

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

DATE: May 20, 2016

SUBJECT: Venor Capital Offshore Ltd. Recommendation

TO: Members of the Board

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

At the June Finance Committee meeting, staff and Aksia will recommend that PSERS invest in Venor Capital Offshore Ltd. (Fund). This Fund, managed by Venor Capital Management LP (Venor Capital), will opportunistically invest in stressed and distressed securities in the U.S. and Western Europe.

Venor Capital was formed in 2005 by co-CIOs Jeff Bersh and Mike Wartell. Both Jeff and Mike have extensive experience in trading distressed securities. Changes in the banking sector, illiquidity in the high yield markets, and volatility in the commodity markets have created an opportunity in the high yield credit market. Staff and Aksia believe that Venor Capital is well positioned to participate in this opportunity.

Staff recommends that the Board invest \$150 million in this Fund, an amount which is within the target ranges established in Exhibit E of the Investment Policy Statement, Objectives and Guidelines as amended from time to time.

Included for your review are Aksia's recommendation letter, an investment memorandum prepared by staff, and the resolution recommending the investment in the Fund.

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



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Venor Capital Offshore Ltd.
Absolute Return Program

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

May 20, 2016



Recommendation:

Staff, together with Aksia, recommends that PSERS invest \$150 million in Venor Capital Offshore Ltd. (Fund). This recommendation is based on our assessment of the current opportunity in the high yield and distressed credit markets and our evaluation of Venor Capital Management LP's (Venor) capabilities as compared to other high yield and distressed credit investment managers.

Firm Overview:

Venor is a credit focused investment manager that invests in high yield credit, stressed/distressed credit, and equity securities. The firm was founded in 2005 by co-CIOs Jeff Bersh (formerly the Head of distressed business at Credit Suisse) and Mike Wartell (formerly the co-Head of distressed research at Deutsche Bank). Jeff has a trading background while Mike has a research background. These backgrounds complement each other well and promote a balanced investment approach between trading and research. Venor has done a good job taking advantage of its size to invest in smaller capital structures that many larger investment managers will not invest in.

Market Opportunity:

The high yield credit market has doubled in size since 2007. With the energy and metals/mining sectors accounting for over 20% of the high yield credit market, recent volatility increases in the commodities market have created a challenging environment for the high yield credit market. In addition, as banks continue to tighten their lending standards, refinancing will become more difficult. In the retail investment space, daily liquidity offered by many retail mutual funds creates a liquidity mismatch with the underlying credits held by these retail mutual funds. The end result of these factors is an increased number of downgrades, decreased liquidity, and increased volatility in the high yield and distressed credit markets.

Investment Strategy:

Venor invests in stressed and distressed corporate situations in the U.S. and Western Europe. The Fund will invest in all layers of the capital structure including corporate bonds, bank loans, and equity securities. New investment ideas are sourced from fundamental, bottom-up research rather than broad macro themes. In general, their focus is on companies with strong asset coverage and cash flows that have some near-term catalyst in the next 6 to 18 months. Given their size, Venor is able to target middle market companies that attract less competition from larger investment managers. Venor has been very willing to actively manage position sizes and shift fund exposures.

Portfolio Fit:

The investment in the Fund will be part of the Absolute Return Program.

Investment Instruments:

Venor will invest in high yield and distressed credit securities, equity securities, and credit/equity derivative securities primarily in the U.S. and Western Europe.

Investment Team:

Jeff Bersh and Mike Wartell each have over 20 years' experience investing in the high yield credit markets. They are supported by four analysts and two traders with an average of over 9 years' investment experience.



Investment Highlights:

Experience of the Investment Team
The co-CIOs have vast experience sourcing, managing, and restructuring credit investments through different credit environments. Collectively, the investment team has over 100 years of investment experience.
Market Opportunity
Venor believes that the elevated macro risks, deteriorating credit metrics, and increasing pressure on the credit markets are leading to an inflection point in the credit cycle. As banks continue to tighten their lending standards, refinancing will become more difficult. Over time, institutional investors will replace banks as the primary source of financing. Staff believes that Venor is well positioned to participate in the opportunity.
Track Record
Since inception through April 2016, Venor has generated a solid risk adjusted return through various credit markets. In prior periods of market weakness, Venor has shown its ability to combine fundamental research and opportunistic trading to generate strong relative and absolute performance results.

Investment / Risk Considerations:

Market Risk
The Fund has been managed to be net long during most periods of its history. While the investment manager has attempted to reduce the market exposure during times of stress by establishing a tail hedging program, reducing the exposure to illiquid assets, and shorting individual securities, the portfolio has experienced losses in sharp market declines.
Idiosyncratic Risk
The investment manager builds a concentrated long portfolio with typical position sizes between 3-7% depending upon the strategy. The largest long positions have grown to 10%, and the top three long positions have grown to 25%. With a highly concentrated, less diversified portfolio, volatility can increase.
Key Man Risk
The Fund offering memorandum includes a provision that is triggered in the event that both Jeff Bersh and Mike Wartell (the co-CIOs) are no longer involved in the management of the Fund. A departure by either one of the co-CIOs, though not considered to be a key man trigger event, could have an impact on the Fund's strategy.
Alignment of Interests
Venor Capital Management LP is majority owned by Jeff Bersh and Mike Wartell. In addition, internal capital represents approximately 10% of the Fund's assets.



Finance Committee Disclosure:

Relationship with Aksia:	None Disclosed
Introduction Source:	Aksia
Placement Agent:	None Used
PA Political Contributions:	None Disclosed
Potential Conflicts:	We are not aware of Venor having any investment conflicts.
PSERS History with the Investment Manager:	PSERS committed \$100 million to the Venor Special Situations Fund II LP in 2015. To date, approximately \$58 million has been called by the investment manager.
PSERS Internal Alpha Committee Approval:	May 20, 2016

Oversight Responsibility:

Investment Office:	Charles J. Spiller Robert E. Little	Deputy CIO, Non-Traditional Investments Portfolio Manager
External Consultant:	Aksia LLC	

Manager Recommendation Memo

May 11, 2016

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

Re: Venor Capital Offshore Ltd

Dear Trustees:

Aksia LLC, having been duly authorized by the Board of PSERS, has evaluated and herewith recommends a direct allocation to Venor Capital Offshore Ltd ("Venor") in line with PSERS Investment Policy Statement, Objectives, and Guidelines.

Jeff Bersh and Mike Wartell launched Venor in 2005 following their roles as the Head of the Distressed Business at Credit Suisse and the Co-Head of Distressed Research at Deutsche Bank, respectively. Prior to working at Credit Suisse, Jeff had various roles at Bear Stearns, Banco Santander and Merrill Lynch in high yield and distressed. In addition to Mike's experience at Deutsche Bank, he had previously worked in the distressed debt group at Merrill Lynch. Venor pursues a variety of related strategies, including long/short credit, stressed/distressed credit and equity special situations. The manager evaluates investments primarily on the basis of fundamental research.

The fund is typically long-biased but the manager looks to short individual securities and apply direct hedges, index tail hedges or hold cash in different markets. Venor's portfolio is relatively concentrated with the core long portfolio accounting for most of the fund's risk, along with a relatively small tail of smaller positions. The manager expects most of the fund's investments to be sourced in the bond, equity or syndicated loan markets. Venor's universe of investments includes all high yield and distressed credit, equities and credit/equity derivatives primarily in the U.S. and Western Europe.

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

- Due diligence of Venor's investment strategy, including a review of their investment strategy, investment team and structure, and risk management process;
 - Most recent on-site Investment Due Diligence visit conducted on April 21, 2016.
- Due diligence of Venor's operations, including an operations and infrastructure review, regulatory and compliance review, PPM review, Form ADV review, and Financial Statement Review;
 - Most recent on-site Operational Due Diligence visit conducted on April 6, 2016.
- Evaluation of Venor's strategy within the context of the current investment environment; and
- Appropriateness of Venor as a 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 Venor, 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 Venor. 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, Global Portfolio Strategist



Patrick Adelsbach
Partner, Head of Credit Strategies