



State of New Jersey

CHRIS CHRISTIE
Governor


DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290

KIM GUADAGNO
Lt. Governor

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

March 12, 2010

MEMORANDUM TO: State Investment Council

FROM: Ray Joseph
Acting Director 

SUBJECT: **Proposed Hedge Fund Investments in Brevan Howard
Master Fund Limited and Pershing Square, L.P.**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9 to report on a proposed \$100 million commitment to Brevan Howard Master Fund Limited and a proposed \$100 million commitment to Pershing Square, L.P.

Please note that these investments are authorized pursuant to Articles 69 and 100 of the State Investment Council's regulations. The Brevan Howard Master Fund and Pershing Square Fund will be considered opportunistic and equity-oriented investments, respectively, as defined under N.J.A.C. 17:16-100.1.

The Division of Investment ("Division") Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on these proposed investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

The **Brevan Howard** Asset Management LLP was founded by Alan Howard, Jeanphilippe Blochet, Ernst Kasper, Trifon Natsis, Christopher Rokos and James Vernon in 2002. The founding partners previously were members of the CSFB (Credit Suisse First Boston) Developed Markets Rates trading team and are actively involved at the firm except Jeanphilippe Blochet, who left the firm in 2008. The assets under management are \$28 billion, out of which \$22.1 billion are in a master fund.

The fund primarily manages Global Macro and Relative Value strategies that are predominantly invested in global fixed income and foreign exchange markets. The fund also invests in equities, commodities and credit which represent approximately 20% of fund assets. Fund assets are managed by approximately 50 traders but seven senior traders control about 70% of the book (Alan Howard manages 25%). Remaining traders

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each manage \$100 million to \$400 million and are there to provide trading diversity and market expertise in specialized areas.

The firm employs more than 100 investment professionals including traders, 10 economists and four strategists. Economists and strategists provide the color on broad global macro trends while the traders form their own opinions and accordingly initiate investments. Traders have a specific, well-defined mandate and guidelines as well as specified instruments they may use to implement their strategies. All traders, including the founders, are assigned strict loss limits. A 4% loss triggers a 25% cut in capital. If the loss increases to 8%, capital is cut back by at least 50%. At the 12% loss level, the trader loses all capital and is asked to leave the firm. In reality, the trader is terminated before the loss approaches 12%. Aron Landy, the chief risk officer, manages a team of 15 risk professionals and reports to the joint CEOs, and not to Alan Howard, the chief investment officer.

Since its inception in April 2003 through January 2010, the fund has generated an annualized return of 15.0% with 7.4% standard deviation. Brevan Howard has managed downside volatility with a maximum drawdown since inception of -5.18%.

Pershing Square Capital Management, L.P. was founded by William Ackman in 2004. The firm manages \$5.4 billion and employs a concentrated, deep-value, activist strategy. Pershing Square has 39 employees out of whom nine are investment professionals.

Due to its activist strategy, the fund typically has a long bias but fund managers also identify highly overpriced, misunderstood securities and take meaningful short positions. The fund, on an average, holds 6 to 12 positions and uses credit default swaps (CDS) to implement its bearish stance. The gross equity exposure is expected to be 50% to 120% with net equity exposure of 35% to 85%. The single largest long exposure could reach 20%, while the largest short exposure is capped at 10%.

The fund has generated an annualized return of 22.69% with a volatility of 16.69% since inception in January 2004 through January 2010. A proposed investment in the Pershing Square, LP fund was previously presented to the Committee and the Council for their review in February 2008. A political contribution disqualified the proposed investment for two years from the date of the political contribution. The two year limit expired in 2009 and Pershing has represented to staff that there were no subsequent political contributions in violation of N.J.A.C. 17:16-4.

We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4).

Formal written due diligence reports for the proposed investments were sent to each member of the Investment Policy Committee on March 5, 2010, and a meeting of the

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Committee was held on March 10, 2010. In addition to the formal written due diligence reports, all other information obtained by the Division on the investments was made available to the Investment Policy Committee.

We look forward to discussing the proposed investments at the Council's March 18, 2010 meeting.

Attachments

SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: March 18, 2010
Subject: Brevan Howard Asset Management Recommendation

Fund Facts

Fund Name:	Brevan Howard LP
Fund Type:	Global Macro
Current Fund Size:	\$22.1 billion
Inception:	April-2003
Fund Address:	55 Baker Street London, UK W1U 8EW

GP Contact Info

Name:	Bruce Terry
Telephone:	(212) 418-8200
Email:	Bruce.Terry@brevanhoward.com

Summary of Terms and Investment Strategy

Investment Strategy:	The fund employs both global macro and relative value trading strategies primarily in the global fixed income and foreign exchange markets. The fund also has a smaller investments in equities, commodities and credit and these strategies representing roughly 20% of overall exposure. The global macro strategy seeks to identify changes in economies around the world and to monetize the traders' views on potential outcomes, including government policy and market reaction. The relative value strategy aims to identify asymmetric risk/return profiles of trades across related sets of securities and derivatives. The investment team comprises approximately 50 traders, who trade within pre-determined and specific areas of the fixed income, currency, equity and commodities market with tight risk limits and stop-loss rules.
Fee Terms:	
Management and Performance Fees:	Management fee - 2% Incentive fee - 25% with a high water mark
Other Fees:	Fund expenses - 73 basis points
Hurdle Rate:	None
Preferred Return	None
Liquidity/Redemption Terms:	
Lock-up:	One year soft
Redemption:	Every month with 90 day notice, 5% redemption penalty in first year, 10% gate
Side Pocket:	None

NJ AIP Program:

Recommended Allocation Current:	\$100 mil
% of Fund:	0.45%
% of New Jersey State Pension Plan:	0.15%
% of AIP Hedge Fund Allocation (\$3b):	3.33%

Consultant Recommendation:	Yes
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*see due diligence memo

Compliance with SIC "Pay to Play" Reg:	
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SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: March 18, 2010
Subject: Pershing Square Capital Management Recommendation

Fund Facts

Fund Name:	Pershing Square, L.P.
Fund Type:	Event Driven
Current Fund Size:	\$5.1 billion
Inception:	January-2004
Fund Address:	888 Seventh Avenue, 42nd Floor New York, NY 10019

GP Contact Info

Name:	Ashley Safronoff
Telephone:	(212) 652-3172
Email:	safronoff@persq.com

Summary of Terms and Investment Strategy

Investment Strategy:	Pershing Square is a concentrated, deep-value, activist hedge fund, which seeks to identify stocks that exhibit significant valuation discrepancies between their current trading price and intrinsic business value. As opposed to most activist funds, which only focus on the long-side, Pershing Square focuses on both long and short opportunities. The research process is bottom-up and highly-intensive, with the majority of ideas generated through internal research.
Fee Terms:	
Management and Performance Fees:	Management fee - 1.5% Incentive fee - 20% with a high water mark
Other Fees:	Fund expenses - less than 25 basis points
Hurdle Rate:	None
Preferred Return:	None
Liquidity/Redemption Terms:	
Lock-up:	2 years
Redemption:	Every 2 years with 45 day notice, 20% gate
Side Pocket:	None

NJ AIP Program:

Recommended Allocation Current:	\$75 mil
% of Fund:	1.47%
% of New Jersey State Pension Plan:	0.11%
% of AIP Hedge Fund Allocation (\$5b):	2.50%

Consultant Recommendation:	Yes
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*see due diligence memo

Compliance with SIC "Pay to Play" Reg:	
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