Market Commentary

New Covenant Funds

August 2019

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- Equity markets sold off around the globe in early August as the U.S.-China trade war appeared to enter a new phase characterized by much broader tariffs.
- U.S. stocks vacillated throughout August—confined to a total range of about three percent—and finished the month toward the high end, partially recovering from the early-month selloff.
- We think there is still life in the global economic expansion. This may seem like a bold statement, but we would need to see a severe deterioration in financial and leading economic indicators before climbing onto the recession train.

Economic Backdrop

Equity markets sold off around the globe at the start of August as the U.S.-China trade war appeared to enter a newly heightened phase. With the promise of U.S. tariffs extending to virtually all imports from China by September, China allowed the yuan (its currency) to depreciate against the U.S. dollar to levels not seen since the 2008 financial crisis. This compounded concerns that the trade war would spill into a currency war. Volatility settled somewhat after spiking in early August, but remained elevated throughout the month.

U.S. stocks vacillated throughout August—confined to a total range of about three percent—and finished the period toward the high end, partially recovering from the early-month selloff. New tariffs went into effect on September 1, imposing a 15% levy on $112 billion of Chinese exports to the U.S. that were previously unaffected.

The U.S. Treasury yield curve reached full inversion in August: The yield on the 30-year Treasury fell below the 1-month Treasury yield, settling at its bottommost level. The low-rate environment for long-term government bonds prompted U.S. Treasury Secretary Steve Mnuchin to assert the possibility of issuing 50- and 100-year Treasurys. Long-term government bond yields decreased more than short-term yields in the U.K. and Europe as well.

U.K. stock prices failed to recover from the early-month selloff as prospects of a reworked Brexit deal remained elusive. Prime Minister Boris Johnson made an effort to suspend Parliament until mid-October, leaving only two weeks for opponents of a no-deal departure to attempt to stop the U.K. from crashing out of the EU upon the planned departure date at the end of October. Sterling tumbled to multi-year lows versus the U.S. dollar at the beginning of September after Prime Minister Johnson threatened to call an election in mid-October; his parliamentary majority appeared to slip away as the House of Commons voted to block a no-deal departure.

European equities partially rebounded in the second half of August. A late-month Group of Seven (G-7) meeting of world leaders in France featured a notable unscheduled visit by Iran's foreign minister; his invitation by French President Emmanuel Macron showcased the gulf between European and U.S. leaders in terms of how to proceed in the wake of President Donald Trump deciding to exit the multi-party Iran denuclearization agreement last year.

Italy's coalition government collapsed on the resignation of Prime Minister Giuseppe Conte, who stepped down in a move to block Deputy Prime Minister (and leader of the nativist League party) Matteo Salvini's attempt to seize control though a snap election. At the request of President Sergio Mattarella, Mr. Conte has since agreed to help form a new coalition comprising the euroskeptic 5-Star Movement (the League's former senior coalition partner) and the pro-EU Democratic Party.

Elsewhere, Argentina revealed plans at the end of August to skip payments on more than $100 billion of debt in favor of comprehensive restructuring, sending prices on Argentine bonds spiraling downward. The Argentine stock market dropped 48% on August 12—the largest single-day decline for a stock exchange since 1989 —as primary election results indicated that President Mauricio Macri, a conservative reformer, would likely face pressure from populists in the upcoming general election. The government announced controls to restrict foreign purchases of Argentine pesos at the beginning of September.

India launched a wide-ranging occupation of Kashmir (a Muslim-majority region in the western Himalayas claimed by both India and Pakistan) in early August, which involved an expanded military presence, the imposition of curfews, targeted

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arrests, and a shuttered communications infrastructure. India's Prime Minister Narendra Modi revoked Kashmir's constitutionally guaranteed right to territorial autonomy on August 5, raising the prospect of conflict between India and Pakistan—both of which possess nuclear arms.

Protests in Hong Kong that begin in early June continued to escalate incrementally throughout August, increasing the risk of a heavy-handed crackdown by the mainland Chinese government.

Index Data (August 2019)

- The Dow Jones Industrial Average dropped by 1.32%.
- The S&P 500 Index diminished by 1.58%.
- The NASDAQ Composite Index receded by 2.46%.
- The MSCI AC World Index (Net), used to gauge global equity performance, fell by 2.37%.
- The Bloomberg Barclays Global Aggregate Index, which represents global bond markets, improved by 2.03%.
- The Chicago Board Options Exchange Volatility Index, a measure of implied volatility in the S&P 500 Index also known as the "fear index", jumped from 16.12 to 18.98.
- WTI Cushing crude oil prices, a key indicator of movements in the oil market, lowered from $58.58 a barrel at the end of July to $55.10 on the last day in August.
- The U.S. dollar ended August at $1.22 against sterling, $1.10 versus the euro and at 106.15 yen.

Portfolio Review

The Growth Fund slightly underperformed the Russell 1000 Index in August. U.S. equity markets declined in August as macroeconomic uncertainty and recession fears increased. The Russell 1000 Index returned -1.83% during the month. The largest of the large-cap growth stocks held up the best: the Russell 1000 Growth Index declined slightly, with a return of -0.77% versus -2.94% for the Russell 1000 Value Index. Mid- and small-cap stocks fell significantly. The S&P Mid-Cap Index returned -4.19% and the Russell 2000 Index returned -4.94% for the month. Increased recession fears following the month's yield-curve inversion propelled defensive sectors (consumer staples, real estate and utilities), which performed best during the month. Classic cyclical-value sectors (energy, materials, financials and industrials) lagged.

The Income Fund performed in line with the Bloomberg Barclays Intermediate Aggregate Bond Index during the month. The Income Fund's duration positioning was slightly short of the benchmark, which contributed to performance as rates declined. An overweight to 30-year bonds was also positive. The Fund's allocation to non-agency mortgage bonds was additive. An overweight to asset-backed securities (ABS) helped, while an overweight to commercial mortgage-backed securities (CMBS) hurt. Corporate credit spreads widened during the month and the Income Fund's overweight detracted. An overweight to agency mortgages, which underperformed during the month, hurt performance, but was offset by good selection within commercial mortgage obligations and 15-year mortgages. Western Asset Management's overweight to spread sectors detracted. Income Research and Management benefited from an underweight to and selection within agency mortgage-backed securities. An overweight to credit and selection within industrials hurt. An overweight to CMBS hurt, while an overweight to ABS added.

Manager Positioning and Opportunities

The Growth Fund seeks to track the performance of the Russell 1000 Index.

The Income Fund's duration ended the period slightly short of its benchmark while maintaining an overweight to the long end of the curve. With the year-to-date rally in yields, the Income Fund's managers have been letting duration drift lower. The Income Fund is likely to remain overweight spread products while adjusting duration and yield-curve positioning to changes in the market.

The New Covenant Balanced Growth Fund invests about 60% of its assets in the Growth Fund and 40% in the Income Fund. The New Covenant Balanced Income Fund invests about 35% of its assets in the Growth Fund and about 65% in the Income Fund.

Financial Glossary

Beta: Beta is a measure of sensitivity to movements in the market. High beta stocks are more sensitive to movements in the broad market. Low-beta stocks are less sensitive.

Duration is a measure of a security's price sensitivity to changes in interest rates. Specifically, duration measures the potential change in value of a bond that would result from a 1% change in interest rates. The shorter the duration of a bond, the less its price will potentially change as interest rates go up or down; conversely, the longer the duration of a bond, the more its price will potentially change.

Spread Sectors: sector spread is the difference in yields between two fixed-income securities with the same maturity, but originating from different investment sectors. As with any type of yield spread, this can help investors compare the potential return between two different types of investment securities, which also implies the comparative levels of risk involved with the two options.

Index Glossary

The S&P 500 Index is an unmanaged, market-capitalization weighted index that consists of the 500 largest publicly-traded U.S. companies and is considered representative of the broad U.S. stock market.

The MSCI All Country World Index is a market-capitalization-weighted index composed of over 2,000 companies and is representative of the market structure of 48 developed and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in U.S. dollars.

The Bloomberg Barclays Global Aggregate Bond Index an unmanaged market-capitalization-weighted benchmark, tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.

The Chicago Board Options Exchange Volatility Index (VIX) tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

The Russell 1000 Index includes 1,000 of the largest U.S. equity securities based on market cap and current index membership; it is used to measure the activity of the U.S. large-cap equity market.

The Bloomberg Barclays Intermediate U.S. Aggregate Bond Index is an unmanaged benchmark index composed of U.S. securities in Treasury, government-related, corporate, and securitized sectors with remaining maturities of less than 10 years.

The Dow Jones Industrial Average is a price-weighted average of 30 large, publicly owned companies based in the U.S. and traded on the New York Stock Exchange and the NASDAQ.

The NASDAQ Composite is a market capitalization-weighted index of approximately 3,000 common stocks listed on the Nasdaq stock exchange, including American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The Nasdaq Composite is not limited to companies that have U.S. headquarters.

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There are risks involved with investing, including loss of principal. Current and future portfolio holdings are subject to risks as well. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Narrowly focused investments and smaller companies typically exhibit higher volatility. Bonds and bond funds will decrease in value as interest rates rise. High-yield bonds involve greater risks of default or downgrade and are more volatile than investment-grade securities, due to the speculative nature of their investments. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Mortgage-backed securities are affected by, among other things, interest rate changes and the possibility of prepayment of the underlying mortgage loans. Mortgage backed securities are also subject to the risk that underlying borrowers will be unable to meet their obligations.

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- **Not FDIC Insured**
- **No Bank Guarantee**
- **May Lose Value**

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