

# Commonwealth of Pennsylvania Public School Employees' Retirement System

**DATE:** January 7, 2009

**SUBJECT:** Internally-managed Emerging Market Equities Portfolio Recommendation  
BlackRock Emerging Markets Macro Fund Ltd. Recommendation

**TO:** Members of the Board

**FROM:** James H. Grossman, Jr., CPA, CFA  
Managing Director of External Public Markets, Risk & Compliance

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At the Finance Committee meeting in January, staff will recommend a \$500 million allocation to an internally-managed emerging markets equity portfolio. Investment Staff has been managing swap exposure to various equity and fixed income markets over the past few years. We have developed an expertise in managing the beta exposure and counterparty risks. The proposed account would be structured as follows:

1. \$500 million in cash would be allocated to this account and invested as follows:
  - a. \$250 million invested in the internally-managed PSERS LIBOR-Plus Portfolio and/or PSERS STIF Portfolio; and
  - b. \$250 million invested in the BlackRock Emerging Markets Macro Fund Ltd. (discussed below). This fund would be the alpha source for the portfolio.
2. Investment Staff would enter into \$500 million of emerging markets equity swaps to gain the beta exposure.

This portable alpha structure has built in liquidity through the PSERS LIBOR-Plus Portfolio or PSERS STIF Portfolio to meet any margin requirements on the swap. The expected total return of this portfolio would be the MSCI Emerging Markets Equity Index return plus 3.5%. Historically, the net excess return of our current emerging markets equity managers is slightly below zero.

In conjunction with this recommendation, staff and Wilshire will recommend investing \$250 million in the BlackRock Emerging Markets Macro Fund Ltd., a new emerging markets macro fund created to exploit the inefficiencies in the emerging markets equity, fixed income, and currency markets. The estimated net annualized return target is between 7.2% and 8.8% with estimated annualized volatility of 12.0%. BlackRock is only marketing this product to their large, strategic relationships since capacity is limited to \$1 billion. We are proposing using this portfolio as part of a larger emerging market portfolio managed by internal staff. Internal staff would enter into a \$500 million emerging market equity swap. The \$500 million in cash backing the swap would be invested 50% in this product (\$250 million) and 50% in PSERS LIBOR-Plus account (\$250 million). A graphical depiction of this account structure is located on page 5 of the synopsis included with this memo. The objective would be for this account to generate a return of MSCI Emerging Markets Equity Index Return plus 3.5%.

Included for your review are a brief synopsis prepared by staff, Wilshire's recommendation, and BlackRock's presentation. Representatives of BlackRock will be here to make a presentation to the Finance Committee on January 21, 2010.

If you have any questions or comments prior to the meeting, please contact me at 717-720-4703.



## Memorandum

Date: January 7, 2010

To: James H. Grossman, Jr., CFA  
Managing Director of External Public Markets, Risk and Compliance  
Pennsylvania Public School Employees' Retirement System

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

A handwritten signature in black ink, appearing to read 'Bill'.

Marlin D. Pease, CFA  
Managing Director  
Wilshire Associates Incorporated

A handwritten signature in black ink, appearing to read 'Marlin'.

**Re: BlackRock Emerging Markets Macro Fund**

The purpose of this memorandum is to provide background information and a recommendation to the Pennsylvania Public School Employees' Retirement System ("PSERS") to retain the BlackRock / BGI ("BlackRock") for a product offering focused on the emerging markets. The product offering (the "Fund") will utilize both long and short positions in emerging markets stocks, bonds and currencies. The Fund will represent a unique exposure and, along with an internally managed and fully-funded emerging markets swap, will serve an absolute return generating role within the non-US equity allocation of the PSERS investment program.

### Organization

BlackRock and Barclays Global Investors ("BGI") created the world's largest asset manager as a result of a business combination completed in December 2009. PSERS has had a long-term, strategic partnership with both BlackRock and BGI. The combined entity, which will go forward as BlackRock, is publicly traded company (Symbol: BLK) with an ownership structure that includes Bank of America (34.2%), PNC Financial Services Group (24.5%) and Barclays PLC (19.8%). The firm is headquartered in New York and has offices in 24 countries. The combined entity manages over \$3 trillion and employs over 9,000 globally. BlackRock offers considerable expertise in a wide variety of global capital market products. The Fund will be managed by the BGI Global Investment Team. This team, which constitutes the Global Market Strategies Group with over 50 market and investment professionals, has sound and consistent leadership and considerable asset management experience in the global capital markets. Wilshire believes that the combined BlackRock / BGI entity represents a high quality, institutionally-oriented firm with deep resources, qualified professionals and a unique skill set to effectively manage the Fund.



### **Investment Approach**

The BlackRock investment approach for the Fund is based on the philosophical belief that the emerging markets are inherently inefficient; that is, the opportunity exists to exploit valuations through active management decisions. BlackRock believes this is true across asset classes in emerging markets – stocks, bonds and currencies. Further, opportunities to exploit these market inefficiencies may be expressed on both the long and short side of the trade. In other words, the Fund will own, or be long, positions they find attractive and sell, or be short, positions they find unattractive. The strategy is designed to be market non-directional as the long and short positions offset one other. Based on the inputs from the Global Market Strategies Group, the Fund will provide a broadly diversified portfolio using 35 countries for stocks, 17 countries for fixed income and 22 countries for currency.

### **Fund Structure**

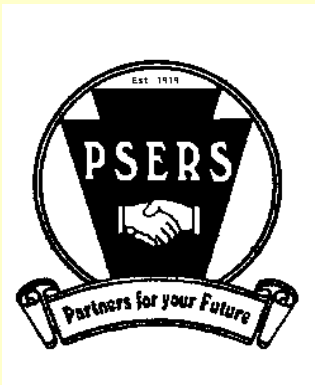
The Fund is structured as a Cayman-domiciled, limited partnership with a target size of \$1 billion. The proposed exposure will be invested in a fund structure with no “hard” lock up period. Staff has negotiated a reduced base fee in exchange for a “soft” lock up with a declining penalty scale for the first three years of the investment. The Fund is subject to a liquidity provision that requires a one month notice. Because the Fund’s market exposure is non-directional, the hurdle rate or benchmark is a cash equivalents return measured by the Citigroup 90-Day Treasury Bill Index. The expected excess return or alpha of the Fund is in 10% - 12% (gross of fees) with a target volatility or risk of 12%.

### **Recommendation**

The PSERS investment program is designed to have a long-term, strategic exposure to the investment opportunities in global emerging markets. The Fund and the strategy to utilize it alongside an emerging market swap, is consistent with this objective. We believe the Fund offers PSERS a unique opportunity to 1) gain access to diversified investment opportunities across asset classes in the emerging markets and 2) leverage an existing relationship and an experienced skill set.

Wilshire recommends that PSERS invest up to \$250 million in the Fund to play an absolute return generating role within the non-US equity allocation of the PSERS investment program.

Please let us know if you have any questions regarding this recommendation.



## Emerging Markets Portable Alpha Allocation

# BlackRock Emerging Markets Macro Fund Ltd.

January 7, 2010

See Page 8 for Disclaimer

**James H. Grossman, Jr., CPA, CFA**  
Managing Director of External Public  
Markets, Risk & Compliance

# BlackRock Emerging Markets Macro Fund Ltd.

## Overview of BlackRock

- World's largest asset manager
- Merger of BlackRock and Barclays Global Investors completed on December 1, 2009
- Firm manages in excess of \$3.0 trillion for more than 5,000 institutional investors in 75 countries

## Integration of BlackRock and BGI

- BlackRock
  - Active portfolio management
  - Global mutual fund platform
  - Customized solutions and advice
- BGI
  - Scientific index/active investing
  - Product innovation
  - Retirement Solutions

# **BlackRock Emerging Markets Macro Fund Ltd.**

## **Fund Strategy**

- BlackRock Emerging Markets Macro Fund Ltd. (BEMM) is an absolute return fund
- BEMM is structured to be non-directional long/short fund
- Asset classes currently invested in include 35 equity markets, 22 currencies, and 17 fixed income markets

## **Investment Team**

- Over 50 employees involved in BEMM
- BlackRock has over 9,000 employees worldwide

# BlackRock Emerging Markets Macro Fund Ltd.

## Value Proposition

- BlackRock believes that there are active management opportunities in emerging markets
  - Non-profit motivated market participants
  - Less active management
  - Barriers to entry
  - Market segmentation
  - Institutional reform (“financial liberalization”)
- Significant opportunity for long/short management

# BlackRock Emerging Markets Macro Fund Ltd.

## History with PSERS

- See appendix for portfolios managed by BlackRock for PSERS as of 12/31/2009

## Targeted Returns and Volatility

- Gross Annualized Target Alpha: 10.0 to 12.0%
- Estimated Net Annualized Target Alpha: 7.2 to 8.8%
- Annualized Volatility: 12.0%
- Sharpe Ratio: 0.60 to 0.73

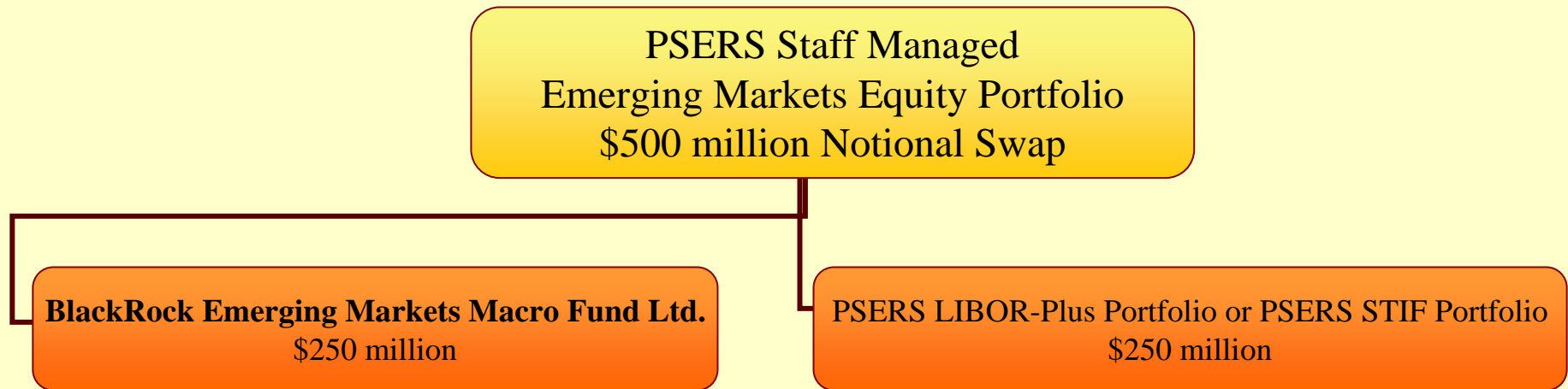
## Portfolio Use of BEMM

- Staff plans to use this product as a portable alpha vehicle in an internally-managed emerging markets equity portfolio as shown on the next slide



# BlackRock Emerging Markets Macro Fund Ltd.

## Proposed Account Structure



This portable alpha structure has built in liquidity through the PSERS LIBOR-Plus portfolio and/or PSERS STIF portfolio and a return target of the MSCI Emerging Markets Equity Index Return plus 3.5%

# BlackRock Emerging Markets Macro Fund Ltd.

## Fund Terms

- Management fee: 1.0%
- Entry/Exit Charge: 0.75%
- Performance Fee: 20% of the increase in NAV over the Citigroup 3-month T-bill Index
- High Water Mark: Yes
- Administrator: State Street
- Auditor: PriceWaterhouseCoopers
- Redemption Fee
  - 1.00% payable on redemptions made within 1 year of acquisition
  - 0.75% payable on redemptions made between years 1 and 2
  - 0.50% payable on redemptions made between years 2 and 3
  - 0.00% payable after 3 years
- Liquidity: Monthly with monthly notice
- Transparency: Partial

# BlackRock Emerging Markets Macro Fund Ltd.

## Other

- Relationships with Wilshire: Yes, source index data.
- Placement Agents: None
- Political Contributions in PA: None

# BlackRock Emerging Markets Macro Fund Ltd.

## Recommendation

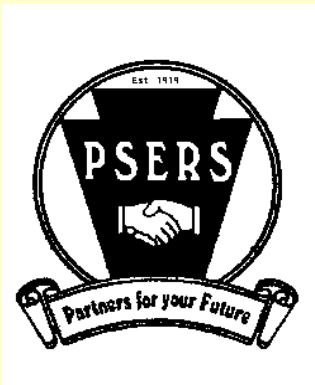
- Staff, together with Wilshire Associates, recommends that the Board invest \$250 million in the BlackRock Emerging Markets Macro Fund Ltd.; \$250 million in PSERS LIBOR-Plus Portfolio and/or PSERS STIF Portfolio; and enter into a \$500 million emerging markets equity swap to create a \$500 emerging markets equity portfolio.

**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.

# Appendix: BlackRock Managed Portfolios

## As of December 31, 2009

<u>Portfolio</u>	<u>Est. Market Value (in 000's)</u>	<u>% of NAV</u>
U.S. Fixed Income	\$ 485,409	1.04
Enhanced U.S. Fixed	605,001	1.30
Mortgage Investors	450,998	0.97
LIBOR-Plus	899,318	1.93
Global Equity	523,645	1.12
E/M Commingled	162,564	0.35
E/M Commingled	37,510	0.08
Global Macro	649,540	1.39
Capital Structures	<u>206,405</u>	0.44
<b>Total</b>	<b><u>\$ 4,020,399</u></b>	8.61
<b>PSERS EST. NAV</b>	<b><u>\$ 46,700,000</u></b>	



## Emerging Markets Portable Alpha Allocation

# BlackRock Emerging Markets Macro Fund Ltd.

January 7, 2010

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Managing Director of External Public  
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