Second Quarter 2008 Commentary
Value & Earnings

When the first quarter ended I think we all breathed a sigh of relief that at least it was over. Unfortunately, despite some encouraging signs the second quarter did not finish with positive news. This now marks the third quarter in a row of down performance. But you don't need us to tell you the obvious.

Thankfully, we have Fox, CNN, MSNBC etc. telling us how bad things are (insert full sarcasm). Better yet, our fine news outlets report one miniscule scrap of data and repeat it 25 times throughout the day. This leads us to believe that by the end of the day that things have gotten 25 times worse. Obviously, this is not the case.

Just remember that the news outlets are in the business of selling advertising—not providing you with honest, logical advice. ***Limit your "news" intake to 30 minutes a day and you will be much better off***.

As bad as we have been told things are here it is all relative. Many of the "hot" markets that we purposely avoided (like China) have now dropped by more than 50%. And while the US markets are down about 20% from their high points we do not believe this represents the operating and earnings reality of many traditional businesses in the US.

In addressing "how bad things are" you must remember that ***the value of a business is its EARNINGS***. A very emotional Wall Street may tell us that a given company is worth wildly varying amounts over all sorts of short time periods. However, ***over long time periods the value of a business ALWAYS will be based on what that company earns.***

While this "VALUE=EARNINGS" concept sounds pretty simple and logical there are often periods of disconnect to where Chicken Little takes over and Wall Street largely ignores EARNINGS. Now is a perfect example of Chicken Little telling us the sky is falling. But is it really?

To provide some analysis we pulled data on a wide range of companies.

General Electric:	5 Yr Earnings: +42%	5 Yr Stock Performance: -37%
Johnson & Johnson:	6 Yr Earnings: +86%	6 Yr Stock Performance: -6%
Proctor & Gamble:	2 Yr Earnings: +32%	2 Yr Stock Performance: -20%
Coca-Cola:	8 Yr Earnings: +98%	8 Yr Stock Performance: -26%
American Intl Group:	7 Yr Earnings: +30%	7 Yr Stock Performance: -73%
American Express:	7 Yr Earnings: +157%	7 Yr Stock Performance: -35%
3M:	5 Yr Earnings: +85%	5 Yr Stock Performance: -18%
Wells Fargo:	4 Yr Earnings: +18%	4 Yr Stock Performance: -28%
Target:	3 Yr Earnings: +23%	3 Yr Stock Performance: -23%
Home Depot:	6 Yr Earnings: +45%	6 Yr Stock Performance: -55%
Walt Disney:	2 Yr Earnings: +19%	2 Yr Stock Performance: -11%
Walgreens:	3 Yr Earnings: +33%	3 Yr Stock Performance: -34%

As you can plainly see this is a wide representation of American based businesses over many industries and over many different time periods. ***In each case these businesses significantly improved their earnings and yet their stock price fell***. The bottom line: ***Over short periods of time the stock market can truly mis-price some great companies***.

Knowing this, ***the value of any business is still its earnings. That has not changed and it never will***. However, the disconnect between Chicken Little and the recognition of earnings equaling value can be dramatic and may last for several years. In fact, ***many companies now trade for less than their book value or liquidation value.***

Even Berkshire Hathaway (Warren Buffett's company) is down over 21% in stock price just since December—despite handsomely increasing its earnings. Do you really think that something materially has changed within Berkshire or do you just think that Wall Street is overreacting?

For this reason we have always said that if we are to be stock market investors we do so understanding and accepting that ***our holding period is TEN or more years***. We make this statement for a variety of reasons, but mainly we know that disconnects of this nature occur. We also know that disconnects of this type correct themselves—if you have the stomach to hang in there and absorb the volatility.

Jumping back to the topic of our friends in the media, let us leave you with one question: If things are so bad ***are you better off today than you were ten or twenty years ago?***

We'll leave this up to you to answer, but our guess is that the answer is that your life is substantially better.

Despite all of the dire talk on the news, our observation is that our lives as a whole are much better today than they were 10 or 20 years ago. And we think that our lives will be much better in another 10 or 20 years from now.

Finally, we encourage you to ***go back and re-read our First Quarter Commentary***. There are some great statistics that relate directly to what is going on now. If you don't have a copy let us know and we will get you one.

If you have any questions, comments or suggestions please know that we continue to be here seven days a week to take care of our clients. We remain obsessed and passionate about the business we are in and want to make sure that our clients are comfortable with where they are headed. As such, please don't hesitate to stop by, call, email, send us a smoke signal etc. We look forward to hearing from you.

Sincerely,

Dave

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™