ICON OUTLOOK

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Yields as a Clue: Where & When to Find Value

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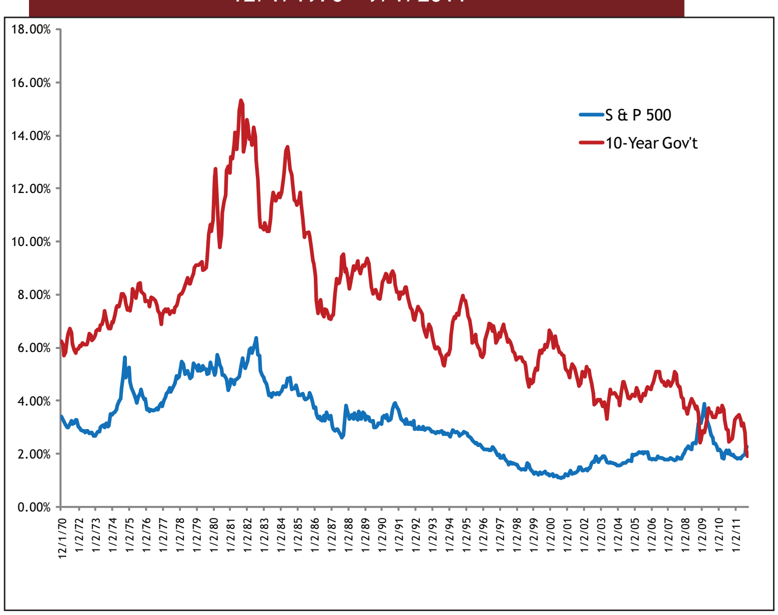
Investors seeking income have a variety of choices. They could buy a bond issued by the U.S. Treasury. For example, if they buy the 10-Year Treasury and hold it to maturity, they would expect to receive the stated interest payment each year and the principal at maturity. As such, their interest income and total return is fixed. Or, they could buy a dividend-paying stock, where they would hope for the dividend to grow and for capital appreciation; both are dependent upon earnings growth. Over the last 40 years, the dividend yield on the S&P 500 stock index has usually been less than the yield on the 10-year Government bond, but the difference between the yields has not been constant. Many investors' preferences for bonds versus dividend-paying stocks fluctuate through time depending upon their view of risk and general market conditions. Using relative yields is one way to analyze which instruments we see as better bargains at different times — bonds or stocks.

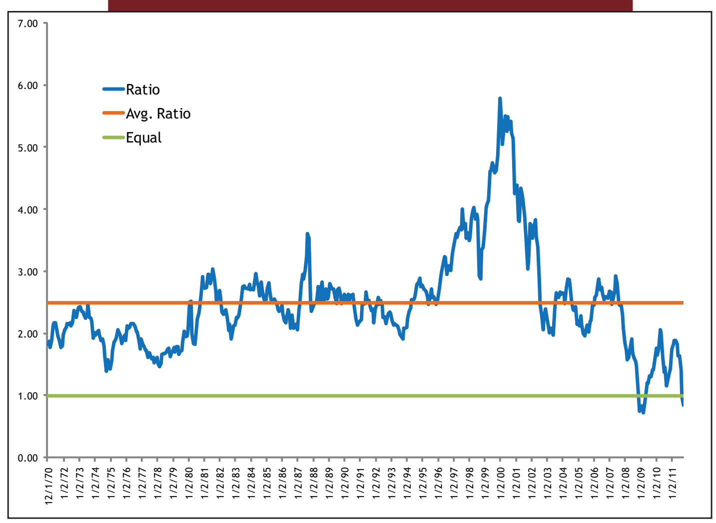
The graph below shows the yield on the 10-year Government bond and the dividend yield on the S&P 500 Index monthly from June 30, 1982 through August 31, 2011. Generally, the yield on the Government bond has been greater than the yield on the stocks in the 500 index during this time period, a relationship that seems to make sense. An investor who buys the Government bond will typically hold it to maturity. For Government bonds, yield and total return are fixed, or limited to the current yield. The typical stock investor, however, may be willing to accept a lower current yield because of the expectation for dividends to grow and for the potential for the price to appreciate due to the investment of retained earnings for growth. Although the difference between the bond yield and the dividend yield varies through time based upon market conditions and investor expectations, over this time period, the average difference between the bond yield and the dividend yield has been 3.93 percentage points, reflecting that, on average, the bond yield has been 3.93 percentage points higher than the dividend yield on the S&P 500.

Yields, 10-Year Government & S&P 500: 12/1/1970 - 9/1/2011



Past performance is no guarantee of future results.

10-Year Government Yield & S&P 500 Dividend Yield: 12/1/1970 - 9/1/2011



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The graph above shows the ratio between the two yields by simply dividing the bond yield by the dividend yield. The other two lines show the average for the time period of 2.68 and 1.00 (which indicates where the two yields are equal). When below the average, the ratio between the two yields might indicate that the two yields are closer to each other than normal and that stocks might be cheap in price, providing a better than average yield. Until the financial crisis and bear market of 2008-09, a ratio of around only 2.00 was typical of cheap stocks and buying opportunities, such as the summer of 1982, summer of 1986, winter of 2003 and the spring of 2005.

Just the opposite, when the ratio between the two yields is above the average, the ratio is indicating the yield on the Government bond is much higher than normal relative to the dividend yield. It could suggest stocks are expensive on a price-to-dividend basis. We saw that condition in August and September 1987, pre-crash, and for a much longer period in the late 1990s, pre-"tech bubble."

The recent recession, ongoing financial crisis, stock market decline and deteriorating investor sentiment all contributed to lower lows in this ratio even to the point where the dividend yield exceeded the bond yield for five months, November 2008 – March 2009. During this time, the ratio may have suggested stocks were cheap and out of favor while investors were seeking the comfort of the risk-free (in terms of default) Government bonds. Favoring Government bonds in this case seems irrational to us, but investors were apparently willing to accept a lower current yield on a fixed investment over the potential of the stock dividends. As we know now, the stock market rallied over 100% from its low in March 2009 through late April 2011.

Once again at the end of August 2011, the yield on the S&P 500 exceeds the yield on the 10-year Government bond (2.22% to 2.13%). It should be noted that ICON uses an intrinsic value equation to value equities during these two occasions and our method agrees with this more simplistic approach of yield comparison. At ICON, we currently favor stocks over Government bonds.

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

Dividend payments are discretionary and can vary widely. By way of example, many financial institutions drastically cut or eliminated their dividend in response to the financial meltdown of 2008.

Investing in securities involves inherent risks, including the risk that you can lose the value of your investment. There is no assurance that the investment process will consistently lead to successful results. Investing in fixed income securities such as bonds involves interest rate risk. When interest rates rise, the value of fixed income securities generally decreases. High-yield bonds involve a greater risk of default and price volatility than U.S. Government and other higher-quality bonds. The 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

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. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment.

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. To analyze intrinsic value, the ICON valuation methodology relies on the integrity of publicly released financial statements.

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