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THE TEMPO VANTAGE

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Let’s Hope This Time Won’t be Different

Who doesn’t like being right? I know I do (just ask my wife!).

In the third quarter 2022 Tempo Vantage, I wrote: ”While I expect short-term volatility to continue, and there certainly could be lower lows, with the markets already down between 25% and 30%, my guess is the worst of the decline may already be behind us.”

That seems to have been accurate, as stocks across the board were up in the fourth quarter. The broad market, as measured by the S&P 500, was up 7.5%.

There was a much bigger difference than usual between the top and bottom performing sectors. Above average outliers were energy (+20%), international stocks (+17%), infrastructure (+9% for general infrastructure to +16% for electric), and financial (+10%). Below average outliers were real estate (+4%) and technology (+2%).

Bonds also staged a bit of a comeback in the fourth quarter. The BarCap Agg Bond Index (Agg) was up 1.8%, with most sectors not far from that.

Ok, enough self-congratulations. For the year my prognostications were less accurate.

I was right about bonds. At the start of 2022, I was expecting a tough year for bond investors (and had positioned portfolios accordingly). In fact, the Agg was down 13% for the year. The spread between the top and bottom sectors was quite wide. Bank loan bonds and non-traditional bonds were down 2.5% and 6%, respectively. Long term bonds were down 25%!

I was less accurate (to say the least) on stocks, where I thought returns would be positive, or at least better than bonds.

Of course, I wasn’t counting on the war in Ukraine, which threw the markets into a tailspin early in the year and still continues to roil the energy markets in particular. For the year stocks were down 18% (S&P 500), with some sectors doing much better (energy +45%, utilities -1%, infrastructure -8%, financial -12%) and some much worse (real estate -25%, technology -37%).

Moving forward I am cautiously optimistic for positive stock returns in 2023.

Part of my optimistic reasoning is the same as it was going into the fourth quarter last year. Market participants have already discounted the potential for a recession, at least a shallow to modest one.

I also see low unemployment. People are still spending money. China is finally opening up from the pandemic (eases supply chain). Interest rates and inflation may have peaked (the yield on the 10-year Treasury was at 4.25% in October, 2022 and is at 3.53% as of this writing).

I said I am cautiously optimistic. My caution has me watching the yield curve and the debt ceiling.

The yield curve is inverted, meaning short-term rates are higher than long-term rates. While there is a correlation between inverted yield curves and recessions, it is far from a perfect correlation. (See Q1 2019 Tempo Vantage for more in inverted yield curves.)

I am particularly worried about the looming battle over the debt ceiling.

This is a process that has played out dozens of times in the past.

Congress battles. Threats are made. People worry that the US could default on its debt (which would be a disaster with a capital D). The market reacts negatively. Eventually cooler heads prevail and the market returns to normalcy.

What worries me is the crop of extreme Congress members that seem to actually want (not just threaten) us to default on our debt.

Will this time be different? I hope not!

Am I worried about the spate of recent layoffs? Not really. Why?

Have you noticed that many (though not all) of these layoffs are occurring in e-businesses (Amazon, Meta, Salesforce, Twitter, Snap, DoorDash, Wayfair, Robinhood, Peloton, Shopify)?

What I see is a maturing of "e" market businesses. From the late 1990s to now, these businesses have been in growth-at-any-cost mode. They were awash in cash first from venture capital and then from public markets. Profits were not important. Market share was.

In this mode you are not worried about too many employees. You can't get enough.

Eventually, you've got to deliver what investors demand (profits) or the well will dry. A bloated work force won't help that.

Not everything about layoffs is bad (unless you are the one being laid off!). The first benefit is more competitive and profitable companies. With my economist goggles I see another benefit: easing inflation.

Tempo Financial Advisors' 4th Quarter Investment Performance

Tempo's investment strategies had modest success in the fourth quarter of 2022 but great success for the year, with all four investment strategies besting their respective benchmarks.

Tempo Lifestyle accounts returned between 7% (conservative) and 9% (aggressive) for the fourth quarter, which was in-line with benchmarks. As you may recall, I never mind being in-line with benchmarks when the market does well.

Where we really shined was in the first three quarters of the year. When both the bond and stock markets were struggling, our tactical overweights in infrastructure, financial, and healthcare helped us on the equity side and our positions in bank loan bonds and non-traditional bonds helped on the fixed income side.

But the real star was our diversified basket of alternatives, which performed better than both stocks and bonds.

Put it all together and Tempo Lifestyle accounts outperformed the benchmarks in 2022 by about 2%.

Tempo Diversified Income, the newest of our investment strategies, continues to impress. It returned 2.6% in the fourth quarter, which was almost 1% ahead of the Agg. For the year, Diversified Income returned -3%, which was 10% better than the Agg!

Tempo Dynamic Income was not as successful in the fourth quarter of 2022. Accounts were flat as compared to the +1.8% return for the Agg. For the year, however, Dynamic Income shined, returning -5% and besting the Agg by 8%.

The **Tempo Dynamic Growth** program also struggled in the fourth quarter, generating a return of +1.3%, which was well below the benchmark return of +6.5%. Two thousand twenty-two was just the opposite. Our return of -4.7% was over 7% ahead of the benchmark.

It is never fun to lose money. Tempo's active (Dynamic Income and Dynamic Growth) and income (Diversified Income) strategies are designed to preserve wealth during extreme times. We were certainly successful at that in 2022.

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