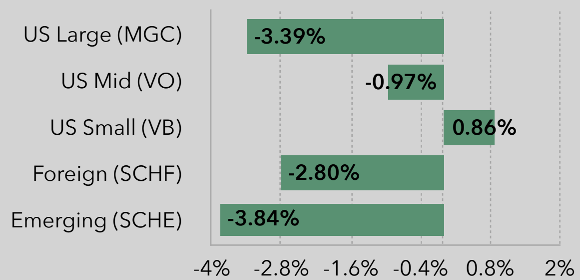
## February 2022

### Economic Data

- Payrolls jumped as 678,000 jobs were added in February; the unemployment rate declined to 3.8%, but wage growth was flat
- Retail sales were up 3.8% for the month of January, pushed higher by furniture stores and nonstore retailers
- Y/y inflation (CPI) rose to 7.5% in January—the ninth month in a row at or above 5% and the highest print since February 1982
- Existing home sales were up 6.7% in January as buyers rushed to get ahead of higher mortgage rates

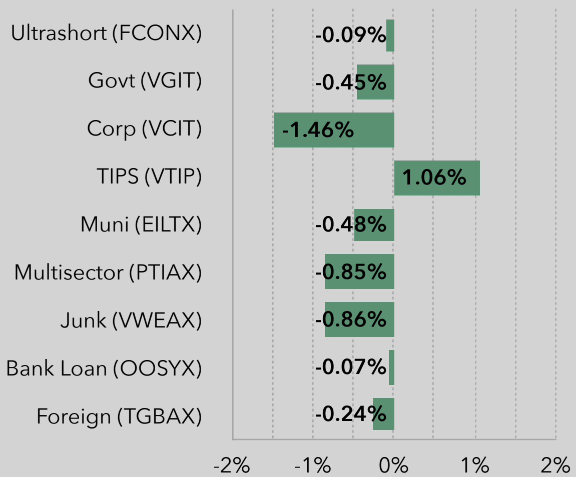
### Stocks

February Returns



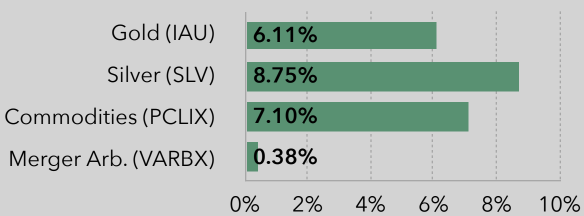

### Bonds

February Returns




### Alternatives

February 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 not guided by emotions. It is that second system — type 2 — that we want in control of our investment portfolios.*

## The New Cold War

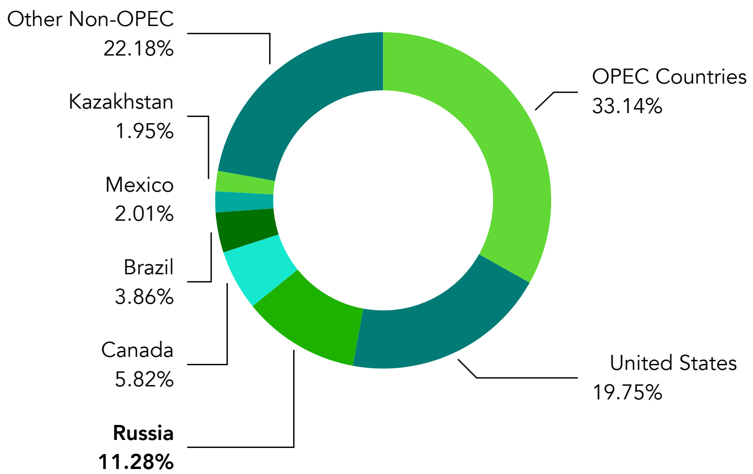
Russia has invaded Ukraine. Typically, geopolitical events like this don't have a lasting impact on the markets. There is a quick, fearful reaction because of the new unknown, but markets tend to recover quickly. This crisis, however, has the potential to be more painfully felt than most past geopolitical events on account of the sanctions.

The sanctions will hurt consumers and markets around the world in two major ways. The first will be in terms of inflation. In 2021, Russia produced 10.78 million barrels per day of crude oil and liquid fuels, which was 11.28% of the global supply. Russia is also a major supplier of natural gas to Europe. You can't just remove that supply and not expect significant pain. Oil prices have already shot up 37% since the onset of the war, and that was before President Biden banned the import of Russian oil and gas this morning.

Russia is also a large producer of nickel, palladium, and fertilizer, as well as the world's largest exporter of wheat. Cutting off these supplies will impact the entire globe, and we are already seeing dramatic rises in prices. It won't only be Russians who pay the price for these sanctions.

The second way I see sanctions potentially hurting us is by locking Russia out of the financial system. Cutting Russia off from SWIFT destabilizes the global financial system because Russia can't remit payments it owes to various creditors and counter-parties. U.S. banks don't have much exposure to Russia, but European banks do. There is a real risk that the inability of Russia to make payments could potentially start tipping over dominoes we didn't expect to fall.

### World Crude Oil and Liquid Fuels Production




*Source: U.S. Energy Information Administration*

## Every Tightening Cycle Ends in a Crisis

It might be easy to forget the Fed is also going to start tightening monetary policy next week. Every tightening cycle ends in a crisis; this might be the first tightening cycle that starts with one. I think that only a 25 bps hike is on the table, as the war in Ukraine has done a little bit of the Fed's job for it. Volatility is the best way to temper risk appetites, and we have plenty of that now. A correction in equities, housing, and cryptocurrencies may help improve the labor supply as dwindling savings is a motivator to get back out there and make some money. Unfortunately, this will mostly attack wage inflation, which is relatively benign right now.

In May of 2020, I warned that we were heading down a path of stagflation, where wages and economic growth wouldn't keep up with inflation. We may very well be there already.

## Portfolio Positioning

Our portfolios had very little direct exposure to Russia and Ukraine, which was only through our broad emerging markets ETF (SCHE). Allocations to Russian companies have since been removed from the index this fund tracks, and any holdings have been all but eliminated at this point. Someone's going to get a good deal on these Russian stocks, but it won't be us.

We are maintaining our underweight to equities and fixed income because we are concerned about a potential liquidity crisis stemming from Russian sanctions. I had been thinking about moving to neutral on international developed stocks, but the war has changed my outlook on Europe for the moment.

Again, this war is being felt mostly in terms of inflation. Russia is a major producer of energy and materials, and Ukraine is a big producer of potash, wheat, and seed oils which will drive up fertilizer and food costs. Our broad commodities fund (PCLIX) has been ripping higher and helping to offset the volatility in stocks and bonds. Gold and silver have also been seeing a boost as investors flee to the oldest of safe havens.

**Tactical Asset Allocation**

| Asset Class | Heavy Under-weight | Under-weight | Neutral | Over-weight | Heavy Over-weight |
|---|---|---|---|---|---|
| **Fixed Income** | | ● | | | |
| Duration | ● | | | | |
| Inflation | | | | ● | |
| Credit | ● | | | | |
| Foreign | | | | ● | |
| **Equities** | | ● | | | |
| Large Cap | ● | | | | |
| Mid Cap | | ● | | | |
| Small Cap | ● | | | | |
| Developed Intl. | | ● | | | |
| Emerging | | | ● | | |
| **Alternatives** | | | | | ● |
| Commodities | | | | | ● |
| Hedging | | | | | ● |

The geopolitical landscape is changing daily, so it's difficult to predict how high oil will go. Crude (WTI) is at $126 per barrel as I type this. It got as high as $147 back in 2008 amid a few supply disruptions and soaring demand that was halted only by the Great Recession.  $200 doesn't seem so ridiculous all of a sudden.

Ryan P. Layton, CFA
p: 612-810-2230
e: ryan@emeraldspark.com

### Binge Box

#### Reacher (Amazon Prime)

One of the things that irked me and other fans of Lee Child's Jack Reacher novels was Tom Cruise playing him in the movies. Jack Reacher is big in the novels, like head-turning big—"extremely tall, extremely broad, long-armed, and long-legged." While I appreciate Tom Cruise as an actor, you can't act your way from 5' 7" to 6' 5". Alan Ritchson of *Blue Mountain State* fame, however, fits the bill quite nicely. *Reacher* is based on the first novel, *The Killing Floor,* and follows our hero as he tries to solve the murder of his brother, leaving a considerable body count in his wake along the way. The eight-episode series is on Amazon Prime and ready to binge.

## 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.



EmeraldSpark