Sather Financial Group Inc.
Comprehensive Wealth Managers

2010 Fourth Quarter Commentary: A Better Year Than Expected

A year ago, if we guaranteed that the year ahead would continue to slog through the worst recession since the Great Depression and unemployment would continue to climb, I doubt any of us would be too excited about our investing opportunities. That is what happened and despite those less than inspiring economic markers, the broad stock market indices performed rather well.

That is great and it feels good to have added some value to our accounts. However, where are we headed from here? A few comments/predictions:

The Presidential Cycle: This year is the third year of the Presidential cycle, which is usually very good for stocks. There have been 19 *Year 3's* since FDR was in office without a single serious bear market. Furthermore, the only down year was a loss of 2%. Will the 20th year 3 follow suit? Although we have had massive and unusual stimulus in the first and second years of this Presidential cycle, we are confident that the government will pull out all the stops to stimulate 2011.

Interest Rates: In an effort to boost the overall economy, the Fed will keep short term interest rates low. We will be surprised if there is any increase in the Fed Funds rate before 2012. That said, it is important to point out that although the Fed can set short term interest rate policy, the broad markets dictate supply and demand for longer dated fixed income securities. The rates on longer maturity bonds are starting to edge up as we have previously predicted.

Politics: Last year saw a large reversal in the political landscape with the Democrats losing control of Congress. Whether pro-Republican or Democrat, the financial markets generally like gridlock simply because it keeps the more extreme ideas in check and forces opposing sides to work together. Sadly, there is still a lack of vision among our elected leaders to see beyond the next election. You cannot successfully or efficiently manage an economy like ours if the extent of your outlook is a mere two years.

The Fed: In addition to keeping Fed Funds low, the Federal Reserve will continue with their Quantitative Easing exploits. This will attempt to drive up the price of fixed income securities which in turn drives down the yield to maturity from these securities. This also puts downward pressure on the US Dollar which is great if you are an exporter. Other nations know how this game is played and are keenly observing our actions which could easily lead to a global trade war.

Unemployment: Currently, stated unemployment is 9.7% and has been above 9% for 19 straight months. Despite this, we see some hope on the horizon. Within the next year we expect companies to return to more traditional hiring practices which should lower unemployment to about 8.6%. Although this is not a great figure, it is a step in the right direction.

Housing: While the government's home buyer tax credits helped to fuel the housing market in 2010, the momentum has lost steam and the cheapest of mortgage rates appear to be history. Unfortunately, home prices are dropping again which may foretell a double-dip in the housing market. On the national level this is rather difficult. Fortunately, the markets in Texas are far better off.

Tax Policy: Whether you agree with the extension of the Bush-Era tax rates or not, at least it has given us some clarity of what to expect for the next two years. Although no one likes to pay more taxes than necessary, sooner or later we will have to contend with our national deficit. This will come in the form of higher tax rates or printing money. For the time being, tax policy will keep rates low in an effort to stabilize a fragile economy.

Energy/Commodities: We are budgeting for high oil prices in 2011. Although we're not sure there is necessarily increased demand for oil world-wide, the strength in price is more related to weakness in the US Dollar. As such, when the Treasury prints more dollars, and therefore devalues our currency on a global basis, the price of oil (which is priced in dollars) increases relative to other currencies around the world.

Although gold gets much of the headlines, similar concerns are present for a wide variety of commodities. They are all going up in price relative to the dollar. As this happens, the cost of living increases for all of us.

The Stock Market: One of the few bright spots on the financial landscape continues to be the highest quality of US based blue chip stocks. These companies saw the on-coming financial nightmare on the horizon and hunkered down by cutting costs and debts and building up cash balances. Now that the worst is behind us, these companies continue to offer cheap valuations, sizeable dividends and a large cash hoard to make acquisitions, buy back stock or further increase dividend payouts. Although stocks will always experience short term volatility along the way, this category of investment offers compelling value, cash flow and long term balance sheet stability.

Given all of the challenges we are facing, give us a call to discuss. Although it is easy to focus on the negatives, we continue to be cautiously optimistic on the long term opportunities in front of us. ***Happy New Year and best wishes for a safe and prosperous 2011.***

Sincerely,

Dave Sather, President
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