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March 12, 2010

MEMORANDUM TO: State Investment Council

FROM: Ray Joseph
Acting Director

SUBJECT: **Proposed Investment in a Commodity-Linked Note Issued by Cargill, Inc.**

This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9 to report on a proposed investment of $150 million in a Commodity-Linked Note ("CLN") to be issued by Cargill, Inc.

Please note that this investment is authorized pursuant to Articles 69 and 71 of the State Investment Council's regulations. The CLN is considered a commodity-linked investment as defined under N.J.A.C. 17:16-71.1. Division of Investment ("Division") staff undertook extensive due diligence on this proposed investment, dating from the time a proposed investment in the Cargill ProAlpha Commodity Program was initially presented to the Council on May 16, 2008.

In 2008, the investment in the Cargill ProAlpha Commodity Program was presented as a total return swap between Cargill, Inc. and Common Pension Fund E. For the reasons described below, we now propose to effect what is essentially the same economic investment through the purchase of a CLN issued by Cargill, Inc.

Since the Cargill investment was presented in May 2008, the Division has worked with representatives of the Division of Law and with our outside counsel to review the proposed investment and to negotiate the specific legal documents, including an ISDA (International Swaps and Derivatives Association) agreement, which would govern the relationship. During this process, a variety of legal and operational issues have arisen with respect to the proposed swap and the requisite legal documentation. At this time, we believe that the legal and operational issues render the swap an imperfect method for achieving the intended investment exposure.

Although the Division has made investments in commodity funds managed by Schroder Investment Management and Gresham Investment Management LLC, the portfolio remains at the low end of the 1% to 4% range allocated for 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. Under current market conditions, an allocation closer to 4% is preferred, prompting this investment proposal.

As explained in a memorandum to the Council dated May 16, 2008, the Division identified the Cargill ProAlpha Commodity Program as an attractive option for investing in this sector given Cargill's presence in the global commodities markets. 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 more than $16 billion. Affiliate companies include Mosaic, Black River Asset Management (with whom we have a relationship in our hedge fund portfolio), and CarVal Investors.

The Cargill ProAlpha Commodity Program seeks to provide core exposure to the commodities asset class through beta and alpha components. The beta component is based on the returns of a commodities index, in this case the Dow Jones-UBS Commodity Index Total Return (the "DJ-UBSCITR," formerly known as the Dow Jones AIG Commodity Index). The alpha component is based on a basket of relative value commodity spread trades developed by Cargill Risk Management's Investor Based Products team. The overall objective of the alpha component is to exceed the return of the underlying beta index by 3% to 5% per annum.

We believe that this is an opportune time to increase our allocation to the commodities sector. In light of the difficulties in finalizing the proposed swap with Cargill, Inc. and the additional time that would be required to do so, we believe that a superior way to achieve investment returns from the Cargill ProAlpha Commodity Program would be through the purchase of CLNs linked to those investment returns. Based on our experience investing in other CLNs, we believe these investments can be structured and issued quickly without the potential legal issues associated with a total return swap.

A CLN is basically a fixed-income security which will have a fixed-maturity date. At maturity, the issuer will pay the initial principal plus or minus the percentage change in the underlying commodity index. In this case, the CLN will be issued by Cargill, Inc. on a private-placement basis and, as such, will be subject to restrictions on re-sale. Thus it is anticipated that it will be held to maturity. Accordingly, we are proposing to purchase CLN with a maturity of 1 year.

Unlike a total return swap, which requires no initial principal investment, but does require daily mark-to-market movements of collateral to secure profits (or losses) with respect to the swap, a CLN does present credit exposure to the issuer, since the full principal amount is invested at the time of subscription. However, we believe these concerns are mitigated to a significant extent by the creditworthiness, liquidity and organizational capabilities of Cargill, Inc., which currently has a credit rating of A. Accordingly, we believe that the CLN can provide a timely and efficient way to proceed with this investment and gain the desired exposure.

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

The proposed investment was sent to each member of the Investment Policy Committee on March 5, 2010, and was reviewed by the Committee in a meeting held on March 10, 2010.

We look forward to discussing the proposed investment at the Council's March 18, 2010 meeting.