McCarthy Asset Management, Inc.
Personalized Wealth Management

October 2014 Monthly Commentary

November 3, 2014

Stock Market & Portfolio Performance

Inside this issue:

October & YTD 2014: U.S. stocks performed well for October while international stocks continued their 2014 struggles:

	October	YTD 2014	Description:
Without Dividends:			
S&P 500	2.4%	9.2%	500 Largest Public U.S. Companies
NASDAQ	3.2%	10.9%	stocks trading on the Nasdaq
Russell 2000	6.1%	0.9%	2000 of the smallest U.S. stocks
MSCI EAFE	-1.5%	-5.1%	international stock index
U.S. Aggr Bond	1.0%	5.1%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.2%	6.5%	non-very conservative MAM portfolios
MAM Conserv	0.6%	4.9%	portfolios with 50%+ bond allocation

Comment: With October ending, we are now in what has historically been the best time of the year for stocks (November through January).

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

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

Economic and Stock Market Update

Recent Market Correction: If you blinked, you may have missed the long-overdue market correction. Reflecting the intra-day low reached on October 15th, the S&P 500 had fallen approximately 10% from September 19th through October 15th. I sent out an email to MAM clients the afternoon of October 15th providing my thoughts on the sharp market drop. I said that in all likelihood it was just a correction. I explained reasons why I felt optimistic about the stock market (the U.S. economy is healthy, oil prices are plummeting, corporate profits continued to rise steadily) and why I felt it is too difficult to predict short-term movements in the stock market. Just as quickly as the correction occurred, the recovery was even faster. By the end of October, the S&P 500 fully recovered, closing at an all-time high on October 31st.

U.S. Economy Continues to Progress: On October 30th, the Commerce Department released its initial measure of the 3rd quarter Gross Domestic Product (GDP), reporting that the economy expanded at a solid 3.5% annual rate from July through September. Currently, economists are projecting 4th quarter GDP to slow a little to approximately 2.5%, and then accelerate back to around 3% for 2015. This slow, steady growth provides a good environment for stocks as the Federal Reserve is likely to remain accommodative as long as inflation remains subdued.

Corporate Earnings Growth Is Good: At the mid-point in reporting season, third-quarter earnings for the S&P 500 are expected to rise 8.1% from the same period a year ago, according to Thomson Reuters. This reflects actual results from half of the companies in the index that have reported so far, and estimates for the rest. It would be the strongest third-quarter growth in three years, though slower than this year's second quarter.

Fed Ends QE 3, Stays with 0% Rate for "Considerable Time": On October 29th, as expected the Federal Reserve said that it is ending its long-running monthly bond purchase program. At the same time, the Fed upgraded its assessment of the job market's performance and said that it will hold short-term interest rates near zero for a "considerable time" (until mid-2015?).

Our Market Outlook: While the S&P 500 closed at an all-time high on October 31st, there is no assurance that the market correction is over and it will be smooth sailing from here. While short-term movements in the stock market are impossible to predict, I continue to feel that for the foreseeable future, the general trend of the stock market will be up.

Focusing on the Long-Term Reduces Investment Risk

The stock market can be volatile, which is not news to you. The recent sharp drop provides a vivid reminder of this. The potential reward, though, for investing in stocks is very appealing. Since 1926, U.S. stocks have returned 10% annualized. However, stocks lost money in 27% of the years since 1926. Are there any secrets to achieving the benefit of investing in stocks while being able to minimize the risks? While not really secrets, there are a number of effective steps to take:

1) **Invest for the long-term.** This is the most important step, and it is the focus of this article. *The longer the investment timeframe, the lower the risk of losing money.*

2) **Invest in a diversified portfolio**. Different segments of the market don't move in sync. Allocating your portfolio among U.S. large stocks, U.S. small & mid-cap stocks, international stocks, bonds and alternative assets will reduce a portfolio's volatility.

3) **Don't invest any more aggressively than what you can stomach in a market downturn.** If you have a hard time staying invested when stock prices are falling, then utilize a more conservative portfolio by allocating more to bonds. While this will reduce the portfolio's long-term returns, it is worth it if it enables you to stay invested during the difficult times.

4) **If you are living off your portfolio (i.e. taking regular distributions), set aside up to three years of withdrawals in a conservative investment** (such as an intermediate bond fund). This way, you should not need to sell any of the stock portions of your portfolio to cover regular distributions. This is because, other than during the Great Depression, stocks have fully recovered from each bear market within three years.

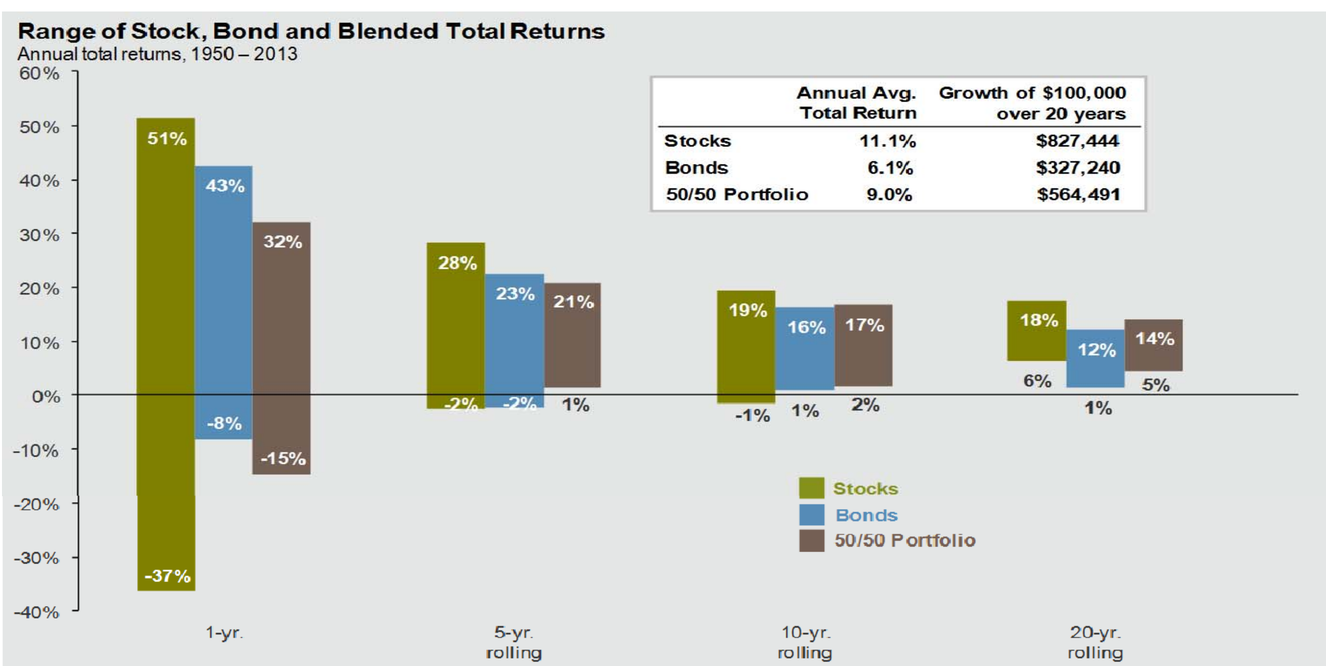
While we are able to implement steps "2" through "4", we need clients to assist with the first step. During difficult markets, it is important for them to focus on the long-term and not be overly influenced by the short-term gyrations and the negative stories being reported by the press. During those times, we can help by talking with clients. In addition, we can help clients focus on the long-term by providing educational pieces like this article.

<u>**Historical Worst Returns by Holding Period- 1950 to 2013**</u>: The chart below from J.P. Morgan is very insightful. It shows for different timeframes the range of annual returns from 1950 through 2013 for an all-stock portfolio, an all-bond portfolio and a portfolio made up of 50% stocks and 50% bonds:

1) *Maximum loss for all-stock portfolio:* While the maximum loss was 37% for 1 year (i.e. 2008), for 5 years the annualized maximum loss was 2% and for 10 years it was 1%.

2) *Maximum loss for Blended portfolio:* For a 50% stock, 50% bond portfolio, the maximum 1-year loss was 15%. For 5 years, the worst performance was an annualized gain of 1% and for 10 years it was a gain of 2%.

3) *Maximum loss for 20-year timeframe:* Since 1950, the worst performance for 20 years for an all stock portfolio was an annualized gain of 6%. Not too bad considering this was the worst performance for any 20-year timeframe since 1950!



Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.

Returns shown are based on calendar year returns from 1950 to 2013. Growth of $100,000 is based on annual average total returns from 1950-2013. Guide to the Markets – U.S.

Data are as of 9/30/14.

Asset Class

Focusing on the Long-Term Reduces Investment Risk– Con't

Historical Worst Stock Returns- 1926 to 2013: The figures above cover the last 64 years (1950 to 2013). Let's go back further in time to include the Great Depression. What were the worst periods like if we go back to 1926 (so now we are covering 88 years: 1926 to 2013)? Here are the figures, courtesy of Ibbotson SBBI, a Morningstar company:

Holding Period	No. of Rolling Periods	No. of Periods With Negative Returns	Best Period	Worst Period
1 year	88	24	54.0% (1933)	-43.3% (1931)
5 years	84	12	28.6% (1995-99)	-12.5% (1928-32)
10 years	79	4	20.0% (1949-58)	-1.4% (1999-08)
20 years	69	0	17.9% (1980-99)	3.1% (1929-48)

Futility of "Market Timing": Many times I have written about the futility of trying to "time the market". For the last twenty years, Dalbar has released its annual study that has consistently shown that individual investors dramatically underperform the market averages. In its most recent report, Dalbar reported that for the last 30 years the average equity fund investor earned an annual return of 3.7% compared with the S&P 500's 11.1% return. This is dramatic underperformance for a long period of time!:

⇒ Earning 3.7% per year for thirty years will turn grow $100,000 into $297,414.

⇒ Increasing the annual return to 11.1% for thirty years will grow $100,000 into $2,351,916.

⇒ Investors can resist the urge to market time by focusing on the long term.

In Summary: This article provides four steps to reducing the risk of investing. While we are able to handle most of the actionable items, the one thing we ask of clients is for them to focus on the long-term and try not to worry about short-term market volatility.

Roth 401(k)'s– An Appealing Alternative

Note to Retirees: While those clients who are retired do not have the opportunity to participate in a Roth 401(k), we recommend they forward this article to their kids or other family or friends who may be able to utilize one.

What is a Roth 401(k)?: Since January 1, 2006, employers have been allowed to offer a Roth 401(k) alternative in addition to the traditional 401(k) plan. The annual contribution limits are the same as traditional 401(k)'s (i.e. for 2014, up to $17,500 for those under age 50 and up to $23,000 for those ages 50 and over). Contributions to a Roth 401(k) are made with "after-tax dollars", while qualified distributions are tax-free.

According to benefits consultant Aon Hewitt, approximately 50% of employers offer a Roth 401(k), up from just 11% in 2007. But only 11% of workers with access to a Roth 401(k) participated in one last year. According to a recent T. Rowe Price study (see a reference to the study here), a Roth 401(k) may be the best option for most workers of any age. "Roths should be the rule and traditional 401(k)s and IRAs the exception", says Stuart Ritter, a senior financial planner at T. Rowe Price.

The classic candidates for a Roth 401(k) are those convinced their marginal tax rates will be higher in retirement, a description that fits many younger workers (and in fact Roth 401(k)s are more popular with younger workers). By paying income taxes on their contributions now, these workers can avoid paying taxes at a higher rate on their withdrawals. (In contrast, with a traditional 401(k), employees receive an upfront tax deduction and pay income tax on their withdrawals.)

Benefits of a Roth 401(k): Here are some of the benefits of a Roth 401(k):

1) **More Savings:** Every dollar saved in a Roth 401(k) is worth more than a pre-tax dollar saved in a traditional 401(k). That's because while you (or your heirs) will eventually pay income taxes on the distributions from a traditional 401(k), you (or your heirs) get to keep every penny distributed from a Roth.

2) **Greater Flexibility/Longer Time to Compound:** With a Roth 401(k) you can avoid required minimum distributions (RMDs) after age 70 ½ as long as you roll over your Roth 401(k) to a Roth IRA. The only RMDs for a Roth IRA are for your heirs, although they can spread the distributions over their life expectancy. That's a lot of years of tax-free compounding!

3) **Lower Income in Retirement:** RMDs from non-Roth retirement accounts are added to your income, which can cause more of your Social Security income to be taxable, push you into a higher tax bracket and/or increase the amount of your Medicare Part B premium (taxpayers with higher income pay higher premiums)

Please let us know if you would like to discuss whether a Roth 401(k) is appropriate for you.

Sincerely,

Steve 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.**

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 several 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) - Allen Hamm**
- **The Savvy Life® Classes, Workshops , and One-on-One Consultations**

Reminders/Updates

This past month, the IRS released the 2015 IRA & 401(k) contribution limits:

	Under Age 50	*Over Age 50*
IRA & Roth IRA:	*$5,500*	*$6,500*
401(k)	*$18,000*	*$24,000*