Sather Financial Group, Inc.
Registered Investment Advisor

Year 2001 Commentary

At a minimum, it is difficult to look back on the past year and feel good about what happened. This is true whether discussing the financial markets or many other facets of American life. However, as I stated on September 21st and again at the end of the third quarter, *the light at the end of the tunnel continues to get brighter* as our country, once again, displays its durability.

As predicted, our financial markets endured the events of Sept 11th. Surprisingly, the markets not only stabilized, but have already *recouped all of their losses stemming from this horrible and unforgettable event*. This is a true testament to the strength of the American economy and its people.

For the full year *the Dow lost 7.1%, the S&P 500 lost 13.09% and the Nasdaq lost 21.05%.* It was the worst two year period in more than twenty three years. Furthermore, it was the *first time since 1973-1974 that all three market indices lost ground in two consecutive years*. Over the past two years the S&P 500 is down 24.5% and the Nasdaq has dropped 61%. Looking forward to 2002, it is interesting to note that the Dow Jones Industrial Average has not had three consecutive losing years since 1939 – 1941. While this performance was bad we probably would have avoided a recession if not for September 11th. The economy was definitely weak, but still positive. The terrorist acts pushed us into what appears to be a mild recession and a "bear market" (20% decline) for stocks. The world financial markets also suffered through a tough year as the Dow World Index (excluding the US) lost 21.02%. This was also the second straight losing year for this indice and its worst performance in its ten year history.

The Federal Reserve also made history in 2001 with a record eleven interest rate cuts. The effect of these cuts was to drop short term interest rates from almost 6% at the beginning of the year to 1.75% by the end of the year. We have not seen rates this low since the Berlin Wall was in its glory. Longer term, ten year rates fluctuated during the year, but ended close to where they started at about 5%. Given this, it is a great time to borrow money, but a bad time to be a fixed income investor.

Many shortsighted people have blamed the Fed for our current situation. These people are just looking for someone to blame. It is a pretty safe assumption that, incredibly, Greenspan would have engineered another "soft landing" for the economy if not for September 11th. Also, it is still up to corporate America to run their businesses in an efficient and profitable manner. In the case of many tech and telecom companies a lack of logic and common sense caused widespread failures. Greespan and The Fed may be very very good, but they can't fix outright stupidity. Furthermore, while interest rates play a large role in the financial markets, their purpose is not to move stocks. Rather, *the job of the Fed, and their interest rate management, is to boost the economy*. Stock price movement is simply a byproduct of the economy doing better as a result of interest rate shifts.

By now I am sure you are wondering where is this light at the end of the tunnel? Good question. To begin with I will reiterate how impressed I am by the markets performance post September 11th. I am equally *pleased with our nations military* efforts in Afghanistan. God bless America and the many freedoms we enjoy.

After the dot.com, tech and telecom debacle, many technology companies were left with tons of excess capacity and inventory. This "inventory overhang" is simply too much merchandise that no one wanted to buy. The Federal Reserve can lower interest rates as many times as they want, but those actions would not help solve this problem. Fortunately though, enough time has passed that this glut of capacity and inventory is starting to fix itself. As such, we have started to see *increases in semiconductor prices and increased spending by high tech companies* in other areas. A rebound in technology will be very good for the overall economy.

Officially, the recession started in March. The average recession lasts about sixteen months. Look for the *Fed to lower interest rates at their January 30th meeting by another quarter point*. By the *middle of the year look for us to pull out of the recession*. Additionally, *consumer confidence, as well as new home sales, are increasing*. The total unemployment number will continue to increase through this past December. However, it is important to remember that unemployment is a lagging indicator and as such, gives a picture of things that happened six months ago. More importantly, the pace of *new jobless claims is decreasing*. As a result of very favorable interest rates, *mortgage rates have also been quite favorable*. Additionally, consumers should continue to benefit from *low oil prices and the tax reform act* passed last year will start to impact households with lower income taxes and lower estate taxes.

While *recovery is on the horizon, possibly in the second half of 2002*, it is important to remember a few key factors. A recovery does not mean we will return to 20% annual stock market gains. I am *hoping that the markets will produce average gains of 7% to 8% annually over the next ten years*. Additionally, after experiencing the market behavior of the past two years it is imperative that stock market investors only invest funds, which, can be left invested for long (10+ years) time frames. Additionally, the Fed will stop lowering short term rates in the first half of the year and ten year Treasury rates will hold around 5% to 6%. While it may not be a new era of "free money", *2002 should see the financial markets continue to stabilize and produce positive, albeit modest, returns.*

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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