HELM
INVESTMENT MANAGEMENT

Thomas Jay Barrett, Jr.
Jay Allan McCormick

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"How do we stop this bleeding?" That was the opening line of a conversation I had with one of our clients after the market closed last Friday. We had a chat which was a "stay the course" homily. She agreed her asset allocation was fifty percent fixed income, which has kept its value, and that all the cash flows from interest and dividends were still occurring. She agreed that her 50% asset allocation to equities had unrecognized losses and the equity account had a long timeframe before retirement distributions would occur. Meanwhile, unanticipated expenses could be met by selling fixed income.

The conversation involved investment management points that she agreed with including "this is a good time to buy … fundamentals are still strong … stay with your financial plan ... asset allocation and diversification works … "stop losses" don't work because there is no ascertainable returning point … the market always bounces back … don't look … etc., etc."

We talked about inefficient markets, irrational fear, the housing boom and sub-prime mortgages, "liar loans," increasingly complex security wrappers, snowball effects and massive de-leveraging. We talked about historical perspective and how 1931 was way worse but was followed by 1932's 54 percent gain. She thanked me for reassuring her and for our firm's "steady hand at the wheel" philosophy. After we rang off, I summarized my notes: "Discussed investing new money in income-producing hybrids such as preferred stocks, convertible bonds and Master Limited Partnerships before we get back into the equity markets."

On reflection, I wish I had answered her by discussing the week that just occurred.

"This is value we're talking about, not bleeding. Hedge funds are dropping like flies just as day traders died with the bear market eight years ago. On Monday, the market rose 900+ points on Treasury Secretary Paulson's announcement that the government would inject up to $250 billion directly into banks. On Tuesday, the market gave up most of that gain when Fed Chairman Bernanke said exports will slow and the labor, housing and credit markets will take time to recover. On Wednesday, the market gave up the rest of Monday's gain when the news reported the nation's factories cut output 2.8% and other data reflected the economy was rapidly downshifting. The market gained 4% on Thursday when oil fell below $70 for the first time in 14 months and the Swiss government announced a bailout of its largest banks. Friday, the market dropped again after President Bush asked Americans to be patient but reported housing starts fell to their lowest point in 17 years. Still, the stock market ended Friday with its best week since 2003. The only rational thing that I heard or saw all week was Warren Buffett saying "buy American stocks."
http://www.nytimes.com/2008/10/17/opinion/17buffett.html?_r=1&ref=opinion&oref=slogin

So what do we make of it all? Simply this: Hold to your financial plan and focus on keeping your asset allocation between equities and fixed income. In the long run, not this week, maybe not in the next year, the markets will come back and the economy will recover. That advice is neither bullish nor Polly Annish; It is a reasoned approach for an irrational time.

1600 Broadway, Suite 930 • Denver, Colorado 80202 • Phone: (303) 861-4835 • Fax: (303) 813-1561
E-mail: tbarrett@helminvest.com or jmccormick@helminvest.com