BRIAN D. LOWDER, INC.

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Financial Market Overview

The overall stock market finished the **fourth quarter** up approximately 8%, but the number of stocks advancing have been primarily limited to about three dozen very large and popular companies. For the **2021 calendar year**, the three most popular stock market indexes finished the year up between 18% and 28%.

Large-company growth stocks had the best performance both during the fourth quarter and for the entire 2021 calendar year. Small and mid-size ***Value*** stocks performed nearly as well as large-company growth stocks especially during the fourth quarter.

The technology stock index was up over 13% during the fourth quarter and up over 30% during the 2021 calendar year. International stocks were up a modest 3% during the fourth quarter, and up only about 11% for the 2021 calendar year.

Emerging markets (smaller-country international stock indexes) had the worst equity (stock) performance during both the fourth quarter and for the entire 2021 calendar year - down 1.59% during the 4th quarter and down 3.63% for the entire year.

Emerging markets were the only primary stock index category with negative 2021 performance mostly due to the poor performance of the Chinese stock market. Energy stocks increased about 5% during the fourth quarter and up more than 50% for the 2021 calendar year. Investment real estate prices jumped 15% during the fourth quarter and up over 40% for the 2021 calendar year. Both real estate and energy were two of the top-performing categories in 2021.

Water utility stocks rallied over 15% during the fourth quarter and were up over 25% during the 2021 calendar year. The price of Gold rose 4% during the fourth quarter but posted a 4% negative return for the entire year.

Fixed income or bond prices for short-term maturities were down the fourth quarter and slightly negative for the 2021 calendar year. Short-term Treasuries were down 0.72% while intermediate-term Treasuries posted a negative 3.33% return during 2021 calendar year as interest rates started rising during the 4th quarter. Intermediate-term Treasuries are down 3.44% year-to-date. As interest rates rise, bond values fall. We are reminding conservative investors again: Interest rates will continue to rise as the recovery advances. Expect negative returns for fixed income/bonds the foreseeable future.

The following chart displays sample returns of various asset categories during the third quarter of 2021 and calendar year-to-date:

Year-To-Date 2021	3rd Qtr. 2021	Index Return (*includes dividends reinvested*)
+ 18.73%	**+ 7.37%**	**Dow Jones Industrial Average (^DJI)**
+ 28.28%	**+10.68%**	**Standard & Poor's 500 Index (^GSPC)**
+ 25.23%	**+ 8.73%**	**DJ U.S. Total Stock Market (VTI)**
+ 27.27%	**+11.51%**	**Large-company stock-Growth (IWF)**
+ 24.41%	**+ 7.30%**	**Large-company stock-Value (IWD)**
+ 12.49%	**+ 2.81%**	**Mid-Size Stocks – Growth (IWP)**
+ 28.11%	**+ 8.52%**	**Mid-Size Stocks – Value (IWS)**
+ 2.44%	**- 0.18%**	**Small-company stock- Growth (IWO)**
+ 27.25%	**+ 3.63%**	**Small-company stock- Value (IWN)**
+ 11.44%	**+ 2.82%**	**International (EFA)**
- 3.63%	**- 1.59%**	**Emerging Markets (EEM)**
+ 40.53%	**+15.61%**	**Real Estate Investment Trusts (VNQ)**
		Fixed Income (includes appreciation
- 0.72%	**- 0.60%**	**Short-term U.S. Treasury (SHY)**
- 3.33%	**+ 0.11%**	**Intermediate U.S. Treasury (IEF)**
		Alternative Investment Category
- 4.15%	**+ 4.10%**	**Gold (GLD)**

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

Financial Market Outlook

If you are limited to only *numbers or financial data* and then were asked to reflect back on 2021 – most people would have celebrated. The **stock market** posted a 26% gain in 2021 and that's after delivering a 29% return in 2019 and 16% in 2020. **Jobs** were plentiful and many positions have still not been filled. **Economic growth** was strong compared to the partially

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shutdown economy in 2020. Non-Fungible Tokens and **crypto currencies** provided stellar returns during the first half of 2021. **Personal residence** values and most home prices were up 15%-25% in 2021. **Interest rates on home mortgages** hit the lowest level in over 60 years.

So why are so many people glum, less confident, and a bit irritable? One measure, the Index of **Consumer Sentiment** dropped 13% in 2021 and hit its lowest level since 2008. Remember the 2008 financial market crisis – when bad bank/real estate loans were exposed, consumer sentiment plunged, and the stock market was down 38%. Today, Consumer Sentiment is just as negative as it was in 2008 and dropping - while oddly the stock market is on a 3-year sprint to all-time highs. There must be more to this quandary than just financial data and numbers.

Generally, people don't feel as good but that didn't stop consumers from shopping – **retail sales** were up 18% in Nov, 2021 compared to Nov. 2020. Just as consumers' pessimism or sentiment isn't necessarily reflected in their actions, investors continue to buy and hold stocks despite an uncertain and sometimes gloomy outlook.

Below are the problem "cards" in this deck:
COVID 19 and its variants were supposed to be on the decline after vaccines were introduced in early 2021 along with protocols that we were instructed to abide by at work, school, and in public settings. But, with a combination of vaccine resistance, confusion, misinformation, politics, and virus mutations, the U.S. ended the 2021 year with more COVID cases compared to 2020 when no vaccines were available. COVID has disrupted our lives and negatively ***impacted*** our sentiment and confidence.

The Federal Reserve's Policy of **easy money** and our Government's willingness to accelerate deficit **spending** are coming to an end. Easy money and deficit spending helped cushion the decline in economic activity due to COVID. In addition, lowering interest rates to a level not experienced in over half a century is also coming to an end. The Federal Reserve has announced at least 3 small **interest rate increases** scheduled for the first quarter of 2022. Europe's central banks have already raised their interest rates.

Perhaps one of the biggest negatives is the rapidly **rising inflation rate** which has jumped from below a 2% annualized rate to over 5% by the end of 2021. The price of Crude oil was up 50% in 2021. **Supply chain bottlenecks**, rising gasoline prices and the cost of many everyday items have jumped considerably. New vehicle prices were up 11% in 2021 and restaurant prices were up 8% These price increases are not temporary or "transitory". Why? Now, wages must increase just to maintain purchasing power – that's the next shoe to drop causing inflation to stay higher and partially explains why many jobs are still available, but are not being filled. Inflation is not and has never been a transitory variable. Once the seeds of inflation are sown, it can take years to reverse course.

Congress' **attempt to raise corporate and individual income tax rates in** 2022 couldn't be worse timing and will simply increase the burden companies and individuals are already experiencing. If the additional income tax revenue is spent wisely, then maybe the change could be beneficial. Yes, income tax rates have been adjusted in both directions many times for nearly a century – it's just the timing and how poorly the tax revenue has been allocated (spending) that makes this change dicey.

Add the **void in unity/political leadership** (both sides) and the strong desire that each party has to thwart the other side from succeeding to this "deck of cards," and the outlook becomes even more disconcerting. We need leadership, unity and honesty to break through the current state of affairs.

Confidence and a clear vision are necessary for economic and stock market support:
It all comes down to the level of confidence over the next 6 months. Our financial markets are currently generously valued – especially the stock market and personal home values. Clearly, we don't have a unified vision at this time. Further, it will take 1-3 years before either party has a chance to increase their seats in Congress. Don't expect much to be accomplished in the near-term.

And just for the fun of it to see how far uncertainty can go, add the **provocative behavior** of China with Taiwan or Russia with Ukraine. Having just exited the Afghanistan occupation, does anyone believe both China and Russia are the least bit concerned about our Government's "warnings" or willingness to start a new confrontation? You know the U.S. will be "tested".

After reviewing and assessing recent financial data and considering all of the highlighted topics above, the near-term future seems to be as predictable as picking a specific card out of the middle of a deck of shuffled cards or trying to pick the correct number between one and thirty.

Be prepared for increased volatility in 2022 – especially on the downside. Even with positive future progress with COVID and better economic growth, our stock market has already sprinted ahead in anticipation that low interest rates and much better economic growth compared to 2020 will eventually take hold – how could our circumstances get any worse? But, it's been 2 years in this barrel and it's time for progress and confidence to show itself and soon. In my opinion, we will find out during the first quarter of 2022 whether the financial markets will continue advancing or adjust downward to better reflect reality.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

What the financial markets and investors need to maintain

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their recent gains and continue forward with further advancement in their portfolios are simply confidence and encouraging news that progress of any kind will occur. The challenges we face with all of the topics mentioned in this newsletter are already known and very frustrating, but these challenges are much better than facing new, unexpected and unknown circumstances.

It's the **unknown or black swan events** (events never seen before) that cause the stock markets to plummet. For example, when the world was hit with the COVID 19 virus, the stock market plummeted 38% over a six-week period ending in mid-March 2020. The September 11, 2001 attacks on the World Trade Center and the Pentagon occurred after a multi-year record tech stock market advance – that unforeseen attack was the beginning of a significant 2-year decline in stocks (2001-2002).

Today, the multitude of problems (COVID and lack of testing kits, rising interest and inflation rates, government deficit spending, pending income tax increases, politician's inability to govern, murder/homicide rates and crime hitting all-time highs, etc.) are already known. The fear that the financial markets will *suddenly plummet* doesn't seem likely. A longer period of continuous decline is more likely than a plummeting stock market.

It's simply a matter of time before investors' confidence is restored through progress and accomplishments or further weakened to the point where some investors begin to make changes to their portfolios. If progress is **not** restored, yes, the financial markets will be subject to *waves of selling*.

Trying to guess which way the markets will move and *even more difficult*, accurately predicting ("timing") **when** investors should make significant changes to their portfolios is a three-fold decision – not just one selling decision. First, investors must decide whether or not to sell and if the choice is to sell ….. when to do it?

Second, investors must consider the capital gains tax implications for selling appreciated stocks in taxable accounts (IRAs and qualified retirement plan assets are not subject to capital gains tax when selling). Many stock positions have appreciated 50% or more over the past 3 years alone. The tax cost (from selling appreciated stocks) must be deducted from the portfolio value. Tax payments reduce an account value just the same as a stock market decline reduces the account value.

For example, assume a $100,000 investment account has appreciated up to $150,000 or 50% over the last 3 years. If all of the stocks are sold, $50,000 of gain would be subject to both Federal capital gains tax and State income tax – or about 20%-25% total tax times a $50,000 gain. Total tax would be $10,000 – $12,500. Paying 10K to 12.5K in taxes is equivalent to about a 7% -8.3% decline of the value of a 150K account. If the investor doesn't sell, he/she could absorb a 7%-8.3% decline in stock values and still be in the same position as someone who sold and paid 10K to 12K in additional taxes.

Third, a correct timing decision must be made to **re-enter or purchase** stocks after the decline is over. When investors sell out after absorbing a 24% decline in stock values during 2002 and over a 30% decline in 2008, they generally will not re-purchase stocks for quite some time and will miss the recovery year as was the case in 2003 and 2009. In other words, it is typical for those who sold out to miss the first big-year stock market recovery following the year of decline, compared to someone else who didn't sell at all.

In summary, making a significant change (selling stocks) to an investment account involves a timing decision as to when to execute the change, incurring and paying capital gains on the profit and then successfully making a second timing decision on when to re-enter the stock market. Investors need to consider all three aspects of the selling decision – not just one.

As described in prior newsletters, we have created and maintained a massive Block Sell trade file to reduce client stock holdings by 50% and are ready to execute this plan in the event we decide a worst-case scenario is more likely to occur than not.

Presently, we are not making significant changes to the investment holdings in our client accounts at this time. We have already made meaningful changes throughout 2021. It is more likely that we will implement any additional changes gradually if need be and assume a significant sell-off does not occur. We will maintain our current asset allocation (proportional exposure to stocks, fixed income, etc.) for most client portfolios for now.

2022 Income Tax Brackets

Below are the maximum retirement plan contribution limits for 2022: Note, all taxpayers age 50 or older can add an "Extra" amount shown in the right column. For example, someone age 50 or older can make a total Regular OR Roth IRA contribution of $7,000.

	Contribution Limit	Extra IF Age 50 or Older
401(k), 403(b) and Defined Contribution Plans:	**$20,500 (employee)**	**+$6,500**
SIMPLE IRA	**$14,000**	**+$3,000**
Regular and Roth IRAs	**$ 6,000**	**+$1,000**
Coverdell (Education IRA)	**$ 2,000**	**N/A**

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Please note, there are "phase-outs" of being eligible to make a <u>tax deductible</u> Regular IRA contribution depending on your adjusted gross income and whether you (or spouse) are covered by an employer retirement plan – call or consult a tax guide for more information. Roth IRA contributions are disallowed for Joint filers with adjusted Gross Income above $214,000 and $144,000 for Individual taxpayers.

STANDARD DEDUCTION: $25,900 (Joint) $12,950 (Single)

Everyone is eligible to reduce their taxable income by the larger of: 1) your itemized deductions or 2) the Standard Deduction shown above.

There are 7 income tax brackets ranging from 10% to 37% as shown below:

2022 Income Tax Brackets

<u>Married: If taxable income is ….</u>	***<u>Tax Rate</u>***
Not more than $ 20,500	10% of taxable income
Over $ 20,500 to $ 83,550	12%
Over $ 83,550 to $178,150	22%
Over $178,150 to $340,100	24%
Over $340,100 to $431,900	32%
Over $431,900 to $647,850	35%
Over $647,850	37%

<u>Single: If taxable income is ….</u>	***<u>Tax Rate</u>***
Not more than $ 10,275	10% of taxable income
Over $ 10,275 to $ 41,775	12%
Over $ 41,775 to $ 89,075	22%
Over $ 89,075 to $170,050	24%
Over $170,050 to $215,950	32%
Over $215,950 to $539,900	35%
Over $539,900	37%

Note: there is an additional 0.9% Medicare Tax on <u>employment income</u> greater than 200K for Individual filers and 250K for Joint filers.

Note: there is an additional 3.8% "Net Investment Income" Tax if <u>Adjusted Gross Income</u> is over 200K for Individual filers and 250K for Joint filers

ANNUAL GIFT TAX EXCLUSION AMOUNT: **$16,000**
Annual gift per person per year without filing requirements

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