Sather Financial Group, Inc.
Registered Investment Advisor

First Quarter 2002 Commentary

While the first quarter of 2002 was marked by high hopes and false starts, it does appear that ***the recovery we are seeking is on its way***.

The stock market, and the folks on Wall Street, continued to be fickle. For the first three months we saw the ***NASDAQ Composite Index continue its fall as it dropped 5.4% and the S&P 500 fell .6%***. Much of that performance is as a result of continued weakness in the technology sector. However, the ***Dow Jones Industrial Average bucked the trend and increased 3.8%***. While the Dow's increase was not overwhelming, we must remember that this performance occurred despite a recession, poor earnings and a series of corporate scandals.

This past summer we predicted that the earliest the economy would turn around would be about the end of the first quarter of 2002. Evidently, that ***prediction is proving to be accurate as we continue to see a variety of improving economic statistics***.

The total amount of goods and services bought and sold (total gross domestic product) for the fourth quarter was revised up to 1.7% growth (from 1.4%). GDP is expected to continue improving, thus providing a strong indication of economic recovery. In analyzing the Dow's gain for the quarter it is determined that cyclical names provided the majority of the positive performance. ***Typically, cyclical industries, as well as services and manufacturing sectors, will provide the initial indications of economic recovery.***

Additionally, the recent Chicago Purchasing Managers Index rose 4.9% giving hope that the industrial sectors are alive and improving. Unemployment did, however, rise unexpectedly. But, it must be remembered that unemployment statistics are a lagging indicator and only show us what happened six months ago. The University of Michigan's Consumer Confidence Index rose in the latest quarter to its highest level in more than two years. Furthermore, growth in American income has spurred continued spending. More surprisingly though, is the fact that while consumer spending has been strong, the American savings rate is also increasing.

In the end, it looks as if corporate earnings are about to end their five quarter losing streak and will return to profitability. This is quite important as the true worth of any business is determined by its net earnings.

Earnings expectations are still modest, especially as the economy continues to look for stability. As discussed previously, the long term stock market investor should ***expect average annual rates of return of about 7%*** over the next ten years. While that is not an outstanding return, it does appear to be substantially better than the 2% to 4% one would get in the fixed income markets.

Fixed income investors have seen a few opportunities in longer term maturity issues. In the middle of February the yield on the ten year US Treasury was about 4.9%. ***Today that yield has risen to about 5.4%***--about a 10% increase in rates. The majority of this rate increase is as a result of the Federal Reserve altering its stance on interest rate policy from lowering to neutral. Most investors are anticipating that the Fed will probably start to increase rates in the second half of the year, if not as early as May. Given the fact that the Fed has not actually changed rates ***the Fed Funds rate still stands at an incredibly low 1.75%***. As such, most fixed income investors looking for short term investments are going to be stuck with rates which are quite low.

The financial community has spent much time attempting to second guess what Greenspan and the Federal Reserve are going to do and why. Currently, they are trying to walk a very fine, and yet undefined, line between trying to stimulate the economy while not allowing it to go crazy. The good news is that ***the Fed sees economic life in the US***. This will allow them to bring ***short term interest rates back to a more normal level of about 3%*** from the current 1.75%. This is good news for fixed income investors as they can anticipate slightly better interest rates on their investments by the end of the year. Additionally, this is good news for stock market investors as well. Greenspan would not consider raising interest rates if they did not have strong convictions about the economy and corporate profits resuming their long term growth patterns.

For the second quarter we can anticipate more choppy behavior out of the stock markets as they try to regain their footing. While interest rates have already started rising we can look for the Fed to help this increase by raising short term rates possibly as soon as May.

Please call or stop by with any questions.

Sincerely yours,

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