

Covenant  
Asset Management, LLC



Fourth Quarter 2023  
Investment Perspectives



# Economic and Financial Markets Review & Outlook



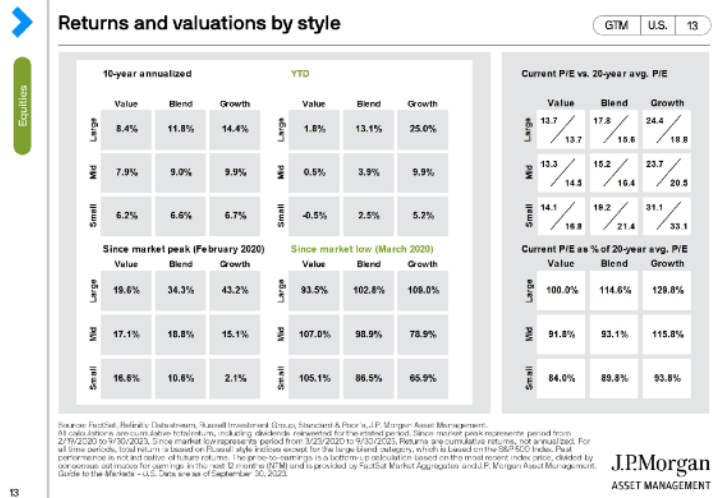
Covenant Asset Management is pleased to offer our latest investment perspectives. In this publication we review third quarter results and highlight key economic, financial and political themes which we expect will drive markets and investment performance in the coming months.

## 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



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

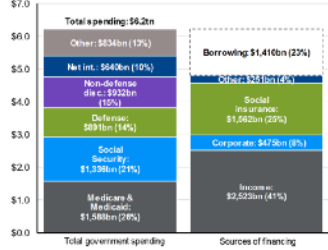
# Economic and Financial Markets Challenges



## Federal finances

GTM U.S. 20

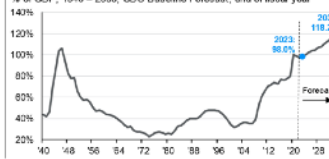
The 2023 federal budget  
CBO Baseline forecast, USD trillions



Federal deficit and net interest outlays  
% of GDP, 1973-2033, CBO Baseline Forecast



Federal net debt (accumulated deficits)  
% of GDP, 1940 - 2033, CBO Baseline Forecast, end of fiscal year



CBO's Baseline economic assumptions

	2023	'24-'25	'26-'27	'28-'33
Real GDP growth	0.9%	2.0%	2.4%	1.9%
10-year Treasury	4.2%	3.8%	3.8%	3.3%
Headline inflation (CPI)	3.3%	2.5%	2.1%	2.2%
Unemployment	4.1%	4.6%	4.5%	4.5%

Sources: CBO, J.P. Morgan Asset Management. (Top and bottom right) BEA, Treasury Department. Estimates are based on the Congressional Budget Office (CBO) February 2023 The Budget and Economic Outlook, except for baseline economic assumptions, which are based on the July 2022 CBO Update to the Economic Outlook. Other spending includes, but is not limited to, health insurance, Medicare, private security and federal civilian and military retirement. Data from other fiscal years, however, 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 uncertainty and risks associated with forecasts, projections or other forward-looking statements, actual results may differ materially from those forecasted or projected.

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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,

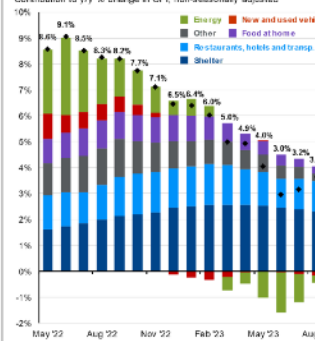
while high mortgage rates have caused existing home sales to tumble. Consumers have continued to spend on service-related items, such as travel, dining out and entertainment. However, there is increasing evidence that cracks are beginning to



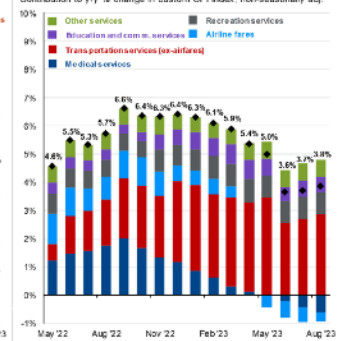
## Inflation components

GTM U.S. 30

Contributors to headline CPI inflation  
Contribution to y/y % change in CPI, non-seasonally adjusted



Contributors to core services ex-shelter CPI inflation\*  
Contribution to y/y % change in custom CPI index, non-seasonally adj.



Sources: BEA, FRED, J.P. Morgan Asset Management. Contributions mirror the BEA methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and excluding occurrences. \*Core services ex-shelter CPI is a custom index using CPI components created by J.P. Morgan Asset Management, LLC. "Shelter" includes owners' equivalent rent and rent of primary residence; "Other" primarily reflects housing for hotels, resorts, education and communication services, medical care services and other personal services. (Rpt) "Transportation services" primarily includes taxis, cabs and trucks, motor vehicle insurance and motor vehicle maintenance and repair. All data from the Bureau of Economic Analysis, as of September 30, 2023.

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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 began 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

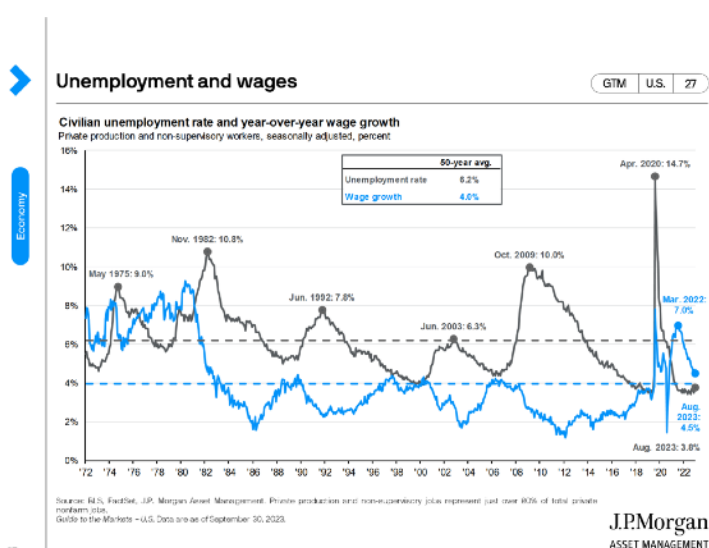


# Economic and Financial Markets Challenges



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

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!

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.





# Economic and Financial Markets Charts

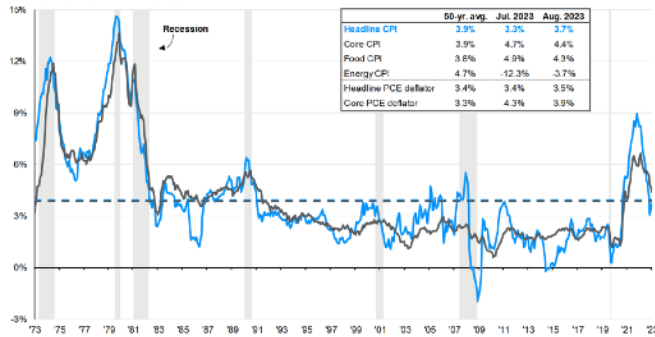


## Inflation

GTM U.S. 28

### CPI and core CPI

% change vs. prior year, seasonally adjusted



Source: BLS, FactSet, 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 innovation.  
Guide to the Markets - U.S. Data as of September 30, 2023.

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## Labor demand

GTM U.S. 25

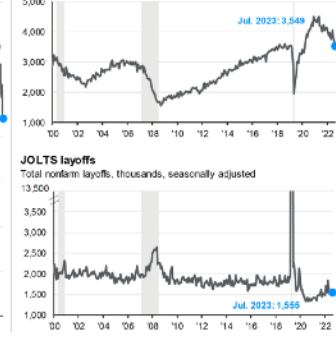
### JOLTS job openings\*

Total job openings, thousands, seasonally adjusted



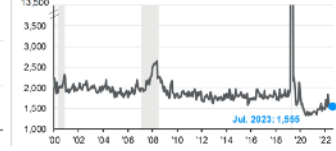
### JOLTS quits

Total nonfarm quits, thousands, seasonally adjusted



### JOLTS layoffs

Total nonfarm layoffs, thousands, seasonally adjusted



Source: U.S. Department of Labor, J.P. Morgan Asset Management. \*JOLTS job openings from February 1975 to November 2000 are J.P. Morgan Asset Management estimates.  
Guide to the Markets - U.S. Data as of September 30, 2023.

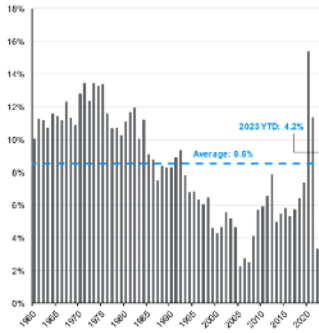
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## Consumer saving and borrowing

GTM U.S. 22

### Personal saving rate

Personal savings as a % of disposable personal income, annual



### Household excess savings

Trillions of USD



### Revolving consumer credit outstanding

% of disposable income, SAAR



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 innovation.  
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## Oil markets

GTM U.S. 32

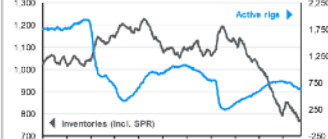
### Change in production and consumption of liquid fuels

Production, consumption and inventories, millions of barrels per day

	2019	2020	2021	2022	2023*	2024*	2019-2023
Production							
U.S.	19.5	18.8	19.0	20.3	21.5	22.2	10.8%
OECD	34.6	30.7	31.7	34.9	33.3	33.8	-9.7%
Russia	11.5	10.5	10.6	10.9	10.0	10.6	-2.2%
Global	100.3	93.9	95.7	99.9	101.2	102.9	0.9%
Consumption							
U.S.	20.5	18.2	19.0	20.0	20.1	20.3	-1.5%
China	14.0	14.4	15.3	15.2	15.9	16.3	13.7%
India	4.9	4.9	4.7	5.0	5.3	5.6	8.1%
Global	100.8	91.6	97.1	99.2	101.0	102.3	0.1%
Inventory Change	-0.6	2.3	-1.4	0.8	0.2	0.5	

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

Million barrels, number of active rigs



### Price of oil

WTI crude, nominal prices, USD/barrel



Source: J.P. Morgan Asset Management, \*World Energy Outlook (WEO) Outlook, (bottom left) Baker Hughes.  
\*\*Forecasts are from the September 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, distillate and fuel ethanol. Active rig count includes both natural gas and oil rigs. WTI crude price are continuous corrected NYM prices in USD.  
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# Economic and Financial Markets Charts

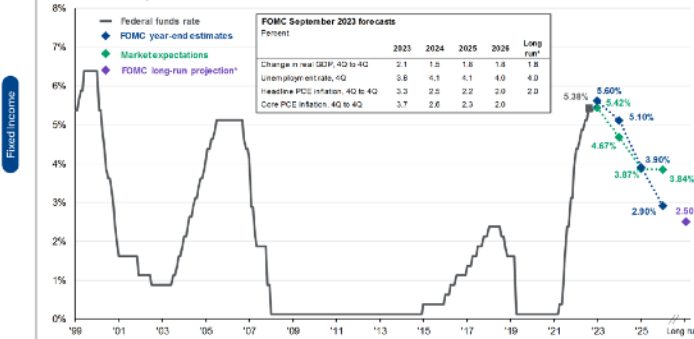


## The Fed and interest rates

GTM U.S. 33

### 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 USD Overnight Index Swaps. Long-run projections are the ratio of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next 10 years in the 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 do not constitute an indication of what may occur. Given the inherent uncertainties and data associated with forecasts, projections or other forward-looking statements, not all investors may be able to perform better than those reflected or contemplated. Guide to the Markets - U.S. Data as of September 30, 2023.

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## Interest rates and inflation

GTM U.S. 34

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



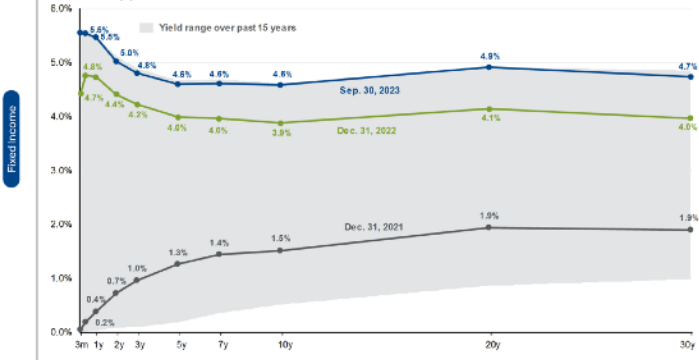
Source: FRED, FactSet, Federal Reserve, J.P. Morgan Asset Management. Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month's core CPI figures until the latest data is available. Guide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

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## Yield curve

GTM U.S. 36

### U.S. Treasury yield curve



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

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## Asset class returns

GTM U.S. 62

2008 - 2022		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD
Large Cap	73.4%	18.0%	27.9%	22.9%	16.1%	19.7%	28.8%	28.0%	13.7%	21.3%	37.8%	1.8%	31.5%	30.8%	41.2%	15.1%	15.1%
Small Cap	72.5%	18.0%	27.9%	22.9%	16.1%	19.7%	28.8%	28.0%	13.7%	21.3%	37.8%	1.8%	31.5%	30.8%	41.2%	15.1%	15.1%
High Yield	72.5%	18.0%	27.9%	22.9%	16.1%	19.7%	28.8%	28.0%	13.7%	21.3%	37.8%	1.8%	31.5%	30.8%	41.2%	15.1%	15.1%
Asset Alloc.	6.1%	23.2%	23.0%	16.4%	16.4%	17.0%	16.4%	5.2%	22.2%	22.2%	19.8%	14.4%	22.2%	19.8%	14.4%	13.9%	4.9%
High Yield	5.4%	23.0%	23.0%	15.1%	15.1%	16.7%	16.7%	7.0%	4.9%	11.6%	14.4%	14.4%	19.8%	13.2%	13.2%	13.9%	3.7%
Fixed Income	2.7%	17.2%	15.0%	14.8%	14.8%	16.7%	16.7%	0.0%	0.0%	11.6%	14.4%	14.4%	19.8%	13.2%	13.2%	13.9%	2.9%
DM Equity	1.9%	10.7%	10.7%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%
EM Equity	1.9%	10.7%	10.7%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Commodity	3.2%	0.4%	12.2%	0.1%	9.4%	11.0%	-1.1%	9.2%	-17.0%	-14.1%	0.2%	0.8%	14.2%	2.2%	-5.1%	-18.1%	-18.1%

Source: Bloomberg, FactSet, VICS, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large cap (SP500), Small cap (Russell 2000), EM Equity (MSCI EAFE), DM Equity (MSCI USA), Commodity (Bloomberg Commodity Index), High Yield (Bloomberg iBoxx HY Index), Fixed Income (Bloomberg US Aggregate), DM Equity (MSCI EAFE), Cash (Bloomberg US Treasury), Asset Alloc (J.P. Morgan Asset Management), High Yield (Bloomberg iBoxx HY Index), 20% in the SP500, 20% in the Russell 2000, 20% in the MSCI EAFE, 20% in the MSCI USA, 20% in the Bloomberg US Aggregate, 20% in the Bloomberg US Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the MSCI EM Equity Index. Balanced portfolio assumes annual reweighting. Rebalanced 50% in cash and 50% in the Bloomberg Commodity Index and 5% in the MSCI EM Equity Index. Balanced portfolio assumes annual reweighting. All data represents total return for stated period. The "Asset Alloc" portfolio is for illustrative purposes only. Past performance is not indicative of future results. Guide to the Markets - U.S. Data as of September 30, 2023.

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# Economic and Financial Markets Charts



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