

April 2015 Monthly Commentary

May 5, 2015

Stock Market & Portfolio Performance

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April 2014: International stocks had another good month, while small-cap stocks and bonds slipped.

	<u>Apr 2015</u>	<u>YTD 2015</u>	<u>Description:</u>
Without Dividends:			
S&P 500	0.9%	1.3%	500 Largest Public U.S. Companies
NASDAQ	0.8%	4.3%	stocks trading on the Nasdaq
Russell 2000	-2.6%	1.3%	2000 of the smallest U.S. stocks
MSCI EAFE	3.9%	8.1%	international stock index
U.S. Aggr Bond	-0.4%	1.2%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	0.8%	2.4%	non-very conservative MAM portfolios
MAM Conserv	0.6%	1.7%	portfolios with 50%+ bond allocation

Comment: We continue to expect stocks to be challenged by lower corporate earnings, which have weakened due to the strong dollar and the drop in the price of oil.

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Last month, New Jersey Republican Governor Chris Christie, who is expected to announce he will run for President, laid out plans to shore up the Social Security system by means-testing for benefits and raising the retirement age. Specifically, his plan would:

- Curb benefits for future retirees earning more than \$80,000 in non-Social Security income, and eliminate them entirely for individuals making \$200,000 or more.
- Raise the retirement age from 67 to 69, for those born in 1960 or later.
- He said his proposal wouldn't apply to current retirees or those near retirement.



Meanwhile, other prominent Republicans, including presidential candidates Jeb Bush, Ted Cruz, and Marco Rubio, have endorsed at least gradually raising the eligibility age for Social Security benefits.

Given that the Social Security System is projected to become insolvent by around 2033, it is good that Republicans are talking about the need to reform it. What we find surprising, if not shocking, though, is a Republican proposing that benefits be means-tested. While we think it is very unlikely that Christie's proposal will go anywhere for now, there is a risk that someday Social Security benefits for higher-income retirees could be curtailed or even eliminated.

When Actively-Managed Funds Have an Advantage

For the last few years, exchange traded funds (ETFs) have become very popular. These passively-managed funds have attracted a large inflow of investor assets. This has been at the expense of actively-managed mutual funds, which have seen a consistent outflow of assets during this time. We like ETFs, as approximately 20% of MAM-managed assets are invested in them. In the August 2014 MAM Monthly Commentary, we wrote an article about how we use ETFs in portfolios ("Are Index Funds Used in MAM Portfolios?").

While we may utilize ETFs even more extensively in the future, we still see a place for actively-managed funds. For one, we don't use ETFs for bond fund exposure, as the bonds funds we use have performed well over time relative to passively-managed bond funds. Furthermore, we do utilize a number of actively-managed equity funds, including American AMCAP, BlackRock Health Science, Capital World Growth & Income, Dodge & Cox International, FMI Large Cap, and Yacktman.

Our feeling is that good managers, while hard to find, can outperform the market averages over time. Last year, historically-quiet American Funds stepped into the active-passive debate with a report titled "The Active Advantage". The study convincingly showed that the firm's own stock funds had excelled decade after decade. In October of 2014, American Funds followed up with a report "Expect More From the Core", which made a strong case for how to select a good active stock-fund manager.

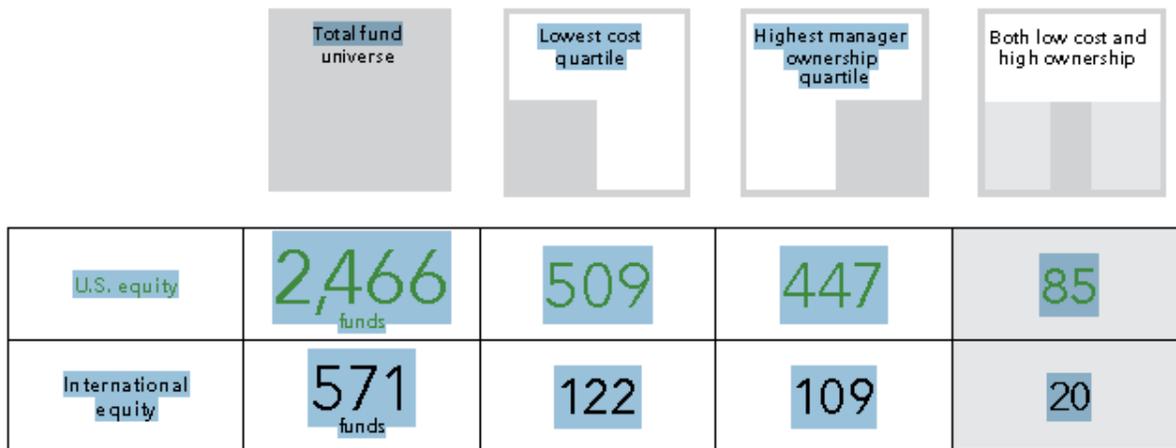
When Actively-Managed Funds Have an Advantage– Con’t

The study compared large-company stock funds, both domestic and foreign, for the 20-year period of 1994 through 2013, to the S&P 500 for domestic funds and the MSCI ACWI ex USA for foreign funds. Among these actively-managed funds, the study sorted for those with:

- Low costs (defined as the landing in the cheapest quartile for annual expenses)
- High-Manager Ownership (defined as manager ownership in the top 25%).

Look for funds that meet two key criteria

Large-cap actively managed equity funds with low expense ratios and high manager ownership



Source: Capital Group, based on Morningstar data. Domestic funds are those in the Morningstar Large Value, Large Blend and Large Growth categories. International funds are those in the Morningstar Foreign Large Value, Foreign Large Blend and Foreign Large Growth categories. Size of quartiles varies because those funds in the Morningstar database that did not include an expense ratio or firm-level investment ownership were excluded from the analysis.

Out of 2466 U.S. equity funds and 571 international funds, 85 U.S. funds and 20 international funds satisfied both the low-cost and high ownership criteria. Here is how these low-cost, high ownership funds performed:

- The 85 U.S. large-cap funds, on average, outpaced the S&P 500 in 76% of the rolling five-year periods and 100% of the rolling 10-year periods.
- The 20 international large-cap funds outpaced the MSCI All Country ex USA Index in 82% of the five-year periods and 93% of the 10-year periods.
- Combining a portfolio split 50/50 between the U.S. large-cap and international funds that satisfied both criteria resulted in an annualized return of 7.47% from 1994-2013, compared to 5.69% for a combined portfolio of 50% S&P 500 and 50% international index.

Expecting an actively-managed fund to beat an index every year is not realistic, just as an index fund won't beat a good actively-managed fund every year. *A good stock fund, though, should deliver superior risk-adjusted returns over a long period (say 10 years or more).* The next article profiles a fund used in MAM portfolios that meets the low-cost, high manager-ownership criteria.

Fund Profile– Capital World Growth & Income

American Funds Capital World Growth & Income (symbol CWGFX) is a global equity mutual fund, meaning it invests in U.S. and international stocks. It has an excellent track record and satisfies the low cost and high-manager ownership test discussed on P. 3 of this Monthly Commentary.



The Fund seeks to provide investors with income (the current annual yield is 2.2%) and long-term growth of capital. Approximately 4.2% of MAM-managed assets are currently invested in the Fund.

Performance: Through active management, the Fund has outpaced its primary benchmark, the MSCI ACWI, over its 21-year lifetime. The chart below from Morningstar shows the performance of the Fund (shown in red) relative to its peer group from 12/1/99 through 11/30/14:

Growth of \$10,000:

Holding(s) from 12-01-1999 to 11-30-2014

Fund/Index	Total Return %	Annualized Return %	Amount at End of Period \$
● American Funds Capital World Gr&Inc F1	246.23	8.63	34,623
● World Stock (MF)	86.23	4.23	18,623
● MSCI ACWI Ex USA NR USD	84.34	4.16	18,434



Management Approach:

- As is typical for other funds from American Funds, Capital World Growth & Income is divided into portions that are managed independently by eight investment professionals with diverse backgrounds and investment approaches. An additional segment is managed by a group of analysts. Typically, a manager will hold 40 to 60 stocks in their portion of the Fund, and each is able to focus on only those ideas he or she feels most strongly about.
- Once a manager has developed a strong conviction in a company, he/she purchases the stock with the expectation of owning it for years. This is reflected in the Fund's low turnover ratio, which has been around 25% for the last few years (meaning the average holding period for its stocks is approximately four years).

Per David Riley, one of the 8 managers of the Fund, "The problem with an index fund is that you are buying whatever the index comprises. If tech and telecom holdings make up 50% of an index, any investment in that index fund will reflect a 50% weighting to those areas," David explains. "As an active manager, I am not looking at index weightings, but at a company's quality, its absolute valuation, and its valuation relative to its own history and other areas of the market. During a market bubble, I am able to adjust my portfolio and invest to a greater extent in companies that I believe represent compelling valuations. Hopefully, by doing so when appropriate, I will have an opportunity to add value for investors over time."

Morningstar Rating & Comments: Morningstar rates the Fund with "4-stars" and an analyst rating of "Gold". In its most recent report on the Fund, Morningstar said "The fund has a stellar long-term record. Since 2000, it has beaten the MSCI AC World Index every calendar year but three. As a result, the fund's 9% annualized gain over the trailing 15 years through July 23, 2014, bests the index by 4.6 percentage points and places in the world-stock category's top decile. Plus, that record has come with below-average risk, as the fund's Sortino ratio (a risk-adjusted performance measure) also ranks within the group's top decile."

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/Updates

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.



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