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Summertime

Vacations, staycations, family time, sunshine, picnics, hikes, the pool.... So many ways to appreciate that this is the season that most lends itself to getting outside – and taking time to be impacted by the beauty of God’s creation. Yes, of course, we should be doing that in the Winter too..... It just seems easier when the sun is shining! It’s probably no coincidence that when offering review meetings, the summer season is the time when many clients will politely decline. And that’s OK. We’ll let you skip a meeting, once in a while! After all, we are the ones charged to watch over our clients’ portfolios – that’s why we are here, so you don’t have to be. So go on – go outside; see all that God has done, and praise Him for it!

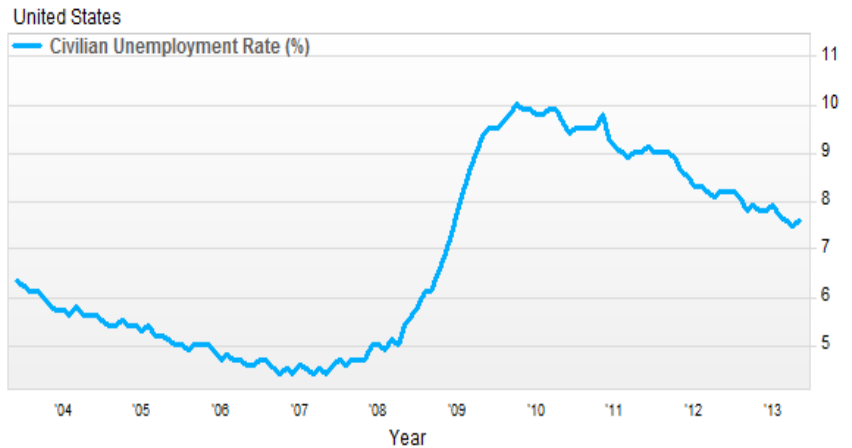
The Markets

When Will The Money Printing End?

Do you remember back in 2000 we were worried (or at least encouraged to worry) about the “Millennium Bug” which was about to crash computer systems worldwide? (The editor has to interject here, observing that those with even the most fragile grasp of mathematics recognize that the new millennium actually began on January 1, 2001.....) The US Federal Reserve (Fed) was so concerned about its potential impact on the financial system, that it quickly provided extra liquidity to the system. A year later, the stock market was mired in the aftermath of a devastating implosion in the technology sector. Alan Greenspan, then chairman of the Fed, injected a huge amount of excess cash into the system. This engineered liquidity laid the foundation for the stock and housing markets surging from 2002 to their collapse and the banking crisis of 2008. The outcome was an economic catastrophe of near great depression proportions. Greenspan’s successor, Ben Bernanke, also took bold actions adding further cash into the financial system. He had formerly (in a 2002 speech to the National Economists Club) alluded to the central bank’s ability to print “an unlimited amount of money”. He enthusiastically exercised that hypothesis from 2009 with US\$85billion of new money still being created each month. This is a staggering level of sustained quantitative easing, unprecedented in the Fed’s history. They cannot know all the risks of their actions, or the consequences of their eventual, inevitable cessation. The Fed wants the public to rebuild their wealth through positive stock market returns and by the lowering of interest rates to lessen the impact of debt burden. The rationale is that if the public is confident of the economy, their spending will increase and unemployment will consequently improve.

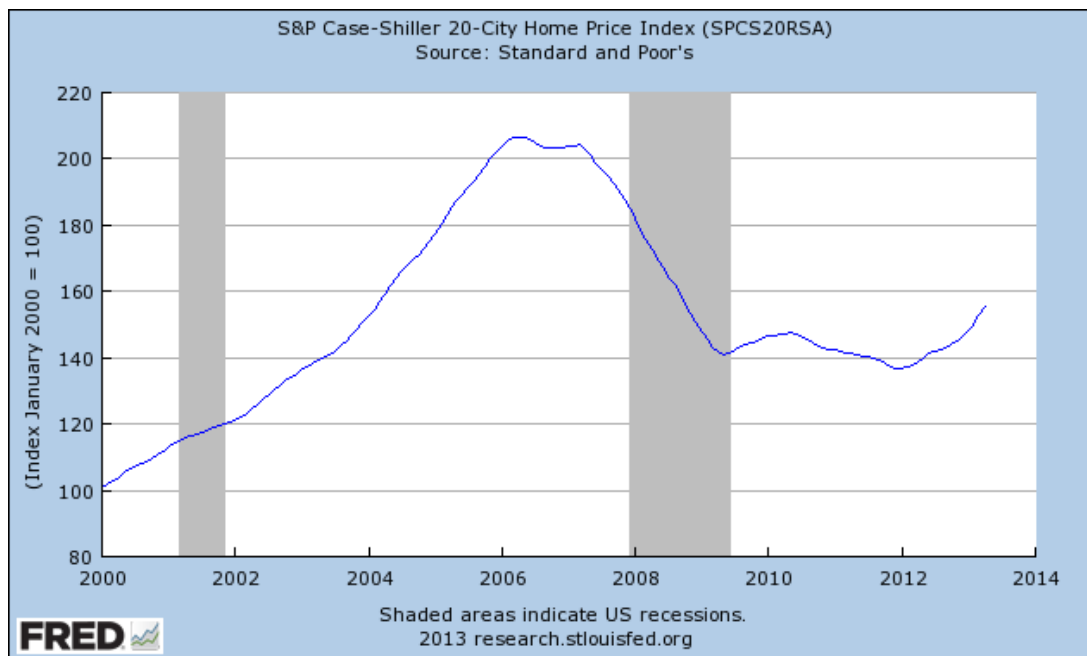


This chart indicates that Fed actions are having a positive effect on the job market. Some caution is needed however, as the US has a method of reporting employment stats that is inconsistent with other countries and broadly criticized for its inaccuracy.



US Unemployment Source : Factset

This chart shows the positive impact of Fed policy on the housing market.



US Housing Price Index Source: St Louis Fed.

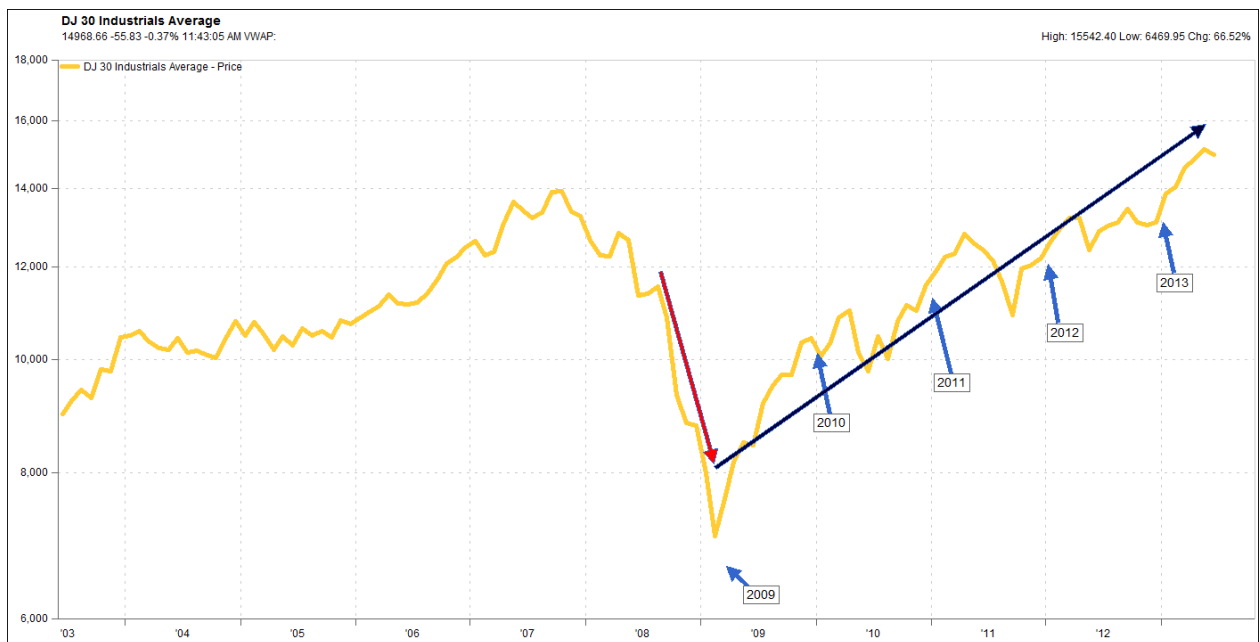
The relentless money printing is, however, causing concerns. In June 2013, the Fed gave a first indication of their intention to reduce the money printing, citing the improvements in unemployment and housing. They stated that they expect: 1) Interest rates to stay low until 2015. 2) Their \$85 billion a month asset purchase program to continue until key economic indicators cause them to consider a reduction. One of the key thresholds being the return of US unemployment to below 7%. Their optimistic assessment of the economy caused interest yields to spike up and the stock market to tank. Gold plummeted even more with investors worried that the Fed will taper their asset purchase program soon. The consensus thinking is that the Fed will not



act before December 2013. The Fed's critics remain unconvinced, citing its poor record on economic forecasting. We feel the Fed is distorting asset pricing and causing greater complexity in market valuation. While the Fed's actions may be necessary in a depressionary environment, its continued interventions will create price instability.

Here are some highlights of the Fed's action on financial markets:

US Stock Markets responded to the fresh liquidity by achieving successive highs each year since 2009. Quantitative Easing is the reason for the stock market rally and is, perhaps, the most closely watched indicator of market direction. In the past few weeks weak economic data have been interpreted as a strong buy signal, while strong data becomes a sell signal. This is because of the focus on the Fed maintaining its current monetary policy.



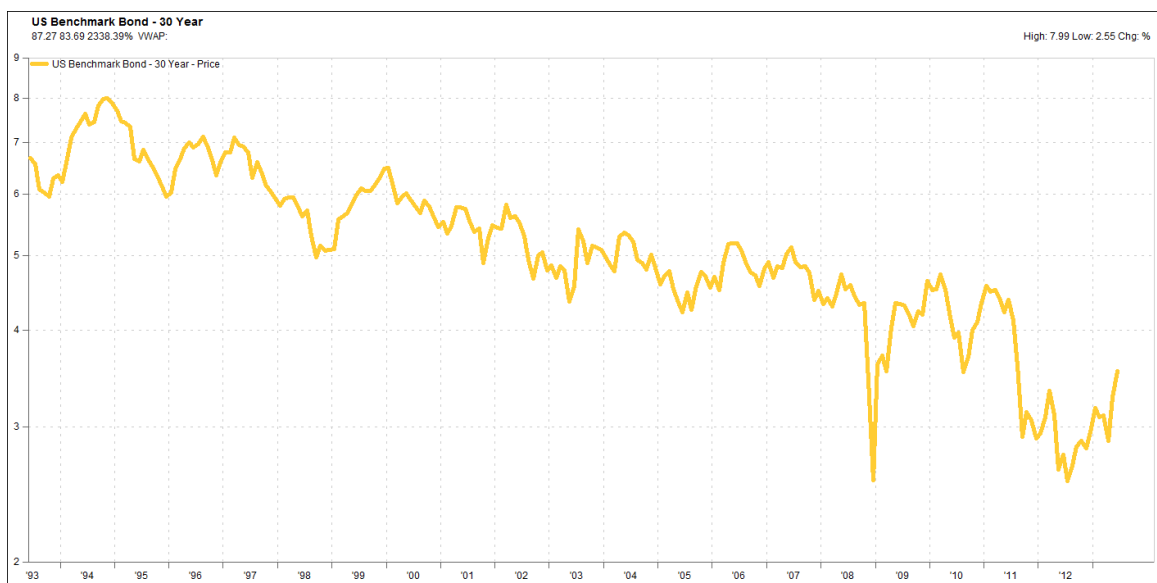
Weekly DJIA US Stock Index Source : Factset

Commodities and Precious Metals benefited mostly from the Fed's policies. They had a huge rally since 1998 benefiting from the US low interest rate and weak US Dollar. The longest rally (10+ years) took gold to a high of US\$1907/oz in 2011. Thereafter it began to correct and has traded below US\$1200/oz recently, a 44% downmove. Currently trading around US\$1240/oz, if prices stay below US\$1200/oz, many high cost gold mining companies will suffer as global all-in-break-even cost for gold extraction is around US\$1200/oz.



Weekly Gold Price Source : Factset

Bond Yields fell to a low of 2.55% in July 2012 before rebounding to around 3.54%. While yields are still low, the sharp rebound is putting pressure on the fixed income sector. Further long term yield gains may be detrimental to recovery in the US housing sector, but the Fed's anchoring of short term rates until 2015, is likely to produce steepening of the yield curve.



US 30 year Bond Yield, Source: Factset

Global and Emerging Market Equities suffered more in the last 2 weeks of June, mainly due to concerns over spillover effects from reduced liquidity and credit concerns in China. However, we are optimistic about growth prospects and seek to add to our modest exposure in this sector. We believe that fundamentally, global, emerging and even frontier markets can provide greater diversification in our portfolios.



Fixed Income

In considering the Fed's recent and likely future actions, we have sought to reduce the average duration in our fixed income allocations. This has been accomplished by reducing Real Return and Corporate Bonds in favor of shorter duration instruments.

The recent upward adjustment in most portfolios of the Covenant Mortgage Pool position is contributing very positively to returns in the fixed income allocations. We are delighted with the 1 year return (to June 30) of 9.96%. The quality and rates of assets recently added to the portfolio gives us some confidence in our ability to maintain similar returns.

On the horizon, we are working hard to introduce our second 'home grown' fund. By replacing the current discrete holdings, the Covenant Fixed Income Pool will provide trading, pricing and administrative efficiencies that should further enhance returns.

Equities

The steep gains in equity markets are making true 'value' (as defined by our absolute value approach) difficult to find. The disciplines we employ prevent us from buying 'comparatively good value' or 'reasonably good value' securities. In our opinion, the broad over-pricing of many equities makes prudence the more attractive option and we are very comfortable to preserve capital by patiently holding increased cash positions until sound opportunities can be quickly grasped.

Even in broadly over-bought market conditions, opportunities do arise. Dorel Industries had been a long-term hold in our Core Equity allocation. At the end of January, we felt that while the fundamentals of the company were still sound, the stock price of \$40.01 no longer represented good value – so we sold and took profits. By mid-June, a broad sell-off saw the price drawn down – so we bought it again, at \$34.68. It now trades in the \$38 range.

Summary

Over-bought markets, a yield-curve in motion, Central Banks' mixed messages and unprecedented money-printing can only add up to one certainty – increased risk. We have long held, and continue to hold, the view that diversification is the only effective antidote to risk. Investors face a choice, reach for returns by taking more risk, or reduce risk and wait for returns to come. We are taking the latter option which is consistent with our desire to preserve our client's capital.



Our portfolios are built upon the assumptions that even the things we assume won't change, might. And that unforeseen events are inevitable. We will continue to seek out new opportunities to further diversify, weighing each carefully against our objective to preserve capital.

The Team

Maria will be in our thoughts and prayers as she takes maternity leave from July 31st. She and her husband Colin expect their second child in mid August. We look forward to her rejoining the team in 2014.

While she is away, much of Maria's workload will be borne by the latest addition to our team, Janet Kim Sing. With seven years experience in the investment industry, Janet spent the past five years at an investment counseling firm in downtown Vancouver working alongside private clients, foundations and institutions as an Associate Portfolio Manager. Her holistic approach to investing is well aligned with Covenant's methodology and she is a strong advocate of financial literacy. In her spare time, Janet enjoys keeping active and can be seen cycling, hiking, or running with her dog. She is passionate about spreading the Good News overseas through global missions.

If he isn't meeting with clients or 'flexing his compliance muscles' to keep us on the right side of government regulations, Stephen Smith can often be found in the ring at Songahm Taekwondo tournaments. He and his three children all hold Black Belts in the sport and this year he and his daughter Amy qualified to compete in North American District Championships. The Northwest District is comprised of all of Canada, Washington, Oregon, Montana, Wyoming and Idaho. Amy won two bronze medals, Stephen a silver and a District Champion title. While he denies any connection, we're also pleased to report Stephen is recovering well from his recent shoulder surgery.

Congratulations to Amanda on completing the 2013 Tough Mudder in Whistler! This grueling 19KM obstacle course throughout mud, ice, snow and electricity, tests the stamina of even the most dedicated athletes. Well done!

Please let us know if you have questions or concerns about your investments managed by our team, or elsewhere.

Enjoy the Summer!

Your Covenant Capital Management Team.