HELM INVESTMENT MANAGEMENT

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2019 HELM CORE STRATEGY

Roller coaster. That's how equity markets felt through most of last year, as sharp rallies were followed by even sharper corrections and a record high set in September was followed by a fourth-quarter drop that left the U.S. stock market just shy of touching bear market territory (a 20% decline).

Ready for another ride? This year kicked off with a solid stock rally of more than 10% and a drop in market volatility (especially when compared with this time last year). However, trade wars, actual wars, political disputes and an aging economic expansion all lead us to expect another year of unsettling stock market volatility.

Much depends on how the trade dispute between the U.S. and China develops during the year. Increased trade tensions and higher tariffs will weigh on many U.S. companies as well as perpetuate the slowdown in growth being seen currently in China. Although the U.S. has relatively little direct trade with China, the effect on global economic growth already has been observed in economic reports. If the trade disputes widen to Europe (the administration has floated the idea of 25% tariffs on European cars), that could lead to a slump in U.S. and European earnings and kick stocks firmly into a bear market. So far, though, the actual tariffs levied have been relatively modest compared with those threatened at the start of various negotiations. Some stock market investors are betting that when the stock market drops enough, the U.S. administration will back off its toughest trade demands. It remains to be seen if that represents a real pattern, or an illusion, which could lead to another sudden fall in stock prices.

In addition, for European stocks especially, the terms of the United Kingdom's exit from the European common market (Brexit) will determine the outlook not only for the UK but also for continental Europe for the coming two or three years. A hard Brexit would reflect a failure by negotiators to settle key trade issues and likely would hit UK industry hard in the short term. It also would hurt European firms that trade heavily with the UK – which is to say almost all of them. Even U.S. multinationals have started to issue warnings in their earnings reports that a hard Brexit would hurt earnings. However, at this point an extension (possibly for more than a year) of Brexit negotiations appears more likely than an abrupt and damaging withdrawal, which gives us hope for at least modest 2019 gains in European equities.

Compared to developed market equities, emerging market equities continue to present a relatively good value. Growth in China is slowing down, as it has been for several years. But overall economic growth in most of Asia continues to be strong. In addition, Chinese stocks will become a larger part of the MSCI emerging markets index later this year, a change that better represents the world's economic reality but also one that could in the short term lead to higher volatility for that important index.

Overall, chances for a normal market correction (a drop of 10% or a bit more) continue to be high. On the other hand, a bear market (a 20% or greater drop) is long overdue based on typical bull market longevity. The U.S. stock bull market hits its tenth anniversary March 9. Despite fears about some sort of pullback, equities continue to offer the highest long-term expected returns. If equity markets do stumble into a bear market, Helm expects any decline to be relatively short-lived and the rebound to be quick, similar to the V-shaped drop and recovery that stock markets have experienced from October through February. That's because the underlying economic and business fundamentals continue to be sound in most parts of the world.

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 2019 shifts slightly to 45% equity indexes, 20% income securities, and 35% fixed income securities. This 45/20/35 mix 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. 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:

- 32% in U.S. large cap stocks (indexes of stocks with a high market value, such as the S&P 500)
- 20% in U.S. mid cap stocks
- 8% in U.S. small cap stocks
- 40% in international holdings

Helm uses both fundamentals-weighted stock indexes (which weight stocks based on company-specific fundamentals such as earnings, dividends and book value) and market-capitalization-weighted indexes for the equity index holdings.

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.
- An emerging markets index, featuring large firms such as South Korea's Samsung, Taiwan Semiconductor, Alibaba and Baidu from China, Infosys from India and Latin American firms such as Mexico's America Movil.
- 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 (20%)

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 2019, Helm is emphasizing value stocks, including equities in such industries as health care, technology and financial services. We also invest from time to time in preferred stocks and gas pipeline companies, which often come in the form of Master Limited Partnerships (MLPs)

For its domestic market equities, 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-to-earnings ratios. That said, we from time to time also consider growth stocks (those with generally higher price-to-earnings ratios) if there are visible and achievable growth prospects for those stocks.

Fixed income (35%)

Helm invests 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. This yield edged higher during much of 2018, but slipped in the final three months of the year to finish at 2.69%. Helm believes interest rates are likely to fluctuate but change relatively little during 2019, as the Federal Reserve backs away from its program of steadily raising short-term rates due to worries about slowing growth in the U.S. Helm expects the Fed to nudge rates higher only if the economy (including the world economy) shows firmer signs of strength or if inflation begins to kick up, which we do not expect in the near-term.

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, both domestic and foreign
- Tax-free municipal bonds
- Agencies (such as the bonds of the Federal Home Loan Bank)

Helm prefers intermediate and 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 six 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 and ready for reinvestment or spending needs.

Conclusion:

As always, the 2019 Helm core strategy is our current best projection for the coming year. Each of our client's portfolios is customized to that particular client's unique circumstances and may deviate significantly from our 2019 core strategy. Please call us with any questions or concerns you might have after reviewing our 2019 Helm Core Strategy.