Sather Financial Group, Inc.
Registered Investment Advisor

1999 Market Commentary
"Blue Chips or Poker Chips?"

I don't often make predictions, however, after experiencing 1999's stock market it is important to point out a few things and from there attempt to look to the future.

In analyzing the past 17 years of U.S. stock market history, we find that in no time in our history has the market done as well as it has since we came out of the 1982 recession. My prediction—and it's a big one—is that there is no way that the market will do nearly as well over the next 17 years. For the past 50-year's corporate profits as a percentage of Gross Domestic Product has been between 4% and 6.5%. Ultimately, on judgement day the value of any business is the earnings it has compiled. Therefore, I will take the stance that the market cannot go up 20% annually if corporate profits as a percentage of GDP are only growing 4% to 6.5%. Sooner or later it becomes a statistical improbability since a component of GDP cannot become larger than the aggregate of GDP.

You cannot expect to forever realize a 15% nor a 20% annual increase in the valuation of American business if its profitability is growing only at 5%. The fact of the matter is that the value of an asset cannot over the long term grow faster than its earnings do. I don't care how much people expect technology to fuel corporate profits—tech and internet stocks cannot carry our economy.

If all of this is true, then why are tech/internet related stocks going through the roof? Speculation is the only answer I can derive. I agree that the internet has and will continue to change the way we function. However, the key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any company and the sustainability of that advantage. The products and services that have true sustained competitive advantages are the ones that deliver financial rewards to investors in the form of earnings. Many of the best performing tech and internet related companies don't currently show any profits and are not expected to show any profits at all in the foreseeable future.

To further provide insight it is helpful to analyze the broader stock markets. *Half of the gains of the S&P 500 in 1999 came from only eight companies*. (Remember this is a market weighted index) Additionally, of the 500 companies in the S&P 500 a full *230 of them now trade at a price lower than they were two years ago*. If it had not been for a select group of tech stocks the S&P 500 that index would have barely broken even for the year. The highflying NASDAQ market was no exception either. *Nearly half the NASDAQ companies lost ground in 1999 with the average loss being 32%*. Furthermore, the ValueLine index, which is an equally weighted index of several hundred stocks, fell 1.4% for the year. To make one final point about the ridiculousness of the market you can divide the market into two groups for 1999: those with positive earnings and those with no earnings or losses. *It is disturbing to me that the companies with no earnings increased in stock price an average of 52% in 1999 while those companies with positive earnings lost an average of 2% for the year*. **Investing with this mentality is nothing more than gambling. It is a house of cards—with one good wind, they will fall.**

There is an old saying that states "when interest rates are low, stocks will grow and when interest rates are high, stocks will die." Obviously, the stock market ignored this adage. As the Federal Reserve raised interest rates several times throughout the year the bond market experienced its second worst year since 1974. In fact, one of the worst performing investments in 1999 was that of a 30 year U.S. Treasury Bond—it lost more than 15% of its value. The bond market started 1999 with the long bond yield at 4.9% and finished the year yielding 6.48%--a 32% increase in long term interest rates.

I don't know what to expect out of the year 2000. Interest rates have risen substantially and several industries have sold off creating very attractive valuations. And yet tech stocks are beyond stratospheric levels. At a time such as this it is paramount to stick to your guns and remember your goals and objectives. The reason anyone invests in a company is because of its earnings. Secondly, an investment in a company is a long term commitment. If we focus our attention on the things that truly matter to a logical investment plan we will all benefit in the long run.

One last item is that the Sather Financial Group, Inc. will move it's office to 108 S. Main (two doors south of the old Bianchi's drugstore) effective February 1, 2000. Additionally, if you would like the 2000 Form ADV for the Sather Financial Group, Inc. please call. I hope the new year is off to a great start.

Sincerely yours,

Dave Sather, President
Certified Financial Planner

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