McCarthy Asset Management, Inc.
Personalized Wealth Management

January 2023 Monthly Commentary

Feb. 1, 2023

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Stock Market & Portfolio Performance

January 2023: U.S. and international stocks got off to a strong start this year with solid gains for January. Bond prices rose modestly due to the hope that inflation will continue to fall and the Federal Reserve is getting close to ending their series of interest rate increases.

	Jan 2023	FY 2022	Description:
Without Dividends:			
S&P 500	6.2%	-19.4%	500 Largest Public U.S. Companies
Russell 2000	9.7%	-21.6%	2000 of the smallest U.S. stocks
MSCI EAFE	8.1%	-16.8%	international stock index
U.S. Aggr Bond	3.3%	-13.0%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	4.4%	-14.0%	non-very conservative MAM portfolios
MAM Consrv	3.1%	-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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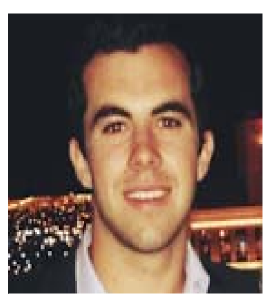

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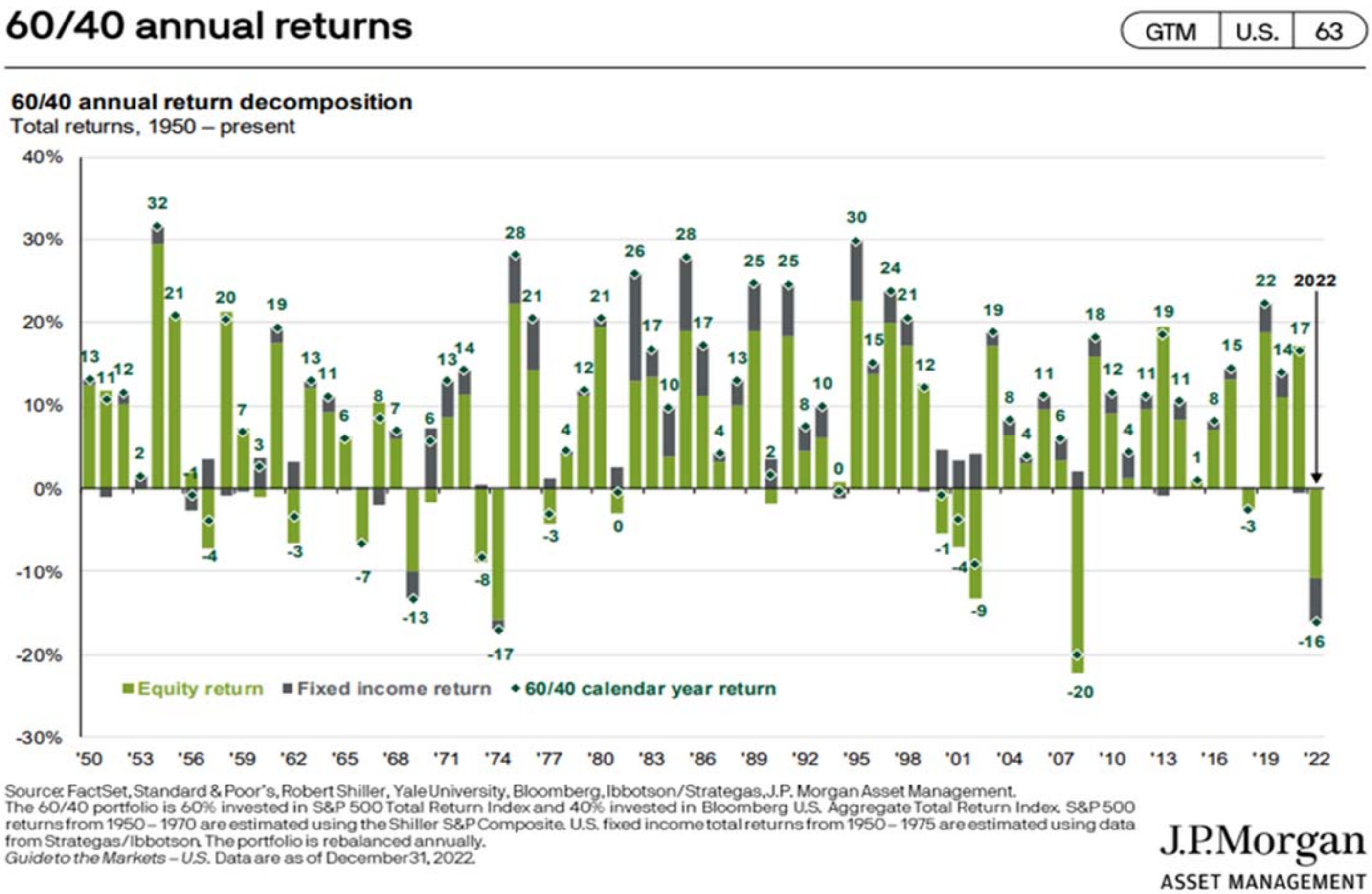
60/40 Portfolio– Better Times Ahead

For many years, a standard in the investment world has been a portfolio invested 60% in equities and 40% in bonds. This 60/40 asset allocation was based on the work of Nobel Prize-winning economist Harry Markowitz, as a way to maximize expected portfolio returns based on a given level of risk. Under this theory, known as modern portfolio theory, or MPT, investors would reduce the total risk of the portfolio through diversification. That is, because stocks and bonds typically have a very low positive correlation, bond prices tend to hold up when stock prices are falling.

According to Vanguard, the 60/40 portfolio has largely worked for many decades because the average correlation of stocks and bonds has been only 10%. Also, according to Vanguard, the annualized return of 60% U.S. stock and 40% U.S. bond portfolio from January 1, 1926 through December 31, 2021 was 8.8%.

As can been seen from the J.P. Morgan chart below, unfortunately, for 2022, 60/40 portfolios had one of their worst years in history with a drop of 16%. Since 1950, this loss was exceeded only twice, with a 17% loss in 1974 (the oil embargo) and a 20% loss in 2008 (the financial crisis).



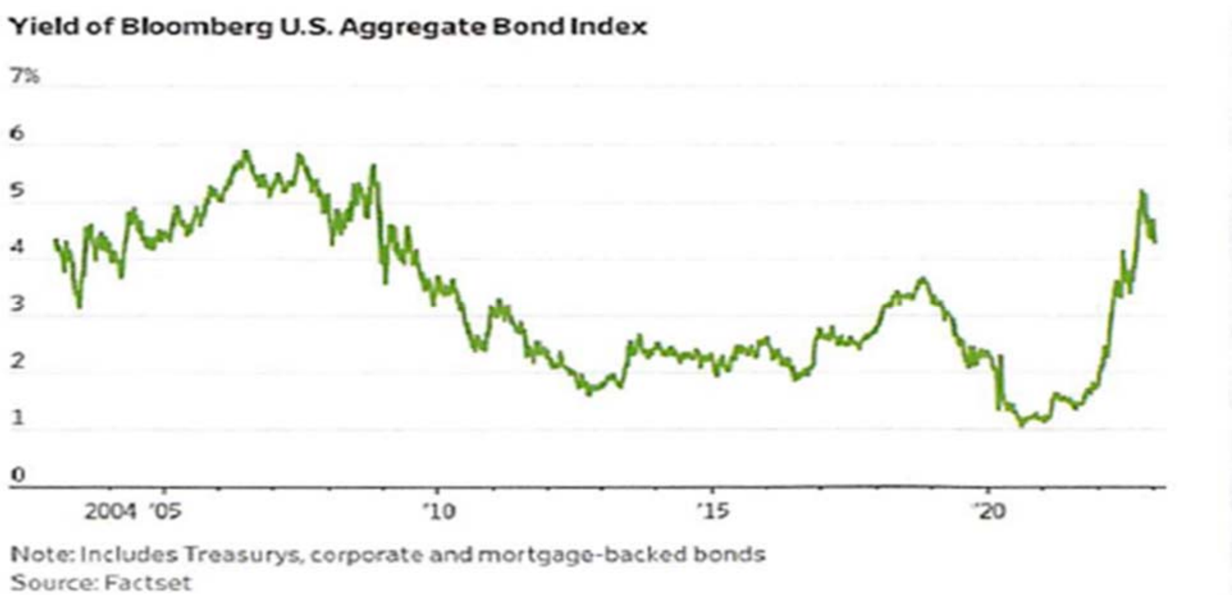
According to Dr. David Kelly, the chief global strategist for J.P. Morgan Asset Management, what happened in 2022 was the worst-case, once-in-a-generation scenario, with both stock and bond prices falling sharply due to the Federal Reserve raising the federal funds rate by 4.5% in an effort to combat inflation. The good news, according to Kelly, is that from a "valuation perspective," there's now value in both stocks and bonds. If we return to a more normal environment where inflation declines and the real threat in 2023 is a recession, then the negative or low positive correlation between stocks and bonds should be re-established.

60/40 Portfolio– Better Times Ahead– Con't

These lower valuations and higher yields mean that markets now offer the best potential long-term returns since 2010, according to J.P. Morgan Asset Management. "I think this is a time where 60/40 investing looks better or more promising than it has in many, many years," said Kelly. In fact, J.P. Morgan Asset Management is now forecasting an annual return for a U.S. 60/40 stock-bond portfolio over the next 10-15 years leaps to 7.20%, up from their estimate a year ago of 4.30%. Over the last 25 years, the rolling 10-year return for a U.S. 60/40 portfolio has averaged 6.20%.

Furthermore, according to a recent commentary from Goldman Sachs Asset Management, history shows that the 60/40 portfolio tends to deliver strong returns in the years immediately following a period of negative returns. For instance, 60/40 portfolios suffered losses for 2018, 2008, and 2002. Each time, they delivered a strong rebound during the following year—22.4% in 2019, 18.2% in 2009, and 18.8% in 2003.

A tailwind that should benefit the bond-portion of the portfolios is that bonds are now paying their highest yield in more than a decade, as can be seen in the chart below from FactSet. This is good news because, historically, 90% of the performance of bonds can be attributed to their current yield.



<u>MAM Comments:</u> We have four comments.

1) We concur with J.P. Morgan that given the losses suffered by 60/40 portfolios in 2022, the outlook for them is now the best it has been in a number of years.

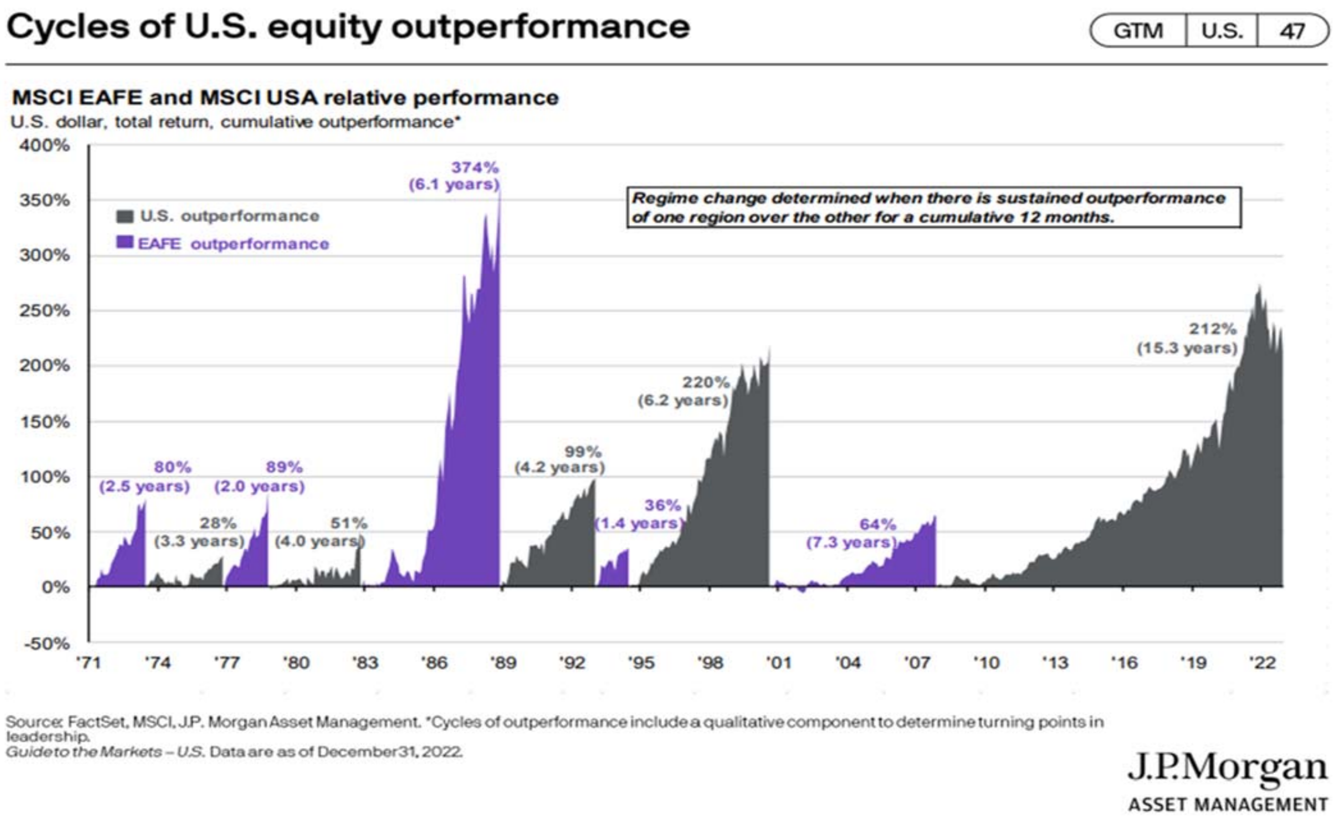
2) On average MAM portfolios are invested a little more aggressively than 60/40. Currently, on average MAM portfolios are invested 67% in equities and 33% in bonds. Despite being a little more aggressively invested, in total, MAM portfolios lost 14.0% for 2022, compared to a loss of 16% for the standard 60/40 portfolio.

3) The 60/40 portfolio discussed in this article is based on investments only in U.S. stocks and bonds. As explained in the article below, we feel international equities are likely to outperform U.S. equities for the next 3-5 years. If so, adding an international equity allocation to a 60/40 portfolio will improve its performance. MAM portfolios currently have a 10% to 15% allocation to international equities.

International Equities– Will They Outperform in 2023?

We last wrote about international equities in our June 2021 Monthly Commentary. While we have been underinvested in this asset class for a number of years, we see reasons why international stocks may once again start outperforming U.S. stocks. As such, we may be increasing the international equity allocation in portfolios this year.

Historically, there have always been cycles of foreign stocks underperforming followed by a period of outperforming. As shown on the J.P. Morgan chart below, during the last fifteen years, U.S. stocks have outperformed international stocks (i.e., the EAFE index) by 212%. This is the longest stretch of outperformance in over 50 years.



For the fourth quarter of 2022, international stocks sharply outperformed U.S. stocks. Specifically, the MSCI EAFE index rose 17.0%, compared to a rise of 7.1% in the S&P 500. Does this represent the start of a multi-year shift where international stocks once again shine? While only time will answer that question, there are some reasons why this could happen:

1) Global economy: Russia's economic war with the West looks set to claim a much smaller toll on Europe than the brutal recession many economists warned about just months ago. Specifically, falling energy prices and government intervention is helping to buttress the continent's economy. Positive factors include a mild winter so far, efforts by businesses and households to cut energy consumption, successful moves by governments to find new natural-gas suppliers, and hundreds of billions of euros in fiscal support for the European economy. According to recent data and estimates, Europe's recession may be shallow and brief—if it happens at all. Furthermore, China's sudden reopening may lead to an economic rebound that could boost demand for Europe's exports.

2) Performance of the U.S. Dollar: A major reason why non-US stocks have lagged for the last decade has been a sharp rise in the U.S. dollar relative to the euro and other international currencies. In fact, from its 2011 low to its recent peak in September 2022, the U.S. dollar advanced by nearly 50% against a broad range of currencies. For at the least the fourth quarter of 2022, the U.S. dollar outperformance reversed, as the U.S. dollar fell 9% relative to the euro.

3) Relative Valuations: Foreign stocks are cheaper than their U.S. counterparts, both in relative and historical terms. The S&P 500 is currently trading at about 17 times forward earnings. By contrast, the MSCI World ex-U.S. is trading at 12 times forward earnings.

4) Higher Dividend Yield: As of 12/31/22, the EAFE index of international equities traded with a 2.6% dividend yield, compared to the S&P 500's 1.6% dividend yield.

5) Diversification: Historically, a portfolio that includes an international stock allocation experiences lower volatility, but comparable performance, to a U.S.-only stock portfolio. This is because adding international equities to a portfolio increases diversification.

6) Emerging Markets: Emerging market equities are likely to outperform developed market equities (including U.S. equities) over the next ten to twenty years. This is because the emergence of a global middle class will drive economic growth in many of these emerging market countries as income levels steadily increase and the number of people living in poverty continues to fall.

MAM View: MAM portfolios currently hold a relatively modest foreign and emerging market equity allocation of between 10% and 15%. We are likely to increase this non-US stock allocation this year if we become confident that international stocks are once again outperforming US stocks.

Schwab Tax Documents Will be Posted to your MAM Portal

As some of you already have seen, your Schwab tax documents are being posted to your MAM portal as they become available. This includes Form 1099-Composite for MAM-managed brokerage accounts and Form 1099-R for distributions from MAM-managed retirement accounts.

To access your tax documents:

1) Log into your MAM portal.

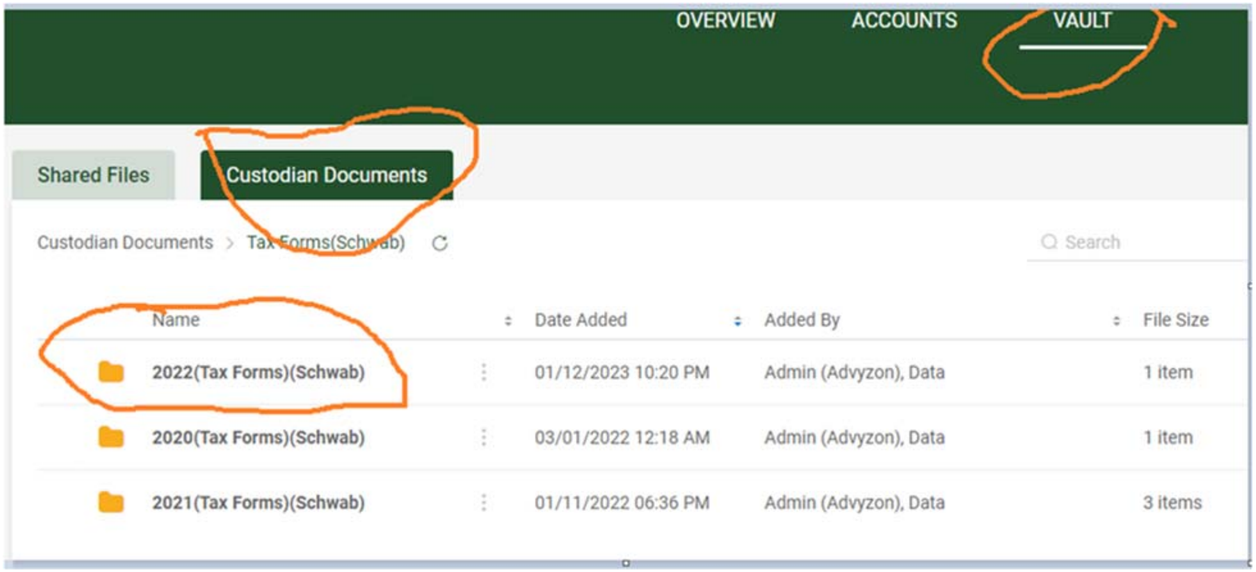
2) Click on “Vault” near the top of the page.

3) Click on “Custodian Documents” near the top of the page.

4) Click on “Tax Forms (Schwab)”.

5) Click on “2022 (Tax Forms) (Schwab)”.

Schwab Tax Documents Will be Posted to your MAM Portal– Con't



6) You can then select which tax document you want to access.

<u>**Timing of When Available:**</u> The Form 1099-Rs are available by around the middle of January for the prior year (i.e., 2022 is now available). The 2022 Form 1099-Composite should be posted by the end of February.

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

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 with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees and our 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.**