

*Agenda Item 1(a)*

**Minutes of the Regular Meeting**

**Held September 16, 2010 at 1 PM in the Pensions Board Room  
50 West State Street, 1<sup>st</sup> Floor, Trenton, New Jersey**

**Council Members in Attendance:**

Orin Kramer, Chair  
Robert Grady  
Jeffrey Oram  
Andrew Michael Greaney  
Douglas A. Love  
James C. Kellogg  
Timothy McGuckin  
James P. Marketti  
Nicholas Caprio  
Richard Klockner  
Marty Barrett

**The Regular Meeting was called to order by Chair Kramer at 1:08 p.m.**

**Meeting Notice**

Secretary Adams reported that notice of the Regular Meeting scheduled for September 16, 2010 was sent by mail deposited in the post office, by facsimile and email on August 31, 2010. A copy of the notice was posted in the Division on August 31, 2010, mailed to the Council, Times of Trenton, Star-Ledger, Bergen Record, and Courier Post on August 31, 2010 and filed with the Secretary of State on August 31, 2010.

**Approval of Minutes for Regular Meetings held May 20, 2010 and July 15, 2010 and Special Meeting held July 6, 2010**

Chair Kramer asked if there were any comments on the minutes for the May and July meetings. Council Member Grady advised Chair Kramer that the minutes for the May 20, 2010 meeting did not reflect Mr. Grady's arrival at the May meeting. Council Member Love motioned to approve the minutes for the Regular Meetings of May 20, 2010 and July 15, 2010 and the Special Meeting held July 6, 2010, as amended to reflect the above change. This motion was seconded by Council Member McGuckin and the minutes were approved by unanimous vote.

Later in the meeting, Council Member Grady brought up a further modification for the July 15 meeting minutes to indicate that a request was being made of Division staff by then-Chair Kramer to analyze the fee breakdown for the Deferred Compensation plan. A motion to approve the minutes with this further modification was made by Council Member Kellogg and seconded by Council Member McGuckin. The motion was approved unanimously.

Chair Kramer said that there have been a number of transitions over the past few months which have affected the normal course of Council business, including the late submission of the Council meeting minutes. He stated that the Council and the Division is fortunate to have a new Chief Investment Officer, Timothy Walsh, and that this is Director Walsh's first State Investment Council meeting. Chair Kramer asked the Council to introduce themselves for the benefit of the new members.

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**Director's Report**

*Memorandum "Investment Reports" dated September 13, 2010*

Director Walsh stated that the markets were down in August, with the S&P 1500 down over 4.5%, with the international markets performing less poorly. Conversely, the fixed income markets performed well, with the Barclay's Capital Long Government/Credit Index up over 5%. Overall, the Fund was down 9 basis points for August, with the Council benchmark being up 10 basis points. The Fund value as of August 31 was \$68.3 billion.

Brian Arena stated that August was a weak month for domestic equities, with the S&P being down 4.7% versus the portfolio being down 4.9%. He attributed the difference to the fund's lack of holdings in Bell Operating Companies and AT&T, and an underweighted position in Verizon. The portfolio is up 2.1% fiscal year-to-date, with the benchmark being up 2% over the same period. For the calendar year-to-date, the portfolio is down 3.9%, versus the benchmark being down 4.2%. During August, there were \$53 million in net equity sales, with the biggest holdings being Apple and ExxonMobil. Director Walsh stated that the approximate value of the domestic equity portfolio is \$16 billion.

Director Walsh stated that the August performance for the International Equity portfolio is down 2.83%, slightly underperforming the benchmark, which was down 2.76%. Director Walsh added that there was a nice rally in the international equity markets in early September. Entering the month of August, the fund had nearly \$500 million in cash and during the course of the month, a significant amount of that money had been invested. Director Walsh also stated that there was a reclassification of Southern Copper. Although it is incorporated in the U.S., it is largely a Peruvian and Mexican operation and has been moved to the Emerging Market portfolio.

Tim Patton stated that there had been a dramatic drop in the rates of long high grade bonds due to a number of factors for the month of August. The Division continued to buy new issues of spread product, with net investment of \$261 million, comprised of purchases of \$550 million and \$289 million in sales. The sales resulted in a \$20 million gain. For the month, the high grade portfolio was up 4.67% versus the index of 5.22%. For the year, the portfolio was up 16.29%, although still underperforming the index, which is up 17.53%. Mr. Patton attributed underperformance to an underweighted Treasury position and shorter duration of bonds.

With respect to the High Yield portfolio, Mr. Patton reported widening spreads across all sectors of the High Yield market. During the month of August, the portfolio was positive 0.61% versus the index being positive 0.04%. Calendar year-to-date, the portfolio was up 7.99% versus the index's gain of 8.27%. Underperformance in High Yield portfolio was mainly attributable to the higher quality bonds in the portfolio as the weaker quality bonds outperformed the B and BB-rated bonds in the first half of the year.

Mr. Patton reported that, overall, the TIPS market dramatically underperformed, given rising deflation fears. This underperformance was especially evident in the short term; however, all of the fund's holdings were in the twenty year sector. For the month of August, the Division's TIPS portfolio was up 4.41% versus the index being up 1.72%. Calendar year-to-date, the portfolio was up 11.08% versus the index's gain of 6.36%.

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Council Member Marketti asked about Exhibit 23 for Common Pension Fund E and stated that a number of the 20 largest purchases were the same as the 20 largest sales. Director Walsh stated that the sales are actually distributions back to the Division. Director Walsh stated that he is considering changes to the exhibit. Council Member Grady asked the Division to consider providing more information with respect to the presentation of private equity reporting, specifically requesting data on commitments made, contributions drawn thus far, distributions made and the carrying value of the remaining investment in order to get a better picture of the investment's worth. Council Member Grady stated that this is the way that private equity positions are reported by many firms. Director Walsh advised him that the Division will attempt to provide this information for the October meeting. Director Walsh said that the Division had some attractive returns due to larger domestic technology companies buying out smaller technology companies over the past several weeks.

With respect to Alternative Investments, Director Walsh reported commodities were down 1.5% versus the benchmark being negative 2.5%. The Hedge Fund portfolio was up 26 basis points, which is significant when taking into account the negative performance of the domestic and international equities markets.

**Report on status of pension and annuity fund investments in Sudan**

*Memorandum "Investments in Sudan" dated September 1, 2010*

Compliance Officer Susan Sarnowski reported on the Sudan divestment law, which was passed in 2005. For any international company defined as having an equity tie with Sudan, the law provides that the Division has three years to divest. The Division divested approximately \$2 million from international companies with equity ties to Sudan and this divestment occurred within about one year from the enactment of the law. Ms. Sarnowski stated that the law requires the Division to provide an annual report to the Legislature. The Division utilizes a third party research provider, RiskMetrics, to assemble basic research and Division staff initiates further dialogue directly with the companies in question to confirm RiskMetrics' research prior to going onto the divestment list.

**Presentation on alternative investment asset allocation from Strategic Investment Solutions**

*Memorandum "Alternative Investment Limitations Recommendation" dated September 13, 2010*

Chair Kramer stated that last meeting there was discussion about developing a plan to increase the permissible limits for alternative investments, in order to increase the Division's flexibility since regulatory changes are an arduous process. Chair Kramer stated that this plan was actually first discussed last January; however, the Council wanted to wait to act on the plan until the new Council members had taken over and also once a new Chief Investment Officer was found.

Chair Kramer introduced Pete Keliuotis from the Division's general investment consultant, Strategic Investment Solutions, to summarize the plan and provide recommendations for alternative investment allocation limits.

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Mr. Keliuotis stated that several months ago, his team began work modeling future cash flows to determine where the Division would hit the limits for alternative investments. He said that the memo provides recommendations to increase the ceilings for 3 of the 4 alternative investment asset classes and also proposes adopting a group limit, which would be less than the sum of the individual asset class ceilings in order to provide both the Council and the Division with greater flexibility. Mr. Keliuotis stated that increasing the alternative investment allocation ceilings will also provide for better risk-adjusted performance going forward.

Chair Kramer asked Mr. Keliuotis if he had an explicit recommendation of what the cap should be. Mr. Keliuotis stated that his recommendation was to keep Real Assets at 7%, as they do not believe that there is a need over the next few years to raise the allocation ceiling beyond its current number. The Real Estate ceiling should be raised from 7% to 9%, the Private Equity ceiling should be raised from 7% to 12%, and the Hedge Fund limit should be raised from 7% to 15%. Mr. Keliuotis stressed that these are the upper limits and not target allocations. There is no change to the target allocation proposed. In the aggregate, he recommended a group constraint ranging between 34% and 43%, with a preference to use the 43% constraint.

Chair Kramer asked Mr. Keliuotis where the Division ranked among the largest state plans with respect to alternative investment exposure. Mr. Keliuotis stated that the Division was ranked 18<sup>th</sup> among the top 21 states. Chair Kramer asked if there had been research conducted to support SIS' recommendation. Mr. Keliuotis stated that SIS consulted three different surveys conducted by Greenwich, Russell Investment Group and Goldman Sachs on institutional investors and alternative investments. All 3 found that institutional investors had expectations to increase alternative investment allocations over the coming years.

Chair Kramer asked Mr. Keliuotis if he had reviewed performance of public funds relative to endowments over the past 10 years. Mr. Keliuotis stated that the average large endowment had approximately 60% allocated to alternative investments and that the median endowment outperformed the median public fund at about 1% per year over the past 10 years.

Council Member Marketti expressed skepticism regarding the report. He went on to state that he believed that, if the ceilings were raised, more money would be invested in alternatives. Council Member Marketti asked why the year 2002 was used for the statistics rather than 2005. Mr. Keliuotis replied that the year 2002 was used because that was the first time that an alternative investment program was proposed by the Council. Council Member Marketti remarked that he was under the impression after the July meeting that the analysis would focus more on what would have happened with different portfolio types, rather than what was presented by SIS. Chair Kramer advised Council Member Marketti that this analysis had been provided in the past and that New Jersey is approximately \$2.3 billion ahead.

Council Member Kellogg asked about the pricing of hedge funds versus stock indices and how this pricing impacts the Division with relation to investment in alternative asset classes. Council Member Kellogg discussed the "2 & 20" fee structure of hedge funds and posited that potential regulatory changes could add to hedge fund fees, which would further decrease hedge fund returns. Council Member asked regarding the usage of hedge fund fees by the partnership.

Council Member Marketti asked the cost value of alternative investments and stated that since inception, the Division has lost \$1.3 billion. Council Member Grady stated that there are four

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different classes of alternative investments and they all have different losses, with approximately \$1 billion being lost in real estate. Council Member Marketti asked Director Walsh regarding the performance of fixed income and the effect of interest rates on the market.

Council Member Grady stated that he has not been a member of the Council long enough to know the past history. He then asked Mr. Keliuotis about the particular methodologies used to simulate returns in the SIS memorandum. Mr. Keliuotis responded that adding alternative investments to the mix gives the Division a more optimal portfolio in terms of risk and return. Council Member Grady observed that the SIS analysis showed that to achieve the same projected return without alternatives would require a material increase in domestic and international equities, which would increase the risk in the portfolio.

Council Member Grady asked about the hedge fund mix and strategy from a policy perspective. Dan Stern replied that there is a two-fold policy: to outperform broad indices and achieve risk diversification across different strategies. He specifically stated that hedge funds sought non-correlated assets. Pete Keliuotis mentioned that SIS does not use Cliffwater's expectations in developing their simulations.

Council Member Love stated that he had presented a study several years ago of the overall asset liability position of the pension system. Pensions are similar to bonds and they also have interest rate exposure. As a result, there will be big swings in the liability exposure due to the new accounting rules and questions of diversification and asset mix will extend well beyond hedge funds to equities and fixed income in the future.

Chair Kramer stated that there were 32 different hedge fund investments made during the bubble of September/October 2008, but only 2 made in the fall of 2008 to take advantage of a cheap market. Even though the Division's timing was off, New Jersey has outperformed its peers in alternatives. The average endowment has 21-24% in hedge funds alone and 50-60% in alternatives. Chair Kramer said that this is the only state that he knows of where alternative investments are controversial.

Council Member Grady asked Pete Keliuotis and Director Walsh to comment on the lower aggregate cap (either 34-38%) proposed in the SIS memorandum to the Council. Director Walsh spoke about the "numerator-denominator effect", where the reduction in the overall value of the pension fund can put hedge funds and private equity out of compliance with the current regulatory ceilings and that the Division needs the flexibility. Council Member Grady suggested adopting one of the lower aggregate ceilings as a compromise given the differences of opinion on the Council and that the draft language should include the maximum individual asset class caps with the lower 38% aggregate cap.

Chair Kramer recommended providing latitude in the regulatory language to provide flexibility for the Investment Committee to discuss fund anomalies.

Council Member Caprio said that the GASB accounting changes to calculate pension fund liability are forthcoming and that flexibility is needed by the Division.

Council Member Love put forth a motion directing staff to draft regulatory language for the Council's review, using a 38% aggregate cap and the maximum individual caps recommended by

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SIS. Council Member Oram seconded the motion. DAG Weiner advised the Council that, after the language was presented to the Council, the Council would vote on whether the drafted language would be submitted to OAL for publication. Once the language is published for public comment, the Council would have to vote again to adopt the regulatory language. Any change to the allocation would require a separate Council vote. The motion was approved 9-1, with Council Member Marketti abstaining and Council Member Kellogg voting against the motion. Council Member Barrett expressed his concern that it was unfair for new members to be presented with this proposal so soon into their tenure.

**Communications**

There was no report from the State Treasurer.

**Nominating Committee Report**

Council Member Oram, as Chair of the Nominating Committee, along with Council Members Love and Kellogg reviewed the background of all of the Council members and after consultation and deliberation, provided the Council with nominations for Chair and Vice Chair. Council Member Oram presented Robert Grady as the Committee's nominee for State Investment Council Chairperson and Nick Caprio as the Committee's nominee for Vice-Chair. No other candidates were proposed. A motion to approve the recommendations of the Nominating Committee was made by Council Member Kellogg and seconded by Council Member Love. All members voted in the affirmative, with Grady abstaining.

Chair Grady offered a resolution recognizing Mr. Kramer for his distinguished service as Chairman to the State Investment Council, which was approved unanimously by the Council.

Chair Grady appointed himself, Vice Chair Caprio, Council Member Kellogg, and Council Member Greaney to the Audit Committee, and appointed himself, Vice Chair Caprio, Council Member Kellogg, Council Member Love and Council Member Oram to the Executive Committee. Chair Grady said that there are a series of other committees on the Council that will be reviewed and Chair Grady will reach out to the Council members to determine their level of interest in serving on a committee. Chair Grady advised that he will join the Investment Policy Committee as the third member with Council Members Kramer and Love and will ascertain whether additional members should be added to the committee as part of the "reaching out" process to ensure proper balance on this and all other committees. He stated that he looked forward to speaking to the other Council members about their interest in serving on the committees and again thanked the Council for their confidence in appointing him as Chairperson.

**Public Comment Period**

Rae Roeder stated that she wanted to use her time to give the Council an idea of why the CWA members attend the meetings. She stated that they are scared about the direction of the pension fund. Ms. Roeder thanked Director Walsh for meeting with her and considering her suggestion to hold future Council meetings at the State Museum Auditorium.

Raymond Weicker commented regarding the time periods selected by SIS for its modeling and questioned the future profitability of alternative investments.

Cliff Cooper said that he was concerned about the proposed new ceilings for alternative investments, because pension fund investments were supposed to be conservative.

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Tony Miskowski protested the direction of pension fund investments, and accused the State of fraudulently misleading pensioners and pension fund performance in order to bolster the State's credit rating. Mr. Miskowski asked the Council to implement a "Volcker-like rule" to the pension fund to limit the fund's risk exposure.

Chair Grady asked to make a clarifying point in response to Mr. Miskowski's remarks. He stated that with respect to the fraud allegations in the SEC settlement, his understanding was that the time period for the violations was 2001-2007 and the violations pertained to bond issue disclosures, not investments made by the Division. Chair Grady commented that in terms of investment performance and the activities of the Division of Investment, he does not believe that fraud has been committed or even alleged. Chair Grady lauded the Division by mentioning that the Division has worked very hard to outperform various indices and peer funds.

Chair Grady thanked Ms. Roeder for bringing her members and for their interest in the State Investment Council proceedings. He went on to say that the Council had a solemn obligation to the 800,000 beneficiaries of the pension fund to maximize investment returns and appropriately manage risk.

Mr. Barrett stated that as a retired policeman, he also shares the concerns of the union members and stated that he is going to try to do everything that he can to help.

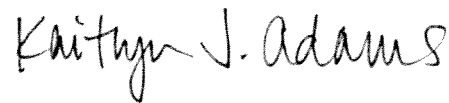
Chair Grady stated that the next meeting will be held at the State Museum Auditorium on October 21, 2010.

**Adjournment of Meeting**

Chair Grady motioned to adjourn the meeting. Council Member Oram seconded the motion.

**The meeting was adjourned at 3:15 PM.**

Respectfully submitted,



Kaitlyn J. Adams  
Secretary to the Council