

**SB**

**118**

Revision Date: \_\_\_\_\_ Dept. Affected: Revenue  
 Title: Alaska Permanent Fund Corp. Investments BRU: Alaska Permanent Fund Corporation  
 Component: Alaska Permanent Fund Corporation  
 Sponsor: Senate Rules Committee  
 Requestor: Legislative Budget & Audit Committee COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	<b>4,265.0</b>	<b>4,986.0</b>	<b>6,118.0</b>	<b>7,278.0</b>	<b>8,508.0</b>	<b>9,863.0</b>
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other-Corporate Receipts	4,265.0	4,986.0	6,118.0	7,278.0	8,508.0	9,863.0
<b>TOTAL</b>	<b>4,265.0</b>	<b>4,986.0</b>	<b>6,118.0</b>	<b>7,278.0</b>	<b>8,508.0</b>	<b>9,863.0</b>

Estimate of any current year (FY97) cost \$ 586.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

SB118 as proposed amends AS 37.13.120(f) which established the Alaska Permanent Fund Corporation's legal investment classes and their respective level of authorization. SB118 increases the percentage level of domestic and nondomestic corporate stocks to 60% of the total investments of the fund.

The projected costs above are calculated based on a 60% exposure to domestic and nondomestic stocks with 35% invested in passive manager accounts and the remaining in active portfolios.

Prepared by: Peter A. Bushro *Peter A. Bushro* Phone: 465-3172  
 Division: Alaska Permanent Fund Corporation Date: March 18, 1997  
 Approved by Commissioner: Wilson L. Condon Date: March 18, 1997  
 Agency: Revenue

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# Alaska Permanent Fund Corporation



SB 118 Presentation to the  
Senate State Affairs Committee

April 22, 1997



# Items to Present

- ◆ Arguments in favor of SB 118.
- ◆ Equities outperform
- ◆ Comparison with other large institutional funds
- ◆ Implications of increased equity authority
- ◆ Comments on current market environment
- ◆ Volatility in fiscal 1997
- ◆ Proposed 1997 Permanent Fund asset allocation
- ◆ Fiscal Note



# Arguments in Favor of SB 118

- ◆ Equities significantly outperform other asset classes over the long term.
- ◆ The Fund would produce more net income for use by both current and future generations.
- ◆ The Fund's principal would be better protected against inflation.
- ◆ The Fund's asset allocation would become more comparable to that of other large institutional funds.
- ◆ The increased volatility would be largely mitigated by the existing provision for 5-year averaging of income available for distribution.



# Equities Outperform

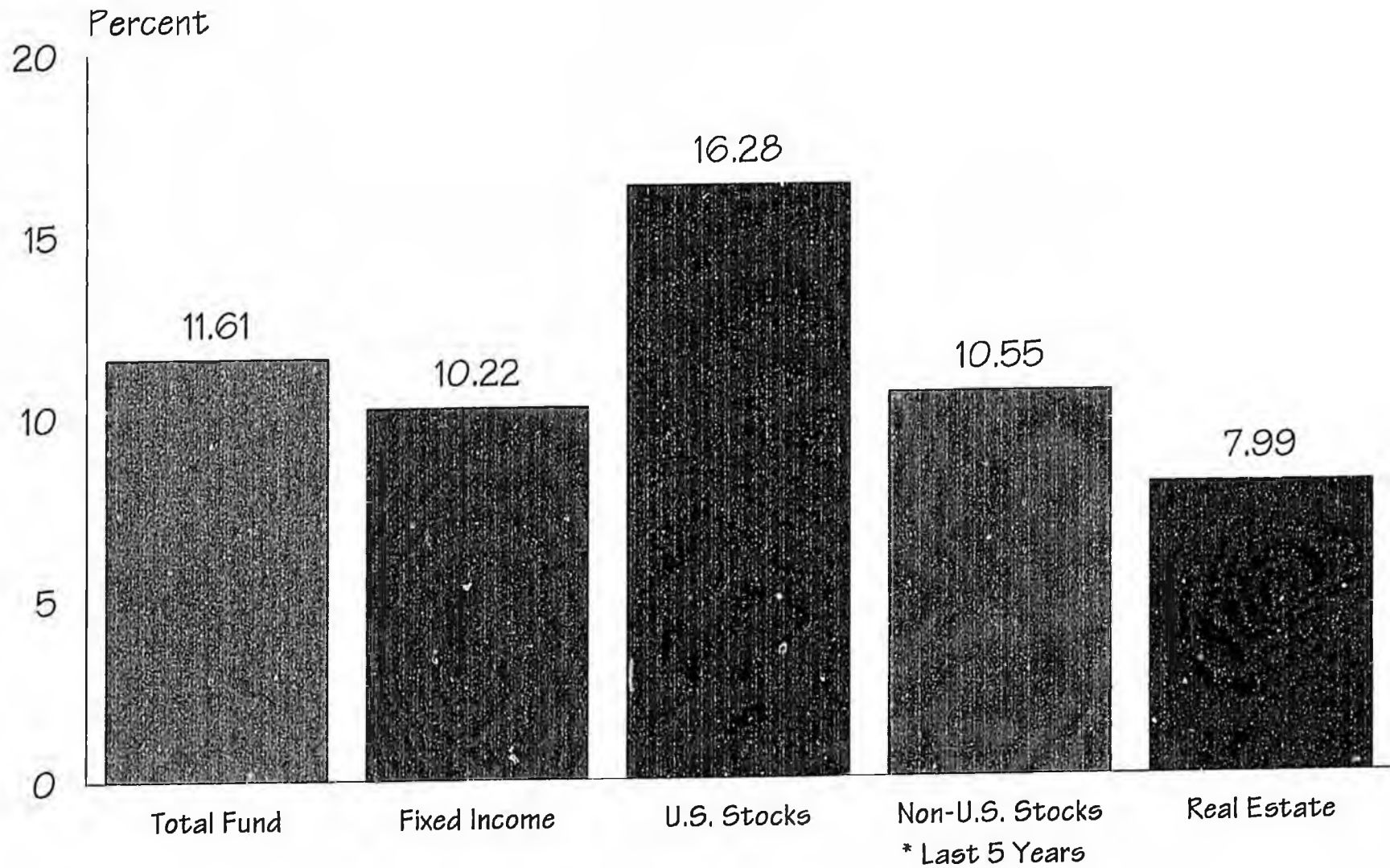
Consider the growth of \$1.00 invested in various U.S. asset classes from Dec. 31, 1925 to Dec. 31, 1995:

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



# Long-Term Total Returns

13 Years Ending December 31, 1996





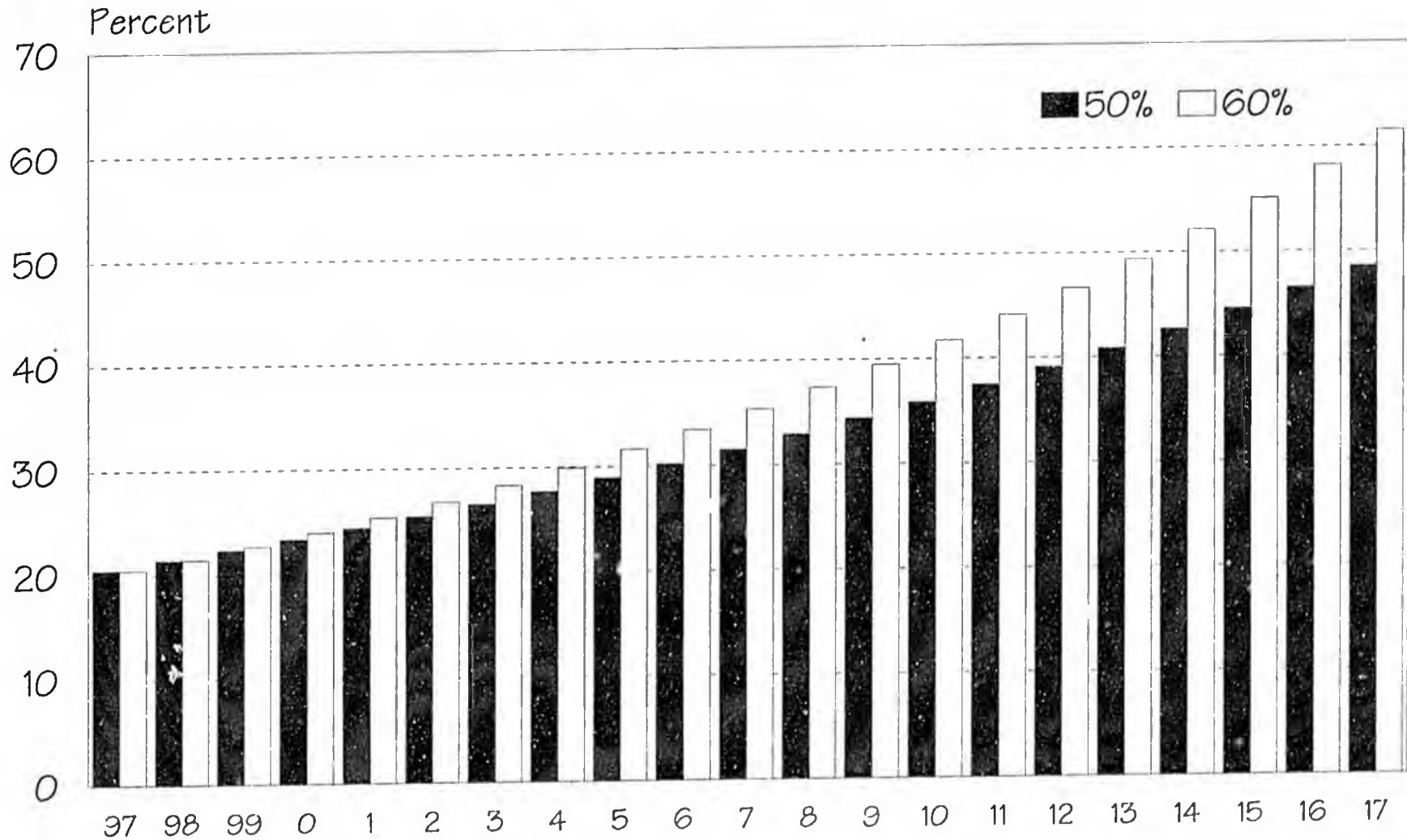
# Other Large Institutional Funds Invest More in Stocks

According to *Pensions and Investments Age*, these are the average allocations to equities of the top 200 largest U.S. defined benefit pension funds as of September 30, 1996:

◆ Corporate	63%
◆ Public	54%
<hr/>	
◆ Alaska PERS	54%
◆ Alaska Permanent Fund	49%



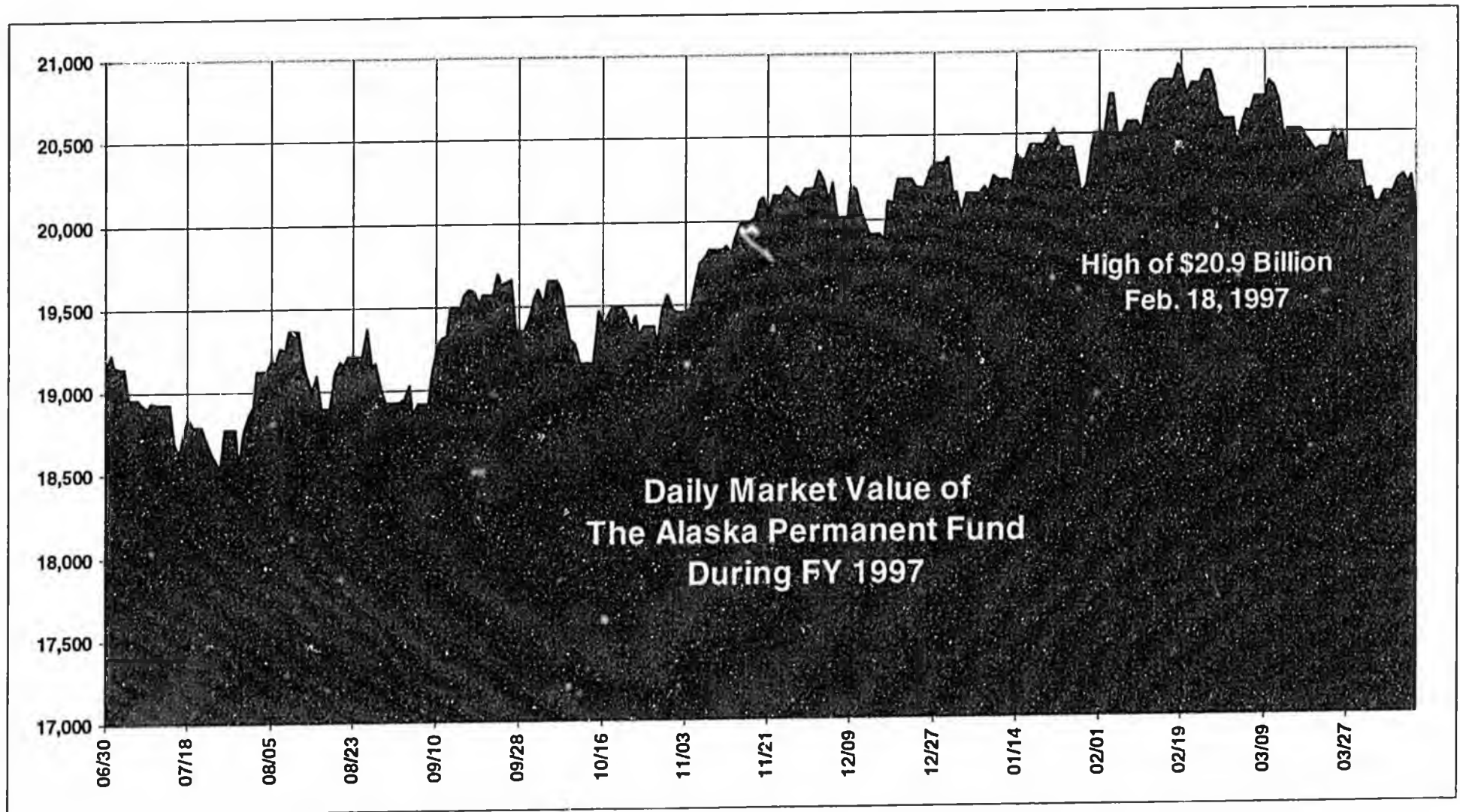
# Growth of the Permanent Fund Equities at 50% vs 60%



Assumptions: Fund with 50% equities earns 8.4%, Fund with 60% equities earns 8.7%  
Growth is net of a 4% annual income distribution



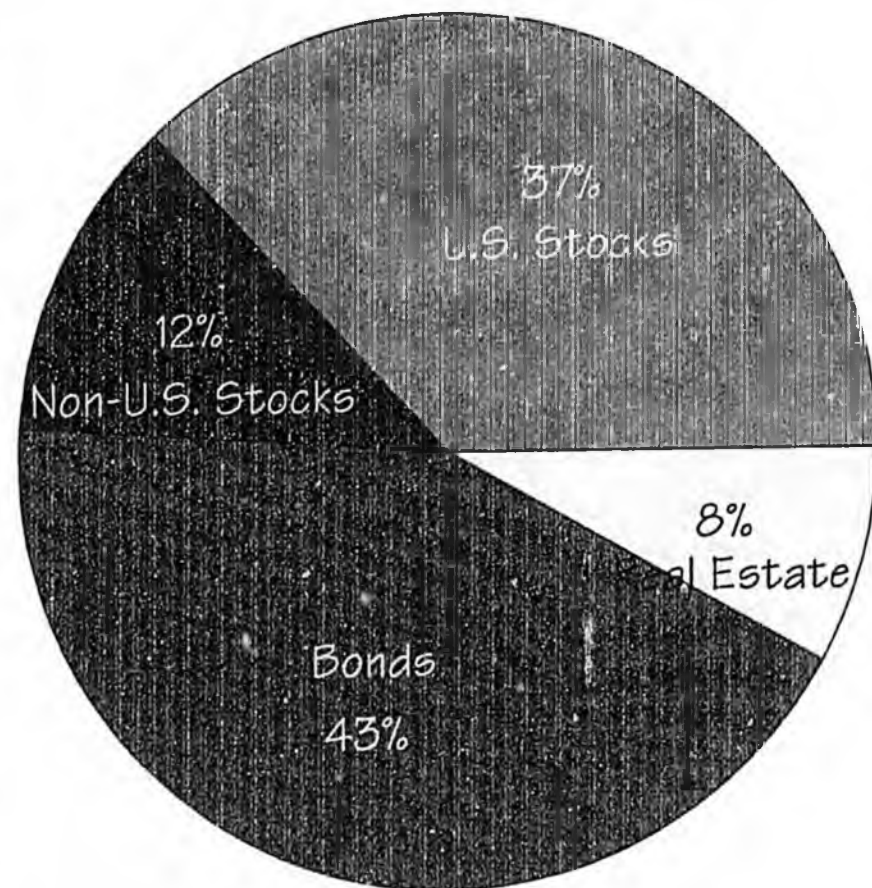
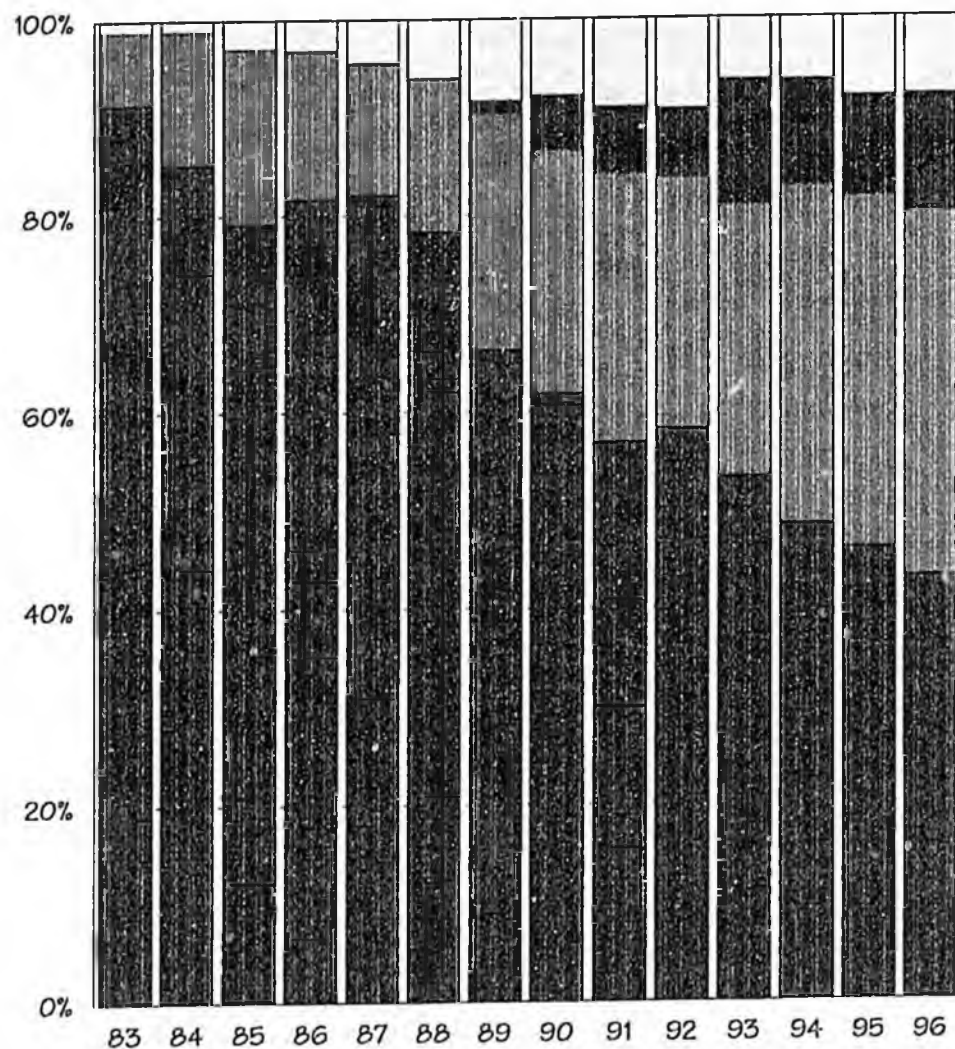
# Volatility in Fiscal 1997



# Permanent Fund Asset Allocation

Since 1983

Current



## IMPLICATIONS OF INCREASED EQUITY AUTHORITY

Each year, Callan prepares an asset allocation analysis for the Alaska Permanent Fund Corporation. The purpose of the analysis is to provide the Board with an objective comparison for a range of asset allocation policy options.

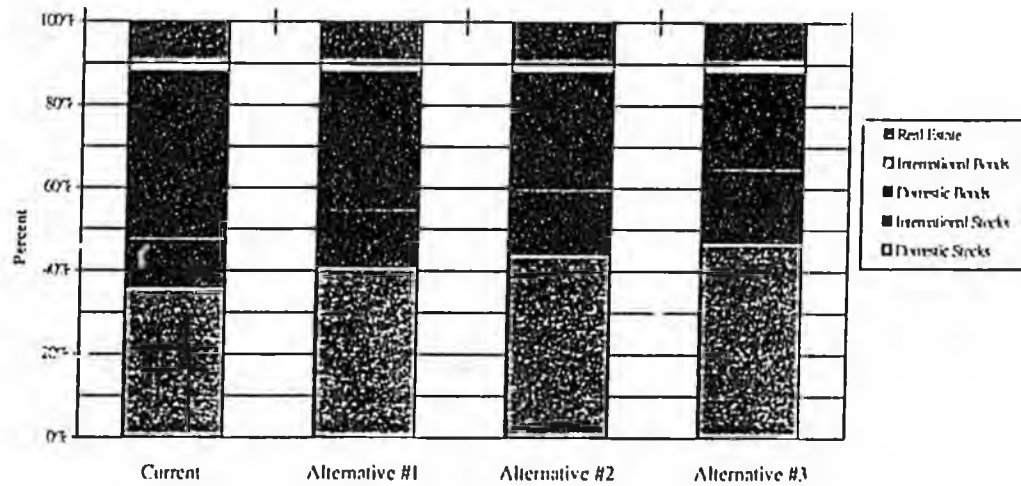
While the analysis is conducted annually, the capital market projections employed are long-term estimates that change only modestly from one year to another. In recent years, the Corporation's commitment to equities has been increased substantially. In 1996, the Legislature further liberalized statutory investment authority. At present, APFC is essentially at the upper limit of the allowable range.

Callan has been asked to provide information regarding the possible policy consequences of further equity authority. We have prepared a comparison of APFC's current policy with three alternative policies. Each of the alternatives is expected to produce a higher, but more volatile, return pattern than the current policy. The analysis should help policy makers better understand the return and risk tradeoffs associated with further, albeit still very reasonable, statutory liberalization.

The current and alternative policies are outlined below:

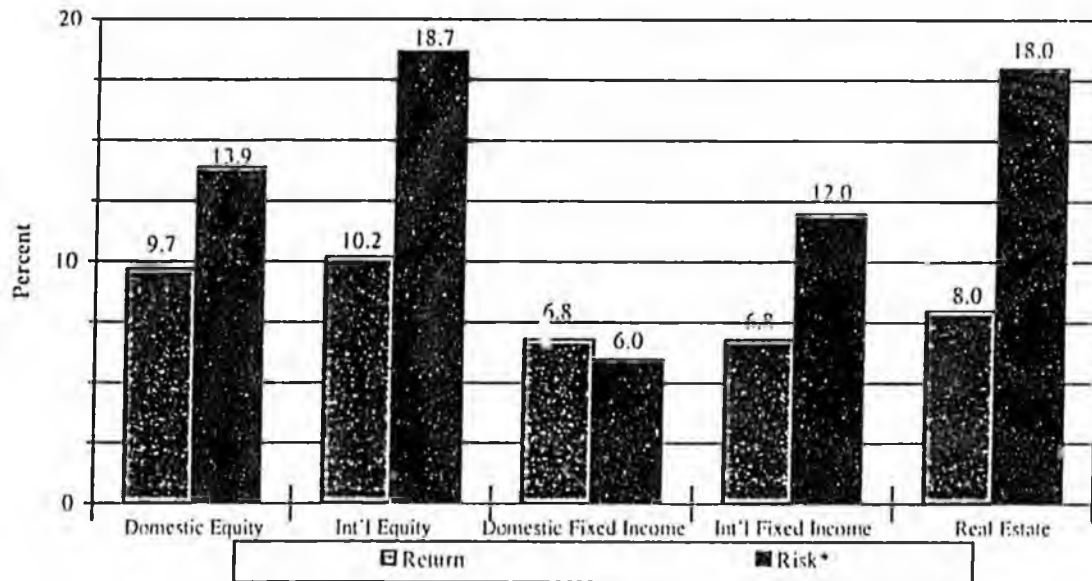
- Current Policy - total equity commitment of 48% including a 12% international exposure. Total bond target of 42% including a 2% international bond exposure. A 10% real estate target exposure.
- Alternative 1 - same as the current except total equity is raised to 55% including a 14% international exposure. Total bond exposure is reduced to 35%.
- Alternative 2 - total equity exposure is 60% including 16% in international equities. Total bond exposure is reduced to 30%.
- Alternative 3 - total equity exposure is 65% including an 18% international commitment. Bonds are 25%.

The alternatives are depicted graphically below.



	Current	Alter #1	Alter #2	Alter #3
Domestic Stocks	36%	41%	44%	47%
International Stocks	13%	14%	16%	18%
Domestic Bonds	40%	33%	28%	23%
International Bonds	2%	2%	2%	2%
Real Estate	10%	10%	10%	10%

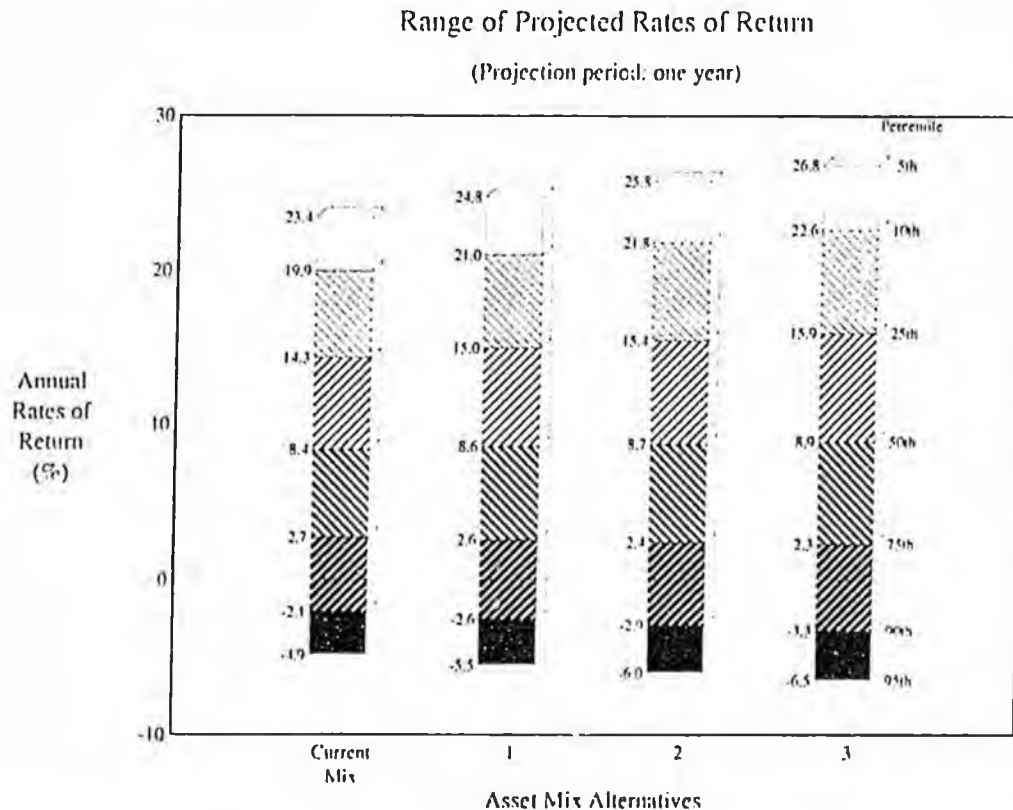
The return and risk estimates used to drive the analysis are Callan's 1996 5-year capital market projections. These are the same projections used earlier in 1996 in the development of the current policy.



\* Risk is defined as standard deviation of annual returns. This is a statistical measure designed to capture two-thirds of the possible returns. For example, the bond return projection (+6.8%) combined with the bond standard deviation estimate of 6.0% would suggest that in two of three annual periods, bond returns would be within one standard deviation from the expected return -- no less than 0.8% nor more than 12.8%. The greater the standard deviation, the greater the range of potential returns.

Since stocks, bonds and real estate do not always move together, the risk (standard deviation) for a mixed asset portfolio will be less than the weighted average risk of the components. In order to estimate this "diversification" benefit, one needs to estimate the statistical inter-relationship of each asset category with one another. Callan's estimates (correlation coefficients) are presented in the Appendix. As with our return and risk estimates, the correlation estimates are based primarily on historic experience.

Using these capital market projections and the alternative policies described earlier, we developed a range of projected returns for a number of different time periods. The results are presented graphically below.



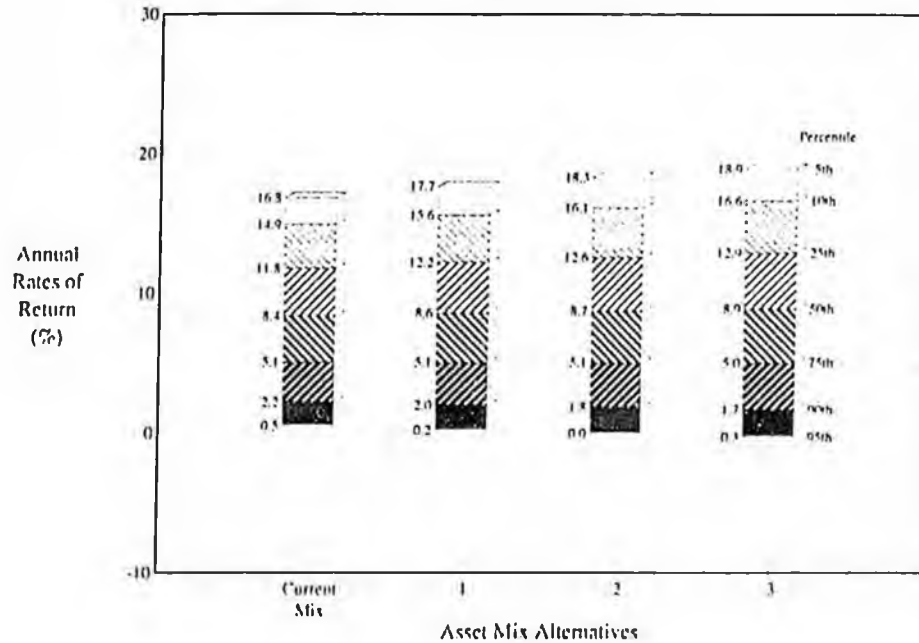
This graph illustrates that APFC's current policy has a median expected return of 8.4%. Based on the inputs, there is a 5 in 100 chance that the return may be greater than 23.4% in a one year period and a similar probability that the total return could be worse than negative 4.9%. As one mix is compared with another, it is useful to focus on the change in expected return (at the median, or 50th percentile) and the change in the "downside risk" -- the expected return at the 95th percentile.

Each alternative, owing to progressively greater equity exposure, produces a higher median expected return but also widens the range of possible returns. For example, Alternative #3, with a total 65% equity commitment, is expected to produce a 0.5% greater median return (8.9% vs. 8.4%) but also has a downside risk that is lower by 1.6% (the 95th percentile return of negative 6.5% compared to the negative 4.9% associated with the current policy).

Over time, the range of possible returns for all mixes narrows. This is intuitively reasonable. The odds of having two or three very good or very bad years in a row are less than those of having a single good or bad year. This can be readily seen by examining the range of compound annual returns for 3 and 5 year periods.

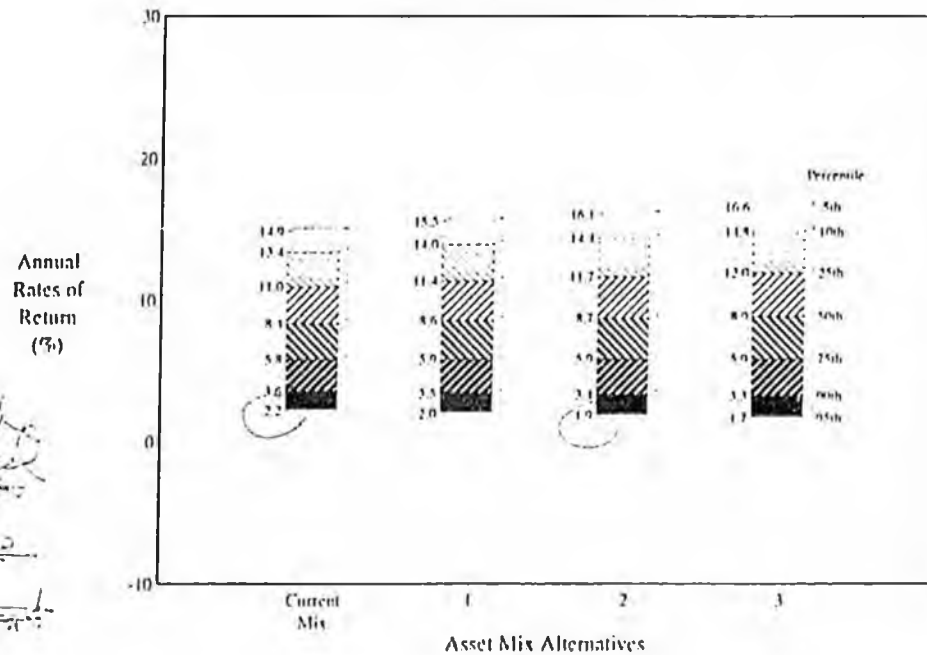
### Range of Projected Rates of Return

(Projection period: 3 years)



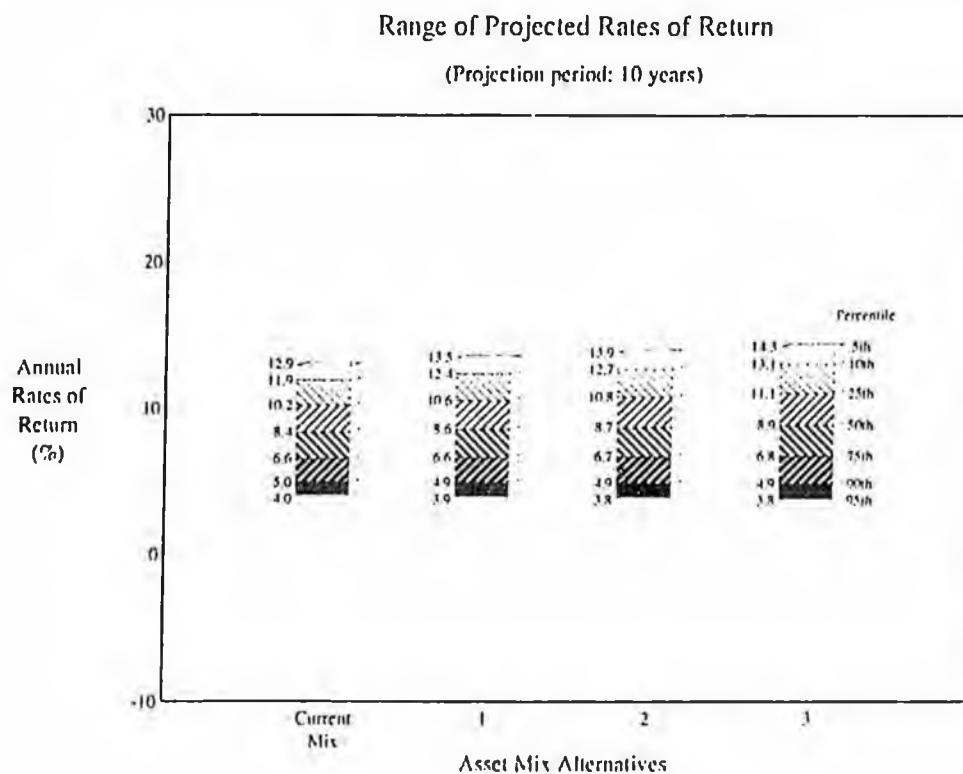
### Range of Projected Rates of Return

(Projection period: 5 years)



*Note the decrease in risk in investment all four of these funds (Current Mix, 1, 2, 3)*

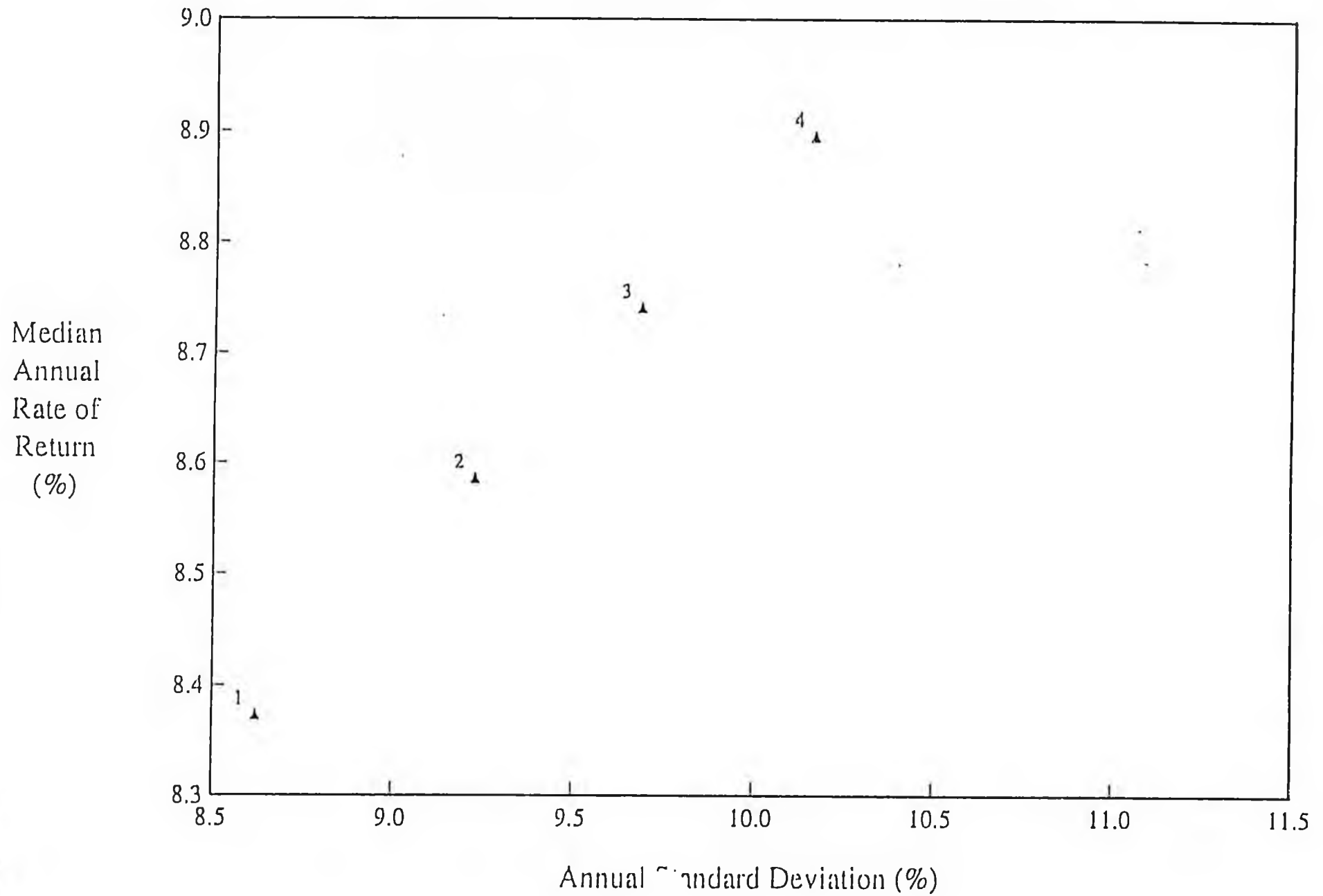
The longer the period considered, the less significant the short-term volatility. For example, if one focuses on a 10 year period, there is very little difference in the downside risk (95th percentile) outcomes for the more aggressive policies when compared with the current policy. Simultaneously, there is a distinct advantage (looking at the median) of the greater equity commitment.



This pattern results from the greater average return expected from stocks relative to bonds. It demonstrates statistically the importance of time horizon in investment policy formulation. Clearly, over the very long-term, equities should produce higher returns than bonds. But, the return pattern will be more volatile. So, for the long-term investor, the real question is how much discomfort can he/she accept both financially and emotionally over the short run. Inevitably, poor short run results produce tremendous pressure to alter the long-term policy. This results in the worst of two worlds (realization of the short-term risk of an aggressive policy and the lower long-term return of a more conservative policy). Finding the right balance is an ongoing challenge. In the fund's early years, any volatility was difficult to accept. Conversely, over the recent past, extraordinary stock market returns may make it easy to ignore the inherently more volatile pattern of stock returns. The 20 year flood level may only occur once in 20 years, but you don't want to build your house in that flood plain.

Financially, as a perpetual fund with limited distribution requirements, the fund can afford to pursue high return policies. The limiting factors are the various stakeholders' reactions to the inevitable shorter-term periods of weak performance. You must have the staying power to reap the long-term benefits. Currently, distributions are a function of average five year results. One could argue that this is the most appropriate time frame on which you should focus. It is long

# Asset Mix Risk & Return



20

APM Files: SEP20.ADT  
September 20, 1996

Projected average results (\$millions) for asset mix 1:

Year	Starting Date	Starting Assets	Ending Assets
1	07/01/96	1.00	1.08
2	07/01/97	1.08	1.17
3	07/01/98	1.17	1.27
4	07/01/99	1.27	1.38
5	07/01/00	1.38	1.49
10	07/01/05	2.06	2.23
Annual change:		8.4%	8.4%

Projected range of assets (\$millions) for asset mix 1:

Percentile	1 year	3 years	5 years	10 years
5th	1.23	1.59	2.00	3.36
10th	1.20	1.51	1.88	3.10
25th	1.14	1.39	1.69	2.63
50th	1.08	1.27	1.49	2.23
75th	1.03	1.16	1.32	1.90
90th	.98	1.07	1.19	1.61
95th	.95	1.02	1.12	1.49

Projected average results (\$millions) for asset mix 3:

Year	Starting Date	Starting Assets	Ending Assets
1	07/01/96	1.00	1.09
2	07/01/97	1.09	1.18
3	07/01/98	1.18	1.29
4	07/01/99	1.29	1.40
5	07/01/00	1.40	1.52
10	07/01/05	2.13	2.31
Annual change:		8.7%	8.7%

Projected range of assets (\$millions) for asset mix 3:

Percentile	1 year	3 years	5 years	10 years
5th	1.25	1.65	2.10	3.63
10th	1.22	1.56	1.96	3.34
25th	1.16	1.42	1.74	2.78
50th	1.09	1.29	1.52	2.31
75th	1.02	1.16	1.33	1.92
90th	.97	1.06	1.18	1.60
95th	.94	1.00	1.10	1.47



**Alaska Permanent Fund Corporation**

P.O. Box 25500 Juneau, AK 99802-5500  
(907) 465-2047

**MEMORANDUM**

**DATE:** April 3, 1997

**TO:** Byron I. Mallott  
Executive Director

**THROUGH:** Terry A. Brown  
Chief Investment Officer

**FROM:** Michael T. Bell  
Assistant Investment Officer

**SUBJECT:** Comment on Alaska Permanent Capital Management  
Move From Equities (20%) to Cash

**PREFACE**

Byron, you asked me to comment on the notes – the first attachment to this memorandum – from the special meeting of the Alaska Permanent Capital Management Company's Investment Committee. I intended to make my comments brief; however, as I wrote, I felt compelled to expand my comments and provide additional detail on key points and issues.

I also took the liberty to make comments not only on the points brought up in the Investment Committee's notes, but to add in additional details and commentary concerning the current state of the U.S. equity market.

Please do not interpret my comments to be a formal recommendation from the Alaska Permanent Fund Corporation's (APFC's) Investment Department. While I do feel strongly, any staff recommendations regarding shifts in the APFC's asset allocation should and will come to you via Terry Brown, Chief Investment Officer.

**COMMENTARY**

The recent move by Alaska Permanent Capital Management of 20% of its equity assets into cash is understandable given the tremendous increase in the valuation of the market over the past two years, recent market volatility as more investors have begun to doubt companies' ability to continue to deliver ever greater earnings, and the prospect of higher interest rates from additional Fed rate hikes as it tries to head off potential future inflation from what it may see as a more vigorous than desired economy.

Information from numerous sources of financial information indicate there are investors taking money off the table as they have become more nervous and wish to preserve current gains, especially as some market analysts are claiming there is increased probability of a market correction, something in the neighborhood of 10%, and that we might be in the midst of one now.

A move by the APFC equivalent to the Alaska Permanent Capital Management move of 20% of its equity assets to cash, would have the APFC sell about \$1.4 billion of domestic equities, putting another 7% of the APFC portfolio into cash, on top of the cash and cash equivalents we currently hold, approximately \$1.0 billion, or 5% of the entire portfolio. This would put 12% of the portfolio in cash.

The Alaska Permanent Capital Management Investment Committee did make important observations about indicators that historically have had great significance, heralding potentially dangerous investing environments, and while a significant move by the APFC to cash now might seem attractive, I do not feel that it is appropriate for the Fund to do so at this time.

Among other measures, the Alaska Permanent Capital Management Investment Committee noted that the market's PE ratio, 21.43, was higher than 1987, the dividend yield was 1.81%, and the price-to-book ratio at 4.56, was also higher than it was in 1987.

Although I do not personally believe as some investors do, that the investing world has changed such that the old indicators no longer have relevance, I do feel that there have been some important changes in the

marketplace that explain the paradox of how this bull market can continue moving upward even as these indicators are in what used to be considered dangerous territory.

For example, stocks' **dividend yield** is indeed at or near historical lows, but this is not alarming for corporations are finding that rather than spinning cash off to investors in the form of dividends as they have in the past, they can bring better value to their shareholders by using that cash to acquire other companies, buy back their own stock, or invest in other projects that bring a higher net present value to their shareholders when compared to a payout of dividends.

**Price/Earnings** ratios, another statistical measure historically used to gauge the value and health of the equity markets, have moved up beyond 20, raising many eyebrows – the S&P 500's PE was approximately 21.44 when the S&P 500 reached its high point of 816.29 on Feb. 18, 1997. Yet it has been higher before, for example, it hit 26.12 in 1991 and 22.82 in 1992, but with the current market pullback, the PE for the S&P 500 is now about 19.7, and the PE based on projected 1997 corporate earnings is about 18.8, both considered to be much closer to the typical ratio, though at the higher end of the normal range.

The U.S. economy, too, has changed, having totally remade itself since 1980, going from the one of the world's least productive to one of the world's most productive economies. This higher level of productivity is having a profound, positive effect upon the economy and corporate earnings, thus helping move companies' stock prices to higher levels.

Many stock market watchers attribute much of the stock markets' performance over the past two years to tremendous cash inflows from the demographic cohort known as the "Baby Boomers." These individuals have made their major purchases – houses, cars, appliances, etc. – and are now in the period in their lives when their disposal income is at its greatest. Additionally, they are now realizing that retirement is not that far away, and they feel that Social Security may not be able to support them in the lifestyle to which they have become accustomed.

The conventional wisdom is that Boomers, with retirement in mind, have been directing ever increasing amounts of their income into stock mutual

funds, intending to keep the investments for the long haul. Additionally, it is thought, backed by survey information, that these investors are much more savvy than previously believed, having watched market recoveries from the 1987 and 1989 corrections, having heard that investing in equities is a long term investment decision, and understanding that for greater long term returns one has to accept greater short and medium term volatility.

Furthermore, it appears that the equity market has, in fact, experienced three or four "rolling corrections" over the past two years where investors have rotated their investments from one sector to another when valuations were perceived to have become too high and unsustainable. This has happened twice to the technology sector, with a similar occurrence in the energy sector and in small cap stocks. The bright side of this, though, is that each of these rolling corrections has taken some of the worrisome froth out of the market, giving it a chance to consolidate before moving higher.

Even so, this may not be a time to vastly increase one's exposure to equities; valuations are high now and there are questions now about the potential for higher future inflation and whether future corporate earnings will indeed continue to increase. Yet if prices decline much further, the valuations may become low enough that a compelling case could be made for buying into the market and increasing our tactical allocation to equities.

We must keep in mind, however, that overvalued markets can stay overvalued for years and corrections do not always look like steep drop-offs. Corrections can simply be plateaus and trading ranges that securities reach and stay in for months or even years.

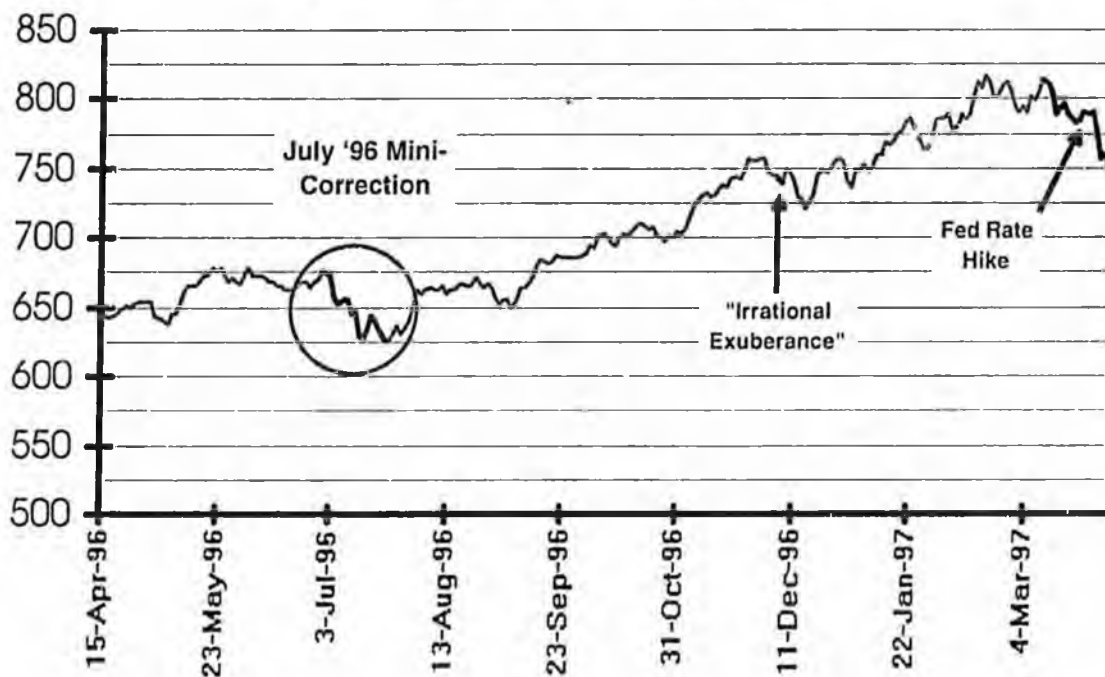
As for stock market volatility, while the stock market has become increasingly volatile in the past several months, it has only reverted back to a more normal, albeit higher, level of volatility. Thus, the U.S. equity market now moves more quickly and significantly up or down, both intra-day and inter-day, yet while the absolute price movement number may be large, the relative percentage of movement up or down is much less at these high levels in the major indices as the table on the next page illustrates:

A 100 Point Move		A 10 Point Move	
With Dow At	% Move In the Index	With S&P 500 At	% Move In the Index
1,000	10.0%	100	10.0%
2,000	5.0%	200	5.0%
3,000	3.3%	300	3.3%
4,000	2.5%	400	2.5%
5,000	2.0%	500	2.0%
6,000	1.7%	600	1.7%
7,000	1.4%	700	1.4%
8,000	1.3%	800	1.3%
9,000	1.1%	900	1.1%
10,000	1.0%	1,000	1.0%

We have witnessed increased volatility on the upside since last summer when we last saw a sizable downdraft in the market. Of course, there were analysts at that time – July – calling for investors to move out of equities into cash and other assets, yet once the market had bottomed out, down anywhere from 7% for large cap to 16% for small cap, it

resumed its upward momentum, regaining its loss and then moving beyond to new highs. Those who exited the market and did not reenter in a *timely* fashion, lost out on the upside the market has enjoyed since. The chart below shows the movement of the S&P 500 for the past year.

### S&P 500 Index



This points out a fundamental issue, it is difficult to time the market: you have to be right not once but twice to succeed. You have to be right about your exit point, but you have to also be right about your reentry point as well. Historically, investors who are tactical asset allocators, also known as market timers, have had portfolio returns that are significantly below those of investors who maintain an asset allocation based on a longer term investing time horizon and who move assets with less frequency.

That does not mean that I propose that we stick our head in the sand and ignore market conditions, rather I believe we have been directed, through our current asset allocation, adopted by a Board of Trustees who have stated their long term investment horizon, to maintain that allocation discipline even in the face of adverse short term market conditions.

However, in recognition of unfavorable short term market conditions, the Board of Trustees-mandated asset allocation does have control bands around each asset target that give us the option to tactically increase or decrease our weighting of a particular asset class relative to an alternative when we feel that it is appropriate to do so.

These control bands also direct staff to trim positions when an asset class increases in value at faster rate than other APFC investments and exceeds its control band's upper limit. This rebalancing both preserves gains and Board of Trustees-mandated asset allocation and diversification.

As of the close of business April 2, the APFC has 34.6% of its investments in domestic equities and 12.1% in international, for a total allocation to equities of 46.7%. According to Resolution 96-4, the allocation to equities is 48%, +2%/-3%. The suballocation to domestic equities is 36%  $\pm$  4%, and the suballocation to international is 12%  $\pm$  4%. Therefore, the APFC is within its control bands for equity investments, and it is already underweighted domestic equities, at 34.6%, relative to its target of 36%.

A dramatic move to cash by APFC staff would take the allocation to domestic equities below the lower limit of its control band, and, in effect, have staff override a Board of Trustees asset allocation decision, thus setting a historic precedent. However, with management's emphasis on frequent communication with the Board of Trustees and its desire to

obtain Trustees' concurrence on actions of major importance to the Fund, I seriously doubt such a large amount of assets would be moved from one asset class to another without Board of Trustees' approval.

The alternative would then be for staff to go to the Board and recommend the Board adopt a measure calling for a move from equities to cash – an asset with no allocation to it currently. Such a move could potentially have a tremendous detrimental effect on the long term total return of the Fund, as the Fund's new expected total return would potentially be less than its current expected total return target, due to a higher allocation to cash, a lower yielding asset historically.

Staff then has a difficult challenge, in between Board of Trustees asset allocation reviews, it must watch the markets and monitor extraordinary investing environments when they appear in light of their potential effect on *both* short term *and* long term returns, constantly balancing the probable net result of recommending the Board of Trustees maintain the existing asset allocation versus recommending the implementation of one of various alternative allocations.

#### **SUMMARY**

The primary emphasis in all Fund decision-making is maintaining the safety of Fund principal, with maximizing the return on its investments an important but secondary consideration. So, the APFC has capital preservation as a primary mandate, thus leading to its conservative investment philosophy and investing practices. The APFC's current asset allocation and portfolio diversification is a direct result of this mandate, and is recognized as prudent management practice. Additionally, we must remember that one of the primary benefits of asset diversification is that the Fund is protected from severe price movements within single asset classes.

It is my sincere hope that the move by the Alaska Permanent Capital Management Company is ultimately a successful strategy. Certainly its staff called the move down quite well, however, the company's investment committee must move back into the market equally successfully at an opportune time if it wishes to preserve the gains it booked.



# ALASKA PERMANENT FUND CORPORATION

## RESOLUTION OF THE BOARD OF TRUSTEES OF THE ALASKA PERMANENT FUND CORPORATION PERTAINING TO ASSET ALLOCATION GOALS FOR THE PERIOD 1997-2000

### RESOLUTION 97-6

*(This Resolution supersedes portions of Resolution 94-6 pertaining to sub-allocations of International Equities and Domestic Equities.)*

The Alaska Permanent Fund Corporation (the "APFC") is managed by a Board of Trustees charged with broad powers to safeguard, protect, invest and account for the Alaska Permanent Fund (the "Fund") and other State assets entrusted to its care. The Board formulates policy and supervises an executive director who, in turn, retains staff and conducts day-to-day operational, administrative, communications, and investment functions of the APFC in accordance with Board policy.

#### INVESTMENT PHILOSOPHY

- Risk Posture

The Board's overriding investment objective for the Fund is to maintain the safety of principal while maximizing total return. Therefore, it will always act to ensure that the level of investment risk in the Fund is prudent and does not jeopardize that primary objective.

- Return

The Board believes, however, that over the long term, there exists a relationship between the level of investment risk taken and the rate of investment return realized. The Board therefore believes that the assumption of a moderate level of investment risk is reasonable and justified in order to enhance potential long-term returns. Furthermore, the Board will attempt to maximize the return to the Fund by selecting a moderately aggressive asset mix that will produce higher median returns, having a wider range of expected returns than more conservative asset mixes. This range of expected returns will narrow as the investment time horizon is lengthened, which fits well with the Fund's role as a long-term investor.

- Diversification

The primary technique employed by the Board to reduce risk and enhance returns is diversification. Therefore, Fund investments are spread among three major asset classes: equities, fixed income and real estate. An asset allocation review is conducted each year to determine what portion of the Fund to invest in each of these asset classes in the coming 36-month period. Fixed-income assets are further diversified by type of

investment, by duration; equities by investment style, by manager, by geographic region, and by individual security; and real estate by type of investment, by region, and by manager.

- Liquidity

The Permanent Fund is managed with a long-term investment horizon, but seeks to avoid major fluctuations in year-to-year results. Although major consideration is given to capital growth over the long term, appropriate consideration is also given to current income. This meets the statutory requirement to provide benefits for both current and future generations of Alaskans.

#### LONG-TERM GOALS

- Protect the principal of the Fund.

The Prudent Investor Rule applies to all investments.

- Maximize the Fund's total return over time.

Achieve a long-term, average, annualized real rate of return of 4%. It is recognized that there may be years, or a period of years, when the Fund does not achieve this goal, and other years when the goal is exceeded. But, over the long-term, the Permanent Fund will achieve a total return at least 4% greater than the rate of inflation.

- Maintain the real value of the Permanent Fund over time.

The Fund must be fully inflation-proofed to maintain its value over time.

- Recognize the long-term importance of the Permanent Fund to the State of Alaska and its people.

Provide reliable and objective information to the Administration, the Legislature, and the people of Alaska on all public policy matters affecting the Fund.

- Asset Allocation shall minimize the Fund's risk through asset diversification.

The Board of Trustees has engaged in extensive discussions and analyses of Fund asset allocation posture, plans, and policies during the meetings of February 12-13 and April 10, 1997. Staff and consultants have been fully involved in formulating the 1997 Asset Allocation Plan.

BE IT RESOLVED:

THAT the Board of Trustees adopts (1) the capital market returns and risk assumptions prepared by the APFC's consultant Callan Associates, dated February, 1997; and (2) an asset allocation plan which targets the following asset allocation percentages for the period ending June 30, 2000:

Domestic Equities (Broad Market)	34% ± 4%
International Equities	<sup>(1)</sup> 14% ± 4%
<u>Total Equities</u>	<u>48% (+ 2%/-3%)</u>
Domestic Bonds	<sup>(2)</sup> 40% (+ 6%/-4%)
Non-Dollar Bonds	2% ± 2%
<u>Total Bonds</u>	<u>42% (+ 6%/-4%)</u>
Real Estate	<sup>(3)</sup> 10% (+2%/-3%)

<sup>(1)</sup> Includes an allocation of 2% of the total Fund to Emerging Markets

<sup>(2)</sup> Includes an allocation of \$300,000,000 for Alaska Financial Institutions' Certificates of Deposit.

<sup>(3)</sup> 1% is anticipated in REITs and mortgages.

FURTHER RESOLVED:

THAT the Board of Trustees adopts the Asset Allocation Plan recommended by staff on this date. The Plan has two primary objectives: (1) to *increase* the amount of large-cap domestic equity that is passively managed from the present sub-allocation target of 35% to a revised target of 45% with a tactical control band range of 40% to 50%, with a corresponding *decrease* in the amount of large-cap domestic equity that is actively managed from 65% to 55% with a tactical control band range of 50% to 60%; and (2) to *increase* the amount of the international equity from the present sub-allocation target of 12% ± 4% to a revised target of 14% ± 4% to include an allocation of 2% Emerging Markets equity with a control band range of 0% to 4%.

In addition, the Plan (1) maintains style neutrality and balanced capitalization; (2) ensures continuing APFC management flexibility; (3) continues the emphasis on global equity management with broader international diversification and the goal of providing low cost, superior risk-adjusted returns.

FURTHER RESOLVED:

THAT policy control bands as set out below will provide staff and equity managers flexibility in tactically managing Fund assets while at the same time maintaining the purpose and intent of the Asset Allocation Plan:

CONTROL BANDS

Domestic Equity: Asset Allocation 34% ± 4%

<i>By Style:</i> *		<u>% of Domestic Equities</u>	<u>Control Band</u>
	Value Portfolios	50%	40-60%
	Growth Portfolios	50%	40-60%

\* *Passive portfolios will be evenly split between value and growth for compliance measurement.*

<i>Cap Size:</i>		<u>% of Domestic Equities</u>	<u>% of Large Cap Portfolio</u>	<u>Control Band</u>
	Large Cap Portfolios	80%		70-90%
	<i>Active Portfolios</i>		55%	50-60%
	<i>Passive Portfolios</i>		45%	40-50%
		<u>% of Domestic Equities</u>	<u>% of Smaller Cap Portfolio</u>	<u>Control Band</u>
	Smaller Cap Portfolios	20%		10-30%
	<i>Active Portfolios</i>		65%	55-75%
	<i>Passive Portfolios</i>		35%	25-45%

International Equity:\*\* Asset Allocation 14% ± 4%

<i>Market:</i>		<u>% of International Equities</u>	<u>% of Developed Portfolio</u>	<u>Control Band</u>
	Developed	85%		70-100%
	<i>Active Portfolios</i>		65%†	55-75%
	<i>Passive Portfolios</i>		35%	25-45%
	Emerging Markets	15%		0-15%

\*\* *Unusually broad range reflects consequences of potential global manager shifts.*

† *Active includes regional developed markets exposure and EAFE portfolios.*

FURTHER RESOLVED:

THAT the Executive Director shall develop and initiate an implementation plan which will include detailed matters such as, but not limited to, funding schedules, asset shifts, benchmarks, performance, style effects, and manager relationships and shall report this plan to the Board at the next regularly scheduled meeting after the adoption of this Resolution. Additionally, staff shall provide periodic written and oral reports to the Trustees on the status of the implementation plan until the plan is completed.

APPROVED AND ADOPTED by the Board of Trustees of the Alaska Permanent Fund Corporation this 24th day of April, 1997.

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*Chair, Board of Trustees  
Alaska Permanent Fund Corporation*

ATTEST:

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*Byron I. Mallott, Corporate Secretary*