



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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State Treasurer

March 18, 2011

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh
Director 

SUBJECT: **Proposed Investments in Third Point Partners, LP Fund and Add-On Investment to Pershing Square, LP Fund**

The New Jersey Division of Investment is proposing an investment of \$100 million in Third Point Partners, L.P. Fund and an addition of \$100 million to our investment in Pershing Square, L.P. Fund. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9. We plan to opportunistically invest these allocations over a number of months.

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

Third Point LLC ("Third Point" or the "firm") was founded in 1995 by Daniel Loeb. The firm currently manages \$4.4 billion in its flagship event driven fund, Third Point Partners LP / Third Point Qualified LP / Third Point Offshore Fund, Ltd. ("Third Point" or the "fund"), its levered fund, Third Point Ultra Ltd, and two separately managed fund platforms. Third Point employs a total of 54 people, of which 20 are investment professionals. In addition, the firm has an investment vehicle, Third Point Offshore Investors Ltd. ("TPOU"), which was listed on the London Stock Exchange in 2007 that currently represents approximately 15% of assets. The firm is headquartered in New York City and has been registered with the SEC since January 2006. The firm is 100% owned by Daniel Loeb, but he is in the process of naming additional partners. At 10% of NAV, Third Point's employees collectively are the largest investor, after the listed vehicle (TPOU), in the fund.

Third Point is an opportunistic event driven fund with a value oriented investment style. Third Point's investment process is research-intensive, relying on fundamental, bottom-up analysis of each investment opportunity. The manager seeks to identify companies where a clear catalyst will unlock value. The fund is nimble and has the experience to opportunistically diversify

investments across industries, geographies, and asset classes. The fund focuses on the following areas; long/short equity, special situations, risk/merger arbitrage and credit.

The fund has produced very strong absolute and risk-adjusted returns for over fifteen years. From its inception in June 1995 through December 2010, the fund generated an annualized return of 22.56% with volatility of 14.07%, resulting in a Sharpe ratio of 1.27. Risk is managed by portfolio manager, Daniel Loeb. In addition, Third Point employs two dedicated risk reporting professionals and has a firm-wide risk committee that meets weekly and applies a proprietary, in-house risk management system, RiskPoint to evaluate portfolio risk exposures. Individual positions are sized based on probability weighted estimates of upside and downside, with a general guideline of limiting the downside to 2% at the position level.

Third Point has made a substantial investment in middle and back office infrastructure. The operations team is led by chief administrative officer Mr. Jim Gallagher who has significant industry experience and totals 34 employees. The senior professionals have implemented a comprehensive framework to manage the trading and business operations. Investor transparency includes a monthly report detailing portfolio exposures on a number of metrics and very detailed quarterly letters. The fund departs from best practices by relying on its external administrator, International Fund Services to keep its general ledger information rather than maintaining a full shadow set of books and records. However, the risk that arises from this departure from best practices is minimal because the manager has a low trading volume and reviews the work of International Fund Services on a daily basis. No other material departures from best practices were found in the operational due diligence analysis.

Third Point offers quarterly liquidity with 60 days notice following a one year soft lock-up period which allows redemptions subject to a 5% penalty payable to the fund. The fund charges a 2% management fee and a 20% performance fee. The incentive allocation is subject to a modified high water mark provision, which is favorable to Third Point. However, it requires that the fund recoup 250% of prior losses, which is a more favorable modified high water mark for investors. There is a key man provision for Mr. Loeb.

Pershing Square Capital Management, L.P. (“PSCM”) is a \$8.5 billion asset management company founded by William Ackman in 2004. The firm’s sole product is a concentrated, deep-value, activist hedge fund. PSCM is located in New York City, where all of its 39 employees are based. Mr. Ackman has invested the vast majority of his liquid net worth in the fund. Further, each member of the investment staff and management team has invested a substantial portion of their liquid net worth in the fund, and the firm as a whole represents one of PSCM’s largest investor groups. The firm is a registered investment advisor with the U.S. Securities and Exchange Commission.

Pershing Square (“Pershing Square” or “the fund”) 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.

The Division invested \$100 million in April 2010. Our investment since April 2010 to January 2011 has returned 17.6% compared to the S&P 500 return of 11.8%. Fund was up 12.2% in November 2010 while S&P 500 was flat. Pershing Square has produced very strong absolute and risk-adjusted returns. Since inception in January 2004 through December 2010, the fund has generated an annualized return of 25.01% with volatility of 16.52%, resulting in a Sharpe ratio of 1.27. Mr. Ackman is responsible for portfolio risk management. Key to Mr. Ackman's risk management philosophy is the belief that the fund is principally exposed to company-specific risks, which are managed through its investment selection and due diligence process. Additionally, risk is mitigated by a limited use of leverage, as well as investments in companies that are, among other things, under levered, less sensitive to macroeconomic factors, mid- to large-capitalization, and trading at a significant discount to their intrinsic value.

PSCM maintains a strong back office operation, with appropriate procedures and personnel, including a COO, CFO, and general counsel/chief compliance officer. The firm is registered with the SEC, and underwent a standard review in October 2005 with no material changes recommended. The fund provides investors with mid-month and monthly performance estimates, monthly statistics, quarterly letters, and annual meetings

The fund charges a management fee of 1.5%, and a performance fee of 20%. Investors are given three liquidity options: (i) rolling two-year hard lock-up or (ii) one-year hard lock-up on the first 1/3, two-year hard lock-up on the second 1/3, and three-year hard lock-up on the final third of each contribution, with any non-redeemed amount automatically subject to a rolling two-year lock-up or (iii) 1/8 of capital available for redemption each quarter, with any non-redeemed amount automatically subject to a rolling two-year lock-up.

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 and a meeting of the Committee was held on March 17, 2011. 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.

Please note that these investments are authorized pursuant to Articles 69 and 100 of the State Investment Council's (the "Council") regulations. Third Point Partners, LP Fund and Pershing Square, LP fund will be considered Event Driven investments, as defined under N.J.A.C. 17:16-100.1.

We look forward to discussing the proposed investments at the State Investment Council's March 24, 2011 meeting.

Attachments

SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: March 18, 2011
Subject: Third Point LLC
Recommendation

Fund Facts

Fund Name:	Third Point Partners LP
Fund Type:	Event Driven
Current Fund Size:	\$4.4 billion
Inception:	June-1995
Fund Address:	390 Park Avenue New York, NY 10022

Investment Rationale:

This is a new investment to a best in class fund in the event driven strategy which is intended to provide additional exposure to corporate events for the NJ hedge fund portfolio. NJ seeks to invest \$100 mil with Third Point Partners LP fund, an event driven hedge fund. This investment will be a complement to the DOI's existing investments in the Davidson Kempner and York Capital funds also in the event driven category. Third Point is highly opportunistic and has been one of the top performing event driven hedge funds throughout its long history dating back to 1995, generating an annualized return of **22.75%**. Similarly to other equity and event oriented hedge funds, the fund experienced negative performance in 2008 (at -32.84%) but has been able to recover and identify great opportunities in corporate events and distressed mortgages since then, earning returns of 38.14% in 2009 and 41.79% in 2010.

Summary of Terms and Investment Strategy

Investment Strategy:	Opportunistic event driven fund with a value oriented investment style. Third Point's investment process is research-intensive, relying on fundamental, bottom up analysis of each investment opportunity. The manager seeks to identify companies where a clear catalyst will unlock value. The fund is nimble and has the experience to opportunistically diversify investments across industries, geographies, and asset classes. The fund focuses on the following areas: long/short equity, special situations, risk/merger arbitrage and credit.
Fee Terms:	
Management and Performance Fees:	Management fee - 2.0% Performance fee - 20% with modified high water mark (10% performance fee until fund recoups 250% of prior losses)
Other Fees:	Fund expenses - approximately 55 bps
Hurdle Rate:	None
Service Providers:	
Prime Broker(s):	Barclays, Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley and UBS (Goldman Sachs, HSBC and JP Morgan serve as custodians)
Administrator(s):	IFS
Auditor(s):	Ernst & Young
Legal Counsel:	Willkie, Farr & Gallagher
Liquidity/Redemption Terms:	
Lock-up:	1 year soft lock with 5% early redemption fee
Redemption:	Quarterly with 60 days notice
Side Pocket:	Up to 10%

NJ AIP Program:

Recommended Allocation Current:	\$100 million
% of Fund:	2.27%
% of New Jersey State Pension Plan:	0.14%
% of AIP Hedge Fund Allocation (\$3.5b):	2.86%

Consultant Recommendation:	Yes
*see due diligence memo	
Compliance with SIC "Pay to Play" Reg:	Side letter required

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.

SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: March 18, 2011
Subject: Pershing Square Capital Management Recommendation

Fund Facts

Fund Name:	Pershing Square, L.P.
Fund Type:	Event Driven
Current Fund Size:	\$8.5 billion
Inception:	January-2004
Fund Address:	888 Seventh Avenue, 42nd Floor New York, NY 10019

Investment Rationale:

This is an additional investment to a best in class fund which has been one of the best performing funds in the NJ hedge fund portfolio. NJ invested \$100 mil with Pershing Square in April of 2010 as a event driven manager following an activist strategy mainly in US companies. Since then, Pershing Square has proved to be one of the best performing managers in the DOI hedge fund portfolio. Since the NJ inception, the fund has a cumulative return of **20.79%** which has significantly outperformed other hedge funds and the equity market over this period. Pershing Square's event driven approach and activist bent should be well suited for the current market environment as companies continue to undergo rationalization and engage in various forms of corporate actions.

Summary of Terms and Investment Strategy

Investment Strategy:	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% Performance fee - 20%
Other Fees:	Fund expenses - less than 25 bps
Hurdle Rate:	None
Service Providers:	
Prime Broker(s):	Goldman Sachs, UBS and JPMorgan (Bank of New York Mellon and Fidelity serve as custodians)
Administrator(s):	Morgan Stanley
Auditor(s):	Ernst & Young
Legal Counsel:	Schulte Roth & Zabel LLP
Liquidity/Redemption Terms:	
Lock-up:	2 years
Redemption:	Class E - 1/8 of NAV per quarter with 65 days notice
Side Pocket:	None

NJ AIP Program:

Recommended Allocation Current:	\$100 mil in addition to existing \$100 million original investment (Dec 2010 NAV \$120 million)
% of Fund:	2.59%
% of New Jersey State Pension Plan:	0.31%
% of AIP Hedge Fund Allocation (\$3.5b):	6.29%

Consultant Recommendation:	Yes
*see due diligence memo	
Compliance with SIC "Pay to Play" Reg:	Side letter in place

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