CIO Report for the September 27, 2016 APFC Board Meeting

Good morning, Mr. Chairman and members of the Board. As mentioned during the last APFC Board meeting in May 2016, I will be providing a brief CIO Overview to you regularly at each of these meetings following the comments and discussion of our Executive Director.

As we approach the end of the first full quarter for Fiscal Year 2017, I wanted to provide you with a "good news" perspective on our investment performance both now and for the future. As you know, the investment return on the Permanent Fund for Fiscal Year 2016 was 1.02%, which was essentially in the middle of the pack among US public plans but generally better than figures posted by endowments. Indeed among, the top 20 university endowments in the United States, only a single plan (Yale's) delivered positive returns at all. Callan will provide you with a more detailed comparison against APFC's peers later today.

Although this 1.02% investment return for Fiscal Year 2016 may at first appear uninspiring, it masks an important transformation that has been underway both in the financial markets generally and for the Permanent Fund specifically. Indeed, virtually all of the negative performance experienced last fiscal year in the Fund occurred from July-December of 2015. During that time, the Permanent Fund was estimated to have lost 2.4% (or roughly $1.3 billion) primarily to declining global stock markets. Since January of this year, however, US stock markets have reversed the previous year's losses and international stock markets also began to recover, leading the Fund overall to return roughly 3 ½ % during the first six months of calendar year 2016.

As of the fiscal year-end on June 30, 2016, the net asset level of the Alaska Permanent Fund stood at $52.8 billion. Overall, net losses incurred in international stock markets and currencies were more than fully offset by double-digit gains in APFC's real estate, infrastructure, and private equity portfolios along with high single-digit returns in APFC's fixed-income portfolio. The catch phrase for APFC in 2016 was therefore "diversification paid off."

The Fund has now experienced a continuation of strong overall returns posted early this calendar year in our new 2017 fiscal year with gains since July 1st of approximately 3%. What is different about these gains, however, is that they have been led by last year's laggards—namely, international stocks and currencies. In fact for the nine months of this calendar year since January, the Permanent Fund has gained some 6 ½% overall, establishing a solid start to the fiscal year for APFC on both an absolute basis and relative to our public fund and endowment peers.

What you will hear today are our recommendations for configuring the Permanent Fund portfolio and its investment teams to deliver compelling risk-controlled performance over the coming five years and beyond. A new term you will be hearing about in particular is "investment risk efficiency," measured in the form of a Sharpe Ratio (or the ratio of real returns divided by portfolio volatility or risk). In effect, investment risk efficiency is the natural extension of the risk measurement and control framework which APFC has developed over the past several years and will continue to maintain with one important distinction—investment risk efficiency shifts the focus of our efforts to delivering investment returns whenever we undertake risk. Doing so well should enable APFC to join the ranks of the best institutional investment plans globally. If approved, you will also see what we believe are more compelling and intuitive analyses and reports which disaggregates the Fund by Investment Objective (that is, Growth or Income) as well as Liquidity (liquid or illiquid). Six distinctive asset classes emerge from this re-categorization all of which should be immediately recognizable to this Board—(1) Global Equities, (2) Tradable Income, reflecting not only investment grade, high yield, and emerging markets bonds but also real estate investment trusts and tradable infrastructure securities which trade on a yield basis, (3) Private Equity & Special Growth Opportunities, (4) Real Estate, (5) Absolute Return Funds, and (6) Infrastructure & Special Income Opportunities. This re-categorization reflects both the changing opportunity set in international markets as well as a focusing of APFC's investment teams' current and expected future strengths, especially building upon APFC's unique credibility and investment-sourcing capability as the United States' premier manager of state sovereign wealth.

In terms of market and portfolio expectations, we have positioned the fund to continue to benefit from renewed but steady strength in both international stock markets and currencies. The shift from Fixed-Income to Tradable Income will enable that portfolio team to benefit from a far wider range of liquid, yield-bearing investments than simply the US or even international bond markets which are experiencing historically low or even negative interest rates. We expect perhaps the biggest increase in APFC's asset class growth in the areas of Private Equity & Special Growth Opportunities as well as Infrastructure & Special Income Opportunities, while APFC's allocation to absolute return strategies will decline slightly as we reposition the program. Tomorrow, you will hear a more extended overview of APFC's current and future real estate investment program, along with the perspectives of real estate investment industry experts with whom we work.

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.