McCarthy Asset Management, Inc.
Personalized Wealth Management

April 2021 Monthly Commentary

May 3, 2021

Stock Market & Portfolio Performance

Inside this issue:

April 2021: Stocks posted strong gains led by large-cap companies. Bonds realized modest positive returns for the month, paring their year-to-date losses.

	Apr 2021	YTD 2021	Description:
Without Dividends:			
S&P 500	5.2%	11.3%	500 Largest Public U.S. Companies
Russell 2000	2.0%	14.8%	2000 of the smallest U.S. stocks
MSCI EAFE	2.7%	5.6%	international stock index
U.S. Aggr Bond	0.8%	-2.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	3.2%	7.0%	non-very conservative MAM portfolios
MAM Conserv	2.6%	5.1%	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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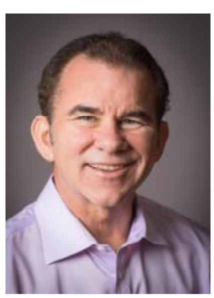

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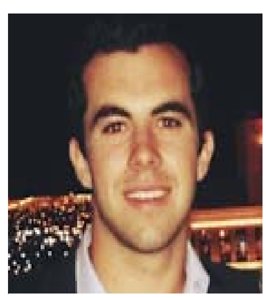

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The U.S. Economy– Robust Growth

The U.S. economic recovery is accelerating, as stimulus money combined with Covid-19 vaccinations and business reopenings has spurred a spring surge in consumer spending. Additionally, the economy has seen a sharp pullback in layoffs, and a recovery in factory output.

In mid-April, the Commerce Department reported that retail sales—a measure of purchases at stores, at restaurants and online—jumped 9.8% in March from a month earlier. The gain in consumer spending—which makes up nearly 70% of the U.S. economy—came as the government began distributing hundreds of billions of dollars of stimulus funds to households. It was the largest monthly gain since last May, during the initial recovery from lockdowns early in the Covid-19 pandemic.

The March gains in retail sales were broad-based, and showed a robust spending pickup in some categories that suffered early in the pandemic as people stayed at home. Strong growth was reported in sales at restaurants and bars, as well as at clothing and department stores. Meanwhile, U.S. consumer confidence is at its highest levels since the pandemic began.

Strongest Growth Since the 1970s: The Biden Administration passed the $1.9 trillion American Rescue Plan (ARP) fiscal relief bill in March. Over the next two years, this additional relief package is likely to help generate the strongest U.S. economic growth since the 1970s. Unlike in prior cycles, the Federal Reserve has pledged to maintain its current extremely accommodative monetary policy until inflation has exceeded its 2% target for a sustained period of time.

Federal Reserve's Projections: At the Fed's Open Market Committee (FOMC) meeting in mid-March, the Committee raised its estimate for the 2021 calendar year real gross domestic product (GDP) growth rate to 6.2%. The FOMC forecast projects a decline in the unemployment rate to 4.5% by the end of 2021, and a further decline to 3.8% by the end of 2022. Currently, the unemployment rate remains elevated at 6.0%. The gradual reopening of the leisure time sector of the economy, including restaurants, hotels, airlines, and events, should play a major role in lowering the rate of unemployment. Widespread progress on immunization remains the key to returning the leisure time sector to normal.

Global Growth: Last month, the International Monetary Fund (IMF) predicted the global economy is likely to expand in 2021 at the fastest pace in at least four decades as vaccine rollouts accelerate and advanced economies spend aggressively to counter the Covid-19 pandemic and related lockdowns. The IMF expects the world economy to grow 6% this year, the most since 1980, when it started tracking data on a comparable set of countries. This is an upgrade from the 5.5% growth the IMF projected in January.

The U.S. and China, the world's biggest economies, are driving the recovery. Despite problems with vaccine rollouts in Europe, the IMF raised its forecasts for other major economies, particularly Canada, the U.K and Italy. The IMF also said the recovery will be less robust in many emerging-markets and developing economies hit hard by slumps in tourism and often lacking the financial resources to cushion their economies.

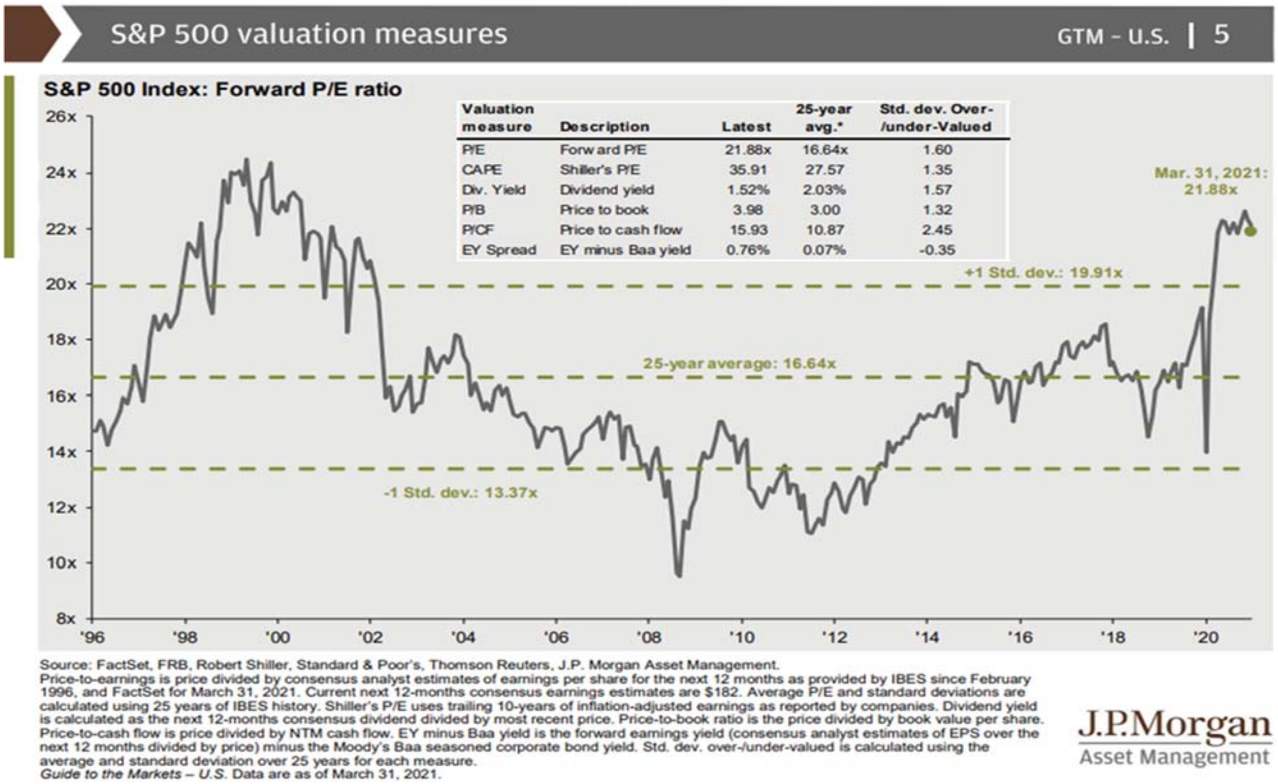
Risks to Growth: Despite rapid progress in vaccinating people, Covid-19 variants still pose a risk to the economy. The three most concerning are the variants identified in the United Kingdom (B.1.1.7), South Africa (B.1.351), and Brazil (P.1). The variants seem to spread more easily, but encouragingly, preliminary research suggests vaccines are effective against them.

MAM Comments: As we wrote last December, we were optimistic about our 2021 outlook for economic growth. Since then, the better-than expected vaccine rollout, along with the massive stimulus from $1.9 trillion American Rescue Plan, increases our confidence for very strong economic growth this year and into 2022.

Stock Market Outlook

We are now in the second year of the bull market that started in late March of 2020. The strong performance of the stock market so far in 2021 can be attributed to the improved economic outlook for the U.S. and global economies (see previous article).

<u>Expensive Stock Prices:</u> The good news for equity prices is that the economic rebound from Covid-19 is looking like a fact. The bad news is that financial assets have never been so expensive at the start of a recovery. As can be seen below in the chart from JP Morgan, as of March 31st, the S&P 500 was trading at a forward price-earnings multiple of 21.88 times. This compares to a 25-year average of 16.64 times.



Partly mitigating this overvaluation is that, despite the sharp rise in the 10-year treasury bond yield this year, interest rates are still very low by historical standards. Low interest rates can justify stock prices trading at a higher multiple of earnings.

The relevance of high valuations isn't—as often thought—that they point to a market crash. Rather, they are an indication that, over the long run, gains are likely to be lower. While we remain cautiously optimistic in our outlook for stock prices over the next year or two, at some point, rising interest rates can have a detrimental impact. We don't expect this to surface until late 2022 or early 2023. Meanwhile, corporate earnings are expected to grow dramatically this year. Such strong earnings growth could enable stocks to grow into their elevated valuations, even if interest rates move a bit higher from here.

The S&P 500 has rallied nearly 90% since its low on March 23, 2020, and is already up 11% in 2021 without so much as a 5% pullback on a closing basis. A market pullback would not only be normal, but could be healthy to help suppress excessive optimism from investors. Any number of factors could trigger a short-term drop in stock prices. These could include the spread of Covid-19 variants, rising interest rates, or an unexpected geopolitical event. Furthermore, if approved, President Biden's proposed infrastructure plan would increase the U.S. corporate tax rates from 21% to 28%. Analysts estimate that such an increase would reduce the earnings of S&P 500 companies by about 8%.

The longer-term risk is that the strong economy could lead to rising inflation. The question is how will the Federal Reserve react to a sustained increase in inflation. We feel that an unwelcome rise in inflation is at least one or two years away. Therefore, we should have time to adjust portfolios if we feel that inflation is starting to rise too quickly. Meanwhile, we continue to favor equities over bonds.

Possible Significant Tax Increases for High-Income Taxpayers

When he campaigned last fall, Joe Biden proposed a series of tax increases for high-income taxpayers. Given that Democrats hold a razor-thin majority in Congress, it is likely that some, but not all, of these tax increases will be enacted. At this early stage, we can only speculate on what the final changes will be. Future Monthly Commentaries will address this topic in more detail as events unfold. For now, we will briefly discuss possible areas of tax increases.

Estate Tax Exemption: Currently, estates of up to $11.7 million are not subject to estate tax. If no action is taken by Congress, in 2026, the exemption amount will revert to 2017 values, with inflation adjustments. It is estimated that by 2026, the inflation-adjusted exemption would be about $6 million per estate, and $12 million for a married couple. President Biden has discussed reducing the exemption to $3.5 million per estate. The earliest this would be effective will probably be the beginning of 2022. We will address this topic more extensively later this year, including possible action to take, if it looks like the exemption amount will be reduced.

Increase Corporate Tax Rate: Last month, President Biden proposed a large infrastructure plan that would be partly financed by increasing the U.S. corporate tax rate from 21% to 28%. While it is likely that an infrastructure plan will be passed this year, it is very possible that the increase in the Corporate tax rate will be scaled back, to a rate closer to 25%.

Long-Term Capital Gains and Qualified Dividends: Currently, long-term capital gains on assets held over one year and qualified dividends are taxed at a maximum Federal rate of 20% plus a 3.8% Medicare surtax. For those with income in excess of $1 million, President Biden's reported proposals would nearly double the top rate to 43.4% on this income in order to help pay for education and childcare proposals. If enacted, this would be a dramatic increase in taxes on this type of income for high-income taxpayers.

Eliminate "Step-Up" in Basis at Death: Currently, capital gains are forgiven when someone dies. The "step-up" in basis rules have been in effect for nearly 100 years. Through the years, there have been attempts to change the rules (including 1976, 2001 and 2015). Our inclination is that once again, efforts to eliminate the "step-up" in basis will fail.

What Should You Do Now? Probably nothing until it becomes clearer what taxes will be increased and when the effective dates will be. Stay tuned, though, as we will discuss possible tax law increases in future Monthly Commentaries.

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:

<u>Investment Management Services:</u>

- **MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.**

<u>Financial Planning Services:</u>

- **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.**

<u>Tax Services:</u> 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**

<u>Other Services:</u> 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

<u>Tax Reminders:</u>

- May 17th is the deadline for filing 2020 individual income tax returns and making 2020 IRA, SEP-IRA, and Roth IRA contributions.