HELM INVESTMENT MANAGEMENT

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A bond is the promise of a sum certain paid at a certain time. When the stock market is rocky, the assurance of getting your money back with interest sounds good! Think of fixed income as principal plus interest, as "buying money."

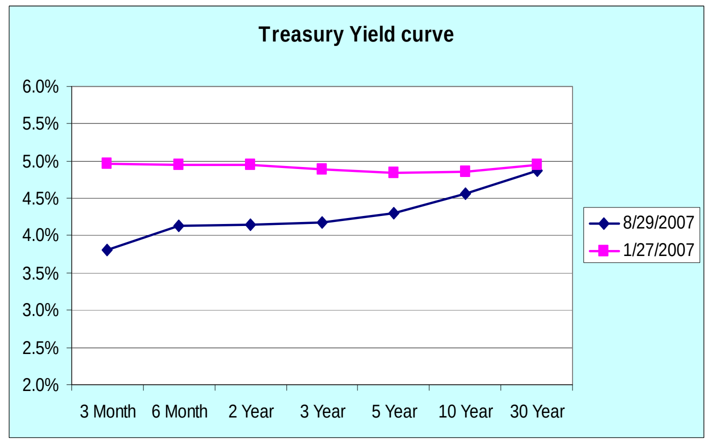
Bonds, especially U.S. Treasury bonds, bank CDs that carry FDIC insurance, municipals and government agencies, are favorite safe harbor investments when the markets are choppy. As a fixed income holder, you are acting as a bank, lending money and expecting both repayment of the loan and regular interest payments.

How safe a bond is and how much you will be repaid depend on many factors:

- **Time:** Normally, the longer until a bond matures, the more interest you are paid to hold it.
- **Credit quality:** The U.S. government is as safe as a greenback dollar. But corporations can go out of business, as do some municipalities. Although bond holders are more likely to get some money than stockholders in this situation, holders often take pennies on the dollar if an issuer goes under.
- **Changes in interest rates:** When market interest rates go higher, that pushes the price on existing bonds lower. If you hold a bond until maturity, you still get the total face value of the bond, so your value is not hurt. But if you are holding a long-term bond that has a relatively low interest rate, its potential selling price will drop to reflect the availability of better-paying bonds elsewhere.

For much of 2006 and part of 2007, the yield curve for governments and other "super-safe" bonds was inverted and flat. Bond holders were not paid anything extra for holding longer-term bonds.

Looking at the recent change in the yield curve below, you can see that investors have poured money into short-term governments (usually called notes or bills), a reaction to the sudden increase in volatility in stocks. There has been little change in interest rates being paid on longer-term governments and agencies.



But the behavior of bonds and yield curves in the government, municipal and corporate markets has differed: Yields on corporates and munis have risen (and prices dropped) as investors have decided they want to be paid more for the risk that one of these entities might renege on its borrowings.

For people who hold a portfolio of assets (stocks, bonds, real estate, master limited partnerships, etc.), bonds can be a strong diversifying tool. When stocks rise, bonds hold back portfolio gains. When stocks plunge, bonds typically hold or improve in value, blunting the effect of the equities drop. Every asset allocation plan needs some "belts and suspenders" investments such as fixed income in addition to faster growing assets such as stocks!

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