

THE CLOSING BELL
Report of Jim Marketti, Public Employee Committee, AFL-CIO
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Mixed performance results were reported to the State Investment Council at its January 15, 2009 meeting. Overall performance for New Jersey's pension fund was up +6.31% for December, 2008 to \$63.9 billion. The domestic fixed income portfolio (mainly government and corporate bonds) was the main driver of this return – the bond portfolio was up +10.89% for the month. Even the domestic equity portfolio (stocks) was up +2.23 %. So far, January's stock market returns have been dismal and the domestic equity portfolio is likely to go down again next month.

The really dismal news is in the alternative investment portfolio (real estate, private equity and hedge funds). Hedge funds are down -26% since inception. More than \$4 billion was invested in 39 hedge funds which now have a value of \$3 billion. Union officials and participants have warned since the funds were first being set up that the Division of Investment should move slowly on hedge funds until there was more proof that they would add positive value to the pension funds. Most disturbing was the revelation that 3 of the 39 funds are being redeemed with a total permanent loss to the pension funds of about \$107 million.

There is a trend in the hedge fund industry of fund managers throwing in the towel after suffering large losses. This is because their huge performance fees (20% of anything earned over the original investment) don't kick in until the losses are made up. So some fund managers want out and are closing their funds and giving back what money is left in them (at a substantial loss to investors).

Asset allocation, i.e., how you spread the pension investments over the various asset classes, will continue to spark controversy on the Council and for every pension fund in the country. At the January meeting, the Council was given a presentation by Strategic Investment Solutions, Inc., a consulting firm, which basically advised investment strategies relying on Modern Portfolio Theory. I challenged some of the assumptions underlying the theory. The investment professionals all attacked me for doing so. I believe there is sufficient solid research in the finance journals and elsewhere to call the Theory into question.

On Friday, January 16, 2009, I was on a conference call sponsored by the Service Employees International Union which included union representatives on several pension investment boards across the country including California, Oregon, Illinois and New Hampshire. All of the trustees commented on how Modern Portfolio Theory based investments were failing their funds and that all the scientific mumbo-jumbo surrounding it was not making accurate predictions on how investments perform. I believe this controversy will become more pronounced nation-wide and certainly here in New Jersey.