



COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

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Public Commodities Policy

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## TABLE OF CONTENTS

|              |   |          |
|--------------|---|----------|
| <b>I.</b>    | <b>SCOPE</b> .....                      | <b>3</b> |
| <b>II.</b>   | <b>PURPOSE</b> .....                    | <b>3</b> |
| <b>III.</b>  | <b>ROLES AND RESPONSIBILITIES</b> ..... | <b>3</b> |
| <b>IV.</b>   | <b>INVESTMENT PHILOSOPHY</b> .....      | <b>3</b> |
| <b>V.</b>    | <b>ALLOCATION</b> .....                 | <b>4</b> |
| <b>VI.</b>   | <b>PERMISSIBLE INSTRUMENTS</b> .....    | <b>4</b> |
| <b>VII.</b>  | <b>PERFORMANCE OBJECTIVES</b> .....     | <b>4</b> |
| <b>VIII.</b> | <b>RISK MANAGEMENT</b> .....            | <b>4</b> |
|              | A. Active Risk .....                    | 4        |
|              | B. Liquidity Risk .....                 | 5        |
|              | C. Sector Risk .....                    | 5        |
|              | D. Delivery Risk .....                  | 5        |
|              | E. Currency Risk .....                  | 5        |
|              | F. Manager Risk .....                   | 5        |
|              | G. Derivatives Risk .....               | 5        |
|              | H. Counterparty Risk .....              | 5        |
|              | I. Leverage Risk .....                  | 6        |
|              | J. Proxies .....                        | 6        |
| <b>IX.</b>   | <b>MONITORING AND REPORTING</b> .....   | <b>6</b> |

### Revision History

Public Commodities Policy  
Established

March 6, 2020



## **I. SCOPE**

This Policy applies to investments in the Public Commodities asset class within the Pennsylvania Public School Employees' Retirement System ("PSERS") Defined Benefit Fund ("The Fund").

## **II. PURPOSE**

This Policy provides the broad strategic investment framework for managing investments in the Public Commodities asset class.

## **III. ROLES AND RESPONSIBILITIES**

Roles and Responsibilities related to this Policy are identified within PSERS' Investment Policy Statement ("IPS").

## **IV. INVESTMENT PHILOSOPHY**

PSERS seeks to diversify assets by obtaining broad exposure to publicly traded commodities markets. Commodity investments consist of energy, precious metals, industrial metals, and agricultural. The prices of commodities are determined primarily by near-term events in global supply and demand conditions and are positively related with both the level of inflation and changes in the rate of inflation. Public Commodities play a strategic role within the Fund, by providing a hedge against unanticipated inflation and diversification benefits. To maintain diversification within the asset class, the Fund pursues an investment strategy across all key commodities and across investment styles.

## **V. ALLOCATION**

The IPS details targets and permissible ranges around targets for investments in the following Public Commodities sub-asset classes:

- Commodities – Diversified exposure to energy, precious metals (including Gold), industrial metals, and agricultural
- Gold

The asset class may include both passively and actively managed strategies, and internally and externally managed strategies. Active management seeks to produce risk-adjusted returns in excess of the benchmark, net of fees. Passive management aims to replicate an index at minimal cost and minimal Tracking Error.



## VI. PERMISSIBLE INSTRUMENTS

Public Commodities assets may be invested in instruments that provide publicly traded commodities returns. Instruments used may be exchange-traded or non-exchange-traded and may be physical securities or derivatives, and leverage may be employed. In the case of Gold, the instruments may include physical gold (bullion). Additional security type constraints may be applied in investment manager portfolio guidelines.

## VII. PERFORMANCE OBJECTIVES

The Public Commodities asset class is designed, in aggregate, to match or outperform the respective sub-asset class benchmarks over the long term, while operating within risk parameters outlined in this Policy.

The performance benchmark for each sub-asset class is shown in the IPS. A manager within the sub-asset class may be assigned a benchmark that is different than the sub-asset class benchmark shown in the IPS if the manager's mandate is to one or more specific regions, commodity sectors (e.g., industrial metals), and/or other benchmark component.

## VIII. RISK MANAGEMENT

The primary approach to managing risk is to monitor key quantitative and qualitative risk factors relative to risk benchmarks while continuing to pursue active returns. The following sub-sections identify the key areas with risk management parameters.

### A. Active Risk

Active Risk or Tracking Error is a statistical measure of the potential variability of a portfolio's return relative to that of the assigned benchmark. The following table provides the Tracking Error ranges, in basis points, for the Public Commodities sub-asset classes:

| <b>Sub-Asset Class</b> | <b>Benchmark</b> | <b>Range</b> |
|------------------------|------------------|--------------|
| <u>Commodities</u>     | *                | 0-400        |
| <u>Gold</u>            | *                | 0-50         |

\* Benchmark used for risk purposes is the same as the IPS performance benchmark for the lookback period.



## **B. Liquidity Risk**

Investment structure impacts liquidity. Therefore, consideration is given to separate accounts and internally managed accounts over commingled accounts, given their greater control and transparency.

## **C. Sector Risk**

The Commodities sub-asset class is expected to be broadly diversified and may have deviations from the benchmark's sector weightings. The Tracking Error constraints or passive index investment mandates and the use of broad-based benchmarks will have the effect of limiting sector concentration. As it comprises just one commodity type, the Gold sub-asset class will not be diversified.

## **D. Delivery Risk**

In commodities investing, there is a risk of a commodity being delivered to the Fund upon the expiration of commodities futures contracts. With the exception of Gold, all investments will be managed and monitored so as to not result in physical delivery. With Gold, both in the Commodities sub-asset class and the Gold sub-asset class, it may be prudent and diversifying to accept delivery, and hold and store physical gold.

## **E. Currency Risk**

Currency risk will be managed in accordance with the Currency Hedging Policy.

## **F. Manager Risk**

The allocation to a single active External Manager mandate is limited to 2.5% of the Total Fund's Economic Exposure, as defined in the Leverage Policy. The CIO shall have discretion on the timing of reducing any External Manager portfolio exceeding the limit. However, the CIO is not permitted to allocate additional exposure to those portfolios currently above the limit.

## **G. Derivatives Risk**

Derivatives usage and limitations as well as risk management are specified in manager guidelines and shall comply with the Derivatives Policy.

## **H. Counterparty Risk**

Counterparty risk will be as prescribed and evaluated in the Derivatives Policy.



### **I. Leverage Risk**

Leverage usage and limitations as well as risk management are specified in manager guidelines and shall comply with the Leverage Policy.

### **J. Proxies**

Proxy votes are considered assets of PSERS. All proxies received shall be voted in accordance with the Proxy Voting Policies.

## **IX. MONITORING AND REPORTING**

See Monitoring and Reporting section of the IPS.