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COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Fixed Income Policy



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Revision History

Public Fixed Income Policy Established	March 6, 2020
Policy Revised	March 5, 2021



I. SCOPE

This Policy applies to investments in the Public Fixed Income 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 Fixed Income 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 fixed income markets. Public Fixed Income plays a strategic role within the Fund in a variety of ways. Nominal bonds serve as a hedge against lower inflation and weak economic growth, produce current income in the form of periodic interest payments, and provide liquidity to meet the Fund's obligations. Inflation protected bonds serve as a hedge against higher inflation and weaker economic growth and provide liquidity. Credit-related securities such as emerging market debt and public high yield bonds generate higher current income relative to investment grade debt and tend to do well when economic growth is stronger than expected. To maintain diversification within the asset class, the Fund pursues a global investment strategy across regions, sectors, maturity segments, credit quality, and investment styles.

V. ALLOCATION

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

Investment Grade

- U.S. Core Fixed – U.S. investment grade credit and government related securities
- Non-U.S. Developed Markets – Non-U.S. investment grade credit and government related securities
- U.S. Long Treasury – long term United States government securities

Credit-Related

- Emerging Markets Debt – Investment grade and non-investment grade credit and government securities of emerging markets countries issued in either U.S. dollar or local currencies
- Public High Yield Bonds – Non-investment grade credit and government securities



Inflation Protected

- U.S. Inflation Protected – U.S. government related securities tied to inflationary measures
- Non-U.S. Inflation Protected – Non-U.S. government related securities tied to inflationary measures

The Public Fixed Income asset class may include 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 Fixed Income assets may be invested in instruments that provide fixed income returns. Instruments used may be exchange-traded or non-exchange-traded and may be physical securities or derivatives (see Derivatives Policy). Additional security type constraints may be applied in investment manager portfolio guidelines.

VII. PERFORMANCE OBJECTIVES

The Public Fixed Income 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, sectors, maturity segments, credit quality segments, 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 Fixed Income sub-asset classes:



Sub-Asset Class	Benchmark	Range
<u>Investment Grade</u>		
U.S. Core Fixed	*	0-300
Non-U.S. Developed Markets	*	0-300
U.S. Treasury	*	0-50
<u>Credit Related</u>		
Emerging Markets Debt	*	0-800
Public High Yield	*	0-700
<u>Inflation Protected</u>		
U.S.	*	0-250
Non-U.S.	*	0-800

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

B. Interest Rate Risk

Interest rate risk will be managed by limiting the option-adjusted duration of fixed income portfolios. Limitations as well as risk management are specified in manager guidelines. In addition, imposing a Tracking Error discipline limits interest rate risk.

C. Credit Risk

Credit risk will be managed by limiting the non-investment grade securities held in the fixed income portfolios. Non-investment grade securities are defined as securities rated below Baa3 by Moody's and securities rated below BBB- by S&P and Fitch. If a majority of Moody's, S&P, or Fitch rate a security non-investment grade, it will be considered non-investment grade. Securities that have not been rated will be considered non-investment grade. Limitations as well as risk management are considered, and as deemed relevant, specified in manager guidelines. In addition, imposing a Tracking Error discipline limits credit risk.

D. 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.



E. Currency Risk

Non-US Developed Markets, Emerging Markets Debt, and Non-U.S. Inflation Protected strategies use non-U.S. dollar denominated instruments which creates foreign currency risk. Managers of these strategies generally do not hedge currency risk. Currency risk will be managed by PSERS in accordance with the Currency Hedging Policy.

F. Sector Risk

The sub-asset classes are expected to be broadly diversified and may have deviations from the benchmark sector weightings. The Tracking Error constraints, in conjunction with the use of broad-based benchmarks, will have the effect of limiting sector concentration.

G. Manager Risk

The allocation to a single active External Manager mandate is limited to 10% 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.

H. Derivatives Risk

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

I. Counterparty Risk

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

J. Leverage Risk

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

IX. MONITORING AND REPORTING

See Monitoring and Reporting section of the IPS.