July 7, 2011

Name
Address
City

Dear Client,

Stock market returns in the just completed quarter started out strong, suffered a bout of weakness and recovered in the last week to finish basically unchanged for the period, while bond holdings improved a bit. The portfolios I manage, with one exception, finished in positive territory.

I want to discuss Greece, as the developments there triggered some portfolio changes that justify explanation. Greece is likely to default, that is not paying interest and/or principle due on bonds issued by the government, or restructure at some point in the next three to five years. While Greece is not such a large economic force that its failure alone would cause market distress, the concern is that the other fringe European countries, Ireland, Portugal and maybe Spain and Italy, might have trouble reissuing debt, which could cause major problems. Furthermore, European banks have vast exposure to government bonds issued by the above list of countries, and might not survive without significant support, but from whom? Finally, money market funds in the U.S. are large holders of bank debt, including the European kind.

Therefore, I have used larger amounts of idle cash in client accounts to purchase U.S. Government Treasury Bills. Known as T-bills, these securities are traded on a next day basis with no cost and a tiny spread, with payoff in less than a year, and can be sold at any time to raise spendable or investable funds. For smaller cash balances I have switched to a money market fund that holds only U.S. Government Treasury securities. While trying to predict a credit crisis is likely a fool’s game and that is not what I am doing here, these moves fall under the heading of “just being prudent.”

Of course, this gives rise to the question, “what if the U.S. Government defaults?” First off, the powers that be would have to choose to default, as Treasury debt is denominated in dollars and the Treasury can create dollars. European governments do not have this option. In the unlikely event that Congress chooses to default as part of the current debt ceiling drama, it would probably be temporary, and if disruptive, where better to put one’s funds? It is also interesting to note that the 1971 repudiation of the gold standard by Richard M. Nixon might be viewed today as a technical default, so we’ve been there before, and the world didn’t come to an end.

Regarding the long-term unsustainable imbalances that result from government spending in excess of revenue collection, adjustments will have to be made, and the sooner the better. The problems are fixable and the citizens of the U.S. appear to be waking up to the idea that action is required. Remember, it was only a decade ago that the United States Government was running a surplus. I continue to believe that cash equivalents, large U.S. stocks that are not economically sensitive and residential real estate owned directly will provide the best returns over the next three to five years, but there are certain to be bumps along the way.

Enclosed please find your portfolio report through the second quarter. Also, the regulatory authorities that oversee Investment Advisors have mandated changes to the Form ADV Part 2. I have made those modifications and am required to deliver the updated brochure to all my current and potential clients. Enclosed please find a copy of Form ADV Part 2 A & B covering New West Investment Management, Inc. and myself, as well as my current client contract, all for your review. Please contact me with questions or comments about this information.

Best regards,

Peter V. Hedberg