HAWK 100

HAWK Talon

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Sow seeds in your portfolio.

June 30 marked the final airing of Glenn Beck's television program. The provocative host often contemplated doomsday scenarios and promoted gold and food.

Beck frequently encouraged viewers to "prepare for the worst, hope for the best." Hawk100 concurs with Beck's prudent advice and recommends wealth strategies that preserve and protect portfolios (i.e., prepare for the worst) and provide and promote portfolios (i.e., hope for the best).

Efficiently diversifying portfolios has been effective to prepare for the worst. Buying alternative assets such as commodities typically reduce portfolio volatility. To that end, Hawk100 frequently recommends placing alternative assets in portfolios. Their short-term price gyrations often run counter to traditional stocks and bonds.

Commodity prices dropped in June to reverse part of the extraordinary rise in prices from a year ago (see chart at right). We believe the selloff in commodities reflects risks consistent with a scenario of deflation and a double dip-recession.

Preparing for that "worst" scenario, we recommend holding seeds in portfolios—food-based commodities to diversify risk. Holding seeds would be of particular benefit if core financial assumptions falter in an extremely deep double dip.

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One Bad Apple in the Bunch.

Food inflation may have upset the apple cart, although prices seem to have settled. iPath Dow Jones—UBS Agriculture Index ETN. Source: Fidelity.

One rotten apple can spoil the bunch. When the apple is a nation and the bunch is an interconnected continent, the adage has far reaching consequences, at least as far as Greece and the European Union.

The European debt crisis leapt to the fore during 2009 when Greece cracked under the weight of public entitlements which it had extended for decades to appease populist demands. Greece and countries throughout Europe are discovering insufficient financial means to meet those demands.

In the early stages of the European debt crisis, some viewed Greece as a relatively isolated, economically weak country succumbing to the strains of the 2007—09 financial crisis. We disagreed then and now (see "Greece is nothing." HawkTalon, April 2010).

Deterioration of the Euro-zone's debt situation has expanded well beyond Greece. Ireland, Portugal, Spain, and now quite likely Italy have fallen into similar straights. We can easily surmise that perhaps a few countries yet to be named could turn for the worse (Belgium carries debt of 97% of its GDP and Britain, Poland and France each forecast sizeable 2011 budget deficits).

The pending collapse of Italy has brought Europe to a "perilous new phase—with the single currency itself now at risk," says The Economist. According to The Economist, Italy's sovereign debt market is the largest in Europe and among the world's largest. Italy's public debt translates to roughly $2.6 trillion. Too big to fail may become too big to cover under the already thinly stretched veil of the Euro-zone.

To illustrate, the European Central Bank (ECB) reports assets of €32 trillion as of May. That sounds adequate, until you consider that the ECB counts €10 trillion due from the troubled countries among its assets. Ponder that those (mostly financial) asset values may prove faulty when they became most needed to prop up failing nations. AIG's holdings of Lehman debt in September 2008 provides a perfect example to risks and challenges to the veracity of asset values.

The IMF is stretched, too. It reports total resources of $880 billion as of April. Further, the IMF funds its balance sheet from funding quotas from each member country. 2011 quotas call for 18% of its funding from the U.S. and a combined 8% from the troubled Euro-zone countries. The U.S. as a significant source of funds could come into doubt as it deals with its own fiscal and monetary troubles. U.S. political pressure is rising to constrain foreign aid while the it shores up domestic finances.

The IMF represents a bunch of economic apples. It forms what may be the most globally interconnected financial system and depends entirely on economic policy cooperation. IMF acting managing director, John Lipsky recently spoke to The American Academy in Berlin. "Increasing interconnectedness—especially of trade and finance—has produced the strongest sustained period of global growth in world history, lifting hundreds of millions of people out of poverty … Every case of a nation rising out of poverty involved a period of strong and sustained growth … In other words, embracing globalization led to better economic outcomes … Global policy cooperation … in the wake of the 2008-09 global financial crisis … (whereby) countries acted together to tackle the crisis. And as a result, the downturn lasted only three quarters—from mid-2008 through the first quarter of 2009—a remarkable result considering the severity of the threat."

We agree with Mr. Lipsky's statement in favor of free trade, global markets, and capitalism. Though, Mr. Lipsky is blind to see the crisis as fully abated. That outcome depends on a bunch of work ahead … and tossing a few bad apples rather than risk ruining the bunch. The hard life lesson that success often comes by failing is a subject for another day.

By Richard Clemens, CFA, President

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