# THE FULL SPECTRUM

Spectrum Financial, Inc.

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## GENERAL MARKET COMMENTARY

The index of US leading indicators rose in June for a third consecutive month, reinforcing signs that the economy may be emerging from the worst recession in five decades.

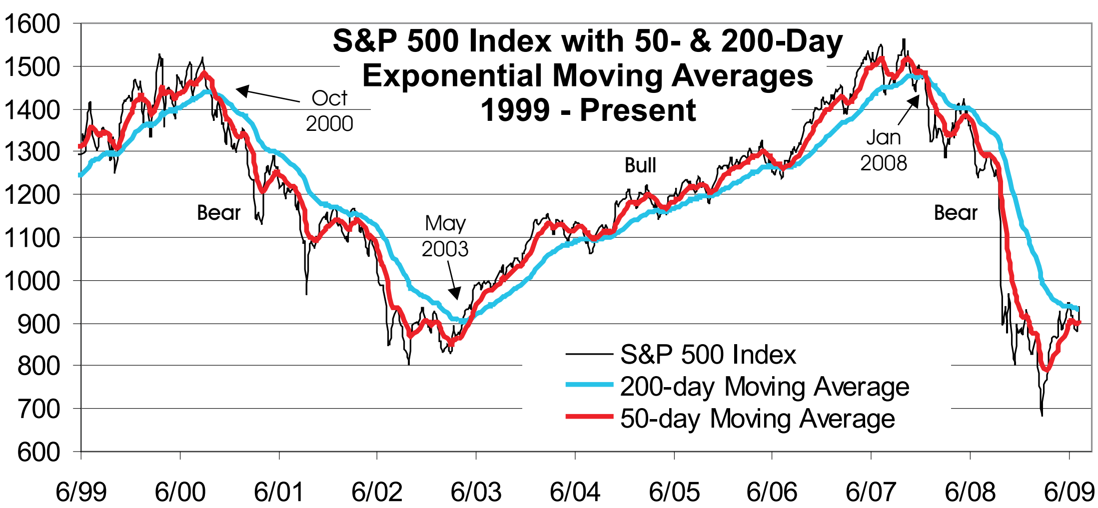
After a revised 1.3 percent gain in May, the Conference Board's gauge of the economic outlook for the next three to six months increased 0.7 percent, which was more than forecasted. The 36% rally of the S&P 500 stock index since March was the steepest rise in seven decades. While this reversal may be short lived, history has shown us that stock prices have extended their gains following the first major boost in consumer confidence from the severely depressed levels like we had in March.

We have been looking for signs of a new bull market unfolding lately while maintaining our investment philosophy of investing in a way that is reasonable and prudent. Our indicators currently seem to be at an inflection point, which requires careful monitoring.

The determination of the major trend is helpful in position sizing, so we tend to trade lightly when the major trend is down and get more aggressive when the trend confirms a bull market. While no indicators are always correct all the time, we review ones that can conceptually help us determine the major market trend.

The chart below shows the S&P 500 stock index for the past 10 years. Superimposed on the chart is the 50-day exponential moving average (red) and the 200-day exponential moving average (blue). When the 50-day moving average crosses the 200-day moving average, a change in trend may be indicated. While this indicator is certainly not infallible, it has been shown to be quite accurate going all the way back to the depression.

In fact, trading it then would have proved quite profitable. We can see from this chart that we may be close to a trend reversal. Another major move higher will likely cause this indicator to signal a new bull market.




## RANDOM PREDICTIONS

The US economy should continue to move to a recovery, beginning late 2009 by inventory rebuilding, with unemployment eventually approaching 11%. The stock market should have a better year in 2009 than it may have in 2010 when we have the choking effects of income tax surcharges, dealing with health care deficits, stimulus hangovers, higher energy costs, commodity inflation, and higher interest rates.

Interest rates should be higher based on the expected economic recovery, and corporate bonds should still outperform government securities. Mortgage rates should go up next year as the housing market stops the free-fall. This is a great time to be buying a home, as we should have the combination of low house prices and low interest rates. This may be the best opportunity for buying a home that we will ever see in our lifetime.

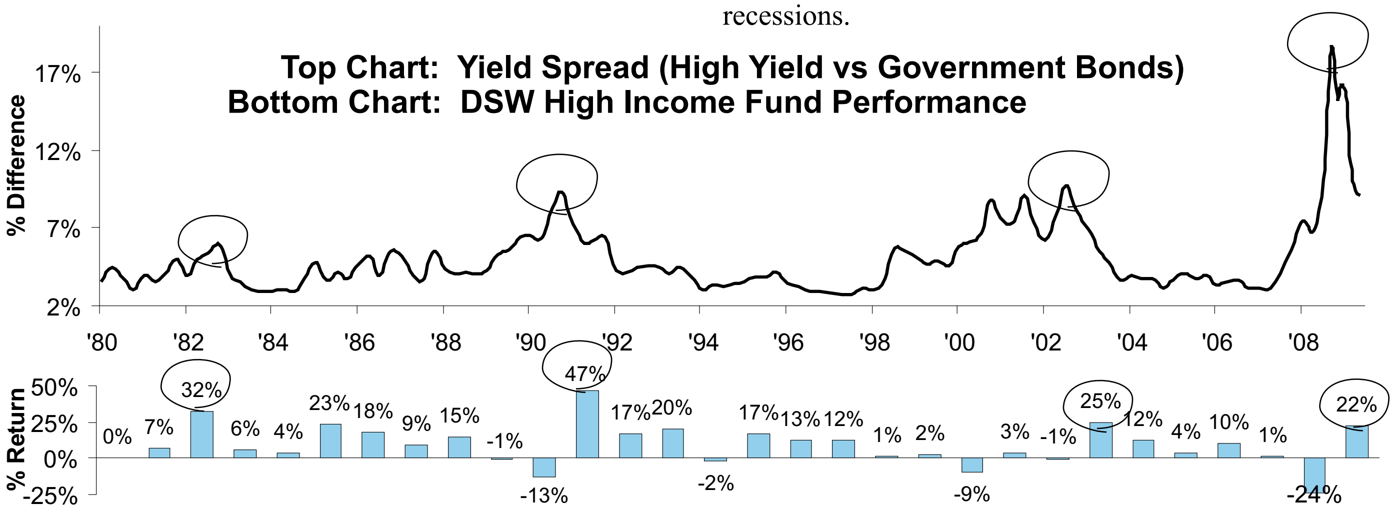
Inflation will not be a problem in 2009, but we continue to see bad things happening in late 2010 and 2011. This will be due to monetary debasement inflation, not demand-based inflation. This should be good for real estate, particularly foreign real estate. The socialistic leanings of the controlling Democratic Party in Washington will cause a weak dollar, as well as the flight of business capital from America to more profitable markets and lower tax rates in other countries.

International investing may be the place to be, due to foreign currency appreciation and the fact that emerging markets, particularly Asia, should continue to be the growth engine. US equity returns should be modest at best, with corporate bonds, but not treasuries, being a safe bet.

We believe the markets will continue to cause buy and hold investors much anxiety and limited profits.

## THE CASE FOR BONDS

After an amazing high yield bond market rally last quarter, many are asking if there is more to come. We mentioned in our last two newsletters that the case for bonds was better than the case for stocks over the near term. While the easy money may have been made this past quarter on high yield bonds, there should be much more to come. Three factors will determine high yield bond returns going forward. The first is the current yield of the bonds, now at about 13%. Secondly, adjustments for loan defaults should slightly drop the yield. However, the third and most profitable factor should be due to price appreciation of the bond portfolio coming back into a more normal yield spread as the recession ends. While there are no guarantees, we expect double-digit returns going forward 12 months, regardless of what the stock market does for the remainder of this year. The chart below (since 1980) illustrates the history of the profit potential of high yield bonds following recessions.




Annual return performance numbers for DWS High Income (KHYAX formerly Scudder-Kemper High Yield) were obtained from Bloomberg. The 2009 performance is year-to-date (7-20-09). Dividends reinvested, sales loads not included. Past performance does not guarantee future results. A fund prospectus should be carefully read to evaluate the fund's objectives, risks, charges, and expenses before investing.

## PERSONAL PERSPECTIVE *by* Ralph Doudera

Last week, at the age of 32, we lost our daughter-in-law Laura, after several years of fighting cancer. As a loving mom, wife, and friend, she filled our lives with love, grace, humility, kindness, and joy. She is missed by all whose lives she touched.

As I play with her three-year-old son Lucas, something inside of me screams "this is not right". I contemplate issues of justice and fairness, and argue with God a bit. I try to read my Bible looking for answers.

I find this scripture: *Precious in the sight of the LORD is the death of his saints.* (Psalm 116:15) That certainly defined her. But that doesn't really make me feel much better.

What is the gift of life? It is not longevity, but quality and purpose in fulfilling God's call on our lives. It occurs to me that Jesus completed his life's work in 33 years. It also occurs to me that this life is nothing more than a vapor with eternal consequences, the impact of which we will never know this side of eternity. One small, seemingly random act of kindness may be quite significant in the eternal picture.

So God, I ask for grace to deal with my mistaken notion of justice, and I ask for your Presence to deal with our loss.

*"Steady plodding brings prosperity; hasty speculation brings poverty" (Proverbs 21:5, LB)*



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