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THE TEMPO VANTAGE

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Watch the Forest, Ignore the Trees

The first quarter of 2012 saw a continuation of the stock market rally that began at the end of 2011, with most equity benchmarks gaining over 10%. At the end of the day the stock market reflects corporate profitability and today corporate profits (and margins) are very attractive. This remains a conundrum given that unemployment has been stubbornly high.

What I do know is that the parking lot at the mall across from my office is constantly full. People are spending money despite their employment status. It is likely that government stimulus and safety nets are keeping the economy afloat.

The first quarter was less successful for bond investors. The Barclays Capital Aggregate Bond Index (the most commonly used bond index) was essentially break-even. Perhaps the long anticipated rise in interest rates may finally be upon us. I expect the rise to be gradual as the Fed is still committed to keeping rates extremely low. Still, I think that the bull market (since 1981) for long term government bonds is over.

It also won't be a straight line to higher rates. Whenever the next fear of the day comes along there will be a flight to safety (i.e. bonds). But it will be temporary.

We've all heard the saying "can't see the forest for the trees." This is a great analogy for investor behavior and the past year has provided some great examples. We saw significant hits to the stock market with the tsunami in Japan, the Greek debt crisis, and the US budget crisis. At those times it was difficult to see beyond these short term influences (trees) to see that the economy was still experiencing a recovery (the forest).

I regularly look back to my prior views to see how accurate I was. I am happy to report that the last few years I have been on target.

In the summer of 2010 I wrote about the typical pattern of stock market recoveries. After a significant rise from the trough the market settles into a sinusoidal pattern in which both rises and falls are the norm. Check.

In the summer of 2011 I wrote that the pattern would continue and that we would see higher highs and higher lows. (Highs today, May 2011 and April 2010 all higher that previous highs. Lows of September 2011 and July 2010 higher than the previous lows.) Check.

In the fall of 2011 I wrote that stocks were attractively priced and that the market is poised for an upturn. Check.

Notice in all of these writings that I was focused on long term patterns and economic trends. Though I certainly wrote about each of the then current market worries, I tried to determine which were trees and which were forests.

Of course I didn't get everything right and it is only fair to point that out as well. As early as 2010 I had been expecting higher interest rates and that did not come true… at least not yet!

So where are we today? There are not any major trees blocking our view at the moment. High oil prices are a concern, unemployment is higher than expected at this point in a recovery, housing remains weak, and the European debt situation still looms. But none of these have been burning front page issues for a while.

My biggest long-term concern remains the extreme level of government debt. Could this be solved? Sure. But so far I see no evidence that our politicians can agree on anything. I also have little confidence that when they do act they will act constructively. And what about timing? Will they attempt to tackle this next year? In 8 years? In 25 years? And if they don't act how long can we go before serious consequences ensue? This is a huge wild card.

I am still in the camp that the market is fairly valued and that we will continue to see higher highs and higher lows. But there will be another low. From a seasonality perspective a "summer swoon" is certainly possible. Still, I would not expect any major movement between now and the Presidential election in November.

Tempo Financial Advisors' 1st Quarter Investment Performance

The past few years have been a battle between the so-called "risk on, risk off" trade on Wall Street. Risk on is when investors bid up stock prices because the economy is recovering, corporate profits are improving, and the alternatives (i.e. low bond yields) are unattractive. Risk off is when market participants shun risk (stocks) in favor of safe investments (bonds) due to short term market influences. This has made it somewhat of a difficult time for Tempo's Dynamic Strategies to gain any traction since the changes in sentiment seem to turn on a dime.

As mentioned above bonds were essentially flat in the first quarter. In light of that we are pleased that the **Tempo Dynamic Income Program** managed to eke out a gain of about 0.5%. Nothing to write home about but at least we are moving in the right direction.

The **Tempo Dynamic Growth Program** gained approximately 2% in the first quarter. Since the goal in Dynamic Growth is not to correlate to the overall stock market but to provide a steadier ride yielding attractive long term returns we should be somewhat satisfied. Still, with the strength in the stock market we also must acknowledge that Dynamic Growth was under-weighted in equities and therefore did not capture as much of the upside as we would have liked.

The Dynamic Programs can be difficult from an emotional perspective since they do not always correlate to the overall market – nor should they. By contrast the **Tempo Lifestyle Program** will almost always be in sync with the market, both capturing attractive gains to the upside as well as falling (hopefully less) when the market is down.

And so it was in the first quarter of 2012 with **Tempo Lifestyle** accounts gaining anywhere from 7% for conservative clients to over 10% for more aggressive clients - exactly where we expect to be in this environment.

You may have noticed two changes to your Lifestyle portfolio over the past few months. The first is that we have carved out a piece of our large cap U.S. equity exposure for a fund focusing on dividend paying stocks. In many ways dividends have been out of favor since the mid '90s. Historically, though, dividends have constituted a significant portion of the total return for stocks and it is likely that they will again in the future. Dividends can also provide some downside protection during declines.

Secondly, we sold our over-weight position in healthcare in favor of a position in financial services. While the healthcare investment served us well over the past 18 months there could be some pressure on this sector if the Supreme Court strikes down any or all of the Obama Healthcare Bill. Without taking sides on the healthcare issue, from an investor perspective I find the sector much more attractive with Obamacare than without.

Relative to financial services, we have been content to wait on the sidelines the past five years or so as that sector struggled not only with profitability but in many cases with solvency. But banking will always be a significant part of our economy, the worst is behind us, and the stage is set for future gains.

Company News
Most of you are aware that I have once again been named a 5 Star Wealth Advisor in *Boston Magazine.* I know this because many of you commented on the similarities between me and Meryl Streep. Thank you for your comments. And, for the record, we try not to wear the same outfit to award ceremonies.

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