"Although our intellect always longs for clarity and certainty, our nature often finds uncertainty fascinating."
— Karl Von Clausewitz

Fourth Quarter 2019 Insights

During our days in the office, we tend to have our screens tuned into CNBC or Bloomberg TV, mostly for background noise and occasionally for insights on current events that cause the markets to gyrate each day. One thing that has stood out this year is the number of times market experts highlight "uncertainty" in their market outlooks. While factually true, isn't that one of the costs of doing business if you choose investing as a profession? Our team has been in the game for over 25 years and we cannot think of any January where we sat at our desks and viewed our market outlook with 100% clarity. Being an investor can be both intellectually and financially rewarding, but the task is never easy as markets are always changing. Continual measurement, judgment, and management of the opportunities and risks in the market are reasons why we continue to espouse the benefits of nonprofits using an OCIO such as Disciplina to help manage their portfolios and missions.

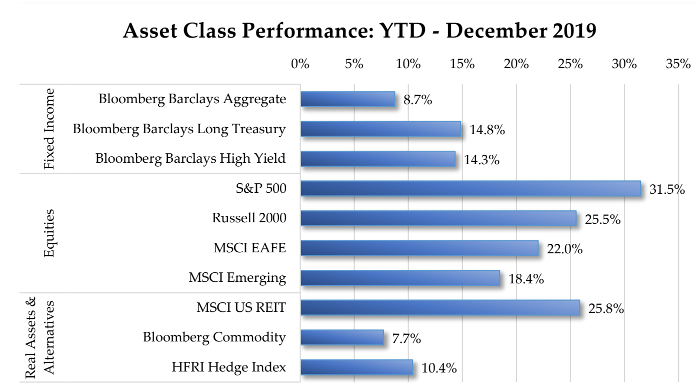
The subject of trade was prevalent in our 2019 outlook and will continue to be an important factor as we think about how to allocate capital in 2020. The transition from free trade to more closed markets and the unpredictable nature of the individuals driving that process has created a new wrinkle to managing portfolios. When we look at recent data from the Federal Reserve, our observations about the prevalence of uncertainty appear to be more than anecdotal.

In this quarter's letter, we will review 2019, offer our thoughts on what investors might expect in 2020, and close with a firm update.

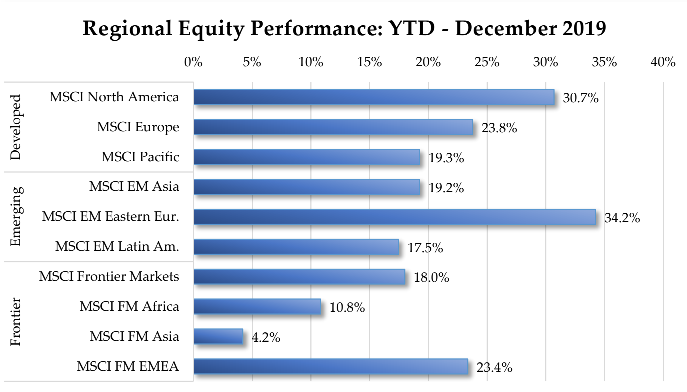
2019 Review

The last calendar year stood in stark contrast to the market performance of 2018. The market's sharp decline in the fourth quarter 2018 was quickly reversed. By the end of January 2019, US equities were up over 8%; a good year's worth of returns in a short timeframe.

Global financial markets concluded a strong 2019 by extending gains into year end. Two significant political risks were avoided during the final quarter, at least temporarily. Tariffs on Chinese imports scheduled to increase on December 15 were avoided through a phase one trade deal. Further, UK Prime Minister Boris Johnson and the Conservative party had a sweeping victory in the December elections. Equity markets proved supportive of both developments.



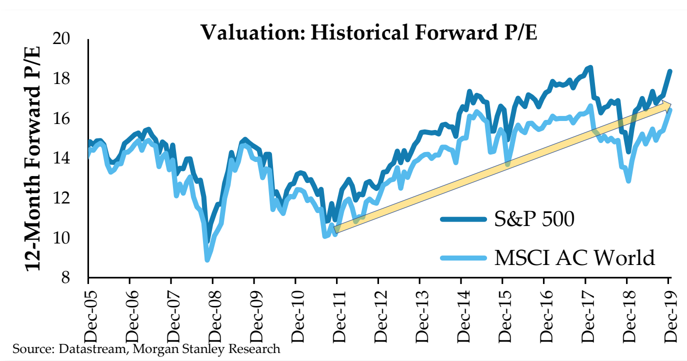
Domestic equity markets were fueled by optimism over US economic growth continuing into 2020. For the trailing year, large caps outpaced smaller caps with the S&P 500 gaining 31.5% while the Russell 2000 gained 25.5%. Outside of the United States, equity markets also fared well. Emerging markets rose 18.4% in 2019 while developed international equity markets gained 22.0%. Regionally, Europe gained 23.8% while the Pacific gained 19.3%. US real estate fared well, gaining 25.8%. Hedge funds experienced double digit gains of 10.4%, last achieved in 2010. Hedge fund returns were led by smaller sized firms and funds investing in directional equity strategies such as long/short equity, activist, sector-focused and special situations strategies.



Just prior to the fourth quarter, both the Long-Term Treasury index and the MSCI World Index were up a remarkable 19.8% and 17.6%, respectively. The outpouring of central bank liquidity helped lift all asset classes. Such strong returns for both traditional risk-off and risk-on assets at the same time is unusual and not likely to continue in 2020.

Thoughts on 2020 Outlook

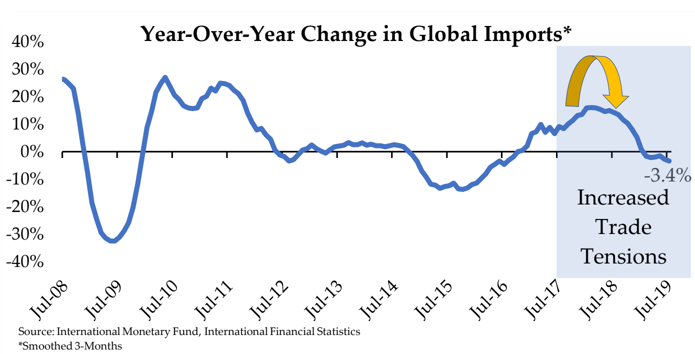
Versus 2019, 2020 has begun with elevated valuations in both the equity and credit markets. As shown in the following exhibit, global equity valuations, as measured by forward price to earnings, are as full as they have been in quite some time. This stems from a bulk of 2019's returns coming from investors paying a higher earnings multiple for stocks as opposed to companies increasing earnings. The recent spread of the coronavirus in China has set global markets back a bit, but valuations are still quite full. For markets to rally further in 2020, earnings will need to be the fuel that propels them higher.



Below, we discuss some of the key variables that we believe will drive markets in 2020:

Trade & Geopolitics: In the first few weeks of the new year, we have greater confidence that there will be less variability on hot button geopolitical issues such as Brexit and US trade policy with China and the rest of the world. No doubt these events contributed to the 9.1% rally that we saw in global equity markets during the fourth quarter. However, neither of these issues are complete. Yet markets were relieved that the Phase 1 deal with China avoided an additional tariff hike in December and gave both sides an opportunity to declare a near term victory. Thorny issues such as intellectual property rights remained unresolved and will likely stay that way as a Phase 2 deal is not expected to be finalized until after the US Election. The December elections in the UK gave Boris Johnson and his Conservative Party a decisive victory and apparent mandate to push ahead with Brexit. As of this writing, it appears the UK is on schedule to clear its next Brexit hurdle on January 31 and move into a standstill period in which EU rules will still apply and both sides will attempt to negotiate new trade agreements that will apply to a post-Brexit world. The goal is to have this completed by the end of 2020, but it will likely take longer.

Capex Recovery: Less trade uncertainty should contribute to a rebound in capex in the new year. As you can see in the next chart, trade uncertainty has caused companies to postpone capital investment as they wait for what the new rules of the game will be. Given that



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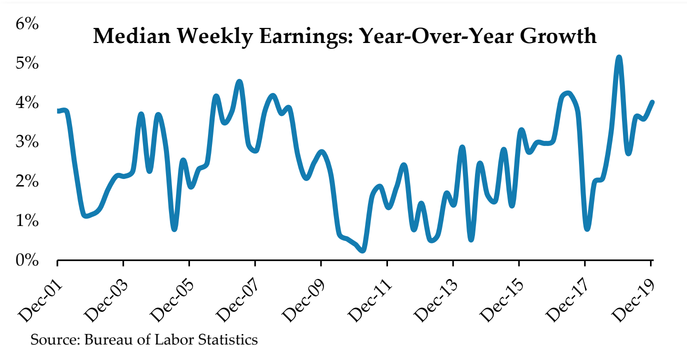
much of the details need to be worked out for these agreements, we don't see a massive capex spike in 2020, but believe it will be less of a drag on global growth.

U.S. Consumer, Again: One item that we flagged as a source of optimism in our 2019 outlook was the strength of the US consumer and that theme continues into this year. Thanks to consumer spending and a cooperative Federal Reserve, the global economy managed to achieve modest growth last year despite the drag from trade related uncertainty. The unemployment rate continued to hit new records during the year, closing at 3.5%, down 0.4% from the prior year. In addition to a robust labor market, low mortgage rates will also be stimulative for the housing market and spending. One notable soft spot on the employment front has been wage growth. Although positive across pay sectors, headline numbers remain below expectations.

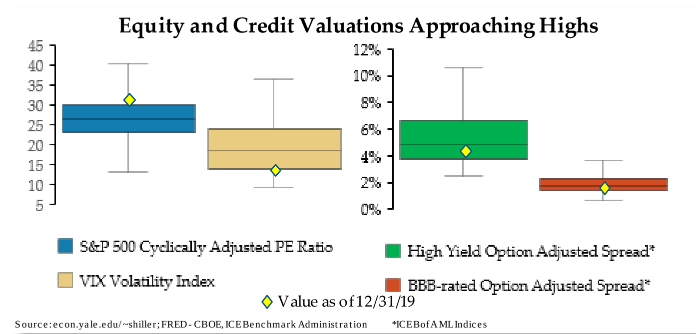


The 2020 U.S. Elections: Aside from trade related uncertainty, the clearest contributor to volatility in the markets will come from reading the tea leaves leading up to the 2020 U.S. Election. Based upon various market surveys, the consensus is a Republican presidency is favored over a Democrat for the health of equity markets. Most of these surveys are overly simplistic as there is a wide range of outcomes that could occur as the Democratic primary plays out. Markets will also consider the nominee's views on taxation and government involvement in the economy. Based upon the primary calendar, we should have a good idea on who will rise to the top of the pack by the end of April.

While the majority of attention is centered on the Presidential Election, the 2020 Senate Race has not garnered much interest as of yet, but is just as important. In November 2020, Republicans will have to defend 23 of their 53 seats while Democrats only need to protect 12 seats. More importantly, according to the Cook Political Report, four GOP Senators are in "toss up" races as compared to only two seats for the Democrats. While the House should stay in Democratic hands, market gyrations around presidential and senate races may heat up into the summer.

Summing Up Our Views

As always, we like to build our investment views by considering the mix of fundamentals, valuations and investor sentiment. As you can see from our comments above, we think market and macro fundamentals will improve, at least in the first half of the year. The challenge is when we compare the state of this market to other periods of mid-cycle weakness in the economy.



Valuations, discussed earlier, are quite full, especially when we look at government bond markets across the globe. Sentiment is also in a much different place than it was a year ago. The S&P 500 volatility index (VIX) is low and credit spreads are near record tights, giving us the feeling that there is a fair amount of complacency in the market despite all the hand wringing that occurred last year.

This leaves us with a much less robust opportunity set of investment opportunities than we saw twelve months ago. Fundamentals are improving, but valuations and investor sentiment already reflect that improvement. We start the year with our portfolios tightly positioned

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to their policy benchmark weights, but we do see a few areas to add value as the year progresses:

- Rates – Concerns about the US conflict with Iran and recent virus outbreak in China have pushed yields on US Treasuries back near their all-time lows. While these are real issues, we think the current level of yields will be hard to sustain in a stable to improving economy.
- Alternatives – With public market valuations quite full, we still see opportunities to add value in the private equity and hedge fund space. Our existing managers performed well in 2019, especially within private markets, and we continue to uncover niche opportunities that drive returns through idiosyncratic strategies.
- Global equities – We plan to stay close to our long-term allocations, leaving us the opportunity to take advantage of dislocations as they occur.

Firm Update

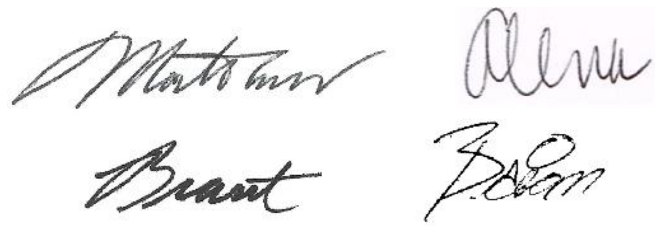
First and foremost, we wish to thank our clients, new and old for allowing us to partner with them in advancing their mission by managing their investment portfolios.

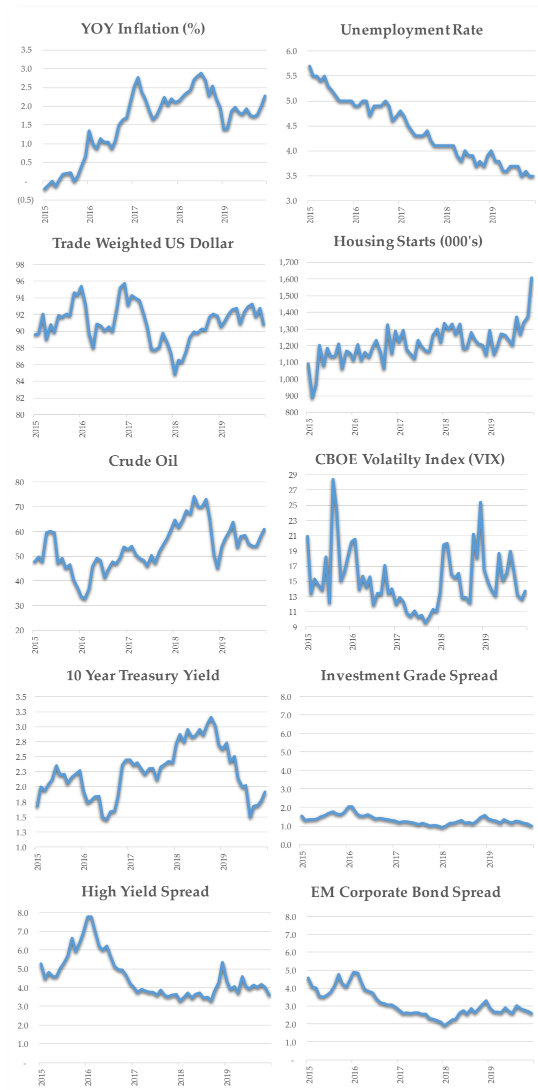
We are pleased to report that our client portfolios were able to keep pace with the rally in risk assets after experiencing limited downside in 2018. We now have a five-year track record across our long-term focused endowment and cash plus investment strategies, and their underlying strategies including global equities, fixed income and alternative investments. All continue to outperform or perform in line with their benchmarks.

As we enter our seventh year of operations, we have made a number of friends through our clients, manager research and business development efforts. We are forever grateful to those who have facilitated introductions on our behalf and share our passion for helping non-profit institutions fulfill their missions.

In 2020, we will continue to focus our efforts on expanding our service to not for profit clients such as civic, community, faith-based, healthcare and higher education institutions, while drawing on our experience and founding principles of Frugality, Focus and Faithfulness. If you or any of your colleagues are considering a new OCIO provider in 2020, please keep us in mind.

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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