ICON Insights

Market Commentary - June 2021

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Equities

Since mid-April the broad market has gone sideways, but it hasn't been dull as there have been some short-term theme changes. Investors have reacted to economic data regarding the economic recovery, vaccination rates, changes in interest rates, and the price of oil. ICON has not chased the theme changes, but instead has remained fairly steady in our sector and industry tilts.

Stocks that investors thought benefited from the "work from home, and stay at home" setting got dropped like a hot rock. In the short-term that sell off drove down the Information Technology sector the most but also hit some Consumer Discretionary and Communication Services stocks. Economically sensitive and cyclical sectors like Energy, Industrials, Materials and Financials have been among the best performers since mid-April as investors continue to look ahead to the economic recovery and potential expansion. The most volatile on a daily basis are the industries most hurt by the pandemic such as airlines, hotels, cruise lines, and restaurants as speculators frequently change their views on what recovery will look like for those industries. We have not been drawn into that speculation.

As stated, we have stayed relatively steady during the recent sideways move, still favoring the economically sensitive, cyclical sectors. We include Information Technology in that group but not the "work from home" theme. In that sector, we like stocks with excellent long term growth prospects but are priced below our estimate of intrinsic value. While the economic recovery is appearing more and more obvious to us, it appears investors are still cautious and unwilling to totally embrace economic expansion. Therefore, the cyclical, economically sensitive stocks can still be bought at prices below our estimate of fair value.

With a market Value/ Price (V/P) ratio of 1.08, we see the potential for the market to move higher over the next year as prices try to catch up with value. We also see the potential for fair value to grow based on earnings forecasts from a survey of analysts, so value could be an upwardly moving target.

Bonds

After rising the first three months of the year, the yield on the 10-year Treasury note has moved sideways to slightly lower the last two months. It ended May at 1.596%. Economists, in a survey reported on Bloomberg News, are calling for CPI inflation of 3.0%, 2.3% and 2.2% in 2021, 2022 and 2023, respectively. Over the long run, we would expect that holders of 10-year notes should at least require a yield that keeps up with inflation. In the short run, however, it appears they are willing to receive negative real returns in exchange for the perceived safety.

Based on the April CPI, inflation over the last year was 4.2%, causing many observers to wonder if the economy is heading toward higher inflation. Federal Reserve officials have stated they believe the uptick to be "transitory." The economists in the survey mentioned above apparently agree as they are predicting declines for 2022 and 2023. We agree also, and are not positioning our fixed income portfolio for long term higher inflation.

Summary

In addition to our market V/P of 1.08, we do not see any extreme behaviors or conditions often seen at market peaks. Volatility, investor sentiment and sector correlations are examples that are all in the moderate, historical average range. We believe the broad market can extend it upward path over the next year.

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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.

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 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.

Sources: Bloomberg

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