

MARKET REVIEW

Halfway through 2017, the political agenda of the 2016 election has all but faded. Market impacting measures such as tax reform and de-regulation have stalled, and through most of the second quarter, the accompanied deflation trade continued to reverse. At this point, expectations for the Republican agenda are non-existent.

More importantly, trends in economic activity moved towards another mini-cycle of moderating growth. Large cap, stable, growth stocks led markets as interest rates trended downward with the 10-year U.S. Treasury reaching a low of 2.13% on June 14th. The last two weeks of the quarter showed some life. Propped up by a rise in overseas bond rates, domestic interest rates rose closing the quarter at 2.3%. The resulting reflationary trade reversed the trends of the last six months, and gave life to small caps and value.

The past several quarters have been challenging for the Microcap strategy. Microcap equities are subject to periods of high volatility, making stock selection even more critical in generating solid relative performance. Several firms, including Westmoreland Coal and Applied Genetics disappointed our expectations while Straight Path Communications--a firm we did not hold--saw explosive growth due to demand for the company's wireless spectrum licenses. Despite these recent disappointments, we continue to believe in the effectiveness of our strategy in the microcap arena and as we near our three year anniversary would note that it has added value over that time frame.

PORTFOLIO POSITIONING

The Microcap Core strategy continues to be broadly diversified versus the Russell Microcap Index. We are slightly underweight Financials, mostly due to limited liquidity among some of the bank stocks, as well as Real Estate. We maintain overweights to the Consumer Discretionary and Industrial sectors.

Portfolio characteristics are generally in line with the Index: weighted average market cap is \$528 million versus the benchmark of \$501 million. The dividend yield of the portfolio is about 0.5% less than the benchmark mostly due to the underweight in Financials and Real Estate. 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 163 names as of the second quarter, 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
VOXX Int'l Corp.	0.67	0.31
Cutera Inc.	1.07	0.22
Merit Med Sys Inc.	1.10	0.20
Orasure Technologies Inc.	1.11	0.19
MCBC Hldgs Inc.	0.89	0.18

TOP FIVE DETRACTORS (%)

Security	Avg. Weight	Portfolio Impact
Westmoreland Coal Co.	0.62	(0.64)
Straight Path Communications	0.00	(0.40)
Exterran Corp.	1.52	(0.25)
Destination Maternity Corp.	0.07	(0.24)
Ovascience Inc.	0.11	(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.

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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- Tenure with HighMark since 2014
- PhD – Chemical Physics & Statistical Analysis, University of California, Los Angeles
- MBA – University of California, Berkeley
- BS – Industrial Automation, Zhejiang University

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Equity Research Analyst

- 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 1992
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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 June 30, 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.