

New Jersey State Investment Council

August 3, 2016 Regular Meeting

Minutes of the Regular Meeting

Held August 3, 2016 at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton, New Jersey.

Council Members in Attendance:

Brendan T. Byrne, Jr., Chair
Adam Liebttag, Vice Chair
Marty Barrett
Thomas Bruno Jr.
Michael Cleary
Charles Dolan
Michael Greaney
James Hanson
Guy Haselmann
James Joyner
Timothy McGuckin (via telephone)
Jeffrey Oram
Eric Richard
Mitchell Shivers

Roll Call and Meeting Notice

The Regular Meeting was called to order by Brendan T. Byrne, Jr., Council Chair, at 10:09 a.m. Ernestine Jones-Booker, Council Secretary, reported that notice of the Regular Meeting, scheduled for August 3, 2016, was posted on the website of the Division of Investment (Division); faxed to the Times of Trenton, the Bergen Record, and the Courier Post; and e-mailed to the Secretary of State on July 05, 2016. A copy of the notice was posted at the Division and is on file. Ms. Jones-Booker performed roll call and reported that a quorum of the Council was present.

Minutes of the Regular Meeting held May 25, 2016

Mr. Byrne presented for adoption the minutes for the regular meeting held May 25, 2016. James Joyner made a motion to approve the minutes, with Mitchell Shivers seconding the motion. All Council Members present voted in favor.

Guest Speaker – Professor Alan Blinder

Chair Byrne introduced Alan Blinder, Professor of Economics & Public Affairs at Princeton University and former Vice Chairman of the Federal Reserve Board. Dr. Blinder discussed the U.S. economy and Federal Reserve policy. Mr. Byrne inquired regarding the source of the Princeton University endowment's superior investment returns. Dr. Blinder responded that, as a long-term investor, Princeton is able to avoid overpaying for liquidity and to invest in unconventional alternative investments. In response to Charles Dolan's question whether Princeton handled its alternatives portfolio internally or externally, Dr. Blinder stated that he believed that the investments were handled externally, although allocation decisions are made and investments are monitored internally by a small staff. Jeffrey Oram asked Dr. Blinder if there were international flashpoints that could affect the State's portfolio. Dr. Blinder discussed Japan and China, as well as UK-EU negotiations in response to Brexit. James Hanson inquired regarding the causes of slow growth in the U.S. economy. Dr. Blinder cited a recent decline in labor productivity.

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Eric Richard questioned whether hedge funds were overvalued and whether the amount of pension fund money invested in hedge funds is disproportionate. Dr. Blinder replied that the Council should focus on the underlying asset classes, rather than the hedge fund governance structure. He stated that hedge fund performance varied widely, and that only the upper echelon of funds have performed well enough to justify the high fees involved. Responding to Mr. Shivers' question about the importance of free trade agreements, Dr. Blinder expressed his view that declining to enter TPP would have a relatively minor effect, but abrogating existing treaties such as NAFTA and WTO could cause more serious economic damage. Guy Haselmann questioned the Fed's interest rate policy and its efforts to create inflation. Dr. Blinder answered that the Fed was leading the global economy toward higher interest rates and had some success in increasing inflation rates, but conceded that monetary policies may be less effective than fiscal measures given the size of central bank balance sheets and global debt levels. He stressed the importance of how borrowed money was being used. Mr. Byrne asked Mr. Blinder whether he believed that a shrinking Fed balance sheet would likely lead to a drop off in stock prices. Dr. Blinder responded that the Fed's balance sheet will likely decrease very gradually. He commented in response to Mr. Byrne that he thinks as a general rule an investor's allocation to U.S. Equity should be at least 30%, if not more. He further stated the diversification benefits of allocation to equities outside the U.S. has diminished greatly in recent years, in his opinion.

Election of Nominating Committee

Mr. Byrne made a motion, seconded by Mr. Shivers, to elect Mr. Oram, Timothy McGuckin, and Mr. Haselmann to continue to serve on the Council's Nominating Committee. All members of the Council present voted in favor, except Mr. Haselmann, Mr. Oram and Mr. McGuckin who abstained.

Director's Report

Deputy Director Corey Amon provided a summary of capital markets for the fiscal year ended June 30, 2016. Mr. Haselmann noted the relatively strong performance of defensive investment sectors such as utilities and consumer staples and remarked on the historically unprecedented difficulty of investing in the current environment. Mr. Byrne and Mr. Haselmann referenced the different performance between long-only hedge funds and macro hedge funds, echoing Mr. Blinder's earlier comments. Director Christopher McDonough responded to Mr. Hanson's question at the Council's earlier meeting regarding the recent lack of downside protection offered by credit- and equity-oriented hedge funds, concluding that the current markets for various reasons have provided less opportunity for these funds to outperform the markets. Mr. McDonough went on to review pension fund performance through May 2016 and current asset allocation.

Pursuant to the Council's Alternative Investment Modification Procedures, Mr. McDonough notified the Council of redemptions from several hedge funds as part of an ongoing restructuring of the hedge fund portfolio. Michael Cleary asked if the redemptions were due to poor performance, to which Mr. McDonough responded that the redemptions were based on a combination of factors, including performance, fund objectives, and alignment of interest.

Lastly, Mr. McDonough notified the Council of the departure of Jason MacDonald, head of the Division's alternative investments portfolio.

Fiscal Year 2017 Annual Investment Plan

Mr. McDonough discussed the recommended FY17 annual investment plan, which was revised to address concerns raised by the Council at its prior meeting. Kristen Doyle of Aon Hewitt compared the Division's proposed alternative investment and hedge fund allocations of those of its peers and public pension plans as a whole. Mr. McDonough also discussed the

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Division's FAIR (Fund Alignment and Incentive Reform) initiative to address concerns regarding hedge fund fees and expenses. Mr. Byrne commented that the new investment plan sends a message to the hedge fund community that fee structures must be more closely aligned with the interest of beneficiaries. Mr. Dolan asked whether there has been any recent compression of fees in the hedge fund industry, to which Mr. McDonough replied that there was some anecdotal evidence in support of a downward trend. Mr. Haselmann noted the Division's leadership in pushing back on hedge fund fees and stated the Division's new initiative would provide further downward pressure on fees. In response to Mr. Oram's query whether the Division was seeking uncorrelated or inversely correlated hedge funds, Mr. McDonough replied the former, adding that there were other means of protecting against down markets. Mr. Byrne summarized the effect of the revised annual investment plan on projected risks and returns. Mr. Richard thanked the Division and the members of the Investment Policy Committee for their work, expressed support for the FAIR initiative, and stated his appreciation for the attempt to obtain a consensus among Council members. Adam Liebttag also thanked the Division staff and pledged support from the labor representatives on the Council to provide more resources to the Division. Mr. Dolan expressed his satisfaction that a full and thorough process was conducted to determine a proper asset allocation. Mr. Byrne made a motion to approve the recommended FY17 annual investment plan, with Mr. Liebttag seconding the motion. All members of the Council present voted in favor.

Benchmark Review

Ms. Doyle provided an overview of the FY17 benchmarks for the total fund and for each asset class, recommending changes to the Investment Grade Credit and Private Equity Buyouts/Venture Capital benchmarks. In response to a question from Mr. Shivers, Ms. Doyle confirmed that the benchmarks are consistent with the best practices of other large public funds. Ms. Doyle explained that the total fund benchmark retained a small weighting for hedge fund categories that have a target of 0% in order to account for delays in implementing the strategy. A motion to approve the proposed benchmarks was made by Mr. Shivers and seconded by Mr. Dolan. All members of the Council present voted in favor.

Global Diversified Credit Investment

Owl Rock Capital Corporation

Mr. McDonough and Mike Krems of TorreyCove Capital Partners presented an investment of \$400 million to Owl Rock Capital Corporation and up to \$200 million for related co-investment opportunities. Owl Rock is a direct lending strategy which would be part of the Division's global diversified credit portfolio. Mr. McDonough explained the Division's rationale for the investment and described the investment's attractive economics. Mr. Krems provided a summary of the investment strategy and the reputation and experience of the fund's investment team. Mr. Haselmann and Mr. Byrne noted that the investment took advantage of regulatory dislocation in the marketplace. Mr. Byrne asked about the relatively large size of the commitment, to which Mr. McDonough responded that there was sufficient diversification in the Division's credit portfolio to allow for a larger investment. In response to a question from Mr. Dolan, Mr. McDonough and Mr. Krems provided further explanation regarding the fee structure and revenue share. Mr. Liebttag inquired regarding potential conflicts with respect to ownership of the holdings company, to which Mr. McDonough responded that the pension fund will own a profit share interest in the company, but will have no say in the operation of the business. Mr. Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

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Hedge Fund Investment

Blackrock Alternative Advisors Separate Account

Mr. McDonough and Pete Kelioutis of Cliffwater presented an investment of up to \$1 billion in one or more separate accounts managed by BlackRock Alternative Advisors, with an initial tranche not to exceed \$500 million. Mr. McDonough stated this investment is part of the Division's FAIR program, creating a portfolio with a focus on risk-mitigating hedge funds with especially advantageous terms. Mr. Kelioutis reviewed the selection process for the investment and described BlackRock's qualifications and the terms of the investment. Mr. Haselmann commented favorably on the appropriateness of the investment, noting the firm's positive reputation in the industry. In response to a question from Mr. Byrne, Mr. Kelioutis described BlackRock's process for monitoring investments. Mr. Liebttag inquired how the investment comports with the Division's goal of reducing hedge fund exposure. Mr. McDonough responded that funds received from pending redemptions will be used to meet capital calls from this investment. Chair Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

Selection of External Investment Advisers for High Yield and Municipal Fixed Income

Kevin McGrath of the Division reported that five advisers were selected as high yield fixed income advisers through an RFP process: AllianceBernstein, Prudential, Hotchkis & Wiley, Wellington, and Nomura. Mr. McGrath discussed how the advisers were selected, and summarized the investment strategies of the selected advisers. Mr. McDonough noted that a municipal fixed income adviser was not selected as part of this RFP.

Verbal Report on Qualified Independent Representative (QIR) Policy

Susan Sarnowski of the Division explained that the Division's Qualified Independent Representative (QIR) Policy, which was adopted in 2013, requires the Division to report annually to the Council on compliance with the QIR Policy. Ms. Sarnowski reported that the Division is in compliance with the Policy.

Treasurer's Report

Dr. Roger Cohen of the State Treasurer's office reported on the State's labor growth and housing markets. Marty Barrett asked if there had been any discussion regarding utilizing pension fund assets to support the Transportation Trust Fund or Atlantic City. Mr. Byrne said he was aware of legislative discussion regarding infrastructure investment, but did not believe that there was any formal proposal to discuss at this point. Mr. McDonough further stated that the Division had not been asked to provide assistance to Atlantic City.

Public Comment

Frank Abella of Investment Partners Group spoke regarding investment in closed-end funds and other issues.

Adjournment

Mr. Shivers made a motion to adjourn the meeting, with Mr. Dolan seconding the motion. All Council Members present voted in favor. The meeting was adjourned at 1:19 p.m.