HighMark®
CAPITAL MANAGEMENT

Liquidity Management Fact Sheet

Q2 2017

INVESTMENT PHILOSOPHY

We believe that safety, liquidity, and yield are the most important drivers of our liquidity management strategy. We seek to maximize after-tax income while preserving principal and maintaining liquidity.

INVESTMENT PHILOSOPHY

1. Fundamental Economic Analysis. Our Asset Allocation Committee conducts fundamental analysis of global economic indicators and fiscal and monetary policy. A strategic focus is placed on the leading indicators that have historically provided insights into the business cycle and potential changes in Federal Reserve policy. Our goal is to ensure that your portfolio is carefully positioned within a macroeconomic framework.

2. Market and Credit Analysis. We identify the most attractive securities among diverse asset classes and market sectors to enhance portfolio diversification and yield. We conduct in-depth yield curve and sector analysis as well as historical spread volatility and excess return trends. Finally, our research team analyzes the creditworthiness of new security candidates and existing securities on regular basis.

3. Portfolio Construction. In building a diversified and customized portfolio tailored to client's stated objectives and liquidity needs, our team seeks to diversify across multiple industries and security types. Portfolios are periodically repositioned to seek opportunities arising from changes in interest rates, the yield curve and sector spreads.

Risk Management
Our overarching goal is to ensure risk is managed and minimized through portfolio diversification, the monitoring of portfolio holdings and interest rate sensitivity analysis. Comprehensive performance measurement, compliance tools and constant adherence to client investment guidelines allow us to manage risk consistent with client expectations.

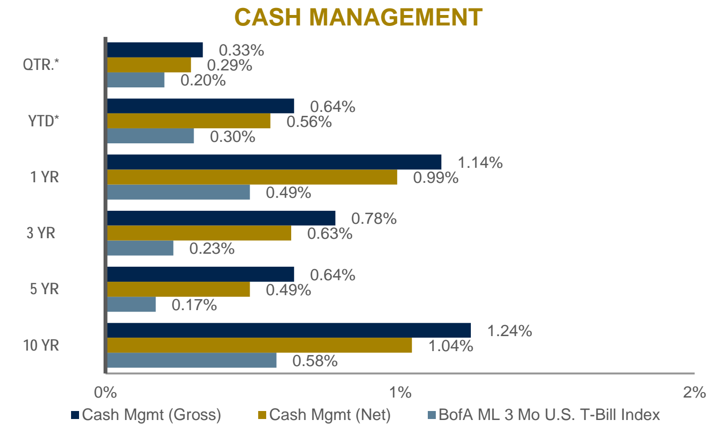
FIRM BACKGROUND

- Founded in 1919 as part of Union Bank in San Francisco
- $15.6 billion in assets under management
- Stable and experienced 52-member investment team
- Over 100 clients from all institutional segments

COMPOSITE PERFORMANCE

(periods under one year are not annualized)

CASH MANAGEMENT



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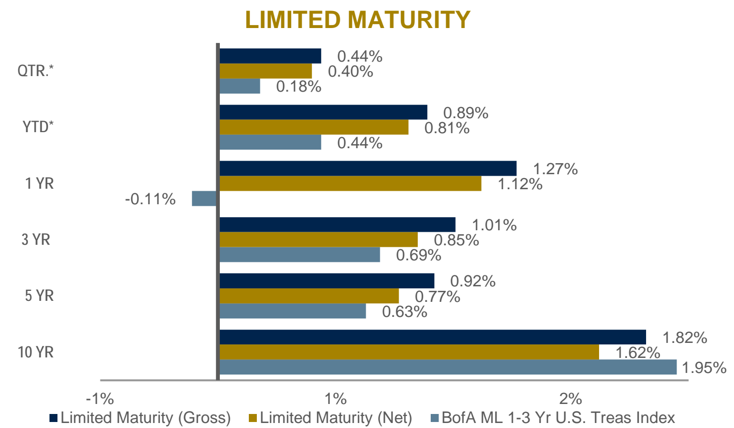
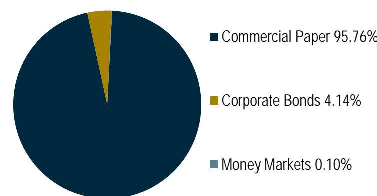


SECTOR WEIGHTINGS

CASH MANAGEMENT



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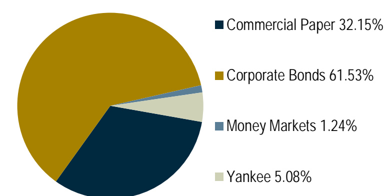
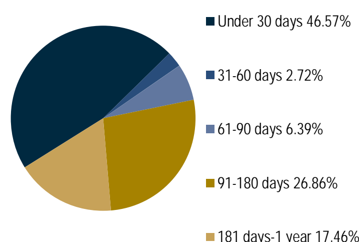


PORTFOLIO MATURITY

CASH MANAGEMENT



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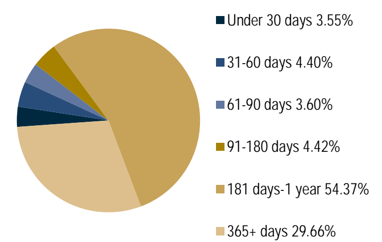

Overview

The relative calm of domestic equity and bond markets indicated that investors tuned out most of the political drama that dominated headlines in the second quarter. Rather, corporate fundamentals and economic data releases remained in focus. Yet interestingly, the respective lenses through which bond and stock market investors interpreted these signals have led to divergent opinions as to what lies ahead. As we noted in last quarter's Perspectives, the so-called 'hard' economic data did not follow the more optimistic 'soft' data driven by expectations of a pro-growth agenda out of Washington. While this disparity remained largely unreconciled in the second quarter, it did not stop investors from speculating on which direction the convergence might play out. Stock investors found themselves riding the wave of consumer and small business enthusiasm, while bond investors took a 'show me' posture as interest rates fell amid weak inflation and real growth data.

Bond investors, in the face of a more hawkish Fed, are not buying into the optimism driven by the prospect of a pro-growth fiscal agenda. True to its traditional skeptical nature, bond market behavior reflects a future that resembles the recent past–one of low growth and subdued inflation. Driven by soft economic data and a lack of meaningful progress on fiscal policy reform, longer-term bond yields fell as the yield curve flattened during the quarter. A flattening yield curve is one of the most ominous signals the bond market can send investors. It can also be a prescient sign of future economic conditions. However, distortions created by both domestic and foreign central bank activity currently make the yield curve's forecasting ability somewhat questionable. What remains clear is that the bond market stands by its belief that the 'proof is in the pudding.'

Outlook

Despite core inflation dipping below its stated 2% target, the Federal Reserve (Fed) raised short-term interest rates by 0.25% for the second time in 2017 at its June meeting, raising from 0.75% -1% to 1% - 1.25%. This move marked just the fourth time the Fed has hiked rates since initially moving off the zero-bound range in December 2015. The Fed is expected to move rates higher once more this year to target a Fed Funds rate of 3% by 2020. In a press conference following the announcement of the policy change, Fed Chairwoman Janet Yellen suggested one-off declines in wireless phone service plans and prescription drugs may have contributed to what the Committee felt was temporary weakness in core inflation.

At her press conference following the Committee meeting, Chairwoman Yellen announced details on how it will begin to slowly unwind its $4.5 trillion balance sheet by reducing bond holdings built up under the quantitative easing programs used to stimulate financial markets following the Global Financial Crisis. At an undetermined date this year, the Fed expects to allow $10 billion per month of U.S. treasuries and agency mortgage securities to mature without reinvestment. The run-off will increase by $10 billion every three months until it maxes out at $50 billion per month.

As desperately as the Fed wants to return to an equilibrium state of monetary policy in order to restock the ammunition required to fight future cyclical downturns, prevailing inflation trends have not cooperated. Concerns about elevated prices for financial asset prices have also motivated monetary policy makers to turn hawkish. So, when prices for goods and services began to accelerate late last year, the Fed felt that its opportunity to commence a sustained campaign to normalize interest rate policy had finally arrived. After years of unfulfilled projections of getting out of the stimulus game, the Fed hopes three consecutive quarters of hikes and a plan to shrink its balance sheet marks the beginning of a gradual exit strategy from an unprecedented level of monetary stimulus.

Looking forward, two major questions will stay top of mind for the Fed. Is the weakness in inflation in fact temporary, as the Chairwoman suggests, and what is the neutral rate of interest (a rate that is neither restrictive nor stimulative for the economy)? The answers to these questions will determine if the Fed can continue to hike and where rates will settle.

The flattening treasury yield curve is responding in part to the continued stalling of pro-growth legislation in conjunction with disappointments in recent readings on inflation. Measured by the difference between the interest rate on long and short maturity Treasuries, the yield curve is now below pre-election levels. Following last November's Presidential election, the yield curve steepened on the anticipation of an economic 'reflation' (a term used to indicate conditions of higher growth and inflation) generated by stimulative fiscal policy – namely tax cuts and deregulation.

Over the near-term, bond returns are likely to face headwinds, but the persistent demand for yield should keep rates in check.

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All expressions of opinion are subject to change without notice in reaction to shifting market, economic or political conditions.

Information presented under Sectors, and Maturity is based on a representative account within the Cash Management and Limited Maturity composites, and on a trade-date basis. As of June 30, 2017, the Cash Management composite consists of ten accounts, and represents 5.69% of the total firm assets. The minimum portfolio size for inclusion in the composite is $10 million. As of June 30, 2017, the Limited Maturity composite consists of equal to or less than five accounts, and represents 3.67% of the total firm assets. The minimum portfolio size for inclusion in the composite is $10 million. The benchmark for the Cash Management and Limited Maturity composites are the Bank of America (BofA) Merrill Lynch (ML) 3-Month U.S. Treasury Bill Index and the BofA ML 1-3 Year U.S. Treasury Index, respectively. The benchmarks are used for comparative purposes only and is provided to represent the market conditions during the period shown. The ML 3-Month U.S. Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month, the issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding T Bill that matures closest to, but not beyond 3 months from the rebalancing date. The BofA ML 1-3 Year U.S. Treasury Index is a subset of The BofA Merrill Lynch U.S. Treasury Index including all securities with a remaining term to final maturity less than 3 years. The BofA Merrill Lynch U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market. Benchmark returns do not reflect the deduction of advisory fees, custody fees, transaction costs, or other investment expenses. The benchmark returns assume the reinvestment of dividends and other earnings. An investor cannot invest directly in either the BofA ML 3-Month U.S. Treasury Bill Index or the BofA ML 1-3 Year U.S. Treasury Index. Gross returns are presented before management and custodial fees but after all trading expenses and reflect the reinvestment of interests and other income. Client's return will be reduced by the advisory fees and other expenses it may incur as a client. Fees charged are at the discretion of HighMark and MUB; investment advisory fees are described in HighMark's Form ADV Part 2, which is available upon request.

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