

***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, March 19, 2009
3 p.m. Council Meeting**

MINUTES

Approved May 21, 2009

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
W. Montgomery “Monty” Cerf
Jose R. Claxton
Susan Crotty
Mark Kandrak
James C. Kellogg – *By teleconference*
Erika Irish Brown
Douglas A. Love
James P. Marketti
Timothy McGuckin

Absent: James Clemente and Karl Kleeberg

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
Joanna Ng, Senior Investment Analyst
Philip Pagliaro, Senior Portfolio Manger
Ainsley A. Reynolds, Accounting Manager-Alternatives
Tim Rollender, Investment Analyst
Susan Sarnowski, Compliance Officer

From the Governor's Office, Dept of the Treasury and Attorney General's Office:
Hans Goff, Legislative Liaison, Department of the Treasury
Tom Vincz, Director-Public Information
Rubin Weiner, Deputy Attorney General

Other Invitees:

Stephen Nesbitt, Cliffwater
Daniel Stern, Cliffwater

Members of the Public:

Frederique Adam-Jupillat
Jamie Barker
Carl Bergmanson
Linda L. Brown
Shirley Bryant
Tom Buckley
Jose Cardona
Shaunelle E. Clark, Revenue
Rhoda Coleman, NJREA
Robert Coleman, NJREA
Clifford S. Cooper III, NJDOBI
Dennis Corny, PhD
Barbara Counts
Terrence Dopp, Bloomberg
Steven Dovidio, Revenue
Dale Favors
Steven Green
Harvey Grossman
Deborah Jacobs
Jacqueline Holmes Johnson
Larry Johnson
Sandra Johnson
Valerie Kazhdan, NJEA
Richard Klockner, NJPSA
Joann Marshall
P. G. Maurer
Wanda McEwen
Dusty McNichol
Anthony F. Miskowski
Mitchell Mercer, DSS
Mary Ann Mesics
Barbara Montgomery
Clayton Mull, SCREA
Ann Newman
Doug Newsome, Babson
Shameko Palmer, Treasury
Dale Parichuk, CPM
Rae Roeder, President CWA Local 1033
Michael J. Rubino, Treasury
John Ruth
Luz Sanchez
D.M. Sanders
Christine M. Smith, DMV

Members of the Public, continued:

John Strachan
Raymond Weicker
Marianne Winters
Jill Ytuarte, Morgan Stanley

I. Call to Order

Chair Kramer called the meeting to order at 3:12 p.m.

II. Notice of Meeting

Secretary Burrows Farber reported that notice of the meeting scheduled for March 19, 2009 was sent by mail deposited in the post office, by facsimile and email on March 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 February 19, 2009 were approved unanimously on a motion by Mr. Kandrac, seconded by Mr. Claxton.

Chair Kramer acknowledged receipt of a March 13, 2009 letter from Mr. Marketti addressed to the Chair and copying the Council, which recommended the Council formally encourage the Governor and Legislature to mandate the full funding of pension fund obligations by all public employer entities.

Deputy Attorney General Weiner reminded the Council that their primary responsibility under statute was investment policy and oversight. Chair Kramer said that he had spoken to Council members in the past week on this issue. He said it was the iterative opinion of the Council that he reach out to the Governor and Legislative leaders on the Council's behalf to convey: 1) a desire that the Governor and Legislature note the pension fund's underfunding, 2) encouragement that some amount of public employer contribution be included in the fiscal 2010 budget now being debated, and 3) the recommendation that full funding be restored as soon as state revenues normalize in order to protect the retirement security of public pension beneficiaries.

Mr. Marketti said he agreed with the principles as stated by the Chair. He suggested that the message be relayed to the Governor and Legislative leaders in person by representatives of the Council as well as by letter. A discussion followed in which the principles were endorsed also by Ms. Crotty, Mr. Kandrac, Mr. McGuckin, Mr. Berg and Mr. Cerf, who questioned the best process for expressing these views. Chair Kramer said that in recognition of the strong feelings of some Council members on the issue and in support of Council collegiality he would move the Council proceed with a letter and request for a meeting on the principles as articulated, and offered to draft this. Mr. Berg seconded the motion, which passed by unanimous vote.

(Note: The Council's letter to the Governor and Legislative Leaders as sent on March 26, 2009 signed by Chair Kramer is attached to the official copy of these minutes.)

IV. Reports of Director Clark

A. Memorandum from Director Clark to the Council, dated February 13, 2009, entitled "Investment Reports."

Director Clark said jokingly that he'd prefer to talk about March's rebound than report on the rough month of February, when the pension fund's value dipped to \$56.4 billion as of February 28. He said the fund continued to outperform the market, noting that the Domestic Equities Portfolio performance of -9.3 percent compared well to the -11.3 percent loss the fund would have sustained had it performed in line with the market. He noted that the Division had taken the equity ratio for February 4 percent below the Council's revised asset allocation range of 41 percent to 37 percent, in order to increase the fund's weight in bonds, including TIPs.

Director Clark noted that March was proving to be a better month, with the fund well-positioned for an expected rally in corporate bonds. He said that while economic data remained bad, the trend was less bad as the federal government and the Federal Reserve had become more aggressive in providing economic stimulus.

Mr. Claxton was told in response to his question that the pension fund's underweight position in equities continued to be a positive driver of relative performance. Chair Kramer noted that for the period since July 1, 2008, the equities portfolio had performed 3.5 percent ahead of its benchmark. Director Clark added the fund overall had ended calendar year 2008 at -21.9 percent, while the bulk of other states reporting on the year were at -26 percent or worse.

Mr. Marketti asked why bonds were underperforming their benchmark. Director Clark said it was the result of an underperformance by TIPs in the portfolio in late 2008 (which are not included in this benchmark), and a slightly early entry into the rising returns of corporate bonds.

Chair Kramer said that the hedge fund market, which ended February at -24 percent for the fiscal year-to-date period, continued to outperform domestic equities (-39 percent) and international equities (-42 percent), adding that the state's hedge fund investments were funded from the sale of equities. He noted that during the worst period of hedge fund performance, hedge funds had still demonstrated their ability to improve overall returns and were proving their value in this year.

B. Memorandum from Investment Officer Maneck Kotwal and Investment Analyst Jessie Choi to the Council, entitled "New Jersey Hedge Fund Portfolio Review," to be presented by Mr. Kotwal and Ms. Choi with Steve Nesbitt and Daniel Stern of Cliffwater.

Director Clark said this presentation is one in a planned series following February's briefing on Fixed Income investments, and as requested by the Council. The full presentation is attached to the official copy of these minutes, and has been posted to the Division's website.

Investment Officer Kotwal offered a history of the pension fund's investment in hedge funds, which began in April 2006 with an initial focus on large fund-of-fund investments to ensure proper diversification. The growth of single-strategy funds was followed by a growth in credit-oriented hedge funds beginning in 2007, followed by international hedge funds primarily in the Asian Pacific and then in emerging markets, he said.

In response to Council questions, Mr. Kotwal said hedge funds generally contact the Division directly, and are screened by Division staff for size eligibility and match to Division investment strategy. Qualifying funds are then referred to the Division's hedge fund consultant, Cliffwater LLC, for due diligence and recommendation. Hedge funds recommended for investment are reviewed in detail with the Council's Investment Policy Committee and subsequently presented to the Council. Mr. Kotwal said the Division works closely with the Attorney General's office in attention to legal issues and process. Funds are monitored by Division staff, in part by quarterly phone meetings and annual site visits with fund management.

A history of general hedge fund strategy and performance was offered by Daniel Stern, Senior Managing Director of hedge fund research for Cliffwater. Mr. Stern said initially hedge funds were used by the largest funds as part of a larger diversification strategy; in this decade, he said, they are used primarily to reduce risk and have proven their value by providing better returns than publicly traded equities. Even in the current period of market contraction, he noted, "investors lost a lot less with hedge funds than equities, if that qualifies as a virtue."

Mr. Stern noted that prior to the market's collapse in 2008, hedge funds grew to as much as 20 percent in some public plan portfolios because of their ability to provide competitive returns with fewer losses and less risk than equity investments. As a result of the market crisis, he said, the number of hedge funds has shrunk naturally, less reputable "hot money" funds have largely disappeared, and the funds remaining tend to be more responsive to institutional investors, offering greater transparency and strong governance.

In response to Council questions, Mr. Stern said hedge funds use "gates" to protect investors from withdrawals exceeding more than a quarter to a third of fund assets at one time. He said hedge funds tend to be more liquid than other asset classes and the number of hedge fund redemptions by public pension systems was very low.

Stephen Nesbitt, Chief Executive Officer of Cliffwater, described the risk-reduction benefits of hedge funds as having a downside about half that traditionally held by stocks. He said today's typical hedge fund has low leverage, and described four main types of hedge fund strategies. Investment Analyst Jessie Choi then described the Division's portfolio in more detail.

A discussion of hedge fund benchmarks followed, with much criticism of the HFRI benchmark because of monthly changes in the composition of its underlying funds and voluntary reporting standards, which mean failing performance is often not included. Mr. Nesbitt suggested that cash return plus 4-5 percent may be a better long-term benchmark. In response to Council questions, Mr. Nesbitt said credit funds help in down markets and are proving their value this year; Mr. Kotwal said there is very little overlap of names among fund-of-fund investments.

Describing Cliffwater's role in the investment process, Mr. Stern said the firm has a team dedicated to due diligence and background checks, and that all results are reviewed annually. He said the firm provides monthly monitoring of each fund in the pension plan, including talking with the fund about organization issues as well as performance.

A brief discussion of fund-of-fund performance followed. Mr. Stern noted that the Goldman Sachs fund-of-fund investment had done quite well and lifted the overall performance of that class. Mr. Cerf asked to see a comparison of fund-of-fund performance in April relative to the other hedge funds in the portfolio.

Ms. Crotty said the Division's hedge fund performance was exceptional compared to the market in general, and that it would be important to re-examine the opportunity set going forward as the hedge fund market evolved, especially over the next few years.

V. *New Business*

A. Alternative Investments

1. Memorandum from Director Clark to the Council, dated March 13, 2009, entitled "Redemption from Intrepid Capital Fund (QP), LP."

Director Clark said the fund would redeem its investment in the Intrepid Capital Fund (QP), LP, because of concerns it lacked adequate staffing to sustain strong performance.

VI. *Committee Reports*

Audit Committee Chair Kellogg's phone connection was dropped. Chair Kramer asked Director Clark to report on the Audit Committee meeting that was held earlier in the day.

Director Clark reported the Council's Audit Committee had met earlier in the day with the auditors, Ernst and Young, to review the preliminary audit for Fiscal Year 2008, and that no serious issues had been identified. He said release of final audit would be held until Ernst & Young's auditors obtained internal approval to proceed in light of audit independence issues raised by state's recently filed litigation against Lehman Brothers, and Ernst & Young's services to that firm prior to its bankruptcy. Chair Kramer noted such internal review was customary and also inevitable when a corporation was sued given that there are only five major US auditing firms. Director Clark noted the auditors had also prepared a management letter with minor suggestions for increased documentation of Division processes, and that the Division had already agreed to these changes.

VII. *New Business, continued*

B. For the Information of the Council

1. Memorandum by Director Clark to the Council entitled "Potential Investment Opportunities Utilizing the Term Asset-Backed Securities Loan Facility (TALF)."

In lieu of a written memorandum to the Council, Director Clark asked Deputy Director Joseph to offer an update on the Division's research into the TALF opportunities being presented by the Federal Reserve, noting this was the first time that the Division had used internal resources for exploring an alternative investment.

Mr. Joseph said the Division was exploring whether an investment structure could be created that would be best for New Jersey. Even if that standard could be met, he said, short lead times would preclude the Division from presenting individual opportunities to the Council in advance. As a result, he said, the Division was proposing the concept in advance for up to \$100 million in investments; the Division would report to the Council after the fact if and when any actual investments were made under the program.

Director Clark said the federal government was making TALF investments very attractive in terms of both risk and return, but that the Division wanted to participate directly without paying the fees to a hedge fund manager. There was a brief discussion in support of the opportunity and the Division's additional investigation.

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

Director Clark said the Division had developed a new procedure to comply with the court's decision, which required the Division to make final investment decisions on all transactions recommended by investment advisors. He said the new rules required restructuring existing agreements with investment advisors and that one firm, BlackRock, had opted not to continue with the Division feeling the process was too onerous.

Mr. Berg asked if the union litigants in the lawsuit had seen the new procedure. Director Clark said there was early feedback from the union litigants, who received a draft of the new procedure incorporating such feedback. There had been no comment from the union on that draft. In response to a question from Ms. Brown, he said the Division was allocating the investment commitment to BlackRock pro rata among the remaining high yield advisors.

3. Memorandum from Deputy Director Ray Joseph to the Council, dated March 11, 2009, entitled, "Highlights of New Jersey Performance from Public Fund Universe Report by R.V. Kuhn & Associates, Period Ending June 30, 2008."

Mr. Joseph noted the Division ranked at opposite ends of the spectrum when compared with other public funds surveyed in its use of external advisors (used for 1.37 percent of DOI investments, compared with the average fund's use of 85.75 percent); and in its active management of investments. (DOI ranks first among the 87 largest funds with 100 percent of its investments made by active management; the national average is 82.54 percent.)

4. Memorandum from Director Clark to the Council, dated March 10, 2009, entitled "Iran Legislation."

Director Clark said that consulting fees of about \$30,000 per year are paid for the identification of firms potentially ineligible for Division investment under the Iran divestiture law, but that no investment consulting is provided.

5. Memorandum from Director Clark to the Council, dated March 11, 2009, entitled "2008 Annual Update on the New Jersey State Employees Deferred Compensation Plan (NJSEDCP)."

Director Clark noted that this report was required annually by legislation from the Division, while the plan was administered by the Division of Pensions and Benefits. He noted one advisor had been terminated and replaced by Pensions since last year's report, and said both Divisions had met to discuss the hiring of an outside consultant for regular analysis of performance and revision of investment options.

6. Verbal report by Kaitlyn Adams to the Council on corporate governance and legislation.

Legal specialist Kaitlyn Adams noted that the Division had entered the 2009 proxy season with the intent of being more aggressive in expressing its shareholder views on excessive compensation and related governance issues. She said the Division would work with the Corporate Governance Committee in updating proxy policy.

7. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated March 13, 2009, entitled "Investment News Clips for March 2009 Council Meeting."

Memo was noted without comment.

8. Updated State Investment Council Meeting Calendar for 2009, adding the Trenton War Memorial as the site for the May 21, 2009 Regular Meeting and the November 19, 2009 Regular and Annual Meetings.

It was noted that the May 21 meeting would be held in Trenton because of graduation commitments at Rutgers.

VIII. Public Comment

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

Mr. Tony Miskowski asked if the Council had a consensus opinion regarding when the recession would end, and a strategy for taking advantage of the recovery. Director Clark said there were good cases to be made for two different scenarios of the future: One, where nothing the federal government tries works and the nation goes into a period of deflation; or two, where the opposite happens and inflation poses the greatest risk. Trying to structure the portfolio to be positioned for both scenarios was a challenge, he said. He said the fund made a huge shift in December toward corporate bonds in an effort to attain the best balance between the risks, and that so far this had worked. The Division was now shifting its focus back to equities, which he said tend to do better ahead of a recovery for the economy at large.

Dr. Steve Green said that while he opposed external advisors as an individual, he believed after today's presentation that there may be a role for hedge funds in the pension plan depending on how these investments were weighted. He urged the Division to increase investment in gold. Director Clark said the Division had recently done so.

Mr. Tom Buckley shared a copy of his letter to the editor urging the Governor to add staff and new equipment to the Division, as published February 29 by *The Times of Trenton*. He also asked the Council to consider issuing a press release citing the specific benefits to the state and taxpayers of such an investment. Chair Kramer said such a message was best conveyed by individuals and groups other than the Council.

Ms. Rae Roeder thanked pension board representatives Kandrac, Marketti, McGuckin and Berg for their positive efforts to talk with the Governor about public employer funding for the pension plan. She said there had been a disconnect regarding union litigant review of the final plan for using external advisors. She asked about the anticipated recovery and legal fees from the state's recently filed lawsuit against Lehman Brothers.

Chair Kramer said the primary players in the lawsuit were the Division and the Attorney General's Office. He said legal fees would be a percentage of the recovery, and that the historical average for recoveries was 3 percent.

Director Clark said the Division had a good record in pursuing such litigation, recovering more than \$200 million to date. He said the message sent by pursuing the pension fund's interests with such litigation was also important.

Ms. Roeder cited a newspaper article that she said raised concerns about past professional affiliations held by some Council members and their ability to be objective in investment decisions involving those same firms. Chair Kramer said the article had been inaccurate and that Council members with prior employment histories posing conflicts consistently recused themselves from discussions of those investments. He reminded Ms. Roeder that the Council serves pro bono. Ms. Crotty said allegations of improper actions by Council members were out of touch with the facts and disrespectful. Dr. Love observed that the Division does business with several hundred major institutions, and it would be hard to find qualified Council members who did not have some affiliation with some of these institutions.

IX. *Communications*

There was no report from the State Treasurer.

X. *Next Meeting*

April 16, 2009

Noon Lunch/1 p.m. Meeting

Rutgers Student Center
ROOM 411 ABC
126 College Avenue, 4th Fl
New Brunswick, NJ 08901

Secretary's note: The April 2009 meeting was cancelled by notice posted April 14, 2009.

XI. Adjournment

The meeting was adjourned by unanimous vote at 5:30 p.m.

Respectfully submitted,

A handwritten signature in cursive script that reads "Susan Burrows Farber". The signature is written in black ink and has a long, sweeping horizontal line extending to the right.

Susan Burrows Farber
Secretary to the Council