September 17, 2008 Commentary

Recent events in the financial markets over the past few weeks have been dramatic to say the least. The things we are experiencing are fairly unprecedented, and quite possibly, represent the greatest financial strain upon our financial system since the Great Depression.

Unfortunately, greed, and a lack of proper supervision by our nation's regulators allowed this situation to occur. Now the federal government is stepping in and bailing out these industries in a near socialist manner.

Although Sather Financial Group clients were fortunate enough to NOT directly have holdings in Bear Stearns, Lehman Brothers or Merrill Lynch the after shocks have been broadly felt. As you can imagine, we have fielded a number of legitimate calls from concerned clients.

So what should be taken away from this?

1. **Charles Schwab & Co. is a brokerage firm, not an investment bank** (unlike Bear Stearns, Lehman or Merrill). The investment banking firms got into trouble because they borrowed massive amounts of money and then gambled with it. As long as they were winning they looked like geniuses. Unfortunately, once they bet incorrectly the massive amounts of debt caused them to implode.

   Schwab does not borrow money for investment banking purposes. Schwab is much like a realtor—they match up buyers and sellers of securities and that is it. They hold our clients securities and report on those transactions each month. It is a very simple business and Schwab is extremely good at their job. This is why we chose them in the first place.

   As such, we have no concerns about Schwab's stability or credit quality.

2. **Leverage kills**. We have droned on for years that when you borrow money you sacrifice flexibility and may jeopardize your future. Most of our clients listened, while a few former clients did not.

   Whether it is personal or corporate, debt should be used sparingly. Prior to 2005 the investment banking houses were limited to a debt to equity ratio of about $15 of debt for each $1 of equity. Unfortunately, in 2005, our "friends" at the Securities and Exchange Commission changed this rule and essentially allowed the investment banking houses to almost self govern their usage of debt.

   In the case of both Bear Stearns and Lehman, they each amassed greater than 100 to 1 debt to equity. Once in this position, all it took was a slight breeze to bring down the house of cards.

   We do not use leverage in the management of our portfolios.

3. **Earnings matter**. To listen to the headlines, many would conclude that the world is imploding and that companies are no longer earning *any* money. Actually, the vast majority of our investments are still quite profitable. We must all remember that over the long term the value of any company is determined by their earnings—not the emotion or irrationality of the idiots on Wall Street.

4. **Diversify**. When we look at our clients portfolios we see securities that are invested in a variety of assets. In general, our clients own no less than fifty different investments, and often far more. We spread our clients assets across small, mid and large sized US based companies, as well as companies in many other countries—all of which are broadly diversified across many industries. We own real estate, energy and fixed income (both corporate and government from within the US and abroad)—all of which produce generous cash flow.

   Structuring portfolios in this nature prevents singular events from destroying a portfolio.

5. **Time frames matter**. Every client we have ever worked with has given us feedback on how long they can leave money invested and how much volatility they can incur. In general, we have not invested money in the stock market for anyone who has not had at least a five year time horizon, and preferably a ten year time horizon.

   Although we never dreamed that the current situation would be occurring, we know that unexpected things do occur. Having the proper time frame allows an investor to be patient and absorb the volatility and other things that go "bump" in the night.

6. **Live below your means**. This concept is greatly detailed in the book *The Millionaire Next Door*. When you live below your means, and strange things happen, you are able to deal with them on your terms. If you live your life on the edge it is much like the investment banks—one good breeze and your personal house of cards can collapse. Living below your means, and on a cash basis, allows an individual to negotiate on their terms.

7. **Scrutinize the difference between "needs" and "wants"**. We live in a society that produces every conceivable good or service we could ever think of. However, very few of these things are "needs". The things we need are affordable shelter, food, and health care. Often, when we confuse needs for wants we sacrifice our financial foundation in an effort to purchase "things". Don't let "things" dictate your financial future.

8. **Life will go on**. Although Hurricane Ike just tore through Houston we are certain that Houston will rebuild and people will reassemble the aspects of their lives. We are in the midst of a Financial Hurricane. Despite the turmoil, we will adjust and adapt and in the process our lives will go on and we will survive.

In closing, thank you for your patience and continued faith in our abilities. We are diligently analyzing and reviewing everything we can possibly get our hands on so we can make informed and intelligent decisions on your behalf.

If you have ANY questions about what is going on, how you are being affected, or anything else please don't hesitate to contact us. We are usually in the office seven days a week and want to make sure we are taking care of our clients to the best of our abilities.

We look forward to hearing from you.

Sincerely yours,

Dave Sather

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