// BRIAN D. LOWDER, INC.
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BRIAN D. LOWDER, INC.

INSIDE THIS ISSUE

FINANCIAL MARKET OVERVIEW

The U.S stock market continued to climb during the third quarter of 2017 and posted an above-average 4.5% gain. The overall stock market has earned a positive return in each quarter this year.

The top performing investment category (within the U.S. stock market) during the third quarter was the technology sector. On average, the technology sector was up 8.3% during third quarter and up over 21% year-to-date.

The second-best performing sector was energy. After falling consistently throughout the year, energy stocks advanced over 6% during the third quarter as the price of oil rebounded. The same scenario occurred with telecom stocks – down during the first two quarters in 2017 and then jumping 5.5% during the third quarter.

Growth stocks continue to outperform value stocks in 2017 and the gap is very large: growth stock performance is almost three times better or higher than value stocks during the first nine months of the year.

Gold and silver prices were also up during the third quarter – nearly 4% for gold and nearly 3% for silver prices. For the third quarter in a row, international stocks (world index excluding U.S.) were up again – this time up over 5% during the third quarter and about 20% year-to-date. Emerging market stocks (small international companies) performed best again earning over 8% during the third quarter and about 28% during the first nine months of 2017.

Fixed income or bonds continue to rise and fall modestly in reaction to the gradual increases in interest rates with additional small increases expected for the foreseeable future. Short-term bond returns ended the third quarter with a fractional gain (+0.2%) and intermediate-term bonds posted a slight positive return of 0.37%. The 10-year U.S Treasury Note started the year paying 2.39% interest and finished the third quarter offering 2.33% for new purchases.

Real estate (REIT's) prices were up slightly during the third quarter, with the total return (price change plus income) advancing 0.8% during the third quarter and up 3.5% during the first nine months of 2017.

The chart on the following page displays sample returns of various asset categories during the third quarter of 2017:

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Yr-To-Date 2017	**3rd Qtr. 2017**	**Index Return (*includes dividends reinvested*)**
+ 13.37%	+ 4.94%	**Dow Jones Industrial Average (^DJI)**
+ 13.99%	+ 4.41%	**Standard & Poor's 500 Index (^GSPC)**
+ 13.82%	+ 4.52%	**DJ U.S. Total Stock Market (VTI)**
+ 20.00%	+ 5.45%	**Large-company stock-Growth (IWF)**
+ 7.58%	+ 2.99%	**Large-company stock-Value (IWD)**
+ 16.99%	+ 5.21%	**Mid-Size Stocks – Growth (IWP)**
+ 6.62%	+ 1.53%	**Mid-Size Stocks – Value (IWS)**
+ 16.93%	+ 6.44%	**Small-company stock- Growth (IWO)**
+ 5.30%	+ 4.98%	**Small-company stock- Value (IWN)**
+ 20.54%	+ 5.03%	**International (EFA)**
+ 28.58%	+ 8.26%	**Emerging Markets (EEM)**
+ 3.44%	+ 0.86%	**Real Estate Investment Trusts (VNQ)**
		Fixed Income
+ 0.60%	+ 0.20%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+ 2.85%	+ 0.37%	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
		Alternative Investment Category
+ 10.92%	+ 3.02%	**Gold (GLD)**

All returns calculated using adjusted historical quotes from finance.yahoo.com

FINANCIAL MARKET OUTLOOK

The main determinant of a *sustainable* stock market advance is economic growth (Gross Domestic Product) and the primary determinant of a *longer lasting* bear market is an economic recession. Almost "everything else" may cause either a short-term rally or correction.

The near and mid-term outlook appears positive for continued improvement in worldwide economic growth. The most recent indicator in the U.S. is an adjusted 3.1% economic growth during the second quarter – a meaningful improvement from the 1%-2% growth over the past four years. U.S. economic growth is accelerating and continues to come in better than expected – a primary reason why stocks continue to advance.

Most other countries and regions are expected to grow between 2% and 4%. All of these growth estimates are slightly below long-term averages, but significantly better than the previous few years and moving in the right direction.

It's the "everything else" (political turmoil, high stock price values, North Korea, and longevity of this advance without a meaningful correction, etc.) that has investors and advisers puzzled and a bit cautious.

Today, one important measure of the fairness of overall stock valuations has nearly reached a level not seen since the dot-com boom. Based on estimates of corporate earnings over the next year, the S&P 500 stock index is trading at nearly 18 times earnings. The historical average or "normal" multiple is 10 to 15 times earnings. Not much room for surprises, disappointments or failed expectations.

Actions that may or may not be taken by North Korea and the response by the U.S. and other nations can certainly change the mood and investor confidence rather quickly and lead to a sell-off. This variable or event is the most unpredictable. It's much easier and prudent to maintain your current portfolio holdings under this unpredictable scenario, but it is much harder to commit cash into new investments at this time.

Many other factors, none of which would cause a correction by itself, are worth noting. The U.S. savings rate has dropped back to its lowest level since the 2008 financial crisis. The low savings rate implies consumers (collectively) don't have a lot of spending power without using credit. Second, if the Federal Reserve continues along its path and publicly announced plan to slowly raise

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the general level of interest rates, the above two variables (low savings and higher interest rates) are a mild wind in the face of future economic growth.

The biggest variable or factor that will support or weaken the future direction of the stock market is Tax Reform. In part, U.S stock market has been rising due to the *expectation* that lower income taxes will boost corporate net profits and leave more spending power to consumers. The initial Tax Reform package supported by the President would lower personal tax rates and reducing the number of individual tax brackets to three: 15%, 25% and 35%. More importantly, the proposal would lower the current 35% U.S. corporate tax bracket to 20% (Trump talked about a 15% rate and it's worth noting that the average corporate tax rate worldwide is near 20%).

If enacted, lower U.S. corporate income tax rates would provide two immediate benefits: One, lower income tax rates mean higher net corporate profits (lower income tax expense equals higher net profit). <u>The U.S. stock market is already reacting to this expectation.</u> In part, our stock market continues to advance because future corporate earnings are expected to be higher under this lower tax rate scenario. Estimates are that corporate earnings collectively will be 8% higher if the proposed 20% corporate tax rate becomes enacted. The direction of the current stock market is based on a forward-looking expectation of corporate profits. If better economic growth, lower corporate income taxes or any combination of the two are the catalyst for better future corporate profits, then the stock market rises.

Two, another part of the proposal to lower U.S. corporate income tax rates is to allow for a one-time corporate *Tax Holiday*. Because *current* U.S. corporate income tax rates are among the highest in the world, many U.S. companies with global operations form corporations in other countries around the world that have lower income tax rates. Those profits rarely come back to the U.S. because of our high tax rates. A Tax Holiday would allow these multinational companies (corporations with names everyone would recognize) to bring their accumulated profits back to the U.S. and be subject to a reduced one-time income tax rate of 5%-10%.

The point is, our financial markets are already expecting some aspects of Tax Reform to pass whether in its current form or in some other manner that is lower than today's rates. That expectation, in part, is supporting the current stock market valuation. This expectation can weaken quickly if Tax Reform is stalled. The growing concern is that some of the Trump initiatives such as health care reform, renegotiated trade agreements and lower income tax rates may be debated and delayed for years. If that concern grows, the stock market will lose its support.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

Our outlook has not changed. We will continue implementing our Buy recommendations periodically as we have in the past. The probability of a rising stock market ***1-2 years from now*** is higher than the probability of a lower stock market valuation. The path toward that expectation is not always smooth and our current high stock market valuation leaves little room for disappointment or delayed expectations.

We have identified and shared our Buy recommendations in your second quarter reports mailed in July 2017. We are maintaining those recommendations and will not repeat them again

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with your third quarter reports. We have also identified the actions we will take if the improving U.S. and worldwide economic growth scenario does not unfold as expected or after a reasonable passage of time.

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Best Regards

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