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THE TEMPO VANTAGE

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Will She or Won't She?

The first six months of 2016 were relatively volatile with the market twice falling significant amounts only to recover within short periods of time.

The first decline was at the start of the year and was due to the slowdown in China and the decline in the price of oil. The second decline was in response to the Brexit vote.

Since then the markets have been relatively stable and mostly higher. Especially equities. This continues the "risk off, risk on" pattern we have experienced the past few years.

The first half of the year was risk off. Equities were relatively flat and income producing assets (i.e. bonds, utilities, etc) did fairly well. The third quarter was risk on. Equities did well and bonds were relatively flat.

For the quarter the S&P 500 was up 3.8%. The star performer for the quarter was technology, which was up over 10%.

Returns for bonds were not as attractive in the third quarter. The BarCap Aggregate Bond Index (the most commonly used bond benchmark) was fractionally positive, returning 0.4%.

But if we move away from the basic bond categories there were healthier gains in some of the more aggressive areas of the bond market. Bank loan bonds (+3%), high yield bonds (+4.5%), and emerging market bonds (+3.8%) all had attractive gains.

Why the low volatility environment? Essentially we have been in a holding pattern waiting to see if she will or if she won't. There are actually two "shes."

The first she is Janet Yellen, Chair of the Board of Governors at the Federal Reserve. And the will-she-or-won't-she is whether, or rather when, she (i.e. the Fed) will raise interest rates. At the start of the year there was a real chance that we would have as many as four interest rate hikes. How many have we had so far? Zero.

Watching the odds of a rate hike bounce back and forth is like watching a tennis match. About a month before the September Fed meeting it seemed likely the Fed would raise rates. But as we approached the meeting that changed. The same script will probably play out in advance of the December Fed meeting.

Rightly or wrongly the market gets scared every time the prospect of a rate hike seems likely. And while I don't think a rate hike should be feared there is no question that the markets will react negatively in the short run. (See the 3Q 2014 Tempo Vantage for more on interest rates and the 4Q 2015 Tempo Vantage for more on rate hikes.)

The second she is Hillary Clinton and the will-she-or-won't-she is will she win the election?

Without getting too political, you may or may not like Hillary, but at least a Clinton Presidency is a somewhat predictable outcome. The markets like predictability.

Donald Trump, on the other hand, is a huge wildcard. His proposals are sketchy at best and no one really knows how he will accomplish what he has been promising. And that scares the markets.

At least we know when the second will-she-or-won't-she question will be answered - on election day November 8. As to the first will-she-or-won't-she question. Well, all I can say is that Fed watching is a life-long endeavor.

Tempo Financial Advisors' 3rd Quarter Investment Performance

In baseball a .667 batting average is spectacular. When it comes to measuring Tempo's three investment programs .667 is, well, it could be better.

I am referring to the fact that two of our three investment programs had positive returns and were ahead of their respective benchmarks in the third quarter. And while the third program did have a positive return, it fell short of its benchmark.

The Tempo Lifestyle Program was the star performer for the quarter. Returns ranged from 4% for conservative accounts to 5% for more aggressive accounts. These are all about 1% better than benchmarks for the quarter. We accomplished this in three ways.

First, as you know, we always maintain diversified portfolios. When the S&P 500 is the best performing asset class we may under-perform. But very often there are other assets classes that perform better than the S&P 500. When that happens we have a good chance of out-performing. And that is what happened in the third quarter. Our positions in small-cap US equities (+7%) and international equities (+6%) both out-performed the S&P 500.

Second is that our selective overweight positions in healthcare (+5%), financial (+6%) and technology (+12%) all performed better than the S&P 500.

Finally, many of our bond positions (non-traditional bonds, bank loan funds, and global bonds) performed better than the BarCap Index.

While I have certainly made changes to Lifestyle accounts over the course of the year those changes have been relatively minor. I don't make changes for the sake of making changes. Sort like playing a game of gin rummy. When you look at the up card you have to decide if swapping a card in your hand for the card on the table is beneficial. As I've considered Lifestyle this year for the most part I have concluded that I like our hand!

The **Tempo Dynamic Income Program** made +0.9% in the third quarter. Though not spectacular from an absolute return perspective it was a positive result and better than the bond benchmark (+0.4 for the Bar Cap Aggregate Index). Remember, small out-performances over the short term lead to larger out-performances over the long term.

We have already rebalanced accounts for the fourth quarter and portfolios look significantly different today than they did just a few weeks ago. Gone are real estate, intermediate term bonds, and long term government bonds. In their place are emerging market bonds, high yield bonds, and long term corporate bonds. All categories that should hold up well in a flat to rising interest rate environment.

Last, and in this case least, is the **Tempo Dynamic Growth Program**, which returned +0.2% for the quarter. A positive result, yes, but a result that trailed its benchmark by over 2%. Not exactly what we are looking for. What happened?

Dynamic Growth had a spectacular second quarter, returning +3.2% as compared to the benchmark return of +0.8%. Recall that the first part of the year was "risk off" and income oriented investments were king. Dynamic Growth was correctly on board. But very quickly at the start of the third quarter that started to change and income was no longer the place to be. But Dynamic Growth positions were still income oriented.

The good news is that since we had significant out-performance for the first six months of the year, even after the third quarter results we are still a bit ahead of benchmark year-to-date.

Dynamic Growth accounts have also been rebalanced for the fourth quarter. Not surprisingly the income oriented investments (utilities, real estate, intermediate term bonds, inflation bonds) are out in favor of small cap equities, technology, commodities, and emerging market bonds. If the risk on environment continues in the fourth quarter we will be very well positioned.

Reminder

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

Dan

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