McCarthy Asset Management, Inc.
Personalized Wealth Management

July 2018 Monthly Commentary

August 1, 2018

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Stock Market & Portfolio Performance

July 2018: Stocks performed well for the month while bonds were flat. For the first seven months of 2018, U.S. stock prices rose while foreign stocks and bonds fell.

	Jul 2018	YTD 2018	Description:
Without Dividends:			
S&P 500	3.6%	5.3%	500 Largest Public U.S. Companies
Russell 2000	1.7%	8.8%	2000 of the smallest U.S. stocks
MSCI EAFE	2.4%	-2.2%	international stock index
U.S. Aggr Bond	0.0%	-1.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	2.2%	3.0%	non-very conservative MAM portfolios
MAM Conserv	1.5%	1.5%	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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Mid-2018 Economic & Stock Market Outlook

This month we are providing an update to our economic and stock market outlook. When last discussed in our December 2017 Monthly Commentary, we expected the U.S. economy to continue to perform well with no recession in sight. Regarding our stock market outlook, we wrote, "…we expect the equity bull market to continue—at least for now, although with a likely increase in volatility. Furthermore, we expect stocks will outperform bonds for the year, but with gains much more muted than in 2017." So far this has been the case for 2018. After a strong January start, the stock market slipped 10% in February in response to a spike in interest rates. While the S&P 500 is back to positive for the first seven months of 2018, it still has not recovered to its January high. Meanwhile, bonds have experienced minor losses.

The Economy

U.S. Economic Growth: The current economic expansion is now officially the second-longest in the post WWII era. Growth, which has benefited significantly from the large tax cuts, is expected to stay strong throughout the remainder of the year. Additionally, the employment picture remains healthy, as seen by the nearly all-time low number of new unemployment claims, as well as the unemployment rate decreasing to 4.0%. Furthermore, both the manufacturing and services Institute of Supply Management's indexes robust growth and the Index of Leading Economic Indicators strong rise, display the booming state of business and consumer confidence.

No Recession in Sight: The enormous fiscal stimulus of the lower tax rates and increased government spending has given the economy a shot in the arm. Barring an unforeseen shock, the likelihood of a recession starting in the next year is very low. While it is hard to project beyond twelve months, by 2020, rising interest rates could potentially trigger an economic contraction.

Interest Rates

The Federal Reserve: After raising the federal funds rate three times in 2017, the Fed has raised it twice thus far in 2018. Despite these raises, the rate is still modest, ranging from 1.75% to 2.0%. As inflation slowly increases toward the Federal Reserve's 2% target, it is expected to raise rates another 0.50% this year. Meanwhile, the 10-year Treasury rate, which is more indicative of mortgage rates, has climbed to nearly 3%, up from 2.5% at the end of 2017.

Stock Price Valuations

Still Elevated Values: After growing 12% in 2017, S&P 500 corporate earnings are expected to increase an additional 22% in 2018. This exceptional growth, coupled with only a modest increase in stock prices, has resulted in stock market valuations becoming more reasonable. The price-earnings ratio for the S&P 500 for 12-month forward earnings is down from about 18.6 at the market's peak in January to 16.7. This is modestly above its 25-year average of 16.0.

Our Stock Market Outlook

While we remain positive, we are now more guarded in our outlook for the stock market for the next 6 to 12 months. Concerns include:

- Rising trade tensions, new tariffs and protectionist threats are all threatening U.S. and global growth.
- The yield curve has been flattening as the Fed's interest rate increases have caused short-term rates to rise more rapidly than long-term rates. An inverted yield curve, which occurs when short-term rates are higher than long-term rates, has been a reliable sign of an impending recession.
- A tight labor market could trigger wage inflation.

Mid-2018 Economic & Stock Market Outlook-Con't

Despite these concerns, we are staying the course for now. We don't try to predict short-term movements in the stock market. We are more focused on protecting against a bear market. Historically, bear markets start about six months before the onset of a recession. Given the very low likelihood of a recession in the next twelve months, we think stock prices are most likely to modestly rise for the foreseeable future, primarily due to strong corporate earnings and steady economic growth.

Health Savings Accounts Offer Triple Tax Advantages

The use of Health Savings Accounts (HSAs) has grown tremendously in the last ten years. It is estimated that such accounts now have over $42 billion in assets, a 23% increase from last year. The increased popularity is not surprising. While they are primarily used to cover current medical bills, they can also provide retirement benefits. In fact, they are the only savings vehicle of its kind that has triple tax-advantages:

- Contributions into the accounts are tax deductible.
- Earnings grow tax-free.
- Withdrawals used to pay for qualified health care expenditures are tax-free.

Many people overlook HSAs as a retirement-savings vehicle. Left untouched, funds in an HSA can grow tax-free until and during retirement. Saving in an HSA for future medical costs is prudent as health care costs are a major expense in retirement. According to Fidelity, the average 65-year-old couple will pay approximately $280,000 in out-of-pocket costs for health care during retirement. This estimate does not include potential long-term care costs.

The HSA "is the most tax-favored savings vehicle in the tax code" says Leo Acheson, a senior analyst at Morningstar Inc. who wrote a recent report on HSAs. As with a traditional 401(k) or IRA, an HSA allows you to set aside money without paying income taxes on it. Money in HSAs grows tax-free and, if used now—or later—for medical expenses, can be withdrawn tax free. In contrast, with a traditional 401(k) or IRA, income tax is paid on withdrawals.

MAM Recommendation: Because of an HSA's triple tax advantage, we recommend contributing the maximum to both an HSA and 401(k) for those who have them available. Personally, I have been very pleased with the HSA that Joanie and I established in 2009.

Qualification and Annual Contributions: Contributions to an HSA can only be made by those who are covered by an HSA-qualified, high-deductible health-insurance plan. Maximum contributions for 2018 are $3,450 for individuals and $6,900 for families, plus an extra $1,000 for those 55 or older. Once you are covered by Medicare, you are no longer eligible to contribute to an HSA (although you can still retain and withdraw from an existing HSA account).

CA Doesn't Recognize HSAs: California does not recognize Health Savings Accounts. Therefore contributions are not tax-deductible and earnings are taxable for CA tax purposes.

Tax Credit for Purchase of a Tesla to be reduced after 2018

Last month, Tesla delivered its 200,000th vehicle, triggering the phase-out period of the $7,500 federal tax credit for the purchase (not lease) of a new Tesla electronic vehicle. The phase-out period for the $7,500 federal tax credit is in effect for all Model S, Model X and Model 3 vehicles delivered on or before December 31, 2018. Buyers taking delivery in 2019 will be eligible for a reduced credit, as seen below:

Federal Credit	For Vehicles Delivered
$7,500	On or before December 31, 2018
$3,750	January 1 to June 30, 2019
$1,875	July 1 to December 31, 2019

Note that the Federal tax credit is only available if the taxpayer's gross Federal tax (i.e. tax before withholding and estimated payments) is at least equal to the credit. If the Federal tax is less than the credit, then the credit is limited to the amount of the Federal tax.

Accelerate Tesla Purchase?: This last week, one of our clients moved up the purchase of his Tesla to take advantage of the larger credit. He is taking delivery of the Model 3 with the longer-life battery and premium interior for a cost of $49k. The Federal credit of $7,500 and CA rebate of $2,500 reduce the cost to $39k. Alternatively, he could have waited until mid to late 2019 to take delivery of the Model 3 with the standard battery and non-premium interior for a cost of $35k. The Federal credit of $1,875 and CA rebate of $2,500 (assuming it will still be available late next year), would reduce that cost to $30,625. The client felt that paying an extra $8,375 for the longer-life battery and premium interior is well worth it.

Electric Vehicle Credit for Other Car Manufacturers: Per an article from EVAdoption, GM is the next car manufacturer that is likely to reach the 200,000th limit, which will start to phase out the Federal credit for the purchase of its new electric vehicles. Currently, it is projected that this limit will be reached in the fourth quarter of 2018 or first quarter of 2019. The article provides a table that projects when each electric vehicle manufacturer will reach the limit that will trigger the phase-out of its credit.

California Rebate for Purchase or Lease of Electronic Vehicle: Certain states provide a rebate for new electric vehicles. Tesla's official Electric Vehicle Incentives page provides a list of the states with rebates. In the case of California:

- The vehicle can be either purchased or leased.
- Unlike the Federal tax credit, the state rebate must be applied for.
- For CA, there is an income phase-out of $250,000 for single filers, $340,000 for head-of-household filers and $500,000 for joint filers.
- Here is a link to the DriveClean, from the California Air Resources Board that provides information about the rebate. Here is a link for how CA residents can apply for the rebate.

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.**
- **Social Security Planning is an analysis of the best strategy for when and how to start claiming Social Security benefits.**

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 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

Please let us know if there are any topics you would like to have us cover or any questions answered in a future Monthly Commentary.