

MARKET REVIEW

The third quarter of 2017 stood in contrast to the two previous quarters in many different ways. Instead of a steady march upward led by large cap growth stocks such as the FANG (Facebook, Apple, Netflix, Google, et al) stocks, the third quarter was characterized by market participants' disagreement over future economic growth.

The key underlying controversy was the direction of global economies. The quarter began with a series of more moderate leading indicators. But as the quarter went on, more and more positive signs began to show, particularly from overseas. Industrial metal prices rose as well as currencies from commodity-producing countries such as Australia and Canada. Global purchasing manager indices remained resilient, and European indices reached a multi-year high.

Smaller stocks performed well relative to larger stocks, microcap stocks leading the way. Given the limited liquidity, these stocks tend to amplify the trends between small and large stocks.

Politically, talk of the potential for tax reform amplified these effect. Smaller companies with fewer write-offs and higher effective tax rates stand to benefit more from a lower simpler corporate rates.

PORTFOLIO POSITIONING

The Microcap Core strategy continues to be broadly diversified versus the Russell Microcap Index. The largest underweights are Real Estate and Financials. Some of this underweight is liquidity driven, but these represent sectors that benefit and are impaired by changes in interest rates, neutralizing that effect on the portfolio. Our largest overweight continues to be Consumer Discretionary.

Portfolio characteristics are generally in line with the Index: weighted average market cap is \$607 million versus the benchmark of \$572 million. The dividend yield of the portfolio is about 0.4% less than the benchmark mostly due to the underweight in Financials and Real Estate. Other characteristics such as price-to-book and forecast earnings-per-share growth are also consistent with the Russell Microcap Index. The portfolio holds 160 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 |
|----------------------------|-------------|------------------|
| Arena Pharmaceutical Inc. | 1.37 | 0.73 |
| Cutera Inc. | 1.45 | 0.68 |
| Triumph Bancorp Inc. | 1.53 | 0.40 |
| Exterran Corp. | 1.46 | 0.28 |
| United Community Financial | 1.78 | 0.25 |

TOP FIVE DETRACTORS (%)

| Security | Avg. Weight | Portfolio Impact |
|--------------------------------|-------------|------------------|
| Proteostasis Therapeutics Inc. | 0.27 | (0.22) |
| Hawaiian Holdings Inc. | 0.79 | (0.18) |
| Dynavax Technologies Corp. | 0.00 | (0.17) |
| Del Friscos Restaurant Group | 1.47 | (0.16) |
| Westmoreland Coal Co. | 0.19 | (0.16) |

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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- Investment experience since 1991
- Tenure with HighMark since 2008
- MBA – University of Michigan
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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 September 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.