McCarthy Asset Management, Inc.
Personalized Wealth Management

June Monthly Commentary/Q2 2016 Quarterly Letter

July 1, 2016

Inside this issue:

Stock Market & Portfolio Performance

2nd Qtr & YTD 2016: U.S. stocks and bonds posted positive returns for both the second quarter and first six months of 2016, while international stocks declined both for the quarter and year-to-date.

	2nd Qtr	FY 2015	Description:
Without Dividends:			
S&P 500	1.9%	2.7%	500 Largest Public U.S. Companies
Russell 2000	3.4%	1.4%	2000 of the smallest U.S. stocks
MSCI EAFE	-2.6%	-6.3%	international stock index
U.S. Aggr Bond	2.2%	5.3%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	2.5%	3.2%	non-very conservative MAM portfolios
MAM Conserv	2.6%	4.2%	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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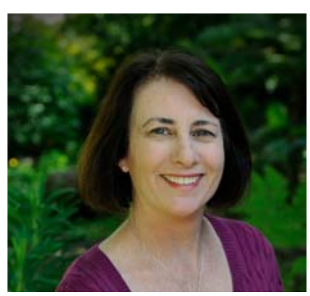

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Brexit Vote– The Market Impact

Financial markets reacted swiftly and sharply on Friday, June 24th, to the unexpected decision by the United Kingdom (UK) to leave the European Union (EU) in a nationwide referendum held on June 23rd. The initial shock of the outcome prompted a sharp decline in stock markets around the world. It may take some time for the shock to fully work through the economic, financial, and political systems in the United Kingdom and Europe.

What happens next? The Leave vote isn't binding until ratified by the British Parliament. Once that happens, under Article 50 of the EU Lisbon Treaty, there is a two-year period for the UK to renegotiate trade and other agreements with the EU. The "clock" starts once the UK formally notifies the EU of its departure plans. How this all plays out is further complicated by the announced resignation of Prime Minister David Cameron, who was a staunch supporter of the Remain side.

It is likely we will have a prolonged period of uncertainty. It is unclear what form of arrangement the UK will adopt with the EU or what the EU will accept. The UK could remain very closely tied to the EU, in a similar relationship to Norway where the country adopts much of the EU legislation and even contributes to the EU budget. At the other end of the spectrum, the UK may become a completely independent entity, relying on the World Trade Organization trade agreements to govern international trade, which would significantly alter the shape of UK trade. For now, nothing changes. All trade and border agreements will remain in place until the exit process is completed.

Economic Impact on the UK. The vote will clearly be a negative for the UK economy, as the UK economy's trade with Europe is over 50% of its total global trade. Furthermore, UK growth is likely to slow, as businesses defer investment decisions until the future economic landscape is clearer. Some international businesses with significant UK bases may activate plans to move at least part of their operations to other EU countries to ensure uninterrupted access to that market.

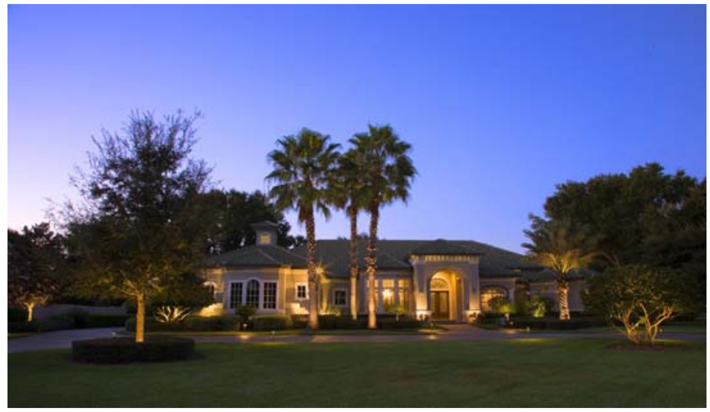
Economic Impact on Europe. The vote will also negatively impact economic growth in the EU. The bigger risk, though, is if this vote is an indication of a rise in populist, nationalist sentiment throughout the whole European continent against the EU. While this is not an immediate risk, it is something that we will monitor over the next year or two.

Economic Impact on the US. Unless the vote to leave the EU triggers a global recession, the impact on the U.S. should be muted. Per Fact Set, U.S. companies derive just 2.9% of their revenue from Great Britain. Furthermore, the U.S. economy is fairly healthy, with GDP growth for the second quarter estimated to be 2.5%. One positive impact is that it is now unlikely the Federal Reserve will raise interest rates anytime soon.

What Action Does MAM Expect to Take? At least initially, we don't expect to take any action. The immediate aftermath of a surprise event like this is not a good time to make big investment decisions—buy or sell. In some cases, the financial markets quickly regain their equilibrium and stock prices march higher once more. Furthermore, the current allocation to European stocks is pretty low (on average, approximately 5% to 6% of MAM portfolios).

We don't like to react to extreme market volatility. Selling off equities now may seem like a good move if the markets continue to be chaotic, but that sense of peace could prove short-lived when stocks recover. When that happens, the tougher decision is when to buy back in. In all likelihood, it will be when stock prices are higher than they are now.

Housing Recovery Continues



Home prices are back to near-record highs across most of the U.S. The S&P/Case Shiller national home-price index has recovered to within 4% of its 2006 peak, a steep rise from the near 30% decline at the bottom in 2012. I do not see another real estate bubble developing anytime soon. The S&P/Case-Shiller index, which is adjusted for inflation, remains about 20% below its peak.

The state of residential real estate is important as most MAM clients are homeowners. Housing, however, is also important for the stock market:

- Housing has been a bright spot for the U.S. economy in recent years. Residential construction has contributed to overall economic output for eight straight quarters, expanding at an annual rate of 17% in the first quarter. The expected increase in housing starts, which is the number of new homes being constructed in a given month, would be a significant positive for continued economic growth.

- Wealth Effect: Back in 2007 through 2012 when home prices were falling sharply, homeowners were cautious with their spending. Now, with home prices back close to record highs, homeowners feel wealthier and are thus more likely to spend.

Comments Regarding Real Estate Prices From Prior Monthly Commentaries:

Below are comments from the four times since late 2009 that we discussed the state of the housing market in our Monthly Commentaries. A benefit of reading these comments is to remind us how bad things were and how far we have come. While it was clear to us during the Financial Crisis that it would be just a matter of time before prices would start to recover, it was difficult to tell preciously when the recovery would begin.

September 2010: "*I have often written about the dismal track record of investors' performance resulting from the ill timing of their purchases and sale decisions. This pertains to not only the stock market, but also to bonds, commodities and real estate. A common tendency is for an investor to "chase performance" and purchase an investment after it has had very strong performance…I recently read an interesting comment from Richard E. Band's Profitable Investing. Band wrote that with gold trading at over $1300 an ounce, it now costs 138 ounces of gold to purchase a typical existing home in the United States. Ten years ago, the same house cost 498 ounces of gold. In other words, during the last ten years home prices have dropped 72% relative to the price of gold. Which is the better buy now? While many may now be looking to invest in gold as an inflation hedge, it is clear to me that real estate currently offers better long-term value.*"

Note: Gold is currently trading at around $1300 an ounce, similar to where it was in September of 2010, while home prices have climbed sharply since then (see chart below).

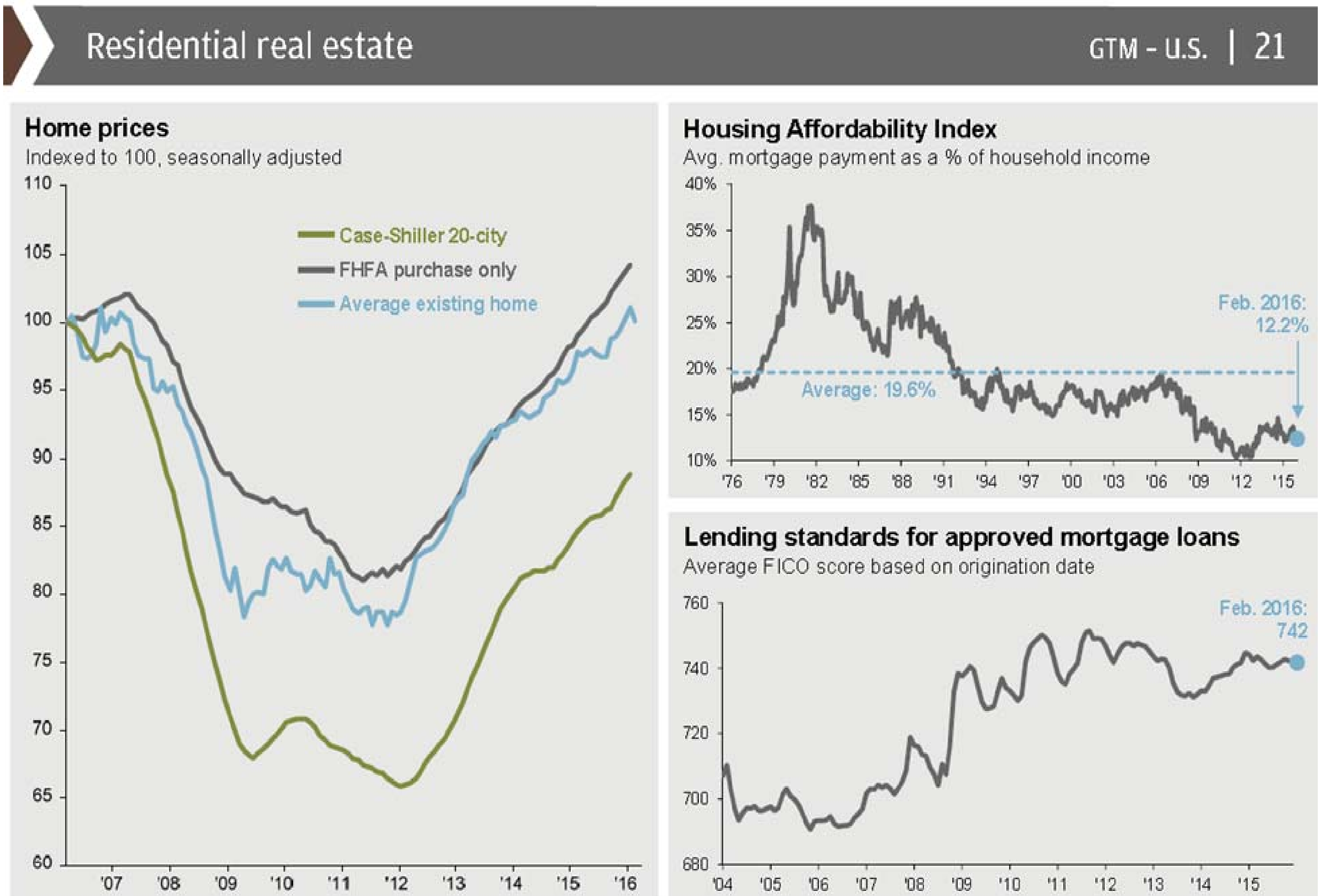
March 2011: *"Despite mortgage rates near sixty-year lows and home affordability at the highest level in many years, real estate is still hampered by a glut of foreclosures that are dragging down home prices, high unemployment and tight credit…It has been nearly five years since real estate prices peaked in mid-2006. Since then prices have fallen approximately 30% and are back down to where they were in April of 2002…Like the stock market, I feel it is nearly impossible to time the real estate market to buy at the bottom. For those who are looking to buy their first home or to upgrade to a more expensive home, I think now is a good time to start looking…While a sustained rise in real estate prices may still be a couple of years away, I don't think it is likely that prices will fall much further."*

Housing Recovery Continues- Con't

<u>January 2012:</u> *"The news regarding housing has been bad for so long (since 2007) that a sustainable recovery in prices may still seem far away…No doubt it will take time to work through the massive foreclosure and short-sale Inventory and to get banks to lend again more readily. Still recent data indicates that the housing sector is in the process of turning the corner with the prospect that 2012 could be a better housing year than 2011…"*

<u>July 2013:</u> **"***The S&P/Case-Shiller index showed that home prices are now down 24.4% from their 2006 peak, compared with a peak-to-trough decline of 35.1% in March of 2012…While we expect home prices to continue to recover, we also expect it will take many years for prices to return to the over-inflated levels they reached in 2006.*"

Where do we think real estate prices will go from here? As long as the economy continues to grow, we expect home prices to continue to climb.



Source: J.P. Morgan Asset Management; (Left and top right) FactSet, National Association of Realtors; (Left) Standard & Poor's, FHFA; (Top right) Census Bureau; (Bottom right) McDash, J.P. Morgan Securitized Product Research.
Monthly mortgage payment assumes the prevailing 30-year fixed-rate mortgage rates and average new home prices excluding a 20% down payment.
Guide to the Markets – U.S. Data are as of March 31, 2016.

J.P.Morgan
Asset Management

Housing Recovery Continues– Con't

The charts on the previous page from J.P. Morgan illustrate:

- The recovery in home prices since 2006 is shown in the chart on the left.
- The chart on the upper right indicates that the "Housing Affordability Index," which measures the average mortgage payment as a % of household income, was recently at 12.2%, a figure close to a multi-decade low. The reason homes are relatively affordable now is due to near record-low mortgage rates.
- The chart on the lower right shows that the average FICO score for approved mortgages at 742 remains close to its high since 2004. This is important as one of the reasons for the collapse in home prices starting in 2007 had to do with borrowers with low FICO scores being approved for loans to buy homes.

Sign Up for IRS Summertime Tax Tips

The Internal Revenue Service is encouraging taxpayers interested in receiving helpful consumer tips this summer to get a jump-start on this year's taxes by subscribing to the IRS Tax Tips email service.

Beginning July 1, the IRS will offer its Summertime Tax Tip series, which includes useful information in English and Spanish. Tax Tip subscribers will receive a new Tip via email three times a week during July and August. They will also get a Tax Tip each weekday during the tax filing season. The IRS also issues Special Edition Tax Tips on important tax topics throughout the year.

IRS Tax Tips are plain language messages that are easy to understand and cover a wide range of topics. They often include links to helpful IRS.gov references, IRS YouTube videos and podcasts.

Summertime Tax Tip topics include:

- Phone scams
- What to do if you receive an IRS notice
- Check your withholding
- Back-to-school – Education credit reminders
- Identity theft

Taxpayers can sign up to receive IRS Tax Tips automatically through a free service on www.irs.gov. From the Subscriptions link on the top right of the IRS website, choose "IRS Tax Tips" on the drop-down menu, and then click on "Subscribe." Click on "more," on the drop-down menu, to subscribe to the IRS Tax Tips in Spanish.

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

*Are you on course for a financially-comfortable retirement? A **Retirement Analysis** can be very helpful in answering that. Please let us know if you would like to have us prepare one for you.*