McCarthy Asset Management, Inc.
Registered Investment Advisor

Re: First Quarter 2009 MAM Letter

Friday, April 3, 2009

Dear Client,

On March 9th, after experiencing the most severe January and February on record, the stock market was down 24%, well on its way to posting another disastrous quarterly performance. This was on top of 2008 when the stock market posted its worst performance since 1933. Things looked awfully grim as the daily economic reports seemed to only worsen. The stock market then did what it does best: surprised a lot of people! On March 10th the market began a sharp dramatic rally, climbing 22% in just 13 trading sessions, producing the market's best monthly performance in six years.

Trying to help clients manage their emotions in this challenging market environment has been very important. To assist in this regard, I have made three adjustments to most portfolios since last October. In most cases we became more conservative. The goal was to provide greater downside protection and to help clients stay invested so they could participate in the eventual recovery. I think this has been a good strategy because as discussed below, MAM portfolios fell much less than the S & P 500 for the first quarter of 2009.

The Problem With Market Timing: While I think it is wise to make portfolio adjustments to reflect the changing market environment, for many I believe their market timing actions are detrimental to their investment performance. During the last six months, many investors did panic and liquidate their investments. In fact, so many have fled the stock market that by early March, cash in CDs, savings accounts and money market accounts was at a record level relative to the value of the stock market. As I have previously discussed, market timing moves like this have caused the average investor to dramatically underperform the stock market averages. *A big challenge for those who sold their equity investments is when to buy back in?* Almost by definition most investors will reinvest when the market is much higher than when they sold. This is because emotionally, it is easier to invest in stocks after the market has performed well.

With this report for the quarter ending March 31, 2009, I discuss the performance of the market and MAM portfolios for the quarter, as well as my outlook for the stock market. In addition, I introduce the "Very Conservative" portfolio which is intended as an attractive choice for medium to long-term savings that are currently held in low-yielding CDs and money market accounts.

Enclosed are four 3/31/09 investment reports:

- *Portfolio Position Analysis*: lists your investments and how each have performed
- *Portfolio Comparative Performance Review*: portfolio performance by year and cumulatively since inception
- *Portfolio Performance Summary*: 1st quarter 2009 portfolio rates of return
- *Realized Gains and Losses*: 1st quarter 2009 investment realized gains and losses (included only for taxable accounts)

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Stock Market & MAM Performance for First Quarter

For the sixth consecutive quarter (tying an undesirable record), the stock market posted negative returns. *Unadjusted for dividends,* the S & P 500 fell 11.7%, the Nasdaq slipped 3.1%, the Russell 2000 dropped 15.4%, and the international equity index MSCI EAFE fell 14.6%.

MAM Portfolio Performance: For the quarter, 98% of MAM portfolios that were in existence for the whole quarter had performance that equaled or exceeded that of the S & P 500. The composite return of assets in MAM portfolios was a loss of 6.2% (after fees), versus a loss of 11.0% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Explanation of MAM out performance: Although MAM portfolios declined significantly for the quarter, they out performed the S & P 500 by 5.8% and on average MAM portfolios fell 56% as much as the S & P 500. The relatively good MAM performance was driven by:

- most of the bond funds used by MAM rose modestly for the quarter
- the Hussman Fund (see February 2009 Monthly Commentary for discussion), which is now MAM's largest investment, rose 7.0% for the quarter
- most of the equity funds used by MAM outperformed the S & P 500

Oldest Portfolio: The MAM portfolio with the longest track record is a moderately aggressive portfolio that was fully invested on September 13, 1999. As of March 31, 2009, the original $50,000 had risen to $57,130, plus $1,193 of cumulative withdrawals. This represents a cumulative return of 16.7%. During the same time, the S & P 500 (as represented by the Vanguard Index 500) fell 32.4%. For the quarter ended March 31, 2009, the portfolio fell 6.4%. All returns quoted for this portfolio (and for all MAM portfolios) are net of MAM fees. Also, past performance does not guarantee future results.

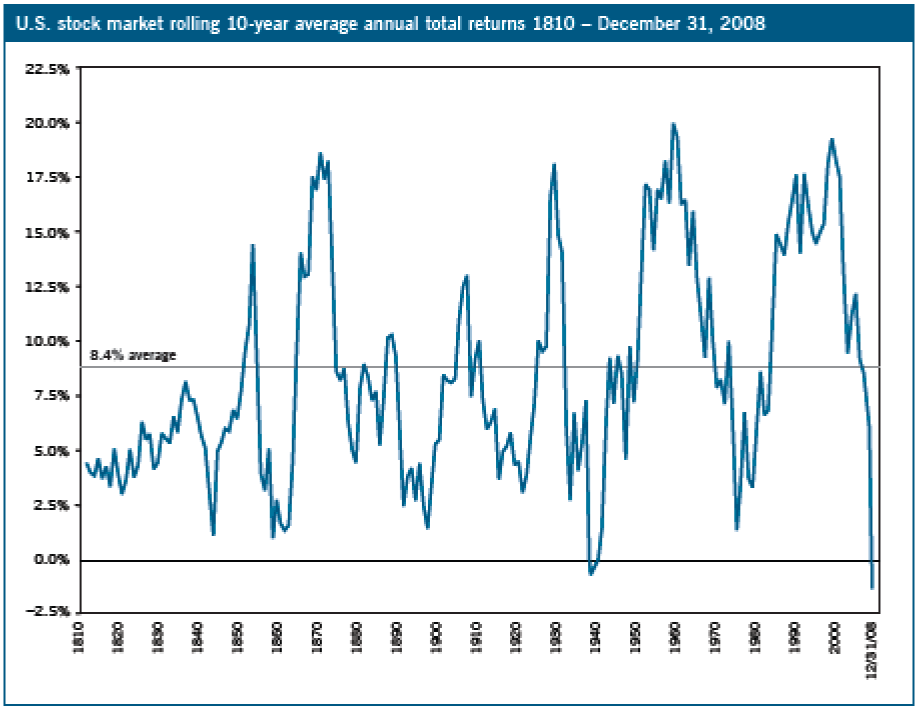
Stock Market Outlook

I am not convinced the stock market recovery which started on March 10th is sustainable. Part of my caution is the stock market technicians whom I respect and follow have doubts about the current rally. While I feel a persuasive argument could be made as to why stocks could continue to rebound, I think it is best to err on the side of caution. For clients with excess cash, I believe it would be best to gradually invest the cash over the remainder of this year using a fairly conservative asset mix.

While I am cautious, I do see reasons for optimism:

1. ***Improving Economic News:*** About the only improvement so far is that the news seems to be getting "less bad". Remember, though, the stock market tries to anticipate where the economy is going to be in four to six months. By the time you read that the economy is growing again, the market may already have staged a very significant recovery.

2. ***10-year Negative Rate of Return from Stocks:*** Although emotionally it is much easier to invest in stocks after the market has done very well (remember how easy it was to invest in late 1999 and early 2000), the best time to invest is after the market has performed very poorly. In that regard, now could be a great time to be invested. I obtained the following chart from American Funds:



Source: Global Financial Data

- This graphic representation of nearly the entire history of the U.S. stock market shows the rolling 10-year average annual total returns for U.S. equities, with an average of 8.4% per year.

- For the 10-year period ended December 31, 2008, the average annual return reached a record low of negative 1.5%. Previously, the lowest 10-year return for large-capitalization U.S. stocks was negative 1.3% in 1938.

- Looking back at every point when the market returned less than a 2.5% annual return for 10 years, it then returned an average 13.3% for the next 10 years, with a range of 7.1% to 18.6%. *Of course, historical results are not predictive of future returns.*

3. ***Federal Reserve Efforts:*** In the middle of March the Federal Reserve launched a bold $1.2 trillion effort to lower rates on mortgages and other consumer debt. To do so, the Fed will spend up to $300 billion to buy long-term government bonds and an additional $750 billion in mortgage-backed securities guaranteed by Fannie Mae and Freddie Mac. The immediate impact of these efforts on mortgage rates has been positive as last week the thirty-year fixed rate mortgage fell to 4.78%, the lowest on record (the records date back to 1971). *This could be the best opportunity in our lifetime to refinance a mortgage (particularly since I expect rates will be much higher within a couple of years).*

4. ***Economic Stimulus Plan:*** Some of the provisions of the $800 billion American Recovery and Reinvestment Act of 2009 that was passed in February are just starting to take effect (ex. starting April 1st most workers will see a small increase in their paycheck due to lower tax withholding). While I have mixed feelings about the wisdom of this expensive plan, I do think it will benefit the economy.

5. ***Cash Not Invested:*** By early March, there was a record amount of "cash" held in CDs, savings accounts and money market accounts relative to the value of the stock market. With the Federal Reserve having cut the Federal Funds Rate to near 0% (an historical low), most of this cash is earning next to nothing. As investors regain their confidence, I expect a significant amount of this money will eventually move back into the stock market (probably at a time when the market is much higher).

6. ***Change in the Mark-to Market Rule:*** In response to Congressional pressure, the Financial Accounting Standards Board (FASB) on March 16th proposed an overhaul of fair-value accounting that may significantly improve profits at banks. The changes to fair-value, also known as "mark-to-market accounting", would allow companies to use "significant judgment" in valuing assets and reduce the amount of writedowns they must take on so-called "impaired investments", including mortgage-back securities. While it is difficult to know how much of an impact this rule change may have, the prior "mark-to market" rule has been cited as one of the reasons for the collapse of some of the financial service companies. In some cases banks and other financial institutions have been forced to mark down the value of their "toxic" assets to unreasonably low valuations. The effect of this rule change should boost earnings for certain financial firms.

Introduction of the "Very Conservative" Portfolio

These are very challenging times for investors. The economy is in its worst shape in decades and over the last seven months the stock market has staged one of its steepest declines ever. My recommendation is for investors to maintain their stock market investments in a way which will allow them to "hang in there" through this volatility. For some it may make sense to get more conservative if that would allow them to not panic if the market does retest the March lows. *But what do you do with "new money" that is not currently invested in the stock market that you do not want to take significant risk with?* I have put together a proposed "Very Conservative Portfolio" for this purpose. Here is a description of the portfolio based on a Morningstar analysis:

- It is made up of ten mutual funds with a significant emphasis on high quality corporate bonds. 5 of the 10 funds are currently used in most MAM portfolios while 2 of the other funds are used in some MAM portfolios.

- The composition of the portfolio is 17% in U.S. stocks, 62% in bonds, 13% in cash, 2% in international equities, and 6% in other assets.

- For the last twelve months the portfolio yield was 3.9%.

- The historical track record for this portfolio's performance would have been (as of 2/28/09):

- positive 1.5% for the last 3 months, negative 4.3% for the 12 months, positive 2.6% annually for the last three years, 3.6% annually for the last five years, and 6.5% annually for the last ten years.

- By my estimate, the portfolio carries only 13% of the volatility of the S & P 500.

I see this "very conservative" portfolio as an alternative to CDs, savings accounts and money market accounts for medium to long-term savings. While the investments in the portfolio are liquid and can be sold at any time, I recommend that it only be used for money that is not expected to be needed for at least three years. *Furthermore, although conservative, the portfolio will have some volatility.*

I want to emphasize that I do not see this "very conservative" portfolio as an alternative to existing MAM portfolios or other diversified stock and bond equity portfolios. As illustrated in the chart on page three, now is not the time to get significantly more conservative with your existing investments. Because the mutual funds in this portfolio are quite conservative, I expect that over the long-term this portfolio will dramatically underperform most diversified portfolios that have significant equity exposure. More importantly, though, I do expect it to outperform CDs, savings accounts and money market accounts.

Please let me know if you would like to discuss whether this portfolio would be appropriate for your situation.

Assets Under Management and Referrals

As of March 31, 2009, MAM assets under management were approximately $65 million down from $70 million at the start of the year. I really appreciate the referrals that some of you have made, as that is my primary source of new clients. While my minimum amount to manage for new clients is $300,000, I am willing to be flexible depending on the individual's situation.

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

Very truly yours,

Stephen P. McCarthy, CPA, CFP

encl: Investment Reports