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THE TEMPO VANTAGE

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Signaling the End of the Recession

A minor decline the last few weeks of September could hardly tarnish what was otherwise a spectacular quarter for the stock market. The S&P 500 returned 15.6% for the quarter, which brings the year to date return to 19.2%. Many people hardly noticed how good returns have been these past months. Several people (clients and others) told me they will think about investing again when the market starts to make money. They were all surprised when I told them that the market was up over 50% since the low of March 9. I do understand their perspective, though. They are no doubt thinking that the market is down significantly from the high back in October of 2007. This is certainly true. The S&P 500 is still down approximately 30% from the peak in October 2007 (which means it must gain another 43% to return to that level).

It is well known that there is a psychological nature to investing. It is easy to be overly influenced by recent history. This is known as anchoring. Think back to March of this year. It was quite easy at that time to be convinced that the market would continue down, even greatly so. How many of you thought the market would be up at all over the next six months, let alone up significantly? Be honest. It's okay. This just means you are human. Understanding this about ourselves can help us in the next bear market. And there will surely be one. (By the way, anchoring can also cause us to assume that an up market will continue – think back to 1999).

Will the advance continue? From a seasonality perspective the market often has declines in the months of September and October. Given how far we've come over the past seven months I would not be surprised to see a pull back here, though I believe that any decline will be short-lived. While I am not willing to jump out on a limb and suggest that the market will return another 50% over the next seven months, I am willing to go on record and say that the low in March will prove to be the recession low.

I've studied all of the recessions going back to 1929. There have been 14 of them (including the current one) over these 80 years, an average of one every 5.7 years. I sought to answer two questions:

1. How long after a recession begins does the stock market hit bottom?
2. Is there a relationship between the time it takes the stock market to bottom and the total duration of the recession?

The average duration of the previous 13 recessions was 13 months (the high was 43 months from 1929-33, and the low was 6 months in 1980). The average time for the stock market to trough was 11 months (the high was 34 months in 1929-33, and the low was 1 month in 1958). On average, therefore, the time it took for the market to reach its eventual bottom was equal to 86% (11/13) of the total duration of the recession.

Let's compare these figures to the current recession, which began in December of 2007. Although it has not been officially declared over, it may very well be. According to Federal Reserve Chairman Ben Bernanke, June was likely the trough in the economy and the third quarter will likely be positive. Of course, by the time the data confirms this and an announcement is made we will be months into the recovery. For our purposes, though, let's assume (have you noticed that economists like to assume things?) that the recession did in fact end in June. That would make the total duration 19 months (which is longer than any recession since 1929-33). If this recession follows the pattern of the average recession and the stock market were to bottom at 86% of the total duration, then the bottom would occur in 16 months (86% of 19). This would translate to a bottom in March, 2009! Ah, if only it were that simple. Averages are averages, statistics lie, and no recession will conform exactly. Still, given the length of this recession and the recent strength in the stock market, I believe that the recession is over and that we have already seen the stock market low.

Tempo Financial Advisors' 3rd Quarter Investment Performance

Of the three Tempo Strategies, the one that most took advantage of the strong up market was the **Tempo Lifestyle Strategy**. In fact, third quarter and second quarter returns were remarkably similar for both the market (S&P 500: Q3 +15.6%, Q2 +15.9%) and the Tempo Lifestyle portfolios that I could simply quote from last quarter's Vantage. I think I will: "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."

In addition to the continued outperformance of the Tempo Lifestyle portfolios the other exciting news is that accounts are much closer to break even than the broad market as shown below:

	% Down From High	% Gain to Break Even
S&P 500	-30	+42.8
Tempo Lifestyle Conservative	-8	+ 8.7
Tempo Lifestyle Growth	-10	+11.1
Tempo Lifestyle Aggressive	-13	+14.9

The Tempo Dynamic Growth Strategy completed another very successful quarter at +6%, which brings the year-to-date return to +8.6%. You may have noticed that Dynamic Growth trailed the S&P 500 by a significant margin. Is this outside the norm? Should we be concerned? Not at all! As you may know the Dynamic Growth Strategy strives for an equity-like return with greatly reduced risk. The result is generally not as much gain on the upside, but much less loss on the downside. It turns out that minimizing the losses is more important than maximizing the gains. Over the past 13 years there were four times (not including this one) when the S&P 500 returned more than 15% in a single quarter. During those quarters the Tempo Dynamic Growth Strategy gained an average of 6.4%. Despite the underperformance during these strong periods, and thanks to loss minimization in the negative quarters, the average annual return over these 13 years was +10.0% for the Dynamic Growth Strategy compared to +4.6% for the S&P 500.

The Tempo Dynamic Income Strategy returned 3.2% in the third quarter. Certainly nowhere near the returns in the equity markets, though quite attractive for an income-oriented investment. The third quarter gain brings the year to date return for the Dynamic Income Strategy to just about break even. While we consider the year as a whole somewhat of a disappointment thus far, it is clear that most of the disappointment occurred in the first quarter when the strategy lost -5%. Since then

Dynamic Income has turned around nicely. Until now positions have remained on the conservative side, which explains why strategy results more closely resemble high quality, short-term bond benchmarks (many of which are still in negative territory for the year) rather than riskier credit areas such as convertible securities and high yield bonds, which have generated attractive returns. As of this writing I am in the process of completing the quarterly rebalance of Dynamic Income accounts. Indeed portfolios are shifting to areas of the income markets that should capture more of the upside (high yield bonds, bank loan funds, convertible securities, and emerging market bonds). Despite the lowest return of all of Tempo's strategies thus far in 2009, because it lost so much less in 2008, Dynamic Income is the strategy that is closest to returning to October 2007 levels, just 3.1% away!

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