CAPITAL MARKET SUMMARY

After ending the first quarter of 2020 down 19.6%, the S&P 500 Index® retraced most of its losses and finished the second quarter up 20.5% which brought the year-to-date return to negative 3.1%[1]. While the market recovered quickly, the economy has not. Therefore, price levels, relative to expected earnings, look more expensive than the same levels at the start of the year. Volatility, as demonstrated by the VIX® Index, ended the quarter at 30.88[2]. This is a notable decline compared to its level in excess of 45 at the end of the first quarter[2]. As we noted last quarter, approximately every 16 points on the VIX equates to an estimated daily change in the S&P 500® of 1%. Therefore, while still well elevated over typical levels, we can expect approximately 1% lower daily volatility moving forward versus what we saw from March to June.

Over the course of the second quarter of 2020, the individual sectors of domestic equity continued to show significant dispersion. Two of the most defensive sectors, Utilities and Consumer Staples, had the weakest performance with returns of 2.73% and 8.12% which is unsurprising in a market with a significant upward trajectory[1]. Some of the top performing sectors in the second quarter were among the largest decliners in the first quarter. These include Energy and Materials, which gained 30.51% and 26.01%[1]. Consumer Discretionary and Technology, in spite of their relative strength in the first quarter, led the way again with returns of 32.86% and 30.53% respectively[1]. During the first half of the year, Technology and Consumer Discretionary were the only two sectors with positive returns[1]. Outside of the S&P 500 Index®, smaller firms, represented by the S&P 400 Mid Cap Index®, gained 24.07% while the S&P 600 Small Cap Index® added 21.94%. This brought their year-to-date returns to -12.78% and -17.85% respectively[1].

With the economy so significantly impacted by the coronavirus and the corresponding shutdown, second quarter corporate earnings are expected to drop by a massive 43.8%[3]. This would be the weakest report since the fourth quarter of 2008 where earnings fell 69.1%[3]. As we mentioned last quarter, we expected the forward price to earnings ratio (P/E) to rise as earnings estimates fell. At quarter end, the S&P 500® had a forward price to earnings ratio (P/E) of 21.8 which is up more than five from the prior quarter[3]. While this is somewhat elevated, we expect heightened volatility in earnings estimates, so we believe that less weight should be placed on this statistic than in typical times. For the whole of 2020, earnings are expected to decline by 21.5% followed by a recovery in 2021 of 28.2%[3].

Within international markets, the MSCI EAFE Index® (developed international equity) recovered from its first quarter decline with a return of 14.88%, while the MSCI EM Index® (emerging market equity) gained 18.1%[1]. International equity has continued to lag the performance of their domestic peers. While there are many factors at work here, the continued strength of the U.S. dollar and the sector composition of international equity with less technology and more financials/industrials were the leading drivers of the differential between it and domestic stock returns.

Broadly speaking, commodity prices have remained in the doldrums even as equity markets rebounded. The Bloomberg Commodity Index®, a broad basket of commodities, made a small gain of 5.08%, but is still down 19.40% year-to-date[1]. Economically-sensitive commodities such as copper and timber outperformed the broader index with returns of 21.16% and 16.66% respectively[1]. Simultaneously, agriculture-based commodities declined 4.85% in the second quarter[1]. Last quarter we highlighted the divergence in gold and silver prices as gold gained over 5.5% while silver dropped almost 23%. Not unexpectedly, this reversed somewhat as gold rose another 9.78% while silver roared to a gain of 27.94%. This has brought the ratio of gold/silver prices from in excess of 120 to under 100[4]. While

1 Morningstar.com (July 7, 2020)
2 VixCentral.com (June 30, 2020)
3 Factset, Earnings Insight (July 2, 2020)
4 Goldprice.org. Gold-Silver-Ratio (July 8, 2020)

continued

476 ROLLING RIDGE DRIVE, SUITE 315 STATE COLLEGE, PA 16801 TEL: (855) 55-VICUS FAX: (814) 235-3500 VICUSCAPITAL.COM

this is still an elevated reading, the opportunity in silver is not as clear as it may have been in late March.

While fixed income and equity often move in different directions, this was not the case in the second quarter. The Barclays' Aggregate Bond Index® rose 2.90% as treasury bonds held firm and credit-oriented securities rallied[1]. The Barclays' Municipal Bond Index® mostly followed suit and rose 2.72% during the same timeframe[1]. High yield municipals recouped most of their first quarter loss as they gained 4.55% during this past quarter[1]. Inflation-protected securities (TIPS) rose 4.24% as 10-year inflation expectations recovered from 0.87% at the end of the first quarter to 1.34% by quarter end[1,5]. The Barclays' Global Aggregate Bond Index® returned 3.32% as it partially caught up to U.S. bond indices. Finally, the non-investment grade corporate bond universe showed a significant recovery as high yield bonds, convertible bonds and bank loans gained 10.18%, 27.36%, and 9.70% respectively[1].

Capital Market Outlook

Where the first quarter started off with a continuation of 2019's rally, the migration of the coronavirus from China to the rest of the world and the economic shutdowns that ensued quickly thereafter induced an abrupt market reversal culminating at the end of the first quarter. Since then, we have seen a robust rebound in equity and credit markets on the back of fiscal and monetary stimulus from congress and the Federal Reserve. During the first half of the year, the roller coaster stock market delivered us the most abrupt 30% or greater decline on record, and then followed that act up with the largest 50-day upward move in history[1]. Similar to what was exhibited during the first quarter decline, the second quarter experienced elevated sector return dispersion. Defensive sectors, including Consumer Staples and Utilities, lagged while the Technology sector and economically-sensitive sectors such as Energy and Consumer Discretionary led gains. As we see economic data beginning to reflect the impact of the coronavirus, this is contrasted against the fiscal and monetary measures taken by the government. Between both of those, we will concentrate on seeking out investment opportunities that arise.

Economic data deteriorated over the course of the second quarter as the unemployment rate peaked in April and still remains above March levels[2]. While now in decline, jobless claims remain elevated at well over one million per week[3]. On a net basis, this means that the country is adding more jobs than it is losing, hence the declining unemployment rate. However, we should also expect the rate of decline in unemployment to slow as rehiring proceeds and certain layoffs will end up being permanent due to company reorganization or bankruptcy. Additionally, other economic data will be coming in soon. Notably, corporate profits are expected to decline precipitously before undergoing a recovery[4]. Loan losses for banks are also sure to tick up, though they have created significant reserves for them. It still remains unknown as to whether those reserves will be sufficient or lacking. If sufficient, it could serve to boost bank profitability markedly over the next 12 months. However, if lacking, it could concern markets over the prospect of a financial crisis similar to 2008 in addition to the employment/health crisis already underway.

The virus itself provides financial markets little in the way of good news outside of very specific industries and businesses, including but in no way limited to: Moderna (MRNA), Zoom Video Communications (ZM), Peloton (PTON), Gilead Sciences (GILD), and Abbott Labs (ABT). These companies either have a business model that benefits from the changes in people's daily lives (PTON and ZM), have products that detect the coronavirus (ABT), can treat the virus (GILD), or potentially provide a vaccine (MRNA). Some of these firms are now trading at very rich valuations that could come back to earth quickly should their business stumble or if the market begins to reward more traditional cyclical companies.

So, as we all deal with the changes to our daily

5 Federal Reserve Bank of St. Louis 10-Year Breakeven Inflation Rate (June 30, 2020)

1 The New York Times. Steven Rattner (July 3, 2020)
2 St. Louis Federal Reserve: Unemployment Rate (July 10, 2020)
3 Department of Labor: Unemployment Insurance Weekly Claims (July 9, 2020)

4 Factset Earnings Insight (July 2, 2020)

continued

lives, the concerning news reports, the weak economic data, and even people we know who are suffering with the coronavirus, one would reasonably ask: "Why is the market so resilient?" or, "How can we possibly be at or near all-time high stock prices?" While there is no perfect answer to these questions, we will attempt to provide some rationale by discussing three potent factors that impact financial markets and their valuations.

The first of these factors is liquidity provided by the Federal Reserve's operations. Not only is the Fed performing quantitative easing, commonly known as bond purchases, at an unprecedented rate, but also with a quantity never seen before. They have expanded their balance sheet from four to seven trillion dollars in just a couple of months[5]. They cut the benchmark interest rate to near zero, are providing leverage to the treasury's programs that are getting money appropriated by congress into people's hands more quickly, and are purchasing both investment grade and high yield bonds[6]. These actions all support market prices as they are directly buying assets, but also support the economy by keeping borrowing rates low and adding firepower to the Treasury Department's fiscal programs.

These fiscal programs are, themselves, the second factor. These came about as a part of the CARES Act and other legislation enacted since the onset of the coronavirus. Included are provisions to provide extra unemployment benefits from the federal government to subsidize what traditionally comes from the states. Also included is the Payroll Protection Program (PPP) which distributes monies to businesses in line with their payroll, rent and utility bills to enable them to keep operating as usual and paying employees even if no revenue is coming in. Note that while the original funding of this program ran out quickly, it was refunded by congress and has since not yet been exhausted. These programs, and others such as direct stimulus payments, have created a seemingly strange situation where the median person is actually taking in 10% more income than they were before the coronavirus situation began[7]. This has resulted in personal debt reduction and a savings rate far higher than we typically see in the United States. The combination of these fiscal actions has served to keep things afloat while we wait for a true economic recovery and because they limit (of course not eliminate) disruption of our daily lives, they can be viewed as bolstering financial markets as well.

The third factor to help explain why markets have been so ebullient is the absolute level of interest rates in treasury bond markets. Treasury bond interest rates have a strong relationship with stock prices for two reasons. First, because they represent an alternative asset in which to invest and, since they are risk-free from a default perspective, the higher the yield, the more attractive they are to own. The second and more complex reason is that they are used to calculate the yields on a corporation's bond. A corporate bond's yield will be the yield of a similar maturity treasury bond plus a premium to represent the relative risk of the company compared to the federal government. From these, we can conclude that lower interest rates possess the ability to fuel stock prices by reducing corporate borrowing costs, thus permitting higher future earnings and by making investments in fixed income securities to be less attractive because of their lower yield.

Therefore, as we approach the second half of 2020, we are keeping our eyes on many data points to evaluate portfolio positioning opportunities appropriate for the environment. For example, we believe that the lower interest rate environment will persist for some time. While it remains, we expect growth-oriented equity to continue its outperformance versus value-oriented equity. We are also considering the U.S. dollar and how that may affect the differential between domestic and foreign market returns. A falling dollar is customarily a tailwind for international equity and we will continue to watch for signs that this may be happening. Additionally, we look at sectors within the domestic market. We currently have a positive view on the healthcare sector for a few reasons. First, it is traditionally defensive, so it could protect portfolios if the market turns lower again. Second, market perception is that the political risk to the

5 St. Louis Federal Reserve: Total Assets (July 10, 2020)
6 Natixis Covid-19 Dashboard (July 9, 2020)

7 Bureau of Economic Analysis: Personal Income and Outlays (May 29, 2020)

continued

sector is far lower with President Trump or Joe Biden in the White House than that of Elizabeth Warren or Bernie Sanders. And finally, healthcare has higher growth and a lower valuation than the average sector. This is just one example of the framework in which we are analyzing the opportunity set in financial markets.

As we navigate the economic environment over the second half of 2020, we expect continued volatility arising from new data on the coronavirus regarding cases, hospitalizations, and deaths. When we commented on this topic following the first quarter, we noted various treatments including Gilead Sciences' Remdesivir. Recent studies have shown some efficacy in reducing both time in the ICU as well as risk of death[8]. Another surprise treatment is dexamethasone, a common steroid. It has also been shown to reduce risk in coronavirus patients[9]. These studies, as well as the vaccine trials currently underway may eventually lead to a breakthrough. We will also keep a watchful eye on the election cycle, as the policies the candidates put forth over the remainder of the summer and early parts of the fall will likely dictate some twists and turns for the market. These will range from tax and healthcare policy to trade and foreign relations. And of course, there will likely be a topic or agenda that the media and public consciousness has yet to fully appreciate that could affect both the election outcome as well as financial market performance. At Vicus Capital, we remain cautiously optimistic as we continue to reassess our geographic, style, and sector positioning throughout the remainder of the year. Our strategic allocations remain broadly diversified to allow portfolios to take advantage of market conditions whether the "growth" rally continues or if other assets such as smaller capitalizations or international equity come into favor.

8 CNBC.com. Gilead Says Remdesivir Coronavirus Treatment Reduces Risk of Death in Severely Sick Patients (July 10, 2020)

9 Statnews.com Major Study Finds Common Steroid Reduces Deaths Among Patients with Severe Covid-19 (June 16, 2020)

Economic Perspectives

Economic Growth & Profits

- Real gross domestic product (GDP) for the first quarter of 2020, according to the Bureau of Economic Analysis (BEA), came in at an annualized rate of-5.0%[1]. This marks the first decline since Q1 of 2014[2]. While it is difficult to read much into this figure with some of the fallout from the coronavirus lockdown not yet included in these numbers, we will have more clarity with the forthcoming second and third revisions.
- Regarding how corporations fared, the BEA stated that, "Profits from current production decreased $262.8 billion in the first quarter, in contrast to an increase of $53.0 billion in the fourth quarter." Current dollar GDP (a measure that does not include inflation) decreased at a 3.4% annualized pace during the quarter[1].

1 U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: 1st Quarter 2020 (June 25, 2020)

2 Statista.com. Quarterly growth of the real GDP in the United States from 2011 to 2020 (July 6, 2020)

Interest Rates

- After reducing rates to the current target of 0-0.25%, the Federal Reserve has continued to provide liquidity to financial markets at an unprecedented level. The most recent statement from the Federal Open Market Committee notes that the coronavirus outbreak is giving rise to significant detrimental effects on the global economy[3].
- Since the new wave of quantitative easing commenced in March, the Fed has expanded both the array and quantity of securities they are purchasing. These actions include, but are not limited to: increasing holdings of treasury and mortgage bonds, conducting overnight "repo" transactions to create dollar liquidity, and reinvesting all principal payments on the bonds that they hold[3].

Employment

- Total non-farm payroll employment rose by 4.8 million in June. This caused the official unemployment rate to fall to 11.1%, after having fallen to 13.3% in May. The labor force participation rate also increased to 61.5%, just shy of two percent below February's reading[4].
- Vicus Capital continues to believe that these numbers should be viewed as simply a snapshot in the past and not that they are

3 U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (June 10, 2020)

4 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, June 2020 (July 2 2020)

continued

indicative of the current environment. Job gains were led by those who were previously classified as "temporarily unemployed," and once this is stripped out, 588,000 people were classified as having permanently lost their position[4].

- Job gains were most notable in the industries initially hit the hardest with leisure and hospitality gaining 2.1 million employees while retail gained 740,000[4].
- The average workweek for all employees on private nonfarm payrolls dropped slightly to 34.5 hours[4]. This is still 0.3 hours more than in our prior quarterly update.
- Average hourly earnings declined by 35 cents per hour to $29.37. Year-over-year, average hourly earnings increased 5.0%[4]. This has been a volatile statistic and its meaning is difficult to decipher as it has mostly increased during the coronavirus lockdown. Vicus Capital believes that this is due to the nature of the types of jobs that were able to be held on to versus ones which were temporarily eliminated. Therefore, a future reduction in this number may be less impactful than in other circumstances.
- The broader U-6 measurement of unemployment slid to 18.0% on a seasonally-adjusted basis, well up from 7.2% one year ago, but down from the peak of 22.8% in April[4].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) declined 0.1% in May on a seasonally-adjusted basis after dropping 0.8% in April and 0.4% in March[5].
- The CPI-U increased by 0.1% over the last 12 months before seasonal adjustment[5].
- The Core-CPI, a popular indicator that looks at all items except food and energy, fell 0.1% in May but rose 1.2% over the last 12 months[5].

Risks and Observations

- Many of the data points we evaluate on a quarterly basis within our Economic Perspectives are backward looking. Given what we know about the effects of the coronavirus on our economy, we expect notable adjustments to data in the categories of GDP growth and employment included in this second quarter commentary.
- Whether the coronavirus fades from our headlines or not, we will encounter a presidential election in November which is often viewed as a source of market volatility. Vicus Capital will be observing the political landscape for any potential opportunities that arise and for any pitfalls to avoid. While our base case is for continued "split government" regardless of who wins the presidency, the potential for one party control will have us considering what that outcome would entail for investors over the coming months.
- The Federal Reserve, at some point, will reduce their level of economic support. This will be an important event that is likely to affect markets. Vicus Capital will be actively monitoring indications of when this may take place. At that time, portfolios may see their fixed income duration reduced in addition to potential changes to the equity allocation. While we do not expect this to be any time soon, it is prudent to keep the eventuality in mind.

5 *U.S. Department of Labor: Bureau of Labor Statistics - Consumer Price Index, May 2020 (June 10, 2020)*

continued

INDEX RETURNS TABLE

Index	Total Return (%) 3 Mo (Mo-End) USD	Total Return (%) 1 Yr (Mo-End) USD	Total Return (%) Annualized 3 Yr (Mo-End) USD	Total Return (%) Annualized 5 Yr (Mo-End) USD
DJ Industrial Average TR USD	18.51	-0.54	9.08	10.62
S&P 500 TR USD	20.54	7.51	10.73	10.73
S&P 400 Mid Cap TR USD	24.07	-6.70	2.39	5.22
S&P 600 Small Cap TR USD	21.94	-11.29	0.56	4.48
MSCI KLD 400 Social GR USD	21.58	10.07	11.88	11.34
MSCI EAFE NR USD	14.88	-5.13	0.81	2.05
MSCI EM NR USD	18.08	-3.39	1.90	2.86
Barclays U.S. Agg Bond TR USD	2.90	8.74	5.32	4.30
Barclays Global Agg Bond TR USD	3.32	4.22	3.79	3.56
S&P GSCI Spot	27.37	-23.48	-4.39	-5.88
S&P Target Risk Cons. TR USD	8.04	5.81	5.39	5.06
S&P Target Risk Mod. TR USD	9.47	5.15	5.45	5.30
S&P Target Risk Aggr. TR USD	15.58	2.29	5.51	6.09
Source: Morningstar® as of June 30, 2020				

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The MSCI U.S. Broad Market Index is comprised of nearly 100% of the total market capitalization of U.S. stocks traded on the NYSE and the NASDAQ. The S&P 500 Index is a market capitalization free-float adjusted index of the prices of 500 large capitalization common stocks traded in the United States. The S&P 400 Mid Cap Index serves as a barometer for the U.S. mid-cap equities sector and includes stocks with total market capitalization that ranges from roughly $750 million to $3 billion. The S&P 600 Small Cap Index covers a broad range of U.S. small cap stocks and is weighted according to market capitalization covering about 3-4% of the total market for U.S. equities. The MSCI KLD 400 Social Index is a free float-adjusted market capitalization index designed to target U.S. companies that have positive environmental, social, and governance (ESG) characteristics. The MSCI EAFE Index is a market capitalization weighted index and is designed to measure the equity market performance of developed markets (Europe, Australasia, and Far East) excluding the U.S. and Canada. The MSCI EM NR USD Index is a free-float adjusted market capitalization index that is designed to measure the equity market performance in the global emerging markets. The Barclays Aggregate Bond Index is a market-capitalization weighted index that is considered to be representative of U.S. traded investment grade bonds. The Barclays Global Aggregate Bond Index includes government securities, mortgage-backed securities, asset-based securities and corporate securities to simulate the universe of bonds in the market. The S&P GSCI Spot is a composite index of commodity sector returns which represents a broadly diversified, unleveraged, long-only position in commodity futures. The S&P Target Risk series of indices comprise multi asset class indices that correspond to a particular risk tolerance with varying levels of exposure to equities and fixed income intended to represent stock and bond allocations across a risk spectrum. The market indices referenced are unmanaged. You cannot invest directly in an index.

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