

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: September 22, 2011

SUBJECT: Proposed Revisions to the Investment Policy Statement, Objectives, and Guidelines

TO: Members of the Board

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

At the October Finance Committee meeting, we will ask the Committee to adopt the Investment Policy Statement, Objectives, and Guidelines (IPS), as revised, as well as changes to Addenda I, Q, and Q1.

Staff and Wilshire recommend the following changes in Exhibits B and C of the IPS:

- Exhibit B (immaterial change): Change the allocation in Global Fixed Income (which includes the U.S.) to Non-U.S. Developed Markets Fixed Income. Since we already have a direct allocation to U.S. Fixed Income, we felt it was appropriate to have dedicated non-U.S. fixed income exposure.
- Exhibit C (material changes):
 - Change the U.S. Fixed Income benchmark from the Barclays Capital U.S. Universal Index to the Barclays Capital U.S. Aggregate Bond Index. The proposed change is from a lower quality index (that includes lower quality instruments such as high yield) to a higher quality index where all of the issues are investment grade. This change was made since staff felt that we had enough high yield credit in the high yield allocation. However, managers will still be able to opportunistically invest in non-investment grade credit.
 - Change the Non-U.S. Developed Markets Fixed Income Index from the Barclays Capital Multiverse Index to the Barclays Capital Global Aggregate GDP-weighted Developed Market ex.-U.S. Index. The Multiverse is an index that includes both the Global High Yield Index and the Global Aggregate Index. The Global Aggregate is a market-value weighted index, meaning that if the country issues a lot of debt, the index weight will be higher. The Global Aggregate GDP-weighted index proposed weights the countries in the index by the size of their economy, not the total amount of outstanding debt and borrowing. In addition, the new index does not have any non-investment grade debt.
 - Change the Emerging Markets Fixed Income Index from the JPMorgan Government Bond (GBI EM) Global Diversified (USD Unhedged) Index to the Barclays Capital EM Local Currency – Government – Market Value

Weighted (Unhedged) – 10% Country Cap Index. This change is proposed to bring all of the indexes used by PSERS under one index provider in fixed income which allows us to better understand our overlaps and gaps in our indexes across the fixed income allocation. The Barclays index is broader (20 countries vs. 15 countries in the JP Morgan index) and it caps the exposure to any single country to 10% of the index so it is more diversified.

For the fixed income addenda I, Q, and Q1, we changed all of their performance objectives to provide for returns in excess of 50 basis points and to do so while generating an information ratio of 0.40 or better. In addition, the benchmarks were changed on each of these addenda to match the changes described above. Finally, addendum Q had some additional changes to permit the investment manager to take outright long or short positions in currencies subject to certain limitations described in section D of their guidelines.

Blacklined copies of the changes to each guideline have been included in the package for your review.

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