



PORTFOLIO UPDATE

May 2008

Domestic Market Commentary

In our April commentary, we noted that the domestic stock market had moved higher off its low on March 10, 2008. That upward move continued during April. We also pointed out in last month's update that the industry and sector leadership during the late-March surge seemed consistent with our readings as the Financials, Consumer Discretionary, and Industrials sectors led. In April, those sectors continued to participate in the advance.

Last month, we stated that we did not know for certain whether the market was experiencing the rally we had been expecting, but that many characteristics were present that our research indicates are typical of sustainable rallies. Another month later, we have more confidence that the recent market advance can continue, absent a major negative event.

During the first two months of 2008, there was an investing theme in place that negatively affected stocks. Speculators saw rising oil prices and a falling dollar relative to a few major currencies. Fearing inflation, those investors bought commodities. The two most prominent commodities, gold and silver, rallied, and many other commodities participated as well. Last month, we noted that gold dropped sharply in late March from more than \$1,000 per ounce to around \$900. Gold dropped even further in April to about \$870 an ounce. As the best-known commodity, we find gold's price decline encouraging for the stock market, perhaps signaling an end to the commodity price spiral.

Current Industry Leadership

The Standard & Poor's Composite 1500 Index, a proxy for the broad market, advanced 9.4% from March 10 through April 30, 2008. Amid concerns about a potential recession and mortgage defaults, the industry leadership may surprise a casual observer. A few of the top 20 performing industry indexes have more than doubled the broad market move in that same period, including thrifts & mortgage finance, steel, home furnishings, marine, automobile manufacturers, consumer finance and railroads. Near the bottom of the industry performance list and posting negative returns over that period are managed health care, gold, tobacco, health care distributors, and soft drinks. The laggards are either commodity-related or part of a recession-proof, non-cyclical theme.

The nature of the leading and lagging industries would seem to convey the message that investors do not think the economy will be as bad six to nine months from now as they had feared in March. As the market has done many times before, it might even be anticipating an economic recovery.

Disguised Market Rally

If this is a sustainable rally, it is disguised. Since March 10, more than 45% of the trading days have posted negative returns, as measured by the S&P 1500 Index. That is fairly normal for rallies; they never go straight up, as there are always doubters and sellers along the way. During this recent advance, most of the gains have been concentrated in just a few trading days. In our experience, this too is typical of rallies, as they normally consist of unpredictable spurts which account for most of the overall gain. Negative days, daily spurts, sensible industry leadership, attractive bargains, and a breakdown in gold, in our view, all paint a favorable picture for stocks.

Bond Market Commentary

The yield on the 10-year government bond moved higher in April. It appears that the low yields in mid-March were the result of investors having a dismal view of the economy. The move up in yields, in our opinion, simply reflects that investors do not think the economy will be as bad as they had feared in March.

We find the best value to be in long-term government bonds and in mid- and lower-quality bonds. As our system requires the combination of value and strength, the bargain segments of bonds do not have the strength yet to attract us. We continue to tilt toward short- and mid-term government notes and higher quality issues. While we do not expect a significant increase in interest rates, it looks a bit early to tilt toward long-term and lower-grade issues.

International Market Commentary

Many country markets have participated in the late March and April advance, although they hit their recent low later. March 17, 2008 seems to be a common low among many countries.

While starting later, many major markets such as Japan, Hong Kong, Great Britain, France, and Germany have outpaced the U.S. market over late March and April with a similar sector theme. The overall value-to-price ratio for international stocks in the ICON database as of April 30, 2008 was 1.23, dictating an invested posture.

Summary

While our valuation calculations suggest that long-term investors should remain invested and while bargain stocks are usually present at the beginning of rallies, value alone is not enough to kick off a rally, in our experience. Six to seven weeks off the market low, we find many other supportive and encouraging conditions for a sustainable rally. For domestic and international markets, our valuation measurements suggest stock prices could be even higher by year-end, with leadership from Financials and the economically sensitive industries.

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.

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Sources: Bloomberg Finance, L.P., FactSet Research Systems, Inc.

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