McCarthy Asset Management, Inc.
Personalized Wealth Management

January 2014 Monthly Commentary

February 1, 2014

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Stock Market & Portfolio Performance

January 2014: Worldwide, stock markets performed poorly for January due in part to concerns about emerging markets (particularly China, Argentina and Turkey). Bonds provided a safe-haven with good performance for the month.

	Jan 2014	YTD 2014	Description:
Without Dividends:			
S&P 500	(3.6)%	(3.6)%	500 Largest Public U.S. Companies
NASDAQ	(1.7)%	(1.7)%	stocks trading on the Nasdaq
Russell 2000	(2.8)%	(2.8)%	2000 of the smallest U.S. stocks
MSCI EAFE	(4.1)%	(4.1)%	international stock index
U.S. Aggr Bond	1.5%	1.5%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	(2.2)%	(2.2)%	non-very conservative MAM portfolios
MAM Conserv	(0.4)%	(0.4)%	portfolios with 50%+ bond allocation

Comment: Perhaps the long-awaited market correction is at hand. See P.2 for our thoughts regarding this.

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Is This a Market Correction?

We recently heard from a few clients who asked whether they should be concerned about the recent fall in stock prices. Our response was, "While we may finally be getting the market correction that we feel is long overdue, we are not overly concerned." We define a market correction as a drop of around 10% (the S&P 500 fell 3.6% for January). Market corrections occur frequently and they are actually healthy, as they serve to lessen speculative pressures which could otherwise cause stock prices to become overly inflated. We don't try to time them as the problem is getting the timing right! On the other hand, if we thought we were at risk for entering a bear market (a drop of 20% or more), we would take action to protect portfolios. We don't think a bear market is about to start.

Since the middle of last year, we have been saying to be prepared for a stock market pullback. We specifically warned of possible turbulence for stocks in the August Monthly Commentary. Historically, September is the worst performing month for stocks, it was feared the Federal Reserve would announce the start of tapering at their September 18th meeting, and Congress was going to be faced with a U.S. Budget debate during the month (which did lead to a temporary government shutdown).

Despite our concern last September that stocks could temporary fall, we didn't act on it. Between September 18th, when investors first started focusing on the brewing conflict over funding the government, and October 8th, when the Republican House leadership acknowledged that it would not permit the nation to default, the S&P 500 lost 4.1%. This loss was quickly erased the following week, when Congress passed the compromise legislation, and the S&P 500 reached a new all-time high.

In summary, while we wouldn't be surprised to see prices fall by 10% at some point this year, we believe any drop will be temporary and we remain cautiously optimistic for 2014.

Europe- Returning to Growth

We last wrote about Europe in our article "Europe Appears to be on the Mend" in the August 2013 Monthly Commentary. At the time we said that Europe's recession appears to be on the verge of ending. The news since then confirmed this as the European economy returned to moderate growth the last two quarters. Although long-term structural problems remain, such as high unemployment, unsustainable government debt levels and weak bank balance sheets, progress is being made:

Unemployment: While unemployment in the United States has fallen steadily since 2009, rates have stayed stubbornly high in Europe. With Europe returning to growth, the economy there should further benefit as the unemployment rates start to fall. There are some initial signs of this. In Spain, the number of employed people rose for the first time since 2008 and in the U.K., the unemployment rate fell to 7.1% in November, the lowest rate since 2009. Unemployment is also falling in Ireland and Portugal.

Structural Reforms: Importantly, a number of European governments have recently undertaken structural reforms to remove obstacles to productivity growth. Spain, Portugal and Greece have made substantial overhauls and are starting to see the benefits. France is following their lead, and even Italy is hinting that it may institute reforms. These reforms, which will allow for a more flexible work force, will reduce some of the obstacles for companies to hire new employees.

Economic Fundamentals Are Improving: Evidence that Europe is returning to growth can also be found in the Purchasers Manufacturing Index (PMI), which have recovered after falling to the lowest levels in the world in 2012. With the exception of France, the PMI for all of the largest European countries are now above 50 (the level above which indicates growth in manufacturing).

World Bank Projections: The World Bank recently updated its economic projections. Currently it projects the global economy would grow by 3.2% for 2014, up from 2.4% last year. GDP growth is expected to inch up to 3.4% in 2015 and 3.5% in 2016. For Europe, where the economy actually contracted the past two years, the forecast is for growth of 1.1% for 2014, before advancing to 1.4% and 1.5% in 2015 and 2016, respectively.

myRA- A New Way to Save for Retirement

What is it? Last week, in his State of the Union Speech, President Obama introduced a new workplace retirement savings account called myRA. He subsequently authorized use of it by executive order. The administration hopes that employers who don't offer a workplace retirement plan will make myRAs available to their employees. Only limited details are currently available.

What we know: myRA accounts are anticipated to be available starting in 2015 to "households earning up to $191,000" (i.e. same eligibility as for Roth IRA contributions) and who work for an employer that does not offer a retirement plan. The new accounts will be structured much like Roth IRAs, in which contributions are made with after-tax money, and investment gains and withdrawals are tax-free.

Limitations: Unfortunately, myRA accounts will feature just one investment option—U.S. government bonds. Initial investments could be as low as $25 and payroll contributions as low as $5. The plans, set up through the Treasury Department, would have a maximum balance of $15,000, after which the money would have to be rolled over into a private-sector Roth IRA.

Should I invest in a myRA instead of a regular Roth IRA? Based on our initial interpretation of this investment vehicle, we feel "no". The limitation of only being able to invest in U.S. treasuries is unappealing compared to the flexible investment choices offered by a Roth IRA account.

A Case for Active Management

"It is impossible to produce superior performance, unless you do something different from the majority."

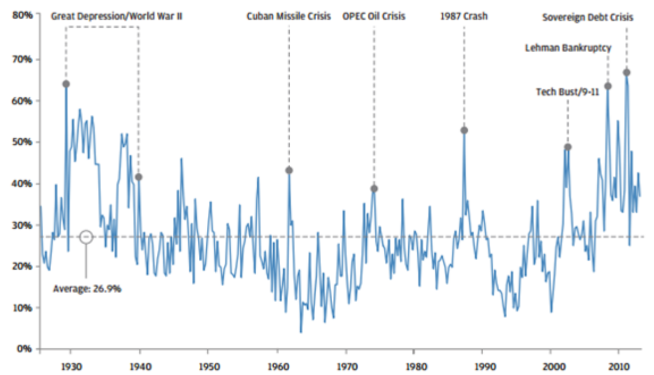
-Sir John Templeton

Active vs. passive management is a long standing debate in the money-management industry. The advocates of active management believe that an investment manager's expertise, security selection skills and timing of the buy/sell decisions can result in a better return on investment than simply letting the money ride in an index (in the parlance of the profession this is known as generating 'alpha'). The proponents of passive management argue that no one manger can consistently deliver returns above that of a market average without taking on excessive risk. Both sides make a strong case and have academic studies by prominent academics and empirical evidence that support their claims.

In the years following the 2008 financial crisis, most actively-managed funds underperformed their relevant index. So does active management still makes sense?

Correlations among large-cap stocks have declined

LARGE-CAP EQUITY CORRELATIONS, 1/1/1926-9/30/2013



Source: Empirical Research Partners LLC, Standard & Poor's, J.P. Morgan Asset Management. Capitalization-weighted correlation of top 750 stocks by market capitalization, daily returns, 1/1/1926-9/30/2013. Chart shown for illustrative purposes only.

- **Active management works best when the correlations among stocks decline:** As Warren Buffet famously said *"A rising tide lifts all boats. It's not until the tide goes out that you realize who's swimming naked*." Active management is most challenging when markets move in synch (have high correlations) due to some external event- positive or negative. In particular, it is difficult to select outperforming stocks when the whole market is moving sharply up. However, high correlation is not the natural state of the market. According to a research report released by J.P. Morgan, those correlations have recently been abating, creating a more fertile environment for actively-managed funds.

- **Active management in small-cap space:** While passive managers must own every security in the index (even if this means being fully invested in an over-valued market), active managers try to hand-pick only the most attractive opportunities. The small-company marketplace is especially attractive to an active manager because many small-cap securities are less liquid, under-followed by analysts, and thus a greater price discrepancy may exist between the market price and the true value of the stock.

- **Active management in fixed income markets:** companies that raise capital through issuing debt vary greatly in their financial condition. An active manager who is able to evaluate a company's financial standing, debt structure, and financial covenants is better able to identify the most attractive lending opportunities. Furthermore, returns on fixed income instruments are largely a function of bond's sensitivity to interest rates (known as duration). An experienced manager can generate excess returns by effectively managing duration and exploiting the shape of the yield curve.

- **Active management in international markets**: international marketplaces, especially those in the developing markets often do not have the same level of liquidity and transparency of the US markets. This is why managers with a local foreign presence and expertise may be able to find bargains. According to a UBS research report, "dispersion among returns in individual emerging market countries hit a post-crisis high in 2013".

Despite a strong academic case for indexing, there are a number of active managers who consistently outperform their benchmarks. At MAM, we strive to identify those managers and add them to our clients' portfolios. We also utilize passively-managed ETFs to gain exposure to areas of the market which we believe are posed to outperform in the long run. In the quarterly reports, our clients can see the breakdown by fund and asset class to see how their investments have done relative to market indexes.

2013 Tax Reporting

Schwab 1099s: As with prior years, we expect that Charles Schwab will be mailing their 2013 Form 1099-Composite in mid-February. Since Schwab started providing the original Form 1099s later, there has been no need for us to amend tax returns to reflect subsequently issued corrected Form 1099s.

No Need to Wait: *For tax clients, there is no need to wait until you receive your Schwab Form 1099 before providing us with your 2013 tax packet. Schwab will be providing us with a copy of the Form 1099 for accounts that we manage. If you have everything else, please provide us with your tax packet.*

Cost Basis Reporting: The Schwab Form 1099-Composite will include a "Realized Gain (Loss)" report which should be used to report the realized gains and losses on your 2013 tax returns. The IRS will also be sent a copy of this report. As with last year, because the Gain-Loss report is now included in the Form 1099, we will no longer be providing clients with a Gain-Loss report from our portfolio management system.

Form 1099 Reporting for Schedule C and Schedule E: As in prior years, business and rental property owners are required to file a Form 1099-Misc for annual payments of $600 or more made to unincorporated persons, vendors, subcontractors, independent contractors and others. **Since the 2011 tax year, Schedule C (for sole proprietors) and Schedule E (rental property owners) ask whether Form 1099-Misc were required to be filed and if they were, whether they were in fact filed.** If you file a Schedule C or Schedule E and you are a tax client, please indicate in the tax organizer (in the section highlighted on Schedule C or Schedule E) whether you filed all required Form 1099s. The penalty for not filing a Form 1099-Misc is $100 per occurrence. *If you need to file Form 1099s and need the forms (they cannot be downloaded from the IRS*

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

Health Insurance Requirement: Under the Affordable Care Act (aka "Obamacare"), most Americans are required to health insurance in 2014. For more information, see California's Marketplace for purchasing health coverage:

coveredca.com