STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 381

Date: May 21, 2014

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

Present: Wayne Chu, Chairperson
Barbara Krieg, Ex-Officio Member
Kalbert Young, Ex-Officio Member
Michael Okumoto, Employee Member (arrived at 9:18 a.m.)
Brian Moto, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic, Mercer Investment Consulting
David Williams, Mercer Investment Consulting
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Julie Klassen, Prudential Retirement
Deborah Baran, Prudential Retirement
Augie Urgola, Prudential Retirement
Paul Dowd, MorningStar Investment Advisory Services
Delia Roges, INVESCO
Todd Egger, INVESCO
Robert Atwell, Harbor
Joel Damon, J.P. Morgan
Maddi Dessner, J.P. Morgan
Vince Ortega, Capital Research (EuroPacific)
Lisa Rosenthal, Victory
James Carville, BlackRock
Brendan Bowe, BlackRock

Tom Smythe, New York Life (Mainstay Investments)
Steve Clear, Winslow/MainStay Investments
Joan Larsen, Prudential
Sue Bonfeld, Wellington Management Co.
Cris Hernandez, Wellington Management Co.
Ed McGettigan, Vanguard
Tom Atchison, Vanguard
Michael Chandra., PIMCO
Bob Formisano, Schroders
Michael Golojuch, C&C of Honolulu

Absent: Neal Miyahira, Employee Member

Call to Order: There being a quorum present, Chairperson Chu called the meeting to order at 9:04 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 Chu welcomed all attendees and thanked everyone, including all the Plan's investment fund providers, for their participation and support at yesterday's Benefits Fair. Trustee Miyahira was excused from today's meeting.

Agenda Item # 1: Semi-Annual Report from Prudential Retirement

Presenting from Prudential Retirement are Mr. Augie Urgola, Ms. Julie Klassen, Ms. Deborah Baran, Mr. Kevin Malmud, and Mr. Paul Dowd.

Mr. Urgola opened with an introduction and remarks. Ms. Klassen followed with comments on the Benefits Fair that was successfully held yesterday at UH West Oahu. There were 400 attendees at the Fair. Ms. Klassen provided the following highlights:

a. Revenue reallocation project:

   Prudential will be crediting revenue back at the fund level as of March 2014 rather than at the participant level. For mutual funds, it will continue to be at the fund level.

b. Administrative Project Plan

Prudential will be focusing on outreach to ensure that beneficiary information is updated as this issue has been discovered and has been discussed on weekly administrative calls with Board staff.

c. Plan Document

This project is underway and Prudential is working with the Board's staff to review the draft document.

d. Audit Agreement

Prudential is working on an agreement with N&K CPAs to continue the audit work that has been done in the past for the Plan.

e. Strategic Business Plan

When looking at the potential within the Plan, one factor is the participation rate which is currently at 26%. Ms. Klassen reviewed the participation at the department levels.

f. "Plan Ambassadors" and Other Outreach

Some initiatives have been in progress by the local representatives to support the outreach efforts.

g. Asset Allocation Initiatives

The Stable Value Fund currently holds 44.5% of the Plan's assets. Developed some communication on diversification to help educate participants on asset allocation and increase diversification.

h. Asset Retention Efforts

Because over 83% of the Plan assets reside with participants over the age of 50 and over, developed communication to explain the benefits of keeping the assets in the Plan. Inflows and outflows are about even.

Mr. Malmud reported on the Local Office activities:

- At the Benefits Fair, a new presentation on market behavior was debuted and which adds to the existing number of available workshop topics. New technology was incorporated into the workshop and allowed for attendee interaction.
- The Local Office staff has been making progress to get into the DOE; met

with the Personnel Regional Officers on April 25, 2014; with DOE's assistance plan to participate in the new teacher orientations and to set up meeting with complex area superintendents at their monthly meetings; plan to make presentation to 200-300 HGEA union stewards on September 27, 2014; and plan to participate in DOE's Teacher Institute Day over four (4) days in October 2014.

Ms. Baran provided communication highlights:

- For the upcoming NAGDCA awards submission, an award submission has been prepared for the category of National Save For Retirement Week. The entry is submitted for the Board's approval. Another submission is being prepared on the transition of the Plan. The Board did not have any objections.
- Ms. Baran reviewed the website activities and noted that for the First Quarter of 2014, there were 18,000 log-ins.
- There was a lot of good feedback and report of positive experiences at the Benefits Fair. Activities engaged attendees to think about their retirement plans. Many of the workshops were at standing room capacity. Chairperson Chu noted that participants did remark that they appreciated having the location of the Fair at this site as it did allow them to spend more time at the Fair with the two (2) hour work time allowance.

Mr. Dowd introduced himself and presented information on the mission and history of Morningstar and reported on Morningstar investment management services:

- Morningstar's use of style box system as a tool to pick investments.
- Provide services through Morningstar Retirement Manager.
- Objective through its tool is to reach a 70% confidence ratio.
- Have real people behind the scenes to oversee each portfolio.
- Provided the benefits of managed accounts and the measurements for success.
- Tools allow participants to have the portfolio management done for them.
- Morningstar system does customize the individual portfolio for each person, based on a strategic process.
- Morningstar provides ongoing monitoring and maintenance.
- Choice of two level of services: Managed by You, for active investors to get same asset allocation recommendations, but they are responsible for own maintenance; and Managed by Morningstar which will place the trades for the individual and manage the account for a low fee/cost.

Mr. Dowd confirmed that for future reporting a Reach and Impact report including utilization with the service can be provided from quarter to quarter to assess if the

Morningstar service and process is working. Mr. Dowd confirmed that along with statements, a quarterly progress report is provided to the individual to show that they are on track with their budget and investments.

Agenda
Item # 2: Investment Performance Evaluation Report from Mercer

a. Economic and Capital Market Environment

Mr. Saharic provided the following report:

- US equities had strong returns in 2013.
- Domestic equity results show indices were up 21-27% for the Russell 2000 growth index.
- Although emerging markets was down, they continue to do well after quarter end.
- Favor equities over fixed income.
- REITS rebounded and commodities strengthened.
- Post financial crisis investors experienced trends like macro factors dominating the market. Macro trends led to strong index fund performance compared to active managers.
- U.S. economies doing okay, with market performance expected at 7.5% rate of return.

Mr. Williams provided the following report on the Plan:

- PIMCO has had shifts in organization; Mercer has retained a "W" rating and waiting to see how the new management team settles into their new roles and degree of stability.
- Victory announced the acquisition of Munder, which will not impact the fund's strategy.
- Winslow's parent company, Nuveen Investments, has been acquired by TIAA-CREF. The team at Winslow will continue to run as an autonomous unit and Mercer is not recommending any changes to the rating. Will continue to monitor this situation.

Mr. Williams provide Plan highlights:

- Plan assets are just short of $1.9 billion at the end of the quarter.
- SDBO had about $1.2 million inflows; in relation to the overall Plan, this is not significant transfer activity.
- No significant changes to the fund expense ratio from the last quarter, and average 32 basis points.
- Custom target date portfolios had good performance over the last

year.

- For the last quarter, positive contributors for the Lifecycle portfolios were the Stable Value Fund, JP Morgan Diversified fund, and the Wellington Research Value Fund. The big detractor was the MainStay Large Cap fund.
- The BlackRock Index strategies tracked their indices.
- The Stable Value Fund saw a quarterly return of 0.7%, and continues to provide a good return.
- The short term performance for Jennison has been favorable; the long term strategies managed by INVESCO has been favorable. Market-to-book ratio has been healthy.
- PIMCO Total Return performance of 1.3% for the quarter; one year performance is behind the benchmark but the long term continues to be favorable.
- JP Morgan strategy has had favorable performance for the quarter.
- Vanguard Wellington had good short and long term performance.
- Wellington Research Value had good performance.
- Victory Diversified Stock fund had a disappointing quarter due to stock selection in a number of sectors, but no Mercer has no recommendation for change at this time.
- MainStay Large Cap Growth Fund performance was down 1.3% for the quarter, and they struggled with stock selection in the health care sector; long term performance is behind and Mercer continues to monitor.
- Harbor had a solid performance for the year with 23% return, except that this is still slightly behind for the quarter due to stock selection in the financial sector. Long term performance is at the median.
- Century SMID cap strategy had a performance of 2% for the quarter.
- MFS International value strategy was behind for the quarter but the long term performance remains favorable.
- EuroPacific Growth fund had a good quarter.
- Schroders was behind for the quarter.

Chairperson Chu called for a break at 10:04 a.m. The meeting resumed at 10:38 a.m.

Chairperson Chu resumed the meeting and made some announcements to acknowledge the sponsors for today's meeting.

Chairperson Chu noted that the information by the investment managers at these Semi-Annual meetings provide the Board with opportunities to learn what is going on in the industry and the Board appreciates these presentations.

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Item # 3: Panel Presentation # 1 on Impact of a Federal Reserve Monetary Stimulus Reduction on the Global Economy: by PIMCO, JP Morgan, and Schroders.

Presenters: Michael Chandra from PIMCO, Maddi Dessner from J.P. Morgan; and Bob Formisano from Schroders along with Alan Ayres via conference call.

Mr. Williams explained that the presenters will talk about the Fed's policy and the expected winding down of the monetary policy that the Fed has had since the financial crisis, and the impact on the global economy and how they are taking into account the policy measure within their portfolio construction process.

Mr. Chandra talked about the Fed rate hiking cycle and impact on the fixed income markets. Fed policy measures have reversed where the Fed is now setting policy rates depending on both how well economy is doing as well as the impact on financial assets, compared to where it has been historically. The Fed has a dual mandate, which is to maximize employment and maintain stable prices.

Mr. Chandra explained the mandates and what the conditions would be. Expectations are that the Fed may be slow in their rate hiking cycle. Mr. Chandra explained that the Fed noted some of the problems associated with the Fed's communication policy. He also described various scenarios on a rising interest rate environment within the bond portfolio and market expectations over the next five (5) years.

Ms. Dessner stated that they expect continued tapering by the Feds until October, then will wait to see when increases in the interest rates will start. Tapering and tightening cycles will not derail the economy growth upswing over the last year and a half. She explained the four (4) things that could derail the opportunities for the continuation of growth.

JP Morgan's views on the impact on the portfolio, is one of a tempered optimism and they are looking at a diverse basket of US securities which look attractive. They are balancing the risks and exposure to the right areas of growth.

Mr. Formisano introduced colleague, Alan Ayres participating via conference call. Mr. Ayres provided comments on the impact of the Fed monetary stimulus reduction on the growth economy, and the outlook for the emerging markets. The strengthening of the dollar helps keep the dollars strong. Last year, the 10-year treasuries jumped from 1.6% around May to close around 3% in September which had a sharp impact on emerging countries. The Fragile Five consisting of South Africa, Indonesia, India, Brazil and Turkey had a difficult time. Whereas, the stronger economies in countries like China, Russia, Korea and Taiwan did fine.

If the U.S. economy is robust and gains traction, then will start to see export growth from emerging markets and will trend upwards. But this depends on how rapid rates rise.

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Item # 4: Panel Presentation # 2 on Bull Market Environment: Outlook for the U.S. Economy and How it Influences Equity Portfolio Positioning: by Victory Capital Management, Harbor Funds, Wellington Management, and New York Life/MainStay Investments

Mr. Williams restated that 2013 was a strong year for U.S. equity performance. The discussion remains whether 2014 will continue to see same risk appetite for equities and with economic growth continuing with low inflation and price volatility what the stocks will look like.

Ms. Rosenthal explained what Victory is looking at and what they are seeing with respect to consumer balance sheets, any improvements in the job markets, and effects on the employment numbers. Ms. Rosenthal reviewed the current and historical valuations in the S&P 500 sectors. She believes that Fed monetary tapering has been good as it is rewarding the companies that are growing but there is still risk.

Ms. Rosenthal provided remarks on what Victory is doing in light of this environment and what they are looking at, which is risk-reward when purchasing names. They continue to look at the financials and technology sectors for better risk-reward.

Mr. Atwell reminded everyone that the Harbor Funds is sub-advised by Earnest Partners. As mentioned earlier, 2013 was a good performing year and small cap stocks were beneficiaries of the good performance. The Russell 200 Value Index posted its best calendar year in a decade (since 2003). Most of the gains within the Fund were driven by stock selection in areas of energy, financials, and industrials. Mr. Atwell focused on their sector exposure and where they are heading, pointing out that almost half of the names of their holdings have been in the portfolio over five (5) years and which shows the consistency to where they have typically been investing. On this note, Mr. Atwell pointed out areas where they have found better values and that this is where you can expect them to be exposed going forward..

Ms. Bonfeld opened that it will be the ten (10) year anniversary that Wellington Management has been managing assets for the Plan.

Ms. Bonfeld explained the portfolio structure, the professional team of analysts who are sector and industry neutral, and the views held by the analysts in the various sectors.

Ms. Bonfeld focused on the retail sector and factors that impacts the sector. Economic recovery is a key backdrop to this industry. She noted that the bigger factor is one of a generational change where there is a shift to online sales. You find that stores that have been around and who have not found an internet strategy are cannibalizing sales from others. You see almost a 60% decline in mall traffic and many stores are going away. So, the ones that are going to survive are the ones that have a proactive approach to online retailing. When the analyst team looks at sector holdings, they focus on those that have an online presence.

Mr. Clear reminded everyone that Winslow Capital is a sub-advisor for the MainStay Fund. Mr. Clear explained the outlook by Winslow when managing the portfolio; the environment and the opportunities in that context; and how they look for companies that will continue to grow and the future of those companies. Mr. Clear noted that inflation typically ends the bull market and the two (2) factors that likely would derail the U.S. economy are price shocks from energy and wage pressures.

Agenda
Item # 5: Other Business/Announcements

Chairperson closed the meeting by thanking everyone for attending the meeting and the Benefits Fair, and for sponsoring today's meeting and lunch. The meeting was adjourned at 12:07 p.m.

(NOTE: Signed copy on file.)