this year's net income to transfer to principal to offset the effect of inflation. That amount is projected at \$405 million.

Permanent Fund Net Income Projected to Exceed Unrestricted State Oil Revenues This Year

As illustrated in the chart above, for the first time in the State's history, annual Permanent Fund net income is projected this year to exceed the amount of unrestricted oil revenues flowing into the State's General Fund. Although this is not expected to occur again for six years, 1996 does give evidence of the long-term trend.

Next Meeting of the Trustees

The Trustees' next meeting will be in Juneau on March 14-15, 1996. The main item on the agenda will be asset allocation.

Respectfully submitted,

Grace Berg Schaible, Chair, Board of Trustees and **Byron I. Mallott**, Executive Director

ALASKA PERMANENT FUND

Statements of Assets, Liabilities, Principal and Earnings Reserve

Unaudited (Millions of Dollars)	January 31, 1996	June 30, 1995	January 31, 1995
Assets			
Cash and temporary investments ⁽¹⁾	\$ 487.3	967.8	855.8
Receivables, prepaid expenses and other assets ⁽⁴⁾	289.1	336.0	424.8
Investments —			
Marketable debt securities ⁽³⁾	7,753.6	7,152.4	7,137.6
Preferred and common stock ⁽⁶⁾	6,605.0	5,762.3	5,374.0
Real estate ⁽⁷⁾	1,461.4	1,433.8	1,315.8
Alaska certificates of deposit ⁽⁸⁾	76.0	116.2	116.2
Total investments	<u>15,896.0</u>	<u>14,464.7</u>	<u>13,943.6</u>
TOTAL ASSETS	<u>\$ 16,672.4</u>	<u>15,768.5</u>	<u>15,224.2</u>
Liabilities			
Accounts payable ⁽⁹⁾	\$ 215.9	214.3	339.8
Science and Technology Endowment Fund ⁽¹⁰⁾	110.1	106.6	106.1
Alaska Mental Health Trust Fund ⁽¹¹⁾	218.5	—	—
Income distributable to the State of Alaska ⁽¹²⁾	3.2	572.7	3.8
TOTAL LIABILITIES	<u>547.7</u>	<u>893.6</u>	<u>449.7</u>
Principal and Earnings Reserve			
Principal ⁽¹³⁾	14,248.3	13,644.7	13,120.1
Principal held in escrow ⁽¹⁴⁾	29.5	27.6	27.5
Earnings reserve ⁽¹⁵⁾	1,846.9	1,202.6	1,626.9
TOTAL PRINCIPAL AND EARNINGS RESERVE	<u>16,124.7</u>	<u>14,874.9</u>	<u>14,774.5</u>
TOTAL LIABILITIES, PRINCIPAL AND EARNINGS RESERVE	<u>\$ 16,672.4</u>	<u>15,768.5</u>	<u>15,224.2</u>

See notes to financial statements

ALASKA PERMANENT FUND

Statements of Revenues and Expenses

Unaudited (Millions of Dollars)	Month ended January 31,		Seven months ended January 31,		Year-end projected/actual June 30,	
	1996	1995	1996	1995	1996	1995
Revenues						
Investment income — ⁽¹⁶⁾						
Interest	\$ 47.4	41.0	335.0	338.6	573.2	591.1
Dividends	8.9	7.3	82.6	67.3	153.5	136.6
Real estate and other income	8.3	6.3	60.4	40.1	106.0	89.4
Total investment income	<u>64.6</u>	<u>54.6</u>	<u>478.0</u>	<u>446.0</u>	<u>832.7</u>	<u>817.1</u>
Realized gains (losses) on —						
Marketable debt securities	35.4	(0.2)	109.0	(0.8)	128.5	7.5
Preferred and common stock	45.8	(1.2)	557.4	46.7	656.9	170.3
Real estate	0.7	1.7	(2.1)	9.1	(2.1)	(37.5)
Foreign exchange contracts	18.8	(0.9)	12.8	(7.7)	12.8	(12.5)
Currency ⁽¹⁷⁾	0.3	9.3	12.1	29.8	12.1	105.6
Total realized gains	<u>101.0</u>	<u>8.7</u>	<u>689.2</u>	<u>77.1</u>	<u>808.2</u>	<u>233.4</u>
Unrealized gains (losses) on foreign exchange contracts ⁽¹⁸⁾	(9.7)	(0.9)	17.5	4.8	17.5	(6.1)
TOTAL REVENUES	<u>155.9</u>	<u>62.4</u>	<u>1,184.7</u>	<u>527.9</u>	<u>1,658.4</u>	<u>1,044.4</u>
Expenses						
Operating expenses ⁽¹⁹⁾	(2.3)	(2.1)	(15.7)	(13.4)	(28.3)	(24.2)
Income before other items Science and Technology	153.6	60.3	1,169.0	514.5	1,630.1	1,020.2
Endowment Fund Earnings ⁽²⁰⁾	(1.0)	(0.4)	(7.8)	(3.8)	(10.9)	(7.3)
Alaska Mental Health						
Trust Fund Earnings ⁽²¹⁾	(2.0)	—	(15.0)	—	(21.7)	—
NET INCOME	<u>\$ 150.6</u>	<u>59.9</u>	<u>1,146.2</u>	<u>510.7</u>	<u>1,597.5</u>	<u>1,012.9</u>

See notes to financial statements

ALASKA PERMANENT FUND

Statements of Changes in Principal and Earnings Reserve

Unaudited (Millions of Dollars)	Month ended January 31,		Seven months ended January 31,	
	1996	1995	1996	1995
Principal				
Balance, beginning of period	\$ 14,229.6	13,098.4	13,644.7	12,972.9
Dedicated state revenues	18.7	21.7	103.6	147.2
Appropriation from the State	—	—	500.0	—
BALANCE, JANUARY 31,	\$ 14,248.3	13,120.1	14,248.3	13,120.1
Principal Held in Escrow				
Balance, beginning of period	\$ 29.5	27.5	27.6	25.5
Escrow earnings	—	—	1.9	2.0
BALANCE, JANUARY 31,	\$ 29.5	27.5	29.5	27.5
Earnings Reserve				
Balance, beginning of period	\$ 1,696.3	1,567.0	1,202.6	1,116.7
Escrow earnings	—	—	(1.9)	(2.0)
Appropriation from the State	—	—	(500.0)	—
Net income	150.6	59.9	1,146.2	510.7
BALANCE, JANUARY 31,	\$ 1,846.9	1,626.9	1,846.9	1,626.9
Total				
Balance, beginning of period	\$ 15,955.4	14,692.9	14,874.9	14,115.1
Dedicated state revenues	18.7	21.7	103.6	147.2
Net income	150.6	59.9	1,146.2	510.7
BALANCE, JANUARY 31,	\$ 16,124.7	14,774.5	16,124.7	14,774.5

See notes to financial statements

ALASKA PERMANENT FUND

Statements of Cash Flows

Unaudited (Millions of Dollars)	Month ended January 31,		Seven months ended January 31,	
	1996	1995	1996	1995
Cash Flows from Investments				
Net (purchases), sales and maturities of investments —				
Marketable debt securities	\$ (251.7)	44.8	(608.3)	485.9
Preferred and common stock	(57.5)	(61.3)	(842.8)	(354.1)
Real estate	(1.1)	17.0	(23.8)	(247.8)
Alaska certificates of deposit	—	(9.5)	40.2	(7.4)
Net change in unsettled trades	72.3	71.7	21.5	(30.8)
	(238.0)	62.7	(1,413.2)	(154.2)
Total net (purchases), sales and maturities				
Investment income received	167.8	70.2	1,174.3	540.8
Amortization	1.5	—	7.2	0.8
Undistributed real estate income	(0.4)	—	(3.8)	(3.3)
NET CASH PROVIDED (USED) BY INVESTMENTS	(69.1)	132.9	(235.5)	384.1
Cash Flows from Non-capital Financing				
Contributions from the State	19.7	22.0	138.8	156.3
Income distributions	—	—	(569.6)	(564.0)
Alaska Mental Health Trust Fund contributions	—	—	203.5	—
Science and Technology Endowment Fund distributions	(1.3)	(1.6)	(4.4)	(6.9)
NET CASH PROVIDED (USED) BY NON-CAPITAL FINANCING	18.4	20.4	(231.7)	(414.6)
Cash Flows from Operations	(0.6)	(1.4)	(13.3)	(11.8)
Cash Flows from Capital and Related Financing	—	—	—	—
Net increase (decrease) in cash and temporary investments	(51.3)	151.9	(480.5)	(42.3)
Cash and temporary investments at beginning of period	538.1	703.9	967.8	898.1
CASH AND TEMPORARY INVESTMENTS AT JANUARY 31,	\$ 487.3	855.8	487.3	855.8
Reconciliation of Net Income to Net Cash Flows From Operations				
Net income	\$ 150.6	59.9	1,146.2	510.7
Adjustments to reconcile net income to net cash used by operations —				
Investment earnings	(155.9)	(62.4)	(1,184.7)	(527.9)
Net change in operating assets and liabilities	1.7	0.7	2.4	1.6
ASTE & AMHT earnings	3.0	0.4	22.8	3.8
NET CASH USED BY OPERATIONS	\$ (0.6)	(1.4)	(13.3)	(11.8)

See notes to financial statements

ALASKA PERMANENT FUND

Notes to Financial Statements

January 31, 1996

1. ENTITY

The Constitution of the State of Alaska (the "State") was amended by public referendum in 1976 to dedicate a portion of certain natural resource revenues to the Alaska Permanent Fund (the "Fund"). The principal of the Fund is to be invested in perpetuity. The Alaska State legislature (the "Legislature") created the Alaska Permanent Fund Corporation (the "Corporation"), a government instrumentality of the State that is administered by a board of trustees (the "Trustees"), to manage the investments of the Fund. By statute, (i) a portion of annual earnings is transferred to the State's dividend fund, and (ii) a portion of the earnings reserve account sufficient to offset the impact of inflation is transferred to the principal of the Fund. The balance of earnings is held by the Fund in the earnings reserve account and is subject to appropriation by the Legislature.

2. SIGNIFICANT ACCOUNTING POLICIES

Contributions

Contributions from dedicated State revenues are recorded when certain revenues defined by statute are received by the Alaska Department of Natural Resources. Contributions from appropriations and other sources are recorded when received.

Dividend Appropriations

Current statutes require that one-half of twenty-one percent of the Fund's net income for the last five fiscal years, excluding earnings from contributions made in the North Slope royalty case (*State v. Amerada Hess, et al.*) settlements and unrealized gains and losses, be made available for the payment of dividends and other appropriations each year.

Dollar Amounts

All dollar amounts are displayed in millions of dollars, unless otherwise noted.

Forward Exchange Contracts

The Fund is party to a variety of forward contracts in its trading activities and in the management of its foreign exchange rate exposure. These contracts are speculative in nature and the contract amounts do not appear on the balance sheet. Realized and unrealized gains and losses are currently included in income, and are determined on the maturity date of the contracts. Unrealized gains and losses are calculated using foreign currency forward rates at the balance sheet date.

Inflation Impact

The impact of inflation is measured by the change in the prior calendar year average of the United States consumer price index for all urban consumers, applied against the balance of contributed equity at the end of the fiscal year.

Interest Income

Interest income is accrued monthly as earned, and is shown net of amortization of premiums and accretion of discounts on marketable debt securities.

Investment Valuation

By resolution, the Trustees have adopted the following accounting policies for the valuation of investments:

Type	Basis
Marketable debt securities	Cost adjusted for amortization of premiums and accretion of discounts
Real estate	Equity
Preferred and common stock	Lower of cost or market
Alaska certificates of deposit	Cost

If, in the opinion of management, a permanent impairment of value has occurred, the investment is written down to fair market value by a charge to operations.

Market Value

Fair market values are obtained from independent sources for debt and equity securities and by independent appraisals for real estate. Market value for all other assets approximates cost.

Real Estate

Investments in real estate are carried at cost plus undistributed equity from the results of operations. Income from commingled real estate funds and pools is recognized as distributions are declared. Income from other real estate is recognized as earned. Unrealized losses that are deemed to be other than temporary are charged to current income as realized losses.

Realized Gains and Losses

Realized gains or losses on the sale of investments are determined on the transaction date by average cost for investments in preferred and common stock, and by specific identification for all other investments.

Securities Transactions

Securities transactions are recorded on the date that securities are purchased or sold.

3. CASH AND TEMPORARY INVESTMENTS

All cash and temporary investments bear interest at competitive rates, and are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Operating account ^(a)	\$ —	0.1	0.1
Cash management accounts ^{(a)(b)}	104.1	214.2	213.3
Repurchase agreements ^(c)	60.0	57.9	158.9
Treasury bills ^(d)	66.9	143.4	80.4
U.S. agencies ^(d)	73.5	389.4	191.2
Commercial paper ^(e)	182.8	162.8	211.9
Certificates of Deposit ^(g)	—	—	—
Bankers acceptances ^(f)	—	—	—
TOTAL CASH AND TEMPORARY INVESTMENTS	\$ 487.3	967.8	855.8

(a) Insured by the Federal Deposit Insurance Corporation (FDIC) to \$100,000 per account. Remaining balance uninsured and uncollateralized.

(b) Share ownership in a money market fund, payable on demand. Collateralized by underlying securities held by the fund in the name of the custodian. Not considered an investment nor assigned a specific risk category.

(c) Uninsured and unregistered. Underlying collateral securities generally comprised of debt obligations of the U.S. government and held by the counterparty bank.

(d) Debt obligation guaranteed by the U.S. government.

(e) Commercial paper rated A-1 by Standard & Poor's or P-1 by Moody's, or the foreign equivalent.

(f) Bankers acceptances drawn on and accepted by United States or non-domestic banks, each of which have a combined capital, surplus and retained earnings aggregating at least \$500,000,000.

(g) Certificates of deposit of financial institutions which may be readily sold in a secondary market at prices reflecting fair value.

4. RECEIVABLES AND PREPAID EXPENSES

Receivables and prepaid expenses are as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Interest receivable	\$ 148.6	151.1	144.8
State dedicated revenues receivable	0.6	35.8	3.0
Securities sold	123.2	132.9	265.7
Dividends receivable	10.8	16.1	11.2
Foreign exchange contracts	5.5	—	—
Other receivables	0.3	—	—
Prepaid expenses	0.1	0.1	0.1
TOTAL RECEIVABLES AND PREPAID EXPENSES	\$ 289.1	336.0	424.8

5. MARKETABLE DEBT SECURITIES

The Corporation is authorized by statute to invest Fund assets in (i) corporate bonds rated A or better by Standard & Poor's or Moody's, or the foreign equivalent; (ii) obligations of the United States Treasury, its agencies and instrumentalities; and (iii) obligations of foreign governments. All marketable debt securities are held by custodian banks in the name of the Corporation on behalf of the Fund.

Marketable debt securities are summarized as follows:

January 31, 1996	Amortized Cost	Market	Unrealized Gains (Losses)	Yield
Treasury notes/bonds	\$ 5,309.8	5,574.1	264.3	6.75%
GNMA pools	128.1	133.8	5.7	8.11%
Other federal agencies	439.6	453.8	14.2	6.54%
Corporate bonds	1,703.3	1,797.9	94.6	7.28%
Yankee bonds	172.8	188.3	15.5	8.34%
TOTAL MARKETABLE DEBT SECURITIES	\$ 7,753.6	8,147.9	394.3	6.95%

June 30, 1995

Treasury notes/bonds	\$ 5,186.5	5,381.2	194.7	7.17%
GNMA pools	103.0	106.9	3.9	8.60%
Other federal agencies	109.7	113.0	8.3	7.93%
Corporate bonds	1,684.8	1,733.8	49.0	7.63%
Yankee bonds	68.4	75.1	6.7	8.82%
TOTAL MARKETABLE DEBT SECURITIES	\$ 7,157.4	7,415.0	262.6	7.32%

January 31, 1995

Treasury notes/bonds	\$ 5,281.9	5,140.0	(141.9)	7.24%
GNMA pools	107.4	107.4	—	8.56%
Other federal agencies	24.8	25.6	0.8	8.20%
Corporate bonds	1,644.8	1,584.3	(60.0)	7.64%
Yankee bonds	78.7	81.1	2.4	8.84%
TOTAL MARKETABLE DEBT SECURITIES	\$ 7,137.6	6,938.9	(198.7)	7.37%

6. PREFERRED AND COMMON STOCK

The Corporation is authorized by statute to invest Fund assets in the preferred and common stock of United States and non-domestic corporations. All preferred and common stock investments are held by custodial banks in the name of the Corporation on behalf of the Fund.

Preferred and common stock are summarized as follows:

<u>January 31, 1996</u>	<u>Cost</u>	<u>Market</u>	<u>Unrealized Gains (Losses)</u>
Domestic	\$ 4,862.5	6,664.4	1,801.9
Non-domestic	<u>1,742.5</u>	<u>2,001.0</u>	<u>258.5</u>
TOTAL PREFERRED AND COMMON STOCK	\$ 6,605.0	8,665.4	2,060.4
Domestic security gains			\$ 1,801.9
Non-domestic security gains			289.0
Foreign currency losses			<u>(30.5)</u>
TOTAL UNREALIZED GAINS			\$ 2,060.4
 <u>June 30, 1995</u>			
Domestic	\$ 4,252.2	5,544.8	1,292.6
Non-domestic	<u>1,510.1</u>	<u>1,685.3</u>	<u>175.2</u>
TOTAL PREFERRED AND COMMON STOCK	\$ 5,762.3	7,230.1	1,467.8
Domestic security gains			\$ 1,292.6
Non-domestic security gains			50.1
Foreign currency gains			<u>125.1</u>
TOTAL UNREALIZED GAINS			\$ 1,467.8
 <u>January 31, 1995</u>			
Domestic	\$ 3,764.9	4,429.3	664.4
Non-domestic	<u>1,609.1</u>	<u>1,710.9</u>	<u>101.8</u>
TOTAL PREFERRED AND COMMON STOCK	\$ 5,374.0	6,140.2	766.2
Domestic security gains			\$ 664.4
Non-domestic security losses			(1.7)
Foreign currency gains			<u>103.5</u>
TOTAL UNREALIZED GAINS			\$ 766.2

7. REAL ESTATE

The Corporation is authorized by statute to invest Fund assets in real estate improved by substantially rented buildings, located in the United States. Improved real estate investments may take the form of equity interests or debt obligations secured by a first lien on the real estate. By statute, the Fund may hold up to one-hundred percent (100%), of the beneficial ownership interest in real estate investments not exceeding \$150,000,000 and may hold up to sixty-seven percent (67%), of the beneficial ownership interest in real estate investments exceeding \$150,000,000. All real estate investments are held by the Corporation in its own name on behalf of the Fund, and are managed by professional real estate management firms.

Real estate investments are summarized as follows:

<u>January 31, 1996</u>	<u>Book Value</u>	<u>Market</u>	<u>Unrealized Gains (Losses)</u>
Commingled funds	\$ 70.1	58.0	(12.1)
Real estate investment trusts	62.2	68.1	5.9
Alaska residential mortgages	0.4	0.4	—
Joint participations —			
Retail	463.8	471.5	7.7
Office	362.9	342.8	(20.1)
Industrial	179.9	169.7	(10.2)
Residential	322.1	327.8	5.7
TOTAL REAL ESTATE	\$ 1,461.4	1,438.3	(23.1)
<hr/>			
<u>June 30, 1995</u>			
Commingled funds	\$ 70.5	60.5	(10.0)
Real estate investment trusts	62.2	68.1	5.9
Alaska residential mortgages	0.5	0.5	—
Joint participations —			
Retail	458.9	467.5	8.6
Office	297.2	279.7	(17.5)
Industrial	190.1	178.1	(12.0)
Residential	354.4	355.6	1.2
TOTAL REAL ESTATE	\$ 1,433.8	1,410.0	(23.8)
<hr/>			
<u>January 31, 1995</u>			
Commingled funds	\$ 77.2	59.2	(18.0)
Real estate investment trusts	62.2	68.3	6.1
Alaska residential mortgages	0.5	0.5	—
Joint participations —			
Retail	428.3	445.7	17.4
Office	264.8	233.7	(31.1)
Industrial	168.5	142.7	(25.8)
Residential	314.3	315.6	1.3
TOTAL REAL ESTATE	\$ 1,315.8	1,265.7	(50.1)

8. ALASKA CERTIFICATES OF DEPOSIT

The Corporation is authorized by statute to invest Fund assets in certificates of deposit or the equivalent instruments of banks, savings and loan associations, mutual savings banks, and credit unions doing business in Alaska. These investments are guaranteed by the Federal Home Loan Bank. All certificates and collateral are held by a trustee bank in the name of the Corporation on behalf of the Fund.

9. ACCOUNTS PAYABLE

Accounts payable are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Accrued liabilities	\$ 9.6	7.2	7.3
Service fees payable	0.5	1.1	0.1
Foreign exchange contracts	—	12.0	1.1
Securities purchased	205.8	194.0	331.3
TOTAL ACCOUNTS PAYABLE	\$ 215.9	214.3	339.8

10. SCIENCE AND TECHNOLOGY ENDOWMENT FUND

The Alaska Science and Technology Endowment Fund (the "Endowment") was created by an act of the 1989 Legislature to provide financial support for the Alaska Science and Technology Foundation (the "Foundation"). By statute, the Endowment is to be held and invested by the Corporation under the same investment authority as the Fund is managed. Net income from the Endowment is distributed to the Foundation after appropriation by the Legislature and is not included in the computation of Fund dividends.

The assets of the Endowment have been commingled with the assets of the Fund for investment purposes. Earnings are allocated to the Endowment on the basis of unit shares and fractional shares. Each unit share or fractional unit share has an undivided beneficial interest in the commingled assets equal to the proportion that it bears to the total units outstanding. Unit shares are credited to the Endowment on the basis of total funds contributed to the investment pool.

Principal and undistributed earnings of the Endowment are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Principal	\$ 101.1	101.0	101.0
Undistributed earnings	9.0	5.6	5.1
TOTAL SCIENCE AND TECHNOLOGY ENDOWMENT FUND	\$ 110.1	106.6	106.1

Distributions to the Foundation are made by liquidation of unit shares valued at cost. Current earnings of the Endowment are reflected on the Statement of Revenues and Expenses as a reduction of Fund income to insure that Fund net income is not overstated.

11. ALASKA MENTAL HEALTH TRUST FUND

The Alaska Mental Health Trust Fund (the "Trust") was created by an act of the State legislature as the result of the settlement of mental health land trust litigation (*Weiss v. State*). The act authorized the Alaska Mental Health Trust Authority (the "Authority"), to use income from the Trust to assist it in fulfilling its purpose of ensuring an integrated comprehensive mental health program for the State. By statute and memorandum of agreement with the Authority, the Trust is to be held and invested by the Corporation under the same investment authority as the Fund is managed. By statute, net income from the Trust is distributed to the Mental Health Trust Income Account at the end of each fiscal year and is not included in the computation of Fund dividends.

The assets of the Trust have been commingled with the assets of the Fund for investment purposes. Earnings are allocated to the Trust on the basis of unit shares and fractional shares. Each unit share or fractional unit share has an undivided beneficial interest in the commingled assets equal to the proportion that it bears to the total units outstanding. Unit shares are credited to the Trust on the basis of total funds contributed to the investment pool.

Principal and undistributed earnings of the Trust are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Principal	\$ 203.5	—	—
Undistributed earnings	15.0	—	—
TOTAL ALASKA MENTAL HEALTH TRUST FUND	\$ 218.5	—	—

12. INCOME DISTRIBUTABLE TO THE STATE OF ALASKA

The Legislature appropriated a portion of the Fund's net income for various purposes, including the payment of dividends to qualified residents of the State of Alaska. In addition, the Legislature appropriated a portion of the Fund's earnings reserves for the cost of oil and gas revenue litigation. Incomes distributable to the State of Alaska are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Dividends	\$ —	536.1	—
Appropriations to the Departments of —			
Corrections	—	0.8	—
Health and Social Services	—	21.9	—
Public Safety	—	4.4	—
Revenue	—	2.0	—
Total to dividend fund	—	565.2	—
Department of Law	3.2	7.5	3.8
TOTAL INCOME DISTRIBUTABLE	\$ 3.2	572.7	3.8

13. PRINCIPAL

The principal balances of the Fund are as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Dedicated State revenues	\$ 5,550.6	5,447.0	5,276.1
Appropriations from the state	4,464.4	3,964.4	3,964.4
Inflation-proofing	4,216.9	4,216.9	3,869.3
Settlement earnings	16.4	16.4	10.3
Citizen contributions	—	—	—
TOTAL PRINCIPAL	\$ 14,248.3	13,644.7	13,120.1

The Fund received dedicated State revenues from North Slope royalty case (*State v. Amerada Hess, et al.*) settlements. By statute, earnings from these settlements are to be treated in the same manner as other Fund income, except that earnings on settlements are excluded from the dividend calculation. Accumulated settlement related activity which is included in the principal balance of the Fund is as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Settlement —			
Principal	\$ 175.6	173.5	135.6
Earnings	16.4	16.4	10.3
Inflation-proofing	15.2	15.2	10.2
TOTAL SETTLEMENT PRINCIPAL	\$ 207.2	205.1	156.1

14. PRINCIPAL HELD IN ESCROW

Certain bonus payments, rent and interest from the joint State-Federal Beaufort Sea lease sale of 1979 were deposited in a federally managed escrow account because ownership of the tracts is in dispute. In December 1987, Congress amended the law to provide for the distribution of twenty-seven percent (27%) of the balance in the account, plus accrued interest, to the State. This distribution represents the total amount which would be due as federal mineral revenue sharing in the event that the Supreme Court awards the ownership of all disputed tracts to the Federal government.

Under State law, the final allocation of this 1987 distribution between the Fund and the State depends upon which party -- the State or the Federal government -- prevails in Court. If the State wins the dispute, fifty percent (50%) of the 1987 distribution would be allocated to the Fund, except for the bonus and interest on the lease of four tracts for which only twenty-five percent (25%) would be allocated to the Fund. If the Federal government wins the dispute, fifty percent (50%) of the 1987 distribution would be allocated to the Fund.

An amount equal to the bonus and interest in dispute on these four tracts has been placed in escrow by the Corporation on behalf of the Fund under a memorandum of understanding between the Corporation and the State, pending final settlement of the litigation between the State and the Federal government. Interest is accrued thereon each year at the rate of return earned by the Fund.

The balances of the escrow account are summarized as follows:

	January 31, 1996	June 30, 1995	January 31, 1995
Federal deposit	\$ 15.8	15.8	15.8
Accrued interest	13.7	11.8	11.7
TOTAL PRINCIPAL HELD IN ESCROW	\$ 29.5	27.6	27.5

15. EARNINGS RESERVE

By statute, the balance of Fund net income remaining after the payment of dividends and the appropriation for inflation-proofing is held in the earnings reserve account. The balance of the earnings reserve account consists of the following elements:

	Months ended January 31,		Seven months ended January 31,		Year ended
	1996	1995	1996	1995	June 30, 1995
Provision for inflation-proofing	\$ 37.3	27.7	236.3	200.7	—
Provision for dividend payment	57.3	45.4	362.8	324.9	—
Provision for escrow earnings	0.3	0.1	1.8	1.1	1.9
Provision for settlement earnings	2.4	0.8	12.6	5.6	—
Unencumbered balance of reserve	53.3	(14.1)	1,233.4	1,094.6	1,200.7
TOTAL EARNINGS RESERVE	\$ 150.6	59.9	1,846.9	1,626.9	1,202.6

16. INVESTMENT INCOME BY SOURCE

Investment income of the Fund is summarized as follows:

	Months ended January 31,		Seven months ended January 31,		Year ended
	1996	1995	1996	1995	June 30, 1995
INTEREST					
Marketable debt securities	\$ 44.6	36.4	308.7	315.9	544.0
Alaska certificates of deposit	0.4	0.6	2.9	3.4	6.4
Cash and other interest	2.4	4.0	23.4	19.3	40.7
TOTAL INTEREST	\$ 47.4	41.0	335.0	338.6	591.1
DIVIDENDS					
Domestic preferred and common stock	\$ 7.1	5.6	66.8	53.2	102.0
Non-domestic preferred and common stock	1.8	1.7	15.8	14.1	34.6
TOTAL DIVIDENDS	\$ 8.9	7.3	82.6	67.3	136.6
REAL ESTATE AND OTHER INCOME					
Real estate interest	\$ 0.5	0.9	5.1	5.4	10.1
Other real estate income	7.6	5.3	53.7	33.5	77.6
Fees on loaned securities	0.2	0.1	1.6	1.2	1.7
TOTAL REAL ESTATE AND OTHER INCOME	\$ 8.3	6.3	60.4	40.1	89.4

17. REALIZED GAIN (LOSS) ON CURRENCY

Realized gains and losses on foreign currency consisted of the following elements:

	Months ended January 31,		Seven months ended January 31,		Year ended June 30, 1995
	1996	1995	1996	1995	
Preferred and common stock	\$ 0.8	9.5	12.7	28.3	104.6
Dividends	—	—	—	0.2	0.2
Currency inventory	(0.5)	(0.2)	(0.6)	1.3	0.8
TOTAL GAIN ON CURRENCY	\$ 0.3	9.3	12.1	29.8	105.6

18. FOREIGN EXCHANGE CONTRACTS AND OFF BALANCE SHEET RISK

The Fund entered into foreign currency forward exchange contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing cash positions in these currencies. The maturity periods for these contracts range from one to five months. The Fund had outstanding foreign exchange contracts with net unrealized gains and losses, calculated as follows:

	January 31, 1996	January 31, 1995	June 30, 1995
Contracted amount	\$ 238.8	113.4	179.8
Market value	233.4	114.6	191.9
Unrealized gain (loss) on contracts	5.4	(1.2)	(12.1)
Unrealized loss recognized in prior year	12.1	6.0	6.0
UNREALIZED GAIN (LOSS) ON CONTRACTS	\$ 17.5	4.8	(6.1)

The counterparties to the foreign currency forward contracts consist of a diversified group of financial institutions. The Fund is exposed to credit risk to the extent of non-performance by these counterparties; however the Fund has established procedures in place to monitor such risk and considers the risk of default to be remote. The Fund's market risk is limited to the difference between contractual rates and forward rates at the balance sheet date.

19. OPERATING EXPENSES

Operating expenses of the Corporation are summarized as follows:

(Thousands of Dollars)	Months ended January 31,		Seven months ended January 31,		Year ended June 30, 1995
	1996	1995	1996	1995	
Salaries and benefits	\$ 160	178	1,099	1,184	2,024
Department of Revenue support	—	—	—	32	32
Travel	10	5	77	108	179
Communications	49	73	277	257	494
Consulting fees	53	16	161	158	410
Custody and safekeeping fees	300	279	1,675	1,933	3,309
Investment management fees	1,663	1,363	11,857	9,224	16,570
Legal and audit	1	110	49	199	367
Public information and subscriptions	20	16	73	71	183
Rent	17	18	129	135	203
Property and equipment	3	—	55	7	122
Other expenses	21	18	194	131	271
TOTAL OPERATING EXPENSES	\$ 2,297	2,076	15,646	13,439	24,164

20. NET INCOME

By statute, net income is computed in accordance with generally accepted accounting principles (GAAP), excluding settlement income and any unrealized gains or losses. Net income is required by GAAP, however, to include unrealized currency valuation gains and losses on non-domestic marketable debt securities and foreign exchange contracts and all other income, regardless of source. Consequently, GAAP net income and statutory net income will not always agree. It is statutory net income that is used to compute the Permanent Fund dividend.

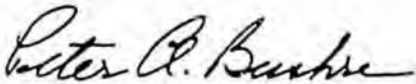
	Months ended January 31,		Seven months ended January 31,		Year ended
	1996	1995	1996	1995	June 30, 1995
Net income	\$ 150.6	59.9	1,146.2	510.7	1,012.9
Unrealized (gains) losses on foreign exchange contracts	9.7	0.9	(17.5)	(4.8)	6.1
Provision for Settlement earnings	(2.4)	(0.8)	(12.6)	(5.6)	11.2
STATUTORY NET INCOME	\$ 157.9	60.0	1,116.1	500.3	1,030.2

.....

The Board of Trustees
Alaska Permanent Fund Corporation

The financial statements and footnotes presented herein were prepared from the books of account without audit, and no independent opinion of the fairness of these statements and footnotes has been rendered.

Sincerely,



Peter A. Bushre
Chief Financial Officer



Alaska Permanent Fund

FINANCIAL PROJECTIONS

(in millions)

as of January 31, 1996

GROWTH OF FUND PRINCIPAL							USES OF FUND INCOME						
FY	FY Begin Balance	Appropriations	Dedicated State Revenues ⁽¹⁾	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall	Net Income	Distributions			Reserves		FY
								Dividends	Inflation-Proofing	General Fund	Add (Delete)	FY End Balance	
78													78
to													to
85	0	2,700	2,424	617	5,741		2,219	653	617	186	763	763	85
86	5,741		323	218	6,281		1,021	303	216		501	1,264	86
87	6,281	1,264 ⁽²⁾	171	148	7,864		1,069	391	148		529	529	87
88	7,864		418	303	8,585		789	424	303		62	591	88
89	8,585		228	360	9,173		868	460	360	4	45	635	89
90	9,173		267	454	9,894		916	487	454	4	(29)	605	90
91	9,894		435	559	10,888		1,030	489	559	4	(22)	581	91
92	10,888		338	477	11,703		1,036	488	477	5	66	645	92
93	11,703	5 ⁽³⁾	315	362	12,385		1,226	532	362	5	322	965	93
94	12,385	6	210	372	12,973		1,098	556	372	11	153	1,117	94
95	12,973	6	318	348	13,645		1,013	565	348	6	88	1,203	95
96	13,645	515 ⁽²⁾	218	405	14,783		1,598	621	405	1	555	1,257	96
97	14,783	9	216	449	15,457		1,170	632	449		80	1,338	97
98	15,457	10	217	499	16,182		1,260	636	499		116	1,453	98
99	16,182	10	229	522	16,943		1,323	658	522		132	1,586	99
00	16,943	11	231	546	17,732		1,389	696	546		135	1,721	00
01	17,732	12	233	572	18,549		1,458	683	572		191	1,913	01
02	18,549	13	239	598	19,398		1,534	721	598		202	2,115	02
03	19,398	14	238	625	20,275		1,612	757	625		216	2,331	03
04	20,275	15	237	653	21,180		1,694	795	653		232	2,563	04
05	21,180	16	223	681	22,106		1,778	835	681		246	2,809	05
06	22,106	17	218	710	23,051		1,865	877	710		281	3,070	06
07	23,051	18	209	740	24,019		1,955	920	740		277	3,347	07
08	24,019	19	203	771	25,012		2,048	965	771		293	3,639	08
09	25,012	21	202	802	26,038		2,144	1,011	802		310	3,949	09
10	26,038	22	198	835	27,092		2,243	1,058	835		328	4,277	10
11	27,092	24	195	868	28,179		2,346	1,108	868		346	4,623	11
12	28,179	25	191	903	29,299		2,453	1,159	903		366	4,988	12
13	29,299	27	184	938	30,448		2,564	1,211	938		387	5,376	13
14	30,448	29	178	975	31,630		2,679	1,266	975		409	5,785	14
15	31,630	31	169	1,012	32,842		2,797	1,322	1,012		431	6,216	15
Cumulative Totals Projected													
For FY 1996 - 2015:			4,233	14,106			37,910	17,931	14,106	1			

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
FY 96:	10.35%	2.82%	7.53%
FY 97: ⁽⁴⁾	6.98%	2.99%	3.99%
FY 98 - 2015: ⁽⁴⁾	7.17%	3.18%	3.99%

⁽¹⁾ Department of Revenue Fall 1995 Mid-Case Revenue Forecast.

⁽²⁾ Earnings reserve appropriated to principal July 1, '87 and '95.

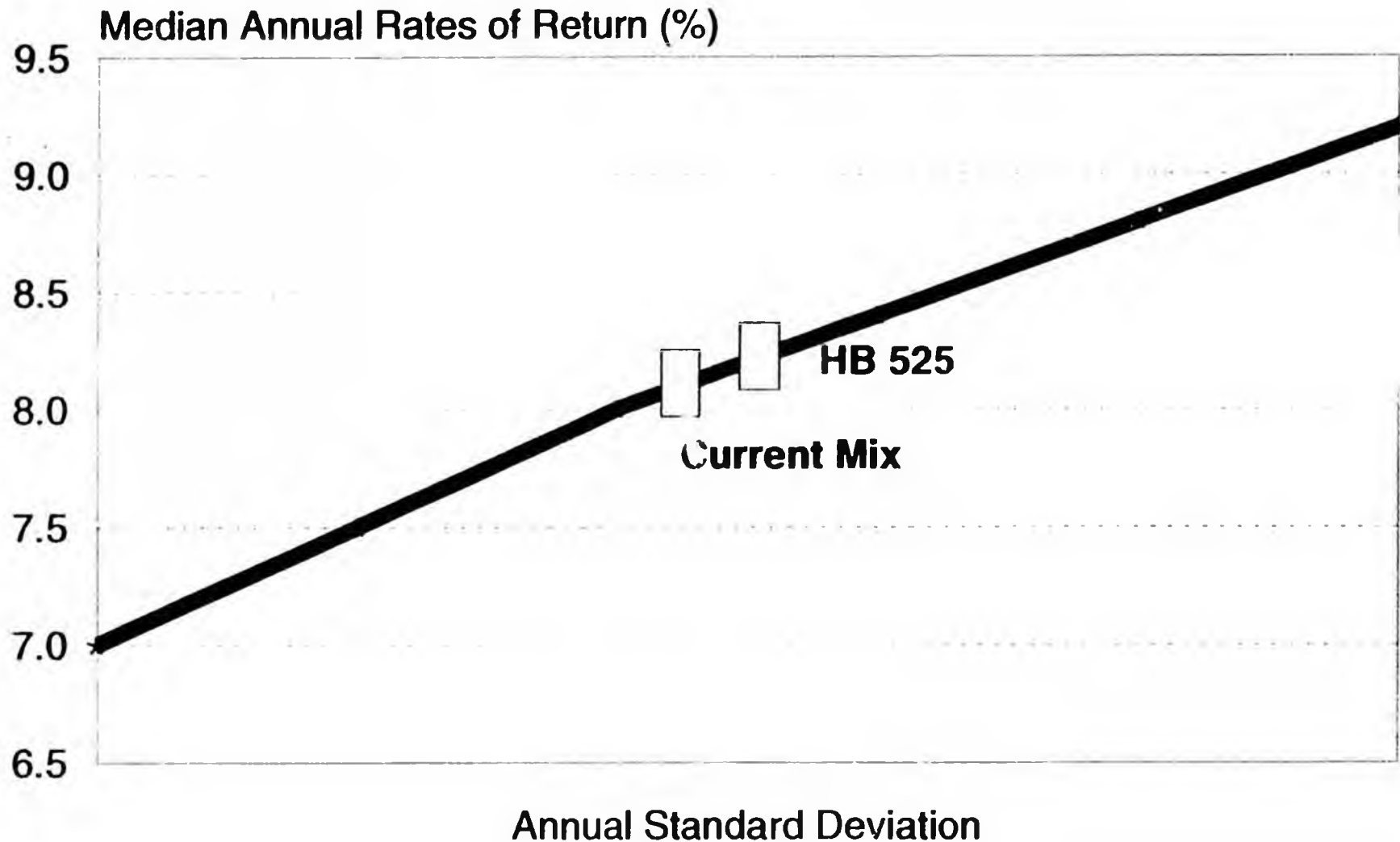
⁽³⁾ Transferred to principal from earnings reserve account per AS 37.13.145(d), 1993-20

⁽⁴⁾ Based on 1995 Callan capital market assumptions.

Current

Impact of House Bill 525

Efficient Frontier/Asset Mix Risk & Return





Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

February 15, 1996

Representative Terry Martin, Chairman
Legislative Budget and Audit Committee
State Capitol Room 502
Juneau, Alaska 99801-1182

Dear Chairman Martin:

At the request of the Board of Trustees (the Trustees) of the Alaska Permanent Fund Corporation (the Corporation), I am transmitting to you a draft bill that would amend the enabling Act of the Corporation to authorize changes in the investment powers. The trustees took this action formally at its regular meeting February 8, 1996 by unanimous vote.

After a careful review of the asset allocations set out in AS 37.13.120 (i), the trustees determined that it would be consistent with the prudent investor standard to increase the power of the corporation to invest in preferred and common stock of domestic and nondomestic corporations and in other securities that were rated as investment grade by nationally recognized rating services. Under existing law, the corporation may not allocate more than 50 per cent of the total investments of the Fund to certain investment instruments which include domestic and nondomestic preferred and common stocks. Existing law also limits the Corporation from investing in domestic and nondomestic corporate debt securities unless those instruments are "A" rated.

At present, the investments of the fund are approaching the allocation limits set out in AS 37.13.120 (i). Research performed for the Board confirms that other public trust funds of similar size and purpose, subject to the prudent investor standard, are allocating more than 50 per cent of their assets to equity investments and are investing in domestic and nondomestic debt securities that are rated investment grade or better. Investment grade covers securities that are rated Baa or better by Moody's Investors Service, Inc. or comparable service. With proper diversification of asset classes, the change in investment powers proposed in the bill affords the Corporation a safe way of balancing expected return against risk of loss so that assets are invested prudently.

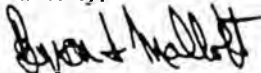
If the fund is to keep achieving returns that meet or exceed those available to other institutional investors, the Board of Trustees must have the ability to allocate more to equities and to invest in a broader range of debt securities. The Corporation is requesting this change in the law so that it has sufficient authorization to allocate investments when it determines that conditions are optimum to increase returns to the Fund. The Board requested that I make it clear that any change in specific asset classes or allocations will occur only after a thorough study of specific asset classes and market conditions is complete.

I would point out the Trustees view these recommended changes as remedial. A comprehensive review of the Corporation's investment powers will be undertaken and in a succeeding legislature further changes may be recommended.

Ltr Representative Martin
February 15, 1996
page 2

On behalf of the Board, I urge you to favorably consider the enclosed draft bill and take steps necessary for the committee to sponsor and introduce the bill.

Sincerely,

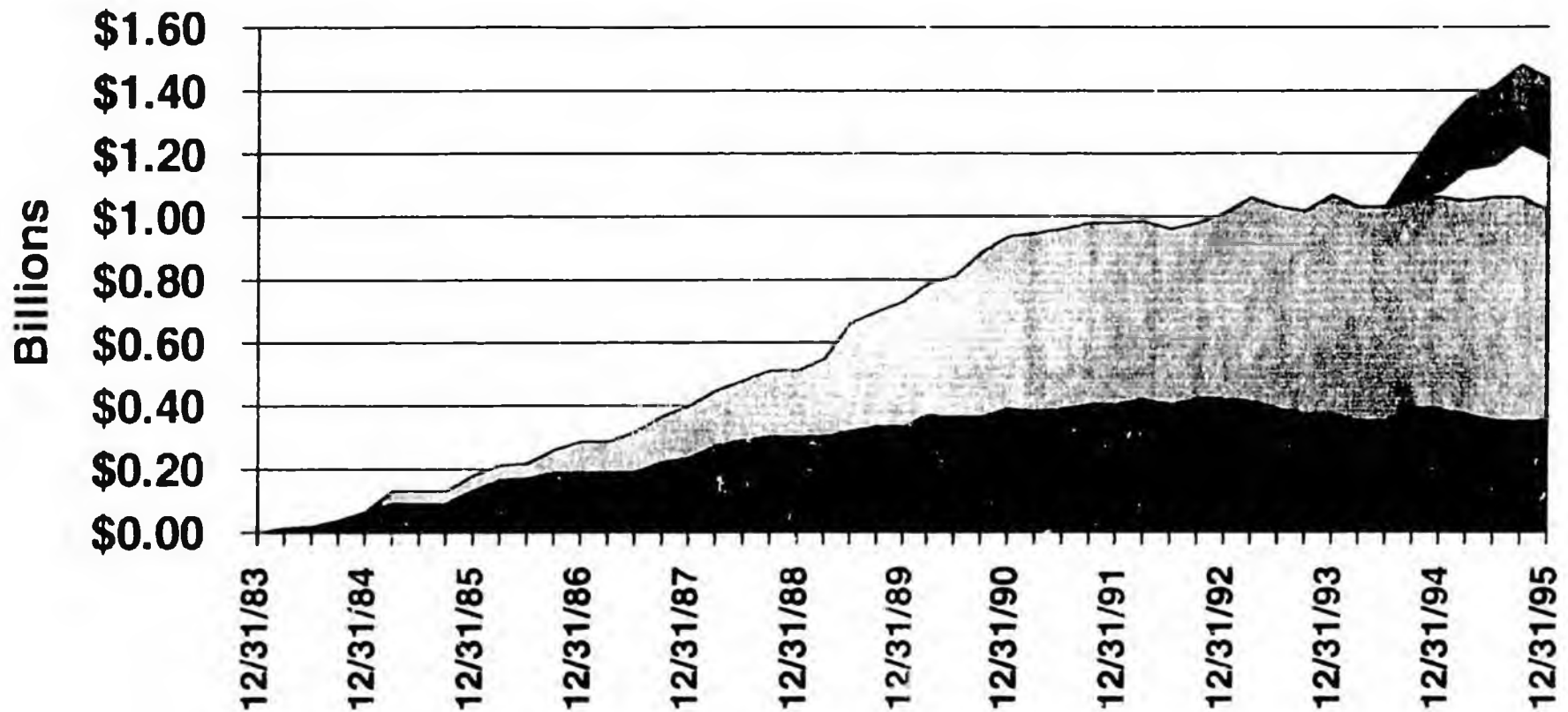


Byron I. Mallott
Executive Director

Attachment.

Permanent Fund Real Estate

Portfolio Construction



- | | |
|--|--|
| ■ Commingled Fund (IRR = 2.05%) | ■ REIT (IRR = 11.96%) |
| ■ Minority Co-Investment, <33% Ownership (IRR = 4.03%) | ■ Minority Co-Investment, >33% Ownership (IRR = 5.01%) |
| □ Majority Co-Investment (IRR = 9.22%) | ■ Wholly Owned (IRR = 9.30%) |

REPRESENTATIVE
TERRY MARTIN
CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
HOUSE FINANCE COMMITTEE

Alaska State Legislature



MAY 15 - JAN 15 258-8169
716 W. 4TH, SUITE 650
ANCHORAGE, AK 99504

JAN 15 - MAY 15 465-3783
STATE CAPITOL
JUNEAU, AK 99801-1182

HOME 333-6990
355 DONNA DRIVE, #11
ANCHORAGE, AK 99504

SPONSOR STATEMENT

HB 525

An Act designating certain permissible investments by the Alaska Permanent Fund Corporation in taxable municipal or state debt securities and corporate debt securities; changing the allocation limits on domestic and nondomestic government and corporate securities, nondomestic corporate promissory notes, domestic and nondomestic corporate stocks, and taxable government debt securities; and providing for an effective date.

A joint meeting of the Legislative Budget and Audit Committee and the Revenue Subcommittee of the House Finance Committee was held on February 7 to examine why the state's PERS, TRS and SBS funds were performing better than the Permanent Fund. It was revealed at the hearing that 90 percent of the performance difference was due to the difference in portfolio makeup between the funds. While the state's retirement funds have to follow only the prudent investor rule in their investment decisions, the Permanent Fund is bound by statutes which restrict types of investments purchased, and amounts which can be invested in specific areas. Consequently, the retirement funds have the flexibility to take advantage of market changes, where the Permanent Fund does not. Specifically, the Permanent Fund is restricted in the amount of equities it may purchase. Also, the Permanent Fund must hold very high ratings of fixed income investments, further reducing the possible return on those investments. The equities market has been performing very well recently and the retirement funds have taken advantage of the situation by increasing their equity holdings. The Permanent Fund currently cannot do this.

At the February 7 joint hearing, Chairman Terry Martin told the Permanent Fund's Executive Director and members of the Board of Trustees that his committee would be happy to present legislation providing more flexibility in



the Fund's investment strategy. The Board of Trustees discussed the matter and presented the following draft legislation which allows more flexibility by making minor changes in two categories of investment. These changes should allow the Permanent Fund to take better advantage of current and changing market situations, and earn more for the Fund. This is also important for the state's financial picture, considering that a one percent increase in Permanent Fund earnings currently amounts to approximately \$152 million.

The proposal for changes to AS 37.13.120 consists of:

- Eliminating the restriction against investing in BBB-rated (investment grade) bonds;
- Eliminating the limitation to five percent for investing in A-rated bonds; and
- Excluding foreign bonds from the category which restricts investment in equities and foreign bonds to 50 percent or less (so that a full 50 percent can be invested in equities, not just 45 percent, as is the case now).



**ASSET ALLOCATION
CONSIDERATIONS**

**PREPARED FOR
THE ALASKA PERMANENT FUND
CORPORATION**

A large, solid black triangle pointing upwards, occupying the bottom half of the page. The text 'CALLAN ASSOCIATES' is printed in white at its base.

CALLAN ASSOCIATES

**ASSET ALLOCATION
CONSIDERATIONS**

**PREPARED FOR
THE ALASKA PERMANENT FUND
CORPORATION**

JANUARY, 1996

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Section I

INTRODUCTION AND OVERVIEW

Annually, Callan Associates Inc. provides an analysis of the Alaska Permanent Fund Corporation's strategic asset allocation policy. This analysis is developed over two or more meetings with the Board.

At the initial meeting, we will discuss the modeling approach utilized, review historic capital market returns, risks and correlations of one asset class to another. We also will discuss our key assumptions and contrast each with recent and long-term results. This year, our asset allocation review will be unusually comprehensive. We will review not only those asset categories available to the APFC, but also those frequently used by other institutional investors. In addition, at later stage in the process, we will focus on a broad range of critical implementation issues such as equity manager structure, rebalancing policies, and liquidity management.

In this first phase, we will ignore your statutory and policy constraints and consider the full theoretical range of potential policy options. It is important to note that Callan does not advocate any particular policy. Our goal is to enable the Board to fairly, objectively and consistently consider the trade-offs associated with a range of potentially viable alternatives. In this process, we do not make specific point forecasts. We create reasonable ranges of expected returns for individual asset classes and for combinations of major asset classes. This process and approach are widely accepted in the professional asset management business and are identical to the approach used in prior years.

At the second meeting, we will present an analysis of the risk and return characteristics for your current policy and a range of viable alternative policies that explicitly recognize your statutory constraints. In this second analysis, we also will include alternative policies developed using other input assumptions that you believe worthy of consideration.

In Section II of this initial report, we provide a non-technical overview of the theory behind strategic asset allocation. In Section III, we describe our capital market projection process and review historic return and risk characteristics for the major asset classes. In Section IV, we provide a detailed description of our 1996 projections and evaluate the return and risk characteristics for a full range of alternative "efficient" policies.

Michael J. O'Leary, Jr., CFA
Executive Vice President
January, 1996

Section II

THE THEORY BEHIND STRATEGIC ASSET ALLOCATION

The theory behind asset allocation is relatively straight-forward, and can be seen as a formalized extension of the wisdom contained in the phrase, "Don't put all your eggs in one basket." If an investor holds one asset in a portfolio, the return for the portfolio is high when the return on the asset is high and low when the return on the asset is low. If the investor is satisfied with the return on the asset and its variation over time, then the simple strategy of holding that one asset can be used. However, the returns on individual assets are almost always much too volatile for a prudent investor. Rather than holding one asset, the prudent investor will combine assets into a portfolio. A portfolio containing more than one type of asset is said to be diversified.

The reason that a prudent investor will combine assets in a portfolio rather than holding just one asset, is that a combination of assets will tend to have less expected volatility or risk associated with it than will any single asset with the same expected return. The reason for this has to do with the co-movement (or correlation) of the return of the assets being held. In general, different assets will have different responses to changes in the economy. While some stocks might drop in value during periods of high inflation, others may drop less or actually increase in value. By holding two stocks that have the opposite reaction to a period of high inflation, you can create a portfolio that has less volatility than either of the single stocks held in isolation. When one stock in your portfolio moves up, the other moves down and the value of the portfolio remains relatively stable.

In the spectrum of investable assets there are, unfortunately, very few instances of assets that always move in the exact opposite direction of one another. However, to the extent that two assets do not move in exactly the same direction, there is still some risk-reduction benefit to combining them. Asset mix optimization (the technique used in this study) is a process which searches for the most effective way to exploit the advantages of combining assets in a portfolio. By examining the co-movements and the associated risks and expected returns for a set of assets, optimization analysis can find the combinations of those assets that should yield the absolute lowest level of risk for a given level of return. These portfolios are known as efficient portfolios and the entire universe of efficient portfolios makes up what is known as the efficient frontier.

Strategic asset allocation is an investment philosophy which has its roots in the process of portfolio optimization. Under a strategic asset allocation policy, the investor identifies a mix of assets which is risk/return efficient and reflects a level of risk that the investor feels comfortable with. The investor then invests assets in the proportions suggested by this strategic mix. As the ebbs and flows in the different asset markets push the investor's actual allocation away from this strategic mix, the investor will rebalance the portfolio to remain on track.

This process of rebalancing is perhaps one of the most critical components of a successful policy. Without periodic rebalancing the portfolio will naturally tend to overweight asset classes which have performed well in recent periods (due to their relative appreciation) and underweight those

that have performed poorly (due to their relative depreciation). By rebalancing the portfolio, the investor diverts assets out of an asset class, which has perhaps just topped out, into an asset class which has just reached a low point. Over time, this passive dynamic strategy will naturally shift assets from potentially overvalued investments into potentially undervalued investments resulting in enhanced long-run returns. Furthermore, these returns will be realized at a risk level significantly lower than that experienced by a similar portfolio that is either not efficient, or does not employ rebalancing.

Thus, by employing asset mix optimization in developing a strategic portfolio, and by periodically rebalancing that portfolio back to the efficient allocation, an investor can successfully minimize the volatility associated with the long-run rate of return on the portfolio.

Section III

THE CAPITAL MARKET PROJECTION PROCESS AND A REVIEW OF HISTORIC RISK AND RETURN CHARACTERISTICS

In most standard portfolio optimization routines, such as Callan's ASSETMAX program, the analyst must provide several inputs characterizing the expected future performance of the asset classes which are being considered. These performance characteristics include the expected future return for each asset class, the expected future volatility (risk) of the asset's returns, and the expected future correlations between the asset class returns. The future in this case represents the capital market expectations. This section summarizes the methodology Callan uses to derive its capital market expectations and then reviews historic return and risk statistics.

There are four distinct steps which act as inputs to the formation of Callan's capital market expectations:

- (1) Development of a five-year economic outlook for the U.S. and other major industrial economies. This outlook involves understanding the range of possible economic scenarios in addition to an evaluation of their likelihood.
- (2) Examination of the historical relationship between major economic and financial variables and five-year asset performance characteristics.
- (3) Examination of historical interrelationships of performance characteristics among the asset classes. This involves searching for inequality relationships among the risks and correlations that indicate which risks and correlations have tended to be higher than others over time and over various economic cycles.
- (4) Fine tuning of preliminary estimates within prespecified ranges so they provide reasonable results in standard optimization routines.

The first step in our process is the development of a five-year economic outlook. The need to develop this outlook arises from the consideration of a five-year investment horizon. When developing expectations about future performance of an asset class, it is important to understand the major factors influencing the variation of this performance. Our research, as well as other academic and professional research, indicates that much of the intermediate/long-term variation in the performance of most asset classes is closely related to the behavior of the U.S. economy and other industrial economies. Thus, a five-year projection of asset performance should explicitly consider the expected state of the economy over the next five years.

Callan's economic outlook is derived using a combination of in-house empirical models and consensus forecasts from the business economics industry. The in-house models focus particular attention on longer-term structural relationships which are particularly important in intermediate/long-term capital market movements.

The second step in the process links our economic outlook with an outlook on asset performance. We study how the economic and financial markets interact in all types of economic and financial environments. We then attempt to apply historical relationships between variables to today's situation.

The third step in our process involves an examination of the historic returns, risks, and correlations for inequality relationships that have persisted through most or all economic periods. For example, the standard deviation of returns on the S&P 500 has been below the standard deviation of returns on the small capitalization stock index for every five-year period since 1946. Likewise, in almost all post-World War II periods, the correlation between high-grade corporate bonds and the S&P 500 has been higher than the correlation between high-grade corporate bonds and small capitalization stocks. These inequality relationships are quite common among risk and correlation measures.

The final step in our capital market process involves fine-tuning these preliminary estimates within specified ranges so that they behave well in a standard optimization environment. The resulting optimal portfolios are subjected to a careful examination to determine:

- (1) Whether the portfolios represented fall within the range of currently held institutional portfolios, and assure that no asset class is under- or over-weighted in any of the optimal portfolios for the associated level of risk.
- (2) Whether there is continuity as we move from safer to riskier portfolios so that a small movement along the efficient frontier does not cause a large (percentage) change in the portfolio weightings.

On a basis of this analysis, the return, risk, and correlation values are adjusted (within predetermined ranges) until reasonable portfolios are produced.

By following this process, we are able to develop values that are consistent with historical economical and financial market behavior, incorporate the current market environment, and behave well in a standard optimization environment.

HISTORIC RETURN AND RISK CHARACTERISTICS

When developing our assumptions for return and risk, we carefully consider how various asset classes have performed over a number of different holding periods and in varied economic environments. Unfortunately, many of the most commonly used market indices have comparatively limited histories and/or significant weaknesses in their composition.

When considering domestic equities, we use a series of market indices that segment the domestic stock market by market capitalization. The aggregation of these component indices, the Callan Broad Market Index, includes 2,000 stocks on a capitalization-weighted basis. Three major sub-indices make up the Broad Index. They are: the Callan Large Cap, the Callan Mid Cap and the Callan Small Cap. The largest 150 companies are the Large Cap. The next 350 companies constitute the Mid Cap and the next 1,500 stocks are included in the Small Cap Index. The combination of the large and mid cap indices is very similar to the S&P 500. The Large Cap Index accounts for approximately 55% of the Broad Market Index. The Mid Cap is 24% of the Broad Market Index. The Small Cap Index, while including 75% of the 2,000 largest companies, only accounts for 21% of the total Broad Index. Since the S&P 500 is widely used as a measure of the large cap component of the U.S. stock market, we are using it and the Callan Small Cap Index to model the full U.S. equity market. We think that using the S&P 500 creates a good historic context for our assumptions. We hasten to note that the assumptions used for the S&P are entirely consistent with those that we develop for the appropriate components of the Callan Broad Market Index.

When considering the bond market, we utilize the Lehman Bond Indices. Lehman's broadest index is the Lehman Aggregate Index. It is composed of two components: the Lehman Government/Corporate Bond Index and the Lehman Mortgage Index. These indices include essentially all investment-grade, publicly-traded debt securities on a market value-weighted basis. It is important to note that the mortgage index includes securities backed by mortgage pools of the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. It does not include securities that are derived from these underlying securities, as such inclusion would result in double counting. It is also important to recognize that these bond market indices are constantly changing as new bonds are issued and existing bonds mature, are refinanced or prepaid.

This year, we are using the Lehman Government/Corporate as the proxy for the bond market. The primary reason for using this index is that its duration is more predictable than that for the Aggregate. It has lower and/or more predictable prepayment risk. It, therefore, is more practical in an optimization analysis. The Aggregate, in our judgment, is a better measure of the total investment grade bond market and is often the preferred benchmark for performance evaluation and portfolio structure analysis.

We use the Morgan Stanley Capital International market indices to model international stocks. The MSCI Europe, Australia and Far East Index (EAFE) is one of the oldest, best constructed

and commonly used indices of non-U.S. developed market performance and is the specific index used to consider the benefits of international diversification. This index does not include emerging markets, nor does it include Canada or Mexico. EAFE is a capitalization-based index that attempts to capture approximately 60% of the market capitalization of the various international markets. The index is therefore heavily influenced by the Japanese, United Kingdom, German, and French markets.

The table on the following page details recent performance for each of the indices mentioned above and also includes data for other major indices commonly used in performance evaluation.

**Historical Capital Market Total Returns
Periods Ended 12/31/95**

Asset Class	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years
Domestic Equity						
Standard & Poor's 500	37.51	15.25	16.57	14.84	14.78	14.57
Standard & Poor's 400	30.95	12.89	19.30	15.64	16.66	--
Callan Large	39.50	14.86	15.37	14.56	14.03	--
Callan Medium	32.96	13.67	18.26	14.22	14.66	--
Callan Small	30.99	14.67	20.34	13.49	14.72	--
Domestic Fixed-Income						
Lehman Aggregate	18.46	8.07	9.47	9.63	11.87	10.06
Lehman Govt/Corp	19.24	8.51	9.80	9.65	11.79	10.03
Lehman Government	18.34	8.16	9.36	9.38	11.43	9.90
Lehman Corporate	22.24	9.61	11.15	10.46	12.85	10.52
Lehman Govt/Corp Int	15.34	7.16	8.62	8.82	10.96	9.66
Lehman Govt/Corp Long	29.93	11.93	12.71	11.64	13.78	10.98
Lehman Brothers G/C Ex Baa	19.02	--	--	--	--	--
First Boston High Yield	17.40	11.40	18.54	11.91	--	--
T-Bills	5.71	4.37	4.50	5.85	7.53	7.71
International						
MSCI EAFE Index	11.21	16.69	9.37	13.63	14.00	14.39
MSCI Europe Index	21.63	17.17	11.63	13.97	14.20	13.51
MSCI Pacific Index	2.78	16.31	7.39	13.35	13.83	15.67
MSCI Emerging Markets Free	-6.94	13.33	20.55	--	--	--
MSCI World	20.71	15.83	11.73	13.10	13.20	13.19
Salomon Brothers Non-US Govt	19.56	13.41	12.18	13.65	--	--
Other						
Callan Real Estate	7.43	5.13	0.84	3.27	6.48	8.04
NCREIF	8.27	5.17	0.88	3.09	6.14	8.26
NAREIT	18.30	12.22	16.55	7.54	10.57	13.75
Venture Capital 100	39.92	18.51	29.09	11.42	7.15	--

In addition to historic returns, it is important to consider risk. We use annualized standard deviations of quarterly returns to measure risk. By definition, standard deviation measures the range of returns around the mean return. One standard deviation captures two-thirds of the observations around the mean. The greater the standard deviation, the greater the range of observed returns. The table on the following page indicates that standard deviations are lower in recent years than in many other periods. This table shows the rolling annualized standard deviations over the last three years, five years, and ten years.

**Historical Capital Market Annual Standard Deviation
Periods Ended 12/31/95**

Asset Class	3 Year	5 Years	10 Years
Domestic Equity			
Standard & Poor's 500	8.32	9.07	14.80
Standard & Poor's 400 MidCap	9.50	13.44	17.36
Callan Large	8.76	9.40	14.33
Callan Medium	8.98	10.21	16.09
Callan Small	9.61	13.39	18.48
Domestic Fixed-Income			
Lehman Aggregate	5.31	5.08	5.29
Lehman Govt/Corp	5.81	5.51	5.64
Lehman Government	5.59	5.43	5.60
Lehman Corporate	6.53	5.86	5.89
Lehman Govt/Corp Int	4.37	4.42	4.22
Lehman Govt/Corp Long	9.53	8.43	9.34
First Boston High Yield	5.27	8.60	8.71
T-Bills	0.58	0.59	0.87
International			
MSCI EAFE Index	7.97	11.00	19.87
MSCI Europe Index	7.24	10.78	15.21
MSCI Pacific Index	15.99	17.48	26.47
MSCI Emerging Markets Free	27.87	26.45	--
MSCI World	5.14	8.24	16.01
Salomon Brothers Non-US Govt	8.46	11.11	13.50
Other			
Callan Real Estate	1.48	3.68	3.18
NCREIF	1.98	3.71	3.03
NAREIT	13.12	13.40	13.39
Venture Capital 100	20.53	28.31	31.73

The final critical statistical measure used in modeling is the correlation coefficient. This statistic measures how two assets are related to each other. A positive correlation of 1.00 would indicate that two assets are perfectly positively correlated. A correlation of -1.00 indicates that two assets are perfectly inversely correlated, when one goes up the other goes down. Most financial assets are positively correlated with one another but are far from perfectly correlated.

The following tables depict correlations between asset classes, equity benchmarks, fixed income benchmarks and international benchmarks over the last three, five and ten years.

**Correlations Among Major Asset Categories
Periods Ended 12/31/95**

Last 3 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.83						
MSCI EAFE	-0.17	0.01					
Lehman Govt/Corp	0.78	0.66	0.24				
Salomon Non-US Govt	0.40	0.30	0.12	0.54			
Callan Real Estate	0.34	-0.01	-0.38	0.25	0.09		
Venture Capital 100	0.43	0.69	-0.44	0.07	-0.02	-0.01	
T-Bills	0.70	0.34	-0.59	0.39	0.17	0.82	0.34

Last 5 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.79						
MSCI EAFE	0.30	0.12					
T-Bills	0.62	0.27	0.41				
Salomon Non-US Govt	0.17	-0.24	0.39	0.67			
Callan Real Estate	-0.09	-0.17	0.19	-0.14	-0.10		
Venture Capital 100	0.55	0.89	-0.13	-0.08	-0.42	-0.12	
T-Bills	0.59	0.38	-0.08	0.34	0.08	0.22	0.37

Last 10 Years							
	S&P 500	Callan Small	MSCI EAFE	Lehman G/C	Salomon Non-US	Callan RE	VECO 100
Callan Small Cap	0.92						
MSCI EAFE	0.58	0.51					
Lehman Govt/Corp	0.21	0.14	0.25				
Salomon Non-US Govt	-0.11	-0.21	0.35	0.53			
Callan Real Estate	-0.04	-0.10	0.17	-0.08	-0.03		
Venture Capital 100	0.77	0.92	0.33	-0.02	-0.26	-0.18	
T-Bills	0.12	-0.02	-0.03	0.17	-0.03	0.33	-0.07

**Correlations Between Equity Benchmarks
Periods Ended 12/31/95**

Last 3 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.80			
Callan Medium	0.95	0.85		
Callan Small	0.98	0.74	0.95	
Standard & Poor's 500	0.87	0.98	0.93	0.83

Last 5 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.82			
Callan Medium	0.96	0.86		
Callan Small	0.96	0.71	0.93	
Standard & Poor's 500	0.88	0.99	0.93	0.79

Last 10 Years

	S&P 400 MidCap	Callan Large	Callan Medium	Callan Small
Callan Large	0.91			
Callan Medium	0.97	0.93		
Callan Small	0.97	0.87	0.97	
Standard & Poor's 500	0.94	0.99	0.97	0.92

**Correlations Between Fixed Income Benchmarks
Periods Ended 12/31/95**

Last 3 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	1.00	1.00	1.00				
Lehman Brothers G/C Int	0.99	0.99	0.99	0.99			
Lehman Brothers G/C Long	0.98	0.99	0.99	0.98	0.96		
First Boston High Yield	0.81	0.80	0.80	0.81	0.83	0.74	
T-Bills	0.44	0.38	0.38	0.42	0.38	0.46	0.06

Last 5 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	0.99	0.99	0.98				
Lehman Brothers G/C Int	0.99	0.99	0.99	0.97			
Lehman Brothers G/C Long	0.97	0.98	0.98	0.97	0.94		
First Boston High Yield	0.36	0.33	0.29	0.44	0.37	0.28	
T-Bills	0.39	0.34	0.32	0.41	0.39	0.43	0.46

Last 10 Years

	Lehman Agg	Lehman G/C	Lehman Govt	Lehman Corp	Lehman G/C Int	Lehman Long	FB Hi-Yield
Lehman Brothers G/C	1.00						
Lehman Brothers Govt	0.99	1.00					
Lehman Brothers Corp	0.98	0.98	0.97				
Lehman Brothers G/C Int	0.99	0.98	0.98	0.96			
Lehman Brothers G/C Long	0.97	0.98	0.98	0.97	0.91		
First Boston High Yield	0.39	0.39	0.36	0.49	0.35	0.42	
T-Bills	0.20	0.17	0.17	0.14	0.14	0.12	-0.17

Correlations Between International Benchmarks Periods Ended 12/31/95

Last 3 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.01				
MSCI Pacific Index	0.93	-0.37			
MSCI Emerging Markets Free	0.02	0.64	-0.21		
MSCI World Index	0.78	0.36	0.58	0.10	
Salomon Brothers Non US Govt	0.12	0.31	0.00	-0.24	0.34

Last 5 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.55				
MSCI Pacific Index	0.88	0.09			
MSCI Emerging Markets Free	-0.08	0.18	-0.18		
MSCI World Index	0.91	0.61	0.74	0.06	
Salomon Brothers Non US Govt	0.39	0.48	0.21	-0.40	0.37

Last 5 Years

	MSCI EAFE	MSCI Europe	MSCI Pacific	MSCI Emerging	MSCI World
MSCI Europe Index	0.55				
MSCI Pacific Index	0.88	0.09			
MSCI Emerging Markets Free	-0.08	0.18	-0.18		
MSCI World Index	0.91	0.61	0.74	0.06	
Salomon Brothers Non US Govt	0.39	0.48	0.21	-0.40	0.37

Section IV

DISCUSSION OF 1996 CAPITAL MARKET PROJECTIONS AND THEORETICAL EFFICIENT ALTERNATIVE POLICIES

Asset Category Projections

To develop a range of alternative efficient asset mix policies, it is necessary to first develop three critical inputs for each asset category. The return and risk estimates for the key asset categories are presented below. All the projections are internally consistent with one another and reflect Callan's expectations regarding the central tendency for a range of possible returns. In formulating these estimates, we focused on a five-year timeframe. If pressed to estimate returns for either shorter or longer periods, we would have similar estimates.

Asset Class	1996 Expected Return	1995 Expected Return	Change	1996 Expected Risk	1995 Expected Risk	Change
Equities						
Large Cap (S&P 500)	9.50	9.80	-0.30	13.30	12.70	0.60
Small Cap (CAI Small)	10.50	10.80	-0.30	19.20	18.50	0.70
International (MSCI EAFE)	10.20	10.30	-0.10	18.70	19.00	-0.30
Fixed Income						
Domestic (LB G/C)	6.80	7.50	-0.70	6.00	6.00	0.00
Int'l (SB Non-US Gov)	6.80	7.50	-0.70	12.00	12.00	0.00
High Yield (First Boston)	7.50	8.00	-0.50	9.20	8.50	0.70
Other						
Real Estate	8.00	8.60	-0.60	18.00	18.00	0.00
Alternative Investments	13.00	13.00	0.00	33.50	30.00	3.50
Cash Equivalents	4.80	4.80	0.00	0.80	0.80	0.00
Economic Variable						
Inflation	3.50	4.00	-0.70	N/A	N/A	N/A
Real GDP	2.40	2.50	-0.10	N/A	N/A	N/A

The projected correlations are:

	1	2	3	4	5	6	7	8	9
1 Large Cap	1.0000	0.7900	0.5000	0.4500	0.1000	0.5200	0.2200	0.6600	-0.0500
2 Small Cap Equity	0.7900	1.0000	0.4200	0.3200	-0.1500	0.5300	0.2200	0.8500	-0.0500
3 Int'l Equity	0.5000	0.4200	1.0000	0.4300	0.3700	0.3500	0.2200	0.3300	-0.2100
4 Domestic Bonds	0.4500	0.3200	0.4300	1.0000	0.6200	0.4600	0.2000	0.2200	0.0500
5 Int'l Bonds	0.1000	-0.1500	0.3700	0.6200	1.0000	0.2000	0.0500	-0.1500	0.0500
6 High Yield	0.5100	0.5400	0.3500	0.4600	0.2000	1.0000	0.2200	0.4600	-0.0100
7 Real Estate	0.2200	0.2200	0.2200	0.2000	0.0500	0.2200	1.0000	0.2000	0.2100
8 Alternative Inv	0.6600	0.8500	0.3300	0.2200	-0.1500	0.4500	0.2000	1.0000	0.0500
9 Cash Equivalents	-0.0500	-0.0500	-0.2100	0.0500	0.0500	-0.0100	0.2100	0.0500	1.0000

The projected return statistics are similar to, but slightly lower, than those utilized last year. Domestic equity returns are 30 basis points below those used last year. International equity expected returns are 10 basis points lower.

Bond expected returns, both domestic and international, were reduced 70 basis points. Real estate's expected return is 60 basis points lower. Expected risk levels were adjusted slightly to incorporate recent trends.

In sum, the adjustments to expected returns were driven by two primary forces. First, they recognize the exceptional strength in the U.S. equity market. Second, the estimates reflect the marked decline in long-term interest rates. The lower interest rate structure, and recovery in many real estate markets, explain the reduction in expected real estate returns.

The basic pattern of long run expected returns remains unchanged. Domestic and international stocks are expected to earn more than real estate which, in turn, is expected to achieve a greater return than bonds. Expected real returns (nominal returns less expected inflation) are consistent with long run ranges.

Unconstrained Efficient Portfolios

In prior years, we have excluded potential alternative policies that would be impossible to implement under your governing statute. Thus, we have excluded asset categories such as high yield bonds and venture capital. We also historically have constrained maximum equity exposure and combined equity and real estate exposure to adhere to your statutory limits.

This year, in this initial phase, staff felt and we concur, that it would be useful to consider an unconstrained set of alternatives.

The table below reflects a broad range of efficient alternative policies. The policies toward the left are lower risk; lower return alternatives while those toward the right are "efficient" higher risk, higher return alternatives. These unconstrained efficient portfolio alternatives utilize two asset categories (high yield bonds and alternative investments/ventures) that are not currently permitted by statute. In addition, alternatives 5 and 6 include equity commitments in excess of the current statute.

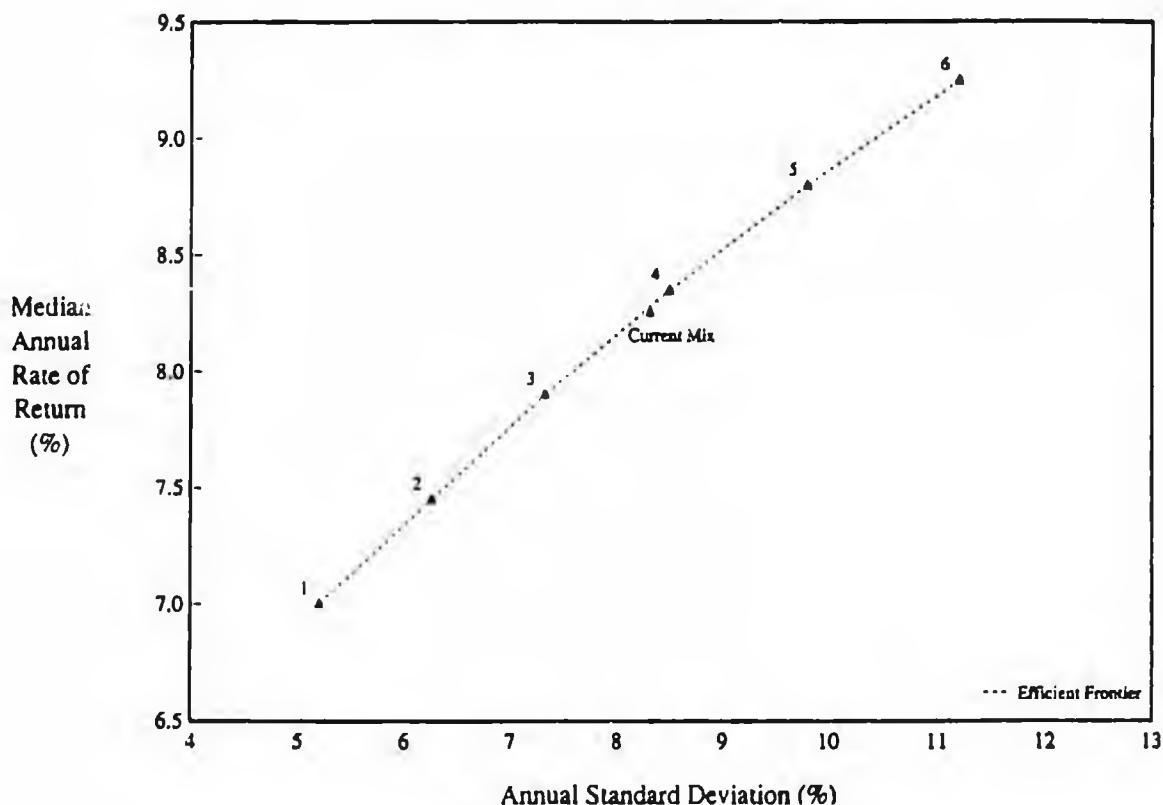
Optimal Portfolios

Portfolio Component	Current Mix	Limits		Asset Mix Alternatives					
		Min	Max	1	2	3	4	5	6
S&P	30	0	100	15	18	22	28	35	41
CAI Small	5	0	100	1	1	1	3	5	6
EAFE	10	0	100	6	7	8	12	16	20
LB G/C Bd	45	0	100	34	41	48	32	15	0
SB WGNONUS	0	0	100	0	0	0	4	8	11
Real Estat	10	0	100	4	5	6	7	8	9
Alt Inv	0	0	100	1	1	1	2	3	5
T-Bills	0	0	100	29	15	0	0	0	0
Hi Yield	0	0	100	10	12	14	12	10	8
Totals(%)	100			100	100	100	100	100	100
Median(%)	8.26			7.00	7.45	7.90	8.35	8.80	9.25
Std Dev(%)	8.30			5.20	6.26	7.32	8.48	9.79	11.20

On the following page is the graphical representation of the table above. Each triangle represents an asset mix from the table while the dashed line between the triangles represents other asset mixes which are also efficient but are not shown on the table. The combination of the portfolios represented by the triangles and the dashed line constitutes what is known as the "efficient frontier."

The three areas of interest on the graph are above the frontier, below the frontier and the frontier itself. All points above the efficient frontier are return and risk combinations which are not attainable, e.g., while it would be desirable to have a portfolio with the same risk as mix 2 but with a return of 8.0%, it is not possible to create one given the returns and risk of the assets under consideration. Conversely, points below the efficient frontier are attainable but not desirable. For example, a portfolio with the same risk as mix 2 and a return of 7.3% can be created with the assets in the study but, since it has a lower return for the same level of risk, mix 2 is preferred. Only portfolios on the efficient frontier have the highest return for any given level of risk.

Asset Mix Risk & Return



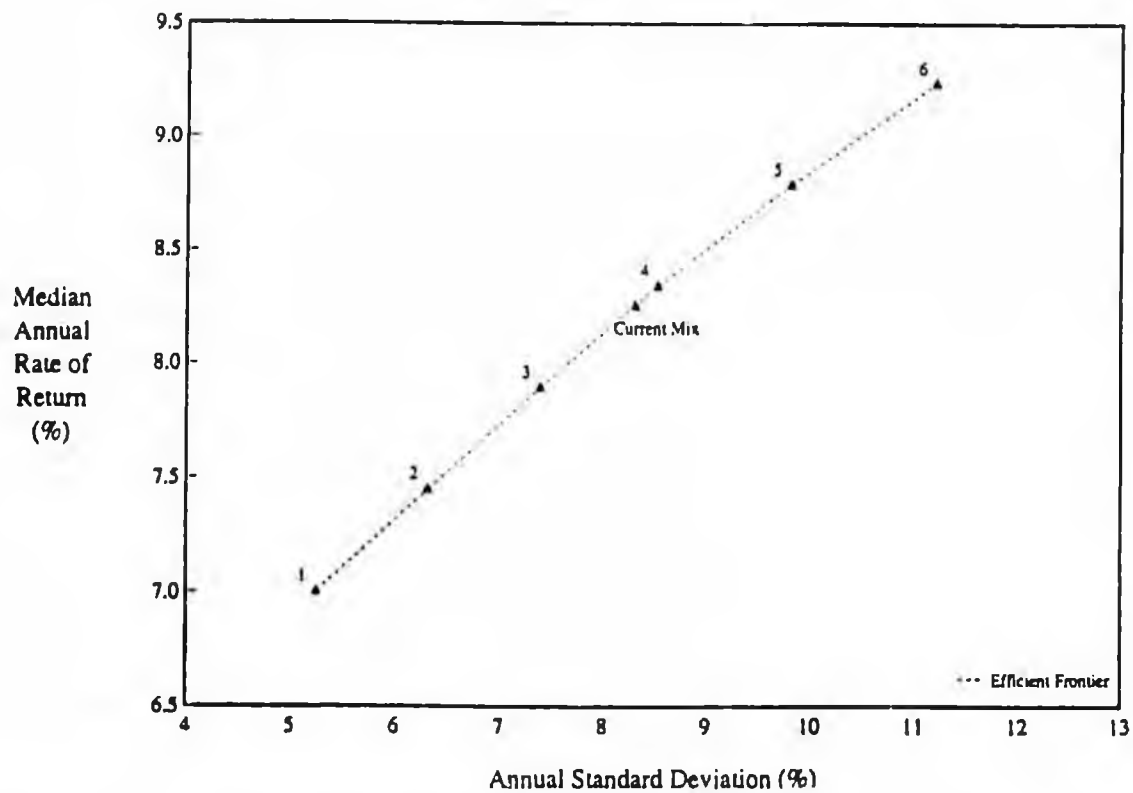
This analysis suggests that APFC's risk/return profile could be improved marginally with the expansion of allowable investments. While the percentage exposure varies, the aggregate exposure to high yield bonds and alternative investments ranges from 10-15%.

The table presented on the following page is similar to the first table, except high yield bonds and alternative investments are excluded from consideration. As in the first table, several of the alternatives are not allowable under current statute (Alternatives 5 and 6). These alternatives have more than 50% total equity exposure. Comparison of the two tables suggests that differences are comparatively minor. While overly simplifying, inclusion of high yield bonds and alternative investments generally result in lower equity exposures (particularly small cap equities) and also less investment grade bond exposure. The risk/return improvement is achieved through a slight reduction in standard deviation.

Optimal Portfolios

Portfolio Component	Current Mix	Limits		Asset Mix Alternatives					
		Min	Max	1	2	3	4	5	6
S&P	30	0	100	16	19	22	29	35	41
CAI Small	5	0	100	3	4	5	8	12	15
EAFE	10	0	100	6	7	8	11	15	19
LB G/C Bd	45	0	100	38	46	53	39	20	2
SB WGNONUS	0	0	100	1	1	2	5	9	13
Real Estat	10	0	100	5	6	7	8	9	10
T-Bills	0	0	100	31	17	3	0	0	0
Totals(%)	100			100	100	100	100	100	100
Median(%)	8.26			7.00	7.45	7.89	8.34	8.79	9.24
Std Dev(%)	8.30			5.25	6.32	7.38	8.52	9.81	11.20

Asset Mix Risk & Return



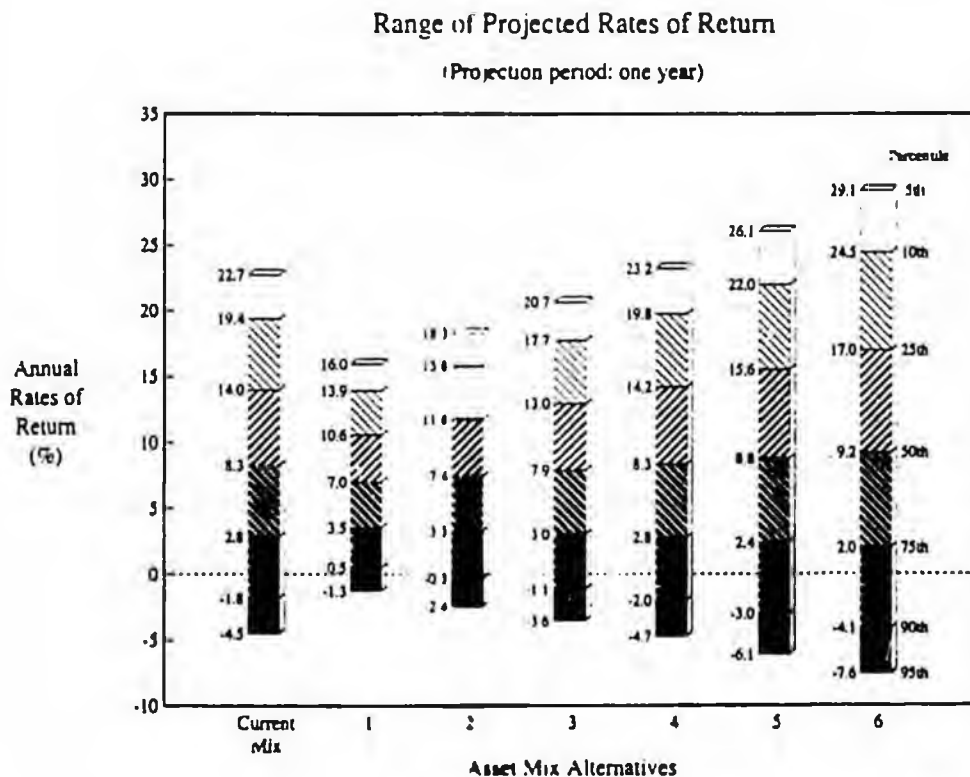
While not readily apparent from the tables, the greatest diversification gains are achieved through inclusion of international stocks and real estate.

Range of Projected Rates of Return (Excluding High Yield and Alternatives)

As a result of the risk (volatility) associated with each asset mix, the actual outcome can vary substantially in any one year. The graph below shows the range of possible returns that each asset mix could produce over a one-year holding period. The median returns are shown as the 50th percentile values, the best-case returns are represented by the 5th percentile, and the worst-case returns by the 95th percentile.

This graph is intended to show how return and risk characteristics of efficient portfolios differ. In each case, moving from a given mix to a more aggressive mix leads to an increase in the median return of the portfolio. For example, moving from mix 1 to mix 2 increases the median return at the 50th percentile from 7.0% to 7.4% due to the higher returns associated with more aggressive investment strategies under normal conditions.

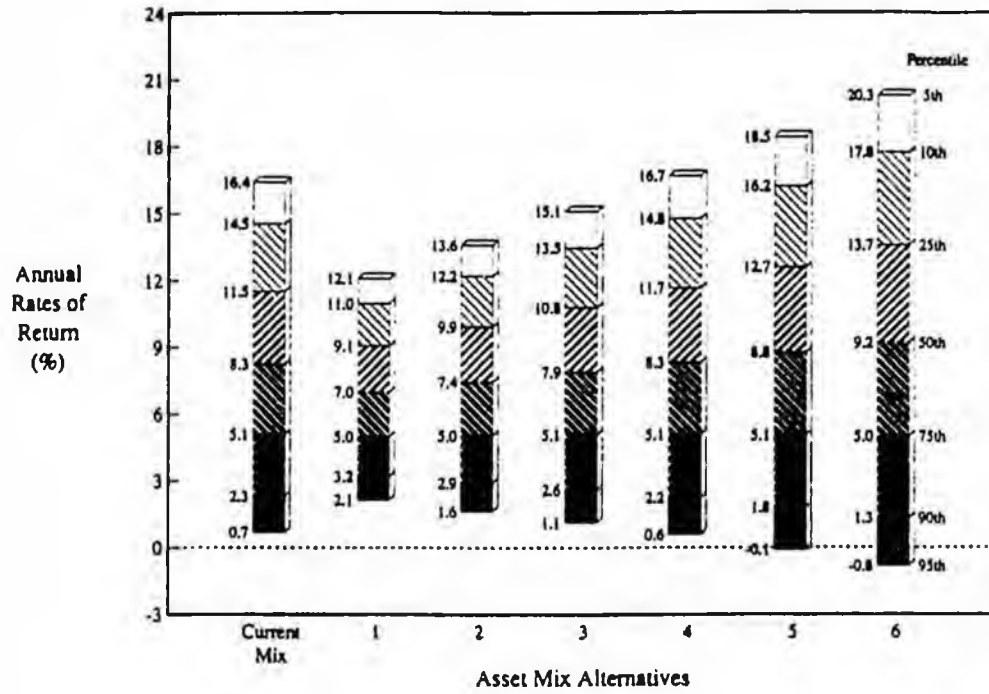
It is generally true that more aggressive mixes have a wider range of potential returns as shown by the increasing width of the bars in the graph. Looking again at mixes 1 and 2, the graph indicates that mix 2 returns 2.3% more than mix 1 in the best-case 5th percentile while it returns -1.1% less in the worst-case 95th percentile. The other mixes follow the same pattern of more aggressive mixes providing higher median-case returns with more return volatility.



The following graphs show a similar return distribution for a three-year, five-year and 10-year projection horizons. Notice that both the best and worst case scenarios are less extreme than in the one-year case. This is due to time diversification.

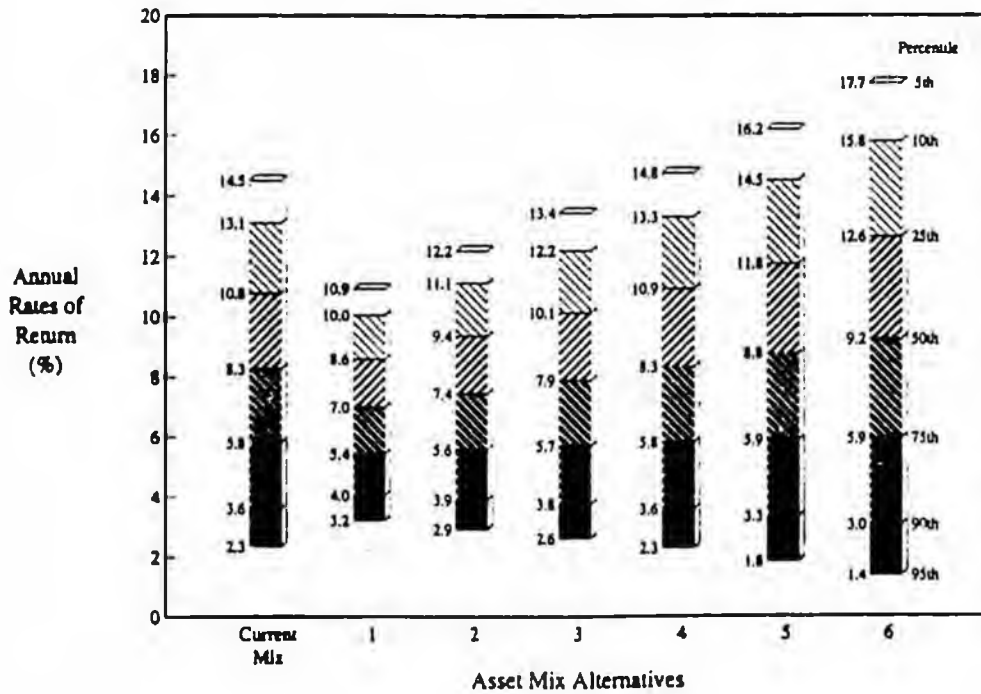
Range of Projected Rates of Return

(Projection period: 3 years)



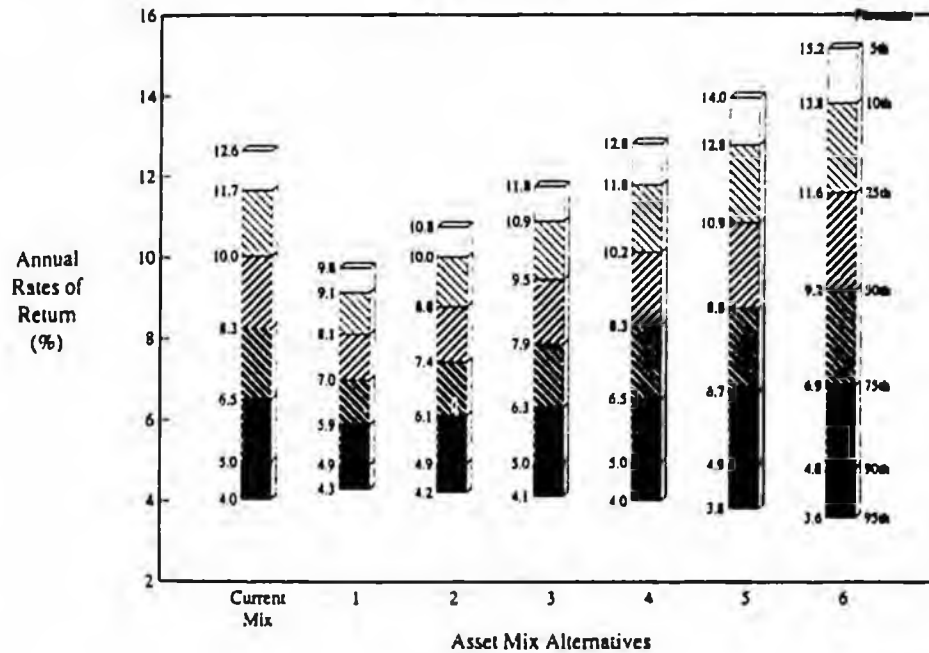
Range of Projected Rates of Return

(Projection period: 5 years)



Range of Projected Rates of Return

(Projection period: 10 years)



Threshold Rates of Return

The table on the next page shows the probabilities of each of the asset mixes exceeding the threshold rates of return shown in the first column. For example, there is an 85.1% probability that one year from now the current mix will have a return that is at least as high as 0%.

There are three rates of return which are examined in these tables: 0%, 3.5% and 7.5%. The 7.5% return corresponds to an investment objective of a 4% real rate of return on investments. There are also four time periods examined: 1, 3, 5 and 10 years.

There are three trends which are apparent in these tables. First, more conservative mixes have higher probabilities of achieving a positive return than more aggressive mixes. For a one-year projection horizon, the most conservative mix, mix 1, has a 91.6% probability of achieving a positive return while the most aggressive mix, mix 6, has only an 80.7% probability of attaining the same goal. Generally, more aggressive mixes are less likely to have positive returns because they have a higher equity exposure. Equities have greater short-term loss potential than assets such as bonds which are more heavily concentrated in the conservative mixes.

The second trend is more aggressive mixes have greater probabilities of higher returns. The same assets in aggressive mixes which can cause negative returns can also produce high positive returns. Conversely, the assets in conservative mixes that protect against negative returns are unlikely to have a very large up side. For example, of all of the mixes, mix 6 has the highest probability of achieving a rate of return greater than 7.5% for every time horizon.

A third trend that is apparent is the probability of surpassing the 0% and 3.5% return targets increases with the passage of time regardless of the asset mix. This is the result of the expected returns greater than the these return targets for each of the portfolios. As the returns over time regress to their expected values, the probability of exceeding the targets increases. This time diversification effect is the strongest in the more aggressive mixes.

Probability (%) of Exceeding Threshold Annual Return over 1 Year

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	85.1	91.6	89.0	86.7	84.7	82.6	80.7
3.50	72.2	75.1	73.8	72.9	72.0	71.1	70.2
7.50	53.7	46.2	49.7	52.1	54.0	55.3	56.3

Probability (%) of Exceeding Threshold Annual Return over 3 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	96.4	99.2	98.3	97.3	96.2	94.8	93.4
3.50	84.6	88.0	86.6	85.5	84.4	83.2	82.1
7.50	56.3	43.5	49.4	53.7	56.9	59.1	60.8

Probability (%) of Exceeding Threshold Annual Return over 5 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	99.0	99.9	99.7	99.4	98.9	98.2	97.4
3.50	90.6	93.5	92.3	91.4	90.4	89.3	88.2
7.50	58.1	41.6	49.3	54.8	58.8	61.7	63.8

Probability (%) of Exceeding Threshold Annual Return over 10 Years

Threshold Return	Current Mix	Asset Mix Alternatives					
		1	2	3	4	5	6
0.00	99.9	100.0	100.0	100.0	99.9	99.9	99.7
3.50	96.9	98.4	97.8	97.3	96.8	96.1	95.3
7.50	61.4	38.2	48.9	56.8	62.4	66.3	69.1

Conclusion

Optimization analysis is a useful tool when developing strategic asset allocation policy. Naturally, the output is only as good as the input. Hopefully, this first step in the asset allocation process has provided a useful framework for further deliberations. It should be apparent that the interrelationships among asset categories are many and complex. The more asset categories considered, the greater the number of required inputs and the greater the probability of resulting error. We attempt to minimize this risk by restricting the number of asset categories considered and using only those with meaningful history and reasonable stability. We also attempt to err on the side of conservatism. For example, our assumption regarding expected risk for real estate is very high. Using a lower risk level would suggest a much heavier allocation to real estate. Similarly, we have not used emerging markets as an asset category because the historic data is very limited and the data series commonly employed have changed radically in recent years. Hence, the inputs used would be highly subjective and could be grossly in error. This should not preclude consideration of emerging markets as an asset category in a well diversified program. Rather, it simply suggests that the category be considered at a later stage once broad overall risk and return parameters have been established.

In the optimization analysis, the data series used for alternative investments was based on the performance of venture capital based high growth companies. Many funds have made significant commitments to "private equity" investments which include both venture capital funds and management buyout funds. In many respects, such investments present similar problems to real estate in asset allocation modeling. The actual observed volatility is generally significantly less than that of publicly traded securities. Intuitively, we all recognize that the true economic risk must be greater. We reconcile this conflict by using the Venture 100 series, forecasting a premium return and a very high risk level. Even with these biases, the optimizer, if permitted, likes a small allocation. Many sponsors deal with this issue by excluding private equity from optimization analysis, but then allocating a portion of their equity commitment to the sector.



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