PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT OBJECTIVES AND GUIDELINES
EMERGING MARKETS FIXED INCOME PORTFOLIOS

ADDENDUM Q1

I. OBJECTIVES

This actively managed emerging markets fixed income portfolio will consist primarily of fixed income securities and cash equivalents. The objectives of this portfolio are:

1. to generate positive excess returns of 50 bps or more annually versus the Barclays Capital EM Local Currency – Government – MV Weighted (Unhedged) – 10% Country Cap Index (Index); and,
2. to generate those excess returns with an Information Ratio of 0.40 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 an Emerging Markets Fixed Income 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 2.0 years in excess of the Index.

B. Spread Risk

The effective or option-adjusted spread duration of the portfolio must range from zero to no more than 1.5 years in excess of the Index.

C. Credit Risk

1. The weighted-average credit rating of the portfolio must be Ba3/BB- or better.

2. Non-rated debt securities and issuers limited to no more than 10% of the portfolio at market value.

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.

Derivative securities, including credit-linked notes (CLNs), are permitted and will be deemed to have the rating of the underlying issuer or security.

D. Currency Risk

1. In addition to holdings in securities denominated in non-U.S. currencies, outright currency exposure and hedging is permitted through the use of futures, options, or forward contracts subject to Derivative Counterparty Risk restrictions documented in G. below.

E. Sovereign Risk

1. No more than 50% of the portfolio may be invested in issuers from non-U.S. countries with a Sovereign Rating below Baa3/BBB-.
2. No more than 10% of the portfolio may be invested in securities and bonds from any individual non-U.S. country with a Sovereign Rating below Baa3/BBB-.

F. Concentration Risk

1. No more than 7% of the portfolio at market value may be invested in the securities of any investment grade (ratings Baa3/BBB- or higher) 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 derivatives of the same, including CLNs) or supranational issuers).
2. No more than 2% of the portfolio at market value may be invested in the securities of any non-investment grade (rating Ba1/BB+ or lower) issuer or any non-convertible preferred stock (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 derivatives of the same, including CLNs) or supranational issuers).
3. No more than 50% of the portfolio at market value may be invested in non-investment grade securities.

4. No more than 10% of the portfolio at market value may be invested in non-convertible preferred stock and convertible bonds (bonds convertible into common stock) that are trading at 110% of par value or less.
5. No more than 15% 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. 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.

H. Derivative Counterparty Risk

1. The commercial and investment banks used for CLNs, approved OTC futures, approved OTC options, or forward/spot currency transactions 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.

III. DERIVATIVES

The portfolio is permitted to establish and maintain long and short positions in:

1. Listed options on currencies;
2. Listed options on fixed income and currency futures;
3. Fixed income forward commitments, including mortgage dollar rolls;
4. Currency forward commitments;
5. Listed fixed income futures contracts; and
6. Listed currency futures contracts.

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

IV. AMENDMENTS

A written request to the Chief Investment Officer (CIO) and Managing Director of External Public Markets, Risk & Compliance (DEPM) 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 DEPM in the CIO's absence, if the request is approved.