Wilshire

Memorandum

Date: June 6, 2012

To: James H. Grossman, Jr.
Deputy Chief Investment Officer
Pennsylvania Public School Employees Retirement System

From: William G. Bensur, Jr., CFA
Managing Director
Wilshire Associates Incorporated

Marlin D. Pease, CFA
Managing Director
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Re: Radcliffe Capital Management, L.P.

The purpose of this memorandum is to provide background analysis on Radcliffe Capital Management, L.P. ("Radcliffe"). Radcliffe is being considered to manage a Libor-Plus short-term investment portfolio that will serve a strategic role in the PSERS investment program. Wilshire believes Radcliffe is an institutional quality firm with a qualified investment team.

Organization

Radcliffe is based in Bala Cynwyd, PA and is owned by its managing principals, Steve Katznelson and Christopher Hinkel. The firm was established in 1996 and currently manages approximately $1.2 billion in a high yield, short duration fixed rate strategy. The firm employs twelve professionals, with five members on the investment team and seven administrative / operations staff. Christopher Hinkel began working with Steve Katznelson in 1998. Christopher left the firm in 1999, returned in 2004 and was promoted to Partner and Director of Research in 2009. The remainder of the investment team consists of Darren Clipston (hired July 2008), Peter Rudnick (hired November 2010) and Ryan Adams (hired April 2012). Investor interests are well aligned with the partners as the partners have in excess of $20 million invested in the Ultra Short Duration Fund.

Investment Approach

The Ultra Short Duration Strategy seeks to capitalize on persistent structural market inefficiencies that enable Radcliffe to identify non-investment grade corporate bonds that offer excess returns while controlling for both credit risk and duration risk. These short-term non-investment grade bonds provide attractive yields with investment grade default probabilities. Radcliffe takes advantage of supply / demand imbalances of short duration non-investment grade bonds and perceived flaws in the methodology used by all of the credit rating agencies to rate bonds. They describe these inefficiencies as follows:

1) *Supply / Demand Imbalances – Hedge funds and mutual funds will continue to sell the shortest dated bonds for three main reasons: A) hedge funds generally have higher return requirements than those offered by short term bonds, particularly net of most hedge funds' fees; B) mutual funds will continue to sell the shortest dated bonds to avoid*

tracking error against the main bond indexes that exclude bonds under 1 year to maturity; and C) mutual funds will continue to have issuer concentration limits that require them to sell the shortest dated bonds when the same issuer announces a new bond offering. Likewise, the largest buyers of short term bonds are focused on IG bonds and are unlikely to begin taking on more perceived risk by increasing their allocation to non-IG bonds: A) money market funds are prohibited from owning non-IG bonds; B) the insurance companies have significant regulatory capital penalties by holding non-IG bonds; and C) the short duration mutual funds are unlikely to dramatically reduce their investible universe and change their indexing model to begin building a portfolio of best-ideas non-IG bonds.

2) *Rating Agencies Flawed Methodology - there is no evidence that any rating agency will correct the two vital flaws in their ratings methodology: A) they rarely or never update the ratings of bonds as they approach their maturity (since they are not paid to do so); and B) they all rate bonds of the same seniority identically without regard to the different terms to maturity (even when the shortest term debt may be pre-funded with excess cash on the balance sheet).*

Radcliffe concentrates on three key credit-related variables when evaluating bonds: strong operating fundamentals of the issuer, covenant analysis to ensure that any bank debt or longer term debt will not be accelerated, and "Cash Coverage". Cash Coverage is a ratio defined as cash divided by all the short term debt. Radcliffe seeks bonds where the issuer has already raised the money to defease their short term debt. 95+% of the research is conducted internally. Average portfolio yields are targeted to be one-year LIBOR plus 300 bps. The maturity (or put) dates are laddered and generally range from a few days to two years, thereby the average term to maturity (or put) of the portfolio is approximately one year. The investible universe includes U.S. dollar denominated corporate and convertible bonds that have a time-to-maturity (put) of twenty-seven months or less. All of the securities in the portfolio are publicly traded bonds in public companies. Radcliffe does not include structured products, derivatives or hedges in their portfolio. The portfolio will be broadly diversified with approximately 100 issues and no issuer concentration above 4%. Since inception, the Ultra Short Duration Strategy has produced consistent excess returns to 6-month LIBOR.

<u>Fees</u>

Radcliffe has proposed the following fee:

A) 0.25% base fee on all assets
B) 20% above 6-month LIBOR + 25 basis points (hurdle rate)
C) The all-in fee (base plus performance) is capped at 1.15%

Please let us know if you have any questions or would like to discuss any of these issues.