Key Points and Issues
For June 2008

Director's Note

After a relatively calm May, global equity and credit markets experienced significant declines again in June. The causes appeared to be similar to those that impacted the financial markets during the spring – concern about continued credit-related writedowns in the financial sector, weakness in the U.S. housing market, the impact on economic growth and inflation from rising commodity prices and a falling currency, and the inability of even creditworthy borrowers to obtain credit. Both domestic and international equity markets were down by roughly 8-10% in June, and credit spreads widened somewhat after a modest rally in April and May.

For the fiscal year, we estimate that the pension fund was down by 3.10%. While a negative total return is always disappointing, the actions taken by the Division and the Council prevented our performance from being much worse. Our performance in each of our three major portfolios – domestic equities, domestic fixed income and international equities, exceeded their performance benchmarks by 2.33%, 2.10% and 1.45% respectively for the fiscal year. In addition, a recent report by Merrill Lynch estimated that the average public pension fund will return -5.1% for the fiscal year ending on June 30, 2008, or nearly 2% worse than New Jersey's estimated performance.

In addition, the asset allocation changes initiated by the Council in 2005 (and refined in 2006 and 2007) also succeeded in reducing the volatility of the overall portfolio. If the portfolio's asset allocation had not been changed in 2005 (meaning no alternatives and a public equity ratio of 65%), we estimate that the portfolio would have returned -6.68% for the fiscal year assuming we had generated the same performance for our domestic and international equity portfolios. Expressed in dollars, this means that the portfolio would have a current value of only $74.8 billion, or $2.9 billion less than the estimated June 30, 2008 market value.

Total Pension Funds

- Estimated performance for the pension funds for the fiscal year is -3.10% versus -2.20% for the Council benchmark. For the month of June, the fund was down 4.88% versus 3.84% for the benchmark. As in past months, the underperformance relative to the benchmark for the fiscal year is attributable to our underweight position in commodities, which are up by nearly 40% for the year as measured by the Dow Jones-AIG commodity index. Total pension fund assets as of June 30, 2008 were $77.7 billion.

- We were net sellers of $208.9 million of U.S. equities in June. Even including our well-publicized purchase of $180 million of common and preferred stock of Lehman Brothers during the month, we were net sellers of $193.3 million of financial services stocks in June. Within the international portfolio, we were net buyers of $132.8 million of developed markets equities. Within domestic fixed income, we were net buyers of $274.0 million, consisting of TIPs and high-quality municipal auction-rate securities offering attractive yields. Finally, we funded an additional $250.3 million in commitments to various alternative investments.

- On June 30, the pension funds received $1.046 billion from the State of New Jersey, representing the State's pension contribution for the fiscal year. This amount is included in the pension funds' Cash Management Fund balance as of fiscal year-end.

Domestic Equity

- Performance for Common Pension Fund A for June was -8.21% versus -8.25% for the S&P 1500 Index, the benchmark for the domestic equity portfolio. For the fiscal year, Common Pension Fund A returned -10.38% versus -12.71% for the benchmark. For the fiscal year, our underexposure to financial stocks was the major contributor to our outperformance, followed by our underweight exposure to GE and our overweight position in the transportation sector.

- As stated above, net sales of equities within Common Pension Fund A during June were $208.9 million. The major purchase for the month was $180 million in common and preferred stock of Lehman Brothers. Even with these purchases, we had net sales of $193.3 million of financial services stocks, with significant sales in names such as Citigroup, Bank of America, Wells Fargo, JP Morgan Chase and Merrill Lynch. Outside of financials, we continued to reduce our holdings of stocks in the energy sector (total sales of $53.6 million), with sales of BJ Services and National Oilwell. Finally, within the technology sector, we were buyers of IBM and Synaptics, but sellers of Qualcomm and F5.

- We closed out our put option hedges on the XLF (the exchange-traded fund tracking the S&P financial services index. We continue to have puts that hedge roughly $1.2 billion of our overall U.S. equity market exposure, along with covered calls on various financial services stocks that were written in February and June. Embedded gains on these covered calls, most of which should expire worthless in July, are $8.5 million.

Domestic Fixed Income

- Performance for Common Pension Fund B for June was -0.11 versus +0.46% for the Lehman Long Government/Credit Index, the new benchmark for the domestic fixed income portfolio. For the fiscal year, we estimate that Common Pension Fund B was up 8.88% versus 6.78% for the benchmark. Please note that the Common Fund B performance numbers include our TIPs portfolio, which does improve our comparison with the index somewhat for the fiscal year-to-date period. The duration of Common Pension Fund B (excluding TIPs) was 9.81

years as of June 30, 2008, versus 11.13 years for the Lehman Long U.S. Government/Credit Index.

- We had net purchases of approximately $274.0 million in domestic fixed income securities in June. This number includes purchases of $229.8 of TIPs, which we viewed as attractive given that breakeven inflation spreads have not widened at all despite the large rise in commodity prices. In addition, we were net buyers of $193.1 million of municipal auction-rate securities, bringing our total position back up to roughly $300 million. We were again able to purchase municipal securities of high-quality issuers at rates of 7% or higher. Finally, we were net sellers of $148.9 million of short-term corporates and CMOs.

<u>International Equity/Fixed Income</u>

- The equity portion of Common Pension Fund D returned -9.07% in June versus a -8.34% return for the MSCI EAFE Index ex-Prohibited, the new benchmark for the international portfolio, which is calculated by the Division and excludes those names deemed ineligible for investment under the State's Sudan and Iran Divestment Laws. For the fiscal year, the portfolio was down -10.09% versus -11.54% for the benchmark.

- We were net buyers of $132.8 million in international developed markets equities in June, consisting primarily of issues in the telecommunications sector. We bought $84.2 million of France Telecom when the stock fell after the company made an offer to purchase TeliaSonera (the company subsequently withdrew the offer). Other telecom names that were purchased include Deutsche Telecom, Telenor and Vodafone.

- We continue to maintain a position of nearly $880 million of short-term JGBs. Given our significant underexposure to the Japanese equity market, we wish to minimize the currency risk associated with our mismatch relative to the benchmark. In addition, we hold $860 million of long-term Euro and Aussie-denominated sovereign bonds. Of this total, $485.7 million of our Euro-denominated exposure is hedged back into U.S. dollars.

- The following companies, while incorporated in a developed market country, will be classified as emerging market companies based upon our review of the various factors as set forth in the State Investment Council Regulations: First Quantum Ltd., Shougang Concord International Enterprises Ltd. and Orascom Development.

Alternatives

- During June, we funded $250.3 million of commitments to alternative investments, including an initial $31.1 million to our newly-established partnership with GMAM and Capital Trust to purchase high-quality commercial mortgages.

- We closed on five alternative investment partnerships in June – HIG Bayside, NJHL European Buyout, GMAM Core Real Estate, the GMAM/Capital Trust partnership discussed above, and Knight Vinke.

Cash Management Fund

- Total assets in the Cash Management Fund were $18.8 billion as of June 30, 2008. The current yield is 2.27% for state participants, and 2.17% for “non-State” participants.