ICON Insights

Market Commentary - January 2023

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2022 Review

The market began 2022 by hitting a peak January 3, 2022, and then heading downward. It was a very unusual peak in that it preceded the Federal Reserve (Fed) raising its Federal Funds target rate by two and a half months. Normally the stock market peaks a few months after the Fed begins hiking rates. With the broad market peaking before the rise in interest rates, we didn't see the usual over pricing that often accompanies peaks.

In late May, the market reversed and moved higher. With interest rates rising we detected over pricing in some industries and sold stocks, resulting in much higher levels of cash than normal. We sold some more stocks in mid-August, further increasing our cash levels. That cash remains as we enter 2023.

2023 Outlook

We expect the broad market to begin a new bull market sometime in 2023, just not right away. We see some of the behaviors and conditions that often occur at market bottoms, just not enough of them for us to believe a new bull market is underway as we begin 2023. Our valuation model sees stocks to be priced, on average, right near fair value. Therefore, we do not see the need for a market plunge, but we usually see much better bargains, or discounts to fair value, at major market bottoms. It would not take much to get there. A modest drop in stock prices combined with a decrease in long-term interest rates could quickly get us to the 15% to 20% discount typical of major market bottoms.

As for sectors, one of the headline problem areas for 2022 was large technology companies. One question being debated as we begin 2023 is whether those technology stocks are ready for a rebound. We do not think so. Only three industries in the Information Technology sector have V/P greater than 1.00, but they do not have any strength relative to the rest of the market. Conversely, the few industries that do have any strength have V/Ps below 1.00. Within the Information Technology sector, there is not one industry that has the combination of value and strength to make it eligible for purchase within our system. Based on that, we do not expect technology to be a leading sector in early 2023. In opposition to that we find eligible combinations of value and strength in Financials and Industrials.

Bonds

In 2022, we wrote that at some point, when investors realize the Fed is determined to and capable of bringing down inflation, short-term and long-term interest rates would become decoupled. Long-term rates would drop while the Fed was continuing to increase short-term rates. That may be happening. Since October 24, the yield on the 10-year Treasury note has dropped from 4.24% to 3.88%, while the yield on the 13-week T-Bill has risen from 4.03% to 4.54%. Perhaps investors are agreeing with economists surveyed by Bloomberg who are calling for the Consumer Price Index to increase only 3.0% in 2023 and hit a year-over-year pace of only 2.6% by mid-2024. From June through November the CPI is increasing at an annual pace of 2.4%.

We like corporate bonds and do not fear the higher rates that were seen in 2022. Moody's Triple-A bond yield finished 2022 at 4.69%, a rate we believe will appear very generous a year or two from now.

Summary

For analysts who watch the Fed and try to anticipate its behavior there are three things that should be separated; (1) what the analyst thinks the Fed SHOULD do, (2) what the analyst thinks the Fed WILL do and (3) what the Fed ACTUALLY will do. Unfortunately, many analyst combine 1 and 2. They think the Fed will do what they think it should do. Currently, many analysts think the Fed should "pivot" and reduce interest rates in early to mid-2023, so that is what they think it will do. But the Fed has a mind of its own. The case for a new bull market being underway is based on the assumption the Fed will pivot soon. That position seems like a risky one to us. We are content holding more cash than normal until we see more of the behaviors and conditions that often appear at market bottoms.

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 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 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.

Moody's AAA Bond Yield is computed and published by Moody's Investment Service, the yield to maturity on a basket of AAA-rated corporate bonds. Represents opportunity cost in ICON's valuation model.

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.

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 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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