Covenant Asset Management, LLC

Third Quarter 2018 Investment Perspectives

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Economic and Financial Markets Review & 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 investment performance in the coming months.

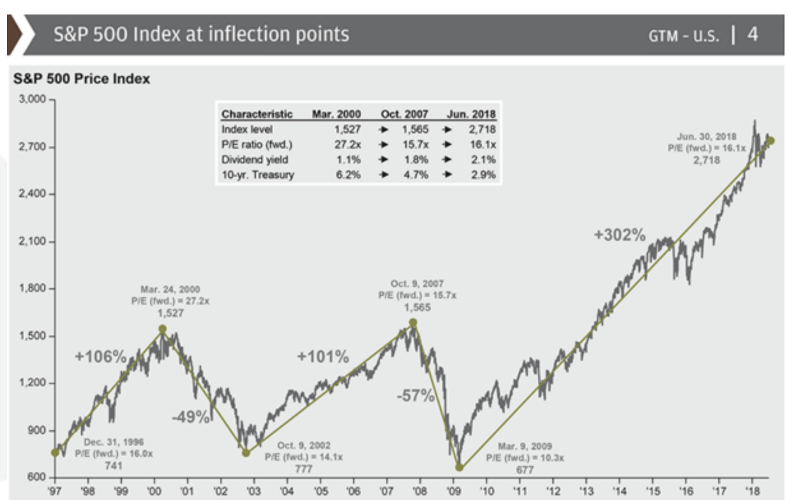
KEY THEMES

1. A more challenging financial market environment continued into the second quarter amid renewed volatility.
2. Global economic activity has diverged this year with the U.S. economy accelerating, but other regions of the world slowing.
3. The Fed has continued its campaign to normalize interest rates by raising the Fed Funds rate twice this year by a total of 50 basis points. A flatter yield curve has investors worried about future economic growth.
4. Trade tensions and the imposition of tariffs are amongst the greatest risks to the global economic expansion and the bull market in stocks.

Established economic and financial market trends continued into the second quarter. Economic indicators are strong and accelerating and financial markets remained volatile, but range bound. The Federal Reserve Bank continued its rate-tightening campaign by raising the Fed Funds rates by an additional 50 basis points in the first half of the year. After threatening to employ tariffs on steel imports and a series of Chinese products, the Trump Administration began to impose those tariffs during the second quarter. The imposition of the U.S. tariffs was met by retaliatory measures from China and other countries. These trade tensions have intermittently roiled financial markets, as investors fret about potential negative economic impact. We explain these concerns more fully in our recent blog entitled [Trade Wars?] and our [Second Quarter 2018 Investment Perspectives].

Most investment benchmarks produced low single digit positive or negative returns in the first half of 2018. The S&P 500 generated a 2.65% return, while many bond indexes were down modestly during this period. The standout performers in the first half were the Nasdaq at 8.8% and the small capitalization Russell 2000 at 7%. Small cap companies are largely domestic and are benefitting in the current environment from lower corporate tax rates, deregulation and low direct exposure to the negative effects of trade conflicts and tariffs.

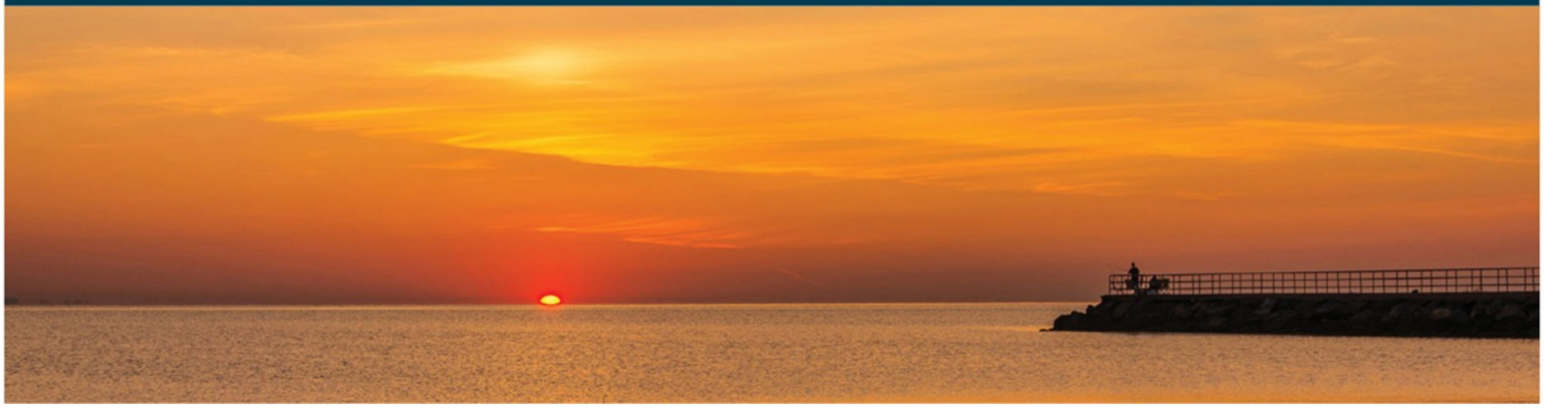
Our focus on growth stocks and willingness to rotate away from lagging performers and into companies showing strong and improving earnings has helped Covenant's U.S. equity growth model produce strong relative performance this year.



Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent 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 June 30, 2018.

J.P.Morgan Asset Management

Economic and Financial Markets Review



Economists attribute the acceleration in U.S. economic activity to tax reform, deregulation and high levels of consumer and corporate confidence. Employment growth remains strong and the unemployment rate has dropped to 4% or less. After nearly a decade of weak wage growth, recent data has shown improvement. ISM manufacturing and non-manufacturing surveys have surged to near the highest levels in the last thirty years. And real U.S. GDP growth is expected to grow this year at 3% or better for the first time since 2005. This stronger economic picture has enabled the Federal Reserve Bank to continue steadily raising short-term interest rates, as monetary policy returns to normal.

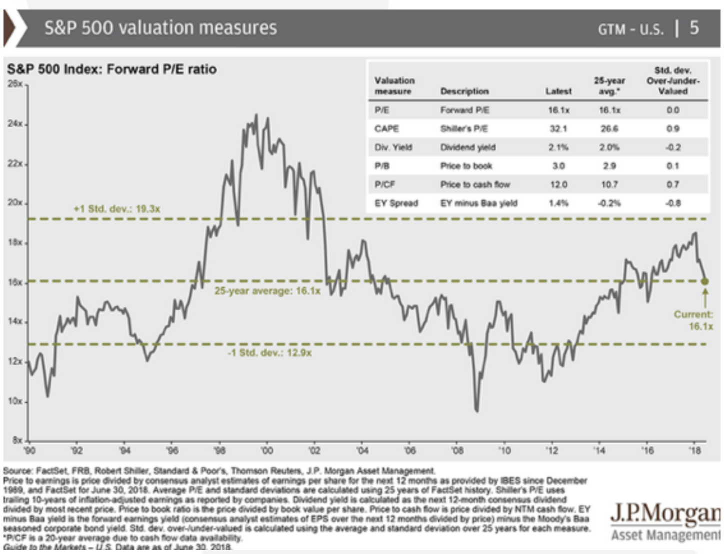
In contrast to the U.S., Europe, Japan and other regions around the world have experienced a slowdown in growth. Capital flight into the U.S. is occurring due to lower U.S. corporate tax rates and rising U.S. interest rates. This action has resulted in a stronger U.S. dollar and has pressured U.S. companies with greater international exposure, as their goods become more expensive to foreign buyers. One of the consequences of divergent economic growth paths for the U.S. and other global economies and a stronger U.S. dollar has been weaker investment performance by many foreign equity markets. Most developed and emerging markets equity benchmarks generated negative returns for the year's first half.

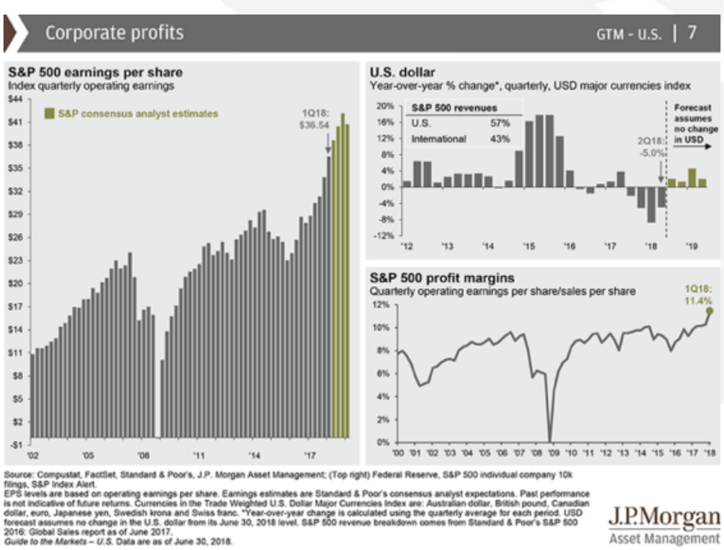
Oil prices have surged to their highest levels in three years with WTI crude priced near $75 per barrel. OPEC production supply restrictions and rising global consumption has brought demand and supply into better balance. Other commodity prices are flat to down thus far this year. Core inflation (ex food and energy), while still low by historical standards, has risen to the Fed's preferred target of 2%. This has liberated the Fed to continue raising the Fed Funds rate without fear of provoking a deflationary response.

In addition to trade tensions and rising short-term interest rates, perhaps the greatest worry for investors is a flattening yield curve. Concerns are growing that the Federal Reserve Bank could make a policy mistake and cause an inversion of the yield curve given the decline in the ten-year U.S. Treasury yield since May. Historically, the yield curve has been a good indicator of economic weakness, having predicted the last seven recessions. An inverted yield curve occurs when short-term interest rates move above longer rates. There is no indication the Fed wishes to purposely invert the yield curve to stave off inflation any time soon. With financial conditions tightening and global monetary stimulus receding, this indicator bears watching. The most significant consequence of a flatter yield curve this year has been weaker relative investment performance by the financial sector. Many financial services companies rely upon the net interest spread they earn from borrowing at short-term rates and lending at higher long-term rates. When the yield curve flattens, their net interest margin gets squeezed, making it harder to generate earnings growth. Like other investors, we have begun to take profits in some of the financial stocks we acquired after the November 2016 elections.

Economic and Financial Markets Challenges

The longevity of the U.S. economic expansion and acceleration in economic activity has allowed corporate profits and profit margins to rise to record levels. With earnings rising faster than stock prices this year, valuation levels have retreated to near their average levels over the last 25 years, alleviating concern that the market might be overvalued.



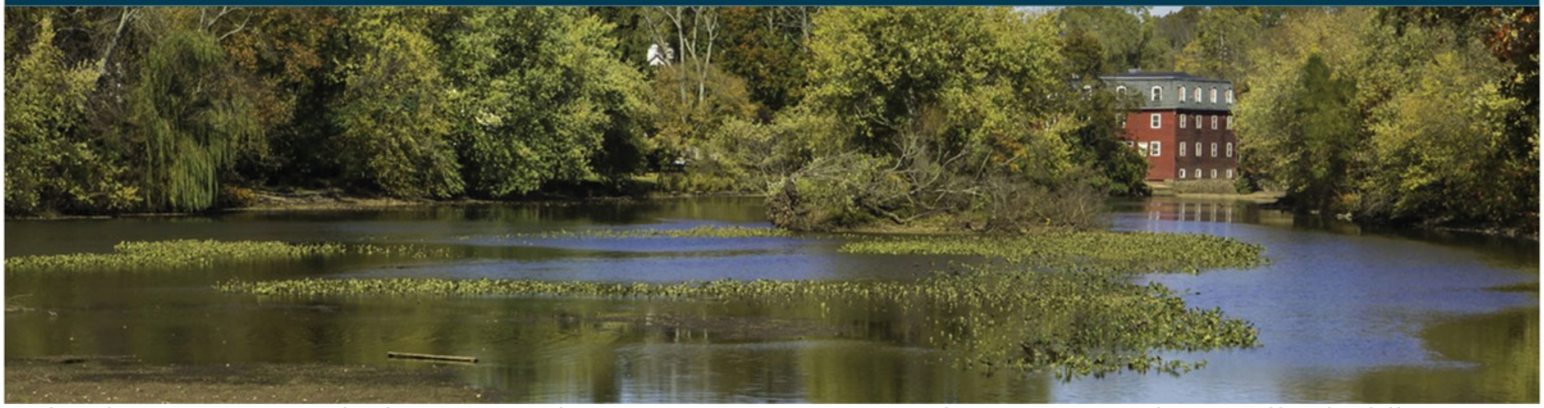


From a strategy standpoint, as we noted in our previous quarterly commentary, we believe further economic and stock market expansion is likely ahead. However, early signs that we are late in this market cycle are emerging. Having watched a bit of the World Cup soccer tournament recently, it is easier to relate the economic cycle to minutes in a soccer match than innings to a baseball game. You know you are getting near the end of the game, but you never know for sure when the game will end. With that said, we have embarked on a strategy to reduce or eliminate margin from client accounts and have rotated away from the more economically sensitive sectors of the economy. As always, aligning asset allocation to long-term objectives is vital.

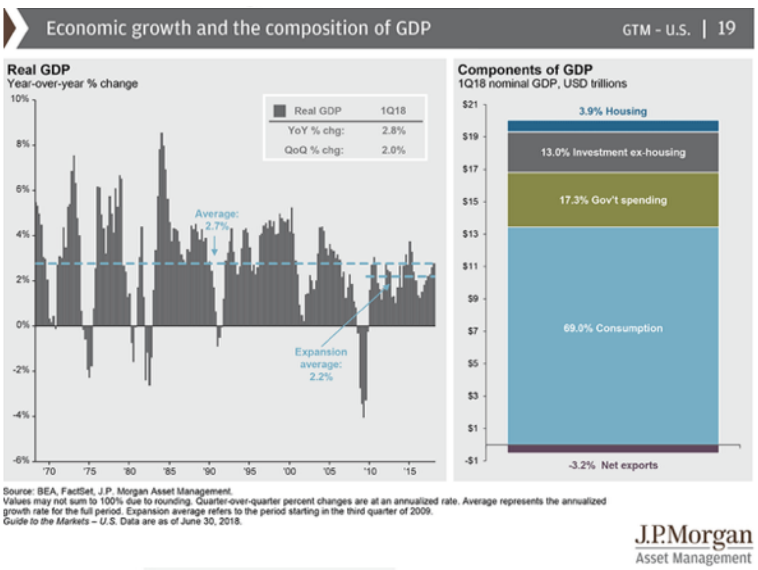
At this stage of the business cycle, it is important to revisit investment objectives and asset allocations. We are currently evaluating additional risk reduction measures such as structured products which can help buffer the downside in certain asset classes. At some point ahead, we are likely to emphasize fixed-income instruments with higher credit ratings. This strategy will almost certainly result in some reduction to portfolio income.

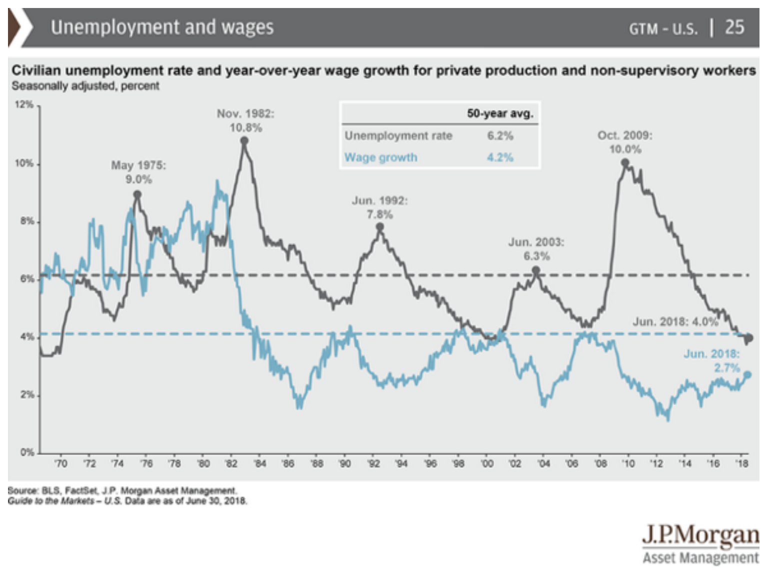
We encourage you to contact your Covenant financial advisor with any comments or questions related to your account(s) or any issues discussed within this investment commentary. Please accept our best wishes for a relaxing and enjoyable summer.

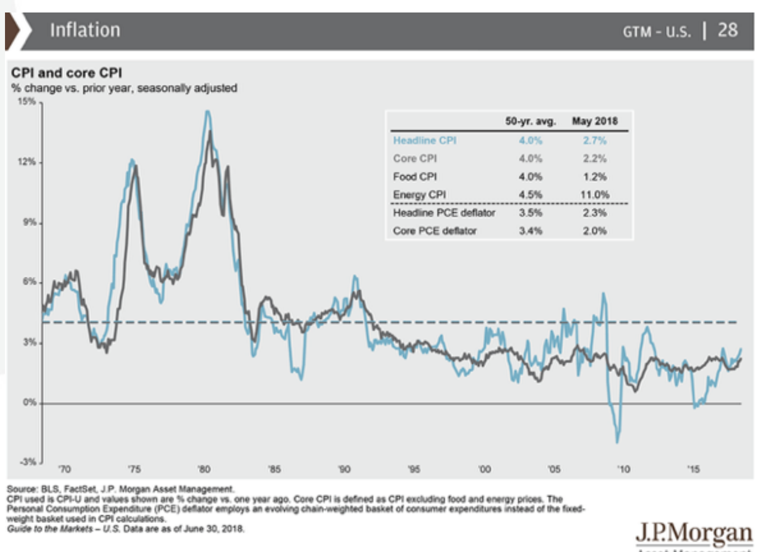
Economic Charts



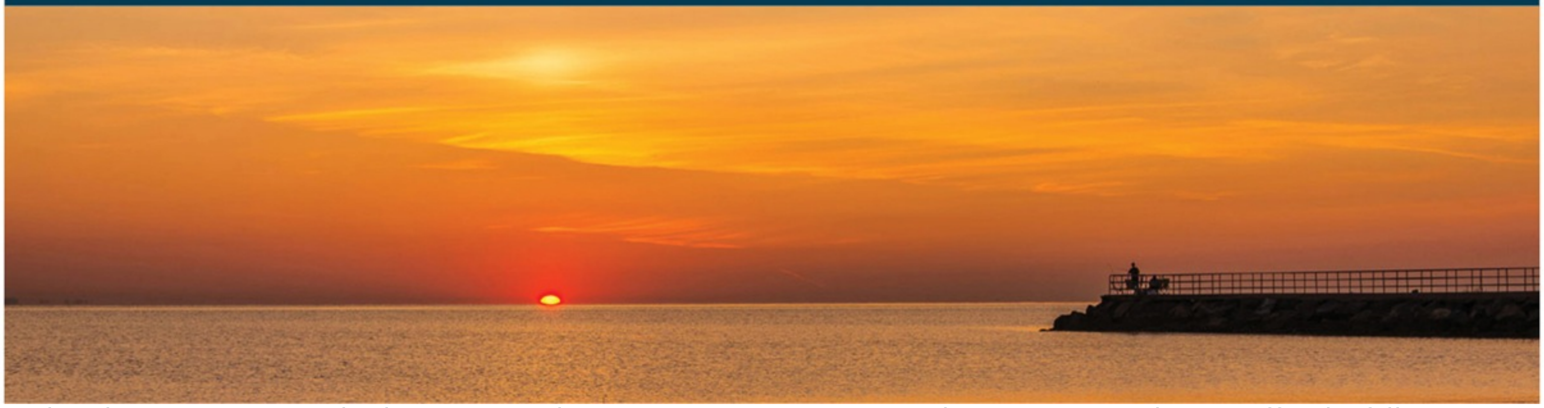
Rather than write extensively about equity valuations, economic statistics and investing principles, we offer the following charts organized by topic and courtesy of J.P. Morgan Asset Management:







Financial Markets Charts



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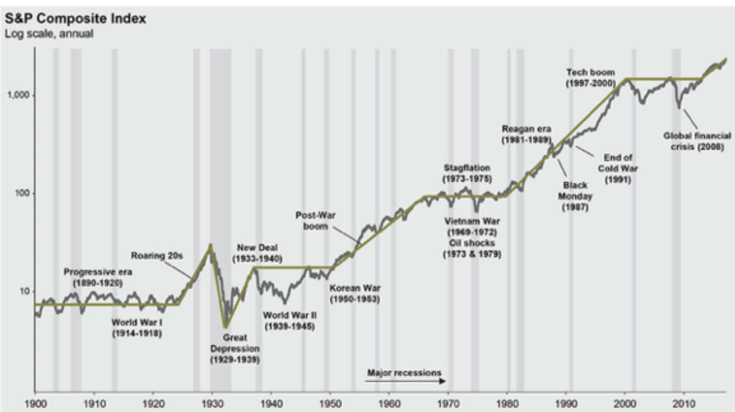
Stock market since 1900

GTM – U.S. | 17



Source: FactSet, NBER, Robert Shiller, 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. Data are as of June 30, 2018.

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Dollar drivers

GTM – U.S. | 29

Source: J.P. Morgan Asset Management; (Left) FactSet, Federal Reserve; (Top right) Bureau of Economic Analysis, FactSet; (Bottom right) Tullett Prebon.
Currencies in the Trade Weighted U.S. Dollar Major Currencies Index are: Australian dollar, British pound, Canadian dollar, euro, Japanese yen, Swedish krona and Swiss franc. *Interest rate differential is the difference between the 10-year U.S. Treasury yield and a basket of the 10-year yields of each major trading partner (Australia, Canada, Europe, Japan, Sweden, Switzerland and UK). Weights on the basket are calculated using the 10-year average of total government bonds outstanding in each region. Europe is defined as the 19 countries in the euro area.
Guide to the Markets – U.S. Data are as of June 30, 2018.

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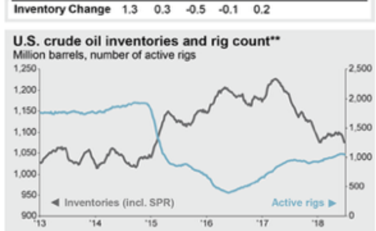
Oil markets

GTM – U.S. | 30

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

Production	2015	2016	2017	2018*	2019*	Growth since '15
U.S.	15.1	14.9	15.6	17.7	19.1	26.3%
OPEC	38.2	39.2	39.3	39.0	39.2	2.5%
Russia	11.0	11.2	11.2	11.2	11.2	1.6%
Global	**96.7**	**97.2**	**98.0**	**100.2**	**102.2**	**5.7%**
Consumption						
U.S.	19.5	19.7	19.9	20.4	20.7	5.8%
China	12.4	12.8	13.3	13.7	14.1	13.9%
Global	**95.4**	**96.9**	**98.5**	**100.3**	**102.0**	**7.0%**
Inventory Change	1.3	0.3	-0.5	-0.1	0.2	



Source: J.P. Morgan Asset Management; (Top and bottom left) EIA; (Right) FactSet; (Bottom left) Baker Hughes.
*Forecasts are from the June 2018 EIA Short-Term Energy Outlook and start in 2018. **U.S. crude oil inventories include the Strategic Petroleum Reserve (SPR). Active rig count includes both natural gas and oil rigs. WTI crude prices are monthly averages in USD using continuous contract NYM prices.
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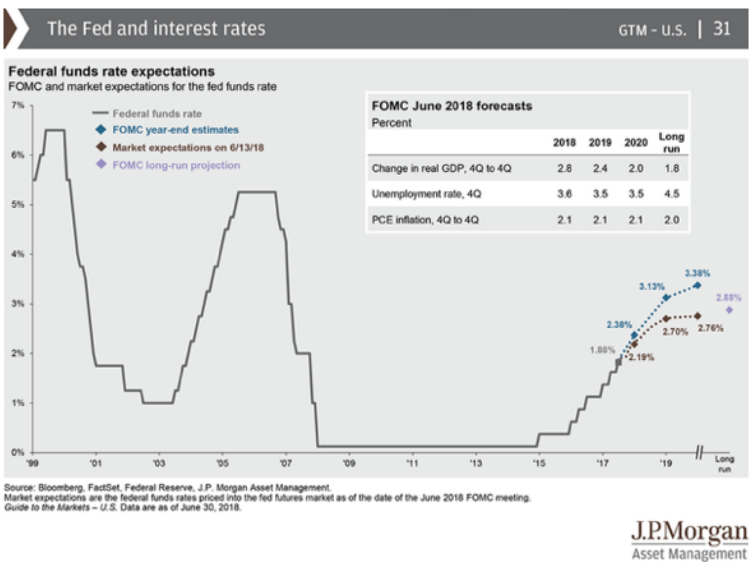
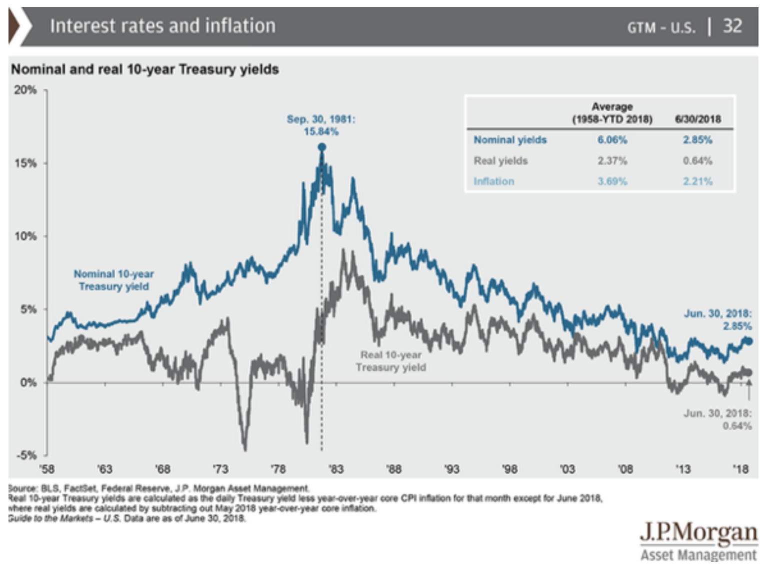
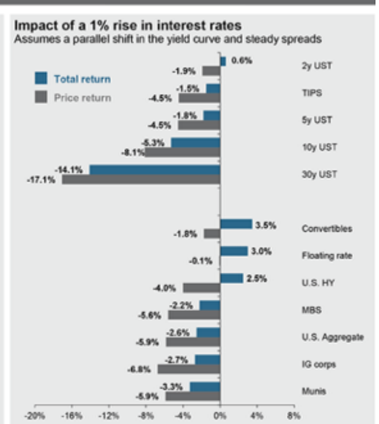




Fixed income yields and returns

GTM – U.S. | 35

U.S. Treasuries	Yield 6/30/2018	Yield 12/31/2017	Return 2018 YTD	Avg. Maturity	Correlation to 10-year	Correlation to S&P 500
2-Year	2.52%	1.89%	-0.02%	2 years	0.68	-0.34
5-Year	2.73%	2.20%	-1.07%	5	0.92	-0.28
TIPS	0.74%	0.44%	-0.02%	10	0.54	0.27
10-Year	2.85%	2.40%	-2.67%	10	1.00	-0.29
30-Year	2.98%	2.74%	-3.40%	30	0.93	-0.31
Sector						
Convertibles	5.21%	6.35%	5.88%	-	-0.27	0.88
Floating Rate	3.08%	2.05%	1.15%	3.3	-0.18	0.39
High Yield	6.49%	5.72%	0.16%	6.1	-0.21	0.71
MBS	3.41%	2.91%	-0.95%	7.5	0.81	-0.11
Broad Market	3.29%	2.71%	-1.62%	8.4	0.86	0.05
Municipals	2.63%	2.26%	-0.72%	9.9	0.53	-0.03
Corporates	4.02%	3.25%	-3.27%	10.9	0.47	0.35



Source: Barclays, Bloomberg, FactSet, Standard & Poor's, U.S. Treasury, J.P. Morgan Asset Management. Sectors shown above are provided by Bloomberg and are represented by – Broad Market: U.S. Aggregate; MBS: U.S. Aggregate Securitized - MBS; Corporate: U.S. Corporates; Municipals: Muni Bond 10-year; High Yield: Corporate High Yield; TIPS: Treasury Inflation Protection Securities (TIPS); Floating Rate: FRN (BBB); Convertibles: U.S. Convertibles Composite. Yield and return information based on bellwethers for Treasury securities. Sector yields reflect yield to worst. Convertibles yield is based on US portion of Bloomberg Barclays Global Convertibles. Correlations are based on 10-years of monthly returns for all sectors. Change in bond price is calculated using both duration and convexity according to the following formula: New Price = (Price + (Price * -Duration * Change in Interest Rates))+(0.5 * Price * Convexity * (Change in Interest Rates)^2). Chart is for illustrative purposes only. Past performance is not indicative of future results.

J.P.Morgan
Asset Management

*Any performance-related data listed in this report may represent un-audited results compiled by Covenant Asset Management or others. It could be intended to reflect results that are indicative of Covenant's individual client's equity performance who religiously invest according to our model portfolios. 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.

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