

**STATE OF HAWAII
OFFICE OF HAWAIIAN AFFAIRS
560 No. Nimitz Highway, Suite 200
Honolulu, HI 96817**

**Minutes of the Office of Hawaiian Affairs Committee on Resource Management
Wednesday, October 12, 2016 9:30 a.m.**

ATTENDANCE:

TRUSTEE COLETTE MACHADO, CHAIR
TRUSTEE HAUNANI APOLIONA, VICE-CHAIR
TRUSTEE LEI AHU ISA
TRUSTEE ROWENA AKANA,
TRUSTEE PETER APO
TRUSTEE ROBERT LINDSEY
TRUSTEE JOHN WAIHEE

ADMINISTRATION STAFF:

KAMANA'OPONO CRABBE, CEO
LISA VICTOR, COO
HAWLEY IONA, CFO
DYLAN ZHENG
RAYMOND MATSUURA
KARLEN ONEHA
KAWIKA RILEY
FRANCINE MURRAY

GUESTS:

RODNEY LEE, SPIRE
DARREN SMITH, JP MORGAN
ZACH PAGE, JP MORGAN
JUSTIN SANTANA, COMMONFUND
STEVE LANZO, COMMONFUND
MARK ANSON, COMMONFUND

EXCUSED:

TRUSTEE DAN AHUNA
TRUSTEE HULU LINDSEY

BOT STAFF:

LIANA PANG
REYNOLD FREITAS
DAYNA PA
U'ILANI TANIGAWA
LOUISE YEE-HOY
LAURENE KALUAU-KEALOHA
KAUIKEAOLANI WAILEHUA
LADY ELIZABETH GARRETT
CAPSUN POE

I. CALL TO ORDER

Chair Machado – Called to order the meeting of the Committee on Resource Management, Wednesday, October 12, 2016, at 9:34 a.m. There are two excused absences from Trustee Dan Ahuna and Trustee Hulu Lindsey. Also our office was notified that Trustee Ahu Isa and Trustee Waihe'e will be a little late.

Trustee	Present	Excused	Comments
TRUSTEE LEI AHU ISA	Not present at time of roll		10:39 a.m.
TRUSTEE DAN AHUNA		X	Excused
TRUSTEE ROWENA AKANA	X		
TRUSTEE PETER APO	X		

TRUSTEE HAUNANI	APOLIONA	X		
TRUSTEE HULU	LINDSEY		X	Excused
TRUSTEE ROBERT	LINDSEY	X		
TRUSTEE JOHN	WAIHE'E	Not present at time of roll		10:02 a.m.
CHAIR COLETTE	MACHADO	X		
TOTAL		5	4	
At the Call to Order, there are Five (5) Trustees that are Present.				

Chair Machado – On the agenda we incorrectly listed instead of the 3rd Quarter, it should read 2nd Quarter 2016 Performance Review, so please make that notation. With that said, we've established quorum and can proceed with the approval of minutes of August 24, 2016.

II. APPROVAL OF MINUTES

A. August 24, 2016 Minutes

Chair Machado – Sought a motion to approve the RM minutes of August 24, 2016 as presented.

Trustee Apoliona – Moved to approve the RM Committee minutes of August 24, 2016.

Trustee Robert Lindsey – Seconded the motion.

Chair Machado – Asked for discussion on the minutes. Hearing none, called for the vote.

Resource Management minutes from August 24, 2016 approved at 9:35 a.m.							
TRUSTEE		1	2	'AE (YES)	A'OLE (NO)	KANALUA/ ABSTAIN	EXCUSED/ ABSENT
LEI	AHU ISA			Not present at time of vote			X
DAN	AHUNA						Excused
ROWENA	AKANA			X			
PETER	APO			X			
HAUNANI	APOLIONA	X		X			
HULU	LINDSEY						Excused
ROBERT	LINDSEY		X	X			
JOHN	WAIHE'E			Not present at time of vote			X
CHAIR COLETTE	MACHADO			X			
TOTAL VOTE COUNT				5	0	0	4
MOTION: [] UNANIMOUS [X] PASSED [] DEFERRED [] FAILED							
Motion passed with Five (5) YES votes, none (0) NO vote, no (0) abstentions and Four (4) excused.							

III. COMMUNITY CONCERNS*

None.

IV. NEW BUSINESS

Chair Machado – Turned this portion over to Kamana’opono and then he can call upon the appropriate staff.

A. Native Hawaiian Trust Fund 2nd Quarter 2016 Performance Review with JP Morgan

(For details: State Street Investment Analytics Office of Hawaiian Affairs Board Report Second Quarter 2016 Meeting Date October 12, 2016)

Ka Pouhana Crabbe – Good morning Trustees; as stated today we have our Native Hawaiian Trust Fund 2nd Quarter 2016 Performance Review. Called upon OHA Investment Manager Ray Matsuura.

Ray Matsuura - Good morning Trustees; just an update on where we stand on the Goldman Sachs transfer of assets to State Street. We finalized the paperwork for the termination letter and expect the transfer of the assets to happen by October 31. We have Darren Smith and Zachary Page from JP Morgan with our quarterly update.

Trustee Akana - Do we have any long term commitments with GS that we have to hold on to?

Ray Matsuura - Yes. OHA has the private equity which will be continued.

Trustee Akana – How long more do we have?

Ray Matsuura - They are fairly old and if we ended the relationship completely, some of those private equity deals would probably be less than ten years maybe about five to seven years.

Trustee Akana - We would have to keep the commitment?

Ray Matsuura - Yes the commitment would still be outstanding; we would not do any more new deals with GS.

Trustee Akana - Could you tell us how much money is committed? If you could get back to us with the answer on those long term commitments.

Ray Matsuura - It’s less than \$10 million. Not much. They were one of our original private equity managers and we haven’t made an investment with them for a while. It’s one of the lowest commitments we have with them.

Chair Machado – Ray, I suggest you provide a memo to all the Trustees where we stand with the GS release; the policy the Trustees took on the removal of GS from our portfolio, and also the question that Trustee Akana raised, the long term. That’s a good question.

Ray Matsuura - I can see that we have \$88 million at the end of June with traditional assets and their total holding s are \$103 million, so it’s about \$15 million.

Trustee Apoliona - Can you commit something in writing to the Trustees. Your short summation of the finalization with GS, and the private equity long term commitments.

Ray Matsuura - I just want to be clear that we’re keeping the relationship with the private equity side. We’re just terminating the traditional assets side which is totally separate from the private equity.

Chair Machado - I think it's important to put that in writing so it's some form of clarification that we still have some relationship with GS.

Ray Matsuura - Absolutely!

Zachary Page - Covering the Economic Market Outlook, touching on the US Economy, Europe, High Yield Credits, as well as Emerging Markets. General summary, globally growth is going to come in a trend-like pace, 2-3% growth. US, Europe, Japan emerging markets are major points of focus. The Feds are planning to raise interest rates and a rate hike cycle is expected to begin at the end of this year. A couple more rate hikes are expected during 2017. For the US economy and the asset prices, globally. On the positive, for the US, unemployment is about 5% which it is about now; gas is below \$3 a gallon, and the workforce is growing for the first time since the financial crisis, which is a very positive sign. The US economy is on very firm footing. The Feds have firm ground to raise rates. The weak spots, we aren't growing at 3-4% like we have had coming out of prior recessions or financial crisis. Where's the balance of risk. This will be highlighted later.

The US consumer is one of the key strengths in the US economy. Corporate earnings came back post financial crisis with margins expanding up until about a year ago. Growth in the US is going to continue being driven by the consumer. We've graphed the consumer's balance sheet; on the left side is the total assets (homes, financial assets, pension funds, deposits); on the right side is the total liability. The single biggest liability for most US households is their mortgage; their household debt. With interest rates rising, long term locked in rates are beneficial for consumers. Household debt service ratio; this is a debt payment of a percent of their personal disposable income. In 4Q07 that was 13.2%. All of the disposable income they took in on an annual basis, they paid 13.2\$ out to service their debts. At the end of 2Q16 that came down to 10%. That's as low as it's been since 1980. The US consumer is in very strong form to continue its expansion within the US. The expansion is quite old, it's 84 months old, 7 years old. As the expansions get into their later stages, we watch; there may be cause for it to turn over into a recession. The average expansion lasted 46 months, this one lasted 84 months. This is the fourth longest expansion and we think this can keep going. Why?

Zachary Page - On the right side of the graph shows the strength of economic expansions. The most recent expansion beginning in 4Q 07 till now. What is notable is that this expansion is below all others since 1948. All little bit of concern is that the length of growth has been slow, so when political events like the US election or international events like Brexit, there seems to be volatility in markets as market participants get concerned about the slow growth chipping into a recession.

We think the economy still has capacity for further growth. The strength has been low but we expect this to be a prolonged business cycle where we will see continued trend like growth for the next two to three years. We do not think that the US economy is going to tip into recession in the next three to six months. It's on sure footing with slow growth but steady growth.

Trustee Peter Apo - Coffee shop talk; people are worried about the presidential election and some people are pulling out and converting into cash to see what happens. What's going on with that in terms of the general market?

Zachary Page - This is a crazy political season, I can comment on how we think the election will impact the US economy and the global economy. The rhetoric from both candidates can be extreme and there a couple of areas we have been able to pin them down. Those are immigration and trade. Very clear that the republican

candidate, Donald Trump, favors a more isolation; his protecting his trade policy. He has gone on record in terms of his opposition to trade agreements like NAFTA and some of our bilateral trade agreements with some key trade partners. Hilary Clinton, she has also walked back on some her free trade stance; she was in favor of NAFTA when that was put in place, had been in favor of the Trans Pacific Partnership and has walked that back. So we think there could be some headwinds to the US trade, no matter who is elected. It'll be a much bigger headwind with Donald Trump, obviously, and that would likely take some percentage points off the US growth.

The other area is immigration. While immigration can be challenging for the labor markets to digest, at a reasonable pace, it's very important. Labor is a key input into economic growth. Having a free flow of workers is important for the US economy. We think that the democratic candidate would be in better position to help stimulate growth from the labor perspective. Some things up in the air are the tax policy of both candidates. Hillary Clinton has been much more firm about what hers are. We think that both would likely either amend and, on the republican side, repeal the Affordable Care Act. I believe there will be some changes there. That is an uncertain area. What does this mean for markets? The silver lining to this is, the presidency is the biggest and most personal vote that any of us make every four years and it is not the only thing that determines US policy. The best atmosphere for US growth is a divided House, Senate, and Presidency. A Republican President and a Republican House has significantly contributed negatively to market returns. I might include financial crisis. The key is that a divided government is good in that we don't want complete gridlock, but we don't want massive change happening all the time. We want corporations and consumers to be able to make forward looking plans and to be certain about the environment they're going to be investing in.

Trustee Peter Apo - Thank you.

Zachary Page - We'll just wrap with a couple of key assets classes from our perspective. One is high yield. High yield is an asset class where OHA has a meaningful allocation to in terms of investment grade, fixed income and below investment grade fixed income. High yield has been an area of conversation within our asset allocation team for a couple of reasons. One, it was one of the asset classes that was hit hardest by the drop in energy prices. You can see, on the graph, how much high yield bonds yield over a US Treasury. You can see that high yield bonds, the asset class including energy, it's almost over 17.5% spread; they were yielding more than 17% over comparable duration, US Treasury bonds. Why are they yielding more? Because they need to pay you for that default risk. The expectation that the energy companies might default. If you strip out energy, it's only about 7.5%, so energy was adding 10% of what we call credit risk. They are paying you for those energy credits that might go default. As energy markets normalized, we think there's an opportunity to invest in high yield and we have been in your portfolio so high yield spreads on an average is now about 6.7%; their long term average is 5.9%, they're above the long term average, while default rates are 3.6% below the long term average of 3.9%. We think there's a good risk adjustment to return within high yield and that's an area of opportunity in today's market.

I want to close with Europe and Emerging Markets. Europe had a double dip recession coming out of the financial crisis. I think Europe has found its firm footing. Three graphs showing PMI and GDP growth, representing statistics on economic activities within Europe. They've stabilized above zero. Euros on growth while low and in the positive since 2013. Unemployment, while still high relative to the US, Europe has been on a consistent downward trend since 2013. Also graphed is credit demand within Europe. Again, consistent

loan growth since 2013/2014. Europe is finally on firm footing and is now in an area for high growth, consistent growth. Emerging markets have been our biggest concern due to it being underweight in the portfolio as of June 30, 2016. The beginning of September the underweight positions went overweight. Our concerns have been an imbalance in the credit of emerging market economies and poor economic policy from a monetary perspective. The balance of risks has evened out, particularly in Asia where there is opportunity for some double digit returns. Latin America is still struggling to generate earnings per share. There is stabilization in the emerging market economies; we think there's an opportunity there. Are there any questions?

Yes. Not just considering but actually voted to do so. We think the Euro, sort of a monetary union, is going to be tested again in the near future. We think the Euro will remain intact, we don't think these are major threats. We do think they are legitimate threats which need to be taken seriously, to the Euro zone's future. What's given us confidence is the response we've seen from the leading governments within the Euro zone and their commitment to a unified trading and open borders zone. We think the Euro zone will remain intact. Related to your question, I think the question is how growth will be within the Euro zone and the UK, as they try to exit. I think the UK is the bigger question mark right now. They voted to leave but they haven't started the process of extracting themselves and trying to negotiate new trade deals and new immigration deals with all their trading partners within Europe. That could be half a percentage point to a percentage point of growth off of the UK's growth for the next two years, as they go through the mechanics of making those changes.

Trustee Rowena Akana - Does that affect our trade with England and their ... (inaudible)

Zachary Page - It will to a lesser degree. As a percentage of our total trade, UK is not a huge percentage. We will have to negotiate a new bilateral trade deal because our trade agreement had been with the Euro zone and that's what governs our trade with the UK. I think it will have some provisions, but it will just have to be done.

Ka Pouhana Crabe - Yesterday we had a talk with Commonfund and the majority of their discussion focused on Eastern Asia, primarily China, and some of the shifting in terms of the Japanese economy; in South Korea, in terms of products and goods. You indicate here on page two about emerging markets performance relying on external conditions. They also spoke about China's ability to transition to form a middle class and how much that would be a factor in their ability to continue growth in their market. Could you share because the graph shows they're certainly higher in comparison to Europe and Latin America? What would that potential future growth look like in the Asian region?

Zachary Page - Just to clarify, when we say growth dependent on external factors, monetary policies and developed markets, mainly the US, the strength of the dollar and how much stimulus the US economy is putting into markets will impact emerging markets. We think that the Fed's raising rates at a slower pace than expected will be good for emerging markets meaning there won't be a headwind of the stronger dollar because if they borrow off an emerging market's economy, if they're borrowing off the US dollar, then they're going to have to repay that debt. If the US dollar is stronger, it's going to be more expensive to repay the debt. The Fed's going at a slow pace will make it easier to repay that debt. We think it won't be hurting the emerging markets economies.

The China in transition, we would agree with Commonfund that that's probably the biggest area to watch; in addition to that, as well as how China services their debt. They've taken on a lot of debt to fuel their growth and their ability to repay that will be important. The way I like to think about it is to first put it all in perspective. All economies have to transition; the US has gone through numerous transitions. In our history, we've had the industrial revolution and then we had to transition out of an industrial based economy. China, just like us, has to go through a similar process. It's uncertain, but we actually think that the Chinese authorities have done quite a good job of managing their economy. They go about it in a different way than the US, it's not free market capitalist economy, but they have done a good job of maintaining stability while stimulating growth. We do think that they should be able to manage that transition. A key sign, like Commonfund said, will be a growth of the middle class within China.

Trustee Waihe'e arrived to the table at 10:02 a.m.

Zachary Page - The other point of perspective, while China has grown incredibly quickly, and for them slow growth is around 6% - 7%, they are still relative to the US, a very poor country on a GDP per capita basis. So developing a middle class, I think they should be able to, with a little bit of growth, giving a lot of people bigger opportunities or more stable footings.

Ka Pouhana Crabbe - You would see the potential in East Asia incrementally?

Zachary Page Yes. It'll be contingent on the stability in China, but we do think the potential in East Asia is where the most growth will come from. We have our macro update; we can touch on the portfolio very quickly on page 31 of the board book. The first half of the year was challenging for active management within the portfolio. Long term numbers still remain solid. We think the third and fourth quarter should be very positive. Early returns through September look very strong. But, as of Q2, OHA's portfolio underperformed it's benchmark by about .3%. On one year it's underperformed by 2.67%, (executive summary on page 32). Outperformance primarily came from core fixed income; corporate bond fund had very strong return vs. the benchmark. Underperformance was primarily focused on US large cap equities, and also small and mid-cap. The large cap equities is where we had our most concerns; as we watched the portfolio, we tried to most understand what's going on there, and tell you why we are still confident in those managers despite our concerns. Just to confirm, there were no portfolio manager changes within the portfolio.

Assets under management, page 34. Beginning of the quarter the portfolio had a value of a 100.3 million, there was market growth of 1.7, withdrawals of 174 million, in addition to fees, and the ending market value was 101.7 million. Market growth since inception has been 37.4 million dollars. (Explained the Inception to Date Cumulative Returns; page 36 graphs) since inception the benchmark has returned 31.85%. The JPM portfolio we manage on OHA's behalf has outperformed that by 4%. 4% higher growth relative (explained page 38, the detailed managers return) ITO still outpacing the benchmark by about .7%, it's an annualized bases; we are at our five year mark. The ITD numbers are the same and we're pleased with these numbers outpacing 5% plus what has been low inflation through September (the numbers are up a couple percentage points). The value and the growth advantage funds are the areas we've been challenged. These two strategies had been performing strong since inception. They invest in US equities; in large cap, small cap and mid-cap stocks. Growth manager underperformed in the beginning of the year, there was a sharp reversal in energy prices. The value manager has underperformed given exposure to financials which has not benefited as the Fed's have held

off on raising rates. The amount they can loan out at to the amount they can borrow at, has been squeezed. I'm happy to touch on any questions from the Trustees.

Chair Machado - Thank you Zach and Darren. Thank you for coming to Hawai'i.

B. Native Hawaiian Trust Fund 2nd Quarter 2016 Performance Review with Commonfund

Ray Matsuura - Up next is Justin Santana from Commonfund. Online is Mark Anson, CEO and Steve Lanzo, Relationships Manager. Along with Justin is Meredith Albright from the San Francisco office.

Justin Santana - Aloha Trustees, good morning! Thank you for having me at your table. I would like to briefly review performance and give the bulk of the air time to the low volatility market on the hedge fund portfolio. Slide five is a review of what transpired during the second quarter of this year and the different asset classes. We've been in an environment where unprecedented monetary policy has conspired to result in highly unusual interest rates, globally. Over the fiscal year through June, the US ten year rallied 88 bases points to end the quarter at 1.47%, a tremendous move in rates. Our expectations looking forward is from muted returns, from fixed incomes from equities, we're expecting 6% from equities over the next five years, maybe 2% from core bonds. Clearly that combination in a passive 60/40 or a 70/30 is not going to get you to your CPI plus 5% spending target. What can we do about that? Mark mentioned that the liquidity premium that you get from taking illiquidity risks for locking up your money is quite rich today relative to the problem markets. Again given our muted expectations for public markets, we think that it's a much better proposition taking some of that illiquidity risks. We've been advocating with all of our clients to build out exposure there and to increase the illiquidity target to the upper end of your policy range. We believe you can comfortably build out that illiquidity premium, liquidity premium and still remain comfortably below your 25.6% maximum policy target.

Justin Santana - The marketable portfolios. We manage four portfolios for OHA. The largest and most important is the Hedge Fund. We also manage three liquidity pools: equity liquid hedge, credit liquid hedge and real assets liquid hedge. These pools were set up to fund future capital calls for your liquid investments. These have been wound down in time as monies been called and we've been working with Ray and Glenn and ultimately would like this structure to change to simplify the structure which is pretty complex. We're not going to spend a great amount of time on these. A brief review, the hedge fund performs have been disappointing. To remind the Trustees, we set up these performance portfolios up in 2011 with the goal of providing low volatility type of return profile and to diversify the risk that you hold elsewhere in your portfolio. This portfolio is to provide downside protection for you. We're here today to reinforce, augment, and enhance. The outperformance of the bond like equities like Utilities and Telecom, rates were up nearly 6% for the quarter, utilities up 27% for the fiscal year to date and in June. That hurt our managers because active managers are generally not trafficking in those sectors. The sectors are not compelling from evaluation perspective. Today their PE is upwards of 22/23 times, that are not appealing. They're also not appealing in growth stories. They are high dividend paying stocks which is why they're so appealing to retail investors because of that dividend payout ratio. Our managers don't own these positions. Our hedge fund portfolios were also hurt by the widely held or crowded hedge fund trades. The macro strategies were flat, they were helpful in the first quarter. The portfolio has underperformed the T-bill plus the 4% target while still outperforming the fund to fund composites which is a proxy for the broader hedge fund market. We've

outperformed that by 70 bases annually since 2011; however, we're not meeting that T-bill plus 4% target. We will be working with Ray and Glenn to modify the structure to make it more simplified.

Page 9. First, we are posing in enhancing our hedge fund offerings to yield the portfolio that offers better risk at adjusted returns. It is more fee efficient. This portfolio should be a pure alpha return for you; it means the return should have nothing to do with what is happening in the broad markets. Our goal is for the return streams not be subject to the whims of the broader market returns: S&P, Barclays Ag, High Yield. Second, they should provide true diversification. They should diversify your hedge fund portfolio as well as your policy portfolio. One of the issues we have is we too many managers dialing in to the same risks. They are exposed to the same risks, the same factors. These crowded trades are susceptible to broad unwinds of these typed of trades when there's market stress and that is something that has buffeted the portfolio in October 2015 when we saw the deal break with the Abbvie Shire, we also had the issue with the Fanny Mae and Freddie Mac preferred stocks. These were positions widely held and driven by credit hedge funds, and that is not what we should be providing to your portfolio. Mark Anson coming on board, he has brought a lot of quantitative tools to our process. He has helped us modify our approach.

Mark Anson - Hedge philosophy. Generally, hedge funds can be expensive. The general fee structure is \$220. Hedge funds are an expensive way to access alternative investments. If you're going to use the hedge funds, you want to make sure you are not using them to access the equity market or the bond market or the credit market because there are better ways that are more effective. The most effective way is to access the bond assets fund. Hedge funds, as was said earlier, should be a source of alpha. Alpha is rare. How do you know if you're getting alpha? Flux capacitor and the pure adding table of risks factors. We take a manager's portfolio, we strip it down and we aggregate it. We look at the holdings and then we recombine to see what is beta and what is alpha. With the tools we now have, we can identify how much is beta and how much is alpha. We see mostly beta and a little alpha.

Justin Santana - Point 3A, We pay for alpha but not for beta. Under Marks leadership we're also negotiating much more aggressively with our managers to reduce fees. Every dollar of fee savings that we can extract from managers we can return to you in terms of performance. We believe in having one larger hedge fund vehicle, we'll have a lot more leverage to negotiate those fees because we represent a larger percent of their assets. You currently have two portfolios, Global Alpha Asset Company and the Strategic Solutions Assets Company. Both of those funds incur audit costs, administrative costs, custody costs, etc. Consolidating to one vehicle we believe you will save on administrative costs. There's also the aggregate portfolio level, an issue we call netting risks. You are also paying an incentive fee on both vehicles. If your total performance on one portfolio is down for the year and another is positive, you're still paying the fee on the positive portfolio. You won't pay any fee on the negative portfolio. We'll remove that sort of netting risks between the two vehicles.

We'll end on slide 11. These T-bills plus 400 basis points is the objective we set out on in 2011, that hasn't changed. This is not a drastic overhaul of the hedge fund portfolio, it's about enhancing the portfolio, as we are already doing for your portfolio, more specifically slicing and dicing off of beta insuring that your portfolio only has true alpha. We believe, going forward, the Global Alpha Asset Company portfolio will be in an even better position to generate a healthy return.

Ray Matsuura - There's some uncertainty about the funds in consolidating seven hedge funds into one. There's going to be some fall out with other investors. They expect it to be a \$1.36 billion fund. I'm concerned

about our exposure, having too much in one fund. What I'm going to recommend to Dr. Crabbe is to cut back our exposure from 42.7 million to about 25 million. It will give us of the entire fund 2.5% rather than 4%. Glenn concurs with this. It's basically a new product. I have confidence in Mark, however, what has not been mentioned is there's going to be some restrictions on liquidity. Instead of semi-annual liquidity, we'll be restricted to quarterly liquidity. Given those gates and untested performance, we don't want to abandon hedge funds but we do want to cut back our risks/exposure.

Trustee Robert Lindsey - Is there a better way to explain stuff so that things are clearer? Ex: on page 7, liquid hedge portfolio returned. 7.47% for the quarter, modestly outperforming the benchmark return of 7.17%. Can that be extracted and explained in terms of dollars?

Ray Matsuura - In dollars?

Trustee Robert Lindsey - Yes, so that we can understand clearly what the real difference is.

Ray Matsuura - Sure. I think going forward, we will convert those into dollars.

Trustee Robert Lindsey - All these tools and all these special concepts, for me, it's money in, money out.

Ray Matsuura - We'll add that to JPM to use the percentage for some people and in dollar terms for others. Dollars can be misleading given the size of the portfolio. JPM's portfolio is a lot more bigger than Commonfund. The dollar returns may seem bigger for JPM. Yes, we'll add that.

Trustee Rowena Akana - I want to understand about what you said about combining all those funds into one fund, committing only a percentage of it. If you were to combine all of it, how much money are we talking about?

Ray Matsuura - Our exposure is \$42.7 million.

Trustee Rowena Akana - The percentage you're recommending is what percentage and what dollar amount?

Ray Matsuura - \$25 million to cap it and that is 2.5% of the proposed hedge fund. I'm not certain of how many investors are in it, we're going through the consent letters now. There's no certainty of how many investors are going to continue with GAC 2.0. Right now, of the \$42 million, we have \$31 million in GAC one. And then, \$11.7 is in diversified companies which are going to be eliminated. Our thinking is if diversified is going to be eliminated, we'll take back our \$11.7 million in that, and then reduce our other exposure about \$6 million to \$25 million and that will eliminate our overall exposure to this particular fund to 2.5%.

Trustee Rowena Akana - My only concern is you have many managers in the same pool, no matter what asset class and they're all pulling from the same thing. So what he's saying makes sense to me. When you look at these hedge fund guys and they're all pulling from the same class, so you minimize your risks. What they're doing is to pick the best of them rather than allowing them to go wherever and pick from the same pool. You can try your experiment...

Ray Matsuura - No, no, no, it's not an experiment, we are reducing our risks. We're still confident with Commonfund.

Trustee Akana – I understand, I just wanted to know what the percentage was that you’re suggesting and what the dollar amount was.

Trustee Ahu Isa arrived to the table at 10:39 a.m.

Ka Pouhana Crabbe - We are taking Commonfund’s suggestion and there’s strategy in minimizing our risks and vulnerability. The will identify and work with the high performance managers. This probably would be much more helpful if we had a presentation on what that transfer would mean. Because the hedge funds are not driven by equity market volatility, we minimize risks. We have long term growth for that to perform as part of our current platform portfolio and it’s much more stable moving forward. This is one of the strategies we’ve been thinking about, working with Rodney as well as the investment fund managers, to move forward with.

Trustee Rowena Akana - What their strategy is, they are not going to pay for beta, only alpha. So, they’re looking at these fund managers who are going to perform not underperform. So to me, you can’t lose with that strategy. So, I don’t see the risks for us.

Ray Matsuura - There’s always some risks. We already are currently in GAC 1 and there’s a reason why it’s being restructured. New product and we have the confidence that Mark’s going to add value here. It’s just from our point of view, I am not comfortable with having a 4% exposure, and we’re just cutting it back to 2.5%. We’re not managing return, we’re managing risks.

Ka Pouhana Crabbe - We’re taking a conservative approach.

Chair Machado - Thank you Justin. We will be moving on to Ray.

C. Native Hawaiian Trust Fund 2nd Quarter 2016 Performance Review with OHA Staff

Ray Matsuura - Overview of the 2nd quarter in reference to what the chart shows. Trustees were provided the chart. Reiterating on what Glenn said and, “What are we going to do going forward.” Ray touched on the following: OHA’s asset classes; first two rows, total portfolio and benchmarks; to the right of the page: annualized return in June 30, for the last five years; on the far right is the annualized 3 year and 5 year return. Down the page are the traditional assets, equities, global credit, global equities credit and real assets. Next below, are the private equity markets such as Pantheon and other companies? Below that is the non-marketable equity hedge funds, these are Commonfund portfolios. Below that is our low market volatility alternative which is also Commonfund. Enhanced liquidity accounts, Hawai`i Direct Investments which is a real assets portfolio with State Street. We have been below 5% on our spending criteria. In the last 2 years we’ve had a negative .32 return, and a minus .68 return. Looking at 3 years from now, we are going to have a 5 year average. We need to be more proactive.

Ka Pouhana Crabbe - Since Ray has come on and Rodney is working with Hawley, we have had discussion on taking a more critical look at the Native Hawaiian Trust Fund and different strategies on how to increase performance beyond the benchmarks or just to reach the benchmarks. The further analyses with Glen, we always talked about active management, but now we are working with our fund managers and encouraging them to find the real high performing portfolios that will help us in the incremental changes in returns. This is consistent with the fiscal sustainability plan as we move forward.

Trustee Ahu Isa - This Native Hawaiian Trust Fund, do we have to change policy, Kamana`o?

Ray Matsuura - Not immediately. In going forward, we're going to have to make some changes with regards to targets, asset allocations. In the short term, we're going to have some mismatch, understandable. By terminating GS, we're going to passive funds, we're not going to have the exact, and we're going to have some track and error. We're trying to make things simple and streamline our benchmarks which will make it easier for our managers. Have them make the decisions and not us. They see something with high yield; they can just invest and don't have to get our approval to do it. We pay them to do their job. We do want them to be accountable too. We will do an asset allocation study; look at the marketable and non- marketable. We're going to get that alpha and sacrifice the liquidity.

Trustee Apo - I keep thinking about the Wall Street Investment portfolio. There are the higher risks of managing commercial properties. We are kind of in a dilemma on what to do with Kaka`ako Makai. The part that would allow us to run a higher risk on Kaka`ako Makai, is if it meets mission driven goals. I think we started out strong with mission driven goals; what is the strategy in balancing the best yield, how do we make the determination that better to cash out, put the \$200 million in the market where you have a predictable yield, or to keep and invest in higher level of investment and to cash out later in order to keep the property and to nurture it with the thought that maybe down the road we will have a higher yield within the land. How do you...?

Ray Matsuura - That's always a tricky balance. We have a lot of land and the security portfolio has a lot of land as well. You make a good point about the higher yield; you have to think the higher risks. The securities portfolio is pretty risky too. We have to turn that down we have the returns of the commercial property and the benefits. We want tangible benefits. Sometimes if you are mission driven, you are willing to give up on a return because that's our mission. We can continue discussing this all day; the land statement policy approved would give us a better condition of what exactly what land responsibility is.

Ka Pouhana Crabbe - This will be a Board decision. Part of the decision would be informed on the fiscal sustainability plan. What goals do we want for OHA, and we would have to take a look at what Rodney calls different scenarios. The investment portfolio is one area one strategy. Commercial properties, Kaka`ako Makai and Na Lama Kukui is one area and another strategy with implications and long term. Part of the fiscal sustainability plan is to look at all of these areas to arrive at decisions and a direction that looks at the long term as well as the short term fiscal sustainability of the organization.

Ray Matsuura - Finishing up on the last page, this is what we expect going into 2017; increase total traditional assets. We have to better define what real global assets are. Performance has been doing well over the years so I feel comfortable. But going forward, to we need an 8% exposure to advance liquidity account, probably not because now that we have the passive funds, we get instant liquidity. We have volatility here but on the aggregate fund, it's less volatility. We need to look at our non-marketable funds that we have for our private equity and try to simplify them. We're looking at balancing our risks and returns. We don't need that much liquidity, 8%, that's \$24 million dollars. Do we need \$24 million dollars just sitting there not earning anything.

D. RM #16-08 Adoption of OHA's Fiscal Sustainability Planning Model and Approval of the Statement of Commitment Relating to OHA's Fiscal Sustainability Implementation Plan***

Chair Machado - Members we are now on Action Item #16-08 Adoption for OHA's Fiscal Sustainability Planning Model and approval of the statement of commitment relating to OHA's physical sustainability implementation plan. At our table are Rodney Lee and Hawley Iona. Kamana`o?

Ka Pouhana Crabbe - Given the four workshops we had on fiscal sustainability plan, which was really about information, education and understanding of what that means for the totality of OHA currently. What we'd like to do in terms of future goals and long term strategies, is to continue building the intergenerational equity and wealth for OHA. So the following action item is a continuation of those workshops. At the same time, we would need some time to build-up further, the plan or decisions so that admin can implement. That's a general overview of what we are trying to propose. I will turn it over to Rodney and Hawley for more specific objectives that we are trying to accomplish.

Hawley Iona - I can walk you through the action item but most importantly is we provide a history. We brought you up through phases one through five, we're going to be going into phase six, we will be incorporating what we've learned from the model itself, into leadership implementation which will be a critical area for us to focus on as we lead ourselves into significant next steps within administration and the organization which is the next biennium budget, and the new strategic plan. There's a lot to consider. We talk about what we envision, the implementation plan, what will it look like, we've taken the mana`o shared by Rodney and his team and we will begin incorporating what is summarized on page five which is the preliminary findings that SPIRE has found. Most important are the recommended targets (on the right hand column of the action item). These are critical targets being focused on in order for us to come up with a synced implementation plan in order to accomplish this within the recommended time frame which is year zero to year five.

Trustee Rowena Akana (inaudible)...you cannot change that by policy...(inaudible)...hierarchy- based, decentralization...(inaudible)....

Hawley Iona - Madame Chair, if I may? This was actually discussed in our Board Workshop. I will defer to Rodney as he was leading the discussions of the workshop.

Rodney Lee - Just to clarify, Trustee Akana. It's not to deride or to take OHA from its entity and its structure but to talk about its operating system. In other words, what it means from statute to real driven is that rather than operating in silos and operating within the functions of a state agency is to look at integration. The team and network oriented meaning integration of your efforts, how one affects another. Decentralization is less about a structure, it's more about the fact that every sector of OHA needs to operate in the way it needs to reach its goal. Decentralization is not to say it is controlled from the top other than the fact that the bottom needs to feed the top; so it's from the bottom up, rather than the top down. Mission oriented and results-oriented is not about the structure of OHA but what is the purpose? It's how the aspects of it, the team itself, drive toward performance and accountability, not just the rule, but to the results it needs. In managing cost, cost is one aspect but we're encouraging the organization to move towards managing value. Same structure, same hierarchy, it's just a shift in mindset and bring everyone together; the operating system. Integrating thoughts, making sure that the plans made are in sync and the risks are understood completely; one side does not talk to the other. We have found is a pattern of the overlaps, the demands for capital/cash, a lot of it is based on timing and execution and then it's focused on what's....

Chair Machado - Trustee Akana.

Trustee Rowena Akana - I just have a problem with this, “focus on what’s best for the organization first”, vs. the beneficiaries. I think they’re both important, you have to focus on what’s best for the organization as well as what’s best for the beneficiaries. If the organization isn’t functioning well, then the beneficiaries aren’t going to get anything. It has to be both, not one or the other. “Quality in performance to rules and standards”, I think that’s the part of it. Managing costs is what Trustees are supposed to do. I don’t get what this means. Once you pass this, it’s a policy.

Rodney Lee - We’re not proposing it as a policy.

Hawley Iona - This is the framework, Madame Chair, if I may. This the framework by which the implementation plan will be developed. It will not have very steadfast rules in it. It will operationalize more of the fiscal accountability in order to make it more results driven.

Trustee Ahu Isa - It says right here, “OHA’s Operating System”. I can see the efficiency of teamwork when we deal in the real business world. Decentralization, in the Legislature as a Representative, we had office managers that handled our travel; efficient, they know when to book us, the changes, the per diems, they get the checks out, we had one person doing it all. This is good, Rowena.

Trustee Akana - Yes, but they still not going to let us do it.

Trustee Ahu Isa - How do you know? This is operation for efficiency.

Trustee Apo - I read the word, decentralization differently, the intent is to empower. To empower people to make maximum contribution by allowing those at the bottom to have more weight and be listened to. That’s what I think you mean by decentralization.

Rodney Lee - What we detected through the effort is that OHA is being pulled in too many directions, but it’s required, there’s a catch. You need to be BOLD. The only way to handle that is to push that level of authority down, not that it’s not monitored, but set it by goals and results that need to be monitored. I agree with Trustee Akana that costs is always going to be a part of the equation, it is part of value. Value is overall net benefit minus costs. Value is the effect, the outcome. In other words, we shouldn’t be investing in a high yield if there’s high costs. If the backend fees are high, we need to look at net value, what is the net overall gain. You are going to manage cost and the way you do that is through your budget cycle. What I am recommending the Board to do is to look at the entire picture. We want to pull value out of everything: legacy lands, mission function.

Trustee Akana - What is see it’s all together, it’s not one or the other.

Rodney Lee - If you are referring to the structure, you will always be a State agency, will-driven, but operationally/internally, because of breath and depth of how it needs to be covered, what should be integrated, it’s how to move effectively. What is it that you need to release and this is part of this implementation plan; how does OHA function the best? What is the best, efficient way to reach its results? We’re not just pushing dollars, but overall net value. Net asset value; what is the amount of assets that you hold in your portfolio, against the overall costs.

Trustee Akana - It bothers me. I can see your concept and I believe in your concept except that we are governed by State rules and there are some things we're not allowed to do.

Rodney Lee - We are not going to perform outside the framework of that. There are also some things beyond the State that the State is not affected to, that you are also responsible to.

Chair Machado - Let us go back to the motion. It's a long motion, I wanted some clarification and if possible, any of the discussions we've had could get integrated. So let's look at the proposed language.

Rodney Lee - The first one is the adopted use of the fiscal sustainability model; the model itself that tests against every scenario, a guidance on how to make decisions. The second is a statement commitment relating to the implementation plan that is going to follow, that is, to adopt an implementation plan effective July 1, 2017, which allows admin and us to put the details together. In other words, put in a financial structure that starts to look at the objective based on the findings we get from the negotiations. Then, to incorporate those success indicators so that we can maintain the structure on these one, three and five year post implementations; those are the goals. Incorporate what the code of ethics would be applicable to this. There's going to be latitudes and those latitudes are going to involve principles. It's looking to see to get those actions approved; adoption of the model as an ongoing method of evaluating the opportunities to search for increase in asset value.

Trustee Akana - Could we vote on adopting a fiscal sustainability plan and put off voting on the structure until we see the structure? We can accept the idea of the plan, but until they put the structure together, we can wait on voting for the structure?

Hawley Iona - Correct. So Madame Chair, once again, number two is very specific to the statement of commitment and the statement of commitment is the implementation of the plan itself. It does not commit to the structure, it just really commits to those four bullets:

- (1) Implementing July 1, 2017, (2) Financial Structure Development, (3) Success Indicators, (4) Code of Ethics

Trustee Robert Lindsey - With the structure, looking at committing voting on the plan.....

Hawley Iona - It's not the plan itself, it's just the "Statement of Commitment".

Trustee Robert Lindsey - So with the plan, eventually we'll come to a financial structure, success indicators, and the code of ethics.

Hawley Iona - And we envision that it will require another round of workshops, at least one workshop to delve into exactly what we are recommending.

Robert Lindsey - This is not the decision point as it is a statement of commitment to move forward which will eventually lead to the plan that provides these four bullets.

Chair Machado - My reservation is if you only adopt the statement, it's just a declaration. I would like to see a little bit more details because we spent hours, your team spent many hours pulling out information to come up with the areas that have been assessed. So the fiscal sustainability implementing plan is a very important

PETER	APO			X			
HAUNANI	APOLIONA		X	X			
HULU	LINDSEY						Excused
ROBERT	LINDSEY	X		X			
JOHN	WAIHE'E			X			
CHAIR COLETTE	MACHADO			X			
TOTAL VOTE COUNT				6	0	1	2
MOTION: [] UNANIMOUS [X] PASSED [] DEFERRED [] FAILED Motion passed with Six (6) YES votes, none (0) NO vote, One (1) abstention and Two (2) excused.							

Chair Machado – Thank you members, this AI will be referred to the BOT for consideration next week Thursday on October 20th. I want to thank administration for the hard work, with Hawley and your team and Kamana’opono and his efforts to coordinate the top managers and also o you SPIRE, Inc.

Trustee Akana – Are we going to have workshops on this? As you folks start to develop workshops, we can have workshops right.

Rodney Lee – Yes, we’re going to have to probably build it.

V. BENEFICIARY COMMENTS*

None

VI. ANNOUNCEMENTS

None

VII. ADJOURNMENT

Chair Machado – Entertained a motion to adjourn the meeting.

Trustee Apoliona – Motioned to adjourn the meeting.

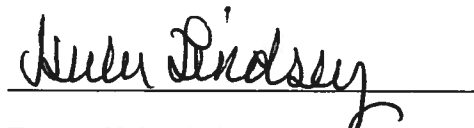
Trustee Waihe’e – Seconded the motion.

Chair Machado - Asked if everyone in favor say I. All in favor. Hearing no objections the meeting adjourned at 11:26 a.m.

Respectfully submitted,



Laurene Kaluau-Kealoha, Aide
Committee on Resource Management



Trustee Hulu Lindsey, Chair
Committee on Resource Management

Approved: RM Committee meeting on January 4, 2017.