BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

Volume 4, Issue 2 July, 2001

Inside This Issue

- **Financial Market Overview**
- **The Economic Growth & Tax Relief Reconciliation Act of 2001**
- **Account Aggregators**
- **Client Survey**

Financial Market Overview

The financial markets are moving forward very slowly. The downward trend in stock prices finally reversed itself during the second quarter of this year. Stock prices moved up sharply in April averaging an 8% gain for the overall market and a bit higher for technology and mid-to-smaller size companies. Stock prices were essentially flat to slightly higher during the month of May. And then June gloom set in and stock prices declined a few percentage points. At the end of the quarter, most portfolios earned positive returns.

Except for small and mid-size companies, all stock averages are still down since January 1, 2001. From January 1st through June 30th, 2001, the Dow Jones Industrial Average was down nearly 3%, the S&P 500 was down more than 7% and the overall stock market down a similar amount. The NASDAQ Composite made up mostly of technology companies was down over 12%. The only categories with positive returns year-to-date were real estate, small-company and mid-size company stocks.

Investor psychology is still down, but some investors still remain hopeful for a swift rebound in stock prices similar to the days in 1999. It's not going to happen that way. Companies are still experiencing much smaller growth rates in revenues and earnings compared to peak economic times in March 2000. In fact, the market is down over the last several weeks because several companies are still publicly disclosing slower growth rates. We know that! But many short-term traders still move the markets on a daily basis. What we are experiencing is a movement back to the norm. Specifically, a 2% to 4% growth in Gross Domestic Product and a 6% to 10% overall average growth in earnings is the proper perspective to have going forward. Investors still need to forget about the stock price performance of tech and Internet companies from 1998 through March 2000.

Many positives are in place. Interest rates have been reduced and may trend lower for awhile and the new Tax Act clearly reduces our income tax burden over the next several years. The combination of the two has always resulted in higher stock prices down the road. Most of the bad news (slower growth in sales and earnings) has already been announced.

There is no better time to maintain a fully diversified portfolio of both growth and value stocks of all sizes

Continued on page 2

E-MAIL ADDRESSES

Brian Lowder	President brian@bdlowder.com
Clinton Winey	Financial Analyst clint@bdlowder.com
Thomas Bhaskar	Operations Manager tom@bdlowder.com
Remette Martinson	Office Manager rm@bdlowder.com
Pam Priest	Admin./Reception pam@bdlowder.com

Continued from page 1

and simply allow the averages to provide your target return. It takes time for people to let go of the methods and games of chance that worked so well just over a year ago. I guess this rationale also explains why I always return to last year's favorite fishing hole only to be disappointed that the trophy fish have move elsewhere.

The Economic Growth & Tax Relief Reconciliation Act of 2001

Over the Memorial Day weekend, Congress approved legislation that significantly reduces individual tax rates, repeals the federal estate tax and provides numerous other tax breaks as well. On June 7, 2001, President Bush signed this Act into law. Unfortunately, most of the changes will be phased in over a ten-year period and unless Congress re-enacts all of the provisions, this Act will expire on January 1, 2011! In other words, it will take ten years for all of the changes to be fully implemented and if Congress does NOT re-approve all of the changes before January 1, 2011, the current tax law will be reinstated. This section of the newsletter will provide a brief summary of the most significant tax law changes, our observations, and the effective dates of these changes as they are phased in over the next ten years. We will also include the tax changes that were enacted years ago with phased-in or deferred effective dates that went into effect Jan. 1, 2001

Long-Term Capital Gains Rate: The 20% long-term capital gain tax rate *(rate of tax applied to the gain on the sale of investments held longer than one year)* remains the same under the provisions of this new Act. However, the second phase of the capital gain rate cut that was enacted in 1997 will take effect in **2001**. All taxpayers in the current 15% federal income tax bracket receive a reduced rate on capital gains. Their 10% rate on gains falls to 8% for investments held more than five years and sold after the year 2000. The current 10% capital gain rate remains in effect for the lowest–bracket individuals who take profits on investments held at least one year but less than five years.

Observation: This lower capital gains rate makes gifts of stock or other assets to children a bit less taxing. If you own appreciated stock held at least five years, you can reduce the family's total tax bill by gifting stock to a child to sell. If the parent's (grandparent) income tax bracket is 28% or higher, he/she would incur a reduced 20% capital gain tax upon sale. Instead, if the stock is gifted to the child (over age 14) and the child's regular income tax rate is 15% or less, the reduced capital gain tax would be only 8%. The child is entitled to claim the same holding period as the person who gifted the stock.

In previous newsletters, we have discussed how taxpayers in the 28% or higher regular income tax bracket can receive a new lower 18% long-term capital gains rate. The new lower 18% tax rate applies to investments purchased AFTER 12/31/00 and held for five years. So, the earliest this new lower 18% rate will apply is for sales made in 2006. Alternatively, taxpayers with investments bought prior to 2001 could receive the new lower 18% rate today if they are willing to pay income taxes now on the gain. They must elect to treat investments purchased prior to 2001 as sold on Jan. 2, 2001 and pay the 20% capital gain tax. Then, if the investment is held for five more years, the 18% maximum rate will apply. Any loss on the deemed sale is ignored.

<u>Planning Considerations</u>: *This election is only a difference of 2% (20% reduced to 18%) and is likely to make sense only for investments with little or no appreciation as of Jan. 2, 2001. We will review your portfolios over the remainder of this year to determine whether this election would be beneficial in selected cases.*

Income Tax Rate Reduction: Income tax rates will be reduced for everyone. Presently we have five federal tax rates ranging from 18% to 39.6%. A new 10% bottom rate begins in 2001 and the 15% bracket will remain unchanged. Each of the top four brackets will drop by 1% in 2002, 2004, and 2006 with the highest rate (39.6%) dropping an additional 1.6% in 2006. The new rates over the next 6 years are summarized below:

Year	Rate of Tax					
2001	10%	15%	28%	31%	36%	39.6%
2002	10%	15%	27%	30%	35%	37.6%
2004	10%	15%	26%	29%	34%	36.6%
2006	10%	15%	25%	28%	33%	35.0%

Continued on Page 3

Continued from page 2

The new 10% bracket was created out of a portion of the 15% tax bracket. The new 10% rate only applies to the first $ 6,000 of taxable income for singles and the first $12,000 of taxable income for joint filers. All taxpayers will benefit from the new 10% rate by reduced payroll tax withholding tables for the rest of this year and by the well-publicized refund check from the IRS due to arrive some time before the end of the summer. Most taxpayers will receive a $300 check (filing single), a $500 check (head of household) or a $600 (filing joint).

Planning Considerations: Shifting income to lower tax-bracket family members is worth considering. If possible, taxpayers should defer income to later years and take advantage of the new lower rates. This can be accomplished primarily by maximizing employee contributions to retirement plans. Retirement plan contributions reduce reported income. Other suggestions include reducing taxable distributions from investment portfolios. If you are self-employed or a consultant, consider deferring billings to 2002 and make needed capital expenditures this year rather than next year.

Repeal and Reduction of Estate Taxes:

A number of complex changes were made to federal estate and gift tax rules. Estate taxes will be reduced and finally repealed over time. Because the entire Act "sunsets" or terminates at the end of 2010, repeal is not permanent unless Congress extends or re-enacts these provisions. If Congress does not re-enact or extend the provisions of this Act, the estate tax laws currently in effect will apply again after 2010. In the meantime, the estate tax is reduced by changes to both the lifetime exemption amount and estate tax rates. No changes are effective for 2001. From 2002 through 2009 the amount taxpayers may exclude from estate tax is increased incrementally from the current $675,000 exemption to $3.5 million. In addition, over the same period, the highest marginal rate of (estate) tax is gradually reduced from the current 55% to 45% as shown below:

Calendar Year	*Exemption Amount*	*Highest Estate Tax Rate*
2002	*$1 million*	*50%*
2003	*$1 million*	*49%*
2004	*$1.5 million*	*48%*
2005	*$1.5 million*	*47%*
2006	*$ 2 million*	*46%*
2007	*$ 2 million*	*45%*
2008	*$ 2 million*	*45%*
2009	*$ 3.5 million*	*45%*
2010	*taxes repealed*	*highest individual income tax rate (for gift tax only)*

Please note the **gift tax** (tax on lifetime gifts) will not be repealed. The maximum tax rate is reduced in accordance with the foregoing table, but the exemption equivalent for lifetime gifts made after December 31, 2001 is increased to $1,000,000 and remains at that amount for all future years. After Dec. 31, 2009, the maximum gift tax will be reduced to the highest individual income tax rate for that year (35% will be the maximum income tax rate). In addition, there are very complex provisions beginning in 2010 with regard to cost basis of assets inherited. Currently, all assets inherited receive a full step-up in cost basis equal to the fair market value at death. If sold immediately, the heir incurs no gain or loss on sale. Beginning in 2010, the ability to leave an unlimited amount of assets to heirs and have a full step-up in cost basis to the value at death will be limited to $1,300,000. If the heir is a spouse, the amount is limited to $4,300,000. The record keeping is going to be a nightmare and the executor of your estate will have to deal with splitting low cost basis assets and high cost basis assets to all heirs very delicately.

Planning Considerations: Now that individuals can leave larger amounts to heirs over time (currently $675,000 up to $3.5 million in 2009), a review of your living trust and irrevocable trusts should be considered. Families with a $1 million estate value after the first death may want to change their trust. Certainly, taxpayers will want the language of the their trust changed if it refers to any of the "old" exemption amounts.

Regarding gifts, the gift tax exemption jumps to $1 million total for all lifetime gifts (in addition to the $10,000/yr exclusion amount per individual). Many taxpayers with large estates should take advantage of this additional or larger exemption and make tax-free gifts beginning in 2002. It continues to be beneficial to move property out of a potentially large taxable estate in case repeal does not become reality in 2010 or death occurs before complete repeal of estate taxes in 2010.

Continued on Page 4

Continued from page 3

Accurate (purchase) records should be maintained on all assets so that the carry-over basis of each asset can be determined accurately if the modified cost basis rule is still in effect in 2010.

Increased Retirement Plan Contributions: Beginning in 2002, you and your employer will be allowed to make larger retirement plan contributions as follows:

	Current Max.	2002	2008
IRA & Roth IRA	$ 2,000	$ 3,000	$ 5,000
Age 50 and older	$ 2,000	$ 3,500	$ 6,000
			2006
401(k), 403(b), 457	$10,500	$11,000	$15,000
Defined Benefit Plan	$35,000	$40,000	
Maximum annual compensation to determine contribution	$170,000	$200,000	
Max allowable contribution to Profit Sharing & stock bonus plans	15%	25% of compensation	

Finally, sole proprietors, partners, and more-than-2%-shareholder employees of S Corporations may now borrow from their retirement plans on the same basis as other employees effective **2002.**

Education Tax Breaks: The maximum annual **Education IRA** contribution increases from $500 per year to $2,000 beginning in **2002**. The contributions grow tax-free and can now be used immediately for elementary and secondary school expenses including those who attend private and religious schools. In addition, the relatively new state **Section 529** plans have added another attractive feature. Previously, contributions grew tax-free and if withdrawals are used for college tuition and other school expenses, the amounts withdrawn are taxable to the child or beneficiary at their presumed lower tax bracket. Now, withdrawals (if used for tuition, books, etc) from Section 529 plans are completely tax-free to the beneficiary! Note penalties still apply if withdrawals are not used for college tuition and books or the contributor takes the funds back.

The phase-out rule that limits **college loan interest deductions** for high-income taxpayers will be liberalized. Effective in **2002**, single filers may deduct college loan interest if his/her adjusted gross income is below $50,000 and partially deductible up to $65,000 adjusted gross income. For joint filers, interest is fully deductible if adjusted gross income is below $100,000 and partially deductible up to $130,000. Prior law only allowed deductions of interest up to a maximum 60-month period. The new law eliminates the 60-month restriction.

Also, the new law establishes a **new deduction for college costs** beginning in **2002**. Taxpayers will be allowed to deduct up to $3,000 of college costs if adjusted gross income is below $65,000 for single filers or $130,000 for joint filers. The maximum deduction increases to $4,000 in 2004 and 2005.

Lastly, a child can no longer claim his or her own personal exemption if at least one parent can take the child as an exemption. Children can earn up to $4,550 and pay no income tax on earnings. However, ***investment income*** (dividends, interest, capital gains etc.) is another matter. If a child does not work, $750 of investment income is tax-free. The next $750 of unearned income is taxed at 15%. Investment income above $1,500 is taxed as if received by the parent with whom the child lives…. or to the parent with the highest income if filing separately.

These rules change when the child reaches age 14. Investment income is no longer treated and taxed at the parent's rate. From age 14 on, income is taxed at the same rates that apply to other taxpayers. Consequently, it is a good idea to defer selling appreciated assets or delay income to a year when the child is age 14 or older.

Planning Considerations: Now the decision whether to use one or a combination of several college savings accounts becomes more difficult to decide. Should a parent establish an Education IRA, Section 529 Plan, Uniform Transfer To Minor's Account or simply keep the funds in the parent's name? Some parent's have stopped adding to investment accounts in their kid's names and are hoping to rely on student loans. In fact, some clients have shared with us their conversations with student-aid representatives at various colleges. Many of these representatives state "we recommend that children never have investment accounts in their own names…". Remember, their job is solely to help parents and students qualify for student loans and grants – not financial planning. If parents don't want to save and ensure their childrens'

Continued on INSERT Page 5

Continued from page 4

college education costs are partially or fully paid for but instead rely upon student loans in the future, then they should not have any of the above-mentioned college savings vehicles in their child's name. Under the formulas used for college aid, students are assumed to use 30% of the investment account values for college costs in each year – parents are assumed to use 3% of total assets. Ignoring everything in life except for qualifying for student loans, then children should not have investment accounts in their names.

We don't agree with this position. First, student loans are a target for reduced government spending and may not be around when your kids are ready for college. Second, interest rates on student loans are higher nowadays, not the reduced rates in years past. Borrowing against your home (up to $100,000 for any reasons) may not be feasible in the future. Tax laws always change in this area and interest may not be deductible in the future. We suggest putting aside funds early and continuously to pay for college. The earlier you begin, the lower the burden later on. Don't rely on today's rules for student loans and college funding five or more years down the road.

If parents or grandparents wish to set aside funds that can only be used for college tuition and books, then the Section 529 Plans are a good choice. The downside to these accounts is limited investment flexibility – nearly all plans do not allow you to switch investment selections. This inflexibility is worrisome to parents who have faithfully saved for college and then cannot move the account value to a safe investment when their children begin college. Education IRA's will now allow $2,000 annual contributions starting in 2002. If the amount parents save is $2,000 per year or less, this is also a good choice. For parents who want maximum flexibility to spend the funds on anything (college costs, computers, clothes, autos, first-time home etc.) the child needs and is willing to assume the risk that the child will be responsible with the funds at age 18, the Uniform Transfer To Minor's Account is still a very good option. Based on past experience, parents who leave monies in their own name earmarked for college always seem to find a reason to invade the account (auto purchase, upgrade their home, vacation, emergencies, divorce, disability etc.) and have all the good intentions to replace the funds but never do. We suggest using one or more of the above accounts based on your own personal circumstances.

Odds and Ends: Several other tax law changes are included in the Act such as marriage penalty relief over the next 5 years (larger standard deduction amount and a larger 15% income tax bracket for joint filers), the phase-out rule that reduces personal exemption deductions and itemized deductions will be repealed gradually starting in 2006 and fully effective in 2010, the child tax credit will gradually increase to $1,000 by 2010 and the dependent care tax credit increases effective 2003. But since many of the changes are phased-in over several years, we won't go into much detail at this time.

Social Security payments increased 3.5% this year. In addition, Social Security recipients can earn more this year before their benefits are trimmed. Those recipients age 62 to 64 can earn $10,680 in wages or self-employment in 2001 without reduced benefits. For every $2 they earn over that amount, they lose $1 of benefits. For those individuals who reach age 65 this year, their earnings limit is $25,000 until the month the beneficiary turns age 65. For each $3 earned above that limit, they lose $1 of benefits. Retirees age 65 or older have no income limit or loss of benefits.

Lastly, the estimated tax rules for 2001 have been altered again. To avoid underpayment penalties, individuals with adjusted gross incomes **over** $150,000 last year must prepay at least 110% of year 2000 income taxes this year or 90% of their (estimated) year 2001 income taxes. Taxpayers with incomes **less than** $150,000 in year 2000, must prepay either 100% of their year 2000 income tax or 90% of the current year's tax.

Summary: The new tax law changes are clearly reducing taxpayers income and estate tax burden over the next 10 years. Unfortunately, many of the changes are phased in over a ten-year period and they must survive the political changes and maneuvering every two years. Taxpayers do not have to anything to receive these benefits, however, they must keep their advisors up to date on any changes within the family and their jobs. Saving for retirement and for college education has been improved. Updating your long-term retirement plans to take advantage of the increased contribution limits in the new tax laws will be an important topic during future meetings. In addition, the retreat in stock prices over the past 15 months will also have an impact on your financial

Continued on Page 6

Continued from page 5

independence goals and deserves equal attention.

We would like to thank all of our clients for their trust and confidence during the past 15 months. We have updated most of our clients' long-term retirement projections and we encourage you to call to discuss any changes or concerns you may have. We are especially thankful for your referrals and hope you will again think of us if family and friends need assistance in their financial planning and investment needs.

Account Aggregation

An interesting new Internet technology is being developed by the online financial services industry. This new online service grabs information from various web sites and presents it on one page for the user's convenience. This new technology is known as 'account aggregation'.

The principal element of this new technology is a type of software program called 'screen scraping'. An account aggregation web site using a screen scraping program can view each of your online bank/brokerage accounts and *scrape off* irrelevant parts of the web page in order to extract the account information, hence the term.

The benefit of account aggregation is that it will allow you access to all your financial information at one convenient location. On one web site you will be able to track your savings, checking, car loans, bank loans and credit card accounts, investment portfolios, 401(k) accounts, electronically delivered bills and even frequent flier mileage. Note that some of your online accounts may not be available through your account aggregator.

Besides consolidating your online account information, account aggregation would also eliminate the need to remember multiple login IDs, and passwords. Another benefit is that some account aggregation web sites plan to offer sophisticated financial planning and money management tools.

In order to use these web sites you must provide the account aggregator with your online account numbers (Usernames) and Personal Identification Numbers (Passwords) for each online bank/brokerage account. The account aggregator can then access all of the data available at those web sites. But is this safe? We have always been told never to give this account login information to anyone.

Safety is a major concern. If a computer hacker were to steal the account login information stored with your account aggregator, who would be responsible for an unauthorized transaction? This question has not yet been answered, as account aggregators are new and not currently overseen by U.S. federal regulators.

Consumer privacy is another point of concern. When you sign-up with an account aggregator you give them access to all of the personal information that your bank/brokerage firms have collected on you over the years (age, income, total savings, total liabilities and even transaction history). This collection of information would be extremely valuable for marketing purposes. It would be very difficult for account aggregators, or their parent companies, to resist using or selling this personal information.

Account aggregators say they have strong security and privacy standards and that they know their credibility and business survival depends on protecting individuals' data. They say they collect and sell information about groups of users, but not about individuals.

You will begin to see account aggregation offered as a feature on many of your bank and brokerage firm web sites. In fact, we are considering* adding this feature to our company web site (www.bdlowder.com). Without a doubt account aggregation will be a convenient and powerful tool for managing your finances online. But before you sign-up for this service you should measure these benefits against the very real concerns of consumer security and privacy.

* *We would like your opinion on the usefulness of account aggregation to you. To gain your input we have included questions about account aggregation in our client survey.*

Some Account Aggregators: Yodlee, AccessMyMoney, Corillian, OnMoney, ByAllAccounts, CashEdge and Digital Insight.

Client Survey

In the next few weeks, Brian D. Lowder, Inc. will be sending a "Client Survey" to each of its clients. Your responses to this survey will help us to evaluate both the service we provide and which direction we take in adopting new technologies to better serve our clients. Please take a moment of your time to complete the survey when you receive it and return it to us in the pre-stamped envelope we will provide. Thank you in advance for your participation.