

## June Monthly Commentary/Q2 2020 Quarterly Letter

July 1, 2020

### Stock Market & Portfolio Performance

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**Second Quarter 2020:** After a terrible month for March, U.S. and international stocks bounced back with the S&P 500 posting its best quarterly results since the fourth quarter of 1998. Bonds also performed well.

	2nd Qtr	YTD 2020	Description:
Without Dividends:			
S&P 500	20.0%	-4.0%	500 Largest Public U.S. Companies
Russell 2000	25.0%	-13.6%	2000 of the smallest U.S. stocks
MSCI EAFE	14.2%	-12.6%	international stock index
U.S. Aggr Bond	2.9%	6.1%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	13.5%	-4.4%	non-very conservative MAM portfolios
MAM Conserv	10.8%	-3.4%	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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For the third straight month, the stock market continued its recovery in June from the dramatic losses incurred during March. For the month, the S&P 500 rose a modest 1.8% and is now down just 4.0% for the first six months of 2020. As mentioned in our May update, with the exception of technology stocks, the overall market has not recovered nearly as much as the S&P 500. For the first six months of 2020, the Russell 2000 Index, which is comprised of small and mid-cap stocks, was still down 13.6% and the MSCI EAFE international stock index was down 12.6%.

**Our Outlook for Remainder of 2020:** While we expect a gradual economic recovery for the remainder of 2020, for a number of reasons we still remain somewhat cautious:

- **Recent Surge in New Infections:** As authorities have relaxed the shelter in place orders to reopen the economy, there has been a recent sharp uptick in new COVID cases. This is not surprising, as without an effective cure or vaccine, reopening the economy was expected to be a very difficult balancing act.
- **Risk of Second Wave of Infections in the Fall:** The start of flu season poses a risk of a second wave of infections occurring. Unlike during the first wave, most governments will probably not shutter their economies in response to a renewed spike in infection rates.
- **November Presidential Election:** As the time gets closer, the stock market is likely to start focusing on the November elections. In particular, if Joe Biden were to win, Trump's corporate tax cuts would be in jeopardy. While we weren't in favor of these tax cuts due to them triggering a massive increase in the federal deficit, they have helped the stock market. It is estimated that a full repeal of the Trump tax cuts would reduce the earnings of S&P 500 companies by about 12%. On the other hand, trade tensions with China would probably diminish under a Biden presidency, which would be a positive factor for equity investors.

**Our 12-Month Outlook:** We have a more favorable outlook on equities over a one-year time-frame. While a second COVID wave would certainly slow the economic rebound, it would probably not reverse it completely given that the mortality rate from the virus now appears to be somewhat lower than initially feared. Furthermore, help may arrive in the form of effective COVID treatments and/or vaccines. Meanwhile, Federal Reserve Chairman Powell announced last month that the Federal Reserve plans to keep short-term interest rates close to 0% through 2022. If economic output and employment continue to rise, stocks are likely to trend higher while interest rates remain near historical lows.

## Forecasts of Long-Term Stock & Bond Returns

Forecasts of long-term returns for stocks and bonds are important because they can have a significant impact on an investor's financial security in retirement. All long-term investment projections assume a certain annual rate of return. If the actual annual returns end up being short of the assumed returns by just 1% or 2%, the resulting impact can be very detrimental.

**Historical Returns:** According to Vanguard, from 1926 through 2018, stocks earned an average annual return of 10.1% while bonds provided a 5.3% return. For several reasons, we expect returns to be significantly below this over the next ten years.



**Assumed Annual Returns We Use:** In the Retirement Analyses we prepare, we currently assume an annual return of 4.99% for a diversified portfolio. We have seen retirement plans prepared by others that use annual returns as high as 7%, 8% or even 9%. We believe that assuming future returns at these high levels is likely to create a false sense of financial security, which can be very problematic for those looking to achieve a financially secure retirement.

**Why Future Returns Are Likely to Be Lower:** The annual return for the stock market is made up of four components:

- The dividend yield of stocks (currently 1.8% for the S&P 500) plus
- The annual real growth in corporate earnings (with 2.0% GDP growth a good estimate of that) plus
- The annual rate of inflation (currently 2.0%) plus or minus
- The change in the price-earnings ratio for stocks.

The first three components total 5.8%. The fourth component, the change in the price-earnings ratio, is the wildcard that causes stocks to soar some years and plummet in other years. Historically, stocks sell for approximately 15 to 16 times their earnings. Presently, they are selling at a little above this range. As such, it is reasonable to assume the current price-earnings ratio for stocks will contract over time back to their historical level.

Adding it all up, we feel it is reasonable that equities will return an average of 4% to 6% annually over the next 10 years or so. Due to their relative underperformance over the last ten years, we expect international stocks to earn a higher average return than this.

As for bonds, the best estimate for future returns is the current level of interest rates. Currently, the aggregate bond index yields just over 2%.

## **10-Year Annual Return Forecasts from Leading Investment Firms:**

BlackRock Investment Institute:

6.1%	U.S. Large-cap Equities
6.5%	European Equities
7.5%	Emerging Market Equities
1.7%	Aggregate Bond Market

J.P. Morgan:

5.6%	U.S. Equities
3.4%	U.S. Investment Grade Bonds

Morningstar Investment Management:

1.7%	U.S. Equities
5.8%	Non-U.S. Developed-Market Equities
5.3%	Emerging Market Equities
2.1%	U.S. Bonds

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## Forecast of Long-Term Stocks and Bond Returns– con't

Vanguard:

3.5% to 5.5%	U.S. Equities
6.5% to 8.5%	Non-U.S. Equities
2% to 3%	U.S. Fixed Income

**MAM Comments:** While there is some dispersion of the projected returns between the different investment firms, there is consensus:

- Expectations should be tempered for U.S. equities with average annual returns to be in the low to mid-single digit range over the next decade.
- Foreign equities are expected to outperform U.S. equities.
- Bond returns are likely to be modest due to their current low yield. Nonetheless, investors should not abandon bonds despite their meager return prospects. This is because they provide downside protection for portfolios when stock prices are falling.

Taking it all in, we think it is reasonable to expect U.S. stocks will earn an average of 4% to 6%, foreign equities 5% to 7%, and bonds 2% to 3%. For a diversified portfolio we are assuming an average annual return of 5.0% (i.e. we use 4.99% for a client's Retirement Analysis).

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## Charitable Donations - Get More Bang for Your Buck By Lauree Murphy



In the past, when we have written about charitable donations, we were instructing clients about tax write-offs and proper documentation. This month we are giving it a different spin by looking at how to get the most positive impact for the dollars you donate.

There are several websites to help you quickly search charitable organizations and see what percent of your donation is spent on charitable causes versus fundraising and administration. I have summarized a couple we like below. Googling the organization might be your first step. You can find out if the organization is registered with the IRS as a charity (a 501c3 organization), or if it is really a PAC (political

action committee). Many organizations, especially those who solicit donations over the phone, are not actually charities. You might still choose to donate to them, but your money is mainly spent lobbying.

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## Charitable Donations - Get More Bang for your Buck By Lauree Murphy– con't

**Charitynavigator.org**, which is free to use, has a nicely arranged “**Top Ten Lists,**” as well as an “**A-Z Directory**” of charities. It only takes a few minutes to learn to navigate this site. We recommend taking a look at the “**Tips for Donors**” section. Most of the large charities have star rankings, ranging from 1 to 4 stars. Additionally, under the star ranking is a “details” link which has information about the charity’s mission and financial data. In the financial performance metrics, you can see the percentage of total expense spent on various categories, including program expenses, administrative expenses and fundraising expense. This is quite helpful. It lets you know how much of your donation is going to its mission versus other expenses. One other thing we like about this site, is that it tells you if the organization is in trouble with a state’s attorney general. I found one organization that I had donated to last year had a cease and desist order issued by the CA Attorney General.

**Impactmatters.org**, which is also free to use, takes a slightly different approach. It helps you find charities that are aligned with the kind of organizations you wish to support. You can filter organizations using the “**Search Nonprofits**” tab and then click “**Cause**” (climate change, veterans, homelessness, etc.), “**Program**” (tree planting, high school graduation, workforce training, etc.), or “**Beneficiaries**” (people with cancer, migrant workers, at risk youth, etc.). The website also tells you the impact that your donation has on a recipient. For example, a \$25 donation to San Francisco-Marin Food Bank provides a meal to 13 people, or your \$25 donation to Disabled American Veterans increases the government benefits claimed by a disabled veteran by \$1,386.

In summary, there are resourceful and free tools on the internet to help you make informed decisions about the charitable organizations you choose to support.

Sincerely,

*Stephen P McCarthy, CPA, CFP®*

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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

### Tax Reminders:

- July 15th is the deadline for filing 2019 individual income tax returns and making 2019 IRA, SEP-IRA, Roth IRA and Education Savings Account contributions.
- July 15th is also the deadline for first and second quarter 2020 Federal and State estimated payments.



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