

The Strength of Diversification

alaska permanent fund corporation

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Global financial markets are in the midst of turmoil unseen in the past 75 years, and 2008 brought some incredible events. The collapse or near collapse of mortgage companies, banks, investment firms, brokerages, insurance providers and even the big three automakers was followed by hundreds of billions of dollars in government rescue packages in the U.S. and abroad. Each one of these items would have generated headlines on their own, but for all of them to occur at the same time was unthinkable just months ago.

Given this recent investment climate, it is no surprise that the Alaska Permanent Fund has been hit with losses similar to those that have affected other large investment funds, as well as businesses and retirement accounts around the world. The Board of Trustees believes that it is always important to provide information about the Permanent Fund to Alaskans, and expects heightened interest during times such as these. This report will explain how the Board makes investment decisions, the current status of the Permanent Fund and the steps the Board expects to take in the future.

When the Board of Trustees sets the Permanent Fund's investment strategy, known as its asset allocation, they do not focus on short-term market conditions. There is no attempt to time the markets by guessing which class of assets looks the strongest for the coming year. Instead, the focus is on the long term, building an all weather portfolio that is well diversified and balances the goal of a 5% return over time with the least amount of risk.

Generally, different types of investments work in disharmony with one another, and as market conditions favor one type of investment, other investments will cycle down. The strength of a diverse portfolio of assets lies in its ability to balance the performance of all of the assets, offsetting the shortcomings of one with the gains of another, so that the fund has a better chance of earning a positive return in most years.

However, it is important to note that diversification is a long-term strategy, and even a well diversified portfolio isn't completely immune from losses in the short-term. For the last year, all of the Permanent Fund's asset classes have had negative returns, which has lead to a drop of more than \$10 billion in the Fund's value.

Fortunately, the Permanent Fund has the advantage of being a long-term investor. The Trustees are very deliberate in the investment decisions that they make, and will hold on to their investment strategy as long as they believe it is in the best long-term interest of the Fund. In the past, the Board of Trustees has held steady to its asset allocation in difficult market conditions, and this has served the Fund well.

This is not the first time in the Fund's history that markets have caused losses, and likely it won't be the last. Alaskans can take comfort that the Board of Trustees is well aware of the issues currently facing the global markets in general, and the Permanent Fund in particular. They will work with the Corporation's staff and consultants to respond appropriately to weather this storm and protect the Permanent Fund for Alaskans' long-term benefit.

WHAT IS REBALANCING?

When the Board of Trustees sets a target asset allocation for the Fund, the targets include a mid-point, as well as a band around that point within which the allocation can move, as illustrated in the table below.

Markets do move, in good markets and in bad, constantly changing the value of the assets the Fund holds. If the allocation to an asset class falls outside of its set band, the Board and staff "rebalances" the Fund's assets to bring them back in line with the adopted asset allocation. This means assets are sold from the investment classes that are doing well (thus becoming too large a percentage of the Fund's overall value), in order to buy more in the investment classes that are under their asset allocation range.

The bands around the target allocations are important. They prevent the need to constantly rebalance the Fund because of minor changes in the markets, which would incur unnecessary transaction costs and movements that might have to be reversed a short time later.

Given the significant drop in value across a number of asset classes, the Fund went out of balance from its established asset allocation this fall. The Board and staff took a deliberate and thoughtful approach to developing a strategic plan for rebalancing the Fund, considering the best timing and sequence of actions to provide the most advantageous outcome, and began implementing this plan in December.

Asset Allocation

AS OF MAY 29, 2008

	Lower	Target	Upper
U.S. STOCKS	20%	26%	32%
NON-U.S. STOCKS	10%	13%	16%
GLOBAL STOCKS	10%	14%	18%
U.S. BONDS	13%	19%	25%
NON-U.S. BONDS	0%	3%	6%
INFRASTRUCTURE	0%	3%	6%
REAL ESTATE	7%	10%	13%
PRIVATE EQUITY	1%	6%	11%
ABSOLUTE RETURN	3%	6%	9%

HOW REBALANCING WORKS

Here is a simple exercise using a two-asset portfolio.

Chart 1

Here, stock and bond investments are worth \$50 and are balanced.



Stocks - \$50

Bonds - \$70

Chart 2

As the bond investments rise in value, they become a greater part of the portfolio, while the percentage of stocks falls even though their value is the same.

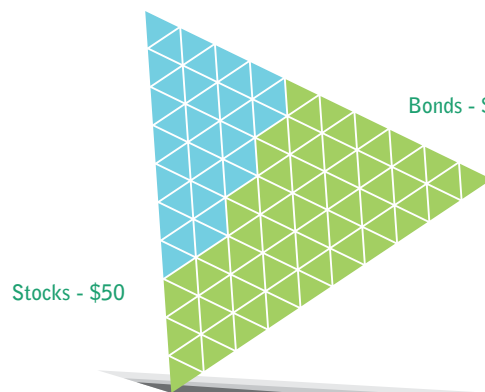
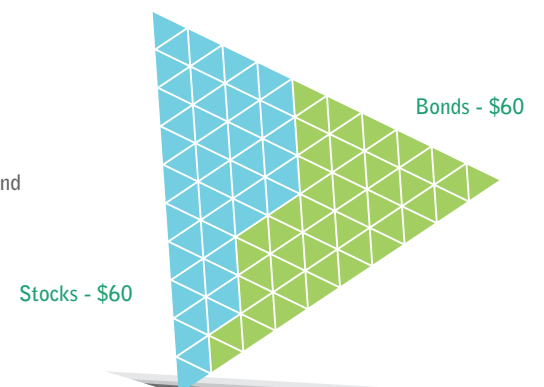


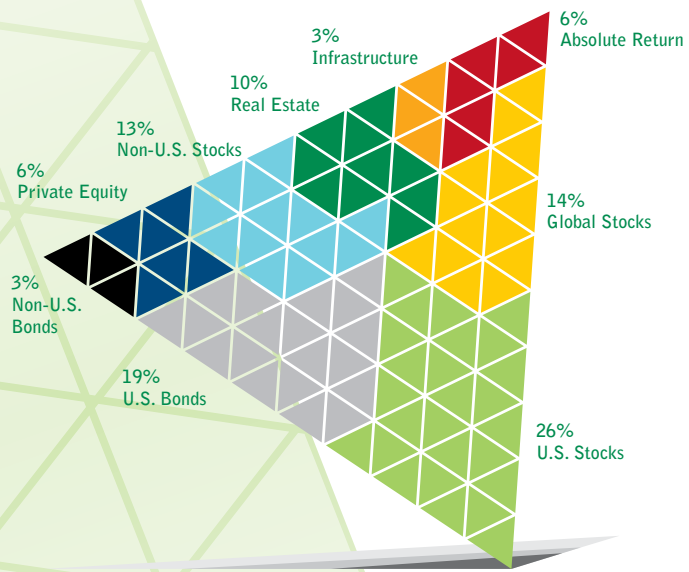
Chart 3

By selling \$10 worth of bonds and buying \$10 worth of stocks, the portfolio is back in balance.



APFC Target Asset Allocation

AS OF MAY 29, 2008



REAL ESTATE HOLDINGS

The Permanent Fund owns more than 60 U.S. properties.



Maui Marketplace | Kahului, HI



Goldbelt Place | Juneau, AK



Inman Park Apartments | Raleigh, NC

APFC's Mission

To maximize the value of Alaska's Permanent Fund through prudent long-term investment and protection of principal to produce income to benefit all generations of Alaskans.

Asset allocation

The Board of Trustees' goal is to *preserve the Fund's principal and limit risk while maximizing return*. The Board tries to achieve these objectives through asset allocation – putting the Fund's money into different types of investments. In addition to the definitions below, we have shown some of the Fund's real estate, infrastructure and stock holdings.

Bonds are a form of loans. A bond "issuer" – a corporation or government – borrows money at a preset interest rate for a preset period of time.

Stocks represent a share of ownership in public companies. The Permanent Fund owns shares in more than 3,000 corporations around the world.

Real Estate includes both direct investments in properties across the U.S., including malls, office buildings and apartment complexes, and real estate investment trusts (REITs). These are publicly traded financial instruments that invest in income-producing real estate, and are traded like stocks.

Private equity investments are made directly in private corporations – corporations that are not publicly traded in stock markets. The APFC uses a gatekeeper to evaluate the firms that make these investments on the Fund's behalf.

Absolute return investments (also called hedge funds) are private investment partnerships that use multiple stock and bond investment strategies to achieve a target return on investments.

Infrastructure investments are facilities or services that are typically owned and managed by governments, such as toll roads or electric utilities. Infrastructure investments provide a steady return over a long period of time.

OUR HISTORY

1976 The people of Alaska voted to amend the state's constitution and establish the Alaska Permanent Fund. One year later, the Fund received its first deposit of dedicated oil revenues, while the first oil tanker departed Valdez carrying Alaska North Slope crude.

1977 The Fund was entirely invested in bonds, which at the time was considered a prudent course of action. Legislators and public leaders began a lengthy debate about the right course for the Fund. Ultimately, the Legislature determined an investment fund, rather than a development bank, was the preferred choice.

1980 To allow all Alaskans to more directly benefit from the state's oil wealth, the Permanent Fund dividend program was established. The Legislature created the Alaska Permanent Fund Corporation to manage the Fund's investments.

1982 At the urging of the Board, the Legislature enacted inflation-proofing, a key component to maintaining the Fund's real value over time.

1983 The Alaska Permanent Fund made its first investments in stocks and real estate.

1987 The Fund earned 11.5% – its highest inflation-adjusted rate of return to date. Alaska's savings account did well despite the stock market crash of October 19, now known as Black Monday.

1989 The Permanent Fund grew to \$10 billion.

1990 The Legislature granted Fund managers the flexibility to invest in non-U.S. stock and bond markets.

1992 The Permanent Fund reached the \$15 billion mark.

1998 A new benchmark was established as Fund earnings exceeded state revenues for the first time in history. The Fund reached a staggering \$25 billion.

2000 The rise of dot-com companies ended and share prices plummeted, beginning a three-year downturn for U.S. and international stock markets. The Trustees' policies of investing for the long-term and maintaining a diversified portfolio served Alaskans well during the bear market. The Fund had smaller losses than many other large institutional funds.

2004 The Trustees increased the Fund's diversification once again, adding private equity and absolute return strategy investments. The Fund reached \$30 billion for the first time.

2007 The Trustees added a new asset class, infrastructure, to the Fund's investments. Several years of strong returns carried the Permanent Fund's value to \$40 billion.



INFRASTRUCTURE INVESTMENTS

Through pooled funds managed by experienced firms, APFC is invested in infrastructure projects around the world.

Channelview is an 800 megawatt natural gas-fired cogeneration facility in Texas that provides steam and electric power.



London City Airport is the UK's leading business airport with 10 airlines serving 32 destinations across the UK and Europe.



TOP 10 STOCKS

The Permanent Fund owns shares in more than 3,000 U.S. and non-U.S. companies. Here are the top 10:



Tysons Corner Center | McLean, VA



120 East 87th St. | New York, NY

600 Pine St. | Seattle, WA



A TWO-PART FUND

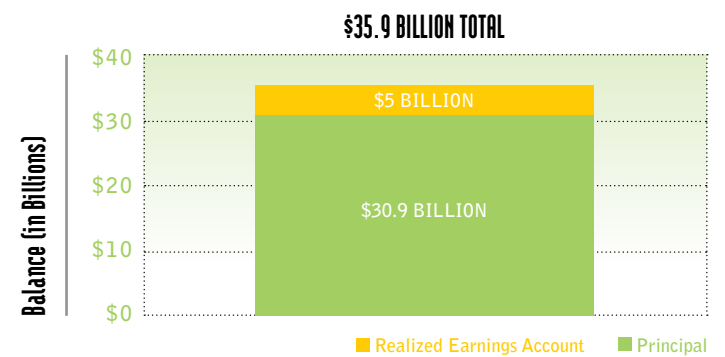
While the entire Fund is invested in assets such as stocks, bonds and real estate, for accounting purposes it is divided into two parts: principal and the realized earnings account. The Alaska Constitution says that the principal may not be spent. The realized earnings in the realized earnings account may be spent by the Legislature for any public purpose, which includes the Permanent Fund Dividend distribution.

What are realized earnings? Realized earnings are the income from bond interest, real estate rent payments, stock dividends and the profits from selling assets that have increased in value. Realized earnings are accounted for in the realized earnings account, and once received are reinvested in the same assets as the principal to increase the Fund's earning potential.

What about unrealized gains? Unrealized gains (and losses) are the increases (or decreases) in value of assets that the Permanent Fund currently holds. These gains (and losses) are considered part of principal until the asset is sold, and then any net realized gains (or losses) are recorded in the realized earnings account.

Principal and Realized Earnings Account

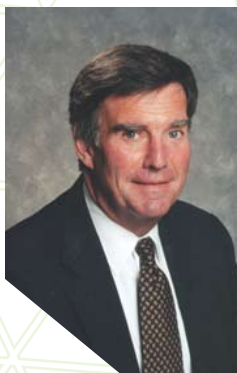
AS OF JUNE 30, 2008



04 LETTER FROM THE EXECUTIVE DIRECTOR

Board Members:

Steve Frank, Chair Emil Notti Patrick Galvin
 Bill Moran, Vice Chair Nancy Blunck Carl Brady



At the end of 2007, the global financial markets started turning downward, bringing to an end a four year run of double digit returns for the Permanent Fund. For the fiscal year ending June 30, 2008, the Permanent Fund's investments returned -3.6%, in line with the portfolio's benchmark. Financial data for the fiscal year, as well as the performance of each of the Fund's asset classes, is shown below.

Usually in these annual updates, we provide you with the audited financial data for the most recent fiscal year end. But the first several months of Fiscal Year 2009 have been some of the most difficult in the history of the financial markets, and the Permanent Fund has sustained significant losses as a result. In order to keep Alaskans as informed as possible, we have decided to include the most current unaudited financial and performance information for the fiscal year-to-date that was available as we went to print with this publication.

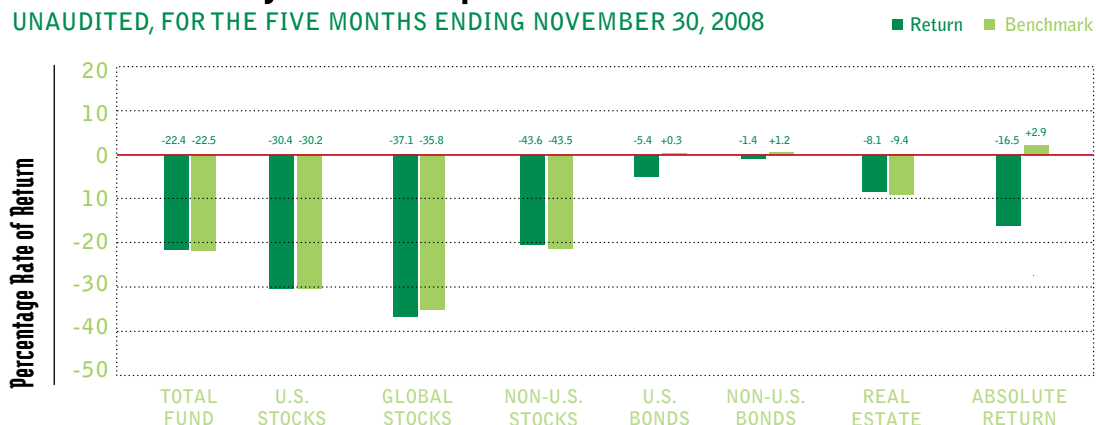
As we mentioned on the front page, the APFC Board of Trustees and staff are keeping a watchful eye on this unfolding situation, and are dedicated to making the best financial decisions for the long-term health of the Fund. I encourage you to visit **apfc.org** for up-to-date information and news of the Permanent Fund.

Sincerely,

Michael J. Burns
 Chief Executive Officer

Fund Fiscal 2009 year-to-date performance

UNAUDITED, FOR THE FIVE MONTHS ENDING NOVEMBER 30, 2008



-22.4%

Fund return to date

\$7.9 BILLION

Decrease from ending balance on June 30, 2008

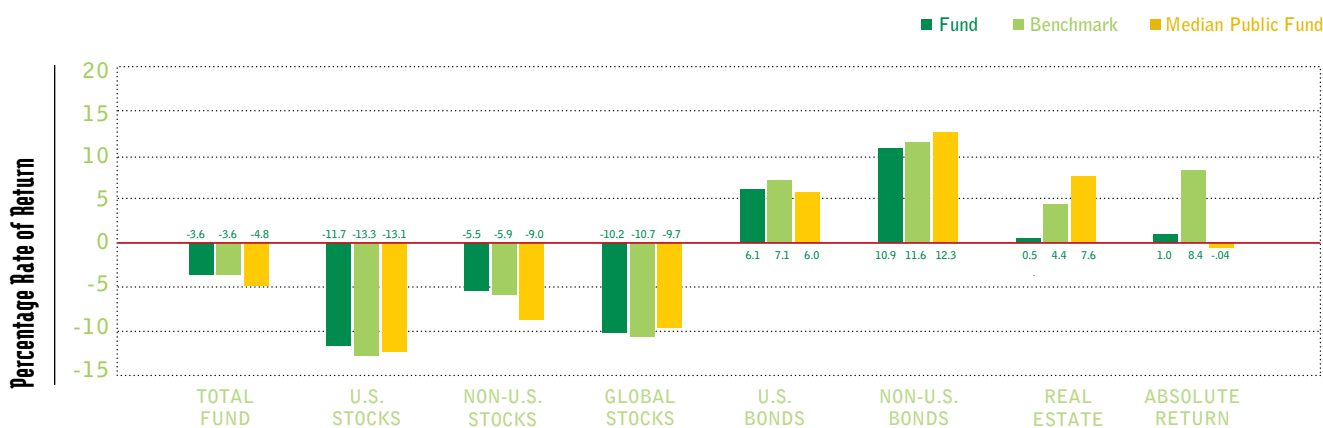
\$28.0 BILLION

Fund balance as of November 30, 2008

Fund Performance

FOR THE FISCAL YEAR ENDING JUNE 30, 2008

Fund Fiscal 2008 Performance



-3.6%

Total Fund return

\$844 MILLION

Constitutional deposit from mineral revenues for the fiscal year

\$35.9 BILLION

Fund balance on June 30, 2008 (after dividends)

\$1.3 BILLION

Total paid for fall 2008 dividends

\$1.9 BILLION

Decrease from ending balance on June 30, 2007 (after dividends)

\$808 MILLION

Amount moved from earnings reserve to principal for inflation proofing for the fiscal year

APFC.ORG

Find the most up-to-date information on the Fund at **apfc.org**.

Important Fund news - Points to the 'fund news' section.

Information on past values and performance - Points to the 'fund market value' section.

Current Fund value - Points to the 'fund market value' section.

Most current financial statements and investment performance - Points to the 'current reports' section.

Upcoming board meetings - Points to the 'board meetings' section.