

## August 2014 Monthly Commentary

September 2, 2014

### Stock Market & Portfolio Performance

#### Inside this issue:

<b>Market &amp; Portfolio Performance</b>	<b>1</b>	<b><u>August &amp; YTD 2014:</u></b> Large-Cap U.S. stocks & bonds performed very well both for the month of August and first eight months of 2014.			
<b>Second Quarter 2014 S&amp;P 500 Earnings</b>	<b>2</b>	<u>August 2014</u>	<u>YTD 2014</u>	<u>Description:</u>	
		Without Dividends:			
<b>Client View Portal– Direct Link to MoneyGuidePro Planning Software (by Lauree Murphy)</b>	<b>2-3</b>	S&P 500	3.7%	8.4%	500 Largest Public U.S. Companies
		NASDAQ	4.8%	9.6%	stocks trading on the Nasdaq
		Russell 2000	4.8%	0.9%	2000 of the smallest U.S. stocks
		MSCI EAFE	-0.5%	0.4%	international stock index
		U.S. Aggr Bond	0.9%	4.8%	index of U.S. bonds
<b>Q&amp;A– Are Index Funds Used in MAM Portfolios?</b>	<b>3-4</b>	With Dividends, after all fees:			
<b>Our Services</b>	<b>5</b>	MAM portfolios	2.9%	7.1%	non-very conservative MAM portfolios
		MAM Conserv	1.8%	5.8%	portfolios with 50%+ bond allocation

*Comment: After a short 4% pullback from July 24 through August 7, stocks recovered with the S&P 500 reaching a new all-time high at the end of August.*

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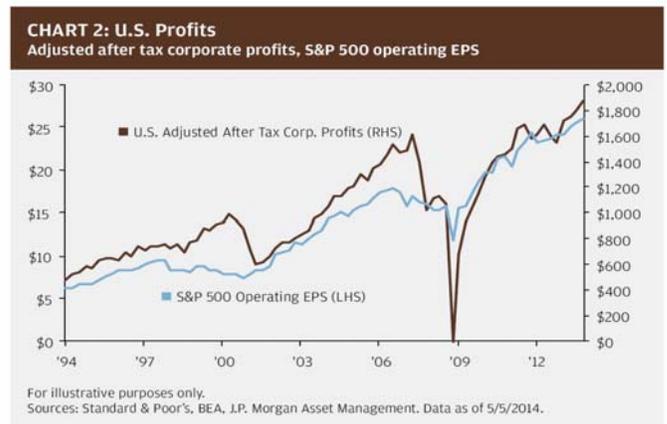
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**A Good Quarter:** Of the 490 companies that have reported earnings to date for the second quarter of 2014, 74% have reported earnings above the mean analyst estimate and 66% have reported sales above the mean estimate. For the companies that have reported so far, the growth rate has been 7.7%, which represents the second highest quarterly earnings growth rate since the fourth quarter of 2011.

**Estimated Future Earnings:** As of August 14<sup>th</sup>, Standard and Poor's estimated that earnings per share for the S&P 500 will total \$119.25 for all of 2014, up from \$107.30 in 2013. For 2015, S&P estimates significant further growth in EPS to \$136.50. History reveals that analyst estimates often prove to be overly optimistic, but the current year-over-year growth rates are an impressive 11% in 2014 and a spectacular 14% for 2015. While stock prices can fall even if profits are rising, history suggests that stock prices generally follow earnings.

**Stock Price Valuations:** With stock prices staging a dramatic rise since March of 2009, prices are probably now a little stretched. Based on the S&P 500's August 29, 2014 closing level of 2003, the \$119.25 EPS estimate for 2014 results in a price-earnings ratio of 16.8, which is a little high relative to historical price-earnings ratios. With the projected 2015 earnings of \$136.50, the forward price-earnings ratio for the S&P 500 drops to a more reasonable 14.7.

**Recent History of U.S. Profits:** The chart on the right from J.P. Morgan shows the U.S. Adjusted After-Tax Profits and the S&P 500 Operating Quarterly Earnings Per Share since 1994. As you can see, other than a modest dip in the 2000-2002 dot.com bust and a very sharp drop during the 2007-2009 Financial Crisis, corporate earnings have been steadily rising. **More importantly, earnings are now approximately five times what they were back in 1994. It is the growth in the U.S. economy accompanied by the increase in corporate profits that drives stock prices up over time.**



## Client View Portal– Direct Link to MoneyGuidePro Planning Software (by Lauree Murphy)

We have created a “Retirement Analysis” for a number of our clients to determine whether they are on course for a financially-comfortable retirement. Recently, we added the capability to directly link the Client View portal to MoneyGuidePro, the financial planning software we use to create the “Retirement Analysis”. By accessing directly from your portal, you do not need to remember a separate password to have access to your Retirement Analysis.

If you had a plan done in 2014, your information is linked and ready to use. The “MoneyGuidePro” tab on the portal has three drop-down selections: **Current Allocation, Net Worth, and Guest Home**. The **Current Allocation** and **Net Worth** pages give you a picture of your assets as of the last time your Retirement Analysis was updated.

## Client View Portal– Direct Link to MoneyGuidePro Planning Software (by Lauree Murphy)– Con’t

The **Guest Home** page is really where the meat of the plan is located. When you open this link, you will see a page called **My Snapshot** (see picture below for what it looks like). It has a number of tabs that you can explore:



- The **Results** tab provides a summary of the results of your Retirement Analysis (typically a “current scenario” and a “recommended scenario”).
- Two tabs I really like are the **Play Zone** and **What are you afraid of?** Both of these allow you to change certain aspects of the data in your plan to see the long term impact. For instance, the **Play Zone** allows you to change the age you retire, the amount you spend on specific goals, your savings amounts, and your portfolio returns. You then quickly get an idea of how those changes positively or negatively impact your plan.
- The **What are you afraid of?** tab makes it easy to see how changes in key financial factors affect the probability of success for your Needs, Wants, and Wishes. You can see how higher inflation, living a longer life, cutting social security benefits, lower returns on your assets, and higher health care costs impact your plan.

You also have access to a number of helpful, easy-to-use financial calculators within MoneyGuidePro in the **My Plans** section (i.e. the tab next to “**My Snapshot**” at the screen after you click on “**Guest Home**”). You can do things such as: calculate college costs, discover if you are eligible to make an IRA contribution, create a budget, quantify the effect of a Roth Conversion and many more.

**Who Needs a Plan?** If you are getting close to retirement (7 years away or sooner), now is a great time to see what kind of financial shape you are in. The Retirement Analysis is the most common application we use MoneyGuidePro for. In addition, it is capable of looking at many other types of financial goals and helping clients achieve those goals. Weddings, home purchases, college costs, home improvements, and travel expenses are examples of financial goals that can be analyzed. This makes it useful for both those who are retiring and individuals beginning their careers. Planning is free and complementary for MAM clients. For non-MAM clients (particularly those who are just getting started saving), we may be willing to do planning for a modest fee.

If you need help getting acquainted with the tools, please contact Lauree. One thing to note is that on the right of most pages is a blue button called **SmartAlex**. When you click on it, you get an audio explanation on how to use that page.

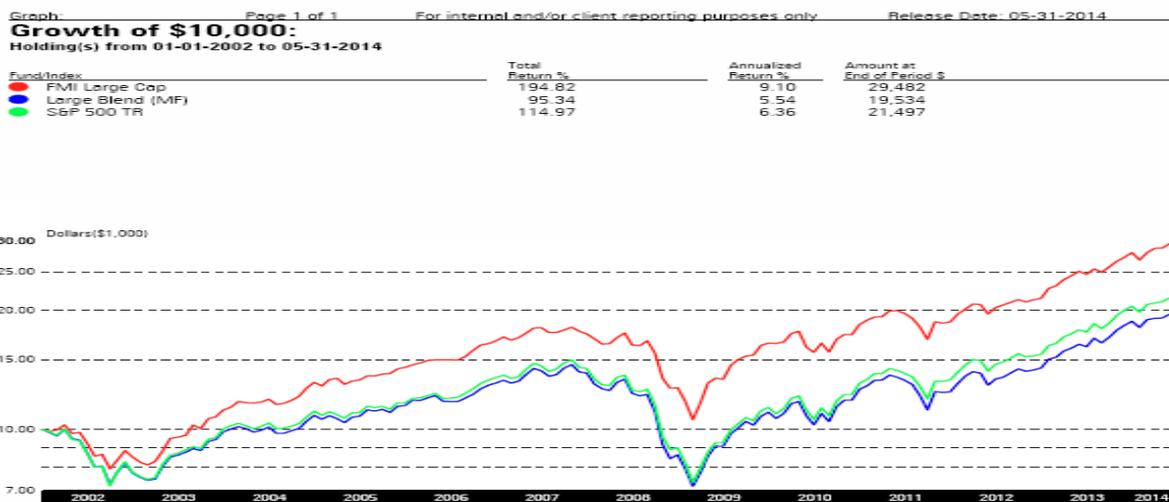
## Q&A– Are Index Funds Used in MAM Portfolios?

This past month, I received an email from a client saying he watched a Frontline episode called “The Retirement Gamble”, and was wondering how extensively index funds are used in MAM-managed portfolios. (The Frontline documentary espoused the virtues of index funds.) I thought this was a good question, so I am sharing my response in this Monthly Commentary.

**The Benefits of Index Funds-** Over the long-term, few actively-managed funds outperform their peer market index. Furthermore, index funds have lower operating expenses and tend to be more tax-efficient than actively-managed funds.

Here are my thoughts about the use of index funds:

- Increased Usage in Portfolios:** The last few years we have increased exposure to index funds through the use of “exchange traded funds” (ETFs) (i.e. most ETFs are index funds). Currently, approximately 20% of MAM-managed assets are invested in ETFs. We like ETFs because of their low costs and tax-efficiency. We use ETFs where we really like the indexes the ETFs track. For instance, two of the ETFs used most extensively are Schwab U.S. Dividend (SCHD) and Vanguard Dividend Appreciation (VIG). Both of these invest in large-cap stocks that have a history of paying increasing dividends. We like this index as studies have shown that stocks that pay an increasing dividend over time have historically outperformed the overall stock market.
- Don't Use Index Bond Funds:** We don't use index funds for bond exposure. (On average MAM portfolios have a 30% allocation to bond funds and cash.) We feel that actively-managed bond funds are superior to index bond funds (and the track records of the bond funds we use have outperformed their peer group indexes). Furthermore, the Barclays U.S. Aggregate Bond Index currently has approximately 40% of its portfolio allocated to U.S. Treasuries (up from 16% fourteen years ago). This is because following the global economic crisis, the Federal Government issued debt at a more rapid pace than corporations in order to finance the growing Federal deficit. The actively-managed intermediate-term bond funds used in MAM portfolios are not constrained to having a large exposure to U.S. Treasuries, and in fact, currently have little or no allocation to them. I expect U.S. Treasury bonds to be more negatively affected than most other types of bonds once interest rates start to rise.
- We Use Some Excellent Actively-Managed Funds:** We use actively-managed funds for the remaining portion of MAM portfolios. The key criteria in selecting these funds is that over time they have out-performed their comparable index, have reasonable operating expenses, and tend to outperform when the stock market is falling (i.e. they offer better downside protection than index funds). For instance, the fund that has the largest position in MAM portfolios, FMI Large Cap, has been used in portfolios for a number of years and has dramatically outperformed its index (U.S. Large Cap Blend index and the S&P 500). See the chart below for the Fund's performance since 2002. relative to the Large Blend Index and S&P 500.



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.
- Medicare Advisory Program (MAP) - Allen Hamm
- The Savvy Life® Classes, Workshops , and One-on-One Consultations

## Reminders

*Please let us know if you would like to have us prepare or update a Net Worth Analysis or Retirement Analysis for you, or for Allen Hamm to prepare a Long Term Care Plan for you.*



Discover the difference with a  
Registered Investment Advisor.