By Craig Callahan, DBA | ICON Founder & CEO **Published 2'1'2023**

Equities

To begin 2023, the S&P 1500 Index advanced 6.53% through the end of January, which just about regained its decline in December that ended 2022. The index finished January 14.80% above its recent low of October 12, 2022. During that 16-week advance, there was a theme, or personality, change on New Year's Day. From October 12, 2022, through December 31, 2022, the worst performing sector indexes were Consumer Discretionary, Communication Services, Information Technology and Real Estate. During that period, Consumer Discretionary was down 6.48% compared to the S&P 1500 index gaining 12.75%. Then in January, those four sectors were among the top five performers with Consumer Discretionary leading with a gain of 15.06%. We are not inclined to chase this new theme as we do not believe this is the beginning of a new bull market.

Expensive industries are leading which, to our system, makes the move unsustainable. Another reason for doubting this advance is an old Wall Street adage. "Don't fight the Fed." We expect the Federal Reserve will raise the target rate for Federal Funds a quarter of a percentage point in February, March and May, and then hold it there the remainder of 2023. It would be very unusual for a new bull market to begin while the Fed is still tightening monetary policy.

For investors buying into stocks in January, their bullish case rests on the assumption that the Fed will reverse, or pivot, and lower the Federal Funds rate in mid-2023. We believe they are not only anticipating the easing, but also assuming the economy will be in its current condition when the easing occurs. We find that unlikely. In our opinion, the Fed only eases when the economy is in trouble. The next time the Fed eases it will be because the economy will need a jolt to get back to one of the Fed's mandates of full employment.

The US Dollar weakened the last three months of 2022. In January we purchased some international stocks in our favored industries and sectors. We bought American Depository Receipts (ADRs) which trade on exchanges in the United States.

Bonds

Midway through 2022 we stated that at some point short-term and long-term interest rates would decouple, meaning short term rates would continue to rise but long-term rates would not follow them. We believe the decoupling has happened. Since its peak on October 24, 2022, the yield on the 10-year Treasury note has dropped from 4.24% to 3.51%. Over that same period the yield on 13-week T-Bills has increased from 4.03% to 4.71%.

Our reasoning for calling for the decoupling was based on our belief that inflation expectations is the most important factor determining long-term interest rates. It appears that in October investors realized the Fed was determined to bring down inflation, and also had the ability to actually bring down inflation. Perhaps bond investors have noticed that the Consumer Price Index (CPI) has increased at an annual pace of only 2.4% the final six months of 2022. We expect bond yields to drop over the next couple of years.

Summary

With stocks, on average, priced near our estimate of fair value, we do not see the need for a sharp drop in the market. We are content holding more cash than normal because we just don't see enough of the conditions and behaviors that we would expect to see at the beginning of a new bull market.

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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.

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 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. Total returns for the unmanaged index include the reinvestment of dividends and capital gain distributions beginning on January 1, 2002. Index returns with reinvested dividends and distributions are unavailable prior to that date. The Standard and Poor's (S&P) 1500 Communications Services Index is an unmanaged capitalization-weighted index comprising companies in the Telecommunications Services 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. The Standard and Poor's (S&P) 1500 Real Estate Index is an unmanaged capitalization-weighted index comprising companies in the Real Estate sector as determined by S&P.

Federal Funds: In the United States, the federal funds rate is the interest rate at which private depository institutions (mostly banks) lend (federal funds) at the Federal Reserve to other depository institutions, usually overnight. Changing the target rate is one form of open market operations that the Chairman of the Federal Reserve uses to regulate the supply of money in the U.S. economy.

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.

A 13-Week Treasury bill (T-Bill) is a short-term debt obligation backed by the Treasury Dept. of the U.S. government with a maturity of less than one year.

Sources: Bloomberg

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