TEMPO
Financial Advisors, LLC

550 Cochituate Road, Suite 25 ■ Framingham, MA 01701
Tel 508.655.7827 ■ Fax 508.655.7829
www.TempoAdvisors.com

# THE TEMPO VANTAGE

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## When Good News Is Bad

I am always interested in the stories that drive the markets. Sometimes news that is normally positive is suddenly viewed as negative.

This occurred in the second quarter of 2013. Here is a piece of good news: The economy is continuing to improve. Read on to find out why that is bad.

The second quarter started much the way the first quarter ended for the markets – steady and positive. But toward the middle of May volatility and uncertainly returned. The concerns were not fundamentally based (i.e. are companies making money and are stocks fairly priced), but were macroeconomic and governmental issues. How soon would the Federal Reserve Bank discontinue its monthly bond buying program? Would the Chinese credit crunch (a spike in bank lending rates) continue?

There are two schools of thought relative to the Federal Reserve Bank's monthly $85 billion bond buying program. One group fears that adding such liquidity to the market will eventually spark excess inflation. This group would like to see the program end sooner rather than later.

The second group believes the only reason the economy has recovered at all is because of the easy money environment that the Fed's bond buying has created. They fear for the economy should the Fed discontinue the program.

All along the Fed has said that it will continue this program until the economy can stand on its own. Indications over the past few months are that the economy is strengthening. That is good news, right?

Yet with every piece of good news about the economy the stock and bond markets fall. Why? Because if the economy is strong enough the Fed will wind down the bond buying program. If you are in the second group (above) that terrifies you. And you sell. Voila, good news turned bad.

You can't have it both ways. The Fed cannot buy bonds forever. Even the people in the second group know this. And we all want a strong economy. At some point the prospect of a strengthening economic recovery and an end to the bond buying will be viewed for what it is: good news.

I often think the same thing about diversification. Wouldn't it be nice if when the market is up all of our holdings would be up as much or more? And then when the market is down all of our investments had more modest losses (or even gains). You can't have it both ways.

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One of my favorite sayings is: If you are properly diversified you always have something to complain about. Think about it. By definition being diversified means owning investments that don't zig and zag at the same time. In investing lingo we look for investments that are not correlated to each other. If everything you own is up and down at the same time then your investments are too correlated and you are not diversified.

This is why I continue to hold investments in Lifestyle accounts such at the Direxion Managed Futures Fund (DXMAX). This has not been a particularly profitable investment for us. But that doesn't mean it isn't valuable.

The Direxion fund will typically not make very much in an up market. As the past few years have been quite positive for the overall market it would be easy to become disappointed with DXMAX. This fund will have its day in the sun though, and recent performance has given us a glimpse of its worth.

Below is a table of the S&P 500 performance in the second quarter on days the market was down more than 1% and the performance on those days of the Direxion Managed Futures Fund.

| Date | S&P 500 Return | DXMAX Return |
|---|---|---|
| 4/3/2013 | -1.1% | -0.0% |
| 4/15/2013 | -2.3% | +3.9% |
| 4/17/2013 | -1.4% | +1.2% |
| 5/31/2013 | -1.4% | +0.7% |
| 6/5/2013 | -1.4% | -0.2% |
| 6/11/2013 | -1.0% | +0.2% |
| 6/19/2013 | -1.4% | +0.0% |
| 6/20/2013 | -2.5% | +2.4% |
| 6/24/2013 | -1.2% | +0.4% |

As an investment advisor I can tell you that this is a terrific result. DXMAX had a -0.24 daily correlation to the stock market in the second quarter and is a true diversifier.

**Tempo Financial Advisors' Investment Performance**

Typically when the stock market declines there is a rush to safety. That usually means bonds. And positive bond returns can partially off-set negative stock returns. This time, however, the decline was actually led by a rise in interest rates (i.e. lower bond prices). As a result any investment prized for income fell as much or even more than stocks. This included bonds of all stripes as well as utilities and REITs. From the middle of May to the last week in June virtually everything was down.

In the end a strong final week of June left most U.S. stock categories with modest gains for the quarter. The S&P 500 was up +2.9%. But many other areas struggled. International stocks (-1%), commodities (-7%), and real estate (-2%) were all down. The same was true for nearly every category of bonds: high yield bonds (-1.4%), inflation bonds (-6.5%), intermediate term bonds (-2.6%), municipal bonds (-3.0%), and global bonds (-3.7%).

Given the above comments on the bond markets and income producing investments it will not be a surprise that the **Tempo Dynamic Income Program** struggled a bit in the second quarter. We were

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doing quite well through June 18, maintaining a positive return for the quarter while most bonds had lost money. But the Fed's comments on June 19 (about winding down the bond buying program) along with the Chinese credit crunch fears accelerated the rise in rates (decline in prices) and we fell into negative territory along with the rest of the income world. For the quarter we were down -1.9%.

While I am never happy with a loss I do look at our returns in comparison to alternatives (see bond returns above). Also of significance is that for the year ending 6/30/13 the total return for 10 Year U.S. Treasurys was down -4.2%. Over this same period Tempo Dynamic Income was up +3.7%.

**Tempo Dynamic Growth** fared a little better than Dynamic Income in the second quarter. Still, with a minimum of 40% exposure at all times to conservative, income oriented investments we sustained a loss of -1.1% for the quarter.

The good news for Dynamic Growth clients is that the turnaround in equities that began the last week in June has continued early in the third quarter and we have already recovered from the second quarter loss.

**Tempo Lifestyle Program** accounts performed the best in the second quarter, and the more aggressive accounts did the best of all due to their lower allocations to bonds. But even minimal exposure to bonds held back accounts as did exposure to other diversifying areas such as international stocks. For the quarter aggressive clients gained approximately 1% while conservative accounts were fractionally positive.

**Company News**

Tempo Financial Advisors, LLC celebrated our 5$^{th}$ Anniversary on June 20, 2013. This has been the most rewarding five years of my career. Thanks to everyone who has helped make Tempo a success. This includes clients, referral sources, friends, and family. Many of you belong to more than one of these groups.

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

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