



ICON

PORTFOLIO UPDATE

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THE MONEY SUPPLY

The monetarist theory of economics believes that when the money supply grows it will stimulate the economy with an approximately six-to-nine month lag, and when the money supply contracts it will slow the economy by a similar lag. One way to measure the money supply is M1, which is defined as currency plus demand deposits (checking accounts). When a bank makes a loan, a demand deposit is created, which by definition creates money. In August of 2007 the Federal Reserve eased monetary policy and injected reserves into the banking system. Such easing normally promotes banks to make loans which creates M1 and stimulates the economy. Despite the continued monetary easing through late 2007 and early 2008, banks did not increase their lending, partly through caution but mostly because the illiquid mortgage-backed securities they held hurt their capital ratios.

The primary goal of the bailout bill is for the U.S. Treasury to buy those mortgage-backed securities. The banks would have recorded a loss on those, as they should, but would immediately have cash and greatly improved capital ratios, which means they could make loans again. Through loans, M1 could grow and stimulate the economy. In separate action, the Federal Reserve announced that it will pump an additional \$630 billion into the global financial system through what it calls currency swaps with foreign central banks.

Whenever monetary easing is undertaken with the goal of promoting bank lending, increasing M1 growth, and ultimately stimulating the economy, there are skeptics and doubters. One reason for that doubt is that M1 growth, unlike a fiscal stimulus, is vague, broad, and not directed at a particular industry, income level, or segment of the economy. M1 growth is, nevertheless, a powerful stimulant that simply requires time to take effect. Somewhat encouraging is that M1, from its low 24 weeks ago, has increased by 8.6% as of September 22, 2008. Just to illustrate the pace, but not to offer a projection, that growth is at a very robust annual pace of 20% (also as of September 22, 2008).

If the banks expand their lending and M1 continues to grow, the economy can still deteriorate as there is a normal delay before the impact of M1 growth kicks in. If M1 can continue growing from current levels, normal timing and lag would, in our opinion, suggest a low in the economy some time next spring and eventually a recovery.

WHAT ABOUT STOCKS?

We believe stocks have a reputation of leading the economy by six to nine months at major turning points, investors perhaps picking up on changes in M1 and believing that those changes will affect the economy later. Money managers cannot sit on the fence, but must take a stance. At ICON, we are behaving as though a bailout bill and Federal actions will be successful. We are investing based on the belief that banks will lend, M1 will grow, and the economy will hit bottom some time next spring. In that scenario, stocks are probably now forming a bottom and will be higher six to nine months out. Under our theory, it would be normal for stocks to rally well before any signs of economic improvement.

LONG-TERM PERSPECTIVE

It is encouraging to see many presumed healthy institutions taking a long-term perspective and buying and/or investing in companies they consider to be cheap. Warren Buffet and Berkshire Hathaway invested \$3 billion into a chemical company in July, \$5 billion into Goldman Sachs in September and \$3 billion into General Electric, Inc. in early October. JPMorgan Chase acquired the banking division of Washington Mutual and raised \$10 billion of equity on one day. Citigroup, Inc. bought the bank division of Wachovia Corp. for \$2.16 billion. Bank of America bought Merrill Lynch for \$50 billion in stock. Lehman Brothers sold its money manager firm, Neuberger Berman, to Bain Capital Partners, LLC and Hellman & Friedman, LLC for \$2.15 billion. Mitsubishi UFJ Financial Group, Inc., Japan's largest financial group and the world's second largest bank, invested \$9 billion into Morgan Stanley for a 21% interest.

We expect these purchases and investments will be rewarded. We believe in the monetarist view of the economy and that an increase in the money supply can be a powerful boost to the economy with a six-to-nine month lag. We hope that the negotiations behind closed doors get back to basics and that is to get banks lending again. The bailout bill was the easiest way, but not the only way to accom-



plish that objective. We are riding through this turbulence with the belief that panic selling usually prices in a scenario much worse than could possibly happen. We think that is the case this time.

While this exact financial and economic situation is unprecedented, there have been times in the past when the stock market has focused on Congress and reacted to day-to-day developments. Viewed historically, we believe any reaction to daily events was not productive. It was more prudent to look out a year and make investment decisions with a long-term horizon.

SUMMARY

It has been a frustrating year. The stock market has drifted lower – not because it was good at anticipating events, but because it simply reacted to events. At each new low, it was our view that the market overreacted. We now believe a bottom is forming. As of the morning of September 30, 2008, the ICON value/price ratios for domestic and international stocks were both 1.36. In addition, there are various measures of market breadth that consider volume, advancing and declining issues, and new highs and lows. We interpret the behavior of these measures as typical of market bottoms. While we are not economists, ICON subscribes to the monetarist view, and expects that M1 growth can stimulate the economy. Although the issue has been clouded in Congress by other agendas, we see the key to M1 growth as pretty straightforward – simply get banks lending again.

Past performance does not guarantee future results.

Investing in securities involves risks, including the risk that you can lose the value of your investment.

Opinions and forecasts regarding sectors, 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, industry, or sector.

M1 is one measure of the money supply that includes all coins, currency held by the public, traveler's checks, checking account balances, NOW accounts, automatic transfer service accounts, and balances in credit unions.

ICON's value-to-price ratio is a ratio of the intrinsic value, as calculated using ICON's proprietary valuation methodology, of a broad range of domestic and international securities within ICON's system as compared to the current market price of those securities. To analyze intrinsic value, the ICON valuation methodology relies on the integrity of publicly released financial statements.

ICON's value-based investing model is an analytical, quantitative approach to investing that employs various factors, including projected earnings growth estimates, in an effort to determine whether securities are over- or underpriced relative to ICON's estimates of their intrinsic value. ICON's value approach involves forward-looking statements and assumptions based on judgments and projections that are not guarantees of future results. Value investing involves risks and uncertainties and does not guarantee better performance or lower costs than other investment methodologies.

If your financial situation or investment objectives have changed, please notify your financial professional or ICON immediately.

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