Minutes of the Regular Meeting
Held July 15, 2010 at 1 PM in the Pensions Board Room
50 West State Street, 1st Floor, Trenton, New Jersey

Council Members in Attendance:
Orin Kramer, Chair
Jonathan Berg, Vice Chair
Mark Kandrac
Jeffrey Oram
Douglas A. Love
James C. Kellogg
James Clemente
Timothy McGuckin *(via teleconference)*
James P. Marketti *(via teleconference)*
Robert Grady *(via teleconference)*

Council Members Absent:
Maj. Karl Kleeberg

The Regular Meeting was called to order by Chair Kramer at 1:10 p.m.

Meeting Notice

Acting Council Secretary Kaitlyn Adams reported that notice of the Regular Meeting scheduled for July 15, 2010 was sent by mail deposited in the post office, by facsimile and email on July 1, 2010. A copy of the notice was posted in the Division on July 1, 2010, mailed to the Council, Times of Trenton, Star-Ledger, Bergen Record, Courier Post on July 1, 2010 and filed with the Secretary of State on July 1, 2010.

Appointment of Council Secretary

Chair Kramer stated the need for the appointment of a new Council Secretary since the position had been vacated since the last Council meeting. Chair Kramer asked DAG Weiner whether the Secretary had to be appointed on an interim basis or if the appointment could be permanent. DAG Weiner advised Chair Kramer that the appointment could be either interim or permanent. Chair Kramer introduced Kaitlyn Adams as the candidate for the Council Secretary position. She was unanimously appointed as permanent Council Secretary on a motion by Council Member Kandrac and seconded by Council Member Oram.

Appointment of Nominating Committee

Chair Kramer discussed the appointment of a nominating committee and stated that he wanted people on the committee who would still be on the Council for the September meeting. Chair Kramer proposed Council Member Oram as the Nominating Committee Chair and proposed Council Members Love and Kellogg to also serve on the Committee. These appointments were unanimously approved on motion by Council Member Kandrac and seconded by Council Member Clemente. Chair Kramer advised Council Member Oram that he was responsible for reaching out to the other Nominating Committee members and that he should wait until after August 1 so that the new Council members could be briefed on the Nominating Committee process. Chair Kramer also discussed the possibility of having a union member as either Chair or Vice Chair of the Council. Council Members Berg and Kandrac stated that they are representatives of the members of their respective pension systems and not necessarily of the employee unions.

Asset Allocation Discussion

Chair Kramer discussed raising the asset allocation ceilings for alternative investments and distributed a memorandum authored by Cliffwater, the Division's hedge fund consultant. He stated that this issue had been brought up several months ago under Director Clark's tenure; however, no action was taken because of the imminent turnover of State Investment Council members. Chair Kramer stated that it would be a good time to bring this discussion back to the table as the regulatory process necessary to make these changes may take up to one year. The Cliffwater memo stated that New Jersey's alternative asset allocation ranks 20th out of the 25 largest pension systems. Chair Kramer acknowledged that this was a contentious issue but stated that it was more about mitigating risk.

Chair Kramer stated that the current allocations were at 7%-7%-7% for hedge funds, private equity and real estate. Even if the allocations were raised to 12%-12%-12%, the pension fund would still be below a number of large public pension systems. Chair Kramer asked SIS to calculate the difference if the Pension Fund had an alternative asset allocation of 12% for hedge funds, 12% for private equity and 12% for real estate for the 10 year period ending in calendar year 2009, assuming mean performance for each asset class with no value added. SIS determined that the Pension Fund would have a $21 billion gain. If the Pension Fund had the 12-12-12 alternative asset allocation as of the end of 2002 when the allocation debate began, it would have $9.6 billion more. The Division is effectively frozen with respect to private equity investments, because it will be bumping against the allocation cap in the next year or two. The Division is unable to take advantage of investment opportunities because they feel constrained by the cap.

Council Member Love stated that the Division can reach the allocation caps simply by a decrease in the equity markets and the proposed allocation increase will help absorb market volatility.

Council Member Kellogg asked whether it made sense to delay the decision until the new Division Director and new Council members are seated. Chair Kramer said that he took that stance for approximately 6 months; however, that attitude cost the Pension Fund about $750 million and it is missing out on $1-2 billion annually by not acting. Council Member Kellogg also expressed concern about the recent losses in endowments as a result of their overreliance on alternative investments. Chair Kramer said that even with the recent losses, the endowments have still significantly outperformed New Jersey's Pension Fund and most other public pension funds.

Council Member Grady clarified that this discussion is not about increasing exposure to the asset classes, it is about creating more flexibility. He asked Pete Keliuotis of Strategic Investment Solutions whether he had any comment on Cliffwater's memorandum. Mr. Keliuotis agreed with Cliffwater's conclusion that New Jersey is behind many major pension funds and that it would be beneficial for the State's risk-adjusted returns to have more flexibility in the alternative asset classes.

Council Member Marketti stated that his stance on alternative investments is well-known; however, he is not opposed to having anything on the table for discussion.

Chair Kramer advised the Council that the proposal to add flexibility to the alternative asset allocation will be discussed internally with the new Investment Director. Council Member Grady stated that he would not be opposed to putting a specific analysis on the table at the September meeting.

Council Member Kandrac stated that he has never had an issue with increasing flexibility; however, future decisions cannot be made solely based on hindsight. The constraints are a disservice to the beneficiaries of the system. He said that he does not have a background in finance and relies on what he hears from other Council members and reads in reports, but he would like the Division to have flexibility.

Council Member Oram said that the one 'free lunch' in portfolio management is diversification and he supports moving forward with this proposal.

Update on Deferred Compensation

Memorandum "2009 Annual Update on the New Jersey State Employees Deferred Compensation Plan" dated June 16, 2010

Acting Director Joseph presented the 2009 annual update for the Deferred Compensation Plan. He stated that the Plan has its own governing board, consisting of representatives of the State Treasurer, the Director of OMB, and the Banking and Insurance Commissioner. Prudential is the Plan Administrator and the investments are selected by the Division of Pensions and Benefits, Division of Investment and Segal Advisors. The Division of Investment acts as a fiduciary for the investments.

Council Member Marketti stated that a member of the public had a question of Prudential's management fees and asked if anyone knew this amount. Acting Director Joseph stated that the information was not contained in the package and the Division did not have the information. Acting Director Joseph stated that he would make a request to the Deferred Compensation Board to disclose fees.

Council Member Kandrac asked how the plan was awarded to Prudential, since they also handle the State's life insurance. DAG Weiner advised that it was done through the public bidding through the Division of Purchase and Property.

Chair Kramer asked Division staff to perform an analysis of separating the indexed funds versus the actively managed funds to ascertain the fee breakdown for each category.

Council Member Clemente motioned to accept the report and Council Member Love seconded the motion.

Director's Report

Memorandum "Investment Reports" dated July 13, 2010

Acting Director Joseph stated that the Fund returned 58 basis points versus the Council benchmark of negative 3 basis points. Fund performance was attributable to the downturn in the domestic and international equity markets and the Division's underweighted position in

Treasuries. Council Member Love and Chair Kramer asked Acting Director Joseph if the rates of return for the Fund are adjusted for negative cash flow. Investment Officer Arena clarified that the numbers are not adjusted for cash flow.

For FY2010, the fund was up 14.36% versus the Council benchmark return of 14.13%. Net benefit payments such as net cash outflows from the fund $7.0 billion since June 30, 2009. Estimated net benefit payments made in June were $595 million.

Investment Officer Brian Arena reported that June was a weak month for equities, with our US equities falling 5.97% in June versus 5.41% in the S&P 1500. We sold $48 million and we were net buyers in economically sensitive areas, such as industrials and consumer cyclical, which are more responsive in an economic recovery. Even without a recovery, these are still good investments because of low valuations. For the fiscal year, US equities gained 15.71% versus 15.56% gain in the S&P 1500. He also stated that Karin Hollinger, an analyst with the Division for 31 years, retired at the end of June. Her responsibilities were reallocated among staff.

Assistant Director Michel reported that the Fund has no exposure to British Petroleum, in response to a question by Council Member Clemente. Assistant Director Michel explained how the Division got out of its investment in BP, which had previously been a large holding in the portfolio. The international portfolio added about 50 basis points in its relative performance, as the benchmark was off -1.16%, while the Common Pension Fund D performance was negative 64 basis points. The performance numbers are somewhat preliminary as the Division changed benchmarks in the middle of the fiscal year, however, they were projected to be very close to the benchmark. The Division was a net seller of $527 million in international equities in June. It was currency neutral as of June 30, 2010.

Senior Portfolio Manager Phil Pagliaro reported that Domestic Fixed Income returned 17.67% versus 16.48% for the benchmark Barclays Long Government/Credit Index for the fiscal year to date. The decision to overweight corporate bonds when the market was in a panic and spreads were at all-time wides has proven to be an extremely good decision. While overweight in corporate bonds, the Division was able to maintain the credit level of the portfolio as well as liquidity, since the portfolio was short duration. The high yield portfolio was up 28.6% for the fiscal year-to-date period versus 26.76% for the Barclays High Yield Index. The TIPS portfolio returned 12.34% for the fiscal year-to-date versus 9.52% for the Barclays TIPS Index. Mr. Pagliaro reported that, currently, not much has changed in the portfolio. The Build America bonds portfolio has continued to grow and was almost at weight with the index. The average yield of these bonds was 6%, while the average yield of other bonds in Common Pension Fund B was 5%, and the 10 year Treasury yield is 3%.

Acting Director Joseph reported on the Alternatives Portfolio. The commodity portfolio was down 0.17% as compared to 0.32% for the Dow Jones UBS Total Return benchmark. For the fiscal year to date, the commodity portfolio returned 5.71% versus 2.74% for the benchmark. Performance for the first six months of calendar year 2010, the commodity portfolio declined 7.72% versus -9.60% for the Dow Jones UBS Total Return benchmark. At the March Council meeting, the Division presented its intention to purchase up to $350 million of additional commodity linked notes, the terms of which had not been finalized at that time. It purchased $100 million in commodity-linked notes with Barclays Capital during June. The note has a maturity of one year and will receive principal plus/minus the return on customized commodity indices. The Division funded approximately $182 million of commitments to private equity and real estate investments in June. Additionally, it received distributions of approximately $27.3 million during the month. The Hedge Fund portfolio returned -0.68% for June versus its benchmark return of -1.08%. Fiscal year to date, the hedge fund portfolio returned 13.91% versus 4.25% for the HFRI Fund of Funds Composite Index.

Acting Director Joseph also reported on the Cash Management .Fund. Total assets in the Cash Management Fund were $13.1 billion as of June 30, 2010. The current yield was 0.35% for state participants and 0.25% for "non-State" participants.

There was a discussion regarding the investment in private equity, prompted by a question asked by Council Member Marketti.

Committee Reports

Council Member Kellogg stated that there was an Audit Committee report. The State is on a fiscal year basis, whereas real estate and private equity are on a calendar year basis, so there has been a historical lag. He stated that the Treasurer's Office asked to speed up the process so that there can be a full accounting. To further compound matters, the Division changed custodians from Bank of New York to State Street. Council Member Kellogg asked Acting Director Joseph to speak on the transition from the Division's perspective. Acting Director Joseph stated that the Division has taken a three month process and turned into a six week process, thanks in large part to Compliance Officer Susan Sarnowski's effort. The compressed audit schedule has put a strain on staff but everyone is putting forth their best effort to keep everything on schedule.

Communications

There was no report from the State Treasurer.

Resolution Regarding Outgoing Council Members

Council Member Kellogg stated that the Council wanted to present the four outgoing representatives of the pension systems (Jonathan Berg, Jim Clemente, Mark Kandrac and Karl Kleeberg) with a token of appreciation for their service. They will all be given inscribed bronze clocks.

Chair Kramer also wanted to put in the record that Susan Crotty was no longer serving on the Council. He praised her as an "intellectual force" on the Council and mentioned her extraordinary service and effort over her tenure. Council Member Grady proposed a formal resolution to thank Ms. Crotty and the pension fund representatives for their service and dedication to the State Investment Council. All members unanimously approved the resolution.

Public Comment Period

Mr. Miskowski asked why the Council had not approved the minutes of the previous meeting on May 20 and the special meeting on July 6. DAG Weiner advised Chair Kramer that we had not approved the minutes because the Council did not have a secretary. Chair Kramer advised Mr. Miskowski that the minutes will be prepared for those meetings.

Mr. Miskowski congratulated the Division on its divestment of BP and sought clarification on the Division's number of shares as well as exposure in corporate bonds and hedge funds. He also asked if we would take part in any class action, to which Chair Kramer advised Mr. Miskowski that was a question best asked of the Attorney General's Office, not the Council.

Adjournment of Meeting

The meeting was adjourned at 2:09 pm by unanimous vote on a motion by Council Member Love, seconded by Council Member Kandrac.

Respectfully submitted,

Kaitlyn J. Adams

Kaitlyn J. Adams
Secretary to the Council