

**Episcopal Diocese of Northern California  
Investment Fund**

**Second Quarter 2020**

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*HighMark Capital Management, Inc. is a subsidiary of MUFG Union Bank, N.A.*

# Investment Fund “A”

## Discussion Highlights – July 2020

### **Economic and Investment Outlook**

The first half of 2020 has been one for the record books. A pandemic-induced panic selloff in equity and credit markets was halted and reversed by a sharp rebound on the heels of an unprecedented globally coordinated fiscal and monetary policy response. During the second quarter, reopening announcements and progress on vaccines and treatments further fueled animal spirits, overcoming a slew of ugly economic data points and forecasts.

Underpinning the five-week long purge of stocks and other risk assets that began in mid-February was mounting uncertainty surrounding the full scope of the economic impact of social distancing measures, both voluntary and mandatory, intended to combat the spread of COVID-19. As businesses shut down and mass layoffs piled up, sources of optimism became increasingly scarce and capital market volatility exploded.

Potential economic casualties of the novel coronavirus were being compared to the Great Depression for good reason. Filings for U.S. unemployment claims tallied up to 6.9 million in the last week of March, exceeding the worst week of the Global Financial Crisis by a factor of ten. The U.S. experience was by no means unique. Economic shutdowns were taking a dramatic toll worldwide. In the absence of a proportional and timely policy response, it was anyone’s guess where the downward spiral would end.

Thankfully, there was no ambiguity about the urgent need for supportive measures and policymakers stepped up to the plate quickly armed with lessons and tools from past financial crises. The global equity market’s historic rally began on March 24 following an announcement by the Federal Reserve that the U.S. central bank would effectively do “whatever it takes” to stabilize the economy and financial markets. In concert with a barrage of lending facilities, limitless Quantitative Easing, or “QE Infinity” as some have called it, was just the antidote investors were looking for.

### **Asset Class Commentary**

In the first half of 2020, the overall portfolio underperformed the custom benchmark by 142 basis points, mainly due to market activity in the first quarter. Second quarter portfolio performance was strong, with the Total Account (Net of Fees) returning 13.27% against the custom benchmark return of 12.82%. Large Cap Equities (-3.1%) outperformed both Mid Cap Equities (-9.1%) and Small Cap Equities (-13.0%) for the year-to-date time period. Fixed Income performed well, with Investment Grade Taxable returning 6.1% in the first six months of 2020. For U.S. styles, Growth outperformed Value across market caps by 2000 to 2600-plus basis points in the first half of the year, continuing a dynamic we have observed the past decade.

### **Recent Activity**

During the quarter, we sold the remainder of our position in the AQR Managed Futures Strategy Fund, which had underperformed both the benchmark and peers.

# Investment Fund “A”

## Discussion Highlights Continued – July 2020

### Fund / Manager Commentary

#### **Equity**

The Total Equity portfolio modestly underperformed the MSCI All Country World Index (“ACWI”) in the first six months of 2020. Second quarter equity portfolio performance was strong, returning 21.04% against the ACWI’s return of 19.22%. Select Small Cap managers such as the Victory RS Small Cap Growth Fund and the Delaware Small Cap Core Fund, performed particularly well in the first half of 2020, beating their benchmarks by 611 and 137 basis points, respectively. The HighMark Custom Fundamental Advantage Strategy also outperformed in the first six months of 2020, returning -2.32% vs. the -3.08% of its benchmark, the S&P 500 Index. This outperformance demonstrates the benefits of active management during more volatile market periods.

#### **Fixed Income**

The combined Fixed Income allocation delivered a positive return (+3.29%), though underperformed the Bloomberg Barclays Aggregate Bond Index (6.14%) in the first half of the year. The position in the PIMCO Income Fund (-1.68%) acted as a detractor, whereas the Dodge and Cox Income Fund, PIMCO Total Return Fund and PGIM Total Return Bond Fund continued their strong performance, returning 5.28%, 6.16% and 3.75%, respectively for the year-to-date period. Longer term (5-, and 10- year periods), all of the fixed income managers (Dodge & Cox, PIMCO, and PGIM) have outperformed the Bloomberg Barclays Aggregate Bond index. We continue to be defensively positioned from a duration standpoint and remain focused on reducing overall credit risk.

#### **Alternatives**

The Alternatives portion of the portfolio underperformed its benchmark, the Wilshire Liquid Alternative Index, by 34 basis points in the first half of 2020. Managed futures strategies continued to outperform, with AlphaSimplex and American Beacon Managed Futures returning 2.77% and 2.94%, respectively. Given the diverse range of strategies within this asset class, there may be deviations to the index. In accordance with its objective, the Alternatives portion is comprised of diversifying strategies with minimal correlation to equities and interest rates. Based on our analysis of each Alternative fund’s annual return range along with actual historical results, the calendar year returns of each fund have been within expectations and have exhibited low correlation to equities and bonds. We continue to view Alternatives as a better source of returns relative to Fixed Income, with particular attractiveness given their profile of uncorrelated returns versus both equities and interest rates.

### Investment Fund Portfolio Commentary

The Total Account (Net of Fees) underperformed the custom benchmark by 142 basis points and the peer group by 22 basis in the first half of 2020. However, more recent performance has been improving. In the second quarter, the Total Account (Net of Fees) beat the custom benchmark by 45 basis points and the peer group by 23 basis points. We continue to believe that active management will be rewarded in the current environment of higher equity and interest rate volatility.

# Asset Allocation – Investment Fund A

## As of June 30, 2020

<b>Current Asset Allocation</b>	
<b>Equity</b>	<b>59.36%</b>
Large Cap Core	33.36%
Mid Cap Core	2.23%
Small Cap Core	2.37%
Small Cap Value	1.72%
Small Cap Growth	2.34%
International Core	4.66%
International Value	3.78%
International Growth	4.46%
Emerging Markets	4.44%
<b>Fixed Income</b>	<b>18.78%</b>
Govt/Corp Obligations	0.04%
Short-Term	3.46%
Intermediate-Term	11.64%
Multisector Bond	3.65%
<b>Alternatives</b>	<b>9.67%</b>
Global Macro	3.08%
Managed Futures	3.97%
Merger Arbitrage	0.85%
Multi Strategy	1.14%
Real Estate	0.63%
<b>Real Estate Loans</b>	<b>7.54%</b>
	7.54%
<b>Cash</b>	<b>4.64%</b>
	4.64%
<b>TOTAL</b>	<b>100.00%</b>

Weighted Embedded Expense Ratio 0.40

# Target vs. Current Asset Allocation (as of June 30, 2020)

Investment Fund “A” Value: \$24,994,650

<u>Asset Class</u>	<u>% Portfolio Weighting</u>			<u>Rationale</u>
	<u>Range</u>	<u>Target</u>	<u>Current Portfolio</u>	
<b>US Large Cap</b>	25-35%	30%	33.36%	Modest overweight given relatively stronger fundamentals versus other equity classes.
<b>US Small-Mid Cap</b>	5-15%	10%	8.66%	Maintain slight underweight due to valuations and high beta.
<b>International Developed</b>	10-20%	15%	12.90%	Continued underweight due to concerns about slowing global growth and European/Brexit risks.
<b>Emerging Markets</b>	0-10%	5%	4.44%	Modest underweight given slowing global growth, trade war, and dollar strength.
<b>Fixed Income</b>	10-30%	13%	18.78%	Maintain neutral weight to traditional bonds with tactical overweight position to Multi-Strategies.
<b>Alternatives &amp; REITS</b>	0-15%	5%	9.67%	Continued overweight to Alternatives given low correlation to fixed income and equities.
<b>Real Estate Loans</b>	15-33%	17%	7.54%	Maintaining position at this time.
<b>Cash</b>	0-10%	5%	4.64%	Focus on risk management. Will re-deploy opportunistically given cautious stance.

**Selected Period Performance**  
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**Period Ending: 6/30/2020**

	3 Months	Year to Date (6 Months)	1 Year	2 Years	3 Years	5 Years	10 Years	Inception to Date 01/01/1988
Cash Equivalents	.03	.34	1.27	1.71	1.53	1.03	.53	3.06
<i>FTSE 3 Month T-Bill Index</i>	<i>.14</i>	<i>.52</i>	<i>1.56</i>	<i>1.92</i>	<i>1.72</i>	<i>1.15</i>	<i>.61</i>	<i>3.07</i>
Total Fixed Income	5.56	3.29	5.63	6.45	4.69	4.39	3.83	6.03
<i>BBG Barclays US Aggregate Bd Index</i>	<i>2.90</i>	<i>6.14</i>	<i>8.74</i>	<i>8.30</i>	<i>5.32</i>	<i>4.30</i>	<i>3.82</i>	<i>6.33</i>
Total Equities	21.04	-6.37	2.23	4.48	6.54	7.23	10.69	9.39
<i>MSCI AC World Index</i>	<i>19.22</i>	<i>-6.25</i>	<i>2.11</i>	<i>3.91</i>	<i>6.14</i>	<i>6.46</i>	<i>9.16</i>	
Total Managed Portfolio	14.45	-3.97	2.56	4.34	5.38	5.74	8.55	7.97
Total Account Net of Fees	13.27	-3.81	2.14	3.81	4.77	5.11	7.41	7.70
<i>IF Benchmark ***</i>	<i>13.29</i>	<i>-2.93</i>	<i>3.53</i>	<i>5.05</i>	<i>5.94</i>	<i>6.18</i>	<i>8.31</i>	
<i>IF Benchmark ****</i>	<i>12.82</i>	<i>-2.39</i>	<i>3.78</i>	<i>4.87</i>	<i>5.73</i>			
<i>MS Mod Allocation Avg</i>	<i>13.04</i>	<i>-3.59</i>	<i>2.23</i>	<i>3.95</i>	<i>4.75</i>	<i>4.89</i>	<i>7.40</i>	
Standard Deviation						9.85		
<i>IF Benchmark ***</i>						<i>9.67</i>		

**Source: SEI Investments**

Returns are gross of account level investment advisory fees and net of any fees, including fees to manage mutual fund or exchange traded fund holdings. Returns for periods over one year are annualized. The information presented has been obtained from sources believed to be accurate and reliable. Past performance is not indicative of future returns. Securities are not FDIC insured, have no bank guarantee, and may lose value. \* The Total Managed Portfolio is gross of fees and excludes the Real Estate Loans. The investment management fees are approximately 0.23%. \*\*The Total Account Net of Fees includes the Real Estate Loans (which are managed by the Diocese). \*\*\*IF Benchmark: 30% S&P 500, 10% Russell 2000, 15% MSCI EAFE, 5% MSCI EM Free, 5% NAREIT, 30% Barclay's Aggregate Bond, 5% FTSE 3 Month T-Bill Index. Benchmark was created and became applicable at the two year period. \*\*\*\*IF Benchmark 2: 30% S&P 500, 10% Russell 2000, 15% MSCI EAFE, 5% MSCI EM Free, 5% Wilshire Liquid Alternative, 30% Barclay's Aggregate Bond, 5% FTSE 1 Month T-Bill Index. Benchmark was created and became applicable on 5/01/2016. Due to the change in the investment guidelines to allow for more equities, asset classes, and manager discretion these benchmarks will become a more appropriate comparison. The MSCI AC World Index is becoming a more appropriate benchmark for stock portfolios that include U.S., International, and Emerging Market exposure since the index has representation in all three areas.

As of: June 30, 2020

## Performance Report

	Market Value	Year to Date (6 Months)	1 Year	2 Years	3 Years	5 Years	10 Years	Inception to Date 05/01/2008
<b>Cash Equivalents</b>	<b>28,568</b>	<b>.34</b>	<b>1.27</b>	<b>1.70</b>	<b>1.52</b>	<b>1.03</b>	<b>.53</b>	<b>.62</b>
FTSE 3 Month T-Bill Index		.52	1.56	1.92	1.72	1.15	.61	.59
<b>Total Fixed Income</b>	<b>532,638</b>	<b>3.49</b>	<b>5.91</b>	<b>6.65</b>	<b>4.54</b>	<b>4.22</b>	<b>3.79</b>	
BBG Barclays 1-3 Yr US Govt/Credit Index		2.88	4.20	4.24	2.87	2.11	1.63	2.05
BBG Barclays Intmtd US Govt/Cred		5.28	7.12	7.02	4.43	3.46	3.13	3.60
<b>Total Managed Portfolio</b>	<b>561,206</b>	<b>3.33</b>	<b>5.66</b>	<b>6.28</b>	<b>4.25</b>	<b>3.58</b>	<b>3.24</b>	<b>3.65</b>
<b>Total Account Net of Fees</b>	<b>561,206</b>	<b>3.33</b>	<b>5.66</b>	<b>6.28</b>	<b>4.25</b>	<b>3.58</b>	<b>3.24</b>	<b>3.65</b>

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As of: June 30, 2020

Performance Report

	Market Value	Year to Date (6 Months)	1 Year	2 Years	3 Years	5 Years	10 Years	Inception to Date 05/01/2008
<b>Cash Equivalents</b>	<b>379,855</b>	<b>.34</b>	<b>1.28</b>	<b>1.70</b>	<b>1.53</b>	<b>1.03</b>	<b>.53</b>	
FTSE 3 Month T-Bill Index		.52	1.56	1.92	1.72	1.15	.61	.59
<b>Total Managed Portfolio</b>	<b>379,855</b>	<b>.34</b>	<b>1.28</b>	<b>1.71</b>	<b>1.53</b>	<b>1.04</b>	<b>.51</b>	<b>.59</b>
<b>Total Account Net of Fees</b>	<b>379,855</b>	<b>.34</b>	<b>1.28</b>	<b>1.71</b>	<b>1.53</b>	<b>1.04</b>	<b>.51</b>	<b>.60</b>

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