COVENANT CAPITAL MANAGEMENT INC.

INVESTORS' JOURNAL

EDITORIAL

Fall is officially here but as we look back over the past few months it is apparent that the media has not had a restful summer by any means. On the international front, tensions are still high between Russia and Ukraine and this past July, a Malaysian Airlines flight was caught in the crossfire and shot down killing all passengers on board. The Ebola outbreak has hit international headlines and claimed the lives of many including several missionaries, and has become a Public Health Emergency of International Concern on August 8th. This September, Scotland went to the polls to vote on whether it would separate from the United Kingdom after its union of 307 years. Although a majority of "No" votes won out, there is still a lot of work to be done to bring about unity. Escalating ISIS insurgence and brutality in the Middle East has gained extra media attention, with Western countries responding by sending support to defending regions. And finally, as at the time of issue, pro-democracy protests have continued to take place in Hong Kong with China unwavering in its position.

All of these scenarios present real geopolitical risks which can easily affect markets around the world. In general, investors have been fairly complacent in their response to these crises, but the reality is that *any* exogenous shock can seriously affect markets both here and abroad. Recent history has proven that the world is more correlated than ever before; which is why we are promoting a diversified portfolio of both traditional and non-traditional securities. Ecclesiastes 11:2 reminds us to "Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the earth."

September 2014

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"Whatever you do, work heartily, as for the Lord and not for men, knowing that from the Lord you will receive the inheritance as your reward. You are serving the Lord Christ."

- Colossians 3:23-24 (ESV)

And Now for Something Completely Different: Q&A Period

As we've spent the past few editions introducing our pooled fund line-up, we'd like to take the time to post some of our clients' more frequently asked questions. This will hopefully shed some light on our views and take the place of our regular Portfolio & Market Update.

Q: It seems that markets are reaching ever new record highs, how long will this go on?

Although stock markets continue to rise, levels of volatility have certainly increased. Stock valuations are exceedingly stretched and without persistently solid economic fundamentals, we feel that there is a lot of risk in being fully exposed to the stock market. In fact, our equity model currently holds a fair amount in cash. However, our YTD return on equities is 7.04% which is not far off from the Canadian stock market which is at 10.05% but with full exposure (as of September 30th).

Q: I keep hearing about a new neutral rate, what is the neutral rate and what does a new neutral rate mean?

A neutral rate is the interest rate which allows GDP to grow at full capacity alongside stable inflation. There is much speculation that we will discover the 'new neutral rate' to be lower than in previous years as our output growth (GDP) could be lower than historically. During the mid-2000's, we were looking at neutral interest rates around 4.5-5.5%, whereas today we could be looking at a rate closer to 2-3%. This is relevant because if it holds true, the Bank of Canada's policy interest rate, currently set at 1%, will likely continue to remain low in order to promote full GDP growth.

Q: When will interest rates rise?

We are reticent to give any specific timeline as we know that circumstances can change quickly. Having said that, the general consensus is that interest rates in the US will rise marginally sometime in mid-2015 with many believing that economic data may be enough to substantiate a rise even before then. The one caveat to this opinion is the market response when Quantitative Easing ends. If the markets respond in a particularly volatile manner, we might see rate hikes held off for a while longer.

The rates in Canada are somewhat influenced by the US situation, but our economic landscape also operates independently. Even though our economy is exhibiting signs of health with decent employment numbers, decreasing consumer debt and a growing export market, inflation is still low and GDP growth marginal. Therefore, we believe rates may increase slightly in the spring, but in the near term there will be no significant rate hikes to cool off an over-heated economy.

Q: Will the official end of Quantitative Easing (QE) in the US affect the markets?

Quantitative easing dates back to 2008 and was a program designed to stimulate the economy, whereby the Federal Reserve buys certain bonds and effectively pumps money into the marketplace. It has long been argued that QE is the primary mechanism supporting the growth in the stock markets. With Quantitative Easing due to end by the end of October, one can expect greater volatility in the equity markets. However, it is also worth noting that while the US is winding down their program, other countries are launching their own. For example, the European Central Bank (ECB) recently announced a triple combination of old and new stimulus measures to revive the European economy which could add up to 1 trillion in money supply to the market. This is noteworthy because while the US is turning off its tap, from a global perspective, liquidity will continue in other forms and from other sources.

Q: Why is the Canadian dollar so low right now while the US is so strong?

There are several factors at play when considering currency. First, the strength of the US dollar has increased on both stronger economic data and, also very importantly, the Fed's continued quantitative easing. Investors in US currency have "got the message" that the Fed is not interested in downside volatility and have developed confidence that they will step in if things begin going south again. This has improved the US Dollars' reputation as a reliable safe haven, thereby increasing its demand and value. The Canadian Dollar is impacted by the sheer strength of the US, but it may also be influenced by the words (supporting downward pressure on the Loonie) of our own central bank. A low dollar will improve export growth, which is a key component of GDP. If the other parts of the GDP equation are not performing well, then it would make sense to promote the one that could outperform; and a lower dollar helps it achieve that result. But regardless of the Bank's influence, it has often been suggested by economists that a high Loonie is not sustainable long term. Canada's huge manufacturing and resource market would require a lower dollar to be efficiently profitable, and so the laws of economics would over time naturally drive it down.

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STATEMENT UPDATE

One of the more frequently asked questions received to our team is regarding our custodian's monthly statements. We recognize that the layout and information can be confusing, and so we are working hard to provide comprehensive, clear and useful information in our own Quarterly statements. The first edition as of September 30th (received with this newsletter), will be further expanded and developed for release on December 31st. We value your patience as we work on this endeavor.

THE TEAM

Summer: A time for fun in the sun and travels!

This Summer, our team was blessed by being able to enjoy some time away from the office to rest, restore and re-energize!

Elyse came back from a 3 week trip to Europe where she spent time in Hungary and Croatia with the highlight being Dubrovnik, otherwise known as the Pearl of the Adriatic with its beautiful castle walls and blue water. Glenn, as a board member of the Mission World Team, was able to spend some time with his family in Paris, London, and Hungary as they attended a World Team conference. More recently, Stephen returned from the happiest place on Earth, Disneyworld in Florida.
The rest of us basked in the glorious beauty of the West Coast with local trips to the Okanagan, Whistler and just enjoying community in our own backyard.

Staff Changes

We welcomed back Maria this past August after her time away on maternity leave.
As Maria gets back into the swing of things, it is now Janet's turn to leave us temporarily on maternity leave. In other staff changes, Amanda will be leaving us this December to pursue her Degree in Social Work. Even though you may not have had the opportunity to interact with Amanda directly, she has been the backbone of our back office support and we are sad to lose such a valuable team member. However, we know that God's ways are higher than our ways and we are excited to see her embark on the Lord's calling in her life.