Minutes of the Regular Meeting
Held May 19, 2011 at 11:30 AM 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 (arrived at 11:45 AM during Director’s Report)
Andrew Michael Greaney
Timothy McGuckin
James P. Marketti
Richard Klockner
Guy Haselmann
Brendan Thomas Byrne, Jr. (arrived at 11:40 AM prior to Director’s Report)
James Kellogg
Marty Barrett

The Regular Meeting was called to order by Chair Grady at 11:35 AM.

Roll Call and Meeting Notice
Susan Sarnowski performed roll call and reported that notice of the Regular Meeting scheduled for May 19, 2011 was posted on the Division’s website on March 24, 2011. A revised notice indicating a revised meeting time was posted to the Division’s public website and sent via facsimile to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post and emailed to the Secretary of State on May 12, 2011. A copy of the notice was posted at the Division and is on file.

Approval of Minutes for Regular Meeting held March 24, 2011
Chair Grady proposed to postpone a vote on the minutes until the end of the meeting as Council members did not have an opportunity to fully review the draft minutes.

Later in the meeting, Chair Grady proposed to vote on the March 24 minutes at the next Council meeting.

Directors Report for March 2011
Director Walsh advised the Council that March was another positive month for the pension fund. The Fund was up 15.65% for Fiscal Year 2011, performing 46 basis points above the benchmark. This outperformance is driven primarily by domestic equity and fixed income. He advised that the world economy is slowing compared to the earlier part of the fiscal year. Although commodities have slowed recently, it is the best performing sector returning over 35%.

Council Member Marketti asked Director Walsh about presenting historical returns in the investment report package. Deputy Director McDonough advised that return data is still under internal review and the Division is anticipating publication of this data for the next meeting. Council Member Marketti also asked Director Walsh about the availability of monthly vs. quarterly data given the proposed meeting schedule, expressing a concern that all months be accounted for. Chair Grady advised that quarterly reporting is a standard practice, although he stated that he does not intend for an entire quarter to pass between meetings. Chair Grady stated that he would like the most current information to be available to the Council, including information regarding all periods since the last report provided to the Council. There was also a discussion with regard to providing information on private equity performance. Chair
Grady stated that the Alternatives portfolio added an aggregate value of $1.7 billion over the fiscal year and that the allocation has increased by only 1.5%. Chair Grady stated that it is good news that the portfolio has outperformed the benchmark and New Jersey has been conservative in its asset allocation by being weighted 35% to fixed income, which has served the Fund well. However, this overweighting to fixed income has impacted our return in FY11, as the equity markets have significantly outperformed the fixed income markets.

Vice Chair Caprio asked about the timing of the next Council meeting and the investment reporting data for that meeting.

Deputy Director McDonough advised the Council that the domestic equity portfolio was up 31 basis points in March, slightly underperforming the benchmark S&P 1500, which was up 36 basis points. The domestic equity portfolio is up 32.7% for the fiscal year, outperforming the benchmark by over 100 basis points. There are two domestic equity portfolios: one which contains approximately 70% of portfolio assets and closely tracks the asset allocation of the benchmark. This portfolio has performed within several basis points of the benchmark. The second portfolio, which contains the remaining 30% of portfolio assets is actively managed by Brian Arena. This portfolio is performing over 500 basis points above the benchmark, which equates to an added value of $300 million. With respect to the larger portfolio, the outperformance is driven by the portfolio’s underweighting to financials, overweighting to materials and stock selection in the IT and financial sectors. The Division has participated in 16 initial public offerings (IPO) and was profitable in all but one of these investments.

With respect to the international portfolio, the absolute performance has been good, with a 25% return for the fiscal year through March; however, on a relative basis, the portfolio’s performance has not been as strong, underperforming the benchmark by over 300 basis points for same period. The underperformance can be attributed to currency hedges, actively managed developed and emerging market portfolios, cash positions and the portfolio’s overweighting to Japan. The developed markets portion of the portfolio is going to be split into an active/passive structure, with 70% being tied to the benchmark and 30% being actively managed.

Senior Portfolio Manager Philip Pagliaro stated that the fixed income portfolio returned 31 basis points for the month of March and 2.60% for fiscal year through March, outperforming the benchmark, which returned -8 and -9 basis points respectively for the same periods. The High Yield portfolio, which utilizes external advisors, has been performing well. As of March 31, 2011, duration was 9.4 years, compared to 10.3 years on December 31, 2010. The portfolio is working to invest in shorter term TIPS in order to further reduce duration. Council Member Haselmann commented on the historical correlation between TIPS and nominals with respect to inflationary changes.

Co-Head of Alternatives Christine Pastore advised the Council that private equity continues to return capital. March was the fourth consecutive month that distributions and contributions outweighed capital calls. The Division has hired Cogent Partners through a search process to assist in selling a portion of the private equity portfolio through secondary transactions.

Chair Grady reminded the Council of the resolution approved at the March 24, 2011 Council meeting directing the Division to invest with private equity and venture capital managers who have demonstrated a top quartile performance track record. Chair Grady noted that all private equity investments show an estimated 12.5% annualized return over the past 15 years, with the top quartile private equity managers yielding approximate 40% returns and top quartile venture capital yielding a
70% IRR, while the total return of the S&P 500 is only 2% for the same period. The private equity portfolio currently is 96% buyouts and 4% venture capital.

Co-Head of Alternatives Christine Pastore advised the Council that the real estate portfolio had greater distributions than capital calls in the month of March. The Division has negotiated a $50-100 million reduction in commitments to permit the fund to focus these assets in more attractive investment opportunities. The real estate portfolio has shown positive returns for the first and second quarters of calendar year 2010 and has gained 15.9% overall.

Maneck Kotwal, Co-Head of Alternative Investments, advised the Council that the hedge fund portfolio returned 98 basis points for February versus the benchmark return of 81 basis points. For the fiscal year through February, the portfolio gained 11.42%, outperforming the benchmark by over 400 basis points.

Asset Allocation Study
Pete Keliuotis of Strategic Investment Solutions presented the 2012 Annual Investment Plan Summary to the Council. He characterized this plan as something that can be implemented during the next fiscal year, rather than a long term strategic plan as some asset classes take longer to invest and the Division wanted something that they could realistically achieve within FY2012.

The aim of the plan is to improve diversification and have better downside protection in the event of a market correction with the ultimate goal of maximizing risk-adjusted returns. The plan also ensures that a vast majority of the assets are liquid. Mr. Keliuotis also discussed specific allocation changes by asset class.

Chair Grady stated that the plan is seeking a lack of correlation to the market and that effort is shown through the proposed allocation increase in hedge funds, real estate and commodities as these sectors have less correlation to the market than private equity. He advised the Council and the audience that it is not accurate to say that the Division or the Council is chasing yield to compensate for a lack of funding; rather, the goal is to chase lack of correlation to mitigate the risk of downside events and prevent a significant loss of capital.

Council Member Kellogg advised the Council to be cautious with regard to the proposed allocation increase in commodities. Chair Grady responded that there is no change relative to the FY11 target versus the FY12 target for commodities. The only proposed change is increasing the actual allocation for commodities, which is currently about 2%. Chair Grady also commented that the proposed plan will adopt ranges to provide the Division with tactical flexibility to respond to market events and opportunities. He stated that this plan allows the Division to continue on the path toward greater diversification, doing so without a great deal of risk since approximately $55 billion will be in liquid assets.

Chair Grady offered a motion proposing that the Council adopt the FY2012 Annual Investment Plan as presented by Mr. Keliuotis. Council Member Haselmann seconded the motion. The motion was approved by a vote of 9 to 2, with Chair Members Marketti and Barrett voting against the motion.

Real Estate Investments
*Secretary’s Note: Council Member Jeffrey Oram excused himself from the room for the discussion of these real estate investments.

Lone Star Real Estate Fund II and Fund IV
Real Estate Investment Officer Jamie Falstrault introduced two proposed investments to the Council. The first fund is Lone Star Real Estate Fund II with a proposed investment of $100 million. Lone Star Real Estate Fund II is a $5.5 billion global opportunity fund with a focus on U.S., Western Europe and Japan. It will invest in a broad range of commercial real estate and commercial real estate-related investments including secured and unsecured debt. The second fund introduced is Lone Star Real Estate Fund VII with a proposed investment of $300 million. Lone Star Real Estate Fund VII is a $4.5 billion global opportunity fund with a focus in the U.S., Western Europe and Japan. LSF VII invests primarily in single family residential loans and mortgage backed securities products. These investments combined will reduce our management fee to 90 basis points on committed capital with a 10% preferred return and a 45 basis point management fee after the three year investment period.

Scott Booth of the Townsend Group indicated that although Lone Star is a new manager for New Jersey, they have a good reputation within the industry. Lone Star is a global firm and has substantial internal resources. Lone Star was formed in 1996 to capitalize on distressed debt opportunities, predominantly in real estate. Prior to 1996, Lone Star founder John Grayken did similar investments. Lone Star is a top-quartile manager with a proven record. They have raised eight prior funds throughout their existence, with an projected net IRR of 21%.

Chair Grady advised the Council that although the IPC discussed this potential investment, given the size of the commitment, Chair Grady and Director Walsh went to New York and met with John Grayken, Lone Star’s founder and chairman. Chair Grady also mentioned that he contacted several large, well respected university endowments that were very pleased with Lone Star’s returns and performance. The fund is buying loans at the bottom on residential and commercial at a great price from the banks. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Marketti wanted to go on the record as being opposed to these investments.

**Bank Loan Fund Investments**

*TPG Specialty Lending (TSL)*

Pete Keliuotis introduced TPG Specialty Lending. The Division is already invested with other TPG funds and is proposing a $200 million investment to TSL. This fund will invest funds through loans to middle market businesses while preserving capital. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Marketti went on record as being opposed to this investment.

**Private Equity Investments**

*Vista Equity Partners Fund IV*

Pete Keliuotis first introduced Vista Equity Partners Fund IV. The Division is already invested with Vista Equity Partners Fund III and is proposing a $200 million investment to Fund IV. Vista is the Division’s best performing private equity manager with a 26% net IRR since 2007. This proposed $200 million commitment will also provide a 25 basis point reduction in management fees, bringing the fee to 1.25%. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Marketti went on record as being opposed to this investment.

*Asia Alternatives (NJAI II)*

Pete Keliuotis then introduced Asia Alternatives (NJAI II), which is an Asian focused private equity fund of funds, with approximately 40-50% of investments focused on China. The Division is proposing a $200 million investment to be deployed from two $100 million pools of capital through 2015. The State has previously invested $100 million in an Asia Alternatives separate account in the fall of 2007. This fund is
one of the Division’s strongest performers. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Marketti went on record as being opposed to this investment.

**Hedge Fund Investments**

**Ascend Add-on Investment**
Dan Stern of Cliffwater introduced a $75 million add-on investment to Ascend Partners Fund II, which is an equity long/short hedge fund manager. The fund has outperformed its peers and the benchmark and invests approximately 80% in domestic securities. It has an annualized net return of 8.22% since inception in February 2004. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Marketti went on record as being opposed to this investment.

**Commodity Investments**

**Rock Creek Commodity Fund of Funds**
Dan Stern of Cliffwater introduced a $200 million investment to Rock Creek-RC Woodley Park, LP. The Division originally invested $150 million with Rock Creek in September 2006. Since then, the fund has earned a cumulative net return of 13.7%, outperforming both the benchmark and S&P 500. The Division was also able to negotiate a reduction in management fees for the newly committed capital. The Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council Member Haselmann commented on the construction of the portfolio aggregate risk level. Chair Grady mentioned that he had visited their Washington, DC offices and received a briefing on their risk management software, which they are proposing to make available to the State for use in analyzing other potential and current investments. Mr. Marketti stated that he had no objection to this investment.

**State Investment Council Regulation Update**
Director of Operations Susan Sarnowski advised the Council that regulations originally set to expire on August 7, 2011 have been extended to August 7, 2013 by P.L. 2011, c. 45, which extends the period of rule readoption from five to seven years. The proposed amendments to N.J.A.C. 17:16-22 (Fixed Income Exchange Traded Funds) and 45 (Put options) were submitted to OAL and published in the NJ Register on May 16, 2011. The 60 day comment period will end on July 15, 2011. Ms. Sarnowski advised that she hopes to have the draft adoption available for the Council at the July meeting.

**Proposed Amendment of the State Investment Council By-Laws**
Chair Grady advised the Council that this would be the first revision to the by-laws since 1986. Chair Grady wanted to brief everyone on the substance of the changes and allow for suggestions and amendments at the current meeting, with a vote proposed for a later meeting. Ms. Sarnowski advised the Council of the proposed substantive revisions. Council Member Barrett expressed concern about having greater specificity for meeting dates. Chair Grady proffered a suggestion to have the by-laws reflect that the Chair will make best efforts to schedule the meetings at regular intervals with ample notice, but did not want to commit to specific days in the by-laws. Chair Grady also agreed with Council Member Barrett that the minimum number of meetings should be left at 6, rather than quarterly. Chair Grady also agreed that the Annual Meeting should be the first meeting of the calendar year. Vice Chair Caprio expressed concern about receiving monthly performance data even though the meetings will not be held on the same schedule. Chair Grady requested that the Director provide the Council with a “flash report” on a monthly basis for fund performance. Council Member Marketti further commented on statutory reporting requirements imposed on the Division. Ms. Sarnowski advised Council Member Marketti that the required report is posted to the Division website on a monthly basis. Chair Grady
asked for the Council members to receive an email advising that the report has been posted to the website. There was some discussion between the Council members regarding the listing of organizational and nominating committee meetings, with Chair Grady expressing hesitation regarding listing specific schedules given the lack of prior revisions to the by-laws. Chair Grady attempted to achieve compromise by amending the by-laws to state that the organizational meeting will occur the meeting after the nominating committee has been established. Chair Grady deferred to Director Walsh with respect to the scheduling of the annual meeting. Director Walsh responded that the Annual Meeting should be the first meeting of the calendar year. Council Member Barrett asked about changes to the special meetings provision to allow for five members to request a special meeting upon written request. Chair Grady agreed with this change. Chair Grady directed staff to provide a revised draft of the bylaws, incorporating the changes discussed, to the Council at its next meeting.

**Audit Committee Report**
Council Member Kellogg provided a report to the Council advising that the Committee met with Ernst and Young to outline the audit process. The committee will reconvene in the fall once the audit has been completed and provide a report to the Council at that time.

**Treasurer’s Report**
Assistant State Treasurer Chris Jeter was in attendance at the meeting and advised that the Treasurer’s Office was working diligently to ensure passage of the budget. He also expressed gratitude to Director Walsh and the Division for their hard work and diligence. Chair Grady concurred with Assistant Treasurer Jeter’s statement.

**Opportunity for Public Comment**
Ms. Sarnowski advised Chair Grady that there were three registered speakers for this meeting: Sandra Johnson, Rae Roeder and Anthony Miskowski.

Mr. Miskowski expressed concern about the unfunded liability of the pension system and posed questions to the Council with respect to specific investment amounts in companies involved in certain New Jersey based ventures. Chair Grady noted for the record that the Council’s exclusive mission is to act in the best interest of the beneficiaries and that at least one of the referenced investments predated Division senior staff and most of the Council members. Chair Grady advised Mr. Miskowski that the Division would confirm specific amounts for him.

Ms. Johnson inquired about the failed March 24 resolution regarding making a request to the Governor and Legislature to fully fund the pension system. Council Member Greaney advised that he believed it was beyond the scope of the Council as it is the Council’s duty to work with the Division to achieve the best returns for the pension system.

Ms. Roeder implored the Council to express their belief to the Governor and Legislature that the pension system should be fully funded. She also asked for the Council to allow public input into the by-law revisions.

Chair Grady said that the volunteer members of the Council are working extremely hard to ensure the maximum risk-adjusted returns and that they are doing a great job. Chair Grady commented that there is a potential $500 million pension contribution for fiscal year 2012, which is contingent upon the enactment of certain reforms. Vice Chair Caprio commented on new legislation that would require the State to make pension contributions.
Chair Grady motioned to adjourn the meeting, with Vice Chair Caprio seconding the motion. All voted in favor. The meeting was adjourned at 2:40 pm.

Respectfully submitted,

Kaitlyn Adams
Secretary to the Council