

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

DATE: July 22, 2014
SUBJECT: Brigade Structured Credit Offshore Fund Ltd. Recommendation
TO: Members of the Board
FROM: Robert E. Little, CPA
Portfolio Manager, Non-Traditional Investment Strategies



At the August Finance Committee meeting, staff and Aksia will recommend that PSERS invest in the Brigade Structured Credit Offshore Fund Ltd. (Fund). This Fund invests in opportunities in the corporate structured credit market.

Brigade Capital Management, LLC was founded in 2006 by Don Morgan and Pat Kelly. PSERS has known Don Morgan since 2000 when Don was the high yield fixed income portfolio manager on our portfolio with MacKay Shields. PSERS followed Don to Brigade investing in two funds since the firm's launch. Don and his team have proven themselves to be strong fundamental investors able to take advantage of inefficiencies in the credit markets.

Staff recommends that the Board invest \$200 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.

Included for your review are Aksia's recommendation letter, a presentation prepared by staff, and the resolution recommending the investment in the Fund. The confidential performance and fund terms are included in a separate folder.

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



High Yield Fixed Income Allocation

Brigade Structured Credit Offshore Fund Ltd.

August 5, 2014

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

Brigade Structured Credit Offshore Fund Ltd.

Overview of Brigade Capital Management, LLC

- Founded in 2006 by Don Morgan (CIO) and Pat Kelly (CEO)
 - Don is the former portfolio manager of the high yield fixed income investment strategy at MacKay Shields
 - Six of the eight members of the MacKay Shields high yield fixed income team left MacKay Shields to join Don at Brigade
 - PSERS has been invested in high yield fixed income with Don since 2000 while he was at MacKay Shields
 - PSERS invested with Brigade in 2007 (Brigade Leveraged Capital Structures Offshore Ltd.) and again in 2011 (Brigade Distressed Value Offshore Fund Ltd.)
- Manage assets of approximately \$16 billion
- Offices located in New York City and Zurich (relocating to London later this year)
- 105 employees
 - Includes 47 investment professionals

Brigade Structured Credit Offshore Fund Ltd.

Fund Strategy

- Dedicated to opportunities in the corporate structured credit market
- Leverages the firm's credit underwriting capabilities to express default views versus the market expectations
- Strategy is an extension of the existing strategy within the Leveraged Capital Structures fund
- To implement the strategy, the Fund will –
 - Buy and sell credit default tranches within the investment grade fixed income index and the high yield fixed income index
 - Buy single name credit default swaps on credits where there is a risk of default
 - Buy out of the money index options

Fund Target Return

- 15% annualized net return over a full market cycle

Brigade Structured Credit Offshore Fund Ltd.

Key Investment Considerations

- The structured credit strategy is a sleeve within the Leveraged Capital Structures fund
- Given risk management considerations, Brigade will not increase the exposure to this strategy within the Leveraged Capital Structures fund
- The structured credit strategy has been the top performing strategy within the Leveraged Capital Structures fund since 2010
- Brigade's credit underwriting expertise and depth of research give it an advantage over its peers

Key Investment Risks

- The index tranches that the Structured Credit Fund will hold are sensitive to underlying credit defaults. Brigade will attempt to hedge this default risk with credit default swaps. If Brigade does not hedge the right risks, losses could occur.

Brigade Structured Credit Offshore Fund Ltd.

Portfolio Use

- Invest \$200 million in the Brigade Structured Credit Offshore Fund Ltd.
- Include this investment in the High Yield Fixed Income asset class

History with PSERS

- This investment will be PSERS' third investment with Brigade Capital Management, LLC
 - \$225 million net capital invested in Brigade Leveraged Capital Structures Offshore Ltd. since 2007, current market value of \$577 million at June 30, 2014
 - \$100 million net capital invested in Brigade Distressed Value Offshore Fund Ltd. since 2011, current market value of \$133 million at June 30, 2014

Other

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

Brigade Structured Credit Offshore Fund Ltd.

Recommendation

Staff, together with Aksia LLC, recommends (i) that the Board invest \$200 million in the Brigade Structured Credit Offshore Fund Ltd., 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.

DISCLAIMER: This document was presented to the Public School Employees' Retirement Board at the public meeting at which the Board acted on the resolution to which the information relates. The sole purpose for posting the presentation information on this website is to enable the public to have access to documents that were utilized at a public meeting of the Public School Employees' Retirement Board, and no other purpose or use is intended.

Manager Recommendation Memo

July 22, 2014

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

Re: Brigade Structured Credit Offshore Fund Ltd.

Dear Trustees:

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

Don Morgan and his team managed over \$16bn in long only high yield funds at Mackay Shields and \$750mm through the Mackay Shields Long/Short Fund LP. In 2006, Don and Pat Kelly teamed up to start Brigade Capital Management and six out of Don's eight employees joined them as partners once his non-solicit provision expired. The flagship fund, Brigade Leveraged Capital Structures was launched in January 2007, and Brigade Distressed Value Fund was launched in January 2011. Brigade Structured Credit is expected to launch in August 2014 as one of the few funds dedicated primarily to opportunities in corporate structured credit. In contrast to model-driven relative value approaches to investing in this market, Brigade's strategy leverages its credit underwriting capability to express its default and spread views versus implied market expectations. We believe this approach is more flexible than traditional synthetic tranche trading strategies and given our existing view on the manager's research capabilities, see this strategy as an effective extension of the manager's core credit expertise. Thus, to the extent that Brigade continues to have a successful track record of predicting timing and likelihood of defaults, the synthetic corporate structured credit markets provide an attractive form of structural leverage to implement the manager's credit views. Steve Bleier and Dylan Ross are responsible for day-to-day management of the strategy, but credit decisions and overall positioning are overseen by Don Morgan and the other senior members of the investment team. We believe that few hedge fund firms have Brigade's depth and experience in high yield credit underwriting.

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

- Due diligence of Brigade's investment process, including a review of their investment strategy, investment team and structure, and risk management process;
 - Most recent on-site Investment Due Diligence visit conducted July 17, 2014.
 - The following is a listing of the relevant points of contact with the manager since the most recent Investment Due Diligence report was completed in April 2014.

Date	Nature of Contact	Aksia Points of Contact
July 17, 2014	Onsite investment due diligence meeting	J. Hemley
June 30, 2014	Update call funds' performance & positioning	J. Hemley
May 27, 2014	Update call funds' performance & positioning	J. Hemley
April 10, 2014	Update call on launch of Structured Credit fund	J. Hemley
April 01, 2014	Call regarding departure of Ben Renshaw	P. Adelsbach, J. Hemley

- Due diligence of Brigade's operations, including an operations and infrastructure review, regulatory and compliance review, PPM review, and Form ADV review;
 - Most recent on-site Operational Due Diligence visit conducted January 23, 2014.
- Evaluation of Brigade's strategy within the context of the current investment environment; and
- Appropriateness of Brigade 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 Brigade, 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 Brigade. 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