BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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INSIDE THIS ISSUE

FINANCIAL MARKET OVERVIEW

U.S. stock price performance was relatively flat during the fourth quarter. Large-company stocks ended the quarter down more than 2%, the overall broad market was up less than ½% and mid/small company stocks up about 1%. The best performing asset categories during the fourth quarter were international and emerging market stocks – both up 8%. Gold and other precious metals ended the fourth quarter down over 5%. Treasury and other fixed income bond prices were down less than one percent.

The calendar year 2012 financial market performance was surprisingly better than most investors thought it would be given all the concern about the Presidential election, massive budget deficits, a stalled global economy and the inability of our political leaders to agree upon and implement policy. All common asset categories finished the year with positive returns ranging from ¼% to 19%.

Emerging markets and international stocks reversed course from 2011 and finished this year with the best performance - earning 19% and 18% returns, respectfully. The overall or broad U.S. market finished the year earning nearly 14% or about 16% including dividends. However, large company stock prices underperformed the broad market with the Dow Jones Industrial Average ending the year with a 7.26% return.

The stock market advance was also broad-based. Large, mid and small-company stocks all posted positive returns during the year with mid-size and small companies leading the advance. In addition, value stocks out-performed growth stocks. Fixed income or bonds posted positive returns ranging from 3% to 7% depending upon the quality and maturity selections.

Gold and precious metals ended the fourth quarter down about 5%, but posted positive performance of about 7% during 2012. Real estate investment trusts posted a strong 18% return in 2012.

Since the fourth quarter market performance was essentially flat, our clients' investment performance did not change significantly from the third quarter year-to-date figures. Depending upon the percentage of total assets held in stocks, most investors (with fully invested accounts) earned a positive rate of return within an 8% to 15% range during the 2012 calendar year.

The following chart displays sample returns of various asset categories during the fourth quarter and for the calendar year ending December 31, 2012:

Calendar Yr 2012	**4th Qtr. 2012**	**Index Return** ***(includes dividends reinvested)***
+ 7.2%	**- 2.5%**	**Dow Jones Industrial Average (^DJI)**
+16.0%	**- 0.4%**	**Standard & Poor's 500 Index (^SPY)**
+16.5%	**+ 0.2%**	**DJ U.S. Total Stock Market (VTI)**
+15.2%	**- 1.2%**	**Large-company stock-Growth (IWF)**
+17.4%	**+ 1.6%**	**Large-company stock-Value (IWD)**
+15.6%	**+ 1.7%**	**Mid-Size Stocks – Growth (IWP)**
+18.3%	**+ 3.9%**	**Mid-Size Stocks – Value (IWS)**
+14.8%	**+ 0.5%**	**Small-company stock- Growth (IWO)**
+18.0%	**+ 3.2%**	**Small-company stock- Value (IWN)**
+18.7%	**+ 8.5%**	**International (EFA)**
+19.0%	**+ 8.0%**	**Emerging Markets (EEM)**
+17.6%	**+ 2.5%**	**Real Estate Investment Trusts (VNQ)**
		Fixed Income
+ 0.3%	**- 0.1%**	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+ 3.6%	**- 0.4%**	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
		Alternative Investment Category
+ 6.6%	**- 5.7%**	**Gold (GLD)**

ONE-HALF OF FISCAL CLIFF AVOIDED

Congress was able to patch together an agreement regarding income, estate and payroll taxes, but this accomplishment only addresses one-half of the Fiscal Cliff agenda –income tax revenue will increase in 2013, but the other and most

Continued on page 2

Continued from page 1

important half was deferred again for another 60 days – reducing government spending. Both halves are necessary, but neither higher tax revenue nor reduced government spending ***alone*** will solve our fiscal and economic problems.

First, the accomplishment – higher tax revenue. Every wage earner in all tax brackets will pay higher Social Security taxes. This will occur because the 2% *temporary* ***Social Security payroll tax*** reduction permitted in 2011 has expired and the rate will increase back to its 6.2% level on January 1. Any kind of payroll tax increase reduces take-home pay for Americans at all income levels. The maximum Social Security (employee) payroll tax is 6.2% on the first $113,700 of employment income, up from 4.2% during 2011. Therefore, the maximum increase will be the 2% difference times $113,700 or $2,274.

Income tax rates will increase for individuals with more than $400,000 of income and married couples with over $450,000 of income. Only the top marginal income tax rate will increase from 35% in 2012 to 39.6% in 2013.

Personal exemptions will once again be subject to reduction or phase-out. Simply stated, when tax law changes reduce or take away deductions/exemptions, then taxable income will be higher. Reporting higher taxable income will result in higher income taxes due. Taxpayers are permitted to claim a $3,800 personal exemption (thereby reducing reported income by the same amount) for each dependent. For example, a married couple with two children is permitted to reduce taxable income by $15,200 ($3,800 times 4 personal exemptions). Under the new tax law, the personal exemption amount will begin to be phased out (reduced) for individual taxpayers who earn more than $250,000 and married taxpayers earning more than $300,000 beginning in 2013. The explanation of the math involved can be confusing, so we will provide an example. If a married couple reports $350,000 of income in 2013 ($50,000 over the $300,000 limit mentioned above), then the couple will lose about 40% of the value of their personal exemptions. Instead of reducing taxable income by the full $15,200 personal exemption amount in the example above, personal exemptions will be reduced by $6,080 to $9,120. What is the actual tax increase? If the couple were in the 35% federal income tax bracket, their income taxes would increase by $2,128 (35% tax bracket times the $6,080 reduction in the personal exemption amount).

Itemized deductions will once again be subject to reduction. Examples of itemized deductions are property taxes paid, charitable contributions, interest paid on home loans, state income taxes paid, etc. Itemized deductions are often the largest allowable deduction taxpayers use to reduce taxable income. When itemized deductions are lowered or reduced, the result will be reporting higher taxable income and therefore a higher income tax bill. Itemized deductions will be reduced up to 80% for individual taxpayers with incomes above $250,000 and married taxpayers with income above $300,000. End result: Lower itemized deductions mean higher reportable income, higher personal income taxes and increased tax revenue to the government.

Again, the mathematical calculations are unpleasant. Simply stated, taxpayers can lose 3% of the value of their itemized deductions above the threshold amounts ($250,000 individual and $300,000 marrieds). In my previous example above, a married couple with reported income of $350,000 ($50,000 over the threshold limit) would lose about $1,500 of itemized deductions (3% times the $50,000 income above the limit). If this couple is in the 35% federal tax bracket, their income taxes would increase by $750 (35% times $1,500)

Long-Term Capital Gains and Dividend Income tax rates will increase from 15% to 20% for higher income taxpayers. Long-term capital gains are realized when taxpayers sell any investment or asset for a profit after holding it for at least one year (i.e. Selling a stock or mutual fund at a profit). The profit is subject to long-term capital gains tax. The capital gain and dividend tax rate increases from 15% in 2012 to 20% in 2013 for individual taxpayers with reported income above $400,000 and married taxpayers with income above $450,000. Taxpayers who are not in the highest income tax bracket will continue to pay the 15% rate and people in the lowest two tax brackets (10% and 15%) would continue to pay 0% capital gains tax.

Estate and Gift Tax exemption (the amount not subject to death tax) will remain at $5 million per person. But the current 35% estate tax rate will increase to 40% in 2013 on any estate greater than $5 million.

Miscellaneous Benefit In 2013, taxpayers age 70 ½ or older, will once again be permitted to make up to $100,000 in charitable donations directly from their IRA account to charity.

In summary, higher income, Social Security, and estate tax rates combined with the loss of some exemptions/deductions will result in higher reported incomes, higher income taxes due, and higher tax revenue to the federal government. Every employed taxpayer will pay 2% higher Social Security payroll tax in 2013 – this increase affects everyone. The additional higher *income* tax bracket (39.6%) will cost "wealthy" taxpayers about $4,600 in additional income tax for each $100,000 they earn above the threshold limits ($400,000 individual and $450,000 for marrieds) and the phase-out of itemized deductions and personal exemptions will also increase income taxes for individuals (earning above $250,000) and marrieds (earning above $300,000), but not by significant amounts.

There are many other provisions for child credits, education incentives, and other child-related tax incentives, but very few of our clients are eligible for these additional incentives.

Continued on page 3

Continued from page 2

Finally, the IRS is making it easier or more applicable for 401(k) plan participants to convert any money in their tax-deferred accounts to a so-called Roth 401(k) account IF their employer offers one. Prior to 2013, a plan participant had to be age 59½ or older (to qualify for a "permitted" distribution) and the conversion only applied to some of the employer contributions. In addition, only about 12% of employer 401(k) plans included the provision allowing conversions to a Roth 401(k) plan. Now, the new provisions say you can convert any money in your regular 401(k) plan. It sounds like a great idea, but the IRS is the sure winner. The rollover is immediately taxable and the IRS is looking for any and all ways to increase tax revenue. For those taxpayers with excess wealth or investment assets, the rollover could be a wise choice if the taxpayers never intend to spend the money and would rather pass on a large pool of tax-free money to heirs. In addition, the income tax due upon conversion should be paid with excess personal monies – not from the 401(k) plan assets.

ONE-HALF OF FISCAL CLIFF IGNORED

All of the new income tax increases and exemption/deduction phase outs discussed above will not fix or even put a dent in our budget deficit problem – reducing government spending is the ONLY answer. By raising tax rates on upper-income Americans and limiting certain deductions for those households, the Congressional Budget Office projects we can reduce our budget deficit by about $737 billion over ***10 years***. The problem is we already owe close to $16.3 trillion dollars today – and it is growing! This means, over ten years, the new higher income tax revenues and deduction limitations will only pay down 5 cents of every dollar this country already owes. Clearly, the new income tax increases will not solve our deficit problem and presently, our deficit is growing – not shrinking.

The big fight hasn't even begun and Congress must reach an agreement by March 27 – the "last day" that Congress must agree to ….. get this ….. raise our debt ceiling even higher! If Congress doesn't raise the maximum debt ceiling again to an amount greater than $16.4 trillion, then our government will have maxed out its credit limit. If Congress does not act, immediate spending reductions will automatically be implemented across all government departments. Our government has tripled our debt over the past 4 years. Overspending (continuing to spend more than the revenues collected) and ignoring the need to balance the government budget has put this country on the brink of a defining moment. Without an agreement, immediate cuts will have to be implemented across the board on all government programs and services mentioned below.

Rather than predict how much reduction in government spending (Social Security, Medicare, unemployment benefits, free rent, food stamps, subsidized this and subsidized that, military, travel expenses for Congress and the President, billions of dollars in foreign aid to other countries, etc.) that Congress MIGHT agree to over the next 60 days, time might be better spent preparing for a rough ride in the financial markets and identifying what strategies should be in place.

INVESTMENT OUTLOOK: CONSIDER BOTH OUTCOMES

The good news is one-half of the mystery and uncertainty regarding the fiscal cliff has been solved. We now know which deductions and exemptions will be reduced and we know what our income, payroll and estate taxes will be for at least the next four years. The financial markets respond positively when uncertainty is removed.

The bad news is the other uncertain half – reduced government spending still must be resolved and Congress must act over the next 60 days. It is not going to be pretty. One side wants to make the necessary spending cuts, and the other side wants to increase taxes and leave spending alone. The increased tax revenue side of the equation has been agreed upon and the increased revenue will not be sufficient to pay down more than 5 cents of every dollar of debt our country owes. It's time to cut expenditures. Nobody enjoys receiving less benefits or entitlements than the year before and politicians do not enjoy reducing funds to voters who helped them get elected.

The financial markets will stay on a bumpy and volatile road until spending reductions are agreed upon. It is likely that some kind of agreement will be reached. If it is a weak spending reduction agreement, the financial markets are likely to decline. If Congress has the courage to act in the best interests of the country, they will agree to reduce spending in line with revenue. Everyone now has the information regarding the new increased income tax "rules" and if spending is reduced to match revenues, the financial markets will likely advance. Americans adapt, adjust and move forward when we know the rules of the game.

Our Strategy Is The Same: Stay The Course – Be Prepared To Act

Beyond mid-2013, there are solid reasons for stocks to lead a sustainable advance. Removing the uncertainties of income tax rates and government overspending discussed above will have a positive impact on the stock market and real estate. Further, even the smallest improvement in economic growth and the unemployment rate will quickly translate to higher stock prices. Real estate prices will improve as well, but not nearly as quickly as stocks.

Fixed income (bonds) will be the biggest disappointment for investors. Excessive government debt, overspending, eventual

Continued on Page 4

Continued from page 3

increased business activity, economic growth and more jobs will ultimately result in higher interest rates. It doesn't matter that interest rates will continue to be relatively low for several more years. It is the direction of interest rate changes (up) that will cause bond prices to fall. There will be no exceptions to the mathematical rule: as interest rates rise, bond prices or values will fall.

Our biggest concern is market risk or disappointment over the next 60 days. The financial markets will be volatile – expect it. The stock market is already fairly valued at this level given the current state of our economy. This country still has a fiscal crisis (too much debt) and our decision-makers (Congress and the President) couldn't be more divided and slow to act.

Beyond the next 60 days, and after Congress reaches some kind of agreement on reducing government spending, it won't take long for investors to begin looking beyond 2013 and begin valuing stocks at what they will soon be worth.

The investment recommendations we have provided in your year-end reports represent our optimistic scenario and apply only if and when Congress agrees upon and implements government spending reductions. For downside protection, our advisory staff has already reviewed all client portfolios and identified which stocks will be sold if a decision is made to quickly reduce stock holdings by 25% to 35%. This downside protection and equity (stock) reduction plan has already been identified; trades have been summarized into block trade files and are ready to be executed in the event we decide to implement the protection plan.

Additionally, long-term bonds of weak companies or countries (junk bonds, emerging markets and countries whose debt is currently a large percentage of their GDP) will not be added to our client portfolios.

COPIES OF INCOME TAX RETURNS

Please send paper or computer file copies of your 2012 income tax returns to our office upon completion. Your tax preparer must receive written or verbal approval/permission to send copies of your personal income tax returns to our office. Our investment decisions and income tax management strategies are greatly improved when we have copies of your income tax returns.

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Best regards

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