McCarthy Asset Management, Inc.
Personalized Wealth Management

May 2018 Monthly Commentary

June 1, 2018

Stock Market & Portfolio Performance

Inside this issue:

May 2018: U.S. stocks rose for the month while international stocks fell due to a rising U.S. dollar. Bond prices rose, partly offsetting their decline during the first four months of 2018.

	May 2018	YTD 2018	Description:
Without Dividends:			
S&P 500	2.2%	1.2%	500 Largest Public U.S. Companies
Russell 2000	6.0%	6.4%	2000 of the smallest U.S. stocks
MSCI EAFE	-2.8%	-3.2%	international stock index
U.S. Aggr Bond	0.7%	-1.5%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.4%	0.6%	non-very conservative MAM portfolios
MAM Conserv	0.8%	0.2%	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.

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

Outstanding S&P 500 First Quarter 2018 Earnings

First quarter 2018 earnings for the S&P 500 companies came in at a highly impressive 26% year-over-year growth from 2017 first quarter earnings. This represents the best quarterly growth since the fourth quarter of 2010. Even when excluding the impact of the new tax law (estimated at 6-7% per LPL Financial), earnings growth was close to 20%.

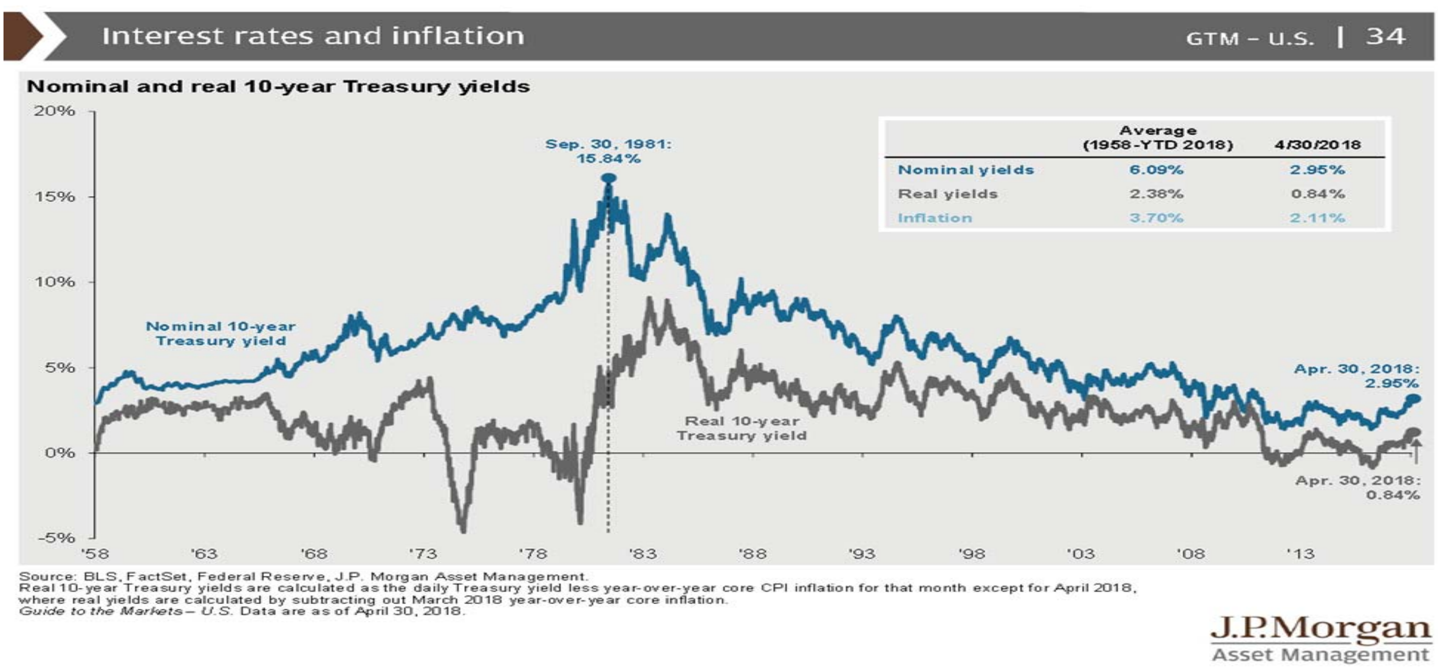
Peak Earnings: While earnings growth is expected to remain strong for the remainder of 2018, it is likely that the first quarter's 26% increase was likely the peak, with remaining growth impressive, but tapering off. Does this peak in the growth rate mean that a recession is close at hand? Per research from LPL Financial, the answer is "probably not." LPL Financial looked at the 12 earnings peaks since 1953, and calculated the number of months from the peaks to the next recession:

- It found that, on average, a recession started approximately 4 years after the earnings peak.
- It also found the S&P 500 was up an average of 59% during these periods between the earnings growth peak and the start of the next recession.

It is very possible that this time, the next recession will occur sooner given that we are already in the 9th consecutive year of economic growth. Nonetheless, at this point, the incredible earnings growth for the first quarter of 2018 bodes well for the stock market for the foreseeable future.

Risk of Owning Bonds Due to Rising Interest Rates

Although interest rates are still low relative to historical levels, they have risen steadily this year. The 10-year Treasury, which is a good indicator of rates on fixed rate mortgages, started the year at 2.40%. It reached a short-term peak of 3.12% on May 18th, and closed the month of May at 2.82%. This compares to an average rate of 6.09% for the last sixty years. The chart below from JP Morgan shows the range of the 10-year Treasury rate since 1958. The blue line is the nominal rate and the charcoal line is the real rate (i.e. nominal rate minus inflation).



Risk of Owning Bonds Due to Rising Interest Rates-Con't

Because bond prices fall when interest rates rise, most bond funds have posted negative returns so far this year. Through 5/31/17, the Bloomberg Barclays U.S. Aggregate bond index was down 1.5%. With the Federal Reserve likely to increase the Federal Funds rate two or three more times in 2018, interest rates are likely to climb further. This leads to questions such as, what is the risk of owning bond funds, and should we reduce our exposure to them?

In response to these questions, we have the following comments:

- It is good that the Fed is raising rates. It's indicative of the continued solid performance of the U.S. economy. More importantly, higher interest rates will provide the Fed with an important tool to combat the next recession: lowering interest rates.

- We expect further increases in interest rates to be gradual.

- While bond prices fall due to rising rates, bond funds benefit from being able to reinvest bonds that mature into higher yielding bonds.

- Not all bonds are impacted equally by rising rates. The longer the maturity of the bond, the greater the drop in price due to rising interest rates. The bond funds utilized by MAM are intermediate and short-term bond funds, rather than longer-term bond funds. These funds generally don't invest in longer-term bonds and have a flexible mandate, which allows them to invest in many types of bonds (corporates, mortgage bonds, foreign bonds, etc.). The bond funds most at risk to rising interest rates are those that invest in longer-term Treasury bonds, of which none of our bond funds do.

- Bond bear markets are generally much milder than stock bear markets. Over the past 40 years, there have only been a handful of years when the Bloomberg Barclays U.S. Aggregate Bond Index generated loses. Even then, the losses tended to be modest compared to bear markets of stocks. For example, when the Fed doubled the federal funds rate from 3% to 6% over the course of 1994, the index suffered a loss of just 3.0%. Moreover, even in the bear market that stretched from 1954 to 1981, negative annual returns were infrequent. That's because the income payments from the bonds offsets a portion of the price decline.

- Most importantly, bonds play an important role in diversifying a portfolio. Once the next bear market occurs for stocks, the bond allocation will help protect portfolios on the downside.

Schwab Transition to FDIC-insured Bank Sweep Feature

You may have already received a letter or email from Schwab announcing that between June and August 2018, they are transitioning the Money Fund Sweep feature to the FDIC-insured Bank Sweep feature. Per the Schwab letter, “this change will take place automatically and no action from you is required. No new accounts will be opened as a result of this change, and your account will continue to function as it does today.”

The benefit of this change is that cash in Schwab accounts will be protected by FDIC insurance (up to the $250k/$500k limit). Nonetheless, we view this change as a negative because Schwab is currently paying only 0.15% annually on the FDIC Bank Sweep. This compares to the approximately 1.50% they are paying on the Schwab Money fund.

We called Schwab to find out if there is anything we could do to prevent this transition from occurring for our client accounts. We were told there isn’t, as once the transition is completed, the only Sweep option will be the FDIC-insured Bank Sweep.

What is the Sweep option used for? Cash is held in the Sweep option to cover distributions. For instance if you write a check off of your account, the funds will be withdrawn from the Sweep option. Generally, we keep 1% or less of the value of an account in the Sweep option. The exception is for those accounts receiving withdrawals.

Action MAM Plans to Take: We use the Schwab Value Advantage, SWVXX, for excess cash in accounts. The Schwab Value Advantage fund earns a higher yield (currently 1.69% annually) than the Schwab Money Fund. SWVXX is considered a “purchased money fund”, and will continue to be available at Schwab. The fund is purchased and sold for no transaction fee. The challenge for us is that funds held in “purchased money funds” are not available to cover withdrawals. If cash is needed for a withdrawal, we must sell SWVXX and the funds will then be available to withdraw the next business day.

Because of its low yield, we expect to hold less in the Bank Sweep option and more in the purchased money funds such as SWVXX. ***If you are withdrawing funds from your account, please coordinate it with us so we can make sure there is sufficient cash in the Bank Sweep to cover the account withdrawal.***

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

- Estimated Tax Payments: Second quarter of 2018 estimated payments are due on June 15th.
- ClientView Portal: Please let us know if you have any questions regarding accessing your ClientView Portal.

RiA
STANDS FOR YOU.

Discover the difference with a Registered Investment Advisor.