McCarthy Asset Management, Inc.
Personalized Wealth Management

May 2013 Monthly Commentary

June 3, 2013

Stock Market & Portfolio Performance

May 2013: After reaching new highs during the middle of the month, stocks started to slip toward the end of the month. Bond prices were particularly weak in the later part of May.

	May 2013	YTD 2013	Description:
Without Dividends:			
S&P 500	2.1%	14.3%	500 Largest Public U.S. Companies
NASDAQ	3.8%	14.5%	stocks trading on the Nasdaq
Russell 2000	3.9%	15.9%	2000 of the smallest U.S. stocks
MSCI EAFE	(2.9)%	6.1%	international stock index
U.S. Aggr Bond	(1.8)%	(0.9)%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	0.6%	9.7%	non-very conservative MAM portfolios
MAM Conserv	(0.7)%	3.2%	very conservative MAM portfolios

Comment: Diversification wasn't beneficial this month. Although U.S. stocks performed well, foreign stocks and bonds did not. While bonds suffered as mortgage rates spiked to a 12-month high, we think it is unlikely that interest rates will continue to climb rapidly in the short run as we believe a stronger economy is needed for that to happen.

Inside this issue:

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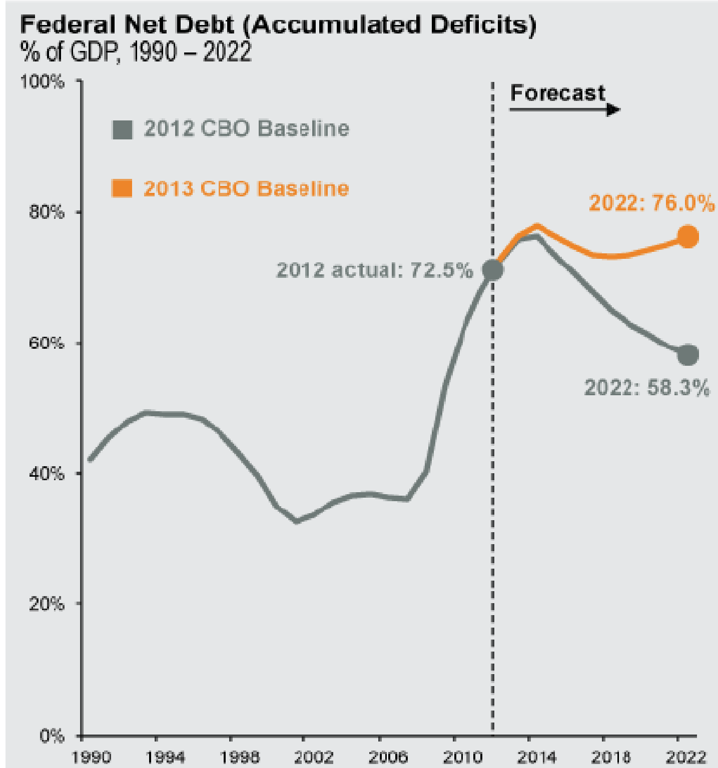
U.S. Deficit is Shrinking

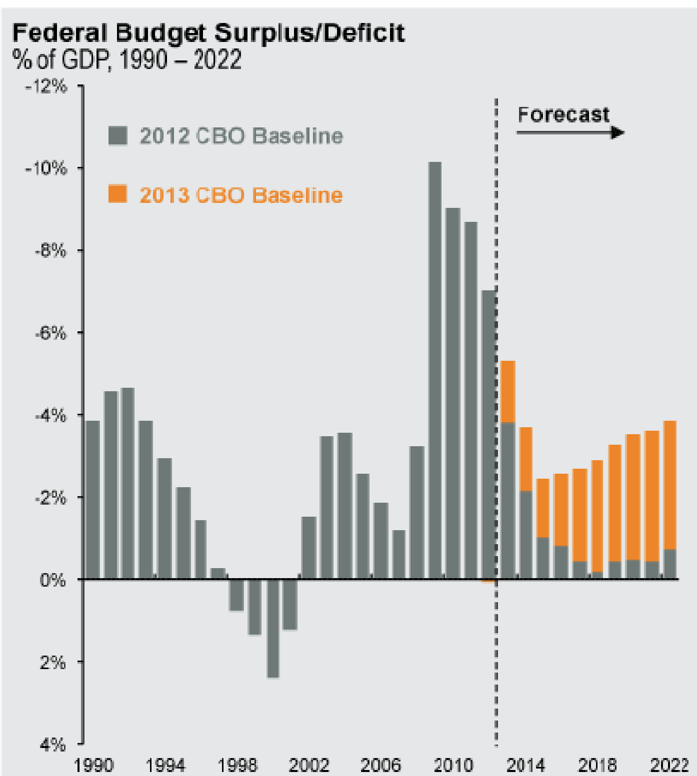
After four straight years of $1 trillion deficits (from 2008 through 2012), the U.S.'s fiscal picture is dramatically improving. The non-partisan Congressional Budget Office (CBO) recently announced that the federal deficit is expected to shrink to $642 billion in the fiscal year ending this September 30, more than $200 billion below its February estimate, and down from 2012's deficit of $1.089 trillion. This year's shortfall would represent 4% of the economy, far less than the 10.1% experienced in 2009 when the government ran a record $1.4 trillion deficit.

Reasons for the Improvement: The agency attributed the drastic reduction in this year's projected deficit to higher-than-expected individual and corporate tax payments, due in part to economic growth and to the higher tax rates that became effective at the beginning of 2013. Also helping is the recent announcement that government-owned Fannie Mae and Freddie Mac plan to pay $95 billion in dividend payments to the government this year.

Negative Impact on Deficit-Reduction Talks: Unfortunately, these positive developments have virtually halted deficit-reduction talks because politicians now have a little breathing room before the next deadline to extend the government's debt ceiling. (Why take care of it before it becomes a crisis!) In particular, lawmakers now aren't expected to face a decision over raising the borrowing limit until this October or November, compared to the summer deadline projected a few months ago.



Source: U.S. Treasury, BEA, CBO, J.P. Morgan Asset Management.



Source: U.S. Treasury, BEA, CBO, J.P. Morgan Asset Management.

Longer-Term Deficits Still Expected to Spike: The CBO also said the improving deficit picture is projected to continue for several years. By 2016, however, it is expected to start worsening again, as tax revenue levels off and entitlement spending accelerates. As more baby boomers retire, the Medicare and Social Security entitlement programs will consume an even larger share of the budget. By 2023, Social Security and government healthcare spending is expected to hit $3 trillion, or half the budget. Only Congress can implement critical reforms to prevent the deficits from spiraling out-of-control, but they appear unwilling or unable to deal with this issue. The recent improvements in the deficit may give a false sense of security and delay ongoing efforts. While sooner is better than later, at some point Congress will have to seriously address entitlement reform.

2012 numbers are actuals. Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Chart on the left displays federal surplus/deficit (revenues – outlays). Federal net debt comprises all financial liabilities of the Federal government (gross debt) minus all intra-government holdings as assets. Deficit and debt scenarios are based on CBO budget forecasts from August 2012 and February 2013, which include the American Taxpayer Relief Act's cost estimates.

Data are as of 3/31/13.

Why is the Stock Market Hitting New Highs?

Most of the U.S. stock market indexes, including the S&P 500 have been consistently reaching new all-time highs this year, with investors enjoying double-digit gains. Even European shares, as measured by the Stoxx Europe 600 index, recently reached their highest levels in almost five years.

What is fueling the stock market? With stock prices racing ahead seemingly unabated, what is fueling the rise?

- It is not the strength of the global economy. Recent data has been mixed and last month the IMF lowered its global-growth forecast from 3.5% down to 3.3%. In addition, in an improving economy, commodity prices usually strengthen. That is not the case this year with gold & silver prices dropping sharply.

- It is also not due to a surge in corporate profits. While first-quarter results from companies in the S&P 500 were better than expected, they still showed only a 5.1% increase compared to 2012's first quarter.

- What is also not driving the market is excessive investor exuberance. The "great rotation" into stocks from bonds is still not happening (at least not yet). After strong flows into stock funds earlier this year, investor interest in equities has been waning as bond funds remain in high demand. More likely could be what Sheila Patel, the head of international at Goldman Sachs Asset Management, calls a "gradual rotation" into stocks, which would be bullish for equities longer term.

- **We believe the main reason for the strong stock market this year has been the stimulus efforts from central banks around the word (including Bank of Japan, The European Central Bank and the U.S. Federal Reserve).** As long as central banks maintain an easing bias, equities could continue to rise. On May 22nd Federal Reserve Chairman Ben Bernanke told Congress that the U.S. job market remains weak and that it is too soon for the Fed to end its stimulus program of purchasing $85 billion-a-month in Treasury and mortgage bonds (called "Quantitative Easing 4 or QE4"). The result of these efforts is to keep interest rates near record lows, which is very beneficial for stocks.

What can derail the stock market? With stock prices having more than doubled from their lows in March of 2009, the stock market is no longer a bargain. Relative to projected 2013 earnings, prices are still reasonable while relative to the last 10 years of earnings, stocks are expensive. Meanwhile, a healthy correction is overdue, and could occur at any time. Through May 31st, it has been 190 days since the S&P 500 experienced a 5% or greater pullback, which is the longest stretch in this 50-month-old bull market. In the spring of each of the past three years, a stock market slide of 10% to 19% began. These were healthy corrections as the market then went on to fully recover. Initial signs that the Federal Reserve will reduce its bond buying could trigger such a correction. For a major correction to occur, we believe would more likely require an external shock such as a serious geopolitical event. While we believe it is nearly impossible to accurately predict the timing of corrections, we continue to maintain a significant allocation to bonds in portfolios to provide downside protection.

Life Insurance– An Overview

Assessing the need for life insurance is a part of a prudent financial plan. In this commentary we will briefly address the uses and benefits of life insurance. In a nutshell, a life insurance policy is a *contract* between the policyholder and an insurance company, whereby the insured pays the company to assume the financial risk of their early demise. While there are many uses of life insurance, we will discuss just a few:

- **Life insurance as an income replacement:** For an income earner, particularly for a younger breadwinner, their earning ability may be their most valuable financial asset. Loss of future earnings can be replaced with disability insurance, in the case of a long-term disability (more on that in a future issue of the Commentary) or with life insurance, in case of breadwinner's early death. The present value of future earnings adds up (replacing a modest salary of $50,000 a year for 45 years could equate to insurance of greater than $1 million, depending on a discount rate and taking inflation into account).

- **Life insurance as a business planning tool:** For a business owner, having an appropriate amount of life insurance may mean that the business survives him or her or that the surviving family members will get a fair price for the business without resorting to a fire sale or having to quarrel with debtors and surviving business partners. How much insurance is appropriate in such a case depends on the value of the business.
- **Life insurance as an estate planning tool:** Life insurance can also be a valuable tool for someone who has accumulated significant assets and is planning to pass them on. It is not uncommon, especially in this part of the country to leave a bequest that includes a house, a business or some other asset which may not be readily converted to cash or sold piecemeal. Heirs often find themselves in a position where they need liquid funds to pay the deceased's costs, debts, legal fees, and, in case of larger estate- an estate tax. Having life insurance proceeds readily available makes this task easier and less stressful.

What type of life insurance is best? The answer depends on the insured's individual circumstance. There are many types of life insurance available, but usually policies fall into one of two categories: Term Insurance and Permanent Insurance.

- **Term Insurance** is usually bought for a specific period of time (e.g. 10 or 15 years). The buyer makes payments and in return receives a lump sum payment if they die during that term. Term insurance payments cover the pure cost of the insurance and allows for no buildup of cash value. It is the most affordable form of insurance, hence the saying "Buy term and invest the difference". This is the view that we also subscribe to except in limited circumstance where Permanent Insurance is more appropriate.
- **Permanent Insurance** contracts come in a variety of shapes and sizes, some tied to investments while others pay a fixed rate. The main feature that differentiates permanent from term contracts is that permanent insurance builds up equity (cash or surrender value) in the policy, which the policyholder may be able to access. The cost of a permanent insurance policy, though, is much greater than cost of a term policy providing the same amount of coverage.

If you are wondering how life insurance fits into your financial plan (or any other type of insurance such as disability, long term care or health insurance), please call or email us and we would be glad to set a time to discuss this further.

Sincerely,

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MAM

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.**
- **The Savvy Life® Classes and Workshops by best –selling author Melis-**

Reminders

Second quarter of 2013 estimated tax payments are due on June 17th.

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