BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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FINANCIAL MARKET OVERVIEW

Stocks reversed course during the second quarter of 2011. The Dow Jones Industrial Average barely posted a positive 0.8% return (1.4% including dividends) while all other U.S. stock averages declined 0.4% to 1.9% (1% - 2% positive return with dividends included) compared to the 6% stock market advance during the first quarter. Without the 5.5% surge in stock prices during the final week of June, the second quarter numbers would have been considerably negative.

Interest rates increased noticeably during the final week of June with the rate on the 10-year U.S. Treasury bond jumping from 2.87% on June 24th to 3.16% on June 30th. During the second quarter, oil prices declined by 11%, wheat prices declined by 23%, corn prices were down 20% during the month of June and the commodity index (which includes aluminum, copper, zinc, etc.) was down 6.7%. Gold prices were up a modest 4% during the second quarter and the U.S. dollar was down 2.3% compared to a basket of foreign currencies. These price declines are significant after considering that media experts were warning that inflation was out of control less than three months ago.

All major stock asset classes – large, mid-size, small, international and emerging markets posted flat to slightly negative performance during the second quarter 2011. Health care stocks and real estate investment trusts managed to post 6% and 3% positive returns during the second quarter.

Overall, U.S. and international stocks gave up nearly all their first quarter gains during the first two months of the second quarter but managed to regain flat performance for the quarter solely because of the 5.5% rally during the last week of June. The final stock market was buoyed by continued *great expectations* for economic recovery and a perceived safe haven to invest compared with the rest of the world. Whether the recovery will regain momentum or reveal another false start is still subject to debate.

The following chart displays sample returns of various asset categories during the second quarter and year-to-date:

Year 2011	2nd Qtr. 2011	Index Return (*includes dividends reinvested*)
+ 6.3%	+ 1.4%	**Dow Jones Industrial Average**
+ 6.0%	+ 1.0%	**Standard & Poor's 500 Index**
+ 6.0%	+ 0.0%	**DJ U.S. Total Stock Market (Broad Market)**
+ 5.5%	+ 0.3%	**Large-company stock-Growth**
+ 5.2%	- 0.7%	**Large-company stock-Value**
+ 8.4%	+ 0.2%	**Mid-Size Stocks – Growth**
+ 5.9%	- 1.0%	**Mid-Size Stocks – Value**
+ 9.8%	+ 0.3%	**Small-company stock- Growth**
+ 4.3%	- 2.5%	**Small-company stock- Value**
+ 4.4%	+ 1.2%	**International (excludes U.S.)**
- 1.4%	- 3.7%	**Emerging Markets**
+ 9.9%	+ 3.5%	**Real Estate Investment Trusts**
		Fixed Income
+ 3.0%	+ 0.2%	**Short-term U.S. Treasury** *(includes appreciation)*
+ 5.6%	+ 1.3%	**Intermediate U.S. Treasury** *(includes appreciation)*
		Alternative Investment Category
+ 5.1%	+ 4.9%	**Gold**
+ 6.5%	- 5.6%	**Natural Resources**

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MARKET UNPREDICTABILITY VS. THE EXPERTS

In our previous newsletter, we stated …. " How confusing and frustrating investors must feel when the world looks as it does today and the stock market still climbs higher. The overall U.S. stock market was up 6% during the first three months of the year in spite of ongoing conflicts in the Middle East and Northern Africa, a U.S.-led attack on Libya, an earthquake, tsunami, and nuclear nightmare in Japan, and the largest deficit this country has ever experienced."

The theme that experts and their media outlets were extolling during the first quarter was the apparent evidence that the recovery was finally underway along with an imminent increase in the inflation rate. The United States was the safest place to invest. Various food prices were rising at an alarming rate; paper, basic materials, oil and packaging costs were increasing, government debt around the world was growing faster than any other time in modern history and corporations had large cash balances ready to deploy. Less than three months later, all of these prices and costs have dropped considerably. How can these expert opinions be so wrong over such a short period of time?

Simply stated, price changes in the financial markets are based on a *complex interaction of economic and human forces* that are rarely "predictable." Each hour of every day is loaded with new information, worldwide events and change. This new information is disseminated and acted upon instantly in many ways by many participants. How can anyone expect or believe he has attained "expert" status in a field that changes continuously?

Analyzing the current and expected value of individual companies continues to be a valuable talent in securities analysis and the best analysts do attain expert status. However, individual company analysis alone is insufficient to achieve successful investment results. Economic conditions, worldwide events, inflation, interest rates, political environment, exogenous events and many other factors have an impact on securities pricing. Further, the direction of the overall market in reaction to new information does have an impact on individual company prices.

Simply stated, "experts" can have a great depth of knowledge in a very narrow area – such as individual company analysis. However, the financial markets move in unpredictable directions based on new information from a broad range of sources.

So why do investors continually search for "expert" opinions? Obviously investors would like an assessment and recommendation for better investment results similar to what a doctor would prescribe for an ailment to a patient. Financial advisors seek expert status because predictions get attention. If and when an "expert" succeeds (the odds are 50% chance of success or failure), she wins attention, increased business and becomes the new guru on page one of the newspaper. Also, the media (newspaper, magazines, television) needs to write and create interesting stories. The public wants predictions and journalists/programmers have deadlines.

Further, when experts are wrong, they simply change their perception of the facts or provide a lengthy explanation as to why exogenous or unpredictable events doomed their predictions. Investors need to realize the financial markets are not predictable on a daily, monthly, quarterly or annual basis. Successful investment management requires a great deal of knowledge in a very narrow area as well as an ability to see the big picture, draw useful information together from a variety of resources, and use discernment and judgment to develop a course of action. Given the sheer number of "expert" opinions, investors should consider these opinions as interesting discussion and entertainment. Remember, we live in the United States of Entertainment.

FINANCIAL MARKETS – OUR APPROACH TO UNCERTAINTY

Our outlook for the economy, financial market performance and specific investment recommendations have not changed from our previous newsletter. As explained last quarter, every client has a target or recommended asset allocation that allows for a specific acceptable range (minimum and maximum) of investment within each asset class according to our confidence level. The problem today is the same – a high level of uncertainty regarding the direction of the

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world economy, government debt, spending cuts, taxes, inflation and more.

We explained that our approach to the current level of uncertainty was to develop not one, but several contingency-dependent future portfolios for our clients. For example, we have considered what would be an optimal mix of asset classes (stocks, bonds, real estate, natural resources, etc.) if an economic recovery gains momentum in the near term. In addition, we have considered what would be an optimal mix of asset classes if the economy continues to struggle, debt levels increase and conflict escalates around the world. Lastly, we have considered what would be an optimal mix of asset classes (such as gold, natural resources, oil, dividend-paying common stocks, etc.) if inflation and interest rates begin to rise and continue increasing. We simply have to consider several scenarios because none of the above scenarios appear to have a higher probability of occurring than the others – which is unusual.

At this time, we believe a modest recovery will begin sometime within the next two years followed by improvement in most investment categories – except for bonds (fixed income). At some point in time, likely to occur simultaneously with the beginning of an economic recovery, interest rates will increase. Rising interest rates reduce bond (and all fixed income securities) values. For example, a one percent *increase* in the general level of interest rates equates to a 4%-12% decline in bond values depending the remaining maturity date of the bond (the longer the bond maturity, the greater the price decline).

Our strategy is to continue holding government bonds of healthy countries (Templeton Global Bond Fund) and use the proceeds from maturing bonds and certificates of deposits to invest in very large, diversified, multinational companies with a long history of stable earnings and dividends. Select multinational and dividend-paying companies pay income equal to or greater than the interest paid on 10-year U.S. Treasury Bonds. Not only is the income from these select large companies equal to or greater than the interest payable on 10-year U.S. Treasury Bonds, but at the end of ten years, we believe the stocks will be worth much more than they are today. The 10-year U.S. Treasury Bond will be worth the same par value (usually the initial purchase cost) at maturity. In summary, we believe the 2.5% - 5% dividends paid by these multinational companies are nearly as safe as or better than the 3% interest income from government and corporate bonds.

In addition, real estate values have adjusted tremendously over the past 5 years – particularly commercial real estate. REIT's (Real Estate Investment Trusts) are traded daily (or once at the closing bell) and offer attractive dividends in the 3% - 6% range. This asset class (real estate) has been absent from most of our managed accounts since 2005 and appears attractive now to begin building a position. Most energy, materials and technology companies should post better earnings growth than compared to retail, manufacturing, construction and service companies.

The problem is much can happen between today and the inevitable start of a recovery. This is why we have created three different contingency-dependent portfolios based on whether the economy worsens, a recovery begins, or inflation takes hold and costs rise rapidly.

Your quarter-end reports may include blue recommendations sheets. Please be advised that we cannot list all recommended investments for all three contingency-dependent scenarios. For example, several clients may have noticed we established or added to our positions last month in technology and a new addition – International Paper, that may have not appeared in earlier blue recommendation sheets. Expect similar additions and deletions in the future. As we stated last quarter, we intend to use our insight and judgment to distinguish between real trends verses emotional and reactive trading. We may invest exclusively in one area or in multiple securities such as large multinational companies, real estate, natural resources, or other selections.

ANNOUNCEMENTS

We have successfully moved our office to a temporary location in the same five-building campus: **12730 High Bluff Drive, Suite 170.** Please note the change of address for personal visits and client meetings only. The mailing address, phone number and fax number have not changed and we expect to re-locate back to our permanent space sometime in October. We will keep you informed of the construction progress and the status of our relocation back to the permanent space.

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On a personal note, many of our clients are aware that Brian Lowder's daughter, Melissa, has been playing soccer since she was 5 years old. Over the Memorial Day weekend her team, Carmel Valley Manchester, was selected by invitation to join the top 20 teams in the United States to compete in the Manchester United Premier U.S. Cup Finals sponsored by Nike in Beaverton, Oregon. The winning team will receive an all-expense paid trip and entry into the World Youth Cup in Gothenburg, Sweden. Carmel Valley Manchester managed to win three of their first four games to secure a spot in the semi-final match. In both the semi-final and final matches, the games were scoreless in both regulation and overtime. The winner was decided by penalty kicks. Melissa's team won both matches and will travel to Sweden July 16th to represent the United States in the 10-day tournament. Congratulations to Melissa and to Brian for making his first trip to Europe.

COPIES OF INCOME TAX RETURNS

If you have not done so already, please send paper or computer file copies of your 2010 income tax returns to our office upon completion. Our investment decisions and income tax management strategies are greatly improved when we have copies of your income tax returns.

Contact Us

Brian D. Lowder, Inc.

Brian D. Lowder, CFP®, CFA
Michael Kinnear, MBA, MSFS, CFP®
Clinton Winey, MBA, CFP®, CFA
Remette Martinson
Pamela Priest

Address
12780 High Bluff Drive Suite 100
San Diego, CA 92130

Telephone
(858) 794-6800

Fax
(858) 794-6906

Website
www.bdlowder.com

Email
brian@bdlowder.com
mike@bdlowder.com
clint@bdlowder.com
rm@bdlowder.com
pam@bdlowder.com

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Best regards

Brian Lowder   Clinton Winey   Michael Kinnear   Remette Martinson   Pam Priest