McCarthy Asset Management, Inc.

Registered Investment Advisor

July 3, 2007

Dear Client,

In one of the best quarters in years, stocks rose sharply, while bonds, REITs and commodities all fell. Despite the solid returns provided, the stock market continued to display volatility.

With this report for the quarter ending June 30, 2007, I discuss the second quarter and year-to-date market and MAM portfolio performance, as well as an explanation of what may have caused the recent spike in long-term interest rates. In addition, I provide a list of book and Website resources pertaining to teaching kids about money and discuss a new service I am contemplating: managing 529 Plan assets.

Enclosed are four 6/30/07 investment reports:

- *Portfolio Position Analysis*: lists your investments and how each have performed
- *Portfolio Performance Summary*: 2nd quarter and YTD 2007 portfolio rates of return
- *Portfolio Comparative Performance Review*: portfolio performance by year and cumulatively since inception
- *Realized Gains and Losses*: YTD 2007 investment realized gains and losses (included only for taxable accounts that have had sales this year).

Stock Market & MAM Performance for Second Quarter

The stock market rose sharply for the second quarter of 2007. The S & P 500 climbed 5.8% to 1503, the Nasdaq jumped 7.5% to 2603, and the Russell 2000 rose 4.1% to 834. These returns do not reflect reinvestment of dividends.

For the quarter, 0% of the MAM portfolios that were in existence for the whole quarter had performance that equaled or exceeded that of the S & P 500. The composite return of assets in MAM portfolios was a gain of 4.3% (after MAM fees) versus a gain of 6.3% in the S & P 500 (as represented by the performance of the Vanguard Index 500 fund with dividends reinvested).

The underperformance of MAM portfolios relative to the S & P 500 was due to poor performance of the bond funds and the alternative asset funds (PIMCO Commodity, Hussman Strategic Growth and Cohen & Steers REIT). In the most recent portfolio repositioning which was completed in early June, Hussman Strategic Growth was completely sold in all but the most conservative portfolios,

3 Lagoon Dr, Suite 155, Redwood Shores, CA 94065, (650) 610-9540 Fax (650) 610-9541
email: steve@mamportfolios.com Web site: mamportfolios.com

while Cohen & Steers REIT, which had provided very strong performance since 2000, was substantially sold in all portfolios.

The performance of equity funds used by MAM was not a cause for the underperformance. Of the U.S. and foreign equity mutual funds used by MAM, 9 of the 14 (64%) outperformed the Vanguard Index 500 for the quarter. Bond funds had the greatest impact on the underperformance. Bonds had one of their worst quarters in memory as the yield of the 10-year Treasury note rose sharply. Bond prices move inversely to yields, so the rise in yields caused a drop in bond prices. See below for a discussion of what may have caused the surge in rates.

Best Performers: The eight best performing MAM investments for the quarter were Allied Capital Corp (up 9.6%), Artisan International Small Cap (up 8.8%), Capital World Growth & Income (up 8.8%), Oakmark Select (up 7.8%), Growth Fund of America (up 7.7%), Causeway International (up 7.1%), William Blair Small Cap (up 6.8%), and Selected American (up 6.8%).

Worst Performers: The eight worst performing MAM investments for the quarter were PIMCO Commodity (down 2.6%), YieldQuest Total Return (bonds) (down 2.1%), YieldQuest Tax Exempt (bonds) (down 1.7%), iShares Select Dow Jones Dividend (up 0.6%), Loomis Sayles Bond (up 1.9%), Oakmark International Small Cap (up 3.3%), PIMCO Developing Local (bonds) (up 3.5%), and Dodge & Cox Balanced (up 3.7%).

Stock Market & MAM Performance for YTD 2007

For the first six months of 2007, the S & P 500 rose 6.0%, the Nasdaq climbed 7.8%, and the Russell 2000 rose 5.8%. These returns do not reflect reinvestment of dividends.

For the first six months of 2007, 10% of the MAM portfolios that were in existence for the whole period had performance that was equal to or greater than that of the S & P 500. The composite return of assets in MAM portfolios was a gain of 5.7% (after MAM fees) versus a gain of 6.9% in the S & P 500 (as represented by the performance of the Vanguard Index 500 fund with dividends reinvested).

Oldest Portfolio: The MAM portfolio with the longest track record is a moderately aggressive portfolio that was fully invested on September 13, 1999. As of June 30, 2007, the original $50,000 had risen to $96,362, plus $1,193 of cumulative withdrawals. This represents a cumulative return of 95.1%. During the same time, the S & P 500 (as represented by the Vanguard Index 500) rose 22.3%. For the quarter ending June 30, 2007, the portfolio rose 4.7%, while for the first six months of 2007 it rose 5.8%. All returns quoted for this portfolio (and for all portfolios) are net of MAM fees. Also, past performance is not necessarily an indicator of future performance.

What Happened to Long-Term Interest Rates and Bonds?

On June 13th the yield on the benchmark 10-year U.S. Treasury reached 5.33%, a five year high, up from 4.56% just two months earlier. What caused the sharp increase? Some analysts feel that the bond market is returning to normal. For years, U.S. bond yields remained low despite impressive economic growth around the world. That confounded economists, bond traders, and Federal Reserve officials alike, who searched for ways to explain the phenomenon. According to Lehman Brothers, long-term rates are now back close to their 200-year average.

The recent jump in yields has been driven by strong economic growth and rising inflation outside the U.S., which has prompted central bankers in Europe, Japan and elsewhere to raise or consider raising rates. Also, the recent spike in long-term interest rates has caused the yield curve—the difference between the yields on short-term and long-term bonds—to regain its typical upward slope. Normally, interest rates are higher on longer-term bonds than shorter-term bonds, because investors want to get paid more to hold bonds for longer periods. But for much of the past year, the yield curve has been inverted, meaning short-term rates were higher than long-term rates, a signal some investors believed would indicate economic growth would weaken.

The return of long-term rates to their long-term average level can be viewed as healthy. It is a symptom of strengthening domestic and global economies. As long inflation remains moderate, the recent rise in rates should not provide a problem for investors.

Economic and Investment Outlook

The Economy: Based on a Wall Street Journal survey of 60 economists taken the middle of last month, the U.S. economy is predicted to grow at an annual rate of 2.6% in the second half of 2007, and 2.9% in 2008. This is up sharply from the depressed 0.7% annualized growth in the first quarter of 2007. In the survey, though, 20% of the economists saw a resurgence of inflation as the greatest risk facing the economy. That is more than twice the percentage who saw it as the No. 1 risk six months ago. As a result, economists now see little chance that by December the Fed will lower its target for short-term interest rates from the current 5.25%. They do, however, lean toward a cut to 5% by June 2008. Six months ago, they were betting the Fed would cut rates to 4.75% by December.

The Stock Market: Given its strong performance during the past quarter, the consistent rise for the last five years and the recent increase in volatility, I would not be surprised to see a short-term drop in the stock market. Such a correction could be healthy as bull markets typically experience one or more 10% corrections. I think it is foolish for investors, though, to try to time these short-term market movements, and studies show that most investors fail miserably in such efforts. More importantly, the domestic and international economic outlooks are good, and due to the strong increase in corporate earnings, stocks are reasonably priced. My advice continues to be to invest based on your risk tolerance, stay diversified, and maintain a long-term outlook.

Net Worth Analysis

We introduced the Net Worth Analysis (NWA) in the 4th quarter of 2005. Since then we have prepared a NWA for 86 clients, with 4 more in process. I encourage all clients to take advantage of this free service. I believe the NWA provides valuable information in tracking someone's progress in saving for retirement, or tracking the use of those assets for those already retired.

During the last month I came across three situations where the NWA proved to be of value to clients in addition to just tracking their invested assets. The first situation was with a client who was contemplating the purchase of a more expensive home. The client's NWA helped show that the "cost" of purchasing the more expensive home would probably lead to a delay in retirement. A second situation was a client who called to discuss estate planning strategies. The completed NWA provided a frame of reference to look at the client's estate planning situation. The third instance occurred when a client was completing the questionnaire for updating their NWA. When they obtained the current value of an ex-employer pension, they realized how little it had appreciated in the last few years. They then decided to roll over the assets into their MAM-managed IRA account.

The bottom line is that the NWA is proving to be useful in providing clients a frame of reference to view their overall financial situation. *Please let me know if you are interested in having us create a NWA for you.*

Teaching Kids About Money

Many parents invest considerable money and effort into educating their kids. They want to provide them with the greatest opportunity to be successful. What is often not taught in school, and may not be properly addressed at home, however, is teaching kids about how to handle money. I feel that this should be a priority in raising our children. Without proper training and advice, young adults can lack important financial skills. The effort of credit card companies to offer cards to young adults increases their vulnerability. The availability of this credit tempts the young adults to live beyond their means, resulting in unaffordable debt payments. On the positive side, instilling at an early age the discipline of saving and investing can be very powerful, as the magic of compounding returns works best when the investment time horizon is very long!

I know that it not easy to teach financial skills. Some adults never learn them! My wife and I are raising two teenage sons. I have talked with them about financial issues for many years since it is in my DNA as an investment advisor and CPA. I have even set up small stock portfolios and we have mutually selected familiar companies to invest in. Time will tell the success of my efforts.

What follows is a list of books and resources for teaching kids about money. I obtained this list from Advisor Intelligence, which is an advisory service that caters to financial advisors. While I have reviewed the Websites, I have not read any of the books. Still I am confident that this list will provide good resources for those who wish to teach their kids about money:

Books- For Parents:

- Raising Financially Fit Kids; by Joline Godfrey (take away ideas)
- Silver Spoon Kids: How Successful Parents Raise Responsible Children; by Eileen Gallo (theory and profiling)
- Children of Paradise: Successful Parenting for Prosperous Families; by Lee Hausner
- Kids, Money and Values; by Patricia Schiff Estess (take away activities)
- What Kids Really Want That Money Can't Buy: Tips for Parents in a Commercial World; by Betsy Taylor

Books- For Kids:

- Ultimate Kids Money Book; by Neale S. Godgrey (reading level age 9-12)
- The Kid's Guide to Money: Earning It, Saving It, Spending It, Growing It, Sharing It; by Steven Otfinoski (reading level age 9-12)

Websites (for kids and adults):

- www.themint.org
- www.moneyopolis.org
- www.ntrbonline.org

- www.consumerjungle.org
- www.federalreserveeducation.org/fed101
- www.kids.gov
- www.younginvestor.com

Please let me know if you have any feedback on these resources, or if you have any recommendations of your own.

529 Plans (College Savings Plans)

I am contemplating offering a new service: management of 529 Plan assets. In the past I have not offered this service because I felt I could not provide enough service to justify my fees (probably 1% of assets) and I felt that it should be straight-forward enough for clients to enroll in CA's Plan (Scholarshare) and select the age-weighted option which adjusts the investment mix as the child gets closer to college age. Three things have recently changed my thinking:

1. Tax Law Change: In May of 2007, a tax law change extended "kiddie tax" through college age. As a result, the benefit of using a custodial account to shift highly appreciated assets to a child was greatly diminished, while the benefit of using a 529 Plan became greater.

2. Advisor Sold 529 Plans: I have seen it quoted from two different sources that 80% of the assets in 529 Plans are through stock brokers and advisors. The reality is that most individuals will not set up a 529 Plan on their own.

3. American Funds 529 Plan: Each state has their 529 Plan managed by an investment company. My favorite fund family (and the one that has about 15% of MAM-managed assets) is American Funds. They are actually the largest mutual fund company and their funds are only available via a financial advisor/stock broker. Fortunately, Virginia uses American Funds to manage their 529 Plans.

I still need to work out the details of offering management of 529 Plan assets. My challenge is making it a cost-effective service. Most broker-sold 529 plans are sold with a commission of 4% to 5%. MAM is fee-based, so we do not charge commissions. I expect my annual fee will be 1% of assets, subject to a minimum fee for small accounts. I will look for ways to streamline our efforts. For instance, by law, 529 Plan assets can be repositioned only one time per year. Also, I expect to have the quarterly reporting provided by American Funds.

As this point I am only looking for an indication of interest. *Please send me an email if you are interested in having MAM manage a 529 Plan account for you.*

Wealth Manager Ranking

I was pleased to see that for the second consecutive year McCarthy Asset Management, Inc. made it into Wealth Manager Magazine's 7th Annual listing of the top 500 U.S. wealth managers. The ranking is based on the average size of clients' managed assets. As listed in the July/August 2007 issue of Wealth Manager Magazine, MAM, Inc. was listed 429th based on an average asset size of $570,404. The ranking is based only on those managers that responded to a questionnaire sent out by Wealth Manager Magazine.

Assets Under Management

As of June 30, 2007, MAM assets under management were in excess of $112 million, up from $100 million at the start of the year. Existing and new clients added over $5 million in net assets during the first six months of 2007.

The majority of new MAM clients come from client referrals. I appreciate these referrals and continue to welcome them. The minimum amount to manage for new clients is $600,000.

Please call me if you wish to discuss the stock market or your portfolio(s).

Very truly yours,

Stephen P. McCarthy, CPA, CFP