

ALASKA PERMANENT FUND



1989 Annual Report

A Public Trust

Investing For Alaska's Future

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Fiscal 1989

Oral E. Freeman, Chairman
John T. Kelsey, Vice-Chairman
David A. Rose, Secretary and Treasurer

Fiscal 1990

John T. Kelsey, Chairman
Marc Langland, Vice-Chairman
David A. Rose, Secretary and Treasurer

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CHAIRMAN'S MESSAGE

\$10 Billion Is Just the Beginning



Over the last 13 years the Permanent Fund has grown, from being nothing more than a good idea, into a world-class trust exceeding \$10 billion in total assets. In fact, according to one national publication, the Alaska Permanent Fund is already one of the 50 largest funds in the world.

This accomplishment is something all Alaskans can take great pride in. It is also exciting to think about how large the Fund can grow in the future if we continue the prudent policies of the past.

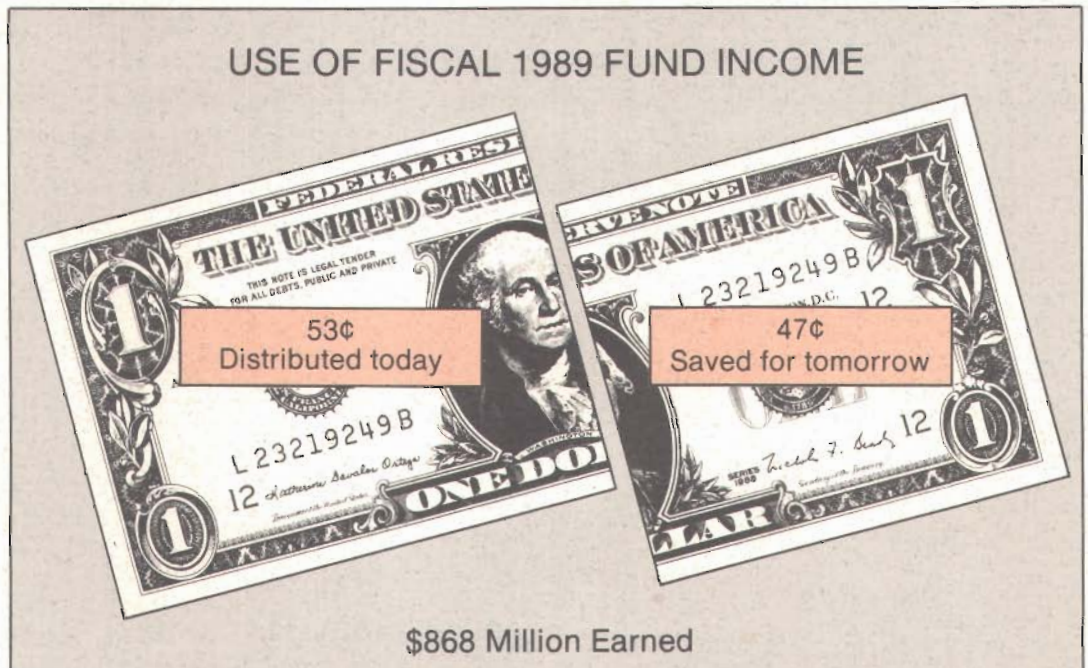
I've always thought that the hard part about creating a truly successful Permanent Fund would be surviving the formative years and building the Fund to a significant size. Well, we Alaskans have managed to build the Permanent Fund to \$10 billion, and I now believe it is well established. I also now believe that it is

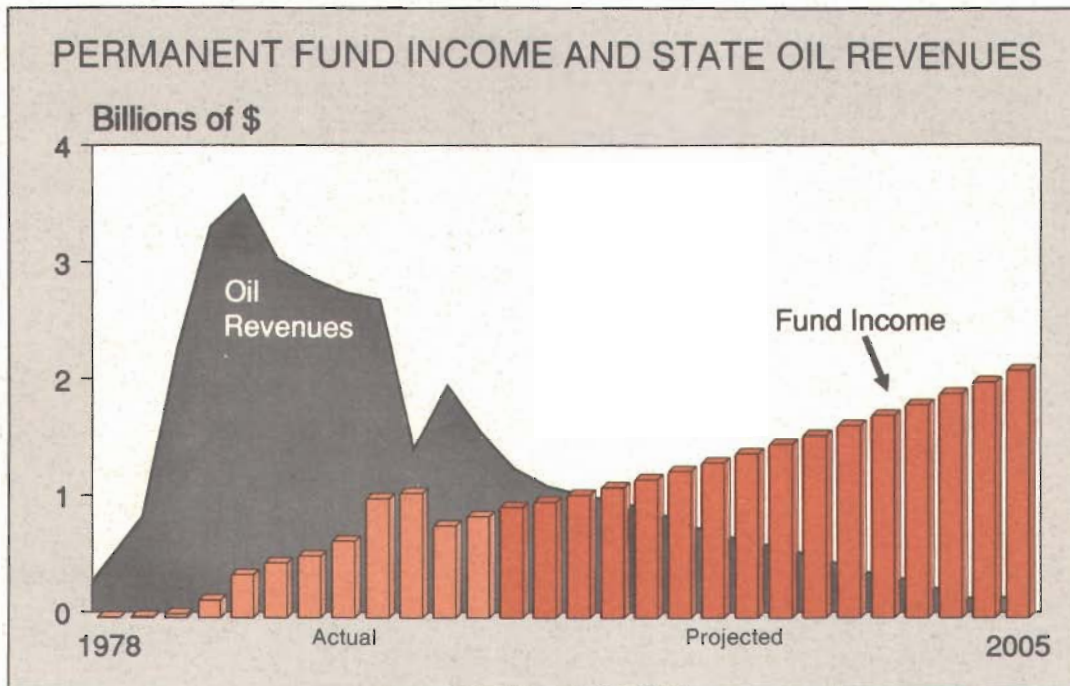
possible to build this \$10 billion into \$20 billion by the end of the century and then to \$25 billion before today's first-graders graduate from college. That's the kind of future I see for the Permanent Fund.

These are attainable goals, but I can hear some people wondering aloud, why would we want to save that kind of money. Why not spend some of it now? I invite your attention to the accompanying graphics.

In fiscal 1989, the Permanent Fund earned \$868 million, \$460 million of which was paid over to the dividend program so that each Alaska citizen could share directly in this year's profits. That means 53 cents of each dollar of Fund income is going directly into the Alaska economy. No more efficient nor more equitable economic stimulus has ever been invented by any politician or economist anywhere.

THE
PRESENT





THE FUTURE

In simple terms, we save money in the Permanent Fund in order to earn more money that we can then distribute equally among ourselves and spend — each of us using the income according to our own present needs and wants. The more we save, the more we make, and the more we have to distribute.

But it's even better than that. The Permanent Fund is also a savings account for future generations. As the chart on this page indicates, the Permanent Fund, sometime in the not-too-distant future, will become the number one producer of revenue for the state. Then, when we can no longer count on oil revenues to provide the level of financial support we have all become accustomed to in Alaska, we will have prudently provided for ourselves by ensuring that there will always be available, each year in the future, large — and ever-growing — amounts of Permanent Fund income.

As many of you know, I believe that past legislatures have acted responsibly over the years in adding money to the Permanent Fund above what was required by law. I continue to believe that each new legislature — each “January Generation” — has the right to decide how best to use each year's Permanent Fund income.

The Permanent Fund exists for the collective benefit of all generations of Alaskans. It is our responsibility as equal shareholders to determine what the purpose of the Permanent Fund is. Let's work together, as Alaskans always have, to build the brightest possible future for ourselves and for our loved ones. \$10 billion is just the beginning.

Oral E. Freeman
Chairman
Board of Trustees
1988-89

Voters Created Permanent Fund 13 Years Ago, Six Trustees Share Fiduciary Responsibility

The Alaska Permanent Fund is a savings account, restricted as to usage, which belongs to all the people of Alaska. It was created in 1976 when the voters approved the attached amendment to the state Constitution.

The Fund is established as an inviolate trust. This means the principal of the Fund is to be invested in perpetuity. The beneficiaries of the trust are all present and future generations of Alaskans.

To manage the investments of the Permanent Fund, the legislature in 1980 created the Alaska Permanent Fund Corporation. It was the intent of the legislature to establish a management system for the Fund which would be protected from political influences but, at the same time, be responsive to changes in state policy and accountable to the people through their elected officials.

To ensure insulation from the political process — but not isolation — the Fund is subject to the provisions of Alaska Statute 37.13. This chapter of state law spells out a number of requirements for the Permanent Fund and its management, but stipulates that Fund policy is to be formulated independently by a board of trustees.

The board of trustees has six members. Four of the trustees are chosen from the private sector and must have recognized competence and wide experience in finance, investments or other business management-related fields. These members are appointed to four-year terms by the

governor. The other members are the commissioner of the Department of Revenue, and one cabinet officer of the governor's choice.

The trustees, except for the two cabinet members, are citizen volunteers. They are not paid salaries, although they do receive an honorarium of \$400 for each day spent at a meeting of the board or at a public meeting as a representative of the board.

Section 15. ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

The trustees delegate responsibility for the day-to-day operations of the Fund to an executive director and a small, professional staff. Additionally, equity investment firms, real estate advisors, custodial banks, performance analysts and independent auditors assist the Fund on a contractual basis.

In July 1988, Oral Freeman and John T.

Kelsey were elected by their colleagues to serve as chairman and vice-chairman for fiscal 1989, and Marc Langland was reappointed to a new four-year term. In July 1989, Mr. Kelsey and Mr. Langland were elected to serve as chairman and vice-chairman for fiscal 1990, and Charles H. Parr was appointed to a four-year term replacing Mr. Freeman.

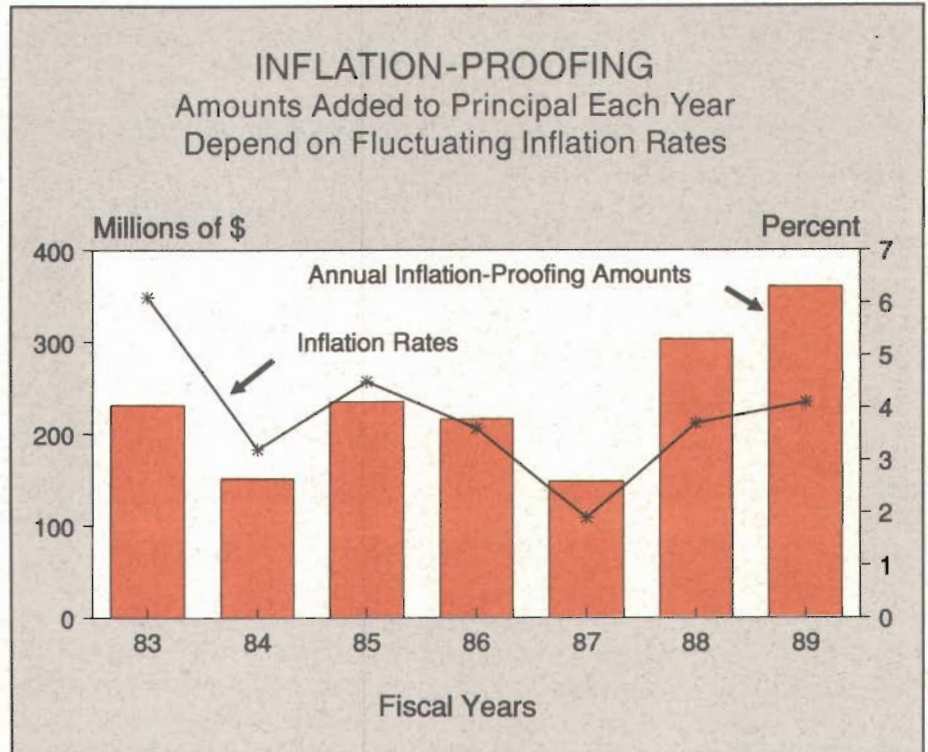
David A. Rose, executive director of the Alaska Permanent Fund Corporation, has served as secretary and treasurer continuously since December 1982.

How the Alaska Permanent Fund Works

The Permanent Fund is made up of principal and income. The principal comes from three sources: (1) oil revenues deposited by constitutional dedication; (2) income of the Fund which has been added to principal by inflation-proofing; and (3) additional funds deposited by special legislative appropriation. This last category has made the largest contribution to date, but it is projected that inflation-proofing will make the greatest contribution in the future.

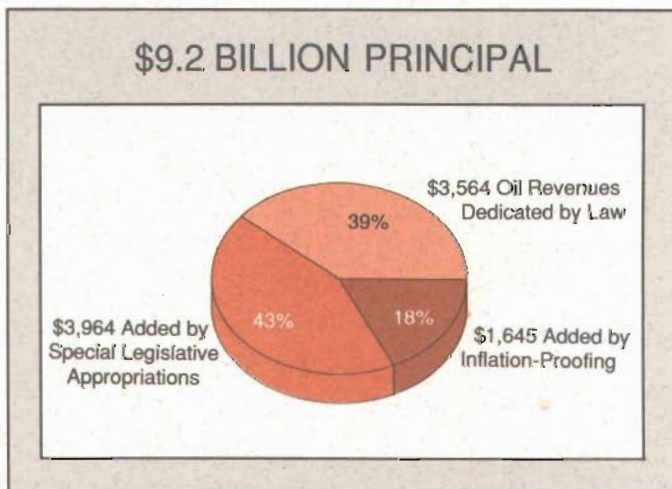
All income from the Permanent Fund shall be deposited in the General Fund unless otherwise provided by law.

According to these instructions extracted from the 1976 constitutional amendment, all questions regarding the use of Fund income are decided by the people of Alaska through their elected representatives.



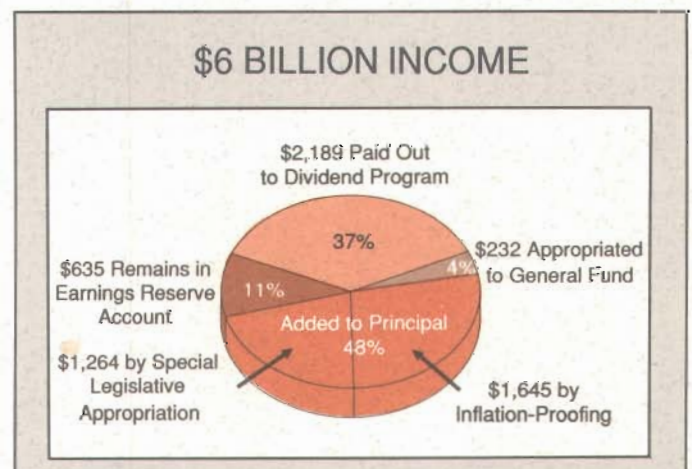
2) After providing for dividends, a portion of Fund income is added to principal to protect its value against the eroding effects of that year's inflation. Popularly known as *inflation-proofing*, the exact amount of income to reinvest is determined by multiplying the Fund's June 30 principal balance by the annual average percentage change in the Consumer Price Index for All Urban Consumers (CPI-U).

3) Any income remaining after these two uses is retained in an *earnings reserve account* in the Permanent Fund, and is available for appropriation by the legislature. If earnings in any year are insufficient to fully pay dividends and meet inflation-proofing needs, then funds in this account will automatically be used for these purposes.



The current uses of Fund income, changed only slightly since they were originally approved by the 1982 legislature, are as follows:

1) *Permanent Fund dividends* are distributed each year to residents who apply and qualify. The amount of the dividend is decided by a formula that helps to bring a stable flow of dividends: (1) add together the Fund's net income for the last five years; (2) multiply that number by 21%; and (3) divide that number by half

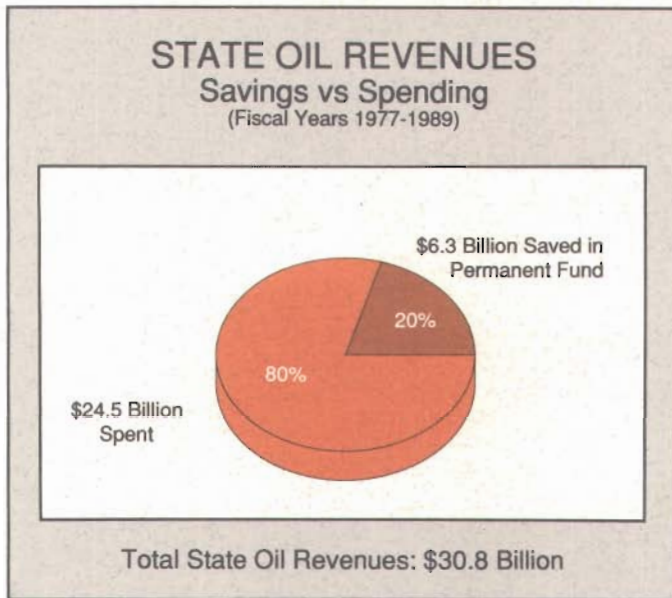


PERMANENT FUND OBJECTIVES

Corporation Saves a Portion of the Oil Wealth, Protects Its Value and Invests It to Produce Income

Alaska Statute 37.13.020 sets out three goals for the Alaska Permanent Fund Corporation:

1) Save a portion of the wealth created by development of the state's non-renewable natural resources to benefit all generations of Alaskans.



The state receives non-renewable natural resource revenues from many sources - corporate income tax, severance tax, property tax, federal shared revenue, royalties, lease bonuses, and rents. A portion of that revenue which is not tax-based is dedicated to the Permanent Fund.

Specifically, the Permanent Fund automatically receives 25% of all non-tax mineral revenues (50% from leases entered into after 1979). Since inception, this has resulted in the automatic deposit into the Permanent Fund of \$3.6 billion in dedicated oil revenues.

In addition to the dedicated revenues, however, the legislature also authorized two special deposits to the Fund in 1980 and 1981. Totalling \$2.7 billion, these special appropriations of surplus oil revenues have added substantially to the state's savings account. Indeed, combining both these sources, Alaska has managed to save a total of 20% of its one-time bonanza from Prudhoe Bay, and has transformed it into a long-term source of wealth and economic diversification for the benefit of all generations of Alaskans.

2) Protect savings from loss of value.

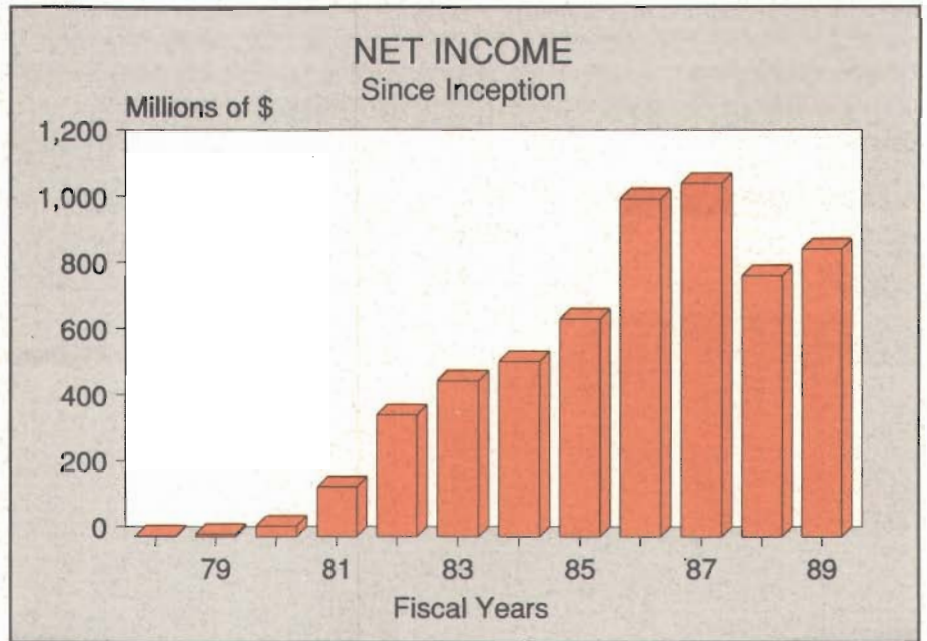
Since inception, all contributions to principal have been retained in the Permanent Fund. There has been no loss of principal. In addition, inflation-proofing has added a portion of annual net income to principal each year since 1983 to protect the Fund from loss of value.

INFLATION-PROOFING AMOUNTS SINCE INCEPTION

Fiscal Year	Inflation Rate	Income Added To Principal	As a Percent of Annual Net Income
83	6.1%	\$ 231,192,000	49%
84	3.2	150,935,000	28
85	4.3	234,570,000	36
86	3.6	216,861,000	21
87	1.9	148,142,000	14
88	3.7	302,861,000	38
89	4.1	360,242,000	41
Total/Averages:	3.8%	\$1,644,318,000	30%

3) Invest savings to produce income for purposes designated by law.

In addition to saving money and keeping it safe, the Fund has a third mandate: produce income for uses provided by law. In this regard, the trustees attempt to maximize total return on the Fund's investment, but their primary concern is maintaining safety of principal. The Permanent Fund has produced, since inception, \$6 billion in net income.



Permanent Fund Real Estate Portfolio

St. Louis Centre, St. Louis, Missouri

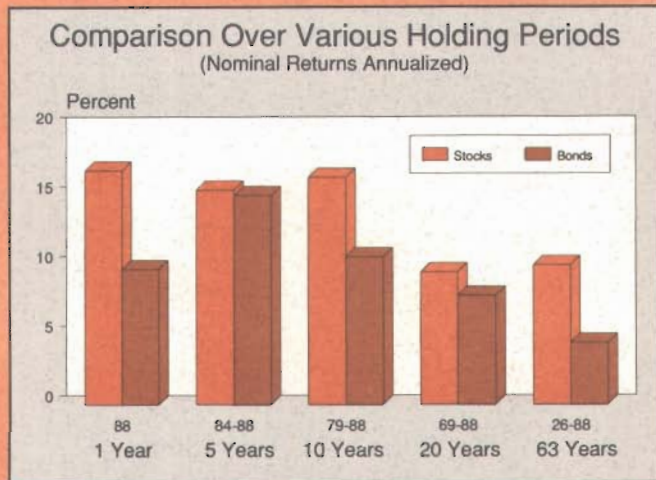
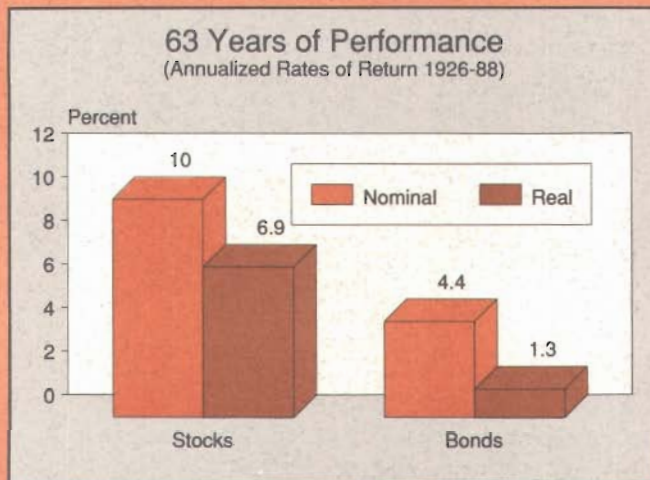
EARNINGS GOAL

Trustees Choose the Fund's Investment Mix to Try to Beat Inflation by 3% Over the Long Term

The trustees have established as an earnings goal for the Permanent Fund a 3% realized real rate of return. This goal is to be achieved over

the long term, recognizing that there will be years when the Fund will do better and years when the Fund will do worse.

STOCKS AND BONDS HISTORICALLY

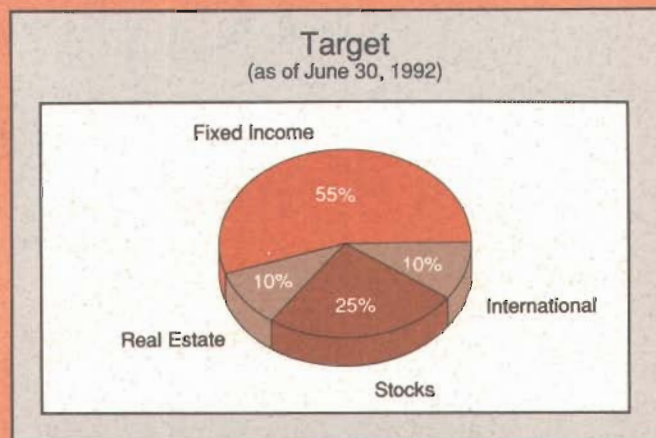
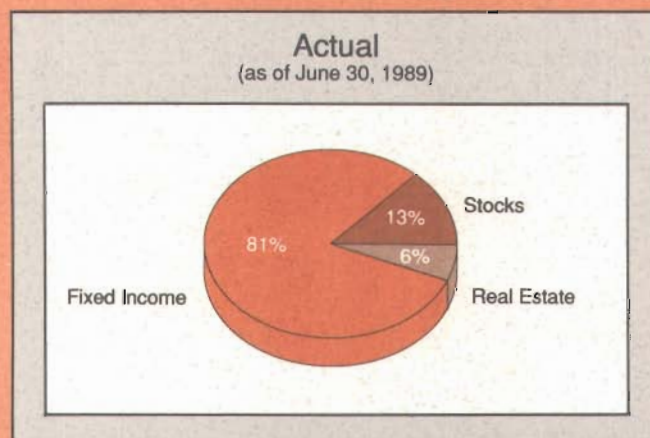


The nominal return minus the inflation rate (3.1%) equals the real return. Historically, to achieve a long-term real rate of return which is 3% higher than inflation, a fund must have a rel-

atively large percentage of its assets in stocks. In all periods, stocks have outperformed bonds.

Source: Ibbotson Associates

PERMANENT FUND'S ASSET ALLOCATION



The trustees have established a three-year plan for moving to a more diversified asset allocation not later than June 30, 1992. It is pro-

jected that the international portfolio will be a blend of both stocks and bonds, with the exact percentages of each still to be determined.

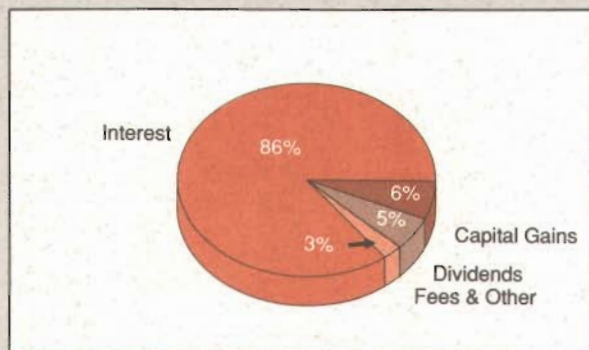
THE YEAR IN REVIEW

Fund Earned \$868 Million in Net Income, Principal Grew by \$588 Million

There are three simple ways to judge the Permanent Fund's fiscal 1989 performance: (1) amounts of income earned; (2) rates of return; and (3) growth of principal.

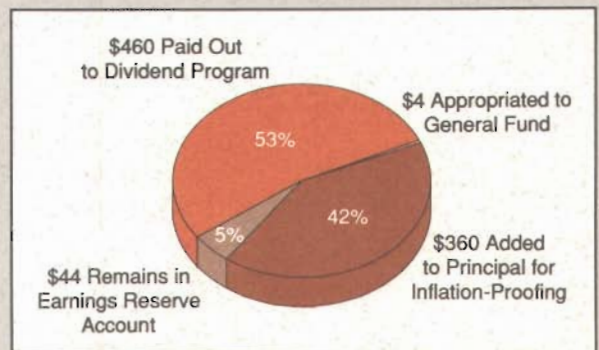
REALIZED NET INCOME

By Source in Fiscal 1989



Total Earned: \$868 Million

By Use in Fiscal 1989
(in millions)

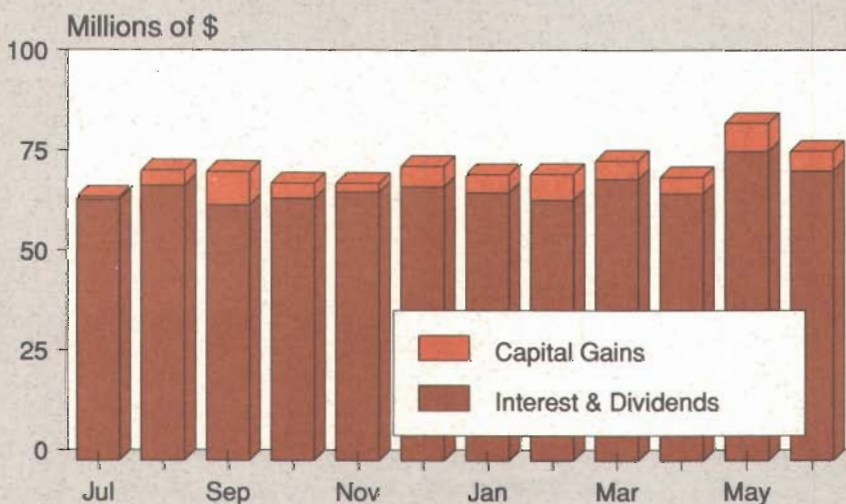


Total Used: \$868 Million

The Fund earned \$868 million in realized net income in fiscal 1989; the majority of it came from interest payments on U.S. government securities.

For the second consecutive year, more than half of the Fund's income was paid out as dividends; the remainder was saved, either in Fund principal or in the earnings reserve.

REALIZED NET INCOME Ordinary Income and Capital Gains



By Month in Fiscal 1989

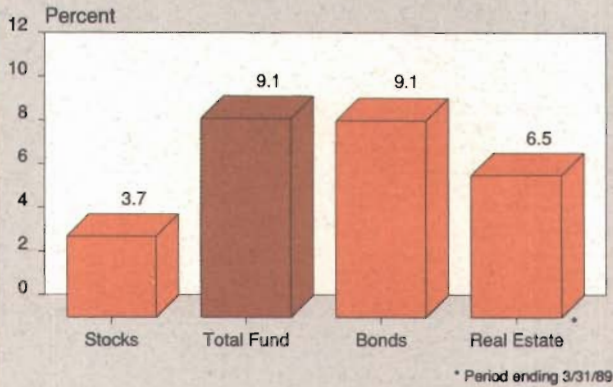
On average, the Fund earned \$72.4 million in net income each month. Of this amount, \$4.7 million came from capital gains realized by the Fund when it sold stocks or bonds for more than it paid for them.

In terms of returns, there are two basic measurements: total return and realized return. Total return includes realized income — that is, cash or net income — plus unrealized gains (or

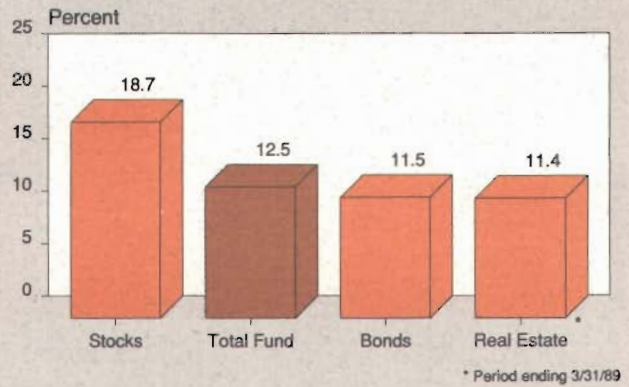
losses). The unrealized gains are considered “paper profits” because the underlying assets have not been sold and the Fund has not realized any actual profits from their sale.

RATES OF RETURN

Realized Returns by Investment Type
Fiscal 1989



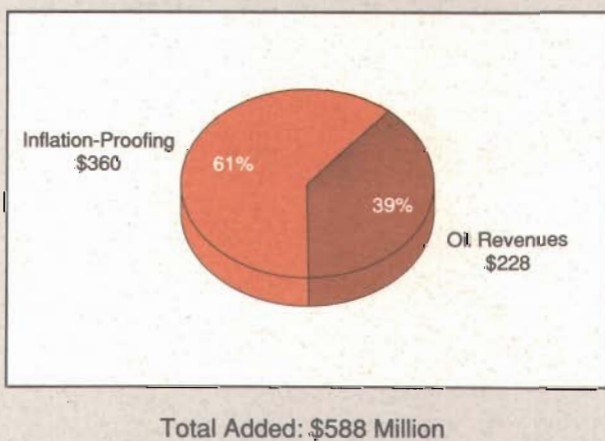
Total Returns by Investment Type
Fiscal 1989



The Fund earned a realized nominal rate of return of 9.1%. After adjusting for this year's 4.1% rate of inflation, that left a realized real rate of return for the year of 5%.

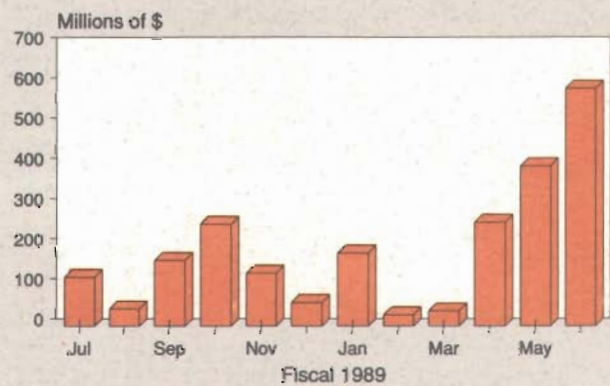
The Fund earned \$1.234 billion in fiscal 1989 including both the \$868 million of realized income and the \$366 million of unrealized income, for a 12.5% total rate of return.

GROWTH OF PRINCIPAL
Fiscal 1989
(in millions)



Fund principal grew by \$588 million in fiscal 1989. For the first time in the Fund's history, inflation-proofing added more than dedicated oil revenues.

TOTAL FUND
Unrealized Gains at Month-End



The Fund's market value was consistently higher than its cost value during fiscal 1989. In the final quarter, the market value rose dramatically, gaining more than \$500 million in just 90 days. The Fund ended the year with \$591 million in unrealized gains.

Fixed Income Earned a 9.1% Realized Return

Fixed-income assets totaled \$8.3 billion at cost as of June 30, 1989, and this was the Fund's largest investment portfolio. These assets earned a realized rate of return for the year of 9.1%, and a total return of 11.5%.

Although the cost value of these assets exceeded their market value for most of the year, the portfolio improved dramatically in value in the final quarter, and fixed-income ended the year with \$3.1 million in realized gains and \$170 million in unrealized gains.

Investment Strategy: Following a buildup of short-term reserves during the second calendar quarter of 1988, a shift in Permanent Fund fixed-income investment strategy was initiated in the second half of the year. The Fund began to redeploy these assets into longer-term Treasury and high grade utility and finance debt securities in a disciplined, systematic manner as interest rates increased.

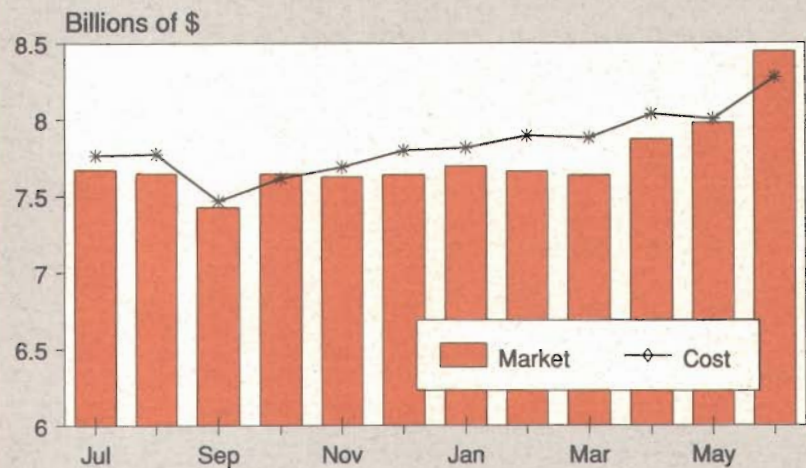
During March and April the Permanent Fund ceased extending maturities temporarily and increased holdings of money market instruments with maturities of 6 months or less. Given the existence of an inverted yield curve at a time of reported rising employment and inflation, short-term investments provided a superior return with minimum risk.

However, as economic evidence developed in late April and early May, suggesting slower economic growth and a more favorable inflationary outlook, the Fund resumed its earlier policy of extending the fixed-income portfolio's duration by acquiring both Treasury and high grade corporate

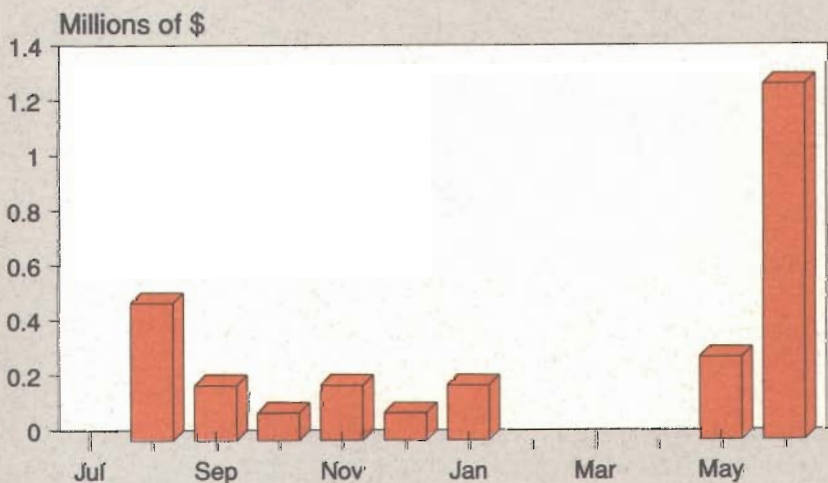
FIXED-INCOME ASSETS

Fiscal 1989

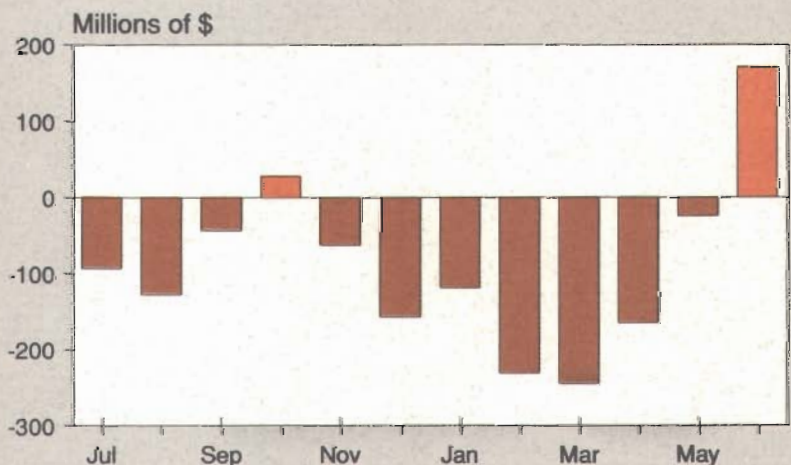
Cost and Market Values At Month-End



Realized Gains Per Month

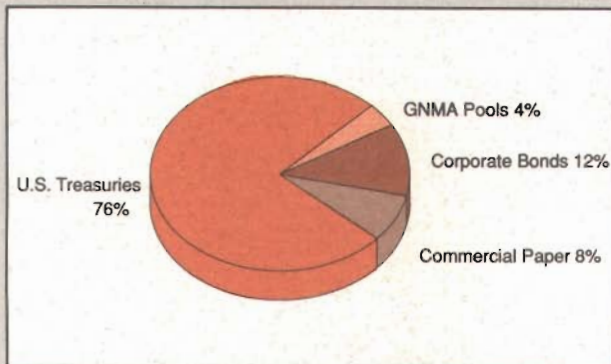


Unrealized Gains at Month-End

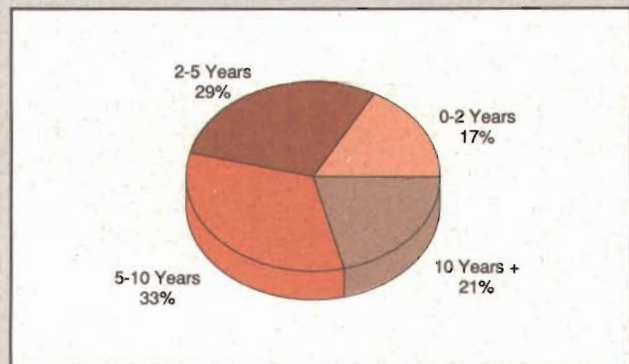


DIVERSIFICATION OF FIXED-INCOME PORTFOLIO

By Investment Type
(as of June 30, 1989)

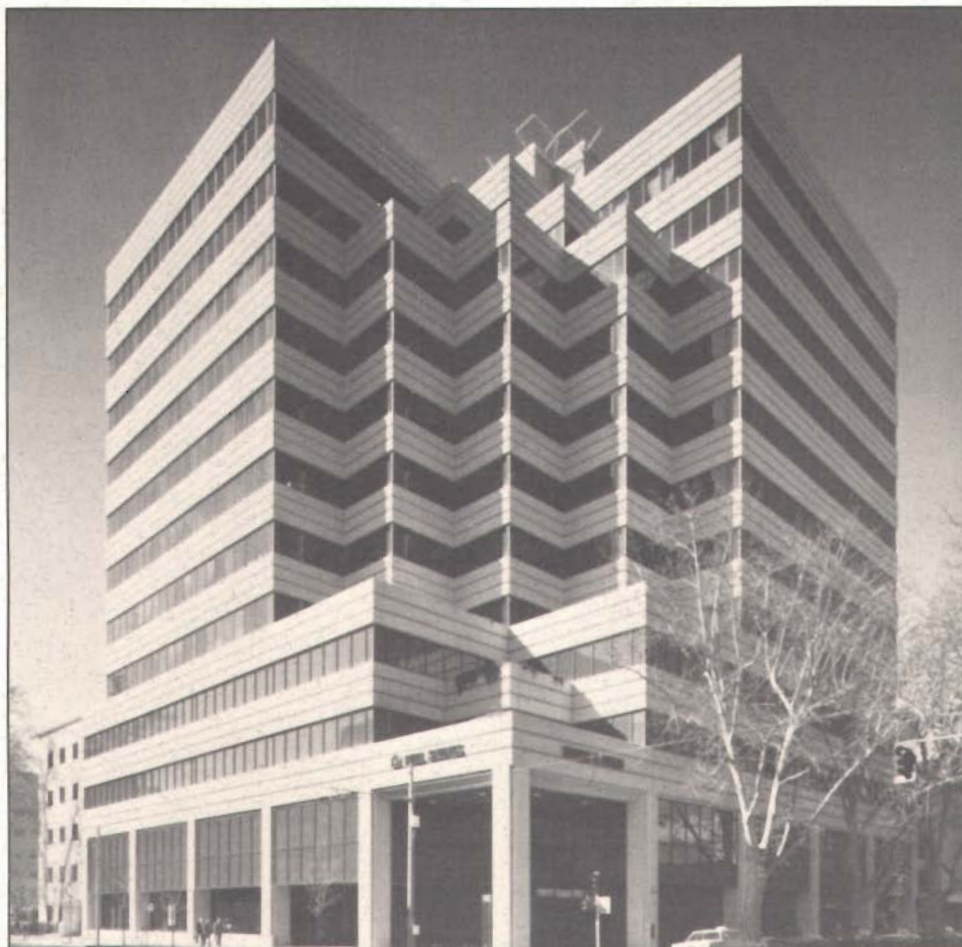


By Length of Maturity
(as of June 30, 1989)



Managed in-house, three-quarters of this portfolio consists of U.S. Treasury bills, notes and bonds. Marketable debt securities are guaranteed to earn a fixed rate of return over a certain period of time, and mature (pay back the money invested) on a specific date.

At the end of the fiscal year, the weighted average life of the portfolio was 8 years, 4 months, compared with 7 years, 1 month a year earlier.



Permanent Fund Real Estate Portfolio

One City Center, Sacramento, California

Stocks Were the Fund's Top Performer in 1989: Equity Managers Earned an 18.7% Total Return

With mergers and acquisitions providing the major impetus for the year-long rise in the stock market, the Permanent Fund's stock portfolio earned a total return for the year of 18.7%, a significant increase over last year's -5.7% return.

Highly profitable stocks in the Fund's portfolio this year included:

* RJR Nabisco, which more than tripled in value and on which the Fund realized \$6 million in capital gains on its takeover by Kohlberg, Kravis, Roberts and Co.;

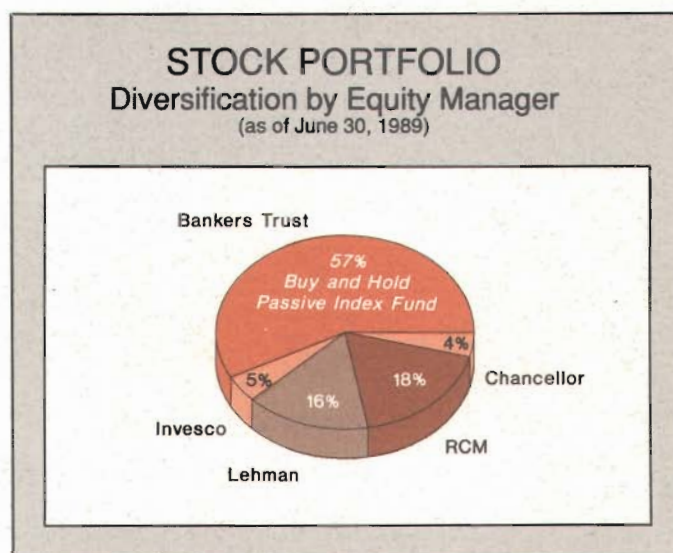
* Kraft, Inc., on which the Fund earned a 225% return as a result of its purchase by Philip Morris; and

* Pillsbury Co., on which the Fund earned a 150% return when this U.S. company was successfully acquired by a buyer from overseas, Grand Metropolitan PLC.

Notwithstanding the serendipitous one-time profits gained on the sale of these takeover stocks, the strategy for the Permanent Fund stock portfolio is essentially long-term oriented. Equity investments are equally divided between two types of management: passive and active.

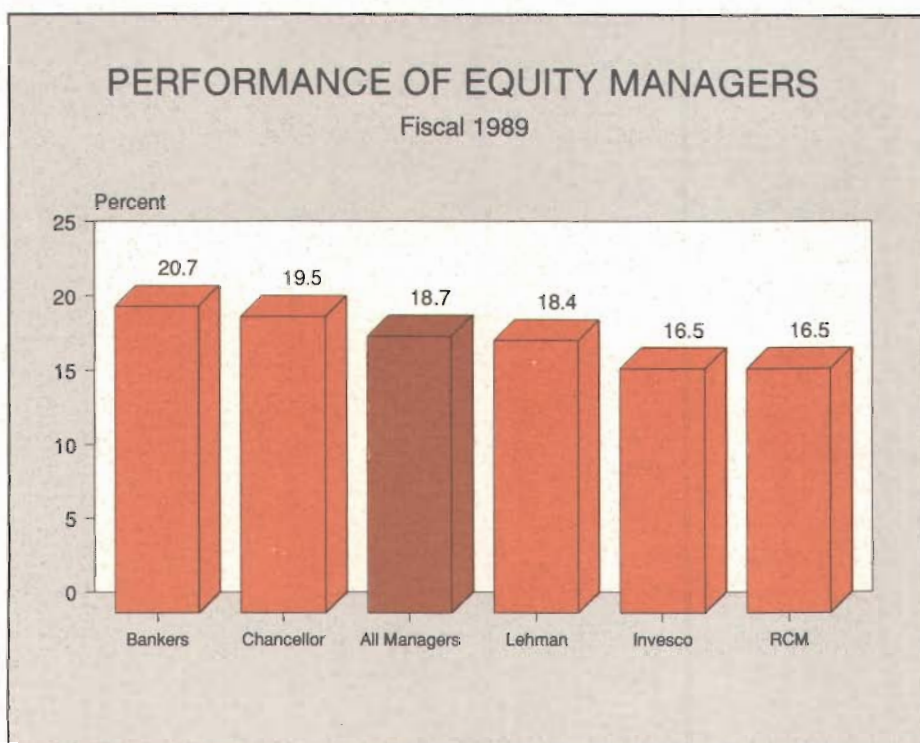
The passive investment is managed by Bankers Trust Company of New York in an index fund which attempts to statistically replicate the performance of the Standard & Poor's 500 Stock Index.

The active management is divided among four equity managers who have been selected by the trustees to provide diversification by different generalized investment styles. Active managers are expected to provide diversification and achieve superior performance; particularly in declining markets.



The active managers are:

- Lehman Management, New York;
- Chancellor Capital Management, San Francisco; Note: This firm was previously Citicorp Investment Management, but was sold during the year to the insurance company, United States Fidelity and Guaranty; its name was subsequently changed.
- RCM Capital Management, San Francisco; and
- Invesco Capital Management, Atlanta.

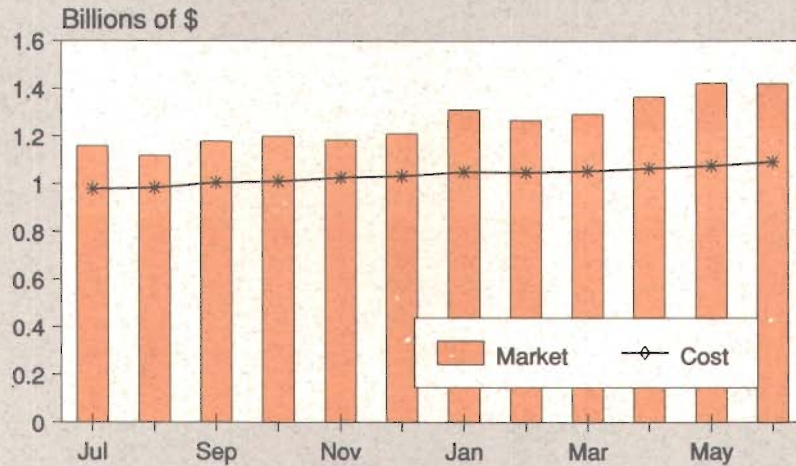


The Fund's equity managers are measured against the performance of the S&P 500, the industry benchmark which is a composite of 400 industrial, 40 financial, 40 utility, and 20 transportation common stocks. For the 12 months ending June 30, 1989, the S&P 500 gained 20.5%. None of the Fund's active managers managed to outperform the S&P 500 in this year's rising market.

STOCK PORTFOLIO

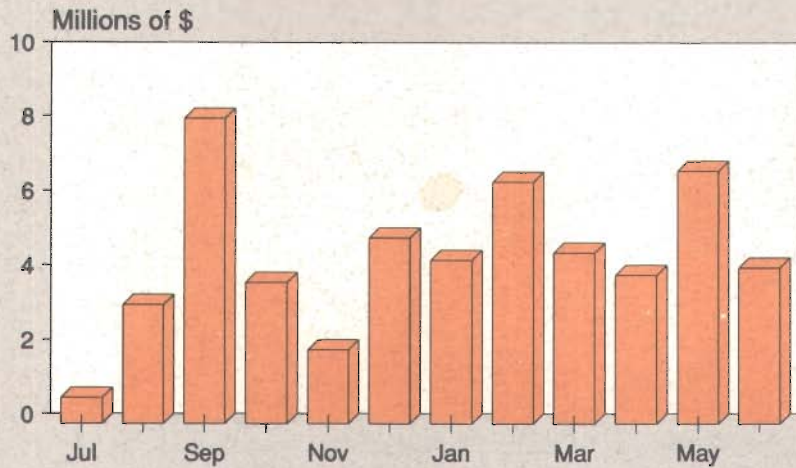
Fiscal 1989

Cost and Market Values at Month-End



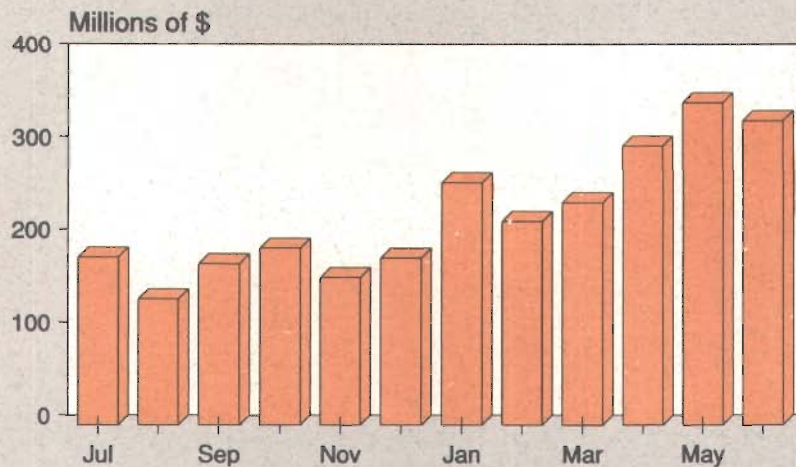
In fiscal 1989, the cost value of the stock portfolio grew by \$118 million as the Fund's equity managers marginally reduced their cash positions and reinvested stock dividends and realized capital gains. The market value increased by \$135 million from June 30, 1988 to June 30, 1989.

Realized Gains Per Month



The Fund averaged \$4.5 million per month in capital gains realized from the sale of common stock. Realized gains totaled \$53 million.

Unrealized Gains at Month-End



At year-end, unrealized gains amounted to \$328 million.



Permanent Fund Real Estate Portfolio
Arboretum, Lisle, Illinois

STATUS OF EQUITY INVESTMENTS

As of June 30, 1989
(in millions)

<u>Equity Managers</u>	<u>Cost</u>	<u>Market</u>	<u>Unrealized Gains</u>
Bankers Trust	\$ 575	\$ 819	\$244
RCM Capital Management	203	256	53
Lehman Management	210	223	13
Invesco Capital	54	64	10
Chancellor Capital	50	58	8
Totals:	\$1,092	\$1,420	\$328

Note: This table does not reflect the impact on performance of gains realized by each manager during fiscal 1989 and preceding years.

15 LARGEST HOLDINGS IN THE STOCK PORTFOLIO

As of June 30, 1989
(in millions)

<u>Number of Shares</u>	<u>Company Name</u>	<u>Cost Value</u>	<u>Market Value</u>	<u>Unrealized Gains</u>
439,600	IBM	\$ 56	\$ 49	\$(7)
691,100	General Electric	27	36	9
650,600	Exxon Corporation	19	29	10
280,600	3M	15	20	5
428,300	Amoco	15	19	4
267,800	Merck & Company	7	18	11
126,100	Philip Morris	9	17	8
459,517	AT&T	11	16	5
419,600	Wal Mart Stores	8	16	8
293,300	Waste Management	8	15	7
210,300	Schering Plough	9	14	5
147,700	Atlantic Richfield	11	14	3
175,158	NYNEX	10	14	4
240,800	Eli Lilly	8	13	5
117,300	E.I. DuPont	7	13	6
Totals:		\$220	\$303	\$83

Equity Real Estate Earned a Total Return of 11.4%

The total return for Permanent Fund equity real estate investments for the 12 months ended March 31, 1989 was 11.4%, consisting of 4.9% in appreciation and 6.5% in realized income.

The Permanent Fund invests in equity real estate assets either through the purchase of an interest in pools of nationally-diversified properties, or through the purchase of individual properties in joint venture with other large institutional investors. In these joint ventures, the Alaska Permanent Fund is either a limited or general partner.

Compared to the 128 funds investing in real estate which are tracked by the Fund's real estate consultant — Institutional Property Consultants of San Diego and Atlanta — the Permanent Fund's portfolio ranked in the top quartile nationwide, with a total return 4 percentage points higher than the industry benchmark.

Equity real estate, by its nature, is the most long-term oriented of all the Fund's investment portfolios. Typically, a period of three years elapses from the date the Permanent Fund acquires a property to the time of its first independent appraisal. Properties are not generally purchased with the expectation of making quick capital gains, and indeed, the Permanent Fund sold no properties from this portfolio in fiscal 1989. Since inception, the Fund has sold only one piece of equity real estate — an office building in New York City in 1987, on which the Fund made a \$7 million capital gain.

Note: Due to the relatively complex nature of real estate investing, the Permanent Fund last year began reporting the annual performance of the equity real estate portfolio with a three-month lag, that is, for the preceding 12-month period ending March 31.



Permanent Fund Real Estate Portfolio

Deerfield Apartments, Louisville, Kentucky

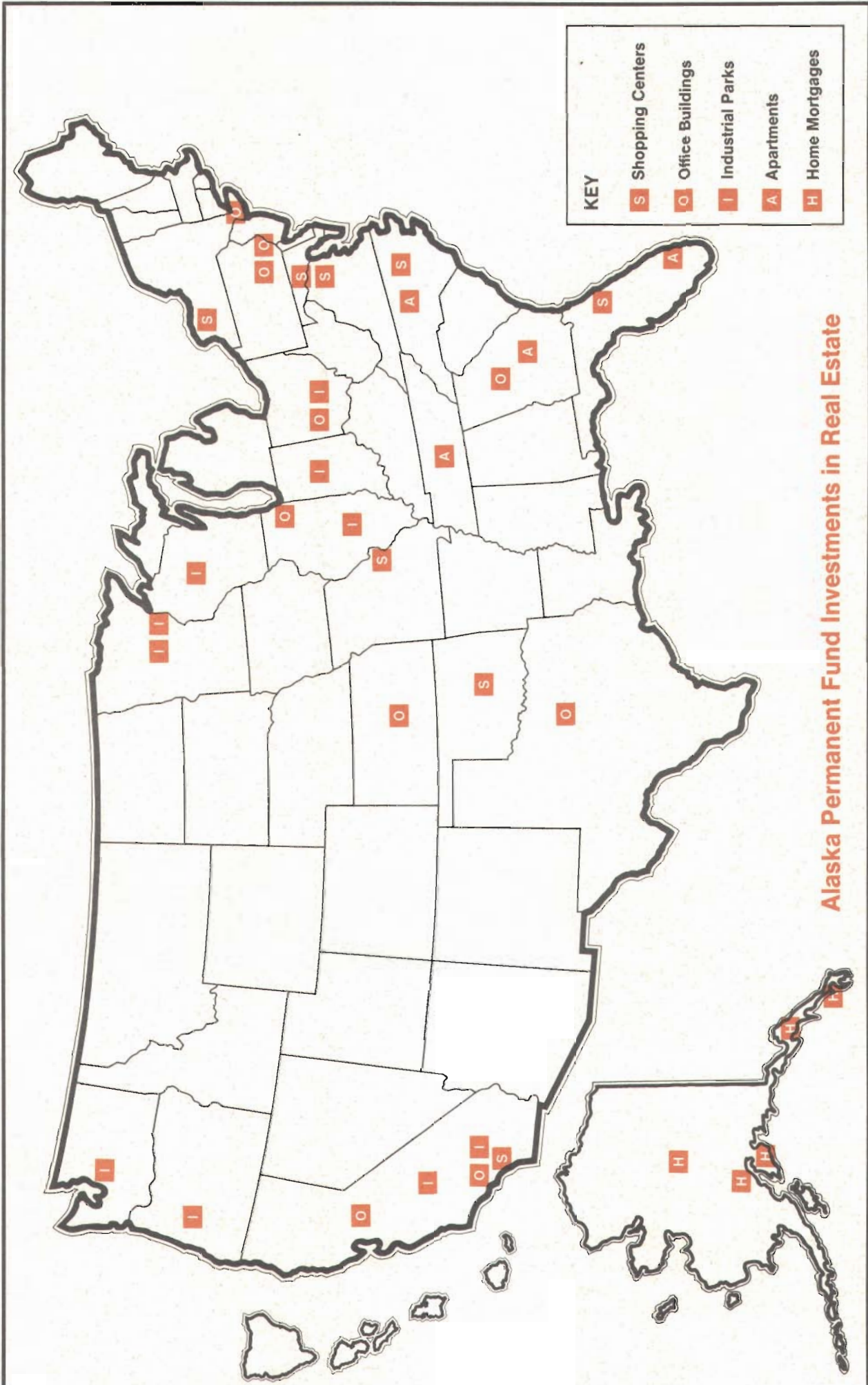
MAJOR 1989 INVESTMENTS

(in millions)

Tyson's Corner	Shopping Center	McLean, VA	\$ 46.6
580 Walnut Street	Office Building	Cincinnati, OH	24.9
Alameda Industrial Parks	Industrial Parks	Alameda County, CA	15.3
37 West 57th Street	Office Building	New York, NY	11.4
Paragon Partners	Office Buildings	FL, NC, KY	9.6
Village at Forest Ridge	Apartments	Charlotte, NC	5.1
Siesta Key/Cedar Key	Apartments	FL	2.3

Total:

\$115.2



KEY	
S	Shopping Centers
O	Office Buildings
I	Industrial Parks
A	Apartments
H	Home Mortgages

Alaska Permanent Fund Investments in Real Estate

As of June 30, 1989 the Fund had a combined 5% interest in five equity pools consisting of 76 separate properties, and a combined 27% interest in 28 joint ventures consisting of 102 properties. All together,

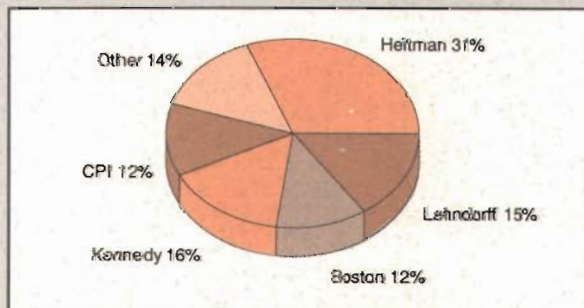
the Fund holds a combined 14% ownership interest in 178 properties in 32 states with a total market value of \$4.9 billion. A complete listing of the Fund's joint venture properties can be found on page 29.



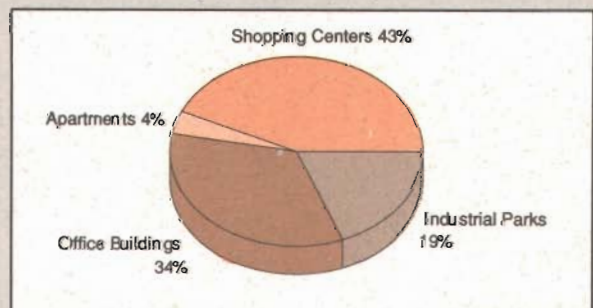
Permanent Fund Real Estate Portfolio
Tysons Corner, McLean, Virginia

EQUITY REAL ESTATE DIVERSIFICATION
\$567 Million at Cost as of June 30, 1989

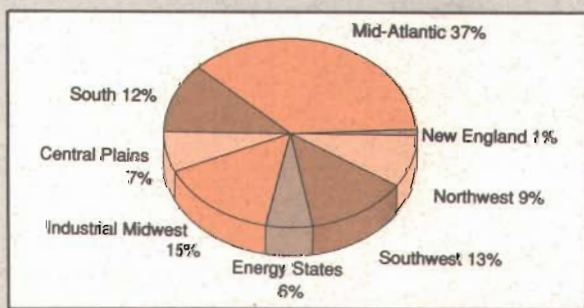
By Investment Advisor



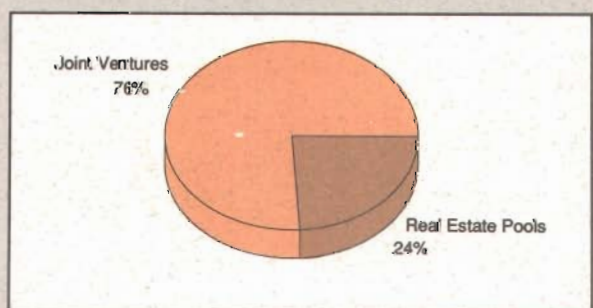
By Property Type



By Region



By Investment Type

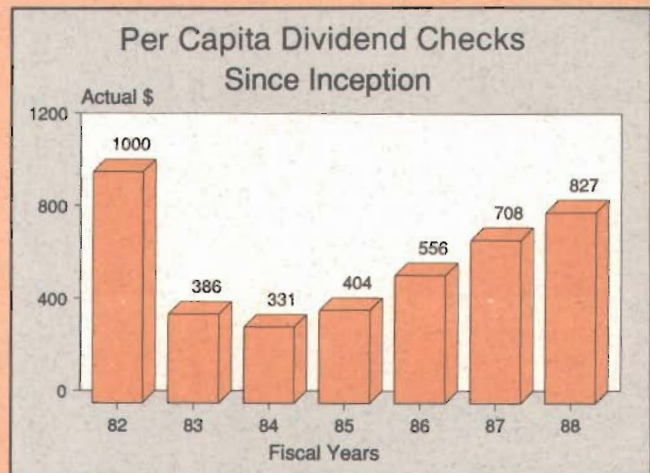
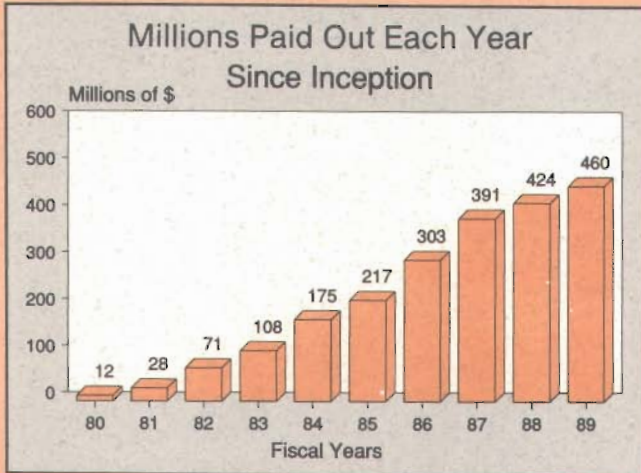


Fund Participates in Alaska Economic Activity

Alaska Permanent Fund Dividend Program: In the fall of 1988, \$424 million of Fund income, minus administrative costs, was paid

out to individual Alaskans through the dividend program. Another \$460 million was paid over to the dividend program in the fall of 1989.

THE ALASKA PERMANENT FUND DIVIDEND PROGRAM



Alaska Certificates of Deposit: Under this program, funds are continuously made available to Alaska financial institutions at market rates of return on a fully-collateralized basis. At year-end, \$133 million was outstanding, down from \$152 million a year ago. There have never been any losses in this program despite numerous bank failures and consolidations.

Home Mortgages in Alaska: This year, three new loans were made, eight old loans were paid off, fifteen non-performing loans defaulted, and nineteen foreclosed properties were sold.

On June 30, 1989, the Fund's Alaska home mortgage portfolio consisted of 198 loans out-

standing, totaling \$32 million. Of these, 34 properties worth \$6 million were over 60 days delinquent (a delinquency rate of 17%). Real estate owned totaled another 22 properties worth an additional \$3 million.

Alaska Science and Technology Endowment: In 1989, the Alaska Permanent Fund Corporation received a \$34 million appropriation from the General Fund to be invested as a separate endowment for the benefit of the Alaska Science and Technology Foundation. Another \$66 million in authorization remains available for additional transfers in fiscal 1990 and 1991.

Designed to stimulate Arctic research, the Foundation will make grants to scientists, businesses and inventors to improve Alaska's use of its resources and improve the state's economy. The Foundation's board of directors will make the grants from income earned on investment of the endowment. John Sibert, a California Institute of Technology chemist, has been hired as the Foundation's first director. It is expected that the research grants will help create new jobs and promote higher standards of public health through new technology.

Endowment income will not be included in the computation of Fund dividends. Assets of the endowment have been commingled with the



Permanent Fund Real Estate Portfolio

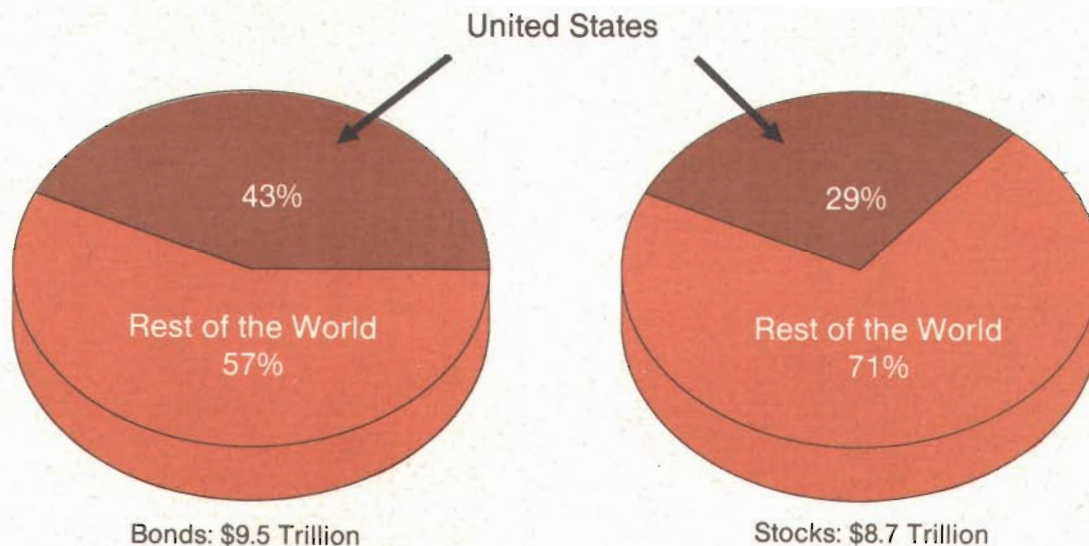
Anchorage, Alaska

1989 Legislature Granted Board of Trustees Authority to Make International Investments

During the First Session of the 16th Legislature, there were 39 bills and resolutions introduced dealing with the Permanent Fund. Six of these bills passed both the House and the Senate and went to Governor Cowper for his signature,

and another three bills and one resolution passed only the House or Senate. All legislation introduced but not acted upon in 1989 carries over to the 1990 session.

WORLD FINANCIAL MARKETS
as of December 31, 1988



The following bills passed into law:

HB 69 (Chapter 4, SLA 1989): This bill authorized the Board of Trustees to invest a portion of the Alaska Permanent Fund in non-U.S. securities.

The trustees believe that international investment will:

- * Assist in reducing overall portfolio risk through increased diversification.
- * Earn rates of return at least comparable to those earned in domestic investments.
- * Provide flexibility to utilize varying institutional-grade investment tools in a volatile market environment.
- * Provide outreach opportunities for Alaska interface with international companies, finan-

greater opportunities for investment of foreign capital, and wider markets for Alaska goods, resources and services.

HB 100 (Chapter 116, Session Laws of Alaska (SLA) 1989): This is the state's fiscal 1990 budget. It included:

\$460 million appropriated from the income of the Permanent Fund to the dividend fund for the payment of 1989 dividends. This included the following allocations:

\$3.5 million from the dividend fund to the Department of Revenue to administer the dividend program;

\$11.8 million from the dividend fund to the Department of Health & Social Services for

\$1.5 million from the dividend fund to the Department of Public Safety and the Department of Corrections. These two allocations were derived from intent language included in a 1988 session law which has since been ruled invalid. That language would have denied an annual dividend to any felon who serves at least one day in jail during the claim year, and intended that the money instead be appropriated to compensate victims of crime.

\$7.8 million from Corporation receipts to the Corporation for its fiscal 1990 expenses.

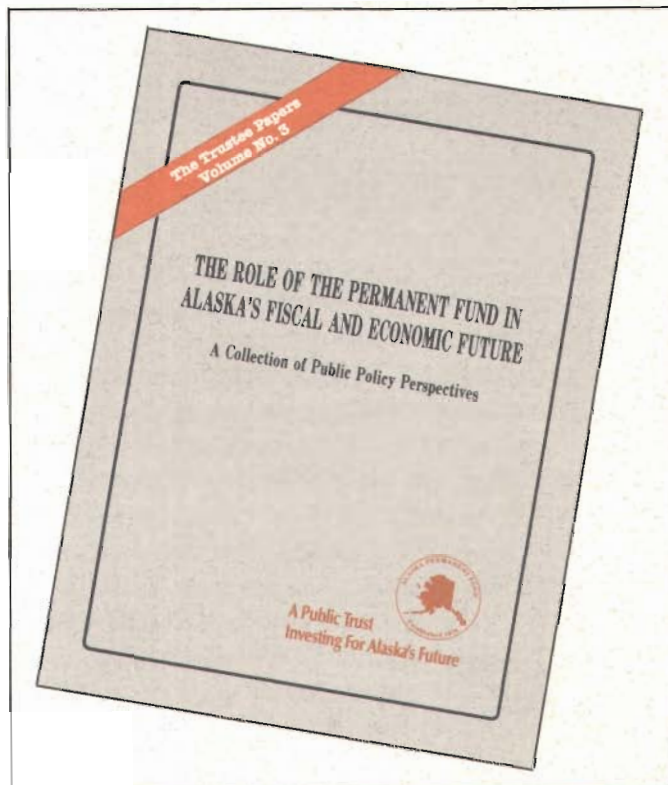
\$500,000 from Corporation receipts in the fiscal note for HB 69, relating to international investments, for investment management fees.

\$100,000 from Corporation receipts in the fiscal note for HB 50, relating to the Commission on the Future of the Permanent Fund, for administrative costs of the Commission.

\$3.5 million from the Permanent Fund's Earnings Reserve Account to pay 25% of the Department of Law's costs relating to litigation on royalty oil matters.

HB 276 (Chapter 38, SLA 1989): This bill prevents any court award in the State v. Amerada Hess case from being used to pay Permanent Fund dividends. At stake in the case is an estimated \$400 million to \$2.6 billion in disputed royalty payments from 12 oil companies. Several of the companies involved in the lawsuit claim they cannot receive a fair trial in Alaska because the judge and the jury would receive a share of the court award through their Permanent Fund dividends. This law stipulates that all money awarded after trial in this case — and all income earned on the investment of that money — must be excluded from all future dividend calculations and instead be transferred automatically to Fund principal each year in perpetuity. This provision will not apply in the event of an out-of-court settlement of the litigation. Trial of the lawsuit is scheduled for September 1990 in Juneau Superior Court.

HB 50 (Chapter 99, SLA 1989): This bill established a nine-person Commission consisting of two state senators, two state representatives, the chairman of the Board of Trustees, the Commissioner of Revenue, and three public members. The Commission's purpose is to hold hearings in each judicial district to gather testimony about the "uses that could be made of the income of the Permanent Fund." The trustees



This booklet was produced as a resource document for the Commission on the Future of the Permanent Fund (HB50).

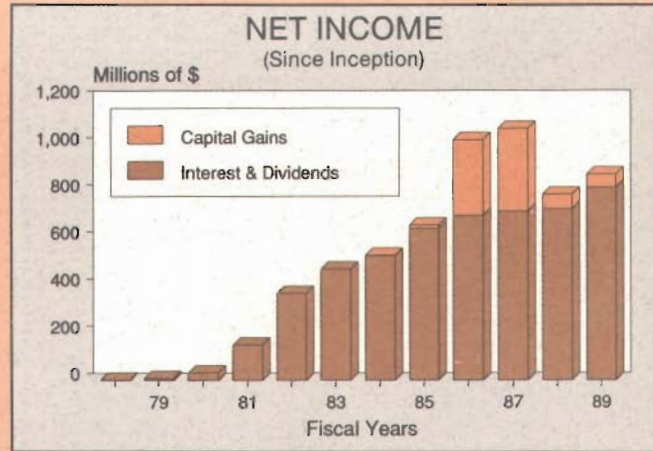
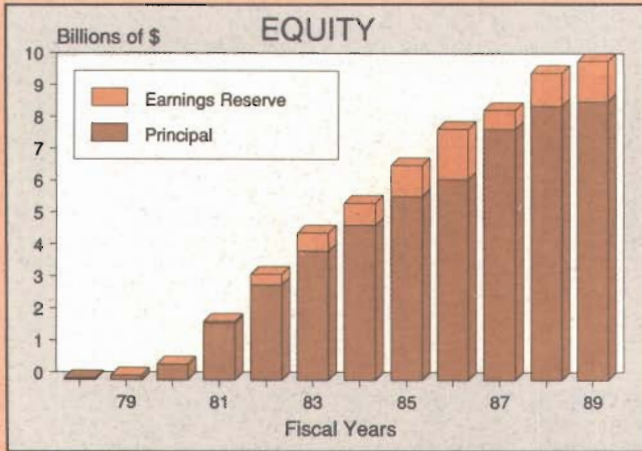
scope to include examination of the Fund in a larger context to include all fiscal and economic policies relating to the optimum long-term flow of total state revenues and expenditures. A final report summarizing the public testimony and containing the Commission's recommendations shall be submitted to the governor and legislature by February 1, 1990.

HB 34 (Chapter 107, SLA 1989): This bill increases the current six-month residency requirement for receipt of Permanent Fund dividends (and the one-year residency requirement for receipt of longevity bonuses) to two years. The Permanent Fund Dividend Division of the Department of Revenue — which administers the dividend program — estimates that this change will drop about 60,000 people from the PFD program in the first year, which could result in almost \$100 more for each of the 1991 recipients. The measure will take effect on January 1, 1991 for those who qualified under the rules in effect this year, but will affect all newcomers as of January 1, 1990.

HB 217 (Chapter 92, SLA 1989): This legislation changes the way jury lists are put together in Alaska. Beginning in 1989, the Court System will rely solely on the preceding calendar year Permanent Fund dividend applications as the source; hunting and fishing license lists and voter registration lists no longer will be

AN OVERVIEW OF LONG-TERM PERFORMANCE

GROWTH OF FUND

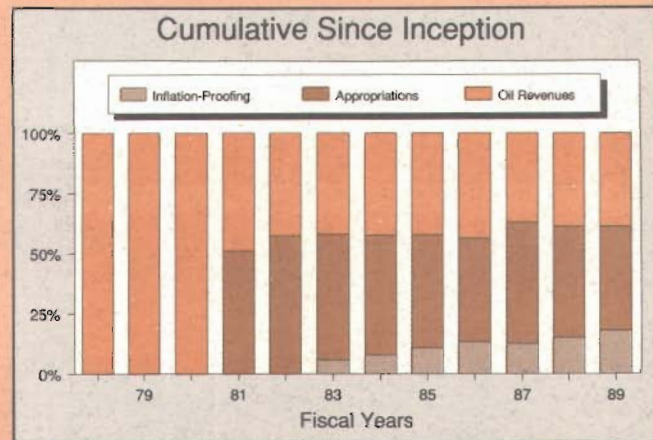
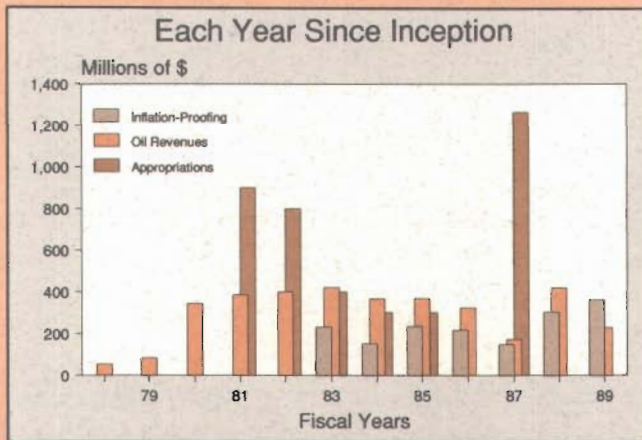


Fund equity is comprised of principal and earnings reserves. Generally the more equity invested, the more income earned.

cause substantial fluctuations from year to year, as happened in 1986-87, when the Fund realized extraordinary capital gains first from the sale of bonds, and then from the sale of stocks.

Volatile financial markets, however, can

SOURCES OF PRINCIPAL GROWTH



In fiscal 1989, for the first time, inflation-proofing contributed more to the growth of

Fund principal than dedicated oil revenues. This trend is projected to continue.

PRINCIPAL

(all \$ in millions)

EQUITY

INCOME

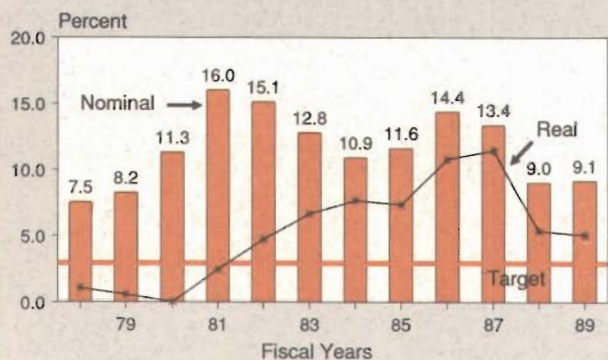
Fiscal Year	Special Appropriations	Dedicated Oil Revenues	Inflation-Proofing
78		\$ 54	
79		84	
80		344	
81	\$ 900	385	
82	800	401	
83	400	421	\$ 231
84	300	366	151
85	300	368	235
86		323	216
87	1,264	171	148
88		434	303
89		228	360

Fiscal Year	Fund Principal	Earnings Reserve Account	Total Fund Equity
78	\$ 54		\$ 54
79	139		139
80	483		483
81	1,769	\$ 59	1,828
82	2,969	244	3,213
83	4,021	354	4,375
84	4,838	557	5,395
85	5,741	763	6,504
86	6,281	1,264	7,545
87	7,864	529	8,393
88	8,601	591	9,192
89	9,190	635	9,825

Fiscal Year	Capital Gains	Total Net Income
78		\$ 2
79		8
80		32
81		150
82		368
83		471
84		529
85	\$ 2	658
86	14	1,021
87	323	1,069
88	352	789
89	63	868

REALIZED RATES OF RETURN

Nominal and Real
(Since Inception)



Annualized Since Inception



* The Trustees' investment goal is to earn, on average, over the long-term, a realized, real rate of return of 3%.

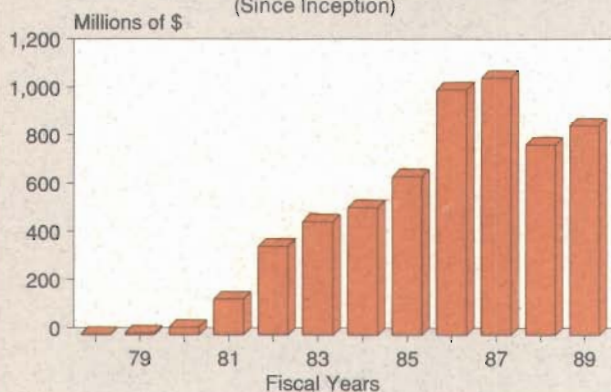
Realized rates of return measure realized income only, that is cash, actually received by the Fund such as dividends paid on stocks, interest

paid on bonds and realized capital gains.

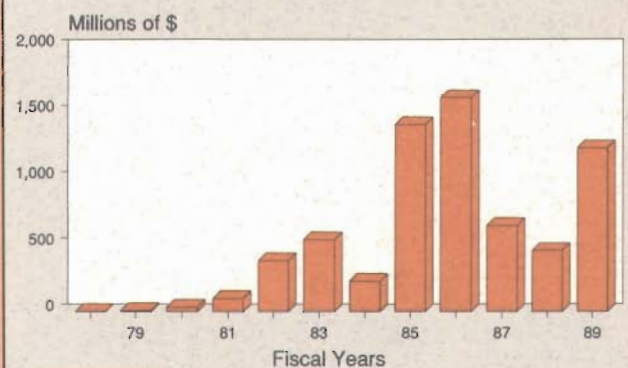
Real returns are nominal returns from which the inflation rate has been subtracted.

TOTAL RETURN INCOME

Realized Income
(Since Inception)



Total Income
(Since Inception)



Total return measures both realized and unrealized income. Unrealized income represents the change in unrealized gains for the reporting period. For example, in fiscal 1989, the Fund

earned \$868 million in realized income, and earned another \$366 million in unrealized income as indicated by the increase in unrealized gains from June 30, 1988 to June 30, 1989.

REALIZED RATES OF RETURN

Fiscal Year	Nominal	Real	Inflation Rates
78	7.53%	1.08%	6.45%
79	8.24	.58	7.66
80	11.29	.03	11.26
81	16.00	2.48	13.52
82	15.10	4.73	10.37
83	12.76	6.66	6.10
84	10.89	7.67	3.22
85	11.61	7.35	4.26
86	14.36	10.79	3.57
87	13.37	11.45	1.92
88	9.01	5.36	3.65
89	9.14	5.06	4.08
Averages:	11.61%	5.27%	6.34%

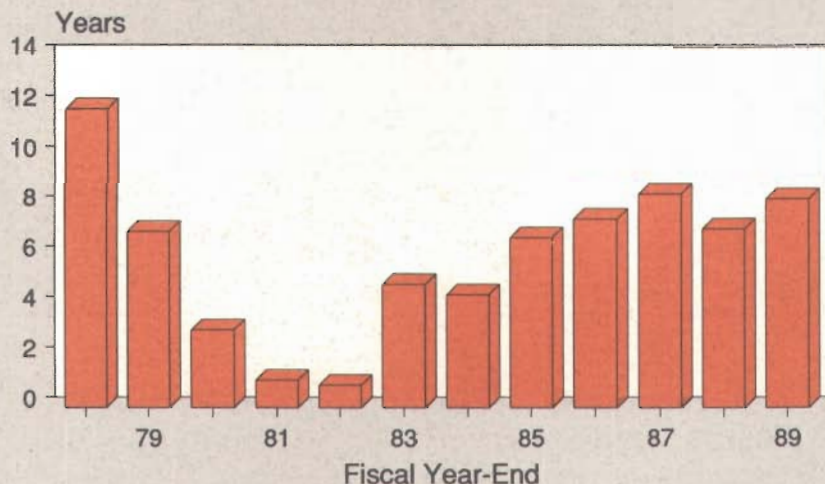
TOTAL RETURN INCOME

Realized Income (in millions)	Net Change in Unrealized Gains (in millions)	Total Return (in millions)
\$ 2	\$ 0	\$ 2
8	0	8
32	2	34
150	(52)	98
368	16	384
471	73	544
529	(300)	229
658	752	1,410
1,021	593	1,614
1,069	(420)	649
789	(326)	463
868	366	\$1,234

FIXED INCOME

FIXED-INCOME PORTFOLIO

Average Weighted Life to Maturity
(Since Inception)



The Fund's basic investment strategy for fixed-income has been to shorten the average life of the portfolio as interest rates begin to rise, and extend it as interest rates begin to fall.

Since inception, the Fund has realized \$324 million in capital gains from the sale of fixed income securities.

LONG-TERM PERFORMANCE OF FIXED-INCOME PORTFOLIO

Fiscal Year	PERMANENT FUND		BENCHMARK INDICES (TOTAL RETURNS)		
	Realized Return	Total Return	Government Corporate	Treasury Index	Intermediate Treasury
85	11.5%	25.7%	28.7%	27.1%	24.1%
86	15.6	21.0	20.7	21.2	16.4
87	9.9	4.0	4.7	3.9	5.3
88	9.2	7.0	7.5	7.0	7.4
89	9.0	11.5	12.3	12.2	10.0
3-years	9.3%	7.5%	8.1%	7.7%	7.6%
5-years	10.8%	13.6%	14.4%	14.0%	12.5%

Note: Total returns are computed based upon market value; realized returns are computed based upon amortized cost value. Period returns are annualized. This portfolio is measured against three Shearson-Lehman-Hutton indices commonly used as benchmarks by the industry: the Government Corporate Index, the Treasury Index, and the Intermediate Treasury Index.

FIXED-INCOME PORTFOLIO STATISTICS

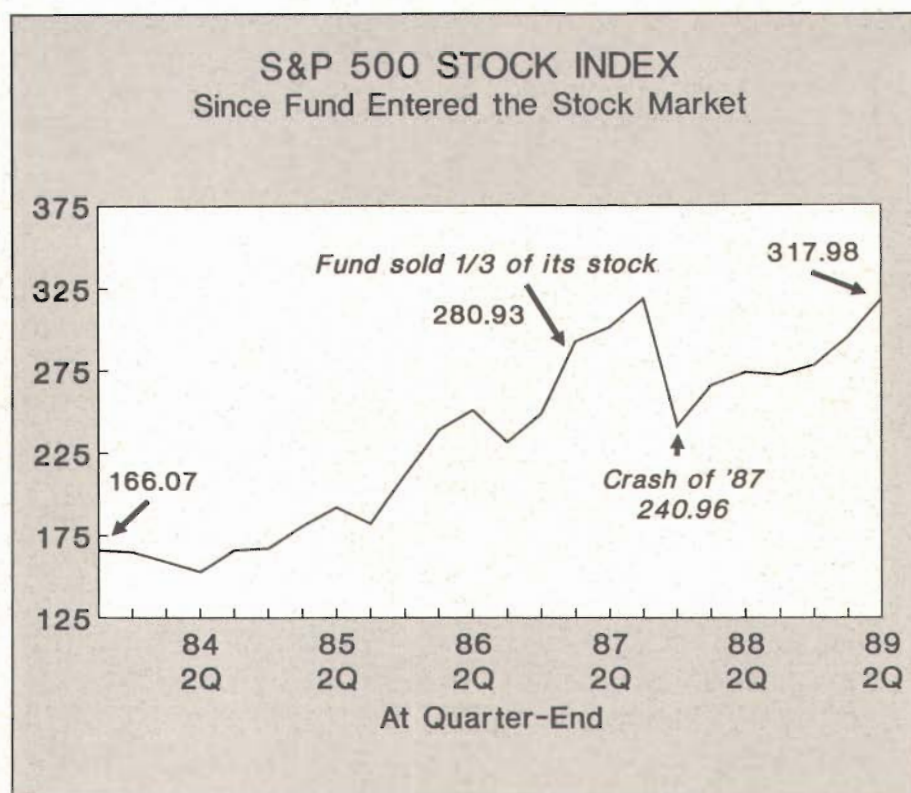
(in millions)

Fiscal Year	Average Life to Maturity (in years)	Cost Value (at June 30)	Market Value (at June 30)	Realized Capital Gains
78	11.9	\$ 54	\$ 52	
79	7.0	138	136	
80	3.1	493	493	
81	1.1	1,846	1,794	
82	.9	3,102	3,138	
83	4.9	4,359	4,396	
84	4.5	5,018	4,702	\$ 1
85	6.8	5,501	5,783	5
86	7.5	5,947	6,510	280
87	8.5	6,996	7,162	23
88	7.1	7,743	7,740	12
89	8.3	8,273	8,444	3

STOCKS

The Permanent Fund began investing in the U.S. stock market in the summer of 1983. By the spring of 1987 its stock portfolio was worth nearly \$2 billion. At that point, the Fund changed its investment strategy and realigned the stock portfolio's passive-active mix from two-thirds/one-third to one-half/one-half. This was accomplished by selling off roughly one-half of the passively-managed index fund: 14.5 million shares worth \$713 million.

As of June 30, 1989, the stock portfolio had a cost value of \$1.1 billion and a market value of \$1.4 billion. Since inception, the Fund has realized \$485 million from the sale of stock in capital gains.



EQUITY MANAGERS' LONG-TERM PERFORMANCE

Equity Managers	Fiscal 1989 Return	Last 3 Years (Annualized)	Last 5 Years (Annualized)
Bankers Trust	20.7%	11.6%	20.0%
Lehman Management	18.4	13.4	21.3
RCM Capital Management	16.4	11.5	20.0
Chancellor Capital	19.5	n/a	n/a
Invesco Capital	16.4	n/a	n/a
S&P 500:	20.5	12.0	20.0
Combined Active:	16.3%	10.0%	17.7%
Combined Equity:	18.7%	11.0%	19.2%

Note: These rates of return are time-weighted total returns for periods ended June 30 which include dividends and capital gains and losses, both realized and unrealized. Bankers Trust began investing for the Fund in July 1983; Lehman and RCM in October 1983; and Invesco Capital and Chancellor Capital in October 1986.

STOCK PORTFOLIO STATISTICS

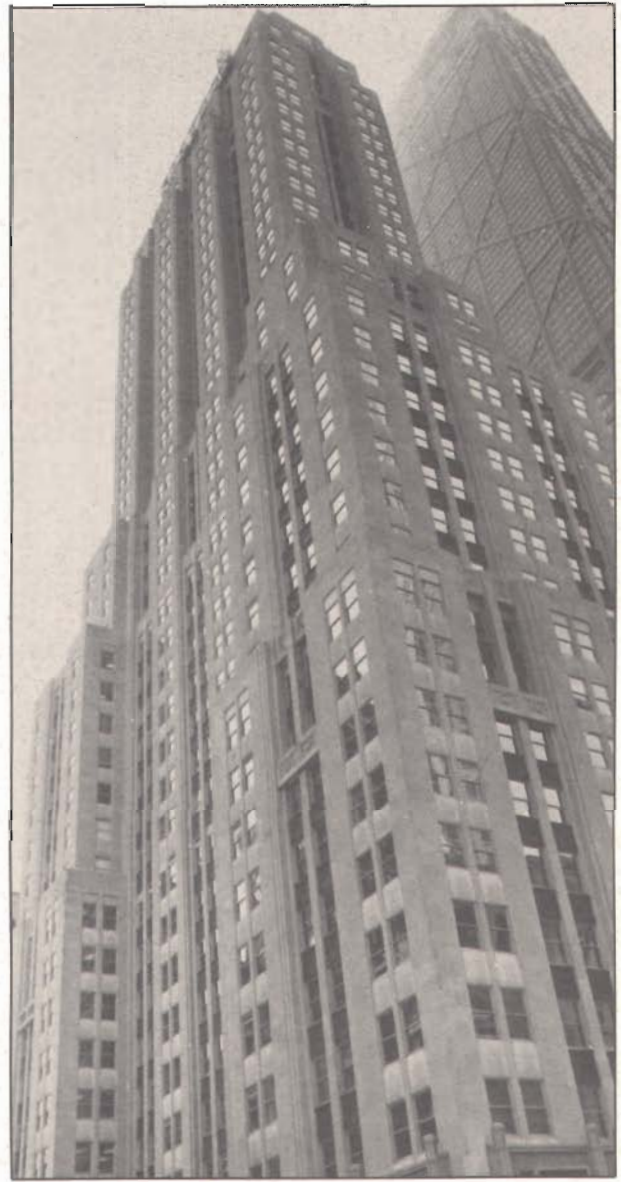
(in millions)

Fiscal Year	Cost Value (at June 30)	Market Value (at June 30)	Unrealized Capital Gains	Realized Capital Gains
84	\$ 312	\$ 291	\$(21)	\$ 2
85	747	839	92	5
86	1,180	1,574	394	44
87	899	1,260	361	328
88	974	1,067	93	48
89	1,092	1,420	328	53

EQUITY REAL ESTATE



Permanent Fund Real Estate Portfolio
1818 Market St., Philadelphia, Pennsylvania



Permanent Fund Real Estate Portfolio
919 N. Michigan, Chicago, Illinois

EQUITY REAL ESTATE LONG-TERM PERFORMANCE

<u>Fiscal Year</u>	<u>Realized Return</u>	<u>Total Return</u>
85	8.7%	18.6%
86	8.1	18.3
87	7.1	13.1
88	7.1	14.8
89	6.5	11.4
Last 3 Years	6.9%	13.1%
Last 5 Years	7.5%	15.2%
Since Inception	7.4%	14.4%

Note: Equity real estate performance is measured for the 12 months ended March 31. Period returns are annualized. The Fund's first purchase of equity real estate was made in October 1983.

SUMMARY OF EQUITY REAL ESTATE INVESTMENTS

As of June 30, 1989

(in millions)

Properties	Location	Cost	Market
Shopping Centers			
Owings Mills	Owings Mills, MD	\$ 25.5	\$ 25.6
McKinley Mall	Buffalo, NY	16.5	19.2
Oakwood Mall	Enid, OK	10.3	12.8
Paragon Partners	FL, NC, KY	9.8	9.8
St. Louis Centre	St. Louis, MO	20.0	21.0
Tyson's Corner	McLean, VA	97.7	128.1
Villa Marina	Marina Del Rey, CA	10.3	19.3
	Totals:	\$190.1	\$235.8
Office Buildings			
37 West 57th Street	New York, NY	\$ 11.6	\$ 11.6
ARA Building	Philadelphia, PA	20.8	24.4
Paragon Building	Dallas, TX	7.9	6.1
Arboretum Lakes	Lisle, IL	11.5	13.4
One City Center	Sacramento, CA	8.3	9.7
1000 Parkwood	Atlanta, GA	4.8	4.7
Epic Center	Wichita, KS	11.4	11.5
1818 Market St.	Philadelphia, PA	25.6	25.1
Walnut Building	Cincinnati, OH	24.9	24.9
Westwood Place	Los Angeles, CA	14.0	14.0
	Totals:	\$140.8	\$145.4
Industrial Parks/Research & Development Facilities			
Alameda Industrial	Alameda County, CA	\$ 15.2	\$ 15.2
Beaverton/Redmond/Tech	OR, WA	17.5	17.5
Blue Ash Business Properties	Blue Ash, OH	8.3	8.4
Harman International	Van Nuys, CA	33.0	38.8
MIW Properties	MN, WI, MI, IL, IN	18.4	18.5
MN-TX Business Center	Eden Prairie, MN	7.4	6.5
Tri-County Center	Cincinnati, OH	3.4	5.5
	Totals:	\$103.2	\$110.4
Residential			
Club Apartments	TN, GA	\$12.4	\$12.2
Polo Club Apartments	Detroit, MI	1.4	1.2
Siesta Key/Cedar Key	FL	2.4	2.4
Village at Forest Ridge	Charlotte, NC	5.1	5.1
	Totals:	\$21.3	\$20.9
Equity Pools			
Corporate Property Investors	Nationwide	\$ 45.7	\$ 75.4
Cigna Fund S	Nationwide	24.0	25.0
JMB II	Nationwide	15.0	17.8
JMB III	Nationwide	20.0	22.6
Aetna Institutional Investors	Nationwide	7.2	7.2
	Totals:	\$111.9	\$148.0
Combined Totals:		\$567.3	\$660.5

Soft Landing for the Economy?

The economy exhibited many signs of weakness in the second calendar quarter of 1989. The appearance of an appreciably stronger dollar and additional economic news suggesting a weakening United States economy produced a major rise in the fixed-income markets. Virtually all the economic news released in May was consistent with a forecast for slower economic growth and moderating inflation. Very weak monetary growth for the year ended June 30, and consumer demand which showed pronounced weakness, created a climate of pervasive economic weakness. Late in June, reports of a 4.2% decline in durable goods orders for May, weaker auto sales in spite of dealer incentives, and a negligible rise in personal income and expenditures confirmed the scenario for slower economic growth. Real consumer spending rose at about a 0.5%-1.0% annual rate in the second calendar quarter, following a 1.3% increase in the first. The 0.1% decline in the June index of leading economic indicators was the fourth drop in five months, following a 1.3% May plunge. Also confirming the economy's retreat was the fact that the majority of the components in the index (7 out of 11) were in decline, suggesting more economic malaise than the marginal 0.1% decline might have suggested.

The National Association of Purchasing Management's July index dropped sharply to 46.0%, its lowest level since January 1983. Every component of the index declined in July. On only one occasion during the past 35 years has the index fallen to 46% without the economy being in recession or about to enter one.

After two months of economic indicators suggesting a significant economic slowdown, evidence supporting a "soft landing" for the economy received a major boost with the release of July's employment figures suggesting that the economy would continue to grow at a slow pace in the second half of 1989. In addition to the employment numbers, new home sales rebounded in June, while chain store sales were up moderately.

In Congressional testimony, Federal Reserve Chairman Alan Greenspan left little doubt that monetary policy had shifted from fighting inflation to fighting recession with the clearly stated

objective of engineering a "soft landing" for the economy. Expansion of the money supply and lower interest rates will be the means to achieve this objective.

Although economic indicators sent mixed signals in the first week of August, the climate of economic weakness continues to suggest declines in short-term interest rates. There is no question that the pace of the seven-year expansion has slipped. Nevertheless, the Federal Reserve is likely to pause in its moves toward monetary ease in light of the employment numbers released for June and July and recent increased monetary growth. Even though inflationary pressures may abate as a result of the recent pause in the economy, monetary policy makers must be concerned that pressures will intensify again if the economy should re-accelerate.

A decided difference of opinion has developed regarding the economic outlook for the months ahead. One group of analysts surmises that the economy is facing recession now because the Federal Reserve has maintained a restrictive monetary policy for too long and very little can be done to prevent a recession at this late date. Other observers are anticipating a resurgence of consumer spending in the fourth calendar quarter based on a high level of consumer confidence, increased savings, and a lower level of interest rates.

While some increase in economic activity, in our opinion, is highly likely in the fourth quarter, we do not anticipate a substantial resurgence in the economy. More likely, from our point of view, the year 1989 will close out as the seventh year of economic recovery. However, we anticipate that the year 1990 will bring with it renewed concerns that an economic recession is imminent. Supporting this thesis undoubtedly will be reports to the effect that the consumer is satiated, corporate earnings are about to deteriorate, exports are weak, capital spending has weakened, and fiscal policy has become more restrictive. In the light of earlier premature predictions of the imminent demise of the current economic recovery, we feel that it is wise to carefully follow unfolding events, both political and economic, without preconceived notions.

ALASKA PERMANENT FUND

**Financial Statements
June 30, 1989 and 1988**

REPORT OF INDEPENDENT AUDITORS

Ernst & Young

Suite 601
301 W. Northern Lights Boulevard
Anchorage, Alaska 99503
Telephone: (907) 279-1411

Board of Trustees
Alaska Permanent Fund Corporation
Juneau, Alaska

We have audited the accompanying statements of assets, liabilities, and fund equity of the Alaska Permanent Fund as of June 30, 1989 and 1988, and the related statements of revenues and expenses, changes in fund equity and changes in financial position for the years then ended. These financial statements are the responsibility of the Alaska Permanent Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Permanent Fund at June 30, 1989 and 1988, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles.

As discussed in Note 18 to the financial statements, in the year ended June 30, 1988, the Alaska Permanent Fund changed its method of accounting for the valuation of real estate.

August 18, 1989

Ernst & Young

STATEMENT OF ASSETS, LIABILITIES AND FUND EQUITY

	<u>June 30,</u>	
ASSETS	<u>1989</u>	<u>1988</u>
Cash and temporary investments - Note 3	\$ 30,768,000	\$ 98,024,000
Receivables and prepaid expenses - Note 4	202,949,000	187,506,000
Investments -		
Marketable debt securities - Note 5		
Short-term	642,242,000	982,676,000
Intermediate and long-term	<u>7,631,016,000</u>	<u>6,760,561,000</u>
Total debt securities	8,273,258,000	7,743,237,000
Real estate - Note 6	567,291,000	433,664,000
Preferred and common stock - Note 7	1,092,660,000	974,277,000
Alaska residential mortgages - Note 8	34,536,000	37,959,000
Alaska certificates of deposit - Note 9	<u>133,325,000</u>	<u>152,825,000</u>
Total investments	10,101,070,000	9,341,962,000
Property and equipment at cost, less accumulated depreciation of \$679,000 in 1989 and \$462,000 in 1988	<u>122,000</u>	<u>255,000</u>
Total assets	<u><u>\$10,334,909,000</u></u>	<u><u>\$9,627,747,000</u></u>
LIABILITIES		
Accounts payable - Note 10	\$ 12,055,000	\$ 11,619,000
Science and Technology Endowment Fund - Note 11	34,253,000	
Income distributable to the State of Alaska - Note 12	<u>463,475,000</u>	<u>424,376,000</u>
Total liabilities	509,783,000	435,995,000
FUND EQUITY		
Contributed equity - Note 13	9,173,245,000	8,584,647,000
Contributions held in escrow - Note 14	16,462,000	15,773,000
Earnings reserve - Note 15	<u>635,419,000</u>	<u>591,332,000</u>
Total fund equity	<u><u>9,825,126,000</u></u>	<u><u>9,191,752,000</u></u>
Total liabilities and fund equity	<u><u>\$10,334,909,000</u></u>	<u><u>\$9,627,747,000</u></u>

STATEMENT OF REVENUES AND EXPENSES

REVENUES	Year Ended June 30,	
	1989	1988
Investment income - Note 16		
Interest	\$747,276,000	\$696,003,000
Dividends	49,095,000	41,418,000
Fees and other income	22,113,000	18,078,000
Total investment income	818,484,000	755,499,000
Realized gains (losses) on —		
Marketable debt securities	3,115,000	11,953,000
Preferred and common stock	53,488,000	47,708,000
Real estate	(653,000)	3,261,000
Total realized gains	55,950,000	62,922,000
Total revenues	874,434,000	818,421,000
Operating expenses - Note 17	5,688,000	5,110,000
Income before other items	868,746,000	813,311,000
Science and Technology Endowment Fund earnings - Note 11	(253,000)	
Cumulative effect of a change in accounting principle - Note 18		(24,159,000)
NET INCOME	\$868,493,000	\$789,152,000

STATEMENT OF CHANGES IN FUND EQUITY

	<u>Total Fund Equity</u>	<u>Contributed Equity</u>	<u>8G Escrow Account</u>	<u>Earnings Reserve</u>
Balance, June 30, 1987	\$ 8,393,273,000	\$ 7,863,856,000		\$ 529,417,000
Dedicated State revenues	433,702,000	417,929,000	\$15,773,000	
Net income from operations	789,152,000			789,152,000
Citizen contributions	1,000	1,000		
Provision for 1988 dividends	(424,376,000)			(424,376,000)
Provision for 1988 inflation		302,861,000		(302,861,000)
Balance, June 30, 1988	9,191,752,000	8,584,647,000	15,773,000	591,332,000
Escrow earnings			689,000	(689,000)
Provision for Department of Law appropriation	(3,500,000)			(3,500,000)
Dedicated State revenues	228,355,000	228,355,000		
Net income from operations	868,493,000			868,493,000
Citizen contributions	1,000	1,000		
Provision for 1989 dividends	(459,975,000)			(459,975,000)
Provision for 1989 inflation		360,242,000		(360,242,000)
Balance, June 30, 1989	<u>\$9,825,126,000</u>	<u>\$9,173,245,000</u>	<u>\$16,462,000</u>	<u>\$635,419,000</u>

ALASKA PERMANENT FUND

STATEMENT OF CHANGES IN FINANCIAL POSITION

FUNDS WERE PROVIDED BY	Year Ended June 30,	
	1989	1988
Investment operations -		
Net income	\$ 868,493,000	\$ 789,152,000
Items not affecting funds -		
Amortization (accretion)	(1,138,000)	3,837,000
Depreciation	218,000	122,000
Undistributed real estate income	(2,071,000)	(66,000)
Cumulative effect of change in accounting principle		24,159,000
Total from operations	865,502,000	817,204,000
Net sales and maturities of investments --		
Marketable debt securities		
Short-term	340,434,000	
Intermediate and long-term		59,121,000
Alaska residential mortgage repayments	3,423,000	3,571,000
Alaska bank certificates of deposit redemptions	19,500,000	29,900,000
Total sales and maturities	363,357,000	92,592,000
Increase in receivables and prepaid expenses	(15,443,000)	(11,168,000)
Increase (decrease) in accounts payable	437,000	(4,041,000)
Citizen contributions	1,000	1,000
Science and Technology Endowment Fund	34,253,000	
Contributions from the State	228,355,000	433,702,000
Total funds provided	1,476,462,000	1,328,290,000
FUNDS WERE USED FOR		
Net purchases of investments --		
Marketable debt securities -		
Short-term		810,082,000
Intermediate and long-term	869,317,000	
Real estate	131,557,000	116,534,000
Preferred and common stock	118,383,000	75,547,000
Total purchases	1,119,257,000	1,002,163,000
Property and equipment purchases	85,000	41,000
Income distributions	424,376,000	390,983,000
Total funds used	1,543,718,000	1,393,187,000
Decrease in cash and temporary investments	\$ (67,256,000)	\$ (64,897,000)

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1989

1. ENTITY

The Constitution of the State of Alaska (the "State") was amended by public referendum in 1976 to dedicate a portion of certain natural resource revenues to the Alaska Permanent Fund (the "Fund"). The principal of the Fund is to be invested in perpetuity. The State legislature created the Alaska Permanent Fund Corporation (the "Corporation"), a government instrumentality of the State which is administered by a board of trustees (the "Trustees") to manage the investments of the Fund. By statute (i) a portion of the annual earnings is transferred to the State for the payment of dividends to eligible residents of Alaska, and (ii) a portion of the annual earnings that is sufficient to offset the impact of inflation is transferred to the principal of the Fund. The balance is held by the Fund in the earnings reserve account.

2. SIGNIFICANT ACCOUNTING POLICIES

Contributions: Contributions from dedicated State revenues are recorded when certain revenues defined by statute are received by the Alaska Department of Natural Resources. Contributions from State appropriations and other sources are recorded when they are received.

Depreciation: Furniture and equipment are depreciated on a straight-line basis over a three-year useful life. Other property is depreciated on a straight-line basis over a five-year useful life.

Dividend Appropriations: Current statutes require that one-half of twenty-one percent of the Fund's net income for the last five fiscal years, excluding unrealized gains and losses, be made available for the payment of dividends each year.

Investment Valuation: By resolution, the Trustees have adopted the following accounting policies for the valuation of investments:

Type	Basis
Marketable debt securities	Cost adjusted for amortization of premiums and accretion of discounts
Real estate -	
Commingled funds	Cost
Joint participations	Equity
Preferred and common stock	Lower of cost or market
Alaska residential mortgages	Cost
Alaska certificates of deposit	Cost

Inflation Impact: The impact of inflation is measured by the change in the prior calendar year average of the United States consumer price index for all urban consumers, applied against the balance of contributed equity at the end of the fiscal year.

Interest Income: Interest income is accrued monthly as earned, and is shown net of amortization of premiums and accretion of discounts on securities.

Real Estate: Investments in commingled real estate funds and pools are carried at cost, and income is recognized as distributions are declared. Investments in real estate partnerships and other joint participations are carried at cost plus undistributed equity in the results of operations. Income is recognized as earned by the investment.

Realized Gains and Losses: Realized gains or losses on the sale of investments are determined on the transaction date by average cost for investments in preferred and common stock, and by specific identification for all other investments.

Securities Transactions: Security transactions are recorded on the date that securities are purchased or sold.

Reclassification of Prior Year: Certain prior year balances have been reclassified to conform with a change in reporting format. The reclassification had no effect on previously reported earnings.

3. CASH AND TEMPORARY INVESTMENTS

All cash and temporary investments bear interest at competitive rates, and are summarized as follows at June 30:

	<u>1989</u>	<u>1988</u>
Operating account (A)	\$ 157,000	\$ 178,000
Cash management accounts (A)	92,000	140,000
Common stock treasury accounts (B)	<u>30,519,000</u>	<u>97,706,000</u>
Total cash and temporary investments	<u>\$30,768,000</u>	<u>\$98,024,000</u>

(A) Insured by the Federal Deposit Insurance Corporation (FDIC) to \$100,000 per account. Remaining balance uninsured and uncollateralized.

(B) Share ownership in a money market fund designated by the custodian bank and payable on demand. Collateralized by underlying securities held by the Fund in the name of the custodian. Not considered an investment nor assigned a specific risk category.

4. RECEIVABLES AND PREPAID EXPENSES

Receivables and prepaid expenses at June 30 are as follows:

	<u>1989</u>	<u>1988</u>
Accrued interest receivable	\$153,768,000	\$157,260,000
State dedicated revenues receivable	42,197,000	20,997,000
Securities sold	2,619,000	5,842,000
Dividends receivable	4,274,000	3,273,000
Other receivables and prepaid expenses	<u>91,000</u>	<u>134,000</u>
Total receivables and prepaid expenses	<u>\$202,949,000</u>	<u>\$187,506,000</u>

5. MARKETABLE DEBT SECURITIES

The Corporation is authorized by statute to invest Fund assets in (i) commercial paper rated A-1 by Standard & Poor's or P-1 by Moody's, (ii) bankers acceptances drawn on and accepted by United States banks, each of which have a combined capital and surplus aggregating at least \$200,000,000, (iii) certificates of deposit of financial institutions which may be readily sold in a secondary market at prices reflecting fair value, (iv) corporate bonds rated AA or better by Standard & Poor's or Moody's, and (v) obligations of the United States Treasury, its agencies and instrumentalities. All marketable debt securities are held by custodian banks in the name of the Corporation on behalf of the Fund.

Marketable debt securities at June 30 are summarized as follows:

1989	<u>AMORTIZED COST</u>	<u>MARKET</u>	<u>UNREALIZED GAIN (LOSS)</u>	<u>YIELD</u>
Short-term -				
Commercial paper	\$ 642,242,000	\$ 642,242,000		9.22%
Intermediate and long-term -				
Treasury notes/bonds	6,281,275,000	6,448,833,000	\$167,558,000	8.65%
GNMA pools	359,669,000	352,688,000	(6,981,000)	9.27%
Corporate bonds	990,072,000	999,758,000	9,686,000	9.10%
Total intermediate and long-term	<u>7,631,016,000</u>	<u>7,801,279,000</u>	<u>170,263,000</u>	<u>8.78%</u>
Total marketable debt securities	<u>\$8,273,258,000</u>	<u>\$8,443,521,000</u>	<u>\$170,263,000</u>	<u>8.78%</u>
1988				
Short-term -				
Commercial paper	\$ 607,925,000	\$ 607,925,000		7.39%
Treasury bills	374,751,000	374,457,000	\$ (294,000)	6.59%
Total short-term	982,676,000	982,382,000	(294,000)	6.76%
Intermediate and long-term -				
Treasury notes/bonds	6,167,168,000	6,207,563,000	40,395,000	8.62%
GNMA pools	211,408,000	197,221,000	(14,187,000)	8.83%
Corporate bonds	381,985,000	352,895,000	(29,090,000)	8.79%
Total intermediate and long-term	<u>6,760,561,000</u>	<u>6,757,679,000</u>	<u>(2,882,000)</u>	<u>8.66%</u>
Total marketable debt securities	<u>\$7,743,237,000</u>	<u>\$7,740,061,000</u>	<u>\$ (3,176,000)</u>	<u>8.66%</u>

6. REAL ESTATE

The Corporation is authorized by statute to invest Fund assets in real estate located in the United States and improved by substantially rented buildings. Investments may take the form of equity interests or debt obligations secured by a first lien on the real estate. By statute, the Fund may hold up to forty percent of the beneficial ownership interest. All real estate investments are held by the Corporation in its own name on behalf of the Fund, and are managed by professional real estate investment management firms.

Real estate investments of the Fund include (i) commingled funds and pools that are sponsored by professional real estate management firms, and (ii) direct property investments that are structured as partnerships and other joint participations.

Real estate investments at June 30 are summarized as follows:

1989	<u>COST BASIS</u>	<u>MARKET VALUE</u>	<u>APPRECIATION</u>
Commingled funds	\$111,872,000	\$147,948,000	\$36,076,000
Joint participations -			
Retail	190,085,000	235,803,000	45,718,000
Office	140,838,000	145,481,000	4,643,000
Industrial	103,197,000	110,401,000	7,204,000
Residential	21,299,000	20,900,000	(399,000)
Total real estate	<u>\$567,291,000</u>	<u>\$660,533,000</u>	<u>\$93,242,000</u>

1988	<u>COST BASIS</u>	<u>MARKET VALUE</u>	<u>APPRECIATION</u>
Commingled funds	\$107,210,000	\$134,331,000	\$27,121,000
Joint participations -			
Retail	132,020,000	138,794,000	6,774,000
Office	102,820,000	103,623,000	803,000
Industrial	77,710,000	78,380,000	670,000
Residential	13,903,000	13,903,000	
Total investment	433,663,000	469,031,000	35,368,000
Pre-acquisition costs	1,000	1,000	
Total real estate	<u>\$433,664,000</u>	<u>\$469,032,000</u>	<u>\$35,368,000</u>

Outstanding Commitments

At June 30, 1989, the Corporation had the following commitments outstanding for the purchase of additional real estate investments for the Fund:

Commingled funds	\$12,871,000
Joint participations -	
Retail	10,808,000
Office	28,938,000
Industrial	2,300,000
Residential	2,491,000
Total commitments	<u>\$57,408,000</u>

7. PREFERRED AND COMMON STOCK

The Corporation is authorized by statute to invest Fund assets in the preferred and common stock of United States corporations. All preferred and common stock investments are held by custodial banks in the name of the Corporation on behalf of the Fund.

Preferred and common stock at June 30 is summarized as follows:

	<u>1989</u>	<u>1988</u>
Market	\$1,420,496,000	\$1,166,918,000
Cost	<u>1,092,660,000</u>	<u>974,277,000</u>
Unrealized gain	<u>\$ 327,836,000</u>	<u>\$ 192,641,000</u>

8. ALASKA RESIDENTIAL MORTGAGES

The Corporation is authorized by statute to invest Fund assets in notes secured by insured mortgages granting a first lien on residential real estate. No insurance is required for residential loans with loan-to-value ratios that are less than seventy percent. All mortgage notes are held by the Corporation in its own name on behalf of the Fund. Included in the balance of Alaska residential mortgages is \$2,717,000 of real estate acquired by the Fund in foreclosure ("REO"), and which is valued at fair market. Gains (losses) on real estate include a net reduction in the value of such REOs amounting to \$604,000 and \$1,212,000, in 1989 and 1988 respectively.

9. ALASKA CERTIFICATES OF DEPOSIT

The Corporation is authorized by statute to invest Fund assets in certificates of deposit or the equivalent instruments of banks, savings and loan associations, mutual savings banks, and credit unions doing business in Alaska. These investments are fully collateralized by securities and mortgages which would qualify as investments of the Fund. All certificates and collateral are held by a trustee bank in the name of the Corporation on behalf of the Fund.

10. ACCOUNTS PAYABLE

Accounts payable at June 30 are summarized as follows:

	<u>1989</u>	<u>1988</u>
Vouchers payable		\$ 256,000
Accrued liabilities	\$ 1,495,000	1,335,000
Securities purchased	<u>10,560,000</u>	<u>10,028,000</u>
Total accounts payable	<u>\$12,055,000</u>	<u>\$11,619,000</u>

11. SCIENCE AND TECHNOLOGY ENDOWMENT FUND

The Alaska Science and Technology Endowment Fund (the "Endowment") was created by an act of the 1989 State legislature to provide financial support for the Alaska Science and Technology Foundation (the "Foundation"). By statute, the Endowment is to be held and invested by the Corporation under the same investment authority as the Fund is managed. Net income from the Endowment is distributed to the Foundation after appropriation by the State legislature and is not included in the computation of Fund dividends.

The assets of the Endowment have been commingled with the assets of the Fund for investment purposes. Earnings are allocated to the Fund and the Endowment on the basis of unit shares and fractional shares. Each unit share or fractional unit share has an undivided beneficial interest in the commingled assets equal to the proportion which it bears to the total units outstanding. Unit shares are credited to the Fund and the Endowment on the basis of total funds contributed to the investment pool.

Principal and undistributed earnings of the Endowment at June 30, 1989 are summarized as follows:

Principal	\$34,000,000
Undistributed earnings	<u>253,000</u>
Total liability	<u>\$34,253,000</u>

Distributions to the Foundation are made by liquidation of unit shares valued at cost. However, total liquidation of all Endowment unit shares would be made at the net asset value of those shares which amounted to \$34,895,000 at June 30, 1989. The Fund has thereby incurred a contingent liability for the net asset value increment of all Endowment shares outstanding of \$642,000.

12. INCOME DISTRIBUTABLE TO THE STATE OF ALASKA

The Alaska State legislature has appropriated a portion of the Fund's net income for various purposes, including the payment of dividends to qualified residents of the State of Alaska. In addition, the State legislature appropriated a portion of the Fund's earnings reserves during the fiscal year ended June 30, 1989, for certain future costs of oil and gas revenue litigation.

Income distributable to the State of Alaska at June 30 is summarized as follows:

	<u>1989</u>	<u>1988</u>
Dividends	\$443,174,000	\$411,268,000
Department of -		
Corrections	763,000	
Health and Social Services	11,764,000	9,850,000
Revenue	3,537,000	3,258,000
Public Safety	<u>737,000</u>	
Total to dividend fund	459,975,000	424,376,000
Department of Law	<u>3,500,000</u>	
Total income distributable	<u>\$463,475,000</u>	<u>\$424,376,000</u>

13. CONTRIBUTED EQUITY

The principal balance of the Fund at June 30 is as follows:

	<u>1989</u>	<u>1988</u>
Dedicated State revenues	\$3,564,053,000	\$3,335,698,000
Appropriated from the state	3,964,385,000	3,964,385,000
Provision for inflation	1,644,803,000	1,284,561,000
Citizen contributions	4,000	3,000
Total contributed equity	<u>\$9,173,245,000</u>	<u>\$8,584,647,000</u>

14. CONTRIBUTIONS HELD IN ESCROW

Certain bonus payments, rent and interest from the joint State-Federal Beaufort Sea lease sale of 1979 were deposited in a federally managed escrow account because ownership of the tracts is in dispute. In December 1988, Congress amended the law to provide for the distribution of twenty-seven percent (27%) of the balance in the account, plus accrued interest, to the State of Alaska. This distribution represents the minimum due as federal mineral revenue sharing in the event that the Supreme Court awards the ownership of all disputed tracts to the Federal government.

Under State law, the final allocation of this payment between the Fund and the State depends upon which party — the State or the Federal government — prevails in Court. If the Federal government wins the dispute, fifty percent of this payment would be allocated to the Fund. If the State wins the dispute, fifty percent of this payment would be allocated to the Fund except for the bonus and interest on the lease of four tracts. Twenty-five percent of those payments would be allocated to the Fund.

An amount equal to the bonus and interest in dispute on these four tracts has been placed in escrow by the Corporation on behalf of the Fund under a memorandum of understanding between the Corporation and the State, pending final settlement of the litigation between the State and the Federal government. Interest is accrued thereon each year at the rate of return earned by the Fund.

15. EARNINGS RESERVE

By statute, the balance of Fund net income remaining after the payment of dividends and the provision for inflation is held in the earnings reserve account. Earnings on the investment of contributions held in escrow during the years ended June 30 has been obligated for payment to the escrow account on July 1.

	<u>1989</u>	<u>1988</u>
Unobligated reserves	\$633,914,000	\$590,643,000
Reserves obligated for earnings on contributions held in escrow	<u>1,505,000</u>	<u>689,000</u>
Total earnings reserve	<u>\$635,419,000</u>	<u>\$591,332,000</u>

16. INVESTMENT INCOME BY SOURCE

	<u>Year Ended June 30,</u>	
	<u>1989</u>	<u>1988</u>
Interest		
Repurchase agreements	\$ 5,189,000	\$ 4,436,000
Commercial paper	46,888,000	9,737,000
Bankers acceptance	916,000	1,106,000
Treasury bills	5,278,000	14,781,000
Treasury notes and bonds	569,151,000	593,966,000
GNMA pools	27,302,000	18,605,000
Corporate bonds	64,106,000	28,852,000
Participating mortgages	7,069,000	5,088,000
Real estate partnerships	59,000	23,000
Alaska residential mortgages	2,753,000	3,143,000
Alaska certificates of deposit	12,464,000	11,244,000
Other certificates of deposit		2,000
Money market accounts and other interest	<u>6,101,000</u>	<u>5,020,000</u>
Total interest	<u><u>\$747,276,000</u></u>	<u><u>\$696,003,000</u></u>
Dividends		
Preferred and common stock	\$ 45,040,000	\$ 36,867,000
Equity real estate pools	<u>4,055,000</u>	<u>4,551,000</u>
Total dividends	<u><u>\$ 49,095,000</u></u>	<u><u>\$ 41,418,000</u></u>
Fees and other income		
Fees on loaned securities	\$ 658,000	\$ 807,000
Real estate income	<u>21,455,000</u>	<u>17,271,000</u>
Total fees and other income	<u><u>\$ 22,113,000</u></u>	<u><u>\$ 18,078,000</u></u>

17. OPERATING EXPENSES

Operating expenses of the Corporation for the years ended June 30 are summarized as follows:

	<u>1989</u>	<u>1988</u>
Salaries and benefits	\$1,035,000	\$ 863,000
Travel	161,000	148,000
Communications	210,000	112,000
Consulting fees	191,000	155,000
Custody and safekeeping fees	672,000	596,000
Investment management fees	2,467,000	2,390,000
Legal and audit	140,000	287,000
Public information and subscriptions	109,000	100,000
Rent	146,000	148,000
Depreciation	218,000	122,000
Other expenses	<u>339,000</u>	<u>189,000</u>
Total operating expenses	<u><u>\$5,688,000</u></u>	<u><u>\$5,110,000</u></u>

18. CHANGE IN ACCOUNTING PRINCIPLE FOR THE VALUATION OF REAL ESTATE

The Trustees have elected by resolution to value investments in real estate at historical cost, effective September 25, 1987. Valuation of real estate in prior fiscal years was at market and recognized unrealized gains from appreciation when independent appraisals were performed on the properties.

This change in accounting principle was based on several factors, including (i) valuation at cost more conservatively measures the performance of real estate investments, and (ii) valuation at market caused a conflict between the statutory computation of net income and net income reported according to generally accepted accounting principles.

As a result of this change in accounting principle, unrealized gains on real estate previously recognized have been reversed. The change has been applied retroactively to all real estate investments, and has caused net income for the year ended June 30, 1988 to be reduced by \$24,159,000.

19. PENSION PLAN

All full-time employees of the Corporation participate in the State of Alaska Public Employees Retirement System (PERS), a multiple employer public employee retirement system. Total salaries and benefits for employees covered by PERS for the years ended June 30, 1989 and 1988 amounted to \$1,035,000 and \$863,000, respectively.

Corporation employees are required to contribute 6.75% of their annual salaries to PERS. The Corporation contributes the remaining amounts necessary to pay benefits when due. These contributions represented 9.65% of covered salary expenses in the fiscal years ended June 30, 1989 and 1988, respectively.



