Covenant Asset Management, LLC

Fourth Quarter 2023

Investment Perspectives

Economic and Financial Markets Review & Outlook

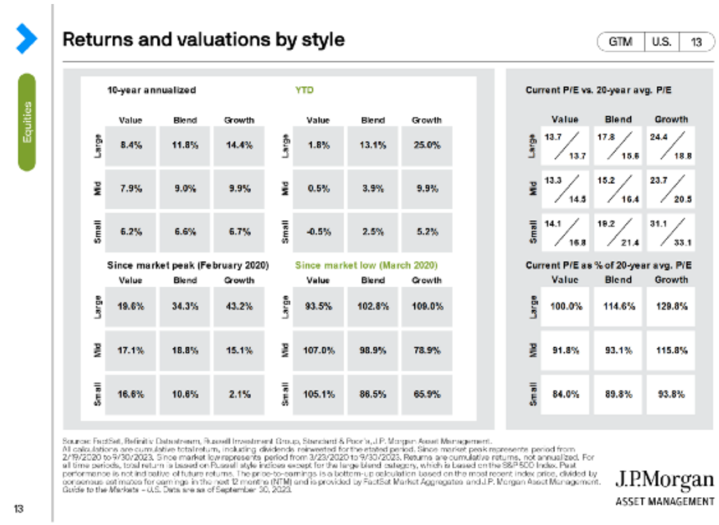
Covenant Asset Management is pleased to offer our latest investment perspectives. In this publication we review third quarter results and highlight key economic, financial and political themes which we expect will drive markets and investment performance in the coming months.

Key Themes

1. A rebound since last October ended as stocks and bonds posted declines in August and September.
2. The rate of inflation continues to decline but remains stubbornly above the Fed's 2% target.
3. Intermediate and longer term bond yields are on the rise as investors believe the Fed will hold the Fed Funds rate high for longer than expected.
4. More Fed governors believe additional Fed Funds rate hikes might be necessary to tame inflation, increasing the odds of recession next year.
5. Economic data is mixed with consumer spending and labor markets strong but manufacturing and interest-rate sensitive sectors weak.

A rebound in stocks ended in July as rising interest rates halted the rally. Major stock market indexes were down anywhere from 2% to 5% in the third quarter. For the first nine months of the year, the Dow Industrials were up 2.7%, the S&P 500 13.1% and Nasdaq 27.1%. Those year-to-date returns somewhat misrepresent the general tone of the market, as indices such as the small-cap Russell 2000 (+2.5%) and the equal-weighted S&P 500 (+1.7%) reflect a broader view of equity investor returns this year. The recent jump in intermediate- and long-term bond yields has now turned many bond index returns slightly negative for the year.

The rate of inflation has been slowly, but steadily, declining this year. Headline inflation, as measured by the Consumer Price Index, has declined to the



Returns and valuations by style

GTM | U.S. | 13

Equities

10-year annualized

	Value	Blend	Growth
Large	8.4%	11.8%	14.4%
Mid	7.9%	9.0%	9.9%
Small	6.2%	6.6%	6.7%

YTD

	Value	Blend	Growth
Large	1.8%	13.1%	25.0%
Mid	0.5%	3.9%	9.9%
Small	-0.5%	2.5%	5.2%

Since market peak (February 2020)

	Value	Blend	Growth
Large	19.6%	34.3%	43.2%
Mid	17.1%	18.8%	15.1%
Small	16.6%	10.6%	2.1%

Since market low (March 2020)

	Value	Blend	Growth
Large	93.5%	102.8%	109.0%
Mid	107.0%	98.9%	78.9%
Small	105.1%	86.5%	65.9%

Current P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	13.7 / 13.7	17.8 / 15.6	24.4 / 18.8
Mid	13.3 / 14.5	15.2 / 16.4	23.7 / 20.5
Small	14.1 / 16.8	19.2 / 21.4	31.1 / 33.1

Current P/E as % of 20-year avg. P/E

	Value	Blend	Growth
Large	100.0%	114.6%	129.8%
Mid	91.8%	93.1%	115.8%
Small	84.0%	89.8%	93.8%

Source: FactSet, Refinitiv Datastream, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management.
All calculations are cumulative total return, including dividends reinvested for the stated period. Since market peak represents period from 2/19/2020 to 9/30/2023. Since market low represents period from 3/23/2020 to 9/30/2023. Returns are cumulative returns, not annualized. For all time periods, total return is based on Russell style indices except for the large blend category, which is based on the S&P 500 Index. Past performance is not indicative of future returns. The price-to-earnings is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM) and is provided by FactSet Market Aggregates and J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of September 30, 2023.

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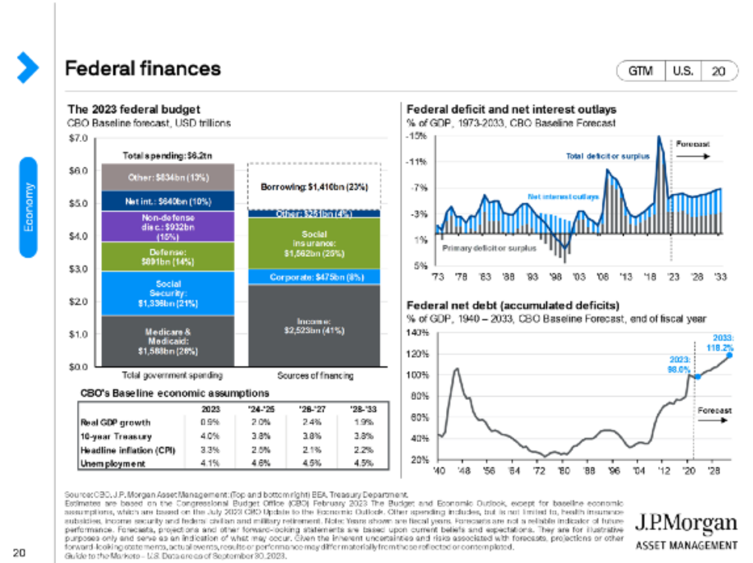
low 3% level over the past couple of months. Core inflation, which excludes volatile food and energy prices, has stalled closer to 4%. In the months ahead, inflation may be helped by lower housing-related data and hurt by rising oil prices. The consensus amongst private sector economists and Wall Street strategists is that the Fed should be done with any additional rate increases for this cycle. Fed governors, however, seem more inclined to raise the Fed Funds rate further in an effort to bring inflation to their 2% target more quickly. The Fed's impatience in dealing with inflation is likely a big contributor to rising volatility in the stock and bond markets and to recent declines in financial markets.

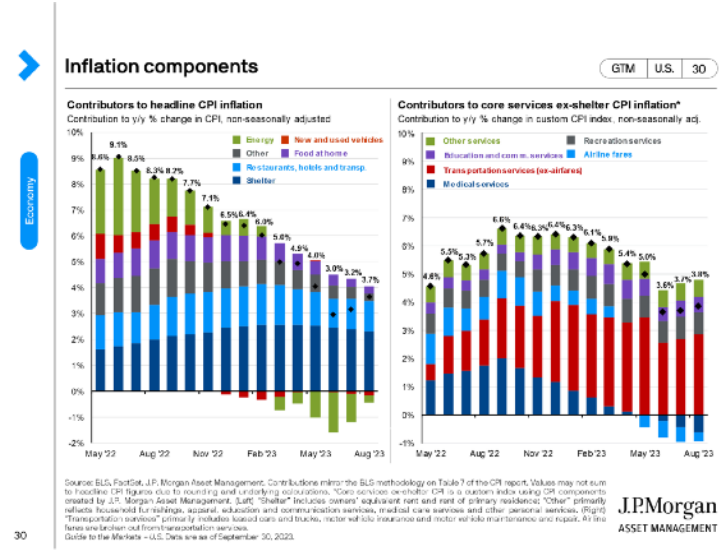
The increase in intermediate and long-term bond yields in the third quarter can be directly linked to two factors. The Fed's persistent hawkish tone to monetary policy and the rising supply of treasury bonds, as the Federal Government seeks to fund the additional programs it authorized in the previous Congress. When the debt ceiling was raised by $4 trillion in May 2023, additional debt authorization was needed to finance programs such as the Infrastructure Bill ($1.2 trillion), Chips Act ($280 billion) and the Inflation Reduction

Economic and Financial Markets Challenges



Act ($1.2 Trillion). When these laws were passed, interest rates were at historically low levels, so the additional debt seemed like a cheap way to pay for the new programs. Now that interest rates have risen sharply in the past eighteen months, these programs, along with all of the federal debt, have become more costly. The Federal debt now stands at $33 trillion, up an estimated $1.7 trillion in the fiscal year ended September 30. This $1.7 trillion represents the 2023 fiscal year budget deficit. The rise in interest expense on the federal debt likely contributed $700 billion of the $1.7 trillion deficit. This illustrates the dangerous effects of high inflation and interest rates on federal finances. At some point, interest on the debt will begin to crowd out the ability to spend additionally on other more important initiatives such as national defense, social security and medicare.

Economic data continues to be mixed with consumer spending and labor markets strong, while manufacturing and most interest-rate sensitive sectors are weak. Housing prices have generally held steady even as mortgage rates have climbed. Many homeowners are locked into mortgage rates below 4% and are reluctant to sell and be confronted with a new mortgage at rates upwards of 7.5%. Limited supply has kept housing prices firm, while high mortgage rates have caused existing home sales to tumble. Consumers have continued to spend on service-related items, such as travel, dining out and entertainment. However, there is increasing evidence that cracks are beginning to

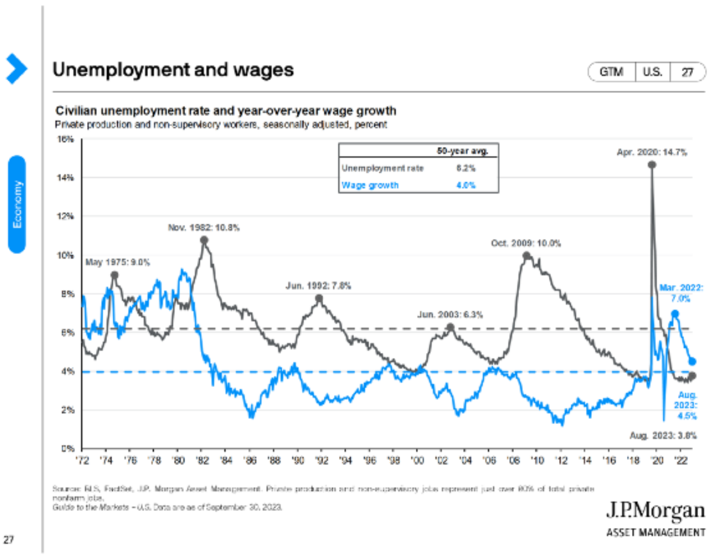


form in the consumer spending binge. Pandemic era stimulus programs have ended and excess pandemic-related savings have largely been exhausted. Student loan debt repayments begin again on October 1, after a more than three-year hiatus. Rising credit card interest rates, rising oil prices and the cumulative effects of two years of high inflation have also begun to strain consumer budgets. Labor demands for higher wages, evidenced by more frequent union strikes, is another cause for concern. Workers have every right to expect higher wage increases to keep up with inflation, but some industries can ill afford to expand their cost of labor for competitive reasons. How these labor contract negotiations play out could weigh on corporate profits and the economy in coming quarters.

Going forward, high and rising interest rates are the most important factor and portend the greatest risk to the economy and financial markets for the balance of 2023 and into next year. The Fed seems to be placing a great deal of weight on the

Economic and Financial Markets Challenges

continued strength of the labor market, causing concern that a strong labor market makes it difficult to bring inflation down to its 2% target. Our view is that the Fed's premise is based upon a faulty theory that there is an inverse relationship between unemployment and inflation. The unemployment rate tends to be a lagging indicator of economic activity. If the Fed insists on raising



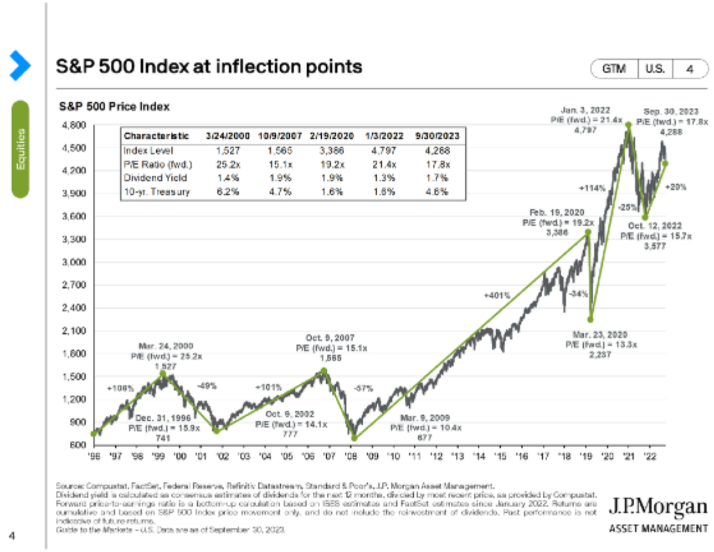
the unemployment rate to tackle inflation, it will likely be successful, but at the expense of economic growth. Said another way, insistence on crushing demand by raising the Fed Funds rate further increases the odds of recession. Our view is that the economy is presently growing slowly, and there are numerous factors that could push it from growth to contraction. Our concern is the Fed generally relies too heavily on backward-looking data and not enough on forward-looking data. This tendency may lead to a policy mistake and contribute to an economic downturn.

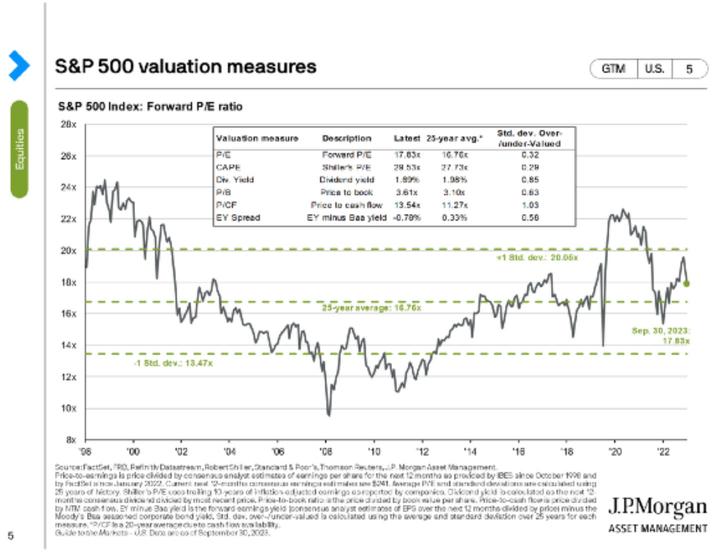
On investment strategy, rising yields have made high grade bonds more attractive. Intermediate-term yields on U.S. Treasuries approaching 5% are becoming more tempting and we may begin to extend a portion of the fixed income component of client portfolios to terms in the 5-10 year range.

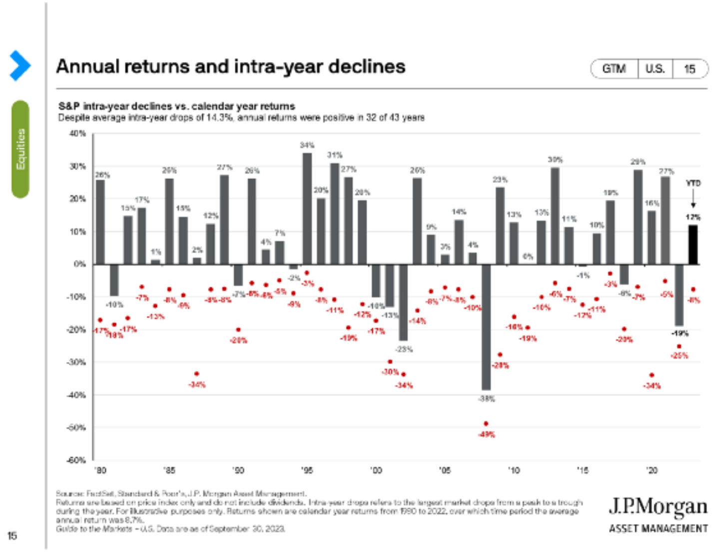
A correction in stock prices approaching 10% from the July 2023 highs is causing valuations to become more appealing, especially for investors with longer time horizons. Seasonal weakness in stocks during August and September often extends into October before prices bottom and then rebound in the seasonally strongest time to invest between October and April. There is a good chance that stocks may follow that typical pattern once interest rates begin to stabilize.

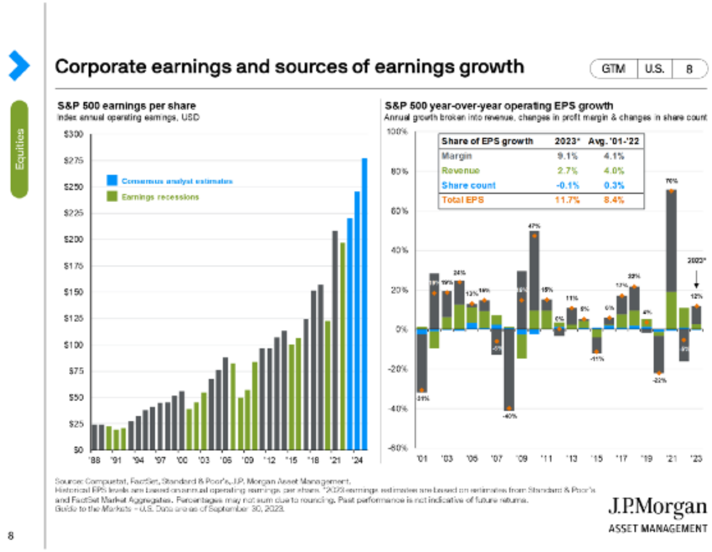
All of us at Covenant wish you a beautiful autumn and a Happy Thanksgiving!

Economic and Financial Markets Charts









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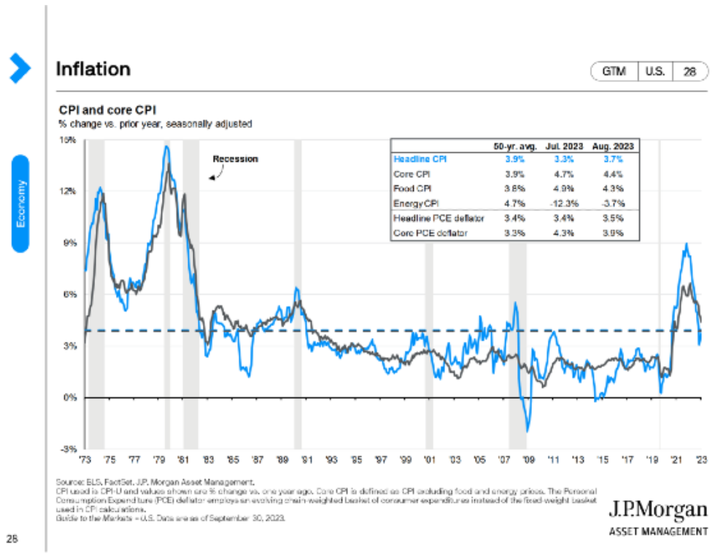

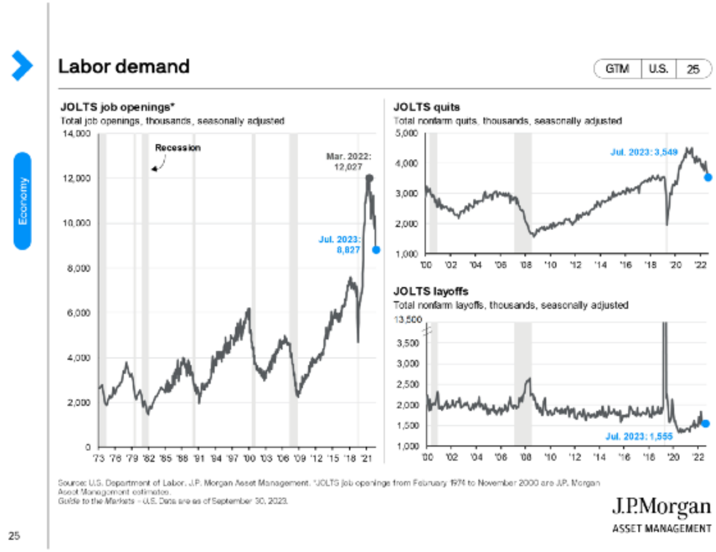

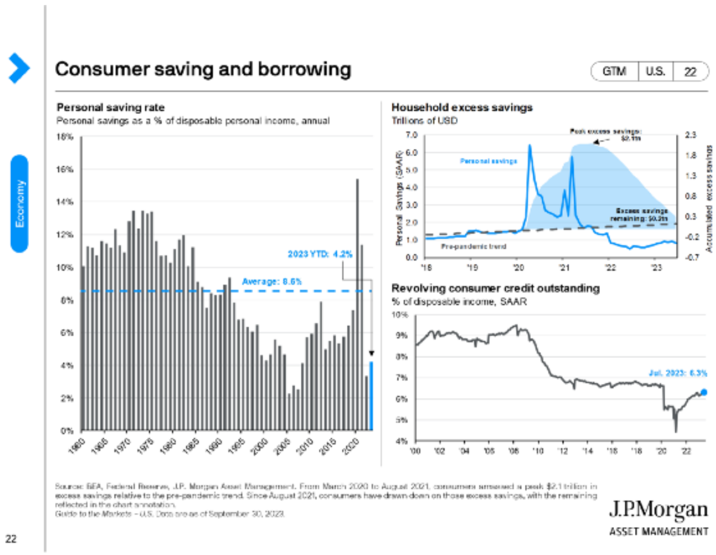

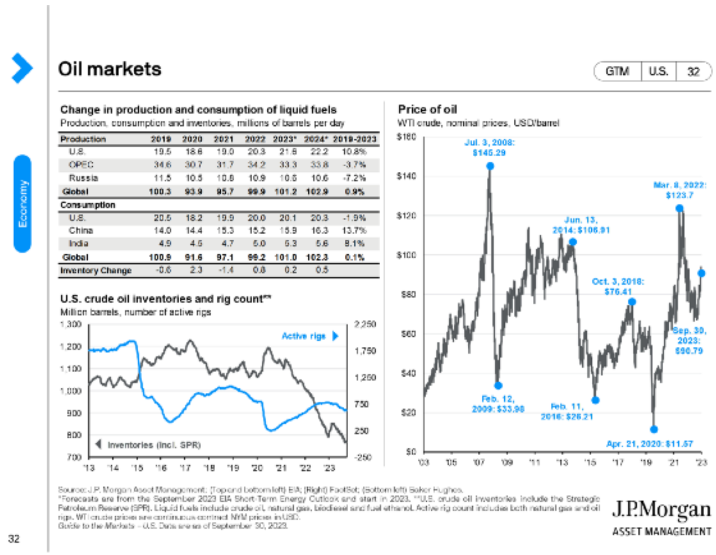

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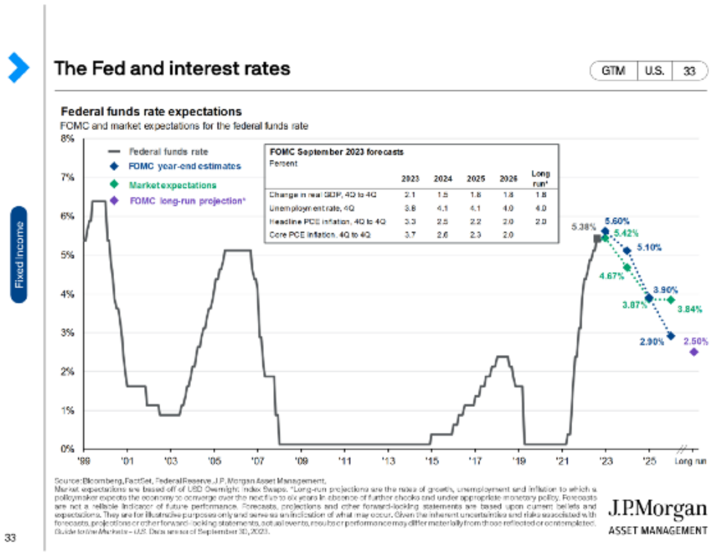

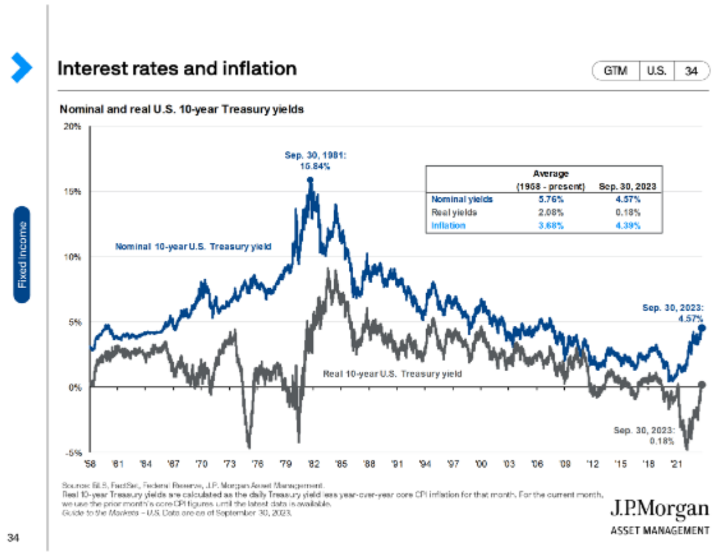

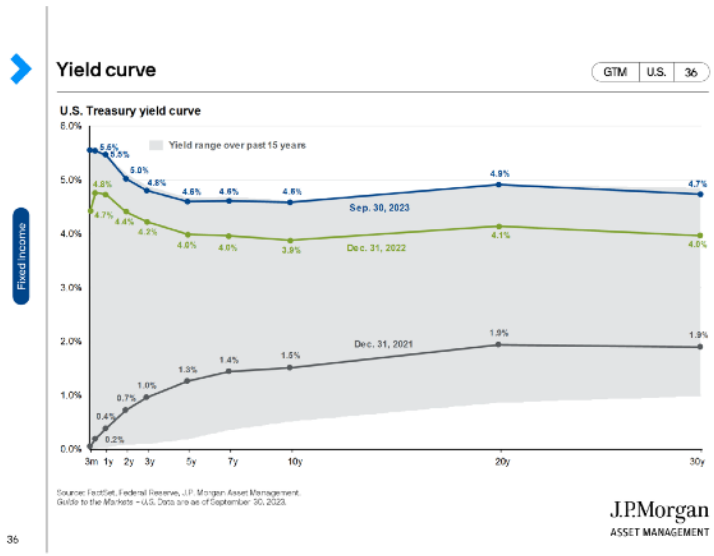

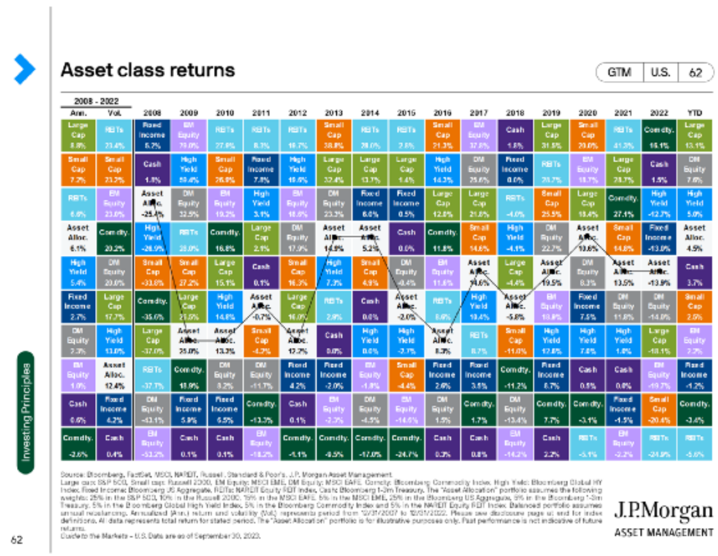

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Economic and Financial Markets Charts

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