COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Caspian Opportunistic Dislocation Strategy
Absolute Return Program

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

September 11, 2018

Recommendation:

Staff, together with Aksia, recommends that PSERS allocate up to $200 million to the Caspian Opportunistic Dislocation Strategy (Strategy or strategy). This recommendation is based on our assessment of the investment strategy and our evaluation of Caspian Capital LP's (Caspian) capabilities.

Firm Overview:

Caspian is a hedge fund manager that was founded in 1997. Caspian's flagship hedge fund, Caspian Select Credit Master Fund (Select Credit), was launched at this time. The open-ended hedge fund invests in stressed/distressed credits. PSERS has been invested in this fund since March 2011. At most times, Select Credit will be fully invested through a combination of long and short opportunities.

When a market opportunity arises, Caspian will launch a drawdown investment vehicle to provide additional credit exposure during periods of dislocation. Prior to the Caspian Inefficient Markets Fund II, Caspian had launched three opportunistic drawdown investment vehicles to take advantage of dislocations in the credit markets: a corporate loan fund (vintage 2009), a middle market fund (vintage 2011), and the Caspian Inefficient Markets Fund (vintage 2016). The first two funds are closed and inactive.

Market Opportunity / Investment Strategy:

In early 2016, Caspian launched a commingled investment vehicle to take advantage of a developing disruption in the U.S. high yield market. Caspian Inefficient Markets Fund (IMF) was launched to acquire performing credits at discounts to par value from investors needing to meet investor redemption requests in the high yield markets at a time when these markets were under pressure from falling prices. In addition, the increased regulatory environment after the Global Financial Crisis contributed to a liquidity shortage in the high yield markets.

Caspian followed IMF with Caspian Inefficient Markets Fund II (IMF II) to have capital available if another dislocation opportunity were to occur. The IMF II strategy allows investors to pre-commit to a fund that will focus on performing credits that are under pressure rather than in a distress/default situation. To date, no capital has been drawn from investors for IMF II.

Caspian is well positioned to invest in a period of credit dislocation for several reasons –

- Caspian has a strong investment platform with stable capital that allows their investment team to maintain due diligence coverage on hundreds of issuers prior to any dislocation. Theoretically, Caspian should be able to act quickly during periods of market disruption.
- Caspian's investment team, led by co-Portfolio Managers Adam Cohen and David Corleto, have been managing capital for multiple decades through varying market cycles.
- While the strategy appears similar in many ways to other stressed/distressed drawdown funds, its narrow mandate limits the scope of the investible universe to mostly performing credits, making the strategy a complement to true distressed drawdown strategies. However, unlike distressed strategies which target longer holding periods, the strategy's focus on performing credits with near-term maturities should result in shorter holding periods.

Portfolio Fit:

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

Investment Instruments:

Caspian will invest in the performing credit securities of corporations that are experiencing some form of stress from a market dislocation or special situation.

Investment Team / Key Investment Personnel:

Adam Cohen and David Corleto lead the investment team. Caspian employs 26 professionals, all of whom are located in New York. Caspian's size allows them to be nimble to take advantage of unique investment opportunities that may arise due to market dislocations or special situations.

Name	Title	Years' Experience Firm / Total	Prior Experience	Education
Adam Cohen	Managing Partner & Co-Portfolio Manager	17 / 21	Goldman Sachs & Co. / Weil, Gotshal & Manges LLP	JD, New York University School of Law BA, Sociology / University of Pennsylvania
David Corleto	Co-Portfolio Manager & Trader	13 / 20	Goldman Sachs & Co. / BT Alex. Brown / CSFB	BA, English / University of Pennsylvania
T. Grey Perkins	President	6 / 21	Mariner Investment Group / Accenture	BS, Mechanical Engineering and BA, Economics / Duke University
Terese Best	Chief Operating Officer / Chief Risk Officer	16 / 18	Wasserstein, Perella & Co.	BA Economics / Princeton University
Adele Murray	Chief Compliance Officer / Chief Regulatory Officer	8 / 22	XE Capital Management LLC / Aisling Capital LLC / Perseus-Soros Management LLC	JD, New York Law School BA, Government (Political Science) / University of Notre Dame

Adam and David are supported by a team of eight analysts with an average experience of greater than eight years, one trader with 11 years' experience, and a loan covenant specialist with 15 years' experience.

Investment Highlights:

- Experience and Positive Track Record
- Existing Coverage and Relationships
- Competitive Fee Structure
- Target Universe

Investment / Risk Considerations:

- Deployment of Capital
- Staffing
- Lack of Diversification

Finance Committee Disclosure:

Relationship with Aksia:	None Disclosed
Introduction Source:	PSERS has been invested with Caspian Capital since March 2011.
Placement Agent:	None Used
PA Political Contributions:	None Disclosed
Potential Conflicts:	We are not aware of Caspian Capital having any material conflicts.
PSERS History with the Investment Advisor:	This investment will be PSERS' third investment with Caspian Capital.
PSERS Allocation Implementation Committee Approval:	September 11, 2018

Oversight Responsibility:

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

Aksia

Manager Recommendation Memo

September 7, 2018

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

Re: Caspian Inefficient Markets II Strategy

Dear Trustees:

Aksia LLC, having been duly authorized by the Board of PSERS, has evaluated and hereby recommends a direct allocation to the Caspian Inefficient Markets II Strategy (the "Strategy", referred to by PSERS as the Caspian Opportunistic Dislocation Strategy), in line with PSERS Investment Policy Statement, Objectives, and Guidelines. It is further recommended that PSERS commit up to $200 million to the Strategy.

Caspian Capital LP ("Caspian" or the "General Partner") is a hedge fund manager dating back to 1997. Its flagship fund, Caspian Select Credit Master Fund (the "Select Fund") is an open-ended fund with approximately $1.9 billion in capital that invests in stressed/distressed credit. Caspian views the Select Fund as its "all weather" vehicle that will be fully invested at most times and maintain stable exposure. In early 2016, the manager launched Caspian Inefficient Markets Fund ("IMF I"), a commingled draw down vehicle to take advantage of a developing disruption in the U.S. high yield market. Caspian followed up on IMF I with Caspian Inefficient Markets Fund II ("IMF II") in order to raise capital in anticipation of a similar dislocation opportunity.

The Strategy will focus on high yield credits that are generally performing and under pressure, but not expected to default. Caspian intends to construct a relatively diversified portfolio of 25 to 50 positions consisting of high yield bonds and leveraged loans with maturities prior to 2023 (coinciding with the term of the Fund). The General Partner does not intend to invest in companies that are likely bankruptcy candidates. Caspian will seek to generate returns primarily driven by current cash coupon and capital appreciation.

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

- Due diligence of the investment process, including a review of their investment strategy, investment team personnel and structure, and risk management;
    - On-site investment due diligence visit conducted December 4, 2017.
- Due diligence of operations, including a General Partner review, operations and infrastructure review, regulatory and compliance review, terms review, and Form ADV review;
    - On-site operational due diligence visit conducted September 18, 2017.
- Evaluation of the Strategy within the context of the current investment environment; and
- Appropriateness of the Strategy as a component of the PSERS' portfolio.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Strategy, 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 Strategy. Aksia manager recommendation memos should be reviewed with other Aksia due diligence materials, including the due diligence reports. 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,

Patrick Adelsbach
Partner, Head of Credit Strategies

Simon Fludgate
Partner, Head of Operational Due Diligence