Fourth Quarter 2014 Investment Perspectives

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

Key Themes

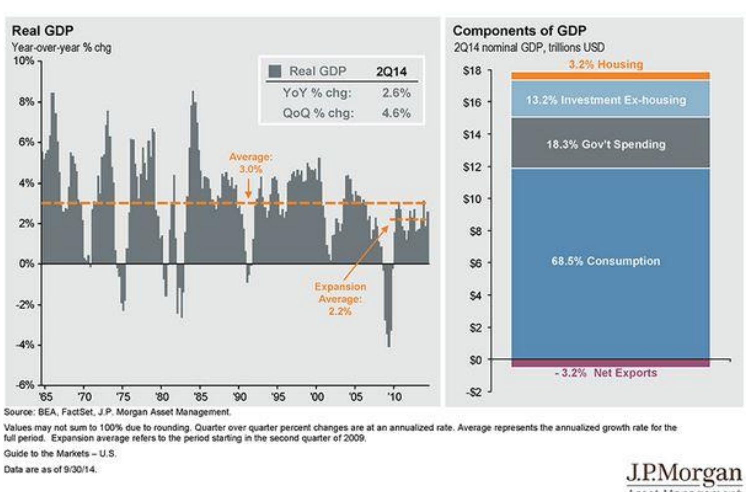
1. **Signs of U.S. economy accelerating**
2. **QE ending, fed funds rate hikes loom**
3. **Increased volatility signaling correction?**
4. **Growth scare in Europe & China**

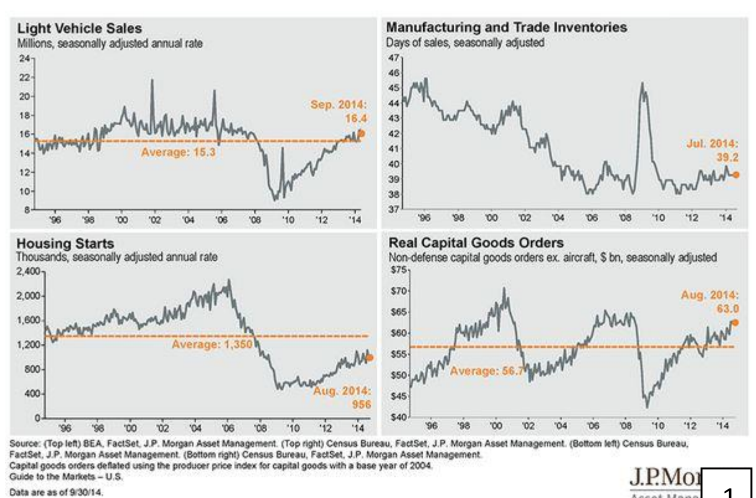
ECONOMIC OVERVIEW

- U.S. economy showing signs of acceleration with growth upwards of 3% projected in the second half
- Cyclical sectors including housing, autos, and manufacturing bolstering growth
- Labor market is improving with monthly jobs growth averaging above 215,000 and other measures strengthening

U.S. Economic Outlook

After a 2.1% contraction in first quarter GDP, growth rebounded strongly with second quarter GDP jumping 4.6% as pent-up demand from unusually adverse winter weather conditions helped drive growth. Recent economic data suggest second half GDP is tracking at a pace in excess of 3% annualized. Underlying the improved economic trends is a reversal of fiscal drag from the federal government as the impact from changes to spending and taxes will swing from -0.9 percentage point in 2013 to +0.4 this year. In addition, other headwinds that have restrained economic growth during the current recovery appear to



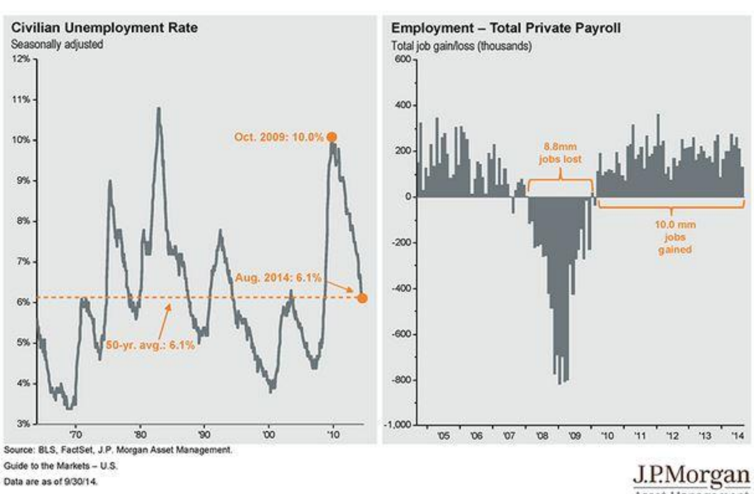


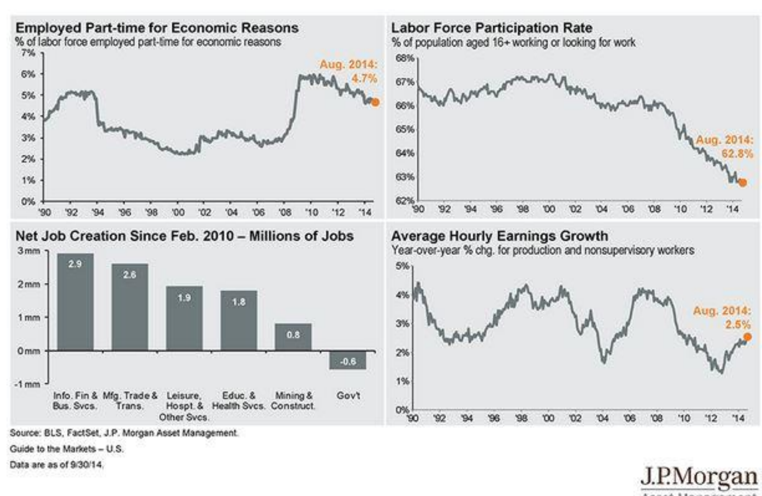
be changing directions. These include heightened risk aversion due to the after-effects of the financial crisis, tight credit conditions, distress in mortgage markets with an abundance of underwater mortgages and unprecedented numbers of foreclosures, and the need for improvements in household and banking sector financial conditions. As these forces abate or reverse, the level of economic activity can rise sharply, leading to a sustained trend of stronger GDP growth. On top of these factors, a continued recovery in the cyclical sectors of the economy, including housing, autos and manufacturing, should bolster growth forecasts.

ECONOMIC IMPLICATIONS

- Accelerating economic growth should lead to higher corporate profits
- Recent U.S. dollar strength should continue with the U.S. economy strongest amongst developed nations and U.S. interest rates higher than most trading partners

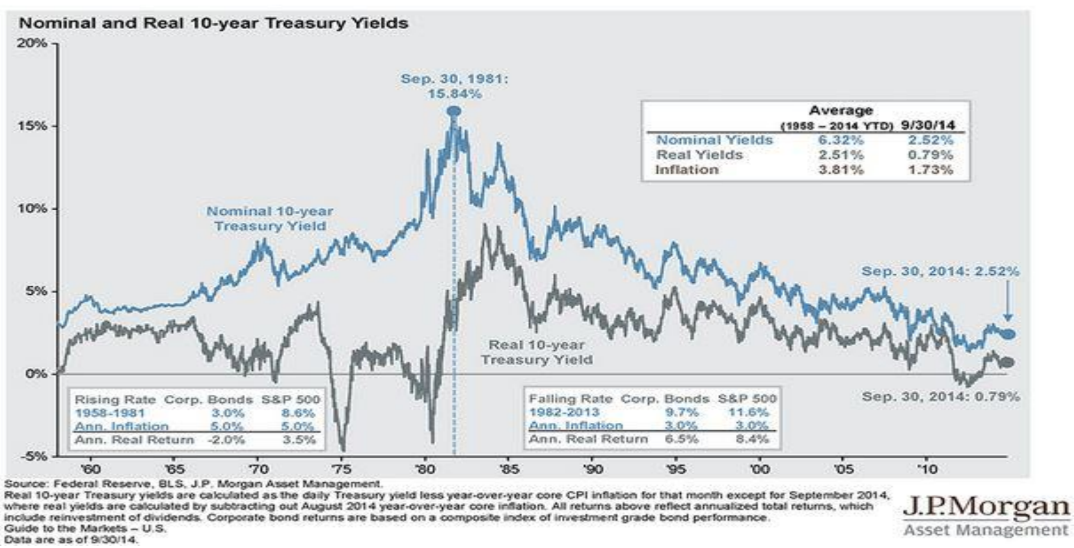
The labor market continues to show steady improvement with monthly private sector employment gains averaging above 215,000 for 2014 and the unemployment rate dropping to 5.9% in September. Other indicators are also consistent with broad improvement in the labor market with job openings rising strongly and initial claims for unemployment insurance tracking below 300,000 for the past several months. There are several data points that aren't quite as encouraging, including average hourly earnings which have risen by just 2% year-over-year, barely above the inflation rate, and the labor force participation rate which recently hit a 36-year low at 62.7%. In addition, the share of the population employed at 59% is historically low and continues to be lower than it was (59.4%) when the recession ended in June 2009.





Monetary Policy

At the September Federal Open Market Committee (FOMC) meeting, the U.S. Federal Reserve Bank (Fed) confirmed its intention to conclude the bond-buying program known as quantitative easing (QE) at the end of October. The program was initiated two years ago with $85 billion per month of U.S. Treasury and mortgage-backed securities being purchased each month in the open market by the Fed with the intention to drive down interest rates and prop up asset prices (real estate and stock prices) and ultimately improve economic conditions. While the first part of the objective has undeniably been met, the jury is out on whether the economy has improved beyond where it might have been without the bond purchases.



MONETARY POLICY OVERVIEW

- October brings an end to QE
- First increase in Fed Funds rate since the financial crisis expected in first half of 2015
- Timing of Fed interest rate hikes to be data dependent and not based upon a specific time horizon
- Europe and Japan continue with aggressive monetary stimulus policies

MONETARY POLICY IMPLICATIONS

- End of QE should produce rising short-term interest rates but economic weakness in Europe and parts of Asia may constrain the level
- Recent weakness in interest rate sensitive sectors such as high yield stocks and bonds, REITs and emerging markets is evidence that investors are positioning for higher rates next year
- Stocks should continue to do well during the early phase of an interest rate hike cycle

Now that QE is about to end, the question on investors' minds is when will the Fed begin to normalize short-term interest rates (raise the fed funds rate)? Despite improving economic data and continued low inflation, at the conclusion of the last FOMC meeting, the Fed opted to retain language in their statement indicating their intention to maintain the fed funds rate at near-zero for a **considerable time**. Fed watchers have been focused on when this phrase would be removed or amended as an indication that the Fed was preparing to begin raising interest rates. In the press conference following the release of the Fed statement, Fed chairwoman Janet Yellen went to great lengths to reiterate that a change in interest rate

policy would be dependent on economic data and not based upon a specific time horizon. While it is difficult to set expectations precisely, especially when they are dependent on future unknown data, market expectations call for the first interest rate hike sometime in the first half of 2015. Historically, stocks, and especially cyclical sectors, tend to do well in the six months leading up to the beginning of an interest rate hike cycle. Additionally, in the past, it hasn't been until investors anticipate that rising rates will cause a recession, usually by the third rate increase, that markets have begun to correct. Coming from the zero percent-level, it is not clear at this time what pace of rate hikes and level of short-term interest rates will be required before markets become concerned.

Commentary on Stock Market Corrections

We continue to believe the S&P 500 will be higher at year-end than current levels and will likely produce double-digit gains for the full year. However, within the past several weeks, the stock market has experienced an undeniable increase in volatility. In nine of the past fourteen trading sessions, the Dow Jones Industrial Average has produced triple digit moves in one direction or another. In addition, the CBOE VIX Index has risen by roughly 50% from trough to peak. What

STOCK MARKET CORRECTIONS OVERVIEW

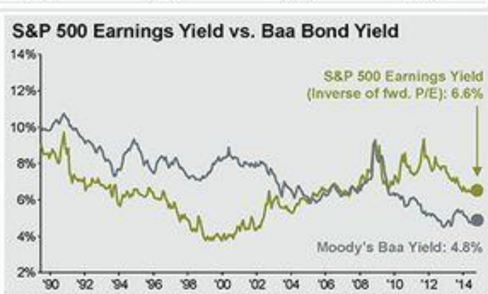
- Recent increase in stock market volatility triggers debate on magnitude and length of a correction
- Geopolitical events, Europe and China economic weakness, the end of QE, concerns about Ebola and seasonal factors cited as root causes of current volatility
- We view current weakness as a buying opportunity and believe any correction will be limited in time and scope

STOCK CORRECTIONS IMPLICATIONS

- Corrections are a healthy part of every bull market
- Investors should avoid changing strategy or allocation in anticipation of a correction
- Focus on disciplined strategy based upon investment objectives, time horizon and risk tolerance rather than the timing of market corrections

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	15.2x	14.2x	13.4x	13.8x	15.6x
CAPE	Shiller's P/E	26.3	25.0	22.1	22.9	25.2
Div. Yield	Dividend Yield	1.9%	2.0%	2.0%	2.0%	2.1%
REY	Real Earnings Yield	3.8%	3.7%	4.2%	3.2%	2.2%
P/B	Price to Book	2.8	2.6	2.3	2.4	2.9
P/CF	Price to Cash Flow	10.8	10.6	9.2	9.7	11.3
EY Spread	EY Minus Baa Yield	1.8%	1.5%	2.1%	1.2%	-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. Price/Earnings to Growth Ratio is calculated as NTM P/E divided by NTM earnings growth. 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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Data are as of 9/30/2014.

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is behind this recent volatility spike? U.S. military action in Iraq and Syria, sanctions imposed on Russia because of its invasion of the Ukraine, European economic weakness, slowing growth in China, concerns surrounding the Ebola virus and uncertainty about Fed policy, have all been cited as possible reasons for the bout of market instability. Seasonal factors may also be at play as September and October have historically been amongst the weakest months of the year for stock performance. Are we in the midst of another mini-correction on the order of 4-6%, such as those we've witnessed six times in the previous two years, or a more serious correction in the range of 10-20%, the likes of which we haven't experienced since the summer of 2011, when a political budget battle put the U.S. on the brink of defaulting on its debt? In the last three years there have been no shortage of investment and financial media pundits calling for a new bear market or recession as shown by the following headlines:

2011
We're In a New Bear Market, Says One Technical Indicator – *Wall Street Journal, 8/12/11*
Signs of a Crash Ahead, Not a Recession – *New York Times, 9/28/11*
Wall Street Approaches a Bear Market – *New York Times, 10/3/11*
What if There's a Bear Market in 2012? – *Forbes, 12/29/11*

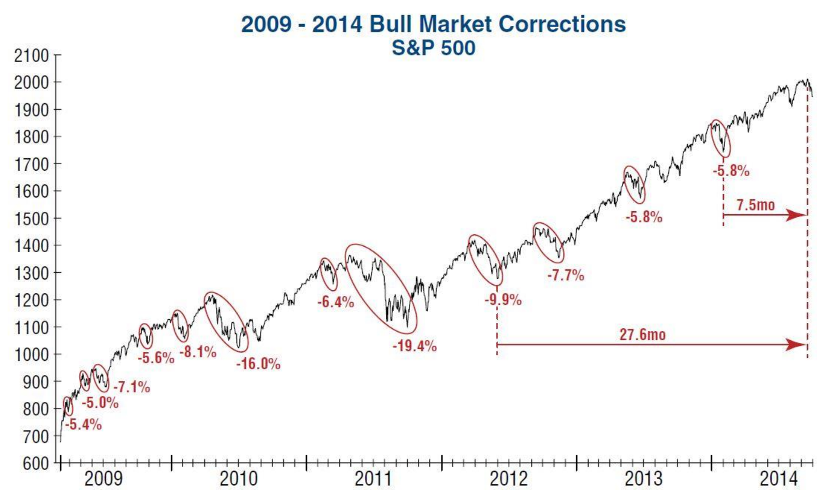
2012
3 Reasons Why the Bear Market is Back – *Yahoo! Finance, 5/23/12*
A bear market in bull's clothing – *MarketWatch, 8/27/12*
Big-name stocks fall into bear markets – *USA Today, 11/9/12*

2013
An epic bear market is coming – *MSN Money, 1/2/13*
Bear Market to Take Hold in 2013: Expert – *CNBC, 3/14/13*
Bear Traps Await Investors – *Wall Street Journal, 7/31/13*
Doomsday poll: still a 98% risk of 2014 stock crash – *MarketWatch, 12/21/13*

2014
Is The Next Bear Market Here Already? – *Nasdaq.com, 4/2/14*
Buckle Up! The New Bear Market Has Begun – *Seeking Alpha, 5/8/14*
Two signs a market crash is coming – *Yahoo! Finance, 7/17/14*
Three Signs That Point to a Stock-Market Tumble Ahead – *Wall Street Journal, 8/1/14*
4 signs this bull market is on its last legs – *MarketWatch, 8/13/14*

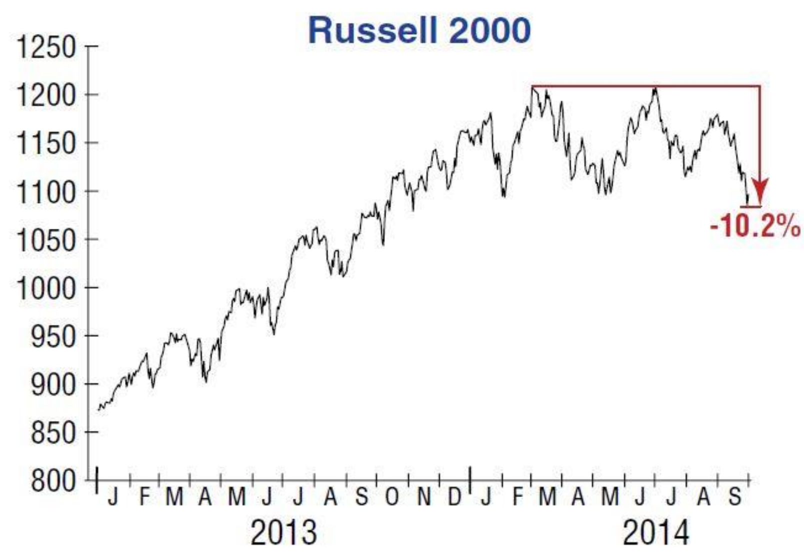
Naturally, a prognosticator, who makes a dramatic call and turns out to be correct with his forecast, will garner a great deal of media fame and attention in the future. But is there really any solid evidence that recent volatility will lead to the next severe correction or bear market, or is it signaling a recession ahead? Virtually all of the public and private sector economic data point to improving trends, not weakening ones. Coupled with continued low inflation and interest rates that are low and likely to stay that way for some time, this is hardly an environment that cries out for a meaningful downturn in the economy or stock market anytime soon. The favorable economic outlook and constructive monetary policy does not rule out the possibility of a 5-10% correction. Corrections are actually a healthy part of every

bull market, allowing valuation levels to realign with fundamentals and technical and sentiment indicators to be reset, positioning the market for further gains. Corrections tend to happen quite frequently, but for the most part are unpredictable in timing or size. Consequently, making a significant change in strategy or allocation in anticipation of a correction is seldom, if ever, advisable. Since 1932 the frequency of corrections in past bull markets indicates that 5% corrections occur approximately every 7 months and 10% corrections happen every 25.9 months on average. The chart immediately below shows that the current bull market has surpassed the average time between 5% and 10% corrections.



InvesTech. Volume 14, Issue 9, August 22, 2014

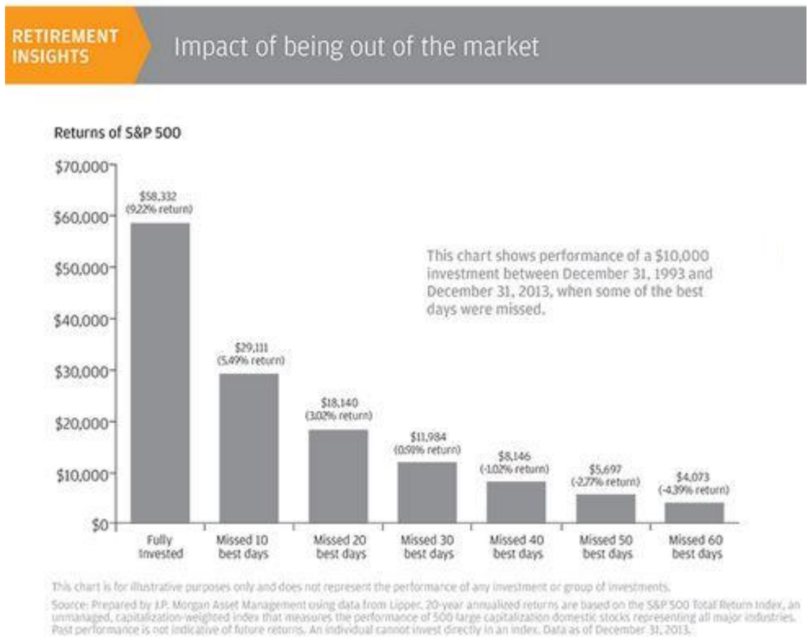
So, strictly from a historical standpoint it can be observed that we are a bit overdue for a correction. With elevated geopolitical tensions, the end of QE on the horizon, midterm election risk and some market sentiment indicators at stretched levels, a traditional bull market correction is possible. In some ways, parts of the market are already in a correction. While the DJIA and S&P 500 have corrected less than -4% recently, the small cap Russell 2000 Index has declined by -10.2% from its peak level earlier this year.



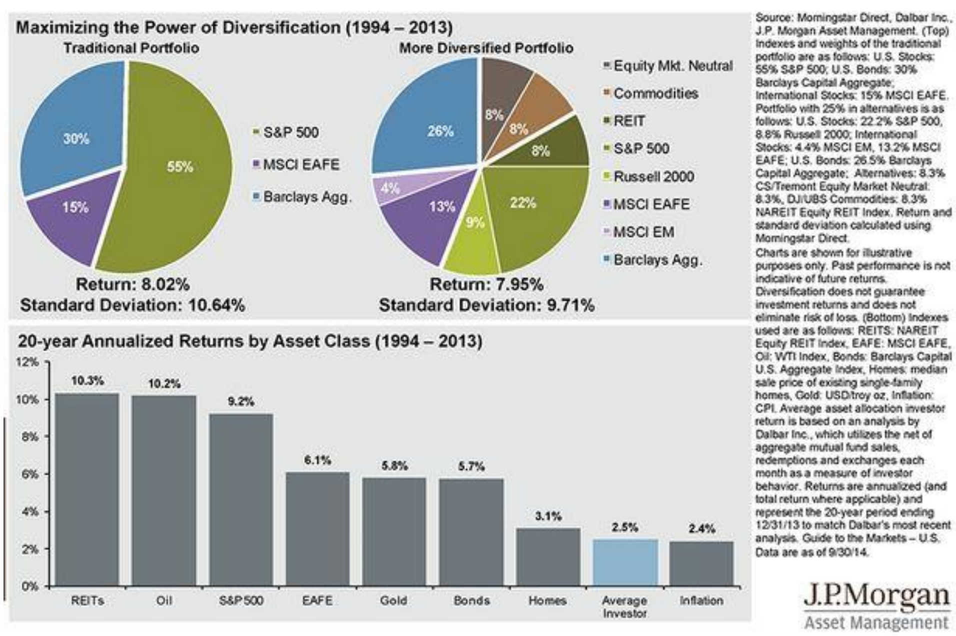
InvesTech. Volume 14, Issue 10.5, October 3, 2014

Our philosophy embraces a holistic perspective and aligns with that of legendary mutual fund manager Peter Lynch, when he stated in the September 2014 edition of *BusinessWeek,* "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." We believe that maintaining a

disciplined investment strategy, based upon an investor's investment objectives, time horizon and ability to assume risk, is more likely to produce better results than attempting to time the market. The chart below shows the impact on performance of being out of the market on some of the best-performing days over a period of time.



Rather than attempting to time the market, even in modest ways, we recommend managing volatility and risk through portfolio diversification tailored to your goals.



International Markets

The resilience of the U.S. economy has rarely been more evident than in the past year. Even as economic activity has begun to accelerate within the United States, Europe is on the brink of its third recession in six years. China's growth is slowing, while Japan's economy has suffered from the aftermath of tax increases in April. Emerging market economies and stock markets, after rebounding through much of the first half, have recently weakened as concerns over China's slowdown have hurt those countries which rely upon Chinese exports.

U.S. monetary policy is moving closer to normalization during the same time as the European Central Bank and the Bank of Japan are employing aggressive monetary stimulus programs. Stronger U.S. growth and relatively higher interest rates make the U.S. a more attractive place for investments, prompting the buying of dollars. Collectively, these conditions have led to a recent spike in the value of the U.S. dollar vs. most major currencies around the world. The implications of a stronger dollar are mostly beneficial to U.S. economic growth. Lower prices for many commodities that are priced in dollars, including oil and many agricultural commodities, and lower import prices, such as for autos, leaves more discretionary spending power for

INTERNATIONAL MARKETS OVERVIEW

- Weakness in Europe & Japan, China economic growth slowing and emerging markets feeling China's pain
- Divergent monetary policy paths and economic growth trends between the U.S. and much of the rest of the world's developed economies have led to a surge in the U.S. dollar
- Gold and most commodities have declined on the heels of the strong dollar

INTERNATIONAL MARKETS IMPLICATIONS

- Stronger dollar and lower commodities prices lead to more discretionary spending power for the U.S. economy
- Inflation rate in U.S. will be suppressed
- Foreign travel is cheaper for Americans
- U.S. exports are more expensive to foreign buyers
- Foreign profits of U.S. multi-nationals take a hit

	3Q14		YTD 2014	
Country / Region	**Local**	**USD**	**Local**	**USD**
Regions / Broad Indexes				
U.S. (S&P 500)	-	1.1	-	8.3
EAFE	1.0	-5.8	4.5	-1.0
Europe ex-U.K.	0.1	-7.4	7.2	-1.6
Pacific ex-Japan	-0.9	-5.9	2.7	1.2
Emerging Markets	0.7	-3.4	5.5	2.7
MSCI: Selected Countries				
United Kingdom	-0.9	-6.0	1.0	-1.2
France	-0.6	-8.3	5.4	-3.4
Germany	-3.7	-11.2	-1.2	-9.4
Japan	5.9	-2.2	3.0	-1.4
China	1.7	1.5	1.2	1.0
India	5.1	2.3	24.5	24.7
Brazil	1.6	-8.6	5.1	1.2
Russia	-4.3	-15.1	-6.6	-19.5

Weights in MSCI All Country World Index
% global market capitalization, float adjusted

Global Equity Market Correlations
Rolling 1-year correlations, 30 countries

Source: Standard & Poor's, MSCI, FactSet, J.P. Morgan Asset Management.
All return values are MSCI Gross Index (official) data. Chart is for illustrative purposes only. Past performance is not indicative of future results. Please see disclosure page for index definitions. Countries included in global correlations include Argentina, South Africa, Japan, UK, Canada, France, Germany, Italy, Australia, Austria, Brazil, China, Colombia, Denmark, Finland, Hong Kong, India, Malaysia, Mexico, Netherlands, New Zealand, Peru, Philippines, Portugal, Korea, Spain, Taiwan, Thailand, Turkey, United States. Guide to the Markets – U.S.
Data as of 9/30/14.

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2-Year Dollar Chart

Source: FactSet, as of September 12, 2014.

U.S. residents and corporations. In addition, foreign travel becomes cheaper for Americans. There are also a few negatives related to an appreciated dollar such as exported products become more expensive and therefore less competitive in foreign markets. Furthermore, profits earned in weakened foreign currencies are worth less when converted back into U.S. dollars.

Current Yield Strategies

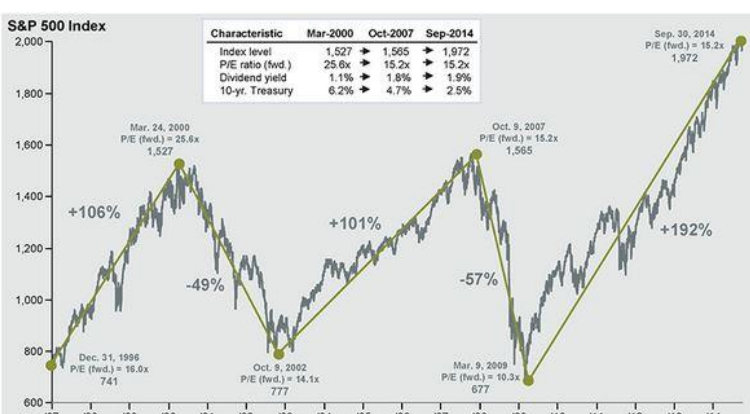
The surprising decline in interest rates during the first three quarters of 2014 has allowed fixed-income assets to produce respectable returns. Emerging-market debt has been the best-performing sector within the fixed-income class, generating an 8.0% return, while the Barclays Aggregate Bond Index of U.S. bonds produced 4.1% through September 30. We recommend investing in fixed-income instruments with short to intermediate average maturities and continue to prefer some credit risk through investing in high yield funds, as opposed to reaching for yield by extending maturities. Master Limited Partnerships (MLPs) have been the best-performing asset class during the first nine months of the year with returns upwards of 19%. Interestingly, REITs have also performed well thus far in 2014, rising 13.4% year-to-date, even after dropping by 2.5% in the third quarter. We continue to believe that REITs and MLPs are attractive high yield alternatives to bonds in the current environment. In addition, high yield stocks and lower grade bond funds are also recommended as bond substitutes in today's low interest rate environment.

CURRENT YIELD STRATEGIES OVERVIEW

- Surprising decline in interest rates year-to-date
- Emerging market debt best performing fixed income sector
- REITs and MLPs have both produced solid double digit returns through September 30

CURRENT YIELD IMPLICATIONS

- Focus on short to intermediate term bonds
- REITs and MLPs should continue to perform well
- High yield stocks and lower grade bond funds also recommended as bond substitutes



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.

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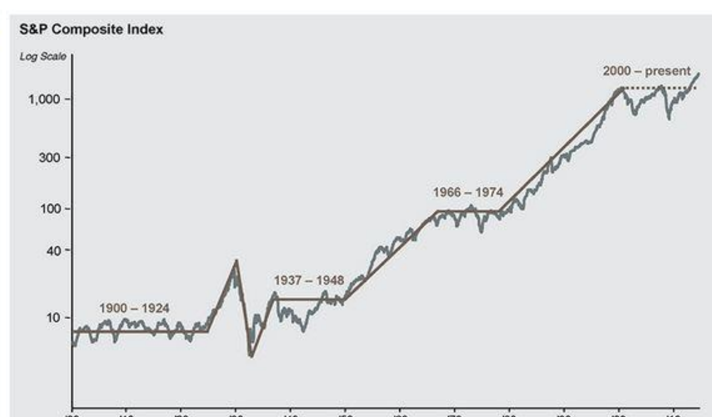

Source: Robert Shiller, FactSet, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns.
Past performance is not indicative of future returns. Chart is for illustrative purposes only.

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