

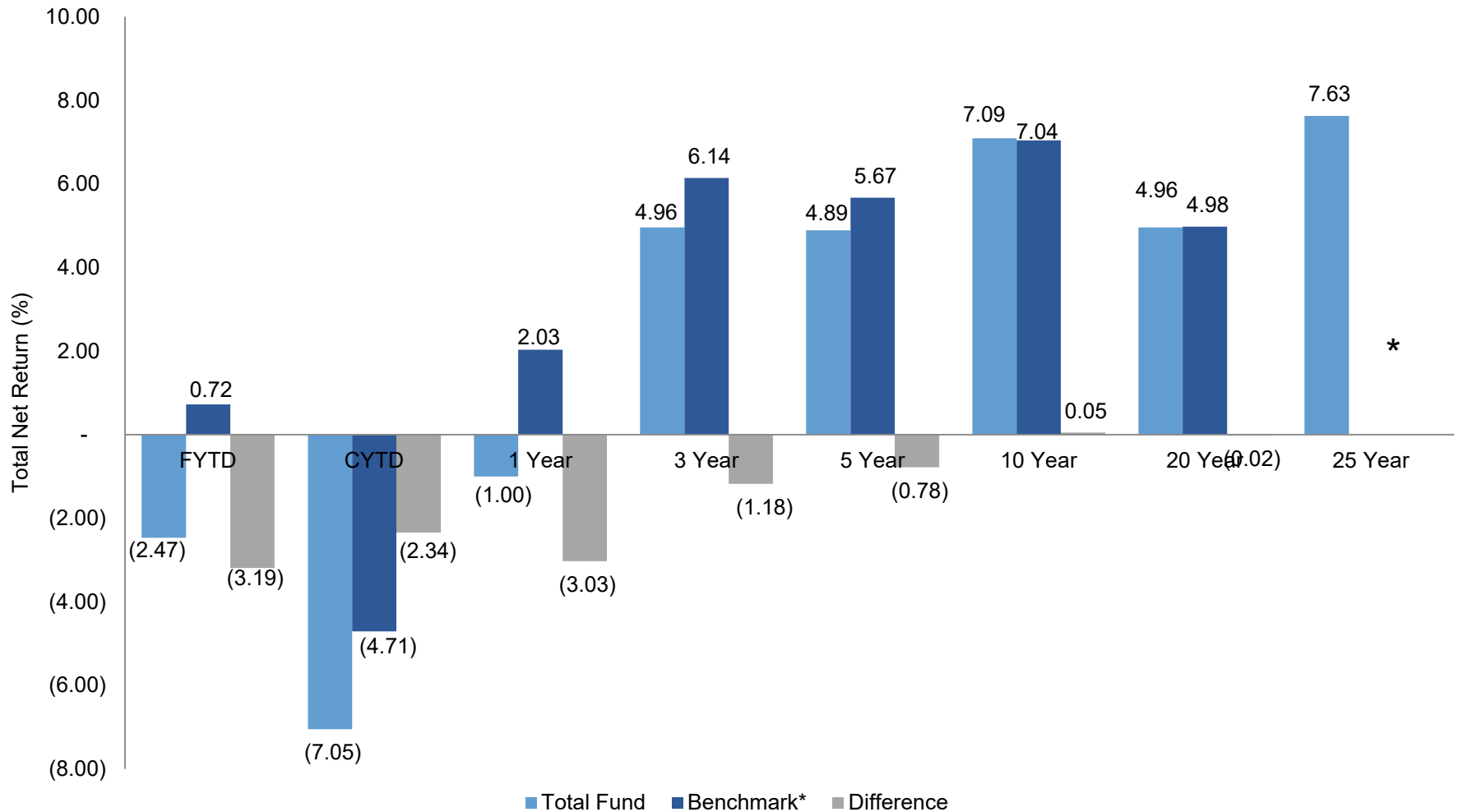
NJ DIVISION OF INVESTMENT

Director's Report

State Investment Council
May 27, 2020

“The mission of the New Jersey Division of Investment is to achieve the best possible return at an acceptable level of risk using the highest fiduciary standards.”

Pension Fund Net Returns⁽¹⁾ for Periods Ending April 30, 2020



(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program. Certain asset class returns, including private equity, real assets, real estate, and private credit do not include up-to-date valuations and benchmark returns for these asset classes are calculated on a lagged basis. This results in performance comparisons that may be less meaningful.

* Benchmark return not available for 25-Year period

Capital Markets Update

	Fiscal YTD thru 4/30/20	Calendar YTD thru 4/30/20	Fiscal YTD thru 2/19/20	2/19/20 thru 3/23/20	3/23/20 thru 5/21/20	Fiscal YTD thru 5/21/20
<u>Global Equity Index</u>						
MSCI ALL Country World Index	-5.17	-12.94	11.90	-33.64	29.14	-4.10
<u>US Equity Indices</u>						
Russell 3000	-1.15	-10.43	15.99	-34.96	33.48	0.70
Russell 1000	-0.13	-9.68	16.50	-34.58	33.40	1.68
Russell 2000	-15.35	-21.09	8.96	-40.67	34.77	-12.87
Russell Growth	9.37	-2.25	21.94	-31.89	37.12	13.88
Russell Value	-12.01	-19.11	9.86	-38.48	28.86	-12.90
<u>Non-US Equity Indices</u>						
MSCI EAFE	-12.08	-17.84	6.16	-32.68	23.23	-11.93
MSCI Emerging Markets	-10.69	-16.60	6.10	-31.17	23.06	-10.13
<u>Fixed Income & Credit Indices</u>						
Bloomberg Barclays U.S. Aggregate	7.56	4.98	4.50	-0.94	4.09	7.76
Bloomberg Barclays U.S. Treasury	10.62	8.89	3.92	5.40	0.70	10.29
Bloomberg Barclays U.S. Credit	5.40	1.29	6.82	-11.12	11.92	6.25
Bloomberg Barclays U.S. Credit (A or better)	7.45	4.08	5.80	-7.08	9.69	7.83
Bloomberg Barclays U.S. Credit (BBB)	3.02	-1.89	8.00	-15.79	14.86	4.46
Bloomberg Barclays U.S. High Yield	-5.12	-8.75	5.27	-20.76	16.49	-2.83
S&P/LSTA Leveraged Loan Index	-6.64	-9.13	3.46	-20.62	15.74	-4.96
Wells Fargo BDC Index	-29.68	-34.53	10.04	-56.97	58.58	-24.91
<u>Real Estate Index</u>						
Bloomberg U.S. REIT Index	-11.09	-17.18	13.43	-41.21	27.31	-15.09
<u>Real Assets & Commodities Indices</u>						
Bloomberg Commodities Index	-23.55	-24.71	-3.87	-19.02	1.62	-20.89
Bloomberg Energy Subindex	-52.31	-52.79	-10.39	-42.92	2.32	-47.66
Alerian MLP Index	-41.64	-35.95	-14.64	-59.37	79.78	-37.65

Asset Allocation and Net Returns by Asset Class (April 30, 2020)

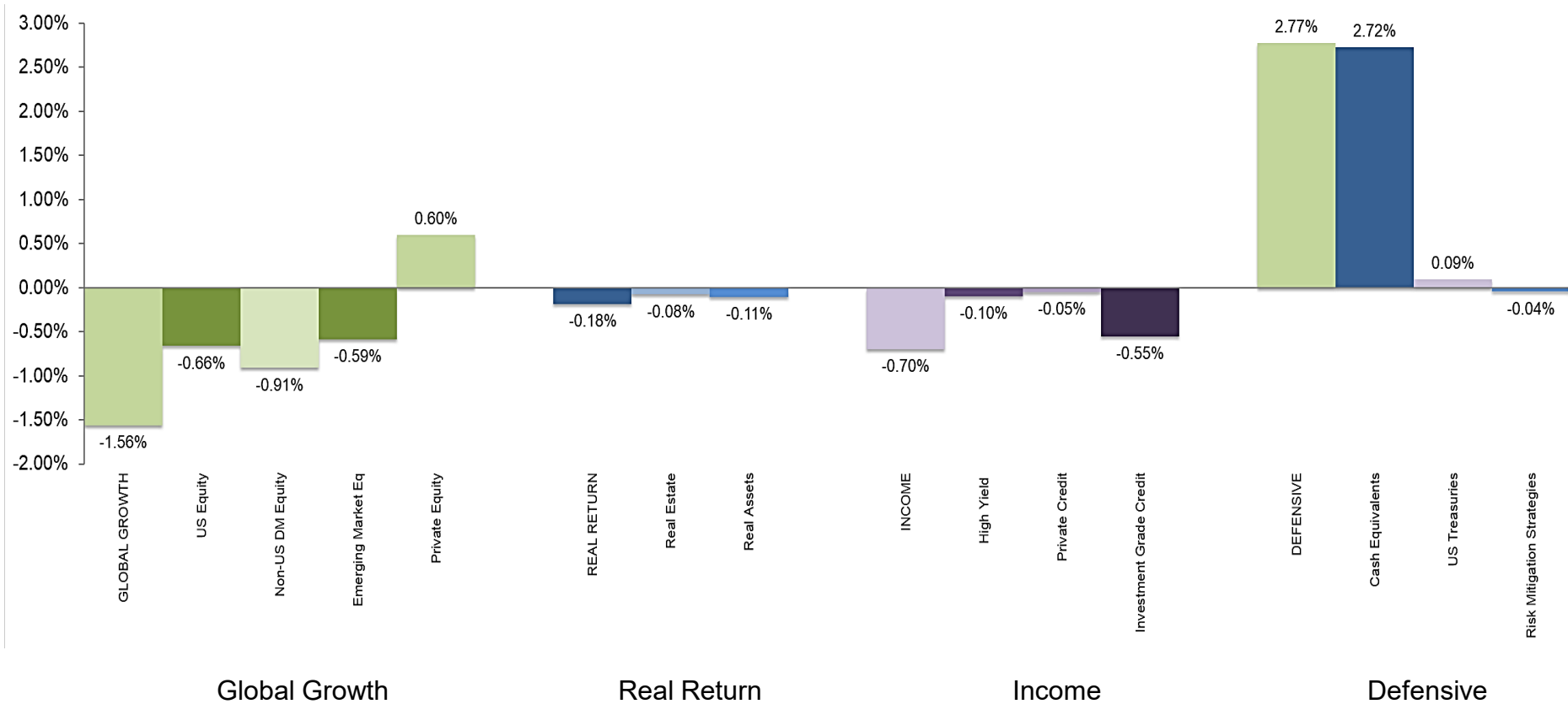
Asset Class	ASSET ALLOCATION				PERFORMANCE (for periods ending April 30, 2020) ⁽¹⁾							
	As of April 30, 2020				FYTD		Calendar YTD		Trailing Twelve Months		Trailing Three Years	
	Mkt Value	Actual (%)	Target (%)	Difference	NJ	Bench	NJ	Bench	NJ	Bench	NJ	Bench
GLOBAL GROWTH												
US Equity	20,571	27.88%	28.00%	-0.12%	-1.67%	-0.79%	-10.37%	-10.42%	-2.07%	-0.68%	6.80%	8.17%
Non-US Dev Market Eq	7,985	10.82%	12.50%	-1.68%	-11.37%	-12.23%	-17.38%	-17.82%	-10.58%	-11.41%	0.16%	-0.52%
Emerging Market Eq	4,501	6.10%	6.50%	-0.40%	-12.53%	-10.41%	-18.43%	-16.42%	-13.42%	-11.70%	-0.83%	0.71%
Private Equity	8,811	11.94%	12.00%	-0.06%	2.34%	9.93%	2.74%	5.43%	8.98%	15.41%	12.35%	15.85%
Equity-Oriented HF	52	0.07%	0.00%	0.07%	-4.98%	-14.58%	3.32%	-18.97%	-3.68%	-16.13%	-0.94%	-4.13%
TOTAL GLOBAL GROWTH	41,920	56.82%	59.00%	-2.18%	-4.18%	-1.47%	-10.45%	-8.87%	-3.33%	-0.67%	5.44%	7.16%
REAL RETURN												
Real Assets	1,883	2.55%	2.50%	0.05%	-10.57%	-3.88%	-9.00%	-1.33%	-10.11%	-1.94%	-0.21%	1.67%
Real Estate	5,095	6.91%	7.50%	-0.59%	1.56%	3.15%	-2.57%	1.27%	5.21%	4.39%	9.21%	6.13%
TOTAL REAL RETURN	6,978	9.46%	10.00%	-0.54%	-2.09%	1.24%	-4.39%	0.62%	0.44%	2.70%	6.22%	4.93%
INCOME												
Investment Grade Credit	6,760	9.16%	10.00%	-0.84%	7.89%	7.45%	4.65%	4.08%	11.96%	11.37%	5.85%	5.70%
High Yield	984	1.33%	2.00%	-0.67%	-6.33%	-5.09%	-10.00%	-8.73%	-5.39%	-4.08%	1.18%	1.87%
Private Credit	5,361	7.27%	6.00%	1.27%	-10.37%	-6.36%	-11.05%	-10.63%	-7.80%	-6.00%	2.17%	1.77%
TOTAL INCOME	13,105	17.76%	18.00%	-0.24%	-1.48%	0.93%	-3.46%	-2.27%	1.52%	3.43%	3.67%	4.08%
DEFENSIVE												
Cash Equivalents	5,751	7.79%	5.00%	2.79%	1.91%	1.61%	0.59%	0.58%	2.48%	2.07%	2.33%	1.81%
U.S. Government	3,126	4.24%	5.00%	-0.76%	10.82%	10.62%	9.08%	8.89%	14.24%	14.27%	5.54%	5.80%
Risk Mitigation Strategies	2,427	3.29%	3.00%	0.29%	0.51%	4.20%	-1.10%	1.58%	3.16%	5.19%	3.29%	4.90%
TOTAL DEFENSIVE	11,304	15.32%	13.00%	2.32%	4.18%	5.39%	2.70%	3.97%	6.01%	6.91%	3.43%	3.43%
OTHER												
OPPORTUNISTIC PE	459	0.62%			3.28%	9.93%	2.50%	5.43%	-2.47%	15.41%	6.58%	15.85%
OTHER	11	0.02%										
TOTAL FUND ⁽²⁾	73,777	100.00%			-2.47%	0.72%	-7.05%	-4.71%	-1.00%	2.03%	4.96%	6.14%

(1) Returns are preliminary, unaudited, and net of all fees

(2) Total Pension Fund excludes Police and Fire Mortgage Program

Notes: Sum of components may not equal totals due to rounding. Certain asset class returns, including private equity, real assets, real estate, and private credit do not include up-to-date valuations and benchmark returns for these asset classes are presented on a lagged basis. This results in performance comparisons that may be less meaningful.

Pension Fund Update: Change in Sector Allocation from March 1, 2020 – April 30, 2020



Market dislocations, along with State and local municipality appropriations, were the key drivers of changes in sector allocations.

Private Credit Portfolio Review

- **Private Credit portfolio positioning**
 - Well diversified by sub-strategy, sector, borrower, collateral type, and geography
 - The General Partners have track records investing (and protecting capital) across market cycles
 - Long-term, patient capital without risk of forced selling
 - Emphasis on opportunistic credit managers with the flexibility to be a liquidity provider
 - Generally positioned defensively heading into COVID-19
 - Investing higher in the capital structure
 - Focusing on lower loan-to-values (“LTV”)
 - Shortening duration
 - Being prudent with the application of leverage
 - Avoiding excessive EBITDA adjustments
 - Predominantly invested in a legacy portfolio with limited ability to divest
 - The most recent commitment to Private Credit was made in November 2018
 - Over 97% of the portfolio’s NAV was committed in 2017 or prior
 - 55% of the capital in the portfolio is currently locked up with no provisions for the Division to elect to exit
 - of the remaining 45% of the portfolio, approximately half is already in the process of being divested (this process was effectuated prior to COVID-19)
- **The outlook for Private Credit appears favorable**
 - Low global public fixed income yields suggest private credit will offer a more attractive risk-return profile
 - Going forward, stronger loan docs, better lender protections, and wider credit spreads are expected to persist
 - Continued opportunities will be provided by evolving banking regulations
- **Next steps for Private Credit portfolio**
 - Rebalance Private Credit portfolio to bring allocation in line with target
 - As capacity becomes available, further diversify the Private Credit portfolio
 - Key structural advantages of Private Credit should be exploited for the benefit of the Pension
 - Illiquidity premium
 - Complexity premium
 - Speed/certainty premium
 - Superior credit docs from bespoke negotiations

Real Assets Portfolio Review

- **Real Assets portfolio status**
 - Legacy positions from the original portfolio construction results in an energy concentration
 - Real Assets grew out of an energy and direct commodities initiative from the 2006 Alternative Investment Program
 - The Division eliminated the commodities exposure, which was largely comprised of public investments, in 2016
 - The current portfolio contains master limited partnerships (MLPs) of energy companies which the Division has been in the process of unwinding
 - The last dedicated private energy investment was made in 2015
 - Large Separate Accounts and fund commitments in the middle of the past decade resulted in vintage year concentration
 - 72% of Real Assets' current NAV was committed in 2012 (42%) and 2015 (30%)
 - The Division benefits from discounted fee structures and governance on the SMAs
 - The Division is diversifying the portfolio away from energy
 - With annual investment pacing of \$200-\$300 million, the process is a multi-year effort
 - In 2015, the Division established a new relationship with a diversified value-add real assets manager
 - In 2017, the Division made its first commitment to a diversified infrastructure manager
 - In 2019, the Division made its first investment with an agriculture (farmland) manager
 - In conjunction with the diversification of Real Assets, the Division has modified its benchmark index over time
 - Real Assets lacks a uniformly recognized index as the sector continues to develop
 - The original benchmark was the Bloomberg Commodities Index to reflect the commodities focus of the portfolio
 - The current Cambridge Associates customized benchmark reflects a more diversified long-term target allocation
- **The outlook for Real Assets appears favorable**
 - Hard assets with long-term contracted cash flows provides implicit inflation protection
 - Real Assets can generate strong current income to support pension benefits
 - The sector is less correlated with fixed income and equities
- **Next steps for the Real Assets portfolio**
 - Continue to diversify Real Assets away from a concentration in conventional energy with target sectors that include:
 - Diversified Infrastructure
 - Renewable Energy
 - Communications
 - Agriculture & Agribusiness
 - Diversify geographically outside North America