INVESTMENT POLICY STATEMENT

FOR

THE PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES'

RETIREMENT FUND

Board Approved December 13, 2002
Board Modified September 19, 2003 to modify Policy Benchmark on page 3

INVESTMENT POLICY
FOR
THE PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES' RETIREMENT FUND

The Public School Employees' Retirement Board (the Board) is responsible for the formulation of investment policy for the Public School Employees' Retirement Fund (the Fund). The Fund is the largest public pension fund in the Commonwealth of Pennsylvania and the custodian of the Fund's assets is the State Treasurer of the Commonwealth of Pennsylvania. The Board, as trustee for the Fund, has exclusive investment control and management of the Fund, subject to constraints set forth in Section 8521 (Prudent Person Legislation) of the Public School Employees' Retirement Code, 24 Pa. C.S. and the laws of the Commonwealth of Pennsylvania, and the interest of the taxpayers of this Commonwealth to support this Fund. As part of the Board's function, it has the responsibility for the implementation of investment policy, retention of investment advisors, and ongoing supervision of investment results. The Board is also responsible for establishing policies with respect to fees and commissions for all managers, investment advisors, and agents to the plan assets. In order to fulfill its responsibilities, it is the intention of the Board to review the Investment Policy at least annually.

Investment policy for the Fund relates to the portfolio of all assets which comprise the total holdings of the Fund. The Board recognizes that the objective of a sound and prudent policy is to produce investment results that will preserve the assets of the Fund, as well as maximizing earnings of the Fund consistent with its long-term needs. These long-term needs have been ascertained through various studies performed on behalf of the Board by its actuary. The reports provide in-depth analysis of the funding policies for the Public School Employees' Retirement System (the System). The investment policies herein set forth and the long-run average allocation of plan assets to which they refer are deemed to be consistent with the projected pattern of cash-flows to the plan and its projected benefit payments. Should either the projected finances of the System change significantly, changes in applicable Federal or State statutes dictate, or changes in the plan's asset valuation methods be adopted, these policies and average asset allocations will be reviewed and modified by action of the Board, if appropriate. The Investment Policy represents policy for the entire Fund, which for the purposes of investment management and control is divided into portfolios that contain similar assets or for which the Board has retained a specific investment advisor. Detailed guidelines for each of these portfolios have been constructed so that they collectively implement policy for the entire Fund.

Investment Objectives

The long-term investment objectives of the Fund are:

1. Preservation of capital in real terms;

2. To maximize total returns while limiting the risk of volatility through diversification;

3. To achieve returns in excess of the policy index (the policy index is a custom index created based on the Board established asset allocation structured to generate a return that supports the growth of the projected actuarial liabilities of the Fund);

4. To achieve a real rate of return over CPI over time;

5. To provide sufficient liquidity to meet the current operating needs of the Fund.

Asset Allocation

The Board will review long-term asset allocation targets at least annually. The Board will seek the opinion of its actuary, consultants, staff, and any other sources of information it deems appropriate in formulating this allocation. The purpose of the Board's long-term asset allocation is to achieve diversification, or a combination of expected return and risk, that is consistent in meeting the near and long-term financial needs and objectives of the Fund.

The following are the long-term asset allocation targets of the Board, based on the market value of the Fund's assets:

ASSET CLASS	SUB-CLASS OBJECTIVE	12/03 OBJECTIVE	POLICY RANGE
Large Cap	30.5%		27.5% - 33.5%
Small Cap	10.5%		8.5% - 12.5%
Developmental Fund	1.0%		0.0% - 1.5%
U.S. Equity Exposure		**42.0%**	**39.0% - 45.0%**
Int'l Developed Large Cap	16.2%		13.2% - 19.2%
Emerging Markets	1.8%		0.8% - 2.8%
Non-U.S. Equity Exposure		**18.0%**	**15.0% - 21.0%**
Total Equity Exposure		**60.0%**	**57.0% - 63.0%**
Liquidity Reserve Account	3.30%		1.80% - 4.80%
Domestic Fixed Income	11.00%		9.00% - 13.00%
Global Fixed Income	4.40%		2.90% - 5.90%
Specialty Fixed Income	3.30%		1.80% - 4.80%
Total Fixed Income Exposure		**22.0%**	**19.0% - 25.0%**
Cash (including Liquidity Account)		**0.0%**	
Private Debt	3.00%		
Private Equity/Venture Capital	8.00%		
Alternative Investments		**11.0%**	
Real Estate (including publicly-traded REITs)		**7.0%**	**5.0% - 9.0%**
		100.0%	

For purposes of this analysis, cash and cash equivalents held in each advisor's portfolio will be considered fully invested based on that advisor's objectives (i.e. cash in a domestic equity advisor's account will be considered as part of the domestic equities in the table above). Cash equivalents include fixed income securities maturing in less than one year for classification purposes.

Policy Index

Based on the asset allocation noted above, the Board has adopted the following weighted policy benchmark to measure the performance of the Fund:

Wilshire 5000 Index	42.0%
MSCI ACWI Index ex. U.S.	18.0%
Lehman Aggregate Index	17.6%
Lehman Global Aggregate Index	4.4%
Wilshire REIT Index	1.1%
NCREIF Index, one-quarter lagged*	5.9%
Venture Economics Median, one-quarter lagged*	11.0%
Total	100.0%

* - both the NCREIF Index and the Venture Economics Median returns will be calculated on a weighted vintage year basis that will account for the timing of commitments made by the Fund.

Asset Class Rebalancing

The asset allocation will be reviewed on a regular basis, but no less frequently than monthly, for potential rebalancing. Any asset class allocation that falls outside the policy ranges described above will be rebalanced to within the policy range, but in no cases beyond the target allocation objective, within a reasonable period of time by the Chief Investment Officer.

Asset allocation rebalancing may be accomplished by using the cash markets or through the use of derivative securities. Derivative securities may only be used to implement temporary adjustments. Where feasible, index funds will be used to facilitate rebalancings to minimize the time frame and costs. However, any account may be increased or decreased to achieve the rebalancing objective based on the judgment of the Chief Investment Officer. When a rebalance is triggered, consideration will be given to the unique characteristics of each asset class, the degree of over/underweight, liquidity characteristics, current market conditions, and any other relevant considerations to ensure prudence and care.

The purpose of this structured reallocation policy is to provide a disciplined approach to asset allocation. All rebalancings will be reported to the Board at the next scheduled meeting.

Termination of Investment Managers

The Chief Investment Officer, after receiving concurrence from the Executive Director and the Chair of the Finance Committee, and notifying the Board, has authority to terminate an investment manager for any valid business reason, including, but not limited to, poor performance, personnel changes, organizational changes, deviation from their investment style, and compliance violations. Notwithstanding the preceding, any individual Board member has the right to request to have the termination decision listed on the agenda of the next scheduled Finance Committee Meeting. Pending said Finance Committee meeting, no action shall be taken by the Chief Investment Officer to terminate the investment manager. The Chief Investment Officer shall inform the Board of the status of the termination at the next scheduled Board meeting. Upon the termination of any investment manager, the Chief Investment Officer has the authority to reinvest the proceeds from the terminated manager with any remaining investment manager(s) previously approved by the Board and/or keep the proceeds in the Fund's cash management account.

Liquidity Reserve Policy

The purpose of the Liquidity Reserve account is to provide the Fund with a permanent exposure to high quality, highly liquid securities. This account will be used to meet the ongoing cash needs of the Fund based on current projections of inflows and outflows. The target allocation to the Liquidity Reserve account is equal to approximately 18 months of net outflows.

The Liquidity Reserve account will be replenished from overweighted asset classes (based on the 12/03 Objective noted in the Asset Allocation section above) at the discretion of the Chief Investment Officer based on current market conditions. Under normal market conditions, the Liquidity Reserve account would be replenished to the targeted 18-month reserve when the reserve is reduced to 12 months of net outflows.

Interest, Dividend, and Other Miscellaneous Income Earned

Interest, dividend, and other miscellaneous income earned each month will be swept from each account one month and one business day after the month in which it was earned (for example, income earned in December will be swept from the accounts on the first business day in February). The amount to be swept shall be determined monthly through the reconciliation process with the custodial bank and/or the Fund as administered by the Investment Accounting Office. The Chief Investment Officer shall have discretion to waive this provision for any manager.

Investment Management Fees

Investment management fees will be submitted to the Fund on a quarterly basis. Once approved by the Fund, the fees will be paid directly out of the investment manager's account as administered by the Investment Accounting Office. The Chief Investment Officer shall have discretion to waive this provision for any manager.