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THE TEMPO VANTAGE

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A Contrarian View

What a difference a year makes! This time last year we had just experienced a significant stock market decline and I was describing reasons why I was feeling optimistic (click *here* for last year's 4Q Tempo Vantage).

Today we are coming off a terrific year for the stock market and I will describe why I am feeling a bit cautious.

Let's start with the good news.

The fourth quarter of 2019 was a wonderful end to a wonderful year, at least with respect to stock market gains, with most equity benchmarks gaining between 8% and 10%. On the high end were healthcare and tech stocks which gained 18% and 12%, respectively. On the low end were real estate and utilities, both of which were up 1%.

Two thousand nineteen as a whole was even better with stocks rising between 20% and 30%. Once again tech stocks lead the way, gaining 37.5%. On the low end were international stocks, which gained 22%.

Bond investors also had reason to cheer, not so much in the fourth quarter, but for the year as a whole. While most bond categories were flat or slightly positive in the fourth quarter, for the year gains were 8%, give or take, for most categories. Emerging-market bonds and high-yield bonds led the way for the fourth quarter (+2.8% & +2.3%) as well as the year (+14.5% & +12.6%).

If things are looking so good for the stock and bond markets, why am I feeling cautious?

Remember that the stock market is a forward-looking vehicle. Returns today reflect expectations for the future, not what happened yesterday. What has changed in the last year to alter my thinking? Two things:

First, recall that in the first quarter we had an inverted yield curve (click *here* for 1Q Vantage Newsletter). While an inverted yield curve is no guarantee of a recession or of a bear market, it is certainly worthy of our attention and respect. The lag between first inversion and negative markets is typically between six and 24 months. We are now nine months from first inversion.

Second is sentiment. You may recall that sentiment is a negative market predictor. Low levels of optimism (fear) are a positive sign for the stock market and high levels of optimism (greed) the reverse. In recent weeks sentiment has turned quite positive. The CNN Business Fear and Greed Index stands at 92, which is considered "extreme greed."

While we are on sentiment, consider the VIX. The VIX is a volatility index created by the Chicago Board Options Exchange that indicates the market's expectation for volatility over the next 30 days. Much as with sentiment, VIX is a negative market predictor. Low levels of VIX are associated with optimism and are considered bearish, whereas high levels of VIX (i.e. high volatility) are associated with fear and uncertainty and are considered bullish. Current levels of VIX are quite low and near term bearish.

None of the above is a guarantee that the market will fall. But where I'm sitting it makes sense to have a modicum of caution.

Tempo Financial Advisors' 4th Quarter Investment Performance

The **Tempo Lifestyle Program** generated the highest return among our investment strategies in the fourth quarter. Returns ranged from +4.5% for conservative accounts to +6.5% for aggressive accounts. While that may seem great, across the board we were about 0.75% below benchmarks. The story was the same for the year as a whole. Returns ranged from +16.5% to +22% and trailed benchmarks by between 1% and 1.5%. The question is why?

Based on the above commentary you may not be surprised that I believe caution is in order at this juncture. Over the past year I have nudged portfolios to be a bit more defensive, most recently adding real estate to portfolios. In the near term those changes have hurt us.

Should the market continue at its recent pace we will certainly make money and most likely trail benchmarks. If, on the other hand, the market does experience some turbulence, we will be positioned better than most.

The **Tempo Dynamic Income Program** had the most successful quarter and year in terms of returns relative to benchmark. Accounts were flat in the fourth quarter, which was in line with benchmarks. Dynamic Income really shined for the year as a whole gaining 14.5%, which was between 6% to 9% ahead of benchmarks. A home run no matter how you look at it!

Dynamic Growth returned just under 1% in the fourth quarter and 11% for 2019. Most years these would be just fine. But 2019 was a better-than-average year and **Tempo Dynamic Growth** failed to capture its fair share of those gains. Our returns trailed benchmarks by 3.5% in the fourth quarter and 5% for the year. Again, we ask why?

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As you may recall Dynamic Growth allocates between 40% and 60% to equities. On the plus side our model correctly had us positioned at our maximum equity allocation for the entire year.

Our algorithm, which cannot be explained in a sentence or two, even if I wanted to, tends to prefer steady market segments and shies away from more volatile areas. The result is that we held utilities for most of the year. While that was fine in the first three quarters (+20%), utilities were clearly out of favor in the fourth quarter (+1% v. +10% for S&P 500).

The same was true for real estate, which we also owned in the fourth quarter. The entire fourth quarter underperformance can be traced to these two positions.

Accounts have been rebalanced for the first quarter of 2020. Despite the outcome in the fourth quarter, the volatility and correlation patterns among equity categories have not changed much. We are still near our maximum equity allocation and we are still overweighted in both utilities and real estate. As with Lifestyle, time will tell if caution is warranted.

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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