THE FULL SPECTRUM

Spectrum Financial Inc.

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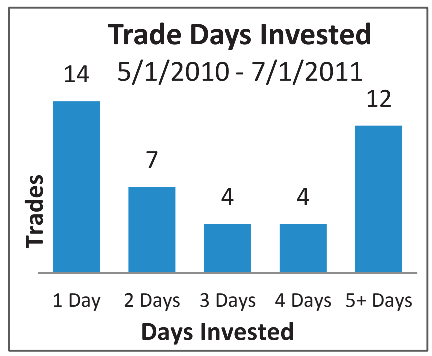
GENERAL MARKET COMMENTARY

The markets are quite concerned about the current budget deficits, and they do not like uncertainty. A government shutdown certainly would cause insecurity among investors, as no one has figured out exactly what would happen if a budget disagreement were to continue indefinitely. My take on it is that once the issue is settled, it will turn loose a large amount of cash sitting on the sidelines. The financial markets tend to look forward 6 to 9 months and are a good predictor of future events. We are now two years into an economic recovery, and it would be quite unusual for it to turn down at this point in the cycle, particularly now that the Federal Reserve remains holding interest rates at essentially zero.

High yield bonds had a nasty selloff recently on concern that Europe's sovereign debt crisis was spreading and the economic recovery is faltering. However, yields are so low on government bonds that the high yield bond is still attractive compared to the alternatives. In addition, defaults continue to decline, with forecasts that the high yield default rate will drop to 1.6% early in 2012 from 2.5% a year earlier. The current yield on high yield bonds is 7.4%, or 4.5% more than the equivalent government bond, creating a better investment opportunity even considering the default issue. We expect this market to remain firm as long as the debt crisis remains contained.

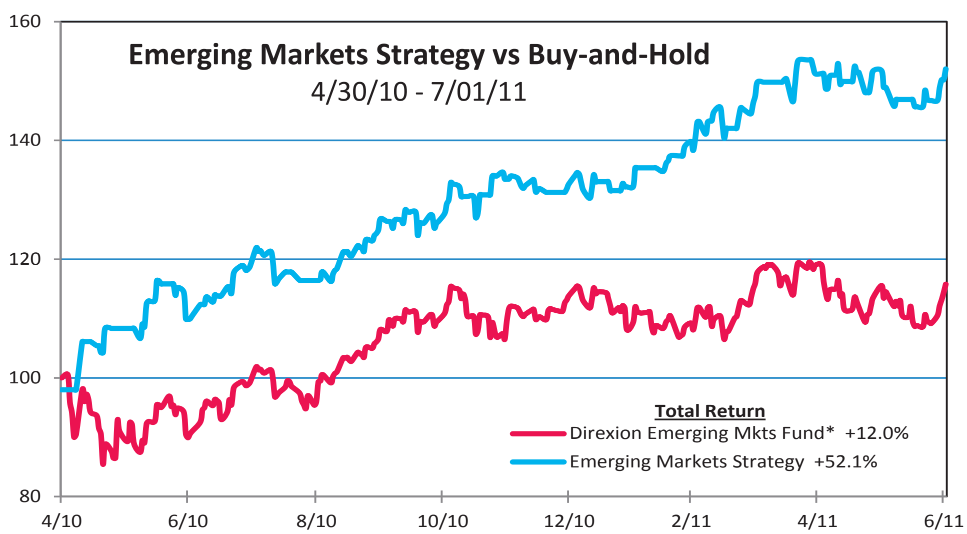
EMERGING MARKETS STRATEGY

Growing emerging market economies have been one of the best places to invest for the past decade. Since its inception in 2003, the EEM (emerging markets exchange-traded fund) has had an annualized return in excess of 20%. However, few people can afford to use an EEM buy-and-hold strategy since it is so volatile. Normal corrections are 10% to 15%, and the bear market of 2008 showed a decline of over 67%. We have been actively trading the EEM since 2004, and continue to observe and learn its "trading personality". Our enhanced Emerging Markets Strategy has been active since May of 2010 and has the objective of gaining steadily in all kinds of markets, without experiencing substantial drawdowns. It is very actively traded, having 41 round trip trades since May 2010, and has been invested only about 60% of the time. Basically, it daily asks the question: "Should I be in emerging markets stocks tomorrow?" You can see from the chart on the right that the majority of trades were two days or less. Relying on technical indicators such as rate of change, candle stick charts, premium/discount, and short-term oversold/overbought indices, plus a "common sense" element, we make a daily evaluation. As you can see from the chart below, our real time trading model, using Direxion Funds EM fund (DXELX), had a return of 52.1% with a maximum drawdown of 5.1%, whereas the DXELX buy-and-hold was up only 12% with three drawdowns in excess of 9% over that same period.



We have used the DXELX fund for our emerging markets trades since it has no trading restrictions. We have adjusted our exposure to reflect a 100% emerging markets exposure for each buy signal. While this system has been utilized as an "all in" or "all out" system, refinements will allow a combination of strategies to further improve performance by allowing the possibility of occasionally being up to 150% invested.

While the numbers shown are real-time performance numbers, a hypothetical blend of two emerging markets strategies has been tested for the past eight years and has shown consistent gains with controlled drawdowns in both bull and bear markets. Call our office for more investment details.



Emerging Markets Strategy performance is calculated by applying actual buy/sell signals to the underlying benchmark DXELX – Direxionfunds Emerging markets Fund. *DXELX is a 2 Beta fund which allows for 200% exposure of the EEM (underlying index). For comparison purposes, DXELX performance was adjusted to 100% exposure (1 Beta). Spectrum's Emerging Markets Strategy for this time period does not exceed 100% exposure (1 Beta). Management fees are 2% and are deducted annually in advance. Past performance does not guarantee future results. Investors should obtain the fund prospectus and read it carefully to evaluate the fund's objectives, risks, charges, and expenses before investing.

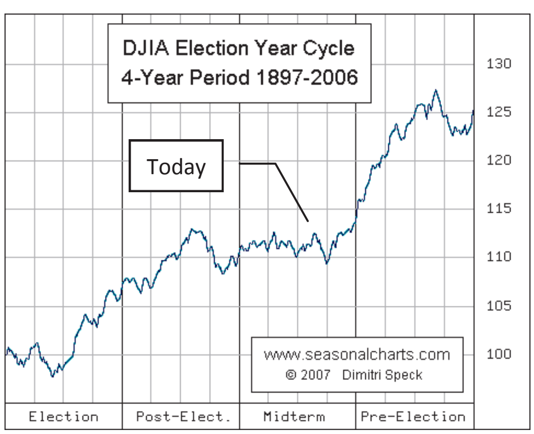
BULL OR BEAR MARKET?

The chart above illustrates one indicator which should not be overlooked by investors. It shows the 50 and 200 day exponential moving average of the equal weighted S&P 500 stock index (RSP Exchange Traded Fund). Whenever the 50 day moving average crosses below the 200 day moving average, unpleasant things can happen to investors. You can see the sell signal generated in November of 2007, and a buy signal in July of 2009. Currently, the moving averages are converging, and the uptrend has stalled. We will continue to monitor this indicator closely.

PRESIDENTIAL CYCLE

Halfway through the third year of a Presidential Cycle, it is time to review history. Despite all the present gloom and doom about the economy and the stock market, there has never been a negative return in the stock market during the third year of any president's four-year term since 1939. Of course, we have not had the current problems of excessive debt, high unemployment, and economic lethargy. With stocks up very modestly for the first half of the year, let's look at history.

Usually, the year immediately following a president's election is negative. Obama's first year, however, was extremely positive. The stock market lows occurred in March of that year and the S&P 500 Index gained 26.4% in 2009 and then another 15% last year. Only once in the last 72 years has the S&P 500 closed more than 10% below its previous end-of-year close during a president's third year in office. On the other hand, the index has gained over 10% (or more) at least once during the third year on 15 out of the last 17 occurrences.



There are political reasons for this cycle which makes economic sense. When a new president is elected, he makes the hard choices and absorbs any negative fallout in the economy in his first and second years. Raising taxes or cutting spending are simply two examples of a new administration "biting the bullet" early on. By year three, reelection considerations come to the forefront.

The state of the economy is usually a major determinant on who will be elected and what party will dominate the political arena. It is already clear that the economy will be the major factor in next year's presidential election. Traditionally, the sitting president will do everything in his power (whether a lame duck or not) to insure that his party gets the most votes possible.

The problem this time around is that the Obama Administration has already done everything in its power to both stimulate the economy and get people working again. The Federal Reserve Board, supposedly above politics, is already doing all it can to stimulate the economy. Tactics such as reducing interest rates and other "easy money" policies are already in place and have been for two years. They don't have a lot of tricks left to stimulate the economy, but don't rule out some new unprecedented move on their part to keep things stable for the short-term. Longer-term, we may see our currency lose value and may see hard assets continue to rise. However, when economic cycles are moving up, it takes a lot to slow it down, and the Federal Reserve should continue to keep things positive for stock prices for the remainder of the year.

PERSONAL PERSPECTIVE *by* Ralph Doudera

One of my eight-year-old's favorite expressions is "that's not fair!" Most people are also upset by any perceived unjust result of our court system. All of us have a little voice inside of us that cheers when the bad guy in the movie gets what he deserves. Since we are all made in God's image, we retain His character which demands justice. But often we mistakenly take it into our own hands and get into trouble. The Apostle Paul said it this way: *Don't insist on getting even; that's not for you to do. "I'll do the judging," says God. "I'll take care of it." Romans 12:19 (Msg)* And Jesus said it a bit differently: *"Blessed are you when people insult you, persecute you and falsely say all kinds of evil against you because of me. Rejoice and be very glad, because great is your reward in heaven… Matt 5:11-12a (NIV)*

Be very glad? A great reward? The Bible is saying that we will all eventually get what we deserve. Justice. But it may not be on our own timetable. Every injustice to us will be made right, and we will be accountable (justice) for every activity where we may have thought we got away with something. The Bible says: *For no other foundation can anyone lay than that which is already laid, which is Jesus Christ, the Messiah. But if anyone builds upon the Foundation… the work of each one will become shown for what it is; for the day of Christ will disclose and declare it, because it will be revealed with fire, and the fire will test and critically appraise the character and worth of the work each person has done. If the work which any person has built on this Foundation survives, he will get his reward.* 1 Cor 3:11-14 (AMP)

Sometimes I also have the short term perspective of an eight-year-old. I have been learning that injustice from my view is temporary and will eventually be made right. There will be a day when everyone will get justice, including those who take unfair advantage of me today. It makes life so much easier for me to handle, when I realize that God will make things right, and I don't have to. It helps me forgive offenses quicker and easier, and that makes my life a lot more pleasant. Since we will get what we deserve, I want to live my life with that thought in mind so I won't be surprised.

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

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