ICON

Portfolio Update January 2017

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Domestic Equities

The broad stock market drifted lower in October 2016 and hit a low Friday November 4, just before the election. From that Friday, the S&P 1500 Index gained a rapid 10.0%, hitting an all-time high on December 13. Most other indexes reached all-time highs on various days in December. In the ICON November Portfolio Update we wrote, "With stock prices sagging in October, our overall average market value-to-price (V/P) ratio began November in the 1.10 range. This V/P – indicating stocks, on average, are priced about 10% below our estimate of fair value – feels about right given the amount of uncertainty facing investors." We concluded with, "Based on our valuation readings, we see potential for the market to move higher over the next year with the Financial, Information Technology and Consumer Discretionary sectors, among others, leading the way." While our upward target proved accurate, the rally was faster than we expected in our pre-election statements.

Before the election, investors had been "pricing in" expectations for sluggish real gross domestic product (GDP) growth of about 2.00%. With President-Elect Trump campaigning on fiscal stimulus policies for economic growth and apparently having a supportive congress, investors rapidly "priced in" 3% or even 4% real GDP growth and the expected positive impact that growth could have on corporate earnings. You may have noticed a wide divergence in opinion regarding the economy's path over the next few years. We believe that is because analysts don't know what they are dealing with and have not seen it before. Analysts have seen one time, temporary fiscal stimuli, such as tax cuts, designed by politicians aimed at jolting the economy out of recession. What is being talked about currently is a structural change of longer term infrastructure spending, new individual and corporate tax codes and regulatory changes all designed by business people. Having just concepts, not knowing what will come out of Congress and having not seen such structural change before, analysts can only guess what the economy will look like the next few years. Those guesses vary widely and change from day to day.

This rally has taken our market V/P below 1.00, meaning stock prices, on average, are below our estimate of fair value. We do not see the extreme over-pricing typical of some market peaks. We also do not see peak-like behaviors such as extremely optimistic investor sentiment or low correlation among sectors. We have not traded or raised cash during this recent advance. As we do not see extreme conditions, we are content to hold steady until analysts get a better picture of what will come out of Washington.

We view this recent rally as the third leg of a market advance that began off the low February 11, 2016. Over that eleven month move, Financials has been the best performing sector. Most recently, from November 4 through December 31, 2016 the S&P 1500 Financials Index gained 20.3%, rewarding our portfolios for our long-term overweight position. Small-cap stocks, another over-weighted position in our portfolios, continued beating large-cap stocks since the February low. During the recent advance, the S&P Small-Cap 600 Index gained about 19% since November 4 while the large cap S&P 500 Index gained only about 8%. The rewards for over-weights in Financials and Small-Caps are examples of the patience required for value investing.

International Equities

International equities did not get the initial boost like domestic stocks after the election. Some markets in countries like Germany, France and the United Kingdom sagged at first but have moved higher in December. Japan, on the other hand, surged immediately. Unfortunately, the U.S. Dollar has strengthened and offset the recent stock price gains from most foreign countries. The ICON overall average International V/P has fallen, but still remains above 1.00 entering 2017. Among developed countries we find more value in Europe than Asia. Among emerging markets it is just the reverse with better value in Asia. We are not seeing extreme enough valuation readings to make major trades or adjustments.

Bonds

The yield on the 10-year U.S. Treasury Note has risen sharply from 1.36% on July 8, 2016 and 1.78% on November 4, 2016 to 2.57% on December 27, 2016. Apparently investors think higher yields and faster economic growth go hand in hand. We see this as a one-time adjustment to a potential new economic setting, not the beginning of a long term interest rate spiral. For a few years we have written that a 10-year yield in the 2.00% to 2.50% range seemed sensible to us. With potential faster economic growth we could see that move to the 2.50% to 3.00% range, which would still be low by historic standards over the last five decades.

While bond prices fall as yields rise, our bond positions held up relatively well as they are at the short-term end of the maturity spectrum. Even with these higher yields, we are not being attracted to long-term bonds.

Summary

If GDP growth increases, we would expect corporate earnings to grow faster, which in our valuation equation increases the intrinsic value of stocks. We subscribe to services with analysts who specialize in forecasting earnings and the growth in earnings. We will be watching them closely to see if earnings and the expected growth in earnings are revised upward as new fiscal and regulatory policies become clearer. If we get a boost in value due to higher growth expectations, we believe stock prices 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. Investments in international securities may entail unique risks, including political, market, regulatory and currency risks. In general, there is less governmental supervision of foreign stock exchanges and securities brokers and issuers. Investing in fixed income securities such as bonds involves interest rate risk. When interest rates rise, the value of fixed income securities generally decreases. High-yield bonds involve a greater risk of default and price volatility than U.S. Government and other higher-quality bonds.

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.

Gross Domestic Product (GDP) is the total value of goods and services produced in the national economy in a given year. It is the primary indicator of economic growth.

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) Composite 1500 Sector Indexes track the performance of sectors that comprise the S&P Composite 1500 Index. 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. 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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