

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

MAY 12, 2020

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

Trustees present: Mr. Vincent Barfield, Chair (Skype)
Dr. Catherine Chan, Vice Chair (Skype)
Mr. Craig Hirai (Skype)
Mr. Emmit Kane (Skype)
Dr. Genevieve Ley (Skype)
Mr. Wesley Machida (Skype)
Mr. Jerome Rauckhorst (Skype)
Mr. Bennett Yap (Skype)

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

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

Guests present: Mr. Colin Bebee, Meketa Investment Group, Inc. (Skype)
Mr. Neil Rue, Meketa Investment Group, Inc. (Skype)
Mr. Chae Hong, Aon Hewitt Investment Consulting, Inc. (Skype)
Mr. Jack Dowd, Aon Hewitt Investment Consulting, Inc. (Skype)
Ms. Natalie Fitch, Hamilton Lane (Skype)
Mr. Paul Yett, Hamilton Lane (Skype)

Public present: None

CALL TO ORDER

A quorum being present (Chair Barfield, Vice Chair Chan and Trustees Hirai, Kane, Ley, Machida, Rauckhorst and Yap), Chair Barfield called the Investment Committee meeting to order at 9:06 a.m. Chair Barfield read the following statement, "Motion to hold meeting closed to the public and allowing Trustees to participate by teleconferencing or other

remote meeting technology, pursuant to Section 4 of the Governor of the State of Hawaii's Supplementary Proclamation dated March 16, 2020, in order to implement social distancing measures."

PUBLIC COMMENT PERIOD

Chair Barfield called for public comment. There was no public comment.

RECESS

No recess was taken, Chapter 91 proceedings was moved to the latter part of the Board of Trustees meeting.

RECONVENE

Chair Barfield continued the Investment Committee meeting.

**APPROVAL OF MINUTES
APRIL 14, 2020**

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley and unanimously carried, the Investment Committee approved the minutes of the April 14, 2020 meeting as presented.

**SUMMARY OF APRIL 2020
INVESTMENT OFFICE ACTIVITIES:**

- MARKET OVERVIEW
- CURRENT STATUS OF ACTIVITIES OF THE INVESTMENT OFFICE
- CREDIT PORTFOLIO UPDATE

Investment Officer ("IO") Howard Hodel and Chief Investment Officer ("CIO") Elizabeth Burton presented an update on the market. IO Hodel presented the market information for the month of April:

April was a good month for the capital markets. The U.S. equity and global equity markets were up about 13 percent and 11 percent respectively. Additionally, credit spreads contracted significantly, recovering over half of the widening that had occurred since the crisis began in late February. These recover increases suggest reassurance for an economic recovery as governments ease Covid-19 restrictions around the globe. Volatility remained high in all markets, especially oil prices which traded in negative territory on April 20, 2020 due to a delivery squeeze from excess supply. Despite the rise in stock prices and contraction in credit spreads, the economic downturn and increased unemployment will generate a global recession in coming quarters, with great uncertainty as to how quickly economies, companies and jobs will recover.

Over the last few months, the Fed took decisive steps to support the capital markets, including cutting the Fed Fund's rate to near zero, launching a major bond buying program, and announcing the TALF (Term Asset-Backed Loan Facility) program to support asset-backed securities (ABS) market by providing attractive financing for investment opportunities to purchase ABS. As a result of these Fed actions and the flight of capital to quality, the U.S. Treasury yield curve fell to historical lows during April. By month end, the curve sloped gradually up from 11 bps for the three-month to 1.35% for the 30-year.

Other highlights for the month include:

1. At the end of March, the U.S. government took unprecedented actions by passing a \$2 trillion relief and economic stimulus package (CARES Act) and two other bills that will provide funds to assist

medical facilities, essential workers treating coronavirus patients, individuals suffering financially, and small businesses to keep workers employed.

2. During April, a fourth stimulus package totaling a half billion dollars was enacted to support small businesses, a coronavirus testing program, and hospitals.
3. By the end of April, the Administration and Congressional leaders were looking into additional spending programs to stimulate the economy providing support to impacted individuals and businesses.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton mentioned the team continues to work remotely per the Governor's stay-at-home order; nevertheless, there is constant communication. Regular team meetings, discussions with managers as well as educational training is still taking place.

The team participated in an operational due diligence online seminar as well as other trainings and is taking advantage of the many online educational opportunities provided now.

Internal and external discussions with the team regarding Hawaii-specific investments are taking place.

April's performance was much better than March. The ERS portfolio is more liquid than those of our peers, by design. Some peers were forced sellers, needing to liquidate assets to meet margin calls; whereas, ERS did not have to.

CIO Burton provided an update on the status of setting up options for pre-funding accounts. The non-investment grade option requires a minimum account size to set up. IO Hodel will give more specifics later in this meeting.

CIO is working together with Executive Director Thomas Williams, the consultants and staff on IPS edits. There will be a completed draft for the Trustees to review prior to the next Board of Trustees meeting on June 8, 2020. The goal is to streamline and update the IPS by the end of July.

Crisis Risk Offset (CRO) has done well; staff is and presently evaluating which modifications to the portfolio are going to assist us moving forward considering the new market environment.

Furthermore, CIO Burton stated that ERS' portfolio is performing as expected.

[End of CIO Report]

Investment Officer Howard Hodel elaborated that staff is moving forward with establishing a short duration investment grade, fixed income option pre-funding account within ERS for the State of Hawaii and Hawaii Counties to invest their advance contributions. This vehicle provides an enhanced return at relatively low risk relative to the new fund is expected to be available by June 30, 2020. If advance contributions reach \$200 million and there is demand by the State and income option in addition to the other options.

Investment Officer Ian Wetzel reported that increasing the core real estate long-term strategic allocation target could potentially increase due to 2019 A/L study results (pending IPS changes). IO Wetzel and consultant will assess any potential increases and incorporate it into future strategic/pacing plans. The Covid-19 situation is impacting real estate markets and ERS' portfolio. There are concerns regarding rent collection or requests for deferral. Concerns are more prevalent with retail and hotel, with industrial and apartments faring relatively better (but still negatively impacted.)

Investment Officer Aaron Au stated that ERS staff and legal counsel are working on five private equity funds with total commitments of up to \$195 million. The funds are in the large- and mega-size buyout space which are consistent with both the strategic plan and pacing plan presented to the Board of Trustees on November 2019 and July 2019, respectively. When completed, ERS would achieve its target allocation of \$550 to \$650 million for calendar year 2020.

IO Au is tracking the current economic stress being placed on the private equity portfolio and has previously requested that the private equity consultants prepare an exposure analysis of the ERS' portfolio.

IO Howard Hodel explained that staff is in the process of onboarding one new reinsurance manager and working closely with another reinsurance manager to structure a separate account while continuing to review other managers. Instead of buying into an existing portfolio, the reinsurance manager will be building a new portfolio starting off at \$50M to segregated within the fund to protect the ERS from any pandemic liability risk that already exist in the fund.

CIO Burton said that she and IO Hodel are in the process of conducting due diligence on discretionary global macro managers, consistent with the approved asset liability study.

IO Ian Wetzel is working with the investment staff and consultants on IPS revisions that will affect the structure of the real return class and other real assets in ERS' portfolio. The plan to combine all the real assets in the portfolio giving optimal structure (more efficient, better aligned with staff/consultant coverage, simplify, etc.)

The Real Return risk class will be renamed Real Assets and moved to Broad Growth risk class (a separate Real Return risk class will no longer exist). Real Estate (both Core & Non-Core) will move to Real Asset and removed from their current areas (Core Real Estate from Stabilized Growth and Non-Core Real Estate from Private Growth). Real Assets will include Real Estate (Core & Non-Core), Timber, Agriculture, Infrastructure as well as other Real Assets.

Investment Specialist Andrew Chen presented that VIX decreased to an average of 41.5% (closing between 31.2% and 57.1%) for the month with the current level above the long-term historical median level of 17.3%.

As the number of new Covid-19 infections declined, U.S. large-cap equities returned 12.7% for the month and central banks rolled out \$8 trillion in stimulus to assist with a speedy recovery.

Daily tracking of the ERS portfolio performance during April showed an annualized volatility of 18% versus 30.3% from the previous month; nevertheless, the current volatility is above the level experienced over the past three years.

Staff continues 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.

Investment Officer Howard Hodel reported on the Crisis Risk Offset (CRO) Q1 2020. Here is a summary of the items covered in the report:

CRO Class First Quarter net performance was 10.64%, with gross performance of 10.81% vs. benchmark of 8.02%.

Crisis Risk status indicators triggered red and the Crisis Risk Committee (CRC) convened on March 13, 2020 with a decision to withdraw capital from CRO, particularly from Treasury Duration Capture (TDC) and adjust manager allocations to limit rebalancing amounts until quarter end.

CRO was rebalanced three times during March as a result of managers breaching allocation thresholds as well as a result of the CRC meeting held on March 13, 2020. ERS withdrew \$325 million of capital from CRO Class in March.

Commodities exposure began the quarter net long but decreased and flipped to net short in the beginning of February, which was driven by energy exposure moving from long to short.

CRO's long U.S. dollar vs. foreign currency positioning increased through the first half of the quarter before decreasing more dramatically in March.

As concerns grew over Covid-19 around the globe and the impact on the global economy of widespread and severe government-mandated social and economic restrictions to slow the spread of the Covid-19 virus on the global economy, crisis indicators spiked across the board to levels last seen during the Global Financial Crisis. The market risk indicator was the first to trigger its threshold as market volatility spiked in the final weeks of February and the VIX 5-day average exceeded 30 by February 28, 2020.

By quarters end, market risk, solvency risk, liquidity risk, and overall systemic risk indicators were all breaching their thresholds.

The ERS portfolio held up well during the crisis.

Investment Specialist Andrew Chen reported on the Risk Report Q1 2020. Here is a summary of the items covered in the report:

Portfolio risk levels are appropriate and consistent with policy and market conditions.

ERS portfolio is estimated to return +9.7%, -10.7% and -23.5% under BlackRock Aladdin's Pandemic Recession-Moderate Recovery, Pandemic Recession-Global Recession, and Pandemic Recession-Depression-Fears respectively.

Current projected annualized volatility for the ERS portfolio is higher than for the policy portfolio (23.1% vs. 19.8%) with a projected tracking error of 3.73% and projected beta of 1.1.

The 10-year Treasury yield increased from 1.92% to 0.7% during the quarter.

U.S. GDP contracted 4.8% in the first quarter, the first decline since the first quarter of 2014. Economists forecast a 3.8% decline.

The Covid-19 pandemic shut down much of global economic activities and pushed the world into a recession.

ENTER EXECUTIVE SESSION

On a motion made by Trustee Chan, seconded by Trustee Machida, and unanimously carried, the Investment Committee entered Executive Session at 10:27 a.m.

EXECUTIVE SESSION

APPROVAL OF EXECUTIVE
SESSION MINUTES – APRIL 14, 2020

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley and unanimously carried, the Investment Committee approved the minutes of the April 14, 2020, meeting as presented.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Kane, seconded by Trustee Machida, and unanimously carried, the Investment Committee exited Executive Session at 10:32 a.m.

MEETING ADJOURNED

On a motion made by Trustee Rauckhorst, seconded by Trustee Yap, and unanimously carried, Chair Barfield adjourned the meeting at 10:33 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer

EB/dlg