BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

On New Year's Day 2014, how many investors predicted nearly all investment categories would post above average investment performance during the first six months of 2014? I don't recall reading any forecasts with that level of optimism. But, it happened and this positive performance occurred even after the government reported that our GDP (Gross Domestic Product) *declined* by 2.9% during the first quarter. Negative U.S. growth resulted in above average investment performance.

Second quarter financial market performance was positive for nearly all indexes – stocks, bonds, real estate, gold, commodities, international, etc. ranging from about 2% to 7% compared to the first quarter where investment performance for most categories was essentially flat or up a modest amount.

During the second quarter, the Dow Jones Industrial Average was up 1.7% or 2.24% after including dividends and the Wilshire 5000 Total Market Index, the broadest measure of U.S. stock prices, was up about 4.8%.

In general, value stocks outperformed growth stocks in all categories except for large companies. International stock price performance was comparable to the U.S. during the second quarter, however emerging markets (smaller international markets) were up over 6%.

Interest rates continued to fall slightly during the second quarter giving another boost to fixed income or bond investments. The 10-year U.S. Treasury yield fell from about 3% to 2.8% during the first quarter and continued to drop to 2.5% during the second quarter. Consequently, U.S. Treasury Bonds posted positive returns ranging from 0.2% for bonds with short maturities to 3.5% for longer-term bonds. This reversal in fixed income performance was a welcome relief as nearly all bond funds posted negative returns in 2013 ranging from -2% to -8%.

The value of the U.S. dollar compared to six other major currencies was down slightly (0.4%) during the second quarter. Gold prices jumped 3.5% during the second quarter and gold was up 10.25% over the first six months of 2014. Real estate (REITs) also posted exceptional performance during the second quarter – up 7% and this performance followed a 10% gain during the first quarter of 2014.

The following chart displays sample returns of various asset categories during the first quarter of 2014:

Yr-to-Date 2014	**2nd Qtr. 2014**	**Index Return (*includes dividends reinvested*)**
+1.51%	**+2.24%**	**Dow Jones Industrial Average (^DJI)**
+6.95%	**+5.16%**	**Standard & Poor's 500 Index (^GSPC)**
+7.0 %	**+4.84%**	**DJ U.S. Total Stock Market (VTI)**
+6.14%	**+5.07%**	**Large-company stock-Growth (IWF)**
+8.08%	**+4.94%**	**Large-company stock-Value (IWD)**
+6.42%	**+4.38%**	**Mid-Size Stocks – Growth (IWP)**
+10.99%	**+5.65%**	**Mid-Size Stocks – Value (IWS)**
+2.32%	**+1.73%**	**Small-company stock- Growth (IWO)**
+4.16%	**+2.40%**	**Small-company stock- Value (IWN)**
+4.40%	**+4.24%**	**International (EFA)**
+4.24%	**+6.24%**	**Emerging Markets (EEM)**
+17.77%	**+6.96%**	**Real Estate Investment Trusts (VNQ)**
		Fixed Income
+0.33%	**+0.20%**	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+5.30%	**+2.38%**	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
		Alternative Investment Category
+10.27%	**+3.58%**	**Gold (GLD)**

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ECONOMIC AND FINANCIAL MARKET OUTLOOK

Last quarter, we suggested that "overall, the U.S. economy is growing at a slower-than-desirable pace, but slow growth is better than no growth" and "the concern that the U.S. economy was susceptible to a decline has faded and the financial markets appear to have correctly anticipated a modest recovery."

That optimistic scenario did not come to fruition as expected. Instead of an expected 1%-2% economic growth rate (GDP), the first quarter 2014 figures were adjusted downward to a ***negative 2.9%*** - that's terrible. Granted, a smaller than expected GDP growth rate is not alarming, but the magnitude of the "miss" from an expected 1%-2% growth rate to ***negative*** 2.9% cannot be ignored. After five long years of subpar economic growth, the stock market has been signaling (via higher stock prices) an expectation that 2014 is supposed to be the year in which the economy finally picked up the economic pace. So, why are the financial markets still rallying and is this recent stock market advance going to hold? Are stock prices rising on thin air or does the pending economic recovery need more time?

Repeatedly, investors' willingness to buy more of whatever asset class is rising seems irresistible. Investor confidence generally rises as stock prices rise. Besides, U.S. stocks have been trouncing the performance of other asset classes or categories for over two years. The continuing theme is investors are positive on U.S. stocks, investment managers expect interest rates will remain artificially low, and the U.S. economy will begin growing modestly. The interest offered on a guaranteed 10-year U.S. Treasury was 3% on January 1st and now the yield or rate has dropped to 2.5%. More investors are opting to reinvest in the stock market after gains of more than 20% in 2012 and nearly 30% in 2013.

The most troubling factor is the unemployment rate or conversely the labor participation rate (percentage of Americans actually working or looking for work.) The labor participation rate is near its lowest levels since the late 1970s – 62.8%. Less than two-thirds of Americans are working. Yet, the press and newspapers are reporting that the unemployment rate has dropped to 6.1% - the lowest level since 2009. A closer look at the figures used to calculate the unemployment and labor participation rates reveals the problem. Part-time workers, specifically those who are working part time because they can't find full-time work are excluded from the calculations. Further, most of the "new job growth" is concentrated in low-wage fields. Last month, the government reported employers added 228,000 new jobs, however, 26,000 were new government positions, over 40,000 were retail jobs, hospitality (hotels, etc.) added over 39,000 jobs, but higher-paying (manufacturing, construction, etc.) added only 22,000 jobs. New jobs are great no matter what the position. But a recent 50% gain in stock prices over the past few years compared to the anemic employment figures makes anyone using a small amount of objectivity nervous and concerned.

Once again, the big question is whether an unexpected, noneconomic, political, global or exogenous (outside and unpredictable) event will spook the markets and cause prices to adjust to a more reasonable level that is more reflective of a slow-growth economic environment. The probability that the pin might find the balloon seems to be growing, but who knows whether we are on the verge of accelerating growth, or more of the same sluggish economy. Most investors and money managers are "reluctant bulls," seeing few alternatives to rising U.S. stock prices.

We are not expecting a downward stock market adjustment of 20% or 37% like 2002 and 2008. The plain fact is; it is "normal" for investors to push the financial markets higher than what can be justified by economic data, and negative surprises or events can open the gates to panic selling that leads to temporary and exaggerated downward adjustments. Presently, stock and bond prices are overvalued, but not by a ridiculous amount like 1999. A ten percent downward adjustment is likely at any time; however, if the world economy is poised to begin growing gradually, then

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any downward adjustment would be short-lived and be considered "normal" fluctuations or volatility on the way to higher records.

The bottom line is while the economy is still sputtering, the U.S. stock market has been on a one-way train going up in spite of the many "uncertainties" over the past several years (our national debt ceiling pierced, threat of government shutdown, both political party gridlock, European banking problems, terrorism, etc.) Just how the U.S. stock market was able to maneuver through that minefield without a single correction is fortunate and unexplainable.

Over the near-term, caution is the perspective we have. Our portfolio management strategy will continue to focus on holding large and established companies and simultaneously increase our equity (stock) exposure to emerging or smaller markets. Emerging market stock prices are below reasonable valuation measures especially when compared to the U.S. stock market. This transition to emerging markets has already begun and will continue without regard to a specific timeline. We do not feel a need to rush in as the U.S. stock market has moved up significantly over the past 2.5 years and the global economy and equity markets are still trailing the U.S. by a significant margin.

RETIRING: PLAN ROLLOVER OPTIONS

Workers who are retiring or changing jobs need to know the options available to them with regard to their employer retirement plans (pension, 401(k), profit sharing, etc.) There are six options available to workers when they leave a job or retire and although the best choice varies according to personal circumstances, the IRA Rollover is the most common and preferred choice. The choices are; IRA Rollover, leave it with the current employer plan, rollover your plan balance to your new employer plan, take a lump sum distribution, make a Roth Conversion, or an in-plan Roth conversion if permissible under the plan document.

Both lump sum distribution and Roth conversion options result in immediate income tax consequences but may be worth considering if you expect to be in a higher income tax bracket during retirement. Leaving the retirement plan balances with your former employer or rolling over the plan balances to your new employer's plan may be best (depending upon state law) to maintain better creditor protection compared to an IRA rollover (applicable to doctors, CEOs, etc.) If a worker has highly appreciated company stock within the retirement plan, several additional choices should be discussed and evaluated. All choices have benefits and drawbacks.

The main point is; workers who are retiring or leaving a job and have vested retirement plan balances, be aware that several choices are available. Ask questions about the choices and know that personal circumstances could result in one option being preferable over others.

COPIES OF 2013 INCOME TAX RETURNS: REVIEW STRATEGIES

Please send paper or electronic (email) copies of your 2013 income tax returns to our office at your earliest convenience. Our investment decisions, income tax management and retirement planning strategies are greatly improved when we have your most recent income tax returns in our files.

2013 was the first year of higher income tax rates for taxpayers in the top income brackets, additional taxes for high-income taxpayers for the Affordable Care Act (Obamacare) and a return of phase outs of valuable deductions for high income tax payers. Some taxpayers will lose all or a portion of these deductions; personal exemptions ($3,950 per person), reduction of itemized deductions, increased tax on investment income, increased tax on earned income (wages/salaries, self-employed income), and a decrease in deductible medical expenses. Simply stated, your income tax situation should be reviewed to keep taxable income as low as possible. The three income areas that taxpayers have some control over are: taxable IRA or other retirement plan distributions, sale of investments and income generated on investment portfolios. Please call our office to make an appointment if you would like to discuss your tax situation.

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Best regards

Brian Lowder   Clinton Winey   Michael Kinnear   Remette Martinson   Pam Priest