



EQUITY VALUES ATTRACTIVE RISK REMAINS CONCERN

Professional investment management involves a systematic portfolio management process that considers valuation, opportunity (returns), and risk. While implementing portfolio management decisions each day, Hawk Investment Management, LLC performs a monthly overall assessment of market valuation, opportunity and internal risk. Based on analysis through September, the equity market presents attractive valuation and opportunity although downside risk has increased.

Valuation is founded on the concept of time value of money. Projected future cash flows are discounted for their representative risk to define intrinsic value for the market. Future cash flows—measured as operating flows available to shareholders after maintaining the firm's capital and debt requirements—are projected into the future based on projected growth rates. The discount factor is applied based on forecasts for interest rates and risk. On a macro-economic basis, Hawk combines these factors to derive a model price for the overall market.

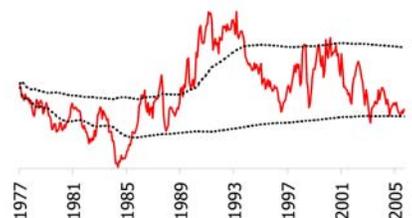


Comparing Hawk's model price to actual market capitalization—value of amounts invested—shows the market undervalued presently and has been since July 2002. Since then, S&P 500 returns have outpaced its long-run average return by 2% annually.

Opportunity recognizes that market performance does not precisely follow model valuation. Myriad factors affect sentiment and conditions fluctuate continuously. To gauge their effect, Hawk compares the valuation multiple for free cash flow (current market capitalization divided by current free cash flow) with a measure for the sustainable rate of macroeconomic growth.

At times, the market is willing to pay more for future opportunity (growth) than at other times. The Free Cash Flow Valuation graph shows the market undervaluing growth and perhaps rebounding from its historical support level.

Free Cash Flow Valuation



Risk to the investment process is difficult to define. Of course, Hawk assesses investor risk on an individual basis and has incorporated that assessment in each investment policy statement. However, risk is internally prevalent in market conditions also. Each month, BARRA publishes indices of exposures to various types of risk. For example, what is the risk that the value of stocks changes subject to changing dividend yields?

Hawk derives a composite of the BARRA risk factors to evaluate the risk internal to market conditions. Increases in the composite risk coincide with higher risk of rising market values. Consequently, declining composite risk indicates higher risk of declining market values. The hypothetical zero line in the chart, indicates neither upward nor downward tendency in stock price. The chart depicts recently increased downward pressure on stock values.

Composite Risk



Overall Hawk recently increased equity targets slightly to reflect strength of valuation and opportunity in the market while we prudently remain cautious in the face of internal market risk.



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