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THE TEMPO VANTAGE

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Is Healthcare Reform a Game Changer?

For a change, recent headlines in the business section are less about stock market performance and more about healthcare reform. That shift to something else, anything else, has led to a period of low stock market volatility. Low volatility generally bodes well for the stock market. Indeed, the first quarter saw a rise in most US equity indices with the Dow Jones Industrial Average, the S&P 500 and the NASDAQ all gaining between 4.0% and 5.5% for the quarter. Small Cap US equities were even stronger, returning over 8%. International stocks were relatively weak, with the EAFE (Europe, Australia, Far East) Index essentially flat.

The bond market also experienced a positive quarter, but less so than the stock market. Most bond benchmarks gained between 1% and 2% in the first quarter. The direction of the bond market moving forward, however, seems much less certain. The key will be the direction of inflation. In the short run it appears that inflation will remain in check, though I do expect it to pick up toward the end of this year or perhaps next.

As a quantitatively-oriented research person, I can tell you that there is a dizzying array of metrics that can be used to attempt to divine the future direction of the stock market. Price earnings ratio, dividend yield, market volatility, investor sentiment, and the yield spread are a few I've written about in the past. Yet there is no holy grail, no single metric which can tell us with certainty what will happen moving forward (though that doesn't stop me and others from trying to find one). About the best we can do is to look at the weight of the evidence - where are the majority of indicators pointing? Even this is not 100% accurate.

Sometimes I look beyond the numbers to get a feel for how the markets are trading. How is good or bad news received? Do early day moves get extended or reversed throughout the day? When I go to the mall, is the parking lot full?

In 2008 both bad news and good news had negative impacts on the market. Time and again good news would help the market start the day on a positive note only to have the trend reverse and the market down (sometimes significantly so) by the end of the day.

Today the reverse seems to be happening. Bad news (unemployment, Greek debt, housing data) seems to have a short lived negative effect on the market, and days that start out lower seem to end higher or at least much less negative than the start. Plus, it took me 15 minutes to find a parking spot at the mall last week! These, along with the weight of the evidence (which is encouraging), lead me to be optimistic for positive stock market performance through the remainder of 2010.

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I am in the midst of reading the book *Game Change,* which gives the reader a glimpse of events that changed the course of the last Presidential election. This got me thinking of game changing events in the stock market. There are far fewer game changing events for the markets than you might be lead to believe in the popular press. In the end, though, stock market performance always comes down to profits. Strong corporate profits lead to higher stock markets, eventually, and vice verse.

Is the recently passed healthcare bill is a game changer? Certainly this law will impact the various healthcare segments (drug companies, biotech companies, insurers, hospitals, etc) differently. It is significant that the day after the healthcare bill was passed healthcare related stocks were up. We may applaud this landmark reform or not. Certainly more people will be covered by healthcare insurance. It appears, however, that costs will not be as contained as many had hoped. While there will certainly be changes within healthcare, this law will not be as much of a game changer for the 84% of the economy not devoted to healthcare. Of course it will be years before the law will be fully implemented and the complete details are still a bit sketchy. Only time will tell.

Tempo Financial Advisors' 1st Quarter Investment Performance

Tempo clients experienced solid gains in the first quarter. Leading the pack, as you might expect in a strong stock market, were **Tempo Lifestyle Strategy** accounts. Returns for the quarter ranged from about 4% for more conservative accounts to over 5% for more aggressive ones. Helping portfolios were positions we took in real estate at the end of January. Since then real estate has gained close to 18%, making it one of the strongest segments of the market. As the economy was getting back on track a few months ago we also anticipated the addition of commodities to portfolios. While we do still expect to add commodities as some point we feel that is still a bit too soon. At this point in the economic recovery, firms do not have pricing power. Until such time we will be content to wait. In fact commodities were one of the lagging segments of the market in the first quarter.

While we expect Lifestyle Strategy accounts to capture the lion's share of bull markets, we do not expect the same from the **Tempo Dynamic Income Strategy**. Yet, that is exactly what happened.

The Tempo Dynamic Income Strategy returned 4.5% in the first quarter. We are very pleased with these results, not only because returns were in line with the stock market, but because the bond markets were not nearly as profitable (with a few exceptions). Our strategy algorithm correctly avoided traditional fixed income categories (i.e. government bonds), instead favoring high yield bonds, bank loan bonds, and convertible bonds, each among the leaders in fixed income performance for the quarter.

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Supplementing the bond holdings were positions in real estate (see above) and utilities. We are in the process of rebalancing accounts and can report that portfolios will see little turnover at this juncture. The only significant change is that we are selling utilities in favor of emerging market bonds.

The **Tempo Dynamic Growth Strategy** also experienced healthy returns in the first quarter, with accounts gaining 2.5%. As we've reported recently, the Dynamic Growth Strategy has been a bit slow to embrace equities, instead generating most of its gains in alternative asset classes and bonds (high yield, bank loan, and emerging market). This is typical coming off a bear market because the algorithm shies away from asset classes deemed to be too risky. Now that we've had a positive market for over a year (the bear market bottom was in March, 2009) the model will not view equities with quite the same trepidation (as if a model could feel trepidation). Indeed, the second quarter rebalance shows that mid cap equities, small cap equities, healthcare, real estate and technology will all be part of Dynamic Growth accounts.

Finally, a reminder to contact us if there has been a change in your financial circumstances that would warrant a fresh perspective on your portfolio.

Daniel J. Traub

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