

February 13, 2008

MEMORANDUM TO: State Investment Council

FROM: William G Clark  
Director

SUBJECT: **Proposed Hedge Fund Investment  
in Pershing Square II, L.P.**

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 a proposed \$100 million direct absolute return fund commitment to Pershing Square II, L.P. to be managed by Pershing Square Capital Management in New York.

Please note that this investment will be authorized pursuant to Articles 69 and 100 of the Council's regulations. The investment will be considered an Equity Long/Short 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 this proposed investment. Cliffwater and Division staff proceeded to undertake extensive due diligence on the proposed investment. 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 the proposed investment meets the criteria for investments set forth in the Alternative Investment Procedures.

Pershing Square Capital Management, L.P. (“PSCM”) is a \$6 billion asset management company founded by William Ackman in 2004. PSCM is located in New York City, where all of its 23 employees are located. The firm is a registered investment advisor with the U.S. Securities and Exchange Commission. The firm’s sole product is a concentrated, deep-value, activist hedge fund. They seek 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. Pershing Square has produced very strong absolute and risk-adjusted returns. From inception in January 2004 to December 2007, the fund has generated an annualized return of 31.46% with a 16.44% standard deviation. Over this period the HFRI Event Driven Index had a return of 11.03%. Due to its concentrated approach, the fund will be more volatile than the average hedge fund.

A formal written due diligence report for the proposed investment was sent to each member of the Investment Policy Committee of the Council on February 8, 2008, and a meeting of the Committee was held on February 13, 2008. In addition to the formal written due diligence reports, all other information obtained by the Division on this investment was made available to the Investment Policy Committee.

After a review of the due diligence conducted on the fund, the Investment Policy Committee of the Council decided to report on the proposed investment 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 the 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 the investment. In addition, the 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 the manager.

We look forward to discussing this proposed absolute return investment at the Council’s February 21, 2008 meeting.

WGC/MK:lt  
Attachments