

## **Alaska Permanent Capital Management Turns 20 and Celebrates Over \$3 Billion in Assets Under Advisement and Management.**

2012 marks APCM's 20th year in business and on behalf of our shareholders and myself, I would like to thank our clients who have made our success possible.

In 1992, my father, Dave Rose, started with an idea that Alaskan's would prefer to have their money managed closer to home with people they know. The proof of this concept is in the tremendous growth of our company which last year exceeded over \$3 billion dollars in investment management and advisement services.

In the early days, the firm built its reputation on thorough and narrowly focused fixed income bond management for government entities from Unalaska to the North Slope. Due to popular demand, we gradually expanded that business into balanced portfolios of stocks and fixed income bonds. When we contemplated this process, APCM wanted to be more thoughtful than just offering the same products as local brokers. By using very diversified low cost index funds, we created a model investment very popular with endowments, foundations, Alaska Native Entities and other fiduciaries.

The staff and board members of these entities encouraged us to make this type of investing available to individuals, so in 2009 we opened our Individual Wealth Management Division. Because of the low-fees, consistent returns and competent experts, APCM has grown to be the second largest Registered Investment Advisor in Alaska.

In 1998, I returned home to Alaska to work with my dad and took over as CEO in 2005. In 2006, my father passed away after a long battle with diabetes. Thanks to his legacy and our tremendous staff, our company continues to exceed all growth expectations, over 44% during the last five years to +\$3 billion in assets under management and advisement. Following in my father's tradition, we have spent much of our resources in cutting edge technology and on hiring the very brightest minds in finance in the state. Our all Alaskan staff consists of several CFAs, CPAs, CFPs and is one of the most credentialed investment staffs in Alaska.

We know this tremendous success would not be possible without the support of clients and neighbors like you. Thank you!



Evan Rose, CEO  
Alaska Permanent Capital Management

# QUARTERLY PERSPECTIVES

## ECONOMY & MARKETS

**ALASKA  
PERMANENT  
APCM  
CAPITAL MANAGEMENT**

Risk on. Risk off. That pretty much sums up the volatile year we had in 2011. It was a year dominated by the European sovereign debt crisis (which has been festering since early 2010) and worries about a double dip recession in the U.S. (and the loss of our AAA rating). Despite the downgrade by S&P to AA+, U.S. Treasury bonds were one of the best performing assets in 2011 as investors sought a safe haven amidst equity volatility. The range in yield of the 10-year Treasury was from a high of 3.7% in Feb to 1.7% in September. 10-year Treasuries ended the year at a record low yielding 1.9%, while gaining +17.1% in total return.

Corporate earnings grew +17% last year and corporations have record cash liquidity on their balance sheets. The cash to asset ratio for companies excluding banks in the S&P 500 is 11%, an all time high. Yet the S&P 500 index was flat in 2011, ending the year about where it began due to unsettling global macro variables. Total return including dividends was +2.1%. Small cap stocks (S&P 600) gained +1% last year.

The overseas markets were hit hard first by the Arab Spring (rising oil prices), then the Japanese tsunami, and finally the European banking and sovereign debt crisis. The latter continues to be the number one risk factor in the outlook. The broad based international equity markets proxied by EAFE lost -12.1%. Emerging markets (EM) lost a surprising -18.3%. Despite their solid finances and better growth prospects compared to the developed markets, EM remain a high beta play.

Non U.S. Sovereign debt provided a +4.2% return as risk premiums widened despite a general move by central banks to keep interest rates low and provide ample liquidity. For example, in 2011 Italian 10 year bond yields jumped 230bp and were yielding above 7% at year end, a level many believe is unsustainable and at crisis levels. Greece is in the process of restructuring its huge debt burden (aka default).

Commodities lost ground last year. The Dow Jones UBS Commodity Index dropped -13.3%. West Texas Intermediate Oil gained \$7 to \$100 a barrel. Investors rode the gold roller coaster as the yellow metal touched \$1,900 an ounce in the summer only to fall back to \$1,563 at year end. The precious metal was up +9.9% in 2011. Natural gas was the worst performer losing -45%, and ending the year at about \$3 per MMBTU. The shale gas revolution (thank you fracking and directional drilling) just may be a "game changer" with respect to US energy independence and help keep a lid on energy prices in general.

It was a frustrating year for investors. Most of the asset classes and even stocks within indices moved together in lockstep driven by macro factors while individual idiosyncratic risks took a back seat. Correlations converged to 1 negating the typical benefits of diversification.

Global economic growth was disappointing. Barclays Capital put global growth at +5.1% in 2010, +3.6% in 2011, and expects +3.3% this year. Global inflation picked up to +3.8% last year, but should cool to +2.9% in 2012.

The Bloomberg consensus of economists has the US growing at +2.1% in 2012, up from +1.8% last year. Japan will rebound from the March tsunami induced 2011 recession to +1.7% growth while Europe is forecast to experience a mild recession (-0.2% growth) and see 10.5% unemployment. China's GDP will likely grow +8.5% in 2012, down from +9.2% last year and +10.4% in 2010. Inflation is expected to moderate across the globe. Inflation in the US is expected to fall to +2.1% this year from +3.2% last year.

2012 is starting off well in the U.S. The economy is gaining momentum. Job growth has picked up (still modest at best, however) and the unemployment rate ticked down to 8.5% in December. Housing remains tenuous, but at least it's not subtracting from growth and there are signs of a light at the end of the proverbial tunnel.

## ECONOMY &amp; MARKETS

Consumer spending represents over 70% of GDP so the consumer is critical to growth. The savings rate declined late last year from 6.0% to 3.5% which will boost fourth quarter growth (some estimates for GDP growth are as high as +4% in Q4 11). But debt burdens are still very high and employment/income growth is likely to be modest. We expect better data early in the year to give way to more tepid growth. We lived beyond our means for many years and now consumers must continue to rebuild savings and reduce debt by spending less for several more years. By the way, that's why inflation should trend lower.

The U.S. budget deficit in FY 2011 was \$1.3 trillion or 8.7% of GDP. That budget deficit added to the national debt, which is now 67% of GDP. The CBO expects that to grow to 74% by the end of FY 2012. The number keeps growing because of demographics, entitlement spending, slow growth, and frankly a tendency on the part of politicians to spend, spend, spend; issuing debt to pay for it.

Congress of course is wrangling over this and the 2012 election will no doubt be fought on the economy and debt dynamics. As a result, there will be considerable policy uncertainty this year. The expiration of the Bush tax cuts and \$1.2 trillion automatic across the board cuts mandated by the Budget Control Act (this comes from the debt ceiling deal last summer and failure of the Super Committee to act) are scheduled for January 1, 2013. We will also have the fight over the extension of the annual payroll tax holiday and unemployment benefits again in February. Then there is the roll out of Obamacare in 2013. The election, political gridlock, tax uncertainty, and looming spending cuts could unnerve investors later in the year.

The Federal Reserve has pulled out all the stops to help the economy. Short rates are at zero and the Fed says they'll stay there until mid 2013. Real rates are negative. Quantitative easing (QE) has ballooned their balance sheet. Operation Twist endeavors to keep long rates down. Who knows what is next, but it's fair to say that easing initiatives have incrementally lost their punch. Perhaps less QE and more QY (quantitative yakking) is in the offing?

These factors highlight a risk to the outlook. Policymakers have run out of ammunition. They don't have much flexibility (despite what they say!) or room to respond to an economic or financial crisis. While the financial system is stronger than it was in 2008 (the U.S. banks in particular are much better capitalized) policymaker's ability to respond to shocks has diminished.

Nowhere are the risks more palpable than in Europe. A shaky banking system with tons of even shakier sovereign debt on its balance sheet is looking to the European Central Bank (ECB) for liquidity. The ECB has delivered and risk premiums have steadied recently, albeit at elevated levels.

There is danger of a euro-zone break-up. Most observers believe the odds still favor some grand solution to nurse the periphery economies (PIIGS: Portugal, Italy, Ireland, Greece, Spain) back to health. The IMF and euro leaders are hard at work. The EU has met 17 times over the past 24 months to discuss the crisis. Austerity and a long slow process is in the cards. It remains to be seen if the public is in sync with their leader's vision of a United States of Europe.

It is hard to imagine it all working out. A one size fits all euro monetary policy puts an enormous burden on fiscal policy to adjust. Different cultures, history, languages, and expected lifestyles are hard to overcome. Even in Alaska we think of ourselves as Americans first, Alaskans second. "Europeans" describe themselves as French, German, or Dutch well before thinking of themselves as European. I know it's a stereotype but, it's hard to see why a hard working German will agree to subsidize a Greeks casual lifestyle through transfer payments.

It is fair to say that government spending is poised to begin a significant decline across many countries. Whether it is the U.S., Europe, or Japan, countries are hitting a debt wall where a combination of reductions in spending/entitlement benefits and tax hikes are necessary to meet long term fiscal obligations. Issuing debt won't fly any more. Consumers are de-levering in the developed world and governments aren't far behind. These are major headwinds for growth.

The one bright spot remains the emerging markets. Consider China; its economy is half the size of the U.S., but has been the single biggest contributor to world growth of late (a 20% share in 2010, for example). In 2009-10 the increase in China's energy demand accounted for 76% of the growth in world energy demand. Getting China right matters.

Last year, tightening in policy to get ahead of inflation caused China and many emerging markets to slow. Stocks sold off. There are worries of a housing bubble. The World Bank sees a soft landing and growth at +8.5%. (A hard landing means +5% growth or less and rising unemployment and social unrest.) Inflation has begun to decline so there is room to ease should the Chinese economy wobble.

So in general the global outlook is soft and sluggish with little room for error. Fortunately, as is often the case, the markets are "pricing in" a shaky scenario and valuation across equities is generally good while the safe haven asset classes (like U.S. treasury bonds) are pricy. Pessimism is what the markets are expecting. An optimistic outcome is not.

## PORTFOLIO STRATEGY

“Economists set themselves too easy a task if in tempestuous seasons they can only tell us that when the storm is long past, the ocean will be flat again.”

- John Maynard Keynes

With all due respect to the Maynard Keynes, as far as investment strategy goes, a lot does depend on your time horizon and willingness to ride out market storms. The idea that investors can jump back and forth based on a macro outlook and consistently make money has never appealed to us. That’s a marketing pitch, not a solid investment approach.

What we can do is try and understand asset pricing and risks to see if there is enough of a cushion or margin of safety built into current pricing. And then construct diversified portfolios that can withstand inclement market weather for the long term. If you are worried about volatility and may need cash soon, stay in short term low yielding investments. It’s as simple as that. There are no free lunches.

So with that in mind...

Treasury bonds are unattractive but do serve as an anchor in the wind during stormy weather (such as 2011). They are an insurance policy and about the only thing that goes up in a risk off environment. But with interest rates at historic lows (cash at 0% and 2% on 10-year Treasuries) the hurdle rate for stocks is very low for investors with a reasonable time horizon.

U.S. stocks trade at a 12x multiple of earnings and earnings yields, currently at 8%, are well above bond yields. We think stocks beat bonds over most scenarios (other than a crisis) and have a modest tilt to equities. Large cap stocks in particular should fare well. Earnings won’t be gangbusters like last year but +5% gains would be just fine.

International stocks are even cheaper than U.S. stocks. But they are cheap for a reason, particularly European names. Diversification is a good thing but we are cautious on Europe. A break up of the euro would be bad and it could happen. Best to keep some powder dry here.

While treasuries are rich, most other sectors of the bond market aren’t. Spreads have widened out and corporates and high quality CMBS remain our choice in the fixed income markets. Within bond portfolios we are a bit short our benchmarks. That has been painful given the steep yield curve and decline in rates, but how low can they go? Admittedly short rates should stay low for a while given

the Federal Reserve’s anxiety over the general economy and unemployment picture. But the overall risk/reward tradeoff says to us “get your yield through spread product not duration.”

Municipal bonds are attractive. But, less Federal spending equals less revenue to state and local governments and maybe higher taxes. We’ll favor state GO’s and essential service revenue bonds and avoid localities overly dependent on property taxes.

Inflation protection is often best achieved through U.S. Government TIPS bonds. They were a star performer last year but have become expensive. Yields here are basically negative out to 10 years. Now you do accrue whatever inflation is over the life of the bonds, but still, negative real yields? Commodities will protect against spikes in inflation. We’ll hold our nose and own some as insurance against inflation, though it is unlikely.

We have been through a very difficult market environment over the past several years. This year will be challenging as well. Hang in there. Be brave.

We at APCM appreciate your business and the confidence you have in us to manage your money. We will do our very best to not let you down. Best wishes for a healthy, peaceful, and prosperous 2012.

**Jeff Pantages, CFA**  
**Chief Investment Officer**



**Bill Lierman**  
Sr. Investment Analyst

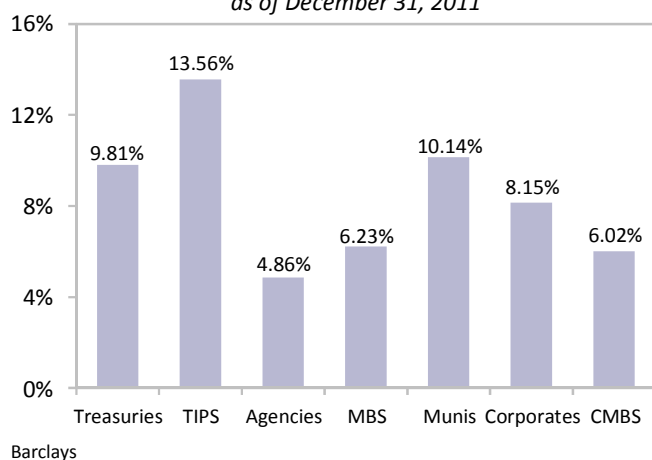
investors abandoned European bonds and flocked into Treasuries, flattening the yield curve.

■ The Barclays U.S. Aggregate Index produced a +7.84% return in 2011. This was mainly driven by decreasing yields as the Fed kept monetary policy easy, with short rates near zero, QE2 finishing up in June, and the introduction of "Operation Twist".

■ The Treasury market produced impressive gains for the year, with nominals returning +9.81% and TIPS +13.56%. This despite news that S&P downgraded the U.S. to AA+.

The Risk off trade was evident as

**2011 Bond Total Return**  
as of December 31, 2011



■ Corporates started the year off well as companies had good earnings, access to cheap financing, and strengthening balance sheets. During May corporates started to slide as investors lost their appetite for financials due to contagion concerns in Europe. The S&P downgrade of 37 global banks, and bankruptcies of MF Global and American Airlines did not help the sector.

■ The GSEs got continued support throughout the year by the Obama administration and technical factors such as a shrinking balance sheet. Agency and MBS index returns were still negative vs. Treasuries (-25 and -106 basis points, respectively) as selling pressure was too much to accommodate given the concerns across the pond.

■ Despite Meredith Whitney's now infamous prediction of mass municipal defaults the Municipal index had a strong year returning +10.14%. Headline risk lessened in the first quarter and investors were attracted to the asset class by relative cheap valuations while revenue and tax collections were stronger than anticipated. At year-end, 10-year AA munis were yielding 2.45%, vs. 1.88% for Treasuries.

■ The CMBS and ABS markets did well vs. treasuries producing 0.47% and 0.52% excess return. Investors extended out the yield curve and obtained yield as the securitization market continued heal. During the year spreads ratcheted in from the highs and investors saw new issues come to market.

■ In the U.S., global macroeconomic headwinds overshadowed record high corporate profits and cash liquidity taking investors on a wild ride only to end the year slightly higher than they started. There were 69 days in which 90% of the S&P 500 stocks moved in the same direction, more than the combined total from two other volatile years, 2008 and 2009. Financials were hardest hit (-18.4%) while utilities added +14.8%.

■ U.S. mid cap stocks finished down -1.7%, behind both large (+2.1) and small caps (+1.0). Information technology and energy were laggards for the year, both down just over -11.0%. Consumer staples offset these returns posting a positive +22.0% return.

■ With the spotlight on Europe, international equities were the worst performers. Developed markets ended down -12.1% while riskier emerging markets were sharply lower (-18.4%) despite their generally healthier long term economic and fiscal outlooks. The well known emerging market leaders were all well into negative territory. China (-18.4%), Russia (-19.6%), Brazil (-21.9%) and India lost (-37.2%). Indonesia was the best performer up (+6.5%).

■ REITs were the best performers with a total return of +8.5%. Dividends played a strong role in this outperformance contributing +3.6% of the total return. REIT prices were boosted as the industry raised over \$50 billion in capital to strengthen its balance sheets.

■ The DJ-UBS Commodity Index which tracks 19 commodities lost -13.3%, its first annual decline since 2008, led by a -45.0% decrease in natural gas prices. This was only slightly offset by a +8.2% increase in West Texas crude while gold was up +10.0%, marking the 11th straight year of rising gold prices.

**Total Return (%) as of December 31, 2011**

	Q4 2011	1 Year	3 Years	5 Years
<b>Domestic Equities</b>				
Large Cap S&P 500	11.8	2.1	14.1	-0.3
Mid Cap S&P 400	13.0	-1.7	19.6	3.5
Small Cap S&P 600	17.2	1.0	17.0	1.9
<b>International Equities</b>				
Developed MSCI EAFE	3.3	-12.1	7.7	-4.7
Emerging MSCI Emerging Markets	4.4	-18.4	20.1	2.4
<b>Other</b>				
Commercial Property S&P U.S. REIT	15.3	8.5	21.5	-1.6
Commodities DJ-UBS Commodity	0.4	-13.3	6.4	-2.1
<b>Fixed Income</b>				
Total Bond Market Barclays Aggregate	1.1	7.8	6.8	6.5
1-3 Yr U.S. Treasury/Agency Barclays 1-3 Gov	0.2	1.6	1.8	3.8
Int'l Treasury Barclays Global Tsy ex-US	0.1	4.3	5.3	7.2

Returns are annualized for periods greater than one year

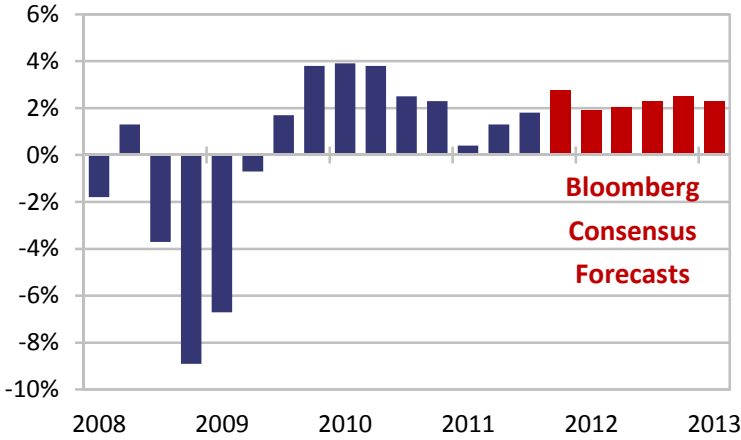


**Brandy Niclai, CFA**  
Sr. Investment Analyst



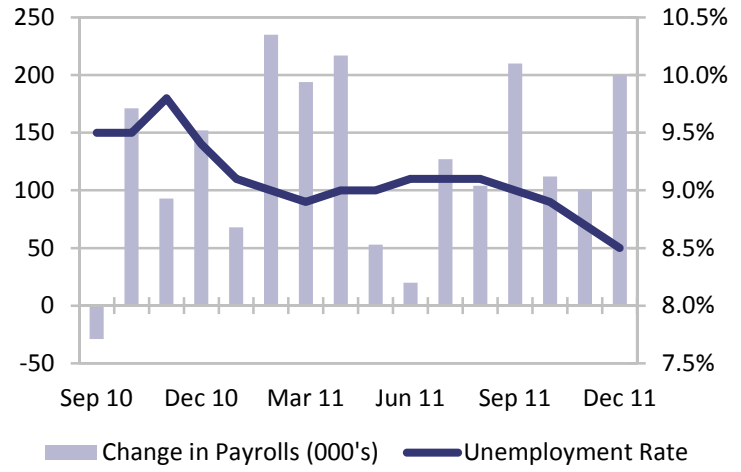
## ECONOMIC TRENDS

### Modest GDP Growth Expected to Continue



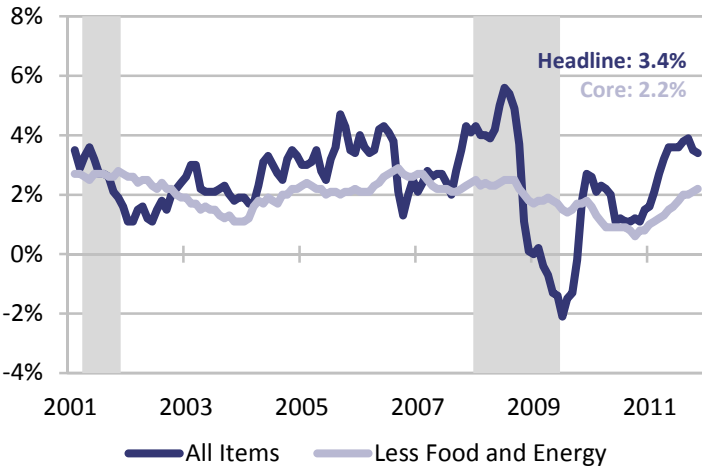
Actual GDP data from the Bureau of Economic Analysis through 9/30/11  
Bloomberg Consensus Forecasts as of 1/11/12

### Job Growth and Unemployment Rate



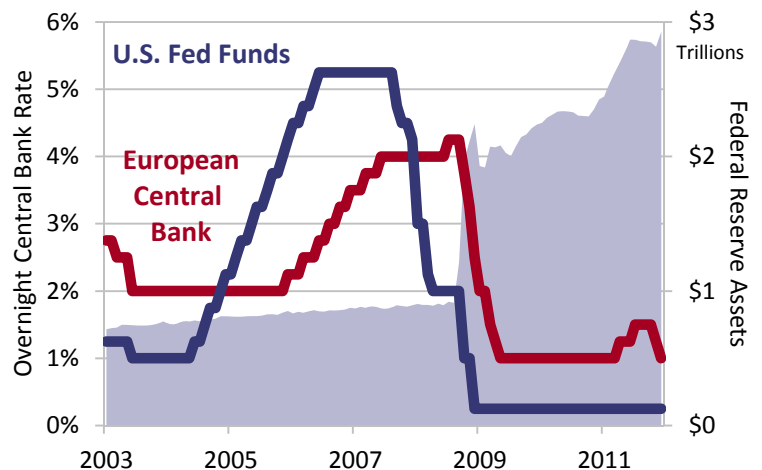
Bureau of Labor Statistics

### Consumer Price Index (YoY)



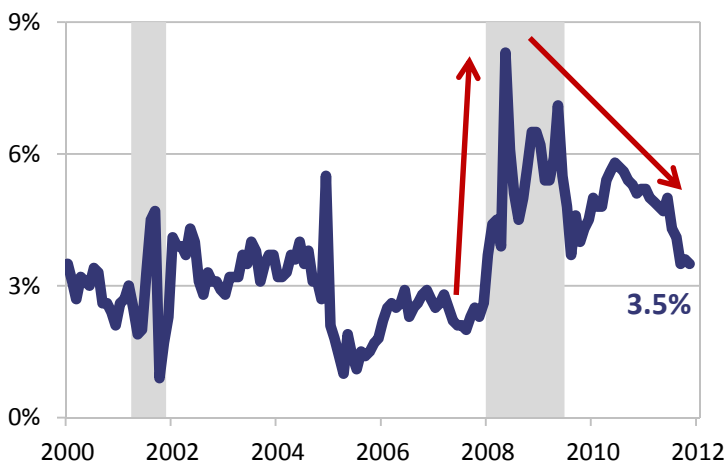
Bureau of Labor Statistics as of November 30, 2011

### Global Central Bank Policy



Bloomberg

### U.S. Savings Rates (% of Disposable Income)



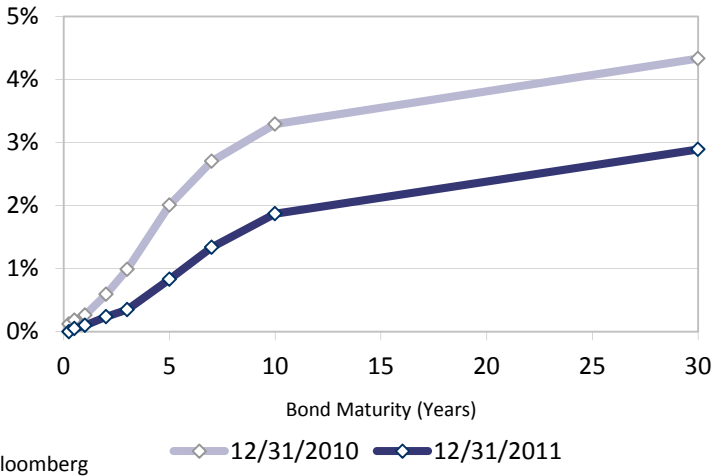
Data: Bureau of Economic Analysis as of 11/30/2011

### Bloomberg Consensus Forecasts

Data as of 1/11/12	2010	2011	2012	2013
Real GDP (% YoY)	3.00	1.80	2.10	2.50
CPI Inflation (% YoY)	1.63	3.20	2.10	2.15
Unemployment (%)	9.60	8.5	8.7	8.30
Fed Funds (%)	0.25	0.25	0.25	-
10-Yr Note (%)	3.30	1.88	2.60	-

### "Flight to Quality" Pushed Yields Lower

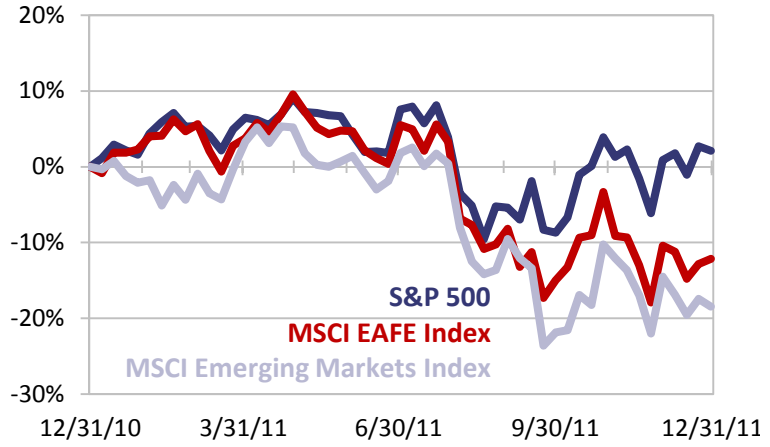
U.S. Treasury Yield Curve



Bloomberg

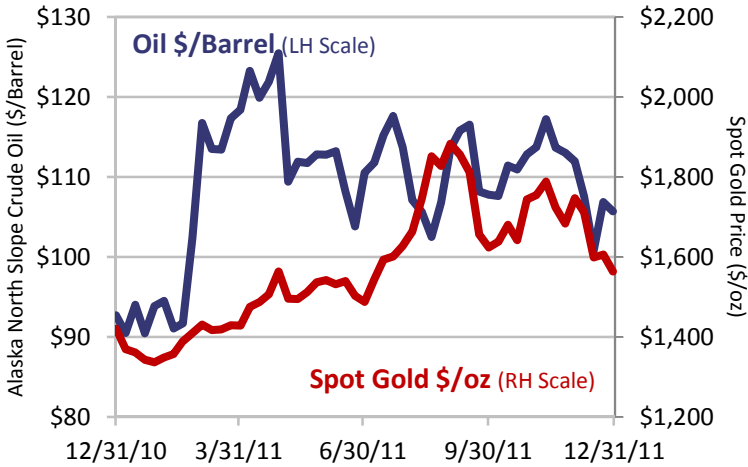
### Volatile Equity Markets During The Year

2011 Total Return



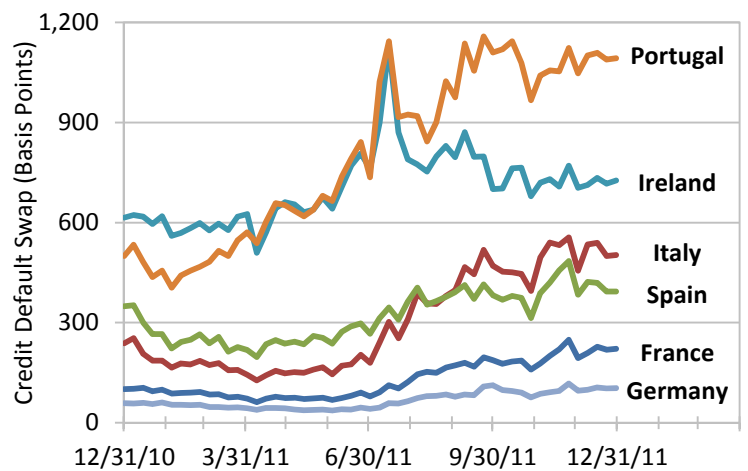
Data: Bloomberg

### Oil and Gold Roller Coaster



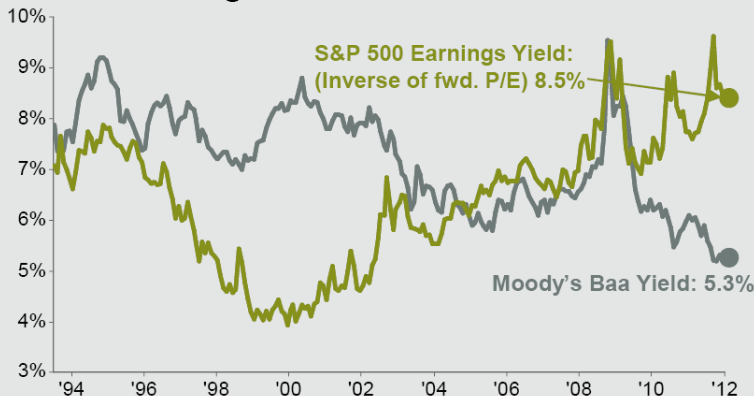
Bloomberg

### Sovereign Debt Woes Worried Markets



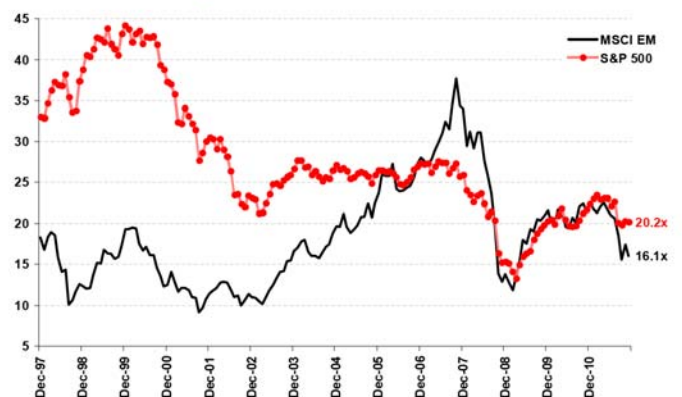
Data: Bloomberg

### S&P 500 Earnings Yield vs. Baa Bond Yield



J.P. Morgan Asset Management

### Emerging Markets Trading at Discount to S&P 500



Source: MSCI, IBEIS, Robert Shiller - Yale University website, Morgan Stanley Research. Data as of December 2, 2011