Key Points and Issues
For November 2008

Director's Note

November 2008 was another extremely volatile month in financial markets, although signs of stabilization began to emerge later in the month. Through November 20, 2008, the S&P 500 Index was down 22.3% for the month, exceeding the decline of 16.8% for October 2008. The equity market rallied somewhat from that point, however, helped by the announcement from the Federal Reserve that it would begin direct purchases (or the equivalent thereof) of $200 billion of asset backed securities, $100 billion of direct debt issued by the housing-related government sponsored enterprises (the "GSEs"), and $500 billion of mortgage-backed securities issued by Freddie Mac, FNMA or GNMA. As a result of these announcements, mortgage rates declined significantly, which helped reduce pessimism somewhat about economic growth in 2009. Equities rallied by more than 19% from November 20 through month-end to finish the month down about 7.2%.

Overall performance for New Jersey's pension fund was down -2.16% for November 2008, with the fund having an estimated portfolio market value of $60.6 billion. Even though our public equity performance was essentially in line with market averages, we were helped by our continued shift of the portfolio's asset allocation into long-term corporate bonds. During October-November, we were net buyers of nearly $1.6 billion of long-term corporates. While spreads on corporate bonds widened modestly in November, our performance benefited from the significant decline in long-term interest rates; the yield on the 10-year U.S. Treasury declined from 3.96% to 2.92% in November, while the yield on the 30-year Treasury fell from 4.37% to 3.44%.

Total Pension Funds

- For the month of November, the fund was down -2.16% versus -1.89% for the benchmark. Estimated performance for the pension funds for the fiscal year-to-date period through November 30, 2008 is -22.37% versus -23.82% for the Council benchmark. Our outperformance for the fiscal year is attributable to (1) our underweight position in commodities relative to the benchmark, and (2) our overweight position in domestic and international fixed income relative to public equities. Total pension fund assets as of November 30, 2008 were $60.6 billion.

- We were net sellers of $195.0 million of U.S. equities in November, with the major sales occurring in the rails and technology stocks. Following up on last month, we purchased an additional $84.9 million in long-term corporate bonds in Common Pension Fund A at yields greater than 9%. Within the international portfolio, we were net buyers of $92.6 million, consisting primarily of "defensive" utility and telecom stocks, offset by sales in energy and consumer discretionary names. Offsetting these purchases were sales of $370 million of international sovereign bonds during November. Within the domestic fixed income portfolio, we were net buyers of $98.9 million, consisting primarily of long-term corporate bonds. Finally, we funded an additional $150.3 million in commitments to various alternative investments in November.

Domestic Equity

- Performance for Common Pension Fund A for November was -7.90% versus -7.50% 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 -29.73% versus -29.88% for the benchmark. The major positive factor contributing to overall performance continues to be our underexposure to the financial services sector. The major negative factor impacting performance is our exposure to the wireless tower stocks, which have underperformed other telecommunications stocks significantly in recent months.

- As stated above, net sales of equities in the portfolio in November were $195.0 million. Within the equity portfolio, the major thrust was to increase exposure in "defensive"' areas and to decrease our exposure to cyclical sectors. We were net sellers of railroad stocks, technology stocks and financials. We were net buyers within the health care, telecommunications and utilities sectors. The major issues that were sold during November were Union Pacific, Anheuser Busch, Norfolk Southern, Hewlett Packard and Intel. The major purchases were of Verizon, Pepsico, Waste Management, Campbell Soup, and Medtronic Inc.

- As stated above, we continue to purchase long-term corporate bonds within the domestic equity portfolio ($84.9 million in November) at yields north of 9%. Our strategy is to obtain equity-like returns on certain bonds in lieu of owning the underlying stocks. Bonds that were purchased include Altria, Alcoa and Verizon.

Domestic Fixed Income

- Performance for Common Pension Fund B for November was +6.02% versus +9.50% for the Barclays Long Government/Credit Index, the benchmark for the domestic fixed income portfolio. Please note that the B Fund performance number includes the performance of our $3.2 billion TIPs portfolio, while TIPs are not included in the Barclays Index. Excluding TIPS, we estimate our performance for November was above 7%. For the fiscal year-to-date period, Common Pension Fund B returned -5.46% versus -1.80% for the benchmark. The duration of Common Pension Fund B (excluding TIPs) was 9.72 years as of November 30, 2008, versus 11.09 years for the Barclays Long U.S. Government/Credit Index.

- We had net purchases of approximately $98.9 million in domestic fixed income securities in November, consisting mostly of long-term corporate bonds. As noted last month, we see strong relative value in long-term investment grade corporates at current yield levels. Major names that were added to the corporate bond portfolio were AT&T, Deutsche Telecom, Pepsico, Time Warner, United Technologies and WalMart.

<u>International Equity/Fixed Income</u>

- The equity portion of Common Pension Fund D returned -5.20% in November versus a return of -5.58% 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, the portfolio was down -39.83% versus -40.07% for the benchmark. Our portfolio of international sovereign bonds returned +1.53% for the month and +5.29% for the fiscal year-to-date period.

- We were net buyers of $92.6 million in international developed markets equities in November, consisting primarily of issues in the utility and telecommunications sectors. Major names that were purchased include E.on, GDF Suez, Telstra and United Utilities.

- We reduced our portfolio of sovereign fixed income securities in November from $980.5 million to $619.6 million. We also virtually eliminated our $500 million hedge on the Euro against the U.S. dollar during the month.

<u>Alternatives</u>

- During November we funded $150.3 million of commitments to alternative investments. Major investments include $15.2 million to our Goldman Sachs European buyout separate account, $23.0 million to PLA Residential Realty Fund III, and $10.9 million to Madison Dearborn Capital Partners.

- Our preliminary performance for the hedge fund portfolio in November is -6.00%. The major factor contributing to this number was the continued negative returns on our various credit-oriented funds, which were impacted by the unprecedented falloff in corporate bonds and bank loan markets. Please note that these funds did start to recover somewhat later in November.

Cash Management Fund

- Total assets in the Cash Management Fund were $14.3 billion as of November 30, 2008. The current yield is 1.59% for state participants (down from 2.00% as of October 31), and 1.49% for "non-State" participants.

- The percentage of the portfolio invested in US T-bills/Notes, U.S. Agencies and Canadian government securities is now 78%, which is the highest percentage in many years. This increase is driven by our credit concerns of various issuers of other types of money market instruments; we have both eliminated names eligible for purchase and reduced our credit limits on other issuers.