THE FULL SPECTRUM

Spectrum Financial, Inc.

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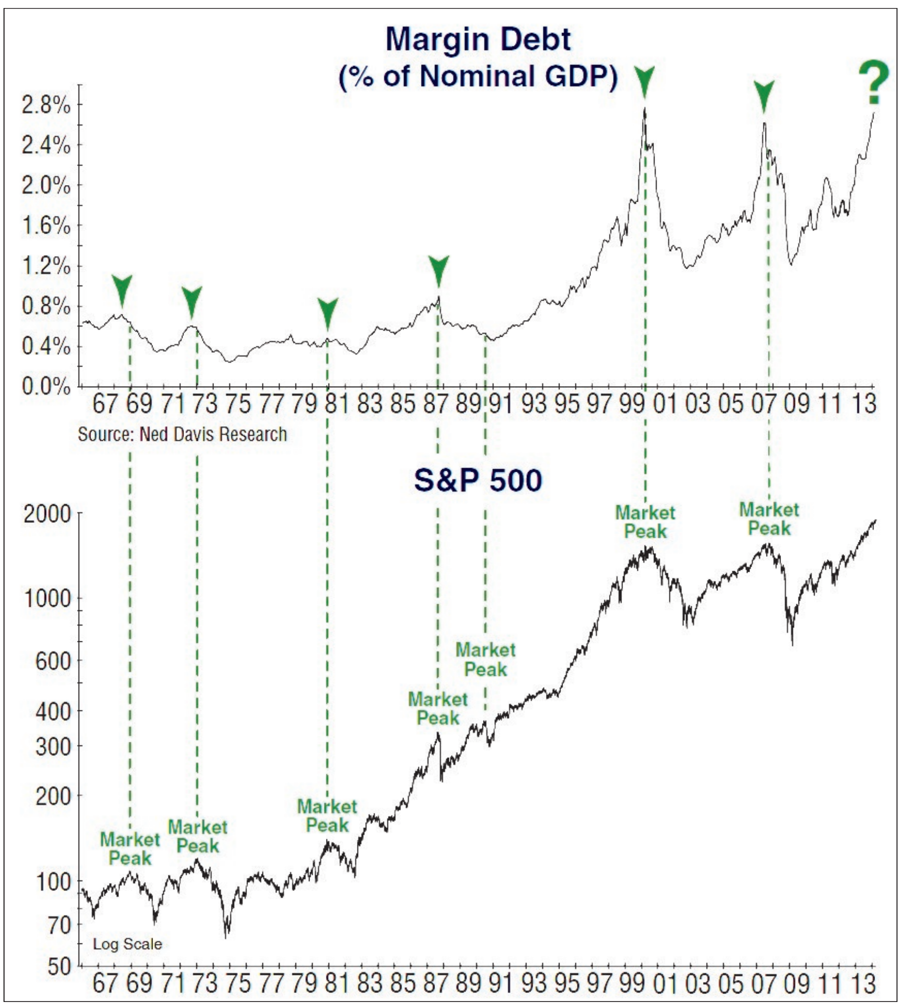
GENERAL MARKET COMMENTARY

The stock market has clearly been getting attention for the past year as people start forgetting about the risks of investing. It likely has more room to run. Investment bubbles have always been with us, and while they are fun to participate in, when they happen, investors need to know that they should have a seat near the fire exit. We remember so well the tech Internet bubble in 2000, the real estate bubble in 2007, and the gold bubble in 2011. There is always a very nasty wake up call for investors when it all ends. We currently may have an IPO (initial public offering) bubble of new companies trying to get their stock issued in one of the more speculative frenzies since 2000.

While stock valuations are not overly extreme at this point, the Price/ Earnings Ratio of the S&P 500 is at 18.9. The long-term average of this indicator is 17. At market peaks, this number has historically exceeded 25 before a bear market brought it back down.

What issue seems to be the most threatening issue at this time? Debt! While riding out a market correction when you own an asset can create some discomfort, investing with borrowed money can potentially cause a major crisis. Ask upside down homeowners who borrowed against their houses and then wanted to sell them for less than the loan amount. We see this happening now in the stock market with margin debt. Margin debt is another way to monitor the degree of excesses in our aging bull market. Aggressive investors can borrow money for nearly nothing due to the Federal Reserve interest rate policies. Interest rates of 1 or 2% can cause dislocations in the financial markets. When these investors are forced to sell to pay back the loans, bad things can happen. Peaks in margin debt usually precede or accompany the peaks in past bull markets (noted by dashed vertical lines). Once margin debt starts to unravel, the risk of uncontrolled selling exists, causing margin calls and forced liquidation.



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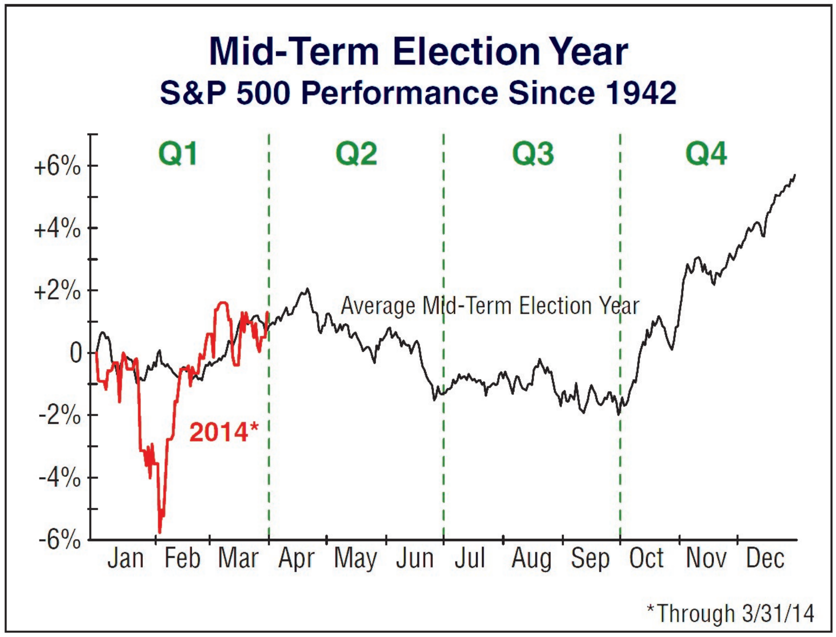
The charts here illustrate this tendency and no one knows how long it will continue, but when it turns down, prices can drop very quickly. Fundamentals indicate that the economic expansion should continue at a very modest rate, keeping the Federal Reserve from raising rates anytime soon, but continuing to taper their aggressive bond buy-back program. Consumer confidence remains high, leading economic indicators continue to expand, the advance/decline line remains favorable, and the yield spread on high yield bonds remains extremely low, paying only 3% more than government securities. Before any recession is on the horizon, this spread tends to move higher and rewards riskier bonds with a greater dividend anticipating higher defaults. In 2007, the spread went from 3% to 8% in less than a year. As long as these spreads remain low, high yield bonds should continue to produce positive returns, but if the yield spread begins to rise, it will be prudent to avoid exposure to them until a better entry opportunity.

MID-TERM ELECTION CONCERNS

While the S&P 500 moved to a new all time high recently, the market corrected sharply right after the first quarter began. Historically, there has been a strong correlation between the 4-year presidential cycle and the stock market. The first and second years of the cycle have been the weakest for the market. Only three of the sixteen quarters have seen negative average returns in the S&P 500, and these are two of them. The chart to the right illustrates the S&P 500 daily change for the past 18 mid-term election years. Despite a 6% market correction in Q1 of 2014 (Red Line) the index ended the quarter right in line with its historical track record.



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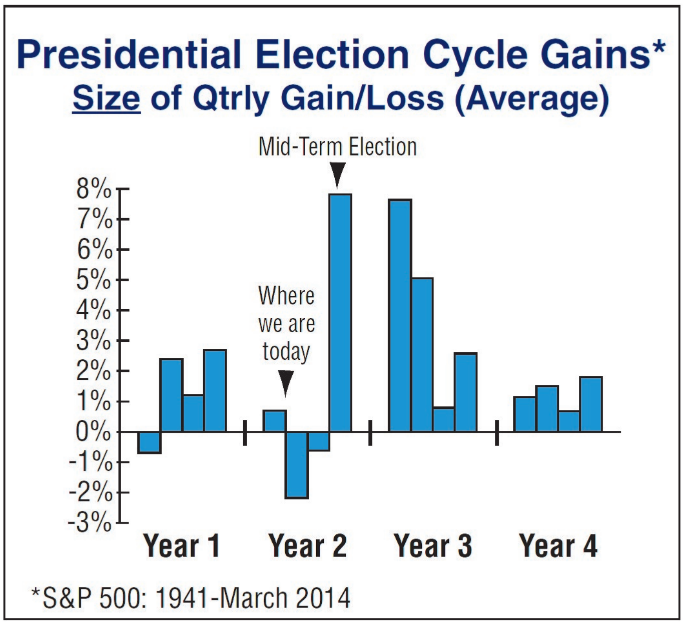

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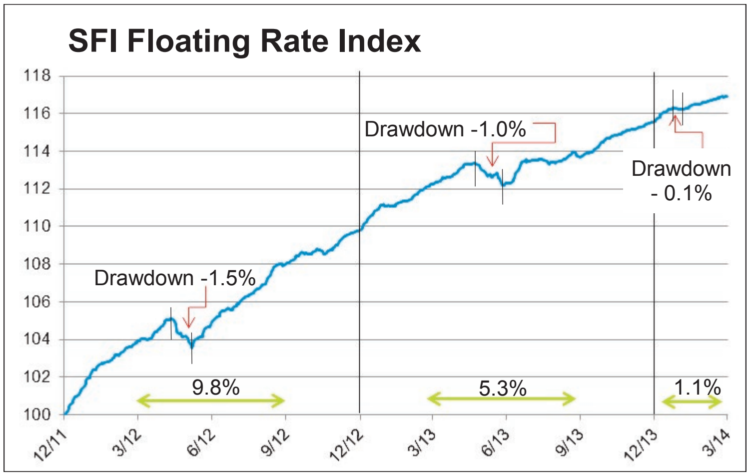
As seen in the chart to the left, historical analysis indicates that this mid-term election year has a good chance of ending on a positive note. The fourth quarter of the mid-term election year is historically the best one, with average gains of nearly 8%. If you include the fourth quarter of the year and add the first quarter of the following year, average returns for the 6-month period are about 15%. The bottom line summary for this pattern indicates that until the summer is over, the risk may be higher than normal. Volatility may also be higher than normal before a meaningful period of higher prices in the fall.

SPECTRUM LOW VOLATILITY FUND

If an investor could purchase an apartment building today that produced a cash flow after all expenses of 8% a year, he might be pleased with his cash on cash return in the current interest rate environment. If he financed his property with a 50% mortgage which had an interest rate of 4%, he could purchase two apartments for the same equity. Scenario one has a net investment return of 8%, but the second scenario will generate a 12% net rate of return on the same investment. A downturn in real estate values might depress the investment return upon sale, but increasing values will give an even higher return. This uses the concept of leverage which can have significant advantages in certain market environments. The chart above illustrates the performance of the SFI Floating Rate Index since 2012. This index is an average of four short-term senior floating rate mutual funds which pay a daily dividend. It is normally a low risk investment that has a dividend payout currently of about 5%. If we are able to borrow funds currently at 1.5%, and have a 50% loan amount like the previous example, we will enhance our return by 3.5% a year on the portfolio. The difference between this example and the real estate example is that we have daily liquidity on our investments, and can go to a liquid cash position without a real estate commission or waiting around for a buyer to come along.



This is one of the many tools available in our Spectrum Low Volatility Fund (SVARX), which we will use to meet the objective of enhancing returns and controlling investment risk. There are times to use leverage and times when the entire portfolio should be in a liquid cash position. Our expertise in determining when to put risk on and take it off has been the result of trading similar debt securities for the past 30 years. This fund has only been available less than six months, and uses some of the best ideas we have refined over the past decades. For more detailed information call our Client Services Team for a prospectus.

PERSONAL PERSPECTIVE *by* Ralph Doudera

"I used to be a mile wide and an inch deep, then when God got a hold of me I became an inch wide and a mile deep." This is one of those quotes I never quite forgot from my friend and prior pastor, Dick Woodward, who passed away last month after 20 years of suffering from a debilitating spinal condition that left him bedridden and unable to use his arms or legs to take care of himself. He was always an inspiration to me when I would visit him, as his infirmities faded into the background as he focused on me. He was one of those stewards of life who could make me feel both good about myself by focusing on me, and yet he exposed my shortcomings by his example of what good stewardship really is. Stewardship is taking whatever hand God has dealt me and playing it to the best of my ability.

At his memorial service, his son told about a time someone who also had an infirmity asked Dick how he was able to get people to stop feeling sorry for him. Dick's response was *"if I don't feel sorry for myself, they won't either"*. I couldn't leave from a visit with him without feeling better than when I got there and more grateful about my personal situation.

Dick worked diligently from his bed using voice dictation software to write books and edit messages for the Mini Bible College, which is a comprehensive study of the Bible that is distributed by International Cooperating Ministries into 31 languages in 66 countries across the world. It is also distributed via a hand-held solar powered "God-pod".

When I look at any accomplishments in my life, I feel like I could have said "Yes" to God a lot more times than I did. But when I have said yes, and I get myself out of the way, good things happen. I continue to ask myself if I am listening to what God wants to do through me. Dick's life summary puts it this way:

God has given me His ability in exchange for my disability. I'm not, but He is. I can't, but He can. I didn't but He did. I don't want to, but He wants to--because I am in Him and He is in me.

For additional information on International Cooperating Ministries go to www.icm.org.

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

Ralph J. Doudera, Editor. 2940 N. Lynnhaven Rd., Suite 200, Virginia Beach, VA 23452 (757) 463-7600 InvestSpectrum.com