BRIAN D. LOWDER, INC.

A QUARTERLY NEWSLETTER TO CLIENTS AND FRIENDS

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Inside This Issue

- **Financial Market Overview**
- **Status of Income and Estate Tax Reductions**
- **New Favorable Rules for Required Minimum Distributions for IRA & Qualified Retirement Plans**
- **Website Insert**
- **Year 2000 Income Tax Returns**
- **ADV Offer**

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Financial Market Overview

"I never want to invest in stocks again." Do you have the same feeling? Have you heard the same or similar comments from those individuals who bragged about their day trading, high tech and dot-com trading successes prior to March 2000? If you answered "yes" to either of those questions, then the stock market low point is probably closer than you realize. Stock prices were down considerably during the first quarter of 2001. After suffering the worst full-year performance ever in 2000 (-39.3%), the NASDAQ market declined another 26% during the first quarter of 2001. The Dow Jones Industrial Average was down about 9% and the broad U.S. stock market as measured by the Wilshire 5000 was down over 13%. Below are sample returns of specific stock categories and broad market index performance data for the 1st **quarter.**

First Quarter, 2001

- 9.2%	**Dow Jones Industrial Average (30 large U.S. companies)**
- 13.0%	**International (Excludes U.S.)**
- 13.1%	**Standard & Poor's 500 Index (500 largest U.S. companies)**
- 13.6%	**Wilshire 5000 (broad U.S. market)**
- 22.0%	**Small-Company Stock- Growth**
- 0.6%	**Small-Company Stock- Value**
- 22.8%	**Mid-Size Stocks – Growth**
- 2.4%	**Mid-Size Stocks – Value**
- 26.0%	**NASDAQ Composite**

Source: Wilshire and WSJ Market Data group

Many of the best companies in the U.S. who are leaders in their industries are now selling for less than their stock prices were in 1998. All of the justifications and explanations of why these companies were selling at such outrageous prices during the 1997 – March 2000 rally have been shattered in less than

Continued on page 2

Continued from page 1

one year. When will the pain end?

In the short-term, stock prices are irrational and price movements typically are primarily affected by investor psychology, greed, or in the present case – fear. Just as stock market prices moved up well beyond rational expectations during the 1997 - March 2000 period, we are now experiencing the opposite effect. Stock prices are declining beyond rational analysis and expectation. In the past, stocks have tended to make a final low at undervaluation levels of between 10% and 20%. In other words, we believe stock prices have already declined beyond where they should be. But, investor psychology can certainly force prices even lower – usually between 10% and 20% of fair value pricing. This lesson of stock market price behavior repeats itself over and over again.

Since no one can correctly guess the market tops or the market bottoms, the best approach is to evaluate where we are now and formulate strategy for the future. Four primary positives are worth considering. One, interest rates are low and heading lower. Two, income tax and estate tax rates will decline this year – the only uncertainty is by how much. Both lower interest rates and lower tax rates translate into greater disposable income. Three, the speculative bubble in stock price valuations has popped. This is a necessary requirement before stock prices can move upward again. Four, while economic growth has slowed and many companies must react by cutting excess capacity and jobs, the economy is healthy.

However, there are several short-term negatives that will keep investor psychology in a depressed mood. One, over the next several months many corporations will publicly report lower revenue growth and lower reported earnings compared to the first quarter of 2000 (the peak of the stock market). The stock market has already (over) reacted to this news, but individual investors will read or hear this information from news sources and financial magazine stories – perhaps for the first time. Just as individual investors did not have the perspective to realize stock prices had already exceeded rational pricing on the way up, the reverse is likely to happen on the way down.

Waiting for the perfect moment (market low) to buy is futile. There is currently an opportunity to re-establish a diversified portfolio and prepare for the future. Corporate profits will not turn around next week or next month. But they will turn around sooner than most people realize. Our **guess** is a resurgence of economic activity and corresponding reversal in the U.S. stock market will occur this year – but we are quick to admit no one has a crystal ball. Simply reflect upon the 20% to 30% annual increases in overall stock prices experienced in 1997 through 1999 as a unique phenomenon that is rarely experienced more than a few times in your lifetime. Real earnings and profits will return as the primary engine of stock price increases in the next decade. For long-term planning purposes, 100% stock portfolios should average 10% - 11% annually. Portfolios with less than 100% stocks (95% of our clients) should use a blended long-term average return of 8%.

Status of Income and Estate Tax Reductions

Talk and Congressional action for a mid-to-large tax cut is heard every day. There will be tax cuts probably by late summer, but there is no clear consensus on how to do it yet. A new 12% tax bracket (down from 15%) for lower-income taxpayers seems likely this year. However, income tax relief for mid and higher-income taxpayers will likely arrive in year 2002. Over a period of four years, the top income tax bracket may fall from 39.6% and 36% in stages to 33%. These tax cuts have already passed the through the House of Representatives.

Marriage penalty relief is also a popular item for both political parties. In 2002, it is likely that the standard deduction for married couples will be double the amount for single filers. This change doesn't help most of our clients who are married because they have itemized deductions that exceed the standard deduction. However, it is also likely that the 15% tax rate bracket will be widened for married couples, increasing in stages until it would be twice the amount as single filers. This new 15% bracket expansion helps all married taxpayers.

A phase-out of estate and gift taxes will soon pass the House too. A gradual repeal starting in 2002 and

Continued on Page 3

Continued from page 2

complete elimination after 2010 is likely – though no immediate change in 2001 is expected. This expected phase-out of estate taxes pertains to the amount of assets a taxpayer can leave to heirs (a surviving spouse can receive unlimited assets free of estate tax) before estate tax rates are applied. Presently, the amount is $675,000 and will increase up to 1 million in 2006. In addition, the estate and gift tax rates (the rate of tax) may also be reduced immediately from a beginning rate of 37% to a new lower rate of 18%.

The big battle for estate tax changes is not only being challenged by the Democrats in Congress, but also by the life insurance industry. Fearful of losing life insurance sales, representatives of the life insurance industry are insisting that the step-up in cost basis at death be repealed. Presently, all assets inherited receive a new "cost basis" equal to the value of the assets on the date of death. If the assets are sold immediately after death, no gain is incurred and no income tax liability exits. Since a repeal of estate taxes would greatly reduce the appeal of life insurance sales to families with total assets exceeding $1.4M, the life insurance industry needs a new "circumstance" to replace the sales of life insurance used to pay estate taxes with something else. Therefore, there is talk of only allowing a step-up in cost basis for first $1.3 million of assets ($3 million for surviving spouses). The rest of the estate assets will not receive a step-up in cost basis and therefore an **income tax** liability will exist in place of an estate tax liability. Under this new scenario, life insurance would still be one viable option to help pay this new income tax liability. This maneuvering is a cruel hoax on taxpayers. Eliminate the estate tax and add an income tax. We will keep you posted as the battle in Congress heats up.

New Favorable Rules for Required Minimum Distributions for IRA & Qualified Retirement Plans

On January 11, 2001, The Government released substantial revisions affecting all taxpayers that hold retirement assets (IRA and qualified retirement plans).

The new proposed regulations have the greatest impact on all taxpayers age 70 ½ or older. These taxpayers must take *Required Minimum Distributions* from their IRA and retirement plan accounts. The new rules may substantially reduce the required minimum distribution.

The mandatory application of these regulations is **January 1st 2002.** Taxpayers have the option to apply the new proposed regulations beginning **January 1, 2001**.

In a nutshell, the new proposed regulations:

1) Provide a simple uniform table to determine the minimum required distribution required during their lifetime. This uniform table is easier because you:
   a) No longer need to determine your beneficiary by age 70 ½ in order to select a computation method.
   b) No longer need to decide whether to use joint or single recalculation, term certain or hybrid method. Everyone uses the same table (except for taxpayers with a spouse beneficiary who is 10 years or more younger).

If you, your parents or grandparents don't like the minimum distribution method you selected years ago, it can be changed. You can change beneficiaries as often as you like. The bottom line is this:

The new calculation table allows most taxpayers to reduce their required minimum distribution by 20% to 30%. The primary example where the distribution amount will not be reduced is when (IRA) taxpayers have listed non-spouse beneficiaries (typically their children). Please contact our office to review how the new proposed regulations may impact your circumstances.

Website Insert

Several clients have already contacted our office to receive their passwords for accessing their quarterly reports from our website. If you would like to receive your quarterly reports from our website, please review the enclosed *Website Insert* and call our office.

Continued on Page 4

Continued from page 3

Year 2000 Income Tax Returns

Please send us copies of your year 2000 income tax returns as soon as they are available. Our investment advice and long-term financial planning recommendations are most effective when we have current income tax information in our files. In addition, when clients provide us with their tax preparer's address, we send year-end income and capital gain reports directly to your CPA to improve accuracy and minimize the cost of preparing the tax return. Request your tax preparer to send us copies, make copies yourselves, or ask that we send a pre-addressed envelope to you or your CPA.

ADV Offer

We want to once again offer a copy of Form ADV to all of our clients. Form ADV is the brochure on file with the Securities Exchange Commission and discloses information vital to our firm. If you've not read it recently, you may find it of interest. If you would like a copy of Form ADV please call or email our office.

Best regards

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