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Domestic Equities

There is an old joke by economist Paul Samuelson about the predictive power of the stock market. To paraphrase, "The stock market has predicted nine of the last five recessions." The quip is referring to the tendency for investors to see some situation or event, deduce that it might cause a recession, and then sell stocks – only to be wrong. From joke to reality, it seems to us this has happened a few times during the current nine-plus year bull market. The most significant times were the European Debt Crises of 2010 and 2011, but there have been other less severe sell-offs based on incorrect recession expectations. We believe the sharp dips in early February and again in October and November of 2018 will qualify as examples of what Samuelson was poking fun at.

In the September market commentary we showed that the four top-performing sector indexes over the nine-plus year bull market were Consumer Discretionary, Information Technology, Financials and Industrials, which reflects a theme of economic recovery from the recession and financial crisis of 2008. During occasional sell-offs driven by recession concerns, however, cyclical, economically-sensitive sectors generally sold off the most as so-called recession-proof, defensive sectors held up the best. These short-term theme reversals were not driven by value, in our opinion, as we would see stocks that appeared cheap to ICON sell off and get cheaper during these periods. We believe the stock market dips in 2018 resemble previous times during this nine-plus year bull market when recession concerns drove the market lower. This year, we believe investors have focused on tariffs and the potential for the Federal Reserve to tighten too much and too quickly. With those concerns about a slowing economy, cyclical, economically-sensitive industries and sectors have sold off despite generally not being over-priced according to ICON's valuation methods. We have ridden through the turbulence expecting the market to move higher into 2019 with the long-term sector leadership resuming. In support of that view, we find it encouraging that the S&P 1500 Index has moved up 4.7% off its low in late November through November 30, 2018. Also, Consumer Discretionary and Information Technology are the two best-performing sectors over this period with Industrials and Financials in the top six, similar to the longer-term sector leadership.

International Equities

China and most emerging markets have been in steady decline since late January. Real GDP in China grew 6.8% in 2015, 2016 and 2017. The rate of growth has slowed slightly to 6.5% for the twelve months ending September 30, 2018, which, combined with increased tariffs, has scared many investors out of Chinese equities. Other emerging markets have dropped as investors believe a strong U.S. Dollar will hurt their exports. Stock declines look like an overreaction to us as emerging markets outside of China dominate the top of our country value/price (V/P) rankings. The average V/P for the almost 400 Chinese stocks in the ICON database is 1.00, suggesting prices on average are at about our estimation of fair value and not among the more attractive emerging market countries.

Bonds

The yield on the 10-year Treasury note finished November at 2.989%, a level that seems sensible to us and in line with inflation expectations. A survey of economists shows an average forecast for the CPI in 2019 of 2.3%, followed by 2.2% in 2020.

The corporate bond market has been hit by the same recession fears that have hit stocks. Credit spreads, which are the risk premiums reflecting default possibilities, have increased. Just like in stocks, we believe this has created some attractive opportunities in situations where investors have overreacted.

Summary

It seems to us many analysts and investors have been incorrectly predicting the end to the bull market for many years. Although there is no quantitative way to define it, whenever a recession and a bear market do occur, we believe they will likely be the most anticipated, expected and predicted recession and bear market in the history of the stock market. Over the years we have used the statement, "rallies don't issue invitations." In our experience, neither do recessions and bear markets. Based on our calculation of value, we expect the broad market to 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. Emerging market countries may experience greater social, economic, regulatory, and potential volatility and uncertainty than more developed countries. 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.

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. 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.

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 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.

Source: Bloomberg, FactSet

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