

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

**OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 413**

Date: May 16, 2017

Place: Hawaii Prince Hotel
100 Sails Restaurant, Naio Room
100 Holomoana Street
Honolulu, HI 96815

Present: Brian Moto, Chairperson
James Nishimoto, Ex-Officio Member
Roderick Becker, Employee Member
Kanoë Margol, Employee Member
Kenneth Villabrille, Employee Member
Kalei Rapoza, Employee Member

Others: Jay Paige, 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
Julie Klassen, Prudential Retirement
Deborah Baran, Prudential Retirement
Carol Blumenthal, Prudential Retirement
Gabe D'Ulisse, Prudential Retirement
Robert Luciani, Prudential Retirement
Adam Faccone, Prudential Retirement
James Headley, MorningStar Investment Advisory Services
Stephen Weeks, William Blair & Co.
Todd Egger, INVESCO
Darren Smith, J.P. Morgan
Greg Franzblau, J.P. Morgan
Michael Albrecht, J.P. Morgan
Michael Bowman, Capital Group (EuroPacific)
Robert Atwell, Harbor Funds
Matt Westhoven, MFS
Tom Smythe, New York Life (Mainstay Investments)

John Maschoff, Winslow Capital
Megan Anderson, Winslow Capital
Sunita Patel, Wellington Management Co.
Mike Trovato, Wellington Management Co.
Ed Baldini, Wellington Management Co.
Ed McGettigan, Vanguard
Mike Manfre, Vanguard
Allan Duckett, Schroders
Shaun Levesque, Schroders
Jean Heinz, BlackRock
Matthew Galligan, BlackRock
Kapena Kim, Prudential
Al Lee, Prudential
Peter Eddy, Prudential
Tom Kalili, Prudential

Via
Conference

Phone: Brian Scott, Vanguard

Absent: Wesley Machida, Ex-Officio Member

Call to
Order:

There being a quorum present, Chairperson Moto called the meeting to order at 9:05 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 opened the meeting noting that all trustees were present except for Trustee Machida, who is excused. He welcomed all attendees and opened with introductions of guests, including those participating via conference call. He stated that there are no public attendees present to testify, and briefly covered some housekeeping items.

Agenda
Item # 1:

Semi-Annual Report from Prudential Retirement

Presenting from Prudential Retirement are Ms. Julie Klassen, Ms. Deborah Baran, and Mr. Kevin Malmud; and Mr. James Headley from MorningStar.

Ms. Klassen opened with introductions of Mr. Gabe D'Ulisse and Mr. Robert Luciani. She provided remarks and a summary overview:

Commentary on Asset Allocation and Education:

- The Stable Value Fund continues to have the largest portion of assets in the Plan.
- The Prudential local office provides strong education on asset allocation.
- Positive cash flows from initiatives and rollovers into the Plan.
- Plan participation rate shows:
 - An overall participation rate of 27% based on all eligible employees in the workforce; and
 - An overall participation rate of 46% without the DOE and the UH eligible population.
- Goalmaker assets have increased over the quarters, since Second Quarter 2016, to 6.8% of the total assets and has about 4,500 participants utilizing the tool.
- Custom LifeCycle portfolio assets totaled 4.96% of the total assets.
- Managed Accounts has 1,581 participants enrolled.
- Usage of the RIC (Retirement Income Calculator) resulted in 915 unique visits.
- Prudential has a Financial Wellness initiative that is being made available to all Plan Sponsors:
 - The impact on organizations shows:
 - 44% of employees are distracted at work by financial issues;
 - \$57 billion are attributable to early retirement withdrawals; and
 - 44% of workers think they will retire later than previously planned.The statistics may or may not be applicable; however, the objective is to have participants have a better experience as they plan for retirement, and Plan sponsors have a more enhanced experience with its employees.
 - Prudential is in a soft launch stage of their Financial Wellness service for their clients and is making tools and services available:
 - Will be a part of a multi-year strategy.
 - New features/initiatives include enhanced digital content in addition to traditional methods; Prudential Pathways is a comprehensive presentation with enhanced budgeting tools, the ability to take actionable steps, and the ability to integrate a portal to the financial wellness site with custom access.
- The Plan Document and the Adoption Agreement have been restated for the Plan's use.

Mr. Malmud reported on the Prudential Honolulu Office activities and observations in the field:

- 2016 accomplishments:

- There was a positive cashflow within CY 2016;
 - The Plan received a NAGDCA Leadership award in 2016;
 - Prudential Retirement Counselors were leaders within Prudential for the rollovers into the Plan;
 - The amount of deferrals into the Plan reached \$7.5 million which was the highest since the transition;
 - Significant events that occurred included the workforce reduction within the hospitals and the transition out of the State. Multiple sessions held at the Maui hospitals for those employees who will be transitioning to Kaiser;
 - The Prudential team was active in reaching out to those affected by the HGEA settlement;
 - The Prudential team will be exceeding the group and the one-on-one consultation meetings for this Plan Year-end compared the last Plan year;
 - For the National Retirement Security Week observance, activities included the first-ever Open House and a new cultural themed presentation;
 - Conducted outreach which included a successful mini-fair at the UH Hilo campus through the assistance of Trustee Rapoza.
- 2017 Accomplishments:
 - The Prudential team has been reaching out to key target areas such as the DOE, UH Hilo, Kauai County, and ERS to discuss communication strategies since Prudential does not have data for the non-participant population.
 - Prudential will work with the HSTA communication committees.
 - The Prudential team will continue with the mini-fairs; one was held at the UH Manoa campus and the team received great supportive assistance from the UH staff to partner on communications.

Ms. Baran provided updates on the communication and education activities.

- New Plan Website Redesign:

Ms. Baran acknowledged the Board subcommittee members, Trustees Villabrille and Rapoza, who participated in the planning meetings and provided feedback during the development of the redesign. The website will be promoted at the Benefits Fair along with a “Go Green” theme.

- Initiatives for the Benefits Fair:

- Emphasis on encouraging participants to sign-up for e-Delivery and

- use of electronic mediums to access Plan information.
- Emails were used to communicate and send invitations out for the Benefits Fair.
- Promotion on Plan awareness through the use of electronic mediums and explore benefits of financial wellness initiatives.
- Working with Mr. Tom Kalili on the new cultural presentation to promote this educational piece in efforts to better engage and educate participants.

Chairperson Moto acknowledged and thanked Prudential for improving access through the mobile devices (e.g., smart phones and tablets).

Mr. Headley, from Morningstar, reported that there are just under 1,600 participants currently enrolled in the managed account service. The methodology that is used for managed account service has not changed. They will update human capital market assumptions to profile participants and assess their risk level. Managed accounts look at factors such as age, gender, salary, etc. to give custom advice recommendations and understand what drives their choices.

He reported that he will also be working with Prudential on additional promotional activities such as holding webinars during the month of June. The webinar will discuss how to access the information. After the Benefits Fairs, generally there are small increases in participation, and expect to see participation increases after the webinars too.

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Item # 2:

Performance Evaluation Report for the First Quarter 2017 by Segal Marco Advisors, including but not limited to:

- a. Economic and Capital Market Environment
- b. Review of Investment Strategy and Option Performance

- a. Economic and Capital Market Environment

Mr. Ezard provided a flash summary update on market activity during the First Quarter 2017:

- The First Quarter 2017 was good with solid returns.
- The economy slowed with GDP at an annualized rate of 0.7% during the First Quarter 2017, but it was interesting that markets were moving up.
- The projected GDP growth rate is 3.6% for the Second Quarter 2017.
- The unemployment rate is improving and decreased to 4.5% at the

end of the First Quarter 2017.

- The Federal Reserve is expected to see the inflation rate moving to 2%, and would like to normalize rates and are looking to move interest rates in conjunction with rate increases.
- The S&P 500 was up 7.6%; and there was a bump in equities.
- Fixed Income was positive during the quarter.
- Non-U.S. equities MSCI ACWI was up 13% year-to-date.

b. Review of Investment Strategy and Fund Performance

Mr. Ezard provided comments on the funds on the watch list and an overview of the investments funds:

- Plan assets were just under \$2.2 billion in March 2017.
- The largest concentration of assets is in the Stable Value Fund.
- The BlackRock Index funds has the next largest concentration of assets.
- Asset allocation options did well; the Goalmaker and the LifeCycle funds have about 12% of the overall assets.
- Three (3) funds are on the watch list:
 - PIMCO Total Return Fund had good returns; the fund will be transitioning to the selected investment fund manager when the contract has been executed.
 - Victory Institutional Diversified Stock Fund continues to underperform; the Board has addressed this by initiating a search for a replacement fund. The Fund currently has \$52 million in assets.
 - MainStay Large Cap Growth Fund went through a period of underperformance but in recent months the Fund has recovered and has exceeded its benchmark over the long-term period. Segal continues to closely monitor the strategy's fluctuations.
- Equities have seen a strong performance; however, likely will not be sustainable. Much was due to the expectations of a strong fiscal stimulus and tax cuts, and deregulations.

Chairperson Moto called a networking break at 10:10 a.m. DAG Paige was excused. The meeting resumed at 10:36 a.m.

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Item # 3: Panel Presentation # 1 on Perspectives on Valuation Among Stocks and Bonds: by J.P. Morgan and Vanguard

Presenters: Michael Albrecht, from J.P. Morgan; Ed McGettigan, from Vanguard,

along with Brian Scott, Vanguard, via conference call.

Mr. Albrecht discussed where to look for value - the pace of declines in yield has outpaced the declines in growth. He provided some observations:

- That factors have created more savers versus borrowers and has driven rates lower. Factors will unwind in next decade and will drive interest rates up within a 3-1/2 year window.
- Preliminary rates have remain depressed due to quantitative easing.
- The Federal balance sheet has been unwinding and will drive rates higher.
- Equity valuation looks stretched but will need to be relative; the demand will be lower.
- Returns will be lower but relative value equity presents better than bonds.

Mr. Ezard added that rates will be lower because prospects for growth is lower.

Mr. McGettigan introduced Mr. Brian Scott who is with the Investment Strategy Group in Vanguard. He presented perspectives on valuations:

- Valuations are not cheap for equities and fixed income.
- Expect lower rates of return.
- Using Shiller CAPE indicator above long term average CAPE; finds that the cyclical adjusted price to earnings ratio is more reasonable than the long-term average CAPE.
- Not expecting interest rates to increase.
- Non-U.S. stocks are most attractive; expect that non-U.S. equities likely to outperform U.S. equities by 100-200 basis points over the next 10 years.
- The 10-year Treasury yield is at 2.5% and may remain; expect that the yield curve will flatten out over the next 5 years.

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Item # 4:

Panel Presentation # 2 on Finding Opportunities Late in the Business Cycle: by Wellington Management Company and New York Life/MainStay

Presenters: John Maschoff from New York Life/Winslow Capital and Ed Baldini from Wellington Management Company.

Mr. Baldini described the styles of management and different factors (groups of stocks) across the marketplace, and looking at the exposure of the different managers to the types of factors. The change in the environment since the global financial crisis started the push of more aggressive monetary policy. The impact shows a pattern of alpha generation has become more volatile.

He examined the headwinds and tailwinds, and benefits over time because of the ups and down cycles. It has been challenging for fund managers. Since the financial crisis, the best performance has been led by the least volatile stocks.

He noted that due to the shift in the path of interest rates, you begin to see lower volatility stocks trending lower, value stocks rebounding, and growth stocks starting to accelerate, and getting to more normalcy. Will expect to see more balanced opportunities, and more capital spending which will help productivity and put the recovery on a more stable footing. He believes that this is more of the early stages of growth rather than the late stages of trying to hold down inflationary pressures.

Mr. Maschoff opened with acknowledging Megan Anderson and Tom Smythe. He stated that Winslow Capital is the subadvisor for the MainStay Large Cap Growth Funds. He presented observations of the marketplace:

- Interest rates have been at historically low levels due to quantitative easing.
- Investors looking for yield have driven huge amounts of money into such things as high yield bonds, real estate investment trusts, ETFs, etc.
- Utilities is a low to no growth industry, but is keeping up with the S&P because utilities pay a high dividend.
- Valuation of growth equities at low rates, so there are opportunities given the macro environment. Their views on the estimates on growth and identifying the companies who will be leaders in their industry will depend on fundamentals (e.g., reasons such as innovative products, acquire competitors, global players in the marketplace, etc.). Even in a low or no growth phase, they are still able to identify companies that have growth opportunities. Winslow will not buy a company unless they see higher growth. 75%-85% of the companies that are in the portfolio that Winslow manages have beaten earnings expectations on a quarterly basis.

Chairperson Moto acknowledged Mr. Maschoff who is retiring soon and for his work and partnership with the State. On behalf of the Board, he conveyed best wishes to him.

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Item # 5:

Panel Presentation # 3 on Trends in Globalization and Prospects for Growth: by Schrodgers

Presenters: Allan Duckett and Shaun Levesque from Schrodgers.

Mr. Duckett opened with introductions, followed by Mr. Levesque who presented some observations on the global marketplace:

- Growth occurring in the emerging markets and developed markets is picking up; global trading has increased.
- Value has picked up last year because of Chinese stimulus (e.g., prices of commodities).
- This has been good for emerging market countries.
- There are concerns for U.S. small businesses being ahead of itself in terms of expectations, and the value of U.S. commercial bank assets have come down. The indicators may suggest for a slowdown in the U.S. versus the rest of the world.
- Tax reform will not likely be a big bump to the U.S. economy, but the impact likely will be as a result of a trade policy for the rest of the world. Any imposition of tariffs in taxes (e.g., a border adjustment tax) would be a negative for the developed and emerging markets.
- Potential forecast that the Chinese will be practical, and will be more about specific issues (e.g., getting their exports of Chinese steel out) rather on trade policy.
- Does not believe that the rate hikes will likely drive the U.S. dollar higher in value. If the U.S. dollar is strong, it will negatively impact emerging markets. Indicators show that the emerging markets currency has recovered.
- Another issue is Chinese leverage. Different countries treat their banks in different fashions. In China, see a huge increase in credit; gives Chinese leeway to do what they will with the loans. However, it is not expected that China will be a driver of emerging market growth, and is viewed as an overblown concern.
- Brazil has a lot of positives, but the issue is the ongoing reforms that have to happen.
- Analysts are starting to see more cash flow and global growth picking up among the emerging market companies.

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Item # 6: Other Business/Announcements

There being no other business or announcements, Chairperson Moto closed the meeting by expressing thanks to the providers for their reports and the fund managers for their presentations and for their participation in the upcoming Benefits Fair. He also acknowledged appreciation to the sponsors for today's Board meeting – Julie Klassen, Gabe D'Ulisse, and Rob Luciani from Prudential Retirement; Tom Smythe from New York Life; Stephen Weeks from William Blair & Co.; Mike Trovato, Ed Baldini, and Sunita Patel from Wellington Management Company; Allan Duckett and Shaun Levesque from Schroders; Matthew Galligan and Jean Heinz from BlackRock; and Darren Smith, Greg Franzblau, and Michael Albrecht from J.P. Morgan.

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There being no other business, Chairperson Moto closed with closing remarks and adjourned the meeting at 12:05 p.m.

(NOTE: Signed copy on file.)