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THE TEMPO VANTAGE

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Nothing to Fear but Fear Itself

Although equity returns in the fourth quarter of 2015 were good, the year as a whole offered few reasons to cheer.

For the quarter equity returns were +5%, +2.5%, and +3.5% for large cap U.S. equities, small cap U.S. equities, and international equities, respectively (as measured by the average mutual fund in each category). For the year, however, those same categories had losses of -1.4%, -5%, and -2%.

Fixed income investors didn't have it much better. In fact bond investors experienced losses in both the fourth quarter and for 2015 as a whole. Fourth quarter losses ranged from -0.6% (intermediate term bonds, inflation bonds) to -2.0% for high yield bonds. For the year losses ranged from -0.3% to -4%. In fact the lowest rated high yield bonds lost over -10% for the year!

The three most likely explanations for the decline in equities are: rising interest rates, the slowing China economy, and falling oil prices. Let's consider these.

Rising Interest Rates - As was long anticipated the Fed finally raised interest rates at the December meeting. But history has shown that the market does fairly well after the first few interest rate hikes. Plus, even after the hike we still have incredibly low rates. (See the Tempo 3Q 2014 Vantage for more on interest rates.) I doubt that slightly higher interest rates caused stocks to fall.

China Economy - I've been an investment advisor for 28 years and hardly a year has gone by when the fear of the slowing Chinese economy hasn't been a concern. That fear was certainly on display in the summer of 2015 when the Chinese stock market fell 43% between June 12 and August 26. The same fears were (and still are) present as we ended 2015 and began the new year. From December 22 to January 7 the Chinese stock market fell 15%. (FYI, the U.S. Stock market fell 7% and 5% during those same periods.)

How do China's economic woes affect us in the United States? Does a weaker Chinese economy mean U.S. companies will make less money? Certainly that will be the case for a few large multinational companies doing significant business is China. But most companies will be unaffected.

The biggest impacts (to us) of a weaker China are lower commodity prices and a stronger dollar vis-a-vis the yuan.

A growing China demands a huge amount of natural resources. A slower growing China demands less. And less demand means lower prices. How is that bad for us? Unless you are in the commodity business it is not bad at all. For the rest of us lower commodity prices are welcome.

How does a strong dollar hurt us? It makes the products we export to China more expensive to the Chinese. While it is true that China is one of our largest trading partners, most of our trade comes from items we import from China. (We import four times more than we export to China, and we export far more to Canada, Mexico, and the European Union.) A strong dollar makes our imports less expensive.

One more thing to keep in mind. A slower growing China might mean growth of 4%-5% (compared to previous growth of 7%) which would still make China the envy of most other countries.

Falling Oil Prices - The price of oil has fallen from over $100 per barrel in 2014 to under $33 today. A slippery slope indeed. Is that bad? If we look at recent stock market behavior you would think so. It seems that every time oil is down so is the stock market.

I believe this is more of a knee jerk reaction to days gone by when lower oil prices meant lower supply, weaker demand, or both. The big fear is that lower demand for oil indicates a weak economy. But that is not the case today.

Oil prices are lower because of supply. What virtually nobody saw a few years ago is that the supply of oil would explode. At the beginning of 2013 the U.S. was producing about 7 million barrels of oil per day. Today we are producing over 9 million barrels per day. And global production is up as well.

Ask any first year economics student what the impact of increased supply is on price and they will answer quickly - lower prices.

What's that, you say? Demand must be down as well in order for prices to have declined so much. Not so. Demand in 2015 was as high as it has ever been.

As you can tell I don't subscribe to conventional thinking on these topics.

But here is the problem: I might be spot on about all of these issues and the market may still fall. If people think there are problems then there will be. Perception is reality. And there is no telling when perception will change. To paraphrase FDR, we have nothing to fear [of lower prices] but fear itself.

Tempo Financial Advisors' 4th Quarter Investment Performance

Two thousand fifteen will not go down as the most impressive year for Tempo Financial Advisors. Though to be fair there wasn't much to work with as most everything was down.

The **Tempo Dynamic Income Program** had quite a good fourth quarter with a return of -0.1%. This is excellent when you recall that most bond categories lost between -0.6% to 2.0%. But the year as a whole was not as successful. Dynamic Income was down over -3% (due entirely to a rough second quarter). While that was better than a few benchmarks, it was worse than many. Plus we never like losing money.

The good news is that as 2016 opened on an extremely negative note (S&P 500 down 6% in the first week) Dynamic Income accounts are essentially unchanged.

Tempo Dynamic Growth clients had an outcome similar to Dynamic Income. Dynamic Growth accounts were up +1.4% in the fourth quarter but down about -2.7% for the year. For both periods our returns were about 1% below benchmarks.

As with Dynamic Income, Dynamic Growth has also done an excellent job of protecting the downside thus far in the first week of 2016. While the market is down -6% Dynamic Growth is down -1.6%.

Tempo Lifestyle accounts all had returns close to 4% for the fourth quarter. These returns were in line with to slightly better than our benchmarks.

For the year Lifestyle returns ranged from fractionally positive to fractionally negative. Though not spectacular from an absolute return perspective these results were about 1% better than our benchmark. And that is the key to success. Small out-performances over shorter periods add up to larger out-performances over longer periods.

Lifestyle portfolios are currently positioned, as they have been for most of the past year, to benefit from a strong dollar and rising interest rates.

Company News

It's hard to believe that it has been two months since the **Tempo Chocolate Tasting Event**. Thanks to those of you who attended. I will apologize now for any extra chocolate weight you may have gained since then. This is a great time of year for resolutions. Here is a good one: I will eat only one square of chocolate per day. Everything in moderation!

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