



Pennsylvania Public School Employees' Retirement System

Asset Allocation / Investment Structure Recommendations
March 9, 2006

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Asset Allocation / Investment Structure Recommendations

US Equity

- Reduce Target Allocation to 30.0% from 40.0%
 - Elimination of Home Country Bias
- Maintain Capitalization Targets
 - 80% Large Capitalization
 - 20% Small / Mid Capitalization
- Explore Opportunities to Relax the “Long-Only” Constraint With Applicable Existing Managers
- Continue to Utilize the DJ Wilshire 5000 Index as the US Equity Composite Benchmark

Investment Structure

US Equity

Philosophy	Current Policy	Recommended Policy	Policy Variance	Current Exposure *
Core Strategies	90.00%	90.00%	0.00%	88.12%
Passive / Index	62.50%	59.00%	-3.50%	61.43%
Enhanced Index	27.50%	31.00%	+3.50%	26.69%
<i>Short Term Fixed Income</i>	17.50%	17.50%	0.00%	17.11%
<i>Global Macro</i>	10.00%	13.50%	+3.50%	9.58%
Active / Style Strategies	10.00%	10.00%	0.00%	11.88%
Core	2.00%	2.00%	0.00%	2.20%
Growth	3.00%	3.00%	0.00%	3.72%
Value	3.00%	3.00%	0.00%	3.93%
Micro Cap	2.00%	2.00%	0.00%	2.03%
Market Capitalization	100.00%	100.00%	0.00%	100.00%
Large Cap	80.00%	80.00%	0.00%	77.10%
Small Cap	20.00%	20.00%	0.00%	22.90%
<i>Small / Mid Cap</i>	18.00%	18.00%	0.00%	20.88%
<i>Micro Cap</i>	2.00%	2.00%	0.00%	2.02%

* As of January 31, 2006

Asset Allocation / Investment Structure Recommendations

Non-US Equity

- Increase Target Allocation to 30.0% from 20.0%
 - Elimination of Home Country Bias
- Increase the PSERS ACW x-US Index Portfolio Exposure to 30% of Non-US Equity
 - Maintain Commitment to Internal Management
 - Reflect Evolving Efficiency in Non-US Equity Market
- Increase Exposures to Small Cap / Developed and Emerging Markets
- Explore Opportunities to Relax the “Long-Only” Constraint With Applicable Existing Managers
- Introduce Currency Hedging as a Strategic Element of the Non-US Equity Exposure to Reduce Risk
 - Target Hedge at 30% of Non-US Equity Exposure
- Diversify Strategic Emerging Markets Exposure by Style and Organization
 - Place Three Additional Emerging Markets Managers With Growth Orientation
 - BatteryMarch Financial Management, Inc.: 2.00% of Non-US Equity / 0.59% of Total Fund
 - Wellington Management: 2.00% of Non-US Equity / 0.59% of Total Fund
 - William Blair & Company, LLC: 1.00% of Non-US Equity / 0.30% of Total Fund
- Continue to Utilize the MSCI ACW x-US Index as the Non-US Equity Composite Benchmark

Investment Structure

Non-US Equity

Philosophy	Current Policy	Recommended Policy	Policy Variance	Current Exposure *
Core Strategies	5.00%	30.00%	+25.00%	4.80%
Passive / Index	5.00%	30.00%	+25.00%	4.80%
Active / Style Strategies	95.00%	70.00%	-25.00%	95.20%
Developed Markets	87.50%	60.00%	-27.50%	84.27%
<i>Large Cap</i>	80.00%	50.00%	-30.00%	76.78%
<i>Small Cap</i>	7.50%	10.00%	+2.50%	7.49%
Emerging Markets	7.50%	10.0%	+2.50%	10.93%
Market Factors / Capitalization	100.00%	100.00%	0.00%	100.00%
Developed Markets / Large Cap	85.00%	80.00%	-5.00%	81.58%
Developed Markets / Small Cap	7.50%	10.00%	+2.50%	7.49%
Emerging Markets	7.50%	10.00%	+2.50%	10.93%

* As of January 31, 2006

Asset Allocation / Investment Structure Recommendations

Fixed Income

- Maintain Nominal Fixed Income Exposure at 17%
 - US Fixed Income: 13.7%
 - Global Fixed Income: 3.3%
- Maintain TIPS Exposure at 5%
- Continue to Search for Opportunistic Segments of the Fixed Income Market
 - High Yield / Emerging Market Debt
- Continue to Utilize the Current Fixed Income Composite Benchmarks
 - US Fixed Income: Lehman Aggregate Index
 - Global Fixed Income: Lehman Global Aggregate Index
 - TIPS: Lehman US TIPS Index

Investment Structure

Fixed Income

Philosophy	Current Policy	Recommended Policy	Policy Variance	Current Exposure *
Core Strategies	0.00%	0.00%	0.00%	0.00%
Passive / Index	0.00%	0.00%	0.00%	0.00%
Active / Style Strategies	100.00%	100.00%	0.00%	100.00%
Core-Oriented	57.25%	57.25%	0.00%	52.25%
Specialty / High Yield	5.00%	5.00%	0.00%	4.82%
TIPS	22.75%	22.75%	0.00%	24.11%
Global	15.00%	15.00%	0.00%	18.82%

* As of January 31, 2006

Asset Allocation / Investment Structure Recommendations

Commodities

- Establish a Strategic Exposure to Commodities as an Asset Class
 - As a Diversification Tool to Reduce Total Portfolio Risk
- Target a 5% Exposure
 - Utilize as Overlay to TIPS Exposure to Create a “Real Return” Basket
 - Establish Position Through the Use of Leverage
 - Total Fund Will be Invested at 105%
- Implement Passively Using Commodity Futures and / or Swap Agreements and Explore Actively-Managed Opportunities for Commodity Exposure on an Ongoing Basis
- Average Into the Exposure Over a 12-Month Period
 - Reduce “Point of Entry” Risk
- Utilize the DJ / AIG Commodity Index as the Commodities Composite Benchmark