McCarthy Asset Management

Certified Public Accountant
Certified Financial Planner

April 19, 2001,

Dear Client,

Enclosed are four investment reports for the quarter ending March 31, 2001. The first is titled "Portfolio Position Analysis". It lists your investments that I manage and shows how each has performed. The second, "Portfolio Performance Summary", shows the rate of return on your investments for the first quarter of 2001. The third is the "Portfolio Performance History". It shows the monthly and cumulative rate of return on your portfolio since inception. The fourth report, "Realized Gains and Losses", is included only for taxable accounts. It lists the investment gains and losses that were realized during the first quarter of 2001.

Stock Market Performance

The first quarter of 2001 was another very difficult quarter for the stock market. For the quarter the S & P 500 fell 12.1% to 1160, the Nasdaq Composite fell 25.5% to 1840 and the Russell 2000 fell 6.8% to 451.

The stock market has experienced a dramatic drop during the last thirteen months. From March 31, 2000 to March 31st, 2001 the S & P 500 fell 24%. The performance of the Nasdaq has been the worst on record. As measured from its peak of 5049 on March 10th, 2000, the Nasdaq fell 64% through March 31st, 2001.

You may recall that on January 3rd, 2001 the Federal Reserve in a surprise move announced the first interest in a series of interest rate cuts. The previous MAM letter (for the quarter ended 12/31/00) was written just after this cut. In the letter I asked the question "When will the stock market in general and technology stocks in particular start to recover?" Under MAM strategies I stated, "despite the recent cut in interest rates I am cautious in my outlook for the short-term (the next three to six months). Once it is clear that further interest rate cuts will be made and if it appears that we are not entering a recession, I expect to be more bullish."

I am now moderately bullish. The interest rate cuts (which have about a six-month lag before they impact the economy) should provide an economic boast by the third quarter of 2001. The risk to the market now is the poor earnings that companies will be reporting for the second and third quarters of 2001. I expect the stock market to remain volatile as companies release these earnings. There is a risk that the stock market could hit new lows this Summer. But the stock market moves based on economic events that are likely to occur six months in the future. Once there are signs that the economy is bottoming, the stock market should do well.

Despite my short-term concerns about earnings and the economy, here are three reasons why I have become more positive:

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1. Interest Rate Cuts: The Federal Reserve followed its first ½% cut on January 3rd with a second ½% cut on January 31st and a third ½% cut on March 20th. On April 18th Federal Reserve Chairman Greenspan announced a fourth ½% cut. This unexpected and welcomed announcement did not occur during one of the Fed's regular meetings. It is anticipated that a fifth cut will occur at the Fed's next meeting which takes place in mid-May.

How significant are interest rate cuts to the stock market? *I think that the change in the direction of interest rates is the single best indicator of future stock prices.* Historically after a second rate cut by the Federal Reserve the stock market is substantially higher one year later, and even higher eighteen months out. This indicator has proven quite effective for many years. Listed in the table below is the return of the S & P 500 after a second rate cut. As you can see the return immediately following the cut is not always that favorable, while the market performance six to eighteen months out has been much better.

SECOND FED DISCOUNT RATE CUT

Date of Cut	S&P 500	1 Mo. Later	3 Mo. Later	6 Mo. Later	1 Yr. Later	18 Mo. Later
10/30/42	9.36	-0.75%	11.86%	23.82%	27.35%	26.82%
4/16/54	27.94	3.22%	7.59%	13.92%	36.97%	48.00%
1/24/58	41.71	-2.54%	3.43%	11.84%	33.71%	43.01%
8/12/60	56.66	-1.57%	-1.89%	7.91%	19.52%	24.36%
12/4/70	89.46	1.89%	9.46%	13.23%	7.88%	21.64%
12/17/71	100.26	3.43%	7.64%	7.83%	16.60%	3.33%
1/10/75	72.61	7.92%	15.37%	30.57%	32.67%	45.85%
6/13/80	115.31	4.08%	8.98%	12.26%	15.87%	6.48%
12/4/81	126.76	-2.79%	-12.97%	-12.81%	12.28%	30.55%
12/24/84	166.76	5.97%	6.72%	13.43%	24.21%	48.14%
2/1/91	343.05	7.99%	10.86%	12.85%	19.38%	23.91%
10/15/98	1047.50	8.44%	18.69%	26.29%	19.08%	33.80%
1/31/01	1366.01	-9.23%	?	?	?	?

2. Effect of 25% drop in the S &P 500: On April 6th, 2001 the S & P 500 had dropped 26.1% from its peak on March 31st, 2000. Although it may seem contrary to common sense, this may be a bullish signal. The following table displays the return investors received one year later in every instance since 1950 in which stocks experienced a 25% or more total loss:

Start of Bear Market	Return One Year After Stocks Had Dropped 25%
12/12/61	35.6%
11/29/68	39.2%
1/11/73	16.0%
8/25/87	27.5%

If history is any guide, stocks should move upward over the next twelve months.

3. Possible Tax Cut: During the first quarter the House of Representatives passed President Bush's $1.6 trillion tax cut proposal. The Senate followed by passing a reduced $1.2 trillion tax cut. Reconciliation must still occur between the House and Senate versions of the bill. It may be several months before a compromise will be sent to the President for signature. While I am not

convinced that the tax cut will provide the stimulus to the economy that some hope, it should lessen the likelihood or severity of a recession.

MAM Performance

The first quarter of 2001 was generally a difficult quarter for MAM portfolios. Most of the mutual funds utilized by MAM declined in value. The technology funds (Red Oak Technology, White Oak Growth, Van Wagner) were down significantly. The small and mid-cap value funds were the best performers with generally a breakeven quarter.

The best performing fund was Oakmark Select that rose 11%. On April 24, 2001 Harris Associates announced that effective May 4th, 2001 they will be closing Oakmark Select to new investors. This is very good news. Oakmark Select is one of my favorite funds and is in almost all client portfolios. As a result of strong performance (up 25.8% for 1999 and 11% for the first quarter of 2001) investors have recently poured over $700 million into the fund. Assets are now up to $3.1 billion. Since the mid-cap fund concentrates its portfolio on only 20 stocks, continued asset growth could be detrimental to performance. Harris Associates has not announced whether Investor Advisors (i.e. MAM) will continue to be able to purchase the fund for new accounts.

The MAM portfolio with the longest track record is a fairly aggressive $50,000 portfolio that was fully invested on September 13, 1999. As of March 31st, 2001 the original $50,000 had grown to $56,380 for a return of 12.8%. During that time the S & P 500 lost 4.08%. For the quarter ended March 31st, 2001 this portfolio fell 11.6% (while the S & P 500 fell 12.1%).

Continued Growth in MAM

Despite the drop in the stock market, assets under management for MAM have continued to grow. As of March 31st, 2001 assets reached $22 million, up from $21 million on December 31st, 2001.

As I have mentioned in the past, I have reduced my tax practice to allow for the growth of MAM. For the tax season just ended we prepared 255 tax returns. That is down from 430 for the prior year's tax season.

I welcome and appreciate any referrals that you have for MAM. For new clients the minimum to invest is $150,000.

MAM Strategies

Here are my current strategies:

1) **Increased weighting in technology stocks-** Effective this month I am making a small increase in the weighting of technology stocks in new portfolios. Of the various sectors of the market, technology stocks declined the most during the last twelve months. Last Summer I reduced technology exposure in most portfolios. While I am not yet ready to reverse this move and increase the technology exposure in existing portfolios, for new money I am increasing the percentage invested in technology by 2 to 4% (to between 20 and 30% of the total portfolio). I plan to increase the technology exposure in existing portfolios if I become confident that technology stocks will lead the market recovery.

2) **Large weighting in small & mid-cap stocks-** I believe that small and mid-cap stocks will outperform large cap stocks for the foreseeable future. This has proven to be a good strategy during the last twelve months. The bear market has brought the overall stock market back into fair value range. However, amazingly, the large-cap growth stocks are still overvalued by almost any measure. Meanwhile small and mid-cap stocks continue to trade at reasonable valuations.

3) **Small, undiscovered funds-** I will continue to search for small, undiscovered mutual funds. Last quarter I purchased for several accounts Bogle Small Cap Growth Investor. This 2-year old fund is run by John C. Bogle, Jr., son of the former Chairman of Vanguard Funds. This is a tiny fund. As of December 31st, 2000 it had only $32 million in assets. The fund performed well in 2000 with a return of 26.8%. During the first quarter of 2001 it lost 8.7%. John C. Bogle, Jr. has an impressive track record with his previous tenure at N/I Numeric Investors. Unlike most of the mutual funds used by MAM, Bogle Small Cap Growth Investor is not part of Schwab's one-source program so Schwab charges a small transaction fee for purchases and sales. Since the minimum for MAM to purchase the fund was $50,000, I aggregated ten different client accounts to make the first purchase. Purchases for additional accounts are not subject to the initial high minimum.

Your Performance

Also enclosed is the invoice that shows my asset management fees for the quarter. Charles Schwab will automatically deduct these fees from your account.

Please call me if you have any questions or if you want to discuss your portfolio.

Very truly yours,

Stephen P. McCarthy, CPA