

***State of New Jersey
State Investment Council***

**Meeting at
Rutgers Student Center – NEW BRUNSWICK
126 College Avenue – Multi-Purpose Room B
New Brunswick, New Jersey 08901-1166**

**Thursday, June 19, 2008
Noon Lunch/1 p.m. Council Meeting**

MINUTES

Approved July 17, 2008

Present: W. Montgomery “Monty” Cerf, Acting Chair
Erika Irish Brown – *joined the meeting at 1:30 p.m.*
Jose R. Claxton – *joined the meeting at 1:20 p.m.*
James Clemente
Sue Crotty
Mark Kandrac
James C. Kellogg
Douglas A. Love – *via teleconference*

Absent: Orin Kramer, Jonathan Berg, Marshall Brown

Also

Present: *From the Division of Investment:*
William G. Clark, Director
Brian Arena, Investment Officer
James Falstrault, Investment Officer
Susan Burrows Farber, Chief Administrative Officer
Jason MacDonald, Analyst
Gilles Michel, Assistant Director
Christine Pastore, Investment Officer
Ainsley A. Reynolds, Accounting Manager
Tim Rollender, Analyst
Susan Sarnowski, Middle Office Manager and Compliance Officer

From the Governor’s Office, Dept of the Treasury and Attorney General’s Office:
Rubin Weiner, Deputy Attorney General
David Ridolfino, Deputy Director, Department of the Treasury

Other Invitees:
Scott Booth, Townsend
Daniel Stern, Cliffwater
Curt Smith, Strategic Investment Solutions

Members of the Public:
Frederique Adam-Jupillat, LPS
Elliott Andersson, SEIU
Jamie Barker, Revenue

Members of the Public, con't:

Karin Bauer, DEP
William Bauer
Linda L. Brown, DOL
Shirley Bryant, L&PS
Vonda Brunsting, SEIU
Dorothy Carl
Adam Cataldo, Bloomberg
Shaunelle E. Clark
Sandy Coia
Phyllis Coleman
Clifford S. Cooper III, DOBI
Mariann Curcio
Paul P. Curcio
Steven Dovidio, Revenue
Steven Green, DOBI
Shirley Huntley
Reginald Jackson
Jim Jameson, NJEA
Sandra Johnson, DMVC
Patricia Latimer
JoAnn Marshall
P.G. Maurer
Wanda McEwen
Tim McGuckin, NJEA
Dusty McNichol, The Star Ledger
Mitchell Mercer, DSS
Anthony F. Miskowski, Member, CWA Local 1033
Barbara Montgomery
Clayton Mull, SCREA
Anne Marie Newman
Doug Newsome, Babson
Rodney Nichols
Shameko K. Palmer, Revenue
Joan Phillips
Lisa Radcliffe, MVC
Sam Smulyan
James Shanley, Revenue
Rodney Stevens

I. Call to Order

The meeting was called to order at 1:02 p.m. by Council Member Monty Cerf, who entertained a motion for the Council's election of a Chair *pro tem* in the absence of Chair Kramer and Vice Chair Berg, who were unable to attend. Mr. Cerf was elected unanimously as Chair *pro tem* on a motion by Mr. Kellogg, seconded by Ms. Crotty.

II. Notice of Meeting

Council Secretary Susan Burrows Farber reported that in compliance with the Open Public Meetings Act, *NJSA 10:4-1 et seq.*, notice of the meeting scheduled for June 19, 2008 was sent by mail deposited in the post office, by facsimile and email on June 2, 2008. A copy of the notice is on file as posted in the Division and sent to the Council, the **Times of Trenton**, **The Star-Ledger**, the **Bergen Record**, the **Courier Post**, and Secretary of State.

III. Approval of Minutes

The minutes of the regular meeting of the Council held on May 22, 2008 were approved unanimously on a motion by Mr. Kandrac, seconded by Mr. Clemente.

IV. Committee Reports

There were no committee reports.

V. Pending Matters

A. Status of Proposed Amendments Filing

Secretary Farber noted that proposed amendments to the Council's regulations governing Alternative Investments and other issues (N.J.A.C. 17:16-12.4, 43.1, 43.2, 45.2, 46.2, 69.9, 71.1, 71.2, 71.4, 90.1, 90.2, 90.4, 100.1, 100.2, 100.4) were filed with the Office of Administrative Law on March 20, and published in the April 21, 2008 issue of the *New Jersey Register*. The 60-day public comment period extends through June 20, 2008.

VI. New Business

A. Proposed Alternative Investments

- 1. Memorandum from Director Clark to the Council, dated June 13, 2008, entitled, "Proposed Hedge Fund Investment in Ironbound Capital Management L.P."*

Mr. Stern of Cliffwater reported that the proposed commitment of \$75 million to the Ironbound Fund provided an opportunity for equity long/short investment in a global fund holding 50 percent of its assets outside the U.S. He said the fund had generated strong returns since its inception, and was based in Princeton.

- 2. Memorandum from Director Clark to the Council, dated June 13, 2008, entitled, "Proposed Real Estate Investments in Morgan Stanley Real Estate Fund VII Global and TA Associates Fund IX."*

Mr. Booth of Townsend reported the proposed commitment was \$150 million to this Morgan Stanley global opportunity fund, whose team has a strong 16-year track record supported by the depth and breadth of Morgan Stanley's real estate organization, including 950 professionals and investments in more than 30 countries. In response to a question from Mr. Kellogg, he said the hurdle rate for this fund was nine percent annually, a standard fee structure. Mr. Kellogg asked that future reports clarify whether the hurdle rates were annually based.

Mr. Booth said the proposed commitment of \$100 million to the TA Associates Fund IX represented a "re-up" commitment for the Division, which also committed \$100 million to Fund VIII. He said this is a U.S. value-added fund, which uses an extensive and informal network for sourcing and provides its own management. He said the hurdle rate in this case is tied to inflation.

3. *Memorandum from Director Clark to the Council, dated June 11, 2008, entitled, "Proposed Private Equity Investment in Fairview Capstone II-NJDOI Emerging Manager Separate Account."*

Mr. Smith of Strategic Investment Solutions said the proposed \$100 million commitment to the Fairview Fund represented a "re-up" to the Division's first \$100 million allocation to this fund, which is focused on biotech and healthcare. Mr. Kellogg questioned the fee structure for this fund of funds; Mr. Claxton noted that this was a private equity fund of funds and that the distinction was important. Mr. Cerf said the value of such a fund was that it allowed the Division to invest in a part of the market it otherwise couldn't reach, justifying an additional fee. Director Clark noted also that the Division had veto rights. Mr. Kellogg said he was satisfied with the explanation, and asked that future reports clarify the term "carry."

B. For the Approval of the Council

1. *Memorandum from Director Clark to the Council, dated June 10, 2008, entitled, "Approval of Proposed Changes to the State Investment Council Regulations for Filing with the Office of Administrative Law."*

Director Clark said the proposed amendments would strengthen the investment opportunities available to the Pension Fund in three important ways. First, the amendments would permit the Fund to purchase bank debt in between the investment-grade and high-yield options allowed under current regulations; such debt often offers competitive yields with lower risk than traditional high-yield bonds. Secondly, the amendments would allow non-convertible preferred stock purchased by the Fund to be more appropriately applied to bond, rather than equity allocations. Thirdly, he said the amendments would grant the ability to use credit default swaps only to hedge risk that already exists in the portfolio.

(Dr. Love left the teleconference connection at this time)

In response to a question about overall risk from Ms. Brown, Director Clark said non-convertible preferred stock purchases, if lower than investment grade, would be applied toward the small permissible bond allocation for this type of investment.

Mr. Cerf questioned whether most non-convertible preferred stock is issued by financial institutions. Director Clark said this was true most recently, and so such purchases by the Division would be limited by the usual diversification goals. A brief discussion of counterparties and collateralized obligations followed.

The amendments were approved unanimously on a resolution moved by Mr. Kellogg, seconded by Mr. Claxton. The resolution as read stated, "Be it resolved that the State Investment Council hereby approves proposed amendments to N.J.A.C. 17:16-12, 13, 14, 15, 16, 19, 23, 24, 40, 41, 44, 46, 58, 63 and 69. The Council hereby authorizes the Director of the Division of Investment to submit the attached proposals to the Office of Administrative Law for publication and public comment, and hereby delegates to staff of the Council and the Division of Investment the authority to make revisions to the proposal as required and as shall be made upon the advice of the Attorney General. This resolution shall take effect immediately." The quorum present included Mr. Kellogg, Mr. Claxton, Mr. Kandrac, Ms. Brown, Mr. Cerf, Ms. Crotty and Mr. Clemente.

2. Acceptance of the annual report for Calendar and Fiscal Year 2007.

Director Clark noted that the delay in releasing the annual report came from a need to modify some accounting and reporting practices in order to provide a more complete and accurate report, and that the resulting report would be used as a template going forward allowing a much faster turnaround. Mr. Cerf commended the report for its thoroughness. It was noted that the audited financials were a part of the annual report, and that it would be posted to the Division's website. The Council voted unanimously on a motion by Mr. Claxton to submit the report as an official report of the Council to the legislature, with a second by Mr. Kandrac.

Mr. Kellogg asked that with the wind-down of the fiscal year that individual presentations be offered at future Council meetings offering a detailed look at the types and strategies behind specific classes of investments. Mr. Claxton added that such a presentation on hedge funds would be valuable in assessing whether we are where we want to be. Director Clark endorsed the idea.

C. For the Information of the Council

1. Memorandum from Chief Administrative Officer Susan Burrows Farber to the Council, dated June 13, 2008, entitled "Corporate Governance and Legislative Update."

The memo was noted without discussion.

2. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated June 13, 2008, entitled "Investment News Clips for June 2008 Council Meeting."

The memo was noted without discussion.

VII. *Reports of Director Clark*

- A. *Memorandum from Director Clark to the Council, dated June 13, 2008, entitled "Investment Reports."*

Director Clark noted that overall Fund performance was up 1.9 percent for the fiscal year to date through May 31, 2008, and this compared favorably to the market, and especially a published report that the average public pension fund was up only .05 percent through the end of May. He said that individual portfolios were showing a strong performance relative to the market overall. In particular, he noted that although Domestic Equities were down 2.37 percent, the market benchmark was down 4.86 percent for the same period; Fixed Income results were up 9.0 percent, compared with 6.3 percent for the market benchmark; and the International Portfolio was down 1.1 percent, versus a negative 3.5 percent for its benchmark.

Investment Officer Arena said May had been a strong month for common stocks, and that the Equity Portfolio's underweight position in the financial sector continued to help overall performance. Mr. Cerf asked why the Fund used puts for hedging when it did not have tax considerations; Director Clark said this applied to rolling profits only, and helped serve as insurance against larger market shocks. Mr. Kellogg asked why the Citigroup and Merrill Lynch preferred stock purchases were reported in the equity portfolio when they behave more like bonds. Director Clark said the Division had footnoted these investments for that reason, and was assessing the best way to report them. Mr. Kellogg suggested that preferred stocks be described as "mandatory convertibles" when this condition applied.

Investment Officer Michel said the International Portfolio was supporting a shift toward domestic bonds, in the belief that inflation risk was a lot lower in Europe than in the U.S.

Director Clark said the Fixed Income Portfolio had slowed its purchase of corporate bonds.

He offered a clarification to press reports about the Division's recent purchase of Lehman stock, noting the investment was minor and financed by the sale of other financial sector stocks because the Lehman price was attractive. Director Clark noted that Division trades are not routinely discussed with anyone outside the Division, including Council members, as a matter of policy.

Director Clark also reported that a Request for Proposals had been issued for a global custodian, and that consolidating the Division's banking and custodian services with one custodian would offer greater operational and reporting efficiencies. He said the transition process would be completed by the end of March 2009 at the earliest. In response to a question from Mr. Kandrak, Director Clark said the custodian's contract would be up for

renewal after five years, with two, one-year renewals possible at the option of the Division. He said an earlier termination of contract was also possible at the Division's option.

He reported that the Division had received and was reviewing four proposals for an external Auditor. Also, that the Division had received some 140 bids in its search for Small Cap Equity managers, and a recommendation could be expected by September.

Mr. Kellogg offered a warning on alternative energy investments, suggesting that many primary investors had unrelated motives for supporting these investments and so didn't care about loss.

Director Clark offered a handout in support of a question raised by the public at the last meeting, and noted that the Division had received \$208 million to date from its participation in class action and direct legal suits. He noted that \$63 million in net proceeds from the Division's lawsuit against Tyco would be received by the end of June. He also noted that the state's annual pension fund contribution of \$1 billion was also due by the end of June.

VIII. Public Comment

Three audience members who had submitted speaker request forms prior to the meeting were invited to address the Council.

Mr. Anthony Miskowski asked to present comments for himself and Dr. Mary Ann Mesics, who was not present. He offered his congratulations to Chair Kramer on his reappointment by the Governor to the Council, and thanked Director Clark for the class action settlement information.

In response to Mr. Miskowski's several questions, Director Clark said the chair is selected by the Council every September; that the division of the recent Lehman investment between common and preferred stock was at the discretion of the issuer; that the Division was told at the time of the purchase that there was not a sovereign wealth fund among the private investors in the Lehman issue; and he explained that a fund recently redeemed as reported on one exhibit hadn't been performing to Division expectations, and that the gain reported on the redemption was net of management fees.

Mr. Steve Green thanked Mr. Kellogg for posing regular questions on fees. Mr. Green suggested that the Division should own a meaningful amount of precious metals as a hedge against inflation. He also questioned whether paying a hurdle rate of eight percent was wise with inflation estimates running as high as 10 to 12 percent. Ms. Crotty noted that the Fund views things in long-term cycles and that the size of the Fund precluded frequent movement around any changing target. A brief discussion followed on how the Division values various investments.

IX. Communications

There were no matters presented on behalf of Treasurer Rousseau.

X. Next Meeting

Thursday, 7/19/08	Noon: Lunch/1 p.m. Meeting	Rutgers Student Center 126 College Avenue, MPR New Brunswick, NJ 08901
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XI. Adjournment

All regular business of the Council being concluded, the meeting was adjourned by unanimous vote at 2:40 p.m. on a motion by Mr. Clemente, seconded by Ms. Brown

Susan Burrows Farber
Secretary to the Council