

As adopted with amendment on January 12, 2011

Minutes of the Regular Meeting

**Held November 18, 2010 at 1:30 PM in the State Museum Auditorium
205 West State Street, Trenton, New Jersey**

Council Members in Attendance:

Robert Grady, chair
Nicholas Caprio, vice chair
Jeffrey Oram
Andrew Michael Greaney
James C. Kellogg
Timothy McGuckin
James P. Marketti
Richard Klockner
Guy Haselmann
Brendan Thomas Byrne, Jr.
Marty Barrett

Council Members Not in Attendance:

Orin Kramer

The Regular Meeting was called to order by Chair Grady at 1:33 p.m.

Roll Call and Meeting Notice

Secretary Adams performed roll call and reported that notice of the Regular Meeting scheduled for November 18, 2010 was sent by mail deposited in the post office, by facsimile and email on November 8, 2010. A copy of the notice was posted in the Division on November 8, 2010, mailed to the Council, Times of Trenton, Star-Ledger, Bergen Record, and Courier Post on November 8, 2010 and filed with the Secretary of State on November 8, 2010.

Approval of Minutes for Regular Meetings held September 16 and October 21, 2010

Chair Grady asked the Council Members if they had any comments on the minutes for the September and October meetings. Council Member Kellogg motioned to approve the minutes for the Regular Meetings of September 16, 2010. This motion was seconded by Council Member Oram and the September minutes were approved by unanimous vote. Council Member Kellogg motioned to approve the minutes for the Regular Meetings of October 21, 2010. This motion was seconded by Council Member Oram and the October minutes were approved by unanimous vote.

Director's Report

Memorandum "Investment Reports" dated November 12, 2010

Director Walsh stated that the Fund was up 1.7% for October but underperforming the Council benchmark. Fiscal year to date, the Fund is virtually even with the benchmark, with the Fund up 9.49% and the benchmark up 9.58%.

Brian Arena stated that domestic equities were up 4% in October versus the benchmark being positive 3.8%. The portfolio is up 16.2% fiscal year-to-date, with the benchmark being up 15.6% over the same period. For the calendar year-to-date, the portfolio is up 9.8%.

As adopted with amendment on January 12, 2011

Materials were the strongest contributor and during October, there were \$95 million in net equity sales.

Mr. Arena and Director Walsh made a short presentation about the domestic equity portfolio, including the types of permissible investments, portfolio performance and benchmark comparison.

Phil Pagliaro stated that, excluding the TIPS and high-yield positions, performance was -1.59% versus -2.23% for the Barclays Long Government/Credit Index, with outperformance due to shorter duration. Calendar year-to-date, Common Pension Fund B (excluding TIPS and High Yield) returned 13.93% versus 14.09% for the Barclays Long Government/Credit Index, due to falling interest rates. For the fiscal year-to-date, Common Pension Fund B (excluding TIPS and High Yield) returned 4.79% versus 3.49% for the Barclays Index. The duration of Common Pension Fund B (excluding TIPS and High Yield) was 10.86 years as of October 31, 2010.

The High Yield portfolio was 2.23% for October versus 2.58% for the Barclays High Yield Index. The High Yield portfolio was 9.03% for the calendar year-to-date versus 14.41% for the Barclays High Yield Index, with the underperformance attributed to the higher credit quality in the Division's portfolio relative to the index. Fiscal year-to-date, the High Yield portfolio returned 5.11% versus 9.47% for the Barclays High Yield Index.

The TIPS portfolio returned 4.30% in October versus 2.65% for the Barclays TIPS Index, and was 16.36% for the calendar year-to-date versus 9.84% for the Barclays TIPS Index. The outperformance is attributable to being long in 20 year issues. Fiscal year-to-date, the TIPS portfolio returned 8.96% versus 5.27% for the Barclays TIPS Index.

Within domestic fixed income, we were net sellers of \$69.7 million in domestic fixed income in October, consisting of purchases of \$476.4 million and sales of \$546.1 million.

Chair Grady asked how the TIPS portfolio differs from the index. Mr. Pagliaro stated that the portfolio is comprised only of 20 year issues and that TIPS are viewed more as a core asset and there is not concern over minor short-term fluctuations.

Gilles Michel stated that the October performance for the International Equity portfolio was up 3.02%, slightly underperforming the benchmark, which was up 3.33%. Europe performed well again, being positive 4.61% versus 4.16% for the Custom International Equity Index (Europe only). Japan was the worst performing nation, which is a complete reversal from the beginning of the year. To that end, the portfolio maintains an underweight position in Japan of 12.92%, versus the benchmark weight of 14.98%. The portfolio had net sales of approximately \$200 million, primarily in Japanese ETFs.

Director Walsh stated that the Alternatives portfolio had a positive month, with Commodities up 4.3%, Real Estate up 0.86%, Private Equity up 0.44% and Hedge Funds positive 2.93%.

Director Walsh advised the Council that the total assets listed for the Cash Management Fund included pension fund monies and state/local agency funds and that the pension fund had approximately \$2.35 billion in cash and that the Division was working to reduce the fund's cash position.

As adopted with amendment on January 12, 2011

Chair Grady said that the need to look at the fund's cash position was particularly germane given the need to develop a new asset allocation plan.

Update on Proposed Regulations

Director of Operations Susan Sarnowski advised the Council that proposed amendments to N.J.A.C. 17:16-69, 71, 90 and 100 regarding investments in alternatives as approved by the Council at its October 21, 2010 meeting, have been accepted by the offices of the Governor and Smart Growth Ombudsman. They were submitted to OAL and are expected to be published in the December 6, 2010 New Jersey Register. The 60 day comment period will end on February 4, 2011.

Council Member Caprio sought clarification on the regulatory ceilings, which was provided by Ms. Sarnowski.

Pete Keliuotis of Strategic Investment Solutions advised the Council that the asset allocation plan will not be set at the Annual Meeting. Rather, the Council will debate approaches to the development of the plan to ascertain what the best approach is for the Division and the Council. Plan recommendation and adoption would likely occur in the spring.

Chair Grady clarified that the Division manages investments in accordance with the Council's asset allocation plan, not to the regulatory limits.

Council Member Byrne sought clarification as to whether the asset allocation plan was done on an annual basis.

Proposed Real Estate Investment

Memorandum "Proposed Investment in Lubert-Adler Real Estate Fund VI-B, L.P." dated November 12, 2010

Alternative Investment Officer James Falstrault provided background on the proposed \$100 million investment in Lubert-Adler Real Estate Fund VI-B, stating that the fund's strategy is opportunistic and distressed debt and that this was the Division's first real estate investment since 2008. Scott Booth of the Townsend Group, the Division's real estate consultant, provided a more in-depth analysis of the proposed investment for the Council. He advised the Council that the investment terms are favorable and that the State would not be paying any management fees on the investment until 2013.

Chair Grady asked Mr. Booth about the quality of investments in the fund and whether it would be better for the Division to purchase such investments through the secondaries market. Mr. Booth advised that the investments from 2008-2009 in the fund have been written down approximately 28% and that the secondary market would not offer a steeper discount. Chair Grady advised the Council that the Investment Policy Committee had the opportunity to hear presentations on this investment and ask questions of Division staff and the consultant. The Committee felt that proper and extensive due diligence was conducted by the Division.

Council Member Kellogg asked Director Walsh if the Division had exposure to public REITs. Director Walsh replied that there are approximately \$250 million in public REITs in the portfolio.

As adopted with amendment on January 12, 2011

Council Member Marketti motioned to reject the report on the Lubert-Adler investment; however, no Council member seconded the motion. Council Member Marketti subsequently went on the record as being opposed to this investment.

Proposed Private Equity Investment

Memorandum "Proposed Investment in Tenex Capital Partners, L.P." dated November 12, 2010

Co-Head of Alternative Investments Christine Pastore provided background on the proposed \$50 million investment in Tenex Capital Partners, which is a middle-market buyout fund. She introduced Harshal Shah of Strategic Investment Solutions to provide a more in-depth analysis of the fund. Mr. Shah advised the Council that although Tenex was a first-time fund, the investment team has extensive experience and that the investment terms and conditions are favorable to the Division.

Director Walsh congratulated Ms. Pastore on negotiating more favorable terms for the Division.

Council Member Marketti went on the record as being opposed to this investment.

Chair Grady advised the Council that the Investment Policy Committee had the opportunity to hear presentations on this investment and ask questions of Division staff and the consultant. The Committee felt that proper and extensive due diligence was conducted by the Division.

Chair Grady also noted for the record that the 16% carried interest rate negotiated by the Division is below market for this asset class.

Proposed Hedge Fund Investment

Memorandum "Proposed Investments in Lynx (Bermuda) Ltd. and Winton Futures Fund" dated November 12, 2010

Co-Head of Alternative Investments Maneck Kotwal provided background on the proposed investments in Lynx and Winton Futures Fund. The Division proposes to invest \$100 million investment in each fund. Mr. Kotwal advised the Council that the entire \$100 million would not be invested right away in each fund; rather, the money would be invested over an extended period of time. He introduced Daniel Stern of Cliffwater to provide a more in-depth analysis of the fund. Mr. Stern advised the Council that investment in these funds will provide further diversification to the fund and that the funds have attractive investment terms, highly liquid structures and have performed well since inception.

Chair Grady advised the Council that the Investment Policy Committee had the opportunity to hear presentations on this investment and ask questions of Division staff and the consultant. The Committee felt that proper and extensive due diligence was conducted by the Division.

Council Member Haselmann commented on the positive effect of alternative investments on reducing correlation to the markets.

Chair Grady asked Mr. Stern about the correlation of the two funds to the equities markets. Mr. Stern replied that there was no correlation and that Winton had a 0.06 correlation and Lynx had

As adopted with amendment on January 12, 2011

a -0.02 correlation to the market. The funds had a negative correlation to other hedge fund strategies.

Council Member Byrne commented on the long-term challenges of managing the pension fund and stated that the Council is trying to maximize absolute returns within reasonable risk parameters.

Council Member Marketti asked how the investment goals of these funds differ from other funds. Mr. Stern replied that they are trend following strategies, focusing on currencies, equity indices, government bonds and commodities, and both funds utilize very low leverage comparatively.

Vice Chair Caprio inquired about the procedure for selecting investments through the IPC. Chair Grady replied that the committee undertook a review of both the Division's and the consultant's due diligence and the committee was satisfied that proper due diligence had been conducted.

Chair Grady announced the appointment of Council Members Byrne and Oram to the Investment Policy Committee, along with himself and Council Member Kramer.

Council Member Haselmann commented on Long Term Capital Hedge Fund Models.

Council Member Marketti commented on his views regarding alternative investments and went on the record as being opposed to the hedge fund investments.

Director Walsh commented that there is much more due diligence performed on alternative investments because of liquidity issues.

Chair Grady commented on the development of the asset allocation plan and that there would be a range of views among the Council members and that the members have to find a prudent way to diversify investments.

Communications

There was no report from the State Treasurer.

Public Comment Period

Anthony Mishkowski expressed his opposition to the proposed increase in regulatory ceilings for alternative investments.

Chair Grady clarified that only the regulatory ceilings will be increased, not the actual alternative investment allocations.

Raymond Weickert commented on due diligence procedures, pension fund liabilities and financial stress testing.

Chair Grady advised Mr. Weickert that Strategic Investment Solutions had provided the Council with analyses regarding future projections at a prior meeting. Mr. Keliuotis provided Mr. Weickert with further information regarding the types of simulations and analyses provided to

As adopted with amendment on January 12, 2011


the Division. Chair Grady also commented that the Division had negotiated substantial fee reductions on alternative investments.

Adjournment of Meeting

Chair Grady motioned to adjourn the meeting. Council Member Haselmann seconded the motion.

The meeting was adjourned at 3:35 PM.

Respectfully submitted,

A handwritten signature in black ink that reads "Kaitlyn J. Adams". The signature is written in a cursive, flowing style.

Kaitlyn J. Adams
Secretary to the Council