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THE TEMPO VANTAGE

July 2011

Tyrannosaurus Debt

After a positive stock market in April (S&P 500 up 2.8% through 4/29/11) the next eight weeks saw a steady decline. That's the bad news.

The good news is that the decline was relatively tame. Over the past few years we have become accustomed to stock market swings exceeding 20%. The decline from April 29 to June 24, by contrast, was 7%. A strong stock market the final few days in June erased the previous losses and the quarter as a whole was nearly unchanged. The S&P 500 (large cap stocks) was up +0.1%, although the Russell 2000 (small cap stocks) was down -1.6%.

In the April Vantage we considered a number of concerns: The Japan earthquake/nuclear meltdown, inflation, potential for a double dip recession, and turmoil in the mid-east. Fast forward a few months and the only one still in the press is the potential for a double dip recession. The state of the economy is in the same quagmire we've been in since the recession ended.

If none of that has changed, and some concerns have been ameliorated, then why did the market decline? Two reasons: Greece and the U.S. debt ceiling.

Although Greece is a small country, as part of the European Union the fear is not only about Greece but the potential contagion to Portugal, Ireland and beyond. The Europeans have been dealing with the Greek situation for a few years and it finally appears to be coming to a head, despite the protests of the Greek people. Fiscally the Greeks have been behaving like a drunken soldier on leave with a pocket full of cash. Something has to give.

And give it did. The Greeks passed the so called austerity measures (to raise capital and reduce spending). In return they will receive much needed financial assistance from the EU. What this means to you and me is that the Greek effect will be short lived. I believe the uptick at the end of June was an indication that the market has already moved on from this concern.

The U.S. debt ceiling is a classic game of chicken between the Republicans and Democrats to see who will blink first. The Republicans only want to reduce spending and the Democrats want to include certain taxes increases. Sound familiar?

The difference this time is that if they can't come to an agreement the government will not only shut down but also default on debt. That would be bad, very bad.

Because both sides understand the severity of default the likely scenario is that there will be a deal – probably at the 11th hour. I do expect some market weakness until it becomes clear that a deal will be reached. It won't make the deficit go away, but it will at least sooth our fears for a few years, likely until after the next election. For now, though, the result for you and me is that the debt ceiling fears will go away in a month.

The debt ceiling issue reminds us that the government is really good at one thing: kicking its problems down the road for the next generation (or at least the next politician) to deal with. This is nothing new. Years ago there was a School House Rock song called *Tyrannosaurus Debt* about the deficit and how it was out of control. Check it out here: http://www.youtube.com/watch?v=_mfMG66LtVU.

Eventually this problem has to be tackled or the results could be disastrous. Or does it? Did you know that the original national debt was due to Revolutionary War spending? The politicians have been successfully kicking this down the road for a very long time and I have no idea if the day of reckoning will happen in 2012 or not in my lifetime.

Oh, and don't sell those European politicians short – they are also quite adept at delaying their issues. I suspect that that we have not heard the last of the Greek (or Portuguese or Irish) debt issue.

In the short run I expect both the Greek debt and US debt ceiling situations to be under control and anticipate that the market will perform reasonably well the remainder of the year. As I wrote this time last year I believe the stock market has entered the third stage common to post recessionary periods: a sinusoidal (sound wave) type pattern with mostly sideways movement. I do expect the net movement over time, however, will be positive – higher highs and higher lows.

Tempo Financial Advisors' Investment Performance – Our Car Ride Together

I am pleased to report that all of Tempo's Investment Programs generated positive results for the quarter.

Although the gains were modest, we are happy to have any gain when many segments of the market were down. The Tempo Dynamic Income Program gained 0.5%, the Tempo Dynamic Growth Program gained 1.2%, and Tempo Lifestyle Program clients gained between 0.5% and 1.2%, depending on how conservative or aggressive their portfolio. Interestingly the more conservative Lifestyle clients did better than aggressive ones this past quarter as it did not pay to own risky assets.

Given that the quarter was calm by recent standards, rather than delve further into the specifics of each investment program (as I usually do) I thought I'd divert the discussion to a more general discourse on risk. People's eyes usually gloss over when I use words like standard deviation, alpha, beta, and sharpe ratio. So let's try an analogy.

Imagine you are on a 30-mile car ride and it is important that you reach the end. You'd also like to get there faster. Why not speed? It might make for an exhilarating ride! The fast lane looks pretty inviting when you see all those cars speeding by. What could go wrong?

The police could catch you. You would have to pay the ticket and the delay could eliminate the time advantage sought by speeding in the first place. Worse, you could get in an accident. Maybe it would

be a fender bender, or maybe the car would be totaled. Not only would you need to repair your car but completion of the trip would be in jeopardy.

Perhaps a better plan would be to go the speed limit (okay 5 miles over the speed limit – nothing too crazy). Chances are your ride will be uneventful; no police, no accidents. And you are very likely to complete this journey.

Now imagine the 30-mile ride is 30 years of investing. Completing the ride means reaching your financial goals. Speeding is risk.

Taking risk can make you a lot of money and you could reach your goal sooner. This is America, after all, and these things do happen. But taking too much risk also means a journey fraught with danger of extreme losses which could jeopardize your financial goals.

This is the thinking behind the Tempo Dynamic Programs. I can't promise that you'll reach your financial goals faster or with more money. But the odds of reaching your goals go up when you avoid major setbacks.

None of this is to say that you should avoid all risk. You couldn't if you wanted to. Even putting all of your money in the bank entails risk (inflation, bank failure). Taking risks is an integral part of investing – they go hand in hand.

Taking prudent and appropriate risk is the key. For some with a long time horizon embracing risk is the right course. For others it is not. At Tempo we work with each client to determine as best we can what is right for you.

Company News

Tempo has recently celebrated our third anniversary. Thanks to you the company has continued to grow each and every quarter and year. Just the sort of company you'd like to buy… if it were public!

As always, 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