

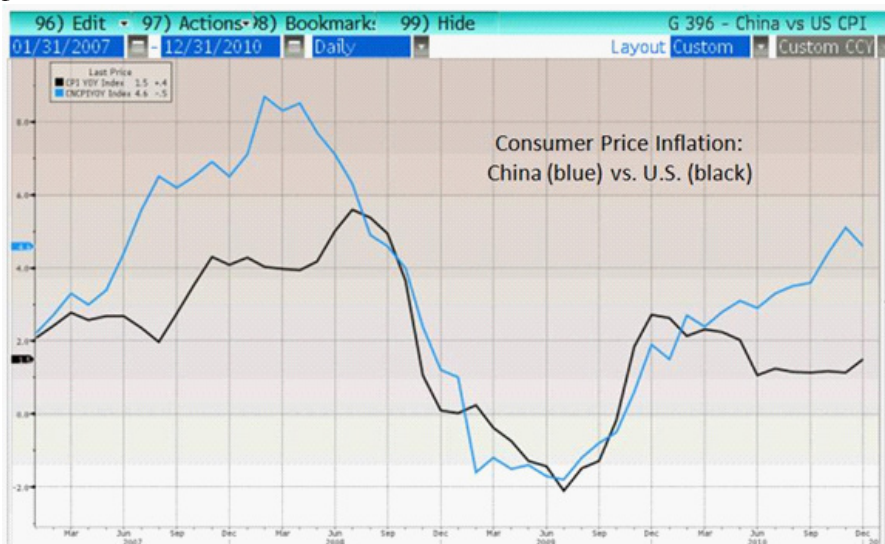
## Market and Portfolio Commentary

As 2011 kicked off, investors' spirits were high thanks to the vigorous stock market rally through the second half of 2010. January saw the recent gains extended even further, as the S&P 500 Index finished higher for the fourth time in the past five months (November had a small loss). While encouraging and seemingly supportive of a bullish disposition, there were some important divergences that crept into the picture. Emerging markets equities, gold, and small-cap stocks all declined during the month, which was a notable split from the "risk on/risk off" phenomenon that existed in recent months where all risky assets seemed to rise and fall in unison. In addition, Treasury bonds continued to fall, pushing interest rates higher.

In our assessment of economic and financial conditions, we believe the outlook is fairly positive when viewed over a cyclical horizon. In our estimation, economic conditions have strengthened in recent months. Leading indicators remain strong, consumer spending has been remarkably resilient, and there have been some encouraging signs on the employment front. In addition, corporate earnings have recovered extraordinarily well and continue to significantly exceed analyst estimates. Clearly, the market itself is reflecting these improvements as the bull market marches on. For now, we believe the technical backdrop remains sound, with strong trends in place and no overly worrisome divergences or warnings yet outside of some short-term caution due to rising levels of investor sentiment. This does not mean, however, that risks have substantially diminished. On the contrary, there are plenty of dangers that could undermine a positive investment stance.

Quickly climbing the list of concerns are fears of an imminent outbreak of inflation. Other than gold, most other commodity prices rose again for the month and have soared since last summer when the Federal Reserve first hinted that it might

implement more quantitative easing. In the U.S., this hasn't appeared in official inflation statistics yet – the broad Consumer Price Index rose only 1.5% in December, while Core CPI (ex-food and energy) was up a miniscule 0.8%. Many economists believe that the amount of slack in the labor market will suppress wage gains, which should prevent generalized inflation from taking off since wages are such an important component.



However, in many emerging market countries, it is a much different story. Food inflation is driving broad price measures to worrisome levels, causing policy makers in those countries to take more restrictive steps to try and counter the threat. Countries like China and India are being forced to raise interest rates, and in doing so have effectively knocked global economic policies out of sync. Indeed, there is now a notable dichotomy that has the U.S. still pursuing stimulative policies, Europe and Japan largely on hold, and several emerging markets now tightening. The investment implications of this change seem to imply that U.S. markets are poised to outperform for a time, and that is a theme that may soon get reflected in client portfolios through a reduction in international positions in favor of U.S. positions.

We are looking for an opportunity to boost risk exposures a notch higher than they currently are in order to better

align portfolio allocations with the brightening backdrop. In the short-term, we remain wary of elevated investor bullishness, and would prefer to wait for a correction to augment positions. We acknowledge there's a risk that the market might not cooperate with that strategy if it continues its seemingly linear ascent, but recent signs of increasing froth and complacency on the part of investors have caused us to patiently wait for those conditions to clear. Ultimately, we believe that the bull market in stocks can carry higher, at least for the first part of the year. Beyond that is unclear, and will likely depend on whether inflation and interest rates behave or not.

### Pinnacle Portfolio Performance for January

Pinnacle portfolios started off the New Year with modest gains. U.S. equities performed well in January, while international equities and some alternative investments lagged. Within U.S. equities, Energy and Technology sector holdings were the top performers. Meanwhile gold, emerging markets equities, and long-term U.S. Treasury bond suffered the worst losses.

The tables below highlights the best and worst performing securities during the month:

Top Five Performers – January 2011		
Position	Weight	Return
S&P Oil & Gas Exploration & Production ETF	2%	7.6%
Energy Sector SPDR	4%	7.2%
iShares Semiconductor ETF	2%	6.8%
iShares Health Care Providers ETF	2%	5.4%
Rydex Equal Weight Industrials ETF	4%	3.1%

Bottom Five Performers – January 2011		
Position	Weight	Return
iShares Software ETF	2%	-1.8%
Hussman Strategic Growth Fund	2%	-2.5%
20+ Year Treasury ETF	2%	-3.1%
Oppenheimer Developing Markets Fund	2%	-5.3%
Gold SPDR	3%	-7.9%

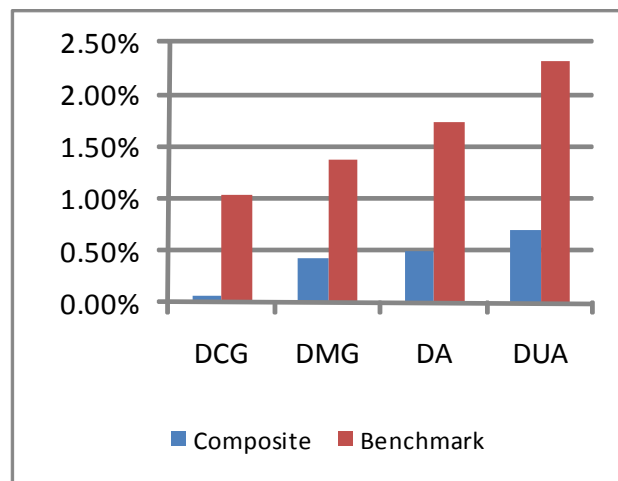
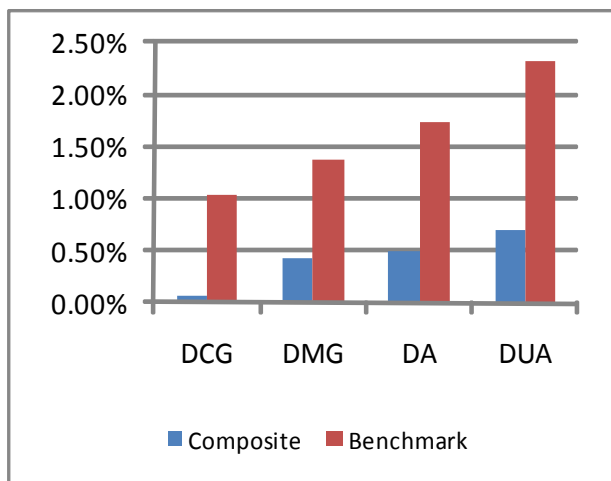
*Please note that the returns and weightings used for this illustration are based on the Dynamic Moderate Growth portfolio at the end of the period. The individual security returns for other strategies may vary due to trade execution or security selection differences. Securities may have been bought and sold during the quarter; therefore, client returns (which are shown here) may not reflect a security's actual quarterly return. Holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. Past performance does not guarantee future results.*

### Portfolio Transactions

In the first week of the year, we tactically reduced positions in gold, which has worked out in the short-term as gold had the worst return among portfolio holdings during the month. The proceeds from that trade, as well as the proceeds from the sale of the Leuthold Fund, were used to boost equity sector positions. Later in the month, we added to our tactical position in U.S. municipal bonds because we believe current investor fears about that asset class are overblown. Overall, we continue to view portfolios as close to or slightly below benchmark levels of volatility, and may increase risk weightings on a pullback if one develops as described above.

Month: January 2011		
Policy	Composite	Benchmark
DCG	0.07%	1.03%
DMG	0.42%	1.38%
DA	0.50%	1.73%
DUA	0.70%	2.31%

Year To Date: 2011		
Policy	Composite	Benchmark
DCG	0.07%	1.03%
DMG	0.42%	1.38%
DA	0.50%	1.73%
DUA	0.70%	2.31%



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**Pinnacle Dynamic Portfolios**

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