

February 2020 Monthly Commentary

Mar. 1, 2020

Stock Market & Portfolio Performance

<u>*February 2020:*</u> U.S. and international stocks experienced a sharp sell off starting on February 20th due to rising concerns about the negative economic impact from the coronavirus that originated in Wuhan, China. Bonds rose as yields fell to near record lows.

Market & Portfolio	1		<u>Feb 2020</u>	<u>YTD 2020</u>	Description:
Performance		Without Dividends:			
Financial Impact of the Coronavirus	2	S&P 500	-8.4%	-8.6%	500 Largest Public U.S. Companies
		Russell 2000	-8.6%	-11.5%	2000 of the smallest U.S. stocks
		MSCI EAFE	-6.3%	-8.3%	international stock index
Dimensional Fund Advisors	3	U.S. Aggr Bond	1.4%	3.0%	index of U.S. bonds
Our Services	4	With Dividends, after all fees:			
		MAM portfolios	-5.3%	-6.0%	non-very conservative MAM portfolios
		MAM Conserv	-3.7%	-4.1%	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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Financial Impact of the Coronavirus



A three-and-a-half-month, largely uninterrupted, rally in stocks ended in late January with the news about the coronavirus outbreak, which started in Wuhan, China. Concerns about the virus, now officially known as COVID-19, sent jitters across global financial markets amid fears of a hit to the global economy. It is still too soon to gauge the financial impact of the outbreak, given the many unknowns related to it. These include:

• **The duration and severity of the outbreak in China:** China accounts for the vast majority of infections, with 80,000 people so far infected, and over 2,400 who have died. Encouragingly, toward the end of February, the number of new infections in China appears to be receding.

• Will the virus be contained geographically? As of February 24th, 97% of the global cases of COVID-19 are still within mainland China, despite the

virus having been around since at least December. Nonetheless, clusters have appeared elsewhere. On February 24th, authorities in South Korea said the country has recorded 763 cases, up sharply from 30 the prior week. That makes it the most virus-hit nation outside of China. In Italy, more than 229 people have tested positive also as of February 24th, up from just 3 a few days prior.

• What will be the financial impact of supply side disruptions? China is a key component of global supply chains. Any sustained outbreak could disrupt the supply chains of certain industries, such as automobiles and technology devices. For instance, on February 18th, Apple Computer warned that its sales will not meet expectations for the quarter as production of iPhones has slowed significantly because of the coronavirus.

<u>Historical Economic Impact of Pandemics</u>: According to research by Charles Schwab & Co, an analysis of 13 global pandemics over the past 50 years shows that once the number of newly identified cases start to decline, economic activity and the stock market tend to quickly rebound. While there is still much uncertainty related to the coronavirus, if the spread of COVID-19 tracks a pattern similar to those tracked in the past by the World Health Organization (WHO), the number of confirmed cases will rise sharply for eight to ten weeks, then the infection rate will likely start to taper off into the spring months. History shows us that the market impact from similar outbreaks has tended to be modest and short-lived:

- **SARS:** After the SARS outbreak in late 2002 and early 2003, which may be the most comparable to the COVID-19 outbreak, the 2003-07 bull market began. The S&P 500 surged 24% in the three months after the World Health Organization (WHO) issued a global emergency alert.
- **Bird flu:** Stock market gains were more modest following the bird flu outbreak in 2005. Still, the S&P 500 managed to gain 5% over the subsequent six months after public interest in the disease peaked.
- **Swine flu:** Swine flu was the deadliest global health event in recent decades, with an estimated 200,00 deaths. During the six months following WHO's global emergency alert, the S&P 500 rallied 30%.

MAM Comments: At this point, no one knows when the coronavirus will start to recede or if it could morph into a true pandemic. While the loss of human lives is tragic and cannot be downplayed, a long-lasting economic impact from a pandemic is unlikely. As a cautionary move, in early February we fully sold the position in Mathews Asia Dividend (MAPIX) in all portfolios. This fund invests in dividend paying stocks located in Asia. We reinvested the proceeds in the exchange-traded fund, Schwab U.S. Broad Market (SCHB), which invests in large-cap U.S. stocks. At this point, we are not planning to take any additional actions in response to the coronavirus outbreak.

Dimensional Fund Advisors

Dimensional Fund Advisors (DFA) is a large money manager and mutual fund company that was founded in 1981. Although the firm manages over \$600 billion in assets, many investors have not heard of them. One of the reasons for this exclusivity is that the firm only wants patient investors that will stay invested for the long-term. As such, DFA does not market or offer its funds directly to individual investors. Instead its funds are only available through fee-only financial advisors who have attended the Company's two-day introductory workshop in Santa Monica and been approved by the firm.

A few years ago, I attended the two-day DFA workshop. I was very impressed by the quality of the information provided and the knowledge of the numerous speakers who presented. Dimensional is an academically-based investment firm. It was founded by David G. Booth and Rex Sinquefield, both graduates of the University of Chicago Booth School of Business. The Company's board of



directors and academic consultants include Eugene Fama, Myron Scholes, and Robert C. Merton, all of whom won the Noble Prize for economics. Most of the presentations at the workshop were very academically-oriented. Two of the speakers were famed economists Eugene Fama and Kenneth French, whose research forms the foundation of Dimensional's philosophy.

The core philosophy includes these beliefs:

- Passive investing is superior to active investing. Active investing is a "zero sum game" where the return of all
 active investors is equal to the return of the market minus the fees that active managers charge. It is very
 difficult to distinguish luck from skill and therefore, it is nearly impossible to identity active managers that will
 consistently beat the market. Instead, Dimensional focuses on identifying where returns come from, and
 building portfolios that capture these higher returns.
- *Market timing is futile.* As the famous annual DALBAR study shows, the average mutual fund investor dramatically underperforms the stock market averages. Much of this underperformance can probably be explained by poor market-timing moves by investors (for instance those that cashed out late in 2008 or early in 2009 and missed the subsequent 200% run-up in the market).
- DFA utilizes enhanced indexing to design portfolios and limit trading costs. These enhancements often allow them to slightly outperform index funds. Meanwhile, Dimensional funds have very low operating expenses, well below the expense level of actively managed funds.

<u>MAM Comments</u>: We started utilizing DFA funds in MAM portfolios in November of 2018. We have been pleased with the performance of their funds and look forward to continuing to utilize them in portfolios.

For additional information about Dimensional, please visit their website at www.us.dimensional.com

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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.
- 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

ADV Part II: You were provided a copy of our ADV Part II when you became a MAM client. As a Registered Investment Advisor, we file this document with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees and our educational backgrounds. Each year, the SEC requires us to offer clients the opportunity to receive a copy of our most recent ADV Part II. **Please let us know if you would like to receive a copy.**



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