BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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FINANCIAL MARKET OVERVIEW

Beyond comparison, the last 24 months have been the most challenging in my career as a financial planner and investment advisor. Both advisors and investors have experienced many changes, opportunities, and fundamental lessons over a short period of time. It seems trivial to discuss our finances after such an enormous tragedy on September 11th, 2001, but we must get back to normal and the financial markets are an important part of what makes this country great. Because of the recent tragedy and the adverse reaction of the world financial markets, it's natural to ask "What's next for the stock market, the economy and what should I do?"

Below are sample returns of specific stock categories and broad market index performance data for the 3rd **quarter.**

Third Quarter, 2001

- 15.8%	*Dow Jones Industrial Average (30 large U.S. companies)*
- 15.6%	*International (Excludes U.S.)*
- 15.0%	*Standard & Poor's 500 Index (500 largest U.S. companies)*
- 15.9%	*Wilshire 5000 (broad U.S. market)*
- 27.3%	*Small-Company Stock- Growth*
- 16.9%	*Small-Company Stock- Value*
- 23.9%	*Mid-Size Stocks – Growth*
- 13.3%	*Mid-Size Stocks – Value*
- 30.7%	*NASDAQ Composite*

Source: Wilshire and WSJ Market Data group

Although I have been in the advisory business for over sixteen years and have seen several difficult and uncertain times – the market crash of 1987, the market decline during Desert Storm, the enormous uncertainty of Y2K (new millennium), the high tech / Internet bubble and then bust, and finally the tragedy in New York – **I still don't know the answer with certainty nor the exact timing of changes. I never have.** How many times must investors hear or read that no one can predict with any certainty which way and when the next 1,000 point move will occur. Market fluctuations, while by no means comfortable, are normal. However, we can navigate through the market volatility and make decisions that will allow us to accomplish our investment and retirement objectives over the long-term. The key is to stay within the boundaries of reasonable and prudent expectations and not allow us to fail on the long-term journey to financial independence by taking short-term gambles. (This is why we begin and spend so much time

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preparing a written investment policy statement and a recommended asset allocation for each client – it creates boundaries).

Since World War II, we have had 9 recessions and several other economic setbacks. Yet, corporate earnings are up 63-fold and the stock market is up 71-fold. Right now, we are facing a difficult time emotionally and psychologically. In addition, an economic slowdown was inevitable. But every economic recovery since WWII has been preceded by a stock market rally and these rallies often start when conditions are or appear grim.

Some economists have said we are on the verge of a recession. I can't tell you with certainty whether we are headed for a recession or not (in my opinion we are experiencing a short-lived slowdown and adjustment to the excesses of the late nineties). But I can tell you that we have been tested by many recessions before and *they have always been followed by recoveries*. The U.S has a perfect record when it comes to rebounding from the most difficult times. Take a look at the historic performance of the largest 500 U.S. companies (S&P 500 Index) after tragedy:

Performance of S&P 500 Index after tragic events

	After 1 Month	*After 1 Year*	*After 3 Years*
Dec. 7, 1941: Pearl Harbor	*1.6%*	*20.3%*	*81.4%*
Nov. 22, 1963: Pres. Kennedy Assassinated	*2.6%*	*18.9%*	*20.9%*
Aug. 2, 1990: Desert Storm – Iraq Invades Kuwait	*-4.9%*	*26.9%*	*57.7%*
Feb. 26, 1993: World Trade Center bombed.	*2.2%*	*8.3%*	*56.6%*

Other positive indicators are: Allan Greenspan, chairman of the Federal Reserve Bank, has **lowered interest rates 9 times this year for a total of 4 percentage points.** The normal lag time for a stock market recovery following three or more interest rate cuts is 12 to 18 months.

Congress and President Bush have **lowered federal income and estate tax rates**.

The **rate of inflation is less than 2.5%**.

The biggest negative indicator is a *decline in corporate earnings*. Yes, the decline is real and is a direct result of the bubble that burst in the outrageous valuations of technology, Internet, and communications stocks. In the late nineties, the share prices of these stocks rose to unbelievable and unsustainable levels. But the rest of the stock market was not overpriced at that time. Small-company stocks, mid-size company stocks and the "old economy" stocks (traditional industries like foods, construction, paper etc.) were dismissed as old and tired companies that no one thought were fashionable to purchase.

In my opinion, the decline in economic growth and declining stock prices were very close to a reversal before the tragic event in New York last month. Investor psychology (the strongest short-term indicator of stock prices) was pushed into a tailspin as quickly as the tragedy unfolded. It may take more time for most Americans to return to their normal routines and confident outlook, but I believe there are great values in this depressed market. For those investors with a long-term investment horizon (I am referring to 3, 5 and 10 years, not days and weeks), now is the time to stay invested in equities.

CONSIDER TAX LOSS SELLING NOW

Normally, a discussion about the merits of tax-loss selling occurs at year-end. In light of the stock market correction that began in April 2000 and the additional decline resulting from the tragedy in New York, tax-loss selling is an important tax-reduction strategy worth considering now. Simply stated, many investors have **unrealized** capital losses on their stock and mutual fund holdings. If an investor does not sell the security before year-end, the loss remains **unrealized** –

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meaning it has not been sold and therefore the loss can **not** be deducted on the 2001 tax return.

If the stock or mutual fund **is sold** before year-end, then the loss **is realized** and can be used to offset (reduce) capital gains. In addition to offsetting capital gains, taxpayers can use capital losses to reduce up to $3,000 of other income (dividends, wages etc.). In other words, the capital loss can be used to reduce income taxes on the year 2001 tax return or carried forward indefinitely (or until death). If carried forward, the capital loss can be used to offset future realized capital gains and up to $3,000 of ordinary income in each year.

In general, we are advising our clients to selectively capture the capital losses now, and use the loss(es) to: 1) offset any realized capital gains in 2001 2) reduce reported income by up to $3,000 and 3) carry forward any unused losses to offset future capital gains and up to $3,000 of ordinary income. In addition, we are recommending that our clients invest the proceeds right back in the U.S. stock market and in some cases, repurchase exactly the same securities that were sold no earlier than 31 days later. The tax law requires a 31-day waiting period to repurchase the ***exact*** same securities that were sold. If a taxpayer does not wait the required 31-day required period, then the capital loss deduction is dissallowed. This 31-day waiting period is referred to as the "wash-sale" rule.

In most cases, we are recommending the purchase of similar securities rather than the exact same security to avoid the wash-sale rule. Normally, 31 days is not too long of a period to wait. However, it is our opinion that the stock market is down much further than justified and it is possible that the stock market averages will begin to move up before the 31-day period expires. Besides, there are so many purchase opportunities (for the patient investor) and similar mutual funds, we do not find it necessary to repurchase the exact same security in 31 days. In addition, some of the current portfolio holdings that have unrealized losses should be sold based on investment merit alone – they do not have to be repurchased. The bottom line is - under present circumstances it does make sense to sell specific investments, harvest some of the losses and reduce your income taxes. Investors might as well receive something positive from an otherwise dismal eighteen months.

Below is a brief summary of the **Benefits** of tax-loss selling:

1) Capture a tax deduction against capital gains in the current year.
2) Reduce up to $3,000 of ordinary income.
3) Carry forward any unused capital losses to future years.
4) The investment portfolio holds the same or similar securities after tax-loss selling is completed and substitute purchases are completed.

Cost or Drawbacks

1) The transaction cost incurred to sell a security or mutual fund plus the transaction cost of the subsequent purchase of the substitute security. Often the total cost here is less than $100.00.
2) The stock or mutual fund sold begins to rise before the exact repurchase can occur 31 days later. Again, substitute investments can easily be identified and purchased immediately to minimize or eliminate this drawback.

We have already contacted clients regarding tax loss selling where the specific situation was urgent or the timing was important. Please refer to our blue recommendation sheets in this mailing for tax loss recommendations (if any).

Consider Home and Other Debt Refinancing Now

Interest rates have declined more than many investors realize. Home mortgage rates range from 6.875% on traditional 30-year mortgages to less than 6% for variable rate and other types of loans. Now is a good time to evaluate a refinance of your home loan(s). If you would like to discuss and review whether a refinance makes sense, please call us at your convenience.

Thank You

We would like to thank all of our clients who responded to our client survey. We received a variety of comments and helpful suggestions. We plan to implement several of your suggestions in the coming year.

Second, the staff and I would like to thank all of our clients for resisting the panic of selling stocks at a very

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low point. *Myopic loss aversion* is the phrase we use to describe a common human tendency that many people suffer without realizing it. It's when people tend to overweigh the painful experience of a loss. Congratulations and thank you for resisting making investment decisions based on short-term emotions. We've been through very tough times over the past 18 months. Your patience and understanding is appreciated.

Best regards

Brian Lowder   Clinton Winey   Thomas Bhaskar   Remette Martinson   Pam Priest