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

## OPEN SESSION MINUTES
## SEMI-ANNUAL MEETING
## MEETING # 431

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| Date: | May 30, 2019 |
| Place: | The Plaza Club<br>Pioneer Plaza, 20th Floor<br>900 Fort Street Mall<br>Honolulu, HI 96813 |
| Present: | Brian Moto, Chairperson<br>Ryker Wada, Ex-Officio Member<br>Kalei Rapoza, Employee Member<br>Kalbert Young, Employee Member |
| Others: | Christopher Leong, Deputy Attorney General<br>Cynthia Akiyoshi, DHRD Staff<br>Craig Chaikin, Segal Marco Advisors<br>Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office<br>Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office<br>Julie Klassen, Prudential Retirement<br>Deborah Baran, Prudential Retirement<br>Carol Blumenthal, Prudential Retirement<br>Kenneth Zlotnick, Prudential Retirement<br>James Headley, MorningStar Investment Advisory Services<br>Stephen Weeks, William Blair & Co.<br>Todd Egger, INVESCO<br>Vince Ortega, Capital Group/American Funds<br>Michael Bowman, Capital Group/American Funds<br>Robert Atwell, Harbor Funds<br>Matt Westhoven, MFS<br>Jeff Budd, New York Life (Mainstay Investments)<br>Megan Anderson, Winslow Capital<br>Mike Trovato, Wellington Management Co.<br>Sunita Patel, Wellington Management Co.<br>Scott Elliott, Wellington Management Co.<br>Ed McGettigan, Vanguard |

Mike Manfre, Vanguard
Tom Atchison, Vanguard
Sarah Browning, Schroders
John Mensack, Schroders
Jeremy Kish, BlackRock
Sonya Park, State Street Global Advisors
Vidur Mehra, State Street Global Advisors

Via Conference Phone: Brian Scott, Vanguard

Absent: Robert Yu, Ex-Officio Member

Call to Order: There being a quorum present, Chairperson 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 opened the meeting noting that all trustees are present, except for Trustee Robert Yu who is excused from today's meeting. He welcomed all attendees and opened with introductions of the Board members and guests, including those participating via conference call. He stated that there are no attendees from the public who are present to testify, and briefly covered some housekeeping items.

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

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

Ms. Klassen opened with opening remarks and commentary on observations at yesterday's Benefits Fair, and a summary overview and commentary on Plan activities, Asset Allocation and data on Plan participation.

- The Benefits Fair was held yesterday, and attendance totaled 492 completed registration cards.
- The transition of the Plan's LifeCycle portfolios to the Vanguard Target Retirement Funds was completed on April 1, 2019 and was made available on April 2, 2019, with over $130 million allocated to the Vanguard Target

Retirement Fund series. No assets were transferred to the even-numbered vintages as there were no corresponding vintages within the Plan's LifeCycle portfolios. The Plan has three asset allocation methods that include the Vanguard Target Retirement funds, the MorningStar managed accounts, and Prudential's GoalMaker asset allocation program which allocates among the Plan's existing funds.

- Prudential will have two panel speakers featured at the upcoming NAGDCA conference in New Orleans, to speak on Asset Allocation Techniques during the Distribution Phase, and on Industry Innovations.
- Prudential issued notices to acknowledge public service workers through social media outlets and on information on retirement savings in conjunction with the national Public Service Recognition Week.
- During the First Quarter 2019, outflows exceeded inflows which resulted in a negative cash flow for the quarter. Strategies to address asset retention and the negative cash flow include initiating callouts by the local office team to educate participants who have separated on the benefits of keeping the assets in the Plan and possibly implementing the legislative initiative, as included in the SECURE Act, that raises the required minimum distribution age to 72 from 70-1/2.
- Plan assets as of March 31, 2019 totaled $2.4 billion.
- For the managed accounts, GoalMaker assets were at 9.03% of the Plan's assets, the custom LifeCycle portfolios were at 5.34%, and the Managed Accounts by MorningStar received 1,378 enrollments.
- The overall participation rate excluding the DOE and the UH is at 46%.
- Demographics on the participation among the agencies showed a 50% participation rate at the Department of Transportation and a 60% participation rate at the County of Kauai. Prudential will continue to look at touch points to ensure all employees are made aware of this benefit Plan without the ability to receive indicative data.

Ms. Baran reported on the communication projects over the past year and the upcoming initiatives.

2018 Project highlights:

- Lunch-n-Learn workshop series were held during August 2018 in various locations and introduced the topic on the "Big Picture" to educate participants on their retirement income that includes the ERS pension, social security, and their voluntary retirement savings plan. Plans are to continue this presentation and expand the sessions to the neighbor islands.
- The Fall Benefits Fair was held on Maui with over 300 attendees. The Aging Booth was introduced at the Fair and the interactive activity was featured in the New York Times on how the Plan is using tools to promote the program.

- In November 2018, a pre-retiree mailing was launched to focus on participants who are age 50 years and older to highlight the benefits of keeping their assets in the Plan.
- The 2018 NAGDCA Leadership award was presented to the Plan in the category of Technology and Social Media for the Plan's re-design and upgrade of the Plan website.

2019 Initiatives:

- The launch of the Financial Wellness campaign in 2018 included emails and announcements. A new brochure was developed to help participants improve their financial health and rolled out at the 2019 Spring Benefits Fair.
- A major initiative was developed and launched to introduce the new Vanguard Target Retirement Funds that replaced the custom LifeCycle portfolios. The communication campaign included notifications on the transition, information featured in the quarterly Plan newsletter, and a new brochure to explain the new funds.
- A new Go-Green initiative was rolled out at the Benefits Fair to encourage e-delivery and to promote going green. To encourage participation, there will be a friendly challenge between Hawaii and the State of Vermont that runs through August 2019.
- Carrying through on the points shared by Wendy Carter during her deep dive analysis, an education campaign will be developed to focus on online financial security tips.
- Prudential has been exploring virtual counseling sessions to address demographic issues and to reach out to participants who are not able to get away from work to go to workshop sessions, individual counseling or to the Benefits Fairs.

Mr. Malmud reported on the local office activities:

Highlights of accomplishments during 2018:

- In looking at data on counselor-assisted actions and actions within the Plan:
  - With respect to the total number of enrollments, there were 1,133 new enrollments and of those 90% were counselor-assisted.
  - 40% of the contribution increases were counselor-assisted.
- Group meetings totaled 663 meetings during the year in which there were 5,438 attendees. The number of individual counseling sessions totaled 7,619. These approximately 13,000 participants of the 27,000 participants in the Plan involved a significant amount of counselor interactions.

- Lunch-n-Learn sessions were conducted by the local office team.
- The NAGDCA award for the interactive activity, the Aging Booth that was successfully launched at the Benefits Fair on Maui, was featured in the New York Times and reprinted in the local news.
- Prudential lowered its administrative fee from .125% to .11%.
- The rollout of the Financial Wellness campaign was implemented to educate and help point employees in the right financial direction.
- The expansion of the workshop presentations continued to focus on millennials and understanding market behavior.
- Distribution of new flyers to active participants 50 years and older was initiated to provide education on the benefits of remaining in the Plan in post-retirement years.
- The Plan saw a reduction in the assets in the Stable Value Fund to 38% of total assets. The Plan is seeing improvement in the diversification of funds using asset allocation tools.
- The use of portable scanners were introduced in the field by counselors to improve efficiencies.
- The expansion of UH-Manoa mini Fairs and participation at key union-sponsored events continued.
- The continuation of meetings with HR/Payroll areas on vacation pay program and the administration of the Plan encouraged communication on the program.

2019 Initiatives:

- Implemented outreach initiatives by Prudential team related to asset retention efforts. The goal is to help reduce the outflows in the Plan.
- Implemented a callout program to participants with multiple target date funds to make sure participants understand how target date funds work.
- Introduction of virtual counseling to create opportunities for participants not able to get to counseling meetings or Benefits Fairs. Virtual counseling will not replace in-person counseling sessions.
- Prudential will be working to incorporate docu-sign to electronically sign documents.
- Development and introduction of EZ Enrollment form to improve efficiencies.
- Continue Lunch-n-Learn workshops on neighbor islands, along with the Go-Green initiative.
- The expansion of departmental HR/Payroll training meetings.
- Exploring ways to reach out to departments such as the DOE which has the lowest participation rate; low rate is partly due to the competing 403(b) plan that is available to DOE employees.

Mr. Malmud added that Ms. Jeanne Kanai received the "President's Award" from President Trump and recognition by top-level senior Prudential management on her volunteerism efforts in the community.

Mr. Headley provided a review and commentary on the Morningstar Investment Advice Services:

- There are 1.4 million users across the nation who are enrolled with the MorningStar program.
- MorningStar brings 2 options, one is a professional managed account service for a fee, and the other is a free advice platform that provides recommendations. He observed at the Benefits Fair that there is a growing interest for managed account services among the participants.
- The methodology remains the same. There are no risk tolerance questions. There is a human capital approach where MorningStar calculates the amount of risk the individual is able to take on, based on assets both outside and inside the Plan, rather than the participant choosing and making decisions on how much risk to take.
- MorningStar relies on the data from participants and runs the data through the engine to come up with the recommendations and make assignments to portfolios. Participants are reassessed quarterly or reassigned to a new portfolio if there is new data.
- Observations on general demographic and usage trends in the Plan:
    - There are 426 participants who have modified their retirement age rather than the normal age of 65 years.
    - Observations are that participants are retiring around age 62 years.
    - Within the Plan, the users using the MorningStar managed account service are around 45 years; the typical average age of the users that MorningStar sees is age 55 years or about 10 years before retirement.
    - MorningStar has built 589 individual portfolios; enrolled Plan users have utilized 168 of the 589 portfolios.
- MorningStar is partnering with Prudential in coordinating events. Two pre-fair online webinar events were held on accessing MorningStar, one-on-one consultations were set up at the Benefits Fair, and one-on-one consultations are being held as a post-fair event today at the Prudential office.
- Sign-up for the MorningStar service is online. Educational information is also available through an online video presentation on the Plan website and explains access to the site and value of the services.
- Fee for the managed account service is a .35% annual management fee; and the online service provides recommendations for free.

<u>Agenda</u>
<u>Item # 2</u>: <u>Performance Evaluation Report for the First Quarter 2019 by Segal Marco</u>

Advisors, including but not limited to:

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

Mr. Chaikin commented that an update for the First Quarter 2019 was provided at the last Board meeting in April 2019. He presented updates for the April 30, 2019 period:

- The market performance was good, and the month of April was another good month in addition to the First Quarter.
- The Plan's assets totaled $2.5 billion at the end of April, up from $2.4 billion at the end of March, the positive net change was mostly driven by the investment performance by the investment managers.
- The Treasury yields have been falling and the yield curve is becoming flatter and becoming an inverted yield curve. It has been positive for fixed income. An inverted yield curve tends to mean that a recession is coming.
- The impact of the move to the Vanguard Target Retirement series from the custom LifeCycle portfolios has resulted in the lowering of the overall estimated expenses on an annualized basis and in a significant fee savings.
- The Wellington Management Research Value fund continues to be on the watch list; there are no recommendations to change the status and the fund will remain on the watch list.

Chairperson Moto called a break at 10:05 a.m. The meeting resumed at 10:30 a.m.

Agenda Item # 3: Panel Presentation # 1 on the Economy: 2019 and the Next 2-3 Years by Vanguard, Wellington Management Company, and State Street Global Advisors

Presenters: Brian Scott, Vanguard via conference call; Scott Elliott, Wellington Management; and Vidur Mehra and Sonya Park, State Street Global Advisors.

Mr. Chaikin stated that the panel discussion will focus on where we have been and the outlook for the economy going forward.

Mr. Scott opened with remarks on where we are and how we got here and post the significant global crisis that was back in September and October 2008.

- According to Ben Bernanke, Federal Reserve Chairperson, he had characterized the global financial crisis as being considered the worst in financial history and that includes the Great Depression.
- Bernanke had said that the speed and the size of the decline is what made

the global financial crisis worse than the Great Depression.

- In looking at Vanguard's leading economic indicators, during the global financial crisis the momentum turned south in 2006, 2007, 2008 and 2009, where housing, financial conditions, and the stock market had accelerated to a negative momentum.
- Things have recovered to where about 50% of the economic factors have turned green.
- Factors that resulted in the shift in the momentum:
    - The aggressive response by the U.S. Federal Reserve Bank and other central banks in 2009.
    - The Federal Reserve Bank cut the Fed fund rate in from 5.25% in 2007 to zero in a period of about 15 months. There were similar actions from the other central banks around the world.
    - They implemented bond buying programs (quantitative easing) which were designed to stimulate the economy.
    - Government also responded with a number of infrastructure projects to put more money into the economy, such as through the American Recovery and Reinvestment Act (or Recovery Act) in 2009.
- Secular forces are influencing the economy and the rate of growth, influences such as globalization, demographics and technology.
- In looking at macro-economic factors such as leverage as an indicator, we are in better shape today compared to prior to the financial crisis. He feels it is still too early to call a recession.

Ms. Park and Mr. Mehra presented on the U.S. outlook:

- For the First Quarter of 2019, the GDP has been stronger than expected, however the outlook is deteriorating because of the escalation of the potential trade wars with China. Because of the length of the U.S. expansion, Ms. Park felt that there is still room for growth for this current expansion period.
- The labor market has been tight. The labor market may remain tight.
- Moving forward, inflation has been showing an upward trend but far from the point of 2002. There is still room for wages to grow and inflation is not dead but is manageable.
- Trade wars and tariffs will put pressure on inflation.
- The drivers will be labor and capital. Labor market is expected to still remain tight.
- There is a survey of CFOs and half of the group predicts a recession by the end of 2019.
- Last quarter, productivity picked up to 2.4%, the best since 2010. Depending on the direction of growth and policy, equity markets may be positive if trade is accelerated to maintain productivity. The focus is on

trade wars which could reverse quickly. The Federal Reserve is on hold with any rate hikes.
- Ms. Park noted that rate cut expectations are premature.
- The longer-term perspective is that the U.S. economy continues to be more dynamic.

Mr. Elliott provided insights on the global growth:

- Within a ten-year period, the expansion has been slow and has been better in the U.S. than in the rest of the developed world. Global expansion has been notably slow in Japan.
- Yield curves around the world, which are a good indicator of economic expectations, have been flatter, indicating a slowdown.
- The expansion has been accompanied by a large accumulation in debt which leaves U.S. vulnerable to inflation. Monetary policy has been loose and there has been no meaningful developed market rate increases. U.S. is entering a slowdown from low rates which puts monetary policy in a box; expect a further expansion of debt and social programs to stimulate economy.
- The U.S. and China conflict needs to be taken seriously. The conflict does not appear to be going away. The interrelationship between the U.S. and China is extensive. The trend will likely have implications. Global profit margins and economies will be caught in the middle. China is proving to be a strong economic competitor.
- We have been in a 10-year period of low inflation and low profit margins. The labor market has been tight worldwide. Labor markets and production are going to be nationalizing which is positive for wages and wages are starting to move upward.
- Tariffs and geopolitical tensions are on the rise which are inflationary indicators. Productivity remains weak.
- Inflation is a disrupter to retirees, so it would be important for plans to look at having options for retirees that have some inflation protection.
- Growth stocks and nominal bonds have done well but expect in the next 5-10 years it will be a different environment. Investors should be encouraged to stick to long term strategies and not pile more into areas of the market with high performance during the last 5-10 years.

Commentary on expectations over the next couple of years:

- Mr. Scott remarked that bonds are extremely expensive and will have a hard time generating much of a return.
- Also, high areas of valuation are the growth stock areas. Mr. Scott expects that the returns will start to be disappointing and will start to go down

during the economic slowdown.

- Mr. Mehra noted a positive outlook in the near term but noted that the key risks will be around the trade wars. We could see some negative shocks to the equity markets if a deal is not reached.
- Mr. Scott commented that investors may need to lower their return expectations. Valuations are a better indicator of longer-term returns. He feels there are more valuations in non-U.S. equity areas since these areas have underperformed the U.S. equity areas over the last 10 years.

With respect to tensions with China, at what point will this become an issue:

- Mr. Elliott commented that for the U.S., the profits of companies in China offset the deficit. Impact on economic growth is modest but the impact on earnings and the supply chain will be much larger. Over the short-term, there has been a negative impact on prices. Long-term supply chain adjustments could have a positive impact.
- Mr. Mehra commented that the tariffs have a negative impact to prices, but over the longer term as the supply chains adjust this could have a positive impact.
- Mr. Scott commented that the impact could be 20-40 basis points for GDP growth. There is optimism that it may not be too bad if there is GDP growth near 3% and therefore losing 20-40 basis points may not mean a large impact versus if GDP is around 2%. There is a mutual interest in not wanting to see the trade conflict go beyond what it currently is.

Chairperson Moto thanked the panelists for their presentations.

Agenda
Item # 4: General Discussion Deck on Financial Health of Plan Participants Living in Hawaii and the Economic Outlook by Segal Marco Advisors

Mr. Chaikin discussed the unique challenges of participants living in Hawaii. The primary challenges and some observations on impact to the Plan's outflows and participation rate are:

- Cost-of-living is significantly higher in Hawaii than in the mainland U.S., about 85% greater than the U.S. national average.
- In comparing salaries, he noted that salary earned in Hawaii may not appear to be as low as that of some other states; however, because the cost of groceries, housing, utilities, and transportation are more expensive in Hawaii, Hawaii is at the top of the list.
- In comparing the cost of living, Hawaii's housing ranks at the top of the list for median gross rent which speaks to the challenges of how difficult it is living in Hawaii. Hawaii ranked #3 on the list of median mortgage

costs, behind the District of Columbia and California. Hawaii is rated second behind the District of Columbia for median debt obligations.

- Other observations noted are the changes seen in the U.S. personal income growth; the highest at 6.8% in Washington, D.C., versus Hawaii's personal income growth at 2.9%, at the lowest income growth. If core inflation runs at 2%, it would leave a Hawaii resident less than 1% of actual earnings growth and does not leave much for other things.
- Other economic indicators included an increase in incoming visitors at 2.6%, but the visits were shorter and subsequently visitors spend less money during the short stay here. It makes it much more challenging for businesses if the trend continues.
- In looking at the Plan's in-service withdrawals such as for unforeseeable emergency withdrawal (UEW) requests, although the requests are not a large percentage of the Plan's population, it may reflect the challenges of participants living in Hawaii. The majority of the UEWs are for reasons such as evictions/foreclosures and job or income loss.

Trustee Young asked about the communication points for prospective employees in saving for retirement and how to address the millennial population who have a different philosophy on savings and their view on longevity of how long they will be employed in the State to vest for a pension. Mr. Malmud stated that communication to employees have been to save in incremental steps such as to forego the Starbucks coffee during the week, bring home lunch as these small incremental steps can lead to accumulation. The counselors have employees focus on getting started as the key and to make those incremental changes so that it does not appear daunting. Mr. Chaikin commented that even though millennials may not see themselves staying employed, communication should still focus on getting started, as the assets are portable, and the importance of compounding growth. It is also important for this group to make the pitch in an easy and understandable manner, like the quick enrollment. Ms. Klassen added that communication strategies are being looked at to finding quick ways for millennials to access and utilize the Plan and be able to take action in quick ways. And, for millennials there are advantages of saving in a section 457 plan since this type of plan does not have withdrawal penalties at age 59-1/2 years as other defined contribution plans. Other observations noted are that millennials seem to be more engaged and interested in saving and in having various options in a plan line-up versus prior generations.

Chairperson Moto called a break at 11:46 a.m. The meeting resumed at 12:18 p.m.

Chairperson Moto thanked the investment managers for the time in preparing the presentations, for participating in yesterday's successful Benefits Fair and for supporting the Fairs and meetings. He acknowledged the Prudential team, the support from DHRD, and to the staff at the Oahu Veterans Center for accommodating the site preparations.

Agenda Item # 5: Panel Presentation # 2 on Demographic Trends and the Impact on Investing Over the Next 5-10 years and beyond by New York Life/MainStay Funds and Schroders

Presenters: Megan Anderson from Winslow Capital; and John Mensack from Schroders

Ms. Anderson, from Winslow Capital, who is the subadvisor for the NYL/MainStay Funds, provided an overview on the demographic trends in the U.S.:

- Within the developed markets and the U.S., the population is more structural advantaged than others.
- There could be potential investment implications over time. The factors of the growth rate of GDP are the growth rate of the working age population and the growth rate of productivity.
- Demographics can affect the quantity of the national savings, the level of investment demands and the rate of potential economic growth. An aging population tends to save more over time. As more of the population moves out of the workforce, the overall labor supply will shrink, and this can result in a lower growth rate and depress the need and demand for investment spending.
- Japan is already seeing an aging workforce of an annual pace of -0.5%, and this is spreading to other developed economies. The U.S. may see a decrease in the working-age population by 2035 without future immigrants.
- The millennials who will hit peak working age will be more into ESG strategies.
- Women and minorities are a growing group in the workforce. The concentration of income and wealth has peaked, and the gender pay gap is narrowing.
- Plutonomy is the income and wealth inequality and those who are affected are women and minorities.
- The younger population is generally asset poor. Quantitative easing is not a benefit to the young whose views of the world are centered around capitalism and socialism.
- Investment implications lead companies to do more and offer advantages such as clean energy and travel.

Mr. Mensack provided an overview on the demographic trends outside the U.S.:

- Emerging markets in Asia and developed markets in Europe are facing demographic challenges with an aging workforce. Countries will benefit from the make-up of the workforce if the younger workforce population is good. With urbanization and their combination of skills, these factors can increase the national income.
- Working age population is growing in India and Mexico. Whereas, there is a negative population growth in emerging Asia such as Taiwan, Korea, and China.
- When there is growth in the labor force, there is productivity. In India, the growing workforce and productivity are both attractive.
- China has an opportunity to raise the standard of living even if it is an older country. The country has made big pension promises.
- Earnings are driven by productivity and earnings per share.
- Regarding investment implications, when looking at emerging markets, country allocations will matter, picking the right country, and looking at economic policies to determine productivity growth including balance sheets and macro factors.

In response to Chairperson Moto's inquiry as to whether productivity enhancements in advantaged industries could potentially displace workers and phase out jobs, Ms. Anderson commented that technology could generally be software used by sales force which would enable them to improve the day-to-day productivity of the workers to do more. She noted that there will be some industries in decline, and some will accelerate.

Chairperson Moto thanked the panelists for their presentations.

Agenda Item # 6: Other Business/Announcements

a. Approval of Minutes No. 430, for the April 16, 2019 meeting

Chairperson Moto stated that Minutes No. 430 was distributed for review and action.

**A motion was made by Trustee Wada and seconded by Trustee Young to adopt Minutes No. 430, as prepared. The motion passed unanimously.**

b. Approval of Payment to DHRD for the Special Funded Position for FY 2020

Ms. Akiyoshi reviewed the Bill For Collection which is for the funding of the special funded position that provides support to the Board and the Plan and which has been authorized to be funded from the Plan's assets. The payment request is for the upcoming Fiscal Year 2020. She noted that the salary schedule for the related bargaining unit has not been finalized, therefore the estimated amount of $141,197.00 that is being submitted is for the same amount as this current fiscal year. The funding amount includes the applicable fringe benefit assessment rate of 60%. She added that the funding is necessary prior to the commencement of the fiscal year beginning on July 1, 2019.

**A motion was made by Trustee Young and seconded by Trustee Rapoza to approve the payment to DHRD for the special funded staff position in the amount of $141,197.00 for Fiscal Year 2020. The motion was passed by a majority of the quorum, with one vote to abstain by Trustee Wada.**

There being no other announcements, Chairperson Moto closed the meeting by expressing thanks to everyone for attending today's meeting.

Chairperson Moto adjourned the meeting at 1:05 p.m.

**(NOTE: Signed copy on file.)**