McCarthy Asset Management, Inc.
Personalized Wealth Management

January Monthly Commentary

Feb. 1, 2017

Stock Market & Portfolio Performance

January 2017: While U.S. stocks performed well, for a change, foreign stocks did even better. Bonds rose modestly for the month.

	Jan 2017	YTD 2017	Description:
Without Dividends:			
S&P 500	1.8%	1.8%	500 Largest Public U.S. Companies
Russell 2000	0.3%	0.3%	2000 of the smallest U.S. stocks
MSCI EAFE	2.9%	2.9%	international stock index
U.S. Aggr Bond	0.2%	0.2%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.8%	1.8%	non-very conservative MAM portfolios
MAM Conserv	0.8%	0.8%	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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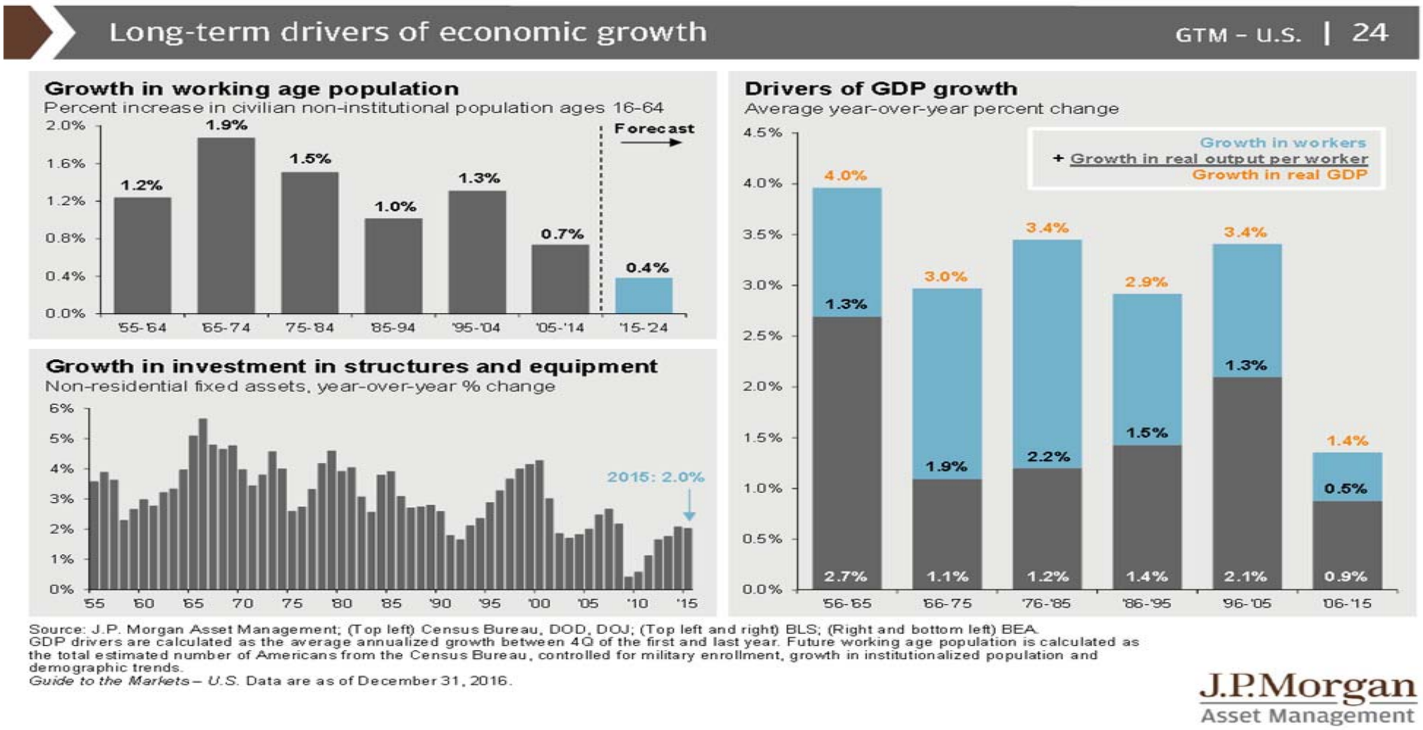
Can U.S. Economic Growth Return to 4%?

Donald Trump has promised to boost annual U.S. economic growth to 4% or more. This would be quite an increase from 2016's rate of 1.6%. Is Trump's promise realistic? The last time growth reached 4% over twelve months was in 2000 as the stock markets surged at the height of the dotcom bubble.

Mr. Trump is calculating that a combination of tax cuts, regulatory relief, infrastructure spending, tougher trade policies, and controls on immigration will generate the needed spurt in growth. Don't count on it. The chart below from J.P. Morgan Asset Management will help illustrate why:



Please note the following:

- As indicated in the far right column, U.S. GDP growth averaged only 1.4% annually from 2006 through 2015. This is why the recovery from the financial crisis has seemed so sluggish. In contrast, for the fifty years prior to 2006, annual growth averaged between 2.9% (1986-1995) and 4.0% (1956-1965).

- In the long-run, real GDP growth is driven by two factors:

  - The growth in the working age population (see upper left of chart above.)

  - The increase in productivity as measured by the growth in investment in non-residential structures and equipment (see lower left of chart above.)

- The challenge for the U.S. (as well as for most other developed countries) is that the growth in the American workforce has slowed dramatically. The chart above projects only 0.4% annual growth for 2015 to 2024. This is because the U.S. has an aging population with baby boomers now reaching retirement age.

Can U.S. Economic Growth Return to 4%?– Con't

- With only a modest expansion in its work force, the only way the U.S. can significantly accelerate its growth would be a large productivity boost and more immigration. The former has been declining over time, while Trump has pledged to make the latter more difficult.

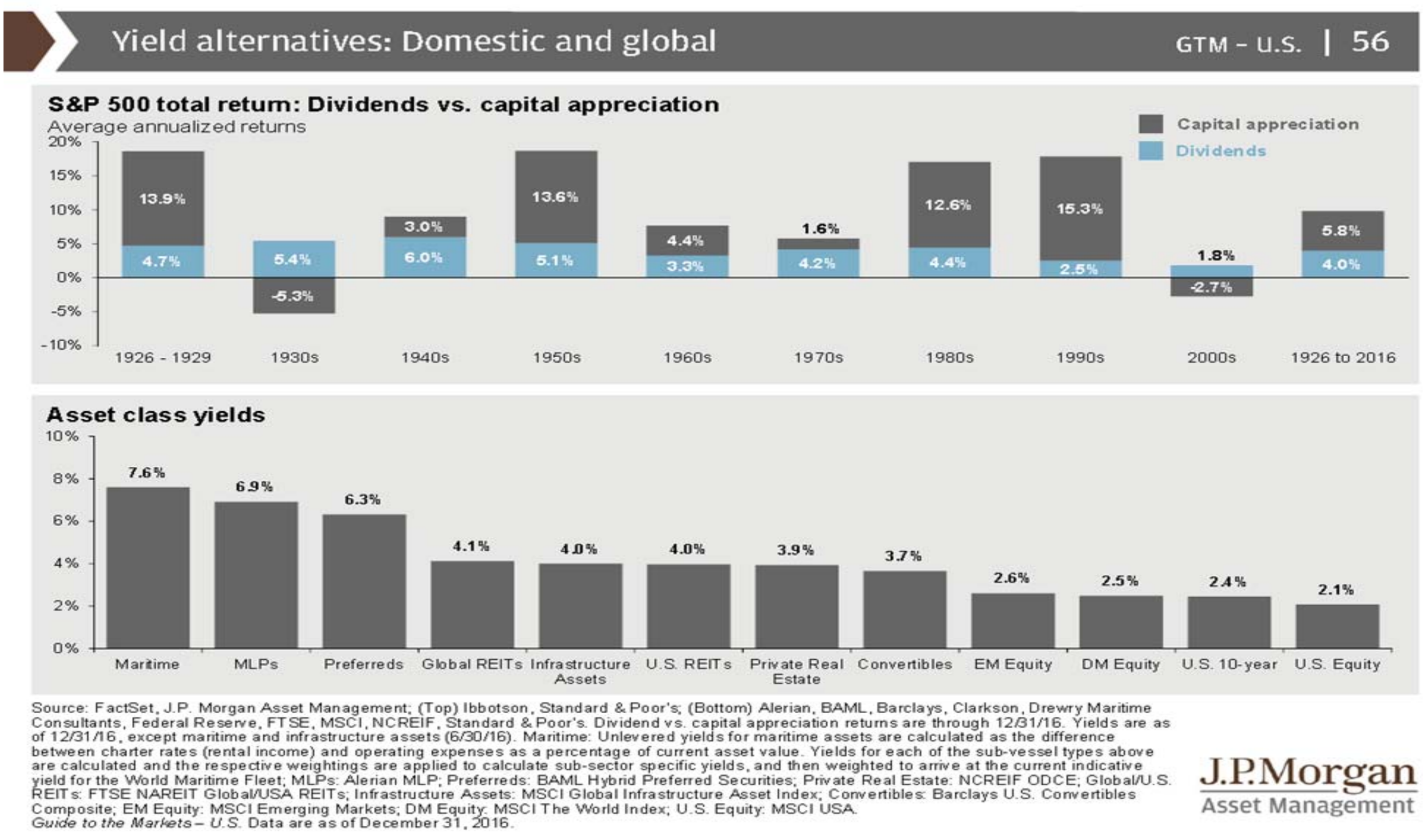
- It is possible that Trump's policies such as tax cuts could temporarily boost growth, but the cost would likely be a significant increase in the budget deficit. I contend that large deficit spending would be ill advised given that the recovery/expansion is nearly eight years old.

The bottom line is, any significant boost in U.S. economic growth is unlikely, with achieving 4.0% seemingly impossible. The good news, however, is that slow, consistent growth, like we have experienced for the last decade, is a good environment for stock prices.

Theme: Dividend-Paying Stocks

For a number of years, an important focus for MAM has been on mutual funds and ETFs that invest in dividend-paying stocks. For instance, the ETF Vanguard Dividend Appreciation (symbol VIG) was added to portfolios in November of 2009 and the ETF Schwab U.S. Dividend Equity (symbol SCHD) was added in November of 2012. Other dividend-focused funds used in portfolios include American Funds Capital World Growth & Income, American Funds Income Fund of America and Matthews Asia Dividend Investor. The purpose of this article is to explore the rational and benefits of investing in dividend-paying companies:

- **Dividend income and its reinvestment have comprised a significant portion of long-term stock gains.** As can be seen in the column on the upper right in the J.P. Morgan chart below, from 1926 through 2016, stocks returned 9.8% per year. Over 40% of that annual return, or 4.0%, was from dividends, with the remaining 5.8% from capital appreciation.

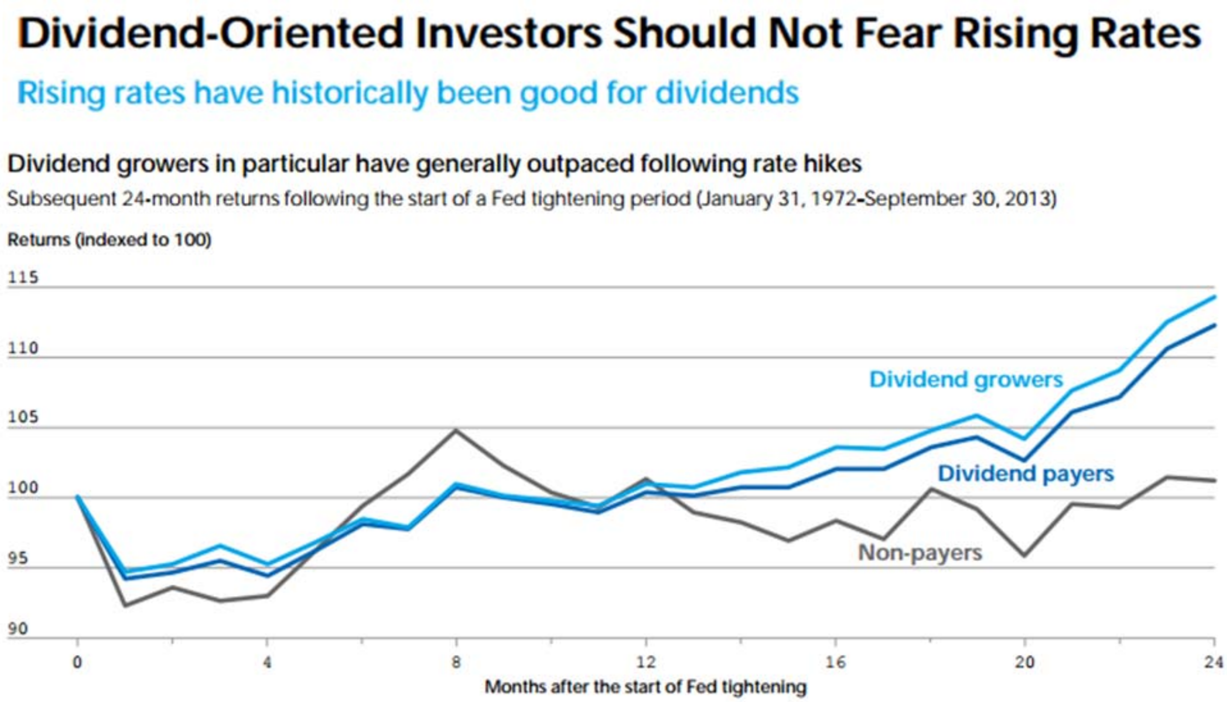


Theme: Dividend-Paying Stocks– Con't

- **Dividend-paying stocks have delivered better long-term total return performance than non-dividend payers.** According to data compiled by Professors Fama & French, from 1927 to 2014, dividend payers rose 10.4% per annum compared to non-dividend payers, which rose 8.5% per annum. (See this article from The Motley Fool which is one of many I found that quoted these returns.)

- **Dividend income can provide valuable downside protection when stock prices are falling.** As can be seen in the chart above, since 1930 there were two decades when stocks had negative capital appreciation (i.e. the 1930s and 2000s). During both periods, dividend income provided important support to performance.

- **Dividend-paying stocks have performed well in past periods of rising interest rates** as can be seen in the chart below from The Capital Group and Ned Davis Research. This is important because we are now in a period of rising interest rates.



Source: Capital Group; Ned Davis Research, Inc. © 2011 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All rights reserved. Disclaimer is at www.ndr.com/copyright.html. For data vendor disclaimers, refer to www.ndr.com/vendorinfo. The chart is based on an equal-weighted geometric average of the historical total return of dividend-paying and non-dividend paying stocks. Dividend growers, payers, and non-payers are sub-components of the S&P 500 Index. The categories are created using actual annual dividends to identify dividend-paying stocks and are rebalanced annually. The dividend policy for each stock is determined on a rolling 12-month basis. The periods shown do not represent the full history of the S&P 500 Index. Start of tightening cycle determined as of the end of any month during which the Federal Reserve fi rst raised the target fed funds rate following a period of stable or declining interest rates; periods measure the 24 months following 1/31/1973, 9/30/1977, 9/30/1980, 9/30/1987, 2/28/1994, 7/31/1999 and 7/31/2004.

Periods of Underperformance: There have been periods when dividend payers underperformed non-dividend payers. Typically, this has occurred at the start of a bull market when stocks are significantly undervalued. During this time, the riskiest stocks, which often don't pay a dividend, perform the best. This was the case starting in March of 2009 with the dramatic recovery in stock prices after the end of the financial crisis. Given the current bull market is now about to start its 9th year, this is an aging bull market with dividend payers likely to once again outperform.

The Best Dividend Stocks to Invest In: Which dividend-paying stocks perform the best? While it may be tempting to go for those paying the highest yield, this could lead investors to companies with little to no growth opportunities, or worse, ones in distress. Per studies from Ned Davis Research and others, over time the best performing stocks are those pay an increasing dividend. This is the focus of the two dividend ETFs (SCHD and VIG) used in MAM portfolios.

Fund Profile: Schwab U.S. Dividend Equity ETF (SCHD)

One of our favorite dividend-focused funds is Schwab U.S. Dividend Equity ETF (symbol SCHD). SCHD is a passively managed exchange-traded fund that invests in high-quality income-producing stocks. The fund's index is comprised of large, liquid companies with above-average dividend yields that have paid dividends in each of the past 10 years. To further identify quality companies, it also requires firms to earn high marks on four fundamental metrics. The result is a relatively concentrated, high-quality portfolio, which is loaded with stocks possessing wide moat ratings from Morningstar Research. The fund charges a rock-bottom expense ratio of 0.07% and currently provides a 2.9% dividend yield.

Portfolio Construction: SCHD tracks the Dow Jones U.S. Dividend 100 Index. The index selects its constituents from a universe of the 2,500 largest U.S. stocks, excluding REITs, master limited partnerships, preferred stocks and convertibles. Companies must have 10 consecutive years of dividend payments and minimum trading requirements. Stocks are then ranked in descending order by their annual dividend yield, with those in the bottom 50 percentile eliminated. The remaining stocks are ranked by four fundamental characteristics: cash flow/total debt, return on equity, dividend yield, and five-year dividend-growth rate. Each stock is ranked based on an equally-weighted composite of the four scores. The top 100 are included in the index and weighted by their market caps. Individual stocks are capped at 4.5% of the index, while sectors are capped at 25%.

Wide-Moat Stocks: According to Morningstar, SCHD's portfolio contains better quality firms than almost any other dividend-oriented ETF. Wide-moat stocks are those that Morningstar analysts believe to possess sustainable competitive advantages. During the past three years, stocks constituting 63% of the value of SCHD's portfolio received a wide-moat rating from Morningstar analysts. This is the highest allocation to wide-moat names among all dividend-oriented ETFs.

Performance: Since its inception in October 2011, SCHD has managed to keep pace with its average peer in the large-value category. The fund's middling performance over this span can be largely attributed to the fact that high-quality stocks have lagged both the broader market and higher-beta, lesser-quality firms. Given its focus on quality companies, the fund should perform relatively well in a market downturn as quality stocks tend to be less volatile than the broad market and are particularly resilient during times of crisis.

Portfolio: Currently, the top ten holdings, which make up nearly 45% of the portfolio, include: Pfizer Inc., Intel Corp, Johnson & Johnson, Verizon Communications, Microsoft Corp, Chevron Corp, Procter & Gamble Co., Exxon Mobil Corp, Coca-Cola Co. and PepsiCo Inc.

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

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 document with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees and our educational backgrounds. 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.