Commonwealth of Pennsylvania
Public School Employees' Retirement System

DATE: June 21, 2007

SUBJECT: Commodity Manager Recommendations

TO: Members of the Board

FROM: Alan H. Van Noord, CFA
Chief Investment Officer

At the Finance Committee meeting on June 21, 2007, Bill Bensur from Wilshire Associates will be reviewing the results of the Fund for the quarter ending March 31, 2007. Bill will also be presenting the results of our search for additional commodity managers. As noted a year ago, staff and Wilshire would continue to look for additional managers in the commodity space to diversify our manager base. Staff and Wilshire met with three active commodity managers on May 8, 2007 (Blackrock, Lehman Brothers, and Schroders). Based on those interviews, Wilshire and staff recommend hiring the following two managers:

- Lehman Brothers Asset Management, Inc.– this manager is partnered with Gresham Investment Management LLC in the management of their active commodity product. They entirely use futures to replicate their commodity exposure. They will weight the commodities at the beginning of each year based on world production value and dollar value of exchange traded futures and forwards. Weights to individual commodities are constrained as part of their risk management process. This product has a track record over 20 years. Currently, we anticipate allocating up to $1 billion, or 30% of our commodity exposure, to Lehman.
- Schroder Investment Management North America – this manager also uses mostly commodity futures to replicate their commodity exposure. However, they may also purchase equities with up to 25% of the portfolio as well as take very defensive positions and hold 33% of the portfolio in cash. Being able to take defensive positions allows Schroders to be more of an absolute-return oriented manager than a relative-value oriented manager. They use a fundamental research driven process and are index unconstrained in the management of their portfolios. Schroders will be very actively managing the commodity portfolio and construct the portfolio with emphasis on the medium-term outlook (4 to 6 months). They have diversification rules in place to prevent excessive risk being taken in any one sector or commodity. Schroders is unique in that they will trade over 35 different commodities while the Dow Jones-AIG Commodity Index consists of only 19 commodities. The inception date for this product was October 2005. Currently, we anticipate allocating up to $500 million, or 15% of our commodity exposure, to Schroders.

Each of these managers has processes that are very different from our existing group of managers (Credit Suisse, Deutsche, and Wellington). This also bears out in the very low correlation of their excess returns among the managers as noted in Wilshire's presentation. We believe that the two recommended managers are very complimentary to our existing group of three. In addition, staff will be exploring opportunities to manage a commodity portfolio internally using swaps in the future.

If you have any questions or comments, please contact me at 717-720-4702.