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THE TEMPO VANTAGE

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Worry All the Way to the Bank

There is a saying that the market likes to climb a wall of worry. I've often thought about why this mythological wall of worry would help the market rise. My analysis is that excessive worries cause people who are inclined to sell to sell and once the sellers have sold there is less selling pressure (try saying that five times, fast!). Basic supply and demand theory tells us that less supply (i.e. sellers) along with the same demand (i.e. buyers) means higher prices.

Whether this old adage is true or not, it certainly seems to have been in effect in the first quarter of 2011. There was plenty to worry about and the market did climb. In the end most equity benchmarks gained about 5%.

The worry parade didn't have the same affect on the bond market. Most bond benchmarks were flat to fractionally positive in the first quarter.

It was not, however, a smooth ride to the 5% return in the equity market. Along the way there were bumps courtesy of some of the worries of the day. What are some of the worries and what is the likelihood they could derail this bull market?

<u>Japan Earthquake, Tsunami, and Nuclear Meltdown</u>

The market had a swift, negative reaction to the events as they unfolded. Within a week of the earthquake the S&P fell close to 4%, wiping out gains to that point in the year. As is often the case, those who sold that week sold too soon. The market has since risen about 5%.

While this undoubtedly will have far reaching affects in Japan, and to an extent around the world for companies that trade with Japan, it is still a one-time event. One-time events tend to have a short impact on the market, which seems to be exactly what happened. It will not have enough impact on our economy to derail the bull.

<u>Double Dip Recession</u>

For much of the past 18 months there have been fears of a double dip recession. Perhaps the biggest concern with the recovery is that unemployment has been stubbornly high. But there has been plenty of good news as well:

- Corporate earnings have been strong.
- GDP growth seems firmly in positive territory.
- The unemployment rate has started to decline.

The risk of a double dip recession at this point is low.

Inflation

It is true that rates have come up a bit over the last 6 months. And with the amount of liquidity the government has been supplying, the smart money (if there such a thing) is betting that rates will continue to rise over the next few years. Higher rates are generally bad for the stock market (the cost of capital is higher, and stock values can be determined by discounting future revenues by current rates).

I view this as more of a long term concern. First, realize that rates are starting at super low levels. While there is certainly a number above which interest rates would be a concern (think back to the early 1980s) we are far from that rate. Second, stocks are considered one of the best assets to protect value during inflation.

Turmoil in the Mid-East

Just a few months ago no one could have predicted the widespread upheaval in so many Middle-East countries. The prospect of democracy spreading to that region is exciting. Of course who is to say that the next regime will be any better than the last? Whichever way the political winds shift, however, they will not have an impact on our economy.

The price of oil might, however. It doesn't take much to imagine the political turmoil affecting the supply of oil. Given that our economy is so dependent on oil, this is the most serious of the worries. History has shown that high oil prices will eventually have a negative impact on the economy.

Tempo Financial Advisors' Investment Performance

I am very pleased with the performance of all three of Tempo's investment programs in the first quarter, and hope you are as well. All three strategies generated returns in-line with or exceeding expectations at comparable risk profiles.

While I imagine most of you do not watch your accounts on a day-to-day basis, you won't be surprised if I tell you that I do. I bring this up because as events unfolded in the first quarter both Dynamic Programs exhibited exactly the type of behavior I expect in volatile markets. The first quarter can be divided into three fairly distinct periods.

1. January 1 to February 18 - S&P gained 6.7%
2. February 19 to March 16 - S&P 500 fell 6.4%.
3. March 17 to March 31 – S&P 500 gained 5.5%

While the Tempo Dynamic Programs did gain during periods 1 and 3, the gains did not match the returns of the market. This is to be expected. What I'm most pleased with is the fact that the Dynamic programs held on to most of those gains in the second period. While the market was losing 6.4%, the Dynamic Income Program gained 0.1% and the Dynamic Growth Program lost just 1.2%.

When all was said and done the **Tempo Dynamic Income Program**, our most conservative strategy, generated a gain of 2.7% in the first quarter. This is especially attractive when you recall that most bond benchmarks were flat or fractionally positive. We owe our success to favoring corporate bonds to treasuries and to our ability to look beyond traditional bonds and into categories such as convertible bonds and alternative funds.

The **Tempo Dynamic Growth Program** was even more profitable in the first quarter, gaining 3.2%. Although we do hold positions in small cap growth US equities and in REITs, we achieved gains despite being under-weight in equities. We also had constructive gains in high yield bonds, global bonds, bank loan funds, and alternatives. Diversification in lower risk areas helped contain losses in the middle of the quarter when the market fell.

Tempo Lifestyle Program accounts experienced attractive gains at all risk levels, just as you would expect in an up market. Returns ranged from over 4% for conservative accounts to 6% from more aggressive accounts. Across the board returns were ahead of benchmarks at appropriate risk levels. We continue to over-weight real estate, technology and healthcare on the equity side and under-weight government bonds and long duration bonds on the fixed income side. These themes have served us well and we think will continue to do well at least in the intermediate term.

Company News

In the event that any of you missed my announcement in February I have once again been named a 5 Star Wealth Advisor in *Boston Magazine.* At the very least that sounds impressive! Plus, I'm told that it is rare for a new firm to garner this award. Even better!

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