Sather Financial Group, Inc.
Registered Investment Advisor

Second Quarter 1999 Commentary

The Federal Reserve gave the financial markets a strong shot in the arm on the last trading day of the quarter. The Fed was expected to increase short-term interest rates by .25% and they did. However, a potential change in plans occurred when it was announced that the Federal Reserve was changing their future interest rate bias towards a neutral position. The markets had anticipated at least another rate hike, possibly as soon as August. The markets reacted favorably late in the day sending the Dow Jones Industrial Average, the NASDAQ and the S&P 500 up an average of 1.5% for the day. June 30th was the fourth heaviest trading volume day in New York Stock Exchange history.

The second quarter experienced a shift in market leadership as cyclical stocks regained strength. This strength allowed companies like Alcoa and International Paper to outperform Microsoft. Sectors such as paper, machinery, aluminum, and transportation equipment all increased more than 25% for the quarter. As a result of this strong performance by cyclical stocks, the Dow Jones Industrial Average increased 12.1% for the quarter while the less cyclical intensive S&P 500 increased 6.7% and the NASDAQ rose 7.4%. Small stocks, as measured by the Russell 2000, also rebounded with a 15.1% increase. Surprisingly, Internet stocks actually dropped a bit.

Some of the momentum garnered by cyclical stocks was due to improvements in the world economy. Asian markets continued to solidify and Brazil weathered the devaluation of its currency. This combination propelled the average Pacific/Asia mutual fund to a 37.8% increase while emerging markets mutual funds increased better than 24% for the quarter.

It has been quite a while since the Nifty 50 of the S&P 500 has not led the markets higher. The fact that cyclical, mid-cap, small-cap and foreign stocks have started showing their abilities again is very good for the markets. Hopefully, we will not rely on such a narrow grouping of securities to provide our gains and the broader stock markets will further their gains.

Typically, falling interest rates spur the stock market higher. The second quarter, and most of 1999, was an exception. In November of 1998 the yield on the 30-year U.S. Treasury Bond hit a low of 4.75%. During the second quarter long-term interest rates increased substantially (more than ½%) with the yield on the 30 year bond hitting 6.25% (an 18 month high) and finishing at 5.96% for the quarter. As a result of increasing interest rates the Lehman Brothers Long Bond index lost 6.6% for the quarter while the municipal bond index lost 4.7%.

Financial markets are now concerned with the implications of rising interest rates. The stock market has been quite strong the past four years due in part to declining interest rates and inflation. Now however, we may be faced with increasing inflation (oil recently hit a 19 month high) and increasing interest rates. As interest rates increase the profitability of companies begins to erode causing weakness in the stock markets.

Given the hurdle of increasing interest rates, the search for “bargain” stocks becomes more and more difficult while fixed income securities are the most attractive they have been in almost two years. It is at times such as these that patience and common sense will prevent one from diving off into dangerous waters.

As June comes to a close it is appropriate that I say thank you for your support of the Sather Financial Group in its first two months of operation. Despite a few obstacles, things are going quite well. Thanks for your support.

Please don’t hesitate to call or e-mail (sather@viptx.net) with questions.

Sincerely yours,

Dave Sather, President
Certified Financial Planner

116 N. Main Suite B, Victoria, Texas 77901 (361) 570-1800