Sather Financial Group, Inc.
Registered Investment Advisor

May 14, 2004 Commentary--What's Not To Like?

Between April 1, 2003 and March 31, 2004 the stock market experienced a very nice rebound. And while the easy money has most likely been made ***we don't think it is time to run for the door***.

That said, the broad stock markets have shown investors some very erratic behavior since April Fools Day. ***Stocks have fallen mainly as a result of rising interest rates fears over inflation***. Real estate investment trusts have been just as dramatically affected. The move in interest rates is nothing new. We have been cautioning investors about inflation and a change in rates for quite some time. Our predictions are proving to be fairly accurate.

However, we think that many investors have gone overboard. Judging by the recent drop in stocks, you'd think something truly awful had happened to the economy. This is not the case. ***Productivity and profitability are stable and getting stronger***.

Though stock investors are predictably unhappy about higher interest rates, we think the mini-panic has gone a little too far. Typically fickle Wall Street types are ignoring what could be a sweet spot of stronger economic growth and corporate pricing power, with inflation and interest rates that are well-behaved, historically speaking.

After waiting months and months for a job market rebound, the U.S. economy received much needed news in March and April. This period posted ***the best two months of job growth in four years***. To most logical people this should be good news.

However, for some reason Wall Street cannot get it through their thick skulls that ***rising interest rates is not the end of the world***. It is a true statement that higher rates can be detrimental to stock prices and economic growth—if they climb too far and too fast.

But we must remember that the Fed's target for short term rates is at its lowest level (emergency levels) in more than 40 years. This "emergency" level has been in place to fight the successive nightmares of a bear market in stocks, a recession, terror attacks, corporate scandals, two wars and prolonged weakness in the job market.

Now, though, the emergency is over and ***the need for Fed funds to be at emergency levels is behind us***. The sooner we become cognizant of the fact that the global economy won't be crushed and corporate earnings won't dive, the sooner the market can focus on the future of long term growth.

We are hopeful that the Fed won't raise rates too quickly. Some Fed policy makers believe there's still plenty of excess capacity in the economy that needs to be worked off before runaway inflation becomes a concern. And if inflation can stay low amid stronger economic growth, the economy may enter a "Goldilocks" phase -- not too hot, not too cold -- that could be good news for stocks. As long as productivity growth can remain high, fast job growth is not a problem.

The fact that we are even contemplating increasing interest rates is a good thing in our opinion. ***Rates have been so low that a need to increase them is confirmation that our economy is growing.***

There are always risks to navigate. ***Oil prices continue to climb higher***. However, in inflation-adjusted dollars, they're not nearly as high as they've been in past "oil shocks." ***Geopolitical risks*** are an even greater potential worry. Violence could interrupt the flow of oil from the Middle East sending even greater energy-price shocks through our economy. ***And there's always China***. Policy makers there want to reign in its ferocious growth rate, raising the possibility of shock waves. We are hopeful that Chinese leaders can moderate their growth in a manner that world economies are not thrown into turmoil. This will be a tricky balancing act. And there's the possibility that ***the Fed might not have quite the handle on inflation it thinks it does***. If it's wrong, the Fed could be playing catch-up in a way that could stomp on the economy and send stocks lower. The faster the Fed hikes, the more suffering there will be, and the greater the risk to the economy and corporate profits.

Obviously, there are plenty of unknowns affecting the world economies. Understanding this, it is imperative that all investors spend the necessary time evaluating their financial goals and objectives. However, we remain confident that ***long term stock investors should be able to weather shorter term volatilities***.

Given the current set of challenges facing investors today, please don't hesitate to call or stop by with questions.

Sincerely,

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™

120 E. Constitution, Victoria, Texas 77901 (361) 570-1800