BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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INSIDE THIS ISSUE

FINANCIAL MARKET OVERVIEW

After enduring an erratic 2011 year where the stock market ended about where it started, who would have predicted on January 1, 2012 that all stock market indexes would be up 10% or more (except for the Dow Jones Industrial Average) during the first quarter of 2012? Although there is no shortage of opinions now as to why the financial markets advanced well above expectations, you won't find anyone who stated these reasons on January 1, 2012. It just happened.

The Total Market Index, the broadest measure of the overall U.S. stock market, was up 12% during the first quarter. Large, mid-size and small-company stock indexes all posted double-digit advances ranging from 10% to 14%. The average stock mutual fund jumped 12% during the first quarter of 2012.

Interest rates increased modestly. The interest paid on 10-year U.S Treasury Notes climbed from below 2% to 2.3% before dropping back to 2.2% by March 31st. As interest rates increase, the value or price of bonds decline. The net result was negative total returns (income plus gains/losses) on bonds and bond funds ranging from 1% to 3%.

International (non-U.S.) stocks also advanced by 10% and emerging market (smaller international countries) stocks performed better, averaging 13% during the first quarter. Gold advanced just over 6% and real estate investment trusts (REITs) advanced nearly 10%.

While the first quarter performance was well-above expectations, over the past twelve months the stock market indexes are still relatively flat with the best performance up about 5%. All stock market indexes are still below where they began in 2008. The following chart displays sample returns of various asset categories during the first quarter of 2012:

1st Qtr. 2012	**Index Return** *(includes dividends reinvested)*
+ 8.1%	**Dow Jones Industrial Average (^DJI)**
+ 12.0%	**Standard & Poor's 500 Index (^GSPC)**
+ 12.3%	**DJ U.S. Total Stock Market (VTI)**
+ 14.4%	**Large-company stock-Growth (IWF)**
+ 10.4%	**Large-company stock-Value (IWD)**
+ 14.2%	**Mid-Size Stocks – Growth (IWP)**
+ 10.9%	**Mid-Size Stocks – Value (IWS)**
+ 13.2%	**Small-company stock- Growth (IWO)**
+ 11.2%	**Small-company stock- Value (IWN)**
+ 10.8%	**International (EFA)**
+ 13.2%	**Emerging Markets (EEM)**
+ 9.7%	**Real Estate Investment Trusts (VNQ)**
	Fixed Income
- 0.2%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
- 2.2%	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
	Alternative Investment Category
+ 6.6%	**Gold (GLD)**
+ 4.2%	**Natural Resources (Lipper Index)**

Continued on page 2

Continued from page 1

ECONOMIC, FINANCIAL MARKETS AND POLITICAL OUTLOOK

We will most likely continue to experience a very slow economic recovery, a divided political atmosphere and gridlock along with excessive worldwide government debt and potential conflict.

Over the past three years, corporations have improved their profitability and are actually in reasonable financial shape. They have been forced to trim costs and become more efficient at producing the same goods and services at the same or lower cost (often referred to as improved productivity). The concern today is improved corporate profitability has been achieved primary through cost reductions and job eliminations. Where will the improvement come from in the future without increased demand from an improving economy? The stock market will not continue to advance in a sustainable manner without improved economic growth.

Individuals have also been forced to alter their spending decisions and many have had to trim their standard of living to better align their income with expenses. Our federal, state and local governments are still dragging their feet.

A disciplined and cautious investment management style is still recommended at this time. Resist jumping into higher risk investment choices (such as adding more stocks) immediately following surprisingly good quarterly performance. Adding more portfolio risk in pursuit of higher returns immediately following an abnormally positive quarterly performance (or the reverse scenario of selling out following poor quarterly performance) is still the most common mistake investors make decade after decade.

Another relatively new mistake or money-loser temptation is allowing your politics to cloud your financial judgment. Political approval/disapproval doesn't correlate well with future gains/losses in the market.

Regardless of which Presidential or Congressional candidate(s) or party wins in November, none of them have the ability to significantly and magically improve the economy. Our world economy can improve with or without them. However, they do have the ability (through their policies) to prolong the uncertainty and hinder the eventual economic recovery.

The bottom line is straightforward. Individuals, corporations and politicians are all in disagreement and prefer opposing solutions that benefit themselves. We need definitive policies, regulations, entitlement programs and tax overhaul rules (whatever they may be) that will stay in place for at least four years. When we know the rules of the game and how long they will stay in place, all of us will be more confident in how we will "play the game." Uncertainty and opposition is prolonging an economic recovery.

CONSIDER 2012 LONG-TERM CAPITAL GAIN/LOSS STRATEGIES NOW

Generally, we advise waiting until the end of the calendar year before making any decisions regarding selling investments to match, minimize or offset capital gains with capital losses. In other words, if you have investment profits or gains, we then consider which investments to sell that currently have losses in order to minimize or eliminate any taxable gains with taxable losses. *This year may be different.*

It appears likely that the capital gains tax rate (the preferred tax rate on investments sold that were held for longer than one year) currently 10% for lower income taxpayers and a maximum 15% tax rate for all other taxpayers, will be increased beginning in 2013 and subsequent years. Here's why.

Our Congress is divided and can't agree upon anything. Beginning in 2013, the Bush tax cuts are scheduled to expire and it is almost guaranteed that Congress, in this 2012 election year, will not agree upon a new tax rate schedule. So, since the current **15%** maximum long-term capital gains tax rate will expire at year-end, the "old" rates will become effective on January 1, 2013. The "old" long-term capital gains tax rate is **20%**. In addition, some itemized deductions will be disallowed for higher income taxpayers which will effectively raise the tax rate by 1.2% for a total capital gains tax rate of 21.2% - or a 41% tax-rate increase (from 15% to 21.2%).

In addition, beginning in 2013, the Obama Health Care bill imposes a 3.8% additional tax on investment income (interest, dividends and capital gains) for high income taxpayers. After adding the new 3.8% additional health care tax to the maximum 21.2% capital gains tax, the two combined will be 25% verses

Continued on page 3

Continued from page 2

today’s 15% rate for “high income taxpayers” or 20% for everyone else. In summary, investments sold with gains or profits in 2012 will be subject to a maximum tax rate of 15% whereas the same investment sold in 2013 will be subject to a 20% tax rate or as high as 25% for some taxpayers. Finally, if Obama’s proposed “Buffet Rule” is passed, those earning over a million dollars could face a maximum tax rate of 30% (compared to 15% this year) on their long-term capital gains as early as 2013.

Therefore, before January 1, 2013, we will need to decide whether to take **capital gains** (sell profitable investments that have been held for longer than one year) in 2012 when tax rates are a maximum 15% rather than later (2013) when the same tax rate increases to 20% - 25%. In addition, **capital losses** will be more valuable in 2013 when tax rates are higher than in 2012 when tax rates are lower.

In conclusion, capital gains tax planning for the remainder of 2012 could be an “upside down” year where capital gains should be recognized (sold) this year and losses deferred to next year – just the opposite of the planning strategies in the past. We will continue to discuss this topic for the remainder of the 2012 year and offer specific recommendations before year-end.

Other Tax-Related Issues Under Consideration:
The House of Representatives Plan for income tax overhaul is to eliminate the current tax rate structure that has 6 tax rates ranging from 10% to 35% into two tax rates: 10% and 25% with the top tax rates for corporations also reduced to a maximum 25%. The lower tax rate structure also comes with a likelihood of losing some deductions such as the deduction for state and local income taxes. In addition, Obama’s commission on income tax overhaul is suggesting further reductions in some coveted tax deductions in exchange for lower tax rates. The most obvious deductions that may be reduced are home mortgage interest and charitable deductions. The most aggressive proposal or suggested change is to begin requiring individuals who inherit IRA accounts (excluding a surviving spouse) to withdraw all of the IRA money within 5 years. The obvious reason for the accelerated withdrawal requirement is to increase reported taxable income. Requiring all IRA funds on inherited IRA accounts to be withdrawn within 5 years would increase taxable income and income tax revenue to the U.S. Treasury.

This is an election year, so whatever income tax overhaul and loss of deduction changes that have been proposed will certainly not become known or passed into law until next year. We will just have to wait and decide what actions we might recommend (discussed above) before January 1, 2013.

ESTATE PLANNING REMINDER

Back in late 2010, our newsletter discussed important estate planning changes and opportunities. Since these changes will expire at the end of 2012, we will briefly discuss these opportunities again. **The estate and gift tax rate** was reduced from 45% to 35% and the lower 35% rate is only guaranteed through the 2012. More importantly, the **estate tax exemption** amount (the total value of your estate that is excluded from the 35% estate and gift taxes) was $3.5 million and was recently increased to $5 million. Simply stated, no estate tax is due on estates valued at $5 million or less at death.

The most important estate planning benefit – the **gift tax exemption** amount was increased from $1 million during your lifetime (or at death) to $5 million. Simply stated, each taxpayer may gift up to $5 million *during their lifetimes* and pay no gift taxes. Taxpayers still have the flexibility to give away up to $5 million during their lifetimes, gift a partial amount or preserve the entire $5 million exemption at death – but only through the remainder of the 2012 calendar year. Parents or grandparents may wish to take advantage of the increased lifetime gift amount by making gifts of appreciated securities, real estate or business interests to children or grandchildren this year before the favorable tax rates and exemption amounts expire.

In summary, the favorable 10% to 15% capital gain tax rate, the lower 35% estate tax rate and the $5 million gift tax exclusion all are due to expire at the end of 2012. In addition, many of the proposed income tax increases suggested by the president and congress will likely be determined in 2013.

Continued on Page 4

Continued from page 3

COPIES OF INCOME TAX RETURNS

Please send paper or computer file copies of your 2011 income tax returns to our office upon completion. Our investment decisions and income tax management strategies are greatly improved when we have copies of your income tax returns.

Contact Us

Brian D. Lowder, Inc.

Brian D. Lowder, CFP®, CFA
Michael Kinnear, MBA, MSFS, CFP®
Clinton Winey, MBA, CFP®, CFA
Remette Martinson
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
rm@bdlowder.com
pam@bdlowder.com

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Best regards

Brian Lowder
Clinton Winey
Michael Kinnear
Remette Martinson
Pam Priest