Economic Update

Broadleaf Partners, LLC

Weighing In

October 8th, 2008

We have been a bit quiet over the past few days, but in no way have we been sitting still. We have been very busy writing and calling our clients, trying to shed some light on what we are going through right now, our interpretation of the events given our experience in the industry, and our game plan for dealing with it. Now that we have a brief moment, we thought we should share some thoughts with the readers of our Economic Updates at large.

First of all, whether you use a financial advisor or do things yourself, the most important question that needs to be answered is not what the markets might do today and in the near term future, but whether or not your ability to maintain a longer term perspective has changed. I know that it is excruciatingly painful to watch your 401(k) plan or other related investment accounts plunge by some 25-30% in a period of just six weeks. The fact that we have had multiple bank failures does not help matters and neither does the fact that we have got a political campaign going on right now where the negatives of the economy are paraded front and center with little talk of solutions that can actually be implemented until our new leader has been chosen. We are in a void from this perspective, but at least that should only last a few more weeks.

But again, the first thing you need to ask yourself is have your circumstances changed such that you need to make adjustments to your investment plan today? If you have lost your job or are concerned that you may, then perhaps some changes are in order. Hopefully, you have set aside some emergency money to get you through a six to twelve month period with no income, but if not, that should be your first priority as we emerge from this mess. Cash, retirement funds and home equity lines can all be considered as various sources of liquidity, each with its own risks and costs to consider.

Assuming that your ability to act longer term has not changed, then listen up, because this is where we come down on matters. First of all, we are being incremental with our decisions rather than revolutionary. We do have circuit breakers in place - our selling discipline - which takes us out of positions when they violate relative performance thresholds on both the downside in times like today, and the upside when the getting is good. At the same time, we are mindful not to allow our cash balances to creep to levels where it would affect our ability to fully participate in a market upswing, when it occurs. Unless this is another Great Depression - and we will get to that in a moment - one of the worst things to happen to an investor with a long term time horizon is to ride a market down, panic sell, and then miss a rebound.

With regards to another Great Depression, there is an excellent article in today's Wall Street Journal discussing the subject, but suffice it to say, we believe one of the biggest differences between then and now are the massive policy responses we have

seen not only from our Fed and Treasury, but now from foreign central banks around the globe. If there is going to be a way to arrest the crisis in confidence we are currently experiencing, it is good to know that many bright people are working around the clock to come up with some creative solutions. No one seems to have their head stuck in the sand as was the case many decades ago. (If you disagree and feel a Great Depression is likely, then you need to grow your emergency fund many fold.)

The market's recent weakness has less to do with the well known financial crisis and much more to do with slowing global growth rates to recessionary levels. While this comment may seem like splitting hairs to some, the reason we mention it is important to how we are positioning our portfolios today. Over the past forty years, the consumer discretionary and technology sectors have both outperformed as the process of deleveraging in the economy begins and recessionary pressures build. Why should we care? Because it is at periods like now where you have to look beyond the fact that stocks are down across the board and begin to realize where the difficult fundamentals are fully discounted in the stock prices. Retailers are undergoing some horrific pressures to be sure, confirmed by same store sales levels released this morning that are not pretty. And yet, in spite of these numbers and estimate reductions, many stocks in the group are outperforming today and have been for most of the year. The same can be said of many financial stocks during the past three months. In spite of the horrific news, they have actually been outperforming, while late cycle global plays including energy, commodities and industrial stocks have been getting hammered the most.

In a nutshell, this is our thesis. Times are tough, so make sure you have your emergency sources of savings identified. If you can afford a long term time horizon, start identifying areas that are likely to do well as the economy gains its footing.

Sir John Templeton, famed international investor who passed away this summer at 95 years of age, said the following in an interview with CFA Magazine in 2003. ***"I have learned that the great opportunities are the places that have been neglected, where other people are not looking. Also, I have learned that making wealth is not the answer to human progress or happiness. Spiritual progress is that answer."***

On both counts, I could not agree more. Our industry desperately needs more folks like Sir John Templeton.

Kindest Regards,

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