McCarthy Asset Management, Inc.

Registered Investment Advisor

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Monthly Investment Commentary- August 2012

Stock Market Performance for August: The stock market continued to perform well this past month. Unadjusted for dividends, the S & P 500 rose 2.0%, NASDAQ jumped 4.3%, the Russell 2000 climbed 3.2%, and the international equity index MSCI EAFE rose 1.6%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 0.1% for the month.

MAM August Performance: MAM portfolios slightly under performed the S & P 500 for the month. Excluding the "very conservative" portfolios (which rose 1.3%), MAM portfolios rose 1.6% (after all fees), versus a rise of 2.2% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Year-To-Date Performance: For the first eight months of 2012, unadjusted for dividends, the S & P 500 rose 11.8%, the NASDAQ climbed 17.7%, the Russell 2000 rose 9.6%, and the international equity index MSCI EAFE inched up 3.5%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 3.9% for the year-to-date. Excluding the "very conservative" portfolios (which rose 6.6%), MAM portfolios rose 7.8% (after all fees), versus a rise of 13.4% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Update on Europe- Initial Signs of Progress

One of the reasons why the stock market has performed well recently is that over the past several weeks a framework for cooperation between Euro-governments and the ECB has started to emerge that could potentially repair the fractured confidence in certain Euro-sovereign markets (and therefore mitigate one of the major risks facing the stock market). In particular, in early August European Central Bank (ECB) President Mario Draghi announced a new philosophical framework where he told the world that the ECB will act like a central bank of a United States of Europe *if the integration of European fiscal policy accelerates*.

Clearly European governments need to engage in credible structural reform to regain the trust of the markets. While Ireland has already been successful in its reform measures, so far politicians have failed to do so in Spain, Italy and Greece. If these weaker countries enact reforms to subject themselves to a European-wide political body that negotiates and sets fiscal terms, the ECB will then be willing to engage in market operations to stabilize the Euro. While much still needs to be done to make this happen, initial progress has been made in creating a framework that could provide an eventual solution.

Stock Market Outlook- An Aging Bull Market?

I think most investors have been pleased and maybe a little surprised at how well the stock market has performed so far this year. The reason I believe many are surprised is because investor sentiment still remains fairly negative and investors have continued to consistently reduce their holdings in equity funds and increase their holdings in bond funds. While this negative sentiment is actually a positive contrary indicator of future market performance

3 Lagoon Dr, Suite 155, Redwood Shores, CA 94065, (650) 610-9540 Fax (650) 610-9541;
e-mail: steve@mamportfolios.com Web site: mamportfolios.com

(because many investors are probably still under invested in stocks), I am concerned that the very strong stock market advance since March of 2009 (with the S & P 500 up over 100%) is showing signs of old age. Not only has this cyclical bull market lasted about 15% longer than the average primary trend since 1929, but various indicators also point to growing "buyer' fatigue". Here are three gauges that support this:

- *Most global stock markets peaked long ago*. Historically, it has been an ill omen when one big stock market, unaccompanied by its peers, zooms up to a multiyear peak. When the S & P 500 closed at a post-2008 high on April 2, not one of the other 10 largest stock exchanges in the world followed suit. Most topped nearly a year before: Brazil and Hong Kong in November 2010, Japan in April 2010, and China (Shanghai) peaked way back in August 2009.

- *Fewer and fewer U.S. stocks are leading the indexes higher*. Back in April 2010, the daily tally of individual NYSE stocks touching new 52-week highs crested at 674. During the second leg of the bull market, only 363 new highs were recorded the day of the April 2011 top. At the April 2012 market peak, a mere 158 stocks achieved new highs.

- *Market breadth is weak*. The Value Line Geometric Index is a lesser-known stock index that assigns equal weight to approximately 1700 U.S. companies. Because of the equal weighting, this index mimics the behavior of the great mass of stocks. While the Dow and S & P 500 indexes have climbed almost all the way back to their April highs, the Value Line index is still languishing well below its April 2012 peak. In short, the stock market has not performed as well as the Dow and the S & P 500 indexes indicate as the strong performance of a few large-cap stocks have benefited these indexes (in particular the market-cap weighted S & P 500 index has significantly benefited from the 64% year-to-date return in its largest weighting--Apple Inc).

While I am not predicting the stock market is about to peak (I am not confident in anyone's ability to predict that), I do think that now would not be a prudent time to get more aggressive. I am pleased with the current downside positioning of MAM portfolios and am not looking to make any changes at this time.

Importance of Being Fiscally and Physically Fit for a Healthy Retirement

The greatest financial goal of my clients is to be financially comfortable in their retirement. For this reason, I often discuss issues related to retirement planning in these Monthly Commentaries. As many of you know, I am also passionate about exercise (with a morning gym workout nearly every day). This month I am excited that Alexey Bulankov has written this article to address two of my passions in one article: the importance of being fiscally and physically fit for a healthy retirement.

Both fiscal and physical fitness play a role in retirement decisions. If you are like many of our clients, you probably have thought about retirement and maybe even made plans. And, if you are like most investors out there, the last decade of market turbulence derailed those plans somewhat and you may be now wondering whether you are still on track. When you find yourself falling short of your retirement goals, there are generally three possible solutions:

- Save More Now
- Spend Less In Retirement
- Work Longer (i.e. Delay Retirement)

The first two monetary solutions are challenging. Even if you are in your peak earning years, you likely have other financial obligations such as a mortgage, kids' education, care of aging parents, etc. Significantly curtailing spending to increase savings is often not a viable option. Meanwhile spending less in retirement is not only an undesirable alternative, but probably a challenging one given the continued rapid rise in retirees' health care costs.

The Solution of Working Longer: An increasing number of people planning for retirement are opting for the third option: postponing retirement and working longer. This option has several benefits: besides shortening the time you spend in retirement, it allows you to add to your 401(k) and other retirement savings, and increases your Social Security payout (your benefits grow by 8% annually from your normal retirement age to when you elect to receive benefits (up to age 70)). Our observations are corroborated by the findings of the Employee Benefit Research Institute (EBRI), which reports *that more than one out of four workers now plans to work until 70 or beyond*. This figure represents a 16% increase from the pre-crisis days of 2007. Just 8% of workers now expect to retire before age 60, down from 17% in 2007.

Retirement Reality: Working longer appears to be the best option for many workers. However you may not have as much control over this option as you think. According to Eleanor Laise, an associate editor for Kiplinger's Retirement Report, *"There is a jarring disconnect between workers' expectations and retirement reality"*. In her article *"Don't Count on Working"*, published in the September 2012 issue of Kiplinger's Magazine she reports that "Fully half of the retirees surveyed by EBRI this year said that they left the workforce earlier than planned, and just 8% of them said that positive factors—such as the ability to afford early retirement--prompted the move. For the vast majority of retirees, negative circumstances, such as the company downsizing, played a role." Physical health is also a factor. According to research from the consulting firm Towers Watson, cited in the same Kiplinger's article, "…*health problems or disability were cited by more than half of retirees forced to retire earlier than planned"*. Thus even if you love what you do, unfortunate circumstances such as company downsizing or health problems may interfere with your plan to continue working.

Clearly, those planning to work longer are taking a big risk. As investment managers and financial planners we know that risk is an unavoidable part of any financial decision, so we encourage our clients to plan and to take only *calculated* risks. We encourage you to have us prepare a Retirement Analysis for you. Using software called MoneyGuidePro, we ask you to quantify and prioritize goals. We input your assets and liabilities from your current Net Worth Analysis along with these retirement goals. Then based on what are hopefully conservative assumptions about rates of return on various asset classes, annual inflation, as well as historical data regarding stock market volatility, the program calculates the probability of success for your retirement. If the probability is not comfortably high enough, then specific recommendations are made to save more now, spend less in retirement and/or to work longer. This is as close as we can come to predicting the future without resorting to the crystal ball. We encourage our clients to have us prepare the Retirement Analysis and to keep it as a working document, updating it periodically to reflect the changes in their situation.

We also encourage our clients to exercise regularly, as good health is a key to enjoying the golden years (as well as to enable you to work longer if necessary).

Sincerely,

Stephen P McCarthy, CPA, CFP®