May 16, 2008

MEMORANDUM TO: State Investment Council

FROM: William G. Clark, Director

SUBJECT: Proposed Investment in Cargill ProAlpha Commodity Program

This 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 investment of up to $500 million in the Cargill ProAlpha Commodity Program (the "Cargill Program"), explained below. The Cargill Program is managed by Cargill Risk Management ("CRM"), a wholly-owned subsidiary of Cargill, Incorporated.

Please note that this investment will be authorized pursuant to Articles 69 and 71 of the Council's regulations. The Cargill Program will be considered a Commodity-linked investment as defined under N.J.A.C. 17:16-71.1.

The Alternative Investment Procedures adopted by the Council in February 21, 2008 require any potential alternative investment opportunities to be identified and initially evaluated by the applicable staff of the Division of Investment ("DOI") and the applicable Asset Class Consultant (in this case SIS) in coordination with the DOI Investment Committee (Director, Deputy Director and senior fund staff member). For this particular asset class the DOI Investment Committee consisted of Mike Sawyer, Senior Investment Analyst, and myself.

As part of the Fiscal Year 2008 Investment Plan, the State Investment Council authorized a target allocation of 4 percent of the portfolio as of June 2008 dedicated to commodities and other real assets. The rationale for this allocation was that (1) strong global growth driven by emerging markets countries would cause demand for commodities to increase over a multi-year period, (2) commodity returns often serve as an effective hedge against increases in inflation, and (3) commodities over the long-term are extremely uncorrelated to other investments in the portfolio, thereby reducing the portfolio's overall risk level.

Given the current size of the portfolio, that four percent (4%) target allocation is roughly $3 billion. Our current dedicated Commodity linked investments, through the portfolios managed by Gresham and Schroders, totals $800 million. During our commodity manager search last year, we identified Cargill as a potential third manager and valuable strategic partner given the firm's presence in the global commodities markets. At that time, the product structure and terms had not been fully developed. In the meantime we maintained correspondence with Cargill and met with the CRM Investor Based Products ("IBP") team in Minnetonka, MN on February 22, 2008.

Cargill was established in 1865 by William Wallace Cargill as the first grain storage facility in the Midwest. Cargill now has 158,000 employees, with operations in 66 countries. It is one of the largest privately held corporations in the world, with annual revenues of $88 billion and a net worth of over $16 billion. Affiliates include Mosaic, Black River Asset Management (with whom we have a relationship in our hedge fund portfolio), and CarVal Investors.

<u>Cargill Risk Management ProAlpha Commodity Program</u> will seek to provide core exposure to the commodities asset class through beta and alpha components. The beta component is based on a total return swap between Cargill and Common Pension Fund E linked to either the S&P Goldman Sachs Commodity Index or Dow Jones AIG Commodity Index; we intend to utilize the Dow Jones AIG Index because it has less concentration in energy-related commodities than the GSCI. Either the Traditional (roll schedule on the 5^{th} through 9^{th} business day) or Enhanced (modified roll schedule) version of either Index can be utilized; we expect to utilize the Enhanced roll strategy.

The Alpha Strategy is a basket of relative value spread trades actively managed by the CRM IBP team, which consists of ten investment professionals and is led by David Dines, President of CRM. This team serves the institutional investor community. CRM employs about 100 people worldwide.

The overall objective of the Alpha Strategy is to exceed the return of the underlying Index by 3-5% per annum, with about 10 trades being executed at any one time. The trades will be either intra-market (time spreads) and/or inter-market (spreads across related markets) and will be close to dollar-neutral at all times.

All Alpha Strategy trade ideas originate from the trading desks embedded within the physical trading Business Units ("BUs"), each of which are leading traders, suppliers, and processors within their respective areas. These include:

- Cargill Grain
- Cargill Petroleum
- Cargill Power & Gas North America
- Cargill Cotton
- Cargill Animal Protein
- Cargill Sugar
- Cargill Cocoa
- Cargill Coal

The trade ideas are communicated to the Alpha Investment Committee ("AIC"), which is responsible for evaluating trade ideas, sizing the trade appropriate to risk, and handling all aspects of execution and monitoring and typically mimic similar trades/themes that the BUs execute in the physical and/or futures markets for either hedging or proprietary trading purposes. The BUs are incentivized to provide ideas to the AIC through a profit sharing mechanism.

ProAlpha trade positions are provided to investors on a daily basis, along with the calculation of the Reference Index. The Swap is reset monthly, will be unwound annually at the end of Cargill's fiscal year (May 31), and has daily liquidity. Loss tolerance levels for individual trades vary between 5 and 10 basis points, with the Alpha Strategy having a lower expected aggregate loss tolerance due to the correlations of trade P&Ls being below 1.0. It is expected that about 40-50 trades will be executed over the course of a full year. Fees are 50 bps of the notional beta exposure (reset monthly) with an additional performance fee of 20% of any positive profits, calculated daily from the swap Trade Date to the Termination Date.

CRM Credit handles credit approvals and margin and collateral management; Cargill Inc. is the counterparty, not CRM. The Division will require an ISDA agreement for this investment (in process). Since this investment is structured as a total return swap, there is no original principal investment with Cargill but we will be required to pay Cargill a quarterly interest amount equal to 3-month LIBOR in return for the commodity return stream. In order to provide for this interest payment to Cargill, we will invest the notional amount of the swap in our Cash Management Fund.

Based on our due diligence, the Division has determined that the proposed investment meets the criteria for investments set forth in the Council's Alternative Investment Policy. The Division believes it will not only benefit from the Fund's investment returns but that Cargill will be a valuable resource for Division staff in generating its own investment ideas.

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 this 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 this manager.

We look forward to discussing this proposed real asset investment at the Council's May 22, 2008 meeting.

WGC:lt
Attachment

*SIC Investment Committee Fund Review Memo

To:	**State Investment Council**
From:	**SIC Investment Committee**
Date:	**May 6, 2008**
Subject:	**Cargill Recommendation**

Fund Facts

Fund Name:	Cargill ProAlpha Index Swap
Fund Type:	Active Commodities
Current Fund Size:	$250 million
Previous Fund Size/Vintage:	N/A
Final Close:	N/A; $2 billion in estimated capacity
Fund Address:	12700 Whitewater Drive and 311 S. Wacker Drive, Ste 5410 Minnetonka, MN 55343 Chicago, IL 60606

GP Contact Info

Name:	Tom King
Telephone:	(312) 789-901
Email:	tom_king@cargill.com

Summary of Terms and Investment Strategy

Investment Strategy:	The Swap will provide beta exposure to the Traditional or Enhanced S&P/GSCI or DJ-AIG Indexes and seeks to generate 3-5% outperformance annually through a basket of 40-50 relative value commodity trades per year. These trade ideas are provided by the glo
Geographic Focus:	Global
GP Co-Investment Amount:	N/M
Terms:	
Term:	1-Year, reset monthly with daily liquidity
Investment period:	Continuous
Management Fee:	0.50% per annum for a $500 million portfolio plus 20% of profit of each trade.
Other Fees:	None
Hurdle Rate:	Traditional or Enhanced S&P/GSCI or DJ-AIG Index

NJ AIP Program:

Recommended Allocation:	$500 million
% of Fund:	25% at full capacity (66.7% currently)
% of New Jersey State Pension Plan:	0.60%
% of AIP Commodities Allocation ($3 b):	16.67%
% of Commodities Allocation for FY08 ($1 b):	50.00%

LP Advisory Board Membership:	In process of developing investor advisory board.
Consultant Recommendation:	Yes
Compliance with SIC "Pay to Play" Reg:	Side letter required

*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.