



# Portfolio Update

## June 2007

### Domestic Market Commentary

"Record Highs!" The media has given attention recently to the news that a few stock market benchmarks such as the Standard & Poor's (S&P) 500 Index and the Dow Jones Industrial Average (DJIA) have flirted with or broken through previous record highs.

The previous record highs date back to the first quarter of 2000. Obviously, it has taken several years to get back to record levels. Other equity indexes, such as the S&P Mid-Cap 400 and the S&P Small-Cap 600, surpassed their previous highs in late 2003 and are now approximately 60% above their peaks seen earlier this decade.

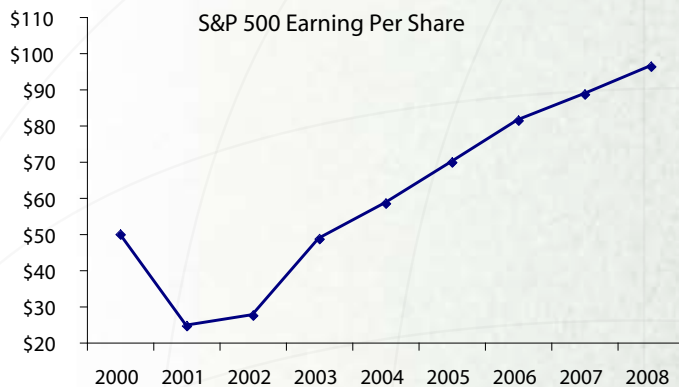
As the S&P 500 and the DJIA are the two most popular and most followed domestic indicators, their performance has attracted the most attention, causing a comparison between now and early 2000 when they reached their previous peaks. In particular, the media and investors are asking whether a peak is developing now. The cover of the May 28, 2007 edition of Barron's featured two headlines: "Signs of Fatigue as Market Flirts with New Highs" and "The Next Minefield for Investors." In other words, since it would have been prudent to sell back in 2000 at these levels, is it prudent to sell now?

### A Review of Earnings Per Share

At ICON, we rely on valuation and relative strength to answer that question and to determine our investment posture. We believe value starts with earnings. Standard & Poor's computes earnings per share (EPS) for the S&P 500 Index. In 1999, just prior to the first-quarter 2000 market peak, the S&P 500 Index EPS was \$48.17. In 2000, the EPS was \$50.00. For 2006, the EPS was \$81.51, and forecasted EPS for 2007 and 2008 are \$88.73 and \$96.40, respectively, according to Standard & Poor's. Depending upon which base year and which ending year are used, current earnings are approximately 80% greater than they were at the market peak earlier this decade.

In our valuation equation, as companies' earnings grow, their intrinsic values grow. Also, as value investors, we believe that price tries to keep up with--and equal--value over time. Over the long run, we think it is proper for price to equal value.

In early 2000, many of the large-cap stocks that are very influential in the S&P 500 Index were overpriced relative to our estimation of intrinsic value. Now, however, with much greater EPS, the intrinsic values of those stocks are much higher, yet prices are where they were in 2000. Below is a graph of the S&P 500 Index EPS, including estimates for 2007 and 2008.



**The earnings shown through 2006 are past results. 2007 and 2008 data shown are estimated earnings based on Standard & Poor's independent research and analysis. Past performance does not guarantee future results. Source: Standard & Poor's**

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The average value-to-price (V/P) ratio for the more than 2,000 stocks in the ICON domestic database was 1.09 as of May 31, 2007, suggesting the broad market is priced about 9% below our estimate of fair value. Stock prices are higher than they used to be, but, in our opinion, they are still not too high because intrinsic value has grown as companies' earnings have grown. Of the 147 industries classified by S&P, only 41 (28%) have V/P ratios below 1.00, meaning almost three-fourths of the industries are still underpriced, according to our methodology.

We have found over time that valuation has been a good guide. It is best used with about a one-year time horizon. The ICON equation has no ability to predict short-term market fluctuation. While we have been invested based on valuation, there have been short-term market dips. During those declines, investors have been concerned about oil, hurricanes, terrorism, housing activity, consumer spending, inflation and China's currency, among other items.

While these scenarios have been unpleasant to ride through, our valuation suggested the market would ultimately move higher. Looking back, we believe we were correct to remain invested during the volatility.

#### **Bond Market Commentary**

The yield on the 10-year government bond moved higher in May, but is still within the trading range seen the last five years. Our valuation readings remain quite neutral. We do not fear a sharp rise in rates, but we do not expect a sharp bond rally either.

#### **International Market Commentary**

The average V/P ratio for the more than 2,300 stocks in the ICON international database was 1.12 as of May 31, 2007. Asia (1.19) now appears more attractive to us than Europe (1.04) from a valuation perspective. Most European country indexes like the S&P 500 Index are approaching the highs seen earlier this decade.

We see the valuation picture internationally being the same as in the U.S.: earnings have grown so international stocks, on average, are not overpriced in our opinion. Japan stands out as being very different, however. In Japan, the Nikkei-225 Stock Index is still about 12% below its level of early 2000. It is interesting to note that, unlike recent index levels in the U.S., the Nikkei is not near its historic high. The record high in Japan was set in the late 1980s. We think bargains are plentiful in Asia, especially in the Industrials sector.

#### **Summary**

New records for stock market indexes do not mean much to us. Corporate earnings form the foundation for valuation, so we see prosperity at the company level. Based on our valuation, we have found plenty of stocks on sale in the U.S. and overseas. Naturally, there may be declines and setbacks associated with troubling news events, but our valuation model dictates that the ICON Portfolios remain invested at this time.

Prepared by ICON's Investment Committee.

***The performance quoted represents past performance. Past performance does not guarantee future results. Current performance may be higher or lower than the performance data quoted. Investing in securities involves inherent risks, including the risk that you can lose the value of your investment. Investment return and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost. Opinions and forecasts regarding industries, companies, countries, and/or themes, and portfolio composition and holdings, 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.***

*An investment in a sector fund may involve greater risk and volatility than a diversified fund. 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.*

*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.*

*The unmanaged Standard & Poor's (S&P) 500 Index is a market value-weighted index of large-cap common stocks considered representative of the broad market. The unmanaged 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 unmanaged 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 Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. The Nikkei-225 Stock Average is an unmanaged price-weighted average of top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange. Total return figures for the unmanaged indexes do include the reinvestment of dividends and capital gain distributions but do not reflect deductions for commissions, management fees, and expenses. Individuals cannot invest directly in an index.*

*To analyze intrinsic value, the ICON valuation methodology relies on the integrity of publicly released financial statements. ICON's value-to-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.*

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Sources: Bloomberg, FactSet Research Systems, Inc., Standard & Poor's

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