

Barometer Capital Report

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Executive Summary

For May of 2010, our Stock Barometer is reporting a very favorable reading in the 80-90 percentile bracket, the same as last month. Meanwhile, the Bond Barometer is reporting a favorable reading in the 50-60 percentile bracket, also no change from last month.

In accordance with our Dynamic Portfolio Management process, the stock allocation in our Model Portfolio remains at 100%.

In the month of April, the Barometer Model Portfolio achieved a solid gain of 1.6%. For the twelve months ending April 2010, the Barometer Portfolio recorded an excellent cumulative gain of 34.5%.

This month's Economic Commentary discusses the remarkably favorable trends exhibited by the latest profits of the S&P 500 Index companies.

Introduction

Barometer Capital LLC has developed proprietary econometric decision-rules that gauge the prospects for stocks and bonds over the next twelve months, based on the current status and direction of the U.S. economy and financial markets. The outputs of the model are combined with an innovative approach to risk management and an easy-to-implement portfolio management process to create the Barometer Investment Strategy. The result is a dynamic asset allocation process that systematically rebalances your portfolio to adjust to changing economic conditions.

This monthly report provides the information needed to monitor the performance of our investment strategy and to implement this strategy with your own portfolio.

May 2010 Barometer Readings

Each month our Stock and Bond Barometers gauge the prospects for stock and bond investments over the next twelve months, in light of current economic and market conditions. Both the Stock Barometer and the Bond Barometer readings are reported in terms of the percentile bracket in which they fall, with 0-10 being the least favorable bracket and 90-100 being the most favorable. More specifically, for both asset classes, a reading above 30 indicates that prospects are favorable while a reading below 30 indicates that prospects are unfavorable.

	Barometer Readings (Percentile Bracket)	Prospects	Historical 12-Month Forward Averages*	
			% Return	Periods with a Loss
Stocks	80-90	Very Favorable	22.3%	7%
Bonds	50-60	Favorable	11.2%	4%

* Based on the revised Barometer Economic Model as discussed in the Feb 2010 Economic Commentary.

This month's Stock Barometer reported a reading in the 80-90 percentile bracket, the same as last month. This reading is considered very favorable, at a level that has historically been associated with annual forward returns of 22.3% and a probability of loss equaling 7%.

The Bond Barometer reported a reading in the 50-60 percentile bracket, also the same as last month. Its reading remains favorable and is consistent with historical periods where long-term bonds delivered 11.2% average annual returns, while experiencing losses 4% of the time. The bullish Bond Barometer reflects the fact that long-term bonds were in a bear market for over 15 months, bringing their valuations to more reasonable levels based on historical relationships.

Model Portfolio Composition

Each month's Stock and Bond Barometer readings become the inputs to our Dynamic Portfolio Management process, which adjusts the recommended asset allocation in the context of changing economic and market conditions. Monthly allocation changes (if warranted) are systematic and relatively modest in magnitude, generally constituting less than 10% between asset classes.

Model Portfolio:	Apr 2010	May 2010
Stocks	100%	100%
Long-term Bonds	0%	0%
Cash	0%	0%

Due to the continued strength of our Stock Barometer, with stock market returns projected to exceed those of long-term bonds, the recommended portfolio allocation remains at 100%. In concert, the allocations to bonds and cash are both 0%.

April 2010 Results

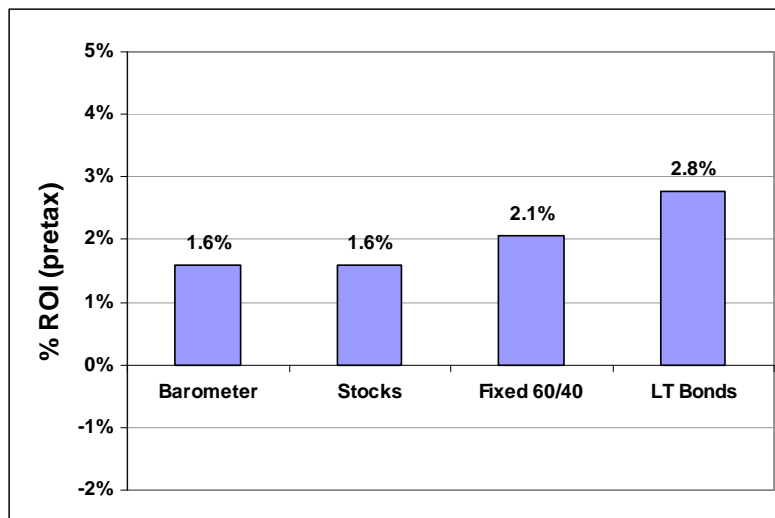


Figure 1: April 2010 Performance Comparisons

In April, the stock market continued its rally, as corporate earnings growth remained solid with analysts projecting significant increases in corporate dividend payments (see this month's Economic Commentary for further discussion).

In concert, the Barometer Strategy recorded a solid gain of 1.6%. Its return for the month was modestly lower than that of the benchmark Fixed 60/40 Allocation Portfolio* (1.6% versus 2.1%), which benefited from strong gains in the bond market.

Long-term bond prices registered a gain of 2.8% in April. Consistent with our favorable Bond Barometer reading in recent months, long-term bonds have been bullish recently.

May 2010 Economic Commentary

Amid the wild headlines (Greek bond crisis, computer-driven trading meltdown, etc.), the stock market has demonstrated remarkable stability and upward momentum. Why, many investors must wonder, with the economy in the early stages of a weak recovery and unemployment rates depressingly high, has the stock market not been brought to its knees by these recent unfavorable developments?

A significant part of the answer lies, I believe, in the trajectory of corporate profits (and their presumed future impact on dividend increases). Although there has been much written lately about Q1-2010 profits showing solid growth over the prior year (with more than 77% topping analyst estimates), these results have generally not been put in an historical perspective to gauge whether the current market is overvalued or undervalued.

To provide such perspective, the following chart graphs the trailing 12-month (TTM) profits of the S&P 500 over the last thirty years versus the long-term growth trend line.

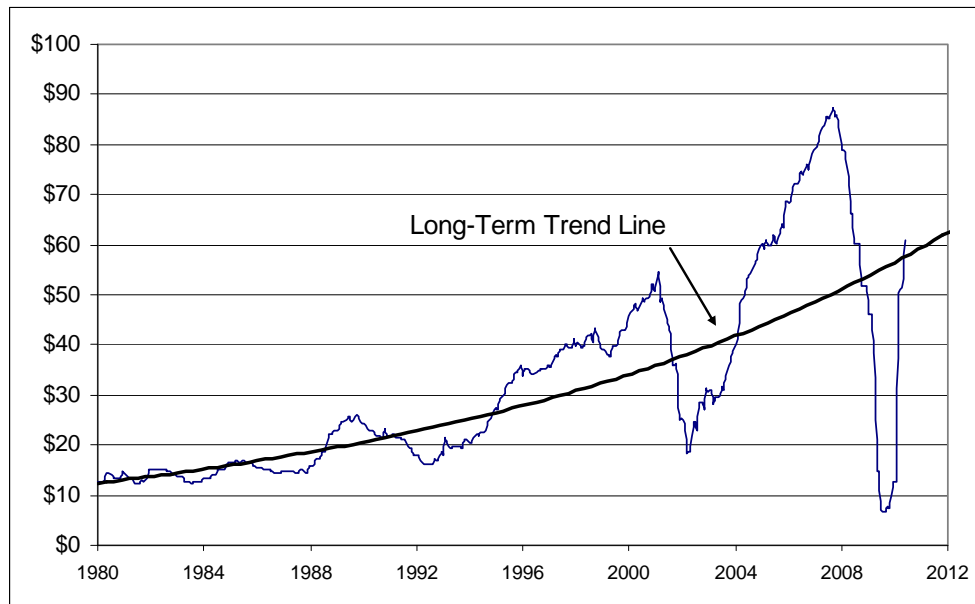


Figure 2: Trailing 12-Month Earnings per Share for the S&P 500 Index, Plotted against Long-Term Trend

As shown, the recent corporate profit recovery has been truly remarkable. After tumbling over 90% during the 2008-2009 financial meltdown, TTM profits have already returned to their long-term trend line. A substantial part of this recovery is due to the fact that the banking and financial services industries are no longer recording massive writeoffs due to the housing/mortgage crisis.

Also important: during the Big Recession, American industry made dramatic adjustments to their cost structures to maintain profitability in the face of rapidly declining revenues. Because of this

reengineering of their cost structures, corporations have been able to grow their profit levels impressively, even in the face of an economy that is expanding in fits and starts.

With profits at their long-term trend line average, this suggests that the stock market should be trading roughly at its long-term price-to-earnings ratio. Accordingly, given a median P/E ratio of 18.8 for the last thirty years, the latest TTM profits of \$61 translate into a target index level of 1,147, as compared to the 1,187 the S&P 500 registered at the end of April 2010. Clearly, on this basis, the market is not wildly overvalued, as suggested by a number of financial pundits following its 75% gains since the lows of March 2009.

Looking forward, assuming no new developments that again bring the economy to its knees, we can expect systematic profit growth, as corporations use their lean cost structures to translate even modest revenue growth into disproportionate profit growth. To this point, first quarter 2010 profits are already running at an annualized rate of \$69.50, up 14% from the trailing 12-month rate. Again at a P/E ratio of 1.88, this translates to an S&P 500 index level of 1,307.

So, based on corporate profits, the market appears fairly valued and well poised for further gains going forward - even in the face of an uneven recovery. In my opinion, this is a major reason why the market has been (and will be) resistant to the impact of unfavorable economic developments, as long as such developments do not threaten to again bring the financial system and economy crashing down.

Previous 12-Month Performance

Our Dynamic Portfolio Management system has been formulated with a twelve-month investment time horizon, which strives to maximize returns while significantly reducing the probability of experiencing losses over that specific timeframe. Accordingly, we track the Model Portfolio's cumulative performance over the previous year as the most relevant means of gauging the current success of our investment strategy.

	Model Portfolio Composition			Barometer Strategy	Monthly Return By Asset Type		
	Stocks	LT Bonds	Cash	Monthly Return	Stocks	Fixed 60/40	LT Bonds
May 2009	83%	0%	17%	4.7%	5.6%	2.3%	-2.7%
Jun 2009	83%	0%	17%	0.2%	0.2%	0.4%	0.7%
Jul 2009	83%	0%	17%	6.3%	7.6%	4.9%	0.8%
Aug 2009	83%	0%	17%	3.0%	3.6%	2.8%	1.7%
Sep 2009	83%	0%	17%	3.1%	3.7%	3.0%	2.0%
Oct 2009	92%	0%	8%	-1.7%	-1.9%	-1.7%	-1.5%
Nov 2009	100%	0%	0%	6.0%	6.0%	4.4%	1.9%
Dec 2009	100%	0%	0%	2.0%	2.0%	-1.1%	-5.7%
Jan 2010	100%	0%	0%	-3.6%	-3.6%	-1.1%	2.7%
Feb 2010	100%	0%	0%	3.1%	3.1%	1.8%	-0.2%
Mar 2010	100%	0%	0%	6.0%	6.0%	3.0%	-1.6%
Apr 2010	100%	0%	0%	1.6%	1.6%	2.1%	2.8%
12 Months	92%	0%	8%	34.5%	38.8%	23.5%	0.6%

Figure 3: Twelve Month Performance Comparisons Ending April 2010

Throughout the last twelve months, our Model Portfolio has been concentrated in stocks and, thus, has captured substantial gains from the continuing bull market. The result has been an excellent cumulative return of 34.5% for the last year, with gains in ten of the twelve months.

During this time, our Model Portfolio delivered a return that was 47% greater than that of the benchmark Fixed 60/40 Portfolio* (a gain of 34.5% versus 23.5%) with the same general exposure to risk.

Of note, the long-term bond portfolio experienced a breakeven performance over the period, totaling a mere gain of 0.6%. When bond investors rushed into U.S. Treasuries for safety during the financial panic of 2008, they bid up bond prices to unsustainable levels that have been under pressure over the last twelve months. Our Bond Barometer is gauging that this phase of weakening has now brought their valuation to more reasonable levels based on historical relationships.

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*As explained in the Barometer Investment Strategy, a Fixed Allocation Portfolio of 60% stocks and 40% bonds was chosen as the benchmark for comparison because it represents the typical ratio of stocks versus bonds in most pension plans, and it demonstrates a risk/volatility level that is roughly equal to the Barometer Strategy over the course of an economic cycle. Therefore, it provides a good measure of what professional pension fund managers are achieving at an equivalent level of risk.

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Before utilizing this report to make any investment decisions, the reader should be knowledgeable of the structure and specifics of this approach to investing, as available in the Barometer Investment Strategy presentation on our website. The disclosures and disclaimers of that document are included in this newsletter by reference.

Publication of this newsletter began in January of 2004. Historical results prior to that date reflect a back-testing of the model to determine the composition and returns of the Barometer Model Portfolio if the strategy and model had been in place at that time. No assets were invested during the periods shown herein; rather the historical results are intended to show what the returns would be had the strategy been implemented as discussed herein.

Performance statistics are based on actual results for the following no-load mutual funds and U.S. Treasury securities, which are used for illustrative purposes only as representative of the respective asset class:

- Stocks: Vanguard 500 Index (VFINX)
- Long-term Bonds: Vanguard Long-Term Treasury (VUSTX)
- Cash: 90-day Treasury Bills

The Barometer performance tracking assumes that the composition of the portfolio at the end of each month matches the Model Composition as detailed in the Barometer Capital Report for that month. Investors following this timing should be able to achieve results closely approximating the performance metrics published in this report. Nevertheless, our published performance results are for illustrative purposes only. Barometer Capital LLC cannot and does not guarantee that an investor's returns will equal the published returns in this report.

All investment returns are stated before taxes and commissions, which vary by individual.

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