McCarthy Asset Management, Inc.

Registered Investment Advisor

March 2, 2012

Monthly Investment Commentary- February 2012

Stock Market Performance for February: The stock market continued its strong start to 2012 with very good performance for February. For the month, unadjusted for dividends, the S & P 500 rose 4.1%, the NASDAQ climbed 5.4%, the Russell 2000 rose 2.3%, and the international equity index MSCI EAFE climbed 5.4%. Bonds, as represented by the Barclays Global Aggregate Index, fell 0.1% for the month.

MAM February Performance: MAM portfolios underperformed the S & P 500 for the month. Excluding the "very conservative" portfolios (which rose 1.4%), MAM portfolios rose 2.6% (after all fees), versus a rise of 4.5% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested. Although the bond funds used by MAM beat the performance of the Barclays Global Aggregate Bond Index, they still held back the performance of the portfolios relative to the all-equity S & P 500 Index.

Year-To-Date Performance: For the first two months of 2012, unadjusted for dividends, the S & P 500 rose 8.6%, the NASDAQ climbed 13.9%, the Russell 2000 rose 9.5%, and the international equity index MSCI EAFE climbed 11.0%. Bonds, as represented by the Barclays Global Aggregate Index, rose 1.6% for the year-to-date. Excluding the "very conservative" portfolios (which rose 3.8%), MAM portfolios rose 6.2% (after all fees), versus a rise of 9.0% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

February Economic Update

The following is a summary of some of the significant economic events this past month:

- **Job Growth:** The Bureau of Labor Statistics said U.S. payrolls added 243,000 jobs in January, the fastest level of growth since last April. The unemployment rate dropped to 8.3%, its lowest level in almost three years.

- **Upward Revision to GDP:** The U.S. economy grew at an annual rate of 3% in Q4 2011, a more rapid pace than the 2.8% initial estimate. While growth is still expected to slow this quarter, a steady stream of fairly upbeat data ranging from employment to manufacturing has caused analysts to temper expectations of a sharp pullback in growth this quarter. Analysts currently estimate first-quarter GDP growth to be between 2.0 and 2.5 percent.

- **2nd Greece Bailout:** Eurozone finance ministers agreed to the terms of a second bailout for Greece, worth 130 billion Euros, after the country's coalition government approved additional austerity measures and private bondholders (i.e. banks) agreed to swap their Greek sovereign bonds for ones worth almost 54% less.

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

- **<u>Payroll Tax Reduction and Unemployment Benefits Extension:</u>** Congress agreed to extend through the end of 2012 the 2% payroll tax reduction and for up to 99 weeks the long-term unemployment benefits (although the duration of benefits will be gradually reduced to 73 weeks over the course of 2012).

- **<u>Real Estate- Close to the Bottom?</u>** Though housing starts, new residential construction, and home resales all improved during the month—they were up 1.5%, 1.5%, and 4.3% respectively—the good news didn't extend to home prices. The S & P 500/Case-Shiller national index of home prices hit its lowest point since its mid-2006 peak dropping 33.8% since then. Robert Shiller, the Yale economist and co-creator of the Case-Shiller index, has a mixed outlook on home prices. Last year he was quite negative when he thought home prices were in danger of falling by up to another 25% before they bottomed out. He recently cited several economic reports as signs that housing could start stabilizing. He also is focused on recent surveys that indicated that Americans are very confident of the long-term prospects for housing as an investment.

<u>Stock Market Outlook</u>

<u>Due for a Pause?</u> After a volatile and disappointing 2011, this year the stock market has gotten off to its best two-month start since 1987. While I remain cautiously optimistic in my 2012 outlook, the market may be due for a modest pullback. There are a number of reasons that could cause this: rising gasoline prices, slowing corporate earnings growth, massive U.S. fiscal deficits that are unlikely to be addressed until after the 2012 Presidential election, pending dramatic 2013 increases in Federal taxes particularly for investment income, the ongoing concerns over European sovereign-debt crisis, and the possibility of hostilities with Iran which could cause oil prices to skyrocket. Wow, that's enough worries to scare away most any investor! The stock market, though, likes to "climb a wall of worry" where investors reflect confidence that the current issues will be resolved at some point. A more important time for investors to be cautious is when all the news seems good (i.e. 1999).

<u>Longer-Term Outlook More Positive:</u> Despite the recent run-up in stock prices, I think the stock market is still reasonably priced relative to earnings. FMI Large Cap, one of the funds used in nearly all MAM portfolios, had its managers named as one of five finalists for Morningstar's U.S. equity fund manager of 2011. The 12/31/11 quarterly report for the Fund provided the following discussion which explains why longer-term I feel more optimistic for the stock market:

*"Today marks the tenth anniversary of the FMI Large Cap Fund. When we started the Fund **(beginning of 2002), the S & P 500 traded at 46.5 times the prior twelve months report earnings** and 30.0 times operating earnings (before write-offs). We indicated in our very first FMIHX shareholder letter that valuations were extraordinarily high and that we expected difficult returns for the S & P 500. On a total cumulative return basis, the S & P 500 gained 33.35% over the past decade, or 2.92% compounded. FMIHX gained 86.68% during this period, for a total compound annual return of 6.44%. Most of the rating services rank the Fund near the top of its class. These results have been achieved while taking less risk than the market, at least as measured by volatility of returns. **Today, valuations are much more reasonable, with the S & P 500 trading at approximately 14 times 2012 earnings** and FMIHX trading at around 12 times. With sentiment poor and valuations reasonable, the next decade looks more favorable than the last."*

Introducing The Savvy Life, A Financial Education Company

I recently met Melissa Tosetti, the founder of Redwood City-based The Savvy Life, a financial education company whose purpose is to provide clients the financial lessons they did not learn from parents or in school. I am very impressed with Melissa. I feel that she offers valuable financial services that complement the financial planning and investment management services offered by MAM. Melissa teaches the financial skills for people to improve their day-to-day money management. In particular:

- Melissa's philosophy is to teach personal finance from a lifestyle perspective because money affects everything. It affects where you live, what you eat, what you wear and how you spend your free time. Effective money management is about more than just contributing to a retirement account or buying an item on sale. For this reason, much of her focus is on the areas where you most often spend including your Home, Food, Wardrobe, Travel and Entertainment.

- She works with clients to create a strong financial foundation by implementing savvy day-to-day habits and routines. She then introduces The Savvy Life Philosophy which is to save money in the areas that are not as important to you so you can focus your spending on the areas that are important to you.

- She provides this through her book, classes, an online program and one-on-one coaching:

  Book: Melissa's international bestseller, Living the Savvy Life, teaches how to create habits and routines that allow you to build and manage your finances effortlessly.

  Classes: Melissa currently teaches a Living the Savvy Life class series at the Unity Church in Palo Alto (see attached for a list of classes offered in March and April).

  Online Program: The Living the Savvy Life online program brings the international best seller to life, guiding you day-by-day, step-by-step to help you create your own savvy life. Through daily emails and a membership site that houses, articles, videos, forums and more, members create a strong financial foundation and then focus their attention on the areas where they most often spend money such as their Home, Food, Wardrobe, Beauty, Travel and Entertainment.

  One-on-One Coaching: Melissa offers two one-on-one coaching programs. With the Bridging The Gap Program, she works with you to create a plan to bridge the gap between your financial resources and your goals and dreams. The Savvy Life Makeover Program is a more extensive three month program that will help guide you through the six areas of your life that are most affected by money: Day-to-Day Financial Management, Home, Food, Wardrobe, Beauty and Travel/Entertainment.

- For more information regarding the services Melissa offers, check out her website: http://www.thesavvylife.com/

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

Sincerely,

Stephen P. McCarthy, CPA, CFP®