

MINUTES OF THE REGULAR MEETING OF THE
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

AUGUST 13, 2018

CITY FINANCIAL TOWER
201 MERCHANT STREET, SUITE 1200
HONOLULU, HAWAII 96813

Trustees present: Mr. Emmit Kane, Chair
Mr. Jerome Rauckhorst, Vice Chair
Mr. Vincent Barfield
Dr. Catherine Chan
Ms. Jackie Ferguson-Miyamoto
Ms. Laurel Johnston
Dr. Genevieve Ley
Mr. Wesley Machida

Staff present: Mr. Thomas Williams, Executive Director
Ms. Kanoë Margol, Deputy Executive Director
Ms. Donna Curry, Program Specialist
Mr. Karl Kaneshiro, Retirement Benefits Manager
Mr. Howard Hodel, Acting Chief Investment Officer
Mr. Aaron Au, Investment Officer – Illiquid Markets
Mr. Andrew Chen, Investment Specialist
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. Ian Wetzel, Investment Specialist
Ms. Dale Kehau Kanae, Recording Secretary
Ms. Lori Kim, Secretary
Ms. Geraldine Konishi, Member Home Loan Assistant
Ms. Wanda Kugiya, Secretary

Attorneys present: Mr. Ivan Torigoe, Deputy Attorney General
Ms. Elmira Tsang, Deputy Attorney General
Ms. Jodi Yi, Deputy Attorney General

Guests present: Mr. Joseph Newton, Gabriel, Roeder, Smith and Co.
Mr. Colin Bebee, Pension Consulting Alliance, LLC
Ms. Mary Bates, Pension Consulting Alliance, LLC
Mr. Neil Rue, Pension Consulting Alliance, LLC
Mr. Chae Hong, Townsend Group, an Aon Company

QUORUM/CALL TO ORDER A quorum being present (Chair Kane, Vice Chair Rauckhorst, and Trustees Barfield, Chan, Ferguson-Miyamoto, Johnston, Ley, and Machida), Chair Kane called the regular meeting of the Board of Trustees (Board) of the Employees' Retirement System of the State of Hawaii (ERS) to order at 9:02 a.m.

PUBLIC COMMENT Chair Kane called for public comment. There were no public present, therefore no public comments.

RECESS Chair Kane called for a recess at 9:02 a.m. and announced that the meeting would reconvene following the conclusion of the Chapter 91 Proceedings and the Investment Committee Meeting.

(All in attendance left the meeting except for the Board; Executive Director, Thomas Williams; Retirement Benefits Manager, Karl Kaneshiro; and Deputy Attorneys General, Ivan Torigoe, Elmira Tsang, and Jodi Yi).

RECONVENE

A quorum being present (Chair Kane, Vice Chair Rauckhorst, and Trustees Barfield, Chan, Ferguson-Miyamoto, Johnston, Ley, and Machida), Chair Kane reconvened the meeting at 11:07 a.m.

PENSION CONSULTING ALLIANCE, LLC – QUARTERLY PERFORMANCE REPORT

Pension Consulting Alliance, LLC, (PCA), Neil Rue, gave an oral and written presentation on the Quarterly Performance Report for the 2nd Quarter of 2018 ending June 30, 2018:

INTRODUCTION

HIERS Portfolio Review

- Portfolio Valuation
- Performance vs. Policy Benchmark and Median Public Fund
- Takeaways:
 - The ERS Total Portfolio matched the Policy Benchmark over the recent quarter and 1-year period. Longer term results outperformed the benchmark.
 - Relative to the Median Public Fund, the ERS Total Portfolio underperformed the Median Public Fund return over the short- and medium- term periods, while performance over the extended time periods tracked Median Fund results.
 - With respect to the evolving policy target that took effect January 1, 2018, the Total Portfolio ended the latest quarter overweight Broad Growth class, while underweight Real Return. All other strategic classes were near the policy target.

ECONOMIC OVERVIEW

Economic & Market Overview – 2Q 2018

- Overview: Real U.S. GDP increased in the second quarter of 2018. GDP growth was driven by increases in consumer spending, exports, business investment, and government spending, while inventory investment and housing investment detracted from GDP growth over the quarter. At quarter-end, the unemployment rate ticked down to 4.0%. The seasonally adjusted Consumer Price Index for All Urban Consumers increased by 2.3% on an annualized basis during the quarter. Commodities ticked up during the second quarter, and the 1-year return for a basket of commodities remains positive at 7.3%. Global equity returns were positive for the quarter at 0.7% (MSCI ACWI). The U.S. Dollar appreciated against the Euro, Pound, and Yen by 5.2, 5.8%, and 4.2%, respectively.
- Market Summary – Long-term Performance

ERS PORTFOLIO RISK REVIEW

Macro Risk Analytics – Key Takeaways

- Late-cycle macro risks (e.g., Growth Risk, Leverage Risk, and Inflation Risk) are all relevant factors to the ERS's portfolio.
- The primary change from 1Q to 2Q was the entrance of Inflation Risk as a material risk factor (with coinciding decreased influence from other factors). This is likely the result of a combination of recent trade war discussions along with late-cycle dynamics.

PENSION CONSULTING
ALLIANCE, LLC –
QUARTERLY
PERFORMANCE REPORT
(CONT'D)

- Leverage Risk is interrelated with Growth Risk, as the credit cycle has a meaningful impact on economic growth across the globe. The rise of Leverage Risk over the last year reflects loosening lending standards and rising societal debt levels.
- The interaction between inflation Risk and Leverage Risk will be important to watch as inflation directly impacts global interest rates, and thus, the cost of borrowing.
- Currently, broad market valuation indicators show that risks are reasonable-to-expensive (in aggregate).
- Investor sentiment shifted to neutral during the quarter.
- The Actual Portfolio's beta (on a 12-month basis relative to the Policy Portfolio) marginally declined from its recent high but still remains well above 1.0. PCA and the ERS Staff will closely monitor the evolution of this metric over the next several months.

ERS PORTFOLIO REVIEW

ERS Portfolio Allocation

Strategic Class Performance

- The Broad Growth class tracked the policy benchmark over the recent quarter and 1-year period, while outperforming over the 3-year period. For the quarter, the Private Growth segment outperformed its benchmark, however, these gains were offset by relative underperformance by the Traditional Growth and Stabilized Growth segments.
- The Principal Protection class underperformed its policy benchmark over the quarter but outperformed the benchmark over the extended time periods reported. The Plan's global intermediate mandate primarily accounted for the segment's underperformance for the quarter.
- The Crisis Risk Offset class matched its policy benchmark for the quarter and exceeded it over the 1-year period. Relative outperformance for the 1-year period was driven by strong double-digit absolute and relative results posted by the Alternative Return Capture segment. Positive 1-year results for the Systematic Trend Following segment also added value.
- The Real Return class underperformed its CPI + 3% benchmark over the quarter as the class's timber and infrastructure segments posted returns that exceeded the benchmark. Trailing 1- and 5-year results bested the benchmark, while 3-year results trailed the index.

TOWNSEND GROUP, AN
AON COMPANY – FIRST
QUARTER 2018 REAL
ESTATE PERFORMANCE
REVIEW

Investment Officer – Illiquid Markets (IO-IM), Aaron Au, and Townsend Group, an Aon Company (TG Aon), Chae Hong, gave an oral and written presentation on the First Quarter 2018 Real Estate Performance Review:

EXECUTIVE SUMMARY

Real Estate Markets Performance and Overview

- The NFI-ODCE trailing one-year return now stands at 7.1% net. While real estate returns are generally in line with the sector's long-run average of 7-9% gross, continued moderation is expected with returns potentially dipping below average over the next year.
- The more typical relationship between deal volume and pricing has not moved in unison over the past year plus. While the reason varies by property type, in most cases volume has moved lower while prices have moved higher. While this indicates a continuing disconnect between buyers' and sellers' expectations, which has been evident in sales trends

TOWNSEND GROUP, AN
AON COMPANY – FIRST
QUARTER 2018 REAL
ESTATE PERFORMANCE
REVIEW (CONT'D)

since volume peaked in 4Q2015, absolute sales volumes remain strong relative to history. Current cap rates support this strength as they remain at or near recent lows—that said, there is little expectation of them going lower.

- Despite many investment classes looking expensive today relative to history (including real estate), and notwithstanding the risk of further capital markets sensitivity to rising interest rates, there remain attractive opportunities to deploy capital prudently in real estate. Real estate fundamentals are currently on solid footings, and generally in balance across most property types, and hence, expected to remain fairly stable offering investors attractive absolute and relative yields.

*Portfolio Funding Status and Real Estate Portfolio Composition
HIERS' Summary of Portfolio Returns (Time-Weighted)*

- Overall the portfolio is performing well.

*HIERS Real Estate Portfolio Highlights
Significant Events*

- No significant events in Q1 2018

MARKET OVERVIEW

REAL ESTATE PORTFOLIO

Core Portfolio Returns (Net Time-Weighted Return)

Non-Core Portfolio Returns (Net Internal Rate of Return)

INFRASTRUCTURE PORTFOLIO

Infrastructure Performance

TIMBER PORTFOLIO

LOWE SEPARATE ACCOUNT

REAL ESTATE SEPARATE ACCOUNT DETAIL

RECESS

Chair Kane called for a lunch recess at 11:47 a.m.

RECONVENE

A quorum being present (Chair Kane, Vice Chair Rauckhorst, and Trustees Barfield, Chan, Ferguson-Miyamoto, Johnston, Ley, and Machida), Chair Kane reconvened the meeting at 12:06 p.m.

ACTUARIAL ISSUES AND
OUTLOOK FOR THE YEAR
ENDING JUNE 30, 2018

Gabriel, Roeder, Smith and Company, Joseph Newton, presented an oral and written presentation on Actuarial Issues and Outlook for the Year Ending June 30, 2018.

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Machida, and unanimously carried, the Board accepted the report by Gabriel, Roeder, Smith and Company Report.

After his presentation, Mr. Newton left the meeting.

CHIEF INVESTMENT
OFFICER STATUS

Executive Director Williams reported that Elizabeth Burton was offered and accepted the Chief Investment Officer (CIO) position and her first day will be October 1, 2018.

RECOMMENDATION TO
ISSUE A REQUEST FOR
INFORMATION FROM

Acting Chief Investment Officer (ACIO), Howard Hodel gave an oral and written presentation with a recommendation to issue a Request for Information from Prospective Managers of Investment Portfolio

PROSPECTIVE MANAGERS
OF INVESTMENT
PORTFOLIO
IMPLEMENTATION
OVERLAYS; AN OVERLAY
IS AN INVESTMENT
ACCOUNT DESIGNED TO
MAKE THE PORTFOLIO
MORE EFFICIENT

Implementation Overlays; an overlay is an investment account designed to equitize cash and make the portfolio more efficient.

On a motion made by Trustee Barfield, seconded by Trustee Chan, and unanimously carried, the Board approved ERS staff's recommendation to issue a Request for Information from Prospective Managers of Investment Portfolio Implementation Overlays.

ENTER EXECUTIVE
SESSION

On a motion made by Vice Chair Rauckhorst, seconded by Trustee Johnston, and unanimously carried, the Board entered into Executive Session at 1:01 p.m.

EXECUTIVE SESSION

- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions, deliberations, and if appropriate, to make decisions on investments or prospective investments by the system that require the consideration of information or records that are exempt from disclosure under Chapter 92F, including information and records that are proprietary information or confidential business information, relating to the Diversified Liquid Corporate Credit Mandate;
- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions and deliberations and, if appropriate, to make decisions on investments or prospective investments by the system that require the consideration of information or records that are exempt from disclosure under Chapter 92F, including information and records that are proprietary information or confidential business information relating to an update on Crisis Risk Offset manager search;
- Pursuant to HRS § 92-5(a)(4), to consult with the Board's attorneys regarding funding of Special Deputy Attorney General contracts for legal services relating to investments in private equity and real estate funds, and to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to such matters; appropriate action;
- Pursuant to HRS § 88-27.5(a)(1) and HRS § 92-5(a)(4), to conduct discussions and deliberations relating to, and to make a decision upon, and to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to, a private equity investment advised by Hamilton Lane;
- Pursuant to HRS § 92-5(a)(4), to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to potential claims against the ERS, and for appropriate action;
- Pursuant to HRS § 92-5(a)(4), to consult with the Board's attorneys regarding developments in ongoing litigation, and to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to such litigation; appropriate action.

EXECUTIVE SESSION,
PURSUANT TO HRS § 88-
27.5(a)(1), TO CONDUCT
DISCUSSIONS,
DELIBERATIONS, AND IF

APPROPRIATE, TO MAKE DECISIONS ON INVESTMENTS OR PROSPECTIVE INVESTMENTS BY THE SYSTEM THAT REQUIRE THE CONSIDERATION OF INFORMATION OR RECORDS THAT ARE EXEMPT FROM DISCLOSURE UNDER CHAPTER 92F, INCLUDING INFORMATION AND RECORDS THAT ARE PROPRIETARY INFORMATION OR CONFIDENTIAL BUSINESS INFORMATION, RELATING TO THE DIVERSIFIED LIQUID CORPORATE CREDIT MANDATE

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(a)(1), TO CONDUCT DISCUSSIONS TO CONDUCT DISCUSSIONS AND DELIBERATIONS AND, IF APPROPRIATE, TO MAKE DECISIONS ON INVESTMENTS OR PROSPECTIVE INVESTMENTS BY THE SYSTEM THAT REQUIRE THE CONSIDERATION OF INFORMATION OR RECORDS THAT ARE EXEMPT FROM DISCLOSURE UNDER CHAPTER 92F, INCLUDING INFORMATION AND RECORDS THAT ARE PROPRIETARY INFORMATION OR CONFIDENTIAL BUSINESS INFORMATION RELATING TO AN UPDATE ON CRISIS RISK OFFSET MANAGER SEARCH

EXECUTIVE SESSION, PURSUANT TO HRS § 92-5(a)(4), TO CONSULT WITH THE BOARD'S ATTORNEYS REGARDING

FUNDING OF SPECIAL
DEPUTY ATTORNEY
GENERAL CONTRACTS
FOR LEGAL SERVICES
RELATING TO
INVESTMENTS IN
PRIVATE EQUITY AND
REAL ESTATE FUNDS,
AND TO CONSULT WITH
THE BOARD'S
ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS,
DUTIES, PRIVILEGES,
IMMUNITIES, AND
LIABILITIES WITH
RESPECT TO SUCH
MATTERS; APPROPRIATE
ACTION

EXECUTIVE SESSION,
PURSUANT TO HRS § 88-
27.5(a)(1) and HRS § 92-
5(a)(4), TO CONDUCT
DISCUSSIONS AND
DELIBERATIONS
RELATING TO, AND TO
MAKE A DECISION UPON,
AND TO CONSULT WITH
THE BOARD'S
ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS,
DUTIES, PRIVILEGES,
IMMUNITIES, AND
LIABILITIES WITH
RESPECT TO, A PRIVATE
EQUITY INVESTMENT
ADVISED BY HAMILTON
LANE

EXECUTIVE SESSION,
PURSUANT TO HRS § 92-
5(a)(4), TO CONSULT WITH
THE BOARD'S
ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS,
DUTIES, PRIVILEGES,
IMMUNITIES, AND
LIABILITIES WITH
RESPECT TO POTENTIAL

CLAIMS AGAINST THE
ERS, AND FOR
APPROPRIATE ACTION

EXECUTIVE SESSION,
PURSUANT TO HRS § 92-
5(a)(4), TO CONSULT WITH
THE BOARD'S
ATTORNEYS REGARDING
DEVELOPMENTS IN
ONGOING LITIGATION,
AND TO CONSULT WITH
THE BOARD'S
ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS,
DUTIES, PRIVILEGES,
IMMUNITIES, AND
LIABILITIES WITH
RESPECT TO SUCH
LITIGATION;
APPROPRIATE ACTION

APPROVAL OF
EXECUTIVE SESSION
MINUTES

- JANUARY 24, 2018
- FEBRUARY 12, 2018
- MARCH 12, 2018
- APRIL 9, 2018

EXIT EXECUTIVE SESSION

On a motion made by Trustee Machida, seconded by Trustee Barfield and unanimously carried, the Board exited Executive Session at 2:07 p.m.

APPROVAL OF MINUTES

- FEBRUARY 12, 2018
- MARCH 12, 2018
- APRIL 9, 2018

On a motion made by Trustee Barfield, seconded by Vice Chair Rauckhorst, and unanimously carried, the Board approved the minutes for February 12, 2018, March 12, 2018, and April 9, 2018, as presented.

EXECUTIVE DIRECTOR'S
REPORT

Executive Director Williams gave an oral presentation of his report as follows:

- Received positive comments regarding the ERS Summit. Recognized Senator Kouchi and his opening remarks and a number of attendees, including the Trustees commented how wonderful that he was there, more importantly to acknowledge the role that the Legislature has played in creating the challenges that we face in the context of unfunded liability. Sent Senator Kouchi a thank you letter for being a guest speaker and how well received his comments were.
- Met with the Compensation Review Committee and reviewed the goals and objectives of the Executive Director and Deputy Executive Director for FY19. The goals and objectives are ongoing and part of the standard review. The Committee asked them to highlight areas to be focused on. Four major areas were identified: **Legislative** - develop legislative packet for consideration by Governor and Legislators. Will go through

EXECUTIVE DIRECTOR'S
REPORT (CONT'D)

process with the Administrative and Legislative Committee. Part of that process includes the development of Administrative Rules on the Hawaii Domestic Relation Orders as well as the creation of the alternative to the Medical Board. **Accounting** - we will determine reorganization and reassignment with a special focus on support to the investment team. **Chief Investment Officer** - Support and work with individual to develop a long term strategic vision that is vital to the organization. **Governance Policies** – Resume development of, in collaboration with the Board.

- Hiring of new Chief Investment Officer (CIO), Elizabeth Burton announced at the Summit meeting and various media have been contacting us for information and interviews.
- Request feedback of any kind relating to the ERS Summit.
- News articles as part of the Board Packet. Specifically, Leanne Orr of Institutional Investor's positive article on the new CIO.
- Compensation Review Committee provided compensation adjustments for investment officers based on their performance evaluation. The Committee is working on a long-term plan as part of a strategic vision for the investment office.
- Former Deputy Attorney General, Brian Aburano gave some of his artwork to ERS staff.
- Attended NASRA in San Diego.
- Met with Howard Hodel and Neil Rue to confirm an Actuarial Experience Study next year and will be done every three years going forward. Asset Liability Study done every five years, will also be helpful to do.

OPERATIONS REPORT

Deputy Executive Director, Kanoe Margol presented the written operations report as receive and file.

ADJOURNMENT

On a motion made by Trustee Machida, seconded by Trustee Barfield, and unanimously carried, the Board adjourned the meeting at 2:26 p.m.

REDACTED SIGNATURE

Thomas Williams
Executive Director

TW:dkik