

May Monthly Commentary

June. 1, 2017

Stock Market & Portfolio Performance

May 2017: Large-cap and international stocks had another good month while small-cap stocks slipped. Meanwhile, bonds were up modestly.

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	May 2017	YTD 2017	Description:
Without Dividends:			
S&P 500	1.2%	7.7%	500 Largest Public U.S. Companies
Russell 2000	-2.1%	1.0%	2000 of the smallest U.S. stocks
MSCI EAFE	3.1%	12.2%	international stock index
U.S. Aggr Bond	0.8%	2.4%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.0%	6.8%	non-very conservative MAM portfolios
MAM Conserv	0.8%	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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Recently, there has been speculation about the possibility of President Trump being impeached. My motivation in writing this article is not political. Rather, it is to address for MAM clients potential stock market implications if this were to occur.



President Trump has come under pressure due to a series of events, not the least of which was the firing of FBI director James Comey. This came at the time that the FBI was investigating contacts between the Trump campaign and Russian officials. Mr. Comey has said that prior to being fired, Mr. Trump asked him to end an investigation of Michael T. Flynn, the onetime national security advisor. If true, this would have the appearance of obstruction of justice.

On May 17th, former FBI Director Robert Mueller III was appointed as special counsel to oversee the federal investigation into Russia's alleged interference in the 2016 U.S. presidential election, giving him wide latitude to explore potential collusion between the Trump campaign and Moscow. The naming of Mr. Mueller, who served under presidents of both parties and is widely respected, could make it harder for both Republicans and Democrats to question the results of the Russia investigation.

What Is Impeachment? The Constitution permits Congress to remove presidents before their term is up if enough lawmakers vote to say that they committed "treason, bribery, or other high crimes and misdemeanors." Only three presidents have been subjected to impeachment proceedings. Two were impeached but acquitted and stayed in office: Andrew Johnson in 1868 and Bill Clinton in 1998. A third, Richard Nixon, resigned in 1974 to avoid being impeached.

What is the Process? The House of Representatives is the accuser and the Senate is the judge and jury. The bar for adopting impeachment articles in the House is low, a simple majority. If more than 50% vote "yes", then the president is impeached, which essentially means indicted. Next, the proceedings move to the Senate, which holds a trial overseen by the chief justice of the Supreme Court. If at least two-thirds of the senators find the president guilty, he is removed, and the vice president takes over as president.

Likelihood of Impeachment: Mr. Clinton was impeached by a Congress in which the opposition party controlled both the House and the Senate. Currently the Republicans have a 21 member advantage in the House, making it politically unappealing for them to vote to impeach him. Unless there becomes direct evidence of Trump in a major scandal, it is not likely to happen. Given Mr. Trump's low approval ratings, though, the Republicans are at risk of losing their majority in the House in the 2018 elections. Were the Democrats to obtain control of the House at that time, there would be a much greater chance that a simple majority will vote to impeach Trump. It would then come down to whether 2/3 of the Senate will vote to remove him from office.

Investment Implications: Given the small number of cases, it is difficult to rely on historical precedents to predict how the market would react to impeachment.

- If scandals surrounding Russian interference in the election grow, the market may begin to price in the Republican loss of the House in November of 2018, which would stall, if not end, Trump's populist agenda. However, this could be bullish for the stock market as it will likely motivate the GOP in Congress to lock in tax and healthcare reform well ahead of the 2018 midterm elections.
- It is also possible that if Trump were to face impeachment, the market may give a sigh of relief because it would mark a clear defeat of populist politics in the U.S. Much as with electoral outcomes in Europe, investors may want to cheer the defeat of an unorthodox, anti-establishment movement in the U.S.
- The stock market has performed well since Mr. Trump won last November's election. The question is how much of that rally has been because of improvements in global fundamentals and how much was due to the expectations of tax cuts and easing regulation boosting corporate earnings.

The Likelihood of President Trump Being Impeached— Con't

According to FactSet, analyst estimates for the earnings of S&P 500 companies over the next year have risen 5% compared with where they were on Election Day. The remainder of the S&P 500's gain came from steeper valuations—the index now trades at about 17.2 times expected earnings versus 16.4 on Election Day. If investors lose confidence in the Republican's ability to deliver, this part of the gain could be wiped out. That would mean a roughly 5% decline from here, which would represent a fairly modest loss.

Muted Market Volatility— What Gives?

This year, investors have become quite complacent about the stock market. This is reflected by the CBOE Volatility Index (VIX), which measures the volatility factor embedded in the S&P 500 options prices. The chart below from the Federal Reserve Bank of St. Louis shows that recently VIX dropped to its lowest level since December of 1993.



What is the VIX? The VIX is based on prices of bets on the benchmark S&P 500 index, known as options contracts. It is designed to measure investor expectations for market turbulence one month in the future, and is used to hedge against bullish wagers on stocks. Since the financial crisis, during which the VIX reached a record 80.86 in November 2008, it has become one of the most widely watched and used financial tools on Wall Street.

Why So Low Right Now? Despite questions about whether President Trump will be able to boost growth, investors are becoming more optimistic about the American economy. Recent events have helped: U.S. companies reported their best quarterly profits in five years and GDP growth is expected to accelerate significantly from the 1st quarter of 2017's tepid pace. Globally, growth has picked up and President Macron's solid win last month in France was very positive for the future of the European Union.

What Does It Mean for the Market? Over the years, analysts observed that the Volatility Index often spikes above 35 when fear is high, which has typically coincided with important market bottoms. Conversely, it has been assumed that when volatility is low, investors have become too complacent and the stock market is setting up for a major sell-off. While extreme spikes in the VIX can be helpful in identifying bear market bottoms, it is far less useful in identifying stock market tops. This is because the VIX can drop to low volatility levels long before an imminent market top appears.

In Summary: Market volatility is currently suppressed, but it will return at some point. As I have discussed recently in these Monthly Commentaries, the market is overdue for a healthy, short-term correction.

Portfolio Adjustments Planned for June

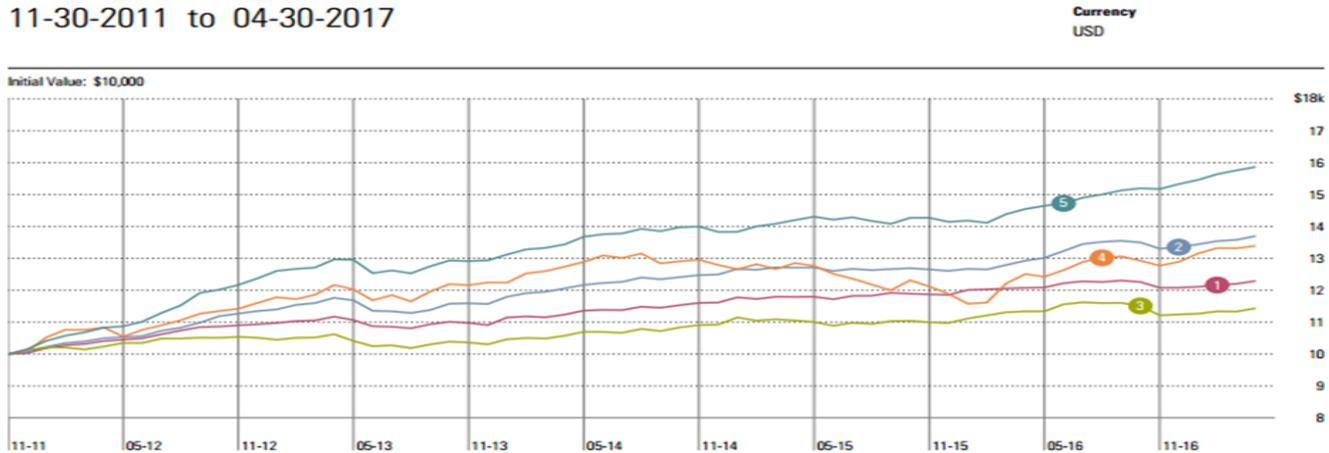
As we generally do twice a year, we are planning to make minor adjustments to portfolios this month. Here is what we expect to do:

Modest Increase in Allocation to International Stocks: As discussed in our March 2017 Monthly Commentary article “Outlook for European Equities,” the case for investing in European stocks is getting stronger based on fundamentals and valuations. Given last month’s solid win for the pro-European Union candidate Emmanuel Macron in France’s presidential election and recent news that economic growth may be finally returning to Europe, we are ready to make a small increase in our international allocation.

Addition of Guggenheim Total Return Bond Fund (GIBLX): We plan to shift part of our bond allocation into the “under-the-radar” intermediate bond fund Guggenheim Total Return Bond Fund. All bond funds used by MAM have significantly outperformed AGG, the ETF that is an index of U.S. bonds. With the exception of the amazing PIMCO Income fund, though, the Guggenheim fund has outperformed other bond funds typically used in MAM portfolios:

Investment Growth

11-30-2011 to 04-30-2017



Investment	Cumulative Return %	Annualized Return %	Amount at End of Period \$
1 DoubleLine Total Return Bond N (USD, DLTNX)	22.95	3.89	12,294.61
2 Guggenheim Total Return Bond P (USD, GIBLX)	36.97	5.98	13,697.42
3 iShares Core US Aggregate Bond (USD, AGG)	14.38	2.51	11,437.94
4 Loomis Sayles Bond Retail (USD, LSBRX)	33.90	5.54	13,390.27
5 PIMCO Income D (USD, PONDIX)	58.62	8.89	15,861.71

Performance Disclosure

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please visit <http://advisor.morningstar.com/familyinfo.asp>.

Replenish the Safety Bucket for “Withdrawal” Portfolios: For portfolios taking regular distributions, such as IRA accounts that have required minimum distributions, we are replenishing this safety bucket for an additional six months of distributions.

Please let me know if there is anything I should factor in before making adjustments to your portfolio(s).

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

- Estimated Tax Payments: Second quarter of 2017 estimated payments are due on June 15th.
- ClientView Portal: Please let us know if you have any questions regarding accessing your ClientView Portal.



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