

# ***McCarthy Asset Management, Inc.***

Registered Investment Advisor

November 1, 2011

## **Monthly Investment Commentary- October 2011**

**Stock Market Performance for October:** Historically, October has been a scary month for the stock market. This proved not to be the case this year as stocks had one of their best Octobers on record. Unadjusted for dividends, the S & P 500 rose 10.8%, the NASDAQ climbed 11.1%, the Russell 2000 jumped 15.1%, and the international equity index MSCI EAFE rose 9.6%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 0.1% for the month.

**MAM October Performance:** MAM portfolios underperformed the S & P 500 for the month. Excluding the “very conservative” portfolios (which rose 3.0%), MAM portfolios rose 6.4% (after all fees), versus a rise of 10.9% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

**Year-To-Date Performance:** For the first ten months of 2011, unadjusted for dividends, the S & P 500 slipped 0.3%, the NASDAQ rose 1.2%, the Russell 2000 fell 5.4%, and the international equity index MSCI EAFE dropped 9.2%. Bonds, as represented by the Barclays U.S. Aggregate Index, rose 6.8% for the year-to-date. Excluding the “very conservative” portfolios (which rose 1.5%), MAM portfolios slipped 0.2% (after all fees), versus a rise of 1.2% 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- Not Looking Like a Double-Dip Recession
2. European Debt Crisis- Agreement Reached- What About Italy?
3. Third Quarter Earnings Have Been Good
4. The Super Committee- Deadline is November 23<sup>rd</sup>
5. Next Portfolio Repositioning
6. New Service- Assistance in Looking for a Long-Term Care Provider

## **U.S. Economy- Not Looking Like a Double-Dip Recession**

The two main fears which drove the stock market sharply lower last quarter were the risk of the U.S. economy slipping back into a recession and the sovereign debt turmoil in Europe. Progress on both fronts is what led to the stock market rebound in October. In my Third Quarter 2011 MAM Letter I listed various reasons why I did not think a U.S. recession was imminent. This belief was validated with a number of October economic reports which pointed toward continued slow but steady growth in the U.S. economy:

- **3<sup>rd</sup> Quarter GDP:** The Commerce Department said the economy grew almost twice as fast in the third quarter as it did during the second. The 2.5% initial estimate of growth surpassed Q2's 1.3% and Q1's anemic 0.4%. The report also said consumer spending rose 2.4%, including a 4.1% increase in durable goods and 3% growth in spending on services. Exports were up 4%, and business capital spending jumped 16.3%.

- Employment Reports: Companies added 103,000 jobs to the nation's payrolls in September, including those of 45,000 striking telecommunications workers who returned to work. The Bureau of Labor Statistics also revised upward its estimates for previous months. The increase wasn't enough, however, to reduce the unemployment rate, which remained stuck at 9.1%. There have been other nascent signs of employment improvement. Initial jobless claims continue to hover around the 400,000 level and various surveys indicated slowly improving employment conditions. In particular, the often-ignored JOLTS (Job Openings and Labor Turnover Survey) report showed that at the end of August there were 3.1 million job openings, up 200,000 from a year ago and 944,000 greater than the trough seen in July 2009.
- Consumer Spending: Consumer spending is very important as it comprises approximately 70% of the U.S. economy (as measured by the Gross Domestic Product). According to the Commerce Department, consumers' income rose 0.1% in September, and they promptly went out and spent 0.6% more than they did in August, especially on autos. That led to a 1.1% improvement in September's retail sales—the biggest increase in seven months. While the savings rate dipped to 3.6%, this is still a significant improvement from previous years (e.g. it was 1% in 2005).

### **European Debt Crisis- Agreement Reached- What About Italy?**

The following information was taken from an October 28<sup>th</sup> report from Schwab Market Perspective. In the report, Liz Ann Sonders, Chief Investment Strategist at Charles Schwab wrote "Across the pond, however, some progress was made on finding at least a temporary solution to the Greek debt problem. Although still short on critical details that could derail any feasible agreement, it appears that participants have started to realize the reality of the situation. The recent summit ended with private Greek debt-holders agreeing to a "voluntary" 50% haircut in the value of their bonds, while also announcing the bolstering of the European Financial Stability Facility (EFSF) and increased capital to the continent's financial institutions. However, where that money is coming from is unclear at this time—a major question still looming. Despite the vagaries, it is a glimmer of hope. Although global risks have intensified in recent months, a meltdown of the global banking system was significantly moderated in our view, with the mere acknowledgement and progress toward actions to fight the Eurozone debt crisis."

"...Italy is in focus due to its large debt load. At 1.9 trillion euros (\$2.6 trillion) Italy has the world's third largest bond market behind the United States and Japan. It represents 120% of Italy's GDP. Italy needs to continually raise vast sums of money to roll over maturing debt. If they are unable to find investors willing to lend at reasonable interest rates, its debts could be too big to bail out. Lastly, with growth nearly stagnant, Italy needs changes to the status quo to put its financial future on a sustainable path."

"...Italy's situation is not entirely dire though—it should not be considered the next Greece. Italy suffers from liquidity concerns due to low confidence, not from questions about solvency. Unlike Greece, Italy has a primary budget surplus; a surplus before debt payments; as well as high percentage of domestic, long-term holders of its debt, and long debt maturities. This suggests that any crisis should be slow to develop. We believe that Italy, like governments of other peripheral nations, will likely eventually come to grips with tough decisions. If the current government doesn't make good on its promises, markets and constituents could force a change in leadership."

### **Third Quarter Earnings Have Been Good**

With 315 companies in the S & P 500 reporting earnings so far for the 3<sup>rd</sup> quarter of 2011, 71% have reported earnings above analyst expectations. Earnings are on track for a 16.3% year-over-year increase with revenues up 10% (and up 1% from the 2<sup>nd</sup> quarter of 2011). While earnings set an all-time record for the 2<sup>nd</sup> quarter, it appears the 3<sup>rd</sup> quarter may be even higher. The forward guidance provided by corporate management for 4<sup>th</sup> quarter earnings are at least as important, and so far that news has also been pretty good.

### **The Super Committee- The Deadline is November 23rd**

A very important item to keep an eye on this month is the November 23<sup>rd</sup> deadline for the Congressional Super Committee to come up with \$1.5 trillion in deficit reductions. Failure of the Super Committee to come up with a Plan or for Congress to approve it will trigger \$1.5 trillion in automatic across-the-board spending cuts, with some exceptions for programs such as Social Security and unemployment insurance.

### **Next Portfolio Repositioning**

I plan to do the next portfolio repositioning in November or December. Although I have not yet made any decisions as to what moves will be made, I am considering adding further downside protection given that last month stocks recovered most of their losses from the second quarter. One way to achieve this that I am considering is to add an ETF (exchange traded fund) or ETN (exchange traded note) that invests in publicly traded energy and infrastructure master limited partnerships (MLPs). MLPs offer attractive yields (5%+), that grow over time and provide low correlation to the stock market.

### **New Service- Assistance in Looking for a Long-Term Care Provider**

From time to time I've written about the services we are providing to our clients through our arrangement with Allen Hamm and his firm, Superior LTC. Earlier this summer I wrote about how his firm can assist you with long-term care insurance claims. Recently, Allen informed me that he has added a new service for our clients: If you or a family member ever has a need for long-term care, Allen's firm can assist you with locating quality providers or care. His firm has access to a database of ratings of over 90,000 home care providers, assisted living facilities, and nursing homes.

If you or a family member has a need for this service, please call or email and we will connect you with Allen and his firm. As a reminder, there's no charge to you for this service. We are paying Superior LTC an annual retainer to bring these and other services to you.

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®