Covenant Asset Management, LLC

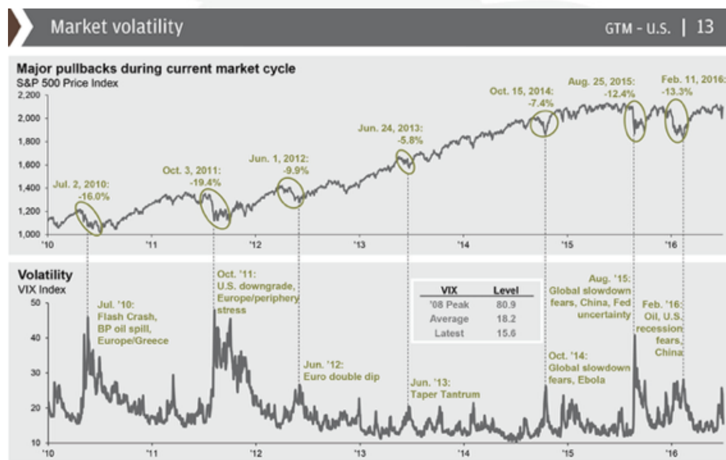
Third Quarter 2016 Investment Perspectives

John Guarino, President | www.covasset.com
125 Maple Avenue Chester, NJ 07930 | (908) 879-4090

Financial Markets Review And Outlook

Covenant Asset Management is pleased to offer our latest investment perspectives. In this publication we review first half results and highlight key economic, financial and political themes which we expect will drive markets and

Financial markets experienced a roller coaster first half of 2016. The year started with the worst six-week loss for any year in the recorded history of Wall Street. Fears of an accelerating economic slowdown in China and tumbling oil prices, coupled with the potential for a monetary policy mistake by the U.S. Federal Reserve Bank, ignited the selling. Additionally, nasty political debates, combined with much anti-business political rhetoric, fueled the correction. But, by the middle of February, moderating monetary policy comments by Fed officials, signs of stabilization in China's economic data and rising oil prices calmed investor sentiment and markets began to rebound. By mid-March, the DJIA and S&P 500 had fully recovered their early year losses, although Nasdaq and other growth-oriented benchmarks continued to lag.



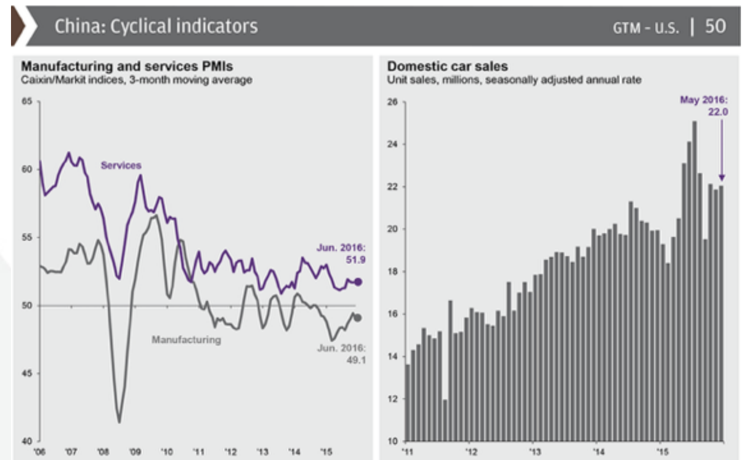
Markets went through another brief scare in mid-June, surrounding the United Kingdom's referendum on whether to remain in the European Union (EU) or exit, commonly known as Brexit. After UK voters surprised global investors by voting to leave the EU, markets around the world

KEY THEMES

1. Financial markets recover from worst start in history and from Brexit
2. Direction of monetary policy reverses 180 degrees in one month
3. U.S. national elections take center stage in the third quarter

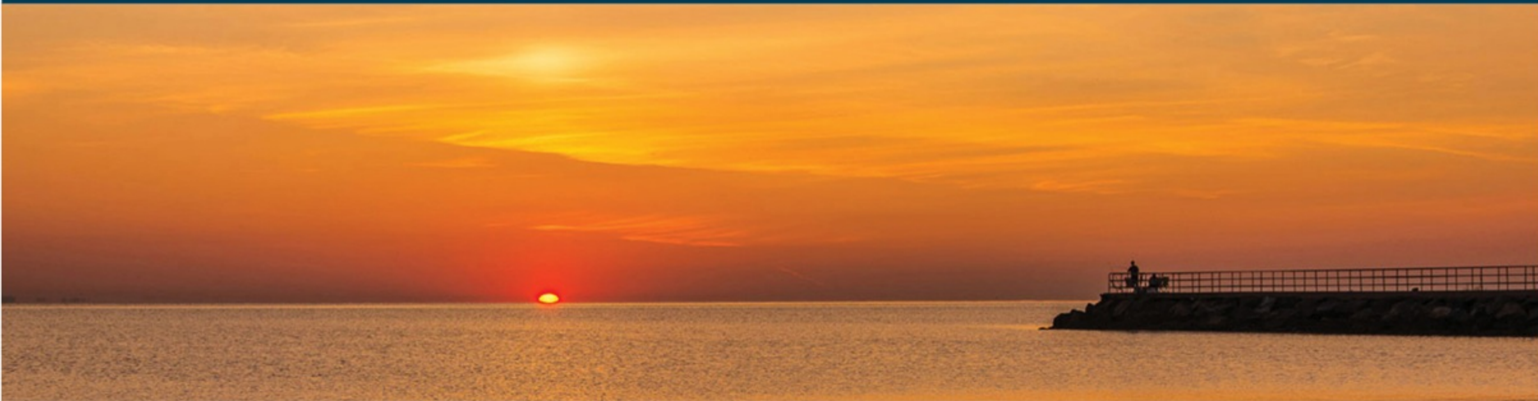
tumbled for a few days before most of the loss was recovered in little more than a week.

After the Fed raised the fed funds rate by one-quarter of one-percent last December, official Fed policy called for four more 1/4 point rate hikes in 2016. In hindsight, this prediction was another in a long string of overly optimistic expectations by the Federal Reserve concerning U.S. economic growth. In fact, the Fed has over-estimated the rate of economic growth in the U.S. every year since the economic recovery began in 2009. Headwinds created by



lower oil prices and a stronger U.S. dollar caused U.S. GDP growth to average 1.3% for the last two reported quarters. In the second quarter of 2016, expectations have been consistently lowered to approximately 2%. It was just a month ago that there were wide-spread expectations that

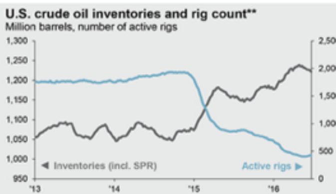
Economic and Financial Market Challenges



Oil markets GTM - U.S. | 30

Change in production and consumption of oil
Production, consumption and inventories, millions of barrels per day

	2013	2014	2015	2016*	2017*	Growth since 2013
Production						
U.S.	12.4	14.1	15.0	14.5	14.4	16.3%
OPEC	37.3	37.2	38.1	39.2	40.2	7.7%
Global	**91.0**	**93.3**	**95.7**	**96.2**	**97.0**	**6.7%**
Consumption						
U.S.	19.0	19.1	19.4	19.6	19.7	3.8%
China	10.5	10.9	11.3	11.7	12.1	15.3%
Global	**91.4**	**92.4**	**93.8**	**95.3**	**96.7**	**5.9%**
Inventory Change	-0.4	0.9	1.9	1.0	0.3	

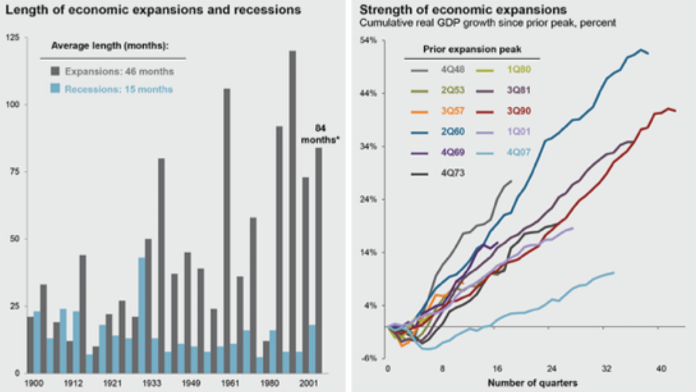


Source: J.P. Morgan Asset Management; (Top and bottom left) EIA; (Right) FactSet; (Bottom left) Baker Hughes.
*Forecasts are from the June 2016 EIA Short-Term Energy Outlook and start in 2016.
**U.S. crude oil inventories include the Strategic Petroleum Reserve (SPR). Active rig count includes both natural gas and oil rigs.
Brent crude prices are monthly averages in USD using global spot ICE prices.
Guide to the Markets – U.S. Data are as of June 30, 2016.

J.P.Morgan
Asset Management

the Fed would initiate another rate hike at some point during the summer - June, July or September at the latest. After the Brexit vote and the subsequent implications for slower european and global growth and potential financial distress, expectations of higher interest rates have now been shattered. As a point of

The length and strength of expansions GTM - U.S. | 17

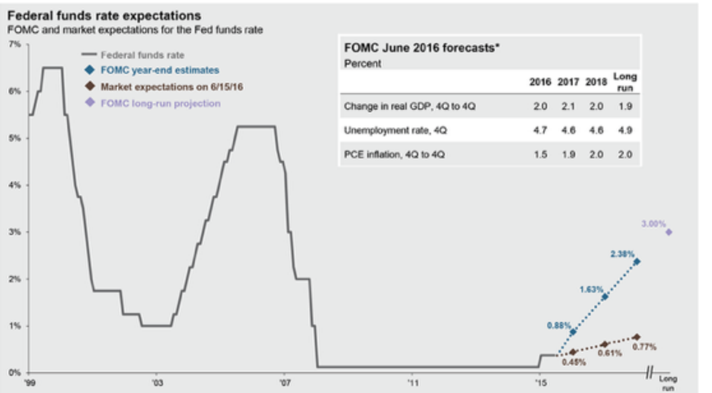


Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through June 2016, lasting 84 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through June 2016.
Guide to the Markets – U.S. Data are as of June 30, 2016.

J.P.Morgan
Asset Management

reference, ten year U.S. Treasury Notes plummeted to 1.38%, and 30-year bonds traded at 2.19%, both the lowest yields recorded in U.S. history. As low as those yields are, they stand well above those of other developed market foreign bonds. UK 10-year bonds

The Fed and interest rates GTM - U.S. | 33



FOMC June 2016 forecasts*
Percent

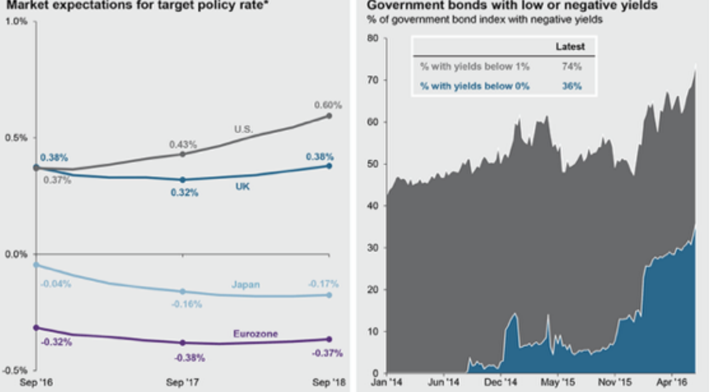
	2016	2017	2018	Long run
Change in real GDP, 4Q to 4Q	2.0	2.1	2.0	1.9
Unemployment rate, 4Q	4.7	4.6	4.6	4.9
PCE inflation, 4Q to 4Q	1.5	1.9	2.0	2.0

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the June 2016 FOMC meeting. *Forecasts of 17 Federal Open Market Committee (FOMC) participants, midpoints of central tendency except for federal funds rate, which is a median estimate.
Guide to the Markets – U.S. Data are as of June 30, 2016.

J.P.Morgan
Asset Management

yield .87%, 10-year German bonds trade at minus .12% and comparable Japanese bonds yield minus .25%. In fact, Barron's posted a report by Bianco Research using Bloomberg data that shows $12.7 trillion - 36% of the $35.07 trillion of all sovereign global debt-yielded less

Developed market fixed income dynamics GTM - U.S. | 35



Source: Bloomberg, J.P. Morgan Asset Management; (Right) BofA/Merrill Lynch.
*Target policy rates for Japan are estimated using EuroYen 3m futures contracts less a risk premium of 6bps. Government bond index is the BofAML Global Government Bond Index, which includes investment-grade sovereign debt denominated in the issuer's own domestic currency. The index includes all Euro members, the U.S., Japan, the UK, Canada, Australia, New Zealand, Switzerland, Norway and Sweden.
Guide to the Markets – U.S. Data are as of June 30, 2016.

J.P.Morgan
Asset Management

than zero as of June 30. Another $14.5 trillion or 41%, yields zero to 1%, while $5.67 trillion or 16% of the total outstanding yields 1% to 2%. Just $2.2 trillion, or 6% of total sovereign debt, yields more than 2%. Last week, the Bank of England strongly suggested that rate cuts are

Economic and Financial Market Challenges

likely in the coming weeks. And futures markets now predict the U.S. Federal Reserve is likely to keep rates steady until sometime in 2018, quite a reversal of expectations since Memorial Day.

After a disappointing May payroll report showed an increase of just 38,000 jobs, all eyes will be on the June report due to be reported on July 8. An increase of 190,000 is forecast for June, the same as was expected for the May report. Market volatility is likely to be high surrounding this report, as it may provide an important signal for future U.S. economic trends.

Oil prices have nearly doubled from their January low of $26 per barrel, as U.S. domestic energy companies cut supply and additional supply expected from Iran and other middle eastern countries has been lower than forecast. The behavior of oil prices in coming months will be an important indicator of global growth expectations, especially after fears that the Brexit vote could exert downward pressure on inflation and growth in the UK and European Union.

While we believe the British vote to leave the EU is primarily a political event, the following scenarios could impact economic and financial markets negatively:

1) Other EU countries could call for their own referendums on EU membership. France, Italy, Holland and Spain have all been cited as possibilities to hold EU exit votes. This could make it difficult for the European Central Bank to carry out its quantitative easing program of buying bonds of countries that might decide to exit the EU.

2) The battle to replace UK Prime Minister David Cameron could result in a new leader who might feel compelled to negotiate the terms of Britain's exit from the EU and trade deals with the EU in an aggressive fashion. EU leaders in response could take hardened positions, making it difficult to negotiate trade deals. If rhetoric becomes heated, markets may become concerned about the potential for mutually damaging exit and trade terms.

3) With the wide differential in interest rates between the U.S. and other developed nations, the value of the U.S. dollar has been on the rise. In addition, if investors continue to seek safe havens, U.S. Treasury securities and U.S. dollar-denominated assets would still be considered one of the preferred choices. A further rise in the value of the dollar could contribute to declines in commodity prices, especially oil prices. Some of the implications of a rise in the value of the U.S. dollar could be additional cuts to earnings estimates for multi-national U.S. corporations as export growth slows, the potential for devaluation of the Chinese yuan and renewed fears about an economic hard landing in China. Also, further appreciation in the U.S. dollar could lead to pressure on emerging market equities and dollar-denominated debt. Recent appreciation of the Japanese yen, another safe-haven currency, has side-tracked the economic plan instituted by Prime Minister Abe and been bad for Japanese stocks.

4) Finally, renewed recession concerns in Britain and the eurozone could occur, as fears of a total breakup of the EU could impact business investment, hiring and consumption.

Once again, we do not assign a high probability to the aforementioned issues, but we will be watching carefully to see if political upheaval in Britain and Europe begins to snowball and affect global economic data and investor sentiment. At the present time it is our belief that instead of being a negative for U.S. stocks, Brexit could very well put the Fed on hold for an extended period of time which would reinforce the fact that there really is no alternative to stocks in the current environment. In fact, market breath as measured by the number of stocks advancing versus those declining recently hit the highest level in this market cycle. In addition, the DJIA and S&P 500 are only a few percentage points from reaching all-time high levels set in May 2015. These factors strengthen the case for major U.S. benchmarks to push to new highs in the foreseeable future.

As we enter the third quarter, U.S. national elections scheduled for November 8, 2016, will begin to influence financial markets in a more meaningful manner. Ordinarily, Presidential election years are reasonably benign for the stock market. A number of factors account for this favorable backdrop, including the lack of unfavorable fiscal or monetary policy as no institution wants to be accused of quashing presidential aspirations. In the last 22 presidential election years covering 88 years, the S&P 500 has gained 6.9% on average. In the absence of a bear market, or one on the horizon, during election years, markets tended to gain strength as the

Investment Strategy

year progressed. While the U.S. economy continues to grow at a sluggish pace, it is not in recession nor is one on the horizon in our opinion. However, this is anything but a normal Presidential election year. The Republican and Democratic nominees for President have the highest negative poll numbers in our lifetime and may be even more polarizing than the last two Presidents, both of whom generated strong partisan passions. Investment strategists believe that, if Hillary Clinton is elected President, her economic policy would closely resemble those that have been in place the past eight years, which would likely lead to a continuation of slow economic growth and historically low interest rates.

Should Donald Trump be elected, his proposed changes to economic and trade policies initially might cause financial market jitters. With the right policy advisors and a willingness to compromise with a Republican-controlled Congress on tax and trade policy, a Trump Administration has the potential to produce a faster growing economy, which would ultimately prove beneficial to corporate earnings and stock prices. It is widely believed that whichever party wins the presidency will control the Senate, while Republicans are likely to retain control of the House, albeit by a narrower margin than presently. Markets are likely to begin forecasting the election outcome in the coming months, as undecided voters begin to make up their minds and polling becomes somewhat more reliable. However, it is important to remember that recent political polls both in this country as well as in others have sometimes proven unreliable as seen in the recent Brexit vote. Polling methods have failed to keep pace with technology as many voters have gotten rid of their landlines and don't answer calls they don't recognize on their caller ID. And online polls have inherent weaknesses with their inability to accurately discern respondents who vote more than once. If the polls are tight heading into election day, it will be anyone's guess as to the outcome of the Presidency and composition of Congress. This scenario would likely lead to a fair amount of financial market volatility in the weeks before the election.

For those clients who have noted their equity investment portfolio results lagging behind market indexes this year, we feel compelled to reiterate comments we made in our previous quarterly Investment Perspectives. The following link to our website details our growth style equity selection process: http://www.covasset.com/philosophy/equity-growth.

This process has served our clients very well over many years with Covenant's Equity Growth Model annual returns meeting or exceeding the S&P 500 Index price performance in six of the past eight years and cumulative returns nearly doubling that of the S&P 500 during that period.* Unfortunately, our style has been out of favor thus far this year and our year-to-date results have significantly lagged the S&P 500. While it is uncomfortable to go through a period of under-performance, we know that in the short-term, equity styles move in and out of favor on a regular basis. From experience, it is vital that we do not panic or attempt to change our style or philosophy. Rather we need to stay disciplined in our approach and redouble our efforts to differentiate those companies which have suffered declines just because they are out of favor with in the eyes of investors from those where their fundamentals have negatively changed. The nature of markets makes it nearly impossible to achieve market-exceeding results over every time-frame, but we are confident that the approach we have utilized in the past with a proven level of success will continue to produce strong results over the longer term.

For those clients requiring a greater degree of current income from the equity portion of their portfolio, we have modified our Equity Income Model and recharacterized it as the Covenant Dividend Appreciation Model. The stocks within this model currently yield approximately 50% more than the S&P 500, have a consistent history of raising their dividend rate each year, have historic and projected earnings growth rates above the S&P 500 average and only pay out 54% of their earnings in the form of dividends. This last factor allows the company to reinvest 46% of earnings in pursuit of future growth. While this strategy is currently in favor and has soundly outperformed our growth model as well as the S&P 500 this year, it is important to note that an equity portfolio comprised of these portfolio characteristics would have underperformed market averages the previous six years. Unfortunately, it is nearly impossible to predict when styles will come in and out of favor. That is why it is so important to work with your Covenant investment advisor to determine the best approach and level of diversification for your investment objectives.

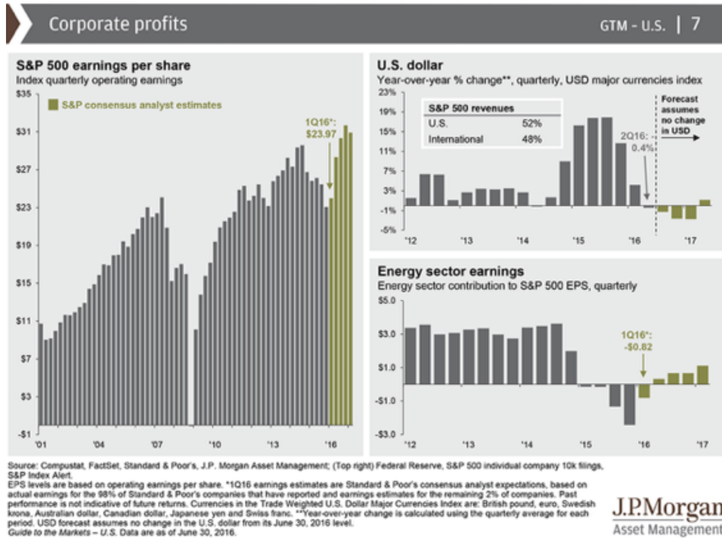
We always appreciate your comments, questions and feedback and wish all of our clients and friends a very safe and enjoyable summer.

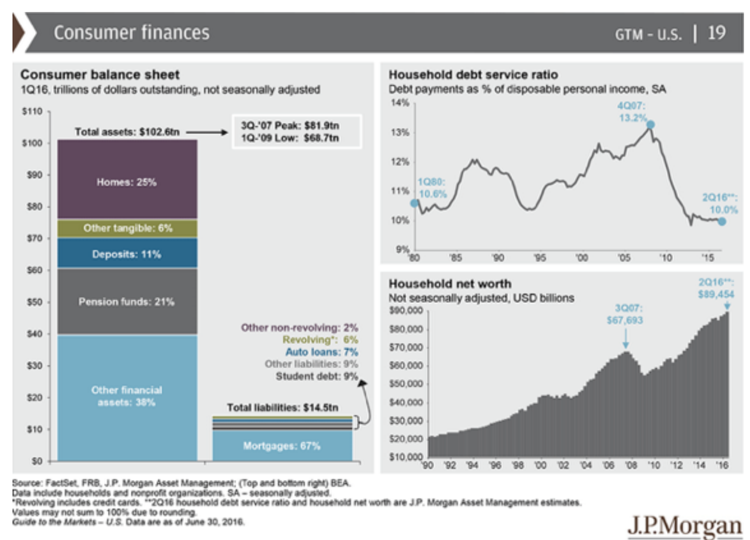
*Performance data listed above represents un-audited results compiled by Covenant Asset Management. It is intended to reflect results that are indicative of Covenant's individual client's equity performance who religiously invest according to our model portfolio. This performance data represents past performance and individual client results may vary materially. Past performance does not guarantee future results and current performance may be higher or lower than the performance data quoted.

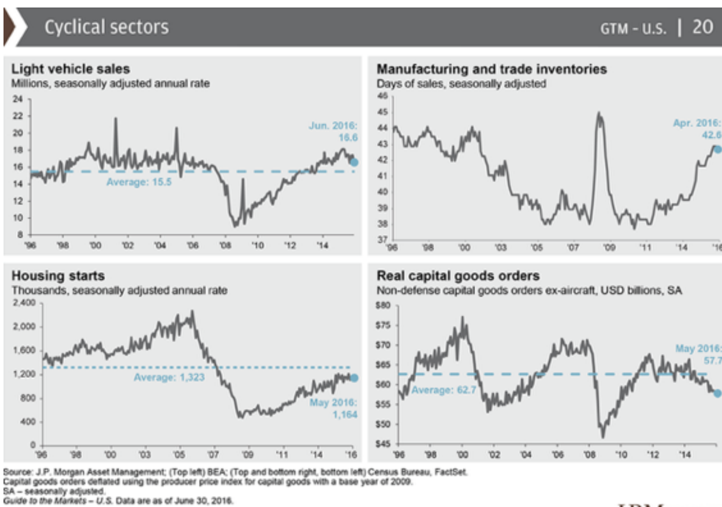
Economic Outlook

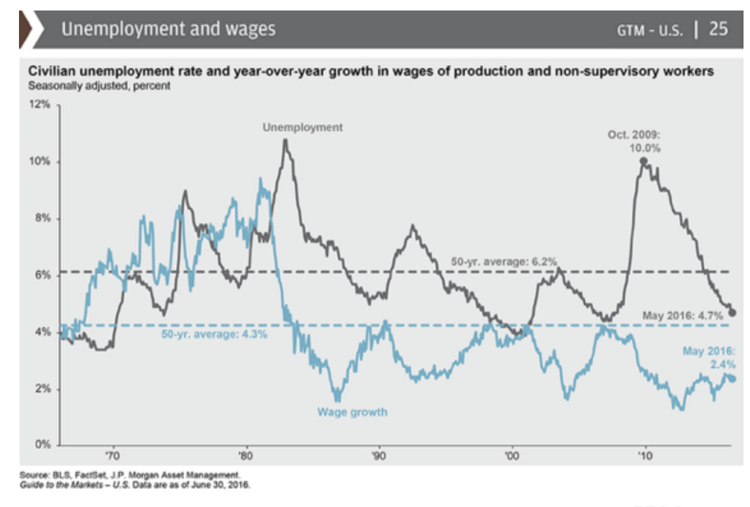
Rather than write extensively about equity valuations, economic statistics and investing principles, we offer the following charts organized by topic and courtesy of J.P. Morgan Asset Management:

Economy:

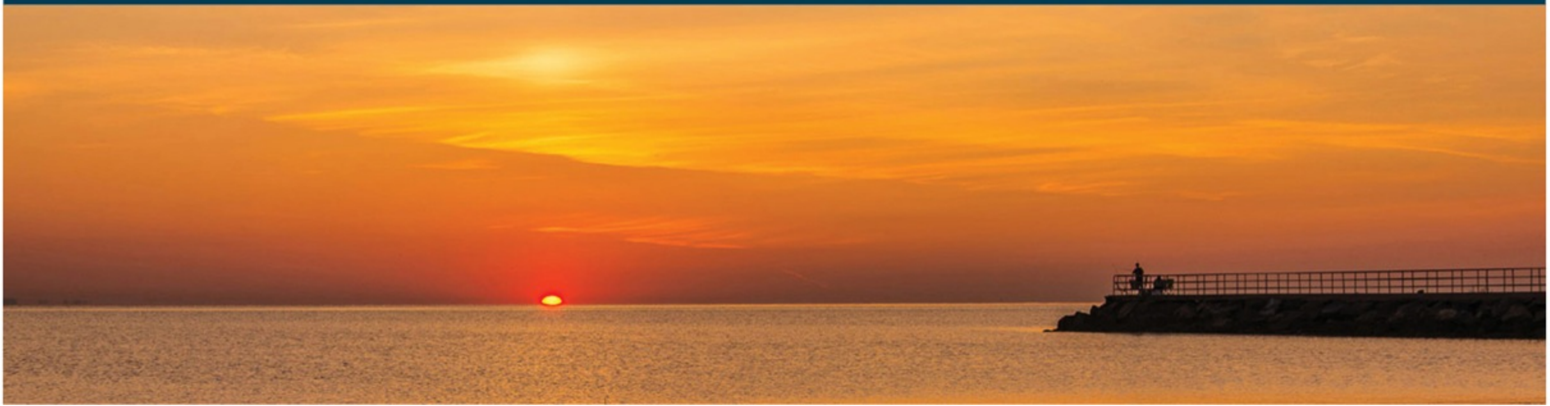




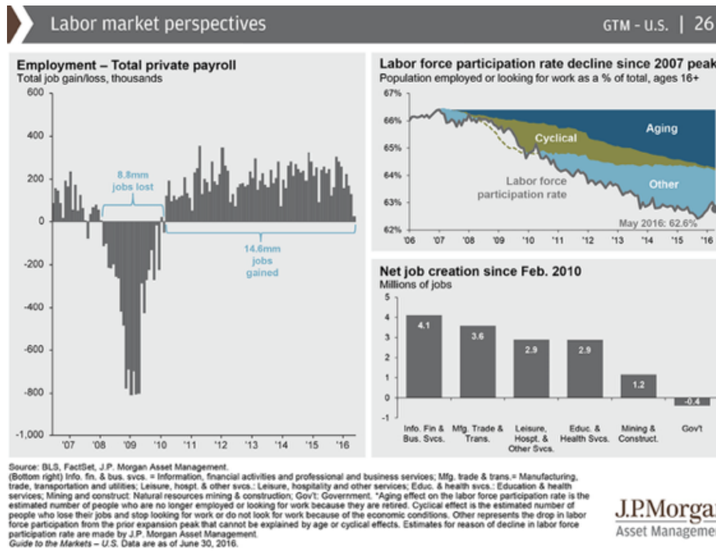




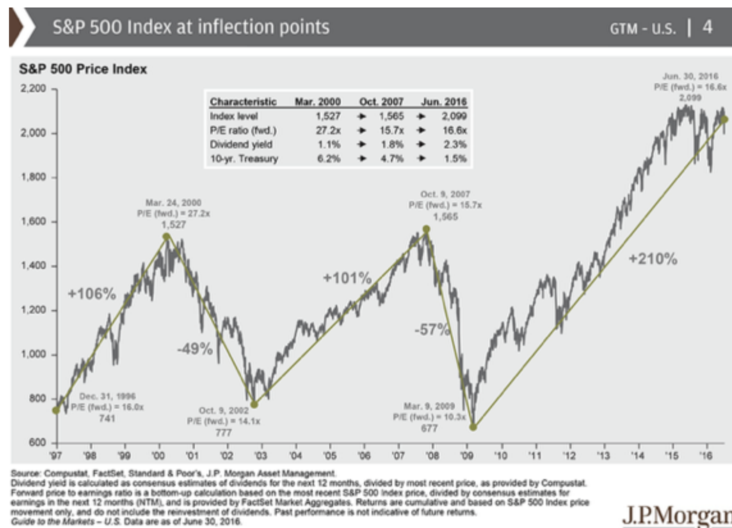
Economic Outlook

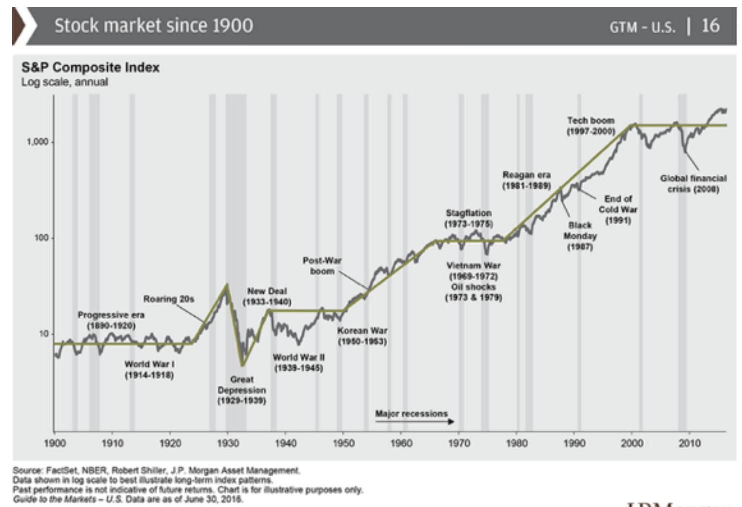


Economy:



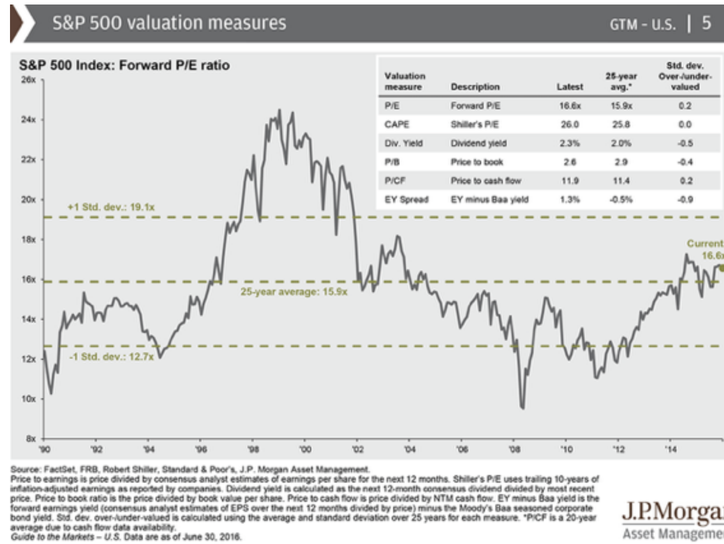
Equities:





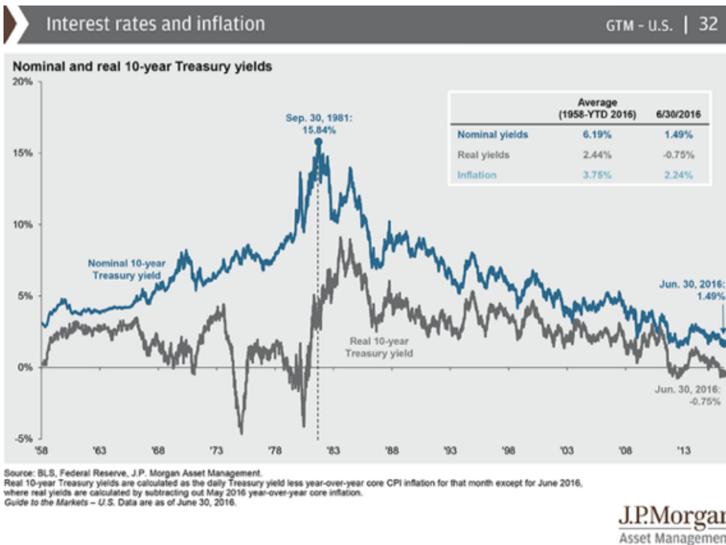
Financial Market Outlook

Equities:

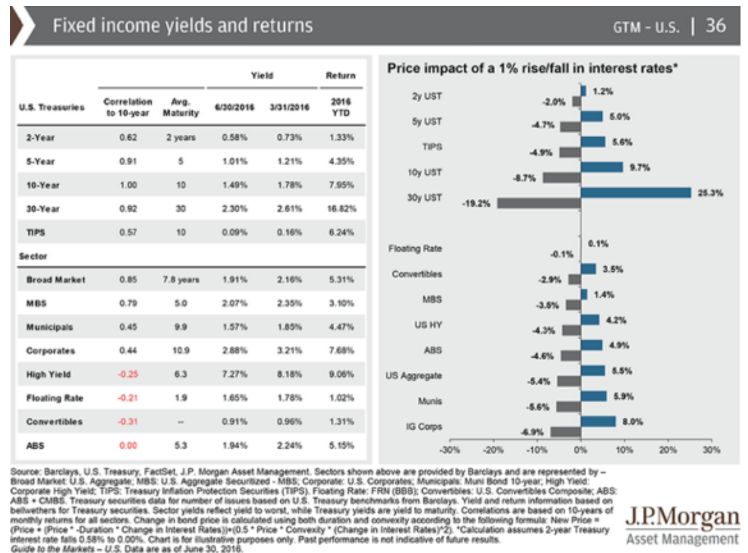


Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	16.6x	15.9x	0.2
CAPE	Shiller's P/E	26.0	25.8	0.0
Div. Yield	Dividend yield	2.3%	2.0%	-0.5
P/B	Price to book	2.6	2.9	-0.4
P/CF	Price to cash flow	11.9	11.4	0.2
EY Spread	EY minus Baa yield	1.3%	-0.5%	-0.9

Fixed Income & Interest Rates:



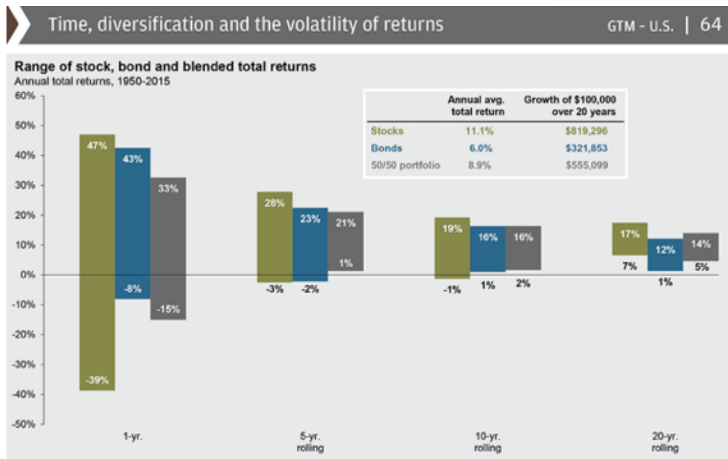
	Average (1958-YTD 2016)	6/30/2016
Nominal yields	6.19%	1.49%
Real yields	2.44%	-0.75%
Inflation	3.75%	2.24%

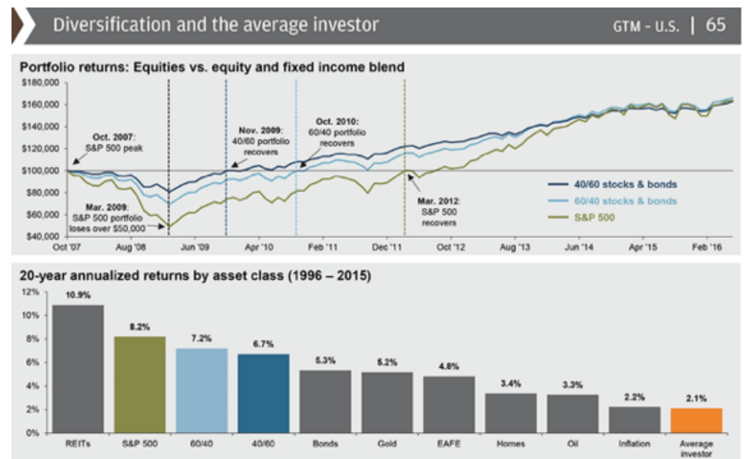


U.S. Treasuries	Correlation to 10-year	Avg. Maturity	Yield 6/30/2016	Yield 3/31/2016	Return 2016 YTD
2-Year	0.62	2 years	0.58%	0.73%	1.33%
5-Year	0.91	5	1.01%	1.21%	4.35%
10-Year	1.00	10	1.49%	1.78%	7.95%
30-Year	0.92	30	2.30%	2.61%	16.82%
TIPS	0.57	10	0.09%	0.16%	6.24%
Sector					
Broad Market	0.85	7.8 years	1.91%	2.16%	5.31%
MBS	0.79	5.0	2.07%	2.35%	3.10%
Municipals	0.45	9.9	1.57%	1.85%	4.47%
Corporates	0.44	10.9	2.88%	3.21%	7.68%
High Yield	-0.25	6.3	7.27%	8.18%	9.06%
Floating Rate	-0.21	1.9	1.65%	1.78%	1.02%
Convertibles	-0.31	--	0.91%	0.96%	1.31%
ABS	0.00	5.3	1.94%	2.24%	5.15%

Investing Principles

Investing Principles:





Covenant
Asset Management, LLC

125 Maple Avenue,
Chester, NJ 07930

www.covasset.com

Main: (908) 879-4090
fax: (908) 879-6468