COVENANT
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WWW.COVENANT.CA

20385 64TH AVENUE, LANGLEY BC V2Y 1N5 **PHONE** 604.546.1100 **TOLL FREE** 1.888.629.0044 **FAX** 604.546.1101 **EMAIL** info@covenant.ca

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Summer Priorities

Having made the effort to produce it, we'd be disappointed if you didn't take a few moments to read our newsletter. But please, don't let it be the highlight of your day! Summer brings so many opportunities to be active (within reason!) to try new ways to explore and re-appreciate God's creation, perhaps even to find new and creative contexts to reconnect with family and friends. One of our clients has taken his entire family to Africa with the specific goal of working together in a missional context and introducing his children to opportunities for service away from home. We may not all be ready to take such a bold step, but there is much we can do here at home to demonstrate God's care, and possibly even get some sun in the process.

Market Overview

In the timeless struggle between the Bulls and the Bears, the present state of play might best be described as stalemate. Three major issues dominate the current economic landscape:

1) Continued weakness in the US recovery
2) Re-emergence of European debt issues
3) Uncertainty surrounding the Chinese economy

Each of these is of sufficient magnitude and influence to get either the Bulls or the Bears wildly excited, resulting in the volatility we have been experiencing.

So far, recovery in the US economy has been anemic, no more than a shadow of the substance needed to generate any growth momentum. It appears that the US government's efforts in monetary stimulus since 2008 have not provided enough support for economic growth. In June the US Federal Reserve extended to the end of 2012 its "Operation Twist" program - a process of buying $267 billion short term (0-3 years) US government bonds and replacing them with longer term bonds (6-30 years). Unfortunately this has yielded limited success, despite interest rates reaching record lows, after a series of monetary and quantitative easing.

In May, the European debt crisis re-emerged following the Greek election, interrupting a period of relative calm in the first quarter. Many observers now consider that in hindsight, the 1999 'experiment' to form a common EURO currency for 17 European member countries, to have been a very bad idea. Many of these countries, with differing social and political attitudes, different fiscal and monetary systems, have little in common beyond their currency. The result is that in times of economic stress, some countries (Italy, Spain, Portugal and Greece are examples) suffer from their inability to make the necessary fiscal or currency adjustments to balance their budgets. A clear solution is yet to emerge but the financial collapse of one or more Euro-Zone countries, the dismantling of the EURO currency, or even the full fiscal, monetary and political integration of the member nations should be considered possible outcomes. The efforts of most European politicians remain focused on preserving a status quo that seems unsustainable.

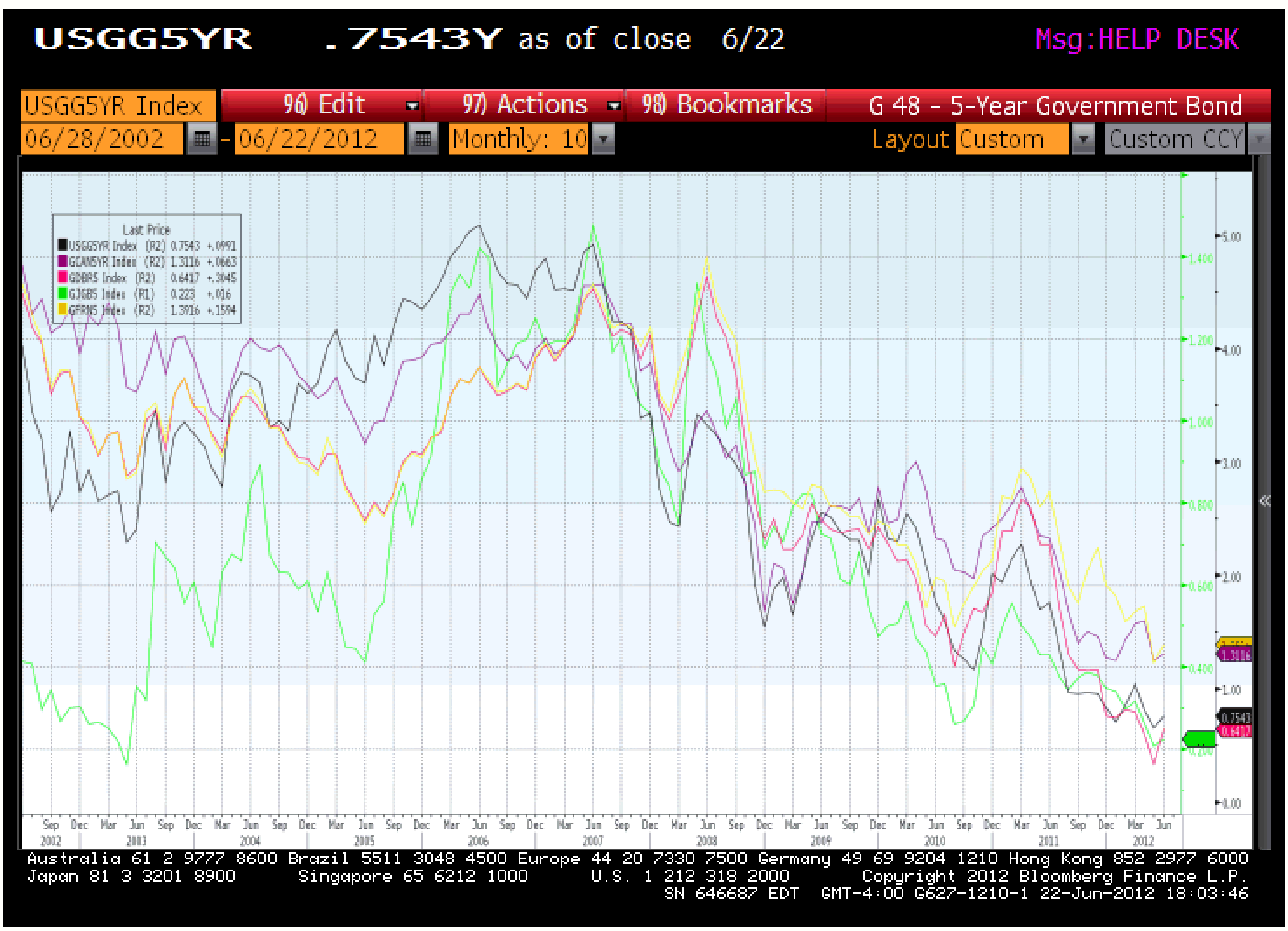
Lastly, let's turn our attention to China. Traditionally a low cost producer and exporter, China has enjoyed a very high rate of growth for more than a decade. In 2008, the country contributed significantly toward global stability in face of the financial crisis, but they now face a challenging transition from being export-driven to a more consumer-led economy. This has led to a lower growth rate in recent quarters. Their growth is being further impeded by stagnation among their major trading partners, notably the US and Europe.

Recent data from China such as the Purchasing Manager Index (PMI) suggest weakening industrial demand reflecting weaker manufacturing, which is one of their main sectors of growth. Given the increasing influence China has on world markets, it remains a key factor to watch when considering the outlook for resource and emerging markets.

Investment Implications

We feel that lower global growth will ultimately translate into lower commodity and energy prices. However, the commodity sector has an 'auto-correcting' mechanism, providing an eventual floor price to commodities. This operates when a declining commodity price reaches a level that is too low to justify further production. Producers then have to cut output, leading to a supply squeeze that will ultimately drive prices higher. A similar mechanism operates when a decline in energy prices has a corresponding positive effect on the discretionary spending power of consumers and corporations, increasing their ability to save or invest for the future.

Lower commodity prices are also disinflationary. A lower inflation rate provides room for central banks to continue the printing of money (quantitative easing) with the desired result of keeping the cost of borrowing low; the chart below shows the 5-year government bond rates in developed countries to be near historical lows.



Source: Bloomberg

The 5 year government bond rates of five leading developed countries are around 1% or less.
The US Federal Reserve has promised to keep their short interest low until June 2014. European Union is looking to ease their interest rate whilst UK interest rate remains low. Canada is not likely to raise its rates in the short term while Japan continues a well-established low rate policy.

USA	0.594%
Canada	1.176%
Japan	0.180%
Germany	0.276%
France	0.754%

Our Portfolios

Despite the volatility in the equity market, our core 50-model portfolio continues to perform well despite its lower level of risk compared to the broad indices. We continue to look creatively for avenues to enhance returns in the persistently low yield environment.

While the volatility of recent months provided some buying opportunities, we still have some positions to fill and continue to maintain a cash position ready for timely deployment within our core equity allocation.

June 29, 2012				
Date	S&P TSX	S&P500	MSCI	CORE 50
5 Year	-3.32%	-2.71%	-7.98%	1.2%
3 Year	3.93%	9.87%	0.58%	8.2%
2 Year	1.34%	13.34%	-1.72%	7.5%
1 Year	-12.81%	8.84%	-11.92%	4.2%
Year to Date	-3.00%	7.82%	0.41%	2.1%

Notes:

1. *The number represented by the "Core" model denotes that model's maximum exposure to equities (e.g. Core 50 Model has up to 50% equity exposure).*
2. *Returns for the Core50 Models are composites of actual client portfolios. Returns for individual portfolios will have some variance from the composites due to the timing of cash flows and different acquisition dates of component securities.*
3. *Returns for the Core Models are after all management fees and transaction costs.*
4. *Returns for the stock indices assume no transaction or management costs; in practice, accessing these markets would incur costs of some type.*
5. *Our standard management fee is 1% per year, with discounts applied to portfolios over $3 million. Covenant's fees may be tax deductible, further enhancing effective returns.*

Team Update

While our working lives may be characterized as somewhat sedentary, some of us occasionally go outside! The Covenant Capital team was recently well represented at a 5KM and a 10KM run, raising funds for Mercy Ministries. Notable performances came from Elyse who proudly finished without the need for medical assistance, and Glenn who placed a very respectable 3rd overall.

(Left to right: Glenn, Maria, Elyse, Rebecca, Amanda, Leanne)

Stephen also gets away from his desk from time to time, working toward his 2nd Degree Black Belt in Taekwondo. He and two of his children recently won Canadian Champion titles.

Sincerely,
The Covenant Capital Management Team