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THE TEMPO VANTAGE

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Welcome to the first edition of the Tempo Vantage, a quarterly newsletter that will look at the current state of the financial markets, explore in greater depth salient themes, and report the results of Tempo Financial Advisors LLC's investment strategies.

After a difficult first quarter, with the S&P 500 falling over 9%, the second quarter started off on a positive note. Through mid-May the market returned nearly 8% and was within shouting distance of recovering the entire loss of the first quarter. Unfortunately these levels were not sustained and from mid-May to the end of the quarter the market took back all the gains - and more. In the end the S&P 500 fell 2.7% for the quarter, which obviously masked the significant intra-quarter variances. Yet there was money to be made if you invested in certain areas of the market. Technology, healthcare, utility, and "growth" style stocks were all up for the quarter. The biggest winners were commodities in general and energy in particular. On the negative side were real estate, foreign, and "value" style stocks. No surprise that the biggest loser was financial stocks. Perhaps most striking was the huge gap in return for the quarter between the best and worst performing market segments: over 48%!

More troubling was the swift and sharp decline at the end of the second quarter which has now spilled over to the start of the third quarter. To borrow from a famous quote from Thomas Paine: These are the times that try investors' souls. How can you deal with markets such as these? Since no one knows for sure where the markets will go from here, the best you can do now (or any time) is invest in a portfolio that corresponds with your particular circumstances (age, time horizon, risk tolerance, etc.) and stick with it.

I would be remiss if I didn't at least attempt to address the two major factors weighing on the markets these days: the price of oil and the credit crunch/subprime crisis.

The price of oil has come a long way in a relatively short period of time. As recently as 2003, prices were at $25 per barrel (inflation adjusted). One could certainly argue that prices were significantly below where they should have been. If prices had merely increased at the rate of inflation since 1980, the price of oil would be $100 per barrel. Obviously we've blown right past that benchmark to make a new all time inflation adjusted high.

The question is: what is driving oil price changes today? There are two schools of thought. The first is fundamental. The theory is that oil is a limited resource, we have reached "peak supply," and supply cannot possibly keep up with future demand. The second explanation is more technical. As all commodities are, oil is traded on a financial exchange. In the long run the price of every commodity settles to where it deserves to be based on the fundamentals (supply and demand). In the short run, however, prices can deviate significantly from the theoretical fair value. How do you explain the price of internet companies in early 2000 or the price of tulips in the 17th century? No, I am not comparing the price of oil today to those bubbles – not yet anyway. The point is that traders (both professional and amateur) themselves can drive prices, and that may be happening today.

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I think it is fair to say that fundamentals took the price from $25 to somewhere over $100. My suspicion is that traders have taken it the rest of the way. Of course this does nothing to predict where oil will be tomorrow. Certainly you can read between the lines and ascertain that I believe prices are somewhat inflated at this time and may settle down a bit. No, I do not think they are going back down to $25… or even $75.

The credit crunch/subprime crisis is another interesting study in investor psychology. Predictions of doom and gloom in the financial sector are rampant. There is no question in the end billions will have been lost. How many billions is impossible to say, because any prediction must rely on certain assumptions (how many homeowners will default, how much home prices will decline, where interest rates will go, etc.). In the media, naturally, the more sensational the prediction, the better. The result has been a virtual fire sale on any stock remotely related to the financial industry. You would think that every bank and broker is going out of business.

Through the years I have found that, when it comes to investing, it usually pays to be a contrarian. I ask myself, "Will there be banks in the United States in five years? Will there be brokerages? Will they lose money every quarter? Every year?" It may be hard to imagine today, but in general banks are solid, profitable businesses. I cannot say for sure when the decline in financial stock prices will end. But, just as those on the "bullish bandwagon" may themselves be inflating the price of oil, those on the "bearish bandwagon" may be having the reverse effect on financial stocks. It could be a bit early, but I believe that those with the courage to go against the crowd and buy financial stocks now will be rewarded as we look back in 3-5 years.

Given that this is the inaugural issue of this publication it is a great opportunity to introduce Tempo's two Dynamic Strategies. These strategies do not attempt to "time" the market and as such are always invested. What they are invested in, though, is far from static. My proprietary algorithms will periodically rebalance among a menu of investment categories with strict risk control parameters. The **Tempo Multi Asset Dynamic Income Strategy** allocates among various fixed income (bond), income oriented equity, and alternative investments. The goal is to generate consistent returns greater than money markets and CDs after fees. In many ways this can be considered an absolute return product. In the first quarter, 2008 the strategy generated a return of +0.36%, and the second quarter return was +1.03%. These returns are certainly attractive in light of the fact that most fixed income sectors were down for the first six months of 2008.

The **Tempo Multi Asset Dynamic Growth Strategy** allocates among all those categories included in the Income Strategy in addition to numerous equity sectors. The goal is to generate consistent "equity-like" returns after fees with greatly reduced risk. In the first quarter the strategy lost just 1.5%, which was a terrific outcome in the midst of a market that lost over 9%. The second quarter was even better. While the market was losing 2.7% the Dynamic Growth strategy made 8.8%. I'd like to tell you that this strategy will always be up when the market is down – I can't. Tempo's Dynamic strategies strive for consistency, which can be a double edged sword. While we expect them to hold up better in down markets, they are unlikely to capture the full gains during strong up markets.

I am always interested to hear thoughts and feedback from my newsletter readers. Please feel free to contact me with any comments or questions at DTraub@TempoAdvisors.com.

If you'd like to be on my electronic mailing list and are not currently, please send me an e-mail.

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