Market Commentary

New Covenant Funds

First Quarter 2021

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- Globally, the cyclically sensitive energy and financial equity sectors led at a distance for the second consecutive quarter, while defensive consumer staples had the only negative performance of the period.
- President Biden signed an aid package totaling $1.9 trillion into law on March 11, and announced a $2.3 trillion package targeted at modernizing infrastructure and a range of other priorities on the last day of March.
- Investors are anticipating the return to a more normal world. This is reflected in the rapid rise in bond yields, the most important change in the financial environment so far this year.

Economic Backdrop

The first quarter of 2021 was marked by transitions. Geopolitically, the federal government came under the leadership of the Biden administration and unified control of his Democratic Party in the Congress, while the U.K. bid the EU adieu after more than four years of anticipation.

This season of change was perhaps most evident in the trajectory of COVID-19's toll: case counts and daily deaths began the calendar year at (or near) their all-time peaks in many parts of the world, which created a sense for much of the quarter that the state of COVID-19 affairs was improving—albeit from a bleak starting point. The increasing availability of vaccines boosted this impression. However, case counts began rising again in several countries near the end of the quarter, and herd immunity was estimated to still be a couple months away at best, leading to the extension or re-imposition of varying restrictive public health measures around the globe.

Forward-looking capital markets focused on the brightening outlook throughout the first quarter. Globally, the cyclically sensitive energy and financial equity sectors led at a distance for the second consecutive quarter, while the defensive consumer staples sector was the only negative performer.

At the country level, Chile delivered the first quarter's top equity market gain. It has the world's largest copper reserves and is responsible for roughly one-third of global copper output. It has also established one of the most expedient vaccination programs on the planet. Energy producers Saudi Arabia and UAE were the next-best performers. Among major markets, Hong Kong had the best performance, followed by the U.K., the U.S., Europe and Japan. Mainland Chinese shares were slightly negative.

As equity performance implies, commodities delivered large gains on the anticipated transition back to normal life. The West Texas Intermediate crude oil price increased by 21.9% during the quarter. OPEC+ (the Organization of the Petroleum Exporting Countries, led by Saudi Arabia—plus Russia) announced on April 1 a planned increase in crude oil production beginning in May and escalating to more than 2 million additional barrels per day by July.

Government bond rates in major developed countries generally increased during the first quarter, and yield curves steepened as longer-term rates rose by more than shorter term rates. The greatest increase in long-term rates came during February, and was most pronounced in the U.S., although U.K. and EU rates followed a similar path. In the U.S., short-term rates fell throughout the quarter, while they only began falling in the U.K. and EU during March. The 10-year Treasury rate nearly doubled during the quarter—moving from 0.93% to 1.74%.

President Biden signed an aid package totaling $1.9 trillion into law on March 11, providing funding for extended and expanded unemployment benefits, direct stimulus payments, child tax credits, schools, state and local governments and elsewhere.

On the last day of March, Biden announced a $2.3 trillion package targeted at modernizing travel and utility infrastructure, care for the elderly and disabled, manufacturing, affordable housing and expanded access to broadband internet, coupled with a broad low-carbon electricity generation mandate. This was the first of a two-part long-term economic plan with costs spread over eight years; the second part will focus on childcare and health care, and more details are expected in late April. The price tag for Biden's proposal would be offset by increasing the corporate tax rate from 21% to 28% for a 15-year period and raising taxes on overseas corporate profits.

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The Biden administration revisited U.S. tariffs in March, agreeing with the EU to suspend $4 billion in EU tariffs on U.S. goods and $7.5 billion in U.S. tariffs on EU goods for a four-month period in an effort to negotiate a resolution. A similar (but smaller) truce was made with the U.K. U.S. tariffs on Chinese goods, however, would remain in place, according to U.S. Trade Representative Katherine Tai.

In the U.K., Chancellor of the Exchequer Rishi Sunak's Spring Budget announcement contrasted upfront spending and tax incentives with higher taxes in the coming years. The budget extends, among other programs, income replacement schemes for furloughed employees and the self-employed, provides payments for non-essential retail, hospitality and leisure businesses and Restart grants for businesses that were required to shut down.

The budget also offers nearer-term investment incentives for businesses—principally in the form of a 130% tax credit for capital expenditures over the next two years, followed by an increase in the corporation tax rate from 19% to 25% in 2023. According to the Office for Budget Responsibility, a five-year freeze on the tax-free personal allowance and higher rate tax threshold is projected to create 1.3 million new taxpayers and push 1 million taxpayers into a higher tax bracket, raising $8 billion in tax revenue between 2022 and 2025.

Central Banks

- The Federal Open Market Committee (FOMC) held the federal funds rate near zero throughout the first quarter and continued its asset purchases apace ($80 billion in Treasurys and $40 billion in agency mortgage-backed securities per month). Its latest Summary of Economic Projections (SEP), release in mid-March, showed marked improvements in 2021 estimates for GDP and employment, as well as a significant increase in the inflation rate, compared to the December SEP. Federal Reserve (Fed) Chair Jerome Powell followed the March meeting by communicating that the FOMC would not seek to pre-empt rising inflation with tighter monetary policy.

- The Bank of England's Monetary Policy Committee (MPC) kept the bank rate at 0.1% and retained a maximum allowance for asset purchases of £895 billion throughout the first quarter. Following its early-February meeting, the MPC communicated that it had no intention of lowering rates into negative territory within the next six months; by mid-March—faced with rising rates—the MPC stated it wouldn't increase rates "at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably."

- The European Central Bank (ECB) announced plans in mid-March to increase the pace of asset purchases under its €1.85 trillion Pandemic Emergency Purchase Programme (PEPP) relative to the speed and size of purchases made in early 2021. This move is intended to counter the negative economic impact of rising rates. The ECB's latest forecast showed a modest improvement in GDP for 2021.

- The Bank of Japan (BOJ) detailed the results of its Assessment for Further Effective and Sustainable Monetary Easing, which includes establishing a programme to subsidize banks to compensate for the impact of negative interest rates. Other changes generally concerned shifting to market interventions on an as-needed, rather than a programmatic, basis. The BOJ established a band in which the 10-year Japanese government bond rate would be allowed to fluctuate before intervening with purchases to control the level. ETF and J-REIT purchases also remained part of the policy mix, but rather than making routine purchases, the BOJ will shift to intervening when faced with market weakness. The BOJ will also continue to purchase corporate paper and bonds to a total of about ¥20 trillion through September 2021.

Index Data for First Quarter 2021

- The Dow Jones Industrial Average surged by 8.29%.
- The S&P 500 Index lifted by 6.17%.
- The NASDAQ Composite Index advanced by 2.95%.
- The MSCI ACWI (Net), used to gauge global equity performance, increased by 4.57%.
- The Bloomberg Barclays Global Aggregate Index, which represents global bond markets, fell by 4.46%.
- The Chicago Board Options Exchange Volatility Index, a measure of implied volatility in the S&P 500 Index that is also known as the "fear index," decelerated, moving from 22.75 to 19.4.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, gained from $48.52 a barrel on the last day in December to $59.16 on March 31.
- The U.S. dollar moved to $1.38 versus sterling, $1.17 against the euro and 110.72 yen.

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Portfolio Review

Results in the Growth Fund were mixed during the quarter. The environmental, social and governance screen (ESG) led to unfavorable underweights to tobacco stocks within consumer staples and to materials was mitigated by solid selection within real estate and information technology, particularly in software.

The Income Fund benefited from an overweight to corporates and solid selection in industrials. Other contributors included an overweight to non-agency mortgage-backed securities (MBS), which continued to rebound during the quarter; an overweight to asset-backed securities (ABS); and an overweight to higher-quality commercial MBS. An overweight to the long-term segment of the U.S. Treasury yield curve detracted as 30-year U.S. Treasury yields rose during the quarter. Poor selection within agency MBS hurt, especially in specified mortgage pools. Income Research & Management benefited from an overweight to corporates as spreads tightened during the quarter. An overweight to and selection in industrials helped, particularly in transportation and energy sub-sectors as growth prospects improved. An overweight to and strong selection in ABS and commercial MBS contributed as markets continued to gradually recover from last March's forced selling. Selection within agency MBS added; although an underweight to the sector pared gains. An underweight to non-corporates slightly detracted. Western Asset Management gained on an overweight to credit sectors (financials and industrials, especially the consumer non-cyclical and communications sub-sectors) as spreads tightened over the quarter. An allocation to non-agency MBS helped as the sector continued its gradual recovery. Overweights to ABS and commercial MBS further contributed. An overweight to the long-term segment of the U.S. Treasury yield curve hurt.

Manager Positioning and Opportunities

The Growth Fund employs a passive strategy designed to track the performance of the Russell 3000 Index, which represents the largest 3,000 U.S. companies and approximately 98% of the investable U.S. equity market, subject to such variation as may arise as a result of implementation of the social witness principles of the General Assembly of the Presbyterian Church (U.S.A.).

Core U.S. investment-grade fixed income had a difficult quarter, but this was largely a correction in terms of valuations as fundamentals remained attractive. Fixed-income markets have signaled improved growth prospects on the tail of higher interest rates in addition to increased stimulus and infrastructure spending that should result in higher deficits and more U.S. Treasury issuance. Still, given the magnitude of the recent move in rates, we see any further moves higher as incremental. Inflation expectations are higher in the short term than in the long term. We share the Federal Reserve's sentiment that higher short-term inflation will likely be transitory. Securitized sectors remain attractive in our view, especially agency mortgage-backed securities. The Income Fund's duration positioning began the quarter slightly underweight the benchmark, but ended the period slightly overweight. Duration is a measure of risk in bond investing and indicates how price-sensitive a bond is to changes in interest rates. A long (overweight) duration stance indicates the portfolio duration is higher than that of the benchmark whereas a short (underweight) duration stance indicates a lower duration. Duration is measured in years and securities with longer durations are more sensitive to interest-rate changes. With yields near historic lows, the Fund's managers are likely to stay close to neutral until volatility subsides. It was overweight corporate bonds as managers viewed them as a better relative value despite higher prices than last year. Within the long-term overweight to securitized sectors, commercial MBS and ABS were the largest allocations while the agency MBS allocation was close to that of the benchmark. An overweight to off-benchmark non-agency MBS remained as the sector continued to trade at attractive spreads.

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:

Federal-funds rate: The federal-funds rate is the interest rate at which a depository institution lends immediately-available funds (balances at the U.S. Federal Reserve) to another depository institution overnight in the U.S.

Index Glossary:

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and NASDAQ.

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 NASDAQ Composite Index is an unmanaged, market-capitalization weighted index that consists of all securities listed on the NASDAQ exchange. It is often used to gauge performance of global technology stocks.

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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 (formerly Lehman Brothers Global Aggregate 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 3000 Index includes 3000 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. 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.

Important Information

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 1-877-835-4531.

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To determine if the Fund(s) are an appropriate investment for you, carefully consider the investment objectives, risk factors and charges and expenses before investing. This and other information can be found in the Fund's prospectus, and if available, the summary prospectus, which can be obtained by calling 1-877-835-4531. Read the prospectus carefully before investing.

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. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. 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. 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.

Diversification may not protect against market risk. There is no assurance the objectives discussed will be met. Past performance does not guarantee future results Index returns are for illustrative purposes only and do not represent actual portfolio performance. Index returns do not reflect any management fees, transaction costs or expenses. One cannot invest directly in an index.

- **Not FDIC Insured**
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- **May Lose Value**

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