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Equities

The broad market completely reversed from its rebound during the last two weeks of March and headed sharply lower in April. While there are plenty of concerns for investors (such as the war in Ukraine), we believe the primary fear driving stock prices lower in 2022 is investors’ belief that the Federal Reserve (Fed) will need to tighten excessively in its efforts to control inflation. Those with that view believe excessive tightening will lead to a recession. A survey of economists for two different measures of inflation, show that the economists, collectively, believe we have just experienced the peak in inflation. They expect it to continue to be above normal over the next year, but trending downward. It may just be that at a peak is when investors would think the Fed would need extreme tightening to contain inflation. If the economists in the survey prove to be correct and inflation does abate, the necessity for the Fed to continue tightening greatly diminishes. We agree with the survey and do not see the need for extreme Fed tightening. We expect inflation to subside because of the Fed’s early moves as well as on its own as supply and demand align.

There are complaints that the Fed has waited too long and those making that case use the phrase the Fed is “behind the curve.” We disagree. Many observing the Fed believe that it is the raising or lowering of the Federal Funds rate that slows down or speeds up the economy, respectively. Instead, we believe the influence to the economy is the rate of growth of the money supply, M1, which the Fed influences by draining or adding reserves to the banking system. The table shows the rate of growth in M1 month-over-month for the first quarter of 2022. This is shown against the annual rate of change if that same monthly rate was maintained for 12 months. The rate of growth of M1 has been slowing gradually for a year but the slowing accelerated in 2020. If this pattern continues and the growth rate of M1 approaches zero, we would expect the economy and inflation to cool down. Regardless, the Fed doesn’t appear to be “behind the curve” to us.

Money Supply (M1), 1Q'2022

Month	Monthly Change	Annualized
January	0.8%	9.7%
February	0.4%	5.1%
March	0.2%	2.5%

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

If you have followed the ICON valuation readings over the years, you have noticed that a rising 10-year Treasury note yield normally reduces value. It has this year, rising from 1.51% to 3.00% on May 2. Yet our market value/price (V/P) ratio has only dropped from 1.10 to 1.06. The increase in the Treasury yield has been partially offset by growing earnings.

For 2021, the earnings for the companies in the S&P 1500 index grew 62.7% over 2021. A survey of analysts who forecast earnings is calling for year-over-year growth to continue at an above average rate in 2022 at 18.0%. As we have brought these growing earnings into our valuation equation, they have somewhat offset the increase in the yield on the 10-year Treasury. We enter May with a market V/P of 1.06, suggesting stocks, on average, are not overpriced.

Bonds

We believe the Fed can influence short-term interest rates but that long-term rates are more a function of inflation expectations. If the Fed proceeds on the path of hiking the Federal Funds rate that many investors are expecting, and inflation comes down as the economists are predicting, we would expect short-term and long-term rates to become detached. In other words, we would expect the upward pressure on long-term rates to ease. We may not be to that point yet, and long-term rates may continue to inch higher, but we do not expect a sharp spike upward.

Summary

In the late 1990s, 2004 to 2007 and 2015 to 2018, the Fed raised its Federal Funds target and the stock market continued higher. Eventually stock prices turned lower but not initially. Most recently, for example the Fed began raising rates in late 2015 and the broad market moved higher until September 2018. It is very unusual that this time stock prices declined in early 2022 even before the Fed started raising rates. It might be an overreaction.

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 (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. 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.

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.

Money Supplyt (M1): M1 is one measure of the money supply that includes all coins, currency held by the public, traveler's checks, checking account balances, NOW accounts, automatic transfer service accounts, and balances in credit unions.

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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