

MARKET REVIEW

The Republican electoral sweep of elections in 2016 was the predominant headline over the last two quarters. In the fourth quarter of 2016 post-election enthusiasm propelled stocks to new highs driven by the promise of a pro-growth political agenda.

Quietly supporting this market move were six months of positive economic trends that went mostly unnoticed.

In the first quarter of 2017, equities continued their advance, but the drivers of performance changed. As the quarter moved on, the hopes of the promised pro-growth agenda grew dimmer.

At the same time, economic indicators also showed signs of turning. The ISM index, a measure of economic trends showed signs of peaking, and, even as the Federal Reserve raised rates in March--the second time in four months--the longer end of the curve remained stubbornly high, causing a flattening that can indicate a slowing economic environment. Consumers and investors remain optimistic, but the hard data is beginning to tell a different story.

These trends, both political and economic, were challenging for microcap stocks. In general, smaller stocks lagged the broader market, and as the smallest of the small, microcaps were affected even more.

Such cycles are typical for microcap investing, and do not reduce the alpha opportunity for those willing to wait out the inevitable ups and downs.

PORTFOLIO POSITIONING

The Microcap Core strategy continues to be broadly diversified versus the Russell Microcap Index. We are slightly underweight the Health Care, Real Estate and Financials sectors and maintain modest overweights to the Consumer Discretionary and Information Technology and Energy sectors.

Portfolio characteristics are generally in line with the Index: weighted average market cap is \$563 million versus the benchmark of \$541 million and other characteristics such as dividend yield, price-to-book and forecast earnings-per-share growth are also consistent with the Russell Microcap Index. The portfolio holds 174 names as of the fourth quarter; roughly midway within our range of 150 to 210 names.

PRODUCT OVERVIEW

The Microcap Core strategy seeks to outperform the Russell Microcap Index by constructing a diversified portfolio using an investment process that combines analysis of economic and market forces; individual stock analysis and risk management; and efficient strategy implementation and trading. The core of our process is knowledge-based investing which uses signals from the activity of informed market participants to assess potential company appreciation.

TOP FIVE CONTRIBUTORS (%)

Security	Avg. Weight	Portfolio Impact
Concert Pharmaceuticals Inc.	0.86	0.45
Orasure Technologies Inc.	1.12	0.39
Exterran Corp.	1.61	0.33
Cynosure Inc.	0.42	0.29
Veracyte Inc.	0.93	0.26

TOP FIVE DETRACTORS (%)

Security	Avg. Weight	Portfolio Impact
Orion Group Holdings	1.31	(0.33)
Modine Mfg. Co.	1.44	(0.28)
Regional Mgmt Corp.	0.90	(0.26)
Hawaiian Holdings Inc.	1.10	(0.24)
Westmoreland Coal Co.	0.62	(0.24)

We seek to add value versus the benchmark through stock selection in multiple sectors and industry groups as opposed to implementing significant sector, theme, or style over/underweights. During the quarter, our selection of Health Care and Materials names added value to the portfolio.

MICROCAP CORE INVESTMENT MANAGEMENT TEAM

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Chief Equity Officer

- Investment experience since 1991
- Tenure with HighMark since 2008
- MBA – University of Michigan
- BA – Computer Science, University of California, Berkeley

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Senior Equity Research Analyst/ Portfolio Manager

- Investment experience since 2008
- Tenure with HighMark since 2011
- PhD – Applied Physics, Cornell University
- MS – Financial Engineering, University of California, Berkeley
- MA – Physics, Brandeis University

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Senior Investment Analyst

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- MBA – University of California, Berkeley
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- Investment experience since 1997
- Tenure with HighMark since 2014
- BA – International Studies, Colby College
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Angela Shen
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- Investment experience since 2001
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The information provided herein represents the opinion of the manager of the market environment at a specific point in time and should not be relied upon as research or investment advice. Information presented for Top Contributors and Detractors is based on a representative account within the Microcap Core Composite, and on a trade date basis. As of March 31, 2017, the composite consists of equal to or less than five accounts, and it represents 0.00% of the total firm assets. The minimum portfolio size for inclusion in the composite is \$500,000. The primary benchmark for the HighMark Microcap strategy is the Russell Microcap Index. This Index is a capitalization weighted index of 2000 small cap and microcap stocks that captures the smallest 1000 companies in the Russell 2000, plus 500-800 smaller U.S.-based listed stocks. Benchmark for this strategy is used for comparative purposes only and is provided to represent the market conditions during the period shown.

Benchmark returns do not reflect the deduction of advisory fees, custody fees, transaction costs, or other investment expenses, but the returns assume the reinvestment of dividends and other earnings. An investor cannot invest directly in unmanaged indices. Specific securities identified and described do not represent all of the securities purchased, sold or recommended for advisory clients, and you should not assume that investments in the securities identified and discussed were or will be profitable.

Please call (800) 582-4734 or write to highmark.capital@highmarkcapital.com to obtain the calculation methodology for contributors and detractors and a list of every holding's contribution to the overall representative account's performance during the quarter.