# THE FULL SPECTRUM

Spectrum Financial Inc.

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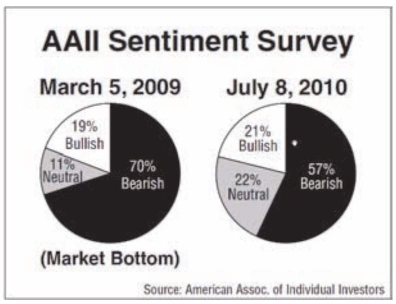
## GENERAL MARKET COMMENTARY

Fear has been dominant in the equity markets, reflecting concerns over the US debt, the European banking crisis, high unemployment, falling consumer sentiment, slowing housing starts, slowing growth in China, and the BP oil spill, not to mention the memory of the market crash of last year still fresh in investors' minds. When investors head for the exits in massive numbers, it may provide the way for a recovery rally of tradable significance. While most bull markets climb a "Wall of Worry", this market has to surmount a "Wall of Fear".

The AAII Investor Sentiment Survey taken in early July showed that 57% of investors expected the market to go down over the next six months—the *highest level since the March 2009 bear market bottom* (see chart). The percent of bullish investors dropped substantially from April highs leaving bears outnumbering the bulls by a ratio of 2.7 to 1.




According to a study by InvesTech Research, when the bear-to-bull ratio rises above this level, the DJIA was up an average of 5.4% after three months, and up 11.4% after 6 months. In contrast, the confidence level of corporate executives is holding steady near the best level in five years. High yield bonds, which also reflect the general tone of the business recovery, have also held near their highs, indicating that a stock market rally may not be far away.

What happens after the market reaches extremes like these five years later? While the most dramatic rebound of stock prices takes place in the first year following the low, the next four years still produce very solid market performance, with the total 5-year return averaging over 100%.

**Market Performance after Bearish Extremes**

| Date | Ratio % Bears to % Bulls | DJIA Gain/Loss 3mos later | DJIA Gain/Loss 6mos later |
|---|---|---|---|
| 10/08/1988 | 2.9 | +2.0% | +7.2% |
| 02/03/1990 | 3.2 | +3.3 | +10.1 |
| 08/18/1990 | 3.3 | -3.6 | +11.0 |
| 09/05/1992 | 3.0 | +0.2 | +3.6 |
| 02/22/2003 | 2.8 | +6.2 | +17.5 |
| 01/12/2008 | 3.0 | -2.2 | -11.9 |
| 03/07/2009 | 3.7 | +32.2 | +42.5 |
| **07/10/2010** | **2.7** | **?** | **?** |
| | **Avg =** | **+5.4%** | **+11.4** |

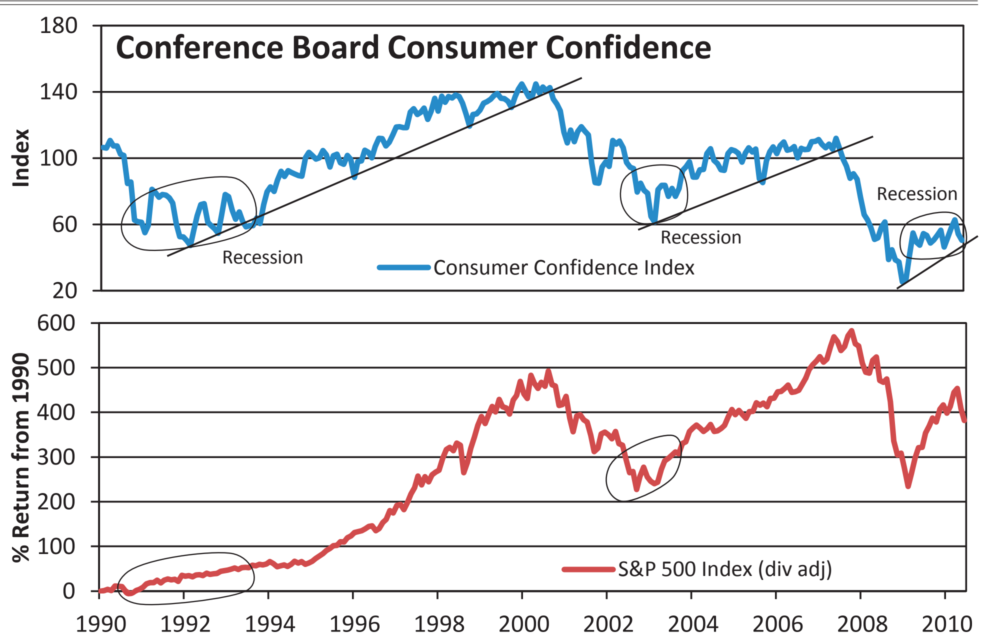
InvesTech Research

What are the possibilities of a double dip recession? Most are unaware that there has been only one double dip recession in more than 80 years. This, of course, does not mean that we can't have one now. What would cause us to reevaluate this position? 1) A stock market drop below recent July lows. 2) High yield bonds begin to weaken. 3) Our proprietary bull market signal may give us a sell signal, currently edging very close to the cliff of a bear market.

As always, we remain unwilling to forecast future market trends, but we let our trading strategies be our guide to determine our investment tactics. They have always been reliable in determining levels of financial commitment. We have found that over the years we need to recognize that the trend is your friend, and currently the trend still looks to be up.

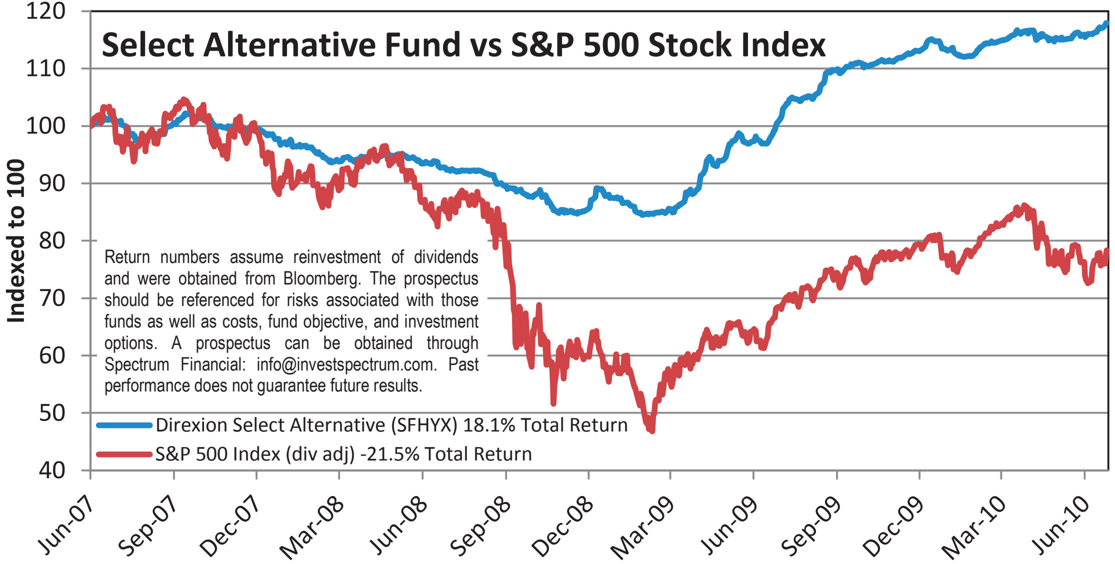
## CONSUMER CONFIDENCE

The consumer confidence number is an important one to watch, because its trend normally indicates the trend of the stock market. The chart to the right shows the correlation between the direction of consumer confidence and the performance of the S&P 500 Index for the past three recessions in 1990, 2002, and 2008. A break of the uptrend line of the consumer confidence should be watched carefully, but the current movement at 50.4% indicates stability and should keep prices moving higher as in past recessions. A break below 40 may indicate another market slide and tougher times ahead.



## DIREXION ACTIVELY MANAGED FUNDS

The Select Alternative Fund continues to move to new all-time highs on very low volatility. It is a fund with very little stock market exposure with primary holdings of bonds, preferred stocks, alternative investments, and other non-correlated investments, and is very actively managed. The chart illustrates the past three years and the fund (SFHYX) is up 18.1% compared to a loss of 21.5% for the S&P 500 Stock Index.

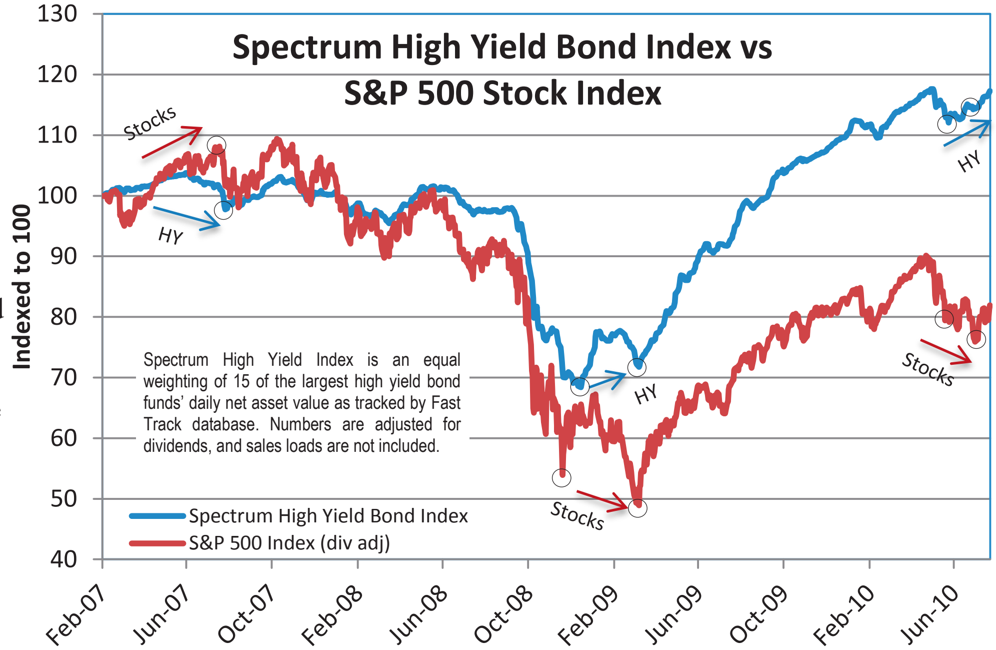


## HIGH YIELD CORPORATE BOND UPDATE

One indicator which we find particularly interesting is the direction of high yield bonds compared to the direction of stocks.

The chart below illustrates the performance of Spectrum's High Yield Bond Index (an average of 15 of the largest high yield bond funds), and the S&P 500 Stock Index. High yield bonds are one of the best indicators of the underlying strength of the economy. When they are weak, it indicates that companies are beginning to have trouble borrowing money, and may have to pay higher rates for loans. As a result, investors begin moving to safer and higher-grade bonds. We have found that the underlying trend of the stock market is influenced by the underlying trend of the high yield bond market, more so than vice versa.

A key to the stock market direction can be observed by periods when these two indices diverge. This occurred in the spring of 2007 when stocks rallied and high yield bonds sold off, indicating that the next major move in stocks would be lower. Also noteworthy was the stock market low in March 2009 was not confirmed by high yield bonds. This also occurred recently in July when the major market sold off to break below support, but high yield bonds were higher, indicating that the next major move in stocks should be up. This is illustrated on the chart below. As long as high yield bonds remain strong, the downside risk of owning stocks remains lower, and currently indicates better times ahead.




## PERSONAL PERSPECTIVE *by* Ralph Doudera

I spent the past few weeks in Costa Rica working on some development projects there, surfing, and letting my daily routine slow down enough to regenerate my creative side. My study guide was the most profound dissertation in the Bible—Jesus' Sermon on the Mount, Matthew 5-7. This study should be of interest to everyone, and is particularly challenging for me. I remember someone in my more youthful days suggesting that this teaching be read weekly or memorized. If I am having any kind of problem today, this passage will cover the solution. It also declares that it is not my knowledge of God's teaching for life which will give me peace, but my behavior—whether I actually do what He says to do. One issue in this teaching still continues to challenge my behavior "don't judge others unless you also want to be judged".

Now that the year is half over, I find myself reviewing how committed I have been to my New Year's resolution. I made only one this year that has been quite a challenge for me, since a lifetime of entrenched habits can keep changes from happening as they give a tenacious fight to their death. But it has come to my attention that I have a judgmental streak that is not an endearing quality. My New Year's resolution has been to stop speaking my judgmental thoughts. Not speaking them is only the initial issue, as the root of the problem comes from *thinking* them. I need to ask myself if what I am saying is, in fact, a true statement. At least I am becoming aware of my bad habit, and am willing to recognize and confess it as it occurs. That is the first step to behavior change. I don't want to grow old and grow hardened in my bad habits.

Want a challenge? Read the entire Sermon on the Mount and see what jumps off the page at you. There is enough material there for anyone to be challenged with an issue that they may currently be dealing with. Maybe my next year's resolution will be to "love my enemies and pray for those who despitefully use me". This year's challenge seems a bit easier.

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



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