

# NEW JERSEY DIVISION OF INVESTMENT

## Director's Report

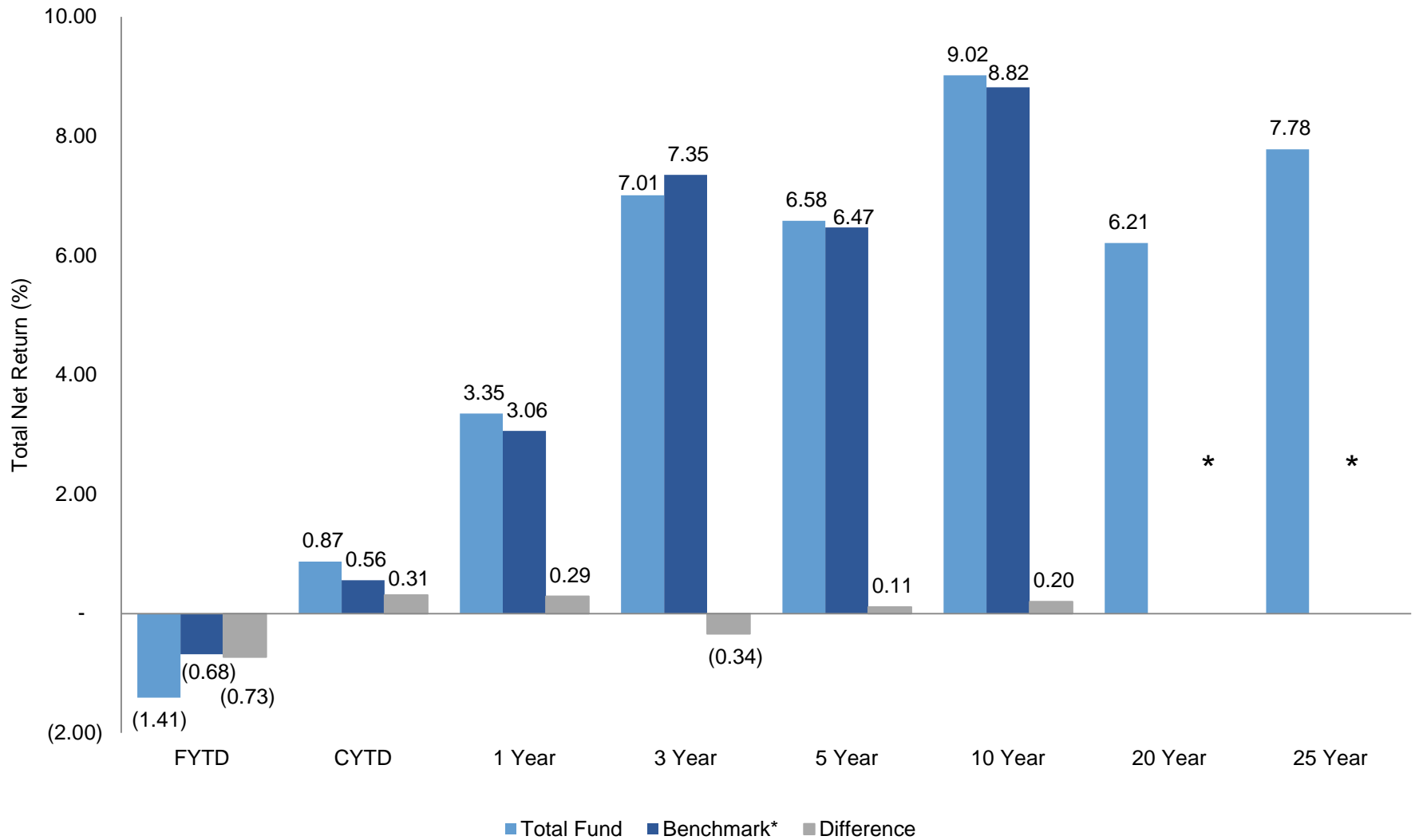
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November 29, 2018

State Investment Council Meeting

*“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<sup>(1)</sup> for Periods Ending October 31, 2018



(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program

\*Benchmark return not available for 20 and 25-Year period

## Capital Market Returns (%)

	Calendar YTD	Fiscal YTD	Start of FY to Peak	Peak to Trough
Start	12/31/2017	6/30/2018	6/30/2018	9/20/2018
End	11/21/2018	11/21/2018	9/20/2018	11/20/2018

### Global Equity Indices

MSCI All Country World Index	-5.21	-4.79	4.57	-9.30
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### US Equity Indices

Russell 3000	0.35	-2.78	7.79	-10.23
Russell 1000 (Large Cap)	0.53	-2.25	8.03	-9.89
Russell 2000 (Small Cap)	-2.03	-9.01	4.95	-14.42
Russell Growth	1.91	-5.15	8.56	-13.20
Russell Value	-1.59	-0.44	7.03	-7.25

### Non-US Equity Indices

MSCI EAFE	-10.08	-7.54	1.58	-9.36
MSCI Emerging Markets	-14.00	-7.87	-2.21	-6.03

### Fixed Income Indices

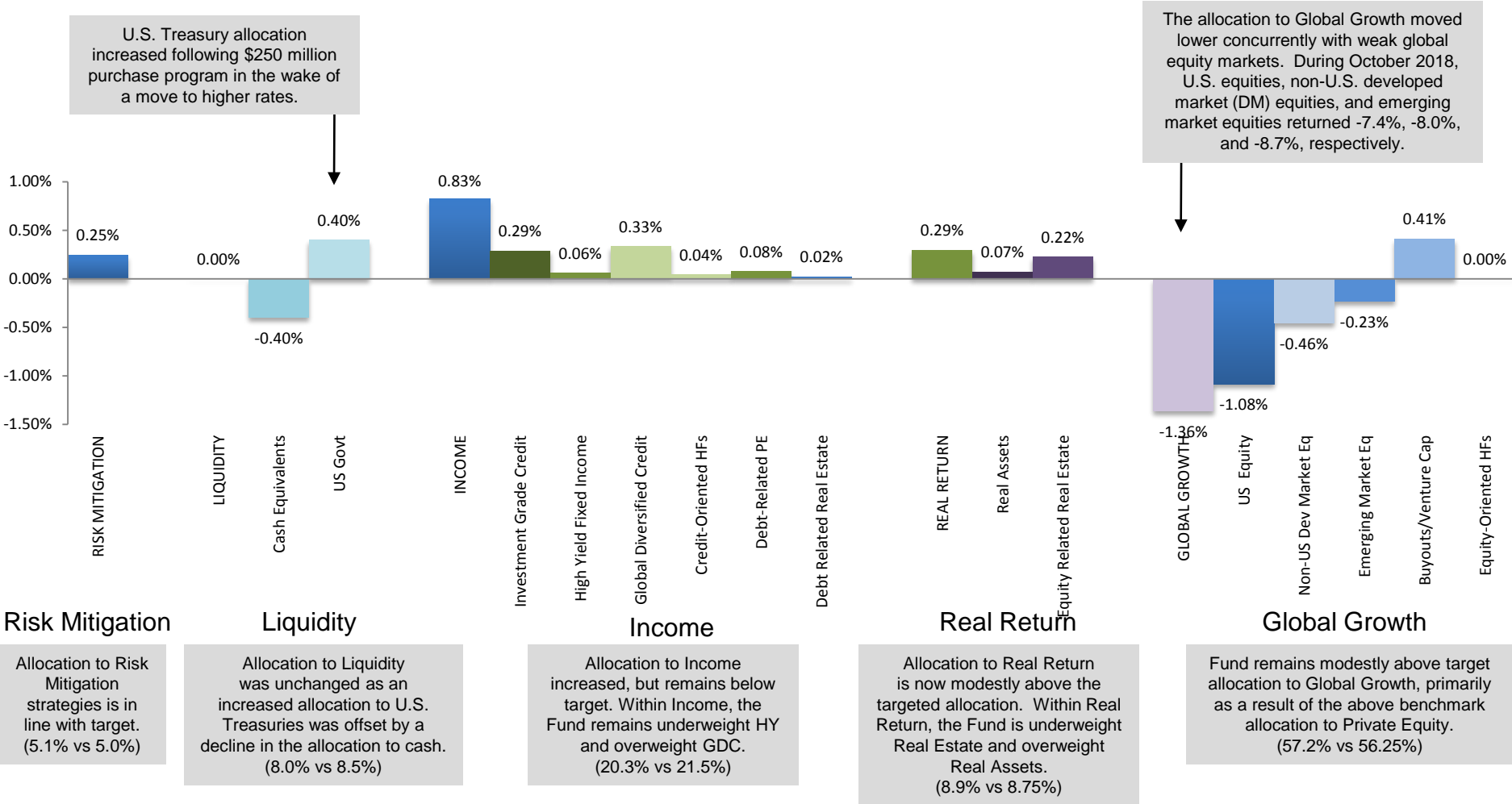
Bloomberg Barclays Aggregate	-1.96	-0.35	-0.23	-0.11
Bloomberg Barclays U.S. Treasury	-1.46	-0.38	-0.78	0.46
Bloomberg Barclays U.S. Credit	-3.46	-0.49	0.58	-1.15
Bloomberg Barclays U.S. High Yield	-0.23	-0.39	2.22	-2.78

## Asset Allocation and Net Returns by Asset Class (October 31, 2018)

Asset Class	ASSET ALLOCATION				PERFORMANCE (for periods ending October 31, 2018) <sup>(1)</sup>							
	As of October 31, 2018				FYTD		Calendar YTD		Trailing Twelve Months		Trailing Three Years	
	Mkt Value	Actual (%)	Target (%)	Difference	NJ	Bench	NJ	Bench	NJ	Bench	NJ	Bench
<b>RISK MITIGATION</b>												
<b>RISK MITIGATION STRATEGIES</b>	<b>3,790</b>	<b>5.08%</b>	<b>5.00%</b>	<b>0.08%</b>	<b>0.88%</b>	<b>1.70%</b>	<b>4.19%</b>	<b>4.06%</b>	<b>5.03%</b>	<b>4.78%</b>	<b>2.56%</b>	<b>3.97%</b>
<b>LIQUIDITY</b>												
Cash Eqv & Short Term	4,443	5.95%	5.50%	0.45%	0.86%	0.67%	1.90%	1.48%	2.20%	1.68%	1.50%	0.90%
U.S. Government	1,488	1.99%	3.00%	-1.01%	-1.00%	-1.07%	-2.30%	-2.14%	-2.16%	-1.97%	-0.04%	0.44%
<b>TOTAL LIQUIDITY</b>	<b>5,931</b>	<b>7.95%</b>	<b>8.50%</b>	<b>-0.55%</b>	<b>0.36%</b>	<b>0.05%</b>	<b>-0.02%</b>	<b>0.20%</b>	<b>0.22%</b>	<b>0.39%</b>	<b>0.71%</b>	<b>0.79%</b>
<b>INCOME</b>												
Investment Grade Credit	7,466	10.01%	10.00%	0.01%	-0.23%	-0.59%	-2.15%	-3.28%	-2.07%	2.69%	1.74%	2.01%
Public High Yield	1,020	1.37%	2.50%	-1.13%	0.62%	0.77%	0.43%	0.93%	0.72%	0.97%	6.28%	6.60%
Global Diversified Credit	4,417	5.92%	5.00%	0.92%	1.77%	0.77%	8.02%	0.93%	9.72%	0.97%	10.79%	6.60%
Credit-Oriented HF's	847	1.14%	1.00%	0.14%	1.29%	2.15%	6.32%	5.20%	8.05%	5.67%	6.59%	6.73%
Debt-Related PE	980	1.31%	2.00%	-0.69%	0.78%	3.18%	11.43%	4.31%	12.76%	5.73%	9.17%	9.34%
Debt Related Real Estate	396	0.53%	1.00%	-0.47%	-0.92%	3.31%	4.73%	7.35%	6.84%	7.80%	4.30%	5.93%
<b>TOTAL INCOME</b>	<b>15,127</b>	<b>20.27%</b>	<b>21.50%</b>	<b>-1.23%</b>	<b>0.52%</b>	<b>0.61%</b>	<b>2.47%</b>	<b>-0.05%</b>	<b>3.23%</b>	<b>0.41%</b>	<b>5.34%</b>	<b>4.68%</b>
<b>REAL RETURN</b>												
Real Assets & Commodities	2,312	3.10%	2.50%	0.60%	-0.21%	3.73%	10.86%	8.37%	13.45%	10.27%	6.74%	3.15%
Equity Related Real Estate	4,290	5.75%	6.25%	-0.50%	-0.16%	1.81%	7.58%	5.73%	10.78%	7.47%	10.43%	8.38%
<b>TOTAL REAL RETURN</b>	<b>6,602</b>	<b>8.85%</b>	<b>8.75%</b>	<b>0.10%</b>	<b>-0.18%</b>	<b>2.36%</b>	<b>8.72%</b>	<b>6.49%</b>	<b>11.73%</b>	<b>8.27%</b>	<b>9.22%</b>	<b>6.99%</b>
<b>GLOBAL GROWTH</b>												
US Equity	22,139	29.67%	30.00%	-0.33%	-1.05%	-0.30%	0.72%	2.60%	4.60%	6.86%	10.01%	11.46%
Non-US Dev Market Eq	8,187	10.97%	11.50%	-0.53%	-6.96%	-6.70%	-8.79%	-9.40%	-6.16%	-6.80%	4.06%	3.75%
Emerging Market Eq	4,578	6.14%	6.50%	-0.36%	-8.96%	-9.87%	-16.42%	-16.08%	-13.21%	-12.89%	6.15%	6.52%
Buyouts/Venture Cap	7,491	10.04%	8.25%	1.79%	1.15%	4.41%	15.40%	13.28%	18.62%	18.75%	12.41%	12.49%
Equity-Oriented HF's	287	0.38%	0.00%	0.38%	0.22%	0.33%	0.42%	2.14%	1.02%	2.64%	4.11%	7.20%
<b>TOTAL GLOBAL GROWTH</b>	<b>42,681</b>	<b>57.20%</b>	<b>56.25%</b>	<b>0.95%</b>	<b>-2.72%</b>	<b>-2.00%</b>	<b>-1.11%</b>	<b>-0.52%</b>	<b>2.27%</b>	<b>3.37%</b>	<b>8.51%</b>	<b>9.58%</b>
<b>OTHER</b>												
<b>OPPORTUNISTIC PE</b>	421	0.56%			-0.01%	4.41%	8.00%	13.28%	8.36%	18.75%	8.50%	12.49%
<b>OTHER</b>	61	0.08%										
<b>TOTAL FUND <sup>(1)</sup></b>	<b>74,613</b>	<b>100.00%</b>			<b>-1.41%</b>	<b>-0.68%</b>	<b>0.87%</b>	<b>0.56%</b>	<b>3.35%</b>	<b>3.06%</b>	<b>7.01%</b>	<b>7.35%</b>

(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program  
Sum of components may not equal totals due to rounding

# Pension Fund Update: Change in Sector Allocation from September 30, 2018 – October 31, 2018



**The primary driver of sector allocation changes was weakness in the global equity markets. The allocation to Income increased in this environment.**

## Noteworthy Developments

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- Staffing:
  - Three Investment Analyst Trainees began with the Division in November; two in the Alternatives Program, and one working with the Director on various investment research projects.
  - The Division has invited for second interviews three finalists in the search for a Corporate Governance Officer
- The Division of Investment is working on the following Requests for Proposals (RFP):

Proxy Research and Voting, Class Action Monitoring Services and Optional Proxy Guideline Review RFP:

The RFP package remains with the Division of Purchase and Property for final approval.

Replacement Investment Systems Platform (RISP) RFP:

The Division submitted the RISP RFP to the Division of Purchase and Property (DPP) to advertise and procure.

Securities Lending RFP:

The Committee has begun meeting to discuss proposals.

ESG Scoring RFP:

The Division is currently developing the requirements and statement of work to advertise an RFP for these services.

## Notification: Modification – Aermont Capital Real Estate Fund IV SCSp

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**Background:** On September 27, 2018, the Division presented to the State Investment Council (the “Council”) an investment of up to \$125 million in Aermont Capital Real Estate Fund IV SCSp (the “Fund”), an opportunistic real estate fund focused on the pan-European market. The Fund is Euro-denominated and Aermont Capital LLP (“Aermont”) allocated €100 million for the Division, which equaled approximately \$114 million as of the date of the presentation.

**Modification:** The Division is notifying the Council that the Division’s investment in the Fund is denominated in Euros, rather than dollars, and that the Division’s commitment of up to €100 million in the Fund may in fact exceed the \$125 million originally presented, depending on exchange rates applicable at the time capital is called.

**Impact on New Jersey:** The Division does not expect exchange rates to dramatically fluctuate during the remainder of the Fund’s investment period, and therefore it is unlikely that the commitment will significantly exceed the dollar value originally presented.

**The Director is notifying the Council of this modification in accordance with the Alternative Investment Modification Procedures.**

## Notification: Modification – Owl Rock Technology Finance Corp.

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**Background:** On September 27, 2018, the Division presented to the State Investment Council (“Council”) an investment of up to \$100 million in Owl Rock Technology Finance Corp. (“Tech BDC”), a private Business Development Company (BDC) specializing in technology sector investments. As a seed investor in Tech BDC, the Division was offered an economic interest in Owl Rock’s technology lending business. This modification provides additional details regarding the terms of the investment, beyond those presented in the Division’s September 21, 2018 presentation to the Council.

**Modification:** As a seed investor, the Division will receive a membership interest in a holding company named Owl Rock Capital Technology Holdings LLC (“Tech Holdings”). Through this interest, the Division will receive distributions on the profits of Tech Holdings. Prior to an exchange listing of Tech BDC, the management fee for the Tech BDC will be 0.90% of gross assets above 200% asset coverage, plus 0.90% of unfunded capital commitments. An additional fee will be charged by Tech Holdings in the amount of 0.60% of the Division’s capital commitment to Tech BDC. The incentive fee for Tech BDC will be 10% prior to an exchange listing. An additional incentive fee will be charged by Tech Holdings in the amount of 7.5%. The hurdle rate for both Tech BDC and Tech Holdings will be 6%. Following an exchange listing of Tech BDC, fees will no longer accrue to Tech Holdings. The management fee and incentive fee for Tech BDC after an exchange listing of Tech BDC will be the same as those set forth in the September 21, 2018 Council memorandum.

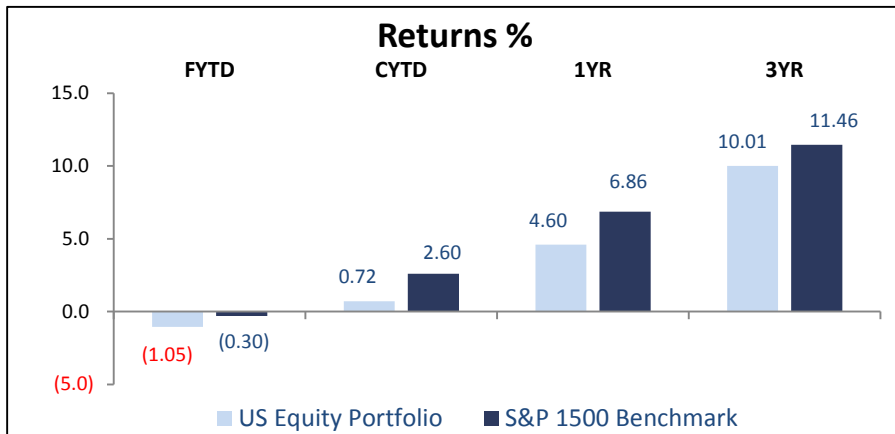
**Impact on New Jersey:** The structure is similar to the Division’s investment in Owl Rock Capital Corporation and Owl Rock Capital Holdings LLC, and is expected to have a positive economic impact to the Division.

**The Director is notifying the Council of this modification in accordance with the Alternative Investment Modification Procedures.**

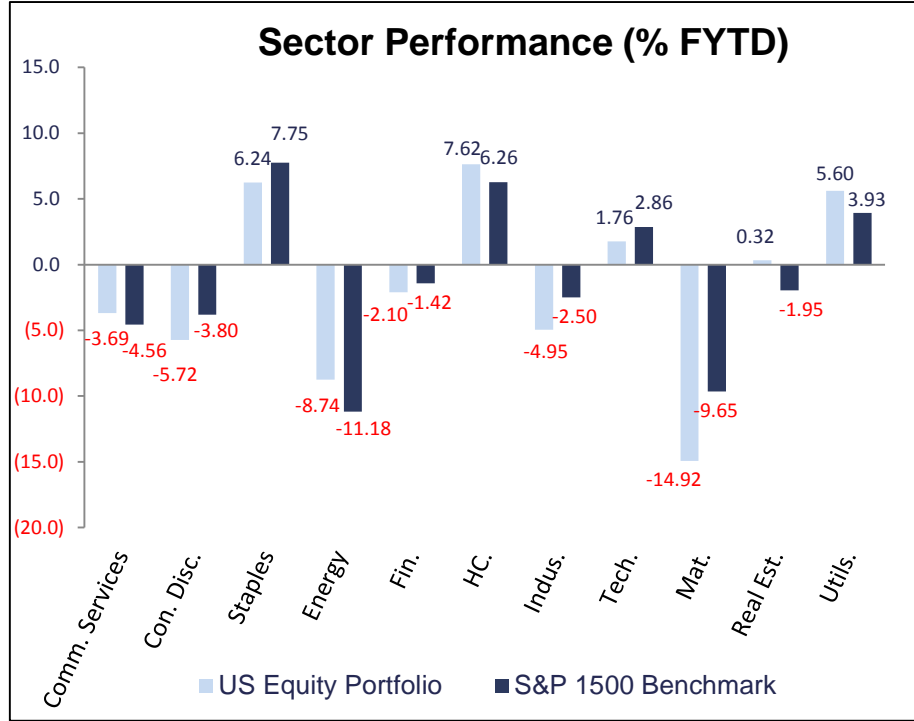
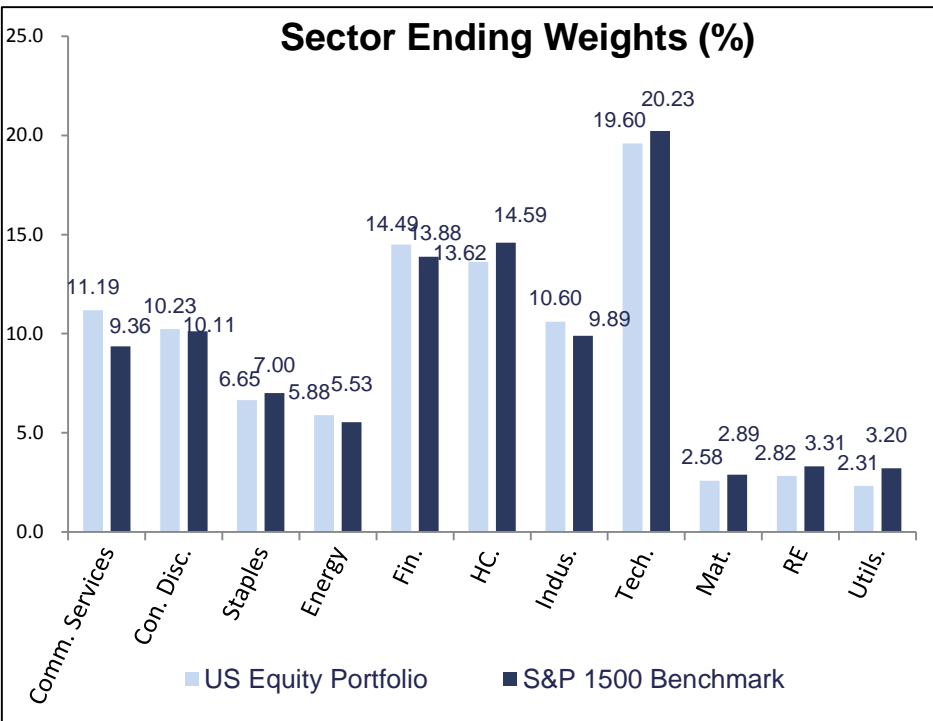


# Performance Appendix

Fiscal year-to-date through October 31, the U.S. equity portfolio returned -1.05%, versus -0.30% for the S&P 1500 benchmark. Domestic equity markets were volatile as investors grappled with the Fed continuing its interest rate tightening cycle, the threat of a potential trade war's impact on global economic growth, and the mid-term elections uncertainty, while the economy remained resilient with strong labor markets and robust earnings growth. The S&P 500 Index hit an all-time high on September 20, 2018, but concerns about higher rates led to a 9.9% drawdown before recovering 2.4% by the end of October. During the third quarter, U.S. earnings are on track for +26% year-over-year growth, with the recent tax change adding approximately 8 points to earnings growth. Consumer staples was the best performing sector, increasing 7.75% thus far in fiscal 2019, followed by healthcare's return of 6.26%. Energy and materials were the laggards.



Portfolio Sector Attribution – Weights, Performance and Effect



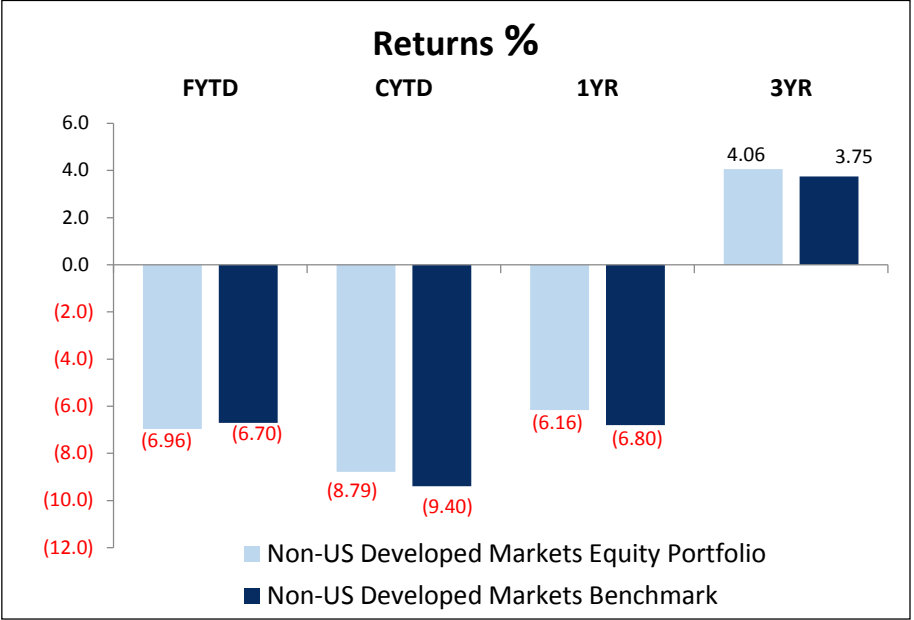
Source: State Street, Factset

Fiscal year-to-date through October 31, the Non-US Developed Markets Equity Portfolio returned -6.96% versus the Benchmark return of -6.70%. The period was marked by a sharp reversal in risk-off sentiment in October, which proved to be a volatile month for market returns.

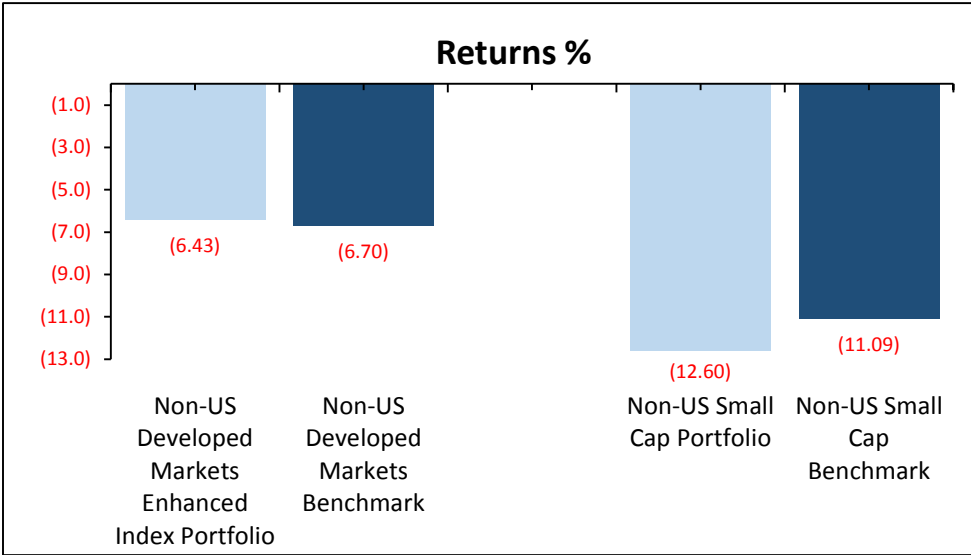
The anxiety over rising U.S. interest rates and trade tensions that dominated the fiscal first quarter culminated in severe corrections across the global equity markets in October. The Eurozone region returned -8.42% for the month, amid disappointing economic data and concerns for Italian financial stability. Brexit-related uncertainty negatively impacted the United Kingdom market return, which fell -6.75%. Notably, Japan returned -8.46% in October, as a slowing global economy and a strengthening yen eroded support for this export-driven market.

The major contributor to portfolio performance was the largest component – the Non-US Developed Markets Enhanced Index – which returned -6.46% versus -6.70% for its benchmark. Detracting from performance was the 8% non-benchmark allocation to small cap securities, as small caps underperformed in a weak financial market environment.

\*Market indices reflect MSCI total return in USD series.

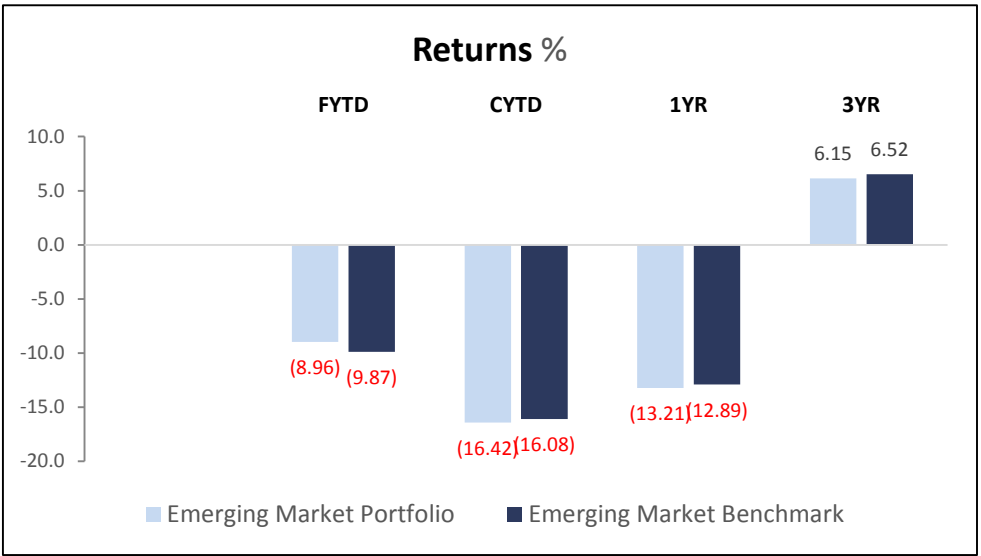


Non-US Developed Markets Equity Portfolio FYTD Decomposition - As of October 31, 2018

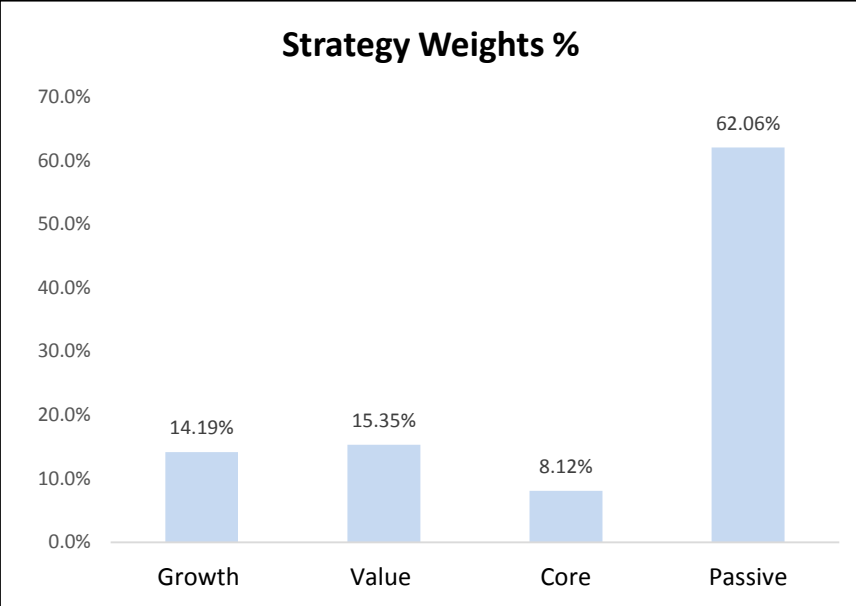


Fiscal year-to-date through October 31, the Non-US Developed Markets Enhanced Index portfolio was the primary contributor to the overall performance of the Non-US Developed Markets Portfolio. The allocation to small cap equities detracted from returns.

Fiscal year-to-date through October 31, the Emerging Markets Equity portfolio returned -8.96%, outperforming the benchmark index return of -9.87% by 91 basis points. Emerging market equities were particularly vulnerable to the geopolitical backdrop of the mid-term elections, concerns over trade, a slowdown in China, rising U.S. interest rates, and a stronger U.S. dollar. Country-specific events also hurt the asset class, with the MSCI Emerging Market Index falling 8.8% in October marking the worst October in a decade. The Emerging Markets Equity portfolio remains balanced between growth and value strategies. Actively managed strategies added value in a challenging market environment. All four of the actively managed portfolios outperformed on a fiscal year-to-date basis, with value strategies being the primary driver.

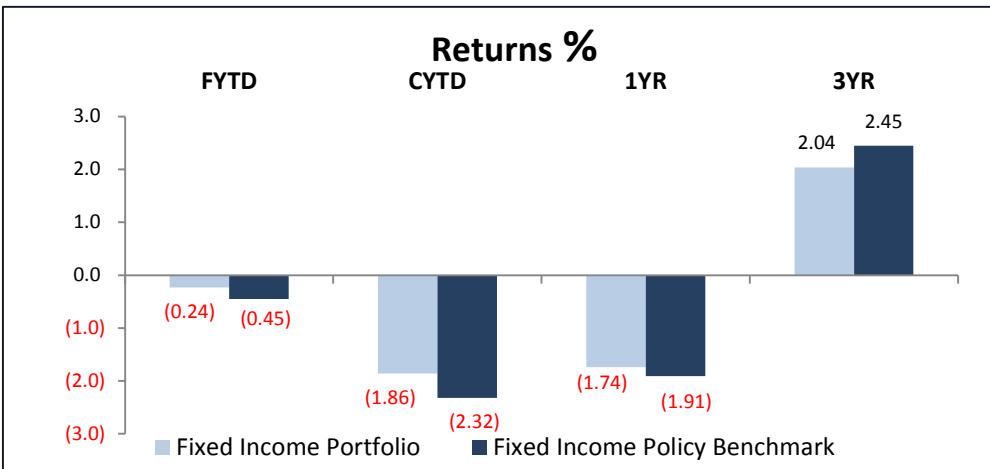


Portfolio Sector Attribution – Weights and Performance

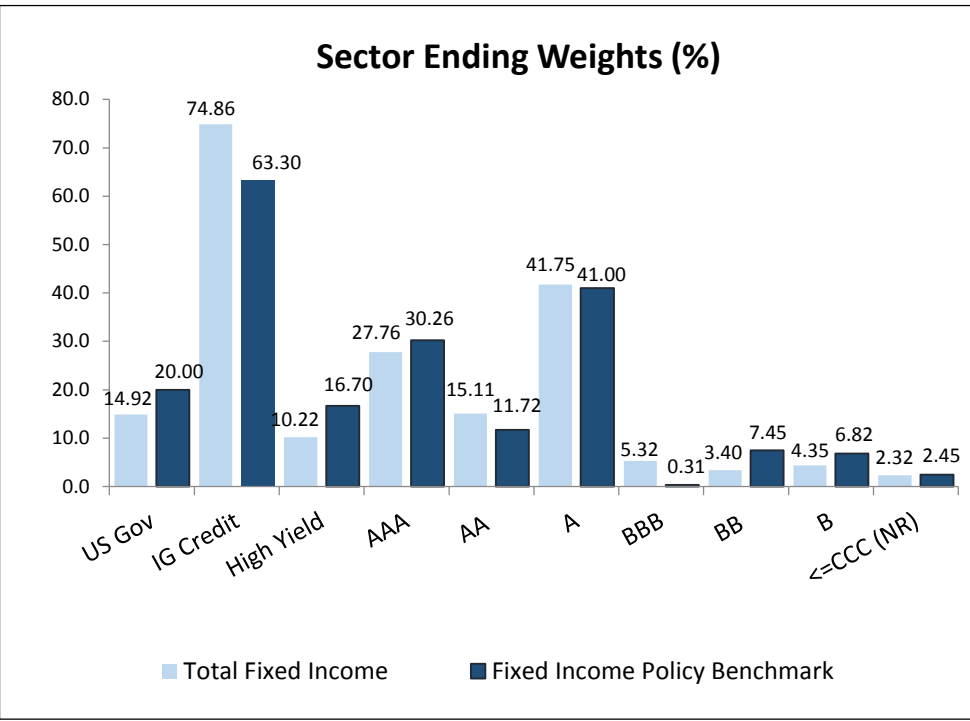
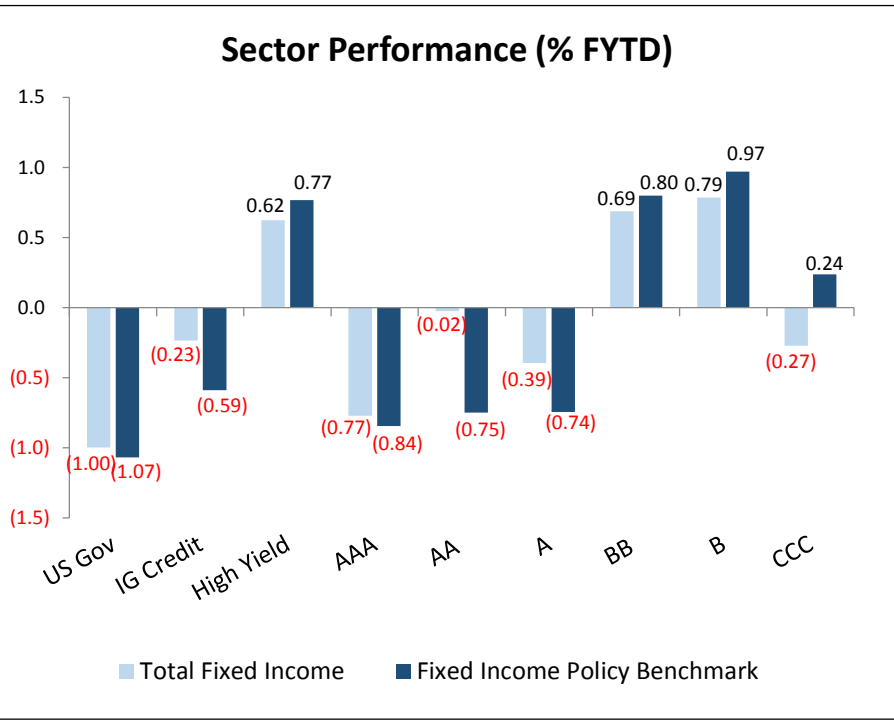


Source: State Street and Bloomberg

Fiscal year-to-date through October 31, the US Fixed Income portfolio returned -0.24% versus the benchmark return of -0.45%. Over the same horizon, the Bloomberg Barclays High Yield, Custom IG Credit and US Government Benchmarks returned +0.77%, -0.59% and -1.07%, respectively. The Investment Grade portfolio was the main driver of positive relative performance as it outperformed its benchmark by 35 basis points. The portfolio's underweight allocation to General Electric and California utility companies were notable contributors to this outperformance. Additionally, the underweight allocation to U.S. Treasuries added value. The fixed income portfolio maintained an underweight allocation to High Yield, adversely impacting relative returns.



Portfolio Sector Attribution – Weights and Performance



Source: State Street and FactSet