Sather Financial Group, Inc.
Registered Investment Advisor

July 19, 2006 Commentary

Lebanon and Israel are doing their best to blow each other off the map. There have been terrorist bombings in India. And don't forget that we still have $75+ per barrel oil taking a bigger chunk of your disposable income every day. It is a confusing and scary world we live in.

Despite the fact that these are sad and challenging events, we all need to maintain proper perspective when it comes to our investments—especially stocks.

The reason any of us owns a stock is because the underlying business earns money. A stockholder is an owner and as an owner of that business we want to share in the company's earnings.

Consider the troubles of the world for a moment and then address these questions:

1. Do you think that Johnson & Johnson will sell less shampoo, Tylenol or Band Aids due to high oil prices? Doubtful.
2. Do you think that Anheuser Busch will sell less Budweiser beer because of the bombings in India? Not likely.
3. Will Berkshire Hathaway sell less insurance because of world tensions? If anything, it will sell more.
4. Will Comcast, the nation's largest cable TV company, sell less cable services? Not a chance.
5. Will Service Corp. International, the world's largest funeral services provider, see a decrease in demand for their services? Sadly, they will probably benefit from the instability in the world.

The point is that ***well run businesses make money in markets all around the world***. These are the types of businesses we look for—especially when they are priced favorably. Businesses of this nature are currently a "value investors" dream come true.

For the past two years the financial markets have mainly rewarded people chasing after energy and real estate stocks. In fact, it is quite reminiscent of 1999 and all of the hype surrounding tech and internet stocks. Just as in 1999, we have not chased the "hot" stock as the investment fundamentals of these sectors are not that attractive in our opinion.

We cautioned against real estate speculation beginning in May of 2004. While these trends take time to play out this one certainly has. The homebuilders, and other real estate stocks, have plummeted between 30% and 60% in the last six months. ***We have been very pleased to avoid this large decline***.

As money chased after "hot" energy and real estate stocks, stalwarts of world capitalism such as Dell, Anheuser Busch, Johnson & Johnson, Home Depot, Berkshire Hathaway, Wal-Mart, Tyco and many others, have been left to languish. ***These amazing businesses continue to earn more and more money each year. And yet their stock prices have not moved in a material manner***. And in several instances, their stock prices have actually declined despite rapidly increasing earnings.

Some of the best examples of this completely irrational behavior can be exemplified with the following:

In 1999 Dell earned $.61 per share and traded for a stratospheric $55 per share. Today, Dell earns $1.46 per share, but trades for a mere $23 per share. This is a 139% increase in earnings while the stock price dropped by 58%.

In 1999 Home Depot earned $1.00 per share and traded for a lofty $70 per share. Today, the same company earns $2.72 per share, but trades for a mere $37 per share. This is a 172% increase in earnings while the stock price has dropped by 47%.

In 1999 Tyco earned $.62 per share and traded for a fat premium at $52 per share. Today, Tyco earns $1.42 per share, but trades for $27 per share. This is a 129% increase in earnings while the stock price dropped by 48%.

And in 1999 Wal-Mart earned $1.25 per share and traded for a pricy $70 per share. Today, the world's largest retailer earns $2.68 per share, but trades for a mere $43 per share. This is a 114% increase in earnings while the stock price dropped by 38%.

Back in 1999 the supposedly brilliant stock "experts" kept bidding the above-mentioned companies to ridiculous levels. And now, despite substantial increases in earnings, and massive pricing sell-offs, these same "experts" won't touch fine companies such as these. ***This makes absolutely no sense***.

In our opinion, ***we will happily continue to buy what amounts to dollar bills for fifty cents***. Sooner or later these "market experts" will wake up and realize what bargains they are missing out on. When they do, our clients should benefit handsomely.

Additionally, ***these fifty-cent dollars provide our clients a comfortable "margin of safety."*** The disconnect between a stocks earnings and its stock price creates opportunity. However, realizing this value requires long term patience and the ability to withstand volatility.

In embracing this ideology it is important to remember that ***volatility in the financial markets creates opportunities***. The more people panic, the greater the opportunity for good quality assets to be mis-priced relative to their intrinsic value.

Why should an investor deal with things such as risk and volatility? Why not just invest in fixed income such as a certificate of deposit or a U.S. Treasury bill?

Fixed income investments are essentially loans. Currently, by loaning money to the US Government for two years you will earn about 5% per year. Unfortunately, once taxes are paid and 4%+ inflation is factored in the seemingly "safe" Treasury note is losing your purchasing power. This is obviously not a good long term strategy and the guarantee of losing purchasing power is unacceptable for our clients with a long term time frame. Long term ***fixed income investing then becomes a far riskier proposition.***

Given this, if you were to tell me that we were to be stranded on a desert island for the next twenty years and had to choose between stocks or long term bonds, we would take stocks every day of the week.

While stranded we will continue to look for investments that are both safe and cheap. "Safe" means that the companies have strong finances, competent management and an understandable business. "Cheap" means that we can buy the securities for significantly less than what a private buyer might pay for control of the business.

Our investment strategy is unlikely to outperform benchmarks consistently. Instead, the goal is to outperform on average, most of the time and over the long run.

The fact that the financial markets continue to behave in a rather fickle and irrational manner should be of no surprise to anyone. They always have been and always will be. That is the very nature of combining business with human emotion.

Knowing this we must all maintain proper perspective and not let irrationality and emotion steer financial decisions.

Please call or stop by with any questions or comments. **And thank you for the opportunity to work for you**.

Sincerely,

Dave

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™