



State of New Jersey

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DEPARTMENT OF THE TREASURY
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State Treasurer

July 27, 2012

MEMORANDUM TO: State Investment Council

FROM: Timothy Walsh
Director

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

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$150 million in MKP Opportunity Partners, LP (“MKP Opportunity” or the “Fund”), managed by MKP Capital Management, L.L.C. (“MKP Capital”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

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

Increased Absolute Return Exposure with Top Decile Manager: An investment in MKP Opportunity provides the portfolio with increased Absolute Return exposure through a top decile manager for the Risk Mitigation asset class, where we are over \$1.4 billion below the FY13 target allocation. We believe increased global macro exposure will benefit the portfolio in the current environment. MKP has generated strong absolute and risk-adjusted performance and the Fund has a since inception annualized return of 9.79% and a Sharpe ratio of 1.36 as of April 30, 2012, placing the Fund in the top decile of all hedge funds and global macro hedge funds on an absolute performance basis and the top percentile on a risk adjusted performance basis. Additionally, the Fund rankings are equally as strong since 2006, when the current strategy was put in place.

Low Correlation to Current Macro Portfolio: The Fund exhibits low, and in some cases negative correlation, to the Division’s current Macro and CTA managers.

Deeply Experienced, Cohesive Team: The Fund is run by a deeply experienced four person Investment Committee (“IC”) consisting of MKP Capital’s two co-CIOs Patrick McMahon and Anthony Lembke, Portfolio Manager Richard Lightburn and Chief Risk Officer Henry Lee. With the exception of Mr. Lightburn, the members of the IC worked together at Salomon Brothers in various roles within fixed income before the firm was founded in 1995 and consequently the senior team has worked together for over 15 years. **Integrated Risk Management Process:** The Chief Risk Officer is a member of the IC and he reports directly to the co-CIOs. He interacts with the PMs directly to discuss trade ideas, profit targets, stop-loss levels, investment horizon and conviction level. This layer of interaction at the portfolio construction level, which continues until the trade is terminated, ensures real time tracking of individual trades and also allows the IC

to monitor the Sharpe ratio of each manager, providing a transparent and fair performance monitoring framework. MKP Capital utilizes a proprietary portfolio and risk management system to accomplish this real-time analysis.

Diversified Portfolio: The Fund is highly diversified and global in nature as a result of both the pod structures and the PMs with specific expertise across global macro, U.S. and global rates, currencies, credit, equities and commodities.

Attractive Terms: The 1.5% management fee is attractive relative to the standard of 2-3% fee for most top tier global macro managers. The monthly liquidity with 60-day notice is also better than average for this strategy.

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

Please note that this investment is authorized pursuant to Articles 69 and 100 of the Council's regulations. MKP Opportunity Fund will be considered an opportunistic 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 Jul 18, 2012. 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 2, 2012 meeting.

Attachments

Fund Name: MKP Opportunity Partners, LP

July 27, 2012

Contact Info: David A. Burke, MKP Capital Management, L.L.C. 600 Lexington Ave, New York, NY 10022

Fund Details:

Total Firm Assets (\$bil.):	\$4.5 billion	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. Anthony Lembke, Henry Lee and Richard Lightburn, 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. Anthony C. Lembke: Principal of MKP, serves as Co-Chief Investment Officer. Mr. Lembke is a member of the Investment Committee and serves on the firm's Management Advisory Committee. Prior to joining MKP in 1998, Mr. Lembke worked for eight years at Salomon Brothers Inc., serving as a Director in the Mortgage Securities Research Department. Henry I. Lee: Chief Risk Officer for MKP, a Partner 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 Partner 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.
Strategy:	Discretionary Global Macro Fund	
Assets in Strategy(\$bil.):	\$1.9 billion	
Year Founded:	1995	
SEC Registration	Yes	
GP Commitment:	approx. 3%	

Investment Summary	Track Record			
MKP Opportunity (the "Fund") is a discretionary global macro fund that uses a top-down fundamental approach to identify and exploit imbalances in global economies and asset classes to produce high risk-adjusted returns over the long term. The Fund seeks to achieve its investment objective by assessing investment and trading opportunities across global asset classes and allocating capital to strategies that offer the most attractive risk-adjusted returns. The Fund generally invests in a diversified portfolio of fixed-income instruments, credit instruments, currencies, commodities, equities and their associated derivatives. Investments may be made on exchanges, over-the-counter and in private transactions. Fund capital is currently managed by seven portfolio managers, one of whom is Patrick McMahon, Co-Chief Investment Officer.	<u>As of Apr 30, 2012</u>	<u>MKP Opportunity</u>	<u>HFRI Macro (Total) Index</u>	<u>S&P 500</u>
	1-Year	10.14%	-5.64%	4.76%
	3- Year	5.99%	3.02%	19.46%
	Inception	9.79%	7.15%	3.34%
	2011	11.41%	-4.16%	2.11%
	2010	-0.34%	8.06%	15.06%
	2009	12.72%	4.34%	26.46%
	2008	9.67%	4.83%	-37.00%

Vehicle Information*:

Fund Inception:	2001	Subscriptions:	Monthly
Fund Size (\$bil.):	\$1.9 billion	Redemptions (notice):	Monthly (60 days)
Management Fee:	1.5%	Lock-up:	None
Profit Allocation:	20%	Prime Broker:	JP Morgan, Credit Suisse
Highwater Mark:	Yes	Administrator:	SEI Global Services
Hurdle Rate:	No	Auditor:	Ernst & Young
Additional Expenses:	approx. 17 bps	Legal Counsel:	Schulte Roth & Zabel, Ogier (Cayman)

NJ AIP Program

Recommended Allocation:	\$150 million	LP Advisory Board Membership:	N/A
% of Fund:	7.89%	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.