COVENANT
CAPITAL MANAGEMENT INC.

INVESTORS' JOURNAL

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Editorial and Market Update

The second quarter of 2015 proved to be more eventful and turbulent than the first. The release of the Canadian Federal Budget in April started things off well. Investors received an increase in annual TFSA contribution room from $5,500 to $10,000, and minimum RRIF withdrawals decreased from 7.38% to 5.28% (starting at age 72).

As the quarter progressed, both oil and the Canadian dollar rallied and then dropped again. China's stock market began a very rapid and precarious descent, while Greek banks came closer to running out of money. During this period, the TSX went on a turbulent ride and finally ended the quarter at -1.63%. The bond market was down -2.11% over 3 months, ending June 30, 2015.

In recent months, there has been much debate over interest rate moves on both sides of the border. At the beginning of the quarter, most commentators believed a US rate hike was imminent. As time progressed and economic statistics were not as strong as predicted, the timing of the hike became less certain. In Canada, the slowing economy precipitated a drop in rates. Canada's economy has suffered because of the drop in oil prices, slowing growth in China, and a decrease in non-resource based exports. On July 15th, Canada's central bank announced a quarter percentage drop in their overnight rate to 0.50%. Although this may help some struggling sectors, there is a very real fear of overheating an already red-hot real estate sector and increasing the burden of Canadian household debt.

Amidst all of this economic uncertainty, we believe it is important to construct well-diversified portfolios. Taking advantage of both non-traditional and traditional investment solutions will help to mitigate downside risk and provide long-term investment growth.

Over the past few months, our pooled funds have each contributed as projected, which lends certainty to the balanced nature of our portfolios. For more information on their performance, please see page 3.

AND THEN THERE WAS GREECE…

Consider the contrast of the following two statements, which struck us this month as an ongoing dichotomy in finance and investment:

"There is no new thing under the sun."
"I don't take part in any historical comparisons."
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"Dishonest money dwindles away, but whoever gathers money little by little makes it grow." – Proverbs 13:11

Editorial and Market Update

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The former wisdom is from Ecclesiastes. The latter, is a response given from German Chancellor Angela Merkel after questions about similarities between negotiations with Greece and the onerous obligations imposed on Germany in the WWI-ending Treaty of Versailles. It is particularly difficult to navigate situations that have lessons from the past, while also understanding that historical comparisons may not take into account the many nuances of a current dilemma.

There is, in fact, no precedent for a “Grexit” – Greece’s potential economic collapse and subsequent exit from the Eurozone. One can consider partial parallels with the USSR dissolution, the Argentinean collapse of 1998, and other European defaults or negotiations, but there is no standard for the dissolution of a currency bloc.

To put it simply – weak fiscal management, spending more than you make, and an attitude of entitlement will eventually result in financial ruin. Although there is nothing novel about these factors in the Greek situation, Merkel’s statement implies that no one can foresee the result. To think that everything about this crisis has a partner in history is overly simplistic and can lead to mistakes in judgement. The contrast of these two ways of thinking – an eye to past mistakes, along with a fresh look at the situation at hand, is something that investors must constantly wrestle with when making decisions.

Greece’s economy is an interesting conversation topic, but why bother having this conversation in the first place? Why is this relevant in Canada? After all, our notional exposure in Covenant funds is miniscule, even if the Greek economy completely collapsed. Greece’s GDP is such a small percentage of the world market.

It appears that Greece has averted a full default, with additional financing of around €86 billion from its creditors on the table for negotiation. This is a lot for Greece, with a GDP of €179 billion in 2014, but it amounts to only 0.62% of the entire EU’s GDP. Compare the US federal national debt of around $18.3 Trillion (105% of their own 2014 GDP) to Greece and it does seem like a lot of fuss is being made over a small position.

Although the numerical reality indicates that the Greeks are not worth the greater part of our attention, if there is one thing we have learned in this business, is that “the numbers aren’t everything.” So, what aren’t the numbers telling us? Here are some thoughts that our investment management team have taken the time to consider:

The EU is a great experiment in the collaboration of 28 very different countries. Although Greece is not economically significant, a “Grexit” would shake the very foundation of this arrangement. Suddenly, other struggling European countries may consider a move away from the EU if the deal works out well for Greece. The erosion of trust and security between these nations (and within them) could have a devastating long-term impact. Consider the financial ramifications of countries leaving the EU Free Trade Agreement. Proverbs 10:9 reminds us that “whoever walks with integrity walks securely...” and losing trust introduces risk, vulnerability, and fear. A loss of trust destroys the mechanisms and structures that make modern finance possible. It is certainly not a recipe for rational and efficient markets.

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The second insight we can glean from the events in Europe is that there is a lot of "dumb money" in the market today. This phrase is about the temptation to move whenever we feel a push; to move with every passing wind of financial superstition and news. Dumb money affects security pricing and statistics in the short-term and it muddies the water from a long-term perspective. In order to journey through the noise, investors need discipline; they must stick to basic financial principles. This disciplined approach recognizes the following:

- Accurately pricing an asset and its starting yield is very important to long-term performance.
- Trailing short-term performance should not force decisions that cost return in the long-term.
- Realistic expectations of returns can help avoid stretching risk.
- Understanding and minimizing costs and fees prevents the erosion of long-term performance.

Integrity, discipline, and a focus on capital preservation are all key pillars of Covenant's investment philosophy. It is important not to presume upon the future and to minimize speculation. We do not know how the Greek crisis will end, or how its resolution will affect the rest of the EU, but we can avoid tossing back and forth with the winds of today's news. We can apply a disciplined approach to all of our investment decisions. Ultimately, we know the Lord has everything in His hands and we must do our part in applying wisdom in all our decisions.

Covenant's Pooled Funds Summary

Covenant Fixed Income Pool:
Conservative, traditional and non-traditional fixed income

3 month: 1.10%
6 month: 3.22%
1 Year: 4.73%
Inception: 4.40% (annualized since November 2013)

Covenant Traditional Equity Pool:
Value-Based approach to investing in traditional equity markets

3 month: 1.39%
6 month: 1.52%
1 Year: n/a
Inception: 2.83% (Since November 2014)

Covenant Mortgage Pool:
Diversified pool of construction and development mortgages

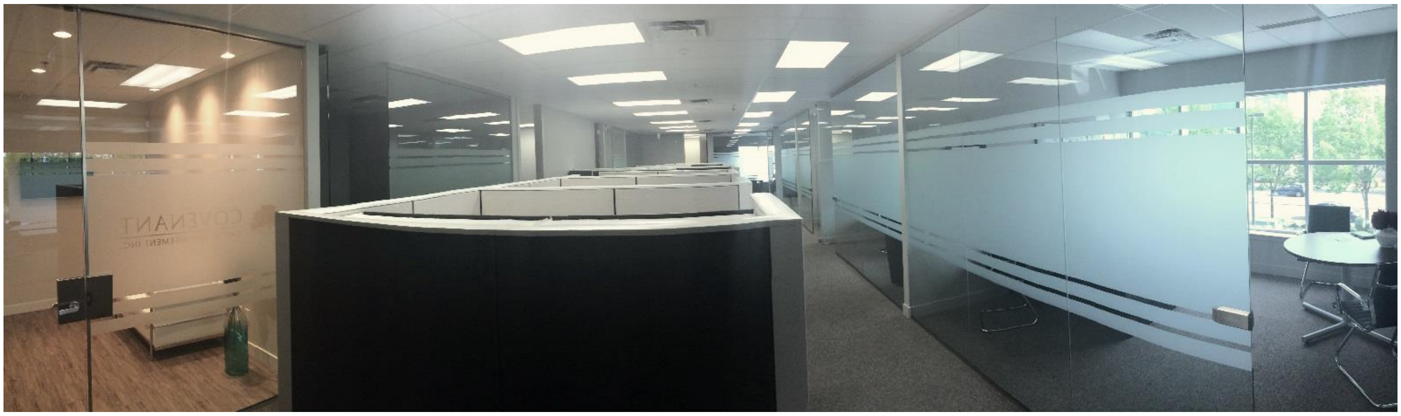
3 month: 2.37%
6 month: 4.87%
1 Year: 10.43%
Inception: 9.60% (annualized since April 2012)

Covenant Non-Traditional Equity Pool:
Diversified portfolio of non-traditional investment opportunities

3 month: 3.36%
6 month: 4.47%
1 Year: 8.61%
Inception: 7.26% (annualized since May 2014)

Performance figures are those of Class I units. Class I units are available only to the managed account clients of Covenant and to certain institutional investors that have entered into a management fee agreement.

We Have Moved!



In our last quarterly newsletter, we noted that we have been transitioning into a new office space. We are now pleased to announce that we have officially moved! Our new office is conveniently located across the parking lot from our former office, where Covenant Planning Group is located. Covenant Capital Management is excited to offer clients a brand new space for meeting.

Please note the following address change before your next visit to Covenant Capital Management:

Unit #218, 20353
64 Avenue,
Langley, BC V2Y 1N5

Glenn was very involved in the design process of the new office. He, along with Marlene and Leanne, have worked very hard over the past six months to plan a functional and efficient workspace. The open concept of the building lends itself well to our team atmosphere, while elements of the design preserve privacy for client meetings.

We look forward to your next visit and would be proud to give you a tour of our new space.