

**Commonwealth of Pennsylvania
Public School Employees' Retirement System**

DATE: January 10, 2013

SUBJECT: Ellis Lake Domestic Fund, LP Recommendation

TO: Members of the Board

FROM: Robert E. Little, CPA
Portfolio Manager, Non-Traditional Investment Strategies

At the January Finance Committee meeting, staff and Aksia will recommend that PSERS invest in the Ellis Lake Domestic Fund, LP (Fund). This Fund invests in the credit securities and equity instruments of small distressed companies with near-term events or catalysts that will impact their valuation.

Founded in 2010, Ellis Lake focuses on smaller companies/issuances that are too small for the larger funds to invest in. Currently, PSERS does not have any credit managers that invest in this space on a dedicated basis.

Staff recommends that the Board invest \$100 million in this Fund, an amount which is within the target ranges established in Exhibit D of the Investment Policy Statement, Objectives and Guidelines as amended from time to time. Ellis Lake will be included in the Public Markets Emerging Investment Manager Program.

Included for your review are Aksia's recommendation letter, a presentation prepared by staff, a presentation prepared by Ellis Lake, the confidential fund terms, and the resolution recommending the investment in the Fund. Representatives from Ellis Lake will make a presentation to the Finance Committee and will be available for any questions.

If you have any questions or comments prior to the meeting, please contact me at 717-720-4707.

Manager Recommendation Memo

January 4th, 2013

Board of Trustees
 Pennsylvania Public School Employees' Retirement System
 5 North Fifth Street
 Harrisburg, PA 17101

Re: Ellis Lake Domestic Fund, LP

Dear Trustees:

Aksia LLC, having been duly authorized by the Board of PSERS, has evaluated and herewith recommends a direct allocation to the Ellis Lake Domestic Fund, LP ("Ellis Lake"). In the ongoing development of PSERS' portfolio of absolute return funds, Aksia recommends an initial allocation in line with Exhibit D of PSERS Investment Policy Statement, Objectives, and Guidelines.

Ellis Lake is a small stressed/distressed credit fund focusing on catalyst-driven trades in small and mid-sized issuers. The manager typically invests in senior secured bank debt, loans and hybrid equity instruments and equities of companies facing multiple near-term catalysts. The manager runs a focused organization with a stated fund capacity at \$1bn. Currently, the fund is less than \$250m and would fit in PSERS' Emerging Manager program.

Aksia's recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines.

- Due diligence of Ellis Lake's investment strategy, including a review of their investment strategy, investment team and structure, and risk management process.
- On site Investment Due Diligence visit conducted on 18 October 2012.
- The following is a listing of the points of contact with the manager since the on site due diligence on 18 October 2012:

Date	Nature of Contact	Aksia Point of Contact
22 October 2012	Update portfolio holdings phone call	Brian Goldberg
1 November 2012	Monthly portfolio update phone call	Patrick Adelsbach
19 November 2012	On site Operational Due Diligence visit	Rahul Desai Simon Fludgate
13 December 2012	Monthly portfolio update phone call	Patrick Adelsbach

- Due diligence of Ellis Lake's operations, including an operations and infrastructure review, regulatory and compliance review, private placement memorandum review, Form ADV review, and financial statement review.

- On site Operational Due Diligence visit conducted on 19 November 2012.
- Evaluation of Ellis Lake's investment strategy within the context of the current investment environment.
- Appropriateness of Ellis Lake for the Absolute Return component of PSERS' portfolio.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in Ellis Lake, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Ellis Lake. Aksia manager recommendation memos should be reviewed with other Aksia due diligence materials, including the full Investment Review and Operational Review. In addition, please consult your tax, legal and/or regulatory advisors before allocating to any private investment fund.

Please feel free to contact us should you have any questions about this recommendation.

Respectfully,



Bruce Ruehl
Partner, Head of Portfolio Advisory, Americas



Patrick Adelsbach
Partner, Head of Event Driven Strategies



Public Markets Emerging Investment Manager Program / Absolute Return Allocation

Ellis Lake Domestic Fund, LP

January 24, 2013

Robert E. Little, CPA
Portfolio Manager, Non-Traditional Investment Strategies

Ellis Lake Domestic Fund, LP

Overview of Ellis Lake

- Founded in 2010 by Gabe Nechamkin, Portfolio Manager
- Gabe has over 25 years experience investing in distressed debt and high yield fixed income securities
- Manage assets of approximately \$205 million – all in this strategy
- Office located in New York City

Investment Team

- Investment team consists of the Portfolio Manager, the Director of Research, and two analysts
- Back office staff consists of an additional four employees

Ellis Lake Domestic Fund, LP

Fund Overview

- Current fund size is approximately \$205 million
- Soft cap of \$600 million; hard cap of \$1 billion
- Net return target of 12% to 15%

Fund Strategy

- Invest in credit securities and equity instruments of small distressed/stressed companies and/or smaller issuances of larger companies with near-term events or catalysts which will impact their valuation
- Focus on companies/issuances that are too small for the larger funds to invest in
- The smaller fund size enables Ellis Lake to focus on company-specific opportunities instead of broad macro themes

Ellis Lake Domestic Fund, LP

Value Proposition for PSERS

- Ellis Lake would be part of PSERS' Public Markets Emerging Investment Manager Program given that their total assets under management are less than \$3 billion
- Ellis Lake generally invests in small companies/issuances with enterprise values between \$200 to \$500 million. PSERS does not have any current credit managers that invest in this space on a dedicated basis.

Ellis Lake Domestic Fund, LP

Performance (through 12/31/2012)

	2010	2011	2012	Inception to Date
Class B shares, net of fees	11.14%	2.09%	22.48%	38.98%

The return data is net of the standard fee schedule for Class B shares (1.5% management fee, 18% performance fee).
Inception date: February 1, 2010

Ellis Lake Domestic Fund, LP

Absolute Return Program Objectives

- Enhance the return/risk profile of the overall program
 - Annualized Return and Volatility of Ellis Lake since 02/01/2010
 - Annualized Return: 11.94%
 - Standard Deviation: 6.18%
 - Sharpe Ratio: 1.91
- Invest in uncorrelated return streams
 - Historical correlation to PSERS' largest absolute return managers:
 - AQR Offshore Multi-Strategy: 0.56
 - BlackRock Global Ascent: 0.39
 - Bridgewater Pure Alpha: -0.09
 - Brigade Leveraged Capital Structures: 0.54
 - Low historical correlations with major equity, fixed income, and commodity indices (see Appendix)

Ellis Lake Domestic Fund, LP

Portfolio Use

- Invest \$100 million in the Ellis Lake Domestic Fund, LP
- Include this investment in the Absolute Return asset class

History with PSERS

- This investment will be PSERS first investment with Ellis Lake

Other

- Relationship with Aksia: None
- Placement Agents: None
- Political Contributions in PA: None
- Introduction Source: Aksia

Ellis Lake Domestic Fund, LP

Recommendation

Staff, together with Aksia LLC, recommends (i) that the Board invest \$100 million in the Ellis Lake Domestic Fund, LP, and (ii) that the Investment Office shall have the discretion to invest additional sums within the target ranges approved by the Board in Exhibit D of the Investment Policy Statement, Objectives and Guidelines, as amended from time to time, provided that any investment of an additional sum by the Investment Office shall be reported to the Board in a timely manner.

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Appendix - Correlations

Correlation (as of 11/2012)	Ellis Lake	MSCI AC World Index IMI	DJ UBS Commodity	Barclays Aggregate	Barclays Global Aggregate
Ellis Lake	1.00				
MSCI AC World Index IMI	0.67	1.00			
DJ UBS Commodity	0.52	0.69	1.00		
Barclays Aggregate	-0.32	0.16	0.10	1.00	
Barclays Global Aggregate	0.32	0.50	0.47	0.73	1.00



Public Markets Emerging Investment Manager Program / Absolute Return Allocation

Ellis Lake Domestic Fund, LP

January 24, 2013

[NEXT](#)

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