HELM
INVESTMENT MANAGEMENT

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Financial markets are prone to fads and "movements." Today, these seem to center around gold and emerging markets. In the early 1970s, "Nifty 50" stocks were all the rage. "Nifty" referred to the "National Index for Fifty" – something akin to the very large company Dow Jones averages.

Those 50 stocks were touted as "one decision" holdings. At the time, the companies had been stable and profitable over a long period of time. It's interesting to look at them now since so many have failed and others simply did not stand up and beat the S&P 500. Chesebrough-Pond's (Pond's Cold Cream) was one of those. It now is a very small part of Unilever. The declines of Eastman Kodak and Polaroid are well known. Sears and Kmart merged and today are a shadow of the top retailers they used to be. Some of the "Nifty 50" companies, such as American Express and Johnson and Johnson have thrived but the success stories are few. Was this an anomaly?

Not really. The times are always changing albeit slowly. In 1900, railroads made up 63% of the total market value of the top 100 companies on the NYSE. By 1950 that had declined to 4%, dropping to 0.2% by 2000. There is no such thing as effective "passive" investing. Equity values and market sector values are constantly changing. All portfolios need rebalancing and change on a regular basis. That includes, for example, increasing the percentage of foreign equities as the U.S. share of the global market declines.

The real challenge of equity investing is buying at a "reasonable price." That is also a mutable concept. The very short term may be a bet on apocalypse or microeconomic "pops" but essentially investors are buying long-term future earnings. American companies are currently quite profitable. Even so, the S&P 500 is selling at a little over 12 times earnings. Inverting that ratio indicates that stocks have a very reasonable current earnings yield of 8%.

The fixed income market is also constantly changing based on yield and various risks. Fixed income portfolios need regular adjustment. Currently the U.S. debt curve is so flat that a 5-year Treasury is yielding 1.51% and a 10-year 2.93%. Investing in U.S. fixed income with maturities longer than 5 years seems like a recipe for failure. If future inflation drives yields on a 10-year Treasury bond to 5.74% (historically a reasonable level), that 10-year bond will lose up to 50% of its value. By the same token, present levels of debt are often scary. Greece and Ireland are not the only bad risks out there. Countries with developed markets account for 62% of the world's GDP and owe 90% of the world's sovereign debt. In other words, the emerging nations produce 38% of the world's GDP and owe 10% of the sovereign debt. Solid emerging nations' debt could be a better fixed income opportunity.

Change and adjustment also apply to hybrids like preferred stocks. Spreads on preferred stocks are normally around two percentage points over 10-year Treasury yields. Currently the spread is four percentage points. This is a change that offers another alternative to the usual fixed income investments. The point about change, though, is the same. All investment portfolios require constant analysis, comparison, and tuning. If you think you can invest and forget about it, like the "Nifty 50," forget about that!

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