

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

AUGUST 10, 2020

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

Trustees present: Mr. Vincent Barfield, Chair
(via teleconference) 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: Mr. Ivan Torigoe, Deputy Attorney General
(via teleconference) Ms. Elmira Tsang, Deputy Attorney General
Ms. Diane Wong, Deputy Attorney General

Staff present: Mr. Thomas Williams, Executive Director
(City Financial Tower) Ms. Kanoe Margol, Deputy Executive Director
Ms. Elizabeth Burton, Chief Investment Officer
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

Staff present: Mr. Aaron Au, Investment Officer – Illiquid Markets
(via teleconference) Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. David Okamoto, Investment Officer – Credit

Guests present: Mr. Colin Bebee, Meketa Investment Group, Inc.
(via teleconference) Ms. Mika Malone, Meketa Investment Group, Inc.
Mr. Neil Rue, Meketa Investment Group, Inc.
Mr. Chae Hong, Aon Hewitt Investment Consulting, Inc.
Mr. Jack Dowd, Aon Hewitt Investment Consulting, Inc.
Mr. Storm Klyve-Underkofler, Aon Hewitt Investment Consulting, Inc.
Mr. Jens Foehrenbach, FRM
Mr. Richard Fong, Parametric
Mr. Zach Olsen, Parametric
Mr. Griffin Rolander, Monashee Capital
Mr. Tom Wynn, Monashee Capital
Mr. Kevin Del Mauro, Leucadia

Public present:
(via teleconference)

Lindsay Saienni, Financial Investment News
Jacqueline, Finance 3
Peter Benson, 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 9:06 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 July 17, 2020, in order to implement social distancing measures.” On a motion made by Trustee Machida, 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 JULY 13, 2020

On a motion made by Trustee Machida, seconded by Trustee Rauckhorst and unanimously carried, the Investment Committee approved the minutes of the July 13, 2020 meeting as presented.

PRESENTATION

- MEKETA CRISIS RISK OFFSET
ANNUAL REVIEW

The Meketa Crisis Risk Offset Annual Review was presented by Colin Bebee of Meketa Investment Group, Inc. Meketa provides overall assistance and key support to ERS staff and general consulting services to the Board of Trustees. The following is a summary of the presentation:

- Crisis Risk Offset (CRO) has been the strongest returning class for ERS for two straight fiscal years providing strong diversification results. A large portion of ERS’ investment assets rely on continued economic growth and success.
- CRO showed very strong crisis protection results in 1st Quarter 2020 and performed as expected.
- The CRO class amounts to approximately 14% of total assets. There are three current components:
 - Treasury Duration Capture (25%)
 - Systematic Trend Following (35%)
 - Alternative Return Capture (40%)

Meketa’s and the investment team recommendations are:

- Modify the CRO structure to create a broader version of Diversifying Strategies

- FRM CRISIS RISK OFFSET ANNUAL REVIEW

- All the underlying components of the former CRO portfolio will still exist, making up most of the Diversifying Strategies class; however, other strategies will be added to improve resiliency.
- The Diversifying Strategies class will have more functional names
- Continuously improve the ERS portfolio. The CRO class is moving towards a broader Diversifying Strategies class which is crucial for long-term success.

The FRM Crisis Risk Offset Annual Review was presented by Jens Foehrenbach of Man FRM. The following is a summary of the presentation:

- Performance evaluation was from July 1, 2019 to June 30, 2020.
- CRO has performed in line with its benchmark inception to date and outperformed its benchmark for most of the evaluation period except for larger drawdowns in 4th Quarter 2019 and end of 2nd Quarter 2020.
- All components of CRO were positive, mostly driven by interest rates.
- Fixed income was the primary driver for the portfolio. CRO class remained long fixed income throughout the period as well as long US dollar vs foreign currency.
- Ex-ante volatility increased across most managers in line with increased market volatility in March. It stayed in the expected range regardless of volatility.

FRM performed various analyses and research for CRO during the fiscal year:

- Addition of new trading sub-strategies or adjustments to existing strategies by CRO managers including:
 - Short-term trading strategy with machine-learning elements
 - A new commodity value strategy.
 - FRM conducted an analysis into fossil fuel exposure to determine impact if removed from portfolio.
 - FRM provided analysis and assisted staff in several minor adjustments to existing strategies.
- FRM works closely with ERS staff on a continuous basis to do operational due diligence on existing and new managers, identifying diversifying strategies and potential managers, etc.

[Mr. Craig Hirai joined in the meeting.]

- ERS DIVERSIFYING STRATEGIES PLAN HIGHLIGHTS

The HIERS Diversifying Strategies Plan Highlights was presented by Howard Hodel, ERS Investment Officer. The following is a summary of the presentation:

HIERS Diversifying Strategies Plan Highlights included:

- Structure
 - Liquid Defensive
 - Liquid Diversifying
 - Illiquid Diversifying

- Allocation Transition Plan

Current	FY 2021	FY 2023	
Liquid Defensive	78%	50%	40%
Liquid Diversifying	20%	40%	45%
Illiquid Diversifying	2%	10%	15%
Percent of Total Assets	20%	28%	35%
- Investment Philosophy
 - Provide stability, diversification and liquidity
 - Manage overall risk
 - Diversify strategies
 - Increase total return
 - Reduce fees
 - Constantly evaluate existing strategies
- Initiatives
 - Continue existing CRO and principal protection strategies
 - Add new diversifying strategies accounts
 - Continue working closely with CRO platform managers

- PARAMETRIC OVERLAY SOLUTIONS PERFORMANCE REVIEW

Parametric representatives Richard Fong and Zach Olsen discussed the Overlay Solutions Performance Review. The following is a summary of the presentation:

- Overlay strategies offer a convenient, low cost means to:
 - Enhance expected return
 - Manage risk
 - Increase efficiency
- Institutional investors use overlay strategies to:
 - Mitigating cash drag
 - Minimizing exposure gaps during transition
- What are the risks of overlay?
 - Market
 - Communication/Information
 - Margin/Liquidity
 - Tracking Error
 - Leverage
 - Counterparty
 - Collateral
- ERS Overlay since inception
 - Increased liquidity and flexibility in fund management
 - Bridged exposure gaps during manager transition event
 - Produced \$30 million in incremental gains to the ERS portfolio

- EQUITY & CONVERTIBLE IPO EDUCATION (MONASHEE: THE NEW-ISSUE DISCOUNT)

Griffin Rolander and Tom Wynn of Monashee presented an educational presentation on their capital markets transactions strategy. The following is a summary of the presentation:

- Monashee Background
 - Strategy was launched in 2012 by Jerry Coughlan & Tom Wynn
 - Focuses on capital raising for public entities
 - 14-member team works with 90+ underwriting banks
 - Monashee generates returns from new issues while preserving capital through hedging
- Capital Market New Issuance Lifecycle
 - Initial Public Offering (IPO)
 - Follow-On (FO) Issuance
 - New Issue Convertible Bond

SUMMARY OF JULY 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 July:

IO Hodel reported that it was more of the same for the month of July, especially for the equity markets. Global equity’s return was over 5%. Dispersion was extremely high in the markets this month. The YTD Treasury rate was down 120 basis points. Precious metals prices such as gold and silver have increased substantially. Oil has stabilized and the US dollar has weakened. Inflation is creeping into the market. There has been a large increase in the money supply and government debt. The economy is in a recession, but it is hard to tell the final impact just yet.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton mentioned that inflation is an underpriced risk. While inflation does not appear to be on the horizon, it is a potential left tail event with significant consequences if it does not occur. In the last few weeks, more investors have been paying attention to those risks. ERS investment team has been paying attention to those risks for a while and talking consistently about it for some time now.

There are reports that one third of American renters anticipated in June that they will miss future rental payments – and this was when they were still receiving stimulus checks. There are reports of asset managers in major cities also deferring rental payments for their leased space.

Currently, it is a challenge to see how the economy is going to pan out. Government bonds is presently an uninteresting investment for institutional portfolios.

Private equity is not negative now, but in a very more expensive place (average purchase price versus history). A lot of returns in the past depended on leverage. A Cambridge study showed that PE returns have lagged public markets over last five years. Currently, the private market is not outperforming the public market.

We are long-term investors and Europe is looking relatively more attractive than US short-term, potentially. Considering what we want to do with China in the long-term if underweight or if excluded from indices. ERS has a global-focused portfolio, not a U.S.-focused portfolio like our peers. There will always be pockets of opportunities to take advantage of.

[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 the pacing plan for non-core real estate commitments is on target with 2020 plan. New commitments have been made to core real estate versus non-core real estate the past few years, but the long-term target to core real estate is increasing, which should

result in new commitments to both core and non-core real estate going forward. The real estate strategic/pacing plan will be presented in the August board meeting. ERS has made several hundred million in commitments to real estate in the last few years. Building out the real asset portion of the portfolio would help get exposure and to mitigate inflation risk going forward.

Investment Officer Aaron Au said Hamilton Lane will give an update at the Board of Trustee meeting. The commitments are consistent with the pacing plan and ERS is well positioned to achieve its target allocation for calendar year 2020. Staff is confident with managers on board to assist in finding deals for various investment as well as confident with foundation managers to assist in finding deals.

IO Howard Hodel had no further information to add. No risk report was presented due to time constraints.

Investment Specialist Chen explained the VIX averaged 26.8% (closing between 32.2% and 24.1%) for the month. The current level is above the long-term historical median level of 17.3%. The S&P 500 index returned 5.6% in July; however, the economic recovery remains fragile.

Daily tracking of the ERS portfolio performance during July indicated an annualized volatility of 6.0%, below the level experienced over the past three years.

Investment Specialist Chen presented the Second Quarter 2020 Risk Report. The following is a summary of his report:

ERS portfolio is tilted toward the U.S. dollar and U.S. equity with 91% of assets denominated in the U.S. dollar and 89% of growth-oriented assets in U.S.-based companies; the international growth-oriented assets are as tilted toward non-U.S. developed companies.

CRO class reduced portfolio volatility from 16.5% to 12.9% during the quarter. Growth risks accounts for nearly all of the projected risk of the ERS portfolio, as most other risks were muted or anticorrelated to growth risk.

The scenario/stress test results showed that ERS portfolio is estimated to return +9.6%, -0.6%, and -13.2% under BlackRock's Aladdin's Pandemic Recession – moderate recovery, Pandemic Recession – Global Recession, Pandemic Recession – Depression Fears, respectively. The risks in the ERS portfolio are appropriate and consistent with Policy and current market conditions.

ENTER EXECUTIVE SESSION

On a motion made by Trustee Ley, seconded by Trustee Machida, and unanimously carried, the Investment Committee entered Executive Session at 11:29 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 – JULY 13, 2020

On a motion made by Trustee Machida, seconded by Trustee Rauckhorst, and unanimously carried, the Investment Committee approved the minutes of the July 13, 2020, meeting as presented.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Machida, seconded by Trustee Ley, and unanimously carried, the Investment Committee exited Executive Session at 11:37 a.m.

MEETING ADJOURNED

On a motion made by Trustee Machida, seconded by Trustee Yap, and unanimously carried, Chair Barfield adjourned the meeting at 11:38 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer
EB/dlg