Key Points and Issues
For May 2008

Director’s Note

Compared to recent months, May 2008 seemed calm. Both U.S. and international equities posted solid, if not spectacular gains after months of significant volatility. Yields on government bonds continued to rise, but spreads on corporate bonds were well-behaved. The only exception was in the energy and broader commodity markets, where most prices continued to rise.

There were no significant changes in the portfolio last month, as we were small net buyers of both domestic and international equities and small net sellers of domestic fixed income securities.

Even though our underexposure to commodities continued to hurt our performance relative to our benchmark, strong performance in each of our major portfolios more than offset this drag. Overall performance for the portfolio exceeded that of our benchmark by 73 bp, and our overall investment return for the month was 1.34%.

Total Pension Funds

- Estimated performance for the pension funds for the fiscal year-to-date period is +1.90% versus +2.64% for the Council benchmark. For the month of May, the fund was up 1.34% versus 0.61% for the benchmark. The underperformance relative to the benchmark for the fiscal year-to-date period is primarily attributable to our underweight position in commodities, which are up by over 60% for the fiscal year-to-date period. Total pension fund assets as of May 31, 2008 were $80.1 billion.

- We were net buyers of $40.4 million of U.S. equities in May. Within the international portfolio, we were net buyers of $52.3 million of developed markets equities and $100 million of emerging markets equities. Within domestic fixed income, we were net sellers of $176.1 million, consisting of sales of mortgage backed securities that were partially offset by purchases of long-term corporate bonds and TIPs. Finally, we funded an additional $244.7 million in commitments to various alternative investments.

- During May, we transferred $300 million out of domestic fixed income securities (Common Fund B) into the international portfolio (Common Fund E).
Domestic Equity

- Performance for Common Pension Fund A for May was 2.50% versus 1.73% for the S&P 1500 Index, the benchmark for the domestic equity portfolio. For the fiscal year-to-date period, Common Pension Fund A returned -2.37% versus -4.86% for the benchmark. Our outperformance in May was widespread throughout the portfolio. As with last month, our underweight exposure to GE and our large exposure to several wireless tower operators (e.g., Crown Castle, American Tower) were among the contributors to our outperformance. For the fiscal year-to-date period, our underexposure to financial stocks is the major contributor to our outperformance.

- As stated above, net purchases of equities within Common Pension Fund A during May were $40.4 million. Purchases for the month were concentrated in the financial and consumer discretionary sectors. Major names that were bought in these sectors were National City ($50 million), Viacom ($38.6 million), Dish Network ($31.5 million), SLM Corp. ($27.9 million), Kohls ($26.7 million) and Best Buy ($26.4 million). Sales were concentrated in the consumer staples and technology sectors. The major names that were sold include Cisco ($52.8 million), Pepsico ($40.4 million) and Anheuser Busch ($20.7 million).

- There was no activity with respect to our put option hedges during May. We continue to have puts that hedge roughly $1.2 billion of our overall U.S. equity market, and $180 million of our exposure to U.S. financial services stocks.

Domestic Fixed Income

- Performance for Common Pension Fund B for May was -0.74% versus -1.91% for the Lehman Long Government/Credit Index, the new benchmark for the domestic fixed income portfolio. For the fiscal year-to-date period, Common Pension Fund B was up 9.00% versus 6.30% for the benchmark. Please note that the Common Fund B performance numbers include our TIPs portfolio, which does improve our comparison with the index somewhat for the fiscal year-to-date period. The duration of Common Pension Fund B (excluding TIPs) was 9.70 years as of May 31, 2008, versus 11.15 years for the Lehman Long U.S. Government/Credit Index.

- We had net sales of approximately $176.1 million in domestic fixed income securities in May. The net number includes purchases of $811.6 million (primarily long-term corporate bonds, TIPs and a handful of municipal auction-rate securities), offset by sales of $987.8 million in mortgage backed securities, municipal auction-rate securities and several short-term U.S. agencies and corporates. Major names that were purchased include AT&T, American Express, Pepsico and United Technologies. Net purchases of TIPs were $217.9 million. Of the total sales for the month, $387.5 million consisted of 30-year Freddie Mac
MBS, $214.8 million were short-term CMOs backed by agency collateral, and the remainder were short-term corporate bonds and municipal auction rate securities.

- As of May 31, 2008, our portfolio of municipal auction-rate securities was down to $108.5 million; at its peak in April, this portfolio’s value had exceeded $200 million. While we still monitor the market to find opportunities, the technical dislocations that created abnormal value in this market have started to subside.

**International Equity/Fixed Income**

- The equity portion of Common Pension Fund D returned 2.83% in May versus a 0.49% return for the MSCI EAFE Index ex-Prohibited, the new benchmark for the international portfolio, which is calculated by the Division and excludes those names deemed ineligible for investment under the State’s Sudan and Iran Divestment Laws. For the fiscal year-to-date period, the portfolio was down -1.12% versus -3.49% for the benchmark.

- We were net buyers of $52.3 million in international developed markets equities in April. The major activity was in the utility sector (where we were buyers of $203.2 million), the consumer staples sector (where we sold $112.6 million) and the financial sector (net sellers of $118.4 million). The major names purchased in the utility sector were Scottish and Southern, Enagas, National Grid and Suez. Within consumer staples, we sold Diageo, Pernod-Ricard, Danisco and Ebro Puleva. Within the financials, we were sellers of Banco Santander and Enskilda. ($87.7 million), Groupe Danone ($67.2 million) and Diageo ($44.8 million).

- Within emerging markets we continue to transition the portfolio to our four external managers. During May, we transferred an additional $100 million to our externally-managed portfolio. The total market value of the emerging markets equity portfolio is $1.1 billion.

- We transferred roughly $750 million out of short-term Euro-denominated bills into short-term JGBs. Given our significant underexposure to the Japanese equity market, we wished to minimize the currency risk associated with our mismatch relative to the benchmark.

**Alternatives**

- During April, we funded $244.7 million of commitments to alternative investments, including an additional $64 million to BlackRock Credit Investors, $17.5 million to Centerbridge and $17.1 million to MacFarlane Urban Real Estate Fund.
Cash Management Fund

- Total assets in the Cash Management Fund were $21.2 billion as of May 31, 2008. The current yield is 2.38% for state participants, and 2.28% for “non-State” participants. These yields are 24 bp lower than last month in response to the decline in the target federal funds rate set by the Federal Reserve.