

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

MARCH 9, 2020

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

Trustees present: Mr. Vincent Barfield, Chair
Dr. Catherine Chan, Vice Chair
Dr. Genevieve Ley
Mr. Wesley Machida
Mr. Jerome Rauckhorst
Mr. Bennett Yap

Trustees absent: Mr. Craig Hirai
Mr. Emmit Kane

Attorneys present: Mr. Ivan Torigoe, Deputy Attorney General
Ms. Elmira Tsang, Deputy Attorney General
Mr. Clayton Zane, Deputy Attorney General

Staff present: Mr. Thomas Williams, Executive Director
Ms. Kanoe Margol, Deputy Executive Director
Ms. Elizabeth Burton, Chief Investment Officer (via phone)
Mr. Aaron Au, Investment Officer – Illiquid Markets
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. David Okamoto, Investment Officer - Credit
Mr. Howard Hodel, Investment Officer – Risk Management
Mr. Ian Wetzel, Investment Officer
Mr. Andrew Chen, Investment Specialist
Ms. Gerri Konishi, Member Home Loan Assistant
Ms. Dale Kanae, Board Secretary
Ms. Lori Kim, Secretary
Ms. Diana Gomes, Secretary

Guests present: Mr. Colin Bebee, Meketa Investment Group, Inc.
Mr. Neil Rue, Meketa Investment Group, Inc.

Public present: None

CALL TO ORDER A quorum being present (Chair Barfield, Vice Chair Chan and Trustees Ley, Machida, Rauckhorst and Yap), Chair Barfield called the Investment Committee meeting to order at 9:04 a.m.

PUBLIC COMMENT PERIOD Chair Barfield called for public comment. There were no members of the public present to offer comment.

RECESS Chair Barfield called for a recess at 9:04 a.m. and announced that the

meeting would reconvene after the Chapter 91 proceedings.

RECONVENE

A quorum being present (Chair Barfield, Vice Chair Chan and Trustees Ley, Machida, Rauckhorst and Yap), Chair Barfield called the Investment Committee meeting to order at 9:17 a.m.

APPROVAL OF MINUTES - FEBRUARY 10, 2020

On a motion made by Trustee Machida, seconded by Trustee Rauckhorst and unanimously carried, the Investment Committee approved the minutes of the February 10, 2020, meeting as presented.

SUMMARY OF MARCH 2020 INVESTMENT OFFICE ACTIVITIES:

- MARKET OVERVIEW
- CURRENT STATUS OF ACTIVITIES OF THE INVESTMENT OFFICE

Howard Hodel and Elizabeth Burton gave an update on the markets and noted the difficulty in assessing the impacts of the pandemic at this point. Howard noted the market information for the month of March:

Global equity markets corrected during the last week of February after advancing to new highs. The capital market moved a lot during the last week of the month due to fears of the Coronavirus and how it would impact the asset prices and economies around the world as the virus spreads. There is no way of knowing how long this pandemic will last or how severely deep it will curtail economic activity and impact health care systems, creating government tension and causing them to act. All industries are impacted by the crisis. Should the virus die out in the summer, then the markets could come back in the second half of the year.

February was not a good month for economic news:

1. Global equity markets dropped about 11%, while large cap U.S. equities dropped nearly 13%.
2. The U.S. Treasury yield curve from six-months out to 30 years dropped roughly 40 bps, bringing the year-to-date drop in yields to about 80 bps for maturities from 5 to 30 years.
3. Fed Funds rate is currently 1.50% to 1.75% while U.S. Treasury yields between one-year and five years are all below one percent.
4. This disparity indicates the market expects the Fed to cut interest rates in March and keep rates at historic lows far into the future.

Investment Specialist, Andrew Chen, reviewed a stress tests the risk team has run on the portfolio and reported the last results according to the latest results the portfolio is down by 22% and would take two to three years to recover.

The investment portfolio assets was at \$17.4 billion as of Friday, March 6, 2020 with 22% in Illiquid. \$2.7 billion CRO was rebalanced on March 2, 2020 due to one manager's underperformance triggered a rebalance during the late February equity market correction and U.S. Treasury bond rally. Crisis Risk Indicators as a group remained GREEN during

the month of February. CRO has been negatively correlated to the rest of the ERS portfolio, which has reduced the volatility of the total ERS portfolio, while adding value so far during both the 2020 fiscal year and the 2020 calendar year. CRO doing what it is intended to do.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton explained the potential use of macro asset strategy during a crisis. A macro asset strategy already exists in the portfolio and looking into expanding macro investments because they can uphold various scenarios.

CIO Burton mentioned the team had an off-site meeting to discuss each portfolio in detail and evaluated where we want to take risks, what improvements can be made considering current markets, and what can be done for the coming year. The team reviewed each Investment Officer's portfolio as well as the risk budget.

Furthermore, CIO Burton stated that ERS portfolio is very liquid which should be an advantage moving forward. ERS' portfolio should do well compare to others given its liquidity and conservative risk profile but need to see how things play out.

The team is continuing to proactively monitor risks related to macro events, such as politics and corona, and simulate regular shocks.

[End of CIO Report]

Investment Officer, Anthony Goo said in addition to what was mentioned in the activities report, the transition is in motion through bids for proposals sent out to our transition managers and requested responses by Wednesday, March 11, 2020 and have a manager selected by Friday, March 13, 2020 with the transitioning happening in mid-March.

Investment Officer, Ian Wetzel explained that progress continued in consolidating from two separate account managers to one. The remaining separate account manager continues to manage existing properties and continues to invest in and look for additional opportunities. Manager is targeting \$550 million in commitments and plans to invest remaining unfunded commitments (approximately \$100 million) by the end of 2020. ERS committed an additional \$50 million to the manager's core real estate debt fund, bringing total commitments to the manager to \$600 million. Looking into a couple of industrial properties since the portfolio is underweight in that area.

Investment Officer, Aaron Au stated that ERS staff conducted final legal and business review on seven potential investment funds with four different managers. Total commitment is \$195 million with managers representing various strategies and geographies. These investments are

consistent with the strategic plan and the pacing plan presented by staff and Hamilton Lane then approved by the Board of Trustees on November 2019 and July 2019, respectively. When completed, its target allocation will be between \$550 to \$650 million for calendar year 2020.

Investment Officer, Ian Wetzel explained the Calendar 2020 pacing plan for non-core real estate commitments is a \$130 million target (\$100M-\$150M range). Actual commitments are expected to be on track with plan. One fund (\$40M) was approved in November 2019 (for 2020 plan) and staff/consultant have identified other potential funds coming to market in 2020 consistent with the approved real estate strategic plan. Staff continues to work with consultant and managers to identify top real estate funds for recommendation to the Board. Approved strategy is to focus on foundation managers and other high-quality managers as well as focus on real estate debt, and European opportunities to compliment Asian Exposure.

Investment Officer, Howard Hodel mentioned the \$2.7 billion CRO rebalanced on March 2, 2020 as one manager's underperformance triggered a rebalance during the late February equity market correction and U.S. Treasury bond rally. Crisis Risk Indicators as a group remained GREEN during the month, although VIX (31.9% five-day average) exceeded its limit of 30% on February 28, 2020.

CRO at month-end remained long fixed income (increasing exposure), equities (decreasing exposure), and the U.S. dollar (increasing exposure), while commodities switched from long to short. CRO has been negatively correlated to the rest of the ERS portfolio, which has reduced the volatility of the total ERS portfolio, while adding value so far during both the 2020 fiscal year and the 2020 calendar year.

The capital markets in February were favorable for the duration and trend strategies, mixed for systematic macro, and unfavorable for risk premia. The long-fixed income position provided strong positive CRO performance for the month as U.S. Treasury rates hit historically low levels, while the somewhat stronger dollar and commodity positioning supported the positive result, and the long equity partially offset the positive performance.

Reinsurance negotiations continue; no major concerns and everything should be fine at this point. An education session is being planned in March/April for this asset class. At the earliest, the plan is to invest in July.

Meketa's UNPRI reporting is 92% complete and staff is currently reviewing responses. The annual Transparency report will be summarized at April's Board of Trustees' meeting.

Investment Specialist, Andrew Chen, explained the VIX increased to an average of 19.6% (closing between 13.7% and 40.1%) for the month, above the long-term historical median level of 17%, while U.S. large cap

equities declined -8.2% in February as the concerns grew about the impact of Coronavirus (COVID-19) outbreak.

Daily tracking of the ERS portfolio performance during February indicated an annualized volatility of 10.2%, above the level experienced over the past three years.

Staff is continuing to monitor potential, significant macro risks in each of the three major economic regions of the world, any of which could trigger another market correction.

ENTER EXECUTIVE SESSION

On a motion made by Trustee Rauckhorst, seconded by Trustee Machida, and unanimously carried, the Investment Committee entered Executive Session at 9:45 a.m.

PURSUANT TO HRS § 88-27.5(A)(1) AND HRS § 92-5(A)(4), TO CONDUCT DISCUSSIONS AND DELIBERATIONS RELATING TO, AND IF APPROPRIATE, TO MAKE A DECISION 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, 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 INVESTMENT MANAGER ORGANIZATIONAL CHANGES.

EXECUTIVE SESSION

APPROVAL OF EXECUTIVE SESSION MINUTES – FEBRUARY 10, 2020

Approval of Executive Session Minutes – February 10, 2020.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Rauckhorst, seconded by Trustee Machida, and unanimously carried, the Investment Committee exited Executive Session at 9:57 a.m.

MEETING ADJOURNED

On a motion made by Trustee Rauckhorst, seconded by Trustee Machida, and unanimously carried, Chair Barfield adjourned the meeting at 9:58 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer

EB/dlg