

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: September 22, 2011

SUBJECT: Capula Special Opportunities Fund Recommendation

TO: Members of the Board

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

At the Finance Committee meeting in October, staff and Aksia will recommend that PSERS invest up to \$250 million in the Capula Special Opportunities Fund (SOF), Class A shares. This fund is an offshoot of the Capula Tail Risk Fund (TRF) created to take advantage of a select number of short-biased investments with a view to profit from the current macroeconomic, political, and fiscal situation. Capula's stated goal is to generate net returns of 50% to 70 % while limiting the annual carrying costs to approximately 10% per annum. SOF will focus on trading in assets that may benefit from a substantial one-time opportunity within the next two years. It is expected that the Fund will be highly concentrated. However, as noted above, the downside risk is well defined at 10% per year should this opportunity not play out as expected. While the TRF will take a small position similar to positions held in SOF, given TRF's liquidity profile, TRF can't take a meaningful position in these assets. In addition, the capacity of SOF is limited to approximately \$500 million as this is the amount Capula believes they can deploy without adversely affecting pricing in the markets that they will be trading. Capula investment professionals have spent the past few months researching this opportunity and feel that the window of opportunity to invest will close in only a few months. Staff and Aksia have had meetings with Capula and concur that the opportunity presented is very attractive.

Capula Investment Management was formed in 2005 by former members of JP Morgan's Proprietary Trading Group, led by Yan Huo, CIO. Capula is a UK registered global investment management firm with offices in London, Tokyo, and Connecticut. They manage approximately \$9.8 billion as of July 2011 in three separate products. Capula has had very consistent performance since their inception in 2005, strong risk controls, and a strong management team and operational platform.

Staff's objective for investing in the SOF is to generate a net return of 50% to 70% over a two-year period from a potential one-time opportunity in short-biased investments with a view to profit from the current macroeconomic, political, and fiscal situation.

Included for your review are a PowerPoint presentation prepared by staff and the resolution recommending an investment in Capula SOF. Representatives from Capula will make a more detailed presentation to the Finance Committee in executive session and will be available for any questions.

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