McCarthy Asset Management, Inc.
Personalized Wealth Management

October 2019 Monthly Commentary

Nov. 1, 2019

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Stock Market & Portfolio Performance

October 2019: U.S. and international stocks had another good month with small cap U.S. and international stocks outperforming U.S. large cap stocks for a change. Bonds posted modest gains for the month.

	Oct 2019	YTD 2019	Description:
Without Dividends:			
S&P 500	2.0%	21.2%	500 Largest Public U.S. Companies
Russell 2000	2.6%	15.9%	2000 of the smallest U.S. stocks
MSCI EAFE	3.5%	13.7%	international stock index
U.S. Aggr Bond	0.3%	8.9%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.5%	13.4%	non-very conservative MAM portfolios
MAM Conserv	1.0%	10.6%	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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Recession Outlook; Minor Portfolio Adjustments Planned for November

After a very strong performance for the first seven months of 2019, stock prices have been relatively flat the last few months, primarily due to concerns about U.S.-China trade tensions and slowing global growth. Nonetheless, the U.S. economy continues its moderate, but steady, growth. This is important because history demonstrates that the primary cause of a bear market is a recession.

To gauge the risk of a recession, the October 2019 issue of Bob Brinker's Marketimer provided an update to its five pre-recession indicators:

1. **Accelerating Inflation:** "The year-over-year rate of inflation, as measured by the consumer price index (CPI), now stands at a moderate rate of 1.7%. Low inflation is a key factor in allowing the Federal Reserve to maintain an accommodative monetary policy stance." This points to a lower likelihood of a pending recession.

2. **Payroll Growth:** "The ongoing low level of initial claims for unemployment insurance, coupled with the healthy flow of new jobs, support our view that the economy can move forward despite the trade dispute with China." This is also a positive factor.

3. **Rising Unemployment Claims:** "Claims are helpful in measuring the health of the labor market as they track layoff activity and a rising trend can serve as an indicator of future economic weakness…The trend of initial unemployment claims has been favorable in recent years and the key four-week moving average remains near its 50-year low."

4. **Inverted Yield Curve:** "During the latter stages of money tightening cycles, the yield curve tends to invert, as short-term rates exceed long-term rates...Each of the seven recessions in the past half-century has been preceded by a yield curve inversion." While the yield curve did invert this summer, more recently it has flattened out, as the 10-year treasury rose and the Fed cut short-term rates. Furthermore, historically, stocks continued to rise for an additional 18 months after the inversion first occurred. Finally, not all yield curve inversions have preceded a recession (i.e. there can be false alarms).

5. **Leading Economic Index (LEI):** "Although the LEI continues to suggest modest economic growth, the pace of expansion has waned under the pressure of the weak manufacturing sector and the United States-China trade war…The sooner the trade war is resolved, the better for the U.S. economy. While we regard the potential for a recession in the 2020-2021 timeframe possible, we will rely on our pre-recession indicators as we look for evidence of further deterioration in the economic outlook."

<u>**MAM Outlook and November Portfolio Adjustments:**</u> Our primary focus in determining when to increase the downside protection in portfolios is the timing of the next U.S. economic recession. **Historically, the worst performance for the stock market is the four to six months leading up to the start of a recession. We still feel the U.S. economy is unlikely to enter a recession within the next 12 months. Nonetheless, during our semi-annual repositioning this month, we plan to make modest adjustments to most portfolios by shifting 2% to 3% of the equity allocation to bonds. We are making this minor adjustment in light of the continuing trade war with China, the global economic slowdown, and uncertainty as we approach the 2020 presidential election. Furthermore, given that the bull market is in its 10th year, it seems prudent to get a little more conservative at this time.**

Please let me know if you would like to discuss any adjustments to make to your portfolios.

Charles Schwab Reduces Commissions to $0 for Online Trades

Effective October 7, 2019, Charles Schwab & Co. lowered the commission rates for online equity and ETF trades to $0, down from $4.95. Within a few days of the announcement, TD Ameritrade, Fidelity and E*Trade all said their online trade commissions were also being reduced to $0.

As a result of the elimination of transactions fees, MAM will continue to shift a greater portion of portfolios from mutual funds to exchange traded funds (ETFs). Relative to mutual funds, ETFs provide the benefit of lower operating expenses and tax efficiency. Because most ETFs are passively managed, however, we do have concerns about how well ETFs will perform in the next bear market. Unlike a passively managed fund, actively managed ones don't have to stay fully invested. As such, we expect well-managed funds, such as T. Rowe Price Capital Appreciation and the Yacktman Fund, to outperform ETFs during the next downturn.

California Enacts New Individual Health Care Mandate

This summer, California enacted its own individual mandate for health insurance. The new law, which takes effect on January 1, 2020, requires California residents to maintain monthly health insurance coverage, or else be subject to penalties. The legislative action came in the wake of the federal government's decision to eliminate the individual tax penalty from the Affordable Care Act (ACA). The CA bill also provides subsidies to keep the insurance "affordable." Unlike the ACA, there are no employer penalties for failure to provide health insurance.

Penalties: The new law imposes a penalty on California residents who fail to obtain "minimum essential health care coverage". The penalty is equal to the greater of 2.5% of salary or $695 per adult and $347.50 per child, or up to $2,085 per family. The new law provides for some exemptions from the penalties.

Subsidies: Similar to the ACA, California's program will provide financial assistance to lower-income residents for paying their premiums. California's subsidy program is more expansive, however, in that federal law provides assistance to individuals and families with incomes at or below 400% of the federal poverty level, whereas California will be providing subsidies to CA residents at or below 600% of the federal poverty level (see chart below). The subsidies may be paid in advance and will be paid directly to the health insurance plan. While the subsidies will not be included in the individual's gross income for CA income tax purposes, it does not appear that there is any exclusion that would apply for federal tax purposes.

600% of Federal Poverty Level for 2020	
Household size	**Amount**
1	$74,940
2	$101,460
3	$127,980
4	$154,500
More	Add $26,520 for each additional household member

The open enrollment period to sign up for health care coverage with Covered California runs from October 15, 2019 through January 15, 2020. For more information about health insurance options and financial assistance, visit CoveredCA.com.

Sincerely,

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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

Year-End Tax Planning: For those of you who are tax clients, please let us know if you would like to have us do any tax planning, such as determining the amount of 4th quarter estimated payments or making a Roth IRA conversion.