





**A Public Trust**

**Investing For Alaska's Future**



## CHAIRMAN'S MESSAGE

### **The Fund's Finest Year**

The fiscal year ended June 30, 1986, was a truly remarkable period for the Alaska Permanent Fund Corporation. From both an operational and a performance standpoint, it was a year of significant accomplishment:

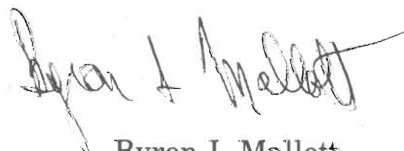
- \* Including a \$1.26 billion appropriation effective July 1, 1986, the principal of the Permanent Fund grew an astounding \$1.8 billion in just one year.
- \* Bolstered by the extraordinary performance of the U.S. financial markets, particularly during the second half of the fiscal year, the Permanent Fund earned over \$1 billion in annual income for the first time in its 10-year history. Much of this was due to unusually large capital gains.
- \* Despite declining interest rates throughout the period, the Permanent Fund earned a realized rate of return this year of 14.36%. After adjusting for inflation, the real rate of return equaled 10.79%, the highest in the Fund's history.

In addition, the Alaska Permanent Fund Corporation continues to mature as an investment institution. The general ledger has been fully computerized and is now on-line. A reliable method of performance measurement has been evaluated and implemented. A comprehensive public information program has been approved and put in place. And, after years of careful and deliberate growth in equity investments, the Permanent Fund's portfolio of assets is now better positioned than ever to achieve its long-term earnings objectives.

I have enjoyed my term as chairman. It has been a distinct pleasure and a memorable opportunity for me to work with such a fine group of fellow trustees. I congratulate the staff of the Corporation for a job well done, and I commend Governor Sheffield and the members of the 14th Alaska State Legislature for their farsightedness in approving this year's special appropriation to the principal of the Permanent Fund. That was a dramatic display of fiscal prudence.

Finally, I want to thank you, the public. Your continued support and involvement have made all of the Fund's successes possible.

I believe the following pages will show you why we are optimistic about the future of Alaska. With the earnings of the Permanent Fund providing a solid base for a sustainable and diversified statewide economy, we may look forward to the years ahead with excitement and confidence.



Byron I. Mallott  
Chairman  
Board of Trustees  
1985-86



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## ORGANIZATION

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### BOARD OF TRUSTEES

Arnold G. Espe  
Byron I. Mallott  
Hugh Malone  
Mary A. Nordale  
Emil Notti  
Clyde M. Sherwood

### OFFICERS

#### Fiscal 1986

Byron I. Mallott, Chairman  
Clyde M. Sherwood, Vice-Chairman  
David A Rose, Secretary/Treasurer

#### Fiscal 1987

Clyde M. Sherwood, Chairman  
Hugh Malone, Vice-Chairman  
David A. Rose, Secretary/Treasurer

### STAFF

#### Executive Director

David A. Rose

#### Chief Investment Officer

William A. Means

#### Investment Officers

Richard E. Alexander  
Robert D. Storer

#### Research & Liaison Officer

Jim Kelly

#### Comptroller

Peter A. Bushre

#### Accountants

Joyce St. Clair  
Drusilla Westall  
Ellen Phipps

#### Office Manager

Alison Farnan

#### Secretary

Becky Mitchell

#### Receptionist

Vicki Soboleff

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## HISTORY AND MANAGEMENT

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### Voters Created Permanent Fund 10 Years Ago

The Alaska Permanent Fund is a savings account, restricted as to usage, which belongs to all the people of Alaska. It was created by public referendum in 1976 when the voters, by a margin of 75,588 to 38,518, changed Article IX of the state Constitution by amending Section 7 (Dedicated Funds) and adding a new Section 15:

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**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.

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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.

In 1980, and again in 1981, the legislature approved special appropriations to the principal of the Permanent Fund — above what was required by the constitutional amendment. In 1980, in remembrance of the 1969 Prudhoe Bay bonus lease sale, the appropriation was a symbolic \$900 million. In 1981, the appropriation was twice that amount, or \$1.8 billion.

In 1982, there were three significant actions taken by the legislature. First, the dividend program as it exists today was adopted as the first priority use of Fund annual earnings. Second, inflation-proofing was approved to protect the purchasing and investment power of the principal of the Fund. Third, the approved investment list for the Permanent Fund was expanded to include stocks and real estate.

This past session, the legislature once again passed a special appropriation to the principal of the Fund — this time \$1.26 billion of Fund undistributed income.

To manage the investments of the Permanent Fund, the legislature created the Alaska Permanent Fund Corporation as a public 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, responsive to changes in state policy and accountable to the people through their elected officials.

Consequently, within the statutory framework of Alaska Statute 37.13, corporate policy is formulated independently by a board of six trustees. Four are members of the public with recognized experience in the management of money. They are appointed by the governor for four-year terms. The other members are the commissioner of the Department of Revenue and one cabinet officer of the governor's choice.

Byron I. Mallott, chief executive officer for a Juneau-based Native corporation, served as chairman this year. First appointed to the board in 1982 by Governor Hammond, he was re-appointed in July 1986 by Governor Sheffield. Clyde M. Sherwood, a retired senior partner in an Anchorage accounting firm, was the vice-chairman. The officers are elected annually by the trustees.

Officers elected to serve in Fiscal 1987 are Clyde Sherwood, chairman, and Hugh Malone, a Kenai surveyor and former legislator, vice-chairman. David A. Rose, executive director of the Alaska Permanent Fund Corporation, has served as secretary/treasurer continuously since December 1982.

Day-to-day operations are carried out by the executive director and an 11-person staff. Additionally, equity investment firms, real estate advisors and custodial banks assist the Corporation on a contractual basis.

## FUND OBJECTIVES

# Conserve, Protect and Produce Wealth To Benefit Present and Future Alaskans

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; (2) protect those savings from loss of value; and (3) invest those savings to produce income for purposes designated by law.

The goals are being met. A significant portion of the state's oil wealth is being conserved, protected and invested — with impressive results.

Of the nearly \$25 billion in petroleum revenues received by the state since Prudhoe Bay began production, 22% has not been spent. Instead, it has been deposited in the Permanent Fund where it

has been transformed from a one-time bonanza into a long-term source of wealth and economic diversification for both present and future generations of Alaskans.

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 provided the principal with protection from loss of value since 1982.

In addition to saving money and keeping it safe, the Corporation 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.

### 22% OF THE STATE'S OIL WEALTH HAS BEEN SAVED IN THE PERMANENT FUND

(amounts in millions)

How Much Saved by  
Constitutional Dedication Alone?

How Much Saved by Constitutional  
Dedication Plus Special Deposits?

Fiscal Year	How Much Saved by Constitutional Dedication Alone?			How Much Saved by Constitutional Dedication Plus Special Deposits?		
	Total State Petroleum Revenues	P.F. Dedicated Revenues	Percent	P.F. Special Deposits	Total P.F. Petroleum Revenues	Percent
1977	\$ 482	\$ 4	1%		\$ 4	1%
1978	496	51	10%		51	10%
1979	906	84	9%		84	9%
1980	2,601	345	13%		345	13%
1981	3,689	385	10%	\$ 900	1,285	35%
1982	3,975	401	10%	800	1,201	30%
1983	3,447	421	12%	400	821	24%
1984	3,228	366	11%	300	666	21%
1985	3,112	368	12%	300	668	21%
1986	2,549	323	13%		323	13%
<b>Totals:</b>	<b>\$24,485</b>	<b>\$2,748</b>	<b>11%</b>	<b>\$2,700</b>	<b>\$5,448</b>	<b>22%</b>

Total state petroleum revenues include petroleum revenues paid to the state as corporate income tax, severance tax, property tax, federal shared revenue, royalties, lease bonuses, and rents. The petroleum revenues constitutionally-dedicated to the Permanent Fund include no portion of the petroleum taxes, but at least 25% of all the other petroleum revenues. The special deposits to the Permanent Fund include only the General Fund appropriations.

# Disposition of Fund Earnings Is a Legislative Prerogative

All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

According to these instructions from the 1976 constitutional amendment, all Fund income was to be deposited in the General Fund until such time as the legislature authorized another use for it. For the first four years, the legislature did not authorize any other use, and the income went directly and solely to the General Fund.

In 1980, however, the lawmakers began exercising their constitutional rights regarding disposition of Fund income, and they authorized the first new use of it: payment of Permanent Fund dividends. (Through fiscal 1983, the legislature continued to allocate a portion of Fund income to the General Fund. From fiscal 1977 — 1983, a total of \$228 million of Fund income was transferred to the General Fund.)

The 1980 dividend program tied the amount of the dividend to the length of residency. That program was ruled unconstitutional and was never implemented.

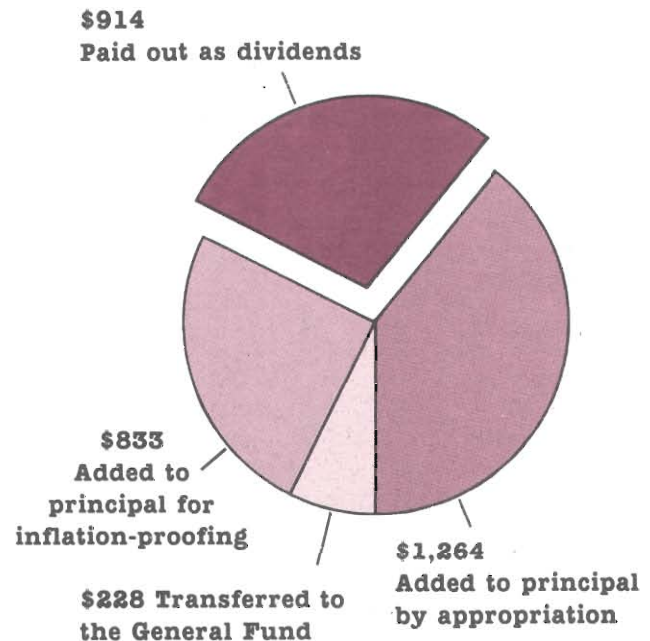
In 1982, the legislature passed a new version of the dividend program and initiated it with a special \$1,000 per capita payment, paid for with Fund income set aside for that purpose since fiscal 1981 — plus an extra appropriation from the General Fund. To date, \$914 million of Fund income has been distributed through five dividend distributions.

The 1982 legislature also directed that a portion of Fund income should be added automatically to principal at the end of each fiscal year in “an amount sufficient to offset the effect of inflation.” To date, \$833 million of Fund income has been used for this purpose.

Lastly, the 1982 legislature directed that any income remaining after the payment of dividends and inflation-proofing be transferred to an undistributed income account in the Permanent Fund. The trustees designated this account a reserve for future inflation impact and dividend payments.

## NET INCOME 1977 — 1986

(in millions)



The Permanent Fund has produced \$3.24 billion in net income in 10 years.

Rather than use the money in this account for any other purpose, the 1986 legislature, by a large majority vote, appropriated the entire balance of the undistributed income account to the principal of the Fund, effective July 1, 1986. This amounted to \$1.26 billion.

The 1986 legislature also renamed the undistributed income account the earnings reserve account, and increased the percentage of income allocated for dividends. Effective in fiscal 1987, each year's dividend payment will equal 21% of the net income of the Fund for the last five years.

The dividend program is not administered by the Corporation. It is administered by the Department of Revenue in accordance with Alaska Statute 43.23. The Corporation's responsibility is to transfer the money required for the dividend distribution to the General Fund in response to the annual legislative appropriation.

## What Makes the Principal Grow?

The Permanent Fund is made up of two parts: principal and income. Principal is the main body, or corpus, of the trust. Income is the money earned from the investment of the principal.

The principal of the Fund comes from three sources: (1) the oil revenues deposited by constitutional dedication; (2) the income of the Fund which has been transferred to principal to inflation-proof the Fund; and (3) extra money deposited by special legislative appropriation.

The chart below shows the amount of principal in the Permanent Fund at the end of each fiscal year, and the cumulative contributions to Fund principal by source.

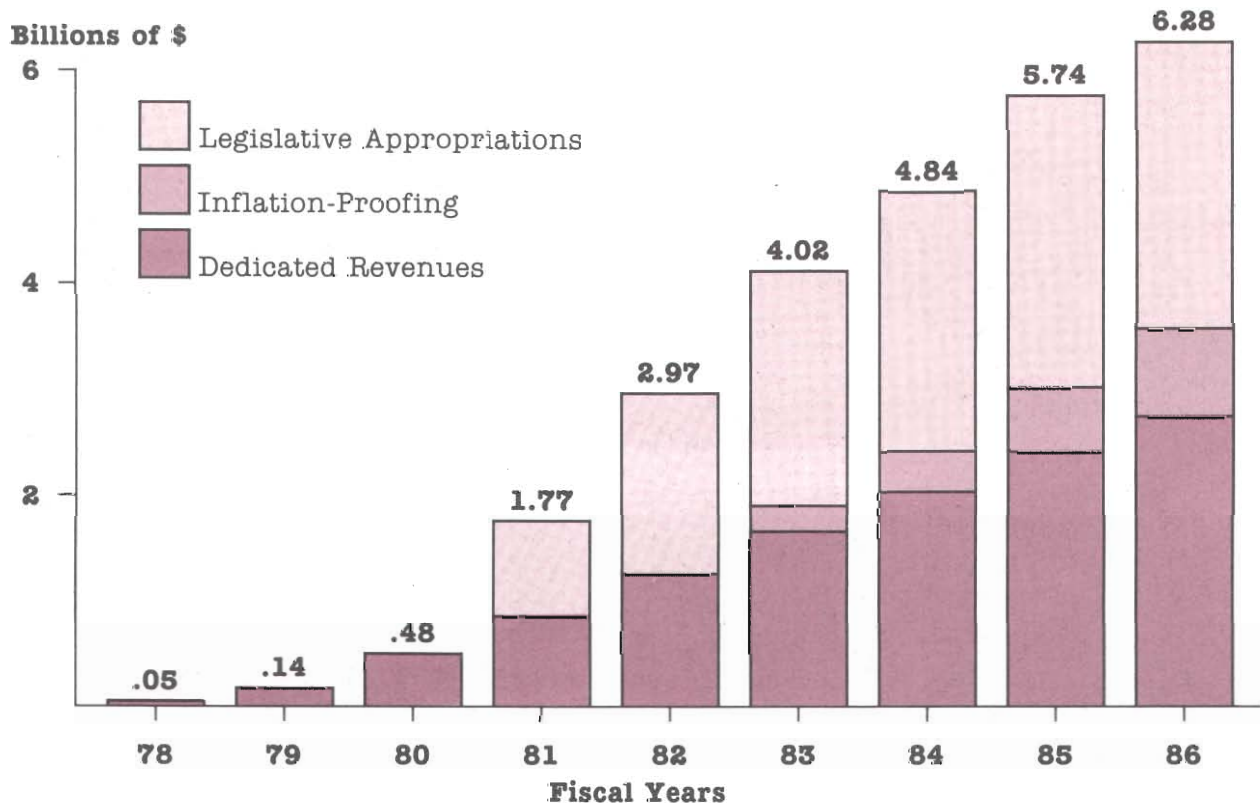
Since inception, the contributions from these three sources have totaled:

- \$2.75 billion from the constitutionally-dedicated oil revenues;
- \$833 million from inflation-proofing; and
- \$2.7 billion from the special appropriations.

As you can see, most of the principal growth to date has come from the dedicated oil revenues and the special appropriations. However, the dramatic decline in oil prices in 1986 certainly means a reduction in future dedicated oil revenues, and might mean an end to future special appropriations as well.

Thus, the future growth of the principal of the Permanent Fund will depend heavily on the annual contributions of inflation-proofing.

**PERMANENT FUND PRINCIPAL  
By Source of Contribution**

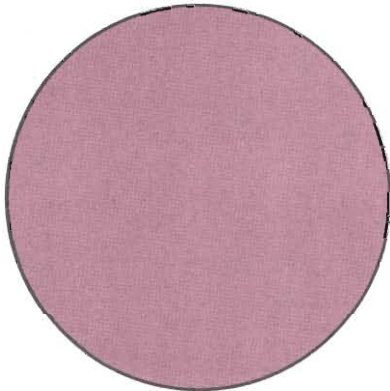


**Note:** The fiscal 1986 total does not include the \$1.26 billion appropriated to principal this past session by the legislature because the transfer did not actually take effect until the first day of fiscal 1987. As of that date, July 1, 1986, Fund principal totaled \$7.55 billion, of which \$3.96 billion was derived from special appropriations.

## THE CHANGING NATURE OF CONTRIBUTIONS TO PERMANENT FUND PRINCIPAL

### Fiscal 1979

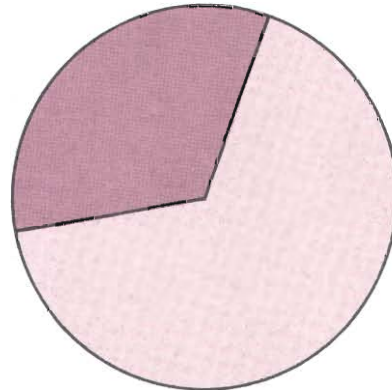
**Dedicated Revenues**  
100%



In fiscal 1979, prior to legislative enactment of inflation-proofing, and prior to the big rise in the price of oil, the only contribution to the growth of Fund principal was \$84 million from the constitutionally-dedicated revenues.

### Fiscal 1982

**Dedicated Revenues**  
33%

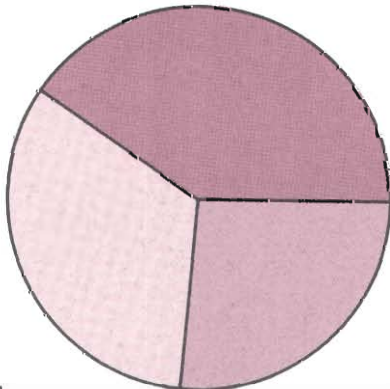


**Special Appropriations**  
67%

In fiscal 1982, still prior to inflation-proofing, but after the big rise in oil prices, the principal grew \$401 million from dedicated revenues, and \$800 million from a partial payment of the \$1.8 billion special appropriation.

### Fiscal 1985

**Dedicated Revenues**  
41%

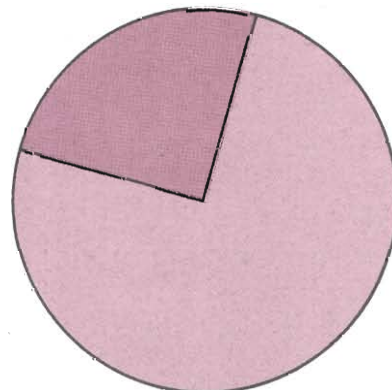


**Special Appropriations** 33%  
**Inflation-Proofing** 26%

In fiscal 1985, the principal of the Fund grew \$235 million from inflation-proofing, \$300 million from the final payment of the 1981 special appropriation, and \$368 million from the constitutionally-dedicated revenues.

### Fiscal 1987 (Projected)

**Dedicated Revenues**  
25%



**Inflation-Proofing**  
75%

In fiscal 1987, after the oil price decline, dedicated revenues are projected to contribute only \$68 million to Fund principal, and inflation-proofing is projected to contribute \$209 million. No special appropriation is projected.

## Inflation-Proofing Is Important To the Permanent Fund

In fiscal 1986, it took about \$1.85 to purchase the same goods and services that cost only \$1.00 in 1977. Conversely, \$1.00 saved in 1977 would have purchased, in 1986, about 54 cents worth of the same goods and services.

That has been the effect of inflation on the first dollar which was ever saved in the Permanent Fund (on February 21, 1977), and that is why protection against inflation is important.

Inflation protection for the Permanent Fund is provided in Alaska Statute 37.13.145. Popularly known as inflation-proofing, this provision of law was first passed by the legislature in 1982 to assist the trustees in their efforts to maintain the real value of the Fund over the long term.

Inflation-proofing protects the Fund by requiring the automatic reinvestment of income each year in an amount sufficient to completely offset the effect of inflation on the principal of the Fund during that year. The income may come from current year earnings or, if earnings are insufficient, from a reserve account established for this purpose.

Considering again the example in the first paragraph, if inflation-proofing had been in effect since the inception of the Fund, 85 cents of income would have been added over the years to that original \$1.00 of principal, so that in 1986, the nominal value of the principal would have increased to \$1.85, but the real value would have remained \$1.00, rather than 54 cents.

That is what inflation-proofing does: maintain the real value — that is, the purchasing power — of all the dollars which have been saved in the Permanent Fund.

To determine the amount of net income to reinvest each year, the trustees, at the end of each fiscal year, multiply the principal balance by the percentage change in the prior calendar year average of the United States consumer price index for all urban consumers (CPI-U). The product of these calculations is then transferred from income to principal.

Inflation this year was computed at 3.57%. The amount reinvested was \$216 million. To date, inflation-proofing has added \$833 million of Fund income to principal to protect the real value of the Fund.

The graphs on the following page depict the importance of inflation-proofing on three aspects of the Permanent Fund: the size of principal, the amount of net income, and income available for dividend distributions.

As you can see, the consequences of eliminating inflation-proofing would be dramatic. Twenty years from now, with no further inflation-proofing, the principal, net income and dividend distributions of the Permanent Fund would be almost 50% less, in nominal dollars, than with inflation-proofing.

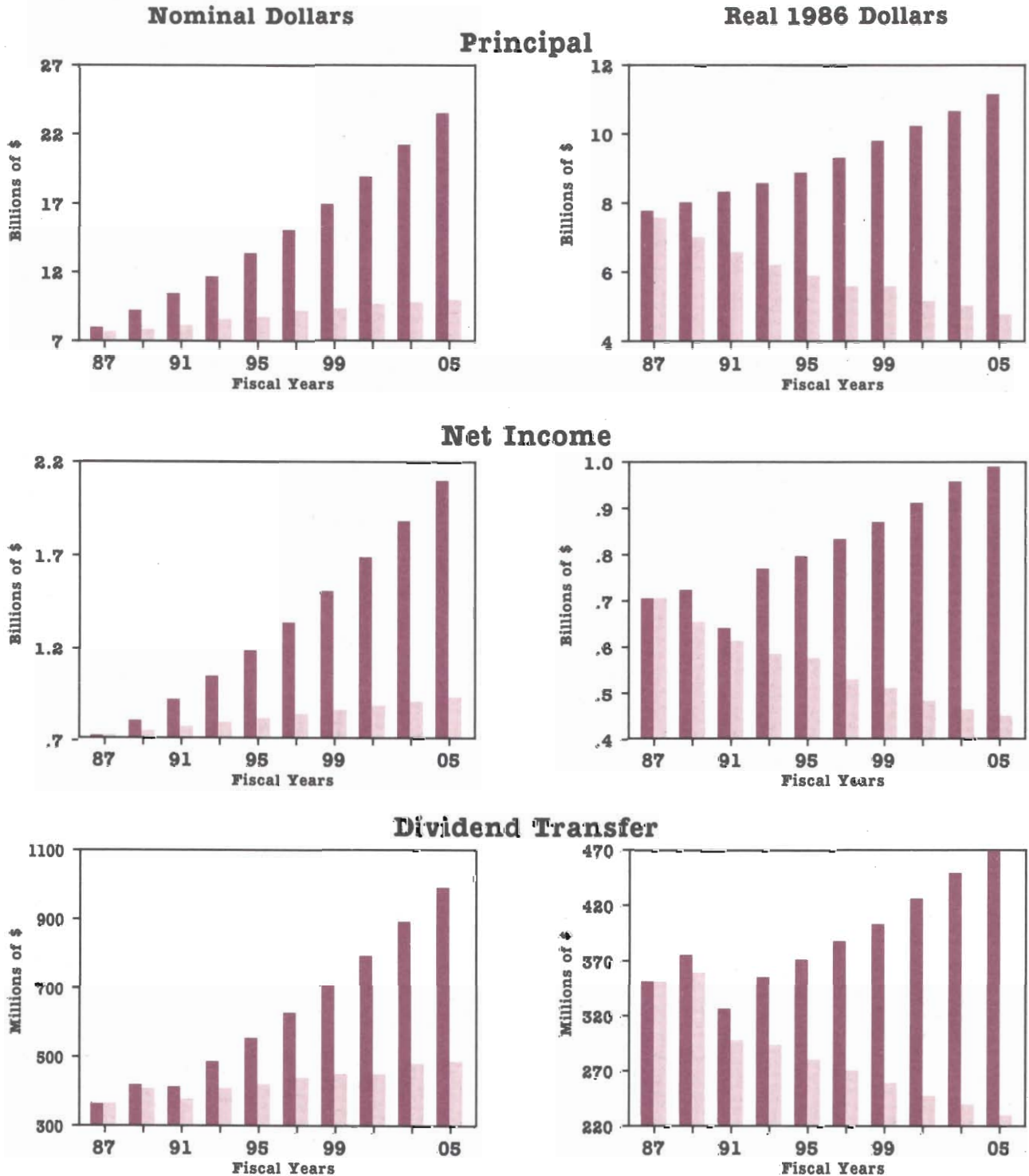
In real dollars — that is, adjusted for the rising cost-of-living — the principal, net income and dividend distributions of the Permanent Fund would be worth less in the year 2005 than they are today.

### INFLATION-PROOFING AMOUNTS

<b>Fiscal Year</b>	<b>Inflation Rate</b>	<b>Income Added To Principal</b>	<b>Percent of Net Income</b>
1983	6.10%	\$231,192,000	49%
1984	3.22%	150,935,000	29%
1985	4.26%	234,570,000	36%
1986	3.57%	216,376,000	21%

## HOW IMPORTANT IS INFLATION-PROOFING?

To realize the importance of inflation-proofing, consider what would happen to the Fund if inflation-proofing were eliminated:



### Assumptions:

- 2.74% Inflation rate fiscal 1987
- 4.50% Inflation rate fiscal 1988
- 6.00% Average inflation rate fiscal 1989-05
- 9.00% Average rate of return fiscal 1987-05

### Legend:

- With inflation-proofing
- Without inflation-proofing

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## INVESTMENT POLICY

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# Trustees Invest Permanent Fund For Long-Term Performance

The trustees have established as an earnings goal for the Permanent Fund an annual rate of return of 3%, measured after inflation and over the long term. They chose this goal for a number of reasons:

First of all, the Permanent Fund is going to be around for a long time, so any investment decisions should be made with the long-term consequences in mind.

Second, the law establishing the Permanent Fund requires Fund managers to avoid high levels of risk, and give top priority to maintaining safety of principal.

Third, based on an analysis of 60 years of historical returns for stocks and bonds, from 1926 — 1985 (see chart), an average annual real rate of return of 3% is, in fact, a realistic target for a conservative fund such as this.

The earnings goal provides the foundation for the Fund's investment policy. To accomplish their goal, the trustees regularly review Fund investments to determine the optimum mix of assets among the three major investment types — equities, fixed-income securities, and real estate. For fiscal 1987, the targeted mix is:

Fixed-Income Securities (Bonds): 76%  
Equities (Stocks): 17.5%  
Real Estate: 6.5%

In addition to this diversification of asset types, there is also a diversification within each type of investment. For example:

\* Fixed-income securities are diversified by length of maturity, that is, short term, intermediate or long term. Since the Fund is so heavily weighted in this asset type, it is especially important for the trustees to review the average life to maturity of the bond portfolio at least quarterly in case there is a need to make adjustments to take advantage of changing market conditions.

\* Stocks are diversified by management style, with two-thirds of the equities allocation invested to match the performance of the Standard & Poor's 500 Stock Index, and one-third divided among a small number of active managers who attempt to outperform the market.

\* Real estate is also balanced by manager, as well as by property type, location, type of investment — equity or a combination of debt and equity, and lease terms.

### STOCKS, BONDS AND INFLATION 60 Years of Historical Returns 1926 — 1985

	Nominal Rate of Return	Consumer Price Index	Real Rate of Return
Common Stocks	9.8%	3.1%	6.7%
Corporate Bonds	4.8%	3.1%	1.7%
Government Bonds	4.2%	3.1%	1.1%
Treasury Bills	3.4%	3.1%	.3%

**Source:** Ibbotson and Sinquefeld, updated by CDA Investment Technologies, Inc. The rates of return are compounded, and assume reinvestment of all income. The Consumer Price Index figure is the average rate of inflation for the last 60 years.

## Cost Versus Market: A Question of Value

Fiscal 1986 was a good time to be invested in financial assets as there were bull markets in both stocks and bonds. Consequently, the Permanent Fund — which is more than 95% invested in financial assets — enjoyed a tremendous increase in the value of its holdings.

In a financial context, the term “value” can have more than one meaning. For example, in the Statement of Assets which appears on page 33 of this report, the dollar amounts listed next to most assets refer to the value of those assets at “cost,” that is, what the Corporation paid for them (adjusted for amortization or accretion).

Assets also have a “market” value, that is, what the Corporation would receive for them if the assets were sold on a particular date. The cost values (except as adjusted for amortization or accretion) never change; the market values may change every day.

When the market value of an asset increases, and the Corporation sells that asset, there has been a “realized gain.” That is money in the bank. The Corporation took \$323 million in realized gains during fiscal 1986, and that was included as part of net income.

When the market value of an asset increases, and the Corporation does not sell that asset, there has been an “unrealized gain” or “paper profit.” That is an increase in value, but it is not money in the bank.

The question arises then, why didn't the Corporation, which at June 30 had \$967 million in unrealized gains (the difference between the cost and the market values), just sell the underlying assets, realize the profit, and put it in the bank? Wouldn't the Corporation have been better off?

Not necessarily.

The problem with this view is that it is too simplistic. Consider it from an investment officer's perspective.

The cash raised from the sale of those assets must be reinvested. If you buy the same asset, essentially what you are doing is trading a low cost value and a high

### CAPITAL GAINS (LOSSES)

(in millions)

Fiscal Year	Realized	Unrealized
1984	\$ 2	\$(337)
1985	14	378
1986	323	967

A capital gain (loss) is realized when an asset is sold for more (less) than it cost. If the asset is not sold, the gain (loss) is unrealized. The realized gains are the total gains taken during each 12-month period. The unrealized gains (losses) are as of June 30 each year.

market value for a high cost value and the same market value. There has not been an increase in the “value” of the asset.

On the other hand, if you sell one type of asset, say stocks, and buy another type, say bonds, you are making a short-term judgement about the future direction of the financial markets. The Fund, however, is long-term oriented, and over the long term, the stock market is expected to outperform the bond market, as it has historically. Consequently, the Fund's stock strategy is mostly “buy and hold.”

As for bonds, over the long term, the real appreciation in value accrues to the holders of those securities paying interest rates which are higher than currently available for new money. At June 30, a large percentage of the Fund's fixed-income portfolio was invested in just such high yielding bonds.

In conclusion, though it is extremely pleasing to be able to discuss the relative value of realized versus unrealized gains, one should keep in mind that markets change. Inevitably, there will come a time when the discussion will again be about realized versus unrealized losses. At that point, the appropriateness of the Fund's present, conservative, long-term oriented investment policy will be quite apparent.

## FUND PERFORMANCE

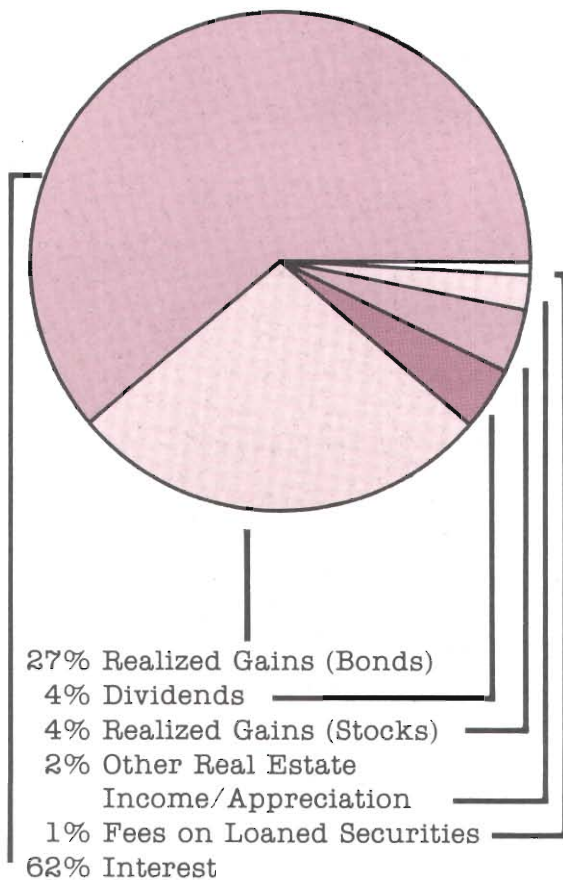
### Permanent Fund Produced \$1.02 Billion in Income

In fiscal 1986, for the first time in its 10-year history, the Permanent Fund earned an annual net income in excess of \$1 billion. Net income of \$1.02 billion represents a 55% increase in earnings over fiscal 1985, and the ninth consecutive year of earnings growth.

Nearly one-third of the income, however, came from unusually large realized gains produced by the sale of stocks and bonds during a record year which saw the equities market reach new all-time highs, and the bond market experience its biggest rise of the century.

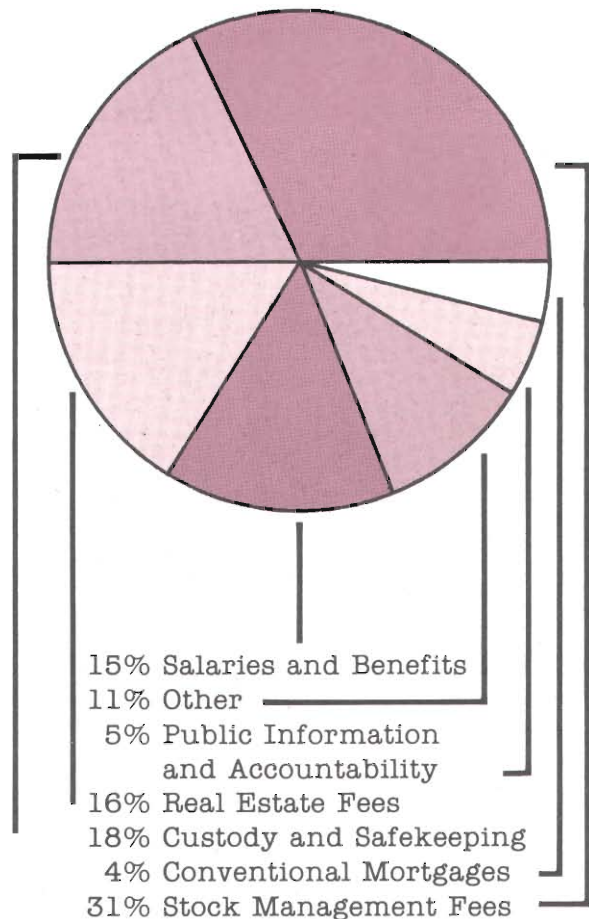
#### REVENUES

Where the Income Came From



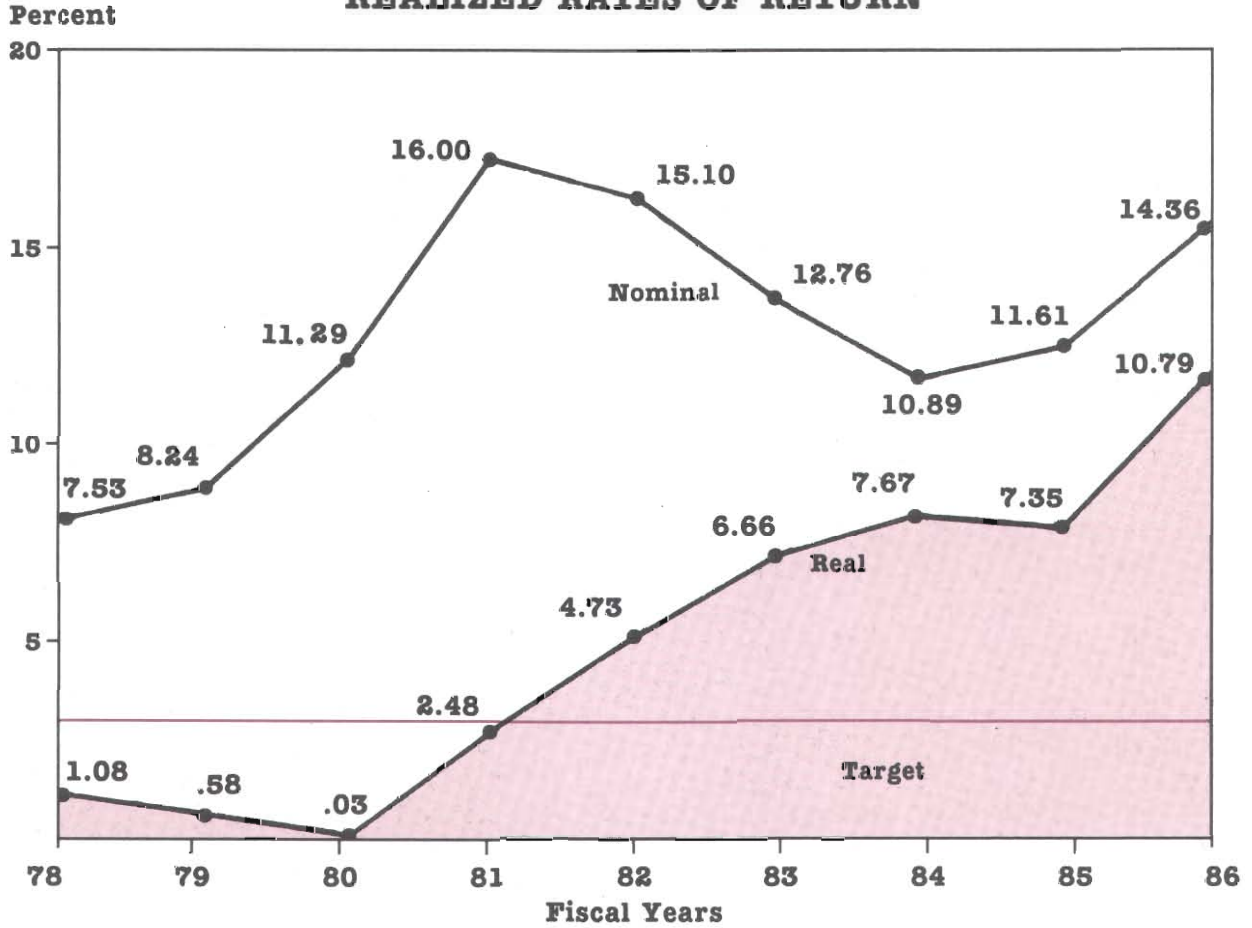
#### EXPENSES

What It Cost to Manage the Fund



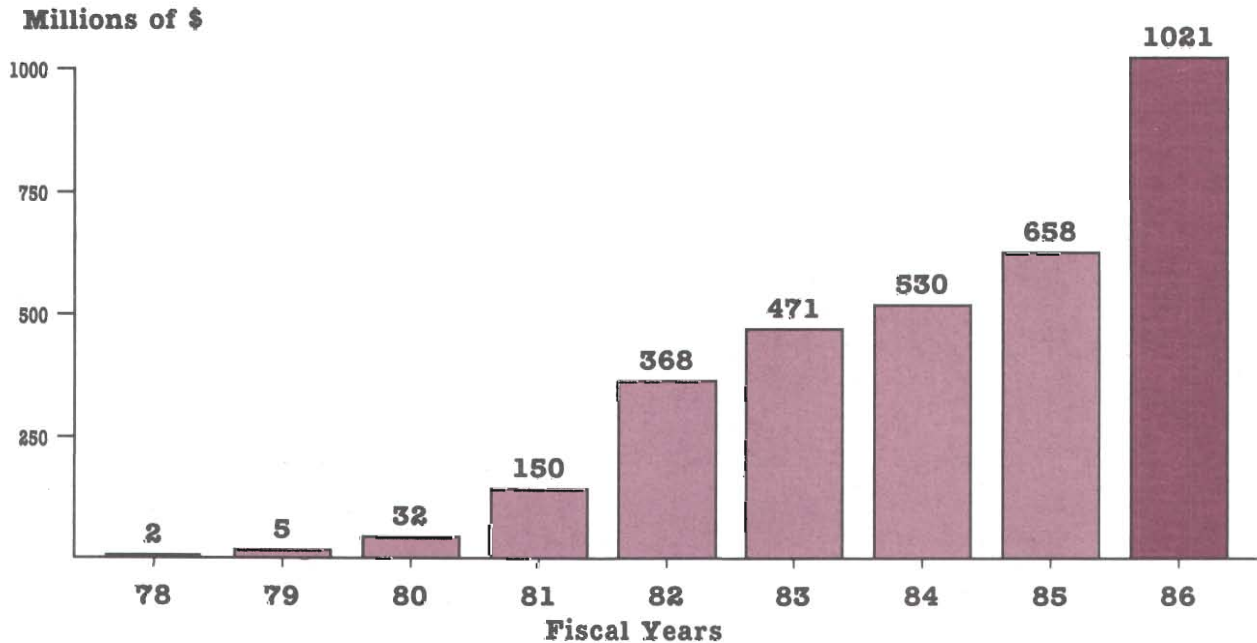
The biggest source of Fund income, as usual, was interest. A much smaller, but still significant, source was the fee income generated by loaning Fund securities to major financial institutions. This produced \$5.4 million which, while a relatively small portion of total income, was enough to completely offset all of the Corporation's operating expenses, and at virtually no risk. Operating expenses for the year amounted to \$5.3 million, or one-half of 1% of total revenues produced. Thus, 99.5% of all Fund earnings constituted net profit for the Corporation, and were made available for use as provided by law. This ratio of operating expenses to income compares favorably with other institutional investors.

## REALIZED RATES OF RETURN



In fiscal 1986, for the fifth consecutive year, the Fund exceeded its goal of a 3% real rate of return. (The real rate of return equals the nominal rate of return minus the rate of inflation.) Thus, the fiscal 1986 real rate of return was 14.36% minus 3.57% or 10.79%.

## NET INCOME



## YEAR IN REVIEW

### Bond Portfolio Earned a Total Return of 21%

At June 30, more than three-quarters of the Permanent Fund was invested in marketable debt securities. Conservative, fixed-income investments — consisting primarily of obligations of the United States government — they are guaranteed to earn a certain rate of return over a certain period of time, and mature (pay back the money invested, plus interest) on a specific date.

At the end of the fiscal year, the weighted average life of the portfolio was seven years, six months, and the weighted average yield to maturity was 10.02%. This compares to six years, nine months, and 11.62% at the end of fiscal 1985.

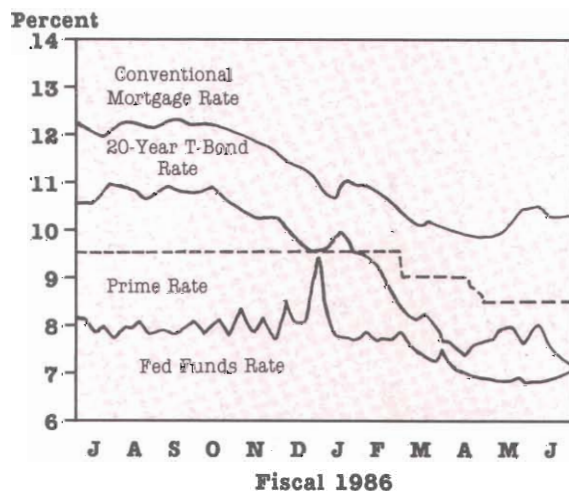
The diversification of maturities at June 30 was as follows:

0-2 years: 22%	5-10 years: 40%
2-5 years: 23%	10+ years: 15%

To understand the significance that varying maturities can have on the value of a bond portfolio, consider one example of the trustees' investment strategy in action.

At a board meeting on December 9, 1985, the trustees made the decision to significantly lengthen the average life to maturity of the fixed-income portfolio. This decision was made in anticipation of a positive market reaction to the likely

#### SELECTED INTEREST RATES



#### BOND PORTFOLIO HISTORICAL PERFORMANCE

Fiscal Year	Total Return	Realized Return
1982	14.4%	12.8%
1983	14.6%	13.6%
1984	4.3%	12.3%
1985	25.7%	12.0%
1986	21.0%	10.5%
5-year:	15.8%	12.2%
3-year:	16.6%	11.6%

The period returns are annualized.

passage of the Gramm-Rudman bill.

It was expected that interest rates would fall dramatically if congressional action were taken to curb the huge federal deficits. The trustees believed adding more long-term bonds to the portfolio would permit the Fund to continue earning double digit returns, and would significantly increase the market value of the Fund as interest rates declined.

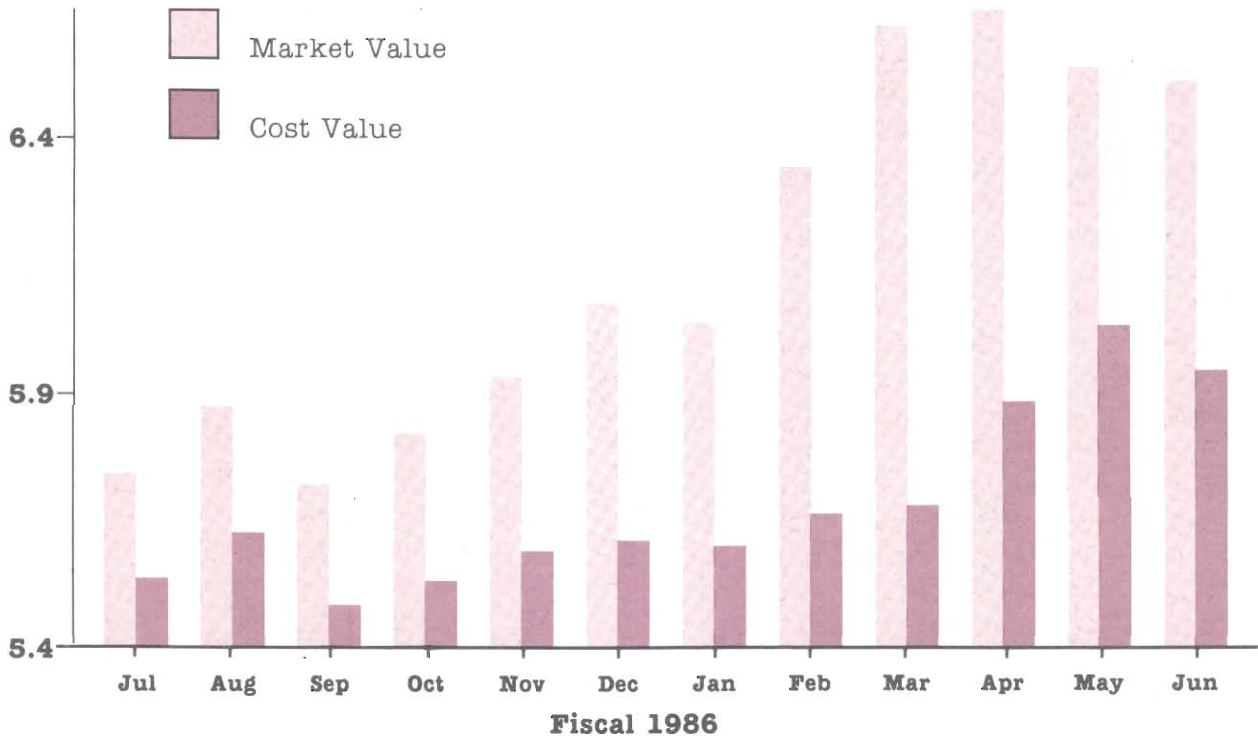
At a special meeting on December 26, the trustees approved an even greater extension of maturities in anticipation that the significant drop in oil prices which was just then beginning, would be disinflationary and further depress interest rates.

This was exactly what happened. Interest rates did fall dramatically in reaction to Gramm-Rudman and the fall in oil prices. February and March turned out to be two of the best performing months for bonds in the history of the financial markets. The effect of all this on the just-lengthened Permanent Fund bond portfolio was to increase its market value by more than \$450 million in only 60 days.

As a result, the Fund was able to take capital gains in fiscal 1986, just on the bond portfolio, totaling \$280 million. Despite the record-setting profit-taking, the Fund continued, at year end, to enjoy high levels of unrealized gains.

## THE VALUE OF THE BOND PORTFOLIO

Billions of \$

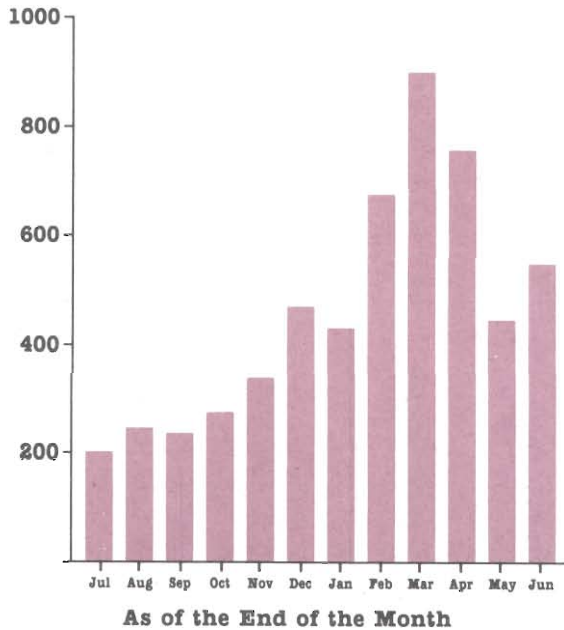


The cost value of the bond portfolio (including all marketable debt securities) increased 9% during fiscal 1986, from \$5.46 billion on June 30, 1985, to \$5.95 billion on June 30, 1986. The market value increased 13% during fiscal 1986, from \$5.74 billion on June 30, 1985, to \$6.51 billion on June 30, 1986. As of June 30, 1986, realized gains totaled \$280 million, and unrealized gains totaled \$563 million. This was a very good year.

### UNREALIZED GAINS IN BONDS

Cumulative

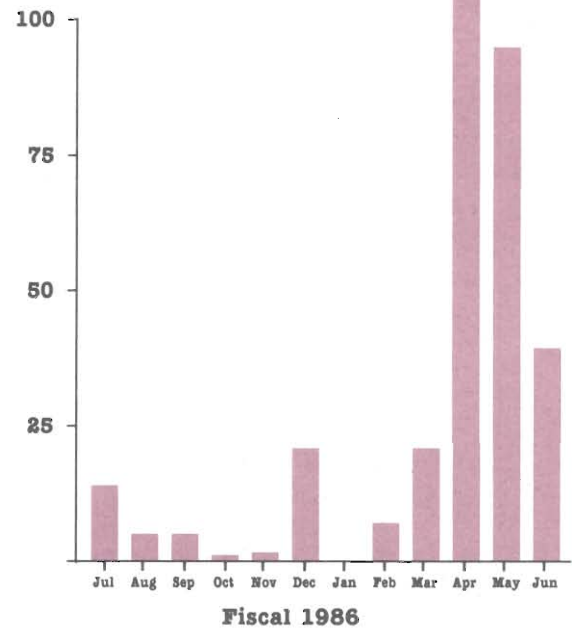
Millions of \$



### REALIZED GAINS IN BONDS

Per Month

Millions of \$



## Equity Real Estate Portfolio Earned 12.6% Total Return

The Fund disbursed \$84 million for equity real estate investments in fiscal 1986, compared to \$109 million in fiscal 1985. Investments funded as of June 30, 1986, totaled \$208 million at cost, or \$224 million at market value, plus undistributed earnings (see Note No. 2, page 37).

This Permanent Fund investment of \$208 million has bought a 7.5% combined interest in real estate assets across the United States valued at \$3.1 billion.

The total return for Fund equity real estate investments, as computed by the Corporation's real estate consultant, Pension Realty Advisors of San Francisco, California, was 12.61% this year, compared to 15.97% last year. The realized return equaled 7.6% in fiscal 1986, compared to 7.19% in fiscal 1985.

The first equity real estate investment was made in October of 1983, when the Permanent Fund purchased \$3.75 million worth of shares in JMB II, a real estate pool invested in properties nationwide. Since then, the Fund's equity real estate portfolio has earned a total return of 11.92% on an annualized basis.

The investment strategy for the equity real estate portfolio is structured to: (1)

maintain safety of principal; and (2) maximize total return. Funds are invested only in income-producing properties — that is, real estate improved by completed and substantially-rented buildings — located in the United States. The objective is to seek a 6% rate of return, after inflation and over the long term.

Individual investments may be pure equity or a combination of equity and debt, but at least 60% of the beneficial ownership interests must be held by other institutional investors. Though the law allows up to 15% of the assets of the Permanent Fund to be invested in equity real estate, the trustees have adopted a more conservative 6.5% limit at this time.

These policies apply to the selection of real estate properties: (1) high probability of providing continuous cash flow; (2) minimal income volatility; and (3) subject to development of reliable projections of future earnings.

In addition, in order to minimize risks attributable to regional economic imbalances, property performance volatility, and management style, the equity real estate portfolio must be well diversified.

There are two types of assets in the equity real estate portfolio: (1) real estate pools; and (2) joint ventures with other institutional investors.

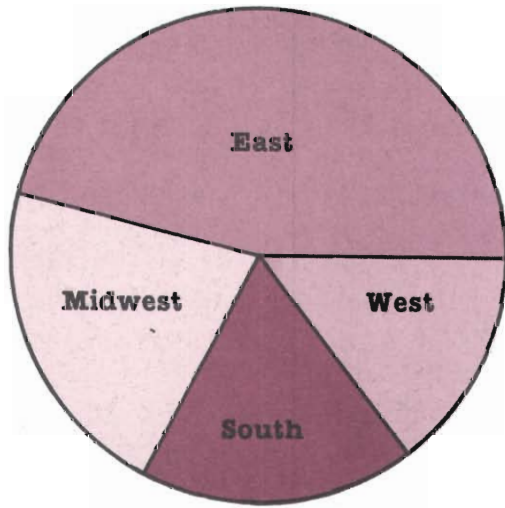
**Real Estate Pools:** These pools are made up of investment contributions of many institutional investors. They are sponsored by professional real estate investment managers with demonstrated experience in the acquisition and management of real estate assets on behalf of institutional investors, and the sponsors of the funds maintain investment discretion of the assets.

**Joint Ventures:** These assets take the form of limited or general partnerships, and involve either property ownership or participating mortgages. (A participating mortgage provides a fixed rate of return, a share in the lease profits and a share in the appreciated value of the property.)

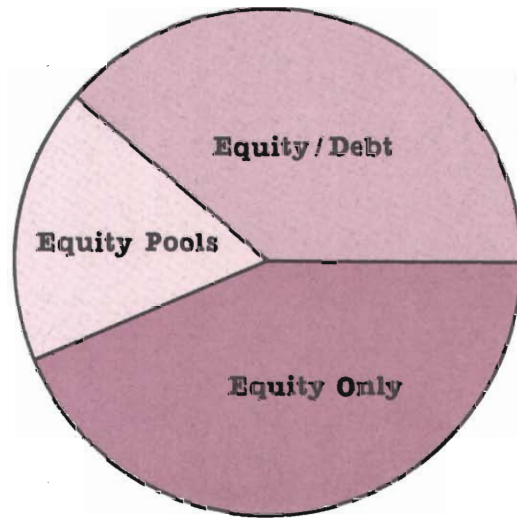
<b>1986 Investments</b>	
<b>Funded</b>	
Oakwood Mall	\$ 263,000
Atrium/45 Broadway	19,238,000
ARA Building	20,276,000
MN-TX Business Center	5,917,000
JMB III	5,000,000
St. Louis Centre	19,788,000
CPI	13,167,000
<b>Committed (Not Yet Funded)</b>	
Epic Center	\$11,400,000
McKinley Mall	15,000,000
Arboretum Lakes	11,480,000
Westwood Place	14,000,000
There are commitments outstanding from prior years totalling \$40,450,000.	

# EQUITY REAL ESTATE DIVERSIFICATION

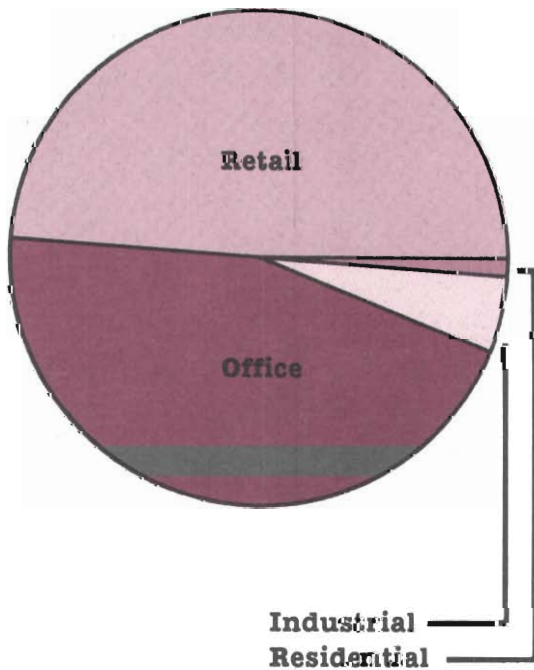
## By Property Location



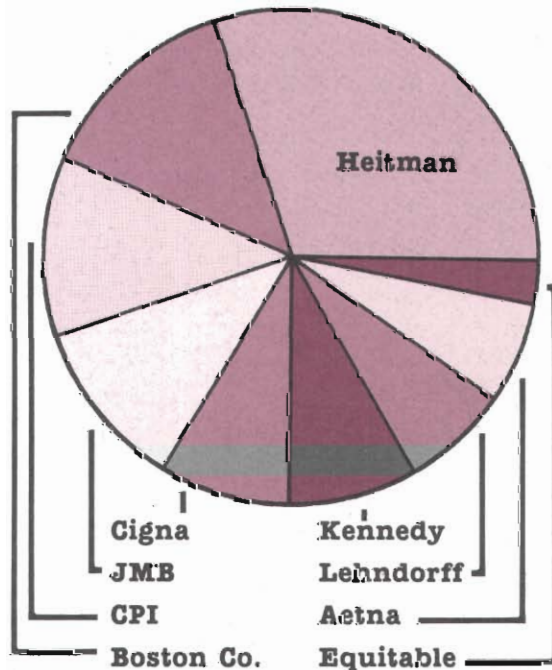
## By Investment Type



## By Property Type



## By Property Manager



## Stock Portfolio Earned a Total Return of 36%

The long-term strategy of the Permanent Fund stock portfolio divides equity investments between two types of management: passive and active. The goal is to do as well as the market — no better, no worse — with two-thirds of the Fund's stock investments (passive management), and to attain superior performance with one-third of the investments (active management).

This conservative approach has worked very well for the Fund, producing a total return for fiscal 1986 of 36%, and since inception, 20.1% per year, on average.

The Permanent Fund made its first stock investment on July 6, 1983. On that date, the Standard & Poor's 500 Stock Index stood at 168.48. On June 30, 1986, the S&P 500 closed at 250.84.

The passive investment is managed by Bankers Trust, a leader in stock index funds. Through use of a computerized technique known as "stratified sampling" the index fund attempts to statistically replicate the performance of the S&P 500.

The active management is divided among a small number of equity managers selected by the trustees to provide diversification by different generalized investment styles. The active managers (and their styles) are as follows:

- Lehman Management Company of New York, New York (Value);
- Rosenberg Capital of San Francisco, California (Demonstrated Growth);
- Eaton/Vance of Boston, Massachusetts (Expected Growth).

The account of Batterymarch Financial Management of Boston, Massachusetts — an active manager since July of 1983 — was terminated in February of 1986, and the proceeds of that account were transferred in full to the index fund.

Subsequent to June 30, 1986, the trustees selected two additional active managers: Citicorp (Demonstrated Growth) and Invesco (Value).

One reason for selecting additional active managers relates to the trustees' concerns about performance in a declining market. While it is expected that over long periods of time the stock market will steadily increase in value, that rise is not expected to be completely smooth. There will be some volatility — bull markets and bear markets.

The "buy and hold" strategy of passive management works very well in a rising market and over the long term, but in a declining market, active management can protect a portfolio from losing value. That is why one of the specific criteria used by the trustees in selecting the active managers was their ability to do well in a declining market.

In fiscal 1986, \$360 million was disbursed to the Corporation's equity managers as follows:

- Bankers Trust: \$247.5 million (including \$7.5 million transferred from Batterymarch);
- Rosenberg Capital: \$41.3 million;
- Lehman Management: \$41.3 million;
- Eaton/Vance: \$30 million.

The trustees' current investment policy calls for incremental investments in equities up to 17.5% of the total assets of the Fund by June 30, 1987, market conditions permitting.

The basic rules for Permanent Fund stock investments are:

- no more than 5% of the voting stock of any corporation may be acquired or held;
- all stocks, except for bank stocks and insurance stocks, must be listed on nationally recognized exchanges;
- only the stock of corporations incorporated in the United States may be acquired or held; and
- the purchase of options, or any security on margin, or purchases in the commodities futures markets, or futures contracts for any purpose other than hedging, are prohibited.

## STATUS OF EQUITY INVESTMENTS

At June 30, 1986

(in millions)

Equity Managers	Cost	Market	Unrealized Gain
Bankers Trust	\$ 881	\$1,187	\$306
Rosenberg Capital	100	136	36
Lehman Management	104	125	21
Eaton/Vance	95	126	31
<b>Totals:</b>	<b>\$1,180</b>	<b>\$1,574</b>	<b>\$394</b>

## PERFORMANCE OF EQUITY MANAGERS

Equity Managers	Fiscal 1986 Rate of Return	Since Inception Annualized Return
Standard & Poor's 500 Stock Index	35.9%	21.3%
Bankers Trust	36.2%	21.2%
Rosenberg Capital	41.1%	22.2%
Lehman Management	36.5%	22.2%
Eaton/Vance	35.3%	15.4%
<b>Stock Portfolio Average:</b>	<b>36.0%</b>	<b>20.1%</b>

The rate of return is a time-weighted total return which includes dividends and capital gains and losses, both realized and unrealized.

## DIVERSIFICATION OF STOCK PORTFOLIO

By Industry Sector at June 30, 1986

Industry Sector	S & P 500	Eaton Vance	Lehman Management	Rosenberg Capital
Building	2%	2%	1%	2%
Consumer Discretionary	14%	22%	10%	12%
Consumer Staples	15%	12%	9%	22%
Energy	11%	0%	8%	2%
Finance	8%	24%	15%	13%
Health	8%	10%	8%	14%
Materials and Processing	6%	4%	8%	6%
Producer Durables	7%	5%	4%	13%
Technology	16%	19%	22%	10%
Transportation	2%	2%	3%	4%
Utilities	11%	0%	12%	1%
Other	0%	0%	0%	1%

## Public Information and Accountability: A High Priority for the Trustees

The Permanent Fund is a public trust which belongs, collectively, to all Alaskans. Since everyone in Alaska is a beneficiary, the trustees have a responsibility to be accountable to everyone, everywhere in the state. As difficult as this is, the trustees have made accountability a high priority.

Consequently, the trustees have designed a public information program to provide the greatest amount of information about the Fund to the largest number of people, in the most cost-effective manner. Every effort is made to ensure that the Alaskan public understands the history of the Fund, how it works, how it is doing, and its role in the future.

With billions of dollars of public money at stake, there are significant dangers that the wealth may somehow be dissipated — by poor investments, improper management, or premature withdrawals to spend the public's savings on special interests. The best insurance against such risks is an informed constituency. In fact, in the view of the trustees, a well-informed public is essential to the long-term viability of the Permanent Fund.

Elements of the Corporation's public information program include:

**Monthly Financial Statements:** These

reports are the cornerstone of the print communications effort. They convey all the current financial information in a timely manner, and each month include an educational narrative highlighting a different aspect of Fund operations. The monthly financials are mailed to all Alaskan news outlets and everyone else who requests them.

**Speakers Bureau:** In fiscal 1986, trustees and staff formally spoke to 23 different civic groups and organizations around the state as part of an organized effort to reach out to Alaskans from all walks of life. The trustees particularly appreciate the public appearances as an opportunity to communicate directly with the Fund's beneficiaries.

**Instructional Television Program:** (See page 24.) This program is available for use in all Alaska junior and senior high schools. Teachers who would be interested in receiving and using these materials should contact the Corporation's office in Juneau.

**Open Meetings:** It is the policy of the trustees to conduct all meetings of the Alaska Permanent Fund Corporation as open meetings. Advance notice is always provided, and the general public is

### 25 LARGEST HOLDINGS IN THE STOCK PORTFOLIO

(in millions)

International Business Machines	\$80	Bell South	\$13
Exxon Corp.	33	Amoco Corp.	12
General Electric	33	Proctor & Gamble Co.	12
Am. Telephone & Telegraph Co.	20	Wal Mart Stores, Inc.	12
General Motors Co.	19	Chevron Corp.	11
Merck & Co., Inc.	18	RJR Nabisco	10
Ford Motor Co.	17	Eastman Kodak Co.	10
Coca Cola	17	Mobil Corp.	10
Sears Roebuck & Co.	17	NYNEX Corp.	9
Phillip Morris Companies, Inc.	15	American Info Tech Corp.	9
E. I. Dupont De Nemours	15	American Home Products	9
Johnson & Johnson	15	Bell Atlantic	9
American Express Co.	14	<b>Note:</b> Market value at June 30, 1986.	

encouraged to attend and participate at each meeting. Alaskans must always be given the opportunity to be involved in — not simply told about — the decisions that affect their lives and futures.

During fiscal 1986, meetings were held as follows:

July 29, 1985	Fairbanks
August 12-13	Sitka
September 19-20	Anchorage
October 3	Teleconference
November 11	Anchorage
December 9	Juneau
December 26	Teleconference
January 13, 1986	Anchorage
February 10	Juneau
March 10	Juneau
April 14	Juneau
May 12	Kenai
June 9	Anchorage
June 19	Teleconference

**Press Releases:** Given the high level of interest in Fund affairs on the part of the press, it is not generally necessary for the Corporation to issue press releases. Communication between the Corporation and the press corps occurs on a regular basis and has been good. Nonetheless, there were six instances when the trustees deemed it appropriate to issue press releases to announce:

- election of a new board chairman;
- termination of a stock management account;
- expansion of an in-state investment program;
- completion of a comprehensive Fund performance analysis;
- unusually large profit-taking; and
- final earnings projections.

## Legislative Oversight: An Important Part of the Process

In January 1986, the Rural Research Agency, under the auspices of the Alaska State Senate, released a 176-page report entitled, "Alaska's Permanent Fund: Legislative History, Intent and Operations."

The Corporation was impressed with the thoroughness of the research, the high

### **Permanent Fund Dividend Brochure:**

Included in the envelope which contains each recipient's dividend check is a simple, easy-to-understand brochure providing basic information about the Alaska Permanent Fund.

The brochure is produced by the Corporation, and distributed with the cooperation of the state Department of Revenue — the agency which administers the dividend program. This method of direct mail provides an excellent opportunity to communicate a limited, but important, amount of information about the Fund to over 525,000 individual Alaskans.

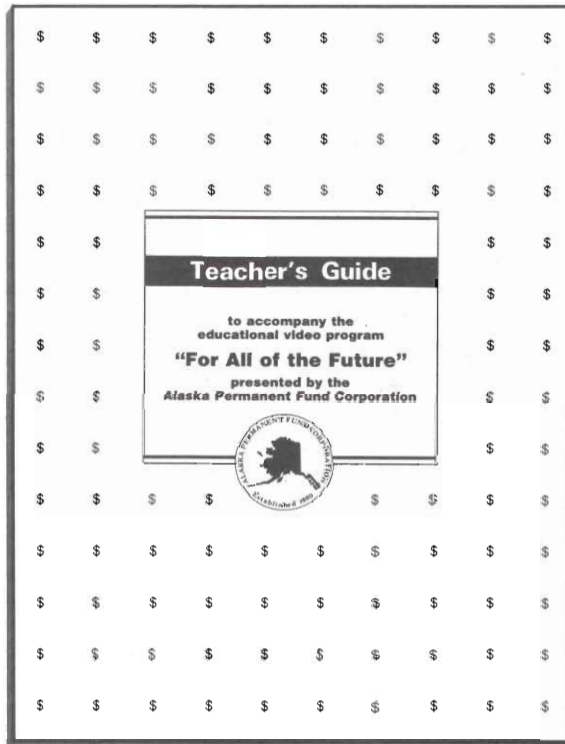
The Corporation also distributes to the public:

- annual reports;
- brochures describing the Fund's Alaska home mortgage program;
- financial projections which detail current expectations of future Permanent Fund revenues, earnings, and balances; and
- research papers on various topics of concern to the Corporation, such as analyses of legislation.

The Corporation was assisted in the development of portions of this public information and accountability program by two Alaskan media firms: Pacific Communications and Marketing, and Alaska Video Productions. Both were chosen as the result of a competitive proposal process.

quality of the writing, and the objectivity of the recommendations. It is accurate and informative, and would be of great interest to anyone wishing to know more about the issues which are relevant to today's discussion of Permanent Fund management. Copies are available through the Alaska State Legislature.

# Corporation Produced Instructional Program "For All of the Future"



One new public information initiative completed in fiscal 1986 was development of an educational video production and accompanying 120-page teacher's guide designed to provide Alaska's secondary school students with basic information about their Permanent Fund.

Entitled "For All of the Future", this is a 25-minute video, set in a dramatic format. The premise of the program involves a group of senior class officers trying to decide how best to use a \$100,000 legacy left to them by a benefactor on whose homestead their high school was built. There is, however, one condition on the use of the money: it must be used to benefit "all the students in the high school."

Through use of this instructional program, students explore the issues and challenges faced by the creators of the Fund, as well as those which continue to confront the custodians of Alaska's savings account. They learn how the Permanent

Fund was created, what it takes to operate and manage this multi-billion dollar trust, and why the Fund is important to present and future generations of Alaskans. In addition, the video and the teacher's guide offer students instructive guidelines for the prudent and responsible use of money in their own lives.

Information about the program was disseminated to school districts throughout the state, and the program aired on Learn Alaska at least half a dozen times. In fiscal 1986, 75 copies of the instructional materials were requested by individual teachers and distributed. Here are some of the comments from users:

*"This will be a tremendous contribution to our curriculum."* — teacher of Alaska Government in an Anchorage private school;

*"This unit is outstanding for my senior Economics class as well as my Alaska History class."* — high school teacher in Fairbanks;

*"I am impressed with the quality of the video production and the accompanying materials. I am confident that my students will find the tape appealing and the discussion topics relevant."* — junior high school teacher in Anchorage;

*"In my opinion, the appendix is the most useful part of the teacher's guide."* — high school teacher in Galena;

*"Much in-depth information here. I really liked how this material was set up. I especially like the high level at which it is written. This is welcome material for an upper-level class, but is still very usable for all other secondary levels also."* — high school teacher in Kodiak;

*"It is informative, well-written, and an overall splendid production. The high school students who have seen it have commented on how much they learned in just the video tape. Objective test results indicate this is true."* — teacher of Social Studies in Fairbanks.

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## COMMITMENT TO ALASKA

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### Dividends and Investments Boost State Economy

In fiscal 1986, \$217 million of the earnings of the Permanent Fund from the prior year (before administrative and other costs) was paid out as 1985 dividends, and another \$303 million from the current year's earnings (again, before costs) was set aside for the 1986 dividends.

These dividends, which are paid to all the residents of Alaska who make application and qualify, make a substantial contribution each year, not only to the personal disposable income of individual Alaskans, but also to the local and state economies as well. In fact, economists have said that no other use of an equal amount of state dollars has a more positive economic effect than this method of direct cash distribution.

Per capita dividends in earlier years were: \$1,000 (1982); \$386.15 (1983); \$331.29 (1984); and \$404 (1985).

Besides the dividends, investment in-state of some of the principal of the Fund also boosts the economy. At June 30, \$400 million, about 5% of the Permanent Fund, was committed to investments in Alaska, and \$209 million was actually disbursed. The largest allocation was to the certificates of deposit purchase program offered to all Alaskan financial institutions.

**Alaska Certificates of Deposit:** In fiscal 1986, the authority for this in-state investment program was expanded by 50% — from \$200 million to \$300 million. The program, which was initiated in March of 1984, is intended to assist economic development by making funds available to Alaskan financial institutions on an open and continuous basis.

There were two reasons for the expansion in 1986: (1) the trustees wished to make a clear statement expressing confidence in the performance and potential of the Alaskan economy; and (2) a bill passed by the 1986 legislature (Senate Bill No. 233) provided the opportunity for banks to participate more fully in the program by expanding the list of allowable collateral.

The way the program works is that the Permanent Fund purchases certificates of deposit issued by Alaskan banks at floating interest rates for a three-year term. The interest rate is equal to the 90-day U.S. Treasury bill rate, plus one-half of 1%, adjusted quarterly. All certificates of deposit are collateralized in excess of 100% of value.

The program is good for the Permanent Fund because it returns a market yield on investment, and it is good for the state because it increases the amount of capital available for lending to Alaskan individuals and businesses.

Lending rates during the year varied from 6.88% to 7.72%. At year-end, \$151 million had been disbursed.

**Alaska Home Mortgages:** The trustees have authorized \$80 million for investment in Alaska residential mortgages (owner-occupied, one-to-four units). These are offered at market rates, adjusted once each year, for a term not to exceed 30 years. There is a 6% cap on the adjustable rate over the life of the loan.

During fiscal 1986, at rates ranging from 10.25% to 11.75%, 42 loans were closed, amounting to \$9 million. At June 30, the total home mortgage portfolio consisted of 303 loans totaling \$48 million. The delinquency rate was 3.2%, and the Fund owned 5 properties through foreclosure.

**AHFC Taxable Bonds:** At June 30, the Fund held \$10 million in taxable corporate bonds issued by the Alaska Housing Finance Corporation (AHFC).

**Alaska Equity Real Estate:** Though no investments have been made to date in properties in Alaska, the authorization exists. The Permanent Fund can and will invest in Alaska real estate which has been improved by completed and substantially-rented buildings, whenever the risk level and expected yield are comparable to alternate investments, and when other institutional investors can be attracted to the project as joint venture partners.

## 1986 Legislature Appropriated \$1.26 Billion Undistributed Income to Fund Principal

The 1986 Alaska State Legislature passed six bills which directly affect the Permanent Fund, and three others which indirectly affect it.

**House Bill No. 28: Chapter 25, Session Laws of Alaska (SLA) 1986.** This was the special appropriation of the entire balance of the undistributed income account on July 1, 1986 (\$1.26 billion) to the principal of the Fund. Together with two appropriations approved by the legislature in earlier years (\$900 million in 1980 and \$1.8 billion in 1981), these special deposits — not required by either the constitution or statutory law — have contributed more than half of the principal of the \$7.5 billion Permanent Fund.

**Senate Bill No. 346: Chapter 28, SLA 1986.** The changes to existing law made by this bill were minimal. First, effective in fiscal 1987, Permanent Fund income available for distribution (half of which is designated for dividends) is redefined from the “average” net income of the Corporation for the last five years (20%) to 21%. Second, the undistributed income account was renamed the earnings reserve account.

These minimal changes, however, represented a major compromise in a two-year struggle between the Senate and the House, between those who wanted to completely revamp the existing policy for disposition of Fund earnings and those who wanted to keep the status quo. In addition, these changes satisfied certain contingency provisions in House Bill No. 28, and thus allowed that special appropriation to take place.

**Senate Bill No. 233: Chapter 83, SLA 1986.** This bill added obligations of the state or instrumentalities of the state to the list of collateral that may be used to secure certificates of deposit under the Corporation’s Alaska CD purchase program. Partially as the result of passage of this

bill, the trustees expanded this in-state investment program by 50% in fiscal 1986.

**House Bill No. 491: Chapter 53, SLA 1986.** This is the bill which established the National Petroleum Reserve Alaska (NPRA) special revenue fund consisting, at least in part, of money previously disbursed to the Permanent Fund Corporation (see Note No. 8, page 41):

**House Bill No. 500: Chapter 129, SLA 1986.** This is the state’s fiscal 1987 operating budget which includes the Alaska Permanent Fund Corporation’s budget of \$5.4 million. Other items of interest were:

**\$24.5 million:** appropriated from the NPRA Fund to the Department of Community & Regional Affairs;

**\$303 million:** appropriated from the Permanent Fund to the Dividend Fund for the annual dividend distribution;

**\$3.4 million:** appropriated from the Dividend Fund to the Department of Revenue to fund 63 positions connected with administration of the dividend program; and

**\$4.2 million:** appropriated from the Dividend Fund to the Department of Health & Social Services to fund eight positions and other “hold harmless” costs associated with the dividend program.

**Senate Bill No. 331: Chapter 6, SLA 1986.** This bill made minor technical changes to the law adopted last year which allows individuals to voluntarily contribute \$5 of their Permanent Fund Dividend to support the Winter Olympics in Alaska.

In total, during the 14th Alaska State Legislature, there were 41 pieces of legislation introduced dealing directly with the Permanent Fund.

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## THE ECONOMIC OUTLOOK

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# Economic Growth in the U. S. Depends on Improved Balance of Trade

Second calendar quarter growth in real GNP was an anemic 0.6%, and the record July 1986 U.S. trade deficit indicates that the outlook is for little or no improvement in GNP during the third quarter. However, growth should begin accelerating late in the third quarter and be more robust during the fourth quarter.

A combination of the automobile industry's incentive financing programs and the likely enactment of the tax reform bill should give the economy considerable stimulus during the fourth quarter. Many consumers are likely to accelerate plans for major durable purchases into 1986 in order to take deductions for increased sales taxes on their 1986 income tax returns. In addition, release of the unsatisfactory July 1986 trade deficit figures is very likely to provide the final impetus to a coordinated lowering of the central bank interest rates in the United States, Japan, and West Germany. Furthermore, with the substantial decline of the U.S. dollar relative to the world's other major currencies, the potential exists in the fourth quarter for a substantial change in direction for the trade deficit. There is concern, though, that the normal beneficial effects which should flow from a major currency devaluation will be considerably muted by worldwide sluggish economic conditions.

Healthy, sustained growth in the economy depends upon a significantly improved balance of trade for the United States which would shift demand from foreign producers to domestic producers. Without this shift, it is extremely difficult to forecast sustained economic growth. An improved balance of trade would lead to increased manufacturing employment, higher inventory levels, increased incomes, greater capacity utilization and eventually, increased capital expenditures.

On the other hand, if a substantial reversal of the trade deficit does not occur in the

fourth quarter of 1986 or early in 1987, it is possible that the U.S. economy will begin to display recessionary tendencies in 1987. One forecast indicates that the tax reform bill would likely raise an additional \$11 billion in revenues in 1987. In addition to this fiscal drag, consumer demand for durables is likely to contract since much of the anticipated growth for the fourth quarter will have been borrowed from future quarters. Any resolution of the Gramm-Rudman issue which results in additional revenues for the Treasury could also negatively impact economic activity in 1987.

The future of the economy at this juncture is dependent upon the answers to three important questions. First and most important, is the U.S. trade deficit about to improve? Second, will tax reform and the resolution of the Gramm-Rudman issue have a significant negative impact on capital spending? Third, will Japan, West Germany, and other major industrial countries stimulate their respective economies sufficiently to assure worldwide economic growth and an increase in demand for U.S. exports?

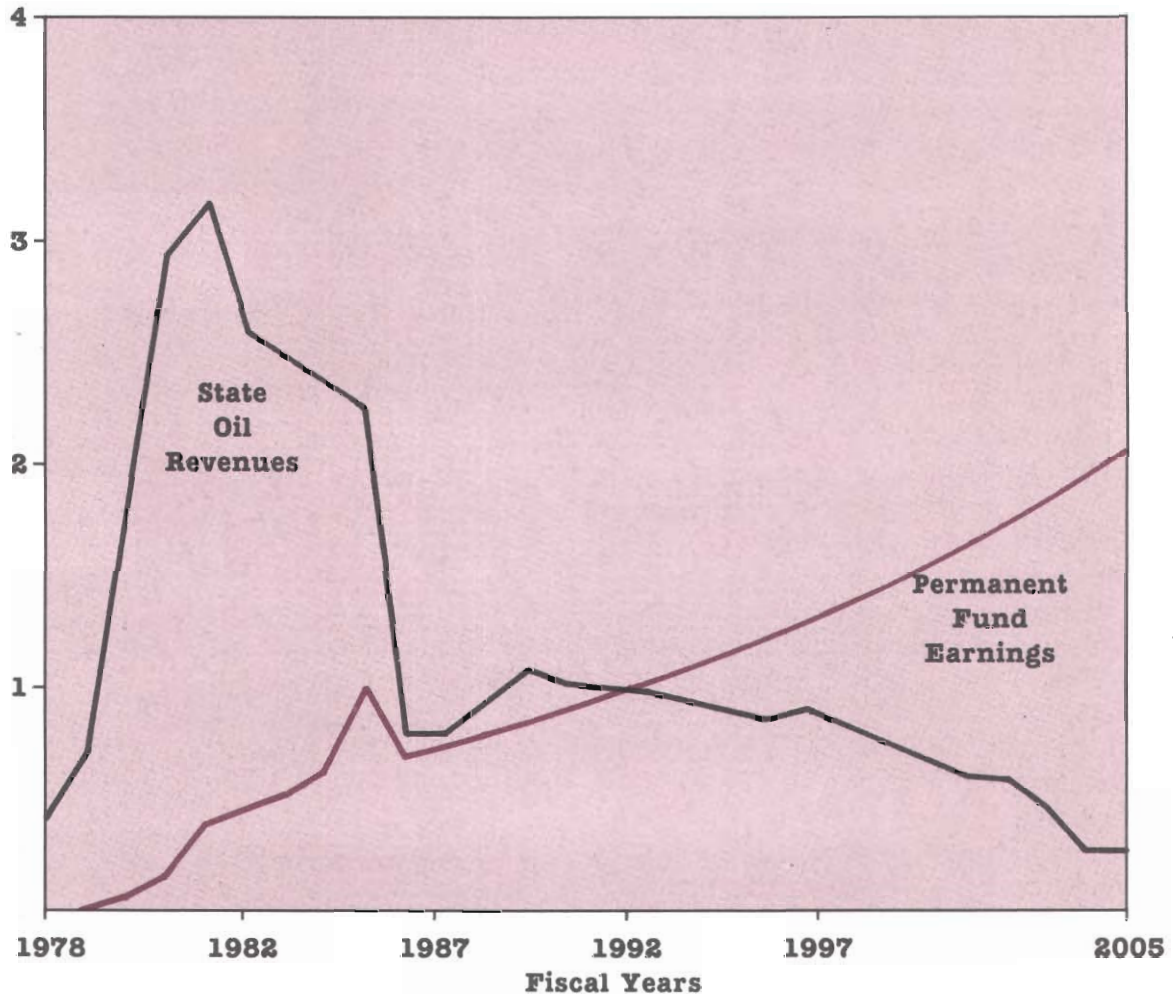
In sum, third quarter 1986 economic growth is expected to be sluggish, followed by a moderate reacceleration of economic activity during the fourth quarter. Until there are definite signs of reinvigorated growth, the Federal Reserve Bank is likely to follow a policy of increasing monetary ease and economic stimulus. Unless there is a sharp increase in economic activity and a substantial improvement in the balance of trade, interest rates may well trend lower in the first half of 1987. Two factors, however, which would radically alter the outlook for both the economy and interest rates would be a free fall of the U.S. dollar in the foreign exchange markets or a sharp, sustained rise in the price of oil.

# TOTAL STATE OIL REVENUES VERSUS PERMANENT FUND EARNINGS

1978 — 2005

(Actual and Projected)

Billions of \$



This graph depicts the relationship between the total oil revenues received each year by the state (net of constitutionally-dedicated contributions to the Permanent Fund) and the annual earnings of the Permanent Fund, from the inception of the Fund into the 21st century. The lines covering the period 1978 — 1986 reflect the actual numbers. For the years 1987 — 2005, the lines are projections based on current forecasts by the state Department of Revenue and the Alaska Permanent Fund Corporation. According to these projections, Fund earnings will overtake oil revenues and become the number one producer of state income within seven years.





# **ALASKA PERMANENT FUND CORPORATION**

**Financial Statements**  
**June 30, 1986 and 1985**

**REPORT OF INDEPENDENT ACCOUNTANTS**

Ernst & Whinney

Suite 601  
301 W. Northern Lights Boulevard  
Anchorage, Alaska 99503

907/279-1411

Board of Trustees  
Alaska Permanent Fund Corporation  
Juneau, Alaska

We have examined the statement of assets, liabilities and fund equity of the Alaska Permanent Fund Corporation as of June 30, 1986, and the related statements of revenues and expenses, changes in fund equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of the Alaska Permanent Fund Corporation for the year ended June 30, 1985, were examined by other auditors whose report, dated August 13, 1985, expressed an unqualified opinion on those statements.

In our opinion, the aforementioned financial statements present fairly the financial position of the Alaska Permanent Fund Corporation at June 30, 1986 and the results of its operations and changes in financial position for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

*Ernst & Whinney*

Anchorage, Alaska  
August 15, 1986

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**STATEMENT OF ASSETS, LIABILITIES AND FUND EQUITY**


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	<u>June 30,</u>	
<b>ASSETS</b>	<u>1986</u>	<u>1985</u>
Cash and temporary investments - Note 3	\$ 172,270,000	\$ 43,821,000
Receivables and prepaid expenses - Note 4	143,887,000	188,592,000
Investments —		
Marketable debt securities - Note 5		
Short-term	353,772,000	18,850,000
Intermediate and long-term	<u>5,592,957,000</u>	<u>5,438,792,000</u>
Total debt securities	5,946,729,000	5,457,642,000
Real estate - Note 6		
Equity pools	67,509,000	43,898,000
Participating mortgage	8,000,000	8,000,000
Limited partnerships	46,411,000	25,648,000
General partnerships	<u>102,385,000</u>	<u>52,104,000</u>
Total real estate	224,305,000	129,650,000
Preferred and common stock - Note 7	1,179,718,000	747,303,000
Conventional mortgages	48,440,000	47,985,000
Alaska certificates of deposit	<u>150,525,000</u>	<u>107,500,000</u>
Total investments	7,549,717,000	6,490,080,000
Property and equipment at cost, less accumulated depreciation of \$194,000 in 1986 and \$136,000 in 1985	<u>473,000</u>	<u>359,000</u>
<b>Total assets</b>	<u><b>\$ 7,866,347,000</b></u>	<u><b>\$ 6,722,852,000</b></u>
<b>LIABILITIES</b>		
Accounts payable	\$ 1,788,000	\$ 1,372,000
National petroleum reserve (Alaska) entitlement - Note 8	15,996,000	
Income distributable to the State of Alaska - Note 9	<u>303,425,000</u>	<u>217,274,000</u>
<b>Total liabilities</b>	321,209,000	218,646,000
<b>FUND EQUITY</b>		
Contributed equity - Note 10	6,280,753,000	5,740,942,000
Reserve for inflation and dividends - Note 11	<u>1,264,385,000</u>	<u>763,264,000</u>
<b>Total fund equity</b>	<u><b>7,545,138,000</b></u>	<u><b>6,504,206,000</b></u>
Total liabilities and fund equity	<u><b>\$ 7,866,347,000</b></u>	<u><b>\$ 6,722,852,000</b></u>

See notes to financial statements

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**STATEMENT OF REVENUES AND EXPENSES**


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	<u>Year Ended June 30,</u>	
<b>REVENUES</b>	<u>1986</u>	<u>1985</u>
Investment income - Note 12		
Interest	\$ 634,347,000	\$ 614,021,000
Dividends	45,579,000	25,325,000
Fees on loaned securities	5,356,000	1,860,000
Other real estate income	<u>8,242,000</u>	<u>2,622,000</u>
Total investment income	693,524,000	643,828,000
Realized gains on the sale of —		
Marketable debt securities	279,624,000	4,889,000
Preferred and common stock	<u>43,548,000</u>	<u>9,125,000</u>
Total realized gains	323,172,000	14,014,000
Unrealized gains on real estate	<u>9,544,000</u>	<u>3,898,000</u>
<b>Total revenues</b>	<b>1,026,240,000</b>	<b>661,740,000</b>
<b>EXPENSES</b>		
Communications	130,000	146,000
Custody and safekeeping fees	943,000	786,000
Legal and audit	117,000	153,000
Other	135,000	33,000
Performance measurement	51,000	5,000
Printing and advertising	79,000	39,000
Public information program	53,000	140,000
Real estate consulting fees	285,000	236,000
Rentals	139,000	90,000
Salaries and benefits	809,000	751,000
Stock management fees	1,661,000	1,117,000
Travel	98,000	104,000
Conventional mortgage service fees	202,000	164,000
Depreciation	58,000	71,000
Participating mortgage service fees	137,000	80,000
Real estate management fees	<u>421,000</u>	<u>64,000</u>
<b>Total expenses</b>	<b>5,318,000</b>	<b>3,979,000</b>
<b>Net income</b>	<b><u>\$ 1,020,922,000</u></b>	<b><u>\$ 657,761,000</u></b>

See notes to financial statements

## STATEMENT OF CHANGES IN FUND EQUITY

	Total	Contributed Equity (Note 10)	Reserve for Inflation and Dividends (Note 11)	Unrealized Loss on Common Stock	Undistributed Income
<b>Balance, June 30, 1984</b>	<b>\$5,374,920,000</b>	<b>\$4,838,344,000</b>	<b>\$ 557,347,000</b>	<b>\$ (20,871,000)</b>	
Appropriations from the state	300,000,000	300,000,000			
Dedicated state revenues	368,027,000	368,027,000			
Net income from operations	657,761,000				\$ 657,761,000
Citizen contributions	1,000	1,000			
Provision for 1985 dividends	(217,274,000)				(217,274,000)
Provision for 1985 inflation		234,570,000			(234,570,000)
Recovery of unrealized loss on common stock	20,871,000			20,871,000	
Provision for future inflation and dividends			205,917,000		(205,917,000)
<b>Balance, June 30, 1985</b>	<b>6,504,206,000</b>	<b>5,740,942,000</b>	<b>763,264,000</b>		
Dedicated state revenues	347,751,000	347,751,000			
Provision for NPRA entitlement - Note 8	(24,317,000)	(24,317,000)			
Net income from operations	1,020,922,000				1,020,922,000
Citizen contributions	1,000	1,000			(303,425,000)
Provision for 1986 dividends	(303,425,000)				(216,376,000)
Provision for 1986 inflation		216,376,000			(501,121,000)
Provision for future inflation and dividends			501,121,000		
<b>Balance, June 30, 1986</b>	<b>\$7,545,138,000</b>	<b>\$6,280,753,000</b>	<b>\$1,264,385,000</b>		

See notes to financial statements

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**STATEMENT OF CHANGES IN FINANCIAL POSITION**


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	<u>Year Ended June 30,</u>	
	<u>1986</u>	<u>1985</u>
<b>FUNDS WERE PROVIDED BY</b>		
Investment operations —		
Net income	\$ 1,020,922,000	\$ 657,761,000
Items not affecting funds —		
Amortization	(3,118,000)	(1,391,000)
Depreciation	58,000	71,000
Appreciation of real estate	(9,544,000)	(3,898,000)
Undistributed real estate income	(1,429,000)	(958,000)
Total from operations	<u>1,006,889,000</u>	<u>651,585,000</u>
Decrease (increase) in receivables and prepaid expenses	44,705,000	(17,342,000)
Increase in accounts payable	416,000	523,000
Recovery of value of common stock		20,871,000
Citizen contributions	1,000	1,000
Contributions from the state	<u>347,751,000</u>	<u>668,027,000</u>
<b>Total funds provided</b>	<b>1,399,762,000</b>	<b>1,323,665,000</b>
<b>FUNDS WERE USED FOR</b>		
Net purchases —		
Marketable debt securities	485,968,000	584,186,000
Equity real estate pools	18,167,000	32,500,000
Limited partnerships	20,276,000	25,000,000
General partnerships	45,239,000	51,794,000
Preferred and common stock	432,416,000	435,597,000
Conventional mortgages	454,000	13,436,000
Alaska certificates of deposit	43,025,000	107,500,000
Property and equipment	<u>173,000</u>	<u>309,000</u>
Total purchases	1,045,718,000	1,250,322,000
Income distributions	217,274,000	155,130,000
Dedicated state revenues applied to NPRA entitlement	8,321,000	
Provision for increase in value of common stock		<u>20,871,000</u>
<b>Total funds used</b>	<b>1,271,313,000</b>	<b>1,426,323,000</b>
Increase (decrease) in cash and temporary investments	<u>\$ 128,449,000</u>	<u>\$ (102,658,000)</u>

See notes to financial statements

## NOTES TO FINANCIAL STATEMENTS JUNE 30, 1986

### 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 public corporation separate from the agencies of state government and governed by a board of trustees (the "Trustees") to manage the investments of the Fund. By law, a portion of the annual earnings is transferred to the State for the payment of dividends to eligible residents of Alaska, and 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 reserved by the Corporation to offset the impact of future inflation and to pay future dividends.

### 2. SIGNIFICANT

#### ACCOUNTING POLICIES

**Contributions:** (i) Contributions from dedicated State revenues are recorded when certain revenues, as defined by law, are received by the Alaska Department of Natural Resources. (ii) 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 law requires that one-half of a five-year moving average of the net income of the Corporation, excluding unrealized gains and losses, be made available for the payment of dividends each year.

**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:** (i) Interest income on all securities is accrued monthly as earned, (ii) Interest income is shown net of amortization of premiums and accretion of discounts on securities.

**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
Preferred and common stock	Lower of cost or market
Real estate	Market
Conventional mortgages	Cost
Alaska certificates of deposit	Cost

**Real Estate:** Real estate investments are carried at cost until independent appraisals are made. Carrying value is then adjusted to reflect market. Unrealized gains from appreciation are reported as revenue for the year in which they occur. Earnings on partnership investments that have not been distributed are recorded as additions to the carrying value of the investments. Earnings distributions are recorded as reductions of the carrying value of investments. Other real estate earnings are accrued as earned or when declared.

**Realized Gains and Losses:** Realized gains or losses on the sale of investments are determined by specific identification.

**Reclassification of Prior Year:** Certain prior year balances have been reclassified to conform with a change in reporting format. The reclassification has 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>1986</u>	<u>1985</u>
Operating account	\$ 120,000	\$ 637,000
Cash management accounts	374,000	240,000
Common stock treasury accounts	53,876,000	35,644,000
Repurchase agreements	<u>117,900,000</u>	<u>7,300,000</u>
<b>Total cash and temporary investments</b>	<b><u>\$172,270,000</u></b>	<b><u>\$43,821,000</u></b>

### 4. RECEIVABLES AND PREPAID EXPENSES

Receivables and prepaid expenses at June 30 are summarized as follows:

	<u>1986</u>	<u>1985</u>
Accrued interest receivable	\$130,752,000	\$183,032,000
Dedicated State revenues receivable	7,696,000	2,572,000
Dividends receivable	4,397,000	2,946,000
Security lending fees receivable	972,000	
Prepaid expenses	<u>70,000</u>	<u>42,000</u>
<b>Total receivables and prepaid expenses</b>	<b><u>\$143,887,000</u></b>	<b><u>\$188,592,000</u></b>

### 5. MARKETABLE DEBT SECURITIES

Marketable debt securities, consisting primarily of United States government obligations, corporate bonds and commercial paper, are held by commercial banks under contract to the Corporation. Buy and sell decisions are made by Corporation investment officers.

Marketable debt securities at June 30 are summarized as follows:

	<u>Amortized Cost</u>	<u>Market</u>	<u>Unrealized Gain</u>
<b>1986</b>			
Short-term	\$ 353,772,000	\$ 353,772,000	
Intermediate and long-term	<u>5,592,957,000</u>	<u>6,155,941,000</u>	<u>\$562,984,000</u>
	<b><u>\$5,946,729,000</u></b>	<b><u>\$6,509,713,000</u></b>	<b><u>\$562,984,000</u></b>
<b>1985</b>			
Short-term	\$ 18,850,000	\$ 19,840,000	\$ 990,000
Intermediate and long-term	<u>5,438,792,000</u>	<u>5,720,038,000</u>	<u>281,246,000</u>
	<b><u>\$5,457,642,000</u></b>	<b><u>\$5,739,878,000</u></b>	<b><u>\$282,236,000</u></b>

### 6. REAL ESTATE

Real estate investments include (i) real estate pools sponsored by professional real estate managers, and (ii) joint ventures with other institutional investors. Investments are structured to maintain the safety of principal and to maximize total return through diversification. By law, the properties must be income-producing and the Corporation may hold up to forty percent of the beneficial ownership interest.

Real estate investments are summarized as follows:

**Equity Pools:** Equity pools represent share ownership in managed funds which invest in high quality real estate diversified by type, lease term, tenant, and geographic location. Earnings do not pass to the shareholders until dividends are declared, and then only to the extent of the dividend declaration.

		<u>June 30,</u>	
		<u>1986</u>	<u>1985</u>
<b>JMB II –</b>			
DESCRIPTION:	8 Office/Retail Properties	Cost of investment	\$ 15,000,000
LOCATION:	Nationwide Diversification	Appreciation	1,541,000
VALUE:	Market		
APPRAISAL:	December 31, 1985	Total JMB II	16,541,000
			15,000,000
<b>JMB III –</b>			
DESCRIPTION:	Office Building/Shopping Center	Cost of investment	5,000,000
LOCATION:	Virginia Beach, VI/San Diego, CA		
VALUE:	Cost		
APPRAISAL:	At Purchase	Total JMB III	5,000,000
<b>CPI –</b>			
DESCRIPTION:	60 Office/Retail Properties	Cost of investment	38,167,000
LOCATION:	Nationwide Diversification	Appreciation	7,801,000
VALUE:	Market		
APPRAISAL:	December 31, 1985	Total CPI	45,968,000
			25,000,000
			3,898,000
		<b>Total equity pools</b>	<b>\$ 67,509,000</b>
			<b>28,898,000</b>
			<b>\$ 43,898,000</b>

**Participating Mortgage:** The participating mortgage represents an investment in a mortgage note which conveys certain rights of participation in the cash flow and appreciation of the property which also serves as collateral.

		<u>June 30,</u>	
		<u>1986</u>	<u>1985</u>
<b>Paragon Building –</b>			
DESCRIPTION:	14-Story Office Building	Outstanding	
LOCATION:	Dallas, Texas	principal balance	\$ 8,000,000
VALUE:	Cost		\$ 8,000,000
APPRAISAL:	At Purchase		
INTEREST:	10.5% Mortgage Note		
STRUCTURE:	50% Cash Flow/Appreciation		
	25% Share of Mortgage Note		
		<b>Total participating mortgage</b>	<b>\$ 8,000,000</b>
			<b>\$ 8,000,000</b>

**Limited Partnerships:** Limited partnerships represent investments in which the Corporation will participate in the cash flow and appreciation of the properties to the extent of its percentage of ownership. Liability for the debts and obligations of the partnerships is limited to the amount invested.

		<u>June 30,</u>	
		<u>1986</u>	<u>1985</u>
<b>CIGNA Fund S –</b>			
DESCRIPTION:	11 Office/Retail/Residential/ Industrial Properties	Cost of investment	\$25,000,000
LOCATION:	Nationwide Diversification	Undistributed earnings	70,000
VALUE:	Market	Appreciation	990,000
APPRAISAL:	June 30, 1985		
STRUCTURE:	16.859% Share of Equity	Total CIGNA Fund S	26,060,000
			25,648,000
<b>ARA Building –</b>			
DESCRIPTION:	32-Story Office Building	Cost of investment	20,276,000
LOCATION:	Philadelphia, Pennsylvania	Undistributed earnings	75,000
VALUE:	Cost		
APPRAISAL:	At Purchase	Total ARA Building	20,351,000
STRUCTURE:	31% Share of Equity		
		<b>Total limited partnerships</b>	<b>\$ 46,411,000</b>
			<b>\$ 25,648,000</b>

**General Partnerships:** General partnerships represent investments in which the Corporation will participate in the cash flow and appreciation of the properties to the extent of its percentage of ownership. Liability for the debts and obligations of the partnerships is unlimited.

		<u>June 30,</u>	
		<u>1986</u>	<u>1985</u>
<b>Atrium/45 Broadway —</b>			
DESCRIPTION:	32-Story Office Building	Cost of investment	<b>\$19,238,000</b>
LOCATION:	Downtown New York City	Undistributed earnings	<b>1,291,000</b>
VALUE:	Cost		
APPRAISAL:	At Purchase		
STRUCTURE:	22% Share of Equity	Total Atrium/45 Broadway	<b>20,529,000</b>
<b>Tysons Corner —</b>			
DESCRIPTION:	Retail Shopping Center	Cost of investment	<b>21,755,000</b>
LOCATION:	McLean, Virginia	Undistributed earnings	\$21,753,000
VALUE:	Market	Appreciation	103,000
APPRAISAL:	December 31, 1985		
STRUCTURE:	14% Share of Equity	Total Tysons Corner	<b>25,490,000</b>
<b>Tri-County Center —</b>			
DESCRIPTION:	Office/Industrial Center	Cost of investment	<b>6,382,000</b>
LOCATION:	Cincinnati, Ohio	Undistributed earnings	6,355,000
VALUE:	Cost		58,000
APPRAISAL:	At Purchase		
STRUCTURE:	33 1/3% Share of Equity	Total Tri-County Center	<b>6,422,000</b>
<b>Oakwood Mall —</b>			
DESCRIPTION:	Retail Shopping Center	Cost of investment	<b>9,950,000</b>
LOCATION:	Enid, Oklahoma	Undistributed earnings	9,687,000
VALUE:	Cost		64,000
APPRAISAL:	At Purchase		
STRUCTURE:	33 1/3% Share of Equity	Total Oakwood Mall	<b>10,017,000</b>
<b>Villa Marina —</b>			
DESCRIPTION:	Retail Shopping Center	Cost of investment	<b>14,004,000</b>
LOCATION:	Marina Del Rey, California	Undistributed earnings	14,000,000
VALUE:	Cost		84,000
APPRAISAL:	At Purchase		
STRUCTURE:	34% Share of Equity	Total Villa Marina	<b>14,082,000</b>
<b>MN-TX Business Center —</b>			
DESCRIPTION:	7 Office/Warehouse Buildings	Cost of investment	<b>5,917,000</b>
LOCATION:	Eden Prairie, MN (Minneapolis)	Undistributed earnings	<b>23,000</b>
VALUE:	Cost		
APPRAISAL:	At Purchase		
STRUCTURE:	40% Share of Equity	Total MN-TX Bus. Center	<b>5,940,000</b>
<b>St. Louis Centre —</b>			
DESCRIPTION:	4-Story Shopping Mall	Cost of investment	<b>19,788,000</b>
LOCATION:	Downtown St. Louis, Missouri	Undistributed earnings	<b>117,000</b>
VALUE:	Cost		
APPRAISAL:	At Purchase		
STRUCTURE:	33.2% Share of Equity	Total St. Louis Centre	<b>19,905,000</b>
		<b>Total general partnerships</b>	<b>\$102,385,000</b>
			<b>\$52,104,000</b>

**Outstanding Commitments:** On June 30, 1986, the Corporation had the following commitments for the purchase of additional equity real estate investments:

Equity pool	\$15,000,000
Participating mortgages	50,850,000
Limited partnership	11,480,000
General partnership	15,000,000
<b>Total commitments</b>	<b><u>\$92,330,000</u></b>

## 7. PREFERRED AND COMMON STOCK

Preferred and common stock investments are held by commercial banks pursuant to custodial agreements. Buy and sell decisions are made by investment management firms under contract to the Corporation, and within limitations established by State law and Corporation policies.

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

	1986	1985
Market	\$1,574,170,000	\$838,765,000
Cost	<u>1,179,718,000</u>	<u>747,303,000</u>
Unrealized gain	<u>\$ 394,452,000</u>	<u>\$ 91,462,000</u>

## 8. NATIONAL PETROLEUM RESERVE (ALASKA) ENTITLEMENT

Under federal law, the State of Alaska receives one-half of federal mineral revenues generated by competitive oil and gas leasing in the National Petroleum Reserve - Alaska ("NPROA"). As a condition to the payments, the State must segregate the funds received and give priority to their use by the municipalities impacted by oil and gas development in the NPROA.

Prior to meeting the federal conditions, the State of Alaska deposited one-half of the NPROA mineral revenue sharing payments in the Fund. Legislation passed by the 1986 legislature provides (i) that the Corporation shall return these funds to the State and deposit them in the NPROA special revenue fund, and (ii) that one-half of all NPROA mineral revenue sharing payments received by the State shall lapse to the Fund at the end of each fiscal year, net of any funds granted to impacted municipalities.

Payment to the State of the Fund's share of the NPROA special revenue fund entitlement is being made by a partial withholding of current dedicated State revenues. The withholding made during the year ended June 30, 1986 was as follows:

Fund share of original NPROA entitlement	\$24,317,000
Withheld from dedicated State revenues	<u>(8,321,000)</u>
Balance due, June 30, 1986	<u>\$15,996,000</u>

## 9. INCOME DISTRIBUTABLE TO THE STATE OF ALASKA

The portion of the Corporation's net income for the fiscal years ended June 30, 1986 and 1985, which has been appropriated by the legislature for payment of dividends, is summarized as follows:

Balance due, June 30, 1984	\$155,130,000
Add: 1985 appropriation	217,274,000
Less: payment of 1984 dividends	<u>(155,130,000)</u>
Balance due, June 30, 1985	217,274,000
Add: 1986 appropriation	303,425,000
Less: payment of 1985 dividends	<u>(217,274,000)</u>
Balance due, June 30, 1986	<u>\$303,425,000</u>

## 10. CONTRIBUTED EQUITY

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

	1986	1985
Dedicated State revenues	\$2,747,678,000	\$2,424,244,000
Appropriations from the State	2,700,000,000	2,700,000,000
Provision for inflation	833,073,000	616,697,000
Citizen contributions	<u>2,000</u>	<u>1,000</u>
	<u>\$6,280,753,000</u>	<u>\$5,740,942,000</u>

## 11. RESERVES

The Trustees have designated, by resolution, undistributed income as a provision for future inflation impact and dividend payments. Accordingly, the balance in the undistributed income account is transferred to the reserve for inflation and dividends at the end of each fiscal year.

## 12. INVESTMENT INCOME BY SOURCE

	<u>1986</u>	<u>1985</u>
<b>Interest</b>		
Money market accounts	\$ 2,616,000	\$ 2,325,000
Repurchase agreements	6,495,000	6,073,000
Commercial paper	1,941,000	1,165,000
Bankers acceptances	1,204,000	1,274,000
Treasury bills	6,992,000	4,269,000
Treasury notes and bonds	590,382,000	576,757,000
Corporate bonds	4,847,000	3,290,000
Participating mortgages	1,094,000	910,000
Limited partnerships	143,000	
Conventional mortgages	6,095,000	5,709,000
State mineral leases	40,000	69,000
Certificates of deposit — Alaska	10,414,000	9,643,000
Other	2,084,000	2,537,000
<b>Total interest</b>	<u>\$634,347,000</u>	<u>\$614,021,000</u>
<b>Dividends</b>		
Preferred and common stock	\$ 42,539,000	\$ 23,367,000
Equity real estate pools	3,040,000	1,958,000
<b>Total dividends</b>	<u>\$ 45,579,000</u>	<u>\$ 25,325,000</u>
<b>Fees on loaned securities</b>		
Treasury notes and bonds	\$ 5,278,000	\$ 1,849,000
Preferred and common stock	78,000	11,000
<b>Total fees</b>	<u>\$ 5,356,000</u>	<u>\$ 1,860,000</u>
<b>Other real estate income</b>		
Participating mortgages	\$ 7,000	
Limited partnerships	2,570,000	\$ 1,211,000
General partnerships	5,665,000	1,411,000
<b>Total other income</b>	<u>\$ 8,242,000</u>	<u>\$ 2,622,000</u>

## 13. SUBSEQUENT EVENTS

The 1986 State legislature appropriated the June 30, 1986 balance of undistributed income (classified as reserve for inflation and dividends by Trustee resolution) to Fund principal effective July 1, 1986. As a result of this appropriation, fund equity on July 1, 1986 as compared to June 30, 1986 will be as follows:

	<u>July 1, 1986</u>	<u>June 30, 1985</u>
Contributed equity	\$7,545,138,000	\$6,280,753,000
Reserve for inflation and dividends		1,264,385,000
<b>Total fund equity</b>	<u>\$7,545,138,000</u>	<u>\$7,545,138,000</u>

The 1986 State legislature amended the Fund enabling act for fiscal years beginning July 1, 1986 as follows:

(a) Dividends will be computed as one-half of twenty-one percent of the net income of the Corporation for the last five fiscal years.

(b) Future inflation-proofing must be computed using the change in the calendar year average of the United States consumer price index for all urban consumers. Although the Corporation currently uses this index, under current law, any nationally recognized inflation index selected by the Trustees is appropriate.

(c) Future Corporation income not used to offset the impact of inflation or to pay dividends shall be recorded in the earnings reserve account.



