Committee Meeting

of

SENATE LEGISLATIVE OVERSIGHT COMMITTEE

"The Committee will hear testimony from invited guests on the State pension system's increasing reliance on alternative investments and the level of management fees paid out to hedge funds"

LOCATION: Committee Room 4
State House Annex
Trenton, New Jersey

DATE: June 4, 2015
10:30 a.m.

MEMBERS OF COMMITTEE PRESENT:

Senator Robert M. Gordon, Chair
Senator Loretta Weinberg, Vice Chair
Senator M. Teresa Ruiz
Senator Paul A. Sarlo
Senator Thomas H. Kean Jr.
Senator Samuel D. Thompson

ALSO PRESENT:

Michael R. Molimock
Office of Legislative Services
Committee Aide

Mark Magyar
Senate Majority
Committee Aide

Brian Ahrens
Senate Republican
Committee Aide

Meeting Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, PO 068, Trenton, New Jersey

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REVISED
COMMITTEE NOTICE

TO: MEMBERS OF THE SENATE LEGISLATIVE OVERSIGHT COMMITTEE

FROM: SENATOR ROBERT M. GORDON, CHAIRMAN

SUBJECT: **COMMITTEE MEETING – JUNE 4, 2015**

The public may address comments and questions to Michael R. Molimock, Committee Aide, or make bill status and scheduling inquiries to Shirley Link, Secretary, at (609)847-3855, fax (609)292-0561, or e-mail: OLSAideSLO@njleg.org. Written and electronic comments, questions and testimony submitted to the committee by the public, as well as recordings and transcripts, if any, of oral testimony, are government records and will be available to the public upon request.

***The Senate Legislative Oversight Committee will meet on Thursday, June 4, 2015 at 10:30 AM in Committee Room 4, 1st Floor, State House Annex, Trenton, New Jersey.**

The committee will hear testimony from invited guests on the State pension system's increasing reliance on alternative investments and the level of management fees paid out to hedge funds.

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SENATOR ROBERT M. GORDON (Chair): Good morning, everyone. I apologize for the late start. We had some technical issues to deal with.

I want to welcome you all to the Senate Legislative Oversight Committee's hearing on the New Jersey pension system. But before we get started, would you all rise and join me in the Pledge of Allegiance? (all recite pledge of allegiance)

May I have a roll call, please?

MR. MOLIMOCK (Committee Aide): Senator Thompson.

SENATOR THOMPSON: Here.

MR. MOLIMOCK: Senator Sarlo.

SENATOR SARLO: Here.

MR. MOLIMOCK: Senator Ruiz is present.

Senator Weinberg.

SENATOR LORETTA WEINBERG (Vice Chair): Here.

MR. MOLIMOCK: Senator Gordon.

SENATOR GORDON: Here.

Again, I'd like to welcome you all to this meeting of the Senate Legislative Oversight Committee. We are meeting today to have a hearing on New Jersey pension system's growing reliance on hedge funds and other alternative investments, and the increasing fees being paid to Wall Street management firms.

It has been 11 years since New Jersey began its foray into the world of alternative investments at the urging of Orin Cramer, a hedge fund executive who headed the State Investment Council under governors McGreevey, Codey, and Corzine. That investment, and the management fees paid, have quadrupled under Governor Christie and his State Investment Council Chair, Bob Grady.

Today, almost $3 out of every $10 in our State pension funds are in alternative investments. And the management and performance fees have jumped from $150 million in 2009, to almost $600 million today. It is time for us to engage in an honest assessment of where New Jersey stands relative to other large pensions systems, and determine if we are getting our money's worth.

While there have been many headlines focusing on the propriety of pension fund investments with politically connected firms, that is not the focus of today's hearing. Our focus is on, one, the growing reliance on alternative investments in the State's pension system portfolio, and whether these investments are the best use of resources in a severeley underfunded system; two, assessing the performance of alternative investments compared with other investment choices in delivering an appropriate mix of risk and return, for the hundreds of thousands of retirees and current employees who rely upon us to make sure their pensions are there when they need them; three, whether the management and performance fees paid for the alternative investment portfolio are justified by the return on investment; four, whether hedge funds truly provide a hedge against losses in stock market downturns; and, finally, whether another mix of investments would provide the same protection in a down market without such high fees.

This is a highly complex issue, and this may just be the first of a series of hearings on the State pension fund and its investments.

I want to stress that this is not a *gotcha* hearing, and it is not partisan. New Jersey's shift to alternative investments was made under both Democratic and Republican governors. Our purpose today is fact finding. Today we are beginning an honest and, I believe, a long overdue dialogue about the health of our State's pension system.

Our hearing today will be divided into three parts: First we will hear from Thomas Byrne, recently elected as the Chair of the State Investment Council; and Christopher McDonough, Executive Director of the State Division of Investment. We are grateful that they are joining us to provide their expert insights into New Jersey's growing reliance on alternative investments, as part of an overall strategy to meet the challenges facing New Jersey's pension system.

Second, we will hear from Mr. Jeff Hooke, an investment expert hired by the State AFL-CIO to analyze the performance of the State's alternative investment portfolio. Mr. Hooke is the author of a groundbreaking 50-state study of Wall Street fees and pension returns, for the Maryland Public Policy Institute, that was the first in the nation to really focus on the issue of how much money state pension systems were paying to Wall Street for fund management.

Third, we will hear from Adam Liebtag, Vice Chair of the State Investment Council, who is a leader of the Communication Workers and serving as the NJ AFL-CIO representative on the Council; as well as Thomas Bruno, Chair of the Public Employees Retirement System Board of Trustees, which has commissioned a forensics audit of the State's pension investment.

The Committee extends its welcome to all of you.

I'd like to invite Mr. Byrne and Mr. McDonough to make some opening remarks.

Mr. Byrne.

BRENDAN THOMAS BYRNE Jr., Esq.: Thank you, Senator Gordon, and good morning to your colleagues and others in the room.

I think the last time I was in this room was in 1996 for a meeting of the Electoral College, so it's been a while.

Anyway, listen -- I welcome the opportunity to be here because we manage a lot of money; we manage it for hundreds of thousands of beneficiaries of the State and other public employees; and I feel it's important that they understand how their money is being managed. And so, from the outset, I've said that I want to make sure that we are as transparent as possible in what we do -- for better or worse, frankly. People ought to understand -- whether it's an individual managing your money, or the State in the case of the pension system -- you ought to know how your money is being managed and so on.

One thing I will say -- and I hope this, over time, helps to clarify things -- at the last meeting of the State Investment Council we had a similar discussion. There weren't that many people in the room, but I thought that in some of the things we went over people who were in the room walked out thinking, "These people are actually doing a pretty good job." And it's easier to convey that in person sometimes than it is in the media -- as anyone who's elected to office knows -- in certain circumstances.

I also just want to point out that the Council is comprised of a roughly equal number of Labor representatives and gubernatorial appointees. Right now, we have a few vacancies, but there are seven Labor reps on the Council; six gubernatorial appointees, I believe. And we've operated in a very collegial fashion. I mean, there really haven't been any major disagreements at all among Council members about how the money is being invested. And I think others on the Council would agree that we have full and open discussions. And I let discussions go on as long as necessary before we reach results on important issues such as asset allocation -- as we did in our last meeting.

So, with that, let me stress a couple of items. First of all, our returns have been above actuarial expectations over most time horizons. They're excellent on a risk adjusted basis. And our nominal returns are roughly in line with our peers, depending on what timeframe you use -- and I'll go through that in more detail in a few minutes.

The diversification into other asset classes has kept us from putting all of our eggs into one or two baskets. And too many eggs in one basket hurt the pension fund badly back in 2000 and 2001, when the tech bubble burst. And that's a mistake that we would like not to repeat.

Those asset classes, in general, require more specialized expertise than do the plain vanilla asset classes -- domestic stocks and fixed income. And so maybe the best analogy I can make is between a general practitioner in medicine and a specialized doctor -- a brain surgeon, for instance. You know, specialization generally costs, and so we're not giving people management fees because we love them; we're giving them management fees because we think the diversification is important.

So let me go through a couple of numbers -- and I'll try to mix not too many numbers -- but mix that with the philosophy and the methodology behind our approach.

So over a three-year period -- and I'm using numbers as of April 30 -- so as of three years our actual return was 10.34 percent on average, annually. And that's against a bogey of 7.90 and 7.95, I guess, for part of that period. It's come down from 8.25 over the last few years since I've been on the Council. But anyway, double-digit returns over the last three years, and against a 9.32 percent benchmark. So when I say *bogey,* what I mean is an actuarial expectation set by the Treasurer in consultation with actuaries and investment experts. And the number they've come up with right now is, as I say, 7.90.

The benchmark is a blend of relevant indexes. So, for instance, in stocks the most common benchmark is the S&P 500 index. We use the S&P 1500 index because we're big and we own a broader array of stocks. They correlate pretty closely.

So when you have all these other asset classes you look at appropriate benchmarks for each asset class and come up with a blended one based on your asset allocation. And, of course, we do this at the same time that we make our asset allocation decisions. So at our last meeting, we said, "Okay, here's the asset allocation we all agreed to." Well, when I say *all*, I think there were two abstentions; there were no dissenting votes. And the abstentions -- it wasn't that anybody put a different idea on the table.

So anyway, it's important to note that we set the benchmark at the same time so that there's no luxury of looking back and creating a slightly different benchmark that makes you look better or worse.

So anyway, we beat our benchmark by a little over a percent, on average, over the last three years. A five-year period, our return was 8.42 percent -- no, I'm sorry, 9.38 percent against a benchmark of 8.42; so outperforming by, again, just slightly less than a percent.

Over a 10-year time horizon, our return was 7.32 percent, on average, annually -- which beat the benchmark, again, by a percent of 6.32 (*sic*) percent. But, as you can see, we were under the actuarial expectation; and, of course, that is because of 2008. But I would argue that this is a huge value added. We beat the benchmark by roughly a percent a year over a 3-, a 5-, a 10-year time horizon.

Now, another way to measure returns is comparing us against peers. And these numbers -- these percentile numbers can vary all over the lot because there's actually a fairly narrow gap, in percentage terms, among large public pension funds. Nobody is doing anything radically different from anybody else, and so the difference between the 25th percentile and the 75th percentile, over a 10-year time horizon, is only 55 basis points, i.e. a half a percent in returns -- a significant amount of money in dollar terms, but, as I said, the point is that these percentile rankings are tight in percentage terms.

So over a one-year horizon, we're in the 58th percentile -- so slightly below the median; over three years we're in the 50th percentile, which is exactly the median; over five years we are in the 75th percentile, which is not particularly good, but there's a reason for that. We had bad relative performance in Fiscal 2011. We were up 18 percent, but it was a big year in the capital markets, particularly the stock market, and we somewhat lagged there. But over 7 years we were in the 27th percentile, which is quite good; and over 10 years the 61st percentile.

So, anyway, as I say, I think it's important that you understand that, but also understand the limitations of that particular measure.

So a fundamental question asked by any critic over the last few years is, "Why don't we invest more heavily in stocks?" And the answer is that we do have our largest exposure to public equities, and that number is -- 46 percent? Is that--

CHRISTOPHER McDONOUGH: Yes.

MR. BYRNE: It's 46 percent.

So, you know, why not 70 or 80? Well, first of all, we invest in some private equity, and we'll get to that. But it's for a number of reasons. First of all, you have to judge asset allocation decisions in the context of what people knew at the time. So if you rewind to 2010, for instance, Robert Schiller, who is a professor -- a well-respected professor of finance at Yale -- in July of 2010 he went through his P/E multiples and basically said that he thought stocks back then were about 25 percent overvalued.

We use outside consultants who are experts, who consult with us and with other large public pensions funds and other managers. And in November of 2010 our consultants said that they expected the return over a 5- or 10-year time horizon for U.S. large-cap stocks to be about 8.1 percent a year. Obviously the market has done better than that.

But anyway, those are the sort of projections on which we prudently rely. Any weather forecaster can tell you what you should have worn yesterday.

So more recent prognostications -- the *Wall Street Journal*, in an article in October 2014, referred to something called the *Pension Consulting Alliance* -- compiled investment-return projections from eight investment consultants and five asset managers for a portfolio of 70 percent stocks, 30 percent bonds. And the median projected return over the next 10 years was 5.9 percent. No advisor projected a return exceeding 6.5 percent. So again, there are limitations on a strategy like that. And we've gone back and looked at numbers historically, and we've concluded that our strategy outperformed a 70-30 strategy in most relevant periods -- that we can cover later.

So some of this-- We digest this information; the staff does, members of the Council do. At least one Council member -- and this is a matter of public record -- has, for a number of years, been arguing that stocks are artificially inflated by the Federal Reserve's very stimulative policies and money creation, and has urged caution. I think it's fair to say -- and this is a purely subjective comment -- that most of the Labor members on the Council have also been concerned with volatility and downside risk, and have leaned toward not being overexposed to stocks.

So again, having said all that, our allocations are pretty much in line with other large plans -- maybe a percent or two on the more conservative side. So here are some comparisons: Bank of New York Mellon reports that public funds with assets over $1 billion have an average allocation of 47 percent to public equities. Another consulting firm, called Cliffwater, reported an average public equity allocation of 50 percent for state pension funds at the end of 2013. We had a target and an actual allocation, as I said earlier, of 46 percent of public equities.

So again, you know, there's a little bit of, "What have you done for me lately?" and the stock market has been strong in these years. But, again, I referred to 2000 earlier, where New Jersey did not do very well at all. And if we look back to the period around 2008 you'll see what diversification has done for us. And I'm going to give you some fiscal year numbers -- because that's what the State runs on -- and then some calendar year numbers -- because that's what people tend to relate to in the market.

So in Fiscal Year 2008, the S&P 500 Index fell 13.11 percent total return; New Jersey, that year, lost only 2.61 percent. Nobody that year asked us why didn't have more money in stocks.

In Fiscal Year 2009, the S&P lost 26.23 percent, and New Jersey's fund was down 15.48 percent. So again, defense mattered.

Relative to a 70-30, I have that for you on a calendar year. New Jersey lost 22.4 percent; a 70-30 strategy would have lost 24.34 percent.

Again, I'll get into some of the specific advantages of alternative investors later on, but we had money in a couple of places. And this is just illustrative, but I think important to understand. In Calendar Year 2008, a firm called Brevan Howard, that we're invested in, was up 20 percent in a year that the S&P was down 37 percent for the Calendar Year.

We have money with another manager, called BlueTrend, that was up 43 percent in that same period of time. And so, the point is that we have money with certain managers and in certain asset classes that have low correlations to other things and that tend to smooth out returns.

Another thing is, I looked at numbers -- just so you have some frame of reference -- of 2000 through 2010. In that period of 11 years, the average return for the S&P 500 was 0.41 percent. The most commonly used benchmark of hedge fund returns for that period was, on average, 6.74 percent. So in 6 out of those 11 years, hedge funds did better than the stock market. And yes, the world has changed since then. And none of us, I don't think, can predict when that world might change again.

So the other measure of returns that I would like to point out is *risk adjusted returns* -- which is to say, you can put money in very risky assets and in good times do very, very well. But there are measures of returns versus volatility in a portfolio. And in those measures, on both a 3- and 5-year basis, New Jersey is in the 19th percentile, i.e. in the top quintile of pension funds around the country. And, you know, defense is important. As you know, if something loses 50 percent, you have to make 100 percent to break even.

So I will say that at times it's hard to please everybody. We had a public commentator at our last meeting who spoke, but also left us a memo -- and I was glad they did, because it makes it easier to respond to certain questions or concerns. At one point in the memo they said, "Pension plans should invest solely in the interest of the participants and beneficiaries, not in a manner to chase high returns." Two pages later, they said, "The State Investment Council has a duty to generate maximum return on our investments." I mean, those are somewhat contradictory statements. So that's what I'm saying: We can't please everybody.

So I want to talk now a little bit about what we've done in alternative investments. As you know, this isn't the good old days of the 1990s where interest rates on Treasury securities ranged typically between 6 and 7 percent -- sometimes a little bit higher. So that, obviously, made it easier to achieve higher returns from the fixed income market. And, of course, returns on corporate fixed income securities were even higher. And so looking back at alternatives, the $20.6 billion that we had invested in alternatives at the start of Fiscal Year 2014 earned $3.7 billion in gross profits, and $3.1 billion in net profits. If those assets had been invested in investment-grade fixed income, they would have earned $1.3 billion. So even after all fees and expenses, this is a difference of $1.8 billion.

So I'll give you what we did just in the last year. Just in these assets that we've shifted in Fiscal Year 2014, with the same analysis, we've generated an additional $125 million in profits.

So a couple of takeaways from this: Number one, our net return on this money is 15 percent. That's $3.1 billion over an opening balance of $20.6 billion. So I think most people would agree that's pretty good. In essence, we paid $334 million in incentive fees for an incremental $1.8 billion into the pension fund. Another way of framing this is to ask you, "Would you pay $335 to make an additional $1,800?" Well, the answer from the endowments at Princeton, and Harvard, and Yale is "yes." Part of our fund is invested in a manner similar to the way top universities invest, although they have far more in alternatives than we do. I dare say that if the alumni of Princeton, and Harvard, and Yale thought their donations were being wasted, they would presumably give less to their institutions -- and that's clearly not the case. What I would say, though, is that they can afford to do more because they have presumably a perpetual life, and they can afford more bumps in volatility in the short term. And they demonstrated that pretty clearly in 2008, but have risen to new highs since.

So if you look at our Fiscal Year 2014 annual report, in alternatives -- which consist of hedge funds, but also private equity, real estate, real assets, and global diversified credit -- $236.9 million can be attributed to management fees and expenses for the Division's alternative portfolios. And again, against a principle balance of $20.6 billion, that comes out to management fees of 1.15 percent for specialized areas. The total performance fees, as I noted earlier, is $334.8 million, so the total management fees come out to about $580 million. The incentive fees come out to a total of 1.63 percent of total alternative assets, and they come out to 9 percent of the profits that we make. So in other words, as I've said repeatedly, the more we make in profits, the higher our incentive fees are going to be.

So I said they're 9 percent of profits; but you read in the newspaper that hedge funds and other such managers charge 2 and 20; so why isn't the number 20 percent, rather than the 9 I cited? Well, for a number of reasons: First of all, there are so-called *hurdle rates*, so that most of these alternative managers don't get paid any incentive fees until they've made somewhere between 6 and 8 percent in a year, depending on the asset class.

Number two, virtually all of these managers have so-called *high water marks*. So if they go down in year one, and back to the same place in year two, they don't make any money yet. They have to generate you real profits -- real economic profits over time to make that money.

And third, there are any number of preferential terms negotiated by the staff of the Division of Investment. And I think they do a remarkably good job in doing that.

You know, one other minor point that I want to make here is that these incentive fees are often referred to in the media as *tax dollars.* They're not tax dollars. They come out of the fund and out of the profits generated by the fund. And if there were no profits, there would no dollars.

So the other important thing to note here is that most comparisons of fees are simply not apples to apples. When I did the percentile rankings of our investment returns versus other states, those are apples to apples. Here, they're not. And the reason is because most states just don't disclose incentive fees at all; or, if they do, they don't put them in the totals, they put them in a footnote somewhere. We wanted to be fully transparent, and so we do do that. I think the world is changing. Some years ago I don't think there really were many questions about this, and so it wasn't necessarily done this way anywhere. So I think New Jersey is certainly one of the leaders in disclosure here, if not *the* leader. And we probably are *the* leader.

Senator Gordon, in one of your questions, you basically asked us if there is a better way. We're always looking for it; we haven't found it yet. And what happens if we say that we won't pay these fees, somebody else will. There's a big world out there. The Norway Sovereign Fund has 10 times as much money as the State of New Jersey pension fund. Singapore, Ontario Teachers, Texas Teachers -- on and on. You know, there are a lot of people who want to hire managers who will make them an incremental 15 percent, and that's just what the good managers are charging.

And we have a top quartile standard for a number of reasons. We won't invest with anybody who doesn't have a track record that's in the top quartile. We could probably get cheaper fees, but then you'd have the problem of adverse selection -- you'd have managers who you probably didn't want. And so we don't want to go down that route.

I don't want to suggest the top quartile suggests that they're always going to be top quartile. The SEC makes you say that, "past performance is no guarantee of future results," for a reason. But we do invest with people with proven track records and credibility in the business, and so on.

It's also important to note that this money really did come out of fixed income, and not out of our equity exposure. Our exposure to public equities was 45 percent -- I can't read my own writing -- 45 or 46 percent in 2009, and the same in 2014. So there's been no shift into alternatives from public equities. It came from fixed income which is, as I've said, just yielding less and less, and is less and less a viable thing for our investments.

So alternative investments -- and I think you all know -- comprise a lot of different asset classes. Private equity -- and most experts think that private equity -- for a number of reasons that I can go into if you want -- should yield, over time, better than public stocks. We've also gone into things like global diversified credit, where there are opportunities for non-bank lenders to make more loans than they did before 2008. The regulations have tightened on banks worldwide, and so certain hedge funds step in and make loans that banks might have made a decade ago.

So over a three-year time horizon in global diversified credit, our average return has been 11.5 percent, versus only 4.3 percent for investment-grade credit. And over a five-year time horizon -- a little bit narrower -- but 10.5 percent versus 7.5 percent.

So in those asset classes in particular, we have done very well. Not every alternative investment has worked out in the way that we had hoped. And again, I think it's important to go back and look at what the best information you had at the time was. So if you rewind to 2009 and 2010, the conventional wisdom was that the Fed was printing a lot of money; when a central bank prints a lot of money it generally leads to inflation; inflation devastated stock portfolios in the 1970s, and it was important to put at least a little bit of our money in an asset class that might protect against that.

So we had some money in real assets, and inflation has not materialized. Real assets have not done particularly well. Who would have guessed that oil would have declined by nearly 50 percent in the past year? And not all things that are considered inflation hedges perform identically. So our real estate portfolio has done relatively well; things in hard assets, such as oil, have not.

And so I just worry about cherry-picking, and saying, "Well, you know, this investment didn't do well." It was a sensible diversification at the time, and so on.

I want to spend just a minute or so on certain misconceptions surrounding some of the alternative investments -- things that people read in the paper and go, "Oh, my goodness, they're doing a terrible job." So here's one: We got a memo from a public commentator that said, "ValueAct Capital Partners II. We paid them $14 million fees, but an investigation by the *Philadelphia Inquirer* revealed that the fund had zero returns." I went back before the last Council meeting and found that article online. And I'll read it, verbatim. "The documents show New Jersey also paid fees totaling $14 million last year to ValueAct Capital Partners II, a San Francisco hedge fund, where the State invested $150 million; it has yet to return a dollar."

Well, what I explained to the people at the meeting was that New Jersey's investment in this outfit was initially $150 million in November 2011. It's currently worth $284 million and change, producing a net gain of about 1.9 times our investment, and generating a 22 percent average annualized return -- pretty good.

People, reporters, commentators -- whomever -- just misunderstood that this money was still locked up in a partnership. And when they say *zero return,* it simply means the money hasn't been given back to us -- but it's our money, and it has nearly doubled.

I'll give you another example, verbatim from *philly.com*: "The State paid Canyon Balanced Fund, run by Canyon Capital Advisors of Los Angeles, $10 million last year. The State invested $125 million, and has received back $1 million so far. A Canyon affiliate was an investor in the failed Revel Casino in Atlantic City." I remember a headline in the *Times of Trenton* -- I almost called the editor -- there was a headline; I can't remember it verbatim, but it said something to the effect of "State pension fortunes rest on casino bets." Well, Canyon was, as I say, $125 million. They invest in a lot of things. And they don't tell you everything that they invest in -- just as if one of you asked me to manage your money, I don't tell you every stock I'm going to invest in.

So we don't know if they made or lost money on Revel. They could have bought distressed Revel bonds at 20 cents on the dollar and sold them for 40 cents on the dollar for all we know. What we do know is that in the years 2012 and 2013, when the Revel Casino was facing particular difficulties, Canyon's Balanced Fund was up 20.5 percent in 2012, and 20.07 percent in 2013. Their other fund, which we're also invested in, was up 18.1 and 15.7 percent in those years, respectively.

And so the reason I mention these things, or some of these news articles, is I think that they can act to really hurt public confidence -- particularly for the beneficiaries -- in what we're doing. When, in fact, in a lot of cases like this we've actually been doing pretty well for them.

So one of the things that alternative does -- and I think I've -- I hope I've made clear -- is that it's made our return smoother. We loose far less in bad markets, but have made less when stocks are strong. In general, I think smoother returns are a good idea. Warren Buffett seems to agree. I'm going to read you a quote from his 2010 letter to shareholders. "Looking forward, we hope to average several points better than the S&P, though that result is, of course, far from a sure thing. If we succeed in that aim, we will almost certainly produce better relative results in bad years for the stock market, and suffer poorer results in strong markets." Now, Buffett has the luxury of investing, solely or primarily, in stocks, which is different than what we do. But the point is that here's the person regarded as the country's, probably, best investor, and he says that smoothing is a good thing and important.

So one other point that I want to make, and it's a question that I've been asked, and may be asked today. If we're so smart, why did California get out of hedge funds? And let me talk about that for a minute. They didn't get out alternatives; they got out of one narrow category of hedge funds -- which I understand was about 2 percent of their overall portfolio. And, from what I understand from consultants -- not talking to California directly, because I don't know those people -- they felt it was an inordinate amount of time spent on a rather small percent of their overall portfolio. And I understand that a number of the funds that they were invested in had not been doing well, even relative to their own benchmarks. Nothing says that they're right or wrong; we don't know yet. What is generally true is that a lot of these types of investors -- hedge funds, in particular -- tend to do well when market volatility is high. And market volatility, as we know, has been relatively low in the last few years.

So as you noted, Senator Gordon, the expansion into alternatives was initiated by Democrats, and later ratified and expanded by Republicans because it's working. An irony here in my mind is that this investment approach is one of the few areas in which governors Corzine and Christie agree -- at least in general -- and yet we get criticized, largely by a few observers who present data selectively and without full context. It's a bit like referring to Reggie Jackson as the all-time strikeout leader without saying anything else about him.

The Labor representatives on the Council have been active participants in our asset allocation discussions and in our review of managers. And as I indicated earlier, they're free to propose a different allocation of assets than recommended by our outside consultants, and any such recommendation can be voted on. But as I indicated, it's been a very collegial approach on the Council, and I think a pretty broad agreement.

I noted that we use this top quartile standard, which I think has protected us. And, you know, our primary focus has simply been on what's best for the beneficiaries. And again, that's why I'm happy to be here today. I want the record to be clear, and I want people to understand exactly what the Council and, more importantly, the staff is doing for them.

While I mention the staff, I want to say that in my interactions with them they've been terrific; they've been professional; they work very, very hard to negotiate good fees for us. They have been-- In domestic equities we have fairly consistently outperformed the S&P 1500 and the S&P 500. They've done a terrific job. And they're quite underpaid, relative not just to Wall Street, but relative to other public pension funds. And so one of the risks that I see is my concern about holding some of the good talent we have. And we've lost a number of really good people over the years. And when I say *underpaid,* I don't mean by 5 or 10 percent; there are people doing this for three times the amount of money in other states as we're paying our senior staff.

One of the areas in which we've lagged, interestingly enough, is in international equities. And we've gotten better, over time, but in a sort of perverse way, I guess. It kind of points out the need that when you get into more specialized asset classes, further from plain vanilla stocks and bonds, it's where expertise actually would helped us. And I haven't attempted to quantify what we might have saved there, but it does point out that expertise actually can be very, very helpful.

So I'm getting to sort of a conclusion. I'm obviously happy to take whatever questions you have.

Our disclosure is extensive; a good bit of what I've said today can be gleaned from the Division of Investment website. If there's any data presented today that seems to conflict with what we've presented, we'll certainly get back to the Committee with any clarifications or corrections.

We issue an annual report which summarizes this data, and I want to make sure that its format stays consistent from year to year so that apples-to-apples comparisons are more easily made. You know, I compare that. And where this came into my head, I guess, is that I've read the budget and brief documents for at least 20 years, and it's not consistent from year to year and so it's very difficult to make apples-to-apples comparisons. So I'm hoping that we can set a standard there as well.

As you all know, the biggest problem in the pension system has been with adequate funding form the State by the last six governors and associated legislators. And so my bottom line is that if we truly care about the sustainability of the system and the retirement security of State employees, I hope that the Legislature focuses its attention primarily on adequate funding, and on the recommendations of the pension Commission on which I serve.

I say that because -- I say all this because, in simple terms, investing this money boils down to, really, three choices. And I'm oversimplifying here a little bit to make a point. Number one, stocks. Stocks can have high returns, but we should not forget the huge draw downs in the 1970s, in 1987, in 2000, and in 2008. Too much exposure to stocks in a bad time could hasten the demise of these funds.

Choice two is fixed income. And as I've noted, the returns from fixed income just aren't there. It's not the good old days.

Choice three is other investments. Here we have the potential for returns that beat stocks in many years -- though not recently -- and at least smooth out our overall returns because they're uncorrelated to stock returns. If I could predict which years alternative investments did better than stocks, I'd be phoning in from a nice island somewhere. (laughter) The fees in this field are much higher than we would like, but unfortunately, we don't get to set the prices. Our choice is, basically, to invest or not. I believe that over the long term we're far better off to spread out our investments, and thus, our risk.

So with that, I'm happy to answer any questions that I can. I'll get back to you on anything that I can't answer. I've also sat with a few legislators individually over the years to discuss these issues, and I'm happy to do so with anyone who desires to do so.

So sorry I went on so long, but I hope it was helpful. And I thank you for your attention.

SENATOR GORDON: Thank you, Mr. Byrne, for a very comprehensive presentation.

I know there are a number of questions, but I think what we're going to do is ask Mr. McDonough--

MR. BYRNE: Yes.

SENATOR GORDON: --if he has a statement -- to present that, and then we'll follow up with some questions.

MR. BYRNE: That would be great.

MR. McDONOUGH: Thank you, Senator Gordon and other members of the Committee.

I had a presentation that was passed out, I believe; hopefully, everybody has a copy.

In the places where it's overlapping with Chairman Byrne's comments, I'll try to breeze through those and focus more on expanding on a few topics and making a few other points.

So just turn to slide 2, just to kind of set the stage. Here are our longer-term returns. These are as of March. Chairman Byrne just told you as of April, but they'll be very similar -- just one month prior here.

You can see the returns have been strong, in both an absolute sense and a relative sense: 3-year at 9.9 percent; 5-year at 9.6 percent; 10-year at 7.1 percent. It's not on here, but the 20-year is actually 8.2 percent.

As Chairman Byrne mentioned, the returns have also been strong relative to our benchmarks. So outperformance in all periods, and if you look at 1 percent of our performance over 10 years, on a fund that's averaged about $74 billion, that's an additional $7 billion of assets that are in the fund today that otherwise would not have been there if we just met the performance of the benchmark over this period.

I just want to take a step back for a minute and talk about a little bit on slide 3, about what exactly are we talking about when we say *alternative investments.* I think that's a little bit about what this discussion here today is about. Broadly speaking, any investment that's not a stock, a bond, or cash is generally lumped into a category called *alternative investments.* So in some cases you can be talking about a completely different type of asset; real estate is a perfect example. You go out and buy an office building or an apartment building. That's clearly a different asset than a stock or a bond.

It can also be a different way of investing in the same asset classes as traditional stocks and bonds. So you can invest in real estate through buying bonds or mortgages related to particular properties. You can invest in hedge funds that also invest in stocks and bonds, but they do it in a hedge basis -- meaning that they're both long securities and short securities -- so they're *hedged* to the market.

The important takeaway is that while these strategies tend to be grouped together, they play vastly different roles in the portfolio. For example, one of the main goals of a real estate portfolio is to provide income. One of the objectives of a private equity portfolio is to enhance total returns of the pension fund. And one of the goals of a hedge fund portfolio is to mitigate risk, provide diversification, and provide downside protection.

On slides 4 and 5 we talk a little bit about the history of the alternative program in New Jersey. So starting on slide 4, the first investment in the alternatives program actually happened at the end of Calendar Year 2005. The genesis of the program was actually several years before that in 2001 and 2002. During that time, the pension fund lost $17 billion in the stock market during the tech crash of 2000 and 2001. This was about 30 percent of the planned assets at the start of this period. As Chairman Byrne said, this is the primary reason why we do not put all of our eggs in one basket.

Around 2003, an independent consultant recommended that consideration be given to decreasing the portfolio's reliance on public equities, and that strategies be introduced to improve the risk-return profile of the plan.

In 2004, a general consultant was hired, and they concurred with the recommendation of the original consultant. And as I said, the program was initiated in 2005.

Importantly, by this point most other large public funds had already been investing in so-called *alternative investments* for a number of years. You can see that somewhat on slide 5.

The reality is, alternative investments are not so alternative anymore. A recent review of 95 state pension systems in the U.S. found that 90 of them have an allocation to alternative investments. The chart on slide 5 shows the growth of New Jersey's allocation to these types of investments -- that's the green bar -- relative to a universe of 11 large public pension funds -- the grey bar. And this universe was compiled by on Hewitt Investment Consulting; they are the largest global investment consulting firm in the world. Their clients have assets of over $2.8 trillion.

As you can see, New Jersey's allocation to alternative assets has grown, but is still below that of our peers.

The chart also drives home a point that Chairman Byrne mentioned, about the fact that the increase in allocations to alternatives has come at the expense of our investments in fixed income -- and that's the blue bar you see declining over time. Since 2010, we have had a strategy to reduce the allocation to fixed income assets and move the money to more attractive investment opportunities, including alternative investments -- and I will touch more on that in the next slide.

I would suspect that one of the reasons we're here today is that recent reports and press items have criticized the performance of our alternatives program because it has underperformed the S&P 500. I suspect you will hear some more of that at some point today. The entire premise is faulty, for two reasons. First, as described earlier, different types of investments have different roles in the portfolio, and the goal of the alternative investment program is not to outperform the S&P 500. The S&P 500 represents a small fraction of the stocks and other investments available to investors in the marketplace today.

Second, as the chart clearly shows, we have funded the increase to alternative investments through a reduction of fixed income. The returns support the fact that this was the correct decision -- and I will close with that at the end.

With regard to public equities, as Chairman Byrne said, our allocation there is in line with what it was in 2010. So any suggestion that we have not participated in the recent bull market is false.

If you would turn to slide 6. Most of the materials and most of our discussion today is generally backwards-looking. But on slide 6 we try to look forward. This slide shows the long-term expected returns for the asset classes we invest in. We use this type of analysis to help us develop our asset allocation plan, which we present to the State Investment Council every year. Public equities, particularly in the U.S., have been fantastic for investors the last few years. Most indices are at record highs. The S&P has returned over 200 percent since the market bottom in 2009; the NASDAQ has returned over 300 percent during this period. Now, with the Fed removing stimulus and valuations, the P/E multiple stretched, the prospects for future returns are lessened. For stocks outside the U.S., the prospects are slightly improved, but the uncertainty and risk is greater.

The first two rows you see on this table here are fixed income investments -- bonds. We have been in the midst of a 35-year (*sic*) bull market for fixed income as interest rates have continuously declined to record lows. That party is likely over as the Fed has told us they have every intention of raising rates. There is an inverse relationship between interest rates and bond prices; as interest rates rise, bond prices decline. To put that into context, the yield in the 30-year Treasury bond, which is generally considered a fairly low risk investment for investors, was 2.8 percent at the end of the year -- meaning if you bought that bond and held it until maturity, you would earn 2.8 percent. The long-term average yield has been 6.7 percent -- that's 400 basis points higher. If yields move back to their historical averages over the next year, an investment-grade bond portfolio would lose 25 percent of its value in a one-year period.

Now, I'm not here to tell you that that's going to happen, but I am fairly confident that yields and rates will be higher in coming years than they are today. So even on a 1 percent increase in the yield on the Treasury bond, a typical portfolio would lose over 5 percent of its value. For every dollar you have losing 5 percent, you need another dollar earning over 15 percent to reach your actuarial assumption. The bottom line is this will not be good for any investor who has a significant portion of their portfolio in investment-grade bonds.

If our goal is to reach the 9 percent actuarial target, we need to find other ways to make money, and we think investments in areas such as real estate, private equity, and hedge funds give us the best chance to do that.

One thing you'll notice here is that we expect returns for private equity and hedge funds to outperform public equities over longer periods of time. This is not wishful thinking. Over the past 20 years private equity has returned 13 percent per year, net of all fees. Investors in global equities have returned 7.5 percent over the same period.

Similarly the case is true for hedge funds. Over longer periods of time, hedge funds have outperformed both global equities and the S&P 500 due to their ability to protect value in down markets, as Chairman Byrne previously mentioned.

On slide 7, I'd like to just touch on the topic of fees and the dangers of comparing them among other pension funds. We -- being the Division of Investment, as well as our consultants -- have done significant work on this topic and can say definitively there is no standard or consistency to the level of detail and the manner in which other public pension funds disclose their fees. Specifically, GASB -- Government Accounting Standards Board -- with respect to the cost disclosure, has issued standards that are ambiguous at best and allow for interpretation that often results in fees and expenses that are netted from returns, which is typically the case for alternative investments being excluded from financial statements.

A recent study by CEM Benchmarking -- which performs cost analysis for 350 public and corporate pension funds -- found that the few plans that are more transparent regarding their fees and expenses related to their investment program are often unfairly criticized for having higher costs, when in reality they are only being more inclusive of the costs related to their investment programs.

We reviewed the financial statements of 17 large public pension funds in the U.S., and found that only 2 disclosed fees and costs at the same level that New Jersey does in their most recent annual report.

Specifically, most plans do not disclose all carried interests and incentive fees retained by their managers. Therefore, any comparison to

New Jersey's costs -- which includes these carried interests retained -- and other plans which do not, is inappropriate. In essence, it is not an apples-to-apples comparison.

I would also note that New Jersey has chosen to disclose a greater level of detail of fees and carried interests beginning in Fiscal Year 2014; therefore, year-by-year comparisons of fees paid by New Jersey are also not meaningful.

I started with a little bit on returns, and I'll close with a little bit on returns as well. We show a few different things here over 1-, 2-, 3-, 4-, and 5-year period. The green bar is the returns for our alternative investment program. We compare that to the total fund, which is the light blue bar; our fixed income portfolio, which is, I guess, what you would call *teal;* and a 70-30 mix of stocks and bonds, which is dark blue.

As we discussed, since 2010 we have moved out of fixed income and into alternative investments. The returns show that this has been the right decision, as alternatives have returned 10.6 percent and fixed income has returned 7.5 percent. Alternatives have also outperformed the total pension fund return, which has returned 9.6 percent over the last 5 years. In essence, that means the total of pension fund return would be lower today if not for alternative investments.

Finally, we show the portfolio against a traditional 70 percent stock, 30 percent bond portfolio. It's important to note that the stock portfolio we use here is a global stock portfolio, representative of how institutional investors invest in the stock market. Alternative investments have also outperformed this portfolio by 230 basis points per year over the last five years.

So as Chairman Byrne mentioned, I am also happy to have this opportunity to be here today. There was a lot of information that we threw at you, but hopefully it was helpful in answering some of the questions and concerns. And I'd be happy to answer any questions you may have.

SENATOR GORDON: Great. Thank you very much, Mr. McDonough.

First of all, I'd like to just react to Mr. Byrne's comment about the staff at the Investment Division. I too am -- I'm really amazed that we are able to retain the quality of staff that we have when one considers what they might be earning elsewhere -- if not on Wall Street, with other large pension funds. When one looks at the returns that they're generating through their in-house money management activities, we seem very lucky to have them. And so I was quite receptive to the comments he made about the staff.

Our interest here is, I think, a bit more focused than the issue of alternative investments. You have pointed to the rationale for these. I think our concern is really focused on the hedge funds.

` MR. BYRNE: Yes.

SENATOR GORDON: You mentioned that the hedge funds are intended to mitigate the impact of a market downturn. But we've seen data that at least the hedge funds that we have in our portfolio really didn't do that during the 2008 market decline. Can you comment on that?

MR. BYRNE: Well, I did cite all our results in 2008 and 2009, which were considerably better than peers, considerably better than universities that invest the same way -- and way, way better than the overall market. And while I didn't bring a full list of hedge funds, by way of illustration, citing Brevan Howard and BlueTrend as people who were not only not down, but up huge in those years, I hope makes the point that we were relatively well protected in that period of time. The problem is -- it's twofold. Number one, not all hedge funds are alike, of course; they all have different strategies, and so on. And number two, past isn't necessarily prologue. So the market is at high levels; the NASDAQ is within 50 points of its all-time intraday high. And who knows what happens to the stock market from there. So it's important to keep some protection on, I think.

So anyway, the point is that I think, on balance, we actually were very well served in 2008 and 2009. And as I say, earlier in the decade hedge funds did considerably better than the stock market. You just don't know from year to year. And I think the smartest investors in the world really can't predict what's going to happen next year. And as you know, from reading the *Wall Street Journal* for 20 or 30 years, there's an article every year in early January with expectations, and results can deviate from them substantially. And that's why I say we spread our chips out all over the place.

What concerns me is if we have another period like 2000 the fund may not withstand it. I mean, we're basically paying out $9 billion a year in benefits. And if you put a 30 percent drawdown on top of that, this fund could fall nearly in half in a year if we have a similar circumstance to 2008. And that's what we want to try to avoid.

So if you want more detail-- I mean, I certainly don't have fund-by-fund performance in 2008, but it's easy enough to go back in the files and get that sort of thing for you. And I think it would give you assurance that we got what we paid for when we needed it.

SENATOR GORDON: If I can just follow up on that.

You know, I think one of things that has been a bit frustrating for me as I've gotten into this issue is that we're seeing different sets of data giving different messages. And sometimes it appears to be the result of the indices that one selects, or the time period. But here's another example: I mean, you just said that the hedge funds did their job in the recent downturn. There was a quotation -- a comment by William Clark, then-Director of the New Jersey Division of Investment, in 2009, which he made after the hedge funds lost $800 million. And he's quoted as saying, "Clearly it did not work as we had hoped and expected. You cannot deny that as a general asset class" -- meaning the hedge funds -- "that they didn't deliver what investors were led to believe." How do you respond to that?

MR. BYRNE: I'll let Mr. McDonough go. I don't know Mr. Clark at all, so--

MR. McDONOUGH: I mean, we're essentially talking about four Division directors ago, so I can't say exactly what Mr. Clark was referring to. And frankly, I can't tell you exactly what the thinking was with regard to hedge funds at the time. I think most investors today would tell you that you'd be misguided to assume a completely diversified portfolio of hedge funds would not produce negative returns if the S&P is down 20 or 25 percent. The objective is to be down significantly less than that. You would likely still have a negative return; perhaps Mr. Clark had different expectations at that time.

MR. BYRNE: That's fair.

The one other thing that I want to say is, yes, you will get different answers and different data from different people over different time horizons. And that's why, at the outset, I did what I did -- I gave you 1 year, 3 year, 5 year, 7 year, 10 year so that we're not cherry-picking; so that-- I told you periods when we were above the median; I told you periods when we were below the median. If anybody wants to criticize, you're going to find a period where we were below the median. That's easy.

SENATOR GORDON: Senator Ruiz, I think, has a question.

Senator Ruiz.

SENATOR RUIZ: Chairman, thank you.

And forgive me if I'm not following, but I think that the Chairman was asking-- What I'm most interested -- I'll speak for myself -- not on the opinion of the then individual who was there, but if in 2009 we saw a $800 million loss explicitly tied to one of the pathways that we were making our investment -- this is not an opinion base -- why we would we have continued making the same types of investments every year and not drawing back or diversifying? That's what I would like to get an answer to -- not on the opinion, but if we see such a dramatic loss, we still paid those third-party providers whatever was expected of them (*sic*) to manage those accounts. Why didn't we start seeing a shift -- or are we seeing a shift, or what is that plan to see a shift?

MR. BYRNE: All right. Well, as best I understand your question, the first thing I'll say is I don't know how to evaluate the $800 million. First of all, I have no idea what the denominator is on that. So in percentage terms, it could be good, or it could be relatively good or relatively bad. So we have to go back and see what that is in percentage terms -- number one.

And number two, your question about diversification is -- essentially, that's exactly what we're trying to do. I mean, our investments are spread out all over the place. And so -- if I can put this in personal terms for just a second. I run a private investment management business. I have run on average, over the last 15 years, about 3 percent, on average, annually ahead of the S&P. There are not a whole lot of money managers who can say that. You can go and look in my records and find some really lousy investments in that time period. Well, maybe not really lousy, but not so good. (laughter)

SENATOR KEAN: Pretty lousy.

MR. BYRNE: Pretty lousy, yes.

And so the point is that I think it's important to look at this on an overall portfolio basis, and not just single out particular people who did badly. Now, I can't answer your question, because I honestly don't know where the $800 million comes from, and I don't know, again, over what principle amount. But, again, that's the kind of thing we can go back and look at and get you some more detail.

SENATOR GORDON: Thank you.

SENATOR RUIZ: Not an answer.

SENATOR GORDON: Senator Kean, do you have a question?

SENATOR KEAN: Yes, if I may.

If I may, you had mentioned, through the Chair, there was an 8.2 percent average over 20 years that's not on this chart. We have the-- Every other year you have a basis where you're above -- the difference above the benchmark. If you cited the 8.2 percent over 20 years, what would be the benchmark during the same time?

MR. McDONOUGH: Unfortunately, we do not have benchmark data going back that far -- which is why we didn't include it here.

SENATOR KEAN: Okay.

MR. McDONOUGH: And if you look at the monthly reports we put on our website, we do publish a 20-year return. But for the benchmark we say *not applicable* because we don't have one.

SENATOR KEAN: Because it wasn't created at that time? Okay. No, that's fair because I think that anybody looking at an 8.2 percent over 20 years -- it's a very impressive average, plus (indiscernible) every year. And I think we have to be careful, through the Chair, as we ask these questions and investigating; and we always should, obviously, manage the managers. We also should realize we shouldn't be caught in a mindset where you are buying high and selling low. So as certain strategies are effective in certain years, and certain ups and downs in the markets, other strategies or not. You have to anticipate that you are always managing towards the next couple of years and not managing towards the past couple.

So I think that, again, getting to your point, through you, Mr. Chair, what the denominator is and everything else, we have to make sure that we are effectively managing the managers, and I think that having questions like this is a good thing.

Thank you.

MR. BYRNE: Yes, thank you, Senator Kean, for that point. It's important.

One of the other volunteer things I do in life is I am a Trustee and Treasurer of The Fund for New Jersey, which is a large philanthropy.

And we do the same thing -- we hire outside managers, and we have had some turnover. And every once in a while, you know, one that you get rid of turns around and has a great year the next time. And so we're very, very mindful of that, and I think it's an important point.

SENATOR GORDON: Any other questions?

Senator Thompson.

SENATOR THOMPSON: Thank you, Mr. Chairman.

First, I'd just like to commend you for the job that you did in 2014. I mean, as I look at your returns -- 16.9 percent ROI; $13 billion increase in value, and we paid out $8 billion -- so net we gained $5 billion in the pension fund. I mean, I'm very impressed with those numbers.

MR. BYRNE: Well, thank you. I'm saying *thank you*, but it's really the staff that does the work. I show up in Trenton once or twice a month. The staff is really doing an amazing job.

SENATOR THOMPSON: This is speaking to the bottom line--

MR. BYRNE: Right, exactly.

SENATOR THOMPSON: --wouldn't you say? If you look at all investments --- yes, you might find some place that, "Okay, yes, that one could have been better." But you are diversified, you're into many things. And if the bottom line -- when you add them up together, you have almost a 17 percent return on your investment.

MR. BYRNE: Right.

SENATOR THOMPSON: You made $13 billion -- you've done a heck of a job.

MR. BYRNE: Yes. No, I think that's right. And I should say that we may have been a little spoiled in New Jersey by returns that have been double-digit or near double-digit, depending on the timeframe that you look at. And if I can just do some very back-of-the-envelope math -- you have a principle balance of, roughly, $80 billion. If you make 11 percent on that, that basically covers everything -- that covers $9 billion that was paid out. It's absolutely no certainty that those kinds of returns will persist, going forward, no matter how good a job the staff does.

And so I mention that to stress the urgency of -- again, I can't help but say another word about the Commission on which I served. I worry about a little too much complacency; $80 billion sounds like a lot of money. But bad markets or even flat markets, combined with these huge annual cash outflows, are a significant risk for the fund and something that we all need to be mindful of.

SENATOR THOMPSON: A question I have for you-- Table 2, *Total Fund Performance as of March 31, 2015*, and it shows 1 year, 7.3 percent, 6.3 percent, etc. Now, is that one year on there 2014 or 2015?

MR. McDONOUGH: That would be one year ending March 31, 2015.

SENATOR THOMPSON: I'm sorry? So this is relating to FY 2015, not FY 2014.

MR. McDONOUGH: This will cover a portion of 2014 and 2015. So it would be April 1, 2014--

SENATOR THOMPSON: I was just wondering because, again, I'm talking about a 16.9 percent ROI; and we're talking 7.3 percent here. It's a big difference.

MR. McDONOUGH: Right.

SENATOR THOMPSON: So no way you can-- Those numbers are not related in any way, you're saying.

MR. McDONOUGH: Yes, yes. It's the best and the most recent quarterly data available. So they're just catching the last quarter of FY 14 and the first three quarters of FY15 here.

SENATOR THOMPSON: Well, this suggests that we'll probably come out with a much lower ROI in FY15 than we had in FY14, is that right?

MR. McDONOUGH: Yes, you're right.

SENATOR THOMPSON: Okay. This is historical, and it might be something better asked of Treasury than you. But your Table 4 there -- you do point out that in 2001 and 2002 combined there was a 417 billion loss because of the stock market basically, and so on. And then at this date, we come back to talk of the situation we're in. Going back to the late 1990s and the early 2000s, Governor Whitman was there; it was that time that we stopped putting money in the pension fund because, actually at the time they were making that assessment, it was determined the pension fund was overfunded. We had over 100 percent of what was required. And that's why they kind of justified not putting money in the pension fund. But obviously-- I did not realize that we lost $17 billion shortly thereafter, and obviously they didn't compensate for that fact. When we lost that $17 billion and were not putting money in -- wow. That's what really got us in-- I always attributed it to us not making contributions. But if we lost $17 billion right there, that may have been an even bigger factor than not making the contributions to the--

MR. BYRNE: Well, what I will say, Senator, is that every actuary who served on this pension Commission with me would say that, just because a defined benefit plan is fully funded at a given point in time, that's no reason to stop the actuarially required contributions; because they're based on assumptions about exactly the kind of market volatility that took place. And so the contributions should have been made even at the time that the thing was fully funded.

SENATOR THOMPSON: All right, I realize that. But I'm saying that if we had a $17 billion drop--

MR. BYRNE: Yes.

SENATOR THOMPSON: -- in the value of the fund right there--

MR. BYRNE: No, it was huge.

SENATOR THOMPSON: --$17 billion covered a lot more than you would put in at any point in time.

MR. BYRNE: That's right.

SENATOR THOMPSON: And so we're still trying to recover from that $17 billion loss right there.

MR. BYRNE: That's absolutely right. And you know, you not only lost the $17 billion, you obviously lost future investment returns on that money.

SENATOR THOMPSON: Returns on that $17 billion, plus what you weren't putting in, so--

MR. BYRNE: Sure, sure.

SENATOR THOMPSON: That's a factor I've never had in mind.

MR. BYRNE: And so a lot of--

SENATOR THOMPSON: And considering how we got into this situation we're in-- Which brings me, again, to the more recent 2008 and 2009.

MR. BYRNE: Right.

SENATOR THOMPSON: Did we actually, during that time period, have a net loss in value because of the economy?

MR. BYRNE: We had a net loss. I gave it to you in percentage terms; we can get it for you in dollars terms. But it was substantially -- we did substantially better in relative terms than we had done in 2000.

SENATOR THOMPSON: Oh, I realize that.

MR. BYRNE: Yes. I don't have the--

SENATOR THOMPSON: Thanks to your diversification, and so on; you pointed that out. We didn't lose nearly as badly as we--

MR. BYRNE: Not nearly as bad.

SENATOR THOMPSON: And that certainly--

MR. BYRNE: And that's our intent, going forward. And that's why, at some level, I know that we're taking some heat from certain sources about the fees paid to diversify. But, again, going back to your question: Is there a better way to do it? We haven't found it, and I don't think it exists. And so we would rather this than to incur another $17 billion -- or larger -- loss.

SENATOR THOMPSON: A valid point I'd like to make. Before Senator Kean arrived, you had cited two press reports about questioning certain investments that the fund had made, and so on. And you clarified that these people just totally missed the point.

MR. BYRNE: Totally.

SENATOR THOMPSON: That's great that you did that here today.

MR. BYRNE: Thank you.

SENATOR THOMPSON: But what I'd like to suggest is that you do a better job -- not you, personally -- in responding to these things when they come out. Because when they come out and there's not a response out there, people accept it and, "My goodness, what are you doing?"

MR. BYRNE: Yes.

SENATOR THOMPSON: I think the Administration, in general, is faulty in a number of areas there when things come out -- they have answers, but they don't respond.

MR. BYRNE: Yes.

SENATOR THOMPSON: Get it out there; clarify what the real situation is and people will understand better and you'll find there are a lot less complaints.

MR. BYRNE: Sure. We do that; we do it in our meetings. We try, but as I think elected officials can appreciate better than just about anybody, it's not always easy to get your message out. Not everybody's listening when you're talking.

SENATOR THOMPSON: I realize that.

MR. BYRNE: But we do make that effort consistently, Senator. I appreciate the comment, and we'll just keep trying.

SENATOR THOMPSON: I thank you for the job the Council and the Division does on this. I think you're doing an outstanding job.

MR. BYRNE: Thank you.

SENATOR GORDON: Senator Kean.

SENATOR KEAN: Thank you, Mr. Chairman. And through you, Mr. Chair. I mean, I think a couple of other things.

In addition to the $17 billion loss (indiscernible), you also had a significantly increased drawdown because (indiscernible) over S&P 500 took place.

MR. BYRNE: That's right.

SENATOR KEAN: So not only did you have a downturn, you also had an increased draw on an annual basis--

MR. BYRNE: That's absolutely correct.

SENATOR KEAN: --and a very significant increase. So that was another factor at that exact same time that you had a lower year-on-year.

The other issue, if I may. These are extraordinarily impressive returns. I think I said that before, and I want to congratulate both of you, as well as the staff in the Division and the organization. But every time you turn on *Bloomberg,* you're hearing an actuarial assumption of a 4.5 basis, or a 6.8, or some number. How do you, I mean, without giving away secrets, what's your-- I mean, if your looking to manage forward, how do manage forward in an environment where people are looking at very potentially different returns on investment opportunities?

MR. BYRNE: Well, it's tough. You know, the first thing I would say is that certainly the actuaries on the pension Commission felt that 7.9 percent is probably just an unrealistic target in this environment. Interest rates are lower than they've been at any time since, I guess, the

1950s, and P/E multiples on stocks are higher. And so we look for other asset classes that may be cheaper. And so most people think that -- what I said earlier about global diversified credit has created opportunities for us because of regulatory changes since 2008 -- that we can squeeze more return out of essentially fixed income or lending type investments there.

The emerging markets are considered by most analysts to be cheaper now than the domestic market. They sort of doubled, I guess, in 2009. They haven't done much since. Who knows when that changes again? But their GDP growth is higher than most of the rest of the world.

And there are specialized managers all over the place who we feel we have to look to when other alternatives don't really exist. So just one example -- I have a hundred I could give you -- one of our alternative managers came down to Trenton and he said that their firm owns an office park in India. The office park tenants are all top United States companies -- mostly technology companies. They pay the rent in U.S. dollars. And their cash-on-cash return on this investment, as I recall, is 14 percent.

And I was joking around, you know. "I wish Byrne Asset Management could fly one of our guys to India and buy an office park and make 14 percent" -- pretty risk-free. And, you know, the staff -- I'm not going to tell Chris to get on a plane and go to India and buy an office park either. But we do invest with people who do that sort of thing.

The same is true in oil tankers and other asset classes. And so the best I can do for you is that we're looking far and wide for these opportunistic sorts of investments that we feel will do better for us than some of the plain vanilla stock and fixed income investments that we have today. But the more we do that, the more management fees go up. We believe the more overall returns will go up as well, but that's not what gets reported, generally. And of course, we do have what we think are very appropriate and sensible caps on these investments, because it is a public pension fund. As I said earlier, universities can have substantially higher allocations to these opportunistic types of situations. And, you know, one of the things that I've done -- I'm pretty good friends with Andy Golden who runs Princeton University's endowment, and is terrific. And he's offered if I were to host a lunch with some of the labor leaders who have questions or concerns about all this, he said he'd sit with them. And it was very generous of him to offer to do that. And so in many different ways we're trying to assure beneficiaries and union leaders that what we're doing really is very much in their long-term interest.

SENATOR KEAN: Thank you. Through the Chair, I think that's what we're all-- All of our common ground is to ensure that there is an opportunity to make sure that the promises made, the investments are there -- all these things are all one in the same.

Thank you.

MR. BYRNE: Thank you.

SENATOR GORDON: Thank you.

You know, I think we all share the view that the in-house staff is doing an excellent job in managing the portfolio. I think the question for me, and perhaps others on this Committee, is that the State Pension Fund might be better off if they were actually doing more. For example, specifically on the hedge funds, I think there's a-- I have a concern that we could have saved ourselves hundreds of millions in fees, and generated a greater return by allocating funds that were managed by hedge funds to our own staff to manage the current asset classes that they do. And I'd just like to focus on that, and then I know that other witnesses will be talking about that.

I'd like to just turn to -- and I am directing this more to Mr. McDonough because he may be more familiar with this report. There was a report issued by the Treasury Department to the Budget Committee, as part of the normal Budget hearing process, in which responses were prepared to OLS questions. And there was one -- I'm referring to a question that, in this report, is called *Discussion Point 29*, in which the Investment Division reported, in its response, that hedge fund performance was 9.8 percent over a 5-year period ending March 31, 2015. And if you were to compare that performance to a hypothetical portfolio which represented a blend of 70 percent stocks, 30 percent fixed income securities the hedge funds would have outperformed this hypothetical mix of securities by 1.5 percent.

Meanwhile, the Division of Investment in-house staff, in managing the stocks and bonds that it does, was able to earn a return of 13.2 percent. Isn't it more appropriate to compare the performance of these hedge funds to what our own staff -- to the performance of our staff? Because wouldn't that really be an alternative to using hedge funds?

MR. McDONOUGH: I can't confirm the 13.2 number; that may have been an OLS number so I'm not sure exactly where that came from.

You know, we do two things pretty well at the Division of Investment: We manage U.S. equities -- in terms of the stuff we manage in-house -- we manage U.S. equities well, and we manage investment-grade bonds well. I talked about investment-grade bonds and what our concerns are there. We don't think that's a good place to be. It's not because we don't think our people are good at it; but we don't think the market is going to give us returns there.

Our U.S. equity team has done an outstanding job, and they should be congratulated. They've had the benefit of the wind at their back. The last five years have been outstanding for anyone who has invested in U.S. equities. Looking forward, we're not sure that those types of returns can be reproduced in the next five years. Not because our people aren't good, but because the returns won't be given to you by the market. So again, it's about diversification, it's about not being concentrated in a particular asset class. There will be a day and a time when we decide that we want to have more money in U.S. equities, or more money in investment-grade fixed income. And at that point the Division staff will be managing those assets because that's what we do.

MR. BYRNE: Senator, if I can add a little bit to that, I'd like to.

It's obviously appealing to say, "Let's do more of this in-house," because it would be cheaper. But the question is, would you generate the same returns and would you generate the same risk-adjusted returns if you did it in-house? I said earlier that one of the places where we lagged was in foreign stocks because we simply didn't have the expertise that we should have. I remember when I was brand new on the Council; the previous Director walked me around and he said -- he pointed to some older guy, who I hope is retired, and said, "This guy has lagged in international benchmark by 1,000 basis points; by 10 percent." He said, "I can't fire him; he's Civil Service." And so, you know, if somebody lags by that much in a private firm, they're gone. And so, right there, there are some risk issues.

More to the point: I know some people who run opportunistic hedge funds. One of my friends was a top-notch bankruptcy lawyer at one of the leading firms in the country before he left and went to this hedge fund. And so he has a level of expertise that you're simply not going to find in too many places. And so I would trust him to run that kind of money. I wouldn't trust myself to run that kind of money. Some of my own money, I hire outside people, even though I think I'm pretty good at the basics. I want my own money diversified, and so I'll use experts in these fields.

Another hedge funds person who we're not invested with -- because she's relatively new -- is somebody who has a Ph.D. in economics; she's been on the faculty of a leading business school; she's a quantitative genius. And again, these are the kinds of people who you don't hire for $100,000 a year; you just plain don't. And so I think we have to be a little bit careful and we just don't want to do things that are -- well, to use the old phrase -- penny wise and pound foolish.

SENATOR GORDON: Okay.

Mr. Byrne and Mr. McDonough, I hear what you both are saying, but we are dealing with a pension fund under great stress; it's greatly underfunded. And the incremental gain that could be achieved with in-house investing is really quite considerable. For example: In the same discussion with OLS in this document, it was pointed out that Treasury estimated that over five years the hedge funds had earned $280 million more than this hypothetical balance portfolio I referred to. The Division of Investment's actual balance portfolio of stocks and bonds returned 4.9

percent more than the hedge funds over a five-year period. That was 13.2 percent for the Division of Investment versus 8.34 percent -- and this was for the period June 30, 2009 to June 30, 2014.

We're talking about some real money here. I mean that, had those funds that had been allocated to hedge funds been invested by the Division of Investment staff, we would have -- the in-house staff would have earned $900 million more than the hedge funds. I'm sorry if you don't have these numbers in front of you, but these are Treasury numbers, and they're based on the returns of the Division of Investment. And that $900 million, or several hundred million dollars per year over a number of years compounded -- you're getting into many billions of dollars that would be in the pension fund that it seems we are foregoing. At the same time, we're paying a lot of money to these hedge funds.

MR. McDONOUGH: So I have the OLS document in front of me; unfortunately I can't find the 13.2. I don't know that I have ever seen that number, so again, I can't confirm what that number actually is.

I can tell you, over the last five years ending this most recent March, the hedge fund portfolio has outperformed our international equity portfolio, which we manage internally; as well as our investment-grade portfolio, which we manage internally. The only thing we've underperformed in hedge funds is domestic equity; and the reality is domestic equity has outperformed everything. So again, the internal team has done an outstanding job, but I think we need to be careful about assuming that just because the returns have been so good in domestic equity the last five years, that that will continue to be the case, going forward. The data just doesn't support that.

MR. BYRNE: Yes, so to add to that -- again, if you pick a particular time period, you can put almost anything you want, I think-- You know, there is just -- as I said before, different asset classes shine at different points in time.

The other thing that I just want to point out is that New Jersey is one of the few states that manages stocks and fixed income in-house. So we already do far more in-house than most other states, and it's just trying to find the appropriate balance. And as I've tried to outline, I just think there are certain asset classes that require such expertise that -- you could have good results in-house but, again, the risks of doing so with people who don't have very, very specialized training in certain asset classes is tough. And the people who do have that specialized training aren't going to work for $100,000.

SENATOR GORDON: You're right.

Just one final point in a similar vein: You and the folks, in your testimony and in this report by Treasury, in response to the OLS questions compare the performance of the hedge funds to the fixed income portfolio. And we all know that that has not been an area of opportunity in recent years. Again, I think that's just a false comparison because the alternative is not to put more money into fixed income; it's to invest in stocks and equities where we've seen the gains. So I just think it's been -- I think some of the comparisons that we've seen in print have not been appropriate because they're really not -- they're using inappropriate comparisons, I think. I mean, we're not going to put more money into fixed incomes; we're going to put it somewhere else.

MR. BYRNE: Well, the comparisons were based on the actual shifts in allocations that we've made. And as I said, we didn't move money from stocks; we did move money from the fixed income into these categories. And so we felt that was -- that's where the cash moved, and that's what we reflected. So in that sense I do think it's fair.

Listen, beyond that, you know, if a majority of legislators think that the State ought to have 50 percent, or 60 percent, or all of our money in domestic stocks, pass a bill and that will happen. I don't think that would be a wise idea but, as I say -- and particularly now with valuations that most experts agree are stretched, I think it would be downright imprudent. At the same time, you know, we have the luxury of looking back to 2009. Should we have put more money in stocks? I guess so, in retrospect. But given what we knew at the time, given what experts were telling us at the time, given what projected returns from experts were at the time, and so forth -- I think we acted very prudently and reasonably, given what we knew then. And we certainly weren't out of line with other public funds. I mean, we were all pretty much in the same place.

SENATOR GORDON: Thank you.

SENATOR KEAN: If I may?

SENATOR GORDON: Senator Kean, we're-- Just make it short, if you could, please.

SENATOR KEAN: Yes, through the Chair. I think -- again, back to the point. If we all remember where this country was in 2008 and 2009 -- where there were banks that were in far greater distress than many are now; when the President of the United States came up and said that we were going to have an -- we were going to financially solve this crisis. Not everybody was 100 percent sure, at that juncture, that that could occur. So it was not only 2001 that people were -- and 2002, 2001 people were concerned about it also -- but in 2007 and 2008 and everything else. And I think what the structure allows for, whether it be hedge funds, or alternative investments, or bonds, or stocks, or what have you, is to mitigate all the downside and maximize the upside. I think to appraise how this organization -- both the professional managers in-house, the professional managers out-of-house, as well as the people who were making the long-term decisions -- balances that, I think is a true testament to the public and the private people who are involved in this process. And I think that if people look at this and see we have an 8.2 over these last several years, given the upside, downside risks, as well as -- and you can't understate this -- the fact that you have drawdowns at the rate that we have right now of 9 -- the 9 number is a huge number when you're talking about the annual drawdown. So you are not reinvesting resources. And so to build a viable platform that has a growth that outperforms the annual drawdown is a very substantive success story for, again, the public sector employees, as well as the professional managers who were hired on the outside.

So I want to congratulate you.

MR. BYRNE: Thank, you Senator.

The one other thing that I would say, with respect to the public markets, is that aside from valuation there is another argument that the risk is increased -- which is to say that public markets are less liquid than they used to be. And so for people who want to play musical chairs and get out right before the music stops -- that's harder and harder to do. The New York Stock Exchange specialist barely exists anymore, so there goes a source of liquidity. The Volcker Rule says that big trading houses, investment banks, or now, places that have turned into commercial banks, like a Goldman, can't inventory securities, so they can't take the other side of big trades. You've seen things like the *flash crash,* where we've seen prices move more quickly than any big institution, like the State pension fund, could adjust to its exposure. You know, we came back from the flash crash quickly; there may come a day where the market doesn't come back. And so, there again, I think risk has to be calibrated in accordance with changing liquidity constraints. So that's just another factor that we have to be mindful of.

SENATOR GORDON: Thank you, both, very much. This is, as I think everyone in the room appreciates, a rather complex issue. As I said at the outset, we may well have additional hearings on this. And if we do I'm hoping that you can continue to be a resource for us.

If there are no other questions for this panel--

Senator Weinberg.

SENATOR WEINBERG: Yes, thank you, Senator Gordon. I apologize for my absence, but I had to go over to another meeting. And I see that you're still in your same seat, Tom Byrne (laughter), so I'm sure I missed a lot of information here. And hopefully, we have a written--

UNIDENTIFIED MEMBER OF COMMITTEE: Yes, we do.

SENATOR WEINBERG: Okay.

MR. BYRNE: I just have a bunch of scribbled notes, Senator. I don't really have prepared remarks.

SENATOR WEINBERG: Okay.

MR. BYRNE: But there's a recording; I know that. So I assume there will be a transcript.

SENATOR WEINBERG: Okay.

Maybe you can help enlighten me; I don't know if you spoke about this earlier. But with the huge 2008 stock market plunge, didn't it show that the hedge fund performances were really closely related to overall stock market performance?

MR. BYRNE: Let me see. I actually have the hedge fund index for that year somewhere; let me see if I can find it quickly enough for this.

What I did go over, Senator -- I don't know if you were in the room at the time -- is that New Jersey's performance in Fiscal Year 2008 and Fiscal Year 2009 was actually really quite good compared to the stock market, and so on. So-- I did find it.

SENATOR WEINBERG: But the hedge fund, as it relates to the stock market?

MR. BYRNE: Bear with me one more second--

SENATOR WEINBERG: Sure.

MR. BYRNE: --I think I am coming to the page.

The answer is-- I can't find it quickly enough. What I did say earlier is that between 2000 and 2010, hedge funds outperformed the stock market in 6 of those 10 years. And during that period -- during that 11-year period, the S&P's average annual return was 0.41 percent, and the return on the hedge funds -- the HFRI Fund Weighted Composite Index -- average annual return was 6.74 percent -- so beating the stock market by over 6 percent, on average, per year in that period of time. Since 2010, obviously, the world has changed considerably, and the stock market has done much better than hedge funds. My point earlier was that, who knows when that changes again?

SENATOR WEINBERG: Right. Now, I know that you're not a fortune teller, but if you are please leave me your number before you go today. (laughter)

But when you talk about the outperformance, are you factoring in the fees to that?

MR. BYRNE: Yes, everything that we've cited--

SENATOR WEINBERG: So that's net?

MR. BYRNE: Correct, absolutely.

SENATOR WEINBERG: Okay.

MR. BYRNE: Yes.

SENATOR WEINBERG: All right. Can you give me a simple -- if that's possible -- explanation between what a private equity and hedge funds -- the difference between the two?

MR. BYRNE: Yes. *Hedge funds* means a lot of different things. Hedge funds can be people who -- are long stocks that they think are undervalued and they sell short stocks that they think are overvalued -- that's one type of hedge fund. Hedge funds can be in the credit markets -- they can be these opportunistic credit guys who I talked about; these guys who are both quantitative and specialists in bankruptcy law who know how to value distressed securities. I wouldn't know whether to pay 50 cents or 10 cents for something; these guys are just experts at reading a document, assessing a particular company's circumstances, etc.

Another kind of hedge fund is simply merger arbitrage guys who, if a stock is going to be taken over -- there's a deal struck at $60 and the stock is trading at $53, they make judgments on positioning to capture the last $7 or whatever. And if a deal falls apart, they get clobbered. But often enough, they make the increment from $53 to $60 when the deal closes. And Goldman-Sachs has a huge desk that does that; that's what Bob Rubin did for a living before he become Treasury Secretary.

You know, there are many, many other categories of hedge funds, and different people with different types of game. I have a personal investment, that's disclosed on my disclosure form, of a hedge fund that I think is way too volatile for the State to be in. But it's a friend of mine who-- We had dinner one night and he outlined what he thought was going to happen in crude oil, and he was up 140 percent last year. So this is just a guy who's a pure macro trader, trying to judge what's going on in the world and speculate accordingly.

Now, compare that to private equity. These are people who -- and Chris, you may be able to provide examples of particular companies. We actually have a slide on this that we didn't bring today that-- There are certain companies that are just in private hands, rather than listed on a stock exchange. And they can be owned by a couple of individuals, or they can be owned by a private equity firm. Sometimes the founder of a business reaches a certain age and wants to cash out, and will sell to a Blackstone or a Kohlberg Kravis Roberts, or whomever. And they feel-- The reason that they feel that they can make money is they think that they've either identified a business--

SENATOR WEINBERG: Who is *they* when you say *they*?

MR. BYRNE: *They* -- the private equity guys, firms --

SENATOR WEINBERG: Okay.

MR. BYRNE: --feel that they can make money either because they've identified a business that has more growth prospects than are realized in the public market or in conventional wisdom; or that they feel that they can deliver more operational efficiency than exists in a particular company; or do things like that. Some of them use leverage to achieve what they regard as better results.

One example: I was riding a train home from New York one night with a friend of mine who is in this business. I said, "Give me an example of what you do." And I don't know exactly how this worked, but this particular firm invested in the Belgium Post Office somehow. And their routes were zigzagging all over the place, and by making the postal routes more efficient, they squeezed money out of that operation and made it a far more efficient operation.

So, you know, there are any number of strategies being employed by these people, each with their own degree of specialization. And as I said earlier, we look for people, with our consultants, who are in the top quartile, based on historical track records, in their field, in their discipline; and invest in them and only in them. And we feel that's value-added for the pension.

SENATOR WEINBERG: Is one or the other more closely tied to the performance overall of the stock market?

MR. BYRNE: I would think that private equity is, generally; yes. You know, they tend to be more correlated. Private equity, in general, has probably done a little worse than the stock market because the stock market has just gone gangbusters in a way that, I think, very few people have expected in the recent years. But generally, because of the inefficiencies -- whether it's the Belgium Post Office, or something else -- the inefficiencies and the lack of liquidity in the private market, there tends to be some premium associated over time with investments in private equity. Now, if we invest in a hedge fund that is, on balance, short -- a short seller -- and I don't think we have anything that is really, totally on the short side -- it would actually be a negative correlation to the stock market. And so what we do with our consultants is we have correlation data for all different types of investments, over time, so that we can assess what kind of diversification that's providing to the overall fund. Does that make sense?

SENATOR WEINBERG: Yes, sort of. (laughter)

How is that hurdle figure negotiated?

MR. BYRNE: You probably can do that in more detail than I can, since it's your staff. So go for that.

MR. McDONOUGH: So generally, when we're evaluating a particular opportunity to invest in a hedge fund, or a private equity fund, or real estate fund, they'll have their standard terms in what's called a *private placement memorandum* that goes to all the investors. And that generally serves as a starting point; it's typically based on both their success in the industry, as well as what the industry standards are for management fees, incentive fees, and hurdles. And then from there, we will try to negotiate terms that are more in our favor than what they originally put out there -- depending on how sought-after the fund is, depending on how early in the process we are. Depending on the size of our investment relative to their overall business, we have varying levels of success. Over the last few years we've been pretty successful in negotiating terms that are better -- more in our favor than the standard market terms available to most investors.

SENATOR WEINBERG: So by and large what we've been able to negotiate, in terms of the hurdle figure, are better than, on average, in the private market? Is that what you said?

MR. McDONOUGH: So our management fee that we pay is lower than standard; the incentive fee tends to be lower. The hurdle rates tend to be pretty standard; *hurdle* meaning they have to achieve a certain return before they collect their incentive fee. What we have been able to do is introduce hurdle rates to investments that previously did not have hurdle rates. So whereas in the past the manager could take 20 percent of the profits on day one, we now force them to achieve a certain return before they can participate in the upside.

SENATOR WEINBERG: Well, that leads me to another question, which I think I know the answer to but I'm going to ask it anyway.

They get a bonus or reward for returning above that rate that's been negotiated. Do they pay in reverse if they don't do well or they are below the hurdle rate?

MR. McDONOUGH: That's an excellent question -- so different fund structures are structured differently. If, on day one, they produce results that are negative and they never recover those results, no, they do not pay us back for the negative returns. In many structures, if they produce negative results early on they have to make those losses back and then some gains before they can participate in the upside.

SENATOR WEINBERG: So those are individual negotiations with different funds?

MR. McDONOUGH: Yes. We negotiate every single document for every single fund that we invest in.

SENATOR WEINBERG: Is there some set of standards you use to guide you in that negation?

MR. BYRNE: There are industry norms--

MR. McDONOUGH: Right; so we have a general sense of what the marketplace-- Just like if you were to go to buy a car, you generally know what the price of that car is; you go on the Internet and figure that out, and that's your starting point. Similar to this -- we know what the standard fees are; we believe because of our size and our scale we're entitled to better fees, and we push hard to get those fees.

MR. BYRNE: But, at some point, they say, "Thanks, anyway. You know, Norway is interested, Singapore is interested, Texas Teachers is interested, so we don't need your money." And that's just what the negotiation is -- pushing as hard as you can, like you would in any negotiation, and then we have to decide if it's worth walking away. And sometimes we do, but if somebody is a good manager that we think is going to produce excellent returns, particularly in a category where we may be underweighted relative to what we want our asset allocation to be, then we negotiate as best we can.

And I do think the staff has done a very good job using our buying power -- the size of the overall fund -- in a way that's benefited the beneficiaries of the fund. But at the same time, would we like the fee to be a straight 1 percent? Yes, of course we would. But that's just not where the market is, and other people will just outbid us, if you will -- other pensions and institutional investors.

SENATOR WEINBERG: Okay, thank you.

SENATOR GORDON: I see that Senator Ruiz has a question.

SENATOR RUIZ: I have the same question that Senator Weinberg had, and I just want to follow up as I try to navigate through all these (indiscernible). And they're all individually negotiated, and I heard what Mr. Byrne was saying that, yes, there's the potential that they will just walk away and go somewhere else. Has there been any thought whatsoever though-- So no matter how-- In some circumstances, you indicated that if it's very early on in the beginning and the productivity is in the negative, there appears to be some kind of claw back, or whatever it is. Is there any thought, in moving forward with these individual contracts, to have some kind of baseline negative mechanism to ensure that they're doing the best on behalf of New Jersey? Does that make sense, what I'm asking you?

MR. BYRNE: I just don't think any manager would go for that. In other words-- Again, I hate to over-personalize this, but it may be the best way to explain.

SENATOR RUIZ: No, I hear what you're saying, because what you're saying is they'll just turn around and say, "Thank you, but no thanks," right? Pretty much?

MR. BYRNE: Yes, pretty much, pretty much. And as I say, when I manage money for individuals, in my world I just charge a 1 percent fee. If I lose money that year, oh well. I feel bad about it, but the SEC actually -- the law won't allow me to refund a management fee. And when we invest with these people, we're investing with people who do have a good track record over time. You know, we're not picking people up off the street. We're using people who are well established, and we have very reasonable expectation that returns will be positive, over time. That doesn't always happen, but usually it does. And so, you know, as I tried to illustrate with the examples I gave, almost all the time we're getting real value and excellent returns for the fees we pay. But there are no guarantees; there's just not. We wish there were.

SENATOR GORDON: I know that Senator Sarlo, now that he's back, has a question.

Senator Sarlo.

SENATOR SARLO: Thank you, Chairman Gordon. I apologize; I had to step out for a Budget meeting and a Budget briefing. So I apologize.

I just have one question; and, as the Budget Chair, just putting things in perspective -- and this number may have been floated before. Chairman, $600 million -- is that the amount of money, in fees and bonuses, that we paid in the last Fiscal Year? Is that the approximate number -- it's about $600 million?

MR. BYRNE: A little under; but yes, you're close.

SENATOR SARLO: Close.

MR. BYRNE: But what I said earlier is that, first of all, in terms of the budget, those are not taxpayer dollars -- those are dollars that come out of the pension fund; and in the case of the incentive fees, come only out of pension profits.

SENATOR SARLO: And I agree with you, but I want to put it into perspective of the budget, as the Budget Chair. This year the courts are making a determination, right now as we sit here, the Supreme Court. We shorted the budget -- the pension payment by $680 million, okay? And if we had that $600 million in the pension fund, that would be $600 million more to pay towards the pension.

The question I have is, you know, there's $600 million there; we're short $680 million. That helps -- goes a long way in making that pension payment -- to live up to the pension/health benefit reforms that we did here in 2011. The question is, are we getting-- This $600 million that we're paying in fees, is it all worth it, in your opinion? Is it all worth it, or--

MR. BYRNE: Yes.

SENATOR SARLO: --or would it be simpler to put that $600 million towards the pension payment?

MR. BYRNE: Well, I understand that you guys are getting pulled in a lot of directions, and that the budget is important. And I can do it again, but I went through sort of a quantitative analysis of how much we made that was far in excess of those fees, that the fund wouldn't otherwise have -- into the billions of dollars. And the general point I made is that the incentive fees go up, obviously, because the profits go up. And the incentive fees, I think I said, were basically 9 percent of the overall profits. So if you think about it in that context, the fund has billions more in assets that it wouldn't otherwise have.

SENATOR SARLO: So the $600 million, in your opinion, is a wise investment.

MR. BYRNE: The $600 million, in a way, is not an investment on the front end; it's an incentive fee. So yes, if--

SENATOR SARLO: It's a wise fee.

MR. BYRNE: Yes. It's a wise *fee*. One of the things I said earlier is, would you pay $335 to make an addition $1,800? And that was essentially the math in the last Fiscal Year.

SENATOR SARLO: Thank you, Chairman.

SENATOR GORDON: Mr. Byrne or Mr. McDonough, perhaps you could just respond to this. A thought just occurred to me. We're paying $600 million in fees. Over the course of 30 years, if those funds had not been paid out, had in fact remained in the portfolio, $600 million over 30 years -- that's, if my math is correct, $18 billion. Factor in the power of compounding based on the rate of return you're getting every year. That $600 million a year translates into, what, $25 billion or $30 billion or more that would be in the pension fund, available to pay for the pensions of our members.

MR. BYRNE: Well, first of all, as you know, there were no alternative investments until about a decade ago. So there were no fees when there were no such investments. I think you can't look at it in isolation; you can't look at the fees in isolation. You have to look at them in the context of how much extra earnings we made. So you know, if I were to say, okay, an incremental $1.8 billion times 30 years -- I'm guessing, I'm not doing this in my head -- we'd probably be fully funded. So again, you have to look at it in the context of the profits generated by these fees.

SENATOR GORDON: Okay. I'm really--

SENATOR THOMPSON: Mr. Chairman.

SENATOR GORDON: Senator Thompson.

SENATOR THOMPSON: I tend to agree with exactly what you're saying there. I mean, you're taking a $600 million (indiscernible) and multiplying it by 30 years. Well, obviously, if we paid $600 million for the amount of money we made in that time, that's a very small fraction. We don't even have to worry about the $600 million, based on the return that we got for paying out that $600 million. The pension fund would be in such great shape, if we made that much money every year, that we wouldn't even be thinking about $600 million.

MR. BYRNE: Well, we wouldn't be talking today. We'd be out celebrating. (laughter)

SENATOR THOMPSON: Otherwise, if we don't make that money, we wouldn't be paying $600 million.

MR. BYRNE: That's right.

SENATOR THOMPSON: Since it's based upon return.

MR. BYRNE: That's right.

SENATOR THOMPSON: If they don't raise that much money, we don't pay $600 million. We'd pay a lot less.

MR. BYRNE: That's correct; that's absolutely correct.

And you know, the only clarification there is that's the total fee. We would be paying management fees, in general. But the incentive fees we paid out were $334.8 million. And as I said, we generated -- what did I say, $1.8 billion in incremental profit off that? So a pretty good deal, in percentage terms.

And look, I well understand. The magnitudes are huge; I well get that. But I urge you to think about some of this stuff in percentage terms because that's really what matters at the end of the day to the beneficiaries. And, you know, $334 million in incentive fees is a lot. But to generate the kind of profits that -- $3.7 billion in total profits; and I believe it was $1.8--

MR. McDONOUGH: It's $3.1 billion in net profits.

MR. BYRNE: It was $3.1 billion in net; yes, $3.1 billion in net. I'm sorry; $3.1 billion net. And I guess $1.8 in incremental, if you will -- given where we took the money from. I mean, that's really an amazing increment.

SENATOR GORDON: Senator Weinberg.

SENATOR WEINBERG: Yes. I just want to correct one statement I think I heard you make -- and that is, the $600 million is not taxpayer money. Is that what you said?

MR. BYRNE: I did say that, yes.

SENATOR WEINBERG: Well, technically, it is taxpayer money.

MR. BYRNE: Well, it's not coming out of--

SENATOR WEINBERG: I mean, we can use all kinds of-- You know, it's not coming out of the General Fund--

MR. BYRNE: Well, I get that. In a holistic sense, you might say that, but the money is being paid out of the Fund.

SENATOR WEINBERG: Well, except then, we, the taxpayers, make up an additional $600 million into the pension fund.

MR. BYRNE: Well, actually, the taxpayers would be paying-- The actuaries will say that the contributions would be less over time, because of the increased profits. I mean--

SENATOR WEINBERG: I'm not going to argue the *what-ifs* -- which way we'd make more money; I just want to correct the statement.

That $600 million eventually comes out of the taxpayers' pocket -- even though there's somebody sitting in the audience shaking her head "no" -- it technically comes out-- All of this comes out of the taxpayers' pocket. Hopefully, we're making money on our investments; the money we're taking from the taxpayers is returning whatever returns, hopefully at the highest. But it's all from the taxpayers. I just don't want to leave some impression here that that kind of fell out of the sky and there's no obligation here.

MR. BYRNE: Well, there's clearly an obligation. And what I said is, holistically I understand what you're saying. I think in technical, cash-flow terms, you and I, I think, see the issue the same way. But technically we just view it differently, Senator.

SENATOR WEINBERG: Okay, thank you.

SENATOR GORDON: Okay. I really want to excuse you; you two gentlemen have been excellent witnesses. I think we've gotten an awful lot of material from you. And as I said before, if we continue this discussion we'd like to be able to draw on your expertise again.

So thank you very much, both of you.

MR. BYRNE: It was a pleasure to be here.

SENATOR GORDON: I'd like to bring up Mr. Jeffrey Hooke, who is a financial consultant and investment expert. He has conducted a study of Wall Street fees paid by the 50 states. And he is the author of three books; and we were both in business school at the same time, but didn't know each other.

And I should say, regarding business school, I never took the course in portfolio management, but after that presentation I feel as if I did. (laughter)

Mr. Hooke, please proceed.

JEFFREY HOOKE: Thank you. It's nice to be here.

I brought a PowerPoint presentation, which I'll go through page by page. Hopefully, I can get through it in 15 or 20 minutes. I'm going to cover a few topics: I'm going to look at the general overview of the fund, its overall investment performance. I will look at fees; the alternative performance from an investment point of view. I will make a few comments on the testimony you just heard, and prior testimony that I was given, and then I'll have a couple of closing remarks.

So, as you know, the pension fund has $81 billion in assets -- most of it is publicly traded stocks and bonds. It covers seven pensions systems, as you discussed the last couple of hours. It also has a big commitment to nontraditional investments, like hedge funds, and private equity funds, and real estate.

A properly designed fund, as I think the two gentlemen here mentioned, is designed to have the money there when the retirees need it. And if you look at that chart up there you can just look -- last Fiscal Year that ended June 30 -- it's actually 2014 -- $16 billion in benefits were paid out from the fund, and it had replenishments of $22 billion, of which $7 billion, roughly, were from the employer, the State, or the taxpayers; $2.5 billion from employee contributions; and the $12 billion in investment income.

So you can see, if there's $16 billion, or $15 billion a year in money going out, there has to be quite a bit of money coming in through one of those three sources.

So it's clearly important for the funds to be adequately financed. I mean, one of the risks that people have been talking about with Detroit and a couple of other states and governments, is that if the pension fund has a shortfall, the taxpayers and the states, technically, have an obligation, but they may not authorize sufficient revenue to take care of that obligation in the future.

Another good reason to have a totally funded plan -- or near-funded plan -- is that from the retirees' point of view the pension fund is bankruptcy remote. So if a state were to have a major financial problem -- not being able to pay its bonds, for example, like Puerto Rico -- the states' creditors cannot attach the fund. Those funds are bankruptcy remote from creditors.

And of course, from the state's financial position itself, it's very helpful to have a fund that's well managed so you can plan your state finances accordingly.

The State asset allocations, with respect to traditional investments, are similar to many state pension funds, as the two people here already mentioned. I think New Jersey has a somewhat heavier orientation to alternative assets, but it's not totally out of line.

Publicly traded stocks -- of course, you've heard of many of those, like McDonald's, or IBM, or overseas like Alibaba. Publicly traded bonds -- a big portion of a portfolio; that would be like Verizon, or Proctor and Gamble, or maybe some of the big foreign issuers; the alternative assets being around 30 percent.

As you heard already, most of the publicly traded securities are managed in-house, and as has already been mentioned, that's sort of unusual for a State fund. Most of them farm out that kind of management to third parties.

Now, the alternative assets -- we've already kind of covered those today -- private equity, hedge funds, real estate funds, and commodity funds. So hedge funds, for the most part, would invest in publicly traded securities, stocks, usually bonds -- mostly U.S.-type of securities. So like, what's one of the big hedge fund managers? Bill Ackman -- you probably saw it; he had a big article in the *New York Times* about his Herbalife short. But Bill Ackman's biggest repositions are Valeant, the Canadian drug company; he publicly traded Air Products and it was another big position; Canadian Pacific Railway -- these are all long positions where he buys the stock, and then he's-- Herbalife is one of the big shorts.

So it's not true diversification; you're still in publicly traded securities. But you're basically paying somebody who says he's smarter than the index fund and will get better returns.

Leveraged buyout funds, which are principally what New Jersey has in the private equities phase-- These are basically big funds that buy companies, both public and private -- usually U.S. companies -- borrowing huge amounts of money. So again, you have U.S. companies-- So a private company owned by a leveraged buyout fund -- say, an auto parts -- is going to have the same economic attributes as a publicly traded auto parts company. So it's not true diversification. The two companies -- one being public, one being private -- should move pretty much in tandem with general market movements. And I can tell you, being an M&A banker, we work with quite a few leveraged buyout funds -- they buy companies that we sell from time to time.

Now, the alternative managers, as you know charge higher fees than the traditional managers -- you know, roughly four or five times the fee for a traditional manager. And for an index fund, they would be about 20 times more expensive. So a huge difference in fees. And to justify that kind of fee, they are basically saying, "Look, we're going to provide higher returns; we provide diversification; we provide lower risk." None of these assertions have been proved, scientifically. So there is no academic study that has really proven these assertions. It's sort of like an article of faith by a lot of people in the pension fund business that it's going to happen. Maybe 20 years ago private equity funds or leveraged buyout funds did much better than the general stock market. But all the excess return has been competed out. When I was an investment banker on Wall Street 20 years ago there were maybe 100 leveraged buyout funds. There are now 2,000. So those smart guys are spread all over the place, and it's much harder for them to get an excess return because there is just too much competition.

So we just did an M&A deal -- we had five offers from different LBO funds. You know, all the smart geniuses -- they're just-- It's going to be competed away with higher prices for these deals.

So like New Jersey, virtually every state fund I've looked at has increased its exposure to alternatives. They've all drank the Kool-Aid -- that these alternatives are going to provide these positive attributes. I just don't see it.

There's been a lot of numbers flying around the last couple of hours, so I did my own calculations. The alternatives really haven't provided a huge benefit to the portfolio. Had it been just invested in a traditional bond and stock mix, the fund would have made an extra $600 million. You know, part of that is because the alternatives have such high fees. If you were to do something which is more logical -- which is try to compare apples to apples, because the fund's traditional mix has a lot of foreign investments -- equity investments. But if you try to go domestic to domestic, and do kind of apples to apples, on a private equity benchmark, the most accurate, probably, measurement -- as most people in the pension fund business will tell you -- would be the S&P 500, or the S&P 1500, or the Russell 2000 -- which are all 100 percent stock indexes. Because the private equity business is all stocks, they're buying domestic companies; yes, some of them are private, but they're going to have the same value as their public counterpart.

So if you were to compare the funds' private equity investments with, say, the S&P 500; or if you were to compare the hedge funds -- which, I think Mr. Byrne pointed out, you have many different styles-- But let's say you just had a 60 equity/40 U.S. bond mix instead of hedge funds, you'd have much greater returns by just ignoring a whole alternative class all together. So my calculation was $2.4 billion.

So yes -- yes, the hedge funds and the private equity funds had profits; that's true. But you would have had more profits had you just put the money in these indexes, with much lower fees. And that's what, as I will point out, the Investment Board doesn't point out.

So my conclusion is a little opposite of theirs. I think the $1.5 billion the funds put into these alternative investments has been a bad deal. And it's generally a bad deal for most states that have pursued the same course of action. So what would you do if you wanted to reduce that kind of exposure? Well, the hedge funds are written -- the contracts are typically written where you can liquidate your position every six months, or every year or two. So you can probably get out of that area in, say, a couple of years. Private equity funds, in contrast -- LBO funds -- is a 10-year contract. It's a no-cut contract, so all the funds you've been in, you're basically stuck with until that 10 years expires.

So I'll just look at the funds' overall returns, and I'll get into investments and alternatives in a minute.

So if you look at the fund overall -- the big fund, everything -- versus its peer group -- and the peer group I use is the Wilshire Index, which is a blue chip consulting firm that puts this index out every three months -- and looking at all public funds over $5 billion, as you can see, in the 1, 3, 5 years the fund was somewhat below its peer group, as defined by Wilshire -- which is the gold standard. And if you look at the 10 years, which is before the fund made a big commitment to alternatives, it's basically right on the average.

Now, what Mr. Byrne said earlier was that, well, you know, we're beating our benchmark return.

Yes?

SENATOR GORDON: If I could just interject a question here.

Could you explain the difference between the peer group that you're using -- the Wilshire -- and the benchmark that Mr. Byrne used in his presentation?

MR. HOOKE: He really used two benchmarks. He used one benchmark which I think is sort of the actuarial goal of the fund, which is to return something like 7.5 percent a year over 20 years; that's one benchmark that people tend to use in his position. The other benchmark would be a risk-adjusted return, which is basically they look at all your allocations -- you know, here's your allocation to public stocks in America, here's your international stocks, here's your bonds, here's your commodities, and so on -- and then the consulting firm adds some plus or minus to whatever the average benchmark is, given your allocations, and they come up with a number -- the consultant does.

And so what he had said, from what I got from his testimony, is that we've beaten that number that the consultants have set up using their scientific-type calculations. I've gone over -- as you mentioned in the introduction -- I've gone over like 50 state pension fund reports; 48 out of 50 say they beat their risk-adjusted benchmark. I mean, it's like Lake Wobegon, where everybody is above average. (laughter) It just can't be true. These are sort of made up numbers that people come up with so they can say, "We beat our risk-adjusted benchmark," which was devised by people we pay to tell us we beat it. So I just don't think it's a good measurement tool. I think this is much better; it tells you how you're performing versus everybody else.

Now, in that study which I had done with the Maryland Public Policy Institute, I had looked at a replicating index. So if you look at public stocks, and U.S. and international stocks, real estate, and private equity you can basically come up with indexes that match each one. And you could -- your in-house staff could basically construct those indexes and buy stocks in the indexes, and basically you wouldn't have to hire any alternatives. You'd basically have the same returns or better.

Here you see the replicating index that was developed a couple of years ago -- and this was featured in the *Wall Street Journal,* and this report was widely quoted in the media. The replicating index outperforms New Jersey; it also outperforms the Wilshire Group. And so what the study had concluded -- and I'll probably be brief about it -- is that the more a state fund paid in fees, the lower it ranked relative to its peer group. So that was very ironic, you know, the reporters thought. The reporters said, "Well, wait a second. If you're paying higher fees, all these geniuses should get you more money, more return." But it was actually the opposite.

And the fact is that these Wall Street people -- and I used to work on Wall Street -- not as a money manager, but as an investment banker. But I used to work for the biggest private equity fund in the world 10 or 12 years ago. You know, they just can't-- It's very hard to beat the indexes, in part because of the fees. The fees are so darn high. Even if you are a semi-rocket scientist, the fees are going to drag down the returns for your clients. So let's say New Jersey had matched that index -- it would have had a lot more money.

Now, I hope you all know what an *index* is -- but an index is basically just a collection of stocks designated by some firm -- like Standard & Poor's or Morgan Stanley -- and so the stocks-- If you're buying an index, you don't need somebody with a business degree to pick stocks, and study them, and go visit the company, and go to China, or India or anything. You just pick the stocks in the index; there's no brain power required. And that's why the fees are so low. Like I said, the fee for an index fund might be what you call *10 basis points* -- one-tenth of 1 percent. The fees on these alternatives are 20 to 30 times that. So it's very tough for the alternatives guys to beat the index.

Okay, now on the fees here as a percent of assets. You know, I didn't have the budget when I was working for the AFL-CIO to really do what I did two years ago with one of my colleagues -- which is to look at all 50 states. So I just said, "Look, I'll look at the five or six states near New Jersey that have the same year-end, and then we'll look at the fees to assets." And as you can see, New Jersey's a little -- basically, the highest one, relative. And I put in California, because that's sort of the blue chip name that everybody likes to talk about. So you're a little higher than the other states; I mean, this could be expanded to 50 states, given a couple of weeks, I suppose, of work. And you actually underperformed those five states on the median investment rate of return over the last five years, I think.

So, again, higher fees tend to lead to lower returns. Now, I thought that Mr. Byrne and his colleague had made a good point. Some of the states tried to hide their performance fees; often they're buried on page 86, or the footnotes, or they're in some weird language. So when we did the study -- and we actually updated it for this purpose -- you know, you have to go in the footnotes and look at the performance fees. If you don't see any description, you have to call the pension fund itself. They might give you the runaround, but usually you get your answer.

Nonetheless, I think he made a good point. You know, I'd say out of 50 states you probably have 6 or 7 that aren't being truthful in their reporting of these fees.

You've already heard about the tripling of the fees. I don't think I need to cover that.

So I looked at your private equity returns relative to these benchmarks. I already mentioned the S&P 500. You usually add 2 or 3 percent to the S&P because private equity is illiquid; you can't sell it, it usually has a much higher debt ratio. A leveraged buyout will have a much higher debt ratio than a normal publicly traded stock.

So New Jersey's private equity portfolio is not beating that index. The hedge funds are not beating 60-40 -- though, as I said, it's a bit of an apples-to-orange comparison there, and it's already been pointed out that the New Jersey in-house managers have beaten both categories. But it's a bit apples-to-oranges because the S&P 500 has a lot of high-tech stocks; it's got a lot of banks; it's got a lot of companies that are not consistently profitable, whereas a private equity portfolio is usually all low-tech money-earning stocks that are simple in their business.

I am actually working with a professor at George Washington who had developed a software, and we published an article in an academic journal a couple of years ago pointing out that with the right kind of software you can duplicate the portfolios of LBO funds using publicly traded stock. I didn't get many calls about that, surprisingly, but that-- Maybe I'll get some calls later.

The interim results from March 30, 2015 -- and I know that April is out already, but the TUCS median only comes out every three months, so if you look at the return for the first nine months of the fiscal year, you're about 0.8 below your competition -- or your peer group

Now, again, I listened to the testimony here. I had some written testimony; and so I was asked, "Can you give us a little bit of a critique?" The PowerPoint I had from the Department of Investment, which was April 15, they looked at six or seven -- well, here, four different dates and reference points. And what you like to do when you're doing comparison is have one straight date -- not three years from March 30, and then six years from June 30 -- if you like that one reference point. So it was a little hard to figure out what they were trying to get at because there were so many different dates.

Also, when they were doing a peer group comparison, they had four different peers groups. And then they used seven years in a couple of places, when the industry standard is usually one, three, and five. So I thought the whole presentation was a little misleading and perhaps guilty of cherry picking. And someone -- I think, one of the Senators -- already brought out the fact that to compare hedge funds or private equity to fixed income is just apples to oranges; it's not logical.

So the alternatives will tend to look good in a rising stock market relative to bonds. Because, you know, bonds don't participate in a price rise of stocks, whereas alternatives will. So, you know, the better thing is what we did -- or what I did here earlier -- is compare it to the S&P 500 or to a 60-40 mix. And I think I already mentioned the last point on that slide, so I don't need to do it again.

I agree -- New Jersey is more open about the way they report fees. I think that's to New Jersey's credit. And as I said, but you can usually get all the information if you do a little digging.

I don't think the fees to assets of this State would be lower than average; I think it's probably slightly higher than average. Again, I didn't go over all 50, but I went over a bunch of them.

The other thing which is interesting to note is that most of the private equity returns -- not the hedge fund returns, because they're buying publicly traded securities, or derivatives, or bonds for the most part -- but a lot of the private equity investments have not been sold. So the performance data that you're looking at is based on the manager's best guess of what those investments are. They're sitting there, they're privately held, they're not trading. So that's a best guess. They're usually not second guessed by anybody. And if you take one example, like all LBO funds started in 2005, according to Preqin -- if you look at the LBO funds started in 2005, it's 10 years later and they still haven't sold half of their investments -- 10 years. So one wonders why are they holding on to them. Do they really -- have they really held their value?

Okay, now we hear -- the comparison that was used by the Treasurer and the Department of Investment sort of, as I said, had an apples-to-oranges comparison. The Senator, here, brought that up, so I don't think I have to mention that again.

So if you come away with anything form my testimony it's that with the high fees, the alternative people -- whether hedge funds, or private equity, or doing commodity funds -- the fees are so high that after 10 years -- you know, the fees could be 15 percent of your principle amount. So you're effectively -- at 85 percent, if you did an index fund clone, you're at 100 percent. So basically the private equity guy -- he's starting at 85, and you're starting at 100 -- it's very tough, very tough for that private equity guy to catch up. And for that reason I think, as more information comes out on private equity and hedge fund returns, you're just going to find that they just can't beat a well-managed, in-house operation like you've got, or really an index that clones the results of the hedge fund or private equity fund.

Thank you very much for listening. I'll be happy to take questions.

SENATOR GORDON: Thank you, Mr. Hooke.

I have been advised that one of our witnesses today has a doctor's appointment and needs to leave in a few minutes. So with your indulgence, Mr. Hooke, I'd ask you to just to hang in there--

MR. HOOKE: Okay.

SENATOR GORDON: If we could bring up Tom Bruno, and then we'll proceed and the Committee will have an opportunity to ask you some questions.

Mr. Bruno, thank you for your patience. If you could just identify yourself, and tell us your role with the Investment Council.

THOMAS BRUNO: Yes. My name is Tom Bruno; I'm the Chairman of the Board of Trustees for the Public Employees' Retirement System.

I appreciate the consideration. Unfortunately, this ran a little longer than I expected.

I'd like to thank you for the invitation to speak before you on the issue of New Jersey's public pension and, in particular, the concerns that have been stated by the elected PERS Board of Trustees relative to the condition of the fund, and the need for a forensic audit of the management fees; and an actuarial study of the pension task force recommendation to freeze the current level of the pension and create a new one.

The condition of the fund has been well documented. Obviously, it's been adversely impacted by a confluence of events over the past two decades; and improper borrowing of the fund by Governor Florio nearly cost us our tax exempt status. But the failure to make the normal payments into the fund began with Governor Whitman in the mid-1990s, along with the actuarial smoothing method of evaluation instead of a market valuation, and those kinds of things. Then we had the economic downturns of 2001 and 2008 and 2009; it's all been discussed already.

But add a dash of 2001's Chapter 133, which changed the pension formula from the denominator of 60 to 55, resulting in a 12 percent increase to all active employees forward, as well as all retirees retroactive to 1955, and you have the perfect storm.

Still, in 2001, lawmakers knew that their actions would upset that delicate balance of assumptions and solvency, so they created the Benefit Enhancement Fund to offset the added benefit. Unfortunately, that fund was also attacked, basically, during budget deficits.

So that's the quick synopsis of what led us to the dire circumstances that we find ourselves in to day.

So fast forward to where we're at right now. I just want to talk about-- The elected Pension Board of Trustees have had some grave concerns. We operate on what's presented to us by the Investment Council, by the Treasurer's Office, by our own actuaries. And so when we started realizing, this year in particular, that for the third straight year numbers weren't adding up right for us, we decided we wanted an actuarial, or at least a forensic, audit of these management fees. And the reason was we were having -- we noticed that in some years-- We went back three years, and one year it was called *management fees*; another year, *performance bonuses* were added in; another year, it was considered *performance allocation* -- the word *bonuses* was absent. One year there was a *carried interest* that was utilized as a term of some sort of bonus.

We, frankly, had a sense that we were going over a Niagara of financial babble in a barrel full of holes. And we wanted something a little less ambiguous -- somebody to identify for us exactly what are we paying for, and are we paying what the industry standard says we should be paying? And to that end, as fiduciaries of the Fund, we voted to do just that.

Unfortunately, our efforts have been frustrated, just like our efforts to enforce the unambiguous language of the 2011 Chapter 78 language involving collecting of the funds -- and we went almost a year before the Administration finally started paying our attorney. And so that was a travesty in and of itself. But now we're at the stage where, two months ago, we passed this motion for an actuarial audit. And to date we are no closer now than we were the day before we started this.

So we are mandated with the fiduciary responsibilities, but we don't have the authority. We're supposed to have the authority, but we don't have the authority. And so there was a recent unpublished court decision that basically says that we do have that authority, but until it's published we can't use it as a precedent.

So we're very frustrated about that, and I guess that's--

SENATOR GORDON: Excuse me, Mr. Bruno. Do you have any idea how much that audit would cost?

MR. BRUNO: We're told somewhere in the neighborhood of $70,000, which would come out of our administrative costs for the fund. That would be an administrative cost.

SENATOR GORDON: Okay. Thank you very much. Mr. Bruno.

Does anyone on the Committee have a question?

SENATOR WEINBERG: Yes. Do you have any -- were you given any reason why you can't do the audit?

MR. BRUNO: They told us we had to go to the Division of Investment. And we said--

SENATOR WEINBERG: Repeat that; I'm sorry.

MR. BRUNO: We were told that we need to make the request through Division of Investment, and they would be the ones to decide whether they would commission that study. And what we said was, "Well, it's their document that we're questioning. Why would we go to them to--" A little counterintuitive; I mean--

SENATOR WEINBERG: Do you have written documents on that -- written documents back and forth between you and the Administration?

MR. BRUNO: What we have is a-- It was done at our actuarial evaluation public meeting.

SENATOR WEINBERG: Okay.

MR. BRUNO: And we have meeting minutes where John Megariotis, the Deputy Finance Director, told us to go to the Division of Investment -- that's in the record.

SENATOR WEINBERG: Through you, Mr. Chairman, can we request copies of those minutes?

SENATOR GORDON: I think we should request copies of those minutes.

Another thought that I had, and this is -- I haven't had-- This is really off the top of my head, but we have an auditing organization within the Legislature called the State Auditor. And perhaps the State Auditor, with support from an outside organization, could perform that kind of audit; maybe it could even be done for less than $70,000. Or perhaps the Budget Chairman can write some language in the budget to see that $70,000 is allocated for a forensic audit. (laughter) I'm just throwing some ideas out here, but I think the taxpayers would be well served by having that audit.

MR. BRUNO: I appreciate that.

SENATOR GORDON: Any other comments or questions from the Committee? (no response)

Seeing none, we thank you for your presentation today.

MR. BRUNO: Thank you very much.

SENATOR GORDON: And we appreciate your testimony.

MR. BRUNO: Thank you very much.

SENATOR GORDON: I think what I would like to do, at this point, is bring up Adam Liebtag to make his presentation. And then what we can do, as a Committee, is pose any questions we have to both Mr. Hooke and to Mr. Liebtag. So if you could come up together.

Believe it or not, I am trying to economize on time.

Mr. Liebtag.

ADAM LIEBTAG: Thank you, Senator.

My name is Adam Liebtag; I am the President of the Communication Workers of America Local 1036, which is a CWA Local that represents about 7,300 members and their families. The predominant majority -- almost all of our members are in the Public Employment (*sic*) Retirement System; they are in PERS. We represent workers in the State Executive Branch, in the Judiciary statewide, as well as various units in both county and municipal government.

I'm also here today wearing another hat, which is the very recently elected Vice Chair of the New Jersey State Investment Council. I was appointed to the State Investment Council back in 2011 as the representative of the New Jersey AFL-CIO.

Within all of the various pension funds -- there are several -- but if you add up PERS, Police and Fire, State troopers, the Judicial system, TPAF -- all of the various pension funds -- there are over 700,000 members in the various retirement systems. And the majority of those are represented by the AFL-CIO affiliate unions. I can tell you that the CWA, by itself, has about 80,000 members in the Public Employment Retirement System.

So, going through all these numbers and the PowerPoint presentations, and some of the academic or financial theory behind these decisions can be dry. I understand that; I sit through State Investment

Council meetings. But our membership and their financial survival for 20, 25, 30 years of their lives depends on the survival of this pension system.

And this pension system is in a crisis -- we all know that -- for various reasons, the largest of which is the lack of full contributions. So it only, in my mind, puts a stronger emphasis on every dollar that is spent -- every dollar that is spent as an administrative fee, or every dollar that is spent as a fee or a performance bonus to an outside manager. So we're deeply concerned. We're thankful that you're convening this hearing.

I want to express a couple of comments, partially in response to Tom Byrne. He started out his comments saying that the State Investment Council has operated collegially -- and I will second that. It has been a collegial atmosphere, and we try to act by consensus. However, it is completely appropriate, at this point, to look at the stress that's on this pension system and look at, perhaps, better ways of investing the money.

The annual report for 2014 was just issued. It was issued to the Governor and to the Legislature, and so I'm thankful that you're taking this opportunity to review that annual report and, hopefully, take future actions on future annual reports.

So as I said, there are about 700,000 members in the system. I did give you copies of my testimony, and some of the points have already been hit by prior folks so I'm going to skip ahead.

I just wanted to call your attention to a chart that I put together at the bottom of page 2 of my testimony. What this shows basically is that the alternative investment portfolio has not only grown by leaps and bounds within the last five years, but the cost of the alternative investment portfolio is growing exponentially faster than the investments that we are making. So if you look at this chart -- I've pulled all of these figures from the annual reports for Fiscal Year ending 2010 through 2014. And what you'll see is that, as of June 30, 2010, the alternative investment portfolio was at $10.5 billion. The total pension fund at that time -- that was after the 2008 and 2009 fallout -- was $66.8 billion. So roughly one-sixth of the fund was committed to alternative investments. The alternative investment fees that were paid in 2010 were $127 million.

And then in 2011, the alternative investment profile was increased from $10.5 billion to $13.2 billion. And the alternative investment fees paid, as reported in the annual report, increased to $174 million.

Now, what that means is that there was a $2.7 billion increased commitment to alternative investments from 2010 to 2011. And there was roughly a $50 million increase in the fees paid for that alternative investment. What that translates to, if we just compare 2010 to 2011, is that there was a 25 percent increase in the amount of money allocated to alternative investments, but a 37 percent fee increase from 2010 to 2011.

Now, some other folks have said that New Jersey changed its reporting, and should be praised for that. And I will echo those sentiments. New Jersey's Division of Investment is doing a better, more accurate, more thorough, and more transparent job of reporting the total of both performance fees and management fees. But that reporting has come after pushing, after pressure, after folks asking for increased transparency and accountability.

And one of the arguments that I've heard is you cannot compare the $600 million in 2014 back to the $127 million in 2010; that it would be an unfair comparison because $127 million, perhaps, was not the sum total of fees. The reporting requirements were not as strict back then.

So let's just look at 2010 to 2011, as I just did -- a 25 percent increase in alternative investments, 37 percent increase in fees. Let's go to 2013 and 2014. In 2013 to 2014, we increased our commitment from alternative investments of $20.3 billion to $23.4 billion. That is an increase of $3.1 billion. However, the fees jumped from $399 million to $600 million. So what we did was increase our alternative investment profile by 15 percent and our fees went up by 50 percent.

There is an imbalance there. That trend, should it continue, is dangerous, in my opinion, for the long-term health of the pension fund, because we are going to continue to pay increased fees that will grow faster than what we're actually committed to investing in the alternative investment profile.

I think the bottom line for us, when you look at the $600 million that was spent last year -- last Fiscal Year for the alternative investment program-- You know, there's been a lot of criticism about public employee pensions. I want to put it in perspective. The average public employee pension benefit is under $30,000 a year. It's a little higher for State workers versus local government workers. So with an average pension of $30,000 a year, the only folks who are getting rich off the system are the hedge fund managers and the alternative investment managers who are reaping the benefits of these performance fees and management fees totaling $600 million a year. That is the imbalance that we're here to talk about.

Since 2007, the alternative section of the portfolio was targeted at 10.3 percent of the overall fund -- back in 2007; in 2014, it had more than doubled to 29.5 percent. If you add up the fees that we've paid to the alternative investment managers, it's almost $1.5 billion over five years.

I also want to make a comment -- one of the things that has been said is that the Division of Investment negotiates good contracts with these outside managers; that the basic 2 and 20 -- 2 percent management fee and 20 percent performance bonus -- is a good, aggressive rate; it is good for New Jersey, it's a lower rate than what the hedge fund might charge someone on the private market. And if that's true -- good for New Jersey, and good for the Division of Investment. I believe that it is true; I believe that they are aggressive in negotiating these hedge fund contracts. But, on the other hand, if New Jersey was to walk away from a hedge fund, or was to try to negotiate even more aggressive terms, and the hedge fund walked away -- there's been this sentiment expressed, "Well, they'll go get the $100 million commitment somewhere else. They don't need New Jersey's money." If that really were true, wouldn't the hedge fund actually do better on the private market? If they're giving us a discount on our fee agreement, why wouldn't they seek $100 million somewhere else and charge 3 percent instead of 2 percent? So the logic doesn't really track for me. I think it cuts against itself.

The role of the State Investment Council and the role of the AFL-CIO, the role of CWA and other Labor unions -- we are not trying to pick a better stock. What we are here to say is that when we look at the hedge fund fees, they are growing exponentially. And they are growing at a time when the fund is under extreme pressure. If we compare the hedge fund performance, as Mr. Hooke did, and others have, to the Division of Investment staff, this contrast is even more stark. The Division of Investment is underfunded, they are understaffed, they are undercompensated relative to their peers -- not only in the investment industry but in other states. And by way of comparison, if you look at the chart that I prepared on page 2, the columns to the right show the in-house costs. The Division of Investment has pretty much held stable at about $10 million per year. They manage between 70 and percent of the fund. Now, you can see that over the last 5 years the percentage of the overall that they have managed has decreased; but as of Fiscal Year 2014, according to their own annual report, the Division of Investment staff managed 74 percent of the $80 billion fund. And they did that for $10 million.

Compare that to what we are being charged for the alternative investment program -- $600 million in fees for a fraction of the fund.

So I would say to you that as elected officials and as concerned protectors of the tax dollar, you can't get a better deal than the Division of Investment. They're doing two or three times the work; they're managing 74 percent of the fund for one-sixtieth of the cost of the outside alternative investment managers.

In terms of performance, they are tracking with or excelling; they are beating their benchmarks, they are beating the S&P, they are beating the performance returns from the alternative investment program. At the top of page 4, I pasted in a chart which was provided to the Legislature by the State Treasurer as part of his OLS response and testimony. If you just look at the line that says "Total AIP," -- this is the alternative investment program performance and fee payments -- you'll see that, for Fiscal Year 2014, the Treasurer reports total FY 2014 fees of $517 million. Now, that is not $600 million. In the annual report, it adds actually up to $612 million, but here in this chart it only adds up to $512 million. I cannot account for the discrepancy, but perhaps that's one of the issues that Tom Bruno and the PERS Board could get to the bottom of with a fresh look.

You'll see the performance returns -- the rate of return on the hedge fund and the alternative asset class versus the domestic equity, international equity, and fixed income returns for the Division of Investment. Again, they're doing it at one-sixtieth of the cost.

So if we benchmarked hedge fund performance against internal performance, I think that we would all agree that the Division of Investment is a better bet. And as a spokesperson on behalf of the beneficiaries, and on behalf of the folks who have never missed a payment to the pension system, I would say that, after all the union meetings that I've gone to -- and they ask questions about the $600 million in fees -- I can confidently say we have more faith doing this in-house than paying exorbitant fees to Wall Street to manage our pension money.

So let me close. Senator Sarlo drew a comparison -- which is accurate, and I had it here as well -- put the $600 million in some context for you. The State's pension obligation, under Chapter 78, in Fiscal Year 2014 was $1.3 billion -- and the Governor only paid $700 million. That difference is $600 million. And how much scrutiny has that undergone, and how much debate has there been over that $600 million? The entire Department of Agriculture's budget, which includes the Jersey Fresh program, Child Nutrition, Aid to Farmers, is $542 million. The much-reported proposed settlement with Exxon is $225 million -- less than half of the $600 million that we've paid out in investment manager fees. How much reporting, how much scrutiny has that undergone, and deservedly so? But to put it in perspective: If we are going to be protectors of the tax dollar, let's apply that equally and be very concerned about what we're spending on outside fees.

So I'll close with this, and then I'd be happy to take any questions, or talk about what some ideas might be for what's next. But I'll close with two thoughts. First, one is a response to something that my colleague, Tom Byrne, said about comparing in-house State worker staff to outside staff. And he made a comment that Civil Service protects people from being dismissed if they lag behind the benchmark. I'm really tired of hearing that excuse -- that Civil Service prevents performance improvements, or that Civil Service prevents the employer from taking steps that are necessary. I'm as tired of hearing that answer as the Division of Investment staff probably is at hearing *lazy* or *missed calculations* about Fiscal Year versus Calendar Year performance. It's just a missed comment; it's wrong. Civil Service, I can tell you, just sets forth rules. It doesn't prevent anyone from being disciplined, or their performance being improved. I've personally represented hundreds of members who have been removed for performance, and the ones who are restored to their jobs are the ones where there was no basis for removal. The ones who were ultimately removed, there was a basis for it -- and that's all it does.

And I'll close with this: $600 million -- we are all concerned about the lifespan of the pension fund. And there have been reports that the pension fund, without a lack of appropriate and full funding by the

State, could be out of money in 10 years. Do we want to pay $600 million for 10 years, totaling $6 billion in 10 years, while this fund is running out of money? That would be unconscionable.

So we thank you for taking this issue up, for thinking about it. And I would say that we can still try to achieve the diversity in the portfolio, but let's look at how we can reduce the overall expenses -- the overall costs -- and have an effective pension investment plan.

Thank you.

SENATOR GORDON: Thank you very much, Mr. Liebtag.

I'd just like to-- I'm sure there are a number of questions. I'd like to pose this one to either of you. A few minutes ago I made a performance calculation, suggesting that if the $600 million were to stay invested, or to remain invested in the pension portfolio, and were to compound over the course of 10, 20 years -- looking forward -- we could be talking about $20 billion or $30 billion and a significant contribution to our pension that would be pretty critical to its solvency. Am I correct?

MR. HOOKE: Yes, you're correct -- assuming that hedge funds and P/E funds provide a return equal to the general, traditional portfolio. You're absolutely correct.

SENATOR GORDON: For either one of you again -- if we're not investing in-- One, if we're not investing in hedge funds, where do you think an appropriate investment would be, in terms of a class of assets? Is it some kind of index fund, as you were -- Mr. Hooke -- talking about a few minutes ago? And, generally speaking, where do you think we should go from here in terms of policy decisions or legislation?

MR. HOOKE: Well, first, Mr. Byrne said, part of the reason of having a hedge fund is in case the stock market goes down. So you're paying 2 percent, essentially, per year for insurance. If the pension fund managers think the stock market should go down, they should just sell stocks, and put it in cash, and wait until the crash occurs. You don't have to pay a hedge fund manager 2 percent. And as I think even Mr. Byrne pointed out, the hedge funds traditionally -- since they own a lot of publicly traded stocks and derivatives -- they move in parallel to the market to begin with. There really isn't a negative correlation between hedge funds and the stock market. So I never quite got it -- why big pension funds audited hedge funds. It just didn't make any sense. I just thought it was illogical and made no sense whatsoever.

What I would do if I was in your position as stewards of the public trust -- and I guess you are, in a way, overseeing the pension fund and the budget, and all that -- is, I would try to withdraw from hedge funds and P/E funds to the extent you can, and just put it in some type of index, as I said earlier, that kind of matches up with the hedge fund result -- if you think we've got to hedge a market crash. I think you could do stock, or cash; or if you're trying to get leveraged returns on equity like a leveraged buyout fund does, as I said earlier, you could pick those kinds of stocks-- they like to buy -- conservative manufacturers, low-techs type stocks. You could just duplicate all that. It sounds to me like you have the in-house expertise; you could hire someone to help out. And you just buy those indexes, as I say up on this chart here, and forget the private equity or the alternatives. I just think it's a waste of money.

SENATOR GORDON: Okay. But then again, if there were a market downturn, those indices would go down with the market, would they not?

MR. HOOKE: Yes, but so will the hedge funds. I mean, the private equity funds, in theory, should go down even more than the market because they're much more leveraged. In my studies, since the underlying investments are similar, they should track the market. If you think the market is going to go down, if that's the consensus of your Board of Trustees or the people over at the State Investment Council -- whatever -- if you think the market is going to crater, you should just put money into cash. You should withdraw money from the stock market and put it into bonds or cash. I just think paying the hedge fund 2 percent would essentially do the same thing. It just doesn't make any sense because I think, as Adam pointed out, the fees for doing that are 20 or 30 times what you could have the staff do it for.

MR. LIEBTAG: And just to follow up on that comment.

I don't want to speak for every individual on the State Investment Council, but I can generally characterize the discussion. I mean, there's a lot of concern about the market being rocky -- that it has been rocky, and that it will continue to be rocky for some months into the future. I don't think that there's a sense that the market will crater, but given changes in the global economy, and given, perhaps, the change in interest rates here domestically, there will be some effect on the marketplace. And we do want to be careful. I don't think that anyone on this State Investment Council would say, "Make a hard left turn right now," right? This is something that should be steered carefully and deliberately, and with a lot of consideration.

But the reason that I think this hearing is timely and, hopefully, what I'm getting across -- the Division of Investment does a fantastic job with the resources they're given and the mandate that they have. And I want to commend them for that. If anything, what I'm here saying is that we're concerned with the scope and the scale of the alternative investment program. It continues to grow; it continues to cost a lot of money. And as that trend may continue into the future, I think now is a good time to take a pause, review it, and think about that -- both at the State Investment Council, at the kitchen table as a beneficiary, and in the State House as you talk about a budget and you talk about the input -- the contribution. But you also have to think about the other input of revenue -- which is the returns on investment.

SENATOR GORDON: Senator Sarlo.

SENATOR SARLO: Yes, I just have one-- This has been a very, very in-depth analysis, and a great job by everybody testifying. A lot of numbers.

I'm going to put a really simple question out there -- and this goes to Adam. I have a hundred dollar bill in my pocket. And I either want to give it to one of your employees -- a State worker -- or I have the option to give it to a high-end hotshot investor on Wall Street. Why should I give you my $100 for the best net return? Regardless of what the fee is going to be, I want to make the most money out of this $100. Tell me why I should give it to the individual from the CWA, and not to that hotshot on Wall

Street -- U Penn, Wharton business; great resumé; investing for all these major corporations. Tell me why I should give it to you guys.

MR. LIEBTAG: If you look at the chart that shows the returns from Fiscal Year 2014, our numbers are as good or better in certain categories compared to hedge funds. I think there's a saying even among investment managers -- and I do not count myself in that group -- that, "The better your investment advisor's golf score is, the worse you're doing as the client." So if you're really going to give it to some hotshot that's going to charge you 2 percent just to match 6 percent return -- right -- they're going to get a 2 percent management fee for the first 6 percent return. You could get 6 percent probably doing it in a much more cost-effective way.

So why give that 2 percent away for the first 6 percent of return? And then if they perform better than 6 percent -- which, by the way, the CWA member in DOI does -- they're charging you, perhaps, 20 percent of that increased performance. So I would say we do it less expensively, more effectively, and as a public policy issue-- Now, you were talking about your $100; but if it was the taxpayers' $100, should the public be in the business of generating $600 million a year in revenue for a handful of hedge fund managers? I don't know that that's the right public policy. I think we all have to make a judgment call on that. But if the State budget is essentially going to become a revenue stream for private investment managers, I would rather keep those dollars here and have them invested by a DOI staff that's twice what it is now -- and it would only cost you $10 million more.

MR. HOOKE: Can I answer-- Mind if I answer that question, Senator?

SENATOR GORDON: Sure.

MR. HOOKE: Every year there's a data fund -- a mutual fund data firm, which you may have heard of.

SENATOR SARLO: By the way, I only have $10 in my pocket, okay? I don't want anybody to think I have $100. (laughter)

MR. HOOKE: Okay. There's a data set fund called Morning Star; you've probably heard about it in the papers.

SENATOR SARLO: I heard about it.

MR. HOOKE: Every year they come out with a table that says how many managed stock funds beat the index -- either their Broad index or their International index. They are each assigned an index that's supposed to be-- How many of them do you think beat it in any given year? Ten percent. So 90 percent can't beat a totally passive index -- that's how bad they are, because they just -- the market is just too competitive, and then the fees drag them down. So it's just so obvious that most individuals -- of course, most institutions are better off indexing the whole thing.

SENATOR SARLO: Thank you. Thank you, Senator Gordon.

SENATOR GORDON: Senator Weinberg.

MR. LIEBTAG: Could I follow up with one additional comment to Senator Sarlo's question?

SENATOR GORDON: Sure.

MR. LIEBTAG: The other way to put it in context, Senator Sarlo-- You know how much the State Budget is, right? -- $32 billion, $33 billion? We've invested $24 billion in the alternative investment program by itself. That's huge, right? And that deserves a lot of scrutiny, and I think we should be demanding the best performance if we're making that kind of a commitment.

SENATOR SARLO: Thank you.

SENATOR WEINBERG: I have a couple of questions, Adam.

First of all, Mr. Bruno's testimony about asking for the forensic audit -- did that come before the Investment Council for discussion or vote?

MR. LIEBTAG: No, it has not.

SENATOR WEINBERG: Okay. So his request to the Investment Council hasn't come before you?

MR. LIEBTAG: No, the--

SENATOR WEINBERG: Would that-- I'm sorry?

MR. LIEBTAG: I said "no." The State Investment Council has not been notified officially that the Board of Trustees requested that audit. It has not come before the Council.

SENATOR WEINBERG: Well, maybe you haven't been notified officially, but I think you've just been notified unofficially. So perhaps that could come up before the next meeting of the State Investment Council in order to get the documents and, perhaps, even have a vote on it -- if that's what the Investment Council so chooses.

And I think, by the way -- I know that you were, I think rightly so, defending the public employees in this, who are doing this work on behalf of the taxpayers. But I think Tom Byrne also said that these employees are underpaid--

MR. LIEBTAG: He did.

SENATOR WEINBERG: --considerably vis-à-vis their counterparts in the private sector. But Tom also said something else -- that he seemed to indicate that alternatives have not been discussed at the Investment Council -- the overall alternatives. Is that so? Has that been -- have you brought it up before an Investment Council meeting?

MR. LIEBTAG: So just to restate, a little bit, your question. I don't think that he said it wasn't discussed; I think what he said was that it has been discussed at the Council, and there hasn't been opposition to the asset allocation plan. I think that's really what he was talking about.

SENATOR WEINBERG: Okay.

MR. LIEBTAG: That asset allocation plan is set, I believe, every May for the upcoming fiscal year, which would begin on July 1. We just adopted the Fiscal Year 2016 asset allocation plan, which lays out, in broad categories, your targeted allocation for each type of asset -- including the alternative investment program.

There was-- He is correct; there was not vigorous debate over that plan this year. It is very -- there were very minor changes from last year. In the past, I have -- a couple of years ago, I distinctly recall asking, "What's the alternative to the alternative investment program? What could we be investing in, otherwise?" And so it's difficult, as a Labor representative to that Council, to have roughly half of those members be investment professionals, investment bankers, real estate fund managers, and so forth -- plus have two or three consultants at the table -- who I do believe have done their best thinking, and this is the plan they came up with.

So that's what we're facing, as Labor representatives -- to try to argue those points. Again, I don't think they're doing anything here other than putting together the best plan that they believe will serve the beneficiaries. But from our standpoint, that increased cost is really starting to give us serious pause.

SENATOR WEINBERG: But wouldn't an audit help you figure this out?

MR. LIEBTAG: I think it would help a great deal. I will go back to your prior question. I wish that Director McDonough and Tom Byrne were here to listen to Tom Bruno's testimony and request. I'm sure that they will become aware of his request, if they aren't already, and I will make sure that I convey that message back to both of them.

SENATOR WEINBERG: Thank you.

SENATOR GORDON: Any other questions from the Committee?

Senator Thompson.

SENATOR THOMPSON: Yes, thank you.

First, at one point, Mr. Liebtag, I think you felt it was necessary to offer some defense of the employees of the Division of Investment. You said some people might talk about them being *lazy* or God know what else. Let me say, that's not necessary. I think everybody here for certain has the highest regards for the employees over there; we think they do a fantastic job; agreed, they're underpaid. So we're totally in support of those employees and think they do a great job.

Secondly, related to your table on page 2, I think there's a very significant piece of information you do not include on your table -- thus you compare the amount of investment with the alternative investments and the fees that are being paid for them. Now, since the fees are not based solely on the amount of investments -- and that's what you're comparing with percent increase in investment, percent increase in fees -- the fees, to a significant extent, are also based upon ROI. You need to have what is the ROI -- how it has modified and changed in each years as it went along as well. Since, again, you have the basic management fee and the amount of increase in fees that you get -- bonus fees. And does that reflect an increase for the increased fees that you are paying there? I mean, you know, it's one thing if Senator Sarlo gives you $100 and you return $5 on it; it's another thing if he gives you $100 and you return $20 on it. Certainly we would be willing to pay you more to give us back $20 than if you only gave us back $5. So that's a very significant piece of information, in order to do a fair comparison here, that needs to be needed in to it.

MR. LIEBTAG: Could I respond to that?

SENATOR THOMPSON: Yes.

MR. LIEBTAG: So this table-- That information, I agree, is very important. It was not omitted for any reason other than this table is not tracking performance returns.

SENATOR THOMPSON: But we're talking about how fees are increasing. I think, "Hey, that's what we want to know -- what are we getting for our money?"

MR. LIEBTAG: Right.

SENATOR THOMPSON: Not just how much money was put in; what are we getting back for it?

MR. LIEBTAG: Well, that chart was then, in part, captured on the next -- on page 4. The chart on page 2, Senator, was only showing the trend of the amount of money committed versus the fee. So actually, if I could just sort of streamline this. This is the expense chart. This tells you how much it costs to invest the money. That's all it was.

SENATOR THOMPSON: But still the bottom line, as far as I'm concerned, I don't care how much money you put in; I want to know what I got back for what I put in.

MR. LIEBTAG: Yes.

SENATOR THOMPSON: And that's the two most important things -- not how much was in there; what did I get back for what I put in -- I mean, for the amount of money I paid?

MR. LIEBTAG: I understand the point. That would just be captured on another chart. And, in fact, I think it was in Jeff's presentation, and also referenced in Director McDonough's presentation.

SENATOR THOMPSON: And, you know, we frequently, again, have had discussions about, well, $600 million over 10 years, or $600 million over 30 years, and so on -- and what impact that would have on the pension fund. But we have to keep in mind that $600 million isn't there unless there's been a very significant return. And if you compare-- Hey, if we didn't put that $600 million in there and didn't get the return back that we're talking about, the pension fund would be in an even worse shape. But if you get that kind of return, even though the $600 million didn't go into the pension fund -- it was paid out -- the net for the pension fund is we've come out much better off than we were. So again, I say we're in an argument and kind of getting off-track.

The discussion there, again, about going into -- putting money into the market, or cash, or so on -- versus hedge funds, and etc. I think Tom Byrne made a very good point when he compared the effect of the market crash, essentially, in 2001 and 2002 on the pension fund -- a $17 billion loss -- versus the effect of 2008 and 2009 when the market came down. The diversification we had done -- the impact of the market and the economy on the pension fund was reduced significantly through the diversification that had been done -- whether utilizing hedge funds or whatever -- it made a very significant difference there. It seems to indicate that they're going in the right direction to me.

MR. HOOKE: Would you like me to respond to that, or--?

SENATOR THOMPSON: You're welcome to.

MR. HOOKE: Okay. Well, the reason the pension fund didn't -- and these are Mr. Byrne's words -- the reason the pension fund didn't drop as much as the S&P 500 was because the pension fund was like 40 percent bonds at that time. The bonds don't drop as much as stocks, so that's the reason the pension fund fell less than the S&P 500. The S&P 500 is 100 percent stocks, so he neglected to point that out.

SENATOR THOMPSON: Well, as I say -- it was diversification: bonds and other things too.

MR. LIEBTAG: And Senator, I agree with your rationale. Laying out that the $600 million in expense is predicated on the idea that we're also getting additional returns from that investment; I understand that. I guess our point here is that if we can try to achieve that same diversification or a different type of diversification with lower expenses and less of the money going out to outside managers, we could probably invest that $600 million better through the Division of Investment. And spending some additional resources, or some additional emphasis within the Division of Investment, we feel like we can still achieve that diversification and get a good strong investment return. So it's just a question of whether that $600 million is paid outside or we're able to limit those expenses somewhat.

SENATOR THOMPSON: Well, you're making a hypothesis there that if we can make the same money without spending the money, then, yes, we'll have more money. There's no question about that. But the *if* you have in front of that -- *if* we can make the same money without spending more money.

SENATOR GORDON: However, if I could point something out.

If I'm correct here, if you look at the return on investment for each asset class on page 4, and compare those -- compare the hedge fund, for example, with those assets that are managed in-house -- in fact, in most cases, the Division of Investment is getting more for the dollar. Is that not correct?

MR. LIEBTAG: According to this chart -- which, again, comes from the Treasurer's testimony -- that is correct, that all the domestic equity and the international equity portfolios managed in-house beat the hedge fund portfolio significantly. And if you were not in those hedge funds you would have not paid $237 million in fees.

SENATOR GORDON: Senator Kean, do you have a question?

SENATOR KEAN: Through the chair, thank you both for your insights and your advice.

A couple of things: Maybe it was Tom Byrne's testimony, or maybe it was one of yours. How many state pension funds are managed in the way that we are -- where they're managed in-house versus managed out of office? I mean, count PERS and others. Of the 50 states, how many are in-state versus out-of-state, or privately managed?

MR. HOOKE: I mean, sort of adopting your model? I'd say maybe 10 percent have your model. It's unusual.

SENATOR KEAN: So 10 percent have this model, and the other 90 percent -- so the other 45 states do what?

MR. HOOKE: Well, they would have-- Like, for example, for managing large-cap U.S. stocks, they would have some outside firm do it -- like a Fidelity or somebody like that, or Goldman-Sachs. Sometimes they index it; you know, they index part of the U.S. or the international stock portfolio.

SENATOR KEAN: So we are, for lack of a better term, a hybrid approach. We have-- And the area that -- I think we are all in agreement -- individuals, both of you today, as well as people who were in the prior panels -- is the expertise on the mid-cap, large-cap, domestics, some international -- was the area, looking back, that had the most growth. And so I think many of us remember, around the table, when there was a threat of a 6,000 Dow versus 18,000 Dow. Right now, the market -- at that junction, when you were going down 200 points on a 6,000 number, it was a lot more concerning than the Dow going down 200 points today over the course of this hearing. You know, I think the issue with it--

SENATOR GORDON: It did go down.

SENATOR KEAN: I'm sorry? 174?

SENATOR GORDON: I'm checking the market. (laughter)

SENATOR KEAN: Okay. I mean, go with other indexes. So I think the intent -- whether it was because of 2001, or because of 2007 and 2008 -- to anticipate that risk, hedge the risk-- I mean, the portfolio was always supposed to complement each other. And, through the Chair, the purpose of the hedge fund, in many large efforts, was just in case the market was not at 18,000, but it was at 14,000, or 15,000, or much less than that -- 6,000, as some we're positing. I mean that, to me, is part of a balanced portfolio. And if you could figure out ways to do that in a better way, then that's the purpose of the Investment Council, and advisors and, to some extent, this Committee.

But isn't competition, by definition, good? I mean, if we're looking at different ways to look at asset classes, different ways to invest, different ways to meet the numbers that we need to meet for the outlays that we have every year -- isn't the thought process that you were looking, at -- a certain percent in one area, and in another area-- I mean, realistically, at the end of the day, what we care about is, yes, the overall general health of the pension fund. And I think we are all in agreement in that. By definition that means it has the ability to meet its obligations to the pensioners -- every year, and 20 years from now. And isn't that much -- don't we have a better chance of making that -- achieve that opportunity over a period of time with a hybrid approach -- meaning in-house, out-of-house expertise in small-, large-, midsize caps, domestic, international, hedge, private equity? I mean, that's part of the overall approach -- is you're making sure you are figuring where is the best return so you can meet your overall obligations.

So when I hear that five people come and pitch an idea versus one, that's a good thing -- because that's competition. You can figure out whether the fees are appropriate, whether you are managing it appropriately in-house; whether you should have a resource approach on an in-house basis, versus an outside approach. Because realistically, just because you're starting on the 20-yard line or the 35-yard line, doesn't mean the 35 necessarily always gets to the end zone first; it depends on who the QB is, what the strategy is, what the offensive line is, what the goal line defense is.

MR. HOOKE: Sure.

SENATOR KEAN: Starting points are just that -- starting points. So it's a long-winded way of saying-- A lot of these things, I think-- The fees are not causal; they are in parallel. I don't think the higher fees are a causal nature of this return issue; they are of a parallel nature. I mean, it's like saying that ice cream sales increased at the same time crime increases. No, it's because they're not causal in any way; it's just that there's more crime overall in summer than there is in winter. These things are happening, I would argue, in parallel; and if it's not the right approach -- and I think that's a way that you and us sense -- and I've got my last question after that long-winded intro -- is, are you questioning -- through the Chair -- is anybody here questioning the intent of anybody on the State Investment Council, any of the hedge fund managers, or anything else in any way that they're not trying to do their best to get the maximum performance for their objects of their responsibility in regards to the pension fund?

MR. HOOKE: You've asked three questions; would you like me to start with the first?

SENATOR KEAN: If I may -- whatever works for you.

MR. HOOKE: Yes, well, on the risk of a downturn -- yes, I mean, everyone, myself included, have bad memories of 2000, 2001, and 2008, as you may. And the way I deal with the risk of a downturn -- which certainly shocked me -- is I just keep more of my portfolio in fixed income or cash. So that's what I would recommend for a big State pension fund. If you think the market is going down -- I think Tom Byrne alluded to that -- if you think the market is very risky now, or more volatile, instead of having 50 percent in stocks, you should just drop it to 40, and then put the extra 10 percent in bonds or cash. So that's how I would deal with a downturn, as I said earlier, as opposed to putting it in hedge funds, which are far less of a good hedge than just putting money into cash; and putting money into cash is a lot cheaper than hedge funds. So that's how I would answer question one.

And question two, you know, I think you have an interesting idea there. You know, if the inside people have to compete a little bit with outside people that might keep them on their toes a little more.

SENATOR KEAN: And vice versa. I mean, if it's internal and external. I mean--

MR. HOOKE: Right, right. So I mean, you have a point there. I just-- You know, when I talk to people in the business, I just don't think 30 percent is enough -- I think it's too much of a counterpoint. I think if you wanted to kind of keep your people on their toes, you might do 5 percent. I think I would do zero, but you might -- if I am following your point, you might do 5 percent in alternatives. You could actually have, maybe, 5 or 10 percent in publicly traded managers, who then you could compare to your in-house people; and again, just as you said, to keep them on their toes.

Lastly, on the intent side, I think he pointed it out. I think all the people working at the fund and probably on the State Investment Council-- I mean, I think your goals are probably the same: You want to get as much income as you can with the proper risk approach. And I'm sure all the managers you hire -- because I worked with a lot of people in hedge funds, and a lot of private equity people I'm in touch with all the time, and I've given plenty of speeches at CFA societies because I'm an author and all that. I've met people all over the world in the investment business. So most of those third-party managers are highly incentivized to get high returns within the risk -- the framework that the client tells them. All over the world, it's the same thing, you know? Hit your benchmarks and go higher, given a certain risk framework.

So I don't think they're trying to cheat -- people are trying to cheat the pension fund or anything like that. I just think that these alternative people, for the most part, have just not met their benchmarks. And as I've tried to mention -- they're not stupid -- it's just that the way the fees are set up -- you could be close to a rocket scientist, but if you're pulling 2 percent a year out from the client, it's just like this. If you look at the math -- if you have 20 or 30 hedge funds and they're starting at the 20, and an index fund or the in-house people are at the 35-- You know, that collection of hedge funds or P/E funds -- they have to be so good to catch up on that 15-yard difference. Mathematically, it's almost an impossibility.

And I think if you were to go -- after this hearing, go up to Rutgers and talk to a few professors and kind of look at this area. They would tell you the same thing. Maybe the hedge fund and the P/E guys are smarter; you know, they went to Harvard, or Wharton, or something like that.

SENATOR KEAN: Isn't that where you went?

MR. HOOKE: And pension fund people did not, or maybe the index fund is not even a human being. (laughter) You know, I just think that when you're 15 yards behind -- and I play golf, so if I'm playing with a guy who is roughly the same skill, and he's driving 20 yards further than me on a par 4, occasionally I'll hit it on the green right next to his. But usually I'm going to be more inaccurate, you know? Just statistically speaking, six or seven times out of eight holes he's going to be closer than me.

I think it's the same thing in the investment business. It's just too far a difference to make up. And if you look -- if you study the stuff, you go to academic work -- because, you know, I've written stuff for academic papers on this -- if you look at the P/E fund, which is really where I've done most of my work, if you look at five or six studies where academics have really looked at it, maybe 20 or 25 percent of the hundred PE funds in any given sample will beat the S&P 500 in a meaningful way. And it's not, as I said, not because they're dumb; it's just that the fees work against them so much. Now, they don't care; you know, their fees actually help their income and stuff. It's the investors who really have the problem.

SENATOR KEAN: If I may, through the Chair, I take great offense that you were devaluing the Chairman's degree. (laughter)

SENATOR GORDON: What's your lot and block number? (laughter)

MR. LIEBTAG: If I may, very briefly.

I mean, just in terms of the competition question, Senator-- Let's ask the Division of Investment what they would do with twice the staff or twice the resources, and how would they be more competitive with the alternative investment program? What might they bring in-house? Or what other things might they do differently? What resources do they need to get better real-time data or maybe rely less on a consultant and do something in-house? Because if we're looking at investment dollars, if I had a dollar, I would give it to the Division of Investment towards staffing and resources because of what they're doing with $10 million right now. For a $10 million investment, who knows what else they could do.

Now, the whole investment game is speculative. It's always looking forward; you can't predict based on past performance. I mean, there is such stark contrast here in terms of competitiveness of the expense that I think we should be looking at empowering the Division of Investment and the in-house staff to do more. And that's where I think there is some innovation and some gains that are possible -- rather than just continuing down the same road of 30 percent, or 32, or whatever it ends up being down the road into alternatives, and letting the outside manager-- I think there's this bias that the outside manager must be a rocket scientist. And we may not believe that, or subscribe to that bias, but let's make sure we do everything to counteract it.

SENATOR KEAN: If I may, through the Chair.

The intent of my question was following up on Jeff's question regarding where there is one person -- the LBO guy came out 20 years ago, and now there are five making the pitch. The competition number is -- we all should challenge our ideas, and our assumptions, and everything else. I would hope that as a basic management tool that -- whether it be the Investment Council, whether it be others involved in this process -- we would be asking the question of what would we do as we were making pitches for additional revenue, or additional staff, or things like that; that you would always use that opportunity to make the argument to say, "What could we do with additional areas of expertise; what could we do with other staff; what do we do when we are only one of 5 percent of states that have a model that looks like -- one of five states, I guess, that has a model like we do. What are the advantages to that, and how can we compound that advantage?"

So my definition of *competition* -- whether it's in-house or out-of-house -- is what's the best value for the pensioners, as well as the best value for the taxpayers. Because in the end, without one you don't have the other. So that's the number one thing; that was the intent of the question.

The second issue is, if I may, Jeff -- what was handed out to us today is-- Is this your-- This says *second draft* on it; is this your final draft?

MR. HOOKE: I sent the final draft a couple of days ago; so somebody must have gotten confused.

SENATOR KEAN: Okay. There's a slideshow presentation that's very different than this.

SENATOR GORDON: Yes.

SENATOR KEAN: So--

MR. HOOKE: There is one that's more like a formal written report, and then there's a slideshow.

SENATOR KEAN: Yes, we got slideshow -- which I think we've all seen here -- and then there's a much-- Ten minutes before you spoke we were handed a *second draft*.

MR. HOOKE: Oh, no, I sent the final draft a couple of days ago.

SENATOR KEAN: Okay.

MR. HOOKE: I could send it again.

SENATOR KEAN: Through the Chair, if the members of the Committee, as well as the OLS staff, are given the actual final version of this document--

MR. HOOKE: Yes, fine.

SENATOR KEAN: --it would be very helpful.

MR. HOOKE: Okay.

SENATOR KEAN: Thank you.

MR. HOOKE: Sure.

SENATOR THOMPSON: One final question, Mr. Chairman.

SENATOR GORDON: Senator Thompson.

SENATOR THOMPSON: A great deal of your discussion, debate here was over in-house versus out-of-house work -- whether it should be that in-house-- Isn't the final answer to whether work will be done in-house or out-of house -- was the Investment Council going to make that decision?

MR. LIEBTAG: There's a finite amount of resources that are allocated to the Division of Investment. So the State Investment Council does not manage the day-to-day operations of the Division; we don't pick the stocks, we don't direct the day-to-day--

SENATOR THOMPSON: No, no, no. But do you determine how much of it will be handled by them, and how much of it will go outside?

MR. LIEBTAG: Only within the constraints of the budget for the Division of Investment.

SENATOR THOMPSON: I'm not sure whether that answered my question or not. (laughter)

MR. LIEBTAG: I'm not sure how else to answer it. I mean, we could not direct the Division of Investment, really, to do anything in terms of its operations because--

SENATOR THOMPSON: Well, for example, you're allocation of how much of it goes to -- is invested by the Division of Investment versus outside, etc. If you didn't put any money up for outside investors, then obviously they wouldn't get any business. That's one way you would control how much was done inside versus outside.

MR. LIEBTAG: Again, I think within the constraints of what the State Treasurer and the Division are budgeting for that Division of Investment.

SENATOR THOMPSON: Well, when you say *what they're budgeting* -- you mean for staff, or what?

MR. LIEBTAG: Yes, for staff and operations. They have an operational budget just as any other State department. There are also some regulatory issues with--

SENATOR THOMPSON: So perhaps you're saying, "Okay, we're not going to have any outside vendors at all. We're going to let the staff -- insist that State do it all."

MR. LIEBTAG: Yes.

SENATOR THOMPSON: Then you are saying they would not have the capacity to do it all?

MR. LIEBTAG: I won't answer that question because I think that's a question that's better directed to Director McDonough -- to talk about his staff capacity and capability. There are regulatory issues with certain types of investment that, right now, will have to be handled by an outside manager. But if we wanted to stop investing in those assets and redirect those funds somewhere else in the portfolio, that certainly could be done. But those operational--

SENATOR THOMPSON: Perhaps where I'm going with my question is, again, you keep suggesting maybe instead of using outside people -- again, save the $600 million and have it done inside. So what are you looking for us to do, if we agree with you that we should go in that direction? Are you saying we need to go to our budget here, and modify our budget; put more money over in Treasury, or whatever? So what are you saying you think we need to do if we agree with what you're wanting us to do? That's what my question comes out to.

MR. LIEBTAG: Okay. So to give you a very direct answer, the Division of Investment was invited to come in today and report on the performance of the fund, the performance of the alternative investment program -- and they did that. Hopefully, this is the start of a discussion to talk about -- and hopefully, I've given you some questions to follow up on -- to talk about what else could the Division of Investment be doing, and would it be at a lower cost than what is currently being done outside. And specifically, with respect to hedge funds, the fees and the size of those fees versus the benefit of those investment returns.

I think that the follow-up needs to be a continued discussion -- with the stakeholders, with the State Investment Council, and the Division -- to talk about maybe a better way, or maybe additional resources so that we could look at being competitive and bringing some of this work in-house, or limiting the expense exposure with these higher expense investments.

SENATOR GORDON: And clearly there are some things that, as I understand it, are not likely to be done in-house; you know, the LBOs, the private equity, finding the investments opportunities internationally that are just logistically would be difficult for in-house personnel to do.

But I do think that we've gotten a very good foundation here today of information, and certainly there are a lot of thought provoking questions we need to follow up on. And I do think we need to, as a Committee, address the issue of where we go from here.

SENATOR KEAN: If I--

SENATOR GORDON: Senator Kean, I know you have another question.

SENATOR KEAN: As a quick follow-up to both Senators' questions.

If there are travel restrictions, and things like that, that inhibit your ability to perform your job in the best possible way-- I mean, those are the types of ideas that we wouldn't necessarily know. So to the extent that you could make some recommendations, if I may add on to those recommendations -- or those questions -- what are the barriers to pursuing other various investments, etc. etc.?

SENATOR GORDON: I think that's a very good point.

Does anyone else have any questions?

Majority Leader.

SENATOR WEINBERG: Yes, while we're doing follow-up, I would also like to officially ask the Investment Council to get back to us about this request for the audit.

SENATOR GORDON: Okay.

SENATOR WEINBERG: It might answer some questions.

SENATOR GORDON: Yes, we will certainly do that.

Any other questions? (no response)

It's been, I think, a very productive hearing -- a tremendous amount of information, very stimulating conservation, and questions that you leave us with.

I want to thank you, both, for appearing here, as well as all of our witnesses.

If there are no other questions, I will adjourn the Committee.

(MEETING CONCLUDED)