Sather Financial Group, Inc.
Registered Investment Advisor

May 12, 2002 Economic Outlook
<u>A Market In Need Of Prozac</u>

Anyone who has paid attention to the financial markets in the past few weeks is most likely suffering from a bad case of whiplash. One day the market is down 150 points, followed by a rebound of 300 points which is then topped off with another drop of 100 points—give or take 50. It is enough to make one scratch their head wondering where exactly an economic recovery is and when it plans on arriving. Furthermore, it is no secret that there are still some large issues to be dealt with, namely, corporate profits, Enron, accountability, the Middle East etc.

However, for the long-term investor, all the pieces are in place to generate healthy, moderate, economic growth for the balance of the year. But so far, political and economic uncertainties seem to be overshadowing the strengthening in corporate profits.

Given this uncertainty it is extremely important for investors to look at the fundamentals—and not the hype. In doing so one sees that the ***economy grew at its strongest pace in more than two years in the first quarter.*** Furthermore, it is widely expected that ***gross domestic product will rise at least 2 to 3 percent for the year***. GDP is the broadest measure of the nation's economy. Perhaps more importantly though, ***productivity is soaring***. The measure of how much Americans produce per hour posted its ***biggest gain in nearly 19*** years in the first quarter, meaning ***companies can sell more goods and services without having to boost wages*** – something that typically ***bodes well for corporate profits***. Additionally, ***consumer spending will probably hold up*** fairly well and there are even signs that spending by businesses is set to come out of its two-year slump.

Elsewhere, there is mostly good news on the economy. ***Consumer confidence has steadied***. ***Industrial production has grown for three straight months***. ***Inflation remains a distant threat***; in fact wholesale prices actually fell in April. And while unemployment hit 6 percent last month--the highest in nearly eight years -- it remains significantly lower than the peaks that followed the two previous recessions -- 10.8 percent in 1983 and 7.8 percent in 1992. It must also be remembered that ***unemployment gauges where our economy was about six months ago***. As such, it is a lagging indicator and is not a good measure of where we stand today nor where we are headed. In addition, the ***Federal Reserve could very well end up holding interest rates steady for several more months***, and possibly a good deal longer, before it starts raising them again in a bid to ward off the inflation that may come with higher growth. The central bank cut rates eleven times last year, but has held rates steady at each of its three meetings so far this year.

In addition to the above mentioned economic factors, it is worth reviewing the findings of the National Bureau of Economic Research's business cycle dating committee, which noted that ***payroll employment***, its most important measure of economic activity, seems to have ***stabilized in the first four months of the year***. They also concluded that ***industrial production and personal incomes have risen*** this year.

Finally, it is worth examining some of Alan Greenspan's comments this past week. Speaking before a group of business executives, Greenspan said that while you can never fully predict a recovery (which he is assuming we are in recovery), but so far ***the economy is following a very typical pattern which leads with an increase in Gross Domestic Product, followed by margin expansion and ultimately profit***.

So why are the markets so manic?

Many investors, and most of Wall Street, continue to live life looking in the rear view mirror. The prolonged drop in corporate profits and the pounding hangover still felt as a result of the tech, telecom and Internet debacle continues to have many investors worried and focused upon past events. Furthermore, with a situation of this magnitude there is a wide array of emotional issues to contend with. And as history has shown, emotional decision making relative to investing is not a great formula for success. As such, many investors are quite skittish, jumping in and out, and playing a game of second guessing. Unfortunately, a strategy of this type is usually a formula for mediocre results—at best.

However, the truly considerate, long-term investor, will examine not only where we have been, but more importantly where we are headed. Once this is accomplished an investor can see that ***the fundamental building blocks are in place to help the economy and corporate profitability regain its footing***. In time this will lead to stability in the economy as well as the financial markets.

These things require time, patience and discipline. As such, none of us should look for the market to rebound tomorrow. The economy is definitely headed in the right direction. It will take time though to work the remaining rust out of the system. As such, do not expect much to happen, with the stock market or interest rates, until at least the second half of this year. While that may not be the answer many short-term investors are hoping for, the investor with the long-term time frame and well defined goals will be properly positioned for the future.

Sincerely yours,

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