McCarthy Asset Management, Inc.

Registered Investment Advisor

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Monthly Investment Commentary- April 2007

Stock Market Performance for April: The stock market turned in a very good month, led by strong performance of large-cap stocks. Unadjusted for dividends, for the full month the S & P 500 and NASDAQ rose 4.3%, while the Russell 2000 rose 1.7%. Bonds, commodities and foreign equities rose modestly, while REITS fell.

MAM Performance: For the month, MAM portfolios under performed the S & P 500, with a composite rise of 2.7% (after all fees), versus a rise of 4.4% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

The five best performing MAM investments for April were Oakmark Select (up 5.2%), Cambiar Opportunity (up 4.7%), Capital World Growth & Income (up 4.6%), Selected American (up 4.1%), and American Growth Fund (up 3.9%).

The five worst performing MAM investments for April were Hussman Strategic Growth (down 0.4%), Cohen & Steers REIT (down 0.3%), Allied Capital (up 0.3%), Nuveen High Yield Municipal Bond (up 0.4%), and PIMCO Commodity (up 1.5%).

The significant underperformance of MAM portfolios relative to the S & P 500 was due to large cap stocks (i.e. the S & P 500) being the best performing part of the market. While the S & P 500 rose 4.3% for the month, the Russell 2000 rose only 1.7%. Furthermore, the five best performing investments used by MAM were four large-cap U.S. stocks funds and one large-cap global fund, while the first worst performing were four alternative assets investments and a bond fund.

Next Repositioning: For the years 2000 through 2006, small cap stocks outperformed large caps. This is a long period of out performance. In anticipation of the reemergence of large cap stocks, I have steadily reduced small cap exposure and increased large cap exposure during the portfolio repositioning of the last two years. I expect to continue to increase large cap exposure with the upcoming portfolio repositioning planned for the later this quarter.

I am also considering replacing Hussman Strategic Growth, a conservative hedge fund, with Black Rock Health Science, an outstanding health care fund, in all but the most conservative portfolios. The Hussman fund performed extremely well during the 2000 through 2002 downturn, and I think it is an interesting fund that provides excellent downside protection in a bear market. I have been growing impatient, though, with the poor performance of the last couple of years as John Hussman has continued to fully hedge the stock exposure in the portfolio. As for Black Rock Health Science, while I normally avoid sector funds, health care is the one sector I am comfortable targeting as I expect health care spending to continue to rise rapidly as our population ages.

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Year-To-Date Performance: For the first four months of 2007, unadjusted for dividends, the S & P 500 rose 4.5%, the Nasdaq climbed 4.6%, and the Russell 2000 rose 3.4%. MAM portfolios under performed the S & P 500 for these four months, with a composite return of 4.0% (after all fees), versus a gain of 5.0% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Slowing Growth in U.S. Economy: The U.S. economy started 2007 with its weakest growth in four years, as a housing slump continued to hobble expansion. On April 23rd the Commerce Department reported that the nation's gross domestic product (GDP) grew at an annual rate of 1.3% for the first quarter of 2007, down from 2.5% for the fourth quarter of 2006.

While former Federal Reserve Chairman Alan Greenspan has put the chance of a recession this year at one in three, at least for now most economists believe the risk of a recession is low. In particular, Federal Reserve Chairman Ben Bernanke has said he doesn't believe the economic expansion, now in its sixth year, is in danger of ending.

The first quarter GDP report actually showed that consumer spending held up well and business investment picked up, suggesting the worst of the slowdown might be past and giving economists reason to predict faster growth in the months ahead. Among the more encouraging signs, consumer spending, which accounts for about 70% of economic activity, grew at a 3.8% annual rate in the first quarter. While that is down from a 4.2% rate in the prior quarter, it was higher than the 3.2% rate for all of 2006.

Slowing Growth in Corporate Earnings: With more than 50% of the companies in the S & P 500 having reported, Thomson Financial expects the year-over-year earnings-growth for the first quarter to come in at 7.1%. That would end a run of 14 straight quarters of double-digit gains. A 7.1% earnings growth is still good as the long-term average annual growth in earnings for U.S. companies is 6%. In addition, earnings for the first quarter have been coming in ahead of expectations. A few weeks ago, analysts were predicting that overall S & P 500 earnings growth would be 3.1%.

Where's The Stock Market Headed? The volatility of the stock market this year shows the difficulty of trying to predict the short-term movement of stock prices. Through February 26th stock prices had been quietly creeping higher. Then starting on February 27th the S & P 500 fell 5% over a span of two weeks. Since then, the market more than fully recovered those losses. As I mentioned in the March 31, 2007 quarterly report, I feel that the return of volatility is good for the health of the stock market because it keeps investors from becoming too complacent. I continue to have a positive outlook for the market for the foreseeable future.

529 Plans (College Savings Plans)

In the interest of covering important financial planning topics in the Monthly Commentary, this month I am discussing 529 Plans:

Overview: I last wrote about state-sponsored college savings plans, commonly referred to as "Section 529 plans", in my newsletter from June of 2002. I think you should consider the use of one of the plans if you have young children or grandchildren. 529 plans have been around for about a decade. Each state has at least one Section 529 plan. No income limits apply for participants or beneficiaries. Contribution limits vary, but it's typical for a state to allow as much as $250,000 to be put into a 529 for each beneficiary—all at once, or over a period of years. Any individual may open an account for a beneficiary. At any time a participant may

change the beneficiary to another family member of the original beneficiary. The participant or beneficiary may reside in California or in another state and the beneficiary may attend school at any institution of higher learning in California or another state that qualifies for federal financial aid.

I feel that the tax advantages of 529 plans make them a good choice in saving for college. Although contributions are not deductible on your federal return, the investment grows tax-deferred, and distributions to pay for the beneficiary's college costs are tax-free. The tax-free treatment was made permanent with the Pension Protection Act of 2006. Certain states (California is not one) allow a deduction for contributions to their 529 plan.

I was very surprised to see in a March 2007 article in SmartMoney that nearly 80% of the 529 accounts are sold through brokers. This is unfortunate, as the upfront commissions as high as 5.75% reduce the amount available to be invested. I made the decision seven and-a-half years ago when I started MAM that I will not "manage" 529 assets for clients. My rational continues to be that I can not justify charging my fee of up to 1% annually for managing money that has only limited investment options (i.e. the choices available in any particular plan). In addition, there are good resources available for investors to select a 529 plan. I recommend checking out www.savingforcollege.com.

California ScholarShare: California's version, called the ScholarShare College Savings Plan, became operational on October 1, 1999. The investments are now managed by Fidelity (previously the manager was TIAA-CREF). To find out more about the California ScholarShare Program or to obtain an application, you can access their website at www.scholarshare.org.

Control of Assets: An important benefit of 529 plans is the control of assets. The account holder (i.e. parent, grandparent) controls the money until it is used for college. If the child ends up not attending college, the money can be transferred to another family member who is expected to attend college. Accounts can even be transferred between cousins, which can provide great flexibility for grandparents. If the assets are not used up for college expenses the money can be withdrawn by the account holder, although the earnings will be taxed and there will be federal and state penalties on the earnings. The control of assets provided by 529 plans is in contrast to custodial account (also called UTMA accounts in California) where the child gains control of the assets at age 18 or 21.

Please call or email me if you have any questions or would like to discuss your portfolio(s).

Sincerely,

Stephen P. McCarthy, CPA, CFP