



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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September 23, 2015

MEMORANDUM TO: State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Additional Investment in MKP Opportunity Partners, LP**

The New Jersey Division of Investment (“Division”) is proposing an additional investment of up to \$110 million in MKP Opportunity Partners, LP (“MKP” or the “Fund”). The Division has aggregate prior commitments of \$243 million to the Fund, which were funded during 2012, 2013, and 2014. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

MKP employs a discretionary global macro strategy across global rates, currencies, credit, equities and commodity markets. The Fund employs a multi-market framework and dynamically allocates capital across specialist portfolio managers to achieve attractive risk-adjusted returns.

The Division is recommending this investment based on the following factors:

Attractive and Complementary Returns: Since inception in August 2001 through July 2015, MKP has generated an annualized return of 8.61% and a Sharpe ratio of 1.26, placing the Fund, on a risk-adjusted basis, in the top quartile of the HFRI Macro (Total) Index on a 5-year and since inception basis. The consistent return, combined with negative/low beta to the various markets such as equities (MSCI Europe: +0.1, Russell 3000 Index: -0.08), high yield (Barclays High Yield Index: -0.04) and commodities (Bloomberg Commodity Index: -0.04), makes MKP unique and complementary to the Pension Fund’s current portfolio.

Veteran Macro CIO: Patrick McMahan, the CIO of the Fund and one of the founding partners of the firm, has 30 years of fixed income and macro trading experience. Prior to starting MKP in 1995, Mr. McMahan worked at Salomon Brothers where he was a Partner and trader in their fixed income division from 1985-1994. Through his time at Salomon Brothers and during the last twenty years at MKP, Mr. McMahan traded through multiple market cycles and is talented at sizing and structuring positions.

Established Investment Committee: MKP’s investment committee oversees the entire investment process and has ultimate authority in all aspects of the portfolio. The committee is comprised of seven senior members of MKP including the CIO, Mr. McMahan, the Chief Risk Officer, Henry Lee, the Head of Strategy and Research, Dominic Wilson, and four senior portfolio managers. The committee monitors the specialist portfolio manager’s performance and

exposures and dynamically allocates capital to the portfolio managers to deploy in their particular area of expertise.

Top-Down Rates and Currency Exposure: While the Fund will have exposures in equities, credit, agencies and commodity markets, the vast majority of risk is in the global rates and currency markets. For the Division's hedge fund portfolio which has meaningful exposure in funds that specialize in equity and credit focused strategies, MKP's currency and fixed income exposure is an attractive complement. Furthermore, MKP employs a top-down valuation approach across asset classes, which provides a counter to the majority of managers in the Division's hedge fund portfolio who invest using a bottoms-up valuation approach.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the Fund has not engaged a third-party solicitor (a "placement agent") in connection with New Jersey's potential investment.

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. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 69 and 100 of the Council's regulations. MKP Opportunity Partners, LP will be considered an opportunistic (global macro) hedge fund investment, as defined under N.J.A.C. 17:16-100.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC and a meeting of the Committee was held on September 15, 2015. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's September 23, 2015 meeting.

Attachments

Fund Name: MKP Opportunity Partners, L.P.

September 23, 2015

Contact Info: Katherine Plavan, 600 Lexington Avenue, New York, NY 10022

Fund Details:

Total Firm Assets:	\$8.4 billion as of 6/30/15	<p>Key Investment Professionals: Patrick McMahon, Founding Member of MKP Capital Management, L.L.C., serves as Chief Executive Officer and Co-Chief Investment Officer. Along with Messrs. Henry Lee, Richard Lightburn and several additional senior investment professionals. Mr. McMahon is a member of the firm's Investment Committee. Prior to founding MKP in 1995, Mr. McMahon worked at Salomon Brothers Inc. (1985-1994) where he was a Partner and a Managing Director in the Fixed Income Capital Markets Division. Henry I. Lee, Chief Risk Officer for MKP, a Principal of the firm and a member of the Management Advisory Committee. Mr. Lee is also a member of the Investment Committee. Before taking on the role of Chief Risk Officer in late 2006, Mr. Lee served as a Portfolio Manager. Prior to joining MKP in 1997, Mr. Lee worked at Salomon Brothers Inc. in the Mortgage Securities Department. Richard Lightburn, Portfolio Manager, a Principal of the firm and a member of the Management Advisory Committee and Investment Committee. Prior to joining MKP in 2008, Mr. Lightburn spent 3 years as a Managing Director at HSBC and 15 years before that at Goldman Sachs.</p>
Strategy:	Global Macro	
Assets in Strategy:	\$4.8 billion as of 6/30/15	
Year Founded:	1995	
SEC Registration	Yes, since 2000	
GP Commitment:	\$170 million as of 6/30/15 invested in MKP's strategies	

Investment Summary	Existing Fund as of 7/31/2015			
	Fund ¹	HFRI Macro (Total)	DJCS Global Macro	
<p>The Division has an aggregate \$243 million investment in MKP Opportunity Partners, L.P., which was funded starting in September 2012. The fund invests all of its assets in a master fund (the "Fund") which invests primarily in global rates and currency markets and secondarily in credit, equities, and commodity markets. From a geographic perspective, the Fund is truly global in orientation and may take positions in developed and liquid emerging markets. The portfolio is actively traded, with gross and net exposures fluctuating over time depending on the market conditions and the team's conviction level. The firm's principals control and own a majority of the firm by virtue of being managing members of a holding company ("MKP LP"). A private equity fund managed by NB Dyal Advisors LLC holds a passive, non-voting, minority equity interest in MKP LP. The Division is an investor in the Dyal fund and therefore benefits by receiving a portion of MKP Capital Management's profits.</p>	1 Year	10.14%	5.85%	6.13%
	3 Year	4.02%	1.57%	4.54%
	5 year	6.27%	2.12%	6.12%
	Fund Inception	8.62%	5.87%	9.10%
	YTD to July 2015	5.15%	0.86%	3.89%
	2014	-2.17%	5.58%	3.11%
	2013	7.11%	-0.44%	4.32%
	2012	6.89%	-0.06%	4.58%

Vehicle Information:

Fund Inception:	2001	Subscriptions:	Monthly
Fund Size:	\$3.576 billion	Redemptions (notice):	Monthly with 60 days' notice
Management Fee:	1.375%	Lock-up:	None
Profit Allocation:	20%	Prime Broker:	JP Morgan, Barclays, Credit Suisse, Citibank and BNP
Highwater Mark:	Yes	Administrator:	SEI Global Services, Inc.
Hurdle Rate:	None	Auditor:	Ernst & Young LLP
		Legal Counsel:	Schulte Roth & Zabel LLP

NJ AIP Program

Recommended Allocation (\$mil):	up to \$110,000,000	LP Advisory Board Membership:	N/A
Current % of Fund:	6.80%	Consultant Recommendation:	Yes
Total % after new investment:	9.58%	Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes

¹ Performance reflects that of MKP Opportunity Offshore, Ltd. and is net of fees and expenses

*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.