Sather Financial Group, Inc.
Registered Investment Advisor

Year 2002 Commentary
A Year of Scoundrels, Scandals, Corruption & The War Against Terror

A lot of people, myself included, predicted that 2002 would see the stock market provide modest, but positive returns. After all, the economy pulled itself out of a mild recession in late 2001, interest rates were low, unemployment was low and statistically speaking the odds favored positive returns. In the past 107 years the stock market has only had four times when it fell three years in a row—the most recent being 1939 – 1941. Obviously, we were wrong.

Although our clients were fortunate enough to avoid investments in Enron, Tyco, Worldcom, Adelphia and Martha Stewart, the fallout from these scandals hit just about everyone. It was enough to cause people to distrust virtually anything that Wall Street and corporate executives had to say—and with good reason. Making matters worse was the mounting evidence of how badly many major Wall Street brokerage houses had lied, mislead and deceived their customers in an effort to line their pockets. Once these items were evaluated along with the continued war on terrorism, as well as Iraq, many people cast aside their long-term investment plans and ran for the hills. ***While this satisfied their short term emotional desires, the long term effect caused tremendous volatility and irrationality, thus hurting themselves in the process***.

For the year we will observe the Dow, S&P 500 and Nasdaq indices drop more than 15%, 20% and 30% respectively—certainly not the positive bounce we were looking for. Does this performance make me want to get out of the stock market? No—it makes me want to continue to put more money in—especially if I am functioning with a logical, long-term investment plan.

President Bush is taking a proactive stance on stimulating the economy. He has shaken up his cabinet replacing his top economic advisor as well as Treasury Secretary. Both of these moves indicate seriousness by the White House that the economy must be a top priority. Also, we should expect ***some type of tax relief package to be passed in 2003***. With the Republican Party controlling Congress there is little reason why a decent tax package should not be passed. However, as with all political items we should realize that what is actually passed will probably be quite a bit different, as well as less dramatic, than what is currently being discussed. As a side note, it is interesting to point out that ***the stock market usually does well in the third year of a presidential term*** (that would be 2003 for Bush).

The price of oil increased 64% this year, while gold increased 25%. Real estate prices increased also. ***All three of these are indicators that inflation may be on the horizon***. If we do see inflation, we can look for the Federal Reserve to start a difficult balancing act of increasing interest rates while not stifling the economy. However, with interest rates at 40-year lows, ***it is a safe bet that rates will increase in 2003 with or without action from the Federal Reserve***. Currently, the yield on a ten year US Treasury bond is a meager 3.81% (down from 5% a year ago). With rates this low it continues to be a difficult time for fixed income investors, but a great time to borrow money.

Despite all of the doom and gloom, the fact of the matter is that ***Gross Domestic Product is growing at 4% per annum, unemployment is a mere 6% and interest rates are at 40 year lows***. Additionally, GDP has increased for the past four quarters and is expected to increase again for the fifth straight quarter. What's not to like about this situation? We will also see increased scrutiny on executive compensation, corporate accounting and the expensing of stock options. All of these items are helpful and necessary in regaining stability, as well as the trust of investors.

The most obvious wild card will be our military efforts relating to terrorism in general, as well as Iraq and now North Korea. While it is true that we do have the most sophisticated and dominant military in the history of the world, a multitude of bad outcomes is always possible when dealing with insane and/or desperate people. Also, in assessing the impact of war it should be remembered that short-term war is unsettling. ***Longer term, though, war actually has a positive impact upon the economy.***

So why would anyone in their right mind want to continue to invest in the stock market at this point? This is a good question, as well as a fair question. As we have always stated, no one should invest in the stock market unless they have at least a ten year plus time frame. Three years of difficult performance is not ten years. Secondly, ***stocks are nothing more than businesses, which are for sale each and every day—often at irrational prices. After three years of down performance there are many opportunities to buy very good companies and fair, if not cheap prices***. Over long periods of time the value associated with the earnings produced by these companies will be reflected in an appreciated stock price. ***You must be patient though and you must stick to your long-term investment plan***. In assessing history it is worth reviewing one particularly nasty period of time in history—1929 through 1939.

During that time period we had the great stock market crash as well as the great depression. If you had invested a lump sum of money, into the 200 largest companies, at the peak of the market in 1929 your investment would have lost over 50% over the next ten years. However, if you continued to save and invest regularly over that same time period you ended up with a positive 13% return. This study is a powerful testament to saving, being fiscally conservative and continuing to invest over long periods of time.

However, I know many people who say that no matter what they are never getting in the stock market again. This is a big mistake in our opinion. We have always discussed the need for a portfolio to outpace taxes and inflation. The worst thing in the world is to have a portfolio that goes up in dollars, while falling behind in terms of purchasing power. To emphasize this point, consider the performance of stocks versus bonds over the past 40 years—once inflation is factored in. **Over this time period stocks produced an average of 6.8% per year, while bonds have lost 2.3% per year. Worse yet, while this comparison factors in inflation, it does not factor in the equally powerful impact of taxation.**

With interest rates at 40 year lows the prospect of 7% to 8% annual stock market returns over the next ten years is very enticing. We continue to be cautiously optimistic.

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.

Let's hope that the new year bring us all good health and prosperity.

Sincerely yours,

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™