



PERSI

Public Employee Retirement System of Idaho

Presentation to Economic Outlook and Revenue Assessment Committee

January 5, 2007

OUTLINE

- Review 2006 Economy and Capital Markets
 - Results and Performance against Expectations
- Present 2007 Economic and Capital Market Expectations
- Review Major Investment Trends and Themes
- Answer Questions
 - How will the economy perform?
 - What trends are you seeing in the area of corporate profits? Are current corporate profits translating into stronger hiring?
 - How do you see the stock market performing over the next 18 months?
 - To what degree, if any, does the performance of the stock market in 2006 predict economic performance in 2007?
 - How has the war in Iraq affected the stock market?
 - How do you see your performance over the next 18 months?

[FORECAST BASICS]

- PRESENTING CONSENSUS ECONOMIC AND MARKET EXPECTATIONS
 - Not Personal Prognostication
 - Surveys show economic consensus
 - Market signals current view of economy
- Current economic expectations discounted in market
 - Good economic 2006 was anticipated in 2005 returns.
- Equities react primarily to expected corporate health or profitability and bond rates, not directly to economy
- If economic and corporate expectations are met and maintained, will get bond yield and 9% - 10% stock returns. Higher or lower result of surprises and changed expectations



2007 EXPECTATIONS

How will the economy perform?

Moderately well

What are the trends in corporate profits?

Major drop in profit growth

Economic conditions and expectations

- 2006 was slightly better than expected, but mostly within usual margin of error
 - Growth and inflation slightly higher
 - Consumer spending slightly higher, business spending slightly lower
 - Biggest surprises –
 - Stunning corporate profits
 - Better than expected improvement in trade balance
 - Lower Federal Deficit
 - Better employment numbers
- 2007 expected to be generally a replay of 2006 expectations, with moderate drop in growth, and major drop in corporate profits

CONSENSUS ECONOMIC EXPECTATIONS AND RESULTS

- **Economic Activity Generally easing substantially but broadly stable**
 - Major issue housing impact
- **Growth to drop moderately**
 - Expected 2006: 3.4% (+/- 0.3%) real GDP growth vs 3.6% for 2005
 - **Actual – 3.3%**
 - **2007 – 2.3% (+/- 0.3%)** (slower in first half of year)
- **Inflation to appreciably recede**
 - Expected 2006: 3.0% (+/- 0.3%) vs current 3.4%
 - **Actual 3.3%**
 - **2007 – 2.0% (+/- 0.3%)**

2006 CONSENSUS ECONOMIC EXPECTATIONS AND RESULTS

- **Consumer Spending to decline**
 - Expected 2006: 2.8% (+/- 0.3%) vs 3.6% (real) in 2005
 - Actual – 3.1%
 - 2007 – 2.7% (+/- 0.3%)
- **Business Spending to drop slightly**
 - Expected 2006: Up 8.4% (real) (+/-1.3%) vs. 8.9% in 2005
 - Actual – 7.8%
 - 2007 – 6.3% (+/- 1.1%)
- **Corporate Profits to fall sharply**
 - Expected 2006: Decline from 15% (2005) to 9.1% (+/- 4.5%)
 - **Actual – 21%**
 - 2007 – 5.1% (+/- 2.5%)

CONSENSUS ECONOMIC EXPECTATIONS (Continued)

- **Oil Prices to stay at current levels**
 - \$56 (+/- \$5.30) vs \$60 then
 - Actual \$60.86 (12/26)
 - Forecast: \$62.30 (+/- \$3.90)
- **Housing starts fall sharply but stabilize**
 - 1.90 million units (+/- 0.8) vs 2.05 million in 2005
 - Actual 1.81 million
 - Forecast: 1.52 million (+/-0.13)
- **Fiscal Deficit to Grow moderately**
 - Deficit to grow \$372 billion (+/- \$39) from \$319
 - **Actual: \$248 billion**
 - Forecast: \$274 million (+/- \$34 million)

CONSENSUS ECONOMIC EXPECTATIONS (Continued)

- **Trade Deficit continues decline**
 - Expected 2006: Grow To \$832 billion (+/-62) from \$790
 - **Actual: \$629 billion**
 - Forecast: \$611 billion (+/- \$24 billion)
- **Job Market to stay low**
 - Expected 2006: Unemployment stay around 5% (+/-0.2%)
 - **Actual: 4.6%**
 - Forecast: 4.8% (+/- 0.2%)
- **Continued Increase in Disposable Personal Income**
 - Expected 2006 up 3.3% (real) (+/- 0.7%) vs 1.1% in 2005
 - Actual: 2.7%
 - Forecast: 3.4% (+/- 0.4%)



REVIEW OF 2006 CAPITAL MARKETS

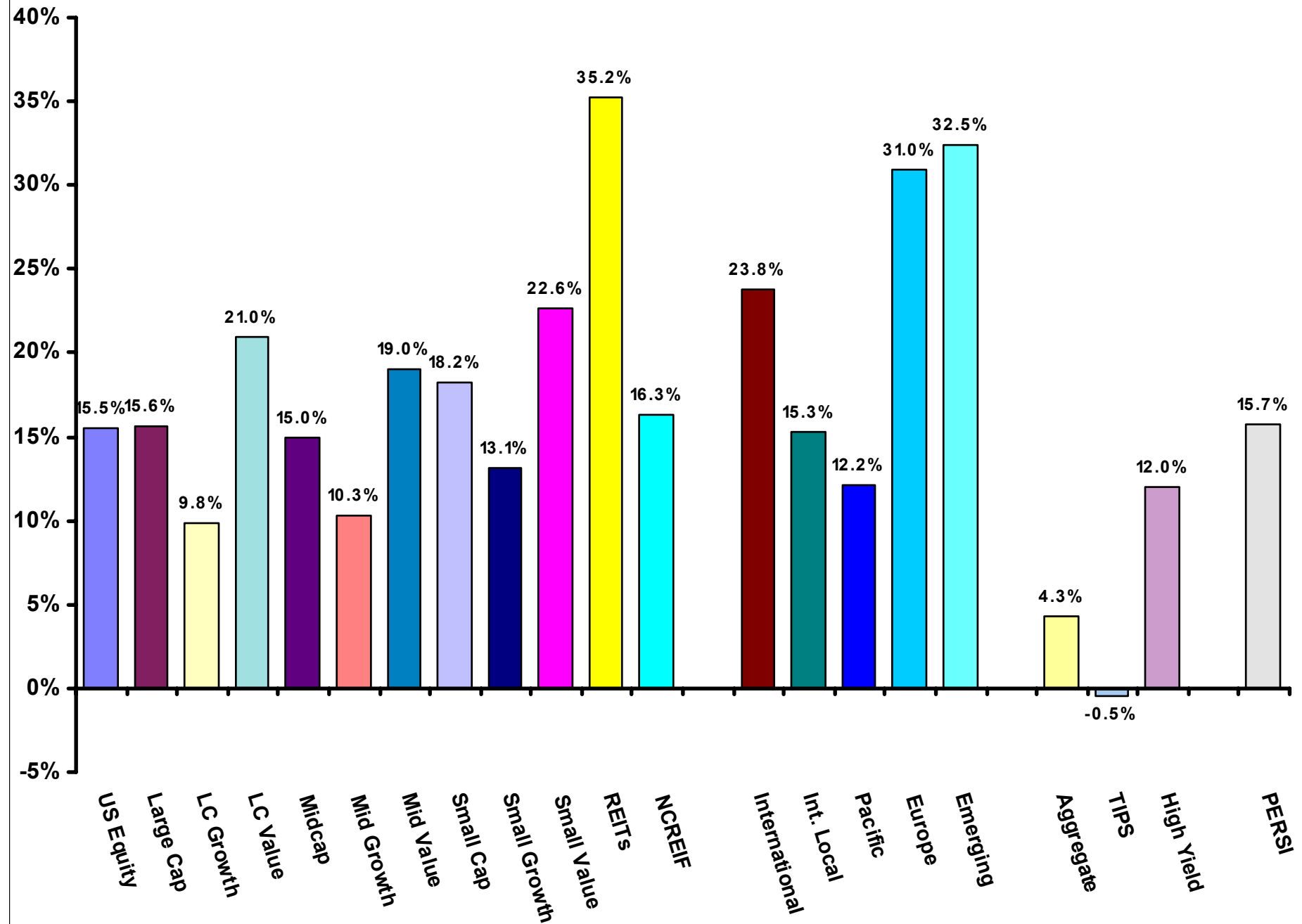
How has the war in Iraq affected
the market?

Answer: Not at all

[Driving Forces]

- Stable Economic Year – generally within expectations
 - Housing decline generally expected
- Massive Global Liquidity
 - Risk Taking Rewarded
- Surprisingly good Corporate Profits
- Excellent Year for Capital Markets
 - Exception: Government and High Quality Bonds

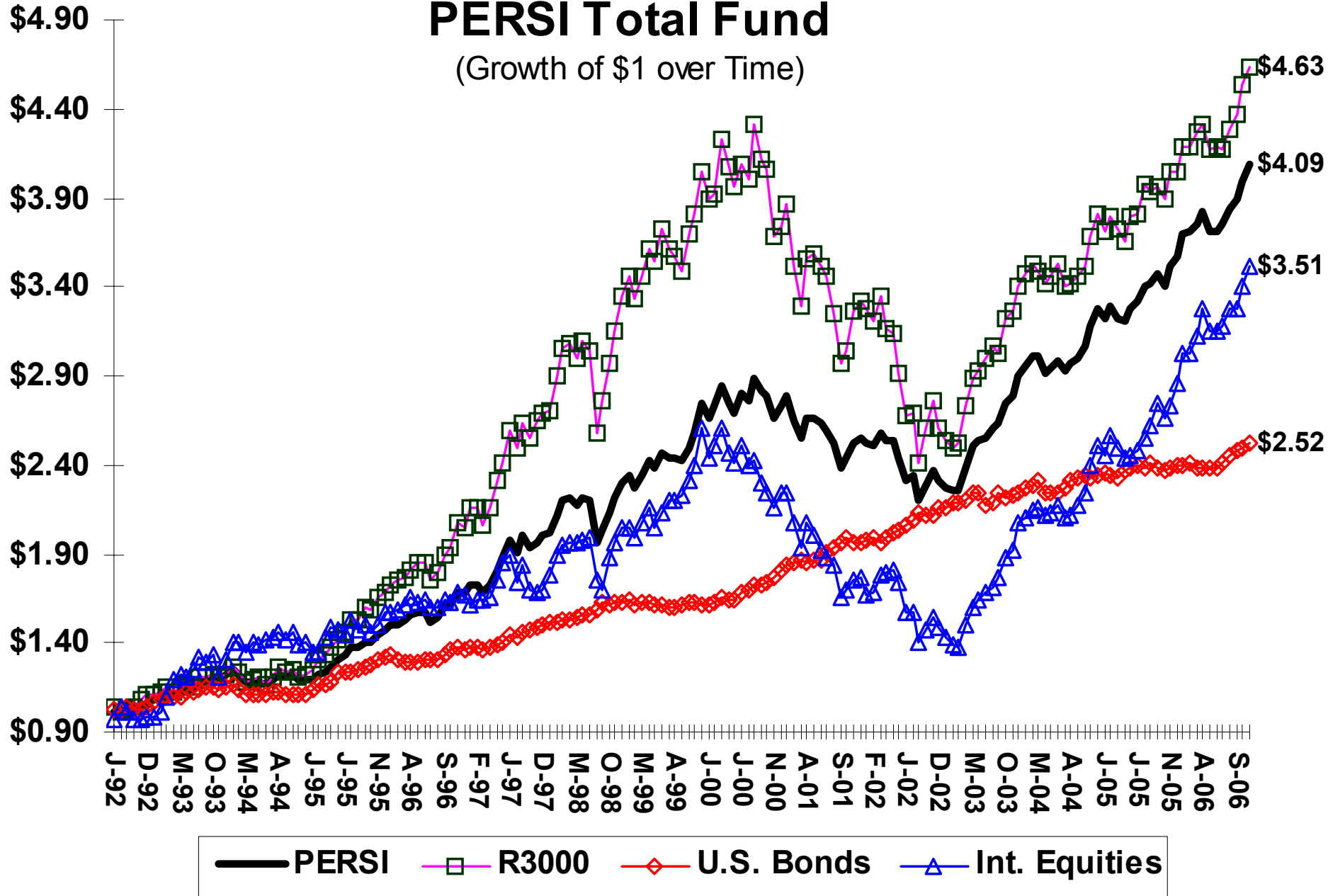
Calendar Year Returns



CUMULATIVE RETURN VS. BENCHMARKS

PERSI Total Fund

(Growth of \$1 over Time)



PERSI PORTFOLIO STATUS REPORT

December 31, 2006

	Latest Month	Fiscal Year to Date
Beginning Value	\$10,528,742,589	\$9,591,291,008
Net Contributions	(\$661,459)	(\$23,398,541)
Investment Gain	\$117,734,449	\$1,077,923,112
Ending Value	\$10,645,815,579	\$10,645,815,579

	Month	3 MO	FYTD	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
Total Fund	1.1%	6.2%	11.2%	15.7%	12.3%	12.5%	15.6%	10.1%
<i>No rebalancing</i>	0.9%	5.7%	10.3%	13.9%	9.9%	10.3%	13.8%	8.0%
<i>Benchmark (55-15-30)</i>	0.9%	5.7%	10.3%	13.7%	9.8%	10.1%	13.2%	7.7%
<i>PERSI rebalancing</i>	0.9%	5.9%	10.5%	14.1%	9.9%	10.3%	13.5%	7.9%
<i>Strategic Policies</i>	0.9%	6.1%	9.9%	14.1%	10.6%	10.9%	14.0%	8.6%
U.S. Equity	0.6%	5.3%	10.2%	15.4%	11.6%	12.5%	16.0%	8.1%
<i>R3000 Index</i>	1.1%	7.0%	11.9%	15.5%	10.7%	11.1%	16.3%	7.6%
Global Equity	2.9%	9.9%	16.3%	25.0%	18.4%	16.7%	23.3%	13.5%
<i>World Index</i>	2.0%	8.4%	13.3%	20.5%	15.2%	15.2%	19.6%	10.5%
Int. Equity	3.7%	12.5%	18.2%	26.6%	23.2%	22.3%	26.6%	16.6%
<i>MSCI EAFE</i>	3.1%	10.3%	14.7%	26.8%	20.2%	20.4%	24.8%	15.4%
Fixed Income	-1.2%	0.8%	4.7%	3.5%	3.2%	4.1%	4.5%	6.1%
<i>Lehman Agg</i>	-0.6%	1.2%	5.0%	4.3%	3.4%	3.7%	3.8%	5.0%



CAPITAL MARKET EXPECTATIONS

How do you see the stock market performing over the next 18 months?

To what degree, if any, does the performance of the stock market in 2006 predict economic performance in 2007?

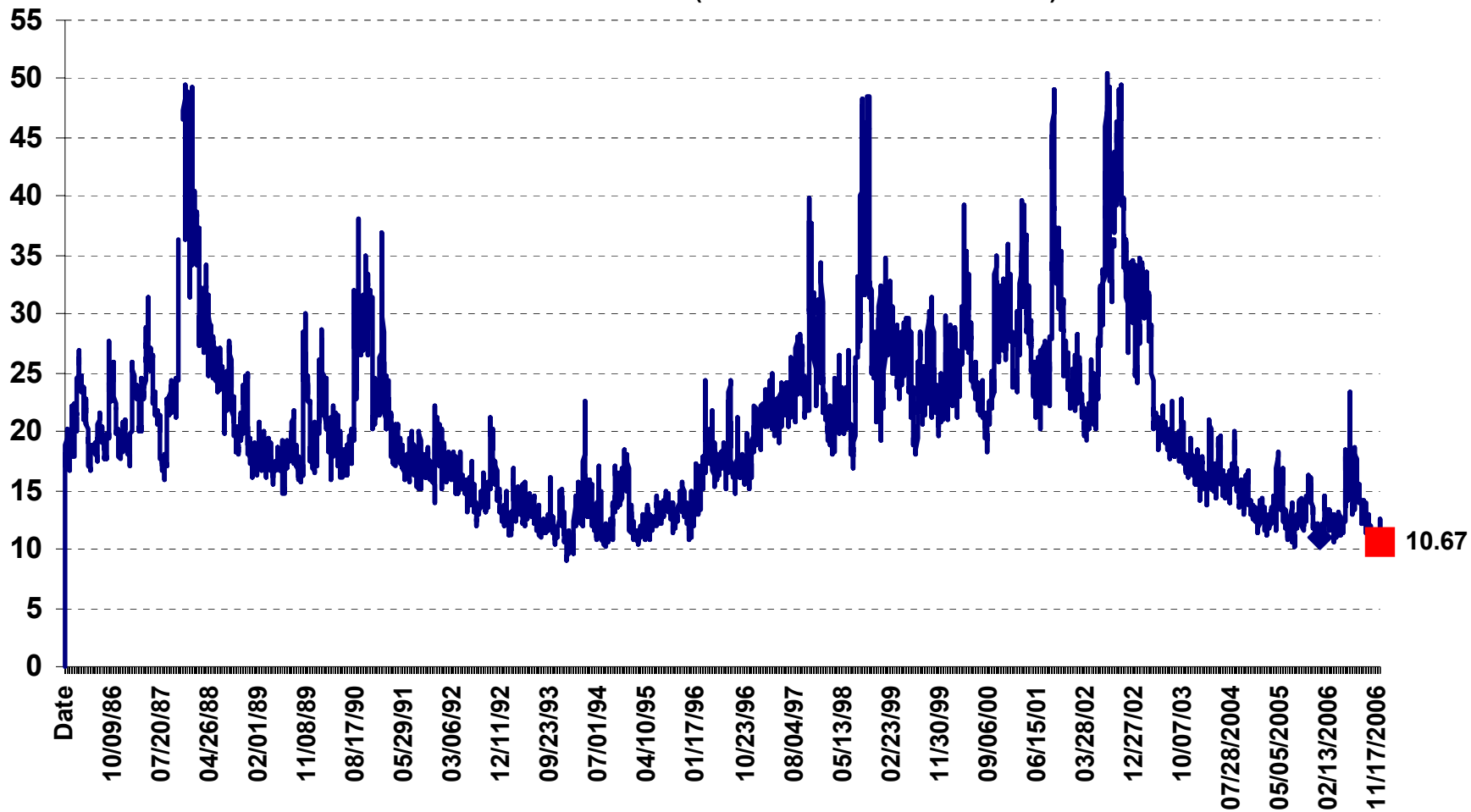
Answer: Probably one more good year left, but noticeably riskier than last year

Capital Market Expectations – Background Conditions

- Slowing but Positive Growth
- Moderate Inflation
 - Long Term Inflation 2.0-2.2% - Bond
 - Next year 2.0% -2.3%
- Risk Low
 - Volatility near record lows
 - Issue if reflects expectations due to market efficiency, or liquidity and hedge fund strategies

VIX (Stock Volatility) Index

1981-2006 (Late October 1987 Excluded)



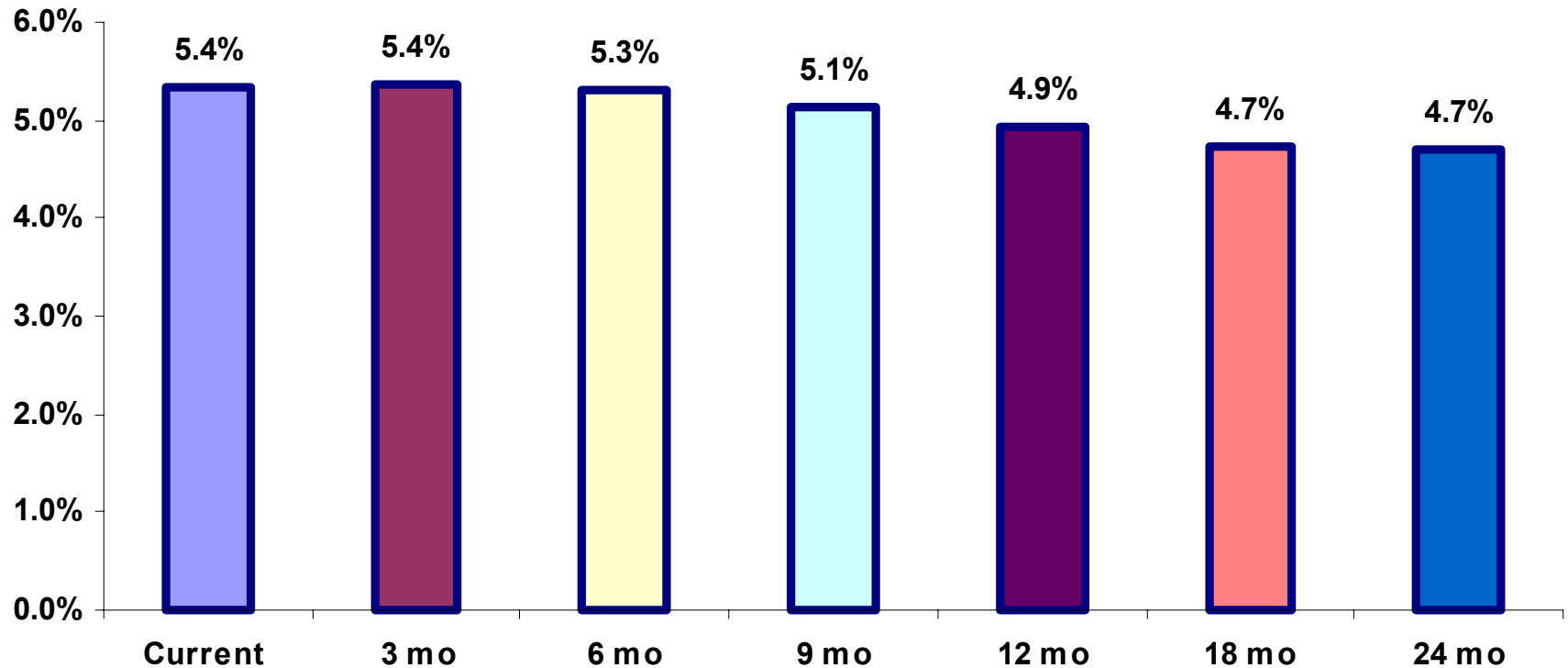
CAPITAL MARKET

Fixed Income and Cash

- **Fed done with raising short term rates**
 - Expectation of rate cut in middle of next year
 - 90 day rate to drop from 5.4% to 4.7%
- **Long Interest rates to rise moderately**
 - 10 Year to rise from 4.5% to 4.8%.
 - Curve Inversion due to global liquidity, not recession prediction
- **Dollar to stabilize against Euro, drop 10% against Yen**
 - Stable against Pound, Weaker against emerging markets

CAPITAL MARKET EXPECTATIONS

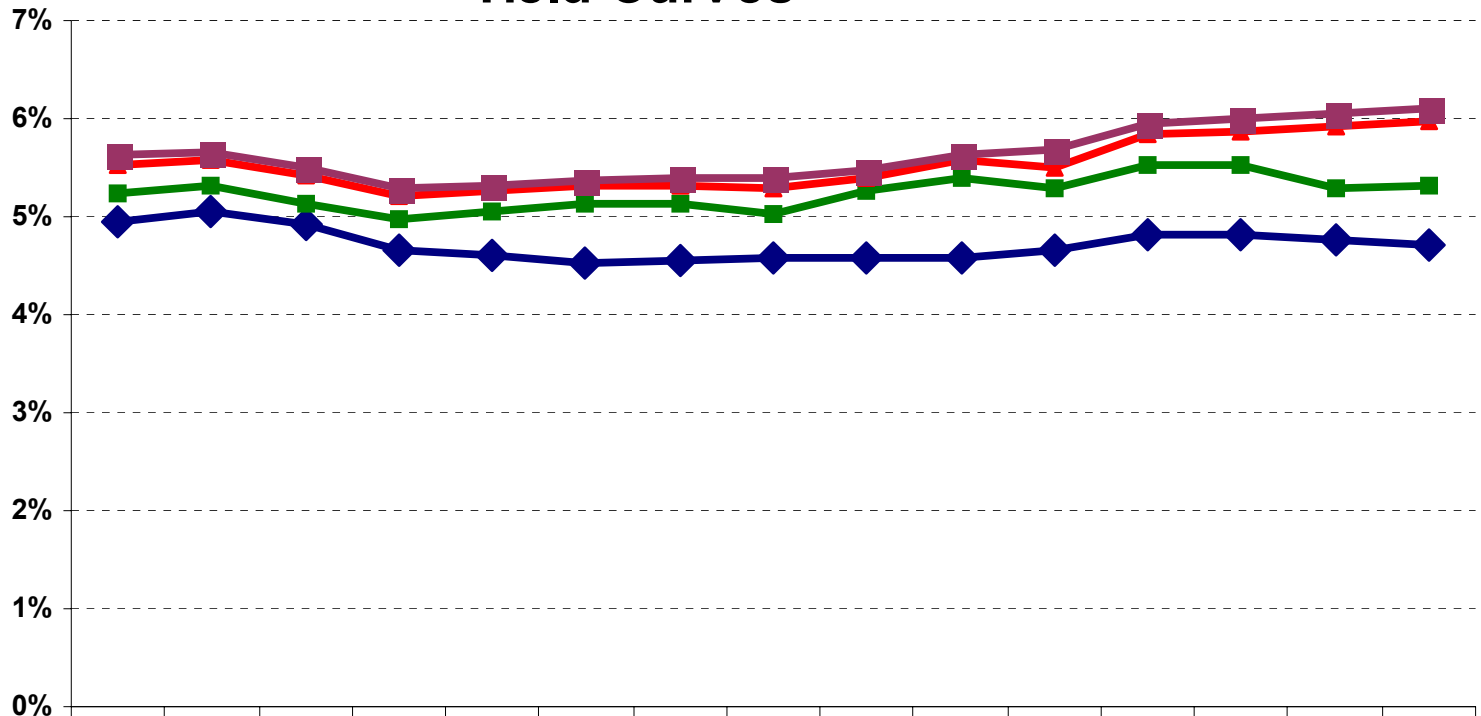
90 DAY EURO\$ FUTURES



Yield Curves Flat to Inverted

Expected Bond Returns – 5%

Yield Curves



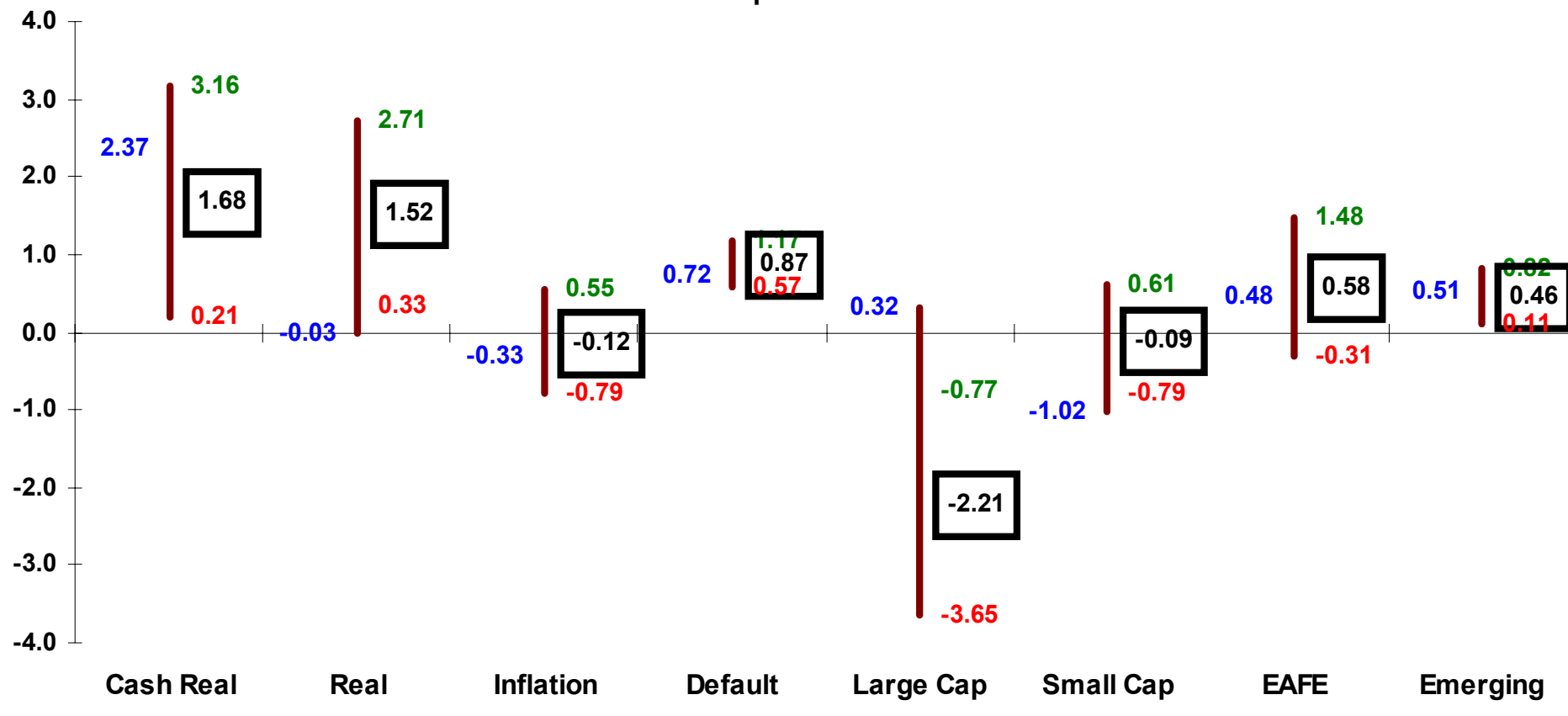
	3 M	6M	1Y	2Y	3Y	4Y	5Y	7Y	8Y	9Y	10Y	15Y	20Y	25Y	30Y
Government	4.9%	5.1%	4.9%	4.7%	4.6%	4.5%	4.6%	4.6%	4.6%	4.6%	4.6%	4.8%	4.8%	4.8%	4.7%
AAA Ind	5.2%	5.3%	5.1%	5.0%	5.1%	5.1%	5.1%	5.0%	5.3%	5.4%	5.3%	5.5%	5.5%	5.3%	5.3%
A1 Ind	5.5%	5.6%	5.4%	5.2%	5.3%	5.3%	5.3%	5.3%	5.4%	5.6%	5.5%	5.8%	5.9%	5.9%	6.0%
BBB Ind	5.6%	5.7%	5.5%	5.3%	5.3%	5.4%	5.4%	5.4%	5.5%	5.6%	5.7%	5.9%	6.0%	6.1%	6.1%

CAPITAL MARKET STOCK MARKET

- Corporate earnings to grow at 8%
 - Compare to Economists at 5-6%
- P/E Ratios to Stay Even
 - Around today's 15 on current earnings
 - Means get earnings growth (8%) plus dividend (1.6%)
- Equity Returns 9.0%-9.5%
 - Issue of net stock buyback – 2.3%
 - Possible expansion of PE ratio
 - Large Cap Growth Looks Relatively Attractive

Capital Market Risk Premiums

Spreads



[Optimistic View]

- Easy Financial Market Conditions
- Economic Growth still continuing
- Rise in corporate investment and hiring
 - Profit margins and ROE still high
 - Valuations reasonable
- Inflation to stay low
 - Still excess capacity

Fears of the Future

- **Global Liquidity dries up too rapidly**
 - Central Banks make policy mistake
 - Foreign savings flee US
- **Household sector tapped out on debt**
 - 2/3rds of Economy Stalls
 - Housing Market Collapse
 - Global markets still dependent on US consumer
- **US Fiscal Picture Precarious**
 - Chronic Budget Deficits
 - Unsustainable current account deficits
- **Commodity Squeeze**
 - Currency Collapse/Inflation/High Interest Rates
- **Global Competition Prevents Pricing Power**
 - Corporate Profits Tumble
- **Open-ended foreign commitments and Terrorism**



PERSI Investment Expectations

How do you see your performance
over the next 18 months?

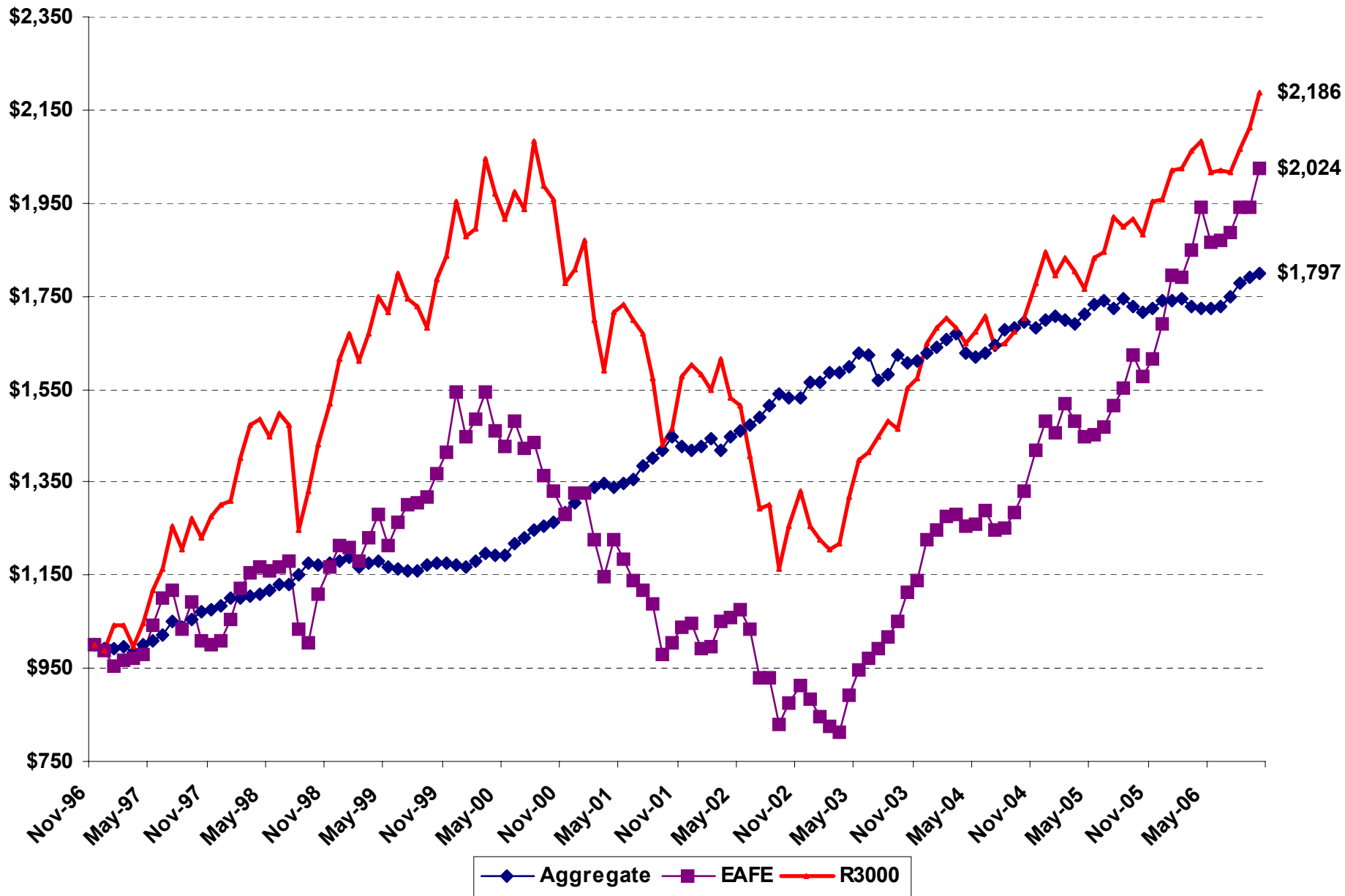
Answer: OK

Remarks by Chairman Alan Greenspan

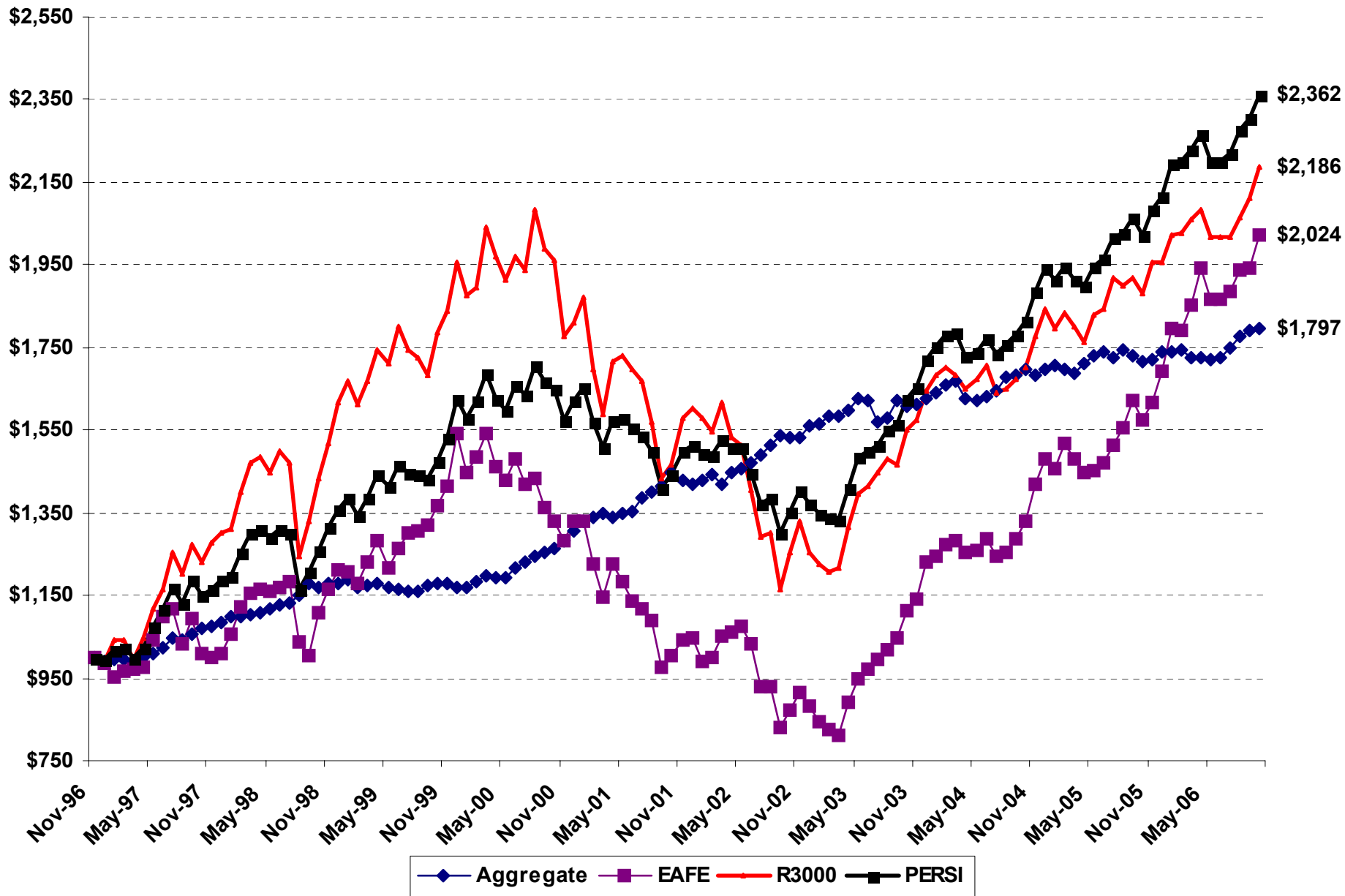
At the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research, Washington, D.C.

- “But what about futures prices or more importantly prices of claims on future goods and services, like equities, real estate, or other earning assets? Are stability of these prices essential to the stability of the economy? Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. **But how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?** “

Growth of \$1000 Since Greenspan



Growth of \$1000 Since Greenspan

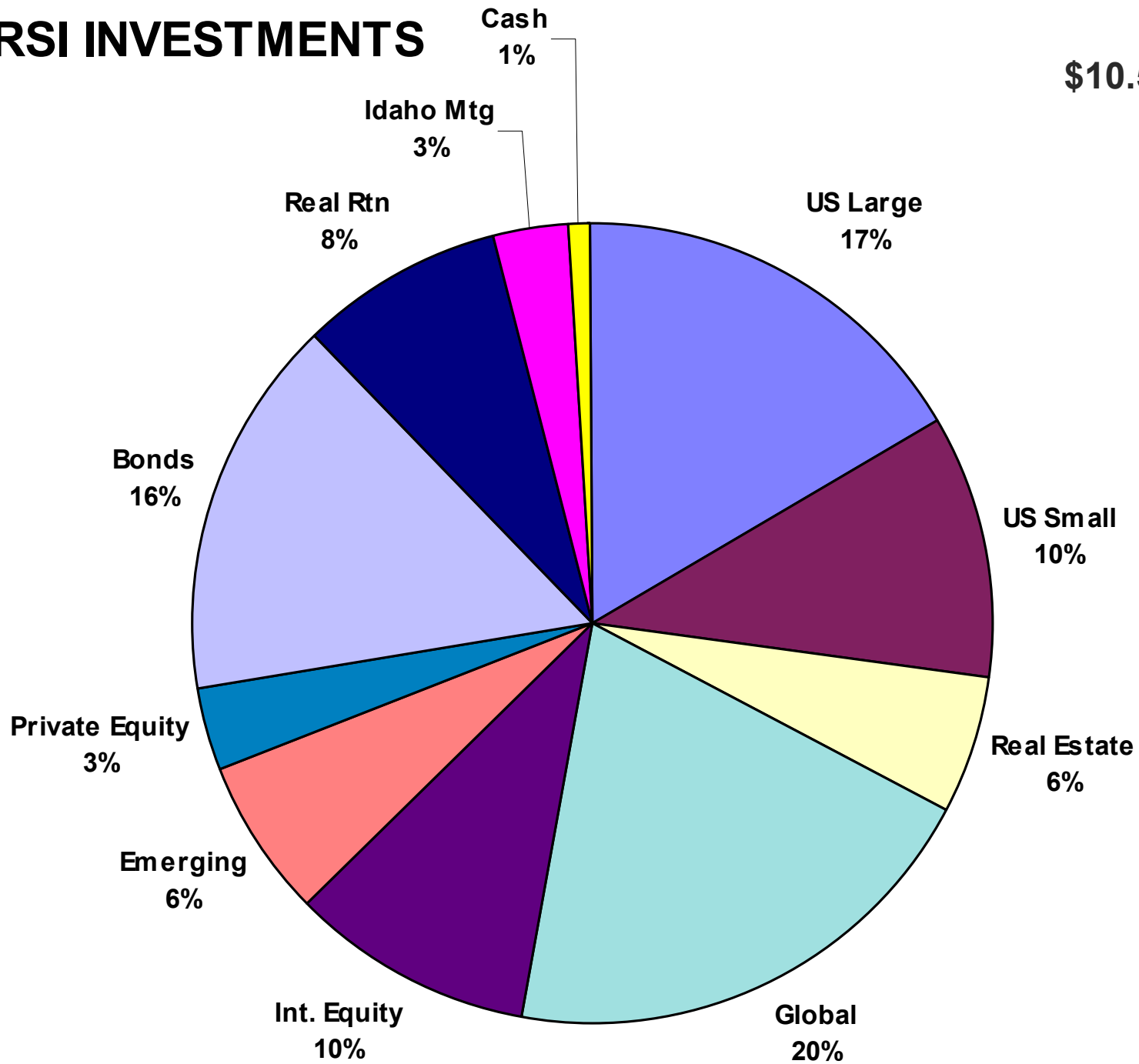


MAJOR INVESTMENT THEMES

- **Massive Global Liquidity**
 - Danger dries up too fast
- **Significant Dollar Imbalances**
 - Particularly with Emg. Mkts and Japan
 - Impacts competitiveness and long rates
- **Wealth shift to Asia has years to go**
- **Economic Slowdown over next 3-5 years likely**
 - Risk taking less likely to be rewarded
- **Large Cap Indices likely to outperform**
- **Focus Shifting from Offense to Defense**

PERSI INVESTMENTS

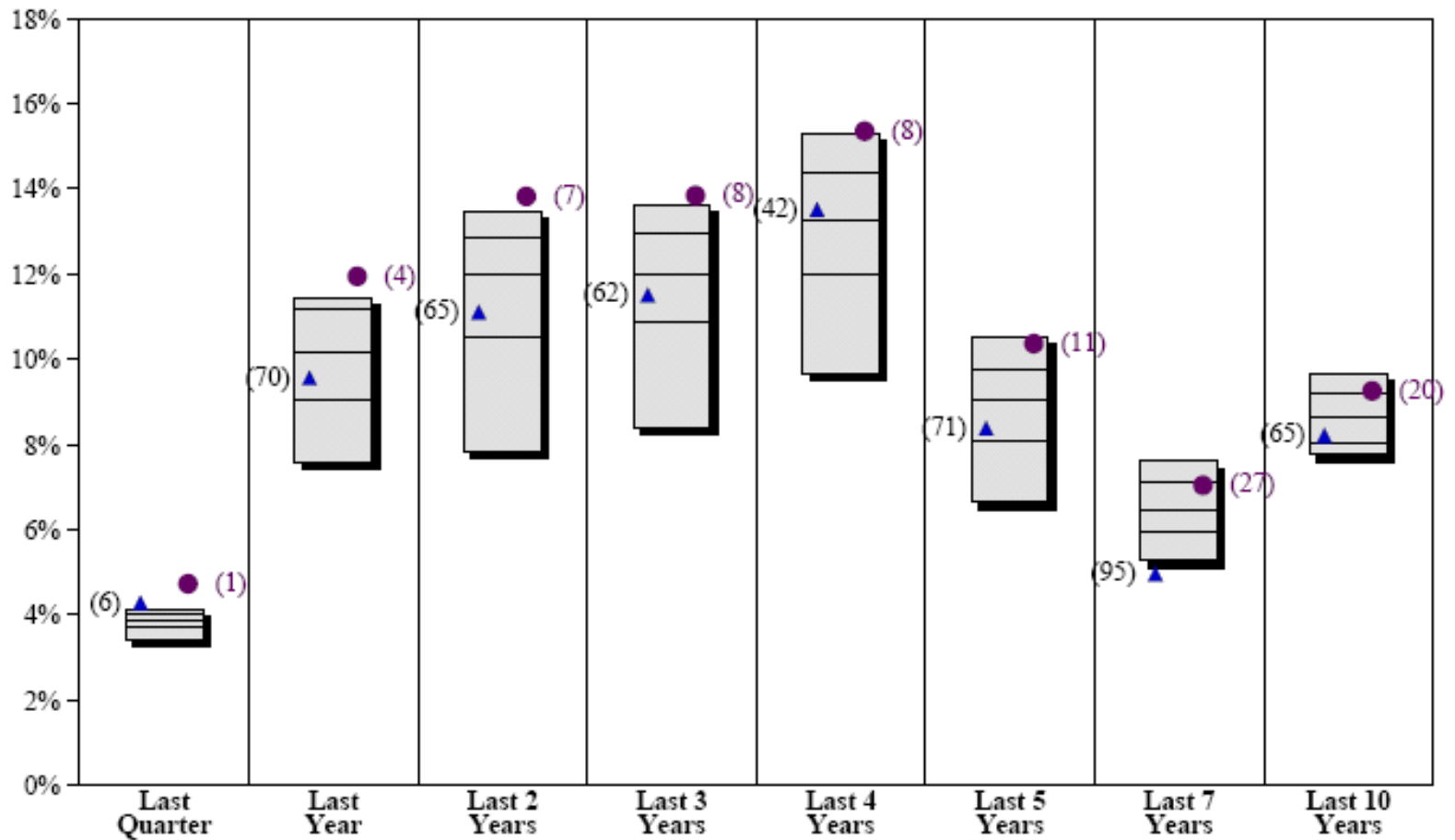
\$10.5 Billion



A Simple, Transparent, “Unsophisticated” Approach

- "Finishing 71st percentile -- or is it 29th percentile? -- may be acceptable in states like Kansas, Idaho and Arkansas where financial acumen is far less important than animal husbandry," Roberts said. "In Connecticut," she continued, "the self-styled land of actuaries, home of some of the richest and most financially sophisticated people in the world, being less than the top 10 is horrible."
 - Linda Roberts
 - Candidate for Connecticut State Treasurer
 - Connecticut New-Times, Oct. 14, 2006

Performance vs CAI Public Fund Sponsor Database



10th Percentile	4.12	11.43	13.48	13.62	15.31	10.53	7.61	9.67
25th Percentile	4.04	11.16	12.86	12.96	14.39	9.78	7.10	9.18
Median	3.86	10.17	11.99	11.97	13.26	9.03	6.45	8.64
75th Percentile	3.71	9.03	10.53	10.88	12.01	8.10	5.93	8.04
90th Percentile	3.43	7.58	7.83	8.41	9.68	6.65	5.27	7.75
Total Fund ●	4.73 (1)	11.94 (4)	13.82 (7)	13.84 (8)	15.35 (8)	10.37 (11)	7.04 (27)	9.26 (20)
Total Fund Target ▲	4.28 (6)	9.56 (70)	11.10 (65)	11.51 (62)	13.51 (42)	8.38 (71)	4.96 (95)	8.21 (65)