McCarthy Asset Management, Inc.
Personalized Wealth Management

December 2022 Monthly Commentary/4th Quarter Letter

Jan. 3, 2022

Stock Market & Portfolio Performance

Inside this issue:

Fourth Quarter 2022: U.S. stocks posted a partial recovery in the fourth quarter, ending a very challenging year. International stocks staged a nice rebound for the quarter. Could this be the start of international stocks outperforming U.S. stocks? Bond prices rose moderately for the quarter, ending one of the worst years in history for the bond market.

	4th Qtr	FY 2022	Description:
Without Dividends:			
S&P 500	7.1%	-19.4%	500 Largest Public U.S. Companies
Russell 2000	5.8%	-21.6%	2000 of the smallest U.S. stocks
MSCI EAFE	17.0%	-16.8%	international stock index
U.S. Aggr Bond	1.6%	-13.0%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	7.2%	-14.0%	non-very conservative MAM portfolios
MAM Consrv	5.0%	-11.3%	portfolios with 45%+ 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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2023 Economic and Market Outlook

2022 was a very challenging year for investors. Many stocks experienced a bear market, while bonds had one of their worst years ever. The combination of both stocks and bonds performing poorly was unusual, as normally, bond prices cushion portfolio losses when stock prices are falling. Most investments suffered losses in 2022 due to the surge in inflation, which led the Federal Reserve to aggressively raise short-term interest rates. I have discussed the monthly inflation reports and the actions of the Federal Reserve in many of our 2022 Monthly Commentaries. Here is the latest update.

More Good News on Inflation: Consumer prices rose in November at their slowest 12-month pace since December 2021, closing out a year in which inflation hit the highest level in four decades and challenged the Federal Reserve's ability to keep the U.S. economy on track. The Labor Department reported its consumer-price index climbed 7.1% in November from a year ago, down sharply from 7.7% in October. This continued a trend of moderating price increases since June's 9.1% peak, but remained well above the Fed's 2.0% target. Core CPI, which excludes volatile energy and food prices, rose 6% in November from a year ago, easing from a 6.3% gain in October. September's 6.6% increase was the biggest jump since August 1982.

Inflationary pressures have been a headwind for the financial markets, so the recent reports showing a declining trend in prices is encouraging. Moderating inflation may slow—or even pause—Federal Reserve interest rate hikes in the near term.

Interest Rate Hikes: The Fed wrapped up its last Federal Open Market Committee (FOMC) meeting of the year in December. As expected, the FOMC raised the fed funds rate by 50 basis points to a range of 4.25% to 4.50%, the highest in over a decade. It represented the first decrease in the pace of rate hikes from the prior four consecutive 75-basis point hikes. The 4.25% of cumulative rate increases in 2022 was the most in any year since 1980.

At the conclusion of its December meeting, the Fed predicted another cumulative 75-basis point in rate increases next year. Fed officials are thus signaling they believe inflation is still too high and aren't backing off their aggressive battle to subdue it despite growing recession risks. Regarding the recent CPI reports showing inflation easing in October and November, Fed Chair Powell said the reports were "welcome", but that "it will take substantially more evidence to provide confidence that inflation is on a sustained downward path."

2023 Economic Outlook: As we turn to 2023, the story for the U.S. economy will likely shift focus from inflationary concerns to potential stresses in the broader economy and labor market. In particular, the Fed's dramatic series of rate increases in 2022 is very likely to slow the economy in 2023. What is unclear is whether they will be enough to tip the U.S. economy into a recession. After its December meeting, the Fed said it expects the U.S. economy to grow 0.50% this year, and the same feeble pace in 2023, below its previous forecast of 1.2% growth for 2023. Most economists forecast a mild recession next year, according to those surveyed recently by Walters Kluwer Blue Chip Economic Indicators. Meanwhile, the Fed projects the current 3.7% unemployment rate to rise to 4.6% by the end of next year. Historically, an increase of this magnitude in one year has coincided with a recession.

The Current Bear Market: The S&P 500 has been in a bear market since the early summer. A bear market is a decline of 20% or more from the previous peak of that index (in this case, the S&P 500). This bear market has been driven by the large Fed interest rate hikes this year. Historically, this type of bear market does not typically end until earnings estimates reach a bottom, triggered by the Fed reverting to cutting interest rates to revive the economic growth. Earnings estimates for stocks of the S& P 500 in the fourth quarter of 2022 have been falling, with analysts now projecting flat earnings relative to the 4th quarter of 2021. If the U.S. economy experiences a recession in 2023, it is likely 2023 earnings will be below 2022 earnings.

MAM Comments: We expect inflation will continue to drop as we move through 2023. It is also likely that the Fed will stop raising rates at some point in 2023. What is unclear, is whether the U.S. economy enters into a recession in 2023. If it does, we expect it will be a shallow one with an accompanying decline in corporate earnings. Given this uncertainty, for now, we are continuing to be cautious with portfolio positioning.

It is likely at some point in 2023 we will become more optimistic. This will either be because the U.S. avoids a recession, or the Fed starts to cut interest rates as the U.S. experiences a shallow recession. Meanwhile, we expect portfolio returns to improve over the next year or two. Stocks are now more reasonably priced, and within a year or two, the U.S. economy should return to solid economic growth. Furthermore, after one of the worst years in history, bonds will perform much better in 2023. The bulk of the interest rate increases have already occurred, and bond yields, which historically account for 90% of bond returns, are much higher than a year ago. For instance, high qualify corporate bonds are now yielding over 5%, compared to less than 2% at the beginning of 2022.

Planning for Long-Term Care

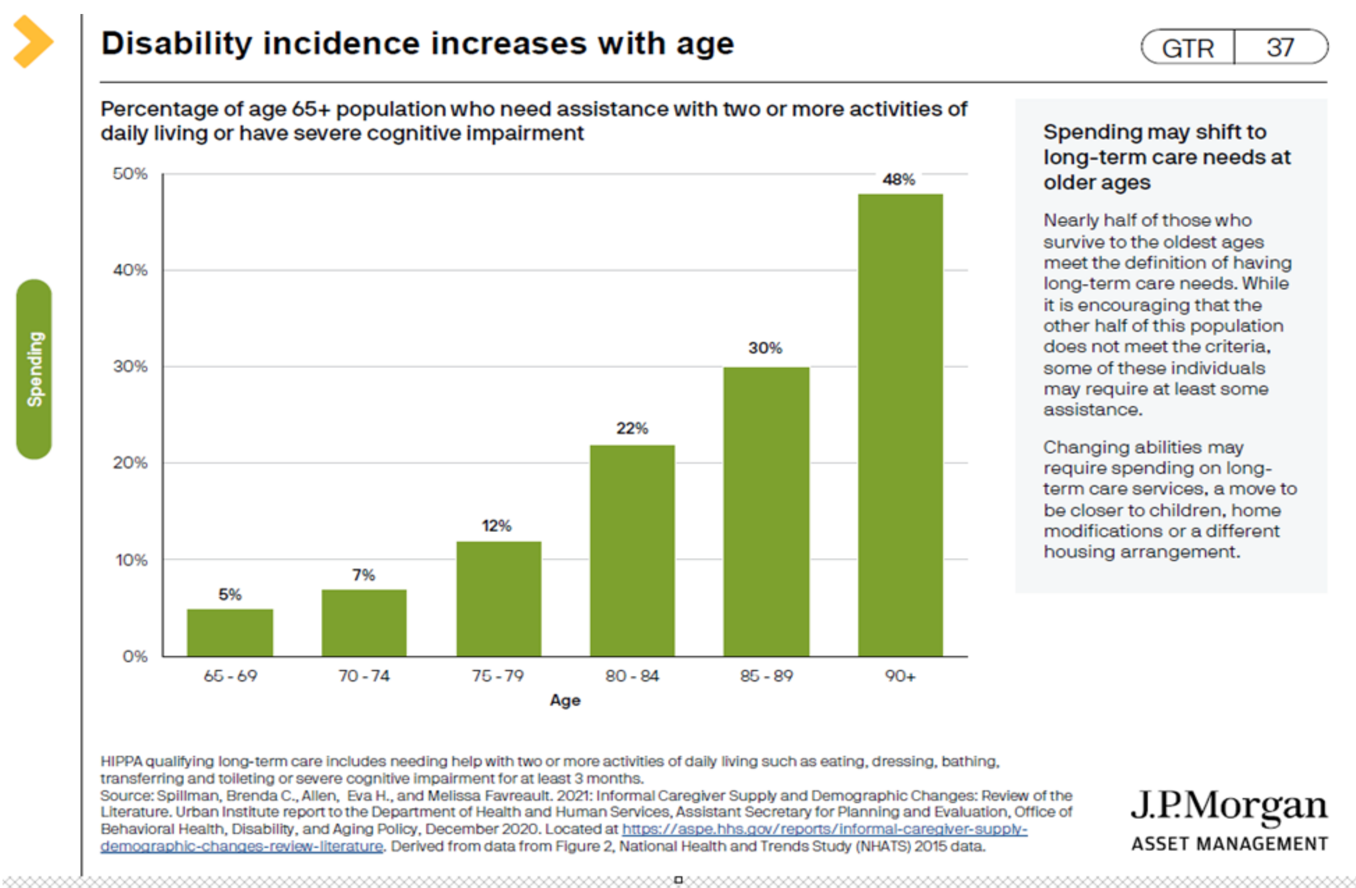
An important consideration in planning for a financially-comfortable retirement is the potential need for long-term care. More than two-thirds of 65-year-olds will need some type of long-term care in their lifetime, according to the Administration for Community Living, a division of the U.S. Department of Health and Human Services. The cost of long-term care can deplete even a well-funded retirement savings plan. “Long-term care” refers to a variety of services that help meet both the medical and non-medical needs of people with a chronic illness or disability who cannot care for themselves for long periods.

Many older Americans have done little to no planning for their own long-term-care needs. Part of the reason for this may be the misconception that Medicare will cover the cost of long-term care. In a consumer sentiment survey conducted by Genworth, two-thirds of respondents said they expect government programs to cover all or part of their long-term-care costs. While Medicaid is the largest single payer of long-term-care costs in the United States, it requires that people exhaust their assets to qualify for benefits.

We recommend clients create a long-term-care action plan as part of their retirement plan. We have engaged the services of long-term care expert Allen Hamm to create a Long-Term Care Plan for MAM clients who are interested. This is discussed in further detail below. If you want to create your own Plan, here are suggested action steps:

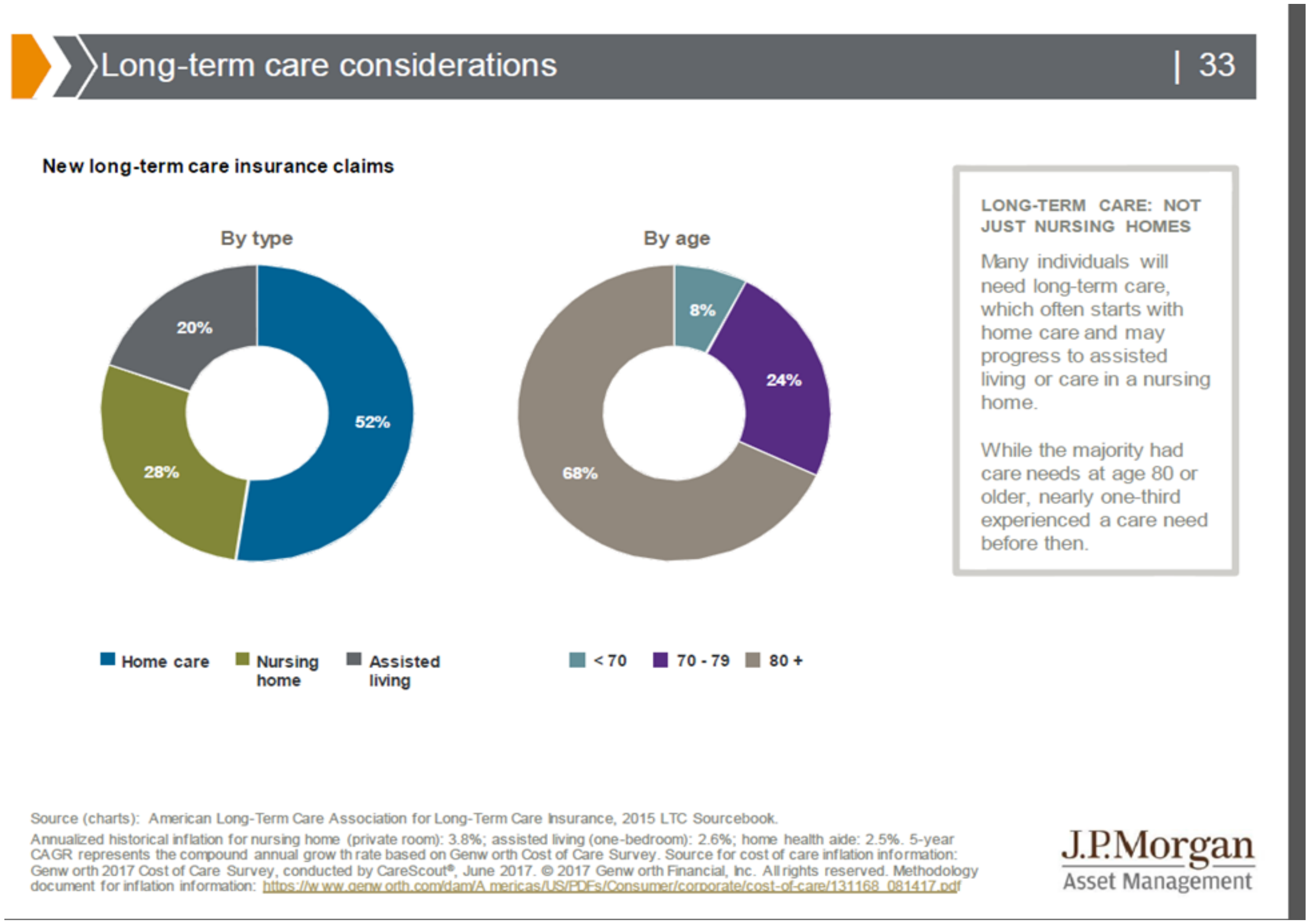
Step 1: Gauge the likelihood of needing care.

As can be seen in the chart below, the longer you live, the greater the likelihood of your need for long-term care:



The following charts from J.P. Morgan illustrate the most common type of care being provided (home care) in 2015, and the age when care was first provided (age 80 or later for 68% of those needing care):

Planning for Long-Term Care– Con't



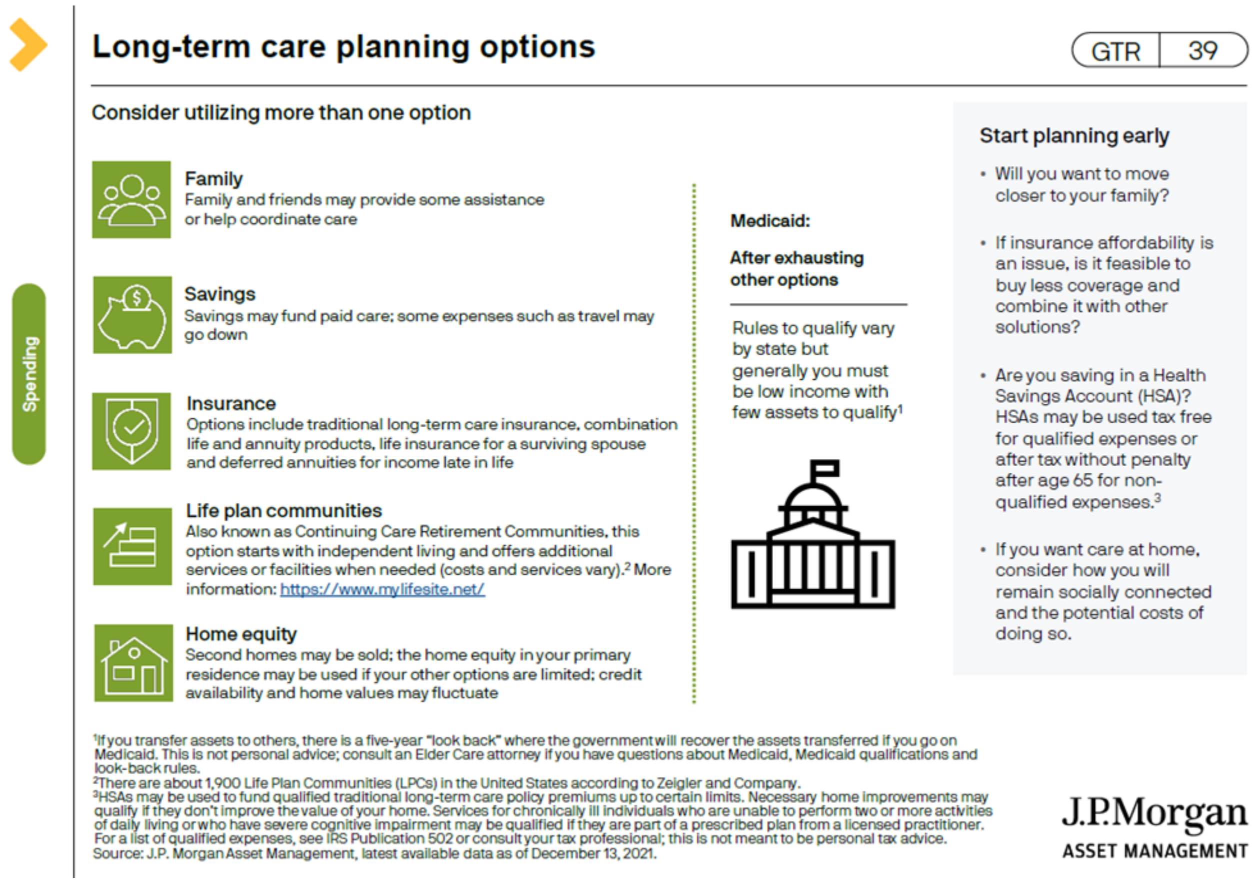
<u>Step 2: Estimate the Cost of Long-Term Care:</u> Genworth's annual Cost of Care survey enables you to estimate the cost of care in the community where you are likely to receive care. The data varies about average duration of care, but most of the statistics cover a range of 2.0 to 2.5 years.

Most people would prefer to receive care in their homes. Hiring in-home care may be cheaper than receiving care in a facility. However, it's important to remember that other household expenses, such as housing and food-related costs, would continue with in-home care, whereas they would be included in the cost of care received in a facility.

<u>Step 3: Assess Your Available Resources:</u> Are your assets and retirement income sufficient to cover your ongoing living expenses plus your projected long-term care costs? The Retirement Analysis that we prepare for clients can help gauge whether you will have sufficient resources to cover long-term care costs. Typically, we run the Retirement Analysis to age 95. If and when long-term care is needed, a good portion of "retirement living expenses" and some portion of healthcare expenses can be allocated toward long-term care costs. If it looks like you will not be able to cover your long-term care costs, long-term care insurance may be advisable.

Planning for Long-Term Care– Con't

The following chart from J.P. Morgan illustrates the various options to cover long-term care. For some, a combination of options, such as care from a family member combined with paid care, may be best.



<u>Long-Term Care Insurance:</u> Long-term care insurance can be an important way to cover part or all of long-term care costs. These policies aren't cheap, though, and insurance companies have been raising premiums dramatically the last few years. One way to determine who is a good candidate to purchase long-term care insurance is based on your level of investable assets:

- Those with sufficient assets (perhaps $3 million or more in invested assets) may be able to forego taking out a policy and self-insure the risk.
- People with limited assets shouldn't purchase long-term-care coverage if the premiums are not affordable. If they incur a lengthy need for long-term care, they are likely to deplete their assets and then have Medicaid cover the cost.
- Many people fall somewhere in the middle. They should be able to spend a certain amount of their personal savings on long-term care, but could also benefit from a more limited policy to cover the remainder.

If you decide to buy a policy, doing so while you are still in your early 60's will make it more affordable. In addition, buying while still in good health has become more important as insurers have tightened underwriting standards.

<u>Traditional or Hybrid Policy?</u> If you decide to purchase long-term care insurance, should you purchase a traditional (or "stand-alone") long-term care policy or a "hybrid" policy, which combines life insurance with a long-term care benefits rider? In recent years, hybrid policies have become popular with consumers. Allen Hamm wrote an article about hybrid policies in our December 2019 MAM Monthly Commentary (which is available on the MAM website).

Planning for Long-Term Care– Con't

<u>Services of Allen Hamm of Superior Long-Term Care:</u> As many of you know, we pay an annual retainer to Allen Hamm of Superior Long-Term Care for Allen to create a Long-Term Care Plan for MAM clients who are interested. The Plan addresses how the client plans to cover long-term care costs from the four possible ways:

- Family members providing the care.
- Self-funding the costs out of assets.
- Government coverage via Medicaid (which entails first depleting your assets).
- Long-term care insurance.

As part of this process, Allen offers long-term care insurance for those whom it makes sense to purchase insurance to cover part or all of the potential long-term care costs. In addition, if you have the opportunity to purchase long-term care insurance through work, he can evaluate whether that would be your best option. If you have not already done so, please let us know if you would like for us to introduce you to Allen.

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

1) **Estimated Tax Payments**: 4th Quarter 2022 Federal & State are due January 16, 2023.

2) **ADV Part II**: You were provided a copy of our ADV Part II when you became a MAM client. As a Registered Investment Advisor, we file this this document annually with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees, experience and educational backgrounds. Each year, the SEC requires us to offer clients the opportunity to receive a copy of our most recent ADV Part II. Please let us know if you would like to receive a copy.