McCarthy Asset Management, Inc.
Personalized Wealth Management

February 2013 Monthly Commentary

March 1, 2013

Stock Market & Portfolio Performance

Inside this issue:

February 2013: With the exception of foreign companies, stocks had a pretty good month.

	Feb 2013	YTD 2013	Description:
Without Dividends:			
S&P 500	1.1%	6.2%	500 Largest Public U.S. Companies
NASDAQ	0.6%	4.7%	stocks trading on the Nasdaq
Russell 2000	1.0%	7.3%	2000 of the smallest U.S. stocks
MSCI EAFE	-1.2%	4.0%	international stock index
U.S. Aggr Bond	0.5%	(0.2)%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	0.8%	4.4%	non-very conservative MAM portfolios
MAM Conserv	0.3%	1.5%	very conservative MAM portfolios

Comment: For February, U.S. stocks rose modestly, foreign stocks fell modestly and bonds reversed January's losses with a small rise. For the first two months of 2013, U.S. and foreign stocks rose while bonds slipped moderately. See page 3 for our stock market outlook.

Advisor Team

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

STEVE MCCARTHY
CPA, CFP®,
Owner and Principal
650 610-9540 x 303
steve@mamportfolios.com

ALEXEY BULANKOV
CFP®, ChFC, CLU, EA
Financial Planner
Director of Business Development
650 610-9540 x 304
alexey@mamportfolios.com

ANTHONY BERTOLACCI , RTRP
Director of Compliance
Tax Accountant
650 610-9540 x 302
anthony@mamportfolios.com

MARILYN BLANCARTE
Executive Assistant
650 610-9540 x 305
marilyn@mamportfolios.com

March 1st marks the start of the Sequestration, Part II in a four-part political drama which began unfolding in 2011.

Part I: The Debt Ceiling Stand-off and the Budget Control Act: In August 2011, in return for raising the debt ceiling, which allowed the U.S. Treasury to pay its obligation and avoid default, Congress imposed approximately $2 trillion worth of spending cuts. About $1 trillion of that was to come from Sequestration, across-the-board automatic spending cuts. A "Super Committee" was formed to agree on spending cuts to avoid this automatic measure. If the Committee were to fail to reduce the federal deficit by at least $1.2 trillion over 10 years, the "sequestration hammer" would fall and the automatic cuts would take effect. The Committee failed, which barring any last-minute action in Washington, now brings us to Part II.

Part II: Sequestration: On March 1st, automatic spending cuts took effect. The cuts were originally to start at the beginning of 2013, but the deal struck by the White House and Congress on New Year's Eve delayed it to March 1st. The 2013 spending cuts are to be $85 billion, half of which will be defense-related and half will apply to non-defense spending. The total cuts will be spread among nearly 1,200 different federal spending programs. Longer-term, if no changes are made, the full impact of sequestration will amount to cuts of $1.2 trillion between 2013 and 2021.

While the issue has received a lot of recent press coverage, and it is impossible to predict how the events will unfold, we feel that the immediate effects of sequestration will be mixed, but muted and not overly dramatic:

- On the downside, the automatic cuts in government spending will dampen growth on an economy that is barely growing. A variety of jobs will be affected in federal agencies such as defense and aerospace. The dilemma is that cuts are needed to get the federal finances meaningfully healthier, but austerity is a dangerous medicine to administer to the fledging US economy before it shows signs of healthy growth. Uncertainty brought about by this may cause the stock market to decline.

- The upside, though, is that the budget cuts will help the U.S. to continue to reduce its budget deficit (which had already fallen from over 10% of GDP in 2009 to 7% of GDP in 2012). In addition, the Federal Reserve will have more reasons to be cautious about ending quantitative easing if growth slows further due to federal spending cuts. This should also help bond prices, as interest rates are likely to remain subdued.

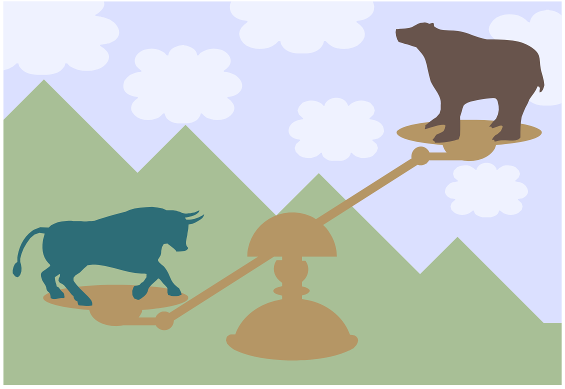
Another important point is that Social Security, Medicaid and Medicare benefits (i.e. "Entitlement Spending") are exempt from sequestration. *Without entitlement reform, the Federal deficit is projected to start growing again in 2016, even if the sequester were fully enacted. We feel that addressing entitlement reform should be a major priority.*

Part III: Potential Government Shutdown: Congress has until March 27th to agree on a plan to fund the government. If the agreement is not reached by then, we could see the first government shutdown since 1995. We believe that neither party would want to take responsibility for shutting down museums and national parks, delays the processing of tax returns and the filing for retirement and disability claims, as well as disruptions to the other functions of the government. Some agreement is likely to be reached and hopefully will include a provision to make the across-the-board tax cuts less drastic.

Part IV: Debt Ceiling Debate 2.0: We expect this may be the most contentious battle of the four. The last debate created a lot of uncertainty and turbulence in the financial markets and resulted in the rating agencies downgrading the ratings of the U.S. Debt. In all the previous agreements, Congress kicked the can down the road and postponed making final decisions. Hopefully this time lawmakers will reach a consensus and work out a long-term solution that includes serious entitlement reform. So far neither side is showing much willingness to compromise. Time will tell if this time will be different.

Stock Market Outlook– Time For A Correction?

We remain optimistic about 2013 as a whole. It's unlikely, though, after a strong 2012 and early 2013 the stock market will continue to climb straight up. The market is due for a pause, if not a short-term correction. Such corrections can be positive as they are a natural part of a healthy bull market, as they help curb excessive speculation and set the stage for further gains.

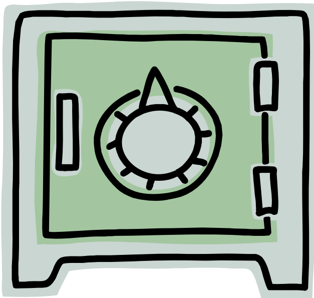


Market Still Reasonably Valued: Current stock market valuations appear reasonable—depending on what series of earnings you look at. On a five-year normalized earnings basis (4 ½ years of historical earnings and two quarters of expected earnings), the market's a bit expensive. On a 12-month forward-earnings basis, the market remains fairly cheap, trading at around 14 ½, compared to the long-term average of "17" times earnings.

Longer-Term Reasons For Optimism**:** As we have written about several times, the renaissance in U.S. manufacturing is gaining traction as "onshoring" spreads to more firms, real estate is staging a comeback and is once again adding to economic growth, and the oil and gas boom continues with, according to ISI Research, oil imports now at a 25-year low while domestic production increased 32% in the past year.

What is Safe to Put in a Safe Deposit Box?

Do you have a safe deposit box at your bank? That's a good idea if you need a secure place to store valuables and important papers. But be aware that a safe deposit box isn't the best place for everything.



What should you keep in the box? Mostly these are items you can't afford to lose or that would be extremely difficult to replace:

- Birth certificates, marriage certificates, treasured family photos, a list of your insurance policies
- Property deeds, rare coins, jewelry, etc.

Our recommendation is to make a list of what you have in your safe deposit box, so that you know what you have there.

What should you not store in your safe deposit box?:

- Your will, trust, and other estate planning documents. Depending on state law, a court order may be required to unseal the box if the owner dies. It's better to keep these documents in a fire-proof safe accessible to other family members. *I also recommend that you provide us with a copy of these documents, so they will be readily available when needed.*
- Don't include a power of attorney that might be needed suddenly in case of an emergency.
- Don't include cash in a safe deposit box as it won't be insured under Federal Deposit Insurance Corporation (FDIC) rules, which normally insure deposits in your accounts up to $250,000.

Disclosure: This article was obtained from Advisor Products, Inc., which is the firm that hosts the MAM website.

Frontier Markets

The maturing of emerging markets equities as an asset class in recent years has left some investors wondering what the next big investment opportunity will be. As a result, some investors have turned their attention to relatively untapped markets like Myanmar or Mozambique that have abundant natural resources and prospects for rapid economic growth. Many frontier markets are experiencing brisk growth, with more than half of the world's fastest growing economies found in Africa, North Africa and the Middle East. These economies were estimated to grow at an average rate of 4.2% in 2012 compared with 1.4% for the world's advanced economies, according to the International Monetary Fund. The IMF forecasts that smaller developing markets in Asia such as Myanmar, Sri Lanka and Vietnam were estimated to grow between 5% and 8%.

Here are some of the appeals of frontier markets:

<u>Outstanding Growth Potential:</u> In contrast to the developed nations, whose populations are aging, most frontier countries have a younger demographic that points to increasing economic productivity and growth in the years ahead. World Bank data indicates that on average, the median age in the economies of the Group of Seven (the 7 largest nations in the world) is almost 41. In BRIC nations (Brazil, Russia, India and China), the median age is 32. But the median age in frontier market nations is just under 27 years old. As Oliver Bell, manager of the T. Rowe Price Africa & Middle East Fund said, with frontier markets "you have 65 countries with more than a billion people, 60% of whom are under the age of 24. Fast forward to 2025, and just think of the number of working people this region will have. This is a multi-decade story."

<u>Good Fiscal Shape:</u> A concern of investors today is the substantial budget deficits developed countries (European as well as the U.S.) have been running while the frontier countries boasted positive budget surpluses.

<u>Diversification:</u> As an asset class, frontier markets are distinguished not only by low correlations with other major equity asset classes, but also by how different these nations are from one another. Other than sharing some basic characteristics and being grouped together by indexes, frontier markets have little in common. The upshot is that investing across a broad cross section of frontier markets can potentially help dampen the risks of investing in these less developed, less familiar nations.

Despite the tremendous potential, we are not yet ready to add exposure to frontier markets in MAM portfolios. This is a long-term play that will remain on our radar screen. Frontier markets as a whole currently encompass a very small segment of the global equity universe. For instance the MSCI frontier market index is composed of 25 nations and has a total investable market capitalization of around $100 billion, or less than 3% the size of the MSCI Emerging Markets Investible Market Index. We will continue to monitor the performance of frontier markets, and may eventually add a small position in them to MAM portfolios

Sincerely,

Stephen P McCarthy, CPA, CFP®

Alexey Bulankov, CFP®

McCarthy Asset Management, Inc.

Three Lagoon Drive Suite # 155
Redwood Shores, CA 94065
USA

Phone: 650-610-9540
Fax: 610-9541
E-mail: Steve@mamportfolios.com

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.**
- **The Savvy Life® Classes and Workshops by best –selling author Melis-**

Reminders

2012 Tax Returns

I want to remind those tax clients who have not yet provided us with their 2012 tax information to please do so as soon as possible. We have set a deadline of March 20th for receiving your tax packet if you want us to complete your returns on time. Thanks!

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