

# Portfolio Update

December 2004

Powered by a Disciplined Investment System

## **Domestic Market Commentary**

We commend you for participating in the market rally that began August 12, 2004. To participate in this rally, you had to (1) be invested, and if you have been in the market for awhile, (2) ride through market volatility during the first eight months of the year. Throughout that time, investors became concerned about many issues such as the election, Iraq, and oil prices, and stock prices oscillated in response.

It is difficult to ride through that type of volatility. In fact, many investors gave up and left the market. But while investors were distracted by events, the intrinsic values of well-managed, growing companies were increasing. Stock prices have been catching up with value, and those who are invested have participated in the rally.

Through your ICON investment, you are witnessing the very inherent nature of the stock market. It involves surges and setbacks. To get the full benefit of the stock market over the long run, you need to be invested when the surges begin. To do that usually means riding through unpleasant periods of volatility.

As for how long this market rally can last and how far it can go, remember that the ICON system does not rely on predicting the future. We try to recognize overpricing and underpricing relative to intrinsic value when it occurs. Currently, the value/price ratio for our universe of approximately 1,700 stocks is 1.12, meaning that on average, stocks are priced about 12% below our estimate of fair value. It appears there is still some "catching up" to do, although that can be interrupted by unexpected, unpredictable news events.

From a sector perspective, the leadership of this rally is very sensible to our system as it includes mostly economically sensitive areas. Energy,

Information Technology, Consumer Discretionary, Industrials and Materials have led since the market low on August 12, 2004. Sectors that are not sensitive to economic activity, such as Healthcare, Consumer Staples and Financials, have lagged. Leading industries are measuring value/price ratios above 1.00, indicating that the leadership is still not overpriced and is sustainable.

The ICON portfolios have undergone few changes during the market advance. The primary adjustments were to increase exposure to industries in the Information Technology sector. That sector was our largest weighting during the rally of early 2003 but was reduced below market capitalization weighting in late 2003 and early 2004. In September and October 2004, it was increased again. To accomplish that adjustment, positions in the Healthcare and Leisure & Consumer Staples sectors were reduced. We are pleased with the current industry and sector positions and do not anticipate much trading in the near future unless a strong surge causes overpricing.

The weak U.S. dollar relative to the Euro and Yen has made headlines lately. The dollar began its decline the fourth quarter of 2001 about the same time that the U.S. economy hit a low with the recession. Since then, the economy, as measured by GDP, has grown while the dollar has weakened. Also, the prices of oil and gold have increased during that same period. Only now, however, when the dollar has hit record lows, have the headlines appeared. We have watched the coincident occurrences (oil, currency and gold) over the last three years but have not paid attention to them as they do not affect our valuation perspective.

## **Bond Market Commentary**

Bond yields moved higher in November after declining from June. Briefly, the 10-year

Government bond had a yield below 4.0% but was above 4.3% as of November 30, 2004. Inflation reports, based on the Consumer Price Index (CPI) were very favorable in July, August, and September, despite higher oil prices, but the +0.6% advance reported for the CPI in October caught the attention of bond investors. With inflation being the worst enemy of bond holders, they have become a bit concerned. Our valuation readings do not dictate any action, so we are holding our positions.

### ***International Market Commentary***

Most country markets have participated in the rally dating back to August 12. Hong Kong and Sweden are among the leaders of the developed country markets. Japan is a notable laggard. The Nikkei 225 Index was barely above its mid-August level as of December 1, 2004. It is interesting that most international markets paused in late October just like the U.S. market.

The foreign industry and sector leadership is similar to that in the U.S. except for Information Technology. While that has been the best performing sector in the U.S. recently, it does not rank that high internationally. In particular, Japanese Information Technology industries are very sluggish. We broadly rotated ICON portfolios with international exposure in November to reduce exposure to Japan and to increase exposure to economically sensitive industries in Europe and Canada.

### ***Summary***

Many investors would think it's ideal to be on the sidelines during short-term volatility and to buy equities just when they are about to rally. Unfortunately, our research indicates such market timing is impossible, so we focus on the rewards of riding through the volatility. The strategy to remain invested is always dictated by our valuation readings, not a guess involving elections, oil, currency, or geopolitical events.

Yours truly,



Craig T. Callahan, DBA  
President and Chief Investment Officer

**Past performance does not guarantee future results.** Investment return and principal value will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. Opinions and forecasts regarding sectors, industries and themes and portfolio holdings and composition 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.

Management of the Portfolios involves sector allocation overlays using sector and diversified mutual funds as the investment vehicle. ICON is also the investment adviser to the mutual funds in which the Portfolios invest and receives a management fee from the Funds for its advisory services. There are risks associated with mutual fund investing, including the risk of loss of principal. There is no assurance that the investment process will consistently lead to successful results. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment, and the technology sector has been among the most volatile sectors in the market. Investments in foreign securities may entail unique risks, including political, market and currency risks. 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 high-quality bonds.

Gross Domestic Product (GDP), also known as Gross National Product (GNP), is the total value of goods and services produced in the national economy in a given year. It is the primary indicator of economic growth.

The Nikkei Stock Average is the average price of 225 stocks traded on the first section of the Tokyo Stock Exchange. The Consumer Price Index (CPI) is the primary indicator of U.S. inflation and is used to make cost-of-living adjustments to billions of dollars in benefit payments. Individuals cannot invest directly in an index.

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.

Please contact us in writing if you would like to receive, at no charge, the most recent copy of our disclosure document, Form ADV, Part II.

Data Source: Bloomberg  
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