TEMPO Financial Advisors, LLC

550 Cochituate Road, Suite 25 ■ Framingham, MA 01701
Tel 508.655.7827 ■ Fax 508.655.7829
www.TempoAdvisors.com

THE TEMPO VANTAGE

April 2014

Don't Believe the Naysayers

The stock market thus far in 2014 has been more volatile that than it was in 2013. Yet the net result was a slightly positive first quarter. The S&P 500 was up 1.3% (not including dividends). International stocks, though positive, were up only 0.5%.

Perhaps the biggest surprise of the quarter was in the bond market. As The Federal Reserve continued winding down the monthly bond buying program, you might have reasonably expected the reduced demand for bonds to lower prices effectively increasing interest rates. But that is not how it worked out. Interest rates have come down in 2014 and the BarCap Aggregate Bond Index gained 1.7% in the first quarter.

Despite this the mid and long term trend in interest rates continues to be higher.

A lot of people are nervousness about the stock market. If I had a nickel for every time someone told me that the markets are about to fall, I could at least take my family out to a nice dinner. That is a lot of nickels!

Predictions of recessions and bear markets are much more frequent than their actual occurrence. There is a joke about economists: economists have predicted seven out of the last one recessions.

As far as I can tell the biggest reason given for expecting a decline is that we haven't had one in a while.

In economic parlance a bear market is a drop of over 20% and a correction is a drop of over 10%. Over the past 100 years there has been a bear market on average every 3.5 years.

The last bear market ended about 5 years ago.

We haven't had a correction since 2011, which is the 5th longest such stretch over the last 50 years.

Are we due?

Rather than prognosticate based on time I prefer to look at other stock market or economic metrics. Here are two: price/earnings ratio (P/E) and the yield curve.

The average P/E for the S&P 500 over the past 100 years is about 15. A lower P/E (under 12) indicates that the market is undervalued and high P/E (over 20) indicates overvaluation. Anywhere in between is somewhere in the fair value range.

The price earnings ratio for the S&P 500 is currently at 17.7. So it is at the upper range of fairly valued. It may surprise you to know that the P/E is actually lower than it was a year ago. Since the market (the "P" in P/E) is up over the past year the only way the P/E can be lower is for earnings (the "E") to be up even more. Companies are making money and a P/E ratio of 17.7, while not undervalued, is certainly not wildly overvalued either.

The yield curve (the slope of a chart comparing short term to long term government bond yields) can be a good predictor of future economic activity. While the yield curve has flattened a bit recently it is still upward sloping (long term rates higher than short term rates). Upward sloping curves are associated with future economic growth. In this case a modestly sloping yield curve would predict modest economic growth. But growth nonetheless.

Could the market fall? Absolutely! Sometimes market expectations and investor behavior can be enough to tip the scales in the short run. You might even argue that periodic declines are healthy (allowing the "E" to catch up with or get ahead of the "P") if only so the bears can be right one out of seven times.

But I would not expect any decline to be deep or extended. And once complete the path would be clear for another up cycle.

How can investors deal with an uncertain future? Invest your short term money (money that you will need within 3 to 5 years) with caution and invest your long term money without fear of short term fluctuations.

Tempo Financial Advisors' 1st Quarter Investment Performance

I am pleased to report that all Tempo managed accounts had positive returns in the first quarter. Of course given what you now know about the markets – that the returns for most market segments were slightly north or south of 1% - it won't surprise you to know that Tempo's returns were also in this range.

First up is the **Tempo Dynamic Growth Program**. This program has done a nice job the past few years of capturing its fair share of the market return without the same exposure to stocks (which means we take less risk). That trend has continued into 2014. The equity we do own is overweight in three segments: small cap, technology, and healthcare. Each of these areas performed in line with or better than the overall market allowing us to capture a 1.5% return for the quarter.

The **Tempo Dynamic Income Program** was also successful in the first quarter. As you may know our strategy limits the allocation to any one segment of the income market. The down side is that we cannot allocate 100% of accounts in the best performing income category (as if we could possibly know this in advance). On the plus side we cannot allocate too much to the worst category.

Perhaps an apt analogy is that the Dynamic Income Program is like all season radial tires. Are they the best summer tire? No. Are they the best winter tire? No. But they can give consistent performance in all conditions and you don't have to know if it'll rain or snow in advance.

Why do I make this analogy now? The Dynamic Income program returned 1.2% in the first quarter and that is a very good outcome for a portfolio that was positioned well regardless of which direction interest rates headed.

Last, and actually least in terms of return, is the **Tempo Lifestyle Program.** Returns for accounts, regardless of risk level, were between +0.5% and +1.2%. That is a very tight range given that some portfolios have as little as 60% in equities and some have as much as 100%.

With returns for stocks and bonds so close in the first quarter this makes sense.

But why would it be that Dynamic Growth out-performed Lifestyle given that Lifestyle accounts generally have more equity? I'm glad you asked.

Even though Dynamic Growth has a maximum allocation to equity of 60%, that 60% can be concentrated in a just few areas. This past quarter there were only three (see above). As it happens, those three areas were among the market leaders in Q1.

Lifestyle accounts are typically much more diversified and hold upwards of eight different segments (both U.S, and international). And while small cap, technology and healthcare are among our holdings they comprise a smaller percent of portfolios.

This is not a knock on Lifestyle, which is performing exactly as it should, but congratulations to Dynamic Growth.

Reminder
Please contact us if there has been a change in your financial circumstances that would warrant a fresh perspective on your portfolio.

Daniel J. Traub