CIO Report for the December 6, 2016 APFC Board Meeting

Good morning, Mr. Chairman and members of the APFC Board.

As we approach the end of the calendar year, I am pleased to report that the investment performance of the Alaska Permanent Fund was strong for the first quarter of the fiscal year. As of September 30, 2016, the fiscal year-to-date (3-month) return was 3.9% on Permanent Fund assets of $54.8 billion and Alaska Mental Health assets of $461 million. In the two months since that quarter-end, fiscal year-to-date performance through five-months remains roughly in the range of 3-4%, reflecting a solid year thus far in terms of APFC's long-term CPI+5% performance benchmark. Indeed, the end of September 2016 marks an unusually healthy performance period for the Permanent Fund in which each of our calendar year-to-date, one-year, three-year, and five-year performance figures of 7.4%, 9.8%, 6.8%, and 9.1%, respectively, all exceed our long-term CPI+5% benchmark.

In terms of returns relative to APFC's US public fund and endowment peers, as Callan reported during our last Board meeting, APFC was roughly a top-quartile performer during the past fiscal year (despite modest fiscal year returns of 1.02%). We anticipate that this year's investment performance thus far will continue APFC's trajectory of success in both absolute terms and also relative to our public fund, endowment, and sovereign wealth fund peers.

Although the Fund's essentially flat investment performance overall during the past two months may appear uneventful overall, the impact of the recent US election in particular has dramatically affected the relative valuations and investment performances, across and within asset classes and geographies. Interest rates in particular have risen dramatically both in the United States and internationally with the yield on the reference 10-yr US Treasury bond rising from 1.74% before the election to closer to 2.4% today. The impact of this rise in interest rates has been dramatic with US investment grade bonds declining by roughly 3.5% and interest rate sensitive listed securities including REITs, Listed infrastructure, and utilities stocks declining roughly 5-10%.

In addition to interest-rate-related declines, international investments (particularly in the Emerging Markets) and a strengthening US dollar since the election have led to a 4% decline in international stocks and a 2.5% decline in international bonds.

However, these investment losses associated with rising interest rates and declining values in emerging markets investments and currencies has been offset entirely in the Fund by an overall rise in APFC's investments in US stocks and the continuation of strong performance in real estate, private equity, and infrastructure investments. US Stocks in the APFC portfolio, for example have risen roughly 2.5% since the US election, led by advances in basic materials, financials, and pharma+biotechnology especially among small-cap names while private equity, real estate, and infrastructure have each contributed between 1.5-4%. The message continues to be that APFC's diversification strategy across asset classes each with compelling long-term prospects materially reduces APFC's volatility risk while delivering attractive returns.

But what does this mean in terms of APFC's strategy going forward? APFC has positioned itself to participate in market growth associated broadly with infrastructure investment and small cap company growth and has now reduced its long-standing underweight to bonds. In addition, APFC has reduced its structural overweight towards Emerging Markets while international trade deals and tax treaties potentially get renegotiated over the coming months. Meanwhile, countries like India (for which APFC has particular interest in over the medium- and long-term) are enduring potential devaluations in both their currencies and securities markets. India, in particular, has recently "de-monetized" fully 84% of its outstanding currency (the functional equivalent of invalidating all US $50 and $100 bills) in a bid towards regularizing Indian business and increasing its overall tax base which currently stands at a 1% participation rate. Irrespective of the potential long-term benefits of such a national policy, the short-term impact across India and the Emerging Market in general is that they may likely endure weakness in both their currencies and potentially real estate. Although our Emerging

Markets investments into infrastructure, private equity, and real estate will thus likely remain relatively small in the short-term, over the coming years, we fully anticipate that material success across the Emerging Markets in both public and private investments will provide APFC with a compelling and differentiated capability from our US public fund and endowment fund peers.

What you will hear today and tomorrow will reflect our plans to deliver outstanding returns in each of APFC's target asset classes while at the same time controlling risk, and thereby increasing the overall investment efficiency and effectiveness of the Permanent Fund. You will also see a transition of reporting from the old "Risk Class" categories to the new "asset classes," particularly for returns which occur after September of 2016 when the re-categorization policy change was approved by this Board. A special focus for this Board meeting will be on international opportunities and risks in the aftermath of the US election, particularly with regard to currencies and both international developed market and emerging market stocks.

Thank you in advance for your consideration, questions, and recommendations, and we very much look forward to our work with you over the coming two days. I am happy to answer any questions you may have regarding APFC's overall investment strategy and outlook.