First Quarter 2015 Investment Perspectives

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COVENANT ASSET MANAGEMENT IS PLEASED TO OFFER OUR LATEST INVESTMENT PERSPECTIVES. IN THIS PUBLICATION WE REVIEW FOURTH QUARTER RESULTS AND HIGHLIGHT KEY ECONOMIC AND FINANCIAL THEMES WHICH WE EXPECT WILL DRIVE MARKETS AND INVESTMENT PERFORMANCE IN THE COMING MONTHS.

Key Themes in 2015

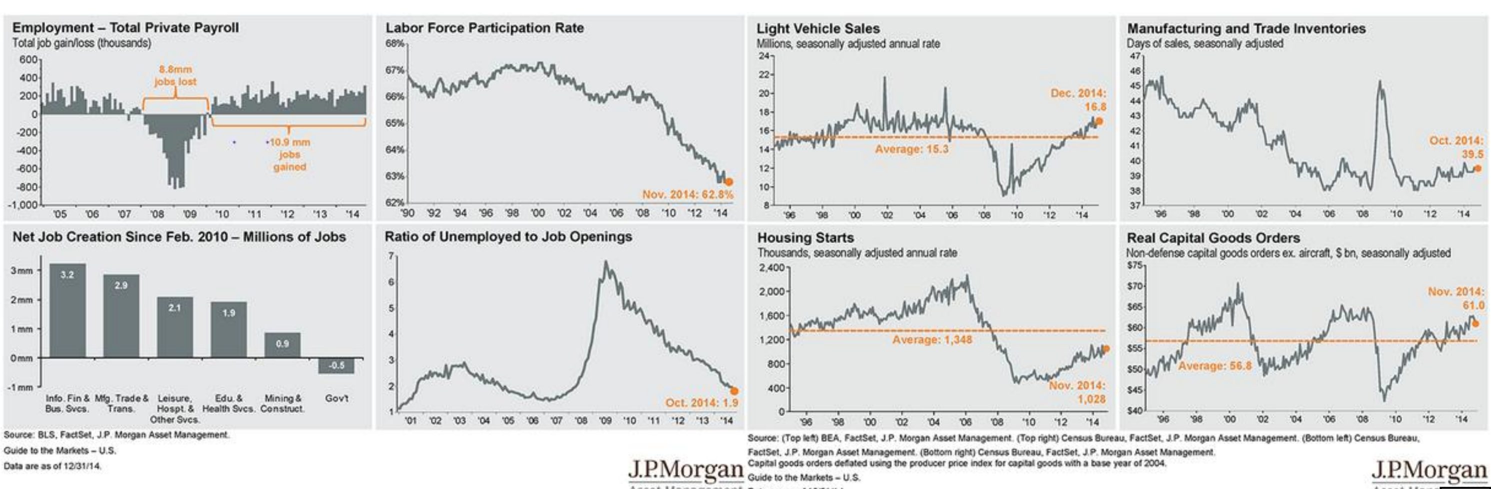
1. **Global growth & deflation worries**
2. **Economic uncertainty rises with the collapse in oil prices and instability in currency markets**
3. **Maturation of U.S. Economic & Stock Market Cycles**

ECONOMIC OVERVIEW

- During the past 3 quarters, the U.S. economy grew at its fastest pace in ten years averaging above 4%.
- Europe & Japan still struggling but attempting to stimulate economies through QE and currency devaluation.
- Fed expected to begin raising Fed Funds rate in 2015 but global economic weakness and deflation concerns may delay timing.

Economic Review & Outlook

U.S. economic activity in the last three quarters of 2014 expanded at its fastest pace in a decade. Fourth quarter GDP is expected to show nearly 3% growth, bringing 2014 growth to 2.4% and averaging above 4% since the end of March 2014. Bearing in mind that part of this impressive surge in activity was related to a rebound from the weather-related contraction experienced in the first quarter of 2014, it is still important to acknowledge that each segment of the U.S. economy displayed improvements and advanced to post-financial crisis highs. Housing, autos, manufacturing, capital goods and labor markets all continued to grow as the economic cycle has progressed.



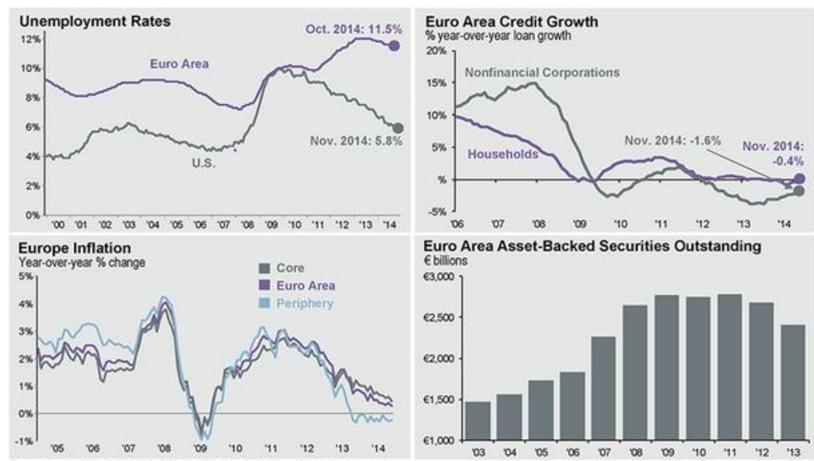
With consensus forecasts calling for upwards of 3% real GDP growth for the U.S. in 2015, the Federal Reserve Bank has been expected to begin raising short-term interest rates by mid-year. Lower energy prices, a stronger dollar and weak global growth - all deflationary influences - have the potential to alter those plans.

ECONOMIC IMPLICATIONS

- Consensus 2015 U.S. GDP growth expected +/- 3%.

- Can the U.S. economy pull the rest of the world up or will the U.S. succumb to slow global growth and deflation?

After enduring another recession in 2012-2013, Europe struggled to generate any economic growth at all in 2014 with GDP likely expanding at merely 0.8%, unemployment barely mproving from a post-financial crisis high of nearly 12% and the continent flirting with deflation. To combat this chronic economic malaise, the European Central Bank (ECB) is expected to announce an economic stimulus program similar to the quantitative easing (QE) bond-buying programs enacted in the U.S., UK and Japan in the aftermath of the financial crisis. Likely as a result of the probable ECB QE announcement, the Swiss central bank suddenly lifted the three-year cap on the value of the Swiss franc, accompanied by a policy of implementing negative deposit rates to discourage demand for francs. With the ECB's monetary actions expected to further weaken the euro, the central bank of Switzerland determined that it no longer made sense to maintain the increasingly costly strategy of buying more and more euros and selling francs to maintain the cap that had been established during the financial crisis.



Source: Eurostat, BLS, SIFMA, ECBC, FactSet, IMF, J.P. Morgan Asset Management.
(Top left) Unemployment rate levels for the U.S. and Euro Area are not directly comparable due to calculation differences. (Bottom right) Euro Area securitization outstanding includes Covered Bonds, Asset-Backed Securities, Residential Mortgage-Backed Securities, Commercial Real Estate Mortgage-Backed Securities, and Small and Medium-Sized Enterprise Asset-Backed Securities.
Guide to the Markets – U.S.
Data are as of 12/31/14.

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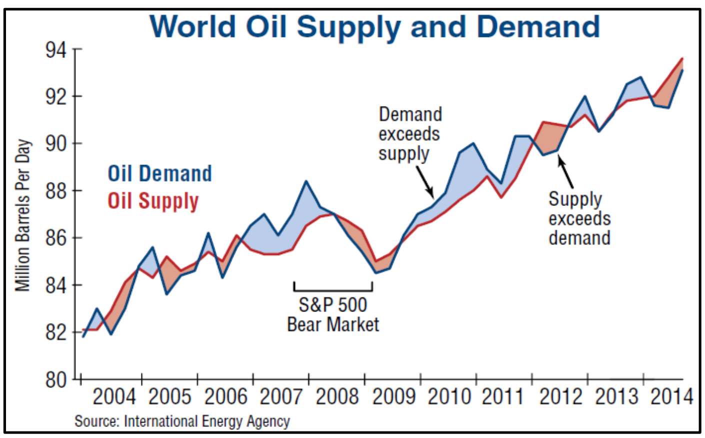
Almost immediately after the announcement, the Swiss franc jumped by 20% relative to the euro. With exports representing 72% of Swiss GDP, Swiss companies suddenly find themselves less competitive, increasing the likelihood that the Swiss economy will slip into recession in 2015. Another risk is that Swiss franc - denominated debt held by non-Swiss entities is now much more expensive to service and pay off. This has the potential of causing a debt-crisis in Eastern Europe and Russia.

Japan's economy dipped into recession during 2014, likely as a result of an increase in Japan's consumption tax in the second quarter. Japan's central bank responded by increasing its asset-buying program and extending purchases to include Japanese stocks as well as bonds. The government also cancelled plans for a second increase in the consumption tax. Forecasts now call for a rebound in the Japanese economy in the 4th quarter of 2014 and into 2015.

Economic growth within China continued to slow in 2014 to a still rapid 7.4%. Nonetheless, this decelerating growth has been enough to reverse the decade-long bull market in commodities and cause hardship for many of the commodity-producing countries that benefitted from China's rapid growth during the early part of this century. Forecasts call for China's GDP growth to continue to slow in the next several years. While there is cautious hope that a relatively smooth transition can be managed from an export-driven economy to one that is more balanced between exports and consumption, we will be watching and considering the consequences either way.

Causes of and Implications of the Collapse in Oil Prices

Rising oil production since 2009, especially in the U.S. due to the shale oil boom, combined with weak global economic growth and energy consumption set the stage for the recent decline in oil prices. Despite the current negative imbalance between oil supply and consumption this is not a historically unique situation. The graph at right indicates that supply has frequently exceeded demand for relatively short periods in the past. Usually market forces, along with OPEC production cuts, have quickly eliminated the oversupply. The concern this time is that rising production in the U.S. and reluctance by the Saudis to cut supply will prolong or even widen the current imbalance. It is possible that these worries are exaggerated and that market dynamics or a change in the stance of Saudi Arabia or other oil-producing countries to cut supply may develop sooner given current low prices. In the U.S., the impulse to cut production may not be as immediate, as big independent companies have suggested that shale wells already in production only require oil prices in the $10-$20 per barrel range to operate profitably. However, although exploration costs are declining, most U.S. shale producers need $60-$70 oil per barrel to break even on new projects. Consequently, current



OIL PRICE OVERVIEW

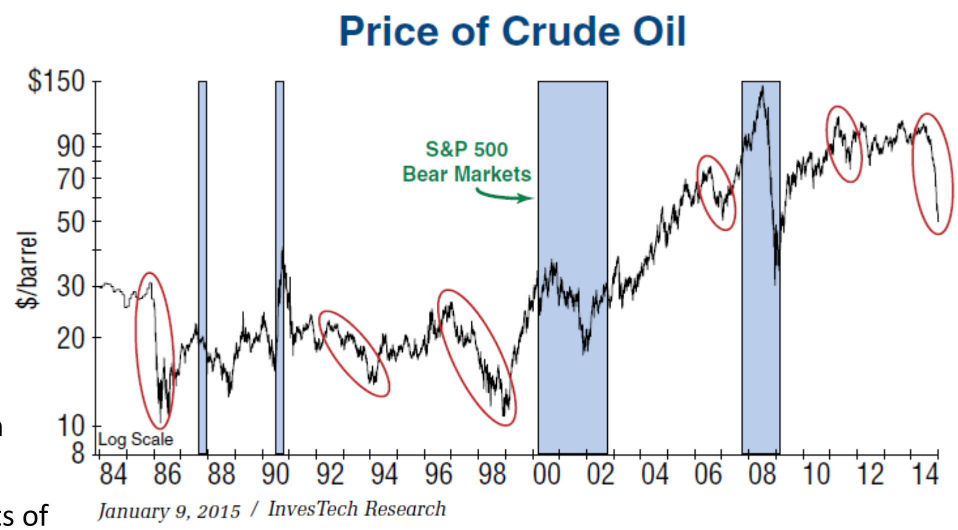
- Rising oil production and weak global energy demand led to recent collapse in oil prices.
- Saudis' refusal to cut production an attempt to drive financially weak producers out of the market.
- Consumers and energy-intensive companies are huge beneficiaries of lower energy costs.
- Energy-producing companies are hurt along with certain oil rich states.

OIL COLLAPSE IMPLICATIONS

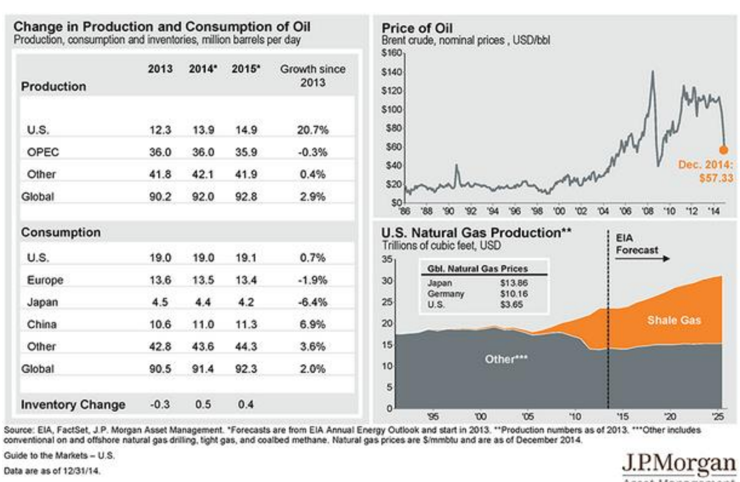
- Oil price decline could add 1/2% - 1% to U.S. GDP growth in 2015.
- U.S. shale oil wells currently in production will remain but future expansion will be curbed until oversupply of oil is resolved.
- Rising risks of highly leveraged oil companies and energy-producing nations defaulting on their debt or certain hedge funds blowing up.

production is unlikely to be curbed, but expansion will be curtailed until the supply/demand imbalance is resolved. Many analysts expect energy prices to remain weak in the near-term, but begin rising by the second half of 2015.

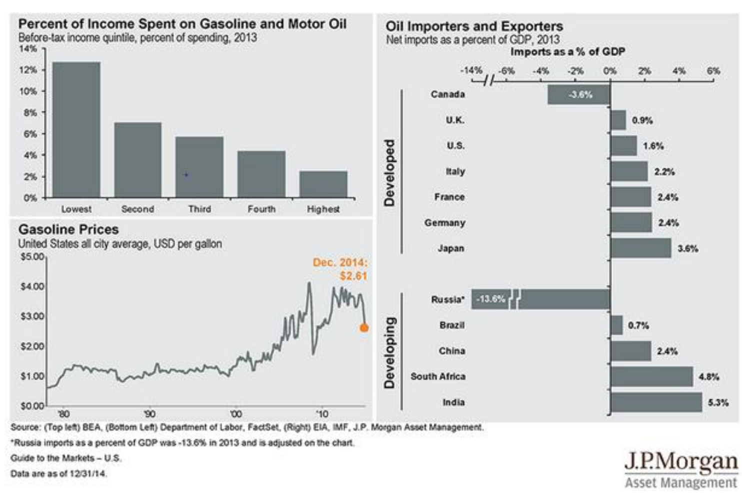
The rapid plunge in crude oil prices since last July from $107 per barrel to under $50 currently has widespread repercussions for the economy and financial markets. On the plus side, falling energy prices are usually stimulative for the economy as the benefits of low cost oil outweigh the negatives. Cheaper gasoline and home heating costs increase consumer disposable income which typically boosts both confidence and discretionary spending. Estimates suggest the average family will save approximately $1,150 on energy costs over the course of the year. Businesses will also save on fuel costs, especially transportation companies and firms that maintain fleets of vehicles. Also, lower oil prices mean cheaper feedstocks for refining, chemical and fertilizer businesses.



Among the negatives, U.S. energy companies' profit forecasts and capital spending plans have been slashed, affecting about 8.5% of S&P 500 capitalization-weighted earnings estimates. Reduced oil and gas exploration will eliminate jobs in that industry and certain oil-producing state government revenues will be hurt. Also, many smaller U.S. oil exploration companies are highly leveraged and account for nearly 16% of the $1.3 trillion junk bond market. Potential defaults among these bonds could negatively affect the high-yield bond market.


Change in Production and Consumption of Oil
Production, consumption and inventories, million barrels per day

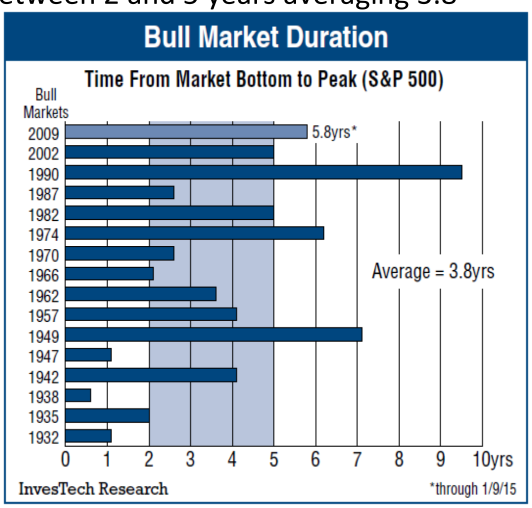
Production	2013	2014*	2015*	Growth since 2013
U.S.	12.3	13.9	14.9	20.7%
OPEC	36.0	36.0	35.9	-0.3%
Other	41.8	42.1	41.9	0.4%
Global	90.2	92.0	92.8	2.9%
Consumption				
U.S.	19.0	19.0	19.1	0.7%
Europe	13.6	13.5	13.4	-1.9%
Japan	4.5	4.4	4.2	-6.4%
China	10.6	11.0	11.3	6.9%
Other	42.8	43.6	44.3	3.6%
Global	90.5	91.4	92.3	2.0%
Inventory Change	-0.3	0.5	0.4	



With consumer spending contributing 68% of GDP in the U.S. and oil and gas production less than 2% of GDP, the benefits of lower oil prices on the economy should more than offset the negative impacts on the energy sector. The implications of lower energy prices for financial markets, at least in the short-term, are more ambiguous. What will happen should an oil-producing country default on its debt or create geopolitical tensions in an attempt to trigger a rise in oil prices, instead of cutting supply? And what will be the impact of fewer petrodollars available to invest in U.S. as well as global stocks and bonds?

State of U.S. Economic and Stock Market Cycle

The current U.S. economic expansion as well as the bull market in stocks has lasted well beyond historical averages. As shown in the following tables, most bull markets last between 2 and 5 years averaging 3.8 years, and most economic expansions average between 26 and 58 months in length, depending on the period examined. The current bull market has run nearly six years and the economic expansion which began in June 2009 is already 67 months long. However, the duration of the economic and market cycles is almost never predictive of their ends. Typically, imbalances in either the economy or financial markets cause the Federal Reserve to change monetary policy in a way that eventually triggers an economic recession and/or bear market in stocks.



Business Cycle Reference Dates	Economic Expansion Duration In Months
Average, All Cycles:	
1854 - 2009 (33 cycles)	38.7
1854 - 1919 (16 cycles)	26.6
1919 - 1945 (6 cycles)	35.0
1945 - 2009 (11 cycles)	58.4
NBER	

ECONOMIC/MARKET CYCLE OVERVIEW

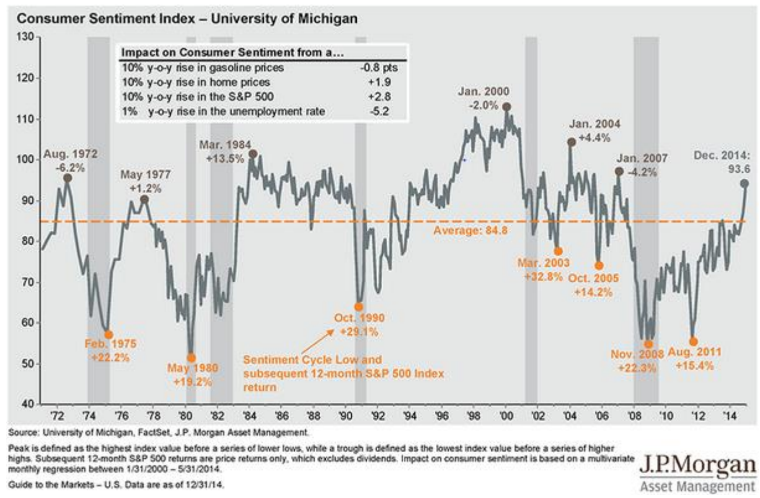
- U.S. Economic expansion and bull market now extends well beyond average durations.
- Slow but steady economic growth coupled with monetary stimulus from central banks have contributed to the unusually long expansions.
- Optimism remains for continued economic growth and stock market appreciation, but warning signs are starting to emerge.

ECONOMIC/MARKET CYCLE IMPLICATIONS

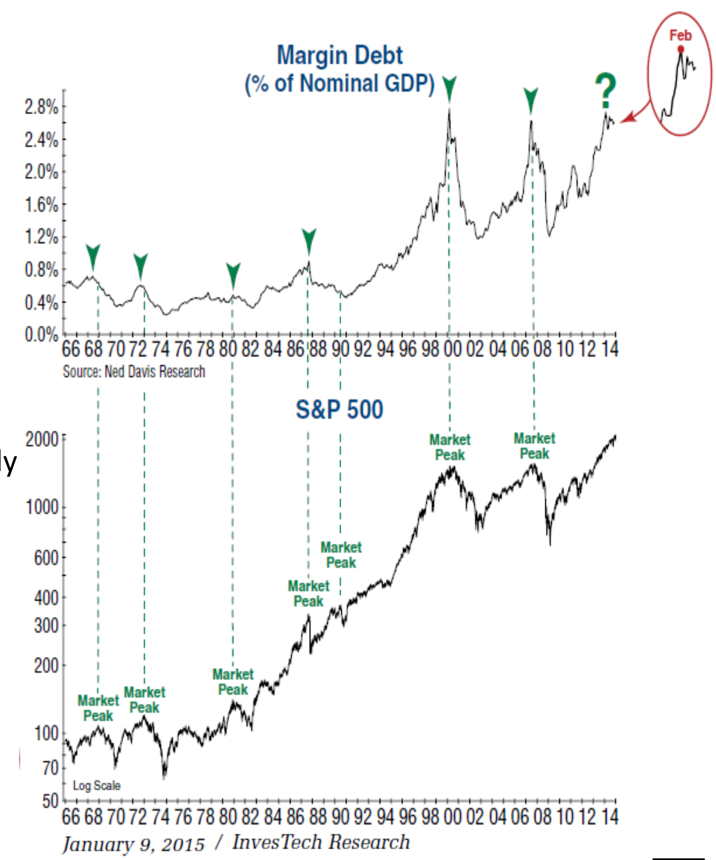
- High levels of margin debt and recent weakness in the Advance-Decline Line are "red flags" that bear watching.
- The last leg of a bull market can produce out-sized gains.

A number of factors have contributed to the unusually long economic expansion and bull market run. Uncertainty over tax rates and regulatory changes during much of the expansion caused businesses to be cautious in hiring new workers and consumers to deleverage and restrain spending. As a result, the average annual GDP growth during the initial three years of the economic recovery at 2.2% was less than half the average GDP growth of previous recoveries and the weakest of the post-World War II economic recoveries. In

addition, persistent global recessionary forces and high sovereign debt levels in developed markets along with slowing growth in China have caused commodity prices to decline, creating deflationary risks as opposed to inflation. Rising U.S. energy production coupled with OPEC's decision to maintain production levels have caused oil prices to tumble providing new economic stimulus via rising consumer confidence and spending.

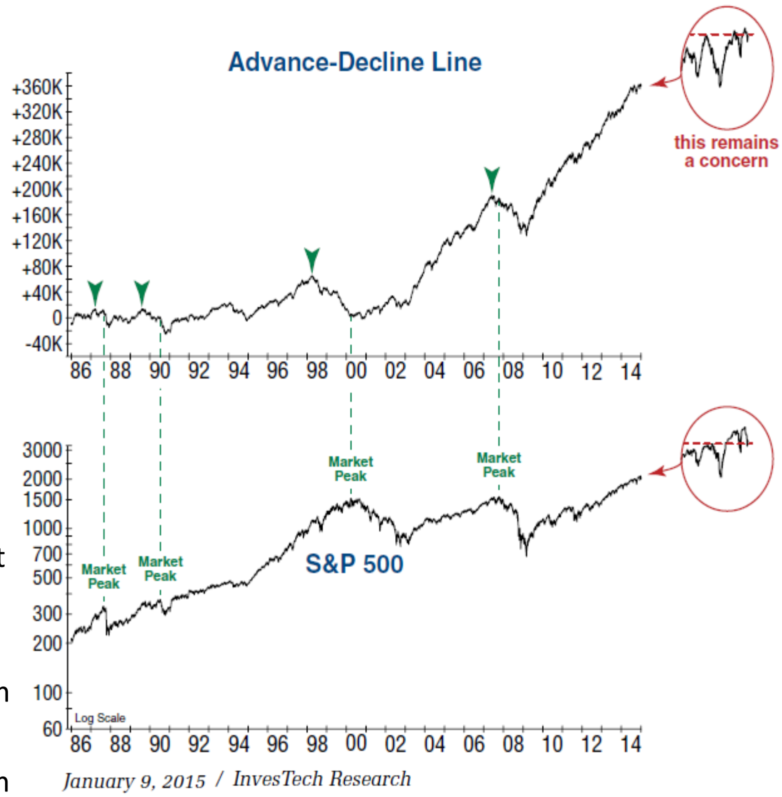


The U.S. dollar has also strengthened along with the fall in oil and commodity prices, which are generally priced in dollars. As economic troubles in Europe, Japan and a number of emerging economies have become more apparent, the U.S. dollar has also been bolstered by a flight to safety as well as investors seeking higher interest rates and a stronger currency. Consequently, with a strong dollar, falling energy prices, rising consumer confidence, accelerating GDP growth and solid manufacturing and service sector activity, economists and market strategists share almost uniformly positive expectations for the U.S. economy in 2015. In fact, lower energy prices alone are expected to add between one-half and one full percentage point to real GDP in 2015.



At this point in time, we remain optimistic concerning U.S. economic growth and are positive, though with some reservations, regarding the U.S. stock market in the year ahead. Price instability in oil, commodities and currencies raises the risk that some economic or financial dislocation may occur somewhere in the world which could distort the rosy economic and market scenario investors are anticipating. In addition, the nearly universal bullishness among economists and strategists should serve as a "red flag" for us to monitor sentiment and valuation data carefully to detect signs of complacency by investors. We are monitoring several technical indicators that have been useful in providing advance warnings of market tops in previous cycles. Margin debt (the dollar value of money borrowed to buy stocks on margin) can provide some reference to the amount of excesses present within the market. In addition, it signifies the value that will likely be sold swiftly if stock market losses start to climb. The chart to the right reveals

how past peaks in margin debt as a percentage of GDP have coincided with or preceded stock market peaks. Margin debt peaked almost a year ago after rising rapidly over the previous few years, thus creating another “red flag.” Any sharp decline from current levels would markedly increase the risk of a big stock market correction.

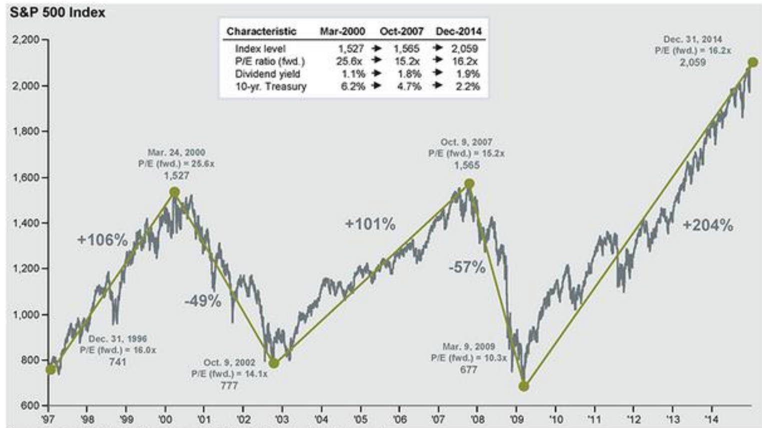


Another technical indicator that bears watching is the recent weakening of the Advance-Decline Line (A-D), an indicator of market participation measured by the ratio of advancing to declining stocks. The Advance-Decline Line, as can be seen on the chart to the right often peaks in advance of the cycle top in stock prices. If the recent divergence between the A-D Line and stock index price performances continues during 2015, a bull market top will become increasingly likely.

Although such warning signs are present, we note that some of the best gains of any market cycle can occur during the final leg of the bull market. On a positive vane, valuation levels are only slightly above long-term averages and there are no obvious market excesses beyond those we’ve discussed. In addition, short-term interest rates are near zero and we believe there is no other place to invest that offers better opportunity than stocks at the present time.

Investment Strategy

We enjoy communicating our economic and market views with you and hope you find our observations useful. When considering investment strategy, we focus first and foremost on your individual needs and objectives. Only after understanding your unique requirements do we tailor a portfolio to meet your objectives for income, capital preservation, asset growth and liquidity, all within the context of your tolerance for risk. This necessitates identifying the right mix of U.S. and foreign stocks, high-grade and high-yield bonds, alternative high yield instruments such as REITs and master-limited-partnerships (MLPS) and, at times, commodities or options. We appreciate our relationship and value your trust as we advise and help manage your financial affairs. Please accept our best wishes for a healthy, happy and prosperous 2015!



Source: Standard & Poor's, First Call, Compustat, FactSet, J.P. Morgan Asset Management.

Dividend yield is calculated as the annualized dividend rate divided by price, as provided by Compustat. Forward Price to Earnings Ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.

Guide to the Markets – U.S. Data are as of 12/31/14.

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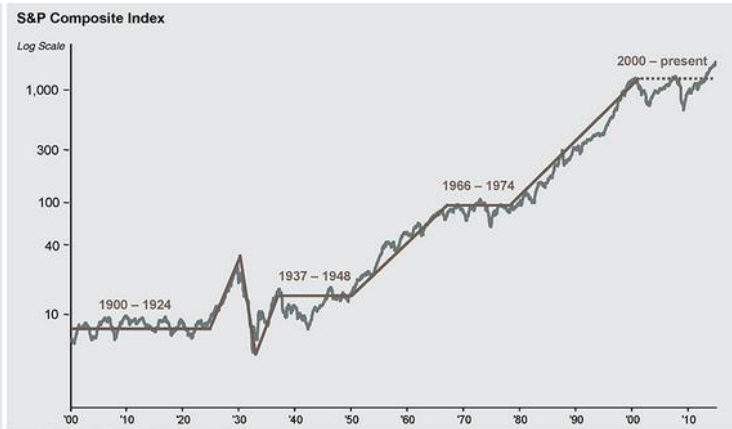

Source: Robert Shiller, FactSet, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns.
Past performance is not indicative of future returns. Chart is for illustrative purposes only.

Guide to the Markets – U.S.

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U.S. Equity: Valuation Measures

Valuation Measure	Description	Latest	Historical Averages: 1-year ago	5-year avg.	10-year avg.	25-year avg.*
P/E	Price to Earnings	16.2x	15.4x	13.5x	13.8x	15.6x
CAPE	Shiller's P/E	27.3	25.5	22.5	22.9	25.3
Div. Yield	Dividend Yield	1.9%	1.9%	2.0%	2.0%	2.1%
REY	Real Earnings Yield	3.7%	3.7%	4.3%	3.3%	2.3%
P/B	Price to Book	2.9	2.7	2.3	2.4	2.9
P/CF	Price to Cash Flow	11.4	10.8	9.3	9.7	11.3
EY Spread	EY Minus Baa Yield	1.5%	1.6%	2.2%	1.3%	-0.7%

Source: Standard & Poor's, FactSet, Robert Shiller Data, FRB, J.P. Morgan Asset Management. Price to Earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months. Shiller's P/E uses trailing 10-years of inflation adjusted earnings as reported by companies. Dividend Yield is calculated as the trailing 12-month average dividend divided by price. Real Earnings Yield is defined as (trailing four quarters of reported earnings/price) - year over year core CPI inflation. Price to Book Ratio is the price divided by book value per share. Price to Cash Flow is price divided by NTM cash flow. EY Minus Baa Yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. *P/CF is a 20-year avg. due to cash flow data availability.
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