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THE TEMPO VANTAGE

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A Goldilocks Market

We all know the story of Goldilocks. A little girl takes a walk in the forest and comes across a house that, unbeknownst to her, is inhabited by bears. Once inside she finds three bowls of porridge: one too hot, one too cold, and finally one that is just the right temperature. Then there are chairs (too big, too small, and just right), and finally beds (too soft, too hard, and just right).

This is an apt analogy for the stock market today as well as for the past few years.

Despite most market pundits being unhappy with the slow growth economy we have been mired in for the better part of five years, this is the just right environment conducive to attractive stock market performance.

Too Cold: If the economy were to grow too slowly (or even contract) we could slip back into recession. Interest rates would remain low but the stock market would decline.

Too Hot: If the economy were to grow too fast initially there would be euphoria in the stock market and prices would rise. But that would likely lead to a market that becomes overvalued (i.e. a high P/E. See the 1Q 2014 Tempo Vantage for information on P/E). A too strong economy could also ignite inflation (higher interest rates). An overpriced market and higher interest rates would set the stage for a bear market.

Just Right: Like Goldilocks, if we want to avoid the bear (market) we need an economy that is neither too cold (very low or negative growth) nor too hot (high growth with inflationary pressure). In this just right territory stocks will continue to perform well.

In fact stocks did perform well in the second quarter as well as for the first six months of 2014. For the quarter large cap stocks gained +5%, small cap stocks +2%, and foreign stocks +4%. Year-to-date returns were +7%, +3.2%, and +4.8%, respectively.

Although these returns are not of the get rich quick variety (like 2013), they are good, solid returns that keep portfolios going in the right direction. And there is nothing wrong with that!

The bond market continues to amaze and confound the majority of fixed income aficionados who are divided between those who believe the economy will remain weak and interest rates low and those who believe the economy will strengthen and interest rate will rise. The last few years have been like watching a tennis match between these two camps.

From 2009 to 2012 the first group (slow growth, low rates) was right. Then in 2013 it appeared the second group's thesis would finally come to fruition and interest rates did rise. Then just as it seemed the trend toward higher rates would take hold along came 2014.

Thus far 2014 has been a good year for bonds (i.e. lower rates). The BarCap Aggregate Bond Index gained 2% in the second quarter and just shy of 4% for the six months ending June 30.

Why bonds have performed so well is of course subject to debate. It could be due to some weak economic reports over the winter and spring, though many believe those reports were negatively affected by weather and therefore were anomalies. Another possible explanation is that during times of crisis there is often a flight to safety (bonds). And there have certainly been some tense moments between happenings in Ukraine and Syria.

You can mark me down for the second group. While I don't think the rise in rates will be meteoric I do believe it is only a matter of time before interest rates continue higher.

Tempo Financial Advisors' 2nd Quarter Investment Performance

Much like the overall stock and bond markets, Tempo's investment programs have generated good, solid returns that keep portfolios going in the right direction. When all market segments move together in a tight range it can be difficult to differentiate your return from the averages. But when returns are up why would you want to?

Given what you now know about the returns for stocks and bonds in the second quarter (ranging from +2% to +5%) you will not be surprised to know that all of Tempo's investment program returns were also in this range.

Tempo Lifestyle Program accounts returned between +2.5% for conservative accounts to +3.5% for more aggressive accounts. While I am pleased with the results I can tell you that portfolios were held back a bit by our stance relative to bonds.

I have positioned our bond holdings to perform relatively better in a flat or rising interest rate environment. That has not happened thus far in 2014. As a result our bond and alternative positions, though still up as a whole, were not up as much as the long term government bonds I have been avoiding.

I am confident that time will prove our thesis correct.

The **Tempo Dynamic Growth Program** returned +2.1% in the second quarter and is now up +3.6% year-to-date. These results are certainly in line with historical expectations for similar market environments. Though I would like to have earned more (which I could say virtually every day) we must recognize that Dynamic Growth is a moderate to conservative strategy that intentionally limits risk in part by limiting the maximum exposure to equity.

Our most conservative investment program, **Dynamic Income**, returned +2.8% in the second quarter. This is a terrific outcome! How did we do it? Nearly everything we owned in the second quarter (convertible bonds, utilities, and high yield bonds) performed in-line with or better than the BarCap Aggregate Bond Index.

I am particularly pleased with both **Dynamic Growth and Dynamic Income** as we look back over the past year (12 months ending 6/30/2014) in which our returns were +14% and +10.6%, respectively. Over this same time period the BarCap Aggregate Bond Index returned 4.3%

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