CIO Report for the February 22, 2017 APFC Board Meeting

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

As we approach the end of the first eight months of our 2017 fiscal year, I am pleased to report that the investment performance of the Alaska Permanent Fund was strong and on-pace towards contributing towards our long-term CPI+5% or better investment return objective. As of the end of December, the net asset level of the Permanent Fund stood at $55.4 billion with the overall six-month investment return of 4.5%. This translates to an annualized rate of return of roughly 8-10%, an overall investment return I would anticipate if the stock and bond market ended the fiscal year at today's levels. Unlike last fiscal year when global equities produced marginal or even negative returns while strength was registered in the fixed-income markets as well as the private markets for real estate, private equity, and infrastructure, this fiscal year public equities have been the principal driver of investment returns led by US stocks (of more than 10% through first half of the fiscal year) and accompanied also by strength in international and Emerging Market stocks.

Meanwhile, longer-term performance has also proved strong with our annualized investment returns for the 1-year, 3-year, and 5-year periods ending in December registering at 8.1%, 5.5%, and 8.4%, generally securing APFC's CPI+5% or better investment objective over these time periods. Notably, this has been accomplished with less reliance on sometimes volatile public market returns for stocks and bonds than in previous years. All said, we enter this 40th year for managing the Alaska Permanent Fund with confidence in our investment portfolio, investment strategy, and professional staff capabilities.

So, how exactly is the Permanent Fund positioned for the future? The answer relies on three elements—(1) positioning the portfolio for success in the public markets for stocks and bonds, (2) developing substantial capability for increasing the quality and quantity of project investment opportunities in real estate, private equity, and infrastructure, and (3) allocating among both our asset classes and geographies to ensure efficient investment whereby the Permanent Fund is compensated for the risks it undertakes.

First, regarding our positioning in the public markets for stocks and bonds, we generally have a more global portfolio than most of our public market counterparts, positioning the Permanent Fund to capture the investment return benefits associated with high-growth economies internationally while also securing a meaningful level of risk diversification in the process. Our positioning reflects a view on the natural "cycles" of investment, with our longest-cycle view being a general preference for Emerging Markets over industrialized market stocks, a view which began to produce tangible benefits for the Permanent Fund particularly over the past calendar year, after lagging somewhat in the two years prior. Another long-cycle view reflects a preference for corporate credit over government credit within our fixed-income portfolio. Shorter-term cycle views include a preference for small-cap versus large-cap stocks, and Japanese and European stocks over US stocks due to the relative attractiveness of company valuations in those geographies.

Second, regarding increasing the quantity and quality of attractive potential project investments in private equity, real estate, and infrastructure, APFC has increased both its internal capabilities as well as its network of international partners. These key partnerships include fund managers as well as external advisors and institutional investment peers such as sovereign wealth funds and other international public funds. Today, APFC's investment performance in these private markets for real estate, private equity and infrastructure has been a net contributor to driving APFC to achieve CPI+5% performance virtually each year over the past decade with the notable exception of during the Global Financial Crisis of 2008-2009. Our expectations are that by expanding APFC's geographic reach and evaluative capabilities, these asset classes will remain critical drivers for APFC's strong performance for many years to come. As mentioned in prior Board meetings, we anticipate the allocation of APFC's private market portfolio to roughly equal the value of its public markets portfolio for stocks and bonds over the coming 5 years, thereby more closely reflecting the rough asset allocation among the best run endowments compared with typical US public plans.

Third, the drive towards increasing APFC's investment efficiency has already begun to demonstrate its benefits. APFC has reduced concentrated risk positions both across its asset classes (in the case of approximately 40% of the portfolio in sometimes volatile public equities compared over half for many public plans) and also by materially reducing concentrated risk positions in three private market investments, each valued at over $500 million. The result has been a material increase in the measure of APFC's investment efficiency measure (the Sharpe Ratio) to over 0.5, which is the level we believe will be commensurate to achieving CPI+5% returns or better on a long-term basis.

As in previous meetings, 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. Owing to this meeting being in Juneau, you will hear both from the investment team leaders and their staffs. A special focus for this Board meeting will be embodied in two special sessions tomorrow morning which will explore infrastructure investing in both the United States and internationally.

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.