

First Quarter 2000 Commentary
“New Economy versus Old Economy”

Despite what you might read and hear from the media, your barber or your Uncle Harry there's only one U.S. economy.

It's the sum of the goods and services Americans produce and buy, whether it's books over the Internet from Amazon.com or aluminum foil from an Alcoa factory.

There's no such thing as a “New Economy” nor an “Old Economy.” This New Economy hype is Wall Street's attempt to push investors into buying, selling or both. Whenever stock prices go to unsustainable heights, brokers and analysts go to great lengths to tell customers, “It's different this time.” Currently, the pitch is that the Federal Reserve -- with the help of productivity gains generated by computers and the Internet -- has killed inflation. But it's more than just different this time -- *it's a whole New Economy.*

Apply the broker's New Economy theory. Since Commerce One Inc. earned \$33.6 million in annual revenue from setting up industrial trading sites on the Internet should they command a market value of \$9.25 billion? Should Celera Genomics, which seeks to identify every human gene and its function, have a market value worth \$5.62 billion (*though last year the company had only \$12.5 million in revenue and lost \$44.9 million*)? It goes without saying that you shouldn't question Krispy Kreme Doughnuts Inc. shares trading at 92 times earnings.

God forbid securities firms call the New Economy market for what it is. A bubble. A craze. A mania. If they did, everybody would sell these particular stocks and new public offerings would disappear. Trading commissions and investment banking fees would dry up. Instead, we have the “experts” telling us that *no matter what the price is; New Economy tech stocks will be there to build the future.*

We have seen these mentalities at work in the market before. In the ‘60's we had the conglomerate craze, technology in the early ‘70's, oilfield services in the late ‘70's, leveraged buyouts in the ‘80's and biotech in the early ‘90's. Each time these New Economy ideologies fell apart. Very consistently we watched as overpriced stocks fell in excess of 70 and 80 percent! That is a long, hard fall. Now we are faced with the same predicament with tech and Internet stocks.

To reiterate my 1999 Year End Commentary; the only reason that anyone purchases stock is to participate in the earnings of a company. Furthermore, on judgement day the value of any business is the compilation of its earnings. To me this concept is one that even this Aggie can comprehend.

Why then is it that we are faced with such irrational investment valuations? Currently, the S&P 500 index as a whole trades at about 26 times earnings. Simply put, an investor pays \$26 to receive in return \$1 worth of earnings from the companies in the S&P 500. Many of the stocks in the broad market are quite fairly valued. In comparison, the *NASDAQ market currently trades at 210 times earnings. Not 21 times earnings, but 210 times earnings!* To provide some perspective during the majority of the 1980's and 1990's the NASDAQ traded between 30 and 40 times earnings. By all historical measures the stocks in this index are quite over priced. I don't care how new our economy is or how different things are this time—*stock valuations of this nature cannot be supported long-term.*

This isn't to deny that the economy is changing. The Internet may bring efficiencies we can't imagine. But the economy is always changing. Think of paper money, electricity, oil, the mass production of cars, ice cream. None heralded a “new economy.” It was still produce, sell, buy, consume.

In the meantime I think I'll stick to investing in companies that I can understand, which do very boring things and which are very consistent in their ability to make money year in and year out. Investing for Aggies 101.

You will notice a new business card is attached. As I mentioned in my last commentary the offices of the Sather Financial Group moved to 108 S. Main, Victoria, Texas 77901 on February 1, 2000. Additionally, I have a new e-mail address: dave@dsather.com.

Sincerely yours,

Dave Sather, President
Certified Financial Planner