



A NEW APPROACH TO MANAGING RISK

The Board of Trustees must strike a careful balance when it is investing the Permanent Fund: maximizing returns while minimizing risk.

If the Fund’s investments are too conservative, there is little potential for the portfolio to grow or pay out the good-sized dividends that Alaskans have come to appreciate. But the investments that allow for growth also carry some level of risk, and the Trustees must set a strategy that manages those risks.

Each year the Board sets the target allocation for the Permanent Fund’s investments. This provides a broad investment strategy within which individual investment decisions can be made. In setting this strategy, the Board doesn’t try to time the markets or focus on short-term market conditions. Instead, it builds a portfolio that will provide a more stable return under a variety of market conditions.

In the past, the Trustees set the allocation solely using the traditional asset classes: stocks, bonds, real estate and alternative investments. The risk level of each asset class was evaluated separately, and the overall investment risk for the Fund was managed through the percentage of the portfolio that was allocated to each asset class.

Last spring the Trustees recognized that some investments might have more in common with investments from other asset classes with regard to their expected levels of risk and return. For example, at times, corporate bonds act more like stocks than they act like U.S. Treasuries. This makes sense when you consider that the companies that issue these corporate bonds are the same companies traded in the stock markets. Grouping corporate bonds alongside stocks allows the Trustees and staff to better evaluate the Fund’s exposure to public companies.

The risk-based approach led to a new grouping of investments by their risk and return profiles and by the market condition or liability that each group is intended to address. This new allocation didn’t change the investments that the Permanent Fund is in; rather it changed the way the assets are observed. In fact, the underlying investments and their proportions haven’t changed significantly and are similar to allocations from recent years, with a similar composite level of risk.

The Permanent Fund isn’t the only organization that is taking a risk management-based approach to investing. According to research from Callan Associates, British Petroleum, Boeing and General Motors use risk-based strategies in managing their employee pension plans, and public pension funds such as the California Public Employee Retirement System, the Teacher Retirement System of Texas and the South Carolina Retirement System use risk-based management strategies as well.

COMPANY EXPOSURE 53%

When the economy is performing well, most public and private companies are performing well. Investing in these corporations allows the Permanent Fund to benefit in times of growth and prosperity.

REAL ASSETS 18%

The value of real assets hedges inflation risk, helping protect the Fund’s real value over time.

TARGET RISK ASSET CLASS ALLOCATION

OPPORTUNITY POOL 21%

This allocation allows the Permanent Fund to invest in special opportunities and to take advantage of dislocations in the markets.

CASH 2%

The cash allocation is designed to let the Fund build up reserves over the course of the year to meet its expected liabilities, primarily the annual dividend payment each July.

INTEREST RATES 6%

Securities with low credit risk usually perform better than other investments in times of deflation or market crises.

ASSET CLASSES

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.

CASH INVESTMENTS are liquid investments with durations of less than 12 months.

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

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.

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.

PRIVATE EQUITY investments are made directly in private corporations — corporations that are not publicly traded in stock markets. The APFC uses gatekeepers to evaluate the firms that make these investments on the Fund’s behalf.

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.

HOW IS THE DIVIDEND CALCULATED?

Each year, the amount of the dividend is calculated using a formula set in state law. The formula is based on an average of the Fund's income over five years in order to produce a more stable flow of dividend amounts from year to year.

Because the foundation of the Permanent Fund is a portion of Alaska's oil royalties, many people think that the dividend amount is affected by the price of oil. In fact, the price of oil has no immediate effect on the dividend, as the calculation below demonstrates.

Using the amounts for the 2009 dividend:

ALASKA PERMANENT CORPORATION RESPONSIBILITIES

STEP ONE: Add the statutory net income from investments for the last five years (in billions)

2005	\$1.754
2006	2.690
2007	3.429
2008	2.938
2009	(2.476)
	<hr/>
	\$8.335

STEP TWO: Multiply the sum by 21 percent
 $\$8.335 \times 21\% = \1.750 billion

STEP THREE: Divide by 2

$$\$1.750 \text{ billion} \div 2 = \$875 \text{ million}$$

STEP FOUR: Check the balance of the realized earnings account. Alaska state law says that no more than half of the balance may be paid out for dividends.

In 2009, the balance of the realized earnings account on June 30 was more than \$2.5 billion, so the full calculated amount of \$875 million was available to transfer to the Permanent Fund Dividend Division (PFDD).

PERMANENT FUND DIVIDEND DIVISION RESPONSIBILITIES

STEP FIVE: Make adjustments for residual funds, designated state expenses and the cost of operating the PFDD.

\$875 million
- 55 million
<hr/>
\$820 million

STEP SIX: The balance is divided by the number of successful applicants.

$$\$820,000,000 / 628,499 = \$1,305 \text{ per person dividend}$$

A TWO-PART FUND

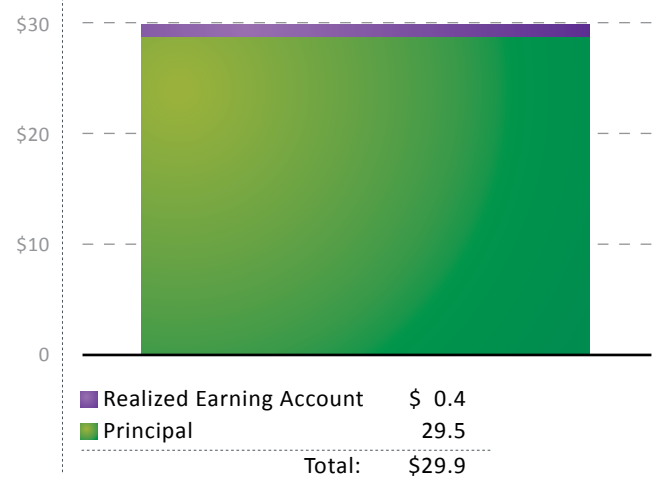
While the entire Fund is invested in assets such as stocks, bonds and real estate, for accounting purposes it is divided into two parts: principal and the realized earnings account. The Alaska Constitution says that the principal may not be spent. The realized earnings in the realized earnings account 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. Any losses from selling assets that have decreased in value are deducted from the realized earnings. 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.

09 PRINCIPAL AND REALIZED EARNINGS ACCOUNT

As of June 30, 2009 Ending Balance (In Billions)



A HISTORY OF ALASKA'S PERMANENT FUND (1969-2009)



1969 The Prudhoe Bay oil lease sale brings in \$900 million in revenues, a significant windfall for Alaska. Some suggest saving some or all of the \$900 million, however it is spent during the next few years on capital projects and programs such as the Alaska Student Loan program and the Alaska Longevity Bonus.



1976 In the Nov. 2 general election, Alaska voters approve a constitutional amendment establishing the Permanent Fund by a margin of 75,588 to 38,518.

1977 On Feb. 28, the Permanent Fund receives its first deposit of dedicated oil revenues totaling \$734,000. At first, the Fund is invested entirely in bonds. The Legislature begins four years of public discussions regarding whether the Permanent Fund should be managed as an investment fund or as an economic development bank.



1980 The Alaska Legislature creates the Alaska Permanent Fund Corporation to manage the investments of the Permanent Fund and places a list of allowed investments into state law. About \$900 million in surplus oil revenues is deposited in the Permanent Fund by special appropriation.



The Legislature also approves the first Permanent Fund Dividend program. The program was ruled unconstitutional by the U.S. Supreme Court because individual dividend payments varied based on length of residency.

1982 The Alaska Legislature, at the request of the Board of Trustees, enacts inflation proofing to protect the Fund's purchasing power. The first Permanent Fund dividend check of \$1,000 is distributed. The Legislature pays this first dividend, not with Permanent Fund income, but with surplus oil revenues.

1983 Following changes to the statutory investment list, the Permanent Fund makes its first investment in the stock market and, later that year, in directly held real estate.



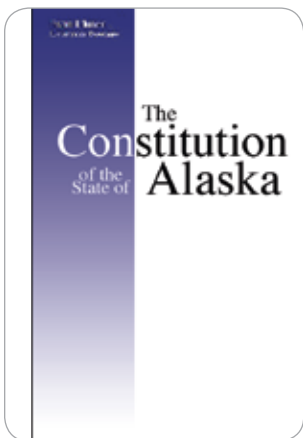
1987 Despite the stock market crash in October 1987, the Permanent Fund's performance ranks in the top 9 percent of all public funds in the United States. Total annual output of oil in the trans-Alaska oil pipeline peaks at 2 million barrels per day.

1989 Permanent Fund assets reach \$10 billion.

1990 After the Legislature expands the statutory investment list, the Permanent Fund begins to invest in stock and bond markets outside the United States.

THE FUND'S TOP 50 STOCKS

The Permanent Fund owns shares in more than 3,000 U.S. and non-U.S. companies. Here are the top 50 stock holdings in order of market value:



1993 Permanent Fund assets reach \$15 billion.

1998 For the first time, Fund earnings exceed state oil revenues as the Fund reaches the \$25 billion mark.

1999 The Legislature increases the Fund's investment flexibility to allow up to 5 percent of the Fund's value to be invested in alternative investments.

2000 Trustees remain committed to a long-term, diverse investment strategy as the stock market begins a sharp decline that will last for three years. Trustees further diversify the Fund's investment portfolio and increase the stock allocation to 53 percent.

2001 After careful study and discussion, the Board of Trustees formally endorses a constitutional amendment to change Permanent Fund payouts to a percent of the Fund's total value (POMV). The first of a series of resolutions that would place this proposed change on a general election ballot are introduced in the Legislature at the Board's request.

2002 The bear market that began in 2000 leads to the Fund's first negative return in 2002. These market conditions carry through 2003.

2004 The Permanent Fund invests in two new asset classes: absolute return strategy funds and private equity. The Legislature changes state law to require cause before any of the four public



members of the Board of Trustees may be removed, helping insulate the Board members from political pressure.

2005 The Legislature makes a significant change in how Permanent Fund investments are determined by removing the allowed investment list from state law. From now on, Trustees make investment decisions solely under the guidelines of the prudent investor rule. Fund assets reach \$30 billion.

2006 The Fund reaches \$35 billion in value, an increase of \$5 billion from the prior year.

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

2008 A correction that began late the year before causes markets to drop dramatically and makes 2008 one of the five worst years in the 218-year history of the U.S. stock market. Oil prices climb to \$140 per barrel, and despite declining production, produce the highest mineral deposits to the Fund's principal to date: \$844 million.

2009 Continued bear market conditions decrease the Fund's value from its \$40 billion peak in 2007 to \$26 billion shortly after the start of the year; however the Fund turns upward with a spring market rally that continues through the year.



LETTER FROM THE EXECUTIVE DIRECTOR



Fiscal year 2009 was by far the most difficult in the Fund's history. Almost all asset classes had sharp losses, and the Fund had a negative return of 18 percent. It may be of some comfort that our relative performance, as compared with our peers, was competitive.

However, markets have turned around and the Fund has grown by more than \$4 billion in the first six months of fiscal year 2010. While the global economy may still have some issues to work through, we're hopeful that the recent performance in the stock markets is a sign that the worst of the recession is over.

It's important to remember that the losses of the recent past don't completely reflect the performance of the Permanent Fund over time. Since 1977 the Permanent Fund has taken in \$14 billion in deposits from mineral royalties, court settlements and special transfers that the Legislature made from the General Fund. During that same period, the Fund paid out \$17.6 billion in dividends to Alaskans and still ended the fiscal year with a value of \$30 billion.

Based on this historical information, I think we can agree that the Fund has been an incredible success in turning a non-renewable natural resource into a renewable financial resource to serve current and future generations of Alaskans.

Sincerely,

Michael J. Burns
Chief Executive Officer

BOARD MEMBERS

Steve Frank
Chair

Bill Moran
Vice Chair

Patrick Galvin

Nancy Blunck

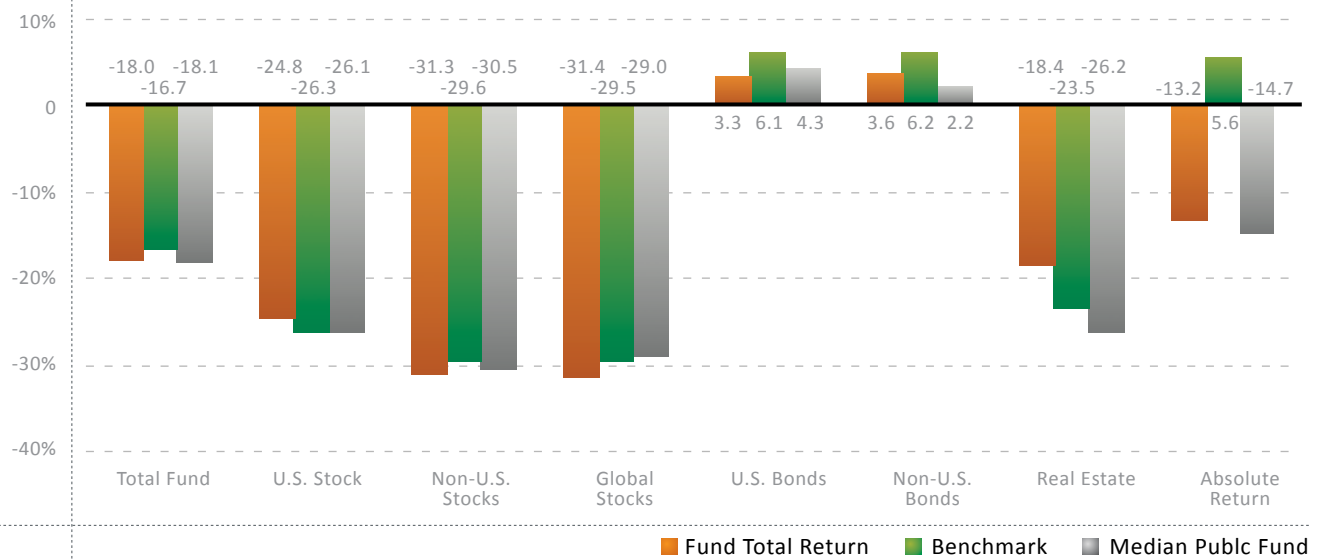
Steve Rieger

Larry Hartig

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FUND FISCAL 2009 PERFORMANCE

Returns for Period Ending June 30, 2009



-18.0%
Total fund return

\$651 million
Constitutional deposit from mineral resources for the fiscal year

\$29.9 billion
Fund balance on June 30, 2009 (after dividends)

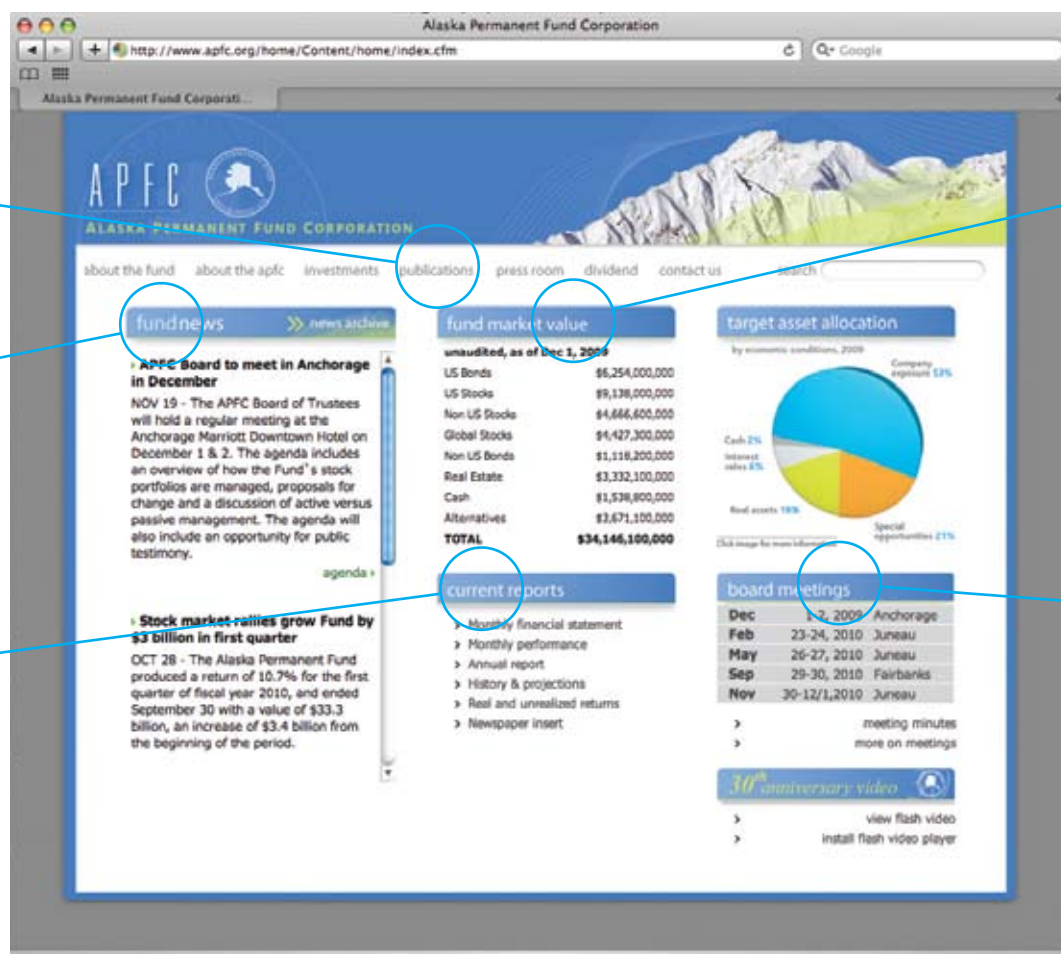
\$6.6 billion
Decrease from ending balance on June 30, 2008 (after dividends)

\$875 million
Total paid for fall 2009 dividends

\$1.1 billion
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.



INFORMATION ON PAST VALUES AND PERFORMANCE

IMPORTANT FUND NEWS

MOST CURRENT FINANCIAL STATEMENTS AND INVESTMENT PERFORMANCE

CURRENT FUND VALUE

UPCOMING BOARD MEETINGS