

***State of New Jersey
State Investment Council***

**Meeting at
Rutgers Student Center – NEW BRUNSWICK
126 College Avenue – Multi-Purpose Room B
New Brunswick, New Jersey 08901-1166**

**Thursday, January 15, 2009
3 p.m. Council Meeting**

MINUTES

Approved February 19, 2009

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
W. Montgomery “Monty” Cerf
Jose R. Claxton
Mark Kandrak
James C. Kellogg – *by teleconference*
Karl Kleeberg
Douglas A. Love
James P. Marketti
Timothy McGuckin

Absent: Erika Irish Brown, James Clemente, Susan Ann Crotty

Also

Present: *From the Division of Investment:*
William G. Clark, Director
Ray A. Joseph, Deputy Director
Gilles Michel, Assistant Director
Kaitlyn J. Adams, Legal Specialist
Brian Arena, Investment Officer
Jessie Choi, Investment Analyst
James Falstrault, Investment Officer
Susan Burrows Farber, Secretary to the Council
Maneck Kotwal, Investment Officer
Jason MacDonald, Investment Analyst
Philip Pagliaro, Senior Portfolio Manger
Christine Pastore, Investment Officer
Timothy Patton, Senior Portfolio Manager
Ainsley A. Reynolds, Accounting Manager-Alternatives
Tim Rollender, Investment Analyst
Susan Sarnowski, Compliance Officer – *by teleconference*

From the Governor’s Office, Dept of the Treasury and Attorney General’s Office:
Tom Bell, Public Information Officer
Rubin Weiner, Deputy Attorney General

Other Invitees:

Pete Keliuotis, Strategic Investment Solutions (SIS)
Stephen Nesbitt, Cliffwater
Daniel Stern, Cliffwater

Members of the Public:

William Bauer
Vonda Brunsting, SEIU
Terrence Dopp, *Bloomberg*
Valerie Kazhdan, NJEA
Michael Kollar, Macquarie Capital (USA) Inc.
Dr. Mary Ann Mesics, DOE
Anthony F. Miskowski
Clayton Mull, SCREA
Rae Roeder, President CWA Local 1033
Rick Rollins, Bank of New York Mellon
Michael Rubino
Jim Shanley, Bank of New York Mellon
Dominic Williams, SEIU

I. *Call to Order*

Chair Kramer called the meeting to order at 3:05 p.m.

II. *Notice of Meeting*

Secretary Burrows Farber reported that notice of the meeting scheduled for January 15, 2009 was sent by mail deposited in the post office, by facsimile and email on January 2, 2009. A copy of the notice is on file as posted in the Division and sent to the Council, the **Times of Trenton**, **The Star-Ledger**, the **Bergen Record**, the **Courier Post** and the Secretary of State.

III. *Approval of Minutes*

Minutes of the regular meeting of the Council held on December 18, 2008 were approved on a motion by Mr. Claxton, seconded by Mr. Cerf. The motion was unanimous, with Mr. Kellogg, Mr. Kandrak and Mr. Marketti abstaining.

IV. *Reports of Director Clark*

- A. *Memorandum from Director Clark to the Council, dated January 9, 2009, entitled "Investment Reports."*

Director Clark reported that the pension fund had a good month in December, with a value of \$63.9 billion, up 6.6 percent and \$3.3 billion over the previous month. The Standard and Poor's 1500 index was up only 1 percent in this same period. He said the two primary drivers of the month's performance were decisions to significantly increase the fund's holdings in corporate bonds, which returned 11 percent for the month, and decisions made with regard to common stock and especially international stocks, which were up 8 percent for the month compared with 6 percent for the market.

Investment Officer Arena said the domestic equities portfolio returned 2.2 percent for the month against a 1.5 percent return for the portfolio's benchmark. He said the portfolio remained down by -28.2 percent for the fiscal year-to-date period as a result of 2008 market losses, but still remained ahead of market performance and indices. He said the fund had used some indexing strategies (i.e. exchange traded funds) in December in order to move in and out of the market more quickly as opportunities arose.

Director Clark introduced Deputy Director Ray Joseph, who joined the Division in November, and credited him as being instrumental in the identification of recent bond opportunities that had provided the fund with lower risks and equity-like returns in December.

Chair Kramer noted that the pension fund's underweight position in financials during calendar year 2008 had created about 1.5 percent of value for the fund relative to market benchmarks. He also noted that the Standard and Poor's 1500 Index was down 36.6 percent for calendar year 2008, while financials in this index were down 52.2 percent. He noted the fund entered the current calendar year still heavily tilted against financial holdings relative to typical pension funds. Director Clark said the fund was about 50 percent underweight in the financials sector.

Assistant Director Michel said the same underweight position in financials applied to the international portfolio, too. He said the portfolio was up 8.2 percent in December, and that the fund had moved to eliminate its short-term bond exposure in yen.

Director Clark noted the numbers reported for private equity and real estate investment performance excluded anything that had occurred in these markets since September, as those numbers were not yet available consistent with industry reporting lags. He said it was obvious that the fourth quarter numbers when available would be in the negative range across the board.

Chair Kramer predicted the decreases in value for private equity and real estate would be dramatic for the fourth quarter. Director Clark agreed, noting that with common stocks down by 50 percent from their peak, it would be unrealistic to expect anything different in these areas.

Mr. Cerf said the move to long-duration commitments in corporate bonds appeared timely and correct, but cautioned that it should not be maintained at the expense of the fund's public equities holdings. Director Clark agreed, and noted that the shift toward corporate bonds was more tactical in nature, viewed as a medium-term opportunity while corporate bonds offered good value against stocks.

Director Clark said the Cash Management Fund was yielding 1.42 percent, mainly because the fund had extended its maturities. He said because the fund is mostly in Treasury bills, that rate will continue to decline in line with market conditions.

Chair Kramer said that Mr. Marketti had previously initiated a discussion about additional forms of disclosure; he said that New Jersey was already in the upper 10 percent of funds in disclosure now, but that it would continue to do more. He said that the holidays had delayed introduction of additional information discussed at the last Council meeting that would be included beginning with February's Director's report. Chair Kramer noted the fund already reports the list of all its hedge fund holdings and performance to date. He said the Division followed conventional methods for presenting annualized returns, and that gross numbers were not meaningful. He said also that annualized returns would be provided.

Mr. Marketti questioned the performance indicated for the BlackRock fund on Exhibit 25A; the answer was deferred for full discussion under New Business. A brief discussion of hedge fund reporting practices followed, in which Chair Kramer and Mr. Stern of Cliffwater explained that hedge funds are not required to report performance to various entities that compile hedge fund indices, therefore there is no incentive for the poorer-performing funds to do so and the resulting indices that can be used for comparison are unrepresentative. Chair Kramer noted the same is true for equity indices; when a stock's returns go to zero, this number is excluded from the indices.

V. *New Business*

A. *Alternative Investments*

- I. Memorandum from Director Clark to the Council dated January 9, 2009, entitled "Reduced and Withdrawn Commitments to Alternative Investments Previously Presented to the Council."**

Director Clark noted that the Council in December had approved a revised investment plan that reduced the pension fund's emphasis on alternatives given current market conditions. He said the Division had gone through the alternatives portfolio and was proposing a series of steps with the net effect of reducing or eliminating previously announced commitments, in order to permit a greater focus on credit-related opportunities and preserve flexibility for superior investment opportunities likely to be available throughout 2009.

He said the Division had decided to:

- Not close on a \$50 million direct commitment to Charterhouse Capital Partners IX.
- Reduce the size of commitments already closed with private equity funds managed by TPG, with a waiving of fees on the portion of capital that is reduced. The Division's commitment to TPG Partners VI was reduced from \$400 million to \$360; its commitment to TPG Financial Partners was reduced from \$100 million to \$75 million.

- Not close on an additional \$100 million real estate commitment to AEW Core Property Trust, and a \$150 million real estate commitment to Morgan Stanley Real Estate Fund VII Global.
- Redeem its \$100 million commitment to the Black River Multi-Strategy Leveraged Fund at the next redemption date in March 2009; and to
- Accept proceeds from its \$100 million commitment to Satellite Fund II as that fund commences an orderly termination.

Mr. Claxton asked if it were possible to have another manager take on the Satellite assets for holding or liquidation purposes; Director Clark said that option was being explored. Mr. Kandrac asked if it were known how much of the original Satellite investment would be recouped; Mr. Stern said it would depend on market conditions at the end of the sale, but the proceeds would be something less than the original investment.

A brief discussion of the Madoff financial scandal followed. Director Clark said the pension fund would not have needed more than a few minutes to reject any Madoff investment as not meeting basic due diligence requirements.

A discussion of the planned redemption from the Black River Fund followed. Mr. Stern said the Division's decision followed a restructuring of the fund's portfolio and elimination of strategies that the Division was not comfortable with. In response to questions from the Council, he said the redemption date was made more secure by the decision of the fund's major investor not to redeem; that the Division felt the unwinding of the fund's teams posed an instability the Division did not want to be exposed to; and that the unwinding was nonetheless proceeding in an orderly manner.

Mr., Cerf noted that the turnover of managers as proposed by the Division represented normal and appropriate activities and validated that the alternatives program was both healthy and working.

VI. *Reports of Director Clark, continued*

B. *Presentation by Strategic Investment Solutions on "Best Practices in Pension Fund Asset Allocation and Performance Measurement."*

Mr. Kelioutis of SIS presented research into pension fund best practices, noting the following key points:

- No large institutional investor is prepared to make huge strategic shifts at any one time, nor are markets prepared for such shifts. Institutional investors make their most effective adjustments working at the margins.
- Asset allocation has the biggest impact on total assets, since most fund increases come from returns not contributions
- Diversification has a positive impact in reducing fund risk
- Public pension funds fall under different reporting requirements than corporate pension funds.

In discussing the New Jersey fund's performance, Mr. Kelioutis noted:

- New Jersey was an "outlier" among public funds for many years because of its lack of alternative investments and limited diversification.
- New Jersey is not alone in embracing alternatives to improve investment diversification.
- In its asset allocation, New Jersey tends to be under the median fund target in domestic equities, over target in fixed income, and typical in its allocation to hedge funds.
- The pension fund would have lost an additional \$300 million without hedge fund diversification.
- The 8.25 percent return estimated by actuaries was necessarily a long-term target for the portfolio, not a quarterly or even annual target.

Director Clark noted the full presentation would be posted to the Division's website. It is also attached to the official copy of these minutes.

Mr. Marketti asked to be referred to empirical studies demonstrating a strong correlation between volatility and returns. Mr. Kelioutis said he would provide Mr. Marketti with a list of such studies; Mr. Cerf said he would also send this research to Mr. Marketti.

Dr. Love commended the presentation for capturing three critical macro ideas: the difference in valuation standards for the private and public sectors; the risk and return arguments for lengthening durations in the bond portfolio; and the downside of depending upon standard deviation as a sole measure of risk.

Mr. Kelioutis also noted a handout prepared by SIS summarizing transparency among the nation's 64 largest public funds. He noted that New Jersey was one of only seven funds publishing monthly fund values. New Jersey was one of only three public funds that publish monthly fund returns in addition to asset allocations.

C. Overview of the Fixed Income Portfolio presented by Senior Portfolio Managers Timothy Patton and Philip Pagliaro.

This presentation was deferred to the February meeting in the interests of time.

D. Verbal report of Director Clark regarding Division employees' compliance with Departmental Code of Ethics.

Director Clark reported all Division employees were in compliance for the year in the required disclosure of personal investments and filings related to personal investment activity. He acknowledged Compliance Officer Sarnowski's contribution to this performance in conducting group meetings for all Division employees on disclosure requirements.

VII. Committee Reports

There were no Committee reports.

VIII. Pending Matters.

There were no pending matters.

IX. New Business, continued

B. For the Information of the Council

1. Verbal report by Director Clark on Division efforts to address the August 2008 Appellate Court decision on external managers.

Director Clark said there had been several meetings with the unions regarding implementation of the court's decision and the discussions were extremely productive. He said another 30-day stay of the decision was likely and was supported by both parties.

2. Memorandum from Director Clark to the Council dated January 9, 2009, entitled "2008 Report on Northern Ireland" for filing with the Governor and Legislature."

Director Clark said the report was required by 1980s legislation that had no sunset, and there were no issues to report on the Division's investments with ties to Northern Ireland.

3. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated January 9, 2009, entitled "Investment News Clips for January 2009 Council Meeting."

The memo was noted without discussion.

X. Public Comment

Two members of the public who had submitted speaker request forms prior to the meeting were invited to address the Council.

Mr. Tony Miskowski congratulated the Council on December's performance gains and the increase in assets held in corporate bonds. He asked for a copy of the Council's bylaws, and was told one would be provided. He questioned the brief reporting of shares in a company that had gone bankrupt. Director Clark said the Division had been the co-lead plaintiff in a class action suit against the company and had won its case. As a result, the Division had received shares of the company in settlement that had only entered the portfolio long enough to be sold immediately.

Ms. Rae Roeder was granted permission by the Chair to relinquish her time to a tax auditor, Mr. Mike Rubino. Mr. Rubino noted the relationship between contributions and returns described in the consultant's "Best Practices" presentation, and expressed the union's continued concerns about missed and reduced employer contributions to the state pension fund. He said it is difficult to maximize returns lacking a full employer contribution. He distributed a handout, attached to the official minutes of this meeting, suggesting that the withholding of employer contributions translates into a performance loss totaling an average of \$30,000 for the typical retiree.

Mr. Cerf commended the handout but said the union was misdirecting its concern to the Council, which has no role in employer contributions. He suggested the union provide its handout to those who work for county and municipal employers. A brief discussion followed in which Council members noted the same concern was being voiced by various pension boards and that efforts to require employer contributions should be focused on the legislature.

Mr. Kandrak recommended that in light of the state's current budget problems the Council go on record as believing the Division could ill afford the loss of any personnel through cutbacks or layoffs. Chair Kramer noted that the Treasurer and Governor's office had been supportive of a small increase in Division staff in recent years. Mr. Berg noted the Division could afford neither personnel cuts nor mandatory furloughs of the investment team.

Chair Kramer articulated the view of the Council that the Division is seriously under-resourced, that additional resources should be provided where available, and that the Division should not be subjected to further constrictions. This view was adopted by consensus.

XI. Communications

There was no report from the State Treasurer.

XII. Next Meeting

February 19, 2009

Noon: Lunch/1 p.m. Meeting

Rutgers Student Center
Multi-Purpose Room B
126 College Avenue, 1st Floor
New Brunswick, NJ 08901

XIII. Adjournment

The meeting was adjourned by unanimous vote at 5:20 p.m.

Respectfully submitted,
Susan Burrows Farber, Secretary to the Council