Capital Market Summary

The S&P 500 Index® concluded 2020 with a fourth quarter gain of 12.15%, bringing the full year return to 18.4%[1]. This came after a very volatile year where the index experienced the fastest 30% drawdown in history, swiftly followed by a robust recovery back to all-time highs[1]. Volatility, as demonstrated by the VIX® Index, finished the quarter at 23.675, well below where it concluded the third quarter and significantly beneath levels from March 2020[2]. While on the decline, it should still be noted that this level implies higher expected volatility than what the markets have been delivering in recent months.

At the sector level, stocks that struggled the most for the year were actually the ones with the some of the greatest fourth quarter returns. Energy and Financials, up 27.77% and 23.22% respectively for the quarter, are two of the three sectors to show declines on the year. Energy is still down 33.68% while Financials have also fallen 1.69% since the beginning of 2020[1]. The other sector to decline on a full-year basis was Real Estate (-5.29%)[1]. While all sectors had positive fourth quarter returns, defensive sectors such as utilities and staples were some of the weakest performers as they rose just 6.54% and 6.35% respectively[1]. For the year, the top sectors were Technology (43.89%), Consumer Discretionary (33.30%), Communication Services (23.61%), and Materials (20.73%)[1]. Finally, the sectors in the middle, Healthcare, Industrials, and Consumer Staples all finished the year with gains between 10.75% and 13.45%[1]. Smaller domestic firms outside of the S&P 500 Index®, represented by the S&P 400 Mid Cap Index® and S&P 600 Small Cap Index® lagged throughout most of the year, but returned 24.37% and 31.31% in the fourth quarter[1]. This brought their year-to-date gains to 13.66% for the mid cap index and 11.29% for the small cap index[1].

Estimates for domestic corporate profits currently stand at-9.7% for the fourth quarter of 2020[3]. This is an improvement of 3.1% from the expectation at the quarter's start in October. Current market prices place the S&P 500® at a forward price to earnings ratio of 22.1, slightly higher than at the end of last quarter[3]. Helping to explain the recent upward trajectory of the market, FactSet shows that the expected annual decline in earnings for 2020,-13.6%, is much better than the expectation at the start of the quarter, where it was -18.0%[3]. Expectations for 2021 are for corporate profit growth to be in excess of 22%[3].

Outside of the United States, the MSCI EAFE Index® (developed international equity) rose 16.05% for the quarter which brought its return back into positive territory on the year with a gain of 7.82%[1]. The MSCI EM Index® (emerging market equity) continued outperforming other international equity as it gained 19.70% for the quarter to end the year just under the return of the S&P 500 at 18.31%[1]. If the dollar repeats the quarter's decline against other currencies, it would be expected to see international equities continue to outperform domestic counterparts.

Commodity markets have been in the doldrums for years. The Bloomberg Commodity Index® is up just over 1% annually for the past five years[1]. However, some commodities had strong 2020 returns, while others posted losses. The broad index returns were 10.19% for the quarter and -3.12% on the year[1]. Some economically-sensitive commodities, copper and timber, gained 15.83% and 21.77% for the quarter on the back of strong housing construction[1]. Others, like oil, have struggled all year. Oil did gain more than 18% in the fourth quarter, but finished the year down a staggering 50.71% in spite of that[1]. Agriculture also posted gains as it rose 21.36% over the quarter and 16.48% on the year[1]. Finally, gold and silver concluded the year by rising 0.12% and 11.49% in the fourth quarter[1]. This brought their year-to-date performance to 23.68% and 46.05% respectively[1].

Fixed income, which often can move opposite

1 *Morningstar.com (December 31, 2020)*
2 *VixCentral.com (December 31, 2020)*
3 *Factset, Earnings Insight (December 21, 2020)*

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to equity prices, bucked its historical correlation, at least over the course of the full year as we saw the Bloomberg Barclay's Aggregate Bond Index® rise 7.51%, 0.67% of which occurred in the fourth quarter[1]. The Bloomberg Barclay's Municipal Bond Index® did better on the quarter as it gained 1.82%, but still lagged on the year with a 5.21% return[1]. This underperformance is not unexpected given the lower starting yields of the tax-advantaged index. High yield municipals came into the quarter with negligible gains on the year and added in excess of 4.5% to finish the year up 4.89%[1]. Inflation-protected securities (TIPS) rose 1.62% over the past three months and that improved their 2020 performance to just under 11%[1]. The Bloomberg Barclay's Global Aggregate Bond index also posted strong returns of 3.28% for the quarter and 9.2% on the year[1]. To conclude, the non-investment corporate space had a very mixed year. Convertible bonds, returning more than 55% for the year, took advantage of both the decline in interest rates and the rise in stock prices to be one of the top performing asset classes of 2020[1]. Bank loans, with their lack of sensitivity to interest rates, only gained 3.12% after being at a cumulative loss for the first three quarters[1]. High yield corporate bond performance played out similarly as they started the final quarter of the year at a loss but managed to eke out a 6.17% return for the whole of the 2020[1].

Capital Market Outlook

If one was told that 2020 would include a pandemic that took the lives of hundreds of thousands of Americans, shutdowns of large swaths of the economy, and air travel declining to levels lower than after the 9/11 attacks, they would probably not expect a year that generated above average market returns. What if, instead, the story was that 2020 would include the Federal Reserve dropping short-term interest rates to zero, pumping trillions of dollars into the treasury and mortgage bond market, backstopping credit and municipal markets, while simultaneously, congress passing fiscal measures that made the stimulus after 2008 look small? Most likely, this would lead to a different conclusion. However, this confluence of events took place over the past year and the market has spoken that the second set of actions overwhelmed the fallout from the coronavirus and associated business shutdowns. This played out in corporate performance too, as the current expected decline in annual profits is far more modest than initially thought[1]. The result of these events, of course, was a year of intense volatility that culminated in strong equity performance.

So, why do these actions result in higher market prices? While there are many reasons, we will address those with the greatest magnitude.

1 *Factset, Earnings Insight (December 18, 2020)*

First, interest rates are low which causes future earnings to have more "current" value than when rates are higher. This is also a primary driver of outperformance from the growth equity style. This is because more of that style's earnings are in future years, as opposed to high earnings in this current year like a value stock may have.

Second, the presence of government spending, particularly of this magnitude. This is a bit more obvious, but we cannot stress enough the size of this spending. In 2009, to combat the recession caused by the financial crisis of 2008, congress spent almost $800 billion[2]. In 2020, the unanticipated fiscal spending was in excess of three times that figure[3]. It is also evident that this spending is reaching the average citizen, as indicated by delinquency rates on different types of debt. Credit card debt and mortgage debt show delinquency rates 50% and 35% lower than at the same time last year[4].

Finally, the Federal Reserve is not just keeping interest rates low, but is also buying certain segments of the bond market that are normally not kept on their balance sheet. This would include corporate debt, municipal debt, and high yield debt. These purchases, and other programs designed to provide liquidity to these markets, have served to give investors confidence that we are not going to see mass defaults in the corporate bond universe.

2 *Politico. David Rogers. Senate Passes $787 Billion Stimulus Bill (February 13, 2009)*
3 *Natixis. COVID-19 Dashboard (December 17, 2020)*
4 *BCA Research. U.S. Investment Strategy (January 5, 2021)*

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This may explain the market's path through 2020, but now what is the outlook for the coming year? Does the recent rise in interest rates signal an end to the dominance of growth-style equity? Will the dollar's fall continue and how may that affect markets? What should we expect for the path of the coronavirus and its effects on our economy? And finally, how will our recent election results influence equity prices?

Beginning with the interest rate conversation, they are quite impactful on equity prices for two reasons. First, is the "alternative investment" argument. Here, you may assume an estimated equity return and compare that to a "safe" bond (defined as a U.S. Treasury Security) yield. When the "safe" bond yield is very low, it makes equities more attractive in a relative sense. Second, interest rates serve as a "cost of money." Therefore, higher interest rate levels mean that future earnings are not worth as much as when interest rates are lower. Of course, these arguments apply to all stocks, not just one particular style. So, why is that relevant to the growth versus value debate? Simply put, value stocks have more of their earnings in the near-term, while growth stocks will have their greatest earnings in future periods. Thus, growth equities can be more sensitive to changes in interest rates. This makes sense in light of market returns over the past decade. During this time frame, interest rates declined to the levels experienced in 2020 while, simultaneously, large cap growth equity outperformed large cap value by 6.7% annually[5]. Cumulatively, over the 10-year period, that adds up to about 91%. A rise in interest rates, potentially triggered by inflation, could be the catalyst that value equity needs to start making up some of this return differential. This will be something to watch as 2021 progresses.

Because the performance of the dollar inversely affects returns of international holdings from the perspective of a U.S. investor, a falling dollar typically leads to increased performance from foreign markets. Since the peak of coronavirus concern in March, the dollar has fallen consistently. International equity markets provided sizeable returns during the second half of 2020 as this took place. Over the long-term, the direction of the dollar is generally described by three main levers. However, only one is bullish for the dollar, that being interest rate differentials (the difference between U.S. and foreign bond yields). Currently, the U.S. bond market has higher yields than most foreign developed markets, and thus, this may cause foreign inflows into our bond market which may push up the dollar as U.S. bonds have to be purchased in dollars. The other two levers go against the dollar.

First, you have the U.S. twin deficits. The fiscal deficit (government spending minus tax revenue), which is at essentially all-time highs, and the trade balance deficit which is not at the highs seen prior to 2008 but is also at very elevated levels[4]. The other lever is purchasing power parity. This is the concept that a good, such as a hamburger, may cost $5 in the U.S., but only $2.50 in another country, yet they come from the same well-known fast-food chain[6]. If you go back a decade, the dollar was much closer to the middle of the pack with 15 currencies being more richly valued[5]. This type of methodology explains that a dollar purchases far more in most countries than it does domestically. Therefore, to equal out over time, the dollar must eventually fall relative to those other currencies. On this type of basis, the dollar is expensive compared to all but three foreign currencies. As 2021 proceeds, Vicus Capital will be watching these markets and, based on expectations for the U.S. dollar, our international allocations may receive adjustment.

The coronavirus was the dominant concern worldwide not just in markets but in our daily lives. While we were able to provide reasoning for why we see markets at current prices in spite of this environment, the path forward is still not fully certain. That lack of certainty may end up giving markets a variety of things to look forward to. Vaccine distribution is expected to ramp up beyond the currently approved Pfizer/BioNTech mRNA vaccine with a similar offering from Moderna that is easier to store. Yet, there will be more variations from the likes of Novavax, Johnson & Johnson, and AstraZeneca which are all close to approvals on very different vaccines that will be even easier to

5 JPMorgan Guide to the Markets Q1 2021 (December 31, 2020)

6 The Economist. Big Max Index (July 15, 2020)

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store than Moderna's. This plethora of choices will likely lead to high vaccination rates by late spring. Furthermore, as the pandemic continues, the CDC is now estimating that more than 91 million people in the United States have had the virus which will likely provide additional immunity for some who have not received the vaccine[7]. Infection rates remain high and the daily fatalities are discomforting. However, the likelihood that the situation continues to deteriorate is on the decline, so our general view is that news on the coronavirus is more likely to be viewed positively by market participants.

Now that the 2020 election season has finally come to an end, we expect the market will turn its attention away from political wrangling and to implemented policy. While there remains some concern that the new majority leader in the senate could change senate rules to implement policy more easily, we view this as less likely now that senators in his own caucus have spoken out against the idea. If the 60-vote threshold (filibuster rule) in the senate holds, our view is that policy changes will be more moderate than some expect. Additionally, the house majority is narrower than expected. While we believe that divided government is better for markets, a very narrow majority in undivided government may not be all that different, at least as far as major legislation goes. Additionally, the new Democratic majority has been clear that they have a variety of priorities that could affect markets. One of these priorities is a reversal of the 2017 tax cut. Offsetting this, however, are expectations for a variety of programs (stimulus, infrastructure, etc.) that would result in increased spending. These will probably come either at the same time, or with spending coming first as it is expected that there will be more support from the Republican party for that than there will be for raising taxes. We expect increased spending to filter into the economy far more quickly than any tax increases, which are very unlikely to be implemented in the same year that they are passed.

As 2021 commences, there are many items on our radar. Actions from the incoming U.S. government, high current market valuations, and the path of the coronavirus are all at the top of the list. We believe, in spite of the recent, small rise in interest rates, that the low absolute level of rates will create a situation where prices can inflate quickly. Fiscal support from legislative action is likely to further this circumstance. However, risks remain. Coronavirus headlines always have the potential to surprise, and our adversaries may find this period of uncertainty in the United States as an opportunity to cause us further problems. So, while headline risks will always be present, the backdrop of federal reserve "easy policy," a strong congressional impetus for stimulus, and a recovering economy where investors still hold significant assets in money market funds should provide a canvas of opportunities for investment. Vicus Capital looks forward to a 2021 filled with good health and a return to our normal lives, hopefully by summertime!

Economic Perspectives

Economic Growth & Profits

- Real gross domestic product (GDP) for the third quarter of 2020, according to the Bureau of Economic Analysis (BEA), came in at an annualized rate of 33.4%, which is slightly above the 33.1% prior estimate. The absolute change in GDP from the prior year in the third quarter was -3.0%, versus -9.0% in the second quarter and plus 0.3% in the first quarter. We expect this absolute change metric to look more attractive at the middle of 2021 when the second and third quarters are being compared to the prior year (2020)[1].
- Regarding how corporations fared, the BEA stated that, "Profits from current production increased $499.6 billion in the third quarter, compared with a decrease of $208.9 billion in the second quarter[1]."

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

7 First Trust. COVID-19 Tracker (January 4, 2021)

1 U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: 3rd Quarter 2020 (December 22, 2020)

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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]."

- The Federal Reserve has also directed its trading desk to do the following: Increase Treasury and agency mortgage holdings by $80 and $40 billion per month respectively; roll over all principal payments and reinvest; conduct open market operations to keep federal funds rate at target; and continue to conduct overnight agreements to keep dollar funding markets liquid.
- 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 by 245,000 in November. This caused the official unemployment rate to fall to 6.7%, after having fallen to 8.4% in August. The labor force participation rate ticked up a bit to 61.5%, still 1.7% lower than this time last year[3].
- In a break from leisure and hospitality leading job gains, transportation and warehousing jobs increased the most of any industry group with an improvement of 145,000 jobs in the industries initially hit the hardest by the coronavirus. Government jobs had the largest decline at 99,000. This was inclusive of 93,000 temporary census workers whose jobs have now been completed[3].
- The average work week for all employees on private nonfarm payrolls rose slightly to 34.8 hours. This is 0.5 hours greater than the average for the same period in 2019. Simultaneously, the average hourly earnings increased by 9 cents per hour to $29.58[3].
- The broader U-6 measurement of unemployment fell again to 12.0% on a seasonally-adjusted basis, still well up from 6.8% one year ago, but down from peaks in excess of 20% in April and May. After seasonal adjustment, this statistic declines further to 11.6%[3].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.2% in November on a seasonally-adjusted basis after gaining 0.2% in September and a flat reading in October. Previously, it had declined by 0.8% and 0.1% respectively in April and May before rebounding with consecutive months of 0.6% in June and July[4].
- The CPI-U increased by 1.2% 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 1.6% over the last 12 months before the seasonal adjustment which reflects a significant reduction in energy prices partially offset by a modest gain in food prices[4].

Risks and Observations

- 2020 was filled with unanticipated events that were difficult for anyone to avoid in their daily lives, and yet the market seemed to shed this quickly as it rebounded throughout the summer and continued to provide gains for the remainder of the year.
- The election, now settled, provides markets with certainty that they were lacking over the prior quarter. Generally, one party control of government is viewed as a risk because it leads to greater levels of governmental action and less "watered down" legislation. For these reasons historically, markets have favored divided government, but this time, perhaps, things could be different. As we see a significant impetus for stimulus, not just with the new Democratic majority, but also among many Republicans, markets could view that as

2 U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (December 16, 2020)
3 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, November 2020 (December 4, 2020)
4 U.S. Department of Labor: Bureau of Labor Statistics - Consumer Price Index, November 2020 (December 10, 2020)

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supportive of increasing valuations.

- While the Federal Reserve at some point will reduce their level of economic support, it is not expected any time soon. Their guidance of allowing inflation to exceed their 2% target before raising rates gives us confidence that we have some time yet before that happens. Still, 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.

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	10.73	9.72	9.90	14.65
S&P 500 TR USD	12.15	18.40	14.18	15.22
S&P 400 Mid Cap TR USD	24.37	13.66	8.45	12.35
S&P 600 Small Cap TR USD	31.31	11.29	7.74	12.37
MSCI KLD 400 Social GR USD	12.12	21.11	15.44	15.72
MSCI EAFE NR USD	16.05	7.82	4.28	7.45
MSCI EM NR USD	19.70	18.31	6.17	12.81
Barclays U.S. Agg Bond TR USD	0.67	7.51	5.34	4.44
Barclays Global Agg Bond TR USD	3.28	9.20	4.85	4.79
S&P GSCI Spot	16.93	-6.13	-2.55	5.61
S&P Target Risk Cons. TR USD	5.13	9.67	6.74	7.02
S&P Target Risk Mod. TR USD	6.43	10.42	7.15	7.78
S&P Target Risk Aggr. TR USD	11.82	13.09	8.64	10.65
Source: Morningstar® as of December 31, 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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