McCarthy Asset Management, Inc.

Registered Investment Advisor

March 1, 2010

Monthly Investment Commentary- February 2010

Stock Market Performance for February: The stock market recovered most of January's losses in February. For the month, unadjusted for dividends, the S & P 500 rose 2.8%, the NASDAQ climbed 4.2%, the Russell 2000 rose 4.5%, and bucking the trend, the international equity index MSCI EAFE dropped 0.9%. Bonds rose modestly for the month.

MAM February Performance: MAM portfolios under performed the S & P 500 for February. Excluding the "very conservative portfolios" (which rose modestly), MAM portfolios rose 1.6% (after all fees), versus a rise of 3.1% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested. The under performance of MAM portfolios relative to the S & P 500 was primarily due to the modest rise in bonds funds and the small decline in international equities.

Year-To-Date Performance: For the first two months of 2010, unadjusted for dividends, the S & P 500 fell 1.0%, the NASDAQ dropped 1.4%, the Russell 2000 rose 0.5%, and the international equity index MSCI EAFE dropped 5.3%. Excluding the "very conservative portfolios" (which rose approximately 1%), MAM portfolios out performed the S & P 500 for these two months with a decline of 0.5% (after all fees) versus a decline of 0.6% for the Vanguard Index 500 fund with dividends reinvested.

Economic Update- Self-Sustaining Recovery?

The economic reports that were released this past month were mixed. On a positive note, the initial estimate of 4th quarter 2009 Gross Domestic Product was revised upwards to 5.9% (the initial estimate had been 5.7%). The Unemployment Report for January of 2010 was generally positive. While the unemployment rate dropped to 9.7% from December's 10.0% rate, much of the decline was due to workers dropping out of the work force. Probably the most negative report was consumer confidence, which unexpectedly plummeted in February, dropping 10 points to 46, as American's evaluation of the job market turned more pessimistic. The index was at 53.6 in December and 50.6 in November. It had hit a record low of 25.3 in February 2009.

Despite these mixed reports, the U.S. economy may be reaching a critical self-sustaining status. In a poll of 62 economists conducted by Bloomberg News, the U.S. economy is now expected to grow 3% in 2010 and 2011, while the U.S. unemployment rate is expected to fall to 9.5% by the end of 2010. While still high on a historical basis, to fall to this rate the U.S. economy would have to average monthly job growth of 116,000 jobs, or about 1.4 million jobs over 12 months. A net increase of 1.4 million jobs may be large enough to generate enough demand for the U.S. economic expansion to feed on itself—or what economists call *self-sustaining status.* That's when an increase in jobs leads to an increase in consumer and business spending, which leads to companies increasing their production and hiring more workers. The hiring of these workers leads to a further increase in consumer and business spending, which leads to companies adding even more to their production and hiring even more workers, etc.

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

This expected employment growth will hopefully be the start of a long journey. The recession resulted in more than 8.4 million jobs lost. It will take at least several years of significant job growth to bring the unemployment rate down to tolerable levels. Nonetheless, it will be very welcomed news if the economy is reaching the stage of a self-sustaining expansion.

Stock Market Outlook- Is The Correction Over?

From January 19th through February 8th, the S & P 500 dropped 8.1%. This has been the biggest correction since the stock market embarked on a 70% rise since last March. As I mentioned in last month's commentary, this drop is probably a healthy, short-term correction that is typically part of any sustained rise in the stock market. While I don't know if the correction has yet run its course as concerns about Greece and certain other struggling European economies play out, I am growing more confident that the overall direction of the stock market will be up this year.

As I contemplate the next portfolio repositioning, I am leaning toward increasing equity exposure and reducing bond exposure. In particular, I will likely increase the allocation to high-dividend paying stocks. You may recall that last fall I added the exchange traded fund Vanguard Dividend Appreciation to most portfolios. While this fund concentrates on stocks that have a strong record of dividend increases, I may add another fund that focuses on high dividend paying stocks. One that I am particularly interested in is Thornburg Investment Income Builder, a global fund which is currently 60% invested in stocks and 40% in bonds and offers a 6.0% yield with a beta of 0.78 (i.e. 78% of the stock market's volatility).

I continue to find appeal in high dividend paying stocks. While historically companies that pay a generous dividend have outperformed non-dividend paying stocks, they dramatically under performed in 2009's "junk stock" rally. Furthermore, the expected 2010 tax rate increases should provide a boost to dividend paying stocks. While the maximum Federal rate on long-term capital gains and dividends is expected to increase to 20% (up from the current rate of 15%), this is still a substantial reduction from the expected maximum rate of 39.6% on ordinary income (which includes wages and interest income). Prior to the Bush tax cuts, dividends did not receive favorable tax treatment and were taxed at the same rate as interest income.

Last Great Chance to Refinance a Mortgage?

Based on the 2009 tax returns I have worked on so far, approximately one-third of my clients refinanced their mortgage last year. I commend them for this as I feel this has been a historical opportunity to lock in very low fixed rates. Having bought my first home when rates were in the double digits, I never would have thought of being able to obtain a fixed rate loan below 5%. While there's still uncertainty surrounding the future direction of mortgage rates, it's safe to assume that rates will rise in the absence of the Fed's mortgage-backed securities (MBS) purchase program. As evidenced by the statement from the very latest Federal Open Market Committee Meeting, the Federal Reserve plans to end the purchase program at the end of this month.

In response to the credit crisis, the Fed first announced the program to purchase MBS on November 25, 2008. The goal was to lower conforming fixed rate mortgages and to promote stability in the housing market by purchasing $500 billion in Fannie Mae and Freddie Mac MBS. By early 2009, during the depths of the credit crisis, the Federal Reserve decided to purchase an additional $750 billion in MBS in order to keep mortgage rates low. By March 31, 2010, the Fed will have spent $1.25 trillion to keep conforming rates at or near historical lows. Mortgage experts estimate that the Fed's involvement in the mortgage market brought conforming fixed-rates down perhaps 0.75% below where they would be absent the program. This means that rates will probably rise once the program ends this month.

The degree to which rates will actually rise will depend in part on whether private investors will step forward to replace the Fed purchases. Some feel rates could climb as much as 1% from their current level. *While it is not clear how far or how fast mortgage rates will rise, if you are considering a refinance, I recommend you move on this right away.*

File Soon- California Refunds Could be Delayed

A California budget crisis is upon us (again). Although it is still too early to tell, it is possible the State Controller may decide to delay income tax refunds if California lawmakers do not resolve the budget crisis. In a budget crisis, one option the Controller has is to delay refunds, like he did last year. The Franchise Tax Board does not have to pay interest if the refunds are paid by May 30, 2010. Given my lack of confidence in the bipartisan California legislature resolving the budget crisis, *if you are expecting a large California refund, I recommend that you file your CA tax return as soon as possible.*

2009 Tax Reporting- Corrected Schwab 1099s Now Available

This past weekend Schwab posted to its website corrected Form 1099s (with a date of February 25, 2010). I estimate that approximately 50% of the taxable accounts managed by MAM had a corrected Form 1099 issued. From the ones I have reviewed so far, the changes were extremely minor. In most cases, the change had little or no impact on the tax returns. For those of you who have a taxable account managed by MAM:

- If you have already filed your 2009 tax returns, there is no need to adjust for the 2/25/10 corrected Form 1099

- For those of you who have not already filed your returns, you may as well reflect the corrected Form 1099 on your tax return. For those accounts that had a corrected Form 1099 issued, the Form 1099 should arrive in the mail in about one week. If you are a tax client, there is no need to provide the corrected Form 1099 to us, as we will obtain it off the Schwab website. If you are not a tax client, and do not want to wait, please call or email Marilyn (marilyn@mamportfolios.com) and she will email the corrected Form 1099 to you.

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