

McCarthy Asset Management, Inc.

Registered Investment Advisor

May 2, 2005

Monthly Investment Commentary- April 2005

Stock Market Performance for April: The first quarter's decline accelerated in April. The greatest declines were in small cap stocks. For the month, the S & P 500 fell -2.0%, the Nasdaq dropped -3.9%, and the Russell 2000 fell -5.9%. Foreign stocks also fell, while bonds were mixed and REITs rose sharply.

MAM portfolios underperformed for the month relative to the S & P 500, with a composite loss of 2.5% (after MAM fees). The three best performing MAM mutual funds were Cohen & Steers REIT (rise of 6.1%), iShares Dow Jones Select Dividends (rise of 0.1%), and Metropolitan West (loss of -0.4%). The three worst performing MAM mutual funds were small cap funds: Bjurman Micro Cap (loss of -7.7%), Artisan Small Cap Value (-7.5%), and William Blair Small Cap (-7.3%).

For the first four months of 2005, unadjusted for dividends, the S & P 500 fell 4.5%, the Nasdaq dropped 11.6%, and the Russell 2000 fell 11.2%. MAM portfolios outperformed each of these indexes, with a composite loss of 3.6% (net of all fees).

MAM Performance: Relative to the S & P 500, MAM portfolios underperformed for the month. The 2.5% loss of MAM portfolios compares to a loss of 1.9% for the Vanguard Index 500 fund (symbol VFINX) with reinvested dividends. As indicated by the 5.9% drop in the Russell 2000, however, the overall stock market was weaker than the drop of the S & P 500. The five primary small cap funds used by MAM fell an average of 6.0% for April.

Historically, the stock market has experienced periods when large companies outperformed smaller companies (e.g. the 1990's), followed by a period when small cap stocks outperformed (2000 through 2004). From 2000 through 2003, MAM portfolios had a very significant exposure to small cap stocks. This was one of the factors which led to MAM portfolios outperforming the S & P 500 for each of those years. Starting in late 2003, I started reducing small cap exposure and increasing large cap. I accelerated this shift in 2004. By the end of 2004, most portfolios had a greater weighting in large cap stocks than in small cap stocks.

Although I plan to continue to reduce small cap exposure in the next portfolio rebalancing, MAM portfolios will always underweight large cap stocks relative to the S & P 500. This is because the S & P 500 is an index of 500 of the largest U.S. publicly-traded U.S. firms, while MAM portfolios are diversified among 5 assets classes. In periods when large stocks are the best performing asset classes, MAM portfolios will probably underperform the S & P 500.

Economy Slowing?: On April 28th, the Commerce Department reported that the gross domestic product, the economy's broadest snapshot of all goods and services produced, rose at a disappointing 3.1% annual rate in the first quarter. Although this initial report is subject to revision, it represents a decline from 3.8% in the fourth quarter of last year. The main culprit of this two-year low in economic growth was rising energy prices.

This March gross-domestic-product report also showed inflation hitting a seven-year annual rate high of a 2.2% in the first quarter. This measure is based on the Fed's index of personal consumption, excluding food and energy. Fears of increased inflation are likely to keep the Fed raising interest rates in "quarter-point increments" this year.

Corporate Earnings: First quarter 2005 corporate profits have been coming in better than expected. Analysts surveyed in January by Thomson First Call projected profit growth of just 7.6% for the companies in the S & P 500. Thomson First Call now says S & P 500 companies are on track to post a 13.2% hike in net income from continuing operations, excluding extraordinary and special items. The combined effect of rising corporate earnings and falling stock prices is that stocks are becoming more reasonably priced.

Outlook for the Stock Market: With year-to-date losses in excess of 11% for the Nasdaq and Russell 2000, the stock market will need to perform well in the remaining eight months to show positive performance for the year. While I was disappointed with the losses in April, I am still not overly concerned with the stock market. To put it in perspective, the S & P 500 is back to where it was last November.

One of my favorite publications that analyzes the stock market is Lowry's. For the last several years, I have closely followed the predictions of the publication in its weekly reports. Although Lowry's has been saying for at least the last few months that the two-year stock market recovery has been losing steam, based on its analysis of the investor supply and demand, they have consistently felt that the classic signs of a stock market top were not present. In its report dated April 29th, Lowry's suggested that the probabilities drawn from the 72 year history of the Lowry Analysis continue to suggest that the recent correction should be followed by another leg to this bull market, lasting approximately four to six months.

If I do feel it is time to become more defensive with the portfolios, I expect to reduce U.S. equity exposure and increase the allocation to alternative assets. The four alternative assets funds used by MAM (Cohen & Steers REIT, Hussman Strategic Growth, Metropolitan West, and PIMCO Commodities) averaged a gain of 0.2% for the month of April.

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

Sincerely,

Stephen P. McCarthy