



State of New Jersey

CHRIS CHRISTIE
Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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Lt. Governor

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State Treasurer

June 30, 2011

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh
Director

SUBJECT: **Proposed investment in Canyon Balanced Fund (Cayman), Ltd Fund**

The New Jersey Division of Investment is proposing an investment of up to \$125 million in Canyon Balanced Fund (Cayman), Ltd Fund managed by Canyon Capital Advisors LLC

The Division invested \$75 million in Canyon Value Realization Fund (Cayman) in January 2007 and the fund has generated a 31.6% cumulative return since inception to April 30, 2011. The Division also invested \$100 million in Canyon Special Opportunities Fund in September 2007 and invested an additional \$49.5 million in October 2008. The Canyon Special Opportunities Fund has generated a 23.2% cumulative return since inception to April 30, 2011.

Canyon Capital Advisors ("Canyon" or "CCA" or "the firm") is a well respected asset management organization staffed with experienced professionals. The firm was founded in 1990 by Joshua Friedman and Mitchell Julis as an investment management firm that utilizes the credit analysis and deal structuring skills of the firm's founders. Canyon and its affiliated companies have 205 employees, including 101 investment professionals, including 46 who focus on the firm's hedge fund strategies. As of April 30, 2011, the firm managed \$19.1 billion in hedge funds, separate accounts, real estate and structured products. Canyon is headquartered in Los Angeles and is an SEC registered investment advisor.

The Canyon Balanced Fund (the "fund") targets equity-like returns through a long-biased, flexible investment approach across public and private securities, including high yield bonds, distressed securities, convertible securities, equities, bank debt, trade claims, securitized assets and privately placed debt originated and structured by Canyon. The fund invests in a concentrated subset of the strategies which comprise the more diversified flagship Value Realization funds, and is expected to have more dramatic shifts in exposures across strategies.

The fund is managed by Messrs. Friedman, Julis and Allen Ba, a senior portfolio manager who has worked at Canyon for ten years.

The fund has produced strong returns over its history. Since inception in June 2004 through April 2011, the fund has produced a net annualized return of 14.53% with a standard deviation of 11.42%, resulting in a Sharpe Ratio of 1.08.

Risk management is the responsibility of Messrs. Friedman, Julis and Ba. Canyon primarily manages risk by adhering to its investment criteria and performing intensive fundamental research. Canyon will also opportunistically hedge issuer specific credit risks and broad market risks, including credit spread risk, equity risk, interest rate risk, and macroeconomic risks.

Canyon has a very strong and well-staffed operations group of over 100 non-investment professionals, who oversee all reconciliation, valuation, compliance and financing functions. Canyon has made a substantial investment in its middle and back office infrastructure including negotiating technology development deals with outside providers to develop its accounting and risk management systems. The firm has implemented comprehensive compliance policies and a clear segregation of duties between front and back office functions.

Canyon Balanced Fund's terms, which are in line with market standards, are a 2% management fee and a 20% incentive fee, with a high watermark. However, in exchange for agreeing to reinvest at least \$75 million of proceeds from the Canyon Special Opportunities Fund into CBF, the Division will receive 75 basis points reduction in the management fee for the first year and 25 basis points reduction in the second year. The investment in CBF will have a one year hard lock, with quarterly redemptions thereafter with a 25% investor-level gate. The liquidity terms are in line with other credit-focused funds.

This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9. The Division of Investment ("Division") Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on this proposed investment. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council. We have attached the SIC Investment Committee Fund Review Memo. As part of its due diligence process, staff has determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with the potential investment.

Formal written due diligence reports for the proposed investment were sent to each member of the Investment Policy Committee and a meeting of the Committee was held on June 21, 2011. In addition to the formal written due diligence reports, all other information obtained by the Division on the investment was made available to the Investment Policy Committee.

Please note that this investment is authorized pursuant to Articles 69 and 100 of the Council's regulations. Canyon Balanced Fund (Cayman) Ltd Fund will be considered a Credit Oriented investment, as defined under N.J.A.C. 17:16-100.1.

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 the investment. In addition, the proposed investment must comply with the Council's regulation governing political contributions (N.J.A.C. 17:16-4).

We look forward to discussing the proposed investment at the Council's June 30, 2011 meeting.

Attachments

State Investment Council Fund Review Memo

To: State Investment Council
From: Division of Investment
Date: June 30, 2011
Subject: Canyon Capital Advisors, LLC
Recommendation

Fund Facts

Fund Name:	Canyon Balanced Fund (Cayman) Ltd
Fund Type:	Credit
Current Fund Size:	\$1.4 billion
Inception:	June-2004
Fund Address:	2000 Avenue of the Stars, 11th Floor Los Angeles, CA 90067

Investment Rationale:

This is a new investment to an existing credit manager that has been a top performing firm for NJ. NJDOI is seeking to invest up to \$125 million to the Canyon Balanced Fund. This investment will be funded with assets that are rolling off the Canyon Special Opportunities Fund, a bank loan fund that is distributing assets as its investment term has ended. The Canyon Balanced Fund is a more concentrated version of the firm's flagship fund, the Canyon Value Realization Fund in which NJ is also invested. Canyon is offering NJ a lower management fee to roll the assets into the Canyon Balanced Fund. **Canyon has been one of NJ's top performing credit managers.** Since inception of the fund in June 2004, the Canyon Balanced Fund has generated an annualized return of 14.52% with 11.42% standard deviation resulting in a Shape Ratio of 1.01.

Summary of Terms and Investment Strategy

Investment Strategy:	The Canyon Balanced Fund targets equity-like returns through a long-biased, flexible investment approach across public and private securities, including high yield bonds, distressed securities, convertible securities, equities, bank debt, trade claims, securitized assets and privately placed debt originated and structured by Canyon. The fund invests in a concentrated subset of the strategies which comprise the more diversified flagship Value Realization funds, and is expected to have more dramatic shifts in exposures across strategies.
Fee Terms:	
Management and Performance Fees:	Management fee - 2% NJ discount of 75 bps in Year 1 and 25 bps in Year 2 Performance fee - 20%
Other Fees:	Fund expenses - 25 bps
Hurdle Rate:	None
Service Providers:	
Prime Broker(s):	BofA, Deutsche Bank, Credit Suisse, JP Morgan. Northern Trust is custodian.
Administrator(s):	IFS
Auditor(s):	Deloitte & Touche
Legal Counsel:	Sidley Austin LLP; Kirkpatrick & Lockhart Nicholson Graham
Liquidity/Redemption Terms:	
Lock-up:	1 year
Redemption:	Quarterly with 25% investor level gate
Side Pocket:	None

NJ AIP Program:

Recommended Allocation Current:	\$125 mil
% of Fund:	8.20%
% of New Jersey State Pension Plan (\$72b):	0.17%
% of AIP Hedge Fund Allocation (\$3.6b):	3.47%

Consultant Recommendation:	Yes
*see due diligence memo	
Compliance with SIC "Pay to Play" Reg:	Side letter required (already in place for other Canyon funds)
Placement Agent	NO

GP Contact Info

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* This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.