McCarthy Asset Management, Inc.

Registered Investment Advisor

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Monthly Investment Commentary- January 2010

Stock Market Performance for January: The stock market has now experienced the first significant correction since last March. After rising for the first half of the month, the S & P 500 fell 6.6% from January 19th through month-end. For the full month, unadjusted for dividends, the S & P 500 fell 3.7%, the NASDAQ dropped 5.4%, the Russell 2000 fell 3.7%, and the international equity index MSCI EAFE dropped 4.4%. Bonds rose modestly for the month.

MAM January Performance: MAM portfolios out performed the S & P 500 for the month. Excluding the "very conservative portfolios (which rose modestly), MAM portfolios fell 2.0% (after all fees), versus a drop of 3.6% for the Vanguard Index 500 fund (symbol VFINX) with dividends reinvested. The out performance of MAM portfolios relative to the S & P 500 was primarily due to the downside protection provided by the bond allocation within the portfolios.

Economic Update- 4th Quarter 2009

Last Friday the Commerce Department released its initial estimate of 4th quarter 2009 Gross Domestic Product (GDP). The report showed that economic output grew at a 5.7% annual rate, the highest rate in six years. This compares to a 2.2% increase for the third quarter of 2009. Historically, two consecutive quarters of growth has been sufficient for the National Bureau of economic Research to declare the end of a recession—in this case, the worst since the Great Depression.

While the growth rate for the most recent quarter is impressive, 3.4% of the growth came from businesses shrinking inventories more slowly than in the previous quarter. The remaining growth of 2.3% was due to a modest 2% increase in consumer spending and 2.9% increase in business investment. Government spending dipped 0.2%. While economists expect positive GDP growth to continue in 2010, the pace is expected to moderate as the temporary boost from the inventory drawdown passes and government stimulus fades.

Economists agree that a sustained U.S. economic expansion cannot occur without job growth. U.S. GDP can rise for a few quarters without job growth—and typically does after a recession ends, as employment gains historically lag the recovery. But in the long run, the economy needs an increase in organic demand driven by jobs and rising incomes to sustain the expansion.

Corporate Earnings- So Far, So Good

Corporate earnings growth has been impressive for the most recent quarter. With just over 56% of the companies in the S & P 500 having reported so far, earnings are running well above expectations and are drastically better than 2008's 4th quarter. However, excluding the Financial sector (which reported a disastrous 4th quarter of 2008), sales are up only 2.6% from estimates and up only 3.3% from the 4th quarter of 2008. Much of the most recent earnings growth was due to corporate cost cutting. For significant earnings growth to continue, corporate sales growth will need to accelerate. For this to occur, consumer and corporate spending will need to pick up. Nonetheless, analysts have continued to increase their estimate of 2010 earnings per share for the companies in the S & P 500 index. Last September their estimate was $73.69. This increased to $76.03 as of 12/31/09. As of the end of January, the EPS estimate now stands at $77.17. Based on a January month-end price of 1096, the S & P 500 now trades at 14.2 times 2010 estimated earnings. This a reasonable valuation based on current 2010 earnings expectations.

Stock Market Outlook- Probably Just a Correction

As mentioned above, the S & P 500 fell 6.6% from January 19th through the end of January. This is the sharpest market correction since the stock market embarked on a 70% rise last March. Has last year's stock market surge led to a bubble leading to another pending crash? I don't think so. There's no bubble in sight (yet) and no sign of a crash. In fact, a 7% to 10% correction could be very healthy, as short-term corrections are typically part of any sustained rise in the stock market. This correction may provide the market a breather to let the fundamentals (corporate earnings) catch up with the huge increase in share prices.

The most recent Lowry's report, a highly regarded technical analysis service, states that the recent drop in stock prices is most likely a short-term market correction rather than a significant market top. Lowry says there are at least two reasons for this:

- At the recent January 19th new rally high, the Selling Pressure Index recorded its lowest reading since last March. Over Lowry's 77-year history, which includes 18 bull market tops since 1937, *there was not a single instance of Selling Pressure recording a new low at a market peak.*

- The NYSE Advance-Decline line is simply a running total of the daily advancing stocks minus declining stocks for companies that trade on the New York Stock Exchange. *Historically, the Advance-Decline line starts to drop well before the stock market peaks.* In fact of the 18 bull market tops since 1937, this occurred 15 times. Lowry's points out that at the January 19th market high, the NYSE Advance-Decline line hit a new high. Therefore this indicator had not been in a decline prior to the start of the current market correction.

My personal expectation is that while the current correction may have a little further to go, I expect stock prices to continue to recover in 2010. If anything, the current correction is more likely to provide an opportunity for investors to add to their stock market exposure.

2009 Deduction for Donations Made to Haiti

On January 22, 2010, President Obama signed a bill into law that established special rules for charitable donations made towards the Haitian relief efforts. The new law allows individuals who make qualified charitable donations to Haitian relief efforts, the ability to deduct those donations on their 2009 tax return. Under the normal rules, charitable donations are deductible in the tax year in which they are made. This law allows individuals to choose to deduct their 2010 donations in 2009 or 2010.

In order to take the deduction in 2009, the charitable donations must be made:

- After January 11, 2010 and before March 1, 2010,
- Specifically for the relief of those in the areas affected by the earthquake in Haiti on January 12, 2010,
- In cash (as opposed to property), and
- To qualified charities as defined by the IRS. (Note: donations to foreign organizations are not usually deductible according to the IRS' guidelines for charitable contributions.)

In addition, the rules under this law are only available to those who itemize their deductions on Form 1040, Schedule A. If you take the Standard Deduction on your federal tax return you would not be allowed to take advantage of these special rules. Keep in mind that other than having the ability to deduct these qualified charitable donations in 2009, all of the other IRS rules and limitations for charitable contributions still apply.

If you meet the criteria for taking this deduction, be sure to keep the necessary documentation of your donation such as receipts and cancelled checks. If you made donations via text messaging, the IRS will allow you to use your phone bill as supporting documentation if the phone bill has the name of the donee organization, the date of the donation and the amount of the donation.

2009 Tax Reporting- Schwab 1099s

Charles Schwab recently announced that their 2009 Form 1099-Composite will be mailed in mid-February. During the last couple of years, Schwab has issued revised Form 1099s in late February or early March for many taxable accounts which own mutual funds. In many cases I had to redo or amend previously completed returns to account for the revised Form 1099. To avoid a repeat of this, for clients with taxable Schwab accounts, I don't plan to start completing their tax returns until early March.

For those of you who are tax clients, there is no need to wait until you receive your Schwab Form 1099 before providing us with your tax packet. Schwab will be providing us with a copy of the Form 1099 for accounts that we manage. If you have everything else, please provide us with your tax packet.

For those of you who are not tax clients who have a taxable Schwab account managed by MAM, Inc:

- In January we mailed your 2009 Realized Gains and Losses Report, along with instructions explaining how to reference and attach the report to your tax return. Be sure to provide this report and letter to your tax preparer, as having this information really simplifies preparation of your return.

- I encourage you to wait until at least early March before completing your 2009 tax returns (in case Schwab issues a corrected Form 1099 that materially impacts your tax returns).

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