# BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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## Inside This Issue



## Financial Market Overview

After a modest gain during the first half of 2018, the overall U.S. stock market finished up over 7% during the third quarter, and the stock market is up about 10% this year through September 30, 2018. The stock market advance was dominated by superior performance of large-company U.S. stocks and technology shares. The Dow Jones Industrial average was up 9% during the third quarter compared to about 7% for the overall or broad U.S. stock market. International stocks are down 1.3% year-to-date and emerging market stocks are down 8.5%.

Healthcare and the Technology/Internet sectors were top performing stock categories during the third quarter. On average, the healthcare sector was up 14% and technology sector was up about 8%. The NASDAQ stock index, loaded with the biggest technology stock companies, was up over 16% during the first 9 months of 2018.

Growth stocks continued to outperform value stocks during all three quarters of this year. U.S. small-company growth stocks were up modestly during the third quarter but are up 15% year-to-date as investors are beginning to anticipate faster growth from smaller corporations compared to large-company stocks as this stock market rally continues.

Real estate (REIT's) performance continues to lag other growth asset categories (stocks) as rising interest rates increase the cost of servicing mortgage debt. REIT performance remains nearly flat over the first nine months of 2018.

Gold prices were down almost 5% during the third quarter after falling nearly 6% during the second quarter and emerging markets (smaller-country international stock indexes) fell 8.5% during the third quarter. Chinese stocks are down 14% year to-to-date and several emerging market countries such as Argentina and Turkey are experiencing significant declines in their currency values.

Fixed income or bond prices continue to fall modestly in reaction to more gradual increases in interest rates with additional small increases expected for the foreseeable future. Short-term Treasury bond returns ended the second quarter with a fractional gain (+0.12%) and intermediate-term Treasury bonds continued to post modest declines (-0.73%). However, the average bond mutual fund is down 3% and even more for long-term bond mutual funds.

The 10-year U.S Treasury Note started the year paying 2.4% interest, the yield rose to 2.85% by the end of the second quarter, and the yield on new 10-year Treasuries was slightly over 3% by the end of the third quarter. As interest rates continue to rise, bond prices or values of previously issued bonds that pay lower interest fall as interest rates rise. Over the first nine months of 2018, the decline in bond values have exceeded the interest income resulting in a negative combined or total return on bonds ranging from -1% to -5%. Not exactly what conservative fixed income investors were expecting during the first nine months of 2018.

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The following chart displays sample returns of various asset categories during the third quarter of 2018 and year-to-date:

| Yr-To-Date 2018 | 3rd Qtr. 2018 | Index Return (*includes dividends reinvested*) |
|---|---|---|
| + 7.04% | + 9.01% | **Dow Jones Industrial Average** (^DJI) |
| + 10.37% | + 7.65% | **Standard & Poor's 500 Index** (^GSPC) |
| + 10.47% | + 7.08% | **DJ U.S. Total Stock Market** (VTI) |
| + 16.82% | + 9.10% | **Large-company stock-Growth** (IWF) |
| + 3.65% | + 5.59% | **Large-company stock-Value** (IWD) |
| + 13.21% | + 7.53% | **Mid-Size Stocks – Growth** (IWP) |
| + 2.91% | + 3.24% | **Mid-Size Stocks – Value** (IWS) |
| + 15.71% | + 5.57% | **Small-company stock- Growth** (IWO) |
| + 7.02% | + 1.67% | **Small-company stock- Value** (IWN) |
| - 1.38% | + 1.52% | **International** (EFA) |
| - 8.51% | - 0.95% | **Emerging Markets** (EEM) |
| + 0.47% | + 0.45% | **Real Estate Investment Trusts** (VNQ) |
| | | *Fixed Income* |
| + 0.13% | + 0.12% | **Short-term U.S. Treasury** (SHY) *(includes appreciation)* |
| - 2.75% | - 0.73% | **Intermediate U.S. Treasury** (IEF) *(includes appreciation)* |
| | | *Alternative Investment Category* |
| - 8.81% | - 4.96% | **Gold** (GLD) |

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

## FINANCIAL MARKET OUTLOOK

This section of our quarterly newsletter will be brief. The financial markets outlook has not changed since our previous newsletter. The primary driver of the advancing stock market – better economic growth – remains intact and solidly on course. In general, the same can be said worldwide, although a few small countries (Turkey, Argentina, etc.) have debt and deficit problems. The deficit problem of smaller countries and the "trade or tariff war", coupled with better economic growth in the U.S. has resulted in a strengthening of the U.S. dollar.

The U.S. dollar's strength and other factors are causing China, Russia, Turkey and a few other country's currencies and/or stock markets to fall 4%-14% so far this year. While deficits and debt problems require much more time to correct, once U.S. Trade Agreements have been restructured with Europe, China, and others, much of the currency and stock market declines of larger countries like Germany and China will likely subside.

During the third quarter, the U.S. has successfully negotiated new trade agreements with Mexico and Canada. As stated in our previous newsletter, the probability of successfully agreeing on new trade agreements will occur simply because every single country would be negatively impacted if everyone holds their ground and this could lead to crippling economies. Second, every country's leadership knows this fact. *Everyone loses*. That's why the probability of this scenario occurring beyond a short period of time is smaller than the probability of reaching new agreements with most, if not all, countries.

The recent strength of the U.S. Dollar has, in part, resulted in a considerable decline in stock market values of several emerging (smaller countries) markets. It's likely that the emerging markets stock market declines are temporary, but we don't know how long the "temporary" will be. This is the primary reason why we reduced or eliminated our emerging market stock positions in client portfolios about one month ago.

It's unfortunate because this category, emerging markets, has the most gain/upside potential over the next several years, once the tariff or trade war disagreements are successfully renegotiated, solved, or accepted as is. Uncertainty will be removed and uncertainty is what causes volatility and sudden stock market declines. Further, trade wars negatively impact each country's economic growth and trade wars are not a positive force for any country, but the U.S. is expected to better withstand a sharp escalation in the trade spat than many other countries, such as China.

Another very short-term issue that can cause sudden financial market changes and belongs in the "everything else" category is mid-term elections in the U.S. Although this subject is overblown and frequently discussed in the news, we can make two observations. First, the mid-term elections are about one month away, so any potential adverse or sudden financial market

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reaction that could possibly occur is going to be known very soon. Second, the U.S. stock market is presently ignoring this issue completely as evidenced by continual new stock market highs.

## INVESTMENT OUTLOOK AND RECOMMENDATIONS

As stated earlier, 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.

At this time, altering our exposure to U.S. and larger foreign country stocks in client portfolios in reaction to the worst-case scenarios of a trade war with China and or Europe does not seem prudent. The changes we have been making this year will continue. We have made some changes recently and clients can expect that we will continue adding to our U.S stock exposure as well as continuing to purchase individual bonds (rather than bond mutual funds) and short-term certificates of deposits for the fixed income portion of client portfolios.

We expect continued modest interest rate increases over the near-term. It's a logical expectation. With continued economic growth in the 3% to 4% range, interest rates should not be near historic lows. Lowering interest rates is a "normal" reaction to counter a slow or declining economy – such as the circumstances we experienced from 2008 through 2016. As the economy finally improves, interest rates should move toward a "normal" range. If interest rates are not increased, the eventual outcome will be higher inflation. High inflation rates eventually lead to declining economic growth.

Lastly, we expect the stock market rally to broaden. For much of 2018, the stock market advance has been dominated by about 12 to 15 big-company stocks – primarily in the tech/internet sector.

Small-company and "Value" stocks (big-name established companies) are just beginning to advance higher and appear attractive compared to the already higher priced technology sector. As economic growth and rising corporate earnings continue, we expect the stock market advance to broaden out beyond the large-company technology sector. Small-company stocks and large established companies are beginning to move up.

We will continue implementing our Buy recommendations periodically as we have in the past. We view the probability of a rising stock market ***1-2 years from now*** as being higher than the probability of lower stock market valuations. 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.

## IDENTITY THEFT AND DATA BREACH UPDATE

On the anniversary of the historic Equifax data breach, we thought it might be a great time to give you an update on what has transpired since our previous article.

Hard to believe, but one year has passed since we wrote about this unfortunate event. However, two important things have transpired. First your free (complimentary) 1 year of credit monitoring has likely expired. Secondly, there is no longer a fee to lock or unlock your credit. In the past, there was a charge of approximately $10 for each time you wanted to lock or unlock your credit. This change was part of a new law that was passed by Congress and is now in effect.

We wanted to again provide you with the credit reporting agencies and a brief description of how to lock your credit. Locking (or freezing) your credit report restricts access to your credit report which makes it more difficult for identity thieves to open new credit in your name. Creditors need to see your credit before they establish new accounts. If your credit is locked, they will not open a new account until you unlock your credit report.

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How to freeze your credit with each of the nationwide credit reporting agencies:

1 ) **Equifax** – 1-888-548-7878 or go to www.equifax.com and scroll down to the bottom of the page and select "place a security freeze on my reports" submit the information required and you will be provided with a PDF that contains a PIN that will be needed to unlock your credit report in the future.

2) **Experian** – 1-888-397-3742 or go to www.experian.com and scroll down to the bottom of the page and select "security freeze" then select "add a security freeze" submit the information requested and a PIN will be mailed to you by regular mail.

3) **TransUnion** – 1-888-909-8872 or go to www.transunion.com click on the Credit Help tab at the top of the page. Once the tab is open, select add freeze. You will be provided a PIN.

Please refer to our website for the original article which is located at www.bdlowder.com in the newsletter section.

## ANNOUNCEMENTS

After nearly 19 years with BDL, Inc. Clint Winey (and his wife) have both chosen to begin retirement early! Clint will formally retire and leave the firm at the end of April, 2019. All of us at BDL, Inc. and clients of the firm appreciate Clint's expertise and devotion over the years and wish him and his wife Tanya-Sue the best in their exciting years of leisure and travel in the years ahead.

## Contact Us

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Best Regards