

McCarthy Asset Management, Inc.

Registered Investment Advisor

February 2, 2005

Monthly Investment Commentary- January 2005

Stock Market Performance for January: The stock market got off to a poor start for the new year--the S & P 500 lost 2.6%, the Nasdaq dropped 5.2%, and the Russell 2000 fell 4.3%.

The composite return of assets in MAM portfolios was a loss of 2.2% for the month. Relative to the S & P 500, MAM portfolios were hurt as small-cap stocks declined more than larger-cap stocks and REITs fell sharply. In total, MAM portfolios still slightly outperformed the S & P 500 due to the performance of foreign stocks, bonds, and alternative assets (excluding REITs). In addition, most of the core U.S. equity funds used by MAM outperformed their benchmark.

The three best performing mutual funds used by MAM were Artisan International Small Cap (a rise of 1.4%), PIMCO Commodity (0.8%), and Oakmark International Small Cap (0.7%). The three worst performing mutual funds used by MAM were Cohen & Steers REIT (down 9.1%), TCW Galileo Select Equities (-7.0%), and Bjurman Micro Cap (-4.4%).

Economy Still Growing: The U.S. economy expanded at its fastest pace in five years in 2004, boosted by strong consumer and corporate spending. But a widening trade deficit led to slower-than-expected growth in the fourth quarter, raising questions about whether the recovery was losing steam.

On January 28th, the Commerce Department reported that the nation's real gross domestic product (GDP) grew at 4.4% last year, up from 3% in 2003 and 1.9% in 2002. GDP was propelled by a strong 3.8% gain in consumer spending and a 10.3% gain in nonresidential fixed investment, a measure of corporate spending.

The question now is whether last year's robust growth rate will continue in 2005 or move to a slower pace. In the fourth quarter, real GDP advanced at an annual rate of 3.1%. While that is still considered strong growth for the world's largest economy, it was well below consensus estimates and was the lowest rate of growth since the first quarter of 2003. The weaker-than-expected results were due mainly to climbing imports and declining exports, which widened the U.S. trade deficit. Some economists believe the fourth-quarter GDP data will be revised higher once the government has more complete trade data.

Short-term Interest Rates Continue to Rise: Today the Federal Reserve raised interest rates for the sixth time since last June as policy-makers continue their efforts to make sure a strengthening economy does not trigger unwanted inflation. The Fed announced that it was raising its target for the federal funds rate, the interest that banks charge each other, by a quarter-point to 2.5 percent. Analysts believe that for the next year the Fed will keep raising rates in small quarter-point increments as long as there are no signs that inflation is becoming a problem.

Corporate Earnings: Corporate earnings reports continue to be good. Currently about half of the S & P 500 companies have reported results for the most recent quarter. Of those reporting, 67% reported earnings that exceeded expectations, while 17% missed targets. For all of 2005, earnings growth is currently expected to slow to about 10%, from 2004's rapid growth rate of 19.3%.

Stock Prices: While stocks aren't cheap, there's no bubble either. The S & P 500 is trading more or less in line with its long-term average of about 15 times earnings in the coming year. Therefore, despite the drop in the stock market for the first month of 2005, I still feel that the stock market should perform reasonably well for the year. As mentioned in last quarter's MAM report, however, I am more cautious than I was last year. If the stock market were to rally sharply or if clear signs emerge reflecting a sharp slowdown in the economy, then I expect to take defensive steps with portfolio positioning.

2004 Tax Reporting: For those of you who are tax clients, I want to remind you that there is no need to fill out anything in the Tax Organizer related to your Schwab account(s) managed by MAM. Schwab is sending us a copy of your Form 1099(s). In addition, for your mutual fund sales, we have produced a gain/loss report that we will attach to your tax return.

For those of you who are not tax clients, we mailed the 2004 Realized Gains and Losses Report last week, along with instructions explaining how to reference and attach the report to your tax return. As a seasoned CPA, I can tell you that having this information really simplifies preparation of your return.

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

Sincerely,

Stephen P. McCarthy, CPA, CFP