# The Type 2 Investor

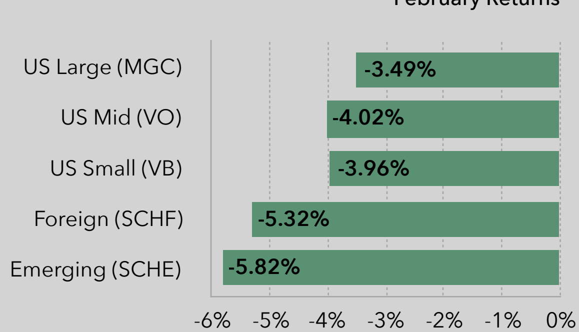
March 13, 2018

## February 2018

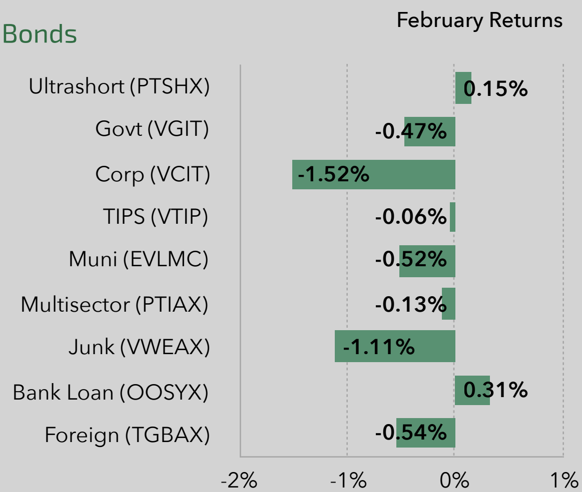
### Economic Data

- An unusually high 313,000 jobs were added in February, but despite the strength y/y wage inflation cooled to 2.6%
- Inflation (CPI) jumped 0.5% in January but the year-over-year rates for both the headline and core remained unchanged at 2.1% and 1.8%, respectively
- Existing home sales fell again, slipping 3.2% in January despite increased supply and a 2.4% drop in median prices
- Not only were January retail sales bad, down 0.3%, but December was revised down to 0.0% from 0.4%

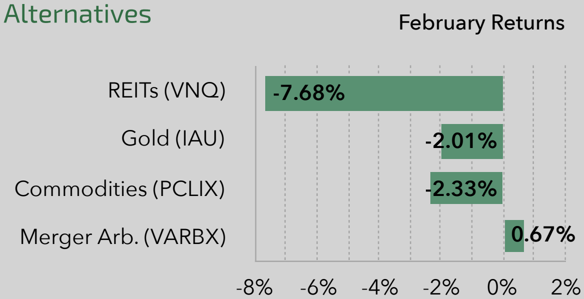
### Stocks




### Bonds




### Alternatives




*Performance data provided by Morningstar.*

*The brain uses two systems to process information. The first type is intuitive but lazy, rapidly forming judgements with no conscious input. The second system is slow, reflective, and is not guided by emotions. It is that second system – type 2 – that we want in control of our investment portfolios.*

### The Three 'B's: Beers, Boats, and Buds

"Can I ask you a question?"

"Sure!"

"Are you happy?"

"Well, I got a boat, good friends, and a trampoline. You tell me."

That was a revelational series of dialogue from the *30 Rock* episode where fictional GE executive Jack Donaghy went to Liz Lemon's high school reunion and realized that everyday middle-class folk were happier than he was. They do say money can't buy happiness, but research argues it in fact can. But only up to a point.

A research paper out of Purdue has caught a few headlines recently by trying to dial in on that point at which further increases in annual income cease to increase happiness. The paper tries to go beyond a very similar study done by Agnus Deaton and the great Daniel Kahnemen almost a decade ago. That study used 2008 and 2009 data, and found the number to around $75,000 in the U.S., although, as the Purdue paper points out, it could've technically been anywhere between $60,000 and $120,000 because of the use of categorical data. "High incomes don't bring you happiness, but they do bring you a life you think is better," Deaton and Kahneman concluded.

The number the Purdue group found, as it pertains to overall life satisfaction (i.e. are you living your best possible life?), is about $105,000 for a single individual in Northern America (U.S. and Canada). As far as your day-to day emotional well being, they found positive affect (things like happiness, enjoyment, and smiling/laughter) satiated at $65,000. So beyond that amount, positive emotions are more or less influenced by factors other than money. At $95,000 you've reached the satiation point for negative feelings of emotional well being like stress, worry, and sadness. So beyond that point, money isn't likely to cure your blues, and can even begin to have a negative impact for some. 'Mo' money, mo' problems', I believe is the expression.

Of course, it's a little more nuanced than that. How you compare to your friends or other professionals in your peer group makes a big difference. Someone making $60,000 out of college while their friends are making only $30,000 is probably going to feel quite a bit more satisfied than, say, someone making $100,000 when others in their same role with similar experience are making two or three times that. Likewise, someone living in Fort Wayne might feel flush making $75,000 per year, while someone in San Francisco might feel borderline destitute making the same. Levels of educational attainment and the number of dependents you have will also play a role. Even the amount of time you spend on social media, where people's lives are often filtered to look as fabulous as possible, may have an effect.

So aiming for exactly $105,000 in your personal life might not be the exact goal and probably misses the point. The key message here is the marginal utility of income diminishes as it increases, and probably faster than most would think. A $10,000 bump in pay could be life-changing for someone at the poverty line, but it would be significantly less meaningful for someone already making $100,000. It's a logarithmic function, rather than a linear one. Meaning, to feel a similar effect of a doubling of income from $25,000 to $50,000, one would have to then double again to $100,000.

What you need to find is the point that works for you, where you realize that anything over that would be welcome but won't really make you any happier. I have a pretty good sense where my number is, having spent significant periods of time below, near, and above it. It is enough to feel secure, live in a nice apartment in a good neighborhood, go out to bars, restaurants, and theaters without too much thought, take a couple nice vacations every year, and still have some money left to sock away for a rainy day.

Once you stop seeing improvements in your emotional well-being and life satisfaction with every raise or promotion, it might be a good time to ask yourself "is it still worth it?" Would a continued climb up the corporate ladder mean less time with those I love? Would it be damaging to my health? Would it mean foregoing other passions and leisures that I really enjoy?

If you haven't hit that point yet, rejoice in the knowledge that more money can still buy you happiness. By all means, keep reaching for that brass ring. Or maybe just move to Latin America or the Caribbean. The study showed it only took $35,000 per year to be happy there.

## Portfolio Positioning

Equity markets have recovered since last month, with the S&P 500 so far clawing back about 70% of it's losses from the correction. We have been underweight equities for some time, and may look to take a little more off the table in the coming weeks or months. The potential implications of the removal of stimulus from the Fed and the ECB are too big to ignore.

## Binge Box

### The Expanse (Amazon Prime)

I know I probably recommend too many sci-fi shows, but what can I say – something about space exploration really ignites my sense of boyhood wonder and imagination. I particularly appreciate shows that make a decent effort to be grounded in hard science, like *The Expanse*. That means artificial gravity that comes from linear acceleration, rotation, or magnetic boots, not some unexplained technology. Communication over distance takes time, and faster-than-light travel is nowhere near possible. The setting is our own solar system – not some far-off galaxy – and you can actually believe this is somewhere close to where humankind could be in a few centuries, making it somewhat relatable. Some have called it the "*Game of Thrones* of sci-fi." I wouldn't go that far, but it's definitely an engaging show worthy of binging.

**Tactical Asset Allocation**

| Asset Class | Heavy Under-weight | Under-weight | Neutral | Over-weight | Heavy Over-weight |
|---|---|---|---|---|---|
| **Cash Equivalents** | | | | | ● |
| **Fixed Income** | | ● | | | |
| US Govt. | | ● | | | |
| TIPS | | | | ● | |
| Multisector | | ● | | | |
| Bank Loans | | ● | | | |
| Foreign Bonds | | | ● | | |
| **Equities** | | ● | | | |
| Large Cap | | ● | | | |
| Mid Cap | | ● | | | |
| Small Cap | ● | | | | |
| Developed Intl. | | ● | | | |
| Emerging | | | ● | | |
| **Alternatives** | | | | | ● |
| Commodities | | | | | ● |
| Hedging | | | | | ● |

Within the bond portfolio, our decision to significantly cut credit exposure by eliminating investment-grade corporate bonds and junk bonds in January has so far proven to be well-timed as spreads there have widened over the past six weeks. Likewise, our move to shorten duration has also been beneficial.

Additionally, the removal of REITs from alternatives in January has also been beneficial as they were the worst-performing asset class we track last month. Merger arbitrage, on the other hand, was the best performing asset class, showing the value uncorrelated assets can have in a portfolio.

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## About EmeraldSpark

EmeraldSpark Investments, LLC is a Registered Investment Adviser based in Chicago, IL. We were founded by Ryan P. Layton, CFA in 2015 to provide personalized financial planning and fiduciary investment management services to select individuals. Our investment process blends the foundations of Modern Portfolio Theory with the latest research in the field of behavioral finance. We specialize in asset allocation and investment due diligence to help provide our clients with investment strategies personalized to match their specific goals and risk comfort zone.