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ICON Insights

Market Commentary - June 2022

By Craig Callahan, DBA | ICON Founder & President **Published 6'1'2022**

Equities

The S&P 1500 Index drifted lower the first two thirds of May then regained its losses to finish slightly higher for the month. Six of the eleven sector indexes gained in May, led by Energy. Five sectors were negative with Real Estate doing the worst. Companies in the S&P 1500 Index reporting first quarter earnings, beat analysts' forecasts by 5.45%, on average, and were 11.6% higher than a year earlier.

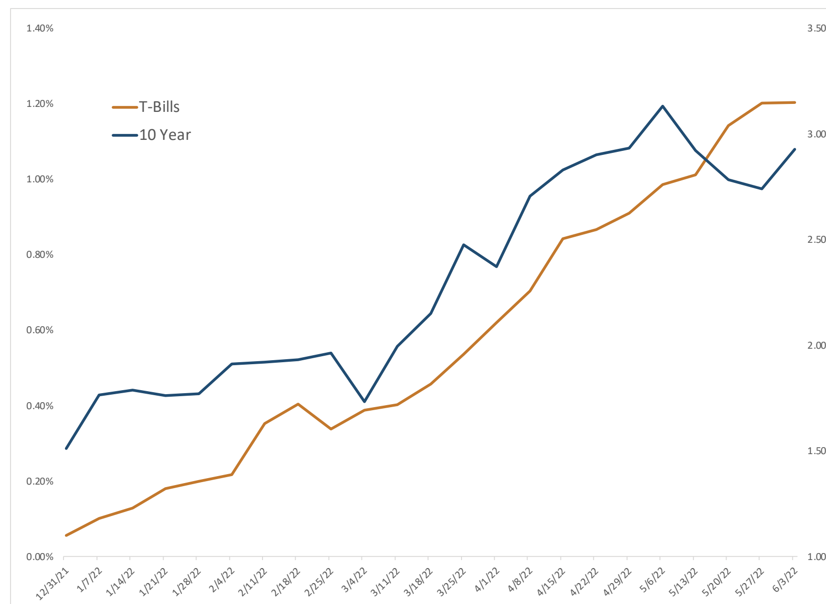
Investors, however, seem to be focused on macroeconomic issues rather than corporate earnings, in particular inflation and the Federal Reserve (Fed). The big fear is that the Fed will tighten monetary policy excessively, either by necessity or by accident, and send the economy into recession. While on some days, that is the predominate view among market participants, a survey of economists reported on Bloomberg shows them calling for continued GDP growth into 2023 and 2024 – slowing but growth nevertheless. That same survey also shows that economists believe inflation will abate to 3.0% in 2023 and 2.4% in 2024. These economists can be wrong and they can change their minds, but for the time being, they are forecasting a growth and inflation setting that gives the Fed the benefit of the doubt and one that would be favorable for equities.

For 2022, only two sectors are positive; Energy and Utilities. The Information Technology sector index is third worst and down 19.3% through May 31, but a narrow subset of that sector has been the worst part the entire stock market. Those are referred to as "innovative disruptors," companies that develop or use technology to deliver services in a radically different way than previously delivered. These stocks experienced tremendous advances in 2020 and 2021 based on anticipation that they would someday become profitable and grow rapidly. This year, however, some of those stocks are down 50%, 60% or more. Lacking profits, those stocks did not look good in the ICON valuation methodology and have not been in our portfolios.

Bonds

The graph shows the weekly yields on the 10-Year Treasury note (scaled on the right axis) and 13-Week Treasury Bills (scaled on the left axis) for 2022. T-Bills have risen steadily from near zero to 1.20% as the Fed has raised its Federal Funds target. Through April, the yield of the 10-year Treasury moved higher in step from 1.50% to 3.13%, but in May the two yields became decoupled. T-Bills continued their climb while the 10-year begins June at the same level as mid-April. It is too early to tell if this decoupling will continue but in time it does make sense to us. The Fed has stated that two more 50 basis point hikes in the Federal Funds rate are likely, but we do not expect the yield on the 10-year to rise step for step. Instead, a 10-year yield in the 2.80% to 3.25% range makes sense to us.

Weekly Yields: 10-Year Treasury & 13 Week T-Bills, 12/31/21 - 6/3/2022



The data quoted represents past performance, which is no guarantee of future results.
Source: Bloomberg

Summary

There is always disagreement among stock market investors and analysts. For example, in my book "Unloved Bull Markets," it is pointed out how incorrectly bearish people were during the two recent bull markets. Lately there seems to be the most disagreement I can remember. If a financial TV show has ten guests on in an hour, there will be ten widely different views of the economy and stock market. One guest says inflation will persist and get worse. The next guest says inflation will abate on its own. Then a guest will predict the Fed will send the economy into recession, followed by a guest who says, "no recession but a soft landing." Just to top it off, a guest will then predict stagflation - a high inflation, recession combination.

In this setting of wide disagreement and rapidly changing views, the market could drift lower in the short run. Despite it all, with stocks not over-priced, on average, and earnings predicted to grow, we would expect the broad market to be higher a year from now.

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 Standard and Poor's (S&P) 1500 Energy Index is an unmanaged capitalization-weighted index comprising companies in the Energy 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 Utilities Index is an unmanaged capitalization-weighted index comprising companies in the Utilities sector as determined by S&P.

Long Term Growth (LTG): An expected rate of growth per year for earnings per share over the next five years, published for thousands of companies by the I/B/E/S service.

GDP: 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 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

T-Bill: A 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. T-bills can have maturities of just a few days or up to a maximum of 52 weeks, but common maturities are 4, 8, 13, 26, and 52 weeks. The longer the maturity date, the higher the interest rate that the T-Bill will pay to the investor.

Sources: Bloomberg

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