

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

MAY 24, 2021

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

Committee Member	Mr. Vincent Barfield, Chair
Trustees present: (via teleconference)	Dr. Catherine Chan, Vice Chair Mr. Emmit Kane Mr. Wesley Machida
Visiting Trustees present: (via teleconference)	Mr. Craig Hirai Dr. Genevieve Ley
Attorneys present: (via teleconference)	Mr. Ivan Torigoe, Deputy Attorney General
Staff present: (City Financial Tower)	Mr. Thomas Williams, Executive Director Ms. Kanoë Margol, Deputy Executive Director Ms. Elizabeth Burton, Chief Investment Officer Mr. Howard Hodel, Deputy Chief 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 – Real Assets Mr. Andrew Chen, Investment Specialist Ms. Gerri Konishi, Member Home Loan Assistant Ms. Lori Kim, Secretary Ms. Diana Gomes, Secretary
Public present: (via teleconference)	Ms. Lindsay Saienni, FIN News Mr. Riley Fujisaki, House Finance Staff

CALL TO ORDER

A quorum being present (Chair Barfield, Vice Chair Chan and Trustees Kane and Machida), Chair Barfield called the Investment Committee meeting to order at 9:00 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 Nineteenth Proclamation related to the COVID-19 Emergency dated April 9, 2021, in order to implement social distancing measures.” On a motion made by Trustee Machida, seconded by Vice Chair Chan 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 APRIL 26, 2021

On a motion made by Trustee Machida, seconded by Vice Chair Chan and unanimously carried, the Investment Committee approved the minutes of the April 26, 2021 meeting as presented.

PRESENTATIONS

- TOWNSEND GROUP, AN AON COMPANY 4TH QUARTER 2020 REAL ESTATE PERFORMANCE REVIEW

IO Wetzel introduced the presentation given by Aon on 4th Quarter 2020 Real Estate Performance Review. The representatives were Mr. Chae Hong and Mr. Jack Dowd. The following is a summary of the presentation:

- The real asset market had a positive return but was obviously impacted by Covid with its lockdowns and restrictions.
- All real assets markets had a good recovery including the real estate markets.
- ERS' real assets portfolio is getting into the maturity stage. Recent infrastructure and real estate commitments should help the portfolio continue to move towards its target allocation in spite of liquidating investments.
- The portfolio is within IPS guidelines except for:
 - Industrial is underweight due to liquidation of an industrial-focused fund.
- The portfolio is performing well, outperforming the NFI-ODCE Index on a net of fee basis over all periods except inception.
- Total real estate portfolio generated 8.0% IRR and 1.41x net equity multiple since inception.
- Total timber portfolio generated 8.1% IRR and 2.49x net equity multiple since inception. The consultants explained the difference between lumber and timber pricing.
- Kaanapali base yard remains up for sale.
- Significant progress has been made in building out the real asset portfolio. There is around \$778 million of unfunded commitments in real estate. In addition, there's around \$400 million of unfunded commitments from recent infrastructure investments (including \$300 million in Core infrastructure commitments) that are not yet reflected as unfunded commitments on the reports (these will start showing up as unfunded commitments once the managers begin drawing capital.)

- HAMILTON LANE ADVISORS, LLC PRIVATE EQUITY PROGRAM UPDATE FOR PERIOD DECEMBER 31, 2020

IO Au introduced the presentation given by Hamilton Lane on the Private Equity Program Update for period ending December 31, 2020 and included that the portfolio performed well overall and outperformed the benchmark. The representatives from Hamilton Lane were Ms. Natalie Fitch and Mr. Paul Yett. The following is a summary of the presentation:

- Record performance in the 4th calendar quarter generating nearly \$350 million in gains, continuing a strong performance from 2nd and 3rd calendar quarters.

- 1st calendar quarter struggled due to the pandemic; however, 2nd through 4th quarters show recovery with double digit returns and has recovered more than its value declined.
- \$772 million cumulative gain for the past 3 quarters.
- 4th quarter extremely high performance with IIR of 15.5 strong performance and strong distribution activity.
- Almost \$2 billion of dry powder to invest.
- The quarterly performance for 2020 showed a positive performance in 3 of 4 quarters. ERS portfolio had positive performance over the last 8.5 years with the exception of 1st quarter 2020.
- Quarterly cash flow activities show a positive net cash flow for 2020.
- The portfolio has 25 foundation managers. Foundation Managers are managers that pass Hamilton Lane's due diligence twice and ERS is invested in at least 2 funds. Foundation Managers are outperforming the total portfolio by 272 bps.
- Commitment activity is on track with the \$550-\$560 million that was approved for 2021 pacing.
- One of the objectives of the strategic plan is to increase the commitment size over the course of time.

- MEKETA INVESTMENT GROUP, INC. QUARTERLY PERFORMANCE REPORT

Meketa presented the Quarterly Performance Report. The representatives were Mr. Colin Bebee, Ms. Mika Malone, and Mr. Neil Rue. The following is a summary of the presentation:

- The ERS portfolio ended the quarter with almost \$21 billion, about \$1 billion increase for the quarter due to strong performance and advance contributions from the State.
- Portfolio outperformed the benchmark for every time period.
- ERS portfolio outperformed peers during the 2020 Q1 drawdown but underperformed since then during the bull market. The ERS portfolio is lower risk than peers.
- During 2021 Q1, most managers had positive returns with some exhibiting very strong returns with equity managers again dominating returns and risk, leading to a record quarter for performance.
- Inflation is evident in consumer pricing which is something to be aware of as CIO Burton has pointed out for over a year.
- The portfolio is overweight broad growth and underweight diversifying strategies
- Three major topics discussed worldwide are:
 - GDP growth
 - Inflation
 - Rising interest rates
- ERS staff is working on adding inflation protection for the portfolio.
- Meketa feels the portfolio is in a good condition and has no concerns.

[Trustee Kane left the meeting.]

- FRM 1ST QUARTER 2021 DIVERSIFYING STRATEGIES REPORT

DCIO Hodel introduced the presentation given by Jens Foehrenbach, FRM CIO on Diversifying Strategies – Liquid Defensive, Liquid Diversifying and Illiquid Diversifying. DCIO Hodel explained that he communicates with Mr. Foehrenbach and his team on a daily basis at

every level of the Diversifying Strategies portfolio and Mr. Foehrenbach is an incredible partner for ERS staff. The following is a summary of the presentation:

- Diversifying Strategies (DS) Liquid Defensive and Liquid Diversifying Strategies were negative 1.69% for the quarter.
- The first quarter of 2021 was not an ideal environment for this strategic class, the main negative driver was the exposure to bond interest rates.
- Interest rates contributed a negative 400 bsp to Q1 performance.
- Q1 was the worst quarter for bonds in over 40 years.
- Systematic trend following was the only positive DS component contribution of 176 bsp to the DS return in Q1.
- Commodities and equities both contributed positively to Q1 performance, while convertible bonds and SPAC's detracted due mainly to very high issuances creating excess supply for the market to absorb during the second half of Q1.
- Realized volatility for Liquid DS vol was 6%.
- There were no risk limits breaches across the managers in Q1.
- Quarterly rebalancing occurred at the beginning of the quarter and ERS staff injected cash to fund a TIPS Duration Capture sleeve into the existing Treasury Duration Capture portfolio.
- One new manager, Aristeia was funded in March.
- There were no issues with operations and there is robust process in place.
- There were 6 capital calls in Illiquid DS totaling over \$300 million. Total commitments are \$475 million.

- MORGAN STANLEY INFLATION STRATEGIES EDUCATION SESSION

CIO Burton introduced the education session presentation given by Morgan Stanley on inflation. The representatives were Mr. Rui De Figueiredo, Mr. Ted Eliopoulos, Mr. John Mecca, Mr. Steven Turner and Ms. Alicia Biggs. The following is a summary of the presentation:

- Important to prepare the portfolio for an inflationary period. A few things to think about:
 - Real assets are an essential part given the role of real assets in the pension fund.
 - Need to think about the scale of the portfolio for intended weight.
 - Need to think about targeting that weight or over targeting for anticipation of inflation.
 - Inflation can be damaging in an unexpected way.
 - Three issues:
 - Most portfolios have overweight in real assets and underweight in DS.
 - How to invest in real asset portfolio and get the returns whether or not there is inflation
 - Implementation is a challenge, especially in a cost-efficient way.
- Should ERS be thinking about inflation and how?

- Nature of the pandemic, very different from other economic shocks going back into history. Everything stopped quickly and now starting up quickly.
- Dissaving. Savings that companies have will be dissaved once economy gets back and creates inflationary pressure.
- Limited supplies that will meet excess demand.
- Policies on the monetary and fiscal side.
- A positive ERS Portfolio:
 - Leans into real estate, heavily in a balanced way between core and non-core.
 - Scope for diversification, infrastructure allocations.
 - Scope for strong returns in portfolio.
- You have a good base, what are the issues?
 - Portfolio is under target, diversify into other categories.
 - As you grow, benefits for expansion both horizontally and vertically.
 - Go into niche markets.
- Where are you going to get returns?
 - Go into smaller funds.
 - Co-investing in niche markets to give you more diversification.
- Choose a broad set of hedging to help portfolio with inflation.
- Look at broader spectrum to help portfolio in non-inflationary conditions.
- Strong financial returns with ESG if:
 - Government policy is supportive as we head toward a low carbon society.
 - Customer/consumer demand is there.
 - Pricing is competitive, compared to any other energy sources.

SUMMARY OF APRIL 2021
INVESTMENT OFFICE ACTIVITIES:

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

Deputy Chief Investment Officer Howard Hodel and Chief Investment Officer Elizabeth Burton presented an update on the market. DCIO Hodel presented market information for the month of April:

DCIO Hodel reported that for the third consecutive month, the global equity markets rose in April (up about 4%), due to economic optimism from the global deployment of multiple, effective COVID-19 vaccines, favorable economic news, accommodative central banks, and the economic impact of the \$1.9 trillion American Rescue Plan. Treasury yields decreased with the 10-year yield falling by 9 bps and the 30-year falling by 11 bps, leaving the yield curve sloping up from 1 bp for the three-month Treasury bill to 2.30% for the 30-year Treasury.

U.S. large cap equities and the NASDAQ were each up about 5% and U.S. small caps rose about 2% during April.

Commodity indexes rose roughly 8% in April.

CIO Burton gave an overview of her report as follows:

CIO Report

CIO Burton reported that May was a very busy month for the Investment Office:

- Investment staff saved about \$22 million in fees this fiscal year.
- Hawaii-based investments make up around 3.7% of ERS' portfolio. These are investments in Hawaii, managed by Hawaii companies, or are Hawaii-focused.
- Table 1 in the activities report demonstrates the growth of the Hawaii portfolio versus its benchmark. Portfolio continues to outperform the benchmark since inception.
- Table 2 in the activities report showed that the global public equities market (a passive portfolio allocation) has much larger drawdowns than the ERS portfolio.

[End of CIO Report]

IO Goo had nothing further to add from what was included in the activities report.

IO Wetzel reported that real assets is a growing area in the portfolio and since January 1, 2019, 16 funds at total commitments of \$986 million have been approved. Staff continues to implement ongoing monitoring process of existing managers and evaluate new prospective investments to build out the real asset portfolio.

Consolidating from two core real estate separate account managers to one continues with the remaining separate account manager managing the existing properties and researching additional opportunities with plans to invest remaining unfunded commitments over the next 18-24 months. ERS committed \$550 million to the manager's separate account and an additional \$50 million to the manager's core real estate debt fund for a \$600 million total commitments.

An updated real estate strategic/pacing plan for CY 2021, including the new long-term allocation targets from 2019 A/L study factored in, was approved by the Board in August. The long-term target allocation to core real estate increased considerably, resulting in a meaningful increase in new commitments to core real estate moving forward with Calendar 2021 commitments targeting \$150 million (\$110-\$190 million range). Calendar 2021 pacing plan for non-core real estate commitments is a \$100 million target (\$70-\$130 million range). Total commitments of \$140 million for three funds were approved for calendar 2021 and actual commitments are on track with plan.

Infrastructure and agriculture components are underweight and a priority to build out new commitments in these areas. Total infrastructure commitments of \$200 million for two funds were approved for calendar 2020. Total infrastructure commitments of \$200 million for two funds (\$150 million & \$50 million) were approved for calendar 2021 by the Internal Investment Committee in May.

Staff is currently working on a new agriculture fund commitment and planning to present to the Internal Investment Committee for approval in June. Additional real asset funds are in the due diligence pipeline for the coming months. Staff is also evaluating a custom real asset solution to complement the build out of the real asset portfolio.

IO Au reported that had nothing further to add from what was included in the activities report and Hamilton Lane's presentation.

DCIO Howard Hodel reported the Crisis Risk Indicators were green in April. The DS liquid portfolio at month-end remained long fixed income, commodities, and U.S. dollar. The DS liquid portfolio has been negatively, or only moderately positively, correlated to the rest of the ERS portfolio, which has reduced the volatility of the total ERS portfolio. The capital markets in April were favorable for trend, alternative risk premia, relative value/arbitrage, systematic macro and duration strategies but unfavorable for defensive macro strategies.

Staff continues 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.

- 1st QUARTER 2021 RISK REPORT

Investment Specialist Chen explained the VIX averaged 17.4% (closing between 18.7% and 16.3%) for the month. The current level is above the average level of 17.8% over the past five years.

Daily tracking of the ERS portfolio performance during April indicated an annualized volatility of 7.6%, above the average annualized volatility of 9.1% over the past three years.

Staff continues monitoring potential, significant macro risks in each of the three major economic regions of the world, any of which could trigger another market correction.

Investment Specialist Chen reported that ERS' portfolio is tilted toward the U.S. dollar and U.S. equity markets with 92% of assets denominated in the U.S. dollar and 86% of growth-oriented assets in U.S.-based companies with the international growth-oriented assets are tilted toward non-U.S. developed companies (10%). He continued with the CRO class dampened the portfolio volatility from 14% to 11% and growth risk accounted for most of the projected portfolio risk at 81%. The portfolio's beta is approximately 0.4 and the Sharpe Ratio, Information Ratio and annual excess returns were 0.8, 0.5, and 1%, respectively. Meketa's Sentiment Indicator and CRO's Crisis Indicators remained green during the quarter. The projected annualized volatility is 18.5% higher than the policy portfolio of 13.9%. The projected tracking record of 5% and projected beta of 1.3, respectively.

A survey will be sent out to all Trustees to determine which days they prefer for the July investment summit.

[Trustee Kane returned to the meeting.]

ENTER EXECUTIVE SESSION

EXECUTIVE SESSION

On a motion made by Trustee Machida, seconded by Vice Chair Chan, and unanimously carried, the Investment Committee entered Executive Session at 11:30 a.m.

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(A)(1) AND (3) 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 HRS 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 UPDATES ON STATUS OR ISSUES RELATED TO CONFIDENTIAL ERS INVESTMENT PORTFOLIO UPDATES REGARDING: PERFORMANCE, ALLOCATION CHANGES, AND CHANGES IN MANAGER ORGANIZATIONAL STRUCTURE, OWNERSHIP, PERSONNEL, STRATEGIES, GUIDELINES AND RISK LIMITS.

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(A)(1) AND (3), 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 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 DIVERSIFYING STRATEGIES INVESTMENT; APPROPRIATE ACTION.

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(A)(1) AND (3) 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 HRS 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 UPDATES ON STATUS OR ISSUES RELATED TO CONFIDENTIAL ERS INVESTMENT PORTFOLIO UPDATES REGARDING: PERFORMANCE, ALLOCATION CHANGES, AND CHANGES IN MANAGER ORGANIZATIONAL STRUCTURE, OWNERSHIP, PERSONNEL, STRATEGIES, GUIDELINES, MANAGER PIPELINES AND RISK LIMITS.

EXECUTIVE SESSION, PURSUANT TO HRS § 88-27.5(A)(1) AND (3), 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 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 – APRIL 24, 2021

On a motion made by Trustee Machida, seconded by Vice Chair Chan, and unanimously carried, the Investment Committee approved the Executive Session minutes of the April 24, 2021.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Machida, seconded by Vice Chair Chan, and unanimously carried, the Investment Committee exited Executive Session at 1:27 p.m.

MEETING ADJOURNED

On a motion made by Trustee Machida, seconded by Vice Chair Chan, and unanimously carried, Chair Barfield adjourned the meeting at 1:28 p.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer
EB/dlg