

Market and Portfolio Commentary

May was a volatile month for risk assets, particularly commodities. The volatility seemed to stem from growing concern that the global economy has slipped into a soft patch, if not something worse. The deceleration was evident in a number of measures including leading economic indicators, real wages, employment, and commodity prices, all of which turned lower. With a slowdown unfolding, the major issue investors must wrap their hands around is whether or not it will merely be, as Federal Reserve Chairman Ben Bernanke likes to say, “transitory.”

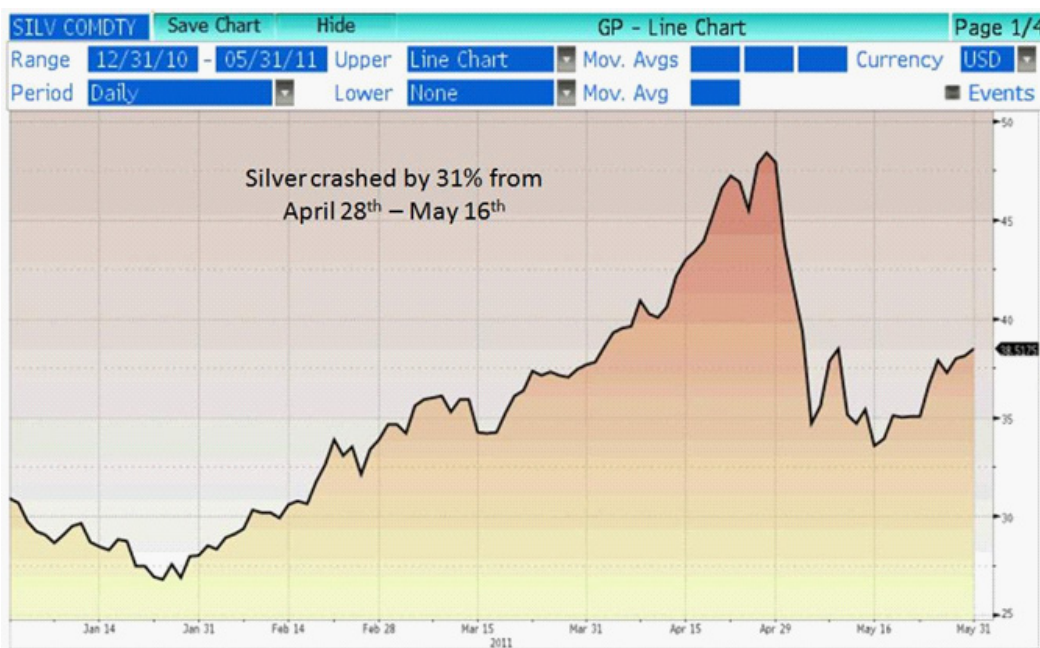
Extreme volatility in commodity markets provided the major fireworks during the month, as commodities suffered a significant setback during the first week of May. The decline was at least

partially due to the Chicago Mercantile Exchange (CME) increasing margin requirements on certain commodities like silver, which had bubbled into a frenzy, in what appeared to be an attempt to stamp out some of the speculation that was rapidly building. Increasing speculation

has been blamed by many on the Federal Reserve’s zero percent interest rate policy, and the quantitative easing program (QE2) through which they’ve been injecting liquidity into the system with large scale Treasury bond purchases since last November. While QE2 was officially implemented to help boost economic growth, an

unofficial byproduct was to simultaneously weaken the U.S. dollar, and since commodities are priced in dollars, the drop in the greenback played a big role in the commodity rally.

We view commodities as an important global growth barometer due to the inherent sensitivity to supply/demand dynamics in commodity price movements, so the volatility was startling after the steady upward march of previous months. At the moment market participants are left to wrestle with the question of whether the latest commodity selloff was more about a weakening economy, or simply an overdue technical correction in an asset class where speculative urges had run too far, too fast. Commodities weren’t the only problem area investors encountered during the month, however. On a macro level, there was large wall of worry in May, and some of the bigger ticket items were: rising interest rates in Emerg-



ing Markets, the ongoing debt crisis in Europe, a generalized slowdown in the global economy, uncertainty regarding how markets will react to the end of QE2 in June, continuing geopolitical issues in the Middle East, and political tensions regarding the U.S. debt ceiling.

The bullish side of the story is that the economy has simply eased into a typical mid-cycle slowdown, albeit one that’s been impacted by the supply chain problems that followed in the wake of the Japanese earthquake and nuclear disaster. If the bulls are correct, then the leveling off in growth could be just what is needed to extend extend the stock market

rally, particularly if it brings energy and other commodity prices back down to more reasonable levels. The upshot is that corporations could be poised to benefit in the second half of the year from lower input cost pressures, a reacceleration in growth, and lowered expectations. In addition, a reduced growth outlook and European debt concerns may compel authorities to conjure up new stimulus programs, which could provide the lift for another leg up in risk assets. Lastly, despite shorter term technical damage, the long term uptrend is still intact for the majority of global markets at present.

For now, we are still willing to give the bull market the benefit of the doubt, and still think that positioning close to benchmark volatility is appropriate. We don't think it's time to make a major asset allocation change yet, because there is still not enough clarity to determine whether or not this slowdown will be temporary or persistent. Our current asset allocation is neutrally positioned, but we are not complacent, and have been making some defensive sector adjustments given the risks that are building. It may just be that we are in for a summer's worth of volatility that refreshes the bull market. But after large rally that is now more than two years old, and with many risks swirling, we must continue to pay very close attention to incoming data and developments. As always, we will continue to follow the weight of the evidence and make portfolio adjustments as necessary.

Pinnacle Portfolio Performance for May

Pinnacle portfolios declined in May as financial markets stumbled. Defensive positions outperformed for the month, continuing a change in trend that occurred in April. High quality fixed income and non-cyclical equity sectors were the top performers. Most cyclical sectors declined, led by Financials and Energy.

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

Top Five Performers – May 2011		
Position	Weight	Return
iShares 20+ Year Treasury ETF	2%	+3.4%
Consumer Staples SPDR	8%	+2.5%
iShares 7-10 Year Treasury ETF	4%	+2.5%
iShares Pharmaceuticals ETF	3%	+2.2%
Utilities Sector SPDR	2%	+2.1%

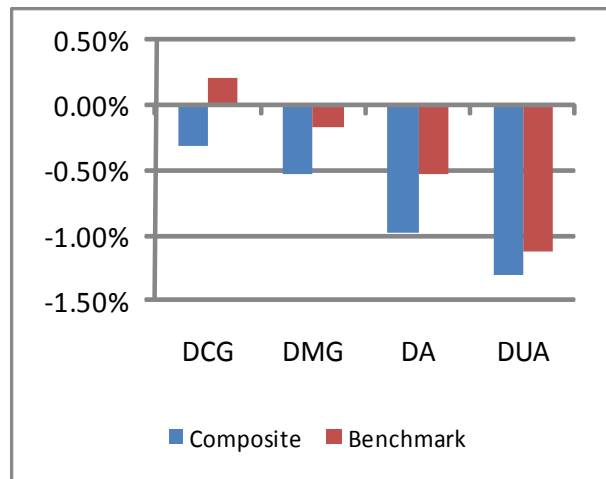
Bottom Five Performers – May 2011		
Position	Weight	Return
iShares Networking ETF	5%	-3.2%
Energy Sector SPDR	6%	-4.2%
S&P Oil & Gas Exploration & Production SPDR	0%	-4.5%
UBS CMCI Commodity ETN	0%	-4.6%
KBW Capital Markets SPDR	2%	-4.8%

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.

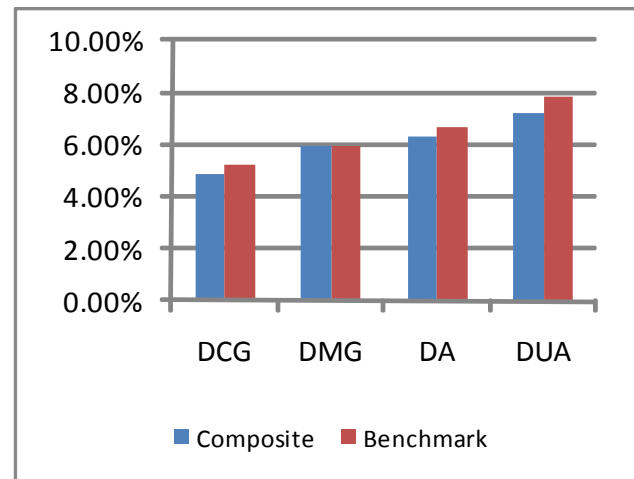
Portfolio Transactions

Towards the end of the month, we decided to eliminate existing holdings in diversified commodities positions and to scale back within Energy sector holdings due to concerns about the impact of a slowing economy on commodity prices. Proceeds from the commodities sale were used to bolster defensive equity sector positions. Separate holdings in gold were maintained, and now represent the only commodity positions in our models for the time being. Overall, we continue to view portfolios as being very close to benchmark levels of volatility.

Month: May 2011		
Policy	Composite	Benchmark
DCG	-0.31%	0.21%
DMG	-0.52%	-0.16%
DA	-0.97%	-0.52%
DUA	-1.30%	-1.13%



Year To Date: 2011		
Policy	Composite	Benchmark
DCG	4.85%	5.19%
DMG	5.93%	5.91%
DA	6.30%	6.63%
DUA	7.19%	7.82%



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Pinnacle Dynamic Portfolios

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