

2011 ANNUAL REPORT

NEW JERSEY STATE INVESTMENT COUNCIL ♦ FOR FISCAL AND CALENDAR YEAR 2011

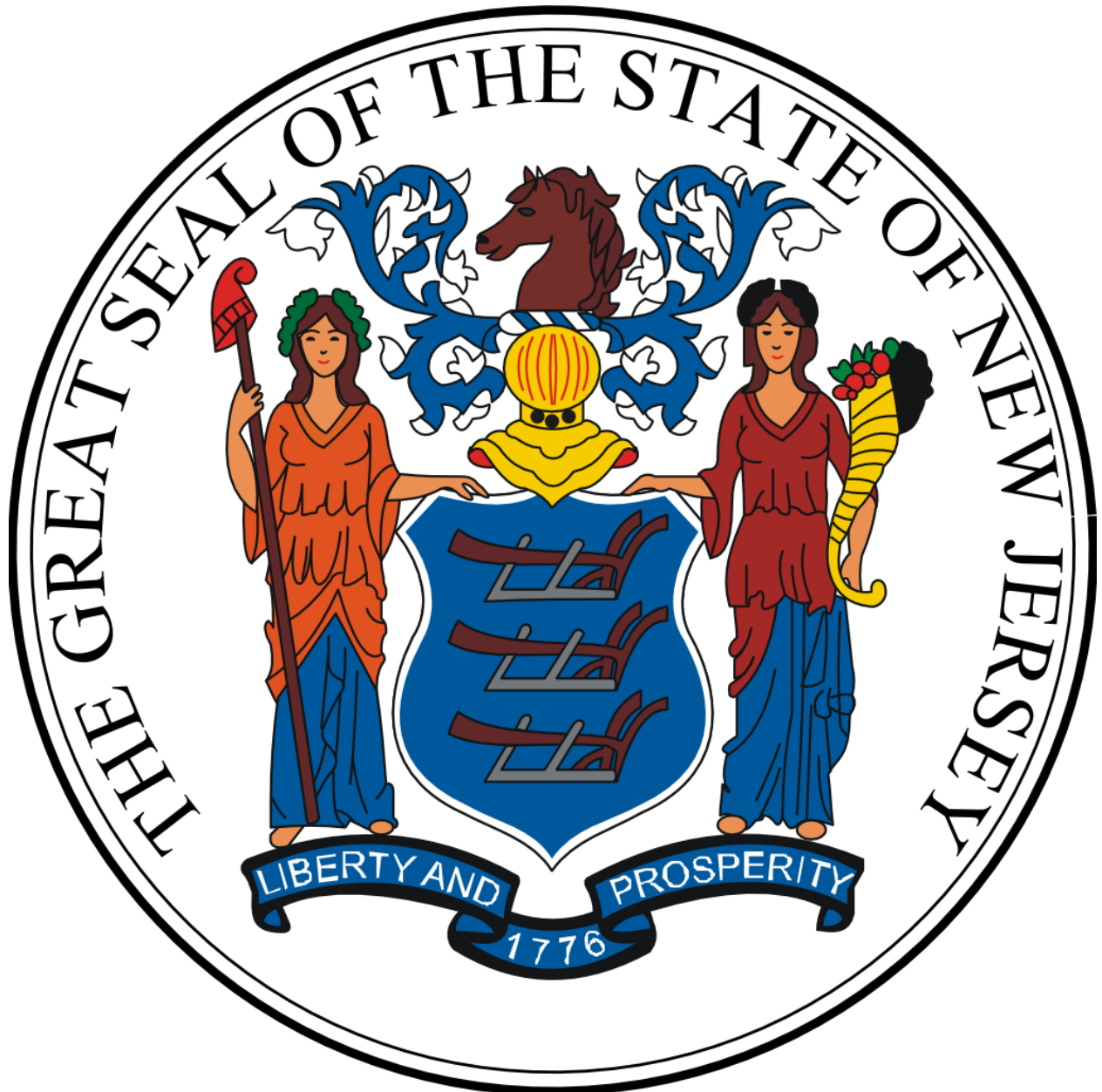


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ADDENDUM A: INDEPENDENT AUDITORS' REPORT ON THE PENSION FUND (SEPARATELY ATTACHED)

**New Jersey State Investment Council
50 West State Street, 9th Floor
P.O. Box 290
Trenton, New Jersey 08625**

February 15, 2012

To the Governor, State Treasurer, the Members of the Legislature, and the Citizens of New Jersey:

I am pleased to send you, as required by statute, the Annual Report of the New Jersey State Investment Council (“Council”) and the Division of Investment (“Division”) for the Fiscal and Calendar Year 2011.

In Fiscal Year 2011, the Pension Fund achieved a return of 18.03% on its investments⁽¹⁾. This represents the Fund’s best return in 13 years. The performance of the Pension Fund also exceeded the benchmark return for the asset allocation selected by the Council and the Division for the portfolio by 1.0%. The Division and its staff should be congratulated for this excellent overall performance and for generating 100 basis points of alpha in 2011 against the policy benchmark.

During the fiscal year, the Pension Fund also paid out \$7.7 billion to plan beneficiaries, a record amount.

At June 30, 2011, the Pension Fund totaled \$73.7 billion, making it the eleventh largest public pension fund in the United States. The Division manages the assets of seven public pension systems for over 800,000 active and retired employees. The Director of the Division is mandated by statute “to manage and invest the portfolio solely in the interests of the beneficiaries of the portfolio and for the exclusive purpose of providing financial benefits to the beneficiaries of the portfolio.”

The Council’s mandate under the law is to formulate investment procedures and policies to be followed by the Director of the Division. The Council takes seriously its responsibility as a fiduciary and its mission to maximize returns for the beneficiaries while managing risk appropriately, and maintains a single-minded focus on that mission. The Council works hard to craft asset allocation policies, to ensure state-of-the-art governance and due diligence policies and procedures, and to provide policy guidance to the Division in pursuit of this goal of maximizing returns for the beneficiaries while managing and mitigating risk.

Over a number of years, the Council and the Division have pursued a policy of increasing diversification. In a volatile world, the Council believes that diversification is a key means of capturing the benefits of attractive investment opportunities while at the same time mitigating the effects of significantly negative performance in any given asset class. Whereas many years ago New Jersey and many other public pension plans invested only in fixed income, and then only in large capitalization U.S. stocks and fixed income, today the Pension Fund invests in a wide array of asset classes and sub-asset classes both domestically and internationally. This diversification has served the Pension Fund and its beneficiaries well. The Division’s consultant has provided data which show that, over the last 20 years, a diversified portfolio of the type which now characterizes the Pension Fund has outperformed either an all-equity or all-fixed income portfolio. This policy of diversification also is important because it recognizes the ongoing and significant changes in the world economy

⁽¹⁾ Returns exclude Police and Fire Mortgages

and the continuing and also significant increase in the scope and sophistication of financial products being made available to institutional investors in today's world.

The long-term funded status of the Pension Fund has also been affected positively by the pension reform legislation signed into law by the Governor in 2011. This package of reforms has brought the projected liabilities closer into balance over the longer term with the Fund's projected assets.

In the current Fiscal Year, the Council and the Division continue to work hard on behalf of the Pension Fund's beneficiaries. We remain committed to the goal of achieving the best returns possible for the beneficiaries while working to recognize, manage, and mitigate risk. All members of the Council thank you for the opportunity to serve in this worthy cause.

Yours sincerely,

A handwritten signature in black ink, appearing to read "R. Grady", written in a cursive style.

Robert E. Grady
Chairman

INTRODUCTION TO THE COUNCIL AND DIVISION

DIVISION STAFF

Director:

Timothy Walsh, Division of Investment

Deputy Director:

Christopher McDonough, Division of Investment

THE STATE INVESTMENT COUNCIL

The State Investment Council (the “Council”) was created by the New Jersey Legislature in 1950 to formulate policies governing the investment of funds by the Director of the Division of Investment (the “Division”), as well as consult with the Director with respect to the work of the Division.

The Council initiates meetings, to discuss major investment policy issues, review Pension Fund performance and accept comments from members of the public. Other investment programs and returns are reviewed annually or when needed.

Council meetings are open to the public. Agendas, meeting times and locations are available on the Division’s website, www.state.nj.us/treasury/doinvest under the State Investment Council tab.

Mailing Address:

PO Box 290, Trenton, NJ 08625-0290

Office:

50 West State Street, 9th Floor, Trenton, NJ 08625-0290 Phone: (609) 292-5106

COUNCIL MEMBERSHIP AT DEC 31ST, 2011:

Council Chairperson:

Robert Grady, Managing Director, Cheyenne Capital Fund ⁽¹⁾

Council Vice Chair:

Brendan Thomas Byrne, Jr., President, Byrne Asset Management ⁽¹⁾

Council Members:

Marty Barrett, Police & Firemen's Retirement System

James E. Hanson II., President and CEO, Hampshire Real Estate Company ⁽¹⁾

Guy Haselmann, Director U.S. Rate Sales & Strategy, Scotia Capital (USA) ⁽¹⁾

James L. Joyner, Teachers’ Pension and Annuity Fund

James P. Marketti, NJ State AFL-CIO Union ⁽¹⁾

Peter Maurer, Public Employees’ Retirement System

Timothy McGuckin, The New Jersey Education Association ⁽¹⁾

Jeffrey Oram, Executive Managing Director, Colliers International ⁽¹⁾

Vacant Positions:

Three gubernatorial appointees

One gubernatorial appointee from nominees submitted jointly by the President of the Senate and Speaker of the Assembly

One gubernatorial appointee from nominees submitted by the AFL-CIO

One gubernatorial appointee from nominees submitted by the State Troopers Fraternal Association

⁽¹⁾ Appointed by Governor

COUNCIL MEMBERSHIP

The State Investment Council is comprised of sixteen (16) members pursuant to N.J.S.A. 52:18A-83 which was amended as part of the Pension and Healthcare reform enacted in June 2011.

Nine members are appointed by the Governor for five year terms, and are drawn traditionally from the corporate investment community. Of those nine appointments, eight are made with the advice and consent of the State Senate. One appointment is made from nominees submitted jointly by the President of the Senate and Speaker of the Assembly. The statute requires that at least seven of the nine gubernatorial appointments shall be qualified by training and experience in the direct management, analysis, supervision or investments of assets, which training and experience shall have been acquired through academic training and/or actual employment in those fields.

Four members are appointed by the Governor from nominees submitted by various employee organizations. Two of the four members are appointed for five year terms from nominees submitted by the New Jersey State AFL-CIO, with at least one appointed member being a member of a union representing police officers or firefighters. One of the four members is appointed for a three year term from nominees submitted by the New Jersey Education Association (NJEA). The fourth member is appointed by the Governor for a three year term from nominees submitted by the State Troopers Fraternal Association. The statute requires that these four appointments shall be qualified by training, experience or long-term interest in the direct management, analysis, supervision or investments of assets and this training, experience or interest shall be supplemented by academic training in the fields of economics, business, law, financial or actuarial science or by actual employment in those fields.

Three members, representing the Public Employees' Retirement System (PERS), Teachers' Pension and Annuity Fund (TPAF) and Police and Firemen's Retirement System (PFRS), are designated from members of the respective pension system's board of trustees and serve three year terms.

All members serve until reappointed or a successor is named and has qualified.

THE NEW JERSEY DIVISION OF INVESTMENT

The Division of Investment, under the supervision of the State Investment Council, is the 11th largest public pension fund manager in the United States⁽¹⁾, the 37th largest pension fund manager globally⁽²⁾ and the 16th largest among public and corporate pension fund managers.⁽³⁾ The Pension Fund supports the retirement plans of approximately 800,000 active and retired employees in seven public pension systems: the Consolidated Police & Firemen's Pension Fund, the Judicial Retirement System, the Police & Firemen's Retirement System, the Prison Officers Pension Fund, the Public Employees' Retirement System, the State Police Retirement System and the Teachers' Pension & Annuity Fund (collectively referred to in this report as the "Pension Fund").

The net asset value of the Pension Fund was \$73.7 billion as of June 30, 2011, an increase of approximately \$6.9 billion or 10.3% from June 30, 2010. In addition, approximately \$7.7 billion was paid to plan beneficiaries during the fiscal year. In total, the fiscal year 2011 investment return for the Pension Fund, excluding the Police and Fire Mortgages, was 18.3%, the highest return for the Pension Fund in 13 years.

⁽¹⁾⁽³⁾ Measured by assets as of 9/30/10. Reported by P&I, [Top 1,000 pension funds back in positive territory](#). February 7, 2011.

⁽²⁾ Measured by assets as of 12/31/10. Reported by TowerWatson.com, [P&I/TW Top 300 Pension Funds: Analysis at 2010 year end](#). September 2011. Page 37

The Division also manages the State of New Jersey Cash Management Fund, Supplemental Annuity Collective Trust (a 403b plan), a portion of the NJBEST Fund (a 529 college savings plan) and several funds under the New Jersey State Employees Deferred Compensation Program (a 457 plan).

STATUTORY AUTHORITY AND HISTORY OF THE DIVISION

The Division was created in 1950 by the New Jersey Legislature (P.L. 1950, c.270) to centralize all functions relating to the purchase, sale or exchange of securities for the State's diverse funds under experienced and professional management. The statute also established a State Investment Council to formulate investment procedures and policies to be followed by the Director of the Division. The statute vests investment authority in the Director of the Division, who is appointed by the State Treasurer from candidates nominated by the Council. New and amended regulations adopted by the Council after public comment are filed with the Office of Administrative Law and reported in the *New Jersey Register*.

INVESTMENT PARAMETERS

All investments must conform to the heightened "prudent person" standard set by the New Jersey Legislature (P.L. 1997, c.26). This standard requires the Director "to manage and invest the portfolio solely in the interests of the beneficiaries of the portfolio and for the exclusive purpose of providing financial benefits to the beneficiaries of the portfolio."

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

NET ASSETS UNDER MANAGEMENT

	<u>Net Assets in Millions</u>	
	6/30/2011	6/30/2010
Pension Fund	\$73,735	\$66,824
The Pension Fund contains pension assets contributed by participants and by state and local employers for currently working and/or retired participants in seven statewide retirement plans.		
Teachers' Pension & Annuity Fund	27,657	25,670
Public Employees' Retirement System	24,334	21,794
Police & Firemen's Retirement System	19,656	17,440
State Police Retirement System	1,808	1,639
Judicial Retirement System	263	262
Consolidated Police & Firemen's Pension Fund	7	8
Prison Officers' Pension Fund	10	11
Cash Management Fund*	\$14,654	\$13,127
This fund contains the cash balances of state government funds and "other-than-state" government entities (counties, municipalities, school districts and the agencies or authorities created by any of these).		
Supplemental Annuity Collective Trust	\$162	\$137
This fund contains voluntary investments by employees for retirement income separate from, and in addition to, their basic pension plan.		
Trustees for the Support of Public School Fund	\$134	\$128
This fund contains reserves required to support the rating of school bonds issued for the maintenance and support of the state's public schools.		

*The total for the Cash Management Fund includes \$4.5 billion in 2011 (\$3.3 billion on 6/30/10) held for and included in the totals for the Pension Fund, the Supplemental Annuity Collective Trust, Trustees for the Support of Public Schools Fund, the NJBEST Fund and Deferred Compensation Program.

NJBEST FUND

The Division manages some of the contributions of New Jersey residents for the state's tax-advantaged 529 college savings program. On June 30, 2011, the Division-managed portion of this fund had a market value of \$426 million (\$390 million on 6/30/10).

DEFERRED COMPENSATION PROGRAM

The Division manages some of the assets contributed by employees into the New Jersey State Employees Deferred Compensation Program. Prudential Retirement, a business of New Jersey-based Prudential Financial, serves as the third-party administrator for this plan. Funds managed by the Division include contributions to the Bond (Fixed Income) Fund, Equity Fund, Money Market (Cash Management) Fund and Small Capitalization Equity Fund. On June 30, 2011, these funds had a combined market value of \$594 million (\$546 million on 6/30/10).

10 YEAR PENSION FUND FINANCIAL SUMMARY

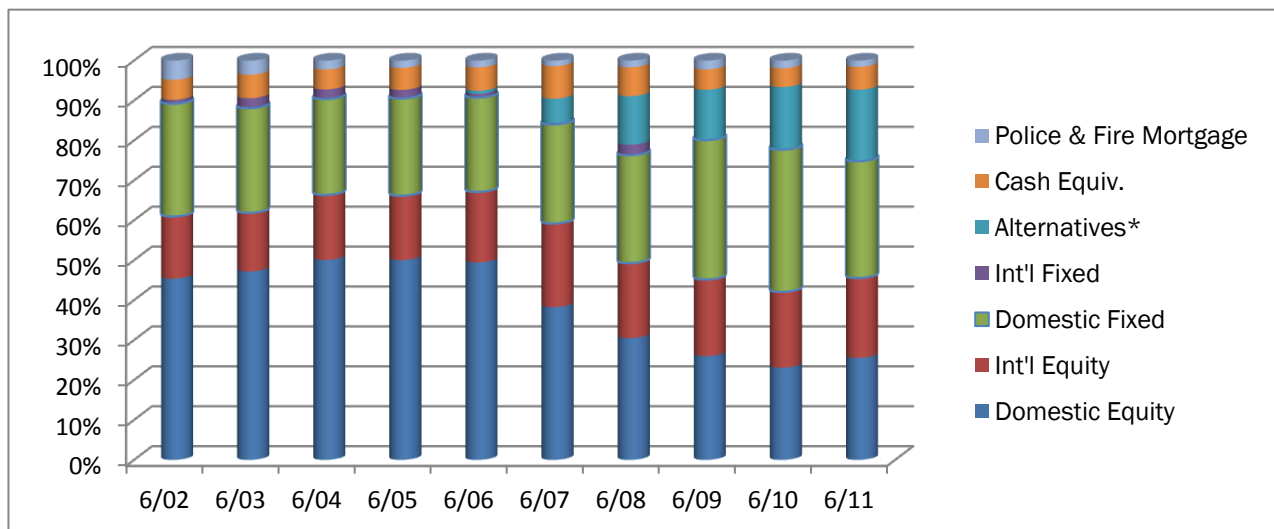
The Pension Fund's return of 18.03% for fiscal year 2011 was the highest return achieved by the fund since fiscal year 1998.

Fiscal Year	Net Assets (\$Billions)	Rate of Return ⁽¹⁾	Gross Pension Payments (\$Billions)
2011	73.7	18.03%	7.7
2010	66.8	13.40%	7.0
2009	62.9	-15.50%	6.6
2008	78.6	-2.70%	6.1
2007	82.5	17.10%	5.6
5 YR Annualized Return		5.23%	
2006	73.1	9.80%	5.2
2005	69.8	8.80%	4.8
2004	67.8	14.20%	4.4
2003	62.6	3.30%	4.1
2002	63.3	-8.60%	3.6
10 YR Annualized Return		5.20%	

⁽¹⁾ Returns exclude Police and Fire Mortgages

Asset allocation policies for the Pension Fund are adopted and revised by the Council as conditions warrant. Eligible investments are governed by the "whole plan" or "whole portfolio" principle, which permits a broad spectrum of investments to ensure diversity, and optimize expected risk/return tradeoffs on the investments as a whole.

Pension Fund Composite Asset Allocation History



*Alternative Investment Program started 9/05

PENSION FUND ASSET ALLOCATIONS

Actual Allocation vs. Fiscal Year 2011 Investment Plan Target 6/30/2011

	Actual Allocation%	Target %	Difference %	Allocation (\$millions)	Performance%
US Equity Total	25.55	19.00	6.55	18,843.07	33.40
Intl Developed Markets Equity	15.70	15.00	0.70	11,552.01	27.04
Intl Emerging Markets Equity	4.30	5.00	-0.70	3,169.46	27.99
Total Public Equity	45.55	39.00	6.55	33,564.54	30.41
US Fixed Income	23.03	30.25	-7.22	17,019.17	4.68
US High Yield	2.47	3.50	-1.03	1,821.39	21.27
Total Public Fixed Income	25.50	33.75	-8.25	18,840.56	6.05
Police & Fire Mortgage Program ⁽¹⁾	1.55	N/A	1.55	1,145.25	5.90
Total Police & Fire Mortgage Program	1.55	N/A	1.55	1,145.25	5.90
Commodities and Other Real Assets	1.61	4.00	-2.39	1,191.93	28.25
TIPS	3.72	5.00	-1.28	2,746.03	8.35
Total Inflation Sensitive Assets	5.33	9.00	-3.67	3,937.96	13.06
Private Equity	7.30	5.50	1.80	5,384.21	21.68
Private Real Estate	3.70	3.00	0.70	2,731.63	17.55
Absolute Return/Hedge Funds	5.30	6.75	-1.45	3,910.59	10.69
Total Alternative Investments	16.30	15.25	1.05	12,026.43	16.93
Cash ⁽²⁾	5.72	3.00	2.72	4,216.60	0.40
Total Pension Fund ⁽³⁾	100.00	100.00	0.00	73,731.35	17.79
Total Pension Fund ex Police and Fire Mortgages					18.03

Totals may not equal sum of line items due to rounding

⁽¹⁾ Police & Fire Mortgage Program is not included in target asset allocation, assets are private mortgages that by law cannot be sold

⁽²⁾ The cash aggregate comprises the Domestic Equity, Domestic Fixed Income, International Equity and the Alternative Investments cash accounts, in addition to the seven plan cash accounts

⁽³⁾ Individual asset class balances include the market value of derivatives; however the performance of derivatives is only included in the Total Pension Fund

TOTAL PENSION FUND RETURN VS BENCHMARK

	RETURNS			
	FY11	3 Years	5 Years	10 Years
Total Pension Fund	17.80			
Total Pension Fund ex Police and Fire Mortgages	18.03	4.18	5.23	5.20
Total Fund Benchmark ⁽¹⁾	17.03	4.25	5.83	7.00

⁽¹⁾ Benchmark is a weighted composite of index returns in each asset class

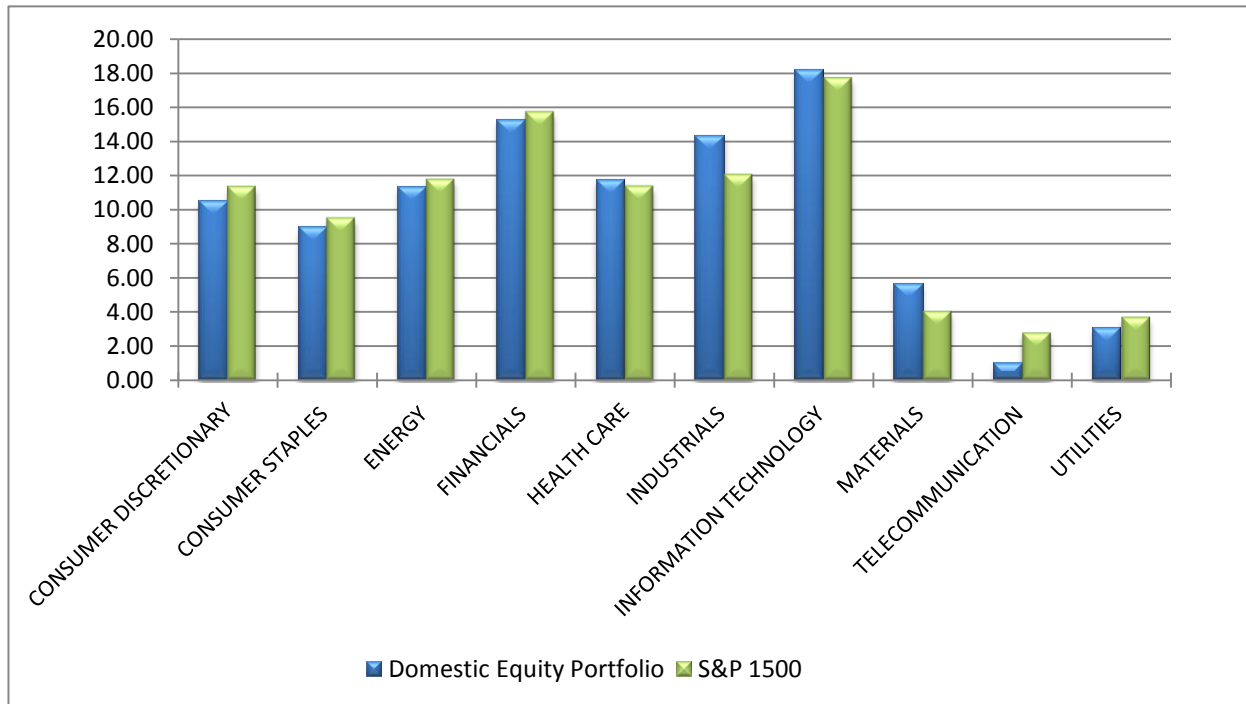
- Total Fund ex. Police and Fire Mortgage outperformed the benchmark by 100 basis points for this fiscal year. The outperformance was driven by strong performance relative to the benchmarks for domestic equity and fixed income, as well as an overweight to the domestic equity asset class.

DOMESTIC EQUITY HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS			
	FY11	3 Years	5 Years	10 Years
Domestic Equity with Cash, Hedges, Miscellaneous	32.47	5.49	4.93	3.67
vs. S&P 1500 Composite	31.65	3.87	3.29	3.31

- The domestic equity portfolio outperformed the benchmark by 82 basis points for fiscal year 2011.
- The domestic equity portfolio is broadly diversified by economic sector and includes approximately 1,000 publicly traded stocks. While exposure to most sectors and industries is comparable to that of the overall market benchmark, the Division will overweight and underweight securities and sectors in the portfolio in an effort to outperform the benchmark.
- For fiscal year 2011, an underweight to the financial sector and an overweight to the industrial and material sectors were the largest contributors to relative performance, while an underweight to the telecom sector was the largest detractor. Stock selection in information technology stocks was the largest single contributor to the outperformance of the portfolio relative to the benchmark, while stock selection in the energy, financial, and material sectors were also strong for the fiscal year. Stock selection within the consumer discretionary sector was the largest deduction to performance.
- The Pension Fund finished the fiscal year with fairly sizable overweight to domestic equity (25.6% actual allocation vs. 19% target for the fiscal year 2011). The overweight benefited performance for the fiscal year as domestic equity was the best performing segment of the total Pension Fund.

Sector Weighting of Domestic Equity Portfolio in Comparison to S&P 1500 as of 6/30/11



Top Holdings in Domestic Equity as of 6/30/11

Company	% of Portfolio
APPLE INC	3.53
EXXON MOBIL CORP	2.98
MICROSOFT CORP	1.97
JPMORGAN CHASE & CO	1.82
GENERAL ELECTRIC CO	1.73
PFIZER INC	1.53
MERCK & CO. INC.	1.51
ORACLE CORP	1.30
CONOCOPHILLIPS	1.24
INTL BUSINESS MACHINES CORP	1.22

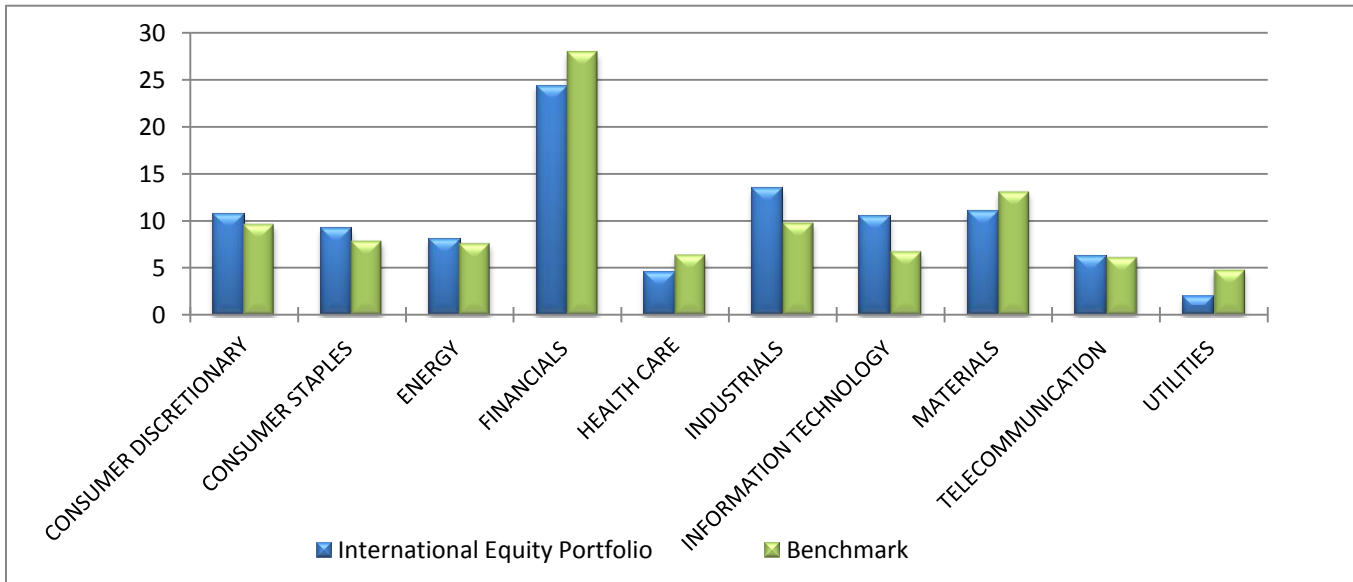
INTERNATIONAL PORTFOLIO HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS			
	FY11	3 Years	5 Years	10 Years
International Equity with Cash, Hedges, Miscellaneous	25.58	0.13	3.24	6.43
<i>vs. Custom International Benchmark ⁽¹⁾</i>	28.70	-1.40	1.51	5.66
<i>vs. MSCI All Country World Index (ex US)</i>	29.73	-0.35	3.67	7.48
Developed Markets Equity	27.04			
<i>Custom International Developed Market Benchmark ⁽¹⁾</i>	28.64			
<i>MSCI EAFE Index</i>	30.36			
Emerging Markets Equity	27.99			
<i>Custom Emerging Market Benchmark⁽¹⁾</i>	27.92			
<i>MSCI Emerging Markets Index</i>	27.80			

⁽¹⁾ These benchmarks are based on MSCI data, which was provided by MSCI for the internal use of the Division only and may not be redistributed or used in connection with creating or offering any securities, financial products or indices. MSCI disclaims all express and implied warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to such data. These benchmarks exclude those securities deemed ineligible for investment under the State statutes governing investments in Iran and Sudan.

- The international arena was particularly challenging with an escalating European debt crisis, the tsunami, earthquake, and nuclear disaster in Japan, Arab Spring uprisings throughout the Middle East, heightened global concern over inflation and lack of confidence in most financial institutions.
- The total international portfolio underperformed the internal custom benchmark by 312 basis points for fiscal year 2011. The emerging market equity portfolio slightly outperformed the custom emerging market benchmark by 7 bps, while the developed market equity portfolio underperformed its internal custom benchmark by 160 bps.
- The international equity portfolio is broadly diversified with exposure to more than 45 countries and approximately 590 publicly traded non-U.S. stocks. The equity asset allocation reflects a top-down, fundamentally-driven investment methodology, which may result in the portfolio having country, sector, and securities weightings that can differ from those of the custom benchmarks.
- For the fiscal year, the portfolio's two emerging markets ETFs generated the largest positive contribution to return. From a regional perspective, Asia ex Japan detracted the most from performance on a relative basis. On a relative basis by country, France was the top performer, while the UK was the largest negative contributor to return.
- Overall, stock selection had a positive impact on performance while country allocation had a negative impact. In particular, our overweight position in Japan and underweight positions in S. Korea and the UK detracted from performance. In contrast, our overweight in France and underweight in China and India were positive for the portfolio's performance.
- From a sector perspective, being underweight in the financial and utilities sectors helped the portfolio while being underweight in the materials sector hurt performance from both an allocation and selection perspective.
- At the close of the fiscal year, the largest geographic overweight was Europe and largest underweight was emerging markets.

Sector Weighting of International Equity Portfolio in Comparison to Custom International Equity Markets Index as of 6/30/11⁽¹⁾



⁽¹⁾ This display represents sector weights against the NJDOI internal custom benchmark, which excludes those names deemed ineligible for investment under the State's Sudan and Iran Divestment laws.

Top Holdings in International Equity as of 6/30/11

Company	% of Portfolio
ISHARES MSCI EAFE INDEX FUND	5.55
ISHARES MSCE EMERGING MARKETS	4.70
VANGUARD EMERGING MARKETS ETF	2.35
HSBC HOLDINGS PLC	2.20
BHP BILLITON PLC	1.47
SAP AG COMMON	1.45
RIO TINTO PLC	1.35
MITSUBISHI UFJ FINANCIAL GROUP	1.18
GIVAUDAN AG	1.08
L OREAL	1.02

DOMESTIC FIXED INCOME HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS			
	FY11	3 Years	5 Years	10 Years
Domestic Fixed Income with Cash, Hedges, Miscellaneous	5.98	9.68	8.65	7.04
vs. Barclays Long Gov/Credit	3.20	8.19	7.67	7.24
vs. Domestic Fixed Income Custom Benchmark ⁽¹⁾	3.98			
Corporates, Treasuries, Agencies	4.68			
TIPS	8.35			
Barclays US Infl-Linked Bond Index	7.78			
High Yield	21.27			
Barclays High Yield Index	15.63			

⁽¹⁾ 83.5% BC Gov/Credit Long and 16.5% BC US Inflation Link Bond Index (TIPS)

- High yield was the best performing segment of the portfolio for the fiscal year, up in excess of 21% (vs. 15.6% for the high yield index). The bank loan fund portfolio within high yield was up 25.6%.
- The Pension Fund's underweight to fixed income (29% allocation vs. 39% target for the fiscal year) benefited the overall Pension Fund performance for the fiscal year.
- The fixed income portfolio benefitted from being overweight investment grade corporate bonds, which outperformed nominal U.S. Treasuries.
- The U.S. Treasury Inflation Protected Securities (TIPS) portfolio performed well, returning 8.35% and outperforming US Infl-Linked Bond Index by 57 basis points. The outperformance can be attributed to a longer duration in the sector.
- Duration was shortened by 0.71 years from 10.36 to 9.65 as there was considerable concern for rising rates earlier in the fiscal year. Rates ended up tightening considerably due to issues in Europe as well as the overall fear of a U.S. recession.

ALTERNATIVE INVESTMENTS

PRIVATE EQUITY HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS		
	FY11	3 Years	5 Years
Private Equity	21.69	3.87	5.44
Cambridge Associates	21.33	4.29	10.40

- The Pension Fund committed \$725 million to seven new private equity partnerships in fiscal year 2011.
- The private equity portfolio contributed \$1.26 billion to various funds and received distributions totaling \$963 million during the fiscal year.
- While the private equity portfolio is beginning to mature, as evidenced by the significant level of distributions in fiscal year 2011, the longer-term performance (5 years) is still impacted by the immaturity of the portfolio relative to the benchmark.

REAL ESTATE HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS		
	FY11	3 Years	5 Years
Real Estate	17.55	-12.19	-4.11
NCREIF(NPI)	16.73	-2.57	3.44

- The Pension Fund contributed \$500 million to three new real estate partnerships in fiscal year 2011.
- The real estate portfolio produced positive performance in all four quarters of the fiscal year and returned 17.6%, beating the NCREIF one-year return of 16.7%.
- The real estate portfolio contributed \$708 million to various funds and received distributions of \$178 million.

HEDGE FUNDS HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS		
	FY11	3 Years	5 Years
Hedge Funds ⁽¹⁾	10.69	-0.77	2.03
HFRI Fund of Funds Composite	7.13	-4.73	-0.93

⁽¹⁾ Hedge Fund performance includes the effect of transferring a number of bank loan funds from Alternative Investments to Domestic Fixed Income in fiscal year 2009. Trailing Hedge Fund Performance including bank loans funds as of June 30, 2011 as calculated by the Hedge Fund Consultant is: 1 Year: 12.88%, 3 Year: 4.27%; 5 Year 5.14%.

- For fiscal year 2011, the Pension Fund allocated \$440 million to direct hedge fund strategies, including new investments and additions to existing investments.
- For the fiscal year, all hedge fund strategies produced positive returns, with most direct hedge fund investments returning in the 10-15% range.
- Fund-of-funds strategies generally underperformed direct investments for the fiscal year.

COMMODITIES/REAL ASSETS HIGHLIGHTS OF FISCAL YEAR 2011

	RETURNS	
	FY11	3 Years
Real Assets/Commodities	28.25	-11.40
DJUBS Total Return Index	25.91	-11.87

- The Real Assets/Commodities portfolio outperformed the benchmark by 234 bps of the fiscal year.
- The Pension Fund remains underweight commodities as the program is built. This underweight was a net positive for fiscal year 2011 with the S&P 1500 outperforming the DJUBS Total Return index.
- The Pension Fund continued to tactically increase the commodity exposure through internal management primarily via ETFs.

SUMMARY OF CALENDAR YEAR 2011

PENSION FUND PERFORMANCE (UNAUDITED)

Returns and Values as of End of Calendar Year 2011

Total Net Assets in Billions	\$66.1
Annual Return ⁽¹⁾	1.68%
Total Fund Benchmark ⁽²⁾	-0.50%

⁽¹⁾ Total Pension Fund excluding Police and Fire Mortgages

⁽²⁾ Benchmark is a weighted composite of index returns in each asset class

The Pension Fund returned an estimated 1.68% for the calendar year versus -0.65% for the benchmark. The outperformance was primarily due to allocation overweights to US Treasuries and investment grade credit, as well as an overweight to US equities versus non-US equities.

Within public equities, the domestic equity portfolio returned 0.22%, versus a benchmark return of 1.75% for the calendar year. Among the factors affecting US equity prices in 2011 were economic and political concerns, European uncertainties, and credit market issues.

The international equity portfolio returned -18.26% for the calendar year, underperforming the international equity portfolio benchmark of -14.32%. External events affecting international equities were the European debt crisis that spanned the whole year, a debilitating March 2011 earthquake in Japan and uprisings and regime changes in parts of the Middle East.

The fixed income portfolio also slightly underperformed, returning 15.11% versus the benchmark's 15.84% return. Investment grade fixed income securities including credit and Treasuries performed well, returning 17.10%, while high yield lagged at 3.87%. Treasury Inflation Protected Securities (TIPS) returned 16.11%.

The alternative investment portfolio had a strong calendar year, returning 6.78%. Private Equity and Real Estate were the best performing sectors, returning 13.31% and 13.73%, respectively. Hedge Funds returned -1.36%, while commodities returned -3.23%. This performance is based on the most recent available cash adjusted market values which are reported on a lag.

Cash assets within the Pension Fund ended the calendar year with an estimated return of 0.25%.

CASH MANAGEMENT FUND

	RETURNS			
	FY11	3 Years	5 Years	10 Years
Cash Mgt. Fund	0.30	0.77	2.40	2.46
vs. US Treasury Bills (3 month)	0.16	0.42	2.00	2.13

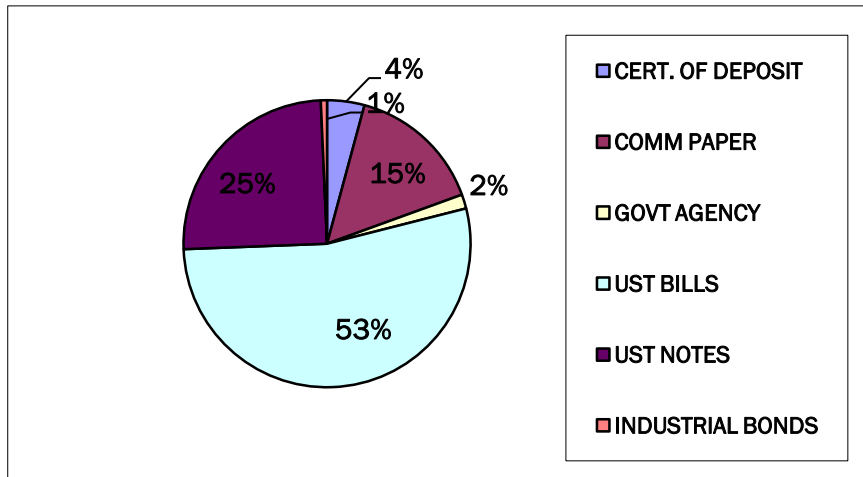
The State of New Jersey Cash Management Fund has consistently beaten its benchmark. The downward trend in rates is due to the Federal Reserve's continuing policy of maintaining lower short term interest rates.

PORTFOLIO ANNUALIZED INTEREST RATES AS OF 6/30/2011

	STATE	NON-STATE	AVG.DAYS
6/30/2011	0.17%	0.07%	118

During the fiscal year ended June 30, 2011 net assets of the State of New Jersey Cash Management Fund increased by \$1.5 billion, or 11.6%, primarily due to net participant contributions. The days to maturity continue to be maintained between 100 to 120 days due to the high concentration of US Treasury securities in the Fund.

CASH MANAGEMENT ALLOCATION CHART AS OF 6/30/2011



CASH MANAGEMENT DETAIL AS OF 6/30/2011

	Percentage	PAR (\$000)
CERT. OF DEPOSIT	4.21%	615,000
COMM PAPER	15.24%	2,228,290
GOVT AGENCY	1.59%	232,965
UST BILLS	53.35%	7,799,042
UST NOTES	24.91%	3,641,200
INDUSTRIAL BONDS	0.70%	102,000
TOTAL	100.00%	14,618,497

COSTS OF MANAGEMENT

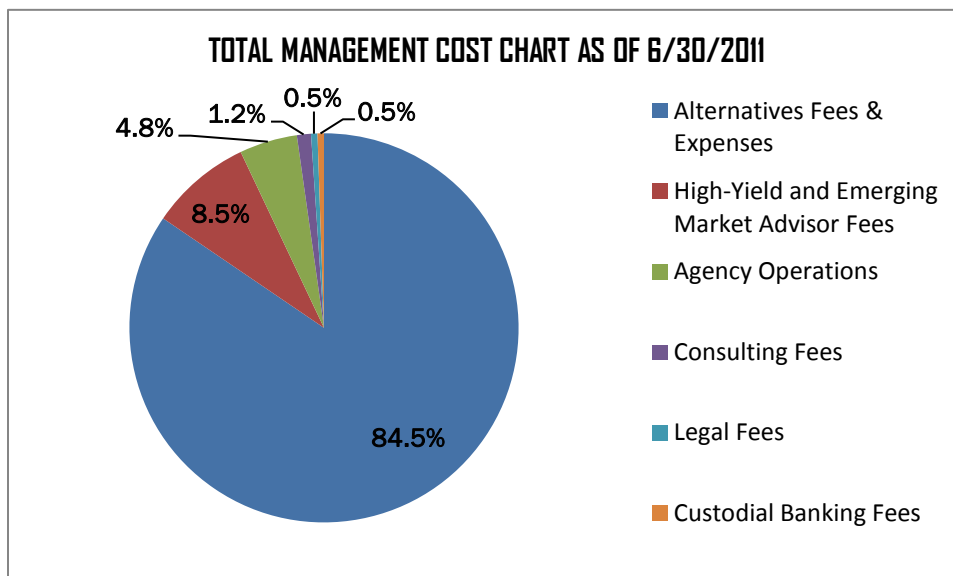
The Division operates at among the lowest costs of all public pension funds, largely because approximately 81% of the net assets of \$85.2 billion are actively managed by in-house staff. The Division relies on external fund managers only for alternative investments; it also utilizes the expertise of external investment advisors in the specialty areas of emerging market equity and high-yield fixed income.

The Division paid \$174 million in fees and expenses in fiscal year 2011 to the alternative investment fund managers. These investments totaled \$13.2 billion on June 30, 2011. Annual fees in this sector therefore represent 1.3% of the June 30 market value. The Division paid an additional \$17.4 million to the advisors of its emerging market equity and high-yield fixed income portfolios in fiscal year 2011. Investments in these portfolios totaled \$2.7 billion on June 30, 2011. Annual fees in this sector thus represent 0.6% of the June 30 market value.

Operating expenses for staff compensation, overhead and equipment were \$9.9 million for the fiscal year, and represent about 4.8% of total costs. Remaining expenses, which include fees for consulting services, custodial banking and legal services, are shown in the chart below.

In total, costs to manage the portfolios totaled 0.24% of assets under management for the fiscal year.

	Fiscal Year Ended	6/30/2011
Alternative Investment Fees & Expenses		\$174.0
High-Yield and Emerging Market Advisor Fees		17.4
Agency Operations		9.9
Consulting Fees		2.4
Legal Fees		1.1
Custodial Banking Fees		1.1
Total		\$205.9 million
Total net assets under management		\$85.2 billion
Cost as a percentage of assets under management		0.24%
Cost per each \$100 under management		24 cents



COMMISSIONS

The Division incurred broker/dealer commission costs totaling \$34.7 million for fiscal year 2011 from equity security trades related to the \$85.2 billion in assets under Division management. The brokerage commission total includes \$3.9 million in “soft dollar” commissions used to procure systems and services critical to the Division’s trading and research.

The Division purchases and sells certain investments with no involvement by a broker/dealer, including commercial paper, certificates of deposit, foreign currency transactions and investments in alternative investment funds by transacting directly with the issuer, partnership or fund; as a result, no direct commissions are paid.

COUNCIL REGULATIONS AND STRUCTURE

In addition to investment guidelines established by law, the State Investment Council is authorized by statute to establish investment policies consistent with economic and fiscal trends and in accordance with its fiduciary responsibility and the authority provided under P.L. 1950, c.270. All proposed regulations and amendments are filed upon approval of the Council with the Office of Administrative Law for publication in *The New Jersey Register*, followed by a 60-day public comment period. Following the public comment period, each proposal is returned to the Council for adoption, along with any comments received. The adopted regulations of the State Investment Council are published in the New Jersey Administrative Code (N.J.A.C. 17:16), and are available for viewing on the Division’s website at: <http://www.lexisnexis.com/njoal/>

COUNCIL ORGANIZATIONAL CHANGES DURING FISCAL AND CALENDAR YEAR 2011

The Council underwent the following organizational changes between December 31, 2010 and December 31, 2011:

- Orin Kramer, who served as Council Chair from September 2002 until September 2010, resigned effective January 27, 2011.
- The membership of the Council was amended by PL 2011 c. 78, effective June 30, 2011.
 - Total membership was increased from 13 to 16 members. The current membership is reflected on page 4 of this report.
 - The terms of four members ended as of the effective date of the legislation:
 - i. Nicholas Caprio (Public Employees Retirement System);
 - ii. Richard Klockner (Teachers Pension and Annuity Fund);
 - iii. Marty Barrett (Police and Fireman’s Retirement System); and
 - iv. Andrew Michael Greaney (State Police Retirement System).
 - Three members were elected by the members of their respective retirement systems:
 - i. Peter Maurer for Public Employees Retirement System;
 - ii. James Joyner for Teachers Pension and Annuity Fund; and
 - iii. Marty Barrett was re-elected for Police and Fireman’s Retirement System.
- James Kellogg resigned effective July 31, 2011.
- The Council elected Robert Grady as Council Chair and Brendan Thomas Byrne, Jr., as Council Vice Chair for a one year term, commencing in October 2011.

LEGISLATIVE AND REGULATORY UPDATE

REGULATORY UPDATE

On April 18, 2011, N.J.A.C. 17:16-69, 71, 90 and 100, governing investments in alternative assets were amended. The aggregate regulatory ceiling for alternative investments was increased from 28% to 38%. The amendments for real estate, private equity and absolute return fund investments allow for limitations of nine percent, twelve percent and fifteen percent, respectively from the prior individual caps of seven percent. The real asset limitation remains at seven percent. These amendments provide the Division with greater flexibility and provide opportunities for further portfolio diversification.

On August 15, 2011, N.J.A.C. 17:16-22, governing investment in fixed income exchange-traded funds, was amended to include funds which invest in international securities to provide for portfolio diversification.

On August 15, 2011, N.J.A.C. 17:16-45, governing put options, was amended to include the purchase of put options for any securities, assets or foreign currencies which are permissible for investment in the Pension Fund, including indexed options. The amendments also allow the use of put spreads (i.e. the simultaneous purchase and writing of put options on the same security). The amendments provide the ability to utilize standard market conventions to hedge downside risk.

On January 17, 2012, N.J.A.C. 17:16-62 (Common Pension Fund A), 63 (Common Pension Fund B), 67 (Common Pension Fund D) and 69 (Common Pension Fund E) were amended to provide for the calculation of a daily net asset value which will enable the admission to or withdrawal from the common pension funds on a daily basis. This will allow the common pension funds to maintain lower cash balances, providing for the continued investment of funds. The amendments also provide for the elimination of the issuance of physical certificates of participation and the monthly cash distribution of income to the participating funds from Common Pension Funds A and B.

The Council has proposed amendments to N.J.A.C. 17:16-71, governing investment in real assets. The proposed amendments will provide for debt investments in addition to equity investments and broaden the real asset categories. The proposed amendments will be published in the *NJ Register* and are subject to a 60 day comment period.

PROHIBITED INVESTMENTS

The Division maintains a list of international companies ineligible for investment under two state laws: a Sudan divestiture law adopted in 2005 (P.L. 2005, C. 162), and an Iran divestiture law adopted in 2007 (P.L. 2007, C. 250). The Division utilizes an independent research firm to assist it in complying with the provisions of the statutes.

Divestitures pose three primary fiscal challenges to the Pension Fund: they require the identification and sale of holdings on a timetable that doesn't consider market conditions; they impact risk and return for the Pension Fund; and they permanently reduce the investment universe available to the Pension Fund. Together, the Sudan and Iran divestiture laws reduce the investment universe by almost 8% in developed markets and 6% in emerging markets, relative to its respective benchmarks in fiscal year 2011.

NORTHERN IRELAND REPORT

The Division has been required since 1987 (P.L. 1987, c.177) to report annually to the Legislature on whether the US companies and their subsidiaries in which it is invested and which do business in Northern Ireland are adhering to the "McBride Principles," a name given to a body of employment laws aimed at reducing religious unrest in that country.