State of New Jersey
State Investment Council

REGULAR Meeting
Trenton War Memorial – Delaware Room
West Lafayette Street
Trenton, New Jersey 08608

Thursday, November 20, 2008
1 p.m.

MINUTES

Approved December 18, 2008

Present:

Orin Kramer, Chair
Jonathan Berg, Vice Chair
Erika Irish Brown
W. Montgomery "Monty" Cerf
Jose R. Claxton
James Clemente
Susan Ann Crotty
Mark Kandrac
James C. Kellogg
Douglas A. Love
James P. Marketti
Timothy McGuckin

Also Present:

From the Division of Investment:
William G. Clark, Director
Ray A. Joseph, Deputy Director
Gilles Michel, Assistant Director
Brian Arena, Investment Officer
Linda Brooks, Senior Portfolio Manager
Susan Burrows Farber, Secretary to the Council
Betty Carr, Portfolio Manager
Jessie Choi, Investment Analyst – *by teleconference*
James Falstrault, Investment Officer
John Giovannetti, Cashier Manager
Maneck Kotwal, Investment Officer – *by teleconference*
Jason MacDonald, Investment Analyst
Tom Montalto, Senior Investment Analyst
Christine Pastore, Investment Officer
Ainsley A. Reynolds, Accounting Manager-Alternatives
Tim Rollender, Investment Analyst
Susan Sarnowski, Compliance Officer
Amanda Truppa, Chief of Staff
Mary Vassiliou, Accounting Manager-International
Mike Wszolek, Trading Officer

From the Governor's Office, Dept of the Treasury and Attorney General's Office:
Joseph Donohue, Treasurer's representative
Tom Vincz, Director of Communications
Rubin Weiner, Esq., Deputy Attorney General

Other Invitees:
Harshal Shah, Strategic Investment Solutions (SIS)
Dan Stern, Cliffwater – *By teleconference*
Rick Tisch, Cliffwater

Members of the Public:
Frederique Adam-Jupillat, LPS
Garrett S. Bagley
Tom Baldwin, Gannett News Service
William S. Bauer, Jr.
Lateshia Belin, Taxation
Gloria Jean Berry
W. Michael Brindle, NJREA
Sharon Brooks, DOL
Linda L. Brown, DOL
Shirley Bryant, L&PS
Michael Calabrese
Gabriele Cantland, DOBI
Jose Cardona
Adam Cataldo, Bloomberg News
Shaunelle E. Clark, Revenue
Russell Coffey
Sandy Coia
Phyllis A. Coleman, Revenue
Clifford S. Cooper III, DOBI
Joseph Coppola, Jr., President Bergen County Education Assn
Barbara Counts, ELEC
Paul Curcio
Susan Deile, NJEA
Steven Dovidio, Revenue
Sharon Favice, DOBI
Marie Flynn
Diane Freeman, Treasury
Thomasine Gaines, Insurance
Steven R. Green, DOBI
Harvey Grossman
J. Grossman, Investment
Ed Hannaman
Elaine Hanson
Nancy L. Hillman
Regina M. Jackson, Taxation
Deborah Jacobs
James Jameson, NJEA

Members of the Public, con't:
Jacqueline Holmes Johnson
Lawrence Johnson
Sandy Johnson, MVC
Larisha Jones, Revenue
Jerry Jones
Harvey Kelly, Leumas Advisors
Danniele Kinsey, Pension
Patricia Latimer
George LeBlanc, Senate Democratic Aide
Miguelina Lebron, Revenue
Lisa J. Logan
Bill Maloney, DOT
Wanda McEwen
Dusty McNichol, The Star Ledger
Mary Ann Mesics, DOE
Scharkner Michaud
Anthony F. Miskowski
Barbara Montgomery
Jerald Morris, NJSM
Clayton Mull, SCREA
Arun Murandhar
Anne M. Newman
Rodney E. Nichols, Staff Representative CWA Local 1033
John C. Onorati-Pascucci
Shameko K. Palmer, Revenue
Dale Parichuk, LPS
Gary W. Ponder
Angelo Principato
Lisa Radcliffe, MVC
Seth Robinson
Rae Roeder, President CWA Local 1033
Freddie L. Richardson-Guerra
JoAnn Richmond
Eula Rivers, MVC
John Ruth
Luz D. Sanchez, LBH
D. M. Sanders, DMV
Christine M. Smith
Paul Southard, DOT
Dianne Spence-Brown, Executive Vice President CWA Local 1033
Pat Stetler
Rodney Stevens
John Strachan
Leah Thomas, BME
Michelle Townsend, Taxation
Sheila Walker
Nellie Weathers

Members of the Public, con't:
Raymond E. Weicker, DOBI
Devida Wells, Revenue
Karole Williams

I. Call to Order

Chair Kramer called the meeting to order at 1:10 p.m.

II. Notice of Meeting

Secretary Burrows Farber reported that notice of the meeting scheduled for November 20, 2008 was sent by mail deposited in the post office, by facsimile and email on November 3, 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 the Secretary of State.

III. Approval of Minutes

Minutes of the regular meeting and the executive session of the Council held on September 18, 2008 were approved unanimously on a motion by Mr. Kandrac. Ms. Irish Brown and Mr. Claxton abstained because of their absence from the meeting.

Minutes of the special meeting of the Council held October 31, 2008 were approved unanimously on a motion by Mr. Kellogg.

IV. Committee Reports

A. Audit Committee Report

Mr. Kellogg reported as Chair of the Audit Committee that the Division had engaged a new external auditor, Ernst & Young, after public bidding and that all parties were engaged in completing the audit for fiscal year 2007. Director Clark noted that a protest by the former auditor over the selection of Ernst & Young had required a review by the Division of Purchase and Property, and so extended the process by several weeks.

V. Welcome New Members

Chair Kramer welcomed two new members to the Council:

James P. Marketti, president-CWA Local 1032, appointed by the Governor from candidates submitted by the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO); and

Timothy McGuckin, director of business- New Jersey Education Association (NJEA), appointed by the Governor from candidates submitted by the NJEA.

Mr. Marketti noted that he held the title of President Emeritus for CWA Local 1032 as of October 31, having retired from the position on that day.

VI. New Business

A. For Action by the Council

1. Memorandum from Director Clark to the Council, dated November 6, 2008, entitled, "Adopted Amendments to N.J.A.C. 17:16-12, 13, 16, 19, 41, 44, 46, 58, 63 and 69; Adopted Repeal of N.J.A.C. 17:16-14 and 15: Adopted New Rules N.J.A.C. 17:16-23, 24 and 40."

Compliance Officer Sarnowski noted that the Division had received no comments on the proposed amendments, repeals and new rules during a 60-day comment period ending October 17, 2008. She said the new regulations: would permit bank loans to be carried in the Fixed Income and Alternatives portfolios, improving the classification and tracking of these investments; would permit non-convertible stock to be carried and tracked in the Fixed Income Portfolio with investments of similar characteristics; and would allow the Division to conduct credit-default swap hedging transactions in cases where the Division held the underlying securities.

A motion by Mr. Cerf to adopt the amendments was seconded by Mr. Claxton and passed unanimously by roll call vote, with Mr. Marketti abstaining. The new regulations will take effect with their publication on December 15, 2008.

2. Memorandum from Investment Officer Brian Arena to the Council dated October 29, 2008, entitled, "Review of the 2008 Report on Northern Ireland."

Investment Officer Arena noted this annual report satisfied a long-standing legislative requirement with no effect on current investment decisions. The report was approved unanimously on a motion by Mr. Kellogg.

B. Proposed Alternative Investments

1. Memorandum from Director Clark to the Council, dated November 14, 2008, entitled "Proposed Private Equity Investments in the Onex Partners III fund and the Charterhouse Capital Partners IX fund."

Director Clark noted a proposed $100 million commitment to the Onex fund represented a follow-on investment in a new fund established by the same general partner, while the proposed $50 million commitment to Charterhouse represented investment in a new direct relationship. Mr. Shah of SIS said the Onex Fund focused on acquiring and building high-quality businesses through active ownership in well-managed, cash flow-positive companies. He said the Charterhouse Fund focused on management buyouts, corporate restructurings and similar transactions in Western Europe, where the firm has operated for more than 30 years. There was a brief discussion in response to Council questions on the size of the Onex Fund relative to its earlier funds, and capital raised to date for the Charterhouse Fund.

2. Memorandum from Director Clark to the Council, dated November 14, 2008, entitled "Report on Additional Hedge Fund Investments in the Canyon Special Opportunities fund and the GoldenTree Credit Opportunities fund."

Director Clark reported that the Division had made two hedge fund investments in October, consistent with its authority to invest amounts up to $50 million without prior presentation to the Council as market conditions required. One investment of $49.5 million was made to the Canyon Special Opportunities fund; the other $49.5 million investment was made to the GoldenTree Credit Opportunities Fund. Both followed investments of $100 million in each fund approved by the Council in September 2007. Because of dislocations in the credit markets, the additional capital was sought by both funds to avoid the forced selling of the investments at distressed prices.

Mr. Tisch of Cliffwater said the additional GoldenTree investment freed the Division from management fees on both the prior and new investment, and from incentive charges on the entire investment unless and until the fund achieves a cumulative return of 30 percent. He said the Canyon Special Opportunities investment carried no management fee or performance fees and was structured as preferred equity, providing the Division with priority status for redemptions.

Mr. Marketti said he was opposed to all four alternative investments. In response to questions from the Council, Mr. Tisch said GoldenTree had raised $200 million without the participation of all original investors, and that those non-participating investors did not benefit from the change in fee structure.

C. For the Information of the Council

1. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated November 14, 2008, entitled "Investment News Clips for November 2008 Council Meeting."

This memo was received with no comment.

2. Council Meeting Calendar for 2008-09

Vice Chair Berg, assuming the role of chair in a brief absence by Chair Kramer, noted that the calendar was also available on the Division's website.

VII. Communications

There was no report from the State Treasurer.

VIII. Pending Matters.

There were no pending matters.

IX. Reports of Director Clark

A. Memorandum from Director Clark to the Council, dated November 14, 2008, entitled "Investment Reports."

Director Clark said his report would be briefer than normal because of the detail to be provided at the Annual Meeting that followed.

He said the recent market was unlike any history had ever seen. He said the pension fund was down 12.72 percent for the month of October, slightly ahead of its market benchmark of -13.71. Total fund assets were $61.9 billion.

Director Clark said the Division did not suffer from the cash shortage problems widely reported for other public funds, but rather entered the fiscal year with a strong 7 percent of fund assets in cash. This positioned the Division to take advantage of low-risk opportunities presented by the market turmoil, he said, including the aggressive purchase of corporate bonds with yields in the 9 to 10 percent range. He noted that in some cases the Division was selling stocks in order to buy bonds in the same blue chip company because the yields were more attractive on a risk-adjusted basis. Major names added to the bond portfolio included AT&T, Bristol Myers, Coca Cola and Procter & Gamble.

He said the Division also was shifting its equity exposure to increase investment in "defensive" sectors, such as health care, utilities and telecom, and to decrease exposure in cyclical sectors, such as technology. He said in the International Portfolio, the Division was investing heavily in all the defensive sectors, where yields were reaching high single digits.

Investment Officer Arena said the Domestic Portfolio had slightly outperformed the Standard & Poor's 1500 index used as its benchmark for October and also in the previous four months, largely because of the portfolio's continued underweight position in financials.

Assistant Director Michel said the International Portfolio was down 21.5 percent and its performance had largely been in line with its index for the fiscal year. He said the portfolio had hedged a portion of its foreign currency exposure.

Mr. Cerf asked about both portfolios' weighting of consumer and auto investments. Mr. Arena said there was no auto exposure in the domestic portfolio, and a mixed consumer investment that underweighted retail. Mr. Michel said International Portfolio carried only one auto name and carried half the benchmark weight in consumer-oriented investments.

Chair Kramer said two strengths behind the Fund's performance were its underweight position in international equities and its underweight position in financials.

He said that as a matter of course the Division and Council did not release pension fund results between Council meetings, but as market conditions had continued to deteriorate in November he had done a "back of the envelope" calculation to estimate fund assets to date. These rough calculations estimated that the Fund held an estimated value of $57.8 billion as on November 19, based on assumptions that the domestic and international equity portfolios had continued to track market indices and assuming no changes in the value of hedge funds or private equity investments for simplicity's sake. Actual valuations for the Fund's assets in November will be released at the December Council meeting.

Chair Kramer said investors will continue to see the kinds of market dislocations not seen in many decades, including a bounce in the percentage of assets held in Private Equity and Hedge Fund investments as other types of investments declined in value. He proposed that the Division have the latitude to explore opportunities without feeling artificially constrained by the 5 percent target for investments in the alternatives classes.

Mr. Cerf agreed, noting the unprecedented volatility of the asset pool meant "Five could be three or seven percent in a matter of weeks with no change in the portfolio." He said it would be dangerous not to contemplate some flexibility.

In response to a question from Mr. Kellogg, Chair Kramer said he was not proposing any change in the regulations, but raising the question of whether the Division should be encouraged to look for lower-risk, higher-return opportunities without feeling constrained by the pre-set limitations.

Dr. Love emphasized the numbers represented targets, not caps. Ms. Crotty said the Division could incur undesirable costs in trying to manage to such targets in the current market environment. She suggested in hindsight the Council should have provided ranges in lieu of targets. Dr. Love agreed, noting, "The opportunity cost of not taking opportunities has to be considered."

Chair Kramer said the Division's high cash position and strong overall liquidity levels had drawn the attention of other funds, some of which had asked the Division to take on some of their investments in order to improve their own liquidity position. He said the Division needs the flexibility to explore such opportunities.

Mr. Marketti noted that in some cases the Division was already over its alternative targets. Chair Kramer said this supported the point that the Division needed more flexibility under current conditions. Mr. Marketti said that he was opposed to any further extension of alternative investments without "convincing evidence that they add value to the portfolio." Chair Kramer noted a history of alternative investments holding their value better than the equities sold to fund alternatives even during the past year, the worst year ever for hedge funds. Mr. Marketti argued that the Division could have held the same monies in cash and lost nothing. This was disputed by several Council members, who estimated the Fund could have lost an additional 14 percent had alternative investments been held in cash instead. Chair Kramer summarized the discussion by noting the majority of Council members wanted to give the Division flexibility in exploring ways to reduce risk to the Fund.

Director Clark said he wanted to provide an update on the Division's involvement with Lehman. Ms. Irish Brown and Mr. Cerf recused themselves and left the room for the duration of this report.

Director Clark said the Division was exploring the possibility of litigation against Lehman and other related entities with the Attorney General's office. He said that the Division was also engaged in discussions with Wachovia over Lehman debentures invested in that bank as a security-lending agent for the Division. Security lending agents lend securities designated by an investor such as the Division, and share the profits generated from the program. Director Clark said Wachovia had held Lehman debentures for the Division; these debentures continue to have value, unlike Lehman equities, but their ultimate liquidation would incur some costs. He said the Division was negotiating with Wachovia to seek to resolve the issue.

X. Brief Recess

The meeting was recessed by unanimous vote at 2 p.m. for a 15-minute break before the convening of the Annual Meeting.

Respectfully submitted,

Susan Burrows Farber
Secretary to the Council

State of New Jersey
State Investment Council

SPECIAL MEETING at
State Pension Boards Meeting Room
50 West State Street, First Floor
Trenton, New Jersey 08625

Friday, October 31, 2008
9:30 a.m.

MINUTES