Sather Financial Group
Comprehensive Wealth Managers

January 18, 2008 Commentary

The other day we received a call from a client who wanted to "sell everything". When asked why he conveyed that he thought all of his investments were going bankrupt—you know, because of sub-prime loans and the stock market.

The sub-prime issue will cause increased volatility. However, ***it will not derail our entire economy and will not cause all companies to go bankrupt.*** This has never happened—not even during the Great Depression.

Furthermore, you will probably hear even more about "accounting write offs". While an ACCOUNTING charge lowers the CARRYING value of an investment, ***it does not mean that an investment is suddenly worthless***. And in fact, we expect that many of these assets will continue to produce which will then result in a gain. ***This is just accounting gamesmanship***.

Through January 17th, the S&P 500 is down a bit more than 9% for the year. While that wasn't exactly the way we had hoped the year would start, it also isn't unexpected and ***it isn't the end of the world***.

When I got up this morning I used the same amount of soap and shampoo as always. I also used electricity and water in my shower. I shaved and brushed my teeth. During breakfast I watched the news on cable TV and ate my Raisin Bran.

On the way to the office I used my cell phone to return a call and then stopped to get a newspaper and put gas in the car. Then I stopped at the bank to pay my mortgage (yes, people still pay their mortgages) and get some cash for the weekend.

Tonight my wife tells me that we are going to the grocery store. I will probably drag her over to Home Depot to get supplies for a home improvement project also.

While my life may not exactly be the most exciting, it is like most Americans—and most people on the face of the earth for that matter.

My point is that ***just because the stock market dropped in value DOES NOT mean that our world stops, nor does it mean that investments mysteriously lose all of their value***. We still live in a capitalist society in which we build things to sell or offer services that people need.

This is the foundation of capitalism. And nothing about this has changed. I still plan on showering and hope you will too.

Unfortunately, the people who work for the news outlets are *journalists* reporting on financial issues. They have very little, if any, financial training. Instead, ***their training is focused upon creating sensationalism*** so their TV station, magazine or newspaper can sell advertising. As such, ***they do not have the first clue about helping you with your personal finances***. Furthermore, they have no clue as to what is really going on in the financial markets. They certainly have no idea what is most appropriate for you.

Given all that is going on **we would love to hear from you** if you are concerned about the current state of affairs. Without our clients we have no reason to come to the office. Therefore, if you want to talk there is the phone, email or an in-person chat waiting. We'll have a fresh pot of coffee on also.

So before the idiots on the "talking box" give you heartburn, give us a call so we can talk through the realities. In the meantime, we have attached our Investment Principles for you to read should you have the desire.

Sincerely,

Dave

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™

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

Investing Principles & Instruction Manual

1. Our clients who experience the best long term returns are the ones who continue to put more money into investments in all markets—whether good or bad. ***This is the concept of Dollar Cost Averaging***. You cannot try to time the market and you must be willing to invest when the market is at peak levels of pessimism.

2. Between 1986 and 2005 the S&P 500 produced gains of 11.9% per year. However, the average investor only received 3.9% per year over the same time period. Why? The average investor buys high and sells low chasing after the emotional decisions.

3. Studies by Nobel Prize winner, William Sharpe, show that ***market timers must be right 82% of the time*** just to match the returns of an investor with a buy and hold strategy. Additionally, market timers incur approximately twice as much risk or volatility as the buy and hold strategy.

4. Investment ***returns in excess of 20% to 25% annualized are unsustainable***. Regression to the mean is a powerful force.

5. ***Discipline is the premier investment virtue***. Discipline is what keeps us from reacting impulsively and emotionally to what happens in our portfolios. It is a willingness to stick to a strategy during those temporary times it may be out of synch with the market.

6. Although a stock certificate may be printed on a piece of paper, it represents much more. Whether you buy one share of stock or many shares of stock, you must function as if you own the entire company. ***Quite simply, that is what stock is—ownership in a company***.

7. The ***stock market is a long term proposition***—meaning a ***ten plus year commitment***. Even if you are 65 years old and are retired you should be a stock market investor with an appropriate amount of funds for the remainder of your life (which statistically is a very long time).

8. If the volatility of the stock market is affecting your current standard of living then you have your assets invested incorrectly. The ***stock market should be utilized to produce long term (10+ years) growth*** in assets. ***Fixed income assets (C/D's, Bonds, etc.) should be used to satisfy short to intermediate cash flow needs***.

9. Assume your dream home is selling for $400,000 and one day some guy on the TV says that because of a variety of scary sounding issues this dream home is now only worth $200,000. Most logical people would assess this discount as an opportunity to be pursued and buy their dream home. Only in the stock market have we witnessed people get so negatively excited when the prices of good quality companies are cut in half. I suppose this is due to people's aversion to volatility and their inability to properly analyze the true value of a business. ***You must separate fear from opportunity***.

10. Over the past 50 years ***the broad stock market has lost as much as 35% in any one year***. Conversely, over the same time period ***the stock market has gained as much as 56% in any one year***. The average of these one year time periods has been 13%.

11. Also, over the past 50 years ***the worst performance of the stock market*** ***over any five year time period has been a loss of 3.2% per year***. ***The best five year gain has been 27% per year***. The average of these one year time periods has been 11%. ***Time is your friend when dealing with the stock market*** and its short term volatility.

12. ***Over the short term the stock market is merely a popularity contest that is quite irrational in nature***. Long term, however, the stock market is a weighing machine which weighs the value (earnings) created by good companies that consistently increase their earnings.

13. While the date of December 31st may have some meaning to you, it has no meaning to your investments. Do not become overly concerned with your investment performance as of this date or any other arbitrary date. ***Long term performance is what matters***.

14. ***Volatility and controversy create fear as well as opportunities***. To take advantage of this you must embrace volatility and have a strong stomach.

15. We own stocks personally and on behalf of our clients. We do so to participate, as owners of these companies, in their increasing pool of earnings.

16. Most days ***there is a disconnect (often substantial) between a stocks price and the true value of their earnings*** or the company as a whole. A perfect example is Berkshire Hathaway. Even though Berkshire has increased its book value by 10% per year between 2002 and 2005, the stock price has done virtually nothing. The stock markets emotional disconnect does not sway us from owning one of the greatest companies, with arguably the greatest CEO of all time. Long term, Berkshire's stock price will catch up to its increased book value and patient investors will benefit.

17. Although we make predictions about developing trends, these ***trends take time to evolve***. When we first started warning about over-valuation in tech and internet stocks in 1999 it took another year for these issues to become apparent. The same has been true for real estate. We first started verbalizing concerns about real estate in May of 2004. Only now are the flaws in real estate being openly discussed. Fortunately, our clients were positioned to avoid the tech disaster and are currently positioned to avoid any impending real estate wreck.

18. Although the financial news focuses heavily on the stock market, we do not obsess over it. We ***constantly evaluate all investment categories relative to one another***. However, stocks typically provide us with the best opportunities to outpace taxes and inflation.

19. ***Inflation is a silent killer***. You will never receive a bill for inflation and yet it has a bigger impact upon your assets than virtually anything else. With great consistency, the things we buy (food, energy, housing, etc.) go up in price. If your assets do not outpace taxes and inflation you lose purchasing power.

20. Consider the following: a ten year U.S. Treasury bond (a default risk free investment) currently yields about 4.5%. In a 33% marginal income tax bracket our clients lose 1.5 of the possible 4.5 percentage points available leaving only 3 percentage points to deal with inflation. Currently, inflation is running in excess of 4% on an annual basis. Therefore, after factoring in the affects of inflation this seemingly "risk free" investment actually guarantees a negative 1% real rate of return. ***Bottom line: this safe U.S. Treasury bond investment can produce horrible long term results.***

21. Many of our more conservative clients experience unrealized losses in their accounts from time to time—not because of their stock market assets, but because of their fixed income assets. Investors must realize that when interest rates rise, bond prices will decline. ***Fixed income assets do not deliver the "safe" returns that many expect.***

22. For quite some time we have been discussing the ***need for foreign exposure***. We live in a large global world and as such want our clients to participate in global capitalism. Most of our clients own stocks that sell more than 50% of their products outside of the United States. This provides us with tremendous international exposure via large mature and stable companies. We have also placed many clients into mutual funds that only invest outside of the U.S. This approach, along with owning U.S. based multi-nationals, provides clients with substantial global diversification.

23. Most ***financial magazines, newspapers and TV shows are designed to sell advertising, newspapers etc.—not individually customized financial advice***. Jim Cramer of CNBC's *Mad Money* TV show is an idiot. His show is designed to elicit emotion and entertainment—not sound investment advice. Cramer's ridiculous "Lightning Round" method of choosing investments is the financial equivalent of Russian Roulette—entertaining, but potentially catastrophic.

24. All of our clients are different, with different goals, income needs, volatility constraints etc. To satisfy our client's needs we ***constantly evaluate all types of investments for relative valuation, liquidity needs, income requirements, time frames, etc.***

25. We are honest with our clients even though it may not be what they want to hear. ***Our job is to look out for our clients with integrity and discipline***.