McCarthy Asset Management, Inc.

Registered Investment Advisor

March 3, 2008

Monthly Investment Commentary- February 2008

Stock Market Performance for February: After a sharp drop on the last day of the month (maybe it is good leap year happens only once every four years), stocks finished February with their fourth consecutive down month. Unadjusted for dividends, for the full month the S & P 500 fell 3.5%, the NASDAQ dropped 5.0%, and the Russell 2000 fell 3.8%. Foreign equities also fell, while bonds rose and commodities soared.

MAM February Performance: For the month, MAM portfolios out performed the S & P 500, with a composite loss of 0.8% (after all fees), versus a drop of 3.3% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

Year-To-Date Performance: So far 2008 has not been kind to investors. For the first two months of 2008, unadjusted for dividends, the S & P 500 fell 9.3%, the Nasdaq dropped 14.4%, and the Russell 2000 fell 10.4%. MAM portfolios out performed the S & P 500 for these two months, with a composite loss of 5.3% (after all fees), versus a loss of 9.1% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

I attribute the 3.8% year-to-date out performance of MAM portfolios relative to the S & P 500 to the following three reasons:

- Bonds: While bond exposure penalized MAM portfolio performance during 2006 and 2007, it has provided a significant benefit during the recent market slide. The move we made in mid-January to increase bond exposure and reduced equity exposure has allowed for greater downside protection and reduced portfolio volatility.

- Alternative Assets: MAM's two alternative asset investments have performed very well so far this year. The high-yielding business development company Allied Capital staged a partial recovery from its dreadful 2007 performance. More importantly, PIMCO Commodity soared over 23% as commodity prices continued to climb sharply.

- Equity Mutual Fund Selection: Excluding balance funds (which invest in equities and bonds), there are 19 U.S. and foreign equity mutual funds used in MAM portfolios. For the first two months of 2008, 15 of the 19, or 79%, fell less than the S & P 500. Unlike the dotcom bust period of 2000 through 2002, when MAM portfolios out performed the S & P 500 by allocating a large percent of assets to small cap stocks, the 2008 performance has been in the large cap area. With the late 2007 portfolio repositioning, dedicated small cap funds were eliminated in most portfolios. So far this appears to have been a good move as small caps have performed even worse than large caps this year, as indicated by the year-to-date drop of 10.3% in the Russell 2000 Index.

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Year-To Date Best and Worst Performers: The five best performing MAM investments for the first two months of 2008 were PIMCO Commodity (up 23.5%), Allied Capital (up 5.1%), PIMCO Total Return (bonds) (up 3.4%), PIMCO Developing Local (bonds) (up 3.2%), Yieldquest Total Return (bonds) (up 0.6%).

The five worst performing MAM investments for the first two months of 2008 were Columbia Marsico 21st Century (down 11.7%), Artisan International Small Cap (down 9.4%), iShares Russell 1000 Growth Index (down 9.4%), Dodge & Cox International (down 9.3%), and Schwab S & P 500 (down 9.2%).

Recession- Are We There Yet? My feeling is that it is likely we either entered a recession at the start of 2008, or will enter one soon. In the most recent Wall St. Journal Survey, 55% of economists still think the U.S. will avoid one. Of the 45% of economists who predict the U.S. will enter a recession this year, most expect a "short and shallow" downturn. While I don't pretend to have any special insight or to be privy to any unique data, I am concerned about these major factors ailing the U.S. economy:

- Employment: Consumer spending represents 70% of the U.S. economy and the major determinate of consumer spending is employment. Since last July, the economy has created an average of just 68,000 jobs a month; far below the 100,000 that economists say is needed to support economic growth. The recent employment reports have been dismal. The Labor Department's December Jobs Report has shown the economy added just 18,000 new jobs, while the preliminary January report has shown the economy lost 17,000 jobs, the first monthly jobs reduction in over four years. On Friday March 7th, the Labor Department will release its Jobs Report for February. Economists are forecasting a gain of 40,000 new jobs, along with a possible upward adjustment to the negative January report. Let's hope so. If instead the report shows that the economy has lost jobs for the second consecutive month, it could signal the end of the five-year U.S. economic expansion.

- Real Estate: After 14 years of rising prices, the housing market is unwinding. On February 26th Standard and Poors reported that U.S. home prices dropped 8.9 percent in the final quarter of 2007 compared with a year ago. This represents the steepest decline in the 20-year history of the S&P/Case-Shiller home price index. Home prices also plunged 5.4 percent from the previous three-month period, by far the largest quarter-to-quarter decline in the index's history. The previous record was the revised 1.8 percent decline in the third quarter of 2007.

  The decline in real estate prices may represent the bursting of another bubble. According to research done by Yale University economist Robert J. Shiller, since 1890, U.S. real estate prices have averaged a 0.4% growth per year above inflation. A real estate bubble may have started forming in 2000, when two powerful forces propelled prices dramatically above their long-term trend line: lax lending standards and the conviction that housing is a fail-safe investment. The correction may simply be an adjustment of real estate prices down to where they should be based on their historical rate of growth. Some economists predict prices could fall another 25%. While I certainly hope we won't experience anything close to that, real estate is in for a rough ride for the foreseeable future. At the current rate of sales, it would take 9.9 month to sell all of the homes currently on the market. The 9.9 month's supply is the largest in more than 26 years. A normal supply is five to six months.

- Consumer Confidence: On February 26th the Consumer Confidence Board reported that the Consumer Confidence Index fell to 75, down from 87.3 in January. With the exception of the Iraqi War in 2003, this represents the lowest level in nearly 15 years.

- ISM Index: On February 5th the Institute for Supply Management said its index of non-manufacturing business activity, which is based on a survey of purchasing managers in service industries, fell to 41.9 in January from 54.4 in December. That was the sharpest decline in the survey's 10-year history. A reading below 50 indicates that industries are shrinking.

- Rising Inflation: The government reported that prices rose 1% last month, with food and energy leading the way. Currently, the Fed is less concerned about inflation, because policy-makers believe it will eventually recede in response to a weak economy, as it has in the past. Nonetheless, the threat of increasing inflation adds complexity to the Fed's role in supporting the U.S. economy.

Stock Market Outlook: Are these economic factors "doom and gloom" for the stock market? Not necessarily. Historically, one of the best times to be invested is when the U.S. economy is in the middle of a recession. My short-term outlook, though, is one of caution. I continue to be concerned that the current level of stock prices does not sufficiently reflect the recession risks that we face.

There are positives, though, that may allow the U.S. economy to avert a recession, or at least lessen the severity of one. Since last September, the Federal Reserve has reduced interest rates five times. While I think the Fed should have been more aggressive in slashing rates last fall, they probably made up for it with the two cuts this January. The current expectation is that the Fed will cut the Federal Funds rate another 0.5% (down to 2.5%) at its March 18th policy meeting. Recently, the futures market put the odds at 68% of an additional 0.25% cut in late April. In addition, the Federal Government Stimulus Package which was passed in late January should provide a significant short-term boost to the economy later this year.

The bottom line is that I continue to feel that the stock will remain very volatile in the foreseeable future, with a possible downside trend. Beyond that (maybe by this summer) I hope for the economy and stock market to start to recover.

Visa IPO: Visa Inc will have its initial public offering the week of March 17th in what is expected to be the largest U.S. IPO ever. I mention this because so far two clients have asked about participating. For regulatory reasons, I don't take part in IPOs with MAM portfolios. To do so would raise significant issues with the Securities and Exchange Commission. For instance, how would I allocate among portfolios the limited number of shares that Schwab may allot to MAM clients? For those of you who want to participate, Schwab told me that investors with retail Schwab accounts are eligible. If you are interested in doing this, you should establish a retail Schwab account ASAP. You should then call Schwab at
1-800-435-4000 and ask to speak with a broker.

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

Sincerely,

Stephen P. McCarthy, CPA, CFP