McCarthy Asset Management, Inc.

Registered Investment Advisor

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Monthly Investment Commentary- May 2012

Stock Market Performance for May: May was a difficult month for the stock market. Unadjusted for dividends, the S & P 500 fell 6.3%, NASDAQ dropped 7.2%, the Russell 2000 slipped 6.7%, and the international equity index MSCI EAFE shed 15.0%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 0.9% for the month.

MAM May Performance: MAM portfolios slightly outperformed the S & P 500 for the month. Excluding the "very conservative" portfolios (which fell 1.7%), MAM portfolios fell 4.4% (after all fees), versus a drop of 6.0% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Year-To-Date Performance: For the first five months of 2012, unadjusted for dividends, the S & P 500 rose 4.2%, the NASDAQ climbed 8.5%, the Russell 2000 rose 2.8%, and the international equity index MSCI EAFE fell 5.6%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 2.3% for the year-to-date. Excluding the "very conservative" portfolios (which rose 2.5%), MAM portfolios rose 2.1% (after all fees), versus a rise of 5.1% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

What Is Ailing The Stock Market?

After a strong start for the year, the stock market stumbled badly in May. The primary cause was continued financial stress in the Eurozone, especially in Greece and Spain. Furthermore, recent reports (particularly the monthly Jobs report) points to a slowdown in growth in the U.S.

Worsening Crisis in the Eurozone: At present, the focus of the European debt crisis is on Greece, particularly the upcoming June 17th election which looks to be a referendum on whether Greece will remain part of the Eurozone. The election of the anti-austerity party (i.e. Syriza) could trigger a Greek default. This does not necessarily mean Greece would leave the Eurozone and in fact polls show the Greeks overwhelmingly want to remain in the monetary union. As I have said before, though, because their fiscal situation is so dire (the unemployment rate continues to climb and is now nearly 22%), it is probably just a matter of time before Greece leaves the Eurozone. In the long run, it may be for the best. This will allow the Greeks to devalue their currency to make their exports (primarily tourism) more competitive.

A greater concern is that a Greek default could spark a run on Greek banks that could potentially spread to Portugal, Spain and Italy. If such a run on banks were to occur, it is likely that the policymakers would quickly try to stop bank runs outside of Greece. In particular, the European Central Bank (ECB) has enough firepower to suppress any crisis, but so far has been loath to do so because it does not want to benefit countries that have not made a serious attempt to stem their deficits. Eurozone countries still have sovereignty, so it may take a crisis to get them to act. This is one reason why the ECB and other policymakers refrained from setting up a permanent "firewall" to fight the crisis like the U.S. Federal Reserve and U.S. Treasury did to stem the U.S. financial crisis in 2008 and 2009.

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The stock market hates uncertainty, and there's a lot of it in Europe right now. The uncertainty, combined with contagion fears, is pressuring European economic growth. Additionally, the Eurozone is large and intricately linked to other economies through trade and the banking system. In the United States, where total exports represent only 14% of GDP, we may be slightly more insulated from the effects of the Eurozone debt crisis—but future profits of U.S. exporters could be reduced nonetheless.

Slowdown in U.S. Growth: Making matters worse for investors, U.S. job growth slowed sharply in May, a sign of a sputtering recovery that may increase pressure on the Federal Reserve to prop up the economy. Nonfarm payrolls grew by a lackluster 69,000 last month, the Labor Department reported today, the smallest gain in a year. The unemployment rate ticked higher by one-tenth of a percentage point to 8.2%, the first increase since June 2011. Economists had forecasted a gain of 155,000 in payrolls and for the jobless rate to remain at 8.1%.

Compounding an already weak report, March and April payroll gains were revised down by a combined 49,000. Nonfarm payrolls increased by 77,000 in April and 143,000 in March. The unemployment rate has fallen sharply since August, when it was 9.1%. But even though companies are hiring, the pace of job creation remains well below figures at the start of 2012. The economy added an average of 226,000 jobs a month in the first quarter.

The disappointing May jobs report is likely to renew focus on the Fed's measures to help the recovery, with a possible announcement of the third phase of "Quantitative Easing".

Semiannual Portfolio Repositioning To Be Done In June

The stock market has come a long way in the past 39 months. Since the current cyclical bull market began in March of 2009, the S & P 500 has gained 94% excluding dividends, through May 31st. Over the past eight months, the S & P 500 Index has gained 20% on a total return basis. As I have discussed before, short-term corrections are a normal part of the cyclical bull market activity as they allow for both profit-taking and the orderly consolidation of market gains. In my view, the May drop in the market is part of a healthy (but painful) short-term correction.

This month we will be doing repositioning to portfolios. At this point, while I don't plan to make any significant adjustments, I am leaning toward getting a little more conservative in light of the elevated risks from Europe. In particular, I expect we will further reduce international stock and bond exposure and add to some of the defensive mutual funds. This is not an easy decision. International stock exposure in portfolios is already the lowest it has been in over seven years. Furthermore, international stocks are very reasonably priced relative to U.S. stocks. For instance European equities overall average dividend yield of 4% is nearly double the S & P 500 dividend yield and trade at an earnings multiple near a 30-year low of close to 10 times annual earnings. Nonetheless, the international stock exposure has hurt MAM's relative performance this year and the elevated risks in Europe lead me to believe that the prudent move for now is to further reduce exposure. I am not looking to make any dramatic changes, though, as stock market valuations are reasonable and with the 10-year Treasury selling at a 60-year low, stocks are particularly compelling relative to bonds. Furthermore, I think it is likely that growth in the U.S. economy will improve as the year progresses.

Please let me know if there is anything you want me to consider when I adjust your portfolio(s).

2012 FPA NorCal Conference

On Tuesday and Wednesday of this week, Alexey and I attended the Financial Planning Association's Northern California annual conference. The conference, which was held at the Palace Hotel in San Francisco, is known to be the best regional financial planning conference in the country. This year's sold-out event was not a disappointment for the 650 financial planners in attendance. Among the useful sessions that I attended included one on "safe withdrawal rates" for retirees living off their portfolios and the "new retirement—career planning for boomers" (see below for a further discussion). The following are two items that I learned at the conference that I hope to implement at MAM, Inc.:

1. Tracking a Systematic Withdrawal Program: Nationally renowned financial planner Norman Boone of Mosaic Financial Partners presented how his firm tracks the portfolio withdrawals for retired clients to ensure that they stay within the "safe withdrawal rate". I have asked Norm for a copy of his firm's Excel template for doing so. If and when I receive that, I will ask Alexey to implement it for our retired clients who are living off their portfolio(s).

2. The Wealth Management Index: Ross Levin of Accredited Investors, another nationally renowned financial planner led a session regarding his "Wealth Management Index", which is an innovative tool for financial advisors to quantify their clients' success in achieving financial planning. I have ordered Ross Levin's book The Wealth Management Index: The Financial Advisor's System for Assessing & Managing Your Client's Plans and Goals. I plan to see how to utilize this Index in conjunction with our existing financial planning tools (The Net Worth Analysis and Retirement Analysis and The Long Term Care Plans developed by Allen Hamm) as well coordinate the estate planning and insurance planning that our clients have done.

New Retirement- Career Planning for Boomers: John Nelson is a speaker and coach for "life stage planning". He is co-author of What Color Is Your Parachute? For Retirement. He wrote the book along with Richard Bolles, the author of the world's most popular career guide What Color Is Your Parachute? As John writes on his website (http://johnenelson.com/About.html) "Now when people retire, they're relatively healthy, will probably live a long time, and want to be pretty active. They may want to—or need to—keep working on some basis. Even more importantly, they need to make as many decisions during retirement, as they did to get ready for it. Some of the decisions are financial—but most of them are not. A few of these decisions have very high stakes, and can be irreversible." John has spent the last five years at the University of Wisconsin-Madison (where he is obtaining a PhD in Continuing and Vocation Education). His focus is on how adults plan for the next stage of life to ensure for Prosperity, Health and Happiness. The end result of his efforts is what he calls "The Well Being Model".

I was impressed with John's workshop. While I haven't read his book, reader reviews are very positive. If you are interested in better preparing for the non-financial aspects of your retirement, I recommend that you read What Color Is Your Parachute? For Retirement.

Please call or email me if you have any questions or would like to discuss your portfolio(s) or any other financial matters.

Sincerely,

Stephen P. McCarthy, CPA, CFP®