Portfolio Update

September 2005

Domestic Market Commentary

After a nice upward move that took most indexes some 10% to 15% higher from their lows of late April, the market stalled and retreated a bit in August. This downward drift was seemingly driven by the resurfacing of conflicting concerns, as some investors feared that rising petroleum prices would slow the economy while others believed that higher oil could be inflationary.

Also contributing to investor uncertainty was the continued tightening of monetary policy by the Federal Reserve. Although designed to maintain a steady pace of economic growth, some analysts suggested that further rate increases could decelerate the economy to below adequate levels. Another area of concern centered on consumer behavior and the belief that personal spending could soften as the backstop provided by low interest rates and mortgage refinancing moderates. However, while these theories possess strong intuitive appeal, we have found no compelling evidence to support any of them.

Fundamentals Not Conjecture

At ICON Advisers, we subscribe to the IBES service, which surveys analysts for their estimates of future corporate earnings and respective growth rates. Despite recent volatility, these analysts, who specialize in evaluating corporate earnings prospects, have not lowered their outlook for FY1 (one-year forward earnings estimates) or LTG (long-term earnings growth rates). What this means is that at the company level, analysts do not anticipate any slowdown in earnings due to higher oil prices or changing consumer spending patterns.

IBES estimates of FY1 and LTG are used in our valuation model. The average value/price ratio for the approximately 1,800 stocks in our domestic database at month-end, indicated that stocks, on average, were priced 23% below our estimate of fair value. In other words, the August retreat in stock prices was not based on valuation fundamentals, although investors who have recently sold stocks may have done so on the grounds that a slowing economy would dampen corporate profits. From our standpoint, the pullback was the result of amateur macroeconomic conjecture that is not in agreement with professional analysts whose livelihoods and reputations are based on their ability to accurately forecast corporate earnings.

Capturing the Leadership

The dip in August was not uncommon. Most indexes have recorded impressive advances from their lows in late 2002 and early 2003, but those upward moves have not been steady nor in a straight line. They have faced numerous setbacks and obstacles. During those times, the key to further advances was that fundamentals remained strong and dips eventually proved more emotional than rational. We expect that this will continue to be the case.

This retreat has also interrupted rapidly fluctuating industry and sector leadership. From one day to the next, different industries rotate as leaders on the upside or laggards on the downside. Our task is to identify and capture the leadership that eventually breaks out.

Bond Commentary

While August was not constructive for stocks, it provided a favorable setting for bonds. The yield on the 10-year Government Bond initially inched to 4.4%, before subsequently falling below 4.1%. This reflects the prior three-year period, in which the 10-year yield hovered in a sideways trading range, typically between 4.0% and 4.5%. Occasionally it has moved

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beyond these levels, but only for limited time frames. It appears investors are comfortable with this range given tame inflation readings and generally stable economic conditions. We agree and judge these moves to be sensible.

International Market Commentary

While rebounding at month-end, most international markets experienced a similar retreat in mid-August, suggesting that concerns facing global investors are highly correlated. Japan has been the exception though, as its advance continued into August and is only slightly off its monthly high. Market leadership has been similar to that in the U.S. with industries in the Energy, Industrial and Healthcare sectors leading the way and daily rotations have become the norm during the retreat. As is usually the case during a pause or retreat, industry leadership has been interrupted, although valuation readings suggest an ultimate breakout to the upside. Our task is to identify industries that will lead globally when that occurs.

Summary

Conflicting perspectives have characterized the market. On one hand, investors acting on macroeconomic conjecture see events and situations slowing the economy, and ultimately, they believe, corporate earnings. The other view is from professional analysts who specialize in forecasting corporate earnings. As of yet, there is no sign that they foresee any slowing in corporate earnings. Trusting the analyst over potential herd behavior, it appears that the August retreat was based on superficial economics. We will stick to valuation fundamentals, which dictate holding stocks judged to be priced below our estimate of fair value.

Yours truly,

Craig T. Callahan, DBA
President

Past performance does not guarantee future results. *Investment return and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost.*

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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 ICON's disclosure document, Form ADV, Part II.

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