Danger Zone: ICON Energy Fund (ICEAX, ICEEX, ICENX)

Check out this week's Danger Zone interview with Chuck Jaffe of Money Life and MarketWatch.com.

Year-to-date the Energy sector is down nearly 9% while the S&P 500 is up 5%. This performance makes the Energy sector the worst performing sector in 2017, as measured by the State Street Select Sector SPDRs. Investors searching for value may now be drawn to the Energy sector, but buyer beware. Without analysis of the holdings in each mutual fund, one may be buying a fund filled with bad stocks.

ICON Energy Fund (ICEAX, ICEEX, ICENX) is one of the Energy funds investors should avoid as all three share classes earn our Very Dangerous rating. In fact, this fund is one of the most expensive Energy funds with over $100 million in assets. All told, its high fees and overvalued holdings land it in the Danger Zone this week.

Look Past Expense Ratios: This Fund Is More Expensive Than It Seems

Per Figure 1, ICON Energy Fund's expense ratios (particularly ICEAX) understate the true costs of investing in this fund. With total annual costs (TAC) of 4.38%, ICEAX is more expensive than 98% of the 7000+ mutual funds under coverage.

For comparison, the average TAC of the 116 Energy mutual funds under coverage is 2.65% and the weighted average is lower at 2.08%. The benchmark, State Street Energy Select Sector SPDR (XLE), charges total annual costs of just 0.15%.

Figure 1: ICON Energy Fund's Understated Costs

Ticker	Total Annual Costs (TAC)	Expense Ratio	Difference Between TAC & Expense Ratio
ICEAX	4.38%	1.73%	**2.65%**
ICEEX	3.02%	2.49%	**0.53%**
ICENX	1.82%	1.44%	**0.38%**

Sources: New Constructs, LLC and company filings

To justify its higher fees, the ICON Energy Fund must outperform XLE by the following over three years:

1. ICEAX must outperform by 4.22% annually.
2. ICEEX must outperform by 2.86% annually.
3. ICENX must outperform by 1.66% annually.

An in-depth analysis of ICEAX's TAC is on page 2 here.

Worst yet, ICON Energy Fund investors are paying these fees for significantly overvalued stocks, as we'll show below.

ICEAX's Allocation Makes Outperformance Unlikely

The only justification for mutual funds to have higher fees than ETFs is "active" management that leads to out-performance. In Figure 2, the details behind our Predictive Overall Fund Rating for ICEAX show the managers of the fund have not selected good stocks in terms of earnings quality and valuation.

Figure 2: ICON Energy Fund (ICEAX) Rating Breakdown

ICON Funds: ICON Energy Fund (ICEAX) Closing Price: $12.64 (Mar 16, 2017)

Overall Rating	Portfolio Management						Total Annual Costs
	Quality of Earnings		Valuation			Asset Allocation	
	Econ vs Reported EPS	ROIC	FCF Yield	Price to EBV	GAP	Cash %	
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	>50	>20%	>4%
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50	8%<20%	2%<4%
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20	2.5%<8%	1%<2%
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10	1%<2.5%	0.5%<1%
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	0<3	<1%	<0.5%
Actual Values							
ICEAX	**Neutral EE**	**1%**	**-1%**	**6.0**	**58 yrs**	**3%**	**4.4%**
Benchmark Values							
S&P 500 (SPY)	Positive EE	17%	1%	2.1	17 yrs	-	0.1%
Russell 2000 (IWM)	Positive EE	6%	-0%	2.9	27 yrs	-	0.2%

Sources: New Constructs, LLC and company filings

The findings from our discounted cash flow valuation of the fund reveal the market implied growth appreciation period (GAP) is 17 years for the S&P 500 - compared to 58 years for ICEAX.

This high valuation of the fund's holdings is more troublesome considering the return on invested capital (ROIC) of the S&P is 17% compared to 1% for the ICON Energy Fund. In other words, despite being less profitable, the market expects the stocks held by ICEAX to grow economic earnings for 41 years longer than those held by the S&P 500.

Furthermore, the price-to-economic book value (PEBV) ratio for the S&P 500, which includes some of the world's most successful companies, is 2.1. The PEBV ratio for ICEAX is 6.0. This ratio means that the market expects the profits for the S&P 500 to increase 210% from their current levels versus 600% for ICEAX.

Lastly, seven of the fund's top 10 holdings receive our Dangerous-or-worse rating and make up 38% of its portfolio. At the end of the day, the high profit growth expectations baked into the valuations of stocks held by ICON Energy Fund lowers the upside potential and increases risks of a blow up.

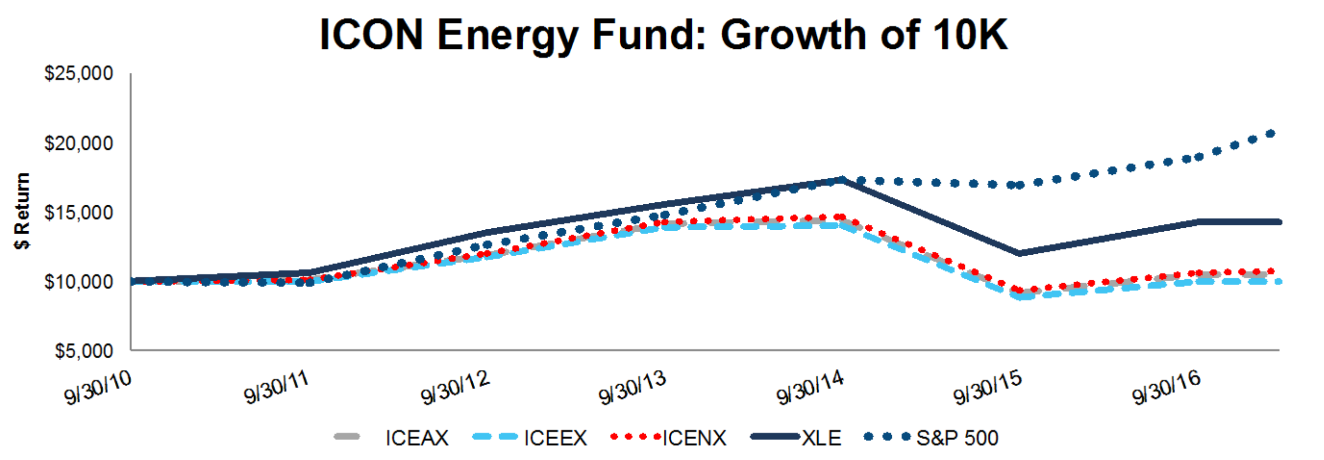
Historical Underperformance Should Continue

Year-to-date, ICEAX is down 8% while XLE is down almost 9%. This slight outperformance is more an outlier rather than what should be expected from ICEAX going forward. In fact, over the last year, ICEAX and XLE are both up 12%. Given that 81% of assets are allocated to stocks with Dangerous-or-worse ratings, long-term outperformance seems unlikely.

Investors looking to buy ICEAX must not only expect the significant profit growth highlighted earlier, but also ignore the fund's history of underperformance. Over the past five years, ICEAX is down 37%, ICEEX is down 38%, and ICENX is down 36%. Meanwhile, XLE is down just 4% over the same time. Figure 3 shows the growth of 10k since ICEAX's inception in 2010.

We think it overly optimistic to invest in the belief that these mutual funds will ever outperform their much cheaper ETF benchmark over significant time frames given the issues outlined above.

Figure 3: ICON Energy Fund Vs. XLE: Growth of 10K



Sources: New Constructs, LLC and company filings.

The Importance of Holdings Based Fund Analysis

The analysis above shows that investors might want to withdraw most or all of the $335 million in the ICON Energy Fund and put the money into better investments. There are no funds that get an Attractive-or-better rating within the Energy sector. If you must have exposure to this sector, you should buy a basket of Attractive-or-better rated stocks and avoid paying undeserved fund fees.

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Disclosure: David Trainer, Kyle Guske II, and Kyle Martone receive no compensation to write about any specific stock, style, or theme.

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Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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