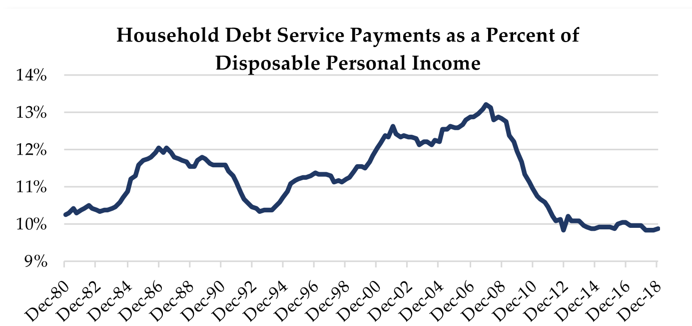
"Some debts are fun when you are acquiring them, but none are fun when you set about retiring them."
- Ogden Nash

First Quarter 2019 Update

Back in the early 1900's Mr. Nash became known for his satirical commentary in poems which were published in the New Yorker early in his career. Perhaps we should have used one of his quotes sooner as Disciplina's home town of Nashville was named for his great-great-uncle, Francis Nash, who was a general in the Revolutionary War. Mr. Nash also spent some time on Wall Street as a bond salesman before he moved on to bigger and much better things. His brief time in the bond market must have given him some perspective on debt and leverage, leading to the timeless quote above.

This quarter we'll look at the concept of debt, the government and this not so new-fangled thing called "Modern Monetary Theory". In short, it's the opposite of fiscal discipline and appears to be explicitly and implicitly accepted in Washington, D.C., regardless of which side of the aisle you are on. Think "Green Deal" and tax cuts, respectively between the political parties. Before we get into the sad state of our Federal balance sheet, we do have some good news to share. Households appear to be maintaining financial discipline well after the financial crisis. As you can see in the following exhibit, individuals were on an almost 15 year borrowing



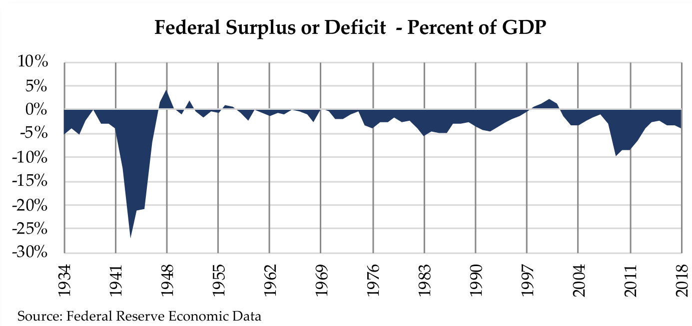
binge leading up to 2008, which pushed debt service payments up over 13% before the consumer debt bubble unraveled. Maybe having two houses, three cars, lavish vacations and dining out all the time was not the best idea. As Nash mentioned, debt may be a lot of fun when you are acquiring it.

On average, households are being much more prudent in managing their spending and dependence on credit. We see evidence supporting this in other macro data such as increases in savings rates versus the prior decade, and also comments on improving credit trends including low delinquency rates from our managers that operate in consumer credit space. We do believe that the strength of the US consumer should allow the economy to remain resilient at least through 2019 and into 2020. On top of favorable credit trends, the labor market is very strong with the unemployment rate near 30-year lows. Keep in mind that what is good for the US consumer is also good for the world, with the US consumer accounting for over 17% of world GDP. This exceeds even China's 16% contribution. While these indicators give us some comfort in the near term, long term trends in the state of the US government's credit status are quite concerning.

Uncle Sam's Borrowing Binge

Before we dig into the state of the federal balance sheet, it might be helpful to clarify two terms which often get thrown around interchangeably, even though they are quite different: the "budget deficit" versus the "national debt". The budget deficit relates to how much revenue the government is taking in relative to what it is spending in a given year (i.e. the income statement, or lack thereof for the government). The national debt refers to the total debt that the U.S. has outstanding. When the government runs a budget deficit, it issues debt to bridge the gap and the national debt goes up.

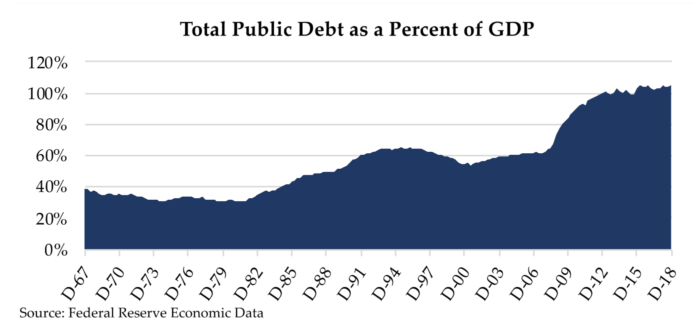
As you can see below, the U.S. government rarely, if ever, spends less than it takes in. To those of us who reside in the real world, spending less than you make is a relatively straightforward concept and pretty much a necessity. Not so much to those in politics. The last time the government ran a surplus was in the mid-90's when President Bill Clinton and a GOP congress led by Newt Gingrich worked to put some constraints on spending while leaving tax rates untouched.



Think about it, if each year you consistently spend more than you make, what happens? For the average person, debt increases until they ultimately must file for bankruptcy. A big difference between us and the government is Uncle Sam never really seems to pay its debt. It just keeps rolling over maturities and adding some more debt along the way. This is a key assumption of MMT, which we will explain shortly.

As you can see in following exhibit, the Debt/GDP ratio for the US government has swelled from 50% to over 100% during the last 10 years. The financial crisis and emergency response needed clearly had a major role in driving up the debt to the levels we see today. This occurred in another period of national emergency as well. The debt/GDP ratio was last above 100% in the mid-1940's as spending was ramped up to finance the war effort. However, this was back below 100% by 1950 and continued to trend lower. That appears unlikely to occur this time around.

Why? A big difference between now and the mid-40's is the portion of the US budget that goes towards "mandatory" spending for entitlements (i.e. social security, Medicare and Medicaid account for 60% of the federal budget). Interest payments on national debt account for another 10%, leaving only 30% of the budget in the "discretionary" category. Furthermore, the demographic shift of eligibility for entitlements continues to grow now with, those born between 1946 and 1964, the "Baby Boomers". The takeaway, in order to reduce the debt, hard choices and collaboration will be necessary in Washington D.C.



What exactly is "MMT"?

Back in 1905, a gentleman named Georg Friedrich Knapp wrote a book called the "State Theory of Money" which is often cited as one of the originators of MMT. The torch was picked up again by a variety of US economists in the mid-90's, but discussion about the topic in the mainstream has been fairly dormant until very recently. In short, this theory can be considered the opposite of fiscal austerity. Fiscal austerity assumes that the strength of a country's balance sheet, as in low debt/GDP ratio, matters and impacts the level of interest rates and long-term strength of the economy. MMT assumes that government spending can be financed by more debt, which can ultimately be paid off by printing more money for a nation that issues its own currency. Opponents of MMT would suggest that this would ultimately lead to a decline in the value of the currency, which would lead to runaway inflation.

Extremely smart people have written lengthy papers with many mathematical equations citing the merits for

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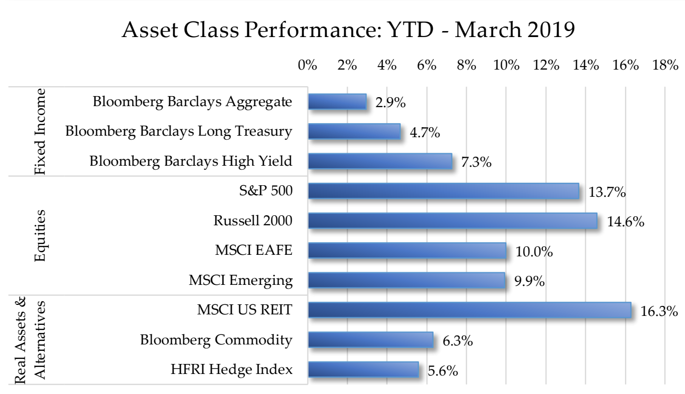
and against MMT, so we are not going to attempt to do that here. However, it is helpful to note some examples that people on both sides of the argument may cite to make their case. Proponents can cite the fact that while debt/GDP has spiked dramatically in the U.S. over the last several years, interest rates remain near historic lows. Opponents can point out that countries who also print their own currency, such as Brazil and Russia, have still defaulted on their own debt in the past. Both sides can point to Japan, which has run its debt up to 200% of GDP for several years with no sign of default. However, all that "stimulus" has failed to yield any sustained economic growth over that time frame.

Perhaps it's as simple as the market maintaining confidence in a country's ability to stay healthy and repay its debt over some meaningful time. One could argue there is a lot more confidence in the U.S. repaying its debts over the next 100 years than there was in Brazil and Russia. The question becomes, at what debt levels does the market lose confidence in a country's ability to repay?

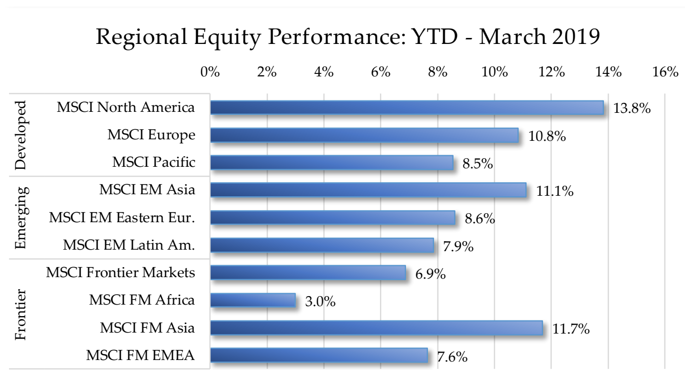
As we wrap up our thoughts on this topic, we are reminded about another quote by the late, great Yogi Berra: "In theory there is no difference between theory and practice; in practice there is." Another way to think about it is that MMT is something that may work very well until it doesn't. This will remain a meaningful risk factor for all markets, which we will continue to monitor over the course of the coming months and years.

Market Update
The new year brought a wave of renewed optimism with equities and credit rallying strongly across the world. The first quarter saw strong returns across almost every asset class.

Real estate (as measured by the MSCI REIT index) was the best performing sector for the first quarter of 2019, gaining 16.3%. Domestic equity markets also posted double digit returns for the quarter. Larger capitalization stocks that are included in the S&P 500 index rose 13.6% but were outpaced by smaller cap stocks as the Russell 2000 rose 14.6% during the first three months of the year.



International equities also fared well as the MSCI EAFE index gained 10.0% and MSCI Emerging Markets gained 9.9% for the quarter. Regionally, gains were widespread amongst the developed markets in the EAFE index as all countries posted positive returns for the quarter. Strength within the emerging markets was more concentrated as the bulk of the gains came from China (+17.7%), Russia (+12.2%) and Colombia (+24.8%). However, the rally in all asset classes was highly front-loaded, with the bulk of the gains coming in January, and to a lesser extent February, as returns slowed down materially in March.



Signs of weakness in the global economy benefitted the fixed income sector in the first quarter as investors sought safety at the end of the quarter. Investment-grade U.S. bonds posted a 2.9%, gain, and the Long Treasury

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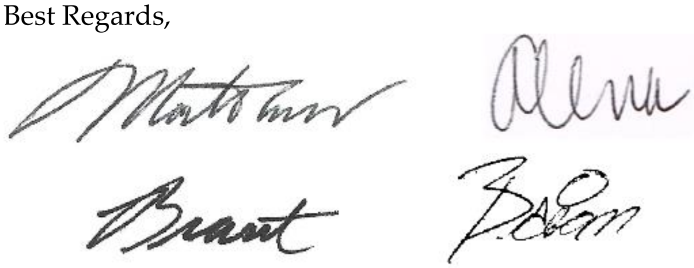
Index gained 4.7%. High yield bonds also posted a gain, rising 7.4%. Commodities also rallied this quarter, gaining 6.3%. Lean hog futures gained 45% and gas and oil prices rose over 30%. These gains were partially offset by declines in coffee futures (-7.2%) resulting from oversupply.

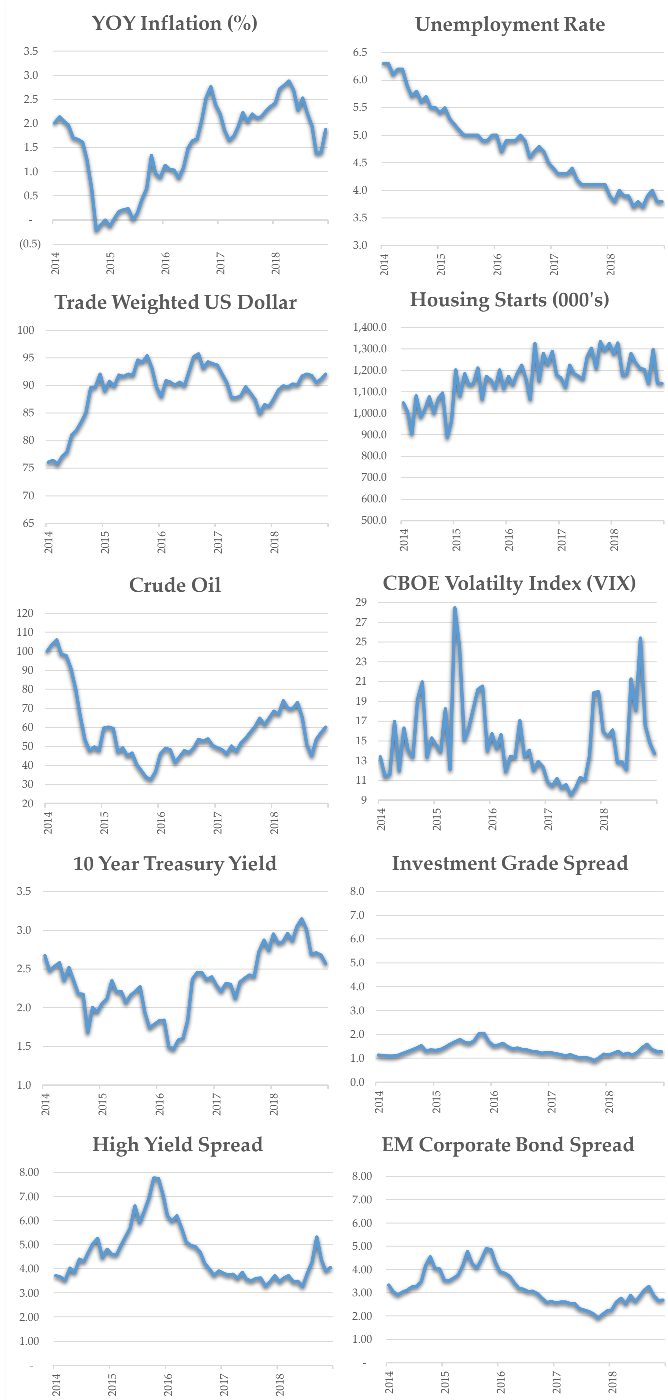
Firm Update

After mitigating much of the downside risk during the downturn in the fourth quarter, we managed to tilt our sails in the right direction in 2019 as our client portfolios kept pace with the dramatic rebound in risk assets to start the year. Our cash plus strategies keep grinding along, up roughly a percent and a half for the first three months of the year. The extent of the recent rally in risk assets does feel a bit stretched to us, but we will maintain current positioning for now.

On the client front, the fruits of our labor in 2018 are paying off. Our strong performance has led to many productive client meetings early in the year and several referrals for new mandates. Meeting with new prospects is always a rewarding endeavor as we are afforded the opportunity to learn about an array of diverse and worthy causes, meet individuals who share a passion for their respective missions, and position ourselves to assist each organization in reaching their financial and fiduciary goals. Thanks to all our clients, investment managers, friends and supporters who continue to help us advance *our* mission.

Best Regards,





* Sources: BofA Merrill Lynch; US Departments of Labor, Commerce & Energy; CBOE; Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System

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