BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

Another unexpected and lopsided quarterly performance by the financial markets during the first quarter of 2021. The three primary stock market indexes (Dow, S&P and Total Market) were up 6% to 7.75% during the first quarter, but the "participation" of stocks going up was NOT broad-based. Growth stocks were the primary drivers of performance last year, however, during the first quarter of 2021, growth stocks were flat or negative.

The "traditional" big name companies that are NOT involved in technology and work-from-home services (i.e. excluding Peloton, Game stocks, Netflix, Zoom, etc.) are finally catching fire. These "Value" stocks were up for a second quarter in a row – up 10% to 20% during the first quarter alone. As hinted in our previous newsletter, the rotation has begun. The economy is coming back to life and the everyday companies that were labeled "boring" and struggling are now on the move.

During the first quarter, "Value" stocks of all sizes large, midsize and small company, performed best. Large Value companies were up over 10%, mid-size value stocks up nearly 13% and small-company stocks up a whopping 21% during the first quarter. Refer to the chart below: For the second quarter in a row, value stocks are on fire. This rotation away from growth to value stocks is good news and makes sense. We are coming out of the pandemic shutdown soon and the expectation is value or traditional/everyday companies will come back to life, not just a small group of darling stocks.

The technology stock index was up only 2.4% compared to the overall 6% return on the total stock market. International stocks delivered slightly lower returns compared to the U.S. – up about 4% during the first quarter. Emerging markets (smaller-country international stock indexes) had slightly lower returns as well – up about 3.25%. Once again, energy stocks had a second spectacular quarter in a row – up nearly 30% during the first quarter after a nearly 25% return during the fourth quarter.
Investment real estate performed well – up 8% during the first quarter, and residential real estate prices soared. Water utility stock performance varied – some were up about 4% and others down almost 4% during the first quarter. The price of Gold was down 10% during the first quarter compared to a 25% gain in 2020.

Fixed income or bond prices were down during the first quarter in response to rising interest rates. Short-term Treasuries were down 0.16% while intermediate Treasuries fell nearly 7% after the rates on 10-year Treasuries jumped from 0.6% to 1.4% during the first quarter.

The following chart displays sample returns of various asset categories during the first quarter of 2020 and calendar year-to-date:

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Year to Date 2020	1st Qtr. 2020	Index Return (*includes dividends reinvested*)
+ 7.76%	+ 7.76%	Dow Jones Industrial Average (^DJI)
+ 6.00%	+ 6.00%	Standard & Poor's 500 Index (^GSPC)
+ 6.19%	+ 6.19%	DJ U.S. Total Stock Market (VTI)
+ 0.79%	+ 0.79%	Large-company stock-Growth (IWF)
+10.84%	+10.84%	Large-company stock-Value (IWD)
- 0.57%	- 0.57%	Mid-Size Stocks – Growth (IWP)
+12.73%	+12.73%	Mid-Size Stocks – Value (IWS)
+ 4.88%	+ 4.88%	Small-company stock- Growth (IWO)
+21.02%	+21.02%	Small-company stock- Value (IWN)
+ 3.99%	+ 3.99%	International (EFA)
+ 3.23%	+ 3.23%	Emerging Markets (EEM)
+ 8.16%	+ 8.16%	Real Estate Investment Trusts (VNQ)
		Fixed Income (includes appreciation)
- 0.16%	- 0.16%	Short-term U.S. Treasury (SHY)
- 5.85%	- 5.85%	Intermediate U.S. Treasury (IEF)
		Alternative Investment Category
-10.32%	-10.32%	Gold (GLD)

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

FINANCIAL MARKET OUTLOOK

Exactly one year ago, the COVID-19 pandemic shut down our economy, schools and just about everything else. Over 20 million people became unemployed and the stock market tumbled 35% over a six-week period. Our GDP (gross domestic product) tumbled over 10% in 2020 and is only off target now by 1.2%. The consensus estimates for the first quarter 2021 is about 4%.

With the lifting of most COVID-19 restrictions, America could be on the cusp of a new beginning. The anticipation of getting back to normal in our personal lives as well as corporate America is THE REASON why the stock market has risen so much since March 2020. Do not assume or suggest that the stock market will go up much higher once all restrictions are lifted and students are back in school. The stock market is an anticipatory machine. It has ALREADY priced that expectation into the market. Now, that expectation of renewed economic growth must progress on a timely basis in order for the stock market to hold on to its gains and continue to advance.

The combination of *trillions* of dollars of fiscal stimulus (this means more U.S. debt), ultra-low interest rates and a newfound sense of life coming back to "normal" means the U.S. economy in the coming months will be unlike any surge this country has ever experienced in over 50 years. Growth will be swift along with eventual *higher inflation and higher interest rates.* This coming environment won't be easy for investors to navigate. The high-flying tech stocks and companies that provide stay-at-home products and services will not repeat their stellar recent performance.

The coming rebound in economically sensitive stocks will take the stage away from last year's hot performers. As economic activity resumes, consumer spending should provide a big boost. Evidence supporting this expectation can already be seen – the first quarter stock performance for "Value" stocks was stellar – up 10% to 20%.

The biggest concern is a combination of the following: **higher interest and inflation rates**, an enormous amount of **deficit spending** (our government is spending 3.4 trillion more than it has), and whether or not the Administration and Congress can accomplish any **progress *on a timely basis.*** The **biggest concern is the proposed *higher tax rates* in multiple areas.**

The new Administration is beginning to reveal how it expects to pay for all the new programs, infrastructure spending, student loan forgiveness and more:

1) **Increase corporate tax rates** from 21% to 28% which amounts to a 33% increase.
2) Raise the top personal income tax bracket from 37% to 39.6% - a 7% increase.
3) **Raise the capital gains tax rate**. Currently, when investors sell anything held for a year or longer, the gain or appreciation is taxed at lower capital gains tax rates. The capital gains tax rates are 0% for investors with taxable income below $53,600, a 15% rate if taxable income is between $53,601 and $469,050 and 20% for taxable incomes above $469,051. Biden has proposed raising the capital gains tax rate from 20% to 39.7%

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for taxpayers who earn more than 1 million per year in taxable income - basically double the current highest rate.

4) **Eliminate the step-up in cost basis when someone dies** with more than a 1-million-dollar estate. Currently, when someone dies **all of their assets** receive a step-up in cost basis as of the date of death. This means everything a deceased person owns (home, real estate stocks, mutual funds etc.) receives a new cost basis equal to the fair market value on the date of death. Essentially it means your new "purchase price" on all assets is the value on the date of death. This "step-up" is wonderful for a surviving spouse or other family members because all of the gains built-up over time are erased. When assets are sold shortly after death, there is very little or no gain or loss when assets are sold. The rationale is: You pay taxes on income earned, and then you invest this money into assets and pay taxes on any income earned throughout your lifetime. Why should heirs have to pay taxes on a home sale, or sale of a business or farm etc. just because someone dies? In California, many 3-4-bedroom homes easily sell for more than 1 million dollars. It seems to many that the 1-million-dollar threshold is very low, especially in cities and states where even a simple 2500 square foot home can easily sell for a million dollars or more. Critics ask why should a surviving spouse or family member have to pay taxes on the sale of a home. Further, under current law, anyone who dies with a total estate value worth LESS THAN 11.7 million will not be subject to **estate taxes. The Estate tax rate quickly reaches 40% on an estate worth 12.7 million.**

In summary, it is much easier to "justify" or get consensus on taxing the wealthy a lot more because 90%-95% of the American population are not in the highest income tax brackets nor do they have an estate worth 1 million dollars or more. So, getting "approval" or support from the general population is an easy sell. The government will give you …. You name it, free college, eliminate student loan, free healthcare, etc. by taxing the top 5%-10% of the population at a higher rate.

This is certainly one way to do it and the "wealthy" should and already do pay proportionately more income taxes than everyone else. *But, what most people need to be told or explained is when taxes are* ***suddenly and dramatically*** *increased at these much higher rates and amounts, those "wealthy" people are the ones who own the companies you would love to work for. The incentive for business owners to keep growing and hiring more workers is diminished when taxes are increased suddenly and dramatically. In fact, the opposite occurs – business owners make their company smaller, leaner and with less employees.* The net result is smaller and leaner companies with less jobs and even more people dependent on the government to survive. Think about it. Why should someone grow their business and then be subject to a 28% corporate tax on net income, and then their salary is subject to a 39.7% income tax rate, and then when they die, a 40% estate tax rate on everything they own valued above 11.7 million or under the new Administration a 1-million-dollar threshold.

Didn't we just go through this scenario/debate over the past 5 years? How do we stop companies like Microsoft, Apple, Ford Motor, steel companies etc from closing plants in America and opening plants overseas? The answer was to change (lower) the corporate income tax rates to a level that is the same and competitive with other countries so businesses will stay in America. The corporate tax rates around the world range between 15% and 25%. The U.S. corporate income tax rate was reduced to 21% and companies no longer had the financial incentive to close plants here and re-open abroad.

My point here is to provide some insight or cause and effect of the impact of raising personal, corporate, capital gains and other tax rates at the same time this country is on the doorstep of getting out of a business contraction. Further, we are certain to have higher U.S deficits, and higher interest and inflation rates very soon. This is where we are

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heading and there is a new kind of uncertainty that the financial markets will have to respond to.

There is a fair and proper balance on this issue of higher tax rates and the pendulum does swing in both directions over time (higher tax rates to lower and then back the other way). But, investors need to understand both sides of this issue and the likely impact of the sudden and dramatic increases in tax rates on our economy and employment growth.

As an investment adviser and you as an investor – we need to understand the complexities we are about to face. Success in this transition is dependent upon progress toward tax rates that are reasonable and our leadership cannot afford to be stumbling and arguing along the way.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

The stock market will continue exhibiting more daily and weekly volatility, but the reasons for the uncertainty have changed. Attention is now refocusing away from COVID, political elections and a shutdown economy to an accelerating economy, inevitable rising interest and inflation rates, and higher tax rates. The stock market has already jumped to record levels under the expectation that economic growth can only get better than where we were just one year ago. Any delays and poor/slow execution will adversely affect the "already priced in" expectations.

We will maintain our current asset allocation (proportional exposure to stocks, fixed income, etc.) for most client portfolios. New accounts or others with high cash balances will be invested ratably over the next 4 months. We have already decided to add or increase exposure to sectors that were unattractive and reduced/removed in the recent past, but appear favorable in the months ahead. Examples are metals, (gold/silver etc.), inflation-protected Treasuries, "Value" stocks and International stocks.

One of our biggest concerns is now a reality. Rising interest rates result in negative returns on the usually safe portion of our clients' portfolios – fixed income or bond investments. Rising interest rates cause bond *values* to drop and that drop in value can easily exceed the current low interest income paid on bonds. Declining bond VALUES combined with very low interest income results a combined negative total return for the year. **Expect the fixed income portion of your portfolio to provide 1% or less in the year(s) ahead.**

We are continuing to deal with this low-interest rate environment by moving some funds into high-quality and established VALUE stocks that pay 2% to 5% dividends. Yes, the safety isn't the same as a guaranteed Treasury or CD, but the modest additional risk is worth receiving 2%-5% dividend income compared to less than 1% for Treasuries and CD's.

Value stocks – meaning recognizable company names that have been around for many years with established products – have not kept pace with growth stocks until this year. This category is much safer than growth and tech stocks plus many of these companies pay 2% to 5% dividend income. This category is also very attractive from a future price gain perspective, is fairly valued and a good source to pursue higher income that clients are losing in the low interest rate fixed income category.

IRA CONSIDERATIONS

Anyone can make a regular IRA contribution in 2021 as long as they have employment income equal to or greater than the amount contributed to the IRA. The maximum IRA contribution is **$6,000 plus an additional $1,000** for those age 50 or older. However, in order for the IRA contribution to be **deductible**, there are income limitations according to your income tax filing

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status and whether you are covered by an employer retirement plan as follows: (***Note "Single and "Head of Household" are the same for Regular IRA limits below and Single/Head of Household and Married or Widow(er) are the same for Roth IRA limits below.)***

Regular IRA

Single (and covered by an employer retirement plan) earning under 66K: *Full deduction*
Single (and covered by an employer retirement plan) earning more than 76K: *No deduction*
Single (and covered by an employer retirement plan) between 66K and 76K: *Partial deduction*
Single (and **NOT** covered by employer retirement plan) and income is above 76K, you can still contribute to an IRA, but it is NOT deductible. *No deduction*

Regular IRA

Married (where the spouse making the IRA contribution IS covered by an employer retirement plan) and the employment income is UNDER 105K: *Full deduction*
Married (where the spouse making the IRA contribution IS covered by an employer retirement plan) and the employment income is OVER 125K: *No deduction*
Married (where the spouse making the IRA contribution IS covered by an employer retirement plan) and the employment income is between 105K-125K: *Partial deduction*
Married (where the spouse making the IRA contribution IS NOT covered by an employer retirement plan, but married to spouse who is covered) and employment income is UNDER 198K: *Full deduction*
Married (where the spouse making the IRA contribution IS NOT covered by an employer retirement plan, but married to spouse who is covered) and employment income is OVER 208K: *No deduction*
Married (where the spouse making the IRA contribution IS NOT covered by an employer retirement plan, but married to spouse who is covered) and employment income is between 198K and 208K: *Partial deduction*
Married (and both spouses are **NOT** covered by employer retirement plan) And income is above 208K, you can still contribute to an IRA, but it is NOT deductible. *No deduction*

Roth IRA

Single and employment income is 125K or lower: *Max contribution allowed*
Partial contribution between 125K and 140K
Single and employment income is 140K or higher: *No contribution*
Married and employment income is 198K or lower: *Max contribution allowed*
Partial contribution between 125K and 140K
Married and employment income is 208K or higher: *No contribution*

In summary, for **Regular IRA contributions** there is a dual "test" as to whether you can make a *deductible* IRA contribution: Do you belong to an employer-provided retirement plan and the amount of your earned income (wages, salary, self-employment). Secondly, regardless of whether you belong to an employer retirement plan and regardless of how high your earned income is, you can still make the Regular IRA contribution, *it just may not be tax deductible*.

In summary, for **Roth IRA contributions**, it does NOT matter whether or not you belong to an employer-provided retirement plan. But, if you earn more than "the limit", you can NOT make a Roth IRA contribution - period. Finally, Roth IRA contributions are *never deductible* on your income tax return.

NEW RULES FOR REQUIRED MINIMUM DISTRIBUTIONS ON *INHERITED IRA's* *beginning January 1, 2020.*
When you are named the beneficiary of an Individual

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Retirement Account (IRA), and the IRA OWNER dies, you are not taxed immediately upon receiving the inherited IRA account value as long as you roll over the IRA into an inherited IRA in your name. But you are still required to take distributions from the IRA account and the income tax consequences depend on the *type of IRA* involved and the *relationship* of the beneficiary (you) to the deceased.

Without regard to special circumstances (like disability, medical expenses, first-time home buyer, etc.), individuals who withdraw from their IRA before age 59 ½ are subject to a 10% **penalty tax** on the withdrawal amount in addition to any **income tax consequences**.

However, when you **inherit** an IRA, you are free to withdraw, *without the 10% penalty tax,* as much of the account value you want at any time. There are *potential income tax consequences* when you withdraw money from an Inherited IRA.

RULE ONE: The new "Required Beginning Date" for *mandatory distributions* from "Regular, Inherited, or Traditional" IRAs was changed in 2020. The required beginning date used to be the year you reached age 70 ½. Now, for anyone who did not reach age 70 ½ by January 1, 2020, your new required beginning date is age 72. Note, the same "Required Minimum Distribution" rules apply to all "Defined Contribution Plans, such as 401(k)s, Profit Sharing, etc.

RULE TWO: There are distinct differences in the NEW rules for withdrawing from an IRA, depending on whether you are the deceased owner's **spouse** or you are a **non-spouse beneficiary** (son, daughter, niece, sister, brother, neighbor, friend, etc.) of the IRA owner.

Special Rules for Surviving Spouse: If you are the SURVIIVNG SPOUSE beneficiary of the IRA, you have *more flexibility* in regards to WHEN or how fast to withdraw the IRA funds. Surviving Spouses can treat the IRA as their own by rolling over (transferring) the IRA into his/her own name. All of the income and appreciation earned on investments held within the IRA continue to grow income-tax free until withdrawals are made. When withdrawals are made from the IRA, that's when income taxes are assessed.

In order to provide an incentive for taxpayers to save for their retirement and not be totally dependent on Social Security, our tax code allows for annual contributions to a Regular or Traditional and Roth IRA accounts and allows an income tax deduction (except for Roth IRAs) to moderate-to-lower-income taxpayers. This means if you contribute $6,000 to an IRA, you will be allowed to deduct (and lower your reportable taxable income) or reduce your reported income by $6,000. Less reportable taxable income means less income tax assessed.

But the IRS wants to eventually tax this IRA money to help pay for all the spending programs and essentially run the government. So, IRA account holders must eventually withdraw the money and all or most these withdrawals are taxable income on a retiree's income tax return. These "required withdrawals" are referred to as ***Required Minimum Distributions or RMD's.*** If this rule to require/start taking requiring distributions were not in place, IRA account holders could just never spend/withdraw any of the IRA funds and pass this wonderful continued tax-free IRA account on to the next generation.

Surviving spouses of a deceased IRA account holder can roll over the IRA into his/her own name and the Required Minimum Distributions (RMD's) must begin at age 72 (up from age 70-1/2 prior to 2020). The calculation for the RMD is: the numerator is the IRA account value at the end of the previous year (12/31/2020) divided by your

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life expectancy. The IRS provides a Uniform Table of life expectancies for taxpayers to use. At age 72 for example, the life expectancy is 25.6 years. If the year-end IRA account value was $100,000, then $100,000 divided by 25.6 years equals a $3,906 **required minimum distribution.**

As the IRA account holder grows older, the life expectancy number declines. At age 80, the life expectancy is 18.7 years. At that time, a $100,000 IRA divided by 18.7 equals a larger $5,348 **required minimum distribution**. The IRS wants the tax revenue eventually.

For non-spouse beneficiaries of an IRA account, the new rules under the SECURE ACT require a much shorter time period to withdraw the IRA funds. The time period IS NOT your life expectancy, but rather a shorter **10-year period.** That means the r*equired minimum distributions* must be made over a ten-year period – not your life expectancy. You don't have to take equal distributions annually over a ten-year period, but you must withdraw ALL of the inherited IRA funds within 10 years.

Using the same example as above, the $100,000 IRA account value divided by only 10 instead of 25.6 for a 70-year-old spouse or 18.7 for an 80-year-old surviving spouse, means relatively equal IRA taxable withdrawals will be larger. The first required distribution would be $10,000 ($100,000 IRA divided by 10) as compared to $3,906 and $5,348 for a 70-year-old and an 80-year-old. The IRA account value must be withdrawn faster and the taxable withdrawal amounts are much larger. If an Inherited IRA account holder chooses to wait and only withdraw funds near the end of the ten-year period, then the withdraw(s) will be larger along with higher income tax consequences.

Bottom line, this means non-spouse beneficiaries of a deceased IRA account holder must take larger taxable withdrawals over a shorter time period than before 2020.

There are limited exceptions for certain non-spouse individuals that DO NOT require complete withdrawals from the inherited IRA within 10 years. These exceptions include:

1) ***Disabled or chronically ill person***
2) ***A child who hasn't reached the age of majority (age 18)***
3) ***A person NOT MORE than 10 years younger than the (deceased) IRA account owner***

Disabled or chronically ill beneficiaries of an inherited IRA may use the more favorable single life expectancy tables – not ten years.

Minors may also use the single life expectancy tables – however, the minor MUST switch to the 10-year rule once he/she reaches age 18.

A non-spouse person who inherits an IRA (such as a sister, brother, close friend, etc.) and is no more than 10 years younger than the deceased IRA account owner, may also use the more favorable single life expectancy tables.

If the IRA account holder dies and did not identify his or her beneficiaries, then the new inherited IRA account holder must withdraw all of the IRA account value within 5 years.

Lastly, Roth IRA's do NOT have Required Minimum Distributions for **the original Roth IRA account owner**, however, if you are a non-spouse beneficiary of a Roth IRA, you must take required distributions (even though distributions from a Roth IRA are not taxable).

In summary, the ability to *minimize taxable required minimum distributions from an IRA*, and therefore minimize the income tax consequences has changed, and only a surviving spouse beneficiary has the best "deal" because the life expectancy method is used. Most other non-spouse IRA beneficiaries have a shorter time period (10 years) to withdraw the funds - except for the three exceptions discussed above.

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LOOKING FORWARD

Change is inevitable. Sometimes uncertainty is higher when unexpected events occur (COVID, bombing of the World Trade Center etc.) and at other times, the unknown future is less "scary" and an orderly adjustment in the financial markets occur. In the years ahead (2021-2022), we are in better or more predictable circumstances compared to the previous year 2 years.

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