

New Jersey State Investment Council May 16, 2013, Regular Meeting

Minutes of the Regular Meeting:

Held on May 16, 2013 at 10:06 AM at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton, New Jersey.

Council Members in Attendance:

Robert Grady, Chair
James E. Hanson via conference call
Brendan T. Byrne, Jr.
James Joyner
Guy Haselmann
Adam Liebttag
Timothy McGuckin
Jeffrey Oram via conference call
Michael Greaney
Michael Cleary
Charles Dolan
Mitchell Shivers

Council Members Absent:

Marty Barrett
Peter Maurer

Roll Call and Meeting Notice

Chair Grady called the meeting to order at 10:06 AM. Christine Eckel performed roll call and reported that notice of the Regular Meeting scheduled for May 16, 2013, was posted to the website of the Division of Investment (the Division) on May 1, 2013, sent via fax to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post on May 1, 2013, and e-mailed to the Secretary of State on May 1, 2013. A copy of the notice was posted at the Division and is on file.

Approval of Minutes for Annual Meeting held on January 17, 2013

In response to a question from Mr. Byrne, Mr. Grady proposed to add the words "above benchmark" before the word "gains" on the sixth line of page 1, paragraph 2. Mr. Grady motioned to approve the minutes as amended, Mr. Byrne seconded, and the motion was unanimously approved, with Mr. Hanson abstaining.

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Approval of Minutes for Regular Meeting held on January 17, 2013

Mr. Haselmann proposed that title be corrected to read "regular meeting." Mr. Grady motioned to approve the minutes as amended, Mr. Haselmann seconded, and the motion was unanimously approved, with Mr. Leibtag and Mr. Hanson abstaining.

Approval of Minutes for Regular Meeting held on March 21, 2013

Mr. Grady motioned to approve the minutes as presented, Mr. Shivers seconded, and the motion was unanimously approved.

Director's Report/Update

Mr. Grady reviewed the performance of the fund, stating that for FYTD the fund was up 13.3% and for CYTD the fund was up 6.2%. Mr. Grady also discussed an article in the Star Ledger regarding State pension contributions.

Director Walsh reviewed the Director's report, commenting on current market conditions and the Division's recent performance. Mr. Grady noted the Division's dividend yield from its equity holdings. Deputy Director McDonough provided more detail on the Division's performance, both on an absolute basis and versus the relevant benchmarks. Mr. Walsh congratulated Kathy Jassem for her work with the Division's REIT investments.

Mr. Walsh provided an update on the Division's secondary sale of certain real estate funds. He stated that the Division was negotiating a purchase and sale agreement, and expected it to be completed within a few weeks. He also discussed the shortening of bond duration and the reallocation of international equity assets from a passive to an active portfolio.

Cash Management Fund presentation

Linda Brooks of the Division presented an overview on the Cash Management Fund (CMF), which is a short-term liquid investment pool utilized by the State's pension funds, the State of New Jersey, and municipalities, school districts, and agencies and authorities who elect to participate in the Fund. Ms. Brooks discussed the purpose of the Fund, its history, the types of investments and the Fund's recent performance. There are approximately 2,600 active non-State participants in the CMF.

Mr. Grady asked what the State receives in fees for managing the funds for non-State participants. Ms. Brooks described the 5 bps administrative fee collected from non-State participants, which totals approximately \$800,000 per year. Mr. Walsh noted that for the 10 year return, the CMF has outperformed the benchmark by 100 bps.

Mr. Liebtag asked Ms. Brooks to describe efforts made by the Fund to inform local agencies of the availability of CMF. Mr. Dolan asked if anyone has been turned away from the Fund. Ms. Brooks

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responded that she has never turned anyone away and also stated that there is no minimum or maximum balance requirement.

Annual Investment Plan & Asset Allocation

Mr. Walsh reviewed historical changes to the Fund's asset allocation and the proposed changes for FY 2014. Mr. McDonough provided more detail with respect to the recommendations for the five asset classes: risk mitigation, liquidity, income, real return, and global growth. Mr. Byrne and Mr. McDonough discussed the Division's plans to hedge the portfolio. Mr. Grady and Mr. McDonough discussed the increase in high-yield debt and private equity.

Brady O'Connell, from Ennis Knupp, compared the proposed allocation with that of other institutional investors and with the Yale model. Mr. O'Connell described the structure of other funds' fixed income portfolios. He also discussed the reduction of bond duration.

Mr. McDonough reviewed the Division's recommendation of a bond duration target range, and the recommended plan benchmarks and their components.

Mr. Grady noted the importance of the return and risk assumptions, and the correlations between asset classes. Mr. Haselmann emphasized the importance of diversification, not only among asset classes but also among geography, in order to mitigate downside risk as a long-term investor. He suggested further consideration of investing in assets with strong negative correlation as hedges, as well as giving the Director flexibility to move assets into cash to avoid risk. Mr. Grady and Mr. Haselmann discussed creative real asset investments such as royalties, with Mr. Grady suggesting a future presentation on such investments. Mr. Byrne expressed support for shortening bond duration, and recommended that the Division track sub-asset class categories within each asset class. He also agreed with Mr. Haselmann's suggestion to increase the Division's flexibility to increase its cash positions, offering an upper limit of 15%.

Mr. Hanson questioned the increase in the high yield allocation target above the Division's current level of investment, given the asset class' anticipated returns and risk profile. Mr. McDonough and Mr. Haselmann responded that the increase was not so much an increase in traditional high yield debt, but rather a move into more opportunistic high yield investments such as bank loans and asset backed securities. Mr. Grady asked the Division to provide the Council with further information distinguishing traditional versus opportunistic high yield investments.

Mr. Shivers asked if the Division was investing resources to prepare staff to better manage increased investments in emerging markets. Director Walsh replied that the Division is unable to rely exclusively on internal staff for its emerging markets portfolios, and is therefore using investment advisers to consult on those investments. Mr. Dolan inquired about the steps being taken by the Division to protect against a sudden decrease in the equity markets. Director Walsh described the Division's hedging activities, as well as its efforts to shorten bond duration.

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Mr. Grady motioned to approve the proposed target allocations for FY 14, the proposed long-term asset class ranges, the proposed shortening of the target range for duration of the fixed income portfolio, and the plan benchmarks for FY 14. Mr. Haselmann seconded. The motion passed unanimously.

Mr. Hanson and Mr. Oram left the meeting.

Mr. Grady motioned to amend the proposed long-term target range for cash from 0-10% to 0-15% as suggested by Mr. Byrne earlier. Mr. Haselmann seconded. The motion passed unanimously.

Proposed Alternative Investments

Mr. Walsh provided background on the European real estate market, and opportunities presented by bank deleveraging.

Perella Weinberg

Mr. MacDonald reported on the proposed investment in Perella Weinberg Real Estate (PWRE), an opportunistic fund led by Leon Bressler which is focused on real estate in the UK, France and Germany. He noted that the proposed real estate secondary sale is recommended in order to increase the Fund's exposure to European Real Estate, which is expected to drop as a result of the proposed real estate secondary sale. He described the terms of the investment, noting in particular the 11% preferred return.

Mr. Nemtsov discussed the lack of competition in the market and the track record of Mr. Bressler. He emphasized the alignment of interest based on the preferred return and the distribution waterfall, and also noted the favorable fee structure.

Mr. Grady noted that the investment, aside from having a top tier manager and favorable terms, also helped the Fund's diversification goals, and stated that the IPC was satisfied that adequate and appropriate due diligence had been performed.

M&G Real Estate Debt Funds II & III

Mr. Walsh and Mr. MacDonald discussed the proposed investment in two M&G real estate debt funds. Mr. Walsh noted the positive risk adjusted returns in the European real estate market compared to the US real estate market, and noted that the window of opportunity is limited. Mr. MacDonald noted the manager is a top-tier fund manager.

Mr. Nemtsov discussed M&G's strategy of providing blended mortgages of 1st mortgages and mezzanine loans. He also described the terms of both funds, including the management fees.

Mr. Grady noted the attractive terms of the investment, stated that the investment furthered the Fund's diversification goals, and reported that the IPC met on the investment and concluded that adequate and appropriate due diligence had been performed. He also noted that this fund used First Avenue Partners

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LLP as a third-party solicitor in connection with the potential investment, and noted that the principals of First Avenue were experienced raisers of institutional capital.

Mr. Haselmann commented on the favorable fee structure and noted that the enhanced returns are not based on increased risk but result from a tightening of banking regulations that created the opportunity in this market.

JANA Strategic Investment Fund (JSI)

Mr. McDonough reviewed the proposal for JSI. He stated the Division was proposing a \$100 million investment in the fund and up to \$200 million more for co-investments. He reviewed the fund's strategy, its track record, and the terms of the investment. He stated that the Division viewed the investment as a complement to the Fund's internal equity portfolio.

Jake Walthour from Cliffwater discussed JANA's management team, its past activist engagements, and its investment strategy. He described the terms of the investment, including management fees with a weighted average of 38 basis points. Mr. Grady noted the fund manager's past performance and the lower than market management fees, and stated that the IPC concluded that adequate and appropriate due diligence had been performed.

Marlin Equity Partners IV, LP Fund

Mr. McDonough gave a brief introduction of the proposed investment.

Steve Hempler from SIS described the fund's strategy, its history and management team. He discussed the fund managers' past performance record and the terms of the fund. In response to a question from Mr. Dolan, he explained the fee offset.

Mr. Grady commented on the investment's positive effect on diversification within the private equity portfolio and the superior returns of prior funds, and stated that the IPC concluded that adequate and appropriate due diligence had been undertaken. He also noted that this fund used Credit Suisse Securities (USA) LLC as third-party solicitor in connection with the potential investment.

SIC Regulation Re-adoption

Ms. Susan Sarnowski gave background information on the readoption process, and outlined significant changes in the proposed regulations. She informed the Council that, if the proposed changes are adopted, the Division will likely propose merging certain of the common pension funds.

Mr. Walsh, Mr. Grady and Mr. Haselmann thanked Ms. Sarnowski and staff for their work on the readoption. Mr. Grady made a motion to approve the resolution presented as Exhibit A (see attached). Mr. Joyner seconded. A roll call vote was done. Councilmembers Grady, Byrne, Joyner, Haselmann, Liebttag, McGuckin, Greaney, Cleary, Dolan and Shivers voted in favor, with none voting against.

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Procurement of Advisers and Consultants

Ms. Sarnowski reviewed the proposed policy whereby DOI would be responsible for the procurement of investment advisers and consultants. Mr. Grady moved for adoption of the Division of Investment Procurement Procedures for Investment Advisers and Consultants and amendment of the State Investment Council Engagement of Investment Advisers Policy. Mr. Shivers seconded. None opposed.

Mr. Liebtag and Mr. Walsh discussed the relationship between these policies and Division of Purchase and Property (DPP) regulations and policy. The motion was approved unanimously.

Brokerage Commissions

Ms. Sarnowski presented the annual report required by the Division's Soft Dollar Policy. She explained what a soft dollar relationship is and how the process works. Mr. Walsh and Mr. Grady commented that the use of soft dollars is a common industry practice.

Treasurer's Report

Dr. Steindel provided an update on current US and New Jersey economic conditions.

Audit Committee

Mr. McGuckin reported that KPMG was selected as the new auditor, and that the audit committee met with KPMG on June 3rd for the preliminary required meeting which allows them to present the audit plan and prepare for the upcoming audit. Mr. Grady added that he resigned from the committee and selected Mr. Cleary to serve on the committee.

Adjournment

Mr. Grady motioned to adjourn the meeting, with Mr. Haselmann seconding the motion. All voted in favor. The meeting was adjourned at 1:53 p.m.