I. OBJECTIVES

This actively managed Treasury Inflation Protection Securities (TIPS) portfolio will consist primarily of fixed income securities and cash equivalents. The objectives of this portfolio are:

1. to generate positive excess returns of 30 bps or more annually versus the Barclays Capital U.S. TIPS Index (Series L) (Index); and,
2. to generate those excess returns with an Information Ratio of 0.30 or greater over a rolling 3-year period.

II. PORTFOLIO RISK MANAGEMENT

The Board’s expectations are that this portfolio be actively managed within the spirit of a Treasury Inflation Protection Securities mandate. Within this framework, the following are the portfolio risk constraints under which the manager is required to operate:

A. Interest Rate Risk

The effective or option-adjusted duration of the portfolio must range from zero to no more than 0.50 years in excess of the Index, as adjusted for allowable leverage.

B. Spread Risk

The effective or option-adjusted spread duration of the portfolio must be not greater than 0.75 years, as adjusted for allowable leverage.

C. Credit Risk

1. The weighted-average credit rating of the portfolio must be Aa2/AA or better.
2. Only securities rated Baa3/BBB- or better are acceptable.

Note: Credit ratings shall include ratings issued by Moody’s, Standard & Poor’s, and Fitch Investor Service (hereafter referred to as the “Credit Rating Agencies”). If each of the Credit Rating
Agencies assigns a credit rating, the credit rating will be the middle of the three ratings (for example, if Moody’s rates a security Baa2, S&P rates a security BB+, and Fitch rates a security BBB-, the middle credit rating would be considered BBB- by Fitch). If only two of the three Credit Rating Agencies assign a credit rating, the credit rating will be the lower of the two. If only one of the Credit Rating Agencies assigns a credit rating, that credit rating will apply.

The rating for the internally-managed PSERS Short-Term Investment Pool is considered Aaa/AAA for credit rating purposes.

D. Currency Risk

1. At no time may the manager’s portfolio invest in securities denominated in foreign currencies.

E. Sovereign Risk

1. No more than 20% of the portfolio may be invested in dollar-denominated non-U.S. government securities and dollar-denominated bonds issued by non-U.S. domiciled entities.
2. No more than 10% of the portfolio may be invested in dollar-denominated securities and bonds from any individual non-U.S. country other than the U.K., Japan, Canada, Germany, or France.
3. Only investments in countries with a sovereign rating of Aa/AA or better are acceptable

F. Concentration Risk

1. No more than 7% of the portfolio at market value may be invested in the securities of any issuer (excluding issues or issuers fully guaranteed by the U.S. Government and its agencies rated Aaa/AAA and securities issued by non-US. Governments or supranational issuers).
2. No more than 30% of the portfolio at market value may be invested in nominal bonds.
3. No more than 20% of the portfolio at market value may be invested in corporate bonds.
4. Non-convertible preferred stock and convertible bonds (bonds convertible into common stock) are prohibited.
5. No more than 20% of the portfolio at market value may be invested in asset backed securities (defined as financial instruments collateralized by one or more types of assets including mortgages, receivables, loan paper, etc.). This limit does not apply to U.S. or U.S. agency guaranteed asset backed securities.
G. Derivative Counterparty Risk

1. The commercial and investment banks used for swaps, approved OTC futures, or approved OTC options, must be rated A3 or better by Moody’s Counterparty Ratings, (if not rated by Moody’s, then rated A- or better by Standard and Poor’s Counterparty Ratings or rated B or better by Fitch’s Bank Individual Ratings).

2. Net forward/spot contracts, futures contracts, and option exposures to any counterparty will not exceed 20% of the market value of the portfolio. Exposure is measured in net U.S. dollar equivalent terms (offsetting contracts will be netted for this purpose).

3. Counterparty limits will not be applied to listed futures and options.

H. Liquidity Risk

Positions in letter stock, private placements (excluding 144A securities), physical real estate, physical commodities, and any other positions unable to be liquidated promptly without severe market impact are prohibited.

III. DERIVATIVES

1. The portfolio is permitted to establish and maintain long and short positions in:
   a. Listed options on fixed income futures;
   b. Fixed income forward commitments, including mortgage dollar rolls; and
   c. Listed fixed income futures contracts.

2. The portfolio is permitted to use TIPS total return swaps for an amount of up to 40% of the total market value of the portfolio provided that an amount equal to or greater than the swap’s first leg (number of index units * price) is held in PSERS’ Internally-managed Short-Term Investment Pool or a LIBOR-Plus short-term investment pool sub-account.

Fixed income derivatives may only be used to manage interest rate risk.

IV. LEVERAGE

The manager is permitted to leverage the portfolio using TIPS total return swaps up to 3:1. Swaps held for the purpose of leveraging the portfolio shall be held in a separate sub-account of the manager to allow for measurement of the performance of the primary, unleveraged portfolio.
V. AMENDMENTS

A written request to the Chief Investment Officer (CIO) and Deputy Chief Investment Officer (DCIO) should be made if the manager believes that these portfolio risk constraints significantly limit the ability of the manager to achieve the objectives of the portfolio. A written amendment will be issued from the CIO, or the DCIO in the CIO's absence, if the request is approved.