McCarthy Asset Management, Inc.
Personalized Wealth Management

February 2015 Monthly Commentary

March 2, 2015

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Stock Market & Portfolio Performance

February 2015: A strong February more than reversed January's negative returns, with international stocks continuing to lead the way. Bonds fell for the month, although returns are still positive for the year-to-date.

	Feb 2015	YTD 2015	Description:
Without Dividends:			
S&P 500	5.5%	2.2%	500 Largest Public U.S. Companies
NASDAQ	7.1%	4.8%	stocks trading on the Nasdaq
Russell 2000	5.8%	2.4%	2000 of the smallest U.S. stocks
MSCI EAFE	5.8%	6.3%	international stock index
U.S. Aggr Bond	(0.9)%	1.1%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	3.8%	2.2%	non-very conservative MAM portfolios
MAM Conserv	1.7%	1.4%	portfolios with 50%+ bond allocation

Comment: In the short run, continued stock market gains may be more challenging as corporate earnings growth has recently slowed.

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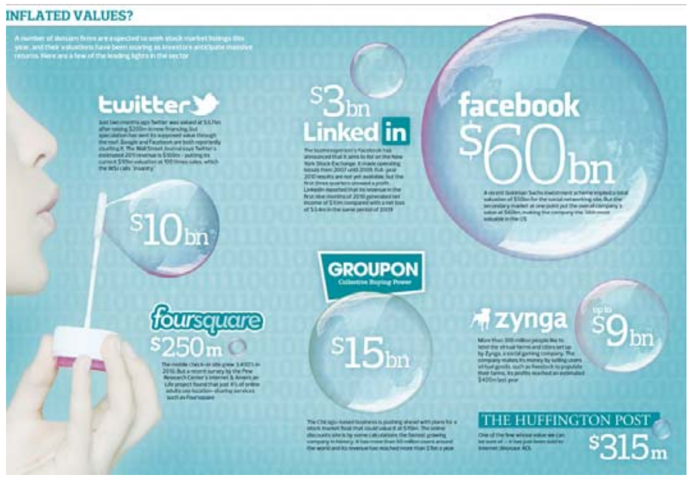
15-Year Anniversary of the Technology Bubble

From time to time, I occasionally receive the question "Is the stock market heading back into a bubble?" Since this is the 15-year anniversary of the Nasdaq bubble, I thought this would be an interesting topic to address.

The Nasdaq Bubble: Fifteen years ago, on March 10, 2000, the Nasdaq Composite index peaked at 5048. Then it started to fall. That continued until it crashed. On October 9, 2002, the Nasdaq closed at 1114, a drop of 78% in 30 months. To use the popular metaphor, the bubble burst. Fifteen years later, the Nasdaq Composite has still not fully recovered (it closed the end of February at 4964).



In hindsight, it is painfully clear that by early 2000, technology stocks had become wildly overvalued. At that time, the Nasdaq was trading at 102 times earnings (versus approximately 22 currently) and the S&P 500 at 30 times earnings (versus approximately 17 currently). How could that have happened? Investors had become enamored with thinking, "the Internet is a game-changer" for the U.S. economy in general, and technology stocks in particular.

The Real Estate Bubble: U.S. housing prices peaked in early 2006, started to decline in 2006 and 2007, and then crashed. While nationally prices fell 50% from their peak, in certain areas such as Las Vegas, prices fell over 60%. What caused the crash? Between 2000 and 2006, the national average of a U.S. home rose over 130%. The rapid, over-inflated price rise was due to reckless lending standards that allowed homes to be purchased by many who could not afford them.

How to Recognize a Bubble: It is important to distinguish between investments that are overinflated and ones that are merely overpriced. When stocks are pricey, future returns are generally lower. But when stocks—or any asset—are in a bubble, the pop can cause values to plummet by 50% or more. How can bubbles be recognized before they pop? Most bubbles have three red flags:

1. *Rapid Rise in Price:* The first sign of a potential bubble, and the easiest to spot, is a rapid rise in prices. The Nasdaq rose 110% in the 12 months before the dot-com bubble crested on March 10, 2000. Throughout the United States, home prices rose 130% in just 6 years, from 2000-2006.

2. *Prices Rise Sharply Above the Asset's Underlying Value:* With stocks, one popular way to measure value is to divide the market's price by 10-year average earnings adjusted for inflation. Using that method, the median price/earnings ratio of large U.S. stocks since the late 1800's is 16, according to Yale economist Robert Shiller, a Noble Prize winner who tracks the data. By contrast, the Shiller P/E exceeded 44 during the dot-com bubble.

3. *"This Time is Different":* At the time of the rapid increase in the price of technology stocks leading up to 2000, many investors and analysts justified the sky-high valuations due to the "game-changing" impact of the Internet.

What is the Next Bubble? Our belief is, despite the dramatic recovery in stock market and real estate prices over the last four to six years, neither is in a bubble. A more likely suspect would be long-term Treasury bonds, given that interest rates are near historical lows.

While we don't feel the stock market is currently at risk of being in "bubble territory", our expectation is that for at least the next 5 to 10 years, both stock and bond returns will be modest compared to historical returns, with 4% to 7% average annual returns for stocks, and less for bonds as they struggle against rising interest rates.

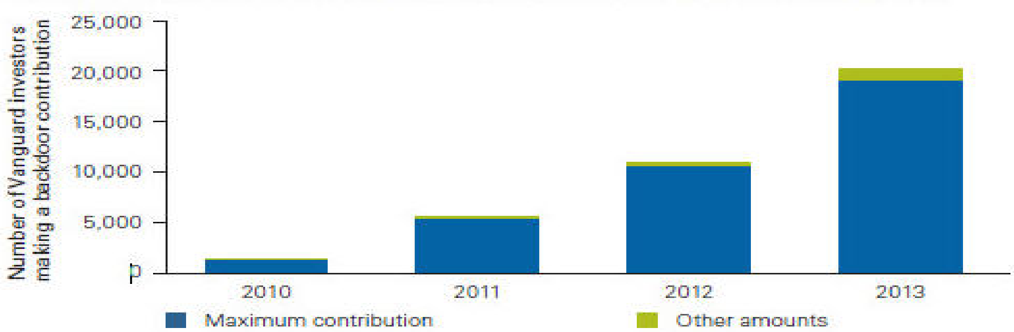
"Backdoor" Roth IRA Contributions

<u>Tax Benefits of a Roth IRA:</u> The tax benefits of a Roth IRA are huge. All appreciation is tax-free for qualified withdrawals. In addition, unlike with a regular IRA, there are no minimum distribution requirements. In fact, Roth IRA account holders can leave all assets in their account as long as they are alive. Once the account holder dies, the beneficiaries can roll over the assets into an Inherited Roth IRA, which will allow the assets to continue to grow tax-free (although there are minimum distribution requirements for heirs).

<u>"Backdoor" Roth IRA Contributions:</u> Only taxpayers with earned income who have adjusted gross income below a certain level (for 2014, below $131,000 for single taxpayers and $193,000 for married taxpayers), are eligible to contribute directly to a Roth IRA. For a number of our higher-income clients, we take advantage of a quirk in the tax law for them to annually make "backdoor" Roth IRA contributions. The procedure is for the client to make a non-deductible IRA contribution, and then convert the IRA assets tax-free to his/her Roth IRA. Note: the conversion is tax-free <u>only if</u> they don't have other IRA assets (so this often works best for a non-working spouse).

The chart below from Vanguard shows how popular backdoor contributions have become. In 2013, more than 20,000 Vanguard IRA investors who contributed to a traditional IRA, subsequently converted to a Roth—almost double the number from 2012:

Backdoor contributions are increasing and are usually the maximum amount



Note: Investors were assumed to have completed a backdoor Roth contribution if they made a traditional IRA contribution and a Roth conversion in the same calendar year and the conversion was within $1,000 of the contribution amount.

Source: Vanguard.

<u>Obama's FY 2016 Budget Would Prohibit Backdoor Roth IRAs:</u> In the recently released budget for fiscal year 2016, President Obama proposed ending this strategy. One unintended consequence of trying to kill off backdoor Roths is that the Administration has in effect given a tacit validation to the strategy, says IRA expert and CPA, Ed Slott. The proposed prohibition would be that after December 31, 2015, only IRA assets that result in income if converted would be allowed to be converted to a Roth. Therefore, non-deductible IRA contributions would no longer be allowed to be converted.

Since the probability of the Republican-controlled Congress to approve Obama's proposed FY 2016 Budget is close to zero, for at least now, backdoor Roth IRAs will remain an effective strategy. *Please contact us if you would like to discuss whether the "backdoor" Roth IRA can work for you.*

Identity Theft– A Fact of Life
Written by Lauree Murphy

Scope of the Problem: Data breaches are a rapidly growing problem. Multinational crime rings with skilled computer programmers are stealing information. The Federal Trade Commission reported tax identity theft as the most common form of identity theft in 2014. There were a million more incidents of identity fraud in 2013 than in 2012. Twenty-five percent of those receiving a notice of a breech became victims.

The Anthem Breach: Last month, Anthem, the second largest health insurance company in the US, reported that its database was hacked, exposing personal information for as many as 80 million customers. The data stolen included names, birthdates, social security numbers, phone numbers, addresses, email addresses, and employment information. Particularly if you are an Anthem policy holder, taking steps to keep information as safe as possible is very important.

How to Reduce Your Risk: Here are some ideas to reduce your risk of identity theft:

- Review your credit reports periodically. Check to make sure that all the information is correct, and be on the lookout for any fraudulent activity. You can get a free credit report annually at www.annualcreditreport.com.
- Regularly review your account and billing statements for charges you didn't make.
- When shopping online, check that the website you use starts with **https:** (the "s" stands for secure).
- Stealing mail is an issue. Get a mail box that locks. If you order new checks, pick them up at the bank.
- Don't routinely carry your Social Security card or any document with your Social Security number on it.
- Don't give a business your Social Security number just because they ask – only when absolutely necessary. Find out why they need it and how it will be used.
- Protect your personal financial information at home and on your computer. Shred sensitive documents using a cross -cutting shredder.
- Protect your personal computers by using firewalls, anti-spam/virus software, update security patches and regularly change your passwords for Internet accounts.
- Check your Social Security Administration earnings statement annually (which you can see by setting up and accessing your account online at www.SocialSecurity.gov).
- Don't give personal information over the phone, through the mail or the Internet unless you have either initiated the contact or are sure you know who is asking. If someone from your bank calls asking for information, get a phone number from a statement and call them back.
- The IRS does not initiate contact with taxpayers by email or phone. Don't provide any personal or financial information in response to an email or phone call purportedly from the IRS.
- Consider using a credit monitoring service.
- Anthem is offering customers free credit monitoring for two years. They will be sending customers a letter in the mail. Do not respond to an email allegedly from Anthem about free credit monitoring services.

Don't Forget Your Children: Children are at risk because parents don't expect a child to have a credit file or credit report. A thief stealing a child's info may use it for years before anyone discovers the theft. Your children's information needs to be protected and monitored just like your own.

Identity Theft– A Fact of Life– Con't
Written by Lauree Murphy

If You Become an Identity Theft Victim: If you become a victim of identity theft, you should take action quickly:

- Contact your bank and your credit card companies.
- Notify law enforcement.
- Contact one of the three credit reporting agencies: Equifax, Experian or TransUnion. They share data, so you only need to contact one. Get a free credit report and check it. Put a 90-day alert on your credit.
- Consider a credit freeze, but be aware that a credit freeze prevents anyone from accessing your credit unless you lift the freeze. It you want to obtain a new loan or other credit, you will need to lift the credit freeze.
- Contact the source reporting the fraudulent activity (i.e. your bank, credit card company, store, etc.) for more specific steps to take.

Further information:

The Federal Trade Commission (FTC) has a publication called "Taking Charge, What To Do If Your Identity Is Stolen". This booklet is a comprehensive step-by- step action guide to dealing with identity theft. You can download it at http://www.consumer.ftc.gov/articles/pdf-0009-taking-charge.pdf

Link to the FTC's identity theft page:

http://www.consumer.ftc.gov/features/feature-0014-identity-theft

Link to the IRS' identity protection page:

http://www.irs.gov/Individuals/Identity-Protection

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/Updates

2014 Tax Returns: *I want to remind those tax clients who have not yet provided us with their 2014 tax information to please do so as soon as possible. We have set a deadline of March 20th for receiving your tax packet if you want us to complete your returns on time. Thanks!*