HELM INVESTMENT MANAGEMENT

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A trendy bit of Wall Street jargon revolves around the Greek letters alpha and beta. As often happens with jargon, there's confusion over what the terms mean.

Why should you care? Because alpha and beta relate to risk, and the amount and kinds of risks you take or avoid in investing make a great deal of difference to how your portfolio does in the long run.

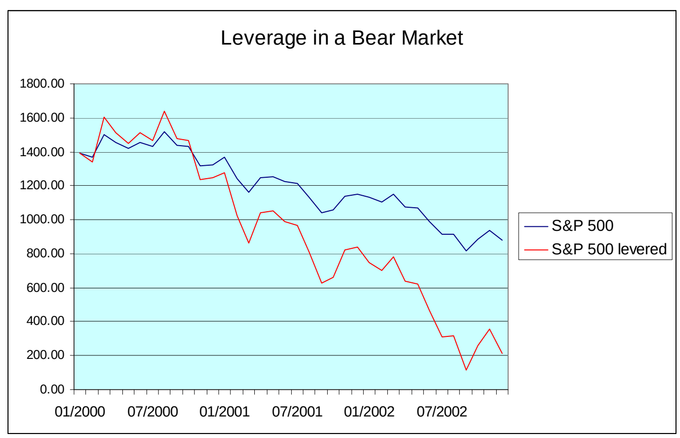
Beta: At the risk of doing this in reverse, let's start with beta. In finance math, beta refers to each stock's relative volatility to the rest of the market. By definition, the overall stock market has a beta of 1.0. Another way of thinking of this is that beta represents the overall market risk.

Alpha: This refers to a security's specific risk, which may have nothing to do with overall market risks. The collapse a few years ago of K mart had little to do with what the market was doing or the fate of retailing. Investors smart enough to spot that K mart was losing to Wal-Mart and Target could (if they moved before other investors) capture alpha by selling K mart short to bet on a drop in its stock.

One of the things about beta, or volatility, risk is that over the long term you will be paid according to the amount of this risk that you can bear. Treasury Bills are as safe as you can get, and pay 4.75%. Stocks are much more volatile and scary. Remember October, 1987 or the 3-year bear market at the start of this decade? But stocks' long-term return is about 10%. The T-bill rate may sound good but it will be fully eaten by inflation over the long term. You need to take some risk if you want your money to grow in real terms.

Finding alpha is by definition a zero-sum game. If you were smart enough to sell shares in K mart before it tanked, someone had to be foolish enough to buy them. Across the overall market, alpha must sum up to zero. You'll hear quite a bit about positive alphas but no asset managers are going to crow about how they are trailing the market.

Investors can crank up beta through borrowing money. Here's how it works: You can buy the index straight up or you can use your margin account or other borrowings to buy twice as much S&P 500 with the same money down. If the market goes up, you'll get twice the return minus borrowing costs. Your S&P 500 portfolio beta will be 2.0 if half is bought with borrowed money. If the market goes down, though, your portfolio will sink more than twice as fast.



Which brings us to our final point on alpha: Plenty of hedge funds and others claim to generate positive alpha when most of their returns come from taking big risks, including borrowing money to buy stocks. That's great in a bull market but disastrous in a bear market.

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