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# THE TEMPO VANTAGE

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## Getting Back on Track

The stock market has made a tremendous turnaround in just a few months. After falling 25% from the start of 2009 through March 9, the market rose 36% through the end of the second quarter. More than half of that advance occurred the last three weeks in March, and the rest (15.9%) in the second quarter. Remember the mathematics of advances and declines (see April, 2009 Tempo Vantage); a 25% decline followed by a 36% advance merely brings the market to slightly better than break even for the year. Even after this advance we are still down 41% from the peak in October of 2007. To return to that peak we still need to advance another 70% from current levels!

While the recent market advance is encouraging, the question everybody wants answered is when will the recession end? Economics wonks can point to a myriad of indicators as evidence of the economy's direction. Here is just a small sampling: purchasing managers' survey, rate of unemployment, new jobless claims, retail sales, home sales (new and existing), real estate values, industrial production, consumer confidence, and money supply. The difficult part is that some of these are leading indicators, some are coincident, and some are lagging. Since there will be no time when all of these indicators point in the same direction, at best the message is mixed. Each day the market fluctuates as fresh statistics are released. Making matters worse, by the time the government officially announces that the recession is over we will be six to nine months into recovery. What is the average person to do?

For what it is worth, seven of the ten leading economic indicators are now pointing up. Sometimes the best predictors are the simplest to understand. Stock market performance is considered a leading economic indicator. An up market today indicates improvement in future economic activity. Another fairly reliable leading indicator is the yield spread – the difference between rates on short term and long term treasury bonds. An inverted yield curve (short rates higher than long rates, which occurred most recently in 2006) usually signals a recession. A strongly upward sloping yield curve (long rates more than 3% higher than short rates) usually indicates that market participants expect economic activity to improve relatively quickly. Today the yield curve is strongly upward sloping.

A question I am often asked is: given where the market is likely to go how should I invest? This is a dangerous question because nobody (including me) knows where the market will go tomorrow. How you should invest depends on your own set of circumstances (age, risk tolerance, time horizon, income needs, etc.), regardless of where the stock market may or may not go. Your answers will lead to a portfolio that is right for you; let's call this portfolio your ideal. A lot can happen to cause your portfolio to deviate from your ideal, stock market movement and emotional responses to market movements chief among them.

If possible investors should periodically seek to restore their portfolios to their ideal (also known as re-balancing). Of course if you are a client of Tempo we do that for you.

At any given time investors fall into three camps: those that are currently invested more aggressively than their ideal, those that are in line with their ideal, and those that are invested more conservatively than their ideal. After having lost significant money over the past 18 months, those who are too aggressively invested may want to use market rallies as opportunities to reduce risk (sell a portion of their equities). Those that are already in line with their ideal are obviously in good shape. The more challenging situation may be how to increase risk if you are too conservatively invested.

What do you do if you are sitting on cash waiting to get back into the market? On one hand you may have been happy to be out of the market (or at least under-invested) at the end of last year and/or the beginning of this year. On the other hand you are not happy to have missed the significant rise over the past four months. The market may even be higher now than when you sold. You may wonder if you missed the boat. You may worry that if you invest now it will be just in time for the rally to end. It can be paralyzing.

The best thing you can do is to take emotion out of the picture. This is easier said than done. One strategy is to set up a dollar cost averaging schedule. Dollar cost averaging involves purchasing a fixed amount of securities (hopefully a well diversified basket) at set intervals over a period of time, regardless of which direction the market is moving. This reduces risk and eliminates the potential to invest all of your money at a high.

Another strategy is to invest in alternative investments. Alternative investments have a low correlation to the overall market, yet still have the potential to capture some of the upside with a fraction of the downside risk as compared to traditional equity investing. I would certainly put Tempo's Dynamic Income and Dynamic Growth Strategies in this category.

Ok, enough of the marketing (though a masterful segue). How did Tempo do in the second quarter? Very much in line with expectations. Let's start with the **Tempo Dynamic Growth Strategy.** As you know we expect the Dynamic Growth Strategy to capture some, though not all, of the up side available in the market. We can accept this because we also expect the Dynamic Growth Strategy to fall less than the overall market in declines. This is exactly what has transpired over the past 18 months. In the second quarter the Dynamic Growth Strategy gained 6.7%, compared to the return for the market of 15.9% (as measured by the S&P 500). Of course I always think we should do better, and this quarter is no exception. Considering that portfolios are still quite conservatively positioned, with only 10% of the portfolio in equities, I am quite pleased with the results. (Please do not confuse conservative positioning within the Dynamic strategies the same as conservative positioning for your entire portfolio.)

The rest of the story is that while the S&P 500 must still rise 70% to return to its peak in October 2007, the Dynamic Growth Strategy only needs to gain 12%. This highlights that in times like these it can be more import to not lose in the declines than it is to gain in the advances.

Although the stock market enjoyed attractive gains over the past few months, the bond market did not. While the S&P 500 rose 36% from its low on March 9, over that same time period the Barclays Capital (formerly Lehman) Aggregate Bond Index gained just 2%. In fact many government and high quality long term bond indices are still in negative territory year to date. Reflecting the bond market, the **Tempo Dynamic Income Strategy** gained 1.8% in the second quarter and is still down year to date. In keeping with the theme of how much gain is need to return to the levels of October, 2007, I am happy to report that Dynamic Income is just 7% away.

As of this writing we are in the process of rebalancing both Dynamic Growth and Dynamic Income accounts according to their respective algorithms.  The Dynamic strategies generally underweight asset classes deemed too volatile.  In case you are not sure, the stock market is still quite volatile these days.  As such we do not expect many changes to accounts, and what few changes there are will not change the fact that both Dynamic strategies will remain quite conservatively positioned. Should the market continue up from here these strategies will not capture the full gain.  Of course they will hold up much better than the market should we experience a decline (as has happened the first few days of the third quarter).

The star performer in the second quarter, as we would expect in any major market advance, was the **Tempo Lifestyle Strategy.** Accounts grew anywhere from 11% to 20% for the quarter.  Aggressive portfolios beat the market by 2% to 4%, moderate portfolios were in line with the market, and conservative portfolios were able to generate returns in the double digits.  A big success any way you look at it.  Accounts are generally 20% to 30% away from their October, 2007 levels.  Perspective is everything.  In a vacuum those number look horrible.  But, when you realize that the gain required is only 1/4 to 1/3 that required for the S&P 500, it is spectacular.

## Company News

I am thrilled to report that on June 20 Tempo celebrated its one year anniversary.  This past year has been rewarding in so many ways.  Most significant is the trust you have put in me to manage your hard-earned assets and thus help make Tempo Financial Advisors a successful, growing business. Thank you!