

A Special Report

August 6th, 2010

Mid-Summer's Update

In Special Reports delivered to you in recent years, I have stated that in my almost thirty years of practice, I have not seen markets with as much contradictory data as currently seen, and each time I say it, it is more true than the last. It is true again today.

Virtually every investor in America today is confused, concerned, and frustrated by the “push-pull” of good news – bad news alternatively coming out of the markets and from economic data generators. I share those feelings and I think, for good reason.

The domestic equity markets this year are nothing short of schizophrenic.



Inflection Point Changes this year (so far):

| | |
|--|---------|
| 12/31/09-to closing "high", on 01/19/10: | +3.14% |
| 01/19/10-to closing "low", on 02/08/10: | -8.09% |
| 02/08/10-to closing "high", on 04/23/10: | +15.13% |
| 04/23/10-to closing "low", 07/02/10: | -15.94% |
| 07/02/10-to July month's end: | +7.62% |
| Calendar Year 2010-through July: | -1.25% |

That's a lot of activity (whipsaw?) for what turns out to be a "flat" year so far!

Of course, 2010 is really looking like a microcosm of the equity markets since the start of this secular bear market, which for all intents and purposes began in early 2000.



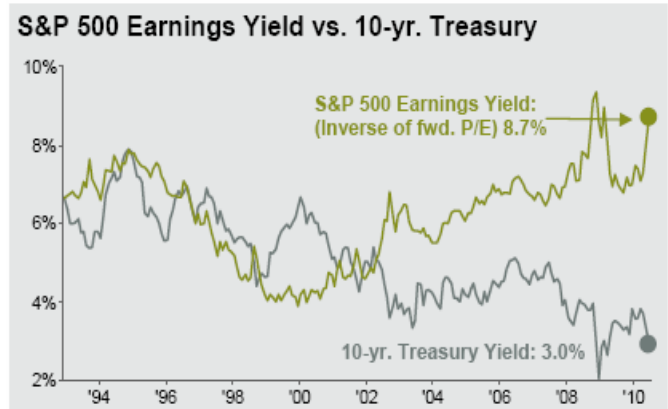
Inflection Point Changes since 2000:

| | |
|--|----------|
| 12/31/99-to closing "high", on 03/24/00: | +3.95% |
| 03/24/00-to closing "low", on 10/09/02: | -49.12% |
| 10/09/02-to closing "high", on 10/09/07: | +101.41% |
| 10/09/07-to closing "low", 03/09/09: | -56.75% |
| 03/09/09-to July month's end: | +62.62% |
| 12/31/99-07/30/10 (10.58 years): | -25.05% |

The increase in equity market volatility is nothing short of dramatic. In the past 50 years, a 1-day gain or loss of at least 2% in the S&P 500 Index has occurred **every 21 trading days**. Since the beginning of September 2008, which was the start of the global credit crunch, a gain or loss of 2% has occurred **every 4 trading days** (Source: BTN Research).

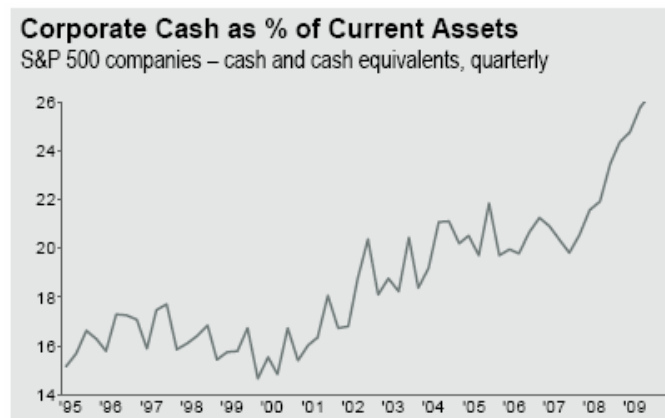
Typically, investors attempt to divine the near-term movement in the prices of individual investments (and the capital markets in which they trade) using “market fundamentals” (i.e. price relative to earnings, sales, market share, etc.), and economic data. The fundamentals *are* improving, as we’ve seen a steady stream of earnings reports that beat analysts’ expectations for the quarter just ended. According to Bloomberg.com, 77% of the companies comprising the S&P 500 index have reported second quarter earnings that *exceeded* analysts’ estimates, and it is now believed that year-over-year earnings gains will exceed 35%, the best earnings improvement data recorded since 1988. In fact, there hasn’t been earnings growth greater than 20% in any year since the 2001 recession.

This has left the S&P 500 Index (a proxy for large company domestic stocks) trading at the “bargain” price of just 11.5 times forward earnings, and delivering an earnings yield of 8.7%, a yield that looks positively delicious when compared to other, more seemingly “popular” investments today, such as the 10 year Treasury Bond for example.



Source: Standard & Poor’s, Compustat, FactSet, J.P. Morgan Asset Management

Cash on corporate balance sheets is at all-time highs.



Source: Standard & Poor’s, FRB, Bloomberg, FactSet, J.P. Morgan Securities, J.P. Morgan Asset Management

Given all this great earnings data, positive fundamentals, and cash-laden balance sheets, the question that comes most readily to mind is: **Why aren’t stock prices soaring?**

Four words: **Economic and Political Uncertainty**

Let's start with a look at economic conditions. Last Friday, the Commerce Department's Bureau of Economic Analysis (BEA) released its first estimate of second quarter 2010 Gross Domestic Product (GDP). While reporting the fourth consecutive quarter of growth following four quarters of decline, the *rate of growth* is clearly declining.



Daily, I sit at my desk, watching what appears to be a continuous loop of “double-dip” versus “no double-dip” recession debates on CNBC and Bloomberg. In the “optimists” camp are the typical luminaries, Abby Joseph Cohen (*Goldman Sachs*), Jim Paulson (*Wells Capital*), Oscar Schafer (*O.S.S. Capital Markets*), Bob Doll (*BlackRock*), and even Bill Gross (*Pimco*). In the “pessimists” camp, we find the usual suspects, Nassim Nicholas Taleb (*author of The Black Swan*), Marc Faber (*Marc Faber, Ltd.*), Felix Zulauf (*Zulauf Asset Management*), and John Hussman (*Hussman Funds*).

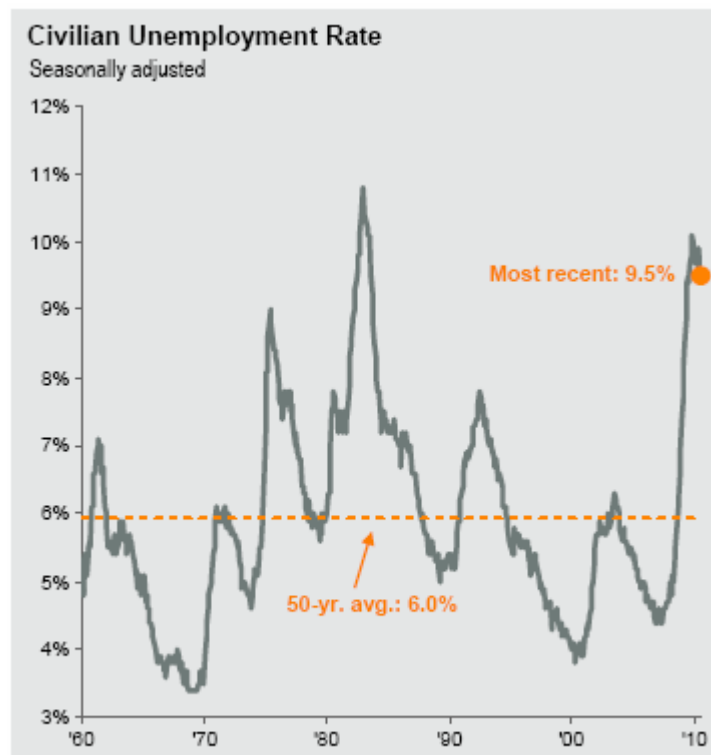
There *are* a number of solid reasons for hope in the economic and market data. Among those most often cited:

- European bank “stress tests” were reasonably successful, dampening concerns that the worst of the sovereign debt crisis overseas may be behind us.
- The aforementioned earnings reports.
- The first “higher low” is in place in market charts, confirming a re-emergence of buying interest.
- Copper has rallied in recent days, offering evidence of an increase in economic demand.
- The BP oil spill is (finally) moving off the front page.

- Growing confidence in the economic health of the emerging markets, especially Asian and Latin American economies. China has successfully curbed its property bubble without bursting it.
- Mortgage delinquencies in California are down five quarters in a row. Consumer credit delinquency rates in the US are rolling over.
- Federal Reserve Chairman Ben Bernanke has indicated that he can, and will, become more aggressive at stimulating monetary policy if necessary.
- Equity market indices have risen in recent days, nearing the higher end of the trading range we've been bound within (again), signaling perhaps, a possible "break-out" to the upside.
- The ISM indexes, while moderating, continue to show readings "north" of 50 (indicating growth) in the manufacturing and service sectors.

Unfortunately, the list of reasons for economic concern is equally long, if not longer.

- Unemployment, persistently high at an "official" 9.5%, is expected to remain so for some time, with few predicting a return to the long-term (50-year) average of 6% before 2015. Weekly unemployment claims stubbornly refuse to drop below 400,000.



Source: BLS, J.P. Morgan Asset Management.
Data reflect most recently available as of 7/2/10.

- US orders for durable goods *fell* 1% in June. Economists expected them to *rise* 1%.
- After a sharp drop in June, consumer confidence fell even more in July. The Conference Board's latest reading was 50.4. A reading of 90 or above indicates a robust economy. (Consumer spending is 70% of GDP.)
- The White House estimates the fiscal year 2010 federal deficit will be \$1.47 Trillion, and \$2.9 Trillion over the next two fiscal years. The massive fiscal deficit won't get a lot better quickly, and if the President's Office of Management & Budget is correct in their estimates, "Publicly Held" US Government Debt (which doesn't count the debt we owe to ourselves in the Social Security, Medicare and Medicaid Trust Funds) will balloon to an *incomprehensible* \$18.57 Trillion by fiscal 2020.
- Fed Chairman Bernanke told Congress a couple of weeks ago that the economic outlook was "*unusually uncertain*".
- The US trade deficit *widened* in May, and was the largest in 18 months. (The trade deficit *subtracts* from GDP.)
- The FDIC has shuttered 108 banks so far this year. Bank lending to consumers and commercial businesses continues to be very tight.
- State and local tax revenues have cratered, at the same time the federal government is shifting more of the entitlement burden to the states. The collective shortfalls for the 50 states' 2011 fiscal year budgets are projected to exceed \$89 billion. 49 of the 50 states have a balanced budget amendment written into their state constitutions, so they will have to "find" the revenues to cover these shortfalls. (Source: National Conference of State Legislatures) Here in Arizona, it was just announced that sales-tax receipts have fallen four years in a row, and last year Arizona conducted a sale and leaseback of state-owned assets (including the State's legislative buildings and various state prison facilities), receiving \$1.04 billion in sales proceeds. It can't sell the State House again!
- The inventory correction (the rebuilding of retail and supplier inventories) that fueled the GDP growth seen in the fourth quarter of 2009, and continued into the first quarter of this year, is largely behind us.
- We'll see lower federal stimulus spending in the 3rd and 4th quarters of this year.
- Housing prices, which had stabilized, are showing signs of weakening again, as inventories are expanding with an acceleration in the number of home foreclosures. Available sales inventory is projected to expand to as much as ten months' worth...again.
- Household savings rates are rising. (While this would be a "good thing" in better economic times, higher savings rates are a drag on consumer spending, and by definition, will slow economic growth.)

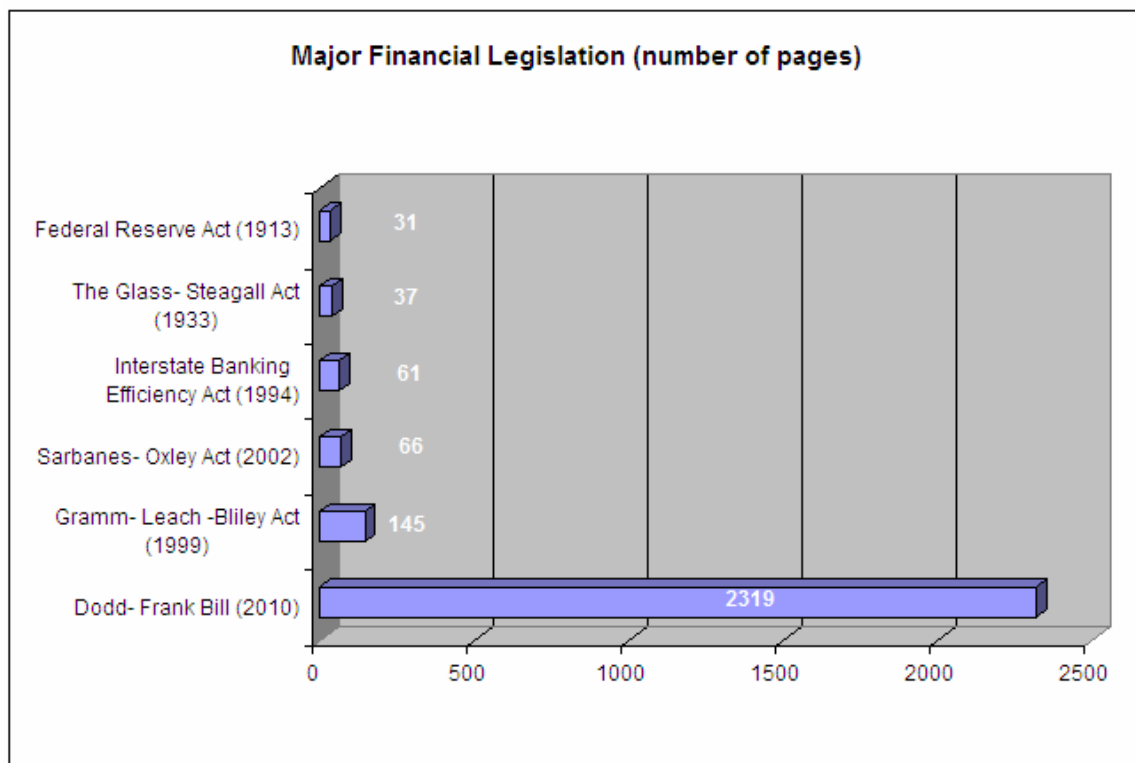
In typical market environments, contradictory economic and market data would be challenging enough. The problems are compounded by what Alan Greenspan described (in his appearance on Sunday's "*Meet The Press*") as, "*the most polarizing political climate (he) can recall in all (his) many years associated with Wall Street*". (And his Wall Street career began in the late '40's!) Politics are more a factor in today's investing calculations than ever before.

Like the economic and market data, there are some political signs pointing to potential improvement:

- Polls are showing the GOP may take back the House, and possibly the Senate in November. (Markets *love* gridlock in Washington.)
- Congress extended jobless benefits (again).
- Cap and Trade legislation appears to be dead...for now.
- Financial Regulatory Reform legislation is behind us – more uncertainty out of the way.
- Some Democrats now want the “sun-setting” of the Bush Tax cuts, scheduled for 2011, to be delayed.

Like the economic data, there are two sides to the political outlook as well:

- While the aforementioned Financial Regulatory Reform legislation is, technically, “behind us”, the rulemaking required within it is *not*. Amazingly, the Dodd-Frank Bill was 2,319 pages long. Just 3 (of 178) Republicans in the House voted for the bill. Just 3 (of 41) Republicans voted for the bill in the Senate. The “rules” that will apply to the legislation’s new regulations have yet to be written, and when one looks at the length of the bill in relation to other “landmark” financial reforms, it’s difficult to imagine what could have been left out!



Source: J.P. Morgan Asset Management - Guide to the Markets 3Q2010

For the record, what comes in the next four paragraphs (in *italics*) is purely partisan in it's nature, so nobody should be offended that I have an opinion on the matter, but I *personally*, truly believe what I'm about to express to be true. For the record, and for the benefit of my excellent Compliance Department, it is not the opinion of anyone else, including Geneos Wealth Management, Inc.

Just as the Health Care "Reform" legislation passed earlier didn't focus enough on "cost containment", ignoring a big portion for the need for the reform itself, the Dodd-Frank Bill didn't address some of the reasons for the need for reform (i.e. mis-management at Fannie Mae, Freddie Mac, et al), leaves many of the regulators who allowed the financial meltdown to occur in place, and in my opinion, allows some of the worst offenders' to continue, a la Madoff, to steal massive sums of money with virtually no oversight. We couldn't even get the regulators to set an across-the-board "fiduciary standard" for all participants in the marketplace, continuing to allow brokers (versus Fee-Compensated Registered Investment Advisors) to avoid being held beyond a "suitability" standard of care in dispensing their services. The brokerage industry and their lobby effectively saw to that. In many ways however, it added additional, and in my opinion, unnecessary costs and delays to the system for the Advisor community. And I'm not certain of its benefit. The cost of everything I deal with in the Compliance area, and the paperwork associated with the maintenance of Compliance-required reports, records, paper, files, etc., is huge, and growing. And it's not Compliance's fault. They can barely keep up with the increase and changes to standards and security and regulatory requirements the Regulators put out.

This report was a few pages longer when I wrote it. You can thank FINRA Advertising Regulations (yes, this is considered "Advertising" because more than 25 people receive it) for sparing you those pages because they had model performance data and return numbers for three of our managers who happen to be mutual funds or L.P.'s regulated as funds. Any performance data that is published has to be pre-approved directly by the Regulating Authority (FINRA) for accuracy, etc. That's not an issue, except the turnaround for such reviews exceed two weeks, and are quite costly. By the time you get Regulatory Approval on the accuracy of your data, It's quite likely the market movements occurring during review (especially in these markets) have made the data no longer relevant. This crates an interesting conundrum. Either wait for approval and send out "stale" performance data, or eliminate it from your communications.

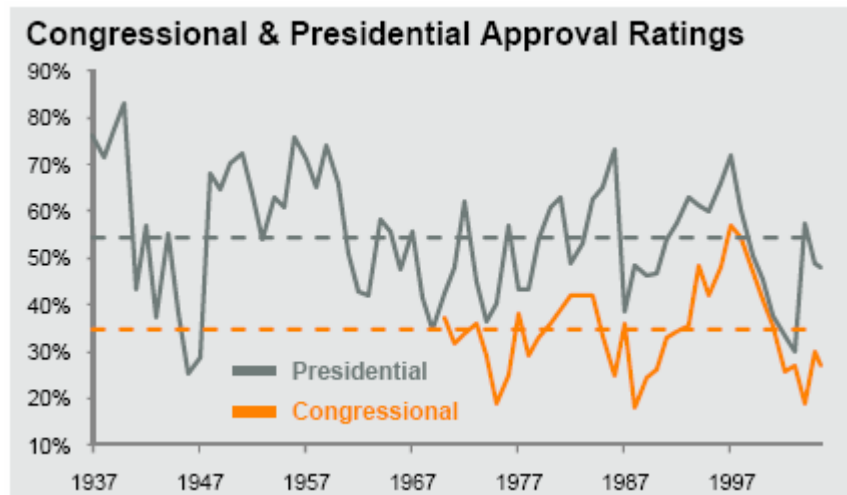
*Obviously, I felt the greater benefit would have been in delivering current data to you where possible and that follows. Clients can call my offices, and we can discuss the performance of the **Permanent Portfolio Fund**, the **Superfund** (Green or Gold) and the **Direxion Commodity Index Strategy Fund**, or any of our **Non-Publicly Traded REIT investments** in the context of their individual accounts. They will not be discussed in this report.*

I fully understand that the reason for the regulation is, appropriately, the protection of the end investor. But I also know that performance data I would submit for a pre-approval that takes weeks to obtain can be routinely and quickly confirmed (5 minutes? 10 minutes?) in any number of places, including the fund family itself, and/or many independent online market data sources (i.e. Marketwatch.com, Yahoo Finance, etc.) using its historical prices function.

Anyway, enough with the personal political opinions, back to the data:

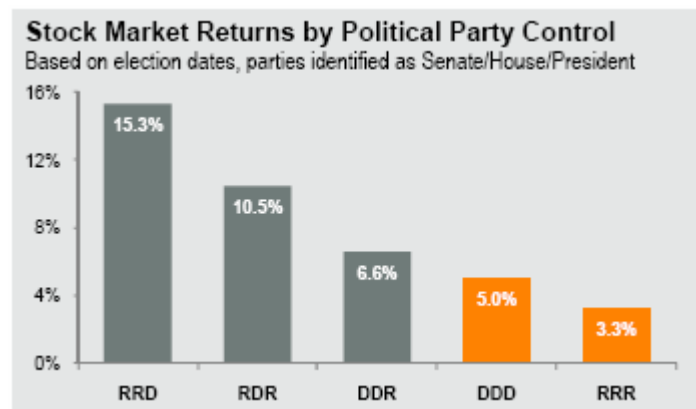
- A particularly burdensome (and *costly*) aspect of the Financial Regulatory Reform legislation is a provision that will require businesses to provide a Form 1099 to every vendor with which it spends as little as \$600 in a calendar year.
- There continues to be debate in Washington on whether or not to allow the Bush Tax cuts to expire for *all* taxpayers. Those of us who think raising taxes on anyone in a recession is crazy are happy there is at least consideration for an extension of the current rates. However, there seems to be growing support for allowing them to expire for just the “wealthiest” Americans (single taxpayers with AGI greater than \$200,000, couples with AGI greater than \$250,000). And while there are some “rebel” Democrats waffling on allowing these tax cuts on the wealthiest Americans to sunset, the “key” Democrats in Washington (i.e. Obama, Geithner, Pelosi, Reid, and Frank, among others) remain solidly behind allowing cuts for the wealthy to expire. Unfortunately, many small business owners and capital investors are in those higher income brackets, and allowing those marginal rates to rise could have a depressing effect on capital formation and/or job creation by those folks.
- There is widespread confusion and concern about the requirements of the Health Care Reform legislation on small employers, and on the costs they’ll incur as a result.
- There is talk that the democrats will try to pass “Card Check” (pro-union) legislation in a “lame-duck” session of Congress that could be called after the November elections, but before the new (possibly Republican?) Congress would reconvene in early January 2011.

The tone and political party polarization in Washington has deteriorated to levels never before seen in my lifetime, and “anti-incumbency” among the populace is at a fever pitch. The President’s approval rating is weakened, and recently fell below 50% for the first time since his taking office, but Congress’ approval rating is nothing short of *abysmal*. Used car salesmen and injury lawyers have higher approval ratings!



Source: US House of Representatives, US Senate, Gallup Inc., FactSet, J.P. Morgan Asset Management

All this anti-incumbency could turn out to be good news for the markets, especially if the GOP takes control of one or both houses of Congress following November’s mid-term elections. Historically, a Republican controlled Congress and a Democratic President has resulted in the best market returns.



Source: US House of Representatives, US Senate, Gallup Inc., FactSet, J.P. Morgan Asset Management

With all of the aforementioned uncertainty on Wall Street, on Main Street, and in Washington D.C., is there any wonder that the market (figuratively) wakes up every morning in the fetal position, looking for the next shoe to drop? Each and every economic and/or earnings announcement is anticipated with fear and trepidation, and the mood in the market swings widely from relief, to abject fear, day to day.

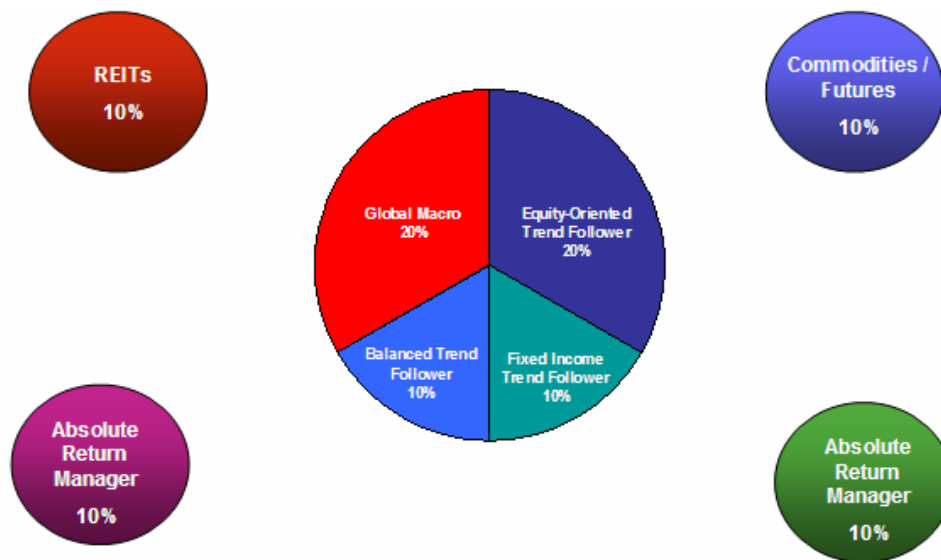
Our Position

We find ourselves in the “no double-dip recession” camp, although we remain defensive in our market exposures. (I still have nightmares about 2008, and noticeably flinch when I turn on my TV in the morning, and pre-market futures are off “big”, which seems to be every four or five days, lately.) While it’s undeniable that the economic recovery is *slowing*, it is also undeniable that it is in fact, *growing*.

The BEA's website reveals that in *nominal dollar terms* our country's collective economic output, as measured by our GDP, has fully recovered, and is back to producing goods and services at an annualized rate of \$14.597 Trillion, breaking the BEA's previous "high" reading (3rd Quarter 2008) of \$14.484 Trillion. In "real" (*inflation-adjusted*) terms, GDP fell (-4.14%) "peak-to-trough", and remains (-1.10%) below its peak output reading.

However, the "recovery" in raw output data ignores the fact that the US population has grown by over 5 million Americans since the depth of the current recession in mid-2008 (309.9 million Americans today, versus 304.4 million in mid-2008, according to US Census Bureau estimates), and there has been a corresponding increase in the available work force. So, while our country's economic output is technically back to where it was at its peak in nominal dollar terms, and is close to its peak in "real" (inflation-adjusted) terms, it is unfortunately spread out over a larger population, many of whom are clearly not working, and as a result, the "recovery" we're experiencing doesn't feel like one.

The bottom line? We're digging ourselves out of a very deep hole, and there is quite a bit of digging left to do. **That is why we are very defensive.** And that is why we're tactically allocated, and broadly diversified. Clients will be familiar with the "core-satellite" strategy (diagram below) we've employed since the spring of 2009.



Our "core" managers, holding 60% of client assets, are investing in the traditional stock and bond markets. Each is very tactical, and each employs both "buy" *and* "sell" disciplines. Some of our core managers are "trend-followers", and others are tactically unconstrained "global macro" managers. All employ fundamental and technical analysis, and are not afraid to "go to cash" to reduce risk exposures if it is seen as prudent.

In fact, we've seen our managers' allocations to "cash" increase as the year has progressed, mostly at the expense of equities, and we saw those cash balances increase markedly in May and June as the equity markets fell by double-digit percentage terms. Our macro (all managers consolidated) \$1 million model portfolio allocation (by month):

| Change in Asset Allocation Over Time (2010) | | | | | | | | |
|---|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | 12/31/2009 | 1/31/2010 | 2/28/2010 | 3/31/2010 | 4/30/2010 | 5/31/2010 | 6/30/2010 | 7/31/2010 |
| Cash or Equivalents | 10.76% | 15.58% | 21.73% | 17.62% | 13.75% | 30.53% | 28.48% | 29.36% |
| Commodities | 4.36% | 4.10% | 3.92% | 4.04% | 3.93% | 3.99% | 3.99% | 3.56% |
| Domestic Bonds | 38.18% | 40.04% | 37.07% | 33.75% | 34.57% | 27.34% | 29.68% | 29.55% |
| Foreign Bonds | 0.28% | 0.56% | 0.94% | 1.04% | 1.05% | 1.06% | 1.07% | 1.01% |
| Domestic Stock | 16.89% | 14.58% | 12.79% | 14.56% | 17.92% | 10.86% | 11.30% | 10.30% |
| Foreign Stock | 9.17% | 5.50% | 2.80% | 7.81% | 8.22% | 6.32% | 5.53% | 6.03% |
| Managed Futures | 4.19% | 3.89% | 3.96% | 4.42% | 4.61% | 4.21% | 4.25% | 4.39% |
| Options | 5.38% | 5.46% | 6.07% | 5.61% | 5.33% | 5.00% | 4.93% | 5.08% |
| Real Estate | 10.80% | 10.30% | 10.72% | 11.15% | 10.62% | 10.68% | 10.76% | 10.73% |
| | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

And while our model's total return has been relatively flat, and therefore "disappointing" year-to-date, it has evidenced extremely dampened portfolio volatility when compared to the equity markets themselves, which have been fluctuating wildly all year!

When I say that I am "disappointed" in the model portfolio's performance this year, but in reality, that disappointment is focused on just two or three managers specifically. Two of these disappointing managers occupy "satellite" positions in our strategy, investing in non-traditional or "alternative" asset classes we would normally expect to be *adding* return to the portfolio in times like these, when the "traditional" markets (i.e. stocks and bonds) are declining, or evidencing extreme volatility. Commodities, managed futures, real estate, and options strategists we employ have historically blossomed in poorly performing stock markets, historically delivering performance that is counter-cyclical to these markets (i.e. "zigging" when stocks or bonds are "zagging"), and dampening losses when traditional markets are in decline. But this year, some of these alternative asset classes have actually declined more than their traditional counterparts.

Correlation, or the rate and direction of price change among asset classes is unusually high. I had some data to this effect, but again, because it related to Exchange Traded Funds (ETF's), which are regulated as funds, the aforementioned FINRA pre-approval submission requirements and resulting time delays leaves me to say only that most asset classes, foreign and domestic, declined during the domestic equity markets' "peak" to "trough" (April 23rd – June 29th), *right along with the domestic equity markets*. Not much diversification benefit in that instance, and such conditions make portfolio risk reduction more difficult. Particularly vexing are the returns in the commodities and real estate markets. Those markets can typically be counted upon to hold up portfolio returns, but in this market they've compounded the problem. Several of our alternative managers would be included in that group.

Let me briefly review the “core” and “satellite” managers we currently employ, and provide a few comments on each, starting with our four “core” strategists:

Hanlon Managed Income – Hanlon’s had another good year, especially on a relative basis, and when one considers his very modest risk exposures. Most of our clients holding this trend-following manager have gains approximating 2.5% year-to-date, and as this is written, Hanlon holds (approx.) 30% of investors’ assets in this strategy in high yield corporate bonds, and 70% in cash.

Hanlon Balanced – Like its “sister” strategy, we’re very pleased with this year’s performance. The Balanced strategy, as its name implies, can hold cash and bonds in any percentage, but may also hold as much as 50% of portfolio assets in equities. Hanlon hasn’t held stocks in this portfolio in well over a year, but announced Wednesday (08/04/10) that it would be investing 35% of the strategy’s assets into equities, with approximately half of that allocation evenly divided into domestic and foreign equities. Also employing a trend-following discipline, the manager has delivered gains approximating 2.9% year-to-date, and when the new allocation to equities is fully implemented, will hold 35% of client assets in high yield bonds, 35% in domestic and foreign equities, with the remaining 30% to be held in cash.

JA Forlines Global Tactical Allocation - Forlines’ strategy is tactically unconstrained, meaning he can invest anywhere, and in any asset class. He often says his strategy is akin to hockey great Wayne Gretzky’s, who once famously claimed that his success was based upon his extraordinary ability for anticipation. (Gretzky is purported to have once said, “*A good hockey player plays where the puck is. A great hockey player plays where the puck is going to be.*”) Forlines has anticipated recent market moves nicely of late. Down approximately (-1.2%) year-to-date, he was down at mid year (06/30/10) by a much higher (-5.1%). In July, he raised some cash, and currently holds 19% in cash, 39% in fixed income (bonds), 40% in equities (stocks), and 2% in a volatility hedge position. He is in the process of implementing a strategy change that will, over time, increase the equity allocation to (approx.) 56%, and reduce the cash to (approx.) 4%.

Portfolio Strategies, Inc. Price History Strategy – The only real disappointment among our “core” strategists, this equity-oriented strategist implements a “pure” trend-following discipline, and the equity markets’ volatility this year has presented a real challenge for such strategists to navigate. Currently, Price History is down approximately (-6.3%) year-to-date. Most disappointing was the fact that they lost approximately (-1.4%) in July, the equity markets’ best month all year. They raised a lot of cash in May, as one by one, most equity indices reversed trend, with shorter term moving averages dropping below their longer-term moving averages, which indicates a negative direction or trend.

Today, he holds 57% of the portfolio in cash, and cash equivalents. 7% is in a US Government Bond Fund, and the rest is an interesting, and fairly unusual “mix” of equity indices and sector funds. He holds approximately 8% in the Nasdaq 100 Index, 8% in an “inverse” (100% *short*) S&P 500 Index Fund, and 4% in a Russell 2000 Index Fund.

He also has leveraged “bets” in the portfolio, with 7% in a (150%) levered Utilities Sector Fund, 3% in a (200%) levered Emerging Markets Equity Index Fund, 3% in a (150%) levered Oil & Gas Sector Fund, and 3% in a levered (150%) Basic Materials Sector Fund. Clearly sticking with his discipline, we’re disappointed in the nominal result, but the discipline has been very effective in declining markets in prior years, such as 2008, when the strategy lost just a fraction of what the equity indices gave up.

Now for some comments on our “satellite” managers:

Genworth Preservation Strategy – As its name implies, the manager’s primary concern is for capital preservation, and in these turbulent times, he hasn’t disappointed. The strategy is up (approx.) 2.2% year-to-date. Approximately 77% of the portfolio is currently invested in Fixed Income (bond) Funds, 13% is in Equity (stock) Funds, 8% in Blend (stocks and bonds combined) Funds, and 2% is in cash. The strategy has been *net positive all year*, and has been an oasis of consistency and calm in a volatile environment.

Tahoma Strategy – The Tahoma Strategy’s manager, Tim Biggam, is Chief Options Strategist at TD Ameritrade’s options trading subsidiary, thinkorswim (yes, “thinkorswim” is all one word, with no capital letters). The Fund’s strategy is described by its manager as an “options arbitrage” strategy, is market neutral, under-levered, and seeks to exploit price inefficiencies created by volume spikes in option chains. If that is confusing to you, you’re not alone. It is a difficult strategy to articulate, and equally challenging to understand.

However, we’ve had many conversations with Mr. Biggam, and feel we have a great grasp on what he’s trying to accomplish. The fund had an amazingly consistent track record going into 2009, never having had a losing year before 2009, when he delivered a modest (-3.30%) loss. In years prior to 2009 he was *up* 7.30% (2003), *up* 17.80% (2004), *up* 8.70% (2005), *up* 28.40% (2006), *up* 10.90% (2007), and *up* 18.00% (2008). 2010 has been a disappointment, as the strategy is down approximately (-7.3%) year-to-date. My earlier comments around some of these historically consistent and countercyclical managers disappointing this year applies especially to the Tahoma Fund. The volatility we’re experiencing in the markets makes trading options even more difficult, and this is admittedly a challenging market environment in which to implement such a strategy. However, Mr. Biggam has “tightened” the range around which he allows fluctuations in his prices, and we have seen some improvement in the fund’s performance in June and July. We’re hoping the improving trend is a harbinger of things to come, but are keeping a close eye on the Fund’s performance.

What Should Clients Expect the Balance of 2010?

As this report has gone great lengths to point out, the traditional markets are extremely volatile, and the near-term direction, up or down, is virtually unknowable.

For our part, we feel that the likelihood of a double-dip recession is decreasing, although it still can't be completely ruled out as a possibility. At the beginning of the year, I would have placed the odds of the economy slipping back into recession at 40%. Today, I would place those odds as low as 15% - 20%. However, even if we don't technically slip back into recession, the growth in economic output the second half of 2010 will be extremely modest, and could be at a rate as small as 1% the balance of this year.

Given the likelihood of frustratingly modest growth in the economy, the pace of growth in corporate earnings will also necessarily slow. However, like our predictions for the economy, we believe that corporate earnings will continue to grow modestly during the second half of the year.

The exceptional percentage (year-over-year) earnings gains seen this past quarter were compared to very low levels last year. Future percentage gains will be far more difficult to achieve from current earnings levels.

Our "flagship" model portfolio strategy is currently holding a lot of cash (29.36% of total portfolio assets, as of July 31st), and given that three of our four "core" strategists are trend followers, if equity or debt markets should rise sharply, it's important for investors to understand, and to expect that we will "lag" their performance. Trend followers wait for confirmation of a change in trend before committing capital to it. By definition, confirmation of a change in trend can only occur after it begins. Therefore, stocks or bonds would have to rise, and continue to rise for some time, before these managers will commit your investment capital. Trend-followers will always be "late" in getting into a rally. That can be frustrating to those who want 100% of a market's advance, but the "price" an investor pays in not getting into the markets at the very bottom of a cycle, also buys them the comfort of knowing they will also not take the full brunt of a market's decline. Our trend-following managers all proved that point, and their value, in avoiding the sharp declines that were seen in 2008. Avoiding those massive losses is a big part of their value proposition to investors, and as this is written, they are obviously very cautious, evidencing a "show-me-first" posture, while keeping their powder (your capital) dry, and available, should a major market move in either direction occur. Year-to-date, they've delivered the (approximate) returns of the markets, but with a small fraction of the volatility we've seen (as shown on the chart back on page 11).

If not for the underperformance of certain "satellite" managers, most notably Direxion Commodity Trends Strategy Fund, and the Tahoma Fund, as well as the disappointing data coming from Portfolio Strategies, Inc.'s Price History strategy, I would give our model performance a solid "B+". Given their (unexpected) underperformance, I'd probably have to grade it a "B-", but with an "A" for effort, and for the avoidance of volatility. The lack of model portfolio volatility and its relative underexposure to the equity markets allows me to sleep well at night during these turbulent times. And my clients have made it clear that loss avoidance is very, very important to them these days. Our model is very loss averse.

In closing, let me thank our clients for their unflinching loyalty and their commitment to our process, and to our strategy. We expect that strategy, and the managers we employ to pay nice dividends when the equity markets recover, as they inevitably do. But as importantly, we believe that the breadth of diversification our clients' portfolios benefit from today is appropriate for the times, and at levels that are unprecedented in my career. And while there can be no guarantees against loss in the implementation and execution of *any* investment strategy, we believe that diversification, and the sell disciplines our "core" tactical managers employ within their strategies, will help prevent a repeat of the massive portfolio declines investors experienced in 2001-2, and again in 2007-8.

Over time, we will "win by not losing", and our clients will reach their long term income and accumulation goals.

As always, thanks for reading these reports, and please feel free to call me with questions or comments. We hope you thoroughly enjoy what remains of the summer!

-JRP

This article is for informational purposes only. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice as individual situations will vary. For specific advice about your situation, please consult with a financial professional.

The views are those of Jay R. Penney, CFA, CFP, and should not be construed as investment advice. This is not a solicitation to buy or sell any security. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic and performance information is historical and is not indicative of future results. Investors cannot directly invest in an index. Additional risks are associated with international investing such as, currency fluctuation, differences in accounting standards, and political and economic stability. Alternative investments such as Managed Futures, Market Neutral Investments, Inflation Benefiting Investments, Private Equity and Trend Following, involve specific risks that may be greater than those associated with traditional investments and may have specific suitability requirements. You should consider the special risks with alternative investments including limited liquidity, tax considerations, potentially speculative investments strategies and different regulatory and reporting requirements before investing.