



State of New Jersey

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290
Telephone (609) 292-5106
Facsimile (609) 984-4425

FORD M. SCUDDER
Acting State Treasurer

CHRIS MCDONOUGH
Director

July 29, 2016

MEMORANDUM TO: State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in BlackRock Alternative Advisors**

The New Jersey Division of Investment ("Division") is proposing an investment of up to \$1 billion in a separate account managed by BlackRock Alternative Advisors ("BAA"). The initial tranche will not exceed \$500 million. The Division will provide a report to the State Investment Council (the "Council") prior to investing any amount above \$500 million. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

The separate account with BAA will be part of the Division's Fund Alignment and Incentive Reform ("FAIR") Program. BAA will identify a diverse range of hedge fund strategies with a focus on "risk-mitigating" strategies. The underlying hedge fund fee is targeted to average a 1% management fee and 10% incentive fee, with hurdles at the individual underlying hedge fund level if possible. The lower fees are achievable as a result of locking up capital, utilizing the managed account/fund of one structure or custom share classes within a commingled fund, leveraging existing hedge fund relationships of the manager, and other negotiation levers. The underlying hedge fund investments will primarily be structured via managed accounts or fund of one structures. The investments will look to mirror the flagship strategy as best as possible for each manager (i.e. no alternative beta strategies, or modified or diluted strategy mandates relative to the hedge fund's flagship strategy). Further, the investment firms must have a minimum AUM of \$100 million, have institutional operations and have greater than a two-year performance track record.

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

Successful history as founding/early stage investor: BAA has successfully sourced best in class managers as day one or early stage investors. BAA invested on day one with 56% of their current approved manager lineup and 59% within the first six-months of fund existence. As a result of investing early and with size, BAA has a strong track record of negotiating reduced fees and future capacity rights with best in class managers. For the FAIR mandate, BAA will leverage their existing

relationships to create a portfolio of larger, more established firms that meet reduced fee requirements.

Industry leader in providing customized solutions: Approximately 66% (\$13.7B) of BAA's \$20.6 billion in assets are in customized hedge fund mandates. The team has been structuring custom solutions since 1995 and they currently have several customized mandates in the \$1-\$1.2 billion size range for US corporate pensions, sovereign wealth funds and public pensions. Compared to their peers, who have a larger percentage of assets in commingled products and less meaningful experience in customized solutions, the BAA team has a long and successful history of designing and implementing customized mandates such as the FAIR mandate.

Experience and global presence: The BAA team has over twenty years of hedge fund investment experience. The team has invested through multiple market cycles and has a history of avoiding more directional beta-oriented strategies, which is in line with the Division's preference for lower beta "risk mitigating" strategies. Further, BAA's global presence via offices in Seattle, New York, London, Tokyo and Hong Kong enables the team to source a broader range of investments in comparison to many of their peers.

Institutional managed account platform: Currently, \$4 billion of the total \$20.6 billion invested assets is structured in separately managed accounts or fund of one structures across approximately 30 investments. For managed accounts, the BAA team uses Blackrock's credit and counterparty teams to assist negotiating the most competitive terms for all their prime brokerage relationships and ISDA agreements which results in notable cost savings and more favorable investor terms. Further, the BAA team has developed proprietary systems to monitor and analyze exposures and factors across the managed accounts. With the FAIR mandate, the Division has the potential to access these systems for its other existing hedge fund investments and also to convert existing direct hedge fund investments into managed account structures on their platform.

Ability to Leverage a Key Relationship: The Division has an established relationship with BlackRock in private equity, with over \$1 billion in private equity commitments currently with the Firm. This hedge fund mandate will expand the relationship; it will allow for increased fee savings and greater ability to leverage BlackRock's resources and systems. BlackRock will serve as an extension of the Division's staff across the entire hedge fund allocation.

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. The BlackRock Alternative Advisors Separate Account will be considered a multi-strategy 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 July 20, 2016. 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 August 3, 2016 meeting.

Attachments

Fund Name: BlackRock Alternative Advisors Separate Account

August 3, 2016

Contact Info: Abigail Gold Geller, 55 East 52nd Street, New York, NY 10055

Fund Details:

Total Firm Assets (\$bil.):	\$4.89 trillion as of 6/30/16	Key Investment Professionals: Bryan Smith, chairman of BAA's Management Committee and responsible for overseeing product strategy, marketing and client services across BAA. Mr. Smith is also a member of the BAA Management Committee. David Matter, CFA, chairman of the BAA Investment Committee, a member of the Absolute Return Strategies Manager Research group and a member of the BAA Management Committee. He is also a portfolio manager and is responsible for overseeing the sourcing, performance of due diligence on and monitoring of hedge fund managers. Mr. Matter's service with the firm dates back to 1998 at the Quellos Group, where he served as a Principal. Bart Coteles, CPA, leads the Operational Due Diligence group within BAA and is a member of the BAA Investment Committee. He is responsible for conducting operational reviews of hedge fund managers. Mr. Coteles' service with the firm dates back to 2007 at the Quellos Group, where he served as an Associate Director. Mark Everitt, CFA, is the head of Risk Management for BAA and is a member of the BAA Investment Committee and the BAA Management Committee. Mark's service with the firm dates back to 2004 at the Quellos Group, where he was a Principal. David Barenborg, Managing Director, member of BlackRock Alternative Advisors (BAA), the firm's Hedge Fund Solutions team. Mr. Barenborg leads the Absolute Return Strategies Manager Research group within BAA. He is a member of the BAA Investment Committee, the BAA Management Committee and the Blackrock Alternative Investors (BAI) Executive Committee. He is also a portfolio manager and is responsible for the sourcing, evaluating and monitoring of hedge fund managers. Mr. Barenborg's service with the firm dates back to 2002, including his years with Quellos Group, LLC, of which the alternative investment management business was acquired by BlackRock in 2007. At Quellos, he was most recently a Portfolio Manager and Director of Research.
Strategy:	Multi-Strategy	
Assets in Strategy(\$bil.):	\$21.1 billion as of 6/1/16	
Year Founded:	1988	
SEC Registration	Yes	
GP Commitment:	1%	

Investment Summary	Existing Fund				
BlackRock Alternative Advisors ("BAA") is a business line under BlackRock, Inc. – a publicly traded company. BAA has successfully sourced best in class managers as day one or early stage investors. The BAA research team will source prospective investments while the Division maintains veto right and approval control over the final investments. In addition to providing meaningful reduction in fees to promote alignment of interest and to enhance the Division's returns, the proposed structure will also offer full, position-level transparency to enhance risk management, enhance internal controls and improve governance. In addition, the Division will leverage the relationship to potentially onboard its current direct hedge fund portfolio onto their platform for improved monitoring and further potential fee savings of the Division's hedge fund portfolio. The fund will make investments on a global basis with a primary goal of investing in managers offering a significantly discounted fee structure relative to average hedge fund industry fees. The proposed fund will allocate to five to ten managers with a bias towards risk mitigation strategies, including global macro, relative value, and long/short equity and credit.	As of 5/31/2016	Flagship Appreciation Strategy	HFRI FoF Composite Index	Barclays Aggregate Bond Index	MSCI AWI
	1 Yr	-2.90%	-5.90%	3.00%	-5.40%
	3 Yr	3.10%	1.60%	2.90%	5.20%
	5 Yr	3.54%	1.50%	3.30%	5.20%
	ITD	8.04%	5.20%	5.60%	6.10%

Vehicle Information:

Fund Inception:	2016	Subscriptions:	with 30 day notice
Fund Size (\$mil.):	\$1.0 billion	Redemptions (notice):	Monthly upon expiration of the initial three-year lock up
Management Fee:	0.30%	Lock-up:	3 years for each contribution
Profit Allocation:	N/A	Prime Broker:	Bank of America Merrill Lynch, JP Morgan Chase & Co.
Highwater Mark:	N/A	Administrator:	Mitsubishi UFJ Financial Group
Hurdle Rate:	N/A	Auditor:	Deloitte and Touche
		Legal Counsel:	Fried, Frank, Harris, Shriver & Jacobson LLP

NJ AIP Program

Recommended Allocation (\$mil.):	up to \$1 billion	LP Advisory Board Membership:	N/A
% of Fund:	99%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes

*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.