McCarthy Asset Management, Inc.
Personalized Wealth Management

Mar. Monthly Commentary/Q1 2018 Quarterly Letter

Apr. 2, 2018

Inside this issue:

Stock Market & Portfolio Performance

First Quarter 2018: With the return of market volatility, U.S. and international stocks fell modestly for the quarter. Bonds were also weak. For the first time in awhile, small-cap stocks outperformed large-cap stocks.

	Mar 2018	1st Qtr 2018	Description:
Without Dividends:			
S&P 500	-2.7%	-1.2%	500 Largest Public U.S. Companies
Russell 2000	1.1%	-0.4%	2000 of the smallest U.S. stocks
MSCI EAFE	-2.4%	-2.4%	international stock index
U.S. Aggr Bond	0.6%	-1.5%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	-1.2%	-0.5%	non-very conservative MAM portfolios
MAM Conserv	-0.5%	-0.5%	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.

Advisor Team

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

STEVE McCARTHY
CPA, CFP®,
Owner and Principal
650 610-9540 x 303
steve@mamportfolios.com

LAUREE MURPHY, CFP®, EA
Financial Planner
Tax Specialist
650 610-9540 x 304
lauree@mamportfolios.com

ANTHONY BERTOLACCI , EA
Director of Compliance
Tax Accountant
650 610-9540 x 302
anthony@mamportfolios.com

MARILYN BLANCARTE, PACE
Executive Assistant
650 610-9540 x 305
marilyn@mamportfolios.com

What is a Sustainable Withdrawal Rate for Retirees?

A "*sustainable withdrawal rate*" is a very important concept in retirement planning. It is *the percentage of your invested assets that you can spend each year without running out of money before reaching the end of your life*. The safe withdrawal rate method is a constructive approach that tries to balance having enough money to live comfortably without depleting retirement savings prematurely.

The "4% sustainable withdrawal rule" was first introduced in a 1994 study by William P. Bengen, in which he stated that for a portfolio comprised of 50% stocks and 50% intermediate-term treasuries, a 4% annual withdrawal rate is sustainable for a minimum of 30 years. The rule states:

> *Withdrawing 4% of your portfolio in the first year of retirement and then withdrawing the same amount adjusted for inflation each year thereafter will result in a high probability of your retirement savings lasting 30 years or more.*

This finding was later confirmed and expanded upon in studies by other academics to account for different asset allocations, time horizons and historical periods. Since then, the 4% rule has become one of the most widely used "rules of thumb" in retirement planning. For example, an investor who has accumulated a portfolio worth $1 million, and who is faced with 3% annual inflation, should be able to withdraw $40,000 the first year of retirement, $41,200 the second (i.e. $40,000 increased by 3%), $42,436 the third and so on, without fear of depleting her assets.

I last wrote about sustainable withdrawal rates in our September 2013 Monthly Commentary ("The Sustainable Withdrawal Rate- Is the 4% Rule Still a Good Estimate?"). Since writing that article, the stock market has appreciated substantially and bond yields have fallen. These are both negatives that suggest future returns for a stock/bond portfolio will be muted relative to historical averages. This is consistent with our outlook, as well as Vanguard's. As discussed in our October 2017 Monthly Commentary, Vanguard's 10-year outlook is for bonds to return 2.5% annually and stocks between 5% and 7% annually. Given this tempered outlook, is it still realistic for a retiree to withdraw 4% annually from his/her invested assets and not run out of money? In particular, here are two of the risks to the rule:

- **Low-Yield Environment and Above-Average Stock Values:** Most research done on sustainable withdrawal rates uses historical data and assumes the same expected return on each asset class year-after-year. This is a reasonable assumption when the stock market is fairly valued and bond yields are at or above their long-term averages. This is not a realistic assumption in today's environment of low bond yields and high stock market valuations. When factoring in the aging population and the slow economic growth, and the 4% rule begins to look too aggressive for the current environment.

- **Sequence of Returns Matter:** Intuitively, most people understand that if they retired in late 2000 or 2007, right before the onset of a major bear market, the withdrawals during those early bear market years had a much bigger negative impact on the overall health of their portfolio. This concept is known as sequence risk.

Devising a Sustainable Withdrawal Program—there is no one simple solution to sustaining portfolio withdrawals during retirement, but rather an array of steps that you can take. Here are some of them:

- **Create a 3-Year Bucket**: For clients who are receiving periodic distributions from their portfolios, we typically set aside 3 years' worth of withdrawals in a conservative bond fund. As long as stock prices are not depressed, we replenish this conservative fund at least every six months when we reposition portfolios. The benefit of using this technique is that when a bear market starts and stock prices drop precipitously, we do not need to sell any equities for at least three years to cover portfolio withdrawals. Given that the duration of the average bear market since the Great Depression has been 18 months, we should have enough held in the conservative bond fund to allow the rest of the portfolio to recover as the market correction runs its course. This 3-year "safety" bucket helps to lessen sequence risk.

What is a Sustainable Withdrawal Rate for Retirees?- Con't

- **Be Flexible**: Recall that the first few years of retirement are critical to the overall success of the sustainable withdrawal program. Reducing expenses during a market downturn will allow you to temporarily reduce distributions from your portfolio(s).

- **Adjust Your Expectations**:

    1. **Reduce the Certainty**: Certainties do not exist in the world of financial planning. As much as we would like to have a 100% certainty plan, many financial planners suggest that 80% probability is an acceptable level of success for a financial plan. Furthermore, a significant downside with a 100% certainty plan is that the retiree is living on less than they could safely withdraw. Unless leaving a large estate is a very important goal, the retiree would be foregoing expenditures that are affordable. In these cases, it may make sense to spend more if it results in a higher quality of life while still minimizing the risk of running out of money.

    2. **Retire Later**: If the probability of success (i.e. the likelihood of not outliving your assets) is lower than what you are comfortable with, consider working longer or saving more.

    3. **Assume Shorter Length of Retirement:** A 30-year withdrawal time horizon may be longer than is likely for many who retire at 65. Consider your family history of longevity and your health when making your plan.

- **Diversify Your Portfolio**: Most of the research that has been done on sustainable withdrawal rates has been based on a portfolio made up of just stocks and bonds. Adding alternative assets to a portfolio can improve the risk-adjusted returns, and therefore increase the sustainable withdrawal rate. Bengen's initial study used only two asset classes (large-company U.S. stocks and intermediate–term U.S. government bonds). When Bengen added a third asset class, small-company U.S. stocks, he raised the acceptable withdrawal rate to 4.5%.

- **International stocks and international bonds** add diversification to a portfolio. In addition, alternative assets, such as rental real estate can add diversification without sacrificing return.

- **Add More Equities, Especially Dividend-Paying Stocks:** As people age and their life expectancies become shorter, it makes sense to be more conservative with their retirement portfolios. For those with a 15-year or longer life expectancy, however, portfolio growth is critical so that future-year distributions can be increased for inflation. Particularly in the early phase of retirement, a portfolio should be more heavily weighted toward equities and less toward bonds. Dividend-paying equities can play a particularly important role here.

In Summary: Factoring in the steps we take in managing portfolios, along with the recommendations above, we still feel 4% is a sustainable withdrawal rate despite future stock and bond returns being lower than their historical averages.

Digital Assets– Estate Planning Considerations (by Lauree Murphy

We live in a world where more and more of our personal data is kept online or stored on a personal device. Besides the need to back up digital devices and keep passwords secure, we also must consider what happens to all that information if we die or become incapacitated.

Digital assets include any electronic data you have saved on a computer, phone, tablet, or in the cloud. Commonly included in this list are:

- Accounts for email, social media, banking, and shopping
- Photos, videos, online storage or back up accounts
- Any website, blog or domain names you may have

Decide how you would like these assets handled. Here are possible decisions to make:

- Who should have access?
- Do you want your Facebook page memorialized or shut down?
- Do you want your family to have access to all the online photos you have stored?
- Do you want someone to be able to find the monthly bills you pay on line?

The first step is to create a list of all your digital assets. Keep it in a safe place with your estate planning documents. **A helpful template to assist you in gathering your digital information in one place is attached to this article.** You can use it or create something like it.

Realistically, even if you keep a list and your executor finds it, it may not be completely up to date. After all, passwords don't remain static. Some passwords need to be changed routinely. Additionally, if someone else logs on to your account posing as you, they might be violating the provider's terms of service and federal law. If nothing else is in place, the "terms of the use" you agree to when you sign up for an online service prevail. In order to give your executor the authority to act on your behalf, add a statement to your Will giving them access. The actual passwords and log on ids should not be included in your Will. Instead, put them in a separate document. Be sure to let your executor know where your estate planning documents are kept.

Some states have enacted laws to assist with this issue. Each state differs and not all states have this covered. In 2016, California passed a law, AB-691, which is the Revised Uniform Fiduciary Access to Digital Assets Act. It allows a decedent's personal representative to access and manage digital assets.

Take action now. Be sure those you want to have access to your information are authorized and can find it.

Sincerely,

Stephen P McCarthy, CPA, CFP®,

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

Phone: 650-610-9540
Fax: 610-9541
E-mail: Steve@mamportfolios.com

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

Tax Reminders:

- April 17th is the deadline for filing 2017 individual income tax returns and making 2017 IRA, SEP-IRA, Roth IRA and Education Savings Account contributions.
- It is also the deadline for first quarter 2018 Federal and State estimated payments.
- April 10th is the deadline for California property tax payments for the first half of 2018.