BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

Volume 23, Issue 4 January 2021

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FINANCIAL MARKET OVERVIEW

What a bizarre year. The pandemic caused the financial markets to be the most volatile – in terms of financial market performance, since I started in this business in 1986. A massive and sudden 35% decline in stocks over a 6-week period from early February to March 20th, followed by a full recovery by early September and then on to new stock market highs by year-end. Here we stand at a stock market high when the economy and the manner in which we live our lives is the worst in my lifetime.

The overall U.S. stock market was up about 14% during the fourth quarter 2020, but the number of stocks participating in this recovery was not broad-based. It's very confusing for many people to read/hear about the above-average "overall" stock market performance in 2020 when comparing to their flat to 10% return. A dozen or so very large growth stocks became favorites to chase. The technology stock index was up 14% and the NASDAQ composite stock index (dominated by information technology) was up nearly 44% during the fourth quarter. Larger companies represent a bigger proportion of the stock indexes. Later in this newsletter, I point out that 5 stocks out of the 500 that represent the S&P 500 Index were up more than 50% and the rest were up about 3%.

A big reversal in leadership occurred during the fourth quarter. "Growth" stocks have dominated and had the best performance for over the past year compared to "Value" stocks. During the fourth quarter, "Value" stocks of all sizes large, midsize and small companies, performed best. Large Value companies were up over 16%, mid-size value stocks up nearly 19% and small-company stocks up a whopping 33% during the fourth quarter. Look at the chart below for quarterly performance verses year-to-date performance. 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.

Although very uneven throughout 2020, all three categories: large, mid and small-company stocks performed very well with small-company value stocks posting a top 33% return during the fourth quarter. International stocks rebounded well during the fourth quarter advancing about 15%, however the calendar year return was a modest 7.59%. Emerging markets (smaller-country international stock indexes) were up slightly more than U.S. stocks during the fourth quarter, and finished the year up 17%.

Once again, energy stocks reversed course but this time they were up about 25% during the fourth quarter after losing 20% during the third quarter. Many recent articles discussing where to find dividend income during this low-rate environment list energy stocks as a prime candidate. We agree, but we suggest staying with top quality companies with strong balance sheets and be wary of simple "pipeline and storage" energy companies.

Investment real estate performed modestly – up 9.29% during the fourth quarter, but down about 5% for the 2020 year. With the recent lockdown, a growing number of commercial tenants whose businesses have suffered during the pandemic are not current on their rent payments, yet residential home prices are still soaring.

Water utility stocks were up slightly during the fourth quarter – up about 2% and the calendar year returns varied based on location. Those areas hit hardest by shutdowns had lower performance relative to other water utilities. For the year, the performance of our three favorite water company stocks varied between down -9% and up 22%.

The price of Gold was flat during the fourth quarter after peaking in early August. Gold was up 24% and silver nearly 50% for the 2020 calendar year.

Fixed income or bond prices were relatively flat as interest rates have declined to less than 1% for guaranteed income with maturities of 2 years or less. Short-term Treasuries earned a measly 0.01% during the fourth and intermediate-term Treasuries were down over 1%. The current interest paid on new 10-year maturity U.S. Treasury Note is still near 0.6%.

The following chart displays sample returns of various asset categories during the fourth quarter of 2020 and calendar year:

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Year-To-Date 2020	4th Qtr. 2020	Index Return (*includes dividends reinvested*)
+ 7.25%	**+ 10.17%**	**Dow Jones Industrial Average (^DJI)**
+ 18.33%	**+ 12.12%**	**Standard & Poor's 500 Index (^GSPC)**
+ 21.07%	**+ 14.75%**	**DJ U.S. Total Stock Market (VTI)**
+ 38.25%	**+ 11.36%**	**Large-company stock-Growth (IWF)**
+ 2.73%	**+ 16.26%**	**Large-company stock-Value (IWD)**
+ 35.42%	**+ 18.85%**	**Mid-Size Stocks – Growth (IWP)**
+ 4.83%	**+ 20.49%**	**Mid-Size Stocks – Value (IWS)**
+ 34.68%	**+ 29.57%**	**Small-company stock- Growth (IWO)**
+ 4.65%	**+ 33.31%**	**Small-company stock- Value (IWN)**
+ 7.59%	**+ 15.74%**	**International (EFA)**
+ 17.03%	**+ 18.40%**	**Emerging Markets (EEM)**
- 4.61%	**+ 9.29%**	**Real Estate Investment Trusts (VNQ)**
		Fixed Income (includes appreciation)
+ 3.03%	**+ 0.01%**	**Short-term U.S. Treasury (SHY)**
+ 10.01%	**- 1.28%**	**Intermediate U.S. Treasury (IEF)**
		Alternative Investment Category
+ 24.81%	**+ 0.71%**	**Gold (GLD)**

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

FINANCIAL MARKET OUTLOOK

Faster than ever before, the overall U.S. stock market ended the year at record-setting levels that began with a wild and significant 35% bear-market drop from early February to March 20th. Extreme fear of a rapidly spreading coronavirus sent stocks, gold, and bonds tumbling. The Federal Reserve acted quickly and flooded the market with a "stimulus" package emphasizing buying bonds and printing dollars. By the end of 2020, one of every five U.S. dollars in existence was printed and created during the year. Eight months after the coronavirus was identified, stocks reached all-time highs by December 31st.

By the end of August, stocks had recovered the initial percentage decline and the second surge began on the most unpredictable day – November 3rd – the Presidential election date. On that very day, instead of waking up in the morning and expecting the stock market to have a volatile reaction to the election results, ***Pfizer announced they had a vaccine***.

The single most important news event of the year and the ONLY expectation that could restore the outlook for the financial markets occurred. Immediately, the vaccine news sent stocks up over 12% in less than 30 days. In less than one year, the pandemic caused the economy, financial markets and investor confidence to move from an expectation of disaster to record-setting advances on Wall Street. Is it real?

Our economy is on its knees. Many big companies and small businesses are suffering and at the same time a relatively small group of stocks are posting some of the biggest percentage gains in decades. Here is the reality: ***Of the 500 companies in the S&P 500 stock index, just five companies*** (Apple, Amazon, Microsoft, Facebook, and Alphabet (formerly Google) ***were up 65% from January 1st 2020 through September 2nd***. ***The other 495 stocks were up 3%***. Those five companies represent 25% of the value of the S&P 500 Index. A small number of big-company stocks are the true winners. Now, investors are pausing and wondering: Are we experiencing another financial market bubble?

In 2020 alone, Tesla was up over 750%, NIO (Chinese electric car manufacturer) up over tenfold, Peloton (indoor exercise bikes) up 445%, Amazon and Apple up over 75%, Bitcoin up over 200%, and gold up over 25%. Airbnb and DoorDash went public (Initial Public Offering) in December and gained 116% and 40% in the month of December alone. Have you noticed that personal residence prices are spiking 10% - 25% since April, while office buildings look deserted?

There are plausible explanations for abnormally high returns for some of the stocks mentioned above, but these explanations do not apply to the future. One obvious explanation is **momentum "investing" or herd investing** has become more popular and easier to implement than in the past. Basically, momentum investing means buy whatever is going up in value irrespective of the product/services regardless of whether the current valuation is reasonable. If the price is rising buy it and when it stops rising, sell it.

Robinhood and several other online firms allow individuals to day-trade securities with no commissions and no minimum account value. There are no brokers, telephone support or physical offices – all you need is a laptop or an iPhone to "invest." You can trade stocks, cryptocurrencies, options and more. In a nutshell, let's call it what it is: gambling. It's simply a matter of time before you lose big - so the best advice is to only play with money that doesn't impact your future financial circumstances. The point is: the number of investors participating in momentum investing is growing rapidly with both traditional advisory firms and individuals.

In addition to the free-style and do-it-yourself trading platforms (Robinhood and others), there are more examples of traditional (managed by professionals) mutual funds and exchange-traded funds that are investing heavily in momentum stocks, cloud-based companies and generally "innovative" companies. The sudden high returns of these darling stocks attract massive inflows as long as the music is stilling playing. The overcommitment and stellar performance of these few momentum stocks is wonderful to behold and teases your conscience to get on board.

Another reason for the stellar performance of a few stocks is the perception that the "shutdown" way of life will be permanent and few companies thrive in this type of environment. We will know whether that perception is true or not by mid-2021. If these companies that performed so well under lock-down conditions (Peloton, Amazon, etc.) cannot

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maintain equal or better growth in the future, the share prices will adjust downward.

Third, the rate of return available in the fixed income sector – the safe category – is near zero. Interest rates are currently at the lowest level in our lifetime. Investors cannot maintain a reasonable rate of return by purchasing and holding bonds, Treasuries, certificates of deposit or most other safe fixed income investments which currently earn 0.2% to 1.8%.

In regards to real estate, rental income from hotels to commercial properties are weak and have been declining as each month passes. Many tenants impacted by the coronavirus are unable or unwilling to pay rent.

Yet, listing prices for personal residences are skyrocketing. Same reason. Just like stocks, real estate is a more attractive asset class than fixed income and the cost to borrow money (mortgages) is below 3%. Since most Americans are spending less under lock-down conditions and safe investments pay so little interest, a big supply of cash is searching for a reasonable return and homes are a very attractive alternative - especially when mortgage rates for personal residences are currently 2.5% or less.

From a macro point of view, the vaccine is exactly what the financial markets needed: a path to recovery and improved economic growth that presumably will get Americans back to work, small businesses to reopen, and corporations back to earning a reasonable profit. Just be prepared for what will come first. The U.S. economic growth figures for the 4th quarter – or should I say economic decline figures, are going to be extremely UGLY and those figures won't be released for months.

So, while enthusiasm and hope springs high right now, the ugly numbers are coming. Honestly, these pending economic figures for the 4th quarter 2020 are irrelevant. It's in the past, it's already known and expected. But, the general public, short-term traders and fast money movers are still out there chasing stocks up and down, so don't be surprised if the stock market reacts negatively and expect volatility to jump in the coming months.

The bottom line is financial markets should perform well during this transition out of a lockdown. The difficulty is trying to determine *today* how long this renewed growth from out-of-the-dungeon period will last.

The second phase is too difficult to predict at this time, but here is a basic picture of what's coming in phase two. Today, economic activity is at a standstill, interest rates are near zero, the Federal Reserve has printed 25% more paper dollars than we had 1 year ago, U.S. debt and deficits have grown to unimaginable levels and in all but a few companies and inventories are at a bare minimum.

Just imagine what happens in a post pandemic environment. The surge in demand for everything could/will outstrip supply as inventories of all products are at a low point and government (state and federal) deficits have ballooned. With the vaccine as a catalyst, very soon we could see a surge in economic activity and demand - especially from the parts of the economy that have been shut down or operating way below normal capacity. Guess what happens next? Higher inflation and higher interest rates.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

The stock market will continue exhibiting more daily and weekly volatility as news related to the economy, politics/election, and updates to COVID-19 cases are announced. The stock market is reasonably valued at this time assuming we continue learn, adapt and move forward to reopen businesses, schools, etc. while pursuing effective treatment.

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.

Worth Repeating: Our biggest concern is the historically low current return (interest) on the safe/guaranteed fixed income portion of client portfolios. New six-month and one-year Certificates of Deposit are down to 0.10% and 0.20% respectively. Corporate bonds only pay slightly higher interest. The 10-year U.S Treasury Notes are paying 0.6% and 30-year maturity government bonds are paying only 1.50% interest. So, the safe section of client accounts is going to earn very little over the next year or so. Any fixed income alternatives that advertise a higher yield must be examined carefully, as there is additional risk for the higher return offering.

Not only is interest income at historically low levels, but the prices or value of existing bonds that were issued in the past when interest rates were higher, are selling for more than the payoff at maturity. We mentioned the growing risk in the safe fixed income category in our previous newsletter and its worth reading again.

Don't look at the historical return for bonds in 2020 year-to-date – which is above 10% because most of that gain is NOT interest. Most of the total return came from capital appreciation or price increase – bonds that have higher interest rates because they were issued years ago when rates were higher, have jumped in value. That gain will not repeat unless interest rates go to zero or negative. **Expect the fixed income portion of your portfolio to provide 1% or less in the year(s) ahead.**

Yes, there are many bonds that offer 4% or higher interest, but you must compare the *quality – i.e. Safety Rating*. Everything – corporates, high yield bonds, convertible bonds, etc. have lower credit quality rating compared to U.S. Treasuries and

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certificates of deposits.

We are continuing to deal with this low-income environment by moving some funds into high-quality and established 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.

The relatively few stocks that are advancing up to 100% or more so far year-to-date and to a lesser extent, the much higher return on tech/information technology sector stocks is eerily reminiscent of the late 1990's. Tech stocks were all the rage and everyone retold their stories of making so much money on this trade and that trade. Then, an UNRELATED and SUDDEN UNPREDICTABLE EVENT occurred that demolished the stock market for 3 years (World Trade Center attacks). Tech stocks were demolished.

Value stocks – meaning recognizable company names that have been around for many years with established products have not kept pace with growth stocks 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 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.

Sometime in the future, our country will return to work, schools, etc. The Federal Reserve has pushed interest rates down to levels not seen since the Great Depression – the current interest rate on a 30-year *home loan* is now below 3%. The interest earned on a 30-year U.S. Treasury is only 1.3%.

We will continue experiencing unusual, uncomfortable and downright scary events due to the COVID-19 virus. The only path is forward and expecting uncertainty. Stay safe and continue protecting yourself as recommended. We will get through this challenging series of events.

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