McCarthy Asset Management, Inc.

Personalized Wealth Management

Sept. 2017 Monthly Commentary/Q3 Qtr Letter

Oct. 2, 2017

Stock Market & Portfolio Performance

Third Quarter 2017: U.S. and international stocks posted strong returns for both the third quarter and first nine months of 2017. Meanwhile, bonds were up modestly.

	3rd Qtr	YTD 2017	Description:
Without Dividends:			
S&P 500	3.9%	12.5%	500 Largest Public U.S. Companies
Russell 2000	5.4%	9.9%	2000 of the smallest U.S. stocks
MSCI EAFE	4.8%	17.2%	international stock index
U.S. Aggr Bond	0.9%	3.1%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	3.0%	10.7%	non-very conservative MAM portfolios
MAM Conserv	2.2%	6.5%	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.

Inside this issue:

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Will There Be Tax Reform This Year?

On September 19th, U.S. Senate Republicans agreed to move forward on a budget deal to reduce income taxes by $1.5 trillion over the next ten years. The Republican lawmakers are under pressure to score a legislative win after their efforts to repeal Obamacare failed. Some details of the tax cut plan are expected to be released by Republican Senators over the next couple of weeks.

Personally, I question the wisdom of passing massive tax cuts this late in the economic cycle as the economy has experienced growth for the last eight years. More typically, tax cuts of this magnitude are done in times of economic hardship when the economy is either stagnant or in a recession. With the Federal Reserve already on the path of gradual interest rate increases, economic stimulus from large tax cuts may force it to accelerate its rate increases which could trigger the next recession.

Furthermore, financing tax cuts through deficit spending essentially means the government will borrow money to pay for tax reductions, rather than finding spending cuts to make up for the lost revenue. Such a move would add to an already-hefty debt load of $20 trillion which is expected to grow another $10 trillion over the next ten years due to the aging U.S. population. The Congressional Budget Office estimates that within 10 years, the federal debt will rise to its highest percentage of gross domestic product since just after World War II.

I think it is questionable whether any significant individual tax cuts will get enacted this year. Democrats are already on record of being in support of tax reform as long as it doesn't reduce taxes for the wealthy or add to the Federal deficit. Some House Republicans who are fiscal hawks may also be resistant to tax cuts that raise the Federal deficit.

Corporate Tax Reform is the Most Likely to Happen: Unlike individual tax reform, corporate tax reform is one of the few issues that attracts bipartisan support. Both Democrats and Republicans agree that the current system is deeply flawed. Per a recent Wall Street Journal editorial article by Laura Tyson, former head of the Clinton Administration's Council of Economic Advisers, "U.S. corporations face the highest corporate tax rate in the developed world—38.9% on average, including state taxes—and a system of taxation that follows them wherever they go. This puts U.S. companies at a disadvantage in global markets and discourages investment, innovation and job creation back home."

Current law allows U.S. multinationals to defer U.S. tax payments on foreign earnings until they are repatriated back to the U.S. Most American companies take advantage of this option and an estimated $2.6 trillion of U.S. companies' foreign earnings are now trapped abroad. This is money that might otherwise be used to finance investment, job creation and domestic growth. Tyson wrote "the competitive dynamics of the global economy were different in 1986, when the U.S. last reformed its corporate tax code. It is time for comprehensive reform that reduces the corporate rate, broadens the tax base, simplifies the system, and adopts a modern territorial approach with safeguards to protect the U.S. tax base. Lawmakers on both sides should work together to craft reforms that will benefit America's workers, companies and economy."

In summary: While the outlook for individual tax cuts is still highly uncertain, I think some form of corporate tax reform will pass either in 2017 or 2018 that will likely benefit the U.S. economy and investors.

Fed to Unwind Crisis-Era Stimulus

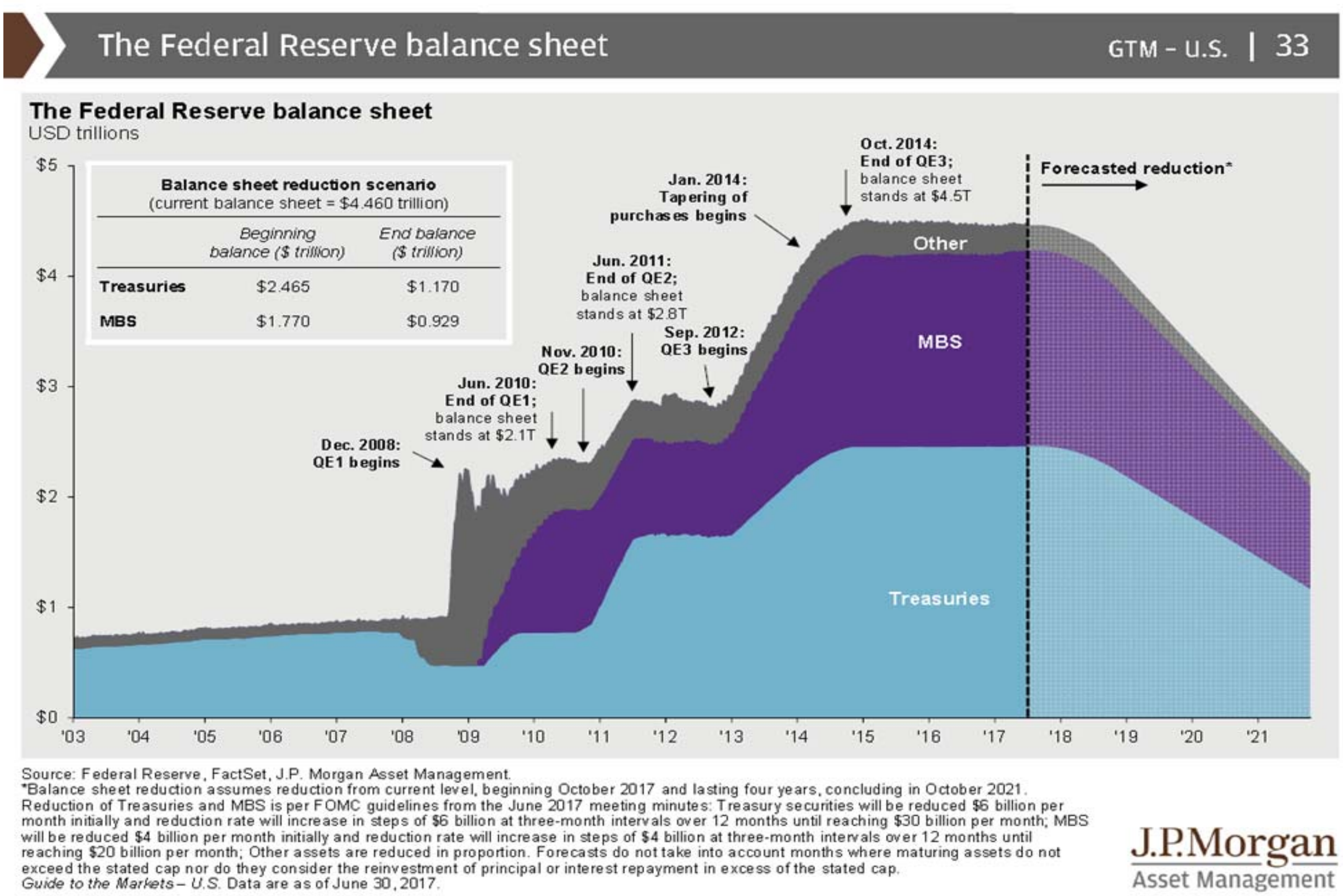
The Federal Reserve held its most recent policy meeting in September. The outcome of the meeting was largely as expected:

- It left its benchmark interest rate ("the Federal Funds rate") unchanged, but indicated that it is leaning toward one more 0.25% increase later this year.

- It announced that in October it will start shrinking its $4.5 trillion balance sheet.

<u>Unwinding the Fed's Balance Sheet:</u> As discussed in our June 2017 Monthly Commentary, beginning in late 2008, the Federal Reserve began large-scale purchases of U.S. treasuries and mortgage-backed securities (MBS) to prevent the collapse of the U.S. financial system. During this time, the Fed's balance sheet grew significantly from $869 billion on August 8, 2007, to nearly $4.5 trillion today. This program, known as "quantitative easing", was intended to spur an economic recovery from the financial crisis. It appears to have worked as the economy has been on a slow, but stable growth path since the program was initiated.

Beginning in October, the Fed will end its practice of fully reinvesting the principal payments of maturing bonds into new bonds. Instead, each month it plans to allow $10 billion in holdings to roll off without reinvestment. The amount will increase by $10 billion each quarter to a maximum of $50 billion. Below is a chart from J.P. Morgan that displays the dramatic growth in the Fed's balance sheet in response to the financial crisis and the forecasted reduction in the balance sheet through 2022:



Fed to Unwind Crisis-Era Stimulus– Con't

Investment Implications: At least for now, we don't expect there to be significant investment implications from the Fed's efforts to unwind its balance sheet other than a likely increase in mortgage rates. We view this as a positive move, though, because it will rebuild a tool the Fed will have at its disposal to utilize during the next economic downturn.

Meanwhile, as discussed in our June 2017 article, we will be monitoring the risk of an "inverted yield curve," which is when short-term interest rates climb above long-term rates. Historically, an "inverted yield curve" is an excellent predictor of the onset of a recession.

The Equifax Data Breach and What to Do About It

As discussed in the email I sent to clients on September 11th, last month Equifax reported a massive data breach affecting 143 million U.S. consumers. The hack exposed critical pieces of information that can be used by identity thieves to impersonate people and conduct fraud, including: names, Social Security numbers, addresses, and birth dates. In addition, Equifax said the hackers stole credit card numbers for 209,000 people and gained access to driver's license numbers for a yet-to-be-determined number of Americans. This is probably the most consequential data breach in history, considering that nearly all U.S. adults have their credit histories on file with Equifax and the other two credit bureaus, Experian and TransUnion.

The four pieces of information exposed in the attack are generally needed for consumers to apply for many forms of consumer credit, including credit cards and personal loans. If you find out your information was hacked, our recommendation is to place a freeze on your credit. Here are various steps to consider:

Determine if Your Information Was Hacked: You can see if you were a victim of Equifax's hack by visiting equifaxsecurity2017.com/potential-impact/ and entering your last name and the last six digits of your Social Security number. Be sure to also check this for your spouse and any children who may have established credit.

Freeze Your Credit: The single most effective action potential victims can take now is to freeze their credit. A credit freeze does not impact your credit score. What it does is restrict access to your credit report, which in turn makes it more difficult for fraudsters to open new accounts in your name. Lenders need to see your credit report prior to extending credit or approving a new loan. While freezing your credit can be a hassle because you will need to unfreeze it every time there is a need to run a credit check on you—it will prevent someone from taking out new credit in your name. A credit freeze locks your credit file at each bureau with a special PIN that only you know. The PIN must be used in order for anyone to access your credit file, or add new credit in your name. **Be sure to save your PINs in a safe place.**

To set up a security freeze, you must contact all three bureaus individually. This process can be done online or over the phone. You will be asked some questions to confirm your identity, but it only takes a few minutes. Depending on your state of residence, freezing your credit can cost anywhere from $0 to $10 at each bureau. I have heard from a number of clients who have taken this action. While some were able to do so easily, others were asked to mail additional information to one or more of the credit bureaus to complete the freeze.

The Equifax Data Breach and What to Do About it– Con't

You can freeze your credit by using the following phone numbers or links:

- **Experian**: 888-397-3742
  Freeze your credit
- **TransUnion**: 888-909-8872
  Freeze your credit
- **Equifax**: 866-349-5191
  Freeze your credit

To lift your freeze, simply contact the bureau used by the lender and provide your PIN to remove the freeze for a certain period of time. This can also be done online or over the phone. It may take a few days for the freeze to be lifted, so be sure to do it a few days in advance of when needed. Note that if you are job hunting, it is possible a prospective employer will want to run a credit check on you. In this case, I recommend holding off on placing the credit freeze until you have completed your job search.

Place a Fraud Alert: As an alternative to placing a freeze on your credit, a simpler but less protective measure is to place a fraud alert on your credit report. You do this by contacting one of the credit reporting agencies and requesting an initial fraud alert be placed on your credit report. They will then contact the other two agencies about the fraud alert. While placing the fraud alert is free, it is effective for only 90 days. It can then be renewed every 90 days.

The purpose of placing a fraud alert is to warn new creditors that you may be a victim of identity theft. In doing so, you reduce the risk of an identity thief opening credit in your name. Furthermore, those with a fraud alert will receive notification whenever there is an attempt to check on their credit history. Personally, at least for now, I have opted for the credit freeze rather than placing a fraud alert because I feel a freeze provides greater protection.

Sign Up for Credit Monitoring: The purpose of a credit monitoring service is for consumers to have their credit monitored for suspicious activity. IdentityGuard and LifeLock are examples of these services. These companies are supposed to alert consumers to credit inquiries, new credit lines and other important changes to one's credit file. Recently, one tech-savvy MAM client, who has utilized LifeLock for a number of years, told me that he has been pleased with the service. I just recently signed up for the most basic plan from LifeLock to see if I find the service beneficial and to share my experience with clients.

Regularly Monitor Your Financial Accounts: Even if your data was not breached, we think it is a good idea to regularly monitor your credit cards and bank accounts. Be certain to report any unusual or suspicious activity to the financial institution.

Please let me know if you have any questions or comments regarding any of this.

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

Please let us know if you would like us to show you how to access the information that is available on your MAM portal.