THE FULL SPECTRUM

Spectrum Financial Inc.

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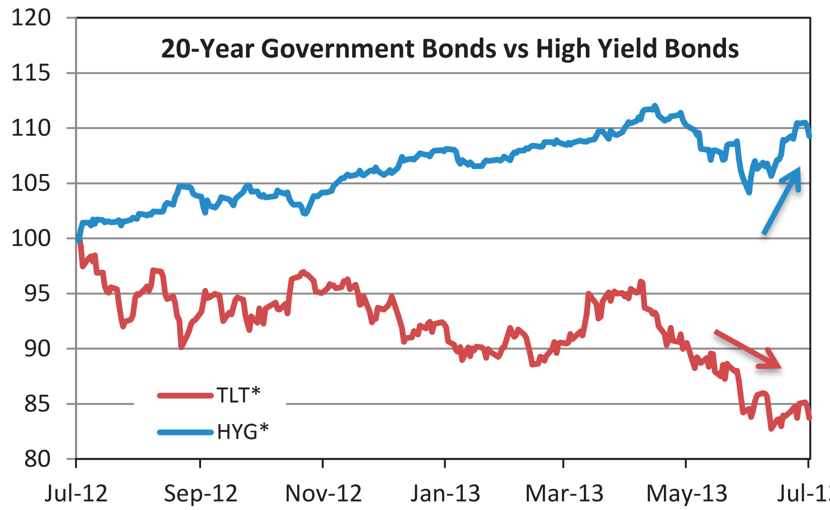
GENERAL MARKET COMMENTARY

The first half of the year has surprised many investors with stock prices up sharply and the price of bonds sharply lower. The Federal Reserve's announcement of the possibility of tapering off its $85 billion monthly bond purchases later this year caused an abrupt ending of the bond bull market, sending yields sharply higher and temporarily ending the stock market's bull run. The question that all investors are asking now is "What does this all mean to the stock and bond financial markets?"

The stock market and the bond market may have different answers to this question. Looking at the past 11 periods of interest rate hikes by the Fed since 1960, the stock market was higher 12 months later 73% of the time. Moreover, the majority of those times showed double-digit gains. In the 17 instances where 10-year treasury yields rose at least 1% from a low, the stock market was higher a year later over 70% of the time. Of course, the reason for this reaction is due to the fact that the Fed only tightens money when the economy is strengthening and profits are increasing. Eventually higher interest rates cause the economy to stall, and a recession ends the party.

The bond market, on the other hand, may suffer losses in a rising interest rate environment. The worst damage will be to the highest quality government bonds with the longest maturity. For example, the TLT (iShares 20+ year treasury bond ETF) was down 16.5% for the one-year period ending July 24, 2013. Bonds that should be minimally affected would be high yield bonds. The return for the high yield HYG (iShares High Yield Corporate Bond ETF) for the same one-year period was a gain of 9%: quite a divergence (see chart this section). Other bonds that should do well would be shorter duration bonds, or floating rate funds, which do not carry much interest rate risk.

Other types of favorable fixed return investments would include money markets, inflation-protected bonds, callable mortgage backed securities, or adjustable rate mortgages.

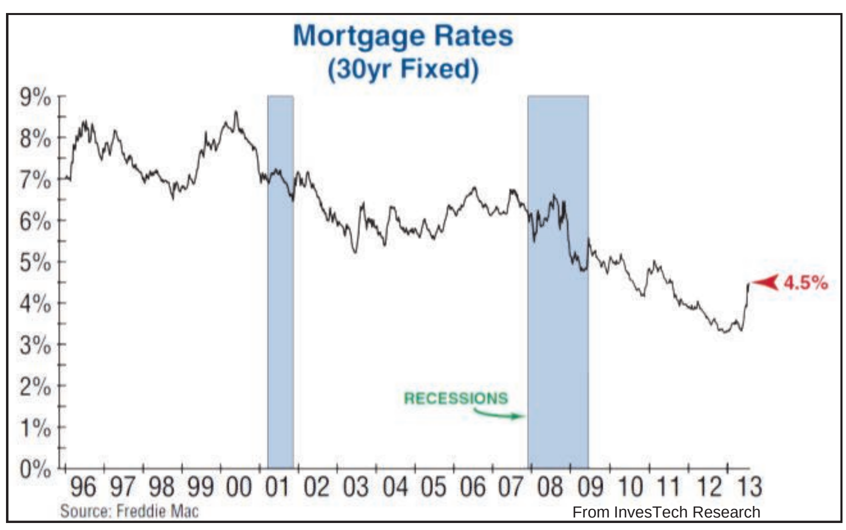


Performance numbers, indexed to 100, obtained from Bloomberg. *ETF's represent iShares 20+ year treasury bond ETF (TLT) and iShares High Yield Corporate Bond ETF (HYG). For additional information please refer to their prospectuses.

HOUSING UPDATE

The real estate housing market continues to gain strength. Sales of new US homes rose in June to the highest level in five years, pointing to gains in residential construction that will support the economic expansion in the second half of the year. Purchases surged 8.3%, the highest level since May 2008 due to growing employment, and the desire to take advantage of historic low borrowing rates before they rise further. Housing inventories remain low and prices are increasing. Building permits are near a post-recession high and housing starts are sitting near the top of an uptrend that has been building since 2011.

As inventory is reduced and prices increase, the housing situation may form another bubble, which can have a bad ending once again. As rates increase, it limits buyers to qualifying for a less expensive house, eventually pricing them out of the market. Recently, the rate for a 30-year fixed mortgage moved up faster than anyone can remember, going from a low of 3.4% in May, to a current rate of 4.5%. Even though this is an increase, it is still attractive compared to four years ago. (see chart below)



RISING INTEREST RATE RISK

Spectrum continues to get many questions about investing in bonds in a rising interest rate environment.

The study below shows an updated chart illustrating every period of rising government bond rates for four or more quarters since 1982. These results show that while government bonds can have loses due to interest rate risk, high yield bonds can have gains. The primary reason for this is that interest rates generally increase when economic indicators are improving, causing government bond prices to go down. However, an improving economy reduces the risk of owning high yield bonds because they should strengthen as their credit rating improves. High yield bonds act more like stocks than bonds in a favorable economic environment. This is consistent with the Federal Reserve's commitment to keep rates low until the economy is stronger. We believe high yield bonds should have more room to continue to be profitable in any case. An impending recession would provide reason to reduce high yield bond exposure due to the fact that risk of default is high. By moving to a cash position when a recession becomes likely, we will be in a position to reinvest the funds and take advantage of a purchase at much lower prices.

Period Ending	# of Quarters with Rising Interest Rates	Annualized Return (Including dividends) CSFB High Yield Index (CSHY)*	Annualized Return (Including dividends) 30-Year Government Bonds (GT30)*
Jun-84	7	2.4%	1.8%
Sep-87	5	5.2%	-7.0%
Dec-94	5	2.7%	-6.5%
Mar-97	5	11.1%	-3.0%
Dec-99	5	4.9%	-20.7%
Jun-04	7	20.6%	0.8%
Jun-06	4	5.0%	-5.7%
Mar-10	5	46.6%	-9.1%
Jun-13	4	9.2%	-5.3%

The CSFB High Yield Index (CSHY) is designed to mirror the investible universe of the $US-denominated high yield debt market. *Data obtained from Bloomberg.

PERSONAL PERSPECTIVE *by* Ralph Doudera

One of my favorite movies is *The Book of Eli*, where God gives Denzel Washington a seemingly impossible task. Of course, no one knows what it is until the movie ends. Everyone thinks he is crazy, but he follows God's instruction on a moment by moment basis. He refers to his mission as "heading west". His careful obedience results in amazing intervention and protection as his life is upheld until his assignment is accomplished.

I ask myself daily, "whose voice am I listening to today?" God's instructions in the Old Testament are revealed in the first of Ten Commandments that states, "You shall have no other gods before Me". Hmm, what are the things (gods) which try to get in my life today before Him? What am I thinking about? What do I want right now? What can't I live without? These become my gods.

Turning to the New Testament, this is stated another way in the Lord's Prayer. "Thy Kingdom come, Thy will be done, on earth as it is in heaven." In the good old days, I prayed this every day in grammar school. Said another way –"God, establish Your kingdom in my life today where you are God, and I am your servant". What is a kingdom? It is a place where the King rules and I live to carry out his purpose.

When asked by his disciples what the greatest commandment was, Jesus answered: "You shall love the Lord your God with all your heart, mind, and soul, and the second is similar, you shall love your neighbor as yourself." Jesus also said, if you love God, you will obey Him, otherwise it is just religious talk.

Who am I listening to this morning? Am I even trying to listen, or is the roar of my own agenda dulling my reception? Am I on the road heading west? Or is the attraction along the side of the road just interesting enough to seductively slip into the number one slot today? I think I will watch the movie again. Join me, but buckle up your seatbelt for this ride, and ask yourself the same question.

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

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