CAPITAL MANAGEMENT GROUP, INC.
CMG
Alternative Investment Strategies

The Blumenthal Viewpoint – September 10, 2010

Below I take a look at the Big Picture, review PE and Sentiment Charts, touch on Investor Behavior and why far too many investors fail and I propose an investment game plan that I believe is better positioned to profit in the "muddle through - new normal" choppy period that lies ahead. It is a game plan that balances passive investment management with active investment management.

In 2007-2008 when the world broke, traditional 60% Stock 40% Bond asset allocation strategy failed investors again. I believe that this strategy will continue to struggle as we move through this long-term secular bear market cycle. There are other investments besides stocks and bonds and there are better ways to manage your portfolio risk. Below, I suggest a new portfolio standard: 33% Stocks, 33% Bonds, and 34% Absolute Returns. But first, a look at the Big Picture, and a study of Investor Behavior.

The Big Picture Outlook – The Long-Term ("LT") Secular Bear Continues:

First some stats on LT Bear and LT Bull Cycles:

There have been four major LT Secular Bear market cycles in the last 113 years. One that lasted 18 years (the net cumulative return for the DJIA was -4.29% after 18 years), one that lasted 25 years (net cumulative return was just 1.69% after 25 years), one that lasted 17 years (net cumulative return was just 0.83% after 17 years), and the current Secular Bear that begin in 2000 (net cumulative return through 2009 was -4.68%). Source Rydex/SGI Security Global Investors using data from dowjones.com.

There have been four major LT Secular Bull markets cycles in the last 113 years. One that lasted 9 years (the net cumulative return for the DJIA was 148.92%), one that lasted 5 years (the net cumulative return was 294.66%, one that lasted 11 years (the net cumulative return was 154.29%), and the big one from 1982-2000 that lasted 17 years (the net cumulative return was 1003.19%). Source Rydex/SGI Security Global Investors using data from dowjones.com.

There are positive and negative years in both LT Secular Bear and LT Secular Bull cycles:
In LT Secular Bear Market Cycles: 57% of the years are positive, 43% are negative.
In LT Secular Bull Market Cycles: 88% of the years are positive, 12% are negative.

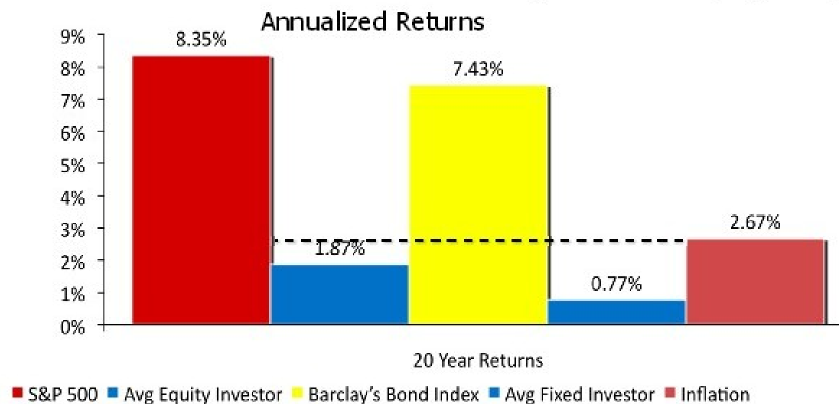
We are 10 years into this cycle. I believe we are approximately half way through the current Secular Bear. The fundamental backdrop remains concerning: deleveraging continues, valuations are better but not at levels that would signal a new long-term secular bull, and higher taxes and higher interest rates lie ahead. Yet all is not lost if you manage your risk differently in Secular Bear cycles than you do in Secular Bull cycles. Which environment do you think we are in? Set your allocation plan accordingly. I suggest a plan below.

Investor Behavior Impacts Returns:

In 2002, a Nobel Prize was awarded to Amos Tversky and Daniel Kahneman for their work in behavioral economics attempting to explain irrational human economic choices. In short, their work reflected that individuals react to pain twice as much as they do pleasure. This emotion behavior pattern is reflected in the investment space where many investors make the wrong choices at the wrong time. Take a look at the next chart (data from DALBAR). Over the last 20 years, the S&P 500 Index gained 8.35% yet the average Equity investor gained just 1.87%. Also note that the Barclay's Bond Index gained 7.43% over that period, yet the average Fixed Income investor gained just 0.77%.

Investors Have Significantly Underperformed the Benchmarks – DALBAR Study

Index returns are not investor returns as timing and emotion play a large part.



Data Source: Investment Company Institute, Morningstar Associates and DALBAR. January 1989 – January 2009

CMG Alternative Investment Strategies — Focused on your long-term investment success

Martin J. Pring sums up best in the following quote from his book Investment Psychology Explained (I highly recommend this book).

"For most of us, the task of beating the market is not difficult, it is the job of beating ourselves that proves to be overwhelming. In this sense, "beating ourselves" means mastering our emotions and attempting to think independently, as well as not being swayed by those around us. Decisions based on our natural instincts invariably turn out to be the wrong course of action. All of us are comfortable buying stocks when prices are high and rising and selling when they are declining, but we need to develop an attitude that encourages us to do the opposite.

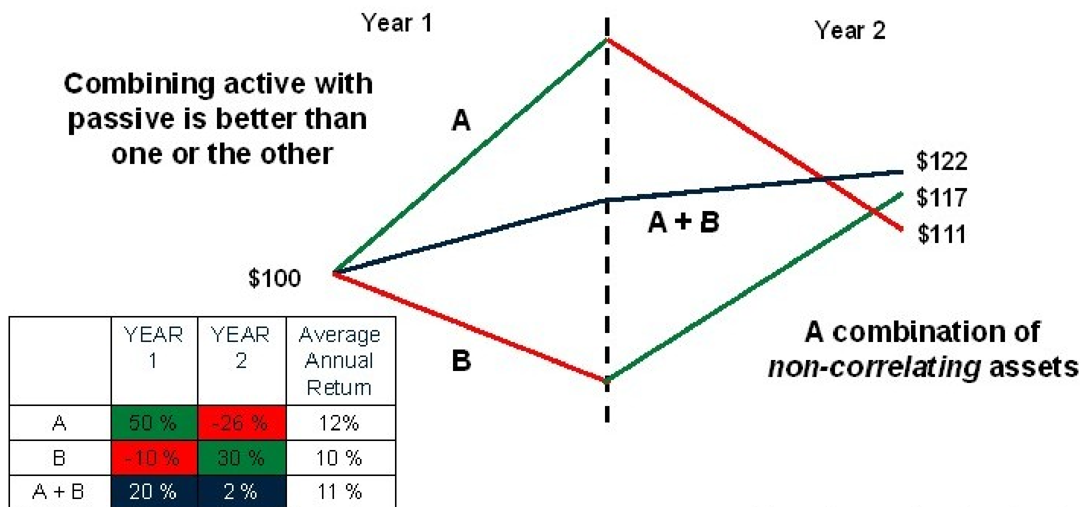
Success based on an emotional response to market conditions is the result of chance, and chance

does not help us attain consistent results. Objectivity is not easy to achieve because all humans are subject to the vagaries of fear, greed, pride of opinion, and all the other excitable states that prevent rational judgment. We can read books on various approaches to the market until our eyes are red and we can attend seminars given by experts, gurus, or anyone else who might promise us instant gratification, but all the market knowledge in the world will be useless without the ability to put this knowledge into action by mastering our emotions."

We work with hundreds of very smart independent Registered Investment Advisors and I can tell you we privately speak about how difficult it is to keep our clients on course as it is human emotion that drives most investor decisions. The common tendency is to chase into a hot fund or strategy near the top and sell out near the bottom. Sure, it is easier to convince an investor to get into a particular fund after a great run (and that is what most people do), yet is it the right thing to advise? Here is what usually happens as reflected in the following chart. Fund A has a great gain in year 1. Fund B doesn't fair as well. John, thrilled about his 50% gain tells his buddy, Joe, about how great he did. Joe, who invested in Fund B, is frustrated with his fund's performance in Year 1 and after convincing himself he gave it a year to perform, decides to switch out of Fund B and chases the return stream and transfers his position to Fund A. In Year 2, Fund A loses 26%, while Fund B gains 30%. Joe wonders why he can never make money investing. While the example is hypothetical, the behavior pattern is real as reflected in the DALBAR Study. Notice how combining a 50% investment in Fund A with a 50% investment in Fund B can produce a smoother return stream. This is the goal of combining passive and active management together within your investment portfolio.

The Power of Balance

Which Return Do You Want?



	YEAR 1	YEAR 2	Average Annual Return
A	50 %	-26 %	12%
B	-10 %	30 %	10 %
A + B	20 %	2 %	11 %

Equity Returns and Absolute Returns the last 10 years:

Following is the performance a typical Equity Investor's portfolio over the last 10 years and the performance of what we feel represents the Active Management Space (a 50/50 mix of two quantitative/systematic indices: HedgeFund.Net's CTA/Managed Futures Index and Hedge Fund Researches Diversified Systematic Investable Index). Focus on the last column showing the percentage return for each year. Please see *1 for important disclosure regarding the indices below.

Equity Composite Index

Monthly Performance (%)													
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2010	-4.51%	3.70%	7.41%	3.05%	-7.72%	-5.46%	7.44						3.05%
2009	-8.00%	-9.70%	9.31%	14.56%	5.22%	0.57%	8.99%	3.57%	5.55%	-3.55%	4.78%	4.96%	39.13%
2008	-7.74%	-2.36%	-0.01%	6.27%	3.67%	-8.63%	-0.04%	0.75%	-10.69%	-20.55%	-10.22%	4.59%	-39.16%
2007	2.24%	-0.98%	1.05%	3.59%	3.56%	-1.19%	-2.99%	1.58%	4.30%	4.13%	-6.02%	-0.65%	8.38%
2006	5.95%	-0.63%	2.67%	1.13%	-5.33%	0.43%	-1.49%	2.87%	1.97%	4.60%	3.32%	0.29%	16.41%
2005	-3.83%	2.39%	-2.41%	-3.08%	5.22%	1.13%	5.70%	-1.13%	1.68%	-2.59%	4.89%	0.41%	8.04%
2004	2.56%	1.20%	0.03%	-4.48%	2.30%	2.67%	-4.76%	0.44%	2.88%	2.86%	6.19%	3.60%	15.99%
2003	-2.14%	-0.96%	0.44%	8.19%	7.70%	1.63%	4.50%	3.84%	-0.97%	7.09%	2.11%	3.65%	40.41%
2002	-1.06%	-3.24%	6.23%	-3.47%	-2.27%	-6.91%	-9.60%	-0.25%	-9.40%	7.61%	7.88%	-6.22%	-20.57%
2001	5.51%	-11.32%	-8.28%	9.82%	0.21%	0.41%	-4.08%	-5.12%	-12.80%	6.30%	9.58%	2.57%	-10.07%
2000	-2.98%	8.35%	2.97%	-6.09%	-4.56%	5.50%	-1.57%	7.03%	-5.27%	-4.47%	-10.68%	2.84%	-10.37%

Barclays Aggregate Bond Index

Monthly Performance (%)													
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2010	1.53%	0.37%	-0.12%	1.04%	0.84%	1.57%	1.07%						6.40%
2009	-0.88%	-0.38%	1.39%	0.48%	0.73%	0.57%	1.61%	1.04%	1.05%	0.49%	1.29%	-1.56%	5.93%
2008	1.68%	0.14%	0.34%	-0.21%	-0.73%	-0.08%	-0.08%	0.95%	-1.34%	-2.36%	3.25%	3.73%	5.24%
2007	-0.04%	1.54%	0.00%	0.54%	-0.76%	-0.30%	0.83%	1.23%	0.76%	0.90%	1.80%	0.28%	6.96%
2006	0.01%	0.33%	-0.98%	-0.18%	-0.11%	0.21%	1.35%	1.53%	0.88%	0.66%	1.16%	-0.58%	4.33%
2005	0.63%	-0.59%	-0.51%	1.35%	1.08%	0.55%	-0.91%	1.28%	-1.03%	-0.79%	0.44%	0.95%	2.43%
2004	0.80%	1.08%	0.75%	-2.60%	-0.40%	0.57%	0.99%	1.91%	0.27%	0.84%	-0.80%	0.92%	4.34%
2003	0.09%	1.38%	-0.08%	0.83%	1.86%	-0.20%	-3.36%	0.66%	2.65%	-0.93%	0.24%	1.02%	4.11%
2002	0.81%	0.97%	-1.66%	1.94%	0.85%	0.87%	1.21%	1.69%	1.62%	-0.46%	-0.03%	2.07%	10.27%
2001	1.63%	0.87%	0.50%	-0.42%	0.60%	0.38%	2.24%	1.15%	1.16%	2.09%	-1.38%	-0.64%	8.42%
2000	-0.33%	1.21%	1.32%	-0.29%	-0.05%	2.08%	0.91%	1.45%	0.63%	0.66%	1.64%	1.86%	11.63%

50% HFN CTA Managed Futures Index / 50% HFRI Macro Systematic Diversified Index

Monthly Performance (%)													
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2010	-2.95%	0.58%	2.01%	0.67%	-2.03%	0.70%	4.23%						3.12%
2009	-0.60%	-0.47%	-1.61%	-0.70%	3.69%	-1.56%	-0.11%	0.79%	1.38%	-1.51%	3.17%	-2.18%	0.09%
2008	2.31%	6.87%	-0.92%	-0.56%	1.85%	2.61%	-3.46%	-0.56%	-0.15%	3.47%	1.20%	1.38%	14.54%
2007	0.59%	-0.79%	-0.66%	2.61%	2.07%	0.92%	-1.02%	-2.74%	5.79%	4.82%	-1.99%	1.62%	11.41%
2006	4.38%	-1.02%	2.31%	3.11%	-2.11%	-0.70%	-1.19%	0.61%	-0.43%	2.21%	3.01%	1.31%	11.85%
2005	-1.95%	1.96%	-0.86%	-2.22%	1.94%	1.83%	1.64%	1.46%	1.82%	-1.78%	3.79%	1.16%	8.92%
2004	0.81%	2.23%	-0.13%	-3.13%	-0.22%	-0.94%	-1.77%	-0.66%	1.97%	2.05%	3.97%	1.12%	5.20%
2003	1.63%	1.85%	-1.89%	1.80%	4.16%	-0.20%	-0.35%	1.34%	0.18%	2.31%	0.26%	2.64%	14.46%
2002	-0.96%	-0.73%	1.11%	-1.04%	0.93%	2.69%	1.33%	1.47%	1.50%	-1.41%	0.17%	1.41%	6.54%
2001	0.38%	-1.42%	1.71%	0.34%	1.08%	0.19%	-1.14%	0.04%	0.97%	3.06%	-0.99%	1.66%	5.93%
2000	1.88%	3.21%	0.59%	-2.75%	1.85%	0.00%	-1.05%	3.33%	-1.89%	0.95%	1.21%	5.31%	13.08%

The Importance of a Balanced Portfolio Game Plan (Combining Passive with Active Investment Management)

Over the last 10 years, Active Management performed well while Passive Buy-and-Hold Management, like past LT Secular Bear periods, did not. Note that over the last 18 months, Passive Management (Equities and Fixed Income) had an exceptional post crash recovery move; however, Active Management, while positive, underperformed. Does one disregard the positive long-term returns in the Active Management space and chase into Equities or into Bonds? Will stocks move higher over longer periods of time? Yes. Can an investor emotionally stay the path with a 20 year vision? Statistics show that most cannot. So what to do? The idea is to set a plan

that will keep you on a path to your longer term goals. I believe a better plan is one of balance that includes a diversified mix of Stocks, Bonds and Active Management.

First, sit down with your advisor (your investment coach), then set an investment game plan that is suitable for your needs and goals, then and perhaps most importantly be prepared to stick to your plan when your emotions want to rule discipline and drive you off course (the best advisors in the business help their clients through the tough emotional periods). If it is an exceptional advisor, many times his/her advice will go counter to what your emotions are telling you (don't end up like the average investor - Dalbar chart). The goal is to set a game plan and have the discipline to stick to that plan. Most investors believe long term but emotions cause them to behave short term. Be different. There will be periods when your Stock bucket will outperform and periods when your non-correlating Active bucket will outperform. The objective is to smooth your return stream to keep from reacting emotionally to every short term move. As reflected in the graph above, the objective is to achieve A B. You'll tweak allocations from time to time, that makes sense but stay focused on the amount you allocate to each of the three investment buckets (Stocks, Bonds, and Absolute Returns) and tie those weightings to the environment you see ahead.

In LT Secular Bear Cycles consider the following as a base standard: 33% Stocks 33% Bonds 34% Absolute Returns. For your Stock bucket, hold core long-term focused positions but more actively manage your downside risk. Look for Tactical Strategies to compliment your core equity positions, dollar cost into your positions, and/or use inverse ETF's or option strategies to protect this portion of your portfolio. For the Bond bucket, I recommend you build a short-term laddered tax free bond portfolio with an average maturity of no more than 4 or 5 years. This is to protect your principal against rising interest rates. Be careful about investing in bond mutual funds as they will get hurt when rates move higher. Note: we have a great tax free municipal bond manager I can introduce you to (send me an email). For the Absolute Return bucket, I'd look to find a number of non-correlating actively managed strategies and actively managed mutual funds. There are a number of mutual funds that are quite effective and we are seeing some interesting new ideas every day. If you are an advisor, we can show you how a blend of our actively managed trading strategies and/or our mutual fund compliments other popular funds like Hussman, Pimco Total Return, TFS Market Neutral, etc. There is a way to build an Absolute Return bucket for your clients in a way that provides you and your clients with daily liquidity, daily transparency, and no K1 hassle. (A quick important disclosure - please note that the above is a general idea and is not a specific recommendation for any individual investor as I have no idea as to your personal needs, goals, level or risk tolerance, and investment time horizon.)

Finally, I've been asked recently about my thoughts on the market. My two cents on where we are:

The fundamental backdrop remains concerning (deleveraging continues - see the Mauldin piece I've attached - he says it best), yet there are some opportunities I see ahead and I'm personally getting ready to move my 401k from cash back into aggressive equity funds (this is my Equity bucket - the balance of my funds are in our various active management strategies).

- Valuations are better (S&P PE GAAP Ratio is at 15.62. NDR Chart below) but not yet at Bear Market lows (PE under 10). The market is fairly priced today but that doesn't mean

it can't go significantly lower. Risk remains large until valuations become cheap. The LT Secular Bear remains in place. I think we chop up and down over a number of years on our way to a PE of less than 10.

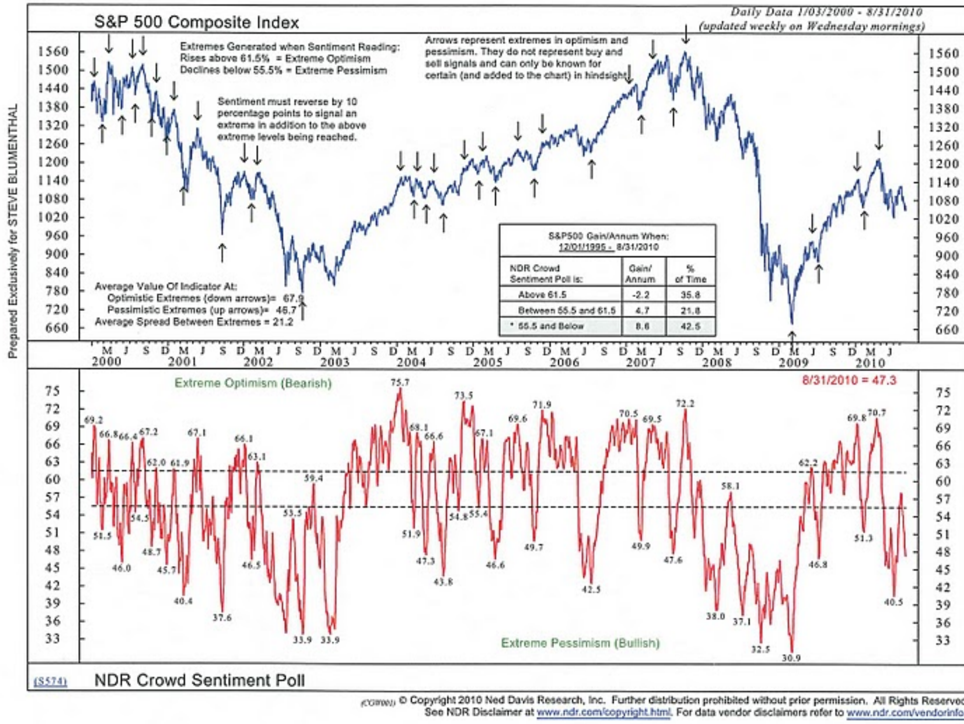
- Housing: In July, existing home sales plunged 27% month-over-month. Home prices declined after five months of gain – this plunge despite record low mortgage rates. The post tax credit data reflects another turn lower in housing.

- Consumer confidence rose 2.5 points in August to 53.5. Not so good considering the average in past recessions was about 70. Deleveraging continues. Unemployment remains stubbornly high. The lower GDP revisions are off the charts.

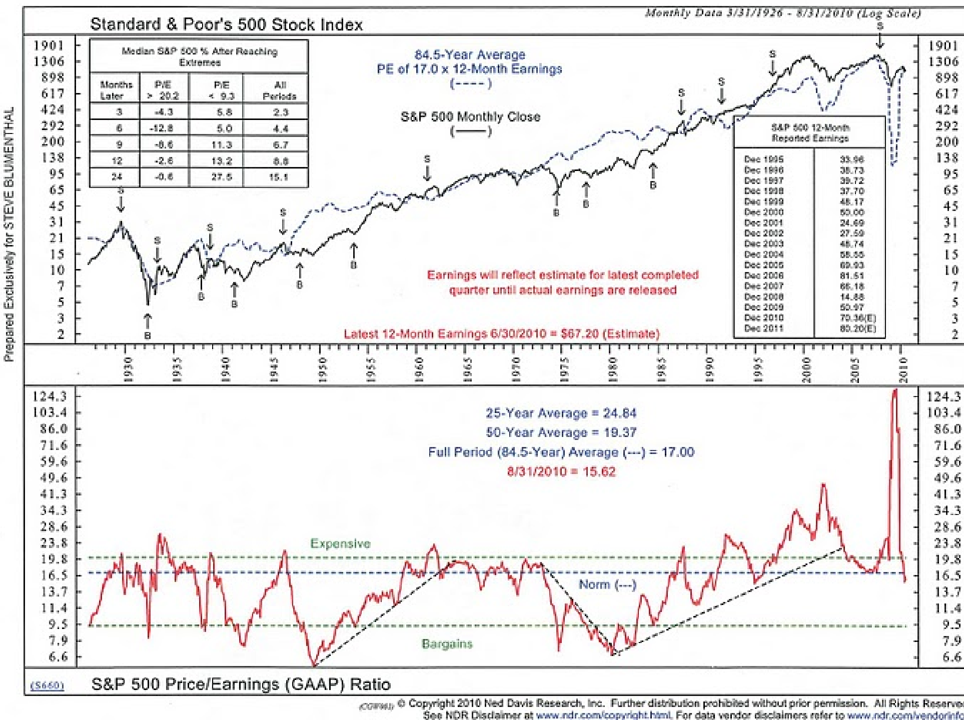
- Liked this from David Rosenberg (Sept 1, 2010 Breakfast With Dave), "Maybe, just maybe, the government should move out of denial and into acceptance that it is a futile exercise to play around with nature. Perhaps the process of mean reverting to a housing debt/asset ratio of 12.5% (now 20%) and a household debt/income ratio of 65% (now 130%) requires additional deleveraging of $6 trillion and should be allowed to occur as quickly as possible. Everything mean reverts." I agree.

Last April, I said it was time to sell/get defensive (bullish sentiment was way too high - the post crash rebound market recovery was aged - my aggressive target above 1200 on the S&P was achieved - and the seasonally difficult May through October was in front of us. Today, I think it is time to get ready for another longer term (12 month) buying opportunity. Remember all past secular bear markets produced some strong positive years and I see one on the horizon. Here is my thinking. As we move through the seasonally difficult September and October months, I will remain patient and defensive (I remain in money market funds in my personal 401k). I am expecting another hard sell off by the end of October. I am looking to re-buy into the market when everyone else is selling. I'll be looking for an extreme pessimistic sentiment reading tied to a tentative re-entry target of 950 on the S&P 500. Sentiment is more important to me than the tentative 950 re-entry target. I'm getting optimistic for an attractive move higher from lower levels. We'll see how this plays out. Note – I believe the long term structural issues remain as does the LT Bear cycle.

Below is the most recent NDR Crowd Sentiment Poll. It is in the extreme pessimistic zone today. We've been working off an oversold condition (recent rally) but I won't chase it as the seasonal risk is too high. Also note the returns gained when an investor invests in the S&P 500 Index when tied to Extreme Pessimism readings vs. an investor who invests at Extreme Optimistic readings and reflect on the DALBAR study above. It is for this reason that I adhere to Sir John Templeton's sage advice, "Buy when everyone else is selling, and sell when everyone else is buying".



A Quick Look at PEs (better, but a ways to go):



With kind regards,

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1: INDEX DISCLOSURE INFORMATION. The Equity Composite Index is made up of the following: 18% S&P 500 Index (Large Cap), 18% S&P 400 Index (Mid Cap), 18% Russell 2000 Index (Small Cap), 22% NASDAQ 100 Index, 8% FTSE NAREIT Index, 8% MSCI World Ex US Index, 8% MSCI EM Index. Returns are rebalanced quarterly. Data source: Bloomberg and Pertrac. Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal to either the hypothetical CMG performance results reflected or any corresponding historical index. The composition/percentage weighting of each corresponding CMG index (i.e. S&P Total Return, Barclays Aggregate Bond, Dow Jones Industrial Average, S&P 500 Index (Large Cap), Tokyo Nikkei Average, Equity Composite Index, HFN/CTA Managed Futures Index, HFRI Macro Systematic Diversified Index) is also disclosed. For example, the S&P 500 Total Return Composite Index (the "S&P") is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. Standard & Poor's chooses the member companies for the S&P based on market size, liquidity, and industry group representation.

Included are the common stocks of industrial, financial, utility, and transportation companies. The historical performance results of the S&P (and those of all other indices) do not reflect the deduction of transaction and custodial charges, nor the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. The S&P is not an index into which an investor can directly invest. The historical S&P performance results (and those of all other indices) are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a CMG portfolio performance meets, or continues to meet, his/her investment objective(s). A corresponding description of the other comparative index, the Barclays Aggregate Bond Index (i.e., a fixed income index), Dow Jones Industrial Average, S&P 500 Index (Large Cap), Tokyo Nikkei Average Index, Equity Composite Index, HFN/CTA Managed Futures Index, HFRI Macro Systematic Diversified Index is available from CMG upon request. It should not be assumed that CMG program holdings will correspond directly to any such comparative index. The Equity Composite Index is comprised of S&P Index (Large Cap), S&P 400 (Mid Cap), Russell 2000 Index (Small Cap), NASDAQ 100 Index, FTSE NAREIT Index, MSCI World Ex US Index, and MSCI EM Index. The CMG performance results do not reflect the impact of taxes.

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