McCarthy Asset Management, Inc.

Registered Investment Advisor

Re: Second Quarter 2009 MAM Letter

Thursday, July 2, 2009

Dear Client,

What a volatile first six months of 2009! After experiencing the worst drop on record for the first two months of a year, the S & P 500 has now posted positive returns for four consecutive months. In fact, for the second quarter of 2009 the S & P 500 had its best quarter in over a decade. Looking forward, although I am cautiously optimistic, a temporary pullback would be healthy for the market to continue a sustainable recovery.

With this report for the quarter ending June 30, 2009, I discuss the performance of the market and MAM portfolios for the quarter and year-to-date. In addition, in my mid-year economic outlook, I discuss signs of economic improvement, list some of my short-term concerns and describe why longer-term I am optimistic. I also discuss a couple of portfolio repositioning moves I am contemplating for the third quarter and explain the recently passed Federal “Cash for Clunkers” bill.

Enclosed are four 6/30/09 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*: 2nd quarter and YTD 2009 portfolio rates of return
- *Realized Gains and Losses*: YTD 2009 investment realized gains and losses (included only for taxable accounts)

Stock Market & MAM Performance for Second Quarter

After posting negative returns for six consecutive quarters, the stock market broke out with its best quarter since the 4th quarter of 1998. Unadjusted for dividends, the S & P 500 rose 15.2%, the Nasdaq jumped 20.0%, the Russell 2000 climbed 20.9%, and the international equity index MSCI EAFE rose 23.8%.

MAM Portfolio Performance: For the quarter, 5% 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 gain of 13.0% (after fees), versus a gain of 16.0% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested. I am pleased that MAM portfolios captured 81% (13.0% divided by 16.0%) of the S & P 500’s return for the quarter. Although ten of the twelve

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

equity funds used by MAM outperformed the S & P 500, the conservative bond funds and Hussman fund held back the performance of portfolios.

Stock Market & MAM Performance for YTD 2009

For the first six months of 2009, the S & P 500 rose 1.8%, the Nasdaq jumped 16.4%, the Russell 2000 climbed 1.8%, and the international equity index MSCI EAFE rose 5.6%. These returns do not reflect the reinvestment of dividends.

For the first six months of 2009, 92% of MAM portfolios that were in existence for the whole period had performance that equaled or exceeded that of the S & P 500. The composite return of assets in MAM portfolios was a gain of 6.1% (after fees), versus a gain of 3.2% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Explanation of MAM out performance: Most MAM portfolios are currently positioned to experience 60% to 70% of the volatility of the S & P 500. As a result, 95% of MAM portfolios rose less than the S & P 500 during the very strong second quarter. On the other hand, 98% of MAM portfolios fell less than the S & P 500 during the very weak first quarter. The net result was that for the first six months of 2009, MAM-managed assets rose 2.9% more than the S & P 500. If the stock market continues to recover sharply, I expect that the performance of MAM portfolios will lag. As discussed below, however, I think it is prudent to remain defensive with portfolio positioning given the fragile economic environment we are experiencing.

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 June 30, 2009, the original $50,000 had risen to $65,404, plus $1,193 of cumulative withdrawals. This represents a cumulative return of 33.2%. During the same time, the S & P 500 (as represented by the Vanguard Index 500) fell 21.7%. For the quarter ended June 30, 2009, the portfolio rose 14.5%. All returns quoted for this portfolio (and for all MAM portfolios) are net of MAM fees. Also, past performance does not guarantee future results.

Mid-Year Economic Outlook

Anticipating Better Days Ahead: If you asked forecasters in early March about the prospects for the economy, you would have heard some very dire predictions of the possibility of a depression or Japan-like lost decade. Although we still face significant challenges and there's no shortage of negative forecasts, the consensus view is that the worst is behind us:

- While we are still seeing some tough news on job losses and corporate earnings, it appears that global economies have generally stabilized and early March was the point of maximum fear and pessimism.

- Consumer and business sentiment has shown modest improvement and some important economic indicators have gone from negative to neutral and in some cases positive. Much has been made of the so-called "green shoots" pointing to early signs of recovery.

- While businesses are still cautious, access to lending has improved and we are seeing some positive prospects for a resumption of economic growth. Even in the face of worsening global growth projections from the World Bank, the current forecast is for the U.S. to exit its recession in the second half of this year and for modest growth in 2010, followed by a return to stronger growth in 2011.

Reasons for short-term caution: Having said that the worst appears to be behind us doesn't mean we won't see continuing challenges in the economy and stock market in the period ahead. As I said at the outset of this letter, I am in the category of "cautiously optimistic". Here are some of the things that make me cautious:

- Consumer spending, which fuels 70% of our economy (i.e. Gross Domestic Product), is depressed as a result of increased savings rates in response to declines in stock markets and house prices. Reducing consumer debt is positive long-term but limits growth prospects in the near-term.

- The housing market is still depressed, with nearly 30% of mortgages in the "upside-down" category, where the mortgage exceeds the value of the house. While house prices are showing signs of bottoming, there is still risk of further downside as a second wave of adjustable mortgage resets is expected to hit starting late this year.

- The government is funding stimulus spending with record issuance of new debt and budget deficits. While at some point this will have to be repaid, it may also fuel inflation down the road. If and when this does occur, I expect to make portfolio adjustments to protect against rising inflation (purchase of REITs, commodity funds and possibly Treasury Inflation-Protected Securities (TIPS)) and a falling U.S. dollar (increased allocation to foreign equities and foreign bonds).

Why I'm Optimistic Longer-Term: While these challenges are real, I believe they are fundamentally manageable and that they are outweighed by longer-term positives. I don't believe anyone can predict market movements in the short-term. Instead I try to focus on prospects for the economy and markets looking out eighteen months to three years. When I do that, there are reasons for optimism:

- The coordinated action by central banks and Governments around the world appears to have stabilized the economy and prevented the precipitous decline that some had feared. We've never seen the level of international cooperation on the economic front that exists today.

- Some of the most extreme fears about the banking system now appear exaggerated. The stress tests of bank balance sheets gave most banks a clean bill of health and some have started repaying the funds they received earlier this year.

- In the past, the American consumer has driven growth in the global economies. In the future, I expect the rapidly growing middle class in countries such as China and India to fuel global economic growth. This provides a tremendous opportunity as currently consumer spending accounts for just 35% of China's economy and families save more than one-third of their disposable income.

- As discussed in my First Quarter MAM Letter, the best time to invest is after the stock market has performed poorly. Unless the stock market returns 60% (not going to happen!) for the remaining six months of 2009, the S & P 500 will have a negative rate of return for the decade ending 12/31/09. In the past, whenever the stock market experienced subpar returns for ten years, the returns for the subsequent decade had been well above average.

Stock Market Outlook

While I am cautious in my short-term outlook for stocks, my five to ten year outlook is that the stock market will provide decent annual returns somewhat below the long-term annual average of 10%. I expect these returns will be "choppy" with the stock market continuing to display above average volatility. These returns, though, should compare favorably to most any other investment alternatives (CDs, money market accounts, savings accounts, government bonds, etc.). In fact, for many investors, modest annual returns of at least 5% to 8% may be necessary for them to achieve their retirement goals. As a result, I expect stocks to benefit from a "tailwind" of increased demand as part of the huge amount still sitting in "cash" is eventually invested back in the stock market. Finally, due to opportunities in the corporate bond market and high-quality, dividend paying stocks, I expect that investors will be able to obtain close to "market-level" returns with diversified portfolios that have lower risk (and volatility) than the overall stock market.

Portfolio Repositioning

I am pleased with the current asset allocation of MAM portfolios. While I estimate that most MAM portfolios are positioned to be 60% to 70% as volatile as the stock market, on average MAM-managed assets have returned 2.9% more than the S & P 500 for the first six months of 2009. I don't think it is necessary or prudent to be aggressive in this current environment. The four largest funds in terms of MAM-managed assets are all conservative funds (Hussman Strategic Growth, Oakmark Equity Income, PIMCO Total Return (100% bonds) and TCW Total Return (100% bonds)). Despite being satisfied with the current asset allocation, I do expect to do some minor portfolio adjustments during the third quarter. At this point, I am contemplating the following changes:

- The healthcare fund Blackrock Health Science is the only "sector" fund that I use in portfolios. I like the healthcare sector because it is a growth industry that is resistant to economic downturns. Blackrock Health Science is an outstanding healthcare fund that is held in most MAM portfolios. Since the recently reopened fund was closed for a few years, some MAM portfolios do not hold a position in it. We will add a position in the Blackrock fund in these portfolios.

- I plan to add a position in Neuberger Berman Genesis to most portfolios. This outstanding small cap fund reopened to new investors earlier this year after being closed for more than seven years. Since historically small cap stocks outperform large cap stocks coming out of a recession, I think this would be a good time to add a dedicated small cap fund to portfolios.

- Although I still need to decide specifically what to sell to fund the purchases above, I expect the sales will come from existing equity funds. I don't plan to increase the volatility (or risk) of portfolios as a result of this repositioning.

"Very Conservative" Portfolios:

The early results of the "very conservative" portfolios that were introduced this past quarter have been good. It has been particularly interesting to see how the portfolios have performed during the days when the stock market has fallen sharply. I still believe these very low volatility portfolios are a compelling alternative to the very low returns offered by savings accounts, CDs and money market accounts.

"Cash for Clunkers"

Last week President Obama signed the long-awaited "Cash for Clunkers" legislation. The program, which will officially start in late July, will allow you to trade in a car with an EPA rating of 18 miles per gallon or less and receive a $3500 credit at the dealer to buy or lease a car rated at 22 mpg or more (18 mpg for small trucks and SUVs and 15 mpg for large trucks). The credit is in lieu of any trade-in allowance (since the old vehicle will be scrapped). You will get a $4500 credit if the replacement vehicle gets at least 10 mpg more than your old vehicle. To qualify, your trade-in must be a 1984 or newer model that's in drivable condition.

Sorry, would-be entrepreneurs: it's off-limits to buy an old car and "flip" it for the program—you must have owned and insured it for at least one year prior to trading it in. Also consumers should act fast. The bill provides vouchers for one million purchases, and the window is only from July 1 to November 1, 2009. The bill will be revisited in the fall, and some changes may be made at that time. For further information check out www.cars.gov, the official government Web site for the Car Allowance Rebate System (CARS).

Review of Beneficiaries for Tax-Deferred Accounts

One of the things that investors can overlook is maintaining current beneficiary information for their retirement accounts. Just like we did three years ago, in July we will be sending a letter to clients providing them with the primary and contingent beneficiary information that Schwab has on file for their tax-deferred accounts managed by MAM. We will be asking clients to confirm that the information is still current or to provide us with any changes.

Assets Under Management and Referrals

As of June 30, 2009, MAM assets under management were over $75 million, up from $70 million at the start of the year. Please keep us in mind if you know of anyone who is in need of help with managing their investments. While our minimum amount to manage for new clients is $300,000, we are 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