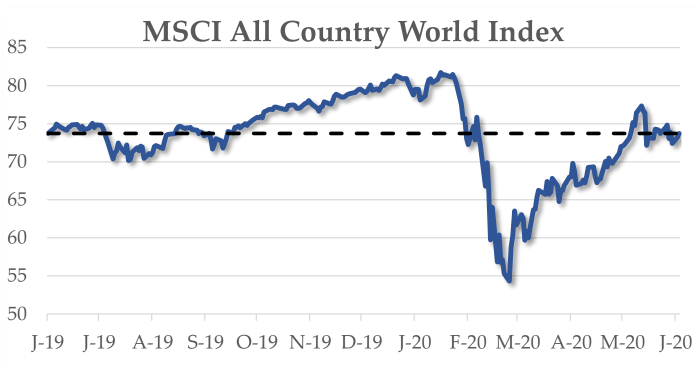
"It's not whether you get knocked down; it's whether you get up."
– Vince Lombardi

Second Quarter 2020 Insights

For those who are not acquainted with football and/or are too young to recall, Coach Lombardi was the head coach of the Green Bay Packers in the 1960s. Under his guidance, the Packers won five championships, and he had such an impact on the game that the trophy awarded to the Super Bowl winner bears his name. Of his many notable statements, this quote to persevere seems to encapsulate the many challenges faced across all walks of life in 2020.

The global equity markets seem to have taken the coach's advice to heart too. After being down -21% in the first quarter of 2020, global equity markets were up 19% in the second quarter. This recovery left most developed market indices negative for 2020, with a handful turning positive over the last 12 months. Leading the way were U.S. equity markets with a 7.8% 12-month gain. Fixed income markets also performed well over the past 12 months, gaining 8.7%. This came as welcome news for most nonprofits who have fiscal years that end on June 30. It is amazing what $9 trillion in government spending and 0% (or lower) interest rates can do to stimulate financial markets during a global recession.

Round Trip Back to 2019 Levels

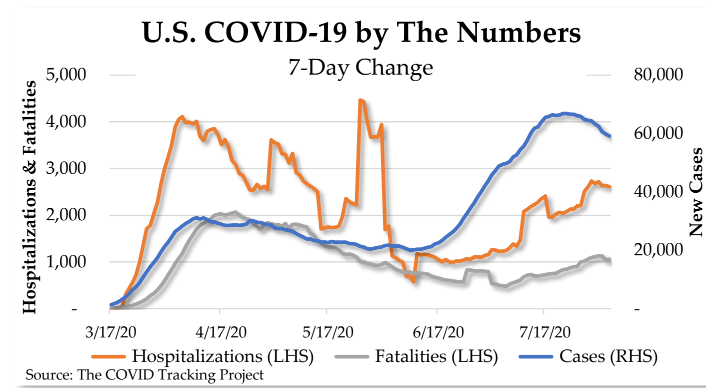


This quarter, we will discuss our thoughts on the outlook for the second half of 2020 and some key factors likely to drive markets: 1) Covid-19 developments, 2) fiscal and monetary stimulus plans, and 3) upcoming US elections. We believe these are three of the largest factors that will shape the recovery's trajectory. Here is a brief breakdown of each framing the market outlook for the second half of 2020.

COVID-19 - The Science v. The Spread

The global pandemic will continue to affect the economy and drive markets in the second half of the year and beyond, so keeping abreast of the latest metrics and forecasts is important. The Covid-19 outbreak in the US has dramatically changed since the initial outbreak. While the Northeast and West Coast were hit hard in the spring, we now see a surge in the Southeast and Southwest and California experiencing a second surge.

Second Spike Looks Different



We are now at a point where almost every state has dealt with the grim reality of this virus. With recent surges in Florida, Louisiana, South Carolina, California, Arizona and Texas, the trendline for daily new cases has increased. However, fatality rates and net hospitalizations have both decreased since the initial outbreak in March. States that were hit early have been more likely to embrace social distancing and mask use, managing a controlled number of cases over the summer. As we await a pharmaceutical solution, we expect some of the new hot spots may accept similar measures coming out of the worst of the current surge.

1033 Demonbreun Street • Suite 300 • Nashville, TN 37203 • 615.490.6007
www.disciplina.com • info@disciplina.com

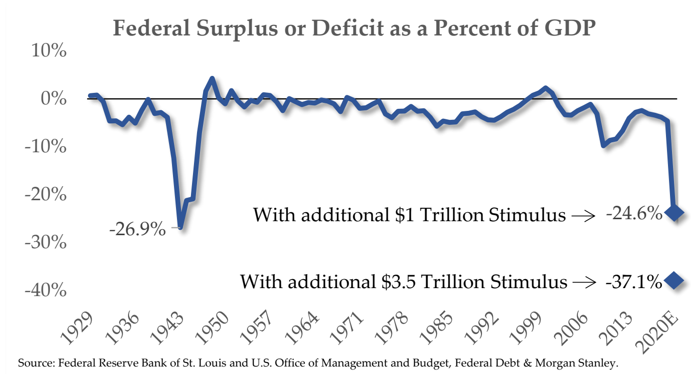
The race for a solution is on as researchers around the world are working on over 165 vaccines to battle the virus. More importantly, 12 are in phase 2 expanded safety trials, and 6 are in phase 3 efficacy tests with Moderna, Pfizer and an Oxford University/AstraZeneca partnership near the head of the pack. There appears to be a consensus that at least one vaccine will be widely available by the first quarter of 2021. Once a vaccine is widely available, we must hope that it will be universally adopted to contain the virus moving forward. While we wait, governments must continue to prop up their economies with low rates and massive public spending programs.

Fiscal and Monetary Stimulus

In our first quarter 2019 letter, we gave our thoughts on the economic concept called "Modern Monetary Theory" (MMT). In short, proponents of MMT believe that a country with its own currency does not have to worry about accumulating too much debt because it can always print more cash to pay the interest and refinance the debt as it comes due. There are brilliant economists on both sides of this debate, but the general consensus is that running large deficits for an extended period can be a risky proposition. We are about to test this theory at levels not seen since World War II.

Both monetary and fiscal policies are crucial to a recovery, but ultimately fall short in the final stage: the return to normalcy. To be fair, given the unprecedented shock to the global economy, a significant, coordinated response was needed to provide both fiscal and monetary stimulus to suffering economies and their citizens. On the fiscal policy front, we have two upcoming catalysts for markets to digest. In the US, policymakers are in a heated debate about the size and structure of the next round of fiscal stimulus as many benefits, including expanded unemployment assistance, rolled off at the end of July. In a vast oversimplification of the debate, on top of the roughly $2.5 trillion in government spending approved earlier this year, Republicans are seeking an additional $1 trillion while Democrats are seeking an additional $3.5 trillion.

<u>**Unprecedented Fiscal Deficit**</u>



In Europe, we have the approval of the EUR750 billion recovery fund. This has already been approved by the European Commission, and now set for the European Council with final approval required by each European Parliament. Regardless, ultimate approval is probably likely after some form of climactic drama.

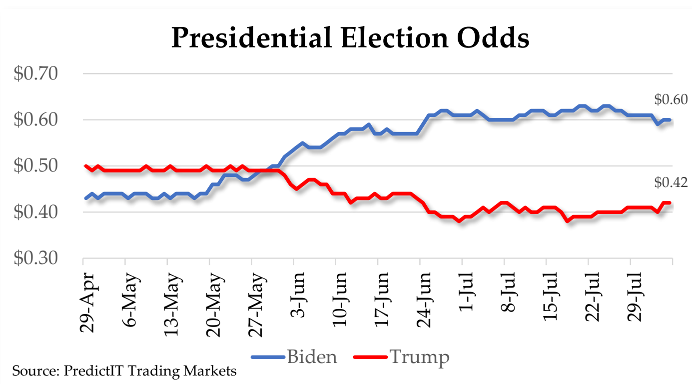
While we have expressed our concerns about the massive uptick in government spending, we do believe that the creation of the recovery fund is a significant and positive step forward for Europe. Since its 1999 inception, the Euro has been a union of currency and monetary policy, but minimal fiscal coordination. With Germany as a key economic power and conservative on the spending front, the European central bank has been on its own in trying to stimulate the economy during difficult times. This news and better containment of the virus has led to European equity indices outperforming the US over the past few months.

Yes, We Still Have an Election this Year

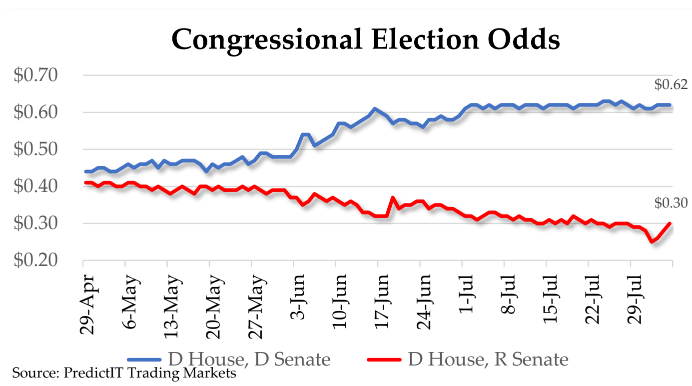
This is one of the few topics on our watch list from our start of 2020 that is still in play—albeit a significant twist in the defining issues. With the range of issues in place here are three potential outcomes they may be expected: a complete Democratic sweep, a Biden administration with a Republican senate and Democratic House, or the status quo with Trump still in office with a Republican senate and Democratic House. A Republican sweep is a highly unlikely scenario in our current view.

Gauging the presidency's outcome is enigmatic as a cloud of uncertainty looms over the future election's dynamic. Nevertheless, general election polls indicate that Vice President Joe Biden has an eight to ten-point lead over Trump. The likelihood of a blue sweep is also increasing as Democrats hold a relatively favorable position in the Senate polls. Polls and betting markets can provide insights into the potential outcomes of the elections. We review the betting markets below where trading levels indicate the price to pay to earn $1 if the result is in your favor. These markets tend to be at least on par with polling indicators.

Currently, PredictIt's betting markets are predicting a Biden win and trading at approximately 60¢ for Biden and 42¢ for Trump.



PredictIt also expects a Democratic House and Democratic Senate, trading at 62¢ and 30¢ respectively.



Gauging the Outcomes

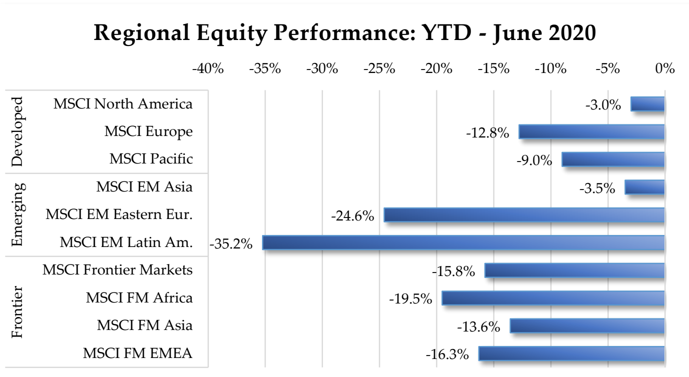
To be clear, a lot can happen over three months in any election year, especially in the environment we are faced with amidst a global pandemic. However, we are close enough where we need to ponder scenarios and examine the effect each might have on markets and the economy. Below, we briefly discuss the two most likely scenarios based upon current projections:

Blue Wave: Conventional wisdom might dictate that this scenario may not be market-friendly, as there would likely be an increase in taxes and regulation. However, Biden's substantial healthcare and infrastructure spending plan could give the markets a near-term boost. Furthermore, the US would likely maintain a firm tone towards China and trade rhetoric would likely decline with many of our historic allies, including Europe. Net/net this could result in a possible near-term boost to markets with a question of sustainability if increased taxes and regulation curtail growth.

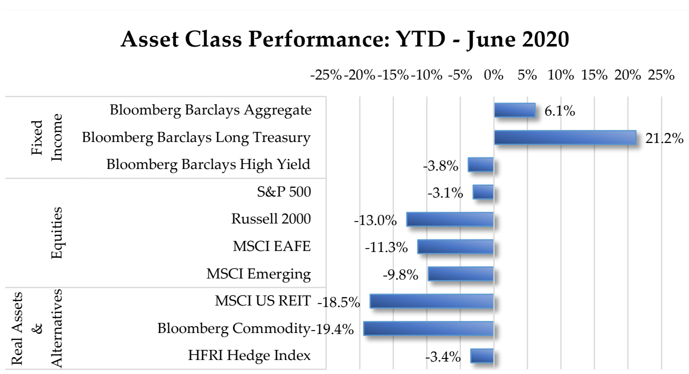
Trump Win with Democratic Senate & House: Although this outcome seems less likely based upon current polls and trends, it is a possibility. Under this scenario, the US ends up in political gridlock, which many investors view as a positive under the "do no harm" theory. We would normally agree, but the divided government approach has not served us well, especially in light of the current state of affairs. The upshot is that the tax and regulatory environment will remain unchanged, and neither party will agree on deficit reduction measures.

Market Update

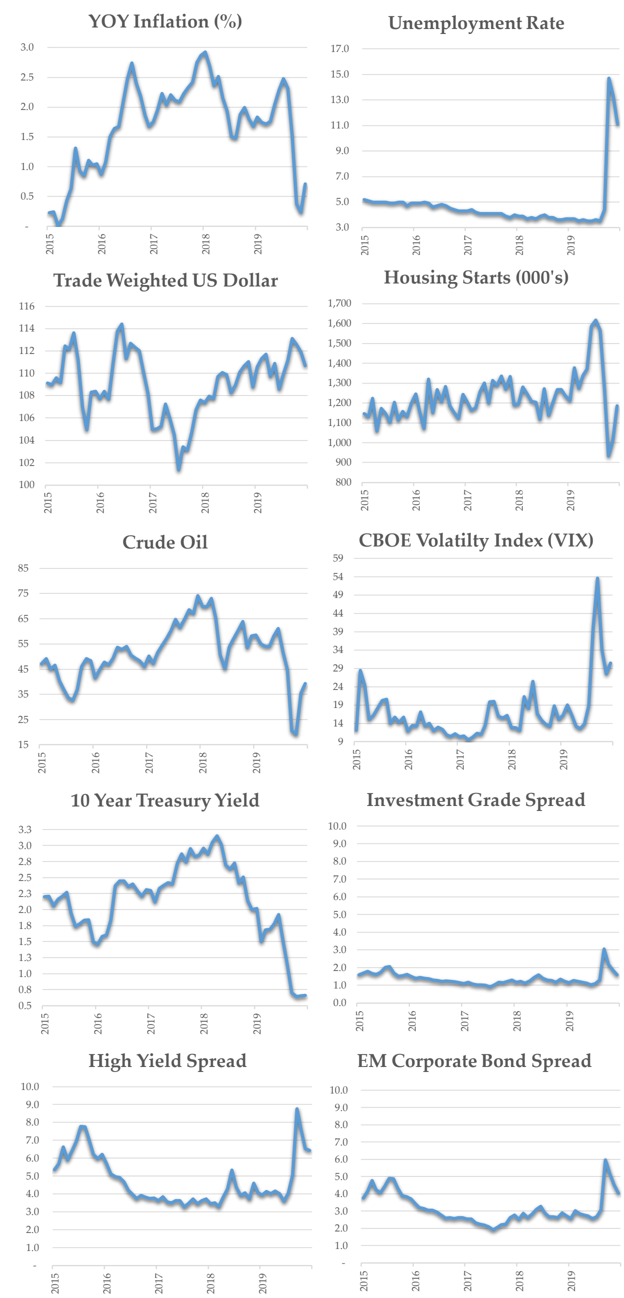
The S&P 500 gained +20.5% for the quarter and the Russell 2000 gained +25.4%, whereas international equity markets (MSCI EAFE) gained +14.9% and are still down -11.3% for the year. Year to date, small cap US equities closed at -13.0%, while large cap US equities closed at -3.1%. Emerging markets also recovered +18.1% this quarter, but are still down -9.8% for the year.



The historic US policy actions and Federal Reserve measures offered initial stability to the markets. Driven by the Federal Reserve increasing their portfolio's fixed income exposure, the Bloomberg Barclays Aggregate Bond index rose +2.9% this quarter and +6.1% year to date. Long-term Treasuries appear less attractive as a hedge against equity market volatility at current levels, gaining +0.3% for the quarter. High yield bonds were up +9.6% for the quarter as investors showed willingness to take on credit risk for higher fixed-income returns.



Real estate markets partially recovered from last quarter's steep -27.0% loss and were up +11.7%. The Bloomberg Commodity Index gained +5.1% during the second quarter, led by crude oil's partial recovery from the unprecedented negative price-per-barrel mark and by gold, in particular, as low rates made gold more attractive to investors.



* 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

1033 Demonbreun Street • Suite 300 • Nashville, TN 37203 • 615.490.6007
www.disciplina.com • info@disciplina.com

Firm Update

After protecting our client's capital during the volatile first quarter, we are pleased that our returns kept pace with the stimulus induced rebound in the second quarter. Allocations toward active management in global equities and a tilt towards credit exposure over duration served our clients' portfolios well. After this rally and considering the challenging economic outlook, we are discussing continuing a balanced yet defensive posture in portfolios for the second half of the year.

We are also thankful for the positive feedback and support we received regarding our June note discussing our views on diversity in the investment management industry. This had led to a healthy uptick in discussions with our clients, colleagues in the industry and new relationships with organizations aiming to make a conscious commitment to allocating capital to firms such as ours.

Best Regards,

1033 Demonbreun Street • Suite 300 • Nashville, TN 37203 • 615.490.6007
www.disciplina.com • info@disciplina.com