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ICON Insights

Market Commentary - March 2019

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Domestic Equities

In our January Market Commentary we labeled the market sell off in the fourth quarter of 2018 a "volatility event" and said it was similar to ones in 1990, 1998, 2010 and 2011. We wrote that if the market continued to behave as it did in those previous events, it would rebound, a move higher that would be supported by our valuation readings. So far, that assessment is proving correct as the S&P 1500 Index has gained 20.07% off its low of December 24, 2018 through March 1, 2019. Its recovery is steeper than in 1990 but not as steep as 1998.

We believe three concerns, which in our view turned into fear, drove the market's decline last fall; (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 believe all three of those fears are subsiding, which is allowing stock prices to recover and move up toward our estimate of fair value. Sector index performance for the decline from 9/20/18 through 12/24/18 and the recovery from 12/24/18 through 3/1/19 shows a theme reversal. Ranked by performance during the recovery, the table shows that the top five sectors in recovery were five of the worst six during the drop. The four sectors that were the most sluggish recently held up best during the decline. The theme reversal and the recent leadership makes sense to us from a valuation perspective and therefore appears sustainable.

S&P 1500 Sector Index Performance

S&P 1500 Sector Index	9/20/18 - 12/24/18	12/24/18 - 3/1/19
Industrials	-24.1%	26.6%
Information Technology	-22.9%	24.4%
Energy	-28.9%	23.9%
Consumer Discretionary	-22.6%	21.1%
Financials	-22.4%	20.3%
Communication Services	-16.5%	19.1%
Materials	-22.9%	18.1%
Real Estate	-10.5%	16.4%
Health Care	-14.8%	15.8%
Consumer Staples	-11.0%	12.1%
Utilities	-2.0%	10.9%

Past Performance is no guarantee of future results.

Stock prices have approached, but not exceeded our estimate of fair value, on average, as our market value/price (V/P) ratio began March at 1.04. In addition, within our valuation system, fair value has the potential to grow due to growth in earnings and a tightening of corporate bond credit spreads, both of which seem possible, even likely, to us.

International Equities

Similar to previous volatility events, international markets, in general, declined with the domestic market last fall. International stocks are rebounding, but at a slower pace than their U.S. counterparts. Emerging markets are participating in the rebound but so far are about in line with, not exceeding, developed countries. Despite this, we see the potential for emerging market leadership, as 10 of the 12 highest country V/P ratios within our system are emerging market countries. It appears to us that investors are looking for a little more relief from a slowing of economic growth in China before buying into emerging market stocks. We do see evidence of stimulus in China. For example, the rate of growth in China's money supply inched higher last month for the first time in a few years.

Bonds

With the fears of recession mentioned above appearing to subside and stock prices advancing, we would have expected the yield on the 10-year Treasury note to rise more than it has. We would also have expected credit spreads to tighten more than they have. The 10-year yield at 2.755% seems to reflect investors' docile outlook for inflation and a willingness to accept a low "real" yield by historic standards. Economists surveyed by Bloomberg are calling for Consumer Price Index (CPI) gains of just 1.9%, 2.2% and 2.2% in 2019, 2020, and 2021, respectively. As for credit spreads, which reflect investors' risk perceptions, we see the potential for further decreases, which would lower corporate bond yields..

Summary

We have stated for a few years that we believe that the economy is in a setting in which low unemployment and low inflation can co-exist. Recent statements from the Federal Reserve suggest its leaders may be coming around to our view. We believe that if they think inflation is not a problem and, therefore, do not tighten monetary policy any more, this economic expansion can continue at least another couple of years. In that case, our value readings suggest the stock market can move higher.

***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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