McCarthy Asset Management, Inc.
Personalized Wealth Management

April 2014 Monthly Commentary

May 1, 2014

Inside this issue:

Stock Market & Portfolio Performance

April 2014: U.S. stocks posted mixed results while foreign stocks and bonds rose modestly.

	Apr 2014	YTD 2014	Description:
Without Dividends:			
S&P 500	0.6%	1.9%	500 Largest Public U.S. Companies
NASDAQ	-2.0%	-1.5%	stocks trading on the Nasdaq
Russell 2000	-3.9%	-3.2%	2000 of the smallest U.S. stocks
MSCI EAFE	1.1%	1.1%	international stock index
U.S. Aggr Bond	0.8%	2.7%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	0.3%	1.8%	non-very conservative MAM portfolios
MAM Conserv	0.6%	2.4%	portfolios with 50%+ bond allocation

Comment: As first mentioned last month, a significant sector and style rotation may have started in March of this year. In particular, some of last year's high-flying segments of the market, such as the U.S. biotech industry, have come under pressure. This is also reflected in the poor April performance for the NASDAQ and small stocks (i.e. Russell 2000). As indicated on page 2, if this continues it would be a positive rotation from growth stocks to value stocks.

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Little has changed in my investment outlook since the start of the year:

U.S. Stocks: While the economic recovery from the deep recession triggered by the Financial Crisis has lacked robustness, it may make up for it with its longevity. This recovery has already lasted longer than half of all post-World War II recoveries. There continues to be many positives with the on-going rise in real estate prices, oil and gas production continuing to accelerate, government austerity measures becoming less of a factor, and the world economy again showing signs of life, potentially boosting U.S. exports.

The first-quarter 2014 earnings season—with nearly two-thirds of S&P 500 companies reporting so far—is turning out to be stronger than expected. Despite negative weather-related factors, as of April 28th, the index is currently tracking at $27.12 in operating earnings per share (EPS) for the quarter, representing year-over-year growth of 5.2%.

Possible Future Returns for the S&P 500: The slow-growth economy provides a good environment for the stock market. Nonetheless, my best guess is for stocks to post mid-to-high single digit returns annually over the next few years, with 4% to 6% coming from earnings growth and 2.5% to 3% from dividends, and very little from a further expansion in the price-earnings ratio (and possibly a negative impact from a contraction in the current price-earnings ratio). The chart to the right, courtesy of J.P. Morgan Asset Management, shows for different price-earnings ratios (currently at 15.2), the projected annual rate of return for the S&P 500 for annual earnings growth ranging from 2% to 8%. As you can see, the price-earnings ratio has a major impact on the projected return.

	11x	12x	13x	14x	15x	16x	17x	18x	19x
2%	-24.2%	-17.5%	-10.8%	-4.1%	2.7%	9.4%	16.1%	22.8%	29.5%
4%	-22.7%	-15.9%	-9.1%	-2.2%	4.6%	11.5%	18.3%	25.2%	32.0%
6%	-21.3%	-14.3%	-7.3%	-0.4%	6.6%	13.6%	20.6%	27.5%	34.5%
8%	-19.8%	-12.7%	-5.6%	1.5%	8.6%	15.7%	22.8%	29.9%	37.0%

Sources: Standard & Poor's, J.P. Morgan Asset Management. Earnings estimates are for the next 12 months and taken at quarter end dates throughout the year. Assumes a starting multiple of 15.2x. For illustrative purposes only. Data as of 4/28/2014

Shift In Market Sentiment? Starting in late March, there appears to have been a shift in market sentiment away from red-hot sectors such as biotech and certain tech and internet stocks and toward industrial and other value stocks. If this continues, I feel it would be a healthy change in market sentiment. If there is currently a bubble, it is probably in these red-hot growth sectors.

Bonds: While I continue to expect stocks to outperform bonds over time, on average our portfolios contain a 30% allocation to bonds to provide downside protection. Given that the bond funds used by MAM held up fairly well last year when bonds performed poorly, I am comfortable holding them to protect against a possible stock market correction.

Europe: The recovery is gaining meaningful traction in the euro zone, with fourth quarter 2013 GDP growth of 0.5%, and growth continuing in the first quarter. Austerity measures and the support of the European Central Bank have led many of the once most-fragile euro zone economies to better prospects. In fact, borrowing costs for Italy, Ireland, Spain and even Greece have been reduced with 10-year bond yields back down to where they were at the start of 2009. Currently, the biggest risk is probably the threat of deflation.

Investment Outlook- Con't

<u>China:</u> There has been fear among some investors that China could be the next "shoe to drop". As China's growth slowed the last couple of years, its debt rose sharply as the government borrowed money at an alarming rate to finance infrastructure projects, and other initiatives to keep its economy growing. While I may cover this topic more extensively in a future Commentary, I feel that concerns about China's economy have been overblown. For one, as a nation Chinese citizens are big savers with domestic savings about 50% of gross domestic product. Furthermore, late last year Chinese officials unveiled a sweeping plan to overhaul its economy. While these steps will take time, they may eventually have a meaningful, positive impact on the Chinese economy.

The Money Talk With Your Adult Kids

Attached to the email that is being sent for this Monthly Commentary is an article from Kiplinger's Personal Finance "The Money Talk You Must Have". According to a 2012 Fidelity study, while virtually all parents and adult children believe they should have such conversations, the majority of families aren't comfortable talking about money with one another.

Why don't more parents have such a conversation with their adult kids? In the Fidelity study, the number one reason parents cited for not discussing their estate plan with their adult children was that they didn't want them to count too much on their future inheritance. This is understandable. In having such conversations, it may be best to not mention the approximate size of your estate. Much can still be discussed without getting into the specifics of the potential inheritance:

1. <u>Estate Planning:</u> Having one or more money conversations will give you a chance to tell your kids how you want your estate handled. This will help ensure that your estate will be administered as you wish.

2. <u>Avoid Hard Feelings Later</u>: If you will be leaving a substantial portion of your estate to a charity or giving more to one sibling to another, it is best to let them know this to avoid surprises later that could result in lasting discord among the siblings.

3. <u>Share Basic Information:</u> Even if you do not want to share your net worth with your children (at least at this time), let them know the basics: That you have done estate planning, who the Executor will be, and generally how assets will be divided up. If your children will not be receiving equal shares, it is important to explain why you have planned the way you did. This will avoid surprises later and to help ensure family harmony long after you are gone.

4. <u>Personal Property:</u> Although the financial value of your personal property may not be significant, there can be great sentimental value to family members. It is very important to have a conversation with your adult children about who will get your personal property.

Fund Profile– Berwyn Income Fund

Berwyn Income Fund (symbol BERIX) is a balanced fund (meaning that it invests in both stocks and bonds) used in many of the MAM portfolios. It has an outstanding track record and has provided very good downside protection during market downturns.

Performance: Since current lead managers George Cipolloni and Ray Munsch took over management in 2005, the Fund has outperformed all of its conservative-allocation peers on both a total-return and risk-adjusted basis. And the performance has been consistent. Over 36 rolling five-year periods during the team's tenure, the fund has landed in the category's top quartile 100% of the time.

The Fund has protected capital well in downturns and typically lagged a bit in up markets, a function of the manager's focus on risk. In rising markets, the Fund captured 99% of the upside of its peers, and during declining markets only 52% of the downside. Overall, through 3/31/14, the Fund earned 7.7% annually for the last 10 years and 8.4% for the last 15 years.

Process: This hybrid fund can invest as much as 30% of its assets in dividend-paying common stocks. The rest of the portfolio is split among corporate bonds, preferred stocks, and convertible securities. Within corporate bonds, the team has focused on BBB-rated and high-yield securities, although it usually avoids the lowest rated debt. The Fund may also invest in other fixed-income instruments. For instance, in 2008 (i.e. during the Financial Crisis) it had nearly a 20% position in U.S. Treasuries, while it currently is avoiding them because they feel Treasuries are not attractive at this time.

Recently Lost a Manager: The Fund recently lost manager Ray Munsch when he retired this past January. Munsch didn't research individual securities—he participated in buy/sell decisions based on the rest of the team's pitches. Munsch's successor, Mark Saylor, joined the firm in June 2007 as an analyst and has been a major contributor to the Fund in recent years.

Price: The Fund's annual operating expenses are 0.64%, compared to an average of 0.90% for its peer group median of other no-load conservative-allocation funds.

My Comment: The outstanding downside protection this Fund has offered along with its overall strong relative performance, makes it one of my favorite funds used by MAM.

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.**

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

Please let us know if there are any topics you would like to have us cover or any questions answered in a future Monthly Commentary.