ALASKA PERMANENT APCM CAPITAL MANAGEMENT

MAY 2011

Monthly Perspectives

Economy & Markets

Last month the S&P 500 gained +3.0% and is now up +9.1% year to date. The "risk on" trade remains in favor. Small stocks rose to record highs and have gained +10.5% for the year. EAFE international stocks jumped +6.0% in April. They are up +9.5% for the year, helped in part by a weak US dollar which is down almost -8% this year.

Despite a sluggish economy, budget battles, and Middle East concerns, corporate earnings have carried the day. S&P 500 corporate profits are up almost +20% and sales have gained +10% over the past twelve months.

Ten year Treasury bond yields fell about 20 basis points last month to 3.30%. The Treasury yield curve is now about where it began the year. Municipal bonds rallied from oversold levels in March as state revenues have begun to improve.

Gold and silver have gone gaga. Gold reached a record high of $1,525 per ounce and silver has exploded by 50% since the start of this year alone; it is now back to levels last seen during the Hunt brothers silver crisis of the early 80's. Oil prices are $115 per barrel and gas is above $4 a gallon. What is going on with commodities?

Recently the Bank Credit Analyst weighed in predicting a "benign" near term outlook but a "worrisome" longer term view, as higher interest rates and increased supply weigh on prices. They argue that the world is not running out of natural resources and that known reserves of most commodities have increased over the past decade.

BCA goes on to say that while the long term outlook for oil is much better than for metals or agriculture, oil prices will be weighed down by substitutes like natural gas (and shale oil) and improved energy efficiency. They predict an eventual commodity bust, but not yet. They opine "silver is in a bubble, and when this bubble bursts, it will take gold down with it."

A different view is from Jeremy Grantham, an investment manager at GMO, who has lately been channeling his inner Thomas Malthus. Recall Malthus was an early 19th century economist who believed that rising population and a limited food supply would doom the world to a brutish life. Then along came the industrial revolution, with mechanization and productivity gains which changed everything.

Grantham notes that a basket of 33 commodities experienced a -70% price decline in real terms from 1902 to 2002. Since then, it has regained all of that ground. He believes we are in the midst of a paradigm shift and that "the world is using up its natural resources at an alarming rate."

He argues that "the rise in population, the ten-fold increase in wealth in developed countries, and the current explosive growth in developing countries have eaten rapidly into our finite resources of hydrocarbons and metals, fertilizers, available land and water."

Still, Grantham says that better weather and a weaker China suggest an 80% probability that commodities will swoon near term. This will produce a "once in a lifetime" buying opportunity.

These two somewhat opposing views are held by two of the most highly respected firms in the economic and investment forecasting business. That's what makes markets!

Mere mortals here at APCM know that diversification is a good thing so we'll maintain our roughly 5% allocation to commodities. But that means diversified holdings across the agricultural, metals and energy sectors. We won't jump on the gold/silver bandwagon.

June 5th is opening day for the Alaska Baseball League; the Bucs and Pilots play a double-header. See you at the ballpark!

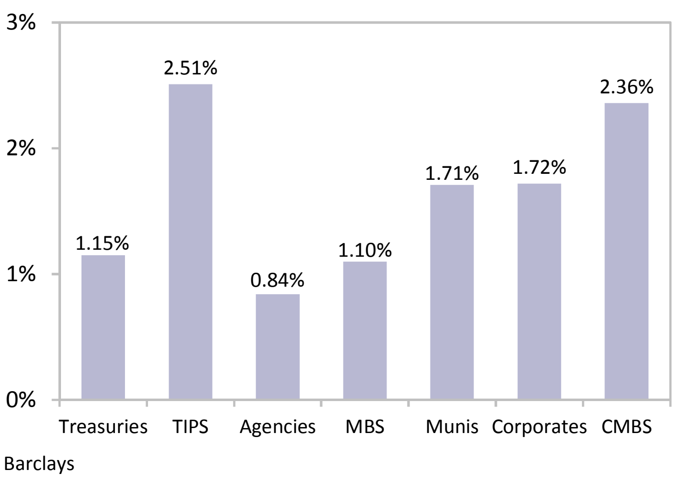
Jeff Pantages, CFA
Chief Investment Officer

Bill Lierman
Sr. Investment Analyst

■ Fixed income markets started the second quarter with a bang as interest rates fell and all sectors had positive performance in April.

■ The Federal Reserve met on April 27th and did not change the fed funds rate. They did comment that an economic recovery is taking place at a moderate pace and conceded that inflation has picked up in recent months. Chairman Bernanke held his first press conference.

April 2011 Bond Total Return



■ The Treasury market gained +1.15% despite news that S&P had lowered their outlook on the US government's debt rating from stable to negative. The yield curve shifted lower with the two year Treasury yield down 17bps to 0.61% and the thirty year Treasury yield declining to 4.41%.

■ TIPS continued their superb performance returning +2.51%. Headline inflation has picked up due to food and energy price increases. While the Fed believes these pressures to be temporary, the markets are pricing in inflation at the front end of the TIPS curve.

■ The corporate sector gained +1.72% for the month. Positive fundamentals continue as companies posted solid earnings. Furthermore, strong technicals remain in place for financials, industrials, and utilities as investors reached for yield in spread products.

■ Securitized product did well. Agency MBS returned +1.10%, CMBS delivered +2.36%, and ABS securities were up +0.95%.

■ The municipal market had a strong month posting gains of +1.71%. Limited supply and improvements in state revenue were catalysts.

EQUITY MARKETS

■ Global equities rallied in April, as the S&P 500 rose +3.0%, EAFE +6.0%, and emerging markets +3.1%. Europe was the best performing region, up +8.0%. Germany, France, Italy, and Spain have all returned more than +18% this year (in part due to a strengthening euro). Japan was close to flat (+0.4%) in April after a -10% return the previous month.

■ In the US, large companies (+3.0%) led the way with mid (+2.7%) and small (+2.6%) cap stocks not far behind. The best performing sectors for the month were defensive stocks; health care was up +6.4% and consumer staples rose +5.1%. The weakest performance came from financials (-0.1%) and telecom (+0.7%).

■ REITs continued to do well (+5.7%) after releasing strong earnings. Most either met (52%) or beat (44%) analyst estimates in Q1. 58% maintained and 38% raised their 2011 guidance.

■ Commodity performance has been strong, up another +3.5% in April. Much of this increase can be attributed to dwindling levels of inventory and threats of supply disruptions from geopolitics and weather.

■ More than 300 stocks in the S&P 500 have released Q1 earnings results. YOY sales grew by +16% while EPS growth reached +19%. Companies with a high percentage of international revenue posted more positive surprises than their domestically focused counterparts. The constituents of the S&P 500 generate 31% of their revenue outside the U.S.

Total Return (%) *as of* ***April 30, 2011***

	One Month	Three Month	Six Month	Twelve Month
Domestic Equities				
Large Cap *S&P 500*	3.0	6.5	16.4	17.2
Mid Cap *S&P 400*	2.7	10.1	23.3	25.1
Small Cap *S&P 600*	2.6	10.3	23.2	21.4
International Equities				
Developed *MSCI EAFE*	6.0	7.0	12.7	19.2
Emerging *MSCI Emerging Markets*	3.1	8.2	9.7	20.7
Other				
Commercial Property *S&P U.S. REIT*	5.7	9.0	15.4	22.7
Commodities *DJ-UBS Commodity*	3.5	7.0	19.2	30.4
Fixed Income				
Total Bond Market *Barclays Aggregate*	1.3	1.6	0.0	5.4
1-3 Yr U.S. Treasury/Agency *Barclays 1-3 Gov*	0.4	0.3	0.1	1.9
Int'l Treasury *Barclays Global Tsy ex-US*	4.7	6.6	3.6	14.3

Brandy Niclai, CFA
Sr. Investment Analyst

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(907) 272-7575 ■ 900 W 5th Ave, Suite 601, Anchorage, AK 99501 ■ www.apcm.net