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, December 18, 2008
Noon Luncheon/1 p.m. Council Meeting

MINUTES

Approved January 15, 2009

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
W. Montgomery "Monty" Cerf
Jose R. Claxton – *by teleconference*
James Clemente
Karl Kleeberg
Douglas A. Love
James P. Marketti

Absent: Erika Irish Brown, Susan Ann Crotty, Mark Kandrac,
James C. Kellogg, Timothy McGuckin

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

From the Governor's Office, Dept of the Treasury and Attorney General's Office:
Tom Vincz, Director of Communications
Rubin Weiner, Esq., Deputy Attorney General

Other Invitees:
Pete Keliuotis, Strategic Investment Solutions (SIS)

Members of the Public:
William Bauer
Vonda Brunsting, SEIU
Dusty McNichol, *The New York Times*
Dr. Mary Ann Mesics, DOE
Anthony F. Miskowski
Clayton Mull, SCREA
Rick Rollins, Bank of New York Mellon
Jim Shanley, Bank of New York Mellon
Dominic Williams, SEIU

I. Call to Order

Chair Kramer called the meeting to order at 1:10 p.m.

II. Notice of Meeting

Secretary Burrows Farber reported that notice of the meeting scheduled for December 18, 2008 was sent by mail deposited in the post office, by facsimile and email on December 1, 2008. 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 November 20, 2008 were approved unanimously on a motion by Mr. Cerf, seconded by Mr. Berg.

Minutes of the annual meeting of the Council held November 20, 2008 were approved unanimously on a motion by Dr. Love, seconded by Mr. Cerf with Mr. Clemente abstaining because he was absent for the annual meeting.

IV. Welcome New Member

Chair Kramer welcomed Major Karl Kleeberg to the Council. Major Kleeberg was appointed by the State Police Retirement System to fulfill the remainder of the term of the late Major Marshall Brown. Chair Kramer said a briefing on Council processes and issues would be offered to Major Kleeberg by teleconference, and invited other Council members to express any interest in participating.

V. Committee Reports

A. There were no Committee reports.

Executive Committee/Audit Committee; Communications and Public Employee Relations Committee; Corporate Governance Committee and Diversity Committee; Economically Targeted Investment Committee; Incentive Compensation Committee; and Investment Policy Committee.

VI. Pending Matters.

A. Compliance Officer Sarnowski reported that revisions to the following Council regulations became effective December 15, 2008 as adopted by the Council on November 20, 2008 following the public comment period: Amendments to N.J.A.C. 17:16-12, 13, 16, 19, 41, 44, 46, 58, 63 and 69; Repeal of N.J.A.C. 17:16-14 and 15: and New Rules N.J.A.C. 17:16-23, 24 and 40

VII. New Business

A. Proposed Alternative Investments

1. Memorandum from Director Clark to the Council, dated December 12, 2008, entitled "Proposed Private Equity Investment in the TPG-TAC 2007 fund."

Director Clark said the proposed investment was a follow-on to the Division's original investment in this levered loan fund, similar to other follow-on investments presented to the Council at the past two meetings with one difference: the majority of this follow-on will not be called now and may never be called; rather, the funds are part of a pro-active strategy to provide an equity cushion if needed.

Mr. Keliuotis of SIS said the capital would generate interest for the Pension Fund even if the funds went uncalled, and a preferred return if funds were called.

In response to questions from the Council, Mr. Keliuotis said there were no fees and no carried interest on the additional investment and that all other partners in the fund were participating.

In response to questions from Mr. Marketti about how this and similar investments are sourced, Director Clark said TPG had approached the Division about Division interest in a follow-on investment, and the Division had decided to make the follow-on investment after internal discussion and due diligence by staff and the Division's consultant, including a review of the portfolio and analysis of returns. More generally, he said, alternative investments other than follow-ons follow a top-down process: the Council sets desired allocations for different types of investments based on a view of the market; the Division obtains lists of available funds that fit these strategies, and both consultants and staff review material on the candidate funds' history of performance. Meetings are held with funds that make the first cut, he said, and the final choice is made by whittling down the options through detailed due diligence.

Chair Kramer added that sometimes opportunities are sourced by the Division but often recommended by the Division's consultants. Director Clark noted the consultants have large quantities of data on funds in the desired investment space, and that in addition to this data the Division may also identify opportunities for the consultants to follow. Director Clark said the consultant writes the due diligence report presented to the Council, with participation and comments from staff.

A brief discussion followed Mr. Marketti's question as to whether having the consultant as the source of a recommendation and also perform the due diligence was a conflict of interest. Chair Kramer said that a recommendation by a consultant without due diligence was inappropriate, and that the performance of due diligence by a firm which did not reach a conclusion would be meaningless. This is why all pension funds merge the functions in one consultant. He also noted that the final judgment rested with the Division. Director Clark said that all consultants who do business with the Division are required to show they have no financial relationship with potential investment firms and that there are penalties for violations. Deputy Attorney General Weiner noted that a new RFQ (Request for Qualifications) being drafted for consultants further details required disclosures.

Chair Kramer said a final item of new business was raised by a letter to the Council from Mr. Marketti asking for additional investment disclosures. He said that since 2002, the Council had substantially added to pre-existing disclosure practices in New Jersey and that the Division had asked its general consultant to verify whether there were greater levels of disclosure that might exist elsewhere. He noted that for most asset classes, the Division already provides monthly, quarterly, fiscal year and calendar year performance disclosures. He said that going forward the Division will also include REITs, US High Yield and TIPs results to its reporting, as well as three-, five- and 10-year annualized results on a quarterly basis. He said that the Division lacked the resources to provide these additional figures on a more frequent basis, and that 15-year figures requested by Mr. Marketti would be too difficult to provide. To Mr. Marketti's question about measuring fund performance against actuarial calculations for required returns and contributions, Chair Kramer explained it was Council policy not to tie investment policy to actuarial estimates but rather the best returns possible at the lowest risk.

Chair Kramer said the Division would also publish the fees paid to external managers and to asset class consultants on an annual basis.

Director Clark noted there had been much press scrutiny of the fund's performance, aided by the fact that New Jersey was one of few funds in the top 10 or 15 that had published performance figures since June 30, 2008. He said the Division takes transparency seriously, and that research suggested the Division was leading other funds in the regular reporting of performance.

Mr. Marketti asked to go on record as opposed to the investment in the TPG fund.

B. For Action by the Council

1. Memorandum from Director Clark to the Council, dated December 12, 2008, entitled "Investment Plan Update."

Director Clark said the Division had exercised its limited authority to deviate from previously established investment targets, consistent with the discussion at the last Council meeting about the need for flexibility in the face of historic market change. He asked for Council feedback and approval on the updated investment plan which outlined those deviations.

The proposed plan presented two major shifts, he said. First, a much larger allocation to fixed-income securities, especially investment-grade corporate bonds, in light of what appear to be tremendous opportunities in the current market to earn historical equity-like returns on these investments. Second, a shift toward inflation-sensitive assets in anticipation of potential inflation pressures at the back end of current fiscal and monetary policy initiatives. He said the plan proposed keeping the allocation to real assets at 3-4 percent, but carving out within that an allocation for precious metals as a better hedge against inflation. Because TIPs offer almost the same yield as bonds but without inflation protection, Director Clark said the plan recommended an increase in the fund's allocation to TIPs and a reduction of emphasis on nominal Treasury bonds.

Director Clark said the plan also proposed a significant shift in the rate of growth of alternative investments. He said the plan's central tendency recommended little real estate investment growth and almost no hedge fund growth, but allowed the opportunity to grow in private equity in the light of anticipated secondary sales of these assets at attractive prices by trusts and endowments seeking to increase their liquidity.

Chair Kramer said the target bands in all asset classes would seem too wide for some and too narrow for others, but he believed the 4-7 percent target band for hedge fund investments to be necessary and appropriate given political constraints, although much narrower than he was comfortable with from a risk-mitigation perspective. Dr. Love concurred, and added he thought the plan overall moved in the right direction particularly in lengthening the duration of fixed income. Mr. Cerf said he agreed with the plan intuitively and analytically, and urged the Division to keep an eye on TIPs to the extent deflationary pressures make them of less value than they are today.

Mr. Marketti said he thought it good to expand the base of asset classes, but there should be a go-slow approach to determining whether new investments made a positive difference to the fund, noting a "dramatic change in losses" since the inception of alternative investments. Chair Kramer said the shift from equity to hedge fund holdings had protected the pension fund from even greater losses, even though hedge funds were having their worst year of performance ever. A brief discussion of the merits of hedge fund investments followed, in which Chair Kramer noted the pension fund would be $10 billion larger today if the pension fund had fully diversified 10 years earlier than it did.

The investment plan was approved unanimously on a motion by Dr. Love, seconded by Mr. Cerf.

C. For the Information of the Council

1. Verbal report by Director Clark on a second stay requested in connection with August 2008 Appellate Court decision on external managers.

Director Clark said the Division had requested an additional 30-day stay from the court in order to continue negotiations with the CWA and NJEA on a proposed plan that would include the use of external advisors while maintaining investment authority within the Division.

2. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated December 12, 2008, entitled "Investment News Clips for December 2008 Council Meeting."

The memorandum was noted without discussion.

VIII. Reports of Director Clark

A. Memorandum from Director Clark to the Council, dated December 12, 2008, entitled "Investment Reports."

Director Clark said the Division was pleased with November results showing only a slight decline in pension fund value to $60.6 billion for the month ending November 30. The fund's overall performance was down -2.16 percent, versus a decline in the Standard and Poor's 1500 index for the same period of -7.5 percent.

Investment Officer Arena said the domestic portfolio was down -7.9 percent for the month, in line with the S&P index, and still modestly ahead of the benchmark for the year.

Assistant Director Michel said the international portfolio was down by -4.8 percent for the month.

Director Clark said New Jersey was possibly the only large fund that had set a long-duration target, and that the fund had benefited from that in November and to date in December. The fund's bond portfolio was up by 6.0 percent for November.

He said that the pension fund had no exposure at all to investments managed by failed financier Bernard Madoff. Director Clark said it was his understanding from published reports that the Madoff investments failed to meet the basic requirements that would have qualified them for the Division's interest.

Director Clark said the Division had retained legal counsel to explore whether the Division should take independent action in connection with the Lehman investment, in addition to the number of class action suits in which it is already a member. He said that the Division remained in negotiations with Wachovia, its securities lending agent, regarding potential losses resulting from Wachovia's investments in Lehman notes as part of the securities lending program, as reported at last month's meeting.

He noted the Division had recovered about $160 million by leading some 13 class action lawsuits and other independent actions, a total that reached above $200 million when including class action lawsuits in which the Division was a participant. He said the Division had recently established a pool of class action legal firms which could evaluate Division losses in cases of possible securities fraud.

He said the Division has assumed a much more aggressive stance in proxy voting when corporate behavior proved contrary to shareholder interests, and would further increase its efforts in the coming proxy season. He said the options being considered included partnering with other funds on proxy action, including CalPERS and AFSCME, and leading proxy initiatives. Primary areas of interest for action are executive compensation and board inaction.

IX. Public Comment

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

Mr. Tony Miskowski offered press predictions of hedge fund closings in the coming year and asked whether the Division had done an analysis of its portfolio to identify funds that might be at risk or over-leveraged.

Chair Kramer said the Division is constantly monitoring the status of the funds. He added the closing of a fund does not necessarily mean a greater loss to the investors as the assets may be sold or redeemed. Director Clark said the Division talks to its hedge funds on a regular basis. Dr. Love said hedge fund losses significantly lagged losses in the equities market; Chair Kramer pointed out that several years ago critics of alternative investments had urged equity investments instead, and that the fund had benefited from not taking this direction.

Mr. William Bauer commended the Division for avoiding exposure to the funds managed by Bernard Madoff.

Dr. Mary Ann Mesics said she strongly opposed Senate Bill 7 for its proposed reduction in municipal and county contributions to the pension fund. She criticized state leaders for failure to contribute their designated share in recent years, and the Division for what she believed was a further reduction in pension fund value from the payment of large fees to outside managers. Chair Kramer said it was outside the scope of Council jurisdiction to address employer contributions.

X. Communications

There was no report from the State Treasurer.

XI. Next Meeting

January 15, 2009	SPECIAL TIME: 3 p.m. Meeting	Rutgers Student Center Multi-Purpose Room B 126 College Avenue, 1st Floor New Brunswick, NJ 08901

XII. Adjournment

The meeting was adjourned by unanimous vote at 2:35 p.m.

Respectfully submitted,

Susan Burrows Farber
Secretary to the Council