Minutes of the Regular Meeting -- APPROVED 1/21/10
1 pm November 19, 2009
And of the Annual Meeting immediately following – APPROVED 1/21/10

Held at the Trenton War Memorial, George Washington Ballroom,
West Lafayette Street, Trenton, New Jersey 08608

Council Members in Attendance:
Orin Kramer, Chair
Jonathan Berg, Vice Chair
Erika Irish Brown
W. Montgomery “Monty” Cerf
Jose R. Claxton
James Clemente
Susan Crotty
Mark Kandrac
James C. Kellogg
Karl Kleeberg
Douglas A. Love
James P. Marketti
Timothy McGuckin

Council Members Absent:
None

The Regular Meeting was called to order by Chair Kramer at 1:15 p.m.

Meeting Notice
Council Secretary Susan Burrows reported that notice of the Regular Meeting scheduled for
November 19, 2009 was sent by mail deposited in the post office, by facsimile and email on
November 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

Meeting Minutes
Minutes of the regular meeting of the Council held on September 17, 2009 were approved
unanimously on a motion by Council Member Berg, seconded by Council Member Cerf. It
was noted that minutes of the Executive Session held following the September 17 public
meeting would be forthcoming to the Council at a later date.

Director’s Report
Memorandum “Investment Report” dated November 13, 2009
Director William G. Clark reported that pension fund returns through October 31, 2009
were up 10 percent for the fiscal year to date. He said that returns for the month of October
were down by 0.9 percent, reflecting the flat market condition for stocks and bonds.

The total value of the fund on October 31 was $64.7 billion, and that the November benefit
payments were also paid out of the fund as of October 31. Director Clark said that net
benefits payments, averaging about $400 million each month, were becoming a bigger
factor and were causing the fund to incur negative cash flows each month.
Investment Officer Brian Arena said domestic equities provided returns of -2.06 percent for October, which was slightly better than the -2.22 percent return of the Standard and Poor’s 1500 Index used as a benchmark. Mr. Arena said the portfolio was up 12.8 percent for the fiscal year to date period versus 13.48 percent for the benchmark. The portfolio is overweight in basic materials, technology, utilities and consumer staples; it is underweight in financial services, telecommunications, consumer discretionary, health care and industrial sectors.

Investment Officer Gilles Michel said the international portfolio including both equities and sovereign debt was up 16.75 percent for the fiscal year-to-date period. October’s returns were -1.79 versus -1.52 for the custom benchmark, which is calculated by the Division and excludes those names deemed ineligible for investment under the State’s Sudan and Iran Divestment laws.

Senior Portfolio Manager Phil Pagliaro said that nothing had changed significantly for several months in the domestic fixed income portfolio, which was up 0.09 percent for October. He said the portfolio continues to do well by favoring quality issuers. Although the portfolio duration is still short of the Council target, he said the portfolio has a longer duration than one year ago. TIPS continue to be a major core holding, he said. The portfolio has increased its investments in Build America Bonds to about $500 million, and is reaping significant gains on sales.

Director Clark said the pension fund continues to benefit from its overweight position in equities, both domestic and international, relative to the benchmark and expects to continue the overweight position for the short term. For the longer term, he said the Division is increasingly nervous about Fed moves that discourage the holding of cash.

In response to a question from Council Member Cerf, Director Clark said the pension fund holds long-dated liabilities that, at the margin, go for 10 to 30 years. He said the Division follows Council policy in trying to balance the duration of the bond portfolio with the liabilities.

Director Clark offered an update on two litigation matters initiated by the Division. First, he announced the Division had reached a settlement in November with Frank Walsh, a former director of Tyco, who was among the defendants named in the Division’s individual action against Tyco for securities fraud. Director Clark noted that it is rare for a plaintiff to collect a settlement directly from an individual defendant; the Division received more than $5 million net of attorney fees from Mr. Walsh. He added that in March 2009, the Division had settled with PriceWaterhouseCoopers in the Tyco case for $5.85 million, with the Division receiving approximately $5 million. The case against Tyco itself was settled in 2008 for $73.25 million; net of attorney fees, the pension funds received almost $63 million. The Division’s lawsuit continues against Dennis Kozlowski, former Chief Executive Officer of Tyco.

Director Clark also announced an October settlement for $400 million in the Division’s class action suit filed against Marsh & McLennan, noting this is one of the top 25 class action securities fraud settlements in history. The complaint alleged that Marsh violated federal securities laws by misrepresenting the nature of Marsh’s contingent commission revenue and by failing to disclose the allegedly improper practices, such as bid rigging and steering, which increased that revenue. The Division brought the action in partnership with several Ohio pension funds. New Jersey’s recovery will depend on how many class members file claims in the case.
Proxy Voting Report
Memorandum “Fiscal Year 2009 Summary Proxy Voting Report” dated November 13, 2009
Chief Administrative Officer Susan Burrows reported that the Division had voted a record total of 2,817 proxies during the fiscal year ending June 30, 2009, reflecting a continued increase in international proxy ballots while the number of domestic ballots remained relatively flat. Consistent with Council direction, the Division continues to vote in favor of corporate actions that strengthen shareholder rights and promote leading corporate governance practices among its equity investments. The Division voted against at least one of the management-recommended proposals at 47 percent of domestic companies and 32 percent of international companies, consistent with this directive. Hard copies of the detailed report are available upon request to the Division.

Committee Reports – Audit Committee
Audit Committee Chair James C. Kellogg reported that the audit for fiscal year 2009 was moving along much faster than the previous audit, which had been delayed by the selection process for a new auditor. He said the Committee expected to receive the report by year's end.

There were no other committee reports.

Pending Matters
Memorandum “Adopted Amendments to NJAC 17:16-12, 16 and 40” dated November 12, 2009
Compliance Officer Susan Sarnowski reported that no comments were received during the 60-day public comment period ending November 7, 2009 regarding proposed amendments to N.J.A.C. 17:16-12, 16 and 40 as approved by the Council at the July 9, 2009 meeting. The amendments would allow one percent of the combined assets of all the Pension and Annuity Funds to be invested in obligations of companies that do not meet the minimum market capitalization of $100 million.

A motion by Council Member Claxton to adopt the amendments was approved by all Council members except Mr. Marketti, who voted as opposed.

Exemptions from Council Policy
Memorandum “Potential Exemptions from State Investment Council’s Policy Concerning Political Contributions and Prohibitions on Investment Management Business” dated November 12, 2009
Chair Kramer noted he would not participate in the consideration of the exemptions before the Council, and would continue to recuse himself from any issue involving individual managers as announced earlier in the year.

Director Clark reported that in early fall, the Division had contacted all investment firms doing business with the pension fund to remind them of the Council’s policy concerning political contributions and prohibitions and to request information on any campaign contributions not previously reported to the Division.

Director Clark said four investment firms had come forward to report contributions outside of permitted conditions. One of these firms, Centerbridge Credit Advisors LLC, reported that one of its associates had purchased a ticket in July 2009 for $90 for an event benefitting a New Jersey gubernatorial candidate; the contributor did not live in New Jersey, a violation of policy. Centerbridge discovered the contribution within four months of the date of the contribution and the contributor obtained a return of the contribution within 60 days of the
date of discovery. Since the contribution did not exceed the policy’s $250 contributions threshold, the circumstances qualified automatically for an exemption to the policy.

Three other reported violations in excess of the $250 permitted under certain conditions were presented to the Council with a recommendation by the Investment Policy Committee that exemptions be granted, based upon the Committee’s review of all violations at its meeting on November 11, 2009. Council policy permits exemptions if the violations are believed to be inadvertent and if granting an exemption is in the best interest of the pension fund. Exemptions were recommended for:

- Blackstone Capital Partners V LP, where a senior managing director made a $1,000 contribution in January 2009 to a gubernatorial candidate. BCP represented that neither its Chief Legal Officer nor any other Blackstone executive had knowledge of the contribution until September 10, 2009, despite the firm’s internal policy requiring pre-approval by its Chief Legal Officer of all political contributions, which was overlooked by the senior managing director. The firm reports the contributor was directed to request a return of the contribution, and he has. The Division selected Blackstone for a $100 million commitment in October 2005.

- Omega Advisors, Inc, where an executive made a $1,500 contribution to a gubernatorial candidate on July 14, 2008 and his wife purchased tickets in May 2009 for $2,000 for a concert event benefitting the same candidate at the New Jersey Performing Arts Center, where the executive is a member of the board of trustees. The executive has sought and received a return of both contributions. The Division selected Omega for a $75 million commitment in January 2007.

- WCAS Management Corporation, where a general partner made a $1,500 contribution to a gubernatorial candidate on March 26, 2009. The firm represented that the individual was unaware of Council policy at the time he made the contribution, and has requested a return. The Division selected WCAS for a $100 million commitment in October 2008.

The Investment Committee recommended exemptions for all three firms based on the belief that: the policy violations were unintentional and inadvertent; the contributions were not material and occurred well after the Division’s selection of each firm; there are no signs of ill intent, supported by all contributors having sought or obtained the return of their contributions; and the significant financial costs that would be incurred by the fund in redeeming or selling the pension fund’s interests in the three funds.

A lengthy discussion of the recommendations followed. Council Member Marketti expressed concern that the senior managers involved at each firm appeared either unaware or indifferent to Council policy and that the Council needed to send a message of zero tolerance. Several members agreed with the message but expressed the need for enforcement balanced with the needs of the fund. Council Member Crotty said that the costs of redemption and sell-off were not the only reason for the Committee’s recommendation for exemptions; she said the relatively small size of the contributions had been considered as well as the fact the contributions were not made in an effort to acquire state business but well after the fact. Council Member Cerf echoed concern for the fund’s reputational risk if the Council did not apply reasonable standards to policy enforcement, noting zero tolerance could discourage the offering of quality opportunities to New Jersey by other managers leery of being fired for inadvertent actions. Council Member Kellogg noted those involved had already suffered the embarrassment of having to ask for a refund of their contributions, as well as the loss of good will they had sought from their candidate.
In addition, he said, each of the firms voluntarily came forward with disclosures of their contributions.

Council Members Kandrac and Marketti asked about the specific costs to the fund if the exemptions were not granted. Council Member Cerf suggested the costs were incalculable given the reputation risk. Council Member Love agreed, noting that redemptions for non-performance reasons would cost the funds millions in transaction costs in the short-term, but more in the long-term by giving New Jersey a reputation for unreasonableness that would limit the number of firms willing to do business with the state. He said such a reputation was especially likely given the relatively small size of the contributions in question. Council Member Crotty noted that New Jersey continued to hold the toughest contribution policy of any state, one that recognized the possibility of exemptions for this very reason, to allow for human error.

A motion to grant the exemptions was made by Council Member Love, seconded by Council Member Crotty, with all Council Members voting in favor except Mr. Marketti, who was opposed.

**Recommended Best Practices for Hedge Funds**

*Memorandum “Recommended Best Practices for Hedge Funds Seeking Institutional Capital” dated November 13, 2009*

Director Clark said the guidelines prepared by the Division's hedge fund consultant, Cliffwater LLC, were intended to serve as general, guiding principles for the Division's relations with its hedge fund managers, rather than pass-fail criteria. Deputy Director Ray A. Joseph said the "best practices” approach was adopted to show that New Jersey regarded the issues seriously, while permitting the Division the flexibility to consider individual investments falling outside of some principles.

In response to a question from Council Member Crotty, Daniel Stern of Cliffwater estimated that the majority of the Division's current managers were compliant with the guidelines.

A brief discussion followed on the preferences of the Governor-Elect, as reported by the press, for a temporary suspension of external investments. It was decided that approval of the guidelines would not interfere with that preference. The guidelines were approved unanimously on a motion by Council Member Claxton, seconded by Council Member Berg.

**Communications**

There was no report from the State Treasurer.

**Adjournment of Regular Meeting**

The Regular Meeting was adjourned at 1:50 p.m. by unanimous vote on a motion by Mr. Berg, seconded by Dr. Love.

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**The Annual Meeting was called to order by Chair Kramer at 2:10 p.m.**

**Meeting Notice**

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Council, the *Times of Trenton*, *The Star-Ledger*, the *Bergen Record*, the *Courier Post* and the Secretary of State.

**Objectives of the Council’s Asset Allocation Plan**
Chair Kramer reported that the pension fund had performed well in the last one-, three-, five- and 10-year periods, especially relative to peer funds, and this performance would be described later in the Annual Meeting. He asked Council Member Love, who chairs the Investment Policy Committee, to discuss the fund’s asset allocation policy and plan.

Referring to a handout entitled “NJDOI Performance/Activity Summary 18 Months Ending June-09” and attached to the official record of this meeting, Council Member Love noted that pension fund equities experienced a decline in value of -39 percent during this period, while the fund’s alternatives investments as a whole declined -37 percent. He noted that hedge fund investments in particular had outperformed the fund’s equities by 13 percent in this period, while real estate investments had experienced the largest losses.

He said the reason for entering the alternatives space was to mitigate the risk of loss by diversifying the portfolio. He noted that the Division’s alternative investments had done this over the past 18 months of historic declines by performing better than equities, with hedge funds performing considerably better.

**Report on Pension Fund Status and Fiscal Year 2009**
Director Clark offered a detailed report of the pension fund’s status and performance for the fiscal year July 1, 2008 through June 30, 2009. A copy of his presentation, “2009 Investment Environment and Results,” was published on the Division’s website immediately following the Annual Meeting.

Among the key points of his remarks:
- The fiscal year marked the worst period of performance for the stock market since 1932. Only U.S. Treasury fixed income investments did well, as investors gravitated to such investments for safety. Cash returns also declined, as reflected in the rates paid on CDs and money market savings.
- The market remains down 30-40 percent from its peak. Of greater long-term concern is that the financial markets and employment levels remain down relative to 10 years ago.
- The federal government has made it a priority to get cash moving back into the system, but five large concerns for investors remain: 1) How much room does the federal government have to raise interest rates without re-triggering a crisis? 2) Can the economy sustain itself when federal spending stops? 3) What consequences will today’s federal spending impose on future generations? 4) How do we reverse unsustainable borrowing by institutions as well as consumers? 5) How do we balance lower levels of borrowing against the need for more spending and rebuilding?
- The pension fund ended the fiscal year with $63 billion, compared with $78.2 billion in June 2008. Almost $4 billion of the decline was attributable to net benefit payments.
- Notable decisions that helped the fund’s performance relative to peers and the market included: purchase of $2.5 billion in investment-grade corporate bonds, which were up 21 percent at fiscal yearend; additional investments of $243 million in several bank loan funds that, although controversial when made, were up 19 percent at fiscal yearend; and cancelling five commitments to alternative investments to preserve liquidity for opportunities in other asset classes.
• Each internally managed portfolio has outperformed the market over 1-, 3- and 5-year periods with the exception of fixed income, which slightly trails its benchmark for the 1-year period.
• New Jersey was the top-performing fund in the country for fiscal year 2009, with an estimated 14.2 percent return. The average of 44 state funds reporting returns for this period was -19.6 percent.
• Fund performance for the calendar year to date is estimated to be 15.6 percent.
• Looking ahead, the fund is likely to seek an increase in the allocation to emerging markets, which is doing extremely well. The Division likely will continue its overweight position in equities for the foreseeable future. Inflation remains a long-term concern.
• Operationally, the Division has only 16 full-time equivalents to make investment decisions, excluding the Director and Deputy. This results in overly large spans of responsibility, with assets to be managed averaging about $4 billion per investment professional. While a substantial concern, it’s also a reason for pride in the results achieved in concert with the guidance and strong support of Council members.

**Independent Assessment of New Jersey Performance**

Pete Keliuotis of Strategic Investment Solutions, the Division’s general consultant, provided an independent assessment of New Jersey’s fiscal year performance against other public funds. A copy of his presentation, “New Jersey Peer Comparison 2009,” was published on the Division’s website immediately following the Annual Meeting.

Among the key points of his remarks:
• New Jersey continues to lag its peers in the amount of investment dedicated to alternatives when comparing funds of similar size and diversification strategy. The inclusion of alternatives has strengthened the fund’s performance, mitigated risk and provided an additional source of funds for investment in other asset classes,
• New Jersey ranks among the top five percent of all public pension funds in performance over the most recent 1-, 3- and 5-year periods.
• New Jersey’s success in the past year is attributable in part to its ability to capture the run-up in corporate bonds and its asset allocation. New Jersey is relatively unique in its long-duration strategy, making it sensitive to interest rate changes.
• Real estate investments that suffer now can be expected to pay off later. The year’s poor commodity performance has already reversed.
• Division staffing levels are exceptionally low compared with other funds, with two Division individuals managing all $24 billion in fixed income investments, and all employees multi-tasking beyond typical spans of responsibility to compensate for staff shortages.

**Report from the Division of Pensions and Benefits**

Director Fred Beaver of the Division of Pensions and Benefits commended the partnership his Division receives from the Division of Investment in supporting Pensions’ ability to pay out some $6 billion annually to some 350,000 retirees. He noted the state had never missed a benefits payment, and expressed appreciation to Division employees for the fund’s performance and their support.

**Public Comment Period**

Ten individuals who had submitted speaker request forms prior to the meeting were invited to address the Council.
Anthony Miskowski expressed concern about the potential for fraud and abuse in some hedge fund investments based on several press examples. Mr. Cerf said that the state hires the best independent consultants possible to assist with this monitoring.

William Bauer expressed concern over the fund’s holdings in Apollo given a recent probe of that company by the SEC. Investment Officer Arena said the fund had only recently resumed a position in Apollo, with shares selling for 13 times forward earnings. He said that there was no connection between the Apollo stock held by the Division and a separate private equity investment with the Apollo name.

Rae Roeder suggested the Council bylaws be revised and questioned the status of three Council members appointed by the Governor but not confirmed in light of the election of a new Governor.

Steve Green urged the pension fund to consider investing in precious metals, particularly silver, and quality producers.

Dale Parichuk expressed concern that regulated companies in the financial industry could make political contributions, and that the Council chair also could.

Meko Palmer asked for an account of how much was paid in FY2009 for external investment management or advising.

John Strachan expressed concern about the recent performance of investments in commercial real estate. Director Clark said only less than 3 percent of the pension fund was invested in real estate, all within the real estate portfolio. He said real estate was a late-cycle investment, and so among the last asset classes to reach the bottom of a market cycle or experience a rebound.

Vincent Kaighn congratulated the Council and Division on its legal recoveries and asked for a report on other legal action pending.

Maryann Mesics said that “Main Street doesn’t trust Wall Street,” and said that excessive greed can be just as damaging to America as terrorism.

Steve Dovidio questioned the attendance of Mr. Kramer at a recent investment conference. Mr. Kramer said that his appearance was approved through the appropriate state ethics process, he does not accept speaker fees and pays for all his own travel expenses.

**Adjournment of Annual Meeting**
The meeting was adjourned at 3:50 pm by unanimous vote on a motion by Mr. Cerf, seconded by Dr. Love.

Respectfully submitted,

Susan M. Burrows
Secretary to the Council