Episcopal Diocese of Northern California Investment Fund

Second Quarter 2019

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

Investment Fund "A"
Discussion Highlights – July 2019

Economic and Investment Outlook

The second quarter and 2019 year-to-date has flipped the script on 2018 when most "risky" asset classes lost money. Nearly every asset class and index, in fact, has shown positive 2019 returns ranging from 26% in U.S. Mid Cap Growth Equity to nearly 14% in U.S. Long-Term Investment Grade Bonds as interest rates continued to decline. In the second quarter, only Chinese equities and diversified commodity indices dipped into the red and asset classes, ranging from municipal bonds to emerging markets to gold, continuing their seemingly unstoppable march upwards.

Risk-hungry investors, buoyed by the prospect of three rate cuts before year-end, drove the S&P 500 index to record highs during the quarter and the index recorded the best first half year since the first six months of 1997: a total return of almost 19% following the 14% selloff in the fourth quarter of last year and a 4% return for the second quarter of 2019. Unlike the volatility of the prior two years, the U.S. dollar, when measured against a trade-weighted basket of foreign currencies, has been remarkably stable so far in 2019. This is one of the most notable differences compared to 2017 when most asset classes also performed well but the dollar sold off from the near-term highs reached in December of 2016.

Equity market enthusiasm is somewhat surprising given the fact that domestic stock valuations are rich at 17 times earnings and, having nearly recovered from the year-end 2018 selloff, now stand at the high end of their historic range. Even expectations that second quarter corporate earnings will fall 3% versus the same period last year have not deterred investor appetite for stocks in an environment of persistent trade tensions and global bond markets signaling caution.

Meanwhile, the global economy is fragile with most regions struggling to regain economic momentum. Many key indicators pointing to economic growth—industrial production, manufacturing, consumer confidence and trade—saw disappointing second quarter readings. The odds of a manufacturing and capital expenditure recession have risen substantially given deteriorating global growth outlooks as the World Bank continues to revise global GDP downwards with 2019 forecast growth downgraded to 2.6% from 2.9% due to weaker-than-forecast trade and investment momentum. Global GDP growth in the region of 2.6% can be considered "stall speed"—neither indicative of growth or decline.

Asset Class Commentary

In conjunction with the market rally in the first half of 2019, the overall portfolio performance was positive across the board during this period, with only the Alternatives and Fixed Income portions of the portfolio underperforming their benchmarks. Mid Cap Equities (+21.4%) outperformed both Large Cap Equities (+18.5%) and Small Cap Equities (+17.0%) for the year-to-date time period. Fixed Income performed well, with Investment Grade Taxable returning 6.1% in the first six months of 2019. For U.S. styles, Growth outperformed Value across market caps by 500 to 800-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 initiated a position in the Blackrock Event Drive Equity Fund and reduced positions in the AQR Managed Futures Strategy Fund and the AQR Style Premia Alternative Fund. Both of the AQR Funds have underperformed the benchmark and peers.

Investment Fund "A"
Discussion Highlights Continued – July 2019

<u>Fund / Manager Commentary</u>

Equity

The Total Equity portfolio strongly outperformed the MSCI All Country World Index by almost 200 basis points in the first half of 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 the year. This trend reversed in the first quarter and continued into the second quarter, with strong performance across equity market caps (Small and Large) and regions (Domestic, International and Emerging Markets). Select Small Cap managers such as the Victory RS Small Cap Growth Fund and the Undiscovered Managers Behavioral Value Fund, performed particularly well in the first half of 2019, beating their benchmarks by 1119 and 303 basis points respectively. The HighMark Custom Fundamental Advantage Strategy also outperformed in the first six months of 2019, returning 19.55% vs. the 18.54% of its benchmark, the S&P 500 Index. This 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 (+5.88%) and relatively in line with the Barclays Aggregate Bond index in the first half of the year. Positions in the PIMCO Income Fund (+5.50%) and the Eaton Vance Floating Rate Note Fund (+5.33%) acted as detractors, whereas the PGIM Total Return Bond Fund continued its strong performance, returning 7.85% for the year-to-date period. Longer term (3-,5-, and 10- year periods), all of the fixed income managers (Dodge & Cox, PIMCO, and PGIM) have outperformed the 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 underperformed its benchmark, the Wilshire Liquid Alternative Index, by 83 basis points in the first half of 2019. Given the diverse range of strategies within this asset class, there can be large 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.

<u>Investment Fund Portfolio Commentary</u>

The Total Account (Net of Fees) performed in-line with the custom benchmark and peer group in the first half of 2019. More recent underperformance in 2018 is dragging down longer-term outperformance relative to both the benchmark and the peer group. Referencing page 8 of the enclosed presentation, the Total Managed Portfolio (excluding loans) has outperformed the past 4 out of 7 annual return periods and is now outperforming in 2019. We 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, 2019

Current Asset Allocation	
Equity	**61.77%**
Large Cap Core	32.09%
Mid Cap Core	2.86%
Small Cap Core	2.01%
Small Cap Value	2.72%
Small Cap Growth	2.67%
International Core	5.52%
International Value	4.62%
International Growth	4.83%
Emerging Markets	4.45%
Fixed Income	**15.43%**
Govt/Corp Obligations	0.06%
Short-Term	3.06%
Intermediate-Term	8.06%
Multisector Bond	4.25%
Alternatives	**9.44%**
Global Macro	4.50%
Managed Futures	2.58%
Merger Arbitrage	0.69%
Multi Strategy	1.67%
Real Estate Loans	**9.31%**
	9.31%
Cash	**4.04%**
	4.04%
TOTAL	**100.00%**

Weighted Embedded Expense Ratio 0.41%

Target vs. Current Asset Allocation (as of June 30, 2019)
Investment Fund “A” Value: $21,904,408

Asset Class	% Portfolio Weighting			Rationale
	Range	Target	Current Portfolio	
US Large Cap	25-35%	30%	32.09%	Modest overweight given relatively stronger fundamentals versus other equity classes.
US Small-Mid Cap	5-15%	10%	10.26%	Maintain neutral weight due to valuations.
International Developed	10-20%	15%	14.97%	Shifted from overweight to neutral given concerns about slowing global growth and European risks.
Emerging Markets	0-10%	5%	4.45%	Modest underweight given contagion concerns and ongoing global trade risk. Possible raise to neutral.
Fixed Income	10-30%	13%	15.43%	Maintain underweight to traditional bonds with tactical overweight position to Multi-Strategies.
Alternatives & REITS	0-15%	5%	9.44%	Continued overweight to Alternatives given low correlation to U.S. interest rates and equities. No REITs due to richer valuations.
Real Estate Loans	15-33%	17%	9.31%	Real estate loans allocation moderated from 9.6% to 9.3% in 2Q19.
Cash	0-10%	5%	4.04%	For cash requests, potential loans, and risk mgmt.

Selected Period Performance

EPISCOPAL DIOCESE ~A~ IAS

Period Ending: 6/30/2019

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

	Year to Date (6 Months)	1 Year	2 Years	3 Years	5 Years	10 Years	Inception to Date (378 Months)
Cash Equivalents	1.13	2.14	1.66	1.24	.78	.43	3.12
FTSE 3 Month T-Bill Index	***1.21***	***2.30***	***1.81***	***1.36***	***.84***	***.46***	***3.12***
Total Fixed Income	5.88	7.28	4.22	4.26	3.57	4.14	6.05
BBG Barclays US Aggregate Bd Index	***6.11***	***7.87***	***3.65***	***2.31***	***2.95***	***3.90***	***6.25***
Total Equities	18.18	6.79	8.77	12.09	7.66	11.74	9.63
MSCI AC World Index	***16.23***	***5.74***	***8.21***	***11.62***	***6.16***	***10.15***	
Total Managed Portfolio	13.27	6.16	6.82	9.05	5.97	9.25	8.15
Total Account Net of Fees**	12.05	5.50	6.11	8.04	5.32	7.95	7.88
IF Benchmark*	***12.88***	***6.59***	***7.17***	***8.72***	***6.06***	***9.41***	
IF Benchmark**	***12.10***	***5.97***	***6.72***	***8.42***			
MS Mod Allocation Avg	***12.12***	***5.69***	***6.03***	***7.56***	***4.95***	***8.47***	
Standard Deviation					7.89		
IF Benchmark*					***7.65***		

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 .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% Citigroup 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% Citigroup 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.

Account Name: EPISCOPAL DIOCESE ~B~ BOND FUND

As of: June 30, 2019

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
Cash Equivalents	**43,633**	**1.14**	**2.14**	**1.65**	**1.24**	**.78**	**.43**	**.56**
FTSE 3 Month T-Bill Index		1.21	2.30	1.81	1.36	.84	.46	.51
Total Fixed Income	**529,801**	**6.08**	**7.40**	**3.85**	**3.86**	**3.29**	**4.25**	
BBG Barclays 1-3 Yr US Govt/Credit Index		2.71	4.27	2.22	1.59	1.46	1.59	1.85
BBG Barclays Intmdt US Govt/Cred		4.97	6.93	3.11	1.99	2.39	3.24	3.30
Total Managed Portfolio	**573,434**	**5.64**	**6.91**	**3.55**	**3.16**	**2.71**	**3.33**	**3.47**
Total Account Net of Fees	**573,434**	**5.64**	**6.91**	**3.55**	**3.16**	**2.71**	**3.33**	**3.47**

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.

Account Name: EPISCOPAL DIOCESE ~C~ CASH FUND

As of: June 30, 2019

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
Cash Equivalents	**347,598**	**1.14**	**2.13**	**1.65**	**1.24**	**.78**	**.43**	
FTSE 3 Month T-Bill Index		1.21	2.30	1.81	1.36	.84	.46	.51
Total Managed Portfolio	**347,598**	**1.14**	**2.13**	**1.65**	**1.24**	**.78**	**.41**	**.53**
Total Account Net of Fees	**347,598**	**1.14**	**2.13**	**1.65**	**1.24**	**.78**	**.41**	**.54**

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.