

# **McCarthy Asset Management, Inc.**

Registered Investment Advisor

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## **Monthly Investment Commentary- November 2011**

**Stock Market Performance for November:** Thanks to a very strong run the last three days of the month, the stock market finished with only modest losses for November. Unadjusted for dividends, the S & P 500 fell 0.5%, the NASDAQ dropped 2.4%, the Russell 2000 slipped 0.4%, and the international equity index MSCI EAFE fell 5.2%. Bonds, as represented by the Barclays U.S. Aggregate Index, slipped 0.1% for the month.

**MAM November Performance:** MAM portfolios underperformed the S & P 500 for the month. Excluding the “very conservative” portfolios (which fell 0.8%), MAM portfolios fell 0.9% (after all fees), versus a drop of 0.2% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

**Year-To-Date Performance:** For the first eleven months of 2011, unadjusted for dividends, the S & P 500 fell 0.8%, the NASDAQ dropped 1.2%, the Russell 2000 fell 5.9%, and the international equity index MSCI EAFE dropped 13.9%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 6.7% for the year-to-date. Excluding the “very conservative” portfolios (which rose 1.0%), MAM portfolios fell 1.1% (after all fees), versus a rise of 0.9% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

**Topics Discussed:** The following are the topics discussed in this Monthly Commentary:

1. U.S. Economy- Signs of Improving Job Growth
2. European Debt Crisis- Coordinated Global Easing
3. The Super Committee’s Super Failure
4. Portfolio Repositioning Completed
5. Retirement Analysis Seminars
6. Investment Spotlight: The Yacktman Fund

### **U.S. Economy- Signs of Improving Job Growth**

As discussed in previous Commentaries, I feel that the number one priority of U.S. politicians should be to focus on getting Americans back to work. A significant increase in new jobs will do wonders for curbing our fiscal deficits, increasing consumer spending, and strengthening residential real estate. While unemployment is still too high, there are signs that employment growth is improving. Yesterday, Automatic Data Processing Inc. (ADP) and Macroeconomic Advisers released their survey of private business hiring for the month of November. According to the report, U.S. private business sharply increased their hiring in November, adding 206,000 jobs. In addition, the October figure for new hires was revised upward to 130,000 from 110,000. The November increase was the largest monthly gain since December 2010 and nearly twice the average monthly gain since May, when employment slowed significantly.

The ADP survey is closely watched as a signal of the direction of the government's comprehensive November jobs report, which is due out this Friday. Although difficult to predict, economists estimate that the government's report tomorrow will show 100,000 to 150,000 net new jobs created. While monthly job growth of 150,000 to 200,000 will be needed to bring down the 9% unemployment rate, the recent trend of improving job growth is encouraging.

Other recent signs of improving job growth include:

- Challenger Gray Layoff Report: The last few monthly reports from Challenger Gray indicate that corporate layoffs are trending down.
- Weekly Initial Jobless Claims Report: Although initial jobless claims climbed by 6,000 to 402,000 in the most recent weekly report, the four-week average, which evens out volatile weekly figures, is at 396,000. Economists generally believe claims must remain consistently below 400,000 to signal a real turnaround.
- Job Openings and Labor Turnover Survey (JOLT): I first discussed the JOLT report in the October Monthly Commentary. The most recent JOLT report from the Labor Department showed that while the number of job openings is still far from its past high, we have recovered a lot of ground and is now at its highest level in terms of job openings since 2008.

### **European Debt Crisis- Coordinated Global Easing**

As announced yesterday by the European Central Bank "The Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve and the Swiss National Bank are today announcing coordinated actions to enhance their capacity to provide liquidity support to the global financial system. The purpose of these actions is to ease strains in financial markets and thereby mitigate the effects of such strains on the supply of credit to households and businesses and so help foster economic activity." The stock market's reaction was very positive as yesterday the S & P 500 rose over 4% and the Dow Jones Industrial Average had its best 1-day percentage advance since March of 2009. How significant is this coordinated global easing:

- While the actions to be taken will not solve the European debt crisis, providing cheaper access to U.S. dollar funding is significant and should help reduce pressure for European banks to sell assets, helping to head off a growing credit crunch within the euro zone.
- The intent is to make the cost of lending cheaper, thereby helping economic growth. If European banks have easier access to low-cost funding, they should be more willing to lend money, which in turn helps the global economy. It was a tightening of credit that led to the 2008 downturn in the U.S.; the global central banks are now trying to prevent a repeat in Europe.
- While helpful, the central banks' action only alleviates the symptoms of the debt crisis. More decisive European efforts will be needed. As Bank of Japan Gov. Masaaki Shirakawa said yesterday in discussing the global easing, "The step is meant to buy time for European countries to proceed with their fiscal and economic reform".

## **The Super Committee's Super Failure**

Created by Congress as part of a last minute deal to avoid a government default last August, the 12-member, bipartisan committee was appointed to come up with \$1.2 trillion in deficit reduction by November 23<sup>rd</sup>. Sadly, there was no agreement reached as the six Republicans were unwilling to increase taxes and the six Democrats were unwilling to cut entitlement spending. The super committee's failure automatically triggers \$1.2 trillion in mandatory cuts in government spending, beginning in 2013, with about \$600 billion cut from military spending and the remainder from entitlement programs. While Congressional action can still be taken to avert the automatic spending cuts, I found it very disappointing that the committee could not find a way to compromise. In all likelihood, little will be achieved in Washington toward deficit reduction until after the November 2012 elections.

## **Portfolio Repositioning Completed**

Last week we completed the semi-annual portfolio repositioning by adding little additional downside protection to portfolios. As explained in the letter that was mailed on the day we repositioned your portfolios, the primary purpose was to reduce international equity exposure and to establish a position in the exchange traded note "JP Morgan Alerian MLP Index" (symbol AMJ). While I continue to feel that long-term many international markets will provide returns better than that of U.S. stocks, for now I remain concerned about the possible ramifications of the European debt crisis. As also explained in the letter, I am attracted to AMJ for its rising dividend (rates charged by MLPs increase each year by the producer price index plus 1.3%). The current dividend yield is a generous 5.3%. Furthermore the performance of MLPs is not tied to commodity prices (pipelines and storage tanks do not take title to the commodity they transport and store) and the correlation of MLPs to the stock market is relatively low.

If the stock market stages a significant rally in the next month or two, it is possible that we may add further downside protection to portfolios. Currently, my outlook for the stock market for 2012 is mixed. The positives include that corporate earnings growth continues to be good, corporations are in the best financial condition in memory, the economy continues to slowly recover, and the stock prices are very reasonable relative to projected corporate earnings. The negatives include the potential risk of the European debt crisis to the global economy and the inability of American politicians to find a way to compromise and make difficult decisions to curb our growing fiscal deficits. In particular, I am concerned about 2013 when the Bush tax cuts are scheduled to expire and the significant tax increases from the Obama Health Care Plan become effective. While I feel that some tax increases need to be part of the solution, they should be phased in gradually and accompanied by targeted cuts in government entitlement and other spending programs. I hold hope, though, that 2013 could provide an opportunity to restructure our tax code in a way to encourage businesses to hire and grow.

## **Retirement Analysis Seminars**

On November 3<sup>rd</sup> we held two Retirement Analysis seminars in our office for 30 MAM clients. The seminars went well with the attendees actively engaged and asking plenty of good questions. We are now in the process of preparing a Retirement Analysis for a number of the attendees. In addition, Alexey is in the process of developing a webinar of the seminar for those who were not able to attend. We plan to hold the webinar this month. I will send out an email once we have set a date.

### **Investment Spotlight- Yacktman Fund**

One U.S. equity mutual fund in most MAM portfolios is the Yacktman Fund. The Fund, which was founded by Don Yacktman in 1992, is now managed by Don, son Stephen Yacktman, and Jason Subotky. For the last 3, 5, 10 and 15 years, the Fund is in the top 1% of its peer group (U.S. large cap value) and it has a 5-star rating from Morningstar. Attached is an article from the October/November 2011 Morningstar Advisor where Morningstar interviews Don Yacktman and Pat Dorsey (Morningstar's former director of research). **I found the article to be of interest because it provides insights into investment opportunities in the current environment while also providing sage investment advice.** Below are a few quotes provided from the article:

- Yacktman: *"I've said before that I've been in this business over 40 years, and on a relative basis now, I have rarely, if ever, seen as many high-quality, good businesses selling at the kind of prices they are, relative to what else is out there. I look at PepsiCo in amazement at the pricing of that particular security. Because of the predictability of the cash flows and the quality of the company, I wonder why anybody would choose a 10-year Treasury over Pepsi."*
- Dorsey: *"These kinds of companies that Don and I are talking about got absurdly, insanely, ridiculously expensive in the late 1990s. Wal-Mart was 40 times earnings, Coke was 60 times. Cisco, for goodness' sake was 90 or 100 times earnings...Just to take an example: Johnson & Johnson basically has gone nowhere in ten years. I mean, the share price has done absolutely nothing. But if you look at the free cash flow they generate, it has doubled. So, the business is worth more. People were just paying too much for it back then. The unfortunate thing is that investors tend to chase performance." Note that Wal-Mart, Coke, Cisco and Johnson & Johnson are all top twenty positions currently in the Yacktman Fund and their current price-earnings ratios range from 13 to 15 (50% to 85% lower than 10 years ago!).*
- Dorsey: *"I see a lot of investors still making the same mistakes that they've made for years and years. They go after hot asset classes, hot stocks, and move away from the stuff that makes both Don and I drool, which are securities that, by and large, were priced very richly 10 years ago, which have gone sideways for 10 years, while increasing their level of cash flow generation. That's a very easy psychological trap to fall into, but one that can be deadly for an investor or an advisor. Focus on the price you're paying today, not the returns in the past."*

Please call or email me if you would like to discuss your portfolio(s) or if you would like to discuss any other financial matters.

Sincerely,

Stephen P. McCarthy, CPA, CFP®