Sather Financial Group, Inc.
Registered Investment Advisor

# Third Quarter 2001 Commentary

In the process of restoring the American dream our financial markets are struggling to find stable ground from which to move forward. ***I do believe we are at that point of finding stability***. The stability we have may not be rock solid at this point, but we certainly have the potential to get there.

Investors reviewing the third quarter will all derive the same conclusion—it was bad. For the quarter the ***NASDAQ lost 31% and the Dow dropped 16%***. This was the worst performance for the Dow since the fourth quarter of 1987 and the second worst quarter ever for the NASDAQ. As a side note, ***September has historically been the worst month*** for stock investors. None the less, ***that light at the end of the tunnel got a little brighter*** during the last week of the quarter. In the ***past week the Dow rose 7.4%***. This was certainly welcome news after watching these blue chip companies plummet 14.2% just one week earlier.

After an emotional and brutal third week in September, stocks regained much of their composure and focused on the business of America. Wall Street responded positively to the ***revised second quarter Gross Domestic Product figures, which came in at plus .3%*** (revised up from .2%). While the economy may not be growing rapidly, it was still growing. As such, prior to the September 11th attacks, the economy was weak, but ***not in a recession.***

Consumer confidence has been negative. As a result of economic weakness, job layoffs, slowing retail sales and September 11th, consumer confidence slipped 14% in September. It is at a time such as this that intelligent investors must realize how emotional many people can be in times of uncertainty. Investor psychology runs from one emotional extreme (greed) to another (fear) and back during a stock market cycle. ***Obviously, the greater the fear, the greater the opportunity for the disciplined investor.***

Many investors think that we are currently in uncharted territory. While current stock market behavior has been extreme, it is not unprecedented. Economic slowdowns propelled the S&P 500 down 36% in 1968-1970, 27% in 1980-1982 and 20% in 1990. Of course, we can't forget the 48% drop in 1973-1974. ***Each time, however, the stock market recovered and long term investors were rewarded for their patience***.

As I have always stressed, ***long term is the key***. If an investor placed $10,000 into the S&P 500 in 1981and held that investment through the year 2000 they would have experienced a multitude of good and bad economic times. However, that $10,000 investment would have grown to $190,000 by the end of that twenty year span. Unfortunately, many people deviate from their plan and either get emotional, try to time the market or waver in some other manner from their long term investment policy. Interestingly, if you did waver and you missed only the 30 best days over this twenty year period your investment did not grow to $190,000, but instead only grew to $56,000. This is a 70% reduction in return simply by not being disciplined and staying invested.

This study of history can be extended. Over the ***past 200 years we have had eight stretches when stocks have posted back to back losing years***. The following year was often a big winner, with stocks climbing an average of 18.8%. ***Longer term, stocks went on to deliver an average of 8.5 percentage points above inflation (about 11.5% annually) over the next five years***. Suffering back to back losing years is unusual. On average it has happened once every 25 years. Additionally, over the past 200 years, stocks on average have lost money every fourth year.

So why own stocks? ***Compared to other investment categories (fixed income and cash) the stock market still provides the best potential to outpace taxes and inflation over the long term***. This is certainly true now with a ten year US Treasury note only yielding 4.59% and money markets paying about 2%. Factoring in 30% for taxes and at least 4% for cost of living adjustments many fixed income investments will provide a negative real rate of return for investors.

From this point forward, the economy is going to have to show stability and strength. While we know that consumer confidence is low, we also know this can be a rather fickle indicator. More importantly though, ***retail sales had resumed*** to a much more normal pace by the end of the quarter. Also, the concern over an oil price spike has never materialized and consumers are actually seeing ***gas prices drop***. Other ***concerns over inflation are very low currently***. The events of September 11 will obviously affect the travel and insurance industries. However, other industries do not seem to have significant new downside risk in corporate profitability. The ***Federal Reserve continues to enhance our economic environment with the most favorable interest rates in almost forty years***. Furthermore, it is quite likely that the Fed will continue to lower rates.

In the next six months, it will not be surprising to see volatile, exaggerated moves in the stock market as investors chase the slightest evidence of recession or recovery. Don't let this short term, emotion filled mindset affect your investments. Always remember that stock market investors have their investments not because of where they want to be today, but because of where they want to be in ten or more years. Given this understanding, I will happily be a regular, consistent investor in the USA; still the greatest economy on the face of the earth.

Sincerely yours,

Dave Sather, President
Certified Financial Planner

108 S. Main, Victoria, Texas 77901 (361) 570-1800