

MINUTES OF THE INVESTMENT COMMITTEE OF THE
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

FEBRUARY 11, 2019

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

Trustees present: Dr. Catherine Chan, Vice Chair
Mr. Roderick Becker
Mr. Emmitt Kane
Dr. Genevieve Ley
Mr. Jerome Rauckhorst

Trustees absent: Mr. Vincent Barfield, Chair
Ms. Jackie Ferguson-Miyamoto
Mr. Wesley Machida

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

Staff present: Mr. Thomas Williams, Executive Director
Ms. Kanoë Margol, Deputy Executive Director
Ms. Donna Curry, Program Specialist
Ms. Elizabeth Burton, Chief Investment Officer
Mr. Aaron Au, Investment Officer – Illiquid Markets
Mr. Andrew Chen, Investment Specialist
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. Howard Hodel, Investment Officer – Risk Management
Mr. Ian Wetzel, Investment Specialist
Ms. Gerri Konishi, Member Home Loan Assistant
Ms. Dale Kanae, Board Secretary (Recording Secretary)
Ms. Lori Kim, Secretary

Guests present: Ms. Mary Bates, Pension Consulting Alliance, LLC (PCA)
Mr. Colin Bebee, Pension Consulting Alliance, LLC (PCA)
Mr. Neil Rue, Pension Consulting Alliance, LLC (PCA)
Mr. Chae Hong, Townsend Group, an Aon Company (Aon)

Public present: Mr. Ben Sadoski, UNITE HERE Local 5

CALL TO ORDER/QUORUM A quorum being present (Vice Chair Chan, and Trustees Becker, Kane, Ley, and Rauckhorst), Vice Chair Chan called the Investment Committee (Committee) meeting to order at 9:07 a.m.

PUBLIC COMMENT PERIOD Vice Chair Chan called for public comment. No members of the public present offered any comments.

RECESS Vice Chair Chan called for a recess and announced that the meeting would reconvene after the Chapter 91 proceedings.

RECONVENE

A quorum being present (Vice Chair Chan, and Trustees Becker, Kane, Ley, and Rauckhorst), Vice Chair Chan reconvened the meeting at 9:10 a.m.

GLOBAL SMALL CAP TRANSITION SUMMARY

Investment Officer-Liquid Markets (IO-LM), Anthony Goo, gave a written presentation to the Committee as a receive and file.

CONTINGENCY FUNDS – CAPITLIZIING ON THE CREDIT PIVOT & EXPLOITING DISLOCATIONS

IO-LM Goo, and Pension Consulting Alliance, LLC (PCA), Mary Bates, gave an oral and written presentation to the Committee on:

- Significant opportunities to capitalize on the “credit pivot” – i.e. the late cycle transition from a benign to stressed to stressed to stressed/distressed credit environment;
- Shorter-term dislocations also are more frequent and severe;
- Serves to complement the CRO – i.e., capturing the upside;
- Size so the allocation is meaningful; and
- Given ERS’s current governance structure, Contingent Funds offer an option for ERS to capitalize on the opportunity.

APPROVAL OF MINUTES

- JANURY 14, 2019

On a motion made by Trustee Ley, seconded by Trustee Rauckhorst, and unanimously carried, the Investment Committee approved the minutes of the January 14, 2019, meeting, as presented.

SUMMARY OF FEBRUARY 2019 INVESTMENT OFFICE ACTIVITIES

Chief Investment Officer (CIO), Elizabeth Burton, commented that she will interject throughout the reports on the markets and portfolio rather than have a separate CIO report.

Investment Officer – Risk Management (IO-RM), Howard Hodel, briefly presented the market overview for January, noting that during January, the markets shrugged off geopolitical issues and their impact on future economic and corporate revenue and earnings growth, as global equity markets rebounded by 8%, erasing December’s 7% decline. He noted that the markets were focused on January’s strong U.S. corporate earnings announcements and the dovish comments from the Fed, rather than the trade dispute between the U.S. and China. The U.S. Treasury yield curve was nearly flat out to five years indicating that the market believes Fed interest rate hikes are nearly over. He added that during January there was little progress on a Brexit withdrawal agreement.

CIO Burton highlighted several mistakes investors make that investors should keep in mind during challenging market environments. The highlighted the law of small numbers, anchoring bias, herding, and loss aversion as things to be aware of over the next few years.

PORTFOLIO

IO-LM Goo, and Investment Officer-Illiquid Markets (IO-IM), Aaron Au, presented highlights on the following risk classes and components:

BROAD GROWTH

Traditional Growth

- PCA continues to evaluate the RFI responses from the global active mid/large cap equity manager search.

Stabilized Growth

- Heitman. Staff to assess changing the Investment Policy to allow a small percentage of the Stabilized Growth (core real estate) portfolio

SUMMARY OF FEBRUARY 2019
INVESTMENT OFFICE ACTIVITIES
(CONT'D)

to invest in riskier Private Growth (non-core) investment opportunities using a “build-to-core” strategy.

- City Financial Tower (CFT) Building buildout for tenant improvements is progressing satisfactorily. Nothing new to report
- Invesco’s separate account continues toward an orderly liquidation. One asset remains which is targeted to be sold by mid 2019.
- Staff will recommend in executive session that a global low volatility equity manager be placed on watch status.
- Investment management agreements with AQR, Geode and HPS are still in progress.

Private Growth

- Robust fundraising environment in 2018 is expected to continue into 2019. Staff is conducting final legal and business reviews for four private equity funds and one real estate fund.

IO-RM Hodel summarized and updated the Committee on the following:

CRISIS RISK OFFSET (CRO)

- January preliminary performance was about -1.5%.
- CRO at month-end remained long-fixed income, equities, and the U.S. Dollar, and short commodities.

IO-IM Au, reported the following:

REAL RETURN

Illiquid Real Return

- CIO Burton noted that Real Return will be a focus for staff this year.

OPPORTUNITIES

Kaanapali

- A presentation, in executive session, will be made at today’s Board meeting.

IO-RM Hodel summarized and updated the Committee on the following:

RISK REPORT

Risk Monitoring

- The VIX was elevated during January, averaging 19.6%, while the ERS portfolio volatility dropped significantly in the robust equity market.

POLICY

Investment Policy & Procedures Manual

- Staff is proposing changes to the core real estate policy at today’s Board meeting.

Due Diligence Site Inspections

- Staff completed the bi-annual due diligence of Mellon Capital (CRO manager) and the onsite due diligence of the two-portfolio implementation overlay finalists during January.
- CIO Burton completed an on-site, routine due-diligence visit of Hamilton Lane in February and was pleased with the outcome.

OPERATIONAL

Public Communications

- EQ Derivatives nominated Hawaii ERS for an investor award related to the Alternative Risk Capture component of our Crisis Risk Offset class. CIO Burton noted that the finalists for consideration were all impressive peers.

RFP/RFI/EOI

- Request for Information (RFI) for Diversified Liquid Corporate Credit mandate contract negotiations are underway.
- RFI for Crisis Risk Offset Systematic Trend Following mandate and Alternative Return Capture mandate; an update on manager and component allocations will be presented at today's Board meeting.
- RFI for the portfolio Implementation Overlay; a recommendation will be presented at today's Board meeting.
- An RFI was issued for an Active Global Mid-Large Cap manager and responses are being evaluated.

CURRENT STATUS OF ACTIVITIES OF THE INVESTMENT OFFICE

IO-RM Hodel summarized and updated the Committee on the following:

FOURTH QUARTER F2018 CRISIS RISK OFFSET REPORT

- CRO class rebalanced twice during the quarter, both times due to an ARC manager exceeding its allocation threshold.
- CRO performance was slightly positive for the quarter with Alternative Return Capture and Treasury Duration Capture making solid contributions to performance in a challenging period for growth assets; Systematic Trend Following detracted from performance, due mainly to losses sustained in October.
- Most of the gains during the quarter were in fixed income while equities detracted.
- CRO volatility was 10.5% during the quarter and correlation to the rest of the ERS portfolio was -0.2, reducing ERS volatility from 9.7% to 8.3%.
- Crisis risk status indicators remained GREEN throughout the quarter, although the VIX breached its limit in late December.
- At quarter end CRO was marginally long equities, long fixed income, short commodities and long the US dollar.

FOURTH QUARTER 2018 RISK REPORT

- Portfolio risk levels are appropriate and consistent with policy and market conditions.
- Portfolio and policy portfolio risk levels returned to historical norms during the quarter after 27 months of rarely interrupted calm markets.
- Staff created four path dependent stress tests based on quarter-end positions; results were promising with a market crisis similar to 2008-09 resulting in a 21% ERS portfolio drawdown versus the 37% which actually occurred.
- Other stress scenarios indicate only small to moderate drawdowns. PCA's sentiment indicator turned RED in December; valuations remain high for real estate, private equity, and U.S. public equity

SUMMARY OF FEBRUARY 2019
INVESTMENT OFFICE ACTIVITIES
(CONT'D)

according to historical standards, indicating the potential for significant declines in these growth assets.

Following the report, all public in attendance left the meeting.

ENTER EXECUTIVE
SESSION

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley, and unanimously carried, the Investment Committee entered into Executive Session at 10:08 a.m.

- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions relating to investments or prospective investments by the system that require the consideration of information or records that are exempt from disclosure under chapter 92F, including without limitation information and records that are proprietary information or confidential business or personnel information, with respect to investment manager organizational changes.

EXECUTIVE SESSION, PURSUANT
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APPROVAL OF EXECUTIVE
SESSION MINUTES
- JANUARY 14, 2019

EXIT EXECUTIVE SESSION

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley, and unanimously carried, the Investment Committee exited Executive Session at 10:09 a.m.

ADJOURNMENT

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley, and unanimously carried, Vice Chair Chan adjourned the Investment Committee meeting at 10:09 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer

ETB/dkik