

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

**OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 402**

Date: May 13, 2016

Place: Hawaii Prince Hotel
Captain's Room
100 Holomoana Street
Honolulu, HI 96815

Present: James Nishimoto, Ex-Officio Member (excused at 11:18 a.m.)
Wesley Machida, Ex-Officio Member
Brian Moto, Employee Member (arrived at 11:05 a.m.)
Kanoë Margol, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Glenn Ezard, Segal Rogerscasey
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Al Lee, Plan Administrator Staff (Prudential)/Honolulu Office
Kapena Kim, Plan Administrator Staff (Prudential)/Honolulu Office
Peter Eddy, Plan Administrator Staff (Prudential)/Honolulu Office
Deborah Baran, Prudential Retirement
Carol Blumenthal, Prudential Retirement
Bart Jeffreys, Prudential Retirement
Jim Diskin, Prudential Retirement
Paul Dowd, MorningStar Investment Advisory Services
Stephen Weeks, William Blair & Co.
Todd Egger, INVESCO
Darren Smith, J.P. Morgan
Vince Ortega, Capital Research (EuroPacific)
Matt Westhoven, MFS
Taylor Alan-Lee, PIMCO
Ian Hendry, Victory Capital Management
Carolyn Rains, Victory Capital Management
Tom Smythe, New York Life/Mainstay Investments

John Maschoff, Winslow Capital Management (MainStay Investments)
Sunita Patel, Wellington Management
Cara Lafond, Wellington Management
Ed McGettigan, Vanguard
Scott Donaldson, Vanguard
Mike Manfre, Vanguard
Allan Duckett, Schroders
Shaun Levesque, Schroders

Via
Conference

Phone: Julie Klassen, Prudential Retirement; and Ben Mandell, J.P. Morgan

Absent: Roderick Becker, Employee Member

Call to
Order:

There being a quorum present, Vice-Chairperson Nishimoto called the meeting to order at 9:17 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.

Vice-Chairperson Nishimoto opened the meeting with all trustees except for Trustee Roderick Becker. Chairperson Moto was delayed to the meeting due to his flight. He welcomed all attendees and opened with introductions, including those participating via conference call. Vice-Chairperson Nishimoto briefly covered some housekeeping items.

Agenda

Item # 1: Semi-Annual Report from Prudential Retirement

Presenting from Prudential Retirement are Ms. Julie Klassen via conference call, Ms. Deborah Baran, and Mr. Kevin Malmud; and Mr. Paul Dowd from MorningStar.

Ms. Klassen opened with an introduction and remarks on the Benefits Fair that took place on Wednesday, May 11, 2016 at the State Capitol, and followed with commentary on:

- The asset allocation changes for the LifeCycle Portfolios have been completed, as recommended by Segal Rogerscasey and adopted by the Board at its March 21, 2016 meeting,
- Initiatives to increase enrollment:

- The Board discussed and adopted Segal's recommendation on the initiative to address participation and enrollment.
- It is expected that online enrollment initiatives would increase participation and activities;
- There is a challenge to collect employee data from all departments and Counties.
- Prudential would look at providing other methods such as quasi-online enrollment capabilities.
- Plan participation rates:
 - The Plan's active deferral participation rate is 27%.
 - The Plan's participation rate, excluding the DOE and the UH, is 46%.
 - The Plan's overall active participation with balances is 31%.
- Updated Specimen Plan Document:
 - Prudential is updating the specimen Plan Document that would include the Windsor provisions, an adoption agreement that elects provisions of the Plan, and a summary Plan description with general information. Completion is expected around July 2016. Board staff is currently working on the summary Plan description document.
- Plan audit by N&K CPAs:

Ms. Klassen reported that all materials that have been requested by N&K have been delivered for the Plan's audit.

- Plan Overview:
 - The Stable Value Fund which is managed by Prudential/Jennison and Invesco has about 44% of the Plan's assets.
 - Asset allocation strategies being utilized are:
 - Goalmaker which comprise 4.9% of the Plan's assets; and
 - Lifecycle Funds which comprise 4.7% of the Plan's assets.
 - Managed accounts by MorningStar has about 1,684 participants.
 - Total assets of \$134 million are in the managed account option, through February 2016.
 - 72.2 % of the assets are attributed to participants over age 55.
 - 94% of the assets attributed to participants over age 45.
 - Asset retention efforts continue.
- Updates on the DOL Fiduciary Rule that was issued in April 2016:
 - The Department of Labor works with ERISA plans; however, government plans can chose to follow DOL's rulings for ERISA plans.
 - Ms. Klassen explained that there were questions on whether asset allocation models are considered educational or if it is considered advice.

She clarified that the asset allocation models like Goalmaker are considered educational. And, the information is considered educational because what is provided upon distribution is general in nature such as information on options that are available.

- She also clarified that Boards are not considered fiduciaries with respect to investment advice.

Mr. Malmud provided highlights of the local office activities:

- Local retirement counselors have had success with Goalmaker enrollments, resulting in 276 enrollments during the 1st Quarter 2016, and around 8 of 9 new enrollments have selected Goalmaker.
- Total rollovers in to the Plan totaled \$2.8 million for the 1st Quarter 2016; and about \$1.72 million are directly attributed to interaction with the retirement counselors.
- Initiatives by local team:
 - Holding mini deferred compensation fairs within University system.
 - Held site visits within HHSC due to the transition to Kaiser.
 - Working with UH for employees requesting lump sum deferrals as a result of an agreement.
 - Exploring retiree-focused educational materials.

Ms. Baran provided updates on the Benefits Fair and key initiatives:

- Benefits Fair attendance totaled 1,070+ attendees at the State Capitol:
 - Summary of past attendance counts at the State Capitol location: in 2013, there were 970; in 2011, there were 934; in 2005, there were 1,500.
 - The Pre-Retirement workshop sessions drew the largest attendance.
 - Enhancements that were added to the Fair included changes to the survey format. Electronic and paper formats were available and 600 attendees completed the electronic survey.
- Other communication initiatives:
 - A cultural presentation is being developed that will focus on retirement.
 - Electronic presentations are being developed for DOE employee orientations and for DHRD's website.
 - Custom website enhancements are planned for the Plan website, to include videos.

Mr. Dowd, from Morningstar reported on the Managed Accounts by Morningstar and provide the following points:

- The investment advisory services incorporates human capital into the allocations.
- The human capital component avoids asking risk tolerance.
- He explained the components of blending financial capital and human capital.
- He commented that studies reveal that people don't know how they invested so the Plan helps people understand. Tools and resources enable participants in the Plan to gain the necessary understanding.
- Users can customize data when going into their accounts which helps determine/assess how to invest.

Mr. Malmud added that space has been made available at the Prudential Honolulu Office for Mr. Dowd to hold additional individual counseling sessions after the Fair.

Mr. Dowd explained the reasons between how fiduciary responsibility for advice through Morningstar and Goalmaker differ. Advice through Morningstar which is a registered investment advisor will be responsible for handling challenges on investment decisions. Goalmaker is seen as an asset allocation tool to help individuals make decisions. The individual is responsible for using the tool and making their own decisions.

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Item # 2:

Investment Performance Report from Segal Rogerscasey

Mr. Ezard provided a brief summary report and overview for the 1st Quarter 2016. A full report will be provided at an upcoming meeting:

- Plan's assets are just over \$2 billion.
- The Stable Value Fund accounted for most of the Plan's assets followed by the BlackRock U.S. Large Cap Index fund.
- The funds on the watch list are the PIMCO Total Return Fund, the Victory Institutional Diversified Stock Fund which is trailing its benchmark, and the MainStay Large Cap Growth Fund which is trailing its benchmark and peer group.
- The downturn in the market has largely been due to China's economy.
- The BlackRock Large Cap Index performed well during the quarter.
- The Stable Value Fund performed well; looking forward, low interest rates will be a concern and is expected to remain low.
- The markets fell early in the quarter, but have since reversed with a weak return.
- Expected outlook is for low returns among most of the asset classes due to the slow growth.
- Despite the interest rate slowing and continuing low GDP, expect some room

to grow and possibly a shallow recession.

Vic- Chairperson Nishimoto thanked the presenters and called a break at 10:22 a.m. The meeting resumed at 10:42 a.m.

Vice-Chairperson Nishimoto acknowledged the sponsors for today's meeting and lunch; the Board wishes to thank Julie Klassen and the Prudential Retirement Team, Tom Smythe of MainStay/New York Life, Stephen Weeks of William Blair & Company, Sunita Patel of Wellington Management, Todd Egger and Delia Roges of Invesco, Ian Hendry of Victory Capital Management, Allan Duckett of Schroders Investments, Matt Westhoven of MFS, and Taylor Alan-Lee and Mike Chandra of PIMCO.

Mr. Ezard opened the panel discussions for today's meeting and commented that the panel will discuss some inflation outlooks, impacts on portfolios, and ways to hedge within the market going forward.

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Item # 3:

Panel Presentation # 1 on Outlook for Inflation and Impact on Stocks, Bonds, and Commodities: by J.P. Morgan and Vanguard

Presenters: Darren Smith and Ben Mandel (via conference call) from J.P. Morgan, and Scott Donaldson from Vanguard.

Mr. Smith and Mr. Mandel presented on forecasting inflation, methodologies, inflation risk, and the impact on stocks, bonds, and commodities. The short, mid, and long term asset classes in different inflation environments over several years was recapped since 1974. They discussed where we are today and the types of forecasting that have worked well, some observations, and where we see inflation going forward. Some factors such as the decrease in unemployment over last 5 years will have an impact on inflation.

Mr. Donaldson described the economic and market outlook going forward and provided observations on the global and U.S. outlook. He noted that the global economy is fragile and there are structural issues that have kept the lid on global growth. Manufacturing and trade have been slow. Within the U.S. economy, there are trends that inflation is creeping into the economy in various ways. Wage growth should rise moderately. He discussed the outlook within the bond and equity markets.

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Item # 4:

Panel Presentation # 2 on What Drives Large Cap Equity Return in a Slow Growth Economy: by Wellington Management Co., Victory Capital Management, and New York Life-MainStay Funds/Winslow Capital Management

Presenters: Carolyn Rains from Victory Capital Management, John Maschoff from Winslow Capital Management, and Cara Lafond from Wellington Management Co..

Ms. Rains discussed the economic cycle, reasons for the slow growth environment, and the drivers of the economic activities. She noted that the average economic expansion has lasted 46 months and recession at 15 months. The drivers of the economic activities come from the growth in the working age population which has been lower than historically. This has resulted in lower GDP growth and slow corporate profit growth.

Mr. Maschoff presented observations on the investment landscape:

- Seeing developed markets converging with emerging markets;
- A subdued inflation outlook;
- Volatility in global markets;
- U.S. population growth will continue and create working age population which will help with GDP;
- Working age population in China is declining; and
- There is a correlation between rising Federal Reserve rate and the equity market performance.

Ms. Lafond presented observations on companies across the spectrum that have products that have succeeded and performed due to its innovation, like Autozone, LBrands, Nike, etc. The pace of change has made a difference in companies reaching consumers and driving sales. Future winners are using advertising strategies and marketing themselves through digital mediums. She noted seeing a shift in trends within renewable energy and a demand in renewable energy, and that they are looking at companies that can harness that trend to drive investment return.

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Item # 5: Panel Presentation # 3 on Emerging Market Equity Investing After the Commodity Super Cycle: by Schroders

Presenters: Allan Duckett and Shaun Levesque, client portfolio manager from Schroders.

Mr. Duckett introduced Mr. Levesque who presented a forecast on emerging markets. He provided some comments and observations:

- Within commodities, there have been peaks and valleys.
- The key is the U.S. dollar; a weak dollar is a good thing for commodities. The

strength of the U.S. dollar is in line with commodity price weakness.

- China has been the driver of metal use in commodities due to their fast growing economy. China's demand for metals has slowed.
- In 2014 and 2015, there was an oversupply of oil and the price of oil crashed.
- Low commodity prices are a boom for some emerging economies like China and Korea.
- The strength of the U.S. dollar correlates to emerging markets; when the dollar is strong, it is bad for emerging markets.
- Composition of Chinese economy is changing to a more service based economy, but economy is still strong. Largest part of China's debt is corporate debt.
- Emerging market asset class is still attractive and provides good diversification.

Agenda

Item # 6: Other Business/Announcements

There being no other business or announcements, Chairperson Moto closed the meeting by thanking the panelists for their informative presentations.

Chairperson Moto adjourned the meeting at 12:01 p.m.

(NOTE: Signed copy on file.)