



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290


CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

March 18, 2011

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh
Director 

SUBJECT: **Proposed Investment in Reservoir Strategic Partners Fund, L.P.**

The New Jersey Division of Investment is proposing an investment of \$200 million in Reservoir Strategic Partners Fund, L.P. fund. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

The Division of Investment ("Division") Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on this proposed investment. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Reservoir Capital Group L.L.C. (RCG) was founded in 1998 by Daniel Stern, Craig Huff and Gregg Zeitlin. The firm currently manages \$4.5 billion in a series of opportunistic hedge funds that make investments in both public and private markets, with a focus on out-of-favor sectors and asset classes, including seed investments in external hedge fund managers. The firm is launching a standalone seeding fund, Reservoir Strategic Partners Fund, L.P., structured as a fund of hedge funds to invest in new and emerging hedge fund investment managers. Reservoir's partners have a long history of seeding alternative investment managers that pre-dates the formation of the firm. Reservoir Strategic Partners is expected to raise \$1.5 billion and have a first close on May 1, 2011 and a final close during the summer of 2011. Reservoir employs a total of 68 people including 15 investment professionals. In 2010, affiliates of Credit Suisse Group AG acquired a passive, minority ownership interest (24.9%) in RCG.

Reservoir Strategic Partners Fund, L.P. will make seed investments on a global basis in managers who have exceptional talent within a given asset class, sector or investment strategy, in asset classes or sectors that are out of favor or are experiencing a loss of capital, and in investment businesses that are scalable through market cycles. In forming the new investment firms, the fund will invest on preferential economic terms, receive a minority ownership interest, and secure other rights and provisions that will mitigate start-up risk and provide downside protection. Reservoir expects to invest in 8 to 12 underlying hedge funds with investments of \$150 million to \$300 million per underlying fund.

Reservoir has produced very strong absolute and risk-adjusted returns from its seeding activities. From January 1999 through December 2010, they have generated an annualized return of 14.96% with volatility

of 9.88%, resulting in a Sharpe ratio of 1.15. Reservoir expects to outperform the broad hedge fund universe by 600 basis points over a full market cycle. Reservoir seeks to manage risk by investing in 8 to 12 underlying hedge funds and limiting an individual fund to 15% of overall assets. Reservoir will typically have full, daily portfolio transparency and conduct regular detailed position reviews with seeded firms. The risk management system, Novus Partners, will aggregate position level information. Risk management is overseen by the Investment Committee. The manager may also hedge major market and factor risk.

Reservoir has a deep and experienced operations group. The operations team is led by Celia Felsher, the Chief Operating Officer and General Counsel, and Norman Katzwer, the Director of Finance, who have significant industry experience and totals 53 employees. The senior professionals have implemented a comprehensive framework to manage the trading and business operations. The manager will provide detailed investor reporting with portfolio exposures. No material departures from best practices were found in the operational due diligence analysis.

Reservoir Strategic Partners Fund, L.P. will be structured as a drawdown fund with an unlimited term. After the initial three year lock-up on each contribution, the fund will offer semi-annual liquidity with 95 day notice. The fund will charge a 1.5% management fee on capital commitments and a 20% incentive fee on distributions which will be held in escrow during the lock-up period. Large investors who commit at the first close will receive a reduction in the management fee; 75 basis points on committed capital, 100 basis points on invested capital. The minority interests in the underlying seed fund management entities will vest over a three year period after the expiration of the lock-up. The fund will have an Advisory Committee comprised of investors and has a key man provision on both Messrs. Stern and Huff.

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, proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4).

Please note that this investment is authorized pursuant to Articles 69 and 100 of the State Investment Council's (the "Council") regulations. Reservoir Strategic Partners Fund, L.P. fund will be considered a Multi-Strategy Fund of Funds investment, as defined under N.J.A.C. 17:16-100.1.

Formal written due diligence reports for the proposed investments were sent to each member of the Investment Policy Committee and a meeting of the Committee was held on March 17, 2011. In addition to the formal written due diligence reports, all other information obtained by the Division on the investments was made available to the Investment Policy Committee.

We look forward to discussing the proposed investment at the Council's March 24, 2011 meeting.

Attachments

SIC Fund Review Memo

To: State Investment Council
From: Division of Investment
Date: March 24, 2011
Subject: Reservoir Capital Group, LLC
Recommendation

Fund Facts

Fund Name:	Reservoir Strategic Partners Fund, LP
Fund Type:	Fund of Funds
Current Fund Size:	\$1.5 billion at close
Inception:	Launching May 1, 2011
Fund Address:	650 Madison Avenue New York, NY 10022

Investment Rationale:

This is a new investment to a Fund of Funds which will provide seed capital to new and emerging hedge funds. NJ DOI is seeking to invest \$200 million to the Reservoir Strategic Partners Fund. Reservoir is launching a seeding fund structured as a fund of hedge funds to invest in new and emerging hedge fund investment managers. Reservoir's partners have a long history of seeding alternative investment managers and since January 1999 have generated a net annualized return of **14.96%** from seeding activities. Reservoir Strategic Partners is expected to raise \$1.5 billion and have a first close on April 30, 2011 and a final close during the summer of 2011. As a large and early investor, NJ will receive a substantially **reduced management fee**.

Summary of Terms and Investment Strategy

Investment Strategy:	Reservoir Strategic Partners will make seed investments on a global basis in managers who have exceptional talent within a given asset class, sector or investment strategy, in asset classes or sectors that are out of favor or are experiencing a loss of capital, and in investment businesses that are scalable through market cycles. In forming the new investment firms the fund will invest on preferential economic terms, receive a minority ownership interest, and secure other rights and provisions that will mitigate start-up risk and provide downside protection. Reservoir expects to invest in 8 to 12 underlying hedge funds with investments of \$150 million to \$300 million per underlying fund.
Fee Terms:	
Management and Performance Fees:	NJDOI Negotiated Management fee of 0.75% on committed capital and 1.00% on invested capital; this compares to the standard management fee of 1.5% on committed capital. Performance fee - 20% net of underlying hedge fund performance fees and held in escrow during the lock-up
Other Fees:	Fund expenses - approximately 10 bps
Hurdle Rate:	None
Service Providers:	
Prime Broker(s):	Not applicable
Administrator(s):	HedgeServ
Auditor(s):	Ernst & Young
Legal Counsel:	Paul, Weiss, Rifkind, Wharton & Garrison
Liquidity/Redemption Terms:	
Lock-up:	3 years on each contribution
Redemption:	Semi-annual with 95 day notice
Side Pocket:	Up to 20%

NJ AIP Program:

Recommended Allocation Current:	\$200 mil
% of Fund:	13.33%
% of New Jersey State Pension Plan:	0.29%
% of AIP Hedge Fund Allocation (\$3.5b):	5.71%

Consultant Recommendation:	Yes
*see due diligence memo	
Compliance with SIC "Pay to Play" Reg:	Side letter required

GP Contact Info

Name:	Emily L. Henry
Telephone:	(212) 610-9018
Email:	ehenry@reservoircap.com

* This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternative Investment Program and the policies and procedures related thereto