

CALSTRS

CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM

**FIXED INCOME
INVESTMENT
POLICY**

INVESTMENT BRANCH

March 2024

EXECUTIVE SUMMARY

In accordance with the CalSTRS Investment Beliefs and the CalSTRS [Investment Policy Statement](#) (IPS), the California State Teachers' Retirement System Investment Committee (IC) has established an allocation for Fixed Income. CalSTRS' Fixed Income assets are to be invested, administered, and managed in a prudent manner for the sole benefit of its participants and beneficiaries, in accordance with the California Constitution, the Teachers' Retirement Law, and other applicable statutes. The CalSTRS Investment Beliefs provide a foundational framework to all of CalSTRS investment decision makers and shall guide investment decisions. No investment instrument or activity prohibited by the IPS shall be authorized for the Fixed Income portfolio.

This document is intended to summarize the fundamental objectives and considerations used in the investment, administration, and management of the Fixed Income portfolio. These policies are designed to set boundaries that will ensure prudence and care in the management of the fixed income assets, while allowing sufficient flexibility in the management process to capture investment opportunities.

CalSTRS believes that environmental, social, and governance, ESG, issues can affect the performance of our investments. As a result, the CalSTRS ESG Policy has been developed as a tool that both internal and external investment managers are expected to use to assess the impact of ESG risk when making an investment on behalf of CalSTRS.

Detailed procedures and guidelines for each of the portfolio mandates are maintained separately.

As with all other plan assets, these policies cannot be altered without explicit direction from the IC.

PROGRAM OBJECTIVES

- a. **Long-term Assets:** The internally and externally managed long-term fixed income assets shall be invested to improve the diversification of the total investment portfolio and to enhance its risk-adjusted total return.
- b. **Short-term Assets:** The investment objective for the internally managed liquidity portfolio is to seek the preservation of capital and liquidity, and to generate the highest possible current income consistent with a prudent level of risk available from investing in a diversified portfolio of short-term fixed income securities.
- c. **Cash Management:** The investment objective for the cash management function is to facilitate cash needs, utilizing various tools, as directed by the chief investment officer, deputy chief investment officer, or designee, in order to minimize the cost of raising cash and limit the effect on the investment managers.

Monitoring and oversight of the implementation of fixed income assets shall come under the purview of the Director of Fixed Income.

PERFORMANCE OBJECTIVES

The CalSTRS Fixed Income Portfolio includes core and opportunistic fixed income strategies which, in aggregate, are to be structured to achieve a long-term total return consistent with the policy benchmarks representative of the fixed income markets.

Separate and distinct performance objectives and benchmarks shall be established for each of the portfolio mandates (e.g., Core, Core Plus, Short-Term) in order to determine whether each portfolio is representative of the market style adopted, and whether the performance objectives have been met.

PROGRAM BENCHMARK

The Fixed Income Policy benchmark is 95% Bloomberg MSCI US Aggregate Climate Custom + 5% Bloomberg MSCI US High Yield 2% Cap Cash Pay Climate Custom Index.

PROGRAM STRUCTURE

Asset Allocation: Under the direction of the Director of Fixed Income, staff has discretion, to implement tactical allocations in the Fixed Income portfolio.

Using both enhanced and active indexing management, the long-term public assets of the Fixed Income portfolio shall be managed within an annualized forecast active risk range of 10 basis points (bps) to 60 bps as measured by the CalSTRS risk management system. If there is an anticipated change in the CalSTRS risk management system or a material change in the methodology used to calculate active risk, staff will notify the Investment Committee.

The long-term assets will be a blend of two major strategies: 1) core and, 2) opportunistic. The core strategy represents a relatively efficient, cost-effective way to provide public debt, market-like returns over time. The opportunistic strategy consists of active portfolios with higher levels of expected risk-returns through diversification and invests in both public and private assets. Private assets will be focused on private credit, primarily direct lending strategies. Detailed sub asset allocation and applicable ranges to private credit will be maintained within the Fixed Income guidelines.

Eligible Securities:

- a. **Debt Securities** – All securities that qualify for inclusion in the performance benchmark. While the performance benchmark has clearly defined rules regarding how sectors and securities are determined to be included, securities that do not technically meet those rules but are correlated to the sector are permitted, as documented within the investment guidelines.
- b. **Derivatives** – The objectives for using derivatives are to assist in the efficient management of risk, asset allocation, and market exposures in the Fixed Income portfolio through the use of tools such as futures, options, swap agreements, or forward agreements. The implementation of the derivatives strategies shall be thoroughly vetted by staff to conform to the risk management section of this policy, along with the ranges specified within the fixed income diversification guidelines. In addition, these strategies may not increase or decrease the fixed income exposure to the total fund outside the ranges identified within the strategic asset allocation section of the IPS. Further limitations with respect to aggregate risk control and counterparty exposure shall be documented within the investment guidelines.
- c. **Private assets** - Within its opportunistic strategy, Fixed Income may invest in both externally and internally managed fixed income private assets, particularly in private credit that includes direct lending.

Fixed Income Internal/External Management: The Fixed Income portfolio is managed by both internal staff and external investment managers. Within the boundaries established in the procedures, the decision to hire an external manager or utilize internal investment staff for an investment strategy is made by applying a criteria matrix to evaluate a variety of factors including, but not limited to, cost effectiveness/control, market transparency and liquidity, market efficiency, active risk, and infrastructure/resource requirements. CalSTRS uses active external management as a tool to implement a portion of its opportunistic strategies and to allocate risks where it believes there is the greatest opportunity for enhanced returns relative to the core Fixed Income portfolio.

Within the boundaries and ranges established by these policies, staff is responsible for the selection, allocation, and oversight of the external fixed income managers. Public manager guidelines, objectives, benchmark selection, active risk, portfolio composition, constraints, and trading activities are to be administered by staff and integrated into the fixed income risk budget. CalSTRS shall also maintain a pool of managers to supplement the existing managers or replace a defunded manager, as needed.

Transition Management: The Fixed Income unit may use internal staff or external managers to prudently administer and liquidate, if advisable, the existing portfolios of managers that have been relieved of investment management responsibility for CalSTRS.

Other Strategies: Periodically the IC will approve investment strategies that may or may not be managed within the fixed income asset class specifically, but are instead designed to take advantage of an opportunity and/or to meet a performance objective. Unless a strategy is addressed by a specific policy of its own, Fixed Income staff is responsible for the implementation of any strategy that may be directed by the chief investment officer, deputy chief investment officer, or designee, within the boundaries and ranges established by this policy. Investment guidelines, benchmark selection, active risk, portfolio composition, constraints, and trading activities are to be administered by staff and integrated into the CalSTRS strategic asset allocation process and risk budget.

RISK MANAGEMENT

Delegation of Authority: The investment, administration, and management of the fixed income assets and strategies are delegated to staff within the boundaries established by policy and the processes described within the relevant investment guidelines.

Forecast Active Risk: The public debt portfolio is managed within predefined risk or active risk guidelines. Forecast active risk is used as a way to control overall portfolio risk. This quantifiable risk is then budgeted among the various sub-asset classes of the Fixed Income portfolio. These risks are monitored on a daily basis by each portfolio manager and reported weekly to the Director of Fixed Income.

Diversification: Diversification within investment portfolios is critical in order to control risk and maximize returns. Minimum and maximum ranges with respect to investment sectors, credit exposure, and duration shall be established for the Fixed Income portfolio within the context of the performance benchmark. Such ranges shall be documented within the investment guidelines and are subject to change as conditions warrant, as determined by the Director of Fixed Income.

Authorized Staff: Authorization letters which specify who may transact business for the internally managed portfolios, shall be sent initially at the time an account is opened, and then periodically to all fixed income broker/dealers with whom CalSTRS conducts business. Whenever a change in authorized staff takes place, the broker/dealers shall be notified in writing within 24 hours in the event of termination, and as soon as possible in the event of newly authorized investment staff.

Trading Parameters: The delegated non-cumulative daily trade limits for approval of transactions are designated in the IPS.

MONITORING AND REPORTING

The following reports will be prepared and presented to the IC, unless otherwise stated, in order to facilitate visibility of compliance monitoring and reporting according to this document:

- a. **Fixed Income Status Report** – prepared by staff and distributed to the chief investment officer and deputy chief investment officer (monthly)
- b. **Fixed Income Semi-Annual Report** – prepared by staff and posted to CalSTRS.com (semi-annually)
- c. **Performance Report** – prepared by master custodian/consultant (semi-annually)
- d. **Business Plan** – prepared by staff (annually)

INVESTMENT COMMITTEE REVIEW

Consistent with all other plan assets, the IC will review and/or alter this policy periodically, as deemed appropriate and in keeping with its fiduciary duties and standards.

[Link to INVESTMENT TERMS GLOSSARY at CalSTRS.com](#)

Adopted by the Teachers' Retirement Board on July 8, 1993

Revised on June 5, 1996

Revised on April 7, 1999

Revised on October 11, 2000

Revised to adopt Lehman Agg (from Salomon LPF) benchmark on July 10, 2002

Revised to increase external management on December 7, 2005

Revised to integrate BlackRock System processes on September 7, 2006

Revised to adjust benchmark, post restructuring on April 4, 2007

Revised to integrate Cash Management function on July 13, 2007

Revised to include the Authorized Use of Derivatives on June 4, 2008

Revised to adjust the Risk Management - Trading Parameters on September 3, 2009

Revised to integrate Other Strategies management on July 9, 2010

Revised to clarify portfolio structure, derivatives and trading ranges on November 3, 2011

Revised to add ESG Risks policy reference on September 10, 2013

Revised to remove reference to presentation of annual report on April 4, 2014

Revised to update benchmark, on November 16, 2016

Revised to define APM trading limits, updated flowchart (Exhibit 1) to reflect APM in the hierarchy and reflect new reporting frequency on April 5, 2017

Revised to reflect new policy format on March 27, 2019

Revised language to support an active risk budget framework and inclusion of private credit as an investable asset on September 1, 2021

Revised frequency of report, remove Exhibits April 7, 2023

Revised to support the low carbon optimization to current indices on May 4, 2023

Revised language to support ALM private credit allocation March 6, 2024