

## June 2021 Monthly Commentary/ Q2 2021 Quarterly Letter July 1, 2021

### Stock Market & Portfolio Performance

**Second Quarter 2021:** Stocks posted strong gains for the quarter led by U.S. large cap companies. Bonds staged a partial recovery, paring their year-to-date losses.

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	2nd Qtr	YTD 2021	Description:
<b>Without Dividends:</b>			
S&P 500	8.2%	14.4%	500 Largest Public U.S. Companies
Russell 2000	4.1%	17.0%	2000 of the smallest U.S. stocks
MSCI EAFE	4.4%	7.3%	international stock index
U.S. Aggr Bond	1.8%	-1.6%	index of U.S. bonds
<b>With Dividends, after all fees:</b>			
MAM portfolios	5.1%	9.0%	non-very conservative MAM portfolios
MAM Conserv	3.7%	5.1%	portfolios with 45%+ 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.*

**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](mailto:steve@mamportfolios.com)



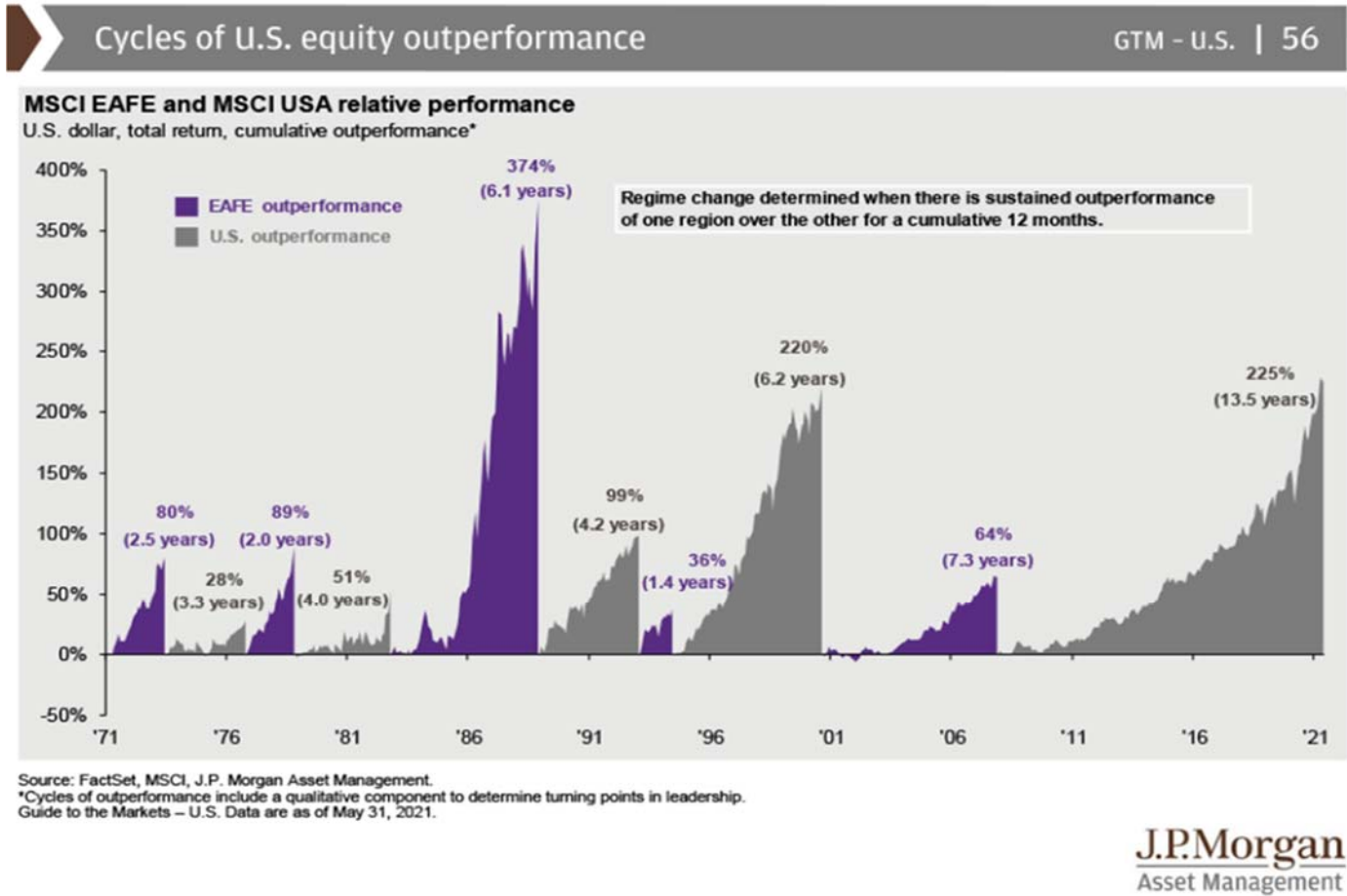
**RYAN McCARTHY,**  
CPA®, CFP®  
Financial Planner  
650 610-9540  
[ryan@mamportfolios.com](mailto:ryan@mamportfolios.com)

**ANTHONY BERTOLACCI, EA**  
Director of Compliance  
Tax Accountant  
650 610-9540 x 302  
[anthony@mamportfolios.com](mailto:anthony@mamportfolios.com)

**MARILYN BLANCARTE, PACE**  
Executive Assistant  
650 610-9540 x 305  
[marilyn@mamportfolios.com](mailto:marilyn@mamportfolios.com)

Investors in U.S. stocks enjoyed strong returns in 2020. This was a continuation of more than a decade of U.S. stocks outperforming their international peers. This trend has sustained for the first half of 2021. It may be time, though, to start increasing the international allocation in portfolios. Global economic improvements, a weaker U.S. dollar, and attractive valuations bolster the case for U.S. investors to consider increasing exposure to international equities.

Historically, there have always been cycles of foreign stocks underperforming followed by a period of outperforming. As shown on the J.P. Morgan chart below, during the last thirteen years, U.S. stocks have outperformed international stocks (i.e., the EAFE index) by 225%. This is the longest stretch of outperformance in over 40 years.



When will international stocks once again start being the better performer? Here are some considerations:

- 1) Improving Global Economy: For 2021, the U.S. economy is expected to experience its greatest economic growth since the 1970s. This is due to a record amount of U.S. stimulus combined with the reopening of the U.S. economy thanks to the very successful rollout of COVID vaccines. Although most other nations are behind the U.S. in distributing the vaccines, their efforts are accelerating. As a result, the global recovery is expected to pick up in the second half of 2021.
- 2) Performance of the U.S. Dollar: A major reason why non-US stocks have lagged for the last decade has been a sharp rise in the U.S. dollar relative to the Euro and other international currencies. During the last twelve months, however, the U.S. dollar has fallen nearly 10% relative to a basket of foreign currencies.

## International Equities– Ready to Start Outperforming?- Con't

- 3) Relative Valuations: Foreign stocks are cheaper than their U.S. counterparts, both in relative and historical terms. The S&P 500 is currently trading at about 23 times forward earnings. By contrast, Europe and Japan are both trading at 18 times earnings, while emerging markets carry a multiple below 15. Compared to the overall MSCI World Index, U.S. stocks are trading at a 10% premium, while European and Asian equities can be bought at discounts of 14% and 24%, respectively.
- 4) Higher Dividend Yield: As of 6/30/21, the EAFE index of international equities traded with a 2.3% dividend yield, compared to the S&P 500's 1.6% dividend yield.
- 5) Diversification: Historically, a portfolio that includes an international stock allocation experiences lower volatility, but comparable performance, to a U.S.-only stock portfolio. This is because adding international equities to a portfolio increases diversification.
- 6) Emerging Markets: Emerging market equities are likely to outperform developed market equities (including U.S. equities) over the next ten to twenty years. This is because the emergence of a global middle class will drive economic growth in many of these emerging market countries as income levels steadily increase and the number of people living in poverty continues to fall. For instance, the percentage of the total population occupied by the middle class in India is projected to increase from 14% in 2018 to 79% in 2030, and for China from 34% to 72% during this timeframe.

MAM View: With our most recent semi-annually repositioning last month, we established a small position in the new exchange-traded fund SCHY, Schwab International Dividend Equity. Despite increasing the international equity allocation in portfolios with this move, MAM portfolios currently hold a relatively modest foreign and emerging market equity allocation of between 10% and 15%. We may further increase this non-US stock allocation if we become confident that international stocks are once again outperforming US stocks.

## President Biden Unveils His Tax Plan



President Biden has released details of his fiscal-year 2022 tax plan, which includes numerous proposed tax increases. It's important to remember that these are just proposals and have not yet been introduced as part of any bills. We are including in this article comments from Michael Townsend, Charles Schwab's vice president of legislative and regulatory affairs, regarding the initial reaction in Congress to these proposed tax increases. Most of any changes that become enacted will not be effective until 2022.

Increased Income Tax Rates: The American Families Plan proposes to increase the top individual tax rate from 37% to 39.6%. At this time, it appears a rate increase is only proposed for the top individual tax bracket (income above approximately \$500,000 for married filing jointly and \$450,000 for single filers).

## Biden Unveils His Tax Plan- Con't

**Long-Term Capital Gains and Qualified Dividends:** Currently, long-term capital gains on assets held over one year and qualified dividends are taxed at a maximum Federal rate of 20% plus a 3.8% Medicare surtax. For those with income in excess of \$1 million, Biden is proposing to nearly double the top rate to 43.4%. This increase would be retroactive to April of 2021. "This is seen as the moonshot starting point proposal from the White House. There is plenty of room to come back and negotiate that," Townsend said. "And there is sort of a sweet spot around 28% or 29%, somewhere in there, for a capital gains tax for the wealthiest filers." As for making any increases retroactive, Townsend said "that is something that has not gotten a lot of support on Capital Hill, so I think it's unlikely that we're going to see any of these proposals being enacted retroactively."

**Eliminate "Step-Up" in Basis at Death:** Currently, capital gains are forgiven when someone dies. The "step-up" in basis rules have been in effect for nearly 100 years. Through the years there have been attempts to change the rules (including 1976, 2001 and 2015). Townsend said the proposal to end the step-up in basis for inherited assets "is getting the cold shoulder from both Democrats and Republicans. It is not at all clear that this can get through Congress and you may see them at some point go after the estate tax rate and try to take it up a little bit, but right now the prospects for eliminating step-up in basis are looking fairly rocky in Washington."

**Increase Corporate Tax Rate:** Biden's large infrastructure plan ("American Jobs Plan") would be partly financed by increasing the U.S. corporate tax rate from 21% to 28%. "Already there is strong push back from a number of prominent Democrats on the Hill that that's too much of an increase. It seems like 25% is a more realistic outcome," Townsend said. In fact, Biden recently proposed a minimum corporate tax rate of 15% in lieu of increasing the maximum rate above 21%.

**Like-Kind Exchanges:** The proposal would limit the deferral of gains on like-kind exchanges up to an aggregate annual amount of \$500,000 for single taxpayers and \$1 million for joint filers. Gains above this amount will be taxed for exchanges completed in taxable years beginning after December 31, 2021.

**Repeal of SALT Limitation?** Neither a partial nor full repeal of the \$10,000 limitation on state and local tax (SALT) deduction is contained within President Biden's proposals. However, a growing number of House Democrats have expressed that they will only support a tax bill if it contains a full repeal of the SALT cap. The optics of raising the SALT cap, however, may not be palatable to Biden as "from a (public relations) perspective, it's a really difficult place for the White House to be because the benefit would go to the wealthier filers," Townsend said.

**Estate Tax Exemption:** Currently, estates of up to \$11.7 million are not subject to estate tax. If no action is taken by Congress, in 2026, the exemption amount will revert to 2017 values, with inflation adjustments. It is estimated that by 2026, the inflation-adjusted exemption would be about \$6 million per estate, and \$12 million for a married couple. While not yet proposed, Biden has discussed reducing the exemption to \$3.5 million per estate. The earliest this would be effective will probably be the beginning of 2022.

**What Should You Do Now?** Probably nothing until it becomes clearer what taxes will be increased and when the effective dates will be. Stay tuned, though, as we will continue to discuss possible tax law increases in future Monthly Commentaries.

## The Federal Reserve Now Expects to Start Raising Interest Rates by Late 2023



On Wednesday, June 16<sup>th</sup>, Federal Reserve officials announced they expect to raise interest rates by late 2023, which is sooner than they anticipated in March. The rationale for the change in plans is the economy is recovering rapidly from the effects of the pandemic and inflation is heating up. Their median projection now shows the Fed lifting the Federal Funds rate to 0.6%, up from near 0% by the end of 2023. In March, they had expected to hold it at close to 0% through the end of 2023.

Fed officials also discussed an eventual reduction, or tapering, of the central bank's bond buying program. The Fed has stated they want the economy to get closer to their goals of "maximum employment and sustained 2% inflation" before reducing the bond purchases. The Fed is now projecting inflation to slow from 3.4% by the end of 2021 to 2.1% by the end of 2022 and 2.2% by the end of 2023. It is fair to assume that if inflation appears to be headed above these levels, the Fed may further accelerate when they plan to start raising the Federal Funds rate.

**MAM Comments:** Currently there is too much economic stimulus being pumped into the U.S. economy. The impact of this stimulus, though, is expected to fade as we move through 2021. Outside of a few industries, wage inflation remains well contained. In those industries suffering from labor shortages, the expiration of emergency unemployment benefits in September, increased immigration, and the opening of schools should replenish labor supply. Furthermore, bottlenecks in the global supply chain are starting to ease. At least at this point, we continue to view rising U.S. inflation as a mid to longer-term risk rather than a shorter-term risk.

Sincerely,

*Stephen P McCarthy, CPA, CFP®*

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## 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](mailto: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.
- 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

*Are you on course for a financially-comfortable retirement? A **Retirement Analysis** can be very helpful in answering that. Please let us know if you would like to have us prepare one for you.*



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