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ICON Insights

Market Commentary - September 2020

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Equities

The stock market rally off the low March 23, 2020, continued in August. The S&P 1500 Index gained 6.91% for the month making it up 12.84% for the quarter and up 57.69% off its March low. During this advance there have clearly been two camps of opinion. One camp includes the skeptics and doubters who we presume have not fully participated. Some have claimed stocks are expensive based on price/earnings (P/E) ratios. Others are waiting for a more impressive economic recovery. Some are waiting for a vaccine. Many have tried to discredit the rally by saying it is too narrow, with only a handful of Technology headliner stocks leading the way.

At ICON, we have clearly been in the opposite camp. On television and radio, in the monthly Portfolio Updates and in supportive research papers, we have stated that last March many of the conditions typical of buying opportunities were in place and that this rally makes sense to our system. To make our case, we have openly disagreed with those in the skeptical camp. We have argued P/E ratios are deficient and that stocks have been cheap, not expensive. We have pointed out the historical relationship of the market leading the economy by six to nine months, so waiting for an economic recovery usually results in missing a rally. Regarding the narrow criticism, various measures such as advancing and declining issue, have shown breadth often seen in previous market advances. In addition, we do not measure the leading Technology stocks, in general, as over-priced.

S&P 1500 Sector Index Returns 6/30/2020 - 8/31/2020

Sector Idex	Returns
Consumer Discretionary	18.9%
Information Technology	17.8%
Communication Services	16.3%
Industrials	13.2%
S&P 1500 Index	12.8%
Consumer Staples	12.0%
Materials	11.6%
Health Care	8.2%
Financials	7.6%
Utilities	4.6%
Real Estate	3.7%
Energy	-5.4%

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

In terms of theme and leadership, the table shows S&P 1500 sector index returns for the quarter, June 30, 2020, through August 31, 2020. At the top are economically sensitive, cyclical sectors. Communication Services was originally Telecommunication Services but S&P moved a few industries from Consumer Discretionary and Information Technology into it and changed its name. Those are the industries contributing to its leadership returns. Energy was among the leaders early off the March low, but has fizzled lately. Otherwise, this economically sensitive theme has been dominant the entire five months. We do not see over-pricing among the leadership. Therefore, the theme and market advance appear sustainable to us.

Bonds

The 23 trading day stock market crash last February and March, was not limited to equities. Even high grade corporate bonds suffered as investors worried about potential defaults. Just like stocks, corporate bonds have rebounded. As for the 10-year Treasury note, we have always felt that the inflation outlook is the primary determinant of its yield. Currently a survey of economists reported on Bloomberg shows them forecasting Consumer Price Index increases of 1.0% in 2020, 1.7% in 2021 and 2.0% in 2022, yet the yield on the 10 year note is only .704%. A yield less than inflation is referred to as a negative real return, meaning investors are not even getting compensated for expected inflation. In this setting, we favor corporate bonds, for the potential recovery, over Treasury bonds with negative real returns.

Summary

We can put stocks into three categories. There are those whose earnings were not affected by the recession. They were, and still are, on an impressive steady growth projection. We will add to that group, companies whose earnings benefitted from the pandemic. There are still some bargains in that combined group, but in general they are fully, but not over, priced. The second group includes companies whose earnings were hurt by the recession but are projected to have impressive recoveries and resume a growth path. This is the group where we find the best bargains. The third group includes companies that were damaged by the recession but show dim prospects from recovery and muted growth. We are not finding them to be attractive. Even though the market has recovered and many indexes are at all-time highs, we can still find stocks and industries with prices that do not adequately reflect their future growth.

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.

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. Total return figures for the unmanaged sector indexes do include the reinvestment of dividends and capital gain distributions but do not reflect deductions for commissions, management fees, and expenses.

Price/Earnings (P/E) Ratio is the price of a stock divided by its earnings per share. 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, FactSet

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