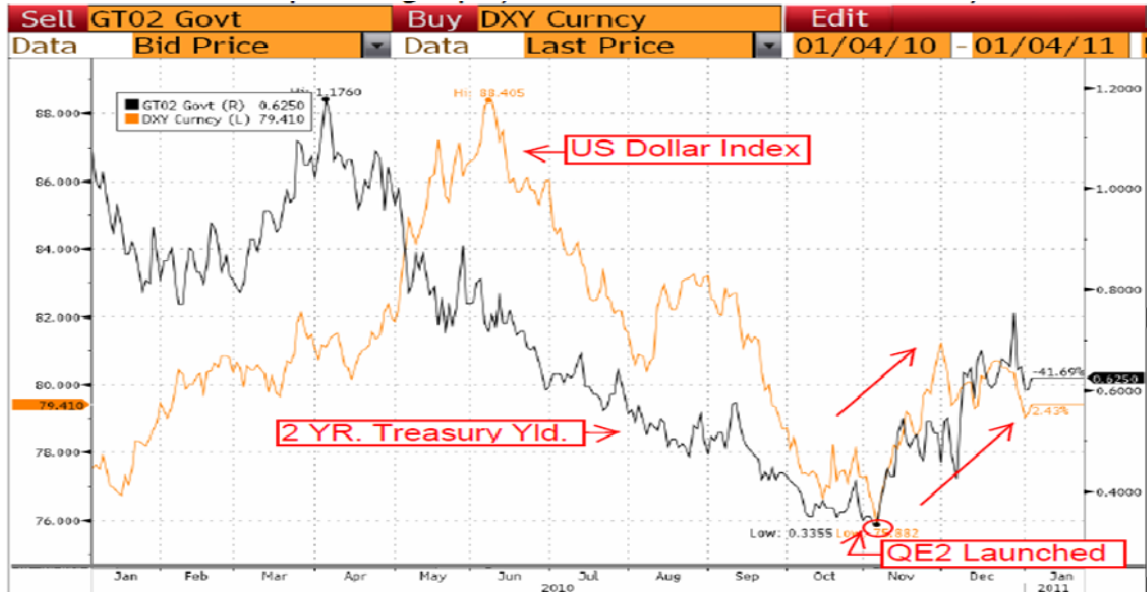


Commentary - 4th Quarter 2010

Happy New Year! The previous year ended with a strong rally in the fourth quarter. The S&P 500 Index rose 10.40% in the final three months, bringing the gain for the year to 14.69%. During the bleak days of the hot summer, most investors were more worried that the economy was going to experience a double dip recession and stocks were a lost cause. The stock market rallied through the fourth quarter even as the same fears of European sovereign debt problems that hurt the growth outlook in the spring resurfaced. Economic indicators are pointing to a self-sustaining recovery in 2011 and the ability of the market to overcome obstacles in the second half of 2010 has given investors more confidence to purchase stocks. We would prefer to see the proverbial “pause that refreshes” in the market rally since there has been a steady march upward since late November and we just experienced the strongest December performance for stocks in many years. We expect investors’ confidence to be fickle as fears of another meltdown have not been assuaged.

In the near term, we would not be surprised to see the market pull back as traders book some gains. But longer term, we are very positive. The economy is gaining momentum. Consumer confidence and small business optimism are increasing. The change in leadership in the U.S. House of Representatives is going to focus on reducing the growth rate in federal spending. As the economy recovers, tax revenues will rise and with restrained spending, the deficit may fall dramatically. This process may further boost consumer confidence and spending as the need for potential future tax increases will dissipate.

Graph 1. Two Year Treasury Note Yield and U.S. Dollar Index, Source: Bloomberg

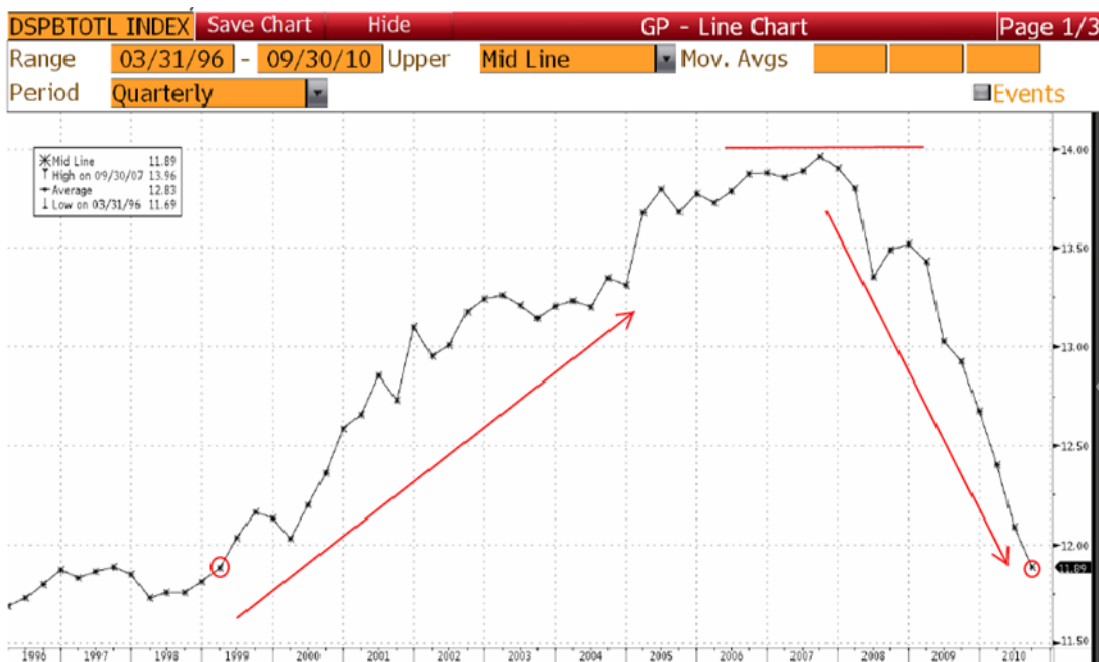


A stronger economy is already being reflected through interest rates in the bond market. The yield on the two year maturity Treasury note has **doubled** in the last eight weeks. Ironically, around the time the Federal Reserve launched their second round of quantitative easing (QE2), the bond market rally ended. The “bond vigilantes” have returned. The Fed will be following the market this year rather than manipulating it. The bond

vigilantes will start the tightening of monetary conditions for the Fed. As seen in the chart on the previous page, since QE2 was launched after the early November Fed meeting, interest rates have increased and the dollar has rallied. We are going out on a limb and suggesting that with stronger domestic growth and higher interest rates, the dollar will strengthen this year, surprising most skeptics. A stronger dollar would limit the strength in the commodity rally and stocks with commodity price exposure. Our expectations of more increases in interest rates lead us to recommend overweighting large capitalization stocks versus bonds. The big companies of our Blue Chip Strategy offer high dividend yields, strong balance sheets, exposure to international economic growth, and American ingenuity and productivity. If we are wrong, and domestic growth sputters, higher growth in developing countries will support the earnings of these global operators.

But one of the strongest reasons that we believe 2011 will surprise to the upside is the capacity of consumers to spend again. Once job growth picks up, the primary reason for the consumer to be cautious will dissipate. And our second graph illustrates the progress consumers have made in reducing their debt over the last few years. Look at the dramatic drop in household debt service as a percentage of personal income. We are back to levels not seen since before subprime mortgages could be obtained at fast food restaurants.

Graph 2. Ratio of Household Debt Service to Disposable Income, Source: Bloomberg



Stronger than anticipated economic activity will put upward pressure on interest rates. If interest rates rise too rapidly, that could put a damper on stock price appreciation. The economy is self-regulating in a normal environment. When the economy is weak, market interest rates fall, and when the economy is strong, market interest rates rise. The outside influences that can disrupt this process are Federal Reserve actions and government spending and tax adjustments. Right now the Federal Reserve is still aggressively stimulating the economy. That influence should be withdrawn gradually this year as the Fed changes policy to align its posture to the bond vigilantes. The federal government's moves to restrain spending and tax policy should be more friendly to the markets. In other words, we should see a return to normal after three years of panic and anxiety. The extremely steep yield curve supports our theory that economic activity will accelerate.

Here is how our asset class strategies performed for 2010:

Blue Chip Strategy: Our big company stock portfolio rose 7.86% in the fourth quarter and gained 13.54% for the year, versus the S&P 500 Index rising 10.40% in the quarter and 14.69% for the year. Large cap stocks fell slightly in November before finishing the year strongly. We became very bullish on large cap stocks during late August when the yield on the ten year Treasury fell below 2.50% while the dividend yield on our Blue Chips was over 2.70%. We still think the Blue Chips are attractive relative to bonds and most other asset classes. They are trading at some of the lowest valuation measures versus small company stocks since 2003. Most have bullet-proof balance sheets with excess cash that can be used for acquisitions. Or even better, they could increase their dividends and pay us more! With less uncertainty in the economic environment and government policy moderating, corporations should be more likely to hire and spend, boosting the economic cycle. The strongest performing holding during the 4th quarter is the one that is the most sensitive to the cyclical economy, Alcoa, which gained 27%. For the year the best performer was Caterpillar, who rose 68%, followed by DuPont, up 54%. Our laggard for the quarter was Cisco Systems which declined 7.6% after lowering their outlook when they reported 3rd quarter earnings. For the full year, Hewlett-Packard was the weakest stock, falling 17.5%. Many of the big technology stocks trailed the market last year as their revenue growth trends have not met historical expectations. They have lots of cash and some paid big premiums for acquisitions. Again, we reiterate, please pay us more in dividends and quit squandering capital. Take the approach that McDonalds initiated a few years ago when they stopped focusing on growth and concentrated on increasing margins and paying a higher dividend. Their stock has tripled since then.

Small Cap Value Strategy: Our small company stock portfolio gained 14.94% in the fourth quarter and 16.51% for the full year. The comparison index, the Russell 2000, rose 16.25% in the quarter and 26.85% for the year. However, over the last two years we have beaten the index by a full 25%. We have a positive outlook for our small cap stocks as the economy strengthens and earnings grow. Our best performing position during the fourth quarter was Daktronics, the manufacturer of gigantic scoreboards and digital billboards, who rose 70%. Daktronics was also the leader for the full year, rising almost 81%. They reported strong earnings and raised guidance for this year. The weakest position in the fourth quarter was Genco Shipping, dropping 9.6%. Investors are worried that the supply of bulk commodity ships will exceed demand as spot shipping rates have fallen dramatically in the second half of 2010. Jackson Hewitt Tax Service received our doghouse award for 2010, falling 83%. We sold Jackson Hewitt in December to book the tax loss, and it subsequently received some good news as its main competitor, H&R Block will have difficulty offering refund anticipation loans this year. The Feds cracked down on Jackson Hewitt's ability to offer refund loans last year, severely hurting their profitability. We did not add any new positions in the fourth quarter, but have a couple that should be added soon. The year 2010 saw us liquidate our most successful position ever, Dollar Thrifty Automotive Group. It would be nice to produce those kinds of returns regularly, but it is not very likely. Our initial purchase of DTG was at \$1.20 in February, 2009. We reduced our weighting in the position four times before selling the remainder in May, 2010 at close to \$47 after Hertz made a bid for the company. We were able to initiate eight new positions with the proceeds from Dollar Thrifty. We will keep the pressure on Brett to find another DTG.

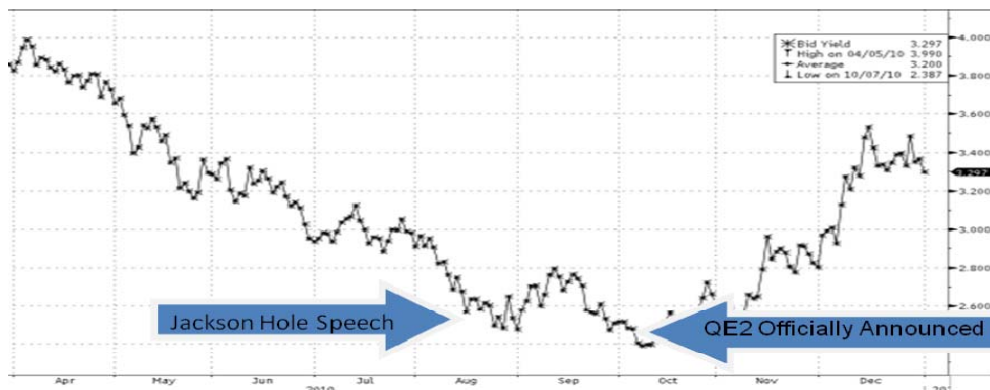
High Yield Convertible Securities Strategy: The strength in the high yield sector persisted through the fourth quarter as our high yield convertible strategy gained another 11.85% bringing the gain for the year to 34.09%. The Merrill High Yield index was up 2.98% in the 4th quarter and 15.24% for the year, while the Merrill Convertible Index rose 7.17% during the quarter and 16.52% for the year. During the fourth quarter, our newest position was the best performer for tax sheltered accounts. Sandridge Energy convertible preferred was purchased in October and gained 21% before year end. Sandridge is highly leveraged, but their acquisition of Arena Resources last year should allow them to boost cash flow, pay down debt, and continue an ag-

gressive exploration program that is focused on oil discovery. The preferred yields over 8.2% while we wait for the common stock to perform. For clients with taxable accounts, the best gainer was Eagle Rock Energy LP, who rose 45%, as they boosted their outlook and expected distribution for 2011. The only convertible bond that declined in value during the quarter was KV Pharmaceutical, falling 9.2%. KV continues to try to conserve cash as they re-start production after receiving FDA approval of their facilities. We believe their equity will be diluted substantially as they raise cash to survive, while the bonds should improve as their revenues recover over the next year. We had many strong performers for the year, led by Eagle Rock, up 90%, and Trinity Industries and Stillwater Mining convertible bonds each rising over 44%. We added one other convertible bond position to the portfolio in October, USEC Inc. They are the only US-owned domestic uranium processor and are supported by numerous government projects. The bond yields over 8.5% while we wait for earnings to increase. Nuclear power should eventually become more of our baseload source of electricity. We added one new MLP position to our taxable accounts, Star Gas Partners. They survived a restructuring a few years ago and are under the radar. The position yields over 5% and they could boost their payout substantially over the next few years. Our outlook for the high yield sector is positive, but we do not expect returns similar to the last couple of years. Rising interest rates will make it harder for high yield bonds to exhibit strong performance but our focus on convertible securities will allow us to participate in the upside if stocks do as well as we anticipate.

Intermediate Bonds-JP Szafranski: The Intermediate Taxable Bond Portfolio declined 0.07% for the quarter, and rose 6.04% for the full year. The Citigroup 1-10 Year Government/Corporate Index fell 1.41% in the fourth quarter and was up 5.98% year-to-date. Our tax-exempt strategy fell 2.04% in the fourth quarter while the Merrill Lynch 3-7 Year Insured Bond Index dropped 1.47%. Our tax-exempt bonds were up 1.88% year-to-date, while the index rose 3.09%.

Our defensive strategy finally paid off in the fourth quarter as interest rates rose dramatically in the final two months of the year. We've focused the intermediate bond portfolio on shorter term maturities because their values are less sensitive to interest rate moves when compared with intermediate and longer term bonds. This concept is what led to our 1.34% outperformance of the index for the quarter.

Chart: 10 Year Benchmark Treasury Yields (4/2010-12/2010)



Last quarter we discussed the old Wall Street adage “Don’t Fight the Fed.” This quarter we’d like to share another one: “Buy on the rumor. Sell on the Fact.” The chart above shows how the bond market drove down rates (bond price positive) in anticipation of the additional bond purchases by the Federal Reserve now referred to as “QE2.” By the time Chairman Bernanke made his first official hint at QE2 at his Jackson Hole speech, rates were already near their ultimate lows. Those that waited to “buy on the

fact” were not so lucky, as the chart shows interest rates spiking (bond price negative) after the Fed’s intentions were made official. We view the upward movement in rates as a positive sign for the economy. Our intermediate bond strategy will eventually begin to look more intermediate (instead of short term) as rates continue to rise.

Cost basis legislation and Tax Consequences, from our newest staff addition -Chas Craig. Investors who forget what they paid for shares of stock will begin receiving assistance from the IRS beginning January 1, 2011, which is when the new cost basis legislation will **require** brokerages to track the purchase price on equities bought after January 1, 2011. Before this rule, the government did not have a way to verify if an investor was reporting the true gain on a sale unless there was an audit. Notice that the legislation is only specifying shares purchased after January 1, 2011. Shares purchased before then will be covered under the old rules. The investors who will be most impacted by the new legislation are those who buy shares of the same company on different dates or at different prices. Under the new legislation the investor must identify which shares they are selling before the sale settles, which typically means within three days for stocks. The normal scenario today involves a client sitting down with their accountant and identifying which lots they would have used at the time of sale using hindsight. This will no longer be the case under the new rules. However, Pinnacle has synchronized our portfolio management software with our custodians so that we can generate tax savings for our clients. We will be taking advantage of the “Tax Lot Optimization” identification method that is newly supplied by Charles Schwab and the similar identification method from Fidelity called “Tax Sensitive”. This method is superior to prior lot identification methods which either focused solely on cost or holding period. By contrast, this new method incorporates both holding period and cost into the analysis of which shares to sell. Essentially, the short term losses will be sold first, followed by the long term losses, then long term gains and finally short term gains. Also, if situations arise where this does not minimize taxes, we reserve the ability to identify specific lots when making sales on behalf of clients. We believe that the new legislation will lead to both tax efficiencies and reduce record keeping requirements for our clients.

Additionally, the regulations take effect at later dates for other types of securities. Starting January 1, 2012, brokers will have to record the cost basis for mutual funds and stocks held in dividend reinvestment plans. Finally, the rules take effect for options and fixed income securities acquired on or after January 1, 2013.