ICON OUTLOOK
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Asset Allocation in a Market Recovery — Good Ol' Stocks

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The last three years has, at best, been a rocky economic ride. Would most people guess that an asset class has returned in excess of 100% during this tumultuous three-year ride? While asset classes can take many forms, you may be surprised to learn that equities have performed solidly over the last three years, outperforming gold, treasuries, commodities, and other popular portfolio solutions. Based on S&P 1500 weekly data, the stock market hit a low on Friday, March 6, 2009. Since then, domestic stocks have been the best performing asset class among the seven asset classes represented in the graph below. The S&P 1500 Index has gained 103% from that low through Friday, June 29, 2012, the end of the second quarter.

International stocks lagged the U.S. due primarily to European debt concerns, but still beat the other asset categories shown. Gold, the subject of so much enticing promotion and television advertising, is next, gaining 70% (according to the Gold Spot price) and beating the TR/J CRB Commodity Excess Return Index, which gained 35.59%. Bonds have had a better-than-average three years, but nevertheless, lagged equities.

With its responsiveness to declining interest rates, the 30-year Treasury produced a 30.1% return, a bit better than a blend of Government and corporate bonds at 25.7%. The 10-year Treasury, which has become a popular landing area for investors seeking safety, earned 23.0%. Barely visible is the 0.4% total return for our proxy for CDs and money markets.

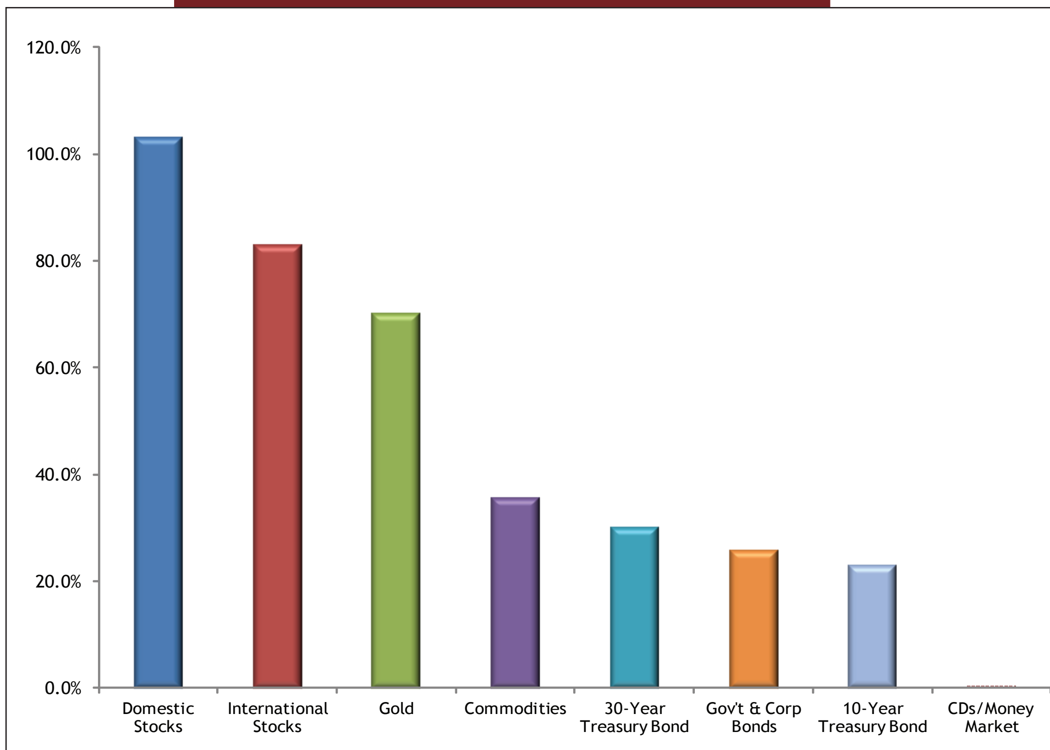
This has been a difficult setting for active equity managers. The average market advance has lasted 43 weeks, while the average decline has lasted 14 weeks. Also, we have seen industry and sector theme reversals during the alternating advances and declines. Cyclical, economically sensitive sectors, such as Consumer Discretionary and Industrials, have led during the advances but suffer the most during subsequent quick declines. Over the course of the last years, recession-proof sectors like Consumer Staples have generally held up best during market downturns. However, we believe market timing these short-term moves is virtually impossible given the random and wholly unpredictable nature of news events. The high correlation among sectors recently has also made it difficult for active managers to differentiate their sector tilts and "best ideas."

In spite of the impressive three-year performance of the stock market, we continue to see investor behavior that ignores the market advance. First, industry statistics reveal that many investors have redeemed their equity mutual funds and not participated. Second, some investors have not liked the volatility, but they may be ignoring the overall gains in equities during the volatile ride. Third, seeking ostensibly less volatile "alternatives" with low correlation has become popular, but we sometimes wonder why anyone would want an alternative to 103% in three-plus years?

It appears that simply holding equities was the best alternative to many "alternatives" over the last three years. There is an old Wall Street saying that stocks climb a wall of worry. Well, there has been a pretty big wall and an equally big climb.

We remain bullish at ICON and believe we are only part way through a market recovery. As of the end of the second quarter in 2012, ICON's value-to-price (V/P) ratio suggests that stocks are approximately 33% undervalued. This gap feels about right to us given the mood of uncertainty and investor concerns. We have observed through time that good bargains and uncertainty go together. Lately, the domestic stock market has been pounding its chest boldly, but the message investors are hearing is: "I'm the best, but stay away because I don't want you to like me!" The market has demonstrated a 103% return with an attitude!

ASSET CLASS RETURNS (3/6/09 - 6/30/12)



Past performance is no guarantee of future results. *Source: Bloomberg*

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The unmanaged Standard & Poor's Composite 1500 (S&P1500) Index is a broad-based capitalization-weighted index comprising 1,500 stocks of Large-cap, Mid-cap, and Small-cap U.S. companies. Total returns for the unmanaged index include the reinvestment of dividends and capital gain distributions, but do not reflect the costs of managing a mutual fund or portfolio. The TR/J CRB Commodity Excess Return Index is an arithmetic average of commodity futures prices with monthly rebalancing. Individuals cannot invest directly in an index.

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The Gold Spot price is quoted as US Dollars per Troy Ounce.

10-year Treasury notes are debt obligations issued by the U.S. Treasury that have a term of more than one year but not more than 10 years. The 30-year Treasury is a U.S. Treasury debt obligation that has a maturity of 30 years. The 30-year Treasury used to be the bellwether U.S. bond, but now most consider the 10-year Treasury to be the benchmark.

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