McCarthy Asset Management, Inc.
Personalized Wealth Management

October 2017 Monthly Commentary

Nov. 1, 2017

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Stock Market & Portfolio Performance

October 2017: Stocks posted good returns for the month, particularly large-cap U.S. companies. Meanwhile, bonds were mostly flat.

	Oct 2017	YTD 2017	Description:
Without Dividends:			
S&P 500	2.2%	15.0%	500 Largest Public U.S. Companies
Russell 2000	0.8%	10.8%	2000 of the smallest U.S. stocks
MSCI EAFE	1.5%	18.9%	international stock index
U.S. Aggr Bond	0.1%	3.2%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.1%	11.8%	non-very conservative MAM portfolios
MAM Conserv	0.7%	7.0%	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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Economic & Stock Market Outlook from Vanguard

On October 12, 2017, I attended an all-day conference that was held by Vanguard Funds in San Francisco for investment advisors. It was an excellent conference with a series of speakers covering a variety of topics. This article will examine the session that was titled “Economic and Market Outlook: A Look Back, A Look Ahead”. It was led by Andrew Patterson, Senior Economist at Vanguard Funds. The following is a summary of Vanguard’s 10-year economic and investment outlook.

Global Economic Growth: Growth will stabilize, but at a historically lower level. This is due to a combination of factors:

- Technology- The falling cost of technology is depressing business capital investment. Andrew gave the example of the evolution of smart phones. The iPhone and related apps provide an incredible depth of capabilities that were not available just a few years ago.

- Demographics- An aging population in the U.S. and most developed countries, with baby boomers approaching retirement age is hindering economic growth.

- The Rise in Populism may also dampen global economic growth as populist policies discourage foreign trade.

U.S. Economic Growth: Vanguard expects 2.5% annual growth for the remainder of 2017 with slightly lower growth in 2018. By late 2018 or early 2019, there is a risk of a recession.

U.S. Inflation: For the next ten years, they see annual inflation in the U.S. to be around 2%. This compares to an average rate of 3.5% for the period 1960 through May of 2017. For inflation to rise above 2%, a more vibrant economy would be needed that what they project.

Central Bank Policy: The Federal Reserve will begin a gradual balance sheet normalization starting in the fourth quarter of 2017. They expect moderate interest rate increases which they forecast will have only a minimal impact on the stock market.

Fiscal Policy: The U.S. fiscal outlook will worsen in the next five years with the deficit widening. The current GDP tax proposal will make the outlook for a growing deficit even more negative.

10-Year Fixed Income Outlook: They expect an all-bond portfolio of 70% U.S bonds and 30% international bonds to return 2.5% annually, compared to a 4.7% average annual return from 2000 through 2017. While they are expecting these more modest returns, they are not anticipating a significant bond correction. Furthermore, they feel that bonds still play an important diversification role, especially when we experience the next stock bear market.

10-Year Stock Market Outlook: Vanguard estimates returns for an all-equity portfolio invested 60% U.S. stocks and 40% international stocks to return between 5% and 7% annually. This compares to historical annual returns of:

Period	Annual Return
2000 – 2017	4.6%
1970 – 2017	10.3%
1926 – 2017	10.0%

Economic & Stock Market Outlook from Vanguard– Con't

Are Current Valuations in the Stock Market Too High? While valuations are currently stretched, Vanguard is not concerned. When factoring in interest rates, which they expect to remain at low levels for an extended period, current valuations of stocks are reasonable.

What Determines Stock Market Returns: After the presentation, I sought out the speaker and asked about what makes up the annual return for stocks. He verified my thinking that the return is made up of the following components:

The dividend yield (currently 2.0% for the S&P 500) plus

Annual real growth in earnings (with the 2.0% GDP growth a good estimate of that) plus

The annual rate of inflation (currently about 2.0%) plus or minus

The change in the price-earnings ratio for stocks

The first three components total 6%, which is in-line with Vanguard's projection of 5% to 7% annual returns for the next ten years. They don't see the change in the price-earnings ratio being a significant factor as they expect stock market valuations to remain relatively high due to interest rates remaining relatively low.

In summary: I found this to be a very informative session. While the information provided was consistent with my thinking, it was nice to have it confirmed by a firm like Vanguard. For the last few years, I have been saying that my expectation for annual stock market annual returns for the foreseeable future is 4% to 7%, with stocks outperforming bonds. Keep in mind that this is an estimate of average returns. For some years, the returns will be higher, while for others it will be lower (and even negative during the next bear market). What was new information was Vanguard's view that interest rates and inflation will remain muted over the next ten years. This is encouraging as it points to why the current level of stock prices is not unreasonable.

Social Security Benefits Expected to Rise 2% for 2018

The Social Security Administration announced in October that the annual cost-of-living adjustment (commonly called COLA) for 2018 will be 2%. Marking the biggest increase since 2012—and coming after a 0.3% rise for 2017—the change means the average monthly benefit for all 66 million Social Security recipients will rise by about $25 to $1283.

Unfortunately, a majority of recipients may actually see little or no raise at all. If they are enrolled in Medicare, have Part B premiums (outpatient service) deducted from their monthly Social Security payment, and have been protected by the "hold harmless clause" in recent years, most or all of the 2% raise will be eaten up by Medicare. "Hold harmless" is the clause that ensures Part B monthly premiums don't increase faster than Social Security's annual COLA.

Increase in the Full Retirement Age: The full retirement age is scheduled to rise in 2018. Next year, newly eligible retirees who were born in 1956 will have to wait until they are 66 years and four months old before they will be able to receive 100% of their monthly retirement benefit. That's a two-month increase compared to those born in 1955.

For those not familiar with the way Social Security benefits work, you become eligible at age 62, with benefits growing by 8% annually until age 70. In other words, the longer you wait to start receiving benefits, the more you will get. Your full retirement age is your 100% payout. If you start to claim at any point between age 62 and a month before your full retirement age, your benefits will be permanently reduced. But if you delay claiming your benefits until after your full retirement age, you will receive 8% more annually, up until age 70.

Open Enrollment for Health Insurance Marketplaces Begins Nov. 1st

Beginning on November 1, 2017, individuals (including their families) may apply for new health insurance or switch to a different healthcare plan through a Health Insurance Marketplace. The open enrollment period for 2018 coverage ends on December 15, 2017 (although some states that run their own insurance marketplace have a later deadline such as January 31, 2018 for California). Given that President Trump has slashed advertising for Obamacare by 90% (see here) we thought it was important to get word out about the open enrollment period. While not many MAM clients obtain their health insurance coverage through one of the Health Insurance Marketplaces, many may have a relative or friend who does.

I am including with the mailing of this Monthly Commentary an article which also addresses:

- Changes that have been made to open enrollment effective for 2018 coverage.
- Other Changes to the Affordable Care Act (ACA).
- Speculation that additional changes may be coming to ACA due to President Trump's so far failed efforts to repeal it.

Medicare Premiums for Higher Income Recipients– Part 2
By Lauree Murphy

Tax Planning for Medicare Premiums

In our July Monthly Commentary article, we discussed changes that are coming in 2018 to the Medicare premium calculation. This month we will look at one strategy that may reduce your premiums.

Your 2018 Medicare premiums will be based on your 2016 tax return. There is nothing that can be done to change that. Looking ahead, you may be able to reduce your 2019 Medicare premiums by making changes that affect your 2017 income.

Qualified Charitable Distribution

One strategy is to make a qualified charitable IRA distribution. To do this, you directly contribute part or all of your required minimum distribution from your IRA to a qualified charity. You can contribute up to $100,000 per year. This strategy works if:

- You are at least 70 ½, the age when required minimum distributions start.
- You plan to contribute to a charity anyway.
- Subtracting your required minimum IRA distribution from your adjusted gross income drops you into a lower threshold for Medicare.

Medicare Premiums for Higher Income Recipients– Part 2 By Lauree Murphy– Con't

Medicare Brackets for 2018

Filing Single MAGI in 2016:	Married Filing Joint MAGI in 2016:	Percent of Cost Covered by Monthly Part B Premiums	Part B Monthly Payment For 2018
Those covered by hold harmless provision	Those covered by hold harmless provision		***2018: To Be Determined*** (2017: $109.00)
$85,000 or less	$170,000 or less	25%	***2018: To Be Determined*** ($134.00 for 2017)
$85,001- $107,000	$170,001- $214,000	35%	***2018: To Be Determined*** (2017: $187.50)
$107,001- $133,500	$214,001- $267,000	50%	***2018: To Be Determined*** (2017: $267.90)
$133,501- $160,000	$267,001- $320,000	65%	***2018 To Be Determined*** (2017: $348.30)
Above $160,000	Above $320,000	80%	***2018: To Be Determined*** (2017: $428.60)

Here's an example:

John is single. He projects his 2017 modified adjusted income to be $166,000. That places him in the highest Medicare bracket. He has a required minimum distribution from his IRA of $10,000. He regularly makes an annual donation to his church of $10,000. Usually he writes a check to the church and claims it as an itemized deduction on his Schedule A. This year, after learning about qualified charitable distributions, he satisfied his RMD by having his IRA trustee directly contribute $10,000 from his IRA to his church. Note that John did not increase his charitable gift. He simply changed how he gives. He shifted the gift from an itemized deduction to a reduction in IRA distribution income.

When John prepares his 2017 tax return, his modified adjusted gross income will be $10,000 less, or $156,000. John has dropped down a bracket for his 2019 Medicare Part B premium. We don't know the rates for 2019 yet, but using 2017 data, he would save $80.30/mo. on his premium or $963.60/yr.

From a tax perspective, it is better to decrease adjusted gross income than it is to increase itemized deductions. Some deductions like medical expenses and miscellaneous itemized deductions are based on adjusted gross income. That means it's also possible that John may be able to deduct more of these expenses on his tax return.

Things to watch out for:

- You must have your IRA custodian (brokerage firm) directly send the check to the charity.
- You are limited to $100,000 per person, per year, which can be excluded from income.
- You cannot also claim a charitable deduction as an itemized deduction for any amount you take as a qualified charitable deduction.
- You cannot use funds in a SEP or a SIMPLE IRA to do a qualified charitable distribution.
- You need to substantiate the charitable deduction. Be sure to obtain a receipt from the charity for the contribution stating no goods or services were received in exchange for the gift.
- If your IRA has nondeductible contributions in it, a special calculation needs to be made.
- Due to the time lag between the end of a tax year and when premiums are determined, it's hard to predict exactly how much savings you will receive by moving into a lower threshold for Medicare. We also can't predict when or if Medicare might shift the brackets again.

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

Year-End Tax Planning: For those of you who are tax clients, please let us know if you would like to have us do any tax planning, such as determining the amount of 4th quarter estimated payments.