BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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FINANCIAL MARKET OVERVIEW

The third quarter of 2013 ended on a downward bias and as we complete this newsletter on the third day of October, the financial markets are continuing to decline. However, the third quarter posted above-average returns with the overall U.S. stock market posting a solid return of approximately 5%.

The Total Market Index, the broadest measure of the overall U.S. stock market, was up 6% during the third quarter. Large, mid-size and small-company stock indexes all posted positive returns ranging from 4% to 13% during the third quarter, however, large-company stocks are trailing the performance of small and mid-size company stocks and growth stocks are performing better than value stocks for the first half of 2013.

International stocks performed better than U.S stocks during the third quarter after trailing for the first half of this year. International stocks are still trailing U.S equities year-to-date through September 30th. The disparity in performance continues for emerging market (smaller international countries) stocks which are trailing domestic stocks by a significant margin and are still in negative territory year-to-date. This disparity is unusual, as emerging market stocks usually rise faster than U.S. stocks during up cycles and declines are typically larger during periods of negative stock price performance. This is the third consecutive quarter where U.S. stock prices significantly outperformed emerging market stocks (smaller international countries).

The total return (income less price decline) for intermediate and long-term bonds (regardless of quality) was flat during the third quarter and still *negative* year-to-date. In essence, the most conservative asset class (bonds/fixed income) continues to perform poorly through September of this year. In addition the value of the U.S. dollar has begun to fall due to growing deficit spending and no budget agreement in Congress.

Gold prices recovered nicely during the third quarter and posted a 7.6% gain. However gold was down 22% during the second quarter and is still down 20% year-to-date. Real estate (REIT's) posted a 2% negative return during the third quarter (due to rising interest rates), but earned a 4% return year-to-date.

The chart on the following page displays sample returns of various asset categories during the third quarter of 2013:

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Yr-to-Date 2013	3rd Qtr. 2013	Index Return (*includes dividends reinvested*)
+ 15.4%	+ 1.5%	**Dow Jones Industrial Average** (^DJI)
+ 19.7%	+ 5.2%	**Standard & Poor's 500 Index** (^GSPC)
+ 21.3%	+ 6.5%	**DJ U.S. Total Stock Market** (VTI)
+ 20.6%	+ 8.3%	**Large-company stock-Growth** (IWF)
+ 20.2%	+ 3.9%	**Large-company stock-Value** (IWD)
+ 25.3%	+ 9.4%	**Mid-Size Stocks – Growth** (IWP)
+ 22.7%	+ 6.1%	**Mid-Size Stocks – Value** (IWS)
+ 32.8%	+ 13.3%	**Small-company stock- Growth** (IWO)
+ 22.9%	+ 7.6%	**Small-company stock- Value** (IWN)
+ 14.4%	+ 11.3%	**International** (EFA)
- 6.9%	+ 5.8%	**Emerging Markets** (EEM)
+ 3.2%	- 2.8%	**Real Estate Investment Trusts** (VNQ)
		Fixed Income
+ 0.2%	+ 0.3%	**Short-term U.S. Treasury** (SHY) *(includes appreciation)*
- 4.0%	+ 0.1%	**Intermediate U.S. Treasury** (IEF) *(includes appreciation)*
		Alternative Investment Category
- 20.8%	+ 7.7%	**Gold** (GLD)

ECONOMIC IMPACT CONSIDERATIONS OF AFFORDABLE CARE ACT

While portions of the Affordable Care Act have already been implemented (new taxes) and some aspects have been delayed (participation), it appears likely that most or all of the provisions will ultimately be implemented. Let's assume for the sake of argument that the new health care system eventually becomes fully implemented.

Consequently, we should also consider how the financial markets will adjust sometime in the near future and the three variables that will most likely have a direct impact on our financial markets. They are higher deficits and debt, higher interest rates and a decline in the value of the US dollar. The timing of the inevitable market adjustment is somewhere between one week and eight years. Note, all short-term changes (weekly-monthly) to the U.S. stock market are excluded from this discussion as many variables impact our stock market on a daily basis and therefore we cannot attribute short-term volatility to only one cause, a few variables or simply the Affordable Care Act.

Variable number one, higher deficits and debt, is not disputed by anyone – not Democrats, Republicans, or the government's own Congressional Budget Office (CBO). In the first 5 to 10 years, implementation of this new Health Care Law will cost us (through government spending) more money than the tax revenues received – the only argument is for how long. Don't confuse individual spending on the cost of health care insurance coverage with government spending to implement and pay for the subsidized care. Some individuals will pay lower health care insurance premiums and others will pay more. Initially, our government's annual deficit spending (government spending exceeding government revenues) will grow and therefore our total National Debt must grow as well (when expenses exceed revenues – the money has to be borrowed).

The question is: Does deficit spending and increasing our federal debt "really matter"? Obviously over the very short-run, it does not, as our government has increased the national debt by 9 trillion dollars over the past 3 years – current debt balance is 17 trillion dollars.

At some point in time, it will matter. Today, our total federal debt equals 73% of total U.S. annual economic output. As a comparison, France currently has 100% debt to total economic output and Greece is over 175% (we assume our readers already know that these two countries have severe financial crises as government expenditures greatly exceed revenues). The nonpartisan Congressional Budget Office's "optimistic" estimate is U.S. debt will reach 81% of total annual U.S. output at the end of **ten years and**

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100% within 25 years – assuming our economy doesn't reverse itself and enter a recession. The CBO's alternative fiscal scenario or "realistic" estimate is national debt will reach **190%** of total annual economic output by 2038. Over the short-term (one to ten years), continued deficit spending and higher total federal debt "doesn't matter" in the sense that irreversible damage is more than a decade away.

Current government benefits and expenditures already exceed revenues (taxes) and adding to that deficit is the cost of implementing the Affordable Care Act. More individuals will receive needed health care, but our national debt will definitely increase during the next 10 years. The timing couldn't be worse. Dramatically increasing our national debt and government benefits (healthcare) or in other words, greatly increasing this imbalance over the next 10 years, coincides with the aging of the U.S. population.

Our working-age population will decline over the next 20 years. The oldest Baby Boomers started their retirement this year (2013). Currently, there are 4.4 working-age taxpayers for every 1 senior/retiree. By 2038, there will be 2.7 working-age taxpayers for every senior/retiree. The mathematical conclusion is very simple and not political. More retirees over the next 25 years will push up the cost of elder-care and entitlements (Social Security, Medicare, healthcare), government spending will rise faster than revenues, annual deficits will grow even larger and these growing deficits add to our total national debt. Instead of 4.4 workers paying for each 1 retiree, this ratio will drop to 2.7 workers paying for the benefits of 1 retiree. And you think balancing the federal budget is difficult now?

In summary, the probability of increasing budget deficits and higher total national debt is certain – how fast and by how much is debatable. Consequently, the financial markets will adjust to this reality – the only question is when? But there is more.

Variables two and three, higher interest rates and a declining U.S. dollar are directly impacted by continued deficit spending and our growing national debt discussed above. Continued deficit spending and growing national debt will eventually impact interest rates. Why? Whether an individual, family or government continues to borrow, lenders will charge more to compensate for the additional risk. Just as France, Greece and several other nations with rising national debt must pay higher interest rates compared to the U.S., China, etc., eventually interest rates will rise in the United States as our deficits and national debt continue to rise. Most of our national debt is sold to foreign countries via U.S. Treasury bonds. Buyers of our Treasury debt will require a higher interest rate as our debt grows.

A counter argument states that the U.S debt can never be a worry because the debt is denominated in the same U.S dollars that our Federal Reserve has the ability to print. Over the past 5 years, that is exactly what the U.S. has been doing – printing more money. But this short-term bandaid leads us to the next variable – a decline in the value of the U.S. dollar in which all of our debt is denominated. At some point in time, devaluation or a declining exchange value of our dollar compared to other foreign currencies is inevitable.

When foreign buyers of our (Treasury) debt receive less value as interest and principle is repaid in depreciating U.S. dollars, not only will they be less willing to buy or reinvest into new treasuries, but a selloff in these bonds would certainly require us to raise interest rates on new debt in order to encourage continued purchases.

We are heading down a path that will eventually cause interest rates to rise. We don't expect a sudden and continual increase, but rising interest

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rates seem inevitable. This is why no matter how "good" or morally responsible it feels to provide as much entitlement as we can, if it is accomplished through continuous deficit spending and with borrowed money, the consequences can only be delayed for an undetermined amount of time. Even without embarking on a national health care program that costs far more money than revenues collected, we only have less than a 10-year period to get our financial house (balanced budget) in order before more Baby Boomers retire. This is our country's biggest pending financial problem and the financial markets will react ***long before*** the above scenario unfolds. Financial markets are anticipatory.

The delay or refusal to deal with this issue is political. The decade 2028-2038 seems closer to infinity than tomorrow and politicians' time horizons do not extend beyond the next election. By the time the debt problem is hemorrhaging, our current political "leaders" will be well into retirement or dead

Economic and Financial Market Outlook

The financial markets ended the third quarter on a downward bias and the first few days of the fourth quarter have been quite negative, however the third quarter return was much higher than many expected. The broad U.S. stock market finished the third quarter up approximately 5%. Once again, stock market performance has been surprisingly strong – up over 50% since October 2011. There are many factors and possible explanations for such stellar performance, but most of the gain can be attributed generally to historically low interest rates and positive economic growth (while GDP growth is well below our 2.7%-3% average – it has moved from annual declines to slightly positive growth).

In addition, the "official" U.S. unemployment rate has improved marginally over the past two years and is holding steady at 7.3%. The official unemployment rate doesn't include individuals who are no longer actively seeking or wanting employment, underemployed or part-time workers, but the point here is our country is not losing more full-time jobs as we were a few years ago.

Overall, corporate profits have improved. Real estate prices have risen recently and it appears the real estate price decline has found and bounced up off the bottom. In summary, the decline in all of the above economic indicator measures have reversed and that is certainly viewed as positive. The stock market has generously rewarded this reversal since October 2011. Now the question is, what will support this new enthusiastic stock market valuation level and what better economic news is yet to come to propel the averages higher?

As stated last quarter and again in this newsletter, the three variables to watch are deficit spending, interest rates and the value of the U.S. dollar. Our best judgment is deficits and interest rates will rise and the value of the U.S. dollar will fall. The big question is whether positive news elsewhere, such as economic growth (GDP), corporate profits, and employment figures will collectively be better or stronger than continued deficit spending, rising interest rates and a weakening dollar. Also, non-economic news will impact our markets and the impact can go either way. A sigh of relief would occur if politicians can actually negotiate and get things done.

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Our portfolio management strategy remains the same. We will maintain our equity (stock) exposure with preference for stable and mature dividend-paying companies over aggressive growth. New clients or new increases in cash deposits will be invested ratably over time and during lower-risk entry points. Our downside strategy is in place to reduce equity holdings if necessary. Over the short-term financial markets will be dealing with much uncertainty - economically, politically and internationally.

U.S. fixed income or bond investments of any kind – Treasury, corporate or municipal, are very unattractive. Rising interest rates cause bond prices to decline and the longer the maturity of the bonds, the greater the price decline. We expect interest rates to rise over time regardless of the level of economic activity and the longer our government's deficit spending continues, the greater the pressure on rising interest rates. Presently, our primary remaining bond investment is international or foreign government bonds denominate in foreign currency. The expected or inevitable depreciating U.S. dollar is the reason for this choice.

In conclusion, the U.S. and global financial markets have a long way to go to navigate through a global economic recovery. Some risks and uncertainties have been removed over the past two years, but the variables we discussed in this newsletter will definitely have an impact on the financial markets. As we stated last quarter, it is going to be a volatile ride – expect it. It feels like we are heading into a dark tunnel and no one knows with certainty how long we may be in darkness or which way the financial markets will turn.

ANNOUNCEMENTS

Soccer news: Brian's daughter, Melissa Lowder, plays club soccer with the local DMCV SHARKS and is also a member of the Region IV Olympic Development Team and the U.S. Women's National Team – all for age 16 year-olds. In July 2013, Melissa's Sharks team won the National Championship for their age group in Overland Kansas after two overtimes and the game was finally settled in penalty kicks.

COPIES OF 2012 TAX RETURNS

Please send paper or electronic (email) copies of your 2012 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.

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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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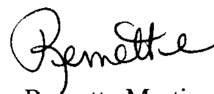
Best regards

Brian Lowder

Clinton Winey

Michael Kinnear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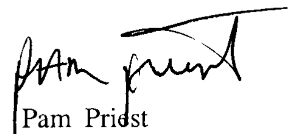
Pam Priest