

# New Jersey State Investment Council

## May 25, 2016 Regular Meeting

---

### **Minutes of the Regular Meeting**

Held May 25, 2016 at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton, New Jersey.

### **Council Members in Attendance:**

Brendan T. Byrne, Jr., Chair  
Adam Liebttag, Vice Chair  
Marty Barrett  
Thomas Bruno Jr.  
Michael Cleary  
Charles Dolan  
Michael Greaney  
James Hanson  
Guy Haselmann  
James Joyner  
Timothy McGuckin  
Jeffrey Oram  
Eric Richard  
Mitchell Shivers (via telephone)

### **Opening Remarks by Chair**

The Regular Meeting was called to order by Brendan T. Byrne, Jr., Council Chair, at 10:00 a.m. Mr. Byrne welcomed Eric Richard to the New Jersey State Investment Council (Council). Chair Byrne made some brief opening remarks, discussing the process of adopting an asset allocation plan and noting disagreement among Investment Policy Committee (IPC) members regarding the proposed allocation to hedge funds. He welcomed a full discussion regarding asset allocation later in the meeting.

### **Roll Call and Meeting Notice**

Ernestine Jones-Booker, Council Secretary, performed roll call and reported that a quorum of the Council was present. Ms. Jones-Booker reported that notice of the Regular Meeting, scheduled for May 25, 2016, was posted on the website of the Division of Investment (Division); faxed to the Times of Trenton, the Bergen Record, and the Courier Post; and e-mailed to the Secretary of State on April 15, 2016. A copy of the notice was posted at the Division and is on file.

### **Minutes of the Regular Meeting held March 23, 2016**

Mr. Byrne presented for adoption the minutes for the regular meeting held March 23, 2016. James Joyner made a motion to approve the minutes, with Thomas Bruno Jr. seconding the motion. All Council Members present voted in favor, except for Timothy McGuckin (who was absent from the March 23 meeting) and Mr. Richard, who abstained.

### **Resolution for James Kellogg**

Mr. Byrne presented the attached resolution recognizing the contributions of recently deceased former council member James Kellogg. The resolution was moved by Mr. Byrne, seconded by Jeffrey Oram, and unanimously approved by the Council.

# **New Jersey State Investment Council**

## **May 25, 2016 Regular Meeting**

---

### **Director's Report/Updates**

Director Christopher McDonough presented the Director's Report, reviewing capital markets, pension fund performance and current asset allocation. Guy Haselmann expressed concern regarding the sustainability of equity and fixed income prices, given historically high equity valuations and muted global economic growth. Mr. Byrne noted the heightened spread between performance in the domestic and international equity markets, as well as the abnormality of the U.S. stock market environment, with a relative few number of stocks contributing to the index's positive returns. Adam Liebttag inquired whether the benchmarks for certain asset classes should be revised, especially given the historical variance between the benchmarks and actual performance. Mr. McDonough described the process for selecting benchmarks and welcomed further discussion of the issue.

Pursuant to the Council's Alternative Investment Modification Procedures, Mr. McDonough notified the Council that the Division was no longer pursuing an investment in Advent International Global Private Equity VIII, L.P. and also notified the Council of a change in the investment manager for Regiment Capital Ltd. Pursuant to the Council's Alternative Investment Sale Procedures, Mr. McDonough notified the Council of a transfer of purchaser interests between NorthStar and Goldman Sachs entities which had the result of shifting responsibility for the approximately \$300 million remaining to be paid in connection with the Division's 2014 sale of various funds in its real estate portfolio.

Finally, Mr. McDonough provided an update on various hedge fund portfolio Initiatives undertaken by the Division over the past year. In response to Charles Dolan's inquiry as to whether the hedge fund initiatives were unduly limiting the Division's investment opportunities, Mr. McDonough replied that the Division has been able to identify certain high quality managers and strategies that meet the Division's objectives. Mr. Haselmann explained the difference between management fees and incentive fees, and Mr. Liebttag noted that, with respect to the management fee, hedge funds would need to outperform other asset classes by the amount of the fee in order to provide the same net returns. Mr. Byrne cautioned that the Division should focus on net risk-adjusted returns rather than absolute net returns.

### **Fiscal Year 2017 Annual Investment Plan Discussion**

Mr. McDonough summarized the process for developing the annual investment plan, noting that certain members of the IPC had requested that the Division perform analysis of additional asset mixes that would reduce hedge fund exposure to four percent. Deputy Director Corey Amon provided an update on return expectations for various asset classes. Mr. McDonough discussed the importance of diversification, presenting a projected cash flow analysis for the Pension Fund. In response to a question from Mr. Liebttag regarding the source of employer contribution data used in the cash flow analysis, Mr. McDonough responded that contribution numbers were obtained from the Division of Pensions and Benefits. In response to a question from James Hanson regarding the recent correlation between hedge fund returns and the S&P 500, Mr. McDonough responded that the extended bull market has made it difficult for hedge fund managers to distinguish returns during this period.

Mr. Liebttag made a motion to reduce the total target allocation in the FY17 annual investment plan for all hedge funds to a maximum of 4% in the aggregate, with the amount reduced from hedge funds to be re-allocated to non-alternative asset classes; to set the long term target range for all hedge funds in the aggregate at 0% to 4%; and to charge the Division and its consultants to present to the Council in June an annual investment plan that adheres to these maximum allocations. Mr. McGuckin seconded the motion.

## **New Jersey State Investment Council May 25, 2016 Regular Meeting**

---

Mr. Byrne questioned if the Council members proposing an aggregate cap on hedge funds had concerns with particular subclasses of hedge funds, and whether they were willing to accept increased risk and lower returns in order to attain the four percent target. He also stated his preference to table the motion in order to give Division staff a chance to develop a plan without tying its hands. Charles Dolan asked how the 4% target amount was calculated and expressed a concern that reducing the allocation to hedge funds would limit the ability of the Division to protect the fund against downside risk. Mr. Haselmann stated that adopting a cap on hedge funds leaves unanswered the critical question of where the additional dollars would be allocated, and that he could not support the motion without seeing how the entire portfolio would look. He repeated his recommendation against reallocating any additional funds to stocks and bonds. Mr. Oram also inquired how the 4% target amount was calculated, and questioned why the motion precluded reallocation to the fund's two best performing asset classes of private equity and real estate. He further stated he could not support the motion without a financial impact analysis. Mr. Hanson acknowledged that investments in hedge funds were an appropriate subject of review and discussion, but questioned the benefit of adopting a cap and limiting alternative allocations without letting the established process play out. Mitchell Shivers opined that hedge funds continue to serve an important purpose as a means of diversification, despite their recent underperformance.

Mr. Richard spoke in favor of the motion, citing various published reports concluding that hedge fund performance did not justify the fees charged and giving examples of other public funds reducing their exposure to hedge funds. He stated that the fund's allocation to alternative investments was greater than that of other states. Mr. Bruno agreed with Mr. Richard, noting that many PERS members have asked for a zero percent allocation to hedge funds, in large part due to the fees being paid to hedge fund managers. Mr. Joyner concurred with the other union representatives, and Marty Barrett also spoke in favor of the motion, stating that he was looking forward to reviewing the analysis to be performed by the Division and its consultants using the new numbers. Mr. Liebttag explained that the purpose of his motion was to send a clear message and direction to change the course of investment with a substantial reduction in the allocation to hedge funds. He noted that the proposed 4% target was consistent with the average allocation for public pension funds as reported by industry surveys, and the lower target would encourage the Division to focus its hedge fund investments on the highest performing funds. He stated that hedge funds were inferior investments due to high fees and poor performance, and encouraged the Division to manage more investments in house.

Mr. McDonough disputed the assertion that public funds as a whole were moving away from hedge funds and objected to recent editorials claiming that alternative investments did not add value to the portfolio. Kristen Doyle of Aon Hewitt presented survey data comparing the pension fund's alternative investment allocation to that of other public pension funds. Deputy Attorney General Pamela Morone reminded the Council that its actions needed to be consistent with the fiduciary duties of the Council and the Director.

Mr. Byrne asked Mr. Liebttag if he would be willing to table his motion in order to provide Division staff with an opportunity to perform a proper analysis. Mr. Liebttag declined, responding that the motion does not call for adoption of an annual investment plan but instead was intended to direct Division staff and its consultants to create a FY17 annual investment plan that adheres to the proposed maximum allocation to hedge funds. He asserted that the motion was consistent with the Division's and the Council's fiduciary responsibilities and did not preclude the Division from presenting the Council with all of its best ideas.

# New Jersey State Investment Council

## May 25, 2016 Regular Meeting

---

Ms. Jones-Booker called for a roll call vote on the motion, with Council members Barrett, Bruno, Cleary, Joyner, Liebttag, McGuckin and Richard, voting in favor of the motion, and Council members Byrne, Dolan, Greaney, Hanson, Haselmann, Oram and Shivers voting against the motion. The motion failed as a tie vote.

### **Private Real Estate Overview Presentation by RV Kuhns**

Dan Krivinskas and Joseph Jehl of RV Kuhns discussed the role of private real estate in the pension fund's portfolio, provided a snapshot of the fund's current real estate investments, and summarized portfolio performance. In response to a question from Mr. Bruno, Mr. Krivinskas explained the fees associated with certain types of real estate investments.

### **Real Estate Investments**

#### ***Focus Healthcare Partners Fund I***

Kevin Higgins of the Division and Mr. Jehl presented an investment of \$100 million in Focus Healthcare Partners Fund I, a fund focused on senior housing. Mr. Higgins discussed the reputation and experience of the fund's manager, its national platform, its performance track record, alignment of interest, and material terms of the investment. In response to Mr. Liebttag's question whether the property would house residents receiving government assistance, Mr. Higgins replied that the fund's properties were primarily private pay. In response to Mr. Liebttag's inquiry whether any of the fund's properties were within New Jersey, Mr. Higgins responded that there were no New Jersey properties currently in the fund's portfolio or in its pipeline. Chair Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

### **Private Equity Investments**

#### ***SONJ Private Opportunities II, L.P. Fund***

Robin Clifford of the Division and Michelle Davidson of TorreyCove Capital Partners presented an additional investment of \$500 million in SONJ Private Opportunities II, L.P., a private equity separate account managed by Black Rock Private Equity Partners. Ms. Clifford described the fund's strong track record, attractive terms, and ability to leverage resources and gain venture capital exposure. Michael Cleary inquired about the difference in IRR between Fund I and II, to which Ms. Davidson and Jason MacDonald of the Division responded that the prior fund's vintage year was during the difficult investment environment of 2006-08. Mr. Dolan asked how the Division's aggregate investment in BlackRock compares to its investment with other fund managers. Mr. MacDonald responded that the size of the investment is misleading, because the Division has the ability to veto investments. Mr. McDonough indicated that the investment with BlackRock would be the Division's third largest. Chair Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

### **Report of Soft Dollar Expenditures/Brokerage Commission**

Susan Sarnowski reported on the Division's soft dollar arrangements, which are arrangements governed by Section 28(e) of the Securities and Exchange Act of 1934 under which brokers allocate a percentage of commissions paid by the Division to pay for research and trading services on behalf of the Division. Ms. Sarnowski reported that expenditures were expected to decrease from FY15 to FY16.

### **Treasurer's Report**

Dr. Roger Cohen of the State Treasurer's office reported on the State's labor and housing markets and revenue estimates. In response to a question from Mr. Barrett regarding the status of State contributions to the pension fund, Dr. Cohen responded that revised revenue forecasts were not expected to affect the State's planned contribution.

## New Jersey State Investment Council May 25, 2016 Regular Meeting

---

### **Public Comment**

Mr. James Kane of UNITE HERE commented on management practices at certain casinos in Las Vegas and Atlantic City owned by private equity funds, including certain TPG entities. Palms Casino employee Tina Rodriguez and Bally's Casino employee James Morgan also spoke.

### **Adjournment**

In response to a request by Mr. Liebttag, Mr. Byrne said he would work with Division staff to check logistics for a special meeting in June. Mr. Byrne made a motion to adjourn the meeting, with Mr. Haselmann seconding the motion. All Council Members present voted in favor. The meeting was adjourned at 1:42 p.m.