// BRIAN D. LOWDER, INC.
QUARTERLY NEWSLETTER
Volume 19, Issue 1 April 2016

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FINANCIAL MARKET OVERVIEW

Stocks finished the first quarter of 2016 up slightly. U.S stocks, as measured by the U.S. Total Market Index (VTI) ended up just less than 1% while the Dow Jones Industrial Average was up almost 1.5% during the first quarter. However, the average stock mutual fund was down 0.4%. Not much of a gain, but the financial markets definitely gave us a roller coaster ride.

Overall, U.S. stocks were *down* 10.8% from the January 1st through February 11th and global equities were down 11.3% over the same time period. Over the following 50 days ending on March 31st, stocks rallied back to finish the first quarter with a small gain ranging from 0.97% (U.S. Total Market Index) to 1.49% (Dow Jones Industrial Average).

International stocks posted a negative 2.75% return during the first quarter while emerging markets (small international companies) were up significantly - gaining 6.4% over the past 3 months after falling 17% during 2015.

Value stocks (fairly valued, mature and dividend paying stocks) outperformed growth stocks. We will discuss the implications when *value* stocks outperform *growth* stocks and what it may suggest about stock returns in the future (the NASDAQ stock index, which is dominated by growth stocks, was down 2.75% during the first quarter).

Energy companies and energy mutual funds were up about 5% during the first quarter as the price of oil climbed to over $38 per barrel after breaking below $30 per barrel several months ago. Real estate (REIT's) advanced 5% as well during the first quarter as interest rates declined. After losing 10% of its value in 2015, gold reversed course and jumped 16% during the first quarter making gold the best-performing category during the first quarter.

Fixed income or bonds were up unexpectedly during the first quarter as the economy slowed further than expected. With economic growth slowing again, interest rates actually declined during the first quarter. The positive implication is the Federal Reserve will defer making further rate increases until the economy is stronger.

The following chart displays sample returns of various asset categories during the first quarter of 2016:

1st Qtr. 2016	**Index Return (*includes dividends reinvested*)**
+ 1.49%	**Dow Jones Industrial Average (^DJI)**
+ 1.33%	**Standard & Poor's 500 Index (^GSPC)**
+ 0.97%	**DJ U.S. Total Stock Market (VTI)**
- 2.75%	**NASDAQ (^IXIC)**
+ 0.68%	**Large-company stock-Growth (IWF)**
+ 1.59%	**Large-company stock-Value (IWD)**
+ 0.26%	**Mid-Size Stocks – Growth (IWP)**
+ 3.90%	**Mid-Size Stocks – Value (IWS)**
- 4.60%	**Small-company stock- Growth (IWO)**
+ 1.78%	**Small-company stock- Value (IWN)**
- 2.66%	**International (EFA)**
+ 6.40%	**Emerging Markets (EEM)**
+ 5.10%	**Real Estate Investment Trusts (VNQ)**
	Fixed Income
+ 0.90%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+ 4.80%	**Intermediate U.S. Treasury (IEF)** *(includes appreciation)*
	Alternative Investment Category
+ 15.95%	**Gold (GLD)**

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FINANCIAL MARKET OUTLOOK

In summary, gold was up 16% during the first quarter, interest rates declined, stocks barely posted a positive return, value stocks outperformed growth stocks and volatile stock prices declined more than 10% during the first five weeks of the quarter followed by a 12% increase by quarter end. None of these first quarter returns were expected. Short-term volatility is here to stay for a while, so expect more of the same. The future is simply very uncertain. When gold performs well and value stocks perform better than growth stocks, this may suggest a continuation of lower (below-average) investment returns ahead for stocks.

During periods of average to above-average economic growth, or during times when the economy is just beginning to rebound from a decline, growth company stock prices advance faster and sell for higher multiples than mature and established (value) companies do. Over the past 6 months, growth stocks have not performed well, however, mature and well-established (value) company stock prices are delivering reasonable returns. Slow economic growth favors value companies primarily because their revenues are more predictable, their share prices are reasonable and based on more predictable revenues and earnings.

Future economic growth is the key variable that will influence the direction of future stock price performance and whether any potential price gains are *sustainable.* In our previous newsletter, we discussed how economic growth in the U.S. and around the world remains very weak. The U.S. GDP growth rate (adjusted for inflation) has averaged 2.2% over the past 7 years ranging from -0.24% to 2.73%. The long-term average GDP growth rate is above 3%.

During the first quarter of 2016, the estimated GDP growth rate is a disappointing 0.7% annual rate, which means the economy grew at less than 0.2% during first three months of the year. Weak economic growth, after 7 years of stimulus, is a problem and weak growth will limit any future stock price advances from holding firm. Over the past 5 years, stock prices have already advanced to a level (17 times earnings) that assumes or implies moderate to above-average growth is imminent. But that level of growth hasn't happened and we don't see a realistic catalyst for improvement.

In addition, 2016 is a Presidential election year. Nothing is going to change with regard to economic policy and nothing new to improve the current economic circumstances is going to be proposed or passed into law in 2016. So, the financial markets are "on their own" until 2017.

As we move closer to the election, income tax policy and government subsidies (health care, low-income financial assistance, food stamps, rent subsidies, etc.) will have a significant impact on the future direction of financial markets. Let's begin this discussion with the assumption that everyone – regardless of political affiliation, agrees with and approves of providing financial assistance for the unemployed, low-income and special needs families. It's important to start with this assumption in order to remove politics and opinions regarding the two major parties and instead, **focus on** how the *financial markets* may react to the two opposing approaches to income taxation and financial assistance/subsidy policies.

Generally, increasing income tax rates during a sluggish or declining economy is not helpful to the financial markets. Simply be aware of the implications on the financial market performance when taxes are increased. On the following page are the current income tax rates, capital gains tax rate and the additional net investment income tax on taxpayers with adjusted gross income exceeding 250K per year as well as proposals by the three leading presidential candidates:

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(Assumes married)	Currently	Trump	Cruz	Clinton
Income Tax Rates	10%-39.6%	0%-25%	10% flat	10%-43.6%
Capital Gain Rate	0%-20%	0%-20%	10%	20%-39.6%
Net Investment income	3.8%	unknown	n/a	3.8%

Simply stated, any expenses or costs that are diverted or taken away from companies and employee compensation (through taxation) beyond what are necessary and effective….. do not benefit "natural" economic growth. Income taxes and government spending are the two primary methods to collect and redistribute monies for the overall benefit and well-being of a democratic society. Granted, some of the monies collected and spent by the government help overall spending and therefore economic growth, but much of the tax collection is used inefficiently or given away. Only the amount collected and how efficiently the funds are spent are subject to debate – meaning the government spends the money, not you.

Presently, we are in the seventh year of a very slow economic recovery from the depths of the financial crisis and stock market decline of 2008. Since that time, interest rates were reduced to a 65-year low through the actions of the Federal Reserve and our government has consistently spent more money than it brings in – resulting in the highest amount of debt this country has ever borrowed and owed in its history ($19 Trillion). To some extent, it makes sense to *temporarily* borrow and spend more than the country earns in order to kick-start the economy.

Now, we are way past the time to end the artificial manipulations (low interest rates and excessive debt) and now the economy and financial markets must move forward on their own. Here lies the problem. Economic growth in the U.S. and around the world is still well-below average and weakening. Yet the overall price or value of stocks today is still hovering at a level that implies or assumes higher economic growth is imminent. If higher economic growth – at least back to the long-term average of around 3%, doesn't materialize very soon, then stock prices must adjust downward to a level that is consistent with a very slow growth economy. This is our biggest concern – stocks are **already** valued at a level that assumes average to above-average economic growth is imminent.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

Over the short-term, anything can happen. Since August of 2015 when we reduced our clients' allocation to stocks, the overall stock market is still down 2.5% and that is after the recent 12% surge in prices since mid-February 2016. We won't even attempt to suggest what the financial markets may do over the next quarter. Our focus is whether or not our clients' existing and additional investment selections will hold their values. Our best judgment is that overall stock prices will not hold at this level, especially during this election year.

We are not expecting a big decline similar to the 38% drop in stock prices in 2008 or the 24% decline in 2002. A very slow growing or weak economy is not a bad place to be. The problem is overall stock prices are at a level that is too expensive given the slow-growth environment. The analogy would be buying stocks at current prices would be the same as paying $15 for a hamburger. A 10% to 18% decline in overall stock prices would be a level that is "fair" in our view. If economic growth accelerates to a 3% annualized rate, we would love to be wrong and then re-establish our former stock asset allocation to 65% to 85% of total assets.

Our plan is to be very selective and continue adding specific and conservative investment selections (rather than index funds that hold all stocks) only when their prices are reasonable. Most recently, we added energy and water stocks to client portfolios as their prices were relatively "cheap" and below the prices of growth stocks

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like technology and healthcare. Other individual companies and specific sectors of the economy may present buying opportunities in the future.

At this time, we expect to maintain the current asset allocation and investment selections for most of our clients. Implementing all investment recommendations for new clients (new accounts over the past year) may take longer than expected. Additional investment purchases may be implemented during market weaknesses. We will simply have to use our judgment. Any purchase suggestions or recommendations that we could identify at this time could change dramatically; therefore, **we will not include any purchase recommendations on the blue sheets you are accustomed to receiving at quarter-end.**

COPIES OF 2015 INCOME TAX RETURNS

The due date for 2015 income tax returns is April 18, 2016. Please request from your income tax preparer to send paper or electronic (email) copies of your 2015 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.

ANNOUNCEMENTS

Brian Lowder was married to Tamara Shreve on March 19, 2016. Brian's daughter, Melissa and son, Andrew were present along with Tamara's daughter Alex and her husband Tyler. Two days later, they moved into a new home in Poway, California.

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Best Regards

Brian Lowder   Clinton Winey   Michael Kinnear   Jennifer Finley   Pam Priest