McCarthy Asset Management, Inc.
*Personalized Wealth Management*

# Sept. 2016 Monthly Commentary/Q3 Qtr Letter

October 3, 2016

**Inside this issue:**



## Stock Market & Portfolio Performance

***3rd Qtr & YTD 2016:*** U.S. and foreign stocks posted strong gains for the quarter, and with the exception of international stocks, have performed well so far this year. Bonds were up modestly for the quarter, but have done well for the first nine months of the year.

| | 3rd Qtr | YTD 2016 | Description: |
|---|---|---|---|
| Without Dividends: | | | |
| S&P 500 | 3.3% | 6.1% | 500 Largest Public U.S. Companies |
| Russell 2000 | 8.7% | 10.2% | 2000 of the smallest U.S. stocks |
| MSCI EAFE | 5.8% | -0.9% | international stock index |
| U.S. Aggr Bond | 0.4% | 5.8% | index of U.S. bonds |
| With Dividends, after all fees: | | | |
| MAM portfolios | 3.4% | 6.7% | non-very conservative MAM portfolios |
| MAM Conserv | 2.2% | 6.5% | 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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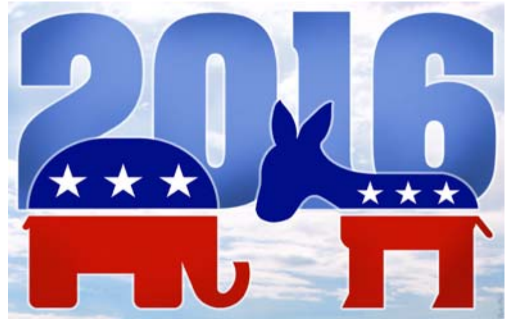
# Stock Market Outlook– Including Impact of Presidential Election






The stock market has climbed a "wall of worry" so far this year:

- Early in the year, it was the risk of falling oil prices and the fear that the global economy was slipping back into a recession. Since then, oil prices have staged a partial rebound and the global economy has continued its slow growth trend.
- Later it was the fear of the Federal Reserve raising interest rates. So far no increases have occurred this year, and it is now likely there will be just one increase late in 2016.
- For a short two-day period in late June, it was the shock of the Brexit vote.
- Now, as the stock market enters the fourth quarter, the uncertainty of the Presidential Election looms.

In fact, during the last few months, a number of clients have asked whether I planned to make portfolio adjustments in light of the upcoming Presidential election. In answer, at least so far, I have not made any adjustments to get more conservative with portfolios. Here is why:

1) Timing the stock market in the short-term is very difficult, if not impossible. In fact, the stock market often does the opposite of what most people expect it to do.

2) I don't think we are about to enter another bear market, primarily because I don't think we are likely to slip into a recession in the foreseeable future. Historically, bear markets are triggered by either an economic recession or a bubble resulting from over-inflated valuations.

3) Until about three weeks ago, odds makers heavily favored a Clinton victory. The chances of a Trump victory, though, improved up until the first debate. While currently it once again looks likely Clinton will win, there is still over one month to go before the election. I have been following this website for the latest odds of who will win:

   http://projects.fivethirtyeight.com/2016-election-forecast/

4) No matter who wins the White House, the likelihood of achieving his or her priorities will rest heavily on the composition of Congress. The House of Representatives is very likely to stay Republican-controlled, which would likely block many of proposals favored by Hillary Clinton. If the Democrats were to win back control of the Senate, they would likely block many of Donald Trump's proposals. Furthermore, I think at least a few Republican Senators will not go along with some of what he has proposed.

5) <u>Fourth Quarter Rally?</u> Historically, the stock market's best quarter is the fourth quarter. Per LPL Financial, since 1950, the S&P 500 has generated an average return of 4% for the fourth quarter, versus a 2.1% average for all quarters. Furthermore, strategy group <u>Fundstrat Global Advisors</u> shows that since 1940, when stock prices have increased more than 5% by mid-September, 87% of the time they rallied further in the fourth quarter. Through mid-September this year, the S&P 500 Index was up 6.3%.

6) <u>Market Timing Services:</u> While I don't believe in trying to time the market, nonetheless I follow several market timing services to get a possible feel for the future direction of stock prices. In particular, Bob Brinker's Marketimer, InvesTech Research, and Ned Davis Research all feel that this bull market likely has more room to run. Lowry's is a little more guarded, although they haven't yet seen the emergence of heavy, sustained selling by investors, which is a common characteristic of a major market top.

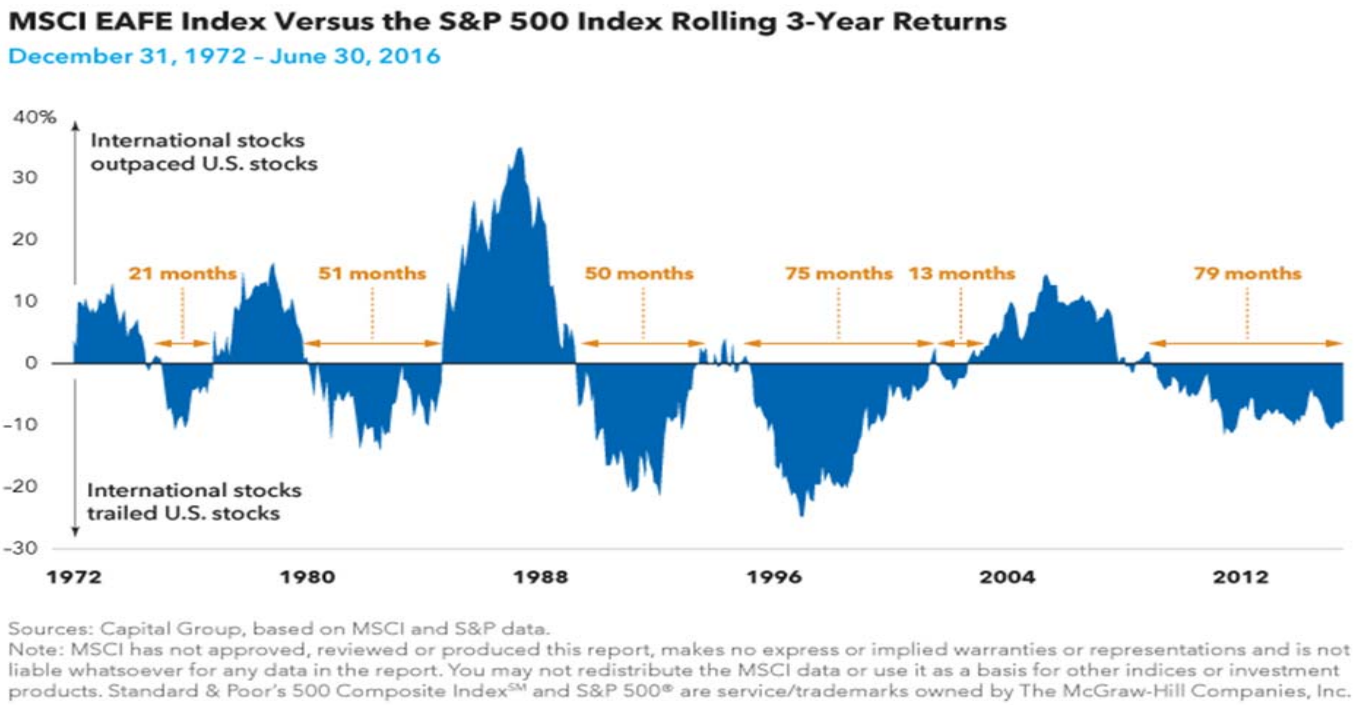
7) <u>Would You Like to Have a Conversation?</u> One of the important factors I consider in managing a client's portfolio is how they would likely react to a market downturn. For those that have concerns now, it may be prudent to get a little more conservative, especially given how much stocks have appreciated since March of 2009. *Please let me know if you would like to discuss the asset allocation of your portfolio(s).*

# International Equities– Down but Not Out



Since the 2008 financial crisis, the U.S. stock market has consistently and dramatically outperformed overseas markets. Per an article titled "The Case for Going Global" from the September 2016 edition of Money Magazine, the S&P 500 is up 270% since March of 2009 while an index of non-U.S. stocks is up only 122%.

Given the significant underperformance of foreign equities, some investors may be questioning the wisdom of including an international allocation in their portfolios. This would be a mistake. While international equities have lagged those in the U.S. for years, don't assume that this trend will last forever. As can be seen from the American Funds' chart below, history shows the reverse was also true for extended periods of time prior to the global financial crisis.




As shown on the chart above, since 1972 there have been a series of cycles, with U.S. equities outperforming for a period of time, followed by foreign equities outperforming. The current U.S. outperformance cycle is now over 79 months in length, which is the longest stretch of outperformance in over forty years . After years of lagging returns, it is understandable that investors have become impatient with international equities. June's Brexit vote is one more source of uncertainty on a long list of challenges. However, it's important to take a long-term view and understand that extended periods of trailing returns will eventually be followed by periods of higher relative returns.

<u>A Long-Term Case for International Equities:</u> In addition, secular demographic trends indicate a compelling long-term investment opportunity for international equities, especially in emerging markets. In particular, the emergence of a global middle class will drive economic growth in many foreign countries as income levels steadily rise and the number of people living in poverty continues to fall. In 2009, approximately 1.8 billion of the global population could be classified as middle class. According to "The Emerging Middle Class in Developing Countries" by Homi Kharas of the Brookings Institute, that figure is projected to rise to 2.9 billion by 2020 and 4.7 billion by 2030. An expansion of this magnitude should positively contribute to increased domestic consumption in many countries, as people begin to enjoy the luxuries middle-class incomes can afford.

<u>Impact on Strategy for Managing MAM Portfolios:</u> We lowered the international equity allocation in portfolios during the 2008 financial crisis due to the risks resulting from the European Sovereign Debt crisis. Currently, most portfolios have a 10% to 15% allocation to foreign equities. While we are not yet ready to increase that allocation, we expect to do so once we are confident that the current cycle has ended and international equities are once again outperforming U.S. equities. Longer-term, it is likely portfolios will have a higher international allocation given the dramatic growth expected to occur in the middle class in emerging markets.

# Beware of Fake IRS Tax Bill Notices

On September 22nd, the IRS sent out an alert warning taxpayers and practitioners about a new scam that uses fraudulent CP2000s letters to solicit money from taxpayers. In one sure sign the notices are fake, many are arriving by email—and the IRS doesn't initiate taxpayer contact by email. Even so, some of the fakes are paper notices sent by regular mail and taxpayers should watch out.


This scam is the latest twist in an epidemic of fraud targeting taxpayers. According to the Treasury Inspector General for Tax Administration, an IRS watchdog, since October 2013, it has received more than 1.7 million complaints from people reporting phone calls from fraudsters impersonating IRS agents. More than 8,800 victims have paid more than $47 million as a result of these scams.

The fake notice makes clever use of language and typefaces similar to those in legitimate IRS letters. It directs the payment be mailed to a PO Box at the "Austin Processing Center", and the IRS does a large processing center there. However, the fake notice tells the victim to make out the check to "I.R.S." rather than the correct payee, which is the U.S. Treasury.

If you receive a notice regarding an unexpected balance due, we recommend you forward a copy to us or whoever is your tax preparer, so the correspondence can be verified.

In an effort to combat scams, the IRS reminds taxpayers that the agency doesn't:

- Initiate contact by phone, email, text or social media asking for personal or financial information.
- Call about taxes owed without first mailing a bill.
- Call to demand immediate payment.
- Threaten to bring in local police or other law-enforcement groups to arrest a taxpayer who owes money.

In addition, taxpayers who receive "phishing" emails should take these steps:

- Don't reply to the message, open any attachments or click on any links. They may have malware that will infect your computer.
- Forward the email to phishing@irs.gov. Then delete it.

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

***Please let us know if you would like to have us show you how to access the information that is available on your MAM portal.***