



THE STATE
of **ALASKA**
GOVERNOR MIKE DUNLEAVY

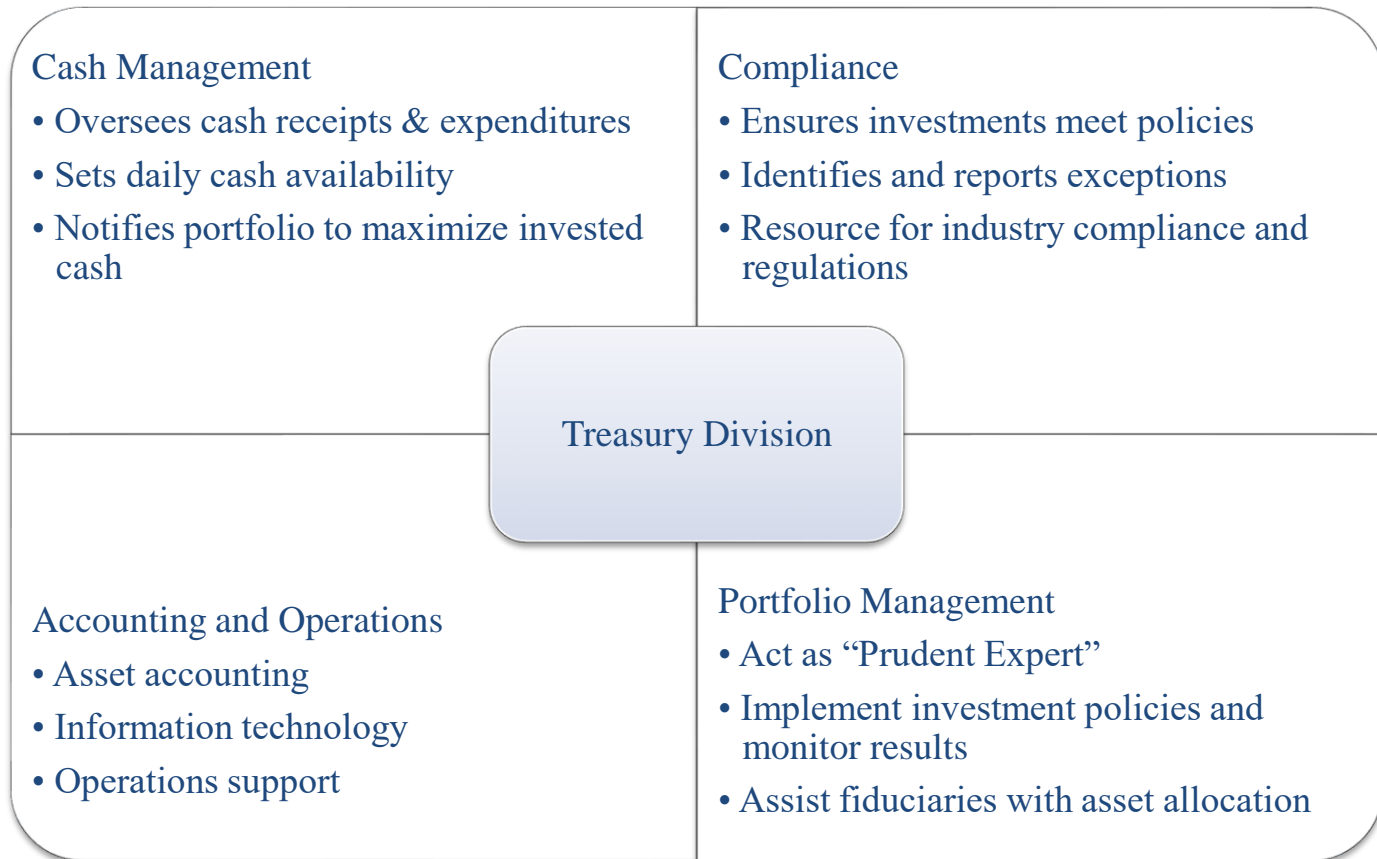
Alaska Mental Health Trust

January 2021

Steve Sikes, CFA
State Investment Officer
State of Alaska, Department of Revenue

Department of Revenue – Treasury Division

Treasury functions supporting the Alaska Mental Health Trust:



Treasury Division – Portfolio Management

Who We Are:

- Staff of 15 investment professionals located in Juneau, Alaska.
- Manage \$45.1 billion in assets as of November 30, 2020.
 - Alaska Retirement Management Board (ARMB): \$37.7 billion
 - Funds under Commissioner of Revenue: \$7.2 billion
 - Other Fiduciaries (includes AMHTA): \$264 million
- Resource to help fiduciaries set asset allocation policy to help achieve objectives and understand risks.
- Implement investment policy and produce results.

Alaska Mental Health Assets

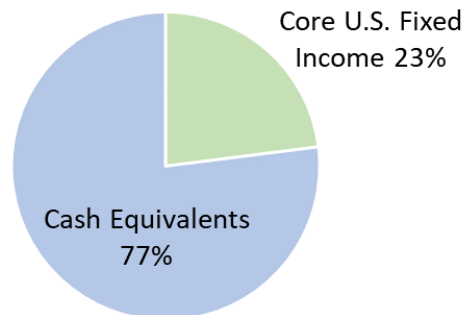
Asset Management for Alaska Mental Health Trust:

- As of November 30, 2020, DOR managed \$96.8 million of AMHTA assets:

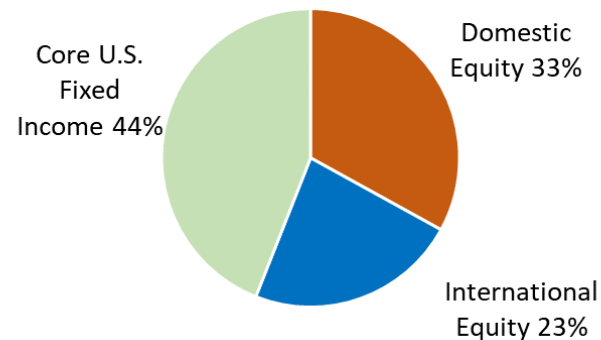
Alaska Mental Health GeFONSI Assets:	
Mental Health Deferred Maintenance	743,761
Mental Health Trust Fund	4,204,352
Mental Health Settlement Account	32,901,754
Total Alaska Mental Health GeFONSI Assets	37,849,867
Alaska Mental Health Trust Reserve	<u>58,964,601</u>
Total AMHTA assets managed by DOR:	\$ 96,814,468

- Asset Allocations:

GeFONSI Asset Allocation



AMHTR Asset Allocation



Alaska Mental Health - GeFONSI

GeFONSI Investments:

- GeFONSI assets are invested internally by DOR staff.
- GeFONSI asset allocation is recommended by DOR staff and approved by the Commissioner of Revenue annually as of July 1st.
- GeFONSI is designed to be conservative with minimal exposure to principal loss and a high liquidity requirement given the short-term time horizon.

Performance as of November 30, 2020	<u>1 Month</u>	<u>FYTD</u>	<u>1 Year</u>	<u>5 year</u>	<u>10 year</u>
GeFONSI	0.27%	0.37%	1.60%	1.59%	1.16%
GeFONSI Benchmark	0.23%	0.31%	1.47%	1.38%	0.94%
Difference	0.04%	0.06%	0.13%	0.21%	0.22%

Alaska Mental Health Trust Reserve

Alaska Mental Health Trust Reserve Investments:

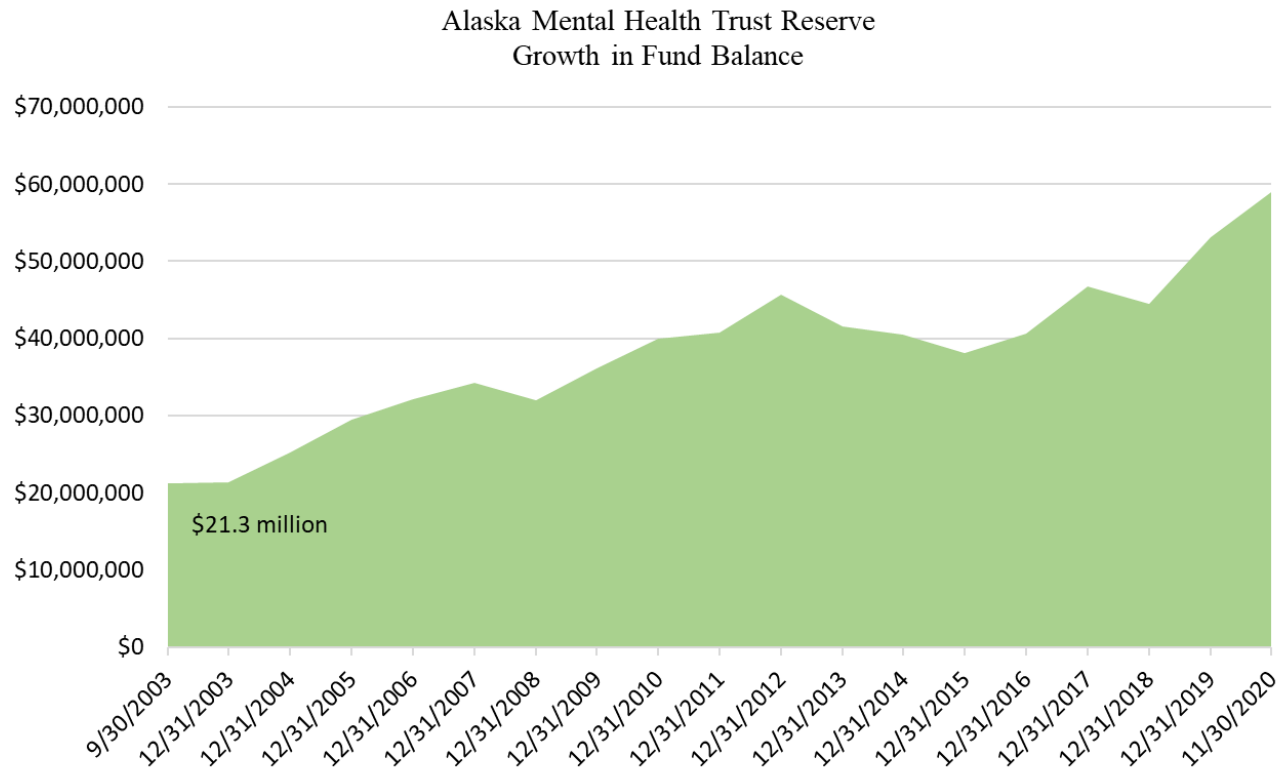
- Alaska Mental Health Trust Reserve assets are invested internally by DOR staff and externally in passive commingled funds managed by State Street Global Advisors.
- The asset allocation is approved by Alaska Mental Health Trust Authority based on the investment policy established in its Asset Management Policy Statement (AMPS).
- The Alaska Mental Health Budget Reserve Fund has a moderate risk tolerance with a medium-term time horizon of five to seven years with an emphasis on balancing preservation of capital while still achieving growth.

Performance as of November 30, 2020	<u>1 Month</u>	<u>FYTD</u>	<u>1 Year</u>	<u>5 year</u>	<u>10 year</u>
Alaska Mental Health Trust Reserve	7.49%	11.19%	13.03%	8.83%	8.79%
Alaska Mental Health Reserve Benchmark	7.54%	11.09%	12.46%	8.67%	8.26%
Difference	-0.05%	0.10%	0.57%	0.16%	0.53%
Cash Equivalents	0.00%	0.01%	0.80%	1.36%	0.84%
Core U.S. Fixed Income	1.10%	1.29%	7.97%	4.59%	3.90%
Domestic Equity	12.12%	19.82%	18.80%	13.83%	13.96%
International Equity	13.49%	18.04%	9.38%	6.87%	8.01%

Alaska Mental Health Trust Reserve

Change in balance over time:

- Fund balance has grown at a 6.30% annualized rate of return since inception.
- The Alaska Mental Health Trust Reserve has benefited from moving to a more aggressive asset allocation in 2006 to include equity investments.



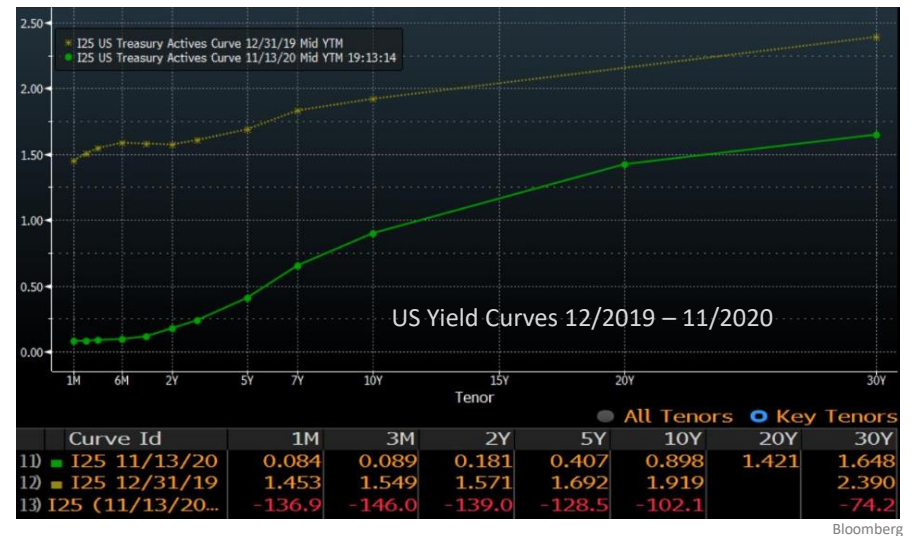
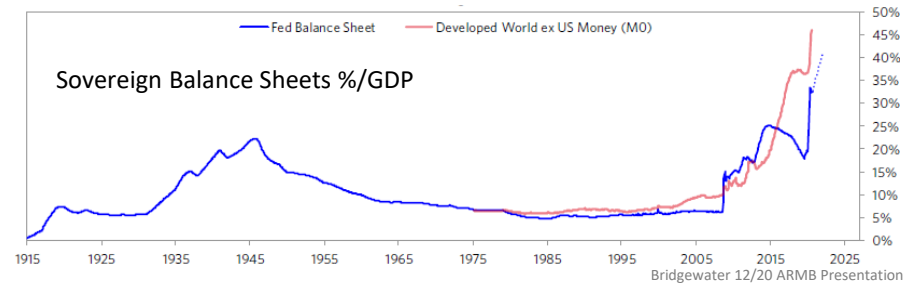
Alaska Mental Health Trust Reserve

Alaska Mental Health Trust Reserve History

- April 2003: Alaska Mental Health Trust Authority (AMHTA) staff met with DOR staff to discuss possibility of Treasury investing some of the trust settlement income account.
- May 2003: AMHTA Board approves motion to invest in DOR Treasury's Intermediate-Term Fixed Income Investment Pool. AMHTA remains fiduciary.
- September 2003: the Alaska Permanent Fund Corporation transferred \$20,963,600 to DOR for investment in the Intermediate-Term Fixed Income Investment Pool.
- August 2006: AMHTA adopted an asset allocation consisting of 30% Broad Market Fixed Income, 45% Domestic Equity Pool, 15% International Equity Pool and 10% Short-Term Fixed Income Pool.
- November 2008: AMHTA adopted an asset allocation consisting of 29% Broad Market Fixed Income, 40% Domestic Equity Pool, 21% International Equity Pool and 10% Short-Term Fixed Income Pool.
- March 2019: AMHTA adopted an asset allocation consisting of 44% Broad Market Fixed Income, 33% Domestic Equity Pool, 23% International Equity Pool and 0% Short-Term Fixed Income Pool.

Pandemic, Stimulus, and Interest Rates

- Rapid and far-reaching fiscal and monetary stimulus has stabilized capital markets and led to all-time low interest rates. All shorter tenors on the yield curve have dropped over 100 basis points.
- The Fed has committed to low rates for the foreseeable future and is willing to allow inflation to move “moderately above” its 2% target “for some time” before raising rates.
- Current bond yields will reduce bond return expectations over the intermediate term and higher debt levels may have a dampening impact on future economic growth.



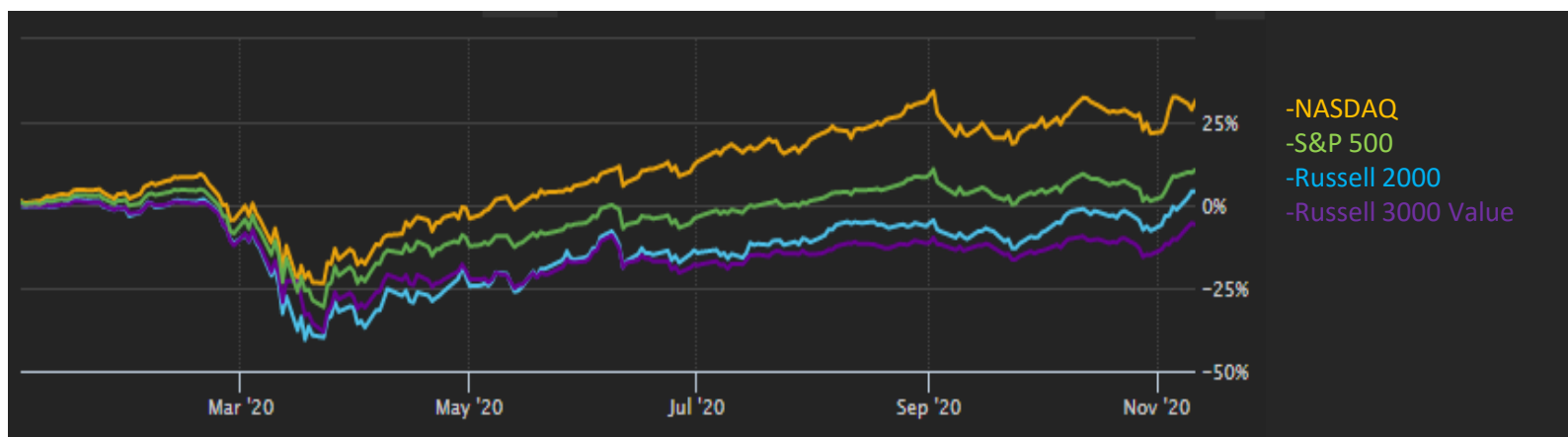
Equity Markets and Risk Assets

- Overall, broad market equities have returned to pre-pandemic levels.
- Many other liquid risk assets have recovered as well, particularly those supported by the Fed's asset purchase programs.
- The equity recovery has been concentrated, with less impacted sectors like technology, consumer staples, and healthcare benefiting most.
- There is more widespread economic damage elsewhere in the economy, partially in smaller and more value-oriented companies.

Weight of the top 5 and top 10 stocks in the S&P 500
% of market capitalization of the S&P 500



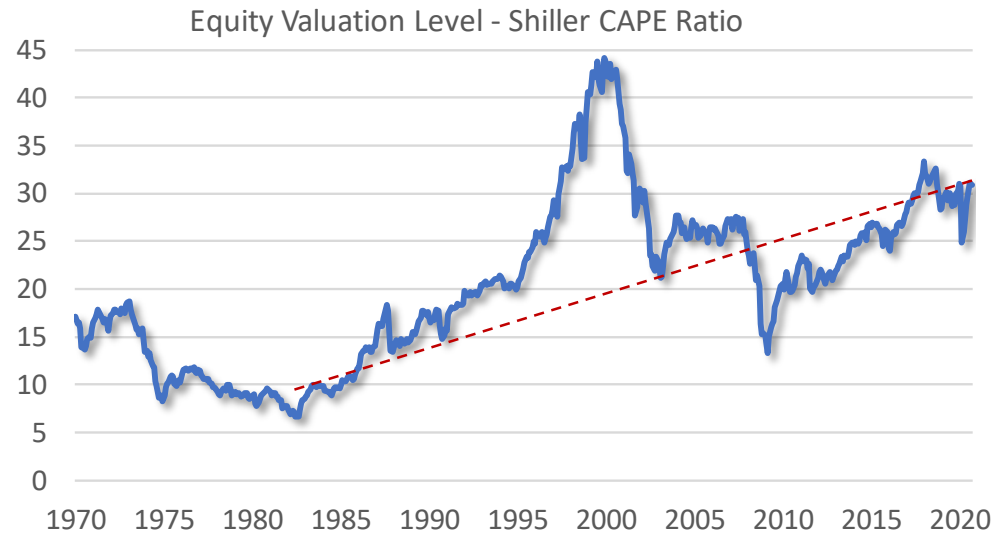
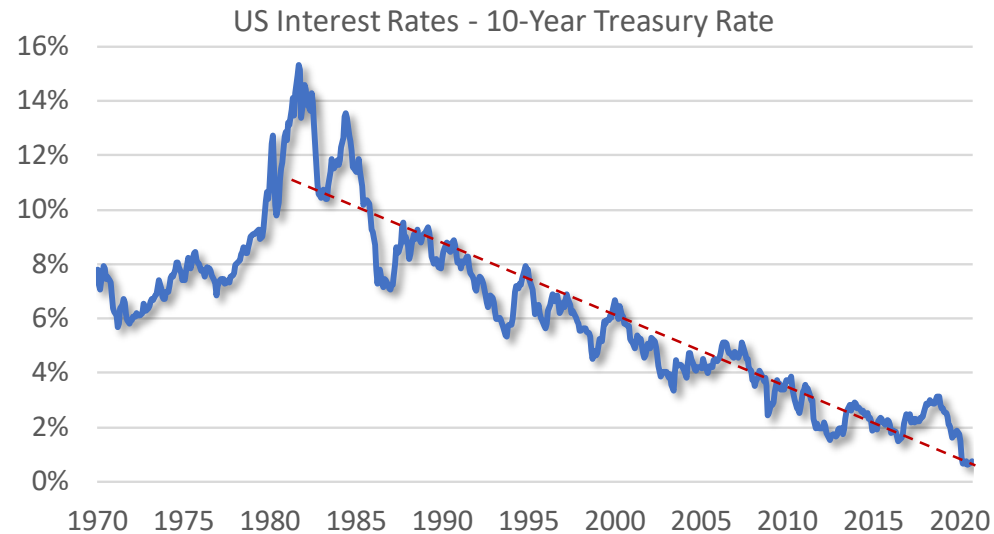
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.



Source: WSJ

Forward Market Conditions

- The pandemic has pushed US Treasuries to near-zero levels, effectively ending the 40-year tailwind of rate reduction for fixed income.
- During this time, fixed income has been a strong equity hedge, while providing high returns and liquidity.
- Equities have also been increasing in valuation, on average, for the past 40 years.
- Both have common root causes led by globalization, productivity, and resulting low inflation.
- The path forward is much less clear with further material rate reduction constrained and potential headwinds for both globalization and growth.



2017 – 2020 Market Returns

Callan Periodic Table of Investment Returns

Annual Returns			Monthly Returns									
2017	2018	2019	Jan 2020	Feb 2020	Mar 2020	Apr 2020	May 2020	Jun 2020	Jul 2020	Aug 2020	Sep 2020	YTD 2020
Emerging Market Equity	U.S. Fixed Income	Large Cap Equity	U.S. Fixed Income	U.S. Fixed Income	U.S. Fixed Income	Small Cap Equity	Small Cap Equity	Emerging Market Equity	Emerging Market Equity	Large Cap Equity	U.S. Fixed Income	U.S. Fixed Income
37.28%	0.01%	31.49%	1.92%	1.80%	-0.59%	13.74%	6.51%	7.35%	8.94%	7.19%	-0.05%	6.79%
Dev ex-U.S. Equity	High Yield	Small Cap Equity	Real Estate	Global ex-U.S. Fixed Income	Global ex-U.S. Fixed Income	Large Cap Equity	Large Cap Equity	Small Cap Equity	Large Cap Equity	Small Cap Equity	Global ex-U.S. Fixed Income	Large Cap Equity
24.21%	-2.08%	25.52%	0.84%	-0.20%	-3.22%	12.82%	4.76%	3.53%	5.64%	5.63%	-0.58%	5.57%
Large Cap Equity	Global ex-U.S. Fixed Income	Dev ex-U.S. Equity	Global ex-U.S. Fixed Income	High Yield	High Yield	Emerging Market Equity	High Yield	Dev ex-U.S. Equity	High Yield	Dev ex-U.S. Equity	High Yield	Global ex-U.S. Fixed Income
21.83%	-2.15%	22.49%	0.76%	-1.41%	-11.46%	9.16%	4.41%	3.42%	4.69%	5.16%	-1.03%	4.77%
Small Cap Equity	Large Cap Equity	Real Estate	High Yield	Emerging Market Equity	Large Cap Equity	Real Estate	Dev ex-U.S. Equity	Real Estate	Global ex-U.S. Fixed Income	Real Estate	Emerging Market Equity	High Yield
14.65%	-4.38%	21.91%	0.03%	-5.27%	-12.35%	7.06%	4.25%	2.57%	4.44%	2.52%	-1.60%	0.62%
Global ex-U.S. Fixed Income	Real Estate	Emerging Market Equity	Large Cap Equity	Large Cap Equity	Dev ex-U.S. Equity	Dev ex-U.S. Equity	Emerging Market Equity	Large Cap Equity	Real Estate	Emerging Market Equity	Dev ex-U.S. Equity	Emerging Market Equity
10.51%	-5.63%	18.44%	-0.04%	-8.23%	-14.12%	6.97%	0.77%	1.99%	2.78%	2.21%	-2.82%	-1.16%
Real Estate	Small Cap Equity	High Yield	Dev ex-U.S. Equity	Real Estate	Emerging Market Equity	High Yield	U.S. Fixed Income	Global ex-U.S. Fixed Income	Small Cap Equity	High Yield	Real Estate	Dev ex-U.S. Equity
10.36%	-11.01%	14.32%	-1.94%	-8.24%	-15.40%	4.51%	0.47%	1.01%	2.77%	0.95%	-3.11%	-7.13%
High Yield	Dev ex-U.S. Equity	U.S. Fixed Income	Small Cap Equity	Small Cap Equity	Small Cap Equity	Global ex-U.S. Fixed Income	Global ex-U.S. Fixed Income	High Yield	Dev ex-U.S. Equity	Global ex-U.S. Fixed Income	Small Cap Equity	Small Cap Equity
7.50%	-14.09%	8.72%	-3.21%	-8.42%	-21.73%	2.04%	0.30%	0.98%	2.66%	0.29%	-3.34%	-8.69%
U.S. Fixed Income	Emerging Market Equity	Global ex-U.S. Fixed Income	Emerging Market Equity	Dev ex-U.S. Equity	Real Estate	U.S. Fixed Income	Real Estate	U.S. Fixed Income	U.S. Fixed Income	U.S. Fixed Income	Large Cap Equity	Real Estate
3.54%	-14.57%	5.09%	-4.66%	-8.88%	-22.76%	1.78%	0.23%	0.63%	1.49%	-0.81%	-3.80%	-19.69%

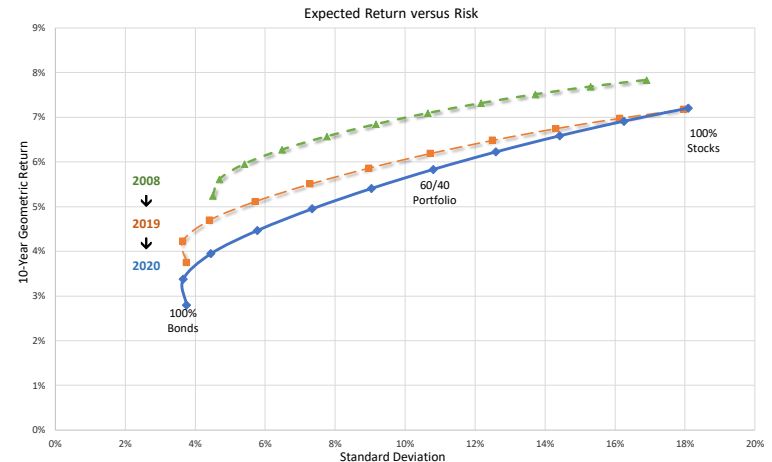
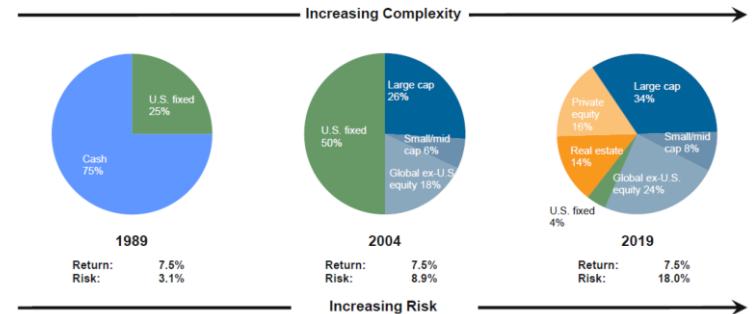
Sources: ● Bloomberg Barclays Aggregate ● Bloomberg Barclays Corp High Yield ● Bloomberg Barclays Global Aggregate ex US
 ● FTSE EPRA Nareit Developed ● MSCI World ex USA ● MSCI Emerging Markets ● Russell 2000 ● S&P 500

Asset Allocation

Asset Allocation Process:

- Financial consultant, Callan LLC, develops annual 10-year capital market assumptions for risk, return, and correlations using a building block approach.
- Return expectations have steadily declined over time due largely to lower growth and inflation expectations caused by global trade, technology, and the transition toward a service economy.
- Staff evaluates Callan's capital market assumptions and current market conditions to develop an asset allocation approach for each State fund.
- The goal is generally to maximize return or minimize risk consistent with investment objectives and risk tolerance using a combination of Modern Portfolio Theory and investment judgment.

7.5% Expected Returns Over Past 30+ Years



2020 Capital Market Assumptions

Capital Market Assumptions:

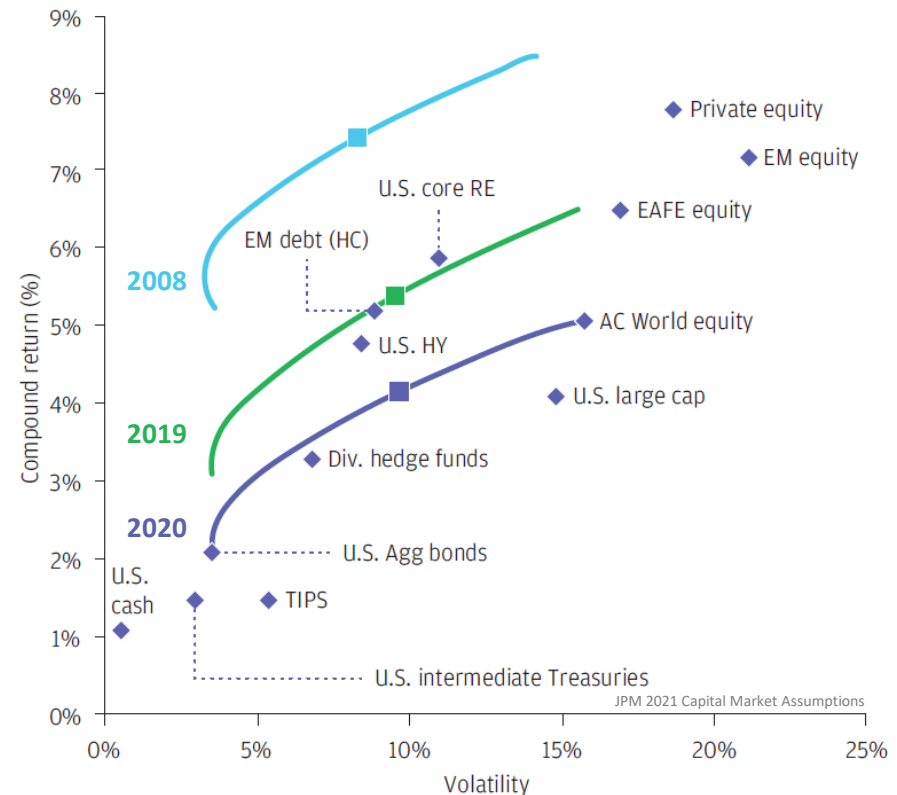
- Callan developed their latest 10-year capital market assumptions in January 2020.
- Staff selects a subset of these asset classes for use in State funds based on risk, return, diversification, and other attributes.
- For FY21, staff recommends using Broad U.S. Equities, International Equities, Core U.S. Fixed Income, and Cash Equivalents for State funds.
- These asset classes are expected to provide a balance of reasonable diversification without undue complexity and cost.
- The capital market assumptions were developed with market volatility in mind – Callan has decided not to change them due to Covid-19 and still recommends using them for longer time-horizon funds.

Asset Classes	1-Year Arithmetic Return	10-Year Geometric Return	Standard Deviation	Projected Yield	10-Year Sharpe Ratio	Correlation to Domestic Equity
Broad U.S. Equity	8.6%	7.2%	18.1%	2.0%	0.35	1.00
Large Cap U.S. Equity	8.4%	7.0%	17.7%	2.1%	0.34	1.00
Small/Mid Cap U.S. Equity	9.3%	7.3%	21.2%	1.6%	0.33	0.95
Global ex-U.S. Equity	9.1%	7.3%	20.5%	3.1%	0.33	0.81
Developed ex-U.S. Equity	8.7%	7.0%	19.7%	3.3%	0.33	0.78
Emerging Market Equity	10.3%	7.3%	25.7%	2.7%	0.31	0.78
Government 1-3 year	2.5%	2.5%	2.2%	2.7%	0.09	-0.25
Core U.S. Fixed	2.8%	2.8%	3.8%	3.4%	0.15	-0.11
TIPS	2.5%	2.4%	5.1%	3.2%	0.05	-0.05
Emerging Market Sovereign Debt	4.7%	4.4%	9.5%	6.7%	0.26	0.53
High Yield	5.1%	4.7%	10.3%	7.3%	0.28	0.61
Core Real Estate	7.1%	6.3%	14.0%	4.8%	0.34	0.70
REITs	8.6%	6.7%	20.7%	5.0%	0.31	0.75
Private Equity	12.0%	8.5%	27.8%	0.0%	0.35	0.84
Hedge Funds	5.3%	5.0%	8.7%	0.0%	0.34	0.78
Cash Equivalents	2.3%	2.3%	0.9%	2.3%	0.00	-0.03
Inflation	2.3%	2.3%	1.5%			-0.01

Capital Market Assumptions

Expected returns are declining:

- Callan's 2021 Capital Market Assumptions (CMAs) will be released in January.
- Generally, fixed income expected returns are ~100 basis points less than last year.
- Equities are tougher to forecast, but some expect a similar reduction due to elevated valuations, slower future growth, and the lower risk-free rate.
- Overall, staff expects a material ~40-80 bps reduction in expected returns at a similar level of risk over long-term horizons.



Alaska Mental Health Trust

Summary:

- Investment results have met expectations and are in line with benchmarks.
- No issues or concerns to report.
- DOR staff looks forward to assisting AMHTA in developing its asset allocation for next year. We anticipate starting this process in January for ARMB and other funds managed under the Commissioner of Revenue.
- Future investment returns, particularly in fixed income, are likely to be lower given the very low level of interest rates.

Questions?

Appendix

Investment returns for quarter ending September 30, 2020:

Performance as of September 30, 2020	<u>1 Month</u>	<u>FYTD</u>	<u>1 Year</u>	<u>5 year</u>	<u>10 year</u>
GeFONSI	-0.01%	0.20%	1.77%	1.54%	1.15%
GeFONSI Benchmark	0.00%	0.17%	1.65%	1.33%	0.93%
Difference	-0.01%	0.03%	0.12%	0.21%	0.22%
Alaska Mental Health Trust Reserve	-1.81%	4.90%	9.95%	8.49%	8.30%
Alaska Mental Health Reserve Benchmark	-1.79%	4.77%	9.35%	8.37%	7.79%
Difference	-0.02%	0.13%	0.60%	0.12%	0.51%
Cash Equivalents	0.01%	0.01%	1.14%	1.37%	0.84%
Core U.S. Fixed Income	-0.07%	0.65%	7.59%	4.41%	3.84%
Domestic Equity	-3.65%	9.20%	14.73%	13.57%	13.41%
International Equity	-2.47%	6.23%	2.53%	5.81%	6.62%