

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

JULY 13, 2020

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

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| Trustees present: (via teleconference) | Mr. Vincent Barfield, Chair Dr. Catherine Chan, Vice Chair Mr. Craig Hirai Mr. Emmit Kane Dr. Genevieve Ley Mr. Wesley Machida Mr. Jerome Rauckhorst Mr. Bennett Yap |
| Attorneys present: (via teleconference) | Mr. Ivan Torigoe, Deputy Attorney General Ms. Elmira Tsang, Deputy Attorney General Ms. Diane Wong, Deputy Attorney General Mr. Clayton Zane, Deputy Attorney General (audio only) |
| Staff present: (City Financial Tower) | Mr. Thomas Williams, Executive Director Ms. Kanoe Margol, Deputy Executive Director Ms. Elizabeth Burton, Chief Investment Officer 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: (via teleconference) | Mr. Colin Bebee, Meketa Investment Group, Inc. Ms. Mika Malone, Meketa Investment Group, Inc. Mr. Chae Hong, Aon Hewitt Investment Consulting, Inc. Mr. Jack Dowd, Aon Hewitt Investment Consulting, Inc. |
| Public present: (via teleconference) | Thomas Lofton, Public Lindsay Saienni, Financial Investment News Luther Yost, Public |

CALL TO ORDER

A quorum being present (Chair Barfield, Vice Chair Chan and Trustees Kane, Ley, Machida, Rauckhorst and Yap), Chair Barfield called the Investment Committee meeting to order at 9:07 a.m. Chair Barfield read

the following statement, “Motion to hold meeting without any members of the public physically present and allowing Trustees and members of the public to participate by teleconference or other remote meeting technology, pursuant to the Governor of the State of Hawaii’s Supplementary Proclamation dated June 10, 2020, in order to implement social distancing measures.” On a motion made by Trustee Rauckhorst, seconded by Trustee Yap and unanimously carried, the Investment Committee meeting continued.

PUBLIC COMMENT PERIOD

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

RECESS

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

RECONVENE

Chair Barfield continued the Investment Committee meeting.

**APPROVAL OF MINUTES
JUNE 8, 2020**

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley and unanimously carried, the Investment Committee approved the minutes of the June 8, 2020 meeting as presented.

**SUMMARY OF JUNE 2020
INVESTMENT OFFICE ACTIVITIES:
• MARKET OVERVIEW
• CURRENT STATUS OF
ACTIVITIES OF THE
INVESTMENT OFFICE**

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

Although the first quarter of 2020 stock market performance was the worst in history, the second quarter was one of the best. During June, there was a continuation of a strong rally in equities with both the U.S. and global markets up around two to three percent, reflecting optimism for an economic recovery. Volatility declined slightly but remained high in virtually all markets. The upcoming U.S. elections are currently not impacting markets; however, tensions between the U.S. and China continued during June.

Other highlights for the month include:

1. Markets are expecting Congress and the President to reach an agreement to spend around another \$1.5 trillion this summer on stimulus and support programs. As a result of these very accommodative U.S. monetary and fiscal actions, the money supply has increased substantially and there is no financial incentive to hold cash with short-term interest rates near zero.
2. The European Union (EU) Commission proposed a 750-billion-euro recovery fund consisting of grants and loans for every EU member state, supplementing its initial 540-billion-euro rescue package.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton mentioned that the labor growth rate has been declining for decades but may pick up due to the rapid advancement and adoption of technology due to COVID-19. Companies should get more efficient by learning to do more with less. Industries that seem to be showing stronger recoveries from the pandemic-induced sell-off are technology related to education and healthcare. The travel and leisure industry (airline, hotels, car rentals, theme parks, etc.), retail, and hospitality industry that relies on face-to-face contact (such as sit-down restaurants) will continue to struggle until the public feels comfortable and is allowed to venture out. The shutdowns unfortunately will likely lead to continued divergence in leading to an increase in income disparity. Relative value trade should return.

Without additional stimulus measures, the \$600 weekly unemployment benefits will cease at the end of July. According to the Paycheck Protection Program (PPP), employers are not required to keep employees after October, which will result in an increase in unemployment numbers.

S&P 500 year-to-date as of July 13 is now ranging close to the previous high. An increase in the equity market as well as VIX is making it difficult on Crisis Risk Offset (CRO). With 2020 being an election year, it may create more volatility.

Staff is looking into the possibility of investing in China. There are winners and losers in COVID, and some ex-US markets look interesting, including potentially China and other parts of Asia ex-Japan. Since ERS' portfolio is liquid, there may also be opportunities in private market secondaries to round out the private markets portfolios. COVID-19 dislocation should be taken advantages of. The investment team needs to act whenever possible to take advantage of opportunities.

Furthermore, CIO Burton stated that ERS' portfolio is performing as expected and is pleased with its performance.

On June 25, 2020, CIO Burton was interviewed on CNBC's Squawk Box.

[End of CIO Report]

Investment Officer Ian Wetzel continues to monitor and oversee existing managers as well as reviewing updates on the COVID-19 situation. In addition, IO Wetzel stated that property types such as multi-family, apartments (regardless of collecting rent), industrial, grocery-anchored retail stores and self-storage facilities are expected to do relatively better (be more resilient); whereas, senior/student housing, retail and hotels are expected to be the most negatively impacted. Office space has great uncertainty and some offsetting impacts, since an increase of office space could occur due to the need of revamping existing areas to meet

social distancing requirements. On the other hand, the need for less office space could arise with the possibility of more employees working remotely.

According to Aon's preliminary numbers, returns for core open-end funds will likely see a decrease of 2-3% in the second quarter. Closed-end fund or value-added and opportunistic funds averaged a decrease of 6% in the first quarter with 25% having double digit write downs, more than likely retail and hospitality.

IO Wetzel mentioned that non-core closed-end funds depended on the cycle of the fund how COVID-19 affected the fund. Value evaluation depends on where the fund is in the cyclical stage and is monitored quarterly. The non-core pacing plan will be updated to reflect changes.

Investment Officer Aaron Au said staff and legal counsel closed on seven private equity commitments totaling \$310 million. Two of the closed funds are classified as venture capital while the remaining funds are Large- to Mega-Buyout funds. Currently one other investment opportunity is in-process representing potentially \$50 million of commitments with other opportunities expected by calendar year end. The commitments are consistent with both the strategic plan and pacing plan approved by the Board of Trustees. ERS will likely achieve its target allocation of between \$550- to \$650- million for calendar year 2020.

IO Au explained estimates for ERS' private equity portfolio there was a decline of 8% to 9% for the first quarter, but aggressive write-downs may push this figure higher for March. For the quarter ending June 30, many GP's took aggressive write-downs in March so the June quarter would have a better performance. Data is still being analyzed for the second quarter.

IO Howard Hodel explained that the \$2.35 billion CRO portfolio declined in value during June as equity and credit markets continued to rally for the third straight month in a volatile environment for many markets. CRO's ex-post and ex-ante annualized volatility are both currently running at slightly over 12%, which is near the long-term expectation

Crisis Risk Indicators were green during June although the VIX indicator breached its limit during the last half of June. The current allocation to the Treasury portfolio is underweight, while trend and alternative return capture strategies are overweight. CRO at month-end remained long fixed income (stable exposure) and the U.S. dollar (decreasing exposure), while commodities were neutral (increasing exposure) and equities turned slightly positive (increasing exposure) early in the month. 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 in both the 2020 fiscal year and the 2020 calendar year to date. The capital markets in June were unfavorable for

three of the four CRO strategies (duration, risk premia, trend and systematic macro strategies), while duration was slightly positive. Staff reduced the number of trend managers to four and completed a quarterly rebalance on July 1, 2020.

IO Hodel continued to explain that staff is in the process of onboarded one new reinsurance manager and is working closely with another manager to structure a separate account and is continuing to review other managers.

IO Wetzel noted that he is working with the investment team and consultants on IPS revisions affecting real return class (& other real assets) in ERS' portfolio. All real assets will be combined into a new combined Real Assets component under the Broad Growth risk class, which will include Real Estate (Core & Non-Core), Timber, Agriculture, Infrastructure (and potentially Other Real Assets).

[Mr. Craig Hirai joined in the meeting.]

Investment Specialist Chen explained the VIX averaged 31.12% (closing between 24.52% and 40.79%) for the month. The current level is well above the long-term historical median level of 17.3%. For the month of June, U.S. large-cap equities returned 1.84% amid mixed economic data. Daily tracking of the ERS portfolio performance during June indicated an annualized volatility of 9.2%, in line with the level experienced over the past three years.

In addition, IS Chen described the risk budgeting study for forward-looking capital market return, correlation and volatility assumptions. Consistent with the results using recent historical data, the allocations that are going into effect over the next three years would result in lower risk over time and higher returns than what the current allocation would produce.

ERS Total Fund has generated an excess return of 3.3% (roughly \$460 million) since the adoption of the risk-based allocation at the end of September 2014, which is about one standard deviation better than if actual performance had just matched the ERS benchmark index.

Despite significant commitments to private markets over the next four years, ERS liquidity is forecast to remain relatively high – 65% to 75% of total assets, above peer portfolio liquidity - as the plan continues to allocate to more illiquid strategies as part of our asset allocation approved in October 2019.

Liquid Assets: Equity, Extended Global Credit, Liquid Defensive Strategies and Liquid Diversifying Strategies.

Illiquid Assets: Private Equity, Illiquid Diversifying Strategies, Real Estate, Infrastructure, Timber and Agriculture.

ENTER EXECUTIVE SESSION

On a motion made by Trustee Ley, seconded by Trustee Yap, and unanimously carried, the Investment Committee entered Executive Session at 9:44 a.m.

EXECUTIVE SESSION

EXECUTIVE SESSION, 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 INFORMATIONAL UPDATES ON INVESTMENT MANAGERS REGARDING ORGANIZATIONAL CHANGES, ADMINISTRATION, AND INVESTMENT STRATEGY.

APPROVAL OF EXECUTIVE SESSION MINUTES – JUNE 8, 2020

On a motion made by Trustee Rauckhorst, seconded by Trustee Ley and unanimously carried, the Investment Committee approved the minutes of the June 8, 2020, meeting as presented.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Ley, seconded by Trustee Yap, and unanimously carried, the Investment Committee exited Executive Session at 9:56 a.m.

MEETING ADJOURNED

On a motion made by Trustee Ley, seconded by Trustee Kane, and unanimously carried, Chair Barfield adjourned the meeting at 9:57 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer
EB/dlg