

**Episcopal Diocese of Northern California
Investment Fund**

Fourth Quarter 2019

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

Investment Fund “A”

Discussion Highlights – January 2020

Economic and Investment Commentary

In contrast to the third quarter’s bumpy ride, financial markets settled down in the fourth quarter as trade policy uncertainty de-escalated and fading economic data showed signs of bottoming. Reflecting an improving outlook for the global economy, yields on longer-dated Treasuries headed higher after approaching all-time lows in early September and even pushed the yield curve out of inversion. Meanwhile, global equities continued to rally on the heels of global central bank easing despite a lackluster year for corporate earnings growth as investors anticipated a reacceleration of positive fundamental momentum heading into an election year.

Buoyed by a confident consumer, the domestic economy remained resilient even as the rest of the world showed signs of sluggishness. A third quarter U.S. GDP reading of 2.1% handily beat consensus expectations, which had assumed ongoing trade conflicts would affect U.S. economic growth by now. Employment, the linchpin of consumer confidence, also performed better than expected with an average of 211,000 new jobs added in October and November while wage growth remained healthy, yet in check. Perhaps most importantly, inflation remained subdued, providing air cover for Federal Reserve (Fed) liquidity injections that soothed fears of a monetary policy that was too tight for conditions.

The economic picture overseas was not as bright, but markets had been pricing in low expectations for some time. The data point most market observers have been keying on as the canary in the coal mine for global growth prospects, the German Purchasing Managers’ Index (PMI), appeared to hit a nadir in September at 41.7 (a level below 50 indicates contraction) after peaking at 63.3 in December of 2017. Other fourth quarter survey data also showed signs of improvement, which gave way to the optimistic view that the worst of the slowdown may be behind us.

With the view that the global economic expansion is on track yet fragile, as evidenced by the need for renewed monetary intervention, investors preferred to take risk in financial markets that had greater perceived relative safety. Within equities, U.S. large cap stocks, as represented by the S&P 500 Index, led global markets by a substantial margin in 2019, continuing the trend since the end of the Great Recession. In the same vein, defensive sectors continued to outperform cyclical areas of the equity market.

Asset Class Commentary

In conjunction with the market rally in 2019, the overall portfolio performance was positive across the board during this period. Large Cap Equities (+31.4%) outperformed both Mid Cap Equities (+30.5%) and Small Cap Equities (+25.5%) for the year. Fixed Income performed well, with Investment Grade Taxable returning 8.7% in 2019. For U.S. styles, Growth outperformed Value across market caps by 600 to 900-plus basis points for the year, continuing a dynamic we have observed the past decade.

Recent Activity

During the quarter, we swapped the Nuveen Real Estate Fund for the Vanguard Real Estate ETF, which has a significantly lower expense ratio and better long term performance.

Investment Fund “A”

Discussion Highlights Continued – January 2020

Fund / Manager Commentary

Equity

The Total Equity portfolio strongly outperformed the MSCI All Country World Index by 243 basis points in 2019. Equity performance lagged that of the benchmark in 2018 mainly due to the portfolio’s lack of exposure to high growth technology stocks, which dominated for most of that year. This trend reversed in the first quarter of 2019 and continued throughout the year, with strong performance across equity market caps (Small, Mid and Large) and regions (Domestic, International and Emerging Markets). The Victory RS Small Cap Growth Fund performed particularly well in 2019, beating its benchmark by 990 basis points. The HighMark Custom Fundamental Advantage Strategy also outperformed, returning 32.77% vs. the 31.49% of its benchmark, the S&P 500 Index. This ongoing outperformance demonstrates the benefits of active management during more volatile market periods. We continue to expect active management to add value given the higher levels of volatility in the market and the normalization of interest rates.

Fixed Income

The combined Fixed Income allocation delivered a positive return (+8.27%), though underperformed the Bloomberg Barclays Aggregate Bond index by 45 basis points for the year. Positions in the PIMCO Income Fund (+8.05%) and the PIMCO Total Return Fund (+8.26%) acted as detractors, whereas the PGIM Total Return Bond Fund continued its strong performance, returning 11.13% for the year. Longer term (3-,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 credit risk.

Alternatives

The Alternatives portion of the portfolio outperformed its benchmark, the Wilshire Liquid Alternative Index, by 81 basis points in 2019. Recent performance has improved significantly and was primarily driven by global fixed income and currency positions. A strong trend has developed as five of the seven managers have outperformed the Index in 2019.

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 given the record low interest rate/yield environment for fixed income.

Investment Fund Portfolio Commentary

The Total Account (Net of Fees) performed in-line with the custom benchmark and peer group in 2019. More recent underperformance in 2018 is dragging down longer-term outperformance relative to both the benchmark and the peer group. We believe that active management will be rewarded in the current environment of higher equity and interest rate volatility.

The Total Managed Portfolio (which excludes the loans) outperformed the benchmark in the fourth quarter as well as the full year of 2019. The Portfolio has also outperformed the benchmark over the longer time periods primarily driven by asset allocation and manager selection.

Asset Allocation – Investment Fund A

As of December 31, 2019

| Current Asset Allocation | |
|---------------------------------|----------------|
| Equity | 60.02% |
| Large Cap Core | 32.70% |
| Mid Cap Core | 2.36% |
| Small Cap Core | 2.55% |
| Small Cap Value | 2.28% |
| Small Cap Growth | 2.15% |
| International Core | 5.02% |
| International Value | 4.40% |
| International Growth | 4.45% |
| Emerging Markets | 4.12% |
| Fixed Income | 17.15% |
| Govt/Corp Obligations | 0.04% |
| Short-Term | 3.04% |
| Intermediate-Term | 10.44% |
| Multisector Bond | 3.62% |
| Alternatives | 9.55% |
| Global Macro | 3.75% |
| Managed Futures | 3.19% |
| Merger Arbitrage | 0.92% |
| Multi Strategy | 1.09% |
| Real Estate | 0.60% |
| Real Estate Loans | 7.69% |
| | 7.69% |
| Cash | 5.59% |
| | 5.59% |
| TOTAL | 100.00% |

Weighted Embedded Expense Ratio 0.40

Target vs. Current Asset Allocation (as of December 31, 2019)

Investment Fund “A” Value: \$26,333,087

| <u>Asset Class</u> | <u>% Portfolio Weighting</u> | | | <u>Rationale</u> |
|---------------------------------|------------------------------|---------------|--------------------------|---|
| | <u>Range</u> | <u>Target</u> | <u>Current Portfolio</u> | |
| US Large Cap | 25-35% | 30% | 32.70% | Modest overweight given relatively stronger fundamentals versus other equity classes. |
| US Small-Mid Cap | 5-15% | 10% | 9.34% | Maintain slight underweight due to valuations and high beta. |
| International Developed | 10-20% | 15% | 13.87% | Modest underweight due to concerns about further trade tensions and dollar strength. |
| Emerging Markets | 0-10% | 5% | 4.12% | Modest underweight due to concerns about further trade tensions, China, and dollar strength. |
| Fixed Income | 10-30% | 13% | 17.15% | Maintain neutral weight to traditional bonds with tactical overweight position to Multi-Strategies. |
| Alternatives & REITS | 0-15% | 5% | 9.55% | Continued overweight to Alternatives given low correlation to fixed income and equities. |
| Real Estate Loans | 15-33% | 17% | 7.69% | Maintaining position at this time. |
| Cash | 0-10% | 5% | 5.59% | Focus on risk management. Will re-deploy opportunistically with higher volatility. |

Selected Period Performance
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Period Ending: 12/31/2019

Actual returns are shown in black. Benchmark returns are shown in orange.

| | 3 Months | 1 Year | 2 Years | 3 Years | 5 Years | 10 Years | Inception to Date 01/01/1988 |
|---|-------------|--------------|-------------|--------------|-------------|-------------|---------------------------------|
| □ | | | | | | | |
| Cash Equivalents | .40 | 2.07 | 1.89 | 1.51 | .97 | .50 | 3.10 |
| <i>FTSE 3 Month T-Bill Index</i> | <i>.46</i> | <i>2.25</i> | <i>2.06</i> | <i>1.65</i> | <i>1.05</i> | <i>.56</i> | <i>3.10</i> |
| Total Fixed Income | .86 | 8.27 | 4.32 | 4.68 | 3.99 | 4.05 | 6.02 |
| <i>BBG Barclays US Aggregate Bd Index</i> | <i>.18</i> | <i>8.72</i> | <i>4.27</i> | <i>4.03</i> | <i>3.05</i> | <i>3.75</i> | <i>6.23</i> |
| Total Equities | 8.91 | 29.03 | 8.09 | 12.81 | 9.31 | 10.49 | 9.77 |
| <i>MSCI AC World Index</i> | <i>8.95</i> | <i>26.60</i> | <i>7.09</i> | <i>12.44</i> | <i>8.41</i> | <i>8.79</i> | |
| Total Managed Portfolio | 6.04 | 20.97 | 6.11 | 9.69 | 7.18 | 8.49 | 8.24 |
| Total Account Net of Fees | 5.54 | 18.98 | 5.49 | 8.68 | 6.43 | 7.42 | 7.95 |
| <i>IF Benchmark ***</i> | <i>5.59</i> | <i>20.39</i> | <i>6.92</i> | <i>9.53</i> | <i>7.17</i> | <i>8.36</i> | |
| <i>IF Benchmark ****</i> | <i>5.64</i> | <i>19.19</i> | <i>6.33</i> | <i>9.03</i> | | | |
| <i>MS Mod Allocation Avg</i> | <i>5.06</i> | <i>18.88</i> | <i>5.79</i> | <i>8.21</i> | <i>6.07</i> | <i>7.46</i> | |
| Standard Deviation | | | | | 7.81 | | |
| <i>IF Benchmark ***</i> | | | | | <i>7.49</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 managements 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% Bloomberg 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% Bloomberg 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: December 31, 2019

Performance Report

| | Market Value | 3 Months | 1 Year | 2 Years | 3 Years | 5 Years | 10 Years | Inception to Date 05/01/2008 |
|--|----------------|------------|-------------|-------------|-------------|-------------|-------------|------------------------------------|
| Cash Equivalents | 24,813 | .40 | 2.07 | 1.89 | 1.51 | .96 | .50 | .62 |
| FTSE 3 Month T-Bill Index | | .46 | 2.25 | 2.06 | 1.65 | 1.05 | .56 | .57 |
| Total Fixed Income | 518,365 | .55 | 8.56 | 4.15 | 4.44 | 3.72 | 3.92 | |
| BBG Barclays 1-3 Yr US Govt/Credit Index | | .59 | 4.03 | 2.81 | 2.15 | 1.67 | 1.54 | 1.89 |
| BBG Barclays Intmtd US Govt/Cred | | .37 | 6.80 | 3.80 | 3.24 | 2.57 | 3.05 | 3.31 |
| Total Managed Portfolio | 543,178 | .55 | 8.02 | 3.90 | 3.83 | 3.15 | 3.08 | 3.52 |
| Total Account Net of Fees | 543,178 | .55 | 8.02 | 3.90 | 3.83 | 3.15 | 3.08 | 3.52 |

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.



As of: December 31, 2019

Performance Report

| | Market Value | 3 Months | 1 Year | 2 Years | 3 Years | 5 Years | 10 Years | Inception to Date 05/01/2008 |
|----------------------------------|----------------|------------|-------------|-------------|-------------|------------|------------|------------------------------------|
| Cash Equivalents | 378,629 | .40 | 2.08 | 1.89 | 1.51 | .97 | .50 | |
| FTSE 3 Month T-Bill Index | | .46 | 2.25 | 2.06 | 1.65 | 1.05 | .56 | .57 |
| Total Managed Portfolio | 378,629 | .40 | 2.08 | 1.89 | 1.51 | .97 | .48 | .58 |
| Total Account Net of Fees | 378,629 | .40 | 2.08 | 1.89 | 1.51 | .97 | .48 | .60 |

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