

# Portfolio Update

## March 2006

### ■ Domestic Market Commentary

February was a month that saw investors guessing and reacting. The guessing was focused on the Federal Reserve (FED), its new chairman, and the likelihood of additional interest rate increases. At times, investors guessed that the economy was so strong that the FED would need to further tighten monetary policy. At other times, they thought the FED had already accomplished its goal of slowing the economy just enough to keep inflation under control. Along the way, investors also reacted to the sharp drop in oil prices. This drop saw oil go from over \$68 per barrel in late January to under \$58 per barrel at one point in February. Energy stocks generally dropped in price along with oil, but other stocks also reacted favorably to lower oil prices.

During the past three years oil prices went from \$25 per barrel to \$40 to \$70. During this time, predictions emerged that the increase in oil prices would increase inflation and interest rates as well as slowing consumer spending and housing. So far, those results have not happened. In fact, the new FED Chairman, Ben Bernanke, stated, "Oil-price increases in the last few years, unlike in the 1970s, have not fed through to any great extent into longer-term inflation expectations and core inflation." Consumer spending has not slowed and housing starts hit a 33-year record in January. Inflation, as measured by the CPI, is higher than it was during the recession of 2001, but is still in the moderate range and certainly far lower than seen during oil spikes of 30 years ago. Short-term interest rates have risen in response to FED tightening, but long-term rates have not demonstrated a strong upward trend. The yield on the 10-year Government bond is slightly above 4.5%, which is below its high in 2002 and in line with, but not above, the highs seen in 2003, 2004 and 2005.

With this economic setting regarding spending, growth, interest rates and inflation, we find prosperous companies. At the company-by-company level, we generally see earnings being reported that suggest companies are hitting their growth objectives.

Although the price of oil and energy stock prices are not as highly correlated over the long run as popularly believed, they did move in tandem in February. Energy was the worst sector of stocks last month. Continuing the shift initiated in January and again in early February, our exposures to the Information Technology and Consumer Discretionary sectors were increased. When the market moves up, under-priced issues in these sectors are often part of the leadership that emerges. Conversely, they generally do not hold up well on days in which the market is down. Guided by valuation and focused on the long term, we do not pay much attention to the daily volatilities. The industries we are favoring appear to have the longer-term leadership traits we like.

### ■ Bond Commentary

The yield on the six-month Treasury Bill continued its advance from a low of about 1% two years ago to 4.7% in February. Behaving quite independently, the yield on the 10-year Government Bond inched up in early February but then declined later and finished the month only slightly above where it started. We are seeing that the FED's tightening is raising short-term rates and slowing the growth of the various measures of money supply. Apparently, however, long-term bond investors are predicting this will keep inflation in check and therefore are not seeing the need for higher long-term rates.

From a valuation perspective, the higher short term (2 year and less) rates are putting a damper on the attractiveness of bonds. As a comparison opportunity cost, our system fairly

values longer-term bonds. So while we do not fear higher long-term rates, we cannot make the case for a bond rally yet.

### ■ International Market Commentary

European and Asian markets did not behave in tandem in February. Most European markets continued the steady climb seen in 2005, while Japan, which had gained most of the headlines last year with its sharp rally, experienced a setback in February. The moves of most indexes in Europe have been gradual over the last year and do not contain the surges seen in Japan. Whether it is a steady climb (Europe) or in surges (Asia), we see international stocks continuing to move higher as stock prices try to catch up to value. Naturally, news events can disrupt that ascent, but as in the United States, we believe the economic setting is favorable for corporate earnings so underlying value at the company level is growing. Stock prices are just trying to catch up. In our opinion, the differences in market patterns seen in Europe and Asia emphasize one reason for international investing -- diversification. When international stocks are not highly correlated, we feel they offset each other and smooth out the short-term volatility at the portfolio level.

### ■ Summary

Two months into this year we still think our 2006 expectations are on track. We believe stock prices in general remain below fair value and so we expect higher prices by year-end. The readings of price being below our estimate of fair value are very broad and across all sectors and market capitalizations. We therefore expect a broad market advance.

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.

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Consider the investment objectives, risks, charges, expenses, and share classes of each ICON Fund carefully before investing. The prospectus contains this and other information about the Funds; please read it carefully before investing. Sources: Bloomberg, FactSet Research Systems, Inc., Greg Ip, Wall Street Journal, "Fed Chief Says Oil-Price Spikes Have Had Little Inflation Impact," February 25, 2006.

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