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THE TEMPO VANTAGE

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It's All Anyone Can Talk About

I'm talking, of course, about the inverted yield curve. You didn't think I was going to say the Mueller report, did you?

An inverted yield curve is when the yield on short-term bonds is higher than the yield on longer term bonds. On March 20, 2019 the yield on 1-year T-Bills (2.47%) was greater than the yield on 10-year T-Bonds (2.44%). The 1-year T-Bill was also yielding more than 2, 3, 5, and 7-year T-Notes. But it was not yielding more than the 30-year T-Bond, so not a total inversion.

It was not much of an inversion, but it was still an inversion.

Why should we care?

The bad news is that inverted yield curves often predict recessions.

But there is good news as well. First, even though the accuracy of inverted yield curves predicting recessions is high it is not a guarantee. A recession may not happen.

Second, the lead time from first inversion to potential recession is typically at least six months and often as long as two years. The market has historically performed well in this interim period.

Finally, inflationary pressures have eased. The Fed has backed away from plans to raise rates multiple times in 2019 to where they will likely not raise rates at all.

Where does that leave us? If you are a long-term investor (time horizon greater than ten years) then you shouldn't worry. Time is on your side. But anyone with a shorter time frame (less than five years) should be cautious and not too aggressive (with the short-term money only).

Before you get depressed I am happy to report that the first quarter of 2019 was a terrific time to be an investor. Large cap U.S. equities were up 13%, international stocks were up 10%, and bonds were up a bit less than 3%.

This is a perfect example of why we shouldn't be overly swayed by short-term sentiment. Remember how you were feeling at the end of last year? The market had just fallen 20% and relief did not appear in sight. No one (not even me, and you may recall I was optimistic) was predicting a double-digit equity return in the first quarter. Yet here we are.

Oh, one more thing. The Mueller report is still hanging over us like a big dark cloud. When it comes to light is anyone's guess and of course what it contains is a huge wild card. There is simply no way to predict how the market will react.

Tempo Financial Advisors' 1st Quarter Investment Performance

Not surprisingly the **Tempo Lifestyle Program** had the highest return among our strategies in the first quarter. Returns ranged from +8% for conservative accounts to +11% for aggressive accounts. These are all in line with benchmarks. Still a bit away from recovering the highs we reached in the third quarter of 2018.

This is where the mathematics of advances and declines is interesting. If you lose 10% and then make 10% what is your return? At first blush you might think 0%. Not so.

Let's say you start with $100,000 and make 10%, or $10,000. Now you have $110,000. If you now lose 10% you will lose $11,000, leaving you with $99,000. So a 10% advance followed by a 10% decline leaves us with a 1% loss! Mathematically (for those of you who care) the formula is:

(1+R1)*(1+R2)-1 = T, where R1 is the return in period one (in decimal format), R2 is the return in period two, and T is Total Return.

In the above example: (1+.10)*(1-.10)-1 = -.01, which in percent terms is -1%. By the way, it works either way - you could first lose 10% then make 10% and you would still be down 1%.

It is because of the mathematics of advances and declines that we pay more attention to losses than gains. Also people don't like to lose money.

Given the mathematics and my thoughts above regarding the yield curve and the Mueller wildcard, I have tilted Lifestyle accounts a bit to the conservative side. Nothing drastic. After all, Lifestyle accounts are still considered long-term accounts. Our current equity overweights are in defensive areas such as healthcare and utilities. Plus I have sold our position in inverse bonds (bond that go up in value as interest rates rise) because at least in the short term it seems that inflationary pressures have abated.

If the markets continue up as in the first quarter we will certainly benefit, but not as much as we would with a more aggressive stance. A price I am willing to pay for a bit more cushion in this environment.

Tempo Dynamic Growth returned +6% in the first quarter, which was our second highest performer from an absolute return basis. But due to equity levels at the lower allowed limit (40%) and the conservative equity owned (utilities, covered call writing funds) we underperformed our benchmark by about 1.5%.

Dynamic Growth accounts have been rebalanced for the second quarter. Although there was some portfolio turnover the result is that we are still at the minimum allowed amount of equity and the equity is still conservative.

While I am never happy to underperform I am comfortable with these positions given the current economic environment.

Tempo Dynamic Income accounts rose 5% in the first quarter. This is the second highest quarterly return for Dynamic Income since Tempo opened its doors in 2008! Even though this was the lowest return among our programs in the first quarter, from an absolute return basis it was the only one to better it's benchmark. And it wasn't even close. We outperformed by over 3%!

Essentially everything we owned (utilities, long-term bonds, corporate bonds, global bonds, market neutral) outperformed the benchmark.

When it comes to utilities (which we own in all three of Tempo's investment programs) it is all a matter of perspective. When we think about utilities in the context of equities they underperformed and held back our performance in both Lifestyle and Dynamic Growth (Not a lot, though. +10% return for utilities versus +13% for the S&P 500). But when we think about utilities as an income-generating investment (i.e. fixed income or bonds) they outperformed by a lot.

Accounts have been rebalanced for the second quarter and remain positioned mostly in the same way. The biggest change was the addition of emerging market bonds at the expense of market neutral.

We are well positioned if interest rates stay the same or even fall. We will likely underperform should inflation suddenly pick up, which I don't deem as likely.

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