

December 7, 2007

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Hedge Fund Investments in Level Global, LP
and Pendragon (Lancelot II) Fund, LLC**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9(a) to report on two proposed direct hedge fund investments: a \$75 million commitment to Level Global, L.P. to be managed by Level Global Investors in New York and a \$75 million commitment to Pendragon (Lancelot II) Fund, LLC. to be managed by Pendragon Capital in London.

Please note that these investments will be authorized pursuant to Articles 69 and 100 of the Council's regulations. The Level Global investment will be considered an Equity Long/Short Fund, while the Pendragon investment will be considered a Low Volatility Fund investment as defined under N.J.A.C. 17:16-100.1.

The Alternative Investments Procedures adopted by the Council on January 20, 2005 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (myself in an acting capacity) and the applicable Asset Class Consultant (Cliffwater LLC for direct hedge funds, or "Cliffwater").

As a result of internal and external sourcing, the DOI Investment Committee identified these proposed investments. Cliffwater and Division staff proceeded to undertake extensive due diligence on these proposed investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Based on this due diligence, the Division has determined that each of the proposed investments meets the criteria for investments set forth in the Alternative Investment Procedures.

Level Global Investors was founded in 2003 by David Ganek and Anthony Chiasson, formerly at SAC Capital. The firm manages \$3.1 billion and is selectively open. Level Global Investors is a long/short equity hedge fund that primarily invests in the technology and financials sectors, with smaller weightings in telecommunications - media, consumer, and energy areas. Level combines a fundamental research oriented approach with event driven trading. Level first takes a longer term secularly driven view of a company and then looks for catalysts or other events that will over the short term drive the price of its stock. The manager seeks to add value from both the long and short investments. The fund's exposures are an outgrowth of the bottom-up stock selection process and will change over time. Since inception Level has a very low net exposure, as compared to the typical long/short equity fund's 50% net long posture. The portfolio is highly diversified with over 150 positions. From August 2003 to October 2007, Level has an annualized net return of 14.43% with a 5.54% standard deviation. Level has 57 employees including 29 investment professionals based in New York and Greenwich.

Pendragon Capital was formed in December 1999 by Gordon Lawson (who retired in 2004), Kaveh Sheibani and Julian Harvey Wood, who formerly managed proprietary capital on the European Risk Arbitrage Desk at Salomon Brothers (later Salomon Smith Barney and then Citigroup). Citigroup maintains an investment in the fund and has a small economic interest in the firm. Pendragon manages \$3.5 billion in an event driven strategy focused on European companies, particularly small and middle capitalization ones. The fund's event value strategy seeks fundamentally mispriced companies where an event will lead to a revaluation of the company. Dependent on market conditions, Pendragon also makes opportunistic investments in other strategies, including merger arbitrage, convertible arbitrage, credit, share spread trades and distressed restructurings. Pendragon applies a fundamental process relying on extensive bottom-up research and a deep understanding of companies and risks. Pendragon seeks to minimize exposure to unwanted risks and retain the exposure to potential value creating events via specific position level hedges. The fund makes modest use of leverage. The fund is diversified across 20 to 40 individual positions. Since inception in January 2000 to October 2007, the fund has generated an annualized return of 12.97% with volatility of 7.53%. Over the past three years, November 2004 to October 2007, the Pendragon Event Fund returned 19.74% with an annualized standard deviation of returns of 9.95%. The firm is located in London where all 37 employees are located. The firm is registered with both the FSA and the SEC.

A formal written due diligence report for each of the proposed investments was sent to each member of the Investment Policy Committee of the Council on December 7, 2007, and a meeting of the Committee was held on December 12, 2007. In addition to the formal written due diligence reports, all other information obtained by the Division on these four investments was made available to the Investment Policy Committee.

After a review of the due diligence conducted on each fund, the Investment Policy Committee of the Council decided to report on these proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures. Under these procedures, the Council may adopt or otherwise act on this report.

Attached to this memorandum is the SIC Investment Committee Fund Review Memorandum for each proposed 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 each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution will not be reached with one or more of these managers.

We look forward to discussing these proposed private equity investments at the Council's December 20, 2007 meeting.

WGC/MK:lt
Attachments