

Manager Research

HighMark Capital Management, Inc.

Large Cap Core Equity

Rating Decile	Weight
4th	100%

Summary

HighMark offers a competitive, quantitative Large Cap Core strategy that is designed to outperform the S&P 500 by 1.5-2% with a tracking error of 3-4% over a full market cycle. The process seeks to identify attractive stocks based on the behavior of informed agents in the market place, including company management, sell-side analysts, and sophisticated investors. The bottom-up process is complemented by an analysis of economic and market conditions to determine an appropriate level of exposure to traditional factors, such as momentum and valuation. The final portfolio typically holds 80-100 positions and is managed with a high level of risk awareness.

Rating Decile	Weight
6th	30%

I. Organization

HighMark Capital Management is an SEC-registered investment advisor located in San Francisco. Originally organized as Merus Capital Management in 1987, the firm formally changed its name to HighMark in 1998. In 2004, HighMark became a wholly-owned subsidiary of Union Bank. In November 2008, The Bank of Tokyo-Mitsubishi (BTMU) successfully acquired all of the shares of Union Bank, resulting in HighMark becoming a wholly owned subsidiary of BTMU. In August 2012, President and CEO Earle Malm retired from the firm after ten years of service. He was succeeded by the head of the Wealth Markets Group, Dennis Mooradian. In December 2012, CIO David Goerz left the firm. Mr. Goerz was replaced by Derek Izuel as Chief Equity Officer and David Wines as Chief Fixed Income Officer.

Investment professionals are compensated with a base salary combined with incentives that are tied to short- and long-term performance of the group and the profitability of the overall firm. In evaluating investment performance, HighMark generally considers the one- and three-year performance of the strategy relative to peer groups and benchmarks. Neither direct nor phantom equity is offered to investment professionals.

The Quantitative Equity team manages the Large Cap Core strategy and is led by the firm's Chief Equity Officer, Derek Izuel. Mr. Izuel, who has been the lead PM since November of 2008, is supported by PM Ed Herbert and quant analysts Yanping Li and Angela Shen.

Overall, while the investment team has remained relatively stable since Mr. Izuel was placed at the helm, the strategy receives a below average organization rating due to recent transitions at the senior executive level, the unfavorable ownership structure, and the lack of meaningful long-term incentives for investment professionals.

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Rating Decile	Weight
5th	17.5%

II. Information

Due to the primarily quantitative nature of the strategy, the information gathering process consists of utilizing top-down and bottom-up data from external sources such as Bloomberg, FactSet, and Thomson Reuters. Internal models are used to evaluate and validate the data. The process incorporates both bottom-up and top-down elements, and therefore, a wide variety of data is utilized.

Due to the team's systematic process, only a small percentage of the research process is conducted in the field. Each team member typically attends one or two conferences per year. The Quantitative Equity team leverages the firm's fundamental research in order to gain further insights into specific companies. A qualitative overlay, dubbed the PALING test, is implemented by the portfolio managers to account for real-time news factors and other fundamental data that may not be captured by the team's model.

Overall, while the team's company-specific knowledge is not as deep as the pure fundamental managers in the space, the strategy still receives an average information rating due to the high breadth of information and the ability to leverage the fundamental research of the other teams at the firm.

Rating Decile	Weight
1st	17.5%

III. Forecasting

The core of the team's stock selection model is the analysis of informed agents. By monitoring the behavior of company management, sell-side analysts, short sellers, and institutional investors, the team is able to gain insight into how informed investors view a stock's potential. Various factors, including changes in outstanding shares, changes in company accruals, insider buying/selling, changes in earnings estimates, short interest, and institutional investor share, are used to generate a signal of attractiveness for each stock in the universe. The model also considers valuation and price momentum, although the team believes the effectiveness of these two factors varies depending on the market environment. The team bases the decision on whether to favor companies with low valuation or strong momentum on the current market environment using a set of rules to help make sure the decision making is disciplined. Generally speaking, momentum will be emphasized when market volatility is low, consumer confidence is high, and the market has been trending upward over the last two to three years. Relative value will be emphasized when the spread between the most and least expensive stocks is abnormally wide and expected to narrow. Valuation metrics utilized include B/P, E/P, CF/P, and S/P.

All potential portfolio holdings are subject to the team's "PALING" test, which measures the extent to which a company is subject to the following exogenous risks: Political, Acquisition, Legal, Investigation, Natural Disaster, and Governance. If a company is affected by one of these conditions and the team deems that this has not been priced into the stock by the informed agents, the team will generally disqualify that stock from being a portfolio holding.

Overall, the forecasting process boasts a few unique attributes and is complemented by a thoughtful fundamental overlay. Wilshire attribution shows that stock selection has been a primary driver of relative returns and that the process has been well-executed since being put into place by Mr. Izuel and Mr. Herbert. As a result, the strategy receives an above average forecasting rating.

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IV. Portfolio Construction

1st	17.5%
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The strategy is benchmarked to the S&P 500. The investment team strives to exceed benchmark returns by 1.5-2% per year with a tracking error of 3 - 4%. Typically, the portfolio will hold between 80 - 100 positions. Individual position sizes are determined by a combination of three main investment criteria: return potential, risk contribution to the portfolio, and liquidity - although the last requirement is generally less important for large cap stocks. The portfolio has a soft individual position limit of a +2% active weight versus the S&P 500 index. Sector overweights are generally limited to +2-3% versus the benchmark.

HighMark subscribes to the Axioma Medium Term Fundamental model for optimization and risk modeling purposes. Risk exposures calculated by the model are used in conjunction with the team's alpha forecasts during the optimization process. An internal transaction cost model is also integrated into the optimizer. To ensure complete understanding of the strategy's factor exposures, risk model reports are available to the team on a daily basis and are reviewed quarterly by the firm's investment policy committee. Proprietary models are used to manage style exposures such as growth and value independently of the Axioma model.

Overall, the team employs a sound portfolio construction process that demonstrates their commitment to managing risk in the portfolio. As a result, the strategy receives an above average portfolio construction rating.

Rating Decile	Weight
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V. Implementation

3rd	8.8%
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The equity trading desk includes two senior equity traders who each possess over 30 years of trading experience. Bill Quinn, vice president and senior equity trader, joined Highmark in 2005; Merritt McGann, senior equity trader, joined Highmark in 2003. The firm utilizes Longview as its order management system. The firm also uses an automated pre- and post- compliance system to monitor investment restrictions and guidelines. To evaluate the firm's execution practices, HighMark uses Quantitative Services Group as its TCA provider. The firm also maintains a proprietary transaction cost model to control position sizes based on the potential market impact of trading. ECNs as well as traditional trading venues are used to access liquidity. The firm utilizes soft dollars, but employs a dedicated committee to oversee the use of client commission arrangements on a quarterly basis. Turnover for the strategy is expected to range from 60-100% per year.

Overall, HighMark's implementation effort is adequate given the nature of the strategy. The product receives a slightly above average rating.

Rating Decile	Weight
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VI. Attribution

4th	8.8%
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HighMark Capital uses two different attribution systems. The firm uses the Axioma portfolio attribution system for factor based attribution, and the Thomson Portfolio Attribution system for sector-based Brinson analysis. The firm runs attribution on all of the portfolios on a monthly basis. The team also performs performance analysis on the different investment criteria and factors used by the investment process.

While the team makes an effort to be aware of its sources of return, there is not a clear feedback loop to the forecasting process. Attribution rates slightly above average due to the variety of systems and methods utilized.

Decile	Rating									
	1	2	3	4	5	6	7	8	9	10
Corresponding Grade	A		B		C		D		F	

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Firm Information

HighMark Capital Management, Inc.

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FIRM FOUNDED: 1919

OWNERSHIP : Wholly Owned Subsidiary
HighMark Capital Management is the investment management subsidiary of Union Bank, N.A.

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