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THE TEMPO VANTAGE

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The 800 Pound Gorilla

An 800 pound gorilla is dominant because of its great size and power. In the latter part of 2017 the stock market had its own version of an 800 pound gorilla: the tax overhaul. As the fourth quarter progressed it seemed that the only thing that mattered was if the Republicans would be able to pass a tax bill.

Clearly the markets were not only optimistic that a bill would be passed, but that the bill would be positive for stocks. As a result we had a nice run-up in stock values leading up to the eventual passage of a bill.

For the quarter stock returns ranged from +3.3% (small caps) to +6.5% (large cap) with most other categories falling somewhere in between. The few exceptions were income oriented equity such as utilities and real estate (+0.25% & +2.0%, respectively) and healthcare (+0.43%).

Two thousand seventeen as a whole was also quite positive for stocks with returns ranging from +14.5% (small cap) to +21.8% (large cap). Performing better than average were technology and defense stocks, both of which rose in excess of 30%. Performing not so well were utilities (+12%) and real estate (+6%).

The situation for bond investors was less exciting. For the fourth quarter most bond categories returned between +0.5% and +1.0%. The year as a whole wasn't much better with returns for most segments hovering near the +3% mark. Not a horrible outcome, but not nearly as attractive as the returns for equities.

Perhaps you've heard the saying, "buy the rumor, sell the news." The idea is that stocks often rise in advance of an event that is expected to be positive only to fall when the actual event comes to fruition.

Well, we certainly had a run-up in stock values leading up to the passage of the tax bill. What didn't happen is a sell-off when the bill was passed. That tells me that the market has not fully adjusted to the positive impact the bill could have on equity valuations.

As for the bill itself it does seem that most Americans will see some sort of a decrease in taxes at least for the short to intermediate term. I'll leave the rest of the analysis of the impact of the tax bill on individuals to the accountants.

But there is one group of people that is universally thought will benefit from the tax bill: investors. Why is that?

The most significant part of the tax bill lowers the corporate tax rate from 35% to 21%. Lower corporate tax rates lead to higher profits which lead to higher stock prices.

I regularly hear from clients (and others) who are convinced that the markets are due for an imminent fall. I don't see it... at least not in the short to intermediate term.

There are a number of metrics that are usually present leading up to recessions and bear markets. None of them are present today. Interest rates are low, inflation is low, corporate earnings are strong (and might get stronger - see above), the yield curve is upward sloping, and oil prices are low.

Does this mean the markets won't fall? No. Changes in any of the above could trigger a decline. The one most likely to trip us up is higher inflation. Of course any number of non-market events could derail us as well, such as trouble in North Korea.

Tempo Financial Advisors' 4th Quarter Investment Performance

The **Tempo Dynamic Income Program** had a terrific year by any measure. First, we beat our benchmark each and every quarter. Naturally that lead to outperformance for the year as well. Let's put this in perspective. For the fourth quarter Dynamic Income returned +1.9%. This was nearly 1.5% better than our benchmark. And our return of 8% for the year was a full 5% better than the benchmark. Once again Dynamic Income has shown that it can thrive even in a mediocre bond market environment.

Tempo Dynamic Growth also had a great year, this despite a so-so fourth quarter. Our return of +2.9% in the fourth quarter actually trailed our benchmark by about half a percent (the only quarter in 2017 Dynamic Growth failed to better its benchmark). Despite that our return of +17.8% for the year was a full 5% better than the benchmark. I'll take it!

Tempo Lifestyle had good returns for the quarter and year from an absolute return perspective. For the fourth quarter returns ranged from +3% for conservative accounts to +4.5% for aggressive accounts. For the year returns ranged from +13.5% to +17%. On its face these seem like great numbers. Unfortunately returns for the fourth quarter trailed our benchmarks by about 1% and our return for the year trailed by about 1.5%.

So what went wrong with Lifestyle? On the plus side we were overweight in two of the best performing asset classes in 2017: technology and defense. On the negative side we are still hedging about half our international equity holdings from strength in the dollar. While that stance helped us over the last few years it hurt us in 2017 as the dollar was weak. Our dollar-hedged international position underperformed its non-hedged brethren by over 8%. The other factor is our exposure to small cap equities. As seen above large caps outperformed small caps by over 7%. Owning small caps is the right thing to do for diversification purposes. Some years it helps. Some years, like 2017, it doesn't.

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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