Pinnacle
ADVISORY GROUP, INC.
Private Wealth Management

January 2010

2009 Fourth Quarter Market Review

Executive Summary

- The fourth quarter began with investors wondering if the prolific gains earned in the second and third quarters would hold. Despite several minor stumbling blocks during the quarter, most financial assets continued to rally as the economic recovery steadily broadened out and gathered steam.

- One of the theories regarding the surprisingly robust market move away from the bottom is that the financial markets are currently positioned in the so-called sweet spot of the economic cycle. Unfortunately, this backdrop can't last forever, leaving investors to worry about when the sweet spot, and consequently the bull market, may end.

- The fourth quarter marked the third consecutive quarter of gains for Pinnacle portfolios. Although the quarterly returns were somewhat more modest than the explosive gains of the past two quarters, 2009 as a whole ranked as the second best year of annual returns since the inception of our performance composites (only the first year of the last bull market in 2003 was better).

- Our current outlook remains consistent with what we stated last quarter. Though the National Bureau of Economic Research (NBER) has not yet officially determined when the recession ended, we continue to believe the economy has been expanding since mid-2009, and that growth will continue through the first quarter of 2010 on the back of a more functional credit market, reviving economic activity, and building momentum that has risen from fiscal and monetary stimulus that continues to liquefy the financial system.

- If our base case is correct, we believe the bull market still has room to produce further gains for now, but that reaching the prior bull market high is not a strong likelihood. Should the market move in our favor and increase toward our target range of 1,200 – 1,300 on the S&P 500 Index, our intention is to begin rotating the portfolio into more defensive areas of the market.

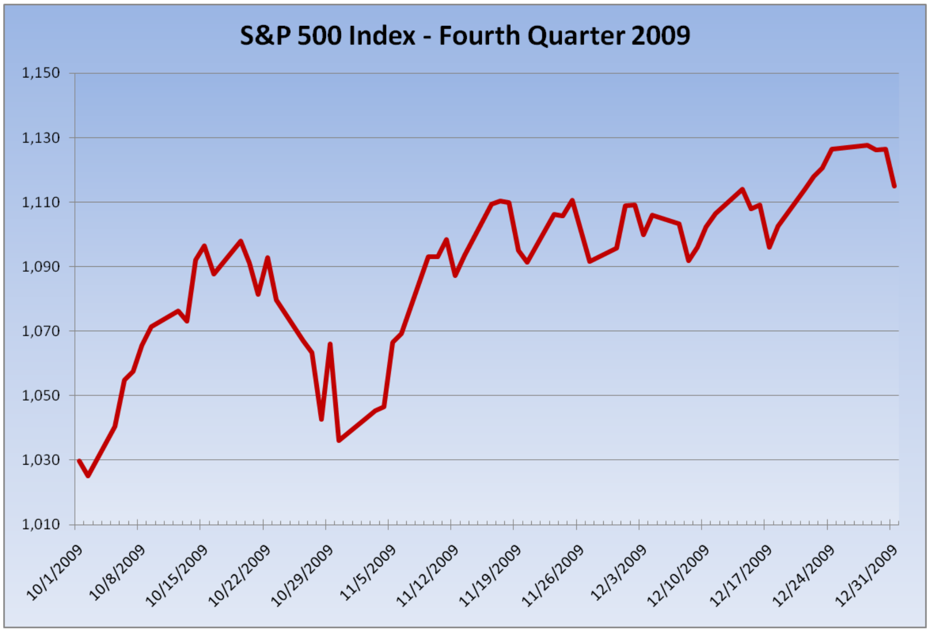
- We currently believe that the next quarter should continue to be supported by the momentum that has built in the economy and financial markets, but we also believe the window for riding the liquidity wave will begin to close sometime in the first half of 2010. For now we feel properly aligned at benchmark volatility and expect to make mostly lateral moves until we hit our target zone. As always, we will monitor changes in incoming data, and should the weight of the evidence change we are prepared to change with it. But until it does, we feel no need to step in the way of a bull market.

Written by:

Rick Vollaro, CPA
Portfolio Manager, Partner

Carl Noble, CFA
Portfolio Analyst

Fourth Quarter Review

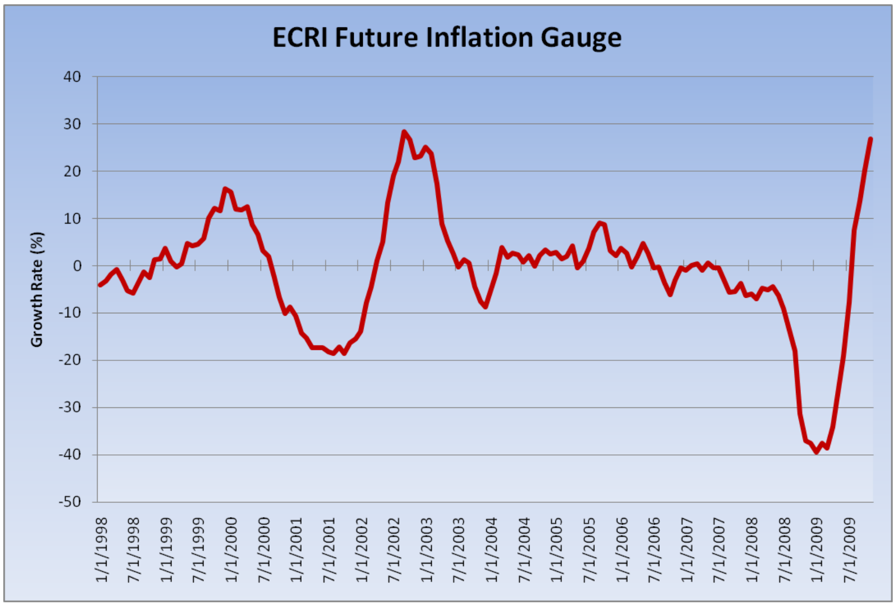


The fourth quarter began with investors wondering if the prolific gains earned in the second and third quarters would hold. There were increasing signs that the market rally was tiring, and valuation had deteriorated somewhat, mostly as a byproduct of rapid price appreciation. However, despite several minor stumbling blocks during the quarter, most financial assets continued to rally as the economic recovery steadily broadened out and gathered steam. Indeed, varying degrees of improvement were witnessed in many of the areas hit hardest by the recession, including credit, housing, employment, and manufacturing. Conversely, there were many ongoing challenges to confront, including declining private credit demand, a reluctance to lend by banks, high levels of emergency unemployment claims, sovereign debt worries, a new wave of mortgage rate re-sets, ongoing commercial real estate problems, and finally a short-term overbought stock market. Despite the extensive wall of worry that continued to hang over financial markets, most risk assets, and Pinnacle portfolios, delivered another quarter of healthy gains.

Index	Fourth Quarter Return
S&P 500 Index (w/ dividends)	+6.04%
Russell 2000 Index (small cap stocks)	+3.87%
MSCI EAFE Index (international stocks)	+2.25%
Dow Jones/UBS Commodity Index	+9.03%
Barclays Capital Aggregate Bond Index	+0.07%
3-month T-bills	+0.04%

One of the theories regarding the surprisingly robust market move off the bottom is that the financial markets are currently positioned in the so-called sweet spot of the economic cycle. This goldilocks environment for risk assets tends to materialize in the wake of a recession, when economic data and earnings begin to improve at the same time that monetary support is flush and inflation expectations are contained. These conditions act to increase confidence in the economy and future earnings, while simultaneously giving the authorities room to keep pumping stimulus into the financial system. Unfortunately, this backdrop can't last forever, leaving investors to worry about when the sweet spot, and consequently the bull market, may end.

Predicting the precise point at which a bull market will exhaust itself is an impossible task. However, it seems safe to conclude that the premature withdrawal of monetary stimulus is one of the primary threats to a further appreciation in stock prices. The Federal Reserve and other central banks may begin to consider removing stimulus since some of the risks to the economy have abated, and several inflation indicators are starting to rise from their deflationary depths of last year. One example where this was apparent was in the widening of the difference in yield, or spread, between nominal Treasury bonds and Treasury Inflation Protected Securities (TIPS). The spread between the two is considered to be a good proxy of market expectations for annualized inflation and it has widened from 0% (implying virtually no inflation going forward) during the worst of the crisis to 2.3% currently. Aside from the TIPS spread, a number of inflation models we follow, such as the Economic Cycle Research Institute's (ECRI) Future Inflation Gauge (see chart below), are also on the rise. Additionally, import prices have crept up as the dollar has fallen, the Producer Price Index and Consumer Price Index are back in positive territory again on a year over year basis, and commodities have risen in a broad-based fashion.



Whether the bounce back in these measures is temporary or lasting still remains to be seen. Regardless, what seems clear is that some parts of the market are beginning to price in higher levels of future inflation, which opens the door for monetary authorities to not only begin withdrawing excess liquidity, but also to start increasing short-term interest rates from their rock-bottom 0% level currently. By the end of the fourth quarter investors were feeling exhausted from the round trip journey they had experienced during the year. The fear and pessimism that was so widespread 12 months ago was replaced by cautious optimism as a result of the Herculean efforts of monetary and fiscal authorities to save the financial system. Weary investors ended the year with higher spirits and portfolio balances, but with legitimate questions about how long this sweet spot might persist.

For a detailed analysis of Pinnacle's current views, please read the section titled "Market Outlook."

Pinnacle Performance Analysis

The fourth quarter marked the third consecutive quarter of gains for Pinnacle portfolios. Although the quarterly returns were somewhat more modest than the explosive gains of the past two quarters, 2009 as a whole ranked as the second best year of annual return since the inception of our performance composites (only the first year of the last bull market in 2003 was better). The additional progress made during the fourth quarter has pulled all of the composites to less than 5% from their pre-crisis levels. For comparative purposes, the S&P 500 Index (including dividends) remains 25% below its previous high set in October 2007, which requires a 33% gain from here to fully recover. Equities were the best performing asset class during the quarter. Holdings in pro-cyclical sectors like consumer discretionary, energy, industrials, materials, and technology continued to perform very well. They were joined by the typically defensive healthcare sector, which reacted favorably to news emanating from the current healthcare reform debate. Financials were the worst performing equity sector, most likely due to rising interest rates and concern about the impact of new accounting rules scheduled to take effect early in 2010.

Composite	Fourth Quarter Composite Return: 9/30/09 to 12/31/09	Trailing 12-Month Composite Return: 12/31/08 to 12/31/09
Dynamic Conservative Growth	+1.48%	+11.20%
Dynamic Moderate Growth	+2.77%	+18.62%
Dynamic Appreciation	+3.35%	+23.43%
Dynamic Ultra Appreciation	+4.48%	+31.53%

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

In Fixed Income, high-quality treasury securities declined, as signs of further economic recovery led to an increase in longer-term interest rates. However, other fixed income investments in corporate credit performed well again. Performance among Alternative Investments was mixed, as gold and commodities rallied, while eclectic managers were more subdued.

Top Five Performers of the Fourth Quarter		Bottom Five Performers of the Fourth Quarter	
S&P Metals & Mining ETF	+13.39%	iShares 7-10 Year Treasury ETF	-2.62%
iShares Semiconductors ETF	+10.41%	iShares Health Care Providers ETF	-2.84%
Technology Sector ETF	+10.26%	Financials Sector ETF	-3.26%
Rydex Equal Weight Health Care ETF	+9.92%	iShares 20+ Year Treasury ETF	-7.70%
iShares Pharmaceuticals ETF	+9.54%	Short-term VIX ETN	-14.26%

Please note that the returns used for this illustration are based on Pinnacle's Dynamic Moderate Growth portfolio. The individual security returns for other Pinnacle strategies may vary due to trade execution or security selection differences. Securities may have been bought and sold during the quarter; therefore, Pinnacle client returns (which are shown here) may not reflect a security's actual quarterly return.

Quarterly Portfolio Activity

Similar to last quarter, portfolio trading activity during the last three months focused mostly on relative trades within asset classes, rather than broad shifts among them. In October, we decided to slightly scale back exposure to credit-sensitive instruments within the overall fixed income allocation because of the significant narrowing of credit spreads that has taken place over the past few months. We've had an overweight to credit for most of the year, and those funds have performed very well. While not abandoning that theme yet, we wanted to rotate to a slightly less aggressive mix of funds. We also added a new fund to alternative investments that specializes in merger arbitrage, which is a low volatility strategy designed to capitalize on merger and acquisition activity. In early December, as we previously communicated, we sold the TCW Total Return in response to the surprising news that the lead manager and most of his staff had left the firm. Some of the proceeds from that sale were used to add to Healthcare sector ETFs. Overall, portfolios continued to be positioned for a neutral level of volatility relative to their respective benchmarks. 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	27 (+3)	50 (-3)	23
Dynamic Moderate Growth	44 (+2)	35 (-4)	21 (+2)
Dynamic Appreciation	57 (+1.5)	26.25 (-2)	16.75
Dynamic Ultra Appreciation	68.5 (+1)	13.5 (-1)	18

Market Outlook

Our current outlook remains consistent with what we stated last quarter. Though the National Bureau of Economic Research (NBER) has not yet officially determined when the recession ended, we continue to believe the economy has been expanding since mid-2009, and that growth will continue through the first quarter of 2010 on the back of a more functional credit market, reviving economic activity, and building momentum that has risen from fiscal and monetary stimulus that continues to liquefy the financial system.

On a short-term basis, the stock market again enters the quarter in a somewhat overbought condition, valuations have swung from cheap to slightly expensive, and the risk of a deeper bull market correction than we have experienced since the March low in stocks continues to grow. 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 quarter or two, as we grind closer to the top of our previously stated target range of approximately 1,200 – 1,300 on the S&P 500 Index.

As the economic expansion and bull market continue to unfold, we remain focused on exercising restraint against becoming overly defensive in the face of broad-based improvement in underlying economic condition. However, as 2010 progresses, we appear to be headed for an inflection point where the sweet spot for the economy and financial assets will face the reality that we are past the apex of the stimulus cycle. As the abundant liquidity and backstops that supported the current recovery begin to recede, a major test of the strength and durability of the current rebound will be underway. How the economy and markets react to the end of emergency stimulus is quite unclear at this time, leading to a lower level of conviction as we look several quarters out.

Given our view of current conditions we continue to feel that portfolios are appropriately positioned close to neutral volatility. Our expectation continues to be that we will reduce risk if the markets drift toward the upper end of the stated target range. Should a material correction occur before that, there is a chance that we may modestly increase exposure, depending on the depth of the decline. We continue to anticipate that any portfolio transitioning during the next quarter or so will likely be dominated by lateral moves between sectors and asset classes that we believe have the most compelling value.

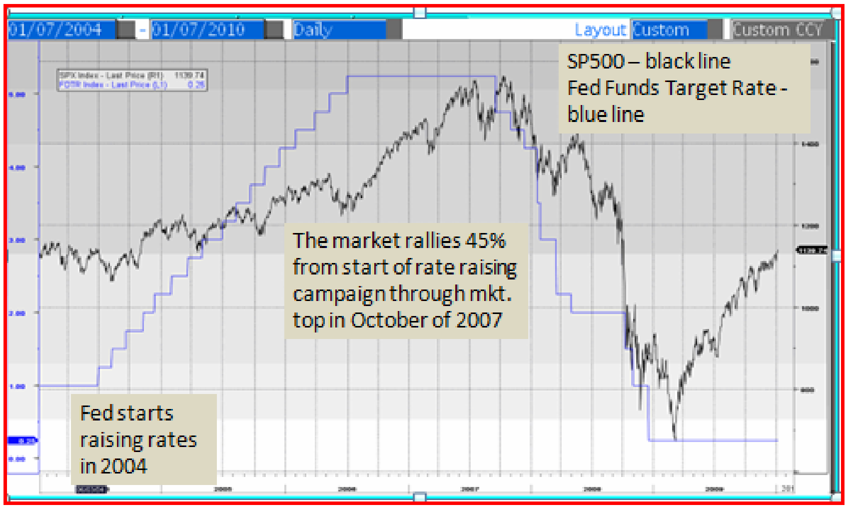
As always, we will continue to monitor changes in macro-economic data, technical conditions and valuation, and are prepared to adjust portfolio allocations as the weight of the evidence changes.

Current Strategy – More of the Same

The investment team recently held a strategy meeting where we discussed the bigger financial issues of the day. "More of the same" was how Chief Investment Officer Ken Solow succinctly summed up the conclusions reached during the lengthy discussion. Perhaps the most universally accepted idea during the meeting was that we are reaching the point in the cycle where some of the emergency measures and other forms of fiscal and monetary stimulus are likely to recede in upcoming quarters. The home-buyer tax credit is set to expire in April, Federal Reserve purchases of mortgage and agency debt will be winding down in the first quarter, cash for clunkers isn't around to boost auto sales this year, and the futures markets are slowly beginning to price in Federal Reserve interest rate hikes throughout the year. The magnitude and timing of stimulus removal is still ambiguous, but what seems apparent is that there is a high probability that we have passed the peak of loose money and excess liquidity. What is much less clear is how the eventual removal of stimulus will impact the economy and financial markets.

Upside Risks and the Bull Case

The best case scenario at this juncture would be for increasing economic confidence to lead to a rise in business and consumers spending. Should this occur, it would create top line sales growth and positive earnings, and encourage companies to begin hiring again. An improving labor market would lead to higher wages, increasing confidence, and stronger consumption. If a virtuous cycle, otherwise known as a positive feedback loop, develops, it could keep the current economic expansion and bull market fueled for longer than the consensus



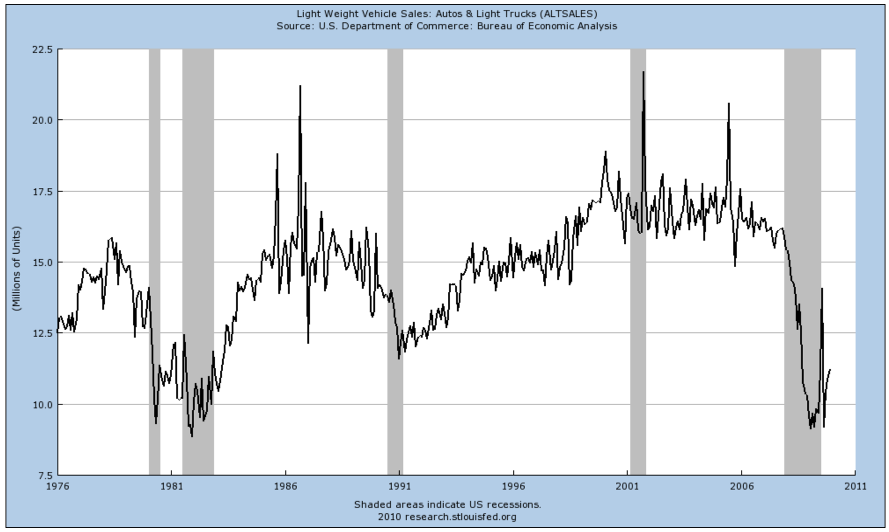
expects. Consider the fact that a large amount of economic slack still exists due to the severity of the recession, and there is leeway for the authorities to be very cautious in removing stimulus from the system. Should we get an environment of expanding growth with ample liquidity, there is potential for not only a continuation of the bull market, but for new asset bubbles to form along the way. Under this scenario, neither a removal of emergency measures nor a moderate increase in interest rates seems destined to derail the bull market.

Investors need only to look back to the 2003-2007 bull market to find an example of a period where stocks rallied in the face of an increasing Fed Funds rate. Back then, the Federal Reserve systematically raised short-term rates from 1% to 5.25% from 2004-2006. And yet, the S&P 500 managed to rise an additional 40% from the time of the first rate hike. The key takeaway is that if the economy has just turned the corner, then there is a chance that the economy may be embarking on a multi-year expansion, keeping the cyclical bull market intact. Under this optimistic scenario, the return of global growth could take the markets beyond our current expectations. While that would certainly be a welcome outcome, we do not view it as having the highest probability at the moment, but we will certainly keep an open mind to the possibility.

Downside Risks and the Bear Case

The main risk to the economy at this juncture is that the improving economic situation and cyclical bull market are nothing but temporary beneficiaries of tremendous amounts of government and monetary aid. Bears contend that even after global authorities have thrown the proverbial kitchen sink at markets in order to stimulate the flow of credit, the economy continues to grow at a subpar rate. Indeed, despite large rebounds in percentage terms from the depths of the recession, the actual unit level of economic indicators like auto or home sales remain well below those achieved in previous expansions.

The bear case may be best explained using an analogy. They argue that the economy is like an athlete who uses performance enhancing drugs. While using the drugs, the athlete may be capable of achieving superhuman feats. But as soon as they stop taking them, the artificial boost disappears and performance quickly fades. It’s entirely possible that the foundation for the broad-based improvement in the economy is built on nothing more than trillions of dollars of stimulus and cost cutting, as opposed to genuine, self-sustaining economic growth. If true, then as soon as the first drop of stimulus is removed it may cause a rapid reversal in the positive trends that have been building for the last six months. After all, the economy is still burdened by elevated debt levels, structurally high unemployment, and a newfound frugality on the part of consumers. Should the economy come off its sugar high and relapse back into recession, it would be reasonable to expect a material pullback in financial markets. This much gloomier scenario is not our base case scenario either, and yet the unclear nature of how this great monetary experiment will resolve itself leaves us in a position where we can not entirely rule it out, either. We believe that if this scenario is to occur, we will start to see it in the data, which we will be watching extremely closely as stimulus reductions begin to occur.



The Base Case – More of the Same

Although both the bull and bear cases outlined above make compelling arguments, we fall somewhere in between the two. What seems most plausible to us is that the economy will continue to gradually gain traction over the next several months. Some of the growth will undoubtedly result from inventory restocking, some will likely come from exporting to the faster-growing regions of the world, and some will be based on momentum from stimulus still running through the system. Towards the second half of the year, however, economic growth may cool again as stimulus fades and some of the longer term headwinds we have written about previously reassert themselves. If our base case is correct, we believe the bull market still has room to produce further gains for now, but that reaching the prior bull market high is not a strong likelihood. Should the market move in our favor and increase toward our target range, our intention is to begin rotating the portfolio into more defensive areas of the market. While we are still working out the details regarding possible allocation changes, it is possible that positions closely linked to government backstops and stimulus, like materials, energy, industrials, financials, small caps, and emerging markets, may be replaced with more defensive sectors of the market, such as consumer staples and healthcare. Within fixed income, we may reduce our high yield and corporate credit in favor of higher quality options, or even cash if traditional bond valuations are unattractive at that time.

In the meantime we are fighting the urge to prematurely adopt a defensive investment posture. For now, we plan to keep portfolios positioned close to benchmark volatility as the bull market continues to grind up. Although this base case leads us to somewhat unexciting tactics at the moment, sometimes the best strategy is to stay with what's working. We feel that this is a time to be patient and stay in harmony with the current uptrend while we watch, wait, and let events unfold before making a major move in client portfolios.

Conclusion

The fourth quarter brought more gains for the financial markets, and for all of our client portfolios. Risk assets continued to move forward, propelled by better economic data and a tidal wave of liquidity. We currently believe that the next quarter should continue to be supported by the momentum that has built in the economy and financial markets, but we also believe the window for riding the liquidity wave will begin to close sometime in the first half of 2010. For now we feel properly aligned at benchmark volatility and expect to make mostly lateral moves until we hit our target zone. As always we will monitor changes in incoming data, and should the weight of the evidence change we are prepared to change with it. But until it does, we feel no need to step in the way of a bull market. For now our stance will be one of staying alert as we patiently await further developments. Rock legend Tom Petty probably put it best in a line from his hit song "The Waiting," when he laments that "the waiting is the hardest part."

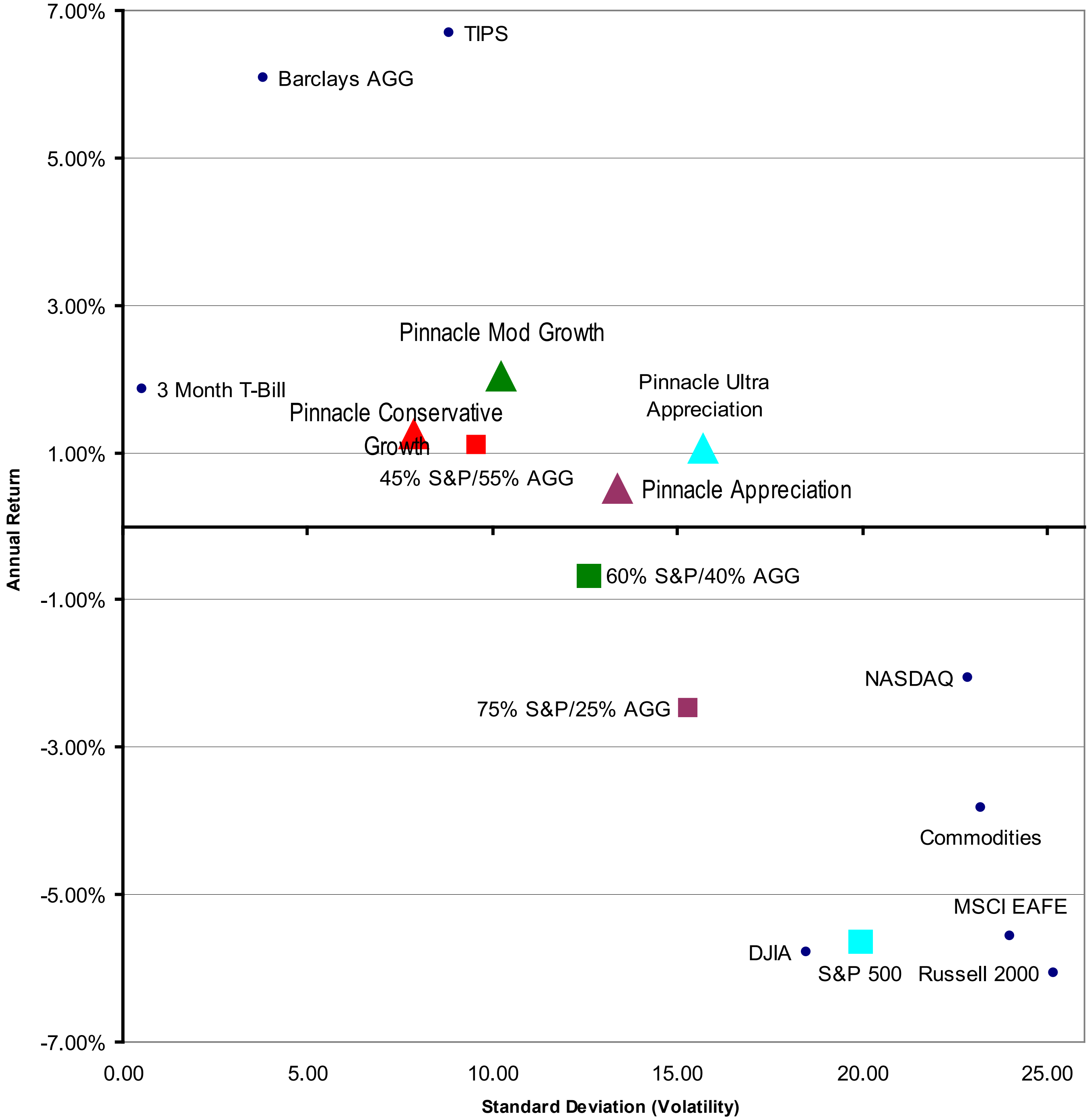
Note: Pinnacle's views are current as of the date of this communication and are subject to change as economic and market conditions dictate.

The following data corresponds with the chart on page nine:

Asset	Annual Return	Standard Deviation
3 Month T-Bill	1.86%	0.53
Barclays Aggregate	6.09%	3.80
TIPS	6.69%	8.85
30% S&P/70% AGG	2.43%	7.36
Pinnacle Dynamic Conservative	0.67%	6.28
Pinnacle Dynamic Con Growth	1.25%	7.85
45% S&P/55% AGG	1.10%	9.57
NASDAQ	-2.06%	22.86
60% S&P/40% AGG	-0.67%	12.57
Pinnacle Dynamic Moderate Growth	2.04%	10.22
75% S&P/25% AGG	-2.48%	15.29
Pinnacle Dynamic Appreciation	0.52%	13.36
Pinnacle Dynamic Ultra Appreciation	1.06%	15.69
S&P 500	-5.62%	19.91
Commodities	-3.83%	23.21
Russell 2000	-6.07%	25.18
MSCI EAFE Index	-5.57%	23.98
DJIA	-5.77%	18.50

3 Year Chart (12/31/06 - 12/31/09)

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 four 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 or 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.