

**STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES**

**OPEN SESSION MINUTES
MEETING # 401**

Date: April 28, 2016

Place: Department of Human Resources Development
14th Floor Director's Conference Room
235 South Beretania Street, State Office Tower
Honolulu, HI 96813

Present: Brian Moto, Chairperson
James Nishimoto, Ex-Officio Member
Wesley Machida, Ex-Officio Member (arrived at 9:55 a.m.)
Roderick Becker, Employee Member
Kanoë Margol, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Kevin Malmud, Jeanne Kanai, and Grace Baracao, Prudential Honolulu Office
Julie Klassen, Prudential Retirement – via conference call
Glenn Ezard and Wendy Young Carter, Segal Rogerscasey – via conference call
Paul Danes, Victory Capital Management – via conference call
John Maschoff and Stephanie Simon, Winslow Capital/MainStay Funds
– via conference call
Tom Smythe, New York Life/MainStay Investments – via conference call

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:02 a.m.

Agenda: The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawaii Revised Statutes section 92-7.

Chairperson Moto welcomed everyone and started the meeting with introductions. He opened with an introduction of himself as the Board Chairperson and introductions of Board members, staff, and guests in attendance, followed by attendees participating via conference line. No other guests were in attendance.

Chairperson Moto proceeded to Agenda Item # 1.

Agenda

Item # 1: New Business

a. Approval of Minutes Nos. 400 and 400-ES

The Board took a few minutes to review Minutes Nos. 400 and 400-ES, for the March 21, 2016 meeting.

A motion was made by Trustee Nishimoto and seconded by Trustee Villabrille to approve Minutes Nos. 400 and 400-ES, as circulated. The motion passed unanimously.

b. Performance Overview by Segal Rogerscasey

- i. Overview of Funds Currently on the Watch List: MainStay Large Cap, Victory Institutional Diversified Stock Fund, and PIMCO Total Return Fund
- ii. Performance Report and Updates from Victory Capital on the Victory Institutional Diversified Stock Fund
- iii. Performance Report and Updates from Winslow Capital on the MainStay Large Cap Growth Fund

Mr. Ezard stated that both the Victory Institutional Diversified Stock Fund and the MainStay Large Cap Growth Fund are currently on the watch list:

- Victory's fund is an active large cap core strategy with \$57 million in assets.
- MainStay's fund is a large cap growth strategy that is sub-advised by Winslow Capital, with approximately \$75 million in the stand-alone core strategy and \$5 million within the LifeCycle portfolios, as of December 31, 2015.
- Performance has been underperforming under the investment policy statement, so representatives have been asked to review their investment performance and address the recent underperformance, and discuss the investment strategy going forward.

Mr. Danes, co-CIO of Victory, presented the following overview and commentary:

- Victory is an independently owned company with \$34 billion in assets under management; the Victory diversified strategy has been around for 26 years and has approximately \$2.5 billion in assets under management.
- The strategy was started by Larry Babin in 1989, and he is the co-CIO.
- The teams are opportunistic and flexible to both growth and value

styles.

- The teams have had a long continuity.
- In 2008, the fund was added to the Plan and outperformed two-thirds of the time over rolling 3-year period; between the years 2000 to 2009, the fund outperformed the market 9 out of 10 years.
- While availed to growth oriented stocks even during slow earnings growth period, found the valuation spread between fastest growing companies and the rest of the universe was too wide. Currently, they have a top down orientation towards value.
- Many managers struggled since the credit crisis. Post crisis, it has been a difficult period for active management. Last year, it was a narrow market around momentum stocks and only a handful of stocks outperformed. They have worked towards raising the quality of the portfolio to make it a more quality defensive portfolio.

In response to Trustee Becker's question on why the fund has been underperforming recently, Mr. Danes explained that in 2015, it was a function of what was owned and what was not owned, and a narrow list of momentum stocks. Not owning stocks such as Amazon and Netflix cost Victory over 100 basis points of performance. In addition, mistakes around value bets on some stocks which have since been eliminated and having too low a quantity of energy stocks. They have since added energy stocks this year.

Mr. Ezard noted that recently, the fund has been underperforming year-to-date, but factors that contributed towards underperformance for last year have dissipated this year, and he asked what is different. Mr. Danes responded that this year it was due to mistakes around orientation of value names with two specific stocks that were detrimental, and therefore were eliminated.

In response to Trustee Nishimoto's question if the mistakes were structural or philosophical and what changes were made in terms of approaches in philosophy and in looking forward, Mr. Danes responded that they have been analyzing, learning, and using risk management tools to understand what happened; and learned a lesson regarding event stocks, whereby when the event happens they need to respond quicker on the sell side. Going forward, the lesson learned is to apply the discipline of identifying those event stocks upfront and respond quicker.

Chairperson Moto turned to speakers Mr. Maschoff, Managing Director of Client Services, and Ms. Simon, Managing Director/portfolio manager, from Winslow Capital, presented the following overview and comments:

- Winslow Capital is the sole sub-advisor of the MainStay Large Cap

Growth Fund.

- Justin Kelly is the CIO and has been the portfolio manager since 1999. He has been the key driver in establishing the investment team.
- Winslow manages \$30 billion in large cap growth.
- The MainStay fund is one half of the total large cap growth assets.
- The employees at Winslow have an equity interest in the firm.
- The focus is on stocks with earnings growth.
- In 2015, the large cap growth space was the best performing indices compared to value, REITS, fixed income, and others.
- The MainStay fund had a net of 6.2% return in 2015; over 10 year period had a net of 9% return.
- In the First Quarter 2016, it has been difficult for large cap managers; in Merrill Lynch survey of large cap equity managers, it showed 94% of active large cap growth managers underperformed the benchmark.
- For 10 years, U.S. large cap space was the place to be; during the 10 years of outperformance, it was reminiscent of the 1990's and value has become extreme in the growth space.
- What drove stocks earnings growth up to 2015 was the earnings differential. In 2015, the Russell 1000 growth index outperformed the Russell 1000 value index by nearly 1000 basis points.
- In 2015, there was a lot of volatility. In the end, it resulted in an earnings driven market. The equity performance was tied to earnings.
- Prospectively see that global growth will remain slow; and emerging markets will start to converge over the next 5 years. Ms. Simon noted that she does not feel that the U.S. will be in a recession.
- The expectations are that growth equities will continue to outperform and alpha opportunities will be more compelling. She feels optimistic for the next 5 years.

Mr. Ezard commented on the growth momentum between the years 2009 to 2013 and asked about this having an impact on the strategy. Ms. Simon to address this the fund closed for new business in 2012 to manage the growth and focus on client servicing. The fund later reopened.

In response to Trustee Machida's question asking the reason for the significant underperformance of the other sectors like financials and industrials in relation to the index, Ms. Simon noted that the outperformance in 2015 came from consumer discretionary which was led by Amazon and in information technology. During the 1st quarter, they continued with the weightings and saw the secular portions of economy being very attractive. Also in the 1st quarter saw high dividend yielding stocks and cheap stocks working well. The problem was they were underweight in sectors such as industrials, utilities, and telecom.

Chairperson Moto thanked Mr. Maschoff and Ms. Simon for the presentation, and Mr. Ezard for arranging the discussions.

Agenda

Item # 2:

Ongoing Business

a. Discussion and Follow-up Action on Segal Rogerscasey's Deep Dive Plan Review

Ms. Carter provided a high level summary as a follow-up from the past meeting and provided the following remarks:

- There are many things that the Plan is currently doing to operate at a high level.
- There are also other services and approaches that the Board could look at and evaluate whether or not to consider.
- A summary chart of considerations/options that the Board could further explore was discussed. Segal will coordinate those considerations and explore with the Board staff and Prudential. She suggested that the Board may want to consider one or two options at this time.
- Of note, a higher consideration could be with regards to participation and enrollment. Other plans have been looking at the Roth feature which tends to be more attractive to the younger population. The loan feature would be the lowest priority for consideration.

Ms. Klassen commented that Prudential would be ready to focus on enrollment capabilities such as auto-enrollment or online enrollment (quasi online enrollment where information is provided by the Plan sponsor of all eligible and the participant submits information). Mr. Malmud offered comments on the loan and Roth features and enrollment initiatives.

The Board agreed that the online enrollment would have a larger positive impact on the Plan.

A motion was made by Trustee Margol and seconded by Trustee Villabrille to adopt the action plan, as proposed by Segal Rogerscasey, and start with a focus on participation and enrollment activities; and requested that Prudential Retirement work with Segal and the Board staff towards implementing the activities. The motion passed unanimously.

Agenda

Item # 3:

Other Business/Announcements

a. Approval of Payment to DHRD for the Special Funded Position for FY 2017

Ms. Akiyoshi presented the Bill For Collection for the funding of the DHRD Special Funded position for FY 2016-2017. She reported that the special funded position has been authorized to be funded from the Plan's budget reserve and requires approval for the upcoming fiscal year 2016-2017 in the amount of \$126,241.00. The funding amount includes the applicable current fringe benefit amount of 52%, and added that the funding is necessary prior to the commencement of the fiscal year beginning July 1, 2016.

A motion was made by Trustee Nishimoto and seconded by Trustee Villabrille to approve the payment for funding of the DHRD Special Funded position for FY 2016-2017. The motion passed unanimously.

b. 2016 NAGDCA Annual Conference

Chairperson Moto announced that the NAGDCA (the National Association of Government Defined Contribution Administrators) which has been one of the national organizations that the Board has acknowledged to be a beneficial resource and forum that focuses on section 457 plans, has opened its registrations for this year's conference. He asked that Board members review the conference information and let the Board staff know if interested in attending the conference.

In addition, Chairperson Moto stated that in the past the Board staff has been allowed to attend the conference since the conference provides an opportunity to network and stay abreast of the latest industry best practices. There were no objections from the Board members.

A motion was made by Trustee Becker and seconded by Trustee Machida to allow the Board staff to additionally attend this year's NAGDCA conference. The motion passed unanimously.

Ms. Akiyoshi added reminders about the upcoming Benefits Fair on Wednesday, May 11, 2016, at the State Capitol, and the semi-annual Board meeting on Friday, May 13, 2016.

Chairperson Moto stated that the next agenda item is regarding the draft RFP for an active core fixed income search and will be discussed in Executive Session since it is subject to procurement.

Item # 4: Discussion and Review of Draft RFP for an Active Core Fixed Income Investment Option

A motion was made by Trustee Machida and seconded by Trustee Nishimoto to move into Executive Session at 10:27 a.m. to confer with legal counsel on procurement matters. The motion passed unanimously.

All guests were excused, with the exception of the Plan's consultant, Segal Rogerscasey.

Chairperson Moto called for a short break. The meeting resumed at 10:29 a.m.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Nishimoto and seconded by Trustee Machida to move out of Executive Session at 11:05 a.m. The motion passed unanimously.**

All guests rejoined the meeting.

A motion was made by Trustee Machida and seconded by Trustee Nishimoto to: (1) establish the entire Board as the evaluation committee; and (2) use the median method of scoring during the scoring phase of the RFP evaluation. The motion passed unanimously.

A motion was made by Trustee Nishimoto and seconded by Trustee Margol to accept the draft RFP with amendments to scoring criteria to reflect:

- | | |
|---|-------------|
| 1. Stability and quality of the firm | 22.5 |
| 2. Investment philosophy | 20 |
| 3. Construction of the portfolio and adherence to stated investment process | 22.5 |
| 4. Strength of overall performance of the product relative to appropriate benchmarks | 25 |
| 5. Fees/expenses | 5 |
| 6. Firm's ability to work with the Board | 5 |

Discussion: The Board discussed the amendments, in particular, the evaluation criteria and the weights assigned to the evaluation categories. Trustees Becker and Machida believed that the points assigned to the fee category are too low and should be increased from 5 to 10 points.

Mr. Ezard remarked that he is comfortable with the weights assigned as the stability and quality of the firm and the construction of the portfolio should carry a higher weight than the investment philosophy. He added that he has seen similar weights applied to the fee category, as noted, in other plans' searches.

Other Board members commented that the 5 points for the fee criteria has been used in the Plan's prior RFPs, and is set at 5 points to ensure that fees alone do not determine the outcome of an RFP. It was explained that the scoring for the fee criteria is determined via a formula specified in the Procurement rules (i.e., the lowest fee proposal gets all of the points for fees, and the other proposals receive a score that is based on a percentage of the lowest fee proposal). In the past, the Board was concerned that a higher fee criteria may result in a lower quality firm being selected because its fees are the lowest. Although fees are important for participants, the Board is more concerned with the firm's stability and performance and placed a higher emphasis on these criteria.

The motion passed with two (2) votes in opposition by Trustees Becker and Machida.

There was no other business. Chairperson Moto adjourned the meeting at 11:16 a.m.

(NOTE: Signed copy on file.)