

New Jersey State Investment Council

June 23, 2014 Regular Meeting

Minutes of the Regular Meeting

Held June 23, 2014 at the NJ State Museum Auditorium; 205 W State Street, Trenton, New Jersey.

Council Members in Attendance:

Robert Grady, Chair
Brendan T. Byrne, Jr., Vice Chair
Marty Barrett
Michael Cleary
Charles Dolan (via conference call)
Michael Greaney
Guy Haselmann
James Joyner
Adam Liebtag
Peter Mauer
Timothy McGuckin
Jeffrey Oram
Mitchell Shivers (via conference call)

Mr. James Hanson was unable to attend.

Roll Call and Meeting Notice

The Regular Meeting was called to order by Robert Grady, Council Chair, at 10:37 AM. Ernestine Jones-Booker, Council Secretary, performed roll call and reported that a quorum of the SIC was present. Ms. Jones-Booker reported that notice of the Regular Meeting, scheduled for June 23, 2014, was posted on the Division's website, faxed to the Times of Trenton, the Star-Ledger, the Bergen Record, and the Courier Post, and e-mailed to the Secretary of State on June 02, 2014. A copy of the notice was posted at the Division and is on file.

Minutes for Regular Meeting held May 28, 2014

Chair Grady stated that draft minutes for the regular meeting held on May 28, 2014 will be circulated to Council members in advance of the next State Investment Council Meeting.

Chair Grady noted that the performance of the fund as of May 31 was up 14.28% FYTD, with a 2 Year annualized performance of 14.34% and a 4 Year of 11.4% stating the funds strong performance.

Mr. Liebtag joined the meeting at this point.

Presentation by James Donald and Thomas Franzese of Lazard Asset Management LLC

Director McDonough introduced guest speakers James Donald and Thomas Franzese of Lazard Asset Management. James Donald presented an overview of both emerging and frontier markets, discussing the reasons for recent underperformance by developing markets and the current relative value of such markets. Mr. Grady noted that the presentation made a case for why the Division has an allocation to emerging markets and suggested that the portfolio may be underexposed to such markets. Mr. Grady commented on Mr. Donald's discussion of increased leverage in

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China, asking whether the increased leverage is allocable to state owned enterprises, and whether China would be able to grow into the leverage. Mr. Donald responded that the increased leverage was a “mixed bag,” and noted that certain state owned enterprises were motivated by profit while others were not. He predicted that China would continue to grow, but more slowly than it historically has. Mr. Grady asked Mr. Donald to explain the makeup of the emerging market and frontier market indices, and asked Mr. Donald to forward the current country makeup and weightings in the emerging and frontier indices to Mr. McDonough to distribute to the Council. Mr. Grady asked Mr. McDonough about the Division’s exposure to frontier markets, and Mr. McDonough responded that the portfolio had minimal exposure to frontier markets due to liquidity concerns. Mr. Byrne asked Mr. Donald to identify specific risks in the emerging market context, and Mr. Donald responded that many are concerned about the risk of an uncontrolled financial crisis in China. Mr. Oram asked Mr. Donald about potential methodologies to rate the geopolitical risk of countries. Mr. Donald responded that investors need to review each company individually, and discount for macroeconomic, political, portfolio, and especially government risk. Mr. Grady asked about the potential impacts of increased oil production and multilateral trade agreements on emerging markets. Mr. Donald responded that both would have a positive effect in general, although lower oil prices could adversely affect certain countries such as Russia and Saudi Arabia.

Director’s Report/Update

Director Chris McDonough reviewed the Director’s Report, discussing economic conditions, including employment numbers, home prices, actions by the European Central Bank, and the effect of the Iraqi crisis on oil prices. Acting Deputy Director Michael Wszolek provided a market update discussing global GDP, including the World Bank’s 2014 forecast. Mr. McDonough discussed the declining trend in market volatility and its impact on the Pension Fund. Mr. Haselmann discussed VaR (value at risk) commenting on balancing volatility with risk and noted that low volatility is not an indication to take on more risk. Mr. McDonough also provided an update on the performance of the portfolio as a whole and specific asset classes year to date, noting the Fund’s performance of 14.28% for the fiscal year to date, and that the Fund’s return was ahead of the benchmark FYTD for the year and over the past 3, 4, 5, and 10 years. Mr. McDonough also reported there were no significant changes in asset allocation in the portfolio since the last Council meeting. Michael Wszolek provided an update on purchases and sales in the equity, fixed income, and alternatives portfolios. Mr. McDonough updated the Council on the status of the Division’s requests for proposals for investment advisers. Finally, Mr. McDonough notified the SIC that lead private equity consultant Pete Keliuotis, CEO of Strategic Investment Solutions, Inc. (SIS), would be leaving SIS at the end of June. Mr. Grady expressed the Council’s gratitude to Mr. Keliuotis for seven years of outstanding service to the State and the Division. Mr. Grady welcomed Mr. Faraz Shooshani who will replace Mr. Keliuotis as lead consultant for the Division.

Opportunistic Investment

Dyal NJ Investors, L.P.

Maneck Kotwal of the Division along with Mark Johnson of Cliffwater presented an additional \$250 million investment in Dyal NJ Investors, L.P., a fund that purchases minority stakes in established hedge fund managers. The Division previously committed \$200 million to the fund in August 2012. The additional \$250 million would allow the fund to invest in Dyal Capital Partners II, L.P., as well as co-investment opportunities. Mr. Johnson noted that this was an opportunistic investment that had characteristics of both hedge funds and private equity. Mr. Kotwal noted the fund’s attractive fee structure and investment terms. Chair Grady reported that the Investment Policy Committee discussed the investment and was satisfied that the due diligence that was performed was adequate and appropriate.

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Asset Allocation Discussion

Director McDonough provided an overview of global market conditions, and presented an Investment Plan with target allocations and ranges for FY15. Kristen Doyle of Hewitt EnnisKnupp (HEK) provided a peer comparison based on a universe of HEK's 11 largest public pension plan clients, indicating that New Jersey is more conservatively positioned than its peers with regard to public equities and its allocation to alternatives was in line with its peers.

Mr. Grady and Mr. Haselmann commented on de-risking the portfolio and making the plan more conservative and better structured to absorb economic and geopolitical risks. Mr. Grady noted an alternative proposal in the Investment Plan to more dramatically reduce risk. Mr. Byrne asked what would happen to total Fund returns on a one year basis, if a lower return is assumed for the cash allocation. Ms. Doyle and Mr. McDonough responded that it would decrease the overall projected return by 20 to 30 basis points. In response to a question from Mr. Grady, Mr. McDonough explained the types of investments that are included in the global diversified credit allocation.

Mr. Liebttag asked whether there was an asset allocation that would meet the assumed 7.9 actuarial rate of return, and, if not, how the Division reconciled this tension. Mr. Grady and Mr. McDonough said that any allocation specifically designed to meet the assumed rate of return would involve a significant increase in public equity holdings, which would be imprudent. Ms. Doyle noted that the rate of return projected by HEK is based on a shorter time horizon than the actuarial rate of return, and also does not factor in active management by the Division. In response to a question from Mr. Byrne, Ms. Doyle explained that weighted average returns were lower than the total Fund projected returns because the latter number factored in correlation between asset classes. In response to a question from Mr. Grady, Ms. Sarnowski stated that the asset allocation plan could be amended as often as the Council desired.

Mr. Cleary asked whether the Pension Fund is on track to be fully funded over the long term based on pension reforms, State contributions and projected investment returns. Mr. Grady responded that at one point there was an expectation that the Pension Fund would be over 90 percent funded in 30 years, but there have been changes in both expected contributions and expected investment returns since then. Mr. Barrett stated his objection to the lack of contributions by the State and local employers. Mr. Dolan asked why the US equity allocation is proposed to increase, given the state of the market. Mr. McDonough responded that the allocation reflected a repositioning from developed non-US Equity to US equity.

Mr. Grady motioned that Council adopt the FY15 proposed target allocation, with Mr. Haselmann seconding the motion. All Council members present voted in favor. Mr. Grady motioned that Council adopt the benchmark for FY15, with Mr. Joyner seconding the motion. All Council members present voted in favor.

Treasurer's Report

Dr. Steindel of the Treasurer's office provided an update on current US and NJ economic conditions. Mr. Barrett inquired about the status of the Treasurer's Office's internal audit report regarding Charles Baker's role with General Catalyst Partners VI, L.P. Mr. McDonough reported that the review was still in progress.

Public Comment

No members of the public registered to speak.

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Adjournment

Chair Grady motioned to adjourn the meeting, with Mr. Oram seconding the motion. All Council members present voted in favor. The meeting was adjourned at 1:19 pm.