CAPITAL MANAGEMENT GROUP, INC.

Alternative Investment Strategies

June 18, 2010 Market Update – A Portfolio Game Plan

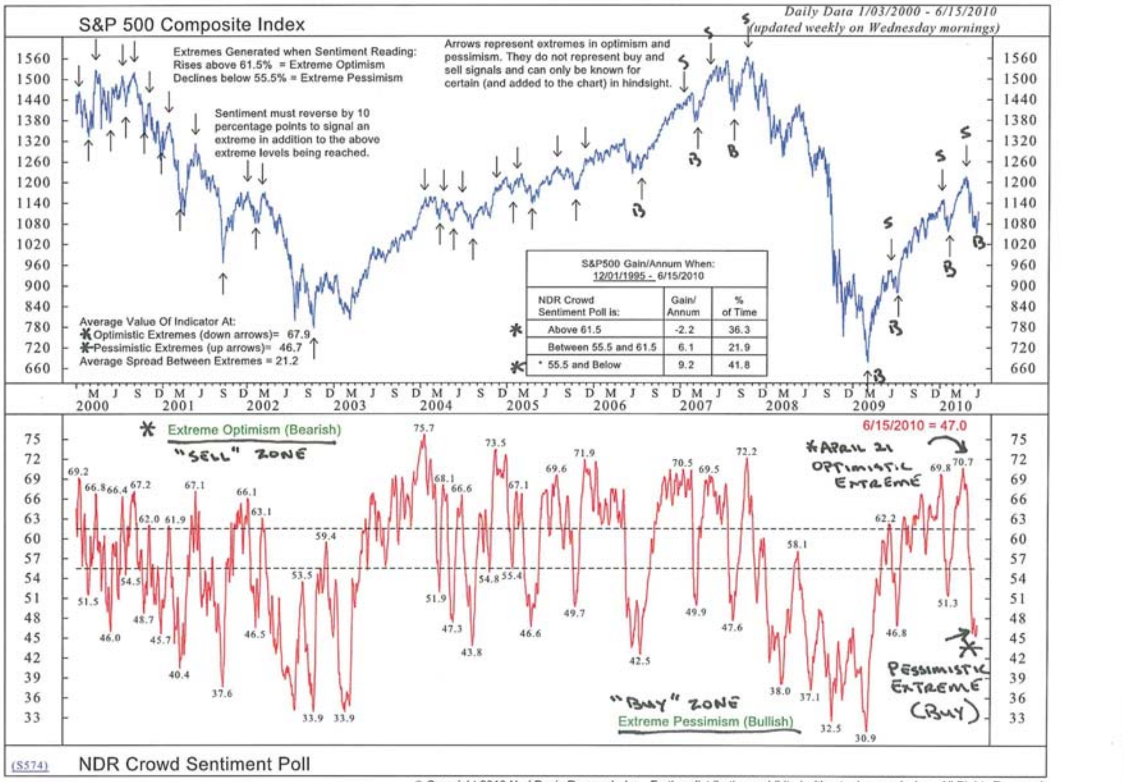
Valuations are better (though still relatively high from a historical bear market perspective) and sentiment has turned decidedly bearish (a bullish signal). I believe it is a good time to prepare for a short-term oversold relief rally.

With over 3000 accounts and several hundred advisor relationships, we have a front row seat to investor tendencies. After nearly 27 years in the business, I feel hesitantly safe in saying that far too many individuals lack a defined portfolio allocation game plan and even if there is a plan, unfortunately, many lack the discipline to stick to that plan (emotions rule reason at points of extreme stress). With this thinking, below I suggest a new portfolio allocation standard, one that replaces the old 60% stocks / 40% bonds allocation along with several ideas as to how you might better manage downside risk against the long directional portion of your portfolio. First a quick sentiment, valuation and fundamentals update.

On April 23, 2010 I wrote the following: April 23, 2010 Market Update: Optimistic Extreme - Time to sell/get defensive. Investor optimism was at a bullish extreme (a strong bearish indicator) just at a point that the S&P 500 Index rally had retraced nearly 61.8% of the 2008/09 crash decline. How quickly we moved from a period of extreme optimism to extreme pessimism. It may be a more permanent element of investing in today's inter-connected, rapid paced world.

So where are we today? The most recent investor sentiment readings are now in the Extreme Pessimism (Bullish) zone (see chart below). Remember that extremes are important indicators of turning points. When the masses get overly optimistic, most of the good news is already priced in the markets. Conversely, when pessimism rules the day, then it's already evident in the level of prices. When these measures hit extremes, it is a good indicator that the tide will soon turn.

NDR CROWD SENTIMENT POLL 6-15-10 (HIGHLIGHTED NOTES ARE S.BLUMENTHAL'S)



Thoughts on the Market:
My best guess is that the equity markets will continue to chop sideways through the summer months into October and finish the year with a strong November and December. Ultimately some good rallies, some rough sell-offs, and little progress over the next five to seven years until this long-term secular bear concludes.

I see a current trading range somewhere between 950 to 1250 (my thoughts on this could change but that's where I see significant support and resistance today). I'm a bit less concerned on the actual support and resistance numbers and more focused on extreme investor optimism and pessimism when the market approaches those support and resistance levels. I see more of a choppy trend environment with higher volatility and some pretty good trading swings. Historically, a favorable environment for active trading strategies.

Currently, I optimistically see fair value on the S&P 500 Index north of 900. With the S&P at 1115 (June 16, 2010), based on actual reported earnings, the S&P is more than 15% overvalued. This is not a place where new long-term secular bull markets begin. I am a big believer in the 17 year cycles of bull and bear markets and believe that this bear market, like those before it, will end when PE ratios decline below 10 (currently at approximately 18, though down from nearly 22 in April). A quick note on the different ways to look at the E (earnings) in PE (Price to Earnings Ratio). I believe it is important to look at actual reported earnings and not future analyst estimates as the Wall Street analysts tend to miss by a very wide margin. Today, in line with their historical optimistic overestimates, Wall Street analysts are forecasting 12% earnings growth this year. Yet historically, actual earnings growth has proven to be closer to 6%, not 12%. Given the difficult issues both domestically and globally, hitting 6% earnings growth is likely a tough target to achieve. In short, I like to follow and compare valuations based on what has actually been achieved and compare the actual PE ratio to historical levels to determine valuation. Based on those numbers, I see the market at roughly 15% overvalued today.

Bull markets start with low PE ratios and interest rates that are moving from higher levels to lower levels. Today we have elevated PE ratios and low interest rates that are set to move higher over the next two to five years. I believe the markets will at best bump sideways for years as the macro fundamentals repair. Thus, a trading range environment that favors tactical trading strategies and a difficult environment for buy-and-hold.

Fundamentals:
For more on the fundamental backdrop, I have provided a few links below that I believe are important to read. As you know, I think the world of my partner John Mauldin. He has been one of the few that has been in front of this bear market for years, was ahead of most on the subprime issues, accurately pointed to the beginning of the secular bear prior to 2000, and is one of the smartest economic minds in the business. If you are not reading Mauldin, you can sign up for his free weekly e-letter by putting your email address in the section provided on his home page http://www.2000wave.com. Also, the following is a link to Mauldin's archives: http://www.2000wave.com/archive.asp. I recommend that you read "What Does Greece Mean to You?". Mauldin explains in a letter to his children how interlinked the problems of the world are today. I think you'll find he writes in a way that has a layman's understanding as to what is going on and how it impacts you and your investment decisions.

I'd also recommend you listen to some of the smartest minds on the planet:
Bill Gross, Pimco – Investment Outlook June 2010
Mohamed El-Erian, Pimco (Mohamed ran Harvard's endowment for years) – Driving Without A Spare
John Hussman – Don't Mess with Aunt Minnie

A New Portfolio Game Plan:
The 60% Stock / 40% Bond Allocation Model is for yesterday's world, not today's; the new model is 33% Stocks, 33% Bonds, 34% Absolute Returns.

Ok, let's go with the idea that it's not so rosy out there. What do you do? An advisor asked me if I had any thoughts on how he might shape his clients' overall portfolio allocations. We work with hundreds of advisors as they allocate some of their client assets to our strategies. Essentially, he wanted a game plan for how he might help his clients through this period and not suffer a similar fate that many investors experienced over the last ten years (no returns). What follows is what I suggested to him yet please know that this is not a specific recommendation for you as you and your client or you and your advisor should carefully review your needs, risk tolerance and time horizon.

I told him that the standard 60% stocks / 40% bonds portfolio allocation won't work in a long-term secular bear market and told him I believe the new portfolio standard is 33% stocks, 33% bonds and 34% absolute returns. Perhaps it is not so new as major endowments like Yale, Harvard and University of Pennsylvania have been allocating to the absolute return space for years. Yet it is new and confusing to many investment advisors and their clients.

33% stock allocation:
I suggested that he should manage the 33% stock allocation (most advisors allocate to equity index ETF's, equity mutual funds and stocks) more defensively. Invest in core equity positions and buy puts on the indices and write covered calls when the market reaches the Extreme Optimism Zone and then

take those positions off when the market reaches the Extreme Pessimism Zone and/or lighten up long equity exposure at Extreme Optimism and average the money back in at Extreme Pessimism. In this way he can defensively protect the downside risk and preserve the long-term tax nature of his 33% stock allocation while keeping his client(s) on course.

33% bond allocation:
I suggested he should be careful with his bond allocation as I believe that rates are ultimately headed higher. Perhaps not this year but the risk of significant default will remain for some time and I believe will include not just Greece, Spain, Portugal, Ireland and Italy – and recently Hungry, but US municipalities as well. The opposing forces of inflation and deflation are both colliding as weak economic growth and deleveraging are deflationary and stimulus spending and budget deficits are inflationary. It looks like deflation is winning the battle today, but eventually inflation will win the war. The Pew Center on the States recently estimated that as of the end of 2008 budget year, states had $1 trillion less than needed to pay for future pensions and medical benefits. That number doesn't even reflect the losses suffered by pension fund investments in the second half of 2008. Warren Buffett suggested last week that the default risk for many municipalities is significant. "Los Angeles is facing a terminal fiscal crisis: between now and 2014 the city will likely declare bankruptcy," former mayor, Richard Riordan, wrote in a Wall Street Journal opinion piece. If the US stepped up to bail out GM, it may seem likely that they step up to bail out the state and local governments. Buffett is taking steps now to protect himself and his shareholders from the coming financial disaster he predicts will hit the US. Now, that does not mean that there aren't many good municipal bond opportunities – there are, but I believe the increased default risk will drive interest rates higher as will the inflationary actions of the world governments. Deflation now, inflation in two to five years down the road. The simple conclusion is to make sure you know what bonds you are investing in. Ladder a portfolio over the next two to nine years with a five year average life so that you can roll the maturing bonds to a higher interest rate and feel comfortable that you can sleep at night and not worry no matter what happens. Allocations to standard municipal, corporate and government bond funds will suffer in a rising interest rate environment. Stay with a shorter-term focus and be careful with standard bond mutual fund investments.

34% Absolute Return Strategies:
Find and create a blend of various non-correlating absolute return strategies. Include a combination of CMG's various absolute return strategies in this portion of your clients' portfolios along with other non-correlating strategies. Find strategies that do not correlate to the market and, importantly, do not correlate to each other. These are becoming more difficult to find as world markets of all types are becoming increasingly linked. I suggested to the advisor that he find a minimum of three different non-correlating strategies. There are strategies that can work for all investors (not just the accredited investor). Consider including a liquid CTA index fund, a liquid mutual fund that replicates a fund of hedge fund return stream, other absolute/alternative strategies funds, a managed futures fund, etc. We can show you how to weave non-correlating strategies together and how this piece compliments the 33% stock and 33% bond portfolio categories.

Summary:
I recommended to the advisor to have a game plan and be prepared to stick to that game plan. Of course, he might allocate 70% to bonds and 30% to absolute return for one client and have a different allocation of 25% stocks, 25% bonds, and 50% absolute return for another client. So much depends on the clients' needs, goals and time horizon. After you determine a particular client's specific allocation mix to each of the three categories, be prepared to rebalance the target allocations at least annually. This way you can dollar cost average into the "out of favor" categories when they have had

a period of underperformance and better help your client stick to an investment game plan. The idea is to smooth the overall portfolio's return stream over time. I believe that by better managing the tail risk (risk of major decline) a client will have more investment success with a greater ability to stick to his/her investment game plan. Facts clearly show that most investors panic out and buy in at the wrong times. I told the advisor that his clients are looking for a different advisor experience and I believe the above plan will help him provide that different experience to his clients and help him grow his business in a more stable way over the years to come.

I conclude by letting you know that we are here to help. We are part of a broader portfolio solution and we have the recourses to help support you in growing your business and growing your clients' wealth. We can help show you how to build out a 34% Absolute Return Strategy allocation bucket for your clients. The key is non-correlation to the stock and bond markets and, importantly, non-correlation between the different Absolute Return Strategies that make up your 34% bucket.

With kind regards,
Steve

Stephen B. Blumenthal
President, CEO
CMG Capital Management Group, Inc.
150 N. Radnor Chester Road
Suite A150
Radnor, PA 19087
steve@cmgfunds.net
610-989-9090 Phone
610-989-9092 Fax

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A copy of CMG’s current written disclosure statement discussing our advisory services and fees is available upon request or you can access this information on CMG’s website (www.cmgfunds.net/public/adv.asp).

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