

# 2009 Supplemental Budget Information

Prepared for the House Appropriations Committee





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February 17, 2009

Members of the House Appropriations Committee

Dear Members:

On behalf of the State Employees' Retirement System (SERS), I am pleased to provide you with the following supplemental information, which may be helpful to you in your budget deliberations.

As detailed at Tab 8, Investment Policy, Objectives and Performance, 2008 was an extremely challenging year for the SERS Fund. The same global financial crisis that froze credit markets, drove down stock and bond markets alike with record and near-record losses, caused the collapse of leading financial institutions, precipitated the current recession and devastated the portfolios of investors large and small also severely impacted SERS. The SERS Fund recorded an investment performance of minus 28.6% in 2008, breaking a string of five strong positive years in which the annualized return exceeded 17%. SERS was far from alone in this regard; other institutional investors incurred similar losses. SERS is a long-term investor and viewed long term, SERS' performance continues to compare favorably to our peers. Whereas our 2008 return lagged the median return of minus 26.2% for large public pension plans, SERS' returns exceed the median over five years (5.1% for SERS vs. a median of 2.5%) and 10 years (4.9% for SERS vs. a median of 3.4%).

Because SERS is a mature pension plan -- one with almost as many retired as active members (see Tab 5, Member Services and Demographics) -- SERS pays out far more in benefits and expenses each year than it collects in employee and employer contributions. The 2008 payouts exceeded \$2.2 billion, contributing to the decline in the size of the SERS Fund over the past year. The Fund value as of December 31, 2008, stood at \$24.0 billion, down from \$35.5 billion the previous year. Over the past 10 years, SERS has paid out almost \$17.2 billion in benefits and expenses, while investment income (including seven years of gains and three of losses) totaled \$12.6 billion. During that 10-year period, employer and employee contributions, combined, totaled \$4.5 billion (employees, \$2.9 billion; employers, \$1.6 billion), or just over a quarter of payouts.

At Tab 7, Funding Process and Actuarial Status, we report on the plan's funded status, which stood at 97.1% as of December 31, 2007. That number certainly will be lower in the next valuation, reflecting the 2008 losses and payouts. But any level above 80% is generally considered to be well-funded so we expect that whatever our precise 2008 funded level is determined to be, it will show SERS to still be well-funded.

Tab 7 also addresses future employer funding obligations, including the projected 2012 rate "spike." The spike -- once projected to be 28.6% of payroll -- had declined into single digits, thanks largely to the Fund's five-year period of sustained strong investment performance. That too will change with the next valuation, due to the 2008 investment performance and payouts. We anticipate that the updated projections will show the spike returning to near the previously projected high level. We recognize such a steep projected jump in employer contribution rates would present the Commonwealth with a severe budgetary challenge. We stand ready to continue working with the Legislature and the Administration to manage and meet that challenge, while maintaining SERS as a well-funded pension plan.

Additional tabs offer information on, among other topics, Pennsylvania investments and the Commonwealth's Deferred Compensation Program, which the SERS Board also administers.

If you have any questions regarding any of the information in this booklet, please contact Executive Director Leonard Knepp. Thank you in advance for your consideration of SERS' 2009-10 budget request.

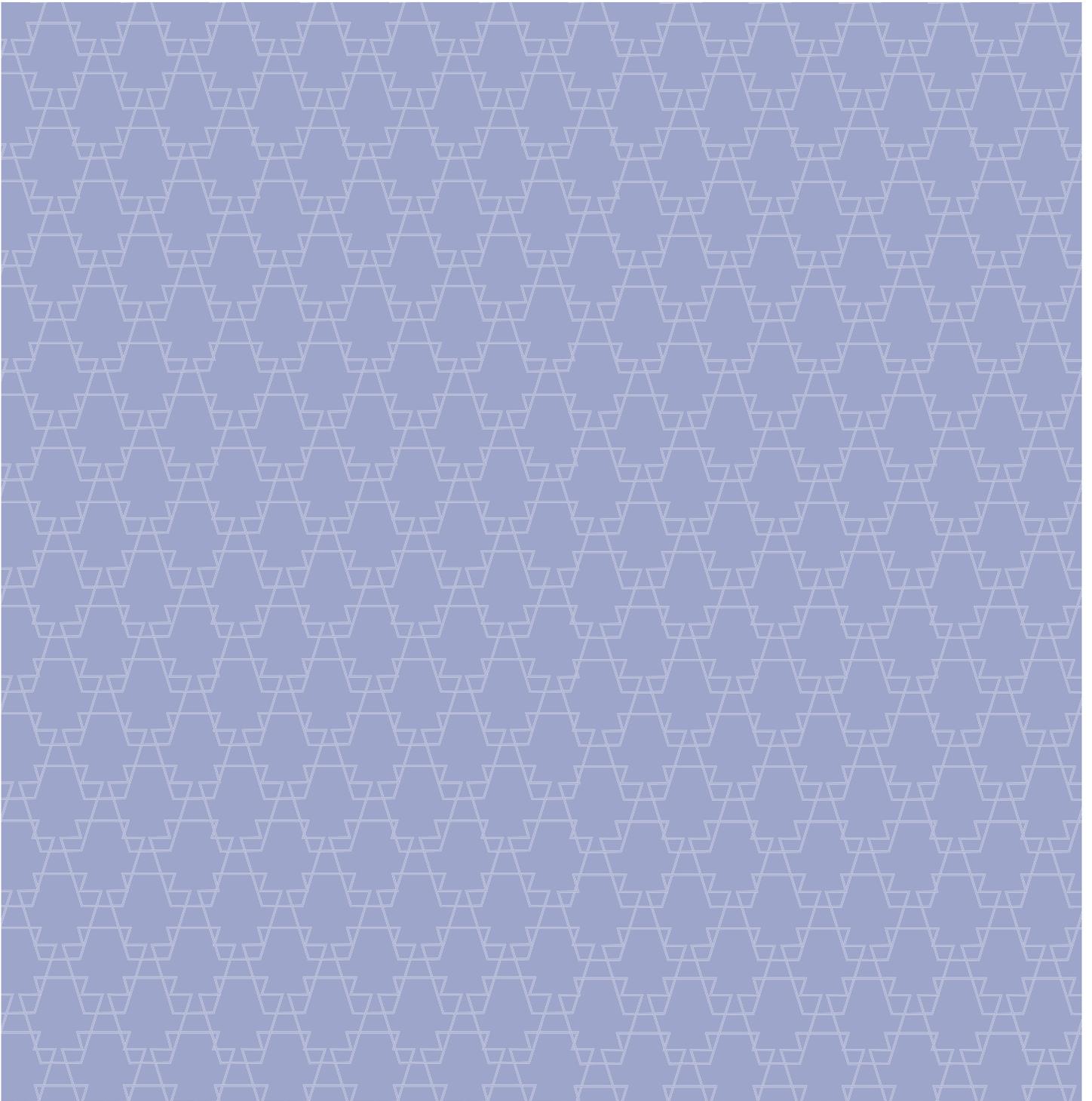
Sincerely,

Nicholas J. Maiale

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# Organizational Overview 1



# Mission, Vision & Guiding Principles

Established in 1923, the Pennsylvania State Employees' Retirement System is one of the nation's oldest and largest statewide retirement plans for public employees, with more than 219,000 members. SERS is among the largest of public and corporate pension funds, with assets of approximately \$24.0 billion as of December 31, 2008.

SERS is responsible for administering the State Employees' Retirement Code in accordance with the expressed intent of the General Assembly and bears a fiduciary obligation to the state employees and retirees who are the plan beneficiaries.

State law provides that the administration of the SERS Fund and the fiduciary responsibility for its management be vested in an 11-member Board. The management of SERS is the responsibility of the Executive Director who, with the approval of the Board, contracts for professional services and employs the staff needed to operate the system.

## Mission

The mission of SERS is to provide retirement benefits and services to our members through sound administration and prudent investments.

## Vision

By 2012, SERS will have implemented programs for personnel and leadership transitions while continuing to address funding, policy and operational challenges.

## Guiding Principles

- Demonstrate Integrity
- Think Strategically
- Lead Innovation and Improvement
- Develop and Empower Employees
- Share Knowledge
- Focus on Customer Service
- Learn from Mistakes
- Safeguard Information, Facilities and Staff
- Fulfill Fiduciary Obligations

# Organization & Operations

The agency's various program functions are administered by staff in SERS' Harrisburg Central Office and through a statewide network of seven Regional Retirement Counseling Centers. Assignment of major agency functions is as follows:

**Executive Office:** Supports the Executive Director who is the agency's senior staff administrator. Provides direct service to the Chairman of the SERS Board and Board members. Makes arrangements for and conducts administrative functions for all Board meetings. Conducts research and provides agency direction on organizational development, strategic planning, pending retirement issues and actuarial considerations. Includes the **Communications and Policy Office**, which serves a variety of support functions related to communications and legislation. These include preparation and dissemination of retirement-related information and publications, tracking and reporting on retirement legislation, serving as the agency's legislative liaison and handling inquiries from the media, state Legislature and the public.

**Office of Finance and Administration:** Provides the accounting structure for SERS' \$24.0 billion Fund; oversees all transactions, including payment of member benefits, purchase and sale of investment securities, receipt of employer and employee contributions and investment income, and administration of the agency operational budget. The office also manages agency operations and disaster recovery planning, while reporting to the SERS Board on management of the approximately \$1.5 billion Commonwealth Deferred Compensation Program.

**Investment Office:** Works closely with the Board to recommend and establish asset allocation, investment policy and investment managers for review and approval by the Board. The office works in tandem with the consultants monitoring the compliance and performance of the outside managers and undertaking research on investment products and investment managers.

**Legal Office:** Provides counsel to the SERS Board and the agency, including handling administrative hearings involving SERS members, reviewing investment and non-investment-related contracts, and providing legal advice.

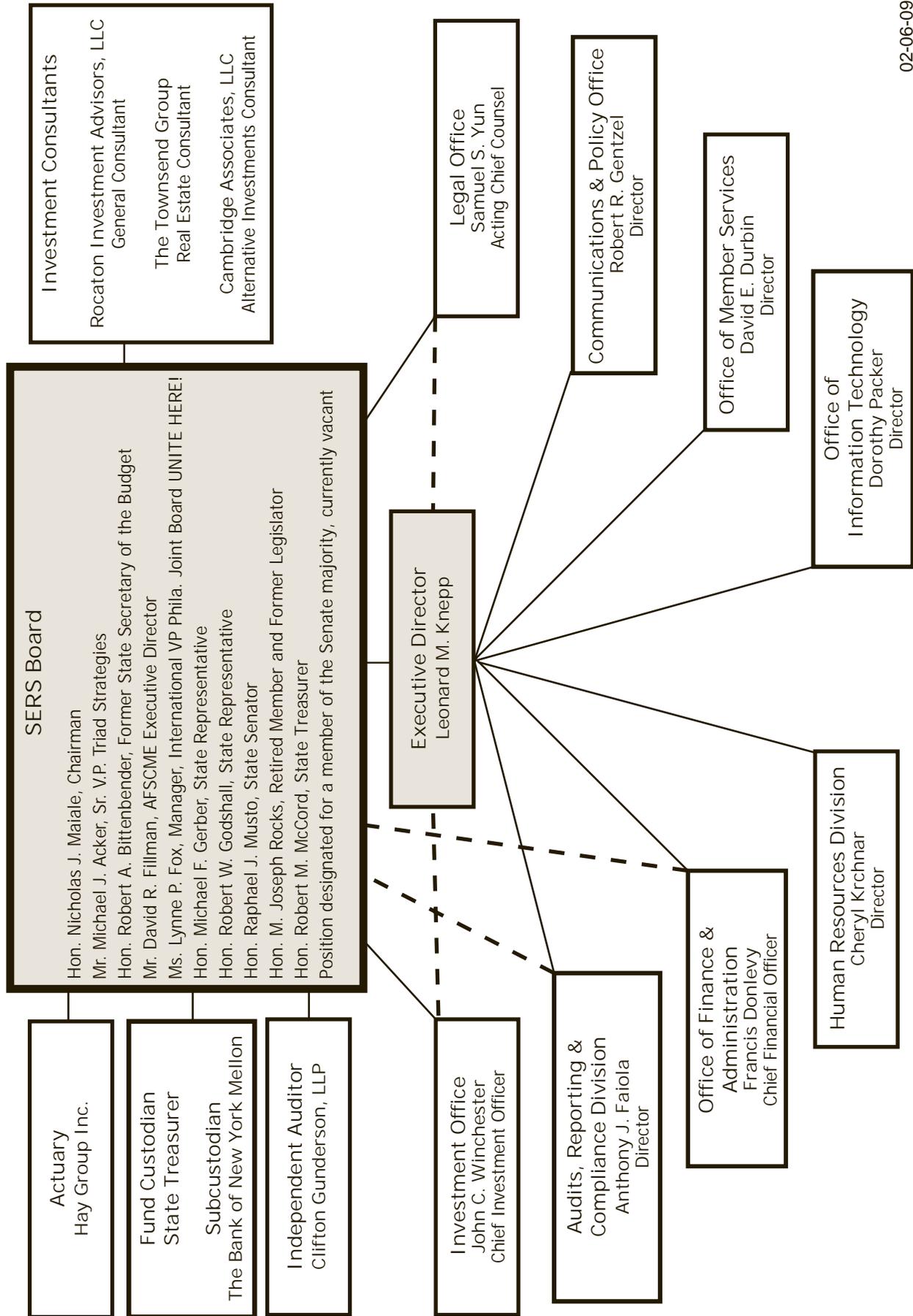
**Audits, Reporting and Compliance Division:** Provides the Board with the assurance that internal controls are adequate and operating as designed through internal audits of business processes. Coordinates audits performed at SERS by external agencies and auditors. Prepares agency financial and investment reports, performs analysis and compliance reviews of investments and other programs.

**Human Resources Division:** Responsible for management and development of human resources.

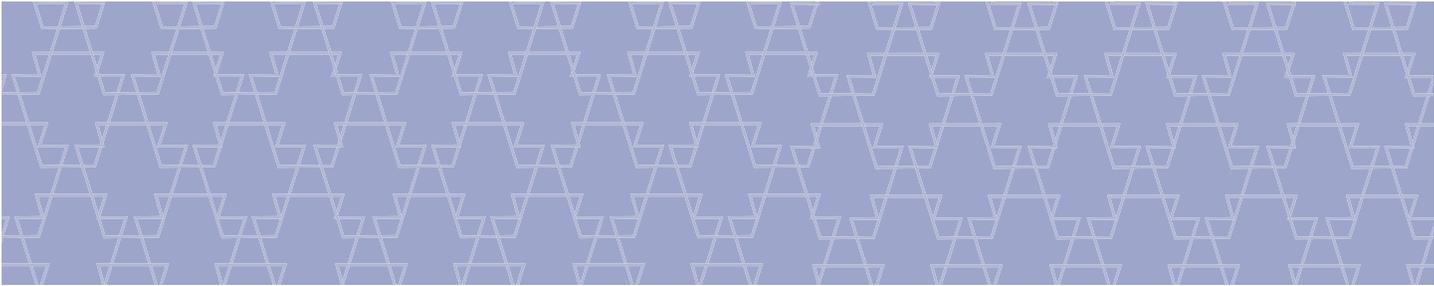
**Office of Information Technology:** Provides all computer and technical support for SERS operations, including a Wide Area Network linking the agency's seven Regional Retirement Counseling Centers.

**Office of Member Services:** Provides individualized counseling and retirement-related seminars through SERS' statewide system of seven Regional Retirement Counseling Centers. Processes member and member-survivor benefit payments and provides membership account services. Researches issues in public pension programs, recommends adoption of new strategies, and performs special retirement-related functions.

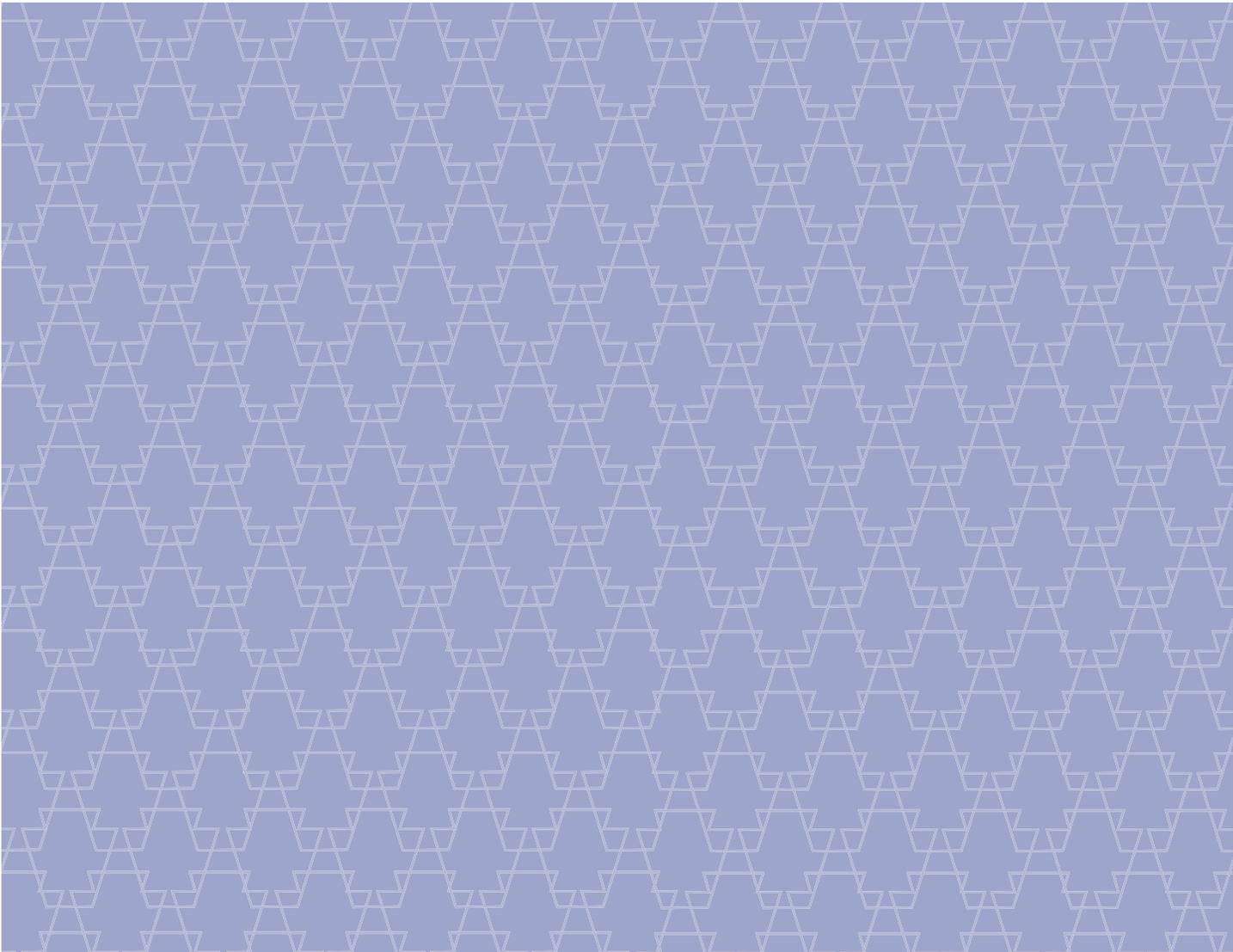
# SERS Organizational Chart



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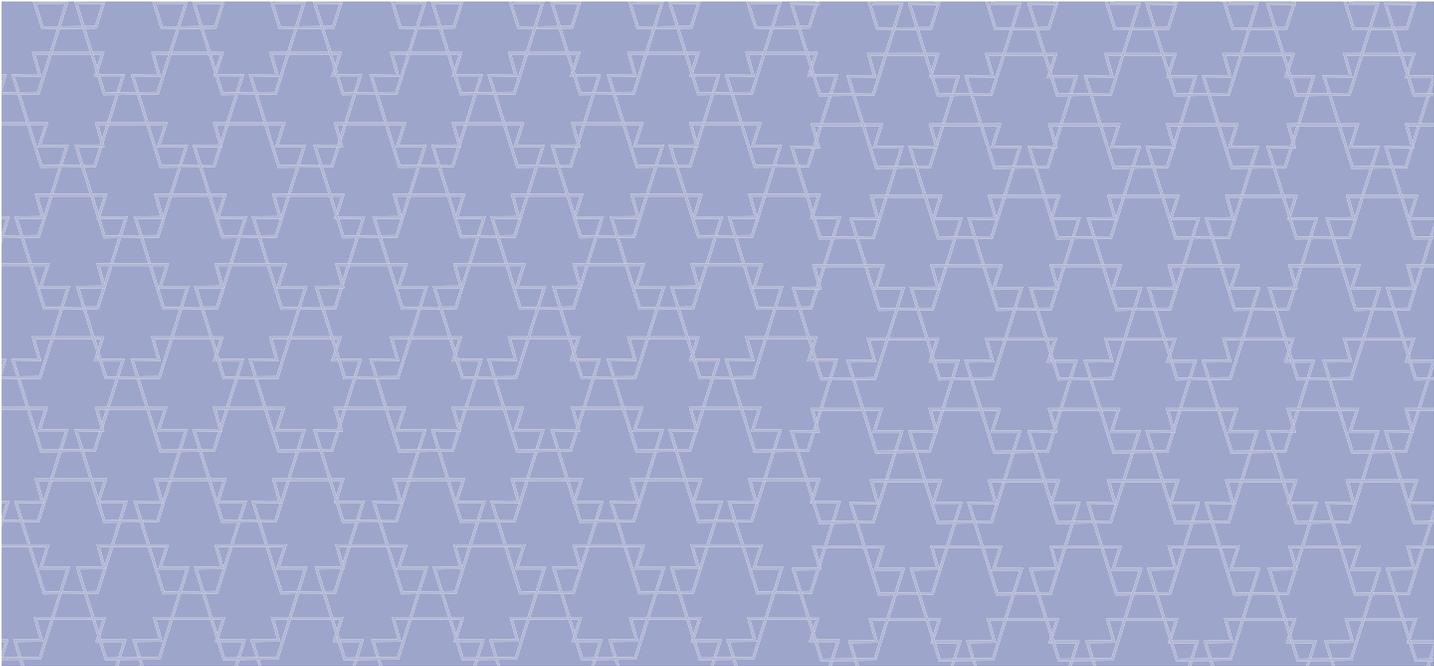


2009-2010 Budget - Board Submission 2

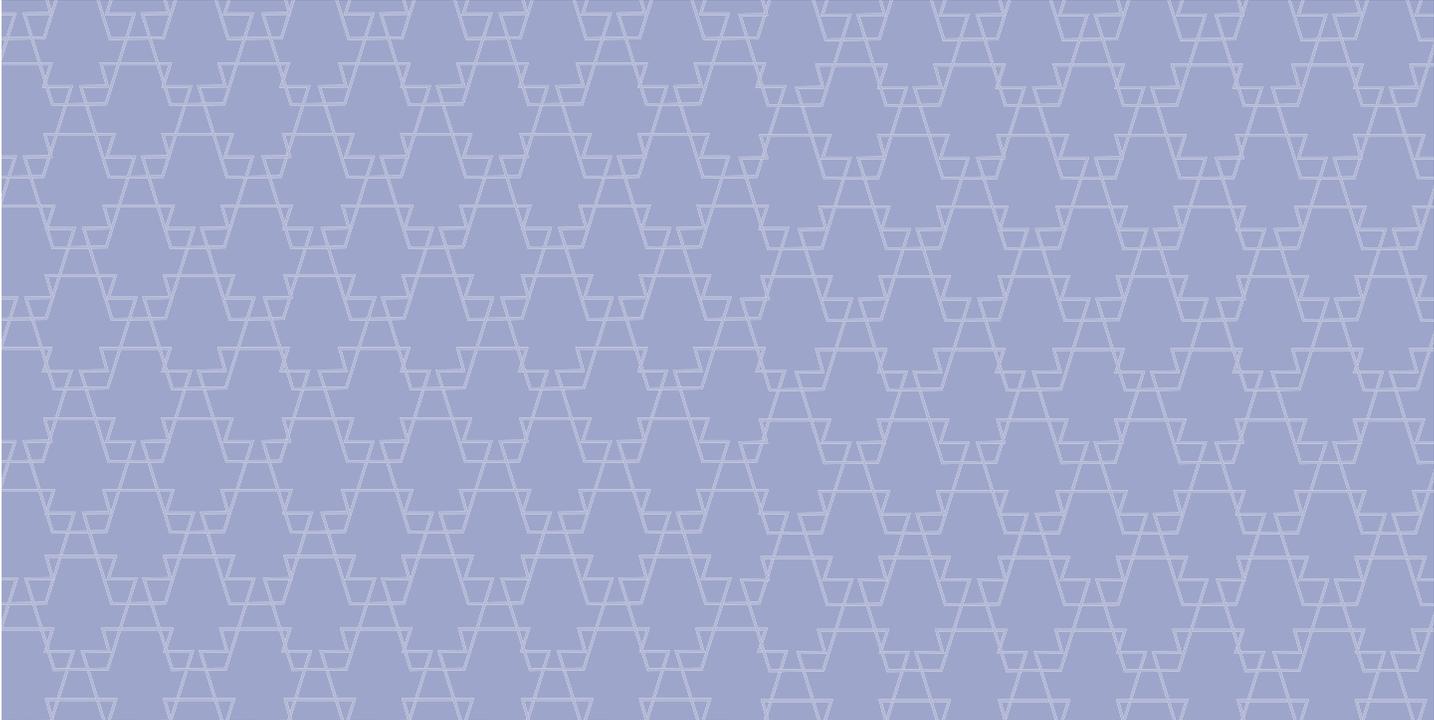


# SERS Budget 2009-2010

	Budget 2005-06	Budget 2006-07	Budget 2007-08	Budget 2008-09	Budget 2009-10
<b>Personnel Services</b>	\$14,374,963	\$15,600,000	\$16,402,000	\$16,913,000	\$17,191,000
<b>Operational Expenses:</b>					
Travel	225,713	230,000	220,000	205,000	249,700
Training	219,985	204,700	189,000	165,000	185,400
Telecommunications	272,530	279,800	312,000	395,000	397,900
Telephone/Equipment	11,700	5,100	165,000	9,000	-
Consultant	3,718,437	2,795,000	2,953,000	3,863,000	3,876,000
Legal Services/Fees	95,775	90,000	50,000	52,000	52,000
Specialized Services	990,805	1,369,000	827,000	781,000	711,300
Advertising	-	-	4,000	5,000	5,000
Contracted EDP Services-Vendor Provided	554,576	781,000	1,366,000	1,038,000	755,000
Contracted Maintenance-Non-EDP	25,475	17,700	39,000	48,000	74,200
Contracted Repairs-Motorized Equipment	805	-	-	-	-
EDP	1,190,296	1,145,500	959,000	862,000	1,076,900
Real Estate	1,491,553	1,605,500	1,545,000	1,611,000	1,630,000
Vehicles	82,900	84,700	63,000	54,000	54,000
Office Equipment	-	23,100	135,000	215,000	179,300
Other Rentals/Leases	103,860	133,000	139,000	142,000	138,200
Office Supplies	420,406	121,000	52,000	48,000	48,500
Educational Supplies	1,900	1,100	1,000	1,000	1,000
Other Computer Equipment	-	346,000	355,000	609,000	619,500
Motorized Equipment	9,600	6,600	16,000	16,000	19,900
Postage	434,321	235,500	315,000	320,000	320,000
Freight	7,000	5,000	7,000	8,000	8,800
Printing	239,550	169,000	210,000	210,000	225,500
Subscriptions	19,645	20,000	32,000	80,000	199,300
Membership Dues	57,280	60,000	58,000	60,000	66,900
Conference Expenses	20,050	45,000	19,000	8,000	8,500
Purchasing Card Purchases	195,975	208,400	216,000	236,000	224,300
Insurance, Surety, & Fidelity Bonds	5,000	5,300	5,000	8,000	10,000
Other Operational Expenses	326,900	268,000	844,000	861,000	904,900
<b>Total Operational</b>	<b>10,722,037</b>	<b>10,255,000</b>	<b>11,096,000</b>	<b>11,910,000</b>	<b>12,042,000</b>
<b>Fixed Assets</b>	<b>90,000</b>	<b>70,000</b>	<b>70,000</b>	<b>25,000</b>	<b>0</b>
<b>Total Budget</b>	<b>\$25,187,000</b>	<b>\$25,925,000</b>	<b>\$27,568,000</b>	<b>\$28,848,000</b>	<b>\$29,233,000</b>



**Investment Advisory and Consultant Fees 3**



# Investment Advisory & Consultant Fees

(unaudited)

## 2008 Advisory Fees

<b>Assets</b>	<b>Fees<sup>1/</sup></b>	<b>Fees<sup>2/</sup> (in basis points)</b>
Stocks	\$88,531,090	71.2
Fixed Income	18,090,806	40.4
Absolute Return	20,317,650	68.5
Real Estate	33,162,488	109.8
Alternative Investments	131,122,618	151.7
Inflation Protection	12,558,852	55.3
<b>Total Fund</b>	<b>\$303,783,504</b>	<b>89.1</b>

<sup>1/</sup> Fees paid and accrued by SERS during the period from January 1, 2008, through December 31, 2008, according to SERS records maintained by the Office of Finance and Administration (OFA).

<sup>2/</sup> The fee data from OFA was divided by SERS' total fund and asset class average values during calendar year 2008 to arrive at the basis point calculations. Alternative Investments were determined based on committed capital during the active investment stage of the partnership, and on market value during the maturity stage of the partnership to most accurately reflect the calculation of fees for those management services.

## Average Basis Points Calendar Years Ended 2004-2008

<b>Calendar Year</b>	<b>Fees (\$ millions)</b>	<b>Basis Points</b>
2004	\$195.1	66.3
2005	231.2	78.4
2006	286.8	83.5
2007	330.8	86.7
2008	303.8	89.1

## 2008 Consultant Fees

<b>Firm</b>	<b>Status</b>	<b>Fees</b>
Cambridge Associates	Alternative Investments	\$1,815,751
Rocaton Investment Advisors	General	486,667
The Hay Group	General	300,008
The Townsend Group	Real Estate	234,900
Institutional Shareholders Services	General	102,500

# Fees to Managers (Non-Budget Appropriation)

(unaudited)

SERS employs outside investment managers because of their investment expertise. The managers of the SERS investment portfolio are paid through a non-budget appropriation. Their fees are treated as a reduction of the investment revenue of the Fund, rather than as a direct administrative expense. Thus, when investment performance is reported elsewhere in this book, the numbers reported are net of fees – that is, performance after all investment management fees have been paid.

## 2008 Fees to Managers

### U.S. Stocks

AQR Capital Management	Greenwich	CT	\$439,669
AXA Rosenberg Investment Management	Orinda	CA	870,832
BAAM - Stable Alpha	New York	NY	18,742,552
Barclays Global Investors	San Francisco	CA	1,020,065
Emerald Advisers	Lancaster	PA	1,301,438
Iridian Asset Management	Westport	CT	1,279,008
Mellon Equity Associates	Pittsburgh	PA	277,104
NISA Beta-Overlay	St. Louis	MO	2,625,029
Northpointe Capital	Troy	MI	273,174
Pacific Alternative Asset Management Company	Irvine	CA	14,586,040
Robeco Investment Management	New York	NY	228,502
Turner Investment Partners	Berwyn	PA	266,069

### Absolute Return

Mesirow Advanced Strategies Fund	Chicago	IL	13,075,726
Morgan Stanley Alternative Investments Partners	West Conshohocken	PA	7,241,924

### Inflation Protection

Blackstone SERS Customized Commodities Fund	New York	NY	5,182,388
NISA Investment Advisors	St. Louis	MO	1,125,993
Wellington Management Company	Boston	MA	6,250,471

### Non-U.S. Stocks

Arden Capital Management	New York	NY	5,900,127
Artisan Partners	Milwaukee	WI	2,988,138
Bernstein Investment Group	New York	NY	1,550,028
Blackrock Investment Management	London	United Kingdom	2,515,507
Harris Associates	Chicago	IL	2,426,509
J. P. Morgan Investment Management	London	United Kingdom	430,753
Morgan Stanley	London	United Kingdom	2,840,265
Oaktree Cap Mgt Emerging Markets - Feeder Fund	Los Angeles	CA	1,511,990
Pictet International Management - Small Capital	London	United Kingdom	1,101,060
Pictet International Management - Emerging Markets	London	United Kingdom	789,126
Rexiter Capital Management	Boston	MA	1,284,121
Rock Creek	Washington	DC	7,067,400
Templeton Investment Counsel	Fort Lauderdale	FL	1,993,285

# Fees to Managers

(Non-U.S. Stocks, continued)

Templeton Strategic Emerging Markets Fund II	Fort Lauderdale	FL	\$4,346,873
Templeton Strategic Emerging Markets Fund III	Fort Lauderdale	FL	331,500
Templeton TIFI Emerging Market	Fort Lauderdale	FL	2,554,286

## Global Stocks

Marathon London Global Fund	London	United Kingdom	4,580,431
Walter Scott & Partners	Edinburgh	United Kingdom	2,410,209

## Fixed Income

Ashmore Emerging Markets Debt Fund	London	United Kingdom	2,176,183
Ashmore Emerging Markets Local Currency Fund	London	United Kingdom	1,729,439
Berwind Financial Group	Philadelphia	PA	127,872
Goldman Sachs Custom Interest Fixed Income	New York	NY	102
Gramercy Advisors	Greenwich	CT	1,156,170
Greylock Capital Management	New York	NY	1,635,554
Morgan Stanley - Domestic	West Conshohocken	PA	1,103,439
NISA Custom TIPS Intermediate	St. Louis	MO	386,701
Oaktree Cap Mgt Mezzanine Fund	Los Angeles	CA	287,890
Pacific Investment Management Company	Newport Beach	CA	1,160,322
Pyramis Global Advisors Trust Company	Smithfield	RI	1,696,528
SEI Structured Credit Fund	Oaks	PA	300,492
Standish Mellon	Pittsburgh	PA	102,391
Stone Harbor Investment Partners - Emerging Market Debt	New York	NY	1,549,966
Stone Harbor Investment Partners - High Yield	New York	NY	2,332,577
Taplin, Canida & Habacht	Miami	FL	268,338
W.R. Huff Asset Management Company	Morristown	NJ	2,076,842

## Real Estate

AG Asia Realty Fund	New York	NY	281,226
Apollo Real Estate Investment Fund III	Purchase	NY	147,782
Blackstone Real Estate Partners III	New York	NY	50,249
Blackstone Real Estate Partners IV	New York	NY	270,852
Blackstone Real Estate Partners V	New York	NY	465,180
Blackstone Real Estate Partners VI	New York	NY	687,500
BPG Investment Partnership IV	Yardley	PA	9,704
BPG Investment Partnership V	Yardley	PA	103,496
BPG Investment Partnership VI	Yardley	PA	133,461
BPG Investment Partnership VII	Yardley	PA	527,963
BPG Investment Partnership VIII	Yardley	PA	374,964
Clerestory Small Cap Real Estate Fund I	New York	NY	163,666
Cliffwood Select Equity Fund	Los Angeles	CA	746,005
Colony Investors VIII	Los Angeles	CA	387,034
Fidelity Real Estate Opportunistic Income Fund	Boston	MA	208,333
Fillmore East Fund	San Francisco	CA	441,240
Fillmore West Fund	San Francisco	CA	321,646

# Fees to Managers

(Real Estate, continued)

Forest Investment Associates	Atlanta	GA	\$1,277,605
Goldman Sachs/Whitehall V & VI	New York	NY	2,882
Grosvenor Investment Management	Philadelphia	PA	4,195,636
Heitman America Real Estate Trust	Chicago	IL	192,057
Heitman Capital Management	Chicago	IL	1,040,660
ING Clarion Real Estate Securities	Radnor	PA	1,457,183
LaSalle Investment Management	Baltimore	MD	3,639,526
Lowe Enterprises Investment Management	Los Angeles	CA	5,803,422
Lubert Adler Real Estate Fund II	Philadelphia	PA	7,156
Lubert-Adler Real Estate Fund VI	Philadelphia	PA	375,000
Oaktree Cap Mgt Real Estate Opportunities Fund III	New York	NY	141,734
Oxford Fund	Pittsburgh	PA	562,500
Prudential Latin America Retail Fund I	Parsippany	NJ	362,597
Prudential Latin America Residential Fund III	Parsippany	NJ	322,623
Prudential Senior Housing Partners II	Parsippany	NJ	67,221
Prudential Senior Housing Partners III	Parsippany	NJ	437,550
Rockpoint Finance Fund I	Dallas	TX	533,649
Rockpoint Real Estate Fund I	Dallas	TX	143,347
Rockpoint Real Estate Fund II	Dallas	TX	408,107
Rockpoint Real Estate Fund III	Dallas	TX	750,000
Scout Fund I-A	Dallas	TX	924,789
Sentinel Real Estate Corporation	New York	NY	805,510
Starwood Global Opportunity Fund IV	Greenwich	CT	40,844
Starwood Global Opportunity Fund V	Greenwich	CT	57,650
Starwood Global Opportunity Fund VI-A	Greenwich	CT	628,961
Starwood Global Opportunity Fund VII-A	Greenwich	CT	436,368
UBS/Allegis-PMSA	Hartford	CT	624,337
UBS/Allegis - RESA	Hartford	CT	892,652
Urdang Securities Management	Plymouth Meeting	PA	306,502
Westbrook Real Estate Fund II	New York	NY	22,710
Westbrook Real Estate Fund III	New York	NY	22,649
Westbrook Real Estate Fund IV	New York	NY	67,603
Westbrook Real Estate Fund V	New York	NY	149,608
Westbrook Real Estate Fund VI	New York	NY	391,549
Westbrook Real Estate Fund VII	New York	NY	750,000

## Venture Capital

Abingworth Bioventures IV	London	United Kingdom	500,000
Abingworth Bioventures V	London	United Kingdom	642,779
Adams Capital Management II	Sewickley	PA	431,486
Adams Capital Management III	Sewickley	PA	652,800
Advanced Technology Ventures VI	Waltham	MA	123,018
Advanced Technology Ventures VII	Waltham	MA	502,394
Alloy Ventures 2000	Palo Alto	CA	242,920
Alloy Ventures 2002	Palo Alto	CA	615,136
Alloy Ventures 2005	Palo Alto	CA	625,400

# Fees to Managers

(Venture Capital, continued)

APAX Excelsior VI	New York	NY	\$308,710
Apex Investment Partners Fund V	Chicago	IL	380,275
Artiman Ventures II	Palo Alto	CA	567,665
Atlas Venture Fund IV	Waltham	MA	108,011
Atlas Venture Fund V	Waltham	MA	539,060
Atlas Venture Fund VI	Waltham	MA	393,554
Austin Ventures VIII	Austin	TX	323,454
Austin Ventures IX	Austin	TX	262,527
Battery Ventures VIII	Waltham	MA	562,667
Battery Ventures VIII Side Fund	Waltham	MA	75,900
Birchmere Ventures Fund III	Pittsburgh	PA	240,637
Care Capital Investments III	Princeton	NJ	580,909
Charles River Partnership XI	Waltham	MA	187,211
CID Greater China Venture Capital Fund II	Taipei	Taiwan	332,354
Clearstone Venture Partners III-A	Santa Monica	CA	1,662,857
Cross Atlantic Technology I	Radnor	PA	89,341
Cross Atlantic Technology II	Radnor	PA	458,913
Devon Park Bioventures	Wayne	PA	178,119
Draper Fischer Jurvetson VI	Menlo Park	CA	75,000
Draper Fischer Jurvetson VII	Menlo Park	CA	415,000
Draper Triangle Ventures I	Pittsburgh	PA	350,000
Draper Triangle Ventures II	Pittsburgh	PA	240,000
Fairview Capital II	Farmington	CT	74,696
Frazier Healthcare III	Seattle	WA	48,408
Frazier Healthcare IV	Seattle	WA	308,664
Frazier Healthcare V	Seattle	WA	858,370
Grotech Partners V	Timonium	MD	367,095
Guggenheim Technology Ventures I	King of Prussia	PA	23,900
Halpern Denny Fund II	Boston	MA	92,019
Halpern Denny Fund III	Boston	MA	98,200
HarbourVest Partners VI	Boston	MA	1,900,000
HarbourVest Partners VII	Boston	MA	750,000
HarbourVest Partners VIII - Venture Fund	Boston	MA	749,968
Healthcare Ventures V	Princeton	NJ	817
Healthcare Ventures VI	Princeton	NJ	813,863
Healthcare Ventures VII	Princeton	NJ	693,129
Healthcare Ventures VIII	Princeton	NJ	479,401
Highland Capital Partners VI	Lexington	MA	578,704
Highland Capital Partners VII	Lexington	MA	856,204
Highland Consumer Fund I	Lexington	MA	442,671
I.P. - Fund II	Bellevue	WA	80,173
I.P. - Fund III	Bellevue	WA	93,898
I.P. - Fund IV	Bellevue	WA	75,518
InterWest Partners VIII	Menlo Park	CA	436,213
InterWest Partners IX	Menlo Park	CA	499,744
InterWest Partners X	Menlo Park	CA	124,300

# Fees to Managers

(Venture Capital, continued)

J.P. Morgan Venture Capital Institutional Investors I	New York	NY	\$795,401
J.P. Morgan Venture Capital Institutional Investors II	New York	NY	929,452
J.P. Morgan Venture Capital Institutional Investors III	New York	NY	967,298
JMI Equity Fund V	Baltimore	MD	183,437
JMI Equity Fund VI	Baltimore	MD	746,487
Keystone Ventures IV	Philadelphia	PA	2,020
Kline Hawkes Pacific	Los Angeles	CA	112,592
Knightsbridge Venture Capital VI	Bartlesville	OK	140,000
Lightspeed Venture Partners VII	Menlo Park	CA	134,176
Lightspeed Venture Partners VIII	Menlo Park	CA	255,350
Meritech Capital Partners II	Palo Alto	CA	133,786
Meritech Capital Partners III	Palo Alto	CA	787,450
Mid-Atlantic Venture Fund IV	Bethlehem	PA	560,784
Morganthaler Venture Partners VII	Menlo Park	CA	802,137
Morganthaler Venture Partners VIII	Menlo Park	CA	476,336
Morganthaler Venture Partners IX	Menlo Park	CA	181,000
New Enterprise Associates VII	Baltimore	MD	217,409
New Enterprise Associates IX	Baltimore	MD	188,700
New Enterprise Associates X	Baltimore	MD	226,842
New Enterprise Associates 11	Baltimore	MD	151,225
New Enterprise Associates 12	Baltimore	MD	385,205
Newspring Ventures II	King of Prussia	PA	200,000
Novitas III	Wayne	PA	200,000
Novo Vita	Radnor	PA	16,063
Oak Investment Partners XI	Westport	CT	707,376
Oak Investment Partners XII	Westport	CT	700,000
P/A Fund III	King of Prussia	PA	481,400
Pitango Venture Capital Fund IV	Herzliya	Israel	420,769
Pitango Venture Capital Fund V	Herzliya	Israel	699,448
Polaris Venture Partners II	Waltham	MA	114,082
Polaris Venture Partners III	Waltham	MA	912,207
Polaris Venture Partners IV	Waltham	MA	1,249,200
Polaris Venture Partners V	Waltham	MA	1,000,000
Quaker BioVentures I	Philadelphia	PA	498,020
Quaker BioVentures II	Philadelphia	PA	623,214
Sofinnova Venture Partners VII	San Francisco	CA	390,900
Sprout Capital VII	New York	NY	4,272
Summit Accelerator	Boston	MA	159,023
Summit Partners Venture Capital Fund II-A	Boston	MA	199,838
Summit Ventures V	Boston	MA	155,907
T RowePrice	Baltimore	MD	436,259
Technology Leaders IV	Wayne	PA	72,892
Technology Leaders V	Wayne	PA	306,888
Three Arch Capital Partners I	Portola Valley	CA	385,744
Three Arch Capital Partners IV	Portola Valley	CA	492,501
U.S. Venture Partners VII	Menlo Park	CA	107,068

# Fees to Managers

(Venture Capital, continued)

U.S. Venture Partners VIII	Menlo Park	CA	\$372,942
Weathergauge Venture Capital	San Francisco	CA	293,616
Weston Presidio Capital III	Boston	MA	175,200
Weston Presidio Capital IV	Boston	MA	466,700
Weston Presidio Capital V	Boston	MA	985,103
Whitney Equity Partners III	Stamford	CT	273,913
Whitney Equity Partners IV	Stamford	CT	1,124,064
Worldview Technology Partners IV	San Mateo	CA	385,083

## Private Equity

ABRY Advanced Securities Fund I	Boston	MA	314,560
ABRY Broadcast Partners III	Boston	MA	130,705
ABRY Broadcast Partners IV	Boston	MA	162,393
ABRY Broadcast Partners V	Boston	MA	473,373
ABRY Mezzanine Partners	Boston	MA	124,287
ABRY Partners VI	Boston	MA	915,543
ABRY Senior Equity II	Boston	MA	295,047
ABS Capital Partners III	Baltimore	MD	149,156
ABS Capital Partners V	Baltimore	MD	152,695
Accel Europe	London	United Kingdom	374,850
Advent International Global Private Equity VI-A	Boston	MA	420,492
Advent Latin American Private Equity Fund IV-G	Boston	MA	590,715
AG Capital Recovery Partners II	New York	NY	4,350
AG Capital Recovery Partners IV	New York	NY	24,685
AG Capital Recovery Partners V	New York	NY	173,177
Alpha Private Equity Fund 4	Paris	France	411,223
Alpha Private Equity Fund 5	Paris	France	2,281,189
APAX Europe Fund V	London	United Kingdom	989,717
APAX Europe VII-A	London	United Kingdom	1,344,857
Apollo Investment Fund IV	New York	NY	35,254
Asia Alternative Capital Partners	San Francisco	CA	62,848
Asia Alternative Capital Partners II	San Francisco	CA	294,825
Audax Private Equity Fund I	Boston	MA	285,926
Audax Private Equity Fund II	Boston	MA	656,606
Audax Private Equity Fund III	Boston	MA	1,012,774
Avenue Asia Special Situations Fund IV	New York	NY	999,993
Avenue Europe Special Situations Fund	New York	NY	402,287
Avenue Special Situations Fund IV	New York	NY	750,000
Avenue Special Situations Fund V	New York	NY	1,049,948
AXA Secondary Fund III-1	Paris	France	211,300
AXA Secondary Fund III-2	Paris	France	113,800
AXA Secondary Fund IV	Jersey	Channel Islands	822,307
Bain Capital Asia Fund	Boston	MA	249,747
Bain Capital Europe Fund III	Boston	MA	716,051
Bain Capital Fund VII	Boston	MA	218,004
Bain Capital Fund VIII-E	Boston	MA	816,002

# Fees to Managers

(Private Equity, continued)

Bain Capital Fund IX	Boston	MA	\$3,846,375
Bain Capital Fund IX Coinvestment Fund	Boston	MA	248,485
Bain Capital Fund X	Boston	MA	1,654,582
Baring India Private Equity Fund III	Port Lewis	Mauritius	22,300
Baring Vostok Private Equity Fund IV	Guernsey	Channel Islands	468,234
BC European Capital VII	London	United Kingdom	415,907
BC European Capital VII - Top Up	London	United Kingdom	146,545
BC European Capital VIII	London	United Kingdom	1,852,665
Berkshire Fund VI	Boston	MA	341,651
Berkshire Fund VII	Boston	MA	468,658
Blackstone Capital Partners III	New York	NY	94,854
Blackstone Capital Partners V	New York	NY	767,980
Blackstone Communications Partners I	New York	NY	65,242
Brait IV	Grand Cayman	Cayman Islands	487,227
Brynwood Partners V	Greenwich	CT	170,308
Centerbridge Capital Partners	New York	NY	1,550,201
Cerberus Institutional Partners Series One	New York	NY	19,026
Cerberus Institutional Partners Series Two	New York	NY	40,641
Cerberus Institutional Partners Series Three	New York	NY	174,447
Cerberus Institutional Partners Series Four	New York	NY	1,124,950
Charterhouse Capital Partners VII	London	United Kingdom	140,169
Charterhouse Capital Partners VIII	London	United Kingdom	1,493,735
Chequers Capital XV	Paris	France	417,525
Clayton, Dubilier & Rice VI	New York	NY	128,997
Clessidra Capital Partners II	Milan	Italy	339,070
Code, Hennessy & Simmons III	Chicago	IL	4,878
Code, Hennessy & Simmons IV	Chicago	IL	175,980
Cognetas II	London	United Kingdom	974,320
CVI Global Value Fund	Grand Cayman	Cayman Islands	906,349
DLJ Merchant Banking II	New York	NY	137,244
DLJ Merchant Banking III	New York	NY	260,001
Dover Street VII	Boston	MA	72,436
Elevation Partners	Menlo Park	CA	193,431
Energy Spectrum Partners IV	Dallas	TX	552,598
Energy Spectrum PartnersV	Dallas	TX	600,000
Eureka II	Yardley	PA	367,978
Execelsior Capital Asia Partners III	Hong Kong	China	500,000
First Reserve Fund X	Greenwich	CT	153,739
First Reserve Fund XI	Greenwich	CT	290,388
First Reserve Fund XII	Greenwich	CT	137,339
Francisco Partners	San Francisco	CA	47,381
Francisco Partners II	San Francisco	CA	441,648
Great Hill Equity Partners II	Boston	MA	506,726
Great Hill Equity Partners III	Boston	MA	475,152
Great Hill Equity Partners IV	Boston	MA	138,300
Gryphon Partners II	San Francisco	CA	118,176

# Fees to Managers

(Private Equity, continued)

Gryphon Partners III	San Francisco	CA	\$255,737
GTCR Fund V	Chicago	IL	15,221
GTCR Fund VII	Chicago	IL	236,842
GTCR Fund IX	Chicago	IL	553,268
H.I.G. Bayside Debt & LBO Fund II	Miami	FL	323,800
HarbourVest International II	Boston	MA	143,017
HarbourVest International Private Equity III	Boston	MA	262,430
HarbourVest International Private Equity IV	Boston	MA	399,918
HIPEP V-Asia Pacific and Rest of World Partnership Fund	Boston	MA	300,032
Hellman & Friedman Capital Partners V	San Francisco	CA	274,074
Hellman & Friedman Capital Partners VI	San Francisco	CA	2,403,096
Insight Venture Partners VI	New York	NY	703,517
Intermedia Partners VII	New York	NY	262,500
Invemed Catalyst Fund	New York	NY	67,592
J.H. Whitney Fund V	Stamford	CT	244,162
J.H. Whitney Fund VI	Stamford	CT	1,826,240
J.P. Morgan U. S. Corporate Financial Institutional Investors II	New York	NY	326,775
J.W. Childs Equity Partners III	Boston	MA	303,813
Kelso Investment Associates VII	New York	NY	526,803
Kelso Investment Associates VIII	New York	NY	1,500,000
Leeds Weld Equity Partners IV	New York	NY	71,159
Lexington Capital Partners II	New York	NY	56,717
Lexington Capital Partners III	New York	NY	61,467
Lexington Capital Partners V	New York	NY	446,038
Lexington Capital Partners VI	New York	NY	203,225
Lime Rock Partners III	Westport	CT	298,358
Lime Rock Partners IV	Westport	CT	533,333
Lime Rock Partners V	Westport	CT	603,151
Lime Rock Resources C	Westport	CT	433,333
LLR Equity Partners	Philadelphia	PA	92,608
LLR Equity Partners II	Philadelphia	PA	497,063
LLR Equity Partners III	Philadelphia	PA	454,521
Madison Dearborn Capital Partners IV	Chicago	IL	56,679
Madison Dearborn Capital Partners V	Chicago	IL	668,915
Matlin Patterson Global Opportunities Partners	New York	NY	53,491
Media Communications Partners IV	Boston	MA	99,091
Media Communications Partners V	Boston	MA	496,744
Meridian Venture Partners II	Radnor	PA	506,664
New York Life Capital Partners III	New York	NY	497,448
New York Life Capital Partners IV	New York	NY	980,769
Newbridge Asia III	San Francisco	CA	111,002
Newbridge Asia IV	San Francisco	CA	121,116
Nordic Capital V	Stockholm	Sweden	398,565
Nordic Capital VI	Stockholm	Sweden	705,555
Nordic Capital VII	Stockholm	Sweden	1,635,514
Oak Hill Capital Partners I	Menlo Park	CA	81,907

# Fees to Managers

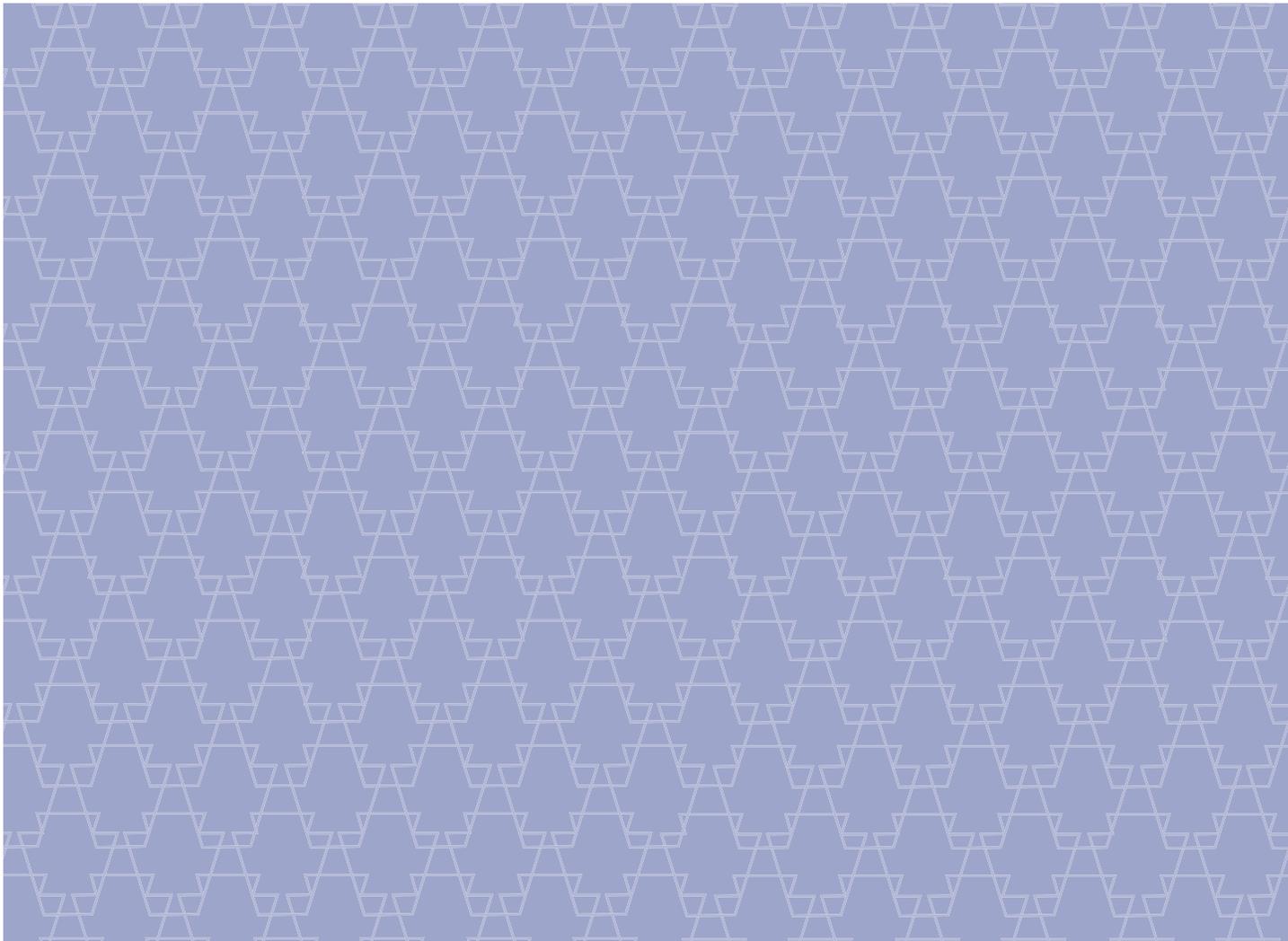
(Private Equity, continued)

Oaktree Cap Mgt Opportunities Fund IV	Los Angeles	CA	\$3,890
Oaktree Cap Mgt Opportunities Fund V	Los Angeles	CA	308,930
Oaktree Cap Mgt Opportunities Fund VI	Los Angeles	CA	487,329
Oaktree Cap Mgt Opportunities Fund VII	Los Angeles	CA	695,957
Oaktree Cap Mgt Principal Opportunities Fund II	Los Angeles	CA	84,523
Oaktree Cap Mgt Principal Opportunities Fund IV	Los Angeles	CA	344,811
Oaktree Cap Mgt/GFI Power Opportunities Fund II	Los Angeles	CA	394,701
Palamon Partners I	London	United Kingdom	394,572
Palamon European Equity II	London	United Kingdom	895,739
Parthenon Investors II	Boston	MA	263,109
Patriot Financial Partners	Philadelphia	PA	276,600
Permira European Fund I	London	United Kingdom	4,963
Permira European Fund II	London	United Kingdom	369,575
Permira European Fund III	London	United Kingdom	1,186,626
Permira IV	London	United Kingdom	1,439,492
PNC Equity Partners II	Pittsburgh	PA	262,286
Providence Equity Partners IV	Providence	RI	94,182
Providence Equity Partners VI	Providence	RI	305,724
Sankaty Credit Opportunities III	Boston	MA	1,088,257
Sankaty Credit Opportunities IV	Boston	MA	368,300
SB Energy Partners I-B	Denver	CO	493,938
SCP Private Equity Partners II	Wayne	PA	165,081
Segulah IV	Jersey	Channel Islands	142,868
ShoreView Capital Partners	Minneapolis	MN	88,172
ShoreView Capital Partners II	Minneapolis	MN	550,131
Siguler Guff BRIC Opportunities Fund	New York	NY	202,152
Siguler Guff BRIC Opportunities Fund II	New York	NY	209,554
Sterling Capital Partners	Northbrook	IL	31,199
Sterling Capital Partners II	Northbrook	IL	201,563
Sterling Capital Partners III	Northbrook	IL	480,954
Summit Partners Private Equity Fund VI	Boston	MA	1,153,707
Summit Partners Private Equity Fund VII-A	Boston	MA	2,717,714
TA IX	Boston	MA	867,919
TA X	Boston	MA	1,109,277
Thomas H. Lee Equity Fund IV	Boston	MA	45,239
Thomas H. Lee Equity Fund VI	Boston	MA	101,528
TPG Asia V	Fort Worth	TX	556,646
TPG Partners IV	Fort Worth	TX	127,386
TPG Partners VI	Fort Worth	TX	467,460
UMS Partners Fund I	Philadelphia	PA	68,471
Versa Capital Fund II-A	Philadelphia	PA	180,000

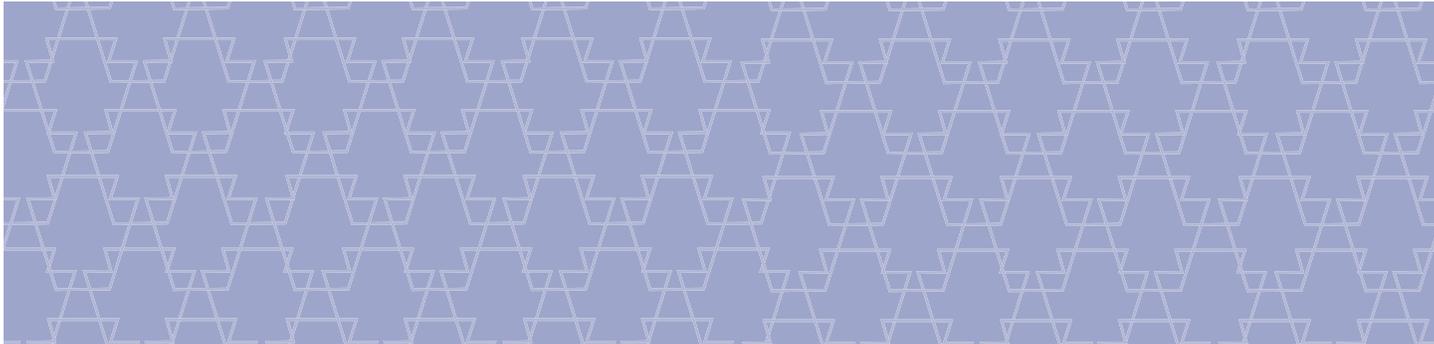
# Fees to Managers

*(Private Equity, continued)*

Vestar Capital Partners III	New York	NY	\$144,259
Vestar Capital Partners IV	New York	NY	754,564
Vestar Capital Partners V	New York	NY	1,131,659
W Capital Partners II	New York	NY	1,102,986
<b>Total</b>			<b>\$303,783,504</b>



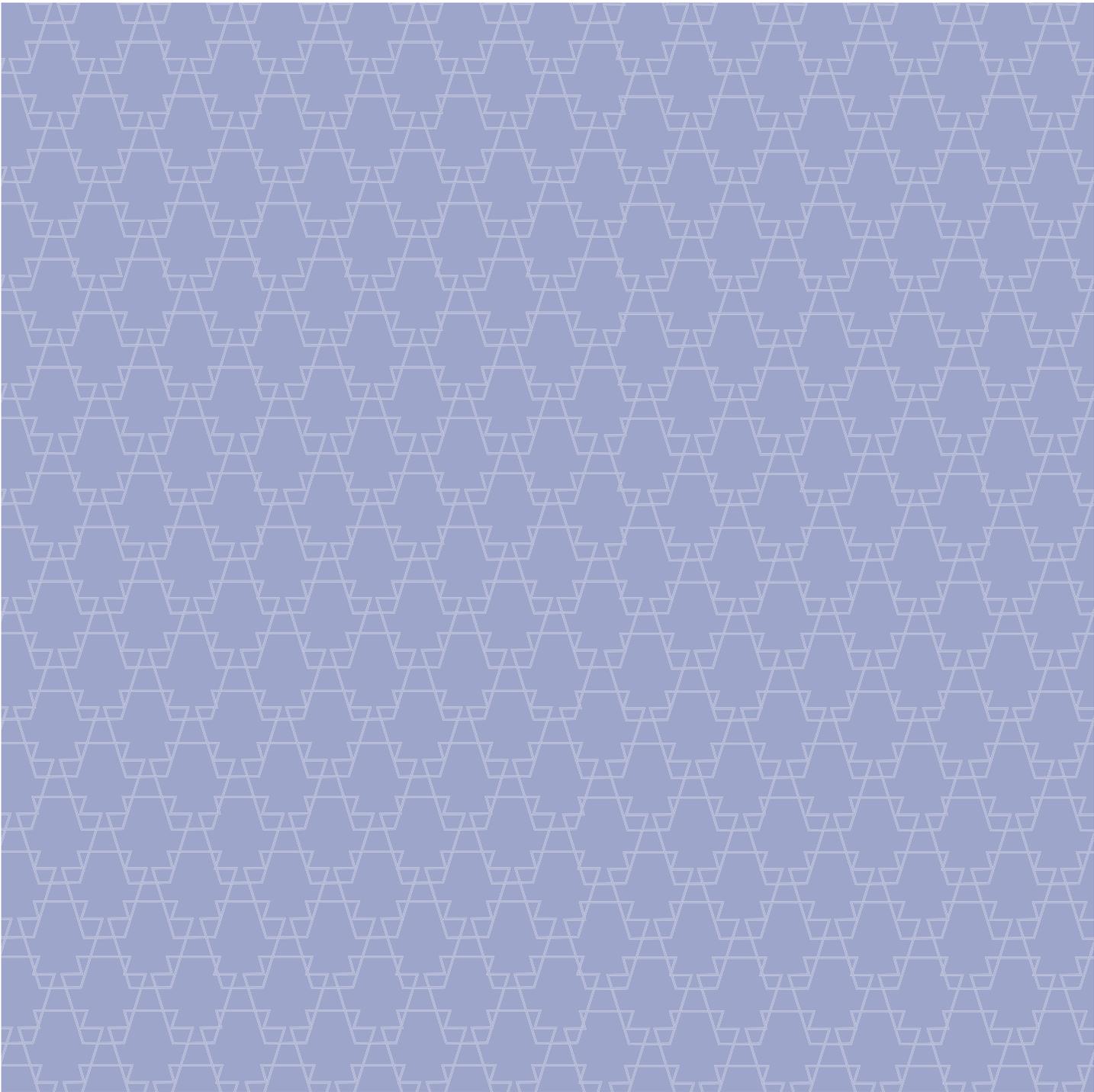
# Directed Commissions 4



# Directed Commissions

(unaudited)

	<b>FY 2008-09 Budget</b>	<b>FY 2009-10 Budget</b>
Beginning Balance	\$3,545,380	\$2,445,380
Directed Commissions	400,000	400,000
<b>Total Available</b>	<b>3,945,380</b>	<b>2,845,380</b>
Investment Consultants	1,500,000	1,500,000
<b>Ending Balance</b>	<b>\$2,445,380</b>	<b>\$1,345,380</b>



# Member Services

The Bureau of Member Services provides a variety of services to SERS active members and annuitants. Following are lists of services provided through the seven Regional Retirement Counseling Centers.

## Services to Active Members

- Calculate regular retirement, disability retirement and vesting estimates upon request.
- Provide one-on-one counseling for any member who is considering retiring or terminating service.
- Provide active members with an annual *Member Statement of Account*.
- Provide counseling to deceased members' Beneficiaries or Survivor Annuitants.
- Conduct group information sessions (Question & Answer Sessions, Pre-Retirement and Vestee Seminars).
- Provide resource speakers for various agency or association information sessions.
- Provide estimates and counsel members on the purchase of creditable State and nonstate service.
- Provide information on members' eligibility for retiree health benefits.

## Services to Retired Members

- Provide direct deposit forms, federal income tax withholding forms, and change of address forms upon request; and provide information and assistance to complete the forms.
- Provide beneficiary forms and assist members in completing the forms.
- Provide all Annuitants with an annual *Personal Statement of Retirement Benefits*.
- Provide all Annuitants with a *1099-R* federal tax form each tax year.
- Take information and process change of dependent information on the retiree's Retired Employees Health Program (REHP) coverage.
- Investigate and place stop payment transactions on checks not received by Annuitants after 10 working days.
- Provide resource speakers for group or association informational seminars.
- Receive and process notifications of death and serve as a contact for Beneficiaries and Survivors.
- Provide option change counseling for members when their Designated Survivor predeceases them, the retiree obtains a divorce, or when the retiree marries after the date of their retirement.
- Provide counseling on any change of monthly annuity payment, when applicable.

## Regional Retirement Counseling Centers

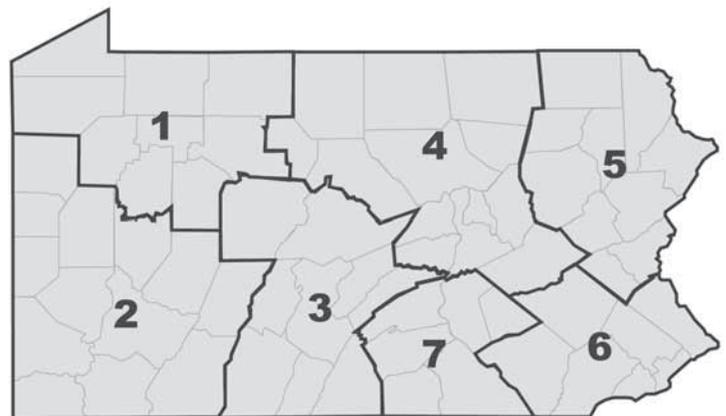
**Region 1 Seneca Office** Serving Clarion, Crawford, Elk, Erie, Forest, Jefferson, McKean, Venango and Warren counties.

**Region 2 Pittsburgh Office** Serving Allegheny, Armstrong, Beaver, Butler, Cambria, Fayette, Greene, Indiana, Lawrence, Mercer, Somerset, Washington and Westmoreland counties.

**Region 3 State College Office** Serving Bedford, Blair, Centre, Clearfield, Franklin, Fulton, Huntingdon, Juniata, Mifflin counties, and active members who are employees of Shippensburg University of Pennsylvania in Cumberland County.

**Region 4 Montoursville Office** Serving Bradford, Cameron, Clinton, Columbia, Lycoming, Montour, Northumberland, Potter, Schuylkill, Snyder, Sullivan, Tioga and Union counties.

**Region 5 Hazleton Office** Serving Carbon, Lackawanna, Lehigh, Luzerne, Monroe, Northampton, Pike, Susquehanna, Wayne and Wyoming counties.

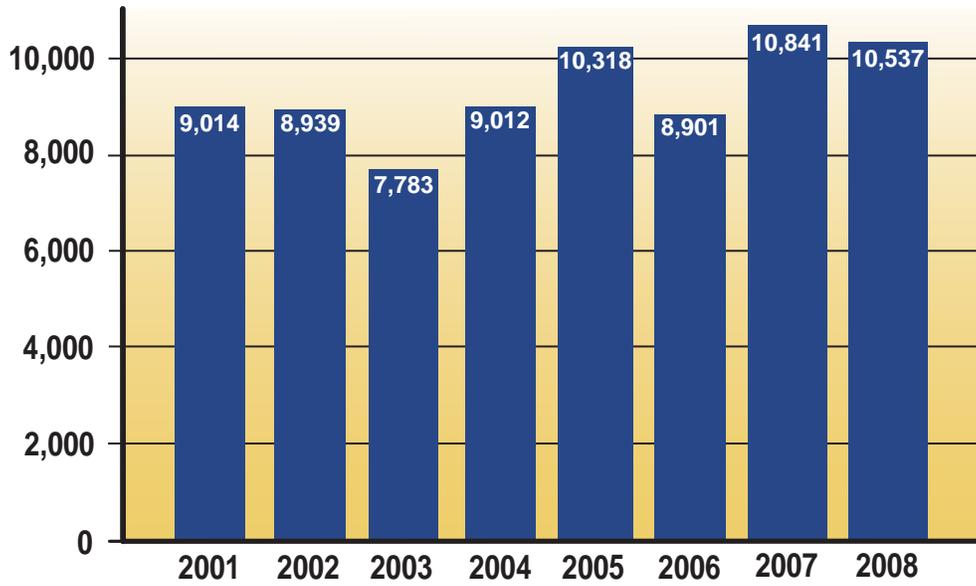


**Region 6 Bensalem Office** Serving Berks, Bucks, Chester, Delaware, Lancaster and Montgomery counties and Philadelphia.

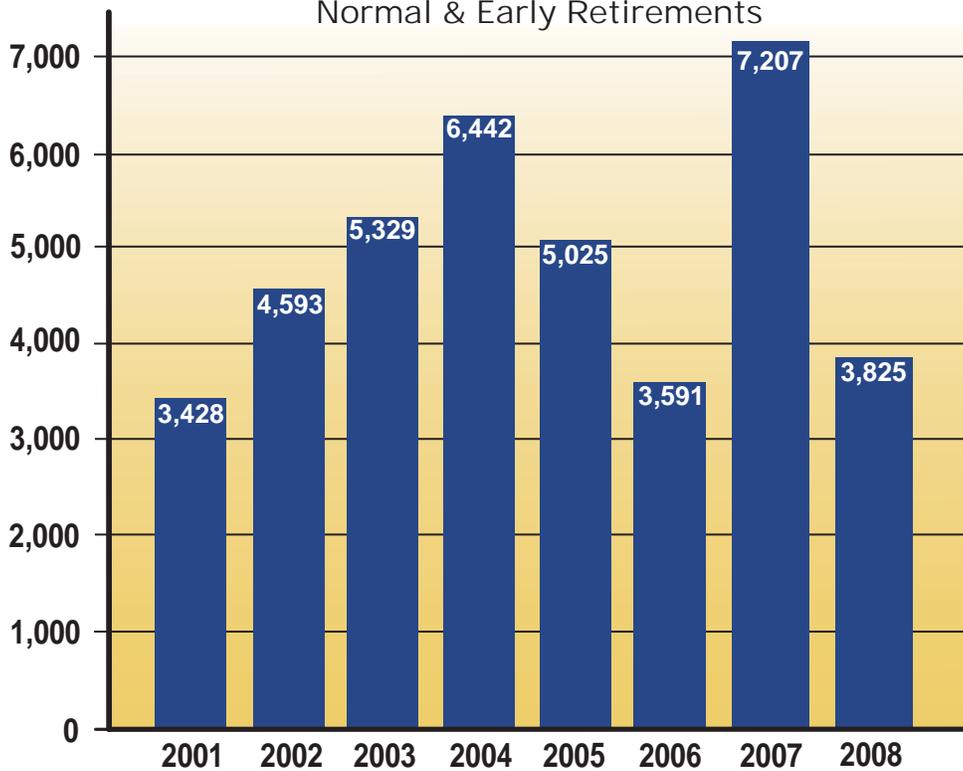
**Region 7 Harrisburg Office** Serving Adams, Cumberland (except active members who are employees of Shippensburg University of Pennsylvania), Dauphin, Lebanon, Perry and York counties.

# Benefit Processing

## New Member Enrollments



## Normal & Early Retirements



# SERS Member Demographics

Year Ending December 31	Membership		
	Total Members	Active Employees	Annuitants & Beneficiaries
2008	219,012	110,866	108,146
2007	216,740	109,610	107,130
2006	213,032	110,972	102,060
2005	211,160	109,981	101,179
2004	207,132	108,405	98,727
2003	203,430	109,018	94,412
2002	202,287	111,059	91,228
2001	198,933	109,716	89,217
2000	197,861	109,469	88,392
1999	196,078	108,035	88,043

Since 1999 Annuitants and Beneficiaries have increased by 22.8% while the number of Active members has remained relatively steady.

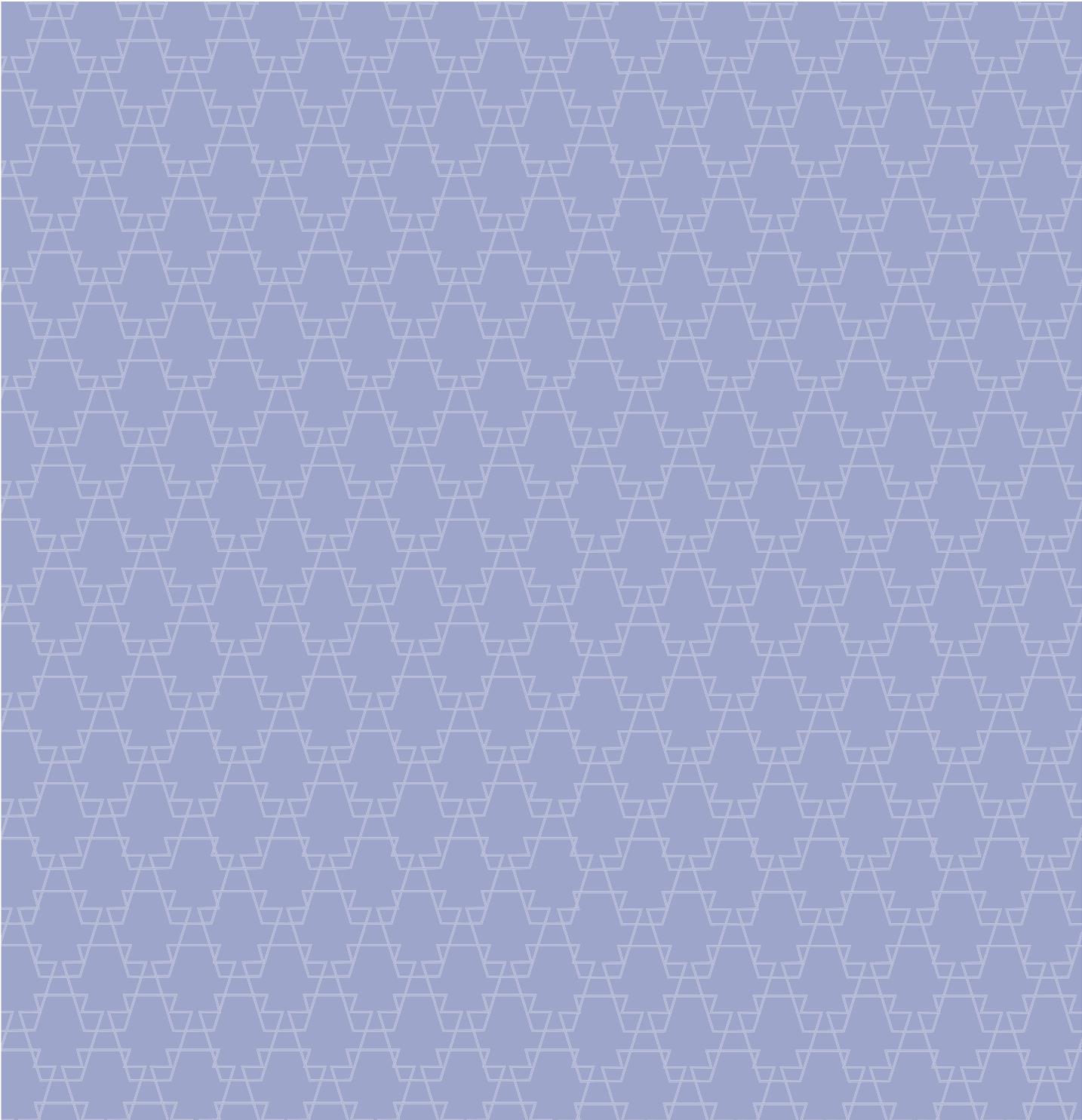
## Active Employee Age and Service (as of December 31, 2008)

Average Age:	46.2
Average Years of Service:	12.5

## Profile of Annuitants, Beneficiaries and Survivor Annuitants (as of December 31)

	Average Age				Average Annual Pension			
	2005	2006	2007	2008	2005	2006	2007	2008
<b>Superannuation Annuitants</b>	73.3	73.4	72.8	72.8	\$19,372	\$20,085	\$21,327	\$21,965
<b>Early Retirees</b>	60.9	61.3	61.4	61.8	13,490	13,638	14,516	14,668
<b>Disabled Annuitants</b>	60.1	60.3	60.5	60.8	12,333	12,654	13,026	13,251
<b>Beneficiary/Survivors</b>	75.0	76.0	75.0	75.0	7,981	8,308	8,654	9,094

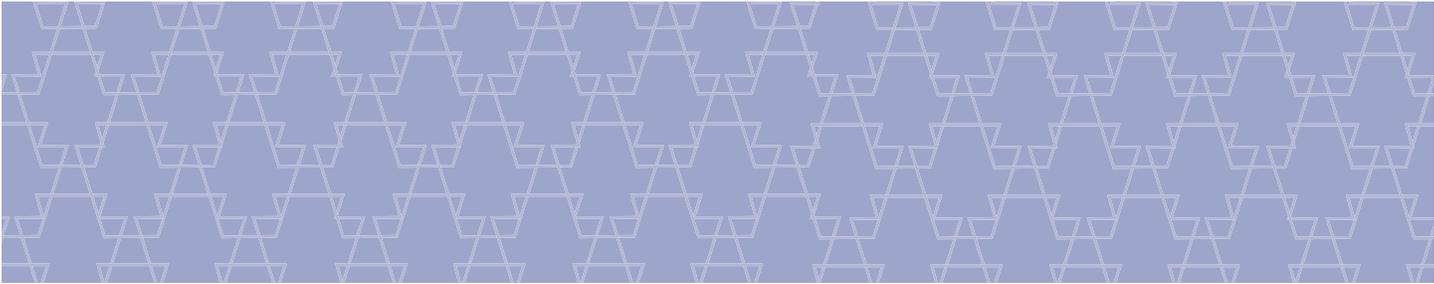
Since 2005 the average superannuation pension is up 13.4%.



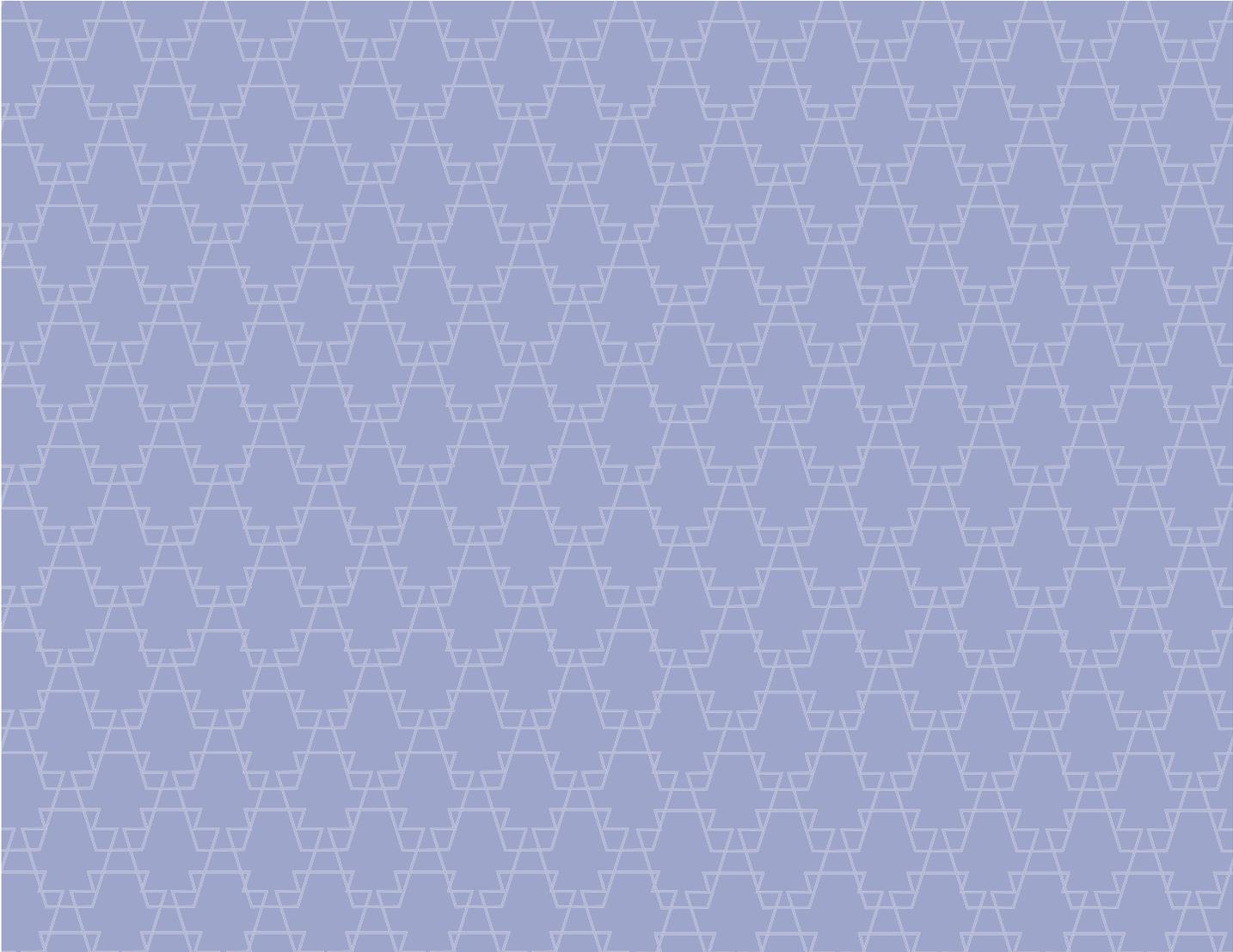
# Legislation

## Legislation Enacted During 2008

No amendments to the Retirement Code (Title 71) became law during 2008.



## Funding Process and Actuarial Status 7



# Funding Process & Actuarial Status

(unaudited)

SERS administers both a defined benefit plan (the Retirement Fund) and a defined contribution plan (the Deferred Compensation Program). This report focuses on the three sources of funding for the SERS defined benefit plan: employee contributions, which are fixed, and employer contributions and investment earnings, both of which are variable. Also included here is an explanation of supplemental annuity (“Cost Of Living Adjustment” or “COLA”) funding. *See below illustration, Sources of SERS’ Funding.*

## What is a Defined Benefit Pension Plan?

A defined benefit pension plan provides benefits that are determined by a fixed benefit formula that takes into account the employee’s length of service, age and compensation, and a legislatively determined accrual rate. Actuarial calculations are used to establish the amount of contributions required to provide those benefits. The law that created SERS, the State Employees’ Retirement Code (Retirement Code), provides that the Commonwealth of Pennsylvania must guarantee payment of SERS benefits.

In contrast, the Commonwealth’s Deferred Compensation Program (Internal Revenue Code Section 457 (b) plan) is a defined contribution plan, which provides supplemental benefits based on the member’s account balance at retirement or time of distribution. Participation in the Deferred Compensation Program is voluntary, and employers do not contribute to it. While this report primarily discusses the funding of SERS’ defined benefit plan, you will find additional information on the Deferred Compensation Program in Tab 12.

## Actuarial Process

The ultimate cost of the Retirement Fund is determined by the total benefits to be paid to retired employees throughout their lives and to Beneficiaries of deceased members. This cost cannot be precisely determined prospectively because the commencement and duration of benefits for Active employees and the duration of future benefit payments for Retirees are uncertain. Therefore, pension cost determinations are based on actuarial assumptions and actuarial cost methods, which are used to establish total cost and assign that cost to periods of time. For example, the amortization period of actuarial gains and losses is established by statute. Actuarial assumptions, gains and losses vary over time and have a significant impact on the determination of an appropriate employer contribution rate.

To provide a basis for predicting future costs, SERS’ actuary reviews economic and demographic experience over five-year periods. That experience is used to develop actuarial assumptions about future salary growth, investment returns, and demographic factors such as rates of retirement and death.

On an annual basis, the actuary conducts a valuation of the Retirement Fund. Based upon the latest member demographic data, the actuary determines the value of expected future obligations and compares it to the value of the Retirement Fund’s assets. Based on this valuation, the actuary recommends employer contribution rates to the State Employees’ Retirement Board (Board). The Retirement Code vests the Board with the authority to establish the employer contribution rates, and the Board uses the annual actuarial valuation to do so.

## Interrelationship of Funding Sources

The framers of the Retirement Code designed SERS as a system that, to remain financially sound, would require regular funding each year from each of the three sources shown at right: employees, employers and investment earnings. Currently, most employees contribute 6.25% of salary, a rate set by statute. The currently assumed annual rate of return



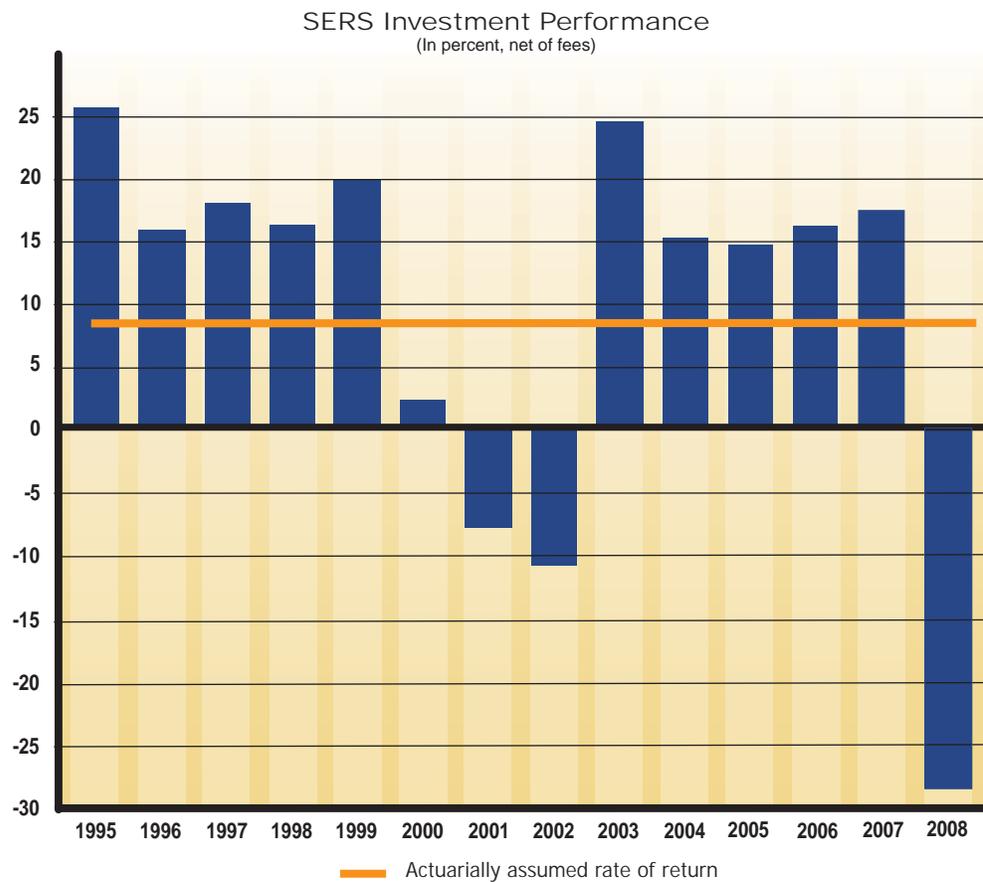
# Funding Process & Actuarial Status *(continued)*

on investments is 8.5% (an assumption adopted by the SERS Board based on advice from the staff, investment consultant and actuary). The “Employer Normal Cost” -- the amount employers would pay if the assumed rate of return and all other actuarial assumptions proved to be precisely correct and there were no unfunded liability -- currently is 8.42% of payroll.

Obviously, it is beyond the power of the Board to know in advance how much investments will earn in any given year. Actual returns can vary widely; in fact, it is highly unlikely that the investment returns will precisely match the assumed return in any given year. The Retirement Code recognizes this reality and deals with it by creating a linkage between investment earnings and employer contributions. It does so by requiring the SERS Board to adjust the employer contribution rate each year based on actual investment returns and actuarial experience. When investment earnings exceed the 8.5% actuarially assumed return, the Board may be able to reduce the employer contribution rate. Conversely, when investment earnings fall short of assumptions, the Board may find it necessary to increase the employer contribution rate. Since the employee rate is fixed by statute, it does not change from year to year, regardless of investment gains or losses. The employer share, however, can and does vary widely. As discussed below, the employer share has recently been as low as zero, is currently 4% and is expected to remain at or near that level until spiking to between 25% and 30% of payroll in 2012 (the precise new 2012 spike projection will not be known until the System’s actuarial valuation for 2008 is completed in April).

## Funding Source 1: Investment Earnings

From 1995 through 1999, the Retirement Fund experienced investment rates of return ranging from a low of 15.9% to a high of 25.2%, and earned its best ever five-year annualized return of close to 19%. Returns fell into barely positive territory in 2000, followed by two years of negative returns in 2001 and 2002. The Fund then posted exceptionally strong returns over the period 2003-2007, achieving a five year annualized return of 17.5%. The global economic crisis and resulting recession struck the SERS Fund hard in 2008, however, resulting in a return of minus 28.6% and essentially erasing the prior two years’ earnings. See illustration *SERS Investment Performance* above.



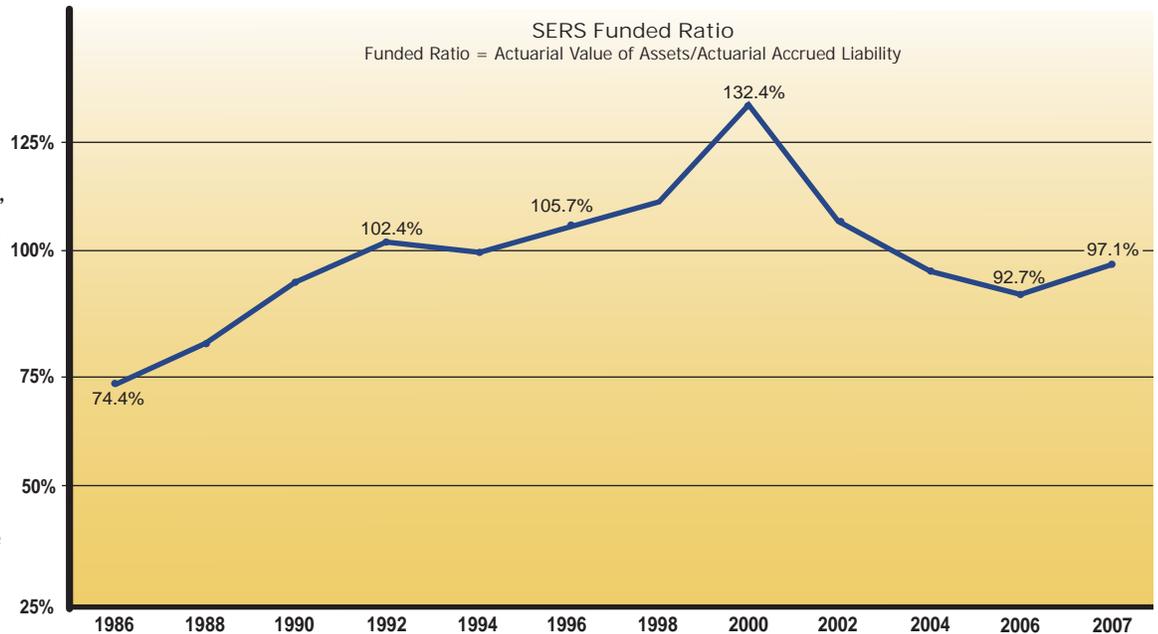
In order to smooth out fluctuations in the market value of assets, which could otherwise result in volatile year-to-year changes in employer contribution requirements, SERS and its actuary rely upon the actuarial value of assets (not the market value) for funding calculations. Over a 5-year period, the actuarial value of assets gradually recognizes the differences between total investment return and the assumed annual rate of return. By allocating the investment rate of return over a five-year period, SERS recognizes only 20% of the asset gain/loss (the difference between the actual return

# Funding Process & Actuarial Status *(continued)*

and the actuarial assumption at 8.5%), which occurred during the year immediately preceding the actuarial valuation date, with the remainder to be recognized (at an additional 20% per year) over the following four years. As a result, when investment earnings trends change, there is a delayed effect on employer contribution rates.

## Funded Position

The funded position of the Retirement Fund is measured by its funded ratio -- the actuarial value of assets, divided by the actuarial accrued liability. The most recent actuarial valuation, as of December 31, 2007, showed the SERS Fund to be 97.1% funded, making it close to fully funded. That too will change, however, as the deep negative return of 2008, combined with ongoing benefit payouts far in excess of contributions, are factored into the actuarial funding calculation.



In addition to the investment losses of 2008 and 2001-02, the System's underfunded status also is attributable in part to Act 2001-9 and the 2002-03 COLA, both of which significantly increased the Retirement Fund's actuarial accrued liabilities, and to changes to funding methodologies – most recently Act 2003-40 – which temporarily suppressed employer contribution rates, depriving the System of revenue. *See illustration SERS Funded Ratio above.*

### Additional points of note:

- The System has used an actuarially assumed rate of return of 8.5% since 1995; this rate is reviewed annually for reasonableness, based on current economic conditions.
- SERS has exceeded the actuarially assumed rate of return in 13 of the past 20 years.
- While the SERS Fund historically has outperformed its assumed rate, the current 10-year compounded return is 4.9%.

## Funding Source 2: Employer Contributions

The Board establishes the employer contribution rate annually, based on the actuary's recommendation. The employer contribution rate is expressed as a percentage of payroll. Different service classifications of SERS members require different contribution rates.

The total employer contributions are made up of two parts - the normal cost and a contribution for the unfunded actuarial liability (UAL), if any. The normal cost is the cost of SERS benefits to be earned in the coming year. Currently, the normal cost is 8.42%. The UAL is the amount of the actuarial accrued liability in excess of the actuarial value of assets. In theory, if the UAL were zero, and all of the actuarial assumptions turned out to be correct, and there were no amendments to the Retirement Code, the normal cost contributions would be sufficient to fund the liabilities for participants. However, the normal cost alone usually will not fund the Retirement Fund's total liabilities. The total of the liabilities that will not be funded by future normal cost is the unfunded actuarial accrued liability.

# Funding Process & Actuarial Status *(continued)*

The UAL is amortized – that is, funded – in installments. The Retirement Code was modified in 2003 and now requires amortization payments to be in equal dollar annual installments over a period of 30 years. Act 2003-40 changed the funding period for most, but not all, of SERS’ actuarial liabilities from 10 years to 30 years, effectively spreading out the payment of SERS’ costs and liabilities. In essence, Act 2003-40 refinanced the pension mortgage from a 10-year term to a 30-year term. The Act also set a series of floor contribution rates, with the highest, and final, floor being 4% for the 2006-07 state fiscal year. Act 2007-8 established 4% as the permanent employer contribution rate floor for SERS.

Prior to the enactment of Act 40, it was projected that if nothing was done, the SERS employer rate would start a steep climb in 2003-04 and would peak, in 2012, at 28.6% of payroll. Act 2003-40 changed the amortization schedule in a way that was intended to still result in regular annual employer rate increases in advance of 2012, but at lower levels, and to produce a somewhat lower 2012 peak. That was achieved by pushing payments into the future.

Subsequent to the enactment of Act 40, SERS produced, as previously noted, five years of exceptionally strong investment returns. That brought the projected 2012 spike down into single digits, even though employer contribution rates in the years prior to 2012 were holding at the statutory floor of 4% -- which is less than half the employer normal cost.

The recent downward trend in rate projections will be sharply reversed, however, as a result of the 2008 investment losses, exacerbated by the fact that annual payouts for benefits and expenses far exceed annual employer and employee contributions. When investment earnings are strong, the Fund can grow even while paying out billions each year in benefits. When earnings are weak or negative, payouts reduce the Fund balance. *See Additions and Deductions to Plan Net Assets table below.* The table documents Chairman Maiale’s statement, in his cover letter accompanying this submission, that “Over the past 10 years, SERS has paid out almost \$17.2 billion in benefits and expenses, while investment income (including seven years of gains and three of losses) totaled \$12.6 billion. During that 10-year period, employer and employee contributions, combined, totaled \$4.5 billion (employees, \$2.9 billion; employers, \$1.6 billion), or just over a quarter of payouts.”

## Additions and Deductions to Plan Net Assets Calendar Years (\$ millions)

Year	Employer Contributions	Employee Contributions	Total Contributions	Investment Income	Benefits and Expenses	Ending Market Value
2008 <sup>1/</sup>	\$228	\$336	\$564	\$(9,842)	\$(2,219)	\$24,019
2007	244	334	578	5,246	(2,361)	35,516
2006	196	318	514	4,730	(1,943)	32,053
2005	148	306	454	3,623	(1,966)	28,752
2004	107	310	417	3,568	(1,880)	26,641
2003	68	308	376	4,936	(1,656)	24,536
2002	51	304	355	(2,731)	(1,450)	20,880
2001	77	240	317	(2,225)	(1,266)	24,706
2000	168	232	400	585	(1,198)	27,880
1999	270	225	495	4,723	(1,248)	28,093
<b>10 Year Total</b>	<b>\$1,557</b>	<b>\$2,913</b>	<b>\$4,470</b>	<b>\$12,613</b>	<b>\$(17,187)</b>	<b>*</b>

<sup>1/</sup> 2008 Unaudited

\* Ten year net additions and deductions were \$(104)

# Funding Process & Actuarial Status *(continued)*

With earnings negative and annual payouts far exceeding contributions, the statutory funding methodology requires that the severe shortfall be made up through future increases in the employer contribution rate. As a result, we expect that when completed, the actuarial valuation as of December 31, 2008 will again show a very large spike in rates beginning in 2012 and extending at high levels into the future. It is anticipated that projected rates will once again exceed 25% of payroll, perhaps approaching 30%.

In discussing projected rates, it must be remembered that the projections are based not only on historical data but also on various assumptions, and that reality almost certainly will diverge from the assumptions. Thus the projected 2012 spike has changed considerably over time, and will continue to change in the intervening years. Perhaps most importantly, the projections assume that SERS will earn exactly 8.5% on investments each year. Earnings in excess of that assumption reduce the projected spike, as we have seen; earnings of less than the assumption push the projection upward. Likewise, any change in the return assumption itself would result in changes to the projections.

## Employer Contribution Provisions

- Employer contributions to SERS are required both to fund the employer normal cost and to amortize the unfunded actuarial liability.
- The current 4% employer contribution rate is less than half the employer normal cost.
- The employer contribution rate actually fell to zero for two years, prior to the imposition of statutory floors.
- The current statutory funding methodology will require a dramatic increase in employer contribution rates beginning in July 2012.
- Under the current amortization schedule, rates will remain at or near current levels until the start of the state's 2012-13 fiscal year.

Among the many SERS benefit costs that the actuary values each year is the cost of the Retirement Code's Option 4. Under Option 4, a retiring SERS member may elect to receive a refund of all or part of that member's Accumulated Deductions (employee contributions plus 4% statutory interest) and receive a reduced annuity. Election of Option 4 increases the cost to the Retirement Fund because the refund is calculated at 4% interest whereas it is assumed that, if the Accumulated Deductions were left in the Retirement Fund, they would earn 8.5% interest. More than 90% of retirees choose the Option 4 refund.

## Funding Source 3: Employee Contributions

The simplest component of the funding mechanism is employee contributions. Pursuant to the Retirement Code, SERS members pay a statutorily determined contribution rate. Most SERS members contribute to the Retirement Fund at the rate of 6.25% of their gross compensation. Commonwealth employees made approximately \$336 million in contributions in 2008.

## Explanation of SERS Supplemental Annuities ("Cost of Living Adjustments" or "COLAs")

The Retirement Code contains procedures, definitions, and actuarial requirements for calculating benefits. The Retirement Code does not provide for an automatic annual inflation-based COLA as Social Security does. Instead, the Legislature has from time to time voted to grant increases in benefits for retirees. While commonly referred to as "COLAs," these supplemental annuities (as they are properly known) are not dictated by any inflation-based formula. The amount and structure of each supplemental annuity is entirely within the discretion of the Legislature, and each requires new legislation. Also, because the Retirement Code does not provide for advanced funding or actuarial reserves for COLAs, COLAs historically have been funded after they have been granted. COLAs are paid from future employer contributions.

Over the past 40 years, the Pennsylvania General Assembly has legislated eight general COLAs effective in 1968, 1974, 1979, 1984, 1989, 1994, 1998, and 2002/2003. Generally, the amount of the COLA has been determined by a formula that accounts for years of service, years in retirement and inflation since the previous COLA.

# Funding Process & Actuarial Status *(continued)*

COLAs generally have been given to retirees who have reached either their Normal Retirement (“superannuation”) age, (60 for most classes but 50 for some) or the age at which the member would have been credited with 35 eligibility credits, and all disabled retirees. COLAs are payable to early retirees once they reach Normal Retirement Age. The Pennsylvania Constitution prohibits paying COLAs to Beneficiaries of deceased members or Survivor Annuitants.

COLAs increase the Retirement Fund’s liabilities (as a result of the increases in benefits paid to members). However, the usual SERS funding mechanism does not provide a source from which to pay for the increased benefits. Therefore, when the actuary determines the cost of a COLA, the liability for the COLA is established in SERS’ Supplemental Annuity Account. Under current law, the COLA liability must be amortized over 10 years, with the amortization payments being included in the employer contribution rate. Thus, the money to pay for COLAs ultimately comes from increased future employer contributions.

## Funding of Supplemental Annuities

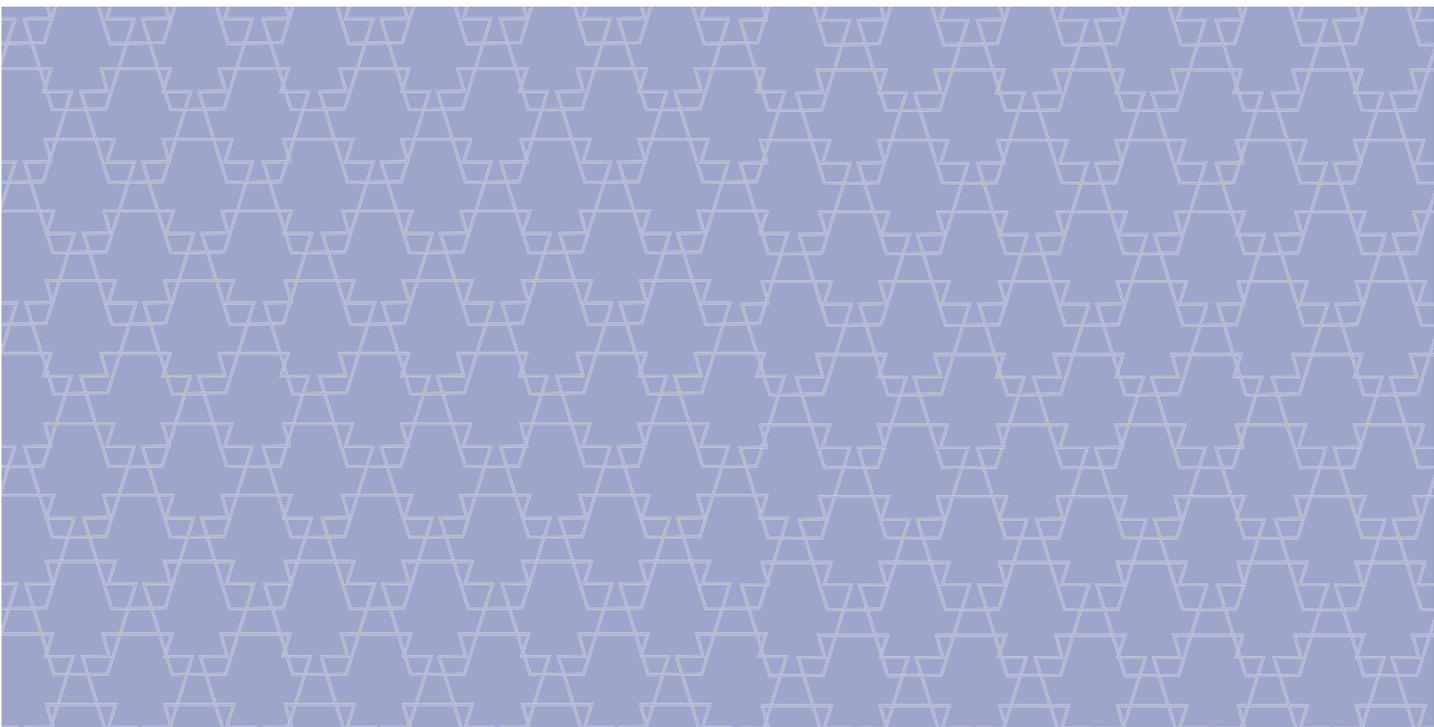
- Because the Retirement Code does not provide for automatic COLAs or the necessary funding, each new supplemental annuity must be legislated individually.
- Every supplemental annuity or COLA enacted since 1968 required an amendment to the Retirement Code and added a new liability to the Retirement Fund.

## Benefits to Members

- At retirement, SERS calculates the actuarial value of the annuity to be paid over the remaining life of the member and transfers the balance of the member’s Accumulated Deductions and reserves from the State Accumulation Account into the annuity reserve accounts to pay the lifetime benefit.
- The annuity reserve accounts contains funds for all current retirees and Beneficiaries based on the amount of the original benefit at retirement.
- No funds are in the annuity reserve accounts to pay for future COLAs.



## Investment Policy, Objectives and Performance 8



# Investment Policy

The State Employees' Retirement Board originally adopted a formal *Statement of Investment Policy* in 1979. It has been revised periodically, to reflect and incorporate legislative changes governing investments and amendments to policies and procedures guiding the investment of the defined benefit portfolio. The latest *Statement of Investment Policy* was adopted in 2007. The purpose of the statement is to formalize the Board's investment objectives, policies, and procedures; to establish guidelines for the investment of Fund assets, and to define the duties and responsibilities of the various entities involved in the investment process. The major elements of the statement are:

- As fiduciaries, the Board will exercise that degree of judgment, skill and care under the circumstances then prevailing which investors of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs in investment matters;
- The Fund's overall investment objective is to provide a total rate of return, over full economic cycles, which exceeds the return of a fully diversified market portfolio within each asset class. The Board seeks to meet this objective within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, quality and geographic location;
- The Board employs an investment staff and also contracts with investment advisors and consultants to provide expert, professional judgment in all investment decisions;
- An annual *Investment Plan* is prepared to establish the allocation of funds during the year among investment advisors and categories of assets;
- Guidelines are established for each category of assets used by the Fund's investment advisors to provide a framework for monitoring quality, diversification and liquidity; and
- Where investment characteristics, including yield, risk and liquidity are equivalent, the Board's policy favors investments which have a positive impact on the economy of Pennsylvania.

# Investment Objectives

To assure an adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth and to provide some protection against the erosion of principal by inflation, the long-term investment objectives of the Fund, are:

- Achieve a net total return equivalent to the actuarial return assumption, or preferably in excess of this rate over market cycles in order to improve the funded ratio of the Fund through investment earnings;
- Achieve in Global Stocks a total return that exceeds the total return of the MSCI World Index;
- Achieve in U.S. Stocks a total return that exceeds the total return of the Russell 3000 Index;
- Achieve in Non-U.S. Stocks a total return that exceeds the total return of the SERS Custom International Stock Index;
- Achieve in the stand alone Absolute Return Strategy a total return that exceeds LIBOR plus 300 basis points;
- Achieve in the Fixed Income asset class a total return that exceeds the total return of the SERS Custom Fixed Income Benchmark;
- Achieve in the Real Estate asset class a total return that exceeds the total return of the Townsend Stylized Benchmark;
- Achieve in the Private Equity asset class a total return that exceeds the Cambridge Private Equity Benchmark;
- Achieve in the Venture Capital asset class a total return that exceeds the Cambridge Venture Capital Benchmark;
- Achieve in Inflation Protection a total return that exceeds the total return of the SERS Inflation Protection Custom Benchmark; and
- Achieve in the Cash asset class a total return that exceeds the total return on U.S. Treasury Bills (90 days).

Total return includes income, both realized and unrealized gains/losses, and is computed on market value. The Board seeks to meet these objectives within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, investment manager style and geographic location.

# Asset Allocation Trends

## Prudent Investor Investment Standards

The SERS Board investment authority is governed by the “prudent investor” standard as set forth in Title 71, Pennsylvania Consolidated Statutes, Section 5931(a). Enactment of the “prudent investor” standard in Act 1994–29 and the 2008 asset/liability study completed by Rocatton Investment Advisors and the SERS Investment Staff are the foundation of SERS’ investment strategy. With “prudent investor” investment authority, SERS is able to pursue a broader array of investment opportunities that enhance the ability to achieve reasonable rates of return while maintaining risk at acceptable levels. The asset/liability study demonstrated that the prudent application of this expanded authority should result in a more efficient portfolio that better serves the needs of the Fund.

## Total Fund Asset Allocation

The 2008 calendar year proved to be filled with extraordinary events culminating with historic market contraction. This has resulted in asset allocation drifting significantly below policy targets for stocks, while conversely pushing real estate and alternative investments well above policy targets. This phenomenon has strained the ability of the Fund to meet liquidity needs. It is anticipated that this may persist for a number of years.

Asset Allocation		
12/31/2008 Actual		Strategic Asset Allocation
3.8%	Global Stocks	5.0%
14.7%	U.S. Stocks	21.0%
12.8%	Non-U.S. Stocks	21.0%
10.0%	Absolute Return	9.0%
13.7%	Fixed Income	15.0%
11.4%	Real Estate	8.0%
24.2%	Alternative Investments	14.0%
6.1%	Inflation Protection	7.0%
3.2%	Cash	0.0%
100.0%		100.0%

*\*Numbers may not add due to rounding.*

# Estimated Investment Performance\*

## Calendar Year Basis

through December 31, 2008 (net of fees)

Asset Class	1 Year Total Return	3 Year Total Return	5 Year Total Return	10 Year Total Return
Global Stocks	-37.5%	N/A	N/A	N/A
<i>MSCI World Index</i>	-40.7%	N/A	N/A	N/A
U.S. Stocks	-47.2%	-11.5%	-3.1%	-0.7%
<i>Russell 3000 Index</i>	-37.3%	-8.6%	-2.0%	-0.8%
Non-U.S. Stocks	-52.2%	-10.8%	0.4%	2.9%
<i>SERS Custom International Stock Index<sup>1/</sup></i>	-45.8%	-7.2%	3.3%	2.8%
Absolute Return <sup>2/</sup>	-15.9%	N/A	N/A	N/A
<i>90 Day LIBOR</i>	3.0%	N/A	N/A	N/A
Fixed Income	-17.5%	-1.9%	1.3%	3.8%
<i>SERS Custom Fixed Income Benchmark</i>	-7.7%	1.5%	2.9%	4.2%
Cash	3.4%	4.5%	3.6%	3.7%
<i>90 day U.S. T-bills</i>	2.1%	4.0%	3.3%	3.5%
Real Estate <sup>3/</sup>	-10.8%	8.7%	14.0%	11.8%
<i>Townsend Stylized Benchmark</i>	1.1%	12.3%	14.4%	12.1%
Private Equity <sup>3/</sup>	-6.8%	17.0%	22.4%	15.5%
<i>Cambridge Private Equity Benchmark</i>	-4.8%	15.2%	20.0%	12.9%
Venture Capital <sup>3/</sup>	-0.2%	8.5%	6.2%	5.3%
<i>Cambridge Venture Capital Benchmark</i>	-0.9%	10.4%	10.8%	13.3%
Inflation Protection <sup>4/</sup>	-31.1%	-5.3%	4.6%	N/A
<i>SERS Inflation Protection Custom Benchmark</i>	-36.4%	-9.5%	1.6%	N/A
<b>Total Fund</b>	<b>-28.6%</b>	<b>-0.9%</b>	<b>5.1%</b>	<b>4.9%</b>
<b>Total Fund Benchmark</b>	<b>-25.1%</b>	<b>-0.7%</b>	<b>5.0%</b>	<b>4.1%</b>

\*Returns for periods longer than one year are annualized.

<sup>1/</sup> The Non-U.S. Stocks and the SERS Custom International Stock Index were hedged between May 1, 1996 ending January 31, 2007.

<sup>2/</sup> Absolute Return was initially funded in August 2007.

<sup>3/</sup> Results for the Real Estate, Private Equity, Venture Capital and Indices are lagged one quarter.

<sup>4/</sup> Inflation Protection was initially funded in November 2001.

# Investment Performance\*

## Commonwealth Fiscal Year Basis

through June 30, 2008 (net of fees)

Asset Class	1 Year Total Return	3 Year Total Return	5 Year Total Return	10 year Total Return
Global Stocks	-8.2%	N/A	N/A	N/A
<i>MSCI World Index</i>	-10.7%	N/A	N/A	N/A
U.S. Stocks	-11.3%	8.1%	11.2%	5.2%
<i>Russell 3000 Index</i> <sup>1/</sup>	-12.7%	4.7%	8.4%	3.4%
Non-U.S. Stocks	-10.0%	15.0%	19.0%	9.1%
<i>SERS Custom International Stock Index</i> <sup>2/</sup>	-8.5%	16.0%	19.9%	8.2%
Fixed Income	3.1%	5.0%	6.0%	6.2%
<i>SERS Custom Fixed Income Benchmark</i>	4.0%	4.8%	5.0%	5.5%
Cash	4.3%	4.5%	3.4%	3.8%
<i>90 day U.S. T-bills</i>	3.6%	4.3%	3.2%	3.6%
Real Estate <sup>3/</sup>	5.9%	18.8%	17.7%	13.2%
<i>Townsend Stylized Benchmark</i>	7.2%	16.6%	16.3%	12.7%
Private Equity <sup>3/</sup>	22.7%	28.0%	27.7%	18.3%
<i>Cambridge Private Equity Benchmark</i>	12.4%	23.9%	24.5%	13.8%
Venture Capital <sup>3/</sup>	13.0%	12.5%	6.6%	5.3%
<i>Cambridge Venture Capital Benchmark</i>	11.5%	14.1%	11.3%	13.6%
Inflation Protection <sup>4/</sup>	50.7%	19.9%	21.1%	N/A
<i>SERS Inflation Protection Custom Benchmark</i>	49.0%	17.9%	19.6%	N/A
<b>Total Fund</b>	<b>2.1%</b>	<b>13.5%</b>	<b>14.9%</b>	<b>8.6%</b>
<b>Total Fund Benchmark</b>	<b>0.7%</b>	<b>11.6%</b>	<b>13.4%</b>	<b>7.4%</b>

\*Returns for periods longer than one year are annualized.

<sup>1/</sup> The U.S. Stocks Benchmark was the Wilshire 5000 through December 31, 1998, and the Russell 3000 thereafter.

<sup>2/</sup> The SERS Custom International Stock Index 26% hedged between May 1, 1996 to January 31, 2007.

<sup>3/</sup> Results for the Real Estate, Private Equity, Venture Capital and Indices are lagged one quarter.

<sup>4/</sup> Inflation Protection was initially funded in November 2001.

# Investment-Related Statistics

## SERS Investment-Related Statistics Calendar Year 1980 through 2008 (Unaudited)

Year End	SERS Fund Market Value (\$ millions) <sup>1/</sup>	# of Investment Advisors	# of Portfolios	# of Consultants	Annual Total Fund Rate of Return
1980	\$2,689	3	3	3	5.3%
1981	2,817	5	6	3	0.9%
1982	3,730	6	7	4	27.8%
1983	4,396	14	17	4	13.0%
1984	4,922	22	24	4	9.4%
1985	6,157	23	26	3	23.1%
1986	7,120	30	34	3	15.2%
1987	7,367	37	42	3	3.3%
1988	8,312	41	49	3	12.8%
1989	9,785	47	59	4	17.8%
1990	9,886	53	65	4	1.0%
1991	11,940	56	68	4	22.6%
1992	12,453	66	79	4	7.4%
1993	13,701	61	80	4	13.2%
1994	13,330	78	100	4	- 1.1%
1995	16,343	81	103	4	25.2%
1996	18,492	96	126	4	15.9%
1997	21,312	112	154	4	18.0%
1998	24,123	99 <sup>2/</sup>	163	3	16.3%
1999	28,093	116	204	3	19.9%
2000	27,881	132	245	3	2.2%
2001	24,706	143	277	3	-7.9%
2002	20,880	149	289	3	-10.9%
2003	24,535	153	295	4	24.3%
2004	26,641	163	324	4	15.1%
2005	28,805	167	364	3	14.5%
2006	32,098	180	403	3	16.4%
2007	35,542	190	438	3	17.2%
2008	24,031	197	463	3	-28.6%

<sup>1/</sup> Market values for Real Estate and Alternative Investments are lagged by one quarter adjusted for allocations and distributions. Market values also include non-investment receivables and payables. Market values based on SERS' asset allocation.

<sup>2/</sup> Restated in 1998 and thereafter to eliminate double counting of managers managing assets across asset classes.

# Plan & Investment Class Rankings

The January 26, 2009, edition of *Pensions & Investments* listed a ranking of U.S. pension plan sponsors according to total assets and amounts invested in various asset classes as of September 30, 2008. The survey results for the total SERS Fund (defined benefit plan plus the defined contribution plan), as well as for various asset classes are listed below.

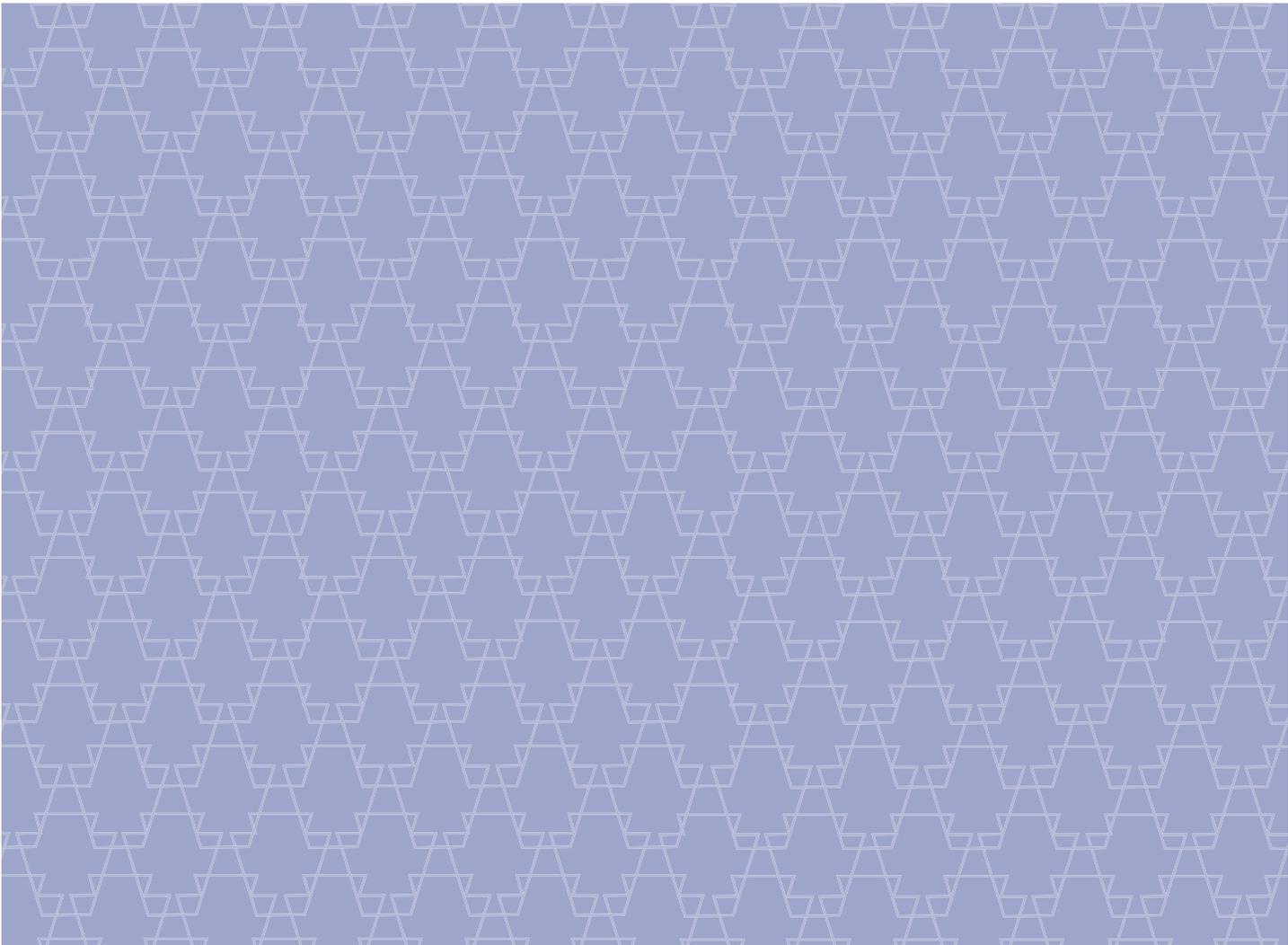
## Plan and Investment Class Rankings as of September 30, 2008

Category	Amount (\$ millions)	Total Fund Rank	Public Fund Rank
SERS <sup>1/</sup>	\$31,144	38 <sup>th</sup>	25 <sup>th</sup>
Venture Capital <sup>2/</sup>	1,538	3 <sup>rd</sup>	3 <sup>rd</sup>
Buyouts <sup>3/</sup>	2,399	15 <sup>th</sup>	14 <sup>th</sup>
Real Estate	2,568	23 <sup>rd</sup>	18 <sup>th</sup>

<sup>1/</sup> The *Pensions & Investments* survey ranked plan sponsors according to the combined assets of their defined benefit and defined contribution plans.

<sup>2/</sup> The Venture Capital data reflects only the market value of actual funded investments as of June 30, 2008. SERS also has outstanding unfunded commitments for the Venture Capital area that have been approved by the Board.

<sup>3/</sup> The Private Equity data reflects only the market value of actual funded investments as of June 30, 2008. SERS also has outstanding unfunded commitments for the Private Equity area that have been approved by the Board.



# Investment Program Summary 9



# Investment Program Summary

as of December 31, 2008 - (unaudited)

The assets of the State Employees' Retirement System (SERS) are administered by the SERS Board (Board). The Board adopted an investment policy (policy) that incorporates the provisions of the Retirement Code which govern the investment of SERS' assets. The policy provides investment objectives and guidelines. The investment plan is reviewed and updated annually for strategic asset allocation purposes, as well as for diversification needs within each asset class.

**Market Exposure as of December 31, 2008:** SERS' assets had an unaudited market exposure of approximately \$24,030.8 million.

## SERS Asset Allocation

Assets	*Market Exposure (Unaudited)		Long-Term Target Allocation
	(\$ millions)	%	
Global Stocks	\$916.2	3.8%	5.0%
U.S. Stocks	3,540.5	14.7%	21.0%
Non-U.S. Stocks	3,072.1	12.8%	21.0%
Absolute Return	2,411.5	10.0%	9.0%
Fixed Income	3,282.5	13.7%	15.0%
Real Estate	2,743.2	11.4%	8.0%
Alternative Investments	5,826.4	24.2%	14.0%
Inflation Protection	1,474.9	6.1%	7.0%
Cash	763.4	3.2%	0.0%
<b>Total</b>	<b>\$24,030.8</b>	<b>100.0%</b>	<b>100.0%</b>

\* Numbers may not add due to rounding.

**Number of Investment Advisors:** Many advisors manage multiple portfolios across and within asset classes. SERS had 197 unique external investment advisory firms managing portfolios. There are 32 advisors in the public markets domain, 160 in private markets and five in both public and private markets. Of these, 17 advisors manage 42 portfolios across asset classes.

- 2 Global Stock advisors
- 11 U.S. Stock advisors
- 12 Non U.S. Stock advisors
- 2 Absolute Return advisors
- 14 Fixed Income advisors
- 2 Cash advisors
- 3 Inflation Protection advisors
- 28 Real Estate advisors
- 57 Venture Capital general partners managing limited partnerships
- 91 Private Equity general partners managing limited partnerships

**Number of Investment Portfolios:** SERS had 463 investment portfolios. Of these, 53 portfolios are public market investments and 410 cover private markets.

- 2 Global Stock portfolios
- 11 U.S. Stock portfolios
- 17 Non U.S. Stock portfolios
- 2 Absolute Return portfolios
- 16 Fixed Income portfolios
- 2 Cash portfolios
- 3 Inflation Protection portfolios
- 62 Real Estate portfolios
- 120 Venture Capital limited partnership interests
- 228 Private Equity limited partnership interests

# Global Stock Investments Summary

as of December 31, 2008 - (unaudited)

Global stock is a component of the stock asset class, one of six major asset classes which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmarks. SERS contracts with external investment advisors to manage the portfolios.

**Investment Objective:** Stock investments are employed by the Fund primarily because their expected return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The global stock accounts are managed on a total return basis.

SERS' long-term investment objective for the global stock component of the Stock asset class is to achieve a total return, net of fees, that exceeds the total return of the MSCI World Index.

SERS' *2008 Investment Plan* targets an allocation of 5% of Fund assets to global stocks.

**Market Exposure as of December 31, 2008:** Global stock had a \$916.2 million market exposure, 3.8% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with two external investment advisors.

**Number of Investment Portfolios:** SERS had two global stock portfolios managed by two investment advisors. SERS uses NISA Investment Advisors to replicate equity indices for rebalancing.

**Type of Investment Portfolios:** As of December 31, 2008, SERS global stock allocation was invested in all-capitalization strategies.

## SERS Global Stock Investments

Global Stock Investment Advisor	Investment Style	*Market Exposure as of 12/31/08 (\$ millions)
1. Walter Scott & Partners Limited	Growth	\$310.0
2. Marathon-London Global Fund	Contrarian sector relative value	606.2
<b>Total Global Stock</b>		<b>\$916.2</b>

*\*Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

# U.S. Stock Investments Summary

as of December 31, 2008 - (unaudited)

U.S. Stock is a component of the stock asset class which is one of six major asset classes which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmark. SERS contracts with external investment advisors to manage portfolios.

**Investment Objective:** Stock investments are employed by the Fund primarily because their expected return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The U.S. stock asset class is managed on a total return basis.

SERS' long-term investment objective in the U.S. Stock component of the Stock asset class is to achieve a total return, net of fees, that exceeds the total return of the Russell 3000 Index.

Stock investments shall include, but not be limited to, publicly traded securities which provide SERS with an equity interest (e.g. common stock, preferred stock, convertible preferred stock and convertible bonds), as well as derivative instruments that provide stock-like returns.

SERS' *2008 Investment Plan* targets a long-term allocation of 21.0% of assets to U.S. Stock comprised of 16.8% of the Fund to large cap and 4.2% of the Fund to mid/small cap, approximating the composition of the Russell 3000 benchmark.

The large cap segment of the portfolio is benchmarked to the S&P 500 Index, and uses an enhanced indexed strategy, and a transportable alpha strategy utilizing funds-of-hedge funds. Exposure to the mid/small cap segment of the U.S. market is achieved with traditional active strategies benchmarked to the Russell Midcap Index, the Russell 2500 Index, and the Russell Microcap Growth Index, as well as synthetic index replication through the use of futures and swaps.

**Market Exposure as of December 31, 2008:** U.S. Stock had a \$3,540.5 million market value, 14.7% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with 11 external investment advisors.

**Number of Investment Portfolios:** SERS had 11 U.S. Stock portfolios managed by the 11 investment advisors.

**Type of Investment Portfolios:** As of December 31, 2008, 12.1% of SERS Fund was in large cap U.S. stock strategies, and 2.5% of SERS Fund was in mid/small cap U.S. stock strategies. SERS uses NISA Investment Advisors to replicate U.S. stock indices for the portable alpha and rebalancing strategies.

# U.S. Stock Investments Summary *(continued)*

## SERS U.S. Stock Investments

U.S. Stock Investment Advisor	Investment Style	*Market Exposure As of 12/31/08 (\$ millions)
<b>Large cap</b>		
<b>S&amp;P 500 Index swaps and portable alpha strategies</b>		
1. NISA Investment Advisors S&P 500 Index swaps and futures	Rebalancing and equitization	\$(403.2)
2. Blackstone Alternative Asset Management	Fund-of-Hedge Funds	1,706.6
3. Pacific Alternative Asset Management Company	Fund-of-Hedge Funds	1,469.7
4. Robeco Sage Capital	Fund-of-Hedge Funds	19.0
<b>Traditional large cap</b>		
5. Barclays Global Investors Alpha Tilts Fund	Enhanced S&P 500 Index	112.9
<b>Mid/small cap</b>		
6. Iridian Asset Management	Midcap private business value	120.6
7. AXA Rosenberg Investment Management	Risk-controlled Russell 2500	98.6
8. Emerald Advisers	Pennsylvania companies	219.9
9. Mellon Capital Management Corporation	Pennsylvania companies	159.1
10. NorthPointe Capital	Microcap growth	14.5
11. Turner Investment Partners	Quantitative microcap growth	22.8
<b>Total U.S. Stock</b>		<b>\$3,540.5</b>

*\*Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

# Non-U.S. Stock Investments Summary

as of December 31, 2008 - (unaudited)

Non-U.S. Stock is a component of the stock asset class, one of six major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmarks. SERS contracts with external investment advisors to manage portfolios.

**Investment Objective:** Stock investments are employed by the Fund primarily because their expected return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The Non-U.S. Stock asset class is managed on a total return basis.

SERS' long term investment objective for the Non-U.S. Stock component of the stock asset class is to achieve a total return, net of fees, that exceeds the total return of the MSCI All Country World Index ex U.S. Investable Market Index.

SERS' *2008 Investment Plan* targets a long-term allocation of 21.0% of assets to Non-U.S. Stock comprised of 13.6% of the Fund to large cap stocks in developed markets, 3.4% of the Fund to mid/small cap stocks in developed markets, and 4.0% of the Fund to stocks in emerging markets.

**Market Exposure as of December 31, 2008:** Non-U.S. Stock had a \$3,072.1 million market exposure which was 12.8% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with 12 external investment advisors.

**Number of Investment Portfolios:** SERS had 17 accounts managed by the 12 investment advisors.

**Type of Investment Portfolios:** As of December 31, 2008, assets were diversified among direct accounts, synthetic equitization, and a transportable alpha strategy utilizing funds-of-hedge funds: 8.5% of total Fund assets were allocated to large cap stocks in non-U.S. developed markets; 2.3% of total Fund assets were allocated to mid/small cap stocks in non-U.S. developed markets; and 1.9% of total Fund assets were allocated to dedicated emerging markets strategies. SERS uses NISA Investment Advisors to replicate the MSCI EAFE Index and the MSCI Emerging Markets Index for the portable alpha, rebalancing, and equitization strategies.

# Non-U.S. Stock Investments Summary *(continued)*

## SERS Non-U.S. Stock Investments

Non-U.S. Stock Investment Advisor	Investment Style	*Market Exposure as of 12/31/08 (\$ millions)
<b>Large cap</b>		
MSCI EAFE Index Exposure		
1. NISA Investment Advisors MSCI EAFE Index swaps	Rebalancing and equitization	\$(452.9)
2. Arden	Fund-of-Hedge Funds	657.0
3. Rock Creek	Fund-of-Hedge Funds	651.0
<b>Traditional large cap</b>		
4. Artisan Partners	Global ex U.S. growth	364.5
5. Templeton Investment Counsel	Global ex U.S. value	410.7
6. Morgan Stanley Investment Management Limited	Developed ex U.S. value	417.7
<b>Mid/small cap</b>		
7. BlackRock Investment Management International Limited	Growth	182.9
8. Pictet Asset Management Limited	Value with growth	184.9
9. Harris Associates	Intrinsic value	195.2
<b>Emerging markets</b>		
10. Rexiter Capital Management Limited	Core	101.5
11. Bernstein Investment Research and Management	Value	94.6
Pictet Asset Management Limited	Value	88.8
Templeton Asset Management Ltd.		
TIFI Emerging Markets Series	Value	61.2
Templeton Strategic Emerging Markets Fund II	Private placements w/public companies	34.7
Templeton Strategic Emerging Markets Fund III	Private placements w/public companies	0.7
12. Oaktree Capital Management	Long/short hedge fund	76.6
NISA Investment Advisors		
MSCI Emerging Markets Index swaps	Rebalancing and equitization	3.0
<b>Total Non-U.S. Stocks</b>		<b>\$3,072.1</b>

*\*Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

# Absolute Return Strategies Investments Summary

as of December 31, 2008 - (unaudited)

SERS uses Absolute Return Strategies as part of its program to diversify the investments of the Fund. This mandate is expected to enhance the Fund's overall risk-adjusted profile, thereby increasing the Fund's long-term efficiency, as measured by the Fund's expected return per unit of risk. SERS contracts with external fund-of-hedge funds investment advisors to manage these portfolios.

**Investment Objective:** Absolute Return Strategies are intended to produce low-volatility, uncorrelated diversified return streams in the portfolio to help preserve and enhance the real value of the Fund over long periods of time. Stand alone Absolute Return Strategies are managed on a total return basis.

SERS' long-term investment objective for the stand alone Absolute Return Strategies is to achieve a total return, net-of-fees, that exceeds LIBOR plus 300 basis points.

SERS' *2008 Investment Plan* targets an allocation of 9.0% of Fund assets to stand alone Absolute Return Strategies.

**Market Exposure as of December 31, 2008:** Stand alone Absolute Return Strategies had a \$2,411.5 million market value, approximately 10.0% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with two external investment advisors.

**Number of Investment Portfolios:** SERS had two stand alone Absolute Return Strategies portfolios managed by the two fund-of-hedge funds investment advisors.

**Type of Investment Portfolios:** As of December 31, 2008, SERS' Absolute Return Strategies were globally diversified across all major asset classes, including exposure to six major strategies and twenty sub-strategies.

## SERS Absolute Return Strategies Investments

Investment Advisor	Strategy	*Market Exposure as of 12/31/08 (\$ millions)
1. Mesirow	Fund-of-Hedge-Funds	\$1,369.5
2. Morgan Stanley Alternative Investment Partners	Fund-of-Hedge-Funds	1,042.0
<b>Total</b>		<b>\$2,411.5</b>

*\*Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

# Fixed Income Investments Summary

as of December 31, 2008 - (unaudited)

Fixed Income is one of six major asset classes that SERS uses to diversify the investments of the Fund. The SERS' investment plan diversifies Fixed Income investments and strategies. SERS contracts with external investment advisors to manage portfolios.

**Investment Objective:** The Fixed Income asset class is employed by the Fund because of its ability to generate current income from interest payments, increase the value of the Fund through the reinvestment of those interest payments, serve as a hedge against disinflation and/or deflation, and to help diversify the overall Fund. The Fixed Income asset class is managed on a total return basis.

In the Fixed Income asset class, SERS' long-term investment objective is to achieve a total return, net of fees, that exceeds the total return of the SERS Custom Fixed Income Index which is comprised of the Barclay's Aggregate, the Custom Intermediate TIPS, the Citigroup High Yield Market and J.P. Morgan Emerging Market Bond indices.

SERS' *2008 Investment Plan* targeted a long-term allocation of 15.0% of assets of the total Fund to the Fixed Income asset class. Of this amount, 40.0% is targeted to the core strategies and 60.0% to specialty strategies (high-yield and emerging market debt).

**Market Exposure as of December 31, 2008:** Fixed Income had a \$3,282.5 million market value, 13.7% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with 14 external investment advisors.

**Number of Investment Portfolios:** SERS had a total of 16 portfolios within the Fixed Income asset class managed by the 14 investment advisors.

**Type of Investment Portfolios:** The Fixed Income asset class is divided into core and specialty segments.

**Core:** Core portfolios invest in relatively liquid, high quality, fixed income securities with intermediate term durations that meet return, disinflation/deflation, high quality liquidity and diversification needs of the Fund. SERS had three actively managed core bond portfolios; one Custom Intermediate Duration Treasury Inflation Protection (TIPS) portfolio, one Barclay's Capital Aggregate portfolio, and one Barclay's Capital Credit portfolio. The three actively managed core portfolios totaled \$1,044.5 million. In addition, SERS had one passively managed Barclay's Capital Aggregate bond portfolio of \$88.3 million. The combination of core portfolios represented 34.5% of the asset class. SERS uses NISA Investment Advisors to replicate fixed income indices for the rebalancing and equitization strategies.

**Specialty:** The specialty strategy portfolios (high-yield, emerging market debt, subordinated debt, mezzanine debt, and bank loan structured credit) focus on debt instruments offering higher return premiums and different risk characteristics than core fixed income securities. SERS has four corporate high yield portfolios with a market value of \$852.3 million, one high yield commercial mortgage-backed securities portfolio with a market value of \$186.5 million, one structured credit portfolio with a market value of \$25.9 million, and six emerging market debt portfolios with a market value of \$1,085.0 million. The specialty portfolios represent 65.5% of the asset class.

# Fixed Income Investments Summary *(continued)*

## SERS Fixed Income Investments

Fixed Income Investment Advisor	Investment Style	*Market Exposure As of 12/31/08 (\$ millions)
<b>Core</b>		
1. Standish Mellon	Domestic - Index	\$88.3
2. Morgan Stanley	Active Domestic	254.4
3. Taplin, Canida & Habacht	Active Domestic	100.3
4. NISA Investment Advisors	Active Intermediate Duration TIPS	689.8
<b>Specialty</b>		
5. Berwind (Eureka) - PA Capital Fund	PA Capital Fund	4.0
6. Pyramis Global Advisors (Fidelity)	Commercial Mortgage-backed Securities	186.5
7. Oaktree Capital Management	Mezzanine Fund	1.1
8. Stone Harbor (Salomon)	Global High Yield	468.1
Stone Harbor (Salomon)	Emerging Market Debt	301.4
9. Ashmore AEMDF	Emerging Market Debt (\$U.S.)	215.7
Ashmore LCD	Emerging Market Debt - local	151.7
10. W.R. Huff	High Yield	379.0
11. SEI Structured Credit Fund	High Yield Bank Loans - Equity Tranche	25.9
12. Gramercy Advisors	Emerging Market Debt - Absolute Return	71.0
13. Greylock Capital Management	Emerging Market Debt - Absolute Return	54.4
14. PIMCO	Emerging Market Debt	290.8
<b>Total</b>		<b>\$3,282.5</b>

*\*Includes securities and cash that the manager had available for investment. Numbers may not add due to rounding.*

# Cash Investments Summary

as of December 31, 2008 - (unaudited)

Cash is one of six major asset classes that SERS uses for investments of the Fund. The SERS' investment plan calls for minimizing cash balances while meeting cash flow requirements. The Fund has adopted a rebalancing strategy that enhances the Fund's liquidity profile by providing a ready pool of cash equitized with synthetic investments, including futures and swaps, which provide measured equity and fixed income market exposure. So, while cash balances may have increased, generally there would not be an effective increase of the Fund's allocation to Cash as an asset class. The equitization allows the Fund to preserve its historical asset allocation of zero percent to Cash; while still earning market returns as though those funds were invested in equity or fixed income market indices. The rebalancing strategy does not use leverage.

**Investment Objective:** Cash investments are employed by the Fund to provide for SERS' liquidity needs and to accumulate funds for future investment. The Cash asset class is to be managed on a total return basis, with the exception that temporary investments such as overnight repurchase agreements ("repo"), commercial paper, and banker's acceptance may alternatively be evaluated on a yield-to-maturity basis given their extremely short maturities.

Cash balances and forecasts are evaluated on a daily basis, and compared to SERS equity and fixed income market exposures. When necessary, cash is used as collateral for swaps and futures to maintain the desired market exposures.

In the Cash asset class, SERS' long term investment objectives are to achieve a total return, net of fees, that exceeds the total return on 90 day U.S. Treasury Bills. SERS' *2008 Investment Plan* targets an allocation of 0% of dedicated assets to the Cash asset class, while maintaining \$300 - \$900 million in short term investments equitized with equity and fixed income derivatives. The cash liquidity is used to support the Fund's benefit payments, swap payments for its portable alpha program and operational expenses of the Fund.

**Market Exposure as of December 31, 2008:** The effective cash exposure was approximately \$763.4 million or 3.2% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** The cash and rebalancing strategies use two advisors. The Pennsylvania State Treasury Department manages the uninvested cash in the liquidity accounts; and NISA Investment Advisors manages the cash and synthetic overlays for the rebalancing strategy.

**Number of Investment Portfolios:** SERS' Cash portfolio is managed primarily by the Treasurer. Certain short term cash investments and the synthetic overlays for the fixed income and equity markets are managed by NISA Investment Advisors.

**Type of Investment Portfolios:** SERS Cash asset class currently employs a money market short-term investment strategy. The portfolio also contains the uninvested cash balances held by other SERS investment advisors in other asset classes. Cash held in the rebalancing account is invested in high-quality, highly liquid, short-term investments.

In the aggregate, the State Treasury managed approximately \$812 million on behalf of SERS and SERS' external investment advisors as of December 31, 2008.

# Real Estate Investments Summary

as of December 31, 2008 - (unaudited)

Real Estate is one of six major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies Real Estate investments and balances real estate management styles. In accordance with the Investment Plan, SERS contracts with external investment advisors to manage portfolios.

**Investment Objective:** Real Estate investments are generally long-term, illiquid investments that, due to their high correlation with inflation, provide an inflation hedge and, due to their low correlation with stocks and bonds, provide diversification within the total portfolio. It is expected that the long-term total return (income and appreciation) for real estate will fall between that of stocks and bonds. The Real Estate asset class is managed on a total return basis.

In the Real Estate asset class, SERS' long-term investment objective is to achieve a total net return that exceeds the total return of the NCREIF Index for rolling five year periods. SERS' *2008 Investment Plan* targets a long-term allocation of 8% of assets to the Real Estate asset class.

Investments are made through commingled fund investments, limited partnerships, REITs and separate account portfolios where SERS contracts with external investment advisors to own properties directly or with other co-investors. SERS' Real Estate portfolio provides for diversification by:

- Transaction structure
- Property type
- Geographic location
- Development phase

**Market Value as of December 31, 2008:** Real Estate had an estimated \$2,743.2 million market value, approximately 11.4% of the total Fund's market value. This market value represents September 30, 2008 reported numbers adjusted for cash flows, which occurred in the fourth quarter 2008. Real estate market values and detailed property data is lagged by one quarter due to the timing of the receipt of the private market valuations and information.

**Number of Investment Advisors:** SERS had contracts with 28 external investment advisors to manage real estate portfolios as of December 31, 2008.

**Number of Investment Portfolios:** SERS had investments in 62 real estate portfolios managed by the 28 investment advisors.

**Type of Investment Portfolios:** As of September 30, 2008, the composition of the real estate portfolio was:

- 33% pooled funds, 67% separate accounts
- 24% office, 5% industrial, 8% retail, 22% residential, 13% hotel/motel, 7% timber, 21% other (including senior and student housing, land and various niche property investments)
- 11% Pennsylvania, 30% East excluding PA, 28% West, 14% South, 6% Midwest, 11% International
- 21% of the market value of the separate accounts was invested in 18 investments located in Pennsylvania

# Real Estate Investments Summary *(continued)*

## SERS Real Estate Investments

	<b>Real Estate Investment Advisor</b>	<b>Vintage Year</b>	<b>Property Type</b>	<b>Investment Structure</b>	<b>*Market Value as of 9/30/08 (\$ millions)</b>
1	AG Asia Realty Fund	2007	Diversified	Limited Partnership	\$17.6
2	Apollo Real Estate Fund III	1998	Diversified	Limited Partnership	21.7
3	Berwind Investment Partnership V	1999	Diversified	Limited Partnership	12.9
	Berwind Investment Partnership VI	2002	Diversified	Limited Partnership	15.2
	Berwind Investment Partnership VII	2005	Diversified	Limited Partnership	25.7
	Berwind Investment Partnership VIII	2007	Diversified	Limited Partnership	8.2
4	Blackstone Real Estate Partners III	1999	Diversified	Limited Partnership	1.6
	Blackstone Real Estate Partners IV	2003	Diversified	Limited Partnership	20.5
	Blackstone Real Estate Partners V	2006	Diversified	Limited Partnership	50.3
	Blackstone Real Estate Partners VI	2007	Diversified	Limited Partnership	32.2
5	Clerestory Small Cap Fund I	2007	Diversified	Limited Partnership	(1.2)
6	Cliffwood Select Equity Fund	2000	REITs	Limited Partnership	42.5
7	Colony Investors VIII	2007	Diversified	Limited Partnership	8.9
8	Fidelity Real Estate Opportunistic Income Fund	2007	Debt	Limited Partnership	29.2
9	Fillmore East Fund	2005	Debt	Limited Partnership	36.9
	Fillmore West Fund	2008	Debt	Limited Partnership	19.5
10	Forest I.M.A.	1992	Timber	Separate Account	206.2
11	Grosvenor I.M.A.	1994	Diversified	Separate Account	385.7
	Grosvenor Residential Investment Partners I	2007	Residential	Limited Partnership	0.9
12	Heitman America Real Estate Trust	2007	Diversified	Limited Partnership	61.0
	Heitman I.M.A.	1988	Diversified	Separate Account	98.6
13	ING Clarion Real Estate Securities	1996	REITs	Separate Account	352.2
14	LaSalle I.M.A.	1994	Diversified	Separate Account	308.8
15	Lowe I.M.A.	1994	Diversified	Separate Account	470.9
16	Lubert Adler Fund II	1998	Diversified	Limited Partnership	2.2
	Lubert Adler Fund III	2000	Diversified	Limited Partnership	8.0
	Lubert Adler Fund IV	2004	Diversified	Limited Partnership	17.1
	Lubert Adler Fund V	2006	Diversified	Limited Partnership	26.0
	Lubert Adler Fund VI	2008	Diversified	Limited Partnership	5.0
17	Miller Global III	1999	Diversified	Limited Partnership	0.9
18	OCM Real Estate Opp Fund A	1996	Diversified	Limited Partnership	3.0
	OCM Real Estate Opp Fund II	1998	Diversified	Limited Partnership	2.9
	OCM Real Estate Opp Fund III	2003	Diversified	Limited Partnership	15.8
	TCW Special Credits Trust VI	1994	Diversified	Limited Partnership	0.3
19	Oxford GSA Strategy	2006	Diversified	Limited Partnership	19.4

# Real Estate Investments Summary *(continued)*

	<b>Real Estate Investment Advisor</b>	<b>Vintage Year</b>	<b>Property Type</b>	<b>Investment Structure</b>	<b>*Market Value as of 9/30/08 (\$ millions)</b>
20	Prudential Latin America Residential Fund III	2007	Residential	Limited Partnership	\$2.4
	Prudential Latin America Retail Fund I	2006	Retail	Limited Partnership	10.7
	Prudential Senior Housing Fund II	2001	Senior housing	Limited Partnership	16.3
	Prudential Senior Housing Fund III	2006	Senior housing	Limited Partnership	35.6
21	Rockpoint Finance Fund I	2006	Diversified	Limited Partnership	1.0
	Rockpoint Real Estate Fund I	2004	Diversified	Limited Partnership	4.9
	Rockpoint Real Estate Fund II	2005	Diversified	Limited Partnership	21.2
	Rockpoint Real Estate Fund III	2007	Diversified	Limited Partnership	0.5
22	Hawkeye Partners: Scout Fund I	2006	Diversified	Limited Partnership	(2.9)
23	Sentinel Real Estate Fund	1986	Residential	Open-Ended Fund	72.5
24	Starwood Fund IV	1997	Diversified	Limited Partnership	1.8
	Starwood Fund V	1999	Diversified	Limited Partnership	1.8
	Starwood Fund VI	2001	Diversified	Limited Partnership	29.1
	Starwood Fund VII	2005	Diversified	Limited Partnership	30.8
	Starwood Fund VIII	2007	Diversified	Limited Partnership	(1.0)
25	UBS - PMSA	1988	Diversified	Open-Ended Fund	78.1
	UBS - RESA	1988	Diversified	Open-Ended Fund	93.0
	UBS Multi-Family Trust	1999	Residential	Limited Partnership	0.4
26	Urdang Real Estate Securities	2002	REITs	Separate Account	62.5
27	Westbrook Fund II	1997	Diversified	Limited Partnership	2.1
	Westbrook Fund III	1998	Diversified	Limited Partnership	3.2
	Westbrook Fund IV	2000	Diversified	Limited Partnership	2.1
	Westbrook Fund V	2004	Diversified	Limited Partnership	2.9
	Westbrook Fund VI	2005	Diversified	Limited Partnership	21.1
	Westbrook Fund VII	2006	Diversified	Limited Partnership	7.6
28	Goldman Sachs: Whitehall V & VI	1994	Diversified	Limited Partnership	0.2
	Whitehall VII & VIII	1996	Diversified	Limited Partnership	1.1
<b>September 30, 2008 Total</b>					<b>\$2,825.6</b>
4 <sup>th</sup> Quarter Net Cash Flow Adjustment					(82.4)
<b>December 31, 2008 Total</b>					<b>\$2,743.2</b>

*\*Market values are lagged by one quarter due to the timing of the receipt of private market valuations and information. Numbers may not add due to rounding.*

# Alternative Investments Summary

as of December 31, 2008 - (unaudited)

Alternative Investments is comprised of Venture Capital and Private Equity investments, both of which take the form of limited partnerships, and is one of six major asset classes that SERS uses to diversify the investments of the fund.

## Venture Capital and Private Equity Defined

Venture Capital is the financing of young, rapidly growing companies, typically at three stages of development. (1) Seed and Early Stage: Seed is the form of venture capital that supports companies in their conceptual phase, i.e., a product and market are identified, and a corporation may have been formed. Early Stage financing supports companies pursuing a business plan but not yet generating meaningful revenues. The product has been developed and may have been shipped to customers for testing. Management positions have been filled and an operating team is in place. (2) Late Stage financing supports companies that have proven revenues, and are in the process of rolling out operations and building sales to achieve profitability. (3) Growth or Expansion financing supports profitable or nearly profitable businesses that, lacking access to significant debt financing, need capital for growth and expansion. Companies at either the later stage or growth or expansion stage may be nearing a strategic sale to another company or an initial public offering.

Private Equity primarily refers to investments in the equity and subordinated debt of established companies. Private equity approaches undertaken by SERS' limited partnerships include: (1) Leveraged buyouts and management buyouts in which companies are acquired through the use of borrowed funds, or a combination of borrowed funds and contributed equity capital. The acquired company's assets serve as collateral for the borrowed funds, which are repaid from the company's cash flows. (2) Distressed debt investing involves: (a) deleveraging of debt-laden, but successful, companies by infusing capital to permit debt reduction in exchange for an equity stake in the company, or (b) acquiring debt of a troubled, sometimes bankrupt company, at steep discounts to face value, followed by assistance to return the company to profitability to permit selling of the debt securities at levels above the discounted purchase price. (3) Secondary interests in established private equity funds – these interests are purchased from other investors who seek liquidity or desire to realign or rebalance their investment portfolios, often for non-financial reasons. Such partnership interests can be purchased at significant discounts to net asset value and often occur when the acquired partnerships begin to realize profits.

**Investment Objective:** SERS' long term investment objective for Alternative Investments is to achieve a risk-adjusted total return, net of fees, in excess of the return generated by the S&P 500 Index. SERS' *2008 Investment Plan* anticipates a long-term allocation range with a midpoint of 14%.

**Market Value as of December 31, 2008:** The asset class total market value stood at \$5,826.4 million after adjusting the September valuation for subsequent cash flows in the 4<sup>th</sup> quarter. Alternative Investment market values lag one quarter due to timing of the receipt of private market valuations, reports and other information. These values do not include 4<sup>th</sup> quarter realized and unrealized appreciation/depreciation. Alternative Investments represent 24.2% of the Fund. Sub-asset class market values and fund percentages were as follows:

### SERS Alternative Investments

	Unfunded Commitments (\$ millions)	Market Value (\$ millions)	Percent of Total Fund
Venture Capital	\$833.3	\$1,511.2	6.3%
Private Equity	2,864.4	4,315.2	17.9%
<b>Total Alternative Investments</b>	<b>\$3,697.7</b>	<b>\$5,826.4</b>	<b>24.2%</b>

**Number of Limited Partnerships:** As of December 31, 2008, SERS had commitments to 348 active Alternative Investments limited partnerships, 120 to Venture Capital partnerships and 228 to Private Equity partnerships.

# Alternative Investments Summary *(continued)*

**Portfolio:** SERS' Alternative Investment Program's scope has expanded over the years to include top investment funds nationally and internationally. The Program holds indirect investment interests in over 4,500 companies. The Venture Capital Program includes investments working to commercialize novel solutions to current and future challenges in information technology, communications, and medicine. In addition to direct fund investments, the Venture Capital Program includes investments in several fund-of-funds. A fund-of-funds is a limited partnership that, in turn, invests in other limited partnerships. Five of these fund-of-funds commitments have the strategic goal of enabling SERS to gain indirect exposure to many top-tier venture capital funds that SERS would otherwise have difficulty accessing directly. Another two of these commitments are to funds investing in minority-focused venture capital funds.

The Private Equity Program invests in buyout, distressed, international, and secondary oriented partnerships. Buyout transactions are privately negotiated or result from investment bank sponsored auctions, and are usually completed with present management in place; hostile acquisitions are generally avoided. Distressed investment managers employ differentiated strategies, i.e., they employ control or non-control approaches, and accordingly, have differing degrees of active influence over the companies in which they invest. European funds are attempting to capitalize on trends favoring the restructuring of large companies, generational succession in businesses established after World War II, cross-border business opportunities within the region since the formation of the European Economic Union and currency harmonization. Asian investments focus on the expanded opportunities in the region created by changing attitudes in many Asian countries regarding foreign investment, favorable demographic trends, globalization opportunities, and economic growth. The Program typically gains initial exposure to emerging markets and other target regions through the use of funds-of-funds. The portfolio's exposure to energy markets is also expanding. Additionally, SERS utilizes one manager to oversee stock distributions and another manager for co-investment opportunities.

**Alternative Investment Portfolio Exposure:** The Alternative Investment Program is well-diversified by stage of investment, industry focus, and geography. As of September 30, 2008, based on market value, the program's exposure was as follows:

## By Sub Sector:

U.S. Private Equity	43.5%
U.S. Venture Capital	23.1%
Non U.S.	16.8%
Distressed/Oppportunistic	8.8%
Pennsylvania Related	5.4%
Other	2.4%

## By Style:

LBO	42.0%
Expansion Stage	17.9%
Early Stage	10.3%
Start-Up	8.3%
Acquisition/Platform	6.4%
Senior Debt LBO	4.1%
Other	11.0%

## By Geography:

U.S. Northeast	14.8%
U.S. West Coast	14.4%
U.S. Southwest/Rockies	12.4%
U.S. Midwest/Plains	9.4%
U.S. Southeast	8.3%
U.S. Mid-Atlantic	8.3%
U.S. Pacific Northwest	1.7%
United Kingdom	5.7%
Germany	3.1%
Denmark	2.8%
France	2.2%
Netherlands	1.7%
Rest of World	15.2%

## By Industry:

Consumer/Retail & Services	22.0%
Healthcare	19.4%
Information Technology	14.3%
Manufacturing	7.2%
Software	7.2%
Financial Services	7.0%
Media/Communications	6.8%
Energy	5.4%
Electronics	3.6%
Other	7.1%

# Venture Capital Committed, Drawn and Distributed

as of September 30, 2008 - (unaudited)

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of capital and profits returned to SERS.

Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
1. ABS Capital Partners VI	Late Stage	*	\$40,000,000	\$0	\$0
2. Adams Capital Management II	Early Stage	10/1/1999	30,000,000	30,000,000	0
Adams Capital Management III	Early Stage	11/21/2000	30,000,000	30,000,000	4,761,905
3. Advanced Technology Ventures VI	Multi-Stage	3/9/2000	10,000,000	10,000,000	240,896
Advanced Technology Ventures VII	Multi-Stage	7/11/2001	27,000,000	25,109,700	6,580,846
4. Alloy Annex I	Seed/Early Stage	10/31/2003	5,000,000	4,000,000	0
Alloy Ventures 2000	Early Stage	5/19/2000	20,000,000	20,000,000	2,074,620
Alloy Ventures 2002	Early Stage	7/22/2002	25,000,000	20,750,000	5,604,706
Alloy Ventures 2005	Seed/Early Stage	8/11/2005	25,000,000	15,000,000	0
5. APAX Excelsior VI	Late Stage	7/3/2000	35,000,000	34,175,159	39,234,762
P/A Fund I	Late Stage	6/30/1993	30,000,000	30,000,000	66,195,539
P/A Fund III	Late Stage	3/31/1997	100,000,000	100,000,000	158,077,955
6. APEX Investment Fund IV	Early Stage	9/17/1999	25,000,000	25,743,967	2,014,209
APEX Investment Fund V	Early Stage	4/19/2002	20,000,000	19,600,000	1,707,066
7. Artiman Ventures II	Seed/Early Stage	10/27/2006	25,000,000	7,375,000	0
8. Atlas Venture Fund IV	Early Stage	3/31/1999	26,000,000	23,846,003	6,135,410
Atlas Venture Fund V	Early Stage	2/7/2000	37,200,000	36,970,720	12,826,952
Atlas Venture Fund VI	Early Stage	8/1/2001	24,800,000	24,149,663	4,386,035
9. Austin Ventures IX	Early Stage	1/9/2006	15,000,000	8,428,570	881,830
Austin Ventures VIII	Early Stage	7/26/2001	20,932,140	21,343,340	6,755,154
10. Battery Ventures VIII	Diversified	8/13/2007	25,000,000	8,166,667	0
Battery Ventures VIII Side Car Fund	Diversified	8/29/2008	9,000,000	666,000	0
11. Birchmere Ventures III	Early Stage	5/5/2005	10,000,000	6,518,524	2,429,462
12. Care Capital Investments III	Middle/Late Stage	2/8/2006	25,000,000	5,850,266	0
13. Charles River Partnership XI	Early Stage	2/15/2001	11,032,259	10,143,572	12,859,261
14. Clearstone Venture Partners III-A	Early/Late Stage	12/22/2004	25,000,000	18,500,000	0
15. Cross Atlantic Technology Fund	Early Stage	2/14/2000	20,000,000	19,949,041	16,915,605
Cross Atlantic Technology Fund II	Early Stage	1/28/2002	32,900,000	32,900,000	16,442,911
Novo Vita	Early Stage	12/26/2000	11,616,498	11,616,498	1,792,200
16. Devon Park Bioventures	Early/Late Stage	12/15/2006	10,842,697	2,883,537	701,849
17. Draper Fisher Jurvetson Fund VI	Early Stage	8/13/1999	8,000,000	8,000,000	2,886,971
Draper Fisher Jurvetson Fund VII	Early Stage	9/22/2000	20,000,000	19,350,000	3,178,088
18. Draper Triangle Ventures	Early Stage	12/20/1999	20,000,000	22,234,659	5,429,038
Draper Triangle Ventures II	Early Stage	10/13/2004	12,000,000	6,232,499	0
19. Edison Venture Fund III	Late Stage	3/31/1994	25,000,000	25,000,000	47,025,202
20. Fairview Capital	Fund of Funds	9/30/1994	10,000,000	10,000,000	4,543,128
Fairview II	Fund of Funds	3/31/1998	10,000,000	9,800,000	2,861,159

# Venture Capital Committed, Drawn and Distributed *(continued)*

Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
21. Frazier Healthcare III	Early Stage	3/31/1999	\$30,000,000	\$29,475,000	\$10,089,880
Frazier Healthcare IV	Early Stage	9/27/2001	30,000,000	27,240,000	9,875,674
Frazier Healthcare V	Early/Late Stage	5/10/2005	30,000,000	18,990,000	2,742,043
22. Grotech PA III	Late Stage	6/29/1990	3,000,000	3,014,865	2,910,452
Grotech Partners V	Late Stage	9/30/1998	25,000,000	25,000,000	24,521,934
23. Guggenheim Technology Ventures I	Early/Late Stage	*	10,000,000	0	0
24. Halpern Denny Fund II	Late Stage	3/31/1998	25,000,000	25,116,871	5,234,363
Halpern Denny Fund III	Late Stage	4/26/2000	25,000,000	23,806,740	16,760,652
25. HarbourVest Partners VI	Fund of Funds	5/7/1999	200,000,000	184,586,055	83,060,974
HarbourVest Partners VII	Fund of Funds	3/24/2003	75,000,000	51,000,000	2,577,151
HarbourVest Partners VIII	Fund of Funds	10/5/2006	100,000,000	29,000,000	0
26. Healthcare Ventures III	Early Stage	9/30/1992	15,000,000	15,000,000	30,778,200
Healthcare Ventures V	Early Stage	12/31/1997	25,000,000	25,000,000	52,285,824
Healthcare Ventures VI	Early Stage	6/19/2000	35,000,000	35,000,000	3,462,611
Healthcare Ventures VII	Early Stage	10/29/2002	35,000,000	28,350,000	1,167,015
Healthcare Ventures VIII	Early Stage	8/22/2005	30,000,000	10,275,000	2,568,786
27. Highland Capital Partners VI	Early Stage	10/25/2001	25,000,000	24,437,500	18,788,669
Highland Capital Partners VII	Early Stage	10/13/2006	35,000,000	14,612,500	1,390,491
Highland Consumer Fund I	Diversified	5/4/2007	25,000,000	9,263,199	0
28. I.P. - Fund II	Early Stage	12/17/2001	8,600,000	8,498,074	1,006,296
I.P. - Fund III	Seed/Early Stage	11/19/2004	10,500,000	7,875,000	490,360
I.P. - Fund IV	Seed/Early Stage	9/21/2007	14,000,000	2,800,000	0
29. Insight Venture Partners VI	Buyouts	8/21/2007	30,000,000	8,430,000	0
30. InterWest Partners IX	Early Stage	10/19/2005	20,000,000	12,000,000	1,106,563
InterWest Partners VIII	Early Stage	8/25/2000	25,000,000	22,500,000	5,323,829
InterWest Partners X	Early Stage	*	30,000,000	0	0
31. J.H. Whitney Equity Fund III	Late Stage	3/31/1998	20,000,000	20,171,316	50,600,435
J.H. Whitney IV	Late Stage	2/1/2000	20,000,000	16,712,208	5,350,037
32. JMI Equity Fund V	Early/Late Stage	6/7/2005	24,000,000	20,381,205	12,977,009
JMI Equity Fund VI	Early/Late Stage	6/27/2007	40,000,000	14,760,000	0
33. JP Morgan Venture Capital Investors	Fund of Funds	7/8/1999	100,000,000	98,481,568	22,861,587
JP Morgan Venture Capital Investors II	Fund of Funds	9/8/2000	100,000,000	89,010,611	21,736,307
JP Morgan Venture Capital Investors III	Fund of Funds	6/20/2006	100,000,000	28,627,732	3,580
34. Keystone V	Late Stage	3/31/1998	25,000,000	25,117,132	2,082,064
35. Kline Hawkes Pacific	Early Stage	8/30/2000	15,000,000	15,100,498	5,089,301
36. Knightsbridge Venture Capital VI	Fund of Funds	12/7/2004	20,000,000	10,150,000	0
37. Lightspeed Venture Partners VII	Early Stage	2/27/2006	18,000,000	11,347,490	917,875
Lightspeed Venture Partners VIII	Early Stage	6/27/2008	15,000,000	1,050,000	0
38. Meritech Capital Partners II	Late Stage	1/2/2001	26,475,166	23,915,898	16,203,258
Meritech Capital Partners III	Late Stage	4/5/2006	35,000,000	20,650,000	966,232
39. Mid-Atlantic III	Early Stage	6/30/1997	20,008,308	20,000,000	5,025,301
Mid-Atlantic Venture Fund IV	Early Stage	5/4/2000	30,000,000	30,000,000	217,297
NEPA Venture-II	Early Stage	12/31/1992	7,500,000	7,500,000	34,879,769
40. Morgenthaler Partners VII	Early Stage	7/26/2001	35,000,000	31,500,000	11,337,692
Morgenthaler Partners VIII	Diversified	10/3/2005	35,000,000	17,500,000	1,313,619

# Venture Capital Committed, Drawn and Distributed *(continued)*

Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Morgenthaler Partners VIII	Early Stage	*	\$20,000,000	\$0	\$0
41. New Enterprise Associates 11	Early/Late Stage	3/1/2004	25,000,000	21,750,000	8,052,762
New Enterprise Associates 12	Early/Late Stage	6/26/2006	35,000,000	17,504,833	1,711,074
New Enterprise Associates IX	Early Stage	11/15/1999	20,000,000	19,600,000	3,333,252
New Enterprise Associates VI	Early Stage	3/31/1994	25,000,000	25,000,000	198,305,408
New Enterprise Associates VII	Early Stage	12/31/1996	30,000,000	30,000,000	97,217,571
New Enterprise Associates X	Early/Late Stage	12/11/2000	35,000,000	33,803,000	18,403,223
42. NewSpring Ventures II	Late Stage	12/5/2006	10,000,000	3,200,000	0
43. Novitas Capital III	Early Stage	4/17/2003	10,000,000	6,475,000	941,822
44. Oak Investment Partners XI	Late Stage	7/21/2004	35,000,000	35,000,000	7,401,464
Oak Investment Partners XII	Early/Late Stage	7/10/2006	40,000,000	21,479,289	1,562,915
45. Polaris Venture Partners	Early Stage	6/30/1996	15,000,000	14,595,000	46,501,899
Polaris Venture Partners II	Early Stage	9/30/1998	25,000,000	24,750,000	24,859,455
Polaris Venture Partners III	Early Stage	1/21/2000	50,000,000	49,000,000	14,911,870
Polaris Venture Partners IV	Early Stage	9/30/2002	50,000,000	48,750,000	10,327,495
Polaris Venture Partners V	Diversified	8/8/2006	50,000,000	18,500,000	0
46. Quaker Bio Ventures	Early Stage	2/20/2003	20,000,000	18,000,000	3,526,430
Quaker BioVentures II	Middle/Late Stage	4/3/2007	25,000,000	4,000,000	0
47. Sofinnova Venture Partners VII	Early Stage	1/18/2007	20,000,000	6,000,000	0
48. Sprout VII	Early Stage	3/31/1995	18,000,000	18,000,000	41,939,060
49. Summit Accelerator Fund	Early Stage	11/15/1999	8,000,000	7,609,500	7,166,347
Summit IV	Late Stage	9/30/1995	25,000,000	24,250,000	182,700,129
Summit Partners Venture Capital Fund II	Diversified	9/22/2006	15,000,000	5,850,000	0
Summit V	Late Stage	3/31/1998	37,500,000	36,187,500	48,131,661
50. T.Rowe Price Stock Distribution	Stock Distribution	1/3/2005	0	277,403,334	252,506,086
51. TA/Advent VIII	Late Stage	6/30/1997	30,000,000	29,541,093	64,136,257
52. Three Arch Capital	Early Stage	12/20/2000	20,000,000	18,650,000	3,145,142
Three Arch Partners IV	Early/Late Stage	6/4/2004	20,000,000	11,450,000	1,941,653
53. TL Ventures III	Early Stage	3/31/1997	15,000,000	15,062,614	20,677,658
TL Ventures IV	Early Stage	5/13/1999	35,000,000	35,000,000	22,807,479
TL Ventures V	Early Stage	10/18/2000	40,000,000	34,848,219	7,269,006
54. US Venture Partners VII	Early Stage	2/18/2000	13,750,000	13,750,000	1,875,020
US Venture Partners VIII	Early Stage	6/1/2001	26,250,000	25,860,000	7,152,911
55. Weathergage Venture Capital	Fund of Funds	6/26/2007	25,000,000	4,187,500	0
56. Weston Presidio III	Late Stage	12/31/1998	35,000,000	31,412,086	22,536,318
Weston Presidio IV	Late Stage	6/21/2000	35,000,000	33,547,500	16,595,504
Weston Presidio V	Late Stage	12/8/2005	50,000,000	28,600,000	0
57. Worldview Technology Partners IV	Early Stage	1/31/2001	18,130,023	16,951,175	3,366,893
<b>Total Active Venture Capital</b>			<b>\$3,465,037,091</b>	<b>\$2,913,117,490</b>	<b>\$2,043,249,653</b>

*\*Not Funded as of 9/30/08  
Commitments as of 12/31/08  
Cash flows as of 9/30/08*

# Venture Capital Committed, Drawn and Distributed *(continued)*

Inactive Venture Capital Funds			
Limited Partnership	Capital Committed	Capital Drawn	Distributions
<b>Total Inactive Venture Capital</b>	<b>\$199,700,000</b>	<b>\$189,553,180</b>	<b>\$399,087,046</b>

# Private Equity Committed, Drawn and Distributed

as of September 30, 2008 - (unaudited)

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of capital and profits returned to SERS.

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
1.	Abingworth Bioventures IV	Multi-Stage	9/1/2003	\$20,000,000	\$16,000,000	\$1,946,463
	Abingworth Bioventures V	Multi-Stage	1/23/2007	33,775,000	9,255,131	541
2.	ABRY Advanced Securities Fund	Senior Debt	8/1/2008	25,000,000	2,326,978	0
	ABRY Broadcast Partners III	Buyouts	3/31/1997	25,000,000	27,309,131	26,294,581
	ABRY Broadcast Partners IV	Buyouts	3/30/2001	35,000,000	28,265,722	29,304,481
	ABRY Mezzanine Partners	Mezzanine	3/15/2002	30,000,000	32,918,060	33,363,320
	ABRY Partners V	Buyouts	7/29/2005	45,000,000	38,449,869	202,738
	ABRY Partners VI	Mid Market Buyouts	3/26/2008	50,000,000	3,853,656	0
	ABRY Senior Equity II	Secondaries	7/27/2006	30,000,000	17,174,262	943,231
3.	ABS Capital Partners III	Buyouts	3/31/1999	35,000,000	29,428,915	17,192,889
	ABS Capital Partners IV	Buyouts	10/13/2000	35,000,000	31,023,276	41,337,580
	ABS Capital Partners V	Buyouts	11/14/2005	20,000,000	14,858,044	1,304,092
4.	Accel Europe	Early Stage	7/2/2001	15,000,000	10,975,000	0
5.	Advent International GPE VI-A	Mid Market Buyouts	7/7/2008	35,000,000	3,675,000	0
	Advent Latin American Fund IV	Buyouts	8/2/2007	30,000,000	12,600,000	0
6.	AG Capital Recovery Partners II	Distressed Debt	10/1/2001	17,600,000	17,695,470	26,989,866
	AG Capital Recovery Partners IV	Distressed Debt	2/4/2003	50,000,000	35,415,216	54,247,171
	AG Capital Recovery Partners V	Distressed Debt	4/17/2006	20,000,000	18,700,000	0
7.	Alpha Private Equity Fund 4	Mid Market Buyouts	5/15/2002	26,580,000	35,443,050	59,209,466
	Alpha Private Equity Fund 5	Mid Market Buyouts	4/1/2006	72,233,400	42,434,289	8,015,060
8.	APAX Europe IV	Buyouts	3/31/1999	35,000,000	29,909,800	37,636,346
	APAX Europe V	Buyouts	4/27/2001	70,000,000	69,542,777	125,087,449
	APAX Europe VI	Buyouts	5/19/2005	76,349,190	63,327,970	25,394,049
	APAX Europe VII	Buyouts	6/27/2007	132,900,000	57,902,950	0
	APAX Germany II	Middle/Late Stage	6/30/1997	8,737,262	8,455,477	16,916,389
	APAX UK Ventures VI	Middle/Late Stage	12/31/1997	6,558,000	6,918,899	12,742,745
9.	Apollo Investment Fund IV	Buyouts	9/30/1998	75,000,000	74,059,843	96,675,923
	Apollo Investment Fund V	Buyouts	8/23/2001	50,000,000	47,875,704	92,484,700
	Apollo Investment Fund VI	Buyouts	7/19/2006	40,000,000	31,276,628	672,450
10.	Asia Alternatives Capital Partners	Fund of Funds	6/26/2007	50,000,000	10,324,323	423,650
	Asia Alternatives Capital Partners II	Fund of Funds	3/7/2008	50,000,000	1,155,726	0
11.	Asia Pacific Growth Fund III	Global Situations	9/28/1999	15,000,000	15,297,100	6,744,686
12.	Audax Private Equity Fund	Mid Market Buyouts	5/25/2000	35,000,000	36,373,372	47,999,365
	Audax Private Equity Fund II	Mid Market Buyouts	6/17/2005	25,000,000	24,531,564	4,764,227
	Audax Private Equity Fund III	Mid Market Buyouts	11/7/2007	37,000,000	13,357,255	190,528

# Private Equity Committed, Drawn and Distributed *(continued)*

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
13.	Avenue Asia Special Situations Fund IV	Distressed Debt	6/30/2006	\$50,000,000	\$18,219,617	\$8,850
	Avenue Europe Special Situations Fund I	Distressed Debt	7/30/2008	38,822,500	15,971,883	0
	Avenue Special Situations Fund III	Distressed Debt	8/25/2003	50,000,000	40,080,214	61,046,216
	Avenue Special Situations Fund IV	Distressed Debt	3/27/2006	50,000,000	37,051,014	0
	Avenue Special Situations Fund V	Distressed Debt	6/4/2007	70,000,000	39,833,454	233,973
14.	AXA Secondary Fund III	Secondaries	11/19/2004	26,000,000	18,622,367	22,504,262
	AXA Secondary Fund III-2	Secondaries	11/24/2004	14,000,000	10,275,974	11,715,290
	AXA Secondary Fund IV	Secondaries	2/26/2007	80,000,000	17,346,215	432,702
15.	B III Capital Partners	Distressed Debt	9/30/1997	35,000,000	34,503,390	50,124,040
16.	Bain Capital Asia Fund	Distressed Debt	10/18/2007	12,000,000	3,000,000	0
	Bain Capital Europe III	Buyouts	7/10/2008	76,555,500	1,765,125	0
	Bain Capital Fund IX	Buyouts	4/10/2006	75,000,000	72,750,000	4,937,278
	Bain Capital Fund VII	Buyouts	7/6/2000	25,000,000	24,562,500	40,277,545
	Bain Capital Fund VIII-E	Buyouts	12/15/2004	13,405,000	12,415,468	2,967,960
	Bain Capital Fund X	Buyouts	1/15/2008	90,000,000	21,600,000	0
	Bain Capital IX Coinvestment Fund	Buyouts	4/20/2006	15,000,000	14,550,000	0
	Bain Capital X Coinvestment Fund	Buyouts	7/28/2008	10,000,000	700,000	0
17.	Baring India Private Equity Fund III Limited	Mid Market Buyouts	*	5,000,000	0	0
	Baring Vostok Private Equity Fund IV	Buyouts	3/10/2008	30,000,000	3,803,971	0
18.	BC European Capital VII	Buyouts	7/28/2000	37,740,202	37,754,746	59,068,229
	BC European Capital VII Top Up	Buyouts	7/2/2001	12,278,596	12,278,596	16,619,528
	BC European Capital VIII	Buyouts	12/13/2005	97,635,000	42,193,517	0
19.	Berkshire Fund VI	Mid Market Buyouts	7/11/2002	20,000,000	17,723,663	13,718,191
	Berkshire Fund VII	Mid Market Buyouts	11/15/2006	32,000,000	6,613,735	608,559
20.	Blackstone Capital II	Buyouts	9/30/1994	40,000,000	42,842,270	93,290,357
	Blackstone Capital III	Buyouts	12/31/1997	75,000,000	74,427,370	115,013,533
	Blackstone Capital IV	Buyouts	2/26/2003	75,000,000	73,898,977	98,044,535
	Blackstone Capital Partners V	Buyouts	5/30/2006	150,000,000	115,127,811	6,684,825
	Blackstone Communications Partners I	Buyouts	8/29/2000	25,000,000	26,377,062	23,426,321
21.	Brait IV	Mid Market Buyouts	12/11/2006	25,000,000	13,831,321	1,128,946
22.	Brynwood Partners V	Mid Market Buyouts	7/31/2005	10,000,000	9,922,689	757,118
	Brynwood Partners VI	Mid Market Buyouts	*	10,000,000	0	0
23.	Centerbridge Capital Partners I	Distressed Debt	2/27/2007	50,000,000	24,432,031	61,886
24.	Cerberus Institutional Partners	Distressed Debt	3/5/1999	35,000,000	35,000,000	76,576,855
	Cerberus Institutional Partners Series Four	Distressed Debt	11/27/2006	75,000,000	41,625,000	0
	Cerberus Institutional Partners Series Three	Distressed Debt	11/13/2003	22,321,354	22,321,354	10,506,186
	Cerberus Institutional Partners Series Two	Distressed Debt	10/9/2001	35,000,000	30,100,793	68,626,640
25.	Charterhouse Capital Partners IX	Buyouts	*	79,290,000	0	0
	Charterhouse Capital Partners VII	Buyouts	1/17/2003	52,120,000	51,624,663	86,164,523
	Charterhouse Capital Partners VIII	Buyouts	4/19/2006	74,400,000	61,491,129	0
26.	Charterhouse Equity Partners II	Buyouts	3/31/1994	40,000,000	43,908,228	100,919,498
	Charterhouse Equity Partners III	Buyouts	12/31/1997	50,000,000	55,395,586	72,280,199
27.	Chequers Capital XV	Buyouts	7/5/2006	31,434,000	12,337,238	0
28.	CID Greater China Venture Capital Fund II	Early Stage	8/10/2007	20,000,000	12,000,000	0

# Private Equity Committed, Drawn and Distributed *(continued)*

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
29.	Clayton Dubilier & Rice V	Buyouts	6/30/1995	\$50,000,000	\$49,756,029	\$49,826,483
	Clayton Dubilier & Rice VI	Buyouts	12/31/1998	50,000,000	36,211,768	55,410,949
30.	Clessidra Capital Partners II	Buyouts	*	31,716,000	0	0
31.	Code Hennessy & Simmons	Mid Market Buyouts	9/28/1989	9,650,000	9,650,000	29,205,907
	Code Hennessy & Simmons II	Mid Market Buyouts	6/30/1994	20,000,000	20,000,000	69,692,351
	Code Hennessy & Simmons III	Mid Market Buyouts	9/30/1997	40,000,000	38,724,000	55,175,239
	Code Hennessy & Simmons IV	Mid Market Buyouts	9/16/1999	100,000,000	100,000,000	132,813,640
	Code Hennessy & Simmons V	Mid Market Buyouts	11/10/2005	50,000,000	41,045,311	1,878,892
32.	Cognetas Fund II	Buyouts	11/2/2005	49,468,400	34,071,704	2,566,249
33.	CVI Global Value Fund	Distressed Debt	2/23/2007	60,000,000	49,651,667	825,601
34.	DLJ Merchant Banking Fund II	Buyouts	3/31/1997	75,000,000	82,833,683	98,557,046
	DLJ Merchant Banking Fund III	Buyouts	8/14/2001	85,000,000	85,304,443	105,273,520
35.	Dover Street VII	Secondaries	7/2/2008	30,000,000	4,520,287	0
36.	Elevation Partners	Private Equity	11/10/2005	35,000,000	18,575,308	4,790,796
37.	Energy Spectrum Partners IV	Mid Market Buyouts	12/15/2004	50,000,000	47,219,716	23,489,557
	Energy Spectrum Partners V	Mid Market Buyouts	7/9/2007	30,000,000	4,701,524	1,748
38.	Eureka II	Small Buyouts	1/30/2006	20,000,000	6,784,768	291,601
39.	Excelsior Capital Asia Partners III	Growth Equity	8/17/2006	25,000,000	13,252,457	40,602
40.	First Reserve Fund X	Buyouts	10/28/2004	30,000,000	29,745,853	33,477,594
	First Reserve Fund XI	Buyouts	12/14/2006	60,000,000	44,221,700	0
	First Reserve Fund XII	Buyouts	*	50,000,000	0	0
41.	Francisco Partners	Mid Market Buyouts	7/27/2000	50,000,000	43,651,611	26,701,954
	Francisco Partners II	Mid Market Buyouts	7/10/2006	30,000,000	18,075,000	6,055,957
42.	Frontenac VII	Buyouts	9/30/1997	40,000,000	40,000,000	55,124,052
43.	Great Hill Equity Partners	Mid Market Buyouts	4/12/1999	30,000,000	30,000,000	29,994,856
	Great Hill Equity Partners II	Mid Market Buyouts	3/28/2001	35,000,000	35,063,336	44,268,235
	Great Hill Equity Partners III	Mid Market Buyouts	3/7/2006	35,000,000	27,825,000	0
	Great Hill Equity Partners IV	Mid Market Buyouts	9/8/2008	25,000,000	1,750,000	0
44.	Gryphon Partners II	Mid Market Buyouts	11/3/1999	35,000,000	32,853,950	28,560,247
	Gryphon Partners III	Mid Market Buyouts	9/8/2004	30,000,000	22,218,062	9,818,516
45.	GTC&R V	Buyouts	3/31/1997	11,400,000	11,400,000	20,399,031
	GTC&R VI	Buyouts	9/30/1998	50,000,000	50,854,013	42,566,570
	GTC&R VII	Buyouts	3/15/2000	55,000,000	48,871,546	106,661,165
	GTCR IX	Early Stage	12/1/2006	50,000,000	14,739,114	3,161,153
	GTCR VIII	Buyouts	7/7/2003	75,000,000	69,393,599	75,485,810
46.	H.I.G. Bayside Debt & LBO Fund II	Distressed Debt	6/17/2008	30,000,000	350,000	0
47.	Hancock IPEP II (Harbourvest II)	Fund of Funds	6/30/1997	25,000,000	24,357,775	32,480,166
	Harbourvest IPEP IV	Fund of Funds	4/9/2001	40,000,000	33,200,000	29,285,130
	HarbourVest IPEP III	Fund of Funds	6/30/1998	40,000,000	38,400,000	40,920,683
	HIPEP V-Asia Pacific & Rest of World Partnership Fund	Buyouts	5/9/2006	30,000,000	13,995,316	0
48.	Hellman & Friedman Capital Partners VI	Buyouts	6/5/2007	125,000,000	76,295,619	441,861
	Hellman Friedman IV	Buyouts	2/14/2000	75,000,000	66,540,777	170,375,597
	Hellman Friedman V	Buyouts	12/20/2004	80,000,000	69,367,076	63,159,825
49.	InterMedia Partners VII	Diversified	1/5/2007	15,000,000	9,984,759	142,200

# Private Equity Committed, Drawn and Distributed *(continued)*

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
50.	Invemed Catalyst Fund	Mid Market Buyouts	10/19/1999	\$16,754,888	\$13,515,153	\$8,170,561
51.	J.H. Whitney V	Late Stage	3/29/2001	20,000,000	21,858,315	35,638,328
	J.H. Whitney VI	Buyouts	1/5/2006	50,000,000	32,680,578	8,221,368
52.	J.W. Childs Equity Partners III	Mid Market Buyouts	8/20/2002	40,000,000	38,299,293	28,352,594
53.	JP Morgan US Corp Finance Investors II	Fund of Funds	1/14/2003	50,000,000	46,658,983	17,812,391
54.	Kelso Investment Associates V	Buyouts	12/31/1993	40,000,000	54,411,479	153,586,319
	Kelso VI	Buyouts	9/30/1998	75,000,000	68,484,560	84,793,059
	Kelso VII	Buyouts	10/18/2004	40,000,000	40,255,876	17,558,138
	Kelso VIII	Buyouts	11/29/2007	150,000,000	5,341,445	31,411
55.	Landmark Equity IV	Secondaries	3/31/1995	14,923,291	12,880,353	18,587,584
	Landmark Equity Partners V	Secondaries	12/31/1995	19,624,113	19,434,947	23,310,603
56.	Leeds Equity Partners IV	Mid Market Buyouts	11/12/2004	20,000,000	19,803,942	2,153,155
57.	Lexington Capital Partners II	Secondaries	6/30/1998	40,000,000	39,538,000	46,423,375
	Lexington Capital Partners III	Secondaries	1/26/1999	35,000,000	34,169,949	37,150,612
	Lexington Capital Partners V	Secondaries	1/17/2002	75,000,000	71,139,456	77,994,517
	Lexington Capital Partners VI	Secondaries	10/21/2005	50,000,000	30,420,376	6,318,574
58.	Lime Rock Partners III	Late Stage	3/7/2005	15,000,000	13,532,763	2,886,836
	Lime Rock Partners IV	Late Stage	11/16/2006	25,000,000	14,882,821	0
	Lime Rock Partners V	Late Stage	*	42,500,000	0	0
	Lime Rock Resources	Diversified	12/28/2005	20,000,000	14,700,823	0
59.	LLR Equity Partners	Mid Market Buyouts	2/4/2000	25,000,000	24,341,235	46,013,054
	LLR Equity Partners II	Mid Market Buyouts	1/29/2004	25,000,000	21,237,377	4,513,889
	LLR Equity Partners III	Mid Market Buyouts	7/24/2008	30,000,000	3,900,000	0
60.	Madison Dearborn Capital Partners	Buyouts	3/31/1993	15,000,000	14,538,849	48,868,414
	Madison Dearborn Capital Partners II	Buyouts	3/31/1997	40,000,000	40,152,017	90,756,231
	Madison Dearborn Capital Partners III	Buyouts	4/6/1999	75,000,000	76,195,099	104,737,723
	Madison Dearborn Capital Partners IV	Buyouts	4/2/2001	90,000,000	84,317,989	62,669,597
	Madison Dearborn Capital Partners V	Buyouts	12/14/2006	75,000,000	59,728,819	1,392,333
	Madison Dearborn Capital Partners VI	Buyouts	5/27/2008	50,000,000	5,470,019	0
61.	Matlin Patterson Global Opportunities Partners	Distressed Debt	5/31/2001	35,000,000	32,524,138	51,996,544
	Matlin Patterson Global Opportunities Partners II	Distressed Debt	6/30/2004	30,000,000	35,346,530	14,814,728
62.	Media/Communication III	Buyouts	6/30/1997	25,000,000	23,750,000	35,813,715
	Media/Communications IV	Buyouts	3/31/1999	25,000,000	23,125,000	5,010,893
	Media/Communications Ventures Fund V	Buyouts	9/27/2000	35,000,000	34,199,705	14,935,375
63.	Meridian Venture Partners II	Buyouts	2/11/2005	10,000,000	10,000,000	823,344
64.	New York Life Capital Partners III	Co-investments	6/30/2006	50,000,000	45,046,510	1,060,031
	New York Life Capital Partners IV	Co-investments	4/4/2008	100,000,000	12,647,436	4,922
65.	Newbridge Asia III	Buyouts	2/15/2001	15,000,000	15,312,650	11,600,753
	Newbridge Asia IV	Buyouts	9/27/2005	40,000,000	36,398,860	4,177,550
66.	Nordic Capital V	Buyouts	5/7/2004	40,000,000	45,443,963	20,356,863
	Nordic Capital VI	Buyouts	7/25/2006	54,441,000	60,595,702	1,128,843
	Nordic Capital VII	Buyouts	5/2/2008	100,237,900	20,770,231	0
67.	Oakhill Capital Partners	Buyouts	5/17/1999	50,000,000	53,195,494	64,752,818

# Private Equity Committed, Drawn and Distributed *(continued)*

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
68.	Oaktree Capital Management	Diversified	5/28/2004	\$40,000,000	\$40,577,048	\$25,501,092
	OCM Opportunities Fund	Distressed Debt	1/31/1996	24,000,000	24,000,000	38,936,140
	OCM Opportunities Fund II	Distressed Debt	3/31/1998	40,000,000	40,000,000	59,655,678
	OCM Opportunities Fund III	Distressed Debt	1/20/2000	60,000,000	60,007,890	87,331,393
	OCM Opportunities Fund IV	Distressed Debt	9/26/2001	70,000,000	68,250,000	113,321,731
	OCM Opportunities Fund V	Distressed Debt	8/12/2004	40,000,000	40,003,507	50,904,530
	OCM Opportunities Fund VI	Distressed Debt	9/28/2005	40,000,000	40,000,000	0
	OCM Opportunities Fund VII	Distressed Debt	5/16/2007	40,000,000	40,000,000	233,643
	OCM Opportunities Fund VII b	Distressed Debt	6/3/2008	40,000,000	12,000,000	0
	OCM Principal Opportunities	Distressed Debt	12/31/1996	25,000,000	25,000,000	31,466,952
	OCM Principal Opportunities Fund IV	Distressed Debt	1/24/2007	20,000,000	17,000,000	38,751
	OCM Principal Opportunities II	Distressed Debt	4/24/2001	25,000,000	25,000,000	34,191,420
	OCM/GFI Power Opportunities Fund II	Buyouts	5/9/2005	25,000,000	(3,273,704)	29,205
69.	Palamon European Equity	Buyouts	7/23/1999	31,499,291	36,567,159	27,103,196
	Palamon European Equity II	Diversified	10/25/2005	40,114,200	18,520,286	0
70.	Parthenon Investors II	Mid Market Buyouts	8/9/2001	20,000,000	21,426,797	13,902,439
71.	Patriot Capital Partners	Mid Market Buyouts	6/12/2008	25,000,000	2,500,000	0
72.	Permira European Fund	Buyouts	9/30/1997	33,789,023	32,159,947	84,005,717
	Permira European Fund II	Buyouts	6/7/2000	47,979,751	45,672,612	78,101,935
	Permira European Fund III	Buyouts	1/12/2004	112,640,170	109,303,420	124,950,460
	Permira IV	Buyouts	12/14/2006	126,870,000	66,040,570	0
	Permira UK Venture Fund III	Middle/Late Stage	3/31/1991	9,063,438	8,946,988	26,106,191
	Permira UK Venture Fund IV	Middle/Late Stage	12/31/1995	15,000,000	15,993,572	22,721,533
73.	Pitango Venture Capital Fund IV	Diversified	7/19/2004	20,000,000	14,201,534	883,720
	Pitango Venture Capital Fund V	Seed/Early Stage	8/22/2007	30,000,000	6,750,000	0
74.	PNC Equity Partners II	Mid Market Buyouts	8/30/2007	15,000,000	4,153,083	2,090
75.	Providence Equity Partners IV	Mid Market Buyouts	11/27/2000	25,000,000	28,520,619	34,285,940
	Providence Equity Partners V	Mid Market Buyouts	4/4/2005	45,000,000	41,171,579	545,004
	Providence Equity Partners VI	Buyouts	3/16/2007	50,000,000	22,804,720	185,427
76.	S.B. Energy Partners I	Buyouts	7/27/2007	25,000,000	3,910,198	0
77.	Sankaty Credit Opportunities III	Distressed Debt	3/8/2007	50,000,000	50,000,000	563,636
	Sankaty Credit Opportunities IV	Distressed Debt	7/15/2008	40,000,000	12,000,000	0
78.	SCP Private Equity Partners II	Buyouts	6/15/2000	25,000,000	24,168,582	6,150,003
79.	Segulah IV	Mid Market Buyouts	9/25/2008	15,688,890	1,752,505	0
80.	ShoreView Capital Partners	Buyouts	6/16/2003	38,000,000	28,782,400	32,181,383
	ShoreView Capital Partners II	Buyouts	3/27/2008	40,000,000	4,629,380	35,903
81.	Siguler Guff BRIC Opportunities Fund	Fund of Funds	5/8/2006	10,000,000	6,558,299	688,923
	Siguler Guff BRIC Opportunities Fund II	Fund of Funds	4/9/2008	25,000,000	4,025,575	0
82.	Sterling Capital Partners I	Buyouts	10/31/2002	15,000,000	14,285,444	12,164,045
	Sterling Capital Partners II	Buyouts	8/18/2005	30,000,000	24,439,113	4,476,101
	Sterling Capital Partners III	Buyouts	8/13/2007	32,000,000	9,332,112	0
83.	Summit Partners Private Equity Fund VII	Buyouts	2/9/2006	97,134,500	44,196,199	2,163,938
	Summit Ventures VI	Late Stage	3/23/2001	62,000,000	63,343,733	46,756,005

# Private Equity Committed, Drawn and Distributed *(continued)*

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
84.	TA/Advent IX	Late Stage	9/20/2000	\$45,000,000	\$43,650,000	\$54,052,404
	TA/Advent X	Middle/Late Stage	4/25/2006	70,000,000	52,150,000	7,350,000
85.	Thomas H. Lee Equity Fund IV	Buyouts	6/30/1998	70,000,000	63,995,339	53,112,077
	Thomas H. Lee Equity Fund V	Buyouts	7/3/2001	100,000,000	102,679,394	89,117,921
	Thomas H. Lee Equity Fund VI	Mid Market Buyouts	11/14/2006	50,000,000	25,611,626	342,587
86.	TPG Asia V	Buyouts	2/19/2008	25,000,000	4,188,626	7,383
	TPG Partners II	Buyouts	6/30/1997	75,000,000	76,270,348	128,160,661
	TPG Partners III	Buyouts	1/13/2000	75,000,000	68,893,654	135,485,935
	TPG Partners IV	Buyouts	12/29/2003	30,000,000	31,245,619	17,612,330
	TPG Partners V	Buyouts	6/27/2006	100,000,000	81,137,641	626,298
	TPG Partners VI	Buyouts	5/22/2008	45,000,000	2,631,397	9,351
87.	UMS Partners Fund I	Distressed Debt	2/15/2005	5,000,000	5,000,000	3,004,822
88.	Versa Capital Partners	Distressed Debt	10/16/2005	20,000,000	17,011,753	6,675,393
	Versa Capital Partners II	Distressed Debt	7/31/2008	15,000,000	150,000	0
89.	Vestar Capital Partners III	Buyouts	6/30/1997	25,000,000	23,634,582	22,799,747
	Vestar Capital Partners IV	Mid Market Buyouts	1/25/2000	100,000,000	95,235,146	99,038,151
	Vestar Capital Partners V	Mid Market Buyouts	1/25/2006	50,000,000	37,110,526	2,826,194
90.	W Capital Partners II	Secondaries	8/8/2007	40,000,000	9,637,824	69,323
91.	Yucaipa American Alliance Fund II	Buyouts	*	25,000,000	0	0
<b>Total Active Private Equity</b>				<b>\$9,738,229,859</b>	<b>\$6,969,047,576</b>	<b>\$5,989,040,560</b>

*\*Not Funded as of 9/30/08  
Commitments as of 12/31/08  
Cash flows as of 9/30/08*

## Inactive Private Equity Funds

Limited Partnership	Capital Committed	Capital Drawn	Distributions
<b>Total Inactive Private Equity</b>	<b>\$208,830,323</b>	<b>\$198,562,933</b>	<b>\$319,150,344</b>

# Inflation Protection Investments Summary

as of December 31, 2008 - (unaudited)

Inflation Protection is one of six major asset classes that SERS uses for investments of the Fund. The objective of this asset class is to reduce the deleterious effects of inflation by investing in strategies that specifically respond to expected and unexpected inflation. In accordance with the Investment Plan, SERS contracts with external investment advisors to manage portfolios.

**Investment Objective:** Inflation Protection investments are employed by the Fund to provide diversification within the total portfolio and to act as a hedge against inflation. The asset class is composed of a combination of passively- and actively-managed commodities; TIPS; and a diversified inflation protection portfolio that includes commodities, inflation-sensitive stocks, and bonds. The strategies that make up the asset class were chosen for their inflation protection properties; commodities historically have the highest correlation to inflation, and Treasury Inflation Protected Securities (TIPS) are adjusted periodically for actual changes in inflation. The Inflation Protection strategies also provide diversification and low correlation to other assets in the portfolio, and are expected to outperform stocks and bonds during periods of rising inflation, but may underperform when inflation is stable or falling.

SERS' long-term investment objective in the inflation protection asset class is to achieve a total return, net of fees, that exceeds the total return of the SERS Inflation Protection Custom Benchmark.

SERS' *2008 Investment Plan* targets a long-term allocation of 7.0% of assets to Inflation Protection. The passive commodity and TIPS portfolio has a long term target of 2.0% of Fund assets, the active multi-manager commodity portfolio has a long-term target of 2.5% of Fund assets, and the active diversified inflation protection portfolio has a long term target of 2.5% of Fund assets.

**Market Exposure as of December 31, 2008:** Inflation protection strategies had a \$1,474.9 million market exposure, 6.1% of the total Fund's \$24,030.8 million market value.

**Number of Investment Advisors:** SERS had contracts with three external investment advisors.

**Number of Investment Portfolios:** SERS had three Inflation Protection portfolios managed by the three investment advisors.

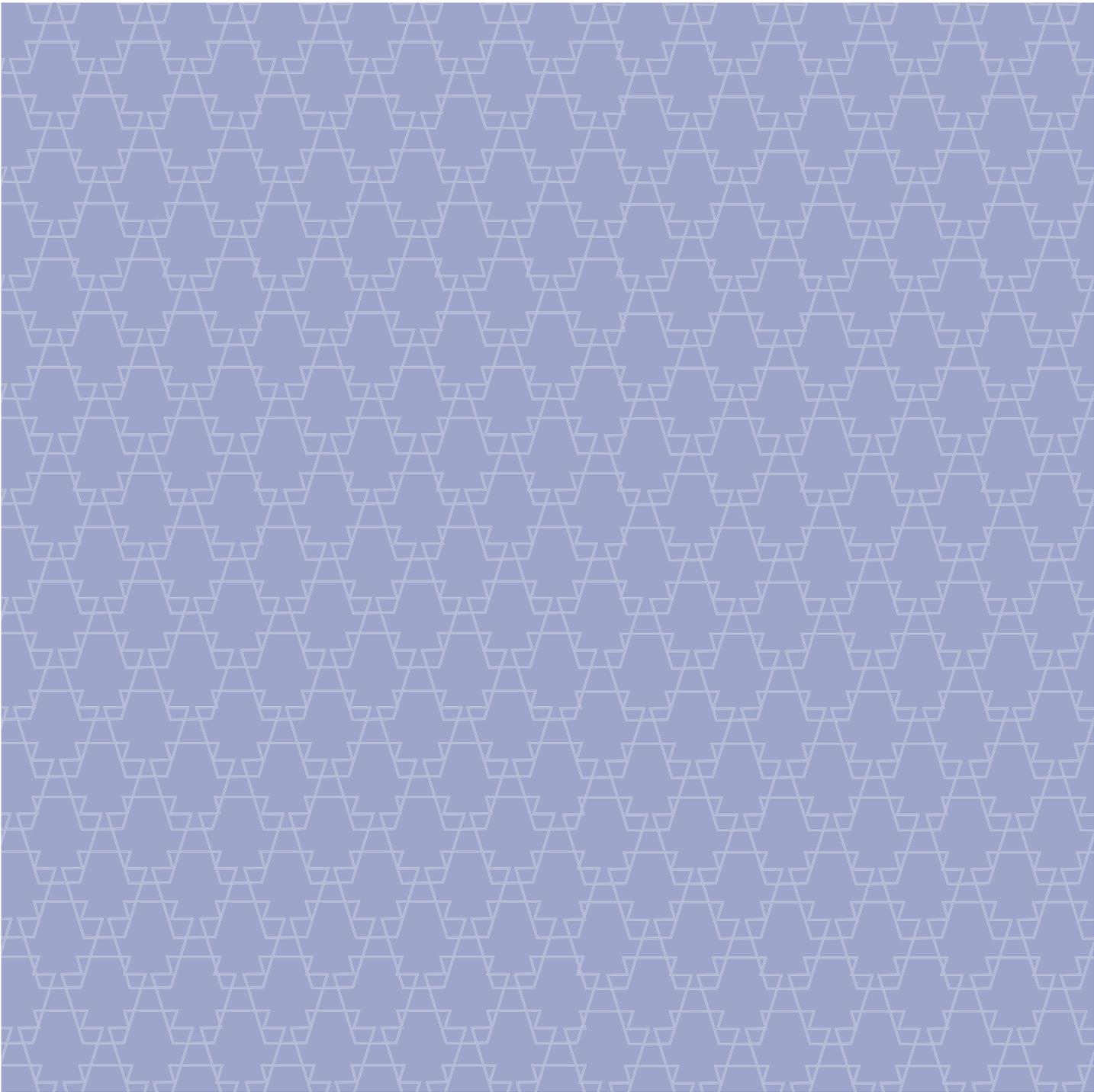
**Types of Investment Portfolios:** As of December 31, 2008, 38% of SERS' Inflation Protection allocation was invested in intermediate-duration TIPS that generate higher incremental return above typical cash instruments. These securities are typically used as collateral for commodity swaps. There was no commodity swap exposure as of year-end. Another 27% of the Inflation Protection allocation was in the actively-managed diversified inflation protection portfolio which invests in commodities, inflation-sensitive global equity and TIPS. The remaining 35% was in the multi-manager commodity product, which employs five underlying commodities managers across the various commodity sectors (energy, precious metals, industrial metals and agriculture).

# Inflation Protection Investments Summary *(continued)*

## SERS Inflation Protection Investments

		<b>*Market Exposure As of 12/31/08 (\$ millions)</b>	
	<b>Inflation Protection Investment Advisor</b>	<b>Investment Style</b>	
1.	NISA Investment Advisors	Indexed commodities and TIPS	\$563.7
2.	Wellington Management Company	Diversified inflation protection portfolio	404.4
3.	Blackstone Alternative Asset Management	Commodity fund of funds	506.9
	<b>Total</b>		<b>\$1,474.9</b>

*\*Numbers may not add due to rounding.*



# Pennsylvania Investments Summary

as of December 31, 2008 - (unaudited)

The State Employees' Retirement System's Board, employees of SERS and agents of the Board stand in a fiduciary relationship to the members and beneficiaries of the System regarding the investments and disbursements of the Fund. Subject to "prudent investor" investment responsibilities contained in the Retirement Code and the Fiscal Code, the Board has exclusive control and management of the Fund and full power to invest the assets of the Fund. The Board adopted a formal Statement of Investment Policy in 1979, which was last revised effective April 25, 2007 to reflect and incorporate subsequent legislative and policy changes governing investments. Where investment characteristics including yield, risk and liquidity are equivalent, the Board's policy favors investments that have a positive impact on the economy of Pennsylvania.

**Market Value of Pennsylvania Investments as of December 31, 2008:** SERS' assets had an unaudited market value in Pennsylvania investments of approximately \$1,311.6 million (5.5% of SERS Fund).

## SERS Pennsylvania Investments By Asset Class (\$ millions)

Asset Class	Total PA Market Value
Stocks	\$356.7
Fixed Income	24.4
Real Estate	300.4
Venture Capital	83.7
Private Equity	546.4
<b>Total</b>	<b>\$1,311.6</b>

SERS investment portfolios have historically held investments in Pennsylvania firms, as some large national firms are headquartered in Pennsylvania, including Comcast, PNC Financial Services Group, PPL Corp, Rohm and Haas Co, and H. J. Heinz Co. In addition, SERS has invested in portfolios that are designed to give emphasis to investments in Pennsylvania while meeting the fiduciary standards mentioned previously.

### Stocks

SERS' Pennsylvania stock universe is comprised of 345 publicly-traded corporations which:

- 1) name their headquarters as Pennsylvania and have Pennsylvania employees or operations; or
- 2) have Pennsylvania-based employment exceeding 25% of total corporate employment. The following are some of the top performing Pennsylvania stocks for 2008.

Emerald Advisers, Inc. of Lancaster and Mellon Capital Management Corporation of Pittsburgh actively manage portfolios principally derived from SERS' Pennsylvania stock universe. These two portfolios, plus the Pennsylvania stocks held in SERS other stock portfolios, provided a total of \$356.7 million invested in Pennsylvania stocks.

# Pennsylvania Investments Summary *(continued)*

## Top-Performing Pennsylvania Stocks

Company	Location	Return for 2008
<b>ViroPharma Incorporated</b> ViroPharma Incorporated is a pharmaceutical company committed to the commercialization, development, and discovery of new antiviral medicines. The Company is focusing on a number of ribonucleic acid virus diseases, including viral meningitis, viral respiratory infection, the common cold, respiratory syncytial virus pneumonia, and hepatitis C.	<b>Exton</b>	<b>63.98%</b>
<b>Lannett Company, Inc.</b> Lannett Company, Inc. manufactures and distributes pharmaceutical products under its own trade name and under generic names. The Company also distributes competitive pharmaceutical products manufactured by other companies. The principal products include antifungals, antacids, dermatological preparations, and analgesic sedatives.	<b>Philadelphia</b>	<b>61.81%</b>
<b>Univest Corporation of Pennsylvania</b> Univest Corporation of Pennsylvania is the parent company of Univest National Bank and Trust Co., Univest Insurance, Inc., and Univest Investments, Inc. The Company, through its subsidiaries, provides a range of banking, investments, and insurance services. Univest has offices throughout Bucks and Montgomery Counties.	<b>Souderton</b>	<b>57.21%</b>
<b>S&amp;T Bancorp, Inc.</b> S&T Bancorp, Inc. is the holding company for S&T Bank and S&T Investment Company, Inc. S&T Bank is a full service bank providing service to its customers through a network of offices located in Allegheny, Armstrong, Clarion, Indiana, Jefferson, Clearfield, and Westmoreland counties in Pennsylvania.	<b>Indiana</b>	<b>33.37%</b>
<b>Omega Flex, Inc.</b> Omega Flex, Inc. manufactures flexible metal hose. The Company's product is used in a variety of applications to carry gases within residential and commercial buildings, vibration absorbers in high vibration applications, and other types of gases and fluids in a number of industrial applications.	<b>Exton</b>	<b>30.63%</b>
<b>ESSA Bancorp, Inc.</b> ESSA Bancorp, Inc. is the holding company of ESSA Bank & Trust. The Bank attracts deposits and offers residential mortgage, construction, commercial real estate, home equity, and commercial loans.	<b>Stroudsburg</b>	<b>26.73%</b>
<b>Republic First Bancorp, Inc.</b> Republic First Bancorp, Inc. is the holding company for First Republic Bank and Republic First Bank of Delaware. The Banks offer full-service commercial banking that markets diversified financial products through full-service offices located in the Greater Philadelphia, Delaware and South Jersey areas.	<b>Philadelphia</b>	<b>26.62%</b>
<b>First Commonwealth Financial Corporation</b> First Commonwealth Financial Corporation is a bank holding company. The Company, through its subsidiaries, provides general banking business and offers a range of financial services including traditional retail banking services, such as savings, time deposits, mortgage, consumer installment, and commercial loans.	<b>Indiana</b>	<b>23.31%</b>
<b>Rohm and Haas Company</b> Rohm and Haas Company is a manufacturer of specialty chemicals. The Company manufactures acrylic polymers, consisting of adhesives, coatings, polymers, monomers, and plastic additives. Rohm and Haas' chemical specialties include ion exchange and consumer and industrial specialties. They also manufacture electronic materials and salt.	<b>Philadelphia</b>	<b>19.44%</b>
<b>InterDigital, Inc.</b> InterDigital, Inc. develops technology for advanced digital wireless telecommunications applications. The Company offers both time division multiple access and wide band code division multiple access proprietary and standards compliant digital wireless technology to customers, licensees, and companies.	<b>King of Prussia</b>	<b>17.87%</b>

# Pennsylvania Investments Summary *(continued)*

## Fixed Income

SERS had approximately \$24.4 million invested as of December 31, 2008, in corporate securities issued by Pennsylvania-based companies. These securities are held in SERS' various externally managed bond portfolios.

In 1998, the SERS Board approved the funding for the Pennsylvania Capital Fund with a \$50 million allocation committed to the program. The program commenced in March 1999 managed by Berwind Financial Group (Berwind) and PNC Equity Management (PNC). Each advisor was awarded commitments of \$25 million to be invested over four years. Both entities matched SERS' investment. The program provides debt financing to support the expansion and growth of Pennsylvania small business. The Fund seeks to lend to established, profitable companies in good financial condition with annual revenues ranging from \$10 – \$100 million. The majority of the Fund's investments had a maturity of between five and ten years. Loan amounts usually ranged from \$2 million to \$15 million. As of December 31, 2008 SERS portion of Berwind investments totaled \$4.0 million while the PNC investments had matured and all capital was returned to SERS. Most of Berwind's investments have also matured and capital distributed back to SERS. An example of SERS' investments through The Pennsylvania Capital Fund as of December 31, 2008 is an investment of \$2.15 million in redeemable preferred stock from Elite Health Solutions, Inc of Mechanicsburg. Elite Health Solutions provides portable x-ray and related mobile diagnostics services primarily at nursing homes and correctional facilities.

## Cash

SERS is one of the largest investors in the Pennsylvania State Treasury Department's Short Term Investment Pool.

## Real Estate

In 1987 SERS began investing directly in the Pennsylvania commercial real estate market and subsequently established two separate account real estate portfolios managed by Heitman Capital Management and Grosvenor Investment Management, formerly Legg Mason Real Estate Services (LMRES), with a Pennsylvania focus. The Heitman separate account originally had a requirement to invest on a best efforts basis 50% of its initial allocation within the Commonwealth while the LMRES account is focused primarily on investing within the state.

As of September 30, 2008, the SERS real estate portfolio contained 66 Pennsylvania properties totaling 10.6 million square feet ("s.f.") of office, retail, and warehouse space, and 9,921 apartment, hotel and senior housing units. The gross market value of the Pennsylvania real estate portfolio investments totaled \$1,828 million, of which SERS' ownership share was \$300.4 million. The portfolio contains numerous notable Pennsylvania real estate investments:

- **30 N. Third Street** – SERS owns a 100% interest in this major downtown Harrisburg office building, which contains 200,000 s.f. of office space. The building serves as both an investment for SERS and as SERS' headquarters, in addition to providing office space for other businesses with operations in the city.
- **Koppers Building** – SERS acquired this 356,439 s.f. 34-story landmark office building located in downtown Pittsburgh in May 1997.
- **Park Ridge One and Two** – These two five-story suburban Pittsburgh office buildings, which total 206,279 s.f., were transferred from SERS mortgage portfolio in the first quarter 1999.
- **General Residential Holdings** – Under the oversight of Grosvenor, SERS has invested with a local developer in eight separate land holdings in the Philadelphia area. To date, six of the parcels have been sold.
- **Lehigh Valley Industrial** – In August 1998 SERS began investing in the purchase of prime industrial parcels located in the Lehigh Valley area, with the guidance of Grosvenor and a local operator.
- **Kinzua Management Unit** – In July 1998 SERS invested in 18,602 acres of hardwood timberland located in seven Pennsylvania counties and one New York county, all within the Allegheny region. Subsequently, in the first quarter of 1999 an additional 2,197 acres of Pennsylvania timberland was purchased. The existing SERS timberland manager, Forest Investment Associates, manages these holdings.

# Pennsylvania Investments Summary *(continued)*

## Real Estate Separate Account Pennsylvania Properties as of September 30, 2008\*

	<b>Property</b>	<b>Location</b>	<b>Description</b>	<b>Net Market Value of SERS (\$ millions)</b>	<b>Manager</b>
1.	30 North Third Street	Harrisburg	10-story office building totaling 200,000 s.f.	\$22.4	Heitman Capital Management
2.	1601 Vine Street	Philadelphia	Retail, 266 residential units, and a 250-room hotel	9.6	Grosvenor Investment Management
3.	Koppers Building	Pittsburgh	356,000 s.f. office building	19.5	Grosvenor Investment Management
4.	General Residential Holdings	Chester County	Residential land development	7.0	Grosvenor Investment Management
5.	Lehigh Valley Industrial	Lehigh Valley	Industrial land development	2.5	Grosvenor Investment Management
6.	Park Ridge One & Two	Pittsburgh	Two office buildings totaling 206,000 s.f.	11.7	Grosvenor Investment Management
7.	Toll Brothers Realty Trust	Huntington Valley	Private REIT	45.2	Grosvenor Investment Management
8.	Toll Brothers Realty Trust II	Huntington Valley	Private REIT	23.4	Grosvenor Investment Management
9.	Alcoa Business Center	Pittsburgh	229,000 s.f. office building	15.6	Grosvenor Investment Management
10.	Dewey Homes Gty	Philadelphia	Gty to Bank for land	12.1	Grosvenor Investment Management
11.	Station Square	Lansdale	348 multifamily units	16.9	Grosvenor Investment Management
12.	Courtyard by Marriott	Collegeville	130 room hotel	10.7	Grosvenor Investment Management
13.	Heritage of Green Hills	Reading	Development of 619 unit senior housing facility	25.2	Grosvenor Investment Management
14.	Windlestrae Residential	New Hanover	Residential development	6.3	Grosvenor Investment Management
15.	Malvern Courtyard	Malvern	Land for future hotel development	9.5	Grosvenor Investment Management
16.	Kinzua Management Unit	Various PA Counties	Timber	64.0	Forest Investment Associates
<b>Total</b>				<b>\$301.6</b>	

*\*Real estate market values and detailed property data lags by one quarter due to the timing of the receipt of private market valuations and information. "Separate Account" denotes assets that are owned by entities controlled by SERS.*

*Net Market Value is exclusive of property leverage. Grosvenor also uses portfolio debt which equaled \$38 million at 9/30/08.*

# Pennsylvania Investments Summary *(continued)*

## Alternative Investments

SERS' Venture Capital Program dates back to 1985. Initially the program targeted a 1% allocation to venture capital with a focus to invest with managers located in Pennsylvania or with managers with a Pennsylvania investment mandate. Over its 23 year life the program has grown to include national and international based private equity and venture capital managers, and the target allocation to alternative investments has grown to 14%. Although the program has become more global, the number of managers investing in companies that impact Pennsylvania via income tax revenue and/or corporate tax revenue continues to comprise a meaningful portion of the program. As of December 31, 2008, 56 of SERS' active managers held investments impacting the state. SERS' market values of Pennsylvania-based and non-PA based companies impacting the Commonwealth are \$163 million and \$467 million, respectively. This equates to 10.8% of the alternative investment program market value.

As of December 31, 2008, SERS' venture capital and private equity partnerships invested in 97 Pennsylvania companies employing approximately 15,920 employees, and representing a payroll of \$1.1 billion. In addition, partnerships in which SERS participates invested in 170 companies domiciled outside Pennsylvania but employing 25,400 Pennsylvania citizens with payrolls of \$1.0 billion. These employment rates are expected to generate millions in state income tax revenue.

The number of employees and payroll reported from period to period is often volatile. This is due to several reasons, one of which is the nature of the investments. Venture capital investments often begin with a handful of employees and grow the staff as the companies progress, while investments in companies facing some type of impediment often involve cost cutting measures. These reported numbers change dramatically as companies are added or deleted from the portfolio. Other reasons for the changes in the numbers include inconsistent reporting or lack of reporting by the portfolio companies to the general partners. Additionally, the report does not differentiate between permanent full time positions created and seasonal or part-time positions. Therefore, there may be a significant increase in the number of Pennsylvanians employed with a minimal increase in the total payroll if a company such as Blockbuster, which primarily employs minimum wage, part-time employees, is held in the portfolio. This highlights a few of the causes for the volatile nature of the numbers, but is by no means all inclusive.

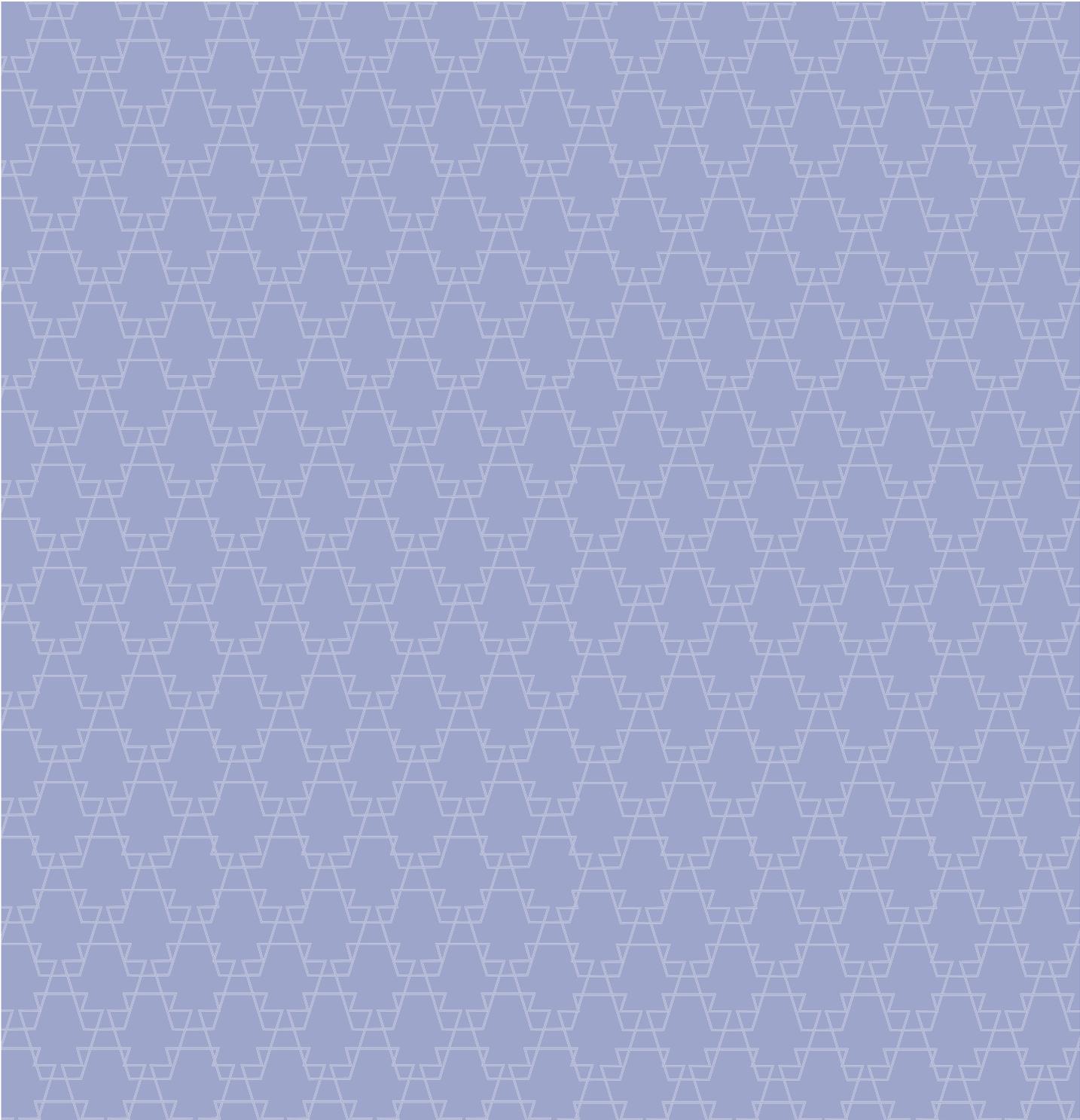
Although the Board's fiduciary duty is to SERS' members and beneficiaries, investments in Pennsylvania provide an ancillary and subordinate benefit to the state's economy as indicated above. The investment policy acknowledges that such benefit, derived from investments in Pennsylvania-based companies, or firms employing Pennsylvanians, should be considered after other primary fiduciary investment characteristics are satisfied.

The following companies are examples of Pennsylvania investments funded by SERS' private equity and venture capital partnerships:

- **Atlantic Broadband Group** (ABRY IV, ABRY Mezzanine, Oak Hill Capital) Atlantic Broadband is a cable operator providing video, broadband internet, and telephony services to customers in Pennsylvania, Florida, South Carolina, Maryland, West Virginia, Delaware, and New York. The company has 273 employees in Pennsylvania with a total payroll of nearly \$10 million.
- **Catapult Learning** (JMI Equity Fund VI) Based in Philadelphia, Catapult Learning is the leading provider of outsourced educational solutions to U.S. private schools funded by federal and state government programs. Services include supplemental reading and math instruction, professional development for classroom teachers and administrative personnel, special education and other educational support services. The company serves over 100,000 students annually in 110 school districts in 16 states and the District of Columbia. There are 260 employees in Pennsylvania with a payroll of \$10 million.
- **CyOptics** (Birchmere Ventures III, TL Ventures V) A full-line supplier of high-speed optical chips and components for broadband access, metro, and long-haul communications systems. CyOptics has chip fabrication operations in Lehigh Valley, PA and employs 215 Pennsylvanians with a total PA payroll of \$14.3 million.
- **Five Below, Inc** (ABRY III) Five Below, headquartered in Philadelphia, is a retailer of extreme-value merchandise to the pre-teen and teen market. They operate 67 stores in a five-state region. Five Below employs 440 Pennsylvanians whose annual salaries total \$4 million.

## Pennsylvania Investments Summary *(continued)*

- **LiquidHub, Inc** (NewSpring Ventures II) LiquidHub, headquartered in King of Prussia, is a technology consultant and systems integrator delivering high-end IT solutions. These solutions include strategy consulting, application development, data and infrastructure management, staff augmentation, and managed services. The company employs 372 Pennsylvania residents earning total annual salaries of \$36 million.
- **VWR** (Madison Dearborn Capital Partners V, New York Life Capital Partners III) Headquartered in West Chester, Pennsylvania, VWR International, formerly a Merck KGaA subsidiary, distributes more than 750,000 different laboratory products. These goods range from chemicals to lab instruments to protective clothing; suppliers include Applied Scientific, Carl Zeiss, Duracell, Kimberly Clark, and Welch Allyn. The goods are sold to more than 250,000 customers in Europe and North America. Other services include training, technical support, and supply chain systems integration. The company employs 650 Pennsylvanians with total PA payroll of \$39 million.



# Women/Minority Investment Advisor and Broker Report

as of December 31, 2008 - (unaudited)

## Investment Advisors

The following five women or minority-owned firms were under contract with SERS to provide investment advisory services as of December 31, 2008.

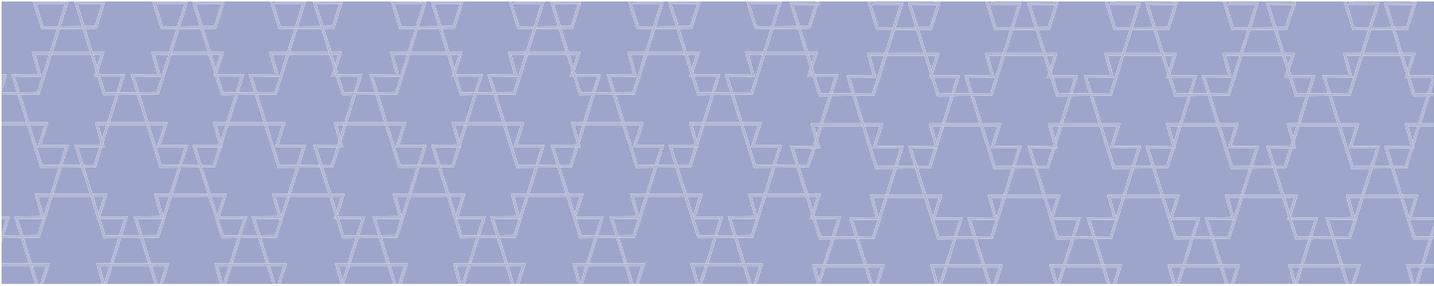
Firm	Status	SERS Assets Under Management
Fairview Capital I & II	Minority Woman-Owned	\$20.0 million (committed) (\$19.9 million actually funded)
Hawkeye Partners	Woman-Owned	\$75.0 million (committed)
Pacific Alternative Asset Management Co.	Woman-Owned	\$1,469.7 million (market value)
Rock Creek	Minority Woman-Owned	\$651.0 million (market value)
Taplin, Canida & Habacht, Inc.	Minority Woman-Owned	\$100.3 million (market value)

## Brokers and Brokerage Commissions

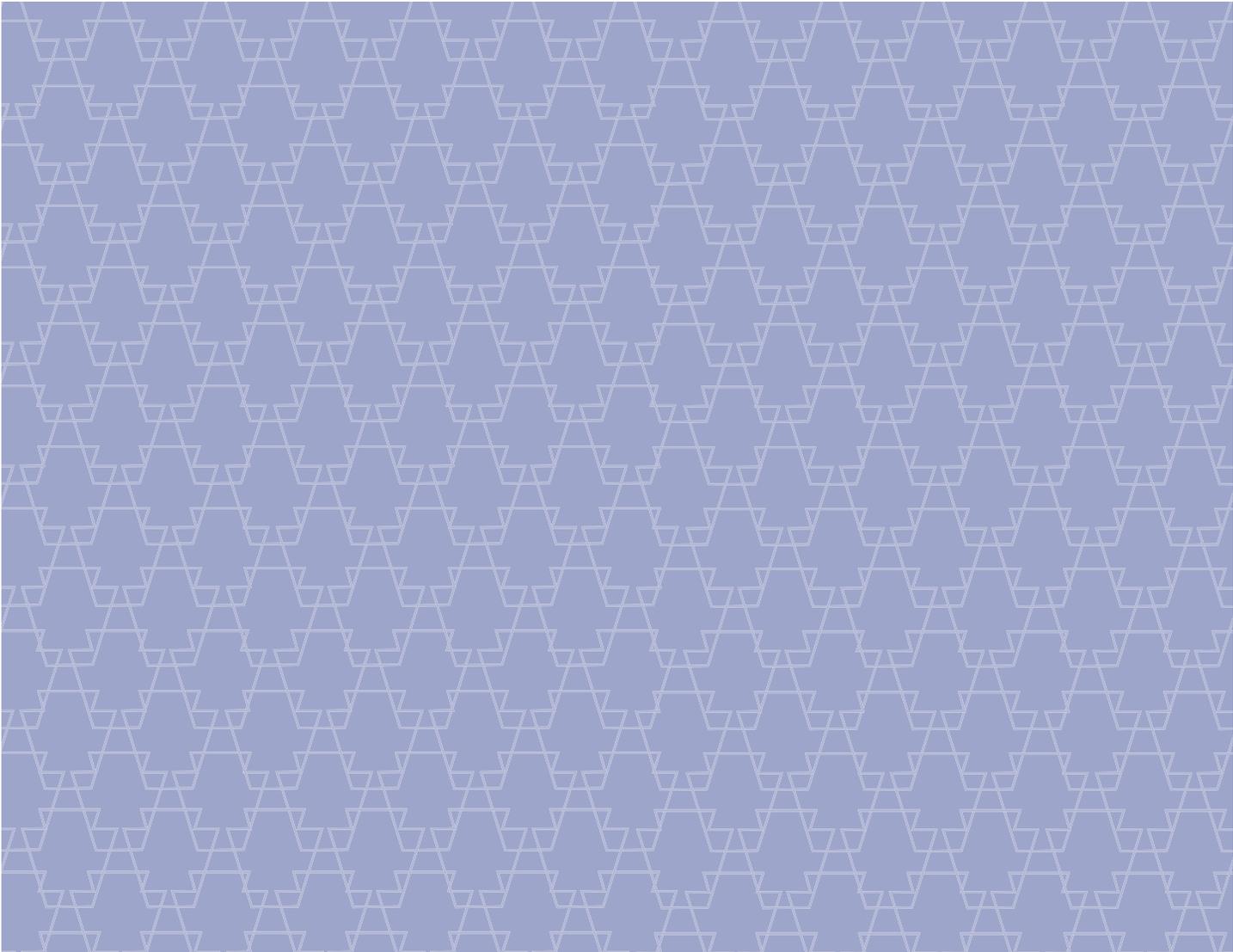
SERS's external investment advisors utilized the following minority-owned brokerage firms during calendar year 2008.

Minority commissions totaled \$534,227 for the year. Of this amount, international stock managers had \$216,402 of commissions credited to minority brokers. The SERS Board has a policy of targeting 5%–10% of domestic stock commissions to be done with minority brokers. This year SERS domestic stock managers directed approximately 10% of their trades through minority brokers. In addition, although not included in the Board mandate, other SERS advisors are encouraged to trade through minority brokers. Last year fixed income managers traded \$74.1 million of securities through minority brokers.

Firm	SERS Commissions
C L King	\$1,820
Cabera	11,552
Castle Oak	7,862
East West	75,708
Guzman & Company	1,881
Jackson Partners	1,899
JAK Direct	932
Loop Capital	3,594
M.R. Beal	30,388
Magna Capital	5,510
Melvin	6,545
Mischler Financial Group	88,508
Mogavero Lee & Co	12,066
Montrose Securities	5,489
Pacific American	18,624
Screaming Eagle Trading	20,437
Selsia Securities	16,465
Sturdivant & Co.	208,079
Williams Capital Group	16,868
<b>Total Minority Commissions</b>	<b>\$534,227</b>



## Deferred Compensation Program 12



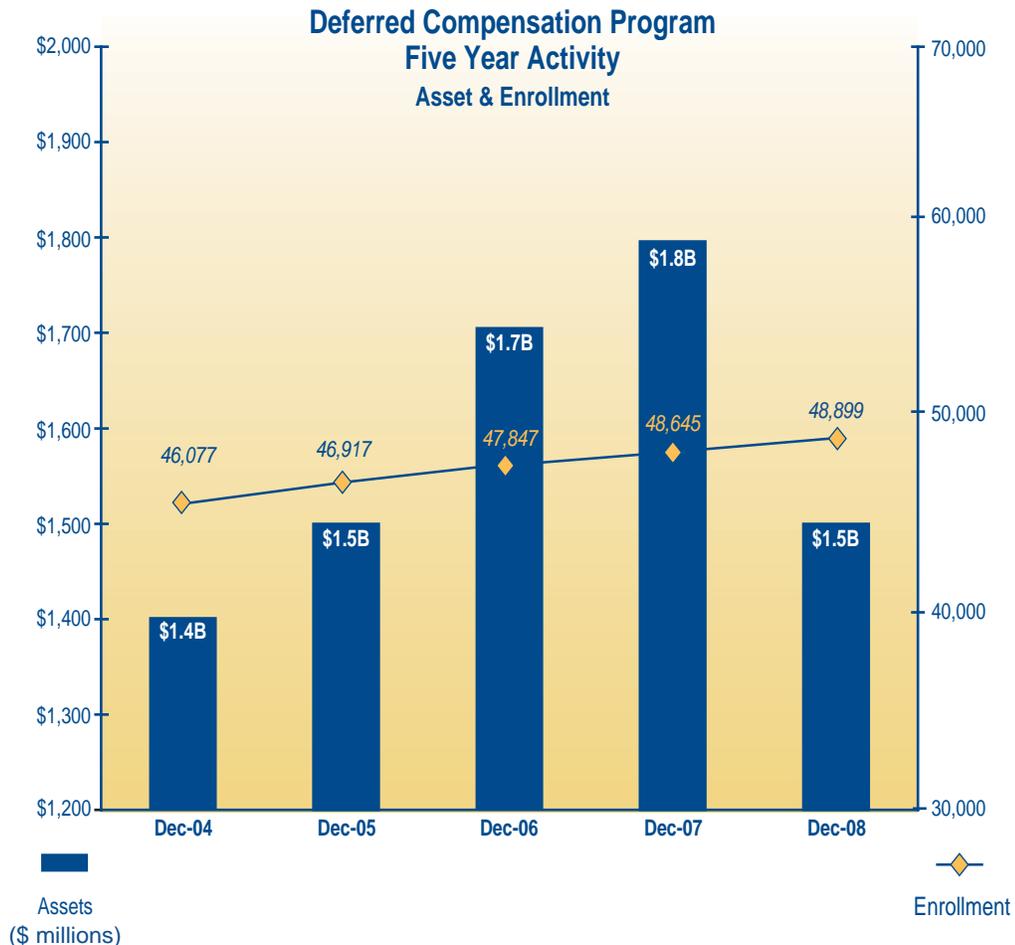
# Deferred Compensation Program

## Program History

Act 1987-81 assigned to the State Employees' Retirement Board (Board) the responsibility to establish and monitor a Deferred Compensation Program (Program) for Commonwealth officers and employees, through which participants may voluntarily build retirement savings by deferring a portion of salary to selected investment options. The Program is established as a trust, and is administered in accordance with Internal Revenue Code Section 457(b). Through the Request for Proposal process, the Board selected Great-West Retirement Services as Third Party Administrator (TPA) of the Program. The duties of the TPA are to maintain individual participant records, market the Program to participants, and counsel the members about the Program's benefits. The core investment options are selected by the Board, and are independent of the TPA's functions.

## Growth of the Program

Over the past five years, the Program's assets have increased in value from \$1.375 billion to approximately \$1.526 billion. The sharp drop in assets from \$1.8 billion in 2007 to \$1.5 billion in 2008 can be attributed to the downturn in the financial markets as participation in the program remained steady. As of December 31, 2008, there were 33,602 active and 15,297 inactive participants in the Program. The amount of annual participant deferrals has ranged from \$136 million in 2004 to \$129 million in 2008. An exception in that period was in 2007, where deferrals were \$160 million. This was attributed to the large number of participant retirements in June 2007 that utilized the Program's special catch-up feature. Benefit payments to participants increased over that same time span, from \$36 million in 2004, to \$48 million in 2008. The chart below depicts the Program's asset and participation levels over the past 5 years.



# Deferred Compensation Program *(continued)*

## Program Highlights

The Program provides participant assistance via individual and/or group counseling sessions with the eligible employee, at the employees' work site. The TPA has established a local walk-in office in the Harrisburg downtown area. A toll free telephone service with counselors is also available to offer personal assistance. A telephone Voice Response Unit can be accessed at any time to allow participants to check on their account balance, transfer funds among different investment options or inquire about other Program features. The participants may also access the Program's Web site to view their most recent investment position, to make future allocation changes, to transfer among investment options and to update beneficiary information. In January 2009, the Program began to offer managed accounts to its participants. Managed accounts are personalized investment portfolios put together from among the plan's investment options for participants who want a professional to do the investing for them.

