McCarthy Asset Management, Inc.
Personalized Wealth Management

January 2018 Monthly Commentary

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Stock Market & Portfolio Performance

January 2018: U.S. and international stocks got off to a strong start for the first month of the year, while bond prices fell due to rising interest rates.

	Jan 2018	YTD 2018	Description:
Without Dividends:			
S&P 500	5.6%	5.6%	500 Largest Public U.S. Companies
Russell 2000	2.6%	2.6%	2000 of the smallest U.S. stocks
MSCI EAFE	5.0%	5.0%	international stock index
U.S. Aggr Bond	-1.2%	-1.2%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	3.8%	3.8%	non-very conservative MAM portfolios
MAM Conserv	2.4%	2.4%	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.

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Major 2018 Tax Law Changes

The Tax Cuts and Jobs Act legislation was signed into law on December 22, 2017. The Act makes extensive changes that affect both individuals and businesses, most of which are not effective until tax year 2018. *The purpose of this article is to discuss most of the changes that affect individuals.* Note that many of the individual provisions sunset and revert to pre-existing law after 2025.

Tax Brackets: The law keeps seven tax brackets, but with different rates and break points. For example, not only is the top individual rate lowered from 39.6% to 37%, but that rate kicks in at a higher income level. Also, whatever new bracket a taxpayer falls into, more of their taxable income will be subject to lower rates than before.

Itemized Deductions will be reduced sharply for many taxpayers:

- **Taxes:** Only a maximum of $10,000 can be deducted for state & local and property taxes. Property taxes remain fully deductible for taxpayers in a business or for-profit activity, so taxes paid on rental real estate can be deducted in full on Schedule E (subject to the passive loss rules).

- **Home Mortgage Interest:** Interest can be deducted on up to $750,000 of new acquisition debt on a primary or second residence, down from $1 million. The new limit generally applies to mortgage debt incurred after Dec. 14, 2017. Older loans and refinancing up to the old loan amount still get the $1 million cap. No write-off is allowed after 2017 for interest on existing or new home equity loans.

- **Misc. Itemized deductions** are no longer deductible, including employee business expenses, investment management fees, and tax return preparation costs.

- **Charity deductions** will still be allowed as an itemized deduction.

- The **Medical expense** deduction has been enhanced. The threshold for deducting 2017 and 2018 medical expenses has been reduced to 7.5% of Adjusted Gross Income (down from 10%).

Other Deductions Eliminated:

- **Job-Related Moving costs** (other than for members of the armed forces who move due to a military order) are no longer deductible.

- **Alimony:** The deduction for alimony paid to an ex-spouse will no longer be allowed, and the income will no longer be taxable to the recipient for divorces entered into after 2018. While existing agreements will not be impacted, if an existing agreement is modified after 2018, it would become subject to the new rule.

- **Personal Casualty Losses** (except for those in presidentially-declared disaster areas) can no longer be claimed.

Standard Deductions nearly doubles to $24,000 for couples, $12,000 for singles and $18,000 for head of households. Folks age 65 or up and blind taxpayers get $1,250 more per person ($1,550 if unmarried). These increased amounts, combined with various reductions in itemized deductions, will result in a significantly greater number of taxpayers taking the standard deduction.

Personal Exemptions for individual filers and their dependents are no longer allowed.

Major 2018 Tax Law Changes– Con't

The Child Tax Credit is doubled to $2,000 for each dependent under age 17, with up to $1,400 of the credit refundable to lower-income taxpayers. The credit phases out at much higher income levels: AGIs over $400,000 for couples and $200,000 for all other filers. Also, there's a new $500 credit for each dependent who is not a qualifying child, including, for example, an elderly parent being taken care of.

Investment Income: The tax rates on long-term capital gains and qualified dividends do not change. The 0% rate will apply for taxpayers with taxable income under $38,600 on single-filed returns and $77,200 on joint returns. The 20% rate starts at $425,800 for singles and $479,000 for joint filers. The 15% rate applies for filers with incomes between these breakpoints. The 3.8% surtax on net investment income remains for single people with modified AGI over $200,000 and $250,000 for married filers.

Alternative Minimum Tax: The law keeps individual AMT but with higher exemptions: $109,400 for joint filers and $70,300 for singles and head of households. Additionally, the exemption phase-out starts at much higher income levels: $1 million for couples and $500,000 for single people and head of households. These changes, combined with the $10,000 limitation for state and property taxes, means that far fewer taxpayers will be subject to AMT.

Kiddie Tax: This tax has been significantly revamped, so that unearned income of children until 18 is taxed at the ordinary income and capital gains rates applicable to trusts and estates, and not at their parents' marginal tax rate, as before.

Estate Tax: The exemption from estate tax has been nearly doubled to $11 million, so estates less than that will not be subject to a 40% estate tax. The annual gift exclusion for 2018 is $15,000 per donee.

Business Taxes: The new law dramatically reforms the taxation of businesses of all sizes. These provisions are some of the most complex in the new law. There are lots of limits and restrictions.

- Regular corporations ("C corporations") will pay tax at a flat 21% rate, down from the 35% top rate now.
- Many individual owners of pass-through entities will get a new 20% deduction. The rules cover sole proprietors and owners of S corporations, partnerships and LLCs. The break phases out for high earners in professional service fields, such as law, consulting, accounting, health or financial services, with taxable incomes in excess of $315,000 for joint returns and $157,500 for all other taxpayers. Non-service businesses can still get a deduction if its income is above these amounts, but the amount of the exclusion is impacted by the level of business wages and the cost of depreciable assets.
- Rental property owners also get the break allowing them to deduct 20% of "qualified business income." The deduction is limited, though, for taxpayers with taxable income in excess of $315,000 for joint returns and $157,500 for all other taxpayers.

New SEC Rule Affecting Account Distributions

This is a technical article that will apply to many of our clients who receive a distribution from their Schwab account. Basically, in many cases we will not be able to initiate new or change existing distributions on behalf of clients due to a new SEC ruling regarding advisors having custody of client assets.

Standing Letters of Authorization (SLOAs): Last year, the SEC issued a new rule regarding "Standing Letters of Authorization" (SLOAs). <u>A SLOA authorizes us to move funds upon a client's request from or to an account with or without "like-kind" registration.</u> Advisory firms who retain such authorization for other than "like-kind" registration accounts will now be deemed by the SEC to have custody of client assets, which could subject them to surprise audits. Because we intend to not have custody of client assets, beginning in 2018, we will no longer retain a client's SLOA for non-identically registered accounts.

New SEC Rule Affecting Account Distributions– Con't

Explanation of This Change: To avoid being considered as having custody of client assets, brokerage firms like Charles Schwab can only accept instructions from an advisor to move money/securities from one Schwab account to another only if the receiving account has the same registration. These are called "first party" money movements. Examples include a distribution from Joe Smith's IRA account to Joe Smith's bank account, as well as Joe & Betty Smith's brokerage account to Joe & Betty Smith's bank account. To avoid having custody, advisor firms cannot have standing instructions for "third party" money movements. A common example of a "third party" money movement is a distribution from an individual's IRA account (i.e. to satisfy IRS required minimum distribution) to a joint bank account with their spouse.

MAM's Response: We have had Schwab change all Moneylink and journals with "unlike" registration to "view only". This means that we (MAM) will only be able to view the action. We will not be able to request any money movement on your behalf, unless it is between two identically-registered accounts.

What to Do If You Need a Distribution to an Account that has Unlike Registration:

- First, contact us to make sure we raise the cash needed for the distribution.
- If you already have a Schwab Moneylink or a standing journal to transfer funds to another account:
  - ◊ Log into your Schwab.com account and request the transfer via the "transfers & payment" tab.

  Or

  - ◊ Call Schwab Alliance at 1-800-515-2157 and request the transfer.
- If you don't already have a Schwab Moneylink or a standing journal to transfer funds to another account:
  - ◊ Request for MAM to fill out an IRA Distribution form, Moneylink form or Journal Request form, depending on the type of account you wish to withdrawal from. We will complete the form and send it to you for signature. Once we received the signed form back from you, we will submit it to Schwab.

  Or

  - ◊ Have MAM request for Schwab to mail a check to the address of record. The check will be payable to the registration of the account.

Please contact Marilyn if you have questions regarding any of this.

Stock Market Outlook– Turbulence Ahead?

Given that our December 2017 Commentary included articles on both our stock market outlook and stock market risks, I didn't plan to discuss them again this soon. With the market off to a fast start in 2018, however, I thought a few comments updating our outlook would be of interest.

Overdue for a Short-Term Correction: Through January 31, 2018, 309 trading days have elapsed since the last 3% dip in the S&P 500. That's the longest stretch since 1928 without a minor setback in the S&P 500. Personally, we would welcome a short-term correction as they are common occurrences within a bull market and they help to prevent investor optimism from becoming excessive. We don't try to time short-term market corrections.

What is Propelling Stocks Higher? As discussed in last month's article, there are at least two significant factors driving stock prices higher:

- Strong Corporate Earnings Growth
- Synchronized Growth in the Global Economies

Potential Risks to the Current Rally: Risks that could trigger a market selloff include:

- Government "shutdown" drama, although historically these have had little impact on stock prices.
- Trade protectionism—including the possibility of the U.S. pulling out of NAFTA. Tariffs could be a meaningful risk for stocks, especially if they contribute to higher inflation.
- Concern over the outcome of the 2018 mid-term elections, although a win by the Democrats would likely put a limit on what can be done legislatively with a Republican President.
- The Trump White House becomes compromised by the Mueller investigation and/or staff defections.
- Higher inflation resulting in higher interest rates. This is what we are most concerned about, as this could end the bull market. In fact, the recently-passed individual tax cuts and resulting increase in the Federal government's deficit could accelerate the arrival of the next recession as the Fed increases interest rates during the next few years to prevent inflation from spiking too high.

MAM Outlook: As we wrote last month, we continue to believe this bull market still has some life. Most bear markets occur near recessions, and the U.S. economy is not showing signs of excesses that historically have built up and led to an economic downturn. In the absence of a recession, stock market declines tend to be more modest. We are keeping an eye on signs of rising inflation, particularly due to wage pressure from the tight labor market. By late 2018 or early 2019, our outlook would likely change if, as a result of rising inflation, the Federal Reserve raises interest rates far enough that it appears the next recession could be getting close at hand.

Sincerely,

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MAM

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.

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