ICON Insights

Market Commentary - February 2019

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By Craig Callahan, DBA | ICON Founder & President

Domestic Equities

We believe three concerns among investors propelled the stock market lower during the fourth quarter of 2018; the beliefs that (1) China's economic growth would slow perhaps to the point of recession, (2) China's sluggishness would spread to the U.S., and (3) the Federal Reserve (FED) would tighten monetary policy too much and send the U.S. economy into recession. We stated that these concerns led to fear that we thought was irrational. Off the market low of December 24, those fears have seemed to subside, and the stock market has rebounded, a move that seems very sensible to the ICON system.

We labeled the drop of last Fall a "volatility event" and stated it was similar to drops in 1990, 1998, 2010, and 2011 in depth and duration. So far, the stock market's rebound is also similar to the previous four. If the market follows a path similar to the previous four volatility events, it could be back to its all-time high by late March or early April. The S&P 1500 would need an 8% advance from its January 31 close to get to its previous high, a move we believe is possible given our market value/price (V/P) ratio of 1.05.

S&P 1500 Sector Index Performance

S&P 1500 Sector Index	9/20/18 - 12/24/18	12/24/18 - 1/31/19
Industrials	-22.9%	18.9%
Consumer Discretionary	-22.6%	18.9%
Energy	-28.9%	18.8%
Communication Services	-16.5%	17.1%
Financials	-22.4%	16.3%
Real Estate	-10.5%	15.9%
Information Technology	-22.9%	15.5%
Materials	-22.3%	14.1%
Health Care	-14.8%	12.7%
Consumer Staples	-11.0%	9.8%
Utilities	-2.0%	6.5%

Past Performance is no guarantee of future results.

As seen in the table, sectors have made a complete reversal during the rebound from what occurred during the drop. The three sector indexes that dropped the least during the decline from 9/20/18 through 12/24/18, Health Care, Consumer Staples and Utilities, have rebounded the least. Those among the worst during the drop, like Energy, Industrials, and Consumer Discretionary, are among the leaders off the late December low. Such a reversal in such a short time (5 weeks) is, in our opinion, support for the view that concerns last Fall were irrational and that fear is subsiding. Also, based on ICON valuation metrics, this sector performance seems sensible and sustainable.

International Equities

In general, international equities have moved higher with the U.S. market off of late December lows, though not quite as much. While we thought the worries for the U.S. economy were irrational last Fall, we believe there are some legitimate concerns around the world that may be a drag on international equities; for example, China's slowing growth, Brexit, and the recession in Italy. The average international V/P in ICON's universe is 1.02, but there is a large spread among countries, with Hungary and Russia at 1.57 and 1.42, respectively, and, at the other end, Indonesia and Australia at 0.84. Such divergence makes us selective on our country exposure..

Bonds

Some investors who sold stocks in the fourth quarter bought Treasury notes and bonds, driving the yield on the 10-Year Treasury down. During the rebound in equities over the last five weeks, we have not seen a proportional move higher in yields. In other words, it does not appear the rally in stocks is being driven by a move out of Treasuries. We suspect bond yields are being driven more by the outlook for inflation. A survey of economists by Bloomberg shows them calling for CPI increases of 2.0% in 2019 and 2.2% in 2020. The current yield on the 10-year Treasury of 2.685% seems sensible to us and in-line with inflation expectations.

Summary

Regarding the three concerns that we think drove investor behavior last Fall, we believe China has adequate control over its economy to avoid a recession. We also do not believe economic conditions spread from country to country. Finally, we trust the FED will be data-driven and realize, in our opinion, there is no need, due to inflation, to tighten monetary policy further. Given those views, we believe there is more room for fear to subside and for stock prices to move higher. Our value readings currently support this outlook.

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) 1500 Sector Indexes track the performance of sectors that comprise the S&P 1500 Index. Total return for the unmanaged index includes 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 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 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

Source: FactSet, Bloomberg.

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5299 DTC Boulevard, Suite 1200
Greenwood Village, CO 80111
1-800-828-4881 • InvestwithICON.com