Jay Allan McCormick
Peter John Quinn

HELM INVESTMENT MANAGEMENT

2023 HELM CORE STRATEGY

A little more than a year ago, the financial markets were abuzz with clever-sounding acronyms such as FOMO (fear of missing out) and YOLO (you only live once). Now, after a year of bear markets not just for stocks but also for bonds, things have simplified to plain old R (risk) and F (fear) or HODL (hold on for dear life) if you still own assets tied to FOMO and YOLO.

The carnage the markets piled up last year is impressive:

- Favorite high-tech stocks were hammered hard – Alphabet (Google) dropped 39.1% during the year, Meta (Facebook) fell 64.2%, Amazon lost 49.6%, and even stalwart Apple was down 26.4%, noticeably worse than the overall market.
- Cryptocurrencies were crushed. Many cryptocurrencies were rendered worthless, and the largest, most widely traded Bitcoin dropped 64.3% during the year.
- The bond market, thought by many to always be a safe haven, tore into the portfolios of investors too focused on yields rather than on risk. The Bloomberg aggregate bond index (the leading bond benchmark) dropped 13.0% on a total return basis in 2022. Investors who held longer-maturity bonds saw the face value of their investment drop even more – for instance, the 20-year U.S. Treasury posted a staggering 31.1% decline.

The main catalysts for all of this are fast-rising interest rates designed to fight inflation and the return of geopolitical instability, particularly Russia's ongoing invasion of Ukraine. This has grown to include the wider economic warfare going on between Russia and the Allied countries. In addition, the global economy has been affected by some chaotic and sudden moves in mainland China regarding its super-strict zero-Covid policy and then the abrupt ending of that policy.

The result of all of these changes? It's time for a reset of expectations for long-term returns from investments – for the better. The long-term outlook for both stocks and bonds has improved significantly compared with a year ago. The look-ahead PE for the S&P 500 index (that is, the ratio of the price of the Standard & Poor's 500 index of large U.S. companies vs. the expected earnings in the coming year) is now a PE ratio of roughly 16.5, about equal to its long-term average. A year ago, that PE ratio was more than 21. In the short term, that doesn't mean much because in the short term, anything can happen in the financial markets (both good and bad). But it is reasonable shorthand for setting expectations for long-term stock market returns. That's to say it's reasonable to expect average annual stock market returns, including dividends, of 9% to 11% over the next 10 years.

For fixed income, the quickest way to know what your long-term return will be is to know what interest income yield you are being offered when you buy the bond (or bank Certificate of Deposit). Once you lock in an interest rate on a bond, you become exposed to further changes in interest rates. If rates rise above the coupon on your bond, the price on your bond will fall (or the reverse if interest rates fall). You still receive 100% of your initial investment at maturity but could experience significant volatility up to that point. The Federal Reserve Board's decision to raise short-term interest rates may be bad news for people who need loans to buy cars or houses, but it's great news for people looking to get a good return on their savings. Investors were offered a yield of only about 1.25% on a five-year Treasury bond about 18 months ago. Today, they get almost 4% on that bond. Several bonds now offer yields of close to 5%.

The importance of diversification became especially clear last year. After three years of U.S. large cap stocks being at or near the top of the performance rankings of various asset classes, which made buying only the S&P 500 seem like a no-brainer, U.S. large caps were the third *worst* major asset class in 2022. So it will be no surprise that Helm continues to hold to 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 2023 changes slightly from last year: 40% equity indexes, 30% income securities, and 30% fixed income securities. This 40/30/30 mix (compared with last year's 45/30/25 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 could continue to be volatile. This recommendation very well could change later this year depending on developments in the outlook for inflation and interest rates. Descriptions and details about the asset classes follow.

Equity Indexes (40%)

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 40% 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. The U.S. dividend growth index holding (ticker: DGRO), for example, performed much better than the regular S&P 500 index in 2022.

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). This index includes large multi-national companies, such as Toyota, Nestle and Total.
- Two different MSCI emerging markets indexes, the first featuring large firms such as Samsung and Taiwan Semiconductor from South Korea, Tencent and Alibaba 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 ongoing worries about instability in China.
- 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 2023, this includes equities in such industries as health care, industrials and financial services, especially insurance companies.

Helm also works with clients to determine if holding high-dividend-paying common stocks fulfills an income need. Remember, stock dividends are taxed at a lower rate than ordinary income from bonds. Plus, many companies have a history of regularly raising their dividends.

Fixed income (30%)

Helm invests in both 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. Despite one of the worst-ever years for fixed income, the benchmark still beat the S&P 500 by 5 percentage points.

The primary benchmark for U.S. fixed income securities is the yield on the 10-year U.S. Treasury note. Since the start of last 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 3.7%.

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

Conclusion:

As always, the 2023 Helm core strategy is our 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. Instead of the world of TINA (there is no alternative) often mentioned a couple of years ago with regard to high-flying tech stocks, we are currently living in a world with TARA (there are reasonable alternatives). Each client portfolio 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 2023 Helm Core Strategy.