

BUTTONWOOD NEWS

BUTTONWOOD RELEASES NEW WEBSITE!

We are proud to announce the grand unveiling of our new online presence at www.ButtonwoodFG.com! Please feel free to peruse our myriad of services we provide including 401(k) management, debt and liability management, insurance, education planning, retirement planning

and estate planning. You can also find past Weekly Commentaries and Newsletters. To access the archives, go to www.ButtonwoodFG.com/a_archives.php

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FILMFEST KC!

It is a distinct pleasure to sponsor FilmFest KC this year as it features nine Sister City Association-Kansas City relationships.

As Vice President of SCAKC, Jon has been instrumental in promoting strong community involvement for SCAKC and many other organizations. FilmFest will take place October 14-20 at the Screenland Theatre.

AMERICAN ROYAL

For the 4th year, Buttonwood will host an American Royal Grand Prix - Client Appreciation celebration for equestrian enthusiasts.

The event will take place Saturday, November 5th, beginning with drinks and hors d'oeuvres at the office and progressing to the Grand Prix by 7pm. Seats are limited, so please contact Haumana by October 31 if you would like to attend.

BUTTONWOOD ART SPACE...featuring Ted & Linda DeFeo

Vivid aquatic life represented in Ted & Linda DeFeo's underwater photo gallery invokes a strong desire to grab scuba equipment and head to the Caribbean. Incorporating images from around the world, Ted has traveled to South America, Asia, the Pacific Islands, and the Middle East to provide an

impressive collection of vibrant images for us to enjoy.

An Artist Open House will be for November 17, 2005 at 5pm. Please contact Haumana to RSVP at 816-285-9003. For a preview of Ted & Linda's art, you can go to: www.defeodecor.com

Dedication to Cameron Herrington

We would like to dedicate this issue of our newsletter to Cameron Herrington who shared in only 10 months of life with us. May we cherish our loved ones and seek or potential in remembrance of his life.

At Buttonwood Financial Group, LLC, our mission is to positively impact each of our clients by providing ongoing consultative assistance allowing them to organize and take control of their financial lives. We accomplish this through education, financial planning, and the development and supervision of unique personalized portfolios for individuals, corporations and financial institutions.

Our growth comes from referrals, so please feel free to share our name and numbers with your family and friends.

YOUR BUTTONWOOD RESOURCES

Jon McGraw - President
Vince Pastorino - Senior Vice President
Wendy McGraw - Office Manager
Bill Ryan - Operations Director
Haumana Johannsen - Project Director
Linda Koschmann - Receptionist

3RD QUARTER REPORT
OCTOBER 2005

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BUTTONWOOD
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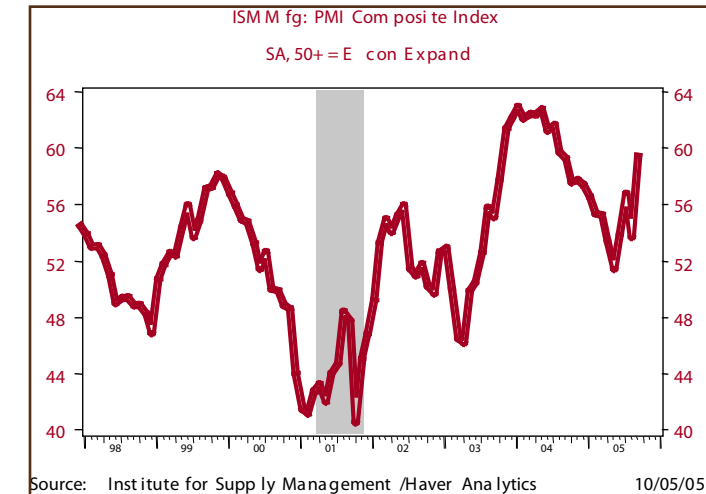
- Discussion of Investment actions over the last quarter
- Asset Allocation Pie Charts
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THE STATE OF THE INVESTMENT ARENA

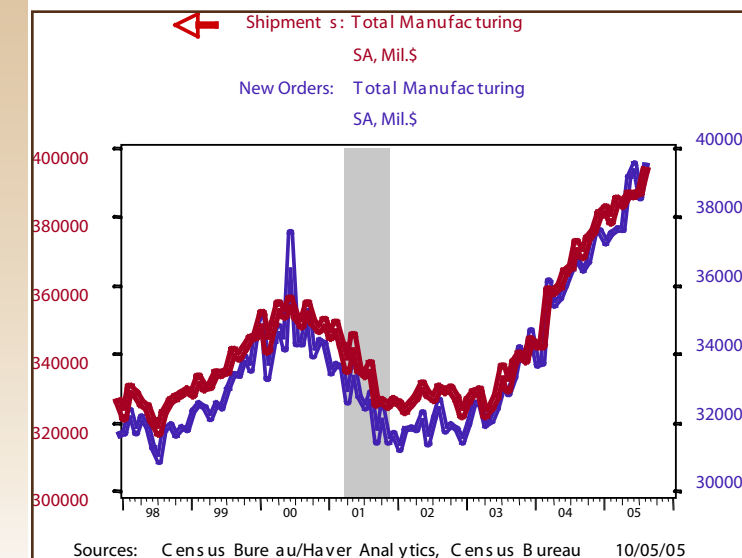
The U.S. economy performed remarkably well over the third quarter. While GDP statistics for the quarter are not yet available, we expect that real growth came in at about 3.5% despite sky-high energy prices and the late hit from Katrina/Rita (K/R). As shown in the chart below, U.S. manufacturing orders and shipments (data through August) remained robust.

Manufacturing appears to be little affected in aggregate post K/R. The September survey of manufacturing purchasing managers by the Institute of Supply Management shows a sharp rebound in the composite index

(see chart above). All of the index components - orders, production,

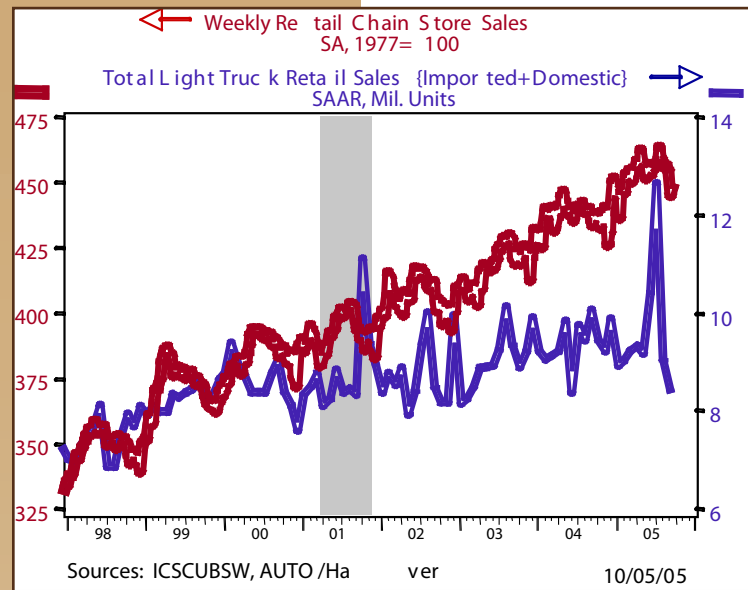


employment, vendor deliveries and inventories - moved higher in September.



Other early indicators for September do show negative impacts from K/R. No new news here but the biggest rise came in refined energy and natural gas prices. What has been making the stock market nervous is that employment and consumer spending appear to be the principle targets for weakness. The drop in

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employment is likely temporary and we expect a complete jobs rebound by later this year.

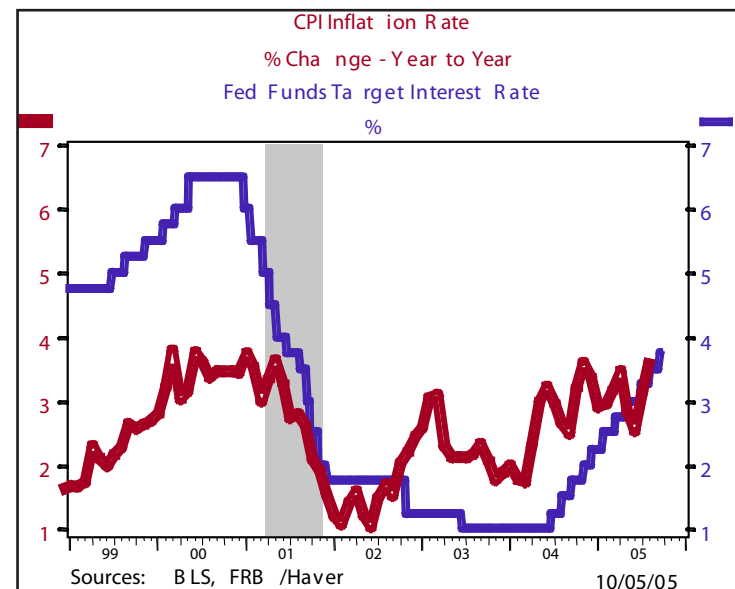
The impact on consumers from K/R will likely be longer. The personal saving rate went negative in July as consumers maintained their non-energy spending and paid for the rise in energy prices out of savings. That makes sense when the energy price rise is viewed as temporary, but in the wake of K/R, we think that the energy price rise is going to be here for the rest of the year (that view is supported by the futures prices of gasoline, heating oil and natural gas). We are assuming that many consumers are also reaching that conclusion and are now ratcheting down spending across the board. As seen above, this slowdown is already evident in weekly chain store sales and light truck (SUV) sales that have dropped fairly sharply in September.

However, as you can see in the chart above, the declines in chain store and light truck sales are not extraordinary. The light truck sales drop in August and September is likely

in part due to the huge sales figure for July when “employee pricing” incentives pushed sales to an all-time high. So, while we expect a slowdown in consumer spending, we do not see an outright decline such as occurs in recessions.

Other GDP components are still looking fairly strong. Business investment is growing steadily, inventories are rising, construction is flattening at record highs, government spending will accelerate due to K/R and international trade is finally improving. We do expect a one or two tenths spike in the unemployment rate in September and a drop in payroll employment of about 150,000 due to K/R, but that should be a one-month only impact. When it all summed up, we expect the slowdown to be modest.

Higher energy prices will likely lift inflation again and this has been the wildcard we have mentioned in the last few reports. The Consumer Price Index (CPI) inflation rate was 3.6% through August. Post K/R energy price increases will likely push the overall CPI inflation rate to 4% for a while, but then overall inflation is expected to fall back towards 3%. This sanguine inflation outlook is based on continued low “core” CPI inflation (which excludes food and energy). Core CPI inflation was 2.2% in

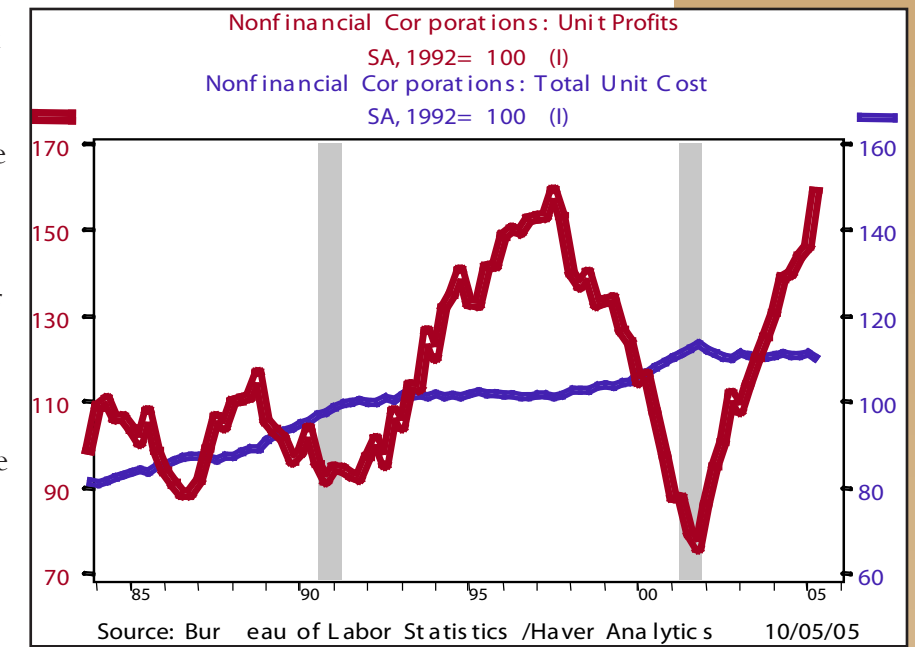


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August, and appears stable at this time. Various Producer Price Index (PPI) inflation measures look well controlled outside of energy. Core finished PPI inflation appears stable and core intermediate and crude PPI inflation measures have fallen sharply. So “pipeline” inflation pressure is low outside of energy. If core CPI inflation remains stable, then the energy price shock to overall inflation will pass through and permit overall inflation to move lower next year.

If inflation remains in check, we expect the Federal Reserve will hike the fed funds rate one more time this year to 4% (chart at the bottom of page 2) and then halt and watch the economic data over the first quarter of next year to decide whether further rate hikes are necessary. This should limit the bond market sell off that has occurred over the last month.

Meanwhile, company earnings / corporate profits remain strong. The consensus estimate for third quarter S&P 500 earnings growth was 15.1% at the start of the quarter and has risen to 17.8% at the end of the quarter despite the impact of K/R and higher energy prices. We do expect both direct (for example in the insurance and airline industries) and indirect (for example in consumer discretionary) negative impacts from K/R and higher energy prices in the fourth quarter. However, we think the trajectory and fundamentals driving profitability still look very good. For example, over the four quarters ending in the second quarter, total U.S. non-financial corporation unit costs fell 1% while the unit price of goods and services sold rose by a modest 0.8%. Rising prices and falling costs yield sharply rising profit margins, which were up 14.9%. Add in the impact of an 8.1% rise in real sales volume yields a total profits gain of 24%. Cost control may begin



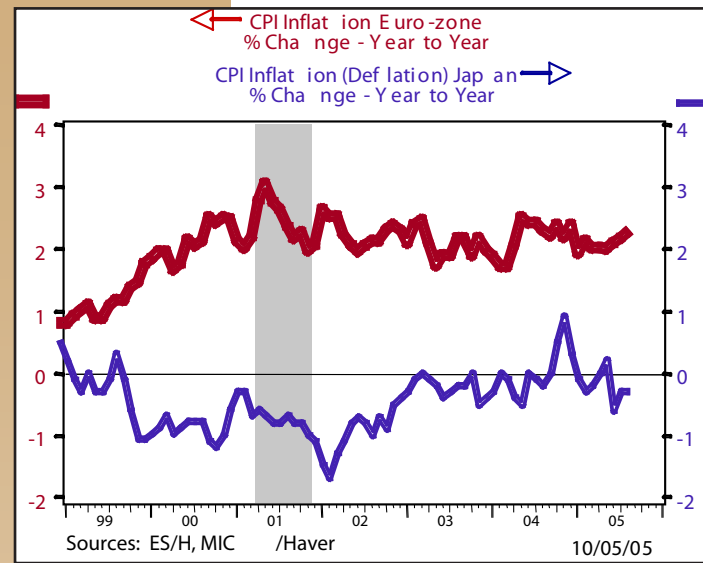
to loosen, but we have yet to see that. Employment growth has been a low 1.7% and wages are up only 2.7%. Interest and depreciation expenses are the biggest components of unit non-labor expense and both are falling outright. Energy costs hurt specific industries, but overall are not big enough to have a major material impact. The levels of unit profits and unit costs are shown in the chart above.

Overseas, growth remains sluggish in Europe and Japan, but their equity markets have done very well. Euro-zone real GDP growth was 1.2% annualized in Q2 and was 1.1% over the last four quarters. In Japan, real GDP is finally picking up, rising at an annual rate of 3.3% in Q2 and up 2.2% over the last four quarters. Japan may have further upside from the big election vote for reform last month. This may bode well for fiscal, financial and regulatory reforms that are critical to a sustained recovery of Japanese financial markets. We are watching the political process, but continue to remain somewhat skeptical given entrenched interest groups. Europe, on the other hand, does not have a political commitment to reform. In Germany, last month’s election yielded a



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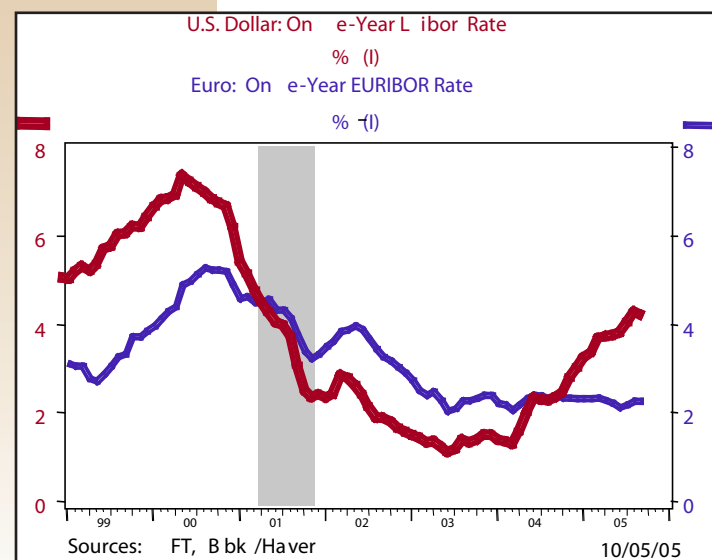
continued political and economic gridlock. Both Europe and Japan are now struggling in international trade with net exports flattening in 2005. We suspect that they are recovering, but are still very low; U.S. dollar exchange rate vs. the euro and the yen is at work here. The low dollar puts



European and Japanese exporters at a competitive disadvantage.

Inflation remains well contained in Europe with the CPI up 2.2% over the last 12 months, while Japan remains mired in deflation with the CPI down 0.3% in spite of the huge run-up in energy prices.

Low or no inflation has kept interest



rates very low in both areas. In Europe, the European Central Bank (ECB) continues to hold its fed funds equivalent interest rate at 2%; while in Japan, short-term rates remain at zero. The combination of low, flat interest rates overseas and Fed rate hikes in the U.S. has swung the interest rate difference between the dollar and the euro from roughly -1% in early 2004 to +2% now, for Japan the spread is 4%. These positive rate spreads also support the dollar exchange rate.

Emerging markets and eclectic foreign holdings continue to generally do very well, driven by high materials prices, high oil prices and, in some countries, significant economic reform. South Africa, for example, is a major material and precious metal producer and the MSCI South Africa is up 43% over the last year. Poland embarked on economic reform and the MSCI there is up 60% in dollar terms over the last year. There are countries that

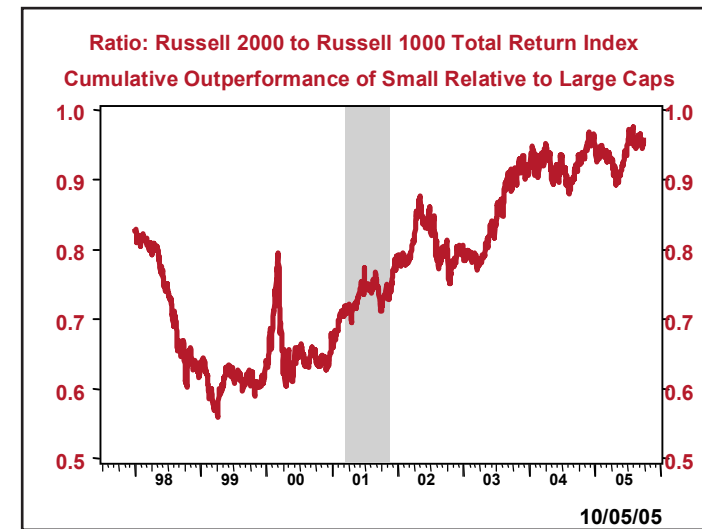
Recommended Asset Allocation Changes for the Fourth Quarter of 2005

have squandered their opportunity. In Venezuela for example, the MSCI is down 32% in dollar terms despite their huge oil production. Emerging markets continue to be a top performer, but country selection is obviously critical for managing risk and return.

Again this quarter we are making very limited changes in our tactical asset allocation recommendations. In a nutshell, we are making no changes to the equity allocations and in fixed income we continue to reduce our exposure to High Yield.

Our in place bets on the equity side are: 1) a small overweight in Large Caps relative to Small Caps, 2) an overweight in Growth relative to Value, 3) a reduced

THE STATE OF THE INVESTMENT ARENA (Continued)



overweight in Large Cap Foreign and 4) a small overweight in Emerging Markets. We will discuss each in turn.

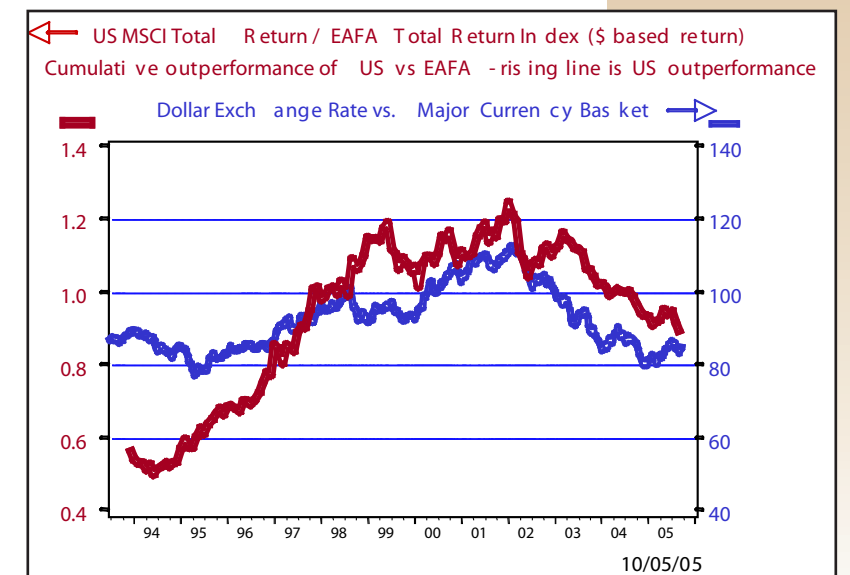
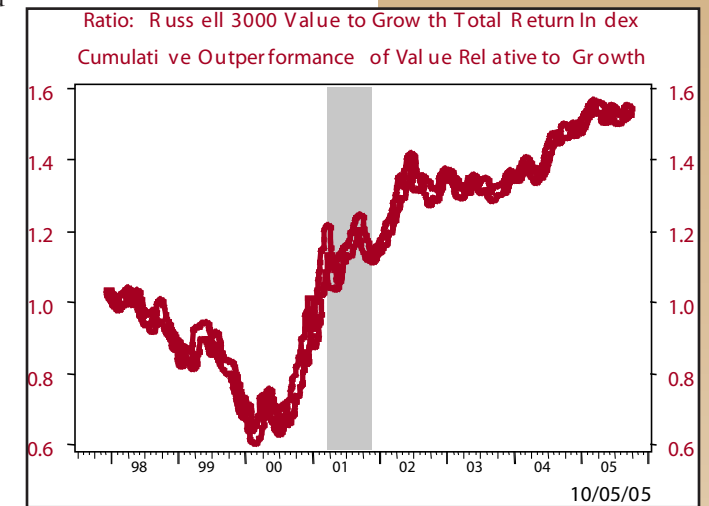
First, as shown in the chart on the top of page 5, we have experienced considerable outperformance of Small Caps relative to Large Caps. Over the last six years, Small Caps have outperformed by about 40 percentage points and through that time period the SAM allocations have had roughly a double weight (20%) on Small Caps. We now believe this Small Cap performance run is extended and valuations are stretched. For that reason, we removed the Small Cap overweight and shifted to a slight underweight vs. the benchmark - a 9% weight. Over the third quarter, this shift did not add value, with the Russell 2000 total return at 4.69% vs. the Russell 1000 total return at 3.95%, but by making this shift we believe we are reducing overall risk and exposure to a sector that has had a great run and are willing to sacrifice some return for a reduction in risk.

We are also maintaining our overweight in Growth relative to Value. Again, as shown in the Russell 3000 chart, Value has outperformed Growth by about 90% over the last five years. We believe that Value valuations have been stretched and that Growth has a good

chance of outperforming going forward. Over the third quarter the total return of the Russell 3000 Growth index was 4.21% vs. 3.81% for the Value index.

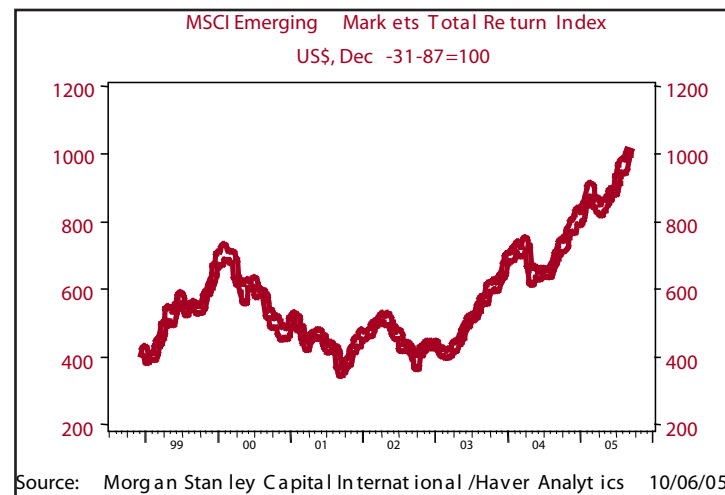
On the foreign side, we are maintaining our reduced exposure to Large Cap Foreign. Our reasoning is that the sectors solid run in outperformance vs. the U.S. equity market over the last four years was associated with the decline in the dollar exchange rate. As of year-end '04, we stated our belief was that

the dollar had hit bottom and would likely reverse direction and rally. It did so in the first and second quarters, but then gave some back in third. Also, the rally in energy pushed the EAFE (Europe, Australia, Far East, the Large Cap Foreign benchmark) harder



THE STATE OF THE INVESTMENT ARENA (Continued)

As shown in the chart to the right, Emerging Markets have done very well over the last two and one half years with the Morgan Stanley Capital International (MSCI) Emerging Markets total return index rising by more than 100%. Despite that increase, we do not yet view Emerging Market valuations as extended, though specific countries may be. Here is a prime example of the value of diversification and nimble active management to add alpha and reduce beta. We continue to maintain a slight overweight to this asset class for more aggressive investors. For those on the conservative side we are staying away from this more volatile sector.

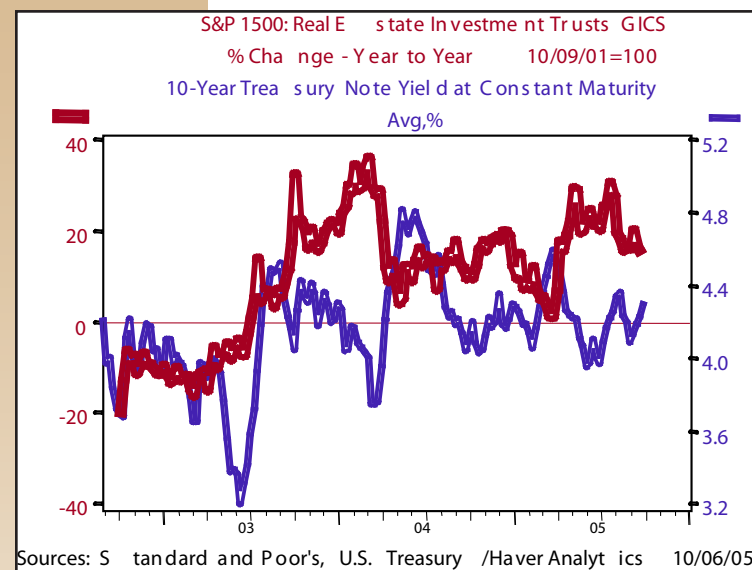


on interest rates; therefore we recommend caution on REIT investments and have reduced exposure to the sector over the last couple of quarters. In the low volatility portfolios we are neutral a 3% weight.

With 11 rounds of Fed rate hikes since June 2004, the short end of the yield curve has moved sharply higher. As shown in the chart below, the yield on the 2-year Treasury note has risen about 3 percentage points from the low in mid-2003. Meanwhile, at the long end, the yield on the 30-year bond is about the same as mid-2003. This is referred to in fixed income circles as “curve flattening” and this huge curve flattening had always been accompanied by a rise in long-term rates, so this episode is highly unusual. We do believe that there is moderate risk in long maturity bonds, so we feel quite comfortable remaining overweight Short/Intermediate high quality fixed income and underweight Intermediate/Long fixed income.

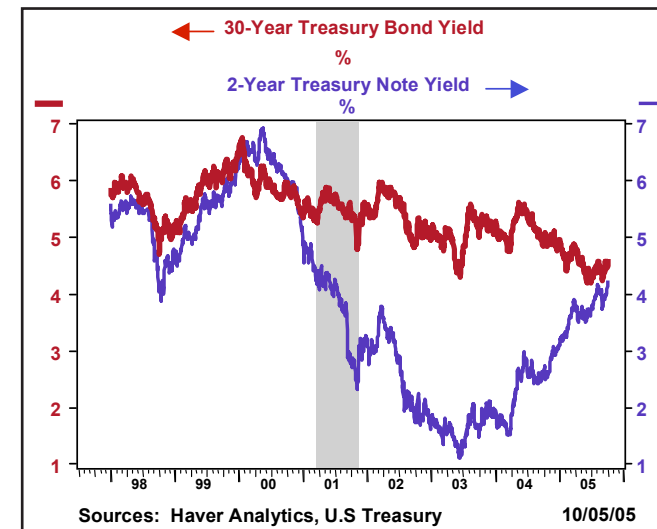
In the High Yield (Junk) fixed income asset class we continue to reduce our overweight quarter by quarter that we had on for about three years. Back then, the spread (shown in the chart to the right) between the High Yield Index yield and the 5-year Treasury note was more than 10 percentage points. Now it is gyrating between 2.5% and 4.5% so in our view it is prudent to gradually remove

The chart above shows the annual



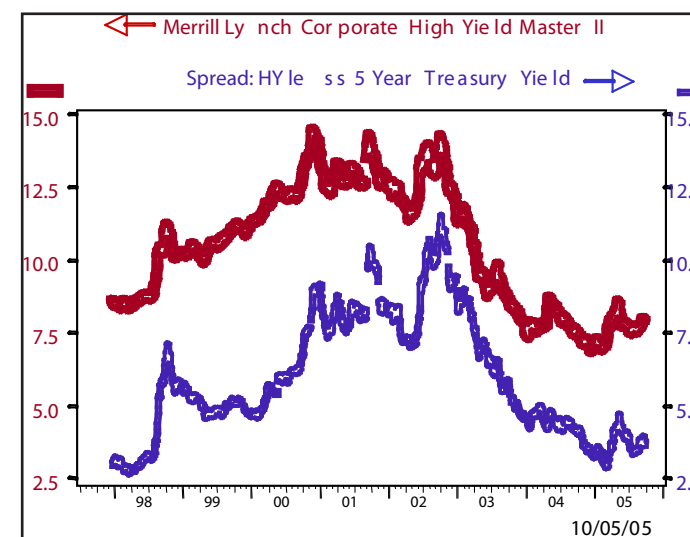
percent change in the S&P 1500 Real Estate Investment Trust (REIT) total return index graphed against the level of the 10-year Treasury note interest rate. This sector has been where we have had exposure for the more conservative investors. As is evident from the chart, there is an imprecise, but powerful negative correlation between REIT returns and interest rates. At this time we believe there is modest further upward pressure

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our overweight, which got as high as 10 percentage points.

Finally, in the Foreign Bond asset class, we continue to recommend a small weight in foreign bond funds that are currency hedged. As an example, the chart below compares the 10-year U.S. Treasury note yield to the German 10-year Bund yield. The continued decline in European bond yields over the last year has delivered solid bond price appreciation. At this point we expect foreign yields to stabilize. Unhedged foreign bond fund returns benefited enormously from the drop in the dollar and they would be hurt by a rising dollar. As discussed above, we believe the 30%+ drop in the dollar over the three years ending in January is reversing and the dollar is more likely to appreciate going



forward. In addition, the hedge back to dollars adds about 2% in annual return in addition to the underlying security yield.

In conclusion, we believe the tactical asset allocation recommendations for the fourth quarter will continue to be well positioned to take advantage of advances in equity markets and avoid undue risk. Our recommended positioning in equities remains overweight Large Caps and overweight Growth, with reduced Large Cap Foreign exposure and

overweight Emerging Markets. Because the core of the economy still looks good to us we still like the exposure to stocks. That being said, throughout the balance of the year many of our shorter term technical indicators are showing caution so we will be more apt to take profits sooner and be less aggressive in adding new investment dollars to the markets in 2005.

For fixed income our underweight on the long end of the bond market reduces, but does not eliminate, duration risk. We believe this stance provides some protection against rising long-term interest rates while also maintaining some protection against unanticipated negative developments - the “shock absorber” role. While we continue to whittle down our overweight in High Yield, the fixed income portfolio recommendation can still be characterized as overweight credit and underweight duration risk.

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.

Past Performance is not an indicator of future results.

