BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

The financial markets displayed significant volatility during the first quarter, but ended up just about where the year began. The relatively flat performance seems to indicate the market isn't confident about where we're headed. Are interest rates, gasoline prices, corporate profits, etc. going up or down? Until we get a clearer picture of those outcomes, don't expect share prices to move much in either direction on an *annual* basis. In the interim the stock market remains in neutral – just as ready to shift into drive as it is into reverse. Over the short-term, the slightest dip or improvement in any one of a number of indicators discussed later in this newsletter could result in significant volatility in the financial markets.

Generally, domestic mid-size stocks performed best during the first quarter of 2007 followed by smaller companies and then large-company stocks. Overall the broadest measure of stock performance – the Wilshire 5000, was up only 1.5% during the first quarter. Growth stocks performed marginally better than value stocks. The Dow Jones Industrial Average was one of only a few stock indexes that posted a negative return during the first quarter. Commercial real estate, international companies and emerging market stocks posted average performance.

In the following column are sample returns of various asset categories during the first quarter of 2007:

1st Quarter 2007	**(includes dividends reinvested)**
(0.3%)	**Dow Jones Industrial Average**
+ 0.6%	**Standard & Poor's 500 Index**
+ 1.5%	**DJ Wilshire 5000 (Broad Market)**
+ 1.0%	**Large-company stock-Growth**
+ 0.9%	**Large-company stock-Value**
+ 4.3%	**Mid-Size Stocks – Growth**
+ 4.4%	**Mid-Size Stocks – Value**
+ 3.1%	**Small-company stock- Growth**
+ 2.7%	**Small-company stock- Value**
+ 3.5%	**International (excludes U.S.)**
+ 2.3%	**Emerging Markets**
+ 3.5%	**Real Estate Investment Trusts**
+ 1.3%	**Short-term U.S. Treasury *(includes appreciation)***
+ 1.9%	**Intermediate U.S. Treasury *(includes appreciation)***

FUTURE ECONOMIC OUTLOOK

Generally speaking, most money managers, economists, strategists and the investing public are staring at each other from across the same crowded boat and silently wondering whether it is a "good or bad sign" that everyone has the same confused and uncertain outlook of where the economy is heading over the next year or two. Unfortunately, no one can predict with any degree of certainty where the stock or bond markets will be over the next twelve months. However, we can identify several variables that impact the financial markets, monitor their movement, rate of change, and then implement adjustments based upon the strength of our convictions. The biggest challenge in this endeavor is identifying and separating the insignificant information from the meaningful data.

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As discussed in our previous newsletter, corporate profits or earnings growth are key drivers of stock prices over the mid-to-long-term and they are definitely slowing. For the past five years, corporate profits have grown much faster than the economy, rising more than 12% a year since 2002. The peak growth rate was 19% in 2004 and recently (third quarter 2006) profit growth was 16%. But, there is growing evidence that this rate will fall to single digits in 2007.

When oil prices were making new highs in the middle of last year, companies involved in energy and materials were posting profit gains exceeding 20%. In 2007, profit growth from these high levels is expected to fall to 5% or less. The slowdown in manufacturing and housing are other primary reasons for this decline in profits along with falling gasoline prices. Over the long-run, profit growth (corporate earnings) must approximate growth in our entire country's GDP (Gross Domestic Product). Simply stated, GDP is the sum total of our country's output and corporate profits are a good measure of our output.

Over the short-term, imbalances can occur and the primary reasons why corporate profits have exceeded our GDP by a wide margin (over the past few years GDP has ranged between 3% and 7% compared to corporate earnings growth of 12% to 17%) is because of increased productivity (producing or delivering the same goods and services faster and less expensively than before due to technology advances, etc.) and cheaper labor costs.

Now, the consensus estimate for GDP growth for 2007 is 3% or less and corporate profit growth at 10% or less. Have you noticed increased price discounting especially during the last Christmas season? In general it has been difficult for companies to increase prices to cover rising costs. Have you noticed the increase in minimum wages recently while health and retirement costs are increasing? The squeeze on profit margins is underway.

There must be something on the other side of the equation that is responsible for holding the economy up and to explain why the consumer is still willing to spend after posting a negative savings rate over the past two years. One, homeowners have been tapping the equity in their homes and that scenario is coming to an end. This is the main reason why many economists and policymakers are concerned about the recent slide in residential real estate values, increasing notice of defaults, and the health of sub prime lending companies who have made questionable loans to lower-quality borrowers.

The two relatively hidden but powerful strengths are fiscal stimulus (or government spending) and the service economy. When our government runs a deficit (spends more than it takes in) by financing the war in Iraq, government programs etc., this fiscal spending or stimulus is just as powerful as consumer spending except we don't readily understand or visualize the impact of government spending compared to our more familiar consumer spending. Government spending has been growing since the terrorist attack in New York and accelerated as the conflict in Iraq continues. This somewhat invisible spending has been absorbing some of the decline in corporate profits while consumer spending continues to increase.

The last and most powerful strength is the service sector of our economy. The service sector is large and diverse with service businesses representing about 80% of America's economy. Job creation in investment banking, finance, restaurants, medical services, education, software and a variety of consulting firms offsets or keeps the economy in balance as the decline in manufacturing continues in America.

The increase or absence of inflation receives far more attention in our financial markets than government spending and the service sector. The rate of change in inflation affects corporate profits, interest rates and the short-term direction of the stock and bond markets. However, the bottom line is core inflation should remain subdued and stay within the range of 2%-3% over the near-term.

Interest rates also receive a great deal of attention on a daily basis. Interest rates affect the rate of return on capital and the cost of borrowing on credit cards, cars, autos, homes, and business loans. Currently, mortgage interest rates are within ¾% of their lowest level over the past 45 years. Therefore any interest rate reduction by the Federal Reserve won't have much affect on our economy and only a very short-lived rally in the financial markets. Because our economy is slowing,

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interest rate hikes are unlikely. If anything, we expect bond yields (interest rates) to drop slightly without much effect.

Summary

Depending upon the author, journalist or desired subject matter, you will read and hear conflicting opinions about where the economy and financial markets are heading. When emphasizing downside risk, we can identify the uncertainty of the war in Iraq, political change in Congress and perhaps the White House, the sell off in Chinese stocks, default rate on home mortgages, declining housing market, oil prices trending up again, a negative personal savings rate for the second year in a row, slowing corporate profit growth, slowing Gross Domestic Product (GDP), uncertainty in the direction of interest and inflation rates, etc.

On the positive side, the job market remains strong, interest rates and the cost of borrowing are very low, government spending continues to rise and counterbalances reduced corporate spending, consumer spending remains strong, the inflation rate remains low and may be trending downward, etc.

When attempting to make sense out of all of the above observations simultaneously, the net result is muddy water or lack of clarity and conviction. That's where we find ourselves. One side doesn't offer a compelling advantage or significantly higher probability of occurrence over the other.

Last summer, we elected to reduce our clients' equity (stock) exposure by 10% to 30% and remain comfortable with that decision today. The proceeds have been partially invested in bonds and the remainder is available to take advantage of future opportunities or return to stocks when low-risk entry points present themselves. Until then, we expect more of the same volatility in both directions from the financial markets over the next 12 to 24 months. But at the end of the day (year), we expect investment returns to stay within a narrow range from normal to slightly below-average.

REVIEW OF BEST TAX AND RETIREMENT SAVINGS OPPORTUNITIES FOR 2007

Retirement Saving. The maximum contribution limits will increase in 2007 for the most common employer-provided retirement plans:

	Under Age 50	Age 50 & Older
401(k) & 403(b) Plans	$ 15,500	$ 20,500
IRA Accounts (same as 2006)	$ 4,000	$ 5,000
Defined Contribution Plans	Lesser of 100% of wages or $45,000	

IRA (Transfers) Charitable Contributions: One year (2007) remains for taxpayers age 70 ½ or older to take advantage of transferring up to $100,000 directly from your IRA to a qualified charity. The transfer (charitable contribution) is not taxable income and counts toward your required minimum distribution.

Estate Tax: The top federal estate-tax rate for estates of people who die in 2007 is reduced by one percent to 45% and the total amount that may be excluded from estate taxes is $2 million. The likelihood of a repeal of estate taxes or further reductions in the tax rate and the amount excluded from estate taxes after 2009 is becoming extremely unlikely. The "best" proposal passed by the Senate is to freeze the amount excluded from estate tax from 2009 through 2012 at $3.5 million and to freeze the highest estate tax rate at 45%.

Inheriting Employer Retirement Plans: A new law will benefit many people who inherit money from an employer-provided retirement plan such as a 401(k) Plan *from someone who wasn't their spouse.* Prior to 2007, inheriting money in a retirement plan from someone who wasn't your spouse could often lead to a required taxable distribution and unexpectedly high income tax bill. Under the new law, a child, domestic partner, or any other non-spouse who inherits money in a qualified retirement plan can transfer it directly into an IRA. The transfer to an IRA allows the heir to stretch out distributions over numerous years rather than taking the entire taxable distribution in a lump sum. In the past, only IRAs could be inherited by non-spouses and transferred to an IRA. This change will allow many people who have "significant others," children, relatives, etc. to rollover remaining balances in company retirement plans under the same favorable rules as surviving spouses.

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Extending this rollover or transfer opportunity to non-spouse beneficiaries will significantly reduce the income tax implications upon receiving an inherited retirement plan balance and allow the beneficiary to accumulate greater wealth over his or her life expectancy.

COPIES OF 2006 INCOME TAX RETURNS

Please send us copies of your 2006 Federal and State income tax returns as soon as they are available. Our investment advice and long-term financial planning recommendations are most effective when we have current income tax information in our files. Our advice is greatly improved when we have current income tax bracket information and capital loss carryforward figures. In addition, we may find opportunities to improve investment performance, implement new financial planning strategies and minimize income taxes. Your tax preparer will only send us this personal information upon your request. Please contact your accountant or send us copies at your earliest convenience.

ANNOUNCEMENTS AND UPDATES

We are pleased to announce a wedding ceremony. Pam Priest, our receptionist and office support person of 11 years, will celebrate her daughter's marriage ceremony this summer. Annie and Randy will be married here in San Diego in June, 2007.

Looking forward, we encourage our clients to make an annual appointment with us to review their goals and circumstances. An appointment is especially important if there has been, or soon will be a change in your financial situation, investment objectives or family circumstances. Now is the best time to discuss whether an update is appropriate for trusts, wills, or health directives. If you have not met with us over the past twelve months, we encourage you to call and schedule an appointment. We wish all of you a happy, healthy and prosperous coming year.

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Best regards

Brian Lowder   Clinton Winey   Michael Kinnear   Remette Martinson   Pam Priest