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Equities

The S&P 1500 Index gained in March but is still down for the year, but is still just 3.6% below its all-time high set January 3, 2022 (through April 4, 2022). The index began March by drifting lower but put on a sharp advance in the last two weeks led by cyclical and economically sensitive industries and sectors. From March 14, 2022 through April 4, the S&P 1500 Index gained 9.3% with Consumer Discretionary and Information Technology sector indexes leading the way gaining 19.9% and 14.6% repsectively. We expect the broad market index to get back to its all-time high over the next year and the leadership theme of cyclical and economically sensitive industries and sectors make sense to our system.

We began the year with a market Value/Price (V/P) ratio of 1.13. At the end of March, it is 1.07 even though stock prices, on average, are lower. In the mathematics of value, there is a race going on. Corporate earnings, on average, are experiencing a growth surge in 2021 and 2022. As we bring in new (larger) earnings into our valuation equation and drop off old (smaller) earnings intrinsic value grows. Offsetting that, however, and winning the race so far this year, has been the sharp rise in the yield on the 10-year Treasury note, which serves as the foundation of our discount rate. It has risen from 1.51% on December 31, 2021, and to 2.48% on March 25, 2022. If this trend continues (yield diminishing value faster than earnings increasing value), ultimately, we would find stocks to be expensive and would prefer to own cash. But we do not expect that. Instead, we expect the boost to value from earnings to at least keep pace with, or even exceed, the drop in value due to any increase in the 10-year yield.

The table, at right, shows the earnings per share for the S&P 1500 and year-over-year growth. 2022, 2023 and 2024 are estimates from a survey of analysts who predict earnings. 2020 was the year we shut down the economy to contain the spread of Covid. 2021 was more than just a recovery, it was a big surge to record earnings. Year-over-year growth for 2022 is again above average. Notice for 2023 and 2024, analysts are not calling for a return back to previous levels, but instead, growth from this new higher base level. Analysts can be wrong and they can revise their forecasts, but for now at least, they are forecasting growth in earnings that can support higher stock valuations over the next two years.

S&P 1500 Index Earnings

Year	EPS	Growth
2019	$34.55	---
2020	$27.79	-19.6%
2021	$45.21	62.7%
2022	$52.78	16.7%
2023	$57.82	9.5%
2024	$63.18	9.3%

The data quoted represents past performance, which is no guarantee of future results. *Source: Bloomberg*

The recent spurt of inflation has many investors concerned that the Federal Reserve (Fed) will tighten monetary policy to fight inflation and go too far, sending the economy into recession. We do not share that concern as we believe inflation is temporary and will abate on its own, an opinion in agreement with a survey of economists reported on Bloomberg News. The table below shows past and forecasted rates of change for two different measures of inflation: The Consumer Price Index (CPI) and the U.S. Personal Consumption Price Index (PCE). The economists see the recent jolt of inflation lasting just two years then in 2023 and 2024 returning to the modest, pre-pandemic level. If these forecasts are correct, it makes severe tightening by the Fed unnecessary.*

Survey of Economists, Inflation Forecasts

	2017	2018	2019	2020	2021	2022	2023	2024
CPI	2.1%	1.9%	2.3%	1.4%	7.0%	4.2%	2.4%	2.1%
PCE	1.7%	2.0%	1.5%	1.4%	4.9%	5.1%	2.4%	2.1%

The data quoted represents past performance, which is no guarantee of future results. *Source: Bloomberg*

Bonds

In the January Portfolio Update to start the year, we wrote “We see Treasury notes and bonds as a bit overpriced.” Although sharper than we expected, the price of the 10-year Treasury note has dropped, and the yield has increased almost 100 basis points. For income-oriented investors, it is interesting to note that in this time of rising bond yields, utilities and dividend paying stocks have held up better than long term Treasuries. As for bonds, we are favoring short term maturities.

Summary

We don’t have to predict how many times and to what degree the Fed will raise its Federal Funds rate target. We just have to recognize underpricing and overpricing when they occur. Currently, we do not see the overpricing often seen at market peaks. With today’s values and predictions for corporate earnings to grow, we favor owning equities.

**For more on inflation and investors’ tendency to be overly concerned about it, there is a chapter devoted to inflation in my book, “Unloved Bull Markets” published by Wiley Publishing.*

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.

Individual account holdings and composition may vary. 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.

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 unmanaged Standard & Poor's (S&P) Composite 1500 Sector Indexes track the performance of sectors that comprise the S&P Composite 1500 Index. Total return figures for the unmanaged sector indexes do include the reinvestment of dividends and capital gain distributions but do not reflect the costs of managing a mutual fund. The Standard and Poor's (S&P) 1500 Consumer Discretionary Index is an unmanaged capitalization-weighted index comprising companies in the Consumer Discretionary sector as determined by S&P. 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.

EPS: Earnings from ongoing operations; earnings per share equals total earnings divided by the number of shares outstanding.

Long Term Growth (LTG): An expected rate of growth per year for earnings per share over the next five years, published for thousands of companies by the I/B/E/S service.

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. Personal Consumption Expenditure Deflator (PCE) is a measure of inflation based on changes in personal consumption. It comes out when GDP comes out.

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

Sources: Bloomberg

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