

McCarthy Asset Management

Registered Investment Advisor
Certified Public Accountant
Certified Financial Planner

Wednesday, December 1, 2004

Monthly Investment Commentary- November 2004

Stock Market Performance for November: Call it the post-election bounce. The stock market performed very well in November. The S & P 500 rose 3.9%, the Nasdaq climbed 6.2%, and the Russell 2000 leaped 8.6%. Bonds, foreign stocks and REITs also rose. On average, MAM portfolios rose 4.8% for the month (after MAM fees).

MAM returns for the month were boosted by small cap funds. Holding back performance were bond funds. The five best performing MAM mutual funds were Bjurman Micro Cap (9.4% rise), Artisan Small Cap (8.2%), Artisan International Small Cap (8.0%), Bogle Small Cap Growth (7.7%), and William Blair Small Cap (7.6%). The five worst performing MAM funds were Metropolitan West (0.8% rise), Pioneer High Yield (1.4%), Loomis Sayles Bond (2.0%), Hussman Strategic Growth (2.3%), and Income Fund of America (2.9%).

Stock Market Performance Year-to-Date: Since January 1, 2004, (excluding dividends) the S & P 500 rose 5.6%, the Nasdaq climbed 4.7%, and the Russell 2000 leaped 13.8%. Adding in an assumed annual dividend yield of 1.6%, the year-to-date return on the S & P 500 was 7.1%. On a size-weighted basis, year-to-date, assets in MAM portfolios rose an average of 8.7% (after MAM fees).

Performance of the Economy and Corporate Profits: Generally, the economic reports have been good. For instance, on November 30th, the Commerce Department revised upward its estimate of third-quarter economic growth. They said that the third quarter gross domestic product (GDP) rose at a 3.9% annual rate, compared with the prior estimated growth of 3.7%. The government said consumers spent more than previously estimated and business-equipment spending was stronger than expected.

Meanwhile corporate profits continued to rise at a slower pace. After four quarters of 20% plus annual growth, S & P earnings grew at a 15.3% rate in the third quarter. Economists expect that high raw-material prices and higher labor costs will cause a further fading in the earnings growth for 2005. The question is how much lower? Investors who believe that productivity will continue to boom, expect the profit slowdown to be mild. These optimists could also argue that a weak dollar and healthy corporate balance sheets will help to soften the earnings decrease. Those who believe that booming productivity has run its course or that consumer spending is likely to wane, expect the profit showdown to be much sharper than anticipated.

Where is the Market Heading? The stock market has surged upwards since the election. Year-to-date returns are now slightly above my prediction of 5 to 7% annual appreciation for the next five to ten years. This prediction is an educated guess based on current stock prices

relative to current corporate earnings and estimated earnings growth. In any given year, returns could be above or below this range. Should the market rise significantly from its current level (by 20% or more), I would be concerned that stock prices are once again becoming inflated. If this occurs, I would make portfolio changes to further protect on the downside.

In addition, as I have said several times during the past two years, if the stock market were to rise significantly, it is probable that the MAM portfolios would under perform the S & P 500. This is because most MAM portfolios have a 16 to 22% weighting in bonds versus a 0% weighting in bonds in the S & P 500. Even though I expect stocks to outperform bonds, I feel it makes sense to maintain bond exposure to protect portfolios from a sharp decline in equity prices. Please contact me if you feel you want to be more aggressive with your portfolio.

Although I feel that no one can predict with certainty the short-term direction of the stock market, I continue to be impressed with the analysis provided by Lowry's, a market timing service for money managers. In the most recent weekly report released on November 26th, Lowry's wrote "of the hundreds of indicators that we monitor each day, virtually all are pointing toward higher prices, with no current warning signs of a bear market in the months ahead".

Client Satisfaction Survey: Thanks to those of you who have already completed and returned the survey. Through November 29th, we have received the completed surveys from 76 clients. ***If you have not returned yours, please do so to help us improve the services we provide to you.***

Here are the survey results so far. There were 10 questions which asked for a numerical score. Depending on the question, "1" indicates either "far below expectations" or "not important". On the other end of the spectrum, "5" indicates "far exceeds" or "very important".

<u>Question</u>	<u>Score</u>
1. Investment returns relative to expectations, etc.	3.2
2. Level of communication with you	4.1
3. How important that we meet regularly?	2.6
4. Monthly Commentary useful?	3.9
5. Satisfied with Quarterly Reporting	4.0
6. Satisfied with "mamportfolios.com" Web site?	2.8
7. Interested in learning to use Web site?	2.1
8. Were the Paper Reduction Actions useful?	4.1
9. Overall, how rate MAM?	4.1
10. Recommend MAM to others?	4.4

The Survey descriptive responses that you also provided are very helpful. They reinforce what we are doing right, and tell us what we could do better.

3 Lagoon Dr, Redwood Shares Office Move: Last week the City of Redwood City approved the construction plans for the remodel of our new office. I visited the office today and reviewed the construction work. It now appears that the suite should be completed by the end of December. Currently, we plan to move to the new office by the middle of January (after completion of year-end reporting).

McCarthy Asset Management, Inc.: Effective January 1, 2005, McCarthy Asset Management will become a corporation. Currently, MAM is a sole proprietorship. This change will have no impact on clients or their portfolios. I will be the sole owner of the corporation.

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

Sincerely,

Stephen P. McCarthy