McCarthy Asset Management, Inc.
Personalized Wealth Management

Dec. Monthly Commentary/Q4 2015 Quarterly Letter

Jan. 4, 2016

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Stock Market & Portfolio Performance

4th Qtr & Full Year 2015: After a positive 4th quarter, stocks posted mixed results for 2015. International stocks were down for the year due to the impact of a surging U.S. dollar, while bonds generated very small gains.

	4th Qtr	FY 2015	Description:
Without Dividends:			
S&P 500	6.5%	-0.7%	500 Largest Public U.S. Companies
Russell 2000	3.2%	-5.7%	2000 of the smallest U.S. stocks
MSCI EAFE	4.4%	-3.3%	international stock index
U.S. Aggr Bond	-0.6%	0.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	3.1%	-3.3%	non-very conservative MAM portfolios
MAM Conserv	-1.3%	-2.8%	portfolios with 50%+ bond allocation

The returns showed above are unaudited. Past performance is not indicative of future results. Returns for McCarthy Asset Management Portfolios ("MAM Portfolios") are net of management fees and transaction costs, and reflect the reinvestment of dividends. Results represent a composite of clients using a similar investment strategy, individual results will vary.

Returns for the indices are provided solely as a general indication of current market conditions. MAM Portfolios are not invested in a style substantially similar to any index. Indices do not reflect the deduction of management fees or transaction costs or the reinvestment of dividends. Performance for the indices would be lower if these costs were reflected.

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2016 Stock Market Outlook

Trying to successfully time the stock market is nearly impossible. Nonetheless, clients often ask about my outlook for stocks. While I don't have any unique insight, I will venture my guess. **I am cautiously optimistic for modest gains in 2016, and favor stocks over bonds, although it is likely we are toward the tail end of a tremendous bull market that started in March of 2009.** With stock prices nearly tripling since then, I believe risks are now elevated. It was for this reason that for the first time since the 2008 Financial Crisis, we became slightly more defensive when we repositioned portfolios in November.

Here are my thoughts on important factors that are likely to impact the stock market in 2016:

- <u>Economic Growth</u>: Currently economists predict that U.S. GDP growth should improve to 2.5% to 2.75% growth for 2016, up slightly from 2015. Global growth is also expected to modestly accelerate. A recession is not on the horizon.

- <u>Federal Reserve</u>: Last month, for the first time in more than eleven years, the Federal Reserve initiated a Fed policy tightening cycle by raising the target for the federal funds rate by 0.25%. The widely expected decision marks the end of a long, seven-year period of zero rates initiated by the Fed to combat the 2008 Financial Crisis. After stocks rose on the news, it is clear that investors viewed the Fed's decision as a vote of confidence that the economy is strong enough to stand on its own. While further rate hikes are likely in 2016, the Fed is expected to be gradual with the increases. *Historically, the stock market performs well in the first year after the first Fed interest rate increase when the subsequent increases are at a "gradual" pace.*

- <u>Corporate Profits</u>: Earnings for the S&P 500 companies are expected to rebound at least 5% in 2016 after a disappointing 2015 which were hurt by both a dramatic drop in earnings from energy firms, as well as the negative impact of a sharp rise in the U.S. dollar.

- <u>Stock Price Valuations</u>: Based on 2015 earnings, stock prices are a little high. Factoring in the still very low level of interest rates combined with the positive outlook for 2016 corporate earnings, prices look more reasonable. My best guess is that stock prices will provide mid-single-digit returns for 2016, with higher volatility than what we have experienced the last few years.

- <u>Increased Stock Market Volatility</u>: Between October 2011 and July 2015, the S&P 500 went nearly four years without a "correction" of more than 10%, while climbing an average of 20% a year. This was a very extended period with low volatility and high returns. Typically, 10% corrections, like the one experienced in August of 2015, are common occurrences. I expect increased volatility in 2016 and wouldn't be surprised to experience at least one 10% temporary correction.

- <u>International Stocks</u>: International markets may re-emerge as a more viable investing opportunity as global growth picks up and the U.S. dollar stops surging. This will be a welcomed change for diversified portfolios as U.S. stocks have significantly outperformed international stocks since the end of the 2008 Financial Crisis.

- <u>Limited Returns for Bonds</u>: I expect bond prices to struggle as the Fed gradually raises interest rates. Despite this outlook, bonds will still play a vital role in portfolios to help reduce volatility and provide diversification.

When Will Oil Prices Recover?

We last wrote about oil prices in the January 2015 Monthly Commentary. At the time, the price of a barrel of oil had plunged from $110 in June of 2014 to around $50. After that fall, many analysts felt that 2015 was going to be a year of slow but gradual price recovery, as U.S. shale producers cut spending and low prices spurred increased demand. Ten banks surveyed by the Wall Street Journal in March of 2015 predicted that U.S. crude oil would average $50 a barrel or better in the fourth quarter. It certainly didn't work out that way. This past month, oil prices fell to the mid $30's. How did market watchers get this so wrong?

- OPEC (led by Saudi Arabia) surprised markets by increasing its output in 2015 instead of cutting it. In fact, the group recently said that it pumped more oil in November than any month in the past three years.
- U.S. production has remained resilient. Even though production started falling in April, it remains near multi-decade highs (although more recently the decline has accelerated).
- Demand has not grown as much as expected as global growth has been disappointing, particularly in China and other emerging markets.

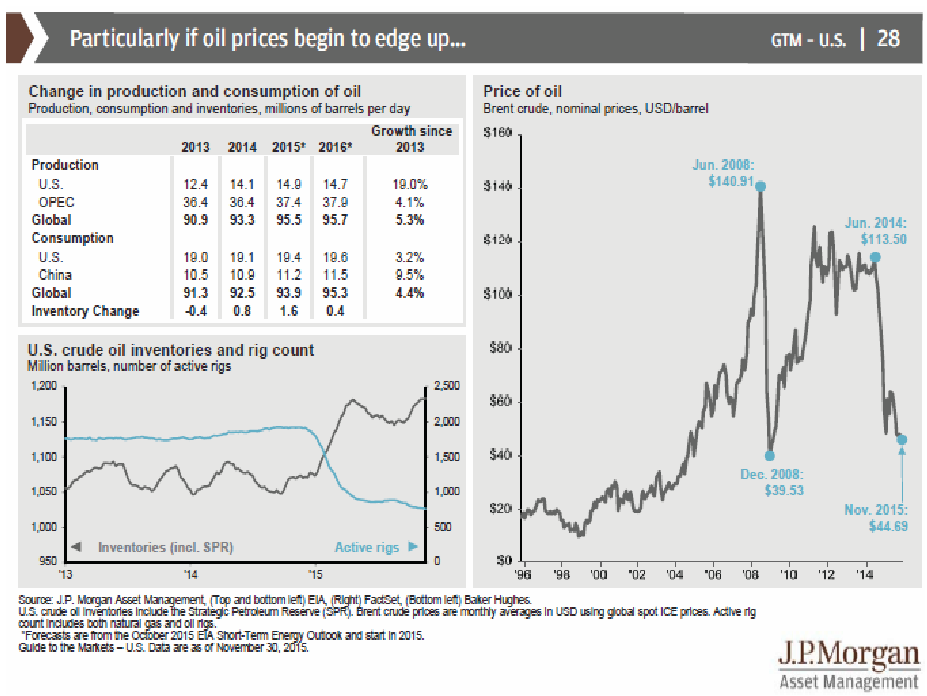
J.P. Morgan's Forecast: In a December 9th webcast, Dr. David Kelly, Chief Economist for J.P. Morgan predicted that oil prices may recover to around $50 by the end of 2016 and $60 by the end of 2017. This oil price recovery would be driven by a dramatic drop in spending by oil companies, which will cause production to drop.

The chart's below from J.P. Morgan show:

- Slowing Production Growth: Global oil production growth, after increasing from 90.9 million barrels a day in 2013 to an estimated 95.5 million in 2015, is forecast to only slightly increase to 95.7 million in 2016.
- Increasing Demand: After increasing from 91.3 million barrels a day in 2013 to an estimated 93.9 million in 2015, demand is expected to reach 95.3 million in 2016.
- The net result is while supply is estimated to have exceeded demand by 1.6 million barrels a day in 2015, the excess is projected to drop to .4 million in 2016.

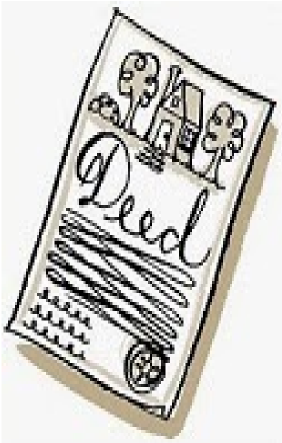
While the timing is difficult to predict, we believe it is just a matter of time before oil prices at least partially recover. Here are predictions from a couple of relevant energy organizations:

- In November, the International Energy Agency (IEA) said that prices for crude oil will gradually recover through 2020. Under its base case scenario, the IEA said it expects crude prices to reach around $80 a barrel by 2020, as the market gradually rebalances by taking high-cost supply out of the market and encouraging higher demand growth.
- Late in December, OPEC predicted oil prices will rebound in coming years. Also, the cartel said it expects to reduce its own production by 2019 and that prices will recover to $70 a barrel by 2020.



	2013	2014	2015*	2016*	Growth since 2013
Production					
U.S.	12.4	14.1	14.9	14.7	19.0%
OPEC	36.4	36.4	37.4	37.9	4.1%
Global	90.9	93.3	95.5	95.7	5.3%
Consumption					
U.S.	19.0	19.1	19.4	19.6	3.2%
China	10.5	10.9	11.2	11.5	9.5%
Global	91.3	92.5	93.9	95.3	4.4%
Inventory Change	-0.4	0.8	1.6	0.4	

TOD Deeds: A New Option to Keep Homes Out of Probate



Effective January 1, 2016, a recently signed California law now allows revocable transfer on death deeds, or “TOD deeds”. More than half of the other states already have this option for real estate. TOD deeds are similar to payable on death accounts offered by banks and other financial institutions.

Per the author (Mike Gatto) of Assembly Bill 139, which created TODs in California, “The most common form of real property transfer upon death, a will, must pass through probate, a lengthy legal process…The process is often grueling, can take up to a year, and often results in statutory probate fees in the thousands of dollars. Similarly, establishment of a revocable trust can cost upwards of $2,000.” A DOD deed offers a simple and inexpensive way to leave property to heirs without it going through probate.

Some of the basic features regarding TOD deeds:

- Applicable property types are one to four residential dwelling units, condominium units, or not more than 40 acres of agricultural land with a single-family residence.
- A revocable TOD deed is not effective unless the transferor signs and dates the deed before a Notary Public.
- The deed does not need to be delivered to the beneficiary.
- The deed must be recorded 60 days or less from the time it is signed with the county where the real property is situated.
- The deed may be revoked by the transferor at any time.
- More than one beneficiary can be named on the deed; the ownership interests will be divided equally among them.
- If the beneficiary—the person named in the deed—dies before the person who is giving the property, then the deed simply has no effect.

<u>What about a living trust?</u> When multiple beneficiaries are involved, a trust is probably a better choice. A trust will name one or more trustees in charge of marshalling, selling and distributing the decedent’s trust assets, including assets other than the residence. This provides a compelling advantage over the TOD deed, which could result in multiple owners of the decedent’s residence having to cooperate regarding what becomes of the residence. There are other instances where using a living trust may be a better alternative to using a TOD deed, such as for larger estates or when the heirs are young.

<u>When should you use a TOD deed?</u> TOD deeds will be most useful for single people, including widows and widowers who have only modest assets other than their home. Married people in California already have a simple way to avoid probate by holding titled to their home as community property with right of survivorship or joint tenants with right of survivorship. If you are considering use of a TOD deed, our recommendation is to first seek legal counsel to determine whether that would be advisable given your situation.

IRS Warns of Pervasive Telephone Scam

We recently heard from a client who received a call from the “IRS” with an automated message saying it had been trying to contact her and that she is being sued by the IRS. Fortunately, the client contacted us and we said to ignore the fraudulent call. We have heard from other clients who have received similar calls.

IRS Warns of Pervasive Telephone Scam– Con't

On August 6, 2015, the IRS released issue number IR-2015-99. In the release, the IRS warns taxpayers to guard against new tricks by scam artists and that taxpayer losses top $20 million. "These schemes—which can occur over the phone, in emails or through letters with authentic looking letterhead—try to trick taxpayers into providing personal financial information or scare people into making a false tax payment that ends up with the criminal."

The most common theme with these tricks seems to be fear. Scammers try to scare people into reacting immediately without taking a moment to think through what is actually happening. Below are five things scammers often do that the real IRS would never do:

- Angrily demand immediate payment over the phone. The IRS will not call about taxes owed without first having mailed you a bill.
- Threaten to bring in local police or other law-enforcement groups to have you arrested for not paying.
- Demand that you pay taxes without giving you the opportunity to question or appeal the amount they say you owe.
- Require you to use a specific payment method for your taxes, such as a prepaid debit card.
- Ask for credit or debit card numbers over the phone.

Fraudulent Emails: The IRS also does not initiate contact with taxpayers by email or request personal or financial information. In addition, recipients should not open any attachments or click on any links contained in the email.

Assets Under Management and Referrals

As of December 31, 2015, MAM assets under management were in excess of $175 million, up modestly from the beginning of 2015. Thank you for being a client, and thanks to those who added to their investments or referred us to friends or family. We really appreciate referrals as they are our primary source of new clients. While our minimum amount to manage for new clients is $500,000, we are able to be flexible depending on the individual's situation.

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.**
- **Social Security Planning is an analysis of the best strategy for when and how to start claiming Social Security benefits.**

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 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) - Eileen Hamm**

Reminders/Updates

1) **Estimated Tax Payments**: 4th Quarter 2015 Federal & State Estimated Payments are due January 15, 2016.

2) **ADV Part II**: You were provided a copy of our ADV Part II when you became a MAM client. As a Registered Investment Advisor, we file this this document annually with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees, experience and educational back-grounds. Each year, the SEC requires us to offer clients the opportunity to receive a copy of our most recent ADV Part II. Please let us know if you would like to receive a copy