Capital Market Summary

Throughout the first quarter of 2021, the S&P 500 Index® rose 6.17%, and continued to accelerate through the second quarter, gaining another 8.55%[1]. This brings the year-to-date return to 15.25% after a 18.40% rise in this benchmark index in 2020[1]. The VIX® Index, an indicator of expected volatility, has continued to decline, which is an expected result of the market being calmer than what it exhibited in early 2020. It now resides at 17.903, compared to 20.734 at the end of the first quarter and 23.675 at the end of 2020[2]. This can be viewed as an expectation of near-term volatility to be approximately 20-25% lower than the same expectation at the start of 2021.

Sector returns demonstrated that it was a "risk-on" quarter in which cyclical sectors outperformed when compared to defensive ones. The top sectors of the quarter were Real Estate, Technology, Energy, and Communication Services which each showed gains in a narrow range between 10.72% and 11.68%[1]. Just below those were Healthcare and Financials which returned 8.40% and 8.36% respectively. Weaker sectors included Consumer Discretionary, Materials, and Industrials which cooled off a bit from their first quarter performance as they showed gains of 6.95%, 4.97%, and 4.48%.

1 Morningstar.com (June 30, 2021)
2 VixCentral.com (June 30, 2021)

Finally, the defensive Consumer Staples and Utilities sectors underperformed broader indices with returns of 3.83% and -0.41% respectively[1]. Unlike in the first quarter where they led performance, 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®, climbed just 3.64% and 4.51%. Despite lagging during the second quarter, both smaller firm indices are still outpacing the S&P 500 for the first six months of the year in total[1].

FactSet is estimating that second quarter corporate profit growth will come in at 64.0%. This is quite a large figure and, should it be realized, it will mark the highest year-over-year quarterly earnings growth since 2009. Contrary to what happens over the course of most quarters, analysts increased their earnings estimates. Estimates rose 7.2% between March 31 and June 30. Market participants reacting to this information was likely a contributor to the upward price movement that occurred during the quarter. The ebullient market has led to a sustained price to earnings ratio (P/E) greater than 20. Currently, this ratio sits at 21.4, which is 15% and 25% above the 5-year and 10-year averages. Looking ahead, FactSet sees year-over-year profits growing 23.7% in the third quarter, and 36% for the entire year, which is just over 10% greater than their full year estimate at the end of last quarter[3].

3 Factset, Earnings Insight (July 9, 2021)

Looking into foreign markets, the MSCI EAFE Index® (developed international equity) gained 5.17% for the second quarter of 2021, while the MSCI EM Index® (emerging market equity) trailed close behind at a 5.05% return[1]. In contrast to domestic equity, smaller capitalization firms slightly outperformed as international small cap equity rose 6.35%[1]. The direction of the U.S. dollar often is often highly impactful on international market returns. It has been trading in a relatively narrow range. If it breaks out to the upside, it could lead to domestic outperformance, and if it breaks lower, foreign stocks could lead again.

Commodities markets continued what they started in the first quarter and led most asset classes with a quarterly gain of 13.30% on the Bloomberg Commodity Index®[1]. Much of the gain came from oil, which rose 24.36% and is the largest individual component of the index. Other economically-sensitive commodities posted more mixed results during the quarter as timber rose 4.83% while copper gained 7.03%[1]. The agriculture commodity subindex was approximately in line with broader commodities and rose 12.77% since the start of the quarter[1]. Lastly, precious metals retraced some of the prior quarter's losses, and gold rose by 4.16% as silver gained 7.22%[1].

After rising interest rates in the first quarter of 2021 reduced bond prices, they recovered

continued

slightly in the second quarter. The Bloomberg Barclay's Aggregate Bond Index® regained 1.83% of its first quarter 3.37% drop[1]. The Bloomberg Barclay's Global Aggregate Bond Index also rose, albeit a smaller amount at 1.31%[1]. Municipal bonds, which fell less than taxable bonds in the first quarter gained 1.42%[1]. Treasury Inflation Protected Securities (TIPS), which are priced based on inflation expectations, posted among the strongest investment grade performance with a gain of 3.25%. Finally, most non-investment grade bond varieties continued to outperform the broader investment grade indices. High yield municipal bonds, high yield corporate bonds, and convertible bonds gained 3.93%, 2.74%, and 3.63% respectively[1]. Unsurprisingly, as interest rates fell, the one laggard of non-investment grade fixed income was floating rate bank loans which still eked out a 1.47% gain[1].

Capital Market Outlook

After the coronavirus vaccines began to receive approvals around the globe, cyclical stocks with depressed prices roared back to life to empower a rapid series of market gains in November 2020. While value-styled stocks helped the market continue its ascent in the first quarter of 2021, they handed off the baton to growth-styled firms during the second quarter which led the S&P 500 Index® to a year-to-date return of 15.25%[1]. As we now move into the second half of 2021, markets will have to respond to four main situations: Reductions in levels of fiscal stimulus, less time before the Federal Reserve reduces its monetary support, rich valuations/difficult year-over-year comparisons, and a rising price index.

Fiscal stimulus totaling more than 25% of annual U.S. gross domestic product (GDP) is nearly four times what was unleashed to combat the recession in 2008 and has now largely made its way throughout the financial system[2]. This took many forms, but notably via direct cash payments. So, how has this stimulative policy affected the economy? Despite many people losing employment, median personal income surprisingly spiked to all-time highs and was up 14% year-over-year[3]. Economic growth rebounded significantly, and both corporations and individuals experienced a drop in bankruptcy filings compared to 2019, a relatively robust year economically-speaking[3]. Additionally, loan delinquencies have been declining and, for most types, are below 2019 levels. Lastly, personal savings for all Americans now total $1.5 trillion more than the pre-pandemic trend[3]. On the other side of the equation, this caused U.S. debt to rise substantially; more than double the largest prior annual increase[4].

Of course, stimulus is not expected to last indefinitely. Certain measures are due to conclude over the course of the remainder of this year and early next year, including but not limited to: enhanced unemployment benefits, economic impact payments, and aid to state and local recovery funds. Markets typically price in future economic conditions before they are fully realized. Therefore, we expect a reaction in anticipation of it being pulled back.

While fiscal support has been an important component in the economic recovery from the coronavirus and associated lockdowns, it is at least equally important to recognize the influence of the Federal Reserve on financial markets and asset prices. As the world realized that coronavirus would be a major event, the central bank stepped in with a variety of policies enacted to help stabilize the economy. Instead of delaying action as they did in the 2008 market selloff, they acted very quickly in 2020. Though not an exhaustive list, the Federal Reserve did the following: Reduced short-term interest rates to essentially zero percent, purchased treasury bonds and mortgage-backed securities in large quantities, backed the commercial paper market, and even went to far as to buy both investment grade and high yield corporate bonds.

These programs served to provide both liquidity and confidence to markets. Evidence that it worked was apparent in short order. Corporate bond spreads declined rapidly across both investment

1 *Morningstar.com (June 30, 2021)*
2 *Natixis COVID-19 Dashboard (June 21, 2021)*
3 *BCA Research Fiscal Stimulus: How Much Is Too Much? (January 8, 2021)*
4 *Federal Reserve of St. Louis. Federal Surplus or Deficit (July 16, 2021)*

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grade and high yield issuers and, at the same time, commercial paper and municipal bond markets recovered from their sell-off. Because they moved so much more quickly than in 2008, we did not see the type of long-term, sustained weakness in credit markets witnessed by investors just over a decade ago.

Looking forward, we anticipate future volatility instigated by the reduction in support from the central bank. What this will look like should be dependent on the pace and type of reductions they implement. For now, our expectation is that they will be cautious and only unexpected inflation would take them on a different path and force them to tighten monetary conditions at a more rapid pace.

When stock analysts look at corporate performance, they are always seeking to observe incremental improvement. The coronavirus environment provided firms with the opportunity to reset these expectations with very weak results early in 2020. Because of this, so far in 2021, companies are outperforming their first halves of last year by notable margins in most circumstances. This is evidenced by earnings estimates improving for the whole of the second quarter by 64% compared to last year[5].

Of course, as we venture toward 2022, it will become much more difficult for businesses to demonstrate improvement of financial performance during the recovery. At the same time, market valuations are far richer now than they were at the same time in 2021 and this is seen through the price-to-earnings (P/E) multiple expanding from just over 18 to 21.3 on a forward-looking basis[6]. These factors combine to create an environment where it will be more difficult for markets to generate appreciation at a rate similar to those in recent years. The more elevated the starting valuation is, the greater amount of economic growth needed to drive the same percentage of performance.

Financial news media are now focusing on rising price levels defined by the Consumer Price (CPI) Index and Personal Consumption Expenditures (PCE) Index. Inflation calculations for Treasury Inflation Protected Securities (TIPS) and Social Security cost of living adjustments are based on CPI. The Federal Reserve, however, prefers to look at the PCE measure which tends to be less volatile. Either way, the 5% print on year-over-year CPI and 3.9% increase in PCE are the largest moves since the recovery from the recession in 2008[7,8].

When comparing current economic conditions to those from a year ago, it makes sense to experience a rise in inflation. Demand was deeply dampened by the economic lockdowns and reductions of economic activity. While some items, most notably toilet paper, became hot commodities, other sales languished. Hotel and restaurant use, sporting events, and social gatherings of all kinds fell by the wayside as people kept to themselves in a socially distant manner. The reduction in movement drove a massive decline in the amount of oil consumed by vehicles. In turn, this resulted in a major disruption of oil markets where oil supply overwhelmed storage causing the price in futures markets to temporarily become negative[9]. This is an extreme example of where low and falling prices in the prior year may make the inflationary uptick seem larger than it would be if prices had risen in 2020 as they had been in prior years.

With all of this being said, the question may be whether there is any good news to discuss? The answer is: Absolutely! Growth in the U.S. gross domestic product (GDP) for the second quarter of 2021 is expected to be 7.5% per the predictions of the Atlanta Federal Reserve[10]. The "blue chip consensus" of top economists is even more optimistic at 9.1%[10]. These are extremely high levels of expansion compared to recent years where annual growth has not been in this range since the 1980s[11]. Elevated levels of economic growth typically correspond to strong corporate performance which should result in elevated stock prices; especially when this effect is compounded by low interest rates. Furthermore, companies themselves typically posted poor results in 2020. When comparing their 2021 results over the remainder of the year, it is reasonable to expect significant improvements in performance. Corporate performance should also

5 Factset Earnings Insight (July 9, 2021)

6 Yardeni.com. Selected PE Ratios (July 8, 2021)
7 Bureau of Labor Statistics. CPI (June 10, 2021)
8 Bureau of Labor Statistics. PCE (June 25, 2021)

9 Ambrose, Jillian. The Guardian. Oil Prices Dip Below Zero as Producers Forced to Pay to Dispose of Excess (April 20, 2020)
10 Federal Reserve Bank of Atlanta. GDP Now (July 16, 2021)
11 Federal Reserve Bank of St. Louis. Gross Domestic Product (January 28, 2021)

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be bolstered by the consumer. American families have lower debt, higher savings and increased earnings compared to this time last year[3]. These factors all should translate into purchasing power to fuel economic growth. And finally, we believe that the likelihood of business shutdowns or measures that will significantly impede economic activity, while not eliminated, are considerably reduced relative to 2020.

In response to the economic and financial market environments we are experiencing, Vicus Capital portfolios continue to maintain an underweight allocation to bond duration and a cyclical tilt to equity exposure. Duration was reduced to offset the potential of rising rates, which would most likely be caused by inflationary pressures, and will help reduce a portfolio's sensitivity to interest rates. This is a slight adjustment to bond positioning as we desire to retain the ability of fixed income to provide ballast to portfolios when equities decline. Our cyclical equity exposure tilt is designed to gain exposure to stocks that have underperformed over recent years. It may serve to both protect against elevated valuations in parts of the market as well as to gain exposure to potentially more attractively-valued firms.

As always, these adjustments remain within the confines or our overall investment philosophy of managing portfolio risk first and foremost. Our portfolio positioning remains broadly diversified with exposures to global equity and fixed income securities of multiple types. We believe that these complementary active allocations will serve to maintain asset class diversification as our portfolios navigate the second half of 2021.

Economic Perspectives

Economic Growth & Profits

- Real gross domestic product (GDP) for the first quarter of 2021, according to the Bureau of Economic Analysis (BEA), came in at an annualized rate of 6.4% which is identical to the prior estimate. This rise in GDP was predicated on increasing non-residential investment and inventory growth slightly offset by an increase to the trade deficit. We continue to believe that the year-over-year GDP growth will continue to look attractive for the coming quarters as we "lap" the Covid-19-affected time periods[1].
- Regarding how corporations fared, the BEA stated that, "Profits from current production increased $55.2 billion in the first quarter of 2021, in contrast to a decrease of $31.4 billion in the fourth quarter of 2020[1]."

Interest Rates

- The Federal Reserve remains committed to maintaining its accommodative monetary policy with the hallmarks of low interest rates and sizeable asset purchases of both treasury bonds and mortgage-backed securities. The most recent statement from the Federal Open Market Committee again begins with the statement, "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 continues to reinvest all principal and interest from owned securities[2]. Due to the new method of inflation targeting by the Federal Reserve whereby they will permit inflation to run above their 2% target, we expect that they will continue their liquidity and stimulative programs for the foreseeable future.
- In light of rapidly appreciating home prices, there has been discussion of reducing purchases of mortgage-backed securities[3]. This could cause an increase to the cost of home ownership and result in lower market liquidity for these types of instruments.

Employment

- Total non-farm payroll employment rose by 850,000 in June which kept the official unemployment rate steady at 5.9%. The labor force participation rate held steady at 61.6%

1 *U.S. Department of Commerce: Bureau of Economic Analysis - Gross Domestic Product: 1st Quarter 2021 (June 24, 2021)*

2 *U.S. Federal Reserve - Federal Reserve Issues FOMC Statement (June 16, 2021)*

3 *Reuters.com. Fed May Opt for Faster Phase-out of Housing-backed Bond Purchases. Burns, Dan & Saphir, Ann (June 11, 2021)*

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which is still 1.7% lower than pre-pandemic[4].

- As reopening continues, the leisure and hospitality industries led job gains again with an increase of 343,000 employed persons. Over half of this came from food service and bars. Local government education was the second largest contributor with a gain of 155,000 jobs[4].
- The average workweek for all employees on private nonfarm payrolls retreated a bit as it fell to 34.7 hours. Simultaneously, the average hourly earnings rose by 10 cents per hour to $30.40 which is $1.05 greater than over the same month in the prior year[4].
- The broader U-6 measurement of unemployment declined again to 9.8% on a seasonally adjusted basis; a substantial reprieve from last June's print of 18.0%[4].

Inflation

- According to the Bureau of Labor Statistics, the Consumer Price Index for All Urban Consumers (CPI-U) rose 0.6% in May on a seasonally adjusted basis after gaining 0.8% in April. This resulted in a total twelve month increase of 5.0%, higher than we have seen since August of 2008[5].
- The Core-CPI, a popular indicator that looks at all items except food and energy also rose 0.7%. However, over the prior 12 months, the Core-CPI lags the CPI-U by 1.2%, demonstrating that food and energy costs have heavily driven the direction of the index despite only equating to about 20% of the index's composition[5].

Risks and Observations

- As market prices grow in line with the rise in earnings expectations, valuations have remained reasonably stable. However, as a greater proportion of the expected future growth occurs, market participants may become concerned over where the next opportunity or hazard lies.
- Over the past 15 years, the current percentage of S&P 500 firms that trade over a price to earnings ratio (P/E) of 20 is approximately at its all-time high while the number of firms under a P/E of 10 is close to all-time lows[6].
- Global risks remain relevant as tensions between China and many of its neighbors, not to mention the United States, continue at a slow boil. In the middle east, OPEC is having trouble figuring out what its quotas will be for the remainder of the year, and there is always the chance of a new coronavirus variant to keep the market on edge.
- Finally, we want to reiterate our thoughts on risk from Federal Reserve action. We continue to believe that changes in the Fed's course of action are the largest known potential risk. While they continue to remain extremely accommodative with their monetary policy, any reduction in bond purchases or an increase in the Federal Funds Rate is likely to cause a negative reaction from the market. In the first quarter, we reduced our portfolio's fixed income durations to limit adverse effects of rising interest rates and we will continue to monitor the situation actively.

4 U.S. Department of Labor: Bureau of Labor Statistics - The Employment Situation, June 2021 (June 2, 2021)
5 U.S. Department of Labor: Bureau of Labor Statistics - Consumer Price Index, May 2021 (June 10, 2021)
6 Yardeni Research. Stock Market Briefing: Selected P/E Ratios. (July 8, 2021)

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Disclosure

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Financial Planning and Investment Advisory Services offered through Vicus Capital, Inc., a federally Registered Investment Advisor.

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	5.08	36.34	15.02	16.66
S&P 500 TR USD	8.55	40.79	18.67	17.65
S&P 400 Mid Cap TR USD	3.64	53.24	13.17	14.29
S&P 600 Small Cap TR USD	4.51	67.40	12.20	15.82
MSCI KLD 400 Social GR USD	8.88	42.22	20.01	18.58
MSCI EAFE NR USD	5.17	32.35	8.27	10.28
MSCI EM NR USD	5.05	40.90	11.27	13.03
Barclays U.S. Agg Bond TR USD	1.83	-0.33	5.34	3.03
Barclays Global Agg Bond TR USD	1.31	2.63	4.23	2.34
S&P GSCI Spot	14.67	64.67	3.21	7.46
S&P Target Risk Cons. TR USD	3.32	11.72	8.21	6.69
S&P Target Risk Mod. TR USD	3.86	15.55	9.11	7.84
S&P Target Risk Aggr. TR USD	5.92	31.52	12.48	12.26

Source: Morningstar® as of June 30, 2021

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.