

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

NOVEMBER 13, 2018

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

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

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
Mr. Karl Kaneshiro, Retirement Benefits Manager (Temporary
Assignment to Deputy Executive Director)
Ms. Elizabeth Burton, Chief Investment Officer
Ms. Donna Curry, Program Specialist
Mr. Howard Hodel, Investment Officer – Risk Management
Mr. Aaron Au, Investment Officer – Illiquid Markets
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. Andrew Chen, Investment Specialist
Mr. Ian Wetzel, Investment Specialist
Ms. Gerri Konishi, Member Home Loan Assistant
Ms. Lori Kim, Secretary
Ms. Dale Kanae, Board Secretary
Ms. Wanda Kugiya, Recording Secretary

Staff excused: Ms. Kanoë Margol, Deputy Executive Director

Guests present: Mr. Neil Rue, Pension Consulting Alliance, LLC
Mr. Paul Yett, Hamilton Lane Advisors, LLC
Mr. Chae Hong, The Townsend Group, an Aon Company

Public present: Ms. Mitra Elie, UNITE HERE Local 5
Mr. Jordan Fein, UNITE HERE Local 5

CALL TO ORDER/QUORUM

A quorum being present (Vice Chair Chan, and Trustees Ferguson-Miyamoto, Johnston, Kane, Ley, Machida, and Rauckhorst), Vice Chair Chan, in the absence of Chair Barfield, called the Investment Committee meeting to order at 9:15 a.m.

PUBLIC COMMENT PERIOD	Vice Chair Chan called for public comment. There were no members of the public present to offer comment.
RECESS	Vice Chair Chan called for a recess and announced that the meeting would reconvene after the Chapter 91 proceedings. (Mr. Karl Kaneshiro was not present after the recess.)
RECONVENE	A quorum being present (Vice Chair Chan, and Trustees Ferguson-Miyamoto, Johnston, Kane, Ley, Machida, and Rauckhorst), Vice Chair Chan reconvened the meeting at 9:19 a.m.
AMENDMENT OF THE AGENDA	Mr. Thom Williams, Executive Director, requested that the Investment Committee amend the agenda of today’s meeting to add a new item in Executive Session, Pursuant to HRS § 88-27.5(a)(1) and HRS § 92-5(a)(4), to conduct discussions, deliberations relating to, and if appropriate, to make decision on (or delegate decision making on) 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 Blackstone Real Estate Partners IX, L.P., appropriate action. On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Rauckhorst, and unanimously carried, the Investment Committee approved the amendment to the agenda.
APPROVAL OF MINUTES - OCTOBER 9, 2018	On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Rauckhorst, and unanimously carried, the Investment Committee approved the minutes of October 9, 2018 meeting, as circulated.
SUMMARY OF NOVEMBER 2018 INVESTMENT OFFICE ACTIVITIES	Ms. Elizabeth Burton, Chief Investment Officer (CIO), discussed her one-month anniversary with the Investment Office. Trustees can contact her or Mr. Howard Hodel, Investment Officer-Risk Management, on any questions regarding the portfolio. She added that given October market volatility, she had sent out an October market and portfolio analysis to the Trustees a week before the meeting. Mr. Hodel briefly presented the market overview for October, noting that October’s capital markets acted similarly to February with global equities down about 8 percent, the dollar strengthening, crude oil lower, and interest rates higher. These are adverse conditions for traditional investment portfolios. Equity market volatility was somewhat above normal for the month, but not extreme and the ERS portfolio performed as expected with stabilized growth and crisis risk offset strategies serving their purpose of dampening portfolio volatility during the near market correction. Messrs. Anthony Goo, Investment Officer-Liquid Markets; and Aaron Au, Investment Officer-Illiquid Markets; presented highlights on the following risk classes and components:

Traditional Growth

- Longview reported an overdraft of EUR 90.69 that occurred in late October. The overdraft was due to a negative interest payment on a EUR credit balance earlier in the month. Funds due were credited back to the account.

Stabilized Growth

- Heitman continues to carefully build up the portfolio. Due diligence continues on niche/specialty asset types to improve diversification. Two major grocery anchors moving into two different mainland properties. They continue to pursue a self-storage joint venture for ERS.
- Robeco reported an overdraft of \$9,837.00 that occurred in October. The overdraft was due to the money market sweep of expected dividend income which was not credited to the account until late October. Funds due were credited back to the account.

(Mr. Jordan Fein and Ms. Mitra Elie arrived at the meeting at 9:26 a.m.)

- City Financial Tower (CFT) leasing discussions continue and are going well with a potential tenant for 2-full floors and a partial floor. Leasing broker negotiating lease terms and tenant improvements, lease signing expected this or next week.
- Invesco continues toward an orderly liquidation. Staff was recently informed that a buyer has been selected for one of the two remaining properties. The Commercial Mortgage Income Fund has about \$13 million funded out of ERS's \$100 million commitment.
- Robeco's account was overdrawn and credited back to the account. As corrective action, Robeco will maintain \$100,000 minimum balance and BNY Mellon will change its procedure to only sweep funds in excess of that amount.

(Trustee Machida left the meeting at 9:27 a.m.)

Private Growth

- Mr. Au reiterated that both private equity and non-core real estate commitments achieved their pacing targets for 2018, but if there were compelling investment opportunities, they would be brought to the Board of Trustees for consideration. One such opportunity will be discussed in executive session.

Crisis Risk Offset (CRO)

- Mr. Hodel summarized CRO positioning and performance during the volatile October capital markets. Ex-ante (projected) CRO volatility increased to about nine percent, slightly lower than the volatility of the rest of the ERS portfolio. All crisis risk indicators remained green during the month. The portfolio's long equity position at the beginning of the month detracted from performance, but by the end of the month CRO was very slightly short equity. The long bonds exposure also hurt performance as interest rates rose. The sizeable long U.S. dollar position helped performance as capital sought safety in haven currencies. Commodities detracted from performance, due mainly to the fall in oil prices and strengthening agricultural prices.

One of the ARC managers triggered a CRO rebalance mid-month when its long dollar and short equity exposures produced about a twelve percent positive return.

- Trustee Barfield asked whether the allocation to CRO helped or hurt performance during the month. Mr. Hodel responded that it did help improve performance—traditional growth was down about 7.5%, low volatility equity was down about 6.5%, and options-based equity was down about 5%, while the credit and principal protection portfolios were down about a half percent. Combining all those and you get about a negative 5% return from the liquid portion of the ERS portfolio, while CRO lost only about half that amount, raising the ERS total return by about a half percent.

(Ms. Donna Curry left the meeting at 9:29 a.m.)

Principal Protection

- Global Mandates: Staff visited Eaton Vance. Report will be forthcoming on removing them from the watch list.
- U.S. Mandates: Site visits for Bank of Hawaii and First Hawaiian Bank. They will be removed from the watch list.

(Trustee Barfield joined the meeting at 9:40 a.m.)

Real Return

- Liquid: Nothing to report.
- Illiquid: Townsend/Aon and PCA are sourcing potential infrastructure and agriculture opportunities.

Opportunities

- Ka'anapali: Staff targeting an update for the Ad Hoc Committee in January 2019 and a potential Board presentation to follow. Lowe will cover milestones reached and updated options on next steps.

Risk Monitoring

- Mr. Hodel noted that during October the markets focused on trade and interest rate issues and their impact on future global economic growth and corporate earnings resulting in both stocks and bonds down. Mr. Hodel then referred the Trustees to the quarterly risk dashboard report for the third quarter of 2018, noting that the ERS's portfolio risks are appropriate and consistent with policy and current market conditions. He explained the stress and scenario tests, noting that the financial crisis scenario shows a -27% impact on ERS assets, which although large is much better than the -37% that the ERS experienced in the actual 2008-09 financial crises. This impact does not include the favorable performance impact that dynamic strategies like CRO and equity-option writing can produce during extended risk-asset drawdowns. Trustee Kane asked whether staff could run path dependent stress tests. Mr. Hodel responded that FRM works with the CRO managers to run path dependent stress tests several times per year and this could be extended to the rest of the ERS portfolio, but it would take a considerable amount of work since

Aladdin is only capable of producing point-in-time shocks. Mr. Hodel indicated that staff would work on getting this accomplished. Mr. Hodel continued that over 90% of the ERS portfolio's total risk is attributable to growth risk, noting that the portfolio's sensitivity (delta) to changes in equity is about 66%. Trustee Barfield asked whether this is appropriate. Mr. Hodel replied yes because a significant level of growth risk is necessary to produce the ERS's target rate of return and even though the portfolio is much more diversified than it was a few years ago, growth risk as a proportion of total risk will be high because the other risks are muted by their low to moderate correlations to growth risk. The main impact of diversification has been to lower total risk rather than changing the proportion of growth to total risk. This is apparent by looking at the contribution to volatility/risk tables in the dashboard. CRO, for example, reduced the total realized volatility of the ERS portfolio from 4.7% to 4.0% in the quarter (that level is about half what would be expected in normal market conditions). The conversation continued with a discussion of active risks.

Mr. Hodel proceeded to the third quarter CRO report and gave a brief summary of operations, performance, risks and exposures. Trustee Chan asked several questions related to the appropriateness of the correlations among CRO managers, especially among the ARC and STF managers. Mr. Hodel and Ms. Burton responded that correlations only tell part of the story about how well the managers fit together, but the correlations are higher than optimal and staff has taken several steps to reduce the price momentum in ARC by adjusting manager allocations and seeking new alternative risk premia managers. Trustee Chan asked about the relationship between volatility and performance to which Mr. Hodel answered that volatility of returns as a statistic has no relationship to the return achieved, it just indicates how choppy the return stream is; but in capital markets, volatility is negatively correlated to returns as markets tend to be more choppy when declining than advancing. The goal is to achieve the target rate of return with the least amount of volatility and this is very important when portfolios like the ERS pay out more in benefits each year than they receive in contributions.

Trustee Barfield questioned whether the short foreign currency exposure was appropriate since the stress test for foreign currency was sizeable. Mr. Hodel replied that yes it is appropriate and it is a significant risk within CRO (a 10% decline in the value of the dollar versus a basket of foreign currencies would result in a 10% decline in CRO assets), but in the context of the rest of the ERS portfolio, it is not large. The ERS already has a large long foreign currency exposure (11% of total ERS assets as is shown on the risk dashboard) including the CRO's short foreign currency holdings, so CRO is cutting ERS's foreign currency risk in half.

(Mr. Paul Yett arrived at the meeting at 9:53 a.m.)

ORGANIZATIONAL CHANGES AT
THE EMPLOYEES' RETIREMENT
SYSTEM INVESTMENT MANAGERS

Mr. Au asked for questions, none were asked.

- Lowe Investment Management, LLC (Opportunities)

AMENDMENT OF THE AGENDA

Mr. Williams requested that the amendment to the agenda be deferred for consideration during the Board meeting. The Investment Committee concurred with the request without objections.

ADJOURNMENT

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Rauckhorst, and unanimously carried, Vice Chair Chan adjourned the Investment Committee meeting at 10:29 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer

ETB/wk