

## MARKET REVIEW

While 2017 has been a difficult period for small cap stocks relative to large caps, the bleeding abated in the second quarter. The Russell 2000 returned 2.46%, trailing the S&P 500 by 0.61%. Value and growth trends continued, with small cap growth stocks outperforming small cap value stocks by 3.63%, bringing the total outperformance of growth versus value stocks to nearly 9%.

Part of this weakness is political, part economic. Politically, Republicans have so far failed to enact the agenda anticipated by the market after their election sweep. The economy is also embarking on another moderating growth 'mini-cycle' that has become common following the financial crisis.

Stable growth stocks led the way, driven by a continued decline in rates. On June 14<sup>th</sup>, however, propped up by a rise in overseas rates, domestic interest rates rose, reversing the deflationary trends of the last six months, and providing a bit of a respite for more cyclical value stocks.

Over the quarter, healthcare and telecom services led returns, while energy fell nearly 20% during a quarter where no other sector fell more than 5%.

## PORTFOLIO POSITIONING

The portfolio remains well diversified. The portfolio management team is comfortable with a limited exposure to momentum stocks at this point in the cycle. The most important industry overweight is to software, while the most important underweight is in health care equipment.

Other exposures remained fairly constant. The team did change the portfolio to lean from value to growth in the late part of the quarter, but the magnitude of the shift was very minor.

The relative sell off in small cap stocks has improved their valuation versus large cap stocks. However, the sell off has not been accompanied by a widening of credit spreads. Narrow spreads leave little room to narrow further, a move that would support small cap outperformance.

The team is optimistic about the potential for value-added returns to the strategy going forward. A continuation of the reflationary trends of the last few weeks of the quarter lead to a broader range of returns across stocks, increasing opportunities for our process to add value.

## PRODUCT OVERVIEW

The Small Cap Core strategy seeks to outperform the Russell 2000 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 unique market participants to assess potential company appreciation.

## TOP FIVE CONTRIBUTORS (%)

Security	Avg. Weight	Portfolio Impact
Clovis Oncology Inc.	0.73	0.30
Axovant Sciences Ltd.	0.77	0.28
AdvancePierre Foods	0.30	0.22
Polyone Corp.	1.43	0.19
Supernus Pharmaceuticals Inc.	0.65	0.18

## TOP FIVE DETRACTORS (%)

Security	Avg. Weight	Portfolio Impact
Tetra Technologies	0.59	(0.22)
Steelcase Inc.	0.17	(0.18)
Matrix Svc Co.	0.22	(0.17)
Radian Group Inc.	1.65	(0.14)
Golar Lng Ltd.	0.67	(0.13)

## REPRESENTATIVE BUYS AND SELLS

Bought	Sector
Hudson Pacific Properties	Real Estate
Interface Inc.	Industrials
Trinseo SA	Materials

Sold	Sector
Qualys Inc.	Information Technology
Sterling Bancorp	Financials
Columbia Banking System	Financials

## SMALL CAP CORE INVESTMENT MANAGEMENT TEAM

Derek Izuel, CFA  
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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- PhD – Applied Physics, Cornell University
- MS – Financial Engineering, University of California, Berkeley
- MA – Physics, Brandeis University

Richard Ren, Ph.D., CFA  
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- MBA – University of California, Berkeley
- BS – Industrial Automation, Zhejiang University

Justin Sheetz, CFA  
Equity Research Analyst

- Investment experience since 1997
- Tenure with HighMark since 2014
- BA – International Studies, Colby College
- MS I – Computational Finance and Risk Management, University of Washington

Angela Shen  
Quantitative Equity Analyst

- Investment experience since 1992
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- BS – Finance, Montana State University

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Current and future portfolio holdings are subject to change and risk. There is no guarantee that the securities listed will remain in or out of the portfolio. The discussion of the strategy's holdings is not intended as a recommendation to buy, hold or sell any of these securities. Past performance is no indication of future results.

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 Small Cap 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 composite represents 1.16% of the total firm assets. The minimum portfolio size for inclusion in the composite is \$500,000. The benchmark for this composite is the Russell 2000 Index. The benchmark is used for comparative purposes only and is provided to represent the market conditions during the period shown. The benchmark measures the performance of the small-cap segment of the U.S. equity universe. The Index is a subset of the Russell 3000® Index representing approximately 8% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. An index of approximately 1,000 of the largest companies in the U.S. equity markets, the Russell 1000 is a subset of the Russell 3000 Index. The Russell 1000 comprises over 90% of the total market capitalization of all listed U.S. stocks, and is considered a bellwether index for large cap investing. The Russell 1000 is a market capitalization-weighted index, meaning that the largest companies constitute the largest percentages in the index and will affect performance more than the smallest index members. 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 an unmanaged index. 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](mailto: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.

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