

McCarthy Asset Management, Inc.

Registered Investment Advisor

December 1, 2008

Monthly Investment Commentary- November 2008

Stock Market Performance for November: November was another difficult and volatile month as the S & P 500 fell 7.5%, the NASDAQ dropped 10.8%, the Russell 2000 fell 12.1%, and the MSCI EAFE international index fell 5.7%. Results for bonds were mixed, while commodities and REITs fell sharply.

November MAM Performance: For the month, MAM portfolios out performed the S & P 500, with a composite loss of 6.6% (after all fees), versus a drop of 7.2% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

The performance of MAM portfolios relative to the S & P 500 was helped by the downside protection provided by bond funds. MAM portfolios' bond allocation has increased this year as bonds have fallen less than equities. While this will help if the stock market continues to fall, it will probably cause MAM portfolios to underperform the S & P 500 if the market were to rise.

Year-To-Date Performance: For the first eleven months of 2008, unadjusted for dividends, the S & P 500 fell 39.5%, the Nasdaq dropped 42.3%, the Russell 2000 fell 38.4%, and the MSCI EAFE international index plummeted 48.2%. During this time MAM portfolios slightly out performed the S & P 500 with a composite loss of 37.0% (after all fees), versus a loss of 37.7% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested.

With the S & P 500's year-to-date drop of 37.7% (with dividends) the market is on pace to suffer its worst calendar year in 77 years (in 1931 the S & P 500 fell 43.3%). Although I am not predicting a repeat performance, in the five years after the 1931 loss (i.e. 1932 through 1936), the S & P 500 gained 176%, or an average annual return of 22.5%.

New Economic Team and Stimulus Package

Saddled with a lame duck President with a record-low approval rating and another two months before a new administration takes office, the economy and financial markets have been grappling with a crisis of confidence. The hope may lie with President-elect Obama. Mr. Obama recently said, "Help is on the way!" So far, President-elect Obama hasn't missed a beat. He has made solid picks in selecting his economic team, including Tim Geithner's nomination as the next Treasury Secretary. Although relatively young, Geithner is a seasoned professional who has played an important role already in diffusing the current crisis as head of the New York Federal Reserve Bank. In an earlier stint in the Executive Branch during the Clinton Administration, Geithner also had a hand in resolving international financial crises.

In addition, Obama is pushing for a massive stimulus package estimated to total \$500 to \$700 billion to jumpstart the economy. Unlike last January's tax stimulus rebate package, the Obama team is looking at much deeper and longer-term spending with a massive two-year spending and

tax-cutting recovery program. In announcing the package, he provided a list of priorities that included creating 2.5 million jobs, and spending on roads, bridges, schools and clean-energy programs. Regarding taxes, Mr. Obama suggested he might not push quickly to implement tax hikes for the highest earning Americans. Although he said that high-end taxes need to be raised to help pay for his proposed public spending, he added that his economic team was evaluating whether to push for tax hikes, or whether to allow rates to rise on their own after President Bush's tax policies expire at the close of 2010.

The Bear Market: This Time is Different?

My guard goes up every time I hear “this time is different” as an explanation for the economy or stock market. I remember reading articles back in the late 1990's justifying the exorbitant prices of technology stocks explaining why the American economy had become immune to recessions due to the “Internet revolution”. For an additional historical perspective, I have attached an insightful commentary from Jim Fullerton, former chairman of the Capital Group (American Funds). Included in these comments were:

“Today there are thoughtful, experienced, respected economists, bankers, investors and businessmen who can give you well-reasoned, logical, documented arguments why this bear market is different; why this time the economic problems are different; why this time things are going to get worse—and hence, why this is not a good time to invest in common stocks, even though they appear to be low. Today people are saying: There are so many bewildering uncertainties, and so many enormous problems still facing us—both long and short term—that there is no hope for more than an occasional rally until some of these uncertainties are cleared up. This is a whole new ball game.”

What I find particularly insightful is that Mr. Fullerton wrote these comments on November 7, 1974, after the Dow had lost more than 40% from its high in January of 1973. He wrote this to compare that period's ugly environment to an even more fearful time, 1942, when stocks bottomed despite rampant inflation and the dismal performance of the U.S. and the Allies in the early stages of World War II. The point is that historically there have been other fearful times for investors when it seems things will only get worse. When it seemed most unlikely, the stock market started to stage a sustainable recovery.

My Outlook for the Stock Market

As I explained in the letter sent with the most recent portfolio repositioning, while I feel that almost all asset classes are currently undervalued, I am not confident that the stock market has reached bottom as concerns about the economy deepen. Historically, the stock market typically starts to recover four to seven months in advance of an economic turnaround. My earliest hope for an economic recovery is next summer. While at best I expect the stock market to remain very volatile for the foreseeable future, I also expect that bottom will occur (if it hasn't already) when things seem most dire. Meanwhile, there are some glimmers of hope:

- Globally, the policy response has been aggressive. Easier monetary policy (lower interest rates), massive liquidity provision, capital infusions, and guarantees of bank debt have helped the financial system to stay afloat, and even begun to thaw the credit freeze

somewhat (though banks remain reluctant to lend). There's more policy ammunition still to be deployed, with a substantial fiscal stimulus in the works (see discussion on page 1).

- Energy prices have plunged, easing pressures on purchasing power and likely helping avoid an even sharper drop in spending.
- Inflation is likely to recede, as energy prices fall and global demand weakens, opening additional slack in labor and product markets. Reduced inflation pressures will afford central banks additional scope to ease monetary policy.

In summary, as I wrote in last month's Commentary, while the timing is unknown and the stock market could fall further in the short run, I feel the stage is being set for outstanding returns from nearly all asset classes over the next several years.

Portfolio Repositioning

Last week we completed minor repositioning of MAM portfolios, the second such repositioning in two months. As explained in a letter that was mailed to clients, the two main purposes of the November repositioning was tax loss selling for taxable accounts and the addition to portfolios of two funds (Permanent Portfolio Fund and TCW Total Return Bond Fund) that have held up relatively well this year. The primary purpose of the October repositioning was to slightly reduce international equity exposure. Due to the addition of these two funds along with the PIMCO Total Return Fund (bonds), and the Oakmark Equity Income Fund, I believe that most MAM portfolios are positioned to out perform if the stock market continues to fall. Once I am confident that the stock market is staging a sustainable rebound, I would like to increase the equity allocation in portfolios to more fully participate in the eventual stock market recovery. I prefer to error on the side of caution, though, to not prematurely anticipate the recovery.

Mortgage Rates Tumble

Lower mortgage rates are often one benefit of a recession. This time is no different as *now is an excellent time to lock in a fixed-rate mortgage*. Last week the Federal Reserve and U.S. Treasury announced they will pump another \$800 billion into troubled credit markets. What makes this different and better than previous such announcements is that the money is more likely to directly benefit consumers and investors, not just troubled banks. Accounting for the bulk of the latest stimulus package, the Fed plans to purchase up to \$600 billion of debt issued or backed by Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Banks. The announcement pushed down rates on 30-year fixed rate mortgages by as much as one-half percentage point.

Per Wells Fargo's Web site (www.wellsfargo.com/mortgage/rates), as of November 1st, their rate for a 30-year fixed rate conforming loan was 5.25% (APR of 5.466%) and 5.125% (APR of 5.494%) for a 15-year conforming loan. As I discussed in the 9/30/08 MAM quarterly report, in certain high-cost areas (the Bay Area), the conforming loan has been temporarily increased from \$417,000 to \$729,750 through December 31, 2008. If the temporary increase is not extended, the conforming maximum will drop to \$417,000 on January 1st. This may be very significant as Wells Fargo's current rate for a 30-year fixed rate jumbo loan is 8.375% (APR of 8.545%). *If*

you are looking to refinance a mortgage between \$417,000 and \$729,750, I recommend that you act immediately to meet the December 31st deadline. Please contact me if you would like to discuss this further.

MAM Web Site

Since its introduction a number of years ago, the MAM Web site (www.mamportfolios.com) has been hosted by Schwab Institutional's Advisory Web Center. Schwab recently notified us that they will be shutting down Advisory Web Center effective February 28, 2009. We have since contracted with CorrectNet, the original developer and current service provider for Advisor Web Center, to host the MAM Web site. While CorrectNet has stated they will add certain new features to their hosted Web sites by next April (customized portfolio views, expanded report delivery, etc.), details are not yet available. MAM Web site users will not notice any change in the use of the Web site with one exception.

The one exception will impact MAM clients that use the Yodlee feature of the Web site, which CorrectNet will no longer support. This feature allows a user to add non-Schwab accounts to be viewed on their login to the MAM Web site. Although CorrectNet has said they are in discussions with alternative vendors offering a Yodlee-like feature, based on their initial cost estimate, it may not be cost-effective for us to provide this feature. I am not sure how popular the Yodlee feature is with MAM clients. According to a report provided by CorrectNet, 24 MAM clients used the feature in November.

For those of you interested in being able to access multiple financial accounts (bank account, investments, mortgages, credit cards, airline frequent flier mileage, etc.) from one Web site, I have found that Yodlee offers this service for free directly from their Web site (www.moneycenter.yodlee.com). I tested this service by setting up an account with Yodlee and linking in many of my financial accounts. I was very impressed with how it performed. Please contact Billy or me if you use the Yodlee feature of the MAM Web site. We would like to discuss how you use it to determine if setting up an account directly with Yodlee will satisfy your needs.

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

Sincerely,

Stephen P. McCarthy, CPA, CFP

encl: Investing Against the Tide