BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

The U.S. stock market started the 4th quarter 2018 with a 10% increase since January 1st. The quick and substantial decline in the U.S. stock market during October and December resulted in the worst annual stock market decline since 2008. Starting from a 10% gain going into the fourth quarter, U.S stocks finished the year with a **negative** 6% return. While there were four larger negative annual stock market returns over the past 10 years, (2000, 2001, 2002, 2008), this one was sudden, reversing course from 10% gain year-to-date to a 6% loss by the end of the year. Stocks were down about 10% during the month of December alone.

The very same stocks (Amazon, Netflix, Facebook, Google, Apple and other "tech" stocks) that significantly outperformed the overall stock market during the first nine months of the year, suffered the largest declines during the fourth quarter. This same lesson seems to come around every 10 to 15 years. Remember the late 1990's when any stock that was considered tech, computer or information/internet significantly outperformed others for several years. The valuations made no common sense at all, yet the higher the prices climbed, the more investors kept buying. And then of course ….. you know the ending. Remember Bitcoin – the virtual currency that climbed to over $20,000 – it lost over 80% of its value during 2018.

Now, investors are worried and heading into 2019 with a sense of caution and wariness. Big tech stocks lost all of their gains and more from the first three months of the year and energy stocks dropped more than 20% after the price per barrel of oil dropped from over $70 per barrel on October 1, 2018 to under $50 per barrel by year-end.

Growth stocks continued to outperform value stocks during all four quarters of 2018. Large-company stocks outperformed mid-size companies and small company stocks performed the worst after leading the pack during the first three quarters of 2018. Overall, stocks were down 9% to 20% during the fourth quarter depending on company size. For the entire 2018 calendar year, stocks were down 2% to 8% with large-company growth stocks leading the way over smaller companies.

Real estate (REIT's) performance was negative as well – about the same negative 6% annual return as U.S stocks but with much less volatility. International and emerging market stocks (smaller-country international stock indexes) had the worst performance – down 14%-16% for the year. Chinese stocks were down 25% in 2018.

Gold prices had positive performance during the fourth quarter as the "fear factor" with stocks usually has a positive impact on precious metal prices. Gold was up 7.5% during the fourth quarter, but still down nearly 2% for the 2018 calendar year.

Fixed income or bond prices recovered slightly during the fourth quarter. When stock prices fall precipitously and investors run for cover in safer fixed income or bonds, that surge in buying demand causes interest rates to fall temporarily (and bond prices to rise). Short-term Treasury bond returns ended the fourth quarter with a 1.3% gain and intermediate-term Treasury bonds posted a 3.86% return. Both had 1%-2% gains for calendar year 2018. However, the average bond mutual fund posted slightly negative performance.

The 10-year U.S Treasury Note started the 2018 year paying 2.4% interest, the yield rose to 2.85% by the end of the second quarter, was slightly over 3% by the end of the third quarter and then fell to 2.7% by year-end.

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

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Calendar Yr. 2018	**4th Qtr. 2018**	**Index Return (*includes dividends reinvested*)**
- 5.63%	- 11.83%	**Dow Jones Industrial Average (^DJI)**
- 4.57%	- 13.53%	**Standard & Poor's 500 Index (^GSPC)**
- 5.23%	- 14.22%	**DJ U.S. Total Stock Market (VTI)**
- 1.67%	- 15.82%	**Large-company stock-Growth (IWF)**
- 8.45%	- 11.67%	**Large-company stock-Value (IWD)**
- 4.88%	- 15.98%	**Mid-Size Stocks – Growth (IWP)**
- 12.43%	- 14.91%	**Mid-Size Stocks – Value (IWS)**
- 9.43%	- 21.73%	**Small-company stock- Growth (IWO)**
- 13.01%	- 18.71%	**Small-company stock- Value (IWN)**
- 13.82%	- 13.20%	**International (EFA)**
- 15.31%	- 7.62%	**Emerging Markets (EEM)**
- 6.02%	- 6.47%	**Real Estate Investment Trusts (VNQ)**
		Fixed Income
+ 1.47%	+ 1.30%	**Short-term U.S. Treasury (SHY)** *(includes appreciation)*
+ 0.99%	+ 3.86%	**Intermediate U.S. Treasury(IEF)** *(includes appreciation)*
		Alternative Investment Category
- 1.94%	+ 7.53%	**Gold (GLD)**

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

FINANCIAL MARKET OUTLOOK

As we have stated before, the primary driver of consistent stock market performance is economic growth. This observation regarding the status or health of current and future economic growth should be applied to the proper perspective: "a long-distance race – not a hundred-yard dash".

In 2017, after the 2016 presidential election, the economy was still in very weak shape. Yet, the stock market advanced 20% that year in anticipation of renewed economic growth. We experienced quite a lot of upside volatility, yet most investors were willing to accept and go along with this volatility presumably because it was on the upside. In 2018, the overall U.S. stock market was up over 8% through September, and then suddenly lost nearly all of that gain in October. During the month of November, the overall stock market performance was very volatile but ended the month where it started, and then came December with the overall stock market down 9%.

Leading into Christmas holiday week, U.S. stocks declined sharply 4 days in a row just before Christmas, only to climb a record-breaking 1,086 points (Dow Jones) the day after Christmas. The day following this record-breaking one-day advance, stocks were down over 611 points during the first half of the day and in the last 90 minutes of the trading day, the market ended up 260 points or 1%.

Remember Bitcoin? It sure gathered a lot of attention on its astonishing advance in 2017. In 2018, Bitcoin has lost over 80% of its value. Many stories were told about how much individuals or friends made through quick trading profits on the way up in 2017, but no stories from anyone except for the sound of crickets on the way down in 2018.

This is pure short-term trading volatility. Some of the obvious explanations for daily market volatility are political events (daily news, general negativity, White House staff resignations and replacements, midterm elections, tariff negotiations/conflict, government shut down, lawsuits, etc.) along with some other indicators that can actually affect economic growth such as tax code changes, rising interest rates, corporate earnings growth, unemployment rate and more.

One significant and lesser-known factor causing increased market volatility is high-frequency algorithm-based trading (program trading). Algorithm trading is an unemotional and (computer) automated method used by large financial institutions and short-term traders to execute very large trades based on volume of trades, price, time, and even words said or written by the President, Federal Reserve Board members and others. It's all pre-programmed. No human judgment or broad-based evaluation of market conditions is considered.

This kind of automated trading can and does cause extreme daily volatility – especially recently. The volatile decline 4 days leading into the Christmas week, the 1,086-point increase (5%) on the day after Christmas and the over 850-point reversal from negative to positive territory on December 27th should tell you that it wasn't the general public (investors) or the majority of portfolio managers that were making these trades.

Clients and investors need to consider a little perspective here. Short-term and algorithmic trading is not the same type of race most investors should be participating in and paying attention to. Short-term trading is a dash – a very short burst of activity. Investors are long-distance runners. Don't get caught participating or making decisions based on someone else's race.

Admittedly, it isn't easy or comfortable trying to discern whether any of the daily news stories or volatile financial market movements will have a lasting effect and no one enjoys seeing their account values drop by the tens of thousands of dollars at the end of the month. But reacting to

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these volatile trading days will result in your making up to a dozen or more changes each year and the probability of success or failure is about 50% at best.

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 not evenly distributed and China is probably experiencing the biggest drop of all large-country economies – yet their economic growth rate is higher than the United States. U.S. economic growth was about 3.4% in 2018 and 2019 growth should be about a 2.5% to 3.5% annualized rate – which is right in the middle of the long-term average. We do not plan to make any significant changes to client portfolios at this time. As uncomfortable as it may seem, stock values are much more reasonable now compared to one year ago and while the economy will not likely grow as fast after the initial spurt in 2018, we are in the best economic environment since 2009.

We did make some changes to client portfolios – primarily reductions in stock exposure in December for two reasons. One, client portfolios were already allocated near or beyond "normal" stock exposure due to the 20% increase in stocks in 2017. In addition, many client accounts had realized (taxable) capital gains to report from profits earned on sales of stocks earlier in 2018. It makes sense, particularly with the recent decline in stock values near the end of the year, to sell those positions with losses to offset the capital gains earned earlier in the year. The cash proceeds from these sales can be reinvested at any time and the loss can help reduce or eliminate any taxable gains incurred from profitable sales earlier in the year.

A few clients have called and made thoughtful and rational decisions directing us to sell some stock holdings before year-end. Besides the concern for recent downside volatility and the opportunity for making tax-loss sells to offset earlier gains, their overall percentage stock exposure was still at or beyond their normal or target allocation to stocks. These are rational decisions and adjustments – not significant changes due to worst-case scenario concerns.

For clients with new investment accounts holding primarily cash, we expect to invest those funds into our recommended stock, bond, and real estate holdings ratably over the next 8 months. We will continue purchasing individual bonds (rather than bond mutual funds) and short-term certificates of deposits for the fixed income portion of client portfolios.

We expect one or two modest interest rate increases over the 2019 calendar year. It's a logical expectation. With continued economic growth in the 2.5% to 3.5% range, interest rates should be higher (starting from a 65-year low in 2016) and closer to the mid-range - not near historic lows.

We expect the stock market to recover. 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.

INCOME TAX CHANGES FOR 2019

The threshold for deducting **Medical Expenses** jumps from 7.5% of *adjusted gross income* to 10% of *adjusted gross income.* A higher threshold means a lower medical expense deduction assuming your adjusted gross income and medical expenses are about the same in 2019 verses 2018.

The 2019 **Standard deduction** moves up slightly from $24,000 (married couple) to $24,400 PLUS an additional $1,300 for each spouse age 65 or older. As before, if your total itemized deductions exceed the standard deduction, you can use whichever is higher. Single taxpayers' standard deduction increases $200 from $12,000 to $12,200 PLUS an additional $1,300 if age 65 or older.

Alimony/Spousal Support paid under post-2018 divorce agreements is no longer deductible and ex-spouses are not taxed on spousal support they receive under post 2018 agreements. Older (pre-2019) divorce pacts can be modified to follow the new tax rules if both parties agree and they modify the divorce agreement in 2019 or later to specifically adopt the changes.

Home Mortgage Interest deduction is limited to interest paid on up to $750,000 of *acquisition* (meaning debt incurred to buy a residence) debt that is secured by your primary home or a single secondary home – the old rule was interest deductible up to 1 million of mortgage debt. This new rule/limit applies to all mortgage debt incurred AFTER Dec. 15, 2017. Homes purchased before this date are grandfathered in and still receive the 1-million-dollar mortgage debt limit – the same old rule applies to refinancing mortgage debt prior to Dec. 16, 2017 up to the old loan amount.

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The interest deduction treatment for home equity loans (equity lines of credit secured by primary residence) and refinance payout loans is more complicated. Before 2018, you could use cash from equity lines of credit or refinance loans to pay off credit cards, buy autos, etc. and still deduct the interest on up to $100,000 of the debt. Not any longer! The interest is NOT deductible for these loans/lines of credit for any new debt or existing debt from prior years. Note, you can still deduct the mortgage interest if the loan/equity line of credit was used to buy, build, or substantially improve a home.

Lifetime Estate and Gift tax exemptions for 2019 RISES to $11,400,000 for individuals and $22,800,000 for couples. Over your lifetime and at death the combined amounts stated above can be gifted or passed on to beneficiaries at death before the 40% estate tax or gift tax applies. The annual amount an individual can give to any child, grandchild or any other person continues to be $15,000 per donor per year without having to make any filings, pay gift tax, or use any of the above lifetime exemption amounts.

Dollar Limits on Retirement Plan Contributions are higher in 2019. The maximum 401(k), 403(b) and 457 retirement plan contribution increase by $1,000 to $19,000 total. Individuals born before 1970 can contribute an additional $6,000 (total $25,000). The 2019 pay in limit for regular IRAs and Roth IRAs increases from $5,500 per year to $6,000. Individuals who are age 50 and older in 2019 can contribute an additional $1,000.

The 6.2% Social Security Payroll tax now applies to your first $132,900 of wages – up from $128,400. **1.45% Medicare tax remains the same** on all wages.

Expansion of College 529 Plan savings accounts now allows tax-free withdrawals/distributions of up to $10,000 per years to help pay for tuition for Kindergarten thru High School costs – prior rules only allowed distributions for college tuition and other qualified expenses (on-campus dorm, books, etc.)

REPEAT ANNOUNCEMENTS

As announced in our last quarterly newsletter, after nearly 19 years with BDL, Inc. Clint Winey has chosen to begin retirement early! Clint will formally retire and leave the firm at the end of April, 2019.

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Best Regards

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