Capital Market Summary

After a strong gain of 13.65% in the first quarter of 2019, the S&P 500 Index® had a somewhat volatile second quarter but concluded with an increase of 4.30% to finish at 2941.76[1,2]. Volatility, as demonstrated by the VIX® Index, had hit a high of 36.07 on Christmas Eve and then fell to 15.23 at the conclusion of the first quarter[3]. Volatility picked up a small amount in the second quarter but managed to close lower at 15.08[3]. While this still remains higher than during most of 2017, it is a more attractive number than what was experienced over most of 2018.

Within domestic equity markets, the significant dispersion between top and bottom performing sectors in the first quarter was more limited during the second quarter. The top performing sector was Financials which was up 8.00%[4]. Rounding out the top four were Materials, Information Technology, and Consumer Discretionary with gains of 6.31%, 6.06%, and 5.28% respectively. The four lowest returning sectors were Energy, Healthcare, Real Estate, and Utilities whose returns ranged from -2.83% to 3.48% over the past three months[4].

Outside of the S&P 500®, smaller firms, represented by the S&P 400 Mid Cap Index® and the S&P 600 Small Cap Index®, gained 3.05% and 1.87%[2] respectively for the quarter. Factset estimates a decline of 2.6% in earnings occurred throughout the second quarter when compared to their estimates at the onset of the quarter[5]. A reduction in expectations over the course of a given quarter is quite common as the 15-year average is -4.2%. It is important to note that this was less dramatic than the first quarter, where estimates dropped more than 7.3% as the quarter progressed. Earnings expectations for the whole of 2019 have also been further reduced from 3.7% to 2.6%. When compared to 2018, estimates show earnings contractions for each of the first three quarters with expectations for a reasonably robust fourth quarter (6.3% earnings growth). Certainly, earnings growth can be a volatile indicator. As an example, since the 2008 recession and 2009-10 recovery, earnings growth has been as low as -15.42% (2015) and as high as 20.49% (2018)[6]. From a revenue growth standpoint, estimates for 2019 currently sit at 4.4%[6].

Outside of domestic markets, the MSCI EAFE Index® (developed international equity) rose 3.68% during the second quarter of 2019 after gaining 9.98% in the first quarter[2]. The MSCI EM Index® (emerging market equity) was up 0.61% after an increase of 9.91% in the first quarter[2]. The U.S. dollar's rise that began at the beginning of 2018 seems to have leveled off[7]. As expectations increase for the Federal Reserve to cut rates, investors seem less keen to continue to bid up the U.S. dollar. Weakness in the dollar will likely benefit international developed and emerging markets as their returns will be magnified (from a U.S. investor's perspective) by the percentage change in the value of their local currencies versus the dollar.

The Bloomberg Commodity Index®, a broad basket of commodities, gave back some of its first quarter gains with a return of -1.19% in the second quarter[2]. Economically sensitive commodities, such as timber and copper, were among the worst performers in the index with losses of 1.20% and 7.30% respectively[2]. On the other hand, the agricultural subgroup of commodities rose 4.50%[2].

Finally, within the fixed income asset class, the Barclays' Aggregate Bond Index® rose 3.08% for the quarter after gaining 2.94% in the first quarter of 2019[2]. While only at the mid-year point, its year-to-date gain of more than six percent is on pace for the largest annual gain for the index since 2011[2]. The Barclays' Municipal Bond Index® increased 2.14% during the quarter after finishing the first three months of the year up 2.90%. Inflation-protected securities (TIPS) increased by 2.86%[2]. Since inflation expectations decreased over the quarter, this gain was mostly a result of falling interest rates[8]. The Barclays' Global Aggregate Bond Index® had a return of 3.29% over the quarter, outpacing domestic bonds due to

1 *U.S.Spindices.com. S&P Dow Jones Indices. S&P Global. (July 8, 2019)*
2 *Morningstar.com (July 8, 2019)*
3 *Yahoo Finance (July 8, 2019)*
4 *Bloomberg Terminal (July 8, 2019)*
5 *Factset, Earnings Insight, (July 3, 2019)*
6 *Multpl.com/s-p-500-earnings-growth/table/by-year (July 8, 2019)*
7 *Bloomberg.com (July 9, 2019)*
8 *Federal Reserve Bank of St. Louis. 10-Year Breakeven Inflation Rate (July 9, 2019)*

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foreign treasury bonds having a longer duration[2]. Lastly, high yield corporate bonds continued their strong start to 2019 by rising 2.50% in the second quarter after a robust return of 7.26% during the first quarter[2].

Capital Market Outlook

With the second quarter of 2019 in the rearview mirror, the S&P 500® has already achieved a greater return than in all but four years since the beginning of the new millennium. Leading the way were cyclical sectors and ones that benefit from low interest rates. These include Financials, Materials, Information Technology, and Consumer Discretionary[9]. The weakest sectors of the quarter were Energy and Healthcare. We commented last quarter on the relatively attractive valuations of cyclical stocks versus defensive stocks. With reasonably strong returns by both groups during the second quarter, this metric remains relevant and we continue to find cyclical equity to be attractive when compared to defensive sectors such as Consumer Staples and Utilities with forward price-to-earnings ratios (P/Es) of 19.6 and 19.0 respectively compared to 17.2 for the broader market[10].

Valuations across market capitalizations currently vary between large, mid, and small cap firms. While large and mid cap are 6.8% and 6.0% above their historical (20-year average) valuation respectively, small cap stocks are only 3.7% above their average valuation[11]. Dispersion between growth and value is also noteworthy, particular among the smaller firms. Within small cap equity, value is trading at a 11.5% discount and growth at a 23.3% premium to their 20-year historical average valuation[3]. While the smaller capitalization securities have underperformed larger ones as of late, we view this as more of an opportunity than a concern. However, if economic growth fails to materialize as expected, these smaller firms could see greater drawdowns than larger firms. To protect against this possibility, Vicus Capital prefers investment in the S&P indices (S&P 400® and S&P 600®) to the more widely recognized Russell indices (Russell Mid Cap and Russell 2000) to acquire mid and small cap exposure. Our preference is due to the fact that S&P requires profitability for index inclusion, while Russell does not, and we would expect this "quality" aspect of the index to assist in reducing downside exposure in an equity market drawdown.

As S&P 500® companies report their second quarter earnings, growth is expected to be quite meager. Sectors leading the way include Utilities (2.2%), Health Care (2.1%), and Communication Services (1.6%). Firms in the Materials, Information Technology, and Consumer Discretionary sectors are expected to see their earnings decline 15.6%, 11.9% and 3.2% respectively. Much of this decline is currently expected to reverse itself to growth toward the end of 2019 before accelerating in 2020[12].

Outside of the United States, equity price appreciation has been more difficult to obtain. This is not completely unexpected, as domestic earnings growth has outpaced that of developed international markets. However, emerging markets continue to grow at an even faster pace. While the forward P/E ratio of the S&P 500® is currently at 17.4, large developed markets such as Japan, the United Kingdom, and the Eurozone are priced at 12.9, 12.5, and 13.2 respectively[13]. This implies a valuation discount ranging from 24% to 28%. Emerging markets trade at an even more attractive valuation as their forward P/E is 12.2[5]. Additionally, emerging market equities are trading at just over half the price-to-book (P/B) value of U.S. firms[3]. Over the past 20 years, this has averaged approximately two thirds[3]. Valuation discounts alone do not guarantee outperformance. However, we believe that a reduction in trade tensions could benefit international equity on the upside, and that the substantial valuation discount could buoy portfolios in the event of a market sell-off.

The U.S. treasury bond yield curve is currently slightly inverted. Short-term rates, from one to three months are higher than that of 1 through 7-year interest rates[3]. An inverted yield curve's implication can vary from a short-term government

9 *Morningstar.com (July 10, 2019)*
10 *Yardeni.com. Stock Market Briefing. (July 10, 2019)*
11 *JPMorgan. Guide to the Markets®. (June 30, 2019)*
12 *Factset. Earnings Insight (July 8, 2019)*
13 *Yardeni.com. Strategist's Handbook (July 11, 2019)*

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funding issue, to fears of a recession. However, most analysts tend to concentrate not on the ultra-short rates such as one- and three-month notes, but on the difference between the 2-year and 10-year treasury bond. At the end of the second quarter, the 2-year treasury bond yielded 1.75% versus 2.00% for the 10-year treasury[3]. While this is a narrow spread, it is not an inversion. Yield curve shape and inversion are indicators that Vicus Capital utilizes to assist in making economic and market projections. Finally, it is important to note that a yield curve inversion does not mean imminent market declines. In fact, over the past 40 years, the average return between an inversion of the 2- and 10-year interest rates and the onset of a recession is 12.7% for the S&P 500 and this occurs over an average of nearly two years (21.3 months) before the market declines[14].

With the increase in interest rates at the end of 2018, Vicus Capital predicted stronger fixed income returns for 2019 and beyond. Since this prediction, trade tensions and expectations of a reduction in the federal funds rate caused longer-term rates to decline. Therefore, we believe that much of the increased return for this asset class has already come to fruition. In spite of this, we still expect investment grade fixed income securities to act as ballast to portfolios during time periods that are tumultuous for stocks and other risk assets. Looking forward, the federal funds futures market is pricing in a 100% chance for a rate cut at their July meeting, with nearly a 25% chance of a 50-basis point reduction[15]. If the federal reserve acquiesces to the market desires, we expect modest gains for shorter-term bonds such as one to three-year treasuries, while at the same time longer-dated bonds will be more influenced by economic growth and predictions of future inflation.

Vicus Capital is maintaining its expectation for elevated levels of equity market volatility compared to the sedate environment experienced in 2017. This will likely be instigated by continued trade tension with both China and Europe, a debt ceiling and budget debate in Washington, D.C., and geopolitical concerns in both the Middle East and East Asia. Nevertheless, expectations for economic growth continue to be reasonably positive. While the Atlanta Federal Reserve's GDPNow model forecasts only 1.4% growth in the second quarter, analyst expectations are for slightly higher growth at 1.7%[16]. Additionally, the second half of the year is typically stronger, and thus, we could see a reacceleration of economic activity at that time. Vicus Capital continues to maintain its portfolios in a broadly diversified manner with fixed income having exposure to both duration and credit and equity being allocated in a global fashion with a tilt toward assets which are trading at lower valuations. With these thoughts in mind, we look forward to a successful second half of 2019.

ECONOMIC PERSPECTIVES

Economic Growth & Profits

- Real gross domestic product (GDP) for the first quarter of 2019, according to the third estimate from the Bureau of Economic Analysis (BEA), came in at 3.1%. This is almost a full percentage point above the fourth quarter's 2.2% growth and marks the third quarter out of the last four where growth exceeded 3.0%[1].
- The BEA also noted that, "Upward revisions to nonresidential fixed investment, exports, state and local government spending, and residential fixed investment were offset by downward revisions to personal consumption expenditures (PCE) and inventory investment and an upward revision to imports[1]."

Interest Rates

- During its December meeting, the Federal Open Market Committee (FOMC) made the decision to keep interest rates steady and left the target range for the federal funds rate at 2.25%- 2.5%[2].
- The FOMC also changed their "dot plot," a graphical view of the FOMC's estimates of future changes to the federal funds rate. The median view for 2019 is now for no interest

14 Forbes.com. Larry Light. (July 11, 2019)

15 CME Group. FedWatch Tool. (July 12, 2019)
16 Atlanta Federal Reserve, GDPNow, (July 10, 2019)

1 U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: First Quarter 2019 (Third Estimate) (June 27, 2019)
2 U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (June 19, 2019)

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rate changes. This view had been as high as four hikes in 2019 as recently as September. The dot plot also implies a single rate cut in 2020. The FOMC's median prediction of the "longer-term" federal funds rate dropped to 2.5% from 2.75%[3].

Employment

- Total non-farm payroll employment increased by 224,000 in June. In spite of this, the unemployment rate increased 0.1% to 3.7%. The labor force participation rate held steady at 62.9%[4].
- The areas with the largest gains in employment were in professional and business services, healthcare, transportation, warehousing, construction, and manufacturing[4].
- The average workweek for all employees remained 34.4 hours[4].
- In June, the average hourly earnings rose six cents to $27.90. This comes after May's gain of nine cents. Year-over-year, average hourly earnings increased 3.1%[4].
- The broader U-6 measurement of unemployment rose to 7.2% on a seasonally-adjusted basis, up from 7.1% in May 2019, but down from 7.8% in June 2018[4].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.1% in May after gaining 0.3% in April[5].
- The CPI-U increased by 1.8% over the last 12 months before seasonal adjustment[5].
- The Core-CPI, a popular indicator that looks at all items less food and energy, rose 0.1% in May and 2.0% over the last 12 months[5]. The main cause of the Core-CPI exceeding the CPI-U is the large decrease in energy prices seen toward the end of 2018 which will continue to affect the annualized number for another six months.

Risks

- Trade tensions continue to dominate global economic concerns. With the White House's seemingly unpredictable pivots from China, to Europe, to Mexico, back to China, and then back to Europe, it can be difficult to know how to set expectations. While the USMCA (U.S., Mexico, and Canada Trade Deal) has been negotiated, it has still not been officially approved by congress. Barring this, the deal will not come into effect. Meanwhile, negotiations with the Chinese remain tenuous. While a deal may eventually benefit both sides, a wide gulch in objectives continues to endure. Important questions will include:
  - How strong will enforcement mechanisms be?
  - What exactly will be covered by the deal?
  - Will intellectual property be protected?

  Vicus Capital will cautiously monitor the situation as these talks pick up again this summer.

- Since the Federal Reserve apparently paused its interest rate hiking regime, market participants have repositioned in the federal funds futures market with expectations for future interest rate decreases. While the U.S. President and the federal funds futures market are both "asking" the Federal Reserve for a rate cut, we believe that the path of interest rates will be determined much more by the underlying economy than by short-term news events. Based on market positioning and the most recent statement release from the Federal reserve, it seems like we could see the 2019 federal funds rate remaining steady or declining 25 to 50 basis points[2].
- As we noted last quarter, 2018's December decline reversed abruptly in 2019. The S&P 500® closed Q2 2019 at 2941.76, less than 12.5 from its all-time high[6]. Will the Federal Reserve turn as dovish as the

3 Fed indicates it will cut rates - but not until 2020. CNBC. Christine Wang. (June 19, 2019)
4 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, June 2019 (July 5, 2019)
5 U.S. Department of Labor: Bureau of Labor Statistics - Consumer Price Index, June 2019 (June 12, 2019)
6 Yahoo Finance. (July 5, 2019)

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president and the market desire? Will the Chinese sign a trade deal "with teeth?" Could the trade spat morph into a more concerning geopolitical confrontation? These are all questions that Vicus Capital will be monitoring and seeking to answer as 2019 continues to progress. While our base case is for continued, slow economic growth, we remain prepared for any eventuality in financial markets.

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	3.21	12.20	16.80	12.29
S&P 500 TR USD	4.30	10.42	14.19	10.71
S&P 400 Mid Cap TR USD	3.05	1.36	10.90	8.02
S&P 600 Small Cap TR USD	1.87	(4.88)	11.97	8.41
MSCI KLD 400 Social GR USD	4.09	10.40	14.41	10.49
MSCI EAFE NR USD	3.68	1.08	9.11	2.25
MSCI EM NR USD	0.61	1.21	10.66	2.49
Barclays U.S. Agg Bond TR USD	3.08	7.87	2.31	2.95
Barclays Global Agg Bond TR USD	3.29	5.85	1.62	1.20
S&P GSCI Spot	-2.02	-12.74	4.38	-8.37
S&P Target Risk Cons. TR USD	2.94	7.01	5.30	3.91
S&P Target Risk Mod. TR USD	3.02	6.76	6.22	4.38
S&P Target Risk Aggr. TR USD	3.29	5.73	9.83	6.18

Source: Morningstar® as of June 30, 2019

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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