McCarthy Asset Management

Certified Public Accountant
Certified Financial Planner

Wednesday, January 9, 2002

Dear Client,

Happy New Year! I think that all of us are glad to see 2001 come to an end. The horrific events of September 11 will forever change our lives. I have been heartened by the response of the Federal Government and fellow Americans and am optimistic about our future. Our economy suffered a brutal blow from the terrorist attacks. America has weathered difficult times before. I am confident that the interest rate decreases, lower energy costs, and government economic stimulus programs will contribute to improving economic conditions during 2002. Experts now predict that a slow recovery should start in the second quarter of 2002. The stock market seems to be expecting this recovery. It has staged a dramatic rise since the third week of September.

Enclosed are four investment reports for the quarter ending December 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 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 2001. Also enclosed is the MAM "Privacy Disclosure Statement". By Federal law I am required to provide this to clients annually.

Stock Market Performance

For the fourth quarter of 2001 the stock market staged a strong recovery. For the quarter the S & P 500 rose 10.3% to 1148, the Nasdaq Composite jumped 30.1% to 1950, and the Russell 2000 rose 20.7% to 489. This was the best quarter of performance for the U.S. stock market since the fourth quarter of 1999.

For all of 2001 the S & P 500 fell 13.0%, the Nasdaq dropped 21.1% and bucking the trend, the Russell 2000 climbed 1.0%. This second consecutive annual drop in the S & P 500 is the first time that has happened since 1973 to 1974 (i.e. OPEC oil embargo).

Will the stock market recovery continue? As I said in last quarter's report, "the market is unpredictable over the short-term. I have learned to respect that. It often does the opposite of what people think. Though it is hard to imagine a rally now, it is not out of the question. First,

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cash on the sidelines is at a 20-year high. This suggests that many investors have already sold and that some of this money will make it back into the market eventually. Investor pessimism is extremely high and this is a good contrary indicator because when investors are extremely pessimistic they have usually already done most of their selling. I don't expect a rally but the point is that I don't know what will happen over the short-term so it makes sense to base decisions on longer-term factors that we can assess." A dramatic rally started on September 24, 2001. It is impossible to predict how long it will continue. I am optimistic though that during 2002 the U.S. economy will start to recover from the recession. More importantly, I am confident that over the longer time equity investments will continue to prove superior to all alternatives.

MAM Performance for the Quarter

In General: MAM portfolios performed well in the fourth quarter relative to the S & P 500. Of the fully invested MAM portfolios, 90% outperformed the S & P 500 return of 10.3%. The average gain (of fully invested MAM portfolios) was 12.1%. The portfolios that under performed the S & P 500 were conservative ones that had a greater than 10% weighting in bond funds.

Best Performers: The seven best performing MAM mutual funds for the fourth quarter were Red Oak Technology (up 49.2%), Firsthand Technology Value (41.4%), Firstar Micro Cap (26.6%), TCW Galileo Select Equities (25.9%), White Oak Growth (24.3%), Bjurman Micro Cap (21.2%) and Artisan Midcap (21.1%). Technology funds did the best and the growth funds outperformed the value funds.

Worst Performers: The MAM mutual funds that under performed the S & P 500 for the quarter had little or no technology exposure. In order of worst performance these were Vanguard Healthcare (up 2.3%), Loomis Sayles Bond (2.7%), Cohen & Steers REIT (3.3%), Weitz Partners Value (5.8%), Oakmark Select (8.3%), and Artisan International (9.8%).

Oldest Portfolio: 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 December 31, 2001 the original $50,000 had grown to $59,653 for a cumulative return of 19.3%. During that time the S & P 500 lost 12.3%. For the quarter ended December 31, 2001 this portfolio rose 12.8%. 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 indicative of future performance.

MAM Performance for the Year

For all of 2001 MAM portfolios performed very well relative to the S & P 500. For portfolios that were fully invested at the beginning of 2001, 89% outperformed the S & P 500 loss of 13.0%. The average loss (after subtracting the MAM management fee of 1.0%) was 7.9%. The portfolios that under performed the S & P 500 held either individual stocks and/or had a large weighting in technology stocks.

I attribute the 5.1% positive performance of MAM portfolios relative to the S & P 500 during 2001 primarily to two factors:

Fund Selection: A distinguishing aspect of MAM relative to other investment advisors is the attention paid to identifying promising small mutual funds that close off to new investors at a small asset level. The strategy is to discover these funds and establish a position in them before they

close. I feel that funds with a small asset based have a significant advantage over larger funds. This is because a manager of a small fund can move in and out of stocks without impacting prices. This is particularly important for funds that invest in small cap stocks. As a result of this strategy, most MAM portfolios have established positions in the Bjurman Micro Cap Growth and Oakmark Select. These two funds have performed extremely well the last two years and both closed to new investors during 2001. Three additional small cap funds that are in most MAM portfolios and I anticipate will be closed are Artisan Mid Cap, Bogle Small Cap Growth and Firstar Micro Cap.

Asset Allocation: Favorable asset allocation has a significant impact on the return of a portfolio. All MAM portfolios are under weighted in large cap stocks (20 to 25% of assets), over weighted in small and mid cap stocks (40 to 50%) and have a significant weighting in REITs (6 to 9%). This asset allocation has been beneficial because since the beginning of 2000 small cap stocks have outperformed large cap stocks and REITS have done even better.

MAM Strategies

One of the best investment research publications I read is the "Advisors Intelligence". This is a online publication from Litman/Gregory Research. It is sold to investment advisors like MAM. In November of 2001 Advisors Intelligence issued an article which discussed 7 themes for investments for the next several years. If you would like to read the article, please contact me and I will send you a copy. I agree with all seven themes and six of them are already reflected in the current asset allocation of MAM portfolios:

***Theme 1:* Returns from large-cap stocks are unlikely to exceed single-digits over the next three to five years and could fall in the mid-single-digit range.**

MAM portfolios continue to be under weighted in large-cap stocks with a 20 to 25% weighting.

***Theme 2:* Investment-grade bond returns will be low (even lower than large-cap stocks).**

Most portfolios have little or no high-grade bond exposure. High grade bond prices will be hurt by rising interest rates which could start occurring later this year.

***Theme 3*: Value stocks are no longer greatly undervalued relative to growth stocks.**

In early 2000 value stocks were significantly undervalued relative to growth stocks. Their appreciation since then combined with the dramatic drop in the prices of growth stocks now

means that value stocks are no longer a bargain. Recently I sold a small portion of the value funds and moderately increased the exposure to growth funds (see "Recent MAM Portfolio Activity" below).

***Theme 4:* In a market where neither growth nor value is a clear choice, we will focus on managers who have the flexibility to switch between the two.**

MAM mutual funds that fit this style are Bjurman Micro Cap (and Bjurman All Cap), Bogle Small Cap Growth, Artisan Mid Cap and Firstar Micro Cap. The technology weighting of these funds can vary widely over time. For instance, at the beginning of 2000, 70% of Bjurman Micro Cap was invested in technology stocks. By the end of 2000, this technology exposure had been reduced to 14%. As a result of September 11, the technology exposure was recently increased to 20%.

***Theme 5:* Pure small-cap exposure should be increased.**

Small and mid-cap stocks continue to comprise 40 to 50% of MAM portfolios.

Theme 6: High-yield bonds will be a very good investment.

This is the one theme that until recently was not emphasized in MAM portfolios. During December I added a 3 to 6% position in Pioneer High Yield bond fund in most portfolios. Please see below for a discussion of this outstanding fund.

Theme 7: REITs should remain a very good investment.

REITS will continue to represent 6 to 8% of MAM portfolios.

Recent MAM Portfolio Activity

Portfolio Adjustments: During the second and third quarters of 2001 I did moderate repositioning in almost all MAM portfolios. The main purpose was to establish positions in Bogle Small Cap Growth and Firstar Micro Cap and to do tax loss swapping in the taxable portfolios. During December I did additional moderate repositioning in those MAM portfolios with $75,000 or more invested. Generally I sold a small portion of the value funds (Artisan Small Cap Value, Oakmark Select, PBHG Clipper Focus, and Weitz Partners Value) and other funds with little or no technology exposure (Cohen & Steers Realty, Loomis Sayles Bond and Vanguard Asset Allocation). I reinvested the proceeds in small cap growth funds (Artisan Mid Cap, Bogle Small Cap Growth and Firstar Micro Cap) and a new MAM fund, Pioneer High Yield. This has resulted in a small increase in the technology exposure in most portfolios.

New Fund: I am very excited about a fund that I recently started purchasing, Pioneer High

Yield Fund. Margie Patel has managed this fund since its inception in 1998. It has outperformed the average high-yield fund by more than 18 percentage points per year for the three years ended November 30, 2001. Ms. Patel's approach is different from many other high yield bond funds. While other high yield bond funds have been hurt by their exposure to the telecommunications industry, Ms. Patel has largely avoided this area. She has focused more on the technology, energy and health-care areas through investments in convertible bonds. While providing a lower yield (9.5%) than the average high yield bond fund (12%), Pioneer has a higher quality portfolio with greater appreciation potential with its convertible bond holdings.

Like Firstar Micro Cap, Pioneer High Yield Fund is a loaded fund (4.5% sales load). The sales load is waived, however, by Schwab Instititutional. In addition, since the fund is part of Schwab's

one-source program, I am able to purchase (and sell) it for no fee. To provide you with more information on the fund, I have enclosed the most recent Morningstar report.

Increase in Minimum Investment Amount

As of December 31, 2001 MAM assets under management were in excess of $29 million. This is an increase from $24 million at the start of the quarter and from $21 million at the start of the year. With the anticipated inflow from new clients, assets under management are expected to exceed $30 million during the first quarter of 2002.

MAM assets grew during 2001 despite a difficult stock market. The greatest source of new clients was referrals from existing MAM clients. I very much appreciate these referrals. My long-term plan is still to limit the number of MAM clients to 200. (The current number of clients who have invested $75,000 or more is 140.) In an effort to keep the number of clients at a manageable level, effective February of 2002 I am raising my $150,000 minimum for new clients to $200,000. If assets continue to grow as they have, I anticipate an additional increase this Summer to $250,000. This increase is only for new clients as I will still manage lesser amounts for existing clients.

Meanwhile I continue to reduce the size of my tax practice. Last year I reduced my tax clientele to 286 (from 512 for 2000). This year I expect to further reduce the number to about 240.

Miscellaneous Item

UAM Clipper Focus is now PBHG Focus: During December the Clipper Focus fund was transferred from UAM funds to PBHG funds. The same Company owns both the UAM and PBHG fund families. The only impact of the transfer is that the symbol for the fund has been changed to "PBFOX". The fund will continue to be managed by its 5-member team. The performance of the fund has been outstanding. For the three years ending September 30, 2001 the fund returned 17.4% per year (versus a 5.0% return for the Russell Top 200 Value index). Like most MAM funds, the asset base is small (less than $250 million as of September 30, 2001). I hope that as a result of the transfer to PBHG the fund will not receive much additional attention leading to a large inflow of new investors. Management has not indicated that the fund will be closed to new investors at a certain asset level. I will continue to monitor the growth in the fund and its impact on performance.

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

encl: Investment Reports
Morningstar report on Pioneer High Yield
Privacy Disclosure Statement