

**ALASKA PERMANENT FUND CORPORATION**  
**QUARTERLY MEETING OF THE BOARD OF TRUSTEES**

**May 23-24, 2018**  
**8:00 a.m.**

**Location of Meeting:**  
**Atwood Building**  
**550 West 7<sup>th</sup> Avenue, Suite 104**  
**Anchorage, Alaska 99501**

**SUMMARY MINUTES**

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**Trustees Present:** William G. Moran, Chair  
Carl Brady, Vice Chair  
Marty Rutherford  
Andrew Mack  
Craig Richards

<b>Staff Present:</b>	Angela Rodell, CEO	Russell Read, CIO
	Valerie Mertz, CFO	Chris Poag, General Counsel
	Paulyn Swanson	Valeria Martinez
	Marcus Frampton	Stephen Moseley
	Fawad Razzaque	Jim Parise
	Chad Brown	Robin Mason
	Danielle Graham	Nellie Metcalfe

**Invited Participants and Others Present:** Bob Schroeder, Public Comment  
Rick Steiner, Public Comment  
Ceal Smith, Public Comment  
Chris Rose, Public Comment  
Clem Tillion, Public Comment  
Gregory Allen, Callan Associates Inc.  
Steven Center, Callan Associates Inc.  
Brian Deese, BlackRock  
John Goldstein, Goldman Sachs  
Hilary Irby, Morgan Stanley  
Michael Abbott, Alaska Mental Health Trust Authority  
Andrew Stemp, Alaska Mental Health Trust Authority  
Michael Oak, McLagan Partners

## **CALL TO ORDER**

CHAIR MORAN called the meeting to order at 8:00 a.m.

## **ROLL CALL**

VICE CHAIR BRADY, TRUSTEE RICHARDS, TRUSTEE RUTHERFORD, TRUSTEE MACK, CHAIR MORAN were present to form a quorum.

## **APPROVAL OF AGENDA**

CHAIR MORAN stated that on the third page of the agenda, the section on real estate investment pacing, and then a review of the annual asset allocation needed to be switched so that the asset review would be at 11:00 and pacing at 12:30. There were no objections raised to the meeting agenda, as modified.

## **APPROVAL OF MINUTES (February 21-22, 2018; March 15, 2018)**

CHAIR MORAN stated that there were two sets of minutes, and if there were no changes, they are considered approved.

## **SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION**

CHAIR MORAN moved to the schedule of appearances and public participation, and stated there were a number of people listed that would like to address the board. Each testimony was limited to two minutes. He recognized Mr. Steiner.

MR. STEINER stated that he had two brief asks of the board that, if possible, could be acted on today. He commended the board and staff for organizing the Environmental Social and Governance session, and for the fantastic panel. First, he endorsed the CIO's recommendation to the board to provide guidance to the staff on the Environmental Social and Governance policy, and asked that the board direct staff to develop a robust, comprehensive ESG policy to bring back to the board for consideration and possible adoption at the next board meeting. Second, he asked to look at the fossil fuel divestment request that hundreds of Alaskans have made since last December's meeting. He asked that the board direct staff to aggregate and understand the total fossil fuel holdings of the fund, analyze performance over time, and their future risk, and then come to the board with a recommendation regarding divestment from a fiduciary standpoint, even over and above the ESG standpoint. He continued that these two simple steps would be a giant leap forward to progressive government policy. He thanked the board.

CHAIR MORAN recognized Ms. Ceal Smith.

MS. SMITH stated that she was with the Alaska Climate Action Network and thanked the board for putting together the ESG panel today. She continued that since the submission of their letter in November, 250 more Alaskans have joined the 200 who initially called for the divesting from fossil fuel. Alaskans have a growing awareness of the seriousness of climate change and the ending of the old energy road. She added that the signs say that coal, oil and gas will be replaced by renewable energy by mid-century. In the spirit of AT CAN!, there is a fossil fuel divestment due to be pursued beyond ESG as a standalone risk to the fund in accordance with the prevailing fiduciary standards of the Permanent Fund, applicable statutes and industry best practices. She

stated that the trustees have first and foremost a fiduciary and a moral obligation to the people of Alaska to meet and to best the two-degrees test and divest. She thanked the board.

CHAIR MORAN recognized Mr. Chris Rose.

MR. ROSE stated that he is the director of Renewable Energy Alaska Project and was speaking for himself. He started the project, REAP, which is a coalition of over 80 organizations around the state, including electric utilities, Native corporations, businesses and developers, conservation organizations, educational institutions, all with the purpose of increasing energy literacy, increasing energy efficiency, and increasing renewable energy development in the state. He continued that the project has been instrumental in many of the state programs that have been created, including the Renewable Energy Fund, the Emerging Energy Technology Fund and the financing of over \$600 million of energy efficiency, weatherization, that AHFC has done. REAP has promoted all of that work which is now saving about 55 million gallons of liquid fuel for Alaskans today. He added that some responsibility to move into the future in a positive way should be taken. He stated that he is currently a member of the Governor's Climate Action for Alaska leadership team that is working with several cabinet members to make recommendations to the Governor by September. They have been hearing from the public that bold action needs to be taken. He stated appreciation for the opportunity to testify, and thanked all.

CHAIR MORAN recognized Mr. Robert Schroeder from Juneau.

MR. SCHROEDER stated that he is a long-term Juneau resident in his career as a research and applied anthropologist and works on natural resource issues for the State of Alaska for the Federal Government. He continued that he is the steering committee for 350 Juneau, an Alaskan organization whose goal is to promote reduction of greenhouse gas emissions to a maximum of 350 parts per million, and to encourage social justice approaches to mitigation. He added that the interest and direction at this point is to examine divestment on purely fiduciary bases. He stated that they believe that fossil fuel investments have been a bad bet for the past ten years and that they will not likely perform well in the future. In further correspondence with APFC's executive director, a letter and e-mail requested on March 28<sup>th</sup> to meet at the convenience of APFC staff. Specifically what was wanted was detailed and clear information on returns to the Permanent Fund from fossil fuel investments. He continued that APFC has not been forthcoming with this information and has had to use proxy measures to estimate the amount that APFC has lost and potential earnings from what is believed to be excessive investment in this investment category. He added that their meeting request was declined, and by May 12<sup>th</sup> the request was clarified for information, and to meet before this meeting. A response has not been received. Performance information cannot be an APFC secret. He stated that if APFC is not forthcoming and simply will not provide the fossil fuel past performance, prospective yields and identified risks, a FOIA request will be filed to get what should be public information. He added that he will also be submitting written testimony.

TRUSTEE RICHARDS recommended filing a public records request rather than a FOIA request. A public records request is for the State.

CHAIR MORAN asked for anyone else on-line that would like to participate.

MS. SWANSON stated that the lines are open.

TRUSTEE MACK stated that Mr. Clem Tillion is present and asked if he would like to speak. He added that he has a long history with the Permanent Fund.

MR. TILLION stated that he is a figurehead on the public defender's Permanent Fund Defenders and spends most of his time representing the Aleutian Island Natives at fisheries meetings. He explained that he was there when Hugh Malone's bill that set the fund up was passed, and is not complaining about the way investments are made. He wanted to make sure to not get carried away with trying to increase the yield by taking risks. Elmer Rasmuson said that it is not how much money is made; it is how safe the investment is. He continued that the dividend is an absolute essential to keep the people in defending the Permanent Fund, or someone may start dipping into it. He reminded all that Legislators are elected by special interests, and the special interests need money. There is an endeavor to put the existing statute into the Constitution so that it cannot be monkeyed around with, like that one that was put in when the Permanent Fund was made. He stated that there is a need for the proposal that is presented to the people to get two thirds of the vote in the Legislature to be able to get that on the ballot for voters to vote on. He continued that the fight has been going on for three years and has succeeded in keeping the Legislature from changing the law. The instructions under the law states to inflation-proof and, as long as that statute is there, there is the authority to move. He asked the trustees to think about what should be put into the Constitution if it comes up for a vote of the people. Simplicity is wanted. Inflation-proofing, 50 percent to the people. He continued that under the 1872 Act, 12.5 percent royalty, plus enough taxes to pay for the roads and stuff to develop it. That is his grandchildren's inheritance. He added that 83 percent of the people said no when paying off the Permanent Fund and ending it was suggested. He is worried about the Legislature's thirst for cash to pay off special interests. That is the biggest threat that the Fund needs to be protected from.

CHAIR MORAN moves to the Chief Executive Director's report.

### **CHIEF EXECUTIVE OFFICER'S REPORTS**

CEO RODELL introduced her full-time executive assistant and board liaison Danielle Graham. She stated that the capital project is moving forward swiftly, and we will have a slide show that is a mock-up for the board showing what the offices will look like upon completion. She would like the board to start thinking about whether or not they will have a new board conference center; and if they want to move the Hugh Malone name to the conference center boardroom, or if it should be renamed something else. She added that there are three naming opportunities with that facility. She continued that bids from contractors have been received, and we hope to have an award and a contractor on the premises starting July 1<sup>st</sup>.

CHAIR MORAN asked for the target date of completion.

CEO RODELL replied that the target completion date is March of 2019. She moved to the packet and pointed out that one of the things made available to staff is lynda.com, an on-line

training suite, which is also available to the trustees. She explained that the site has thousands of different courses under different types of work that can be looked through. She stated that if there is anything of interest, enrollment and getting signed up is available. It has been found to be a good training tool because it can be done on-line on your own time. The courses tend to be short and are targeted to specifics. She moved to cash flow for the three months, which points out activity and reflects what actions are being done day-to-day. She completed her comments and asked for any questions.

TRUSTEE RUTHERFORD asked for a reiteration on how staff will continue to function while this major capital project is occurring, assuring the board that there will be continuity in the work.

CEO RODELL replied that staff is relocating on site, on premises and we are consolidating that. It is called Suite 303, and will be the new board suite. Staff will be accommodated in that room. The other site is where private markets is currently located on the west side of the building, and that will accommodate 20 people. She stated that the board approved the virtual desktop which will allow work from home by staff because of how crowded it could be. She continued that there will be some discussion in budget about moving some money and using some money that would otherwise lapse in FY18 to make sure that all is up and running by July 1<sup>st</sup>. She added that all of the staff will still be located at the Michael J. Burns Building, which will be their duty station. They will have remote tools if there is a need to travel.

TRUSTEE RUTHERFORD asked if all the computer space will be there prior to the actual construction of the existing facilities.

CEO RODELL replied yes, and thanked the board for the commitment in moving those funds into IT and buying both the software and hardware.

CHAIR MORAN moved to the CIO report.

## **CHIEF EXECUTIVE OFFICER'S REPORT**

CIO READ stated that in contrast to the generally strong market returns for both the U.S. and international stocks during the 18-month period from mid-2016 through the end of 2017, this year, 2018, is proving to be a different one altogether. He continued that the story for stocks' cumulative calendar year-to-date is largely that they are range-bound and are investment-performance flat. With rising interest rates, fixed-income-plus has retreated nearly 2 percent in the first three months of 2018, as noted at the previous board meeting in February. Anticipated is that the impact of rising interest rates will continue to mute stock returns for most of the remainder of the calendar year or longer. He moved to the first three quarters of the current fiscal year through March 2018, and stated that the Permanent Fund has returned 8.86 percent or slightly less than one-half percent better for the six-month period reported at the February meeting. The strong nine-month overall return for the fund resulted from better than a 15-percent return on private equity and special opportunities. He continued that the performance scorecard, which will be presented later, the long-term five-year performance of 8.35 percent has outperformed the Fund's CPI-plus-5 percent objective by nearly 2 percent. He added that the

overall size of the Permanent Fund rose to \$64.6 billion, up only slightly from the end of 2017; but \$4.8 billion more than the start of the fiscal year in July of 2017. The Fund size is comprised of \$47 billion of principal, and a record \$17.6 billion in its earnings reserve, up by \$2.3 billion in December. If the stock market continues to be range-bound for the remainder of 2018 or longer, the Permanent Fund could expect to add value because of its multiple sources of investment returns. He continued that, first, U.S. stocks comprise only about 20 percent of the Permanent Fund's overall portfolio; second, APFC's strong private equity and private income programs, including infrastructure, have been increasing moderately in scale, while preserving their top quartile record against peer programs; third, the Fund is more diversified globally, particularly across the emerging markets, in every asset class, compared to many of the U.S. fund peers. He explained that this diversification advantage has also resulted in meaningful ways from investment partnerships that the Fund has already established or continues to develop investment managers or large plan peers internationally in virtually every asset class. It is anticipated that the strength of these international investment partnerships will give the Permanent Fund a materially higher quality and quantity of investment opportunities compared with other U.S. and other international sovereign wealth funds. He stated that the board meeting will cover some special topics, in addition to the additional review of the fund and asset classes, and we will hear from a panel of environmental social and governance, or ESG, experts from the leading fund management partners regarding prevailing industry best practices. He continued that an entirely new revision of APFC'S investment policies and procedures which reflects prevailing best practice standards among investment plans, as well as APFC'S unique investment history and trajectory, has been completed. He stated that he would be happy to answer any questions.

TRUSTEE RICHARDS requested a very brief summary of the Capital Constellation and MEASA and how it was reported.

CIO READ stated that, regarding those two initiatives, one is in the private markets and the other is in the public markets. The history was that, for almost all public plans, the APFC is the allocator, almost exclusively. Over the past several years, this shifted to more direct investments and have changed the relationship with both the fund managers and peer plans. He continued that the view is that the quality and quantity of investment opportunities has not declined around the world but has shifted in the geography and how it can be accessed. He added that this is a very important time in terms of a partnership model for seeing deal flow.

TRUSTEE RICHARDS stated his thanks.

CIO READ introduced Brian Deese from BlackRock; John Goldstein from Goldman Sachs; and Hilary Irby from Morgan Stanley. Each has run the ESG and sustainable investing practices for their institutions. He added that they are very seasoned on this topic. He turned the presentation over to Brian Deese.

MR. DEESE began by setting the stage for what is being seen in the industry. He talked about the prevailing best practice that has been seen in terms of investment research on the issue of ESG and its incorporation to investment strategies. He explained that the space of ESG is a stable investing space that is rife with terminology and often short on precise definitions. Sustainable investing is defined as a combination of traditional investment approached with

insights about the environments, society and governance in an effort to try to improve long-term, risk-adjusted return. He pointed out that the field of sustainable investing and the incorporation of ESG into investment strategies is fundamentally consistent with a core fiduciary duty. It is an effort to try to improve the investment process and investment outcomes over time. He moved to the second point, which is that interest in this issue in terms of assets invested into strategies and demand interest from the client base has taken off over the last 12 to 18 months. Regional variation continues around that, both the level of flows into investments and interests is higher in Europe than in the United States. He added that the pace of increase both in terms of commitment of assets and interest is accelerating quite significantly in the United States, as well. He noted a couple of high-level points that summarized where BlackRock research is with respect to investment strategies. He talked about the particular opportunity in the area of private markets where there are a number of impact or thematic investment themes that are quite exciting. He stated that in emerging markets, where the research actually demonstrates the highest opportunity to actually drive over performance by the incorporation of ESG, where there is traditionally less focus on these issues and less structured regulatory process, the risks of being on the wrong side of ESG issues are higher. In looking at a particular variable, there is a lot of discussion about carbon and the carbon footprint of companies and securities. He continued that what their research found is that the carbon footprint is principally relevant in thinking about how exposed the security is to regulatory or idiosyncratic risks associated with controls that might be put in place or technological changes. He highlighted four board approaches that institutional investors are taking: First is a focus on exclusions, which translates in approach of negative and exclusionary screens; second is integration of ESG considerations into the investment process itself; third is in investment solutions where the research is increasingly pointing to the opportunities in that space; the final is stewardship and engagement.

CIO READ thanked Mr. Deese and introduced John Goldstein from Goldman Sachs.

MR. GOLDSTEIN stated that the question is how to thoughtfully integrate ESG in a changing world, into stewarding a large portfolio. He continued that the world is changing and there are things to do in an investment portfolio and sometimes focusing too narrowly can delay action in a way that is less constructive. Step one is to ask the right question; step two is to take an investment-minded practical approach; three, for anything investment-wise, implement well and thoughtfully with great care; and finally, learn and adapt. He moved on and clarified the different tools in the tool kit. He continued that Mr. Deese talked about exclusions, and he called it alignment. The idea is getting efficient market exposure in a way that the ability to get that efficient market exposure is not changed. He stated that alignment is about the financial irrelevance in the near term of these factors, and the ESG integration is all about materiality. He continued that impact investing, private investments with measurable social and environmental impacts within a growing market, and solving a problem around health, around education, around efficiency, is a driver of growth and profitability. He added that progress is meaningful when engaging with the changing world as it matters to the portfolio. He continued on to efficiency where a suite involving broader-based employee ownership was created. Worker safety is actually a proxy for quality, training. Margins could increase by 5 to 15 percent of the companies that were bought. He stated that he talked to a lot of institutions on how to get smarter across all the data inputs. This is genuinely building muscles for market intelligence and insight, which is hard. The other big thing is not getting dragged into labeling. He went back to

investing and the solutions transformation where there are sectors that are quickly growing in a disruptive way with interesting opportunities. He stated that digging deeper into these sectors may be attractive, which the competitors do not yet appreciate, which is good business.

CIO READ recognized Hilary Irby of Morgan Stanley.

MS. IRBY stated that it is exciting to be having this conversation because this is one of the few places where the day-to-day realities of this conversation are playing out in real time. She continued that for many of the institutional clients this is playing out in terms of both risk management, fiduciary duty and investment opportunity. Some macro-tech trends are driving increased stress on natural resources around the world, with food, energy and water at the top. She added that these are interesting debates for investors of all sizes. In a recent poll of institutional investors, more than 60 percent of those who responded are \$10 billion in assets or larger. 84 percent are actively incorporating ESG consideration or are actively considering doing so, which is a significant shift from the past years; and 43 percent of them can envision a time where the only investments that are made are considering ESG. She moved to the range of factors that are motivating institutional investors. Risk management is at the top with return potential close behind; mission alignment and expectations around changes in policies and regulations, and then stakeholder demand. She added that the outcome in the approach that is taken is often very different than what might be stated or requested specifically by external stakeholders. She stated that shareholder engagement takes on a number of forms, and it is a clear proxy and engagement in public markets; and private markets are an active part of the investment process. She talked about ESG integration, measuring ESG risk, and ESG improvement where a lot of variables are factoring in. She continued that true integration is using all of these factors to understand the material ESG issues for a company and a sector, and looking for how a company is positioned relative to that. Plus the belief with how that will help the forward drive. She stated that, in terms of institutional investors' approaches, ESG integration is pretty significantly the place where most institutional investors are playing. She continued that impact investment is something that a lot more investors are doing on an opportunistic basis; but not something that is often seen consistently applied across an entire portfolio. She added that the top three themes are: Climate change; inclusive growth; and gender diversity. She stated that climate change is seen as a binary decision and that is because of the conversation around the question of divestment, which is asking the right question. Investors are fossil-fuel aware and are taking a strategic approach to the impacts of fossil fuel within the investment context. She continued that this is a progressive approach and recognizes the best practices within the industries that are the most exposed to fossil fuel are evolving and will be consistently investing in line with best practices. She moved to inclusive growth which lends to investing and looks to reducing the inequalities by investing opportunities that help lift people out of poverty and helps to promote human rights. She stated that she sits on the Global Sustainable Finance Group at Morgan Stanley, and partners across three core businesses of the firm to drive sustainable investing opportunities for clients, and to help think about how to incorporate this into core thinking.

CIO READ launched the discussion about some different approaches to ESG-related investing and incorporating everything ranging from divestment to value-added programs with thematic or



impact investing. He asked if an ESG policy is needed by the board or if this is a discussion that is had with investment staff about day-to-day activities for adding value to the portfolio.

MS. IRBY replied that whether it is specifically an investment policy statement or a documented approach taken and how it will be applied across the investment portfolio can be very important and is a good practice.

MR. GOLDSTEIN agreed and stated that having a place where it lives is important. He pointed out that there is a lot that goes into making good investment decisions, and overly prescribing how those get made tends not to be conducive of a great practice. It tends to work.

MR. DEESE responded that he would strongly recommend developing an ESG strategy, and then, a policy statement can be an effective way to achieve that strategy. He also cautioned against creating any sort of ESG policy if there is no confidence in a strategy underneath it. He stated that one thing that is the most persistent in the data is that there is a strong, persistent, negative relationship between companies that are out there proclaiming a lot of policies but are not actually acting.

CIO READ asked how the ESG part of a portfolio can be separated to adopt those principles.

MR. DEESE replied that it is an important distinction in terms of thinking about incorporating the ESG considerations in the index passive investments and in the active part of the portfolio. He stated that the approach would be different and there are two things about the index side that are worth considering.

CHAIR MORAN stated that investment managers are picked and all of them make independent investment decisions.

MR. DEESE stated that, with respect to indexes, there is emerging data that suggests that a traditional benchmark index can be swapped out with a version that is optimized for ESG consideration. He continued that, second, ESG provides an opportunity to build a systematic approach to manager diligence.

MR. GOLDSTEIN stated that on the passive side, there is less conviction in leaning on the ESG scores. Choices are still being made in building a passive portfolio with efficient ways to embed other choices in that. On the manager selection he added that it is just part of the management diligence process. The whole point of hiring an active manager is that they will pick the stock.

CHAIR MORAN asked if there are any policies or way of doing business that addresses the subsets in the Fund doing business with Goldman, BlackRock and Morgan Stanley.

MR. DEESE responded that they have a couple of specific policies that could be looked toward but thinks that the diligence process involves both looking at those policies and also understanding how they operate in practice within a set of investment processes.

MR. GOLDSTEIN replied that there are two layers of ESG: The layer of it all clients should get because it helps manage risk and return; and the views that develop good sector-based views. He stated that this is a balance of having an R&D function and integrating what is discovered more broadly in the portfolio.

MS. IRBY stated that she agreed with both and used the real estate portfolios as an example. She continued that one area in real estate that is currently under-researched is resilience. Not just resilience of a building or city, but finding the context of an area both on an individual asset basis and a portfolio basis.

CEO RODELL asked if companies move off these exclusionary screens and if there are benefits and observations.

MS. IRBY replied that a lot of active managers are doing company engagement through proxy voting, in person or phone calls where issues are identified that can have material, financial impacts. She stated that there are great examples of managers who have gotten companies to recognize that value may be left on the table if these things are not thought about. One of the significant things that are being done is looking at and using that data to look at the market-based and accounting-based metrics on ESG factors and how that is equated to financial value, and putting the conversation in that language.

MR. GOLDSTEIN replied that the conversation can be messy, sometimes very constructive and other times less so. He stated that the good management teams thoughtfully engage, figure out what is useful and try to do it well, and ignore the rest.

MR. DEESE added that, at BlackRock, there is an extraordinary amount of engagement directly with corporate management teams. He emphasized that this is a dynamic and rapidly-evolving conversation.

MR. MITCHELL asked if, in the public markets, proxy voting comes into play in ESG investing, and if the firms take adversarial positions to management in those issues.

MR. DEESE answered yes it comes into play and is in the category of shareholder engagement. He stated that there is a value principally in having a private engagement interaction where these conversations are had in a meaningful way. He continued that the approach is to be clear and to try to focus on issues that are material, and the entire engagement approach is tied to where the connection between the ESG issue and long-term financial performance is seen.

MR. GOLDSTEIN replied that they have a very different business profile in terms of the perspective. He stated that this is rough material and are learning what is going on in companies and sectors, things woven into the agenda to basically have a conversation with management. The proxy is one of the modes of having something on that agenda. He added that it is grounded in the sense of the best material research in some of the contextual specifics.

MS. IRBY echoed what Mr. Goldstein said, and stated that they have a publicly available proxy policy and also report on proxy voting.

CIO READ stated that the only ESG factor that the Fund has is given by the Alaska Legislature by statutes and that is an Alaska investment policy. He asked what type of direction would they like to give to the board.

CHAIR MORAN disagreed a bit on the composition of the policy and stated that what he heard is that when there is a social issue or an environmental issue it seems to be a governance issue. He stated that the board worked really hard on the governance issues in that investment policy and these subsidiary issues should be driven from that.

TRUSTEE RUTHERFORD stated that she was curious about how they have dealt with the fossil fuel market in the ESG sustainability analyses for various companies or themselves.

MR. GOLDSTEIN replied that they have taken a lot of approaches and have clients from every end of the spectrum, from clients that were profoundly centered on fossil fuels to folks at all points in between. He stated that they like to take more risk-aware approaches that allow people to express their view in an efficient way.

MR. DEESE stated that he understood, in the context of the Permanent Fund, there is the question of what the Permanent Fund's overall exposure is and then there is a broader question about what the State of Alaska's overall exposure is from a budget perspective. He continued that part of the unique situation could be a consideration about the risk from the perspective of the overall exposure to future oil price or fossil prices, which is a different lens to think about from the traditional arguments around reducing the exposure in the portfolio.

MS. IRBY stated that focusing it from the question of divestment is the wrong place in starting how to apply it on the portfolio context. She continued that when thinking of it at an asset-class level, the implementation could be very different on more liquid investments versus longer-term investments. She added that the permanence in Permanent Fund is an important part of that overall equation.

TRUSTEE RICHARDS stated that it was alluded to earlier that this board has been given its investment guidelines by the Legislature, and the Legislature has adopted the proven investment rule as our standard for investment. He continued that in looking at ESG issues and other governance issues this dialogue should be occurring in front of the Legislature.

TRUSTEE MACK stated appreciation for the presentation and thought that it is a very critical conversation to have. He continued that one of the themes of the Walker/Mallott Administration was to really think about how to manage the volatility of the price of oil and understanding that the investment policies going forward should be focused on and discussed. He added that there is room for further discussion on this, and he encouraged that.

CIO READ appreciated the comments from the panel members. He stated that the fund is pretty progressive and successfully progressive in the transformational quality of the private-market investments from private equity, venture capital, extending into infrastructure, and potentially real estate. He added that these factors can be value-added if used in the right way, particularly

in the private markets.

CHAIR MORAN asked if, as the CIO, he is finding enough direction in the investment policy to enable to stretch the portfolio that eliminates investments that do not have long-term returns that meet your goals and selecting ones that do.

CIO READ replied that the fund is on an excellent run in terms of seeing a quality and quantity of attractive deal flow.

CHAIR MORAN asked if there are tools available in that policy to address those issues.

CIO READ replied that from the investment staff perspective they have the tools that they need.

CHAIR MORAN called a break.

(Break.)

CHAIR MORAN moved to the performance review.

## **PERFORMANCE REVIEW**

MR. CENTER began the presentation with a review of the capital markets, what happened during the quarter, and then moved on to discussing the performance of the Permanent Fund as a whole, along with various asset-class summaries. He started with the red numbers and stated that for the first time in quite some time there are some negative numbers, particularly in looking at various capital markets indices during the first quarter. He added that the longer-term performance remained quite positive. He talked about the equity markets and stated that the emerging market and equity overweight was a positive for this quarter and was one of the few areas of the equity market that performed in the positive territory. He stated that emerging markets are up over 25 percent, and the U.S. equity market remains to be the strongest performing area. He continued that the U.S. equity market saw a pullback during the quarter which is after 300 straight days of not experiencing a 3-percent correction. That is a record for the U.S. equity market.

MR. ALLEN stated that, in the last five years, this was only the second quarter where U.S. equities were down.

MR. CENTER looked at sector performance divided up by large-cap and small-cap equities and saw some divergence this quarter. He stated that small-cap health care was a very strong performer, while energy and small-cap area was a very weak performer. He continued that technology was the strongest performing sector in both small-cap and large-cap equities in the U.S.

MR. ALLEN stated that the technology sector is now 25 percent of the U.S. equity market and there has only been a few times when a single sector has gotten that large as a percentage of the

U.S. equity market. He added that the market has gotten very concentrated in technology, once again, in the U.S.

MR. CENTER moved to the non-U.S. equities and stated that most posted negative results. He continued that Japan and China were two areas that actually had positive returns.

CHAIR MORAN asks how much of the emerging market strength was dollar weakness.

MR. CENTER replied that it helped a bit, but a lot of it was driven by the increase in the price of oil, and Brazil and Russia were the two best performers. He added that China was also a very strong performer based upon manufacturing growth rather than dollar weakness.

MR. ALLEN noted that the Permanent Fund recently installed a currency overlay hedging program. The way that was designed it would be almost impossible to make money in a market like the one in the first quarter where there was a strong dollar. The goal is just not to lose as much during those types of periods and the manager did a good job of protecting it. The total impact of the overlay program was about 2 basis points, but it was in the negative direction.

MR. CENTER moved to the long-term performance of four major currencies versus the U.S. dollar, and stated there was a tailwind for non-US. Equity investors over the last 12 months. He continued on to fixed income and stated that there was some shifting within the interest rates for the quarter. The new Fed Chair, Jerome Powell, introduced his first rate hike during March. This was widely anticipated, and the market currently expects two more rate hikes before the end of the year, as well as some additional hikes during 2019. He stated that the Bloomberg Barclay's U.S. Aggregate Index fell by 1.5 percent during the quarter. Credit had a pullback, and investment-grade credit was the worst performing area of the fixed income market, falling over 2 percent. The U.S. bond market continued to tighten, and more moves from the interest rate side from the Fed are anticipated by the end of the year.

TRUSTEE RICHARDS asked if industry rates go up when bond prices go down.

MR. CENTER replied that was correct.

TRUSTEE RICHARDS asked if there is any measurable income on quantitative easing policy on bond prices and if there is any correlation.

MR. CENTER replied that it depended on how telegraph quantitative easing is.

CHAIR MORAN asked if there was anything that happened in the TIPS market that was noteworthy.

MR. CENTER replied that TIPS held in okay during the quarter. They did move negatively, but it was pretty much in line with the aggregate. He added that they moved more in line with the bond market than with inflation, which is not uncommon. He touched on real estate where supply-and-demand fundamentals remain fairly balanced. All areas of the real estate sector remained positive for the quarter. He stated that hedge funds performed better than hoped for in

the quarter, and came in positive. Private-equity investors remained enthusiastic; however, rising borrowing costs and the impact of tax reform may curb some of the optimism on a near-term and long-term basis. The U.S. economy as a whole remained healthy during the first quarter with quite a few positive earnings announcements in the March period that helped to steady things.

CHAIR MORAN asked about private equity and if there was a demographic coming to that, or was it just a cycle of the market.

MR. CENTER answered that it is a cycle of the market and moved to the fund as a whole first, looking at the asset allocation for the Permanent Fund. He stated that, as of March 31, it remains well diversified across all major asset classes using standard asset allocation bucket classifications. He continued that the Permanent Fund was allocated 40 percent, the public equity 21 percent to fixed income, and 39 percent to alternatives. He explained, that represented a minor downturn from the equity allocation from the last quarter. He stated that the remainder of the presentation would focus on total fund performance with a few highlights from the sector standpoints. He continued that the total fund outperformed the performance benchmark by 0.3% during the quarter. Manager performance within public equities and infrastructure/private credit/income opportunities was beneficial and offset manager performance within asset allocation, which detracted slightly. In aggregate, active management added 26 basis points to the relative performance, while deviations from the policy target were neutral. He added that, for fiscal YTD 2018, the total fund outperformed the performance benchmark by 1.5%. He touched on the overall risk for the fund and looked at the historical standard deviation over the last three, five, seven, 10, and 20 years. He moved on to the Sharpe ratio for the fund, which is a measure of return per unit of risk, and the Sharpe ratio has been quite high for the Permanent Fund over time. He stated that the equity portfolio had a negative return for the quarter, coming in at negative 0.4 percent, which was ahead of its benchmark, which came in at negative 0.9, and over the fiscal year to date in the last year has outperformed its index by over a percent over both time periods. He continued on to the U.S. equity portfolio versus peers and stated that the U.S. equity portfolio ranks favorably versus the other U.S. equity portfolios of other fund sponsors within the database. It returned a negative 0.4 percent for the quarter, and long-term performance exceeded the benchmark and ranked above median versus peers. APFC's large-cap portfolio ranks around median within the large cap universe over all time periods shown and compared favorably versus the benchmark. He looked at the small-cap portfolio which performed well during the quarter up positive 0.5 percent versus about flat for the Russell 2000 Index. It met the benchmark over all time periods and performed around the median over long term, seven and 10 years; overall it has performed well versus peers. He identified the emerging market equity portfolio which performed in line with its benchmark over time, and slightly lagged the index during the quarter. He noted that last year that emerging market equity portfolio underperformed the index by about 50 basis points. He added that a positive 25.4 percent return on an absolute basis is very impressive for the emerging market equity portfolio. He stated that the global equity portfolio ranked in the third quartile over all time periods, and noted that over the five, seven, and 10-year periods it is ahead of the benchmarks overall, three of the longer-term time periods. He continued that it was important to touch on fixed-income-plus this quarter because it is the first time since REITs and listed infrastructure were added to this portfolio. Both REITs and listed infrastructure were down over 5 percent for the quarter, and that negatively impacted the

performance of fixed-income-plus allocation relative to other fixed income portfolios that he compared. He moved to the performance of the real estate portfolio relative to the real estate performance of other public funds. He explained that the fiscal year-to-date showed that the real estate performance was ranked in the bottom quartile. He stated that that came back to the same performance issue that was discussed two quarters in a row when the lag was implemented which had to do with reevaluation of some underlying real estate investments. He noted that long-term performance compares favorably versus the peers and the index. He continued with the performance of absolute return portfolio relative to the hedge fund of funds universe. He added that the hedge fund portfolio performance last quarter was positive and came in at 0.8 percent. That was ahead of the asset return benchmark which is the HFRI Fund of Funds Index. Fiscal year-to-date, the program is up 5.25 percent; and over the last 12 months was up over 6 percent. He closed his comments and stated that they would be here this afternoon to make any comments when the specialists present.

CHAIR MORAN called a lunch break.

(Lunch break.)

CHAIR MORAN called the meeting back to order.

CIO READ introduced Valeria Martinez, director of asset allocation, for an overview and update on asset allocation.

## **FUND PERFORMANCE OVERVIEW AND UPDATE**

MS. MARTINEZ began with a review of how the Fund is positioned and what the performance was as the scorecard was introduced last year. She continued with that and how the Fund did versus benchmarks and added that position translated to a risk which will be discussed later. She stated that last year the Fund was divided into two big groups: income and growth. In the income category there were 27 percent tradeable which included fixed income, REITs and public infrastructure, and for the liquid income categories that included real estate and private infrastructure and private credit which represented 14 percent of the fund. On the other side, for the 59 percent of growth assets, the tradeable portion was mostly public equities at 40 percent, and the rest is private equity and hedge funds that represented 19 percent of the fund. In terms of performance, she explained that the Fund outperformed the passive benchmarks and performance benchmarks and lagged in the CPI-plus-5 objective during the first quarter. This 2018 quarter started with higher volatility, and there is an expected correction in the equity markets. She added that returns for the longer-term periods look very good, and pointed out the fund outperforming all the benchmarks including the CPI-plus-5 objective for the year, last year and five years. It also helped that there was an overweight to public equities. She reminded all that there will be a discussion of the liquidity overlay, and the asset allocation bucket has the cash account which is used for anything that has to do with operations for the fund, funding new strategies and so on, and will also be used for funding any liquidity out of the fund. She talked about the Sharpe ratios and then moved to the performance scoreboard that introduced how to measure success for the fund over the short and long term. Overall, during all time periods, given this new scorecard, we outperformed.

## **RISK OVERVIEW**

CIO READ stated that the next part is a risk overview which will provide a historical context in a way that has not been done before. He continued that, in the future, this will be presented by Samantha LaPierre. He added that this is about risk management measurement and efficiency. He reinforced some of the measures, the target, where it came from, and what happens. He stated that this uses a new technique which would be a weighted moving volatility. He explained that this used the actual historical of the fund and is intended to give an estimate just using the performance information on the realized volatility. He stated that it is specifically data from a year ago, which is half as important as current data, and is weighted to consider the most recent information. He added that the difference here is that history can actually be looked at and questions on what happened here could be asked on why there was a spike. There is a story in each of those that can be seen. He talked about how comparative volatility was attributable to U.S. stocks, and that most of the risk of the fund comes from stocks. That has been true as of late except in the most recent time period stocks were flat. He stated that the two charts show volatility of an asset class, and the Sharpe ratio of an asset class. In equities, the equity markets have declined substantially in volatility since the financial crisis. At the peak of the financial crisis, 30 percent volatility was coming from stocks. He continued, that declined fairly substantially to only about 10 percent volatility in the stock portfolio. Fixed income is running at about a 4 percent realized volatility, and this has been an efficient asset class where that 5.5 percent was met. In real estate, the illiquid asset classes expect a higher Sharpe ratio generally because there is smooth volatility. He added that infrastructure, private credit, and income opportunities realized volatility inching up toward 10 percent, and the Sharpe ratio has been very efficient at about 1.25. He stated that private equity has been a success story with a realized volatility running at about 20 percent. He added that the Sharpe ratio actually did not change. He continued on to absolute return funds that are running at about a 4 percent realized volatility, and a Sharpe ratio that has been above 0.5 for the past year and a half. He wanted to make sure that absolute returns have enough volatility that will be consistent with the CPI-plus-5. Next, he went to asset allocation, which includes both the multi-strategy funds and, also, the liquidity of the portfolio. A 3 percent volatility and the Sharpe ratio, most of the time, above 0.5. He continued on to value at risk, which is a going-forward value at risk measure from the BlackRock system. He explained that it shows on an ex ante basis; the markets had been in a much lower volatility state and have upticked more recently.

TRUSTEE RICHARDS asked how much of the private equity risk is really reflecting a lack of transparency during a liquid market as to value.

CIO READ replied that some of that is absolutely the case and, generally, the private equity is more levered. He stated that it is managed differently and was adjusted for leverage, the private equity portfolio. He added that private equity was more volatile than public equity. He continued that the other part of this is that a privately managed company, privately managed funds are managed toward an absolute return objective, relative to a stock market.

MS. MARTINEZ added that private equity considers some of the liquidity, lack of transparency and leverage.



CIO READ moved on to currencies and stated that the primary currency risk was from developed markets; emerging markets do not hedge. He stated that it is only about 4 percent of the overall currency risk. Then, the emerging markets in South Korea are the largest emerging markets currency exposure, followed by India, Brazil, Taiwan, and South Africa. He continued that the liquidity risk becomes increasingly important as the private-market part of the portfolio increased. There is nearly \$18 billion invested into the private markets and future commitments of about \$6.9 billion. He moved on to the asset class updates.

## **ASSET CLASS UPDATES**

CIO READ stated that Marcus Frampton, director of real assets and absolute return investing, is next.

### **REAL ASSETS (Infrastructure, Special Income, Real Estate, Absolute Return)**

MR. FRAMPTON stated that the presentation will cover real assets/private income and absolute return. He added that real estate is now included in the overall presentation on private income. He explained that it has a similar objective to what is being done in infrastructure and private credit in terms of privately generated income source for the Permanent Fund. It is an inflation protection and is 11.7 percent of the portfolio. He stated that it is worth remembering that they instituted the lag and these numbers are through December 31; and the fiscal-year-to-date numbers are nine months ended December 31. He continued that there was a large divestment in the calendar first quarter and, as of December 31, that number was actually \$5.6 billion. He continued that performance has been strong and began with absolute return. The industry and the Fund's portfolio did not distinguish well in the financial crisis and was not hedged as advertised. There were some hedge funds that were left-hand skewed or had kurtosis in terms of fat tails. Historically, money was lost in a down market and his view is that the return stream is not worth having in the portfolio; it is a high fee, does not have a lot of transparency, and was no protection in the down market. He stated that his expectation is to get about half of that money back in the next 12 months. The target returns were benchmarked against the industry as measured by the fund-of-fund index. He continued that he is more focused on the return objective because it is absolute return. He explained that in the concept of kurtosis, the strategy that exemplifies that best is fixed-income arbitrage. Arbitrating anomalies on Treasury curves with a lot of leverage is a common hedge-fund strategy. He added that they will continue to update the board on these metrics. He moved to the real estate portfolio which targets return between equities and fixed income. It is a lower-leveraged portfolio than a private equity real estate-type strategy where people might be using 50 or 60 percent leverage. He stated that this portfolio has, in the period that included the financial crisis, delivered on that return between equities and fixed income. The real estate strategy has been worked on for the last few months and is very close to engaging a real estate consultant, which is planned for in the next few weeks. He explained in detail the need for this consultant. He talked about the portfolio prior to the Simpson Housing sale, which showed the sector mix and then the NCREIF. He stated that with the Simpson sale, the 5.7 became 4.1, with about \$3 billion under target in real estate. The target is 11 percent and the fund is around 6 percent now. This sale brought about being inline with the NCREIF on office exposure; retail exposure is relatively high at around 45 percent. He added

that the Fund is underweight in multifamily and industrial. He moved to infrastructure which has a similar objective to real estate. The approach has been very different and there was no strategy of buying control interests in infrastructure assets away from managed. He stated that the base of the strategy was to lead with fund commitments and co-invested with funds, which has been a successful strategy. He continued that infrastructure has put up good returns recently and had been a great area recently. He moved to private credit and income opportunities. The private credit and income opportunities program objective is to provide an income source to the APFC in excess of what is available in public markets for similar risk investments and outperform a U.S. high yield and a blended real assets benchmark. He stated that his strategy in private income is to default to real estate and infrastructure, and then do credit and income opportunities. He continued that these income opportunities being a private income-generating deal that is neither real estate, credit or infrastructure when the risk/return is better in that category than what is seen in real estate. He added that there are four investments in income opportunities which are American Homes 4 Rent, two small fund investments, and Generate Capital, which is a preferred stock investment made in a sustainable infrastructure company. There is also a board seat at Generate Capital. He commented that they are two-and-a-half years into moving away from fund of funds and private credit. He concluded his presentation.

CIO READ moved to asset allocation strategy with Valeria Martinez.

## **ASSET ALLOCATION STRATEGY**

MS. MARTINEZ stated that this is part of the portfolio that had never been reviewed individually and is increasing. She continued that this part of the portfolio includes three main strategies: One is the liquidity portfolio that includes cash, fixed income, and the overlay; the ECIO program; and then the currency overlay. She began with the liquidity portfolio which, as of March 31<sup>st</sup>, was \$3.7 billion; which increased from \$900 million. This is becoming a more important part of the fund. She stated that the introduction of an overlay program was presented to the board last year which can be exposed to the market, reduce the cash drag and still have the liquidity because of being exposed to the market via futures derivatives. She moved to the overview and explained that a liquidity overlay manager was hired to securitize the cash. It was decided to split it, which was similar to how we are exposed to the market, except no private investment, 65 percent in equities and 35 percent in fixed income. The initial amount was around \$1 billion and was divided into almost \$350 million, and the fixed income portion and the rest on the equity program. She explained this with the help of her slide presentation. She stated that the second area under the asset allocation strategies is the multi-asset managers or ECIOs. This is a mix of managers that allocate risks in a more balanced way. She continued that AQR has been the best-performing manager since the inception of the program. It started with five managers and now there are three. Right now the risk parity is very heavy, which is a good thing because it is something different than what has been done. She added that the last portion of this area is the FX overlay and is basically hedging currency from the public equities portfolio.

CIO READ thanked Ms. Martinez and recognized Jim Parise, director of Fixed Income Plus.

## **FIXED INCOME**

MR. PARISE stated that he would go over the Fixed Income Plus portfolio and will focus in the beginning on the internally managed portfolios. First is the internal Agg portfolio, showing the performance with the one- and three-year numbers beating the index. The attribution is where the actual performance comes from and is on a quarterly basis. The asset allocation is overweight corporates, and corporates underperformed the broad market; the asset allocation is a negative 6. He explained that the predicted tracking error showed that the majority of it comes from the fact of overweight spread product. The index comparison was looked at very closely and was recently moved away from. It will not look the same at the next board meeting. He stated that 30 percent of the portfolio is corporates versus 25 percent for the index, the underweight to Treasurys, and essentially slightly underweight MBS, which is close to neutral. The duration is neutral. He continued that the benchmark is slightly short, which means that duration is slightly short. He added that the internal corporate bond portfolio continues to do well and beat in all periods: one, three, and five years. He stated that the internal TIPS portfolio is now at \$100 million, having sold \$500 million over the last month; \$400 million will be put into global rates, and \$100 million into emerging markets. He continued that completely eliminating the asset class is not wanted. The market is still being tracked and it will be a small portfolio. He added that is the best way to go about it. He pointed out that in the global government bond portfolio FX is now done in-house. This used to be outsourced, but it cost a lot of basis points through that frustration of underperforming, and a lot of it had to do with the fact of paying a custodian to do it. It came out of the performance to see if it could be done internally. He stated that they started to go into India, which is exciting, getting into markets that we were not in before. They are also trying to get into China, if possible. There are a lot of people working on this because it is very complicated. There are regulatory and currency issues to get through. He continued to the Fixed Income Plus allocation where there are overweights and underweights. The benchmark of non-U.S. rates is at 10 percent, and it is at half of that. He added, that will be much closer because of this selling out of TIPS. TIPS will have a much larger underweight. He stated that TIPS went into non-U.S. rates, global rates and EM; \$100 million into EM and \$400 million into non-U.S. rates. He continued that the value in this is the actual asset allocation, and we have gone to more passive types of portfolios when possible. He talked about ADAC which is the new thing being worked with private credit. This is a high-quality, high-yield, in-house bond portfolio that is buying and selling bonds versus a double B index. The idea it to get it up to about \$500 million of ETFs and actual bonds.

CHAIR MORAN called a 15-minute break.

(Break.)

CIO READ recognized Fawad Razzaque, director of Global Equities.

## **PUBLIC EQUITIES**

MR. RAZZAQUE stated that there were modestly negative returns of public equities for the quarter. He continued that part of public equities and emerging markets noticed positive returns, while other parts have modestly negative returns. The quarter had a strong start in January, and

then quickly gave it all back in February. This was partly because interest rates went up sharply and what really spooked the markets was the employment report in February. He added that the wage inflation part was way above inflation, 2.9 percent year-over-year growth, and the market was concerned about margin pressures coming from high labor costs affecting corporate profitability. He stated that equities were replaced for the rising rate environment, and it gave back all of January gains. He continued that information technology was the best performing sector, and all the areas of the public equity market each had more organic growth and reasonable valuations did well, even in that market. Emerging markets was the other one where strong growth prospects for cyclical rise plus good valuation did very good returns. He moved to equity price. Equities were repriced downwards to account for higher interest rates, which, for a ten-year yield, went up from 2.4 at the end of 2017, to almost 2.95. 50 basis points rose in ten-year yield within two months. He continued that in 2017 the estimates were pretty stable and were not revised down. What is unusual for 2018 is that estimates actually went up for the S&P 500 with very strong corporate revenue and earnings growth that have not been seen for a lot of years. He added that equities were priced downwards; and earnings estimates were revised upwards, which means valuation contraction. He stated that it looks like corporate earnings growth and all of the global growth remains quite strong, and valuation is a lot more reasonable across the board, and it is a better time for public equities. In a rising earnings environment, it is cyclical areas of the market, like financials, energy, industrials, materials, tech, that are green, and defenses outperformed. He explained that the opposite is true when the earnings are going down for heat, utilities, staples, telecom, health care-type, and things like that. He stated that in terms of relative performance, public equities did better than the MSCI All Country World Index by 47 basis points for the quarter, and just over 100 basis points of outperformance for fiscal year to date. He continued that in global equities the biggest drag was all the way to Europe. He then went over the performance of fund managers over one-, three-, and five-year time horizon, as well as the last one year; 68 percent of the fund managers outperformed.

CHAIR MORAN asked how often the managers are turned over.

MR. RAZZAQUE replied that if turning over means termination, then very infrequently. He explained that over the last three years only two managers were terminated. He stated that he has seen a lot of underperformance due to styling, which can last for years, but that does not mean the manager is bad. He added that his bias is to give them more time and have as little turnover as possible. He stated that the need is to have equally good managers and use a single manager concentration, rather than having one or two really big allocation managers going south and impacting the entire public equity returns. He moved on and stated that performance was good last quarter and tactical tilts outperformed 40 basis points. He looked at it from the allocation which is overweight to U.S. equities and overweight to emerging markets and underweight to the non-U.S. developed markets. Sector tilts, tactical are feeling economically sensitive, and higher beat sectors have shown that is the area that does well, and earnings are increasing. He went through the risk factors and moved to yield curve. He added that there is a flat yield curve that has about 47 basis points. He explained this is more detail, and stated that the single largest risk factor is the earnings trend.

CIO READ introduced Steve Moseley, director of Private Equity and Special Opportunities Investing.

## **PRIVATE EQUITY AND SPECIAL OPPORTUNITIES**

MR. MOSELEY stated that he will talk about performance of the portfolios, the market and strategy. The portfolio continued generating strong returns; cumulative net gains reached \$4.9 billion at calendar year end. He added that the private equity portfolio and the special opportunities portfolio are composed of a lot of other investments, most of which do not have a lot of fees attached to them. He discussed market performance strategy which supports the market performance. Things are expensive, which is heard from all the other asset managers and are also progressively levered; it is hard to make money. He added that people are selling, and the underlying managers are selling when they can, and there is a lot of activity out there. The third point is that allocations from existing private equity investors are increasing all the time on a dollar-weighted basis. In particular, it is pension funds trying to hit their targets, and the way to do that is asset class with higher expected returns, which will compress returns. He stated that vintage year is one common and sensible way to measure private equity performance. It says that the fund commitments that were made in each one of these years, remember the commitments in year X and then draw it down over as many as five years. Commitments made in each one of those years have outperformed the median. The portfolio has outperformed public markets because it is less liquid, and the amount of that outperformance has increased and compounded over time. He summarized that the overall objective, the strategy in private equity and special opportunities, is to deliver great returns. He continued that the second task is to make those returns sustainable to try to industrialize the process more. It is not just co-investment by co-investment, personal relationships or hard work, but competitive benches that can be sustained over time. He added that the process elements that have been introduced over time, like the investment committee process and the calling efforts on GPs to talk about co-investment, can be replicated over time and can be repeated. Performance distributions have been high, and he is pleased with the performance.

## **EXECUTIVE SESSION**

CEO RODELL asked Mr. Poag to explain before the motion.

MR. POAG stated that the question is why would an executive session be convened. He continued that the Open Meetings Act allows for a body of this type, who is subject to the Open Meetings Act, to convene in executive session to discuss identified subjects. He explained that one of these subjects is to consider government records that are confidential under state law. The presentation is a preliminary audit report regarding the Alaska Mental Health Trust. That preliminary audit report is confidential under state law until it is reviewed by the Legislative Budget and Audit Committee and approved for release. He added that, at this point in time, that report has not been released and is still covered by confidentiality requirements. Therefore, if the board is going to hear about the impacts that the preliminary audit report may have on the Permanent Fund Corporation, the need is to convene in executive session and discuss that.

**MOTION:** In accordance with Alaska's Open Meeting Act, VICE CHAIR BRADY made a motion that the Board of Trustees convene in executive session to discuss how the pending audit of the Alaska Mental Health Trust Authority could impact the Alaska

Permanent Fund Corporation. Because the contents of this audit are currently required to be kept confidential under Alaska law, this discussion should take place in executive session. CEO RODELL seconded.

Following the roll call vote, the MOTION WAS APPROVED by the Trustees (RUTHERFORD, RICHARDS, MACK, MORAN and BRADY.)

(Executive session from 4:42 p.m. until 5:18 p.m.)

CHAIR MORAN called the meeting back into session. He announced that, while in executive session, the board considered only the matters mentioned in the motion and took no action. He recessed the meeting until the following morning at 8:30 a.m.

(Alaska Permanent Fund Corporation Quarterly Board of Trustees meeting recessed at 5:19 p.m.)

## **MAY 24, 2018**

CHAIR MORAN reconvened the meeting and stated that the first item on the agenda is the investment policy review and update.

### **INVESTMENT POLICY REVIEW AND UPDATE**

CIO READ stated that any revision of policies and procedures usually requires the extended efforts of a great number of investment staff, which included the investment staff, legal, finance, and executives at APFC. He continued that a hard look was taken at what prevailing best practices are for policies and procedures, and we got to something very fundamental. The policy statement should be the best means for the board to set the direction, the strategic direction, setting policy for the organization. He explained that the complication is that there are a combination of two types of concepts: One is the high-level concepts that set policies that are understandable; second are detailed operational concepts. The combination of these two together in a policy document typically renders the resulting policy unreadable, which puts the board in a potentially hazardous position of signing off on something that is not necessarily fully understood. He stated that a hard look was taken at prevailing policies and procedures among the top public plans across the United States and Canada. He continued that they are not offering a revision, but a new set of policies and procedures, a new document. The objective is to go over how it is organized and to let the board set policy. This document, as written, is intended to be a translation document. With the advice of Callan and others, this document is not to set new policy. He added that it represents a translation of what already exists and what is already prevailing practice at APFC. But, it is written in a way that differentiates the high-level concepts from the operational details. The hope and intent is to work on it and get a more readable document. He explained that the principle was to try to adhere to the original as much as possible. He added that this is a voting item. This represents the annual review, and, if approved today, this document would go into effect July 1<sup>st</sup> with the new fiscal year. He moved to the first section, which is objectives, which has the statement of the mission as well as vision and values.

CEO RODELL stated that the commission is written in the statute for the corporation; the vision

and values were done in the strategic planning May meeting in 2016 for the 2017 five-year strategic plan, which was adopted by the board.

CIO READ stated that there are no changes from what has been seen in the past. He continued that the total fund objectives are stated in terms of three criteria: One is achieving outstanding investment performance; two, investing efficiently; and three, measuring and controlling investment risk. He added, that is in line with State and board tolerances, as well as peer group norms.

TRUSTEE RICHARDS stated that one of the areas where the Permanent Fund can do a lot better is the statutory mandate on Alaska investing. He would like to see the reference to secondary statutory requirement of the investment rules on page 3, as well as in section 5 regarding the Alaska investment policy.

CIO READ moved to the total fund mix where things were organized in terms of asset classes with the investment objective that is growth versus income, and liquidity. Then, part (e) seeks to codify and put an extra burden on Callan regarding the performance scorecard. The three measures are a long-term objective, CPI-plus-5 percent, the medium term three-year objective of doing well versus peers, and the one-year short-term objection of doing well versus indexes; demonstrating investment skill versus indexes. A discussion ensued, and from his perspective he stated that the nature of this type of discussion is exactly the intent of the document. He continued that it should be a document that can be dug into and changed in a way that maybe was a bit more difficult when the detailed investment concepts were embedded with the high-level concepts.

TRUSTEE RUTHERFORD was interested in knowing how staff felt about the optimum or alternative ways of dealing with this annual draw.

CHAIR MORAN replied that his read of the explanation was that it was more of an accounting issue than a portfolio issue.

CIO READ stated that may be true for Day One, but Day Two is that the part managed for the two-year profile is going to move differently than the rest of the portfolio. He added that in aggregate, starting out, they add up to the same.

TRUSTEE RUTHERFORD asked how smart people in other endowment situations looked at this, and the time spent optimizing it for their situation.

CEO RODELL stated, for the board's benefit, that when looking at other sovereign law endowment behavior, they have more greater control with the spending amount and get to adjust the spending rate. This board does not have those same controls, and we wanted to make sure to put that caveat there. There is still a tremendous amount of control of this fund that does not reside with this entity.

CHAIR MORAN observed that, if the draws are defined and sequential over time, he cannot think of a time in the Fund's history that the portfolio has been in a situation where it could come

up with a billion dollars in four or five days, let alone what was needed in 60 or 100 days. Of a \$65 billion fund, structured the way it is right now, he does not see a liquidity issue if it is known when the draws are coming and we need to write the check for it.

CIO READ stated that illiquidity in the two different accounts is not irrational even if was to be divided up for accounting reasons. There are certain portfolio reasons to make sure that the amount of illiquidity that can be undertaken is a function of how large the principal is.

CHAIR MORAN stated that there are two concerns on the earnings reserves: One is the part that can be controlled; and then the part that cannot be controlled. He speculated that if the whole balance of the fund goes down \$15 billion, there are no earnings reserves.

TRUSTEE RICHARDS replied that everything is apportioned, and if 30 percent of the value of the fund is lost, the ERA would go down 30 percent of the corpus.

CEO RODELL stated that the point about realized is important. If it is unrealized it is going to stay and be proportional in the corpus, and there will no longer be an ability to restore the losses endured by the corpus of that fund that was once had. She added, that is off the table because it will not be able to be rebalanced.

TRUSTEE RICHARDS stated that he had worked through some of the beginning aspects of this thought process before and requested that this be economically modeled to be a public model and that we put out something that this board can consume, look at and analyze, and that the public can as well. He continued that there are a lot of moving parts, and it is very complex.

CIO READ moved on to Table 2 and pointed out in real estate and private income, absolute returns, the long-term objective with those plans for those programs is a CPI-plus-5 percent or better. He stated that Section 3 looks at the public markets, in general. This is where there are more references to guidelines with more details. This was structured so the guidelines correspond to the sections in the investment policy. He continued that this document structurally makes it much more workable for staff. He added that the investment guidelines should be part of the overall document, should not be hidden from the board, and whenever a change is made to the guidelines it should be reported to the board. The innovation is formally establishing the difference between policies and procedures versus guidelines and the process by which they are reported and revised.

CHAIR MORAN asked if the guidelines for these managers will be changed, or have their mandates expanded at some point.

CIO READ replied that most of the managers that survived are already risk parity. He stated that another key difference with the absolute return program where liquidity is not necessarily being sought from the absolute return program.

MR. ALLEN stated that one other important distinction is that in order to have things that are being asked for, leverage is needed. A risk parity generally employs leverage.



CIO READ stated that the idea is that there are identifying risks, and we want managers that are identifying risks that are attractive; and some of those risks are in low-volatility markets. They want to compare the markets on a risk-adjusted basis and use leverage to equalize that, which is essentially what risk parity is. He continued that the other part of this is securities lending, which is an artifact not of the private markets, but of the public markets for stocks and bonds. Securities lending has generally been a value-added part of the portfolio. He moved to Section 5, Alaska Investment Policy, which is verbatim to what was there previously. He continued that the remaining sections have to do with the authorized use of derivatives risk management and the internal and external managers. The authorized use of derivatives is a better articulation, two pages of the intent by which derivatives are used to efficiently invest the assets of the program beyond traditional investments to be able to shift the risks as needed and particularly to manage and control the risks of the portfolio. He then went through the document's appendices.

CHAIR MORAN stated the need for a motion to approve the discussed amendments, with a final approval at the September meeting.

**MOTION:** A motion that the board accept the rewritten, re-presented policy document pending a red-line associated with overall cleanup, as well as specific language identifying some sort of trigger for notifying the board on major positions, and the leverage language as identified by Chair Moran was made by TRUSTEE RUTHERFORD.

CEO RODELL questioned the motion to make sure that this document has the full force in place. She stated that if it is pending, she is not sure it does.

TRUSTEE RUTHERFORD asked if the motion is accepted as is or if an amendment is needed.

TRUSTEE RICHARDS stated that he did not have a problem passing this document with the authority to do things that are needed to talk about with the staff, with the Alaska policy and the other big piece that will be tacked on separately.

TRUSTEE RUTHERFORD stated that with those amendments, the staff will make those changes and the cleanup.

CHAIR MORAN asked for a second.

TRUSTEE RICHARDS seconded the motion.

Following the roll call vote, the MOTION WAS APPROVED by the Trustees (RICHARDS, BRADY, RUTHERFORD and MORAN.)

CHAIR MORAN called a break.

(Break.)

CHAIR MORAN stated that the agenda was adjusted, and Callan will present next.

## **REVIEW OF ANNUAL ASSET ALLOCATION CAPITAL MARKETS ASSUMPTIONS**

MR. ALLEN began with the whole asset allocation process, the capital market assumptions that will play into the 5 percent real and the new bill that is going to result in a spending that is even greater than that for the first couple of years. He stated that Callan goes through this exercise every year, coming up with a ten-year projection for the various capital markets. He continued that their capital expectations are long-term, 10 years, and are designed to operate as a set and have fairly standard relationships. He added that stocks are expected to return more than bonds; bonds are expected to bring in more than cash. He stated that there is not a lot that really changes from year to year. One of the challenges is that the Permanent Fund has a fairly complicated portfolio, with a lot of different asset classes to come up with for return projections. He continued that the 10-year projections focus on the compound 10-year geometric return, and have a return of about 7 percent for global equities. He added that the geometric return incorporates the impact of capital market volatility (standard deviation) earned by an investor over time. His second point was about projecting bonds, and he explained that there is an expected return of around 3 percent, which is a 75-basis-point expected real return. Bonds are expected to outperform inflation for about three quarters of a percent per year over the next 10 years. He added that nothing has really changed since last year in terms of the 10-year outlook. He noted that the Permanent Fund has a number of advantages: A very mature program, well-diversified across time and across every investment category; great general partners; long-term relationships; co-investments; a lot of advantages with a huge dispersion between the good implementations in private equity and the implementations that are captured in the risk numbers. He continued that with this mature program the potential implementation risk relative to the broad market is narrowed down. He stated that hedge fund expectations are on the low end relative to some of the peers, particularly those with robust hedge fund practices. He added they were very reasonable. He moved on to the 2019 target for illiquidity and stated that it is one way to 40 percent, but moving out of the liquid into the illiquid in this type of constrained efficient frontier analysis tends to move up and to the left. He continued that 2019 is already in the process of being addressed by the five-year plan. The only thing that is available is to get rid of the last bit of cash. He suggested that it would be prudent to have cash in the target as opposed to equitizing all of it, and it is a decision open to discussion. He talked about inflation-proofing and stated that the theory behind it is that it inflation-proofs itself because the return is high enough.

CHAIR MORAN stated that yesterday there was a presentation on ESG and there were a number of people commenting that there was a desire on behalf of the people that the fund should divest all of the interest in fossil fuels. Staff would like a general sense of the board's viewpoint on fossil fuel investments. He continued that he is not inclined to completely divest fossil fuel investments anytime in the near future.

TRUSTEE RUTHERFORD stated that she thought that there was going to be some follow-up conversation which she thought was decided.

CEO RODELL replied that there was no motion and no decision yesterday. She stated that the ESG presentation was an educational piece and the investment policy was not talked about;

which was an oversight on her part. She moved to fossil fuels and asked for clarity from the board as to the direction they would want to take.

CHAIR MORAN stated that, in the presentation, it was clear that it was the governance issues that were the primary driver of people's success. He continued that he thought the governance issues were addressed with the consolidation of and improvement of the investment portfolio. He added that if the governance issues are continually addressed, over time the position will be stated and improved across the board. As a trustee, he stated that he does not see any way that directing staff to divest fossil fuel investments, given the Permanent Fund's dependence on fossil fuels and the future of the State's dependence on them.

TRUSTEE RICHARDS agreed with everything Chair Moran said and does not think that the fossil fuel risk in the portfolio should be thought about in a vacuum to the State situation. He continued that the board cannot ignore the demands on the cash flows for the funds, which will be influenced in some way by where oil prices are.

CHAIR MORAN agreed, and added that the issue of whether there should be fossil fuel investments in the portfolio and the size of those fossil fuel investments should be a risk management, portfolio management and not a social statement issue.

TRUSTEE RUTHERFORD added that she completely agreed that it has to be done within the portfolio risk assessment. She stated that it was important and clear from the presentation that a divestment of fossil fuel assets would be a very flat-footed approach to what was considered to be ESG investment strategies.

CEO RODELL stated that there has been an effort to try to comply with the requests of members of the public to compile data. This has been very difficult because of things that happened over time with databases changes and how things get coded. She assured the board that staff has been looking into and have been getting at this. She explained that in 2011, as oil prices fell, the holdings fell, which is what is expected. She added that as oil prices went back up, external managers found the stocks to be more attractive and got back into it.

CHAIR MORAN stated that it is important to emphasize this to the extent of getting the information out. He continued that what is in the portfolio should be transparent to the public. An effort to get as much transparency out of the partners, even into the hedge fund realm, as to what is being held without jeopardizing the risk strategy has always been made.

CEO RODELL clarified that the holdings are not as much of a problem as figuring out the performance because the stocks go in at different performance points. The challenge is tying the two together.

CIO READ stated that there is a sort of sensitivity of the portfolio to changing oil prices, but it is not the biggest risk factor of the portfolio.

CHAIR MORAN asked CEO Rodell if there has been enough direction of the board to make a firm response.

CEO RODELL replied that she understood the direction of the board and can make a firm response.

CHAIR MORAN called a break for lunch.

(Lunch break.)

CHAIR MORAN recognized private equities and special opportunities.

### **ANNUAL INVESTMENT PACING FOR PRIVATE EQUITY, INFRASTRUCTURE, AND REAL ESTATE**

CIO READ recognized Steve Moseley, director of Private Equity and Special Opportunities.

MR. MOSELEY stated that the answer to the question about how quickly we should commit to private equity funds and invest in operating companies at a different time is how quickly the money is put out. He continued that this is super important because it determines outcomes to a large degree; and investing inconsistently consistently leads to bad outcomes. He added that it is extremely important to continue doing what has been done recently, investing in a fairly linear way. Which is as important as picking the right investments. He stated that the objective is going back to the asset allocation discussion. The plan in the background is to go from 11 percent exposure to private equity and special opportunities, to 12, to 13, to 14 percent in a few years. The projections developed and the models that were built will get us there. He continued that there is a separation between private equity fund commitments and special opportunities, which include some fund commitments and other structured deals. He added that there are assumptions being made and the real range of outcomes is unpredictable. The rate of distributions is also something that is not controlled but is very important. The goal is not to control a certain amount but to return a certain amount, and there is a limited degree of control and an expectation that the process will be adjusted along the way. He stated that the goal, the plan and the expectation is to commit \$1.6 billion. If the markets changed dramatically, then that will change. If things get very cheap, we want to accelerate. He continued that sometimes it is hard to do that in private markets because transaction volume slows. He added that as much success as there has been in venture, venture is very expensive and that continues to be the case; and the group is increasingly reluctant to put money to work in venture.

CIO READ stated that Marcus Frampton will present the pacing targets and ranges for private income, including real estate, infrastructure, private credit.

MR. FRAMPTON stated that he is covering the same topic, the same concept as Steve Moseley, and starting in a different point where the current exposure for real assets and private income is well below the current target. He continued that the target is going to grow modestly, whereas, in private equity, it is at target and the target is going to grow modestly. He added that this portfolio is \$82 billion and is 12.7 percent of the fund. The current target is 17 percent, which goes up to 18 percent next year. That represents about a \$3 billion deficit from the current target, and coincidentally, the current unfunded commitments are \$2.7 billion. He noted direct versus

funds and stated that the bulk of what is being done in funds is everything except for real estate, with a handful of co-investments and direct investments. In terms of exposure, real estate has really declined in the last two years.. The two drivers there are moving up the REIT portfolio, which included close to a billion dollars of American Homes 4 Rent stock. That is the dip to fiscal '17, and the dip to fiscal '18 is the Simpson sale. He highlighted that the current target allocation is not a higher number than what it used to be.

CHAIR MORAN asked how much of the infrastructure stuff is turning out to be co-investment or opportunities.

MR. FRAMPTON replied that, looking at the portfolio NAV, it is about 18 percent co-investment, direct investment.

CHAIR MORAN asked if there are expected superior returns being seen from those co-investments.

MR. FRAMPTON replied that the direct line is about 12 percent IRR now, and the fund investments are about 10 percent. He stated that one factor that does not make that gap bigger is the timber deal, Twin Creeks Timber, where there is a joint venture with the State of Oregon, State of Washington, and a private timber company with about \$120 million of exposure. He continued, that has been about 2.5 percent return because lumber prices went up quite a bit, but log prices have been pretty stagnant. He continued that the short answer is that they have had outperformance, but it was not a dramatic outperformance in the co-investment direct portfolio. He added that it is a lower risk investment because there is no leverage, and if there are no demands, the trees can grow. He agreed with Mr. Mosely about the importance of having a steady commitment pace into the market so there is no overcommitment in an expensive environment. He continued to a sensitivity analysis that is most intuitive and easier for people to think about the total fund size at different points. This forecasts to a point in time, to June 2021, and shows different CAGRs and different commitment paces. He added that a process was run to help identify some international real estate funds that are being executed now. The ambition and expectation is to see more deal flow once there are those fund partners in the international market.

CIO READ added that, in previous years, the C model was a voting item. That has shifted to an informational item with the caveat that we have the banks, where the targets are for asset allocation, and we are coming to the board on an annual basis for the plan. He continued that this is a good plan for how to manage the program. Procedurally, this is no longer a formal voting item. He stated that a vote is not required, and the plan is to do this on a consistent basis annually.

MR. FRAMPTON stated that the real estate bands were a lot tighter than the other banks, and one of the changes in the investment policy was to put real estate's bands in line with infrastructure's. This resulted in real estate being in the green zone.

CEO RODELL stated, for the record, that for reasons that we do not understand, WebEx extended the meeting midstream and the telephone number that is in the public notice cannot be

utilized. She continued that an alternative number has been set up and if folks were listening in, can call the Permanent Fund Corporation headquarters and get the new number to dial into.

CHAIR MORAN asked if anyone was cutoff.

MS. GRAHAM replied close to 20; a lot of them were Permanent Fund employees but there were a few other callers.

CHAIR MORAN stated that there are two action items.

CEO RODELL agreed and added that one is for fiscal year '18, and the other is for fiscal year '19. She thanked Valerie Mertz and her staff for the work they have done over this last year. A lot of time and money was spent on a new accounting system that was not IRIS because the prior system was done before IRIS. This system is called One Solution, which was the accounting system used, and a lot of it has to do with models that were needs for accounting and things like that. It has a budget module that has been incorporated and produces the regular reports. She asked Ms. Mertz to continue.

MS. MERTZ stated that there are two items to take care of in relation to the budget. One is an overview of where we are currently and where the end of the fiscal year '18 is projected. Second is the authorization to expend the FY19 budget. She continued that there are memos related to each in the packet, and an action item associated with each of them potentially. She stated that board resolution 98-4 requires staff, prior to the end of the fiscal year, to present an analysis of the budget situation for the current year. It also gives the board an opportunity to consider staff recommendations on transferring funds between items of expenditure. She recapped that the FY18 budget authorization is in one appropriation, which is split into two allocations. The first is the corporate operating budget, and the second is the allocation for investment management fees; and then separate from the operating budget other appropriations for the capital project have been added. She stated that the corporate operating budget is split into five items of expenditure: Personal services; travel; contractual services; commodities; and equipment. The board does have authority to move budgetary funds between these categories within the operating budget. There was an authorization of \$12.3 million for the fiscal '18 operating budget. She reminded all that any funds that were lapsed or go unspent in the budget remain in the earnings reserve invested alongside the rest of the fund. She went through the detail of the corporate operating budget beginning with personal services, and then moved through the other items of expenditure. She moved on to the investment management fee allocation and stated that the authorization of \$143.8 million includes the \$5 million supplemental that the board approved in December and was ultimately approved by the Legislature. She stated that part of the process at this time of year is for staff to review where we stand on the budget and figure out if it is appropriate to request board approval to transfer funds between items of expenditure. She continued that staff projected to lapse \$109,000 in IT services under the contractual services line, and are requesting approval to move \$83,000 to commodities and \$12,000 of that to equipment. The additional funding on commodities would be used to purchase additional workstation equipment in order to build out the VDI fully, as well as general IT supplies related to moving offices. She added that the \$12,000 is to move to equipment and the leftover in equipment would be to purchase some switches and other hardware for the data center.

**MOTION:** TRUSTEE RUTHERFORD made a motion to approve the proposal for \$95,000, which was seconded by VICE CHAIR BRADY.

Following the roll call vote, the MOTION WAS APPROVED by the Trustees (BRADY, MACK, RICHARDS, RUTHERFORD.)

MS. MERTZ stated that resolution 98.6 requires staff to present the final operating and capital budgets as they were authorized by the Legislature, and part of this is an action item for the board to authorize the chief executive officer to begin expending those funds, as authorized, on July 1. The FY19 budget request was a total of \$168.5 million. The board put this forward as a single allocation, combined operating and manager fees into one allocation, and also suggested that it be included in the language section of the budget, which is a change from prior years. She continued that the budget as approved by the Legislature is shown with one small difference between what is here and what was approved in September. When the single allocation was split between the corporate operating budget and the investment management fee budget, there was about \$750,000 moved from investment systems under the management fee budget to IT services, under contractual services. That is a slight difference, and there is no recommendation to change it at this point. She also highlighted in the investment due diligence budget, in the investment management fee area, that amount does include \$300,000 to cover costs associated with hosting the 2019 annual meeting of the International Firm for Sovereign Wealth Funds in Juneau. That will happen in the fall of 2019. She stated that there is a motion at the end of the memo to authorize CEO Rodell to begin this budget as authorized by the Legislature on July 1.

**MOTION:** TRUSTEE RICHARDS made the motion to authorize CEO Rodell to begin this budget as authorized by the Legislature on July 1.

TRUSTEE RUTHERFORD seconded.

Following the roll call vote, the MOTION WAS APPROVED by the Trustees (RICHARDS, BRADY, MORAN, and RUTHERFORD.)

## **LEGISLATIVE UPDATE**

MS. SWANSON stated that, in listening to the discussion over the past few days, the board is quite up to speed on what has happened with the Legislature. She continued that the 30<sup>th</sup> Alaska State Legislature adjourned sine die on May 13, 2018. That was within their constitutional 120-day session limit. She added that throughout the course of this Legislature, the debate was on how to use the Alaska Permanent Fund earnings reserve to help fund the fiscal gap. The Board's resolution 1801 and 1701 actually added to and informed that legislative debate towards the last part of the session. Two bills did pass this session that directly impact the fund. Senate Bill 26 provides a statutory structure to use the Permanent Fund earnings, and the other one is HB286, that is the FY19 operating budget, and within that budget is the first time in the history of the fund that a POMV has been put into place to use funds from the earnings reserve account to fund the General Fund government and also the dividend. She stated that both bills are still awaiting transmittal to the Governor for signature. They have not been signed or enacted yet. She

continued that Senate Bill 26 does implement a statutory structure for withdrawals from the Permanent Fund earnings reserve account, and it does maintain the current royalty deposit structure to the principal of the fund. That is the 25 percent constitutional mandate of royalty deposits, and the 50 percent statutory structure for deposits.

TRUSTEE RICHARDS asked if there was a deliberate and intentional decision not to include that extra little bit of royalty, or was it just lost in the shuffle.

CEO RODELL replied that it was neither. She stated that this was a discussion that was going on for three years and there have been a number of different bills that had been proposed and were pulled back. She explained that the version of SB26 was sitting in conference committee for a year, and it did roll back to the 25 percent royalty as a ceiling.

MS. SWANSON stated that there are many renditions of Senate Bill 26 throughout the course of the debate, and at the end of the day, they did not make a change to that structure. She continued that it does allow for a POMV draw of 5.25 percent from the earnings reserve account, and that is for fiscal years '19, '20, and '21 and the rate steps down to 5 percent effective July 1 of 2021, which is FY22. She added that the Permanent Fund Corporation will determine the amount that is available under that POMV percentage, and then the Legislature will have to make that appropriation within the budget. She pointed out that part of the debate for the conference committee was that they did not want to change the current construct in statute that pertained to the statutory net income calculation and the amount available for distribution. She added that the caveat to all of that is that appropriation limit maximum POMV percentage draw for each fiscal year. She continued that Senate Bill 26 also maintains the existing inflation-proofing mechanism, which is important to note. She stated that SB26 is the operating budget, and that is the appropriations bill. It sets out the statutory structure for the appropriation, and then HB286, the operations bill for the operating budget, puts in the appropriation. She added that a contingency to make an additional draw if the CBR vote was not attained. The CBR requires a three-quarter vote to access monies from the CBR account. This was not used because they did get the three-quarter vote. She stated that it was a successful legislative session, full funding for the APFC budget, also inflation-proofing for FY19, and a structural statutory draw for withdrawals from the earnings reserve account.

CHAIR MORAN commended the staff on the work that went into this. He called a break.

(Break.)

CHAIR MORAN stated that there is a presentation about incentive compensation.

### **INCENTIVE COMPENSATION STRUCTURE**

CEO RODELL introduced Mike Oak from McLagan. She stated that her goal with this board item is to really start the process. There is a resolution to approve, and that resolution will give the framework, the outlines to put the detail into the personal management plan that would then be adopted at the September meeting. This will set an outline as to eligibility, maximum amounts of incentive compensation, and then will go into the numbers. She continued that goal



No. 5 was to implement a competitive incentive compensation program for FY19 by October of 2019. The FY19 budget has already been passed, so this is a bit behind. She added that this compensation program is being designed with no pay cuts to base salaries so that in the event the Governor does not want to carry this forward in a budgetary request, and the Legislature does not approve it, staff are not overly harmed because they have taken a pay cut in anticipation of receiving incentive compensation. She walked through the incentive compensation program beginning with the need to adopt a peer group, which is an important first step because it gives the information needed to compile the data by setting this peer group. She stated the recommendation that the board adopt a blended peer group which is comprised of 75 percent public funds and 25 percent of private funds. She asked Mike Oak to continue.

MR. OAK stated that he assembled two pieces of information: One is about pay levels; and the other is about pay structure and what an incentive plan looks like at other public funds. He assembled pay data from three peer groups: U.S. and Canadian public funds with internal/direct asset management capability; private sector investment organizations with AUM less than \$100 billion, including advisory firms, banks, insurance companies, endowments, foundations, and corporate plan sponsors; and a blended peer group, 75% public fund and 25% private sector firms.

CEO RODELL added that the idea of a blended peer group rather than all public or all private is not a unique recommendation to the Permanent Fund Corporation.

MR. OAK explained that 75/25 means that one row in the information from the public fund, the median bonus from the public funds, and the second one would be median salary, median bonus from the private sector; then a weighted average of those two is done. He stated that one of the suggestions was to reflect back on the compensation and philosophy, and then refine the position in the competitive organizations. The second recommendation is to implement an incentive compensation plan. He explained that the fact that the compensation is so far behind market is why looking at the incentive compensation is recommended.

CEO RODELL stated that the proposal she made in the resolution is to cap the incentive compensation, the maximum amount of eligibility would be 50 percent of the base salary. This is for the investment staff that are eligible for incentive compensation; the incentive pool would be about \$1.9 million. That is the maximum amount, and if all employees were incorporated it would be about \$2.5 million, maximum.

VICE CHAIR BRADY asked if there was a formula to get to that.

CEO RODELL replied yes, and continued that staff wanted to tweak the formula and will provide it as part of the personnel management plan. She emphasized that the resolution recognized that it is a three-year performance review.

CHAIR MORAN asked for a summary of all that will participate in this.

CEO RODELL replied that she divided corporate staff into three categories: management or executive; investment; and administration. Generally, CFO, chief operating officer, general counsel do not receive incentive compensation.

CHAIR MORAN asked if this is for a resolution to move to the next step.

CEO RODELL replied yes.

CHAIR MORAN asked for a motion.

**MOTION:** TRUSTEE RUTHERFORD made a motion that the Board of Trustees adopt resolution 18-02, allowing the Executive Director to progress this compensation program as discussed. It was seconded by TRUSTEE RICHARDS.

Following the roll call vote, the MOTION WAS APPROVED by the Trustees (BRADY, RICHARDS, RUTHERFORD, and MORAN.)

CHAIR MORAN moved to other matters.

## **OTHER MATTERS**

CEO RODELL stated that she did not have any other matters to come before the board at this time.

CHAIR MORAN asked for adviser comments.

MR. MITCHELL stated that he admired the board and staff's willingness to take on a revision of the procedures, which is always a difficult thing to do. He continued on about performance, which has been excellent, and as important as good performance is, the way that the board and staff have achieved that is equally important. He added that he has confidence that the staff knows what it is doing. He stated that there has been 30 years of up bond market performance which means that most of the participants in the bond market were in middle school when there was last a down market. He continued that he is concerned on whether they will be able to deal with a falling bond market. The other thing is about currencies, and it stated that the hedging program, the approach to currencies that the staff has put in place is good, but that is for normal times. He stated that the combination algorithmic trading, high-frequency trading, trading programs, passive trading all make up, like, 90 percent or more of all the trades that go on in the stock exchanges, and there have been some glitches. He continued that they were rectified, but he is concerned that could really have an upset in the trading platforms which would wash out over the entire confidence that people are supposed to have in the market. He added that he is optimistic, positive, and thinks that everyone here is doing a good job. He suggested writing down their three worst fears just to help prepare if they do occur.

CHAIR MORAN asked for any trustee comments.

VICE CHAIR BRADY added that he has kids that have bought homes in this low interest environment and remembered a mortgage he had once at 13 percent; Jimmy Carter, 19 percent. He thanked CEO Rodell and her staff for all their work, and he has never seen a session with this Legislature where the Permanent Fund was able to do as well while the Government was working in a different direction. He congratulated them for that.

TRUSTEE RUTHERFORD echoed that and added that the entire Permanent Fund staff is doing a fabulous job in representing all of us at the Legislature and being so successful.

TRUSTEE RICHARDS stated that he heard once that it is fun to be on a board when the company is winning, and not so much fun when they are not. He continued that you guys are winning, and that makes this fun and a good job. He directed to Russell that he was not sure if he was clear about his comments on the Sharpe ratio and was just concerned about some of the specific asset classes, whether the distributions are normal enough to use the Sharpe ratio as a statistically meaningful tool. He added that the discussion of the 4.3 percent Callan projection versus the 5 percent board expectation was very good, and he would like to keep having that. He stated that regarding the Alaska policy, to use the opportunity over the summer to think about developing that in more detail. He also looks forward to that dialogue.

CHAIR MORAN thanked all and stated that this was one of the best meetings that he has attended in his time here. A great job was done, and is greatly appreciated.

CEO RODELL stated her thanks, and that the meeting is adjourned.

(Alaska Permanent Fund Corporation Quarterly Board of Trustees meeting adjourned at 4:07 p.m.)