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# THE TEMPO VANTAGE

July 2016

## Brexit Shmexit

After a negative and volatile start to 2016 (January to mid February) the markets steadied and recouped earlier losses. In fact the second quarter was shaping up to be reasonably profitable until June 24.

What happened on June 24? Brexit.

Unless you have been hiding under a rock the last few weeks you know that Brexit is the combination of British and exit (not to be confused with Grexit, which we were talking about at this time last year). It is the term given to the possibility that Great Britain (GB) would vote to leave the European Community (EC).

I couldn't hide under a rock if I wanted. Within two business days of the Brexit vote I received no fewer than 60 e-mails about it. While I'm sure you received your share of such blasts it is likely that I subscribe to a few more financial sites than you do. Consider yourself lucky.

The pre-election day polls predicted that the vote would be in favor of GB staying in the EC. And the markets were rallying in anticipation of that outcome. Boy did the polls and the markets get this one wrong!

As I'm sure you know by now GB did in fact vote to leave the EC.

The market reaction was swift and negative. US and GB stocks fell over 5% in the next two market sessions, while French and German stocks fell over 9%. The question is, why?

The politicians and bureaucrats told us in no uncertain terms exactly how bad it would be if GB were to vote to leave the EC. How did they know?

They didn't know then and they don't know now.

I suspect the predictions were a product of entrenched leaders wanting to keep their jobs. After singing the praises of the Eurozone for so long they were too deeply committed - for better or worse.

The truth is no one knows what will happen. We are in uncharted territory. There is no historical precedent for a Eurozone exit. The market reaction was the classic knee jerk that often occurs before people stop to think on their own.

For most Americans I expect this to have minimal consequences. Certainly there will be some disruptions between GB and its Eurozone trading partners. But the repercussions will play out over years, not days.

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For now business that went on before the vote continues. Plus GB is already on their own currency, and that will help with the transition. Finally, even if European growth prospects may be somewhat reduced, the effects in the United States will be a fraction of what they will be in Europe.

My biggest concern has to do with currency. The most immediate effect of the vote was that the British Pound sank dramatically. The world has been in a race to the bottom relative to interest rates and currency. Denmark, Eurozone, Switzerland, Sweden, Japan, and Hungary all have negative interest rates already. The weakness in the pound will do nothing to ease the situation.

The good news, if you are inclined to think this type of thing is good news, is that there is almost no pressure at the moment for the Fed to raise our interest rates anytime soon.

Oh, I may have buried the lead. Within three days after the initial negative market reaction GB stocks were 2.6% higher than the day before the vote and U.S. stocks had mostly recovered. (German and French stock markets were still down about 5%.)

For the quarter as a whole U.S. stocks were up 2.4% (S&P 500) and bonds were up 2.2% (BarCap Aggregate Bond Index). International stocks, however, were down -1.6%.

**Tempo Financial Advisors' 2nd Quarter Investment Performance**

Anyone out there who has been reading the Tempo Vantage for a few years knows that I measure performance in two ways. Did we make money (absolute performance) and did we outperform benchmarks (relative performance)?

The ultimate, of course, is when we can answer yes to both questions for all three of Tempo's Investment Strategies. I am happy to report that in 2Q 2016 we can answer yes to all questions.

Let's begin with the **Tempo Dynamic Income Program**, which was our star performer for the quarter. Dynamic Income clients made 3.6% as compared to our benchmarks which both returned a fraction over 2%. We accomplished this by being heavily weighted toward longer duration bonds, having 5% in real estate, and holding no liquid alternatives. We could hardly have been positioned better!

The Brexit vote was actually quite positive for Dynamic Income. In the confusion immediately following the vote there was a flight to safety. That means bonds. While we already had attractive gains leading up to the vote we were able to add 1.5% in the just last week of the quarter.

The **Tempo Dynamic Growth Program** made 3.1% for the quarter. This compares to our two benchmarks which made 1.2% (blended benchmark) and 2.5% (moderate allocations funds). Our models had us positioned about as conservatively as we can be. Equities were both at the low end of the allowable range (40%) and were income oriented (real estate, utilities). You know by now that income was the place to be in 2Q.

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We are also quite pleased that both Dynamic Growth and Dynamic Income accounts are up for the one year ending June 30, 2016 (+1.1% & +3.1%, respectively). This may not seem like a lot, but it is significantly better than the benchmarks, which were down -2.7% & -1.7%.

One of the hardest things to do in investing is, well, nothing. We learn this lesson over and over. Twice so far in 2016. Early in the year when the market began on an extremely negative note, losing more than -10% in the first six weeks, it was compelling to do something. But that would have been a mistake. In a little over a month the loss was erased.

The same thing happened with Brexit, but on an even quicker scale. Within two days of the vote the market dropped over -5%. The pull to do something was strong. But as we now know that would have been a mistake as the market has nearly made up the loss in only three days.

Patience can also be a virtue as we consider our investments within the **Tempo Lifestyle Program**. In the first quarter many of the themes in our portfolios were working against us. Because of that Lifestyle client returns trailed their benchmarks by a fraction of a percent in Q1. But I felt strongly that these themes would turn in our favor. It didn't take long!

In the second quarter our positions in healthcare, small cap U.S. equities, MLPs (energy Master Limited Partnerships), and hedged (for strength in the dollar) international stocks and bonds all outperformed. About the only thing we own that did not outperform is technology stocks.

The result is that Lifestyle accounts returned between 1.5% and 2.5% in Q2, which was between 0.5% and 1.5% better than benchmarks.

We are not doing anything drastic within Lifestyle accounts due to Brexit. I am, however, reevaluating our positions relative to interest rates.

As you may know from previous Vantage newsletters I felt that it was only a matter of time before interest rates rise in the U.S. As indicated above in the discussion of currencies and interest rates around the globe I am coming around to the notion that interest rates in the U.S. may be low for a lot longer than I had anticipated. This has implications for some of our equity (financial) and bond positions.

**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

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