McCarthy Asset Management, Inc.
Personalized Wealth Management

August 2015 Monthly Commentary

September 1, 2015

Stock Market & Portfolio Performance

Inside this issue:

<u>Aug & YTD 2015:</u> Starting August 21st, the stock market experienced the start of a sudden, sharp correction. Stock prices are now down modestly for the first eight months of 2015, while bond prices have risen slightly.

	August	YTD 2015	Description:
Without Dividends:			
S&P 500	-6.3%	-4.2%	500 Largest Public U.S. Companies
Russell 2000	-6.5%	-3.8%	2000 of the smallest U.S. stocks
MSCI EAFE	-7.6%	-2.2%	international stock index
U.S. Aggr Bond	-0.1%	0.5%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	-4.8%	-3.4%	non-very conservative MAM portfolios
MAM Conserv	-2.7%	-2.5%	portfolios with 50%+ bond allocation

Comment: The long anticipated market correction is finally here. See P. 2 for a discussion of how we think it is likely to play out.

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Current Stock Market Correction

After nearly four years, the stock market experienced a 10% correction this past month. Amazingly, it took only 4 trading days (Aug 20th – 25th) for the S&P 500 to drop 10.2%. As discussed in the email we sent on August 21st, the primary cause was concern over slowing growth in China. Here are some of our thoughts regarding the correction:

- **<u>How Long Will It Last?</u>** While the S&P 500 Index did recover a good portion of the drop during the last four trading days of August, historically, 10% market corrections take weeks, if not months, to run their course. One possible path for this correction is for the stock market to retest its lows (which at this point was when the S&P 500 closed at 1868 on August 25th). The market falling back to this recent low and then not dropping further (i.e. "a successful test of the low") would be a very positive sign. Possible catalysts sparking a turnaround include improving corporate earnings and stabilizing commodity prices.

- **<u>Should I Be Concerned?</u>** Also as mentioned in our August 21st letter, we believe this represents a temporary market correction, rather than the start of a new bear market. The main reason for our confidence is that neither the U.S. nor global economy is likely to fall back into a recession anytime soon. U.S. employment growth has been steady, housing continues to improve, and consumer spending (which makes up 70% of the U.S. economy) should benefit from low oil & gas prices. Furthermore, corporate earnings growth is expected to resume during the next year. We feel the most likely scenario is for this correction to run its course, and then the stock market to continue with a slow upward climb.

- **<u>Is MAM Doing Anything in Response to the Correction?</u>** Because we feel that this is a temporary market correction and portfolios have performed as expected, we do not plan on implementing any asset allocation changes at this time.

Please let us know if you would like to discuss any of this with regards to your personal situation.

Bob Brinker's Review of the Five Causes of a Bear Market

Bob Brinker is a well-known financial advisor and radio personality. Since 1986, he has hosted the nationally-syndicated financial radio show Moneytalk. Brinker also produces a monthly newsletter "Bob Brinker Marketimer". In a timely update, Brinker reviewed in the August 4th issue the current status of five causes of a bear market. Here is a summary of what he had to say:

1. **<u>Tight Money:</u>** For the first time since 2006, the Federal Reserve is likely to start raising interest rates this year. The Fed is expected to be very gradual with their rate increases. Brinker said that there have been five times since the end of World War II that the Fed commenced a gradual pace of rate increases. In four of the five cases, the stock market posted solid returns in the year following the initial rate increase.

2. **<u>Rising Rate:</u>** Sharply rising interest rates have been a cause of previous bear markets. Based on the current projections from the Federal Reserve Open Market Committee, the likely interest rate increases for the next year or two are expected to be gradual.

Bob Brinker's Review of the Five Causes of a Bear Market– Con't

3. **High Inflation:** Currently, inflation is very moderate. With the sharp drop in commodity prices this last year, the rate of inflation is unlikely to accelerate significantly any time soon.

4. **Rapid Growth:** Rapid economic growth can lead to a bear market because the Federal Reserve often raises interest rates to prevent the growth from triggering high inflation. Brinker defines rapid growth as real gross domestic product (GDP) above the historical average of 3% to 3.5%. Because Brinker is currently estimating 2015 GDP growth of around 2.5%, economic growth is expect to remain moderate for at least the foreseeable future.

5. **Overvaluation:** Brinker currently estimates that operating earnings for the S&P 500 Index will be $130 for 2016. The average S&P 500 price earnings ratio over the past 50 years is 16 to 16.5 times operating earnings. Based on his view that the inflation outlook will remain moderate, he feels the S&P 500 can trade at a price-earnings ratio of 16.5 to 17 times earnings. Using these figures, he feels the S&P 500 Index has the potential to trade into the 2200s range going forward (it closed August 31st at 1972).

In summary, Brinker is maintaining his favorable stock market view based on the high probability that the gradual economic recovery, which has supported growing corporate earnings, will continue at least into the next year. In a timely comment, he also stated that it had been four years since the stock market staged a major correction (i.e. 10% or greater decline). In the event a major correction develops (it did just 3 weeks after his newsletter was issued!), he believes that it would be limited to no more than 10% to 15% and would represent a buying opportunity for those looking to add to positions.

Collapse in Commodity Prices

It will come as no surprise to many that oil prices have collapsed in the last year. What is not as commonly known is that the prices of nearly all commodities (including industrial & precious metals, natural gas & agricultural products) have tumbled as well during this time. As can be seen from the chart below, during the last 12 months, the broad-based iShares S&P GSCI Commodity-Indexed Trust ETF (symbol GSG), shown in blue on the graph, has fallen more than an index of energy stocks (Energy Select Sector SPDR, symbol XLE), shown in purple on the graph.

Prepared by: STEVE MCCARTHY

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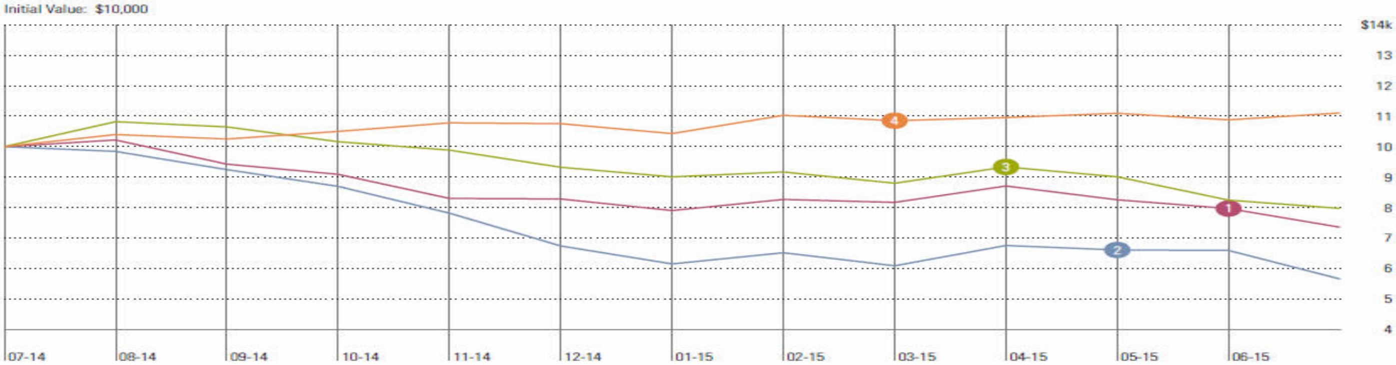
Investment Growth

07-31-2014 to 07-31-2015

Currency USD

Initial Value: $10,000



Investment	Cumulative Return %	Annualized Return %	Amount at End of Period $
1 Energy Select Sector SPDR® ETF (USD, XLE)	-26.42	-26.42	7,358.05
2 iShares S&P GSCI Commodity-Indexed Trust (USD, GSG)	-43.38	-43.38	5,662.50
3 JPMorgan Alerian MLP ETN (USD, AMJ)	-20.24	-20.24	7,976.00
4 Vanguard 500 Index Inv (USD, VFINX)	11.05	11.05	11,105.44

Performance Disclosure

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please visit http://advisor.morningstar.com/familyinfo.asp.

Collapse in Commodity Prices– Con't

In particular, the CRB raw materials spot price index is now at its lowest level since November of 2009. The Bloomberg Commodities Index is now close to levels unseen since June 2002, as crude oil prices recently fell below $40 a barrel, and gold tumbled below $1,100 an ounce to five-year lows.

During the last few years, some experts predicted rising inflation would result from the Federal Reserve's aggressive Quantitative Easing programs. Commodities such as gold were thought to be a safe-haven to protect against this risk. At least so far, the reverse has happened. What has caused the sharp drop in commodity prices? There are a number of factors:

- **Demand is Soft Due to Sluggish Economic Growth:** While China is still growing faster than many countries, it has slowed significantly in recent years. That's a critical factor because China's previously insatiable demand for natural resources made it the world's "swing producer". Also, many emerging markets like Brazil and Russia, and developed economies like Europe and to a lesser extent the U.S., are growing at a sluggish pace.

- **Too Much Supply:** The poor demand is being exacerbated by too much supply. The commodities boom, fueled by China's explosive growth in previous years, motivated energy and metals companies to ramp up production to levels that current markets cannot support.

- **Rising U.S. Dollar:** The U.S. dollar has raced ahead of rival currencies like the euro and the yen, as the Federal Reserve has ended its Quantitative Easing programs and is likely to soon start raising interest rates. A rising dollar is bad for commodities because most of them are priced in dollars.

- **When Will Prices Bottom?:** While the timing is unclear, at some point, commodity prices will stop falling. Eventually, lower production will balance the lack of demand, which should stabilize prices. In the case of oil & gas, rising global demand will eventually catch up with the current excess production.

Update Regarding MLPs

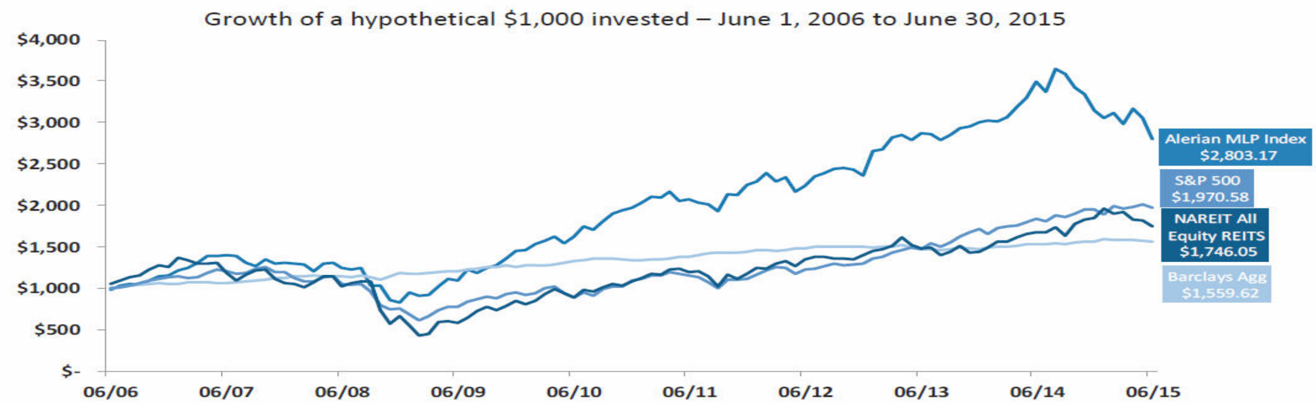
MLPs are master limited partnerships that trade on the major exchanges just like a stock. To qualify for MLP status, a partnership must receive at least 90% of its income from what the IRS deems to be "qualifying" sources, primarily the transport or processing of national resources such as oil, natural gas, and coal. In early 2009, JP Morgan introduced AMJ as the first exchange-traded fund to offer exposure to MLPs. MAM first initiated a position in AMJ in the November 2011 repositioning.

Here is why we initially liked MLPs in 2011 and still do:

- As can be seen from the chart on page 5 curtesy of Eagle Funds, during the last ten years, MLPs have significantly outperformed the S&P 500, an index of REITs, and the Barclay's Aggregate Bond Index. In particular, between June 1, 2006 (which was the launch date of the Alerian MLP Index) and June 30, 2015, the Alerian MLP Index outperformed the S&P 500 index with a cumulative gain of 180% versus a gain of 97% for the S&P 500 Index (or 12.0% annualized compared to 7.8% for the S&P 500).

Update Regarding MLPs– Con't

Total Returns vs. Equities and Bonds



For index and statistical definitions and index-specific risks see the Glossary at the end of the presentation.

The indices shown are for informational purposes only and are not reflective of any investment. As it is not possible to invest in the indices, the data shown does not reflect or compare features of an actual investment, such as its objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, or tax features. Indices do not include fees or operating expenses and are not available for actual investment. Indices presented are representative of various broad base asset classes. They are unmanaged and shown for illustrative purposes only. Data from Alerian and Bloomberg.
Past performance is not indicative of future results. *The Alerian MLP Index does not represent the Eagle MLP Strategy Fund.*

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- The performance of MLPs is driven by their yield (currently 6.1% for AMJ) plus the appreciation in MLP prices. Since June of 2006, MLP prices have risen in step with the increase in their distributions, which have averaged a 7% annual growth during that time.

- Over time, the performance of MLPs should not be tied to commodity prices because pipelines and storage tanks do not take title to the commodity itself. Instead they make money simply by charging a tariff on the volume of product flowing through their pipelines. These tariffs are cost-indexed, giving investors a built-in inflation hedge. Unfortunately, in the short-run, investors lump MLPs in with other energy investments and penalize them when oil prices fall sharply (as they did in 2008 and again during the last twelve months).

- The short-term poor performance of MLPs (down roughly 25% in the last twelve months) due to the drastic drop in the price of oil has created an opportunity for investors. Despite the collapse in oil prices, MLPs are expected to continue to grow their distributions in 2015 and beyond—just as they have for the last ten years through ups and downs in the economy and markets. MLPs even grew their distributions in 2009 during the depths of the financial crisis when the price of oil fell from $140 per barrel to $40 per barrel. For the foreseeable future, the pace of the distributions growth will slow, just as it did during previous periods of turmoil, but they are still expected to grow.

Long-Term Outlook: We feel that the long-term outlook for MLPs is very positive. Distribution growth should still be strong. This is because the U.S. is expected to require significant energy infrastructure investments during the next couple of decades as it moves toward energy independence. There will be further demand for energy infrastructure as the U.S. becomes a major exporter of oil and gas. By the 2020s, the U.S. is projected to be one of the world's top exporters of liquefied petroleum gas (LPG), possibly surpassing Qatar and the United Arab Emirates. Meanwhile, there is a concerted effort in Congress to remove the decades-long ban on U.S. oil exports, which could occur as early as 2016.

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

Are you on course for a financially-comfortable retirement? A Retirement Analysis can be very helpful in answering that. Please let us know if you would like to have us prepare one for you.

Discover the difference with a Registered Investment Advisor.