

# New Jersey State Investment Council

## September 28, 2016 Regular Meeting

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

Held September 28, 2016 at the 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  
Michael Greaney  
James Hanson  
Guy Haselmann  
Timothy McGuckin  
Jeffrey Oram  
Eric Richard  
Mitchell Shivers

Charles Dolan and James Joyner were not in attendance.

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

The Regular Meeting was called to order by Brendan T. Byrne, Jr., Council Chair, at 10:06 a.m. Ernestine Jones-Booker, Council Secretary, reported that notice of the Regular Meeting scheduled for September 28, 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 August 22, 2016. A copy of the notice was posted at the Division and is on file. Ms. Jones-Booker performed roll call and reported that a quorum of the Council was present.

### **Minutes of the Regular Meeting held August 03, 2016**

Mr. Byrne presented for adoption the minutes for the regular meeting held August 03, 2016. Jeffrey Oram made a motion to approve the minutes, with Thomas Bruno, Jr. seconding the motion. All Council Members present voted in favor.

### **Opening Remarks by Chair**

Mr. Byrne made some brief opening remarks, reporting a return of -0.87 percent for fiscal year 2016. Mr. Byrne noted that New Jersey's investment portfolio lagged internal benchmarks for the first time in many years, but that it continued to exceed the benchmarks over 3-, 5-, and 10-year periods. Mr. Byrne warned that outsized returns should not be expected in the near future given low interest rates and high equity valuations relative to historical data. Mr. Byrne commended Division staff for its hard work and good long term results in a difficult investment environment and pledged to continue to urge others to adopt a realistic long-term funding solution that would restore the health of the Pension Plans.

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### **Election of Chair and Vice Chair**

Mr. Oram, Chair of the Nominating Committee, reported that the Nominating Committee, consisting of himself, Guy Haselmann and Timothy McGuckin, met telephonically on September 26<sup>th</sup> and that the Committee was nominating Mr. Byrne to continue to serve as Chair and Adam Liebttag to continue to serve as Vice Chair of the Council. There were no additional nominations. In a roll call vote, all members of the Council present voted in favor of Mr. Byrne's election as Chair and Mr. Liebttag's election as Vice Chair.

### **Appointments of Members to Council Committees**

Mr. Byrne reappointed himself, Mr. Liebttag, Mr. Haselmann, Mr. McGuckin, and Mr. Oram to the Executive Committee; himself, Mr. Liebttag, Mr. Haselmann, Mr. McGuckin, Mr. Oram, and Mitchell Shivers to the Investment Policy Committee; and Michael Cleary, Michael Greaney, James Hanson and Mr. McGuckin to the Audit Committee, with Mr. McGuckin to serve as chair.

### **2017 Proposed State Investment Council Meeting Dates**

Mr. Byrne presented a proposed meeting schedule for 2017. Marty Barrett suggested that the Council consider moving some of the meetings to 11 a.m. Mr. Byrne acknowledged Mr. Barrett's suggestion, but recommended keeping the 10 a.m. start time.

### **Presentation by John Megariotis of the Division of Pensions and Benefits**

Mr. Byrne introduced John Megariotis, Deputy Director of the Division of Pensions and Benefits, who made a presentation comparing actuarial figures calculated according to state law to figures calculated according to industry accounting standard, specifically those required by GASB 67 and GASB 68. Mr. Megariotis explained the various factors resulting in higher unfunded liability amounts using the GASB standards. Mr. Byrne and Mr. Barrett asked whether the projected depletion dates for the various funds would be extended if State contributions increased in future years. Mr. Megariotis responded yes, provided that the formal funding policy has been followed over several years. In response to Mr. Barrett's question regarding the allocation of PFRS' net pension liability to local versus state employers, Mr. Megariotis explained that the bulk of the PFRS membership are local employees. Mr. Liebttag asked about the discrepancy between the total asset value under the actuarial calculation and under the GASB calculation. Mr. Megariotis responded that the actuarial value did not fully incorporate market gains and losses. Mr. Liebttag also asked for more information regarding investment assumptions, which Mr. Megariotis agreed to provide in the future. Eric Richard expressed concern regarding the looming depletion date for the Judicial Retirement System and asked what would happen if the State made no changes. Mr. Megariotis responded that if the current funding mechanism continued to be implemented in the future, the expected depletion would not occur at the currently projected date. Mr. Haselmann pointed out that both contributions and investment returns are subject to change dramatically and noted that, even though the funded status of the pension funds does not impact the Council's mission to maximize returns per unit of risk, it constrains the Council's decisions with respect to allocations to illiquid investments. Mr. Megariotis added that it is important to look at the benefit side as well as the contribution side of the funding equation. Mr. Cleary asked how often the State reviews the actuarial rate to reflect historical investment returns. Mr. Megariotis responded that the Treasurer periodically reviews information to determine whether to adjust the rate. Mr. Barrett asked whether there should also be a depletion date under the State actuary calculations. Mr. Megariotis replied that calculating a depletion date is less helpful where the underlying numbers are not being calculated using generally accepted auditing standards.

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### **Director's Report**

Director Chris McDonough presented the Director's Report, reporting that the Pension Fund returned, on an unaudited basis, -0.87 percent for the fiscal year, underperforming the benchmark for the year. Mr. McDonough provided an update on the performance of the portfolio as a whole and the performance of specific asset classes, noting that real estate and private equity were the best performing strategies while non-U.S. equities and equity-oriented hedge funds performed poorly. Mr. Byrne pointed out the real estate and private equity asset classes have consistently performed well over time. Mr. McDonough concurred, but cautioned that the recent high levels of returns were not expected to continue in the future. Mr. Cleary asked about the discrepancy in performance between public equity and equity-oriented hedge funds. Mr. Haselmann explained that much of the difference is due to the lower net long position of hedge funds, and noted that public equity prices have been higher over the past five years in part due to central banking activity which may be unsustainable. Mr. Byrne added that the investment environment for equity-oriented hedge funds has been difficult, and that was a reason for the Council's recent decision to allocate away from those types of investments.

Deputy Director Corey Amon compared the Pension Fund's performance, including its long term performance per unit of risk, to that of other large pension funds. Kristen Doyle of Aon Hewitt discussed the impact of asset allocation on the peer analysis. Mr. Haselmann cautioned against placing too much emphasis on past performance or peer analysis in an unprecedented investment environment, and encouraged the Division to be open-minded about new innovative types of asset classes.

Brian Arena and Karen Paardecamp of the Division presented an overview of the domestic and international equity portfolios, respectively. Tim Patton of the Division discussed the fixed income portfolio. Mr. McDonough provided an update on capital markets, portfolio performance and asset allocation for the current fiscal year, and notified the Council of recent legislation requiring divestment from certain companies that were identified as boycotting Israel. In response to a request from Mr. Bruno, Mr. McDonough agreed to provide a list of the identified companies to the Council when it is available.

Mr. McDonough notified the Council of redemptions from several hedge funds, and summarized the schedule for receiving proceeds. Mr. Haselmann inquired regarding the redemption from GSO Special Situations Fund, L.P., and Mr. McDonough explained that the partial redemption was designed to help the Division meet the revised asset allocation target for credit-oriented hedge funds.

James Hanson departed the meeting at this time.

### **Private Debt Investment**

#### ***Benefit Street Partners Special Situations Fund L.P.***

Mr. McDonough and Meghna Desai of the Division, along with Matt Coyne of TorreyCove, presented an investment of up to \$150 million in Benefit Street Partners Special Situations Fund L.P., a private debt fund that pursues event-driven opportunities in stressed and distressed middle market companies. Ms. Desai described the fund's strategy, its investment team and the negotiated terms of the investment. Mr. Byrne reported that the IPC had discussed the investment and was satisfied that appropriate and adequate due diligence had been performed.

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### **Private Equity Investment**

#### ***Warburg Pincus China, L.P.***

Mr. McDonough and Ms. Desai, along with Michelle Davidson of TorreyCove, presented an investment of up to \$100 million in Warburg Pincus China, L.P. Mr. McDonough noted that this investment is part of the Division's strategy to better diversify the private equity portfolio geographically. Ms. Desai stated that the fund will focus on growth equity investments in China and reviewed the merits of the investment. Ms. Davidson commented on Warburg Pincus' investment expertise. Mr. Byrne pointed out that there was no hurdle rate for this investment, and expressed concern regarding legal risks in investing in China. Ms. Davidson replied that although the rule of law is different in China, Warburg Pincus has experience in dealing with these differences. Mr. Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

### **Risk Mitigation Investment**

#### ***Aspect Core Diversified Strategy***

Samantha Rosenstock and Pete Kelioutis of Cliffwater presented an investment of up to \$200 million in the Aspect Core Diversified Strategy, a trend-following strategy managed by Aspect Capital Ltd. Ms. Rosenstock stated that the Division would be reallocating funds from trend-following strategies with higher fees. Ms. Rosenstock described the relationship of the core strategy to Aspect's flagship strategy, described the firm's experience, and the investment's fit in the portfolio.

Mr. Bruno asked how much would be saved in fees; in response, Ms. Rosenstock summarized the cost savings under various performance scenarios. Mr. Byrne asked if the Division was sacrificing returns for cost savings, to which Ms. Rosenstock replied that the return expectation remained the same. Mr. Haselmann emphasized that the focus should be on the net return, and not the amount of fees paid. He also noted positively the investment's lack of correlation with other investments in the portfolio. Chair Byrne reported that the IPC had reviewed the investment and was satisfied that appropriate and adequate due diligence had been performed.

Mr. Byrne notified the Council of a brief discussion during the Investment Policy Committee about infrastructure as an asset class and stated that further discussion was likely. Mr. Haselmann opined that these types of investment deserved consideration as an alternative to stocks and bonds.

### **Annual Report on Sudan Divestment Law**

Susan Sarnowski of the Division presented the Division's annual report to the Legislature concerning investments in Sudan. Ms. Sarnowski reported that there were no divestments in the past year and no current holdings that were in violation of the Statute.

### **Treasurer's Report**

Dr. Roger Cohen of the State Treasurer's office reported on the State's labor and housing markets and revenue forecasts. Mr. Byrne asked when the revenue growth figures for Fiscal Year 2016 will be calculated. Dr. Cohen responded that these numbers will be available when the CAFR is completed prior to the end of the calendar year. Finally, Dr. Cohen announced his imminent retirement, stating that this Council meeting would be his last. Mr. Barrett made a motion asking the Governor's Office for a resolution recognizing Dr. Cohen's service. The motion was seconded by Mr. Richard and all members of the Council voted in favor.

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### **Public Comment**

John Avigliano, Chair of the New Jersey Retired Public Employees Organization (NJRPEO), recommended certain changes to the Division's public website and the monthly Director's Report. Mr. Avigliano also commented on the depletion dates referenced in Mr. Megariotis' presentation.

### **Adjournment**

Mr. Byrne made a motion to adjourn the meeting, with Mr. Shivers seconding the motion. All Council Members present voted in favor. The meeting was adjourned at 12:51 p.m.