// BRIAN D. LOWDER, INC.
QUARTERLY NEWSLETTER
Volume 8, Issue 4 January 2006

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FINANCIAL MARKET OVERVIEW

Unlike last year, the final thirty days of 2005 reversed what appeared to be a moderate but acceptable year for stock investors into an uninspiring year of below-average investment performance. The first quarter began on a losing note followed by a moderate second quarter. By mid-year, the stock market was essentially back to where it had started the year. The third quarter was up and down and the fourth quarter began with a decline. Most of the positive stock market performance for the year came during the month of November, but was followed by a disappointing final month of the year.

Excluding dividends, the Dow Jones Industrial Average was the only major market index to post a negative 0.61% return for 2005. The Standard & Poor's Index of large-company stocks advanced only 3% and the broad market, as measured by the Wilshire 5000 was up 4.6%. When dividends are *included*, the total return for these indexes ranged from 1.72% to 6.38% - not exactly an impressive year for stock investors. On the other hand, U.S. mid-size companies and international stocks performed quite well advancing 10% and 16% respectively.

Bond investors were disappointed as well. Short-term interest rates rose by 2% and long-term interest rates increased approximately ½% in 2005. The result was falling bond prices and interest income was not sufficient to provide an acceptable total or combined return. Intermediate term bonds were up about 2% and the 10-year Treasury Notes earned approximately 3%.

As usual, there were some narrow sectors of the market that performed quite well. Gold, international emerging markets and energy stocks were up more than 30% and real estate funds earned about 10%. Below are sample returns of various asset classes during the fourth quarter and for the entire 2005 calendar year:

4th Quarter	Calendar Year 2005 (includes dividends reinvested)		2005 Year Excluding Dividends
+ 1.4%	+ 1.7%	Dow Jones Industrial Average	- 0.61%
+ 1.6%	+ 4.9%	Standard & Poor's 500 Index	+3.0%
+ 1.8%	+ 6.3%	Wilshire 5000 (broad market)	+4.6%
+ 2.5%	+ 2.2%	NASDAQ	+1.9%
+ 4.6%	+ 6.7%	Large-company stock-Growth	
+ 2.1%	+ 6.1%	Large-company stock-Value	
+ 4.3%	+ 10.4%	Mid-Size Stocks – Growth	
+ 2.8%	+ 9.7%	Mid-Size Stocks – Value	
+ 2.9%	+ 6.4%	Small-company stock- Growth	
+ 1.8%	+ 6.6%	Small-company stock- Value	
+ 5.8%	+ 16.1%	International (excludes U.S.)	
+ 7.1%	+ 32.1%	Emerging Markets	
+ 14.5%	+ 34.1%	Gold funds	
+ 0.6%	+ 1.4%	Short-term U.S. Treasury *(total return)*	
+ 0.6%	+ 1.6%	Intermediate U.S. Treasury *(total return)*	

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In retrospect, last year's investment performance was respectable given the forty percent jump in energy prices, the economic impact of multiple hurricanes to the Gulf Coast region, a record trade deficit (imports exceeding our exports), growing federal budget deficit (government spending exceeding revenue) and the steady rise in short-term interest rates. In spite of the above headwinds, our Gross Domestic Product (GDP or our country's overall economic growth) exceeded 4% throughout the year.

FUTURE OUTLOOK

Shouldering the above burdens and still producing over 4% growth does demonstrate the strength and resilience of the U.S. economy, particularly the economic power of the Baby Boom Generation and their willingness to keep spending. It's unlikely that all of the above factors will repeat themselves in 2006. Oil prices will not likely rise as much as they did in 2005. I doubt that we will experience anything like the hurricane experience of 2005. Also, after raising short-term interest rates thirteen times over the past two years, the Federal Reserve is probably near the end of its tightening process.

While the *rate* of corporate earnings growth has decelerated, corporations are experiencing sufficient growth. Capital spending for buildings and equipment has been growing steadily over the past few years and jumped noticeably in the 4th quarter of 2005. While short-term interest rates have increased over 3% during the past two years, the current 4% to 5% rate is still reasonable to encourage continued borrowing for expansion. Borrowing costs are likely to rise modestly and economic growth and consumer spending are likely to slow somewhat. Overall, the economic outlook in the U.S. appears to be solidly in the middle of its historic range and international growth rates are expected to be higher. The unemployment rate continues to hover around 5%, which is still very reasonable. From a macro perspective, our view of the economic environment is similar to our outlook one year ago: the economy will likely continue growing in a slow and steady expansionary fashion and the financial markets will likely deliver modest or average returns in the near future. In summary, there are many indicators to monitor closely and any significant change in the items mentioned above could change our outlook.

Our most troublesome concerns from a mid-to-long-term perspective are consumer debt and real estate prices. For the past several years, consumer spending has been one of the most reliable engines of the world economy and is primarily responsible for moving us through and beyond the three-year stock market decline (2000-2002), terrorist attacks, high energy prices and the conflict in Iraq. Concurrently, low interest rates have fueled a boom in housing prices.

U.S. households, primarily borrowing against home values, now *spend more than they earn for the first time since 1947.* Often we are told how low our savings rate is here in the U.S. (typically 1% to 2%), but now it has turned negative by one to two percent. Our maturing baby-boom generation should be building their nest eggs and paying down debt. Instead, many families are taking on larger amounts of adjustable-rate and interest only debt with payments that are rising with the general level of interest rates. Our federal and state governments are also spending more than they collect at the same time.

Simply stated, this is clearly an unprecedented financial imbalance. The longer it continues, the harder it becomes to rebuild household savings, reduce deficits, and stabilize the housing sector without causing some economic pain. But, in typical fashion, Americans will find it difficult to proactively change their spending patterns until the pain becomes noticeable. A recent study by A.G. Edwards showed that San Diego County has a lower savings rate than the national average due to higher credit card debts and mortgage payments on escalating real estate prices.

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We have expressed our outlook for real estate values for nearly two years. We have stated many times that the most important indicator of future real estate values is the level and direction of interest rates. While commercial real estate prices performed well in 2005, residential real estate values are clearly slowing. Mortgage rates (the most important variable affecting real estate prices) for standard 30-year fixed-rate loans edged lower early in 2005 and then rose steadily. The average 30-year fixed-rate loan hit a low for the year at about 5.5% in June, down from 5.75% in January, but rose to 6% by year-end.

Not coincidently, the record number of homes for sale indicates owners are likely to spend more time waiting for a declining number of buyers to make offers. The backlog of unsold homes is presently at a nine-year high and the number of listings in San Diego County has more than doubled since March 2000. The impact of having more homes for sale is beginning to show up in real estate appreciation rates.

Local newspapers frequently report price appreciation on a year-over-year basis. For example, in October 2004, the year-over-year (Oct. 2003 to Oct. 2004) price appreciation was over 26%. In November 2005, the year-over-year price gain had dropped to 6.4%. What this means is prices have actually declined during 2005 and those numbers won't be reflected as declines until year-over-year price gains (declines) are reported sometime in the middle of 2006. The bidding wars for resale homes are over.

The combination of rising interest rates, declining real estate values and over-extended borrowers on variable-rate or interest only debt is an awful mixture that can lead to a reversal in real estate values. Many corporations from Wal Mart to General Motors know very well what they must do when buyers are over-extended and sales begin slowing. They must discount their prices more deeply than they already have and market them more aggressively.

Our message is simple. Expected returns are likely to remain in a narrow range equivalent to or slightly below historical averages. If you find your family finances are continually relying upon home equity lines of credit and/or mortgage refinancing to meet normal living expenses and extra large-ticket items, the time has come to tighten the budget. Long-term planning is much more predictable and less stressful when home mortgage rates are fixed or locked in for 10 years or longer. Adjustable rate financing and interest-only options are best suited for *short-term* situations, job transitions and a declining interest rate environment. Voluntarily and proactively take the necessary steps to keep your finances in balance before changes in the economic environment, interest rates, real estate values or other the market changes force you to make adjustments.

RETIREMENT & TAX PLANNING IN 2006

The New Year brings greater opportunity to save more and make larger contributions to qualified retirement plans. The maximum contribution limits below are effective January 1, 2006:

Name of Plan	**Contribution**	**Age 50 & Older Contribution**
401(k), 403(b), 457	$15,000	$20,000
Defined Contribution (Profit Sharing etc.)	$44,000	same
Simple IRA	$10,000	$12,500
Regular/Roth IRA's	$ 4,000	$ 5,000

In addition, Social Security benefit checks will increase by 4% in 2006 and the annual gift tax exclusion increases by $1,000 to $12,000.

Income tax brackets have widened in 2005 to allow for inflation. On the following page are the income tax brackets and rates for 2005:

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Married: If taxable income is ….	***Tax Rate***
Not more than $ 15,100	10% of taxable income
Over $ 15,100 to $ 61,300	15%
Over $ 61,300 to $123,700	25%
Over $123,700 to $188,450	28%
Over $188,450 to $336,550	33%
Over $336,550	35%

Single: If taxable income is ….	***Tax Rate***
Not more than $ 7,550	10% of taxable income
Over $ 7,550 to $ 30,650	15%
Over $ 30,650 to $ 74,200	25%
Over $ 74,200 to $154,800	28%
Over $154,800 to $336,550	33%
Over $336,550	35%

FAREWELL TO 2005

Last year was both successful and enjoyable. We appreciate the trust and confidence you have in us to assist you in making better financial decisions and preserving your wealth. We will continue to work hard to preserve that trust and confidence and appreciate the opportunity to serve as your advisor.

We encourage our clients to make an annual appointment with us to review their goals and circumstances. An appointment is especially important if there has been, or soon will be a change in your financial situation, investment objectives or family circumstances. This is also a good time to discuss whether an update is appropriate for trusts, wills, or health directives. If you have not been by to see us in the last twelve months, please call our office and schedule an appointment with Pam or Remette at 858-794-6800.

We wish all of you a happy, healthy and prosperous new year.

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Brian D. Lowder, Inc., a California Corporation, is a fee-only wealth advisory firm specializing in comprehensive financial planning and investment management. Brian D. Lowder, Inc. is registered with the Securities and Exchange Commission and licensed by the State of California Department of Corporations as an Investment Advisor.

Best regards

Brian Lowder   Clinton Winey   Michael Kinnear   Remette Martinson   Pam Priest