McCarthy Asset Management, Inc.
Personalized Wealth Management

1st Quarter 2013 Letter
(also March 2013 Monthly Commentary)

April 1, 2013

Stock Market & Portfolio Performance

Inside this issue:

1st Quarter 2013: The stock market got off to a great start for 2013 with the S&P 500 closing at an all-time high on the last day of the quarter.

	Mar 2013	1st Qtr 2013	Description:
Without Dividends:			
S&P 500	3.6%	10.0%	500 Largest Public U.S. Companies
NASDAQ	3.4%	8.2%	stocks trading on the Nasdaq
Russell 2000	4.5%	12.0%	2000 of the smallest U.S. stocks
MSCI EAFE	0.4%	4.4%	international stock index
U.S. Aggr Bond	0.1%	(0.1)%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	2.8%	7.3%	non-very conservative MAM portfolios
MAM Conserv	1.1%	2.6%	very conservative MAM portfolios

Comment: U.S. stocks posted very strong gains for the quarter, while foreign stocks lagged and bonds were close to breakeven. While some may be tempted to chase performance and shift more into U.S. stocks, diversification among various asset classes remains important and an allocation to bonds will provide downside protection when the next correction occurs.

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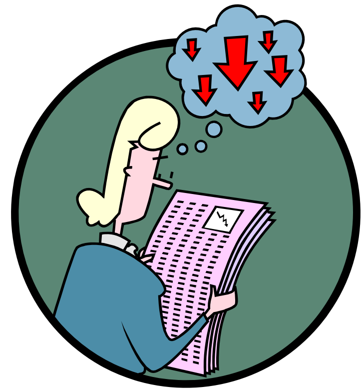
What To Do With Stocks At An All-Time-High?



On the last day of the quarter, the S&P 500 hit an all-time high, surpassing the previous high reached in October of 2007. The unpleasant experience of the stock market crash that followed the 2007 highs is still fresh in many investors' minds. As such, a few of our clients have recently asked if this is the time to get more conservative, while others have asked if this is a time to get more aggressive. While we know our clients are pleased to see their portfolios reach new highs, some may be worried whether another significant pullback is coming. In this article we share our thoughts on the subject, drawing on our experience of the past market cycles and on the research, from Liz Ann Sonders, Chief Market Strategist as Charles Schwab & Co.

The table below presents the key distinctions between the market on March 15th 2013 and the previous cycle's high from 1,984 days ago, on October 9th, 2007. We still believe that positives (in green) outweigh the negatives (in red):

	THEN (October 9th, 2007)	NOW (March 15th, 2013)
THE MARKET		
S&P 500	1,565	1,561
S&P 500 Price-to-Earnings (TTM)	17.5	16.1
S&P Dividends per Share	$28	$32
10 Year Treasury Yield	4.7%	2.0%
THE ECONOMY		
Budget Deficit	$169B	$1002B
Gross Federal Debt	$9,007B	$16,432B
Debt as a % of GDP	64%	104%
THE CONSUMER		
Unemployment Rate	4.7%	7.7%
Americans Unemployed	7 M	12M
Household Debt	$13,555B	$12,831B
U.S. Median Home Price	$206,700	$173,600
Average 30-yr Mortgage Rate	6.4%	3.6%
Consumer Price Index (Core Inflation)	3.5%	2.0%

Other sources: BLS, National Association of Realtors, Liz Ann Sonders' "Vertigo"

Factors contributing to our positive outlook include:

- A very accommodating Federal Reserve that is keeping interest rates very low
- Significant improvement in Housing adding to GDP and employment growth
- Unemployment claims being at a 5 year low with modest but persistent employment gains
- Higher GDP forecasts (helped by industrial production and retail sales)
- Analysts' projections for continued growth in corporate earnings
- Continued consumer deleveraging (as evidenced by lowered delinquency rates and lowered balances relative to personal income)
- A U.S. oil & gas boom that has many significant positive economic implications for the U.S.

Markets are said to be a "voting machine" in the short run and a "weighting machine" in the long run. <u>We see enough positives for the long run to continue to stay invested and not try to time the market</u>.

Markets do not go up in a straight line and there are plenty of factors out there that can cause pullbacks. Some of the known negatives are:

- The fear of what will happen when the Fed starts raising interest rates
- The dramatic growth in the Federal government's debt
- The Sequester with the possibility of government shutdown
- The European crisis (most recently brought back to the headlines with the bank crisis in Cyprus)

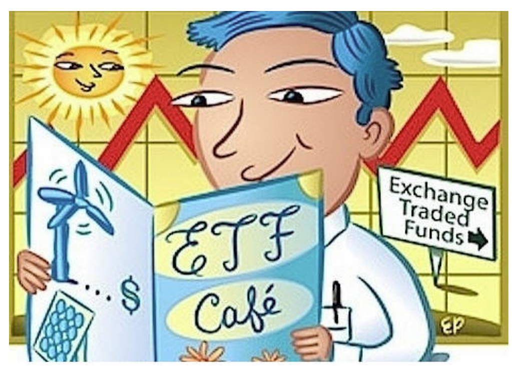
There are also future exogenous events which cannot be foreseen or predicted (black swans) that may also cause markets to shake. However, we believe that the pullbacks will come in a form of healthy periodic corrections of a modest magnitude, rather than a crash like we saw in 2008.

That said, we are not adverse to tactical moves. Those clients who have been with us for a while know that in addition to regularly rebalancing the portfolios, we sometimes make tactical moves where we believe such moves are warranted. **At this point we think that our clients are best served staying the course, despite possible volatility along the way, rather than trying to time the next pullback.**

In the meantime we continue to monitor the investment landscape looking for ways to improve the risk-return characteristics of our clients' portfolios. We do this by selecting mutual fund managers who show consistent, risk-adjusted strong performance while minimizing losses and ETFs that give our clients exposure in the areas in the markets which we believe are most poised for growth and provide consistent income.

Exchange Traded Funds– An Overview

This January marked the 20th birthday of the first and the biggest Exchange Traded Fund, SPDR S&P 500. Ever since they were first introduced, ETFs have been gaining traction with individual and institutional advisors alike. In this article, Alexey gives a quick primer on what ETFs are and profiles some of the ETFs which you may have in your MAM portfolio(s).



What are ETFs? An Exchange Traded Fund (or ETF for short) is a basket of securities (stocks, bonds, alternative instruments, etc.) similar to a mutual fund, but trades on the exchange like a stock. An ETF allows investor to invest in a sector, an asset class, a region or some corner of the financial market without having to pick individual securities. Nearly $60 billion of exchange traded products are swapped daily on US exchanges, accounting for almost a third of a total trade volume. According to the Investment Company Institute, assets in domestic equity ETFs jumped $146.31 billion, or a 27% increase since December 2011 and global equity ETFs increased $83.41 billion. The total size of the ETF market in 2012 was estimated to be $1.337 trillion, including $243.2 billion in bonds and $656 million in hybrid ETFs.

The adoption of ETFs has increased among financial advisors in recent years. Low cost fund champion Vanguard manages nearly $230 billion in ETFs, while Schwab offers a suite of ETFs that have the lowest operating expense in their respective Lipper categories. A recent development, which is likely to increase the use of ETFs even more, also comes from Schwab. *More than 100 ETFs can now be traded commission free*.

Why use ETFs? ETFs can be used to gain broad exposure to the stock market, to gain access to a specific corner of the market or to augment an existing portfolio. According to Reginald Browne, a senior trader at Knight Capital, whom Forbes Magazine recently profiled as "the Godfather of ETFs", *"ETFs are the future of mutual funds. They just don't know it yet."* The market for ETFs is robust and growing fast, but is dwarfed by $10 trillion of investors' money still sitting in traditional mutual funds.

While it is premature to write-off mutual funds, ETFs do combine some of the best features of investing in mutual funds and individual equities:

- **Liquidity:** ETFs are traded throughout the day and change price constantly. The market is "deep" and efficient. Some exchanges even chose to pay market makers to provide liquidity and maintain a competitive quote.
- **Transparency**- Unlike many investment vehicles and investing strategies that only disclose their holdings quarterly, most ETF index funds publish their exact holdings on a daily basis, so an investor always knows what he or she owns.
- **Low Cost**- ETFs trade with no loads or 12(b)(1) fees. Because of the passive nature of the investment, expense ratios (cost of running an ETF) are low, which translates to investors keeping more of their gains.
- **Tax Efficiency**- most ETFs in existence today are not actively managed (i.e. track an index or a category). Thus there is very little buying and selling (turnover) going on inside the fund. That, in turn, contributes to tax efficiency.
- **Diversification**- an ETF investor can obtain a broad exposure to a market or an index with just one trade.
- **Fairness**- ETFs are often considered to be more "fair" to existing shareholders than a mutual fund. For example, if a mutual fund is successful and becomes popular, experiencing large inflows of cash, the fund manager has to put the money to work, buying more shares, thus creating turnover, resulting in more expense for existing shareholders. Conversely, when a fund is facing large redemptions (investors pulling money out), a fund manager has to sell the shares, sometimes burdening remaining shareholders with unwanted capital gains. In an ETF, investors are insulated from the tax consequences of the actions of their fellow shareholders.

Why Not Only Invest in ETFs?: One drawback of ETFs is that most of them are passively managed. The manager of the fund (which can actually be a computer program) has the ETF mimic an index. For areas of the market where we feel investing in indexes is appropriate (i.e. stocks paying a rising dividend and Master Limited Partnerships), we use them. There are areas, though, where we still prefer to use actively managed funds. For instance, many of the ETFs that invest in bonds have a large exposure to U.S. Treasuries, which is the area of the bond market which is most exposed to the potential of rising interest rates. In addition, we use some actively managed funds such as Yacktman and BlackRock Health Science, which over time have substantially outperformed their benchmarks.

ETFs in MAM portfolios: At MAM we have been keeping a close eye on ETFs and added a few to portfolios in areas where we think they can add value. Some of the examples of the ETFs found in our portfolios are:

- VIG– This fund tracks the performance of the index which consists of common stocks of companies that have a record of increasing dividends over time.
- SCHD– The most recent addition to MAM Portfolios, this ETF seeks investment results that tracks, net of expenses, the total return of the Dow Jones U.S. Dividend 100 Index.
- AMJ- This exchange-traded note seeks to replicate, net of expenses, the Alerian MLP Index, which tracks the performance of midstream energy Master Limited Partnerships, giving our clients access to this growing alternative asset class that offers a generous dividend.
- IWM– This ETF seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of the Russell 2000 Index which measures the performance of the small-capitalization sector of the U.S. equity market.

Because we customize portfolios to meet the goals, objectives and risk tolerances of our clients, not every portfolio will have every ETF listed above. We constantly monitor for new additions which we believe will benefit our clients in the long haul. If you would like to learn more about the ETFs or have questions about any of the investment funds in your portfolio, please contact us.

Umbrella Insurance Policies

As you are probably well aware, we live in a very litigious society. Lawyers are suing for larger amounts of money than ever. Homeowner, auto, and watercraft policies have a limit on liability insurance. If an unfortunate accident should happen that is your fault, do you have enough liability insurance from your current policies? Since no one can predict how much a judge may award the injured person, umbrella insurance is not just for the wealthy anymore, but a needed protection for many people.

Umbrella insurance policies were created to provide additional liability coverage when a lawsuit brought over injuries and/or property damage that exceed the liability limits on auto, home, boat, etc. insurance policies. Here is <u>why most people should have an umbrella policy</u>:

- It provides additional lawsuit coverage of $1 million or more.
- It provides added coverage for legal defense costs, which can easily amount to $100,000 or more.
- It can provide liability coverage for some lawsuits not covered by your auto or homeowners insurance. (e.g. sued over renting a boat while on vacation or a car rented in Europe).
- Since these policies provide "catastrophic coverage" that is unlikely to ever be needed, they cost as little as $200 to $500 per year. This cost is well worth the peace of mind provided by the coverage.

<u>How to purchase a policy?</u> In most cases, policyholders add this policy to current coverage using the same insurance provider as their auto and home insurance.

<u>Who really needs such a policy?</u> The more financial assets you have, the greater is your potential exposure to a lawsuit. Furthermore, families with teenage drivers, swimming pools and dogs are more at risk. Also, owning rental properties is a potential liability risk.

<u>How much coverage should be purchased?</u> Mark Schussel, a spokesman for the Chubb Group of Insurance Companies, which caters to affluent home and auto owners, was quoted in a New York Times article "Some people have some coverage. But they haven't changed the amount in years. Some people have a $1 million figure in their heads, and it just doesn't make sense anymore." A major factor to consider in determining the amount of coverage is the amount of how much you have in financial assets (home, retirement accounts, brokerage accounts, etc.) that could be at risk to a lawsuit.

<u>Why don't more people have umbrella policies?</u> Banks force people to buy home insurance when they get a mortgage and states require drivers to buy auto insurance. But no one mandates buying a policy that could turn out to be the most important part of your insurance package.

<u>What do the policies cost?</u> The first $1 million in coverage is usually the most expensive, at perhaps $200 to $350 annually, per Jeanne M. Salvatore, a specialist in home insurance at the Insurance Information Institute. Each additional $1 million in coverage, she said, could cost $100 to $200 annually. The rates per million decline as coverage increases. But at $10 million in coverage, the rate jumps because few customers buy that much, meaning insurers can spread the risk over only a relatively small group of customers.

Sincerely,

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Our Services

McCarthy Asset Management, Inc. (MAM) is an independent, privately owned Registered Investment Advisor firm. We provide clients with the peace of mind that comes from knowing professionals are managing their financial affairs. The services we offer include:

Investment Management Services:

- **MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.**

Financial Planning Services:

- **The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.**
- **"Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.**

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- **Tax Return Preparation**
- **Income Tax Projections**
- **Tax Minimization Ideas**
- **Tax Authority Representation**

Other Services: MAM has retained several outside experts, whose services are available at no cost to our clients:

- **Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.**
- **The Savvy Life® Classes and Workshops by best –selling author Melis-**

Reminders

Tax Reminders: April 15th *is the deadline for filing 2012 individual income tax returns and making 2012 IRA, SEP-IRA, Roth IRA and Education Savings Account contributions. It is also the deadline for first quarter 2013 Federal and State estimated payments. April 10th is the deadline for California property tax payments for the first half of 2013.*

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