Investment Thoughts

Buttonwood Partners, Inc. B & I Advisors

Fall 2008

CRAMER WAS RIGHT!

Christopher Bugg

Many of our clients are going to receive their October 31 statements within the next few days, and we want you to know we're fully aware that this is probably the worst report you've seen in all of the years we've been working together. Clichés like "stay the course" offer little comfort at a time like this. Nevertheless, our job is to see that you have money available in the future to meet your needs and goals. It is helpful to us if you understand how we see the world.

Last week, I asked a group of people if they had seen or heard about either Suze Orman's comments on TV (after the Dow drop of 777 points on September 29th), or Jim Cramer's now-famous appearance on the Today show the following week (on October 6th). Several people raised their hands. When I asked what they had heard or seen, they universally replied, "Take all your money out of the stock market." Their observations were supported by the headlines. A few examples that a quick Google search will provide: "Cramer: Now is the time to panic;" or "Mad Money's Jim Cramer on the Today show told people to get out of stocks;" or "Jim Cramer begs America to abandon hope."

Suze Orman said, "It is possible one day you will go to your ATM and nothing is gonna come out." And "People say to me, 'I have money. Should I invest it?' Are you CRAZY?" Or one more: "We have built an entire economy on lies and deceit."

Well, it's "true" that Jim and Suze said these things, just as it's "true" that Senator Obama has spoken out against apple pie and Senator McCain against motherhood. Unfortunately, it's also true that at the moment their words were captured for replay on U-Tube, their intended message was to get their viewers riled up. Their actual words, however, were quite different.

What Jim Cramer actually said was, **"**Whatever money you may need for the next five years, please take it out of the stock market right now, this week. I do not believe that you should risk those assets in the stock market right now." He also said, "I think what you have to do, if you can withstand it, is just ride it out."

What Suze Orman actually said was, "Continue to invest in your Roth IRA and 401k, especially if there is a match," and "As long as you are invested in good quality mutual funds, diversified across the board, as this all goes down, you're buying more shares. The more shares you buy, eventually, when it turns around ... the more money you'll make."

How do we feel about this advice? We agree. Stocks are cheaper (a lot cheaper) than they were a year ago. If you are saving for retirement or some other goal that is several years away, we think this is a great time to buy. While it may not be easy to buy now, it's fairly obvious that long-term investors have a great opportunity today.

What is a great deal less obvious is our take on Cramer's "money you may need for the next five years." Suppose that a retired couple, one year ago, had $300,000 in retirement assets. They had been withdrawing $1,500 per month, or $18,000 per year. If 75% of their total portfolio was in stocks, do they have enough to take care of what they "need for the next 5 years?" We think they do. The 75% invested in stocks means they still had 25% (or $75,000) in cash, CD's and bond mutual funds. Although their account may well be down to $200,000, that $75,000 remains largely intact. At $1,500 per month, their $75,000 will provide them (after interest payments) with the $90,000 they need over the next five years.

This couple has already taken their money out of the stock market, because it was never in the market. In order to move on after 5 years – for the period beginning in October of 2013 – they will indeed need a stock market recovery. But remember, even Jim and Suze's most inflammatory comments were only talking about the next 5 years.

On page three, you can read about Warren Buffet's 5-year plan. Contact us, please, to tell us about yours. Remember our questions: How much do you need, and when do you need it?

The "R" Word

Gregory Rademacher

That's right, recession. While technically a recession has not yet begun, the general consensus is that a domestic recession started sometime earlier this year and a global recession is now underway. The debate is no longer about if we are facing a recession, but about the length and depth of it. But beyond the bold-type headlines, what does this mean for you? What should you expect in the coming weeks and months? We hope the following "recession primer" helps answer some of your questions. *(Continued on page 2)*

In this Newsletter:

Recession and the Market Factoids *(The "R" Word, continued from page 1)*

- The rule of thumb definition of a recession is two or more consecutive quarters of negative growth in real GDP (gross domestic product). However, the National Bureau of Economic Research (NBER) is officially in charge of declaring a recession, and their definition is "a significant decline of economic activity spread across the economy, lasting more than a few months…"
- Since 1945, there have been 11 recessions, with an average length of 10 months. The two most recent recessions (1990-91 and '01) both lasted 8 months, while the economy contracted for 16 months during the most severe recessionary periods (1973-75 and 1981-82).
- Stock market declines and recessions do tend to go hand-in-hand. In fact, during the 6 recessions since 1973, a decline of 20% or more in the Dow Jones Industrial Average has occurred every time (including 2008). However, the stock market tends to be a leading indicator, peaking before the recession begins and bottoming before it ends. With the exception of 2001, the Dow reached its low at least three months before the recession ended. In fact, during the time period the actual recession was occurring, the stock market actually rose 7 times, and the average market return during all 11 recessions was 3%.
- In August 1998, the Dow fell 1,000 points – about one-fifth – in a few days, following the financial crisis in Asia and Russia. Despite the dire warnings, the U.S. did not enter a severe recession. Most people have even forgotten there was a panic in 1998.

It wasn't the crash of 1929 that caused the Great Depression. Wall Street actually rallied sharply in the following six months.

Financial Tips for a Recession

- The primary causes of this recession were the bursting of the housing bubble and the subsequent credit crunch that resulted as financial institutions attempted to deal with catastrophic losses on their mortgage portfolios. As a result, credit has become less available, and at less favorable terms.
  - ⇒ Action Item: If you are looking to buy a house in the next few years, be prepared to have a much larger down payment ready – the traditional 20% has once again become the standard in order to receive the lowest mortgage rates. And the 30-year fixed mortgage is still your friend.
- A slowdown in economic activity hits certain industries harder than others – car dealers and appliance stores are particularly hard hit this time around.
  - ⇒ Action Item: Don't hesitate to watch for attractive financing deals when shopping for that new car, TV or refrigerator – or to hold out and/or negotiate until you receive them.
- Managing your credit score is more important than ever. A good score is always useful in borrowing at favorable terms, but now it's a virtual requirement to even have access to financing.
  - ⇒ Action Item: You have free access to your credit report (annually) through www.annualcreditreport.com. You are eligible for one free report from each of the three rating agencies, so you can monitor the report up to three times per year by only requesting your report from one agency at a time. Viewing your actual credit score usually carries a fee, but the report is a good starting point.
- Time is on your side. If you had invested in the Dow Jones Index at the market bottom, your annual returns for the following 10-year periods would have been 7.8% ('74-84), 14.0% ('80-'90), 15.5% ('82-'92) and 16.7% ('90-'00).
  - ⇒ Action Item: Review your investment plan and savings goals. Continue to fund your retirement account, Roth IRA's, and other long-term savings vehicles. The reason dollar-cost averaging works is the ability for your regular contributions to purchase a greater number of shares when prices are low – which is exactly what is occurring right now.

Retirement Planning for 2009

Jodie McLellan

It's my favorite topic: retirement planning. Given the recent market conditions, many people are calling to ask us whether they should cut back or even stop their contributions to their retirement plans. Our answer is a resounding **NO!** We want you to ***INCREASE*** the amount of your contributions. As stock prices trade at or close to their 5-10 year lows, we believe you should use this time to take advantage of the potential for long-term growth.

No matter what your contribution level, small increases can really add up. An extra $5 per week (one extra brown bag lunch per week) would put $260 into your retirement plan over the course of a year and over 20 years, it could grow to more than $14,500 (at a 9% annual growth). ***Little changes and small increases can make a big difference to your retirement plans.***

The IRS has again increased the maximum contribution limits in 2009 (for most types of plans), so please review the tables below.

It is an uncertain time, but please give us a call if you have questions or would like us to review your current retirement plan.

		Plan Type	
	401(k), 403(b), 457	Simple	Traditional or Roth IRA
2009 Deferral Limit	$16,500	$11,500	$5,000
Catch-up if age 50+	$5,500	$2,500	$1,000

		Plan Type	
	SEP	Simple	401(k) or Profit-Sharing
2009 Deferral Limit	20% of pay or $48,000, whichever is less	100% of pay or $11,500, whichever is less	100% of pay or $49,000, whichever is less
Catch-up if age 50+		$2,500	$5,500
Annual pay eligible for contributions capped at $245,000			

Buy American. I am

By Warren E Buffett
The New York Times
Published October 16, 2008

THE financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary.

So ... I've been buying American stocks. This is my personal account I'm talking about, in which I previously owned nothing but United States government bonds. (This description leaves aside my Berkshire Hathaway holdings, which are all committed to philanthropy.) If prices keep looking attractive, my non-Berkshire net worth will soon be 100 percent in United States equities.

Why?

A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.

Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month — or a year — from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.

A little history here: During the Depression, the Dow hit its low, 41, on July 8, 1932. Economic conditions, though, kept deteriorating until Franklin D. Roosevelt took office in March 1933. By that time, the market had already advanced 30 percent. Or think back to the early days of World War II, when things were going badly for the United States in Europe and the Pacific. The market hit bottom in April 1942, well before Allied fortunes turned. Again, in the early 1980s, the time to buy stocks was when inflation raged and the economy was in the tank. In short, bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price.

"Over the long term, the stock market news will be good."

Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497.

You might think it would have been impossible for an investor to lose money during a century marked by such an extraordinary gain. But some investors did. The hapless ones bought stocks only when they felt comfort in doing so and then proceeded to sell when the headlines made them queasy.

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "I skate to where the puck is going to be, not to where it has been."

I don't like to opine on the stock market, and again I emphasize that I have no idea what the market will do in the short term. Nevertheless, I'll follow the lead of a restaurant that opened in an empty bank building and then advertised: "Put your mouth where your money was." Today my money and my mouth both say equities.

Warren E. Buffett is the chief executive of Berkshire Hathaway, a diversified holding company.

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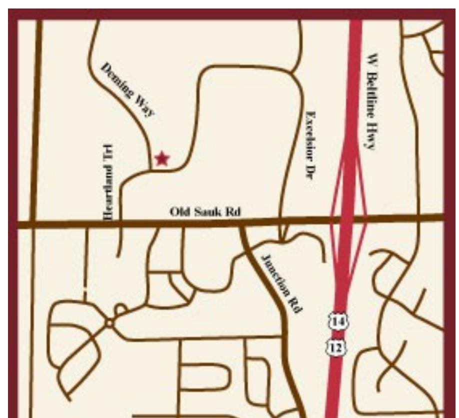

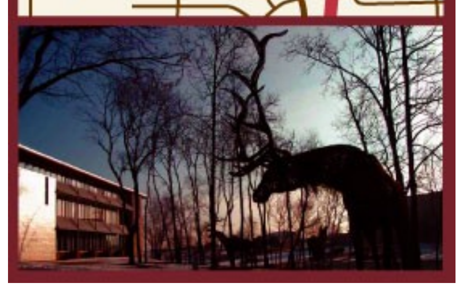

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