BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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FINANCIAL MARKET OVERVIEW

The U.S. stock market finished up 2% on the last day of March, but the first quarter of 2018 was a wild ride. Stocks were up 4.5% in January, fell 3.6% in February and finished down 1.3% in March. During the first quarter, the overall stock market was down over one percent, however the Dow was down 2.5%.

The top performing stock category (within the U.S. stock market) during the first quarter was the technology sector. On average, the technology sector was up 3.2%. Other sectors that performed well last year, such as utilities, water stocks and big dividend common stocks were down more than 5% during the first quarter. Energy stocks were also down over 6% during the first quarter.

Growth stocks continue to outperform value stocks in 2018. Both the overall stock indexes and value stocks posted negative returns while all large, mid and small-cap growth stocks outperformed value stocks.

Gold prices were also up during the first quarter – up about 1.73%, however, silver was down nearly 3.5%. International stocks (world index excluding U.S.) were down about 1%, however, emerging markets (small international companies) advanced nearly 2.5% during the first quarter.

Fixed income or bonds continue to 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 first quarter with a fractional loss (-0.13%) and intermediate-term bonds posted a larger loss of approximately 2%. The 10-year U.S Treasury Note started the year paying 2.4% interest and by the end of the quarter, the yield was 2.75%. As interest rate rise, the interest income is slightly higher on new issues, but bond prices or values fall as interest rates rise. The decline in value exceeded the interest income during the first quarter.

Real estate (REIT's) prices were down significantly during the first quarter with the average REIT fund falling by 8% during the first quarter. Same problem as fixed income: rising interest rates negatively impact real estate values.

The following chart displays sample returns of various asset categories during the first quarter of 2018:

Yr-To-Date 2018	1st Qtr. 2018	Index Return (*includes dividends reinvested*)
- 2.49%	- 2.49%	**Dow Jones Industrial Average (^DJI)**
- 1.03%	- 1.03%	**Standard & Poor's 500 Index (^GSPC)**
- 0.71%	- 0.71%	**DJ U.S. Total Stock Market (VTI)**
+ 1.33%	+ 1.33%	**Large-company stock-Growth (IWF)**
- 2.98%	- 2.98%	**Large-company stock-Value (IWD)**
+ 2.13%	+ 2.13%	**Mid-Size Stocks – Growth (IWP)**
- 2.65%	- 2.65%	**Mid-Size Stocks – Value (IWS)**
+ 2.23%	+ 2.23%	**Small-company stock- Growth (IWO)**
- 2.75%	- 2.75%	**Small-company stock- Value (IWN)**
- 0.90%	- 0.90%	**International (EFA)**
+ 2.46%	+ 2.46%	**Emerging Markets (EEM)**
- 8.17%	- 8.17%	**Real Estate Investment Trusts (VNQ)**
		Fixed Income
- 0.13%	- 0.13%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
- 1.94%	- 1.94%	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
		Alternative Investment Category
+ 1.73%	+ 1.73%	**Gold (GLD)**

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

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FINANCIAL MARKET OUTLOOK

As stated last year, 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.

Last year, the prospect for better economic growth was confirmed as GDP rates in the U.S. and around the world improved in spite of the daily chatter and “news” stories that interest rates are rising, Tax Reform is not likely to be approved, military conflict with North Korea is imminent and other stories that properly belong in the “everything else” category. Over time, nothing in the “everything else” category prevented the stock market from advancing during every month (except one) in 2017.

Then February 2018 arrived and the overall stock market fell 4% followed by another 1.5% decline in March. The immediate reaction was selling as traders considered whether the prospect of continued economic growth should be reevaluated as Trump announced new tariffs will be implemented against countries that continue to dump steel and aluminum in our markets at prices below the cost of production and violate our intellectual property rights. Short-term stock traders quickly sold stocks in response to the *possibility* that “Trade Wars” would follow. Sure, this particular scenario is possible, but is it probable? At best, we think it’s way too early to make that call.

The near and mid-term outlook still appears positive for continued improvement in worldwide economic growth. The most recent indicator in the U.S. is an adjusted 2.9% economic growth during the fourth quarter – a meaningful improvement from a less-than-1% growth rate over the past seven years and very near the target 3-4% annual economic growth rate range. U.S. economic growth is accelerating and projected earnings growth for corporate America is forecast at 17% for 2018 – a primary reason why stocks should continue to advance.

It’s the “everything else” (political turmoil, high stock price values, North Korea, and potential trade wars with other countries, etc.) that has investors and advisers feeling a bit cautious or concerned with “what-if” scenarios. Investors can choose any multi-year time period in the past and find months of extreme volatility – that’s one of many characteristics of the overall stock market. When investors or traders react to these periodic “everything else” themes in the market, then volatility in stock prices increases. Frankly, the sudden spurts in stock market volatility often have more to do with investors’ feelings and reactions to recent events or stories based primarily on their political identity.

Anytime an individual investor or financial advisor feels the need to re-assess his/her overall asset allocation and the future direction of the stock market because of recent news, volatility or downside performance, it is most important to measure your conviction before acting. Are your reactions and reasons for making changes primarily based on feelings, facts, or both? Ultimately a person must assign a probability of occurrence to the event or reason for possibly making changes. For us, there must be a 60% or higher probability or conviction to make changes. Otherwise, we would be making in and out changes frequently – and this latter approach is definitely a losing strategy.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

Our outlook with regard to continued economic growth and its positive impact on the stock market have not changed. Economic growth worldwide is still in place for continued improvement.

Initial financial market reactions to ongoing changes and challenges such as Income Tax reform, hostility with N. Korea, tweets, and now potential trade wars will likely continue. These news events and “everything else” occurrences will continue. Currently, the volatility in financial (stock) markets is directly related to the worst-case scenario concerns about trade wars. Trump announces tariffs, and China responds with an equal amount of their own tariffs (incidentally China has placed tariffs on U.S. products for years) and traders in the financial markets are handed the opportunity to move monies around.

The truth is, neither side on any trade/tariff dispute gains from placing additional tariffs on products coming into their country. Neither side will favor this scenario. At this time, altering (reducing) our exposure to stocks in client portfolios in reaction to the worst case scenarios of a trade war with China does not seem prudent. Both sides understand the current trade

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relationship is imbalanced. One side wants to continue receiving the favorable trade imbalance and the other does not. Neither side will voluntarily change until one side begins to take action.

All tariffs that have been announced by the U.S. and China have not been applied and are not in effect at this time. That's the process or dance. Make the announcement and allow a few months to negotiate before changes become effective. The U.S. has a review process and China has gone to the World Trade Organization. A deadline has been announced and the negotiations will pick up the pace as the deadline approaches.

Aside from this significant distraction, the financial markets are fairly valued. 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 volatile stock market reaction to tariffs and whatever else may arise is normal.

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 with your first 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.

SELECTED TAX REFORM CHANGES EFFECTIVE IN 2018

- **Taxes**

1) *Individual Income tax rates have been reduced beginning in 2018.* The seven tax brackets have been retained, but the rate is lower for 6 of the seven brackets as follows:

2017	10, 15, 25, 28, 33, 35, and 39.6%
2018	10 12, 22, 24, 32, 35, and 37%

2) *Corporate Income Tax Rates have been reduced from a tiered rate with a 35% maximum rate to a flat 21% beginning in 2018.*

3) *Estate and Gift Tax EXCLUSION amount has been increased.* In 2017, a deceased taxpayer could pass $5.49 million of assets (collectively during his/her lifetime and at death) without incurring any estate tax at a 40% rate on the excess over $5.49 million. The new threshold is double the 2017 amount. The 2018 estate and gift tax exemption has been increased to $11,180,000. Gifts made during a taxpayer's lifetime of $15,000 or less per person are excluded or exempt (up from $14,000 in 2017). Most families will not be subject to estate taxes unless their estate exceeds about $11.2 million.

- **Itemized Deductions**

1) *Increased Standard Deduction*. A single taxpayer can take a $12,000 standard deduction against income and a married couple can take a $24,000 deduction. That's nearly double the rates in 2017.
2) *Reduced/Limited Deduction for Property taxes and state income taxes.* Prior to 2018, taxpayers could deduct an unlimited amount of property taxes and state income taxes paid. Beginning in 2018, the combined total of both state income taxes paid and property taxes is limited to $10,000.
3) *Interest Deduction on home mortgage reduced.* Prior to 2018, taxpayers could deduct home mortgage interest on a maximum $1 million mortgage created when the property was purchased, plus up to $100,000 of home equity debt on their personal residence. In 2018, the interest deduction on acquisition (mortgage) debt is reduced to $750,000 and interest paid on home equity lines of credit/loans is not deductible. Taxpayers who purchased their primary home before 2018 can continue to use the "old rules".
4) *Miscellaneous Itemized Deductions* include employee business expenses, tax preparation fees, investment management fees/expenses, safe deposit box fee, and legal fees. All of these expenses will no longer be deductible in 2018 through 2025.

- **Exemptions Eliminated**

1) Under 2017 and earlier tax law, taxpayers were allowed a *personal exemption* of $4,050 for the filer and spouse and for each qualified dependent (children). High income taxpayers did not receive personal exemption deductions

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in the past, but in 2018, the deduction for personal and dependent exemptions is repealed for ALL taxpayers.

- **Education Benefits**

1) <u>*Section 529 College Savings Plans*</u> have been amended and now (2018 forward) allow up to $10,000 a year to be used for *elementary school and high school education expenses.* Prior to 2018, nontaxable withdrawals from 529 Plans could only be used for college education expenses. Now up to $10,000 annually can be used for private elementary and high school tuition and expenses.

- **Business owners Lose deductions for entertainment expenses**

1) <u>*Entertainment expenses are no longer deductible beginning in 2018.*</u> Before 2018, firms / business owners could generally take a tax-write-off for **one-half** of their business-related <u>entertainment costs</u>. So, no more writing off show tickets, golf course fees, sporting events and the like, even if taking clients.

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COPIES OF 2017 INCOME TAX RETURNS

The due date for 2017 income tax returns is April 18, 2018. Please request that your income tax preparer send paper or electronic (email) copies of your 2017 income tax returns to our office as soon as possible after completion. 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.

Contact Us

Brian D. Lowder, Inc.

Brian D. Lowder, CFP®, CFA
Michael Kinnear, MBA, MSFS, CFP®
Clinton Winey, MBA, CFP®, CFA
Jennifer Finley
Pamela Priest

Address
12780 High Bluff Drive Suite 100
San Diego, CA 92130

Telephone
(858) 794-6800

Fax
(858) 794-6906

Website
www.bdlowder.com

Email
brian@bdlowder.com
mike@bdlowder.com
clint@bdlowder.com
jenn@bdlowder.com
pam@bdlowder.com

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Best Regards

Brian Lowder Clinton Winey Michael Kinnear Jennifer Finley Pam Priest