

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

NOVEMBER 9, 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. Aaron Au, Investment Officer – Illiquid Markets
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. David Okamoto, Investment Officer – Credit
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.
(via teleconference) Mr. Neil Rue, Meketa Investment Group, Inc.
Mr. Chae Hong, Aon Hewitt Investment Consulting, Inc.
Mr. Jack Dowd, Aon Hewitt Investment Consulting, Inc.
Ms. Natalie Fitch, Hamilton Lane Advisors, LLC.
Mr. Paul Yett, Hamilton Lane Advisors, LLC.

Public present: Mr. Riley Fujisaki, House Finance staff
(via teleconference) Ms. Stacey Ferreira, Public
Mr. Janos Palko, Public
Mr. Dane Wicker, Public

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 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 Fourteenth Proclamation related to the COVID-19 Emergency dated October 13, 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.

APPROVAL OF MINUTES OCTOBER 13, 2020

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

PRESENTATIONS

- FRM Relative Value/Arbitrage Strategies

IO Hodel introduced the first presentation given by FRM on relative value/arbitrage strategies. The representative was Mr. Manish Keshive, Head of Credit. The following is a summary of the presentation:

Credit Arbitrage:

- Capital Structure - a company's equity & debt obligations
- Ranking of obligations in capital structure determines risk, cost of capital & priority of payments
- Credit Arbitrage managers take advantage of mispricing within capital structures & across issuers

Convertible Arbitrage:

- Convertible bonds are hybrid securities that combine debt & equity features
- Convertible Arbitrage managers take advantage of mispricing among convertible bonds & underlying stock
- Managers buy convertible bond & short stock in the same company while hedging out interest rate risk
- Convertibles are a gray area between stocks & bonds, influencing investor preferences

Merger Arbitrage:

- Merger Arbitrage managers capture the spread between price offered by an acquirer & price of a target company post-deal announcement
- Common transaction types or manager strategies include cash deals or stock deals
- Types of strategy implementations include Systematic or Discretionary

Relative Value Strategies:

- Managers have flexible investment approach vs. traditional investing
- A Sharpe ratio than traditional asset classes
- Have a low beta in correlation to traditional asset classes
- Improves portfolio diversification

- Cordillera Niche & Non-Correlated Opportunities

IO Hodel introduced the second presentation given by Cordillera on Niche and Non-Correlated Opportunities. The representative was Gus Araya. The following is a summary of the presentation:

Niche & Non-Correlated Asset Investments:

- Alternative asset classes
- Broadens range of investment opportunities
- Investing in areas that remain inefficient
- Offers significant diversification

Examples of Niche & Non-Correlated Opportunities:

- Specialty Resources (water rights, environmental assets, permanent crops)
- Specialty Finance (litigation finance, royalties, media & content)
- Specialty Real Estate (marinas, disaster recovery, IDD residential)
- Specialty Assets (spectrum, spirits inventory income shares)

Niche Opportunities:

- Allow for greater alpha
- Invests in areas with lack of institutional capital
- Invests in areas with fewer competitors
- A range of strategies, structures & assets
- Sourcing, due diligence & execution are challenging
- Requires focused approach, multidisciplinary team & specialized capabilities

Non-Correlated Opportunities:

- Behave differently across market cycles
- Increases diversification of institutional portfolios
- Sourcing, due diligence & execution are challenging
- Requires focused approach, multidisciplinary team & specialized capabilities

**SUMMARY OF OCTOBER 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 October:

IO Hodel reported that global equity markets retreated for the second consecutive month in October due to concerns around the U.S. election outcome, potential lack of another fiscal stimulus package, delays in approving, or ineffective Covid vaccine and further government lockdowns as a result of localized Covid outbreaks. This year the U.S. Treasury yield curve has fallen by about 70 bps and is currently sloping gradually up from about 9 bps for the three-month to 1.65% for the 30-year.

Globally, the value of stimulus programs exceeds \$10 trillion as developed countries, in particular, intervene in their capital markets to support their financial systems, by providing aid to businesses, incentives to support job retention, and additional benefits to workers who have lost their jobs.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton warned that although the markets may look exuberant today, over the next four to six months, she warns there is the potential for another sell off. She is very cautious.

The US economy is showing signs of inflation. Consumers are paying the same price for goods but receiving less; all costs are passed on to the consumer. Food prices have increased by 16%. Minimum wage has increased. Inflation is showing signs of creeping up worldwide, including Europe.

Due to Covid, the economy is smaller than a year ago and producing fewer items. The economy needs to be at 100% of prior capacity in order to return to pre-Covid days. Continuous shutdowns weaken the economy and even if a vaccine is available, it will take time for the mass population to receive it.

Federal government may eventually be forced to tighten rates. If the government thought that the economy is strengthening, over several quarters then it would raise rates. A poor outlook for government bonds.

[End of CIO Report]

Investment Officer Ian Wetzel had no additional information other than what was presented in the activities report.

Investment Officer Aaron Au said he had no additional information to report; however, wanted to point out that the economic slowdown saw a sharp downturn in private equity valuations for the first quarter ended March 30, 2020; nevertheless, was quickly reversed with a swift recovery by the second quarter ending June 30, 2020.

IO Howard Hodel reported the Crisis Risk Indicators were green in October. The DS liquid portfolio has been negatively or slightly positively correlated to the rest of the ERS portfolio, which has reduced the volatility of the total ERS portfolio, while adding value so far this calendar year. The capital markets in October were favorable for trend and systematic macro strategies, but unfavorable for risk premia and duration.

Staff is in the process of onboarding two managers and conducting due diligence on discretionary global macro, relative value / arbitrage, defensive (long volatility / tailing hedging), multi-strategy, and systematic completion managers, consistent with the approved asset liability study, and plans to onboard up to 10 new managers by the end of 2021.

Investment Specialist Chen explained the VIX averaged 29.4% (closing between 25% and 40.3%) for the month. The current level is above the long-term historical average level of 18.8%. The S&P 500 index declined 3.3% in October, while the ERS's Stabilized Equity and Traditional Equity declined 1.24% and 0.89%, respectively.

Daily tracking of the ERS portfolio performance during September indicated an annualized volatility of 6.9%, below the average annualized volatility of 8.7% 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.

- **THIRD QUARTER 2020
CRISIS RISK OFFSET
REPORT-LIQUID
DIVERSIFYING
STRATEGIES**

IO Hodel summarized the Crisis Risk Offset Q3 2020 Review.

CRO Class was rebalanced to new target weights effective July 1, 2020 for the Quarter 2 rebalance coinciding with the launch of a new strategy with Crabel (Tactical Response) as an additional share class and rebalanced to target weights on July 20, 2020 due to P/E breaching its lower rebalancing threshold.

A Quarter 3 rebalance was instructed on September 21, 2020. Net performance was -0.50%, gross performance of -0.36% vs the benchmark of -0.96%. Crisis risk indicators were green throughout the quarter; however, the VIX indicator breached its threshold in July and mid-September while the Gold indicator breached in July through early August.

Daily intra-quarter volatility was 6.8% (annualized) while correlation to the rest of the ERS portfolio was 0.1. For the quarter ending June 30, 2020, ERS volatility decreased to 7.7% from 12.9% intra-quarter (annualized). There were no risk breaches in third quarter.

CRO was long equities for the majority of the quarter but ended the quarter slight short. Long rates exposure decreased while modest long commodities exposure was maintained. At the end of July, the portfolio flipped from net long to net short USD in FX. By quarter-end, CRO Class exposures were slightly short equities, long fixed income, long commodities and short the US dollar.

- **THIRD QUARTER 2020
RISK REPORT**

IS Chen summarized the Risk Report.

The risks in the ERS portfolio are appropriate and consistent with Policy and current market conditions.

Growth risk dominates, market and ERS projected volatilities are elevated, active risk is high, funding path shortfall and other risks remain high. Growth risk accounts for nearly all of the projected risk of the ERS portfolio as most other risks were muted or anti-correlated to growth risk.

ERS portfolio is tilted toward the US dollar and US equity markets with 86.8% of assets denominated in the US dollar and 84.9% of growth-oriented assets in US-based companies. The international growth-oriented assets are tilted toward non-US developed companies about 11.6%.

The 2008 financial crisis scenario indicates a 21% drawdown, a significant improvement from the -35% over what the ERS portfolio experienced in 2008. Other moderate impacts on the ERS portfolio include 2011 US Downgrade (-9%), Cyber Attack on Financial Services (-8.7%), and 10% Global Equities Drop (-8.1%).

ERS realized portfolio volatility measured using daily data was 7.7% in the current quarter, an improvement from 12.8% in the previous quarter. The CRO class reduced ERS portfolio volatility to 7.7% from 8.7% due to CRO's diversifying exposures. The policy portfolio had a 6.1% volatility during the quarter.

The 10-year Treasury yield increased slightly from 0.66% to 0.69% during the quarter.

IS Chen believing that there will be a moderate recovery.

ENTER EXECUTIVE SESSION

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.

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(A)(1) AND (3), AND HRS § 92-5(A)(4), TO CONDUCT DISCUSSIONS AND

On a motion made by Trustee Machida, seconded by Trustee Yap, and unanimously carried, the Investment Committee entered Executive Session at 10:44 a.m.

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 HRS CHAPTER 92F, INCLUDING INFORMATION AND RECORDS THAT ARE PROPRIETARY INFORMATION OR CONFIDENTIAL BUSINESS INFORMATION; OR TO DELIBERATE CONCERNING THE AUTHORITY OF PERSONS DESIGNATED BY THE BOARD TO NEGOTIATE INVESTMENTS OR THE SALE OF PROPERTY HELD BY OR FOR THE BENEFIT OF THE SYSTEM, OR DURING THE CONDUCT OF SUCH NEGOTIATIONS; 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 INVESTMENT; APPROPRIATE ACTION.

APPROVAL OF EXECUTIVE SESSION MINUTES – OCTOBER 13, 2020

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

EXIT EXECUTIVE SESSION

On a motion made by Trustee Rauckhorst, seconded by Trustee Machida, and unanimously carried, the Investment Committee exited Executive Session at 11:08 a.m.

MEETING ADJOURNED

On a motion made by Trustee Yap, seconded by Trustee Machida, and unanimously carried, Chair Barfield adjourned the meeting at 11:09 a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer
EB/dlg