



THE ICON SYSTEM

VALUATION DISCIPLINE

ICON uses a modification of the valuation model once used by noted value investing pioneer Benjamin Graham. Although probably best known for his price-to-book value and dividend yield approaches to value investing and for being Warren Buffett's former professor, Graham worked throughout his career to develop a way to calculate intrinsic value. In 1962, he published an equation that he called the "Central Value Formula," which included normalized earnings, a growth rate in earnings, and the AAA bond yield. Graham was never able to find an appropriate measure of normalized earnings or an estimate of future earnings growth. (For further insight into Graham's equation, see "Smart Crash of October 19th," *Harvard Business Review*, June 1988.)

The ICON modifications to Graham's formula address the shortcomings of his equation. ICON's system includes a functional definition of "normalized earnings," the addition of beta as a measure of volatility, and the use of I/B/E/S estimates of future earnings growth. The I/B/E/S service started several years after Graham's death in 1976 and features a decades-long history of Wall Street analysts' estimates.

ICON's valuation discipline is non-emotional and based upon the fundamentals of finance. The ICON valuation equation uses average earnings per share, future earnings growth estimates, beta, and the bond yield. In principle, it projects earnings growing into the future and then discounts those projections back to their present value according to risk and interest rates (opportunity cost).

ICON VALUATION MODEL

$$\frac{(\text{EARNINGS, GROWTH})}{(\text{BETA, BOND YIELD})} = \text{INDIVIDUAL STOCK VALUATION}$$

This equation is applied to the thousands of domestic and international securities in ICON's database. The value derived from this equation is then divided by price to calculate a value-to-price (V/P) ratio used to determine whether a security is over- or underpriced relative to our estimate of intrinsic value. According to our methodology, a V/P reading of 1.00 indicates stocks are priced at intrinsic value. We believe stocks with V/P readings above 1.00 to be undervalued.

We categorize stocks according to the 154 industries comprising the Standard & Poor's (S&P) Composite 1500 Index. By computing equal-weighted averages, ICON assigns a V/P ratio to each industry. These ratios power the ICON system. Industries are ranked to determine which industries may provide what we believe to be the best value for the investment dollar.

INDUSTRY EMPHASIS

ICON believes markets have themes with certain industries assuming leadership roles for many quarters or even years. While the ICON system starts with the calculation of V/P ratios for individual stocks, we calculate individual V/P ratios in order to establish industry V/P ratios. The industry V/P ratios are used in an effort to identify themes early in the market cycle. This approach is based on ICON's belief that

it is easier to select industries than it is to select individual stocks. By stressing industry exposure and by holding a selection of stocks within an industry, we attempt to reduce the random risk associated with individual securities.

RELATIVE STRENGTH

We believe value investing has an early market bias. Stocks may appear to be bargains, but they can become even less expensive until it is their time to rally back to fair pricing. An article appeared in

the *Financial Analysts Journal* in 1986 that provided a solution to the early bias inherent in selecting industries based on value alone. The article's authors, Sorensen & Burke, worked with industry indexes and computed the relative strength for each industry over the previous 26 weeks.

Over the 12-year test period (1972-1984), 10 industries were purchased on relative strength alone. Then, quarterly, industries were sold and replaced based on relative strength. This system earned a 14% annual return* compared to a 6.6% return for the S&P 500 Index for the same period. The authors concluded that markets have themes led by certain industries and that once industries reach a leadership role, they tend to stay in that role for many quarters.

**Gross annual return, net of transaction costs. Past performance does not guarantee future results.*

COMBINING RELATIVE STRENGTH AND VALUE

ICON uses relative strength as a way to reduce the inherent early bias associated with value investing. In our system, a relative strength reading above 1.00 means that an industry is stronger than the broad market over the previous 26 weeks. A reading below 1.00 means we believe that an industry is weaker, while a reading of 1.00 means that an industry is simply about average. The table above right illustrates how the system works.

VALUE & RELATIVE STRENGTH EXAMPLE			
INDUSTRY	VALUE-TO-PRICE RATIO	RELATIVE STRENGTH	SIGNAL
AUTOMOTIVE	1.20	1.06	BUY
PHARMACEUTICALS	1.19	0.95	DO NOT BUY
AIRLINES	1.18	1.04	BUY
PERSONAL PRODUCTS	1.17	0.97	DO NOT BUY
REGIONAL BANKS	1.16	1.02	BUY

These examples are hypothetical, do not reflect the performance of any ICON-managed portfolio or the market, and should not be construed as a recommendation of any sector, industry, or security.

Assume the five industries in the example above are at the top of ICON's industry V/P ratings. In other words, they are the five best bargains. In this hypothetical, automotive would be purchased because it has the highest V/P and relative strength above 1.00. Pharmaceuticals would not be purchased; the industry is a bargain, but the relative strength of 0.95 suggests to us it is too early to buy. Airlines and regional banks would be purchased because they are priced below our estimation of fair value and also have relative strength above 1.00. Similar to pharmaceuticals, personal products is a good bargain but with a relative strength below 1.00, it is probably not time to purchase.

Note the difference between relative strength and momentum. Momentum captures only a move to the upside; however, an industry could have a relative strength reading greater than 1.00 if it is declining less than the market average in a down market. Ideally, the use of relative strength allows for the identification of industries at, or prior to, market bottoms if they have high V/P ratios and are simply stronger than the declining market. Relative strength does not require that an industry move higher; the industry simply needs to be stronger than the market. The combination of value and relative strength results in a focus on industries that, we believe, are bargains and beginning to show leadership.

For more information on the concepts of relative strength and valuation, refer to "The Interaction of Value and Momentum Strategies," Clifford S. Asnes, *Financial Analysts Journal*, March/April 1997.

THE COMBINATION OF VALUE AND RELATIVE STRENGTH RESULTS IN A FOCUS ON INDUSTRIES THAT ARE BARGAINS BEGINNING TO BE DISCOVERED, OR BARGAINS THAT ARE BEGINNING TO SHOW LEADERSHIP.

ICON'S BENCHMARK

In 1996, Standard & Poor's created a new index by adding the MidCap 400 Index and the SmallCap 600 Index to its popular Large Cap S&P 500 Index. Called the S&P Composite 1500 Index, it was first comprised of 115 industries. These industry classifications provided an ideal architecture for ICON's industry rotation system. In subsequent years, S&P increased the number of industries to respond to the changing composition of the economy. As of September 2008, the S&P 1500 Index included 154 industries.

The creation of that index and the industry classifications by S&P prompted ICON in 1997 to adapt and enhance its system to invest in the industries covered by the index.

BUY AND SELL DISCIPLINES

When S&P defined industries with the S&P 1500, no performance history was provided. ICON had to create industry indexes for all industries for the 11 preceding years. Thousands of back tests have been undertaken to develop and refine ICON's buy and sell rules. Even with the greater specificity and broader choices, the optimal rules for buying and selling industries remained similar to those we had used for a decade. An industry can be sold for two reasons:

- It's overpriced relative to value
- Its performance has been poor relative to the market

We generally sell when an industry drops into the bottom 10% of our V/P rankings. That means it has to rank among the bottom 15 of the 154 industries. Such a requirement indicates that an industry has to be overpriced relative to other industries. We may also sell an industry based on poor performance, measured as the bottom 20% on our relative strength scale. Given that we compute relative strength using the trailing 26-week period, this reading is rarely sensitive to short weekly dips or surges.

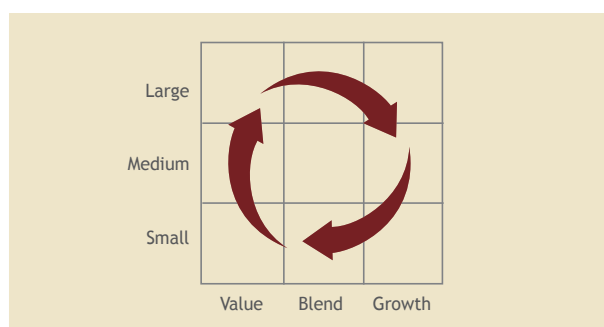
STOCK SELECTION

Individual stocks within an industry are screened for quality. We favor companies that are high in cash, low in debt, and well-managed. Income statements, balance sheets, and return ratios are used to assess management quality, corporate control, planning, and efficiency. The objectives of this quality screening are to increase the probability that price will move up to value and to reduce the potential for value to deteriorate.

ICON's value approach is not limited by restrictions on companies of a specific market capitalization; we attempt to identify potential industry leadership wherever we think it emerges – small cap, mid cap or large cap. Our analysis shows that industries migrate around or across the style grid, so that when a market theme develops, industries leading the theme can be located anywhere

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in the market. ICON's system allows us to identify industries that have the potential to become market leaders without the arbitrary barriers or restrictions of the style grid. Our ability to move anywhere in the grid to find bargains makes us a Multi-Cap manager that invests in securities we believe are undervalued.



HISTORICAL SYSTEM TENDENCIES

We believe that new industry leadership often emerges from a market bottom, and the ICON system seeks to identify this new leadership early. The ICON system concentrates on value and relative strength and ignores the news headlines that distract many investors. Sometimes major theme changes occur at market bottoms or when the market experiences a jolt of volatility. Over time, ICON has seen a variety of theme changes.

For example, the market decline of August 1998 signaled the end of a four-year advance and provided the characteristics of a major bottom and the beginning of a new bull market. ICON correctly and boldly communicated to investors our optimistic outlook and concentrated on rotating into industries that had the emerging leadership characteristics we look for: value and relative strength.

Our next major rotation occurred in early 2000. During the first two months of that year, ICON sold its positions in the Information Technology sector. By March, that sector was greatly reduced and the Financial sector was increased to more than double its market capitalization weighting.

The recession-proof theme featuring the Financials, Health Care, Consumer Staples, and Utilities industries was successful during the final 10 months of 2000. In January 2001, those industries were replaced by Consumer, Industrial, and Cyclical industries. Those proved to be the strength of the market for more than a year.

That leadership was displaced by fear over a pending war in Iraq and corporate accounting scandals. For eight months of 2002 and early 2003, leadership was absent as the market drifted. With investors focusing on various geopolitical concerns, stock prices remained far below our estimate of intrinsic value for much longer than normal.

In late March 2003, we performed a sector rotation to increase our exposure to cyclical and economically sensitive issues, the types of industries that have historically led during economic recoveries. We believe those industries were on sale because

investors were incorrectly fearful of a slow or sluggish economy and worried that higher oil prices, war, and terrorism would hurt the economy. This cyclical theme, in which the Energy, Industrials, and Materials sectors led, characterized the market for more than three years.

A FOCUS ON THE NUMBERS

We believe that the characteristics of being underpriced relative to fair value and having relative strength consistent with or greater than the broad market puts an industry in a position to beat the market average. That is the essence of the ICON system. Fundamentally, we seek underpriced industries beginning to show leadership.

At ICON, we focus on numbers. Our investment system is analytical, quantitative, and non-emotional. We do not rely on traditional brokerage research or subscribe to any Wall Street newsletters. Nor do we visit directly with public companies or go to company-sponsored PR lunches. Instead, we buy data and compute value. Our analysis strives to keep portfolios in touch with ever-changing industry and sector leadership, and our numbers guide us to go against the crowd when we find value.

IF YOU'RE SEEKING TO
**CAPTURE SECTOR AND
INDUSTRY LEADERSHIP**
THROUGH VALUATION-BASED
PORTFOLIOS, CALL ICON TODAY AT
1-800-828-4881.

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Sorensen, Eric H., and Burke, Terry. "Portfolio Returns from Active Industry Group," *Financial Analysts Journal*, September/October 1986.

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Investing in securities involves inherent risks, including the risk that you can lose the value of your investment.

Investments in international securities may entail unique risks, including political, market, regulatory and currency risks. Financial statements of foreign companies are governed by different accounting, auditing, and financial standards than U.S. companies and tend to be less transparent and uniform than in the United States. Many corporate governance standards, which help ensure the integrity of public information in the United States, do not exist in foreign countries. In general, there is less governmental supervision of foreign stock exchanges and securities brokers and issuers.

An investment in a sector fund may involve greater risk and volatility than a diversified fund, and the Technology sector has been among the most volatile sectors in the market.

ICON's value-based investing model is an analytical, quantitative approach to investing that employs various factors, including projected earnings growth estimates, 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 not guarantees of future results. Value investing involves risks and uncertainties and does not guarantee better performance or lower costs than other investment methodologies.

Portfolio composition and holdings are subject to change at any time based on market and other conditions, and should not be construed as a recommendation of any specific sector, industry, or security.

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. ICON's relative strength ratio is a ratio of the performance for the preceding six months of a group of securities within ICON's universe as compared to the preceding six-month performance of the broad market.

ICON's "relative strength" estimate reflects ICON's calculation of how an individual stock has performed compared to the broad stock market over a six-month period.

The unmanaged Standard & Poor's (S&P) Composite 1500 Index is a broad-based, capitalization-weighted index comprising 500 large-cap, 400 mid-cap, and 600 small-cap U.S. companies. The unmanaged S&P 500 Index is a market value-weighted index of common stocks considered representative of the broad market. The S&P MidCap 400 Index is a widely recognized unmanaged mid-cap index of 400 domestic stocks chosen for their market capitalization, liquidity, and industry group representations. The S&P SmallCap 600 Index is an unmanaged index of 600 domestic stocks chosen for their market capitalization, liquidity, financial viability, and sector representation. The Portfolios' composition may differ significantly from the indexes. Individuals cannot invest directly in an index.

The beta coefficient is a measure of a portfolio's volatility relative to the market. An index relevant to the portfolio is used as the proxy for the market, and is considered to have a 1.00 beta. Therefore, if the portfolio has a beta of 1.50, it has historically been 50% more volatile than the market for the periods shown.

The bond yield represents opportunity cost in ICON's valuation model.

ICON's mutual fund allocation products are only available through financial advisers, who can help you determine how they might best be used to pursue your long-term investment goals.

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