

# NEW JERSEY DIVISION OF INVESTMENT

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## ANNUAL MEETING

State Investment Council

January 29, 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.”*

## Background: The New Jersey State Investment Council

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### New Jersey State Investment Council (the “Council”)

- **The State Investment Council is responsible for the formulation of policies that govern the investment of funds by the Division of Investment consistent with the fiduciary duties set forth by statute**
  - the Council provides fiduciary oversight for the assets managed by the Division
  - the Pension Fund, with \$80 billion in assets, is the largest fund managed by the Division
  - pursuant to P.L. 2018, c. 55 (the “PFRS Act”), the authority to direct investment policy of the Police and Firemen’s Retirement System (“PFRS”) was transferred from the Council to the Board of Trustees of PFRS
    - the PFRS Act became fully effective on July 5, 2019
  - the Council retains its oversight responsibility for the non-PFRS portion of the Pension Fund
- **The State Investment Council is NOT responsible for:**
  - Funding Policy (plan contributions)
  - Benefits Policy (plan design)
  - Actuarial Activities (setting actuarial expected return)

## Background: The New Jersey Division of Investment

### New Jersey Division of Investment (the “Division”)

#### Division of Investment Assets Under Management

Assets as of 6/30/19 (\$millions)	
Pension Fund <sup>(1)</sup>	\$79,992
Cash Management Fund (CMF)	15,131
Deferred Compensation Plan funds (DCP)	571
NJBEST Funds (NJBEST)	264
Supplemental Annuity Collective Trust (SACT)	230
Trustees for the Support of Public Schools Fund (TSPSF)	158
<b>Total<sup>(2)</sup></b>	<b>\$92,337</b>

#### Division of Investment “At A Glance”

- 40<sup>th</sup> largest global pension fund manager <sup>(3)</sup>
- 18<sup>th</sup> largest U.S. pension fund manager <sup>(4)</sup>
- 58 active employees with a \$11.5 million personnel budget
- during Fiscal Year 2019, the Division traded:
  - › 596 million shares of stock worth \$18.6 billion
  - › \$12.3 billion in fixed income securities <sup>(5)</sup>
  - › \$1.3 billion in foreign currency transactions
- during Fiscal Year 2019, the Division earned:
  - › \$978 million in stock dividends
  - › \$393 million in bond interest

#### MISSION STATEMENT

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

Note: All figures are as of June 30, 2019 unless otherwise noted.

(1) Throughout this presentation, Pension Fund totals include PFRS assets.

(2) The Total excludes \$4 billion held in CMF which is included in the totals for the Pension Fund, the DCP, NJBEST, SACT, and TSPSF

(3) Measured by assets as of December 31, 2018. Reported by Pensions & Investments (P&I) and TowerWatson.com

(4) Measured by assets as of September 30, 2018. Reported by P&I on February 8, 2019

(5) The total trades in fixed income securities include only the Pension Fund

## Division of Investment Update: 2019 Year in Review

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### The Division completed a formal Asset Allocation Study during the first half of 2019

- a new targeted asset allocation, approved by the Council, included a gradual shift towards a global equity allocation more aligned with the opportunity set, a modest increase in the allocation to private equity, and a partial reduction in hedge funds

### The Division transitioned the U.S. equity portfolio to a passive index-based strategy

- this approach is consistent with the practice of other large institutional funds with internally managed portfolios

### The Division expanded its efforts to foster opportunities for minority-owned and women-owned business enterprises (MWBEs)

- the Division hosted a roadshow sponsored by the National Association of Investment Companies (NAIC), a trade association of MWBE fund managers

### The Division engaged in a comprehensive review of its information technology, trading, reporting and risk analytics capabilities

- the Division released an RFP in November 2019 to solicit proposals from a wide universe of potential bidders

### The Division worked with the Environmental, Social, and Governance (ESG) Committee to incorporate ESG analysis into the investment process

- the Division released an RFP in August 2019 to solicit proposals for ESG-related services provider(s)
- a new Proxy Voting Policy, approved by the Council, incorporates ESG considerations into proxy voting

### The Division worked closely with the PFRS Board and staff to assist in the transition of oversight responsibilities over PFRS assets

- the Division provided support in drafting regulations
- the Division provided training opportunities for PFRS Board members and has made numerous presentations to PFRS Board members to familiarize the Board with the Division's investment process

### The Division experienced a number of personnel changes in 2019

- the Division designated Jeff Warshauer as its Corporate Governance Officer
- the Division welcomed Robert Tona and Lynn Jahn to the team

## NJ Pension Fund Annual Performance: Fiscal Years 2005-2019

	NJ Pension Fund <sup>(1)</sup>	Policy Benchmark	Variance
FY 2005	8.77%	8.07%	70
FY 2006	9.79%	8.13%	166
FY 2007	17.14%	16.49%	65
FY 2008	-2.61%	-6.00%	339
FY 2009	-15.49%	-14.76%	-73
FY 2010	13.34%	13.51%	-17
FY 2011	17.97%	17.03%	94
FY 2012	2.47%	0.26%	221
FY 2013	11.72%	10.96%	76
FY 2014	16.79%	15.79%	100
FY 2015	4.09%	2.93%	116
FY 2016	-0.93%	0.23%	-116
FY 2017	13.07%	13.14%	-7
FY 2018	9.06%	8.65%	41
FY 2019	6.27%	7.07%	-80
<b>Annualized Returns</b>	<b>7.06%</b>	<b>6.40%</b>	<b>66</b>

Over the past fifteen years, the NJ Pension Fund has outperformed its Policy Benchmark by 66 basis points (annualized)

(1) Throughout this presentation, NJ Pension Fund returns exclude Police and Fire mortgage program

## Long-Term Capital Market Returns

### Annualized Returns for Periods Ending December 31, 2019 (%)

	One Year	Three Years	Five Years	Ten Years	Fifteen Years
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#### Global Equity Indices

MSCI All Country World Index	26.60	12.44	8.40	8.78	6.85
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#### US Equity Indices

Russell 3000	31.01	14.56	11.23	13.41	9.02
Russell 1000	31.42	15.04	11.47	13.53	9.11
Russell 2000	25.49	8.57	8.20	11.81	7.90
Russell Growth	35.84	19.88	14.22	15.04	10.36
Russell Value	26.24	9.31	8.18	11.70	7.56

#### Non-US Equity Indices

MSCI EAFE	22.01	9.56	5.67	5.50	4.84
MSCI Emerging Markets	18.42	11.57	5.61	3.68	7.48

## Long-Term Capital Market Returns

Annualized Returns for Periods Ending December 31, 2019<sup>(1)</sup> (%)

	One Year	Three Years	Five Years	Ten Years	Fifteen Years
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### Fixed Income Indices

Bloomberg Barclays Aggregate	8.72	4.03	3.05	3.74	4.15
Bloomberg Barclays U.S. Treasury	6.86	3.31	2.35	3.13	3.70
Bloomberg Barclays U.S. Credit	13.80	5.76	4.39	5.32	5.10
Bloomberg Barclays U.S. High Yield	14.32	6.37	6.13	7.57	7.20

### Commodities

Bloomberg Commodities Index	5.44	-2.59	-4.96	-5.28	-3.84
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### Private Equity

Cambridge Global Private Equity and VC Index	10.55	15.17	13.27	14.42	13.80
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### Real Estate

NCREIF Property Index	6.23	6.76	8.56	9.77	8.55
Bloomberg REIT Index	27.71	9.94	8.36	12.60	8.13

(1) Private Equity and Real Estate (NCREIF) returns are presented with a three-month lag  
 Source: Bloomberg, Cambridge Associates, and National Council of Real Estate Investment Fiduciaries

## Ten Year Periodic Table of Returns<sup>(1)</sup>

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2019
EM 18.88	Real Estate 16.10	EM 18.22	R3000 33.57	Private Equity 17.76	Real Estate 13.47	High Yield 17.13	EM 37.28	Private Equity 18.17	R3000 31.01	Private Equity 14.42
R3000 16.92	Private Equity 14.49	EAFE 17.32	EAFE 22.78	R3000 12.55	Private Equity 11.52	R3000 12.72	EAFE 25.03	Real Estate 7.16	EAFE 22.01	R3000 13.41
Private Equity 16.86	Treasuries 9.81	R3000 16.37	Private Equity 16.71	Real Estate 11.26	Treasuries 0.84	Commodities 11.40	R3000 21.12	Treasuries 0.86	EM 18.42	Real Estate 9.77
Commodities 16.67	Corporates 8.35	High Yield 15.77	Real Estate 11.00	Corporates 7.53	R3000 0.47	EM 11.19	Private Equity 16.93	High Yield -2.08	High Yield 14.32	High Yield 7.57
High Yield 15.12	High Yield 4.98	Private Equity 12.25	High Yield 7.44	Treasuries 5.05	Corporates -0.77	Private Equity 9.43	High Yield 7.50	Corporates -2.11	Corporates 13.80	EAFE 5.50
Corporates 8.47	R3000 1.03	Real Estate 11.00	Corporates -2.01	High Yield 2.45	EAFE -0.81	Real Estate 9.22	Real Estate 6.90	R3000 -5.25	Private Equity 10.55	Corporates 5.32
EAFE 7.75	EAFE -12.14	Corporates 9.37	EM -2.60	EM -2.19	High Yield -4.47	Corporates 5.63	Corporates 6.18	Commodities -12.99	Treasuries 6.86	EM 3.68
Treasuries 5.87	Commodities -13.37	Treasuries 1.99	Treasuries -2.75	EAFE -4.90	EM -14.92	Treasuries 1.04	Treasuries 2.31	EAFE -13.79	Real Estate 6.23	Treasuries 3.13
Real Estate 5.83	EM -18.42	Commodities -1.14	Commodities -9.58	Commodities -17.04	Commodities -24.70	EAFE 1.00	Commodities 0.75	EM -14.57	Commodities 5.44	Commodities -5.28

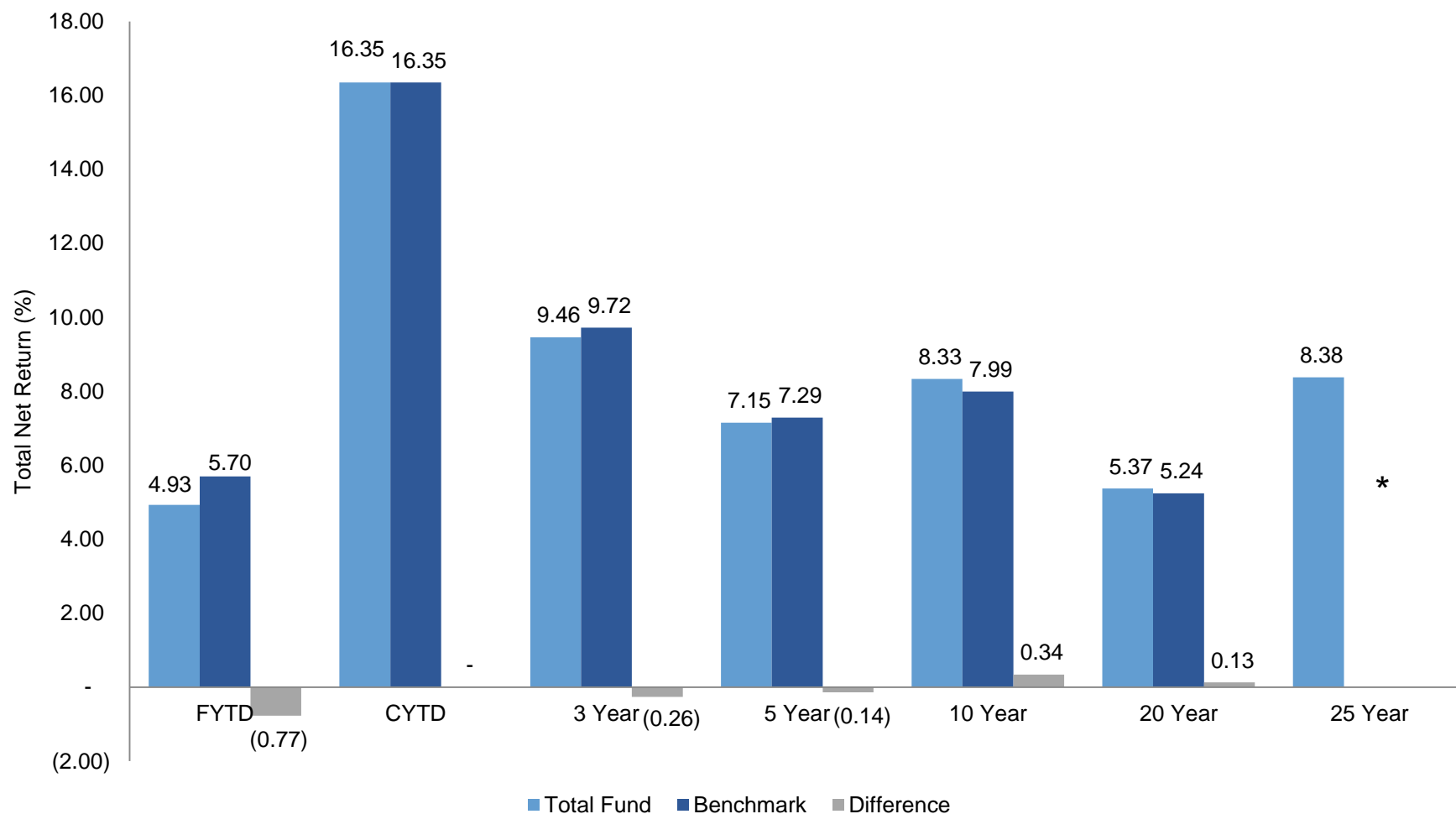
Over the past ten years, Private Equity, U.S. Equities, and Real Estate were the three best performing asset classes. The wide variation of returns amongst asset classes in each of the past ten years reinforces the important role of diversification in asset allocation.

(1) Private Equity and Real Estate returns are presented with a three-month lag

Source: Bloomberg, Cambridge Associates, and National Council of Real Estate Investment Fiduciaries



## Long-Term NJ Pension Fund<sup>(1)</sup> Returns versus Policy Benchmark (as of December 31, 2019)

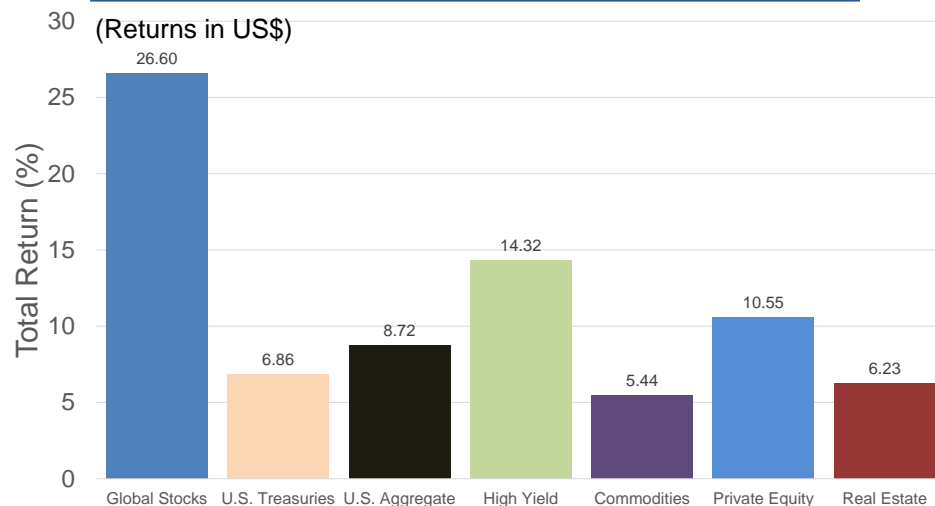


(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program. Certain asset class returns, including private equity, real assets, real estate, and private credit do not include up-to-date valuations and benchmark returns for these asset classes are calculated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

\* Benchmark return not available for 25-Year period

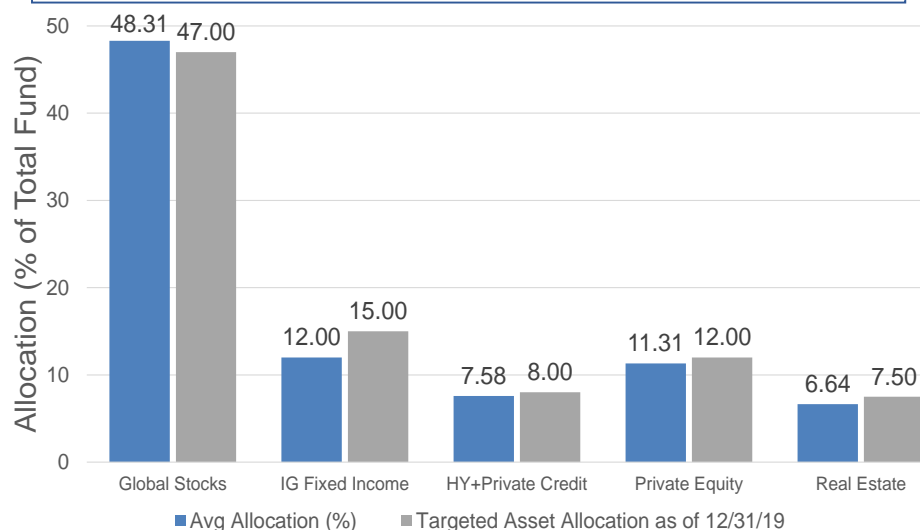
## 2019 Capital Markets Review: Multi-Asset Class Returns

### 2019 Select Capital Market Returns <sup>(1)</sup>



During 2019, all major asset classes realized positive returns. Global Stocks (+26.60%) were the best performing asset class following negative returns (-9.42%) the prior calendar year. Fixed Income returns were strong, led by High Yield (+14.32%). Private Equity realized double-digit returns for a third consecutive year.

### 2019 Pension Fund Asset Allocation



The Pension Fund maintained an asset allocation generally in line with the targeted allocation throughout the year. A modest overweight for Global Stocks benefited the Pension Fund.

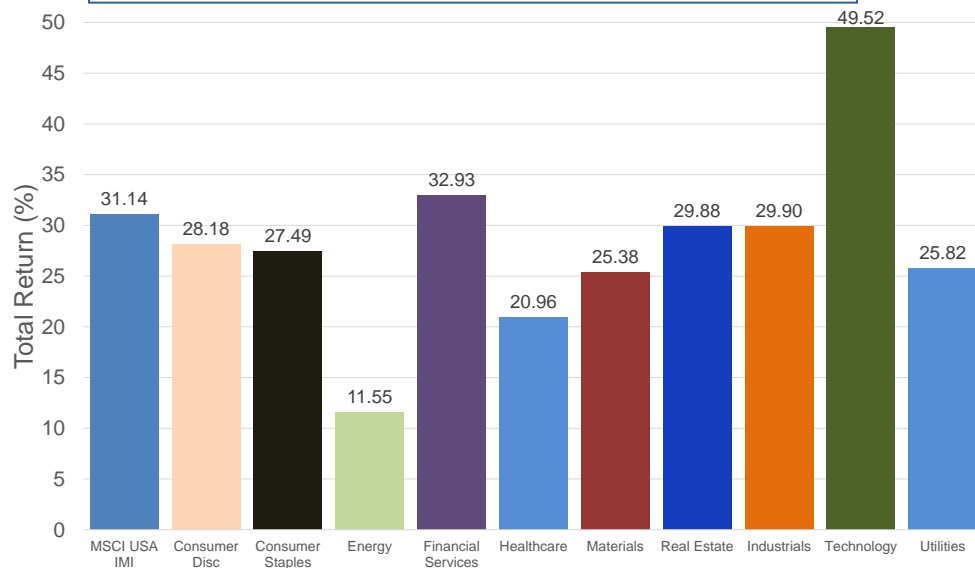
Capital market returns were favorable during 2019, led by a strong rebound in Global Equities. Returns across asset classes were more highly correlated as declining interest rates supported economic growth and higher equity multiples.

(1) Private Equity (PE) and Real Estate (RE) returns reflect a three-month lag

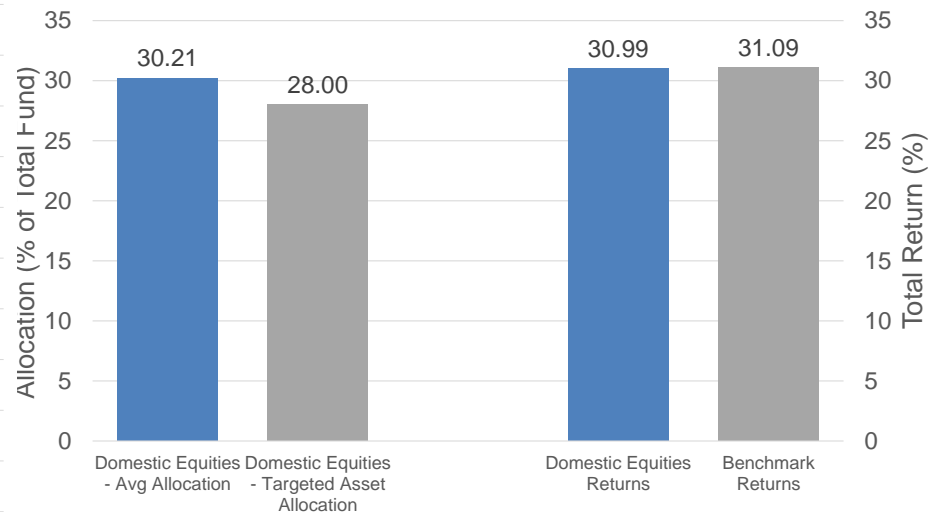
Source: Bloomberg, Cambridge Associates, National Council of Real Estate Investment Fiduciaries, and State Street

## 2019 Capital Markets Review: US Equity Sector Returns

### 2019 Select Capital Market Returns



### 2019 Pension Fund Asset Allocation and Returns (1)



2019 marked the ninth calendar year in the past decade that U.S. Equities outperformed the global market. Returns were led by the Technology sector (+49.52%). Over the past decade, Technology has been the best performing sector of the equity market, outperforming the broader market by 389 basis points, annualized (+17.39% versus +13.50%).

Following an extended period of outperformance for U.S. Equities, the Council approved a modest decrease in the targeted allocation (from 30% to 28%). The Division shifted the U.S. Equity portfolio to a passive index-based approach.

Following a 20% drawdown in the fourth quarter of 2018, U.S. Equities realized outsized returns during calendar year 2019.

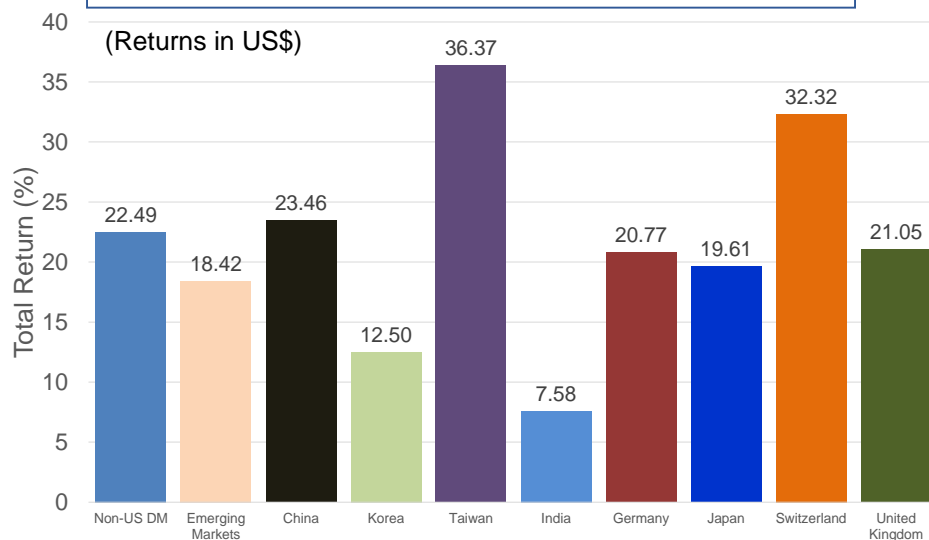
(1) Targeted Asset Allocation as of 12/31/19

Source: Bloomberg, MSCI, and State Street

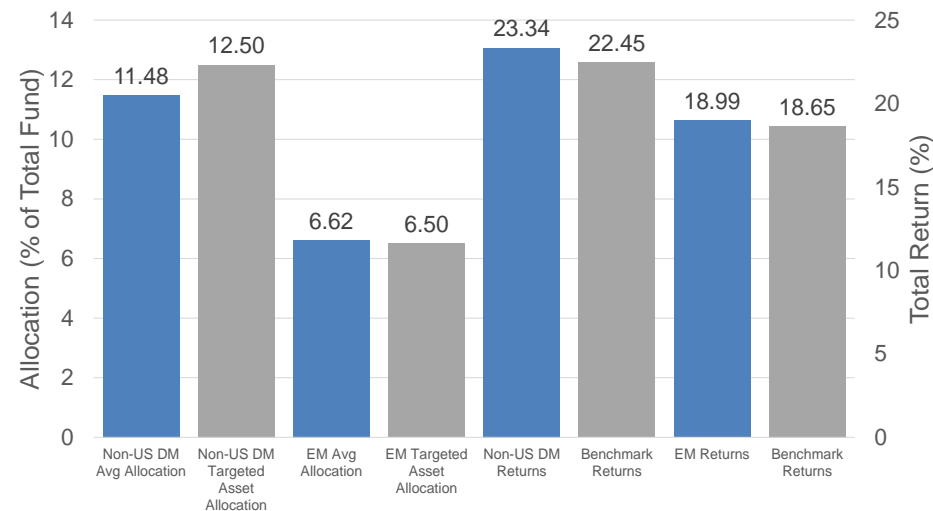
Note: Fund returns are unaudited. Fund and Benchmark returns are based on preliminary values.

## 2019 Capital Markets Review: International Equity Returns

### 2019 Select Capital Market Returns



### 2019 Pension Fund Asset Allocation and Returns (1)



During 2019, Non-US Developed Markets (DM) and Emerging Markets (EM) realized strong absolute returns, up +22.49% and +18.42% respectively, rebounding from negative returns the prior calendar year.

The Council approved a modest increase in the targeted allocation to DM, from 11.5% to 12.5%. During 2019, the Pension Fund benefited from favorable relative returns in both the DM and EM portfolios.

During 2019, Non-US Developed Markets (DM) and Emerging Markets (EM) realized favorable returns. Over the past decade, DM and EM have lagged U.S. Equities by 7.90% and 9.72%, respectively, on an annualized basis.

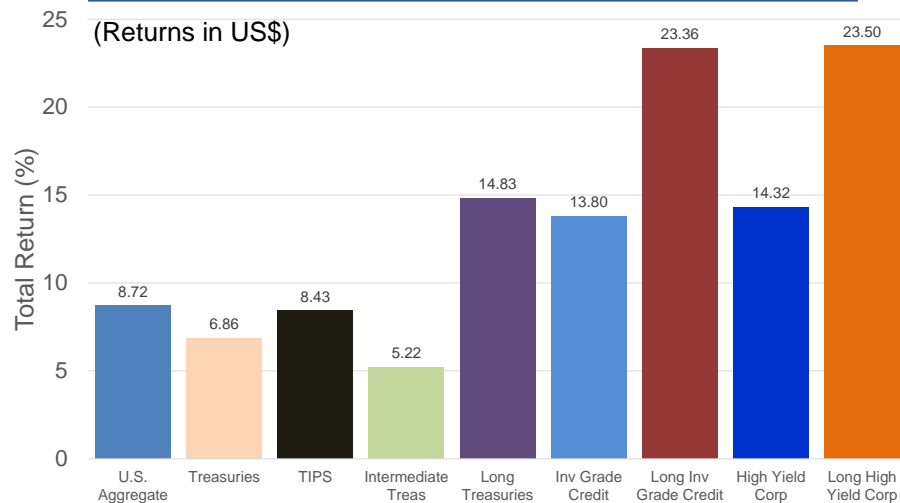
(1) Targeted Asset Allocation as of 12/31/19

Source: Bloomberg, MSCI, and State Street

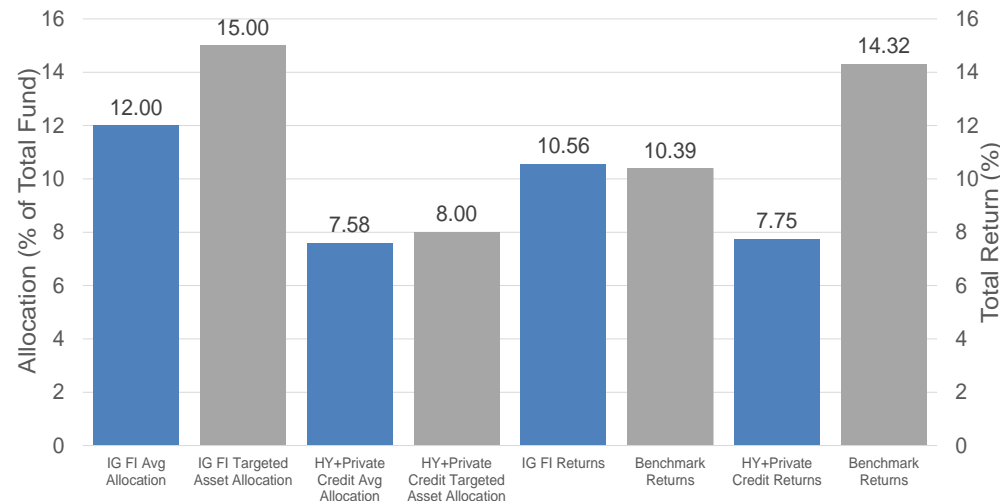
Note: Fund returns are unaudited. Fund and Benchmark returns are based on preliminary values.

## 2019 Capital Markets Review: Fixed Income Returns

### 2019 Select Capital Market Returns



### 2019 Pension Fund Asset Allocation and Returns <sup>(1)</sup>



Fixed Income realized strong returns, led by High Yield (+14.32%) and Investment Grade (IG) Credit (+13.80%) as spreads narrowed. U.S. Treasuries (+6.86%) and IG Credit realized their best calendar year returns since 2011 and 2009 respectively. Longer duration securities outperformed in a declining interest rate environment.

The Council approved a modest increase in the targeted allocation to U.S. Treasuries, from 3% to 5%, as assets are shifted out of risk mitigation hedge fund strategies over time. Strong absolute and relative returns within IG Credit portfolio added value during 2019.

During 2019, the Bloomberg Barclays U.S. Aggregate Bond Index realized its strongest returns since 2002 as yields declined and credit spreads narrowed throughout the period.

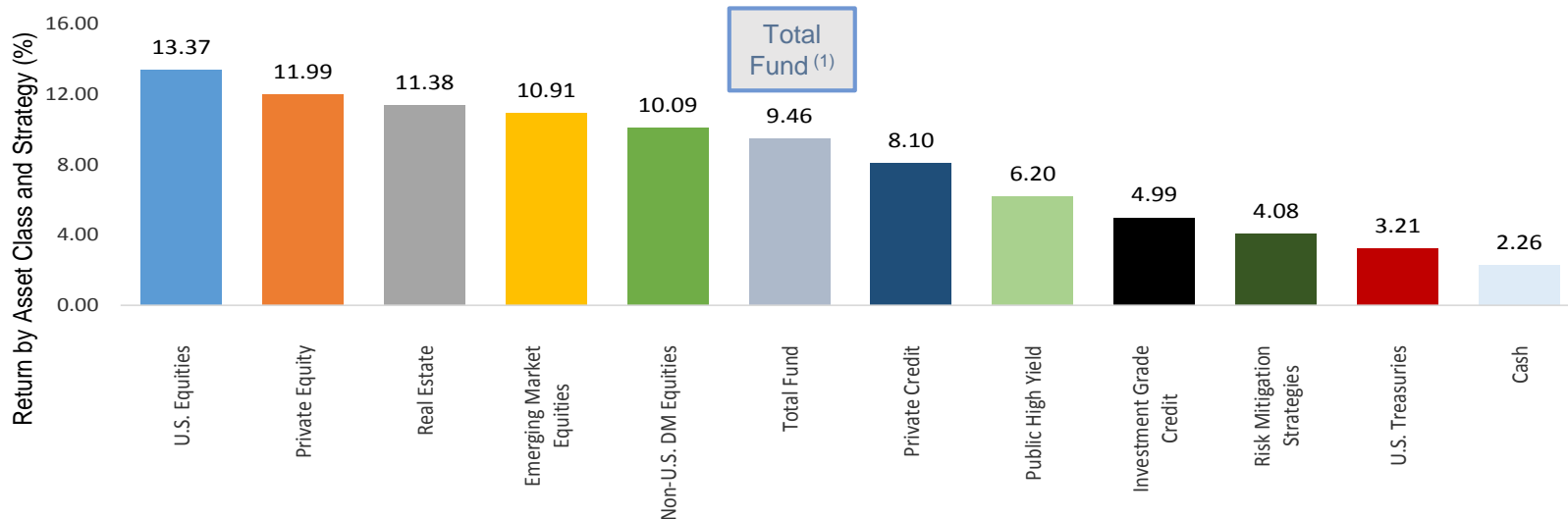
(1) Targeted Asset Allocation as of 12/31/19

Source: Bloomberg and State Street

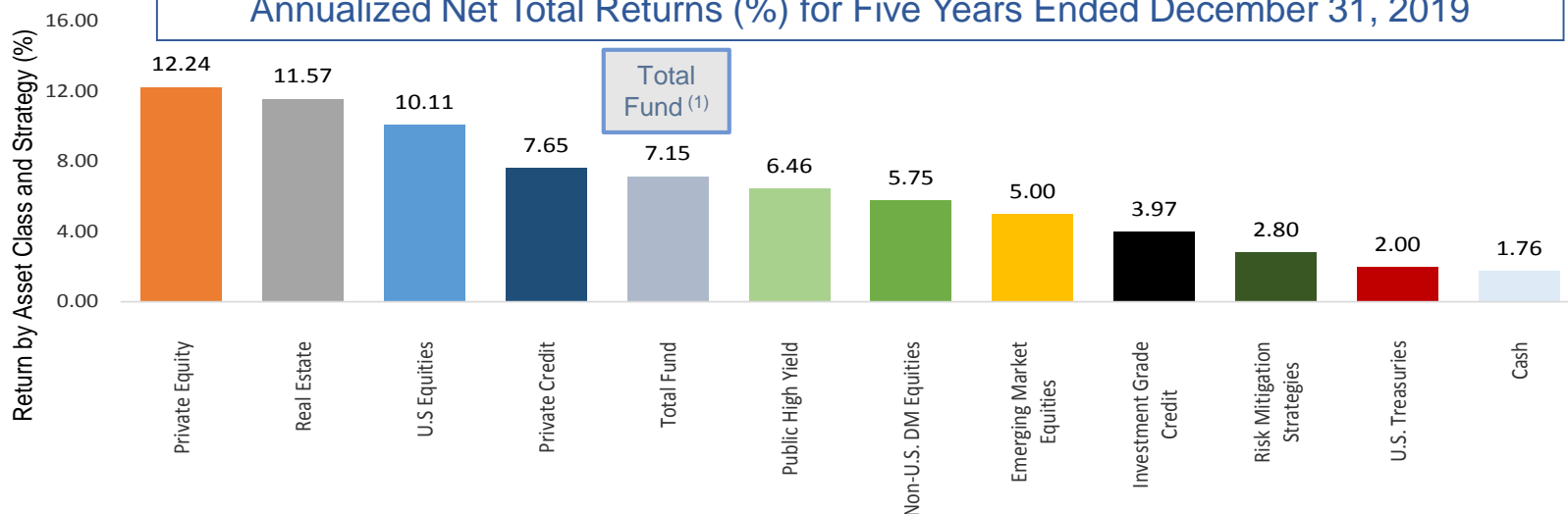
Note: Fund returns are unaudited. Fund and Benchmark returns are based on preliminary values. Private credit returns do not include up-to-date valuations and the benchmark return for private credit is calculated on a lagged basis. This results in performance comparisons that may be less meaningful.

## Pension Fund Three and Five Year Net Returns<sup>(1)</sup> By Asset Class and Strategy

### Annualized Net Total Returns (%) for Three Years Ended December 31, 2019



### Annualized Net Total Returns (%) for Five Years Ended December 31, 2019

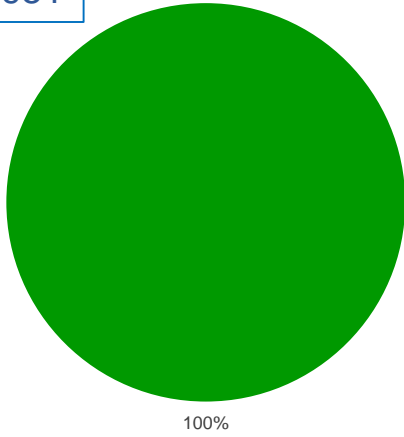


(1) Returns are net of all fees and unaudited. Pension Fund returns exclude Police and Fire Mortgage Program

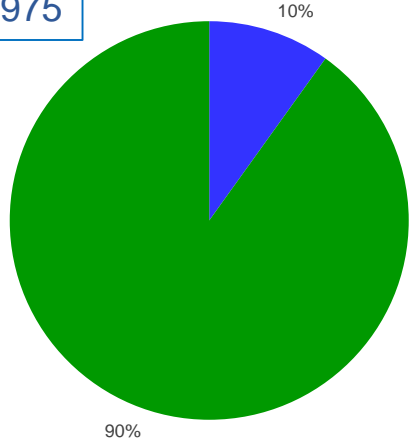
Note: Certain asset class returns, including Private Equity, Real Estate, and Private Credit do not include up-to-date valuations. This results in performance comparisons that may be less meaningful.

# Pension Fund Asset Allocation: A Long-Term Perspective

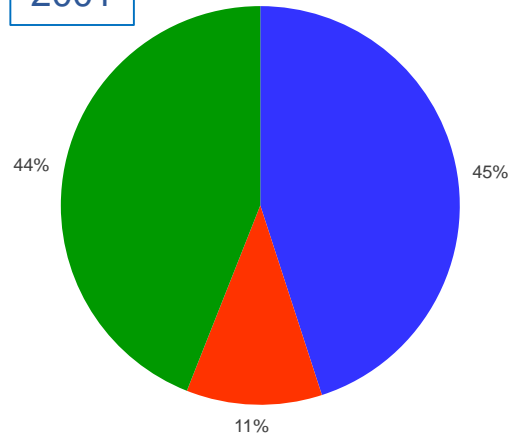
1951



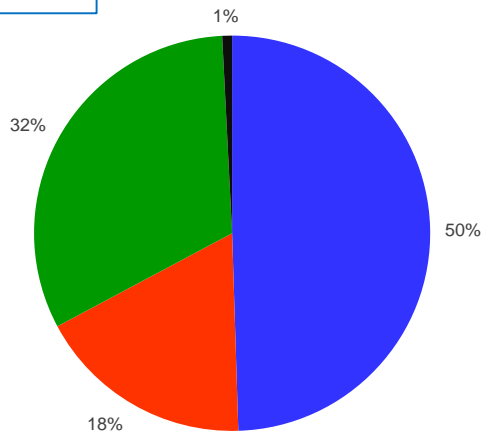
1975



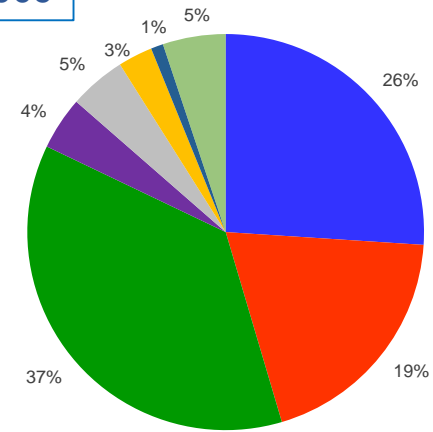
2001



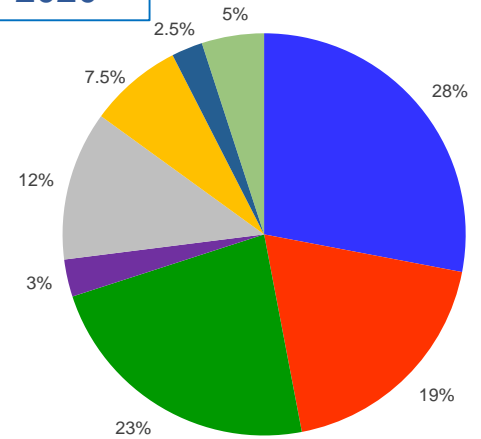
2006



2009



2020 (1)



■ Domestic Equity ■ International Equity ■ Fixed Income ■ Risk Mitigation ■ Private Equity ■ Real Estate ■ Real Assets ■ Cash ■ Alternative Investment Program

The well-diversified NJ Pension Fund asset allocation has evolved over a period of decades from a portfolio comprised solely of fixed income securities.

(1) 2020 reflects the Council's current targeted asset allocation

## Recent Trends in the Pension Fund's Targeted Asset Allocation<sup>(1)</sup>

Asset Class	FY 2015 Target <sup>(2)</sup>	FY 2016 Target <sup>(3)</sup>	FY 2017 Target	FY 2018 Target	FY 2019 Target	FY2020 Target
<b>GLOBAL GROWTH</b>	<b>54.90%</b>	<b>54.75%</b>	<b>58.25%</b>	<b>58.25%</b>	<b>58.25%</b>	<b>59.00%</b>
U.S. Equity	27.25%	26.00%	30.00%	30.00%	30.00%	28.00%
Non-US DM Eq	12.00%	13.25%	11.50%	11.50%	11.50%	12.50%
Emerging Market Eq	6.40%	6.50%	6.50%	6.50%	6.50%	6.50%
Private Equity	9.25%	9.00%	10.25%	10.25%	10.25%	12.00%
<b>INCOME</b>	<b>19.50%</b>	<b>18.75%</b>	<b>18.50%</b>	<b>18.50%</b>	<b>18.50%</b>	<b>18.00%</b>
Investment Grade Credit	10.00%	8.00%	10.00%	10.00%	10.00%	10.00%
High Yield	2.00%	2.00%	2.50%	2.50%	2.50%	2.00%
Private Credit	7.50%	8.75%	6.00%	6.00%	6.00%	6.00%
<b>REAL RETURN</b>	<b>8.25%</b>	<b>8.55%</b>	<b>9.75%</b>	<b>9.75%</b>	<b>9.75%</b>	<b>10.00%</b>
Real Estate	5.25%	6.05%	7.25%	7.25%	7.25%	7.50%
Real Assets	3.00%	2.50%	2.50%	2.50%	2.50%	2.50%
<b>DEFENSIVE</b>	<b>12.25%</b>	<b>13.00%</b>	<b>13.50%</b>	<b>13.50%</b>	<b>13.50%</b>	<b>13.00%</b>
Cash Equivalents	5.00%	5.00%	5.50%	5.50%	5.50%	5.00%
U.S. Treasuries	3.25%	3.00%	3.00%	3.00%	3.00%	5.00%
Risk Mitigation Strategies	4.00%	5.00%	5.00%	5.00%	5.00%	3.00%

(1) Prior year targeted allocations have been adjusted to reflect changes in the classification of assets approved by the Council. Global Diversified Credit and Credit-Oriented Hedge Funds were combined into Private Credit. Buyouts/Venture Cap and Debt-Related PE were combined into Private Equity. Equity Related Real Estate and Debt Related Real Estate were combined into Real Estate.

(2) FY 2015 target excludes a 4.0% allocation to Equity-Oriented Hedge Funds and a 1.1% allocation to the PFRS mortgage program.

(3) FY 2016 target excludes a 3.75% allocation to Equity-Oriented Hedge Funds and a 1.2% allocation to the PFRS mortgage program.



## Division of Investment Update: 2020 Key Goals and Initiatives

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### The Division continues to expand its internal capabilities in the private markets

- Division resources have been reallocated to the alternative investment program to reinforce that effective strategies for investing in private markets remain in place
- the Division will further expand training resources available to the team
- the Division will be reviewing RFP responses for a Private Credit consultant

### The Division continues to work toward filling key senior investment roles

- key roles include Deputy Director and Head of the Alternative Investment Program, among others

### The Division continues to move forward in refreshing its entire information technology system

- the Evaluation Committee will be reviewing RFP responses and interviewing bidders ahead of selection and implementation
- the long-term objective of the initiative is to ensure the Division's entire front, middle and back-office IT infrastructure is consistent with best practices

### The Division continues its efforts to foster opportunities for MWBEs

- an important next step will be the retention of a full-time employee who will lead the Division's MWBE initiatives, with a goal to build upon the Division's outreach efforts to date
- the Division believes that diversity can enhance financial outcomes and a greater utilization of diverse businesses may lead to better risk-adjusted investment returns

### The Division's Environmental, Social, and Governance (ESG) efforts continue to expand and evolve

- the Division expects to engage ESG-related service provider(s) to support its efforts
- the Division anticipates pursuing other engagement activities to address ESG issues where it is determined that such activities may enhance the value of an investment

### The Division continues to work with PFRS to ensure a smooth transition

- it is expected that PFRS will be adopting investment regulations in 2020
- the Division will continue to manage investments on behalf of PFRS in accordance with statute