

2009 Third Quarter Market Review

Executive Summary

- The start of the third quarter could be characterized as a time of mixed emotions for investors, as the joy from a great second quarter had to be balanced against concern that economic fundamentals would need to show continued improvement to keep the financial markets ascending off their March lows. As it turned out, the third quarter went to the bulls in a landslide.

- In our estimation the violent market move during the third quarter was largely due to ultra low short-term interest rates that brought back a “cash is trash” mentality to the financial markets. The migration from low yielding cash to higher yielding assets helped to bring back so-called “animal spirits,” but by quarter’s end stocks and risk assets had risen so much that a number of technical and sentiment measures cautioned that markets were overbought on a short-term basis.

- Pinnacle Advisory Group managed accounts experienced their largest quarterly gains since the inception of our current composites, dating back to 2002. Additionally, Pinnacle portfolios are showing gains from the previous year for the first time since before the onset of the financial crisis. At the individual security level, performance themes were very similar to last quarter’s, with riskier assets again leading the way.

- Our current outlook is that the economy is likely to continue to recover on the back of massive amounts of fiscal and monetary stimulus, which should help maintain a supportive environment for financial markets. We believe that the recession most likely ended sometime during the summer, although an official announcement from the National Bureau of Economic Research (NBER) probably won’t be made for quite some time, as is typically the case.

- Given the level of uncertainty going forward, we continue to feel comfortable positioning portfolios close to neutral volatility while we navigate what we believe is a wide trading range. We are attempting to restrain ourselves from the urge to take profits and become overly defensive in the face of a powerful market rally, while also remaining vigilant to prevent the complacency that often accompanies a rising market from setting in.

- At the moment financial markets appear to be in a sweet spot, and our impression is that there may be more gains to be earned. At the same time, however, we also subscribe to the theory that lasting structural damage was incurred during the last cycle, and we don’t believe that we have embarked on the next long-term bull market at this time. Despite signs of improvement, investors need to be extremely vigilant in monitoring changing conditions, and will have to find the flexibility and willingness to be more nimble than ever in navigating markets that may trade in a wide range for some time to come.

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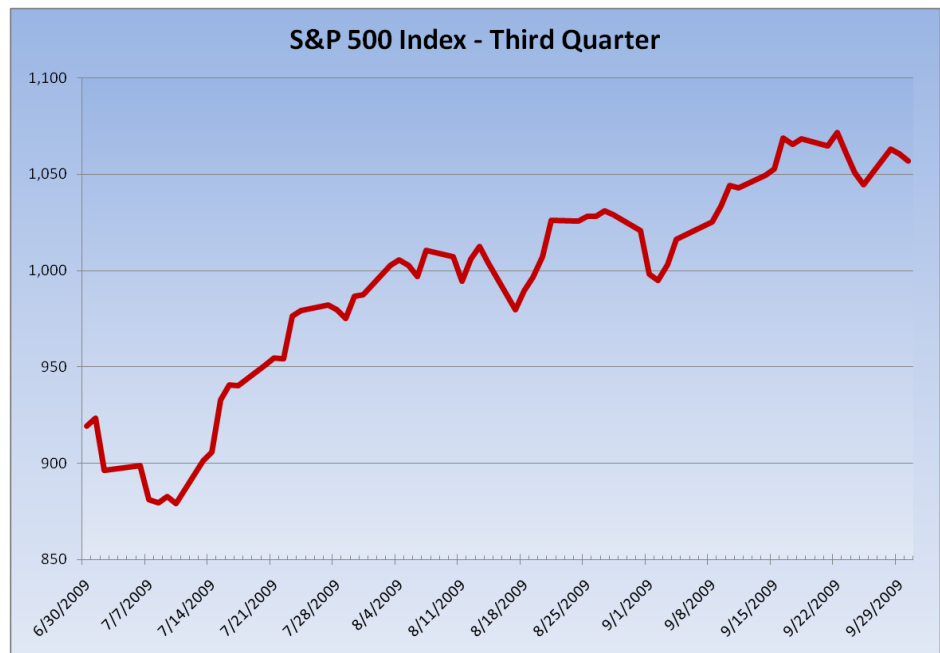
Third Quarter 2009 Market Review

Third Quarter Review

The start of the third quarter could be characterized as a time of mixed emotions for investors, as the joy from a great second quarter had to be balanced against concern that economic fundamentals would need to show continued improvement to keep the financial markets ascending off their March lows. Bears growled that even though most second quarter economic reports were less dire than before, there was very little actual growth to be found. The bulls on the other hand were confident that new bull markets typically start three to six months ahead of the fundamental data turning, and they were quick to remind the bears that bull markets traditionally love to climb the

same wall of worry that they were hanging their bearish hats on. As it turned out, the third quarter went to the bulls in a landslide thanks to abundant liquidity, improving fundamental data, strengthening technical conditions, and increasing risk appetites as previously bearish investors scrambled to get reinvested. The returns on the table below reveal that the third quarter was again ruled by risk assets, and those who invested in the risk trade were handsomely rewarded.

The combination of stabilizing fundamental economic data, strengthening technical conditions, and very low interest rates mixed together to form a potent brew for the riskiest assets on the investment spectrum. The economy was boosted by government-backed programs such as Cash for Clunkers and the first time homebuyer's tax credit, and the markets seemed reassured about the future of monetary policy when President Obama nominated Ben Bernanke to serve another term as Federal Reserve Chairman after his current term expires in January. Economic data improved on almost all fronts, including in many of the more important areas that we track such as real wages, various housing market indicators, credit conditions, corporate earnings, and several leading economic indicators. Meanwhile, technical conditions in the marketplace gained momentum as many global markets climbed above key moving averages, advancing issues solidly outpaced decliners, and stocks making new lows virtually disappeared. In other words, underlying support for the rally has been steadily growing.



Index	Third Quarter Return
S&P 500 Index (w/ dividends)	+15.61%
Russell 2000 Index (small cap stocks)	+19.28%
MSCI EAFE Index (international stocks)	+19.55%
Dow Jones/UBS Commodity Index	+4.20%
Barclays Capital Aggregate Bond Index	+3.67%
3-month T-bills	+0.07%

While no one knows precisely what causes violent market moves like what occurred during the third quarter, in

our estimation it was largely due to ultra low short-term interest rates that brought back a “cash is trash” mentality to the financial markets. As credit markets have healed, and inter-bank lending rates have dropped to pre-crisis levels, the bond market has disproportionately rewarded the companies with the worst credit ratings, many of which were priced at levels that implied imminent bankruptcy during the climax of this recession. Since risk-free cash yields next to nothing, and as more evidence emerged that fears of Armageddon were overblown, investors naturally flocked to assets that offered more bang for the buck. The migration from low yielding cash to higher yielding assets helped to bring back so-called “animal spirits,” but by quarter’s end stocks and risk assets had risen so much that a number of technical and sentiment measures cautioned that markets were overbought on a short-term basis. As the quarter drew to a close, investors were left to decide whether they should stick with the prevailing trend and stay in the market, or pare back their risk exposure based on fears that the entire rally is based on nothing more than an ephemeral sugar high. For a detailed analysis of Pinnacle’s current view, please read the Market Outlook section.

Pinnacle Performance Analysis

We’re pleased to report that Pinnacle Advisory Group managed accounts experienced their largest quarterly gains since the inception of our current composites, dating back to 2002. Additionally, Pinnacle portfolios are showing gains from the previous year for the first time since before the onset of the financial crisis. Looking back two years, most portfolios are within approximately 5 percent to 10 percent of fully recovering their pre-crisis values, which is remarkable considering that the S&P 500 is still down by more than -30 percent from its high on October 9, 2007.

Composite	Third Quarter Composite Return: 6/30/09 to 9/30/09	Trailing 12-Month Composite Return: 9/30/08 to 9/30/09
Dynamic Conservative Growth	+7.45%	+5.15%
Dynamic Moderate Growth	+10.27%	+6.94%
Dynamic Appreciation	+12.61%	+4.99%
Dynamic Ultra Appreciation	+14.23%	+7.91%

Please see the last page of this report for important performance-related disclosures.

At the individual security level, performance themes were very similar to last quarter’s, with riskier assets again leading the way. All equity sectors posted positive returns. Cyclical sectors such as materials, energy, industrials, technology, and consumer discretionary were the leaders, while the non-cyclical consumer staples and health care sectors trailed. Treasury bonds posted modestly positive returns, after suffering declines during the second quarter. Credit-related fixed income holdings performed very well, including investments in both high yield and investment grade corporate bonds, mortgage-backed bonds, and international bonds.

Top Five Performers of the 3rd Quarter		Bottom Five Performers of the 3rd Quarter	
Energy Equipment & Services SPDR	+27.62%	iShares 20+ Year Treasury ETF	+5.36%
Metals & Mining SPDR	+23.57%	Credit Suisse Commodity Fund	+4.50%
Equal Weight Industrials ETF	+21.00%	Jennison Dryden Short-Term Corp. Bond Fund	+4.17%
Oppenheimer Developing Markets Fund	+20.73%	iShares 7-10 Year Treasury ETF	+2.75%
Consumer Discretionary SPDR	+19.41%	Hussman Strategic Growth Fund	-0.15%

Third Quarter 2009 Market Review

Quarterly Portfolio Activity

While there were no major shifts in portfolio positioning during the quarter, there were several trades in July that involved rotating out of more defensive equity sectors and into more cyclical sectors in response to increasing signs that the recession had ended. Overall, portfolios remain positioned very close to neutral volatility across all models after combining equity weightings with several equity-like holdings in alternative investments and fixed income. We do not anticipate substantially boosting equity weightings in the near term since equities have already rallied more than 50 percent off the bottom, and there are still significant risks to the recovery. As always though, the mix of holdings can change in order to better position portfolios, without altering broad asset allocation.

The following table details the current asset mix across strategies (the net change from the prior quarter is indicated by the number in parentheses):

Composite	Equities	Fixed Income	Alternative Investments
Dynamic Conservative Growth	24	53 (-4)	23 (+4)
Dynamic Moderate Growth	42 (+2)	39 (-2)	19
Dynamic Appreciation	55.5 (+3.5)	28.25 (-0.5)	16.75 (-3)
Dynamic Ultra Appreciation	67.5 (+4)	14.5	18 (-4)

Market Outlook

As we enter the fourth quarter, our current outlook is that the economy is likely to continue to recover on the back of massive amounts of fiscal and monetary stimulus, which should help maintain a supportive environment for financial markets. We believe that the recession most likely ended sometime during the summer, although an official announcement from the National Bureau of Economic Research (NBER) probably won't be made for quite some time, as is typically the case.

Although the underlying trend in financial markets has been very positive since the March lows, we may be about to transition to a new phase of the rally where gains are still attainable, but will likely accumulate in a more volatile manner. On a short-term basis, the stock market appears to be overbought, stocks are no longer cheap, and the risk of a bull market correction is growing. While a market setback could occur at any time, we still believe the greater probability is that the bull market will persist over the next few quarters, although the character of the rally is likely to change. It would not be surprising if there is a moderation in the pace of gains, an increase in intermittent volatility, and a narrowing of the uniform participation as the bull market matures from its initial explosive stage to a still healthy, but more tempered pace.

Despite a brighter cyclical profile, we are acutely aware that significant structural risks still exist, which have the capacity to inhibit long-term growth and keep stocks from achieving new highs. Contracting private credit, falling money velocity, and muted consumer spending are all insidious deflationary forces that are pressuring authorities to implement extremely accommodative fiscal and monetary policies. These structural challenges, along with the unintended consequences of the reflationary battle currently being waged to shore up the financial system, continue to contribute to a forecast with lower than average conviction at this time.

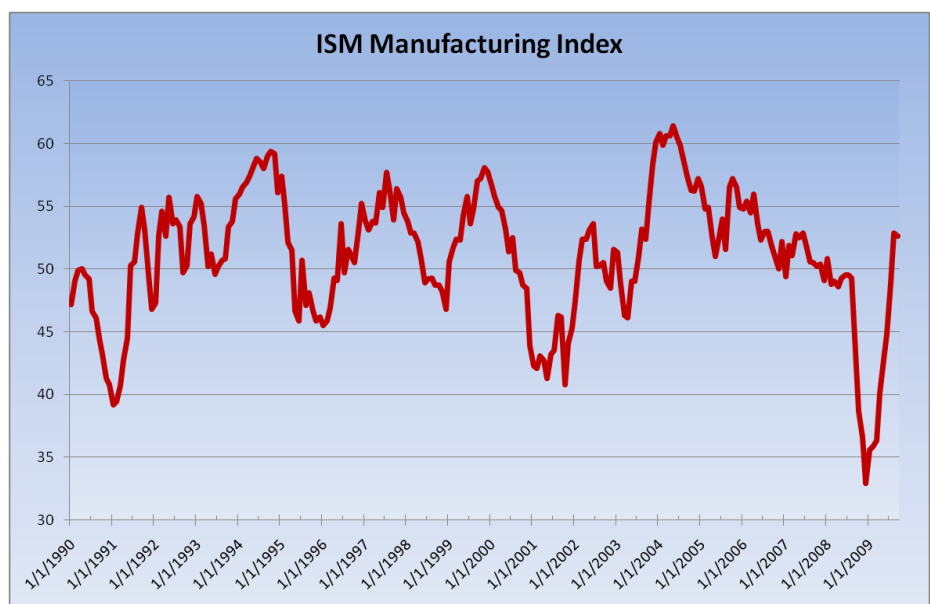
Given the level of uncertainty going forward, we continue to feel comfortable positioning portfolios close to neutral volatility while we navigate what we believe is a wide trading range (currently between the March low of 666 and a high of approximately 1,200 - 1,300 on the S&P 500). As we communicated last quarter, we intend to use the market's position within this range to help guide allocation shifts. If the market makes it toward the upper end of the range, our current plan is to gradually reduce risk, which would take portfolios back below neutral to an underweight position. If the market does correct sometime soon, we may modestly increase exposure depending on the depth of the decline.

If the market simply gyrates in a sideways manner in the middle of the range, then transactions will likely be dominated by lateral moves between sectors and asset classes that we believe have the most compelling value. Right now, we are simply being patient, and allowing the market to steer us. We are attempting to restrain ourselves from the urge to take profits and become overly defensive in the face of a powerful market rally, while also remaining vigilant to prevent the complacency that often accompanies a rising market from setting in. As always, we will continue to assess incoming information and are prepared to adjust portfolios based on our evolving view of the economy and financial markets.

The Good News: The Recession Appears To Be Over

Improvement across a variety of economic indicators during the past few months has made it clear to us that the recession probably ended sometime over the summer. The exact date that it ended probably won't be known for some time, since the NBER has historically waited until well into a recovery before officially marking the end of a recession. We don't believe we have the luxury of waiting for the NBER's official declaration, since market movements are anticipatory in nature, which is why we tend to heavily emphasize leading indicators of economic activity.

Economic data during the third quarter was marked by several series that exhibited actual growth, as opposed to the less dire phenomenon that characterized second quarter data. For example, the Institute for Supply Management's Manufacturing Index climbed above 50 for the first time since January 2008, indicating that the manufacturing sector is growing again. Credit conditions continued to improve, with several yield relationships and inter-bank lending rates dropping back to levels that existed prior to last year's failure of Lehman Brothers, which led to a near complete credit freeze. Leading economic indicators continued to gain steam, housing market indicators improved due to increased affordability and the \$8,000 first time home buyer's credit, and inflation-adjusted wages continued to soar, although they have not translated into more spending, yet. Lastly, for the second straight quarter, corporate earnings beat the overly-pessimistic consensus analyst estimates, this time by approximately 10 percent for S&P 500 companies.



Third Quarter 2009 Market Review

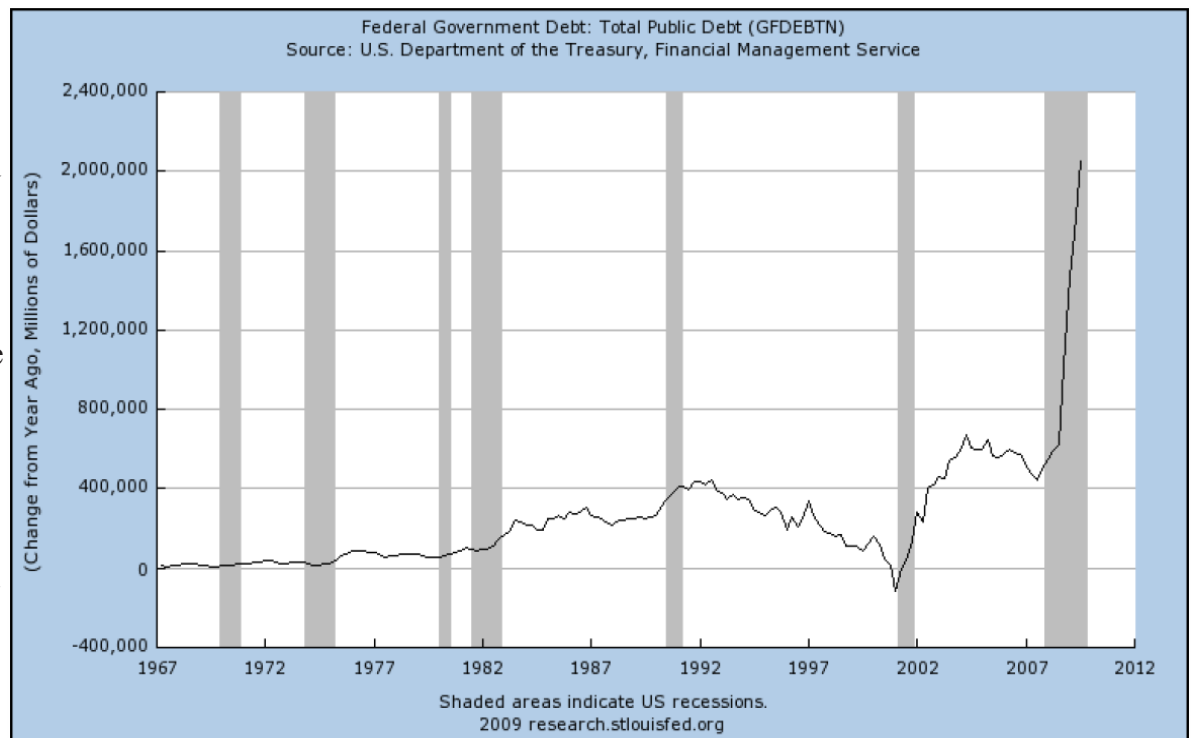
In addition to improving fundamentals, the message from technical measures is that this bull market is on very solid footing. Mixed all together, the weight of the evidence seems to be implying that a new expansion and bull market has arrived, and that is good news!

So, Now What?

While it's nice to look in the rearview mirror and feel good about healthy gains in financial markets for the year, investors must remain focused on the view looking forward through the windshield to try to determine where things are headed over the next six to 12 months, and beyond. In that regard, there are several interrelated issues that we're wrestling with right now, including how sustainable the rebound might be, how much of the recovery has already been discounted by the financial markets, and how the dichotomy of positive cyclical forces but over-hanging structural concerns will ultimately play out.

In the shorter-term, given the intensity and magnitude of the economic downdraft, we wouldn't be surprised if an equally vigorous rebound materializes, even if it ultimately proves to be temporary. Therefore, third quarter growth may be stronger than anticipated, buoyed by the Cash for Clunkers program that clearly jumpstarted auto sales, some inventory restocking, and a pickup in export growth as China and other parts of the emerging world resume their robust growth. However, above-trend growth may not last long, and there is an equal chance that the fourth quarter may also experience growth, but at a more subdued rate as some of the stimulus winds down. Cash for Clunkers has already ended, the first time homebuyer's tax credit is set to expire in December, and the Federal Reserve is planning on completing their direct purchases of Treasury and agency debt by the end of the year. The absence of these supportive measures could partially undermine recent economic momentum.

Looking ahead more than a few quarters, it seems that risks to the forecast increase exponentially based on the potentially hazardous structural backdrop. In the last Market Review, we introduced the concept of a New Normal, which is the idea circulating through the investment community that this economic recovery will be weighed down by several substantial challenges, creating the likelihood of a long period of below-trend economic growth. Some of the bigger issues that need to be resolved include the potential that we have reached the end of a long-term uptrend in the credit cycle, debt deleveraging as consumers and businesses repair their bloated balance sheets, more government involvement and increased



regulation, the potential for higher taxes, an end to leveraged financial securitization, a structurally high level of unemployment, and the inevitable withdrawal of government stimulus programs that have helped to offset the immense decline in private sector spending and investment. We agree with the general premise of this argument, and believe that it creates an unstable foundation for the current bull market to build off of. In short, we believe the New Normal reduces the probability that stocks will exceed the prior high of 1,565 on the S&P 500 Index anytime soon.

Conclusion

The third quarter yielded robust gains for investors who correctly identified signs that an economic recovery had arrived. Risk reigned and returns were exceptionally robust, which was reflected in the impressive performance of Pinnacle portfolios. The great news is that we believe the recession is currently over and the global market cycle is back on the upswing. At the moment financial markets appear to be in a sweet spot, and our impression is that there may be more gains to be earned. At the same time, however, we also subscribe to the theory that lasting structural damage was incurred during the last cycle, and we don't believe that we have embarked on the next long-term bull market at this time. Despite signs of improvement, investors need to be extremely vigilant in monitoring changing conditions, and will have to find the flexibility and willingness to be more nimble than ever in navigating markets that may trade in a wide range for some time to come. The good news is our current philosophy and money management process have prepared us for just these types of markets.

Note: Pinnacle's views are current as of the date of this communication and are subject to change as economic and market conditions dictate.

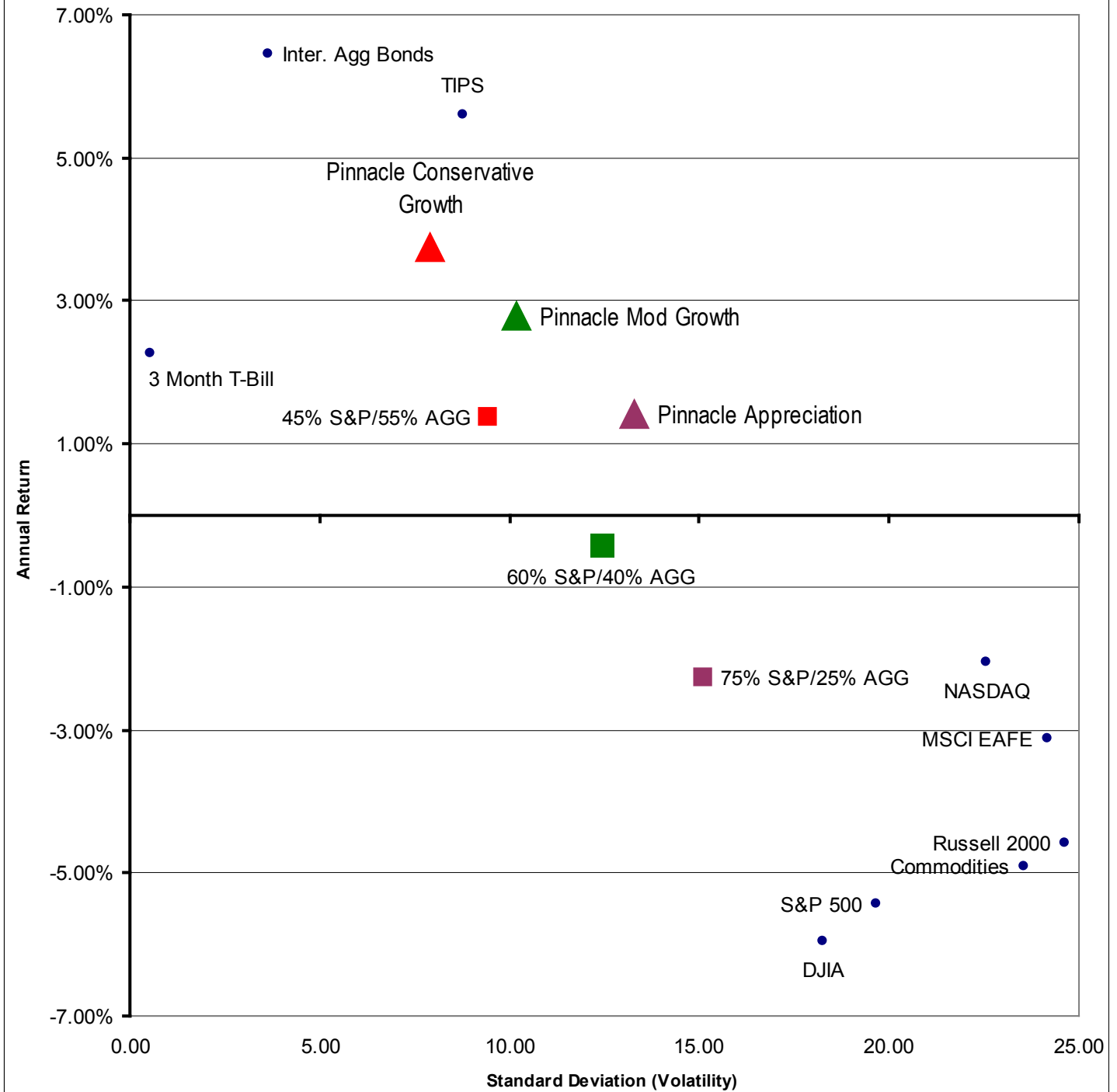
The following data corresponds to the chart on page 8:

Asset	Annual Return	St. Dev	Asset	Annual Return	St. Dev
3 Month T-Bill	2.27%	0.55	Pinnacle Dynamic Moderate Growth	2.80%	10.18
Barclays Inter. Agg. Bonds	6.46%	3.63	75% S&P/25% AGG	-2.26%	15.11
TIPS	5.61%	8.77	Pinnacle Dynamic Appreciation	1.41%	13.30
DJIA	-5.96%	18.25	Pinnacle Dynamic Ultra Appreciation	1.74%	15.56
Pinnacle Dynamic Conservative	1.76%	6.30	S&P 500	-5.43%	19.68
Pinnacle Dynamic Con Growth	3.75%	7.91	Commodities	-4.91%	23.55
45% S&P/55% AGG	1.37%	9.45	Russell 2000	-4.57%	24.64
NASDAQ	-2.05%	22.56	MSCI EAFE Index	-3.12%	24.18
60% S&P/40% AGG	-0.42%	12.43			

Third Quarter 2009 Market Review

3 Year Chart (9/30/06 - 9/30/09)

Pinnacle Composite Portfolios may be compared to a variety of asset classes, blends of asset classes, or mutual fund universes. This chart shows risk and return for three Pinnacle composites. Risk is expressed on the horizontal axis as standard deviation. A high standard deviation means a security is more volatile than a security with a low standard deviation.



Intermediate Government Bonds – An unmanaged index based on all publicly issued intermediate gov't debt with an avg maturity of 4 years.

Barclays Capital Aggregate Bond Index (AGG) – An unmanaged, intermediate term, market-capitalization weighted index used to represent investment grade bonds being traded in the U.S. The index includes Treasury securities, Government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in U.S.

TIPS - These are inflation-protected securities issued by the US Treasury.

Dow Jones Industrial Average Index (DJIA) - An unmanaged, price-weighted index of 30 widely held stocks traded on the NYSE. The 30 stocks in the Dow Jones Industrial Average are all major factors in their industries and their stocks are widely held by individuals and institutional investors.

S&P 500 – An unmanaged, capitalization-weighted index composed of 500 widely held common stocks listed on the NYSE. This index provides a broad snapshot of the overall U.S. equity market . The index selects its companies based upon their market size, liquidity, and sector.

S&P 500 Total Return Index – S&P 500 index including reinvestment of all dividends and distributions.

AIG Commodity Index (Commodities) - This rolling index is composed of futures contracts on 19 physical commodities. It is designed to be a highly liquid and diversified benchmark for the commodity futures market.

Russell 2000 – An unmanaged, market-capitalization weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000 index.

MSCI EAFE Index - An unmanaged, market capitalization weighted index composed of stocks from 21 developed markets, but excludes those from the U.S. and Canada. The countries included in the index are located in Europe, Australia, Asia, and the Far East.

NASDAQ – An unmanaged, market-capitalization weighted index. The security types eligible for the index include domestic or foreign common stocks, ordinary shares, ADRs, shares of beneficial interest or limited partnership interests, and tracking stocks.

45% S&P/55% AGG – Comprised of the S&P 500 Total Return Index and Barclays Capital Aggregate Bond Index.

60% S&P/40% AGG – Comprised of the S&P 500 Total Return Index and the Barclays Capital Aggregate Bond Index.

75% S&P/25% AGG – Comprised of the S&P 500 Total Return Index and Barclays Capital Aggregate Bond Index.

Disclaimer

Pinnacle Advisory Group, Inc. (hereinafter “Pinnacle”) is an investment advisor registered under the applicable provisions of the U.S. Securities and Exchange Commission (SEC).

Pinnacle Dynamic Portfolios

Any reference to “Pinnacle’s” portfolio volatility or portfolio performance is based on the actual performance of Pinnacle’s composite portfolio groups. There are five Pinnacle composite portfolios – Dynamic Conservative, Dynamic Conservative Growth, Dynamic Moderate Growth, Dynamic Appreciation, and Dynamic Ultra Appreciation – and each is managed within the constraints of a specific Investment Policy Statement. The composite portfolios are actively managed and the underlying securities and/or percentage holdings in each security can and do change as Pinnacle alters its market outlook based on a continuous evaluation of market and economic conditions. The composite portfolios typically own a diversified mix of no-load or load-waived mutual funds and exchange-traded funds that invest in U.S. and international equities, fixed income securities, and alternative investments such as commodities, real estate, and hedge-fund-like strategies. It is important to note that the returns and volatility shown are accurate representations of past performance, but are not necessarily predictive of future performance or volatility as market conditions can and do change. Returns are calculated using month-end portfolio values. Any and all return or volatility data for the composite portfolios are shown net of all Pinnacle fees and any other related fees (such as fund expense ratios or transaction/trading costs where applicable), include dividends and interest, and are size- and time-weighted. Policy composites include portfolios formerly categorized as “Stock” or “Mutual Fund,” which may have deviated slightly from target model weightings in the past. Policy composite returns may vary from individual Pinnacle client accounts due to deposits or withdrawals from the account, or other client-driven market timing or security selection issues. Pinnacle composite portfolios may be compared to various asset classes, blends of asset classes, indices, or mutual fund universes. The performance and volatility of these asset classes are for comparison purposes only and such performance can be materially different than a Pinnacle composite portfolio.