NEWSLETTER FALL 2007

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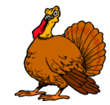
Investment Thoughts from Chris and Greg

Dear Clients,







"The difference between a successful person and others is not a lack of strength, not a lack of knowledge, but rather a lack of will." - Vince Lombardi

We hope you've been enjoying the final weeks of summer, and taking advantage of the sunny days, which have been far too precious recently.

Given the recent market volatility, we'd like to take this opportunity to discuss the importance of maintaining the perspective that fits your investment circumstances. While the Dow Jones Industrial Average was up 4.6% from June 30th until its July 19th peak, then down 10.73% to the August 16th bottom, and now back up 6.4% as of August 27th, the net result is a meager drop of –0.65% for the quarter.

On a day-to-day basis, the market has indeed fluctuated to an extent we haven't seen since the late '90s. And if you need to sell a mutual fund to pay for first semester tuition, those swings can indeed be meaningful. However, if you're saving for retirement in 5, 10 or 20 years, the importance of daily (or even monthly) swings pale in comparison to having an appropriate savings plan in place – and being willing to stick with it through thick and thin.

Human nature has a funny ability to trap us in the moment, feeding on our insecurities and letting emotion take over at the most inopportune times. At these moments, it's extremely difficult to look beyond the circumstances of the here and now. How many of us were certain four weeks ago that Madison would never see another drop of rain – or now that it will never stop? Or assumed that the value of our homes would always grow at double-digit rates? Did you stop looking at your account statements during the bear market because it was inevitable that the account value would have gone down? These thoughts and impulses are perfectly normal (we're certainly susceptible as well, despite our profession) – the trick is not to make rash decisions because of them.

In practice, that means building a portfolio that strikes the appropriate balance between risk and reward, and then maintaining the integrity of that plan in spite of the market's best efforts to tempt us to switch tracks. Our two featured articles, both excerpted from the Wall Street Journal's "Getting Going" column, discuss the critical decisions in assembling that portfolio: arriving at an appropriate stock/bond split, and then effectively diversifying within that split. While we're pleased to see a number of our portfolio concepts echoed, we view them as we do all of these articles: as a starting point for discussion rather than the final word. We hope that you find them interesting, and look forward to continuing the conversation with you.

Our New Assistant ...

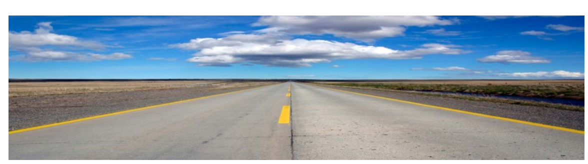
Hello, my name is Andrea Watson, and I am very excited to be joining the Bugg/Rademacher group. Chris, Greg and Jodie are fabulous to work with. I will be acting as Executive Assistant to Chris as well as assisting Jodie and Greg with any projects they may have.

I am originally from St. Louis, MO, but have spent the last 5 years in Chicago. Most recently, I was a new accounts representative with optionsXpress, specializing in account transfers. I moved to Madison about 3 months ago with my fiancée, Eric and our cat, Pickett. As great as Chicago is, we love living in Madison and have been spending our free time playing tennis in Stricker's Park, exploring some of the great restaurants in the area, and bird watching out of our window (that's Pickett's favorite activity).

I've enjoyed meeting many of you throughout the summer, and am looking forward to meeting many more. Please feel free to give me a call if you have any questions. I'm always happy to help.

...And A New Role For Jodie

We are also proud to announce that Jodie will be taking on increased responsibilities within our team. We want to know, "What would you like us to do better?" A more proactive approach to learning about my goals was the answer that topped our list. As Yogi Berra once said, "If you don't know where you are going, you'll end up some place else." Jodie's focus will be on helping us to better keep in touch with you and your financial needs—and on the straight path to your financial destination.



Congratulations, Jodie!

Why Your Paycheck is Really a Bond

By: Jonathan Clements

July 11, 2007

Many folks think the world revolves around them. And financial experts agree.

Among leading investment advisers, one of this year's most discussed topics is so-called lifecycle finance. The notion: Often, our most valuable asset is our ability to earn income, so we ought to figure our "human capital" into our investment mix.

Indeed, lifecycle finance provides a great framework for thinking about money -- and it could help you build a more prudent portfolio.

WHAT YOU'RE WORTH

How to figure out your paycheck into your finances:

- **When you join** the work force, think of your earning ability as a bond and diversify it with stocks.
- **As you age,** you have fewer paychecks ahead of you, so you will want to shift toward bonds
- **When you retire,** consider replacing your salary with an income annuity.

• **Managing capital.** If you are in your 20s, you likely have precious little savings, but ahead may lie four decades of paychecks. By contrast, if you are in your 60s, your income-earning days are probably drawing to a close. With any luck, however, you have amassed a fair amount of financial capital to replace your human capital.

How can you best manage your financial capital to complement this gradual decline in your human capital? Think of your paycheck as similar to a bond, with its steady stream of income.

Early in your career, you will want to diversify this bond by investing heavily in stocks. But as you grow older, you should prepare for the eventual disappearance of your paycheck by buying more bonds in your portfolio.

• **Seeking stability.** Seem reasonable? Problem is, not everybody's paycheck is bondlike. Suppose you're a salesperson on commission. Your month-to-month income may be highly unpredictable, so you might want to lean toward bonds in your portfolio.

Favoring bonds can be especially smart if you're a Wall Street employee whose income rises and falls with the stock market. Terry Burnham, director of economics at Boston's Acadian Asset Management, tells the story of a friend in the money-management business.

"He has 100% of his money in short-term, high-quality bonds," Mr. Burnham recounts. "His broker says, 'You could earn higher returns in stocks.' His response is, 'I am the S&P 500.' "

• **Avoiding yourself.** Once you decide how much risk to take with your portfolio, think carefully about which particular investments you buy.

Workers will often invest heavily in their own company's shares. Real-estate brokers will buy rental properties. Silicon Valley employees will load up on technology stocks. This "invest in what you know" strategy may be comforting. But it isn't as safe as it seems.

"What are the characteristics of your human capital?" asks Moshe Milevsky, a finance professor at Toronto's York University. "If you're a real-estate developer, maybe you're a real-estate investment trust. If you're a miner, maybe you're an ounce of gold. If you work for Weyerhaeuser, maybe you're a forest product."

The implication: Your income is already riding on one sector of the economy. Don't crank up your risk even further by sinking yours

• **Insuring income.** Lifecycle finance can also help you figure out what type of insurance to buy.

Given that your human capital is so valuable, you will want to protect your family against the loss of this income by buying life insurance and, if your employer doesn't provide it, maybe disability insurance as well. The amount of life insurance you need, however, should decline as you grow older. After all, not only will you accumulate more savings, but you will have fewer paychecks ahead of you.

Meanwhile, once you quit the work force, you will want to replace your paycheck. "Up until now, we've been telling people that what matters is how big your portfolio is on the day you retire," notes Milwaukee financial planner Paula Hogan. "But what really matters is how much you can spend each year over your whole life."

If you try to pay for retirement by slowly drawing down your nest egg, there's a risk you will outlive your savings or your finances will get derailed by rotten markets. To protect yourself, you'll want insurance -- in the form of guaranteed lifetime income.

Your Social Security benefit will provide some of this insurance, and you may have a pension as well. If you want further protection, consider buying immediate annuities that pay lifetime income.

What Your Portfolio Really Needs

By: Jonathan Burton

August 15, 2007

Feeling whipsawed by this market? It's times like these when a diversified portfolio is supposed to pay off. But with so many exotic choices out there, it's hard to know what diversification really means.

These days, what happens on Wall Street doesn't stay there. Gyrating U/S. stocks affect Europe, Asia and elsewhere, as has been painfully evident recently to investors seeking shelter from the markets' torrential storms.

So why diversify? Two words: ***risk control***.

Diversification keeps several pots simmering at once. It's a curious fact that adding riskier assets to a portfolio actually makes it safer. The key is how much of each ingredient you use. Ultimately that depends on your taste, but if Julia Child had been an investment adviser, she would have told you that a little spice goes a long way. Putting 5% of a portfolio in emerging-market stocks and 5% in real estate, for example, has been shown to boost returns and lower volatility.

It turns out that when viewed over many years, markets aren't so intertwined after all. Stocks in the U.S. and other developed countries take independent paths, and emerging economies are in another orbit. Stocks have even looser ties to bonds, real estate, commodities and other alternative investments.

Your options, however, seem endless. Some tap vital markets; others are just clever marketing. Confused? Here's what you really need to diversify, what's nice to have and what you can do without

• **Need to have.** *Stocks:* Fundamentals apply. Own shares of large and small companies -- only now when you buy locally, think globally. The big companies in the Standard & Poor's 500 Index, for example, generate almost half of their sales outside of the U.S.

With a conservative allocation of 60% stocks, for example, give brand-name S&P 500 stocks 35% of the portfolio and small caps 5%. Then earmark 15% to an international index fund that holds companies of all sizes, plus another 5% to a geographically dispersed emerging-markets fund.

HOW TO DIVERSIFY

• **Need to have:** U.S. stocks, overseas developed and emerging market stocks, U.S. government bonds.

• **Nice to have:** U.S. and international real estate investment trusts and other real estate securities.

• **Don't really need:** Sector stock funds, gold and other commodities.

Bonds: The subprime mortgage mess is tainting bonds. Avoid trouble by investing in U.S. government bonds and other top-quality issues. Bonds provide regular income, so they're a terrific diversifier, and over time show decent returns. Long-term Treasurys, for example, have delivered three-fourths of the S&P 500's 11.7% annualized gain since 1989 with about 60% of stocks' volatility, says Ibbotson Associates.

Bond prices fall when interest-rates rise, and vice versa. Longer-dated bonds are susceptible to rate changes, while short-term issues are insulated. Cover yourself with a "laddered" strategy of one-, three-, five- and 10-year debt. Consider Treasury Inflation Protected Securities, or TIPS, which unlike most bonds will hold their value as the cost of living climbs.

"Have the core of your portfolio in stock index funds and bond index funds," says John Bogle, founder of mutual-fund giant Vanguard Group. "That's the way you will capture the largest percentage of returns that a business earns."

• **Nice to have.** *Real estate:* Home ownership is probably enough real estate for most of us. But property does act differently from other investments. A 5% stake in a mutual fund or exchange-traded fund that owns real-estate stocks or real-estate investment trusts should do the job. Again, think globally -- the world is getting wealthier, and as the saying goes, they're not making any more land.

• **Don't really need.** *Sector funds:* Buying a surging sector is tempting, but such bets can turn against you quickly. "Be involved in profitable businesses around the world regardless of what's hot and what's not," says Kacy Gott, a financial adviser in San Francisco. "Don't chase sectors. That's not for investors; that's for traders."

Gold: It insures against financial catastrophe and marches to its own drum. But as an investment, short-term risk is high and long-term reward is marginal. If you want gold, buy jewelry.

Other commodities: This is a controversial call, for good reason. The price of so-called hard assets is soaring. China, India and other fast-growing countries need oil, natural gas, metals and materials to fuel development. Demand for agricultural products is also high.

You can play this trend with funds or ETFs that own a basket of commodities, and yes, you'll get diversification. But in truth, you'll do fine without direct exposure.

"Commodities are way overhyped as an asset class," says Jeremy Siegel, a Wharton School finance professor. Instead, he'd buy stock in oil producers, mining companies and other businesses that stand to profit from this global boom.

Discussion Point : What is the #1 thing we can do to improve our level of service?
(write or call any of us, or e-mail katie@btnwd.com for an anonymous submission)

From all of us on the Bugg/Rademacher team, we hope that you have had a great summer, and we look forward to seeing you soon. Feel free to contact us to set up a time to meet — we would love to hear from you!

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