Minutes of Regular Meeting:

Held on November 8, 2012 at 10:00 AM at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton New Jersey.

Council Members in Attendance:

Robert Grady, Chair
Marty Barrett (Telephonic)
Brendan T. Byrne, Jr.
Michael Cleary
Charles Dolan
James E. Hanson (Telephonic)
Guy Haselmann
James Joyner
Adam Liebtag
Peter Maurer
Timothy McGuckin
Jeffrey Oram (Telephonic)
Mitchell Shivers (Telephonic, joined at 10:56)

Roll Call and Meeting Notice

Chair Grady called the meeting to order at 10:07 am. Ms. Christine Eckel performed roll call and reported that notice of the meeting was posted on the website of the Division of Investment (the Division), sent via fax to the Times of Trenton, the Star-Ledger, the Bergen Record, and the Courier Post, and e-mailed to the Secretary of State on October 19, 2012. A copy of the notice was posted at the Division and is on file.

Chair Grady thanked Council Members and members of the public for making a special effort to attend the meeting, given the events caused by Hurricane Sandy and the persistent bad and snowy weather in New Jersey.

Approval of Minutes for Regular Meeting held on October 11, 2012

Chair Grady asked the council members if they had any comments on the minutes to the October 11, 2012 Regular Meeting. Vice Chair Byrne asked for a change on page 7 of the minutes to reflect that he had stated he was willing to sit down with legislators to discuss pending legislation, and that he was not speaking on behalf of the rest of the Council. A motion was made by Chair Grady to approve the minutes of the October 11, 2012 meeting with the change requested by Vice Chair Byrne, with Vice
Chair Byrne seconding the motion. All Council Members in attendance at the time of motion voted in favor of the motion.

Proposed meeting schedule for Calendar Year 2013

Chair Grady read the dates of the proposed meetings for 2013 and asked that the schedule be posted on the Division’s website.

Directors Report/Update

Chair Grady asked Director Walsh how the storm affected the Division. Director Walsh responded that the Division was relatively unscathed, and noted that a skeleton crew was in the office while the State was closed to do trades and take care of operational issues.

Director Walsh gave an overview of the months of July, August and September, with funds returning 1.25, 1.50 and 1.75 respectively. The Fund was down .12% for the month of October, which was very minimal, bringing fiscal year returns to date to approximately 4.28%. Director Walsh commented that these numbers reflected a relatively strong start for the fiscal year, somewhere around the median for public pension funds. Chairman Grady noted that for the calendar year, New Jersey’s pension funds were up approximately 11 percent, slightly above the policy benchmark for the funds’ asset allocation.

Director Walsh reviewed the Fund’s asset allocation, noting the Fund was underweight to absolute return hedge funds because of limited investment opportunities in that asset class, and that the Fund continues to be overweight in investment grade corporate debt, especially under the new asset allocation that was adopted for FY 2013. Chairman Grady commented that he believed it was commendable that the Division does not force investments where opportunities do not exist, merely to meet asset allocation goals, and that the Council understood that it would take time to execute the significant shift (downward) in the allocation to investment grade fixed income that was adopted by the Council in the FY 2013 asset allocation plan.

Deputy Director McDonough advised the SIC as of September 30, 2012, that returns for the total Fund were approximately 95bps below the policy benchmark for the first three months of the fiscal year, but noted that the fund was ahead of its benchmark by about 40 basis points for the calendar year 2012 to date. Deputy Director McDonough stated that a portion of the fiscal year to date underperformance was attributable to the time lag in reporting Alternatives investment returns, such that with the
September quarter in alternatives included, the fund is probably closer to 30 to 50bps under benchmark for the first 3 months of the fiscal year.

Deputy Director McDonough stated that the outperformance for the calendar year was attributable to being underweight in Risk Mitigation and overweight in Global Growth and Income in a risk-on environment. While Risk Mitigation has been positive the first three months, it has not kept up with the equity, high yield and commodity markets. Another area in which the fund has performed well is in Domestic Equity where the fund is ahead of benchmark by 65bps fiscal year to date. What has hurt is the investment grade credit portfolio, which tends to be a lower beta, higher quality portfolio which hasn’t kept pace in this environment, where lower rated securities tend to outperform. The other detraction has been the Non-US Equity portfolio, both the developed and the emerging portfolio. With respect to the developed side, the active portfolio has underperformed, and on the emerging side, while the advisors have done very well the first three months of the fiscal year, the ETF portfolio for emerging markets has underperformed.

Council Member Haselmann reiterated that asset allocation is vital, and stressed the importance, in an interconnected global economy that is constantly changing, of the Council regularly discussing and reassessing asset allocation. Chairman Grady and other members of the Council agreed.

**Update on Blackstone Investments**

Director Walsh gave the SIC an update on the Blackstone investments entered into by the Division starting back in November 2011. He stated that the secondary purchase of Blackstone Real Estate Partners VI has experienced 70% appreciation since the time of investment, representing a gain of $15 million, which is more than the cost of running the Division for one year. The Blackstone Tactical Opportunities funds have invested about $126 million of the $750 million available for investment, and have generated a $33 million gain. In total, Director Walsh stated that the Blackstone investments have performed in an A plus fashion, generating excellent returns. Chair Grady noted that these results have been achieved at the same time the Division is paying below-market fees.

**Report on Hedge Fund Leverage**

Director Walsh presented a slide comparing leverage in the Fund’s hedge fund portfolio to leverage in other investments, including mortgages, bank investments, and equity investments. He noted that the Fund’s hedge fund and credit-oriented hedge fund investments have leverage ratios of 1.3 to 1.4, which is higher than certain equity investments (e.g., Apple and Exxon), but much lower than bank investments (e.g., Deutsche Bank and JP Morgan) and FHA mortgages.
Bank Loan Fund Investment-**GoldenTree Credit Opportunities Fund**

Deputy Director McDonough along with Jake Walthour of Cliffwater presented the proposed investment of $100 million in GoldenTree Credit Opportunities Fund ("Goldentree"), which would be an add-on investment. The Division invested $150 million in Goldentree back in 2007 and has seen a profit of $110 million, that equates to an annualized return of 16.6% and a 1.8x multiple. The Division was able to secure attractive terms on this new investment, with a 1% management fee, a 10% performance fee, and no lock up.

Mr. Walthour noted that this investment is distinguished from a hedge fund, and that it increases the Division’s exposure to fixed-income high-yield debt. He noted that default rates on bank debt are at historic lows, but noted that Goldentree’s long strategy results in increased volatility relative to hedge funds.

Chair Grady asked Mr. Walthour to address the issue of volatility, while Vice Chair Byrne asked about Goldentree’s dynamic hedging program. Council Member Liebtag asked about an investor that had departed from Goldentree, and Deputy Director McDonough responded that the investor had moved money to a related GoldenTree fund.

At this point, Council Member Shivers announced that he had joined the meeting.

Chair Grady reported that the IPC had determined that appropriate and adequate due diligence was performed.

**Private Equity/Venture Capital Investment-Blackrock-SONJ Private Opportunities Fund II**

Jason MacDonald along with Harshal Shah of Strategic Investment Solutions presented the proposed add-on investment of $400 million to Blackrock-SONJ Private Opportunities Fund II, which adds on to an existing $400 million commitment first made in 2007. The relationship with Blackrock began in 2006, with a $100 million commitment to a fund seeking opportunities to invest in private equity buyout funds. The 2006 vintage fund has yielded a .87% net IRR, 1.04x multiple to date. The 2007 Fund has fared much better with a 14.9% net IRR, 1.25x multiple, investing in private equity co-investments, and in venture capital and secondary opportunities. The Division would be investing $200 million out of the additional $400 million in top-tier venture capital firms. There is an opportunity to leverage resources as well, with staff participating in due diligence alongside Blackrock and receiving research from Blackrock. The terms are very attractive, with management fees of 75 bps on co-investments and secondary investments and 25 bps on venture capital, with an 8% preferred return and a 10% carry across all investments.
Chair Grady reported that the IPC had determined that appropriate and adequate due diligence was performed.

**Hedge Fund Investment - Scopia PX, LLC Fund**

Maneck Kotwal along with Jake Walthour of Cliffwater presented an investment of up to $150 million in Scopia PX, LLC Fund. Scopia is a long/short equity hedge fund and will be classified as equity oriented hedge fund investment. Investing in this fund would help address the issue of being underweight by approximately $350 million in equity oriented hedge fund bucket and also brings down the overall net exposure of equity oriented portfolio. Scopia has had top quartile returns on both an overall and risk-adjusted basis. The Division would be paying a 1.25% management fee. Scopia is also offering a hurdle rate, which would be capped at 4%, before taking the 20% incentive fee. Chair Grady asked about the net long/short exposure of the fund.

Chair Grady reported that the IPC had determined that appropriate and adequate due diligence was performed.

**Audited Financial Statements**

Council Member Tim McGuckin reported that the Audit Committee received clean, unqualified opinions from Ernst and Young LLP on the three Audited Financial Statements for the Pension Funds, the Cash Management Fund (CMF) and the Supplemental Annuity and Collective Trust Fund (SACT) Chair Grady asked whether the financial statements were on the Division’s website, and was told that they would be posted on the website after the meeting. There was no management letter, for the second year in a row. Next year, the Division’s financial statements will be combined with the financial statements for the Division of Pensions and Benefits. An RFP has been issued, and Council Member McGuckin has submitted his credentials to be a non-voting technical advisor, which means he can participate in discussions and update the Council on the process. Chair Grady thanked the Audit Committee and Ernst and Young, and stated that he looked forward to the combined financial statements that would track cash flows on a net basis in and out of the pension funds.

**Actuarial Assumption for Rates of Returns**

Council member Haselmann briefly discussed a paper he had drafted for the Council which reviewed in general terms the various ways in which actuarial assumed rate of return are established. He noted the State’s assumed rate of return, which was previously 8.25% and has more recently been lowered to 7.95%. He noted that there has been some question as to whether this rate makes sense in the low interest rate world environment that we are in right now. He noted that, in general, actuaries use a laundry list of factors that are not black and white, and emphasized that the measurement of liabilities is independent from the manner in which assets are funded. He noted that the Council is not involved in
determining the source of funding, the actuarial assumptions used or the State’s funding obligations and calculations. Rather, the role and duty of the Council is to maximizing return per unit of risk.

Report from the Treasurer

There was no report from the Treasurer. John Megariotis pointed out that the interest rate assumption is a long-term assumption and is in large part based on statutory requirements. He also noted that the Division of Pensions and Benefits was looking forward to working with the Division of Investment and the Council’s audit committee on combined financial statements.

Public Comment

Mr. Miskowski, Secretary of CWA Local 1033, asked whether the charts in the Director’s reports could provide dollar amounts along with the percentages.

Chair Grady motioned to adjourn the meeting, with Council Member Maurer seconding the motion. All Council members voted in favor. The meeting was adjourned at 12:20 pm.