

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

OCTOBER 25, 2021

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

Committee Member
Trustees present:
(via teleconference)

Mr. Vincent Barfield, Chair
Dr. Catherine Chan, Vice Chair
Dr. Genevieve Ley
Mr. Lance Mizumoto

Visiting Trustees
present:
(via teleconference)

Attorneys present:
(via teleconference)

Mr. Ivan Torigoe, Deputy Attorney General

Staff present:
(City Financial Tower)

Mr. Thomas Williams, Executive Director
Ms. Kanoe 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

Guest present:
(via teleconference)

Mr. Colin Bebee, Meketa Investment Group, Inc.
Ms. Mika Malone, Meketa Investment Group, Inc.
Mr. Boaz Weinstein, Saba Capital
Mr. Michael Buckius, Gateway

Public present:
(via teleconference)

Mr. Albert Vargas – House Finance Staff
Mr. Riley Fujisaki – House Finance Staff
Ms. Lindsay Saienni – FIN News
Mr. Oscar Sheehan - Journalist

CALL TO ORDER

A quorum being present (Chair Barfield, Vice Chair Chan, Trustees Ley and Mizumoto), 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 Emergency Proclamation Related to the COVID-19 Response dated August 5, 2021, in order to implement social distancing measures." On a motion made by Trustee Mizumoto, 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 AUGUST 23, 2021

On a motion made by Trustee Mizumoto, seconded by Vice Chair Chan and unanimously carried, the Investment Committee approved the minutes of the August 23, 2021 meeting as presented.

PRESENTATIONS

- LONG VOLATILITY/TAIL
HEDGING EDUCATION SESSION
– SABA CAPITAL MANAGEMENT

Mr. Boaz Weinstein, Founder and Chief Investment Officer of Saba Capital Management, a \$3.4 billion credit hedge fund based in New York, presented an educational session on long volatility and tail hedging. The following is a summary of the presentation:

- Saba was founded in 2009 by Boaz Weinstein.
- Saba is a registered investment advisor.
- The firm has \$3.4 billion in AUM and 39 employees, with 13 investment professionals.
- The Saba investment team are at the forefront of utilizing credit derivative to hedge tail risk and arbitrage dislocations between debt and equity instruments.
- Saba developed a rigorous research and investment process by combining fundamental credit analysis with proprietary quantitative models.
- Since 2011, Saba has been running dedicated tail hedging mandates for institutional clients and currently managing \$1.1 billion in tail hedge strategy assets.
- Research done by Goldman Sachs shows that tail hedging via low spread credit has historically outperformed high spread credit and equity hedges.
- The Investment Grade Credit Index is comprised of 125 equally weighted investment grade companies and is commonly used as a portfolio hedge. Some of the index's companies experience more severe credit spread widening while others are stable even during periods of stress.
- Saba deconstructs the index to 1) identify companies that have been most valuable tail hedges historically (shorts) as well as 2) identifies companies that have been most stable in periods of stress as long positions resulting in a long-short portfolio designed to outperform and index hedge in periods of stress with minimal cost of carry.
- During the Covid selloff, Saba's single name shorts produced >100% alpha compared to an index-based credit hedge and Saba's short positions also outperformed the index.

[Trustee Ley leaves meeting at 9:42 am]

- PUT-WRITE EDUCATION SESSION AND PORTFOLIO UPDATE – GATEWAY INVESTMENT ADVISERS, LLC

Mr. Michael Buckius, President and Chief Investment Officer of Gateway Investment Advisers, LLC presented the Put-write education session and portfolio update. Mr. Buckius also serves as a co-portfolio manager for several mutual funds advised by the firm as well as the firm's separate account strategies.

- Gateway has a 10-year relationship with ERS.
- Gateway was established in 1977 to focus on pioneering options-based investment strategies.
- In 2008, Natixis Investment Managers, LLC acquired Gateway.
- The firm has experience in long-term investment management in index options market.
- Gateway's approach has a history of reducing equity volatility in a strong, repeatable way.
- Gateway's investment team averages over 19 years of tenure. It is a stable team with a consistent process.
- AUM is \$10.8 billion as of 9/30/2021.

Gateway's Investment Philosophy:

- Although the equity market is the most reliable source of long-term real returns, Gateway believes equities become less risky over the long-term.
- When strategically used, index options have the potential to:
 - Reduce risks associated with the equity market exposure.
 - Accessing the implied volatility risk premium by enhancing risk-adjusted returns.
- Gateway's strategies are active, not tactical and approach is quantitative, not systematic.

[Trustee Ley returns to meeting at 9:57 am]

Account Summary:

- The objective is to outperform a custom risk-weighted global benchmark over the long term.
- The strategy is low-volatility equity that secures an actively managed portfolio of written index put options on global equity markets with a portfolio of short-term, high quality cash securities.
- The driver of alpha potential is consistent and attractive cashflow from index put writing creates potential for better long-term risk-adjusted returns than the equity market.
- The assets under management are approximately \$720.5 million as of September 30, 2021.

Gateway's Active Investment Process:

- Gateway employs a rigorous process to manage its option portfolio. Factors in the process include:
 - Volatility Levels
 - Volatility Richness
 - Term Structure
 - Skew
 - Option Variables
 - Delta
 - Theta
 - Vega

- Rho
 - Qualitative Factors
 - Market Technical
- Contracts are analyzed on a “hold-to-expiration basis” but are typically replaced prior to expiration.
- Timing of replacement is the result of judgment and experience applied to the response of these variables to market action.
- There are no quantitative rules, static triggers or algorithms that drive management decisions.

[Trustee Ley leaves the meeting at 10:26 am]

SUMMARY OF SEPTEMBER 2021 INVESTMENT OFFICE ACTIVITIES:

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

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

DCIO Hodel reported that in September the global equity markets fell (down 0.4%) for the first time since January, due to waning economic optimism, worsening corporate earnings forecasts, rising U.S. inflation, global supply chain problems, numerous issues with the Chinese economy and markets, and the Biden administration’s highly costly fiscal programs along with rising government debt. Treasury yields increased about 17 bps. The U.S. Treasury curve slopes up from 4 bps for the three-month Treasury bill to 2.08% for the 30-year Treasury. Globally, the value of stimulus programs exceeds \$20 trillion as developed countries in particular intervene in their capital markets to support their financial systems and provide aid to businesses and individuals.

Commodity indices rose about 5% in September.

CIO Report

CIO Burton stated that September was another very busy month for the Investment Office.

CIO Burton reported that oil prices are increasing and should continue to rise as we move toward winter. Supply chain disruption continues to cause issues throughout the economy.

Another potential issue to watch for is the stock/bond correlation. Stocks/bonds have been negatively correlated for the past 20 years and now the correlation has been showing signs of breaking down with a couple daily prints of positive correlation. This can have big impacts on portfolios that assume bonds are diversifying to the equity book.

The investment team has been preparing the portfolio for changing times so as not to be caught off guard. The team has been exploring changes in the real assets portfolio to get the portfolio into market faster. The team reduced some of the equity overweight (only about 1 to 1.5 points.) This is not a massive shift, but we continue to try to reduce exposure; equities are still overweight.

Currently searching for an Investment Officer-Operations. The job has been posted on CFA Hawaii, CAIA, Kayo, Toigo, 100 Women in Finance and others.

[End of CIO Report]

IO Goo informed the committee that Robeco (Global Min-Vol Equity) reported an overdraft which happened on September 27 and was resolved on September 30. The overdraft was caused by a trade instruction being sent by the broker after cutoff time which delayed the settlement of the trade. The amount of the overdraft charges applied to the account were in the amount of \$373.44 which will be reimbursed to the account. IO Goo had nothing further to add from what was included in the activities report. The portfolio is performing as expected.

IO Wetzel mentioned that staff has been monitoring managers, attending annual meetings, Limited Partner Advisory Committees (LPAC), and have been working on GP consent requests and portfolio updates. Real assets markets continue to rebound from the initial COVID-19 related write-downs and the real assets portfolio is performing strongly on both an absolute basis and relative to its benchmark.

Approximately \$950 million is targeted for deployment to new core real estate commitments over CY 2021-2025 (~\$200 million/year). CY 2021 pacing plan for core real estate commitments is a \$150 million target (\$110 million - \$190 million range); staff and consultant plan to recommend a fund commitment in the next 1-2 months. CY 2022 pacing plan for core real estate commitments is a \$200 million target (\$150M-\$250M range).

CY 2021 non-core pacing plan for real estate commitments is a \$100 million target (\$70 million - \$130 million range). Actual commitments are on track with plan. Total commitments of \$140 million (3 funds) have been approved for CY 2021. CY 2022 pacing plan for non-core real estate commitments is a \$150 million target (\$110 million - \$190 million range).

CY 2021 pacing plan for infrastructure commitments is a \$150 million target (\$100 million - \$200 million range). Infrastructure commitments of \$200 million (2 funds) were approved for CY 2020 and \$200 million (2 funds) were approved for CY 2021, which was above pacing targets and at the upper end of the pacing range for each year. CY 2022 pacing plan for infrastructure commitments is a \$150 million target (\$100 million - \$200 million range).

CY 2021 pacing plan for agriculture commitments is a \$150 million target (\$100 million - \$200 million range). One agriculture fund (\$100M) was approved in September and staff and consultant are currently evaluating another agriculture fund for potential approval in the coming months. CY 2022 pacing plan for agriculture commitments is a \$150 million target (\$100 million - \$200 million range).

[Trustee Ley returned to the meeting at 10:36 am]

IO Au reported that private growth continued its remarkable performance for the period ended September 30, 2021. Long- and short-term performance was **18.4%** (7-years) and **57.8%** (1-year). Outperformance over the public market benchmark was **6.7%** and **14.8%**, respectively.

Three more investments closed for the month and staff has one other high conviction manager in the final closing process for \$50.0 million. Once closed, staff would have achieved its pacing goal of between \$550 and \$650 million with roughly \$649 million in aggregate commitments for 2021.

Many foundational managers are expected to fundraise in calendar year 2022, thereby helping achieve the commitment target of between \$550 million and \$650 million and continue the exceptional outperformance.

DCIO Howard Hodel reported that the Diversifying Strategies (“DS”) liquid portfolio was modestly negative during the month. The DS liquid portfolio’s annualized ex-ante volatility was steady at 5%, while ex-post volatility inched up to 6%.

Crisis Risk Indicators remained green during September. The DS liquid portfolio at month-end remained long fixed income, commodities, equity, 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 September were favorable for relative value/arbitrage, defensive macro and trend, and unfavorable for duration, systematic macro and alternative risk premia.

In Illiquid Diversifying Insurance-Linked, both of the managers were negatively impacted by Hurricane Ida, which made landfall in Louisiana as a Category 4 Hurricane in late August. Staff is planning to complete the staged funding of both managers by the end of 2021.

Investment Specialist Chen explained the VIX averaged 19.8% (closing between 16.1% and 25.7%) for the month. The current level is in line with the average level of 18.1% over the past five years.

Daily tracking of the ERS portfolio performance during September indicated an annualized volatility of 6.6%, below the average annualized volatility of 9.2% 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.

CIO Burton reported that the IEIC approved Staff recommendation to invest up to \$70 million in a new sleeve in the Leahi Capital Fund. The IEIC also approved the Staff/Consultant recommendation to invest up to \$100 million in a Real Assets - Agriculture (Core) fund.

[Chair Barfield called for a 10-minute recess at 10:40 a.m. Meeting resumed at 10:50 a.m.]

ENTER EXECUTIVE SESSION

On a motion made by Trustee Mizumoto, seconded by Vice Chair Chan, and unanimously carried, the Investment Committee entered Executive Session at 10:51 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 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: CHANGES IN (1) MANAGER ORGANIZATIONAL STRUCTURE FOR TWO DIVERSIFYING STRATEGIES MANAGERS, (2) MANAGER PIPELINES FOR BOTH STRATEGIC CLASSES, (3) UPDATE ON A PRIVATE EQUITY FUND.

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 – AUGUST 23,
2021

On a motion made by Trustee Mizumoto, seconded by Vice Chair Chan,
and unanimously carried, the Investment Committee approved the
Executive Session minutes of the August 23, 2021.

EXIT EXECUTIVE SESSION

On a motion made by Trustee Mizumoto, seconded by Vice Chair Chan,
and unanimously carried, the Investment Committee exited Executive
Session at 11:24 a.m.

MEETING ADJOURNED

On a motion made by Trustee Mizumoto, seconded by Vice Chair Chan,
and unanimously carried, Chair Barfield adjourned the meeting at 11:24
a.m.

**REDACTED
SIGNATURE**

Elizabeth T. Burton
Chief Investment Officer
EB/dlg