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Domestic Equities

Let’s begin by looking at what has happened in 2017 through September 1. The broad U.S. stock market as measured by the S&P 1500 Index has gained 11.3%, a pace faster than its historic norm. A breakdown by market capitalization shows that larger cap stocks (represented by the S&P 500 (up 12.2%)) have set the pace, whereas small-cap stocks (represented by the S&P 600 (up 1.9%)) have lagged. The S&P Information Technology Index has been the best sector, gaining 25.4%, while the S&P Energy Index has been the worst, losing 15.7%. Corporate earnings have supported the gains in the 1500 Index. 1,462 of those companies have reported their most recent quarterly earnings with an average increase of 8.9% from the same quarter in 2016. Through September 1, the yield on the 10-Year Treasury Note has dropped from 2.45% to 2.17%. The U.S. Dollar Index has lost about 9.1% in 2017. Inflation, as measured by the Consumer Price Index (CPI) has remained below an annual pace of 2%. All in all, these conditions have represented a favorable setting for stocks: low inflation, declining interest rates and growing earnings.

In fact, earnings and the yield on the 10-Year Treasury Note are two components of our valuation equation. Growing earnings and declining interest rates have propelled our estimate of fair value for stocks, on average, higher this year, which explains why we can have the 1500 Index up 11.4% yet still have an ICON market value/price (V/P) ratio of 1.04 to end August. Prices have increased but so has our estimate of fair value.

With a market V/P of 1.04, meaning stocks on average are priced below our estimate of fair value, we do not see the over-pricing often seen at market peaks, but instead see room for stock prices to advance over the next year. Such a posture puts us in disagreement with those claiming stocks are expensive based on a simple price/earnings (P/E) ratio. In a recent research report we issued (*“Deficiencies of P/E in Predicting Returns”*), we made the case that the P/E ratio for the S&P 500 Index does not have much predictability to future returns. We favor intrinsic value, which we believe has been a good guide for us over the last eight and a half year bull market.

As for sectors, we still favor Information Technology and Financials, although those two are far from synchronized. During short-term moves, one of those sectors might rally but the other one lags, then the exact opposite happens a few months later. Even though they have not moved together lately, we believe both can lead over the long run.

International Equities

On Friday September 1, 2017 two international indexes hit all-time highs; the broad MSCI ACWI (ex. USA) and the narrower MSCI Emerging Market Index. Through September 1, the former is up 19.9% in 2017 while the latter has gained 29.1%. Just as it has domestically, fair value has been growing, in general, for international stocks, leading us to believe the rallies are sustainable. Sector V/P rankings are fairly similar to those in the U.S., with Financials and Information Technology near the top and Energy at the bottom. The best values remain in developed European countries, but a variety of emerging markets have V/P ratios in the top half of our country rankings. In general, the international advances appear sensible to our system, and the ICON global and international portfolios remain over-weighted international equities.

Bonds

Before ticking higher September 1, the yield on the 10-Year Treasury Note ended August at a 52-week low of 2.118%. What might at first appear to be an extremely low yield, can be explained by international factors. Economic growth and inflation are lower in Europe than in the U.S., and interest rates are even lower overseas. For global investors searching for high quality bonds and yield, our 10-year Treasury still appears attractive, so there are buyers for it, even at these low yields.

Summary

People think of these as uncertain times. Investors may be sitting on the sidelines while they wait to see how any number of issues – North Korea, tax reform, deregulation attempts and Government spending limits, to name a few – develop and shake out. We believe this explains why investors have been restrained and have not taken prices too high in a flurry of optimism. Based on value and investor behavior and sentiment, we do not see the conditions that often appear at market peaks. We believe stocks, on average, can move higher over the next year.

The data quoted represents past performance, which is no guarantee of future results..

Opinions and forecasts regarding sectors, industries, companies, countries and/or themes, and portfolio composition and holdings, are all subject to change at any time, based on market and other conditions, and should not be construed as a recommendation of any specific security, industry, or sector.

Investing in securities involves inherent risks, including the risk that you can lose the value of your investment. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. There are risks associated with Small and Mid Cap investing such as less liquidity, limited product lines, and small market share.

ICON's value-based investing model is an analytical, quantitative approach to investing that employs various factors, including projected earnings growth estimates and bond yields, in an effort to determine whether securities are over- or underpriced relative to ICON's estimates of their intrinsic value. ICON's value approach involves forward-looking statements and assumptions based on judgments and projections that are neither predictive nor guarantees of future results. Value readings are contingent on several variables including, without limitation, earnings, growth estimates, interest rates and overall market conditions. Although valuation readings serve as guidelines for our investment decisions, we retain the discretion to buy and sell securities that fall beyond these guidelines as needed. Value investing involves risks and uncertainties and does not guarantee better performance or lower costs than other investment methodologies.

ICON's value-to-price ratio is a ratio of the intrinsic value, as calculated using ICON's proprietary valuation methodology, of a broad range of domestic and international securities within ICON's system as compared to the current market price of those securities. According to our methodology, a V/P reading of 1.00 indicates stocks are priced at intrinsic value. We believe stocks with a V/P reading below 1.00 are overvalued while stocks with a V/P reading above 1.00 are undervalued. For example, we interpret a V/P reading of 1.15 to mean that for every $1.00 of market value, there is $1.15 of intrinsic value which has not yet been realized in the market price.

The Consumer Price Index (CPI) is a measure of the average change in prices over time of goods and services purchased by households. The CPIs are based on prices of food, clothing, shelter, fuels, transportation fares, charges for doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living.

The unmanaged Standard & Poor's Composite 1500 (S&P 1500) Index is a broad-based capitalization-weighted index comprising 1,500 stocks of Large-cap, Mid-cap, and Small-cap U.S. companies. The unmanaged Standard & Poor's (S&P) 500 Index is a market value-weighted index of large-cap common stocks considered representative of the broad market. The unmanaged Standard & Poor's (S&P) SmallCap 600 Index is an unmanaged index of 600 domestic stocks chosen for their market capitalization, liquidity, financial viability, and sector representation. The Standard and Poor's (S&P) 1500 Information Technology Index is an unmanaged capitalization-weighted index comprising companies in the Information Technology sector as determined by S&P. The Standard and Poor's (S&P) 1500 Energy Index is an unmanaged capitalization-weighted index comprising companies in the Energy sector as determined by S&P. The Morgan Stanley Capital International (MSCI) All Country World Index ex-United States (ACWI ex-U.S.) is a leading unmanaged benchmark of international stock performance. The capitalization-weighted index is representative of the performance of securities of companies located in developed and emerging markets outside of the United States. The Fund's emerging market exposure reflects countries that are members of the Morgan Stanley Capital International (MSCI) Emerging Markets Index℠, a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of June 2007, the MSCI Emerging Market Index consisted of the following 25 emerging market country indexes: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Total return for the unmanaged indexes include the reinvestment of dividends and capital gain distributions but do not reflect deductions for commissions, management fees, and expenses. The Portfolios' composition may differ significantly from the indexes. Individuals cannot invest directly in an index.

The 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

Source: Bloomberg FactSet

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