

# Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: April 17, 2009

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

TO: Members of the Finance Committee

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

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At the April Finance Committee meeting, we will ask the Committee to adopt the proposed changes to Exhibit C – Policy Index of the Investment Policy Statement, Objectives, and Guidelines as well as portfolio specific guidelines for U.S. and non-U.S. equity mandates, as revised (hereafter referred to as addendums).

The more substantive changes to Exhibit C and the Addenda have been black lined for your convenience in reviewing the changes. Substantive changes to the Addenda are based on suggestions made by Investment Office Staff. If you have any questions or comments regarding these changes, please contact me at 717-720-4703.

## **Exhibit C – Policy Index**

1. Changed the policy benchmark for public market equity exposure from a mix of the DJ Wilshire 5000 and the MSCI ACW ex. U.S. Investable Market Index to the MSCI ACW Investable Market Index. The new benchmark is a global benchmark that includes large, mid, and small capitalization U.S. and non-U.S. equity securities. Staff re-evaluated the indexes used after Dow Jones and Wilshire terminated their partnership and created two different U.S. equity benchmarks. We have adopted a global approach to investing our public market equity exposure and have weighted our allocation accordingly (55% non-U.S.; 45% U.S.). There is no material difference between the performance of the DJ Wilshire 5000 and the MSCI U.S. Index, and we have already adopted the MSCI Index series for all of our non-U.S. equity exposure. Finally, this change in benchmark will not require any material changes to our existing asset allocation or underlying portfolio structures.
2. Changed the policy benchmark for high yield and opportunistic fixed income from the Credit Suisse High Yield Index to the Barclays Capital U.S. High Yield Index. We currently use the Barclays Capital Index series

for both U.S. and global fixed income portfolios. A transition to the Barclays Capital U.S. High Yield Index would provide consistency in the fixed income benchmarks we use. In addition, we are currently using the Barclays Capital U.S. High Yield Index in BlackRock Solutions for portfolio risk measurement. The returns for the two indexes for the one-year ended January 31, 2009 were only 1 basis point different (0.01%) while the risk of the two indexes as measured by differences in sector allocations, spread duration, and standard deviations was comparable.

### **Addendum A / U.S. Style-Oriented Large Cap Equities**

No material changes.

### **Addendum B / U.S. Master Limited Partnership Index Portfolios**

1. Clarified that investments in stocks obtained through PIPE transactions that are registered are permissible without limitation.

### **Addendum C / U.S. Style-Oriented Small Cap Equities**

1. Changed the benchmark index from the Russell 2000 style-oriented index to the MSCI U.S. Small Cap style-oriented index. There is no material difference between the performance of the Russell 2000 Index and the MSCI U.S. Small Cap Index. In addition, we have already adopted the MSCI Index series for all of our non-U.S. equity exposure and are proposing adopting the MSCI Index series for all of our U.S. equity exposure as well.
2. Changed the sector diversification requirement to link the guideline to the benchmark.
3. Eliminated the guideline that prohibited the initial investment in a company with a market capitalization less than \$100 million. Automatically monitoring this transactional guideline with the BlackRock Solutions compliance system is not possible. The MSCI U.S. Small Cap Index has approximately 1.5% of the benchmark in companies with a market capitalization less than \$100 million. Given that the addendum has a 10% limitation on securities with a market capitalization less than \$100 million, we do not believe that this time of purchase limitation is necessary.

### **Addendum C1 / U.S. Micro Cap Equities**

1. Changed the benchmark index from the Dow Jones Wilshire Micro Cap Index to the MSCI U.S. Micro Cap Index. There is no material difference between the performance of the Dow Jones Wilshire Micro Cap Index and the MSCI U.S. Micro Cap Index. In addition, we have already adopted the MSCI Index series for all of our non-U.S. equity exposure and are proposing adopting the MSCI Index series for all of our U.S. equity exposure as well.

2. Changed the sector diversification requirement to link the guideline to the benchmark.

#### **Addendum D / Enhanced S&P 500 Index Fund**

Eliminated this addendum as it is no longer necessary.

#### **Addendum G / Enhanced U.S. Mid Cap Equities**

Eliminated this addendum as it is no longer necessary.

#### **Addendum M / Non-U.S. Equities**

No material changes.

#### **Addendum N / Non-U.S. Small Cap Equities**

1. Eliminated the guideline that prohibited the initial investment in a company with a market capitalization less than \$100 million. Automatically monitoring this transactional guideline with the BlackRock Solutions compliance system is not possible. Given that the addendum has a 15% limitation on securities with a market capitalization less than \$100 million (see #2 below), we do not believe that this time of purchase limitation is necessary.
2. Increased the permissible investment in companies with a market capitalization less than \$100 million from 10% to 15% of the portfolio at market value. The MSCI All Country World ex. U.S. Small Cap Index has approximately 7.8% of the benchmark in companies with a market capitalization less than \$100 million.

#### **Addendum O / Emerging Markets Equities**

No material changes.

#### **Addendum O1 / Emerging Markets Small Cap Equities**

1. Eliminated the guideline that prohibited the initial investment in a company with a market capitalization less than \$100 million. Automatically monitoring this transactional guideline with the BlackRock Solutions compliance system is not possible. Given that the addendum has a 30% limitation on securities with a market capitalization less than \$100 million (see #2 below), we do not believe that this time of purchase limitation is necessary.
2. Increased the permissible investment in companies with a market capitalization less than \$100 million from 10% to 30% of the portfolio at market value. The MSCI Emerging Markets Small Cap Index has

approximately 21.7% of the benchmark in companies with a market capitalization less than \$100 million.

**Addendum T / U.S. Publicly Traded Real Estate Securities**

1. Changed the sector diversification requirement to link the guideline to the benchmark.

**Addendum T1 / Non-U.S. Publicly Traded Real Estate Securities**

1. Changed the sector diversification requirement to link the guideline to the benchmark.

**Addendum T2 / Global Publicly Traded Real Estate Securities**

1. Changed the sector diversification requirement to link the guideline to the benchmark.