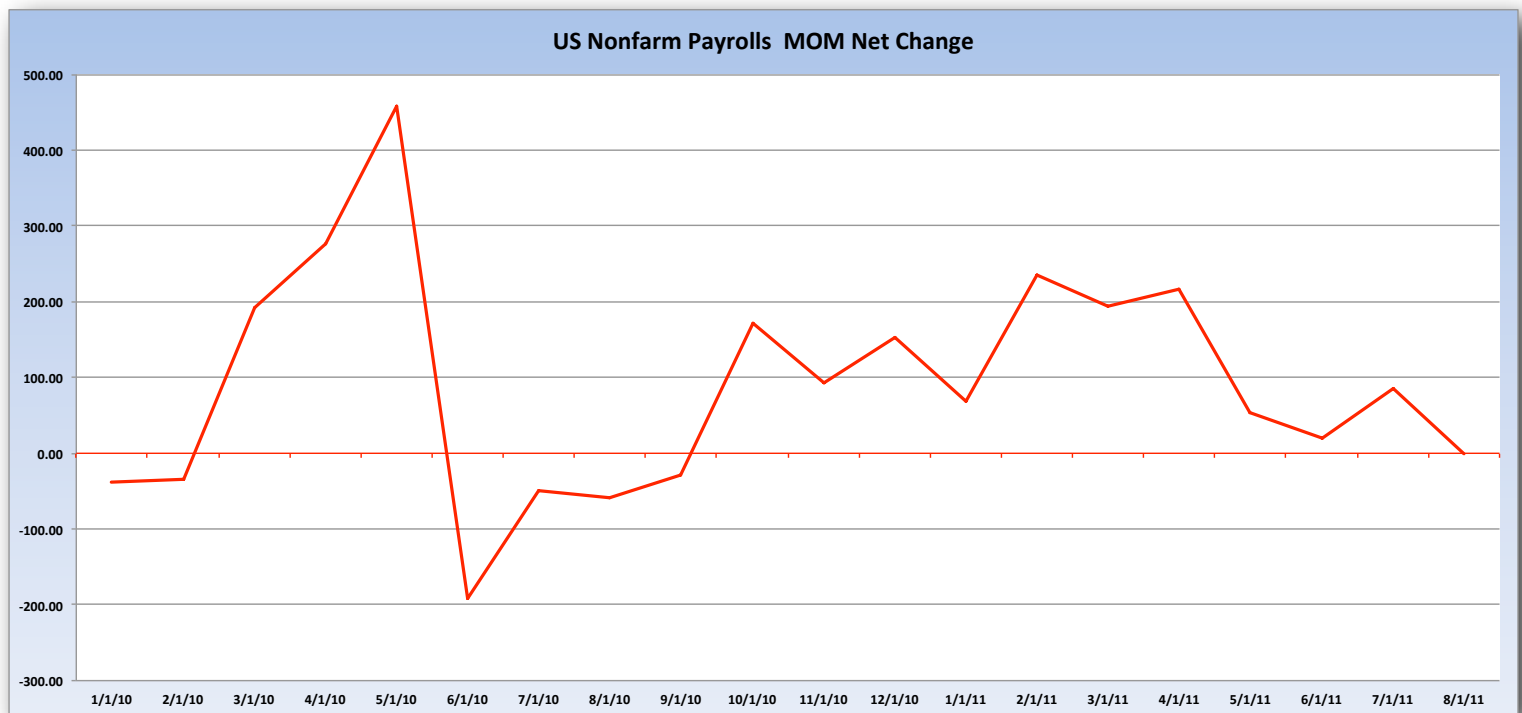


## Market and Portfolio Commentary

August kicked off on the back of July jitters, and during the month that uncertainty translated into a market implosion. The month was wild and contained a confusing mix of cross currents that included politics-gone-bad, weakening economics, and heightened system risk in Europe. By themselves, each of the issues had the capacity to be problematic for markets. Together they created a vortex that sent the markets into a ferocious waterfall decline that stunned investors with its speed. During the month, we changed our investment forecast and now believe we have likely

included political incompetence, a lower U.S. credit rating, material deceleration in manufacturing data, softening consumer spending trends, considerable erosion in leading indicators, and faltering in employment data. We've highlighted jobs before, and have felt they were the key to the cycle either continuing or fizzling out. The jobs data for August was horrific, showing zero job creation and cementing a negative trend within this series that has built for months. This level of job growth will not support the economy or risk assets.



entered into a bear market rather than a correction within a bull market. Making this call was not easy, and to justify it we simply followed our process. Here's a recap of the three tenets of that process that helped bring us to this important conclusion.

### **The Business Cycle: Stagnant/Contracting**

U.S. economic data has been slowing for months, and August deteriorated on multiple levels. The month

As worrisome as the U.S. situation is, the European situation is even worse. Stagnant growth rates, continuing problems on the periphery, dysfunctional politics, escalating banking risk, and rumors of member nations defecting from the common currency make Europe a very big risk at this juncture. Lastly, parts of the emerging world, led by China, are still fighting a war against inflation that is weighing on growth rather than bolstering it at this time.

## Technical Conditions: The Trend is No Longer Your Friend

The global uptrend formerly in place is broken. Many global markets are now trading below down-sloping long term averages, and measures of momentum and volume imply that new lows could be in the offing. Lastly, inter-market analysis would suggest that we are likely in the midst of something more than a deep correction in an ongoing bull market. The best that can be said about technicals at the moment is that sentiment is getting gloomy, which can be positive from a contrary perspective.

## Valuation: Cheaper/Not Cheap

Valuation is improving, and the market is certainly less expensive than it was just a few short months ago. As has been the case for months, the forward price to earnings ratio and earnings yields comparisons are now cheap. However our composite valuation model, which includes normalized P/E ratios as well as a number of non earnings related measures, still looks much closer to neutral levels. Valuation at the extremes should never be ignored, and we'll keep a close eye on our indicators. For now, we acknowledge that markets are getting less expensive, but we don't yet feel that current valuations give us a margin of safety against the potential for further losses during this bear phase.

For now our bear market call has us defensively positioned in all model portfolios. While a downside target for the S&P is impossible to define precisely, a number of analysts we follow are aiming at S&P 950-1000, which seems like a reasonable estimate given our current view and the average magnitude of losses during prior bear markets. Eventually the tide will turn again, and when it does this downside volatility will represent a great chance to position our portfolios to earn healthy returns again. For now, we'll keep defensive and await better evidence before taking on more risk.

## Pinnacle Portfolio Performance for August

Pinnacle portfolios declined in August as significant volatility returned to financial markets. High quality fixed income positions and gold were the best performers during the month. Within the equity market, defensive sectors handily outperformed cyclical sectors.

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

Top Five Performers – August 2011		
Position	Weight	Return
Gold SPDR	3%	+12.3%
iShares 20+ Year Treasury ETF	3.5%	+9.7%
iShares 7-10 Year Treasury ETF	4%	+4.7%
Utilities Sector SPDR	4%	+4.6%
DoubleLine Total Return Fund	5%	+1.6%

Bottom Five Performers – August 2011		
Position	Weight	Return
Equal Weight Industrials ETF	0%	-9.4%
Capital Markets SPDR	2%	-11.6%
iShares Networking ETF	0%	-11.7%
Energy Sector SPDR	4%	-12.2%
Consumer Discretionary SPDR	0%	-14.9%

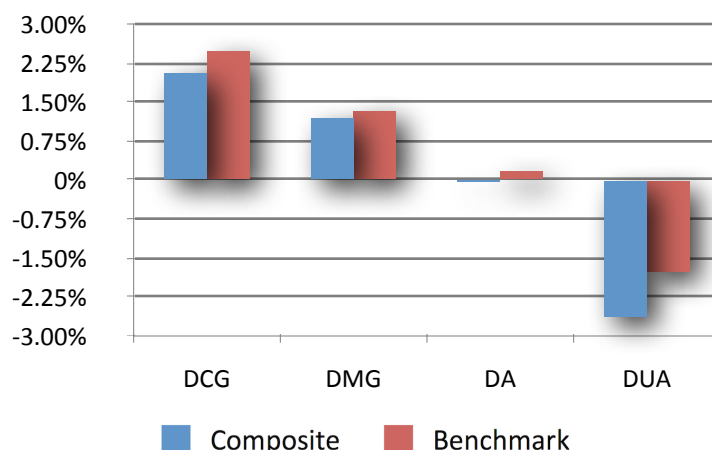
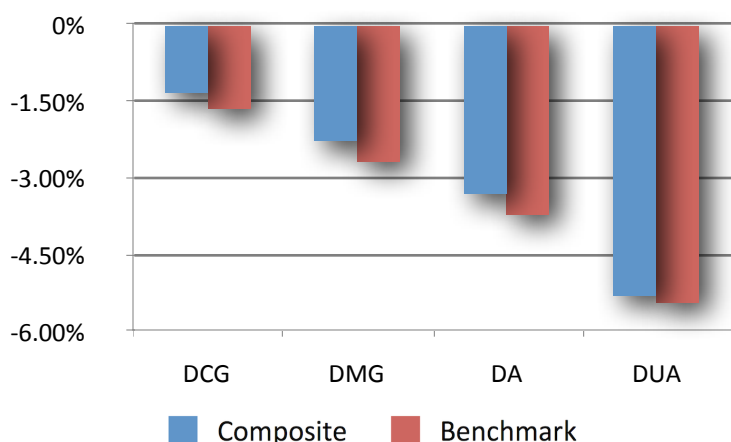
*Please note that the returns and weightings used for this illustration are based on the Dynamic Moderate Growth portfolio at the end of the period. The individual security returns for other strategies may vary due to trade execution or security selection differences. Securities may have been bought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

We were very active during the month, with the general theme of transactions focused on materially reducing risk across all portfolios. This was primarily achieved by significantly lowering equity weightings, with an emphasis on reducing exposure to economically sensitive cyclical sectors. Proceeds from the sales remain in cash for the time being. We also slightly trimmed hedge positions in long-term Treasuries and gold as prices for both soared. Overall, we now view portfolios as being well below benchmark levels of volatility.

Month	August	
Policy	Composite	Benchmark
DCG	-1.33%	-1.64%
DMG	-2.27%	-2.67%
DA	-3.30%	-3.71%
DUA	-5.29%	-5.43%

Year To Date	2011	
Policy	Composite	Benchmark
DCG	2.06%	2.48%
DMG	1.18%	1.33%
DA	-0.02%	0.17%
DUA	-2.63%	-1.77%



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**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.

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