

# NEW JERSEY DIVISION OF INVESTMENT

**Director's Report**

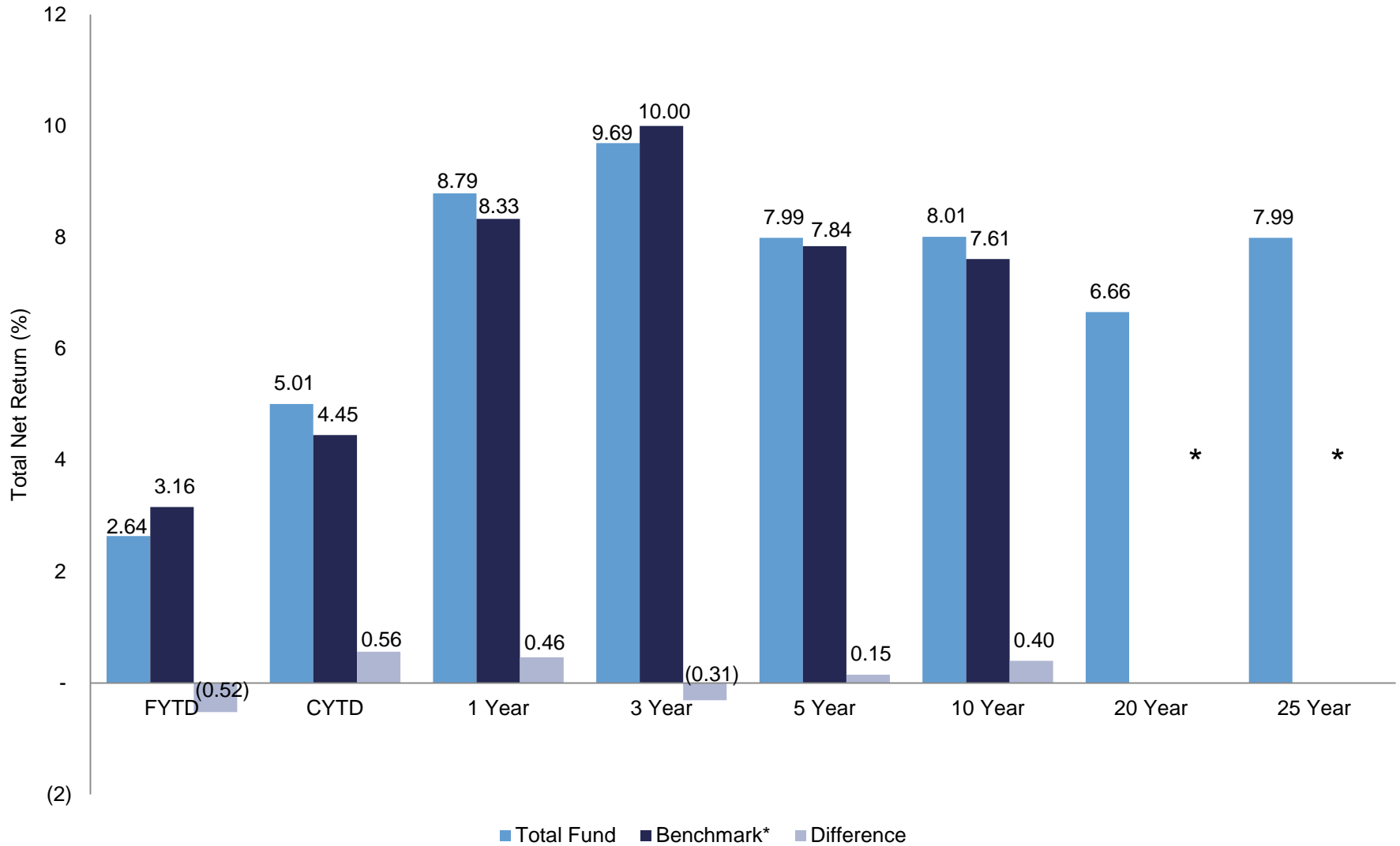
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**October 25, 2018**

**State Investment Council Meeting**

*“The mission of the New Jersey Division of Investment is to achieve the best possible return at an acceptable level of risk using the highest fiduciary standards.”*

## Pension Fund Net Returns<sup>(1)</sup> for Periods Ending September 30, 2018



(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program

\*Benchmark return not available for 20 and 25-Year period

## Capital Market Returns (%)

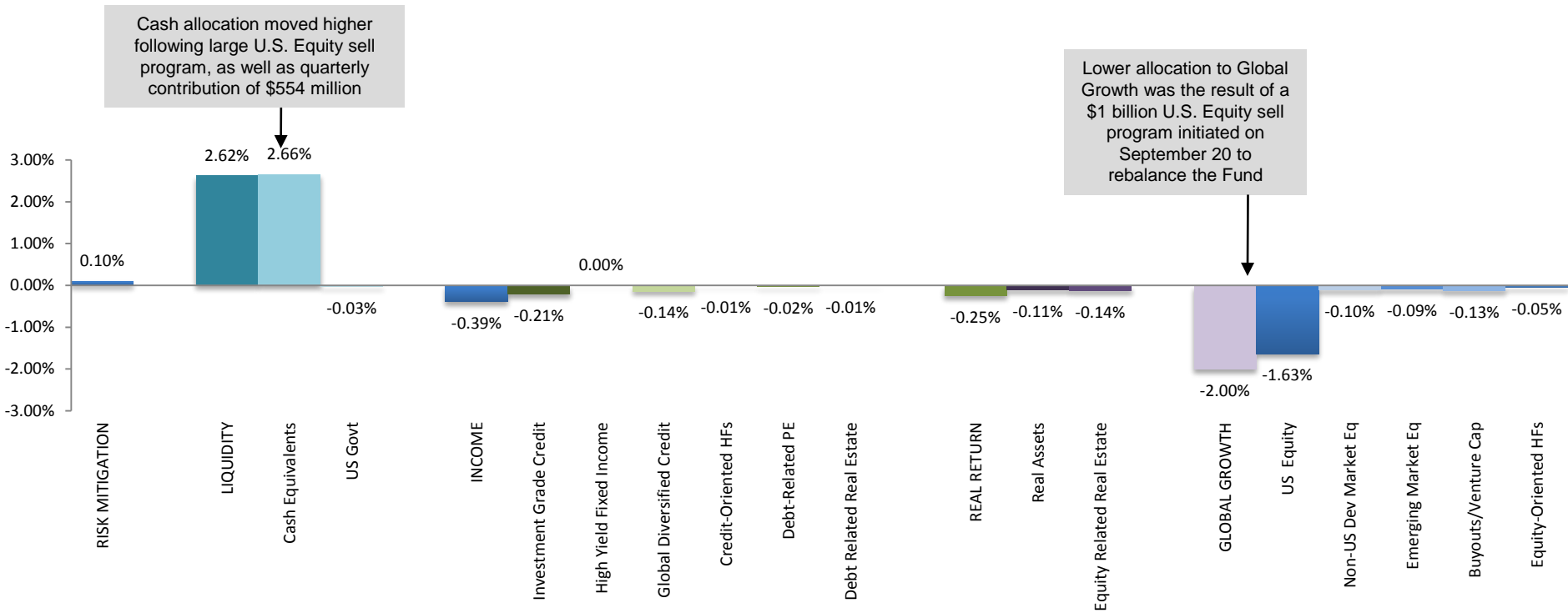
	Calendar YTD	Fiscal YTD	Start of FY to Peak	Peak to Trough	Return Since Trough
Start	12/31/2017	6/30/2018	6/30/2018	9/20/2018	10/11/2018
End	10/18/2018	10/18/2018	9/20/2018	10/11/2018	10/18/2018
<b>Global Equity Indices</b>					
MSCI All Country World Index	-2.01	-1.59	4.57	-6.86	1.05
<b>US Equity Indices</b>					
Russell 3000	4.68	1.42	7.79	-7.29	1.49
Russell 1000	4.84	1.94	8.03	-7.06	1.53
Russell 2000	2.62	-4.69	4.95	-10.08	1.00
Russell Growth	9.01	1.46	8.56	-8.22	1.83
Russell Value	0.21	1.38	7.03	-6.36	1.16
<b>Non-US Equity Indices</b>					
MSCI EAFE	-7.44	-4.82	1.58	-6.37	0.07
MSCI Emerging Markets	-14.42	-8.31	-2.21	-7.82	1.71
<b>Fixed Income Indices</b>					
Bloomberg Barclays Aggregate	-2.29	-0.69	-0.23	-0.21	-0.25
Bloomberg Barclays U.S. Treasury	-2.20	-1.13	-0.78	-0.17	-0.19
Bloomberg Barclays U.S. Credit	-3.04	-0.06	0.58	-0.31	-0.33
Bloomberg Barclays U.S. High Yield	1.65	1.49	2.22	-0.86	0.14

## Asset Allocation and Net Returns by Asset Class (September 30, 2018)

Asset Class	ASSET ALLOCATION				PERFORMANCE (for periods ending September 30, 2018) <sup>(1)</sup>							
	As of September 30, 2018				FYTD		Calendar YTD		Trailing Twelve Months		Trailing Three Years	
	Mkt Value	Actual (%)	Target (%)	Difference	NJ	Bench	NJ	Bench	NJ	Bench	NJ	Bench
<b>RISK MITIGATION</b>												
<b>RISK MITIGATION STRATEGIES</b>	<b>3,782</b>	<b>4.83%</b>	<b>5.00%</b>	<b>-0.17%</b>	<b>0.75%</b>	<b>1.25%</b>	<b>4.06%</b>	<b>3.60%</b>	<b>4.27%</b>	<b>4.68%</b>	<b>2.44%</b>	<b>3.90%</b>
<b>LIQUIDITY</b>												
Cash Eqv & Short Term	4,972	6.35%	5.50%	0.85%	0.65%	0.49%	1.69%	1.30%	2.13%	1.59%	1.48%	0.84%
U.S. Government	1,246	1.59%	3.00%	-1.41%	-0.54%	-0.59%	-1.85%	-1.67%	-1.82%	-1.62%	0.07%	0.59%
<b>TOTAL LIQUIDITY</b>	<b>6,218</b>	<b>7.95%</b>	<b>8.50%</b>	<b>-0.55%</b>	<b>0.33%</b>	<b>0.11%</b>	<b>-0.05%</b>	<b>0.25%</b>	<b>0.23%</b>	<b>0.46%</b>	<b>0.72%</b>	<b>0.80%</b>
<b>INCOME</b>												
Investment Grade Credit	7,604	9.72%	10.00%	-0.28%	0.58%	0.52%	-1.36%	-2.19%	-1.09%	-1.31%	2.03%	2.55%
Public High Yield	1,023	1.31%	2.50%	-1.19%	2.32%	2.40%	2.12%	2.57%	2.91%	3.05%	7.85%	8.15%
Global Diversified Credit	4,370	5.59%	5.00%	0.59%	0.93%	2.40%	7.13%	2.57%	9.26%	3.05%	10.10%	8.15%
Credit-Oriented HFs	854	1.09%	1.00%	0.09%	1.14%	1.31%	6.15%	4.33%	7.05%	5.45%	6.07%	5.77%
Debt-Related PE	967	1.24%	2.00%	-0.76%	0.37%	1.79%	10.97%	2.91%	14.93%	5.73%	8.96%	8.74%
Debt Related Real Estate	400	0.51%	1.00%	-0.49%	-0.34%	2.02%	5.34%	6.01%	6.87%	8.23%	4.71%	6.10%
<b>TOTAL INCOME</b>	<b>15,218</b>	<b>19.45%</b>	<b>21.50%</b>	<b>-2.05%</b>	<b>0.78%</b>	<b>1.42%</b>	<b>2.73%</b>	<b>0.76%</b>	<b>3.73%</b>	<b>1.76%</b>	<b>5.40%</b>	<b>5.23%</b>
<b>REAL RETURN</b>												
Real Assets & Commodities	2,369	3.03%	2.50%	0.53%	0.33%	3.73%	11.46%	8.37%	13.97%	10.27%	6.27%	3.15%
Equity Related Real Estate	4,323	5.52%	6.25%	-0.73%	0.29%	1.81%	8.06%	5.73%	12.30%	7.47%	11.35%	8.38%
<b>TOTAL REAL RETURN</b>	<b>6,692</b>	<b>8.55%</b>	<b>8.75%</b>	<b>-0.20%</b>	<b>0.30%</b>	<b>2.36%</b>	<b>9.24%</b>	<b>6.49%</b>	<b>12.90%</b>	<b>8.27%</b>	<b>9.68%</b>	<b>6.98%</b>
<b>GLOBAL GROWTH</b>												
US Equity	24,064	30.76%	30.00%	0.76%	7.22%	7.35%	9.14%	10.47%	15.54%	17.69%	16.02%	17.26%
Non-US Dev Market Eq	8,942	11.43%	11.50%	-0.07%	1.35%	1.29%	-0.65%	-1.63%	3.67%	2.55%	9.66%	9.23%
Emerging Market Eq	4,982	6.37%	6.50%	-0.13%	-0.93%	-1.31%	-9.04%	-8.10%	-2.92%	-1.26%	11.35%	12.31%
Buyouts/Venture Cap	7,535	9.63%	8.25%	1.38%	1.20%	4.41%	15.45%	13.28%	18.66%	18.75%	12.58%	12.49%
Equity-Oriented HFs	300	0.38%	0.00%	0.38%	1.89%	1.71%	2.10%	3.55%	5.67%	5.83%	2.93%	6.62%
<b>TOTAL GLOBAL GROWTH</b>	<b>45,824</b>	<b>58.56%</b>	<b>56.25%</b>	<b>2.31%</b>	<b>4.10%</b>	<b>4.59%</b>	<b>5.82%</b>	<b>6.16%</b>	<b>11.25%</b>	<b>12.41%</b>	<b>13.08%</b>	<b>14.17%</b>
<b>OTHER</b>												
<b>OPPORTUNISTIC PE</b>	425	0.54%			-0.14%		7.86%		10.53%		8.45%	
<b>OTHER</b>	83	0.11%										
<b>TOTAL FUND <sup>(1)</sup></b>	<b>78,245</b>	<b>100.00%</b>			<b>2.64%</b>	<b>3.16%</b>	<b>5.01%</b>	<b>4.45%</b>	<b>8.79%</b>	<b>8.33%</b>	<b>9.69%</b>	<b>10.00%</b>

(1) Returns are preliminary, unaudited, net of all fees, and exclude Police and Fire Mortgage Program  
Sum of components may not equal totals due to rounding

# Pension Fund Update: Change in Sector Allocation from August 31, 2018 – September 30, 2018



### Risk Mitigation

Allocation to Risk Mitigation strategies remains below target. (4.8% vs 5.0%)

### Liquidity

Allocation to Liquidity increased as the cash allocation moved higher following equity sell program and the receipt of quarterly State appropriation. (8.0% vs 8.5%)

### Income

Allocation to Income remains below target. Within Income, underweight allocation to HY is offset by overweight allocation to GDC. (19.5% vs 21.5%)

### Real Return

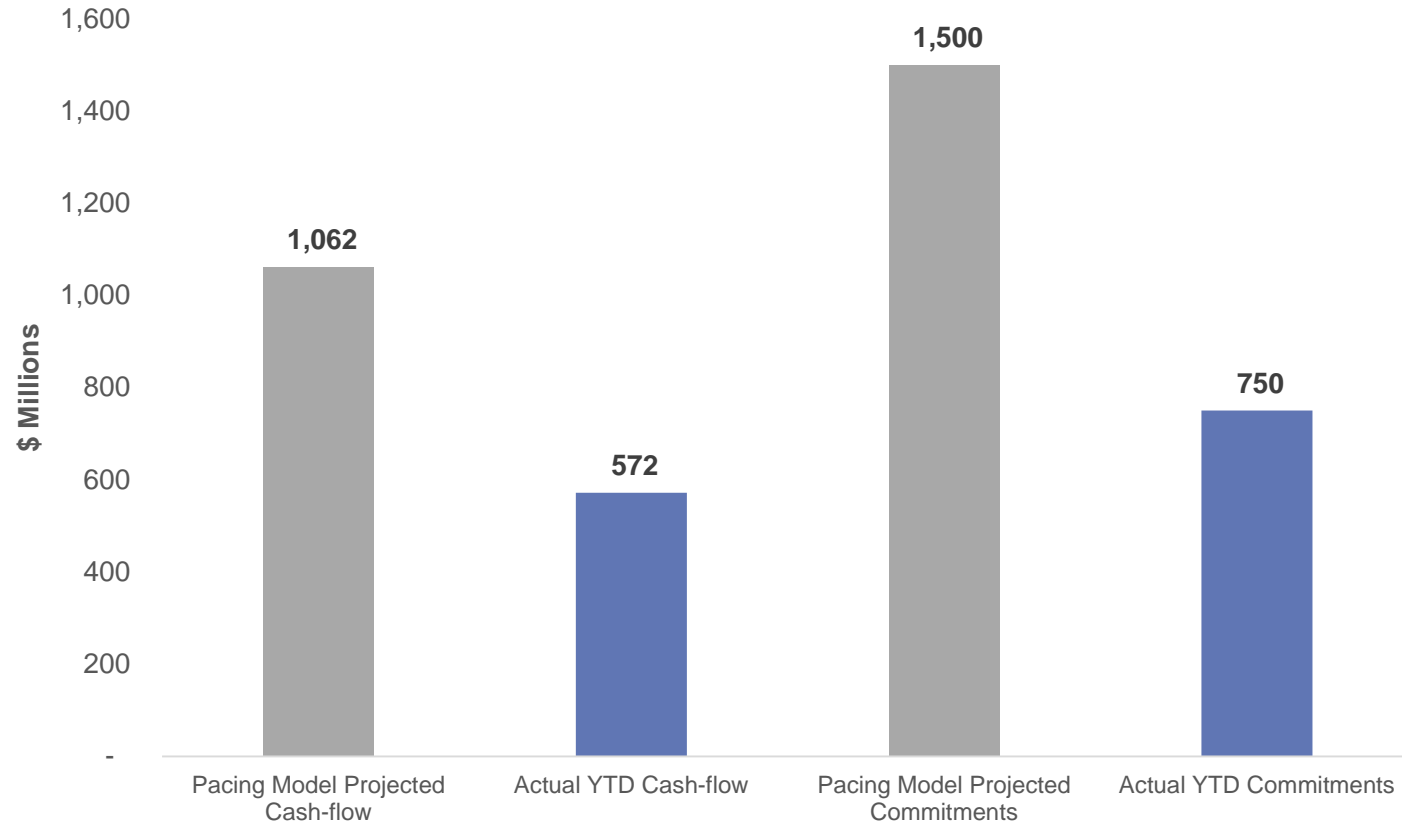
Allocation to Real Return is in line with the targeted allocation, with an underweight to Real Estate offset by an overweight to Real Assets. (8.6% vs 8.75%)

### Global Growth

Fund is modestly above target allocation to Global Growth, primarily as a result of the above benchmark allocation to Private Equity. (58.6% vs 56.25%)

Most sector allocation changes have been modest. The lower allocation to U.S. stocks and higher allocation to cash resulted from a rebalancing following strong equity market returns.

## Calendar Year 2018 Private Equity and Real Estate Pacing Update



Calendar year-to-date net distributions have been somewhat below expectations. New commitments are expected to be modestly below the pacing model as well.

Source: Division of Investment, Hamilton Lane, and Torrey Cove

Notes: Actual YTD cash flows shown are for the nine months ended September 30, 2018. Actual YTD commitments include agreements signed over the same time horizon.

## ESG Committee Referral

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- **During the September 2018 State Investment Council meeting, the Council approved a motion to refer the issue of the Division's investment in Nike to the ESG Committee**
  - according to a letter from Council Member Barrett submitted after the motion, Nike's "leadership has demonstrated poor judgment in sponsoring a TV commercial with quarterback Colin Kaepernick" and Nike "made one of the worst business decisions of all time."
  - the Pension Fund holds 312k shares of Nike stock with a market value of approximately \$23.6 million <sup>(1)</sup>
- **The ESG Committee determined not to recommend either divestment from Nike or engagement with Nike on the basis of concerns related to its marketing campaign**
  - the Division provided analysis of the financial impact of the company's recent marketing efforts on Nike
  - according to the ESG Policy, "Engagement activities shall not be undertaken merely to impact a standard of social behavior, to the extent such behavior has no material impact on the financial performance or stability of an investment."

(1) As of October 18, 2018

## Noteworthy Developments

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- Staffing – Linda Brooks, Cash Management Fund Manager, will retire effective November 1, 2018 after 38 years of service with the Division of Investment.
- The Division of Investment is working on the following Requests for Proposals (RFP):
  - Proxy Research and Voting, Class Action Monitoring Services and Optional Proxy Guideline Review RFP:  
The RFP package remains with the Division of Purchase and Property for final approval.
  - Replacement Investment Systems Platform (RISP) RFP:  
The Division submitted the RISP RFP to the Division of Purchase and Property (DPP) to advertise and procure.
  - Securities Lending RFP:  
The Division has received five bids and the Committee is reviewing.
  - ESG Scoring RFP:  
The Division is currently developing the requirements and statement of work to advertise an RFP for these services.
- The Division of Investment is pleased to welcome Vaughn Crowe and Samir Pandiri to the State Investment Council
  - there are currently eleven seated members of the Council



## Notification: Modification – Winton Futures Fund

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**Background:** Between 2011 and 2015, the Division invested \$350 million in Winton Futures Fund (the “Fund”), a systematic commodity trading advisor (“CTA”) fund, as part of its overall global macro strategy. The Net Asset Value of this investment, net of distributions, was approximately \$322 million as of June 30, 2018.

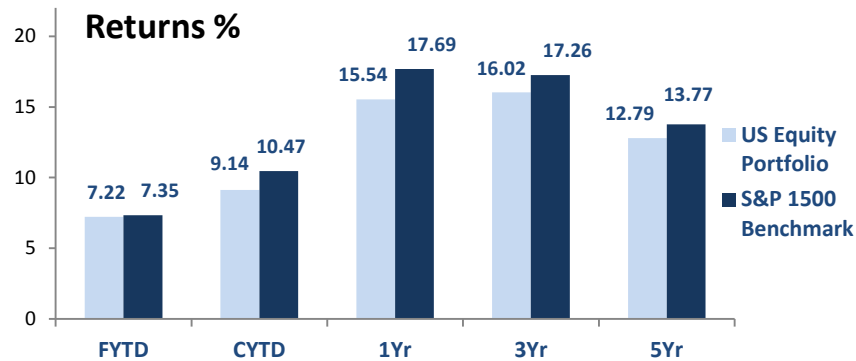
**Modification:** Winton Capital Management Limited (“Winton”) is proposing to restructure the Fund and to modify a number of fund terms. The restructuring would have the effect of consolidating four Winton-managed funds, including the Fund, and will ultimately result in the Division’s interest in the Fund being exchanged for an interest in a newly created feeder fund in a master-feeder structure. The modified fund terms include a more favorable crystallization of performance fees on an annual, rather than quarterly, basis. The new terms also increase the required notice period for monthly redemptions from 2 days to 30 days and add a 25% master fund level gate. Although extending the notice period and enacting a gate could reduce the Fund’s liquidity, the Division believes these changes do not materially affect the investment thesis.

**Impact on New Jersey:** The Division believes that the proposed restructuring and modifications will result in modernizing the firm and increasing trading and operational efficiencies as well as economies of scale. The Division intends to consent to the proposal, subject to negotiation of satisfactory documentation.

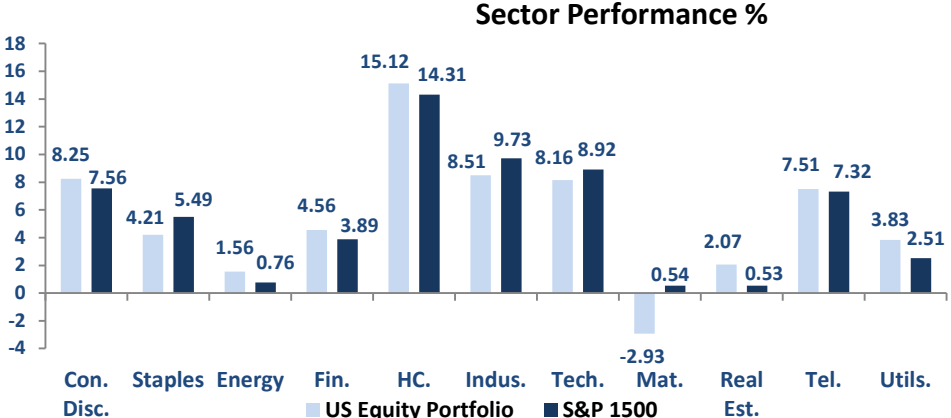
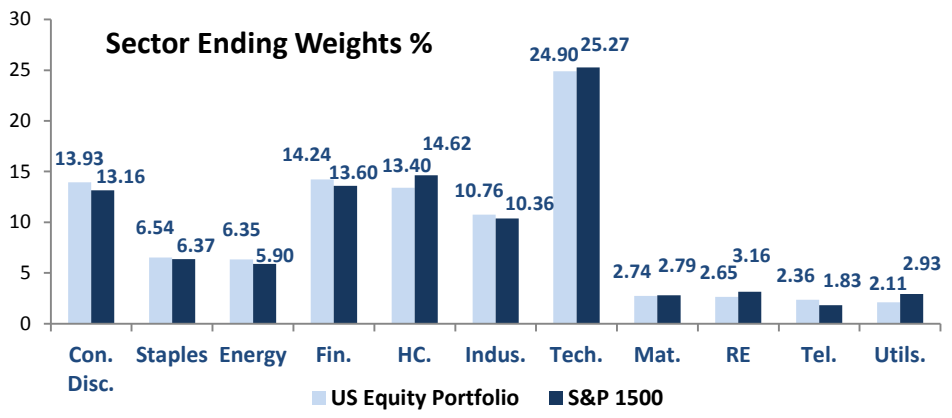
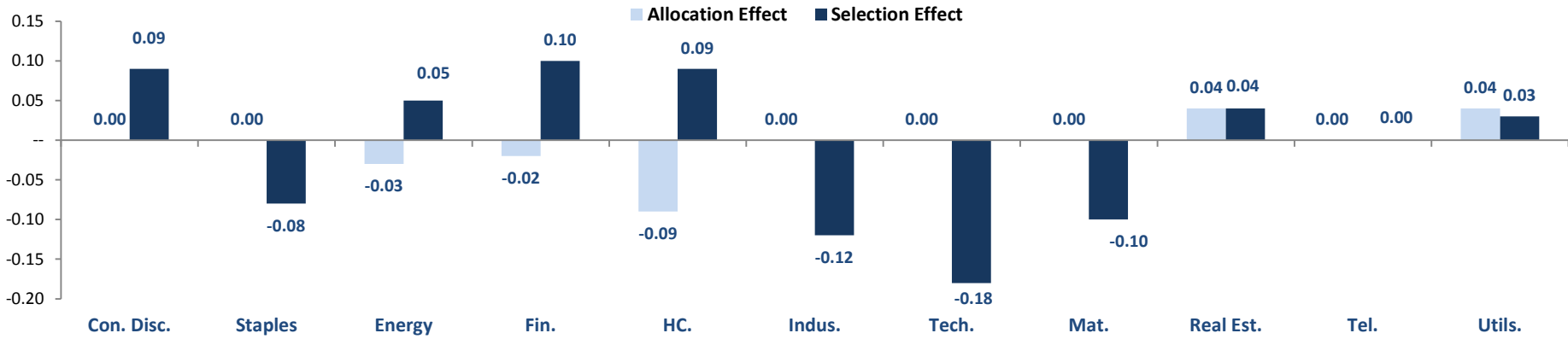
**The Director is notifying the IPC of this modification in accordance with the Alternative Investment Modification Procedures.**

# Performance Appendix

Fiscal year-to-date through September 30, the U.S. equity portfolio gained 7.22% versus 7.35% for the S&P 1500 benchmark. Domestic equity markets were volatile as investors grappled with positive and negative market dynamics. The markets focused on the tailwinds: robust earnings growth and strong labor markets. During the second quarter of 2018, U.S. earnings growth increased 26% year-over-year, with the recent tax change adding approximately 8% to earnings growth. Markets climbed a wall of worry which included the threat of a potential trade war's impact on global economic growth, the Fed continuing its interest rate tightening cycle, mid-term elections uncertainty, and Emerging Market concerns led by Turkey. Despite the trade war concerns, large capitalization stocks have outperformed small cap stocks on a fiscal year-to-date basis by 414 basis points. Healthcare was the best performing sector, increasing 14.31%, followed by industrials (up 9.73%). Materials and real estate were the laggards.



Portfolio Sector Attribution FYTD% - Breakdown of Excess Return:			
Portfolio Return:	+7.22%	Benchmark Return:	+7.35%
		Excess Return:	-0.13%



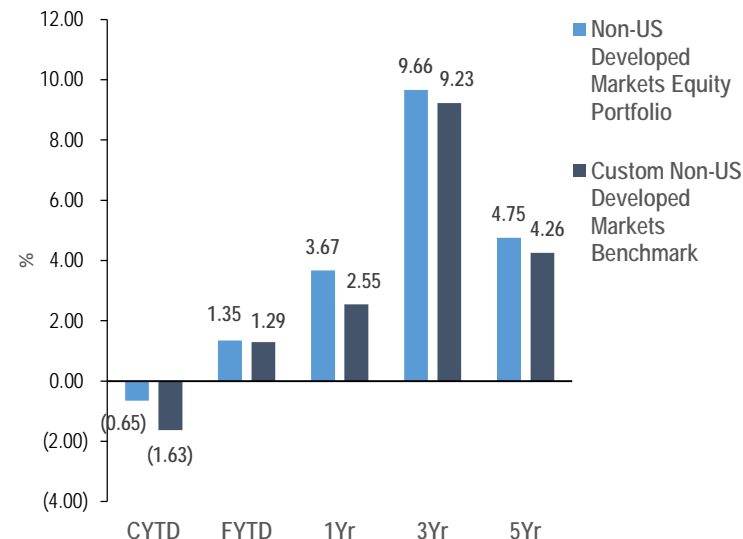
Source: State Street and FactSet

Fiscal year-to-date through September 30, the Non-US Developed Markets (DM) Equity Portfolio returned 1.35% versus 1.29% for the Benchmark. Rising concerns pertaining to economic growth, trade tensions, and political risk in the international markets dominated the period.

The dispersion of returns was notable. Returns for the United Kingdom were negative (-1.64%), driven by Brexit-related concerns. The Eurozone region also reflected a loss, as the ramifications from possible US tariffs on autos and exposure to troubled Turkish banks led to a modest decline (-0.29%). In contrast, Japan posted a robust 3.80% gain, as both an ease in political risk (the Prime Minister remained in power) and a weaker yen (which benefitted the corporate profit outlook) helped to support this market.

Driving returns for the Portfolio was the Non-US Developed Markets Enhanced Index component that comprises 92% of the Portfolio, up +1.49% versus +1.29%. Detracting from returns was the non-benchmark allocation to small cap securities, as small cap securities underperformed large cap securities. Within the small cap allocation, security selection added value.

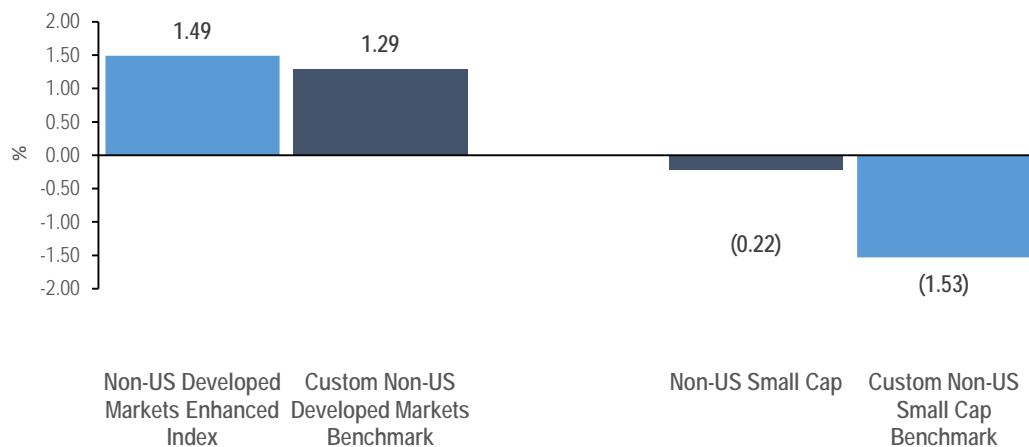
Returns Ending September 30<sup>th</sup> 2018



Note: Region market indices reflect MSCI total return in USD series

## Non-US Developed Markets Equity Portfolio FYTD Decomposition - As of September 30, 2018

Returns Ending September 30<sup>th</sup> 2018

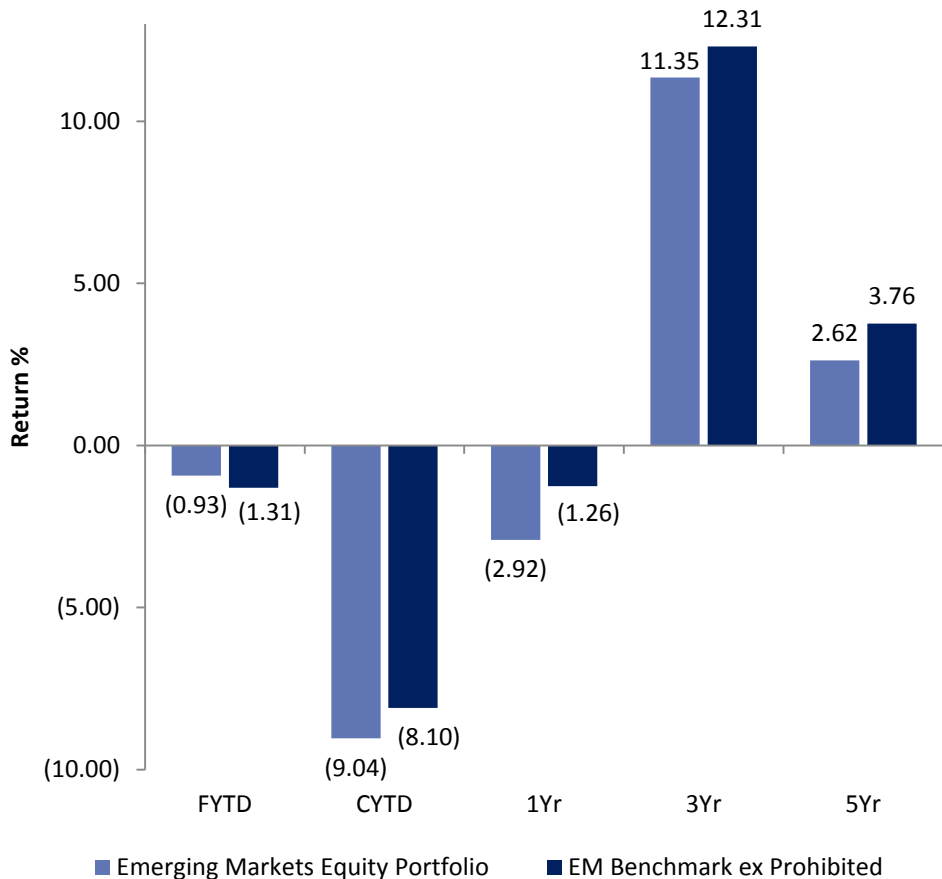


For the first quarter of the fiscal year, the positive performance of the Non-US Developed Markets Enhanced Index portfolio was the primary contributor to the overall performance of the Non-U.S. Developed Markets Portfolio.

Fiscal year-to-date through September 30, the Emerging Markets Equity Index returned -0.93% versus -1.31% for the benchmark index.

Emerging markets underperformed developed markets. The underperformance was primarily attributed to US dollar strength, a sharp depreciation in Turkey’s currency, political uncertainty in Brazil, and the ongoing US – China trade tensions. Additionally, higher US interest rates have led to significant capital outflows from riskier assets, particularly Emerging Markets equities.

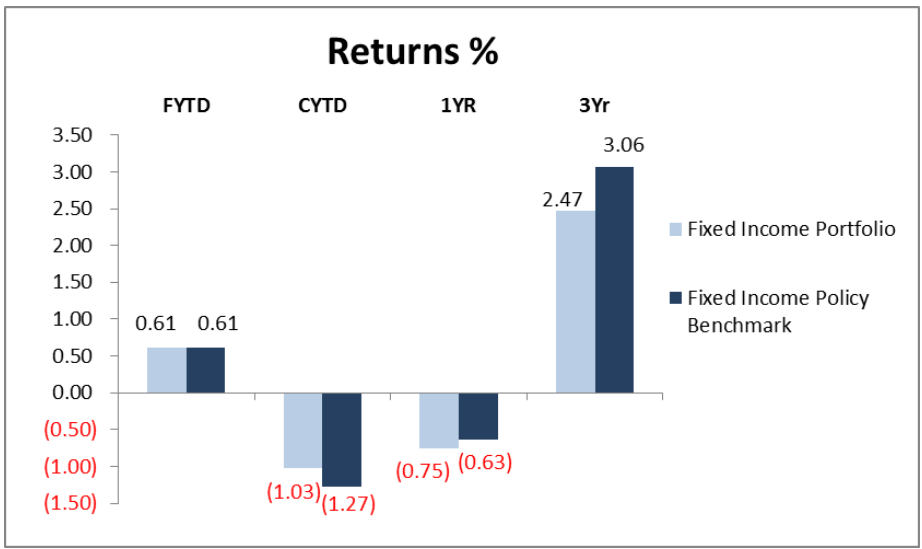
Relative returns benefitted from the portfolio’s underweight to China (~2.6%), as China returned -8%. The portfolio’s underweight to Information Technology and Financials versus the benchmark index also added value. Detracting from relative returns was the portfolio’s slight overweight to Turkey, specifically to Financials, and poor stock selection in Brazil.



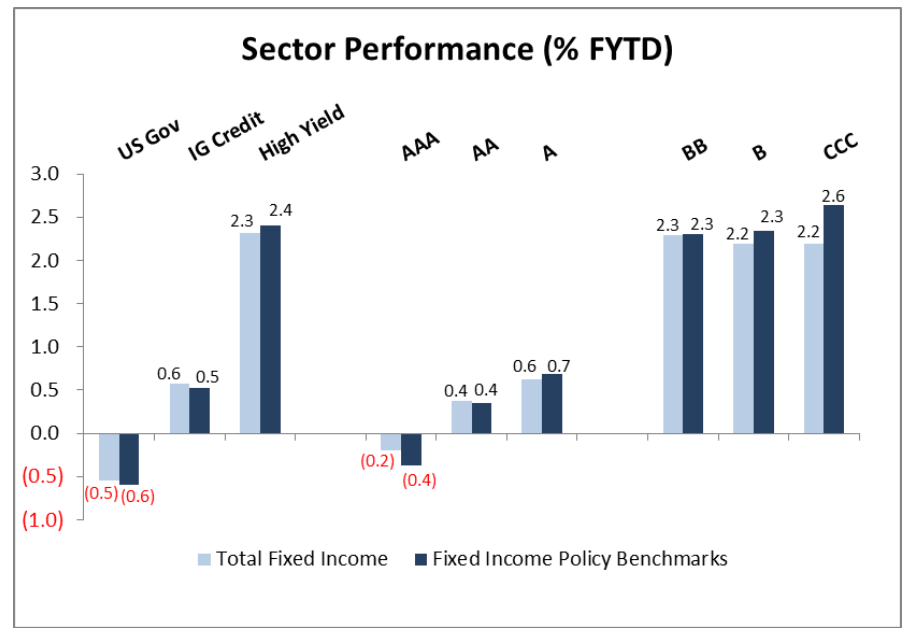
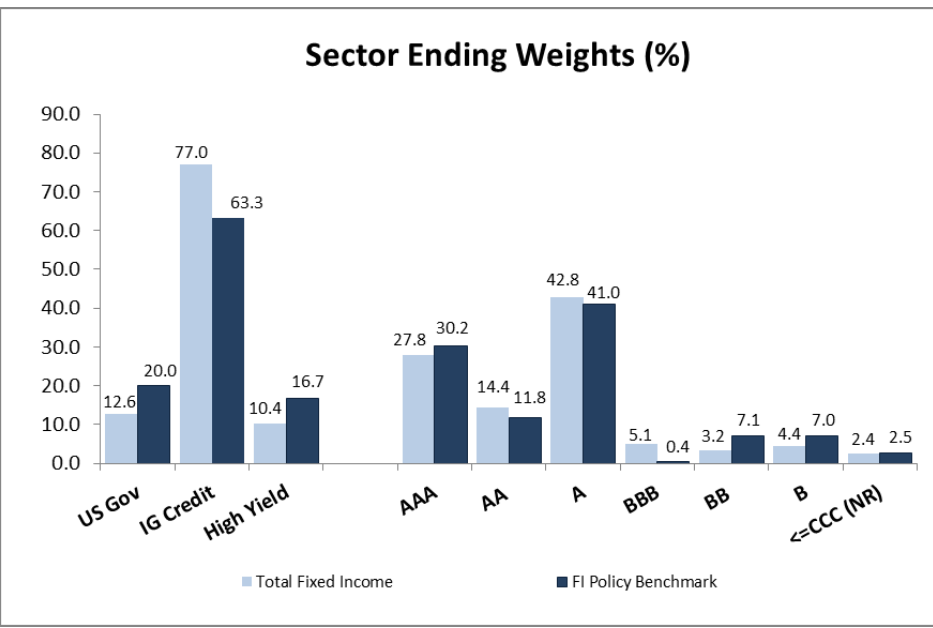
Fiscal year-to-date through September 30, the US Fixed Income portfolio returned +0.61% versus the benchmark return of +0.61%. Through September 30<sup>th</sup>, the Barclays High Yield, Custom IG Credit and US Government Benchmarks returned +2.40%, +0.52% and -0.59%, respectively.

An underweight allocation to U.S. Treasuries benefited relative returns as Treasuries realized negative returns. A modestly below benchmark duration profile also benefited relative returns as Treasury yields increased.

Our underweight allocation to High Yield, which outperformed the broader composite, and poor relative returns within the asset class (-8 bps) detracted from performance in the quarter. Security selection, specifically within in the energy space, was the primary driver of underperformance.



## Portfolio Sector Attribution – Weights and Performance



Source: State Street and FactSet