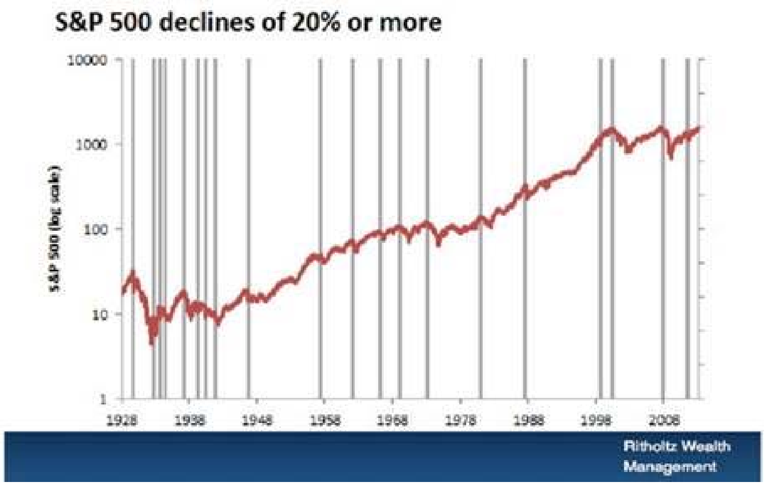
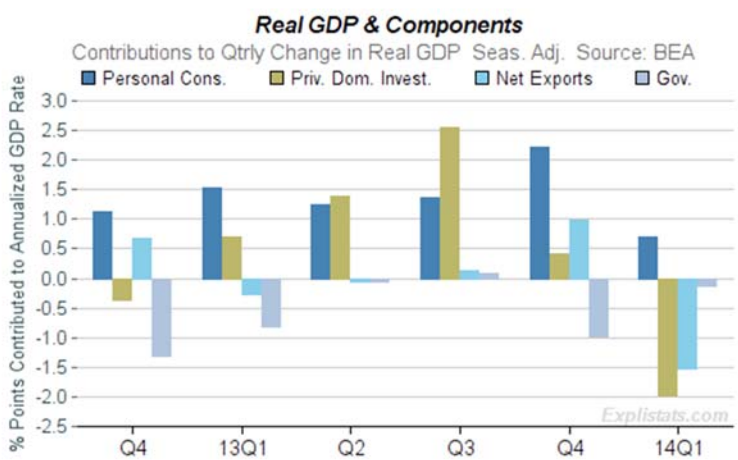
Sather Financial Group, Inc.
Private Wealth Management

Second Quarter Commentary 2014
TINA: (T)here (I)s (N)o (A)lternative

Stocks: At the halfway point of 2014 the S&P 500 and the Dow Jones Industrial Average both produced gains. Although we'll gladly accept the performance, we do so with one eye on the future and the other over the shoulder. This is due to a variety of conflicting matters weighing upon the economy as a whole. We also believe that due to such low interest rates the stock market continues to be favored simply because investors see no other good alternatives—hence, the TINA market.



Given the rebound in the stock markets, we have received numerous calls from concerned investors wondering when the stock market will "crash." Unfortunately, ***we don't have a crystal ball***. However, if history is any guide there will be some sort of "correction" eventually. As the graphic above shows, ***in the last 86 years the S&P 500 has dropped by at least 20% on 21 different occasions. This is an average of one drop of this magnitude every 4.3 years***. As such, it is not a matter of "if" but "when". Furthermore, this is why we don't make short term stock market decisions and instead focus on where we want to be 10 or more years from now.



GDP: For the first quarter, Gross Domestic Product was revised from -1% to -2.9%. The revision was expected to be at -1.7%. Obviously, the coldest winter in 30 years put quite a damper on spending. This was the biggest decline in GDP since "the bottom" in the first quarter of 2009.

Although we think GDP will bounce back to a positive figure in the second quarter, it is obvious that the economy continues to be weak. ***It will not surprise us if GDP struggles along at a 2% per annum pace***.

Corporate Profits: ***US corporate profits as a percentage of GDP hit a new high of 11.2% in the first quarter***. Although many assume that this is due to increased efficiency, it is also due to a lack of hiring, a lack of expansion and a lack of refilling inventory. As such, we are not entirely sure this is a good thing.

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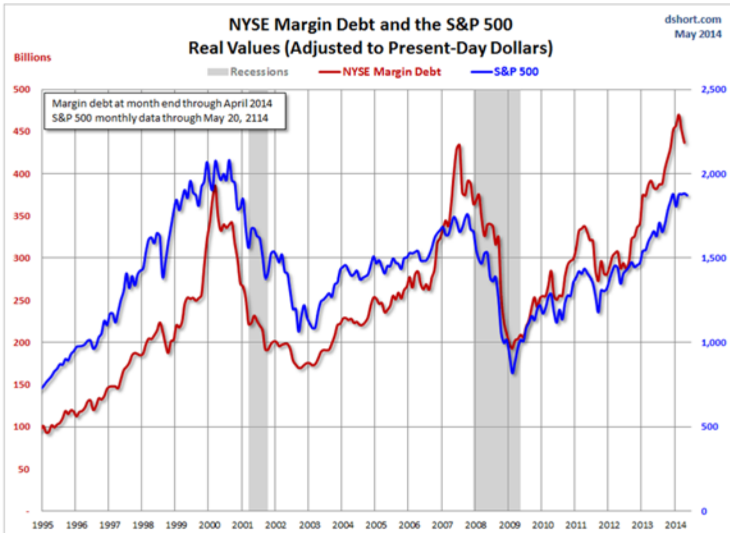
Interest Rates: At the end of 2013 the 10 Year US Treasury Bond was yielding about 3% interest. Since then, interest rates have dropped back down to 2.52%. This drop in rates comes with the Federal Reserve backing out another $10 billion in "Quantitative Easing" purchases.

Although many are calling for higher interest rates we can honestly say that we don't know. There are strong arguments for higher rates in the future—as well as rates staying right where they are.

Given the lack of clarity, we prefer to favor investments that perform well in all markets. As a for instance, the demand for Coca-Cola products is quite neutral relative to interest rates. Although that may be a simple decision, we find that ***simplicity is widely rewarded***.

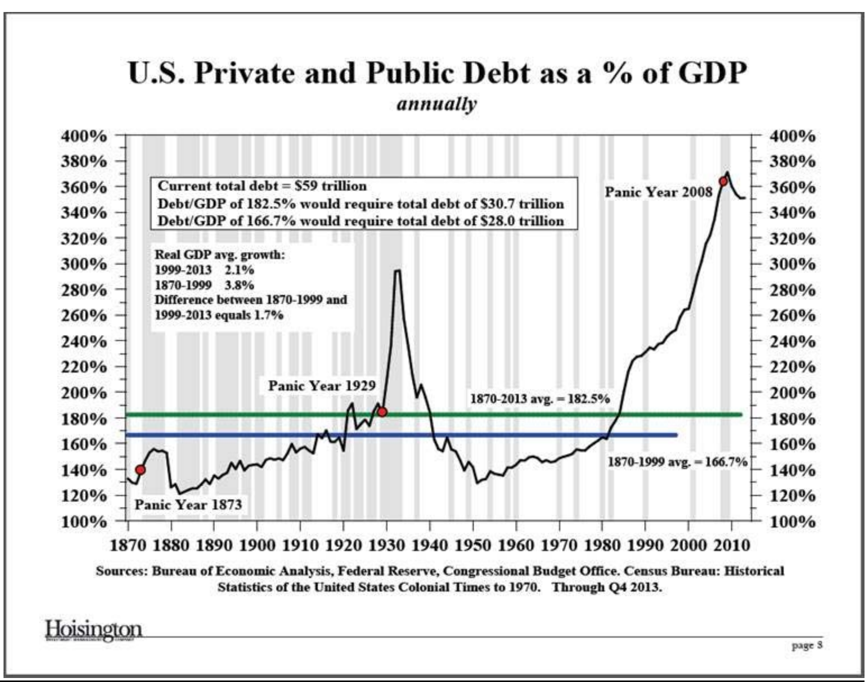
Margin Debt: Stock market investors have seized upon this "easy money" and borrowed heavily against brokerage assets. Some have used this "margin" debt to buy more stocks while others may be borrowing against their brokerage accounts to withdraw money and buy other things. Fortunately, we are seeing some reduction in this reliance on borrowed money—but margin levels are still very high.



This should remind investors that leverage does not make you right or wrong—but it greatly magnifies the amount by which you are right or wrong. Depending upon which way interest rates are moving, highly leveraged investments can make you look very smart or ridiculously foolish.

National Debt: As a whole, we remain a nation addicted to debt. Although the public and private debts as a percentage of GDP have fallen from their 2008 peaks, they have now leveled off and remain well above historical averages.

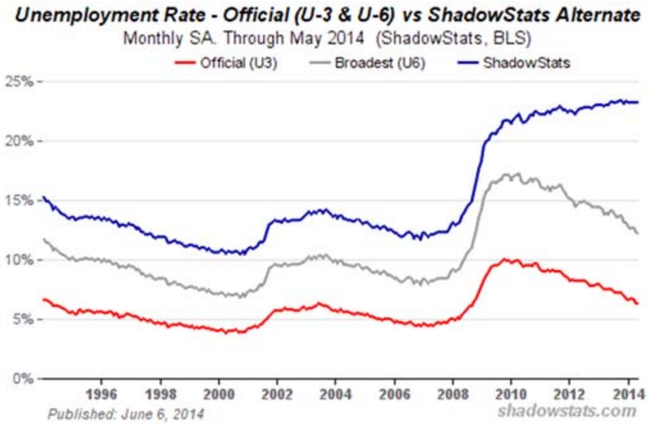
In general, debt levels of this nature stifle future growth as you eventually have to pay these obligations back.



Employment: It was recently announced that we have finally recouped all of the jobs lost since 2008. Assuming this is true, then why are the unemployment figures so anemic?

The US Labor Department reports the "official" U-3 unemployment figure at 6.3% in May. Although that tells part of the story, the broader U-6 metric of unemployment adds in other categories of people.

For instance, the U-6 calculation adds in the unemployed, the *__under__*employed and those that have given up looking for a job—but still want a job (the discouraged).



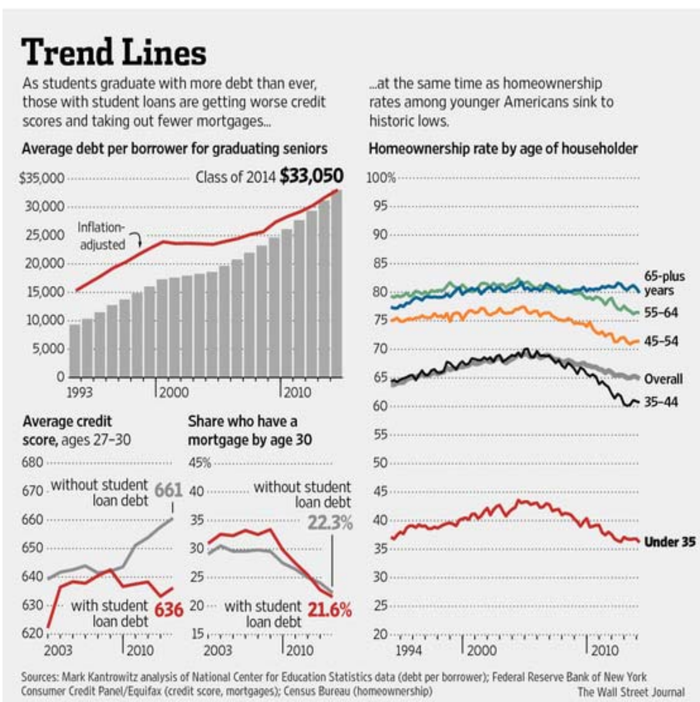
ShadowStats recognizes that other people in our economy are not covered by the "official" definitions of unemployment. For instance, if your unemployment benefits have run out—but you still don't have a job—you are no longer officially considered "unemployed." Furthermore, recent college graduates within the past two years—who don't have a job—are not considered unemployed. Also, people who are only able to find part-time work are not considered in the unemployment figures.

__After factoring in all of the caveats of people who are NOT officially counted, the true picture of unemployment/underemployment is about 23%.__ As we have mentioned in the past, it is very hard to have meaningful growth in Gross Domestic Product with this many people out of work.

Immigration: A major reason the Labor Participation Rate has declined to a multi-decade low level is immigration. As such, it is a true statement that all of the 8 million+ jobs lost in the Great Recession have been replaced. However, at the same time many people immigrated to the US. Since 2010 43% of the employment growth has gone to immigrant workers.

Student Loan Debt/Housing: The graduating class of 2014 left the academic world in search of employment with an ***__average of more than $33,000 in student loan debt__***. Along with the burden of paying back these loans many are seeing a decline in home ownership, especially among those coming out of college.

It is estimated that due to record student loan obligations payable over the next ten years that we should expect a corresponding drop in GDP and home ownership over the same time period as typical expenditures are diverted to pay back borrowed money.



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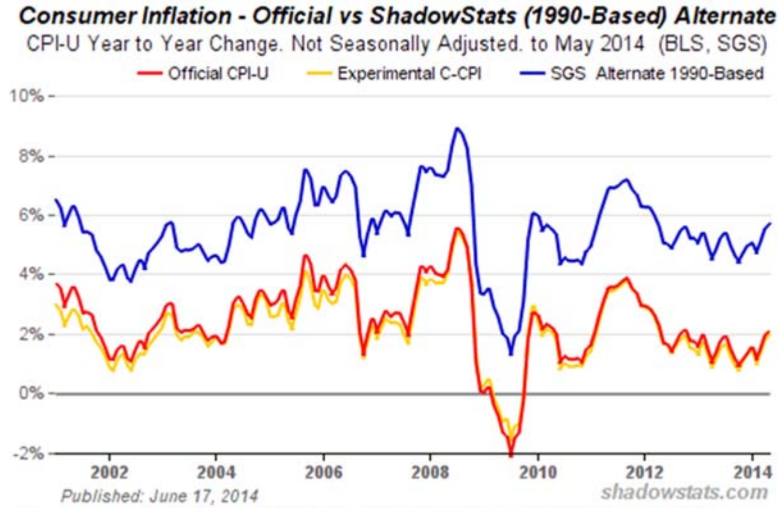
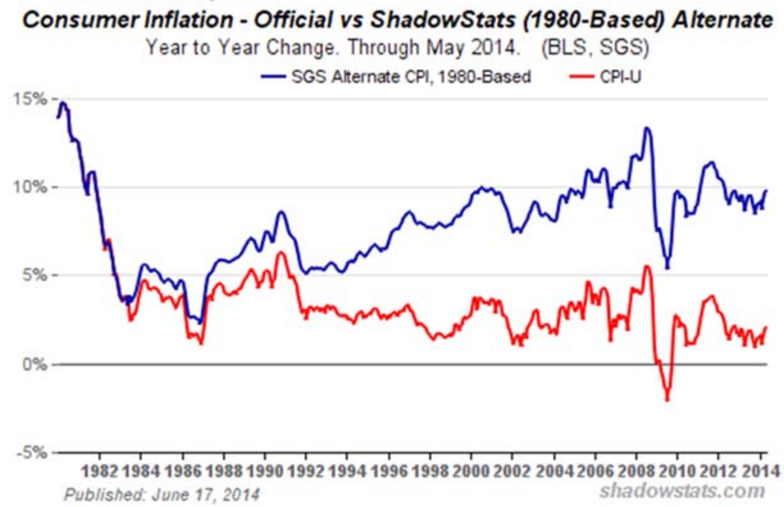
<u>Inflation</u>: Depending upon your preferred metric of inflation, life is definitely more expensive. Although the federal government reports "official" inflation at 2%, using past governmental calculations would indicate a more realistic figure of between 5% and 10%. We think the argument can be made that the true cost of "life" is somewhere in between.





<u>Where Do We Go From Here?</u> Despite the numerous problems, challenges and issues in the world, our preference for LONG TERM investors continues to be focused on investing in high quality companies. We believe this will deliver better stability and predictability in client portfolios—and the ability to sleep at night. As such, we think this is not only a necessary discipline, but a preferred one.

<u>It is at times like these that we are reminded of the saying "In order to finish first, you must first finish."</u>

<u>Finally, we wish you health and happiness as you celebrate the 4th of July and enjoy our many freedoms.</u>

Let us know if you have any questions.

Sincerely yours,

Dave

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