Commonwealth of Pennsylvania
Public School Employees' Retirement System

DATE: March 6, 2008

SUBJECT: Proposed Revision to Barclay's Active Non-U.S. Equity Portfolio

TO: Members of the Board

FROM: James H. Grossman, Jr., CPA, CFA
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At the Finance Committee meeting on March 6, 2008, Barclays Global Investors (BGI) will be presenting a proposal to change the existing Active Non-U.S. Equity mandate to a new solution that is projected to have a higher net of fee alpha and a higher information ratio (IR). Staff and Wilshire are recommending that the Fund migrate from the existing active non-U.S. equity portfolio strategy to the proposed strategy based on the expectations that it will provide a higher net of fee alpha and a higher net of fee IR. The details of the proposed changes are discussed below.

Currently, BGI manages an MSCI ACW ex. U.S. index portfolio with a targeted net of fee alpha of 2.55% and an active risk target of 3.0%. The targeted net of fee IR is 0.85. Under the proposed solution, the targeted net of fee alpha increases to 3.52% while the active risk target remains 3.0%. This leads to a targeted net of fee IR of 1.16.

This increase in net returns and net IR is due to the following changes to the existing portfolio:

1. The current Active International Equity (AIE) portion of the portfolio will be converted to World ex-U.S. Alpha Advantage (WAA). The difference between the two is that AIE is a long-only product while WAA is a long/short product where they can go up to 150% long and 50% short (150/50); however it will probably average 130/30 over time. The portfolio will be managed to a beta of 1.0 (meaning that they will be directionally correlated with the market).
2. BGI currently uses a constrained currency overlay within AIE. This will be eliminated and replaced with the unconstrained Active Currency Fund that will provide them more ability to add value in currency markets.
3. BGI is going to add an allocation to the 32 Capital Fund into the portfolio. The 32 Capital Fund is BGI's global equity market neutral fund that has gross of fee annualized returns since inception in August 2002 through December 2007 of 10.5%. The purpose of adding The 32 Capital Fund is to generated additional alpha and provide diversification.
4. The Emerging Markets Strategic Index that is currently used in our portfolio to gain emerging market exposure will not change.
5. The Canada Alpha Tilts fund will no longer be needed since the Canadian exposure is included in WAA.

6. BGI will need to overlay beta on the capital allocated to the 32 Capital Fund and the Active Currency Fund (similar to what PSERS does internally with the portable alpha strategies).

We believe that this structure will provide a better alpha opportunity set over time since it offers more diversified sources of alpha and is less constrained than the current portfolio. The new portfolio will have a performance fee for outperformance in excess of the MSCI ACW ex. U.S. Index with a combined high water mark. The combined high water mark means that we do not pay a performance fee independently on the specific components but on the whole portfolio. In other words, if one of the components is generating negative returns in the period, it offsets any performance fee from successful components.

Please contact Alan Van Noord or me with any questions or comments.