Guidance for Current Market Conditions: The Market Can Be Wrong

By Craig T. Callahan, DBA
Founder & President of ICON Advisers, Inc.

The stock market has a reputation for leading the economy at turning points. There have been several occasions when the stock market rallied for six to nine months, hit a peak and then turned sharply lower. We've also seen a number of instances in which the stock market took a sudden dip motivated perhaps in part by investors' fears of a recession, but no recession occurred. Instead, what materialized might be characterized as a temporary setback.

We agree with the sentiments expressed by noted economist and Nobel Prize laureate, Paul Samuelson, who jokingly stated: "The stock market is a leading indicator. It has correctly predicted 10 of the last five recessions." At ICON, we believe this latest sharp market slide will prove to be another temporary setback. That's certainly not to say this is an enjoyable ride; it's just to say we feel it's a temporary condition. Let's look at three examples of past setbacks for perspective.

Through July 16, 1990, when Iraq invaded Kuwait, the market had been moving higher over the course of the previous 12-months. Between July 16, 1990 and October 11, 1990, the S&P 500 Index dropped 19.9% over 62 trading days. At the time, there was no shortage of analysts and talking heads who were predicting an imminent recession. In an October 10, 1990 *New York Times* article, for example, economist H. Erich Heinemann noted that Labor Department data showed that the number of jobs declined by almost a half-million in the third quarter, "… and that means lower consumer income and lower consumer spending … The economy's in a recession, and in a recession stock prices normally reflect prospects for lower earnings."

The article similarly quoted Walter F. Loeb, a retail analyst, as saying, "We're looking at a prolonged consumer recession that will continue into 1991." Heinemann, Loeb, and others who shared their pessimistic views may have missed a buying opportunity. The market hit bottom for the year on October 11, 1990. Six months later, however, the market was 28.2% higher. One year later the market had risen 33.6% off the October low.

In 1998, the market was again on an upward path from its October 27, 1997 low when investors evidently became concerned that the slowdown in Asia would spread to Europe and, subsequently, to the U.S. As in 1990, the S&P 500 dropped over 19% in just six weeks between July 17, 1998 and October 8, 1998. Approaching the market bottom, investors behaved as though they were convinced a recession was both inevitable and imminent. In an October 11, 1998 *New York Times* article, Alan Greenspan, then the chairman of the Federal Reserve, struck a pessimistic tone. He was quoted as saying the United States economy had "weakened measurably." Greenspan continued, positing that, "We are clearly facing a set of forces that should be dampening demand going forward to an unknown extent." The article reported that following Greenspan's testimony, "JP Morgan economists said they expect a recession in 1999, which would end the nation's longest peacetime economic expansion." There was no recession, however, and with investors' concerns apparently assuaged, the market again resumed its upward path.

In the spring and summer of 2010, the market's recovery was interrupted by a 16% decline over about nine weeks (beginning approximately April 23, 2010 and concluding on July 2, 2010) as European sovereign debt problems led investors to price in a double-dip recession scenario. After some volatility, the market recovered and resumed an upward path off its 2009 low. And while the last month or two have been especially volatile, as many investors respond emotionally to disturbing news and perhaps contemplate getting out of the market altogether, we've seen similar volatility in the past and will likely see it again in the future. We believe, however, that investors are generally well served by weathering these storms and remaining invested over the long term.

The following table illustrates the similarity among the events we've characterized as temporary setbacks. Of course, as of this writing, we do not know whether August 8, 2011 will prove to be the low for the year, but we believe the illustration is valid nonetheless. For each setback discussed in this article, the drop from the peak to trough is between 16.0% and 20.0%, placing our recent drop of 17.9% in the mid-range. The 17.9% decline we experienced between April 29, 2011 and August 8, 2011 is thus similar to the market declines we saw during the other periods addressed in this article. Moreover, the fact that this decline took place over the course of 69 days reveals the downturn has been similar in duration to the other downturns noted below.

DATES	% DROP TO LOW POINT	DAY DROP TO LAST DIP
7/16/90 - 10/11/90	-19.9%	62
7/17/98 - 10/8/98	-19.2%	58
4/23/10 - 7/2/10	-16.0%	62
4/29/11 - 8/8/11	-17.9%	69

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

Our experience shows some common traits among these temporary setbacks. They were sudden, sharp, and unexpected. Unfortunately, the temporary setbacks were all harsh enough to cause many investors to depart the market and derail their long term investment plans. We believe timing your trading activity (e.g., selling your positions immediately before you think the market will decline and/or buying in at the bottom) is virtually impossible.

While we recognize that many investors will have a knee-jerk response to each market downturn, with many withdrawing their investments as conditions sour, our experience reminds us that we've had setbacks before and will again in the future. Not every market downturn presages a recession: Professor Samuelson's quote is well-taken.

The highest overall domestic market V/P ICON has shown during this recent downturn is 1.58 as of August 8. As of August 22, 2011 our system is calculating a still very impressive overall market V/P of 1.56. While no one can predict what today's market volatility holds for the future, our analysis leads us to believe the current situation is a market correction that offers many great buying opportunities.

Past performance does not guarantee future results.

Investing in securities involves risks, including the risk that you can lose the value of your investment. 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) 500 Index is a market value-weighted index of large-cap common stocks considered representative of the broad market.

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5299 DTC BLVD, 12th Floor Greenwood Village, CO 80111

1-800-828-4881 www.InvestwithICON.com