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

INSIDE THIS ISSUE

FINANCIAL MARKET OVERVIEW

The tug-of-war between positive and negative stock market performance continues. During the first quarter of 2010, stocks *gained* over 5%. During the second quarter, stocks reversed course and posted a *decline* of over 10%. During the third quarter, stocks *advanced* more than 10% with nearly all of that gain attributable to the 8.8% increase during the month of September.

Small-company and mid-size company stocks outperformed large-company stocks during the third quarter and year-to-date. While emerging markets, foreign stocks and real estate investment trusts declined more than the overall stock market during the second quarter, these categories reversed course and out-performed the overall market during the third quarter rally. As expected, higher risk investments should lead the way up during rallies and decline more than the overall market on the way down.

Gold continued to outperform most of the major asset categories during the third quarter and has posted a 25% gain since the beginning of the year. Lastly, the U.S. Dollar declined significantly during the third quarter. By the end of the third quarter, all major U.S. and international stock indexes had turned positive for the year ranging from 2.5% to 4%. The average U.S. stock mutual fund is also up approximately 4% year-to-date ending September 30, 2010.

The chart in the following column displays sample returns of various asset categories during the third quarter and year-to-date through September 30, 2010:

2010 YTD	3rd Qtr. 2010	Index Return (*includes dividends reinvested*)
+ 3.9%	+ 11.1%	**Dow Jones Industrial Average**
+ 2.7%	+ 11.3%	**Standard & Poor's 500 Index**
+ 3.8%	+ 11.5%	**DJ U.S. Total Stock Market** (Broad Market)
+ 2.9%	+ 12.6%	**Large-company stock-Growth**
+ 2.3%	+ 10.3%	**Large-company stock-Value**
+ 10.4%	+ 14.1%	**Mid-Size Stocks – Growth**
+ 14.6%	+ 13.1%	**Mid-Size Stocks – Value**
+ 9.4%	+ 12.1%	**Small-company stock- Growth**
+ 8.9%	+ 10.2%	**Small-company stock- Value**
+ 3.4%	+ 16.3%	**International (excludes U.S.)**
+ 18.7%	+ 11.6%	**Emerging Markets**
+ 19.1%	+ 12.9%	**Real Estate Investment Trusts**
		Fixed Income
	+ 0.9%	**Short-term U.S. Treasury** (*includes appreciation*)
	+ 2.6%	**Intermediate U.S. Treasury** (*includes appreciation*)
		Alternative Investment Category
+ 25.8%	+ 15.5%	**Gold**
	+ 14.3%	**Natural Resources**
+ 0.5%	- 9.0%	**U.S. Dollar**

CURRENT AND NEAR-TERM ECONOMIC OUTLOOK

Most investors simply cannot understand why or how stocks could advance nearly 10% during one month when unemployment, manufacturing, production, and the U.S. dollar are weakening, while simultaneously the prices of gold and oil have increased over 10%.

There is no shortage of opinions or possible explanations offered daily through television, newspaper and internet articles and interviews. Examples include the pending November elections, short-selling (hedge-fund investors betting the market will go down and when wrong, they must buy stocks to cover their positions) had grown to a 12-month high, or perhaps the stock market was due for a rally after dropping over 10% during the second quarter. No one can rationalize market movements over such short time periods. The truth of the matter is: every day an enormous amount of new financial, economic, and political information collides

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with investor's psychological and emotional expectations along with rapid-fire trading activity resulting in a confusing cocktail of unpredictable market movement.

The majority of corporations have more cash today than they normally would set aside due to cutting costs, reducing their workforce and more importantly simply holding back expansion plans due to the uncertainty of future economic growth, tax rates, pending corporate responsibility for providing employee healthcare coverage and government gridlock. Simply stated, corporations and investors are afraid or reluctant to take risk (expand, invest and create jobs) when the rules of the game are unknown. But the demand and desire to grow and invest is building like water behind a dam.

Only on one other occasion in the history of this country (Great Depression) have we experienced a 10-year period of negative stock market returns until the recent decade 1999-2009. In addition, there have been 4 ten-year periods since the Great Depression when equity returns averaged less than 5%. In every case, the following ten-year period produced stock returns that averaged greater than 14%. The reason for expecting above-average future stock performance is not merely statistical or historical. The economy and stock prices declined in each of those decades for a variety of reasons (war, inflation, recession, etc.), but in every case, excesses are washed out of the system and new growth is created in spite of the fear or concern at the time that the "economy will never recover." The average annual total return on stocks for the 5-year periods ***after*** each decline was ***positive*** 100% of the time. The overwhelming probability is that stocks (and real estate) will recover again. The real issue is not "if"…….. but rather "when."

The difference today compared to the past is that the financial markets can move very quickly in either direction. Information is disseminated quickly and trading capabilities today allow for large trade executions in a matter of seconds. On Black Monday in October of 1987, I personally experienced the biggest one-day decline in stock prices – over 20% in one day. Earlier this year, stock prices declined over 10% in just 20 minutes!

Our biggest challenge is trying to navigate through short-term and difficult market conditions when our mid-to-long-term forecast is very positive. One of the most important lessons we have learned is to be patient and unemotional during periods of extreme volatility (both upside and downside risk). The biggest mistakes and regrets often occur during periods of extreme optimism (1999 technology rally) and pessimism (today). Investors have always had great difficulty resisting the temptation to chase after assets that have performed well recently (gold and silver) and can't see the wisdom in purchasing deflated asset classes during declines (stocks and real estate).

We expect both the economy and stock prices to recover. The rebound in the economy will likely occur over time (years), however, stock prices will likely advance significantly and powerfully long before the actual numbers and statistics confirm a recovery is underway.

Our strategy is to identify the asset classes and specific investment selections today that we expect to perform well in the future. The actual implementation or shift toward these strategies and investments are likely to occur in stages over time. The investment recommendations we have provided in this mailing identify the investments we wish to increase (decrease) over time, not immediately. The specific investment selections may also change as new opportunities and specific selections are identified.

SMALL BUSINESSES CATCH A BREAK

Congress is expected to pass a tax bill for small businesses soon as both parties agree small businesses are the lifeline of our economy and the best creator of new and lasting job opportunities. Some of the most applicable and likely benefits are:

a) Up to $500,000 of new business asset purchases can be expensed all at once rather than depreciated or written off over a period of years.

b) Expensing is expanded to include some real estate improvements (renovations to restaurants and retail stores) up to $200,000 in landlord improvements.

c) Self-employed taxpayer(s) can deduct their medical premiums on Schedule C for 2010.

d) Balances in 401(k)s can be rolled directly into the plan's Roth 401(k) account. Note the rollover is a taxable event.

e) A healthcare coverage credit for small business employers of up to 35% of the health care cost paid by employers for employees. Full credit available for employers with 10 or fewer employees as long as average full-time wages are below $25,000 – no credit for employers with more than 25 employees or the average annual wages are $50,000 or more.

INCOME & ESTATE TAX PLANNING PARALYSIS

Congress has failed to act again by halting plans to pass a major tax bill before the November elections, leaving taxpayers and financial advisers unsure about how to plan for income tax and estate tax rates for 2011. Once again, political posturing and attempts to protect their political future has taken priority over Congress's responsibility to govern on difficult matters.

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<u>*Income Tax Rates:*</u> If no action is taken on passing new income tax and estate tax legislation before the end of 2010, then the 2001 "Bush" era tax rates will expire. Three scenarios are possible:
1) Congress will extend all of the "Bush Era" tax cuts and no taxpayers will experience a change into a higher or lower income tax bracket;
2) A new tax bill will miraculously pass before year end and perhaps incorporate Obama's budget proposal to raise income tax rates by 3% and 4.5% for the top two income tax brackets (single taxpayers earning more than $200,000 and married taxpayers earning above $250,000); or
3) Congress will not act before year-end resulting in the expiration of all "Bush Era" tax rates and everyone reverts to the pre-2001 income tax rates. In this case, all taxpayers across the board will be subject to higher income tax rates.

<u>*Investment Income/Capital Gains Tax Rates*</u>: One of three scenarios is likely:
1) If the Bush tax cuts are extended, the **top** rate on capital gains (investments held for longer than one year and then sold) and dividend income will remain at 15%;
2) If a new tax bill is passed incorporating Obama's proposals, capital gains and dividend tax rates will rise to 20%; or
3) If the Bush tax cuts expire at the end of this year because Congress fails to enact new legislation, then the capital gains tax rate rises to 20% and dividend income is treated as ordinary income and taxpayers will pay whatever their individual tax rate is ranging from 10% to 39.6%.

The most likely scenario or expectation is Congress will extend the Bush tax rates until 2011 when Congress is expected to enact and approve a new income tax code.

<u>*Estate Tax*</u>: There is no estate tax in 2010 because Congress failed to enact new legislation before the 2010 year began. If Congress doesn't act before year-end, then beginning in 2011 the estate tax law will revert back to pre-Bush rules – only a $1 million exemption (compared to a $3.5 million exemption in 2009) on estate valuations and a 55% top estate tax rate (compared to a maximum 45% rate in 2009).

If someone is experiencing dire health conditions and may die within a few months or if a taxpayer wishes to gift assets to heirs today at a flat 35% estate/gift tax rate (betting that the new legislation, whenever enacted, will result in an estate tax rate greater than 35%), then clients have only a few months to make any changes. The problem is: how can any advisor confidently suggest tax avoidance or minimization strategies when no one has any idea what the new income and estate rates will be?

One practical suggestion for investors who plan to: a) liquidate a portion of their investment account soon and b) plan on selling an investment that has been held for longer than one year with a significant gain, is to consider implementing the sale transaction before year-end and take advantage of the lower 15% capital gains rate. The capital gains rate certainly won't be lower next year and, by all indications, raising the capital gains rate to 20% is very likely.

We have already elected to sell and take the 40%-50% gains in gold and silver mining stocks last month because of the rapid appreciation in prices, the growing frenzy of opinion that metal prices will continue to climb and to take advantage of the lower capital gains tax rate (tax rates are not applicable to IRA and other retirement accounts) before the end of 2010. If any client anticipates a near-term need to raise cash and expects to liquidate appreciated securities, we suggest selling before December 31, 2010.

NEW TAX REPORTING LAW – BROKERAGE ACCOUNTS

The *Emergency Economic Stabilization Act of 2008* contained new tax reporting requirements for brokerage firms and custodians. The Act requires brokerage firms and custodians to report *adjusted cost basis* for *taxable accounts* to the IRS and taxpayers beginning with the tax year 2011. While brokerage firms will bear the burden of <u>compliance</u> with regards to reporting, you must be aware of the changes because taxpayers will bear the potential <u>cost</u> of higher income taxes due to inaccurate information reported on their Form 1099 and personal income tax returns. Brokerage firms **are not required** to provide cost basis on any investment holdings that were purchased prior to 2011.

In the past, brokerage firms, custodians, banks, etc. were not required to include cost basis information (cost basis is simply the purchase date, price per share and total amount invested upon purchase) on investor's annual 1099-B statements. Form 1099 summarizes all dividends, interest and total proceeds from sales of securities. It has always been the investor's responsibility to maintain accurate cost basis information on their investment accounts and report the cost basis on their income tax returns.

Some brokerage firms include cost basis information on their monthly or quarterly statements, but custodians have not been held responsible for the accuracy and were not required to include this information on Form 1099. Form 1099 is the document that taxpayers and the IRS receive from brokerage firms. The IRS compares the 1099 data to the information you report on your income tax return.

The importance is simply stated: Cost basis determines the amount of capital gains or losses on an investment when sold for income tax purposes. The difference between the total cost of an investment at purchase and the subsequent proceeds upon sale is the "capital gain" that is subject to capital gains taxes.

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Here is the potential problem: There are many instances where the current custodian or brokerage firm does NOT have records of your cost basis, but the custodian must enter a cost basis number or enter “uncovered / not applicable” on any assets sold beginning in 2011. The IRS will be comparing information received from your brokers/custodians with the information you enter on your income tax returns.

Common circumstances where the custodian/brokerage firm does not have an accurate cost basis are: a) the security was purchased a very long time ago; b) the security was purchased elsewhere and subsequently transferred into your new brokerage account; c) dividends were reinvested into more shares; and d) the securities were inherited by the client and the cost basis received a “step-up” in cost basis to the fair market value on date of death.

Recommended action: Our investment management clients receive quarterly reports from us that contain accurate and current cost basis information <u>for all securities purchased by our firm</u> (through Charles Schwab). For those clients who hold securities in their *taxable accounts* that were not purchased through Brian D. Lowder Inc. and/or Charles Schwab and have not provided us with original cost basis, you should research and provide cost basis data to us or be prepared to validate cost basis when those particular securities are sold in the future.

For all clients who have received a “step-up” in cost basis due to the death of a spouse or received inherited securities (generally all investments receive a new cost basis equal to the values on the date of death in community property states such as California), we will provide Charles Schwab with the adjusted cost basis.

Lastly, the new reporting requirements begin in 2011. Brokerage firms are only required to report gain/loss information on **stocks** purchased in 2011 and thereafter. The cost basis reporting requirements for **mutual funds** begin in 2012. Reporting requirements for **all other securities** (bonds, option contracts, etc.) begin in 2013.

ANNOUNCEMENTS

Pam Priest is now a first-time grandmother! Wyatt Paul Tippin was born September 18, 2010. Mother (Pam’s daughter Annie), baby and grandmother are doing great.

Thank you for your continued trust and confidence and we look forward to hearing from you soon.

Best regards

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