McCarthy Asset Management, Inc.
Personalized Wealth Management

December 2024 Monthly Commentary

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Inside this issue:

Stock Market & Portfolio Performance

4th Qtr, 2024: U.S. stocks posted mixed returns for the quarter. Large-cap tech stocks once again lead the way. U.S. small cap stocks were flat and international equities fell. Bonds prices also fell due to a spike in the 10-year U.S. Treasury rate.

	4th Qtr	FY 2024	Description:
Without Dividends:			
S&P 500	2.1%	23.3%	500 Largest Public U.S. Companies
Russell 2000	0.0%	10.0%	2000 of the smallest U.S. stocks
MSCI EAFE	-8.4%	1.2%	international stock index
U.S. Aggr Bond	-3.1%	1.4%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	-0.7%	12.2%	non-very conservative MAM portfolios
MAM Consrv	-1.2%	8.7%	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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2025 Stock Market Outlook

Stock Prices Are Expensive: Here are two scary forecasts for investors. Goldman Sachs thinks the S&P 500 will return 3% a year over the next 10 years, as Big Tech dominance eventually falters. Bank of America is even more pessimistic. They expect 0% - 1% a year for a decade, which would be terrible for investors. Yet both Goldman Sachs and Bank of America recommend investors buy stocks because 2025 looks great.

The underlying problem is simple to understand, but hard to do much about. Stocks are expensive on just about every measure. That historically has meant low returns in the long run. Hence the dire 10-year forecasts. But history also suggests no link between expensive valuations like we have today and returns over the next year. Expensive stocks can always get more expensive, and often do. Stretched valuations, though, weakens the market's ability to absorb negative surprises in corporate earnings, economic data, or government policy.

Corporate Earnings: Earnings have risen fast and are expected to rise even faster, with Wall Street analysts predicting 14% growth for 2025. While this is very positive for stock prices, robust 2025 earnings growth is probably already factored into current stock market valuations.

Foreign Stocks: The U.S. stock market is at its highest valuation relative to the rest of the world based on forward earnings since at least 1988. U.S. stocks trade for 22.5 times forecast earnings, and these earnings are at a record high. Stocks for the rest of the world trade at less than 14 times forecast earnings. While they are many reasons why the U.S. stock market has outperformed international stock markets over the last decade, at some point this outperformance will reverse.

Bond Market: After a few years of very low yields, things changed when the Fed aggressively raised interest rates in 2022 and early 2023. Bond yields now are very attractive. We particularly like short to intermediate-term bonds. We are cautious on long-term bonds due to the risk of the ever-growing national debt eventually leading to higher inflation. If bond yields remain at attractive levels, they could offer some competition for the equity market.

T.R. Price Capital Appreciation Fund (TRAIX): We have written about this Fund many times in these newsletters. The Fund is the largest weighting in most MAM portfolios. The manager, David Giroux, has an outstanding track record of picking stocks and adjusting the portfolio allocation over time. Giroux concern over the current high valuation of U.S. stocks is reflected in the current bond weighting of 35% of the portfolio compared to 17% traditionally.

Government Policy: Trump campaigned on a platform of lower taxes and less-stringent regulations, which are both growth positive for the economy. But he also campaigned on higher tariffs on imported goods and mass deportation of illegal immigrates, which are both seen as inflationary. Not knowing what policies get enacted creates uncertainty for our economic and interest rate outlook for 2025.

Recession Outlook: At the beginning of 2023, many economists were expecting the U.S. economy to slip into a recession. That did not occur as the economy performed better than expected. For 2024, the U.S. economy did well thanks to solid consumer spending and strong employment growth. Most economists now feel the U.S. economy has managed to achieve a rare "soft landing," which is steady economic growth combined with falling inflation. While the current economic outlook for 2025 is good, that could change as the year progresses. If the economy were to experience a recession, stock prices would fall while high quality bonds would likely perform well.

MAM Comments: Stock prices ended 2024 at very rich valuations relative to earnings. But as indicated above, this doesn't necessarily mean that stock prices won't climb further in 2025. What we can say with confidence is stock market returns over the next ten years are likely to be well below their historical average. Furthermore, there is uncertainty on the policy front. Meanwhile, the U.S. economy continues to perform well, but the Fed is now expected to reduce short-term interest rates only twice in 2025. Normally, we are cautiously optimistic in our outlook, but for 2025, we are a little more cautious than normal.

Fed Signals Plan to Slow Interest Rate Cuts

On December 18th the Federal Reserve reduced its key interest rate by a quarter-point to a new range of 4.25% - 4.5%. This was the third consecutive rate cut, for a cumulative cut of 1% since September. The Fed also signaled that it expects to reduce rates more slowly next year than it previously envisioned. The revised consensus among Fed officials is for two rate cuts in 2025, down from the four previously forecasted in September.

The central bank's expectation of just two rate cuts in 2025 rattled Wall Street, sending stocks prices down in the worst day for the market in four months. The S&P 500 fell 3.0 % and the Nasdaq composite fell 3.6%. This sharp drop was a little surprising given that recent disappointing reports on inflation suggested that the Fed was likely to slow down its rate cuts.

At the conclusion of the December Fed meeting, Chairman Powell said recent data, and not just potential policy shifts, warranted a changed in the inflation forecast. The labor market has also been a little sturdier than officials thought it would be when they started cutting rates in September.

In terms of potential policy shifts, Trump has promised to impose tariffs and deport millions of unauthorized immigrants. These steps could boost domestic prices by raising the cost of imports or increase wage pressures in certain industries through tighter immigration controls. Economists at Goldman Sachs, for example, expect tariffs could boost core inflation by 0.3 percentage points over the next year.

Powell said it's too soon to say what Trump's proposed economic policies will do to the economy and how much that might bear on the central bank's policy choices. At this point, "it's very premature to make any kind of conclusions. We don't know what will be tariffed, from what countries, for how long, in what size," Powell said in a press conference. "We need to take our time, not rush" and see what the new president delivers, Powell said.

MAM Comments: If the Fed were to keep short-term rates higher for longer, it would be a negative for the stock market. On the other hand, this would be positive for bonds as their yields would remain attractive. We will monitor these developments over the course of 2025.

How a Second Trump Term Could Affect Social Security Benefits

We have recently received questions from a few clients asking how a second Trump Presidency could affect Social Security benefits. In this article, we will discuss what we have heard so far and what our thoughts are about what may happen.

President Trump sparked worries last March when he suggested in a CNBC interview that he was open to making cuts to Social Security and Medicare. His campaign quickly sought to clarify the remarks, saying Trump was referring to cutting waste. Since then, Trump has sought to reinforce his intention to protect the program. He and the Republican National Committee in July released a platform that indicated it was a top goal should he win the presidency.

Many presidents and presidential candidates have vowed to address Social Security's looming insolvency. So far, there has been no progress. According to the latest Social Security trustees report, unless Congress intervenes, the program's trust funds are expected to be depleted by 2035. After that, payroll tax revenue and other income would only be enough to pay 83% of scheduled benefits.

During his campaign, Trump unveiled a series of targeted tax breaks, as he sought to appeal to key blocs of voters. These proposals included eliminating federal income taxes on Social Security benefits and ending federal taxes on tips and overtime pay. According to a recent analysis from the Committee for a Responsible Federal Budget ("the Committee"), a nonpartisan government watchdog, these policies would drain critical tax revenue from Social Security's trust fund.

How a Second Trump Term Could Affect Social Security Benefits- Con't

As a result, if these tax breaks were to be enacted, the Committee forecasts Social Security's trust funds could be depleted by 2032, three years earlier than currently projected. Our expectation is that Congress and the Trump Administration won't enact the targeted tax breaks that would negatively impact Social Security's ability to pay benefits.

MAM Comments: In terms of addressing the financial health of the Social Security system, solutions include raising revenue (by increasing taxes), trimming benefits or employing some combination of both. Any changes would require congressional approval. While anything is possible, we would be surprised if in the next four years Congress enacts the reforms needed to shore up the Social Security system. Furthermore, if there are any reforms, we would also be surprised that they would impact either those currently collecting Social Security or those close to the age to start collecting benefits (currently age 62).

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 are able to utilize the income tax services provided through either the firm Stephen P. McCarthy, CPA or from the CPA firm of Lauren Be. 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 2024 Federal & State are due January 15, 2025.

1) **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 document annually with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees, experience and education. 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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