McCarthy Asset Management, Inc.
Personalized Wealth Management

December 2023 Monthly Commentary

Jan. 2, 2024

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Stock Market & Portfolio Performance

Fourth Quarter, 2023: U.S. and international stocks posted strong returns triggered by solid economic reports and the continued drop in the rate of inflation. Bond prices rose as the yield on the 10-year Treasury fell due the likelihood the Federal Reserve will start lowering rates next year.

	4th Qtr 2023	FY 2023	Description:
Without Dividends:			
S&P 500	11.2%	24.2%	500 Largest Public U.S. Companies
Russell 2000	13.6%	15.1%	2000 of the smallest U.S. stocks
MSCI EAFE	10.1%	15.0%	international stock index
U.S. Aggr Bond	6.7%	5.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	8.2%	14.0%	non-very conservative MAM portfolios
MAM Consrv	6.1%	9.6%	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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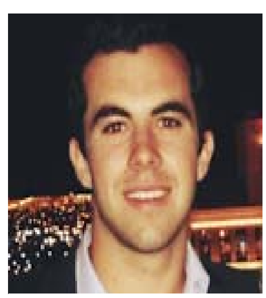

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U.S. Economy: For the first half of 2023, the consensus among economists was that the U.S. economy would enter a recession. As the year progressed and the economy performed better than expected due to strong consumer spending and solid employment growth, the debate shifted to whether a soft landing for the U.S. economy was possible. As we enter 2024, current expectations are that a soft landing is likely with no recession in sight. Furthermore, the Federal Reserve is expected to start cutting interest rates by mid-year. While this would be a very positive environment, we will be on the lookout for risks to this forecast.

Federal Reserve: At its December meeting, Fed Chairman Jerome Powell signaled that due to slowing inflation, the Fed may institute three 0.25% interest rate cuts in 2024 starting around mid-year. The news ignited a rally on Wall Street with both stock and bond prices rising. At his mid-December press conference, Powell mentioned the risk of causing unnecessary harm to the economy by leaving rates too high as inflation falls. “We are focused on not making that mistake.”

Powell indicated officials were turning their attention to rate cuts because inflation has declined much faster than they expected. In their latest projections, they expect core prices, which exclude volatile food and energy items, to rise 3.2% for the fourth quarter of 2023 from one year ago. This is down from their September projection of 3.7%. They see core inflation falling to 2.4% by 2025.

U.S. Equities: 2023 turned out to be a surprisingly strong year for equity markets, with the S&P 500 posting a return of 24%. Many investment professionals project another good year for 2024 in part based on analysts’ expectations of S&P 500 company earnings growing by 11% in 2024, which is double the long-term average. We feel that investors should temper expectations as these estimates for profit growth look lofty. If economic growth slows enough for the U.S. economy to slip into a recession, corporate earnings are likely to decline from 2023’s level. As a result, stocks prices would likely decline.

The Magnificent Seven: By late December, collectively, the stocks known as the Magnificent Seven—Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta—soared 75% in 2023, leaving the other 493 companies in the S&P 500 in their dust. As of late December, these 493 companies rose a more modest 13%, while the full index (reflecting the performance of the seven mega tech stocks) was up 24%.

The Magnificent Seven stocks have grown to represent about 30% of the S&P 500’s market value, according to Goldman Sachs Global Investment Research. That is approaching the highest-ever share for any seven stocks. Another concern about these seven stocks is their elevated valuations relative to their earnings. While these seven companies have posted strong profits lately, they are still trading at an average of 32 times forward earnings. This compares to the price-to-earnings ratio of 19 times for the S&P 500 index of companies.

Market Breadth: In general, the greater the number of stocks that are helping to lift the market higher, referred to as “market breadth,” the more support the market has. In a market with good market breadth, a stock market rally is likely to last longer. Until early November, market breadth was weak, as the vast majority of the gains were provided by the Magnificent Seven. As we wrote in our November 2023 Monthly Commentary, for the market rally to continue, we felt broader market leadership would be important, with both large-cap and small-cap stocks performing well. For December, this was the case. For the month, large-caps, as represented by the S&P 500, rose 4.4%, while small-cap stocks, represented by the Russell 2000 index, surged 12.1%.

International Equities: For 2023, the average international stock outpaced the average U.S. stock. Most investors are unaware of this because the S&P 500, driven by the amazing performance of the Magnificent Seven, allowed the S&P 500 index to outperform the international stock indexes. Should the U.S.’s mega-cap seven stocks lag in 2024, international stocks may outperform for 2024.

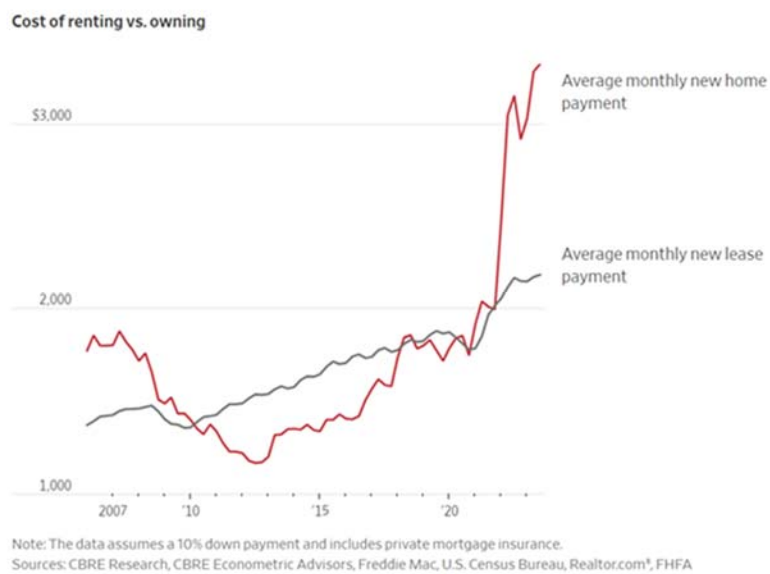
MAM Comments: While much of the concern for the last year and a half was the high rate of inflation, we think it is fair to say the Fed has won that battle. For 2024, the greater concern is likely to be the state of the U.S. economy. After 2023’s strong performance, stock prices are now pricing in a soft landing with a series of interest rate cuts by the Fed. If a hard landing occurs and the economy enters a recession in 2024, stock prices are likely to fall. If we see signs of an on-coming recession, we will likely take steps to protect portfolios on the downside.

Furthermore, if as currently expected, the Fed does start lowering interest rates by mid-2024, the attractive current yields (5%+) on cash and ultra-short-term bond funds will decline. Therefore, one portfolio consideration is to shift part of the cash or ultra-short-term bond exposure into an intermediate bond fund. If it turns out that interest rates have peaked for this cycle, this would be a good move, as it will allow the portfolio to lock in attractive interest rates for a longer period. Furthermore, bond prices will likely rise in response to declining interest rates.

The Difficulty of Buying in the Current Housing Market
By Ryan McCarthy

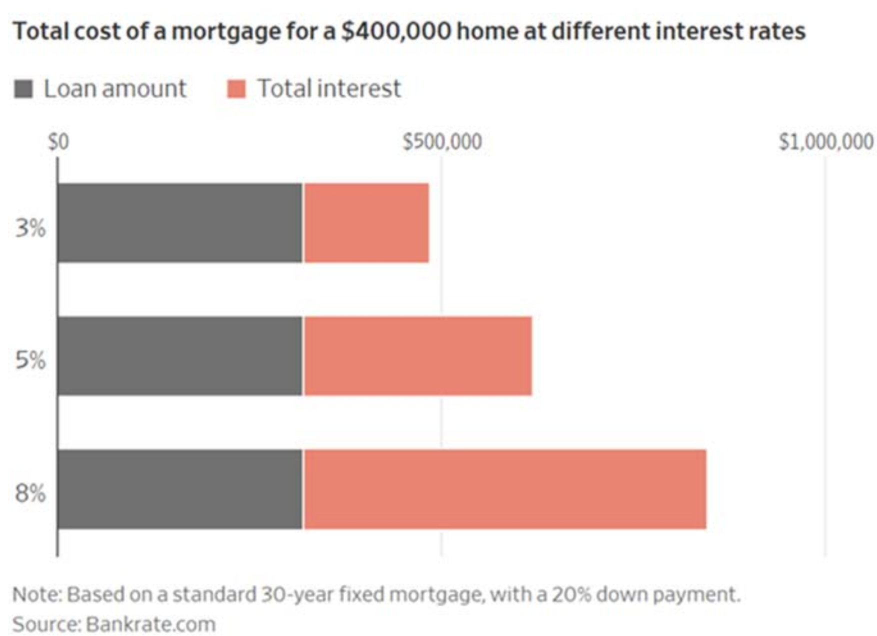
Homeownership is a key milestone for many individuals. Unfortunately, homeownership has become a pipe dream for so many Americans, even those who could afford to buy a year or two ago.

The cost of buying a home versus renting one is at its most extreme since at least 1996. The average monthly new mortgage payment is 52% higher than the average apartment rent, according to CBRE analysis. The last time the measure looked out of whack was before the 2008 housing crash. Even then, the premium peaked at 33% in the second quarter of 2006. The graph below highlights this disparity.



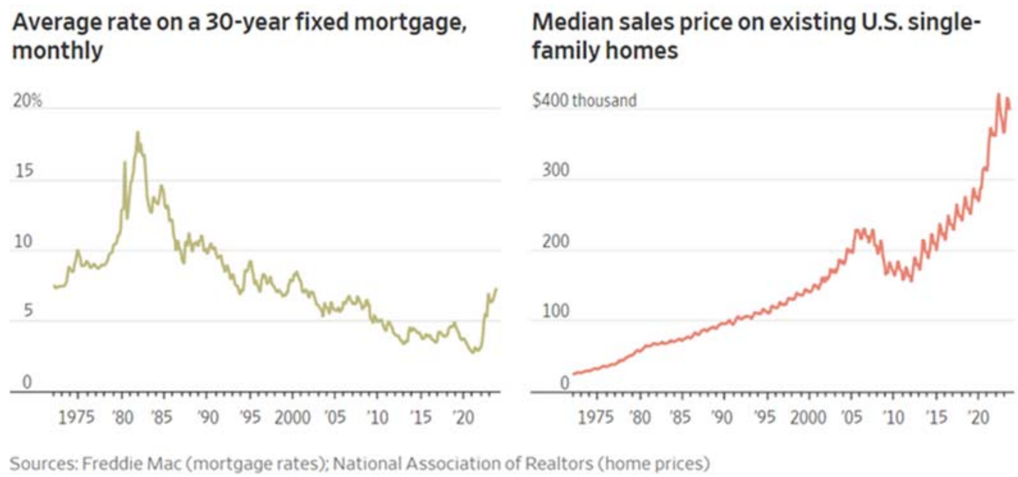
Why is it less affordable to buy a home right now than at any point in recent history? Soaring mortgage rates, resilient housing prices, and unusual supply constraints are the three main factors.

Mortgage rates are at their highest levels in 23 years. While rates decreased to around 7% earlier in December, their lowest in several months, they are still more than double what they were two years ago. Mortgage rates have a tremendous impact on the cost of owning a home, as an increase of just a few percentage points can mean hundreds of thousands of dollars more in interest over the life of a standard 30-year loan.

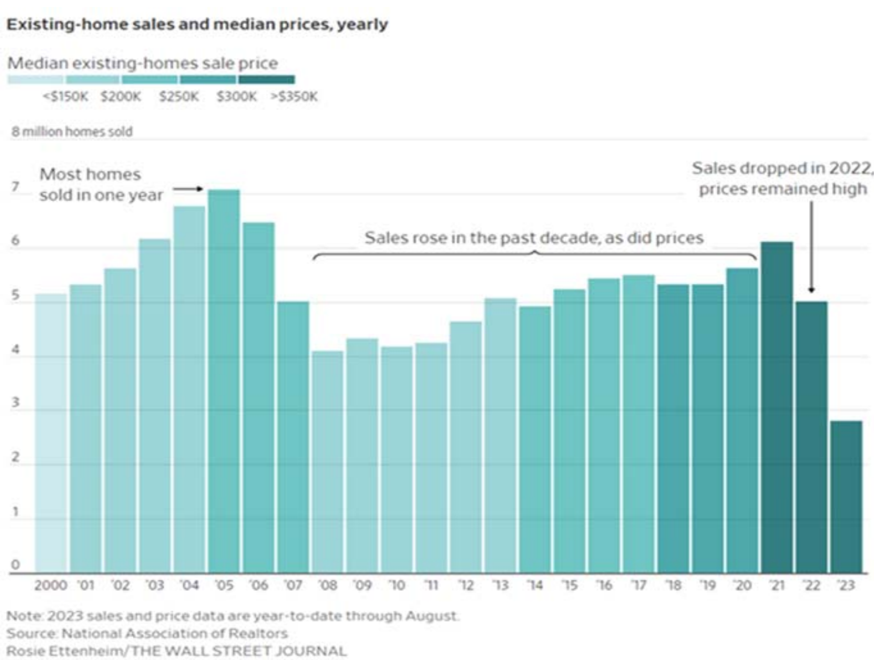


The Difficulty of Buying in the Current Housing Market
By Ryan McCarthy– Con't

What has made buying a home particularly difficult during this period is that, typically, rising mortgage rates slow down home sales, and home prices should soften as a result. The chart below depicts how that has not been the case this time around, as home prices have remained resilient.



A significant reason for the resiliency of home prices is that current homeowners, carrying mortgages that are far below today's rates, are unwilling to move, and that has placed severe constraints on the supply of homes. Chen Zhao, economics research lead at real-estate brokerage Redfin, estimated that total existing-home sales in 2023 would amount to around 4.1 million, which would mark the smallest number of sales since about 2008, the year that Lehman Brothers collapsed and sparked the global financial crisis. The chart below illustrates this decline.



Why are so many homeowners reluctant to sell? Current interest rates provide a strong disincentive to move. Around 80% of outstanding U.S. mortgages have an interest rate below 5%. This concept, known as "golden handcuffs," is causing many homeowners to remain content in their current homes and is squeezing the supply of houses for sale. Absent those unusual supply constraints, it seems likely that home prices would be lower than they are now. These supply constraints are causing the equilibrium prices for homes to be much lower than the current spot prices.

The Difficulty of Buying in the Current Housing Market
By Ryan McCarthy– Con't

What will improve the situation for potential buyers stuck on the sidelines? Restoring the homeownership advantages that existed in the 2010s would require dramatic shifts in market conditions. Specifically, average mortgage rates would have to fall to 3.2%, house prices would have to decrease by one-third, or rental costs would have to rise by at least 50%. None of these outcomes seems likely in the near term.

The high mortgage rates, resilient home prices, and unusual supply constraints are keeping many individuals looking to buy a home on the outside looking in. Buying a home is likely to remain challenging until some combination of higher incomes, lower rates, decline in value of homes, and increase in the number of sellers brings the housing market to some semblance of health. Until that happens, many would-be buyers are forced to put their dream of buying a home on hold.

The Clean Vehicle Credit
By Lauren Be, CPA, MBT

Starting January 1, 2024, you can claim the Clean Vehicle Credit **directly at the dealership** at the point of sale for the purchase of either a new or used qualifying clean vehicle for personal use. Here are some important tax considerations you must understand:

1. The **credit you receive at the dealership** is treated as an **advance on a credit**, which you would otherwise claim on your federal income tax return. The IRS pays the dealer the amount of the credit, up to $7,500 ($4,000 for used vehicles), and the dealer passes the credit on to you. Most dealers will encourage you to use the credit as part of your down payment for the vehicle.

2. You must still report the vehicle purchase and reconcile the credit on your personal income tax return at the end of the year since the credit is an "advance."

3. There are adjusted gross income ("AGI") **limitations**. If your income is above the income limitation for both the year of purchase and the prior year, then any advanced credit you claim at the dealership must be repaid when you file your income tax return.

	New Vehicles	**Used Vehicles**
MFJ	**AGI must be less than $300,000**	**AGI must be less than $150,000**
HOH	**$225,000**	**$112,500**
Single	**$150,000**	**$75,000**

4. The dealerships will need to collect more information from you than they ordinarily would when selling a car. This additional information is required to be provided to the IRS to help limit vehicle credit fraud. When the dealership submits your advanced credit application to the IRS, they should receive approval instantly. Please be sure you obtain a copy of this credit approval before you complete the purchase. You cannot claim a tax credit for the vehicle if your advanced credit application is denied by the IRS.

The Clean Vehicle Credit
By Lauren Be, CPA, MBT– Con't

5. You are **not required** to claim the advanced credit at the dealership. You can wait to claim the credits on your income tax return if you want. However, if your overall tax liability is very low, it's possible that claiming the credit at the dealership will provide a greater benefit to you

There are other special rules such as the number of advanced credits you can claim each year, what happens if you return or resell an eligible vehicle within 30 days of taking delivery, eligibility for taxpayers who marry or divorce, and availability of the credit for taxpayers who can be claimed as a dependent by someone else. Please be sure to contact your CPA to discuss the tax consequences with you.

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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 2023 Federal & State are due January 15, 2024.

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.

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