Summer 2015

PINNACLE QUARTERLY

Staying the Course

Rick Vollaro, Carl Noble
Sean Dillon, Sauro Locatelli

Six Questions to Ask Before Buying that Vacation Home
Mike Hamolia

Taking the Long View on the Dollar and Commodities
Rick Vollaro

PINNACLE
Advisory Group, Inc.

Summer 2015

Table of Contents

MARYLAND
6345 Woodside Court
Suite 100
Columbia, Maryland 21046
410.995.6630
410.505.0960 Fax

FLORIDA
5150 North Tamiami Trail
Suite 500
Naples, Florida 34103
239.692.8888
239.692.8878 Fax

PINNACLE
Advisory Group, Inc.

No Pain, No Gain: Taking the Long View on the Dollar and Commodities

Rick Vollaro
Chief Investment Officer

Long ago, Ben Graham taught me that price is what you pay; value is what you get. Whether we are talking about socks or stocks, I like buying quality merchandise when it is marked down.

Warren Buffett

We pointed out in our recent quarterly commentary that a major countertrend movement was brewing in both the dollar and commodity patch. In other words, the primary trends for the dollar (up) and commodities (down) might have hit a point where their respective gains and losses were overdone in the short-term, but we have a firm conviction that the strong dollar and weak commodity thesis should continue to dominate the backdrop in the long-term.

Therefore, our recent discussions have centered on if we should either make material changes to our portfolio construction based on the likely unfolding of a short-term countertrend correction or simply utilize market movements to augment the position in our long-term thesis. In essence, if we choose the long-term view then we continue to believe that any dollar weakness should be viewed as an opportunity to buy the dips. From the opposite perspective, future commodity strength is likely an opportunity to sell the rips.

The rub here is that the opportunity for long-term gain will only come if we can stomach through short-term pain that we think could potentially last for a quarter or more. Countertrend corrections can vary widely in terms of magnitude and duration, and these two moves in particular could be as reflexively powerful as the moves that preceded them. Also, there is a time element to digestion/consolidation phases, and if these markets do not end up in swift and steep price corrections, it is possible that they will meander laterally for a while. There are risks to our long-term view, and also a realization that in order to follow our plan for the long-term gain, we are going to have to deal with undesirable pressure and short-term pain.

After many hours of strategizing about which way to play this temporary rotation in assets markets, we have decided to stick with our multi-year view of the longer trends. In doing so, we will ask our clients to join us in taking the long-term perspective. It may be painful to watch small positions in the dollar edge down, currency hedged international positions to lag

Instant gratification feels good, but often fails to be valuable in the long-term.

unhedged ETFs, and commodity futures and energy shares outperform while we own less than benchmark weights in those positions. All in all, this may cause the portfolio to relatively drag a bit as we build our positions in quality merchandise that we think is being marked down (strong dollar plays), and slowly drip out of questionable merchandise that is being marked up (commodity linked positions).

Yes, it is true we could try to trade the shorter-term countertrend movement. But that would come with a more speculative mindset and expose our portfolios to unnecessary trading, and the potential for unnecessarily realizing capital gains. Avoiding some of the short lags in performance would feel good, but only if we get it right. If the primary trends in each area materialize sooner than anticipated then we face another round of trades, associated tax issues, and a short-term whipsaw that would have us buying high and selling low as we continually readjust the portfolio according to short-term market gyrations. We simply don't think the risk and lack of efficiency is worth the reward as we look out over a multi-year period.

As investors we consider ourselves realists, so it is not lost on us that our world is increasingly dominated by second-to-second news viewed on smartphones. Our society looks for instant gratification in almost everything that we do. Perhaps we should be accused of having old school views because we believe that the most valuable things in life require hard work, a little pain, and some sacrifice. Instant gratification feels good, but often fails to be valuable in the long-term.

The investment team continues to have a strong conviction in a strong dollar over a period of years, and likewise a commodity super-cycle that has busted and turned down, primarily due to a divergence in monetary policy and relatively stronger U.S. growth compared to most of the rest of the world. We think our long-term approach will translate over the next few years into the full cycle success we are striving for. Therefore, during the countertrend corrections in these trades, we are asking our clients for the patience to stomach a little short-term relative pain in order for our long-term gain thesis to be fully realized over a multi-year time frame.

Rick Vollaro is a partner and the Chief Investment Officer for Pinnacle Advisory Group.

Email: rvollaro@pinnacleadvisory.com
Profile: pinnacleadvisory.com/rvollaro/

Six Questions to Ask Before Buying that Vacation Home

Mike Hamolia, CFP®
Wealth Manager

With a humid mid-Atlantic summer in full swing, many locals are entertaining the idea of purchasing a vacation home. That might be wise — it can be a great place to rejuvenate and spend time with family and friends.

However, a vacation property also comes with its own set of challenges and those considering a purchase should be aware of them. With that in mind, here are six important questions to ask before making the move.

1. Will the vacation home be mortgaged?

If you're not going to purchase the home outright, you're probably thinking about a mortgage. If that's the case, you should know that there are generally more stringent requirements for a second mortgage, and you may need to put more money down than you would if you were getting a first mortgage.

2. Do you have enough money to put down to avoid private mortgage insurance?

If your down payment on a new home is less than 20% of the cost, you will have to pay for private mortgage insurance (PMI). Insurance fees run between 0.3% to close to 1.5%, depending on your down payment and credit score.

3. Have you seriously considered the up-keep costs?

Like your primary residence, a vacation home requires upkeep. A good rule of thumb for general maintenance costs is 1% of the purchase price per year.

Of course, you must also factor in utilities. Even though the home would only be occupied for a portion of the year, some utility expenses (water/gas/electric) can be comparable, whether the home is being lived in or not (this depends on location). For example, a home needs air circulation throughout the year to prevent mold, and pipes must be kept minimally warm in the winter to avoid freezing.

> **A vacation property comes with its own set of challenges and those considering a purchase should be aware of them.**

When it comes to cable/satellite/Internet costs, you can always opt for seasonal billing (if it's available). With that, you have a wider selection of channels in those months when you're in residence and a much reduced (and less expensive) lineup when you're not. This is worth investigating, since you don't want to pay for services you're not going to be there to enjoy.

4. How much will extra insurance cost?

Since you're insuring a second home, you may need an additional policy to cover it. If your new home is in a coastal area, you might also need flood insurance (if it's available in that area).

5. Have you priced out a security system or service?

Because vacation homes are empty for much of the year, they can be popular targets for thieves. If you store any valuables there — computers, televisions, expensive kitchen items, recreational equipment, etc. — it might make sense to invest in a security system or service. That could give you peace of mind during the off season.

6. What will you be paying in new taxes (property and otherwise)?

Your vacation home may very likely be in a different state, with a different tax code. Have you checked to see how tax friendly that new state is? What will you be paying in property taxes (if anything)? And do you intend to rent your home out in the off-season? If so, you may have to report and pay taxes on it.

A vacation home can be a great purchase for a family, but make sure you've considered all the costs and ramifications first. Talk to your financial adviser about financing options and how much you can afford for a down payment without negatively affecting your financial future.

This article originally appeared in the July 2015 issue of *The Business Monthly*.

Mike Hamolia, CFP® is a Wealth Manager at Pinnacle Advisory Group.

Email: mhamolia@pinnacleadvisory.com
Profile: pinnacleadvisory.com/mhamolia/

MARKET REVIEW

Rick Vollaro
Chief Investment Officer

Carl Noble
Senior Analyst

Sean Dillon
Technical Analyst

Sauro Locatelli
Quantitative Analyst

The summer heat has finally arrived, and it's naturally coincided with lower volume markets that are prone to the rumor mill and news flow. The second quarter of 2015 was choppy, but included some reversals in behavior across asset classes. Domestic equity markets bounced around in a flat range, while broad emerging equity markets declined slightly on the quarter. The big shifts arrived in commodity, currency and fixed markets, as commodities reversed their slide and enjoyed a solid quarter, the dollar softened, and bond yields rose producing sizeable losses at the longest end of the yield curve. The weight of the evidence that dictates our asset allocation was not without some volatility, as well. But despite mild shifting and softening in the rating of some sub-categories we follow, the cumulative message of the evidence is still mixed enough to keep us positioned at roughly neutral levels of volatility in client portfolios. A neutral volatility and asset allocation profile puts more pressure on our sector rotation strategies to try and earn risk-adjusted returns, and there continue to be several relative value opportunities that we are positioned to take advantage of.

The Bull Keeps Aging; We're Still Riding

When reflecting on the bull market in stocks, the pessimistic view is that the rally that started in March 2009 is now aged, and with every passing day the risks grow that mean reversion and high valuations will ultimately catch up and end this bull run. On the other hand, the optimists contend that the current backdrop of low growth and high liquidity should give this bull market longevity, and market bulls are quick to point out that there have been similar historical backdrops that produced bull markets longer than the current one.

At Pinnacle, we consider ourselves realists and believe both views have some merit. As risk managers, we are not blind to risk, and we fully realize that at some point there will be a powerful shift that ends this torrid bull run. But given the amount of liquidity being pumped into global markets, we also acknowledge that there is a risk of being early to exit, as well. Flush valuations and an aging backdrop do provide a ceiling on how much risk we are willing to take at this stage of the cycle, but beyond that we continue to ride the bull market and look for more warning signs to develop before really pulling on the reigns and getting more defensive.

Central Banks Still Dominate Backdrop

In the pre-crisis world, raw economic fundamentals may have been the dominant force behind earnings and asset market appreciation, but we're clearly in an unusual period where economic fundamentals are taking a backseat to central bank liquidity. As we wrote in our May 2013 Market Update ("The Twilight Zone Market"):

This disconnect between poor growth dynamics and red hot equity markets does at first blush seem odd, but things begin to make sense when you consider the fact that central bankers and unprecedented liquidity are currently in charge of financial markets. When viewing the behavior of markets through this lens, anything that encourages central bankers to keep priming the pump is likely to temporarily be good for markets.

Although the Federal Reserve seems to be preparing to be the first central bank to start slowly shifting away from massive liquidity, central banks in Japan and Europe are ready and willing to keep priming the pump through massive asset purchase programs. Given an increasingly gloomy backdrop, even China has begun to pour more liquid fuel on the fire in order to arrest a vicious slide in their equity markets. In short, world dynamics continue to support our theme of following central banks.

Recently Europe has been the source of headline news thanks to the latest chapter in the Greek drama. If our thesis is correct, the problems in Greece and the Eurozone will only encourage the European Central Bank (ECB) to do more to support the system. Therefore, though exhausting, it may be that the recent Greek acrimony has led to another good buying opportunity within Europe. We are currently staying the course in Europe and looking to slowly build into our theme of following central bank liquidity.

Dollar: Staying Bullish

Major divergences in monetary policy are one reason we continue to like the U.S. dollar. Given that the U.S. is much farther along in its post-crisis adjustment phase, it is natural that the Fed appears ready to begin the process of slowly normalizing interest rates. At the same time, many countries across the globe are in a vicious cycle of policy easing to combat slow growth rates, and various structural, geopolitical, and political headwinds. Currently there seems to be no end in sight to the quantitative easing programs that the Bank of Japan and the ECB are pursuing, which means the dollar should remain firm versus the yen and euro over time. Additionally, emerging market currency weakness against the dollar is likely to continue given the weakening in China and a commodity super-cycle that appears to be dead. The dollar may still be caught in a lateral digestion phase that was preceded by its enormous run up in recent quarters, but looking out over the next few years, we are staying the course with a pro-dollar investment stance.

Value Traps Show Their True Colors

It's been a whippy year in many asset markets, and we continue to think that investors need to be wary of markets that appear cheap on the surface, but will likely continue to disappoint. Commodities, the energy space, and broad emerging markets that contain healthy percentages of the BRICs (Brazil, Russia, India, and China) are a few value traps that have been on our list, and we believe that they should continue to be avoided. In a business that focuses on returns that are driven by what is owned, sometimes an underappreciated aspect of manager skill is knowing what segments of the market not to own.

Emerging markets present a good example of how important this can be. Since peaking relative to U.S. markets in late 2010, an index of emerging markets has trailed U.S. markets by about 100%, and other developed international markets by roughly 40%. Even worse, investors in emerging markets have actually lost about 12% during that time when they could have made about 88% in a simple S&P 500 ETF, or 27% in the EAFE index of developed international markets.

Emerging market equities are not part of our benchmark but they are on the menu of asset classes that we can invest in as global investors. We think it is safe to say our clients' overall wealth has certainly benefited from our decision not to be invested in emerging markets for the last 4 years, even if we have received no benchmark gratification from our prior positioning. We will continue to pay attention to what we don't want to own, and we continue to believe that staying the course in our theme of avoiding value traps should pay dividends over the next few years.

Fixed Income: Sticking with Barbell While Increasing Alternatives

The thirty-year bond bull market is no spring chicken, and so we understand why many clients and investors fear higher yields and lower bond prices. Despite the low yield cushion in global bond markets, the world still has many deflationary tendencies, particularly in a world where China's growth rate is decelerating, commodities will likely churn lower, and inflation stays subdued. In this environment where central banks are out of normal policy ammunition and have resorted to using unconventional weapons to control asset prices, owning a few chips to help defend the portfolio against a potential deflationary shock still seems prudent to us. Eventually, classic inflationary pressures will begin to build in a manner that will make it more compelling to reduce bond exposure, but we don't believe that growth is likely to accelerate by enough to create that risk in the near-term.

On the other hand, as long as the growth is able to maintain its moderate pace of the past few years, default rates should stay low and credit sensitive fixed income securities should be able to outperform treasuries over time. For now, we are staying the course with our barbell approach to fixed income portfolios, but we are also beginning to build an alternative bucket within fixed income that consists of dollar positions and merger arbitrage. Both of these alternatives have very little correlation to bonds over time, and should benefit if the short end of the U.S. yield curve does begin to rise in September (or soon after).

Staying the Course Not Easy, but Still Makes Sense

Sometimes doing nothing is the hardest thing to do as an investment manager. After all, every day is full of news stories, changing data points, dire predictions, and emotional events. Particularly during low volume summer markets, news stories can whip up volatility and increase overall anxiety. As longer-term investors, we have to be able to separate the noise from the signals, and the reality is that there is far more noise in most short-term data and news flow than there is signal. We've written several times about some of the bigger themes that we believe are shaping markets, and at the halfway point of the year, we're confident those themes will be great guides in helping us shape portfolio asset allocations over the rest of the year. At some point we'll be forced to make major changes based on a shifting view of the market cycle, but until sufficient evidence arrives we will continue to stay the course and ride the themes that we have conviction in over the next few years.

Note: The above discussion applies to the management of Pinnacle's Dynamic Prime models. Below is a brief description of changes during the quarter to Pinnacle's new investment strategies that were introduced earlier this year. The Dynamic Market Series and the quantitative component of the Dynamic Quant are not managed according to Pinnacle's macro outlook. (see disclosures related to the new investment strategies)

Dynamic Market Series

The satellite of the Dynamic Market strategies, comprising 30% of the portfolios, remained on a defensive posture throughout the second quarter. Such posture was driven by our valuation model for the S&P 500 index, which continues to indicate that the market is presently overvalued, implying poor prospects for expected returns over the intermediate to long term. As a result, during most of the quarter the satellite was allocated to bonds. However, the gradual downtrend in bonds (i.e., rise in yields) that started in the first quarter of the year caused the technical component for bonds to eventually move from a "buy" signal to a "sell" signal near the end of the second quarter (on June 30th to be exact). As a result, the entire satellite of the Dynamic Market strategies moved from bonds to cash on the same day, and remains in cash at present.

Dynamic Quant Series

The allocation of the quantitative satellite, comprising 37.5% of the Dynamic Quant strategy, was unchanged during the second quarter. The little turbulence that the stock market experienced during the quarter was not enough to budge the technical component, which remained on a firm "buy" signal. As a result, the strategy remained on an aggressive posture and the quantitative satellite was allocated according to the sector rotation component. During the entire quarter, the two largest overweights carried by the satellite were in the Technology and Energy sectors, mostly thanks to attractive valuation scores. While the Technology sector was approximately a market performer, the Energy sector faced renewed pressure after rebounding in April, and was one of the most significant drivers of the strategy's underperformance during the quarter. In addition, the satellite continues to carry two mild overweights in the Financials and Consumer Staples sectors, as well as a neutral weight in Telecom.

Net Returns as of 6/30/2015

Start Date	End Date	Dynamic Conservative	Dynamic Conservative Growth	Dynamic Moderate Growth	Dynamic Appreciation	Dynamic Ultra Appreciation*	S&P 500	Barclays U.S. Aggregate Bond
10/31/2002	12/31/2002	1.74%	0.82%	0.63%	0.57%		-0.33%	2.04%
12/31/2002	12/31/2003	10.09%	17.82%	20.83%	24.78%		28.68%	4.10%
12/31/2003	12/31/2004	6.51%	8.71%	9.48%	10.65%		10.88%	4.34%
12/31/2004	12/31/2005	3.71%	4.35%	5.93%	5.70%	6.36%	4.91%	2.43%
12/31/2005	12/31/2006	8.90%	8.88%	10.82%	12.71%	14.20%	15.79%	4.33%
12/31/2006	12/31/2007	5.65%	6.61%	7.75%	7.97%	8.45%	5.49%	6.97%
12/31/2007	12/31/2008	-9.86%	-12.59%	-16.93%	-23.84%	-27.69%	-37.00%	5.24%
12/31/2008	12/31/2009	9.25%	10.87%	18.68%	23.61%	31.67%	26.46%	5.93%
12/31/2009	12/31/2010	5.75%	8.39%	10.99%	11.33%	11.29%	15.06%	6.54%
12/31/2010	12/31/2011	4.14%	3.38%	2.11%	0.71%	-2.42%	2.11%	7.84%
12/31/2011	12/31/2012	4.83%	6.38%	7.24%	8.62%	11.73%	16.00%	4.22%
12/31/2012	12/31/2013	3.31%	10.06%	14.08%	18.10%	24.30%	32.39%	-2.02%
12/31/2013	12/31/2014	3.26%	3.35%	3.81%	3.49%	3.52%	13.69%	5.97%
12/31/2014	6/30/2015	0.27%	0.89%	1.06%	1.37%	1.82%	1.23%	-0.10%
Total Return		73.11%	107.35%	141.52%	153.70%	115.63%	201.55%	75.41%
Annualized Return		4.43%	5.93%	7.21%	7.63%	7.24%	9.10%	4.54%
Trailing Returns								
Trailing-Three-Month		-1.12%	-0.72%	-0.60%	-0.47%	-0.14%	0.28%	-1.68%
Trailing-One-Year		1.07%	1.63%	1.77%	1.84%	1.90%	7.42%	1.86%
Trailing-Three-Year		3.16%	5.87%	7.48%	8.95%	11.83%	17.31%	1.83%
Trailing-Five-Year		3.86%	6.57%	8.11%	9.19%	10.36%	17.34%	3.35%
Trailing-Ten-Year		3.76%	4.80%	6.01%	6.17%	7.13%	7.89%	4.44%
Quarterly Returns								
Best		5.60%	8.08%	10.31%	12.76%	17.60%	15.93%	4.58%
Worst		-6.05%	-6.05%	-7.30%	-11.95%	-14.21%	-21.94%	-2.44%
Average Negative		-1.38%	-1.92%	-2.49%	-3.74%	-4.71%	-6.70%	-0.86%
Three-Year Returns								
Best		8.10%	11.50%	14.38%	17.10%	19.57%	25.56%	8.87%
Worst		-0.40%	-1.86%	-3.31%	-6.60%	-8.31%	-15.11%	1.83%
Average Negative		-0.22%	-0.83%	-1.58%	-2.46%	-2.86%	-7.25%	
Risk Metrics Vs. Benchmarks								
Beta		0.84	0.81	0.83	0.86	0.79		
Alpha		-0.19%	0.51%	1.08%	0.79%	1.42%		
Correlation		89.54%	93.17%	95.42%	96.51%	96.43%		
Standard Deviation		4.16%	5.67%	7.41%	9.42%	11.56%	13.95%	3.50%
Sharpe Ratio		0.74	0.81	0.79	0.67	0.43	0.56	0.91

*Dynamic Ultra Appreciation inception date: 6/30/2004

PINNACLE ADVISORY GROUP, INC.

Net Returns as of 6/30/2015

Start Date	End Date	Dynamic Market Conservative	Dynamic Market Moderate	Dynamic Market Appreciation	Dynamic Quant	S&P 500	Barclays U.S. Aggregate Bond
10/31/2002	12/31/2002	1.89%	1.46%	1.02%	0.98%	-0.33%	2.04%
12/31/2002	12/31/2003	18.32%	21.38%	24.47%	21.33%	28.68%	4.10%
12/31/2003	12/31/2004	7.54%	8.78%	10.02%	11.10%	10.88%	4.34%
12/31/2004	12/31/2005	3.44%	4.73%	6.02%	6.50%	4.91%	2.43%
12/31/2005	12/31/2006	8.52%	10.42%	12.35%	11.11%	15.79%	4.33%
12/31/2006	12/31/2007	5.85%	6.09%	6.32%	7.90%	5.49%	6.97%
12/31/2007	12/31/2008	-14.17%	-20.04%	-25.60%	-13.37%	-37.00%	5.24%
12/31/2008	12/31/2009	23.35%	25.87%	28.34%	26.92%	26.46%	5.93%
12/31/2009	12/31/2010	9.37%	10.49%	11.55%	11.04%	15.06%	6.54%
12/31/2010	12/31/2011	-0.58%	-1.92%	-3.29%	-2.24%	2.11%	7.84%
12/31/2011	12/31/2012	9.57%	10.72%	11.86%	11.09%	16.00%	4.22%
12/31/2012	12/31/2013	7.28%	10.68%	14.18%	20.09%	32.39%	-2.02%
12/31/2013	12/31/2014	3.50%	3.90%	4.29%	6.35%	13.69%	5.97%
12/31/2014	6/30/2015	-0.20%	0.15%	0.49%	-0.30%	1.23%	-0.10%
Total Return		115.31%	128.60%	141.55%	193.46%	201.55%	75.41%
Annualized Return		6.24%	6.74%	7.21%	8.87%	9.10%	4.54%
Trailing Returns							
Trailing-Three-Month		-1.17%	-1.02%	-0.87%	-1.07%	0.28%	-1.68%
Trailing-One-Year		-1.14%	-0.77%	-0.40%	1.58%	7.42%	1.86%
Trailing-Three-Year		5.08%	6.64%	8.21%	9.94%	17.31%	1.83%
Trailing-Five-Year		6.16%	7.48%	8.79%	9.66%	17.34%	3.35%
Trailing-Ten-Year		5.12%	5.41%	5.66%	7.83%	7.89%	4.44%
Quarterly Returns							
Best		13.77%	15.88%	18.00%	12.71%	15.93%	4.58%
Worst		-6.64%	-10.13%	-13.56%	-7.15%	-21.94%	-2.44%
Average Negative		-2.59%	-3.31%	-4.23%	-2.78%	-6.70%	-0.86%
Three-Year Returns							
Best		14.92%	17.07%	19.20%	15.63%	25.56%	8.87%
Worst		-3.42%	-6.08%	-8.71%	-1.22%	-15.11%	1.83%
Average Negative		-1.55%	-2.52%	-2.71%	-0.79%	-7.25%	
Risk Metrics Vs. Benchmarks							
Beta		1.03	0.99	0.96	0.71		
Alpha		-0.23%	-0.18%	-0.18%	2.84%		
Correlation		96.71%	97.78%	98.37%	89.94%		
Standard Deviation		6.96%	8.60%	10.34%	8.31%	13.95%	3.50%
Sharpe Ratio		0.70	0.63	0.57	0.91	0.56	0.91

***See back tested disclosures**

Disclosure

Indexes

S&P/BGCantor 0-3 Month U.S. Treasury Bill Index - A broad, comprehensive, market-value weighted index that seeks to measure the performance of the U.S. Treasury Bill market. The index includes the reinvestment of all cash distributions.

Barclays Capital U.S. Aggregate Bond Index - 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. The index includes the reinvestment of all cash distributions.

S&P 500 Total Return Index - 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. The index includes the reinvestment of all cash distributions.

MSCI Daily TR Net USA USD Index - An unmanaged, capitalization-weighted index reflecting the full breadth of investment opportunities within the US equity markets. The index includes large, mid, small and micro capitalization companies, covering approximately 99.5% of the capitalization of the US equity market. The index includes the reinvestment of all cash distributions.

Dow Jones Industrial Average Total Return Index - 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. The index includes the reinvestment of all cash distributions.

Russell 2000 Total Return Index - An unmanaged, market-capitalization weighted index that measures the performance of the 2,000 smallest market capitalization companies in the Russell 3000 index. The index includes the reinvestment of all cash distributions.

NASDAQ Composite Total Return Index - 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. The index includes the reinvestment of all cash distributions.

MSCI Daily Total Return Net EAFE USD Index - An unmanaged, market capitalization weighted index composed of stocks from 21 developed markets, but excluding those from the U.S. and Canada. The countries included in the index are located in Europe, Australia, Asia, and the Far East. The index includes the reinvestment of all cash distributions. The index reinvests dividends after the deduction of withholding taxes, using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

MSCI Daily Total Return Net Emerging Markets USD Index - An unmanaged, market capitalization weighted index composed of stocks from 26 emerging markets. The countries included in the index are located in Europe, South America, Africa, and Asia. The index includes the reinvestment of all cash distributions. The index reinvests dividends after the deduction of withholding taxes, using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

Bloomberg Commodity Index Total Return - A rolling index, rebalanced annually, composed of futures contracts on 19 physical commodities. It is designed to be a highly liquid and diversified benchmark for the commodity futures market. The index includes the reinvestment of all cash distributions.

iPath® Bloomberg Commodity Index Total Return ETN - An investable vehicle designed to provide exposure to the Bloomberg Commodity Index Total Return. The vehicle's inception date is 6/30/2006.

Commodity Blended Benchmark - Comprised of 100% Bloomberg Commodity Total Return Index from 10/31/2002 to 6/30/2006 and 100% iPATH Bloomberg Commodity Index Total Return ETN from 6/30/2006 to present.

CPI Index - This index measures changes in the price level of a market basket of consumer goods and services purchased by households. The index is published by the Bureau of Labor Statistics.

Market Series Benchmarks

DMC Benchmark - 33% S&P 500 Total Return Index / 9% MSCI Daily Total Return Net EAFE USD Index / 3% Commodity Blended Benchmark / 49% Barclays Capital U.S. Aggregate Bond Index / 6% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

DMM Benchmark - 44% S&P 500 Total Return Index / 12% MSCI Daily Total Return Net EAFE USD Index / 4% Commodity Blended Benchmark / 36% Barclays Capital U.S. Aggregate Bond Index / 4% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

DMA Benchmark - 55% S&P 500 Total Return Index / 15% MSCI Daily Total Return Net EAFE USD Index / 5% Commodity Blended Benchmark / 23% Barclays Capital U.S. Aggregate Bond Index / 2% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

Prime Series Benchmarks

DC Blended Benchmark - Comprised of 21% S&P 500 Total Return Index / 6% MSCI Daily Total Return Net EAFE USD Index / 3% Commodity Blended Benchmark / 63% Barclays Capital U.S. Aggregate Bond Index / 7% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index from 10/31/2002 to 8/31/2009, and 14% S&P 500 Total Return Index / 4% MSCI Daily Total Return Net EAFE USD Index / 2% Commodity Blended Benchmark / 72% Barclays Capital U.S. Aggregate Bond Index / 8% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index from 8/31/2009 to present. The benchmark is rebalanced monthly.

DCG Benchmark - 33% S&P 500 Total Return Index / 9% MSCI Daily Total Return Net EAFE USD Index / 3% Commodity Blended Benchmark / 49% Barclays Capital U.S. Aggregate Bond Index / 6% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

DMG Benchmark - 44% S&P 500 Total Return Index / 12% MSCI Daily Total Return Net EAFE USD Index / 4% Commodity Blended Benchmark / 36% Barclays Capital U.S. Aggregate Bond Index / 4% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

DA Benchmark - 55% S&P 500 Total Return Index / 15% MSCI Daily Total Return Net EAFE USD Index / 5% Commodity Blended Benchmark / 23% Barclays Capital U.S. Aggregate Bond Index / 2% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

DUA Benchmark - 72% S&P 500 Total Return Index / 20% MSCI Daily Total Return Net EAFE USD Index / 6% Commodity Blended Benchmark / 2% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

Quant Series Benchmarks

DQ Benchmark - 27.5% S&P 500 Total Return Index / 37.5 MSCI Daily TR Net USA USD Index / 7.5% MSCI Daily Total Return Net EAFE USD Index / 2.5% Commodity Blended Benchmark / 22.5% Barclays Capital U.S. Aggregate Bond Index / 2.5% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index. The benchmark is rebalanced monthly.

Definitions

Standard Deviation - A measure of risk, defined as the dispersion of a set of returns from its mean.
Correlation - A statistical measure of how two securities or portfolios tend to move in relation to each other.
Beta - A measure of systematic risk of a portfolio in comparison to the market or benchmark. It is calculated using a linear regression.
Alpha - A measure of risk-adjusted performance, defined as the return in excess of a normal return implied by a portfolio's systematic risk, measured by Beta.
Sharpe Ratio - A measure of risk-adjusted performance, calculated as the ratio of return in excess of the return on Treasury Bills, divided by the Standard Deviation of returns.
Drawdown - A measure of percentage decline from a prior peak.

Disclaimer

Pinnacle Advisory Group, Inc. ("Pinnacle") is a registered investment adviser under the SEC Investment Advisers Act of 1940.

The performance of the Prime series strategies includes all client groups with assets values over $200,000 and no material restriction implementation of the firm’s investment strategy. This applies to the following: Dynamic Conservative, Dynamic Conservative Growth, Dynamic Moderate Growth, Dynamic Appreciation, Dynamic Ultra Appreciation.

BACK TESTED AND MODEL PERFORMANCE
MARKET SERIES

Pinnacle Advisory Group, Inc. ("Pinnacle") is a registered investment adviser under the SEC Investment Advisers Act of 1940.

The **Market** series of portfolios represent hypothetical model portfolio results that are designed to capture market returns across the investment cycle but also to protect or improve returns at market peaks and troughs. Back tested and model presentations may not be relied upon for investment purposes and are not meant to represent actual current or future performance. This report is unaudited and does not replicate actual returns for any client.

This is a hypothetical model presentation and may only be used in a one-on-one presentation for specified individual clients. This should not be further disseminated without compliance approval. Perspectives, opinions, and testing data may change without notice. Please contact a Pinnacle investment professional for additional information. Past performance is not indicative of future return. All information is believed to be correct but accuracy cannot be guaranteed.

The Market series of portfolios are structured with a 70% Core portfolio and 30% Dynamic portfolio. The core portfolio owns a static diversified 11-asset class portfolio of equity and fixed income securities. The satellite portfolio owns a quantitatively derived (based on a set of valuation and technical indicators) mix of equities and fixed income to protect against market extremes. Back tested results represent the period of October 2002 to the most recent month-end date. Results should be evaluated over a complete market cycle, which includes both bull market and bear market returns.

The **Dynamic Market Conservative (DMC)** portfolio performance is measured against a five-asset class benchmark, rebalanced monthly, consisting of 45% equities and alternatives (33% S&P 500 Total Return Index, 9% MSCI Daily Total Return Net EAFE USD Index, 3% Commodity Blended Benchmark*) and 55% fixed income (49% Barclays Capital U.S. Aggregate Bond Index, 6% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index). Pinnacle's proprietary investment process considers factors such as additional guidelines, restrictions, weightings, allocations, market conditions and other investment characteristics and thus returns may at times materially differ from the stated benchmark.

The **Dynamic Market Moderate (DMM)** portfolio performance is measured against a five-asset class benchmark, rebalanced monthly, consisting of 60% equities and alternatives (44% S&P 500 Total Return Index, 12% MSCI Daily Total Return Net EAFE USD Index, 4% Commodity Blended Benchmark*) and 40% fixed income (36% Barclays Capital U.S. Aggregate Bond Index, 4% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index). Pinnacle's proprietary investment process considers factors such as additional guidelines, restrictions, weightings, allocations, market conditions and other investment characteristics and thus returns may at times materially differ from the stated benchmark.

The **Dynamic Market Aggressive (DMA)** portfolio performance is measured against a five-asset class benchmark, rebalanced monthly, consisting of 75% equities and alternatives (55% S&P 500 Total Return Index, 15% MSCI Daily Total Return Net EAFE USD Index, 5% Commodity Blended Benchmark*) and 25% fixed income (23% Barclays Capital U.S. Aggregate Bond Index, 2% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index). Pinnacle's proprietary investment process considers factors such as additional guidelines, restrictions, weightings, allocations, market conditions and other investment characteristics and thus returns may at times materially differ from the stated benchmark.

Portfolio holdings are assumed to be rebalanced when holdings diverge from model weightings by more than 1%. No taxes or transaction costs are included in the analysis. All returns are net of maximum investment management fees, but are gross of all other costs, expenses and commissions associated with client account trading and custodial services. Any comments regarding an individual security are presented at the client's request, may only be used for client reference, and are not reflective of composite or individual portfolio ownership. Pinnacle may or may not have held or currently hold a specific security. The position may or may not have been profitable and may or may not be profitable in the future. Any positive comments regarding specific securities may no longer be applicable and should not be relied upon for investment purposes. No security is profitable all of the time and there is always the possibility of selling it at a loss. Investments are subject to change without notice.

Decisions and information provided were based on available research at the time and as these are not realized returns, specific action or lack of action is not known for certainty. Material economic and market factors may have changed and certain investment restrictions may have affected performance. Foreign investments involve special risks including greater economic, political and currency fluctuation risks, and international accounting difference risks which may be more excessive in emerging markets. Returns do include the reinvestment of gains, dividends and other income. Individual client returns may be materially negatively affected due to expenses and commissions associated with client account trading and custodial services.

*Comprised of 100% Bloomberg Commodity Total Return Index from 10/31/2002 to 6/30/2006 and 100% iPATH® Bloomberg Commodity Index Total Return ETN from 6/30/2006 to present.

BACK TESTED AND MODEL PERFORMANCE
QUANTITATIVE SERIES

Pinnacle Advisory Group, Inc. ("Pinnacle") is a registered investment adviser under the SEC Investment Advisers Act of 1940.

The **Quantitative** series of portfolios represent hypothetical model portfolio results that are designed to capture market returns across full market cycles, and also to protect or improve returns at market peaks and troughs. Back tested and model presentations may not be relied upon for investment purposes and are not meant to represent actual current or future performance. This report is unaudited and does not replicate actual returns for any client.

This is a hypothetical model presentation and may only be used in a one-on-one presentation for specified individual clients. This should not be further disseminated without compliance approval. Perspectives, opinions, and testing data may change without notice. Please contact a Pinnacle investment professional for additional information. Past performance is not indicative of future return. All information is believed to be correct but accuracy cannot be guaranteed.

The **Dynamic Quantitative (DQ)** portfolio uses Pinnacle's Dynamic Moderate Growth (DMG) portfolio as the chassis (see Dynamic Prime Series as described in investment policy statement for description of the DMG portfolio), and then adds on a purely quantitative allocation of the portfolio. The DMG's actively managed portfolio is 62.5% of the total portfolio, while the quantitative allocation makes up 37.5%. The Quantitative allocation rotates between ten U.S. equity sectors and fixed income, depending on how the quantitative model evaluates current market conditions based on a set of valuation and technical indicators. Back tested results represent the period of October 2002 to the most recent month-end date. Results should be evaluated over a complete market cycle, which includes both bull market and bear market returns.

The **Dynamic Quantitative (DQ)** portfolio performance is measured against a six asset class benchmark, rebalanced monthly, consisting of 75% equities and alternatives (37.5% MSCI US, 27.5% S&P 500 Total Return Index, 7.5% MSCI Daily Total Return Net EAFE USD Index, 2.5%% Commodity Blended Benchmark*) and 25% fixed income (22.5% Barclays Capital U.S. Aggregate Bond Index, 2.5% S&P/BGCantor 0-3 Month U.S. Treasury Bill Index). Pinnacle's proprietary investment process considers factors such as additional guidelines, restrictions, weightings, allocations, market conditions and other investment characteristics and thus returns may at times materially differ from the stated benchmark.

Portfolio holdings are assumed to be rebalanced when holdings diverge from model weightings by more than 1%. No taxes or transaction costs are included in the analysis. All returns are net of maximum investment management fees, but are gross of all other costs, expenses and commissions associated with client account trading and custodial services. Any comments regarding an individual security are presented at the client's request, may only be used for client reference, and are not reflective of composite or individual portfolio ownership. Pinnacle may or may not have held or currently hold a specific security. The position may or may not have been profitable and may or may not be profitable in the future. Any positive comments regarding specific securities may no longer be applicable and should not be relied upon for investment purposes. No security is profitable all of the time and there is always the possibility of selling it at a loss. Investments are subject to change without notice.

Decisions and information provided were based on available research at the time and as these are not realized returns, specific action or lack of action is not known for certainty. Material economic and market factors may have changed and certain investment restrictions may have affected performance. Foreign investments involve special risks including greater economic, political and currency fluctuation risks, and international accounting difference risks which may be more excessive in emerging markets. Returns do include the reinvestment of gains, dividends and other income. Individual client returns may be materially negatively affected due to expenses and commissions associated with client account trading and custodial services.

*Comprised of 100% Bloomberg Commodity Total Return Index from 10/31/2002 to 6/30/2006 and 100% iPATH® Bloomberg Commodity Index Total Return ETN from 6/30/2006 to present.