McCarthy Asset Management, Inc.

Personalized Wealth Management

October 2016 Monthly Commentary

November 1, 2016

Stock Market & Portfolio Performance

Inside this issue:

October 2016: Living up to its reputation as a "scary" month, U.S. stocks, foreign stocks and bonds all posted losses for October. Year-to-date, with the exception of foreign stocks, gains have been decent.

	Oct 2016	YTD 2016	Description:
Without Dividends:			
S&P 500	-1.9%	4.0%	500 Largest Public U.S. Companies
Russell 2000	-4.9%	4.8%	2000 of the smallest U.S. stocks
MSCI EAFE	-2.1%	-3.0%	international stock index
U.S. Aggr Bond	-0.8%	5.0%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	-1.8%	4.8%	non-very conservative MAM portfolios
MAM Conserv	-1.3%	5.1%	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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Bull Market– Still No Respect

The U.S. stock market has been relatively flat the past few months, which may not be surprising given the uncertainty of the election and concern of a Fed interest rate increase. After this pause, I believe the bull market may still have a ways to run despite the lack of respect it has received from investors. This Rodney Dangerfield of bull markets is reflected in poor investor sentiment and fund flows that have consistently exited out of equity funds and into bond funds.

Negative Investor Sentiment: Market history shows that stocks normally perform better when investors are overly bearish than when they are overly bullish. Sentiment polls are one way to gauge investor sentiment, and so far this year, there has been an unusually high level of fear. For instance, the American Association of Individual Investors (AAII) Sentiment Poll has seen the percentage of bulls below 30% for eight consecutive weeks. That is the second longest such streak in 22 years. The latest sentiment reading saw a further decline in the percentage of bullish investors to 23.7%, in addition to investors with a bearish outlook rising to 37.8%. Furthermore, going back to 1987 when the weekly poll started, the average percentage of bulls has been 38.5%. Incredibly, the bulls have come in below this figure for a record 49 straight weeks, trouncing the previous record of 33 consecutive weeks.

Fund Flows: Investors are notorious for their poor market timing. They tend to invest when prices are close to a peak, and sell when prices are near a bottom. According to the Investment Company Institute, recent data shows that investors are very skeptical of equities, which is indicated by a record 32 straight weeks of outflows from domestic equity mutual funds. The previous record was 25 straight weeks ending in late 2010, when many investors were concerned about a double-dip recession. Where is all this money going? Much of it is moving into bonds, as 31 of the previous 32 weeks have seen net inflows into bond mutual funds. While bonds can be a safe-haven in times of market distress, my long-term outlook for most bonds is for only modest returns given that interest rates are near historical lows and likely to rise.

Corporate Earnings: Since stock prices are no longer cheap due to a seven-year bull market, corporate earnings growth will need to resume for further gains. Earnings have declined for five consecutive quarters. The third quarter of 2016 will likely see profits come in roughly even or slightly up compared to the third quarter of last year. Starting in the current quarter, analysts have high expectations going forward. According to Bloomberg, as of September 30th, analysts were expecting a 10% earnings growth rate in the fourth quarter and a robust 16% growth rate in 2017. While analysts tend to be too optimistic, earnings should start growing again as a partial recovery in oil prices will help solidify energy companies. Earnings should also benefit from the stability in the U.S. dollar this year, which has removed what had been a headwind for exporters and the industrial sector.

Economic Growth: Economic growth will also be needed for stock prices to continue climbing. The following are indicators pointing toward continued growth in the U.S. economy:

- *Consumer confidence, as measured by the Conference Board, jumped in September to its highest level since 2007.* Since consumer spending makes up approximately 2/3 of the U.S. economy, high consumer confidence bodes well for future spending.
- *First-time filings for jobless benefits recently touched a 43-year low.* Meanwhile, U.S. payrolls have increased an average of 232,000 per month over the past three months as the job market continues to expand and the unemployment rate is down to 5.0%.
- *3rd Quarter, 2016 GDP Grew at 2.9%.* As reported by the Commerce Department last week, the initial estimate of 3rd quarter 2016 GDP came in at a 2.9% annual growth rate. This was stronger than the second quarter's pace of 1.4% and higher than economists' estimated rate of 2.5%. While this growth estimate is subject to revision and may not be sustained in subsequent quarters, it does indicate that the economy is growing at a decent pace.

Stock Market Outlook: Once we move past the Presidential election, it will be interesting to see if the stock market can finish strongly for the year. Looking toward 2017, as long as economic growth continues, corporate earnings improve, and the Federal Reserve is slow to raise rates, I am cautiously optimistic for further stock market gains.

Health Savings Accounts— Also Beneficial for Retirement

When saving for retirement, health savings accounts, or HSAs, may be even better than 401(k) or other retirement accounts. Most people overlook HSAs as a retirement-savings vehicle. However, these accounts come with more tax advantages than 401(k)'s and IRAs when used to cover medical costs, which are a major expense in retirement.

Introduced in 2003 as a way to reduce the cost of health insurance plans, an HSA allows you to pay for current out-of-pocket health expenses and save for future qualified medical and retirement health expenses with pre-tax dollars. I last wrote about HSAs in our April 2013 Monthly Commentary. A white paper on the article is available here.

As with a traditional 401(k) or IRA, an HSA allows you to set aside pretax money without paying Federal income tax on it (since CA does not recognize HSAs, contributions are not deductible for CA tax purposes.) Money in HSAs grows tax-free and, if used for medical expenses, can be withdrawn tax-free. This is a significant advantage over a traditional 401(k) or IRA, in which you pay income tax on your withdrawals.

Eligibility: To open an HSA, you must be covered by an HSA-qualified health plan (i.e. "high-deductible plan"), either through your employer or your own health insurance plan, if not covered by an employer plan. To qualify for 2016, a health plan must have deductibles of at least $1,300 for individuals and $2,600 for a family. Because an HSA requires a high-deductible insurance plan, the healthcare premiums are typically lower. The savings in the premium costs can be used to help fund the contribution to the HSA. Two additional qualifications to be eligible for contributing to an HSA are that you can't be enrolled in Medicare and you can't be claimed as a dependent on someone else's tax return.

Tax-Deductible Contributions: For 2016, the maximum contribution is $3,350 for individuals and $6,750 for families. Those over age 55 can contribute an additional $1,000.

Compared to Flexible Spending Accounts (FSAs): HSAs are far superior to employer-offered FSAs. While money set aside in a FSA must be spent during the year ("use it or lose it"), a balance in an HSA carries over from year to year. Furthermore, an HSA is portable—if you change employers or retire, you can take it with you.

Retirement Calculators— Do It Yourself? By Lauree Murphy

Sometimes when we talk to clients about preparing a retirement analysis, they tell us that they have used an online calculator to plan for retirement. Fair enough. I applaud those who want to assess their retirement readiness. Curious to see the results, I decided to test the accuracy of these online calculators. There are many available as indicated by my google search of "retirement calculators" yielding more than 17 million results. All the large brokerage firms have tools, as well as many others. With some calculators, you put in a few numbers (your assets, retirement spending, social security benefits, retirement age, etc.) and voilà, you get a quick answer. Others ask for much finer detail.

Just for fun, I tried using calculators from Fidelity, T. Rowe Price, Schwab and AARP. I compared the results to Money Guide Pro, the financial planning software we use. Most tools allow you to save the results if you create a guest account. Personally, I have been tracking my own progress using Money Guide Pro for a number of years, so I feel I have a pretty good handle on where I stand. In my opinion, the most important inputs in the analysis are your retirement spending goals and the assumptions used for investment returns, inflation and life expectancy.

The results I received from the four calculators were all over the board. When I read the assumptions used by each calculator, I was able to see why the outputs differed so much. Most plans we do are over a period of 30 years or more. Assumptions change over time and plans need to be refreshed at minimum every 5 years or so, to make sure things are still on track. It is important to use assumptions that are realistic, based on current estimates:

Retirement Calculators– Do It Yourself?
By Lauree Murphy- Con't

- Life Expectancy- For those who don't have a health issue, we recommend using at least age 95 for life expectancy. Many of the calculators are preset with a life expectancy much lower, often in the high 80s. With so many people living into their 90s and longevity continuing to increase, it's important not to underestimate this.
- Inflation Rate- It's hard to know where inflation will be years into the future. While currently we are using 3%, we may need to increase this if inflation starts to accelerate. Most of the calculators I looked at were using 2.5%. Our software allows us to vary inflation on each expense. Healthcare and college costs, for instance, are currently increasing at about twice the rate of overall inflation. Using one general low rate for all spending categories will likely understate your expenditures.
- Return on Investment- Most retirement calculators use either a fixed rate of return, which may be on the high side, or base the calculation on your asset mix. We currently have been projecting annual returns in retirement at about 5%. Our expectation is that in retirement, assets will be invested slightly more conservatively than before retiring.
- Spending in Retirement- Spending is the single most important variable in the calculation. Sometimes a few thousand dollars a year can make or break a plan. That's because we are talking about such a long period of spending. When you get close to retirement, it's important to get a good handle on your retirement spending. Most clients aren't aware of the significant cost of healthcare. Drug plans, supplemental insurance policies, and out of pocket costs add up even when you qualify for Medicare. Often left out is the cost to replace autos every few years. Some costs are discretionary, like travel, and should be separated from essential costs. We like to break it down into various goals that can then be adjusted depending on the predicted outcome. Additionally, Money Guide Pro does a Monte Carlo analysis, where it runs the numbers varying the rates of return and tells us the probability of success, which is the percentage of scenarios where you have money left at the end of the plan. In other words, success means not running out of money before you die.

Additional Research- A June 20, 2016 article in Investment News, "Retirement Calculators Show Dramatically Different Results" confirmed my analysis. (Click on the article name to see the article.) In particular:

- "Comparing the outputs from several retirement planning programs shows a huge dispersion of results, underpinning how investors and advisors should use them as a guide rather than take them at face value."
- "The 12 planners we examined for this study…all provided dramatically different results in terms of intuitiveness, comprehensiveness and even overall quality. These disparage results can lead to confusion among investors, and, at worst, could encourage poor behavior."
- A study earlier this year by researchers from Texas Tech University and Utah Valley University, "The Efficacy of Publicly-Available Retirement Planning Tools" found advice provided by a majority of such tools "extremely misleading".

What Online Retirement Calculators Don't Tell You- There are many issues that should be addressed when approaching retirement. We have the capability to do a much more comprehensive retirement analysis. Money Guide Pro allows us to model various scenarios and compare the results. We can show one-time expenses like the purchase of a home, remodeling costs, weddings, college tuition, etc. We can vary the assumptions in a more realistic manner. We write a letter which summarizes the results and discusses other important considerations such as Social Security benefit timing, estate planning, long term care planning, and healthcare costs. We serve as the second set of eyes. We will alert you if you are off track, and recommend any necessary adjustments we believe will help ensure a financially-secure retirement. We have done over sixty of these retirement analysis for clients in a wide variety of situations. Best of all, as a MAM client, this service is complementary.

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

***2017 Social Security Benefits:* Social Security benefits will get a slight 0.3% increase next year, up from zero this year. 2017 will be the fourth consecutive year in which the COLA increase will be less than 2.0%.**