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HawkLetter First Quarter 2012

Dear Hawk100 Member.

Your Hawk100 wealth advisor is pleased to share your Wealth Alignment Report for the first quarter of 2012. To offer you a changed perspective from our usual quarterly letter, I have assembled recent quotes from a variety of investment industry leaders to frame the quarter. Then, I color the picture with my own interpretation of their comments.

The Buffett Rule. I start with a man of great notoriety who has garnered inordinate attention lately for having his name attached to the latest ill-conceived idea out of Washington. In his February 17 annual letter to Berkshire Hathaway shareholders, Warren Buffett describes three assets generally: currency-based assets (bonds), sterile assets (gold), and productive assets (stocks). Of bonds and gold, Mr. Buffett says:

> "Our first two categories enjoy maximum popularity at peaks of fear: Terror over economic collapse drives individuals to currency-based assets, most particularly U.S. obligations, and fear of currency collapse fosters movement to sterile assets such as gold. We heard "cash is king" in late 2008, just when cash should have been deployed rather than held. Similarly, we heard "cash is trash" in the early 1980s just when fixed-dollar investments were at their most attractive level in memory. On those occasions, investors who required a supportive crowd paid dearly for that comfort."

Buffett asserts that sterile assets fail to preserve the purchase power of wealth over long investment horizons. The chart at left compares the London a.m. Gold Fix price (green) versus the US Consumer Price Index (red). Generally, gold has lagged inflation supporting Buffett. Gold exceeded CPI only after last fall's rush to $1891. Even after an 8% rebound this quarter, gold remains 12% below that September high.

That's Gross. A Buffett follower with his own reputation running the largest mutual fund, according to Morningstar, is William Gross, of PIMCO Total Return Fund's $252 billion assets. In March Gross comments that government largess makes it time to play investment defense.

> "… the primary way to coin money over the past 30 years has been to use money to make money. Although the price of it started in 1981 at a rather exorbitantly high yield of 15% for long-term Treasuries, 20% for the prime, and real interest rates at an almost unbelievable 7-8%, the gradual decline of yields over the past three decades has allowed P/E ratios, real estate prices and bond fund NAVs to expand on a seemingly endless virtuous time-line. Books such as "Stocks for the Long Run" … captured the public's imagination … Yet … accelerating asset prices [were due to the] Federal Reserve and their global counterparts who were printing money, lowering yields and bringing forward a false sense of monetary wealth that was dependent on perpetual motion."

To illustrate Gross's point, we look at the real yield (nominal interest less inflation) of the 10-year US Treasury for the thirty year period Gross describes. Indeed, real yields have consistently fallen. Falling yields correspond with rising prices; therefore, this trend has lifted bond prices for thirty years. That has delighted investors particularly when the cost of living has been relatively manageable as depicted by CPI. However, yields have now fallen to negative territory.

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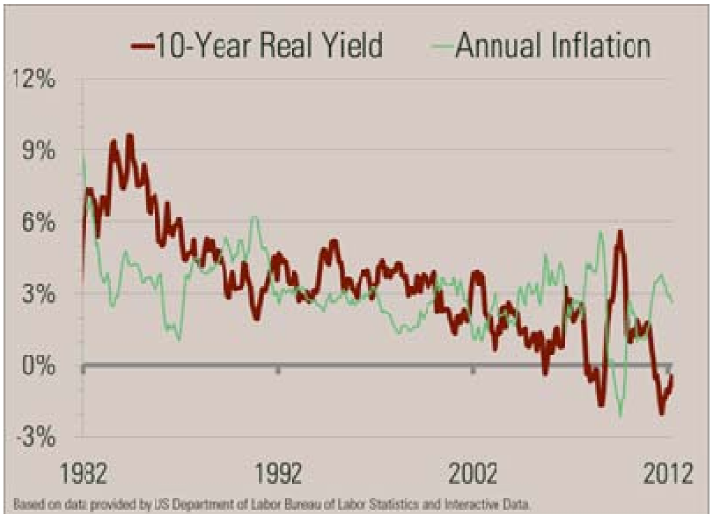

Based on data provided by US Department of Labor Bureau of Labor Statistics and Interactive Data.

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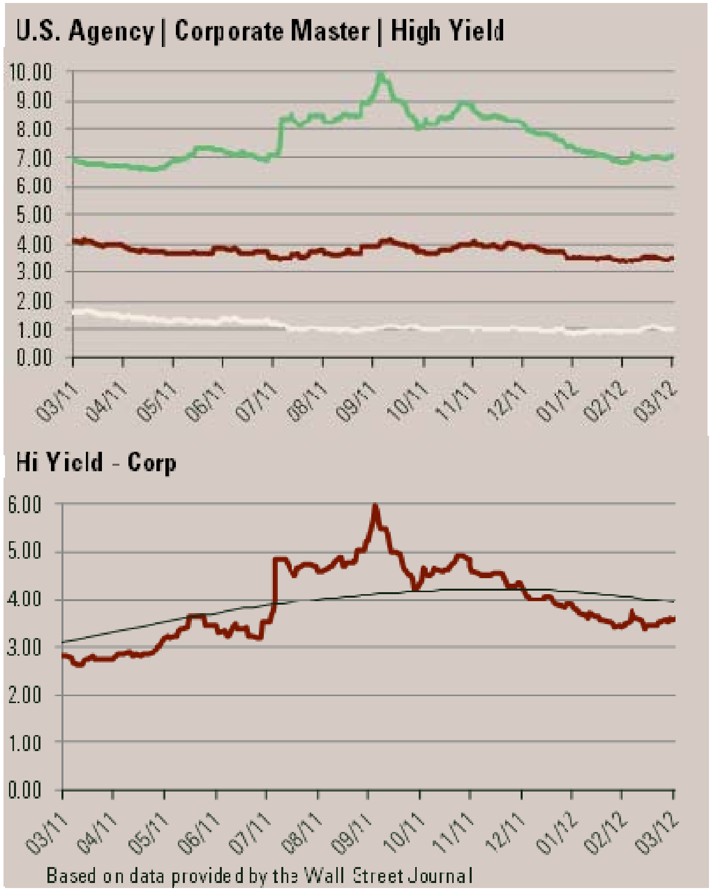
Negative real yields are rational only if one expects persistent deflation (i.e., negative inflation). The US had deflation only once in 58 years—during a brief slip in 2009. Then, deflation rarely persists as the second chart's moving average shows. In effect, Treasury investors now demand negative returns for the dimmest of prospective deflation.

Gross conveys concern that central banks have extended monetary risk deep into the economy and financial markets. Central banks have taken on leverage to mask deleveraging taking place in wider audiences since 2007. Hawk100 has written on numerous occasions that extraordinary measures taken by the Federal Reserve to expand the monetary base have exposed financial markets to increased risks of inflation … not deflation.

Taking Nothing for Granted. In January, James Grant, author of *Grant's Interest Rate Observer*, expressed trouble with negative real yields is US Treasuries and near-zero yields among other government bonds – even those based in currency under scrutiny for its very existence which is the current citation against the Euro. In his famously funny way, Grant observes … nothing:

> "Nothing percent is the topic under review. The opportunities to earn nothing in securities denominated in unredeemable scrip, i.e., today's paper money, is one point of focus. The theory of investments returning nothing is another. The contribution[s] of central banks to nothingness … are others … *Grant's* is bearish on nothing, bullish on more than nothing. "

Hawk100 agrees to be "bearish on nothing" and searches for "more than nothing" for which to be bullish. One area of focus has been corporate (rather than Treasury) debt. The accompanying charts present two favorable conditions for the last 12 months. The first illustrates that corporate and high yield debts provide more than nothing in terms of investment income when compared to US Agency debts. The second illustrates that yield spreads—the additional income earned for taking additional credit risk—are still high and are trending lower. Just as falling yields increase prices, falling yield spreads increase relative prices. In any environment, these conditions are cause to be bullish. Hawk100 agrees with Grant's observation.



Taking stock. I thought it would be useful to quickly discuss the quarter for stock markets. The S&P 500 returned 12.6% during the quarter. Index fundamentals, as tracked by Morningstar, are somewhat more challenged from the beginning of the year. The index now measures a price to earnings ratio of 15.1, also up 12% during the quarter. The index dividend yield has fallen nearly as much to 1.9%. Earnings are expected to grow at 10.4%. Hawk100 will continue to hunt for opportunities and manage the nest of your portfolio in such a way that aligns your wealth with your life.

I deeply and humbly appreciate your Hawk100 membership.

Warmest regards,

Hawk100
Richard Clemens, CFA
President

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