McCarthy Asset Management, Inc.
Personalized Wealth Management

3rd Quarter 2013 Letter
(also September 2013 Monthly Commentary)

October 1, 2013

Stock Market & Portfolio Performance

Inside this issue:

3rd Quarter 2013: For the quarter, U.S. stocks performed well, foreign stocks did even better, and bonds staged a partial recovery. For the first nine months of 2013, U.S. and foreign stocks had double-digit returns while bonds declined moderately.

	3rd Qtr 2013	YTD 2013	Description:
Without Dividends:			
S&P 500	4.7%	17.9%	500 Largest Public U.S. Companies
NASDAQ	10.8%	24.9%	stocks trading on the Nasdaq
Russell 2000	9.9%	26.4%	2000 of the smallest U.S. stocks
MSCI EAFE	10.9%	13.4%	international stock index
U.S. Aggr Bond	0.6%	(1.9)%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	4.6%	12.9%	non-very conservative MAM portfolios
MAM Conserv	2.1%	3.3%	portfolios with 50%+ bond allocation

Comment: As discussed on P.2, the stock market may experience turbulence in October with a partial shutdown of the Federal government and debt ceiling debates which are expected to be heated.

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No Fed Tapering (Yet)

In a widely watched decision, on September 18th the Federal Reserve surprised the markets by declining to begin reducing ("tapering") its asset-purchase program. Most observers expected the central bank to begin a modest pullback in its $85 billion a month in bond purchases. Regarding the decision:

- The Fed made it clear that the recent increase in long-term rates (including mortgage rates) was a key reason for holding off tapering. In essence the Fed may be sending a signal that the bond market overreacted when the 10-year yield spiked to nearly 3.0%.
- The Fed indicated they want to see more evidence that the economy can sustain improvements before scaling back its bond purchases, but they made it clear they are posed to reduce the program if they see more evidence of a strengthening economy. Chairman Bernanke said that the market risks from the "upcoming fiscal debates" were also a factor in the decision to not taper.
- The Fed now sees the economy growing in 2013 in a range of 2.0% to 2.3%. The earlier forecast had predicted growth of 2.3% to 2.6%. For 2014 the Fed is now forecasting 2.9% to 3.1% growth (down from 3.0% to 3.5%), and for 2015 the forecast is 3.0% to 3.5%.
- In a press conference following the Fed announcement, Chairman Bernanke indicated tapering could still start before year-end. To do so, the Fed wants more confirmation of a pickup in economic growth, sustained job gains, and proof that the current low inflation is moving back up toward the Fed's 2% target.
- Kathy Jones, Schwab's fixed income strategist, said the she and her team believe the 10-year Treasury yield will probably fall back to 2.5% or so and short-term rates are likely on hold for a lot longer than many had thought.

2013 Federal Government Shutdown

With the Federal government having begun a new fiscal year on October 1st, Washington had a deadline of midnight Sept 30th to pass a new continuing budget resolution to fund the government's discretionary spending. The deadline passed without a resolution, so the government began a partial shutdown on October 1st, This was reminiscent of similar episodes that occurred in the mid-1990's.

What's the holdup?: House Republicans insist the spending bill include anti-Obamacare amendments. Senate Democrats are insistent that it doesn't.

Likely Economic Impact: Assuming that the Federal government will only be shut down for a short period of time (which is likely), both fourth-quarter economic growth and consumer confidence will be hurt only moderately while the stock market could experience increased volatility.

Next Up- The Debt Ceiling Debate: By mid-October the Federal government is expected to reach the statutory limit on the amount of debt the U.S. can issue. If Congress and President Obama cannot come to agreement that would raise the debt ceiling before the threshold is reached, the United States may technically default on its debt, an event that has never happened before.

Our Expectation: Ultimately, Congress will find a way to reach an agreement to pass the budget resolution and to extend the Debt Ceiling, but probably not until the last moment.

Medicare Advisory Program (MAP)

For the last couple of years we have utilized the services of Allen Hamm to create a Long-Term Care Plan for clients. We are pleased to announce that Allen has expanded his service offering to include assisting our clients with navigating the "Medicare maze".

Medicare is a particularly complex area of planning, with many important choices that must be made in a relatively short period of time, right around age 65. Through a service he calls "Medicare Advisory Program (MAP)", Allen and his firm will now be available to:

- Assist clients with signing up for Medicare in a timely manner to make sure no penalties are incurred.
- Assist clients with understanding the differences between a Medicare Advantage plan and Medicare Supplement plan and with choosing the best option for them.
- Assist clients with choosing a Medicare Supplement plan if traditional Medicare is their chosen option.
- Assist clients with evaluating and choosing their Plan D prescription drug coverage.
- Evaluation of supplemental coverage if a client is already on Medicare disability.
- Review annually, as needed.

Allen Hamm

Allen Hamm is the Author of the book "How to Plan for Long Term Care", Creator of the Smart LTC Planning System and the Medicare Advisory Program (MAP). Allen's Services are available at no cost to MAM Clients.

Not included in these services is assisting clients with signing up for Medicare disability (for clients under age 65) or with signing up for Social Security Disability.

As you get closer to becoming eligible for Medicare, I suggest you have a phone consultation with Allen, so that he can guide you through your Medicare choices. As with Allen's Long-Term Care Planning services, there is no charge to MAM clients for this new service because we pay his firm an annual retainer fee to assist our clients with objective, professional advice.

We welcome your feedback on our decision to make this new service available to you. Please let us know if you would like to talk with Allen and we will send him an introductory email.

THE SUSTAINABLE WITHDRAWAL RATE

Is the 4% Rule Still a Good Estimate?

The 4% Sustainable Withdrawal Rule is one of the most widely used "rules of thumb" in retirement planning. It is very useful as it serves as a rough guide to determine how much someone needs to save up for a financially comfortable retirement and then, once retired, how much they can spend per year without depleting their savings. The rule states:

> *Withdrawing 4% of your portfolio in the first year of retirement and then withdrawing the same amount adjusted for inflation each year thereafter will result in a high probability of your retirement savings lasting 30 years or more*.

For example, an investor who has accumulated a portfolio worth $1 million, and who is faced with 3% annual inflation, should be able to withdraw $40,000 the first year of retirement, $41,200 the second (i.e. $40,000 increased by 3%), $42,436 the third and so on, without fear of depleting their funds.

This rule was first introduced in a 1994 study by William P. Bengen, in which he stated that for a portfolio comprised of 50% stocks and 50% intermediate-term treasuries, a 4% annual withdrawal rate is sustainable for a minimum of 30 years. In his 2006 book, Conserving Client Portfolios During Retirement, Bengen further discussed the concept of the safe maximum withdrawal rate, which would allow for 30 years of withdrawals without depleting savings. This finding was later confirmed and expanded upon in studies by other academics to account for different asset allocations, time horizons and historical periods. In the recent years, though, the rule has come under fire and received a lot of attention in the financial press.

Problems with the 4% Rule:

- **Low-Yield Environment and Above-Average Stock Values:** Most research done on sustainable withdrawal rates uses historical data and assumes the same expected return on each asset class year-after-year. This is a reasonable assumption when the stock market is fairly valued and bond yields are at or above their long-term averages. This is not a realistic assumption in today's environment of low bond yields and high stock market valuations. Factor in the aging population and the slow economic growth, and the 4% rule begins to look too aggressive for the current environment. A recent Morningstar study suggests that **a 4% withdrawal rate provides only a 48.2% probability of assets lasting for 30 years. The same study found that a 2.98% rate can result in a 90% probability of the money lasting that long.**

- **Sequence of Returns Matters**: Intuitively, most people understand that if they retired in late 2000 or 2007, right before the onset of a major bear market, the withdrawals during those early bear market years had a much bigger negative impact on the overall health of their portfolio. This concept is known as sequence risk. This concept was discussed further in a recent MarketWatch article.

Devising a Sustainable Withdrawal Program – there is no one simple solution to sustaining portfolio withdrawals during retirement, but rather an array of steps that you can take. Here are some of them:

- **Create a Cushion:** For clients who are receiving periodic distributions from their portfolios, we set aside typically 3 years' worth of withdrawals in a conservative bond fund. As long as stock prices are not depressed, we replenish this conservative fund at least every six months when we reposition portfolios. The benefit of using this technique is that when a bear market starts and stock prices drop precipitously, we do not need to sell any equities for at least three years to sustain portfolio withdrawals. Given that the duration of the average bear market since the Great Depression has been 18 months, we should have enough held in the conservative bond fund to allow the rest of the portfolio to recover as the market correction runs its course.

- **Be Flexible:** Recall that the first few years of retirement are critical to the overall success of the sustainable withdrawal program. Reducing expenses during a market downturn will allow you to temporarily reduce the distributions from your account(s).

- **Adjust Your Expectations:**

1. **Reduce The Certainty:** Certainties do not exist in the world of financial planning. As much as we would like to have a 100% certainty plan, many financial planners suggest that 80% probability is an acceptable level of success for a financial plan. Furthermore, a significant downside with a 100% certainty plan is that the retiree is living on less than they could safely withdraw. Unless leaving a large estate is a very important goal, the retiree would be foregoing expenditures that are affordable. In these cases, it may make sense to spend more if it results in a higher quality of life while still minimizing the risk of running out of money.

2. **Retire Later:** If the probability of success (i.e. the likelihood of not outliving your assets) is lower than what you are comfortable with, consider working longer or saving more.

3. **Assume Shorter Length of Retirement:** A 30-year withdrawal time horizon may be longer than is likely for many who retires at 65. Consider your family history of longevity and your health when making your plan.

- **Diversify Your Portfolio**: Most of the research that has been done on sustainable withdrawal rates has been based on a portfolio made up of just stocks and bonds. Adding alternative assets to a portfolio can improve the risk-adjusted returns, and therefore increase the sustainable withdrawal rate. Bengen's initial study used only two asset classes (large-company U.S. stocks and intermediate–term U.S. government bonds). When Bengen added a third asset class, small-company U.S. stocks, he raised the acceptable withdrawal rate to 4.5%.

International stocks and international bonds add diversification to a portfolio. In addition, alternative assets can add other asset classes that reduce the volatility of a portfolio without sacrificing returns. Currently we are investing in Master Limited Partnerships as an alternative asset. In the past we have also used commodities and REITs as alternative assets. As other alternative assets become more attractive, we are likely to add them to portfolios.

- **Add More Equities, Especially Dividend-Paying Stocks:** As people age and their life expectancies become shorter, it makes sense to be more conservative with their retirement portfolios. For those with a 15-year or longer life expectancy, though, portfolio growth is critical so that future-year distributions can be increased for inflation. Particularly in the early phase of retirement, a portfolio should be more heavily weighted toward equities and less toward bonds. Dividend-paying equities can play a particularly important role here.

- **Work with a Planner**- According to a recent article in a Financial Planning Magazine, working with an advisor who can help you implement an appropriate Total Wealth Asset Allocation, Tax Efficiency, Dynamic Withdrawal Strategies, Annuity Planning and Liability-relative Optimization, can add the equivalent of a 1.82% annual arithmetic return to your portfolio, translating to almost 29% more that clients can spend in retirement.

In addition to our expertise at MAM, we have purchased financial tools that help our clients plan for a worry-free retirement. Please contact us if you would like to discuss your retirement plan with us or have us prepare a Retirement Analysis for you.

Sincerely,

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MAM

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

October 1st Affordable Care Act Deadline*: October 1st was the deadline for businesses covered by the Fair Labor Standards Act (generally business with at least one employee and $500,000 in annual sales) to provide a written notice to employees of the options available to them under the Affordable Care Act (ACA).*

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