McCarthy Asset Management, Inc.
Personalized Wealth Management

October 2015 Monthly Commentary

November 2, 2015

Stock Market & Portfolio Performance

Inside this issue:

October & YTD 2015: The stock market rebounded with solid gains in October, with the S&P 500 having its best month since October of 2011. International stocks also posted strong gains, while small cap stocks lagged large-cap stocks. Bonds were flat for the month.

	October	YTD 2015	Description:
Without Dividends:			
S&P 500	8.3%	1.0%	500 Largest Public U.S. Companies
Russell 2000	5.5%	-3.6%	2000 of the smallest U.S. stocks
MSCI EAFE	7.7%	-0.2%	international stock index
U.S. Aggr Bond	0.0%	1.1%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	5.2%	-1.4%	non-very conservative MAM portfolios
MAM Conserv	2.9%	-1.3%	portfolios with 50%+ bond allocation

Comment: Stocks have almost fully rebounded from the August correction. See P.2 for our thoughts regarding whether the bull market still has room to run.

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

Stock Market Update: Does the Bull Market Still Have Room to Run?

By the end of October, the stock market had nearly fully recovered from its sharp mid-August correction. In the last couple of Monthly Commentaries, we discussed what triggered the correction and expressed the opinion that it would prove to be temporary. Positive events s that occurred this past month include:

- Indications continue to show that U.S. consumer spending remains relatively strong, and should be an important driver of economic growth.
- The European Central Bank suggested that it may expand its quantitative easing program in December.
- China engaged in yet another interest rate cut in an attempt to stimulate growth.
- 3rd quarter corporate earnings are beating expectations. While earnings may be down slightly for the quarter, they would be up 4% to 5% excluding energy companies.
- U.S. Government Shutdown: Surprisingly, Congressional leaders and the White House reached a major deal to avoid a possible government shutdown this December. The two-year deal was passed by Congress at the end of October, and is expected to be signed by President Obama in early November.

Does the Bull Market Still Have Much Room to Run? This is a difficult, but important question. The bull market is now in its 7^{th} year with the S&P 500 up over 200% from its March 2009 low. This is a very long and powerful rally relative to prior bull markets. While we don't see a new bear market on the horizon, the easy gains have been made and with the stock market no longer undervalued, risks have increased.

Opinions from Market Timers: We are not "market timers," as we feel it is nearly impossible to consistently and accurately predict the direction of the stock market. Nonetheless, with two periods since 2000 when the S&P 500 collapsed 50%, we think it is prudent to take defensive measures when the performance of the stock market appears to be at risk. We would do this by shifting part of a portfolio's equity allocation into bonds.

The hard part about market timing is getting it right. We regularly read a number of respected investment publications that make calls regarding the general direction of the stock market. Frequently, the predictions conflict with each other. Here are some of the publications along with their current thinking:

1. Bob Brinker's Marketimer: We have followed this publication since Brinker made the prescient call to get out of stocks in January of 2000, just three months before the March 2000 start of the dot.com crash. While he did miss the call to get out of stocks prior to the Financial Crisis, his overall track record is good, at least relative to most market timers. Currently, based on his positive outlook for the U.S. economy, Brinker feels that the S&P 500 will reach new highs by 2016.

2. Richard Band's Profitable Investing: We have followed this publication for many years. In July of this year, Band warned that he saw growing signs the stock market was vulnerable to a 5% to 10% correction. He was right on, with a 10% correction occurring in just four days during August. Band was impressed by the strong performance of stocks in October. He now feels the market recovery should continue through at least year-end, although he has significant concerns for 2016.

Stock Market Update: Does the Bull Market Still Have Room to Run?- *Con't*

3. Lowry's Research: Lowry's view turned negative this year. Despite the October recovery in stock prices, it feels that the stock market peaked this past summer and a new bear market may have started.

4. InvesTech Research: We just recently started following this publication, although it has been in existence for over 25 years. To its credit, InvesTech recommended to sell stocks in 2007 just prior to the start of the Financial Crisis. Then within months of the 2009 market bottom, it recommended to increase stock allocations back to 97%. Since then, it maintained a bullish stance until this past March, when it stated we were in the latter third of the bull market. As a result, InvesTech lowered its equity allocation to 80%. The publication recently turned more optimistic given the strong performance of stocks in October. It believes the key to the future direction of the market will be whether consumer and business confidence will be strong enough to continue the U.S. economic expansion.

Possible Modest Defensive Adjustments to Portfolios: The upshot of this is that we are concerned with how much longer the current bull market has to run. We are keeping a close eye on the performance of the U.S. economy. As discussed in previous articles, historically, most bear markets have been triggered by a recession. At this point, we don't see a risk of the U.S. economy slipping back into a recession for at least the next year or two. Nonetheless, for the first time since the Financial Crisis, we may get slightly more defensive with portfolios when we conduct the semi-annual repositioning later this month. **Please let us know if you would like to discuss any adjustments to your portfolio(s).**

Key Steps for Building a Successful Retirement Portfolio

Note: This article is based on an American Funds research article titled, "Key Steps to Retirement Success: How to Seek Greater Wealth and Downside Protection", that was published in July 2015.

The key to building a successful portfolio for retirement is generating sustainable income while managing risk. In retirement, investors must balance two key risks: longevity risk (the risk of outliving assets) and market risk (volatility). That balancing act has become more difficult in recent years due to low bond yields, which has increased the importance of a meaningful equity allocation in retirement. Since compared to bonds, equities have greater total return potential accompanied by higher volatility, an increase in equity can reduce longevity risk—but at the cost of higher market risk.

Three Key Traits: In this environment, investors need an equity allocation that can generate strong returns to address longevity risk while also providing downside resilience to protect against market risk. New research from American Funds, which offers an excellent family of actively-managed mutual funds, has identified a group of active equity and balance funds that have delivered on these goals. While past results aren't a guarantee of future success, these funds share three traits:

- **Low expense ratios**
- **High firm-level manager ownership**
- **A history of outpacing indexes in market declines (a trait known as "low downside capture")**

Mutual funds that contain these three traits have a history of outpacing indexes in scenarios where regular portfolio withdrawals are being taken, while experiencing less volatility and greater risk-adjusted returns.

Key Steps for Building a Successful Retirement Portfolio- *Con't*

The benefits of the first two traits (low expense ratios and high manager ownership) were discussed in our April 2015 Monthly Commentary article "When Actively-Managed Funds Have an Advantage." Funds that combine these two traits have performed well relative to index funds over time. American Funds extended its research to focus on the distribution phase for portfolios (i.e. when investors take regular withdrawals to fund their retirement). In doing so, it found that adding a third trait—low downside capture—to the investment selection process enhanced results during withdrawal scenarios.

Downside Capture: Morningstar calculates "downside capture" for a mutual fund by taking the fund's monthly returns during the periods of negative S&P 500 index performance and dividing it by the S&P 500's return. *A downside capture ratio of less than "100" indicates that a fund has lost less than the S&P 500 in periods when the stock market fell.*

At MAM, we have used "low downside capture" as one of the criteria we evaluate when selecting funds to include in a client's portfolio. As a result, most of the equity mutual funds used in portfolios have a downside capture of less than 100. In particular, per recent Morningstar figures:

Name of Fund	10-Yr Downside Capture Ratio
American Funds AMCAP	93 (i.e. 93% of S&P 500's drop)
Capital World Growth & Income	77
FMI Large Cap	80
Yacktman Fund	79

Results of American Funds Study: To evaluate the results of the study, American Funds tested *two hypothetical portfolios containing funds that satisfied all three key traits (i.e. "select active funds")* over a 20-year withdrawal scenario ending December 31, 2014. They assumed a $500,000 initial investment and a 4% initial withdrawal rate (growing 3% annually thereafter).

The first portfolio (shown in the left-half of the chart on page 5) consisted of a 50% allocation to the select U.S. large-cap funds and a 50% allocation to the select foreign large-cap funds. This was compared against an index blend consisting of 50% allocated to the S&P 500 and 50% to the MSCI All Country World ex USA index. Because these portfolios did not include a bond allocation, they are not representative of MAM portfolios. Nonetheless, the "select active funds" significantly outperformed the index blend over the 20-year period.

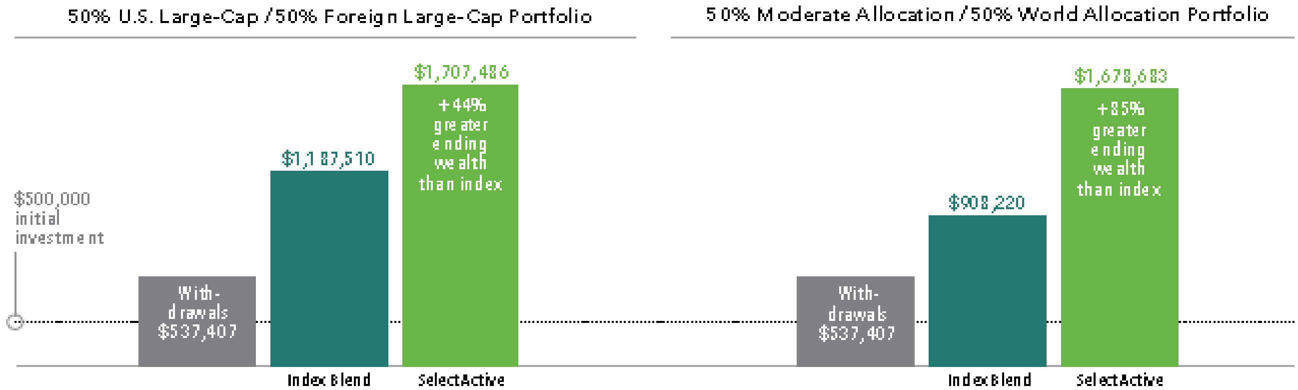
The second portfolio (shown in the right-half of the chart on page 5), which is more representative of a relatively conservative MAM-managed portfolio, consisted of a 50% allocation to the select Moderate Allocation funds and 50% to World Allocation funds. It was compared to a portfolio consisting of 60% allocated to the MSCI All Country World Index and 40% to the Barclays Global Aggregate Bond Index. As shown in the chart below, the select portfolios (i.e. which contain all 3 key traits) significantly outperformed the indexes for the 20-year withdrawal period.

The one caveat I have is that with interest rates currently near historical lows, I expect the next 20 years will be a more challenging time for a balanced stock/bond portfolio because bonds will not perform nearly as well as they did in the past 20 years when bond prices benefited from falling interest rates. The key takeaway, though, is that selecting mutual funds that contain all three of the traits discussed above is likely to help a retiree generate sustainable income while managing risk.

Key Steps for Building a Successful Retirement Portfolio- *Con't*

Select Active Portfolios Delivered Greater Wealth in Distribution

Return of a hypothetical $500,000 initial investment, with a 4% initial percentage withdrawal rate, increasing by 3% each year thereafter for the 20-year period ended December 31, 2014



	Index Blend	SelectActive	Index Blend	SelectActive
Avg. Annual Returns	8.13%	9.57%	7.15%	9.50%

Source: Capital Group, based on Morningstar data. Based on monthly returns. Average annualized returns are at net asset value and include withdrawals. See Appendix for methodology. U.S. funds are those in the Morningstar Open-End Large Value, Large Blend and Large Growth categories. International funds are those in the Morningstar Open-End Foreign Large Value, Foreign Large Blend and Foreign Large Growth categories. Moderate Allocation and World Allocation funds drawn from Morningstar categories of the same name. Moderate Allocation index is 60% S&P 500 and 40% Barclays U.S. Aggregate indexes. World Allocation index is 60% MSCI All Country World Index and 40% Barclays Global Aggregate Index. U.S. index is S&P 500. Foreign index is MSCI All Country World ex USA. The indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

No Social Security Raise for 2016; Benefits Not Keeping Up With Inflation

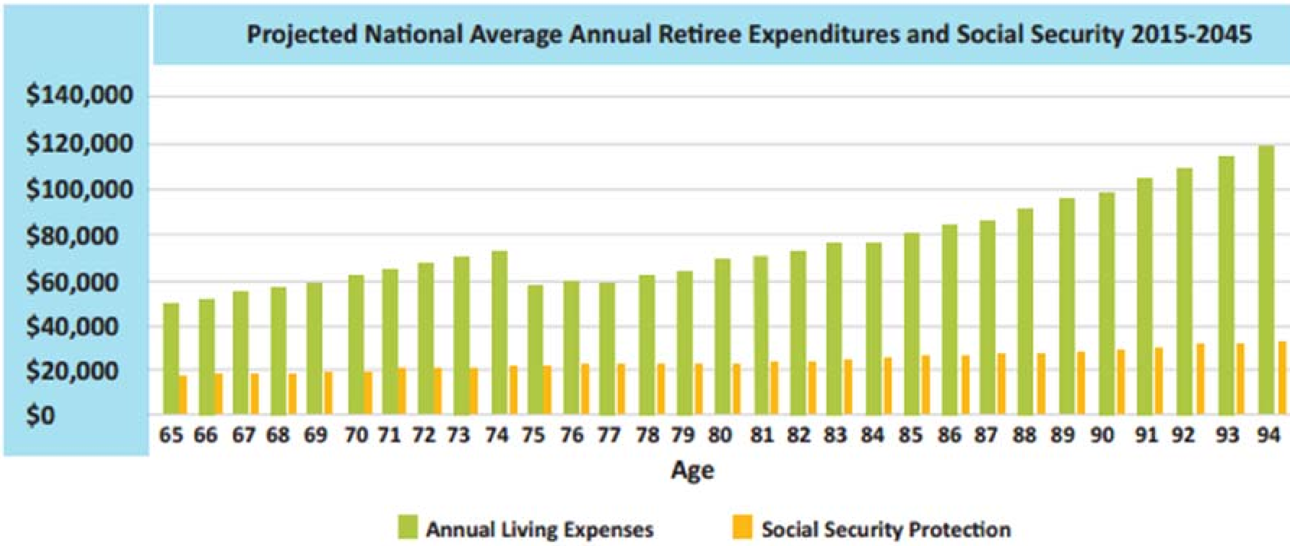
For just the third time in 40 years, next year, millions of Social Security recipients, disabled veterans and federal retirees will not receive an increase in benefits. They can blame low gasoline prices. By law, the annual cost-of-living adjustment (COLA) is based on a government measure of inflation, which is being dragged down by lower prices at the pump.

The problem for seniors is that the way the government measures inflation simply doesn't reflect how people on Social Security spend. Seniors don't benefit as much from lower gas prices as the average American worker because most are no longer driving to and from work. Medical costs have also increased faster than overall inflation, and a greater percentage of seniors' spending is on health care.

In fact, Social Security COLA benefits haven't kept up with the actual cost of living for quite some time. According to the Baby Boomers and Retirement Planning Strategy report (click on the name to access the report) from the Insured Retirement Institute, during the 30-year period between 1984 and 2013, average annual consumer expenditures for Americans ages 65 to 74 increased by 3.8% annually, and for those ages 75 and up by 4.0% annually. In comparison, the Consumer Price Index for All Urban Consumers (CPI-U) for the same period was 2.8%.

Projecting expenditures and Social Security income 30 years into the future, the Insured Retirement Institute shows an average American retiring now, at age 65, would be faced with an increasing shortfall as depicted in the charts on page 6.

No Social Security Raise for 2016; Benefits Not Keeping Up With Inflation- *Con't*



Age	Projected Annual and Cumulative National Average Living Expenses & Social Security Income					
	Annual Expenditures	Annual Social Security	Annual Income Gap	Cumulative Expenditures	Cumulative Social Security	Cumulative Income Gap
65	($50,378)	$16,260	($34,188)	($50,378)	$16,260	($34,118)
75	($54,856)	$21,411	($33,446)	($654,121)	$206,021	($448,100)
85	($80,96)	$28,193	($52,774)	($1,337,928)	$455,891	($882,037)
95	($119,506)	$37,123	($82,382)	($2,347,214)	$784,912	($1,562,302)

As indicated above, the "annual income gap", or the amount of annual expenditures not covered by Social Security income, is expected to increase as a retiree ages. To cover this shortfall, a retiree will need to have investment or other income. This suggests that to maintain their standard of living, they may need a diversified portfolio that includes growth elements.

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

This past month, the IRS released the 2016 IRA & 401(k) contribution limits:

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

Discover the difference with a Registered Investment Advisor.