ICON

ICON Insights

Market Commentary - May 2023

By Craig Callahan, DBA | ICON Founder & CEO

Published 5'1'2023

Equities

The Federal Reserve's (Fed) monetary policy is the biggest question currently hanging over Wall Street. Investors and money managers are taking positions based on their guesses of what the Fed will do. We believe the assumption that the Fed will ease and lower its Federal Funds target rate in 2023 will be proven wrong.

Let's start with a few lines out of my book, Unloved Bull Markets*. "The Federal Reserve was created in 1913. With regard to monetary policy, it has two, sometimes conflicting, mandates of full employment and price stability. In other words, we want people working but we don't want inflation." There have been times when the Fed has focused on one of its mandates at the expense of the other. At those times, it must have thought that the one mandate was of such great importance that it just didn't care about the other mandate for a year or two. Here are two examples. In 1981, to end the inflation spiral of the late 1970's and early 1980's, it took the Federal Funds rate to over 20%, which reduced inflation but took unemployment to over 10%.

Just the opposite was the Fed's behavior in 2020. Society had shut down the economy to try to slow the spread of COVID as we didn't know if there would be a treatment or vaccine for the virus. Staring down a deep potentially bottomless economic hole and not knowing if Congress could agree on an economic stimulus package, the Fed eased monetary policy like never seen before. They were risking inflation but must have thought the potential unemployment problem was so serious and severe that it was worth the risk.

We believe the Fed is now in the mode where it is so intent on fighting inflation that it just doesn't care about unemployment. It has stated that low inflation is the key to economic growth and that it believes it is possible to get inflation down to its 2% annual target. Investors and managers guessing the Fed will reduce the Federal Funds target in 2023 are assuming the Fed has some sensitivity to increasing unemployment. We disagree and expect the Fed to hold the Federal Funds rate even for the remainder of 2023. Unemployment will increase, but the Fed just won't care until inflation gets down to its goal.

The ICON market Value/Price (V/P) ratio ended April at 1.06. We don't see the need for a steep drop in equity prices, but we don't see the behaviors or conditions that would take stock prices to new highs. As a result, we are content holding more cash than usual.

Bonds

Inflation is coming down from its peak registered in June 2022. A survey of economists reported on Bloomberg shows that they expect inflation to continue to drop. It appears bond investors agree as the yield on the 10-Year Treasury note has been in the 3.4% to 4.2% range since August of 2022. It ended April at 3.43%. That ranges seems sensible to us. In fact, we would be surprised to see it hit 4.00% again in 2023.

Summary

ICON's definition of neutral monetary policy is when the yield on Treasury Bills (risk free rate) equals the inflation rate. We ended April at about neutral with T-Bills and trailing 12-month CPI at about 5%. We expect policy to soon reach our definition of "tight" as inflation drops but T-Bills stay near 5%. In that setting and with stocks priced barely below our estimate of fair value, we like holding more cash than normal.

** "Unloved Bull Markets: Getting Rich the Easy Way by Riding Bull Markets," Wiley Publishing, February 2022.*

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.

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.

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.

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

Please visit ICON online at ICONAdvisers.com or call 1-800-828-4881 for the most recent copy of ICON's Form ADV, Part 2.

ICON

© 2023 ICON Advisers℠

8480 E Orchard Road, Suite 1200
Greenwood Village, CO 80111
1-800-828-4881 • ICONAdvisers.com

Portfolio_Update (5/2023)