

Covenant  
Asset Management, LLC



Third Quarter 2023  
Investment Perspectives

# Economic and Financial Markets Review & Outlook



Covenant Asset Management is pleased to offer our latest investment perspectives. In this publication we review second quarter 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. The stock market enjoyed a powerful rally in the first half with momentum and breadth both improving in June.
2. The Federal Reserve Bank paused its interest rate hikes in June but indicated additional hikes are likely in an effort to combat still high inflation.
3. Economic data is mixed with consumer spending and labor markets strong but manufacturing and interest-rate sensitive sectors weak.
4. Second-half economic and investment performance will be strongly influenced by how well corporate earnings hold up to continuing efforts by the Fed to reign in inflation and diminished fiscal stimulus.

After a brutal year for investors in 2022, financial markets were on edge as 2023 began. Concerns about persistently high inflation, increasingly tight monetary policy, weakening corporate profits and potential turbulence surrounding debt ceiling negotiations weighed on investor sentiment. In the face of these fears, the stock market ascended the proverbial wall of worry in a mighty way in the first half of the year. The Nasdaq composite followed last year's 32.5% decline with a 32.3% rebound in the first six months of 2023. The S&P 500 rose 16.9% and the Dow Jones Industrials generated a 4.9% return. The bond market was volatile, but managed to produce low single-digit total returns, depending on the sector, credit quality and duration, with the Bloomberg Aggregate Bond Index up 2% for the year-to-date. Energy prices slumped along with many commodities prices in the first half, with oil prices down by 13%. In many ways, the first half of 2023 was the opposite of what investors experienced

in 2022. Growth stocks and riskier investments like bitcoin were hard hit in 2022 and recovered the most so far this year. Value stocks and other safe havens held up better last year, but they have been notable laggards in 2023. The only knock on performance in the first half in the stock market is that the rally has been very narrow with a small number of large-cap growth stocks responsible for most of the gains. The market did begin to broaden in June, as the S&P 500 equal-weighted index outperformed the standard market-cap-weighted S&P 500 Index by 1.1 percentage points. Small-cap stocks outperformed as well.

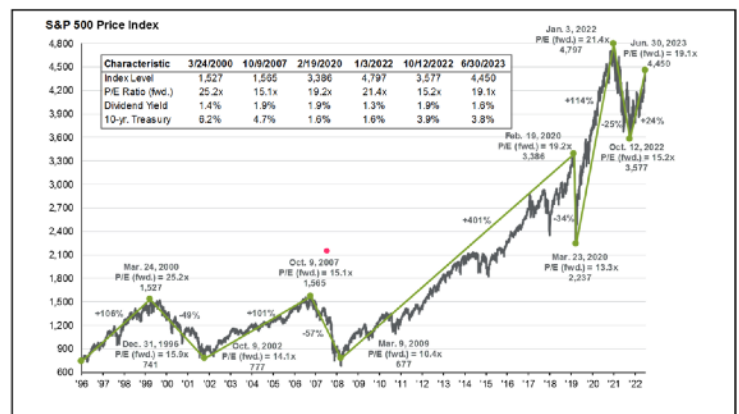


Chart sourced from JP Morgan Guide to Markets

The Federal Reserve Bank continued its policy of raising the fed funds rate in an effort to combat higher than desired inflation. In the first half, the Fed tempered its aggressive monetary tightening initiatives by raising the fed funds rate in three 25-basis-point increments. The rate was last raised in May to 5.00-5.25%. At the June meeting, the Fed decided not to change the rate for the first time since March 2022. In that timeframe, the Fed Funds rate was increased by 5 percentage points, one of the most aggressive tightening cycles in the history of the Federal Reserve Bank. The Fed and other central banks appear to be disappointed at the pace at which price inflation is subsiding. The Fed has been clear that, even at the risk of

# Economic and Financial Markets Challenges



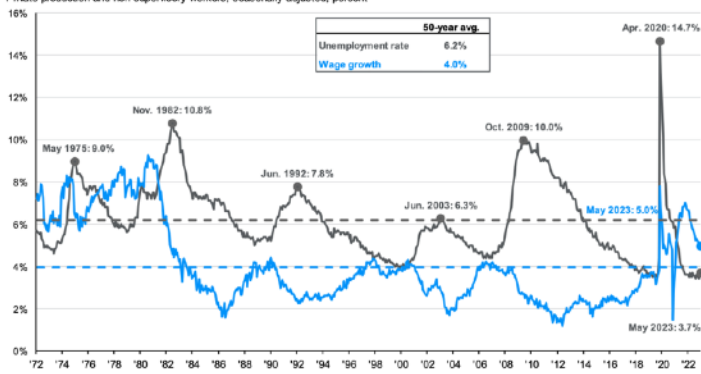
recession, they intend to engineer a return to a 2% targeted inflation rate. Fed officials have indicated recently they believe the Fed Funds rate may need to be raised further and kept at higher levels longer than originally anticipated. At present, investors expect rates to rise another 25 to 50 basis points in coming months. The question is, will the economy be able to endure further rate hikes without tumbling into recession?

## Unemployment and wages

GTM U.S. 30

### Civilian unemployment rate and year-over-year wage growth

Private production and non-supervisory workers, seasonally adjusted, percent



Source: BLS, FactSet, J.P. Morgan Asset Management. Private production and non-supervisory jobs represent just over 80% of total private nonfarm jobs. Guide to the Markets - U.S. Data are as of June 30, 2023.

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Overall, the economy has held up better than expected during the monetary tightening period. Manufacturing, energy and interest rate sensitive sectors like housing have suffered. Consumer-related sectors, especially travel and dining, have prospered, as pandemic-related savings and pent-up demand bolstered spending. The labor market has held up, but cracks are beginning to emerge. Hiring has slowed, unemployment claims have risen and the unemployment rate, while still low, has increased from 3.4% to 3.7% in recent months. Excess pandemic savings are expected to be depleted before year-end and fiscal stimulus has wound down. The federal government debt ceiling agreement is intended to restrict discretionary spending in the next two years and will further inhibit economic activity. Can the economy continue to grow in the face of slower fiscal spending and monetary tightening? Investors seem to be betting that the economy will slow or perhaps slip into a

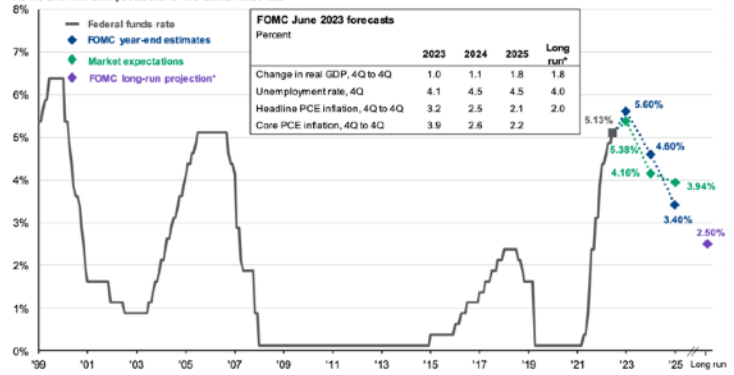
mild recession, but any fallout will be contained and may help reign in inflation. Time will tell.

## The Fed and interest rates

GTM U.S. 36

### Federal funds rate expectations

FOMC and market expectations for the federal funds rate



Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management. Market expectations are based off of the respective Federal Funds futures contracts for December expiry. \*Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. Guide to the Markets - U.S. Data are as of June 30, 2023.

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Investment performance in 2023's first half was driven by an economy that has held up better than expected and by slow, but steady progress on the inflation front. Corporate earnings have been resilient and the crisis in the regional banking sector appears to be contained presently. Tech stocks received a boost, as the potential for artificial intelligence (AI) spending and investment was recognized. Nvidia is the biggest beneficiary because they make the best computer chips for AI processing. Microsoft and Adobe also received boosts from the potential for AI profits. Investors then began imagining the future spending boost industry-wide for semiconductor and software stocks in an AI world. Understanding first-half performance becomes clearer in hindsight when we think about an environment marked by disinflation and optimism about future technology spending. This puts into better perspective the decline in stock market volatility measures, such as the VIX, to the lowest levels since before the pandemic. Momentum is strong for stocks, as we head into the second half, and more stocks appear to be joining the rally. The June run-up may also incorporate a degree of investor FOMO, (Fear Of

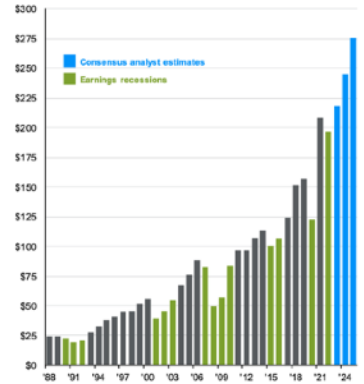
# Economic and Financial Markets Challenges



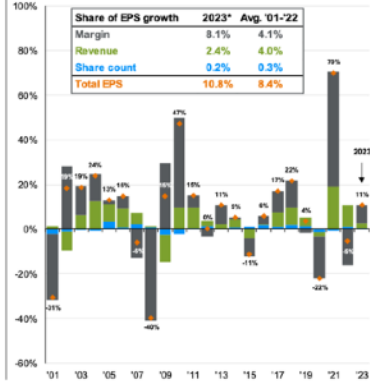
## Corporate earnings and sources of earnings growth

GTM U.S. 8

**S&P 500 earnings per share**  
Index annual operating earnings, USD



**S&P 500 year-over-year operating EPS growth**  
Annual growth broken into revenue, changes in profit margin & changes in share count



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.  
Historical EPS levels are based on annual operating earnings per share. \*2023 earnings estimates are based on estimates from Standard & Poor's and FactSet  
Market Aggregates. Percentages may not sum due to rounding. Past performance is not indicative of future returns.  
Guide to the Markets - U.S. Data as of June 30, 2023.

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The experience of the past eighteen months has proven once again that it is nearly impossible to predict the short-term direction of financial markets and that aiming to time the market is a fool's game. Attempting to predict which investment styles or sectors will perform best in the short term is similarly difficult. Selecting investments and securities in a proven disciplined manner is the best chance for long term success. Equally important is selecting an asset mix that best fits investor objectives. This approach has served our clients well and we look forward to continuing working with you to achieve your financial goals.

Please accept our best wishes for an enjoyable summer.

Missing Out). After the jump in stocks in the past month, the market may be extended in the short term. Market bond yields have been on the rise again, as investors embrace the idea that the economy is somewhat stronger than expected and the Fed is likely to continue to raise interest rates. Most of the time, when markets experience a strong first half, further gains are achieved during the rest of the year. The economy may continue to grow and it is possible that we realize the elusive soft landing. But odds continue to favor a recession at some point within the next twelve months, given the likelihood of continued interest rate hikes, restrictive monetary policy and slower federal spending.

# Economic and Financial Markets Charts

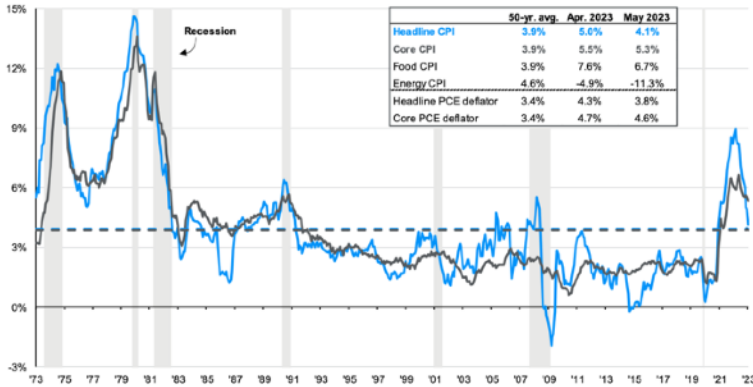


## Inflation

GTM U.S. 31

### CPI and core CPI

% change vs. prior year, seasonally adjusted



Source: BLS, FactSet, J.P. Morgan Asset Management. CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations. Guide to the Markets - U.S. Data as of June 30, 2023.

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## Oil markets

GTM U.S. 35

### Change in production and consumption of liquid fuels

	2019	2020	2021	2022	2023*	Growth since '19
<b>Production</b>						
U.S.	19.5	18.6	19.0	20.2	21.3	8.6%
OPEC	34.0	30.7	31.7	34.2	33.5	-3.2%
Russia	11.5	10.5	10.8	10.9	10.7	-6.7%
<b>Global</b>	<b>100.3</b>	<b>83.9</b>	<b>95.7</b>	<b>99.9</b>	<b>101.4</b>	<b>1.1%</b>
<b>Consumption</b>						
U.S.	20.5	18.2	19.9	20.3	20.4	-0.6%
China	14.0	14.4	15.3	15.2	16.0	13.8%
<b>Global</b>	<b>100.9</b>	<b>81.6</b>	<b>97.1</b>	<b>99.4</b>	<b>101.0</b>	<b>0.1%</b>
<b>Inventory Change</b>	-0.8	2.3	-1.4	0.4	0.4	

### Price of oil

WTI crude, nominal prices, USD/barrel



### U.S. crude oil inventories and rig count\*\*



Source: J.P. Morgan Asset Management, (Top and bottom left) EIA; (Right) Baker Hughes. \*Forecasts are from the June 2023 EIA Short-Term Energy Outlook and start in 2023. \*\*U.S. crude oil inventories include the Strategic Petroleum Reserve (SPR). Liquid fuels include crude oil, natural gas, biodiesel and fuel ethanol. Active rig count includes both natural gas and oil rigs. WTI crude prices are continuous contract NYM prices in USD. Guide to the Markets - U.S. Data as of June 30, 2023.

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## Global commodities

GTM U.S. 58

### Bloomberg Commodity Index

Since index inception, total returns



### Commodity prices

Bloomberg Commodity Index constituents

Sub-index	Current price level	Change since 12/31/2021	Change since 6/9/2022*
<b>Energy</b>	\$31.64	2.4%	-49.0%
WTI crude oil	\$89.86	-7.3%	-47.5%
Natural gas	\$0.99	-43.6%	-77.1%
Brent crude	\$49.61	22.5%	-29.2%
Low sulphur gas oil	\$253.11	45.6%	-33.8%
RBOB gasoline	\$480.59	48.2%	-21.3%
U.S. diesel	\$3.82	5.5%	-21.1%
<b>Grains</b>	\$44.77	6.4%	-29.4%
Corn	\$12.58	11.0%	-15.1%
Soybeans	\$72.80	12.8%	-24.2%
Soybean meal	\$458.17	16.8%	8.2%
Wheat	\$31.98	-21.5%	-42.0%
Soybean oil	\$77.30	3.1%	-30.7%
HRW wheat	\$21.25	0.1%	-27.5%
<b>Industrial metals</b>	\$146.55	-18.9%	-23.9%
Copper	\$325.49	-18.3%	-16.5%
Aluminum	\$29.16	-26.8%	-25.0%
Zinc	\$19.75	-26.6%	-26.7%
Nickel	\$191.41	-3.0%	-28.7%
<b>Precious metals</b>	\$548.43	3.3%	3.8%
Gold	\$202.09	-0.8%	-1.2%
Silver	\$196.55	-7.2%	-3.1%
<b>Softs</b>	\$49.06	2.2%	-7.8%
Sugar	\$176.81	35.0%	28.7%
Coffee	\$110.60	-23.7%	-28.4%
Cotton	\$29.56	-11.4%	-33.5%
<b>Livestock</b>	\$33.91	6.6%	8.1%
Live cattle	\$65.46	16.1%	18.9%
Lean hogs	\$3.61	-8.7%	-11.8%

Source: Bloomberg, FactSet, J.P. Morgan Asset Management. All the Bloomberg subsectors and constituents are represented by the respective Bloomberg subindices except ULS Diesel, which is represented by the EIA composite for U.S. ULS diesel prices. \*The Bloomberg Commodity Index peaked on June 9, 2022. Guide to the Markets - U.S. Data as of June 29, 2023.

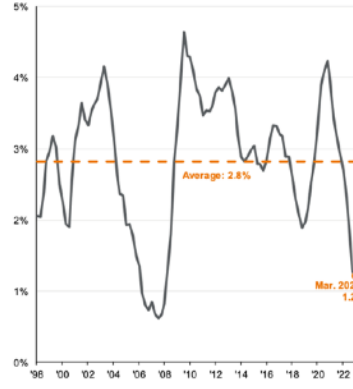
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## U.S. real estate dynamics

GTM U.S. 59

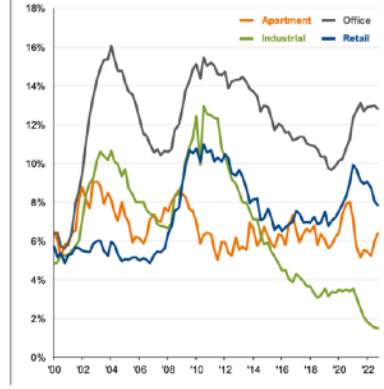
### U.S. real estate cap rate spreads

Transaction based, spread to 10y UST, 4-quarter rolling average



### U.S. vacancy rates by property type

Percent



Source: NAREIT, NCREIF, Starbix, J.P. Morgan Asset Management. The cap rate, which is computed as the net operating income over sales price, is the rate of return on a real estate investment property. Vacancy rate data is as of 12/31/2022. This slide comes from our Guide to the Markets. Guide to the Markets - U.S. Data as of June 30, 2023.

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# Economic and Financial Markets Charts



## Interest rates and inflation

GTM U.S. 37

### Nominal and real U.S. 10-year Treasury yields



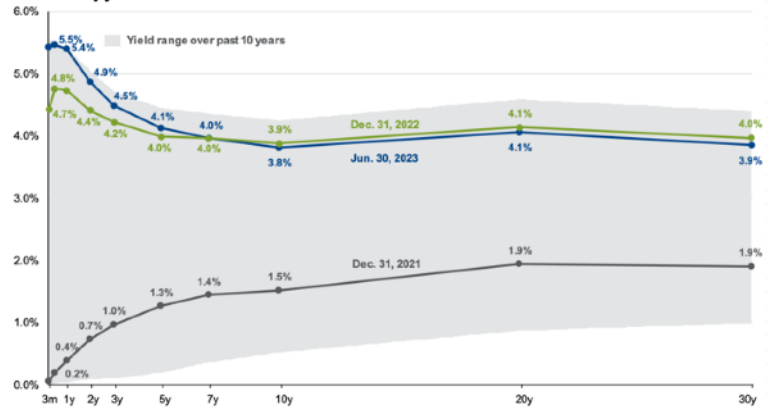
Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management. Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month's core CPI figures until the latest data is available. Guide to the Markets - U.S. Data area as of June 30, 2023.

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## Yield curve

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### U.S. Treasury yield curve



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management. Guide to the Markets - U.S. Data area as of June 30, 2023.

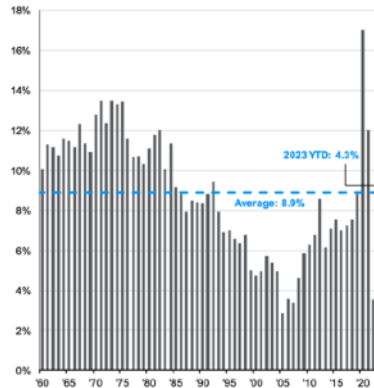
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## Consumer saving and borrowing

GTM U.S. 25

### Personal saving rate

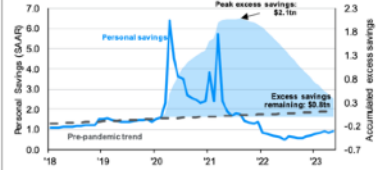
Personal savings as a % of disposable personal income, annual



Source: BEA, Federal Reserve, J.P. Morgan Asset Management. From March 2020 to August 2021, consumers amassed a peak \$2.1 trillion in excess savings relative to the pre-pandemic trend. Since August 2021, consumers have drawn down on those excess savings, with the remaining reflected in the chart annotation. Guide to the Markets - U.S. Data area as of June 30, 2023.

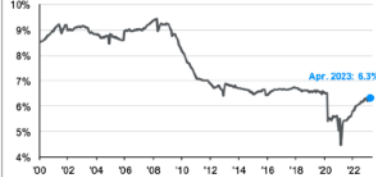
### Household excess savings

Trillions of USD



### Revolving consumer credit outstanding

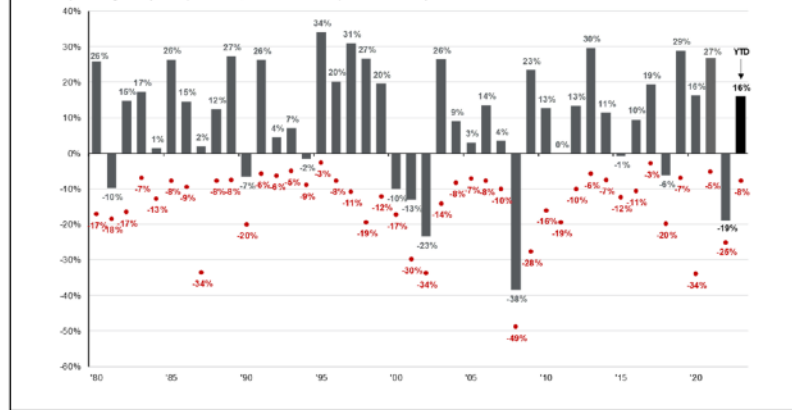
% of disposable income, SAAR



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### S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.3%, annual returns were positive in 32 of 43 years



Charts sourced from JP Morgan Guide to Markets

\*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.

