BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

The first quarter performance for stocks was positive for all stock indexes ranging from 2% to 11%. For the first time since 2021, all of the stock index categories participated in the advance and not just technology or AI stocks. None of the index categories shown below had negative returns for the first quarter except for real estate and intermediate/long-term bonds.

The overall broad stock market index and the **S&P 500 Index** were both up about 10%-11% during the first quarter. The NASDAQ stock index, which is dominated by technology stocks, was up 8.5% during the first quarter and the Dow Jones Industrial Average was up 9.5%. The small-company stock index, the Russell 2000, was up only 3.2% during the first quarter.

Large-company ***growth*** stocks (dominated by tech stocks) were up 11% during the first quarter and large-company ***value*** stocks (older and established companies) were up about 8% during the first quarter. Once again, performance during the first quarter was dominated by about two dozen large-company tech stocks, but now the performance has broadened out to include other companies as well.

Mid-size ***growth*** stocks were up over 9% during the first quarter and mid-size ***value*** stocks were up approximately 7.75%. International stocks were up only 6% during the first quarter and emerging markets (smaller-country international stock indexes) were up only 2%.

Investment real estate (real estate investments trust) was the only category that posted a negative return for the first quarter – down just over 2%. Interest rates are moving back up and starting to negatively impact real estate values. Water utility stocks were down about 10% during the first quarter, however, energy stocks were up about 10% as gas prices have started rising again. Gold price performance jumped about 7.6% during the first quarter.

Fixed income or bond prices for intermediate and long-term bonds posted a negative 1.3% return as interest rates moved higher (higher interest rates lower the price or value of bonds even though the interest income is higher). Short-term bonds and Certificates of Deposit with 6-12-month maturities are still paying just over 5% which is more than all other bonds with maturities up to 30 years. The inverted yield curve is still here – short term bonds pay more interest than long-term bonds.

The following chart displays sample returns of various asset categories for the calendar year and during the first quarter of 2024:

Yr-To-Date 2024	1st Qtr. 2024	Index Return (*includes dividends reinvested*)
+ 5.62%	+ 5.62%	**Dow Jones Industrial Average (^DJI)**
+ 10.20%	+ 10.20%	**Standard & Poor's 500 Index (^GSPC)**
+ 9.56%	+ 9.56%	**DJ U.S. Total Stock Market (VTI)**
+ 11.18%	+ 11.18%	**Large-company stock-Growth (IWF)**
+ 8.39%	+ 8.39%	**Large-company stock-Value (IWD)**
+ 9.27%	+ 9.27%	**Mid-Size Stocks – Growth (IWP)**
+ 7.77%	+ 7.77%	**Mid-Size Stocks – Value (IWS)**
+ 7.37%	+ 7.37%	**Small-company stock- Growth (IWO)**
+ 2.24%	+ 2.24%	**Small-company stock- Value (IWN)**
+ 5.99%	+ 5.99%	**International (EFA)**
+ 2.16%	+ 2.16%	**Emerging Markets (EEM)**
- 2.13%	- 2.13%	**Real Estate Investment Trusts (VNQ)**
		Fixed Income (includes appreciation)
+ 1.00%	+ 1.00%	**Short-term U.S. Treasury (SHY)**
- 1.79%	- 1.79%	**Intermediate U.S. Treasury (IEF)**
		Alternative Investment Category
+ 7.61%	+ 7.61%	**Gold (GLD)**

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

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FINANCIAL MARKET OUTLOOK

Another quarter has ended and for nearly two years now the financial press, traders, and some forecasters have continuously held that the Federal Reserve Board is done raising interest rates and will begin lowering them soon. However, no interest rate reductions have occurred. Instead, the most recent prediction of at least three quarter-point interest rate reductions coming this year, has changed yet again. Now the theme is maybe one rate reduction in June or this summer.

The bottom line: Whether or not the Federal Reserve lowers interest rates by a fraction of one percent sometime this year, don't expect a second stock market rally anywhere close to the 25% gain in stocks in 2023 and about 10% so far this year. A jump in stock prices due to expected lower interest rates are *already reflected in the stock price performance in 2023 and the first quarter of 2024.*

Looking forward, the best case for the stock market's continued gains no longer depends on Fed interest rate cuts, but rather on the outlook for a stronger economy - and that's how it should be. The Federal Reserve will lower interest rates when and if economic growth is declining – not when economic growth is improving. Currently, the labor market (new jobs) is solidly improving as well and the stock market has performed well-above average for 5 quarters.

Stocks are already priced about 25% higher than "normal" as measured by price-to-earnings or P/E ratio. More importantly, about 7-10 mega stocks involved in artificial intelligence, cloud computing and other technologies of the future are primarily responsible for the well-above average stock market performance over the past 5 quarters.

Currently, all companies combined are selling at about 21 times earnings – the "normal" or long-term average is about 15 times earnings. So, optimism is already reflected in stock prices over the past 5 quarters. The current higher P/E ratio can hold, advance and even stay higher, but economic growth must advance by at least 3% annually – last year economic growth was up 2.5%. The consensus or average of Wall Street analysts' forecasts is 11% earnings growth in 2024 for the 500 largest U.S stock companies – compared to only 2% in 2023. Earnings growth must improve in order for the overall stock market to hold on to recent gains and continue moving up.

Lastly, the inflation rate has been declining since a year ago. The last reading was 2.8%, but will not likely fall to the 2% target rate the Fed believes is ideal. Further, simply changing the definition or rather how the inflation rate is calculated is cynical. The most widely reported inflation rate mentioned by the Federal Reserve and the White House is *the personal consumption expenditure price index*. Guess what is *excluded* in this calculation. The change in the price of food and energy costs are excluded – and these two items are what most Americans are struggling with.

Another anomaly to add to this mix of financial market variables is the recent performance in the speculative area of the financial markets. Specifically, the price for bitcoin and gold are both up 149% and 15% since October 15, 2023. Gold/bitcoin/crypto currency are generally considered to be alternative assets and move in the opposite direction to price performance of stocks, bonds and real estate - especially when inflation, uncertainty and global conflict are present. Yet for the past 6 months, these "contrarian asset classes" are both moving abnormally higher at the same time.

The last topic is one that moves very slowly over time and rarely is the topic of conversation when discussing future investment returns. The Federal government (meaning all of us as taxpayers) is now 34 trillion dollars in debt after years of spending far more than what it receives in income tax revenue. This overspending is magnified as the U.S. decides how much more of our money that we don't have (deficit spending) to help Ukraine, Israel and forgive student loans. The point is not to ask which side you favor in the spending. The point is we are 34 trillion in debt and just the interest cost annually is more than what the U.S. spends for our entire military operations each year.

I don't have a good explanation for these anomalies, nor the current and immediate future of the financial markets. During 2023 and through the first quarter of 2024, insurmountable risks did not prevent significant gains in asset classes that <u>normally do not move in the same direction</u>. Bitcoin, gold and stocks moved significantly higher at the same time. Bottom line: the previous 5 quarters well-above average financial market performance – meaning all asset classes moving up well above average at the same time, doesn't make sense.

And finally, as we continue into the 2024 year with an economic outlook that is better and improving yet still uncertain and unclear, we will have to ponder how positive change and current investment values can possibly be sustainable during a Presidential election year with two polarizing parties. Neither side will support the other's efforts to improve our financial circumstances. When gold, stocks, Bitcoin and Crypto currencies are all increasing at the same time, don't be surprised - rather be prepared for volatility.

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INVESTMENT OUTLOOK AND RECOMMENDATIONS

In summary, we are continuing to hold a higher proportion of short-term U.S Treasuries and certificates of deposits with very short maturities (6-12 months) in the fixed income section of client portfolios. In 2023, the stock portion of client portfolios held less equities (stocks) than normal and some portion of the Treasuries/certificate of deposits *will go back into stocks* sometime in the future.

The yield curve is still slightly inverted – meaning investors holding a short-term Treasury, certificates of deposits, or any bond with a 6–12-month maturity is receiving more interest income than bondholders holding the same investments with 1-30-year maturities. Investors are still receiving a 5% safe rate of return in this category (compared to just 1% in early 2022). It is simply a matter of time before the yield curve is upward sloping – meaning the longer the maturity, the higher the interest rate paid. I expect short-term interest rates to hold or decline slightly and mid-to-long-term interest rates to increase.

We are still taking a middle-of-the-road stance and are cautious over the short-term. A broader based stock market performance did occur during the first quarter – meaning stocks other than technology and artificial intelligence started to increase in value – and that is a positive sign. However, a broad-based rally is still elusive and necessary before we can experience a *sustainable* rally.

When a sustainable stock market arrives, the easiest way to participate is to first re-allocate funds back into the broad market stock indexes. Small and mid-size company U.S. stocks are even more attractive. This category has lagged in performance over the past 5 quarters, but this category excels above the market averages when sustainable stock market advances are underway. Emerging markets that exclude China (small-company stocks of smaller international companies) will also be on the list for new purchases as well as mid-cap stocks.

We have identified several stock investments that we intend to add to client portfolios outlined on your blue recommendation sheets, but the timing of when to purchase is still uncertain. Ideally, we will begin adding additional stocks to client portfolios carefully and slowly within the next 12 months.

TAXES & 2024 PRESIDENTIAL ELECTION

New income and other taxes will be a top issue in 2025 – the 2024 Presidential election will be decided by year end and the former President Trump's 2017 Tax Reform laws will expire at the end of 2025. President Biden has several tax proposals that you won't hear much about until after the 2024 election and if he s re-elected. Two are discussed below.

(1) Unrealized Gains at Death. The current tax laws that have been in place for many decades do NOT tax gains on investment accounts, real estate, personal residence and other assets on the date of death. Instead, every asset from cars, to stocks and real estate receive a "step-up in cost basis" at death. This means all assets (except for retirement plan accounts) of a decedent receive a current market valuation as of the date of death – any gains or losses are wiped away and beneficiaries receive a cost basis or purchase price equal to the fair market value at death. Biden wants to end the step-up in cost basis for "wealthy individuals".

Under Biden's proposal, it would treat death as a *realization event* for income tax purposes… essentially whether or not beneficiaries keep the stocks, real estate etc. that they inherit, the *Decedent* must pay capital gains taxes immediately in the year of death on the difference between the original purchase price and the fair market value of all assets on the date of death. Essentially, the Decedent's final income tax return will report taxable gains on all assets held at death.

Who would be NOT be subject to these new rules or in other words, who IS or is NOT wealthy? **Each individual will receive a $5 million lifetime gain exclusion.** So, if your estate is worth $5 million or less, these new rules would not apply. Plus, there are a few more exceptions. One, **property left to a surviving spouse** would not be taxed until that spouse's death (if you were not married, too bad). Charitable donations would be exempt. Family-owned businesses would escape tax IF the heirs continue to own and run the business.

The existing *gain exclusion* of $250,000 for an individual or $500,000 if married, on the sale of a primary residence would continue as it is today. Further, gain on tangible personal property would be exempt. "Tangible personal property" exists physically (i.e., you can touch it) and can be used or consumed. Clothing, vehicles, jewelry, and business equipment are examples of tangible personal property.

(2) Upper-income taxpayers, defined as those with taxable income greater than $1 million would NOT receive the 15% or 20% lower maximum capital gains

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tax rate. Instead, their gains would be taxed as *ordinary income tax rates* which go as high as 40%.

You will hear more about “revenue raising” tax ideas AFTER the election. The bottom line is this is a perfect example of why Federal Deficit Spending (now over 34 trillion) matters. Families have to stay within a budget to prevent over-spending and acquiring too much debt, but when our government overspends – we the people – especially our adult children and grandchildren will have to pay the price via higher income taxes for rest of their lives. This is the biggest issue that will impact both economic growth and interest rates in the coming years.

ANNOUNCEMENTS

Pam Priest has retired and her replacement Tayler Foster is now our newest team member. We are pleased to welcome Tayler to the BDL Inc. Team.

Tayler was born in Arizona and has lived in San Diego since she was 3 years old. She currently resides in El Cajon, with her fur child Ruger a 4-year old black Lab. She loves anything outdoors, but mostly enjoys hiking and soaking up the sun at the beach. Ruger also shares her love for the outdoors and adds an extra dose of joy to her outdoor escapades. Be sure to give Tayler a warm welcome when seeing her in the office or hearing the unfamiliar voice on the phone, as she will be the new face of our front desk!

Rebecca and her husband Tyler are very excited to bring Baby (Boy) Dodge into this world! He is expected to arrive in mid to late April 2024.

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