State of New Jersey
State Investment Council

Meeting at
Rutgers Student Center, Busch Campus
Multi-Purpose Room B, First Floor
604 Bartholomew Road
Piscataway, New Jersey 08554

Thursday, January 17, 2008
Noon – Lunch
1 p.m. Council Meeting

MINUTES

Approved February 21, 2008

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
Erika Irish Brown
Marshall Brown
W. Montgomery "Monty" Cerf
Jose R. Claxton
Susan Ann Crotty
Mark Kandrac
James C. Kellogg
Douglas A. Love

Absent: James Clemente

Also Present: *From the Division of Investment:*
William G. Clark, Director
Jessie Choi, Analyst
James Falstrault, Investment Director
Susan Burrows Farber, Chief Administrative Officer
Maneck Kotwal, Investment Officer
Jason MacDonald, Analyst
Gilles Michel, Assistant Director
O. Ike Michaels, Deputy Director
Christine Pastore, Investment Officer
Ainsley A. Reynolds, Accounting Manager
Tim Rollender, Analyst
Susan Sarnowski, Middle Office Manager and Compliance Officer

From the Governor's Office, Dept of the Treasury and Attorney General's Office:
Elizabeth Cervenak, Legislative Liaison, Department of the Treasury
Mark Perkiss, Public Information Officer
Rubin Weiner, Deputy Attorney General

Members of the Public:
Frederique Adam-Jupillat, LPS

Also Present: *(continued)*

Jamie Barker, Revenue
Shirley Bryant, L&PS
Vonda Brunsting, SEIU
Russell Caffey
Jose Cardona, TESC
Dorothy Carl, Revenue
Sandy Coia
Clifford S. Cooper III, NJ DOBI
Barbara Counts. ELEC
Paul P. Curcio, P&P
Terry Dopp, Bloomberg
Steven Dovidio, Revenue
Harvey Jay Grossman, Banking and Insurance
Jeffrey Grossman, DOI
Deborah Jacob, MVC
James Jameson, NJEA
Sandy Johnson, DMV
Richard Klockner, NJ Principals and Supervisors Assn
Anthony Koze
Nikk Kriss
Michael LaRossa
Patricia Latimer
Tim McGuckin, NJEA
Peter Mitchell
Mitchell Mercer, DSS
Anthony F. Miskowski, Member, CWA Local 1033
Marion Mnych, Public Defender
Frank C. Mull
A.M. Newman, MVC
Rodney Nichols
Kevin P. Norton, Bank of NY Mellon
Frank O'Shea
Shameko Palmer, Revenue
Dale Parichuk, LPS
Frank Percoskie, DOBI
F.L. Richardson-Guerra
Rae C. Roeder, President, Local 1033
Richard A. Rollins, Bank of NY Mellon
John Ruth, Treasury
Saul Smulyan
Rodney Stevens, Division of Revenue
Pat Stetler
John Strachan, NJDHTS
Raymond E. Weicker, NJ DOBI

Also Present: *(continued)*
Anne Wintens, DOE

I. Call to Order

Chair Kramer called the meeting to order at 1:15 p.m.

II. Notice of Meeting

Interim Council Secretary Susan Burrows Farber reported that in compliance with the Open Public Meetings Act, *NJSA 10:4-1 et seq.,* notice of the meeting scheduled for January 17, 2008 was sent by mail deposited in the post office, by facsimile and email on January 2, 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 Secretary of State.

III. Approval of Minutes

The minutes of the regular meeting of the Council held on December 20, 2007 were approved on a motion by Mr. Claxton, seconded by Mr. Berg, with all voting aye except Mr. Kandrac and Ms. Irish Brown, who abstained because they were not at the December meeting.

IV. Reports of Director Clark

A. Memorandum from Director Clark to the Council, dated January 11, 2008, entitled "Investment Reports."

Director Clark reported the Pension Fund had outperformed its benchmarks significantly in each portfolio for the 2007 calendar year, with an overall return of 9.20 percent. He said the Fund's significant underweight position in the financial sector was a main reason for its out-performance, and cited the contributions of the Fund's outside managers in raising early concerns about credit risks in the market that allowed the fund to move to a more secure position.

In response to a question from Dr. Love, Director Clark said that hedge funds were the top-performing asset class for the year, with estimated returns in the 11-12 percent range net of all fees. In addition to providing extremely good returns, Director Clark said the hedge fund investments "did what they're supposed to do" by buffering risk (i.e., the volatility) of equities.

Mr. Arena noted that both the equities portfolio and the Standard and Poor's Index were down in December, as stocks suffered from the credit crisis fallout. Director Clark noted the fund continued to view corporate debt cautiously.

Mr. Michel said the big story in the international portfolio was Japanese stocks, which trade as a proxy for global growth. As a result, the portfolio is underweight in Japanese equities, which contributed to the portfolio's strong performance in the past calendar year. Director Clark noted that the Division has commenced the funding of its emerging markets program by retaining four outside managers, but so far has provided only a conservative allocation to this portfolio.

Director Clark briefed the Council on two preferred stock purchases recently initiated and completed by the Division with Citigroup and Merrill Lynch, for $400 million and $300 million, respectively. Director Clark said what differed from other Division stock purchases was that both investments were done privately with the companies, allowing the Division to obtain superior terms over what was available on the open market; also that other private investors purchasing the preferred stocks included sovereign wealth funds. He reported that the size of the investments was comparable to many other purchases in the past, noting the Division had made moves much larger, and that both purchases still left the fund underweight in financials.

Director Clark said both purchases had been initiated by the Division in an effort to raise its financials weighting at a time when monetary and fiscal action historically signaled positive effects on this sector. He noted the terms obtained in both deals were superior to purchasing the common stocks of either company: a 9 percent current dividend for Merrill and a 7 percent return for Citigroup, with no fees. He noted the investments provide one of the most visible signs of the developing synergy between external managers, who provided market intelligence, and internal investment staff who sought, negotiated and closed both investments.

The Council commended the staff for a "fabulous performance." Mr. Cerf said not only were these "very good deals" for the fund, but that the Division's ability to move quickly "set New Jersey apart from the pack" as also noted positively by the press. Dr. Love agreed the Division's ability to move "quickly and credibly" with larger players was impressive. Chair Kramer cited staff for overtime work for doing "more than anyone could expect" in landing both opportunities for the Fund.

B. *Distribution of Audited Financial Statements for the Pension Fund and the Trustees for the Support of Public Schools Fund, including the Agreed-Upon Procedures Report for the Trustees for the Support of Public Schools Fund, as issued by KPMG for the fiscal year ended June 30, 2007.*

Ms. Sarnowski noted that KPMG had issued no management letter to the Division, a positive indication that the auditors saw no significant weaknesses in internal controls. *Note:* Mailed separately as a part of each Council package were courtesy copies of the Division of Pension and Benefits' Final Financial Statement and the Final Financial Statements for the following individual pension plans, as issued by KPMG for the fiscal year ended June 30, 2006: Consolidated Police and Firemen's Pension Fund, Judicial Retirement System, New Jersey State Employees Deferred Compensation Plan, Police and Firemen's Retirement System, Prison Officers' Pension Fund, Public Employees'

Retirement System, State Police Retirement System, Supplemental Annuity Collective Trust, Teachers' Pension and Annuity Fund.

C. Memorandum from Compliance Officer Sarnowski to the Council, dated January 8, 2008, entitled "Review of Fiscal Year 2007 Commissions." Accompanying the memorandum is the audited commissions report containing the Schedule of Dollar Volume of Domestic Transactions and Commissions, Schedule of Dollar Volume of Foreign Transactions and Commissions and Schedule of Direct Transactions, as issued by KPMG for the fiscal year ended June 30, 2007.

Ms. Sarnowski noted the Division had paid $37.5 million in commissions in fiscal year 2007. The average domestic commission rate decreased a bit over the previous year as part of an overall downward trend and the negotiation of more competitive rates by the Division. International per-share costs increased slightly as a result of the country mix and rising market environment.

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

Ms. Sarnowski reported that the Division has an ethics policy covering personal trading by staff, consistent with industry practice. The policy requires that any personal trades be approved in advance, that blackout periods for personal trading are observed when the Division is trading, and that employees cannot profit from trades made within a 60-day period. All Division employees are required to make an initial filing of securities held upon employment and to update their record each calendar year.

Ms. Sarnowski reported that during the 2007 calendar year, the Division had two employees who traded without prior authorization and eight employees who failed to report the ownership of securities. Division process is that each receive a written warning upon violation; all of the foregoing employees have been or will be issued warnings.

E. Verbal report of Director Clark on recent Division recognition.

Director Clark noted that the Division had been nominated by Institutional Investor and Money Management Letter as Large Public Pension Fund of the Year; the winner will be announced in early March. He said that in February, the Division will be inducted into the Wall Street Hall of Fame by the National Association of Securities Professionals, New York Chapter. The Council offered congratulations on the honors.

V. Committee Reports

There were no committee reports.

VI. Pending Matters

There were no pending matters.

VII. New Business

A. Proposed Alternative Investments

There were no alternative investments proposed.

B. For Adoption by the Council

1. Memorandum from Director Clark to the Council, dated January 11, 2008, entitled "Fiscal Year 2008 Investment Plan."

Director Clark said that presentation of the fiscal year planned had been delayed by staff to accommodate the installation of a new Council. He said the fiscal year plan did not carry any significant changes: Alternative investments would continue to increase at the same pace as previous years and that our allocation to alternatives would still be less than that used by other large public pension funds. He said the plan called for a somewhat lighter allocation in equities, consistent with the risks perceived in that class.

He noted three long-term investment initiatives:

- Leveraging the Fund's size where appropriate to seek equity stakes in investment management firms, so that the Fund gains not only returns but shares in the manager's profits as well. CalPERS has started doing this, and New Jersey also will seek such opportunities, Clark said.
- Partnering with other funds to increase negotiating power in investments, particularly over fees. Director Clark said the Division will seek such partnerships with other public funds, but also with foreign funds and endowments. Sectors of interest are infrastructure and "sustainable investments" including alternative energy.
- Contracting with a new, global custodian to upgrade the investment tools and systems available to the Division. A request for bids is currently being prepared, he said. The move to a global custodian is expected to modernize and improve Division operations and save money.

Mr. Kellogg requested the Division to seek opportunities to encourage the use of hurdle rates. Mr. Berg said the increased allocation in alternatives is consistent with the best practices of other public funds, though the targets remain below those of other large investors. He said the change will further reduce risk in the portfolio by increasing diversification.

The investment plan was approved unanimously on a motion by Dr. Love. (Marshall Brown was absent from the room at the time of the vote.)

C. *For Acceptance by the Council*

1. Memorandum from Director Clark and Deputy Director Michaels to the Council, dated January 11, 2008, entitled "Third-Party Management of the New Jersey State Employees Deferred Compensation Plan (DCP): Annual Report 2006-2007."

Director Clark said this was the first annual report on the investment options within the Employees Deferred Compensation Plan, as required by the Council's regulations. The Plan is overseen by the Division of Pensions and Benefits, which drove the change to outside management of the fund, he said; the Division's role is to advise Pensions and Benefits on investment options and to ensure those options are consistent with the regulations of the State Investment Council. Director Clark said while there are always one or two funds on the Division's "watch" list, there are no changes recommended at this time. He said history of the plan to date has emphasized the benefits of diversification, and more recently growth stocks have significantly out-performed value stocks.

The plan was accepted unanimously on a motion by Mr. Claxton, seconded by Dr. Love. (Marshall Brown was absent from the room at the time of the vote.)

D. *For the Information of the Council*

1. Memorandum from Director Clark to the Council, dated January 11, 2008, entitled "2007 Report on Northern Ireland" for filing with the Governor and Legislature.

Director Clark said that this annual report detailed companies in the domestic portfolio with holdings in Northern Ireland, and the compliance of these companies with the so-called McBride principles. He said there were no companies requiring action and no material non-compliance or violations in letter or spirit.

2. Memorandum from Director Clark to the Council, dated January 11, 2008, entitled "Highlights of New Jersey Performance from Public Fund Universe Report by R. V. Kuhns & Associates, Period Ending June 30, 2007."

Director Clark noted that the report supported Chair Kramer's earlier comment about New Jersey's smaller allocation to alternative investments versus other public pension funds, and that operating costs were lower than among peer funds because the Division has fewer external managers. Chair Kramer noted the report shows the Division has the fewest outside managers of the public funds surveyed and the most active management. Over the last year and for the past three-years, the Fund's performance was superior to the sample.

3. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated January 11, 2008, entitled "Corporate Governance and Legislative Update."

   Ms. Burrows Farber reviewed memo highlights. There was no discussion.

4. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated January 11, 2008, entitled “Investment News Clips for January 2008 Council Meeting.”

The memorandum was acknowledged without discussion.

VIII. Communications

There were no matters presented on behalf of the Acting Treasurer. Chair Kramer noted that David Rousseau had been newly named Acting Treasurer subject to confirmation. He said that Acting Treasurer Rousseau was a state veteran well versed in budgets and operations. He expressed appreciation on behalf of the Council for the support provided by former Treasurer Abelow and interim Acting Treasurer Michelline Davis. Director Clark cited them as strong supporters of the Division.

IX. Public Comment

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

Rae C. Roeder, president of CWA Local 1033, provided the Council with copies of the Pew Study of state pension funds and called New Jersey’s level of contribution “utterly disgraceful.” She urged the Council members who represent pension boards to talk with legislators about the state’s annual contribution. The full text of her remarks as written is attached to the official record of the meeting.

Anthony F. Miskowski, executive secretary of CWA Local 1033, offered criticism of the performance of public stock issued by Apollo Management and Blackstone and asked why the Division pays both firms management fees when it could buy their stock instead. Council members clarified that the Division does not own stock in either firm, and that management services for which the Division pays are independent of the firms’ public stock price. Mr. Miskowski also questioned what role the Division secures in alternatives management in exchange for its investments, noting CalPERS had been able to place a representative on the board of Silver Lake. Director Clark said that in most funds in which the Division is invested, the Division does hold an advisory seat. He added that direct equity shares as outlined in the investment plan would allow the Division to have not only a voice but a stake in the manager’s profits. The full text of Mr. Miskowski’s remarks as written is attached to the official record of the meeting.

William S. Bauer, an employee with the Department of Education, offered remarks for Mr. Dennis Cory who had registered to speak but was absent. Mr. Bauer criticized the investments in Merrill Lynch and Citigroup as a philosophically different direction for the fund, and asked when the State Investment Council approves such investments. Director Clark said the decision to buy the stock was made by Division employees as part of daily fiscal duty. Chair Kramer clarified that the Council sets policy and does not make investment decisions.

An extended conversation on these two investments followed, in which Council members responded to many questions from the audience. Director Clark said the Division initiated both investments because the Pension Fund was underweight in financials relative to the market and the price was right. He said that by privately negotiating the sale, the Division was able to get terms that wouldn't have been possible in the public market.

Mr. Cerf said he was concerned by the suggestion of some speakers that something was amiss. He said the speed of both decisions was normal for a process where opportunities come and go on very short notice, and noted Division staff had spent the weekend ensuring the Fund would benefit. He said he was concerned by the hostile tone of some speakers, noting that the decisions followed criteria regularly urged by these same speakers: namely, the decisions were made by internal management, the deals were done without fees and on terms "conspicuously better than the usual," and the money was invested in US companies.

Chair Kramer acknowledged that in a perfect world such investments wouldn't come from foreign countries but that at present other countries had capital that could help stabilize US companies. Mr. Claxton noted that New Jersey was likely helping ensure fewer layoffs of US workers than if it had not participated alongside foreign interests. Mr. Kandrac observed that both deals satisfied common financial criteria: the investments were made in solid American companies, and followed a "buy low-sell high" strategy. He challenged the audience to exercise patience and tolerance for new ways of investing, and urged them to have faith in a Council of experts working without pay as well as their Division colleagues. Ms. Crotty noted that everyone's goal was to make the value of the pension system go up.

The discussion ended with audience expressions of appreciation to the Council for its patience and assistance with questions.

X. Next Meeting

Thursday, 2/21/08	Noon: Lunch/1 p.m. Meeting	Rutgers Student Center College Campus 126 College Avenue, Room MPR-B New Brunswick, NJ 08901

XI. Adjournment

All regular business of the Council being concluded, the meeting was adjourned by unanimous vote at 2:55 p.m. on a motion from Mr. Claxton, seconded by Mr. Cerf.

Susan Burrows Farber, Interim Secretary to the Council