

***State of New Jersey***  
***State Investment Council***

**Meeting at**  
**Rutgers Student Center – NEW BRUNSWICK**  
**126 College Avenue – Multi-Purpose Room B**  
**New Brunswick, New Jersey 08901-1166**

**Thursday, February 19, 2009**  
**1 p.m. Council Meeting**

***MINUTES***

*Approved March 19, 2009*

***Present:***      Orin Kramer, Chair  
                  Jonathan Berg, Vice Chair  
                  W. Montgomery “Monty” Cerf  
                  Jose R. Claxton  
                  Susan Crotty  
                  Mark Kandrac  
                  James C. Kellogg  
                  Karl Kleeberg  
                  Erika Irish Brown  
                  Douglas A. Love  
                  James P. Marketti  
                  Timothy McGuckin

***Absent:***      James Clemente

***Also***  
***Present:***      *From the Division of Investment:*

William G. Clark, Director  
Ray A. Joseph, Deputy Director  
Gilles Michel, Assistant Director  
Kaitlyn J. Adams, Legal Specialist  
Brian Arena, Investment Officer  
Jessie Choi, Investment Analyst  
James Falstrault, Investment Officer  
Susan Burrows Farber, Secretary to the Council  
Maneck Kotwal, Investment Officer  
Jason MacDonald, Investment Analyst  
Joanna Ng, Senior Investment Analyst  
Philip Pagliaro, Senior Portfolio Manager  
Christine Pastore, Investment Officer  
Timothy Patton, Senior Portfolio Manager  
Ainsley A. Reynolds, Accounting Manager-Alternatives  
Tim Rollender, Investment Analyst  
Susan Sarnowski, Compliance Officer

*From the Governor's Office, Dept of the Treasury and Attorney General's Office:*  
Tom Vincz, Director-Public Information  
Rubin Weiner, Deputy Attorney General

*Other Invitees:*

Harshal Shah, Strategic Investment Solutions (SIS)  
Scott Booth, The Townsend Group  
Kevin Lynch, The Townsend Group  
Daniel Stern, Cliffwater

*Members of the Public:*

Frederique Adam-Jupillat  
LaBella Barnes, Risk Management  
William Bauer  
Linda Brown  
Shirley Bryant  
Tom Buckley  
John Bury  
Jose Cardona  
Shaunelle E. Clark  
Sandy Coia  
Bradley Coleman, ProxyDemocracy.org  
Phyllis Coleman  
Rhoda Coleman  
Robert Coleman, NJREA  
Jeremy Cook, Bloomberg  
Clifford S. Cooper III, NJDOI  
Dennis Corny, PhD  
Barbara Counts  
Steven Dovidio, Revenue  
Steven Green  
Harvey Grossman, DOBI  
J. Grossman  
Nancy Hillman  
Regina M. Jackson  
Jacqueline Holmes Johnson, Consumer Affairs  
Lawrence Johnson  
Vincent Kaighn  
Nikk Kriss  
Patricia Latimer  
Joann K. Marshall  
Wanda McEwen  
Dusty McNichol  
Joseph Michelsohn  
Anthony F. Miskowski  
Mitchell Mercer, DSS

Marion Mnych  
Barbara Montgomery  
*Members of the Public, continued:*  
Jerald Morris  
Clayton Mull, SCREA  
Anne Marie Newman  
Doug Newsome, Babson  
Kevin Norton, Bank of NY Mellon  
Joan C. Onorati-Pascucci  
Shameko Palmer, Treasury  
Joan Phillips  
Lisa Radcliffe  
Rae Roeder, President CWA Local 1033  
Joanna Ronson  
Joann Richmond  
Michael Rubino, Treasury  
John Ruth  
Luz Sanchez  
D.M. Sanders  
Christine M. Smith  
Rodney Stevens  
John Strachan  
Paula Van Pelt  
Ray Weicker  
Marianne Wintear

**I. Call to Order**

Vice Chair Berg called the meeting to order at 1:10 p.m. at the request of Chair Kramer, who was delayed in arriving.

**II. Notice of Meeting**

Secretary Burrows Farber reported that notice of the meeting scheduled for February 19, 2009 was sent by mail deposited in the post office, by facsimile and email on February 2, 2009. 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 of the Council held on January 15, 2009 were approved on a motion by Mr. Kandrac, seconded by Mr. Kellogg. The motion was unanimous with nine votes; Chair Kramer and Mr. Clemente were not present for the vote, and Ms. Crotty and Ms. Irish Brown abstained because of their absence from the January meeting.

Chair Kramer arrived and requested that the Fixed Income presentation deferred from the January Council meeting be presented first.

**IV. Reports of Director Clark**

A. *Overview of the Fixed Income Portfolio presented by Senior Portfolio Managers Timothy Patton and Philip Pagliaro.*

Mr. Patton and Mr. Pagliaro provided an overview of the fixed income market for calendar year 2008, noting corporate spreads versus 10-year Treasury notes had widened since July 2008 to levels not seen since the 1930s. They said the dispersion of performance across the fixed income sectors during the year was unprecedented. Pension fund performance was helped by the movement toward a long-duration strategy and the high overall credit quality of the portfolio, and hurt by the fund's exposure to TIPS. (The full presentation is attached to the official record of this meeting.)

Director Clark noted that Mr. Patton and Mr. Pagliaro represent the Division's entire fixed income team managing the \$20 billion fund. He said the fact that the fund did as well as it did in 2008 was a credit to both men and their ability to "turn the battleship" several times in the past year to seize advantage of unique market opportunities.

Chair Kramer concurred with the praise, noting the Division was doing a remarkable job with limited resources. He added that the municipal bond market was not as attractive an opportunity as many investors believed because of the uncertain levels of local government solvency and default risk that would not be fully visible for another six to nine months. Mr. Patton agreed, and said the fund had already sold most of the munis purchased when the market first turned for a nice profit. Mr. Pagliaro said munis were not normally a core holding because they weren't needed for tax benefits, but the rise in yields to as high 10 percent had led the Division to invest some \$300 million as a "nice, short-term power play" that took advantage of dislocations in the market, and were now being reversed as yields dropped.

A brief discussion followed on the effects of federal mortgage foreclosure legislation introduced the previous day. Director Clark noted that the move was not positive for Freddie Mac and Fannie Mae unless one believed the federal government would put its full power behind the agencies.

Mr. Patton noted the pension fund had been among the first buyers of corporate bonds when spreads began to widen. In response to a question from Mr. Claxton, he said all purchases were investment grade.

Mr. Pagliaro said TIPs had become an ideal core holding at the moment. In response to questions about recovery of this market, he said that because the Division is not able to do extensive credit research, the fund buys higher-than-typical credit quality. Chair Kramer

predicted recovery rates will not match historic norms. Director Clark concurred, adding the “covenant-lite” phenomenon would allow weak companies to survive longer than in the past, so that losses from ultimate defaults when they came would be the worst in history.

A discussion based on questions from Ms. Irish Brown followed, regarding how the Division calibrates risk, makes investment selections and conducts research. Mr. Patton and Mr. Pagliaro said the fund is underweight banks and financials and is overweight in industrials to mitigate risk; investment selection starts by sector, currently favoring industrials, and then moves into companies within a sector using credit research, executing choices as possible. They said the fund uses a combination approach to research, relying on research from the street, some Division-generated research and some custom-ordered. In addition, they said the Division leverages the knowledge of researchers on the equity side for their opinions.

In response to a request from Ms. Irish Brown, Director Clark said he would provide returns by sector. Mr. Patton said the fund looks for highly liquid bonds, so that if investments start to get into trouble “we can get out faster than we got in.” Director Clark added that given limitations in staffing, investment decisions had to be large enough to have impact, generally \$10 million or greater.

Mr. Kandrac said it was astonishing that two people were successfully handling a fund of this size, saying this underscored that the Division could not afford to lose any staff to cuts, reductions or “even a day of furlough.” Chair Kramer said the Council had gone on record regarding human resource constraints at its last meeting, and that he’d also talked on the matter with the Governor, noting the Administration was “fully cognizant” of the limited resources available.

Dr. Love noted his longstanding belief that pension funds should extend the duration of their bond portfolios and asked about duration targets. Director Clark said the fund targeted a duration of more than 10 years. Mr. Kellogg asked whether deficit outlooks and potential currency implications affected judgments about duration. Dr. Love suggested this could be addressed by investing in more TIPs. Mr. Cerf and Dr. Love briefly discussed the merits of considering duration as a policy or tactical decision.

*B. Memorandum from Director Clark to the Council, dated February 13, 2009, entitled “Investment Reports.”*

Mr. Kellogg asked if each monthly report could include net cash outflows, so that the Division received full credit for its performance. Director Clark said the Division would seek to include this going forward, noting that the outflow in benefits averaged about \$300-\$400 million each month, more than is currently received in employer contributions. He acknowledged Joanna Ng in the audience, who recently joined the Division to manage performance measurement and reporting.

Director Clark said January was not a good month for investors or the pension fund: the fund was down \$5.3 billion. He said the equities markets were down 8.24 percent, while the fund’s equity portfolio was down 6 percent. He noted bonds and international markets were also down, and the only portfolio gaining value in January was hedge funds, up 3.8 percent.

Investment Officer Arena said equity performance had been helped in the month relative to the index by the purchase of corporate bonds and the continued underweighting of financials. Responding to a question from Ms. Irish Brown, Mr. Arena said the portfolio had never been a big user of IPOs.

Assistant Director Michel said the international markets had also struggled in January, and the fund had now sold most of its financial positions.

Director Clark said the fixed income portfolio was down 5.2 percent for the month, due mostly to an increase in interest rate levels in the market. He said that corporate bond spreads continued to tighten in January, and that high-yield investments also did extremely well in January.

Director Clark said final numbers showed the pension fund had ended the calendar year down by 21.5 percent, compared with -24.9 percent for the average pension fund performance as tracked by Wilshire Associates, and -28.6 and -29.7 percent for the two public pension funds in neighboring Pennsylvania. He noted that New Jersey was one of only three public funds reporting yearend performance and market values, as reported at the January meeting, and said he believed it would become evident that New Jersey's performance would be strong relative to other funds.

Director Clark noted several improvements to Exhibit 2 of the monthly report, "Preliminary Report on Performance," including a detailed breakout for high-yield and TIPs performance. He said the Division would continue to keep working on the format for increased transparency. He reminded the Council that all numbers in the report are "flash" numbers as reported by various systems, reconciled for monthly reporting and subject to change when more accurate numbers become available. Hedge funds numbers in particular were aggregate estimates, he said, because of lags in industry reporting norms. He noted that in general the Division's assumptions were conservative so that changes when made were generally positive.

He noted that Exhibit 25 on the Alternatives Portfolio now included annualized numbers so that results could now be examined fund by fund. In response to a question from Mr. Marketti, he said the Division would try to break out returns by asset class. He thanked Joanna Ng and Maneck Kotwal for their work on the overall improvements in reporting.

A brief discussion of hedge fund performance followed. Chair Kramer cautioned against comparing performance month to month. He agreed that hedge fund results for the past year were not good, down 23 percent, but compared that to equity performance which was down 36 percent in the same period. Chair Kramer was also critical of the prevalence of gates in the hedge fund industry, saying they were evidence of an asset-liability mismatch. He said that to impose them after the fact of investment, without a reduction of fees, was a breach of fair conduct. Director Clark noted the Division had gone hard after funds that had done this for justification.

Chair Kramer pointed out there were still no fourth quarter numbers for real estate and private equity investments, predicted again that there would be substantial markdowns when that

reporting happened, and he estimated that large buyout firms may be down 25 percent or more for the quarter. Chair Kramer repeated his view that valuations for many investments in the private equity and real estate space were carried at valuations that appeared excessive.

**V. Committee Reports**

Mr. Kellogg, chair of the Audit Committee, reported that the Committee hoped to review a draft audit next month, noting the schedule had been delayed by the changeover to a new auditor.

**VI. New Business**

**A. Alternative Investments**

1. Memorandum from Director Clark to the Council dated February 13, 2009, entitled “Redemption from GoldenTree Master Fund, L.P. and Satellite Fund II”

Mr. Stern of Cliffwater was invited by Director Clark to provide an update on the redemption from the Satellite Fund as discussed at the January meeting of the Council, and a proposed hedge fund redemption from the GoldenTree Master Fund.

Mr. Stern said the Satellite Fund was mostly liquidated. In response to a question, he said the fund did not offer in-kind distribution of securities because these were in the form of bank loans that could not be split easily between investors.

He said that the GoldenTree Fund had decided unilaterally to change three key provisions in their legal documents that reduced liquidity rights for their investors, and advised their investors that those who did not accept the terms would be cashed out of the fund. The Division called the bluff by expressing a desire to redeem, he said, and after multiple negotiations managed by Cliffwater, the fund is now monetizing state investments in an orderly manner. Director Clark said the Division’s response had sent a clear message to GoldenTree and the hedge fund community that the Division won’t tolerate heavy-handed tactics from private funds or public companies. In response to a question from Mr. Claxton, he said the Division would revisit continuing its investment in the bank loan fund also managed by GoldenTree.

Director Clark offered a kudo for good behavior to the management of another hedge fund, Ironbound, which had waived the performance bonus it was entitled to take for 2008 in light of weak market returns. He also praised Credit Suisse for agreeing to a significant reduction in fees for their fund of funds, until the market improves.

Director Clark said the Division had devoted a lot of time to examining the structure of the hedge funds in which it wished to invest, and would seek to present its approach formally to the Council next month. He added the Division is also exploring changes in its current policy which would permit more negotiating room and improve transparency.

*B. For the Information of the Council*

1. Verbal report by Director Clark on Division efforts to address the August 2008 Appellate Court decision on external managers.

Director Clark said the Division had requested another 30-day stay so that the state could continue to restructure its current arrangements with its external managers. He said one external manager had already balked, saying the new terms would be too onerous. Director Clark said the largest burden of the changes would fall on Division staff to oversee the new advisory arrangements. Ms. Crotty noted historic proof that such arrangements would have a detrimental impact on performance that should be noted, and that judging the performance of external advisors would become much harder by the blurring of lines between advisor and staff roles.

2. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated February 13, 2009, entitled "2008 Corporate Governance Report and Update."

Ms. Burrows Farber noted the report of activity as provided to the Council, and introduced Kaitlyn Adams who would partner in corporate governance activities this year. Director Clark said the Division had already reached out to labor groups and other institutional investors on shareholder issues in an effort to become more active, particularly in cases of management misbehavior and excessive compensation.

Chair Kramer said credit for the Division's outperformance relative to market benchmarks was due to the Division team and the pension fund's underweight position in financials. He said the public outrage at financial institution misbehavior and greed was deserved, and that the Division would add its voice in support of reforms in the coming proxy season.

3. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated February 13, 2009, entitled "Investment News Clips for February 2009 Council Meeting."

Memo was noted without discussion.

4. Updated State Investment Council Meeting Calendar for 2009, changing the time of the March 19, June 18, September 17 and December 17 meetings to 3 p.m.

Memo was noted without discussion.

Mr. Kandrac offered copies of a February 10, 2009 letter to the Governor from the Board of Trustees of the Police and Firemen's Retirement System, expressing concern about legislation that would defer government pension contributions, and expressing strong opposition to any invasion or modification to the regular flow of governmental payments. He expressed the same concern for outflows that exceed inflows as reported by Director Clark. A copy of the letter is attached to the official record of these minutes.

**VII. Public Comment**

Five members of the public who had submitted speaker request forms prior to the meeting were invited to address the Council.

Mr. Tony Miskowski thanked Director Clark for the improvements to the monthly exhibits and commended the staff presentation on the Fixed Income portfolio. He read from a speech given in the past by Chair Kramer predicting a liquidity crisis, large losses on securitized products and historical levels of alternative investment redemptions and asked Chair Kramer to comment relative to pension fund policy. Chair Kramer said that in the past, recessions had been brought about by fed tightening to reduce inflation. In contrast, he said, the current market decline had been driven by a massive deleveraging by institutions and consumers, with so many negative feedback loops it lacked any historical precedent. Chair Kramer acknowledged that he had outlined in the speech how things could end badly, but noted the pension fund's diversification strategy had improved returns relative to its prior asset allocation.

Mr. Ray Weicker asked if there was a trigger point for letting go of securities that were being downgraded; what affect FASB rules have on hedge fund accounting; and whether the pension fund was over-invested in TIPS as a way of chasing alpha. Dr. Love said TIPs were in effect a hedge on liabilities that would allow assets to increase in value as inflation (and liabilities) went up. Director Clark said TIPs provide a long-term benefit to the fund as the primary reason for owning them. With regard to equity sales triggers, Director Clark said sometimes a rating downgrade triggers a sale, but that the ratings model was so riddled with inherent conflicts of interest that the Division regarded ratings with a grain of salt. He said FAS 157 applied only to the extent that hedge funds owned assets not publicly traded, and that the Division examined valuation methods carefully.

Mr. John Strachan asked the Council to voice a demand that the state make both current and deferred pension fund contributions, and said he believed doing so was part of the Council's fiduciary responsibility.

Ms. Rae Roeder asked Mr. Berg if he would take a statement similar to the one shared by Mr. Kandrac to the PERS board for similar action; Mr. Berg said he would discuss the matter with the PERS board. Ms. Roeder said the publication of the Director's phone number in an ad purchased by a state legislator critical of the Division was offensive to members of her CWA local, and expressed the view that criticisms of investment policy were more appropriately directed to the Council. Director Clark noted that the ad had been a disservice to retirees frightened by misinformation, and a disservice to the pension fund as the calls had pulled staff time away from managing investments. He thanked Ms. Roeder for her local's support.

Mr. John Bury asked several questions about numbers included in the monthly report. He criticized the handling of pension obligation bonds issued by the state in 1997.

**VIII. Communications**

There was no report from the State Treasurer.

***IX. Next Meeting***

March 19, 2009

*Note Special Time:* 3 p.m. Meeting

Rutgers Student Center  
Multi-Purpose Room B  
126 College Avenue, 1<sup>st</sup> Floor  
New Brunswick, NJ 08901

***X. Adjournment***

The meeting was adjourned by unanimous vote at 3:20 p.m.

Respectfully submitted, Susan Burrows Farber, Secretary to the Council