

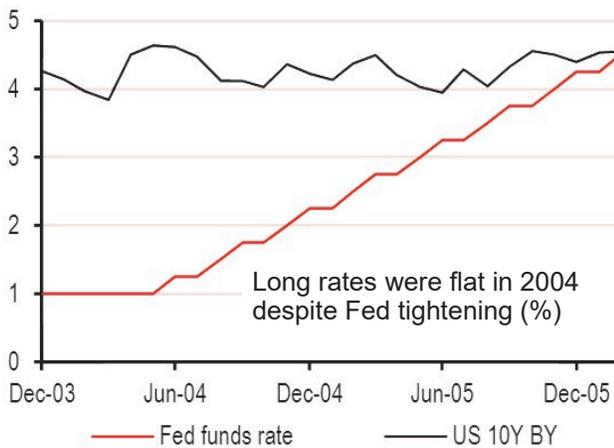
GENERAL MARKET COMMENTARY

2015—The Year Nothing Worked. Since 1995, practically every year has seen some asset deliver returns exceeding 10%. Most investors were disappointed last year...from treasuries to high yield bonds, technology, internationals, emerging markets, or commodities. 2016 has started off on an even more disappointing note. Many famous hedge fund managers closed down their funds because their strategies had significant declines. Also, many investors redeemed their investments having thought that hedge funds always meant low risk.

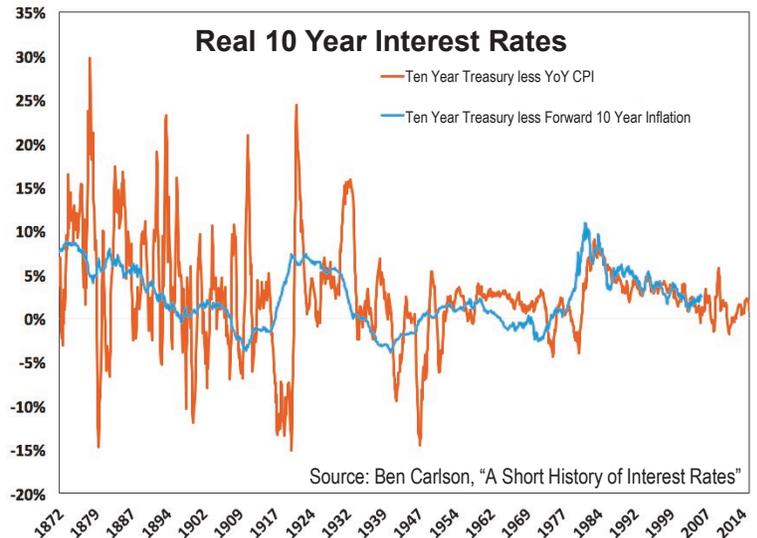
The recent rout in global stocks is being fueled by investors reducing leverage as the central bank runs out of

options to prop up economies. While the US economy remains stable, overseas markets are not in good shape, with China, in particular, being very unsettled. The Federal Reserve did increase interest rates in December for the first time in nearly a decade, and historically, more increases are likely this year. That does not always mean long term interest rates will increase. The chart below left illustrates what happened in 2004.

Over the long term, interest rates are directly related to inflation rates. Interest rates (adjusted for inflation) can be seen since 1872 in the chart below right. Real rates were negative during extreme inflation and higher during periods of deflation. If inflation remains low, so will interest rates.



Source: Thomson Reuters Datastream, HSBC

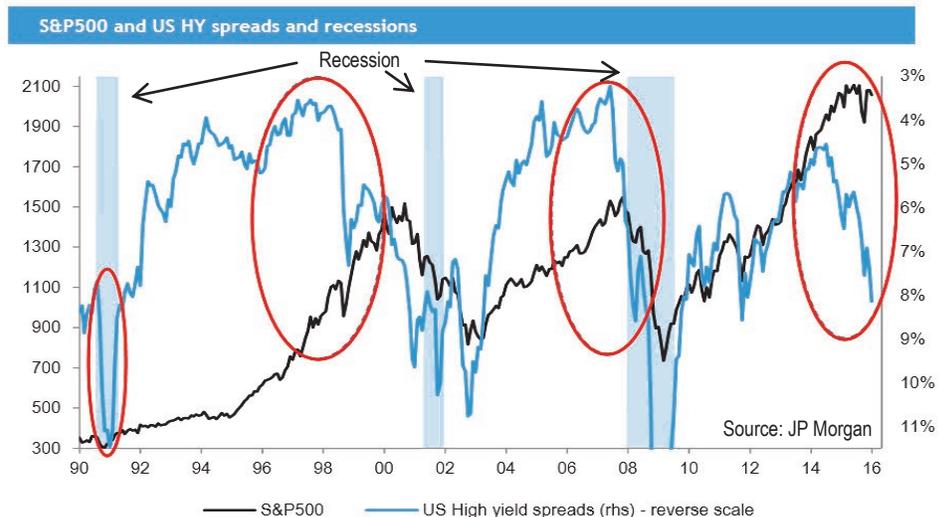


RECESSION, HIGH YIELD, AND STOCKS

According to Jeffrey Gundlach, co-founder of Doubleline Capital, the high yield bond market may be signaling a recession this year. He puts the probability at 33%, and Martin Fridson, a long-term analyst in high yield credit analysis, puts the probability at 44%. The accompanying chart shows the correlation between stocks and high yield bonds. The indications are that stocks have to drop significantly lower to get back in sync with high yield credit. Of course, one can also interpret the chart to indicate that a recession is imminent.

We have been trading high yield bonds for 30 years and have learned that there are times to be on the sidelines, and times to be invested. This is one of those times to be ready to take advantage of a meaningful rally. If a recession does come this year, the yield spread will get even

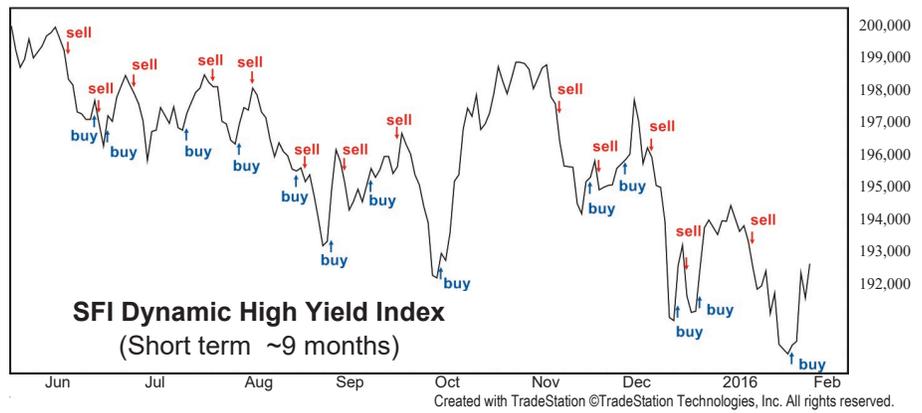
better for investing and we will carefully monitor the markets to capitalize on this "once every decade" opportunity.



DYNAMIC & HIGH YIELD TRADING SIGNALS

These charts illustrate our recent actual trading signals for both our short-term Dynamic and intermediate-term High Yield Bond Strategies. As you can see, we attempted to let our profits run and cut short losses. These trading strategies continue to make a positive case for active management.

The Dynamic Strategy (top chart) has no restriction on the number of trades, so it is more active. The High Yield Bond Strategy (lower chart) only generates about three buy signals per year. We are encouraged by the opportunity high yield bonds now offer, paying dividends of 7% more than government bonds. This offers profit potential that we have not seen in five years. When this happened in December 2011, the 1-year return of the High Yield Index was over 15%.



HIGH YIELD BOND OPPORTUNITY

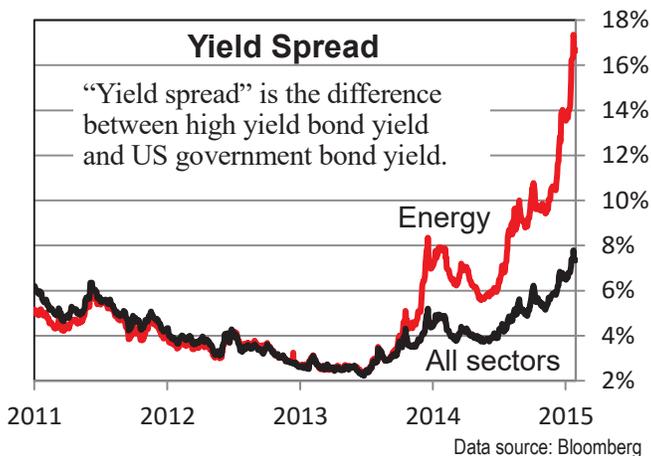
High yield bonds have been in a downtrend for the past several months and this downtrend has accelerated along with the stock market in the past few weeks. The Merrill Lynch High Yield Master II Index is down over 12% from its May 2015 peak. That is the second worst decline in the 19-year history of this index. Only the 2008 meltdown was worse—and that produced a 57.5% rally.

There have been a number of reasons investors have fled the high yield bond market over the past year, including concerns over interest rates, energy and commodity exposure, liquidity, and defaults. With this sell-off, spreads have increased to multi-year highs, creating opportunity for

investors like us to take advantage of the current environment (see chart below left).

High yield bonds have never lost money for two consecutive years, so a full year of high yield bond losses in 2016 would be unprecedented, based on BofA Merrill Lynch U.S. High Yield Index data going back to 1987. Junk bonds have lost money in only six of the past 29 years—in 2015, the U.S. recessions of 1990, 2000 and 2008, the WorldCom bankruptcy in 2002, and during rate hikes by the Federal Reserve in 1994. In all prior cases, robust recoveries occurred in the year immediately after a year of losses (see table below right).

Our investors should be well rewarded as the yield spread returns to normal.



Largest Junk Bond Sell Offs and Recoveries

Sell off - Total Return (%)		Recovery - Total Return (%)	
2008	-26.4	2009	57.5
2000	-5.1	2001	4.5
2015	-4.6	2016	???
1990	-4.4	1991	39.2
2002	-1.9	2003	28.1
1994	-1	1995	20.5
Average	-7.2	Average	30.0
Median	-4.5	Median	28.1

Source: BofA Merrill Lynch U.S. High Yield Index

PERSONAL PERSPECTIVE by Ralph Doudera
As I study the philosophy of candidates running for President of the United States, I see one issue which is never publicly discussed. But it is essential for great leadership so I must evaluate everyone with this added character trait. The word is “humble”- “not arrogant haughty or conceited, unpretentious and unassuming, modest, courteous, respectful, teachable, selfless.” By itself, humility does not make a good leader, but without it you will never have a great leader. Examples that come to my mind are Lincoln, Gandhi, Mother Teresa, and Reagan.

When a man asked Evangelist George Mueller the secret of his service, he responded: “There was a day when I died, *utterly died*; died to George Mueller, his opinions, preferences, tastes, and will; died to the world, its approval or censure; died to the approval or blame even of my brethren and friends; and since then I have studied to show myself approved only to God.” I have also heard it said that if I have one eye on God and one on man, I will be cockeyed.

The spirit of humility frees a leader to concentrate on the real needs of others. It allows him to be in a position to accept insights from others and learn from them. Dare I ask myself some questions? “Am I motivated by the opinion of others? Am I offended by an insult? Do I demand that someone understands my opinion? Do I welcome criticism?

Will I be willing to change my opinion? Do I talk over others without letting them finish their sentence? Or just tune them out?” Pride has sneaky ways of working, and a proud person never even realizes it. I have also realized that issues of pride in someone else which bothers me is proof that the same issue resides in me. Dwight L. Moody was asked “are you saying that the humble person doesn’t think much of himself?” Moody retorted, “No. He doesn’t think of himself at all.” Humility is unconscious of itself. The man who is humble doesn’t know he is humble.

I love to photograph sunsets. God in his very nature reflects humility. I see His handiwork in each one and am overcome with awe at His creation. He could paint the sky with letters bringing attention to how great He is, but he chooses not to and allows us to comprehend Him and His handiwork by revelation. Jesus Christ, the ultimate example of leadership, lived a life of humility. He never demanded his rights, but put on the life of a servant, even washing his disciples’ feet and laying down his life for all, illustrating to us what he taught. This also reminds me of Jesus teaching “*whosoever exalts himself shall be humbled; and he that shall humble himself shall be exalted.*” (Matt. 23:12) It is interesting to note here that in either case we need to go through humility--one by choice and one by unpleasant consequence. We get to choose the path to humility.

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

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