



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



FORTIETH ANNUAL REPORT

For the Fiscal Year Ended June 30, 1990



JAMES J. FLORIO
Governor



DOUGLAS C. BERMAN
State Treasurer

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

Submitted by the
State Investment Council

For the Fiscal Year ended June 30, 1990

November 15, 1990

To the Honorable:

The Governor;

The Legislature;

The State Treasurer;

We are pleased to submit the Annual Report of the Division of Investment, Department of the Treasury, for the fiscal year ended June 30, 1990, as required by Section 13, P.L. 1950, c. 170. This report is a summary of the activities of the Division during the year. Separate reports are also prepared for the Supplemental Annuity Collective Trust and the State of New Jersey Cash Management Fund, both of which are available upon request from the Investment Division.

The Investment Division, under the jurisdiction of the State Investment Council, has the investment responsibility for 121 funds, including seven pension and annuity funds. The book value of all funds on June 30, 1990, was \$26.3 billion, compared to \$24.1 billion at the end of the prior year, and the market value of the funds was \$31.0 billion, compared with \$27.7 billion at the end of the previous fiscal year. The Council is equally balanced between employee representatives and gubernatorial appointees. State law mandates that no Council member can be an elected official or an official in a political party, and none can benefit from the transactions of the Division.

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

Fiscal 1990 provided strong, positive returns for the Division. The returns on book value of the pension funds met the statutory requirements set by state law. Furthermore, the estimated total returns of the pension funds, which include income and changes in market value of the securities held by the funds, was 13.3 percent, which compares with a 14.5 percent for fiscal 1989. For the past five fiscal years the estimated average annual total return of the pension funds was 14.1 percent. Appendix II sets forth the estimated total returns of the state administered pension funds. The total returns of the pension funds ranked the Division in the top third of all balanced fund managers in fiscal 1990, and in the top fifth of such managers for the five year period ended June 30, 1990.

All investments under the supervision of the Council must conform to standards of prudence set by state law, which mandate that the Division make investments in which fiduciaries of trust estates may legally invest. Such investments are further defined as investments in property of every nature, provided the fiduciary shall exercise care and judgment under the circumstances then prevailing, which persons of ordinary prudence and reasonable discretion exercise. The Council has resolved that the Division is bound by law to make prudent investments for the sole and direct benefit of the beneficiaries of the various funds under the supervision of the Council, and that the Division may not make any concession as to rate, risk or terms which would benefit any other party at the expense of the beneficiaries of such funds.

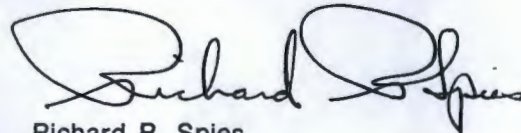
In recent years members of the public, political figures and lobbyists have raised the issue as to whether investments under the jurisdiction of the Council should be guided by non-financial considerations. Such investments could be directed regionally or toward specific capital markets or could be averted from certain areas. The Council has considered each of these issues as they have arisen and has concluded, with the concurrence of the Attorney General's office, that state law requires that the

financial merits of each investment are the only considerations provided for by law. However, social and regional issues may have financial implications for fund beneficiaries, and the Division analyzes such implications in the determination of its investment decisions. The policies of the Council regarding social investment are discussed in detail herein. Council policies have been reviewed by special gubernatorial commissions established by both Governors Byrne and Kean, representing different political parties, and both commissions support the present structure and policies of the Council. Summaries of these reports are included herein.

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

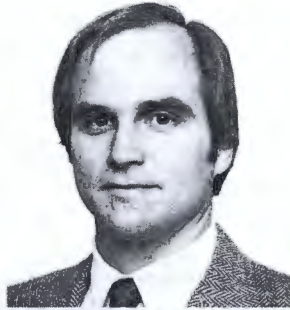
For each of the past 40 years, the Council has requested and obtained a review of the records and procedures of the Division by an independent accountant. The accountant's report for the current year is included in this report.

Respectfully submitted,

A handwritten signature in dark 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



FREDERICK HALPERN



ROBERT T. HOFFMAN



WILLIAM W. PRIEST, JR.



ARTHUR W. WHITE, JR.



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



HARRY W. BALDWIN
Teachers' Pension and
Annuity Fund



REGINE BROWN
Public Employees'
Retirement System



JAMES H. JEFFERY
State Police
Retirement System



JAMES M. KOPLEY
Police and Firemen's
Retirement System

Division of Investment



ROLAND M. MACHOLD
Director



ANTHONY O. ARCUNI
Deputy Director



STEVEN E. KORNRUMPF
Assistant Director



Staff of the Division on the steps of the Division, 349 West State Street, Trenton.



Administration Group: Eleanor Chiaramonti, Clementine Gardner, Roland Machold, Cathy Ryan, Steve Kornrumpf, Pat Osvai, Tony Arcuni, and Celeste Brennan.



Portfolio Management Group: Fred Lansmann, Linda Thompson, John Jacknowitz, Helen Imbalzano, Maryann Smith, Tim Patton, Bruce Smith, Sandra Holmes, and Jack Pennington.



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



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



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



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



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



Data Processing Group: Nick Maximenia, Jackie Henderson, Ed Meyers, and Sandi Glass.

FIVE YEAR SUMMARY

Fiscal Year Ended June 30,

1986	1987	1988	1989	1990
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\$ Millions

FUNDS UNDER THE SUPERVISION OF THE STATE INVESTMENT COUNCIL:

Book Value at Year End:

Pension Funds	\$12,943	\$15,046	\$17,405	\$19,517	\$21,697
All Funds	16,973	19,825	22,443	24,115	26,286

Book Value of All Investments at Year End by Category:

U.S. and other Government bonds	\$ 7,679	\$ 9,320	\$10,635	\$10,485	\$10,834
Commercial Paper, Bankers' Acceptances and Certificates of Deposit	596	621	1,126	1,458	1,508
Corporate Bonds and Other	1,927	1,367	764	1,279	1,692
Mortgages	1,715	2,214	2,603	3,141	3,635
Common Stocks	5,056	6,303	7,315	7,752	8,617
	\$16,973	\$19,825	\$22,443	\$24,115	\$26,286

Investment Income:

Pension Funds	\$ 981	\$ 1,027	\$ 1,174	\$ 1,360	\$ 1,517
All Funds	1,220	1,256	1,475	1,681	1,867

Weighted Average Effective Rate of Return (1):

Pension Funds	7.57%	7.09%	6.95%	7.30%	7.30%
All Funds	7.39	6.92	6.89	7.60	7.45

Weighted Average Effective Rate of Return for New Investment (2):

Short Term Securities	7.31%	6.11%	6.70%	8.86%	8.45%
Long Term Securities	9.53	8.21	9.35	9.06	8.64

Total Rate of Return (3):

Common Pension Fund A (4)	38.4%	23.8%	(10.2)%	16.6%	18.7%
Common Pension Fund B (4)	25.2	4.2	7.4	13.0	7.2
All Pension Funds, Estimated (4)	30.9	14.9	(0.7)	14.5	13.3 (5)
Supplemental Annuity Collective Trust	40.3	21.8	(10.4)	13.5	14.7
Deferred Compensation Plan—Equity	36.2	21.3	(11.5)	15.2	19.6
Deferred Compensation Plan—Debt	19.9	4.2	7.0	11.5	7.1

Returns of Various Market Indices:

Salomon Brothers' Mortgage Index	17.1%	8.3%	9.4%	11.8%	9.7%
Salomon Brothers' High Grade Corporate Bond Index	27.6	5.1	8.5	16.2	6.0
Shearson Lehman Government/Corporate Bond Index	20.7	4.7	7.5	12.3	7.1
S&P's 500	35.9	25.2	(6.9)	20.5	16.5
S&P's 400	36.6	29.8	(7.9)	18.8	19.2
Dow Jones Industrials Average	47.9	32.2	(8.3)	18.7	22.7
N.Y.S.E. Composite	29.6	18.8	(9.7)	15.2	9.9

State of New Jersey Cash Management Fund:

Book Value of Units of Participation:

All Participants	\$ 4,450	\$ 4,807	\$ 5,381	\$ 4,936	\$ 5,740
Other-than-State Participants	1,038	995	1,299	1,118	1,437

Average Annualized Daily Rate of Return:

State Participants	7.53%	5.97%	6.88%	8.08%	8.57%
Other-than-State Participants	7.37	5.82	6.67	7.95	8.42

Number of Funds Under the Supervision

of the State Investment Council	107	109	108	110	121
Total Number of Transactions	25,219	27,413	36,410	32,281	34,600

1. Represents the average yield on the book value of all securities in the portfolio as of the end of the fiscal year. The yield is calculated as the interest or dividends on each security as a function of its amortized cost. See a discussion of effective rates of return herein under "The Year's Activities."
2. The weighted average effective rate of return for new investment is the average yield realized on new investment during the year and is representative of market yields available for the period. The yield is calculated in the manner described in note 1 above.
3. Total rate of return includes income and changes in market prices for securities held by the funds during the period shown.
4. Common Pension Funds A and B are the principal vehicles for investment by the pension funds in stocks and bonds, respectively. The returns cited are for the whole portfolios and reflect a small amount of cash equivalents. Returns for stocks and bonds alone are shown in Appendix II, as are estimated total returns for the pension funds.
5. The stock market sold off sharply in the first quarter of fiscal 1991 in response to the Iraqi invasion of Kuwait; however, bond returns were slightly positive for the period, and the estimated total return of the pension funds for the quarter was a negative 5.7%.

The Year's Activities

Summary Financial Information

The 121 investment funds under the supervision of the Council on June 30, 1990, had a book value of \$26.3 billion. This total represents an increase of 9.0 percent over the 1989 fiscal year-end total of \$24.1 billion held by 110 funds. The investment funds had a market value of \$31.0 billion at June 30, 1990, an increase of 11.9 percent over the market value of \$27.7 billion at June 30, 1989. The market value of the seven pension funds increased from \$23.0 billion at June 30, 1989, to \$26.3 billion at June 30, 1990. The market value of the pension funds increased due to moderate economic growth and higher stock prices.

Investment income for all funds for fiscal 1990 amounted to \$1.9 billion as compared with \$1.7 billion last year. The slight increase is due to higher fund balances and improved dividends on the Division's stock holdings.

The average effective rate of return on long-term fixed-income securities (maturing in more than one year) purchased during the year was 8.64 percent as compared with 9.06 percent in fiscal 1989. The effective rate of return on purchases of short-term securities (maturing in one year or less) was 8.45 percent as compared with the 8.86 percent rate reported last year.

During the year, the Division of Investment purchased securities with a par value of \$95.4 billion. Approximately 58 percent of this amount, or \$55.4 billion, represented the overnight investment of surplus balances in the state's cash accounts. In fiscal 1989, the Division purchased securities with a par value of \$62.3 billion, of which \$38.1 billion was generated by overnight investments. During fiscal 1990, the Division's net holdings of mortgages increased from \$3.1 billion to \$3.8 billion.

The Division sold securities totaling \$1.7 billion in fiscal 1990, compared with sales of \$3.3 billion in the prior year. Many of the sales were made to meet cash requirements, to take advantage of market opportunities, or in response to the divestiture legislation. Such sales resulted in net realized profits of \$302 million during the year, compared with \$389 million for the prior year. The transactions information in this paragraph includes transactions effected within the common funds, which are not included separately in the financial summaries in this report.

Effective Rates of Return

The average effective rate of return of the pension fund portfolios remained at 7.30 percent at June 30, 1990.

The following table shows the effective rates of return of the respective pension funds, together with the "regular interest" rates established July 1, 1990, by the State Treasurer for use by the pension fund actuaries:

	<u>"Regular Interest"</u> <u>Rates Established by</u> <u>the State Treasurer</u>	<u>Effective Rate</u> <u>of Return at</u> <u>June 30, 1990</u>
Consolidated Police & Firemen's Pension Fund	6.00%	8.33%
Judicial Retirement System	6.50	7.29
Police & Firemen's Retirement System	7.00	7.29
Prison Officers Pension Fund	6.50	8.24
Public Employees, Retirement System	7.00	7.27
State Police Retirement System	6.50	7.27
Teachers' Pension & Annuity Fund	6.875	7.32

The effective rates shown above are the weighted average income returns on the book value of all securities held in the respective portfolios, including bonds, other fixed income investments and stocks, as of a specific point in time, or, in the case of the table above, as of June 30, 1990. The effective rates do not reflect market appreciation or depreciation of securities held by the pension funds. These book effective rates are computed in accordance with the long-standing procedures used by the Division of Investment.

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

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

the calculation of book effective rates until after the fact.

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

The average effective rate of the pension funds remained at 7.30 percent at the end of fiscal 1990 as interest rates remained fairly stable throughout the year and common stock dividends rose moderately.

Fixed Income

Total fixed income allocations for new investment in fiscal 1990 totalled \$1,380.0 million, of which \$595.0 million was allocated to the purchase of U.S. Government and corporate debt securities, on a very selective basis. The remaining \$785.0 million of funds for new investment was allocated to the purchase of mortgage-backed securities issued by various agencies supported by the U.S. Government.

In fiscal 1990, the Division purchased \$347.5 million of Federal Home Loan Mortgage Corporation (FHLMC) 15 year mortgage-backed securities and \$625.0 million of Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) 30 year mortgage-backed securities. Sales of mortgage-backed securities in fiscal 1990 totalled \$253.6 million, which reflected transactions which were effected on behalf of the various pension funds.

Common Pension Funds

Under the authority granted by P.L. 1970, c. 270, the Division has created Common Pension Fund A and Common Pension Fund B to consolidate investments of five of the pension systems in stocks and bonds, respectively. At June 30, 1990, the book value of the units of ownership of both Common Pension Fund A and Common Pension Fund B were \$8.3 billion. The State of New Jersey Cash Management Fund provides a vehicle for the pension funds to make short-term investments.

During fiscal 1990, the Council approved the distribution of \$347 million of realized gains from Common Pension Fund A to the participating pension funds.

Total Rate of Return Calculations for Selected Portfolios

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

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

SEI Evaluation Services has provided the Division with calculations of total return, and their data shows that the total returns for Common Pension Funds A and B in fiscal 1990 were 18.7 percent and 7.2 percent, respectively. Common Pension Funds A and B represent, in the aggregate, 48.5 percent and 31.9 percent, respectively, of the market value of the total pension fund portfolios.

The remaining securities held directly by the pension funds consist primarily of mortgages and industrial bonds. If the returns provided by Indata for these portfolios are used for these holdings, it is possible to estimate that the total return of the aggregate pension fund portfolios was approximately 13.3 percent in fiscal 1990, compared with a return of 14.5 percent in fiscal 1989 and a negative return of 0.7 percent in fiscal 1988. Subsequent to the close of fiscal 1990, the stock market sold off sharply in response to the Iraqi invasion of Kuwait; however, the bond market gained slightly, and the estimated total return of the pension funds was a negative 5.7 percent for the first quarter of fiscal 1991.

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

The State of New Jersey Cash Management Fund

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

The total book value of the units of participation in the fund increased from \$4.9 billion at June 30, 1989, to \$5.7 billion at June 30, 1990, due to higher balances in the state's pension accounts and the accounts of participating municipalities and state agencies.

The net investment income of the fund was \$421 million in fiscal 1990, compared with \$371 million in fiscal 1989. The number of participating state funds increased from 110 to 121 during the year.

During fiscal 1990 the number of "Other-than-State" participants increased from 547 to 560, and

the aggregate investment of "Other-than-State" participants was about \$1.4 billion at the end of fiscal 1990, compared with about \$1.1 billion at the end of fiscal 1989.

The average daily annualized rate of return to participating state accounts and accounts of the pension funds was 8.57 percent during fiscal 1990, compared with 8.08 percent during fiscal 1989. During fiscal 1990, the highest daily annualized rate of return to "Other-than-State" participants was 9.25 percent on October 3, 1989, and the lowest was 7.97 percent on June 8, 1990. The average daily annualized rate of return to "Other-than-State" participants, which is net of two small charges, was 8.42 percent in fiscal 1990, compared with 7.95 percent in fiscal 1989.

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 1990 would have been 8.78 percent, compared with 8.25 percent in the prior year. The higher rates of return during fiscal 1990 were the result of higher interest rates available in the markets for short term debt investments, particularly in the first half of the fiscal year.

Historical Background

Legislative History

Fiscal 1990 marks 40 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 121 funds in 1990, with a book value of \$26.3 billion.

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

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

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

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

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

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

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

The Legislature has also enacted laws that 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 Division has established Common Pension Fund A and Common Pension Fund B, which pool a portion of the investments of five pension funds in stocks and bonds, respectively.

This law also authorized the creation of the State of New Jersey Cash Management Fund, which was created in 1977 to pool investments in short-term debt obligations by certain state funds, including the pension funds. In fiscal 1978, legislation (P.L. 1977, c. 281) was enacted which permits counties, municipalities, school districts and the agencies and authorities created by any of these entities or the state to participate in the fund. Such participation began in January 1978. In fiscal 1990, the Council created a new Common Pension Fund D to form an investment vehicle for investment in international stocks and bonds.

On August 27, 1985, Governor Kean signed into law an act, P.L. 1985, c. 308, which states that "no assets of any pension and annuity fund shall be invested in any bank or financial institution which directly or through a subsidiary has outstanding loans to the Republic of South Africa or its instrumentalities, and no assets shall be invested in the stocks, securities or other obligations of any company engaged in business in or with the Republic of South Africa." Furthermore, the Council and the Division shall effect divestment "within three years of the effective date of the act." The act further provides that certain reports had to be filed on a quarterly and semi-annual basis. The final report to the Legislature for the period July 1, 1988, through August 27, 1988, and cumulatively for the period August 27, 1985, through August 27, 1988, was attached in full as Appendix II to the Council's Annual Report for fiscal 1988. This report showed that the divestment of \$4.2 billion (book value) of targeted securities was completed in full. The issue of South Africa divestment is discussed here in greater detail under "Social Investment."

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

Regulations of the State Investment Council

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

Present regulations of the State Investment Council limit the authority of the Director to invest in common stock. At present the Council limits the permissible level of pension fund stock holdings in domestic companies, which is based upon the total book value of units of participation in Common Pension Fund A, to 40 percent of the book value of any one pension fund. At June 30, 1990, the aggregate common stock holdings of the pension funds were 38 percent, as defined, of the total book value of the funds. The market value of the units of Common Pension Fund A represented 48 percent of the total market value of the pension funds at June 30, 1990. 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 that meet specific eligibility standards.

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

In fiscal 1990, the Council reviewed all of the outstanding regulations in accordance with state law, and amended many in order to add clarity to the language or to add minor modifications. The most significant new regulations which were approved by the Council and which became effective

during the year pertained to international investment. These regulations create a new Common Pension Fund D to hold a balanced portfolio of international stocks and bonds. Such investments are limited to 5 percent of the book value of the total pension fund portfolio, and investments in stocks are limited to 2 percent of the book value of the portfolio. At least 75 percent of the currency risk of the portfolio will be hedged in the currency markets. During the year, the state retained a custodian bank for the new fund and investments in the fund will be initiated in fiscal 1991.

Review 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 nonprofessional employees could remain in the Civil Service salary structure and system; (c) professional salaries would be set by the Council and possibly could be designed to incorporate performance bonuses; and (d) the Council would have the flexibility to provide necessary personnel depth for the Division. The Council has taken these matters up with appropriate state officials, but, to date, only the first part of item (a) above has been implemented.

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

commitment to stocks of up to 40 percent by the pension funds. However, the Council refrained from increasing the limitation to 50 percent in view of the prospective enactment of South Africa divestment legislation which would have the effect of limiting available stock investments to a universe of smaller companies with a higher risk profile.

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

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

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

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

a. The company should have growth in revenues and earnings which exceed growth in the Gross National Product;

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

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

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

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

f. The company should have conservative accounting practices.

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

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

The Council also considered the further pooling of direct holdings of pension fund bond assets. The Council concluded that pooling of the bonds held directly by the pension funds would permit greater operating efficiencies and better measurement of pension fund performance. By the end of fiscal 1990, only a very small percentage of pension fund assets was represented by direct bond holdings.

In fiscal 1990, the Council continued to review the legislative and regulatory definitions of risk and return for the pension funds and studied various asset allocation and portfolio optimization simulations. As a result of these reviews and studies, in July 1990, the Council approved four new regulations which would enable the Division to invest in international

stocks and bonds. In doing so, the Council acknowledged that the state's divestment legislation had reduced the universe available for investment. Furthermore, the studies noted that the world is approaching a global economy, wherein large corporations based abroad have major manufacturing plants and significant numbers of employees in the United States, and, conversely, many corporations based in the United States maintain substantial operations abroad. Finally, the studies showed that international investments in developed countries had historically provided higher returns with lower levels of risk than had investments in the United States.

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

Also, during fiscal 1990, the Council initiated a review of all broad investment policies. This review is still in process.

Council Procedures and Reports

The State Investment Council meets at least six times a year, and the Executive Committee of the

Council may meet in intervening months. In addition to reviewing and formulating all major policy issues related to the state's investments, the Council reviews the investment programs and returns of each fund on a periodic basis. Furthermore, each year the Council reviews each of the major classes of assets held by the Division, including stocks, industrial bonds, utility bonds, bank stocks and indebtedness, U.S. Government securities, mortgages and commercial paper, and finance company debt. These reviews are extensive and encompass financial, economic and social factors. For instance, in 1990, the report on securities issued by utilities analyzed issues associated with the implementation of nuclear power plants and with deregulation. Similar reports on other classes of securities analyzed the exposure of American banks to foreign loans, real estate loans and loans to support leveraged buyouts, and governmental support for farm credit and mortgage programs.

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

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

Social Investment

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

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

In fiscal 1986, the Division initiated a program whereby on a monthly basis the Division offered to purchase New Jersey mortgages from New Jersey banking institutions at market rates, as mandated by prudence law. Once a month the Division determines the true market level for a package of mortgages backed by an agency of the U.S. Government. The Division immediately offers this price to interested New Jersey financial institutions for identical mortgages which originate in New Jersey. In effect, the Division creates an "open window" to buy at market prices New Jersey mortgages guaranteed by U.S. Government agencies. In fiscal 1990, \$8.4 million of New Jersey mortgages were purchased by the Division under this program. Fiscal 1990 was a year of high liquidity in the U.S. banking system, and mortgages originated in the state were readily absorbed in the national capital market.

Reports of Gubernatorial Commissions

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

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

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

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

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

commensurate with their responsibilities. This is not being done currently and should be addressed as soon as possible.

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

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

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

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

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

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, in-

vestments which benefit the fund beneficiaries need not exclude investments in New Jersey or those which advance other social goals. All of the members of the Council are New Jersey residents, and for many years the Division and the Council have reflected concerns of New Jerseyans through internal policy guidelines. In 1984 these were codified, and they are listed below:

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

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

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

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

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

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

7. The Division of Investment should identify New Jersey employers on any "approved lists" provided under regulations of the State Investment Council for the purchase of common stocks, commercial paper and certificates of deposit.

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

Voting of Proxy Statements

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

During fiscal 1990, the Division voted on 191 corporate proxies. On 60 proxies the Division voted against the recommendations of corporate management on a total of 94 individual proposals. Of these proposals, 58 concerned changes in corporate governance procedures designed to reduce shareholder voting power in order to protect the company against acquisition suitors, 25 related to corporate activities in South Africa, three related to executive compensation, seven related to compliance of the corporation with the MacBride principles in Northern Ireland, and one required an environmental report.

South African Divestment

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

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

divestiture and further states that "nothing in the act should be construed to require the premature or otherwise imprudent sale, redemption, divestment or withdrawal of an investment."

At August 27, 1988, the date set for the completion of the divestment program, the pension and annuity programs managed by the Division had sold or otherwise disposed of all of the \$4.2 billion (book value) of securities targeted by the law, and at August 27, 1988, the pension and annuity funds managed by the Division were entirely free of securities of companies which do business in or with the Republic of South Africa.

The final report to the Legislature indicated that the transaction costs incurred in effecting the divestment program were about \$43 million, and that another unanticipated \$7 million of identifiable opportunity costs were incurred in the State of New Jersey Cash Management Fund. The final report also stated that the Division believes that the prospective ongoing costs of the divestment program are considerably in excess of the original \$25 million annual cost estimate provided by the Council in April 1985.

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

The Division continues to monitor the activities of corporations in South Africa. In fiscal 1990, subsequent to the completion of the mandated divestment program, a number of large American corporations cut their ties to South Africa and once again became eligible for investment by the state pension funds. To the knowledge of the Division, no American corporation, whose securities were held by the Division, established new relations with or activities in South Africa; however, several corporations were affected when they acquired other corporations with activities in South Africa. In every such case, the acquiring corporation has indicated that they have disposed of the South Africa-related activity, or the Division has a period of grace under the law to dispose of the affected securities, and the Division remains in compliance with the law.

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the amortized cost basis on the accompanying Summaries of Amounts Invested by Fund and Investments by Major Category of the various pension and other State funds maintained by the Division of Investment, Department of the Treasury, State of New Jersey as of June 30, 1990, the related summaries of investment income by fund and investment activity for the year then ended. These summaries are the responsibility of the Division of Investment's management. Our responsibility is to express an opinion on these summaries based on our audit.

In connection with our audit of the aforementioned summaries, we audited the records maintained on the amortized cost basis by the Division of Investment, Department of the Treasury, State of New Jersey for the various funds under the jurisdiction of the State Investment Council and the various funds of the State agencies and authorities (see Note A). The accompanying summaries have been derived from those records.

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

In our opinion, the summaries referred to above present fairly, in all material respects, the investments by fund and major category which are carried at amortized cost and held for the various funds at June 30, 1990, and their investment income and investment activity for the year then ended, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the amortized cost of investments by fund and by major category taken as a whole. The par, cost or principal amount, market value and market value over (under) amortized cost at June 30, 1990 have been subjected to the auditing procedures applied in our audit of the amortized cost and, in our opinion, are fairly stated in all material respects.

Ernst & Young

Princeton, New Jersey
August 24, 1990

SUMMARY OF AMOUNTS INVESTED BY FUND
June 30, 1990

	Par, Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
PENSION AND ANNUITY GROUP				
Consolidated Police and Firemen's Pension Fund	\$ 74,179,784	\$ 73,420,891	\$ 72,975,843	\$ (445,048)
Judicial Retirement System of New Jersey	83,706,674	83,479,593	98,548,117	15,068,524
Police and Firemen's Retirement System	4,350,018,858	4,323,220,976	5,223,687,873	900,466,897
Prison Officers Pension Fund	1,111,468	1,111,468	1,111,468	—
Public Employees' Retirement System	7,676,015,385	7,631,005,039	9,316,014,976	1,685,009,937
State Police Retirement System	490,226,117	488,736,849	587,640,397	98,903,548
Teachers' Pension and Annuity Fund	9,152,548,576	9,096,165,972	11,034,832,528	1,938,666,556
		<u>21,697,140,788</u>	<u>26,334,811,202</u>	<u>4,637,670,414</u>
STATIC GROUP				
Rutgers Medical School—Restricted Fund	1,116,999	1,118,043	1,286,645	168,602
Trustees for the Support of Free Public Schools Fund	58,324,996	57,787,910	73,904,687	16,116,777
University of Medicine and Dentistry of New Jersey—Construction Grant Fund	9,989,806	9,989,806	9,989,806	—
University of Medicine and Dentistry of New Jersey—Grant Fund	366,690	364,518	312,363	(52,155)
University of Medicine and Dentistry of New Jersey—Grant Fund B	16,426	16,426	16,426	—
Waste Water Treatment Fund (Act of 1985)	36,509,070	36,509,070	36,509,070	—
Waste Water Treatment Trust Fund (Act of 1985)	2,784,073	2,784,073	2,784,073	—
		<u>108,569,846</u>	<u>124,803,070</u>	<u>16,233,224</u>
DEMAND GROUP				
Boarding House Rental Assistance Fund	17,042,791	17,042,791	17,042,791	—
Catastrophic Illness in Children's Relief Fund (Act of 1987)	10,244,050	10,244,050	10,244,050	—
Clean Communities Account Fund (Act of 1985)	14,330,482	14,330,482	14,330,482	—
Development Fund Luxury Tax	4,992,450	4,992,450	4,992,450	—
Emergency Services Fund	3,342,231	3,342,231	3,342,231	—
Enterprise Zone Assistance Fund (Act of 1983)	15,609,432	15,609,432	15,609,432	—
Higher Education Assistance Fund	34,626,523	34,626,523	34,626,523	—
Luxury Tax Fund	18,740,660	18,740,660	18,740,660	—
Motor Vehicle Security Responsibility Fund	149,321	149,321	149,321	—
New Jersey Automobile Insurance Guaranty Fund	46,173,559	46,173,559	46,173,559	—
New Jersey Insurance Development Fund	80,074,407	79,991,215	80,260,405	269,190
New Jersey Spill Compensation Fund	87,278,055	87,278,055	87,278,055	—
Outstanding Checks Account	13,235,188	13,235,188	13,235,188	—
Real Estate Guaranty Fund	795,624	795,624	795,624	—
Resource Recovery Investment Tax Fund (Act of 1985)	50,664,381	50,664,381	50,664,381	—
Sanitary Landfill Facility Contingency Fund	36,668,177	36,668,177	36,668,177	—
Solid Waste Services Tax Fund (Act of 1985)	16,583,388	16,583,388	16,583,388	—
State Disability Benefits Fund	185,485,541	185,314,789	185,640,340	325,551
State Recycling Fund	25,704,778	25,704,778	25,704,778	—
Unclaimed Personal Property Trust Fund	81,875,300	81,848,932	81,931,879	82,947
Uncompensated Care Trust Fund (Act of 1986)	36,026,373	36,026,373	36,026,373	—
Unemployment Compensation Auxiliary Fund	23,474,612	23,474,612	23,474,612	—
Unsatisfied Claim and Judgment Fund	227,300,906	227,300,906	227,300,906	—
Volunteer Emergency Service Organizations Loan Fund	141,058	141,058	141,058	—
Worker and Community Right to Know Fund	5,772,882	5,772,882	5,772,882	—
Workmen's Compensation Security Fund—Mutual	7,103,606	7,102,588	7,103,107	519
Workmen's Compensation Security Fund—Stock	60,959,045	60,933,601	60,946,566	12,965
		<u>1,104,088,046</u>	<u>1,104,779,218</u>	<u>691,172</u>
TEMPORARY RESERVE GROUP				
Alcohol Education Rehabilitation and Enforcement Fund	16,795,974	16,781,402	16,816,574	35,172
Beaches and Harbors Fund (Act of 1977)	1,843,820	1,843,820	1,843,820	—
Capital City Redevelopment Loan and Grant Fund	5,409,459	5,409,459	5,409,459	—
Clean Waters Fund (Act of 1976)	8,406,582	8,406,582	8,406,582	—
Community Development Bond Fund (Act of 1981)	3,575,206	3,575,206	3,575,206	—
Correctional Facilities Construction Fund (Act of 1982)	6,172,626	6,172,626	6,172,626	—
Correctional Facilities Construction Fund (Act of 1987)	62,684,051	62,684,051	62,684,051	—
Emergency Flood Control Fund (Act of 1978)	7,484,154	7,484,154	7,484,154	—
Energy Conservation Fund (Act of 1980)	23,222,474	23,222,474	23,222,474	—
Farmland Preservation Fund (Act of 1981)	6,817,993	6,817,993	6,817,993	—
Farmland Preservation Fund (Act of 1989)	5,101,454	5,101,454	5,101,454	—
General Investment Fund	777,101,023	777,089,304	777,069,979	(19,325)
General Trust Fund	16,067	16,067	16,067	—

SUMMARY OF AMOUNTS INVESTED BY FUND—(CONTINUED)

June 30, 1990

	Par, Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	28,072,077	28,072,077	28,072,077	—
Green Trust Fund (Act of 1983)	23,363,456	23,363,456	23,363,456	—
Hazardous Discharge Fund (Act of 1981)	43,872,505	43,872,505	43,872,505	—
Hazardous Discharge Site Cleanup Fund (Act of 1985)	21,402,546	21,402,546	21,402,546	—
Higher Education Buildings Construction Fund (Act of 1971)	561,146	561,146	561,146	—
Housing Assistance Fund (Act of 1968)	576,222	576,222	576,222	—
Human Services Facilities Construction Fund (Act of 1984)	8,138,381	8,138,381	8,138,381	—
Institutional Construction Fund (Act of 1978)	665,395	665,395	665,395	—
Institutions Construction Fund (Act of 1976)	212,745	212,745	212,745	—
Jobs, Science and Technology Fund (Act of 1984)	2,314,752	2,314,752	2,314,752	—
Jobs, Education and Competitiveness Fund (Act of 1988)	52,034,832	52,034,832	52,034,832	—
Medical Education Facilities Fund (Act of 1977)	560,248	560,248	560,248	—
Mortgage Assistance Fund (Act of 1976)	3,168,937	3,168,937	3,168,937	—
Natural Resources Fund (Act of 1980)	15,966,448	15,966,448	15,966,448	—
New Home Warranty Security Fund	56,554,329	56,510,816	56,644,329	133,513
New Jersey Bridge Rehabilitation Fund (Act of 1983)	35,207,058	35,207,058	35,207,058	—
New Jersey Bridge Rehabilitation and Improvement and Railroad Right-of-Way Preservation Fund	10,202,908	10,202,908	10,202,908	—
New Jersey Local Development Financing Fund	2,233,386	2,233,386	2,233,386	—
New Jersey Green Acres Fund (Act of 1983)	15,602,597	15,602,597	15,602,597	—
New Jersey Green Trust Fund (Act of 1989)	4,081,163	4,081,163	4,081,163	—
New Jersey Medical Malpractice Reinsurance Recovery Fund	3,826,200	3,826,200	3,826,200	—
New Jersey State Dental Program	8,028,708	8,028,708	8,028,708	—
Pension Adjustment Fund	13,977,933	13,977,933	13,977,933	—
Pension Payroll Investment Fund	1,417,444	1,417,444	1,417,444	—
Pinelands Infrastructure Trust Fund (Act of 1985)	9,368,102	9,368,102	9,368,102	—
Prescription Drug Program Fund	3,111,566	3,111,566	3,111,566	—
Public Buildings Construction Fund (Act of 1968)	2,135,446	2,135,446	2,135,446	—
Public Purpose Buildings and Community-Based Facilities Construction Fund	12,243,490	12,243,490	12,243,490	—
Public Purpose Buildings Construction Fund (Act of 1980)	11,196,823	11,196,823	11,196,823	—
Resource Recovery and Solid Waste Disposal Facility Fund (Act of 1985)	10,957,301	10,957,301	10,957,301	—
Safe Drinking Water Fund	6,932,125	6,932,125	6,932,125	—
Salem Municipal Port Authority Assistance Fund (Act of 1987)	128,557	128,557	128,557	—
School Building Aid—Capital Reserve Fund	866,412	866,412	866,412	—
Shore Protection Fund (Act of 1983)	14,883,269	14,883,269	14,883,269	—
State Facilities for Handicapped Fund (Act of 1973)	2,579,088	2,579,088	2,579,088	—
State Health Benefits Fund	129,576,534	129,436,651	129,510,234	73,583
State Land Acquisition and Development Fund (Act of 1978)	14,949,141	14,949,141	14,949,141	—
State Lottery Fund—Investment	57,909,155	57,909,155	57,909,155	—
State of New Jersey—Alternate Benefit Program	11,094,881	11,094,881	11,094,881	—
State of New Jersey Cash Management Fund— Administrative Expense Fund	684,339	684,339	684,339	—
State of New Jersey Cash Management Fund— Other than State Funds	1,438,104,552	1,438,104,552	1,438,104,552	—
State of New Jersey Cash Management Fund— Reserve Fund	12,114,990	12,114,990	12,114,990	—
State Recreation and Conservation Land Acquisition Fund (Act of 1971)	776,010	776,010	776,010	—
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	5,321,595	5,321,595	5,321,595	—
State Transportation Fund (Act of 1968)	2,824,283	2,824,283	2,824,283	—
State Water Development Fund (Act of 1958)	92,592	92,592	92,592	—
Stormwater Management and Combined Sewer Overflow Abatement Fund	5,101,454	5,101,454	5,101,454	—
Transportation Rehabilitation and Improvement Fund (Act of 1979)	31,574,477	31,574,477	31,574,477	—
University of Medicine and Dentistry of New Jersey—Self-Insurance Reserve Fund	17,074,470	17,001,226	17,137,330	136,104
Urban Development Investment Fund (Act of 1985)	223,236	223,236	223,236	—
Veterans' Guaranteed Loan Fund	6,883	6,883	6,883	—
Water Conservation Fund (Act of 1969)	3,304,551	3,304,551	3,304,551	—
Water Supply Fund (Act of 1981)	37,050,821	37,050,821	37,050,821	—
Water Supply Replacement Trust Fund	9,017,553	9,017,553	9,017,553	—
		3,127,593,064	3,127,952,111	359,047

SUMMARY OF AMOUNTS INVESTED BY FUND—(CONTINUED)
June 30, 1990

	Par, Cost Or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
TRUST GROUP				
New Jersey State Employees' Deferred Compensation Administrative Charges	292,535	292,535	292,535	—
New Jersey State Employees' Deferred Compensation Cash Management Fund	62,865,866	62,865,866	62,865,866	—
New Jersey State Employees' Deferred Compensation Equity Fund	38,995,787	38,995,787	47,623,993	8,628,206
New Jersey State Employees' Deferred Compensation Fixed Income Fund	28,182,838	28,238,437	28,048,383	(190,054)
New Jersey State Employees' Deferred Compensation Holding Account	2,255,661	2,255,661	2,255,661	—
Supplemental Annuity Collective Trust Fund	108,041,195	108,041,195	133,085,891	25,044,696
Tischler Memorial Fund	475,409	471,963	477,413	5,450
University of Medicine and Dentistry of New Jersey—Endowment Funds	1,508,586	1,508,503	1,508,507	4
University of Medicine and Dentistry of New Jersey—Endowment Fund B	5,788,307	5,792,852	9,379,952	3,587,100
		<u>248,462,799</u>	<u>285,538,201</u>	<u>37,075,402</u>
TOTAL AMOUNTS INVESTED BY FUNDS		<u><u>\$26,285,854,543</u></u>	<u><u>\$30,977,883,802</u></u>	<u><u>\$4,692,029,259</u></u>

See notes to investment summaries.

SUMMARY OF INVESTMENT INCOME BY FUND

Year Ended June 30, 1990

	Net Investment Earnings— Note A	Gain Or (Loss)— Note A	Total Income
PENSION AND ANNUITY GROUP			
Consolidated Police and Firemen's Pension Fund	\$ 6,800,705	\$ —	\$ 6,800,705
Judicial Retirement System of New Jersey	6,074,881	1,060,187	7,135,068
Police and Firemen's Retirement System	301,062,131	1,273,812	302,335,943
Prison Officers Pension Fund	184,356	—	184,356
Public Employees' Retirement System	547,229,891	5,867,207	553,097,098
State Police Retirement System	34,659,228	3,868,236	38,527,464
Teachers' Pension and Annuity Fund	620,688,749	1,626,114	622,314,863
	<u>1,516,699,941</u>	<u>13,695,556</u>	<u>1,530,395,497</u>
STATIC GROUP			
Rutgers Medical School—Restricted Fund	123,453	—	123,453
Trustees for the Support of Free Public Schools Fund	5,001,966	1,874,283	6,876,249
University of Medicine and Dentistry of New Jersey—Construction Grant Fund	884,339	—	884,339
University of Medicine and Dentistry of New Jersey—Grant Fund	28,982	—	28,982
University of Medicine and Dentistry of New Jersey—Grant Fund B	50,610	—	50,610
Waste Water Treatment Fund (Act of 1985)	1,287,305	—	1,287,305
Waste Water Treatment Trust Fund (Act of 1985)	196,129	—	196,129
	<u>7,572,784</u>	<u>1,874,283</u>	<u>9,447,067</u>
DEMAND GROUP			
Boarding House Rental Assistance Fund	1,270,404	—	1,270,404
Catastrophic Illness in Children Relief Fund (Act of 1987)	750,593	—	750,593
Clean Communities Account Fund (Act of 1985)	1,161,347	—	1,161,347
Development Fund—Luxury Tax	455,400	—	455,400
Emergency Services Fund	289,154	—	289,154
Enterprise Zone Assistance Fund (Act of 1983)	1,218,940	—	1,218,940
Higher Education Assistance Fund	3,263,965	—	3,263,965
Luxury Tax Fund	1,420,401	—	1,420,401
Motor Vehicle Liability Security Fund	180,944	(8,647)	172,297
Motor Vehicle Security Responsibility Fund	12,765	—	12,765
New Jersey Automobile Insurance Guaranty Fund	244,559	—	244,559
New Jersey Insurance Development Fund	7,219,374	—	7,219,374
New Jersey Spill Compensation Fund	6,846,059	—	6,846,059
Outstanding Checks Account	1,079,889	—	1,079,889
Real Estate Guaranty Fund	91,790	—	91,790
Resource Recovery Investment Tax Fund (Act of 1985)	3,260,004	—	3,260,004
Sanitary Landfill Facility Contingency Fund	3,274,670	—	3,274,670
Solid Waste Services Tax Fund (Act of 1985)	1,491,578	—	1,491,578
State Disability Benefits Fund	16,480,348	—	16,480,348
State Recycling Fund	2,300,094	—	2,300,094
Unclaimed Personal Property Trust Fund	5,385,180	—	5,385,180
Uncompensated Care Trust Fund (Act of 1986)	2,006,228	—	2,006,228
Unemployment Compensation Auxiliary Fund	2,150,899	—	2,150,899
Unsatisfied Claim and Judgment Fund	10,840,682	—	10,840,682
Volunteer Emergency Service Organizations Loan Fund	31,058	—	31,058
Worker and Community Right to Know Fund	568,306	—	568,306
Workmen's Compensation Security Fund—Mutual	706,755	—	706,755
Workmen's Compensation Security Fund—Stock	4,911,562	—	4,911,562
	<u>78,912,948</u>	<u>(8,647)</u>	<u>78,904,301</u>
TEMPORARY RESERVE GROUP			
Alcohol Education Rehabilitation and Enforcement	1,416,178	—	1,416,178
Beaches and Harbors Fund (Act of 1977)	136,198	—	136,198
Capital City Redevelopment Loan and Grant Fund	460,706	—	460,706
Clean Waters Fund (Act of 1976)	939,880	—	939,880
Community Development Bond Fund (Act of 1981)	266,683	—	266,683
Correctional Facility Construction Fund (Act of 1982)	954,355	—	954,355
Correctional Facility Construction Fund (Act of 1987)	4,187,198	—	4,187,198
Emergency Flood Control Fund (Act of 1978)	250,189	—	250,189
Energy Conservation Fund (Act of 1980)	2,005,166	—	2,005,166
Farmland Preservation Fund (Act of 1981)	854,448	—	854,448

SUMMARY OF INVESTMENT INCOME BY FUND—(CONTINUED)
Year Ended June 30, 1990

	Net Investment Earnings— Note A	Gain Or (Loss)— Note A	Total Income
TEMPORARY RESERVE GROUP—(continued)			
Farmland Preservation Fund (Act of 1989)	84,455	—	84,455
General Investment Fund	69,983,495	66,031	70,049,526
General Trust Fund	1,367	—	1,367
Green Acres Cultural Centers and Historic Preservation Bond Fund (Act of 1987)	571,783	—	571,783
Green Trust Fund (Act of 1983)	2,122,285	—	2,122,285
Hazardous Discharge Fund (Act of 1981)	726,315	—	726,315
Hazardous Discharge Site Cleanup Fund (Act of 1985)	1,522,345	—	1,522,345
Higher Education Buildings Construction Fund (Act of 1971)	48,531	—	48,531
Housing Assistance Fund (Act of 1968)	50,900	—	50,900
Human Services Facility Construction Fund (Act of 1984)	289,594	—	289,594
Institutional Construction Fund (Act of 1978)	64,260	—	64,260
Institutions Construction Fund (Act of 1976)	24,943	—	24,943
Jobs, Science and Technology Fund (Act of 1984)	577,742	—	577,742
Jobs, Education and Competitiveness Fund (Act of 1988)	861,443	—	861,443
Medical Education Facilities Fund (Act of 1977)	47,704	—	47,704
Mortgage Assistance Fund (Act of 1976)	255,338	—	255,338
Natural Resources Fund (Act of 1980)	1,474,598	—	1,474,598
New Home Warranty Security Fund	4,677,175	—	4,677,175
New Jersey Bridge Rehabilitation Fund (Act of 1983)	3,306,013	—	3,306,013
New Jersey Bridge Rehabilitation and Improvement and Railroad Right-of-Way Preservation Fund	168,910	—	168,910
New Jersey Local Development Financing Fund	110,701	—	110,701
New Jersey Green Acres Fund (Act of 1983)	1,465,709	—	1,465,709
New Jersey Green Trust Fund (Act of 1989)	67,564	—	67,564
New Jersey Medical Malpractice Reinsurance Recovery Fund	21,200	—	21,200
New Jersey State Dental Program	635,855	—	635,855
Pension Adjustment Fund	1,411,979	—	1,411,979
Pension Payroll Investment Fund	495,553	—	495,553
Pinelands Infrastructure Trust Fund (Act of 1985)	890,781	—	890,781
Prescription Drug Program Fund	349,680	—	349,680
Public Buildings Construction Fund (Act of 1968)	191,133	—	191,133
Public Purpose Buildings and Community-Based Facilities Construction Fund	202,692	—	202,692
Public Purpose Buildings Construction Fund (Act of 1980)	603,985	—	603,985
Resource Recovery and Solid Waste Disposal Facility Fund (Act of 1985)	616,320	—	616,320
Safe Drinking Water Fund	588,410	—	588,410
Salem Municipal Port Authority Assistance Fund (Act of 1987)	81,768	—	81,768
School Building Aid—Capital Reserve Fund	75,322	—	75,322
Shore Protection Fund (Act of 1983)	1,491,135	—	1,491,135
State Facilities for Handicapped Fund (Act of 1973)	219,873	—	219,873
State Health Benefits Fund	11,382,707	—	11,382,707
State Land Acquisition and Development Fund (Act of 1978)	747,517	—	747,517
State Lottery Fund—Investment	3,083,486	—	3,083,486
State of New Jersey—Alternate Benefit Program	896,139	—	896,139
State of New Jersey Cash Management Fund— Administrative Expense Fund	56,142	—	56,142
State of New Jersey Cash Management Fund— Other than State Funds	115,631,290	—	115,631,290
State of New Jersey Cash Management Fund— Reserve Fund	935,603	—	935,603
State Recreation and Conservation Land Acquisition Fund (Act of 1971)	74,158	—	74,158
State Recreation and Conservation Land Acquisition and Development Fund (Act of 1974)	616,237	—	616,237
State Transportation Fund (Act of 1968)	293,817	—	293,817
State Water Development Fund (Act of 1958)	17,352	—	17,352
Stormwater Management and Combined Sewer Overflow Abatement Fund	84,455	—	84,455
Transportation Rehabilitation and Improvement Fund (Act of 1979)	2,847,285	—	2,847,285

SUMMARY OF INVESTMENT INCOME BY FUND—(CONTINUED)
Year Ended June 30, 1990

	Net Investment Earnings— Note A	Gain Or (Loss)— Note A	Total Income
TEMPORARY RESERVE GROUP—(continued)			
University of Medicine and Dentistry of New Jersey—Self-Insurance Reserve Fund	1,312,999	—	1,312,999
Urban Development Investment Fund (Act of 1985)	27,407	—	27,407
Veterans' Guaranteed Loan Fund	564	—	564
Water Conservation Fund (Act of 1969)	347,493	—	347,493
Water Supply Fund (Act of 1981)	3,469,903	—	3,469,903
Water Supply Replacement Trust Fund	255,063	—	255,063
	<u>249,929,474</u>	<u>66,031</u>	<u>249,995,505</u>
TRUST GROUP			
New Jersey State Employees' Deferred Compensation Administration Charges	47,011	—	47,011
New Jersey State Employees' Deferred Compensation Cash Management Fund	4,902,326	—	4,902,326
New Jersey State Employees' Deferred Compensation Equity Fund	1,442,205	1,992,676	3,434,881
New Jersey State Employees' Deferred Compensation Fixed Income Fund	2,024,484	—	2,024,484
New Jersey State Employees' Deferred Compensation Holding Account	263,337	—	263,337
Supplemental Annuity Collective Trust Fund	4,843,260	15,702,446	20,545,706
Tischler Memorial Fund	40,464	—	40,464
University of Medicine and Dentistry of New Jersey—Endowment Funds	127,136	—	127,136
University of Medicine and Dentistry of New Jersey—Endowment Fund B	537,939	—	537,939
	<u>14,228,162</u>	<u>17,695,122</u>	<u>31,923,284</u>
TOTALS	<u><u>\$1,867,343,309</u></u>	<u><u>\$33,322,345</u></u>	<u><u>\$1,900,665,654</u></u>

See notes to investment summaries.

SUMMARY OF INVESTMENTS BY MAJOR CATEGORY
June 30, 1990

	Par, Cost or Principal Amount— Note A	Amortized Cost— Note A	Market— Note A	Market Over (Under) Amortized Cost
U.S. Government and other government bonds and obligations	\$ 324,966,600	\$ 322,439,799	\$ 323,991,619	\$ 1,551,820
Industrial bonds and commercial paper	10,480,000	10,481,477	10,158,671	(322,806)
Telephone bonds	31,927,500	31,663,322	28,524,481	(3,138,841)
Gas, electric and water bonds	147,186,500	146,443,589	137,482,087	(8,961,502)
Finance companies—senior debt	8,175,000	7,954,562	7,817,344	(137,218)
Common stocks	142,065,271	142,065,271	194,927,462	52,862,191
Mortgage-backed certificates	3,762,757,228	3,634,780,180	3,656,162,007	21,381,827
Units—Common Pension Fund A	8,261,371,267	8,261,371,267	12,773,469,913	4,512,098,646
Units—Common Pension Fund B	8,284,284,175	8,284,284,175	8,401,099,588	116,815,413
Units—State of New Jersey Cash Management Fund	5,438,142,385	5,438,142,385	5,438,142,385	—
Other investments	6,236,000	6,228,516	6,108,245	(120,271)
TOTAL AMOUNTS INVESTED BY FUNDS		<u><u>\$26,285,854,543</u></u>	<u><u>\$30,977,883,802</u></u>	<u><u>\$4,692,029,259</u></u>

See notes to investment summaries.

SUMMARY OF INVESTMENT ACTIVITY

Year Ended June 30, 1990

Purchases at cost:		
Bonds	\$ 318,673,774	
Mortgages	1,066,061,641	
Stocks	87,799,872	
Units of common funds	<u>19,204,843,609</u>	\$20,677,378,896
Discount accretion		11,508,194
Sales, at amortized cost		(579,849,991)
Mortgage principal payments, at amortized cost		(290,170,212)
Redemptions, at amortized cost		(2,201,421)
Maturities, at par amount		(839,908,400)
Redemptions of units of common funds		(16,805,935,924)
Premium amortization		(187,640)
NET INCREASE IN AMORTIZED COST OF INVESTMENTS		<u>2,170,633,502</u>
Total amounts invested by funds—Note B		
Beginning of year		<u>24,115,221,041</u>
END OF YEAR		<u>\$26,285,854,543</u>

See notes to investment summaries.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Administration

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

Amortized Cost

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

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

Investment Transactions

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

Discount and Premium

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

Investment Income

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

Expenses

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

NOTE B—INVESTMENT ACTIVITY

Statutes of the State of New Jersey and regulations of the State Investment Council authorize the Division of Investment to invest in obligations of the U.S. Treasury, U.S. Government agencies, and their instrumentalities; obligations of the State of New Jersey or municipal or political subdivisions of the State;

commercial paper; bankers acceptances; revenue obligations of public authorities; debt instruments of banks; collateralized notes and mortgages; certificates of deposit; repurchase agreements; equity and convertible equity securities and other common types of investment securities. Investee institutions and organizations are prescribed by the statutes and regulations based on such things as minimum capital, dividend paying history, credit history, and other evaluation factors.

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

GASB Statement No. 3 requires disclosure of the level of investment risk assumed by the Division at June 30, 1990. Category 1 includes investments that are insured or registered or for which the securities are held by the Division or its agent in the Funds' name. Category 2 includes uninsured and unregistered investments for which the securities are held by the Trust Department or agent in the Funds' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the Funds' name. As of June 30, 1990, all investments held by the Division are classified as Category 1.

Federal securities, including federal securities held as collateral on repurchase agreements (\$23,565,000 at June 30, 1990 secured by federal securities), are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the State of New Jersey. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the State of New Jersey. The custodian banks as agents for the state funds maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the state funds.

Securities not maintained by the Federal Reserve Banks or DTC 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 authorities and agencies other than their investments in the Cash Management Fund are not a direct responsibility of the State Investment Council. That function is being performed by the Division of Investment as a service under a provision in the law providing that each authority and agency may avail itself of the services of any state department or agency as it may require. Accordingly, the Summary of Amounts Invested by Fund, the Summary of Investment Activity and the Summary of Investment Income by Fund do not include the results of non-cash management fund investment transactions made on behalf of the authorities and agencies.

The investment activity includes the purchase and redemption of units in the Common Pension Fund A, Common Pension Fund B, and the State of New Jersey Cash Management Fund by the participants. Realized gains and losses arising from investment activity by Common Pension Fund A and Common Pension Fund B, consisting of net gains of \$266,639,331 in fiscal year 1990, are not reflected in the Summary of Investment Income by Fund.

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

The following is a summary of investments by major category at June 30, 1990 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.

NOTES TO INVESTMENT SUMMARIES

	Par, Cost Or Principal Amount	Amortized Cost	Market	Market Over (Under) Amortized Cost
U.S. Government and other government bonds and obligations	\$10,815,683,600	\$10,811,226,283	\$10,932,756,007	\$ 121,529,724
Industrial bonds and commercial paper	1,885,965,400	1,875,523,393	1,866,343,029	(9,180,364)
Telephone bonds	275,825,500	258,530,563	248,082,237	(10,448,326)
Gas, electric and water bonds	882,936,500	838,349,014	814,340,524	(24,008,490)
Finance companies—senior debt	38,945,000	37,873,839	36,083,875	(1,789,964)
Common stocks	8,617,003,005	8,617,003,005	12,919,735,762	4,302,752,757
Repurchase agreements	23,565,000	23,565,000	23,565,000	—
Mortgage-backed certificates	3,762,757,227	3,634,780,180	3,656,162,007	21,381,827
Time certificates of deposit	400,000,000	400,000,000	400,000,000	—
Other Investments	79,971,000	79,230,900	78,067,804	(1,163,096)
Total investments		<u>26,576,082,177</u>	<u>30,975,156,245</u>	<u>4,399,074,068</u>
Differences in accounting by unit funds:				
Undistributed realized gains (cumulative)		(287,721,398)	—	287,721,398
Other assets		288,005,679	288,005,679	—
Other liabilities		(284,438,267)	(284,176,622)	261,645
Other accounting practices		(6,073,648)	(1,101,500)	4,972,148
		<u>(290,227,634)</u>	<u>2,727,557</u>	<u>292,955,191</u>
Total amounts invested by funds		<u>\$26,285,854,543</u>	<u>\$30,977,883,802</u>	<u>\$4,692,029,259</u>

The following describes the accounting differences between the total amount invested by fund and total investments primarily relating to unit funds:

- I. The summary of investments by major category (page 26) includes the "Par, Cost, or Principal Amount" and "Amortized Cost" of the units of participation at the total purchase price of the units by the participating funds. The total investments shown above reflects the "Par, Cost, or Principal Amount" and "Amortized Cost" of the actual investments held by the Unit Funds.
- II. Market Value as shown in the summary of investments by major category represents the net asset value of the Common Pension Funds and the State of New Jersey Cash Management Fund as of June 30, 1990. The market value included in the total investments shown above reflects the market value of the investments held by the Unit Funds.
- III. Total investments shown above does not reflect the other assets and liabilities of the Unit Funds, e.g., cash, accrued interest receivable, amounts due or owed for investments purchased, and undistributed income due to participants. These items are included in calculating the net asset value of the Unit Funds.
- IV. Total amounts invested by funds do not reflect cumulative net realized gains from Unit Funds investment transactions which have not been distributed to the participating funds. Fiscal 1989 net realized gains of Common Pension Fund A were distributed in fiscal 1990 and 1990 net realized gains will be distributed in 1991. Common Pension Fund A and B cumulative net realized gains are distributed at the discretion of the State Investment Council.

NOTE D—SOUTH AFRICAN DIVESTITURE

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

Subsequent to that date, due to acquisitions or changes in operating practices, there have been changes in the South African status of certain companies. These companies included in the June 30, 1990 investment portfolio, previously determined to be free from a presence in South Africa, are subject to divestment legislation. Under the current Attorney General's ruling, the Division is allowed three years from the date of determination of South African status to effect divestment. The aggregate book value of investments in these companies was \$121,411,929 at June 30, 1990. The Division believes that the aggregate market value of such investments is in excess of cost as of June 30.

APPENDIX I

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

	Consolidated Police & Firemen's Pension Fund		Judicial Retirement System of New Jersey		Police & Firemen's Retirement System	
	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market
SHORT-TERM OBLIGATIONS						
U.S. Government and other government securities and obligations	\$ 8,258	\$ 8,257	\$ 5,199	\$ 5,199	\$ 119,584	\$ 119,572
Commercial paper	2,991	2,991	1,883	1,883	43,312	43,312
Time certificates of deposit	1,080	1,080	680	680	15,640	15,640
	<u>12,329</u>	<u>12,328</u>	<u>7,762</u>	<u>7,762</u>	<u>178,536</u>	<u>178,524</u>
LONG-TERM BONDS						
U.S. Government and other government securities and obligations	41,526	41,585	28,917	29,445	1,305,927	1,330,464
Industrial bonds	—	—	1,968	1,934	91,769	90,189
Gas and electric bonds	3,277	3,154	2,975	2,911	154,398	150,141
Telephone bonds	3,193	2,953	976	944	48,669	46,838
Finance companies—senior debt	5	5	124	116	6,153	5,802
Intermediate term corporate notes	283	285	1,008	1,001	42,622	42,275
Other	250	241	816	799	45,080	44,018
	<u>48,534</u>	<u>48,223</u>	<u>36,784</u>	<u>37,150</u>	<u>1,694,618</u>	<u>1,709,727</u>
MORTGAGES						
Mortgage-backed certificates	<u>12,163</u>	<u>12,034</u>	<u>6,720</u>	<u>6,794</u>	<u>750,672</u>	<u>753,292</u>
STOCK						
Common stock	—	—	30,510	45,809	1,683,970	2,528,423
	<u>73,026</u>	<u>72,585</u>	<u>81,776</u>	<u>97,515</u>	<u>4,307,796</u>	<u>5,169,966</u>
Difference due to accounting practices	395	391	1,704	1,033	15,425	53,722
	<u>\$73,421</u>	<u>\$72,976</u>	<u>\$83,480</u>	<u>\$98,548</u>	<u>\$4,323,221</u>	<u>\$5,223,688</u>

**INCLUDING INVESTMENTS OWNED BY THE COMMON PENSION FUNDS AND THE STATE OF NEW JERSEY
(000's Omitted) at June 30, 1990**

Prison Officers Pension Fund		Public Employees' Retirement System		State Police Retirement System		Teachers' Pension and Annuity Fund		Totals	
Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market	Amortized Cost	Quoted Market
\$ 612	\$ 612	\$ 147,109	\$ 147,095	\$ 21,715	\$ 21,712	\$351,411	\$ 351,376	\$ 653,888	\$ 653,823
221	221	53,281	53,281	7,865	7,865	127,277	127,277	236,830	236,830
80	80	19,240	19,240	2,840	2,840	45,960	45,960	85,520	85,520
<u>913</u>	<u>913</u>	<u>219,630</u>	<u>219,616</u>	<u>32,420</u>	<u>32,417</u>	<u>524,648</u>	<u>524,613</u>	<u>976,238</u>	<u>976,173</u>
203	203	2,345,647	2,390,128	176,759	180,048	2,697,147	2,747,071	6,596,126	6,718,944
—	—	166,498	163,629	12,469	12,242	190,090	186,788	462,794	454,782
—	—	287,030	279,594	19,096	18,641	365,408	354,365	832,184	808,806
—	—	90,878	87,336	6,598	6,350	107,630	103,135	257,944	247,556
1	1	10,711	10,091	832	787	18,476	17,710	36,302	34,512
21	21	74,930	74,283	5,895	5,850	90,561	89,882	215,320	213,597
—	—	85,513	83,663	5,764	5,629	101,912	99,756	239,335	234,106
<u>225</u>	<u>225</u>	<u>3,061,207</u>	<u>3,088,724</u>	<u>227,413</u>	<u>229,547</u>	<u>3,571,224</u>	<u>3,598,707</u>	<u>8,640,005</u>	<u>8,712,303</u>
—	—	1,317,488	1,324,536	36,781	36,723	1,510,956	1,522,784	3,634,780	3,656,163
—	—	3,056,063	4,588,573	188,144	282,491	3,516,252	5,279,531	8,474,939	12,724,827
1,138	1,138	7,654,388	9,221,449	484,758	581,178	9,123,080	10,925,635	21,725,962	26,069,466
(26)	(26)	(23,383)	94,566	3,979	6,462	(26,914)	109,198	(28,820)	265,346
<u>\$1,112</u>	<u>\$1,112</u>	<u>\$7,631,005</u>	<u>\$9,316,015</u>	<u>\$488,737</u>	<u>\$587,640</u>	<u>\$9,096,166</u>	<u>\$11,034,833</u>	<u>\$21,697,142</u>	<u>\$26,334,812</u>

APPENDIX II

UNAUDITED COMMON PERFORMANCE DISCLOSURE FORM FOR PUBLIC FUNDS

	Avg. Annual Return 5 Years Ended 6/30/90	One Year Period Ended				
		6/30/86	6/30/87	6/30/88	6/30/89	6/30/90
TOTAL RETURN						
Aggregate of All Pension Funds	14.1%	30.9%	14.9%	(0.7)%	14.5%	13.3%
Consumer Price Index	3.8%	1.7%	3.7%	3.9%	5.3%	4.3%
EQUITY TOTAL RETURNS						
Common Pension Fund A Equities	16.6%	39.8%	24.3%	(10.5)%	16.9%	18.7%
Approved List—Before Divestment	17.6%	37.0%	23.5%	(8.3)%	20.1%	20.6%
Approved List—South Africa Free	—	—	19.8%	(7.0)%	18.7%	14.0%
Dow Jones Industrial Average	21.2%	47.9%	32.2%	(8.3)%	18.7%	22.7%
Standard & Poor's 500 Index	17.3%	35.9%	25.2%	(6.9)%	20.5%	16.5%
N.Y. Stock Exchange Composite	12.0%	29.6%	18.8%	(9.7)%	15.2%	9.9%
FIXED INCOME TOTAL RETURNS						
Common Pension Fund B and Other Bonds	11.3%	25.6%	4.2%	7.4%	13.0%	7.2%
Shearson Lehman Government/Corporate Bond Index	10.3%	20.7%	4.7%	7.5%	12.3%	7.1%
Salomon Brothers High Grade Bond Index (AA and AAA)	12.4%	27.6%	5.1%	8.5%	16.2%	6.0%
Salomon Brothers Broad Bond Index	10.6%	19.9%	5.6%	8.1%	12.2%	7.7%
MORTGAGES—TOTAL RETURNS						
Pension fund holdings	11.1%	17.1%	8.3%	9.4%	12.1%	9.2%
Salomon Brothers Mortgage Index	11.3%	16.7%	8.7%	9.7%	11.8%	9.7%
CASH EQUIVALENTS						
Total Returns—Cash Management Fund	7.5%	7.5%	6.0%	6.9%	8.5%	8.9%
91-Day Treasury Bills	6.8%	7.1%	5.6%	5.5%	7.8%	7.9%

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

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

