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Dear Hawk100 Member.

Your Hawk100 wealth advisor extends his warmest midsummer regards to you and yours.

One way Hawk100 offers wealth advisory services to align your wealth with your life is to enlighten members with financial education using everyday terms. We hope to add to your Wealth Alignment Report while pursuing that educational endeavor. We also hope to bring clarity to the risk associated with the U.S. debt limit. We then challenge a few basic financial assumptions:
(1) currency is a store of value;
(2) US Treasuries offer a risk free investment; and
(3) diversification improves investment results.

Is the dollar store a real value?

Ben Franklin once said, "If you would know the value of money, go try to borrow some; for he that goes a-borrowing goes a-sorrowing." Since 1928, Franklin's image graces the $100 Federal Reserve Note. With the Federal Reserve stuck in easy-money-mode, Ben Bernanke may soon print Franklin's note in place of Washington's bill.

A true store of value holds relatively constant purchase power. In 1928, America's national debt was $17 billion, and national income (GDP) was $104 billion. The Dow Jones Industrial Average was 239. Gasoline retailed for $0.21 a gallon, and the Consumer Price Index (CPI) was 17.1. In hardly a lifetime by June 30, 2011, those amounts had increased by factors of 872, 145, 52, 17, and 13, respectively. The dollar has not held a constant purchase power.

The US's vaulted ceiling.

"America's net indebtedness is a perfectly affordable 65% of GDP, and throughout the past three years of recession and tepid recovery investors have been more than happy to go on lending to the federal government." – The Economist, July 9

We challenge The Economist view. First in fact, the US Treasury reports $14,825,308,000,000 gross external debt as of March 31, and the US Bureau of Economic Analysis reports $15,018,100,000,000 annualized first quarter GDP. By our Hawk eye, America's indebtedness looks dangerously closer to 98% than 65% of GDP. Second, investors have been happy to lend to the US because they assume US Treasuries are risk free notes. This assumption is fracturing under the weight of gathering global evidence to the contrary.

To explain the US debt limit situation, imagine you are the US Treasury. So you could relate to the scale of the Treasury, we divided each Treasury amount by 10,000,000.

Suppose you earn a stable, gross annual salary of $216,000 which has grown 1% on average annually for the last decade. Supporting your current lifestyle, you spend $350,000 per year. You have spent more than your annual income each of the last ten years and 6 out of every 7 years since you began keeping such records. You expect to lose $165,000 this year, and you foresee no end to your string of losses. Your income statement is seriously weak.

Despite this, suppose your bank approved you for a loan of no more than $1,430,000. You have already borrowed $1,483,000 ($53,000 more than the approved amount). Plus, you have not told your bank about commitments you made to pay another group more than $10,000,000. In all, your balance sheet is uglier than your income statement.

To compound matters, you present your bank with financials in disarray so it takes a doctor of economics to comprehend your financial position, and you tell your bank and neighbors not to worry since your customers make $1,500,000 per year in aggregate and that you can make counterfeit money if you run out of cash. Your bank accepts your story and loans you money at 3.1% interest rate for ten years (the June 30 yield to maturity on 10-year Treasuries).

That scenario does not seem to be absent of risk, so we rather doubt the Treasury is a risk-free investment and would prefer to heed the words of Ben Franklin than to buy Treasuries at 3.1%.

Diversify interest rate risk.

If the US Treasury is not risk free, as S&P and Moody's join Hawk100 in questioning, then either the true risk free yield is less than Treasury rates imply, Treasury rates will rise to reflect relative credit risk, or both. Since the interconnected global economic policy in recent years has expanded the money supply to rare heights, Hawk100 believes the likely scenario is higher Treasury rates, regardless of what Obama and Congress do to an arbitrary debt ceiling.

Unfortunately, rising rates among Treasury indices ripples trouble throughout the financial system. Every fundamental valuation model assumes a risk-free rate to determine the value of assets and

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derivatives. When risk-free rates rise, every asset is likely to fall.

This problem prevailed in September 2008 when core assumptions fractured and every asset fell. Yet the condition was short-lived and diversification resumed accreting long-run value.

At last check, your investment horizon extends well beyond one month, so we continue to recommend an efficiently diversified portfolio strategy for you.

Hawk100 recommends cash equivalents (i.e., money market funds) which preserve your liquid portfolio value and provide current yield comparable with so-called risk-free rates of return.

Hawk100 seeks to maximize your income yield relative to duration (risk) by focusing on four factors:

(1) duration, (2) term structure,
(3) credit risk, and (4) inflation.

Duration, the primary descriptor of risk, estimates the probable loss of value if interest rates rise. Hawk100 recommends duration of 3.5 meaning if market yields would rise 1%, your portfolio value could decline approximately 3.5%. Importantly, your relationship of income to risk remains above the comparative Barclays Aggregate Bond Index.

Hawk100 seeks to maximize your expected investment return relative to volatility of investment returns, suitably aligned with your objectives and constraints, with efficient diversification. Applying fundamental valuation techniques, Hawk100 relies on metrics to evaluate the relationship of price to expected earnings, accounting for growth, for your portfolio as a whole and compared with the S&P 500 Index.

Hawk100 recommends investments in alternative assets to enhance portfolio diversification.

Thank you for your Hawk100 membership.

Warmest regards,

Hawk100
Richard Clemens, CFA
President

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