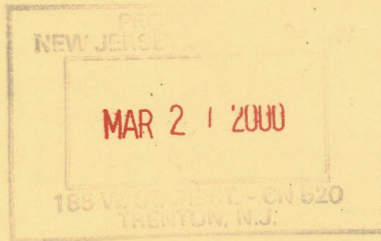




**STATE INVESTMENT COUNCIL
DEPARTMENT OF THE TREASURY
STATE OF NEW JERSEY**

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FORTY-NINTH ANNUAL REPORT
For the Fiscal Year Ended June 30, 1999



CHRISTINE TODD WHITMAN
Governor



ROLAND M. MACHOLD
State Treasurer

A Report to
Governor Christine Todd Whitman
the Members of the
New Jersey Legislature
and the State Treasurer

Submitted by the
State Investment Council

For the Fiscal Year ended June 30, 1999

November 15, 1999

To The Honorable
Governor;
Legislature;
State Treasurer:

We are pleased to submit this Annual Report of the Division of Investment, Department of the Treasury, for the fiscal year ended June 30, 1999, as required by Section 13, P.L. 1950, c.270. The report is a summary of the activities of the Division during the year. A separate annual report is also prepared for the State of New Jersey Cash Management Fund, which is available upon request from the Investment Division.

The Division, under the jurisdiction of the State Investment Council, has the investment responsibility for 160 funds, including seven pension and annuity funds. The cost basis of all funds on June 30, 1999, was \$48.7 billion, compared with \$44.5 billion at the end of the prior year, and the fair (or market) value of the funds was \$86.2 billion, compared with \$76.2 billion at the end of the previous fiscal year. The Council includes eleven persons appointed to fixed terms. Five employee representatives are appointed by their respective pension fund boards for one-year terms, and five members are appointed by the Governor for staggered five-year terms. In fiscal 1992, the Legislature provided for the eleventh member of the Council, to be appointed by the Governor from a list of three candidates to be nominated jointly by the President of the Senate and the Speaker of the Assembly. The new law also provided that all gubernatorial appointments to the pension fund boards and to the Council are subject to the advice and consent of the State Senate. State law requires that no Council member shall 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 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 investment of the pension funds and other state funds also contributes to the funding of services and benefits provided by the state to its citizens and thus directly benefits the taxpayers of New Jersey.

Pension fund returns were well in excess of actuarial guidelines in fiscal 1999, as the strong domestic stock market rally continued, and the domestic bond market and international markets provided positive returns. The estimated total return of the pension funds, which includes changes in fair (or market) values of the securities held by the funds and dividend and interest income over the year, was 16.1 percent, which compares with a 22.7 percent return in fiscal 1998. For the past five and ten fiscal years the estimated annual total return earned by the pension funds was 19.3 percent and 14.3 percent, respectively. These total returns of the pension funds ranked the Division in the top quartile of all State fund managers in all periods. Appendix II sets forth estimated total returns of the State-administered pension funds for the past five years.

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. State prudence law was amended in April 1995, by P.L. 1995, c.48. Eligible investments are defined as investments in property of every nature, provided the fiduciary shall exercise the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The amendment to the law provides for the "whole plan" principle, which permits a broader spectrum of investments. The law also states that the fiduciary shall be under a duty to manage and invest the portfolio solely in the interests of the trust beneficiaries and for the exclusive purpose of providing financial benefits to trust participants.

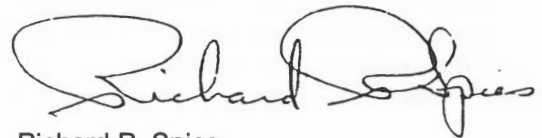
Over the years, members of the public, political figures and lobbyists have raised the question of whether investments under the jurisdiction of the Council should be guided by non-financial considerations. Such investments could be directed regionally or toward specific capital markets or could be averted 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 factors that should be considered. Social and regional issues may have financial implications for fund beneficiaries, and the Division analyzes such implications in the determination of its investment decisions, but it is only those financial risk and return characteristics that are taken into account in making the final investment decisions. The policies of the Council regarding social investment are discussed in greater 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. These reports are discussed further herein.

The Council is pleased to note that the 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. 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 make such loans, but it does participate indirectly in these areas through investments in securities of U.S. Government agencies and other financial intermediaries. The Council has been asked to provide below market interest rates for New Jersey investment programs for housing and economic development, but has declined to do so 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 generally provides more favorable interest rates to borrowers.

Over the years, the Council has addressed the major issues which concern fiduciaries, such as the standards for investment, the allocation of invested funds among asset classes and the resources available to the Division of Investment. In fiscal 1999, the Council again addressed the issue of the asset allocation of the pension funds, and decided to retain existing asset allocation guidelines.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard R. Spies". The signature is fluid and cursive, with a large initial "R" and "S".

Richard R. Spies
Chair

The State Investment Council



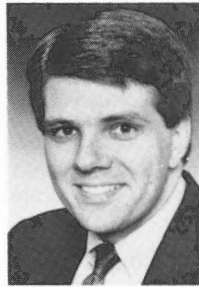
RICHARD R. SPIES
Chair of the Council



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



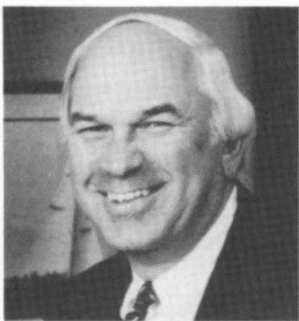
THOMAS C. GONNELLA



ROBERT T. HOFFMAN



CHERYL A. MILLS



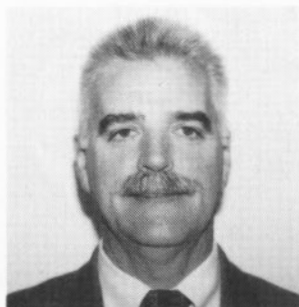
J. PETER SKIRKANICH



ARTHUR W. WHITE, JR.



HARRY W. BALDWIN
Teachers' Pension and
Annuity Fund



PATRICK B. DOHERTY
Police and Firemen's
Retirement System



EDWARD HANNA
Public Employees'
Retirement System



BARRY ROBERSON
State Police Retirement
System

Division of Investment



STEVEN E. KORNRUMPF
Director



WILLIAM G. CLARK
Deputy Director



Staff of the Division on the steps of State Street Square, 50 West State St., Trenton, New Jersey.



Administration Group: Joanne Yakelewicz, William Clark, Cindy Everett, Cathy Ryan, Steven Kornrumpf, Gilles Michel and Celeste Brennan.



Portfolio Management Group: Linda Brooks, Maneck Kotwal, Jeff Lebowitz, Karin Hollinger and Brian Arena. Not Pictured: Linda Thompson and Sandra Holmes.



Trading Group: Vince Pagnotta, Tim Patton, Ed Burns, Rob Schragger, Mary Ann Smith, Tim Corliss, Jack Jackowitz, Helen Imbalzano, Michael Wszolek and John Penza. Not pictured: Ellie Chiaramonti and Celia Daino.



Research Group: Kevin Onderdonk, Sharon Montalto, Tom Montalto, Betty Carr, Jim Vandervort, Ed Pittman, William Trent, Linda Gaspari and Joel Fishbein.



Common Fund Accounting Group: Andrea Szul, Dan Costanzo, Jeff Taylor, Madeline Amico, Manick Jhingade, Patty DiMemmo, Joe Aduabato, Elsie Lawrence and John Jusiewicz.



Auditing Group: Ken Scott, Olga Grozio, Bart Pericoloso, Heather Rodriguez, Nancy Brancolino and Charles Coleman.



Cashier Group: Bea Wolfe, Rosetta Muccie, Roxanne Tyner, John Giovannetti, Kass Cole, Melissa Cook, Joanne Yakelewicz, and Ron Hentnik. Not pictured: Loretta Sytnik.



Data Processing Group: Nick Maximenia, Ed Meyers and Sandi Beale.



International: Bruce Smith, Kersti Alabert, and Vitaly Smirnov. Not pictured: Danielle Scholl.



International Accounting: Valerie Oscilowski, Vivian Velenger, Chris Eckel, Mary Vassiliou, Patti Hricak and Carletha Murray. Not pictured: Dolores Ewanis.

FIVE YEAR SUMMARY

Fiscal Year Ended June 30,

	1995	1996	1997	1998	1999
	\$ Millions				
FUNDS UNDER THE SUPERVISION OF THE STATE INVESTMENT COUNCIL:					
Cost Basis at Year End (1):					
Pension Funds	\$28,240	\$30,067	\$34,248	\$35,988	\$39,272
All Funds	35,955	37,810	42,035	44,488	48,700
Fair (or Market) Value at Year End:					
Pension Funds	\$40,508	\$45,620	\$56,632	\$67,314	\$76,230
All Funds	48,304	53,505	64,693	76,243	86,246
Fair (or Market) Value of Pension Funds at Year End by Category:					
Short-term obligations	\$ 1,420	\$ 1,568	\$ 4,120	\$ 2,309	\$ 4,424
Long-term bonds	13,018	13,934	14,404	17,831	18,954
Mortgages	1,947	2,225	2,490	2,571	3,499
Stocks	23,408	27,047	34,825	43,683	49,338
Accounting differences	715	846	793	920	15
Total	<u>\$40,508</u>	<u>\$45,620</u>	<u>\$56,632</u>	<u>\$67,314</u>	<u>\$76,230</u>
Investment Income (1):					
Pension Funds					
Net Income and Realized Gains (Losses)	\$ 2,081	\$ 2,848	\$ 2,610	\$ 3,092	\$ 4,598
Change in Unrealized Appreciation (Depreciation)	4,494	3,286	6,831	8,941	5,632
Total	<u>\$ 6,575</u>	<u>\$ 6,134</u>	<u>\$ 9,441</u>	<u>\$12,033</u>	<u>\$10,230</u>
All Funds					
Net Income and Realized Gains (Losses)	\$ 2,485	\$ 3,249	\$ 3,015	\$ 3,516	\$ 5,060
Change in Unrealized Appreciation (Depreciation)	4,552	3,347	6,963	9,093	5,791
Total	<u>\$ 7,037</u>	<u>\$ 6,596</u>	<u>\$ 9,978</u>	<u>\$12,609</u>	<u>\$10,851</u>
Total Rate of Return (2):					
Common Pension Fund A (3)	25.9 %	23.4%	32.3%	30.8%	27.4%
Common Pension Fund B (3)	13.6	4.4	8.0	11.8	2.8
Common Pension Fund D (3)	9.1	14.0	16.2	15.6	4.9
All Pension Funds, Estimated (3)	19.7	16.1	22.1	22.7	16.1
Supplemental Annuity Collective Trust	22.8	23.8	30.2	27.7	22.6
Deferred Compensation Plan—Equity	24.1	24.4	34.3	29.3	28.7
Deferred Compensation Plan—Fixed Income	9.6	4.9	6.5	8.8	4.6
Deferred Compensation Plan—Small Cap Equity (5)	—	—	17.0	24.6	27.1
Returns of Various Market Indices:					
Salomon Brothers' Mortgage Index	12.1 %	5.8%	9.0%	8.9%	4.1%
Lehman Government/Corporate Bond Index	12.7	4.7	7.8	11.3	2.7
S&P 500 Index	26.1	26.0	34.7	30.2	22.8
S&P 1500 Index	25.4	25.2	32.8	29.3	21.4
Dow Jones Industrial Average	29.2	27.1	38.6	18.5	24.7
Salomon Brothers' World Gov. Bond Index—Unhedged	18.8	0.4	3.9	4.3	4.9
EAFE International Stock Index	1.7	13.3	12.4	6.1	7.6
State of New Jersey Cash Management Fund:					
Book Value of Units of Participation:					
All Participants	\$ 9,944	\$ 9,753	\$12,463	\$11,838	\$10,353
Other-than-State Participants	2,755	2,942	2,954	3,366	3,804
Average Annualized Daily Rate of Return (4):					
State Participants	5.27 %	5.60%	5.47%	5.56%	5.15%
Other-than-State Participants	5.13	5.40	5.29	5.41	4.98
Number of Funds Under the Supervision of the State Investment Council					
	134	137	149	152	160
Total Number of Transactions					
	48,208	45,413	43,944	46,663	48,883

1. Fiscal years 1998 and 1999 are presented at original cost while prior years include amortization of premiums and accruals of discounts. This change conforms to Government Accounting Standards Board Statement No. 31 (GASB-31).
2. Total rate of return income and changes in the fair (market) prices for securities held by the funds during the period shown.
3. Common Pension Funds A, B and D are the principal vehicles for investment by the pension funds in domestic stocks, domestic bonds, and international securities, respectively. The returns cited are for the whole portfolios and reflect cash equivalents. Returns for stocks and bonds alone are shown in Appendix II.
4. Simple interest.
5. The fiscal 1997 rate of return for the Deferred Compensation Plan Small Capitalization Equity Fund is for the second quarter ending June 30, 1997 only.

The Year's Activities

Summary Financial Information

The 160 investment funds under the supervision of the Council on June 30, 1999, had a cost (or book value) of \$48.7 billion. The investment funds had a fair (market) value of \$86.2 billion at June 30, 1999, an increase of 13.1 percent over the fair value of \$76.2 billion at June 30, 1998. The fair value of the seven pension funds increased from \$67.3 billion at June 30, 1998, to \$76.2 billion at June 30, 1999. The fair value of the pension funds rose in large part due to a continuing strong rally in the domestic stock market.

The total investment income for all funds for fiscal 1999 amounted to \$10.9 billion as compared with \$12.6 billion last year.

During the year, the Division of Investment purchased securities with a par value of \$136.0 billion. Approximately 54.9 percent of this amount, or \$74.6 billion, represented the overnight investment of surplus balances in the State's cash accounts. In fiscal 1998, the Division purchased securities with a par value of \$122.8 billion, of which \$31.0 billion was generated by overnight investments. During fiscal 1999, the Division's net holdings of mortgages increased from \$2.6 billion to \$3.6 billion.

The Division sold securities totaling \$47.7 billion in fiscal 1999, compared with sales of \$28.2 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 \$4.2 billion during the year, compared with \$2.7 billion for the prior year. Net realized profits as a result of settlements of currency hedges in Common Pension Fund D amounted to \$3.1 million in fiscal 1999, compared with \$154.0 million for the prior year. The transaction information in this paragraph includes transactions effected within the common funds, but are not included in the financial summaries of this report.

"Regular Interest Rates"

The pension revaluation law which was enacted in June, 1993, sets the "regular interest rate" of the pension funds at 8.75 percent, which reflects expected income and market returns of the funds over time. The law further provides that the "regular interest rate" shall bear a reasonable relationship to the rate of earnings on investments, based on the fair value of assets, but shall not exceed the assumed percent-

age rate of increase applied to salaries plus 3 percent. At present the average assumed percentage rate of increase applied to salaries is 5.95 percent.

Fixed Income

The pension fund allocation of domestic fixed income securities was increased by a net amount of \$3.5 billion in fiscal 1999 due to attractive corporate and mortgage yield spreads available in the market.

In fiscal 1999, the Division purchased \$1.6 billion of FHLMC, FNMA, and GNMA 15-year and 30-year mortgage-backed securities. Principal repayments on mortgage-backed securities held by the Division for fiscal 1999 totaled \$368 million.

In October 1985, the Division developed a program for the state pension funds to purchase eligible mortgage pools from interested New Jersey financial institutions. The Division calls such institutions on a monthly basis and offers to purchase eligible mortgage pools at the prevailing market prices for similar pools. The Division has purchased in recent years 100 percent New Jersey mortgage pools guaranteed by FHLMC.

In fiscal 1992, a law was enacted which allocated up to 10 percent of the Police and Firemen's Retirement Fund to mortgages for members of the Fund. In fiscal 1999, the Fund purchased \$1.0 million of such mortgages.

Common Pension Fund B is the vehicle for investment by the pension funds in debt securities issued in the United States. In fiscal 1999, the cash flow of this Fund was increasingly directed towards investment in corporate securities, due to the widening yield premiums offered on corporate debt. In fiscal 1999, the fund purchased \$2.0 billion of corporate debt securities, compared with \$1.8 billion in the prior year.

The Division maintains a "roll" program for U.S. Treasury and Agency debt securities. A "roll" is defined as the simultaneous sale of a security coupled with its repurchase at a later date. Proceeds from the sale are invested in the State of New Jersey Cash Management Fund. In fiscal 1999, the Division "rolled" \$20.3 billion of securities at a profit of \$1.3 million, compared with \$14.5 billion of securities at a profit of \$1.0 million in fiscal 1998.

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 domestic stocks, domestic bonds and international investments, respectively. At June 30, 1999, the fair (or market) value of the units of ownership of Common Pension Fund A, Common Pension Fund B and Common Pension Fund D were \$39.0 billion, \$15.7 billion and \$14.3 billion, respectively. The State of New Jersey Cash Management Fund provides a vehicle for the pension funds and other state and municipal funds to make short-term investments.

Total Rate of Return Calculations for Select Portfolios

Calculations of total rate of return reflect both income and changes of fair values of securities in a portfolio over a specific period of time. The calculation includes unrealized appreciation or depreciation 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 pension fund portfolios and selected other portfolios. These historical returns are shown on page 8 herein.

New England Pension Consultants has provided the Division with calculations of total rates of return, and their data shows that the total rates of return for Common Pension Funds A, B and D in fiscal 1999 were 27.4 percent, 2.8 percent and 4.9 percent, respectively. The estimated total rates of return for the active pension fund portfolios were approximately 16.1 percent in fiscal 1999, compared with returns of 22.7 percent in fiscal 1998 and 22.1 percent in fiscal 1997. 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 estimated total returns for the pension funds do not include the mortgage loan program of the Police and Firemen's Retirement System. This pro-

gram was established by law in fiscal 1992, and provides that members of the fund may receive mortgages from the fund at rates which are fixed by formula. The law further provides that the fund may not sell the mortgages, and no independent market exists for them. Consequently, the Council has taken action to exclude the program from calculations of the total return for the fund. The attached financial statements include \$491 million par value of assets of the mortgage loan program with an appraised value of \$490 million at June 30, 1999.

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 by the State ("Other-than-State" participants) to participate in the Fund on a voluntary basis.

The total fair value of the units of participation in the Fund increased from \$11.8 billion at June 30, 1998 to \$14.1 billion at June 30, 1999.

The total income of the Fund was \$622 million in fiscal 1999, and \$599 million in fiscal 1998.

The number of participating State funds increased from 152 to 160 in fiscal 1999. The number of "Other-than-State" participants increased from 1,022 to 1,051 during the year, and the aggregate investment of "Other-than-State" participants was \$3.8 billion at the end of fiscal 1999, compared with \$3.4 billion at the end of fiscal 1998.

The average daily annualized rate of return to participating State accounts and accounts of the pension funds was 5.15 percent during fiscal 1999, compared with 5.56 percent in fiscal 1998. The average daily annualized rate of return to "Other-than-State" participants, which is net of two small charges, was 4.98 percent in fiscal 1999, compared with 5.41 percent in fiscal 1998.

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 1999 was 5.18 percent, com-

pared with 5.64 percent in the prior year. The lower rates of return during fiscal 1999 were the result of lower interest rates available in the markets for short-term debt investments.

GASB Statement No. 31— Changes In Accounting Practices

In March, 1997, the Government Accounting Standards Board issued Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The Division adopted the new standard in its financial statements for the year ended June 30, 1998. As

required by GASB Statement No. 31, the value of the investments and investment funds contained in this annual report are stated at fair value. Fair value is defined by the Government Accounting Standards Board as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. For investment purposes, if a quoted market price is available, fair value and market value would be equal. The only basic change in the current reporting of fair value is that the Cash Management Fund units are presented at the fair value of the underlying portfolio. The value of the Cash Management Fund units presented, equates to \$.999430357 versus the historical value of \$1.000000 per unit.

Historical Background

Legislative History

Fiscal 1999 marks forty-nine 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 160 funds in 1999, with a book value of \$48.7 billion and a fair value of \$86.2 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 original legislation provided that the Council consisted of ten members, five appointed for staggered five-year terms by the Governor and five appointed for one-year terms by the boards of trustees of five of the pension systems. The statute was amended by P.L. 1992, c.125, to

provide for an eleventh member of the Council, to be appointed by the Governor from among three persons nominated jointly by the President of the Senate and the Speaker of the General Assembly. The eleventh member serves for a five-year term. The new law also provides that all gubernatorial appointments to the Council are subject to the advice and consent of the Senate. The statute 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 Department 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 over time 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 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 subsequently, investment in property of every nature, provided the fiduciary shall exercise care, skill, prudence and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, and reasonable discretion exercise (P.L. 1995, c.48).

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 domestic stocks, domestic 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 by the State to participate in the Fund. Such participation began in January 1978.

In August 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 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 remained in compliance with the law. In April 1994, Governor Whitman signed legislation which repealed the state's South African sanctions.

In July 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.

In December 1991, Governor Florio signed into law an act, P.L. 1991, c.414, which provides that up to 10 percent of the assets of the Police and Firemen's Retirement System may be made available to eligible members of that fund for mortgage loans at rates which are set by formula. The law provides that the Treasurer shall delegate the administration of the mortgage loan program to the New Jersey Housing and Mortgage Finance Agency, and, with certain advice, the Treasurer

shall set the mortgage loan standards. In June 1992, this law was amended by an act (P.L. 1992, c.78) which clarified that the mortgage loan program is an investment program to be administered as part of the state's general investment program. At its meeting in July 1992, the Council distinguished the mortgage loan program from other investment programs under the supervision of the Council and specified that the returns of the pension funds will be segregated from the mortgage loan program for the purposes of performance reporting.

In June 1992, Governor Florio signed an act, P.L. 1992, c.41, which provided for the revaluation of the pension funds from a book valuation basis to a market valuation basis for the purposes of actuarial calculations. The act changed the economic assumptions of the funds to reflect market valuations and modified the actuarial methodologies for the funds. The act also provided for an eleventh member of the Council, to be appointed by the Governor from a list to be submitted jointly by the President of the Senate and the Speaker of the Assembly.

In April 1995, Governor Whitman signed into law an act, P.L. 1995, c.48, which amended the State's prudence law. The new law provides for the "whole plan" principle, whereby the fiduciary may consider the whole portfolio, rather than any individual investments, in determining the prudent level of expected risk and return of the pension fund. The "whole plan" principle has the effect of permitting a balance of high and low risk investments in the portfolio, rather than requiring that all investments must approach a common standard of expected risk and return. The new law also expands the investments that are listed as examples of eligible investment to include diversified pools of venture capital and securities loan transactions. Also, certain forms of investment are permitted, including limited partnerships and investment trusts.

In July 1995, Governor Whitman signed into law an act, P.L. 1995, c.175, which permits the pension funds to invest in bonds of Israel.

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. In fiscal 1995, the Council acted to increase the permissible level of aggregate pension fund stock

holdings in Common Pension Funds A and D from 60 percent to 70 percent of the fair value of the active pension funds. At June 30, 1999, the aggregate common stock holdings of the pension funds were 64.7 percent of the total fair 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 Department 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.

As a consequence of the State's Sunset Law, all of the regulations of the Council were resubmitted to the regulatory review process in fiscal 1996 and were readopted with various modifications and clarifications.

In fiscal 1996, the Council approved an increase in the maximum permitted investment by the pension funds in stocks from 60 percent to 70 percent of the fair value of the portfolios of the active pension funds. Studies by the Division show that investment in stocks provides higher but more volatile returns than investments in bonds over the long term.

In fiscal 1997, the Council reviewed its policies towards currency hedging in Common Pension Fund D, the pension funds' vehicle for investing in international securities. The Division's returns on currency hedging have been positive on balance since the inception of the international investment program in fiscal 1991. However, the returns were very volatile, and in July 1997, the Council modified its regulations to limit hedging of international stocks to unusual circumstances, and to state that the objective of hedg-

ing international bonds was to improve and protect the inherent returns of the portfolio.

Also, in fiscal 1997, the Division instituted a new investment option for the State's Deferred Compensation Plan, a Small Capitalization Equity Fund.

In fiscal 1999, the Division instituted an investment program for the Office of Student Assistance to provide a savings plan for higher education known as the New Jersey Better Educational Savings Trust.

Reviews of Major Policy Issues

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.

At that time, 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 over time 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."

At that time, 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 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 also 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 its 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.

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 allocation 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 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), which 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. The most significant changes permitted the Division to invest up to 60 percent of the total fair value of the assets of the active pension funds in stocks, and up to 15 percent of total assets in international securities.

In fiscal 1993, the Council studied the resources provided to the Division and concluded that the resources provided to the Division were not adequate

to fully fund the Division's investment programs, including several programs which had the potential to provide significant additional returns to the state funds over the years. The Council discussed its concerns with the appropriate state officials and with members of the legislature, and the State's budgets for fiscal 1995 and 1996 included additional funding for the Division.

Also, in both fiscal 1993 and 1994, the Council reviewed the asset allocation policies set forth in the Council regulations for the State-administered pension funds, and decided that such policies continued to be appropriate.

In fiscal 1995, the Council again reviewed the asset allocation policies set forth in the Council Regulations, and acted to increase the permitted allocation of pension fund assets to international securities from 15 percent of the fair value of total pension fund assets to 20 percent. As a consequence of the passage of P.L. 1995, c.48, which modified the State's prudence law, the Council also considered new asset classes, such as real estate and emerging international markets, as potential areas for further diversification of the pension funds. After careful consideration, the Council decided to defer any action on investment in either real estate or emerging markets. However, the Council acted to increase the maximum permitted investment by the active pension funds in stocks from 60 percent to 70 percent of the total fair value of the pension fund portfolios.

In fiscal 1996, the Council again reviewed all of its regulations in view of their prospective expiration under the State's Sunset Law. All regulations were modified to add clarity where needed, and all were readopted.

In fiscal 1997, the Council reviewed its currency hedging policies, and acted to modify its policy by limiting hedging of international stocks to unusual circumstances and by stating that the objective of hedging international bonds was to improve and protect the inherent returns of the portfolio.

Also, in fiscal 1997, the Council received a report from the State Auditor, who had undertaken to determine whether the Division is properly executing its fiduciary responsibility in its portfolio management, specifically whether it properly structures, monitors and analyzes the investment portfolios and activities, controls investment risk and expense and properly measures and evaluates investment performance. The report concluded that the Division properly fulfills these functions. The report cited certain control weaknesses, which have been addressed by the Division, and also noted that the Division is not in technical compliance with the State's bank custody law.

Legislation has been introduced which would remedy this problem.

In June 1997, the State issued \$2.7 billion of Pension Obligation Bonds, the proceeds of which were applied to the unfunded liabilities of the pension plans.

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 the asset allocation policies of the pension funds.

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.

In fiscal 1999, the transactions of the Division generated total commissions both actual and implied, of \$27.5 million, including \$7.0 million of domestic stock commissions. Of this amount, \$2.9 million was directed to pay for fixed-fee charges for performance measurement and access to various economic and financial databases.

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 State's prudence law (P.L. 1995, c.48) provides that "the fiduciary shall be under a duty to manage and invest the portfolio solely in the interests of the trust and beneficiaries and for the exclusive purpose of providing financial benefits to trust participants." The Council has taken the position that the Division is bound by law to make prudent investments for the exclusive financial 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 are 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 any eligible agency supported by 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 supported by the U.S. Government.

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, former 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 allocation is an example of a positive step already taken. 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, counterproductive. 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, have 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 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 and breadth of potential investment of the pension funds. However, the Council cannot independently respond to recommendations regarding staffing, compensation and budget support, which are the prerogative of the Legislature. During fiscal 1994, the Council again reviewed these issues and took them up with the appropriate authorities. As a result of these concerns, recent budgets have provided incremental funding for the Division for certain investment programs. Furthermore, in fiscal 1995, State prudence law was amended to codify the sole benefit provision.

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 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 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 be prepared to 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, provide for improvement of the environment, or are controlled by economically disadvantaged individuals, provided such investments meet the fiduciary standards of the Investment 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 call for a report on employment practices in South Korea, require companies to leave South Africa, require compliance with World Health Organization standards for the sale of infant formula in underdeveloped countries and require compliance with the MacBride Principles in Northern Ireland.

During fiscal 1999, the Division voted on 1,234 U.S. corporate proxies. On 844 proxies, the Division voted with management on all issues. On 390 proxies the Division voted against the recommendations of corporate management on a total of 456 individual proposals. Of these proposals, 346 related to executive compensation, 55 related to corporate governance, three related to compliance of the corporation with the MacBride Principles in Northern Ireland, four related to confidential proxy voting, 45 related to the election of directors, one related to tobacco advertising to minors, and two related to contract supplier standards.

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

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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 accompanying summary of amounts invested by fund and summary of investments by major category of the Division of Investment, Department of the Treasury, State of New Jersey, including the portfolio of investments as of June 30, 1999, and the related summary of investment income by fund and summary of 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.

As described in Note 1, these summaries are not intended to be a complete presentation of the Fund's net assets or operations.

In our opinion, the summaries referred to above present fairly, in all material respects, the investments by fund and by major category of the Division of Investment, Department of the Treasury, State of New Jersey as of June 30, 1999, and the related investment income and investment activity for the year then ended, in conformity with generally accepted accounting principles.

The Year 2000 issue supplementary information listed in the foregoing table of contents, is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board (GASB), and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because disclosure criteria specified by GASB Technical Bulletin No. 98-1, as amended, are not sufficiently specific to permit us to perform procedures that would provide meaningful results. In addition, we do not provide assurance that the Division is or will become Year 2000 compliant, that the Division's Year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Division does business are or will become Year 2000 compliant.

August 27, 1999

Ernst + Young LLP

SUMMARY OF AMOUNTS INVESTED BY FUND
as of June 30, 1999

	Par, Cost or Principal Amount— Note 1	Cost— Note 1	Fair Value— Note 1	Fair Value Over (Under) Cost
PENSION AND ANNUITY GROUP				
Consolidated Police and Firemen's Pension Fund	\$ 44,915,964	\$ 45,004,735	\$ 44,884,062	\$ (120,673)
Judicial Retirement System of New Jersey	233,188,785	232,425,436	390,932,375	158,506,939
Police and Firemen's Retirement System	8,814,088,720	8,803,655,345	16,607,138,880	7,803,483,535
Prison Officers Pension Fund	19,313,926	19,313,926	19,302,924	(11,002)
Public Employees' Retirement System	12,571,674,191	12,555,516,195	25,113,531,548	12,558,015,353
State Police Retirement System	927,994,637	926,461,856	1,818,090,228	891,628,372
Teachers' Pension and Annuity Fund	16,709,314,133	16,689,464,554	32,236,541,469	15,547,076,915
		<u>39,271,842,047</u>	<u>76,230,421,486</u>	<u>36,958,579,439</u>
STATIC GROUP				
Trustees for the Support of Public Schools Fund	97,163,460	96,384,766	160,379,263	63,994,497
Waste Water Treatment Fund (Act of 1985)	262,634,961	262,634,961	262,485,353	(149,608)
Waste Water Treatment Fund (Act of 1992)	1,630,821	1,630,821	1,629,892	(929)
		<u>360,650,548</u>	<u>424,494,508</u>	<u>63,843,960</u>
DEMAND GROUP				
Atlantic City Casino Parking Fund	1,368,439	1,368,439	1,367,660	(779)
Atlantic City Tourism Promotion Fund	293,851	293,851	293,684	(167)
Boarding House Rental Assistance Fund	3,360,500	3,360,500	3,358,585	(1,915)
Body Armor Replacement Fund	1,744,076	1,744,076	1,743,083	(993)
Casino Simulcasting Fund	1,508,900	1,508,900	1,508,040	(860)
Casino Simulcasting Special Fund	5,241,398	5,241,398	5,238,412	(2,986)
Catastrophic Illness in Children Relief Fund (Act of 1987)	14,376,964	14,376,964	14,368,774	(8,190)
Clean Communities Account Fund (Act of 1985)	6,774,360	6,774,360	6,770,501	(3,859)
Development Fund—Luxury Tax	1,757,069	1,757,069	1,756,068	(1,001)
Division of Motor Vehicles Surcharge Fund	4,354,153	4,354,153	4,351,673	(2,480)
Dredging & Containment Facility Fund	20,005,801	20,005,801	19,994,405	(11,396)
Emergency Services Fund	3,018,844	3,018,844	3,017,125	(1,719)
Enterprise Zone Assistance Fund (Act of 1983)	161,971,886	161,971,886	161,879,620	(92,266)
Hazardous Discharge Fund (Act of 1986)	3,128,475	3,128,475	3,126,693	(1,782)
Health Care Subsidy Fund	64,861,465	64,861,465	64,824,517	(36,948)
Higher Education Assistance Fund	21,774,984	21,774,984	21,762,580	(12,404)
Higher Education Assistance Operating Fund	21,526,617	21,526,617	21,514,354	(12,263)
Korean Veterans' Memorial Fund	807	807	806	(1)
Luxury Tax Fund	424,511	424,511	424,269	(242)
Motor Vehicle Security Responsibility Fund	141,776	141,776	141,695	(81)
New Jersey Automobile Insurance Guaranty Fund	177,013,253	177,013,253	176,912,419	(100,834)
New Jersey Insurance Development Fund	41,350,112	41,350,112	41,326,557	(23,555)
New Jersey Spill Compensation Fund	62,428,828	62,428,828	62,393,266	(35,562)
Petroleum Overcharge Reimbursement Fund	24,373,814	24,373,814	24,359,930	(13,884)
Real Estate Guaranty Fund	1,542,335	1,542,335	1,541,457	(878)
Resource Recovery Investment Tax Fund (Act of 1985)	332,756	332,756	332,566	(190)
Sanitary Landfill Facility Contingency Fund	29,764,914	29,764,914	29,747,959	(16,955)
Solid Waste Services Tax Fund (Act of 1985)	6,153,370	6,153,370	6,149,865	(3,505)
State Disability Benefits Fund	98,112,476	98,112,476	98,056,587	(55,889)
State of New Jersey Judiciary—Bail Fund	31,537,769	31,537,769	31,519,804	(17,965)
State of New Jersey Judiciary—Child Support Fund	25,119,559	25,119,559	25,105,250	(14,309)
State of New Jersey Judiciary—Probation Fund	6,649,003	6,649,003	6,645,215	(3,788)
State of New Jersey Judiciary—Special Civil Fund	2,691,892	2,691,892	2,690,358	(1,534)
State of New Jersey Judiciary—Superior Court/Other Misc. Fund	3,405,798	3,405,798	3,403,857	(1,941)
State Recycling Fund	8,583,312	8,583,312	8,578,423	(4,889)
Tourism Improvement Development District Act Fund	69,176	69,176	69,136	(40)
Unclaimed Child Support Trust Fund	851,907	851,907	851,422	(485)
Unclaimed County Deposits Trust Fund	2,595,928	2,595,928	2,594,449	(1,479)
Unclaimed Insurance Payments on Deposit	1,960,617	1,960,617	1,959,500	(1,117)
Unclaimed Personal Property Trust Fund	119,227,719	119,227,719	119,159,802	(67,917)
Unemployment Compensation Auxiliary Fund	20,726,988	20,726,988	20,715,181	(11,807)
Unsatisfied Claim and Judgment Fund	333,238,240	333,238,240	333,048,413	(189,827)
Volunteer Emergency Service Organizations Loan Fund	1,048,333	1,048,333	1,047,736	(597)
Worker and Community Right to Know Fund	1,200,934	1,200,934	1,200,250	(684)
Workers' Compensation Security Fund—Mutual	10,378,901	10,378,901	10,372,988	(5,913)
Workers' Compensation Security Fund—Stock	76,557,172	76,557,172	76,513,562	(43,610)
Workforce Development Partnership Fund	99,890,280	99,890,280	99,833,379	(56,901)
		<u>1,524,440,262</u>	<u>1,523,571,875</u>	<u>(868,387)</u>

SUMMARY OF AMOUNTS INVESTED BY FUND (CONTINUED)
as of June 30, 1999

	Par, Cost or Principal Amount— Note 1	Cost— Note 1	Fair Value— Note 1	Fair Value Over (Under) Cost
TEMPORARY RESERVE GROUP				
Alcohol Education Rehabilitation and Enforcement Fund	\$ 5,617,253	\$ 5,617,253	\$ 5,614,053	\$ (3,200)
Beaches and Harbors Fund (Act of 1977)	55,949	55,949	55,918	(31)
Capital City Redevelopment Loan and Grant Fund	2,451,612	2,451,612	2,450,215	(1,397)
Central Pension Fund	12,292	12,292	12,285	(7)
Clean Waters Fund (Act of 1976)	2,730,879	2,730,879	2,729,323	(1,556)
Community Development Bond Fund (Act of 1981)	25,886	25,886	25,872	(14)
Contributory Insurance Fund—PERS	115,497,140	115,302,218	115,566,984	264,766
Contributory Insurance Fund—TPAF	68,618,111	68,463,033	68,682,962	219,929
Correctional Facilities Construction Fund (Act of 1982)	615,039	615,039	614,688	(351)
Correctional Facilities Construction Fund (Act of 1987)	16,268,416	16,268,416	16,259,149	(9,267)
Development Disabilities Waiting List Reduction and Human Services Facilities Construction Bonds (Act of 1994)	24,021,450	24,021,450	24,007,766	(13,684)
Drinking Water State Revolving Fund	802	802	801	(1)
Emergency Flood Control Fund (Act of 1978)	221,978	221,978	221,852	(126)
Emergency Medical Technician Training Fund	8,438,307	8,438,307	8,433,500	(4,807)
Energy Conservation Fund (Act of 1980)	2,356,589	2,356,589	2,355,246	(1,343)
Farmland Preservation Fund (Act of 1981)	258,115	258,115	257,968	(147)
Farmland Preservation Fund (Act of 1989)	1,774,069	1,774,069	1,773,058	(1,011)
Farmland Preservation Fund (Act of 1992)	4,940,866	4,940,866	4,938,051	(2,815)
Farmland Preservation Fund (Act of 1995)	25,613,783	25,613,783	25,599,192	(14,591)
General Investment Fund	1,650,399,815	1,650,399,815	1,649,459,676	(940,139)
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	3,700,611	3,700,611	3,698,503	(2,108)
Green Trust Fund (Act of 1983)	13,060,664	13,060,664	13,053,224	(7,440)
Hazardous Discharge Fund (Act of 1981)	341,073	341,073	340,879	(194)
Hazardous Discharge Site Cleanup Fund (Act of 1985)	53,810,871	53,810,871	53,780,218	(30,653)
Higher Education Facility Renovation and Rehabilitation Fund	432,643	432,643	432,396	(247)
Historic Preservation Fund (Act of 1992)	5,693,210	5,693,210	5,689,967	(3,243)
Historic Preservation Fund (Act of 1995)	2,295,305	2,295,305	2,293,997	(1,308)
Historic Preservation Revolving Loan Fund	2,741,542	2,741,542	2,739,981	(1,561)
Horse Racing Injury Compensation	940,475	940,475	939,939	(536)
Housing Assistance Fund (Act of 1968)	16,157	16,157	16,148	(9)
Human Services Facilities Construction Fund (Act of 1984)	1,864,520	1,864,520	1,863,458	(1,062)
Institutional Construction Fund (Act of 1978)	6,990	6,990	6,986	(4)
Institutions Construction Fund (Act of 1976)	9,274	9,274	9,268	(6)
Jobs, Education, and Competitiveness Fund (Act of 1988)	15,053,998	15,053,998	15,045,422	(8,576)
Jobs, Science, and Technology Fund (Act of 1984)	48,167	48,167	48,139	(28)
Lake Restoration Fund	3,023,616	3,023,616	3,021,894	(1,722)
Medical Education Facilities Fund (Act of 1977)	540,044	540,044	539,737	(307)
Mortgage Assistance Fund (Act of 1976)	2,194,186	2,194,186	2,192,936	(1,250)
Natural Resources Fund (Act of 1980)	5,141,939	5,141,939	5,139,010	(2,929)
New Home Warranty Security Fund	32,356,923	32,356,923	32,338,491	(18,432)
New Jersey Bridge Rehabilitation and Improvement and Railroad Right of Way Preservation Fund	12,233,084	12,233,084	12,226,116	(6,968)
New Jersey Bridge Rehabilitation Fund (Act of 1983)	15,371,787	15,371,787	15,363,031	(8,756)
New Jersey Coastal Blue Acres Fund	2,984,457	2,984,457	2,982,757	(1,700)
New Jersey Dam Restoration & Clean Water Fund (Act of 1992)	7,983,610	7,983,610	7,979,063	(4,547)
New Jersey Green Acres Fund (Act of 1983)	21,525,803	21,525,803	21,513,541	(12,262)
New Jersey Green Acres Fund (Act of 1989)	1,828,046	1,828,046	1,827,004	(1,042)
New Jersey Green Acres Fund (Act of 1992)	8,043,506	8,043,506	8,038,924	(4,582)
New Jersey Green Acres Fund (Act of 1995)	6,961,289	6,961,289	6,957,323	(3,966)
New Jersey Green Trust Fund (Act of 1989)	28,625,078	28,625,078	28,608,772	(16,306)
New Jersey Green Trust Fund (Act of 1992)	22,713,092	22,713,092	22,700,153	(12,939)
New Jersey Green Trust Fund (Act of 1995)	16,326,001	16,326,001	16,316,701	(9,300)
New Jersey Inland Blue Acres Fund	4,479,369	4,479,369	4,476,817	(2,552)
New Jersey Medical Malpractice Reinsurance-Recovery Fund	12,463,179	12,463,179	12,456,080	(7,099)
New Jersey State Dental Program	10,742,695	10,742,695	10,736,575	(6,120)
Pension Adjustment Fund	5,151,728	5,151,728	5,148,793	(2,935)
Pension Payroll Investment Fund	8,618,209	8,618,209	8,613,300	(4,909)
Pinelands Infrastructure Trust Fund (Act of 1985)	3,320,216	3,320,216	3,318,325	(1,891)
Pollution Prevention Fund	3,564,004	3,564,004	3,561,974	(2,030)
Public Buildings Construction Fund (Act of 1968)	3,489	3,489	3,487	(2)
Public Purpose Buildings and Community-Based Facilities Construction Fund (Act of 1989)	13,160,400	13,160,400	13,152,903	(7,497)
Public Purpose Buildings and Construction Fund (Act of 1980)	470,424	470,424	470,156	(268)

SUMMARY OF AMOUNTS INVESTED BY FUND (CONCLUDED)
as of June 30, 1999

	Par, Cost or Principal Amount— Note 1	Cost— Note 1	Fair Value— Note 1	Fair Value Over (Under) Cost
TEMPORARY RESERVE GROUP—(continued)				
Resource Recovery & Solid Waste Disposal Facilities Fund (Act of 1985)	\$ 40,326,826	\$ 40,326,826	\$ 40,303,854	\$ (22,972)
Safe Drinking Water Fund	5,990,100	5,990,100	5,986,688	(3,412)
Shore Protection Fund (Act of 1983)	10,582,943	10,582,943	10,576,915	(6,028)
State Facilities for Handicapped Fund (Act of 1973)	210,893	210,893	210,773	(120)
State Health Benefits Fund	331,291,440	331,234,018	331,133,767	(100,251)
State Land Acquisition and Development Fund (Act of 1978)	1,268,340	1,268,340	1,267,617	(723)
State Lottery Fund—Investment	96,134,070	96,134,070	96,079,308	(54,762)
State of New Jersey—Alternate Benefit Program	9,232,837	9,232,837	9,227,578	(5,259)
State of New Jersey Cash Management Fund— Administrative Expense Fund	1,983,952	1,983,952	1,982,822	(1,130)
State of New Jersey Cash Management Fund— Other than State Funds	3,805,215,615	3,805,215,615	3,803,048,000	(2,167,615)
State of New Jersey Cash Management Fund— Reserve Fund	65,550,754	65,550,754	65,513,414	(37,340)
State of New Jersey Development Potential Transfer Bank Fund	3,091,160	3,091,160	3,089,399	(1,761)
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	1,838,006	1,838,006	1,836,959	(1,047)
Stormwater Management and Combined Sewer Overflow Abatement Fund	15,073,780	15,073,780	15,065,194	(8,586)
Transportation Rehabilitation and Improvement Fund (Act of 1979)	317,594	317,594	317,413	(181)
University of Medicine and Dentistry of New Jersey Self-Insurance Reserve Fund	92,948,440	92,299,789	92,107,988	(191,801)
Water Conservation Fund (Act of 1969)	2,928,624	2,928,624	2,926,956	(1,668)
Water Supply Fund (Act of 1981)	83,645,646	83,645,646	83,597,998	(47,648)
Water Supply Replacement Trust Fund	5,267,341	5,267,341	5,264,340	(3,001)
		<u>6,851,602,313</u>	<u>6,848,237,930</u>	<u>(3,364,383)</u>
TRUST GROUP				
New Jersey State Employees' Deferred Compensation Administrative Charges	602,096	602,096	601,753	(343)
New Jersey State Employees' Deferred Compensation Cash Management Fund	120,769,733	120,769,733	120,700,937	(68,796)
New Jersey State Employees' Deferred Compensation Equity Fund	296,226,120	296,226,120	670,476,413	374,250,293
New Jersey State Employees' Deferred Compensation Fixed Income Fund	123,994,781	125,666,476	125,691,565	25,089
New Jersey State Employees' Deferred Compensation Holding Account	7,432,449	7,432,449	7,428,215	(4,234)
New Jersey State Employees' Deferred Compensation Small Cap Equity Fund	43,153,409	43,153,409	59,386,215	16,232,806
Insurance Annuity Trust Fund	51,822	51,822	51,792	(30)
NJ Best Fund—Administrative Expenses	18,549	18,549	18,539	(10)
NJ Best Fund—Holding	296,195	296,195	296,026	(169)
NJ Best Fund—Investments	2,428,816	2,456,331	2,478,626	22,295
Supplemental Annuity Collective Trust Fund	93,995,128	93,995,128	231,679,894	137,684,766
Tischler Memorial Fund	647,789	646,112	652,539	6,427
		<u>691,314,420</u>	<u>1,219,462,514</u>	<u>528,148,094</u>
TOTAL AMOUNTS INVESTED BY FUNDS		<u><u>\$48,699,849,590</u></u>	<u><u>\$86,246,188,313</u></u>	<u><u>\$37,546,338,723</u></u>

See accompanying notes.

SUMMARY OF INVESTMENT INCOME BY FUND
for the Year Ended June 30, 1999

	Net Investment Earnings (Note 1)	Change in Unrealized Appreciation/ (Depreciation)	Net Gain (Loss) from Investment Transactions	Total Investment Income
PENSION AND ANNUITY GROUP				
Consolidated Police and Firemen's Pension Fund	\$ 2,554,866	\$ (347,121)	\$ 965	\$ 2,208,710
Judicial Retirement System of New Jersey	9,460,693	35,978,013	6,688,902	52,127,608
Police and Firemen's Retirement System	379,482,829	1,187,341,225	652,547,191	2,219,371,245
Prison Officers Pension Fund	1,016,204	(13,540)	—	1,002,664
Public Employees' Retirement System	593,580,908	1,903,253,849	946,134,828	3,442,969,585
State Police Retirement System	42,390,628	151,060,570	51,112,042	244,563,240
Teachers' Pension and Annuity Fund	736,806,665	2,355,141,775	1,175,317,799	4,267,266,239
	<u>1,765,292,793</u>	<u>5,632,414,771</u>	<u>2,831,801,727</u>	<u>10,229,509,291</u>
STATIC GROUP				
Trustees for the Support of Public Schools Fund	4,923,494	10,782,043	6,685,855	22,391,392
Waste Water Treatment Fund (Act of 1985)	11,956,742	(175,576)	—	11,781,166
Waste Water Treatment Fund (Act of 1992)	116,839	(1,312)	—	115,527
	<u>16,997,075</u>	<u>10,605,155</u>	<u>6,685,855</u>	<u>34,288,085</u>
DEMAND GROUP				
Atlantic City Casino Parking Fund	35,677	(964)	—	34,713
Atlantic City Tourism Promotion Fund	12,718	(188)	—	12,530
Boarding House Rental Assistance Fund	205,449	(2,785)	—	202,664
Body Armor Replacement Fund	65,178	(1,141)	—	64,037
Casino Simulcasting Fund	93,503	(1,285)	—	92,218
Casino Simulcasting Special Fund	287,092	(3,386)	—	283,706
Catastrophic Illness in Children Relief Fund (Act of 1987)	861,734	(10,235)	—	851,499
Clean Communities Account Fund (Act of 1985)	436,784	(4,865)	—	431,919
Development Fund—Luxury Tax	91,288	(1,235)	—	90,053
Division of Motor Vehicles Surcharge Fund	475,264	(3,087)	—	472,177
Dredging & Containment Facility Fund	374,162	(11,396)	—	362,766
Emergency Services Fund	111,265	(1,899)	—	109,366
Enterprise Zone Assistance Fund (Act of 1983)	7,680,474	(109,598)	—	7,570,876
Hazardous Discharge Fund (Act of 1986)	294,704	(2,292)	—	292,412
Health Care Subsidy Fund	3,378,562	(43,136)	—	3,335,426
Higher Education Assistance Fund	1,666,066	(17,421)	—	1,648,645
Higher Education Assistance Operating Fund	386,617	(12,263)	—	374,354
Korean Veterans' Memorial Fund	497	(2)	—	495
Luxury Tax Fund	18,771	(265)	—	18,506
Motor Vehicle Security Responsibility Fund	7,219	(98)	—	7,121
New Jersey Automobile Insurance Guaranty Fund	9,607,183	(124,253)	—	9,482,930
New Jersey Insurance Development Fund	2,074,932	(28,474)	—	2,046,458
New Jersey Spill Compensation Fund	2,315,964	(40,872)	—	2,275,092
Petroleum Overcharge Reimbursement Fund	1,333,530	(17,133)	—	1,316,397
Real Estate Guaranty Fund	78,135	(1,058)	—	77,077
Resource Recovery Investment Tax Fund (Act of 1985)	16,703	(230)	—	16,473
Sanitary Landfill Facility Contingency Fund	1,468,352	(20,642)	—	1,447,710
Solid Waste Services Tax Fund (Act of 1985)	291,558	(4,214)	—	287,344
State Disability Benefits Fund	4,730,524	(68,131)	—	4,662,393
State of New Jersey Judiciary—Bail Fund	1,579,769	(21,930)	—	1,557,839
State of New Jersey Judiciary—Child Support Fund	1,277,559	(17,105)	—	1,260,454
State of New Jersey Judiciary—Probation Fund	288,003	(4,456)	—	283,547
State of New Jersey Judiciary—Special Civil Fund	145,892	(1,993)	—	143,899
State of New Jersey Judiciary—Superior Court/ Other Miscellaneous Fund	197,798	(2,385)	—	195,413
State Recycling Fund	420,489	(5,974)	—	414,515
Tourism Improvement Development District Act Fund	7,983	(46)	—	7,937
Unclaimed Child Support Trust Fund	47,947	(634)	—	47,313
Unclaimed County Deposits Trust Fund	135,136	(1,797)	—	133,339
Unclaimed Insurance Payments on Deposit	100,617	(1,366)	—	99,251
Unclaimed Personal Property Trust Fund	3,465,190	(70,378)	—	3,394,812
Unemployment Compensation Auxiliary Fund	600,895	(13,031)	—	587,864
Unsatisfied Claim and Judgment Fund	15,467,990	(233,383)	—	15,234,607
Volunteer Emergency Service Organizations Loan Fund	50,059	(700)	—	49,359
Worker and Community Right to Know Fund	86,593	(1,130)	—	85,463
Workers' Compensation Security Fund—Mutual	520,075	(7,043)	—	513,032
Workers' Compensation Security Fund—Stock	3,864,582	(36,865)	—	3,827,717
Workforce Development Partnership Fund	4,849,171	(69,479)	—	4,779,692
	<u>71,505,651</u>	<u>(1,022,243)</u>	<u>—</u>	<u>70,483,408</u>

SUMMARY OF INVESTMENT INCOME BY FUND (CONTINUED)
for the Year Ended June 30, 1999

	Net Investment Earnings (Note 1)	Change in Unrealized Appreciation/ (Depreciation)	Net Gain (Loss) from Investment Transactions	Total Investment Income
TEMPORARY RESERVE GROUP				
Alcohol Education Rehabilitation and Enforcement Fund	\$ 310,910	\$ (3,921)	\$ —	\$ 306,989
Beaches and Harbors Fund (Act of 1977)	54,679	(178)	—	54,501
Capital City Redevelopment Loan and Grant Fund	129,303	(1,736)	—	127,567
Central Pension Fund	3,445	(10)	—	3,435
Clean Waters Fund (Act of 1976)	137,951	(1,889)	—	136,062
Community Development Bond Fund (Act of 1981)	1,188	(16)	—	1,172
Contributory Insurance Fund—PERS	5,337,926	(1,088,799)	—	4,249,127
Contributory Insurance Fund—TPAF	3,618,724	(623,853)	—	2,994,871
Correctional Facilities Construction Fund (Act of 1982)	40,062	(461)	—	39,601
Correctional Facilities Construction Fund (Act of 1987)	536,827	(12,122)	—	524,705
Development Disabilities Waiting List Reduction and Human Services Facilities Construction Bonds (Act of 1994)	803,246	(14,371)	—	788,875
Drinking Water State Revolving Fund	802	(1)	—	801
Emergency Flood Control Fund (Act of 1978)	16,521	(201)	—	16,320
Emergency Medical Technician Training Fund	399,426	(5,715)	—	393,711
Energy Conservation Fund (Act of 1980)	135,383	(1,694)	—	133,689
Farmland Preservation Fund (Act of 1981)	14,234	(189)	—	14,045
Farmland Preservation Fund (Act of 1989)	92,953	(1,258)	—	91,695
Farmland Preservation Fund (Act of 1992)	186,201	(3,190)	—	183,011
Farmland Preservation Fund (Act of 1995)	693,505	(16,075)	—	677,430
General Investment Fund	54,416,638	(1,153,090)	—	53,263,548
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	175,526	(2,743)	—	172,783
Green Trust Fund (Act of 1983)	605,294	(8,885)	—	596,409
Hazardous Discharge Fund (Act of 1981)	186,873	(846)	—	186,027
Hazardous Discharge Site Cleanup Fund (Act of 1985)	2,242,044	(35,277)	—	2,206,767
Higher Education Facility Renovation and Rehabilitation Fund	16,595	(335)	—	16,260
Historic Preservation Fund (Act of 1992)	205,409	(3,475)	—	201,934
Historic Preservation Fund (Act of 1995)	45,305	(1,308)	—	43,997
Historic Preservation Revolving Loan Fund	155,033	(1,950)	—	153,083
Horse Racing Injury Compensation Fund	47,191	(647)	—	46,544
Housing Assistance Fund (Act of 1968)	1,382	(16)	—	1,366
Human Services Facilities Construction Fund (Act of 1984)	98,549	(1,315)	—	97,234
Institutional Construction Fund (Act of 1978)	355	(5)	—	350
Institutions Construction Fund (Act of 1976)	471	(8)	—	463
Jobs, Education, and Competitiveness Fund (Act of 1988)	333,443	(9,014)	—	324,429
Jobs, Science, and Technology Fund (Act of 1984)	6,165	(55)	—	6,110
Lake Restoration Fund	23,616	(1,722)	—	21,894
Medical Education Facilities Fund (Act of 1977)	27,501	(375)	—	27,126
Mortgage Assistance Fund (Act of 1976)	98,443	(1,478)	—	96,965
Natural Resources Fund (Act of 1980)	272,323	(3,658)	—	268,665
New Home Warranty Security Fund	1,694,645	(371,560)	—	1,323,085
New Jersey Bridge Rehabilitation and Improvement and Railroad Right of Way Preservation Fund	305,690	(7,514)	—	298,176
New Jersey Bridge Rehabilitation Fund (Act of 1983)	348,285	(9,118)	—	339,167
New Jersey Coastal Blue Acres Fund	89,509	(1,700)	—	87,809
New Jersey Dam Restoration & Clean Water Fund (Act of 1992)	216,227	(4,854)	—	211,373
New Jersey Green Acres Fund (Act of 1983)	761,368	(14,978)	—	746,390
New Jersey Green Acres Fund (Act of 1989)	160,270	(1,602)	—	158,668
New Jersey Green Acres Fund (Act of 1992)	363,734	(5,443)	—	358,291
New Jersey Green Acres Fund (Act of 1995)	359,507	(4,867)	—	354,640
New Jersey Green Trust Fund (Act of 1989)	628,326	(16,805)	—	611,521
New Jersey Green Trust Fund (Act of 1992)	636,490	(13,137)	—	623,353
New Jersey Green Trust Fund (Act of 1995)	470,550	(9,784)	—	460,766
New Jersey Inland Blue Acres Fund 1995	124,411	(2,552)	—	121,859
New Jersey Medical Malpractice Reinsurance-Recovery Fund	1,063,231	(10,343)	—	1,052,888
New Jersey State Dental Program	498,205	(7,099)	—	491,106
Pension Adjustment Fund	499,863	(3,292)	—	496,571
Pension Payroll Investment Fund	860,478	(5,095)	—	855,383
Pinelands Infrastructure Trust Fund (Act of 1985)	165,103	(2,253)	—	162,850
Pollution Prevention Fund	195,818	(2,522)	—	193,296
Prescription Drug Program Fund	448,780	(735)	—	448,045
Public Buildings Construction Fund (Act of 1968)	177	(2)	—	175
Public Purpose Buildings and Community-Based Facilities Construction Fund (Act of 1989)	332,891	(7,952)	—	324,939

SUMMARY OF INVESTMENT INCOME BY FUND (CONCLUDED)
for the Year Ended June 30, 1999

	Net Investment Earnings (Note 1)	Change in Unrealized Appreciation/ (Depreciation)	Net Gain (Loss) from Investment Transactions	Total Investment Income
TEMPORARY RESERVE GROUP—(continued)				
Public Purpose Buildings and Construction Fund (Act of 1980)	\$ 36,783	\$ (432)	\$ —	\$ 36,351
Resource Recovery & Solid Waste Disposal Facilities Fund (Act of 1985)	1,953,443	(25,466)	—	1,927,977
Safe Drinking Water Fund	274,131	(4,164)	—	269,967
Shore Protection Fund (Act of 1983)	480,746	(7,373)	—	473,373
State Facilities for Handicapped Fund (Act of 1973)	11,198	(148)	—	11,050
State Health Benefits Fund	17,400,213	(594,996)	—	16,805,217
State Land Acquisition and Development Fund (Act of 1978)	50,037	(751)	—	49,286
State Lottery Fund—Investment	4,186,426	(65,952)	—	4,120,474
State of New Jersey Alternate Benefits Program	682,874	(6,859)	—	676,015
State of New Jersey Cash Management Fund— Administrative Expense Fund	74,822	(1,354)	—	73,468
State of New Jersey Cash Management Fund— Other than State Funds	191,171,686	(2,589,198)	—	188,582,488
State of New Jersey Cash Management Fund— Reserve Fund	3,187,788	(44,582)	—	3,143,206
State of New Jersey Development Potential Transfer Bank Fund	155,728	(2,135)	—	153,593
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	100,219	(1,334)	—	98,885
State Recreation and Conservation Land Acquisition Fund (Act of 1971)	3	—	—	3
Stormwater Management and Combined Sewer Overflow Abatement Fund	599,532	(10,174)	—	589,358
Transportation Rehabilitation and Improvement Fund (Act of 1979)	15,826	(219)	—	15,607
University of Medicine and Dentistry of New Jersey Self-Insurance Reserve Fund	5,797,808	(1,528,384)	53,588	4,323,012
Water Conservation Fund (Act of 1969)	169,796	(2,134)	—	167,662
Water Supply Fund (Act of 1981)	3,551,703	(57,060)	—	3,494,643
Water Supply Replacement Trust Fund	270,194	(3,659)	—	266,535
	<u>311,865,956</u>	<u>(8,451,462)</u>	<u>53,588</u>	<u>303,468,082</u>
TRUST GROUP				
New Jersey State Employees' Deferred Compensation:				
Administrative Charges	41,410	(435)	—	40,975
Cash Management Fund	5,651,047	(81,695)	—	5,569,352
Equity Fund	6,819,777	131,704,797	8,875,623	147,400,197
Fixed Income Fund	7,464,375	(2,107,663)	—	5,356,712
Holding Account	490,819	(5,071)	—	485,748
Small Cap Equity Fund	326,990	9,401,509	2,363,661	12,092,160
Insurance Annuity Trust Fund	2,217	(35)	—	2,182
NJBEST—Administrative Expenses	284	(10)	—	274
NJBEST—Holding	5,505	(169)	—	5,336
NJBEST—Investments	40,848	22,295	4,186	67,329
Supplemental Annuity Collective Trust Fund	3,062,042	18,887,698	20,173,276	42,123,016
Tischler Memorial Fund	33,988	(2,892)	—	31,096
	<u>23,939,302</u>	<u>157,818,329</u>	<u>31,416,746</u>	<u>213,174,377</u>
TOTAL INVESTMENT INCOME	<u>\$2,189,600,777</u>	<u>\$5,791,364,550</u>	<u>\$2,869,957,916</u>	<u>\$10,850,923,243</u>

See accompanying notes.

SUMMARY OF INVESTMENTS BY MAJOR CATEGORY
as of June 30, 1999

	Par, Cost or Principal Amount— Note 1	Cost— Note 1	Fair Value— Note 1	Fair Value Over (Under) Cost
U.S. Government and Other Government Bonds and Obligations	\$ 334,235,000	\$ 334,390,165	\$ 336,243,297	\$ 1,853,132
Industrial Bonds and Commercial Paper	25,500,000	25,425,483	24,860,790	(564,693)
Gas and Electric Bonds	1,500,000	1,542,660	1,504,095	(38,565)
Telephone Bonds	1,000,000	882,570	997,850	115,280
Finance Companies Senior Debt	3,500,000	3,515,600	3,577,983	62,383
Mortgage-Backed Certificates	3,086,681,419	3,037,874,397	3,009,440,641	(28,433,756)
Police and Firemen's Mortgage Program	491,020,530	491,020,530	489,994,561	(1,025,969)
Preferred Stocks	79,759	79,759	133,427	53,668
Common Stocks	437,445,468	437,445,468	1,028,629,218	591,183,750
Units—Common Pension Fund A	7,844,510,418	7,844,510,418	38,968,579,136	31,124,068,718
Units—Common Pension Fund B	15,026,741,782	15,026,741,782	15,688,136,504	661,394,722
Units—Common Pension Fund D	9,080,233,252	9,080,233,252	14,284,978,515	5,204,745,263
Units—Cash Management Fund	12,416,187,506	12,416,187,506	12,409,112,296	(7,075,210)
TOTAL INVESTMENTS BY MAJOR CATEGORY		<u>\$48,699,849,590</u>	<u>\$86,246,188,313</u>	<u>\$37,546,338,723</u>

See accompanying notes.

SUMMARY OF INVESTMENT ACTIVITY
for the Year Ended June 30, 1999

Purchases at cost, including common funds:		
Bonds	\$ 92,281,286	
Mortgages	1,534,334,879	
Stocks	<u>95,259,735</u>	\$ 1,721,875,900
Purchases of units of common funds, at cost		38,401,059,934
Unrealized appreciation		5,791,364,550
Sales		(80,079,589)
Mortgage principal repayments		(417,850,360)
Redemptions		(135,432,469)
Maturities		(108,400,000)
Redemptions of units of common funds		(38,049,516,459)
Realized gains distributed to funds		<u>2,879,711,305</u>
NET INCREASE IN INVESTMENTS		10,002,732,812
Total amounts invested by funds— Beginning of year Note 2		<u>76,243,455,501</u>
Total amounts invested by funds— END OF YEAR		<u><u>\$86,246,188,313</u></u>

NOTE 1—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.

Investment Valuation

Investments are stated at fair value.

Fair values of securities 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 securities 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. Other non-traded securities on the valuation date are priced by a commercial pricing service. Fair 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. Par, cost or principal amount are presented in the summaries for informational purposes.

The Police and Firemen's Retirement System (the "Fund") includes a mortgage loan program established by law in 1992. The program provides that participants of the Fund may receive mortgages from the Fund at rates which are fixed by formula. The law further provides that the Fund may not sell the mortgages, and therefore no independent market exists for them. As of June 30, 1999 the mortgage loan program had a cost of \$491,020,530 and an appraised value of \$489,994,561, determined using market prices obtained from an independent broker.

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.

Investment Income

Investment income includes interest earned, dividends, unrealized appreciation and the gain or loss from investment transactions. Interest and dividend income is accounted for on the accrual basis. Net investment gain includes realized gains and losses on security transactions and distributed gains from the State of New Jersey Cash Management Fund.

Administrative Expenses

Administrative expenses allocable to the Division 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.

Other

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income during the reporting period. Actual results could differ from those estimates.

NOTE 2—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, 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.

N.J.S.A. 52:18A-8.1 requires the Division to utilize only custodian banks with a principal office located in the State of New Jersey to safeguard the securities held. At June 30, 1999 the Division was not in compliance with this requirement because of mergers and acquisitions of New Jersey banks by out-of-state banks. Legislation is pending that will amend this law with respect to banks which can be selected as custodians of the funds.

Government Accounting Standards Board ("GASB") Statement No. 3 requires disclosure of the level of investment risk assumed by the Funds at June 30, 1999. Category 1 includes investments that are insured or registered, or securities held by the Division or its agent in the Funds' name. Category 2 includes uninsured and unregistered investments held by the Fund's trust department or agent in the Funds' name. Category 3 includes uninsured and unregistered investments held by a broker or dealer, or held by the Fund's trust department or agent but not in the Funds' name. As of June 30, 1999, all investments held by the Division were 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") or Participants Trust Company ("PTC") through the custodian banks in trust for the State of New Jersey.

Investment securities denominated in a foreign currency are maintained by the various established book entry systems, in the countries where available, through the custodian bank in trust for the State of New Jersey. In addition, certain investment securities denominated in a foreign currency are physically maintained by sub-custodian banks within the foreign country. The custodian banks, as agents for the State funds, maintain records identifying the securities as securities owned by or pledged to the State funds.

Domestic securities not maintained by the Federal Reserve Banks, DTC or PTC 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.

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 \$4,054,475,379 in fiscal year 1999, are not reflected in the Summary of Investment Income by Fund. Realized losses arising from foreign currency related transactions by Common Pension Fund D of \$150,280,415 in fiscal year 1999 are not reflected in the Summary of Investment Income by Fund. Undistributed investment income of \$1,951,819,003 as of June 30, 1999, arising from investment activity by Common Pension Fund D is not reflected in the Summary of Investment Income by Fund. These amounts are not reflected as they were not distributed to the holders of the Funds.

NOTES TO INVESTMENT SUMMARIES

NOTE 3—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, 1999, 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	Cost	Fair Value	Fair Value Over (Under) Cost
Industrial bonds and commercial paper	\$ 9,634,721,822	\$ 9,604,231,934	\$ 9,581,879,332	\$ (22,352,602)
Time certificates of deposit	1,750,000,000	1,750,484,190	1,750,500,000	15,810
U.S. Government and other government bonds and obligations	17,736,452,000	18,093,821,005	18,200,356,715	106,535,710
Foreign government bonds and notes	1,802,719,921	1,802,719,921	1,637,473,264	(165,246,657)
Foreign stocks	8,406,990,207	8,406,990,207	10,663,612,619	2,256,622,412
Telephone bonds	268,575,000	262,434,406	268,430,786	5,996,380
Gas and electric bonds	360,135,000	357,612,800	355,140,232	(2,472,568)
Common stocks	15,124,533,326	15,124,533,326	39,573,555,358	24,449,022,032
Preferred stocks	39,182,506	39,182,506	129,780,358	90,597,852
Mortgage-backed certificates	3,086,681,419	3,037,874,399	3,009,440,644	(28,433,755)
Police and Firemen's mortgage program	491,020,530	491,020,530	489,994,561	(1,025,969)
Merchant marine bonds	146,613,000	146,613,000	138,759,148	(7,853,852)
Finance companies senior debt	482,965,000	486,027,243	484,043,242	(1,984,001)
International bank bonds and notes	55,000,000	53,795,313	54,576,050	780,737
Total investments		<u>59,657,340,780</u>	<u>86,337,542,309</u>	<u>26,680,201,529</u>
Differences in accounting by unit funds:				
Other assets		2,492,301,569	2,482,382,290	(9,919,279)
Other liabilities		(4,599,947,562)	(2,574,728,007)	2,025,219,555
Undistributed realized gains and other income		<u>(8,849,845,197)</u>	<u>991,721</u>	<u>8,850,836,918</u>
Total amounts invested by funds		<u>\$48,699,849,590</u>	<u>\$86,246,188,313</u>	<u>\$37,546,338,723</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 27) includes the “Par, Cost, or Principal Amount” 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” of the investments held by the Unit Funds.
- II. Fair 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, 1999. The market value included in the total investments shown above reflects the fair value of the investments held by the Unit Funds.
- III. Total investments shown above do 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. 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 4—COMMITMENTS

As of June 30, 1999, Common Pension Fund D had entered into the following forward foreign currency exchange contract which contractually obligate the fund to deliver/receive at specified future dates. The open contracts were as follows:

Contract	Foreign Currency	In Exchange For	Value	Settlement Date	Unrealized Gain (Loss)
Purchases:					
CHF	30,000,000	\$ 19,802,307	\$ 19,356,072	07/26/99	\$ (446,235)
CHF	50,000,000	33,025,099	32,317,555	08/10/99	(707,544)
CHF	35,000,000	23,157,338	22,660,187	08/24/99	(497,151)
CHF	30,000,000	20,337,604	19,901,412	03/23/00	(436,192)
EUR	24,000,000	25,761,600	25,346,002	04/27/00	(415,598)
EUR	23,000,000	24,722,700	24,299,567	05/02/00	(423,133)
EUR	43,000,000	46,309,710	45,516,407	05/26/00	(793,303)
JPY	6,000,000,000	50,596,618	49,615,200	07/06/99	(981,418)
JPY	6,000,000,000	50,686,378	49,659,000	07/12/99	(1,027,378)
JPY	6,000,000,000	50,980,309	49,659,000	07/12/99	(1,321,309)
JPY	4,000,000,000	33,636,058	33,729,200	11/10/99	93,142
SEK	450,000,000	53,376,984	53,290,710	10/14/99	(86,274)
Subtotal					<u>(7,042,393)</u>
Sales:					
JPY	6,000,000,000	53,175,933	49,615,200	07/06/99	3,560,733
JPY	8,000,000,000	72,661,217	66,172,800	07/08/99	6,488,417
JPY	6,000,000,000	54,975,261	49,659,000	07/12/99	5,316,261
JPY	3,000,000,000	25,534,088	24,829,500	07/12/99	704,588
JPY	3,000,000,000	25,475,111	24,829,500	07/12/99	645,611
CHF	30,000,000	22,107,590	19,356,072	07/26/99	2,751,518
EUR	20,000,000	23,417,000	20,666,300	07/26/99	2,750,700
GBP	65,000,000	104,715,000	102,483,023	08/03/99	2,231,977
CHF	50,000,000	35,714,286	32,317,555	08/10/99	3,396,731
CHF	35,000,000	24,630,542	22,660,187	08/24/99	1,970,355
JPY	3,500,000,000	30,421,556	29,276,100	09/20/99	1,145,456
EUR	55,000,000	64,350,000	57,190,375	10/14/99	7,159,625
SEK	450,000,000	55,411,895	53,290,710	10/14/99	2,121,185
JPY	8,000,000,000	68,846,816	67,212,000	10/18/99	1,634,816
JPY	4,000,000,000	36,429,873	33,729,200	11/10/99	2,700,673
JPY	4,000,000,000	33,911,237	33,729,200	11/10/99	182,037
DKK	290,000,000	44,629,117	40,703,559	11/16/99	3,925,558
JPY	6,000,000,000	54,460,793	50,641,800	11/16/99	3,818,993
GBP	15,000,000	24,667,500	23,681,854	11/17/99	985,646
GBP	15,000,000	24,645,000	23,681,854	11/17/99	963,146
EUR	110,000,000	122,160,500	114,835,116	12/03/99	7,325,384
DKK	325,000,000	48,041,390	45,688,955	12/08/99	2,352,435
EUR	23,000,000	25,630,050	24,216,840	03/20/00	1,413,210
CHF	30,000,000	21,276,596	19,901,412	03/23/00	1,375,184
EUR	12,000,000	13,168,800	12,652,904	04/07/00	515,896
EUR	16,000,000	17,424,800	16,889,286	04/21/00	535,514
EUR	24,000,000	26,163,000	25,346,001	04/27/00	816,998
GBP	55,000,000	88,825,000	87,024,965	04/27/00	1,800,035
EUR	60,000,000	65,388,000	63,365,004	04/27/00	2,022,996
EUR	23,000,000	25,136,700	24,299,566	05/02/00	837,133
JPY	2,500,000,000	21,739,130	21,669,750	05/08/00	69,380
JPY	6,000,000,000	52,137,643	52,063,200	05/15/00	74,443
JPY	6,000,000,000	50,933,786	52,134,600	05/24/00	(1,200,814)
EUR	43,000,000	46,693,700	45,516,407	05/26/00	1,177,293
JPY	6,500,000,000	55,770,056	56,530,500	05/30/00	<u>(760,444)</u>
Subtotal					<u>72,808,669</u>
Total open forward foreign currency contracts					<u>\$65,766,276</u>

REQUIRED SUPPLEMENTARY INFORMATION

June 30, 1999

Year 2000 Issue

The Division and its outside vendors (including governmental entities) each use software that may be affected by the date change in the Year 2000 and recognize that the arrival of the Year 2000 poses challenges that will require modifications to portions of its software to function properly. As the Year 2000 approaches, date sensitive systems may recognize the Year 2000 as 1900 or not at all. This may cause systems to fail or to process critical operational information incorrectly, resulting in disruption of operations, including, among other things, a temporary inability to engage in normal business activities.

The Division has interface systems with third parties (including various State agencies) which could result in Year 2000 issues. The Division is in the process of communicating with its vendors, suppliers and business partners to determine their current levels of compliance; however, there is no guarantee that the systems of these third parties, or others on which the Division rely, will be timely converted and will not have an adverse effect on the Division's operations.

The Division has completed the awareness, assessment, remediation and validation/testing stages. The costs of implementing the Year 2000 issues did not have a material adverse impact on the Division's financial position.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the Division is or will be Year 2000 ready, that the Division's remediation efforts will be successful in whole or in part, or that parties with whom the Division does business will be Year 2000 ready.

**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	
	Original Cost	Fair Value	Original Cost	Fair Value	Original Cost	Fair Value
SHORT-TERM OBLIGATIONS						
U.S. Government and other government securities and obligations	\$ 6,914	\$ 6,948	\$ 8,800	\$ 8,843	\$ 402,952	\$ 404,904
Commercial paper	8,589	8,606	10,932	10,952	500,562	501,525
Time certificates of deposit	2,839	2,838	3,613	3,613	165,421	165,422
	<u>18,342</u>	<u>18,392</u>	<u>23,345</u>	<u>23,408</u>	<u>1,068,935</u>	<u>1,071,851</u>
LONG-TERM OBLIGATIONS						
U.S. Government and other government securities and obligations	17,507	17,472	56,972	57,348	2,462,632	2,478,738
Industrial bonds	15	15	13,498	13,374	580,250	574,929
Gas and electric bonds	52	52	1,672	1,660	72,072	71,521
Telephone bonds	—	—	1,296	1,325	55,715	56,967
Finance companies—senior debt	—	—	2,391	2,381	102,782	102,347
Intermediate-term corporate notes	948	945	6,004	5,976	261,459	260,241
International Government bonds and notes	—	—	14,923	14,016	575,651	540,888
	<u>18,522</u>	<u>18,484</u>	<u>96,756</u>	<u>96,080</u>	<u>4,110,561</u>	<u>4,085,631</u>
MORTGAGES						
Mortgage-backed certificates	8,403	8,313	32,126	31,851	1,212,090	1,200,618
STOCKS						
Common stock (U.S.)	—	—	194	643	8,329	27,617
Preferred stock	—	—	72,785	191,016	3,128,578	8,210,667
Common stock (International)	—	—	48,144	61,067	1,851,112	2,347,992
	<u>—</u>	<u>—</u>	<u>121,123</u>	<u>252,726</u>	<u>4,988,019</u>	<u>10,586,276</u>
	45,267	45,189	273,350	404,065	11,379,605	16,944,376
Difference due to accounting practices	(262)	(305)	(40,925)	(13,133)	(2,575,950)	(337,237)
	<u>\$45,005</u>	<u>\$44, 884</u>	<u>\$232,425</u>	<u>\$390,932</u>	<u>\$ 8,803,655</u>	<u>\$16,607,139</u>

**INCLUDING INVESTMENTS OWNED BY THE COMMON PENSION FUNDS AND THE STATE OF NEW JERSEY
(000's Omitted) at June 30, 1999**

Prison Officers Pension Fund		Public Employees' Retirement System		State Police Retirement System		Teachers' Pension and Annuity Fund		Totals	
Original Cost	Fair Value	Original Cost	Fair Value	Original Cost	Fair Value	Original Cost	Fair Value	Original Cost	Fair Value
\$ 5,821	\$ 5,849	\$ 470,982	\$ 473,263	\$ 30,451	\$ 30,599	\$ 737,245	\$ 740,816	\$ 1,663,165	\$ 1,671,222
7,231	7,244	585,070	586,196	37,828	37,900	915,832	917,594	2,066,044	2,070,017
2,390	2,390	193,349	193,350	12,501	12,501	302,655	302,658	682,768	682,772
<u>15,442</u>	<u>15,483</u>	<u>1,249,401</u>	<u>1,252,809</u>	<u>80,780</u>	<u>81,000</u>	<u>1,955,732</u>	<u>1,961,068</u>	<u>4,411,977</u>	<u>4,424,011</u>
3,240	3,226	3,844,607	3,870,835	268,146	269,992	4,794,173	4,825,852	11,447,277	11,523,463
13	13	928,306	919,796	65,086	64,489	1,136,311	1,125,891	2,723,479	2,698,507
43	43	114,050	113,158	7,978	7,915	140,765	139,683	336,632	334,032
—	—	89,171	91,176	6,252	6,393	109,118	111,571	261,552	267,432
—	—	164,503	163,805	11,535	11,486	201,300	200,447	482,511	480,466
798	795	394,617	392,754	27,317	27,188	504,949	502,589	1,196,092	1,190,488
—	—	808,740	760,265	66,450	62,431	1,151,354	1,081,746	2,617,118	2,459,346
<u>4,094</u>	<u>4,077</u>	<u>6,343,994</u>	<u>6,311,789</u>	<u>452,764</u>	<u>449,894</u>	<u>8,037,970</u>	<u>7,987,779</u>	<u>19,064,661</u>	<u>18,953,734</u>
—	—	993,902	984,611	78,711	78,008	1,203,663	1,196,036	3,528,895	3,499,437
—	—	13,331	44,201	936	3,099	16,313	54,088	39,103	129,648
—	—	5,007,275	13,141,138	351,103	921,439	6,127,348	16,080,667	14,687,089	38,544,927
—	—	2,588,997	3,283,942	213,874	271,283	3,704,863	4,699,329	8,406,990	10,663,613
—	—	7,609,603	16,469,281	565,913	1,195,821	9,848,524	20,834,084	23,133,182	49,338,188
19,536	19,560	16,196,900	25,018,490	1,178,168	1,804,723	21,045,889	31,978,967	50,138,715	76,215,370
(222)	(257)	(3,641,384)	95,042	(251,706)	13,367	(4,356,424)	257,574	(10,866,873)	15,051
<u>\$19,314</u>	<u>\$19,303</u>	<u>\$12,555,516</u>	<u>\$25,113,532</u>	<u>\$ 926,462</u>	<u>\$1,818,090</u>	<u>\$16,689,465</u>	<u>\$32,236,541</u>	<u>\$ 39,271,842</u>	<u>\$76,230,421</u>

**UNAUDITED COMMON PERFORMANCE DISCLOSURE FORM
FOR PUBLIC FUNDS**

	Avg. Annual Return 5 Years Ended 6/30/99	One Year Period Ended				
		6/30/95	6/30/96	6/30/97	6/30/98	6/30/99
TOTAL RETURN						
Aggregate of All Pension Funds	19.3%	19.7%	16.1%	22.1%	22.7%	16.1%
Consumer Price Index	2.4%	3.0%	2.8%	2.3%	1.7%	2.0%
STOCK TOTAL RETURNS						
Common Pension Fund A—All Stocks	28.2%	26.0%	23.7%	32.7%	31.0%	27.6%
Common Pension Fund A—Small Capitalization Stocks Approved List	24.4%	27.1%	18.1%	14.1%	26.9%	37.0%
Dow Jones Industrial Average	27.8%	27.0%	26.4%	32.4%	29.9%	23.4%
Standard & Poor's 500 Index	27.4%	29.2%	27.1%	38.6%	18.5%	24.6%
Russell 2000 Index	27.9%	26.1%	26.0%	34.7%	30.1%	22.7%
	15.4%	20.1%	23.8%	16.3%	16.5%	1.5%
FIXED INCOME TOTAL RETURNS						
Common Pension Fund B and Other Bonds	8.0%	13.6%	4.3%	8.0%	11.8%	2.8%
Lehman Brothers Government/Corporate Bond Index	7.8%	12.7%	4.7%	7.8%	11.3%	2.8%
Salomon Brothers Broad Bond Index	7.8%	12.6%	5.0%	8.2%	10.5%	3.1%
MORTGAGES—TOTAL RETURNS						
Pension fund holdings	8.4%	13.9%	5.5%	9.7%	10.2%	3.4%
Salomon Brothers Mortgage Index	7.9%	12.1%	5.8%	9.0%	8.9%	4.1%
INTERNATIONAL TOTAL RETURNS						
Common Fund D Total—Hedged	11.9%	9.1%	14.0%	16.2%	15.6%	4.9%
Common Fund D Fixed Income	7.4%	20.6%	7.2%	2.1%	5.4%	2.9%
Common Fund D Stocks	13.2%	10.1%	10.6%	20.7%	19.4%	5.7%
Salomon World Gov. Bond Index—Unhedged	6.1%	18.8%	0.4%	3.9%	4.3%	4.1%
EAFE International Stock Index	8.2%	1.7%	13.3%	12.8%	6.1%	7.7%
CASH EQUIVALENTS						
Total Returns—Cash Management Fund—Compounded	5.6%	5.5%	5.8%	5.7%	5.8%	5.4%
91-Day Treasury Bills	5.2%	5.4%	5.4%	5.3%	5.3%	4.7%

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 and comparative purposes only.

