

Sept. 2018 Monthly Commentary/Q3 Qtr Letter

October 1, 2018

Stock Market & Portfolio Performance

Third Quarter 2018: U.S. stocks posted decent returns for both the third quarter and first nine months of 2018. Meanwhile, international stocks and bonds suffered small losses for the year-to-date.

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	3rd Qtr	YTD 2018	Description:
Without Dividends:			
S&P 500	7.2%	9.0%	500 Largest Public U.S. Companies
Russell 2000	3.3%	10.5%	2000 of the smallest U.S. stocks
MSCI EAFE	0.8%	-3.8%	international stock index
U.S. Aggr Bond	0.0%	-1.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	4.2%	5.1%	non-very conservative MAM portfolios
MAM Conserv	2.5%	2.5%	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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International stocks have performed poorly so far this year. Through September 30th, the MSCI EAFE international index was down 3.8% compared to a rise of 9.0% in the S&P 500. Historically, there have always been cycles of international stocks underperforming followed by a period of outperforming. As can be seen in the J.P. Morgan chart below, from March of 2009 through June 30, 2017, the S&P 500 returned 302% while the MSCI All Country World ex-U.S. index returned 115%. This is the longest stretch of underperformance in over 40 years.

U.S. and international equities at inflection points GTM - U.S. | 43

MSCI All Country World ex-U.S. and S&P 500 Indices

Dec. 1996 = 100, U.S. dollar, price return



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
 Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.
 Guide to the Markets – U.S. Data are as of June 30, 2018.



The main reason international stocks have lagged so far this year is due to a rise of nearly 10% in the U.S. dollar. While we don't know when international stocks will shine again, we will likely maintain our existing international allocation when we next reposition portfolios later this year. The rationale for investing in international stocks is they add diversification to portfolios. Furthermore, a case can be made that emerging market stocks, which make up a subset of international stocks, offer a tremendous long-term growth opportunity.

Last month, I met with a representative of American Funds. He told me that emerging markets is currently its highest investment conviction. This is not based on a "top-down" global call from portfolio managers, but rather based from a company by company analysis. Portfolio managers at American Funds feel that companies with significant exposure to emerging markets are the most undervalued and provide the best opportunity for growth. He said that while the U.S. economy is probably in the later stages of economic growth, emerging markets are in a much earlier stage.

International Equities Continue to Underperform— cont'd

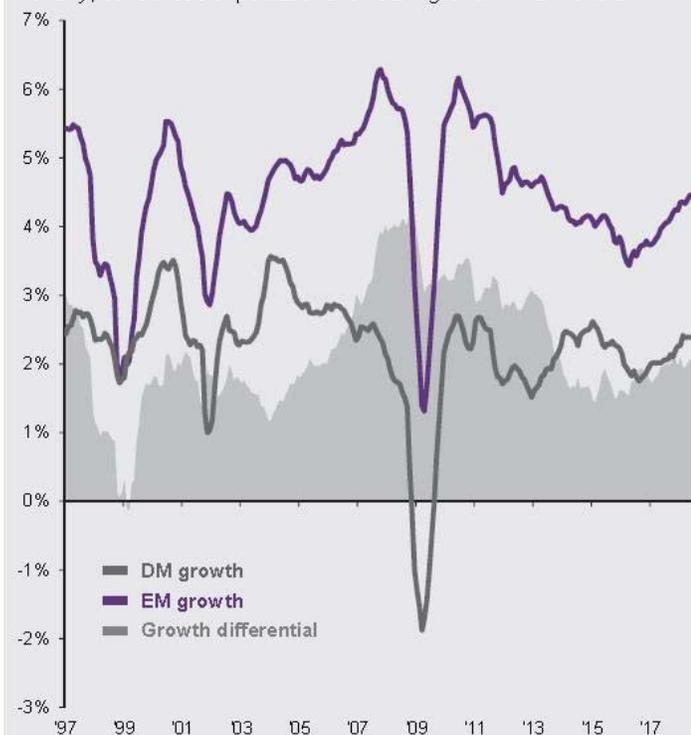
Furthermore, secular demographic trends indicate a compelling long-term investment opportunity for emerging markets. In particular, the emergence of a global middle class will drive economic growth in many of these countries as income levels steadily increase and the number of people living in poverty continues to fall. The projected growth in the middle class in emerging markets is dramatic, as can be seen on the right side in the following J.P. Morgan chart:

Emerging markets

GTM - U.S. | 52

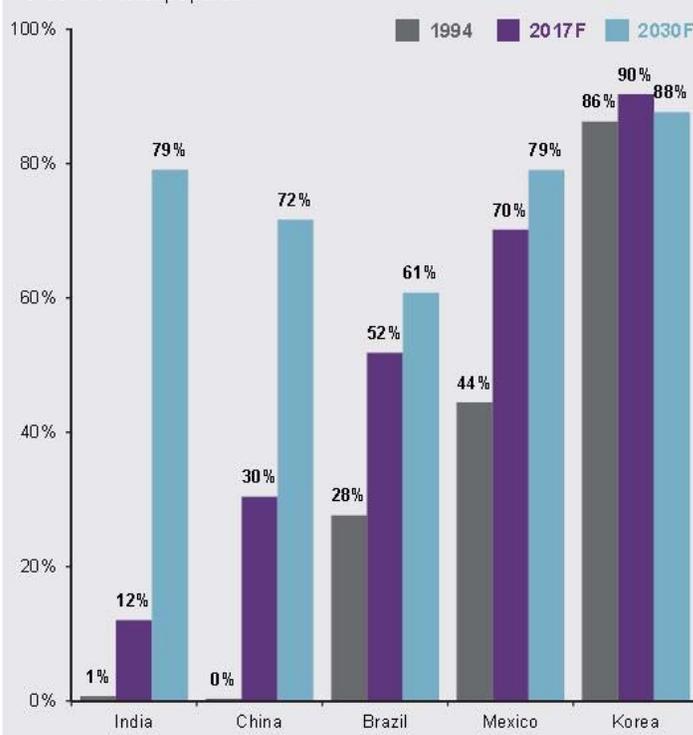
EM vs. DM growth

Monthly, consensus expectations for GDP growth in 12 months



Growth of the middle class

Percent of total population



Source: J.P. Morgan Asset Management; (Left) Consensus Economics; (Right) Brookings Institute. "Growth differential" is consensus estimates for EM growth in the next 12 months minus consensus estimates for DM growth in the next 12 months, provided by Consensus Economics. Middle class is defined as \$3,600-\$36,000 annual per capita income in purchasing power parity terms. Historical and forecast figures come from the Brookings Development, Aid and Governance Indicators. *Guide to the Markets* - U.S. Data are as of June 30, 2018.

J.P.Morgan
Asset Management

The chart highlights the significant changes in percentage of the total population occupied by the middle class in India and China from 2017 to 2030. In India, the middle class is projected to increase from 12% to 79%. The middle class in China is projected to increase from 30% to 72% during that timeframe.

Bottom Line: Most MAM portfolios currently hold a foreign and emerging market stock allocation of somewhere between 12% and 17%. We will likely maintain this allocation when we next reposition portfolios later this year. At some point in the future, I do expect international stocks in general and those in emerging markets in particular to outperform U.S. stocks. When we feel that time is at hand, we will likely increase our international and emerging market allocation.

Medicare Open Enrollment

For 2019 Medicare coverage, the annual enrollment period (“Open Enrollment”) will run from October 15, 2018 to December 7, 2018. During this time, you can make changes to various aspects of your coverage, such as switching from Original Medicare to Medicare Advantage, or vice versa. For additional information about what changes can be made, check out this link to [Medicare Open Enrollment](#).

As most of you know, MAM has retained the services of Eileen Hamm and her firm to help our clients with issues related to Medicare. Because we pay Eileen’s firm a fee, this service is available at no charge to you. Quite a few clients have already utilized Eileen’s services when they first became eligible for Medicare, or during the annual Open Enrollment. For those who have worked with Eileen in the past, she will be in contact to see if they would like to have her review their coverage.



Here is what Eileen can help you with during Open Enrollment:

- Reviewing your Medicare supplement coverage to see if it has met your needs during the past year and evaluating other options as appropriate.
- Reviewing and making recommendations for any changes to your Part D prescription drug plan.

Per Eileen, “If you are on a Medigap-type supplement plan and are happy with it, no change will be needed. However, the Part D prescription plans have changed drastically from prior years. Even if you are currently happy with your Part D plan, it makes sense to evaluate your coverage every fall. During Open Enrollment, many of the Part D Plans make changes to their coverage and premiums. They will mail you a notice about these changes, so pay close attention to the letter. Otherwise, in January you may find you are now paying \$40 for your prescription when you used to only pay \$10, or that your premium is now \$52 a month, up from \$26.”

If you would like to work with Eileen, let us know and we will send an introductory email. Alternatively, you can call her at 1-800-400-0577, or communicate by email with her at eileen@superiorlhc.com. Personalized Medicare advice is that close!

Backdoor Roth IRA Contributions

Roth IRAs are an increasingly popular retirement savings vehicle because they allow savers to generate tax-free income. Here are the basic tax benefits of Roth IRAs:

- Contributions are made with “after-tax” dollars.
- Qualified withdrawals are tax-free.
- There are no required minimum distributions (RMDs) for account holders.
- There could potentially be decades of tax-free growth. If someone inherits a Roth IRA, they can roll it into an Inherited Roth IRA. While there are RMDs for non-spouse beneficiaries, leaving a Roth IRA to the next generation could add many more years of tax-free growth.

Backdoor Roth IRA Contributions— cont'd

Unfortunately, direct Roth IRA contributions can only be made by those whose annual income is below certain levels. In 2018 those limits are:

- \$199,000 for married couples filing jointly
- \$135,000 for single filers

For some, the solution is a “backdoor” Roth IRA contribution. Doing so is a 2-step process:

- Make a non-deductible IRA contribution (up to \$5,500 for those under age 50 or \$6,500 for those over 50). To make this contribution, you must be under age 70 ½ and either you or your spouse must have earned income at least equal to the contribution amount.
- Convert the IRA contribution tax-free to your Roth IRA.

Caveat: If the IRA contribution is tax deductible, then the conversion will be taxable. Also, if the Roth IRA holder has other IRA assets, when you convert money from your traditional IRA to your Roth IRA, the regulations require the Pro-Rata rule to determine how much of the conversion is tax-free.



Are Backdoor Roth IRA Contributions Legal? Although this strategy has existed since 2010, the IRS has not officially commented or provided formal guidance on whether it violates the [step-transaction rule](#). (When applied, this rule treats what are several different steps as if they were a single transaction for tax purposes.) When I last wrote about backdoor Roth IRAs in our February 2015 Monthly Commentary, I indicated that President Obama’s 2016 Budget would have prohibited them. The Republican-controlled Congress did not pass Obama’s proposed FY 2016 Budget, so this did not happen.

Backdoor Roth IRAs Blessed by the Tax Cuts and Jobs Act (TCJA) of 2017: TCJA was the sweeping tax bill passed in December of 2017. Though not part of the law itself, the Conference Committee’s Explanatory Statement of the TCJA explicitly blesses backdoor Roth contributions. The Conference Committee confirms that backdoor Roth contributions are legal, under both prior law and the TCJA. The Explanatory Statement states four times that “Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA...”

MAM Experience with Backdoor Roth IRAs: We have a number of clients for whom we assist with doing these contributions each year. Typically, it is done for the spouse who has little or no other IRA assets. We think it is an excellent strategy and highly recommend it to clients for whom it is appropriate. Please let me know if you would like to discuss your situation.

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 us to show you how to access the information that is available on your MAM portal.



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