# BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

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## FINANCIAL MARKET OVERVIEW

Stocks ended the third quarter by falling 3% over the final one-week period. Even with the poor finish, U.S. stocks were up about 1% or less for the third quarter. In general, most asset categories posted flat or negative performance.

Third quarter financial market performance was mixed for nearly all indexes. Only large U.S. stocks posted a small positive return while small-company and mid-size stocks posted negative returns ranging from -1% to -8%. The Wilshire 5000 Total Market Index, the broadest measure of U.S. stock prices, was down a fraction of one percent. In general, growth stocks outperformed value stocks in all categories.

International stock price performance was awful compared to the U.S. – down over 6% during the third quarter and emerging markets (smaller international markets) were down about 3.75%.

While interest rates moved around during the quarter, the rate on the 10-year U.S. Treasury ended the quarter about where it started at 2.5%. Fixed income investments posted fractional gains for short maturities and about a 1% gain for longer-term bonds.

The value of the U.S. dollar compared to six other major currencies rose to a 4-year high by the end of the third quarter. Crude oil prices dropped from over $100 per barrel to $90 – about a 9% decline during the third quarter. Gold prices had the worst performance ending the third quarter with over a 9% decline. With all the turmoil and new military intervention in Iraq and Syria, one would have expected a significant gain in metal prices during the third quarter. The value of gold is the same today as it was on the first day of this year.

While real estate (REITs) values ended the third quarter with a 3% decline, REITs have the best year-to-date performance compared to all of the other indices shown below. The following chart displays sample returns of various asset categories during the third quarter of 2014:

| Yr-to-Date 2014 | 3rd Qtr. 2014 | Index Return (*includes dividends reinvested*) |
|---|---|---|
| + 2.81% | + 1.29% | **Dow Jones Industrial Average (^DJI)** |
| + 8.16% | + 1.13% | **Standard & Poor's 500 Index (^GSPC)** |
| + 6.93 % | - 0.07% | **DJ U.S. Total Stock Market (VTI)** |
| + 7.69% | + 1.45% | **Large-company stock-Growth (IWF)** |
| + 7.87% | - 0.19% | **Large-company stock-Value (IWD)** |
| + 5.48% | - 0.88% | **Mid-Size Stocks – Growth (IWP)** |
| + 7.87% | - 2.79% | **Mid-Size Stocks – Value (IWS)** |
| - 3.82% | - 6.00% | **Small-company stock- Growth (IWO)** |
| - 4.79% | - 8.59% | **Small-company stock- Value (IWN)** |
| - 2.09% | - 6.22% | **International (EFA)** |
| + 0.22% | - 3.86% | **Emerging Markets (EEM)** |
| + 14.12% | - 3.10% | **Real Estate Investment Trusts (VNQ)** |
| | | *Fixed Income* |
| + 0.38% | + 0.04% | **Short-term U.S. Treasury (SHY)** *(includes appreciation)* |
| + 5.92% | + 0.59% | **Intermediate U.S. Treasury (IEF)** *(includes appreciation)* |
| | | *Alternative Investment Category* |
| + 0.08% | - 9.24% | **Gold (GLD)** |

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## ECONOMIC AND FINANCIAL MARKET OUTLOOK

The broad U.S. stock market continued to rise during the third quarter, however the percentage gain was smaller and volatility in stock prices has increased considerably. While U.S. stocks ended up less than 1% during the third quarter, the percentage gain/loss varied between negative 3% and positive 3% along the way. Small company stocks were down by more than 8%. Which direction accurately reflects our future economy?

U.S. Gross Domestic Product (the monetary value of all goods and services produced by our country during a given time period) ***dropped 2.1%*** during the first quarter 2014 – the worst quarterly decline since the late 1940's. Unbelievably, three months later our government reported that second quarter 2014 GDP ***rose 4.6%***. Its likely most Americans did not notice such a dramatic increase in business activity over the three month period April – June. We didn't see it either. Additional government statistics that measure business activity also seem to be higher or better than expected. If statistical measures have been accurate, the prior two-year stock market advance has correctly anticipated improved economic conditions to come and the current U.S. stock market valuation isn't overly priced.

Although there is no shortage of pundits willing to provide his/her opinions from the vantage point of the rear-view mirror, the bottom line is: statistical economic data and current stock prices don't seem to match reality – that's the problem bothering most investors and advisers. Why are current stock prices at a level that is generally associated with a moderate to above-average economic growth period?

Either (stock) prices are too high and will eventually adjust downward or the economy is on the verge of a growth spurt and therefore stocks are simply anticipating that pending improvement. Certainly many investors are continuing to purchase U.S. stocks because our market returns over the past two years are better than most other countries around the world and alternative asset classes are not performing well either. Gold, oil and commodities are down, fixed income (bonds) pays very little interest, and rental or investment real estate is performing moderately. U.S. stocks seem to be the only sure bet.

The optimistic scenario portrays most investors as positive on U.S. stocks, investment managers expect interest rates will remain artificially low, and the U.S. economy will soon begin growing modestly. The negative scenario views stock prices as overvalued and it is just a matter of time before a market correction begins after an unexpected, noneconomic, political, global or exogenous (outside and unpredictable) event will spook the markets and cause prices to adjust rapidly to a more reasonable level that is reflective of a slow-growth economic environment.

Which scenario is correct over the short-term is anyone's guess. A better question is: Why have forecasts been so terribly inaccurate over the past 4 years? Why do people with years of experience, massive expertise and mountains of data at their disposal so often get the future wrong?

First and foremost, the future is the realm of surprises; no one, no matter how expert, can reliably foresee what will happen **and** *how people will react to it*. As the economist Friedrich von Hayek said in his lecture *The Pretense of Knowledge*, "in the study of such complex phenomena as the market, which depend on the actions of many individuals, all the circumstances which will determine the outcome of a process …

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<u>*will hardly ever be fully known or measurable.*</u>" Simply stated short-term forecasts of future market performance cannot be consistently or accurately predicted.

Secondly, just a few short decades ago, most of the movements in the financial markets use to be directly impacted by changes in economic data (growth, interest rates, company earnings, inflation, etc.) or basically "hard data". Today, opinions, dubious government statistics, media stories, politics, rapid trading and world events have a much larger impact on investor confidence and short-term market performance.

Over the near-term, we do not expect to increase our clients' exposure to the equity markets. It is more likely that we will reduce equity exposure by 20% to 33%. Over the past three years, the financial markets could have easily adjusted downward given all of the political turmoil, budget deadlines missed, implementing new healthcare reform and so much more. Yet, our stock market continued to advance with exceptional performance. Reducing stock exposure at any time over the past three years would have been a mistake. Therefore, looking forward, the decision to reduce or increase exposure to stocks must be used sparingly. Our portfolio management strategy will continue to focus on larger dividend-paying companies, a balanced exposure to all equity markets, and we will continue to do so without regard to a specific timeline. Currently, we do not have a compelling reason(s) to increase stock holdings beyond the current exposure or allocation to U.S. stocks.

## PHISHING SCAM

Please be aware that a "phishing" e mail is currently being sent out purportedly from Charles Schwab regarding the SEC. (Phishing is a fraudulent e mail that targets clients in order to install malware, a virus or steal personal information.) These emails are not associated with Schwab. Schwab has been aware of this e mail for over a month, and is working with outside vendors to block and ultimately shut down the sites associated to the links in the phishing emails. The following is an example (including typos and bad grammar) of a fraudulent phishing email received by one of our clients:

***"Hello, Client***

***SEC Rule 17a-3(17) requires that brokerage firms create a record for each account with an individual customer. You need to login to online access by the link bellow to avoid your account be halted by the SEC;***
***http://www.schwab-seccase0346340324.mobi?m=bm51dHRlckBjbnBzaWducy5jb20=***

***Barber Jack, Managing Director, The Charles Schwab Corporation"***

As always with questionable e mails, do not click on the link.

## COPIES OF 2013 INCOME TAX RETURNS REVIEW STRATEGIES

Please send paper or electronic (email) copies of your 2013 income tax returns to our office at your earliest convenience. Our investment decisions, income tax management and retirement planning strategies are greatly improved when we have your most recent income tax returns in our files.

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Best regards

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