The Type 2 Investor

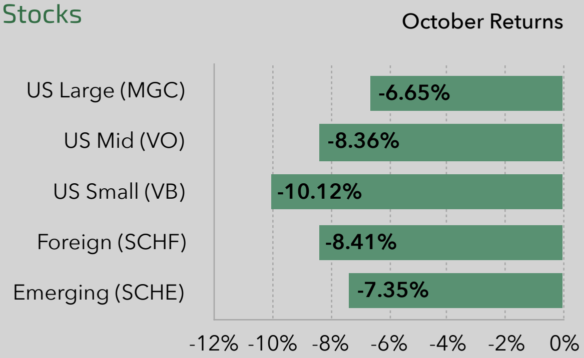
November 7, 2018

October 2018

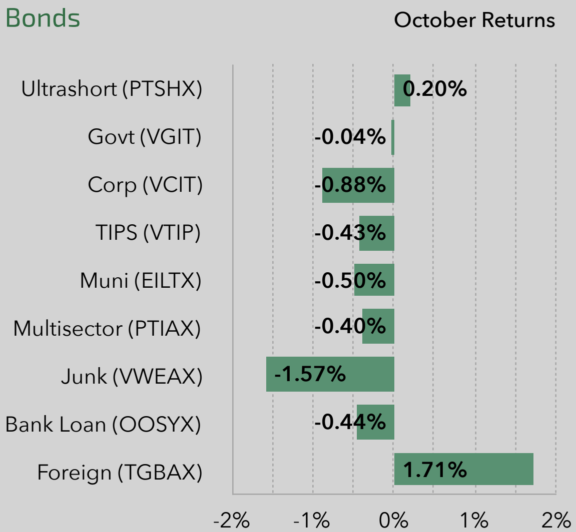
Economic Data

- A better-than-expected 250,000 jobs were added in the US in October, and average hourly earning grew 3.1% y/y–the biggest pay raise since '09
- Inflation (CPI) slowed further to 2.3% y/y in September
- After taking a short breather in August, existing home sales resumed their decline, falling 3.4% in September
- Retail sales were up another 0.1% in September, matching August's tiny gain
- 3Q GDP grew at a 3.5% annualized rate

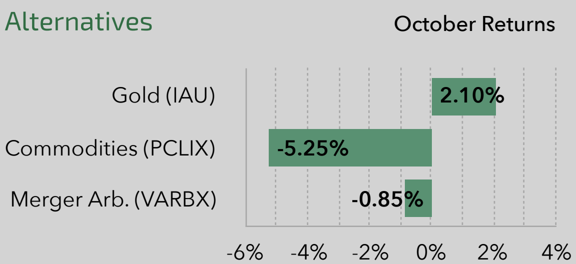
Stocks



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.

Mid-Terms

There was apparently an election yesterday, which, I'm told, had little in the way of surprises. Here in Illinois, the billionaire beat the other billionaire for the governor's office. No doubt our troubles are over in the Land of Lincoln. On the national stage, democrats took control of the House and republicans increased their advantage in the Senate.

What does this mean for the markets? I honestly don't know. On the one hand, I tend to like gridlock because it typically means fewer stupid laws are made. On the other hand, with control of the House, the potential for an impeachment and the turmoil that comes with it is now on the table. That's not a prediction, I'm just saying the door is open a crack. Lastly, I'm interested to see if President Trump pushes the lame-duck Congress to fast-track any legislation in the next couple months, particularly the middle-class tax cuts he's alluded to but given no real details on.

IRS Increases Contribution Limits

One more thing before we get to talking about those sharp declines in the markets. The IRS made an announcement on Thursday that contribution limits for IRA and 401(k) accounts will be going up next year. The limit for IRA accounts will be increased for the first time since 2013, rising from $5,500 per year to $6,000 in 2019. For 401(k) accounts the limit will be increased from $18,500 to $19,000. Catch-up contributions will remain unchanged for workers aged 50 and older, at $1,000 and $6,000 respectively.

The phase-out range for single workers wishing to make Roth IRA contributions will increase to $122,000 - $137,000. For the marrying type who files jointly the range increase to $193,000 - $203,000. So, if you are under those numbers next year, you can and probably should make Roth contributions.

With that out of the way, on to the carnage…

Correction Territory

The stock charts to the left look pretty ugly. The S&P 500 had its worst month since September 2011. Small caps were hit hardest, and remain ever-so-slightly in correction territory, which is generally considered a 10% drop from a recent high. Rising interest rates and concerns over the trade war's potential impact on earnings have been a couple of the triggers that market analysts have been pointing to, but these aren't exactly new developments. Others point to tech stocks. The FAANGs (Facebook, Apple, Amazon, Netflix, and Google) which had long been the darling of the market were now leading the way down on a number of days over the past month. Amazon (AMZN), for example, which arguably, isn't even really a tech stock, fell hard, dropping 21% during the month.

But trying to point fingers at the specific cause at this specific time is kind of pointless. The why doesn't change the fact that it happened. Really, this is something that's been brewing for a while, and it's why we have been lighter on equities than we normally would be. Which, I suppose is good, but not cause to take a victory lap. Kind of like the weatherman correctly forecasting rain for the 4th of July. It doesn't mean he's happy about it.

The real question is whether this is just a correction that we soon recover from, as most often times is the case, or if it's something that moves into bear market territory. Price-to-earnings valuations are obviously more attractive than they were a month ago. That tends to happen when the numerator drops quickly. But I think we are still a ways from calling stocks cheap.

On the bond side, higher credit risks sold off. Safer US treasury bonds didn't provide much help, but they at least held their ground. The ultrashort and foreign bond positions were the only ones that were up.

Crude oil had its worst month since 2016, falling 10.8% and dragging our commodities fund down with it. The WTI futures curve is no longer in backwardation on the front end, but still offers some positive roll yield further out on the curve. This is something we will continue to monitor, and we may be forced to cut our position if the curve moves into contango (negative roll yield). Until then, I still believe oil will move higher if we are in fact in the twilight of the current business cycle.

One bright spot was gold, which, you know, finally did what it was supposed to. It was up 2.1% in October as investors sought it out as a safe-haven and hedge funds who were net short bid the price up to cover their positions.

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

Binge Box

Maniac (Netflix)

Jonah Hill plays Owen, a schizophrenic desperate enough for cash that he signs up for a drug trial that hopes to explore the human brain and solve happiness. There he meet's Emma Stone's character, Annie, who is haunted by the death of her sister. Emma Stone and Jonah Hill give their best performances since *Superbad*, and I only say that half-chuckling. I mean, I really liked *Superbad*, but the two actors are really at the top of their game in this. *Maniac* is set in a near-future, but one that is seemingly viewed through an 80's lens. Think Rubik's cubes, mainframe computers with a lot of blinking lights, and Japan mattering a lot. It's a wild, surreal, and whimsical story, that isn't made to appease the lowest common denominator.

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.