McCarthy Asset Management, Inc.

Registered Investment Advisor

Wednesday, April 6, 2005

Dear Client,

The stock market stumbled in the first quarter of 2005, repeating its 2004 pattern. All the major U.S. indices were down. As the economy continues to perform well, I am cautiously optimistic that the market will rebound and produce modest gains for the year.

With this MAM report for the quarter ending March 31, 2005, I will discuss the first quarter 2005 market and MAM portfolio performance, and will include my outlook for the remainder of 2005. In addition, I will discuss Schwab's plans to lower equity trading costs and revisit an attractive place to park short-term savings.

Enclosed are four 3/31/05 investment reports:

- *Portfolio Position Analysis*: lists your investments and how each have performed
- *Portfolio Performance Summary*: 1st quarter 2005 portfolio rate of return
- *Portfolio Performance History*: portfolio rate of return since inception
- *Realized Gains and Losses*: 1st quarter of 2005 investment gains and losses realized (included solely for the few taxable accounts that had sales in the first quarter)

Stock Market Performance

The first quarter of 2005 was weak for the market. The S & P 500 fell 2.4% to 1181, the Nasdaq Composite dropped 8.1% to 1999, and the Russell 2000 fell 4.8% to 615. These returns do not reflect reinvestment of dividends.

Outlook for the Stock Market

Will the stock market stage a turn-around? While I don't expect the performance to match the strength of the last two years, I continue to feel that the market will likely rise modestly for the full year. There's no argument that investors have a lengthy list of concerns. These include the omnipresent threat of terrorism, the budget and trade deficits, the weak dollar, rising interest rates and sky-high oil prices. My moderate optimism is fueled by a number of factors, including interest rates remaining low by historical standards, contained inflation, corporate profits coming in better than forecast, alternative investments providing lackluster returns, merger and acquisition activity heating up, and investor sentiment hitting high levels of bearishness. Time will tell. The best course of action requires patience and perseverance and entails investing in a diversified portfolio that is adjusted over time.

3 Lagoon Dr, Suite 155, Redwood Shores, CA 94065, (650) 610-9540 Fax (650) 610-9541
email: SteveMtax@aol.com Web site: mamportfolios.com

Interest Rates and Performance of the U.S. Economy

As expected, on March 22nd, the Federal Reserve raised interest rates for the seventh time since June of 2004. In making the announcement that it was raising the federal funds rate by 0.25% to 2.75%, the Fed kept language that it has used with every rate increase since last June, saying that future rate hikes would occur "at a pace that is likely to be measured". This would indicate that the future increases will continue to be at 0.25% increments.

For the first time in more than four years, however, the Fed signaled its concern with inflation. As indicated in a March 23, 2005 Wall Street Journal article, futures markets now see a 50% probability of a half-point increase at one of the Fed's next two meetings, and the rate will top 4% by year end.

As reported in its April 1, 2005 weekly report, Value Line indicated that "the economy continues to press forward at a healthy clip. Recent reports, for example, show that key housing measures, such as sales of new and existing homes, remained at near-record levels, industrial activity was improving at a steady gait; and productivity (or labor cost efficiency) was increasing at a solid pace. All of this suggests that the gross domestic product will rise by nearly 4% in the first quarter. We expect GDP growth to approach that level in the second quarter, but to slow a bit over the final six months of the year, as higher oil prices and rising interest rates take an ever-greater toll."

MAM Performance for the Quarter

In General: For the quarter, 93% of the MAM portfolios out performed the S & P 500. The composite return of assets in MAM portfolios that were in existence for the whole quarter was a loss of 1.2% (after MAM fees) versus a loss of 2.2% in the S & P 500 as represented by the performance of the Vanguard Index 500 fund (symbol VFINX) with reinvested dividends.

Best Performers: The eight best performing MAM mutual funds for the quarter were PIMCO Commodities (a rise of 11.2%), Oakmark International Small Cap (5.4%), Artisan International Small Cap (5.1%), Artisan Small Cap (2.2%), Hussman Strategic Growth (1.7%), Metropolitan West (0.5%), Century Small Cap Select (0.2%), and Oakmark Select (0.1%).

Worst Performers: The eight worst performing MAM mutual funds were Cohen & Steers REIT (down 7.3%), William Blair Small Cap (-5.1%), Bjurman Micro Cap (-4.8%), Marsico Focus (-4.0%), Bogle Small Cap Gth (-2.7%), Pioneer High Yield (-2.2%), Oakmark Select (-2.2%), and iShares Dow Jones Select Dividend (-2.2%).

Oldest Portfolio: The MAM portfolio with the longest track record is a fairly aggressive portfolio fully invested on September 13, 1999. As of March 31, 2005, the original $50,000 had risen to $71,953, plus $1,135 of cumulative withdrawals. This represents a cumulative return of 46.2%. During the same time, the S & P 500 lost 7.3%. For the quarter ended March 31, 2005, the portfolio lost 2.5%. All returns quoted for this portfolio (and for all MAM portfolios) are net of MAM fees (0.25% per quarter). Also, past performance is not necessarily an indicator of future performance.

Explanation of Performance: I am pleased with the relative performance of the MAM portfolios for the first quarter of 2005. I am heartened that MAM portfolios lost "only" 1.2% (after fees)

versus a loss of 2.2% in the Vanguard Index 500 fund (with reinvested dividends). This is even more impressive given that the Nasdaq and the Russell 2000 fell 8.1% and 4.8%, respectively.

How did MAM portfolios achieve this relatively strong performance? There are three reasons:

1. *International Exposure:* International equities had a positive impact as the most commonly quoted international index, the MSCI-EAFE, lost only 0.8%. The three international and two global funds used by MAM all rose in the quarter. This helped significantly as international equities represent 15% to 20% of most portfolios.

2. *Alternative Asset Classes:* Four of the five alternative asset funds rose in the quarter. The exception being a sharp drop in Cohen & Steers Realty. As first introduced in the MAM quarterly report for the period ending December 31, 2004, I define "alternative asset funds" as funds that have a low or negative correlation to the stock and bonds markets. Most MAM portfolios currently have a 10% to 12% weighting in alternative assets. As I mentioned in last quarter's report, I will increase this weighting later this year if I decide to reposition portfolios to provide further downside protection.

3. *Underweighted in Technology Sector:* Technology stocks were particularly weak for the quarter, as indicated by the 8.1% drop in the Nasdaq Composite. MAM portfolios continue to be underweighted in technology stocks: most portfolios have a 7% to 10% weighting, versus a 14% technology weighting in the S & P 500.

Benefit of Repositioning: When I analyzed which portfolios underperformed for the quarter, an interesting pattern emerged. 7% of the MAM portfolios (27 out of 368) underperformed the Vanguard S & P 500's loss of 2.2%. 14 of the 27 underachievers were portfolios that, due to tax considerations, had not been repositioned in at least 18 months.

13 of these 14 "static" portfolios were small custodial accounts for children under age 14. A repositioning of these portfolios would involve selling mutual fund positions, which would require a tax return to be filed for the minors. The 14th fund is the first MAM portfolio, which is subject to backup Federal withholding. Since no adjustments have been made, these portfolios continue to have a significant weighting in small caps, and relative to other MAM portfolios, a smaller weighting in international and alternative assets. The point is illustrative that *for a portfolio to continue to perform well, it is important that the asset allocation mix be adjusted in light of the changing dynamics in the stock market.* There is no guarantee that the asset allocation changes we make will improve performance, but the alternative of doing nothing, is clearly inferior.

Schwab Institutional Lowers Equity Commissions

Effective May 25, 2005, Schwab Institutional will lower the equity pricing for trades placed electronically for clients with $50,000 to $1 million in household assets. The new rate will be $12.95 for the first 1000 shares, plus $0.015 per share thereafter. This is a reduction from the current rate of $19.95 per trade. For clients with household assets in excess of $1 million, the price of equity trades will remain $9.95.

Most of the trades placed in MAM accounts will not be impacted by the fee reduction, because most trades are for mutual funds. The fee reduction will provide a savings for exchange-traded funds, and in cases where there are individual stocks to be liquidated.

To be eligible for the reduced rate, clients must sign up for eConfirms and then eStatements when available later this year. As a result of the Paper Reduction Actions we took two years ago, 60% of MAM clients are already signed up for eConfirms. If you are one of the 40% and would like to sign up, please send us an email with the address you want Schwab to use for the eConfirms.

INGdirect.com – A Place to Earn 2.8% on Savings

I first mentioned INGdirect (www.INGdirect.com) in a MAM quarterly report one year ago. At the time, the ING savings accounts were paying 2.0%. One year later (after numerous Federal Reserve interest rate increases), the accounts are paying 2.8%.

I have been very pleased with the ING account I established in January of 2004. There are no fees, and accounts are FDIC insured. ING is able to pay such competitive rates because of their low cost structure provided through automation. ING offers no retail branches. Accounts are set up over the Internet and are linked to your existing bank account. You are not able to write checks on your ING account. Instead, you transfer money to and from the linked bank account. You initiate the transfer by logging on to your ING account via the Internet or by phoning them.

Now even more attractive alternatives to ING are appearing. One client recently alerted me to EmigrantDirect (website www.emigrant-direct.com), which is paying 3.25% on savings. I have not researched or used EmigrantDirect, other than to look at their website.

I do not view INGdirect accounts or any of the alternatives as a long-term investment vehicle. I feel that for long-term savings, investors will do better with a diversified portfolios such as those offered by MAM. However for short-term or emergency savings, it is a good choice.

Increase in Minimum Amount for New Clients

I appreciate the confidence that existing and new clients continue to show in adding to the assets that MAM manages. I mentioned in the last quarterly report that I would be raising the minimum investment amount for new clients if managed assets continue to grow rapidly. Existing and new clients added over $2 million in net assets during the first quarter, bringing the MAM assets under management to over $67 million as of March 31, 2005.

In line with keeping the number of MAM clients at a manageable level, the minimum to become a new client was raised to $350,000 (up from the existing level of $300,000), effective April 1, 2005. This increase does not impact existing clients who have less than $350,000.

Miscellaneous

Please call me if you wish to discuss the stock market or your portfolio(s).

Very truly yours,

Stephen P. McCarthy, CPA
encl: Investment Reports