

# *McCarthy Asset Management*

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Monday, November 1, 2004

## **Monthly Investment Commentary- October 2004**

**Stock Market Performance for October:** October was a good month for equities. The S & P 500 rose 1.3%, the Nasdaq leaped 4.1%, and the Russell 2000 climbed 1.9%. Bonds, foreign stocks and REITs also rose. On average, MAM portfolios rose 1.3% for the month (after MAM fees).

The five best performing MAM mutual funds were Cohen & Steers REIT (6.3% rise), Artisan International Small Cap (4.3%), Oakmark International Small Cap (3.0%), Capital World Growth & Income (3.1%), and Oakmark Global (3.0%). The five worst performing MAM funds were Bogle Small Cap Growth (down 0.7%), Marsico Focus (-0.5%), Artisan Small Cap (+0.1%), Oakmark Select (+0.2%), and Hussman Strategic Growth (+0.3%).

**Stock Market Performance Year-to-Date:** Since January 1, 2004, excluding dividends, the S & P 500 rose 1.6%, the Nasdaq declined 1.4%, and the Russell 2000 climbed 4.8%. Adding in an assumed annual dividend yield of 1.6%, the year-to-date return on the S & P 500 was 2.8%. Year-to-date, on average, MAM portfolios rose 3.7% (after MAM fees).

**Performance of the Economy:** On October 29<sup>th</sup>, the Commerce Department reported that the third quarter gross domestic product (GDP) rose by 3.7%. Although the figure is an improvement from the 3.3% growth for the second quarter, it was less than the 4.3% rise that economists had expected. Growth in consumer spending and business investment drove much of the increase. Indeed, consumer spending (which accounts for about two-thirds of GDP) rose 4.6% in the third quarter versus a 1.6% gain in the previous three months.

Soaring oil prices in the third quarter were partly to blame for the slower-than-expected growth, analysts said. As oil climbed through the \$55 per barrel mark in October, investors feared a further slowdown for the fourth quarter as well.

**Portfolio Repositioning:** During the month of November, I will be doing some minor repositioning in most MAM portfolios. The primary change will be to add two core funds: iShares Dow Jones Select Dividend Index (symbol DVY) and American Funds Amcap. A portion of various positions will be sold to generate the cash to invest in these two new funds.

This latest repositioning continues a theme to anchor MAM portfolios with core funds and “turbocharge” them with specialized funds (small cap equities, bonds, REITs, foreign equities, and commodities). I define a core fund as those that have low operating expenses, relatively low volatility and good long-term performance relative to its peer group.

iShares Dow Jones Select Dividend Index (symbol DVY): DVY is an exchange-traded fund that has low operating expenses (0.40% annually) and a high dividend yield (approximately 3.8%). I profiled this fund in the July 2004 MAM Commentary (available via [www.MAMportfolios.com](http://www.MAMportfolios.com)).

American Funds AMCAP: AMCAP is a large-cap growth fund that also qualifies as a core MAM fund (i.e., low annual operating expenses are 0.78%, low volatility for a large-cap growth fund, and performance that has exceeded the S & P 500 for each year since 1998).

The most challenging asset class to find a strong fund has been large-cap growth. This part of the stock market was the hardest hit during the 2000 through 2002 downturn. Over AMCAP Fund's lifetime, spanning both up markets and down, the fund has provided competitive returns during periods when the stock market was strong, and even better relative returns when it was weak. The fund was started on May 1, 1967. Since inception through June 30, 2004, the fund returned 12.6% annually versus a 10.6% return in the S & P 500, during the same period.

Like all funds offered by American Funds, AMCAP is managed by a team of portfolio counselors. Typical of their funds, these managers have had a long tenure. These counselors have been with AMCAP for a period ranging between 12 and 37 years.

For additional information on AMCAP, I will enclose the most recent Morningstar report on the fund with the letter that I send when I reposition your account(s) this month.

**Client Satisfaction Survey:** On October 22<sup>nd</sup> we mailed the *Client Satisfaction Survey* to 191 clients. As of November 1<sup>st</sup>, we have received the *Survey* back from 34 clients. I am very pleased to get such a strong early response. I encourage those of you who have not responded, to please do so. I plan to use the results to improve MAM services.

I have been surprised at how many respondents listed their names on the *Survey*. Although this is optional, a benefit in doing so is that you can list specific issues for us to address (e.g., training in use of "mamportfolios.com", action items related to "Paper Reduction Actions", and other specific questions).

**Redwood Shares Office Move:** As announced in the September 2004 Quarterly Report, after ten years in our San Mateo office, we will be relocating back to Redwood Shores. Currently, the projected move date is for mid to late December.

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

Sincerely,

Stephen P. McCarthy