The Type 2 Investor

September 9, 2020

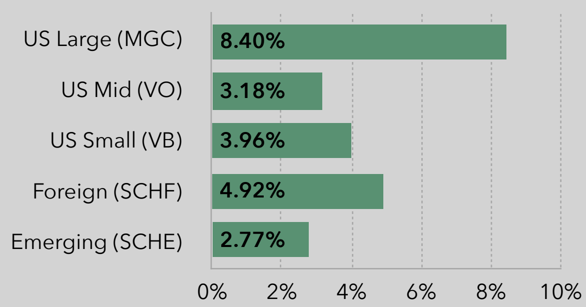
August 2020

Economic Data

- US payrolls growth slowed to 1.371 million in August and the unemployment rate somehow fell to 8.4%, according to the BLS
- Retail sales were up 1.2% in July and up 2.7% y/y
- Y/y inflation (CPI) rose to 1.0% in July
- Existing home sales rose by another record, surging 24.7% in July following June's 20.7% record gain
- The Conference Board LEI rose 1.4% in July

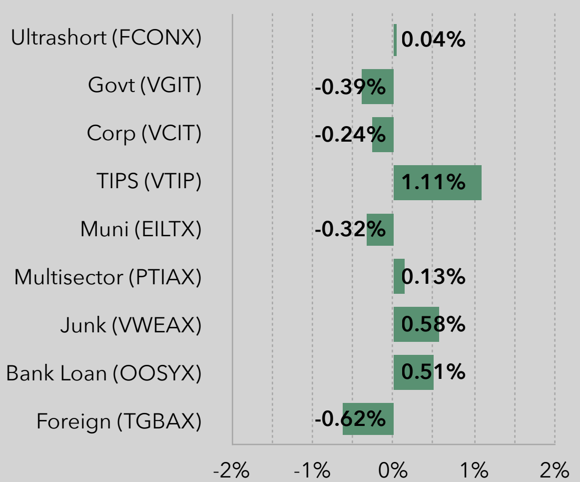
Stocks

August Returns



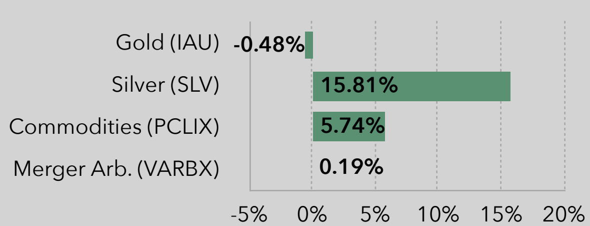
Bonds

August Returns



Alternatives

August Returns



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.

Tech Stocks and Fantasy Football

Between August 11 and August 31, Apple was up 18% and Tesla was up an eye-popping 76%. Was it earnings that drove the stocks higher? I don't really think so. Neither of them released earnings during that period, and the most recent release showed Apple's 3Q earnings were flat and essentially the same as they were two years ago when the stock traded at half its current price. It would appear Apple's heady growth days are behind it. And Tesla? Earnings? What are those?

So what did happen? Well, on August 11 both Apple (AAPL) and Tesla (TSLA) announced stock splits and for August 31, with Apple doing a 4-for-1 and Tesla—not to be outdone—going 5-for-1. Stock splits are pretty meaningless from a mathematical standpoint. If I take your dollar and give you four quarters, guess what? You still have a dollar. But the market bid up the stocks anyway because… maff is hard? The argument has been made that cheaper share prices make expensive stocks more accessible to the little guy, who otherwise couldn't afford to buy one single share. The counterargument is that these aren't exactly the players who move the market. Plus nowadays fractional shares are available through a lot of brokerages. Still, a stock split is news, and people like buying stocks in the news. This is called the availability heuristic in behavioral finance, and is a frequent and much easier substitute for proper analysis. So maybe this was all it took.

I do think there was something else at play here, though. What if I told you this was a classic gamma short squeeze in the options market creating a positive feedback loop in the stock prices? This would probably be the point you stop reading tout of boredom. Fair enough, but I do believe that was a factor, too.

Either way, in the last week both stocks have come back down a little closer to Earth, with Tesla losing nearly one-third of its market cap, while Apple is about 18% below its high. Maybe it's because people learned how to do math. Maybe it's because a certain Japanese firm closed out $7 billion worth of long call options. Or maybe, just maybe…it's because fantasy football is back, baby!

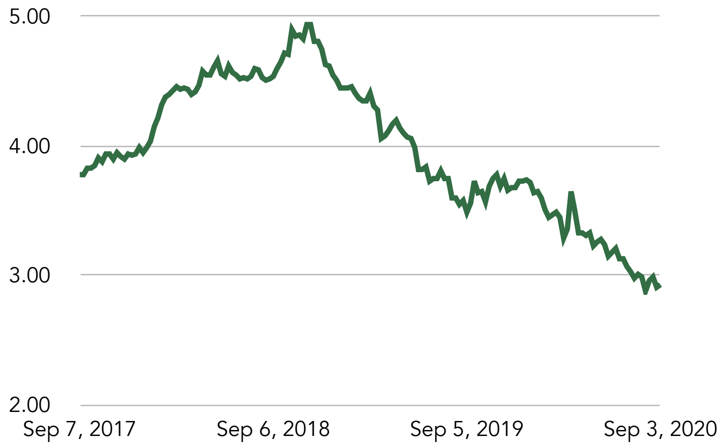
Hear me out. A pandemic strikes. Gamblers have stimulus checks burning holes in their pockets, but the usual fare—casinos and sports—are shut down. They open a Robinhood account instead and start day-trading stocks and options. Markets rally. This is exciting. But football season starts tomorrow. The tech stock market crashes as they sell out of their investment positions and move the money over to DraftKings.

Maybe not, but I am pretty excited about football and my fantasy teams. Yes, I said "teams". Plural. But please don't lump me in with the group I talked about in the previous paragraph. I'm only in two leagues, which is fine. Fantasy football leagues are like cats. It's okay to have one. It's even okay to have two. If you have three or more, however…well, that's probably too many.

Cold Water on the Mortgage Refi Rush

I started encouraging mortgage refinancing as a potential action item back in March when the Fed was slashing interest rates to zero. With record-low interest rates, it should be no surprise that this has been a popular move as of late. Refinances helped the mortgage industry issue $1.1 trillion in home loans between April and June, according to mortgage-data firm Black Knight Inc., which was up more than 200% from a year ago and the highest number they had on record going back to 2000.

30-Year Fixed Rate Mortgage Average in the United States



Source: Freddie Mac

But on August 12, without warning, the Federal Housing Finance Agency rolled out a new "adverse market" refinance fee of 0.5% which would be assessed on all mortgage refinances sold to Fannie Mae and Freddie Mac after September 1. The surprise move through cold water on the refi rush and drew wide condemnation from various industry trade groups, as well as the White House.

Mortgage refinances, on average, took 48 days to close as of June, according to Ellie Mae. This would have left many lenders holding the bag on mortgage refinances that were already locked in but would not close before the deadline.

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					●

The FHFA bent to the pressure and pushed back implementation until December 1, but the fee is still happening. So if you were considering a refi because of historically low rates, it would probably be wise not to hesitate much longer.

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Binge Box

High Score (Netflix)

High Score is a limited series documentary on video games. Each episode covers a different topic that is an integral part of the history of the industry, and showcases some of the people that were involved. Each episode also ties in a little competitive gaming component, similar to what you might have seen in the documentary *King of Kong*. The show isn't a perfect documentary, but that doesn't really matter to me. For me the show was about remembering the arcades I used to spend all my chore money at; how excited I was when my dad brought home an NES; and thinking how cool I was when I jumped ship to Sega when the Genesis came out. Nostalgia abounds.

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 clients. 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.