

Presentation:

PFD

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**FILE**

# **\$20 Years, \$20 Billion Building an Investment Policy for the Next 20 Years**

Exploring options for the Permanent Fund

8:00 - 9:30 a.m.

Wednesday, February 12

*Joint Finance & Legislative Budget & Audit Committee Hearing*

• • •

*Senate Finance Committee Room*

## **The Yale Model**

Superior returns for the present; safeguards for the future

## **The New Mexico Experience**

Voters say yes to 65% equities ceiling & new distributions policy  
based on average market value

## **Inside Tomorrow's Portfolio**

More investment options than ever

## **Balancing Risk and Return**

How they do it in the Pacific Northwest

## **What it Means for the Fund**

Michael O'Leary, the Fund's investment consultant,  
examines the implications of investment policy options  
and changes to the Fund's asset allocation

**A Permanent Fund Forum  
February 12, 1997**

**“20 Years, \$20 Billion:  
Building an Investment Policy for the Next 20”**

Last year some legislators asked why the Fund isn't earning more relative to other large funds. Similar questions were raised by the Long-Term Financial Planning Commission. The simple answer is that the Fund is performing exactly as it was designed, carefully preserving a significant portion of Alaska's oil revenues for the benefit of present and future generations, based on an investment list determined in statute by the Alaska legislature.

This is a position of comfort for the Alaska Permanent Fund Corporation (APFC) and the Fund's shareholders, the residents of Alaska. It's a position that Alaskans can understand and one that has worked well – with some legislative adjustments – over the past 20 years. The Fund's conservative investment policy has ensured that our state's oil resources will continue to produce significant revenue streams and its corpus will remain intact and safe.

But the more complex answer is yes, the Fund likely could produce a larger, consistent, long-term revenue stream. For example, compared with similar institutions like the state's pension funds, the Fund's historic performance is just average or slightly below-average. There are alternative asset allocations and alternative distribution policies that could significantly enhance the Fund's overall performance. These policies all carry an element of increased risk and management cost.

To help the legislature gain a deeper perspective into the Fund's potential, and the various alternatives available, the APFC is putting together a forum entitled “20 Years, \$20 Billion: Building an Investment Policy for the Next 20.” This forum will examine how the investment world has changed over the past two decades, how it is likely to change in the next 20 years, and how institutions similar to the Alaska Permanent Fund are developing individualized policies to fulfill their own particular public policy needs.

This forum is purely informational. It is not the APFC's role to set or inappropriately influence policy. The right to establish policy belongs exclusively to the residents of Alaska and their elected representatives. It is, however, the APFC's role to respond to specific requests for information – like those raised during the last legislative session – and to present information to assist in furthering the public debate over the future of the Fund.

The APFC has no desire to change public policy. It does, however, have a very keen interest in any policy changes the legislature may deem appropriate. The Fund has grown to such a magnitude that it needs sufficient lead time to respond to major policy changes.

It is the APFC's hope that this forum will provide meaningful and timely information on the role of the Fund in Alaska's fiscal future, its potentialities and its appropriate levels of performance.

The forum will be held the morning of February 12, 1997 in the Senate Finance Committee Room (Rm 532) of the State Capitol Building in Juneau, Alaska (exact time TBA.) Panelists at the forum will include:

- **Richard J. Franke**, Chairman of the Board, Yale Endowment
- **Duane M. Johnson**, Portfolio Manager New Mexico State Investment Council
- **Denis S. Karnosky, Ph.D.**, Managing Partner Asset Allocation, Brinson Partners
- **W. Dan Smith**, Investment Manager, Oregon Investment Council (LATE NOTE: Mr. Smith has notified the APFC that he has just been scheduled to testify before the Oregon State Legislature, so will be unable to attend the forum in Juneau.)

The moderator for the forum will be Michael O'Leary, Executive Vice President, Callan Associates. Callan Associates is the APFC's performance measurement, manager search and asset allocation consultant.

This is an educational, not an advocacy, event. Its purpose is to inform Alaska public policy makers about the key investment issues faced by the Board of Trustees as they build an investment policy for the Fund's next 20 years.

The panel has been chosen to provide the following perspectives:

- Mr. Franke will describe the reasons for the superior investment performance of the Yale Endowment. Yale's 10-year total return ranks in the top one percent of all large institutions. He will also discuss Yale's income distribution formula which has been carefully designed first, to safeguard their fund's value against inflation; and second, to balance the demands of the present generation of beneficiaries against the claims of future generations.
- Mr. Johnson will share New Mexico's recent experience in which on November 5, 1996, the voters of New Mexico approved an amendment to their state Constitution allowing up to 65% of the \$7 billion New Mexico Permanent Funds to be invested in stocks, and changing the method of making distributions to the beneficiaries from payment of all interest and dividends to one based on the funds' average market value.
- Dr. Karnosky will provide the long-term performance record of various investment asset classes. His presentation will include both an historical perspective and a consideration of how asset allocation in a global portfolio like the Alaska Permanent Fund's may look different in the future.
- Mr. Smith will present the investment policy and philosophy of a large institutional investor in the U.S. Northwest comparable in size to the Alaska Permanent Fund (\$23 billion versus \$20 billion), but somewhat different in terms of asset allocation and their approach to balancing risk and return.

Each panelist will make a 12-15 minute presentation and respond to questions.

**RICHARD J. FRANKE,  
CHAIRMAN, YALE INVESTMENT COMMITTEE**

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Mr. Franke was born in Springfield Illinois in 1931, graduating from Springfield High School. He received a BA in history from Yale University in 1953 and then entered the U.S. Army, where he spent two years as a military officer. After discharge from the Army, he attended Harvard Business School, receiving his MBA in finance in 1957.

He spent his entire business career as an investment banker with John Noveen & Co. He began as a summer intern while in business school and after graduating, entered the Noveen training program. He worked his way up through various levels of management, specializing in the underwriting and origination phases of the business. He was made a Vice President in 1965, Executive Vice President and Director in 1969, Chief Administrative Officer in 1970, President and Chief Executive Officer from 1974-89. In 1988, he was elected Chairman and Chief Executive Officer and served until his retirement in June of 1996.

He has held various leadership positions in industry-related organizations, such as the Securities Industry Association and the Bond Club of Chicago. In addition to his business and professional activities, Mr. Franke maintains an active interest in the humanities and in higher education. In 1990 he was appointed to the President's Committee on the Arts and the Humanities, and he currently serves on the boards of the Illinois Humanities Council, the other central Association of Chicago, the Lyric Opera of Chicago, and the Newberry Library.

In 1990 as Chairman of the Illinois Humanities Council, Mr. Franke spearheaded the development of the Chicago Humanities Festival, now an annual event that brings together Chicago's premier cultural institutions in a literary and artistic celebration of the Humanities. In recognition of his leadership and service, the Illinois Humanities Council named Mr. Franke recipient of the Council's Public Humanities Award in May 1994. In February 1995, he testified before a Congressional Appropriations Subcommittee to support federal findings for the humanities and the arts. In January he became chair of Americas United to Save the Arts and Humanities (AUSAH), a national cultural advocacy organization made up of business and community leaders.

He has a special concern for the education and serves as Senior Fellow of the Yale Corporation and Chairman of the Yale Investment Committee. He is also a Trustee of the University of Chicago where he serves on the Executive and Investment Committee and chairs the University Visiting Committee for the Humanities. He also serves on the Harvard Business School Board of Directors of the Associates. He has held several board positions at the North Shore Country Day School in Winnetka, Illinois as Treasurer and President of the Board as well as Chairman of the school's major fundraising campaign.

He exemplifies a commitment to education in a life long activity and was a participant in the First Stanford Executives program in the Humanities. His interest in the study of Western civilization spans many years. He helped to organize a study group, coordinated by a University of Chicago professor, that focuses on the words of leading philosophers, historians and artists from ancient to modern times.

**DUANE M. JOHNSON**  
**PORTFOLIO MANAGER**  
**NEW MEXICO STATE INVESTMENT COUNCIL**

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Duane M. Johnson, Portfolio Manager, joined the New Mexico State Investment Council in 1986. He is the co-manager of over \$4.1 billion in fixed income assets. Duane is also the special-projects director for the Investment Office, and prepared all of the internal analysis for the Council and the state Legislature on the recently approved constitutional amendment. This amendment has rewritten all of the controlling documents for the State Investment Council and redefined the two permanent funds managed by the Council as total rate of return funds. Duane has also managed the alternative investments portfolio (monthly venture capital) since its inception in 1987. This program has been so successful (over 25% annual IRR over the last 8 years) that it is currently being expanded to 3 percent of the Fund's market value (about \$240 million).

Previously, Duane spent 20 years as a United States Air Force officer, where he served as a pilot, test pilot, staff officer, test director and commander. From 1983 to 1986, he was a consultant with an aviation consulting firm which provided services to commercial airline operators and governmental agencies.

Duane received his MBA in Finance and General Management from the University of New Mexico (Summa Cum Laude), and his BS in Physics (with distinction) from Pacific Lutheran University.

**DENIS S. KARNOSKY, PH.D.**  
**MANAGING PARTNER, ASSET ALLOCATION**  
**BRINSON PARTNERS**

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**Academic**

Blackburn College, BA  
University of Missouri, MA  
Duke University, Ph.D

**Experience**

As Managing Partner of the Asset Allocation Group of Brinson Partners, Inc., Dr. Karnosky is responsible for the management of asset allocation activity. These responsibilities include the development and management of asset allocation policy and strategy, performance analysis and development of new products and systems. As chairman of the firm's Asset Allocation Committee, he oversees asset allocation for multi-asset clients across U.S. stocks and bonds, non-U.S. stocks and bonds, private markets real estate and cash equivalents. He is also a member of the firm's senior management team that develops and coordinates overall business and investment strategy.

Dr. Karnosky has research and senior policy making experience in the U.S. government, including the Federal Reserve System, the U.S. Treasury and several foreign countries. He has held the positions of Deputy to the Under Secretary for Monetary Affairs and Director of the Office of Monetary Policy analysis in the Treasury Department. He has also served as an economic advisor to the National Bank of Austria and the General Confederation of Italian Industry. He has written and lectured extensively on economic issues, with an emphasis on the fundamental role of asset markets in the economy.

Prior to joining the firm in 1987, Dr. Karnosky directed risk management research and development for several financial service firms.

**Professional affiliation and significant roles**

- Chairman of Brinson Partners, Inc., Asset Allocation Committee
- Chairman of Brinson Partners, Inc's Research and Development Committee
- Member of the following Brinson Partners, Inc's Investment Committees, Senior Investment Emerging Markets, Risk Management, U.S. equity, U.S. Fixed income, Non-U.S. and Private Markets.
- Member of Board of Directors of Brinson Partners, Inc.

**Publications**

- Karnosky, Dr. Denis S, and Singer, Brian D. "Global Asset Management and Performance Attribution" The Research Foundation of the Institute of Chartered Financial Analysis. (February, 1994)
- Karnosky, Dr. Denis S. "Global Investing in a CAPM Framework," The CAPM Controversy: Policy and Strategy Implications for Investment Management. AIMR, (October, 1993)
- Karnosky, Dr. Denis S. and Singer Brian "A General Framework for Global Currency Management," Securities Analysis Journal (March, 1991).

**MICHAEL J. O'LEARY, JR.  
EXECUTIVE VICE PRESIDENT  
CALLAN ASSOCIATES INC.**

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Michael J. O'Leary, Jr., CFA, is an Executive Vice President and shareholder. Mike has national oversight responsibility for Callan's plan sponsor consulting practice. He is a member of Callan's Client Policy Review and Management Committees. He also serves as chairman of Callan's Manager Search Committee.

Prior to first joining Callan's Chicago in 1984, Mike held positions as an investment research analyst, director of research and director of portfolio management and defined contribution plan product management for major trust companies in Chicago and Hartford.

In 1988, Mike joined Mercer Asset Planning in Denver, where he headed their investment consulting practice in the Denver office and also served on the firm's National Practice Committee.

Mike rejoined Callan in 1990 and established the firm's Denver office. Throughout his portfolio management and consulting career, Mike has worked extensively with major corporate and public funds. In addition to ongoing performance evaluation, he has led numerous asset/liability and asset allocation studies. He has conducted for his clients, more than 80 manager search projects across all major asset categories. He has advised clients on optimization of their management structures and a wide variety of special projects, including: securities lending, brokerage recapture programs, custodial searches, and alternative investments.

Mike received his Bachelor's degree from Fordham University and is a Chartered Financial Analyst. He has taught investments at the graduate level and has spoken frequently before professional and industry groups.

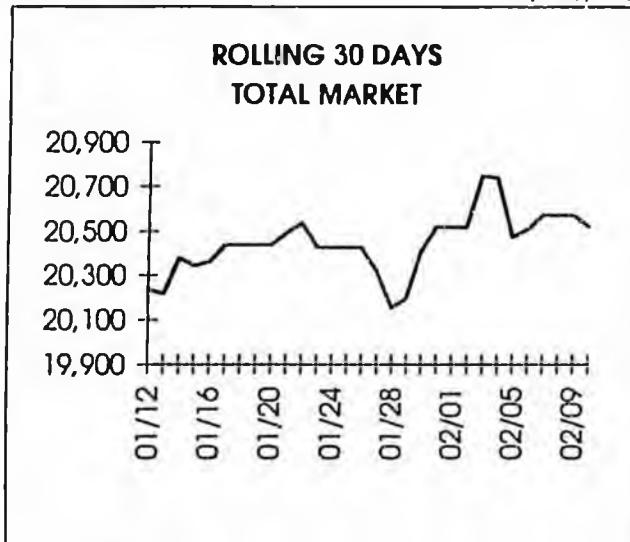
**ALASKA PERMANENT FUND  
DAILY POSITION  
2/10/97**

DAILY UNAUDITED* CUSTODIAN POSITION	COST	%	MARKET	%	UNREALIZED GAIN(LOSS)
BNY - MARKETABLE DEBT	8,897,800,000	49%	8,949,400,000	44%	51,600,000
BNY - DOMESTIC EQUITIES	5,444,890,000	30%	7,566,700,000	37%	2,121,900,000
BBH - FOREIGN EQUITIES	2,126,600,000	12%	2,430,500,000	12%	303,900,000
REAL ESTATE	1,401,200,000	8%	1,437,400,000	7%	36,200,000
ALASKA CD'S	135,000,000	1%	135,000,000	1%	0
<b>TOTAL</b>	<b>18,005,400,000</b>	<b>100%</b>	<b>20,519,000,000</b>	<b>100%</b>	<b>2,513,600,000</b>
PRIOR DAY TOTALS					2,559,000,000

**CHANGE FROM PRIOR DAY** **(45,400,000)**

\* Custodians report trade date positions which are adjusted where possible for pending trades. However, due to occasional lags in transactions reporting, total cost shown may vary from actual cost. This effect is more pronounced when large scale portfolio liquidations and fundings occur.

TOTAL INVESTED FUNDS	COST	MARKET	UNREALIZED GAIN(LOSS)
JANUARY 1996	16,300,700,000	18,732,400,000	2,431,700,000
FEBRUARY 1996	16,600,200,000	18,826,000,000	2,225,800,000
MARCH 1996	16,697,900,000	18,749,400,000	2,051,600,000
APRIL 1996	16,837,200,000	18,891,800,000	2,054,600,000
MAY 1996	17,019,400,000	19,081,000,000	2,061,600,000
<b>JUNE 1996</b>	<b>17,085,600,000</b>	<b>19,210,700,000</b>	<b>2,125,100,000</b>
JULY 1996	17,319,600,000	18,813,200,000	1,493,600,000
AUGUST 1996	17,467,600,000	19,072,400,000	1,604,800,000
SEPTEMBER 1996	17,273,700,000	19,354,000,000	2,080,300,000
OCTOBER 1996	17,199,000,000	19,406,200,000	2,207,200,000
NOVEMBER 1996	17,406,100,000	20,192,200,000	2,786,100,000
DECEMBER 1996	17,617,500,000	20,035,300,000	2,417,800,000
JANUARY 1997	17,955,100,000	20,518,100,000	2,563,000,000



## EXHIBIT I

### Yale Endowment Investment Philosophy Equity Bias

Consider the growth of \$1.00 invested in various U.S. asset classes from December 31, 1925 to December 31, 1995:

Inflation	\$	9
Treasury bills		13
Treasury bonds		34
Large company stocks		1,114
Small company stocks		3,822

**EXHIBIT II**  
**Yale Endowment**  
**A Comparison of 1976 to 1996**

	<u>Dec. 1976</u>	<u>Dec. 1996</u>
Size	\$ .58 Billion	\$ 5.25 Billion
<b>Asset Class</b>	<b>Percentage</b>	<b>Percentage</b>
Domestic Equity	68%	23%
Foreign Equity	.0%	13%
Private Equity	.0%	18%
Absolute Return	.0%	23%
Real Estate	5%	12%
Fixed Income	21%	12%
Other (cash, etc.)	<u>6%</u>	<u>-1%</u>
<b>Total</b>	100%	100%
<b>Historical Rates of Return</b>		
1 year	13%	26%
3 year	7%	18%
5 year	4%	17%
10 year	5%	14%
<b>Actual Payment to University</b>	\$ <u>36 Million</u>	\$ <u>170 Million</u>

## EXHIBIT III

### Spending Rule Calculation for Fiscal Year 1996/1997

Yale's spending rule uses a long-term spending rate of 5.0 percent combined with a smoothing rule which adjusts spending gradually to changes in Endowment market value. Annual spending is limited to the weighted average of 70 percent of the previous year's spending, adjusted for inflation, plus 30 percent of the targeted long-term spending rate applied to the previous year's market value.

#### Inputs

Endowment Value at Decemer 31, 1995	\$	4,368,844,019
Spending in Fiscal Year 1995/1996	\$	169,124,190
Inflation		3.55%

#### Step One:

Take 30% of targeted long-term spending rate (5.0%) applied to previous year's Endowment value

$$= (0.3) * (0.5) * (\text{Endowment Value at December 31, 1995}) \quad + \quad \$ 65,532,660.29$$

#### Step Two:

Take 70% of last year's spending adjusted for inflation

$$= (0.7) * (1 + \text{inflation rate}) * (\text{Spending in Fiscal 1995/1996}) \quad + \quad \$ 122,589,669.41$$

#### Step Three:

Adjust for spending from gifts received in Fiscal 1996/1997

$$+ \quad \underline{\$2,641,853.80}$$

**Total Spending for Fiscal Year 1996/1997 Budget:**

$$\underline{\underline{\$190,764,183.50}}$$

*PRESENTATION*  
 BY  
 THE NEW MEXICO STATE INVESTMENT OFFICE  
 TO  
 THE ALASKA STATE LEGISLATURE  
 AND  
 THE ALASKA PERMANENT FUND CORPORATION

February 12, 1997

I. THE HISTORY OF NEW MEXICO'S PERMANENT FUNDS

**C**hart 1 New Mexico is an enabling act state (entered the Union in 1912) and in anticipation of statehood, was given 13.4 million acres of Federal land between 1898 and 1912. The 1898 Ferguson Act also created the first of our two permanent funds, the Land Grant Permanent Fund (LGPF), and established controlling conditions for its investment. The 1910 Enabling Act superseded the Ferguson Act, and is the current controlling document for the LGPF. The LGPF has 20 beneficiaries, the largest of which is the public schools. The Severance Tax Permanent Fund (STPF) was created by an act of the state Legislature in 1973.

II. NEW MEXICO'S PERMANENT FUND PROBLEMS

**C**hart 2 The fundamental problem for the Funds was that they were not growing with inflation. The statutory and constitutional method of making distributions from the Funds was to distribute monthly all interest and dividends, which then created differing objectives for the Legislature and the State Investment Council. The Legislature wanted more immediate payouts to use on state budgets, and the Council, by the late 1980's becoming more and more aware of its fiduciary responsibility to preserve the Funds for future generations, wanted to move more into equity to combat inflation. For the last decade or more, raising taxes has been a very unpalatable option for the Legislature. The easiest course of action was to force more distributions from the Funds by influencing the asset allocation decision. The two Permanent Funds were regarded as current-income Funds, and the need to protect them against inflation was largely ignored in favor of generating maximum current-year and next-year payouts for the state's general operating fund.

**C**hart 3 In the early- to mid-1980's when contributions were nearly 20% of the Funds' values each year, inflation was not considered much of a negative.

**C**hart 4

**C**hart 5 By 1988, the three major weaknesses of this distributions method were evident to the Council staff. First, only about 6% of the Funds were in equity, and as a result the Funds were distributing too much each year (approaching 10% of the Funds' market values in the mid-1980's) and were losing real value. The second drawback was that the Funds were capable of earning much higher total returns to benefit the current beneficiaries, and finally, better diversification would actually decrease risk while at the same time producing better returns. We were doing well on performance, but we didn't have our Funds allocated to the right assets.

**C**hart 6

CHART 7

The Council had identified three primary objectives for the Funds:

- 1) To preserve the Funds for future generations by growing the Funds at a rate at least equal to the rate of inflation;
- 2) To distribute the real (inflation adjusted) return to New Mexico citizens;
- 3) To maximize total returns within acceptable levels of risk in order to increase the benefits for both current and future New Mexicans.

It was obvious that these objectives were not being met.

### III. FOCUSING ON THE PROBLEMS

CHART 8

Two factors brought the problems to the attention of the legislative leadership. First, the outdated distributions scheme, which depended upon contributions and high interest rates to maintain current payouts, and second, long-term structural declines in both the general level of interest rates and contributions beginning in the early 1980's. By 1994, the Funds were growing rapidly, but distributions were declining for the first time ever, and just at a time when the budget needs of the state were increasing exponentially.

CHART 9

CHART 10

### IV. THE NEW MEXICO SOLUTIONS

The key to solving these problems was education. All affected parties must be involved. It only takes one influential and disaffected party to scuttle any constitutional amendment. The first attempt to amend the Constitution in 1994 met with failure because of one such influential member of the executive branch.

The first step was to gain credibility with all the affected parties. A Permanent Funds Advisory Committee was appointed by the Governor to study the problems and recommend solutions. The Committee was staffed with reputable private citizens from the state who had experience in endowment fund management and theory. When the Committee published its final report, the State Investment Council endorsed the findings, and recommended amending the Constitution. No attempt was made to do anything radically different than the majority of the endowment funds in the US. When discussing changes to the governing documents for permanent funds, most people become very conservative.

It was obvious that the payout policy needed to be disconnected from the investment decisions, especially where it impacted asset allocations. Solutions needed to be found where the Investment Council and the Legislature could become part of the same team and work together for the same objectives. The most logical answer was to tie payouts to the Funds' growth and performance so that distributions would increase only when the Funds' market values increased. About 70% of the endowments in the US have reached this same conclusion.

CHART 11

The Committee's recommendations were:

CHART 12

1. **Changes to the distribution policy:**

- a. Change the payout to a fixed-percentage of the Fund. This percentage should be based on the expected long-term average real (inflation adjusted) return on investments;
- b. Use a 5-year average market value to smooth out market value fluctuations; and
- c. Adopt a transition period to ease the changeover to the new distributions method.

The payout percentage selected was 4.7% of the most-recent five-years' average market values. This figure was arrived at both by considering what other endowment funds distributed and from an analysis of average long-term total returns for stocks and bonds since 1945. Several historical periods from 20 to 50 years were factored in to obtain an average total return for a 50% equity / 50% bond portfolio of 9.2% and an inflation rate of 4.5%. This produced a 4.7% real return.

The 5-year smoothing period was selected because it provided relatively stable distributions as well as adding a conservative factor. Actual distributions should be about 4.25% of the most recent year's market value over time.

The transition period guarantees a 2% growth in annual distributions until the 4.7% formula produces a higher number.

CHART 13

2. **Changes to the investment restrictions:**

- a. Authorize a limit of 65% in equity securities;
- b. Authorize up to 15% in international securities;
- c. Authorize small- and mid-capitalization stocks.

CHART 14

The recommended investment limits were based on surveys of average asset allocations among endowment funds in the US. The objectives here were both higher returns and better diversification.

## V. THE EDUCATION PROCESS AND RESULTS

A serious program to educate the beneficiaries, the legislative membership, and the voters was then conducted. A private citizen's committee was formed to focus on the voters. The educational effort included identifying and explaining the problems, and offering a package of constitutional and statutory changes to solve the problems. This package of changes had to offer something for all affected parties. The Investment Council and staff spent over a year traveling

CHART 15

the state and holding public meetings to obtain voter support. Presentations or mailings were made to every organized group that could be identified, and to all radio and TV stations and newspapers in the state. With only one or two small-town exceptions, all were supportive when we had a chance to present our case.

CHART 16

The results of this effort were that all of the beneficiaries endorsed the Constitutional Amendment, the Legislature passed the Amendment overwhelmingly (unanimously in the 70-member House, and with only three dissenting votes in the 42 member Senate) and the legislative leadership also committed to getting the measure in the first position on the General Election Ballot. In the 1996 General Election, Constitutional Amendment #1 was approved with nearly 68% of the vote.

The Investment Council is now in the process of revising the state statutes to reflect the constitutional changes, and obtaining the approval of Congress for the necessary changes to the Enabling Act. The support for these changes continues to be strong in the Legislature and in New Mexico's congressional delegation.

## VI. CONCLUSIONS AND LESSONS LEARNED

We believed our proposal was the right thing to do for all of the beneficiaries, and we had good supporting data to sell it with. It was not easy, but we did it. All of New Mexico's present and future citizens will benefit from reduced taxes. The principal lessons:

CHART 17

1. Study the issues thoroughly, and involve both respected citizens and professional consulting advice in the process;
2. Recommend solutions that are in line with average endowment fund practices;
3. The solutions must offer advantages for all affected parties;
4. Obtain support from the leadership of all affected parties;
5. One influential disaffected party can defeat the initiative;
6. Don't pay too much attention to the nay-sayers - there will be some;  
and finally,
7. Publicize the problems and solutions using all available media..

CHART 15

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*NEW MEXICO STATE INVESTMENT COUNCIL*

FEBRUARY 12, 1997

*PRESENTATION*

TO THE

ALASKA STATE LEGISLATURE

AND THE

ALASKA PERMANENT FUND CORPORATION

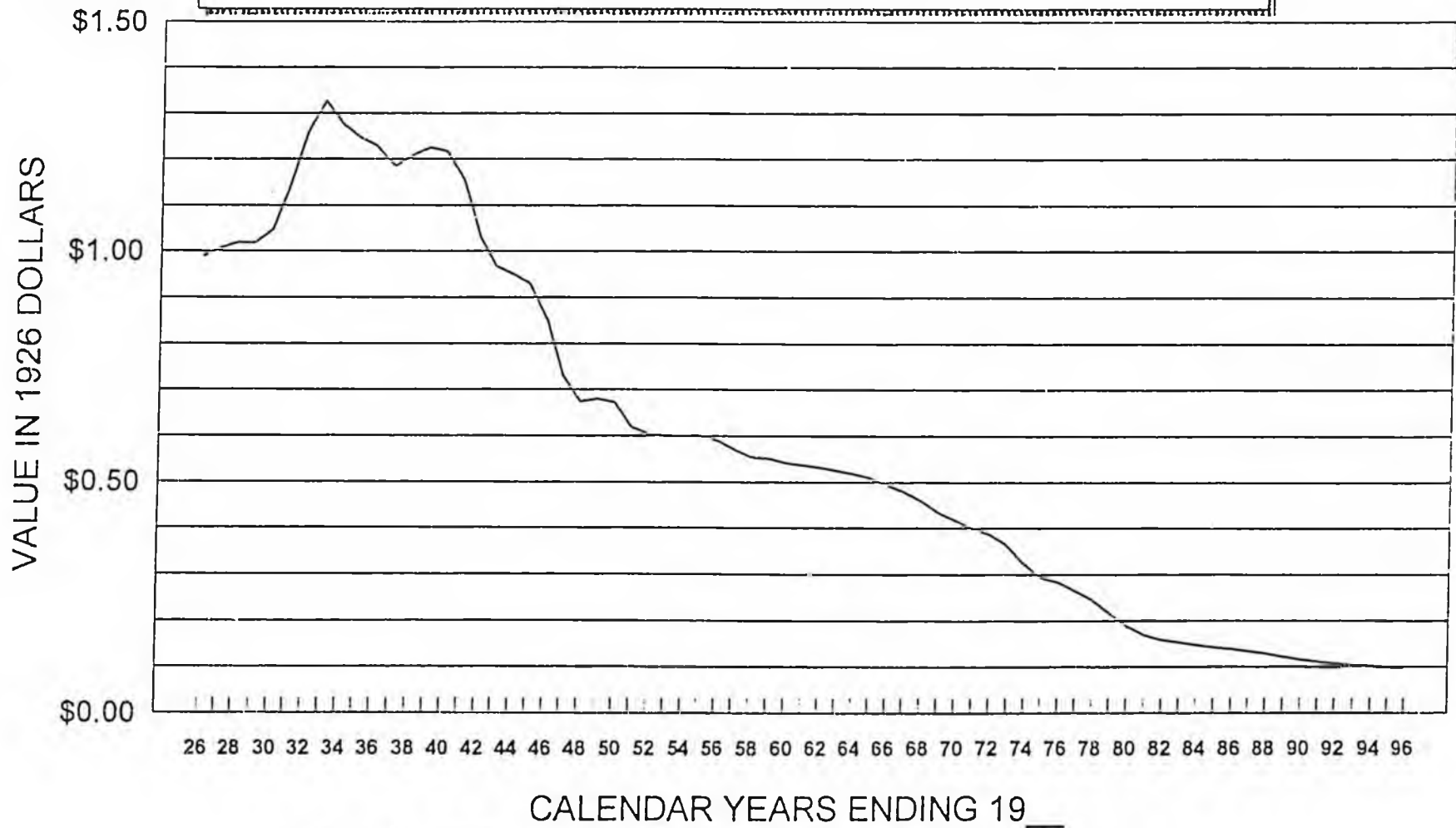
WHERE DOES THE  
MONEY GO?  
TO THE BENEFICIARIES!

WHO ARE THE BENEFICIARIES?

LAND GRANT PERMANENT FUNDS:		Amount Distributed
Public Schools		\$204,521,642
NM Military Institute		9,262,997
NM School for the Deaf		5,551,212
NM School for the Visually Hdcp		5,536,561
Penitentiary of New Mexico		5,544,740
University of NM		4,335,311
Miners' Hospital in Raton		2,968,811
Public Buildings - Capitol		2,668,767
Water Reservoirs		2,290,133
Charitable, Penal & Reform		1,631,291
NM State University		1,098,719
Rio Grande Improvements		937,683
NM State Hospital		688,110
NM Inst of Mining & Tech		504,553
Eastern NM University		298,722
Western NM University		83,701
NM Highlands University		82,825
Northern NM State School		56,259
UNM Saline Lands		21,305
NM Boys' School		18,251
TOTAL:		\$248,101,593
<b>THE SEVERANCE TAX PERMANENT FUND</b>		
State's General Fund (Budget)		\$131,291,316
TOTAL BOTH FUNDS		\$379,392,908

# VALUE OF A 1926 DOLLAR

THE EFFECTS OF INFLATION: 1926 - 1996



— CUMULATIVE VALUE OF A DOLLAR

## CONSTITUTIONAL AMENDMENT #1 WHAT IT MEANS TO YOU!

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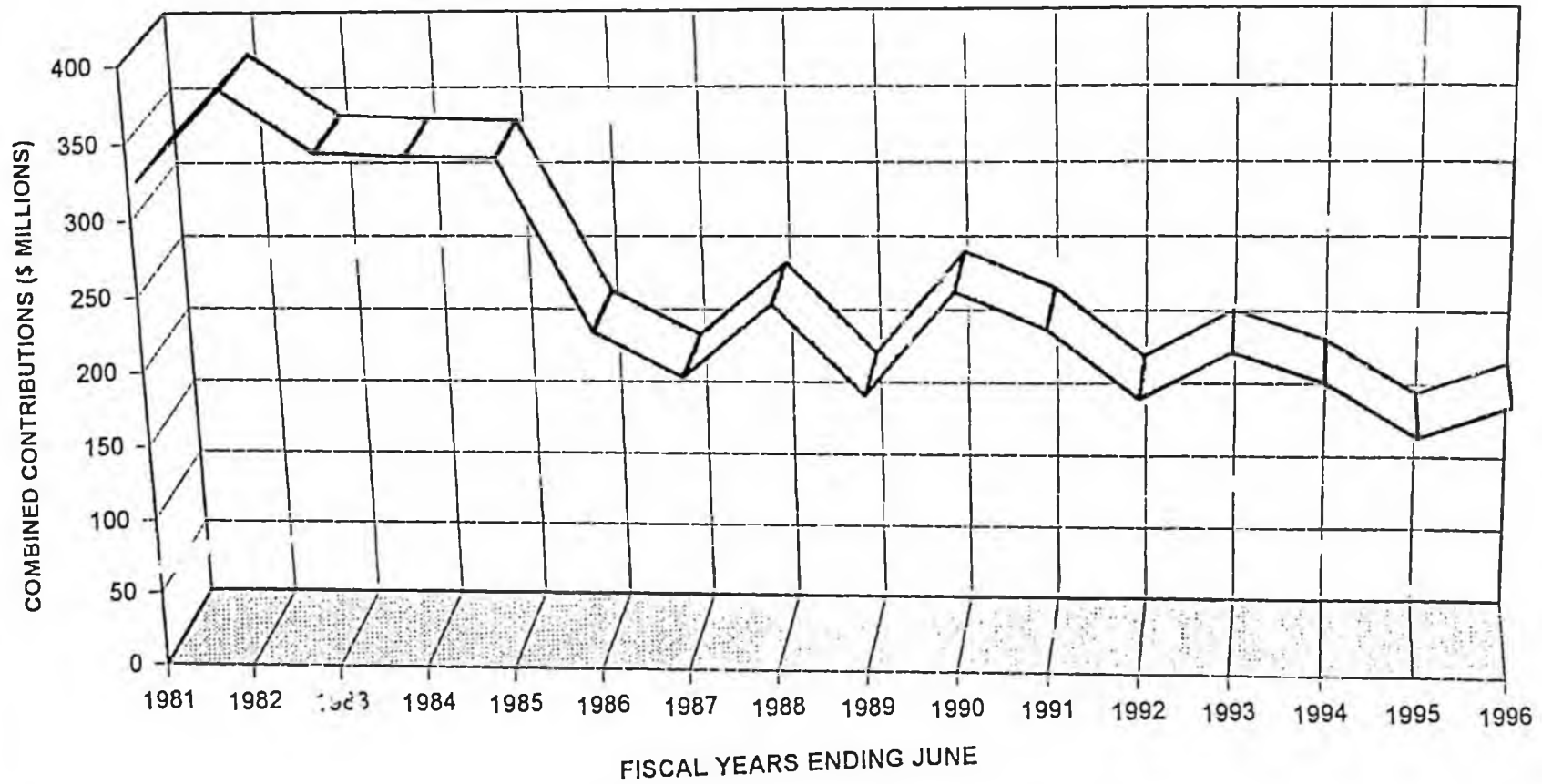
Perhaps Theodore Roosevelt said it best:

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**"The nation behaves well if it treats the natural resources as assets which it must turn over to the next generation increased, and not impaired, in value."**

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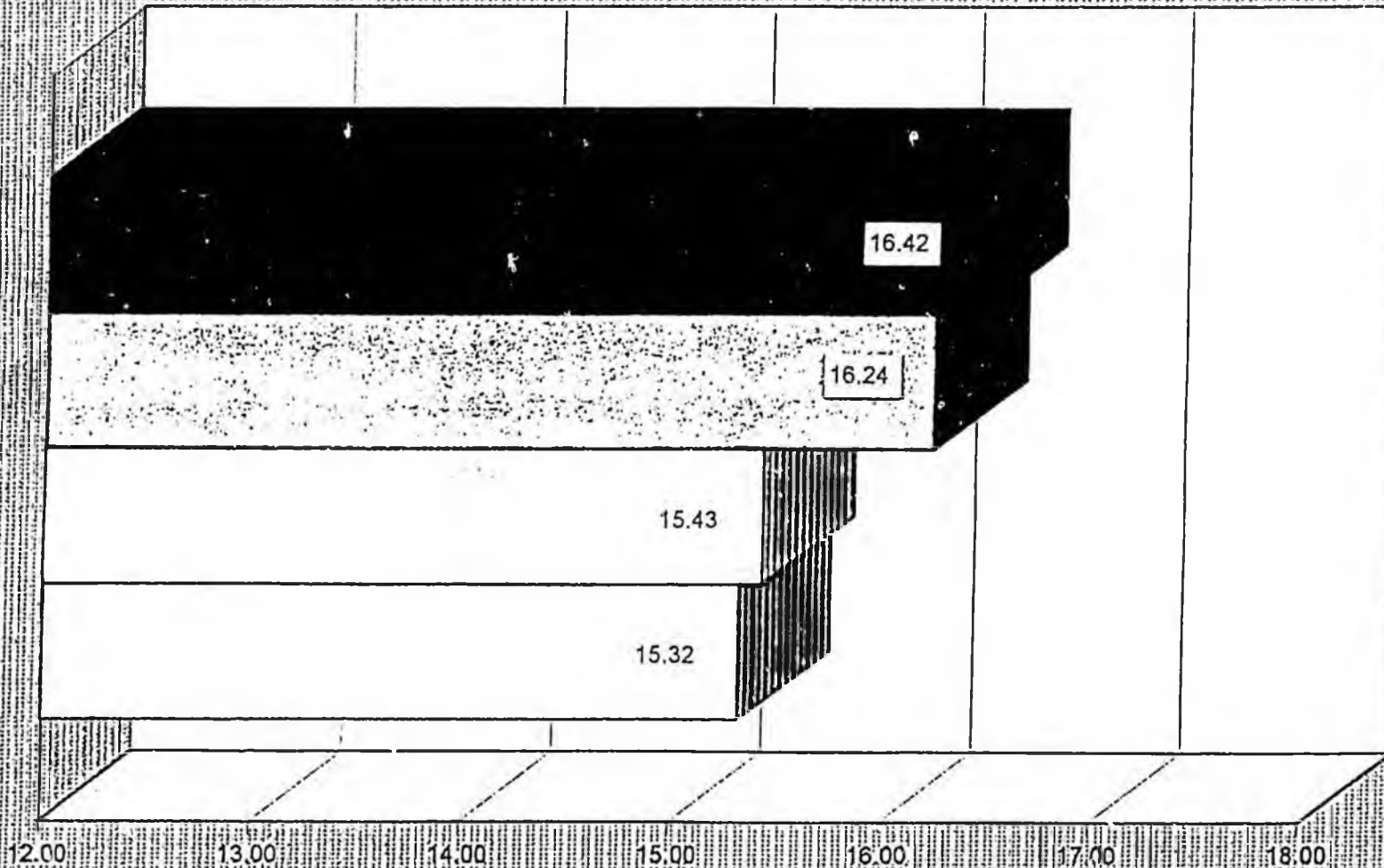
# TOTAL CONTRIBUTIONS COMBINED FUNDS



□ COMBINED CONTRIBUTIONS

# 8 YEARS' ANNUAL TOTAL RETURNS - LGPF & STPF STOCKS

COMPARED TO THE S&P-500 INDEX AND THE CALLAN TOTAL EQUITY DATABASE

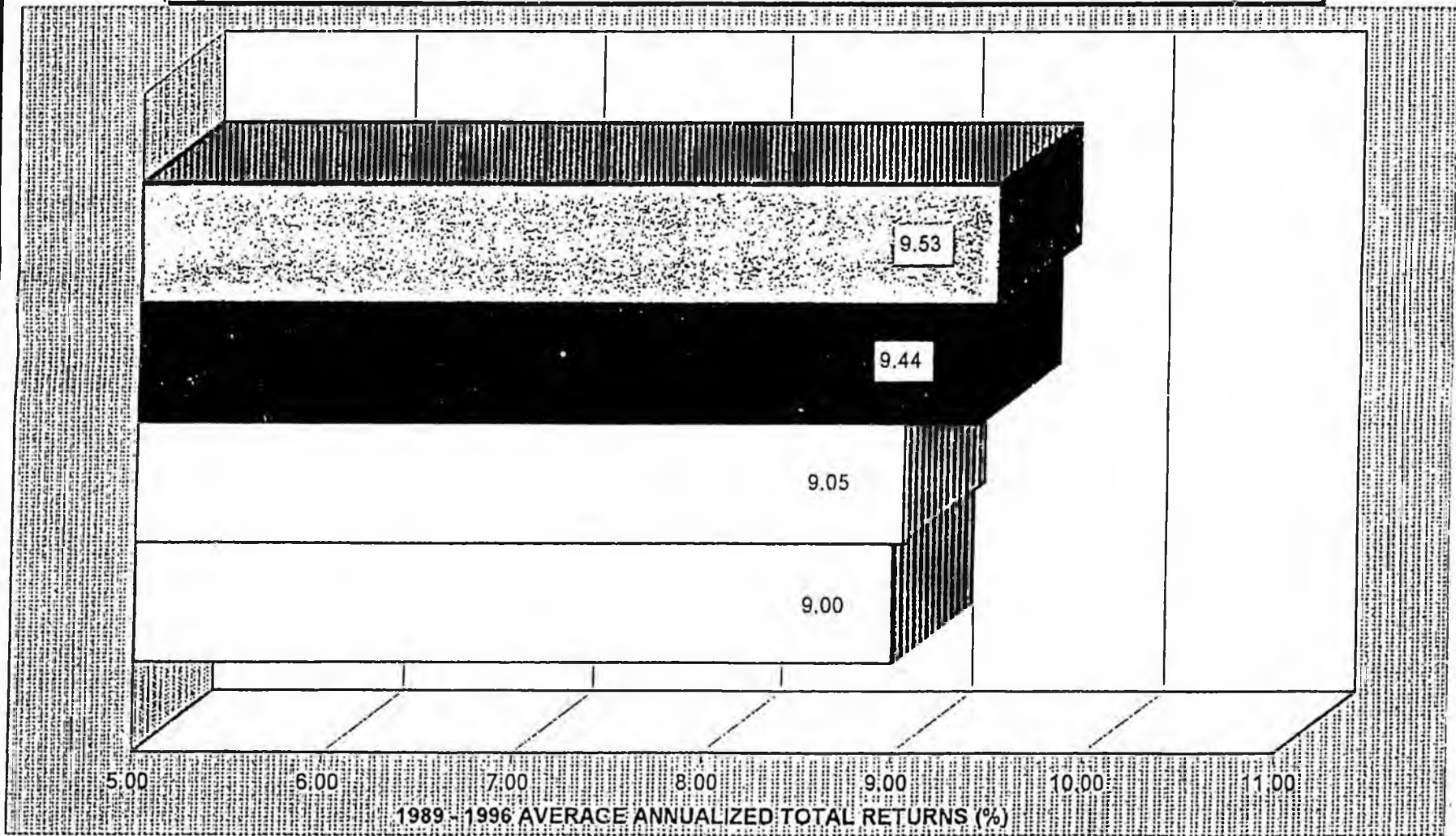


1989 - 1996 AVERAGE ANNUALIZED TOTAL RETURNS (%)

□ S&P-500 INDEX      □ CALLAN TOTAL EQUITY DATABASE      □ STPF STOCKS      ■ LGPF STOCKS

# 8 YEARS' ANNUAL TOTAL RETURNS - LGPF & STPF BONDS

COMPARED TO THE AGGREGATE INDEX AND THE CALLAN TOTAL FIXED-INCOME DATABASE



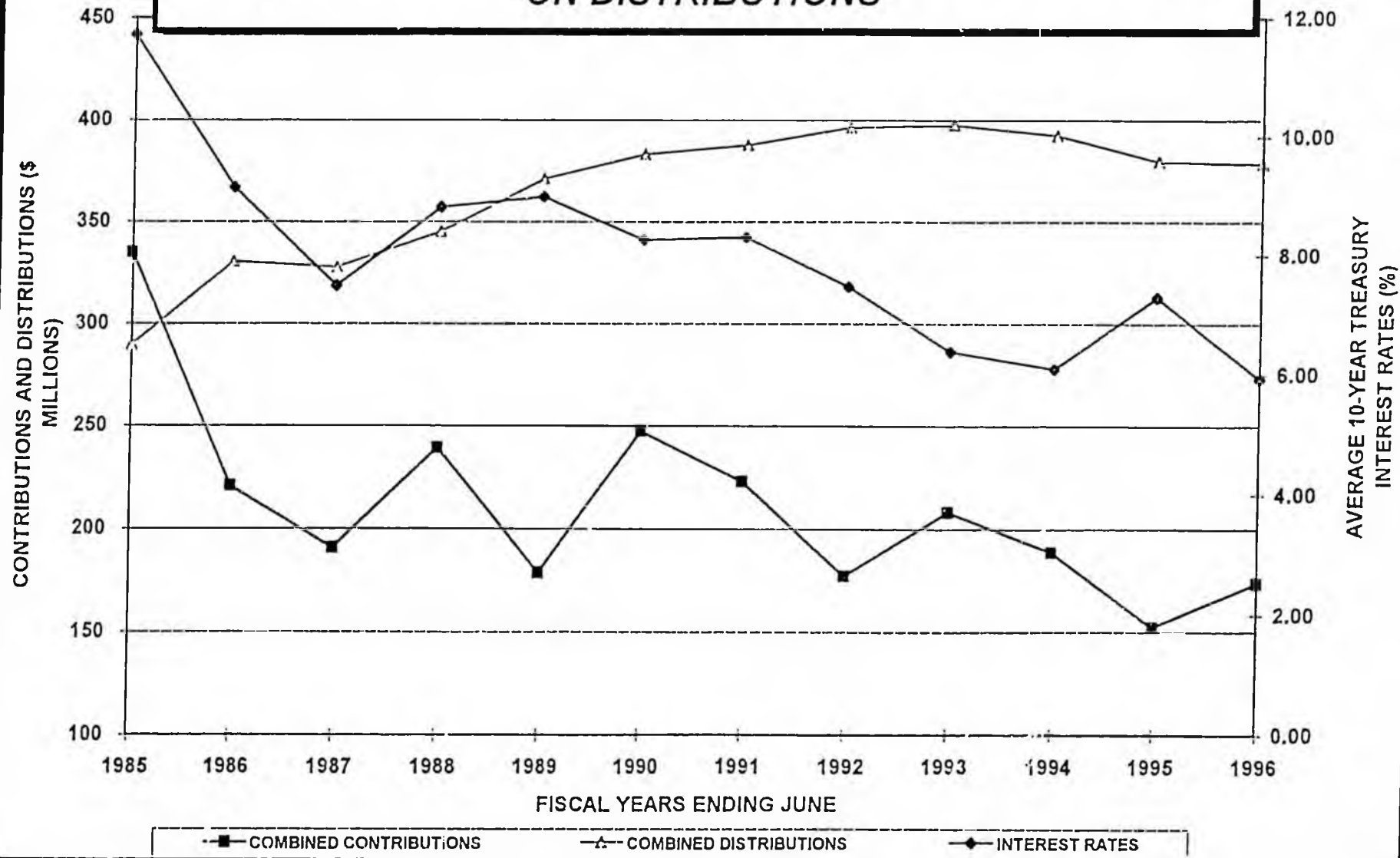
□ AGGREGATE INDEX      □ TOTAL FIXED-INCOME DATABASE      ■ LGPF BONDS      □ STPF BONDS

## *NEW MEXICO STATE INVESTMENT COUNCIL*

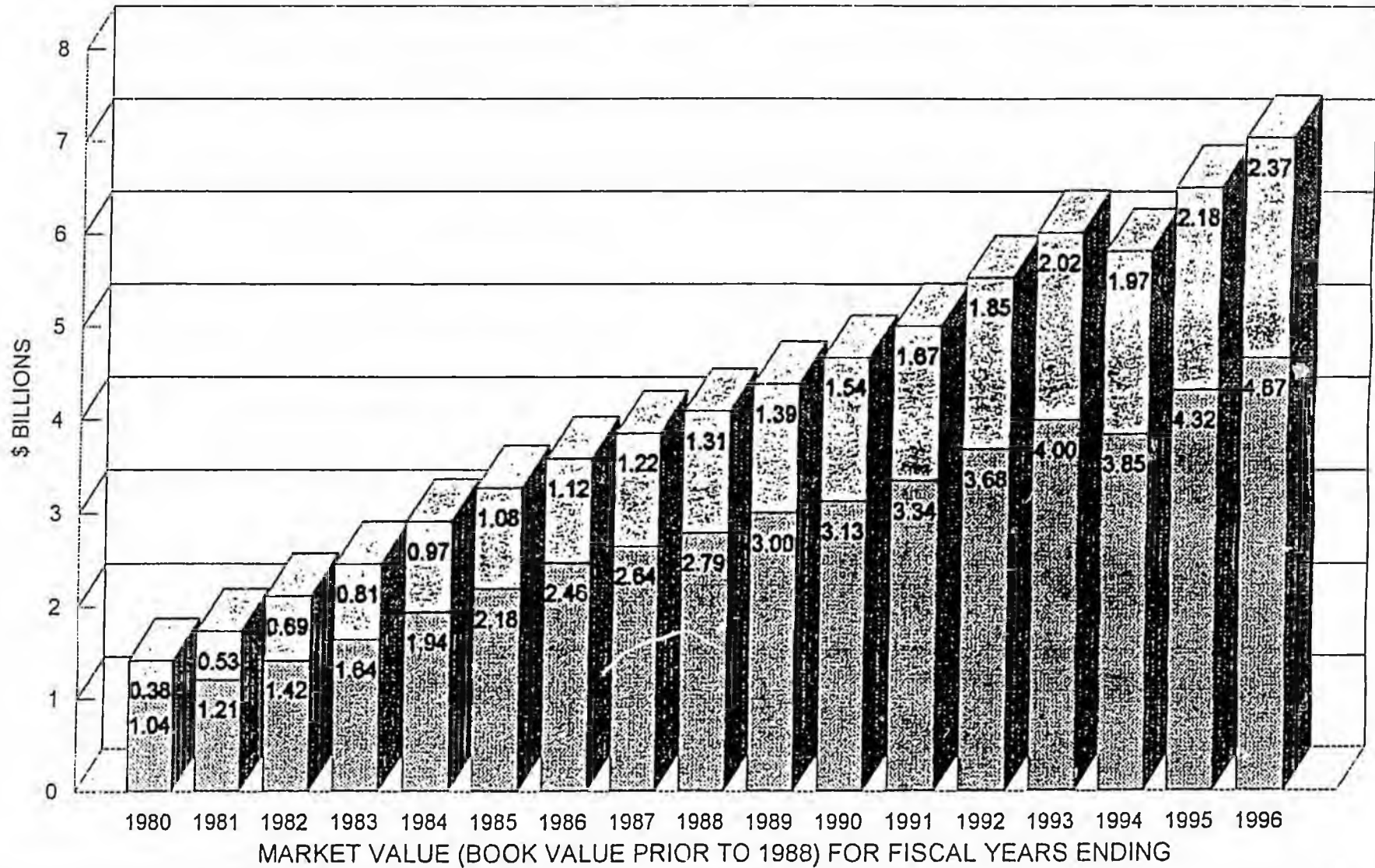
### OBJECTIVES FOR THE PERMANENT FUNDS

- TO PRESERVE THE FUNDS FOR FUTURE GENERATIONS BY GROWING THE FUNDS AT A RATE AT LEAST EQUAL TO THE RATE OF INFLATION;
- TO DISTRIBUTE THE REAL (INFLATION ADJUSTED) RETURN TO NEW MEXICO CITIZENS;
- TO MAXIMIZE TOTAL RETURNS WITHIN ACCEPTABLE LEVELS OF RISK IN ORDER TO INCREASE THE BENEFITS FOR BOTH CURRENT AND FUTURE NEW MEXICANS.

# THE EFFECTS OF CONTRIBUTIONS AND INTEREST RATES ON DISTRIBUTIONS



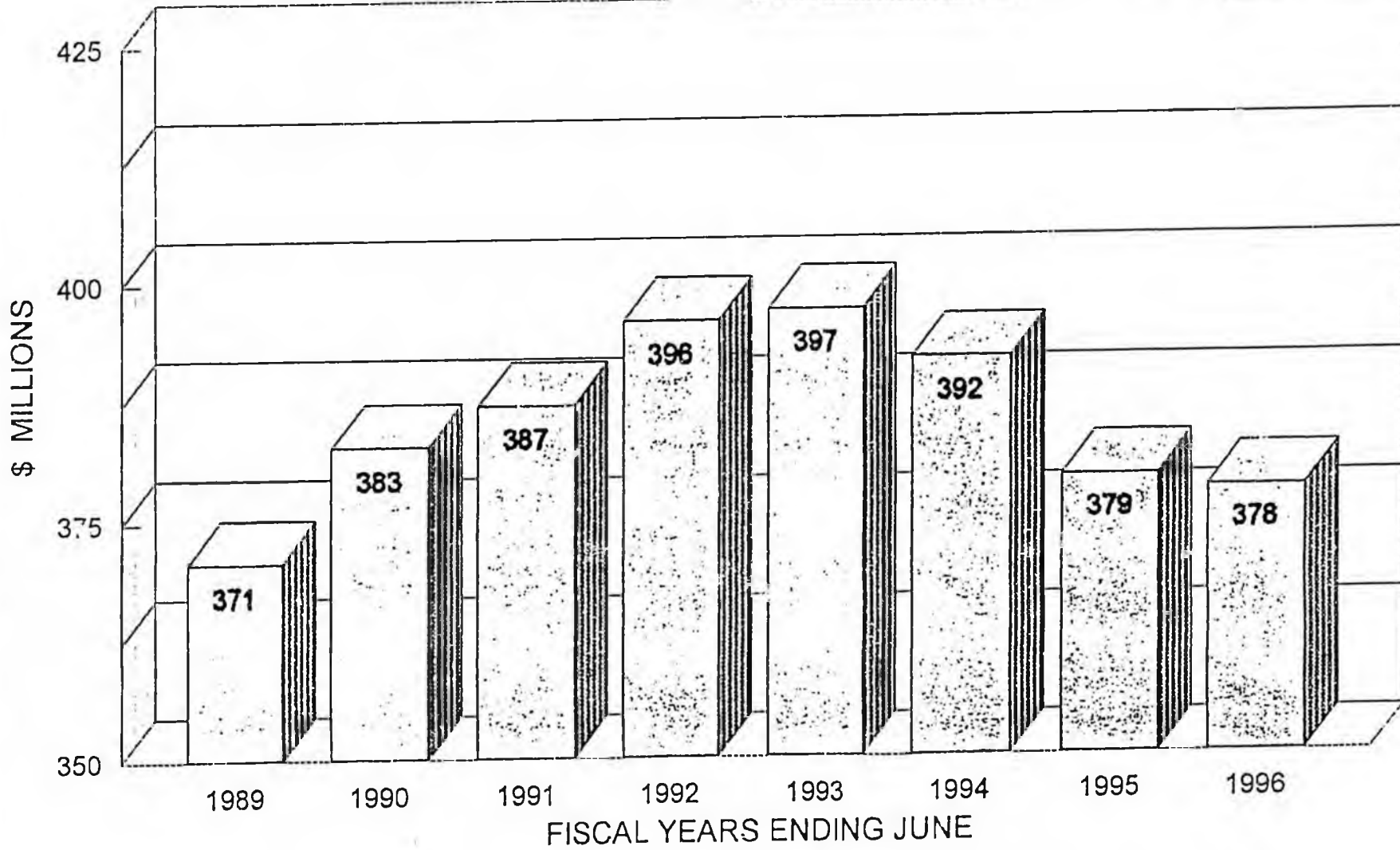
# GROWTH IN TOTAL ASSETS COMBINED FUNDS



□ LAND GRANT PERMANENT FUND

□ SEVERANCE TAX PERMANENT FUND

# TOTAL DISTRIBUTIONS COMBINED FUNDS



□ LGPF AND STPF COMBINED DISTRIBUTIONS

**ON THE BALLOT IN NOVEMBER, 1996:**

**A JOINT RESOLUTION PROPOSING AMENDMENTS TO  
ARTICLE 8, SECTION 10 AND ARTICLE 12, SECTIONS 2,  
4 AND 7 OF THE CONSTITUTION OF NEW MEXICO:**

**TO PROTECT THE STATE'S PERMANENT FUNDS  
AGAINST INFLATION BY LIMITING DISTRIBUTIONS  
TO A PERCENT OF EACH FUND'S MARKET VALUE AND  
BY MODIFYING CERTAIN INVESTMENT RESTRICTIONS  
TO ALLOW OPTIMAL DIVERSIFICATION OF INVESTMENTS.**

*NEW MEXICO STATE INVESTMENT COUNCIL*

CHANGES TO THE DISTRIBUTIONS POLICY

- CHANGE THE PAYOUT TO A FIXED-PERCENTAGE OF THE FUND;
  - USE A 5-YEAR AVERAGE MARKET VALUE TO SMOOTH OUT MARKET VALUE FLUCTUATIONS;
- ADOPT A TRANSITION PERIOD TO EASE THE CHANGE OVER TO THE NEW DISTRIBUTIONS METHOD.

\$10,000

# MAJOR ASSET CLASS COMPOUND TOTAL RETURNS

Stocks, Bonds, Bills, and Inflation - 1926 thru 1996

\$1,000

356.24 (1996)

\$100

40.76 (1996)

\$10

\$1

\$0

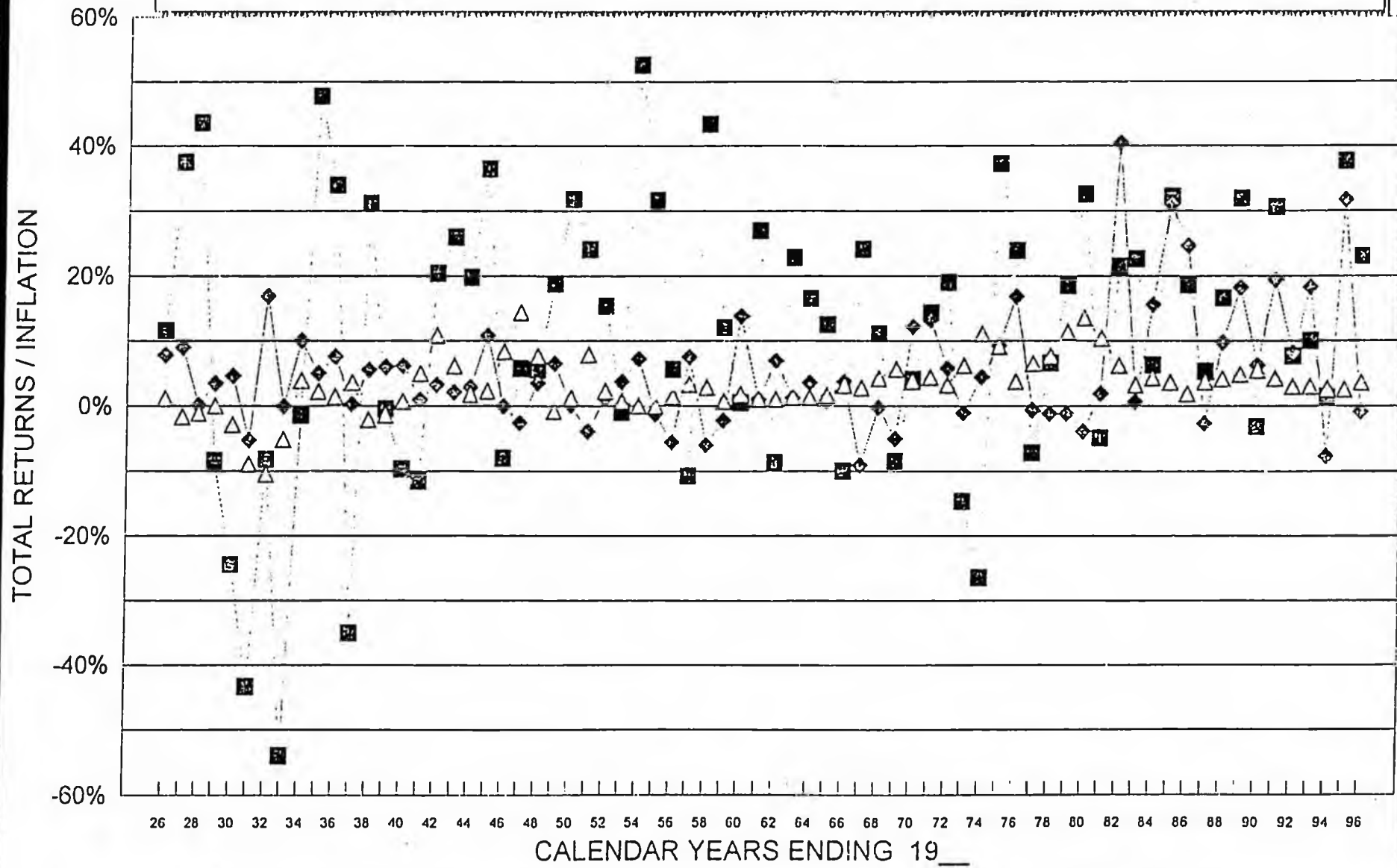
26 28 30 32 34 36 38 40 42 44 46 48 50 52 54 56 58 60 62 64 66 68 70 72 74 76 78 80 82 84 86 88 90 92 94 96

CALENDAR YEARS ENDING 19\_\_

- |                  |                          |                  |
|------------------|--------------------------|------------------|
| - SMALL STOCKS   | - LARGE STOCKS (S&P 500) | - LT GOV'T BONDS |
| - 90-DAY T-BILLS | - CPI                    |                  |

# EQUITY / BOND TOTAL RETURNS VERSUS THE CPI

RELATIVE VOLATILITY AND CORRELATIONS CHART: 1926 - 1996



■ EQUITY TOTAL RETURNS    ◆ LT GOVT. TOTAL RETURNS    △ CONSUMER PRICE INDEX

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## WHAT ARE THE STATE'S PERMANENT TRUST FUNDS?

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New Mexico has two large permanent trust funds, the \$2.3 billion Severance Tax Permanent Fund and the \$4.7 billion Land Grant Permanent Fund. Together, these Funds total over \$7 billion and are the savings accounts or "nest-eggs" for future generations of New Mexicans. The Funds will help future taxpayers when the state's natural resources are depleted.

The Severance Tax Permanent Fund is a separate savings account derived from a portion of taxes paid on oil, gas, coal and other resources when they are severed from the earth within New Mexico. The Fund distributes all interest and dividend income each year to the state's operating budget, sixty-four percent of which was spent on public schools, higher education and special education in the fiscal year ending 6/30/96.

The Land Grant Permanent Fund is the state's savings account for royalties on oil, gas and other natural resources extracted from the 13.4 million acres given to New Mexico by the federal government at statehood. The interest and dividends earned on the Fund's investments have provided a primary funding source for twenty public institutions, most of which are public schools, universities, and hospitals.

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## WHAT BENEFITS DOES NEW MEXICO RECEIVE FROM THE PERMANENT FUNDS?

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In fiscal year 1996, \$378 million, or 13%, of the state's budget was derived from distributions of income from the two Funds. During the last eight years, nearly \$3.1 billion of the state's revenue has come from this source. Without this income, state income taxes would have been about \$600 higher per year for each taxpayer.

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## WHAT DOES PASSAGE OF THE AMENDMENT DO?

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If approved by the voters, the Amendment will allow the State's Permanent Funds (New Mexico's nest-eggs or savings accounts for the future) to be managed similar to other major educational endowment funds in the U.S., using long-term investment goals.

The Amendment has been approved by the Governor's Permanent Fund Advisory Committee, the Constitution Revision Commission, the Legislature, the State Investment Council, the beneficiaries of the Fund (public schools, higher education and other public institutions) and independent financial experts.

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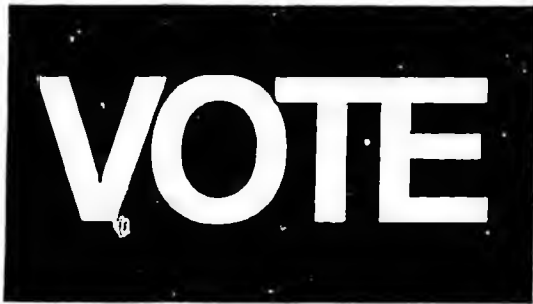
## WHO ARE THE BENEFICIARIES OF THE LAND GRANT PERMANENT FUND?

Public Schools  
New Mexico Military Institute  
New Mexico School for the Deaf  
New Mexico School  
for the Visually Handicapped  
Penitentiary of New Mexico  
University of New Mexico  
Miners' Hospital of New Mexico  
Capitol Buildings Repair Fund  
Water Reservoirs  
Charitable, Penal & Reform  
New Mexico State University  
Rio Grande Improvements  
New Mexico State Hospital  
New Mexico Institute  
of Mining & Technology  
Eastern New Mexico University  
Western New Mexico University  
New Mexico Highlands University  
Northern New Mexico State School  
UNM Saline Lands  
New Mexico Boys' School

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## WHO IS THE BENEFICIARY OF THE SEVERANCE TAX PERMANENT FUND?

The state's annual operating budget, of which 64% is appropriated to public schools, higher education and special education.



On the Ballot November 5, 1996:

## CONSTITUTIONAL AMENDMENT # 1

TO AMEND ARTICLE 8  
SECTION 10 AND ARTICLE 12, SECTIONS  
2, 4 AND 7 OF THE NEW MEXICO  
CONSTITUTION

TO PROTECT THE STATE'S  
PERMANENT TRUST FUNDS AGAINST  
INFLATION

BY LIMITING DISTRIBUTIONS  
TO A PERCENTAGE OF EACH FUND'S  
MARKET VALUE

AND BY MODIFYING CERTAIN  
INVESTMENT RESTRICTIONS TO ALLOW  
OPTIMAL DIVERSIFICATION OF  
INVESTMENTS.

For additional information about the  
proposed constitutional amendment, contact  
the State Investment Council  
(505) 827-6226

A VOTE  
"FOR"  
THE AMENDMENT:

A VOTE  
"AGAINST"  
THE AMENDMENT:

<p>Is intended to protect the Funds from inflation by limiting annual distributions to 4.7% of the average market value of the Funds for the preceding five years.</p>	<p>All income, including the inflation component of interest, is paid out each year which may expose future distributions to potential reductions in their purchasing power.</p>
<p>Is intended to provide greater stability in the amount of income paid to public schools and other beneficiaries.</p>	<p>Distributions of income will continue to be determined primarily by interest rates. If interest rates continue to fluctuate widely, distributions may vary accordingly.</p>
<p>Allows the trustees to further diversify investments for the purposes of protecting the safety of the Funds and to try to maximize the total rate of return.</p>	<p>The historical practice of investing the Funds to maximize current income, rather than trying to maximize both current income as well as future income, will continue.</p>
<p>Allows the Funds to be invested for growth as well as preservation of principal similar to the majority of other educational endowment funds in the U.S.</p>	<p>The Funds are mainly managed to preserve the principal, rather than for growth, which may, over time, diminish the real, inflation-adjusted, value of the principal of the Funds.</p>
<p>Allows up to 65% of the Land Grant Permanent Fund to be invested in stocks. The Legislature, by a vote of 3/4 of its members, may authorize not more than 15% to be invested in international securities.</p>	<p>Limits Land Grant Permanent Fund investments in both corporate stocks and bonds combined to 50% or less, and prohibits any investments in international stocks.</p>
<p>Allows the Permanent Fund to purchase higher-growth stocks that have not paid dividends or are listed on NASDAQ, such as Intel and Microsoft.</p>	<p>Limits Land Grant Permanent Fund stocks to those listed on a national exchange and to those that have paid dividends for ten consecutive years.</p>

## ***NEW MEXICO STATE INVESTMENT COUNCIL***

### **CONCLUSIONS AND LESSONS LEARNED**

- **Study the issues thoroughly, and involve both respected citizens and professional consulting advice in the process.**
- **Recommend solutions that are in line with average endowment fund practices.**
- **The solutions must offer advantages for all affected parties.**
- **Obtain support from the leadership of all affected parties.**
- **One influential disaffected party can defeat the initiative.**
- **Don't pay too much attention to the nay-sayers - there will be some.**
- **Publicize the problems and solutions using all available media.**

*New Investment Trends:  
The Callan Perspective*

Alaska Permanent Fund Corporation

February 12, 1997



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

## *Asset Allocation*

### Pension & Investments (1/20/97):

- Corporate DC Plan equity exposure
  - 48% in 1992
  - 63% in 1996
- Corporate DB           63% equity
- Public DB               54% equity
- Taft Hartley DB       45% equity

# *Now Is Always The Hardest Time To Invest*

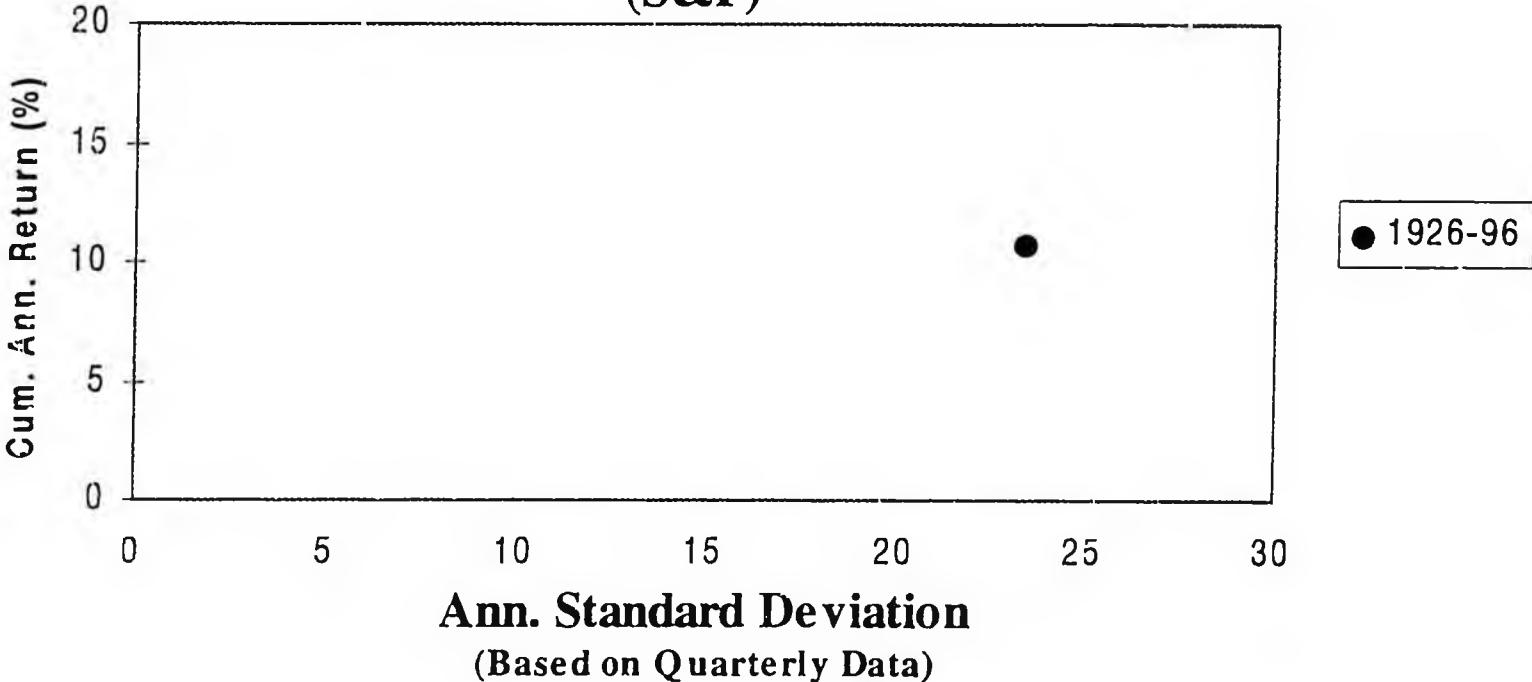
- Historic perspective
- Callan's 5-year projections
- Implications

# *Callan's Asset Allocation Process*

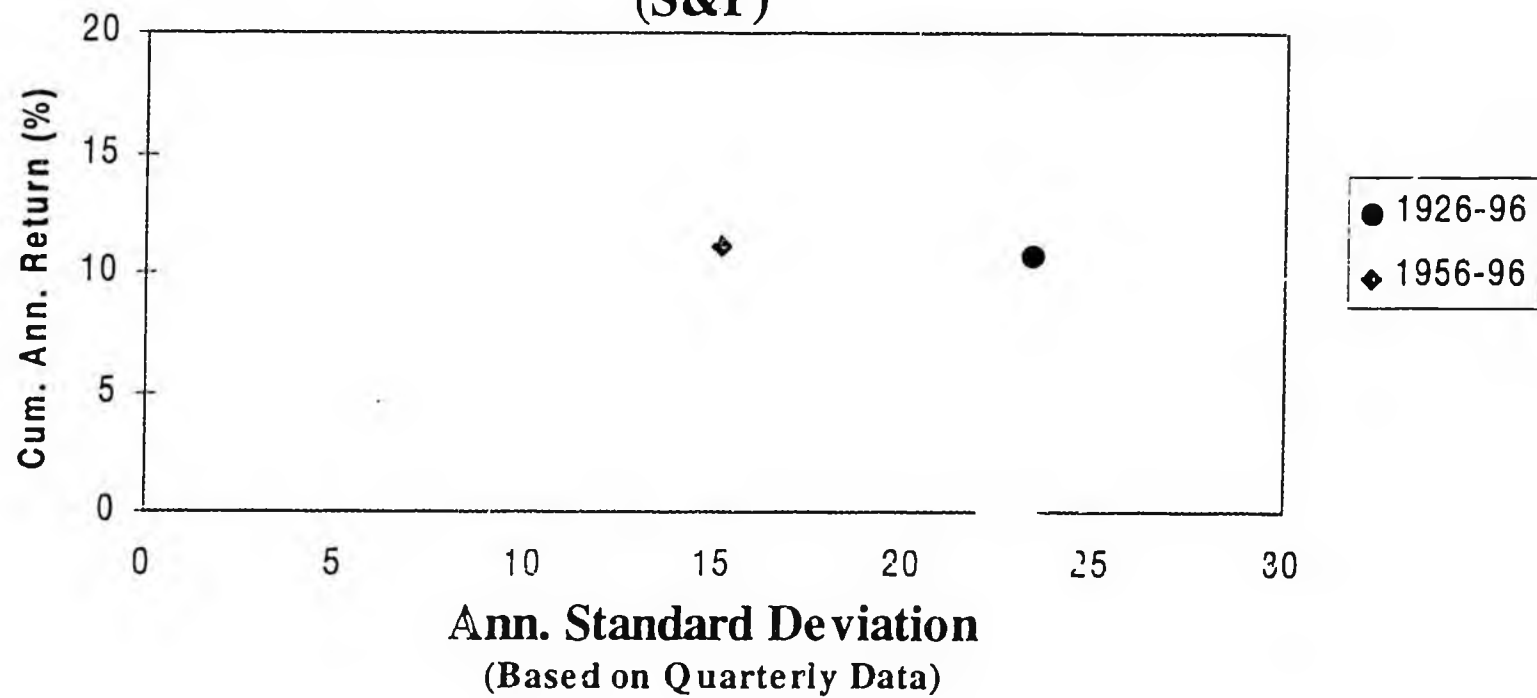
## 3 Key Inputs:

- 5-year mean
- Annual standard deviation
- Correlation estimates

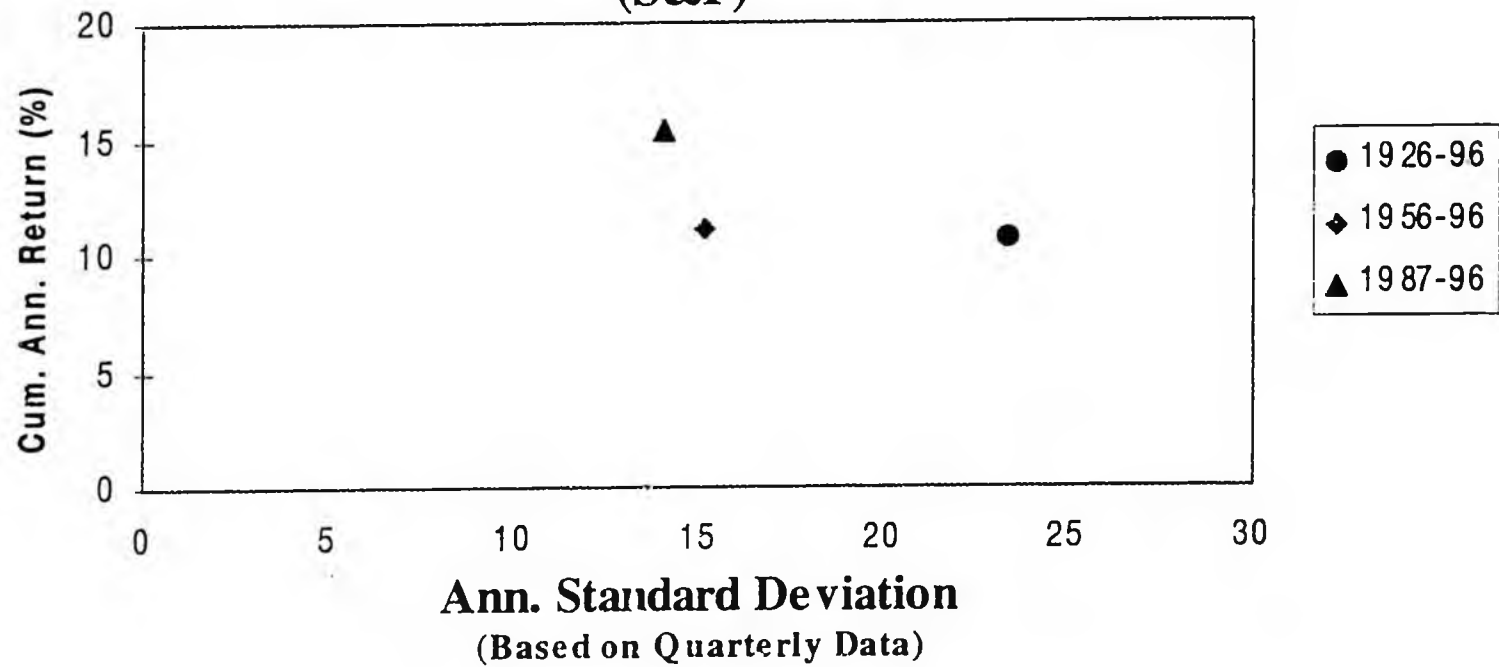
# Risk/Reward Domestic Stocks (S&P)



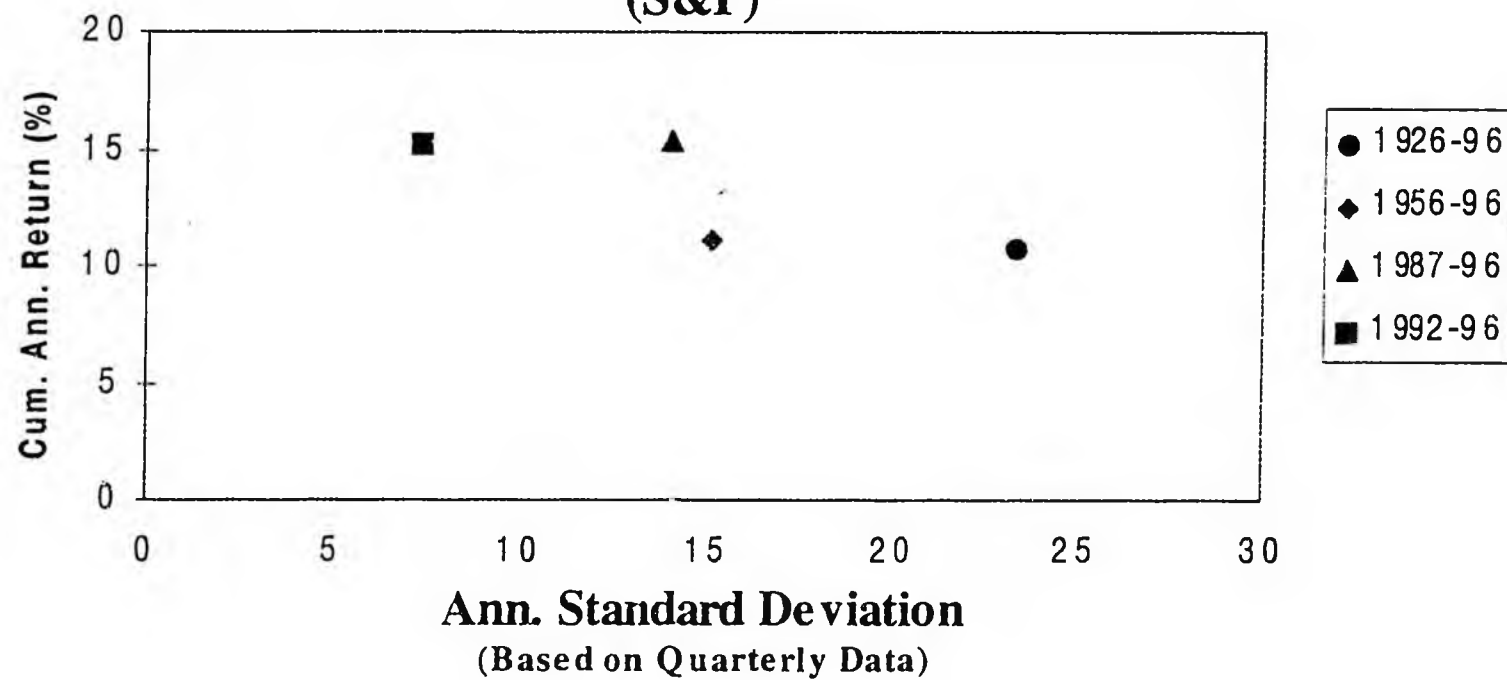
# Risk/Reward Domestic Stocks (S&P)



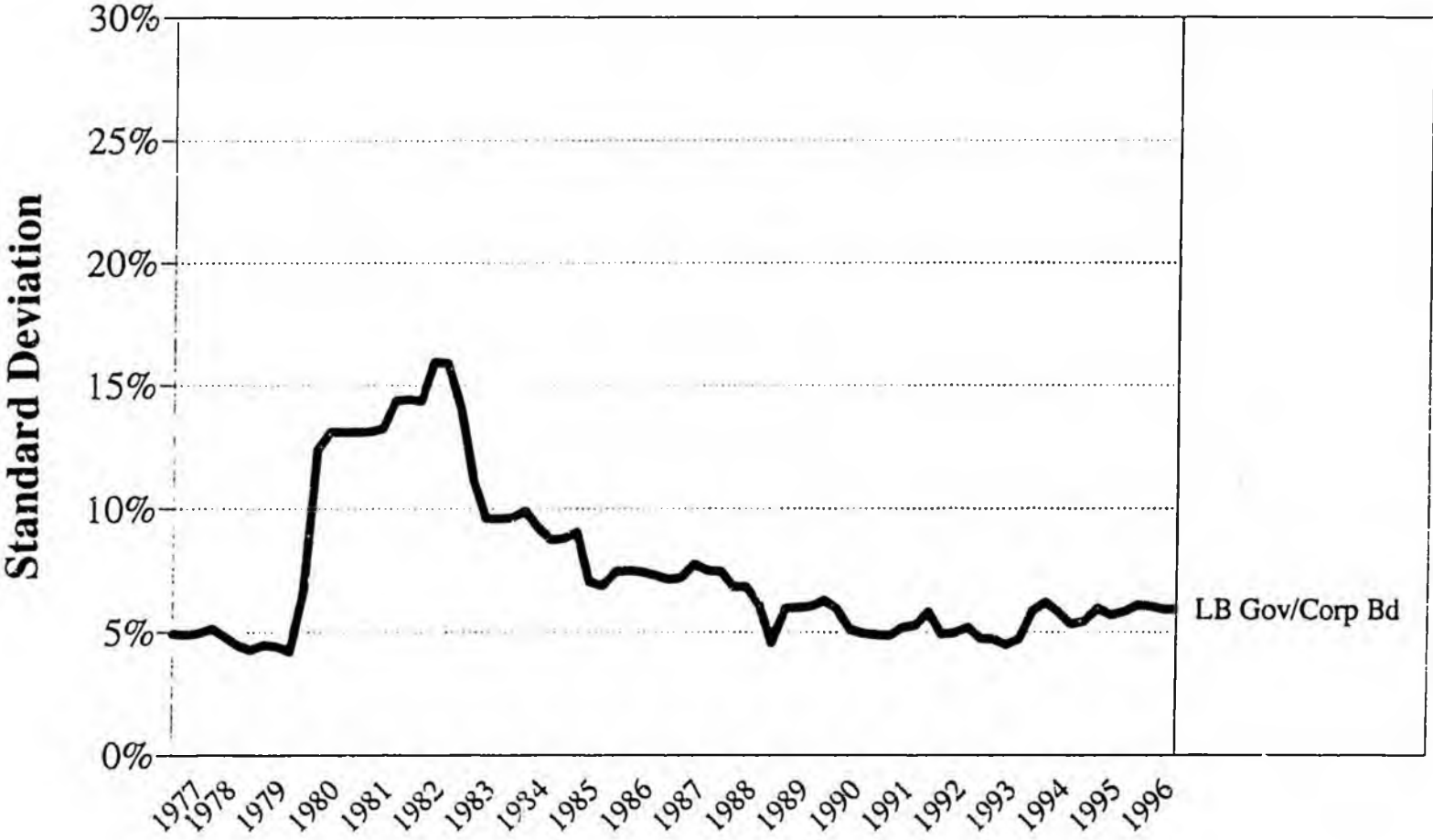
## Risk/Reward Domestic Stocks (S&P)



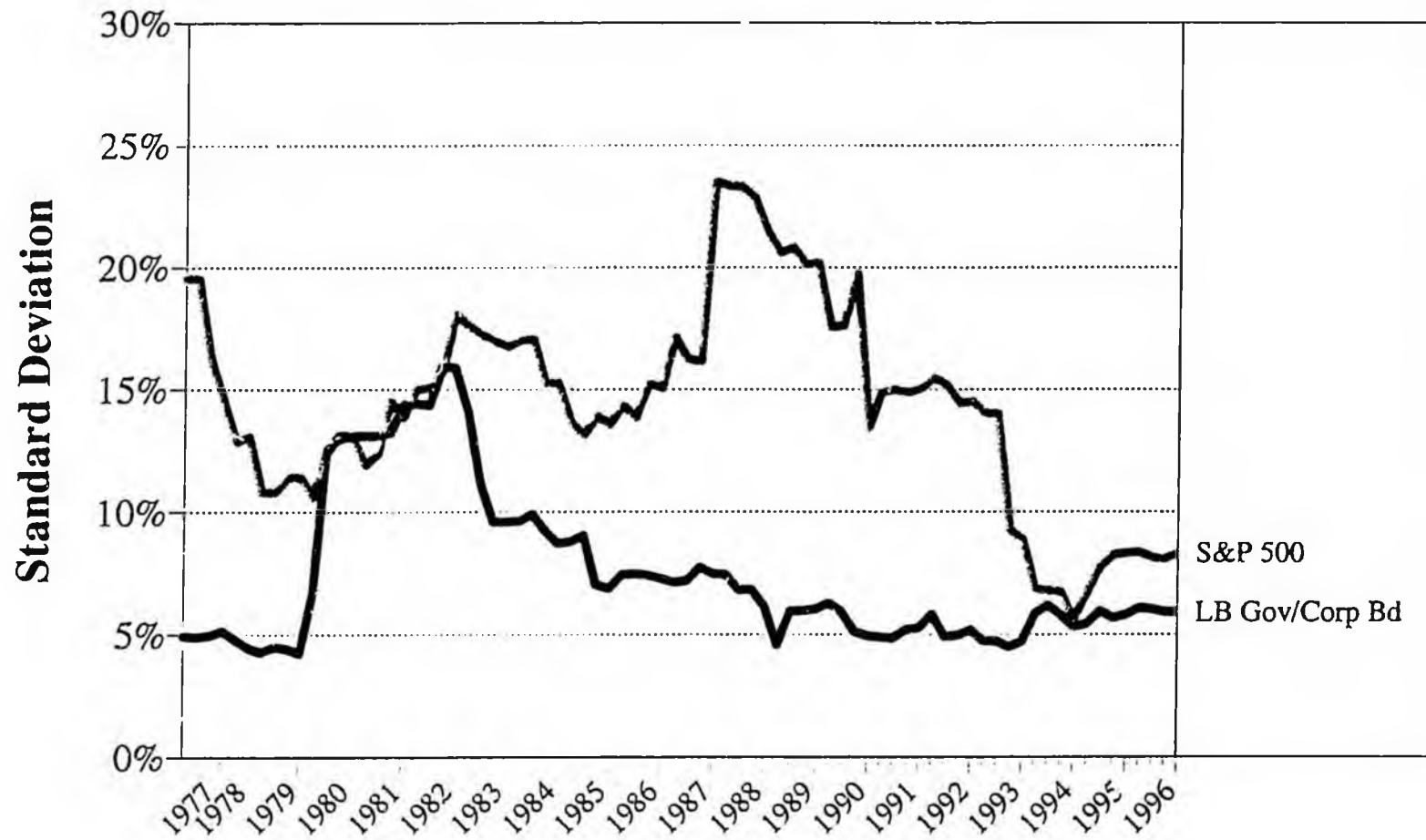
# Risk/Reward Domestic Stocks (S&P)



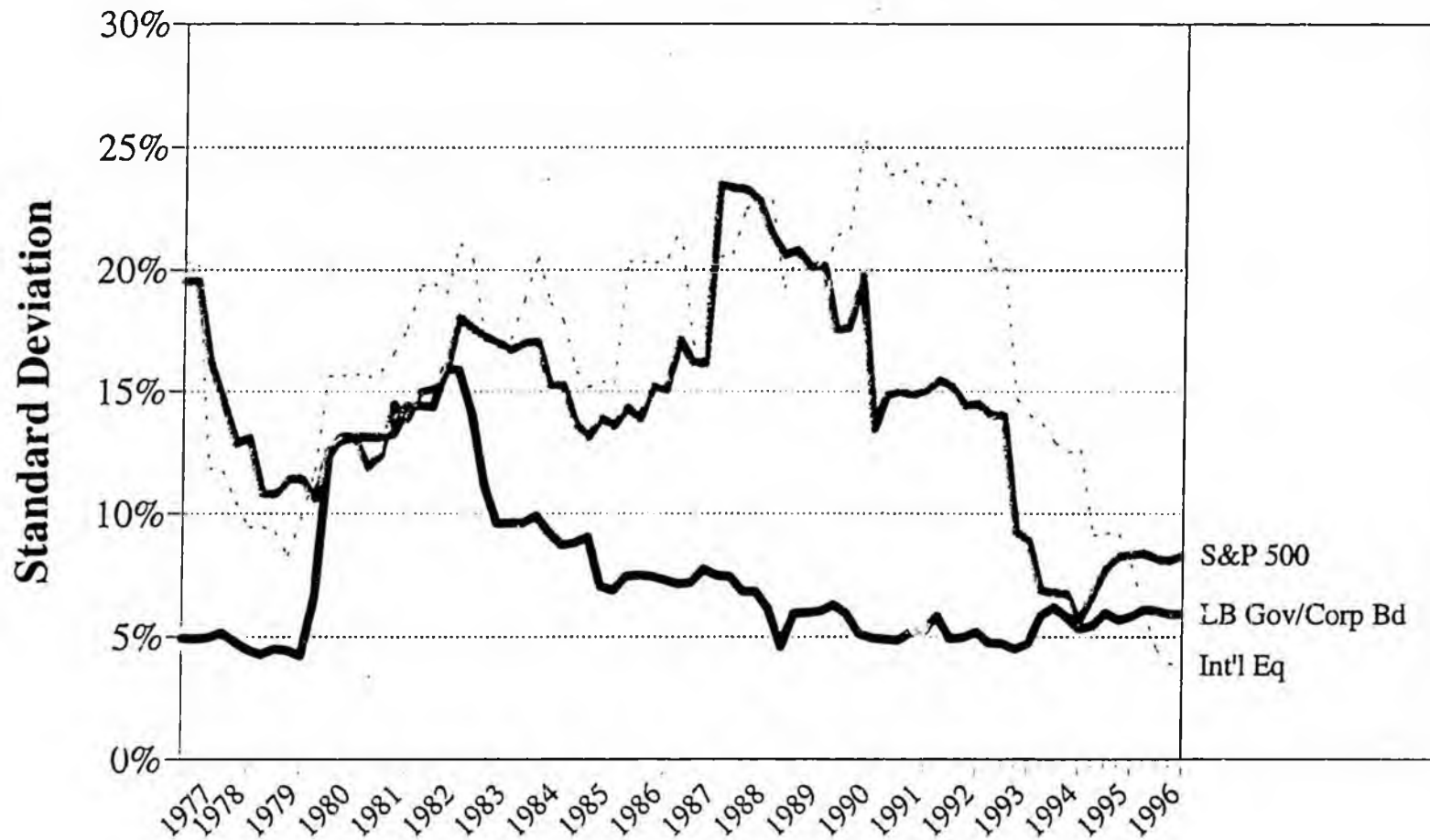
# Annualized Standard Deviation Using Rolling Periods of 12 Quarters



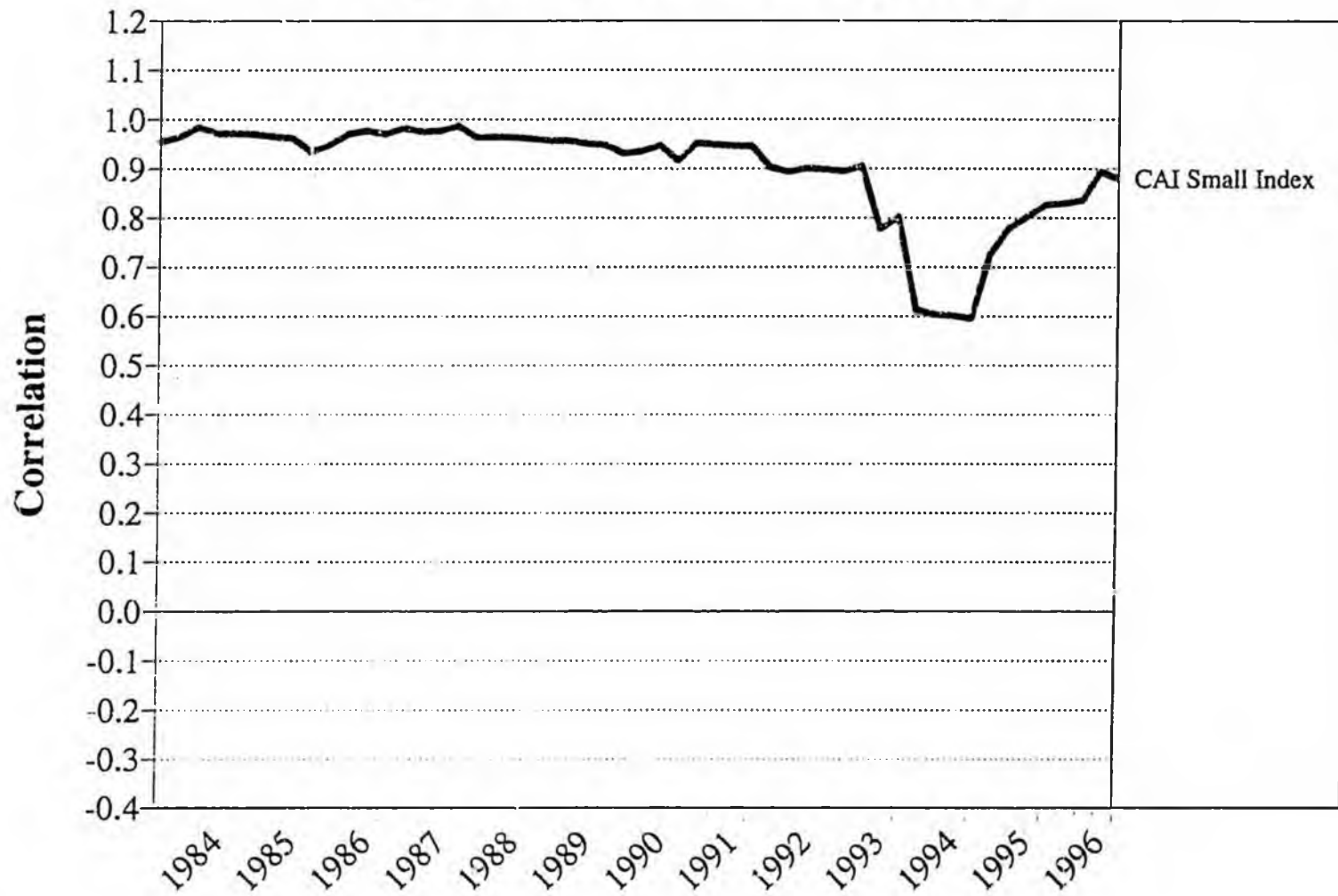
## Annualized Standard Deviation Using Rolling Periods of 12 Quarters



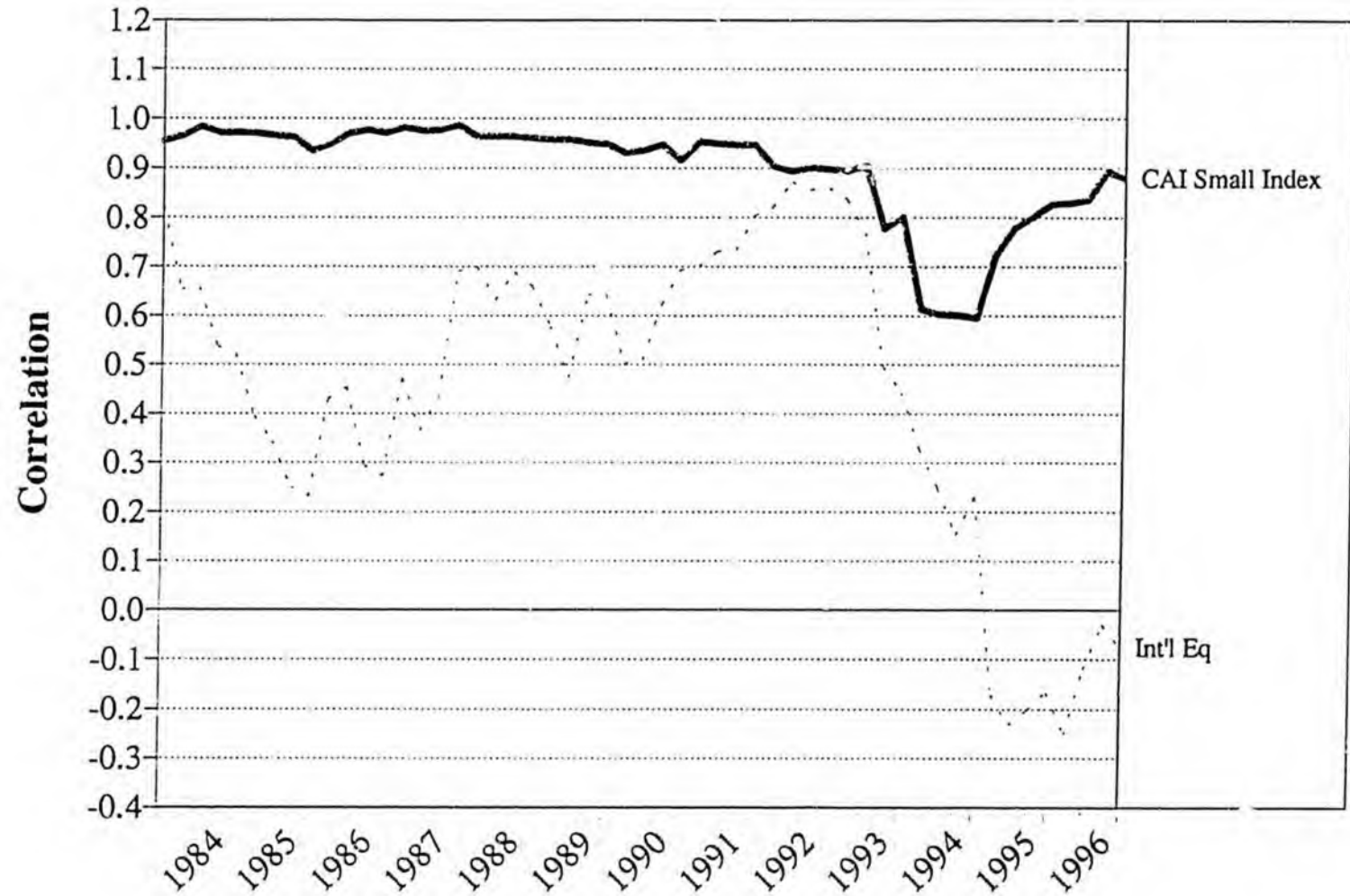
## Annualized Standard Deviation Using Rolling Periods of 12 Quarters



### Correlation Relative to S&P 500 Using Rolling Periods of 12 Quarters

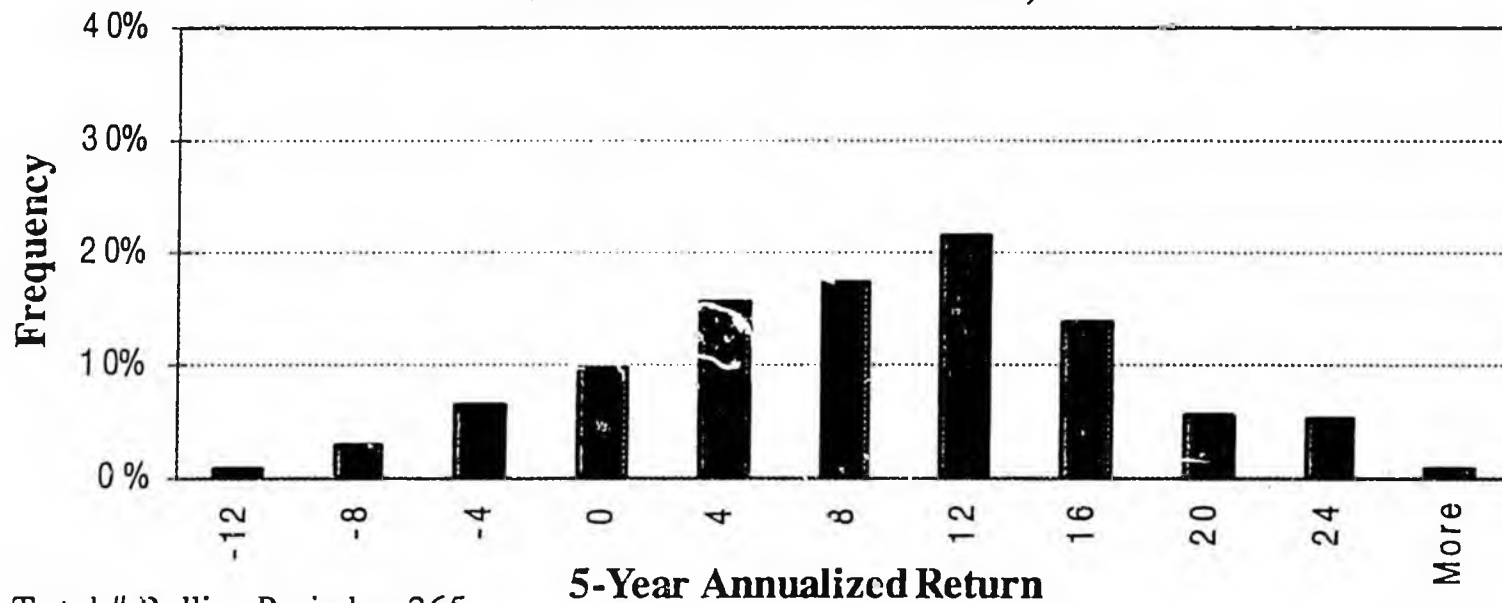


### Correlation Relative to S&P 500 Using Rolling Periods of 12 Quarters



# Domestic Stocks 5-Year Real Return Histogram 1930-1996

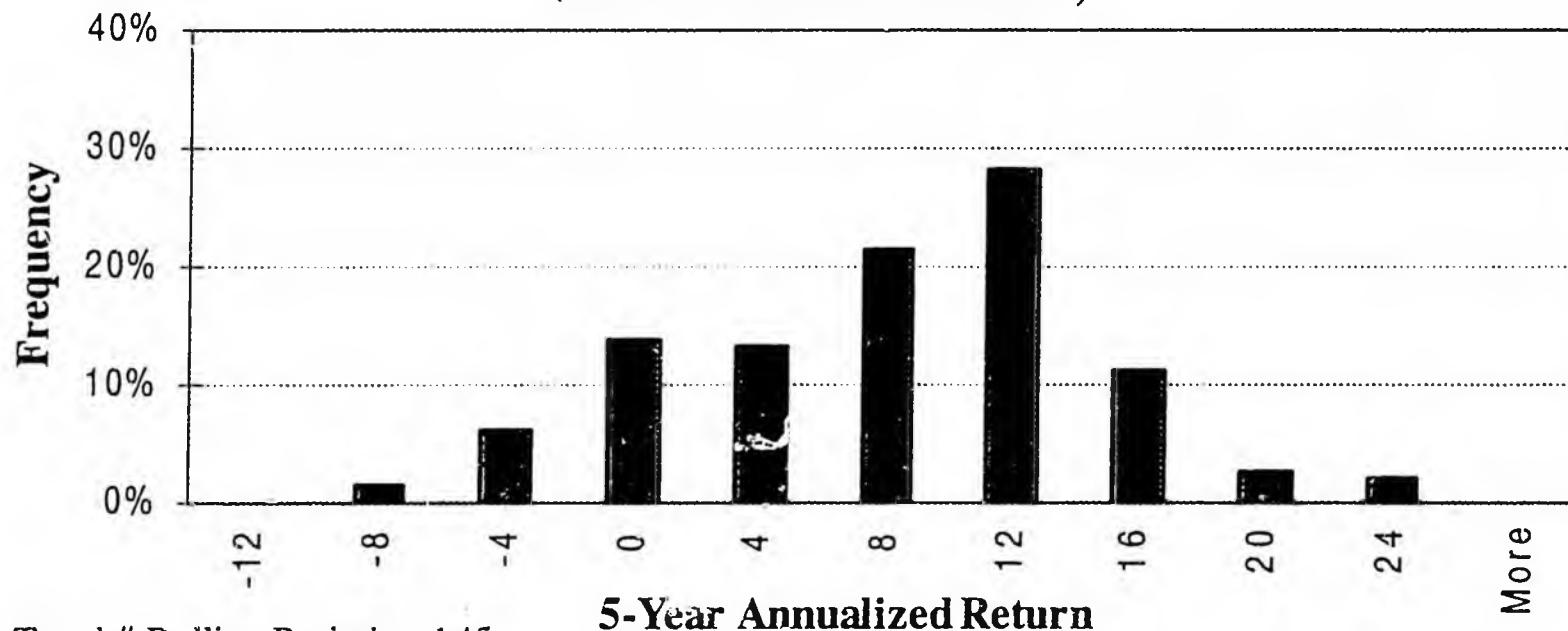
(1st 5-Yr Period: 1/26 to 12/30)



Total # Rolling Periods = 265  
(Based on quarterly data)

# Domestic Stocks 5-Year Real Return Histogram 1960-1996

(1st 5-Yr Period: 1/56 to 12/60)

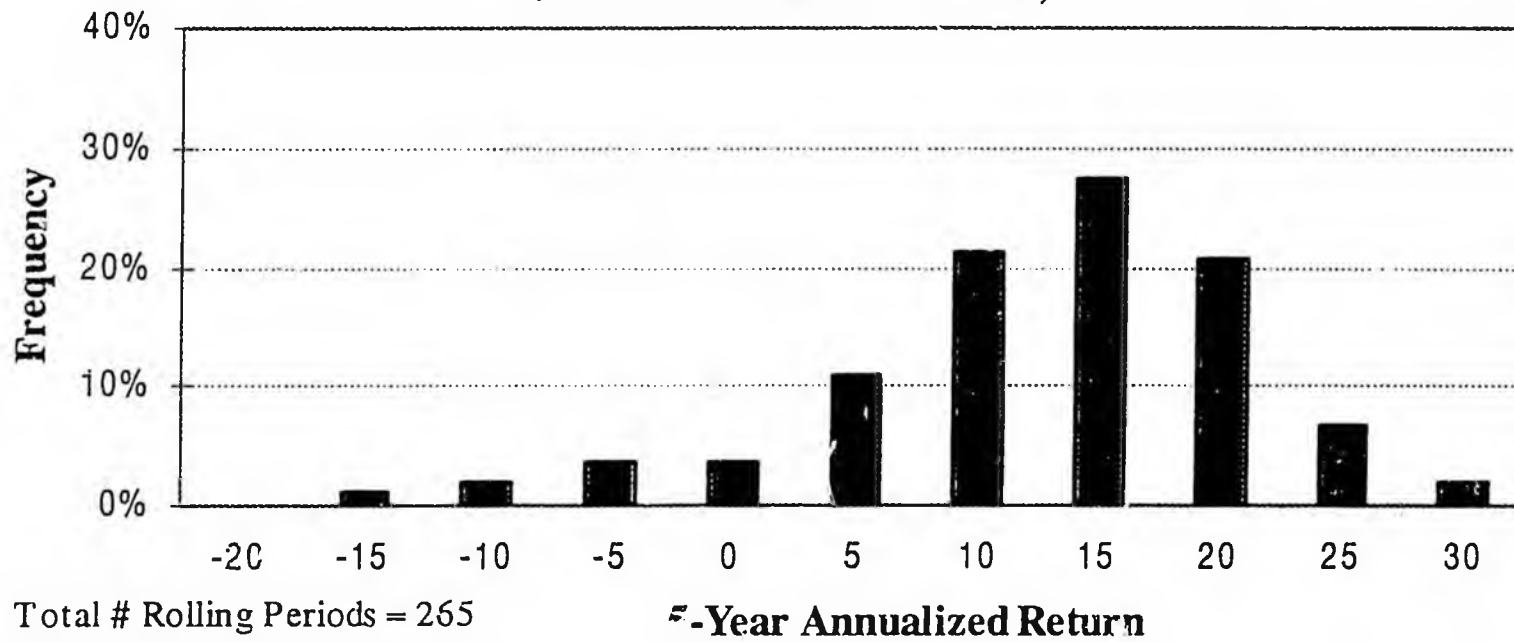


Total # Rolling Periods = 145  
(Based on quarterly data)



**Domestic Stocks**  
**5-Year Nominal Return Histogram**  
**1930-1996**

(1st 5-Yr Period: 1/26 to 12/30)



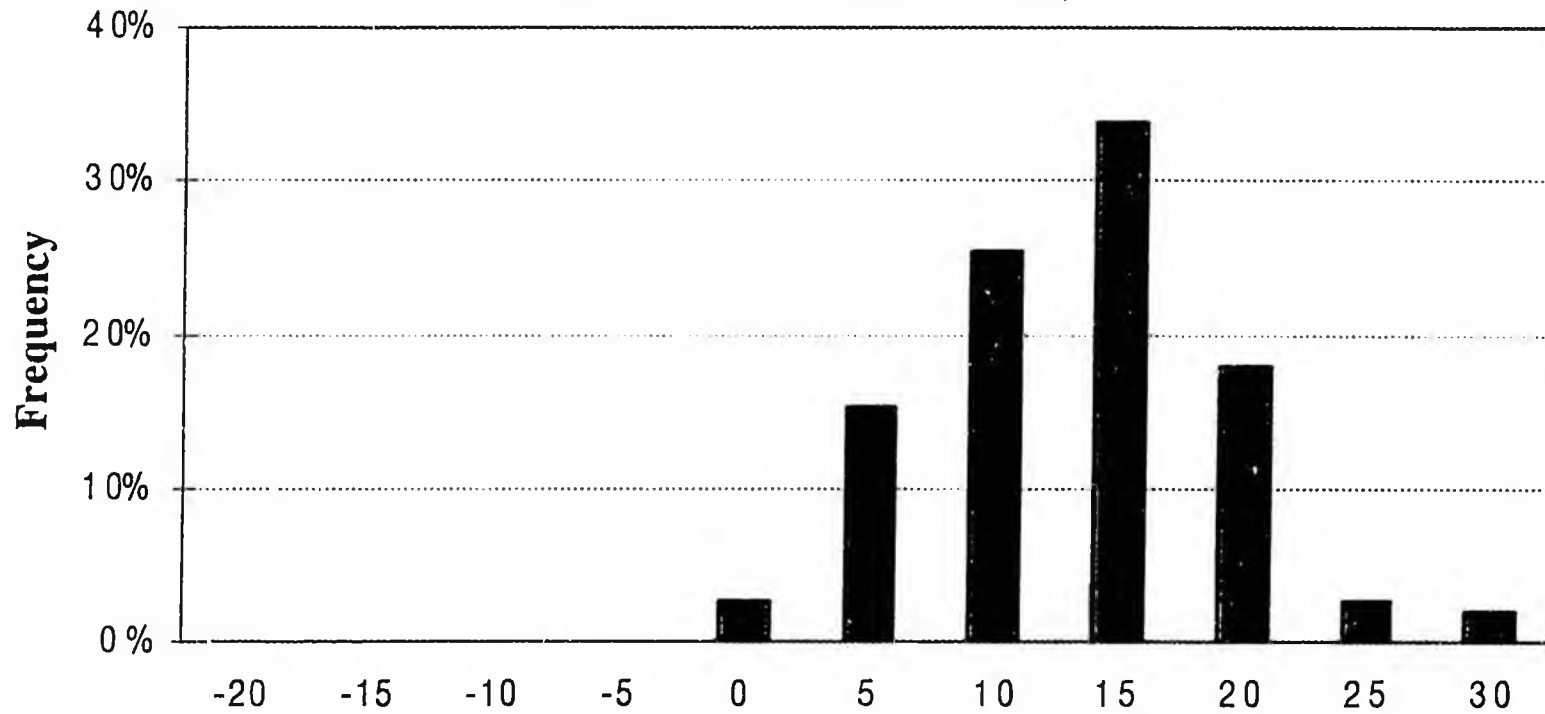
Total # Rolling Periods = 265  
(Based on quarterly data)

**5-Year Annualized Return**



**Domestic Stocks**  
**5-Year Nominal Return Histogram**  
**1960-1996**

(1st 5-Yr Period: 1/56 to 12/60)

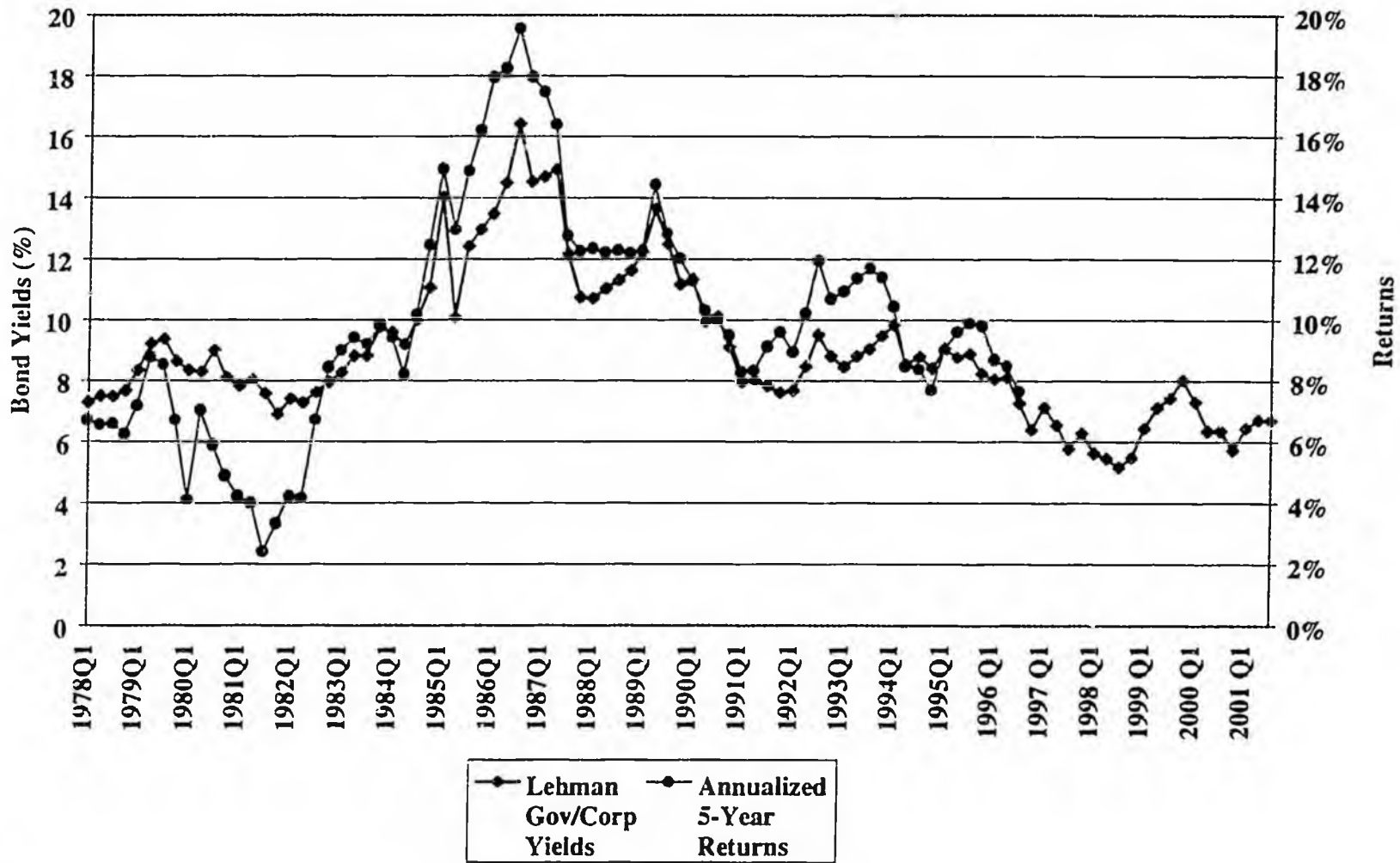


Total # Rolling Periods = 145  
(Based on quarterly data)

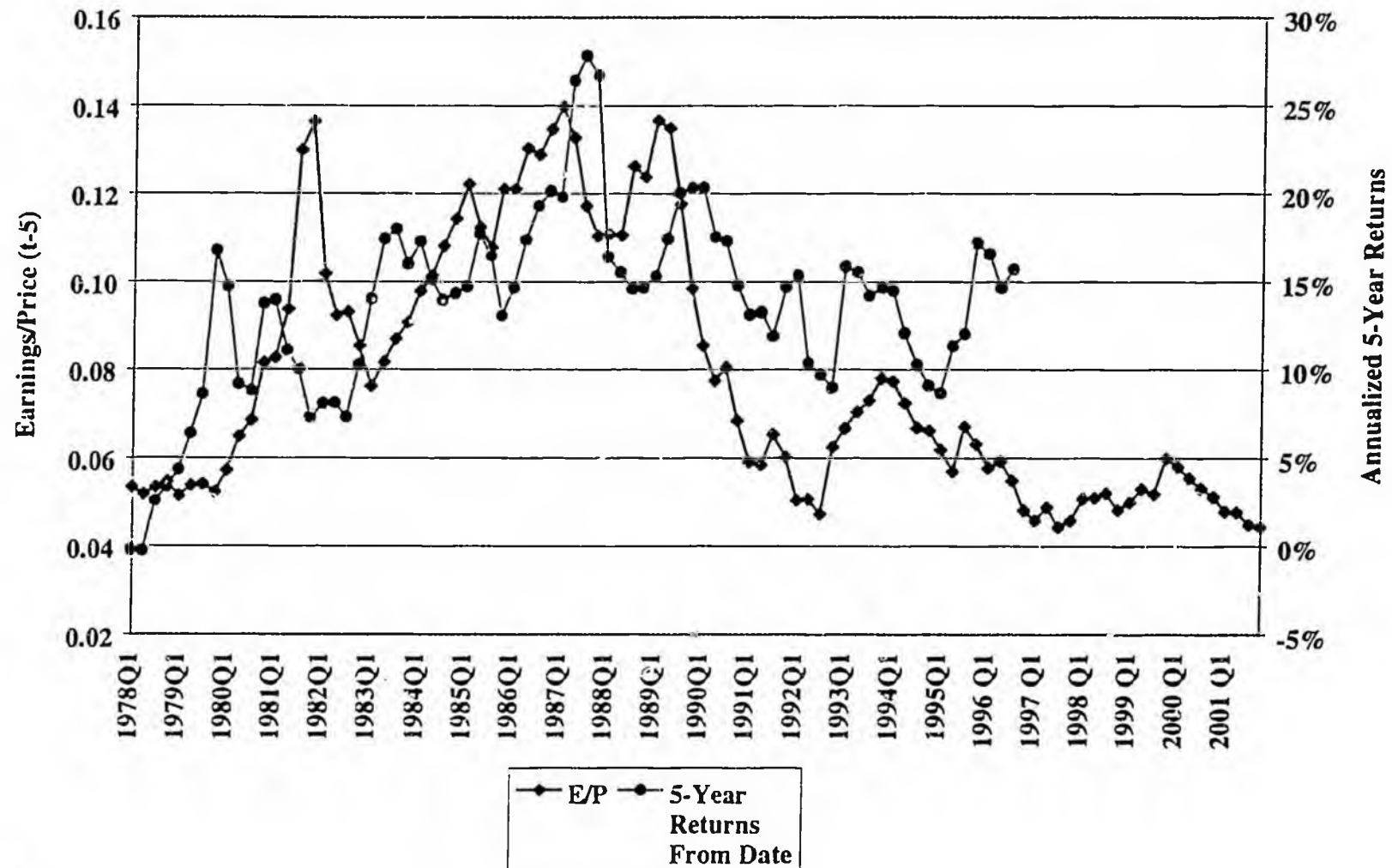
**5-Year Annualized Return**



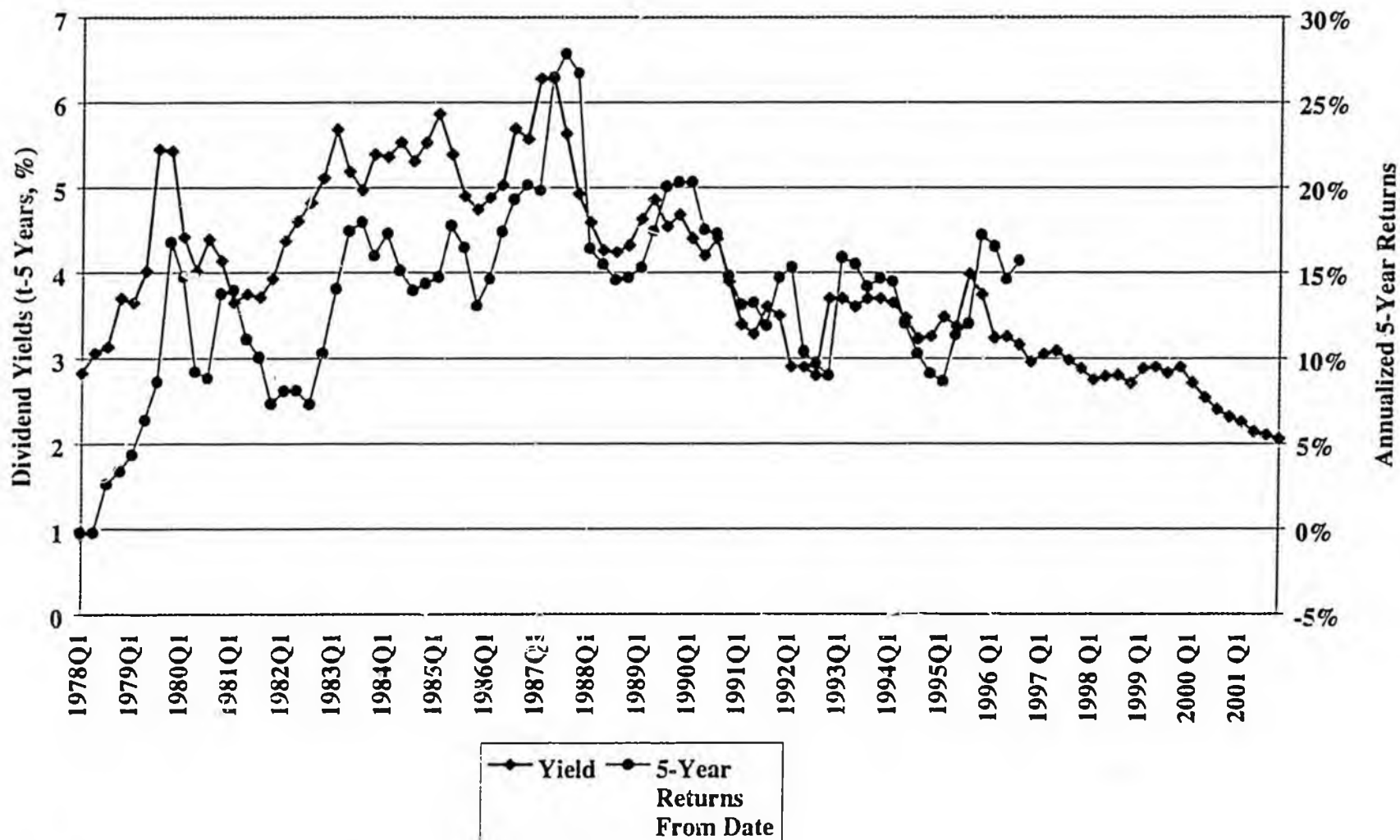
## Bond Yields and Subsequent Returns



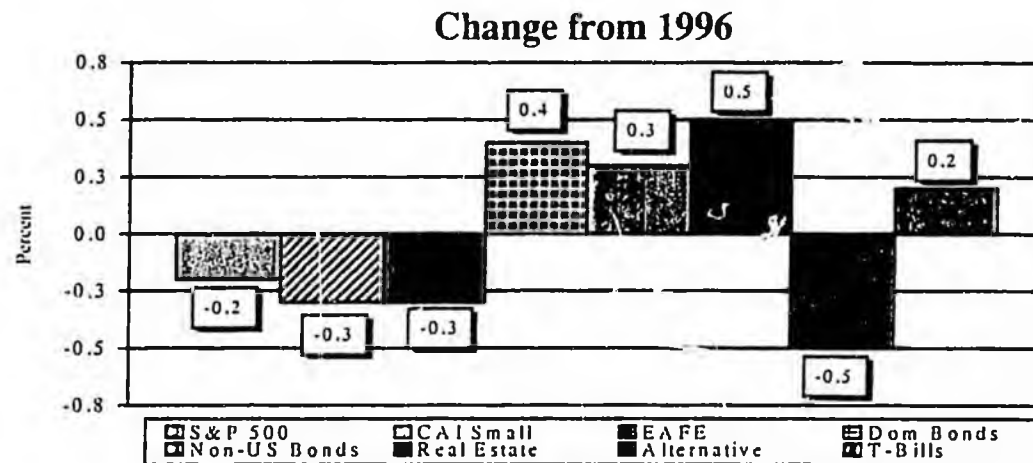
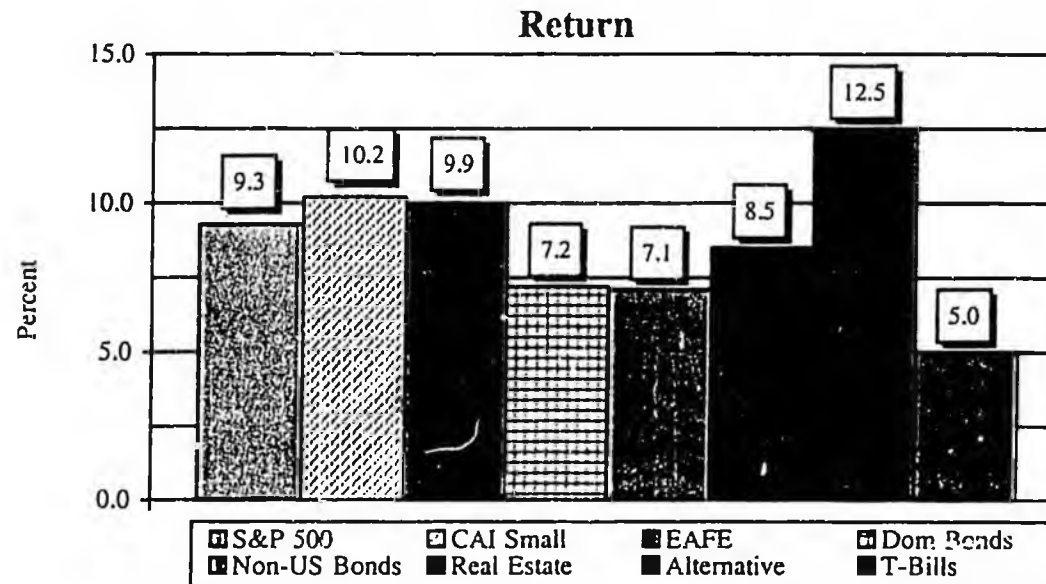
## S&P 500 Earnings-Price Ratios and Subsequent Returns



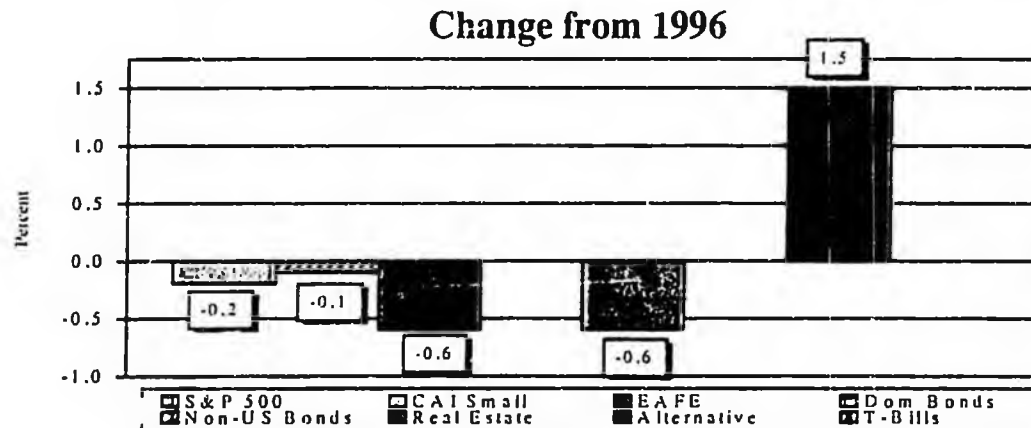
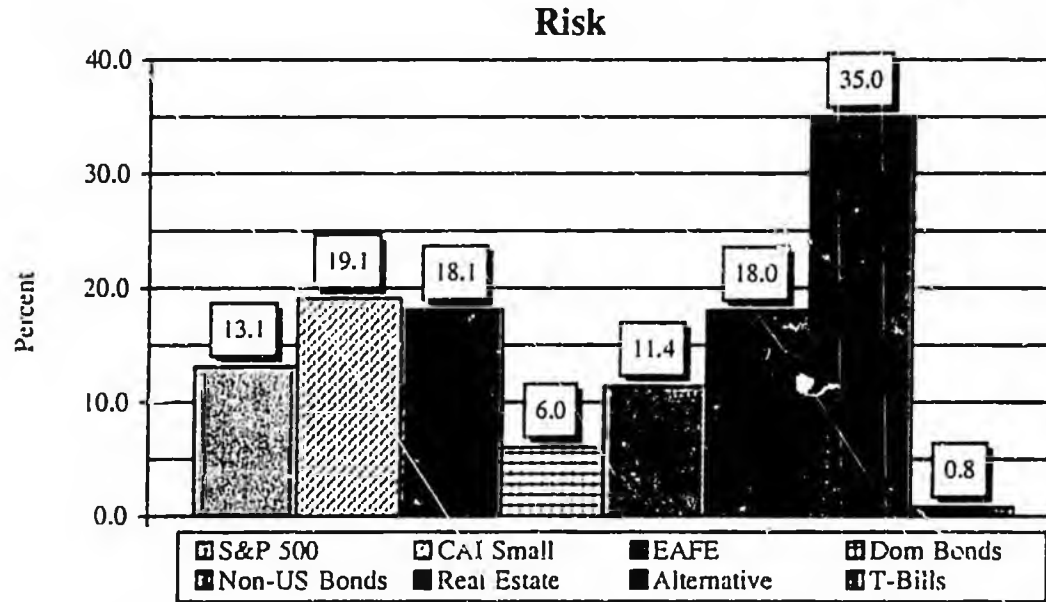
### S&P 500 Yield and Subsequent Returns



# 1997 Five Year Projections

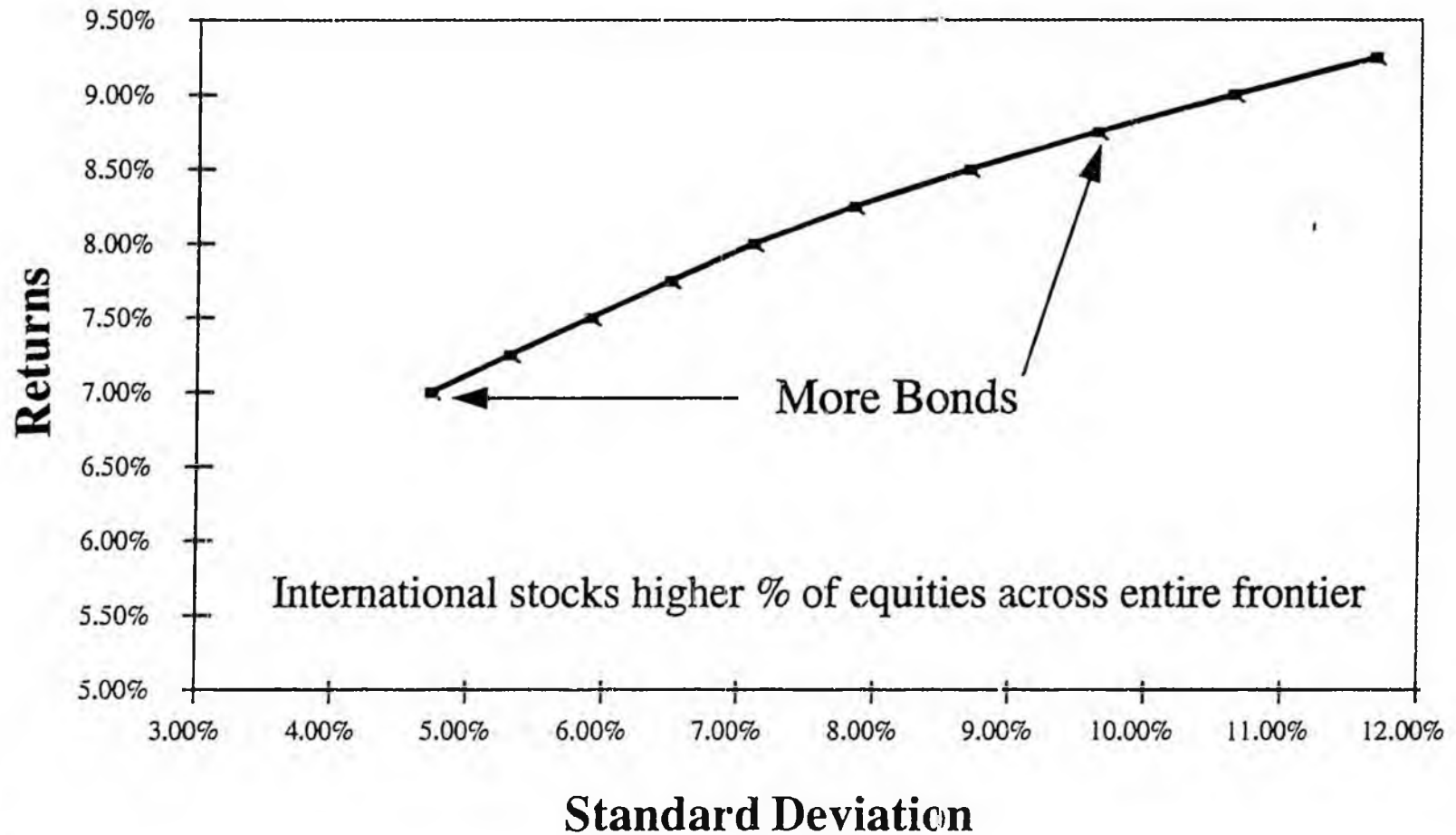


# 1997 Five Year Projections

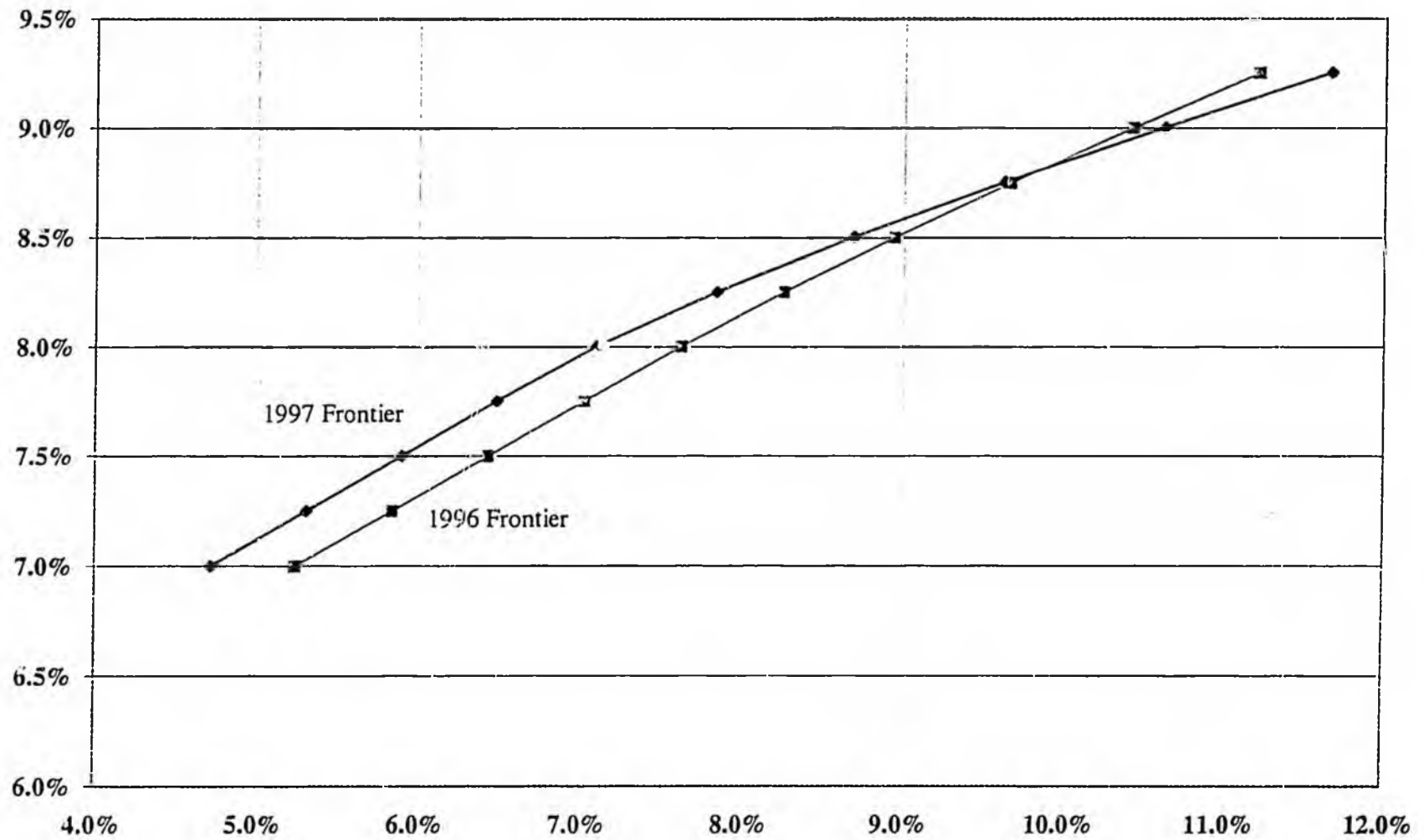


# Implications

## Efficient Frontier - 1997 Projections



## Efficient Frontier with All Major Asset Classes

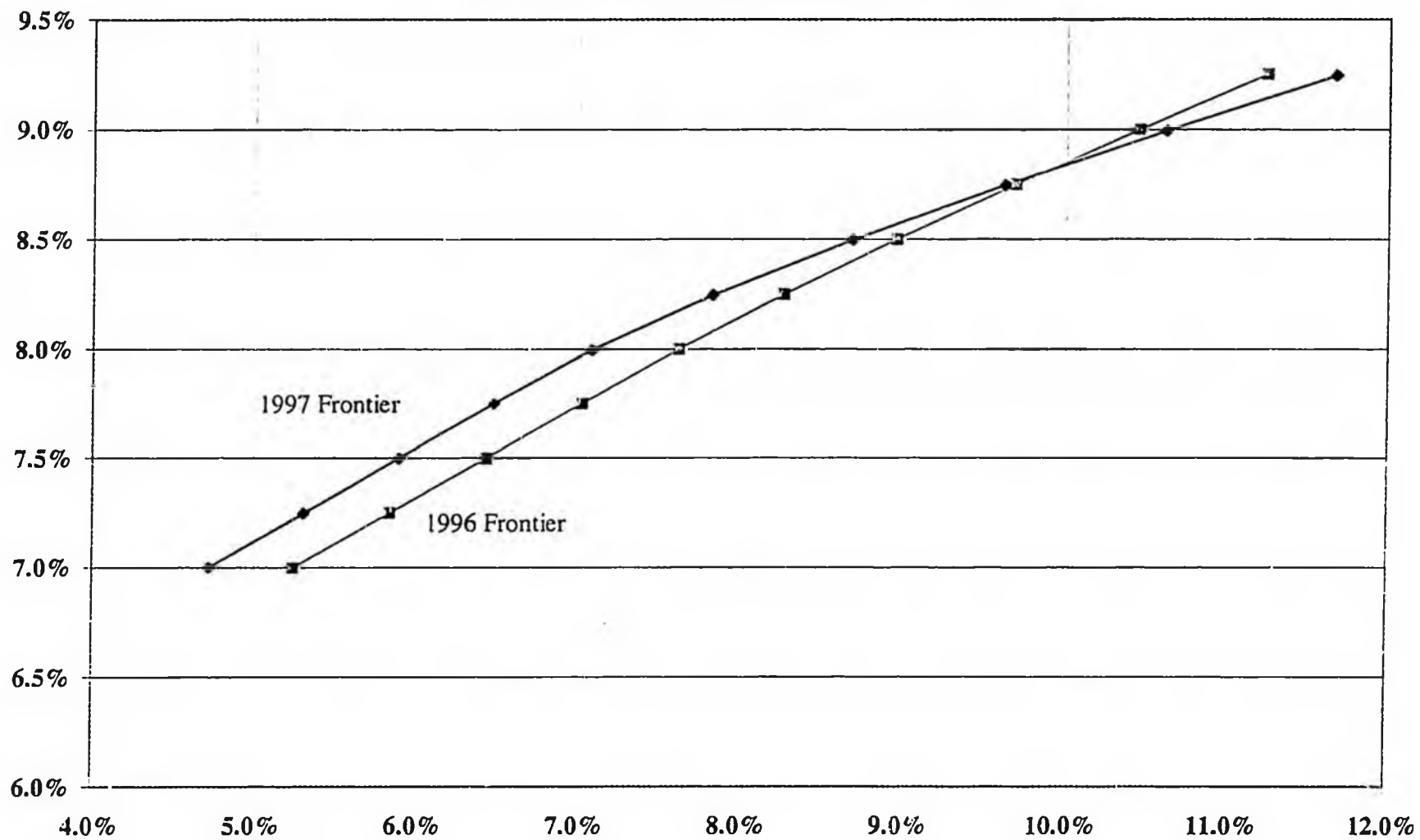


## Efficient Frontier with All Major Asset Classes

1997 Component	Asset Mix Alternatives									
	1	2	3	4	5	6	7	8	9	10
S&P	10%	11%	13%	14%	16%	21%	26%	31%	35%	40%
CAI Small	2%	2%	2%	2%	3%	4%	5%	6%	8%	9%
Intl Eq	6%	6%	7%	7%	9%	11%	13%	15%	18%	20%
LB G/C Bd	47%	53%	59%	65%	62%	50%	38%	26%	14%	2%
NUS Bonds	0%	1%	1%	1%	2%	4%	6%	8%	9%	11%
Real Estat	4%	5%	5%	6%	7%	8%	9%	11%	12%	13%
Alt Inv	0%	0%	0%	1%	1%	2%	3%	3%	4%	5%
T-Bills	31%	22%	13%	4%	0%	0%	0%	0%	0%	0%
Totals	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Median	7.00%	7.25%	7.50%	7.75%	8.00%	8.25%	8.50%	8.75%	9.00%	9.25%
Std Dev	4.73%	5.31%	5.90%	6.49%	7.10%	7.84%	8.69%	9.63%	10.63%	11.67%

Difference from 1996 Component	Asset Mix Alternatives									
	1	2	3	4	5	6	7	8	9	10
S&P	-6%	-7%	-7%	-7%	-7%	-6%	-4%	-3%	-3%	-1%
CAI Small	-1%	-1%	-1%	-2%	-1%	0%	-1%	0%	1%	1%
EA FE	0%	0%	0%	-1%	1%	1%	0%	0%	1%	1%
LB G/C Bd	9%	10%	12%	14%	7%	5%	3%	1%	-1%	-3%
SB WGN on US	-1%	0%	0%	0%	0%	0%	0%	0%	-1%	-2%
Real Estat	-1%	0%	-1%	-1%	0%	0%	1%	2%	3%	3%
Alt Inv	0%	-1%	-1%	0%	0%	0%	1%	0%	0%	1%
T-Bills	0%	-1%	-2%	-3%	0%	0%	0%	0%	0%	0%
Totals	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Median	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Std Dev	-0.52%	-0.53%	-0.54%	-0.55%	-0.53%	-0.42%	-0.26%	-0.05%	0.19%	0.45%

### Efficient Frontier with All Major Asset Classes, except Alternative Investments



## Efficient Frontier with All Major Asset Classes, except Alternative Investments

1997 Component	Asset Mix Alternatives									
	1	2	3	4	5	6	7	8	9	10
S&P	10%	11%	12%	14%	17%	21%	26%	31%	35%	40%
CAI Small	2%	2%	3%	3%	4%	7%	9%	11%	13%	15%
Intl Eq	6%	6%	7%	7%	9%	11%	14%	16%	19%	22%
LB G/C Bd	47%	53%	59%	65%	61%	49%	36%	23%	11%	0%
NUS Bonds	0%	1%	1%	1%	2%	4%	6%	8%	10%	10%
Real Estat	4%	5%	5%	6%	7%	8%	9%	11%	12%	13%
T-Bills	31%	22%	13%	4%	0%	0%	0%	0%	0%	0%
Totals	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Median	7.00%	7.25%	7.50%	7.75%	8.00%	8.25%	8.50%	8.75%	9.00%	9.25%
Std Dev	4.73%	5.31%	5.90%	6.48%	7.09%	7.83%	8.69%	9.62%	10.62%	11.67%

Difference from 1996 Component	Asset Mix Alternatives									
	1	2	3	4	5	6	7	8	9	10
S&P	-6%	-7%	-7%	-7%	-6%	-6%	-5%	-3%	-3%	-2%
CAI Small	-1%	-2%	-2%	-2%	-2%	-1%	0%	0%	0%	0%
EA FE	0%	0%	0%	-1%	1%	1%	1%	1%	2%	3%
LB G/C Bd	9%	10%	12%	14%	7%	6%	3%	1%	0%	-1%
SB WGN on US	-1%	0%	0%	0%	0%	0%	0%	-1%	-1%	-3%
Real Estat	-1%	0%	-1%	-1%	0%	0%	1%	2%	2%	3%
T-Bills	0%	-1%	-2%	-3%	0%	0%	0%	0%	0%	0%
Totals	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Median	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.01%	-0.01%	-0.01%	-0.01%
Std Dev	-0.52%	-0.53%	-0.55%	-0.56%	-0.54%	-0.44%	-0.28%	-0.07%	0.16%	0.42%

**Table 1****Rolling Periods 1926-1996****Average Rolling 5-Year Real Returns (Annualized)****Quarterly**

Returns	1st Period	# Rolling	S&P 500	LT Corp	75/25	50/50	25/75
Since	End Date	Periods					
1/1/26	12/31/30	265	6.79	2.31	6.03	5.03	3.79
1/1/56	12/31/60	145	5.98	2.40	5.28	4.45	3.48

**Rolling 5-Year Counts (At least 4% Real Return)****Quarterly**

Returns	1st Period	# Rolling	S&P 500	%	LT Corp	%	75/25	%	50/50	%	25/75	%
Since	End Date	Periods		Periods		Periods		Periods		Periods		Periods
1/1/26	12/31/30	265	171	65%	93	35%	163	62%	149	56%	123	46%
1/1/56	12/31/60	145	95	66%	52	36%	88	61%	75	52%	66	46%

**Table 2****Rolling 5-Year Counts (Negative or 0% Real Return)****Quarterly**

Returns	1st Period	# Rolling	S&P 500	%	LT Corp	%	75/25	%	50/50	%	25/75	%
Since	End Date	Periods		Periods		Periods		Periods		Periods		Periods
1/1/26	12/31/30	265	53	20%	122	46%	52	20%	55	21%	71	27%
1/1/56	12/31/60	145	31	21%	61	42%	37	26%	41	28%	47	32%

Note: 50/50 is a composite portfolio consisting of 50% S&P 500/50% LT Corp, rebalanced quarterly.  
 75/25 is a composite portfolio consisting of 75% S&P 500/25% LT Corp, rebalanced quarterly.  
 25/75 is a composite portfolio consisting of 25% S&P 500/75% LT Corp, rebalanced quarterly.

**Table 3**

**Rolling Periods 1973-1996**

**Average Rolling 5-Year Real Returns (Annualized)**

**Quarterly**

Returns Since	1st Period End Date	# Rolling Periods	S&P 500	LT Corp	EAFE	Gov/Corp	50/50	40/10/50	50/15/35
1/1/73	12/31/77	77	7.83	4.55	8.57	4.15	6.48	6.36	6.97

**Rolling 5-Year Counts**

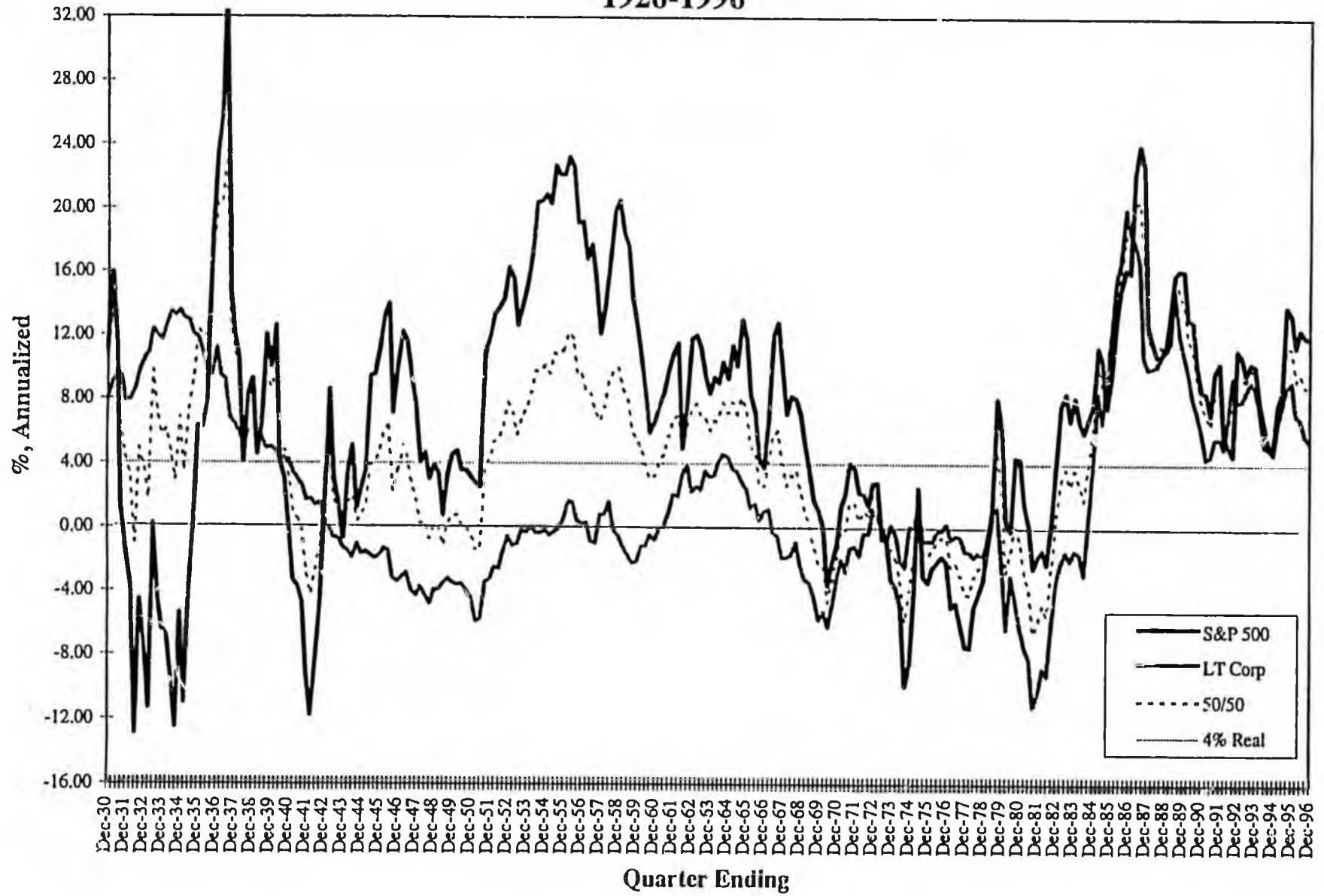
Real Return Hurdle	# Rolling Periods	S&P 500	%	LT Corp	%	EAFE	%	Gov/Corp	%	50/50	%	40/10/50	%	50/15/35	%
At least 4%	77	61	79%	49	64%	40	52%	47	61%	50	65%	52	68%	55	71%
At least 3%	77	61	79%	49	64%	45	58%	49	64%	53	69%	57	74%	58	75%
At least 0%	77	66	86%	52	68%	60	78%	57	74%	61	79%	62	81%	63	82%

Note: 50/50 is a composite portfolio consisting of 50% S&P 500/50% LT Corp, rebalanced quarterly.

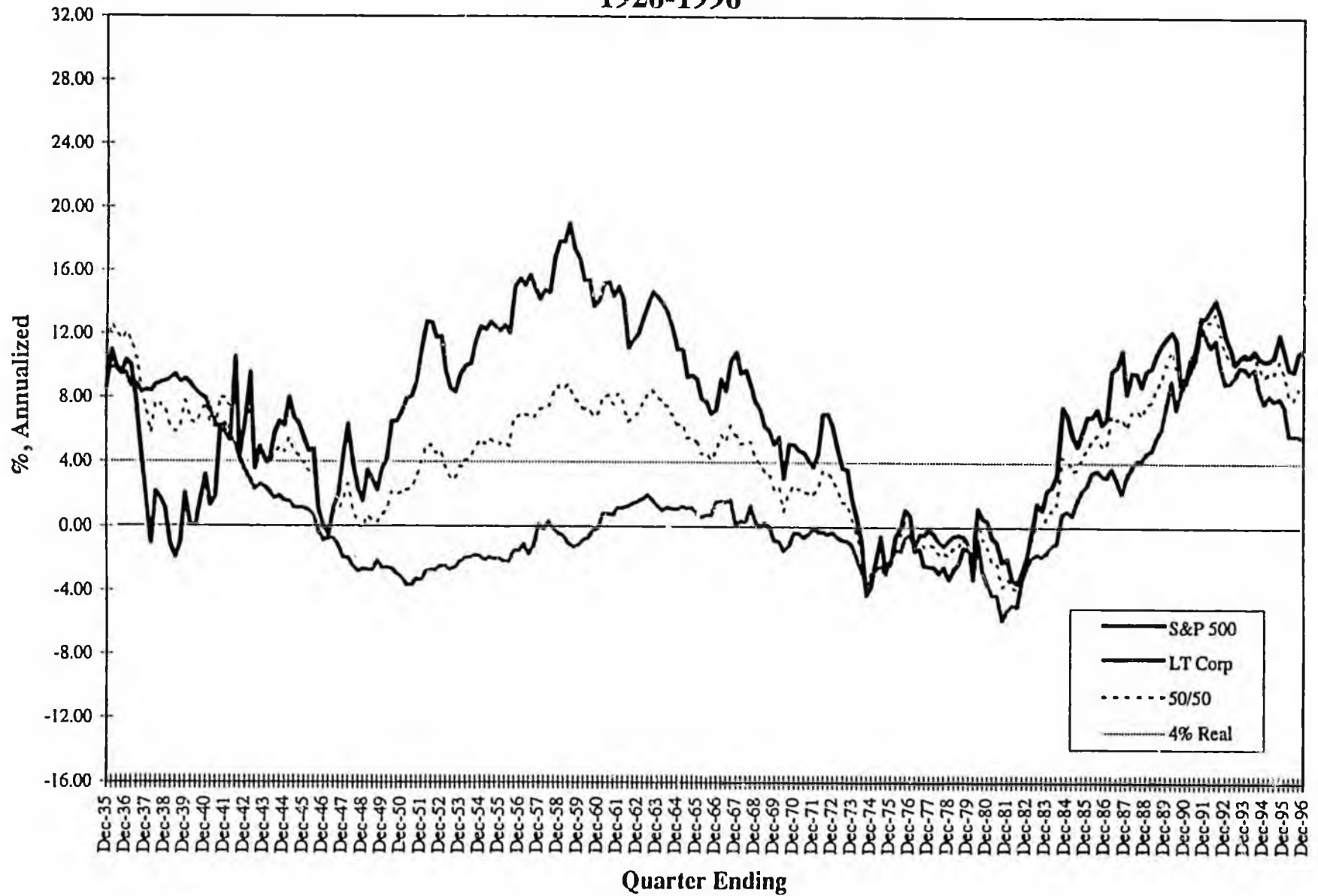
40/10/50 is a composite portfolio consisting of 40% S&P 500/10% EAFE/50% LB Gov/Corp Bonds, rebalanced quarterly.

50/15/35 is a composite portfolio consisting of 50% S&P 500/15% EAFE/35% LB Gov/Corp Bonds, rebalanced quarterly.

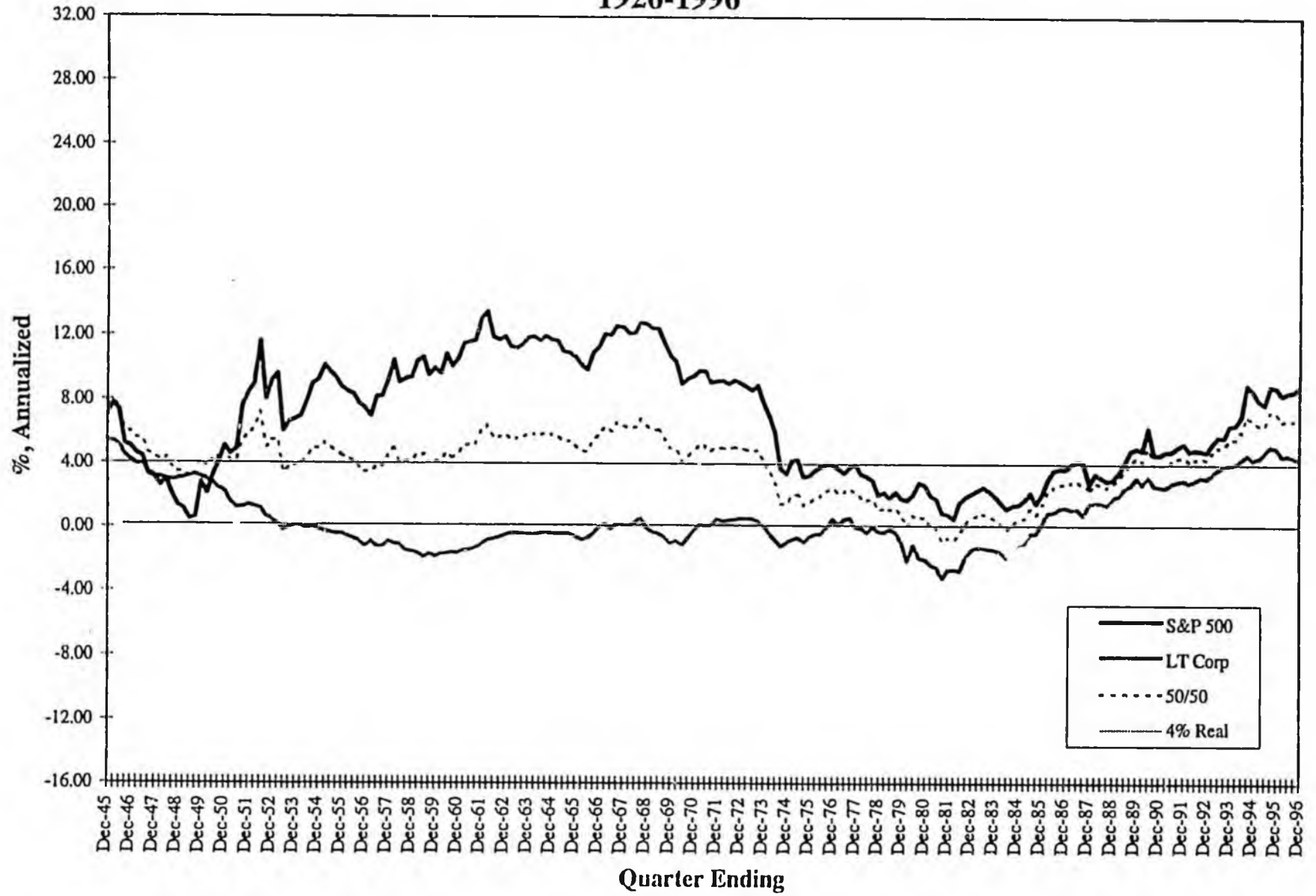
### Moving 5-Year Real Returns 1926-1996



### Moving 10-Year Real Returns 1926-1996



**Moving 20-Year Real Returns  
1926-1996**



**Table 11**

**Rolling Periods 1926-1996**

**Average Rolling 5-Year Nominal Returns (Annualized)**

**Quarterly**

<b>Returns</b>	<b>1st Period</b>	<b># Rolling</b>	<b>S&amp;P 500</b>	<b>LT Corp</b>	<b>75/25</b>	<b>50/50</b>	<b>25/75</b>
<b>Since</b>	<b>End Date</b>	<b>Periods</b>					
1/1/26	12/31/30	265	10.35	5.62	9.53	8.47	7.17
1/1/56	12/31/60	145	10.86	7.13	10.13	9.26	8.26

**Table 12**

**Rolling 5-Year Counts (Negative or 0% Nominal Return)**

**Quarterly**

<b>Returns</b>	<b>1st Period</b>	<b># Rolling</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
<b>Since</b>	<b>End Date</b>	<b>Periods</b>	<b>S&amp;P 500</b>	<b>LT Corp</b>	<b>75/25</b>	<b>50/50</b>	<b>25/75</b>	<b>S&amp;P 500</b>	<b>LT Corp</b>	<b>75/25</b>	<b>50/50</b>	<b>25/75</b>
1/1/26	12/31/30	265	28	11%	14	5%	24	9%	12	5%	3	1%
1/1/56	12/31/60	145	4	3%	11	8%	2	1%	1	1%	2	1%

Note: 50/50 is a composite portfolio consisting of 50% S&P 500/50% LT Corp, rebalanced quarterly.  
75/25 is a composite portfolio consisting of 75% S&P 500/25% LT Corp, rebalanced quarterly.  
25/75 is a composite portfolio consisting of 25% S&P 500/75% LT Corp, rebalanced quarterly.

**Table 13**

**Rolling Periods 1973-1996**

**Average Rolling 5-Year Nominal Returns (Annualized)**

**Quarterly**

Returns Since	1st Period End Date	# Rolling Periods	S&P 500	LT Corp	EAFE	Gov/Corp	50/50	40/10/50	50/15/35
1/1/73	12/31/77	77	13.78	10.28	14.55	9.90	12.33	12.23	12.87

**Rolling 5-Year Counts**

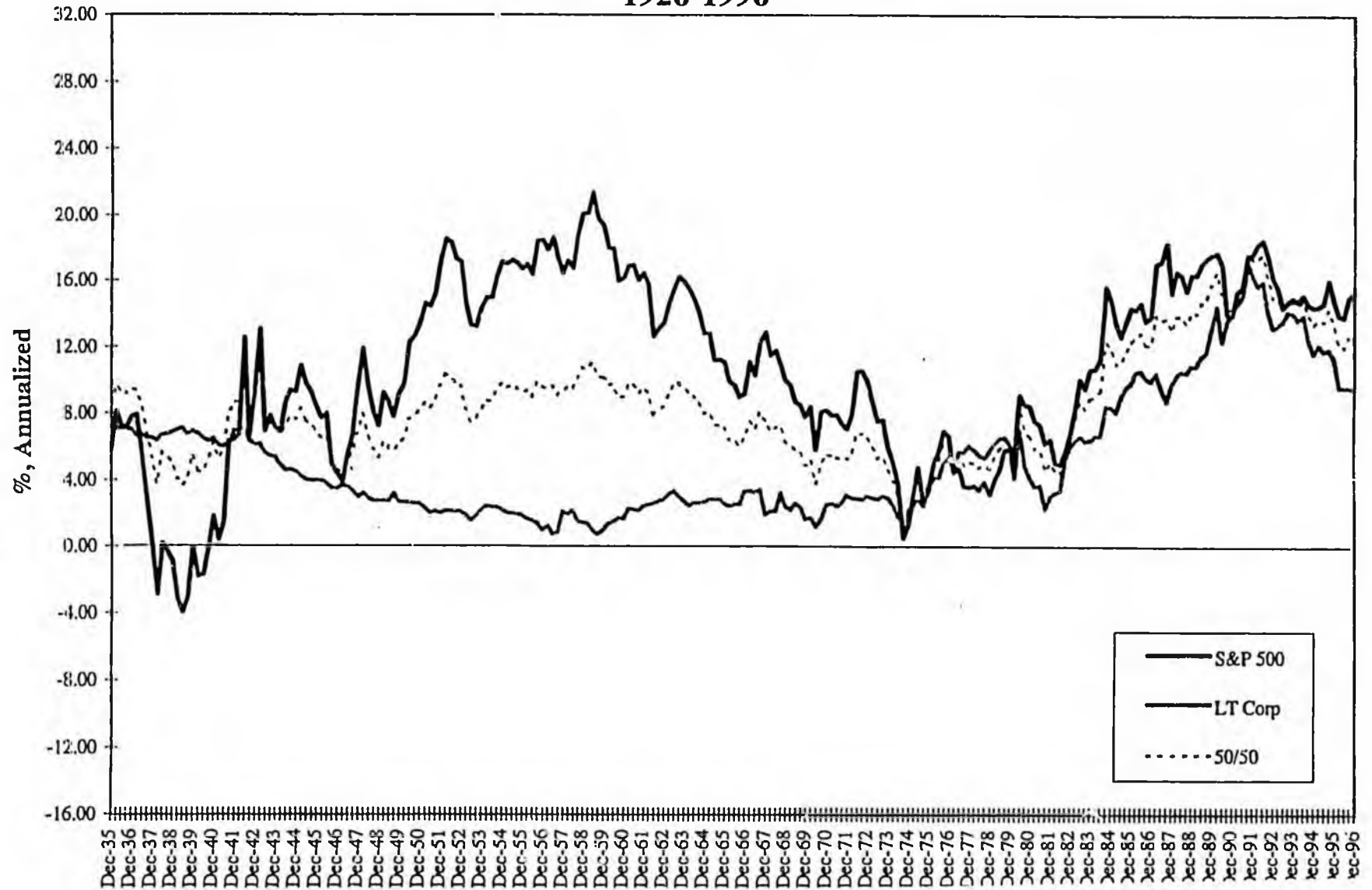
Return Hurdle	# Rolling Periods	S&P 500	% Periods	LT Corp	% Periods	EAFE	% Periods	Gov/Corp	% Periods	50/50	% Periods	40/10/50	% Periods	50/15/35	% Periods
At least 0%	77	75	97%	73	95%	76	99%	76	99%	77	100%	77	100%	77	100%

Note: 50/50 is a composite portfolio consisting of 50% S&P 500/50% LT Corp, rebalanced quarterly.

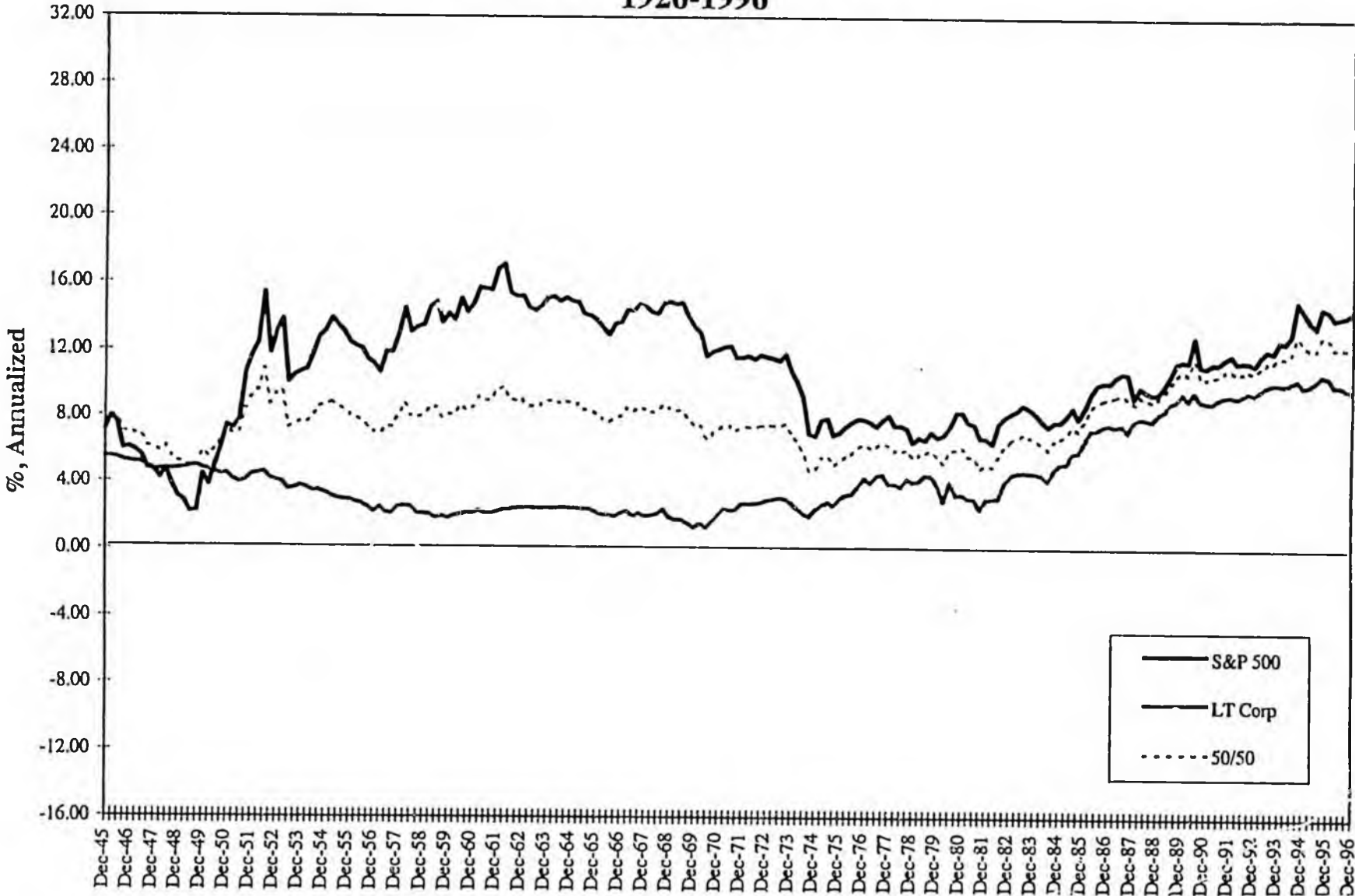
40/10/50 is a composite portfolio consisting of 40% S&P 500/10% EAFE/50% LB Gov/Corp Bonds, rebalanced quarterly.

50/15/35 is a composite portfolio consisting of 50% S&P 500/15% EAFE/35% LB Gov/Corp Bonds, rebalanced quarterly.

### Moving 10-Year Nominal Returns 1926-1996



### Moving 20-Year Nominal Returns 1926-1996



JIM HILL  
STATE TREASURER



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OREGON STATE TREASURY

Facsimile Cover Sheet

<b>To:</b>	<b>Jim Kelly</b>
<b>Company:</b>	<b>Alaska Permanent Fund</b>
<b>Phone:</b>	
<b>Fax:</b>	<b>907-586-2057</b>
<b>From:</b>	<b>W. Dan Smith</b>
<b>Company:</b>	<b>Oregon State Treasury</b>
<b>Phone:</b>	<b>503-378-4111</b>
<b>Fax:</b>	<b>503-378-6772</b>
<b>Date:</b>	<b>2/11/97</b>
<b>Pages including this cover page:</b>	

Comments:

**Alaska Permanent Fund  
Presentation to Legislature/Board  
February 12, 1997**

Description of Oregon PERS

a. Membership

1. retired: 67,000
2. active: 180,000

b. Funded status: Roughly 95-100%

Market Value: \$ 24 Billion

Cash Flow: Benefit payments modestly exceed the total  
of employee/employer contributions

c. Administration:

1. PERS Board: responsible for benefit side only
2. Oregon Investment Council: responsible for asset side only

d. Investment authority: Prudent Person Standard

## History of Asset Allocation

### a. Inclusion of stocks dates to the mid - 1960's

OPERF was one of the first public pension funds to make equity investments. Over the 30 year history of the equity program, results have been favorable, and this success has enabled the System to both reduce contributions and to enhance benefits. Cumulative results for the equity program, on a real dollar basis, have been roughly twice that of bonds. Total holdings of domestic and international stocks is currently 60%.

### b. Alternatives (LBO's, etc.) dates to mid-1980's

Over the past 15 years, OPERF has been an active participant in Alternative equity vehicles. This program has yielded an inception-to-date internal rate of return in excess of 20%. As conventional markets have become more "efficient", the System has made more active use of this asset category. Currently, about 11% of total assets are invested (actual funded amount) are invested within this category.

## Discuss current asset allocation

### a. Comparisons to other funds

Historically, Oregon has had an equity allocation far in excess of most public pension funds. Currently, this allocation is only modestly higher than the 'norm'.

b. Asset allocation process

The Investment Council, in conjunction with their consultants, have established policy ranges for each asset category/sub-category.

c. Re-balancing process

As sector allocations move above or below established policy ranges, assets are re-balanced to the mid-point of the policy ranges. In a sense this can be viewed as selling high, and buying low.

Discuss investment results

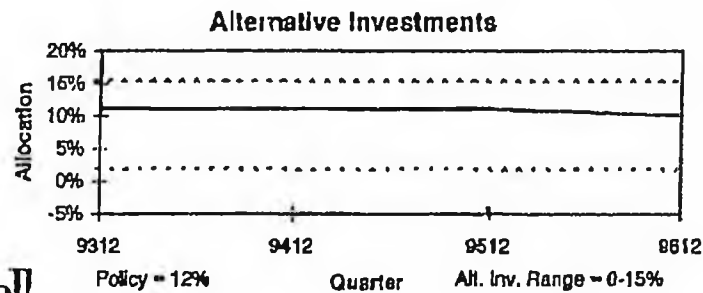
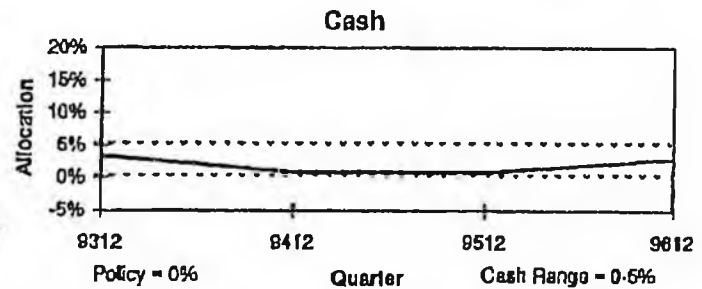
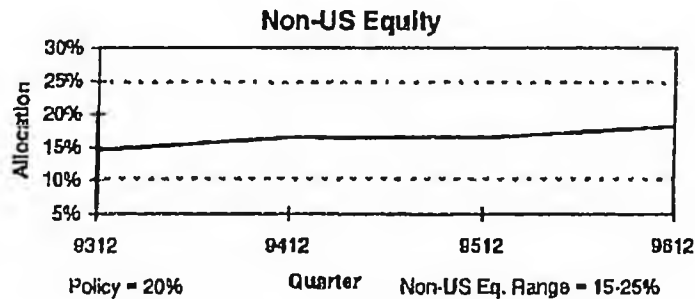
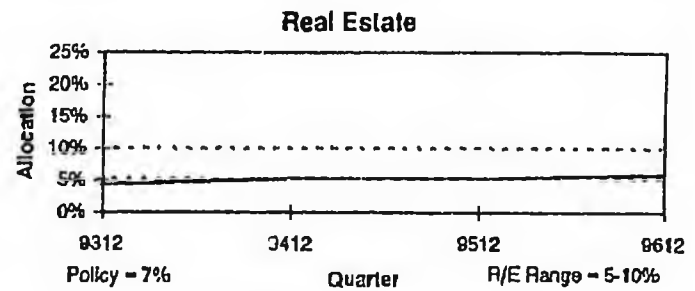
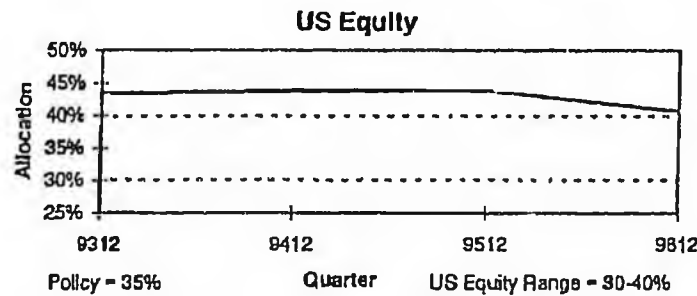
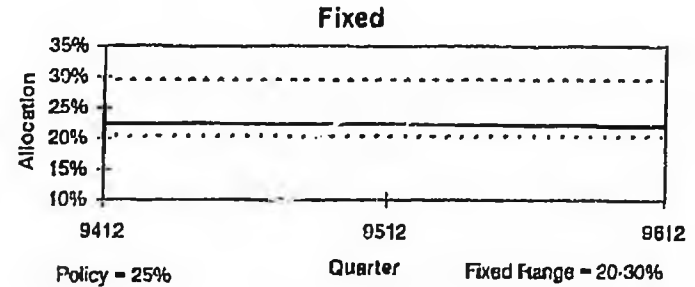
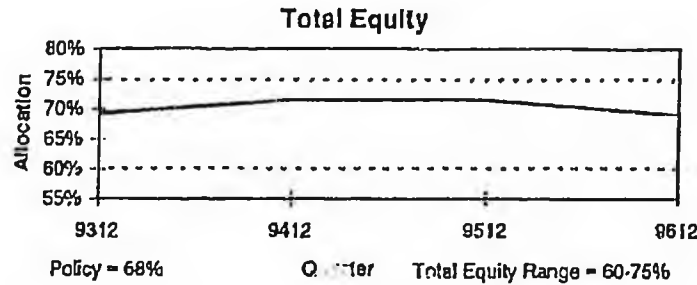
- a. Absolute
- b. Relative

Summary

Total fund performance has been favorable relative to the Council's established investment policy. Further, total fund results compare very favorably with both public and private plan universes. These favorable comparisons are substantially due to the high equity and alternative allocations.

The long time horizon of the PERS allows us to capture the higher returns that equities have historically provided.

# State of Oregon Historical Asset Allocation, Current Policy and Ranges



----- Policy Range  
————— Actual Allocation

	<u>Policy Ranges</u>	<u>Estimate (\$ Million)</u>	<u>12/31/96 %</u>	<u>Proposed Changes</u>	<u>New Allocation</u>	
<b>Equity Total</b>	60-75%	16,360	68.97%	-330	16,030	67.58%
Domestic	30-40%	9,640	40.64%	-1,180	8,460	35.67%
International	15-25%	4,320	18.21%	430	4,750	20.03%
Alternative	0-15%	2,400	10.12%	420	2,820	11.89%
<b>Fixed Income</b>	20-30%	5,230	22.05%	700	5,930	25.00%
<b>Real Estate</b>	5-10%	1,430	6.03%	230	1,660	7.00%
<b>Cash</b>	0- 5%	700	2.95%	-600	100	0.42%
<b>Total Fund:</b>		23,720	100.00%	0	23,720	100.00%

Sheet1

OPERS Performance Comparisons

Periods ending 9-30-96

Source: Wilshire Associates

	<u>Quarter</u>	<u>1 Year</u>	<u>3 Years</u>	<u>Since 12-31-92 (1)</u>
<b>OPERS Total Fund:</b>	2.2%	14.7%	12.2%	12.6%
Policy Return (2):	2.1%	12.9%	11.4%	12.2%
Universe Percentiles:				
Public Funds	91st.	14th.	25th.	---
All Funds	65th.	22nd.	19th.	---
<b>Domestic Equity:</b>	2.6%	19.3%	15.8%	15.9%
Russell 3000 Index	2.9%	19.0%	16.4%	15.9%
<b>International Equity:</b>	-0.6%	9.1%	8.2%	17.0%
EAFE Index	-0.1%	8.6%	8.1%	15.7%
<b>Domestic Bonds:</b>	2.5%	6.3%	5.7%	10.8%
Lehman Aggregate Index	1.8%	4.9%	5.0%	9.0%
<b>Real Estate: (3)</b>	2.8%	12.2%	8.3%	6.7%
Russell NACREIF	2.5%	9.6%	7.2%	na
<b>Alternatives: (3)</b>	4.5%	27.9%	20.9%	15.9%
S&P 500 + 5.0%	4.3%	25.3%	22.4%	na
<b>Short-Term</b>	1.4%	5.7%	5.0%	4.8%
T-Bills	1.4%	5.6%	5.1%	na

(1) Wilshire began calculating 'Total Fund' returns on 12-31-92.

(2) Policy Return = policy weight of each segment multiplied by the index return of each segment.

(3) Real Estate &amp; Alternative returns are lagged by one quarter.

**OPERF: Comparative Performance**

**Periods Ending 9-30-98**

	(1)	(2)	(3)	(3)
	<u>OPERF</u>	<u>OPERF Policy Portfolio</u>	<u>Wilshire Median Public</u>	<u>Wilshire Median All Funds</u>
1 Year % Rank	14.69	12.80	13.72 14 th.	12.51 22 nd.
2 Years % Rank	15.73	15.88	16.53 64 th.	15.95 54 th.
3 Years % Rank	12.20	11.40	11.37 25 th.	10.93 19 th.
Inception (4)	12.60	12.20	NA	NA

- (1) As calculated and reported by Wilshire Associates.
- (2) Policy Return = policy weight of each segment multiplied by the index return of each segment.
- (3) Fund Universes supplied by Wilshire Associates. "All Funds" includes both public and private plans.
- (4) Inception date is 12-31-92. Prior to that time, Wilshire had not calculated a Total Fund return.

Calendar Years:

Wilshire Universe Comparisons - Public Funds

		<u>OPERS</u>	<u>High</u>		<u>1st. Qrtl.</u>		<u>Median</u>		<u>3rd. Qrtl.</u>		<u>Low</u>
1987	(1)	9.00	9.98	X	4.94		2.57		1.96		0.20
1988		16.86	17.47	X	11.96		11.18		9.91		7.60
1989		19.75	23.41		19.78	X	18.10		16.17		14.63
1990		-1.54	8.90		4.98		2.94		1.50	X	-1.89
1991		22.45	29.51		23.13	X	20.61		18.44		14.90
1992		8.85	10.26		8.34		7.53	X	6.23		4.81
1993	(2)	14.86	17.52	X	13.11		10.93		8.43		6.56
1994		-0.14	1.21		0.17	X	-0.77		-2.21		-3.65
1995		24.04	28.63		26.54		24.34	X	21.93		18.65
1996	(3)	14.40	15.52	X	14.30		12.78		10.84		8.47

- (X) Indicates OPERS position within the Universe.
- (1) Years 1987 through 1992 are from PERS annual report.
- (2) 1993 through 1996 are from Wilshire Associates.
- (3) OPERS 1996 figure is estimated.

Calendar Years:

Wilshire Universe Comparisons - All Funds

		<u>OPERS</u>	<u>High</u>		<u>1st. Qrtl.</u>		<u>Median</u>	<u>3rd. Qrtl.</u>		<u>Low</u>
1987	(1)	9.00	9.80	X	5.48		3.93	2.21		-1.03
1988		16.86	17.47	X	13.44		11.62	9.80		7.07
1989		19.75	25.44		21.19	X	18.10	15.05		11.35
1990		-1.54	8.88		4.98		2.35	-0.16	X	-5.29
1991		22.45	30.67		23.82	X	21.06	18.12		12.53
1992		6.95	11.48		8.66		7.50	6.24	X	3.93
1993	(2)	14.86	18.07	X	13.31		10.79	8.90		5.31
1994		-0.14	2.19		0.32	X	-0.98	-2.14		-4.23
1995		24.04	30.47		27.00	X	23.98	20.77		14.31
1996	(3)	14.40	19.11		15.42	X	13.28	11.30		5.14

- (X) Indicates OPERS position within the Universe.
- (1) Years 1987 through 1992 are from PERS annual report.
- (2) 1993 through 1996 are from Wilshire Associates.
- (3) OPERS is estimated.

Annual Returns Dec 31, 1966 to Dec 31, 1996

<u>Period End</u>	<u>Real Bond Return</u>	<u>Real S&amp;P 500 Return</u>
Dec-67	-7.79	20.35
Dec-68	-2.06	6.09
Dec-69	-13.44	-13.81
Dec-70	12.26	-1.42
Dec-71	7.42	10.63
Dec-72	3.64	14.94
Dec-73	-5.96	-21.80
Dec-74	-10.94	-34.80
Dec-75	5.01	28.40
Dec-76	10.25	18.36
Dec-77	-3.48	-13.17
Dec-78	-7.07	-2.46
Dec-79	-10.13	4.66
Dec-80	-8.82	17.68
Dec-81	-2.53	-12.83
Dec-82	27.76	16.52
Dec-83	4.41	17.97
Dec-84	10.80	2.06
Dec-85	17.69	27.28
Dec-86	13.99	17.20
Dec-87	-1.63	0.80
Dec-88	3.34	11.94
Dec-89	9.49	25.79
Dec-90	2.64	-8.95
Dec-91	12.58	26.69
Dec-92	4.40	4.66
Dec-93	6.83	6.85
Dec-94	-5.46	-1.35
Dec-95	15.58	34.12
Dec-96	0.27	19.18

20-Month Rolling Returns Dec 31, 1966 to Dec 31, 1996

<u>Period End</u>	<u>Real Bond Return</u>	<u>Real S&amp;P 500 Return</u>
Jan-67	1.78	8.57
Dec-67	0.16	10.88
Dec-68	0.35	7.77
Dec-69	-0.84	5.14
Dec-70	-0.41	5.10
Dec-71	-0.10	3.74
Dec-72	-0.38	6.29
Dec-73	-1.04	1.77
Dec-74	-2.52	-3.86
Dec-75	-1.81	-2.39
Dec-76	-0.54	0.67
Dec-77	-0.08	-2.57
Dec-78	-0.60	-3.38
Dec-79	-0.23	-1.49
Dec-80	-2.28	0.27
Dec-81	-3.23	-2.09
Dec-82	-1.18	-1.95
Dec-83	-0.15	2.16
Dec-84	2.06	6.84
Dec-85	3.23	6.75
Dec-86	3.57	8.65
Dec-87	3.77	8.25
Dec-88	4.88	9.75
Dec-89	6.97	11.79
Dec-90	8.24	8.95
Dec-91	9.81	13.10
Dec-92	7.62	11.90
Dec-93	7.86	10.79
Dec-94	6.17	10.42
Dec-95	5.97	11.00
Dec-96	4.62	11.18

Cumulative Returns Dec 31, 1966 to Dec 31, 1996

<u>Period End</u>	<u>Real Bond Return</u>	<u>Real S&amp;P 500 Return</u>
Dec-66	1.00	1.00
Dec-67	0.92	1.20
Dec-68	0.90	1.28
Dec-69	0.78	1.10
Dec-70	0.88	1.08
Dec-71	0.94	1.20
Dec-72	0.98	1.38
Dec-73	0.92	1.08
Dec-74	0.82	0.70
Dec-75	0.86	0.90
Dec-76	0.95	1.07
Dec-77	0.91	0.93
Dec-78	0.85	0.91
Dec-79	0.76	0.95
Dec-80	0.70	1.11
Dec-81	0.68	0.97
Dec-82	0.87	1.13
Dec-83	0.91	1.34
Dec-84	1.00	1.36
Dec-85	1.18	1.74
Dec-86	1.35	2.03
Dec-87	1.32	2.05
Dec-88	1.37	2.29
Dec-89	1.50	2.89
Dec-90	1.54	2.63
Dec-91	1.73	3.33
Dec-92	1.81	3.48
Dec-93	1.93	3.72
Dec-94	1.83	3.67
Dec-95	2.11	4.93
Dec-96	2.12	5.87

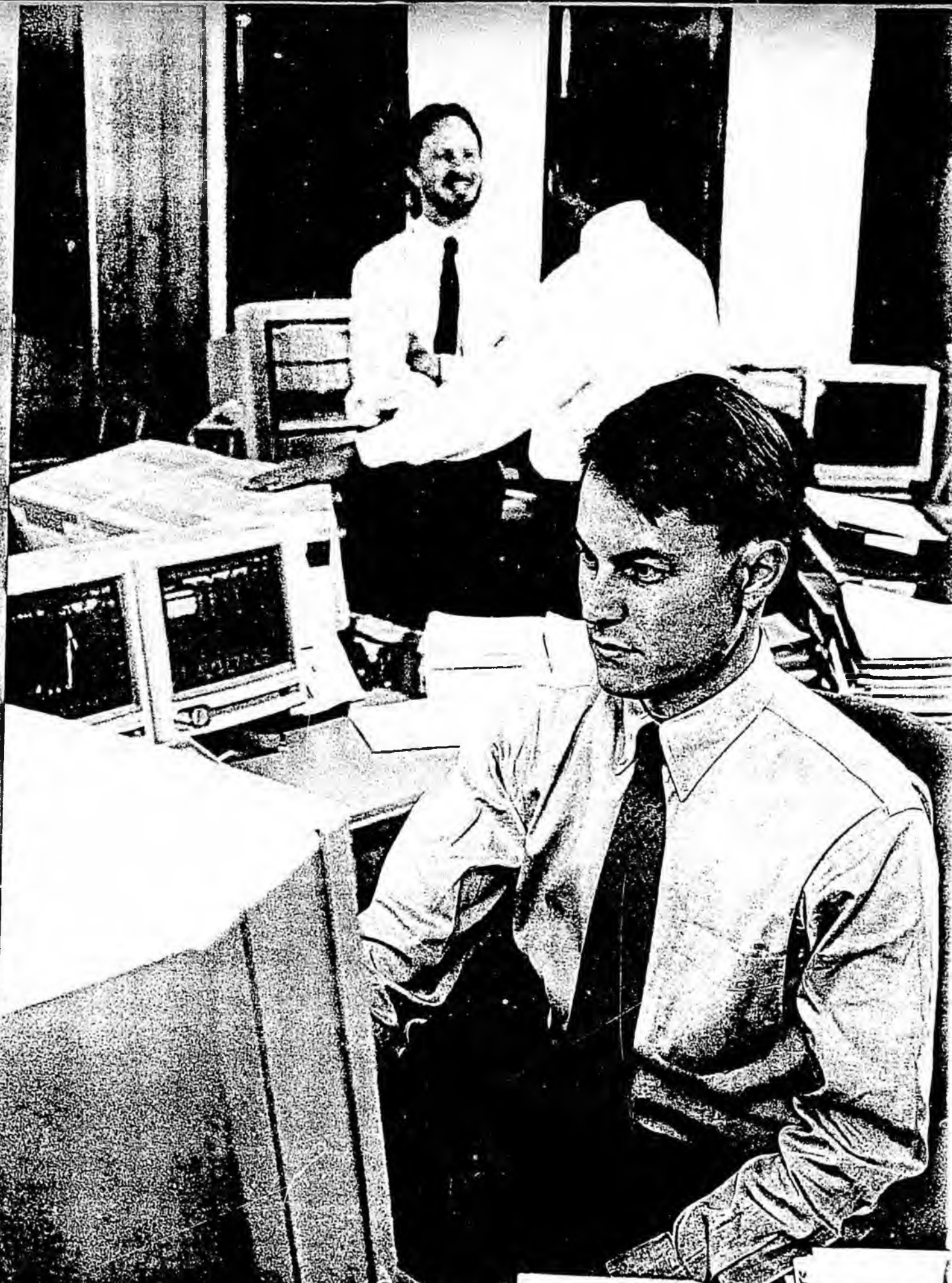
Risk/Return Dec 31, 1966 to Dec 31, 1996

<u>Assets</u>	<u>Risk</u>	<u>Total Return</u>
REAL BOND RETURN	7.18	2.53
REAL S&P5 RETURN	15.22	6.08

02/11/97 15:52 503 378 8772 OREGON TREASURY 019/019

**THE FOLLOWING DOCUMENT  
HAS NOT BEEN FILMED  
BUT IS AVAILABLE IN THE  
ORIGINAL FILE**

ALASKA PERMANENT FUND CORPORATION



1996 ANNUAL REPORT