Recommendation on Phase III of Hedge Fund Implementation Plan

To: RISIC
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The purpose of this memo is to provide RISIC with a summary of Cliffwater's recommendation for Phase III of the Hedge Fund Implementation Plan. To date, six funds were approved for Phase I in September and six funds were approved for Phase II in October. Due to time constraints, we have added a Phase IV. Phase III as presented in this memo, recommends five funds and the final recommendation will be Phase IV for three funds. Phase IV will likely be presented at the January RISIC meeting.

Cliffwater has presented to the RISIC an investment plan for hedge funds. The goal of the plan is to reduce volatility in the ERSRI portfolio (or the "Fund") as well as individual long-only asset classes and to improve the Sharpe Ratio of the Fund.

The overall investment plan calls for an allocation of 15% of the Fund to hedge funds. The hedge fund allocation will consist of three components, grouping hedge funds strategies by associated market beta. As shown in Table 1 below, 8% of the 15% hedge fund allocation will be made to equity related strategies (i.e. equity long/short and event driven strategies) and they will be allocated to the Fund's global equity allocation. Similarly, 5% of the 15% hedge fund allocation will be made to absolute return strategies (i.e. global macro and multi-strategy) and they will be allocated to the Fund's real return allocation; 2% of the 15% hedge fund allocation will be made to fixed income strategies (i.e. credit and relative value strategies) and they will be allocated to the Fund's fixed income allocation.

Table 1.

	RISIC Policy		Recommended Hedge Fund Allocations		Recommended Structure	
	% Target	$ Target	% Target	$ Target	# Funds	$/Fund
Cash	3%	$210				
Fixed Income	20%	$1,400	2%	$140	3	$47
Real Estate	8%	$560				
Real Return	11%	$770	5%	$350	7	$50
Global Equity	51%	$3,570	8%	$560	10	$56
Private Equity	7%	$490				
	100%	$7,000	15%	$1,050	20	$53

Recommendations on individual hedge funds will be subject to the following:

1. Completion of investment due diligence by Cliffwater
2. Completion of operations due diligence by Cliffwater
3. A recommendation to invest by Cliffwater
4. A review of the hedge fund's fit within the Hedge Fund Implementation Plan

Cliffwater recommends that the Hedge Fund Implementation Plan be executed in four phases over a six month period with a recommendation on three to six managers per phase. Cliffwater is currently recommending Phase III which consists of five managers. Table 2 lists the five managers that are recommended. The appendix to this memo includes a summary of our recommendation report for each manager.

Table 2.

Asset Class	*Strategy*	*Manager/Fund*	*Recommend Amount (Millions)*
Global Equities	Long Short Equities	Indus Asia Pacific	$40
	Event Driven	Third Point	$50
Real Return	Global Macro	Graham Global	$50
	Global Macro	Blue Crest	$20
	Multi-Strategy	Wexford Spectrum	$50

Table 3. on the next page shows Cliffwater's share class recommendation for each fund. The table also shows the terms for the recommended share class.

Table 3. Recommended Share Class and Terms

	Hedge Fund Terms (recommended share class)												
	Subscriptions	Mgmt Fee	Perf Fee	Hurdle	High Water Mark	Expense Ratio	Lock Up	Redemption Frequency (includes investor level gates)	Early Withdrawal Fee	Fund Level Gate	Max Side Pocket	Vehicle*	Share Class
Global Equities													
Indus Asia	Monthly	1.50%	20%	None	Yes	0.20%	1 yr hard	Quarterly	None	None	None	Onshore	
Third Point	Quarterly	2.00%	20%	None	Modified - 10% while recouping 250% of losses	0.55%	1 year soft	Quarterly	5%	20%	Opt out	Onshore	
Real Return													
BlueCrest	Monthly	2.00%	20%	None	Yes	1.01%	1 yr soft	Quarterly	5%	10%	None	Onshore	Class B
Graham	Monthly	2.00%	20%	None	Yes	0.25%	None	Quarterly	None	None	None	Offshore	
Wexford Spectrum	Monthly	1.50%	20%	None	Yes	0.43%	1 yr hard	Quarterly	None	20%	Opt out	Onshore	

Appendix – Manager Recommendation Summaries

Indus Capital Partners

People and Organization: Indus Capital Partners ("Indus") was founded in 2000 by five former colleagues from Soros Fund Management, including David Kowitz who managed the Asia Pacific portfolio. The firm's main focus is equity long/short within the Asia Pacific region. Headquartered in New York, Indus has seven offices worldwide with 92 employees including more than 40 investment professionals. Senior professionals have a substantial portion of their net worth invested in the funds, representing more than [redacted] of firm assets. Indus is registered with the SEC.

Investment Strategy and Process: Indus applies a fundamental bottom-up approach to equity long/short investing in the Asia Pacific ex-Japan region, but also incorporates their view of the macro environment, attempting to capture the sensitivity of various companies within this backdrop. Their approach relies heavily on meetings with management teams and detailed financial models to identify the catalyst(s) in fundamentally undervalued companies. Indus pursues alpha generating shorts, as well as market hedges, and maintains net long exposure in the range of 30%-70%.

Performance: Indus Asia Pacific has generated strong performance since inception in December 2000. The fund has produced a net annualized return of 10.34% with a 9.05% standard deviation, resulting in a 0.85 Sharpe ratio.

Risk Management: The fund does not have strict sector, country, size, or loss limits, but maintains a set of risk guidelines including limiting exposures relative to liquidity, exiting positions where the thesis does not develop, and limiting losses to individual names. The fund is typically diversified across more than 100 positions, with positions sized by Mr. Kowitz, taking factors such as liquidity into consideration. The fund typically has 60% of the portfolio in 25-30 core names, but position sizes are managed to limit losses to no more than 1.5% of NAV. Indus's shorts are typically fundamental, but they may hedge security, market and macro risks utilizing individual names, indices, ETFs and CDS, and the fund often maintains out-of-the-money puts as protection against large market drawdowns.

Operational Analysis: Indus has a solid operational and back-office infrastructure. The firm has more than 40 employees dedicated to operations, accounting, IT, investor relations and legal functions and has experienced team members heading these functions. Monthly, Indus provides detailed portfolio characteristics and exposure reports, along with commentary. No material departures from best practices where found during Cliffwater's onsite operational review.

Investment Terms: The fund charges a 1.5% management fee and 20% performance fee. There is a one-year lock with quarterly withdrawals available upon 30 days notice. The high water mark has a two-year loss carryforward provision whereby no performance fee is charged until the preceding two-year loss is offset by current year net profits.

Third Point LLC

People and Organization: Third Point LLC ("Third Point" or the "firm") was founded in 1995 by Daniel Loeb. The firm currently manages $4.4 billion in its flagship event driven fund, Third Point Partners LP / Third Point Qualified LP / Third Point Offshore Fund, Ltd. ("Third Point" or the "fund"), its levered fund, Third Point Ultra Ltd, and two separately managed fund platforms. Third Point employs a total of 54 people, of which 20 are investment professionals. In addition, the firm has an investment vehicle, Third Point Offshore Investors Ltd. ("TPOU"), which was listed on the London Stock Exchange in 2007 that currently represents 15% of assets. The firm is headquartered in New York City and has been registered with the SEC since January 2006. The firm is [redacted] owned by Daniel Loeb, but he is in the process of naming additional partners. At [redacted] of NAV, Third Point's employees are, collectively, the largest investor in the fund.

Investment Strategy and Process: Third Point is an opportunistic event driven fund with a value oriented investment style. Third Point's investment process is research-intensive, relying on fundamental, bottom-up analysis of each investment opportunity. The manager seeks to identify companies where a clear catalyst will unlock value. The fund is nimble and has the experience to opportunistically diversify investments across industries, geographies, and asset classes. The fund focuses on the following areas; long/short equity, special situations, risk/merger arbitrage and credit.

Performance: The fund has produced very strong absolute and risk-adjusted returns for over fifteen years. From its inception in June 1995 through November 2010, the fund generated an annualized return of 22.15% with volatility of 14.04%, resulting in a Sharpe ratio of 1.24.

Risk Management: Risk is managed by portfolio manager, Daniel Loeb. In addition, Third Point employs two dedicated risk reporting professionals and has a firm-wide risk committee that meets weekly and applies a proprietary, in-house risk management system, [redacted] to evaluate portfolio risk exposures. Individual positions are sized based on probability weighted estimates of upside and downside, with a general guideline of limiting the downside to 2% at the position level.

Operational Analysis: Third Point has made a substantial investment its middle and back office infrastructure. The operations team is led by chief administrative officer Mr. Jim Gallagher who has significant industry experience and totals 34 employees. The senior professionals have implemented a comprehensive framework to manage the trading and business operations. Investor transparency includes a monthly report detailing portfolio exposures on a number of metrics and very detailed quarterly letters. The fund departs from best practices by relying on its external administrator, [redacted] to keep its general ledger information rather than maintaining a full shadow set of books and records. However, the risk that arises from this departure from best practices is minimal because the manager has a low trading volume and reviews the work of [redacted] on a daily basis. No other material departures from best practices were found in the operational due diligence analysis.

Investment Terms: Third Point offers quarterly liquidity with 60 days notice following a one year soft lock-up period which allows redemptions subject to a 5% penalty payable to the fund. The fund charges a 2% management fee and a 20% performance fee. The incentive allocation is subject to a modified high water mark provision, which is favorable to Third Point. However, it requires that the fund recoup 250% of prior losses, which is a more favorable modified high water mark for investors. There is a key man provision for Mr. Loeb.

BlueCrest Capital Management

People and Organization: BlueCrest Capital Management LLP ("BlueCrest" or the "firm") was founded in 2000 by Michael Platt and William Reeves. BlueCrest Capital International ("BCI" or the "fund") was launched in December 2000. The firm manages $23.9 billion in assets, including $8.1 billion in BCI, a discretionary global macro fund. BlueCrest is headquartered in Guernsey and maintains offices in Geneva, London, New York, Boston, and Singapore. The firm has 364 employees, of which 185 are investment professionals. Firm ownership is split such that [redacted] is owned by the firm's partners and [redacted] by Man Group plc. Mr. Platt has invested the vast majority of his liquid net worth in BlueCrest funds. The firm is registered with the SEC, the FSA and the Guernsey Financial Services Commission.

Investment Strategy and Process: The fund employs both directional macro and relative value trading strategies primarily in the global fixed income, FX and equities markets. The fund follows a specialist model where the members of each team have in-depth experience trading within a defined universe. A dynamic, top-down portfolio construction process, driven by Mr. Platt, allocates capital to strategy desks and individual traders. The fund is currently comprised of an allocation to a diversified group of strategies including rates, fixed income relative value, FX volatility arbitrage, fixed income absolute return, equity derivatives and venture finance.

Performance: The fund has generated very strong absolute and risk-adjusted returns, posting an annualized return since inception of 14.53% and a standard deviation of 6.03%, resulting in a Sharpe ratio of 1.84 from the period December 2000 through October 2010.

Risk Management: The risk oversight process at BlueCrest is an independent function run by [redacted], chief risk officer. BlueCrest manages its risk through the diversification of the traders' styles, strict solvency leverage rules and strictly enforced stop-loss rules for all traders.

Operational Analysis: BlueCrest has made a substantial investment in building out its middle and back office teams and infrastructure. BlueCrest distinguishes itself from other hedge fund groups as it is currently working to complete a level 2 SAS 70. There is an experienced back office team led by the firm's CEO and CFO. No material departures from best practices were identified.

Investment Terms: BlueCrest's terms are generally in-line with other hedge fund strategies and the fees are better than most discretionary global macro funds but the liquidity provisions are worse. Management fees for the different share classes range from 1.5% to 2% and performance fees range from 20% to 25%. All share classes have a soft lock up and redemptions are monthly or quarterly, and subject to different gates, depending on the share class.

Graham Capital Management

People and Organization: Graham Capital Management, L.P. ("GCM," "Graham" or "the manager") is a Connecticut-based asset management company founded in 1994 by Kenneth Tropin. GCM is [redacted] owned by KGT Investment Partners, which is in turn [redacted] owned by Mr. Tropin. GCM began as a systematic global macro trend-following investment firm but expanded in 1999 to include discretionary global macro trading strategies. The discretionary macro traders exclusively managed Mr. Tropin's proprietary capital until 2004, when the firm launched the Discretionary-6V fund ("D6V" or "the fund") and took external capital. Today, the firm manages $8.6B across systematic and discretionary strategies. The discretionary macro strategies (D6V + D12V) have $1.7B in assets under management.

Investment Strategy and Process: D6V combines 14 of GCM's most successful discretionary trading strategies into a single fund. D6V's underlying component strategies trade all major liquid asset classes globally: rates, credit, commodities, currencies, and equity index markets. Trading strategies vary from relative value-focused to directionally-focused, and time periods vary from short-term (intra-day) to long-term (3 month+). The key to the diversification of D6V is the idiosyncratic nature of each of the 14 underlying strategies' return streams.

Performance: The D6V Fund aims to maximize Sharpe ratio with a target volatility of 5-7%. The D6V Fund has generated a 7.12% return with a standard deviation of 5.64% since inception, for a Sharpe ratio of 0.79 over the period June 2004 to August 2011.

Risk Management: An eight-person Risk Committee meets daily to review position-level details, current market conditions, performance by strategy, and firm-wide liquidity and counterparty risk. The chief risk officer's four-person risk team monitors daily P&L of the 14 portfolio managers as well as the 10 "farm team" proprietary capital portfolio managers. Each portfolio manager is subject to strict position and concentration limits. Similarly to other global macro managers, the firm applies a stop-loss risk management framework. Portfolio managers are required to reduce risk by 50% as they experience a peak-to-through rolling monthly drawdown in excess of 5%.

Operations Analysis: Graham's team of 93 non-investment professionals effectively manages all trading and business operations. The manager has institutional-quality processes and controls related to trade confirmation and reconciliation. The firm is registered with the CFTC and has developed robust compliance and risk monitoring procedures. The independent administrator, [redacted] has a dedicated team of 25 to ensure focus on the valuation and maintenance of the official books and records of the firm. No material departures from best practices were identified during Cliffwater's operational due diligence.

Investment Terms:
D6V charges a 2% management fee and a 20% performance fee subject to a high-water mark. These fees are in line with hedge fund standards and lower than Graham's multi-manager global macro peers. Redemption terms are quarterly with 30-days' notice. There are no lock-ups, hurdle rate, gates or side-pockets. No key man provisions are provided by the fund.

Wexford Capital

People and Organization: Wexford Capital LP ("Wexford" or "the firm") was founded by Charles Davidson and Joseph Jacobs in 1994. The firm currently manages $7.0 billion, including $4.6 billion in three hedge funds and $2.3 billion in 13 vintage year private equity funds. The majority of the assets in the hedge fund business are invested in the multi-strategy Spectrum Fund ("the fund"), which currently has $3.8 billion in assets under management. The firm is based in Greenwich, CT, where most of its 86 employees are located. The management company is owned by the ten partners, with a [redacted] held by Mr. Davidson. Wexford has been registered with the SEC since 1997.

Investment Strategy and Process: The Wexford Spectrum Fund pursues an opportunistic, multi-strategy approach to investing that is guided by a strong value bias, global macroeconomic views and consideration of market psychology and sentiment. The fund has a more narrow focus than many other multi-strategy funds and tactically allocates capital among a more limited number of strategies. Underlying strategies include long/short equity (with a particular focus on energy/natural resources, real estate, technology/telecommunications and transportation), bankruptcy/distressed, fixed income macro and commodities.

Performance: Wexford Spectrum has produced strong absolute and risk-adjusted returns on a standalone basis and relative to other multi-strategy funds. Since inception in April 1997 through May 2011, the fund generated an annualized return of 14.42% with volatility of 10.50%, resulting in a Sharpe ratio of 1.02.

Risk Management: Portfolio manager [redacted] is responsible for the risk management of the Wexford Spectrum Fund. The strong value bias and contrarian nature of the investment process reinforces the general risk management philosophy that "buying cheap is the best hedge". The majority of the positions are highly liquid and concentration limits are strictly enforced. The fund also utilizes soft stops or flags when trades experienced downside moves greater than 5%.

Operational Analysis: Wexford's back office team of 47 non-investment professionals has developed an institutional-quality platform to handle the wide range of products it trades. The manager has developed processes for trading, reconciliation and valuation for each security type in the portfolio. In addition, the manager has been a Registered Investment Advisor for over 10 years and is also registered with the Commodity Futures Trading Commission and with the National Futures Association. Wexford has an affiliate office in Toronto, Canada and a wholly owned subsidiary office in Tel Aviv, Israel but all its operational professionals are located in their Greenwich, CT headquarters. No material departures from best practices were identified except that the risk management process is not completely independent from the portfolio management process.

Investment Terms: Wexford Spectrum offers standard terms for a multi-strategy fund, including a 1.5% management fee and 20% performance fee. The fund requires a one year hard lock-up period and has quarterly liquidity with 90 day notice period thereafter. There is a multi-tiered gate, although Wexford has not enforced this provision. Investors may elect to invest 10%, 20%, or 30% of their capital in side pockets (or opt out completely).