

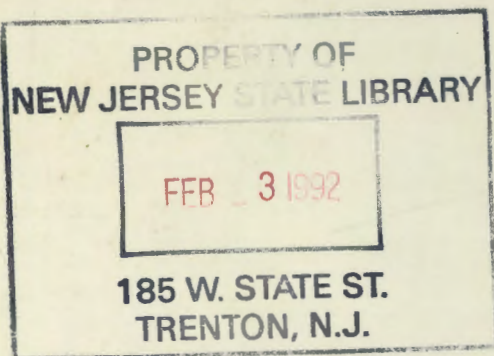
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**STATE INVESTMENT COUNCIL
DEPARTMENT OF THE TREASURY
STATE OF NEW JERSEY**



FORTY-FIRST ANNUAL REPORT

For the Fiscal Year Ended June 30, 1991



JIM J. FLORIO
Governor



DOUGLAS C. BERMAN
State Treasurer

A Report to
Governor Jim J. Florio,
the Members of the
New Jersey Legislature
and the State Treasurer

Submitted by the
State Investment Council

For the Fiscal Year ended June 30, 1991

November 15, 1991

To the Honorable:
The Governor;
The Legislature;
The State Treasurer;

We are pleased to submit the Annual Report of the Division of Investment, Department of the Treasury, for the fiscal year ended June 30, 1991, as required by Section 13, P.L. 1950, c. 170. This report is a summary of the activities of the Division during the year. Separate reports are also prepared for the Supplemental Annuity Collective Trust and the State of New Jersey Cash Management Fund, both of which are available upon request from the Investment Division.

The Investment Division, under the jurisdiction of the State Investment Council, has the investment responsibility for 115 funds, including seven pension and annuity funds. The book value of all funds on June 30, 1991, was \$29.9 billion, compared to \$26.3 billion at the end of the prior year, and the market value of the funds was \$35.2 billion, compared with \$31.0 billion at the end of the previous fiscal year. The Council is equally balanced between employee representatives and gubernatorial appointees. State law mandates that no Council member can hold any office, position or employment with any political party, and none can benefit from the transactions of the Division.

The investment of state funds by the Investment Division benefits all citizens of the State of New Jersey. The investment income generated by the pension funds contributes directly to the assets of the various pension funds and the retirement security of pension fund beneficiaries. The income generated by the pension funds and other state funds contributes to the funding of services and benefits provided by the state to its citizens and thus directly benefits the taxpayers of New Jersey. The state funds have been invested in conformity with the regulations of the Council and in accordance with policies approved by the Council.

Fiscal 1991 provided strong, positive returns for the Division. The returns on book value of the pension funds met the statutory requirements set by state law. Furthermore, the estimated total return of the pension funds, which includes income and changes in market value of the securities held by the funds, was 10.0 percent, which compares with 13.3 percent for fiscal 1990. For the past five fiscal years the estimated average annual total return of the pension funds was 10.2 percent. Appendix II sets forth the estimated total returns of the state administered pension funds. The total returns of the pension funds ranked the Division in the top quarter of all balanced fund managers in fiscal 1991 and for the five year period ended June 30, 1991.

The Division's positive returns in fiscal 1991 are particularly notable because the year was marked by the Iraqi annexation of Kuwait and the subsequent invasion by allied forces, deteriorating economic conditions in the Soviet Union and a recession in the United States. During this period financial institutions came under great stress, due to loan defaults related to real estate, international lending and highly leveraged transactions. However, the Council's regulations and the Division's investment practices have precluded investment in these troubled areas, and during the year the funds under the supervision of the Council suffered no defaults of payments on any of its security holdings. The minutes of the Council meetings during the year noted the remarks of one Council member, who is in charge of a major money management organization, to the effect that the taxpayers of the state are getting a bargain in the Division of Investment.

All investments under the supervision of the Council must conform to standards of prudence set by state law, which mandate that the Division make investments in which fiduciaries of trust estates may legally invest. Such investments are further defined as investments in property of every nature, provided the fiduciary shall exercise care and judgment under the circumstances then prevailing, which persons

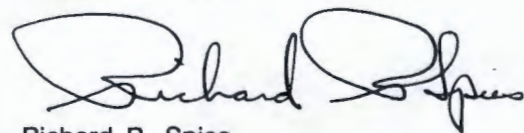
of ordinary prudence and reasonable discretion exercise. The Council has resolved that the Division is bound by law to make prudent investments for the sole and direct benefit of the beneficiaries of the various funds under the supervision of the Council, and that the Division may not make any concession as to rate, risk or terms which would benefit any other party at the expense of the beneficiaries of such funds.

In recent years members of the public, political figures and lobbyists have raised the issue as to whether investments under the jurisdiction of the Council should be guided by non-financial considerations. Such investments could be directed regionally or toward specific capital markets or could be averted from certain areas. The Council has considered each of these issues as they have arisen and has concluded, with the concurrence of the Attorney General's office, that state law requires that the financial merits of each investment are the only considerations provided for by law. However, social and regional issues may have financial implications for fund beneficiaries, and the Division analyzes such implications in the determination of its investment decisions. The policies of the Council regarding social investment are discussed in detail herein. Council policies have been reviewed by special gubernatorial commissions established by both Governors Byrne and Kean, representing different political parties, and both commissions support the present structure and policies of the Council. Summaries of these reports are included herein.

The Council is pleased to note that the large majority of the corporate debt obligations and equities held by the Division have been issued by corporations which are identified as New Jersey employers. The pension funds have investments in major companies who have their headquarters in New Jersey and in out-of-state companies which provide employment within the state. Securities of the U.S. Government and other companies are purchased to provide portfolio diversification. From time to time the Council has been asked to consider direct investment in personal loans, individual mortgages and loans to small businesses. The Division does not have the facilities or personnel to do so, but it does participate indirectly in these areas through investments in securities of U.S. Government agencies and other financial intermediaries. In addition, the Council has been asked to provide below market interest rates for New Jersey investment programs for housing and economic development. However, the Council has declined, since Council members believe that to do so would be a violation of their fiduciary responsibilities to the beneficiaries of the funds under their supervision. Furthermore, in many instances, such programs can be funded through tax-exempt bond financing, which provides favorable interest rates to borrowers.

For each of the past forty-one years, the Council has requested and obtained a review of the records and procedures of the Division by an independent auditor. The auditor's report for the current year is included in this report.

Respectfully submitted,

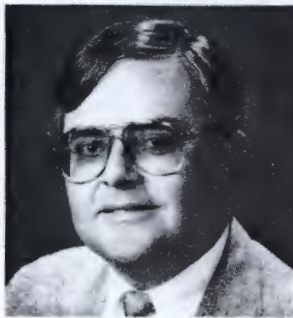
A handwritten signature in dark ink, appearing to read "Richard R. Spies", written in a cursive style.

Richard R. Spies
Chair

The State Investment Council



RICHARD R. SPIES
Chair of the Council



FREDERICK HALPERN



ROBERT T. HOFFMAN



WILLIAM W. PRIEST, JR.



ARTHUR W. WHITE, JR.



NANCY A. NAUGHTON
Consolidated Police and
Firemen's Pension Fund;
Vice Chair of the Council



HARRY W. BALDWIN
Teachers' Pension and
Annuity Fund



ROY D. BLOOM
State Police & Firemen's
Retirement System



REGINE BROWN
Public Employees'
Retirement System



PETER KATEVAKIS
Police and Firemen's
Retirement System

Division of Investment



ROLAND M. MACHOLD
Director



ANTHONY O. ARCUNI
Deputy Director



STEVEN E. KORNRUMPF
Assistant Director



Staff of the Division on the steps of State Street Square, 50 W. State St., Trenton, NJ.



Administration Group: Cathy Ryan, Ellie Chiaramonti, Steve Kornrumpf, Clementine Gardner, Celeste Brennan, Roland Machold, Tony Arcuni, Pat Osval.



Portfolio Management Group: seated—Linda Thompson, Sandra Holmes and Mary Ann Smith; standing—Fred Lansmann, Helen Imbalzano, John Jacknowitz, Don Haroz, Bruce Smith, Dolores Ewanis, and Tim Patton.



Trading Group: Michael Wszolek, Patti Hricak, Bob Schragger, Ceil Daino, Linda Brooks, and Peter Pantelides.



Research Group: Linda Gaspari, Denise Haines, Tom Montalto, Jim Vandervort, Betty Carr, Dick McGowan, Brian Arena, Karin Hollinger, Victor Yu, Ann McDermott, and Bruce LaBar.



Common Fund Accounting Group: Madeline Amico, Manick Jhingade, John Jusiewicz, Carletha Murray, Joe Adubato, Mary Vassiliou, Andrea Szul, Elsie Lawrence, and Dan Costanzo.



Bookkeeping Group: Charles Coleman, Olga Grozio, Linda Coughlan, Bonnie Lombardi, Ken Scott, and Nancy Brancolino.



Cashier Group: Rosetta Muccie, Kass Cole, Joanne Yankewicz, Bea Wolfe, Loretta Sytnik, John Giovannetti, and Melissa Cook.



Data Processing Group: Ed Meyers, Sandi Glass, Angel Rust, and Nick Maximenia.

FIVE YEAR SUMMARY

	Fiscal Year Ended June 30,				
	1987	1988	1989	1990	1991
	\$ Millions				
FUNDS UNDER THE SUPERVISION OF THE STATE INVESTMENT COUNCIL:					
Book Value at Year End:					
Pension Funds	\$15,046	\$17,405	\$19,517	\$21,697	\$24,081
All Funds	19,825	22,443	24,115	26,286	29,924
Book Value of All Investments at Year End by Category:					
U.S. and other Government bonds	\$ 9,320	\$10,635	\$10,485	\$10,834	\$12,087
Commercial Paper, Bankers' Acceptances and Certificates of Deposit	621	1,126	1,458	1,508	2,568
Corporate Bonds and Other	1,367	764	1,279	1,692	2,032
Mortgages	2,214	2,603	3,141	3,635	3,861
Common Stocks	6,303	7,315	7,752	8,617	9,376
	<u>\$19,825</u>	<u>\$22,443</u>	<u>\$24,115</u>	<u>\$26,286</u>	<u>\$29,924</u>
Investment Income:					
Pension Funds	\$ 1,027	\$ 1,174	\$ 1,360	\$ 1,517	\$ 1,653
All Funds	1,256	1,475	1,681	1,867	2,011
Weighted Average Effective Rate of Return (1):					
Pension Funds	7.09%	6.95%	7.30%	7.30%	7.12%
All Funds	6.92	6.89	7.60	7.45	6.93
Weighted Average Effective Rate of Return for New Investment (2):					
Short Term Securities	6.11%	6.70%	8.86%	8.45%	6.95%
Long Term Securities	8.21	9.35	9.06	8.64	8.52
Total Rate of Return (3):					
Common Pension Fund A (4)	23.8%	(10.2)%	16.6%	18.7%	8.0%
Common Pension Fund B (4)	4.2	7.4	13.0	7.2	10.3
All Pension Funds, Estimated (4)	14.9	(0.7)	14.5	13.3	10.0(5)
Supplemental Annuity Collective Trust	21.8	(10.4)	13.5	14.7	5.8
Deferred Compensation Plan—Equity	21.3	(11.5)	15.2	19.6	5.1
Deferred Compensation Plan—Debt	4.2	7.0	11.5	7.1	10.7
Returns of Various Market Indices:					
Salomon Brothers' Mortgage Index	8.3%	9.4%	11.8%	9.7%	12.0%
Salomon Brothers' High Grade Corporate Bond Index	5.1	8.5	16.2	6.0	10.6
Shearson Lehman Government/Corporate Bond Index	4.7	7.5	12.3	7.1	10.2
S&P's 500	25.2	(6.9)	20.5	16.5	7.4
S&P's 400	29.8	(7.9)	18.8	19.2	8.4
Dow Jones Industrials Average	32.2	(8.3)	18.7	22.7	4.7
N.Y.S.E. Composite	18.8	(9.7)	15.2	9.9	4.1
State of New Jersey Cash Management Fund:					
Book Value of Units of Participation:					
All Participants	\$ 4,807	\$ 5,381	\$ 4,936	\$ 5,740	\$ 4,816
Other-than-State Participants	995	1,299	1,118	1,437	2,130
Average Annualized Daily Rate of Return:					
State Participants	5.97%	6.88%	8.08%	8.57%	7.47%
Other-than-State Participants	5.82	6.67	7.95	8.42	7.30
Number of Funds Under the Supervision of the State Investment Council	109	108	110	121	115
Total Number of Transactions	27,413	36,410	32,281	34,600	38,298

1. Represents the average yield on the book value of all securities in the portfolio as of the end of the fiscal year. The yield is calculated as the interest or dividends on each security as a function of its amortized cost. See a discussion of effective rates of return herein under "The Year's Activities."
2. The weighted average effective rate of return for new investment is the average yield realized on new investment during the year and is representative of market yields available for the period. The yield is calculated in the manner described in note 1 above.
3. Total rate of return includes income and changes in market prices for securities held by the funds during the period shown.
4. Common Pension Funds A and B are the principal vehicles for investment by the pension funds in stocks and bonds, respectively. The returns cited are for the whole portfolios and reflect a small amount of cash equivalents. Returns for stocks and bonds alone are shown in Appendix II, as are estimated total returns for the pension funds.
5. In the course of fiscal 1991, the Division initiated a new Common Pension Fund D for the purpose of pooling investments of the pension funds in international securities. The estimated return of the pension funds for fiscal 1991 reflects the initial returns of investments in the new fund.

The Year's Activities

Summary Financial Information

The 115 investment funds under the supervision of the Council on June 30, 1991, had a book value of \$29.9 billion. This total represents an increase of 13.7 percent over the 1990 fiscal year-end total of \$26.3 billion held by 121 funds. The investment funds had a market value of \$35.2 billion at June 30, 1991, an increase of 13.5 percent over the market value of \$31.0 billion at June 30, 1990. The market value of the seven pension funds increased from \$26.3 billion at June 30, 1990, to \$29.3 billion at June 30, 1991. The market value of the pension funds increased due to lower interest rates, which improved the prices of the bonds held by the Division, and the recovery of stock prices in the second half of the fiscal year.

Investment income for all funds for fiscal 1991 amounted to \$2.0 billion as compared with \$1.9 billion last year. Income remained stable as lower interest rates offset the effect of higher fund balances.

The average effective rate of return on long-term, fixed-income securities (maturing in more than one year) purchased during the year was 8.52 percent as compared with 8.64 percent in fiscal 1990. The effective rate of return on purchases of short-term securities (maturing in one year or less) was 6.95 percent as compared with the 8.45 percent rate reported last year.

During the year, the Division of Investment purchased securities with a par value of \$91.8 billion. Approximately 37.9 percent of this amount, or \$34.8 billion, represented the overnight investment of surplus balances in the state's cash accounts. In fiscal 1990, the Division purchased securities with a par value of \$97.0 billion, of which \$55.4 billion was generated by overnight investments. During fiscal 1991, the Division's net holdings of mortgages increased from \$3.8 billion to \$4.0 billion.

The Division sold securities totaling \$3.4 billion in fiscal 1991, compared with sales of \$2.4 billion in the prior year. Many of the sales were made to meet cash requirements or to take advantage of market opportunities. Such sales resulted in net realized profits of \$153 million during the year for all funds, compared with \$302 million for the prior year. The transactions information in this paragraph includes transactions effected within the common funds, which are not included separately in the financial summaries in this report.

Effective Rates of Return

The average effective rate of return of the pension fund portfolios was 7.12 percent at June 30, 1991, compared with 7.30 percent at the end of the prior year.

The following table shows the effective rates of return of the respective pension funds, together with the "regular interest" rates established July 1, 1991, by the State Treasurer for use by the pension fund actuaries:

	<u>"Regular Interest"</u> <u>Rates Established by</u> <u>the State Treasurer</u>	<u>Effective Rate</u> <u>of Return at</u> <u>June 30, 1991</u>
Consolidated Police & Firemen's Pension Fund	7.00%	7.89%
Judicial Retirement System	7.00	7.09
Police & Firemen's Retirement System	7.00	7.16
Prison Officers Pension Fund	7.00	6.08
Public Employees, Retirement System	7.00	7.12
State Police Retirement System	7.00	7.11
Teachers' Pension & Annuity Fund	7.00	7.10

The effective rates shown above are the weighted average income returns on the book value of all securities held in the respective portfolios, including bonds, other fixed income investments and stocks, as of a specific point in time, or, in the case of the table above, as of June 30, 1991. The effective rates do not reflect market appreciation or depreciation of securities held by the pension funds. These book effective rates are computed in accordance with the long-standing procedures used by the Division of Investment.

In a static investment environment these effective rates would be an accurate measure of future rates of return. However, as these portfolios expand or contract, these rates do not reflect incremental income on new investments or the loss of income which might result from the liquidation of securities.

The effective rates do not reflect future returns on the portfolios, since even though the interest income and maturities on fixed income securities are known by their terms, the dividend income from common stocks may be increased or reduced at the discretion of corporate managements and cannot be predicted accurately. Furthermore, investment transactions involving the purchase and sale of securities and bond exchanges, together with the compounding effect of the reinvestment of income and maturities, will have a profound effect on the rates of return for the portfolios, which is not reflected in the calculation of

book effective rates until after the fact.

Similarly, these rates of return do not reflect historical earnings as a percentage of the average assets held in the portfolios during the year. Such effective rates, therefore, while accurate, are not a measure of either past or future rates of return and should only be used as a guideline.

The average effective rate of the pension funds decreased from 7.30 percent at the end of fiscal 1990 to 7.12 percent at the end of fiscal 1991 as interest rates fell during the year and stock dividends remained stable in view of the recessionary economic environment.

Fixed Income

Total fixed income allocations for new investment in fiscal 1991 totalled \$1,895.0 million, of which \$990.0 million was allocated to the purchase of U.S. Government and corporate debt securities, and \$350.0 million was allocated for international fixed income investment through Common Pension Fund D. The remaining \$555.0 million of funds for new investment was allocated to the purchase of mortgage-backed securities issued by various agencies supported by the U.S. Government.

From July 1, 1990, through June 30, 1991, the Division purchased \$407.0 million of FHLMC and GNMA 30-year mortgage-backed securities and \$148.0 million of collateralized mortgage obligations (CMOs). Principal repayments on mortgage-backed securities held by the Division for fiscal 1991 totaled \$332.0 million.

Common Pension Funds

Under the authority granted by P.L. 1970, c. 270, the Division has created Common Pension Fund A, Common Pension Fund B and Common Pension Fund D to consolidate investments of five of the pension systems in stocks, bonds and international investments, respectively. At June 30, 1991, the book value of the units of ownership of Common Pension Fund A, Common Pension Fund B and Common Pension Fund D were \$9.1 billion, \$9.3 billion and \$350 million, respectively. The State of New Jersey Cash Management Fund provides a vehicle for the pension funds to make short-term investments.

During fiscal 1991, the Council approved the distribution of \$255 million of realized gains from Common Pension Fund A to the participating pension funds.

Total Rate of Return Calculations for Selected Portfolios

Calculations of total rate of return reflect both income and changes of market values of securities in a portfolio over a specific period of time. The calculation includes unrealized market gains or losses and thus is not indicative of the cash returns on the portfolio. It would be indicative of cash returns if the portfolio were liquidated at the end of each period of measurement, but such liquidation would be impractical for portfolios of the size managed by the Division. Furthermore, the calculation is historical and is not predictive of future returns. However, the calculation of total rate of return is a means of comparing returns of varying types of portfolios by a common standard.

At the present time, the Division is only able to calculate total rate of return for the common pension fund portfolios and selected other portfolios. These historical returns are shown on page 7 herein.

SEI Evaluation Services has provided the Division with calculations of total return, and their data shows that the total returns for Common Pension Funds A and B in fiscal 1991 were 8.0 percent and 10.3 percent, respectively. Common Pension Funds A and B represent, in the aggregate, 47.9 percent and 32.4 percent, respectively, of the market value of the total pension fund portfolios. During fiscal 1991, the Division initiated investment in a new Common Pension Fund D, which pools the investments of the active pension funds in international securities. At the end of fiscal 1991, this fund represented 1.2 percent of the market value of the total pension fund portfolios.

The remaining securities held directly by the pension funds consist primarily of mortgages and industrial bonds. If the returns provided by Indata for these portfolios are used for these holdings, then it is possible to estimate that the total return of the aggregate pension fund portfolios was approximately 10.0 percent in fiscal 1991, compared with returns of 13.3 percent in fiscal 1990 and 14.5 percent in fiscal 1989. In the first quarter of fiscal 1991, the stock market sold off sharply in response to the Iraqi invasion of Kuwait. However, during the year interest rates fell and bond prices rose, and later in the fiscal year the stock market rose in anticipation of a recovery from recession.

It is difficult for public pension funds to find a common basis for reporting. However, several states have developed a format for common reporting practices and the Investment Division has provided these

estimates in response to this format in Appendix II to this report.

The State of New Jersey Cash Management Fund

The Division initiated the first investment in the State of New Jersey Cash Management Fund in May 1977. The fund provides the state and its municipalities with a vehicle for short term investment. At that time state statutes provided that only certain state funds were eligible to participate in the fund, but, in November 1977, legislation was enacted (P.L. 1977, c. 281), which permitted counties, municipalities, school districts and the agencies and authorities created by any of these entities or the state ("Other-than-State" participants) to participate in the fund on a voluntary basis.

The total book value of the units of participation in the fund increased from \$5.7 billion at June 30, 1990, to \$6.9 billion at June 30, 1991, due to higher balances in the state's pension accounts and the accounts of participating municipalities and state agencies.

The net investment income of the fund was \$432 million in fiscal 1991, compared with \$421 million in fiscal 1990. The number of participating state funds decreased from 121 to 115 during the year as several older funds were closed out.

During fiscal 1991, the number of "Other-than-State" participants increased from 560 to 638, and the aggregate investment of "Other-than-State" participants was about \$2.1 billion at the end of fiscal 1991, compared with about \$1.4 billion at the end of fiscal 1990.

The average daily annualized rate of return to participating state accounts and accounts of the pension funds was 7.47 percent during fiscal 1991, compared with 8.57 percent during fiscal 1990. During fiscal 1991, the highest daily annualized rate of return to "Other-than-State" participants was 8.39 percent on July 10, 1990, and the lowest was 5.93 percent on June 24, 1991. The average daily annualized rate of return to "Other-than-State" participants, which is net of two small charges, was 7.30 percent in fiscal 1991, compared with 8.42 percent in fiscal 1990.

These rates are the average of all daily rates realized during the year and do not reflect the compounding effect of leaving moneys on deposit over time. The compound rate of return for "Other-than-State" funds in fiscal 1991 was 7.57 percent, compared with 8.78 percent in the prior year. The lower rates of return during fiscal 1991 were the result of lower interest rates available in the markets for short term debt investments, particularly in the second half of the fiscal year.

Historical Background

Legislative History

Fiscal 1991 marks 41 years of operation of the Division of Investment of the Department of the Treasury of New Jersey. During that time the investment responsibility of the State Investment Council has increased from 20 funds in 1950, with a book value of \$350 million, to 115 funds in 1991, with a book value of \$29.9 billion.

The Division was created by P.L. 1950, c. 270, which became effective on July 1, 1950. An important objective of the statute creating the Division was to centralize all functions relating to purchases, sales or exchanges of securities for the state's diverse funds under experienced and professional management.

The statute provides for a State Investment Council and a Director. The Council consists of ten members, five appointed for staggered five-year terms by the Governor and five appointed for one-year terms by five of the pension systems. At least three of the five members appointed by the Governor must be qualified by training and experience in the field of investment and finance. The law provides that no member of the Council shall hold any office, position or employment in any political party, nor shall any member benefit directly or indirectly from any transaction made by the Director of the Division. Members of the Council serve without compensation.

The statute vests investment authority in the Director of the Division. The Director is appointed by the State Treasurer from candidates for the office selected by the Council.

The role of the Council is to formulate investment procedures and policies to be followed by the Director. State legislation provides that the Council may issue regulations which specifically approve and authorize any form of investment. New regulations adopted by the Council from time to time are formal documents which are filed with the Secretary of State and reported in the New Jersey Register.

The Council periodically reviews the investment objectives of all of the individual funds under its supervision. With respect to the pension funds, the primary investment objectives are the preservation of capital and the realization of earnings sufficient to meet or exceed the regular interest rate established for the actuaries in their determinations of the assets and liabilities of each pension fund system. The Council sets as a further investment objective the realization of the greatest possible returns on investment, commensurate with the standards of risk and prudence set forth within the Regulations of the Council.

Prior to 1950, investment was limited by law to United States Government and municipal obligations. P.L. 1950, c. 270, provided that investment could also be made in obligations which are legal investments for savings banks within the state. Since 1950 the Council has requested and obtained a number of amendments to P.L. 1950, c. 270, which were designed to increase the scope of potential investment opportunities and to provide a foundation for achieving better portfolio balance and diversification.

Such legislation broadened the authority of the Division to include investment in short-term debt obligations, including commercial paper and certificates of deposit, and certain Canadian government and provincial obligations payable in U.S. dollars (P.L. 1952, c. 17, and P.L. 1971, c. 176); and, more recently, investment in property of every nature, provided the fiduciary shall exercise care and judgment under the circumstances then prevailing, which persons of ordinary prudence and reasonable discretion exercise (P.L. 1975, c. 337).

The Legislature has also enacted laws which permit the operation of common funds. P.L. 1970, c. 270, permits the Director to combine, for the purpose of investment, money and property belonging to the various funds in the custody of the State Treasurer. Under this authority the Council and the Division have

established Common Pension Fund A, Common Pension Fund B and Common Pension Fund D, which pool a portion of the investments of five pension funds in stocks, bonds and international investments, respectively. This law also authorized the creation of the State of New Jersey Cash Management Fund, which was created in 1977 to pool investments in short-term debt obligations by certain state funds, including the pension funds. In fiscal 1978, legislation (P.L. 1977, c. 281) was enacted which permits counties, municipalities, school districts and the agencies and authorities created by any of these entities or the state to participate in the fund. Such participation began in January 1978.

On August 27, 1985, Governor Kean signed into law an act, P.L. 1985, c. 308, which states that "no assets of any pension and annuity fund shall be invested in any bank or financial institution which directly or through a subsidiary has outstanding loans to the Republic of South Africa or its instrumentalities, and no assets shall be invested in the stocks, securities or other obligations of any company engaged in business in or with the Republic of South Africa." Furthermore, the Council and the Division shall effect divestment "within three years of the effective date of the act." The act further provided that certain reports have to be filed on a quarterly and semi-annual basis. The final report to the Legislature for the period July 1, 1988, through August 27, 1988, and cumulatively for the period August 27, 1985, through August 27, 1988, was attached in full as Appendix II to the Council's Annual Report for fiscal 1988. This report showed that the Division's divestment program was completed in full, and the Division remains in compliance with the law.

On July 9, 1987, Governor Kean signed into law an act, P.L. 1987, c. 177, which directs the Director of the Division of Investment to investigate the extent to which United States corporations doing business in Northern Ireland, in which the assets of any state pension or annuity fund are invested, adhere to principles of non-discrimination in employment and freedom of workplace opportunity, as defined in the law by various standards commonly referred to as the MacBride principles. Furthermore, the law requires the Director to file an annual report with the Legislature and to initiate and support shareholder petitions or initiatives requiring adherence to the MacBride principles. Subsequent to the enactment of the law, the Council adopted procedures to comply with the law, and the Director has filed the required reports, copies of which are available upon request.

Regulations of the State Investment Council

In addition to the investment guidelines established by law, the State Investment Council sets specific investment policies by regulations in accordance with the authority provided to it by P.L. 1950, c. 270.

Present regulations of the State Investment Council limit the authority of the Director to invest in common stock. At present the Council limits the permissible level of the market value of pension fund stock holdings in Common Pension Funds A and D to 60 percent of the market value of any one pension fund. At June 30, 1991, the aggregate common stock holdings of the pension funds were 47.9 percent of the total market value of the funds. Attached hereto as Appendix I is an unaudited summary of investments by major category for individual pension funds.

The regulations of the State Investment Council also set criteria for the Division's investments in long-term debt obligations. These regulations require issuers of debt to meet certain standards, which, depending on the type of security and the nature of the issuer, may refer to the capitalization, operating history, interest coverage, bond rating or other criteria relating to the issuer.

In the case of mortgages, Council regulations require, in almost all cases, that the securities be directly or indirectly supported by the Federal government. One regulation permits investment in pools of conventional mortgages which meet specific eligibility standards.

All of the regulations of the State Investment Council, including the regulations which pertain to the common funds, have been published in the New Jersey Register and are on file with the Secretary of State. The Council constantly reviews its regulations which govern the activities of the Division. As a result, a number of regulations are revised during each year. These refinements keep the Council's policies abreast of economic, fiscal and accounting trends.

In fiscal 1990, the Council created a new Common Pension Fund D to hold a balanced portfolio of international stocks and bonds, and in fiscal 1991 the Division initiated an investment program for the new fund. In fiscal 1991, virtually all of the Council's regulations were due to expire in accordance with the state's sunset law. In the course of the year, the Council reviewed all of the regulations and amended and modified many in order to add clarity to the language or to add minor modifications. The most significant changes were to increase the permitted level of investments by the pension funds in stocks

from 40 percent of total assets at book value to 60 percent of total assets at market value. In addition, the Council increased permitted investment by the pension funds in international stocks and bonds from five percent of total assets at book value to 15 percent of total assets at market value, and further provided that the Division would have discretion over the amount of currency hedging that was appropriate for the pension fund holdings of international stocks and bonds. All of the regulations of the Council were resubmitted to the legislative review process and were adopted early in fiscal 1992.

Reviews of Major Policy Issues in Recent Years

During fiscal 1984 and 1985, the Council reviewed a number of major policy issues which had been raised by Governor Kean's Pension Study Commission and its own review and analysis. Early in fiscal 1985, the Council made the following findings and recommendations.

The Council members agreed that the salary structure, budget limitations of the Division, lack of personnel depth and the inflexibility of the Civil Service system posed grave dangers for the successful management of state funds and state-administered pension plans. The Council agreed that any complete solution to the budgeting, staffing, salary and Civil Service issues would provide that: (a) funding of the Division's budget would be made from pension fund income and other fees, with all expenses of the Division subject to the discretion of the Council; (b) all professional employees would serve at the pleasure of the Council, although non-professional employees could remain in the Civil Service salary structure and system; (c) professional salaries would be set by the Council and possibly could be designed to incorporate performance bonuses; and (d) the Council would have the flexibility to provide necessary personnel depth for the Division. The Council has taken these matters up with appropriate state officials, but, to date, only the first part of item (a) above has been implemented.

The Council concluded at that time that its objective for the active pension funds was to reach a 50 percent commitment to stocks, based on book value, with the provisos that an expansion of the stock program would not endanger the realization of the "regular interest rates" utilized by the actuaries and that expansion of the program be flexible in view of changing market conditions. In July 1985, the Council

acted to amend its regulations to permit commitment to stocks of up to 40 percent by the pension funds. However, at that time, the Council refrained from increasing the limitation to 50 percent in view of the prospective enactment of South Africa divestment legislation which would have the effect of limiting available stock investments to a universe of smaller companies with a higher risk profile. (Subsequent to 1985, the Division completed the divestment program, and the Council has increased the permitted investment in stock by the pension funds to 60 percent of the market value of the funds).

The Council also confirmed the investment objectives for the pension funds which are as follows: "primary investment objectives are the preservation of capital and the realization of earnings sufficient to meet or exceed the regular interest rate established for the actuaries in their determination of the assets and liabilities of each pension fund system. The Council sets as a further investment objective the realization of the greatest possible returns on investment commensurate with the standards of risk and prudence set forth within the Regulations of the Council."

The Council reviewed the stated objectives and discussed the possibility of amending them to include reference to specific market indices, the rate of inflation or percentile rankings of other managers. They also considered whether a higher risk profile for the portfolios would be appropriate, under the assumption that a diversified portfolio of higher risk securities could, in the aggregate, provide higher returns over the long term. The Council concluded that the pension funds' primary objectives were preservation of capital and income, and that these requirements were inherent in the state prudence and pension laws. The Council concluded that no modifications in investment objectives were warranted.

The Council noted that its regulations had broadened the permissible investment universe of the Division in recent years to include options, real estate, conventional mortgages and a broader list of common stocks. The Council concluded that the present investment regulations provide for a satisfactory range of investment opportunities within the Council's fiduciary standards, and that new investment opportunities could be considered in the traditional manner as they arose.

The Council reviewed and confirmed the present standards for selecting stocks, which are set forth below:

a. The company should have growth in revenues

and earnings which exceed growth in the Gross National Product;

b. The company should have a strong market franchise, unique products and proven marketing capability;

c. The company's management should have demonstrated the ability to preserve profit margins, to avoid earnings surprises and to take the needed initiatives to preserve and improve upon the company's strengths;

d. The company should have a capitalization which is not heavily leveraged, thereby allowing it more flexibility to finance future expansion; the company should not be unduly capital intensive, which might expose it to the necessities of raising capital at times when capital markets were unduly expensive; and, the company should demonstrate that it can generate capital internally for growth;

e. The market for the company's shares should have enough liquidity to permit the orderly acquisition and disposition of a full position; and

f. The company should have conservative accounting practices.

The standards are only meant to serve as guidelines. The Council agreed that not all companies on the Approved List will meet all of these guidelines; however, a failure to meet most of these guidelines will be cause for concern. In addition, the Council believes that good corporate citizenship enhances the value of a company, and, conversely, that poor corporate citizenship detracts from a company's value.

The Council considered the use of outside managers. However, opinions from the Attorney General's office indicated that the use of outside managers by the Division is not legal under state law. The Council concluded that it might like to use outside managers in specialized circumstances, such as equity real estate investment, but that it would be necessary to modify the state's general prudence law to permit such use. The Division is presently working towards this objective.

The Council also considered the further pooling of direct holdings of pension fund bond assets. The Council concluded that pooling of the bonds held directly by the pension funds would permit greater operating efficiencies and better measurement of pension fund performance. By the end of fiscal 1991, only a very small percentage of pension fund assets was represented by direct bond holdings.

In fiscal 1990, the Council continued to review the legislative and regulatory definitions of risk and return for the pension funds and studied various asset al-

location and portfolio optimization simulations. As a result of these reviews and studies, in July 1990, the Council approved four new regulations which enabled the Division to invest in international stocks and bonds. In doing so, the Council acknowledged that the state's divestment legislation had reduced the universe available for investment. Furthermore, the studies noted that the world is approaching a global economy, wherein large corporations based abroad have major manufacturing plants and significant numbers of employees in the United States, and, conversely, many corporations based in the United States maintain substantial operations abroad. Finally, the studies showed that international investments in developed countries had historically provided higher returns with lower levels of risk than had investments limited to the United States.

During fiscal 1990, the Council received the reports of two independent actuarial firms, Buck Consultants and Actuarial Science Associates (ASA), who had been retained by the Treasury Department to provide comprehensive analyses of the Public Employees Retirement System, including both benefit and investment issues. With respect to the state's investment program, Buck Consultants concluded that "the state's present portfolio appears to be carefully thought out and, in terms of modern portfolio theory, efficient within the constraints of the fund," and ASA stated that "the current asset allocation was appropriate." Both reports endorsed the concept of international investing as a means of adding diversification to the portfolio and thus reducing portfolio risk.

In fiscal 1991, the Council once again reviewed all of its regulations in view of their prospective expiration under the provisions of the state's Sunset Law. Many regulations were readopted without change, and others were modified in minor ways to add clarity and to modernize them in accordance with current financial practices. As was noted before, the most significant changes permitted the Division to invest up to 60 percent of total pension fund assets in stocks, and up to 15 percent of total assets in international securities. These changes were initiated in order to provide greater diversification for pension fund investments and to increase access to asset classes which have historically provided slightly higher returns and lower risk than domestic securities.

In fiscal 1992, the Council has undertaken a study of the resources of the Division.

Council Procedures and Reports

The State Investment Council meets at least six times a year, and the Executive Committee of the Council may meet in intervening months. In addition to reviewing and formulating all major policy issues related to the state's investments, the Council reviews the investment programs and returns of each fund on a periodic basis. Furthermore, each year the Council reviews each of the major classes of assets held by the Division, including stocks, industrial bonds, utility bonds, bank stocks and indebtedness, U.S. Government securities, mortgages and commercial paper and finance company debt. These reviews are extensive and encompass financial, economic and social factors. For instance, in fiscal 1991, the report on securities issued by utilities analyzed issues associated with the implementation of nuclear power plants and with deregulation. Similar reports on other classes of securities analyzed the exposure of American banks to foreign loans, real estate loans and loans to support leveraged buyouts and governmental support for farm credit and mortgage programs.

Almost all of the investment transactions of the Division are effected through competitive bidding. In specific markets which require that the Division exercise discretion in the choice of a bank or broker, such discretion is exercised according to an allocation plan prepared by the Director on the basis of the Division's evaluation of the merits of the services provided by each bank or broker. The allocation plan is reviewed by the State Investment Council, and the final allocation of commissions is audited by the Division's independent accountants.

The provisions of P.L. 1950, c. 270, also require that the Director of the Division prepare and make available to the public a monthly report of all transactions effected by the Division. This report lists all sales, purchases, exchanges and commissions paid by the Division for all of the Division's transactions. The report is provided to the legislature, state officials, the press and the public.

Social Investment

There has been a spirited public debate for many years on the subject of "strategic" or "targeted" investment, whereby investments are either directed towards areas which are deemed to be socially desirable or withheld from areas which are deemed to be socially undesirable. The Council has taken the position that the Division is bound by law to make prudent investments for the sole and direct benefit of the beneficiaries of the various funds under its supervision and that the Division may not make any concession as to rate, risk or terms which would benefit any other party at the expense of the beneficiaries of the funds. The Council and the Division have been open to any investment program which would benefit socially desirable purposes, particularly investment within the State of New Jersey. All such investment programs are reviewed by the Division and the Council on a case by case basis from a financial point of view, and investment decisions are made in the light of such a review and the prudence standards cited above.

In fiscal 1982, the Council reviewed two investment concepts which would have directed pension fund assets to mortgage markets in New Jersey. The Council found that one of these was concessionary and thus was prohibited by state law. In the second instance, the Council reviewed a complex concept for investing in growing equity mortgages and concluded that the concept was feasible; however, no investments were initiated due to changing market conditions.

In fiscal 1986, the Division initiated a program whereby on a monthly basis the Division offered to purchase New Jersey mortgages from New Jersey banking institutions at market rates, as mandated by prudence law. Once a month the Division determines the true market level for a package of mortgages backed by an agency of the U.S. Government. The Division immediately offers this price to interested New Jersey financial institutions for identical mortgages which originate in New Jersey. In effect, the Division creates an "open window" to buy at market prices New Jersey mortgages guaranteed by U.S. Government agencies. In fiscal 1991, \$5.4 million of New Jersey mortgages were purchased by the Division under this program.

Reports of Gubernatorial Commissions

In fiscal 1982, former Governor Brendan Byrne created a task force to study the use of state pension funds to spur economic activity within the state. The task force did not find evidence that pension funds can be invested to achieve secondary objectives without compromising the primary goal of maximizing the investment return for the beneficiaries, and the task force concluded that no formal change in investment policy should be made. The report of this task force is described in greater detail in annual reports of prior years.

During fiscal 1983, Governor Kean created the Governor's Pension Study Commission to review all aspects of the state-administered pension funds. The Commission's conclusions relating to the policies and practices of pension fund investment, as reported on March 15, 1984, are quoted below in their entirety:

"1. The current structure within which New Jersey's pension investments are made is, in our judgment, both sensible and appropriate for the task and should not be changed in any substantive way. The balance which exists between the accountability of the pension investment fiduciaries to the beneficiaries of the funds with the insulation from political influence is of decisive importance. It is crucial that the twin pillars of fiduciary responsibility—namely, prudence and loyalty—be maintained. The current structure allows for and facilitates that to a better extent than any other we have seen or considered.

2. The Division of Investment should continue to consider investment alternatives with respect to improving potential returns. An increase in the equity exposure from 25 percent of book value to 35 percent of book value is an example of a positive step already taken. A subsequent increase to 50 percent would be worthy of consideration. The Investment Council should also consider other investment options such as venture capital pools, options, commercial real estate and a broader universe of stocks as long as these investment options meet the fiduciary standards of the Council.

3. The resources of the Division of Investment are too limited. The relatively small staff of 61 is not commensurate with the responsibility of the Division. Moreover, the salaries which attract high quality investors are not currently available. We noted that the committee whose report led to the creation of the Division and the

State Investment Council recommended that the investment managers be paid at a level commensurate with their responsibilities. This is not being done currently and should be addressed as soon as possible.

If the state were to allow the operation of the Division to be funded from the returns on investment, this would make available money for outside counsel of a technical sort. Legal counsel, data processing specialists, and investment advisors would be made available to the Division to enhance returns to fund the operation of the investment structure. New Jersey should take advantage of this.

4. All investment professionals of the Division of Investment should serve at the discretion of the State Investment Council. This would be consistent with the statutory purpose of the Investment Council. Current Civil Service regulations are an impediment to fostering the best investment operation.

5. The Investment Council should consider non-economic criteria in its decision-making process only insofar as these criteria have a direct impact on economic criteria. Socially dictated investments and socially sensitive investments are, in the long run, counter-productive. Nonetheless, the efforts which the Division and the Council have made to take into account non-economic criteria have been laudable. The consideration of generally accepted corporate practices, such as those covered by the Sullivan principles, has been a healthy factor in New Jersey's investment policy. These considerations should continue to be made and the Council and the Division should be alert to non-economic considerations which may adversely affect the pension portfolio.

6. The beneficiaries of the pension funds should be the sole concern of the State Investment Council and the Division. Non-beneficiaries should not be taken into account by the Council or the Division in its investment programs. Consequently, it would be appropriate for state statutes to include the ERISA language stipulating the 'sole benefit' provision of that federal law."

Studies commissioned by two governors of different political parties have reviewed and confirmed the mandate of state law that the Division make prudent investments for the sole and direct financial benefit of the beneficiaries of the several funds.

The Council has responded in full to those recommendations over which the Council has jurisdiction, such as the appropriate asset allocation of the pension funds. However, the Council cannot independently respond to recommendations regarding staffing, compensation and budgeting support, which are the prerogative of the Legislature. During fiscal 1992 the Council will once again review these issues and take them up with the appropriate authorities.

Policies of the Council Towards Social Investment

The State Investment Council has determined that social and financial considerations are not mutually exclusive, and many social considerations may have significant financial implications. Furthermore, investments which benefit the fund beneficiaries need not exclude investments in New Jersey or those which advance other social goals. All of the members of the Council are New Jersey residents, and for many years the Division and the Council have reflected concerns of New Jerseyans through internal policy guidelines. In 1984 these were codified, and they are listed below:

1. The Division of Investment should prefer investments in New Jersey in instances where such investments provide the same or better terms and returns in the marketplace as are available for out-of-state investment and where such investments meet the prudence standards set by law and the State Investment Council.

2. The Division of Investment should review all reasonable investment proposals presented by New Jersey corporations and should report any consequent investment decision to the State Investment Council at one of its regularly scheduled publicly advertised meetings.

3. The Division of Investment should prefer a New Jersey broker, bank or securities dealer in instances where identical bids are received in purchase or sale transactions involving publicly traded homogeneous securities such as money market investments, certificates of deposit and eligible mortgage pools.

4. The Division of Investment should recognize in its evaluation of corporate securities that good corporate citizenship enhances the financial prospects for a corporation, and, conversely, that poor corporate citizenship detracts from such prospects.

5. The Division of Investment should consider the financial effects of citizenship issues in the determination of proxy votes at corporate shareholder meetings.

6. The Division of Investment should prefer investments in New Jersey mortgages in instances where such mortgages meet the fiduciary standards of the Council and provide fair market returns.

7. The Division of Investment should identify New Jersey employers on any "approved lists" provided under regulations of the State Investment Council for

the purchase of common stocks, commercial paper and certificates of deposit.

8. The Division of Investment should prefer investments in companies which advance the economic development of New Jersey, support alternative energy sources or are controlled by economically disadvantaged individuals, provided such investments meet the fiduciary standards of the Council and provide fair market returns.

Voting of Proxy Statements

Each year the Division votes on issues raised in corporate proxy statements. Many of these issues deal not only with routine matters of corporate governance, but also reflect political and social issues. The Division reviews all such issues on a case by case basis from a financial point of view. In prior years the Division has supported shareholder resolutions which called for a report on employment practices in South Korea, required companies to leave South Africa, required compliance with World Health Organization standards for the sale of infant formula in underdeveloped countries and required compliance with the MacBride principles in Northern Ireland.

During fiscal 1991, the Division voted on 277 corporate proxies. On 78 proxies the Division voted against the recommendations of corporate management on a total of 108 individual proposals. Of these proposals, 48 concerned changes in corporate governance procedures designed to reduce shareholder voting power in order to protect the company against acquisition suitors, nine related to corporate activities in South Africa, 25 related to executive compensation, six related to compliance of the corporation with the MacBride principles in Northern Ireland, nine related to confidential proxy voting, four related to state of incorporation, six related to director elections, and one related to a plan of merger.

South African Divestment

In fiscal 1989, the Division completed the divestment mandated by law of securities of South Africa-related corporations and banks.

On August 27, 1985, Governor Kean signed a law (P.L. 1985, c. 308) which requires that "no assets of any pension or annuity fund under the jurisdiction of the Division of Investment in the Department of the Treasury should be invested in any bank or financial institution which directly or through a subsidiary has outstanding loans to the Republic of South Africa or its instrumentalities, and no assets shall be invested in the stocks, securities or other obligations of any company engaged in business in or with the Republic of South Africa." The law also provided for a three year period to effect the divestiture.

The Division's Final Report to the Legislature, as required by P.L. 1985, c. 308 (South African Divestment) for the period July 1, 1988, through August 27, 1988, and cumulatively for the three years ended August 27, 1988, was attached in its entirety as Appendix II to the Annual Report of the State Investment Council for fiscal 1988.

The Division continues to monitor the activities of corporations in South Africa. Subsequent to the completion of the mandated divestment program, a number of large American corporations cut their ties to South Africa and once again became eligible for investment by the state pension funds. To the knowledge of the Division, no American corporation, whose securities were held by the Division, established new relations with or activities in South Africa; however, several corporations were affected when they acquired other corporations with activities in South Africa. In every such case, the acquiring corporation has indicated that they have disposed of the South Africa-related activity, or the Division has a period of grace under the law to dispose of the affected securities, and the Division remains in compliance with the law.

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REPORT OF INDEPENDENT AUDITORS

To the Members of the
State Investment Council,
Division of Investment,
Department of the Treasury,
State of New Jersey

We have audited the amortized cost basis on the accompanying summaries of amounts invested by fund and investments by major category of the Division of Investment, Department of the Treasury, State of New Jersey as of June 30, 1991, and the related summaries of investment income by fund and investment activity for the year then ended. These summaries are the responsibility of the Division of Investment's management. Our responsibility is to express an opinion on these summaries based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial summaries are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial summaries. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial summary presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the summaries referred to above present fairly, in all material respects, the amortized cost of the investments by fund and major category of the Division of Investment, Department of the Treasury, State of New Jersey at June 30, 1991, and the related investment income and investment activity for the year then ended, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the amortized cost of investments by fund and by major category taken as a whole. The par, cost or principal amount, market value and market value over (under) amortized cost at June 30, 1991 have been subjected to the auditing procedures applied in our audit of the amortized cost and, in our opinion, are fairly stated in all material respects.

Princeton, New Jersey
August 26, 1991

Ernst & Young

SUMMARY OF AMOUNTS INVESTED BY FUND

June 30, 1991

	Par, Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
PENSION AND ANNUITY GROUP				
Consolidated Police and Firemen's Pension Fund	\$ 70,811,209	\$ 70,139,607	\$ 70,953,396	\$ 813,789
Judicial Retirement System of New Jersey	94,262,955	94,062,513	111,122,359	17,059,846
Police and Firemen's Retirement System	4,751,125,352	4,723,325,845	5,734,523,207	1,011,197,362
Prison Officers Pension Fund	1,001,158	1,001,158	1,001,158	—
Public Employees' Retirement System	8,562,190,377	8,518,984,196	10,399,564,224	1,880,580,028
State Police Retirement System	547,434,946	546,127,828	657,166,914	111,039,086
Teachers' Pension and Annuity Fund	10,184,680,818	10,127,721,712	12,297,267,313	2,169,545,601
		<u>24,081,362,859</u>	<u>29,271,598,571</u>	<u>5,190,235,712</u>
STATIC GROUP				
Trustees for the Support of Free Public Schools Fund	59,352,430	58,941,873	76,823,489	17,881,616
Waste Water Treatment Fund (Act of 1985)	47,329,333	47,329,333	47,329,333	—
Waste Water Treatment Trust Fund (Act of 1985)	1,406,934	1,406,934	1,406,934	—
		<u>107,678,140</u>	<u>125,559,756</u>	<u>17,881,616</u>
DEMAND GROUP				
Boarding House Rental Assistance Fund	17,045,637	17,045,637	17,045,637	—
Catastrophic Illness in Children Relief Fund (Act of 1987)	16,947,769	16,947,769	16,947,769	—
Clean Communities Account Fund (Act of 1985)	13,061,864	13,061,864	13,061,864	—
Development Fund—Luxury Tax	6,190,934	6,190,934	6,190,934	—
Emergency Services Fund	3,595,226	3,595,226	3,595,226	—
Enterprise Zone Assistance Fund (Act of 1983)	20,539,950	20,539,950	20,539,950	—
Higher Education Assistance Fund	29,764,874	29,764,874	29,764,874	—
Luxury Tax Fund	24,321,691	24,321,691	24,321,691	—
Motor Vehicle Security Responsibility Fund	145,541	145,541	145,541	—
New Jersey Automobile Insurance Guaranty Fund	369,661,245	369,661,245	369,661,245	—
New Jersey Insurance Development Fund	79,267,657	79,240,092	79,438,655	198,563
New Jersey Spill Compensation Fund	99,305,114	99,305,114	99,305,114	—
Outstanding Checks Account	15,995,354	15,995,354	15,995,354	—
Real Estate Guaranty Fund	329,997	329,997	329,997	—
Resource Recovery Investment Tax Fund (Act of 1985)	61,491,969	61,491,969	61,491,969	—
Sanitary Landfill Facility Contingency Fund	40,761,330	40,761,330	40,761,330	—
Solid Waste Services Tax Fund (Act of 1985)	18,096,230	18,096,230	18,096,230	—
State Disability Benefits Fund	157,230,577	157,048,456	158,032,574	984,118
State Recycling Fund	30,580,205	30,580,205	30,580,205	—
Unclaimed Personal Property Trust Fund	62,879,190	62,868,731	62,986,190	117,459
Uncompensated Care Trust Fund (Act of 1986)	29,329,475	29,329,475	29,329,475	—
Unemployed Compensation Auxiliary Fund	11,030,188	11,030,188	11,030,188	—
Unsatisfied Claim and Judgment Fund	275,716,839	275,716,839	275,716,839	—
Volunteer Emergency Service Organizations Loan Fund	206,748	206,748	206,748	—
Worker and Community Right to Know Fund	5,159,634	5,159,634	5,159,634	—
Workmen's Compensation Security Fund—Mutual	4,910,128	4,909,385	4,913,872	4,487
Workmen's Compensation Security Fund—Stock	64,793,632	64,775,056	64,887,232	112,176
		<u>1,458,119,534</u>	<u>1,459,536,337</u>	<u>1,416,803</u>
TEMPORARY RESERVE GROUP				
Alcohol Education Rehabilitation and Enforcement Fund	16,588,610	16,594,607	16,666,609	72,002
Beaches and Harbor Fund (Act of 1977)	2,641,081	2,641,081	2,641,081	—
Capital City Redevelopment Loan and Grant Fund	5,281,325	5,281,325	5,281,325	—
Clean Waters Fund (Act of 1976)	8,636,592	8,636,592	8,636,592	—
Community Development Bond Fund (Act of 1981)	1,257,323	1,257,323	1,257,323	—
Correctional Facilities Construction Fund (Act of 1982)	5,670,098	5,670,098	5,670,098	—
Correctional Facilities Construction Fund (Act of 1987)	79,879,473	79,879,473	79,879,473	—
Emergency Flood Control Fund (Act of 1978)	6,636,911	6,636,911	6,636,911	—
Energy Conservation Fund (Act of 1980)	21,830,606	21,830,606	21,830,606	—
Farmland Preservation Fund (Act of 1981)	3,659,392	3,659,392	3,659,392	—
Farmland Preservation Fund (Act of 1989)	14,647,748	14,647,748	14,647,748	—
General Investment Fund	825,503,989	825,493,703	825,477,410	(16,293)
General Trust Fund	15,890	15,890	15,890	—
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	45,333,490	45,333,490	45,333,490	—
Green Trust Fund (Act of 1983)	20,229,249	20,229,249	20,229,249	—
Hazardous Discharge Fund (Act of 1981)	46,476,839	46,476,839	46,476,839	—
Hazardous Discharge Site Cleanup Fund (Act of 1985)	23,963,191	23,963,191	23,963,191	—
Higher Education Buildings Construction Fund (Act of 1971)	479,621	479,621	479,621	—

SUMMARY OF AMOUNTS INVESTED BY FUND—(CONTINUED)
June 30, 1991

	Par. Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
Housing Assistance Fund (Act of 1968)	550,026	550,026	550,026	—
Human Services Facilities Construction Fund (Act of 1984)	5,279,115	5,279,115	5,279,115	—
Institutional Construction Fund (Act of 1978)	221,616	221,616	221,616	—
Institutions Construction Fund (Act of 1976)	177,621	177,621	177,621	—
Jobs, Science and Technology Fund (Act of 1984)	6,202,582	6,202,582	6,202,582	—
Jobs, Education and Competitiveness Fund (Act of 1988)	139,239,520	139,239,520	139,239,520	—
Medical Education Facilities Fund (Act of 1977)	554,093	554,093	554,093	—
Mortgage Assistance Fund (Act of 1976)	3,189,898	3,189,898	3,189,898	—
Natural Resources Fund (Act of 1980)	14,499,228	14,499,228	14,499,228	—
New Home Warranty Security Fund	61,661,224	61,598,445	62,017,123	418,678
New Jersey Bridge Rehabilitation Fund (Act of 1983)	26,772,207	26,772,207	26,772,207	—
New Jersey Bridge Rehabilitation and Improvement and Railroad Right-of-Way Preservation Fund	26,093,212	26,093,212	26,093,212	—
New Jersey Local Development Financing Fund	1,610,031	1,610,031	1,610,031	—
New Jersey Green Acres Fund (Act of 1983)	10,513,117	10,513,117	10,513,117	—
New Jersey Green Acres Fund (Act of 1989)	31,582,401	31,582,401	31,582,401	—
New Jersey Green Trust Fund (Act of 1989)	14,571,097	14,571,097	14,571,097	—
New Jersey Medical Malpractice Reinsurance Recovery Fund	6,457,722	6,457,722	6,457,722	—
Pension Adjustment Fund	9,183,040	9,183,040	9,183,040	—
Pension Payroll Investment Fund	4,403,090	4,403,090	4,403,090	—
Pinelands Infrastructure Trust Fund (Act of 1985)	14,552,814	14,552,814	14,552,814	—
Prescription Drug Program Fund	2,532,705	2,532,705	2,532,705	—
Public Buildings Construction Fund (Act of 1968)	1,014,775	1,014,775	1,014,775	—
Public Purpose Buildings and Community-Based Facilities Construction Fund	12,967,045	12,967,045	12,967,045	—
Public Purpose Buildings Construction Fund (Act of 1980)	9,937,085	9,937,085	9,937,085	—
Resource Recovery and Solid Waste Disposal Facility Fund (Act of 1985)	7,767,063	7,767,063	7,767,063	—
Safe Drinking Water Fund	8,276,715	8,276,715	8,276,715	—
Shore Protection Fund (Act of 1983)	5,662,495	5,662,495	5,662,495	—
State Facilities for Handicapped Fund (Act of 1973)	2,362,739	2,362,739	2,362,739	—
State Health Benefits Fund	94,484,116	94,416,590	95,114,614	698,024
State Land Acquisition and Development Fund (Act of 1978)	8,700,870	8,700,870	8,700,870	—
State Lottery Fund—Investment	51,580,892	51,580,892	51,580,892	—
State of New Jersey—Alternate Benefit Program	12,547,733	12,547,733	12,547,733	—
State of New Jersey Cash Management Fund— Administrative Expense Fund	895,892	895,892	895,892	—
State of New Jersey Cash Management Fund— Other than State Funds	2,130,390,945	2,130,390,945	2,130,390,945	—
State of New Jersey Cash Management Fund— Reserve Fund	15,349,908	15,349,908	15,349,908	—
State of New Jersey—New Jersey State Dental Program	9,018,425	9,018,425	9,018,425	—
State Recreation and Conservation Land Acquisition Fund (Act of 1971)	5,777,012	5,777,012	5,777,012	—
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	3,820,415	3,820,415	3,820,415	—
State Transportation Fund (Act of 1968)	617,569	617,569	617,569	—
State Water Development Fund (Act of 1958)	76,396	76,396	76,396	—
Stormwater Management and Combined Sewer Overflow Abatement Fund	15,594,792	15,594,792	15,594,792	—
Transportation Rehabilitation and Improvement Fund (Act of 1979)	21,685,983	21,685,983	21,685,983	—
University of Medicine and Dentistry of New Jersey—Self-Insurance Reserve Fund	19,873,256	19,780,283	19,917,656	137,373
Urban Development Investment Fund (Act of 1985)	2,096,479	2,096,479	2,096,479	—
Veterans' Guaranteed Loan Fund	15,288	15,288	15,288	—
Water Conservation Fund (Act of 1969)	3,032,520	3,032,520	3,032,520	—
Water Supply Fund (Act of 1981)	50,003,784	50,003,784	50,003,784	—
Water Supply Replacement Trust Fund	3,193,170	3,193,170	3,193,170	—
		<u>4,005,093,582</u>	<u>4,006,403,366</u>	<u>1,309,784</u>

SUMMARY OF AMOUNTS INVESTED BY FUND—(CONCLUDED)
June 30, 1991

	Par, Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
TRUST GROUP				
New Jersey State Employees' Deferred Compensation Administrative Charges	524,476	524,476	524,476	—
New Jersey State Employees' Deferred Compensation Cash Management Fund	80,648,285	80,648,285	80,648,285	—
New Jersey State Employees' Deferred Compensation Equity Fund	44,527,561	44,527,561	52,883,065	8,355,504
New Jersey State Employees' Deferred Compensation Fixed Income Fund	35,741,175	36,041,821	36,372,192	330,371
New Jersey State Employees' Deferred Compensation Holding Account	2,403,477	2,403,477	2,403,477	—
Supplemental Annuity Collective Trust Fund	106,995,958	106,995,958	129,771,997	22,776,039
Tischler Memorial Fund	535,386	<u>532,593</u>	<u>546,346</u>	<u>13,753</u>
		<u>271,674,171</u>	<u>303,149,838</u>	<u>31,475,667</u>
TOTAL AMOUNTS INVESTED BY FUND		<u>\$29,923,928,286</u>	<u>\$35,166,247,868</u>	<u>\$5,242,319,582</u>

See notes to investment summaries.

SUMMARY OF INVESTMENT INCOME BY FUND
Year Ended June 30, 1991

	Net Investment Earnings— Note A	Net Gain— Notes A and B	Total Investment Income
PENSION AND ANNUITY GROUP			
Consolidated Police and Firemen's Pension Fund	\$ 5,987,895	\$ —	\$ 5,987,895
Judicial Retirement System of New Jersey	6,428,579	526,288	6,954,867
Police and Firemen's Retirement System	326,805,197	167,612	326,972,809
Prison Officers Pension Fund	203,969	—	203,969
Public Employees' Retirement System	586,405,758	5,017,056	591,422,814
State Police Retirement System	36,845,107	—	36,845,107
Teachers' Pension and Annuity Fund	682,202,540	2,235,351	684,437,891
	<u>1,644,879,045</u>	<u>7,946,307</u>	<u>1,652,825,352</u>
STATIC GROUP			
Rutgers Medical School—Restricted Fund	37,865	—	37,865
Trustees for the Support of Free Public Schools Fund	5,133,587	—	5,133,587
University of Medicine and Dentistry of New Jersey—Construction Grant Fund	433,591	—	433,591
University of Medicine and Dentistry of New Jersey—Grant Fund	14,817	—	14,817
University of Medicine and Dentistry of New Jersey—Grant Fund B	10,354	—	10,354
Waste Water Treatment Fund (Act of 1985)	2,862,784	—	2,862,784
Waste Water Treatment Trust Fund (Act of 1985)	130,478	—	130,478
	<u>8,623,476</u>	<u>—</u>	<u>8,623,476</u>
DEMAND GROUP			
Boarding House Rental Assistance Fund	1,208,170	—	1,208,170
Catastrophic Illness in Children Relief Fund (Act of 1987)	891,972	—	891,972
Clean Communities Account Fund (Act of 1985)	1,088,847	—	1,088,847
Development Fund—Luxury Tax	407,524	—	407,524
Emergency Services Fund	260,995	—	260,995
Enterprise Zone Assistance Fund (Act of 1983)	1,380,884	—	1,380,884
Higher Education Assistance Fund	2,638,351	—	2,638,351
Luxury Tax Fund	1,776,030	—	1,776,030
Motor Vehicle Security Responsibility Fund	10,985	—	10,985
New Jersey Automobile Insurance Guaranty Fund	13,793,686	—	13,793,686
New Jersey Insurance Development Fund	6,190,529	—	6,190,529
New Jersey Spill Compensation Fund	6,860,239	—	6,860,239
New Jersey Uncompensated Care Trust Fund	2,173,891	—	2,173,891
Outstanding Checks Account	1,090,055	—	1,090,055
Real Estate Guaranty Fund	34,373	—	34,373
Resource Recovery Investment Tax Fund (Act of 1985)	3,984,280	—	3,984,280
Sanitary Landfill Facility Contingency Fund	2,893,644	—	2,893,644
Solid Waste Services Tax Fund (Act of 1985)	1,280,839	—	1,280,839
State Disability Benefits Fund	13,278,997	—	13,278,997
State Recycling Fund	2,210,648	—	2,210,648
Unclaimed Personal Property Trust Fund	5,522,951	—	5,522,951
Unemployment Compensation Auxiliary Fund	1,225,576	—	1,225,576
Unsatisfied Claim and Judgment Fund	14,658,810	—	14,658,810
Volunteer Emergency Service Organizations Loan Fund	15,690	—	15,690
Worker and Community Right to Know Fund	324,502	—	324,502
Workmen's Compensation Security Fund—Mutual	449,996	—	449,996
Workmen's Compensation Security Fund—Stock	4,721,456	—	4,721,456
	<u>90,373,920</u>	<u>—</u>	<u>90,373,920</u>
TEMPORARY RESERVE GROUP			
Alcohol Education Rehabilitation and Enforcement	1,246,346	—	1,246,346
Beaches and Harbors Fund (Act of 1977)	162,479	—	162,479
Capital City Redevelopment Loan and Grant Fund	398,529	—	398,529
Clean Waters Fund (Act of 1976)	634,647	—	634,647
Community Development Bond Fund (Act of 1981)	193,772	—	193,772
Correctional Facility Construction Fund (Act of 1982)	440,845	—	440,845
Correctional Facility Construction Fund (Act of 1987)	4,035,348	—	4,035,348
Emergency Flood Control Fund (Act of 1978)	540,668	—	540,668
Energy Conservation Fund (Act of 1980)	1,706,048	—	1,706,048
Farmland Preservation Fund (Act of 1981)	368,288	—	368,288
Farmland Preservation Fund (Act of 1989)	551,968	—	551,968
General Investment Fund	36,378,266	—	36,378,266
General Trust Fund	1,190	—	1,190

SUMMARY OF INVESTMENT INCOME BY FUND—(CONTINUED)
Year Ended June 30, 1991

	Net Investment Earnings— Note A	Net Gain Notes A and B	Total Investment Income
TEMPORARY RESERVE GROUP—(continued)			
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	2,201,027	—	2,201,027
Green Trust Fund (Act of 1983)	1,658,705	—	1,658,705
Hazardous Discharge Fund (Act of 1981)	3,372,640	—	3,372,640
Hazardous Discharge Site Cleanup Fund (Act of 1985)	1,670,781	—	1,670,781
Higher Education Buildings Construction Fund (Act of 1971)	37,007	—	37,007
Higher Education Facility Renovation and Rehabilitation Fund	74,275	—	74,275
Housing Assistance Fund (Act of 1968)	43,296	—	43,296
Human Services Facility Construction Fund (Act of 1984)	415,224	—	415,224
Institutional Construction Fund (Act of 1978)	30,481	—	30,481
Institutions Construction Fund (Act of 1976)	14,818	—	14,818
Jobs, Science and Technology Fund (Act of 1984)	272,565	—	272,565
Jobs, Education and Competitiveness Fund (Act of 1988)	5,421,941	—	5,421,941
Medical Education Facilities Fund (Act of 1977)	41,550	—	41,550
Mortgage Assistance Fund (Act of 1976)	236,662	—	236,662
Natural Resources Fund (Act of 1980)	1,148,141	—	1,148,141
New Home Warranty Security Fund	4,670,490	—	4,670,490
New Jersey Bridge Rehabilitation Fund (Act of 1983)	2,292,246	—	2,292,246
New Jersey Bridge Rehabilitation and Improvement and Railroad Right-of-Way Preservation Fund	1,045,957	—	1,045,957
New Jersey Local Development Financing Fund	115,015	—	115,015
New Jersey Green Acres Fund (Act of 1983)	956,798	—	956,798
New Jersey Green Acres Fund (Act of 1989)	541,169	—	541,169
New Jersey Green Trust Fund (Act of 1989)	490,394	—	490,394
New Jersey Medical Malpractice Reinsurance Recovery Fund	255,994	—	255,994
New Jersey State Dental Program	606,002	—	606,002
Pension Adjustment Fund	552,817	—	552,817
Pension Payroll Investment Fund	486,459	—	486,459
Pinelands Infrastructure Trust Fund (Act of 1985)	792,907	—	792,907
Prescription Drug Program Fund	322,401	—	322,401
Public Buildings Construction Fund (Act of 1968)	156,462	—	156,462
Public Purpose Buildings and Community-Based Facilities Construction Fund	940,990	—	940,990
Public Purpose Buildings Construction Fund (Act of 1980)	792,408	—	792,408
Resource Recovery and Solid Waste Disposal Facility Fund (Act of 1985)	609,763	—	609,763
Safe Drinking Water Fund	594,589	—	594,589
Salem Municipal Port Authority Assistance Fund (Act of 1987)	3,157	—	3,157
School Building Aid—Capital Reserve Fund	13,970	—	13,970
Shore Protection Fund (Act of 1983)	656,890	—	656,890
State Facilities for Handicapped Fund (Act of 1973)	183,651	—	183,651
State Health Benefits Fund	10,750,472	—	10,750,472
State Land Acquisition and Development Fund (Act of 1978)	895,599	—	895,599
State Lottery Fund—Investment	2,750,737	—	2,750,737
State of New Jersey—Alternate Benefit Program	1,214,137	—	1,214,137
State of New Jersey Cash Management Fund— Administrative Expense Fund	56,208	—	56,208
State of New Jersey Cash Management Fund— Other than State Funds	133,368,450	—	133,368,450
State of New Jersey Cash Management Fund— Reserve Fund	1,012,866	—	1,012,866
State Recreation and Conservation Land Acquisition Fund (Act of 1971)	222,761	—	222,761
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	341,555	—	341,555
State Transportation Fund (Act of 1968)	127,103	—	127,103
State Water Development Fund (Act of 1958)	6,156	—	6,156
Stormwater Management and Combined Sewer Overflow Abatement Fund	566,629	—	566,629
Transportation Rehabilitation and Improvement Fund (Act of 1979)	2,037,647	—	2,037,647

SUMMARY OF AMOUNTS INVESTED BY FUND—(CONCLUDED)
June 30, 1991

	Net Investment Earnings— Note A	Net Gain— Notes A and B	Total Investment Income
TEMPORARY RESERVE GROUP—(continued)			
University of Medicine and Dentistry of New Jersey—Self-Insurance Reserve Fund	1,465,287	—	1,465,287
Urban Development Investment Fund (Act of 1985)	68,882	—	68,882
Veterans' Guaranteed Loan Fund	805	—	805
Water Conservation Fund (Act of 1969)	185,400	—	185,400
Water Supply Fund (Act of 1981)	3,067,350	—	3,067,350
Water Supply Replacement Trust Fund	489,098	—	489,098
	<u>239,005,178</u>	<u>—</u>	<u>239,005,178</u>
TRUST GROUP			
New Jersey State Employees' Deferred Compensation Administration Charges	36,105	—	36,105
New Jersey State Employees' Deferred Compensation Cash Management Fund	5,384,748	—	5,384,748
New Jersey State Employees' Deferred Compensation Equity Fund	1,758,972	776,321	2,535,293
New Jersey State Employees' Deferred Compensation Fixed Income Fund	2,668,579	32,640	2,701,219
New Jersey State Employees' Deferred Compensation Holding Account	243,833	—	243,833
Supplemental Annuity Collective Trust Fund	4,971,889	4,219,260	9,191,149
Tischler Memorial Fund	42,806	—	42,806
University of Medicine and Dentistry of New Jersey—Endowment Funds	74,692	—	74,692
University of Medicine and Dentistry of New Jersey—Endowment Fund B	240,426	—	240,426
	<u>15,422,050</u>	<u>5,028,221</u>	<u>20,450,271</u>
TOTALS	<u>\$1,998,303,669</u>	<u>\$12,974,528</u>	<u>\$2,011,278,197</u>

See notes to investment summaries.

SUMMARY OF INVESTMENTS BY MAJOR CATEGORY

June 30, 1991

	Par, Cost or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
U.S. Government and other government bonds and obligations	\$ 329,514,400	\$ 327,764,632	\$ 333,933,696	\$ 6,169,064
Industrial bonds and commercial paper	9,622,000	9,625,461	9,627,199	1,738
Telephone bonds	27,030,000	26,875,151	24,995,379	(1,879,772)
Gas, electric and water bonds	98,567,000	98,375,621	95,050,576	(3,325,045)
Finance companies—senior debt	8,175,000	8,174,317	8,175,000	683
Common stocks	148,051,046	148,051,046	195,609,294	47,558,248
Mortgage-backed certificates	3,989,298,326	3,860,674,083	3,950,552,326	89,878,243
Units—Common Pension Fund A	9,120,265,619	9,120,265,619	14,011,963,781	4,891,698,162
Units—Common Pension Fund B	9,274,307,938	9,274,307,938	9,488,155,077	213,847,139
Units—Common Pension Fund D	350,004,473	350,004,473	348,362,493	(1,641,980)
Units—State of New Jersey Cash Management Fund	6,694,014,172	6,694,014,172	6,694,014,172	—
Other investments	5,802,000	5,795,773	5,808,875	13,102
TOTAL INVESTMENTS BY MAJOR CATEGORY		<u>\$29,923,928,286</u>	<u>\$35,166,247,868</u>	<u>\$5,242,319,582</u>

See notes to investment summaries.

SUMMARY OF INVESTMENT ACTIVITY

Year Ended June 30, 1991

Purchases at cost, excluding common funds:		
Bonds	\$223,303,074	
Mortgages	862,347,725	
Stocks	<u>64,621,854</u>	\$ 1,150,272,653
Purchase of units of common funds, at cost		21,831,115,117
Discount accretion		12,169,773
Sales, at amortized cost		(534,801,664)
Mortgage principal payments, at amortized cost		(331,930,859)
Redemptions, at amortized cost		(3,080,439)
Maturities, at par amount		(109,199,300)
Redemption of units of common funds		(18,376,320,740)
Premium amortization		<u>(150,798)</u>
NET INCREASE IN AMORTIZED COST OF INVESTMENTS		3,638,073,743
Total amounts invested by funds—Note B		
Beginning of year		<u>26,285,854,543</u>
END OF YEAR		<u>\$29,923,928,286</u>

See notes to investment summaries.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Administration

The operations of the Division of Investment are governed by Chapter 270, Public Law of 1950, as amended, for the purpose of investing in securities for various funds under the jurisdiction of the Department of the Treasury, State of New Jersey. The Division acts in an investment capacity only and receipt and disbursement of cash is a direct function of the respective funds. These financial summaries present the amounts invested by the various pension and other state funds maintained by the Division and are not intended to be a complete presentation of the various funds nor the Division's financial position or results of operations.

Amortized Cost

Investments are stated in the Division's records at cost, as adjusted for the accretion of discount or amortization of premium. State of New Jersey Cash Management Fund units are stated at a cost of \$1.00 per unit, which approximates market value.

Par, cost or principal amount and market are presented in the summaries for informational purposes. Market values of common stock traded on a national securities exchange (or reported on the NASDAQ national market) are presented at the last reported sales price on the day of valuation. Other common stock traded in the over-the-counter market and listed securities for which no sale was reported on that date are presented at the last quoted bid price. Bonds and mortgage-backed certificates are valued in accordance with fair market value procedures established by the State Investment Council primarily through valuations obtained from a commercial pricing service. Market values of Common Pension Fund A, Common Pension Fund B and Common Pension Fund D are based on the net asset values of the respective fund in which the underlying investment securities are valued via the previously prescribed methods.

Investment Transactions

Investment transactions are accounted for on their trade date. Gains or losses from investment transactions are calculated on the average cost basis and recognized as investment income when they occur.

Discount and Premium

Accretion of discount and amortization of premium are recorded on the straight-line basis for investments which mature within one year. For other investments, the effective interest rate method is utilized.

Investment Income

Investment income includes interest earned, dividends, and discount accretion, reduced for premium amortization. Interest and dividend income is accounted for on the accrual basis.

Expenses

Expenses allocable to the Division (including payroll costs, occupancy costs, audit fees, and supplies) are paid by the Department of the Treasury, State of New Jersey and, therefore, are not included in the accompanying Summary of Investment Income by Fund.

NOTE B—INVESTMENT ACTIVITY

Statutes of the State of New Jersey and regulations of the State Investment Council authorize the Division of Investment to invest in obligations of the U.S. Treasury, U.S. Government agencies, and their instrumentalities; obligations of the State of New Jersey or municipal or political subdivisions of the State; commercial paper; bankers acceptances; revenue obligations of public authorities; debt instruments of banks; collateralized notes and mortgages; certificates of deposit; repurchase agreements; equity and convertible equity securities, international debt and equity securities, currencies, and currency futures, options and other common types of investment securities. Investee institutions and organizations are prescribed by the statutes and regulations based on minimum capital, dividend paying history, credit history, and other evaluation factors.

The purchase, sale, receipt of income and other transactions affecting investments are governed by custodial agreements between the investing funds through the State Treasurer and custodian banks as agents for the funds. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institution, amount of the portfolio to be covered by the agreements and other pertinent matters.

GASB Statement No. 3 requires disclosure of the level of investment risk assumed by the Division at June 30, 1991. Category 1 includes investments that are insured or registered or for which the securities are held by the Division or its agent in the Funds' name. Category 2 includes uninsured and unregistered investments for which the securities are held by the Trust Department or agent in the Funds' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the Funds' name. As of June 30, 1991, all investments held by the Division are classified as Category 1.

Federal securities, including federal securities held as collateral on repurchase agreements, are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the State of New Jersey. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the State of New Jersey. United Kingdom bonds and other investment securities denominated in a foreign currency are maintained by the United Kingdom Central Gilts Office (CGO) and the Cedel book entry system in Luxembourg, respectively, through the custodian bank in trust for the State of New Jersey. The custodian banks as agents for the State funds maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks, DTC, CGO and Cedel as securities owned by or pledged to the State funds.

Securities not maintained by the Federal Reserve Banks, DTC, CGO or Cedel are in the name of a designated nominee representing the securities of a particular State fund which establishes the State fund's unconditional right to the securities.

The investments of the various State of New Jersey counties, municipalities and school districts and the agencies or authorities created by any of these entities, other than their investments in the Cash Management Fund, are not a direct responsibility of the State Investment Council. That investment function is being performed by the Division of Investment as a service under a provision in the law providing that each county, municipality and school district and the agencies or authorities created by any one of these entities may avail itself of the services of any State department or agency as it may require. Accordingly, the accompanying summaries do not include the investments or results of non-cash management fund investment transactions made on behalf of the authorities and agencies.

The summary of investment activity includes the purchase and redemption of units in the Common Pension Fund A, Common Pension Fund B, Common Pension Fund D and the State of New Jersey Cash Management Fund by the participants. Realized gains and losses arising from investment activity by Common Pension Fund A, Common Pension Fund B and Common Pension Fund D, consisting of net gains of \$138,682,224 in fiscal year 1991, are not reflected in the Summary of Investment Income by Fund. Undistributed interest income of \$2,089,425 in fiscal 1991, arising from investment activity by Common Pension Fund D is not reflected in the Summary of Investment Income by Fund.

NOTES TO INVESTMENT SUMMARIES

NOTE C—SUMMARY OF INVESTMENTS BY MAJOR CATEGORY INCLUDING INVESTMENTS OWNED BY THE COMMON PENSION FUNDS AND THE STATE OF NEW JERSEY CASH MANAGEMENT FUND (THE "UNIT FUNDS")

The following is a summary of investments by major category at June 30, 1991 including investments owned by the Common Pension Funds and the State of New Jersey Cash Management Fund, the "Unit Funds." In the Total Amounts Invested by Funds shown in the investment summaries, the Common Pension Funds and the State of New Jersey Cash Management Fund are shown at their unit value.

	Par, Cost Or Principal Amount	Amortized Cost	Market	Market Over (Under) Amortized Cost
U.S. Government and other government bonds and obligations	\$11,927,381,400	\$11,928,854,383	\$12,115,112,435	\$ 186,258,052
Foreign government bonds and notes	550,000,000	158,112,771	138,459,813	(19,652,958)
Industrial bonds and commercial paper	3,035,346,753	3,022,776,149	3,024,162,716	1,386,567
Telephone bonds	307,003,000	289,896,298	285,381,090	(4,515,208)
Gas, electric and water bonds	808,322,000	769,196,843	765,573,598	(3,623,245)
Finance companies—senior debt	80,995,000	80,588,662	79,351,916	(1,236,746)
Common stocks	9,375,508,234	9,375,508,234	14,172,772,683	4,797,264,449
Mortgage-backed certificates	3,989,298,326	3,860,674,083	3,950,552,327	89,878,244
Time certificates of deposit	615,000,000	615,000,000	615,000,000	—
Other Investments	209,265,000	207,747,816	206,829,149	(918,667)
Total investments		30,308,355,239	35,353,195,727	5,044,840,488
Differences in accounting by unit funds:				
Undistributed realized gains (cumulative)		(173,057,227)	—	173,057,227
Other assets		468,542,943	468,542,943	—
Other liabilities		(665,623,998)	(654,873,232)	10,750,766
Other accounting practices		(14,288,671)	(617,570)	13,671,101
Total amounts invested by funds		<u>\$29,923,928,286</u>	<u>\$35,166,247,868</u>	<u>\$5,242,319,582</u>

The following describes the accounting differences between the total amounts invested by Fund and total investments, primarily relating to unit funds:

- I. The summary of investments by major category (page 26) includes the "Par, Cost, or Principal Amount" and "Amortized Cost" of the units of participation at the total purchase price of the units by the participating funds. The total investments shown above reflects the "Par, Cost, or Principal Amount" and "Amortized Cost" of the investments held by the Unit Funds.
- II. Market value as shown for total amounts invested by fund represents the net asset value of the Common Pension Funds and the State of New Jersey Cash Management Fund as of June 30, 1991. The market value included in the total investments shown above reflects the market value of the investments held by the Unit Funds.
- III. Total investments shown above does not reflect the other assets and liabilities of the Unit Funds, e.g., cash, accrued interest receivable, amounts due for investments sold or owed for investments purchased, and undistributed income due to participants. These items are included in calculating the net asset value of the Unit Funds.
- IV. Total amounts invested by funds do not reflect cumulative net realized gains from Unit Funds' investment transactions which have not been distributed to the participating funds. Fiscal 1990 net realized gains of Common Pension Fund A were distributed in fiscal 1991, and 1991 net realized gains will be distributed in 1992. Common Pension Funds A, B and D cumulative net realized gains are distributed at the discretion of the State Investment Council.

NOTES TO INVESTMENT SUMMARIES

NOTE D—SOUTH AFRICAN DIVESTITURE

By act of the New Jersey State Legislature (P.L. 1985, c.308), the Division of Investment has been directed to divest the portfolio, of any pension and annuity fund it manages, of all securities of companies with a presence in the Republic of South Africa. This divestiture was accomplished by August 27, 1988 in accordance with the enactment.

Subsequent to that date, due to acquisitions or changes in operating practices, there have been changes in the South African status of certain companies. These companies included in the June 30, 1991 investment portfolio, previously determined to be free from a presence in South Africa, are subject to divestment legislation. Under the current Attorney General's ruling, the Division is allowed three years from the date of determination of South African status to effect divestment. The aggregate book value of investments in these companies was \$15,536,896 at June 30, 1991. The Division believes that the aggregate market value of such investments is in excess of cost as of June 30.

APPENDIX I

UNAUDITED SUMMARY OF INVESTMENTS BY MAJOR CATEGORY OF INDIVIDUAL PENSION FUNDS, CASH MANAGEMENT FUND

	Consolidated Police & Firemen's Pension Fund		Judicial Retirement System of New Jersey		Police & Firemen's Retirement System	
	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market
SHORT-TERM OBLIGATIONS						
U.S. Government and other government securities and obligations	\$ 6,469	\$ 6,468	\$ 2,156	\$ 2,156	\$ 55,755	\$ 55,752
Commercial paper	4,101	4,101	1,367	1,367	35,350	35,350
Time certificates of deposit	1,292	1,292	431	431	11,131	11,131
	<u>11,862</u>	<u>11,861</u>	<u>3,954</u>	<u>3,954</u>	<u>102,236</u>	<u>102,233</u>
LONG-TERM BONDS						
U.S. Government bonds and other government securities and obligations	43,774	44,602	35,869	36,728	1,494,765	1,530,873
Industrial bonds	22	22	2,685	2,670	112,559	111,954
Gas and electric bonds	1,095	1,043	3,220	3,218	147,190	146,583
Telephone bonds	3,202	3,119	1,262	1,250	55,705	54,948
Finance companies—senior debt	93	93	166	160	6,950	6,688
Intermediate term corporate notes	314	313	1,744	1,766	71,337	72,254
Foreign Government bonds and notes	—	—	1,044	914	34,073	29,838
Other	—	—	1,192	1,187	41,126	40,916
	<u>48,500</u>	<u>49,192</u>	<u>47,182</u>	<u>47,893</u>	<u>1,963,705</u>	<u>1,994,054</u>
MORTGAGES						
Mortgage-backed certificates	<u>10,440</u>	<u>10,564</u>	<u>5,937</u>	<u>6,135</u>	<u>796,810</u>	<u>814,110</u>
STOCK						
Common stock	—	—	34,141	51,715	1,837,187	2,782,853
	70,802	71,617	91,214	109,697	4,699,938	5,693,250
Difference due to accounting practices	(662)	(664)	2,849	1,425	23,388	41,273
	<u>\$70,140</u>	<u>\$70,953</u>	<u>\$94,063</u>	<u>\$111,122</u>	<u>\$4,723,326</u>	<u>\$5,734,523</u>

**INCLUDING INVESTMENTS OWNED BY THE COMMON PENSION FUNDS AND THE STATE OF NEW JERSEY
(000's Omitted) at June 30, 1991**

Prison Officers Pension Fund		Public Employees' Retirement System		State Police Retirement System		Teachers' Pension and Annuity Fund		Totals	
Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market
\$ 308	\$ 308	\$ 193,141	\$ 193,129	\$ 7,085	\$ 7,084	\$ 286,477	\$ 286,459	\$ 551,391	\$ 551,356
195	195	122,454	122,454	4,492	4,492	181,630	181,630	349,589	349,589
62	62	38,560	38,560	1,414	1,415	57,195	57,195	110,085	110,086
565	565	354,155	354,143	12,991	12,991	525,302	525,284	1,011,065	1,011,031
125	125	2,692,018	2,756,111	207,450	212,468	3,130,073	3,203,893	7,604,074	7,784,800
1	1	199,934	198,858	15,836	15,746	233,446	232,209	564,483	561,460
—	—	260,676	259,863	19,280	19,242	333,324	331,373	764,785	761,322
—	—	101,430	99,939	7,877	7,765	120,420	118,361	289,896	285,382
4	4	13,291	12,830	961	925	22,751	22,222	44,216	42,922
15	15	131,052	132,669	9,875	10,002	154,023	155,881	368,360	372,900
—	—	49,869	43,670	9,945	8,709	63,182	55,329	158,113	138,460
—	—	61,176	60,923	11,328	11,274	77,978	77,619	192,800	191,919
145	145	3,509,446	3,564,863	282,552	286,131	4,135,197	4,196,887	9,986,727	10,139,165
—	—	1,398,549	1,429,191	32,494	32,966	1,616,444	1,657,587	3,860,674	3,950,553
—	—	3,289,589	4,982,859	210,386	318,680	3,856,155	5,841,057	9,227,458	13,977,164
710	710	8,551,739	10,331,056	538,423	650,768	10,133,098	12,220,815	24,085,924	29,077,913
291	291	(32,755)	68,508	7,705	6,399	(5,376)	76,452	(4,560)	193,684
<u>\$1,001</u>	<u>\$1,001</u>	<u>\$8,518,984</u>	<u>\$10,399,564</u>	<u>\$546,128</u>	<u>\$657,167</u>	<u>\$10,127,722</u>	<u>\$12,297,267</u>	<u>\$24,081,364</u>	<u>\$29,271,597</u>

APPENDIX II

UNAUDITED COMMON PERFORMANCE DISCLOSURE FORM FOR PUBLIC FUNDS

	Avg. Annual Return 5 Years Ended 6/30/91	One Year Period Ended				
		6/30/87	6/30/88	6/30/89	6/30/90	6/30/91
TOTAL RETURN						
Aggregate of All Pension Funds	10.2%	14.9%	(0.7)%	14.5%	13.3%	10.0%
Consumer Price Index	4.3%	3.7%	3.9%	5.3%	4.3%	4.7%
EQUITY TOTAL RETURNS						
Common Pension Fund A Equities	10.8%	24.3%	(10.5)%	16.9%	18.7%	8.1%
Approved List—Before Divestment	12.3%	23.5%	(8.1)%	20.1%	20.6%	8.6%
Approved List—South Africa Free	10.2%	19.8%	(7.0)%	18.7%	14.0%	7.6%
Dow Jones Industrial Average	13.1%	32.2%	(8.3)%	18.7%	22.7%	4.7%
Standard & Poor's 500 Index	11.9%	25.2%	(6.9)%	20.5%	16.5%	7.4%
N.Y. Stock Exchange Composite	7.2%	18.8%	(9.7)%	15.2%	9.9%	4.1%
FIXED INCOME TOTAL RETURNS						
Common Pension Fund B and Other Bonds	8.4%	4.2%	7.4%	13.0%	7.2%	10.4%
Shearson Lehman Government/Corporate Bond Index	8.3%	4.7%	7.5%	12.3%	7.1%	10.2%
Salomon Brothers High Grade Bond Index (AA and AAA)	9.2%	5.1%	8.5%	16.2%	6.0%	10.6%
Salomon Brothers Broad Bond Index	8.9%	5.6%	8.1%	12.2%	7.7%	10.8%
MORTGAGES—TOTAL RETURNS						
Pension fund holdings	10.2%	8.3%	9.4%	12.1%	9.2%	12.0%
Salomon Brothers Mortgage Index	10.4%	8.7%	9.7%	11.8%	9.7%	12.0%
CASH EQUIVALENTS						
Total Returns—Cash Management Fund	7.7%	6.2%	7.2%	8.4%	8.9%	7.9%
91-Day Treasury Bills	6.7%	5.6%	5.5%	7.8%	7.9%	6.6%

Several public funds have voluntarily undertaken to create common standards for reporting returns. This table is provided in accordance with the Division's desire to further comparability of public fund reporting.

The aggregate total returns shown on the above table are estimates, and are shown for illustrative purposes only. The Division does not have the resources to price all of its securities on a periodic basis, which would be necessary for an accurate calculation of total returns which includes both income and changes in market values.

