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THE TEMPO VANTAGE

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Trade is Not a Zero-Sum Game, Mr. President

Right now I see two dominant forces affecting the markets which are also likely to exert influence as we move forward.

The first is interest rates, which have been rising. Rising rates are generally bad for both stocks and bonds. But, as I have written in the past, more important than the fact that rates are rising is whether rates are so high as to inhibit business and whether our expectations for future rates are accurate. Rates are still low by historical standards (3Q 2014 Tempo Vantage) and inflationary expectations have been consistent with reality (3Q 2017 Tempo Vantage).

Bottom line: Interest rates don't worry me at the moment.

Having said that I am not blind to the notion that most of President Trump's policies (i.e. immigration, trade, infrastructure spending, lower unemployment) are inflationary and at some point could spark inflation that is higher than expected. That would be bad.

The second force affecting the markets today is international trade. Even the most ardent liberal would have to agree that the United States is party to some lopsided trade agreements. In my opinion Trump is right to try and level the playing field.

Unfortunately he goes about it in such a belligerent and confrontational manner that the message often gets lost in his rhetoric. Even worse is that he provokes both allies and rivals to the point of inviting retaliation and disdain.

It seems to me that Trump looks at trade negotiations as a game.

Most games are zero-sum games. If one person (or team) wins the other loses. Think checkers, monopoly, or basketball.

But not everything in life has a zero-sum outcome.

Take investing, for example. If I decide to sell shares of stock xyz and you buy those shares is there a winner and a loser? No. The shares you bought might end up being a very good investment. Likewise whatever I do with the proceeds of that sale, whether it be buy another stock or pay for my child's college education, might also be a good outcome for me. We both can win.

It seems clear that Trump views trade as a zero-sum game. In order for the U.S. to win other countries must lose. But trade is not zero-sum. Effective trade policies will benefit all parties.

An all-out trade war would certainly be bad for the stock market.

Trump has a history of going to extremes at the outset of negotiations only to pull back to a more tempered stance. I think he will come to his senses before any short-term psychological damage he created becomes long-term economic damage... at least I hope he will.

The market is watching trade very closely. For most of the second quarter the market was humming along quite nicely driven by a strong earning season due in part to lower corporate taxes. At the peak (June 12) the S&P 500 was up 5.5% for the quarter. But as trade tensions increased toward the end of June the market pulled back.

In the end the S&P 500 gained 3.4% for the quarter and most U.S. equity categories had similarly attractive gains. But U.S. equities were about the only bright story. U.S. bonds were down (intermediate term bonds -0.25%, long term bonds -2%) as were both International stocks and bonds (over -2%, each).

Tempo Financial Advisors' 2nd Quarter Investment Performance

The results for Tempo's three investment programs has been mixed thus far in 2018.

Tempo Lifestyle accounts gained 1% on average for the quarter with aggressive accounts doing somewhat better and conservative accounts not quite as well. This was in line with our benchmarks. Thanks to our outperformance in the first quarter we are still about 1% ahead of the benchmark year-to-date.

Our tactical overweight in technology stocks (+5%) continued to perform well for us as did our small cap holdings (+6%). As you can imagine our positions in international stocks held back performance. Such is the nature of diversification. No matter how much we'd like everything we own to be up at the same time, unless we own investments that zig and zag at different times we are not diversified.

Also helping portfolios were our particular bond holdings. Our average fixed income position was up between 0.25% and 0.5% as compared to a loss of 0.24% for the BarCap Aggregate Bond Index.

While that 0.5% to 0.75% advantage may not seem like much, I am thrilled. As you know we try to tilt results in our favor any way we can. Lots of little victories in the short run add up to more significant outperformance over the long run.

Tempo Dynamic Growth accounts were flat for the quarter, which was 0.9% lower than the benchmark. Holding back performance in the second quarter were positions in international stocks.

The good news is that as with Lifestyle accounts, because Dynamic Growth had outperformed in the first quarter we are still ahead of the benchmark by 1% year-to-date.

Accounts have been rebalanced for the third quarter and international stocks are out in favor of small cap stocks. Dynamic Growth accounts now hold the lowest amount of equity (40%) that the model allows.

While the results for Tempo Lifestyle and Tempo Dynamic Growth have been mixed in the short run with year-to-date results that are still quite good, the results for **Tempo Dynamic Income** clients have been less than inspiring. Our return of -0.5% in the first quarter was ahead of the Bond Index by nearly 1%. Unfortunately our return of -2.5% in the second quarter was over 2% worse than the benchmark, which means we are now trailing the benchmark year-to-date by close to 1.5%.

I suppose we can take solace in the fact that for the one year ending June 30, 2018 Tempo Dynamic Income accounts are up 1.1% as compared to the Bond Index which was down 0.4%.

Once again it was our international holdings that tripped us up - in this case global bonds and emerging market bonds. The combination of the surprisingly strong dollar and rising rates outside the U.S. were a one-two combination that the rest of the portfolio couldn't overcome.

Dynamic Income accounts have been rebalanced for the third quarter and international bond positions have been sold. Accounts are now as conservatively positioned as they have been in a while with 70% invested between bank loan bonds and inflation protected bonds.

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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