Winter 2009

Investment Thoughts

This Issue

"Seasonally adjusted, the lakes never freeze." I heard that many years ago, and it has stuck with me. In our featured article (on page 2 inside) Humberto Cruz writes that in the stock market there are seasons, and the lakes do freeze. Sometimes they stay frozen through spring, summer, fall and into the next year. In times like these, it's easy to conclude that the whole investment game is too chancy, or, a more dangerous conclusion, that "it's different this time." The lakes have frozen, so we must be entering a new Ice Age.

If you read carefully, however, you'll see that Mr. Cruz comes to the opposite conclusion. In order for stocks to match the worst 20-year period in history (which is an average annual compounded gain of 3.1%, he tells us), the average return over the next 10 years will need to be 7.6%. That is, if we have 10 years of -1.4%/year (1999-2008), followed by 10 years of +7.6%/year, the result would just equal that "worst ever" +3.1% over the entire 20 years. As we always say, past results are no guarantee of future performance, but we do have a bunch of 20-year benchmarks to serve as reference points.

My point is, before you move all of your retirement savings into a CD making significantly less than 7.6%, consider the odds. And consider the odds of knowing when to "get back in once we have reached the bottom."

This is NOT, in any way, a recommendation to put the money you need for the September 2010 tuition payment into the stock market. In that case, a CD paying 3% is just fine. However, if you are 55 years old and expect to retire when you're 62, you need some investments that are likely to have a return that will beat inflation. "Provided [your] total allocation to stock does not exceed [your] risk tolerance," as Mr. Cruz writes.

As we've written so many times in the past year, "How much do you need and when do you need it?" The money that is effectively already spent (that tuition payment) should be in a CD-type investment. The rest should be in a balanced portfolio that you can build until you need it, and then draw on for the rest of your life.

Which brings us to the "Roth IRA and Retirement Reminder" on page 3. If you have a job and can pay your bills: 1) Thank your lucky stars, 2) Contribute every nickel you can afford into that balanced portfolio mentioned above.

On December 22, the days began to get longer. Sometime in April, the ice on Lake Mendota will break up. It will likely take the stock market a bit longer. In the meantime, the best values are usually found in the "off season."

Please call Andrea (827-6411) to set up an appointment and we'll review what your balanced portfolio should look like.

BUTTONWOOD PARTNERS

LONG-TERM STOCK RETURNS NOT ALWAYS CONSISTENT YEAR TO YEAR

By Humberto Cruz

January 12, 2009

"The returns from any particular period are an unreliable anchor for long-term return expectations"

You've heard it many times: Stocks are the best-performing investments over the long term.

But just how long is long term?

Financial advisers typically recommend investing in stocks the money we won't need for at least 10 years. But 10 years - or even 20 - sometimes is not long enough.

By my calculations, if you put $10,000 in stocks on Jan. 1, 1999 and matched the return of the Standard and Poor's 500 Index, you ended up with just $8,705 on Dec. 31, 2008, even after counting reinvested dividends.

That's the equivalent of an average compounded loss of almost 1.4 percent a year - the worst 10-calendar-year stretch ever for stocks as measured by the S&P 500 and predecessor indexes of large-cap U.S. stocks. The previous worst was a nearly 0.9 percent average annual loss in 1929-1938 during the Great Depression.

And yet, as late as the end of 2006, $10,000 invested in the S&P 500 Index 10 years earlier would have grown to $23,011 - an average annual compounded gain of about 8.7 percent.

Conclusion: Ten-year market returns, as reassuring as they seem when they are good, range all over the map and depend heavily on which period we are measuring.

"The returns from any particular period are an unreliable anchor for long-term return expectations," said chartered financial analysts Francis Kinniry Jr. and Christopher Philips in an article published by Vanguard's Institutional Investor Group. (In its best 10-year period, the S&P 500 chalked up average annual compounded gains of about 20 percent. Over 20 years, returns have ranged from average gains of about 18 percent to just 3.1 percent).

Yet, many investors mistakenly believe that "average" stock market returns are the returns they can expect consistently. When they don't, many abandon stocks and miss out on strong gains that often follow down periods.

The average historical long-term return for the S&P 500 Index is about 10 percent a year. But the index rarely comes close to returning 10 percent any particular year.

In the past 40 years, returns have ranged from a gain of 37.5 percent in 1995 to last year's 37 percent loss. Only twice - gains of 10 percent in 1993 and 11 percent in 2004 - did gains range between 8 and 14 percent.

I've run into many investors, however, who believed they would be averaging 10 percent a year or close to it all the time, or at least every few years.

My fear is that many may now shun stocks forever. The percentage of American households investing in stocks already had fallen from a peak of 57 percent in 2001 to 47 percent early last year, according to a study in February and March 2008 by the Investment Company Institute and the Securities Industry and Financial Markets Association, both industry groups. The bear market that lasted until 2002 likely contributed to Americans' lower appetite for risk, the study said.

I expect last year's market drop will lower this appetite further as future 10-year returns will look lousy for years. Even if stocks gain 10 percent a year for the next nine years, the average annual compounded return for the 10-year period ending Dec. 31, 2017 would be only about 4 percent.

And yet - again historically, but with no guarantees - strong market gains tend to follow periods of declines. Provided their total allocation to stocks does not exceed their risk tolerance, investors may consider dollar-cost-averaging now, or investing equal amounts of money at set intervals. That way they use volatility to their advantage, buying more shares when prices are down.

NO REQUIRED MINIMUM DISTRIBUTION FOR 2009

On December 23, 2008, President Bush signed the Worker, Retiree and Employer Recovery Act of 2008. This is important news for retirees as it suspends—for 2009 only—the IRS regulation that requires individuals to withdraw money from their retirement accounts each year. For people with inherited or beneficiary IRAs, the Act also suspends the required minimum distribution limits, including those being taken under the five year rule for 2009. If you have already taken your RMD for 2009 and wish to undo the distribution, firms are allowing those funds to be returned within 60 days of the original distribution.

We are excited about this Act and the tax planning flexibility it offers. We strongly urge you to speak to your tax planner about how you can best take advantage of this opportunity.

If you receive your RMD automatically and wish to suspend it for 2009, please sign and return the letter you should have already received from our office. If you have any questions or wish to return an RMD that has already been received, please feel free to contact us.

ROTH IRA AND RETIREMENT REMINDER

You have until April 15th to make your 2008 Roth IRA contribution. The maximum amount for 2008 is $5,000, or $6,000 if you are over 50 years old. We are convinced that the Roth IRA is nearly a 'no brainer' as a savings vehicle. It combines significant long-term tax savings with more liquidity potential than other retirement structures. Take advantage of it!

In addition, if you have a retirement plan, you should review your contribution rate. For 2009, the maximum you can contribute to your 403(b), 401(k), or 457 plan is the lesser of $16,500 or 100% of your income. If you are age 50 or older, you may contribute more to "catch up". This year, for instance, you may increase your contribution by $5,500, for a total of $22,000. If you have a Simple IRA the standard limit is $11,500 with a catch-up of $2,500.

The Roth contribution limits will remain the same for 2009. The maximum you can contribute in 2009 is $5,000 with an additional $1,000 catch-up for those 50 and over.

It is a great time to review your account and investment objectives. Please give us a call to set up an appointment or to discuss your account.

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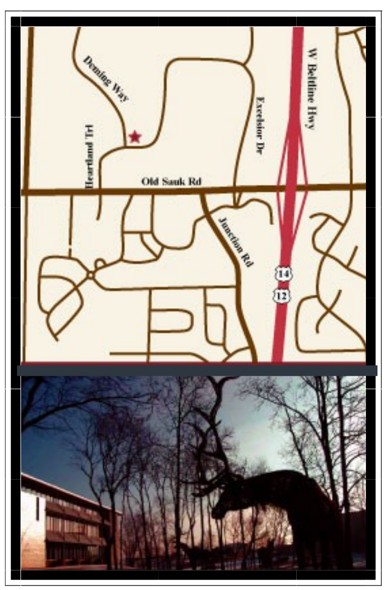

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Winter Newsletter