PARAGON CAPITAL MANAGEMENT, LLC

July 2013

The More Things Stay the Same . . . the More They Have Really Changed

The U.S. stock market; as measured by the Standard & Poor's 500 index; is up almost 14% through June 30, 2013. This is slightly above last year's first six-month return of 9.5%. Although, generally speaking, the first half of each of the past two years has been outstanding. However, the components of those returns, and the environments in which they were fostered, could hardly be more different.

Last year, Apple was the engine that powered the market. Apple stock was up roughly 40% during the first half of 2012 when it overtook ExxonMobil as the largest capitalized stock in the world, this played a large part in the overall market's excellent returns.

This year however, Apple is down roughly 25% during the first half of the year while the market is still up over 13%. What changed? What engines are driving the market this year?

It's certainly not Fed policies. Last year, an election year, the Federal Reserve was quite loose with its monetary policies and was implementing Quantitative Easing. In short, the Fed was pumping about $85 billion a month into the markets. Amazingly, when you pump $1 trillion into the markets in a year – they tend to go up.

However, the Fed has recently announced that these policies cannot continue forever. The bond market was shocked to hear that there is no such thing as a free lunch, and immediately began selling bonds. This, in turn, drove the 10-year Treasury yield from about 1.6% to 2.6% in one month. A 1% nominal increase may not look like much, but when you look at it as a percentage of the beginning yield (1% on top of 1.6%) you can see that it is a huge relative move for the market.

Another Apple aside: In order to save roughly $9 billion in taxes from repatriating cash from overseas, Apple borrowed $17 billion earlier this year to pay dividends. How was their timing? They only paid 2.4% for 10-year notes, and 3.85% for 30-year bonds. How was the timing of anyone who bought that debt? As of June 30, 10-year note holders were down 7.5% and 30-year bond holders were down almost 13% - in just two months.

The drivers of the market so far this year seem to be big, boring companies. Companies that are diversified internationally, have semi-recession-proof products and services (GDP growth for the 1st quarter of 2013 was revised downward – we are still in a muddling economy, to say the least), and have strong balance sheets are doing very well. In short, Paragon type of companies.

As we write every quarter, *"We continue strive to identify industries and companies that are profitable in all kinds of economic environments. We attempt to determine appropriate values for those companies, and invest in them when the stock price is materially below what we believe the true value to be. There is no magic in that, and there is no timetable, there is simply work."* As boring as it may be, it works. And as long as it continues to work, we are fine with being boring.

However, as we also wrote last quarter, *"Just as we cautioned against panic in 2009, so we caution against euphoria in 2013. Yes, markets have recovered relatively quickly and materially. And yes, interest rates are still [historically] low. However, the economy is not yet thriving, but still muddling."*

We are thrilled that we have been able to generate outstanding returns for you over the past six months. However, due to rising interest rates and a slow economy, we are as cautious in our near to mid-term outlook for the stock market as we have been for some time, and will take steps to lock in recent gains as appropriate.

As always, thank you for your continued trust and support.

Ward, Craig, Howard & Elizabeth

In the ongoing effort to continue to give our clients the most detailed, and meaningful, data available, you may have noticed that your Schwab statement now includes, within the detail sections, cost basis information on your individual securities.

Although this is information which we provided to you on an ongoing, quarterly basis in the past, it is now available on your custodial statements. We trust that you find it useful.

A copy of our SEC Brochure (formerly Form ADV Part II) is available to you at anytime. This document describes who we are, what we do, and how we do it. Also, our Proxy voting policy is available to you at any time. If you would like to receive either of these documents, or inquire as to how your shares have been voted, please contact us at a phone number, or e-mail, listed below.

As a Registered Investment Advisor, Paragon Capital Management receives and collects non-public personal information from various activities and statements.

Paragon does not disclose such information unless instructed to do so by the client.

We maintain physical, electronic and procedural safeguards that comply with federal regulations to guard your non-public personal information

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