Capital Market Summary

The S&P 500 Index® had another volatile three months but managed to gain 1.7% over the quarter ending at 2,976.74[1,2]. Volatility, as demonstrated by the VIX® Index, had hit a high of 36.07 on Christmas Eve last year and then fell to 15.08 by the end of the second quarter. In spite of the S&P 500 advancing during the third quarter, the VIX ended at 17.125[3]. While this reading is higher than we have experienced for much of the past couple years, with the exception of December 2018, it is below the average reading since 2004 of 18.29[3].

The overall positive return of domestic large cap equity markets over the quarter was not felt equally among the various sectors. Traditionally defensive sectors, sans Healthcare, were the quarter's top performers with Utilities, Real Estate and Consumer Staples leading the way with gains of 9.33%, 7.30%, and 6.11% respectively[2]. More economically-sensitive sectors such as Energy, Materials and Consumer Discretionary returned -6.30%, -0.12%, and 0.51%[2]. Healthcare, normally more correlated with defensive sectors, fell 2.25% during the third quarter[2].

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®, fell 0.09% and 0.20%[2]. Factset estimates a year-over-year decline in corporate earnings of 4.1%[4]. Prior to the start of the quarter, this was estimated to be a decrease of 0.6%. This decline in estimates was approximately in line with the average historical revision and slightly larger than the decline over the previous quarter. This brings the forward price to earnings (P/E) ratio to 16.5 versus a five-year average of 16.6. Growth expectations for the fourth quarter are 2.6% for earnings and 3.6% for revenue. If these numbers come to fruition, that would place growth for the whole of 2019 at 1.2% for earnings and 4.1% for revenue. 2020 earnings growth estimates are still holding steady at 10.5%.

In international markets, the MSCI EAFE Index® (developed international equity) declined 1.07% after rising by 13.87% during the first two quarters of the year[2]. The MSCI EM Index® (emerging market equity) fell 4.25% following its increase of 10.14% in the first half of 2019[2]. International equity, from the perspective of an American investor, had a headwind in the form of U.S. dollar strength. As the dollar rises, international returns can become muted due to the effects of the foreign currency depreciating against the U.S. dollar. The reverse is also true. 2017 was a prime example of international equity having significant outperformance that was amplified by a falling dollar. Given the persistent U.S. trade deficits and fiscal deficits, we foresee the dollar being more of a tailwind in future years.

The Bloomberg Commodity Index®, a broad basket of commodities, dropped by 1.84% over the third quarter. This lowered the index's return in 2019 to 3.13% with all of the gains coming in the first quarter[2]. As it was with equities, economically-sensitive commodities were the weakest performers in the space as timber and copper fell 3.97% and 4.76% respectively[2]. Trade concerns negatively impacted the agricultural commodity sub index's returns as it declined by 6.15%. Precious metals bucked the broader commodity trend with gains of 5.31% for gold and 13.23% for silver[2]. Last quarter, we noted that the gold to silver ratio hit its highest point since 1990 (over 90:1). Silver's strong performance over the past quarter has dropped this ratio to 85:1, still well above longer-term averages[5].

To conclude, fixed income assets had another strong quarter as they generally outpaced equity markets. The Barclays' Aggregate Bond Index® rose 2.27% for the quarter which brings its gain on the year to 8.52%[2]. Declining interest rates around the world, but primarily in the U.S., was the main driver of this performance. The Barclays' Municipal Bond Index® increased 1.58% over the past three months and is now up 6.75% year-to-date[2]. Inflation-protected securities (TIPS) increased by 1.35%. TIPS have lagged treasury bonds all year by a small amount as inflation expectations have come down 0.17% since the

1 *U.S.Spindices.com. S&P Dow Jones Indices. S&P Global. (October 4, 2019)*
2 *Morningstar.com (September 30, 2019)*
3 *VixCentral.com (September 30, 2019)*
4 *Factset, Earnings Insight (October 4, 2019)*
5 *Macrotrends.com (October 4, 2019)*

continued

start of the year[6]. The Barclays' Global Aggregate Bond Index® had a return of 0.72% over the quarter as international interest rates declined, but less so than domestic rates[2]. Lastly, high yield corporate bonds continued their strong performance with a return of 1.33% during the third quarter. This places the asset class at a gain of 11.41% since the start of the year. Much of this gain occurred early in the first quarter as credit spreads declined abruptly in January after increasing significantly just prior to the start of 2019.

Capital Market Outlook

Three quarters of 2019 are now in the books and the strong performance of the S&P 500® has kept plowing ahead. Having said that, it was a volatile quarter where trade tensions, yield curve inversions, and economic growth concerns all contributed to wavering markets at various points during the period. Unlike in the second quarter, in which cyclical firms were the strongest performers, the third quarter was led by defensive-oriented stock sectors. The top performing sectors were Utilities, Real Estate, Consumer Staples, and Technology. The weakest performers were Energy, Healthcare, Materials, and Consumer Discretionary, though only the first two of these had a negative return during the period. This reversal from the second quarter has expanded the divide between valuations of cyclical versus defensive sectors. This can be seen in sectors such as Utilities and Consumer Staples which are trading at forward price-to-earnings ratios (P/Es) of 19.8 and 19.4 as compared to the broader market (S&P 500) at 16.8[7,8].

Valuations across market capitalizations have compressed slightly over the course of the quarter. This is evidenced by large cap stocks trading at 7.9% above its 20-year, long-term valuation while mid and small cap are 5.3% and 6.8% above their long-term averages respectively[7]. Dispersion, a metric that is often cited as correlating to performance of active portfolio management, has also increased and is most evident in smaller capitalization equity. While large cap growth trades at an 11.1% premium to its historical average and large cap value trades at a 4% premium, in small cap, there is a different story. Small cap growth valuations are now at 39.2% above historical averages while value remains 9.2% below. Vicus Capital is maintaining exposure to smaller capitalization equity throughout our allocations as we expect strong performance both over long time frames and in the near-term, should economic uncertainty be reduced by a resolution in trade tensions. As we noted in the previous quarter, we seek to protect our smaller capitalization equity positions by utilizing the S&P indices (S&P 400® and S&P 600®) to take advantage of their removal of non-profitable firms.

Most S&P 500® constituents will be reporting their third quarter earnings soon and some have already reported. Wall Street analysts are expecting earnings to decline by 4.1% overall[9]. This will not be felt evenly across the market's sectors. Utilities, Real Estate, and Healthcare are expected to lead the market with earnings growth of 4.0%, 3.5%, and 2.2%, respectively[9]. At the same time, Energy, Technology, and Materials are expected to show declines of 31.8%, 10.2% and 8.4%[9]. It should be noted that it is typical for earnings to exceed expectations. Because of this, it would not be surprising to see a number closer to zero than the negative 4.1% reduction in earnings expected by the analyst community. Furthermore, earnings are expected to recover slightly in the fourth quarter and more so as 2020 commences.

Since the Great Recession of 2008-2009, the U.S. dollar has strengthened, appreciating versus a basket of international currencies by 45%[7]. This nine-year streak matches the longest time period of sustained U.S. dollar movement, either up or down, and has significantly muted foreign market returns from the perspective of a U.S. investor. A possible end to the current trend could spell significant appreciation for foreign equity over the coming years. However, this is not the only reason to maintain foreign exposure. Price-to-Earnings (P/E) valuations are 21% less expensive than domestic markets and the average dividend yield is 69% higher[7]. Additionally, emerging markets'

6 *Federal Reserve Bank of St. Louis. 10-Year Breakeven Inflation Rate (October 4, 2019)*

7 *JPMorgan. Guide to the Markets®. (September 30, 2019)*
8 *Yardeni.com. Stock Market Briefing. (October 11, 2019)*

9 *Factset. Earnings Insight (July 8, 2019)*

continued

growth and the Price-to-Book (P/B) metric hint at a relative opportunity with more than double the expected GDP growth and half of the P/B valuation. While these are attractive metrics, trade concerns and weakening manufacturing are hitting foreign markets more than domestic ones. A mitigation of trade tensions could be just the catalyst that international equity markets need to produce strong equity returns.

Fixed income markets have exhibited elevated volatility. However, much of this volatility has been in the form of upside, mitigating the effect on investor psychology. Short-term rates, most heavily influenced by the Federal Reserve's Open Market Committee (FOMC), have been inverted to intermediate and longer rates which indicates they are higher than the longer rates. The heavily-watched two-year bond spent part of the quarter at higher yields than the 10-year bond. However, this has now reversed and we are seeing a spread of more than 0.1% between the two rates. While this is a very narrow spread, we can infer market confidence in the direction of the spread (larger), versus concern if the spread were to shrink. As we noted last quarter, yield curve inversions can be indicative of future recessions. However, we caution against being overly pessimistic about markets as they tend to predate market tops by nearly two years on average[10].

Last year, we commented on how the increase in interest rates experienced during the market selloff from October to early December would benefit future fixed income returns. As 2019 unfolded, trade tensions and global economic concerns grew. Market participants piled into fixed income assets bringing yields close to where they were before they started rising last year. This effect has pulled forward much of the expected future return from investment grade fixed income. Therefore, we see more muted returns in the coming years, relative to 2019. Still, we expect that high-quality fixed income has the potential to provide a ballast for equity allocations should a market drawdown occur. The federal funds futures market is currently pricing a nearly 60% chance of one reduction in the federal funds rate by year's end and approximately a 25% chance of two reductions. If this comes to fruition, the bond rally may not be over. However, the various parts of the yield curve from short-term to long-term, could react differently. If rates are cut, Vicus Capital expects continued gains from short- and intermediate-term fixed income, with less certainty in what may happen with longer-duration bonds.

As we enter the fourth quarter of 2019, we continue to expect market volatility with headline-centric gyrations triggered by trade negotiations (or the lack thereof) and international disputes (Middle East, South China Sea, Brexit). The market's propensity to climb the "wall of worry" has been in full effect as evidenced by market prices being near all-time highs in spite of headlines being awash in negativity. The Atlanta Federal Reserve's GDPNow model is forecasting 1.7% GDP growth in the third quarter, while the New York equivalent is expecting slightly over 2.0%[11,12]. With the expectation for continued volatility as the fourth quarter unfolds, we remain resolute in maintaining portfolio diversification within fixed income allocations between credit and duration as well as equity allocations across both global regions and market capitalizations to take advantage of potential opportunities for pockets of outperformance.

Economic Perspectives

Economic Growth & Profits

- Real gross domestic product (GDP) for the second quarter of 2019, according to the third estimate from the Bureau of Economic Analysis (BEA), came in at 2.0%. This is a decline from an annualized rate of 3.1% during the first quarter[13].

- The BEA also noted that, "positive constributions from PCE (personal consumption expenditures), federal government spending, and state and local government spending were partly offest by negative contributions from private inventory investment, exports, and fixed investment."

10 CNBC.com. Thomas Franck. (August 14, 2019)

11 Atlanta Federal Reserve. GDPNow. (October 9, 2019)
12 New York Federal Reserve. Nowcasting Report. (October 11, 2019)
13 U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: Second Quarter 2019 (Third Estimate) (September 26, 2019)

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Current dollar GDP (a measure that does not include inflation) increased at a 4.7% annualized pace during the quarter. This was a faster pace than the 3.9% in the first quarter indicating potentially increasing inflationary forces.[13]

Interest Rates

- During its September meeting, the Federal Open Market Committee (FOMC) made the decision to cut interest rates and changed the target range for the federal funds rate to 1.75% - 2.00%[14].
- The FOMC also changed their "dot plot," a graphical view of the FOMC's estimates of future changes to the federal funds rate. The current median view for 2019 is for no further interest rate changes. One year ago, this view had been for four hikes in 2019. The dot plot also implies no change for 2020. A single 0.25% hike is expected by the Committee in both 2021 and 2022. Finally, the FOMC's median prediction of the "longer-term" federal funds rate remians at 2.5%[15].

Employment

- Total non-farm payroll employment increased by 136,000 in September. While this was slightly below expectations, revisions from earlier months helped drive the unemployment rate down to 3.5% from 3.7%. The labor force participation rate held steady at 63.2%. While not a change from last month, this is 0.3% higher than one quarter ago[16].
- The areas with the largest gains in employment were in healthcare, professional and business services, government, transportation, and warehousing[16].
- The average workweek for all employees on private nonfarm payrolls remained unchanged at 34.4 hours[16].
- In September, average hourly earnings declined by one penny to $28.09. Year-over-year, average hourly earnings increased 2.9%[16].
- The broader U-6 measurement of unemployment fell to 6.9% on a seasonally-adjusted basis, down from 7.2% in August of 2019, and 7.5% in September of last year[16].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.1% in August after gaining 0.3% in July[17].
- The CPI-U increased by 1.7% over the last 12 months before seasonal adjustment[17].
- The Core-CPI, a popular indicator that looks at all items less food and energy, rose 0.3% in August and 2.4% over the last 12 months[17]. The main causes of the Core-CPI exceeding the CPI-U are food inflation being muted and energy prices declining.

Risks and Observations

- Global trade friction has been joined by impeachment proceedings to provide an uncertain backdrop to world markets and economies. Because impeachment requires only a simple congressional majority, Vicus Capital views it as a quite possible outcome. However, removal of the president would necessitate approximately one third of senate Republicans voting with the Democrats. This is something that we believe to be improbable as the country's political polarization has only grown, reducing the likelihood of agreement between the parties. The risk to markets is that impeachment will snuff out other potential initiatives that could be economically beneficial. These include but are not limited to trade deals with China and the European Union, signing of the USMCA trade agreement, and infrastructure improvements.
- As the Federal Reserve reversed its policy from 2018 and cut interest rates twice, market participants repositioned in the

14 U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (September 19, 2019)
15 Federal Reserve Dot Plot. Bloomberg Terminal (September 19, 2019)
16 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, October 2019 (October 4, 2019)
17 U.S. Department of Labor: Bureau of Labor Statistics - Consumer Price Index, September 2019 (September 12, 2019)

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federal funds futures market with expectations for future interest rate decreases. While the U.S. President and the federal funds futures market continue "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. Our prior outlook indicated a potential decline in rates by 25 to 50 basis points. In spite of the previously-mentioned FOMC median view, we now believe that another rate cut is quite likely and we could see a total decline in the federal funds rate of 75 basis points over the whole of 2019.

- After quickly gaining back December 2018's losses, the market stalled out over the summer. The S&P 500® closed Q3 2019 at 2,976.74, around 50 points and less than two percent from its all-time high[18]. Will the Federal Reserve remain as dovish as the 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? Will impeachment proceedings affect markets or even slow the economy? These are all questions that Vicus Capital will be monitoring as we approach 2019's conclusion. While our base case continues to expect slow economic growth with elevated levels of market volatility, we remain prepared for any eventuality in financial markets.

18 *Wall Street Journal. Historical Prices. (October 4, 2019)*

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	1.83	4.21	16.44	12.28
S&P 500 TR USD	1.70	4.25	13.39	10.84
S&P 400 Mid Cap TR USD	-0.09	-2.49	9.38	8.88
S&P 600 Small Cap TR USD	-0.20	-9.34	9.33	9.89
MSCI KLD 400 Social GR USD	1.83	5.81	13.39	10.75
MSCI EAFE NR USD	-1.07	-1.34	6.48	3.27
MSCI EM NR USD	-4.25	-2.02	5.97	2.33
Barclays U.S. Agg Bond TR USD	2.27	10.30	2.92	3.38
Barclays Global Agg Bond TR USD	0.72	7.60	1.59	1.99
S&P GSCI Spot	-5.11	-17.00	3.46	-6.81
S&P Target Risk Cons. TR USD	1.73	7.50	5.22	4.55
S&P Target Risk Mod. TR USD	1.52	6.60	5.91	5.05
S&P Target Risk Aggr. TR USD	0.68	3.00	8.52	6.88

Source: Morningstar® as of September 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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