

# *Investing for Generations*



**Alaska  
Permanent Fund  
Corporation**

**Annual Report 2001**

# Legacy of the past, hope for the future

The Permanent Fund means different things to each generation of Alaskans.

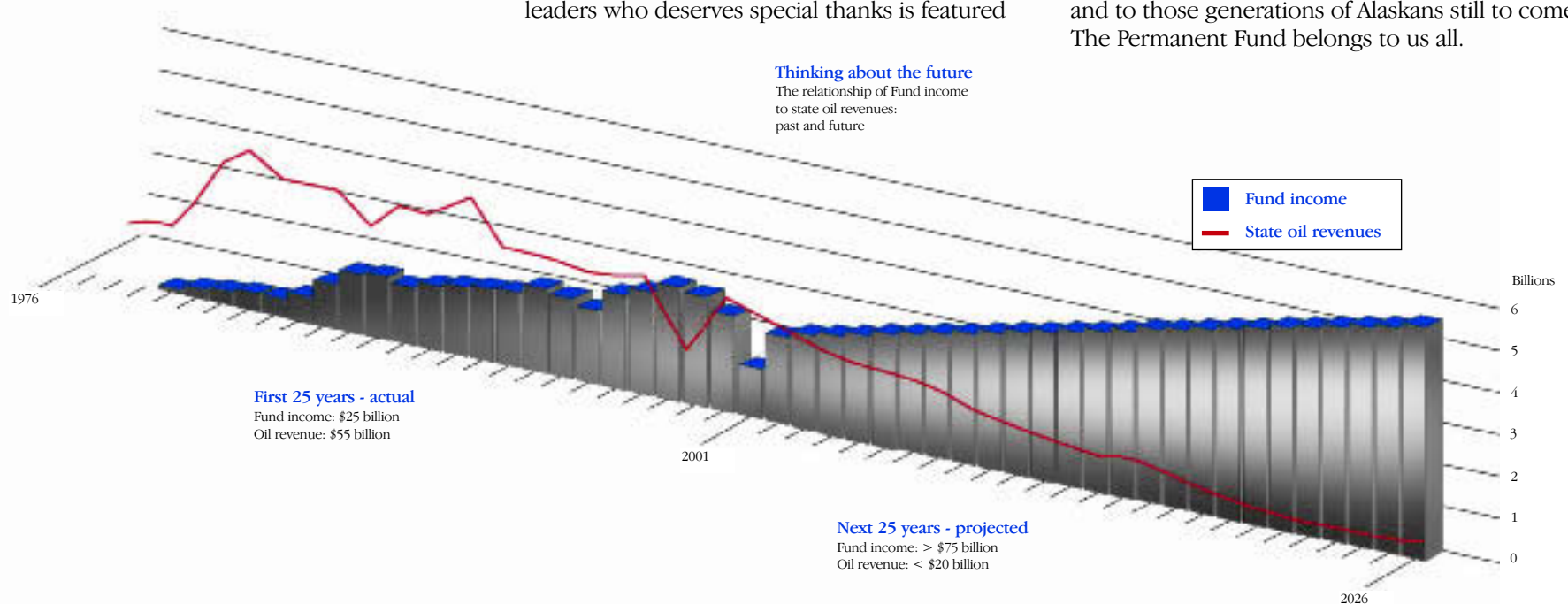
Children born in this year of the 25th anniversary of Alaska's Permanent Fund do not yet know what an important role the state's savings account will play in their lives. Their parents do, and so do pioneer Alaskans who, over the last quarter century, have watched the Fund grow beyond their most hopeful expectations.

Alaskans who are 25 years old have never known a time when the Permanent Fund was not a part of this state's public policy. They don't remember a fall season since 1982 when they didn't receive their own personal share of Alaska's oil wealth. The Permanent Fund, this great experiment in saving and sharing public wealth, is an integral part of their lives.

It took wisdom and leadership, courage and tenacity 25 years ago to create something of such enduring and abiding value. One of Alaska's past leaders who deserves special thanks is featured

on the cover of this report. Hugh Malone, who passed away this year, made such a lasting contribution that the Trustees this year named the Alaska Permanent Fund Corporation's board room in his honor.

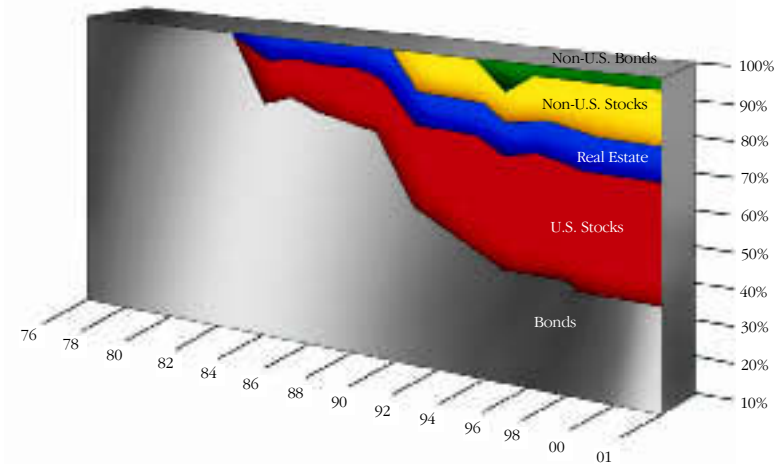
This annual report, which marks the 25th anniversary of the creation of the Permanent Fund, will tell you what happened to the Fund in fiscal 2001. But, it will also highlight the Fund's history and demonstrate why we Alaskans today owe so much to those generations who have come before ... and to those generations of Alaskans still to come. The Permanent Fund belongs to us all.



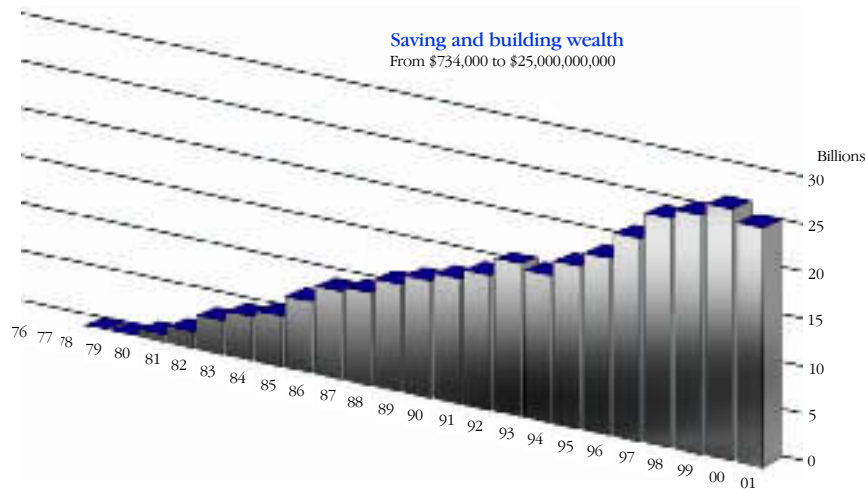
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**Managing risk and return by diversifying**  
Fund's asset allocation 1976-2001

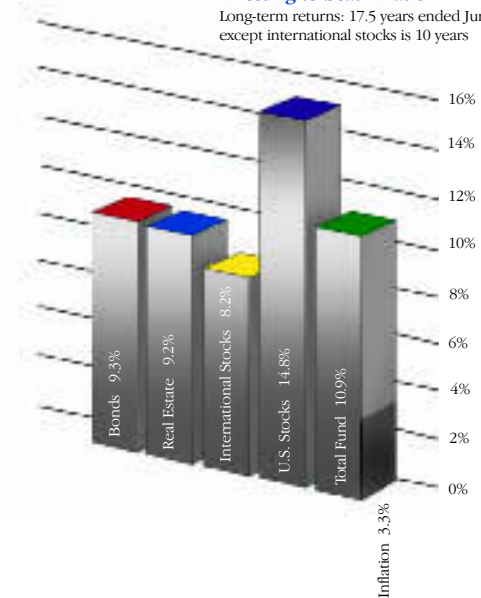


**Saving and building wealth**  
From \$734,000 to \$25,000,000,000



**Investing to beat inflation**

Long-term returns: 17.5 years ended June 30, 2001  
except international stocks is 10 years



# *Letter from the Chair: “Investing for generations” —*

*Dear Alaskan:*

In November 1976, voters of Alaska, by a two-to-one margin, approved an amendment to the state’s constitution and thereby created the Permanent Fund. This was, arguably, the most significant public policy action in state history. Shortly thereafter, in February 1977, the Fund received its first deposit of dedicated oil revenues: \$734,000. Now, 25 years later, Fund assets exceed \$25 billion.

That remarkable growth is due primarily to two factors: positive financial markets and prudent fiscal management. The chart on the preceding page shows the impact of the positive financial markets. For the prudent fiscal management, we have to thank those who have worked together over many years to maintain and grow the Fund,

diversify it, inflation-proof it for future generations and ensure its safety of principal. Those responsible include 37 distinguished Alaskans who have served as members of the APFC Board of Trustees, and all the Alaska legislatures, governors and APFC employees and investment managers who have worked with the Trustees to enable this unique Fund to invest so successfully.

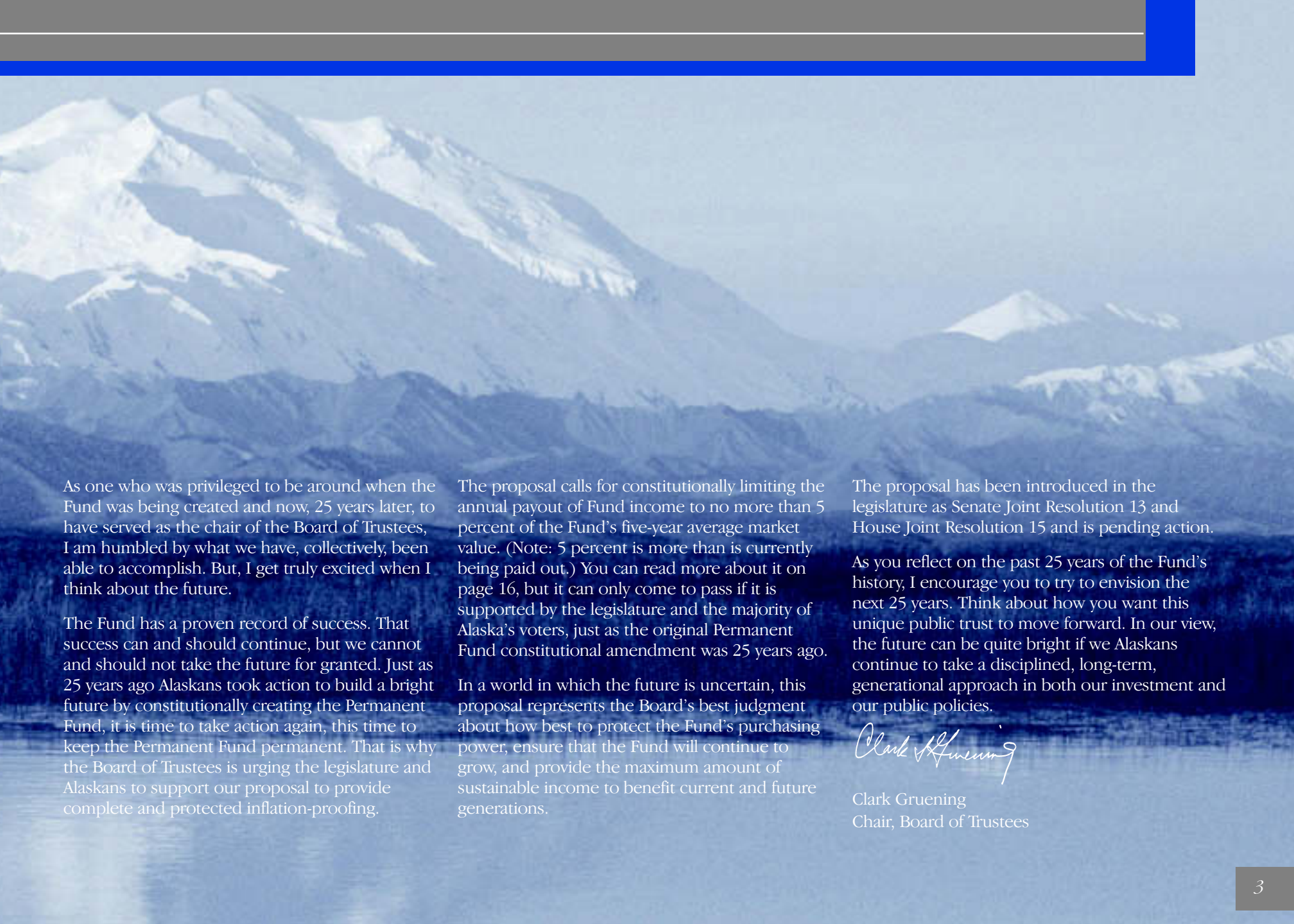
There have been many significant milestones in the Fund’s 25-year history and you can view them in the four-page fold-out timeline that begins on page 19.

Certainly the Fund would not be the magnificent legacy it is today if the residents of Alaska had not voted 25 years ago to save a portion of our one-time oil wealth. Nor would the Fund be as large as it is if the people’s elected representatives had not

voted to add approximately \$14 billion of non-constitutionally required money to the Fund’s principal by special appropriation and inflation-proofing.

The Fund would not be the empowering source of hope for the future that it is today if not for the Trustees who have consistently argued for, developed and implemented sound investment policies which have proven their value in the crucible of time.

All of the key benchmarks of Alaska’s oil-fired public savings account have been achieved by steadfastness, vision, dedication — and a shared common mission — to keep the Permanent Fund permanent.



As one who was privileged to be around when the Fund was being created and now, 25 years later, to have served as the chair of the Board of Trustees, I am humbled by what we have, collectively, been able to accomplish. But, I get truly excited when I think about the future.

The Fund has a proven record of success. That success can and should continue, but we cannot and should not take the future for granted. Just as 25 years ago Alaskans took action to build a bright future by constitutionally creating the Permanent Fund, it is time to take action again, this time to keep the Permanent Fund permanent. That is why the Board of Trustees is urging the legislature and Alaskans to support our proposal to provide complete and protected inflation-proofing.

The proposal calls for constitutionally limiting the annual payout of Fund income to no more than 5 percent of the Fund's five-year average market value. (Note: 5 percent is more than is currently being paid out.) You can read more about it on page 16, but it can only come to pass if it is supported by the legislature and the majority of Alaska's voters, just as the original Permanent Fund constitutional amendment was 25 years ago.

In a world in which the future is uncertain, this proposal represents the Board's best judgment about how best to protect the Fund's purchasing power, ensure that the Fund will continue to grow, and provide the maximum amount of sustainable income to benefit current and future generations.

The proposal has been introduced in the legislature as Senate Joint Resolution 13 and House Joint Resolution 15 and is pending action.

As you reflect on the past 25 years of the Fund's history, I encourage you to try to envision the next 25 years. Think about how you want this unique public trust to move forward. In our view, the future can be quite bright if we Alaskans continue to take a disciplined, long-term, generational approach in both our investment and our public policies.



Clark Gruening  
Chair, Board of Trustees

*Dear Alaskan:*

In fiscal 2001, the Alaska Permanent Fund recorded its first-ever fiscal year loss, - 3.3 percent. In a very difficult year for equity markets around the globe, the APFC minimized Fund losses by adhering to a disciplined investment approach which emphasized asset diversification, risk management and "staying the course."

Despite the negative return, it was actually a pretty good year for the Fund:

- Each Permanent Fund portfolio – stocks, bonds and real estate – beat its respective benchmark. For example, the Fund's combined U.S. stocks outperformed the Russell 3000 stock index.
- The Alaska Permanent Fund's performance was better than that of the average public pension fund – largely due to the fact that most other funds had higher allocations to stocks than the Fund.
- Constitutionally protected principal grew by \$1 billion; \$686 million was transferred from the earnings reserve for inflation-proofing and \$339 million was added from new oil and other mineral revenues.
- A total of \$1.113 billion, down \$60 million from last year's all-time record, will be transferred this fall for payment of the 2001 PFDs.
- Long-term asset allocation, designed to balance the risks of negative returns in the short term against the rewards of higher positive returns in the longer term, stayed on course.

## **Policy actions**

One focus of activity during the year was increased internal monitoring. This began with reviewing and rewriting all investment policies to ensure consistency and to emphasize secure internal controls and increased reporting. In the fixed-income area, there was direction provided to increase scenario and compliance analysis. In the area of stocks, more quantitative tools were added to better analyze and monitor the Fund's equity holdings.

The turbulence in the financial markets this year challenged the Board of Trustees to adhere to its disciplined, long-term strategy. At the beginning of the fiscal year, investments in U.S. and non-U.S. stocks totaled 53.5 percent of the Fund, slightly above the asset allocation target of 53 percent. At the end of February 2001, declining markets brought the market value of total stocks below the lower policy boundary of 48 percent. It might have been tempting to allow the Fund's exposure to stocks to continue to decline, but in mid-March the Board instead authorized the purchase of \$750 million of additional stocks to bring the Fund's holdings back within the control bands of the asset allocation policy. This was not an attempt to "time" the market. Rather, it was an affirmation of the belief that a long-term investor will eventually do well by rebalancing; that is, taking profits in the investments that have done well and reinvesting the proceeds in those investments whose prices have fallen below normal levels.

During the year the Board allocated funds to a new Enhanced S&P 500 Index portfolio and selected Deutsche Asset Management to manage it. This portfolio is designed to add incremental return above the index return from security selection, but within much tighter risk constraints and with lower fees than an actively managed portfolio.

The Board of Trustees also made watchful judgments as to the two equity managers who had been placed under heightened scrutiny in the previous year. The Board determined that one of the managers had coped with the changes and uncertainties of new ownership and reorganizations well enough to warrant their retention. The manager went on to post the best

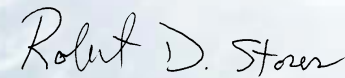
returns for the year of all the active stock managers in both U.S. and international portfolios. The other manager was terminated.

One other challenge facing the Board was how best to use the increased investment flexibility authorized by the 2000 legislature. That flexibility included a 5 percent “basket clause” which allows the Trustees to invest up to 5 percent of the Fund in any investment which meets prudent investor standards. As part of their due diligence looking into alternative investments, the Trustees completed an in-depth study of private equity (i.e., companies which have not yet gone public), and although they decided not to proceed immediately, the issue is certain to come up again in fiscal 2002.

#### **Administrative changes**

New directors were hired for two key departments. Joining the APFC this year were Allan Moore who replaced retiring Chief Investment Officer Terry Brown, and Marshal Kendziorek who became the new Director of Information Technology. On the Board, Attorney General Bruce Botelho replaced retiring Trustee John Shively.

The Corporation has been fortunate indeed in the caliber of the professionals who have worked here over the years, and I would like to thank all those who have been with the organization in the past as well as those who continue on with us as we celebrate the Permanent Fund’s 25th anniversary.



*Robert D. Storer*

Robert D. Storer  
Executive Director

Fiscal Year 2001 will be remembered as a time when a number of trends ended and reversed. The decade-long economic expansion finally ended, the seemingly inexorable growth in capital expenditures for technology finally abated, and U.S. and international stocks plummeted. Real estate and fixed-income investments produced stronger-than-average returns, but their good performance was insufficient to offset the magnitude of the fall in stocks, and the Alaska Permanent Fund recorded its first-ever fiscal year loss.

More trend reversals are evident by comparing this year's conditions to those reported in last year's 2000 Annual Report. In 2000, the Federal Reserve tried to slow an overheating economy by raising interest rates in steps totaling 1.75 percent; in 2001 the Federal Reserve tried to stimulate a faltering economy by fast steps that lowered rates by 2.75 percent. In 2000, the Fund's international stocks were the best-performing asset class, up 23.3 percent; in 2001 they were the worst-performing asset, down 22.9 percent. In 2000, growth stocks continued several years of superior performance even with a very weak final quarter; in 2001 value stocks bested growth by never-before-seen margins.

## Changing benchmarks

Defining a benchmark for a portfolio is how the Fund establishes objectives and measures results. This year, the Board changed benchmarks for select portfolios investing in both stocks and bonds to better reflect the breadth and depth of the investable markets.

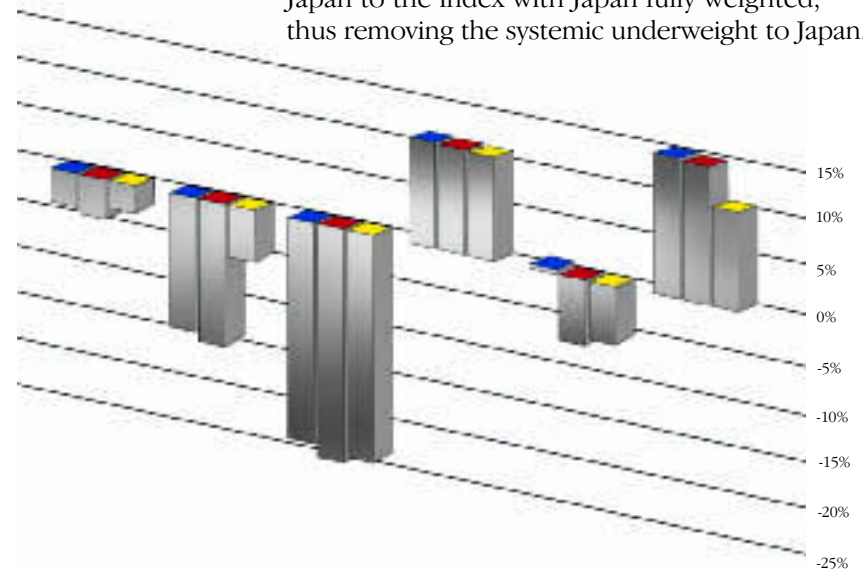
The Board changed the benchmark for the internally managed fixed-income portfolio to the Lehman U. S. Aggregate from the Lehman U.S. Government/Credit index. This "simple" change which adds mortgage-backed securities to the APFC's investment universe, necessitated the turnover of some \$3 billion of fixed-income securities, but it will allow the portfolio to garner equivalent returns with less risk.

The Fund changed the benchmark for two global portfolios, one managed by Brinson Partners and one by Lazard Asset Management. Previously, the benchmark had been a combination of 60 percent S&P 500 — representing U.S. stocks and 40 percent MSCI (Morgan Stanley Capital International) EAFE (Europe, Australia and Far East) index—representing international stocks of developed countries. The new benchmark is the MSCI World Index, which better reflects the Fund's objective to obtain a return like that of all the global developed markets. It also challenges the investment managers to add value by actively managing the ratio of U.S. versus international stocks.

Lastly, the benchmark for the Schrodgers' Pacific Basin portfolio was changed from the Pacific Basin index with a fifty percent weighting for Japan to the index with Japan fully weighted, thus removing the systemic underweight to Japan.

**Fund 2001 performance**  
Permanent Fund compared to benchmarks, other funds and inflation

Fund 2001 performance						
	Total Fund	U.S. Stocks	International Stocks	U.S. Fixed Income	International Fixed income	Real Estate
Inflation	3.4%					
APFC	-3.3%	-13.1%	-22.9%	11.4%	0.8%	14.8%
Benchmarks	-4.5%	-14.3%	-23.8%	11.2%	-7.4%	14.1%
Median fund	-3.6%	-5.3%	-23.4%	11.0%	-6.5%	10.2%



## Alaska Permanent Fund Asset Allocation

Dollars in millions, as of June 30, 2001 (including cash held by managers)

	Market Value	% of Total Fund		Market Value	% of Total Fund
<b>Actively Managed Stocks</b>			<b>Fixed Income</b>		
<b>U.S. Managers</b>			<b>APFC - Internal Fixed Income</b>		
Alliance Capital Management	151	0.58%	Alaska Permanent Capital Management	238	0.91%
Brinson Partners	550	2.11%	Alliance Bernstein	342	1.31%
Dresdner RCM - Large Cap	1,225	4.70%	Brinson Partners	300	1.15%
Invesco Capital Management	503	1.93%	Julius Baer	271	1.04%
Lazard Freres	521	2.00%	Rogge Global Partners	325	1.25%
McKinley Capital Management	174	0.67%	Alaska CD Program	149	0.57%
Putnam Investments	601	2.31%			
Capital Guardian - Small Cap	693	2.66%	<b>Total – all fixed-income managers</b>	<b>10,554</b>	<b>40.48%</b>
Dresdner RCM - Small Cap	355	1.36%			
<b>Total – U.S. managers</b>	<b>4,773</b>	<b>18.31%</b>	<b>Real Estate</b>		
<b>International Managers</b>			<b>Direct Investments</b>		
Capital Guardian	501	1.92%	AEW Capital Management	188	0.72%
Clay Finlay - Europe	606	2.33%	CB Richard Ellis	368	1.41%
Schroders Pacific Rim	194	0.74%	Heitman Property	46	0.18%
Brinson Partners	590	2.26%	Henderson Investors	74	0.28%
Lazard Freres	532	2.04%	Kennedy Property	225	0.86%
Dresdner RCM	157	0.60%	L&B Property	340	1.30%
Schroders Capital Mgmt. - Emerging Markets	193	0.74%	LaSalle Property	307	1.18%
Capital Guardian - Emerging Markets	263	1.01%	Sentinel I & II	193	0.74%
<b>Total – international managers</b>	<b>3,037</b>	<b>11.65%</b>	<b>Total real estate – direct</b>	<b>1,742</b>	<b>6.68%</b>
<b>Total active equity</b>	<b>7,810</b>	<b>29.95%</b>	<b>Other</b>		
<b>Passively Managed Stocks</b>			Commingled Funds	9	0.03%
Deutsche Asset Mgmt. - S&P 500	2,591	9.94%	REITs (Real estate investment trusts)	679	2.60%
Deutsche Asset Mgmt. - S&P 500 Enhanced	830	3.18%	Mortgages / CMBS	306	1.17%
Deutsche Asset Mgmt. - S&P 1000	546	2.09%	<b>Total real estate – other</b>	<b>994</b>	<b>3.81%</b>
Deutsche Asset Mgmt. - EAFE	1,006	3.86%	<b>Total – all real estate managers</b>	<b>2,736</b>	<b>10.49%</b>
<b>Total passive equity</b>	<b>4,974</b>	<b>19.08%</b>			
<b>Total – all equities managers</b>	<b>12,784</b>	<b>49.03%</b>			

Market events over the past twelve months reminded investors that patience, humility and moderation are virtues, that beauty is subjective, and that financial markets can be very fickle indeed. Above all, the past year underscored the importance of diversification, both within and between asset classes.

The Fund's equity performance for the past year has been consistent with market trends. Overall, the U.S. stock portfolio returned -13.1 percent. Style and size were the major determinants of performance, as value and small-cap stocks returned to favor. Brinson Partners led all Fund

U.S. equity managers with an 11.7 percent return, and outperformed its benchmark, the Russell 1000, by 26.7 percent.

The Fund's passive S&P 1000 portfolio (consisting of the S&P MidCap 400 Index and the S&P SmallCap 600 Index) returned 9.8 percent, reflecting benchmark returns for smaller-cap equities. However, the remainder of the Fund's domestic equity portfolios posted negative returns for the fiscal year, ranging from -0.5 percent for Lazard Asset Management's portfolio to -29.3 percent for Dresdner RCM Global Investors' small-cap growth product.

The Board concluded its search for an enhanced S&P 500 index product in September by hiring Deutsche Asset Management. Deutsche also manages the Fund's other passive equity portfolios. In December, the Board terminated a large-cap value manager, due to poor long-term performance. To avoid a potential style imbalance in comparison to the broad market (i.e., growth stocks versus value stocks, large capitalization versus small capitalization), in April the Board of Trustees subsequently authorized searches for two value style managers, one large-cap and one small-cap.

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*"Indeed the strength and impact of the Alaska Permanent Fund is felt in ways we cannot measure or quantify."*

Byron I. Mallott,  
former trustee and executive director.

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## U.S. equities managers' performance

FOR PERIODS ENDED JUNE 30, 2001

U.S. EQUITY LARGE CAP	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns	17 1/2-Year Returns
<b>Passive Managers</b>					
Deutsche Asset Mgmt. - S&P 500	-14.7%	4.0%	14.5%	15.1%	15.3%
Deutsche Asset Mgmt. - S&P 500 Enhanced	-	-	-	-	-
<i>S&amp;P 500 Index</i>	-14.8%	3.9%	14.5%	15.1%	15.3%
<b>Large-Cap Value Managers</b>					
Brinson Partners	11.7%	2.6%	10.6%	-	-
Invesco Capital Management	-1.2%	0.3%	9.7%	13.0%	-
Lazard Freres	-0.5%	2.4%	11.0%	-	-
<i>Russell 1000 Index</i>	-15.0%	4.3%	14.3%	15.2%	15.1%
<i>Russell 1000 Value</i>	10.3%	5.4%	15.0%	15.8%	15.3%
<b>Large-Cap Growth Managers</b>					
Alliance Capital Management	-28.2%	-	-	-	-
Dresdner RCM	-18.2%	16.2%	22.2%	18.6%	18.1%
McKinley Capital Management	-26.3%	-	-	-	-
Putnam Investments	-27.8%	0.8%	-	-	-
<i>Russell 1000 Index</i>	-15.0%	4.3%	14.3%	15.2%	15.1%
<i>Russell 1000 Growth</i>	-36.2%	0.7%	12.0%	13.8%	14.2%
<b>U.S. EQUITY SMALL CAP</b>					
<b>Passive Managers</b>					
Deutsche Asset Mgmt. - S&P 1000	9.8%	12.8%	-	-	-
<i>S&amp;P 1000 Index</i>	9.5%	12.5%	-	-	-
<b>Small-Cap Value Managers</b>					
Capital Guardian	-22.4%	-	-	-	-
<i>Russell 2000 Index</i>	0.6%	5.3%	9.6%	13.5%	11.0%
<i>Russell 2000 Value Index</i>	30.8%	6.9%	13.4%	16.0%	13.2%
<b>Small-Cap Growth Managers</b>					
Dresdner RCM	-29.3%	-	-	-	-
<i>Russell 2000 Index</i>	0.6%	5.3%	9.6%	13.5%	11.0%
<i>Russell 2000 Growth Index</i>	-23.3%	2.2%	4.8%	10.2%	8.4%
<b>Combined Fund U.S. equities return</b>					
<b><i>Russell 3000 Index</i></b>	<b>-13.1%</b>	<b>4.1%</b>	<b>13.0%</b>	<b>14.5%</b>	<b>14.8%</b>
	<b>-13.9%</b>	<b>4.2%</b>	<b>13.8%</b>	<b>15.0%</b>	<b>14.7%</b>

## Permanent Fund's target asset allocation

U.S. Equities	37%	+/-7%
International Equities	16%	+/-5%
<b>Total Equities</b>	<b>53%</b>	<b>+/-5%</b>
U.S. Bonds	35%	+/-7%
Non-Dollar Bonds	2%	+/-2%
<b>Total Bonds</b>	<b>37%</b>	<b>+/-5%</b>
<b>Total Real Estate</b>	<b>10%</b>	<b>+/-2%</b>

# International stocks

Increasing correlations between the world's equity markets and the growing interdependence of global economies contributed to poor returns for the Fund's international stock portfolios.

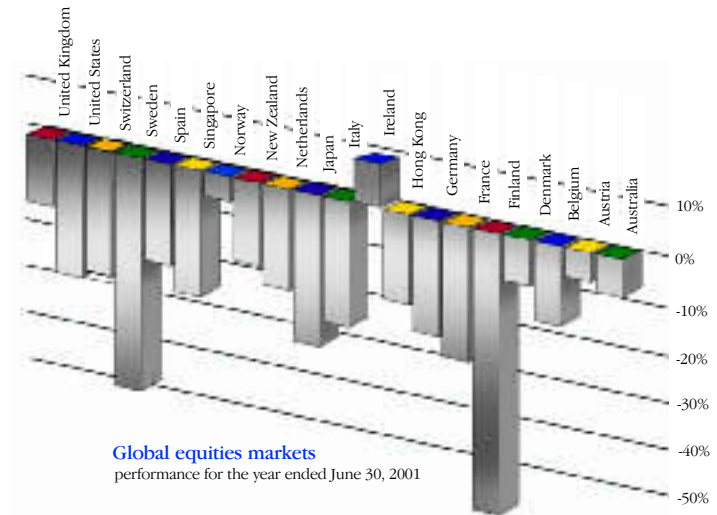
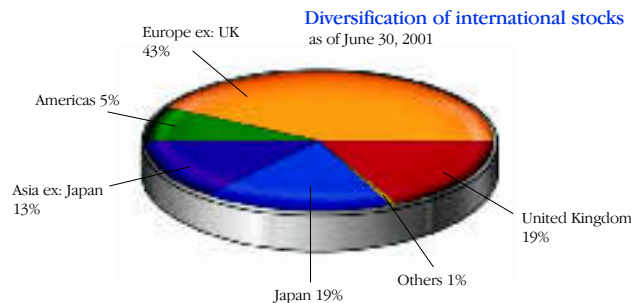
Developed and emerging markets both suffered as growth in U.S. GDP slowed, particularly in capital goods spending.

*"I was proud growing up in Alaska to be taught about the Fund and how our leaders took the initiative to establish something that can live on for many generations,"*

*Adrianna Coonrod, 25-year-old Alaskan.*

The best absolute and relative performing non-U.S. Fund manager was Brinson Partners. Although Brinson's MSCI EAFE (Morgan Stanley Capital International Europe, Australia and Far East stock index) portfolio lost 12.8 percent during the fiscal year, the firm outperformed its benchmark by 11.0 percent. Dresdner RCM Global Investors, because of its strong growth-style orientation, went from being one of last year's top performing non-U.S. EAFE managers to the APFC's worst this fiscal year, down 30.0 percent. The passively managed EAFE index portfolio returned -23.3 percent.

In the emerging markets, increasing investors' risk aversion contributed significantly to a 25.9 percent decline in the MSCI Emerging Markets Free Index. The Fund's emerging markets managers Schroder Investment Management and Capital Guardian Trust, who are benchmarked against the MSCI Emerging Markets Free Index, returned a disappointing -31.2 percent and -31.8 percent, respectively for the fiscal year, lagging the benchmark return of -25.9 percent.



## International equities managers' performance

FOR PERIODS ENDED JUNE 30, 2001

	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns
<b>EAFE Passive Manager</b>				
Deutsche Asset Mgmt. - EAFE	-23.3%	-1.0%	4.0%	-
<i>Morgan Stanley Capital International (MSCI) EAFE</i>	-23.8%	-1.3%	2.8%	6.4%
<b>EAFE Active Managers</b>				
Brinson Partners	-12.8%	2.3%	6.7%	-
Lazard Freres	-19.0%	-0.7%	7.0%	-
Dresdner RCM	-30.0%	-	-	-
Capital Guardian	-27.4%	7.6%	11.5%	13.4%
<i>MSCI EAFE (Europe, Australia and Far East)</i>	-23.8%	-1.3%	2.8%	6.4%
<b>Europe Manager</b>				
Clay Finlay	-18.8%	1.5%	13.8%	14.6%
<i>MSCI Europe Index</i>	-22.1%	-3.8%	9.6%	11.6%
<b>Pacific Manager</b>				
Schroders Capital Management - Pacific Rim	-17.8%	15.3%	-4.8%	5.5%
<i>Custom Pacific Basin target</i>	-21.6%	12.7%	-7.7%	3.6%
<b>Emerging Markets Managers</b>				
Capital Guardian	-31.8%	-	-	-
<i>MSCI Emerging Markets Free Index</i>	-25.9%	-	-	-
Schroders Capital Management	-31.2%	-	-	-
<i>MSCI Emerging Markets Free Custom Index</i>	-26.3%	-	-	-
<b>Combined Fund international equities return</b>	<b>-22.9%</b>	<b>1.3%</b>	<b>6.0%</b>	<b>8.2%</b>



As real estate in general experienced stronger-than-average returns in fiscal 2001, the Fund's real estate portfolio posted an overall return of 14.3 percent net of fees, compared to its blended benchmark of 14.1 percent.

It was the Fund's best performing asset class for the year and for the trailing three years.

These positive results in real estate reflect the value of asset diversification in a year marked by a significant downturn in the stock market. The portfolio was fully invested at 10.5 percent at fiscal year-end, marking the first time it has ever been above its asset allocation target of 10 percent of the total Fund.

Approximately two-thirds of the real estate portfolio consists of direct holdings of individual properties. The Fund's direct investments returned 11.4 percent net of fees, just short of the NCREIF Classic Index of 11.5 percent gross of fees.

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*"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."*

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Oral Freeman, former trustee.

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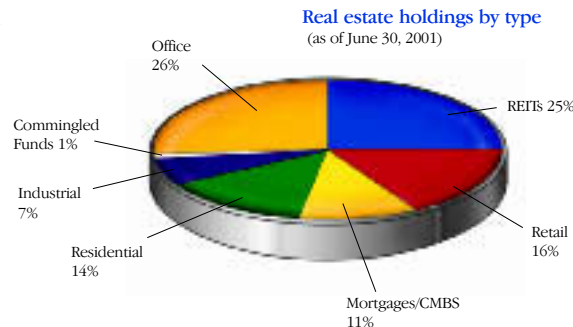
Another 25 percent of the Fund's real estate portfolio was invested in Real Estate Investment Trusts (REITs). The APFC's two REIT portfolios managed by AEW Capital Management continued to post above-average returns, with 23.8 and 24.2 percent. The returns from the equity securities component of the portfolio exceeded

the benchmark Morgan Stanley REIT Index return of 23.5 percent.

The remaining 11 percent of the Fund's real estate portfolio was invested in mortgages. Managed by Lend Lease, this is a fully invested, diversified portfolio of investment-grade commercial mortgage-backed securities (CMBS) and whole loans. Lend Lease returned 13.3 percent for the year compared to the Lehman Brothers Corporate Series A Index of 12.5 percent.

During the year, two direct investments – 919 North Michigan and Arboretum Lakes – and three commingled funds were sold, there were no new acquisitions, and partner's interests were purchased in two apartment properties, making those properties, the Island Club located on Brickel Key in downtown Miami and Treetops located in suburban Philadelphia, 100 percent wholly owned by the Alaska Permanent Fund.

The total portfolio closed the year with a market value of \$2.8 billion which included \$293 million in unrealized gains.



## Real estate managers' performance

PERIODS ENDED JUNE 30, 2001

	1-Year Return	3-Year Return	5-Year Return	8 1/2-Year Return
<b>Direct Investments</b>	<b>11.4%</b>	<b>11.7%</b>	<b>12.1%</b>	<b>9.5%</b>
AEW Capital Mgmt	10.6%	15.8%	20.9%	-
CB Richard Ellis	9.7%	9.3%	11.7%	-
Heitman Property Agg	33.0%	19.5%	16.8%	9.5%
Henderson Investors	12.2%	12.4%	12.5%	-
Kennedy Property Agg	8.7%	9.8%	10.1%	8.8%
L&B Property Agg	8.3%	9.8%	9.3%	6.9%
LaSalle Property Agg	17.3%	14.2%	11.7%	10.0%
Sentinel I & III*	8.5%	10.6%	11.0%	11.7%
<b>REITs</b>	<b>23.8%</b>	<b>11.9%</b>	<b>10.0%</b>	<b>7.6%</b>
AEW Capital - Focus	23.8%	-	-	-
AEW Capital	24.2%	10.6%	-	-
Simon Property Group	21.7%	12.0%	10.4%	7.9%
<b>Real Estate Mortgages</b>	<b>13.3%</b>	<b>-</b>	<b>-</b>	<b>-</b>
Lend Lease	13.3%	-	-	-
<b>Commingled</b>	<b>4.8%</b>	<b>7.6%</b>	<b>10.2%</b>	<b>8.7%</b>
<b>Combined Fund Real Estate</b>				
Net of Fee	14.3%	11.6%	11.9%	9.3%
Gross of Fee	14.8%	12.1%	12.4%	9.9%
<b>Benchmarks</b>				
NCREIF Classic Index	11.5%	12.6%	13.5%	10.4%
Morgan Stanley REIT	23.5%	5.4%	11.0%	-
LB Credit A	12.5%	5.6%	7.3%	7.3%
APFC Target	14.1%	10.4%	11.6%	9.3%



Fixed-income performance was quite good last year. The Fund's total domestic fixed income returned 11.4 percent versus 11.2 percent for its benchmark. That small increment of added value may seem modest, but on a base of \$10 billion in assets it's \$20 million of profit. Likewise, the Fund's international non-dollar assets return of 0.8 exceeded the benchmark's return of 0.4 percent.

Among the domestic bond managers, the portfolio managed by APFC staff provided the best returns, while Julius Baer topped the non-dollar manager rankings. Please refer to the accompanying table showing performance data for more details.

## Diversification makes sense

The difference in performance between bonds and stocks was so large last year that the Trustees were forced to rebalance in late March in order to stay within the Fund's asset allocation control bands. So, the Fund sold \$750 million of bonds, on which the Fund had earned a large profit, to buy stocks, which had fallen in price. If one never buys stocks when they are down in price, one never owns cheap stocks. And if one never sells bonds when prices are high, one always owns expensive bonds.

## Benchmark and procedural changes

There were a number of procedural changes made during the last year to better assure that the APFC staff is taking all reasonable steps to invest and monitor the Fund's investments in fixed income. The Board changed the benchmark for the internal domestic portfolio to the Lehman U.S. Aggregate from the Lehman U. S. Government/Credit index. This change adds mortgage-backed securities issued by major government-sponsored agencies such as Federal National Mortgage Association to our investment universe. Mortgage-

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*"The most important thing for my future is that the Fund is protected so it can continue to grow."*

Scott Bell, 15-year-old Alaskan.

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backed securities are a high quality bond sector, and so this change reduces some of the credit risk inherent in the previous benchmark.

The Board's guidelines for fixed-income investing were rewritten to reflect the new benchmark. At the same time, the Board decided to apply the same guidelines to our external domestic managers that we apply to the internally managed portfolio, to consolidate all fixed-income

resolutions into one simpler document. All of the changes were designed to expand and streamline oversight of internal and external managers.

## How the economy affected bonds

Last year was truly a tale of two economies. The first half of the fiscal year saw real economic growth in excess of a 4 percent annual rate, with growing capacity constraints, particularly in skilled labor.

As the year began, the Federal Reserve had just finished raising its target for the federal funds rate for the sixth time. They raised the rate a total of 1.75 percent in six steps beginning in mid-1999 to reach 6.50 percent. By the end of the fiscal year, it was the complete opposite. The Federal Reserve had just finished its sixth reduction in rates, having dropped them a full 2.50 percent in six steps beginning at the end of December.

By fiscal year-end, the economy had slowed dramatically, capital investment had dropped precipitously and profits were collapsing. All of these things were supportive of lower interest rates and higher bond prices, but also indicated a deterioration in credit quality of corporate bonds.

## Market highlights

There were several noteworthy bond market developments last year. The first is that virtually the entire decline in interest rates occurred in the bonds with shortest maturities. Thirty-year interest rates fell only one-eighth of one percent while one-year rates for treasury notes fell over two percentage points.

The second is that during the year 2000 and the first half of 2001, the publicly traded securities portion of the U. S. treasury market shrank in size. This helped treasuries to post excellent results during the period. Normally, this less-risky asset also provides a less robust return. The rapidly disappearing federal budget surplus may cause a reversal of this trend soon.

The third event of note concerns the significant transformation of the corporate bond sector. On the one hand, there has been remarkably strong foreign investor demand for U. S. corporate bonds. This has raised prices in the corporate bond market so far this calendar year. On the other hand, the sharp decline in profits and a reduced appetite for risk have reduced the prices for any corporate bonds perceived as likely to be down-graded by a major rating agency. The market prices of such bonds can decline precipitously. The only antidotes are strong research and widespread diversification of holdings.

## Fixed-income managers' performance

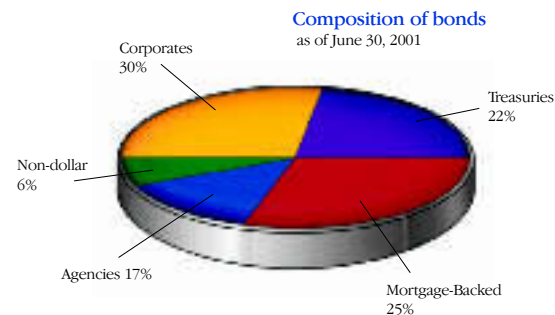
FOR PERIODS ENDED JUNE 30, 2001

### U.S. FIXED INCOME

	1-Year Return	3-Year Returns	5-Year Returns	10-Year Returns	17 1/2-Year Returns
APFC in-house	11.5%	5.5%	7.1%	7.7%	9.3%
Alaska Permanent Capital Mgmt.	9.3%	5.4%	-	-	-
Brinson Partners	10.5%	5.9%	-	-	-
Alliance Bernstein	10.9%	6.5%	-	-	-
<i>APFC in-house target</i>	<i>11.2%</i>	<i>6.0%</i>	<i>7.4%</i>	<i>7.9%</i>	<i>9.5%</i>
<i>Lehman Aggregate Index</i>	<i>11.2%</i>	<i>6.3%</i>	<i>7.5%</i>	<i>7.9%</i>	<i>9.6%</i>
<b>Combined Fund U.S. fixed-income return</b>	<b>11.4%</b>	<b>5.5%</b>	<b>7.1%</b>	<b>7.7%</b>	<b>9.3%</b>

### NON-U.S. FIXED INCOME

	1-Year Return	3-Year Returns
Julius Baer	1.7%	2.6%
Rogge Global Partners	0.0%	2.4%
<i>Salomon Non-US World Gov Bond Index (50% Hedged)</i>	<i>0.4%</i>	<i>3.1%</i>
<b>Combined Fund non-U.S. fixed-income return</b>	<b>0.8%</b>	<b>2.5%</b>



*“I’m sure that it’s obvious to everyone who is sitting ... around this table that one of the big problems with the Permanent Fund is that there’s no protection against inflation ...”*

*— Trustee Tom Williams, Minutes of the Board of Trustees’ first meeting, September 12, 1980*

The Board of Trustees this year put forth a proposal to solve that problem once and for all. The proposal, introduced in the legislature as Senate Joint Resolution 13 and House Joint Resolution 15, calls for constitutionally limiting the annual payout of Fund income to no more than 5 percent of the Fund’s five-year average market value.

The proposed constitutional amendment is designed to

- preserve the Fund’s purchasing power;
- maximize distributions of Fund income over the long-term; and
- limit spending to “real,” i.e., after inflation-proofing, Fund income.

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*“Trustees should always have a due regard for the contract with the public and the foundation of trust upon which this institution is built.”*

*The late Hugh Malone, former trustee.*

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The proposal would add a new constitutional limit on Permanent Fund spending. Principal would continue to be off-limits for spending, and appropriations from the earnings reserve would be limited to no more than 5 percent of the Fund’s average market value for the past five years.

### ***Why limit the payout to 5 percent?***

- 5 percent real rate of return is at the high end of what is actually achievable for the Permanent Fund;
- 5 percent is the maximum sustainable payout rate that still maintains the Fund’s real value;
- 5 percent allows greater distributions over time than a higher payout; and
- 5 percent is what the majority of endowments pay out.

The proposal does not impact the existing dividend program because the 5 percent limit is set higher than what is needed to accommodate the annual distribution which, under current law, pays out the equivalent of approximately 4 percent of the Fund’s average market value. All income not used in excess of the 5 percent payout limit would be retained in the Fund to offset inflation.

In the words of Board Chair Clark Gruening, “It’s been 25 years since we’ve asked the people of Alaska to make a constitutional change to the Fund, and it may be another 25 years or longer before another change is recommended. This proposal is of the utmost importance as we look at the long-term. It will keep Alaska’s Permanent Fund permanent.”

### **How SJR 13/HJR 15 works**

8.25%	Fund’s projected average annual return
<u>-5.00%</u>	Maximum sustainable payout from Fund
3.25%	Equals projected average annual inflation/ remains in the Fund as inflation-proofing

**Trustees' proposed constitutional amendment for complete and protected inflation — proofing**

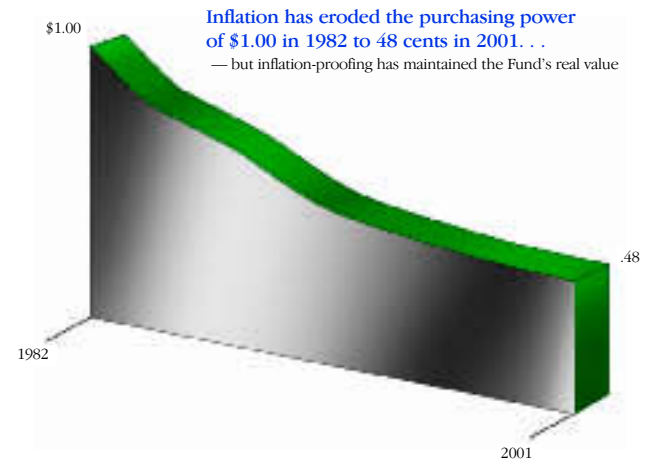
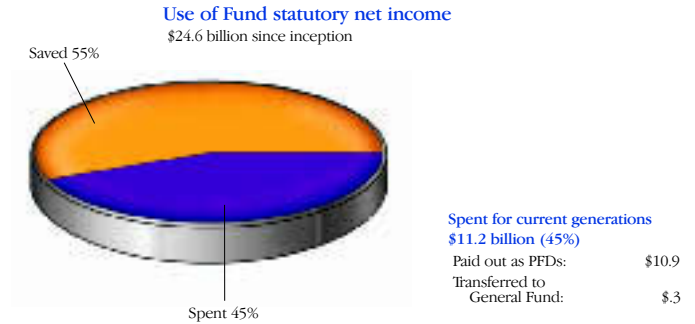
Section 15. Alaska Permanent Fund. (a) At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the permanent (GENERAL) fund [UNLESS OTHERWISE PROHIBITED BY LAW].

(b) For any fiscal year, appropriations from the permanent fund shall be limited to five percent of the average of the year-end market values of the permanent fund for the last five fiscal years, including the fiscal year just ended. No other appropriations from the permanent may be made.

**NOTE:** New language to be added is underlined; language removed is [CAPS IN BRACKETS].

**Saved for future generations**  
\$13.4 billion (55%)

Added to principal by inflation-proofing:	\$6.9
Added to principal by special appropriations:	\$4.1
Retained in Fund as undistributed income:	\$2.4



Since the APFC was established by statute in 1980, 37 Alaskans have been members of the Board of Trustees. The Board is comprised of six members, of whom four are public members appointed by the governor, and two, including the Commissioner of Revenue, are Cabinet members. The board members serve staggered four-year terms.

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*“My wish for the Permanent Fund on its 25th birthday is that it will grow even larger and stronger by its 50th birthday.”*

Austin Sture, 9-year-old Alaskan.

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This year, the 25th anniversary of the Fund, the Board consists of Chair Clark Gruening, who was a key participant in legislation establishing the Fund, Vice Chair Melphine Evans, Trustee Wilson Condon, who served on the original 1980 Board, and Trustees Jim Sampson, Bruce Botelho and Eric Wohlforth.

The APFC Board of Trustees sets policy for the Corporation and establishes the Fund’s asset allocation.

The APFC staff is led by Executive Director Robert D. Storer, who oversees the management and daily operations of the Fund. Allan Moore assumed the position of Chief Investment Officer in November, 2001. He is responsible for all investment functions and a staff of ten. Bob

Bartholomew is the Fund’s Chief Operating Officer. He is responsible for the APFC’s annual management plan and directs the activities of all support departments (Administration, Finance, Information Technology and Communications).

The APFC’s Finance Director is Chris Phillips, who oversees the financial reporting, accounting and supervision of the Finance Department. Marshal Kendziorek is Director of Information Technology, having joined the organization in March, 2001. Communications Director Jim Kelly leads the public information program, overseeing communication with the public, media and legislature, as well as all external print and electronic publications.



From left to right: Chair Clark S. Gruening, Vice Chair Melphine Evans, Trustee Wilson L. Condon, Trustee Jim Sampson, Trustee Eric E. Wohlforth, Trustee Bruce M. Botelho and Executive Director Robert D. Storer.



## 1976

In the General Election on November 2, Alaska voters approve a constitutional amendment establishing the Permanent Fund by a margin of 75,588 to 38,518.

## 1977

On February 28, the Permanent Fund receives its first deposit of dedicated oil revenues totaling \$734,000.

## 1978-79

Continuing debate concerning whether the Permanent Fund should be invested and managed as a public trust or as an economic development bank.

## 1980

The Alaska Legislature creates the Alaska Permanent Fund Corporation, adds \$900 million in surplus oil revenues to the Permanent Fund by special appropriation, and approves the first Permanent Fund Dividend program, which later was ruled unconstitutional by the Supreme Court.

## 1981

The Alaska Legislature approves a second special appropriation of surplus oil revenues to the Permanent Fund for \$1.8 billion.

## 1982

The Alaska Legislature, at the request of the Board of Trustees, enacts inflation-proofing to protect the Fund's purchasing power. The first Permanent Fund dividend check of \$1,000 is distributed. (Note: The legislature paid this first dividend, not with Permanent Fund income, but with surplus oil revenues.)

## 1983

The Permanent Fund makes its first investment in the stock market, and later that year, in equity real estate.

## 1984

Permanent Fund assets reach \$5 billion.

## 1985

The Permanent Fund initiates the "Learning is Permanent" education program.

## 1986

The Alaska Legislature approves the Fund's third special appropriation. This \$1.26 billion addition to Fund principal is transferred from undistributed Fund income.

## 1987

In its first decade, the Alaska Permanent Fund has grown larger than any endowment or private Foundation in the U.S.

## 1988

The Permanent Fund, with an above-national-average allocation to bonds, ranks in the top 9 percent of all public funds in the United States as the stock market crashes in the preceding October.

## 1989

Permanent Fund assets reach \$10 billion.

## 1990

The Permanent Fund begins to invest in stock and bond markets outside the United States.

## 1991

The Permanent Fund's dedicated share of state oil revenues reaches \$435 million, the largest single-year amount in its history.

## 1992

The Permanent Fund dividend distributed to Alaskans totals \$488 million, or \$915.84 per person.

## 1993

Permanent Fund assets reach \$15 billion.

## 1994

Dedicated oil revenues received by the Fund since inception reach \$5 billion.

## 1995

The Permanent Fund's investments in stocks reach \$7 billion.

## 1996

Fund assets reach \$24 billion.

## 1997

The Fund combined all its custody and safekeeping services under one global contractor, Bank of New York, the nation's oldest bank.

## 1998

For the first time, Fund earnings exceed state oil revenues as the Fund earns a record \$2.6 billion and reaches \$25 billion in assets.

## 1999

The Alaska Legislature grants increased investment flexibility to the Board of Trustees, including, for the first time, authorization to invest up to 5 percent of the Fund in accordance solely with the Prudent Investor Rule rather than the statutory list of investments.

## 2000

With markets returning to higher, more traditional levels of volatility, Trustees further diversify the Fund's investment portfolio and increase the equity allocation to 53 percent.

## 2001

At the request of the Board of Trustees, the Alaska Legislature introduces House Joint Resolution 15 and Senate Joint Resolution 13, which would place before Alaska voters a constitutional amendment to provide complete and permanently protected inflation-proofing to the Fund.

The Alaska Permanent Fund owes much of its success to the efforts of many dedicated Alaskans. This group includes all the Trustees, past and present who have worked diligently as fiduciaries in maintaining the safety of principal and maximizing income within prudent risk parameters. To those who have committed their time, expertise and energy to this challenge, we pay tribute.

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*“The Permanent Fund is not a private business. It is not a pension fund. There is no other fund like it on the face of the earth ... Public confidence is the very backbone and lifeblood of the Permanent Fund Corporation.”*

March, 1991, Trustee Oral Freeman.

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*“Twenty-five percent of the mineral bounty has been, in one form or another, parked in the Permanent Fund. That’s a huge commitment by the people of Alaska to the future.”*

August, 1990, Trustee Hugh Malone.

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On the 25th anniversary of the Fund, we’d like to provide a special acknowledgement of those Trustees who served the Fund and have passed away. These include Hugh Malone, a former legislator and House Speaker from the Kenai Peninsula, who, more than anyone, can properly be called the father of the Permanent Fund. Also included are long-time Alaska bankers Elmer Rasmuson and Arnold Espe, former Commissioner of Transportation and Public Facilities Robert Ward, Anchorage CPA and business leader Clyde Sherwood and former Fairbanks lawmaker Charlie Parr.

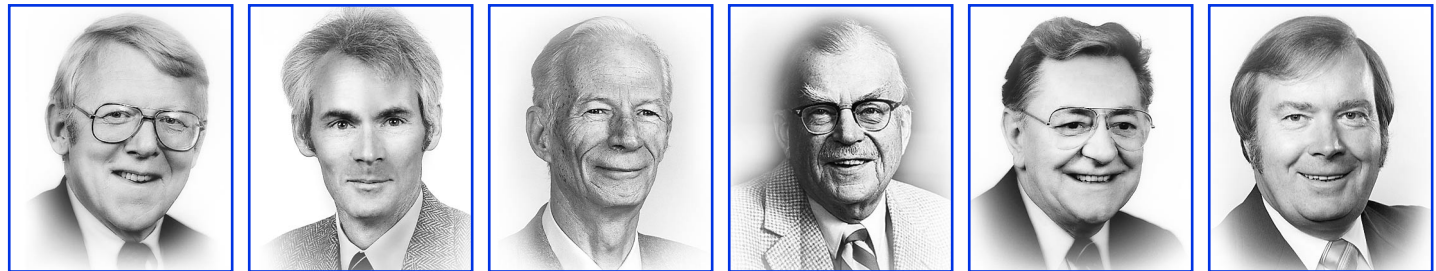
These Trustees are each in their own way responsible for part of the foundation upon which the Fund was firmly constructed. Their hard work and dedication, their foresight and commitment will not be forgotten.

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*“I think we might well preserve the essential objective, which is safety ... and offset the ravages of inflation, which I just think is prudent for anybody managing money to consider.”*

January, 1981, Trustee Elmer Rasmuson.

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From left to right: Arnold Espe, Hugh Malone, Charlie Parr, Elmer Rasmuson, Clyde Sherwood and Robert Ward

Providing benefits to the people of Alaska has always been a critical part of the APFC's mission. Maintaining safety of principal and producing a competitive rate of return are the primary ways the mission is accomplished, but there are other means as well. One is the APFC's Alaska college student internship program.

The intern program, which began in 1988 as a way for the Fund to help young Alaskans gain entry into the field of finance and investing, is a cooperative effort between the APFC and its various investment managers. Students are accepted to intern either directly with the APFC or with one of the managers. In fiscal 2001, there were 18 participating firms and 14 Alaska students were hired.

Designed to serve as a career springboard for Alaska college students, the program has a high success rate of permanent placement. One of the APFC's managers, Kennedy Associates of Seattle, has permanently hired a total of seven Permanent Fund interns.

In addition to investing in our young Alaskans, the APFC provides opportunities for established Alaska money managers. There are currently two such Alaska businesses serving as Permanent Fund investment managers.

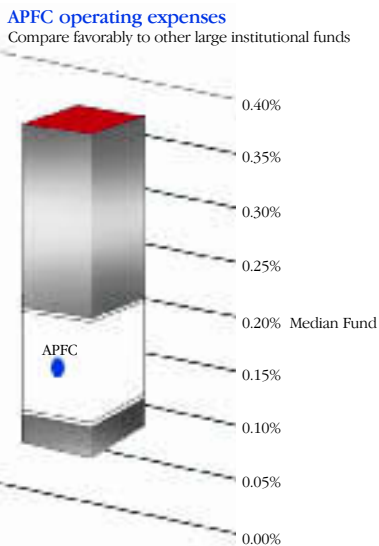
Another means by which the Fund contributes to the Alaska economy is the Alaska brokerage program, through which nine Alaska businesses are able to share in the commissions that result from the Fund's stock trades.

Lastly, the APFC manages three other funds besides the Permanent Fund. See the financial statements footnote 17 for details.

APFC FY 01 total operating expenses were \$39.5 million, or .15% of the Fund's average market value. That equates to 15 cents for every \$100 of Fund value — compared to 20 cents for the median large (10 billion plus) institutional fund.  
Source: APFC and Callan Associates, Inc.

Management costs for each APFC portfolio are well-below median.

Operating expenses by asset class				
	U.S. Stocks	Non-U.S. Stocks	U.S. Bonds	Non-U.S. Bonds
APFC	.19%	.27%	.03%	.22%



Olivia Mendoza of UAS, an intern this summer with Kennedy Associates in Seattle.

The Board of Trustees  
Alaska Permanent Fund Corporation  
(A Component Unit of the State of Alaska):

We have audited the accompanying statements of assets, liabilities, principal and earnings reserve of the Alaska Permanent Fund as of June 30, 2001 and 2000, and the related statements of revenues and expenses, changes in principal and earnings reserve, and cash flows for the years then ended. These financial statements are the responsibility of the Alaska Permanent Fund Corporation's (a Component Unit of the State of Alaska) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

Anchorage, Alaska  
August 10, 2001

# Statements of assets, liabilities, principal and earnings reserve

June 30,

2001

2000

## Assets

Cash and temporary investments	\$ 544,014,000	747,739,000
Receivables, prepaid expenses and other assets	365,158,000	496,173,000
Investments		
Marketable debt securities	10,005,722,000	9,723,751,000
Preferred and common stock	12,617,711,000	14,663,776,000
Real estate	2,504,466,000	2,326,403,000
Alaska certificates of deposit	147,423,000	152,318,000
Total investments	<u>25,275,322,000</u>	<u>26,866,248,000</u>
<b>Total assets</b>	<b><u>\$ 26,184,494,000</u></b>	<b><u>28,110,160,000</u></b>

## Liabilities

Accounts payable	\$ 253,160,000	419,018,000
Income distributable to the State of Alaska	1,116,444,000	1,175,231,000
<b>Total liabilities</b>	<b><u>1,369,604,000</u></b>	<b><u>1,594,249,000</u></b>

## Principal and earnings reserve

Principal	21,047,579,000	20,014,648,000
Earnings reserve		
Unrealized earnings reserve	1,383,576,000	3,528,804,000
Remaining earnings reserve	2,383,735,000	2,972,459,000
Total earnings reserve	<u>3,767,311,000</u>	<u>6,501,263,000</u>
<b>Total principal and earnings reserve</b>	<b><u>24,814,890,000</u></b>	<b><u>26,515,911,000</u></b>
<b>Total liabilities, principal and earnings reserve</b>	<b><u>\$ 26,184,494,000</u></b>	<b><u>28,110,160,000</u></b>

# Statements of revenues and expenses

Years ended June 30,

2001

2000

## Revenues

Investment income —

Interest	\$ 710,312,000	687,158,000
Dividends	155,551,000	166,816,000
Real estate and other income	225,215,000	195,570,000
Total investment income	<u>1,091,078,000</u>	<u>1,049,544,000</u>

Net increase (decrease) in the fair value of investments —

Marketable debt securities	359,608,000	(334,289,000)
Preferred and common stock	(2,486,857,000)	1,547,321,000
Real estate	119,877,000	29,186,000
Foreign exchange contracts	37,172,000	2,296,000
Currency	(5,280,000)	(3,825,000)
Total gains (losses)	<u>(1,975,480,000)</u>	<u>1,240,689,000</u>

### Total revenues

**(884,402,000)** 2,290,233,000

## Expenses

Operating expenses (39,490,000) (41,457,000)

### Net income (loss)

**\$ (923,892,000)** 2,248,776,000

Adjustments to bring net income (loss) to statutory net income — settlement earnings and unrealized (gains) losses

2,122,997,000 (26,613,000)

### Statutory net income

**\$ 1,199,105,000** 2,222,163,000

# Statements of changes in principal and earnings reserve

Years ended June 30,

	2001	2000
<b>Principal</b>		
Balance, beginning of year	\$ 20,014,648,000	19,000,909,000
Dedicated state revenues	339,315,000	310,488,000
State transfer from earnings reserve	—	250,000,000
Inflation-proofing	685,929,000	422,920,000
Settlement earnings	7,687,000	30,331,000
<b>Balance, end of year</b>	<b>\$ 21,047,579,000</b>	<b>20,014,648,000</b>
<b>Earnings reserve</b>		
Balance, beginning of year	\$ 6,501,263,000	6,131,203,000
Appropriation to other state agencies	(3,843,000)	(3,014,000)
State transfer from earnings reserve	—	(250,000,000)
Inflation-proofing	(685,929,000)	(422,920,000)
Settlement earnings	(7,687,000)	(30,331,000)
Dividends	(1,112,601,000)	(1,172,451,000)
Net income (loss)	(923,892,000)	2,248,776,000
<b>Balance, end of year</b>	<b>\$ 3,767,311,000</b>	<b>6,501,263,000</b>
<b>Total</b>		
Balance, beginning of year	\$ 26,515,911,000	25,132,112,000
Dedicated state revenues	339,315,000	310,488,000
Appropriation to other state agencies	(3,843,000)	(3,014,000)
Dividends	(1,112,601,000)	(1,172,451,000)
Net income (loss)	(923,892,000)	2,248,776,000
<b>Balance, end of year</b>	<b>\$ 24,814,890,000</b>	<b>26,515,911,000</b>
<b>Earnings reserve components</b>		
Unrealized earnings reserve	\$ 1,383,576,000	3,528,804,000
Remaining earnings reserve	2,383,735,000	2,972,459,000
<b>Total earnings reserve</b>	<b>\$ 3,767,311,000</b>	<b>6,501,263,000</b>

Years ended June 30,

2001

2000

**Cash flows from investments**

Net (purchases), sales and maturities of investments —

Marketable debt securities

\$ 23,805,000

675,380,000

Preferred and common stock

(506,180,000)

(1,505,015,000)

Real estate

(54,310,000)

(283,401,000)

Alaska certificates of deposit

4,896,000

(9,903,000)

Net change in unsettled trades

(53,186,000)

38,051,000

Total net (purchases), sales and maturities

(584,975,000)

(1,084,888,000)

Investment income received

1,288,180,000

2,302,054,000

Undistributed real estate income

(34,697,000)

(25,679,000)

**Net cash provided by investments**

**668,508,000**

1,191,487,000

**Cash flows from non-capital financing**

Contributions from the state

345,382,000

282,385,000

Income distributions

(1,175,231,000)

(1,048,225,000)

**Net cash used by non-capital financing**

**(829,849,000)**

(765,840,000)

**Cash flows from operations**

(42,384,000)

(39,089,000)

Net increase (decrease) in cash and temporary investments

(203,725,000)

386,558,000

Cash and temporary investments at beginning of year

747,739,000

361,181,000

**Cash and temporary investments at end of year**

**\$ 544,014,000**

747,739,000

**Reconciliation of net income to net cash used by operations**

Net income (loss)

\$ (923,892,000)

2,248,776,000

Adjustments to reconcile net income (loss) to net cash used by operations —

Investment (earnings) loss

884,402,000

(2,290,233,000)

Net change in prepaid expenses and accrued liabilities

(2,894,000)

2,368,000

**Net cash used by operations**

**\$ (42,384,000)**

(39,089,000)

June 30, 2001 and 2000

### **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 Alaska State Legislature (the "Legislature") created the Alaska Permanent Fund Corporation (the "Corporation"), a component unit of the State that is administered by a board of trustees (the "Trustees"), to manage the investments of the Fund. By statute, (i) a portion of annual earnings is transferred to the State's dividend fund, and (ii) a portion of the earnings reserve account sufficient to offset the impact of inflation is transferred to the principal of the Fund. The balance of the Fund's earnings is held in the earnings reserve account and is subject to appropriation by the Legislature.

The accounting and reporting policies of the Fund conform to generally accepted accounting principles. The Fund follows the accrual method of accounting. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenue and expenses for the period. Actual results could differ from those estimates. The more significant accounting and reporting policies applied in the preparation of the accompanying financial statements are discussed in note 2.

### **2. Significant Accounting Policies**

As allowed by the Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Corporation has elected not to apply Statements and Interpretations issued by the Financial Accounting Standards Board after November 30, 1989.

#### **Contributions**

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

#### **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 earnings from contributions made in the North Slope royalty case (*State v. Amerada Hess, et al.*) settlements and unrealized gains and losses, be made available for the payment of dividends and other appropriations each year.

### **Forward Exchange Contracts**

The Fund is party to a variety of forward contracts in its trading activities and in the management of its foreign exchange rate exposure. These contracts are speculative in nature and the contract amounts do not appear on the balance sheet. Realized and unrealized gains and losses are currently included in net income, and are determined on the maturity date of the contracts. Unrealized gains and losses are calculated using foreign currency forward rates at the balance sheet date.

### **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. The inflation rates were 3.37% and 2.19% and applied to the years ended June 30, 2001 and 2000, respectively.

### **Interest Income**

Interest income is accrued monthly as earned.

### **Income Taxes**

As integral parts of the State, the Fund and the Corporation are not subject to Federal or State income taxes. In addition, the Internal Revenue Code provides that gross income for tax purposes does not include income accruing to a state or any subdivision thereof, which is derived from the exercise of any essential governmental function. The Fund and the Corporation perform an essential governmental function and are therefore exempt from Federal income taxes under that provision, as well.

### **Investments**

The Fund's marketable securities, excluding direct real estate investments, are reported at fair value in the financial statements. Unrealized gains and losses are reported as components of net income. Fair values are obtained from independent sources for marketable debt and equity securities and real estate investment trusts.

Real estate commingled funds, direct real estate investments and direct commercial mortgages are carried at historical cost plus the Fund's share of undistributed earnings. If, in the opinion of management, a permanent impairment of value has occurred, the investment is written down to fair market value by a charge to operations.

### **Securities Transactions**

Securities transactions are recorded on the trade date that securities are purchased or sold.

### **Statement of Cash Flows**

The Fund considers all highly liquid short-term investments purchased with an original maturity of one year or less to be cash equivalents for purposes of the statement of cash flows.

### 3. Cash and Temporary Investments

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

	<u>2001</u>	<u>2000</u>
Cash <sup>(a)</sup>	\$ 111,649,000	99,981,000
U.S. agencies <sup>(b)</sup>	60,839,000	212,719,000
Commercial paper <sup>(c)</sup>	371,526,000	435,039,000
<b>Total Cash and Temporary Investments</b>	<b>\$ 544,014,000</b>	<b>747,739,000</b>

- a) *Share ownership in a money market fund, payable on demand.  
Collateralized by underlying securities held by the fund in the name of the custodian.*
- b) *Debt obligation guaranteed by the U.S. government.*
- c) *Commercial paper rated investment grade.*

### 4. Receivables, Prepaid Expenses and Other Assets

Receivables, prepaid expenses and other assets at June 30 are as follows:

	<u>2001</u>	<u>2000</u>
Interest receivable	\$ 144,902,000	173,928,000
Dividends receivable	13,973,000	13,761,000
Sales receivable	154,712,000	255,660,000
Foreign exchange contracts	8,152,000	3,337,000
Contributions receivable	43,419,000	49,487,000
<b>Total Receivables, Prepaid Expenses and Other Assets</b>	<b>\$ 365,158,000</b>	<b>496,173,000</b>

## 5. Marketable Debt Securities

The Corporation is authorized by statute to invest Fund assets in (i) corporate bonds rated investment grade; (ii) obligations of the United States Treasury, its agencies and instrumentalities; and (iii) foreign obligations of comparable quality. 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:

	Cost	Market	Unrealized Gains/(Losses)
<b>2001</b>			
Treasury notes/bonds	\$ 2,266,045,000	2,214,159,000	(51,886,000)
Mortgage-backed securities	2,516,102,000	2,521,856,000	5,754,000
Other federal agencies	1,657,298,000	1,708,042,000	50,744,000
Corporate bonds	2,954,476,000	3,005,088,000	50,612,000
Non-domestic bonds	587,719,000	556,577,000	(31,142,000)
<b>Total Marketable Debt Securities</b>	<b>\$ 9,981,640,000</b>	<b>10,005,722,000</b>	<b>24,082,000</b>
<b>2000</b>			
Treasury notes/bonds	\$ 3,234,534,000	3,191,033,000	(43,501,000)
Mortgage-backed securities	811,435,000	786,199,000	(25,236,000)
Other federal agencies	1,675,307,000	1,650,972,000	(24,335,000)
Corporate bonds	3,751,391,000	3,587,763,000	(163,628,000)
Non-domestic bonds	532,778,000	507,784,000	(24,994,000)
<b>Total Marketable Debt Securities</b>	<b>\$ 10,005,445,000</b>	<b>9,723,751,000</b>	<b>(281,694,000)</b>

**6. Preferred and Common Stock**

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

The Corporation may invest Fund assets in (i) equity securities up to 55% of total Fund investments, and (ii) other investments, which meet the test of prudence, including those currently authorized by law, up to 5% of total Fund investments.

Preferred and common stocks at June 30 are summarized as follows:

	Cost	Market	Unrealized Gains/(Losses)
<b>2001</b>			
Domestic	\$ 7,608,189,000	8,924,945,000	1,316,756,000
Non-domestic	3,752,908,000	3,692,766,000	(60,142,000)
<b>Total Preferred and Common Stock</b>	<b>\$ 11,361,097,000</b>	<b>12,617,711,000</b>	<b>1,256,614,000</b>
<b>2000</b>			
Domestic	\$ 7,469,847,000	10,297,594,000	2,827,747,000
Non-domestic	3,385,069,000	4,366,182,000	981,113,000
Total Preferred and Common Stock	\$ 10,854,916,000	14,663,776,000	3,808,860,000

## ***7. Real Estate***

The Corporation is authorized by statute to invest Fund assets in real estate improved by substantially rented buildings located in the United States. Real estate investments may take the form of direct equity interests, real estate title-holding entities, real estate investment trusts, real estate operating companies or other entities whose assets consist primarily of real property, debt obligations secured by real property or similar entities. 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 management firms. Real estate investment trusts and commercial mortgage backed securities are held by custodian banks in the name of the Corporation on behalf of the Fund.

The carrying value of real estate at June 30 was \$2,504,466,000 in 2001 and \$2,326,403,000 in 2000. Carrying value consists of the equity value of direct real estate investments, commingled funds and commercial mortgages and the market value of real estate investment trusts and commercial mortgage backed securities.

In the ordinary course of business, the Corporation has made commitments related to real estate investments. In the opinion of management, meeting these commitments will not have a material adverse effect on the Corporation's financial position, results of operation or liquidity.

Real estate investments at June 30 are summarized as follows:

	Book Value	Market	Unrealized Gains/(Losses)
<b>2001</b>			
Commingled funds	\$ 4,783,000	8,984,000	4,201,000
Real estate investment trusts	559,071,000	651,590,000	92,519,000
Commerical mortgage backed securities	221,026,000	223,773,000	2,747,000
Commercial mortgages	72,035,000	72,035,000	—
Alaska residential mortgages	117,000	117,000	—
Direct investments -			
Retail	398,817,000	430,200,000	31,383,000
Office	625,644,000	725,416,000	99,772,000
Industrial	184,223,000	197,485,000	13,262,000
Residential	343,484,000	388,148,000	44,664,000
<b>Total Real Estate</b>	<b>\$2,409,200,000</b>	<b>2,697,748,000</b>	<b>288,548,000</b>
<b>2000</b>			
Commingled funds	\$ 12,338,000	18,236,000	5,898,000
Real estate investment trusts	510,621,000	520,799,000	10,178,000
Commerical mortgage backed securities	225,937,000	221,971,000	(3,966,000)
Commerical mortgages	65,644,000	64,278,000	(1,366,000)
Alaska residential mortgages	198,000	198,000	—
Direct investments -			
Retail	385,377,000	385,166,000	(211,000)
Office	636,194,000	753,364,000	117,170,000
Industrial	172,459,000	177,166,000	4,707,000
Residential	311,423,000	329,820,000	18,397,000
Total Real Estate	\$ 2,320,191,000	2,470,998,000	150,807,000

### ***8. 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. Letters of credit from the Federal Home Loan Bank secure these investments. The market value of these certificates approximates cost.

### ***9. Accounts Payable***

Accounts payable at June 30 are summarized as follows:

	<u>2001</u>	<u>2000</u>
Accrued liabilities	\$ 9,505,000	12,398,000
Service fees payable	1,754,000	3,275,000
Foreign exchange contracts	740,000	8,051,000
Securities purchased	241,161,000	395,294,000
<b>Total Accounts Payable</b>	<b>\$ 253,160,000</b>	419,018,000

**10. Income Distributable to The State of Alaska**

The Legislature appropriated a portion of the Fund's statutory net income for various purposes, including the payment of dividends to qualified residents of the State of Alaska. In addition, the Legislature appropriated a portion of the Fund's earnings reserves to fund various other agency activities. Income distributable to the State at June 30 is summarized as follows:

	<u>2001</u>	<u>2000</u>
Dividends	\$ 1,082,300,000	1,142,148,000
Appropriation to the Departments of -		
Corrections	3,615,000	2,929,000
Health and Social Services	16,147,000	17,518,000
Revenue	5,099,000	4,985,000
Public Safety	5,376,000	4,871,000
Legislature	64,000	—
Total to Dividend Fund	1,112,601,000	1,172,451,000
Other agencies	3,843,000	2,780,000
<b>Total Income Distributable</b>	<b>\$ 1,116,444,000</b>	<b>1,175,231,000</b>

**11. Principal**

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

	<u>2001</u>	<u>2000</u>
Dedicated State revenues	\$ 7,070,741,000	6,731,426,000
Appropriations from the State	6,885,906,000	6,885,906,000
Inflation-proofing	6,929,350,000	6,243,421,000
Settlement earnings	161,582,000	153,895,000
<b>Total Principal</b>	<b>\$ 21,047,579,000</b>	<b>20,014,648,000</b>

On June 30, 2000, a \$250,000,000 transfer was made from earnings reserve to the principal of the Fund. The transfer was authorized by the Legislature through House Bill 18, *“An Act making a special appropriation in an amount not to exceed \$250,000,000 from the earnings reserve account to the principal of the permanent fund; and providing for an effective date.”*

The Fund received dedicated State revenues from North Slope royalty case (*State v. Amerada Hess, et al.*) settlements. By statute, realized earnings from these settlements are to be treated in the same manner as other Fund income, except that these earnings on settlements are excluded from the dividend calculation. Total realized earnings on settlement principal were \$22,230,000 in 2001 and \$38,638,000 in 2000. Of these amounts, \$14,543,000 and \$8,307,000 during 2001 and 2000 respectively, were added to inflation-proofing. The remaining earnings of \$7,687,000 and \$30,331,000 during 2001 and 2000 respectively, have been added to Fund principal in accordance with law. Accumulated settlement related activity, which is included in the principal balance of the Fund at June 30, is shown as follows:

	<u>2001</u>	<u>2000</u>
Settlement -		
Principal	\$ 229,242,000	215,655,000
Earnings	161,582,000	153,895,000
Inflation-proofing	62,948,000	48,405,000
<b>Total Settlement Principal</b>	<b>\$ 453,772,000</b>	417,955,000

**12. Investment Income by Source**

Investment income during the years ended June 30 is summarized as follows:

	<u>2001</u>	<u>2000</u>
<b>Interest</b>		
Marketable debt securities	\$ 656,442,000	672,348,000
Alaska certificates of deposit	7,633,000	8,189,000
Cash and other interest	46,237,000	6,621,000
<b>Total Interest</b>	<b>\$710,312,000</b>	687,158,000
<b>Dividends</b>		
Domestic preferred and common stock	\$ 89,212,000	100,122,000
Non-domestic preferred and common stock	66,339,000	66,694,000
<b>Total Dividends</b>	<b>\$155,551,000</b>	166,816,000
<b>Real Estate and Other Income</b>		
Real estate interest	\$ 22,297,000	21,568,000
Real estate dividends	39,130,000	34,086,000
Other real estate income	150,226,000	129,963,000
Loaned security and other income	13,562,000	9,953,000
<b>Total Real Estate and Other Income</b>	<b>\$225,215,000</b>	195,570,000

Under Statute 37.13.120(f), the Corporation is authorized to enter into securities lending transactions. The Corporation, through an agreement with the Bank of New York (the "Bank"), lends marketable debt and equity securities. These loans are fully collateralized at not less than one hundred two percent (102%) of the market value of the loaned securities for U.S. securities and one hundred five percent (105%) of market value for non-U.S. securities. The Corporation is fully indemnified by the Bank against any loss resulting from a default on a loaned security. The Corporation is able to sell any securities out on loan. The Bank may sell collateral upon borrower default. The Bank receives a fee based on earnings from securities lending. At June 30, 2001, there was \$3,670,925,000 in loaned securities outstanding. During the years ended June 30, 2001 and 2000, there were no losses incurred as a result of securities lending transactions.

### ***13. Net Realized Losses On Currency***

Net realized losses on foreign currency inventory were \$5,280,000 and \$3,825,000 for the years ended June 30, 2001 and 2000, respectively. Currency gains and losses resulting from the purchase and sale of securities are included as part of the net increase or decrease in the fair value of the traded securities.

### ***14. Foreign Exchange Contracts and Off-Balance Sheet Risk***

The Corporation entered into foreign currency forward exchange contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing cash positions in these currencies. The maturity periods for these contracts ranged from one to five months. At June 30, 2001, the Corporation had net unrealized gains with respect to such contracts.

The counterparties to the foreign currency forward contracts consisted of a diversified group of financial institutions. The Corporation is exposed to credit risk to the extent of non-performance by these counterparties; however, the Corporation considers the risk of default to be remote. The Corporation's market risk is limited to the difference between contractual rates and forward rates at the end of the fiscal year.

The Corporation had net sale contracts outstanding totaling \$8,053,000 and \$263,447,000 for the years ended June 30, 2001 and 2000, respectively. The market value of these contracts, using the forward rate at June 30, 2001 and 2000, was \$506,000 and \$268,228,000, respectively. This resulted in net unrealized gains of \$12,328,000 for the year ended June 30, 2001 and net unrealized losses of \$11,690,000 for the year ended June 30, 2000, including prior year reversals in each year. The Fund had realized gains amounting to \$24,844,000 and \$13,986,000 for the years ended June 30, 2001 and 2000, respectively.

**15. Operating Expenses**

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

	<b>2001</b>	2000
Salaries and benefits	\$ 2,687,000	2,810,000
Travel	235,000	245,000
Communications	978,000	864,000
Custody and safekeeping fees	1,701,000	2,047,000
Consulting fees	369,000	595,000
Investment management fees	32,135,000	32,784,000
Legal and audit fees	278,000	433,000
Public information and subscriptions	245,000	231,000
Rent	154,000	308,000
Property and equipment	203,000	340,000
Other expenses	505,000	800,000
<b>Total Operating Expenses</b>	<b>\$ 39,490,000</b>	41,457,000

**16. Pension Plan**

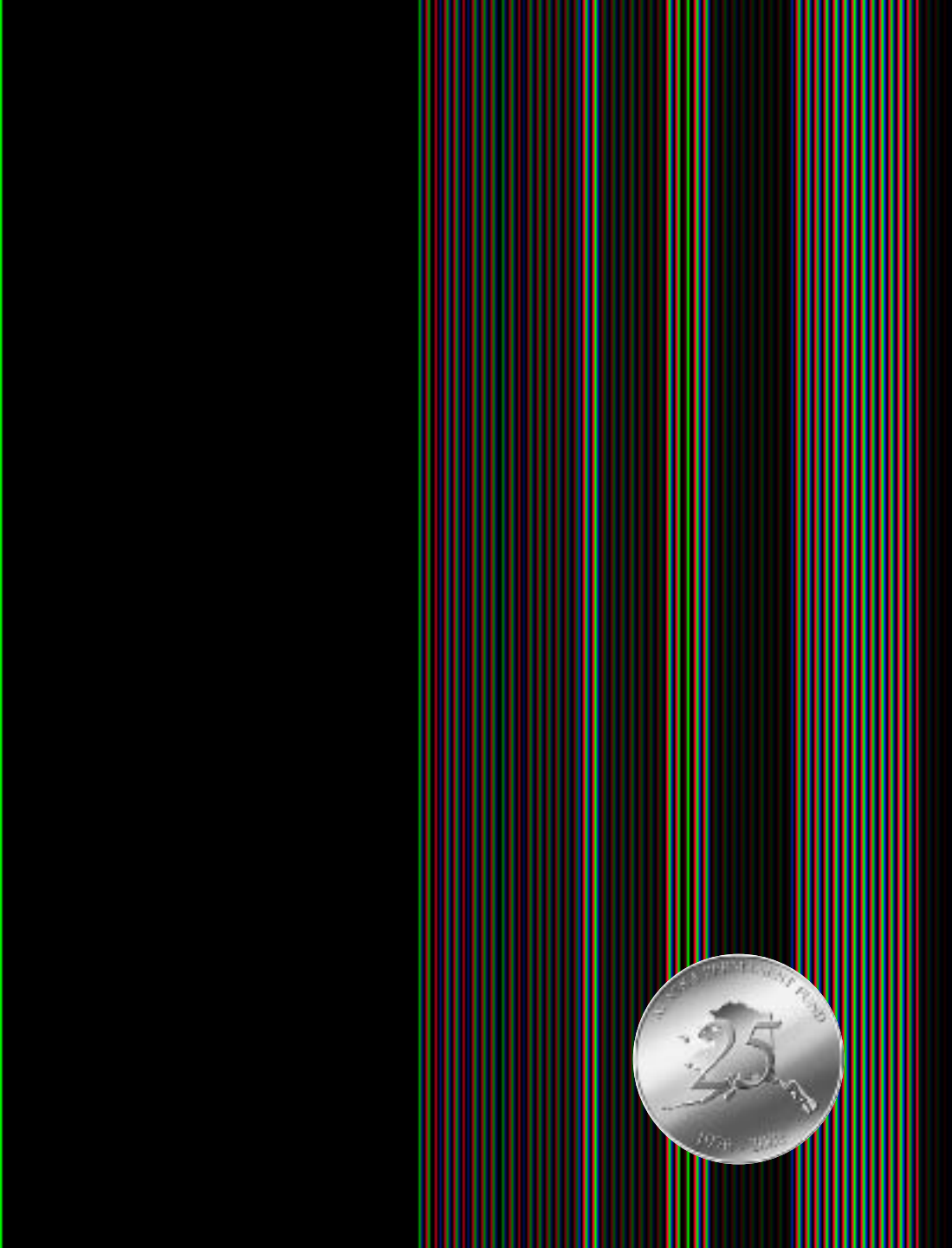
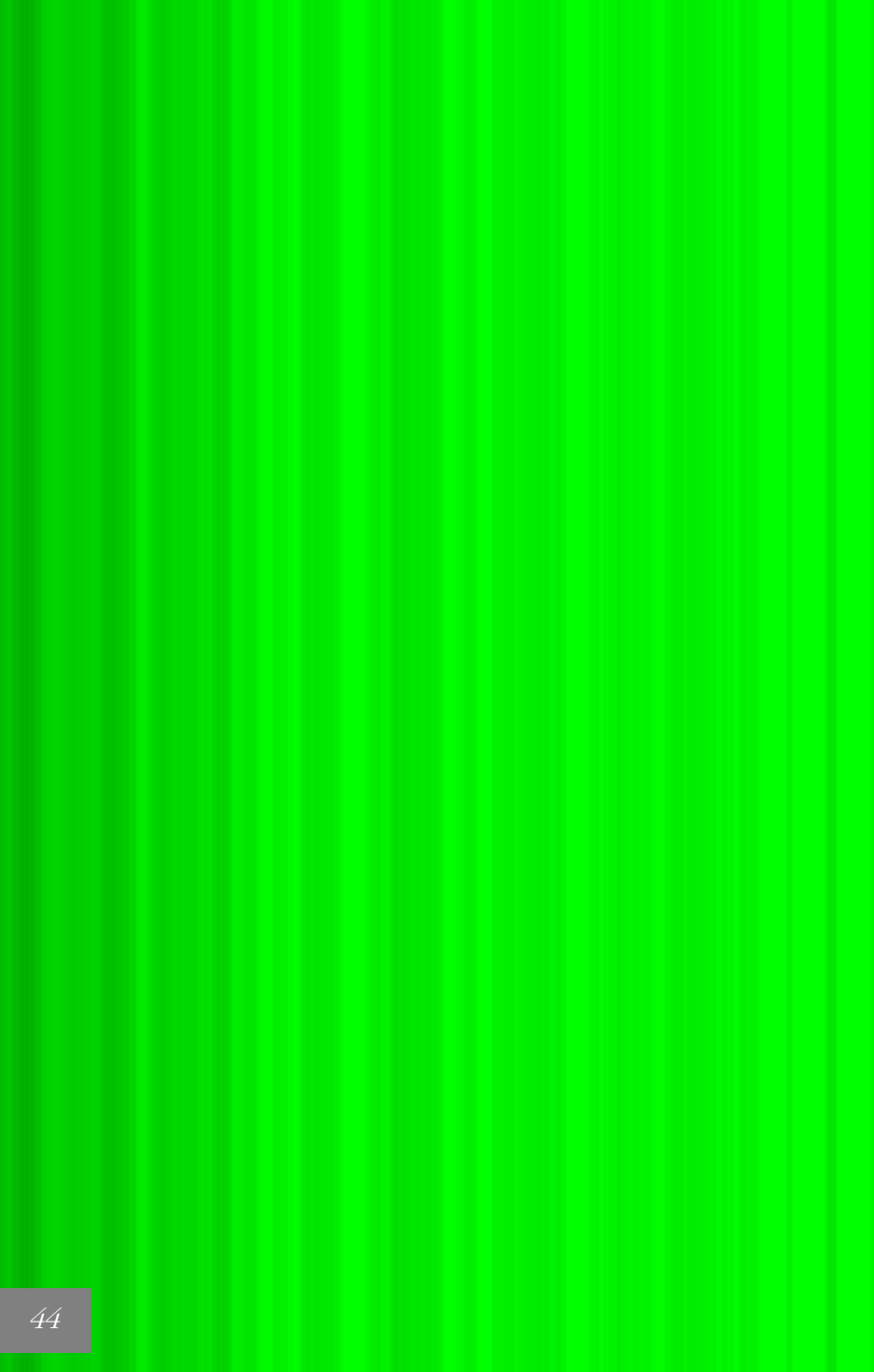
All full-time employees of the Corporation participate in the State of Alaska Public Employees Retirement System (PERS), a multiple employer public employee retirement system. Total salaries and benefits for employees covered by PERS for the years ended June 30, 2001 and 2000 amounted to \$2,687,000 and \$2,810,000, respectively.

Corporation employees are required to contribute 6.13% of their annual salaries to PERS. The Corporation contributes the remaining amounts necessary to pay benefits when due. These contributions represented 8.09% and 8.13% of covered salary expenses in the years ended June 30, 2001 and 2000, respectively.

### ***17. Investments Managed on Behalf of Other Entities***

By statute, the Alaska Science and Technology Endowment Fund, the Alaska Mental Health Trust Fund and the International Trade and Business Endowment Fund (other funds) are invested by the Corporation under the same investment authority as the Fund is managed. The assets of the other funds are commingled with the assets of the Fund for investment purposes. Earnings are separately allocated to the other funds on the basis of unit and fractional unit shares, which have undivided beneficial interests in the commingled assets equal to the proportion that such shares bear to the total units outstanding. Unit shares are credited to the other funds on the basis of amounts contributed to the investment pool. The following represents the other funds' shares of the commingled net assets, which are not reflected in the accompanying financial statements:

	<u>2001</u>	<u>2000</u>
Alaska Science and Technology Endowment Fund	\$ 106,680,000	117,715,000
Alaska Mental Health Trust Fund	306,406,000	327,301,000
International Trade and Business Endowment Fund	5,647,000	5,917,000
<b>Total Other Funds</b>	<b><u>\$ 418,733,000</u></b>	<u>450,933,000</u>



***Executive Director  
& Corporate Secretary/Treasurer***

[ROBERT D. STORER](#)

Sandra Firestack, Executive Assistant

***Investments***

[ALLAN MOORE, CHIEF INVESTMENT OFFICER](#)

Joyce Andrews, Executive Secretary

Rosemarie Santana, Investment Associate

***Fixed Income***

Richard Shafer, Manager of Fixed Income Investments

Jim Parise, Senior Investment Officer/Fixed Income

Steven Eason, Investment Officer/Fixed Income

***Equities***

Michael Bell, Manager of Equities Investments

Christy Leer, Investment Associate

***Real Estate***

Peter Naoroz, Manager of Real Estate Investments

Andrew Donovan, Investment Officer/Real Estate

Christi Grussendorf, Investment Officer/Real Estate

***Chief Operating Officer***

[ROBERT N. BARTHOLOMEW](#)

***Administration***

Shawn Lew, Executive Secretary

Freda Westman, Administrative Officer

Kathy Thatcher, Administrative Specialist

Ted Fosket, Procurement Specialist

Lisa Flores, Receptionist/Secretary

***Finance***

[CHRIS PHILLIPS, DIRECTOR OF FINANCE](#)

Dawn Veter, Executive Secretary

Valerie Mertz, Controller

Tobie Putman, Portfolio Accountant

Ruth Danner, Portfolio Accountant

Karen Emberton, Accountant

Jeffrey Holzinger, Accounting Technician

***Information Technology***

[MARSHAL KENDZIOREK,](#)

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Rob McKnight, Senior Information Technology Specialist

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