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ICON Insights

Market Commentary - May 2017

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Domestic Equities

The broad market, as measured by the S&P 1500 Index, hit an all-time high March 1, 2017, and has been drifting sideways through March and April. At the sector level there have been unique sector-specific moves resulting in low correlation among the various S&P 1500 sector indexes. At April month-end, four sector indexes and one market capitalization index hit all-time highs; the S&P 1500 Information Technology Index, S&P 1500 Consumer Discretionary Index, S&P 1500 Consumer Staples Index, S&P 1500 Materials Index and S&P Small-Cap 600 Index. The S&P 1500 Real Estate Index and S&P 1500 Utilities Index hit 52-week highs a week earlier. Just the opposite, the S&P 1500 Energy Index registered a new 52-week low the first week of May. This atypical behavior appears to us to be driven by investors' reactions to various events and situations, such as the price of oil, the level of interest rates and Congressional actions (or inactions).

While energy bulls had hoped the OPEC agreement would keep oil in the $60 per barrel range, supply and demand conditions are making it difficult for oil to stay above $50 per barrel, contributing to the weakness in Energy stock prices. Utilities, on the other hand, appear more sensitive to interest rates, in particular, the yield on the 10-year U.S. Treasury Note. As that yield dropped from Mid-March, the S&P 1500 Utilities Index moved higher. The Financials sector appears to be reacting to the 10-year Treasury yield, but opposite of Utilities, as investors apparently find higher yields favorable for Financials. Other sectors like Industrials, Materials and Natural Resources have been reacting to hints out of Washington, D.C. of what infrastructure spending will look like. Also contributing to sector-specific behavior were first quarter earnings, which have been announced in April and May. As of May 4, 1079 of the companies in the S&P 1500 Index have reported. On average, they have beaten expectations by 5.86% and grown 14.98% from a year ago. Yet, positive and negative earnings surprises have affected sectors differently. All in all, as we stated above, we are in a very low sector correlation environment.

We initiated a rotation in the ICON Tactical Allocation Portfolios (the Portfolios) in late April, reducing positions in the Consumer Discretionary and Natural Resources segments and increasing holdings in the Information Technology sector. Natural Resources is heavily tied to the potential infrastructure spending being promoted by the President and Congress. We are not predicting whether or not the spending will occur, it is just that stock prices in that sector have moved up in anticipation of the proposed spending. As a result, a few industries appear over-priced according to our system. As for the Consumer Discretionary sector, when we initiated the position, most of the 34 industries in that sector had V/P ratios of 1.00 or greater. When we reduced the Portfolios' position in the sector it was down to 19 of the 34. We can still find attractive industries in the Consumer Discretionary sector, just fewer than before. We didn't view the Consumer Discretionary and Natural Resources segment of the market as absolute "sells," they were just sensible sources for the reallocation to Information Technology. The Information Technology sector has worked its way up to #2 in our value-to-price (V/P) rankings and the S&P 1500 Information Technology index is the best-performing sector index year to date. That combination of value and strength makes the sector worthy of an over-weighted position.

As for the broad market, the stocks in the ICON database began May about 3% above our estimate of fair value. With earnings growing we would expect fair value to grow, so we still like being invested in our favorite sectors.

International Equities

International indexes have generally been outperforming the U.S. market year to date, with emerging markets being the leader. The MSCI Emerging Markets Index has gained 15.17% year to date through May 2, while the MSCI ACWI (ex U.S.) has gained 11.22%, both beating the domestic S&P 1500 Index, which is up 7.10%. In the global MSCI ACWI Index the United States comprises 53.2% of the index leaving international equities at 46.8%. Entering 2017, value favored international equities over domestic, and as a result the equity portions of our Global Portfolios have generally targeted an over-weight in international equities. Given this overweight target, the Global Portfolios are participating in the international leadership. Further, in mid-February, based on valuation, we increased the emerging market exposure in the Portfolios. As relative valuations have remained about the same, we are content with our current allocations favoring international equities over domestic.

Bonds

In 2017, the yield on the 10-year U.S. Treasury Note has drifted sideways in the 2.20% to 2.60% range, which makes sense to us. Some analysts thought that if the Federal Reserve raised the Fed Funds rate that all yields might rise. We disagreed and wrote in early February, "we do not expect a boost in inflation, so the current yield makes sense to us. We do not expect the yield to move much higher." We followed up in early March, "we expect longer-term bond investors will be comforted in the view that a higher Federal Funds rate will help keep inflation low. Therefore, we do not see longer rates rising in the near future." Currently, we do not see a catalyst for the yield to move a large amount in either direction.

Summary

We do not see the behaviors and conditions typical of peaks in equity prices, and we find stock prices, on average, to be within 3% of our estimate of fair value. With corporate earnings, in general, growing year over year, we think the broad market can move higher over the next year. If the low sector correlation continues, any move higher could be sector-specific.

Past performance does not guarantee 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. There are risks associated with Small and Mid Cap investing such as less liquidity, limited product lines, and small market share.

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.

The target weightings are for each new ICON account as of the stated date. The holdings of individual accounts will vary over time due to fluctuations in the market value of individual holdings. Target weightings will change over time.

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.

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. The unmanaged Standard & Poor's (S&P) Composite 1500 Sector Indexes track the performance of sectors that comprise the S&P Composite 1500 Index. The Portfolios' composition may differ significantly from the indexes. Individuals cannot invest directly in an index.

The 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

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