



Franklin Financial Group

Buttonwood Financial Group, LLC



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Financial Checkup

Have you....

- Contributed to your IRA or ROTH for 2003 yet? You have until April 15th, 2004.
- Started a 529 Education Savings Plan for your children's education yet? Save for college and you may be able to deduct contributions from your state taxes!
- Heard about I-shares? A great new investment product!
- Reviewed or updated your will, power of attorneys or trusts recently?

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4th Quarter Report

January 2004

The State of the Investment Arena

The Global economy is finally starting to lift, led by surging GDP growth in the U.S (GDP = Gross Domestic Product = "Market value of the goods and services produced in the US"). The US economy now appears to be in high gear. Real GDP rose by 8% in the third quarter and will likely take only a modest breather in the fourth, rising by about 4%. We expect that U.S. real GDP growth will average between 4 and 6% in 2004. Strong GDP growth is already shifting companies from cutting costs to expanding operations to meet higher expected sales. The "jobless recovery" that characterized the first half of 2003 looked a little better in the third quarter with payroll employment up in each of the last four months, rising a total of 328,000. Capital spending is up and inventories are rising. The end of cost cutting along with sustained consumer and government spending means the U.S. economic

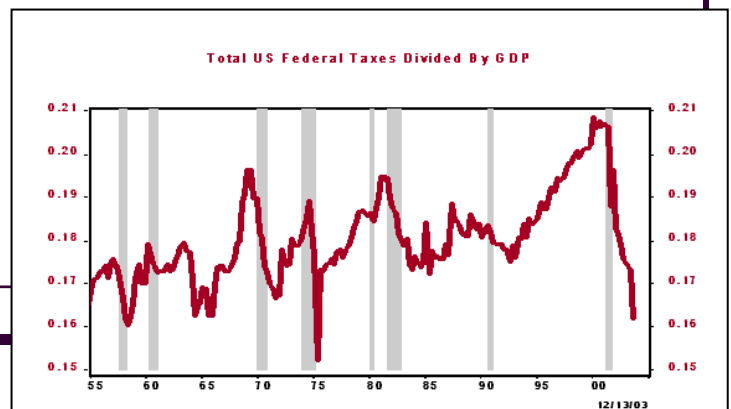
engine is now hitting on all cylinders. Even trade is turning. U.S. exports rose 11% in the third quarter following three straight quarterly declines. A weak dollar can have advantages.

Inflation appears to be moving modestly higher. An easy monetary policy, rising inflation indicators like commodity and gold prices, the decline in the dollar and relatively rapid (though slowing recently) money supply growth all indicate that the deflation threat that was a worry early in 2003 is now gone. For now we do not see a threat of a substantial rise in inflation, but prices are now rising enough to contribute to profit margin expansion.

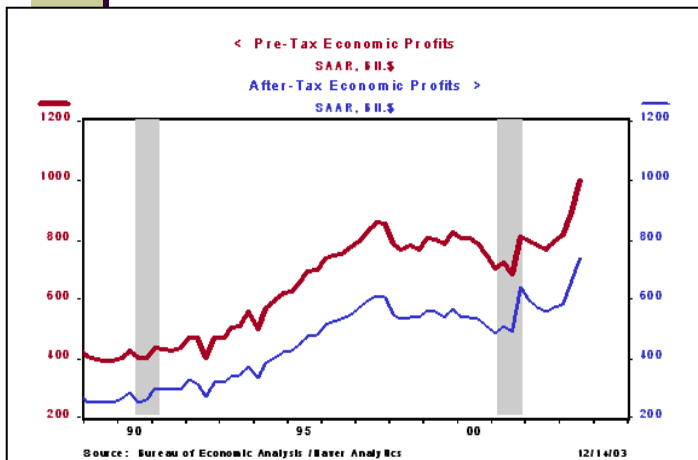
The driving factors behind the economic surge are some of the most expan-

sionary fiscal and monetary policies we have ever seen. The fall of total Federal taxes as a share of GDP is astonishingly large (see chart below). And, with the fed funds rate at 1%, the Federal Reserve is delivering substantial monetary stimulus.

The combined impact of stronger real GDP growth, three years of cost cutting and a modest return of pricing power are pushing corporate profits sharply higher. Total economic profits soared in the third quarter, moving to record high levels (see chart on top of page two). The rolling four-quarter change in total pre-tax economic profits was 30% through the third quarter 2003. After-tax economic profits rose 33%.



The State of the Investment Arena (continued)



The earnings reports from the S&P 500 companies are just about as strong, though not yet back to record high levels (see [chart below](#)). Given that earnings have moved sharply higher from very depressed levels last year, trailing P/E measures of stock market valuation still look high. The four-quarter trailing P/E for the S&P 500 is 27, but the forward P/E is at 19. And that forward P/E is based on, we think, very conservative estimates of a 5% drop over the next four quarters. We believe that earnings will continue to rise, albeit at more modest growth rates.

In summary, our forecast is for between 4 and 6% percent real GDP growth in 2004 and inflation between 2 and 3% percent. We look for steady gains in

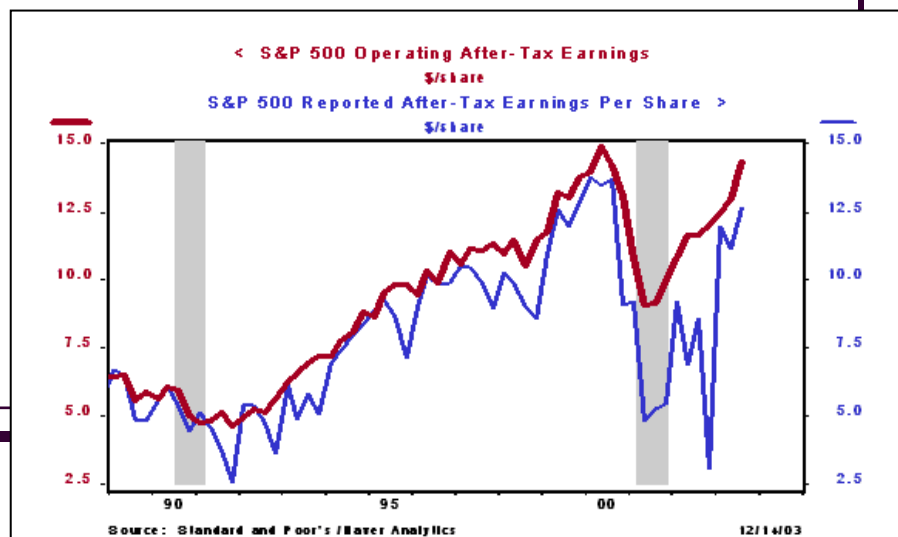
employment with the unemployment rate drifting down to about 5% by yearend. We also look for corporate profits to rise between 10 and 20% percent over the year. The risks to the outlook remain much the same as those we have mentioned in our previous reports. Primary risks include terrorist attacks, high oil prices, and some concern about the dollar. Under these circumstances, we remain bullish on equities, especially in the U.S. where growth is higher and bearish on bonds, again especially in the U.S. On the bond side, we expect yields to move higher driven by modest Federal Reserve tightening in 2004 as well as rising inflation fears driven by strong real GDP growth.

RECOMMENDED ASSET ALLOCATION CHANGES FOR Q1 2004

We continue to be positioned to capture relative returns and avoid undue risk in equity and

fixed income over the fourth quarter. In Q3 we were overweight Small Caps, overweight Growth, underweight Large Cap Foreign and neutral on Emerging Markets. On fixed income, we were overweight Short/Intermediate High Quality, overweight High Yield, overweight Foreign Bonds, and underweight Intermediate/Long High Quality. These "bets" were generally correct and our tactical asset allocation added value.

Turning to the first quarter asset allocation recommendations, we are making few changes compared to the fourth quarter. We are shifting some of our Growth exposure to Large Cap Growth from Small Cap Growth. We are making this change because we are seeing the beginning of a shift in performance from Small to Large Cap Growth and somewhat of a momentum break after the big gains we saw in 2003. Given the huge



The State of the Investment Arena (continued)

out-performance in Small Caps relative to Large Caps, we think this shift will, at a minimum, reduce risk and, best case may actually enhance investment performance as well.

On the fixed income side we are maintaining our modest overweight on Foreign Bonds and our very large overweight on High Yield Bonds. High Yield fixed income has done very well

over the last two quarters as spreads compressed due to improving economic and company fundamentals. A good case could be made to start reducing the High Yield overweight, but we think spreads will continue to narrow for the next quarter. However, with the sizeable gains here as well we have less conviction on this overweight and as such we will be watching this sector very carefully. In

addition, we are increasing our shift from the High Quality Intermediate/Long fixed income area to the Short/Intermediate area. We are expecting a rise in bond yields and we want to be very defensively positioned in that event. Again, this rise may be slow to come in this election year, so we are not recommending zeroing out the Intermediate/Long fixed income exposure; we just want to be

Mutual Funds Make Headlines in 2003

In light of the recent investigations and allegations affecting the mutual fund industry, we wanted to share our thoughts on these matters to help you put them into perspective.

Almost every day there seems to be a new headline about market timing, late trading, breakpoint pricing and other mutual fund related issues. These inquiries by the regulatory agencies are just beginning, and we expect there will be more headlines with additional firms being named.

Those of us at Buttonwood & Franklin as well as our broker/dealer, LPL, share your concern and are disappointed by this inappropriate behavior. However, our recommenda-

tion is not to be overly alarmed by what you read in the news for several reasons.

In most of these cases, we anticipate investors will receive restitution from the parties involved. Firms and individuals are being held accountable. It has been a great time to be invested in the capital markets and mutual funds remain an excellent vehicle for individual investors. Despite recent events, it's important to remember that the mutual fund industry is made up of hundreds of firms and thousands of employees, most of whom are dedicated to managing your investments with the highest degree of integrity.

We firmly believe the end result of these investigations

will be a wave of regulatory reform that will ultimately benefit and protect investors like us. We hope that better controls and procedures will be established, that there will be improved disclosure, and more uniformity in pricing practices.

Lastly, we are here for discussion if you have any specific questions. And we have been assured LPL will continue to work with industry regulators and investment companies to ensure that the appropriate policies and procedures are put in place for your protection. We will continue to communicate any changes to you as the reviews continue to roll in. And be assured we are committed to you and your long-term financial well being.

*Just a
Reminder...
Please let us
know if your
investment
objectives or
financial
situation
ever change!*

State of Investment Arena con't

positioned defensively if the increase does take place.

Comparing the current quarter tactical recommendations to the strategic recommendations shows where we are recommending placing a tactical "bet". In general, we are overweight both Large and Small Cap Growth. **As shown in the chart below**, Growth under performed mightily from the first quarter of 2000 through the first quarter of 2002. Since then, it has been a pitched battle between Growth and Value. In the second quarter, Value outperformed, but we view this most likely as a one-time step adjustment to the change in the tax code, specifically the cut in the tax rate on dividends to a 15% maximum rate. In the third quarter, Growth outperformed and then Value in the fourth quarter. The rapid rise in earnings is expected to benefit Growth, especially Large Caps and in addition, the huge run in Value relative to Growth in 2001 and 2002 leads us to believe that risk is lower in Growth. We expect these factors should disproportionately benefit Growth relative to Value.

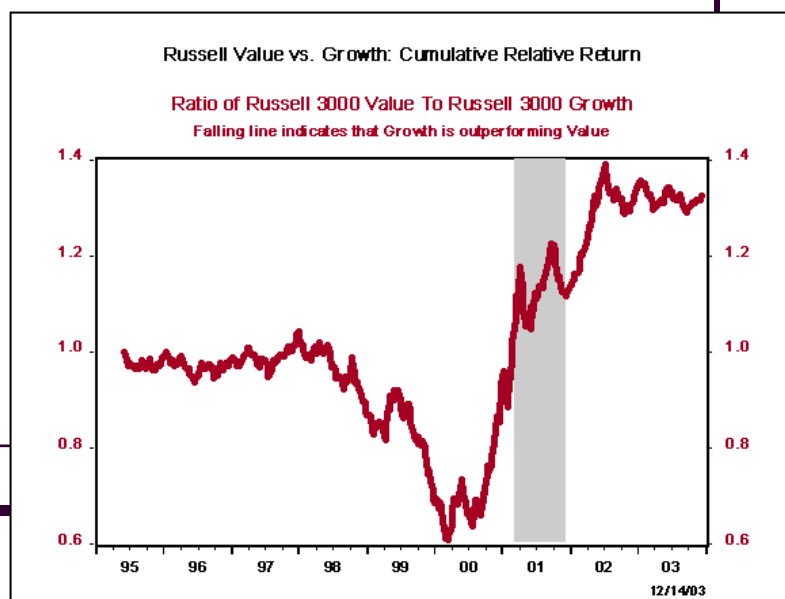
We are also beginning to

think the run is Small Cap outperformance is ending and as such our belief that Large Caps may outperform moving forward will be due to improving earnings visibility and thus translated into increased safety. Therefore our U.S. equity asset allocation has an increasing tilt towards Large Caps at this time. Small Caps are now slightly underweight relative to the "Strategic" weights, but still overweight relative to the Russell 3000 Index (which has a 10% small cap weight). Given the huge performance run in Small Caps relative to Large Caps (see chart above page 5), we are watching Small Cap performance closely. When we see a substantial break in Small Cap outperformance, we will move to reduce Small Cap exposure further. As we mentioned in the 3rd Quarter report, that could

happen intra-quarter, and if it does we will take appropriate action.

As we have stated throughout 2003, we continue to be less bullish on the economic prospects for Europe and Japan. Therefore, we remain underweight the Large Cap Foreign asset class at this time. For Emerging Markets, we have also remained neutral through 2003, mostly to reduce risk, but this has caused us to have missed some performance. Emerging Markets have done very well over the last three quarters, but we think we would be chasing performance if we increased our exposure to this asset class now.

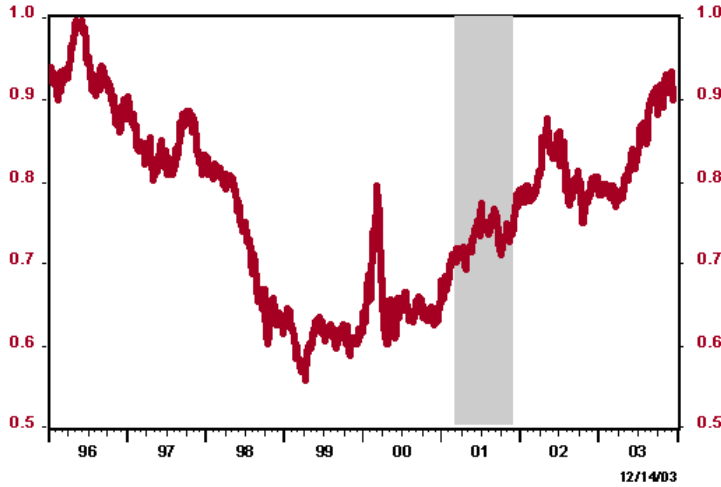
For fixed income, we are increasingly underweight in the High Quality Intermediate / Long-term Bond and overweight in High Quality Short / Intermediate Bond where we think the risk/reward profile is



State of Investment Arena (continued)

Small vs. Large Caps: Cumulative Relative Return

Ratio: Russell 2000 Index to the Russell 1000 Index
 Falling line indicates Large Caps outperforming Small Caps

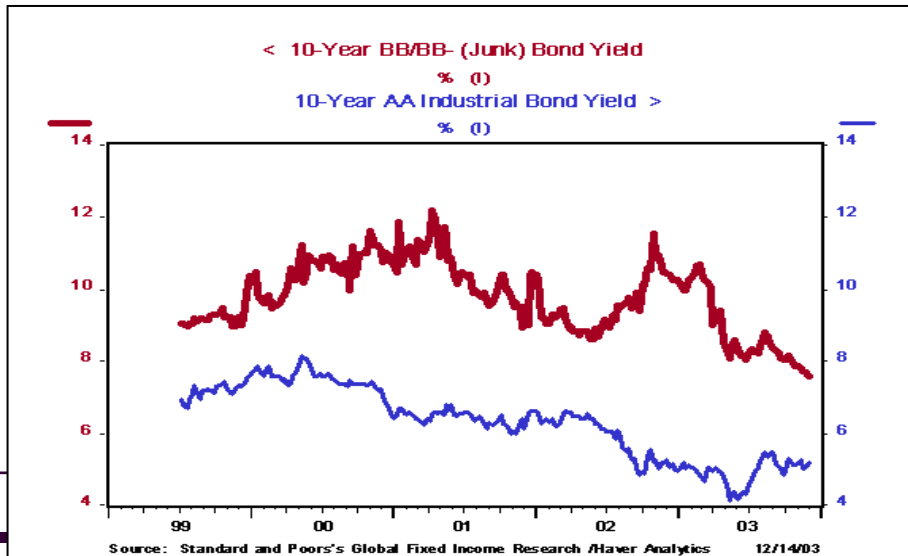


fiscal and monetary policy that we believe will benefit the economy and equity markets. We are optimistic that the U.S. economy will gather further momentum over the year ahead. Also, we believe the deflation scare is behind us and the return of modest pricing power should strongly benefit company earnings. We continue to be modestly concerned about growth overseas and continue to remain under weight traditional Foreign stock holdings.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. The Russell 1000 Index consists of the 1,000 largest securities in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index. The Russell 2000 Small Stock Index is an unmanaged index generally representative of the 2000 smallest companies in the Russell 3000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. Russell 2000 Index measures the performance of the Russell 2000 companies with lower price-to-book ratios (small caps). The Russell 1000 and Russell 2000 Growth and Value Indices are companies in each index that are split into two groups based on price-to-book ratio to create growth and value indices. The Russell 1000 and 2000 Value indices contain companies with lower price-to-book ratios, while the Russell 1000 and 2000 Growth indices contain those with higher ratios.

better. We are slightly underweight high quality fixed income and remain overweight High Yield. (See chart below). Spreads have continued to tighten and returns were good in the fourth quarter, but spreads still look wide given the economic boom, so we expect additional spread tightening.

In conclusion, the asset allocation recommendations remain tilted towards higher volatility asset classes with overweights in Large Cap Growth and High Yield. This reflects the changes in U.S.



Getting More from Charitable Giving

If Americans continue to give as generously as in the past, charitable donations could exceed \$240 billion in 2003, according to the American Association of Fundraising

Charitable Giving can bring great satisfaction as well as a tax break, but there are strategies that can increase the benefits of giving to both the giver and the receiver.

Following are three trust strategies that may help increase the value of your gift and help maximize the tax benefits of giving.

It may help to think of your donation as having two parts: income and principal. Depending on the strategy you employ, it may be possible to give one or both, for a specific period or indefinitely.

When an individual transfers assets, or principal, to a **charitable lead trust**, any income generated by the principal goes to a designated charitable organization for the duration of the trust. Upon termination of the trust, typically upon the death of the donor, the assets pass to the donor's beneficiaries. This strategy can help reduce, or in some cases eliminate, estate taxes on the assets in the trust. The income tax benefits of a charitable lead trust are rather modest. But this strategy is especially useful if the assets placed in the trust have appreciated because there will be no capital gains taxes.

With a **charitable remainder trust**, an individual places assets in the trust and names a charitable organization as the recipient. The trust pays an income to the donor for his or her life or for the joint lives of the donor and his or her spouse. After the donor's death, the assets in the trust go to the charitable recipient and are no longer part of the donor's estate for estate tax purposes.

Because there are no capital gains taxes due on appreciated assets placed in the trust, this strategy helps preserve the full value of the gift for the charity and also helps increase the income generated by the principal. Typically, contributions to this type of trust are partially deductible for income tax purposes.

Individuals who hoped to leave something for heirs may want to consider using a **wealth replacement trust** in conjunction with a charitable remainder trust. Here's how it works. The donor designates the wealth replacement trust as one of the beneficiaries of the charitable remainder trust. The wealth replacement trust is

funded with a life insurance policy on the life of the donor, and the premiums are paid with part of the income from the charitable remainder trust. When the donor dies, the death benefit paid to the wealth replacement trust is distributed to the heirs.

Of course, there is at least one limitation on the use of these trusts that should be considered. Donations to charitable remainder and charitable lead trusts are irrevocable. A donation cannot be taken back once it has been made. Before implementing a strategy involving trusts, you should consult an experienced estate planning professional, either your own, or one of our partners. There are many other factors to consider when setting up charitable trusts, such as your tax circumstances, the amount you wish to donate, and the size of your overall estate. Using the appropriate strategy for your situation may help increase the effectiveness of your gift and we stand ready to assist in any way we can!

Buttonwood/Franklin... Giving Back to the Community

Giving back to the community is rewarding in many different ways, whether it is volunteering your services or contributing monetary donations. We all look to help our community and become better citizens.

Over the years the staff at Buttonwood/Franklin has assisted a number of our clients in planning their Charitable giving. One of the questions often asked of us during planning is which charities do we support?

Following is a fairly good summation of the organizations that we, both as a business and as individuals, took pride in helping in 2003!

- Sister City Association of KC
- Town Art Show of KC - benefiting Parkinson's Assoc.
- Rose Brooks Women's Battered Shelter
- Tivol Golf Classic - benefiting Alzheimer's Association
- Don Bosco Adopt - A- Family
- Susan G. Komen Breast Cancer Foundation
- Kansas City Blues - Rugby
- University of Missouri - Columbia
- University of Missouri - Kansas City
- University of Iowa
- University of Northern Colorado
- Knights of Columbus
- Jazz Ambassadors
- Unicorn Theatre
- American Jazz Museum
- Kansas City Blood Centers
- Nelson Atkins Museum
- Longview Horse Park Association
- Ancient Order of Hibernians
- Kansas City Regional Fox-Trotting Horse Assn.
- United Plantation Pleasure Horse Association
- Charlie Parker Institute of Jazz
- Kansas City Community Church Organization
- Saint Luke's of Kansas City
- Fireman's Local #42
- And more...

We are always interested in learning about what activities and organizations are near and dear to our clients, friends and family. If you have an organization or charitable giving story that has been memorable to you we would love for you to share it with us!

Diversification of Portfolio Accommodates Market Swings

Swings in emotion accompany swings in the market. The third quarter of 2002 was among the worst in U.S. stock market history. Investors were frozen in the fear and panic (sell) stage last September.

Over the last 12 months, we have advanced through the doubt, suspicion and caution stages. We are now somewhere between the (buy) stages of confidence and enthusiasm. If stocks continue to climb, the cycle will continue – maybe even to the level of greed we saw in the past.

Does the present stock market really merit enthusiasm? What makes a good stock market?

Bruce Johnstone, managing director and 38-year veteran with Fidelity Investments, believes a strong market rests on three "pillars". Healthy corporate earnings, Reasonable valuations and Ample liquidity.

Based on his assessment of these conditions, investors should not get carried away with their emotions.

The first pillar - Healthy corporate earnings: According to Johnstone, corporate earnings a year ago were still quite weak. Today, they are stronger and are expected to remain so for a while. Monetary and fiscal policy have provided tremendous stimulus. Low interest rates, the refinancing of mortgages, and the wealth effect of the higher market are just a few reasons why the consumer is ramping up spending. (cont)

**4th Quarter Report
January 2004**

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Buttonwood Financial Group, LLC

**Our goal is to be
viewed as the best in the minds of our
clients at guiding them towards financial security.
We will guide our clients in making the right decisions
for their financial future through
education, communication, and service
which exceeds their expectations.**

Diversification of Portfolio Accommodates Market Swings

And it is starting to show. The weak dollar also helps earnings by making our exports more competitive. Johnstone cautions, however, against unbridled enthusiasm. "The problem with the earnings pillar is that I see it teetering out in 12 to 15 months," he says, citing three reasons.

First, the monetary and fiscal policy stimuli will flatten out and wane. The housing stimulus from mortgage refinancing is clearly past its peak. Second, terrorism and war perpetuate underlying fears. Third, sustained consumer spending on automobiles and housing even during the recession means less pent-up demand than we would normally see after a recession. The consumer is somewhat satiated. Without all the additional stimuli, Johnstone predicts below-average consumer spending.

The second pillar - Ample liquidity: This occurs when interest rates are low for a large segment of both the consuming and investing public. Cheap money historically has been positive effects on housing, construction, auto sales and municipal financing.

When we have a cyclical pickup in economic growth, however, long-term rates start to rise, which we have seen since mid-June. Because of the increase in long-term interest rates and the record trade and budget deficits, support for benign interest and inflation rates will likely wane.

The third pillar - Reasonable valuations: Valuations are cheaper than they were 3 ½ years ago when they peaked, but they are still not cheap. Johnstone believes valuations have gotten back to the trend line but remain just OK.

The weak dollar is not a strong point when it comes to valuation. Investors will shy away from assets denominated in a currency that is down. They do not want to buy stocks, bonds, companies or real estate of a country if they fear that asset value will decline because the currency is down. That is clearly a negative for valuation.

Johnstone's best advice is to have a well-diversified portfolio. You should have both U.S. and international stocks as well as different types of bonds in your portfolio, regardless of where we are in this cycle of emotion.