CAPITAL MARKET SUMMARY

After concluding the first half of 2020 down 3.1%, the S&P 500 Index® resumed its ascent to gain 8.93% during the course of the third quarter bringing the index's year-to-date return to 5.57%[1]. Volatility, as demonstrated by the VIX® Index, ended the quarter at 30.37%, slightly below where it ended the prior quarter[2]. Keep in mind that approximately every 16 points on the VIX equates to an estimated daily change in the S&P 500® of 1%. Interestingly, as we approach the election, the futures market is pricing in a volatility spike over the course of November (encompassing the election). After that, the market is expecting a steady but shallow decline in volatility[2].

Similar to the second quarter of 2020, individual sectors of domestic equity continued to show significant dispersion in the third quarter. The weakest sector of the market was Energy, which declined 19.72%. All other sectors finished the quarter with positive performance. Outside of Financials, which only gained 4.45%, cyclical sectors dominated the quarter. Consumer Discretionary, Materials, Industrials and Technology rose 15.06%, 13.31%, 12.48%, and 11.95% respectively. With three quarters of 2020 now in the books, the variance between sectors has been substantial, as top performers like Technology and Consumer Discretionary are up 28.69% and 23.38%, whereas the weakest sectors, Energy, Financials, and Real Estate are down 48.09%, 20.22%, and 12.08%. All other sectors returned between -10% and +10% year-to-date. Outside of the S&P 500 Index®, smaller firms, represented by the S&P 400 Mid Cap Index®, gained 4.77% while the S&P 600 Small Cap Index® added 3.17%. This brought their year-to-date returns to -8.62% and -15.25% respectively[1].

As the economy remains heavily impacted by the coronavirus and the corresponding shutdowns, third quarter corporate earnings are expected to decline by 21.0% on a year-over-year basis[3]. While not an attractive figure, this prediction is 4.3% better than the belief at the start of the quarter. Still, this would be the largest quarterly decline since the second quarter of 2009 which came in at -26.9%. The market's forward price to earnings ratio derived from FactSet's estimates is 21.6. This remains above historical averages, but actually below where it began the quarter due to increases in expected earnings over the course of the last three months coupled with modest price increases. For the whole of 2020, earnings are expected to decline by 18.0% followed by a recovery in 2021 of 25.7%[3].

Looking abroad to international markets, the MSCI EAFE Index® (developed international equity) moderated the pace of its gains from the second quarter, but still rose 4.80% over quarter three[1]. The MSCI EM Index® (emerging market equity) outpaced both developed international and U.S. equity over the past three months as it gained 9.56%[1]. This brought developed international and emerging market performance to -7.09% and -1.16% year-to-date[1]. The U.S. dollar declined modestly during the quarter, which may have served as a tailwind for global equities particularly in emerging markets. We expect that the future movements of the dollar will continue to impact the returns of non-domestic equities.

Commodities have started to rebound slightly by showing mostly positive returns in the third quarter. The Bloomberg Commodity Index®, a broad basket of commodities, achieved a respectable gain of 9.07%, but remains down 12.08% year-to-date[1]. Many economically-sensitive commodities such as copper and timber outperformed the broader index with returns of 10.31% and 14.57% respectively[1]. On the other hand, oil was about flat (up 0.84%) for the quarter and remains down 58.29% on the year. Unlike during the second quarter, agriculture-based commodities joined in on the rally with a gain of 11.90% in the third quarter[1]. Gold continued its strong year and added 6.61% this quarter and is now up 23.53% on the year. Finally, silver, rallying since its March low, delivered 32.85% this quarter.

1 Morningstar.com (October 5, 2020)
2 VixCentral.com (September 30, 2020)
3 Factset, Earnings Insight (October 2, 2020)

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The fixed income market cooled off in the third quarter, but still generated positive returns. The Barclays' Aggregate Bond Index® rose 0.62% as treasury bonds remained close to flat (+0.18%) and credit-oriented securities gained modestly[1]. The Barclays' Municipal Bond Index® rose 1.23% for the quarter outperforming taxable bonds after having inferior performance during the first half of 2020[1]. High yield municipals were up 3.09% during this past quarter bringing year-to-date performance back into positive terriorty[1]. Inflation-protected securities (TIPS) rose 3.03% as 10-year inflation expectations changed from 1.34% at the end of the second quarter to 1.63% by the end of the third quarter[1,4]. The Barclays' Global Aggregate Bond Index® exceeded the return of domestic bonds as they gained 2.66%, but global bonds still lag their domestic peers for the year in total. Lastly, the non-investment grade corporate bond universe continued to see credit spreads contract as high yield bonds, convertible bonds and bank loans gained 4.71%, 15.05%, and 4.14% respectively[1].

Capital Market Outlook

To begin, let's take a quick trip down memory lane. You may recall the 2015 market environment and its subsequent titling of the "year of no returns." In actuality, U.S. bonds and stocks actually eked out just under one percent gains[1]. 2018 was a difficult year also and returns were actually worse than in 2015[1]. However, the surge in valuations that occurred in the early months of 2019 quickly relegated the 2018 December sell-off to a distant memory. Which brings us to 2020, and what a year it has been. While the S&P 500 Index® is higher at the end of the third quarter than at the start of the year, it has not been a comfortable ride. As we noted last quarter, markets had just endured the fastest decline and ensuing recovery on record. Rationale for the recovery includes but is not limited to: massive government spending, unprecedented action by the federal reserve, and historically low interest rates. Each of these is likely to continue in the near future and should continue to support market prices, but with the contrast of elevated valuations and meager earnings growth; not to mention potential election turmoil. Vicus Capital expects volatility to remain elevated, subjecting the market to potentially abrupt movements.

As we navigate the final leg of 2020, we will analyze the following questions: Will the growth style end its dominance? Will the dollar continue to decline and how will that impact markets? What is the reality of the employment situation and the virus's effect on it as well as on financial markets? And obviously, how will the election affect all of the above?

It is relevant to note the continued dominance of growth-styled equity when compared to that of the value style. In the time since the market peak on February 19 of this year, the large cap value style is down 12.6% while large cap growth is up 13.8%[2]. This is due to those categories gaining 41.3% and 66.0% from the bottom on March 23. However, that is only one part of the story. Looking back further, for the past five and 10 years respectively, the Russell 1000 Growth outperformed the Russell 1000 Value by 12.6% and 7.5% annually[3]. Styles tend to move in cycles, and this cycle's magnitude has been high and its duration, long. Our portfolios have been attempting to take advantage of this via slightly overweighting the growth style; however, we are actively watching the following conditions to determine when it may be time to take that positioning off, or rotate into value:

- Interest rate moves, as higher rates tend to be better for value;
- Sector leadership changes, as these tend to coincide with style shifts; and
- Business cycle observations due to value tending to outperform earlier in the business cycle.

We have often commented that the direction of the dollar is likely to be indicative of the relative performance between domestic and international equities. Following the dollar's ascent to a level not seen since 2002, it has abruptly declined by 10% to where it currently trades[4]. With this tailwind,

4 *Federal Reserve Bank of St. Louis 10-Year Breakeven Inflation Rate (September 30, 2020)*

1 *Morningstar (October 7, 2020)*

2 *JPMorgan Guide to the Markets Q4 2020 (September 30, 2020)*
3 *Morningstar (October 7, 2020)*
4 *CNBC.com (October 7, 2020)*

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emerging markets in particular have outpaced domestic equities in recent months. If the dollar continues to decline, we would expect that emerging market outperformance to also endure. However, our base case is for the dollar to remain somewhat rangebound. This is due to uncertainty about the economy and the election which tend to strengthen the dollar, offset by the ever-increasing size of the United States' twin deficits; the trade deficit and the budget deficit. The latter of which is at all-time highs due to the fiscal stimulus in the CARES act[5].

The coronavirus continues to loom large over the broader economy and market sentiment. Evidence of this exists as soon as we step into a public space or turn on a television, but there is also evidence in financial markets. Interest rate levels at or near historical lows imply two things which generally go together: low inflation and concern about growth. Cash "on the sidelines" which is defined by the size of money market balances is at all-time highs at more than $4.6 trillion[6]. While the virus and the response to it have significantly impacted all of our daily routines, the larger stock market components such as Apple, Facebook, Microsoft, and Amazon have bolstered stock indices due to their relative immunity, a consequence of their business models. Companies that are struggling such as cruise lines, movie theaters, and certain on-site retailers tend to be much smaller components of the market, and thus, their stock moves are not as impactful on the index performance. Additionally, employment tends to correlate with market performance. While employment has fallen considerably, the average wage has increased potentially reducing this normal correlation between employment and market prices. This is a corollary to our prior mention of companies that have been able to thrive in the current environment as the bulk of the job losses have been in the lower income categories[7].

Simply put, there are two types of virus-related news that can affect markets: Positive news, such as vaccine or therapeutic approval and negative news, such as a concerning virus mutation, significant new outbreaks, or lack of antibody maintenance in those who previously had the virus. We believe that the positive news remains more likely as so many labor hours and dollars are being spent on the aforementioned treatments and solutions. Additionally, virus mutations often lead to less mortality, albeit sometimes with higher levels of transmissibility[8]. With all of this in mind, we expect market turbulence emanating from the news flow on this topic to continue for at least the next three to six months.

Outside of the coronavirus, the news cycle has been dominated by the U.S. elections. While we are not going to make a prediction regarding the exact outcome, as with both polls and betting markets missing the mark by a significant margin in 2016, we believe that the most likely outcome will be some sort of split government. Whether or not the Democratic Party takes the White House, it will be difficult, but not impossible, to also unseat the Republican senate majority. Divided government tends to enact less major legislation and therefore, in our view, represents the "status quo." The only undivided government that we could foresee would be a Democratic Party sweep. If this happens, there will likely be investment implications. First, there would be far fewer barriers to passing legislation, making items such as infrastructure much more likely. We would expect other lawmaking to increase taxes and regulations. Generally, taxes and regulations would be negative for the market, but all else is not equal. Increased spending may offset some of this adverse scenario, and other investment opportunities may arise, some of which could utilize a defensive posture if the government policy hinders the business environment. Regardless, a new policy direction almost certainly leads to disruptive events. Vicus Capital, with the assistance of its research partners, will seek these out so that we can tailor our portfolios' market exposure to areas likely to benefit from current policies.

Having brought up a multitude of potential investment concerns and opportunities, where do we stand as of now? Markets are certainly not cheap in the traditional sense. U.S. large cap stocks sport a forward-looking price to earnings (P/E) ratio of 21.5, well in excess of the 16.5 average over the

5 *Peter G. Peterson Foundation. (October 8, 2020)*
6 *Wall Street Journal. Investors Are Sitting on the Biggest Pile of Cash Ever. Gunjan Banerji. (June 16, 2020)*
7 *Pew Research Center. Economic Fallout From COVID-19 Continues to Hit Lower-Income Americans the Hardest. Kim Parker, Rachel Minkin, and Jesse Bennett. (September 24, 2020)*
8 *Healthline.com. COVID-19 Will Mutate – What that means for a Vaccine. Julia Ries. (June 15, 2020)*

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past 25 years[2]. Other valuation metrics such as price-to-cash flow or price-to-book remain at elevated levels. However, not all indicators point in the same direction. When one compares the earnings yield or (inverse P/E) to the yield of corporate bonds, they will find that compared to bond pricing, stocks are actually inexpensive as evidenced by the spread being wider than average[2]. Therefore, the question is, are bonds too expensive also? Well, that would be the topic for an entire commentary all unto itself. In short, it may be the case, and we are watchful for indications that yields could start rising. Yet we do not fear this outcome in the short-term due to the Federal Reserve's intense intervention in the bond market. Furthermore, when stocks are at this P/E level, the future returns tend to be much more muted than what we have experienced in recent years[2].

While this backdrop may feel quite negative, there are some positive indicators worthy of highlight. First, debt of Americans, while high is barely more than 10% of total owned assets making the average person's leverage ratio quite reasonable[2]. Next, debt service, as a percentage of income is at historical lows. And, as we noted previously, cash on the sidelines (held in money market accounts) is at all-time highs[9]. And finally, fiscal and monetary policy are expected to remain accommodative for a significant period of time. These conditions could necessitate higher equity valuations in spite of the current concerns. Vicus Capital will continue to diligently observe market conditions to best serve portfolio objectives as we navigate the choppy waters of financial markets throughout the remainder of 2020 and into the new year.

9 BNY Mellon. Vantage Point Q4. 2020. (September 30, 2020)

Economic Perspectives

Economic Growth & Profits

- Real gross domestic product (GDP) for the second quarter of 2020, according to the Bureau of Economic Analysis (BEA), came in at an annualized rate of -31.4%. This marks the first recession as defined by two consecutive quarters of decline since the 2008 Great Recession. While a very deep recession in absolute terms, two things should be noted. First, growth is expected to rebound in the third quarter and second, the annualization of the rate becomes less meaningful as the magnitude of the change increases. The absolute change in GDP from the prior year in the second quarter was -9.0%, while the first quarter actually rose 0.3% (where the quarter-over- quarter annualized rate was -5.0%)[1].
- Regarding how corporations fared, the BEA stated that, "Profits from current production decreased $208.9 billion in the second quarter, compared with a decrease of $276.2 billion in the first quarter[1]".

1 U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: 2nd Quarter 2020 (September 30, 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 Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals[2]".
- 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[2].
- It is expected that the Federal Reserve will continue to provide market liquidity with robust support and maintain the benchmark "overnight interest rate" at its current levels for the foreseeable future.

Employment

- Total non-farm payroll employment rose

2 U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (September 16, 2020)

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by 661,000 in September. This caused the official unemployment rate to fall to 7.9%, after having fallen to 8.4% in August. The labor force participation rate declined slightly to 61.4%, 1.8% lower than this time last year[3].

- Job gains continue to be most robust in the industries initially hit the hardest by the coronavirus. Leisure and hospitality gained another 318,000 employees while retail added 142,000[3].
- The average work week for all employees on private nonfarm payrolls rose slightly to 34.7 hours, another 0.2 hours higher from the end of the second quarter, and a full half hour more than at the end of March[3].
- Average hourly earnings increased by 2 cents per hour to $29.47. The Bureau of Labor Statistics notes that, "The large employment fluctuations over the past several months—especially in industries with lower-paid workers—complicate the analysis of recent trends in average hourly earnings[3]."
- The broader U-6 measurement of unemployment slid to 12.8% on a seasonally-adjusted basis, well up from 6.9% one year ago, but down from peaks in excess of 20% in April and May[3].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.4% in August on a seasonally-adjusted basis after gaining 0.6% in both June and July. Previously, it had declined by 0.8% and 0.1% respectively in April and May[4].
- The CPI-U increased by 1.3% over the last 12 months before seasonal adjustment[4].
- The Core-CPI, a popular indicator that looks at all items except food and energy has the same overall gain as the CPI-U, but is up 1.7% over the last 12 months before the seasonal adjustment[4].

Risks and Observations

- As we enter the final quarter of what has been a tumultuous 2020, we continue to see both risks and opportunities in financial markets. The coronavirus continues to put a strain on certain sectors and industries, not to mention the toll on our lives and emotional states. A presidential election has many on edge. And, of course, international flare-ups continue to make waves in various regions of the globe.
- With regard to the election, we continue to view split government as the optimal scenario for markets. As polls have shifted, the likelihood of this has possibly decreased, but remains our base case.
- The Federal Reserve, at some point, will reduce their level of economic support. Vicus Capital is 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 the Fed has guided that this will not be any time soon, it is prudent to keep the eventuality in mind.

3 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, September 2020 (October 2, 2020)

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

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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	8.22	5.70	9.98	14.02
S&P 500 TR USD	8.93	15.15	12.28	14.15
S&P 400 Mid Cap TR USD	4.77	-2.16	2.90	8.11
S&P 600 Small Cap TR USD	3.17	-8.29	-0.33	7.20
MSCI KLD 400 Social GR USD	8.83	17.64	13.36	14.72
MSCI EAFE NR USD	4.80	0.49	0.62	5.26
MSCI EM NR USD	9.56	10.54	2.42	8.97
Barclays U.S. Agg Bond TR USD	0.62	6.98	5.24	4.18
Barclays Global Agg Bond TR USD	2.66	6.24	4.10	3.92
S&P GSCI Spot	7.59	-13.24	-4.28	-0.52
S&P Target Risk Cons. TR USD	2.97	7.10	5.65	6.18
S&P Target Risk Mod. TR USD	3.71	7.41	5.81	6.78
S&P Target Risk Aggr. TR USD	6.50	8.20	6.24	9.03
Source: Morningstar® as of September 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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