HELM
INVESTMENT
MANAGEMENT

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2022 HELM CORE STRATEGY

After a rugged start to 2022 brought on by various problems relating to inflation, Russia and China, stocks are on the verge of a bear market. In addition, bonds have had their roughest start to a year in a long time and that market has shown that fixed income also carries risks. Here are some thoughts about how best to deploy investment capital from here for the rest of this year.

The biggest change facing investors is a dramatic shift from a world of low-cost loans and steady and low interest rates to a world of rising interest rates and expensive loans. The Federal Reserve has vowed to fight the sharp rise in inflation to over 8% year over year. The primary weapon it will use is a steady stream of hikes in the overnight borrowing cost for banks. So far, the Fed has put through two rate hikes and stated it will continue to hike short term rates by a half percent for at least the next two meetings, and then hike by either a half percent or a quarter percent each meeting after that until short-term rates are in a range of 2.5% to 3.0%.

In last year's Strategy letter, Helm warned that bond markets would have a rough time and they did – the total return on the Bloomberg aggregate bond index in 2021 was a negative 1.5%. This year already has been worse – far worse, with that same index dropping more than 10% in four months. The silver lining for bond investors: sometime later this year or early next year, bond yields may finally be higher than the expected inflation rate, making fixed income a much more attractive investment once again. Until then, Helm recommends keeping the average maturity of fixed income holdings very short – no more than an average of one to two years.

After posting very good gains in 2021, stocks were reaching high valuation levels by the end of the year. Now that most stock indexes have posted double digit drops, many stocks and some stock indexes again look to be good investments for long-term investors. For the shorter term, expect stock market volatility while the economy and the markets digest the steady diet of Fed rate hikes, the Ukrainian war and continued disruption in some overseas countries from COVID.

Helm continues to abide by two longstanding key principles:

- Diversify among individual securities, market sectors, countries and regions to reduce overall portfolio volatility and to capture returns in unusual places.

- Create investment plans and protocols for regular rebalancing of investments based on each client's goals, and continuously assess each client's willingness and ability to take on financial market risks including volatility.

Helm's recommended mix of assets for 2022 changes slightly from last year: 45% equity indexes, 30% income securities, and 25% fixed income securities. This 45/30/25 mix (compared with last year's 45/25/30 suggested allocation) of assets creates a balance of more stable, income-producing assets intended to help maintain investor returns through times when equity market returns are weak, while allowing for participation in what could continue to be an uptrend for equity markets later this year. This year, that core allocation plan may shift back in favor of holding more fixed income if the yields on bonds get high enough fast enough and there are signs that inflation is beginning to ease. Descriptions and details about the asset classes follow.

Equity Indexes (45%)

In the equity index component of investment portfolios, Helm strives to gain higher returns while keeping overall risk close to that of the MSCI All Countries World stock index. Helm is an active manager employing Exchange Traded Funds (ETFs) of stock market indexes to execute the equity index component of the core investment strategy. Within the baseline 45% equity index allocation, Helm recommends a mix of:

- 28% in U.S. large cap stocks (indexes of stocks with a high market value, such as the S&P 500)
- 19% in U.S. mid cap stocks
- 8% in U.S. small cap stocks
- 45% in international holdings

Helm uses mostly market-capitalization-weighted indexes for the equity index holdings, plus some holdings in indexes designed to reduce market volatility or add yield to the portfolio.

International equity index holdings are diversified among a basket of international equity ETFs. The categories of international equity indexes we invest in include:

- MSCI EAFE (Europe, Australasia and the Far East). These are large multi-national companies, such as Toyota, Nestle and HSBC. Helm's index model uses two EAFE indexes – one of them entirely in local currency and a smaller holding in an EAFE index that hedges against currency fluctuations.
- Two different emerging markets indexes, the first featuring large firms such as Samsung and Taiwan Semiconductor from South Korea, Alibaba and Baidu from China, Infosys from India and Latin American firms such as Mexico's America Movil. The other emerging market index that we incorporate excludes companies from China – a reflection of Helm's worries about economic growth in China due to its crack-down on successful businesses and zero Covid policies leading to widespread lockdowns.

- An international small cap index, which holds smaller market capitalization companies, primarily in the EAFE countries and Canada.

Elements of the equity index investment mix may change throughout the year as part of Helm's active management.

Income securities (30%)

In the income securities component of investment portfolios, Helm invests in securities intended to generate income above the rate of inflation or above-market returns. These securities include U.S. and international large and mid-capitalization stocks with strong balance sheets relative to other companies in their industry. For 2022, this includes equities in such industries as health care, industrials and the more profitable parts of the technology industry. We also invest from time to time in preferred stocks.

Helm also works with clients to determine if holding preferred stocks and high-dividend-paying common stocks fulfills an income need. Remember, stock yields today often are higher than fixed income yields even though they are taxed at a lower rate. Drug maker Pfizer, for example, offers a dividend yield of more than 3.3%, has a strong balance sheet and dependable cash flow with which it can pay those dividends. And many companies raise their dividends regularly, which means the income could increase over time as compared to the safer but flat and very low income currently offered by short-term bonds and CDs.

Fixed income (25%)

Helm invests partly in individual fixed income securities and indexes of fixed income securities for its clients. Fixed income securities are essentially "loans" to companies rather than an ownership stake. These securities are intended to provide significant diversification from equities and act as a financial safety net and help clients to preserve capital even in times of market volatility.

The primary benchmark for U.S. fixed income securities is the yield on the 10-year U.S. Treasury note.

Since the start of this year, both short-term and long-term rates have been rising. At the moment, the yield of a 10-year Treasury has risen to over 3.0%. The Federal Reserve has indicated that investors should expect steady rate increases through this year.

Fixed income investments include:

- U.S. Treasuries
- Publicly traded Bank Certificates of Deposit (CDs)
- Highly rated corporate bonds
- Money Market funds and short-term fixed income indexes
- Tax-free municipal bonds
- Agencies (such as the bonds of the Federal Home Loan Bank)

Helm prefers shorter-term maturities in the fixed income component of client portfolios. That is to say, fixed income portfolios will generally hold securities that mature in four years or less, with an average maturity of roughly two or three years. We buy different maturities to create a maturity ladder, so bonds are maturing on a regular basis and ready for reinvestment or spending needs.

Conclusion:

As always, the 2022 Helm core strategy is our current best projection for the coming year. Every year comes with surprises, which is one of the reasons we emphasize holding a portfolio of diverse assets. Each of our client's portfolios is customized to that particular client's unique circumstances and may deviate significantly from our core strategy. Please call us with any questions or concerns you might have after reviewing our 2022 Helm Core Strategy.