



Portfolio Update

December 2006

Domestic Market Commentary

The market dropped from early May through mid-June 2006 and experienced sideways volatility through late July. In the August Portfolio Update, our position was that we did not fear a major market decline from those levels and that being invested in equities was prudent based on valuation. We wrote: "When the Federal Reserve is done tightening, we expect a rally based on historic experience and our value/price ratio. Like most rallies, it will probably begin suddenly with no warning or obvious invitation."

In September we stated: "Because of a valuation cushion, we do not expect a major decline. Instead, we expect the ultimate breakout to be to the upside." Guided by valuation, we did not need to forecast the exact timing of a rally. Valuation dictated that we keep the ICON Portfolios invested in order to participate in a market advance whenever it occurred.

By the October Portfolio Update, we were convinced that a rally was underway, declaring: "Based on value, we are bullish and expect stock prices to move higher but with different industry and sector leadership than seen in the last three years." Rather than trying to predict the beginning of a rally, our focus was on identifying the market theme during August and September. We conducted major industry and sector rotations during those two months. By October, a new theme appeared clear to our system. We also stated in the October commentary, "After a modest market retreat and some volatility in late spring and early summer, it appears to us that a new, sustainable theme has suddenly emerged." With the modest market advance in October, it was clear enough for us to state last month: "We believe we are in a new bull, or rising, market."

We Believe a New Bull Market is Taking Hold

As November concludes, the Standard & Poor's Composite 1500 Index, a broad market-capitalization proxy for the U.S. equity market, has moved higher six consecutive months. The continuation of the recent market advance through November convinces us that we are indeed in a new bull market.

As we have stated, though, it is a new and different market than seen the last three years. It has new leadership, and the stocks and industries leading the market are behaving differently than the leaders of the last three years. This appears to us to be a less volatile and less sensational advance. Many of the stocks leading the way are those of large, mature companies, which are normally steady performers. In our opinion, many market observers have not recognized the new bull market because of the slower, steadier nature of this move.

Not only is the industry leadership different from that of the early 2003 to early 2006 advance, but also it has not been constant over the last four months. In late July and early August, we saw the leadership concentrated in large companies in the Financials, Information Technology, Health Care and Telecommunication sectors. It favored recession-proof industries, those with revenues not closely tied to the economy.

As the market advanced through August, September, October and November, the leadership changed a bit. Perhaps in response to the election and shift of control in Congress, Health Care stocks such as pharmaceuticals dropped sharply. At this time, our numbers suggest this was a temporary over-reaction.

Recent Strength in the Consumer Discretionary Sector

Also in November, stocks of smaller companies in various sectors came alive and participated. Many of these companies are in the Consumer Discretionary sector. Our system indicates good value in that sector as those stocks fell out of favor a year or two ago when the Federal Reserve was tightening. It appears to us that they are priced on a worst-case scenario in anticipation of tighter monetary policy. Lately, their move higher may have been a case of prices trying to return to our estimates of fair value. Some attractive industries in that sector include household appliances, specialty stores, internet retail, apparel retail and apparel accessories & luxury goods.

There is a strong similarity now to what the leadership was in late July, but a few new industries have joined in while others have declined. We generally like our current positioning and feel that our portfolios reflect the leadership as our system indicates it may be over the next year.



Bond Market Commentary

After a brief up-tick in the first half of October, long-term bond yields have continued the decline that began in late June. The yield on the 10-year Government bond has dropped from above 5.2% to around 4.5%, approximately 70 basis points. We view this as not only positive for bond holders, but also positive for, and very supportive of, the current rally in stocks. It resembles a pattern seen during the disinflation secular trend since 1981. The Federal Reserve has tightened at times, and interest rates have risen. Then, inflation and interest rates have dropped, showing the power of tight monetary policy.

The recent drop in yield appears to us to reveal that investors believe the tight monetary policy of the last two years can accomplish the goal of squelching any inflationary pressure that had sneaked into the system.

International Market Commentary

Most international markets have exhibited the same steady climb the last few months as seen in U.S. stocks. Based on valuation, we believe those moves also look like the early stages of a sustainable rally. The theme is quite similar to that in the United States: large, mature companies are leading the way, and most are steady growth, non-cyclical issues. As in the U.S., other companies from the Consumer Discretionary sector have joined in the advance. Lately, some weakness in the U.S. dollar relative to the euro and yen has helped returns for U.S. investors. Our bullish posture is based on valuation, not expectations of currency benefits.

Summary

It is our opinion that the market has just completed the fourth month of a new bull market. The industry leadership appears sensible to our system and sustainable based on valuation and relative strength. It is a scenario of many high-quality companies having stock prices below our estimate of fair value. While investors are worrying about Federal Reserve policy, currency fluctuations and other variables, stock prices have steadily moved higher. We believe that trend has the potential to continue into next year.

As 2006 closes, we thank you for your continued support of ICON and wish you a safe and happy holiday season.

Prepared by ICON's Investment Committee.

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There are risks associated with small- and mid-cap investing such as less liquidity, limited product lines, and small market share. 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.

To analyze intrinsic value, the ICON valuation methodology relies on the integrity of publicly released financial statements. ICON's value/price ratio is a ratio of the intrinsic value, as calculated using ICON's valuation methodology, of a broad range of U.S. equities within ICON's system as compared to the current market price of those equities. 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.

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 Portfolios' composition may differ significantly from the index. Individuals cannot invest directly in an index.

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