HELM INVESTMENT MANAGEMENT

Thomas Jay Barrett, Jr.
Jay Allan McCormick

2013 HELM CORE STRATEGY

Some of the most worrisome issues that sprang from the financial panic of 2008 ebbed during 2012, helping to fuel a strong year for global equity returns. Europe no longer appears on the brink of dissolution. The U.S. government finally took its first steps toward addressing deficit and debt problems. The financial markets remain far from normal, though, as most nations in the developed world continue to work their way through what many economists dub the "great de-leveraging" that will gradually reduce huge debts taken on during the 1990s and 2000s.

The actions that large countries and their central banks are taking to address both high debt and the related Age of Austerity resemble giant science experiments: The UK has tightened its belt to the point of risking a triple recession at the same time that a newly elected government in Japan is launching a record-sized stimulus in hopes of escaping 20 years of recessions and slow growth. The U.S. seems divided between the two paths. As a result, financial markets sometimes seem turned on their heads. The bond market, typically thought of as a "safe" asset class, is now a treacherous place to invest, at least when it comes to long-term and intermediate-term U.S. bonds. Stocks, much feared by investors after the horrible declines of 2008, frequently sport dividend yields significantly higher than the yields of 10-year Treasury bond and valuation ratios comfortably below long-term averages.

While the current situation may seem strange and unsettling, Helm Investment is bullish about the outlook for equities in the long term. As investment strategist Richard Bernstein recently noted on CNBC, periods of calm and certainty actually are the most dangerous times for investors; it's those who find the courage to invest in unsettling times who will find the greatest investment rewards.

Helm continues to steer by two key principles:

- Diversify among investment assets, both to reduce overall portfolio volatility and to capture returns in unusual places.
- Formulate a firm investment plan and protocols for rebalancing investments based on each client's goals, willingness and ability to take on risks.

Helm's recommended mix of assets for 2013 is 50% equity indexes, 25% income-oriented equities, and 25% fixed income securities. This 50/25/25 mix of assets creates a stream of income to help carry investors through times when equity returns are weak while allowing for participation in stock market rallies. Descriptions and details about the assets classes follow.

Equities

In equities, Helm strives to gain higher returns while keeping overall risk close to that of the Standard & Poor's 500 (S&P 500) stock index. Helm is an active manager typically using Exchange Traded Funds (ETFs) of stock market indexes to execute the core investment strategy. Within the equity allocation, Helm recommends a mix of:

- 26% of equities in U.S. large cap stocks (indexes of stocks with a high market value, such as the S&P 500)
- 24% in U.S. mid cap
- 10% in U.S. small cap
- 40% in international holdings

Within that structure, Helm leans toward value stocks – typically defined by low price-to-book value (that is, a low stock price relative to the value of the company's assets) and low price-earnings ratios. Studies have shown that over the long term, value stocks will outperform growth stocks – though that can vary in any given year.

Helm also diversifies among the various classes of international equity ETFs, giving more weight to Pacific Rim markets than to Europe. Economic forecasts published by ***The Economist*** magazine for regional growth around the world show very slow growth for Western Europe and Japan and strong growth for much of Asia and Latin America. The categories of overseas indexes we invest in include:

- Two emerging markets indexes, one featuring large firms such as Taiwan Semiconductor and Russia's LUKOIL, the other featuring mid-cap and small-cap emerging market companies that typically service consumers in those countries.
- MSCI EAFE (Europe, Australasia and the Far East), with emphasis on firms that pay dividends. These are large companies, such as Vodaphone and Nestle.
- MSCI Pacific ex-Japan, which has an emphasis on Australia and Hong Kong.
- The S&P Latin America 40 index, which includes Brazil's Petroleo Brasileiro, Mexico's America Movil and Wal-Mart de Mexico.
- Holdings in the MSCI Canada index.

Elements of the equity investment mix may change as part of Helm's active management. Significant changes in index price-valuation ratios or the appearance of superior indexes in certain areas can lead to investment shifts.

Income-oriented equities

For investors interested in increasing yield in their investment portfolios, Helm also follows a number of companies that pay relatively high dividends or distributions. These include international blue chip stocks with strong balance sheets, preferred stocks, utility stocks, and Master Limited Partnership (MLP) units of companies that run natural gas and oil pipelines in the U.S. Real Estate Investment Trusts (REITs) also are under consideration for inclusion in this group of income equities, though few of them currently provide a strong enough combination of yield and growth to warrant purchase at this time. This group of income-oriented equities likely will have lower price volatility than the equity index portfolio, more than making up for the category's slightly lower long-term expected returns.

Fixed income

Helm invests in a number of different forms of fixed income securities for its clients to provide significant diversification from equities for each investment portfolio. Fixed income securities are essentially "loans" to companies rather than an ownership stake.

After a prolonged period that saw interest rates decline in the U.S. until the yield on a 10-year Treasury note hit a low of 1.5% last year, Helm believes interest rates are likely to edge higher from the 1.9% level at the start of 2013, and possibly rise significantly in 2014 or 2015. Bond prices move in the opposite direction of yields, so an increase in interest rates will lead to falling prices for bonds – especially long-term bonds with maturities of 10-years or longer.

Helm invests in

- U.S. Treasuries
- Agencies (such as the bonds of the Federal Home Loan Bank)
- Publicly traded Bank Certificates of Deposit (CDs)
- Corporate bonds
- Money Market funds
- TIPS (Treasury Inflation-Protected Securities)
- Municipal bonds
- Overseas fixed income in the form of bond indexes.

We buy different maturities to create a maturity ladder, so a part of the fixed income portfolio is being reinvested through the year, a partial protection against inflation. Each of these fixed income securities has different levels of risk related to how much prices fluctuate as interest rates change and to the chances that the bond issuer might stop paying interest or default on the bond. This portion of a portfolio is designed to be a financial safety net and help clients hold to the overall investment plan even in times of great market volatility. We typically hold maturity of fixed income to five years and less.

Helm emphasizes a cautious municipal bond strategy, including buying general obligation bonds from taxing districts with high ratings. We also buy revenue bonds that cover their interest from dependable revenue sources, such as critical services including water and power.

As always, our 2013 Helm core strategy is our current best projection for the next 12 months. Each of our client's portfolios is customized to that particular client and may deviate significantly from our 2013 Helm core strategy.

January 2013