Sather Financial Group, Inc.
Registered Investment Advisor

Year 2000 Commentary

We have just come through the worst year for the broad stock market since 1990 and the worst year for Nasdaq stocks in its entire history. Call me a glutton for punishment, but I think *this has been a good thing*. Hopefully, this will be a signal to the investment world that boring old fashioned business fundamentals do matter. Furthermore, people actually need to realize that when they buy stock they are buying a business and with any business transaction, price and the valuation that justifies that price, is extremely important. Continuing that theme, anyone involved in investments must recognize that earnings matter, buying last year's winners is not always a great strategy, the business cycle has not been repealed and neither has stock market cycles. This is not rocket science. It is common sense. We just need to practice it with discipline.

In view of all the hope (and hype) that the new millennium seemed to offer, 2000's weak stock market was a disappointment for some investors and almost all gamblers. But, put in perspective, the market weakness in 2000 didn't meet the standard most people use for a bear market – a 20% or more decline from the market high. Nasdaq's more-than-50% plunge since the March 2000 high clearly qualifies as a major bear market, trailing only the 21-month decline of 60% during 1973-74. But, at its worst, the Dow was down just 16%, a decline that was halved by the end of the year. The S&P 500's peak-to-trough decline of 17% was trimmed to 14% by year-end 2000. Most of this damage came from excruciatingly overpriced technology and telecom stocks.

Investors have been spoiled by the string of good markets since August 1982. In much the same sense, after a record run of economic growth, the U.S. economy now has the feel of recession, but hopefully, just a slowdown. Nasdaq may be signaling recession, but indicators like the consumer confidence index and the leading economic indicators are still saying slowdown, not recession, as are the broader market averages.

A year ago, inflated by Y2K spending and a soaring stock market, economic growth was running at an 8% annual rate; a rate which was too fast. Today, fortunately, we have slowed down. In support of a soft landing, the Fed could cut interest rates up to 1 percentage point in the first half of 2001, which should give consumers, businesses and investors reason to be positive.

Still, one shouldn't expect stock prices to bounce back as quickly in 2001 as they did in 1998 when the Fed last eased. Certainly investors will be a lot more wary of the dot-com's – at least until they exhibit some, if any, potential for making profits. As important, investors who entered the stock market for the first time during the late 1990s now have the experience of a down market to temper their enthusiasm. They fully recognize that business and market cycles have not been repealed, a conceit that led to unrealistic expectations one year ago. "Irrational exuberance" hopefully will not reappear in 2001.

Is now a good time to look for bargains? It depends on what you are looking for. Many tech related companies are more attractive now than I have seen them in many years. However, you still must be quite careful about blindly throwing money back into the Nasdaq. Remember everything focuses on value and earnings. The price to earnings ratio on the Nasdaq 100 (the 100 largest stocks in the Nasdaq) has come down from 240 times earnings at its peak last March. However, the Nasdaq 100's P/E ratio is still an astronomical 100 times earnings. ***In NO rational world can valuation levels of this nature be considered a bargain.*** Give me a boring Old Economy company with consistent earnings, low debt and a simple product mix any day.

A year ago at this time my comments focused on the fact that there is no difference between New or Old Economy companies. Simply put, companies have value because of the stream of earnings that they produce. At that time I argued that the Internet craze would end or at a minimum be severely damaged. The Dow Jones Internet Index finished the year down 74%. Companies that appeared to be guarantees of overnight wealth such as drkoop.com, Pets.com, Webvan, Priceline, Furniture.com and Mothernature.com not only lost severely—**THEY COMPLETELY CLOSED UP SHOP WITH INVESTORS GETTING NOTHING BUT LOSSES!** Internet companies obviously were not the only companies hurt; Lucent dropped 80%, AT&T fell 66%, AmericaOnline decreased 55% and WorldCom fell 40%. Why? One simple reason: they had become sharply over valued relative to the earnings that they produced.

The year 2000 corrected many of the market's speculative excesses, returning investor focus to fundamentals such as sales, earnings, dividends and even book value. This is all for the good, as is the realization among investors that the 20%-30% returns seen in the five years 1995-99 are not a new norm for equities. The economic outlook is still judged to be sound, although not without risk. While the Fed is expected to lower interest rates soon, it is still important to emphasize some basic principles, such as diversification and investing in quality securities. As always, stock market investing is a long term (10 plus years) proposition. Seen in this light, 2000's stock market weakness has created some interesting opportunities for 2001 and beyond.

Finally, if you are interested in receiving the most recent update to the Sather Financial Group, Inc.'s Form ADV please let us know and we'll have one mailed to you shortly.

If you have any questions or comments please drop by or give us a call.

Sincerely yours,

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