The Type 2 Investor

April 7, 2022

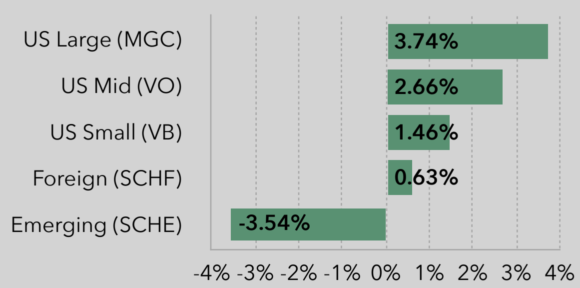
March 2022

Economic Data

- 431,000 jobs were added in March; the unemployment rate declined to 3.6%
- Retail sales were up 0.3% for the month of February but would have declined if it weren't for spending at gas stations
- Y/y inflation (CPI) rose to 7.9% in February—the tenth month in a row at or above 5% (not transitory) and the highest print since January 1982
- Existing home sales were down 7.2% in February; monthly payments were up a staggering 28% over last year because of higher mortgage rates and prices, according to NAREIT

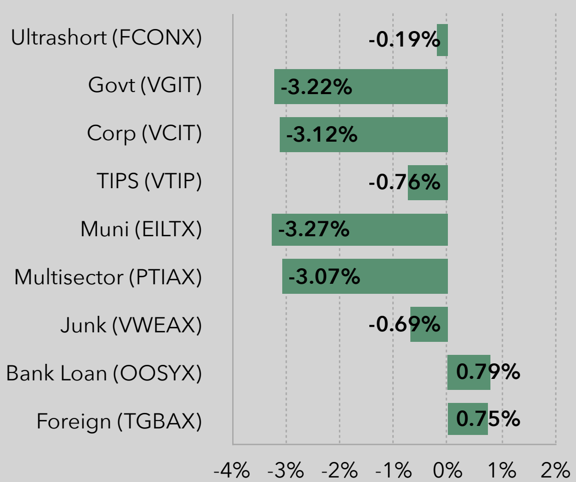
Stocks

March Returns



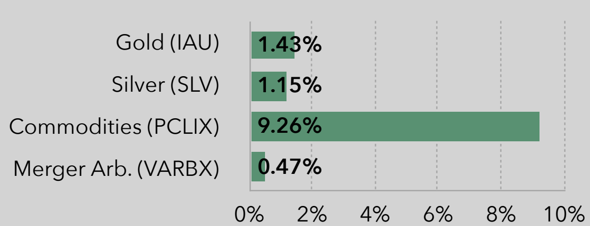
Bonds

March Returns



Alternatives

March 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.

Will the Real Estate Market Crack?

Back in February of last year the median sales price for an existing home was $315,100, according to NAREIT. The average 30-year mortgage rate at the time was around 2.73% (good times). So if you were an average Joe and went out and bought that median house you would have needed $63,020 for a 20% down payment and your monthly payment for just the mortgage would be $1,026.43. Fast-forward one year later and the median home price is $363,800 and the average 30-year mortgage rate is sitting two percentage point higher at 4.72%. So now you need 15.55% more for the down payment and your monthly payments are now going to be $1,512.94–a 47.4% increase. Gulp.

I'm pretty sure the average person isn't making 47% more than they were last year. Something has to give. It's not likely to be mortgage rates, which are still on an upward trajectory as the Fed is just beginning to raise rates.

Wall Street and investors in general continue to become a larger percentage of homeowners. Last year, according to Redfin, investors accounted for nearly one in seven homes sold in America's top metropolitan areas, the most in at least two decades. Investors are more likely to acquire homes in all-cash deals and are thus less affected by the rapid rise in mortgage rates.

Perhaps more houses will be built? Maybe, but for now supply-chain issues continue to plague the housing industry. Homebuilders are struggling to actually complete new homes as they await delivery of the necessary materials and fixtures to do so.

I expect we will begin to see some softness in real estate prices as the final rush to the market fades. I think active listings will remain low and perhaps dry up even more as homeowners will be less willing to try to trade up to a bigger house knowing they would have to get a significantly higher mortgage rate to do so.

Not surprising, refinancing activity is crashing. Mortgage volume in general is down 41% from last year, according to the Mortgage Bankers Association. If you were one of those fortunate enough to buy your house before rates exploded, or wisely refinanced your mortgage back when rates were under 3%, consider yourselves lucky. Hold on tight to that mortgage. Hug it and squeeze it and love it until maturity, as you're not likely to see rates like that again anytime soon, if ever.

We Were Inverted

As expected, the Federal Reserve raised the fed fund rate for the first time since 2018, increasing the target range by 25 bps to 0.25% - 0.50%. The FOMC statement signaled greater concern that higher inflation might persist and made specific reference to the war in Ukraine causing upward pressure on prices.

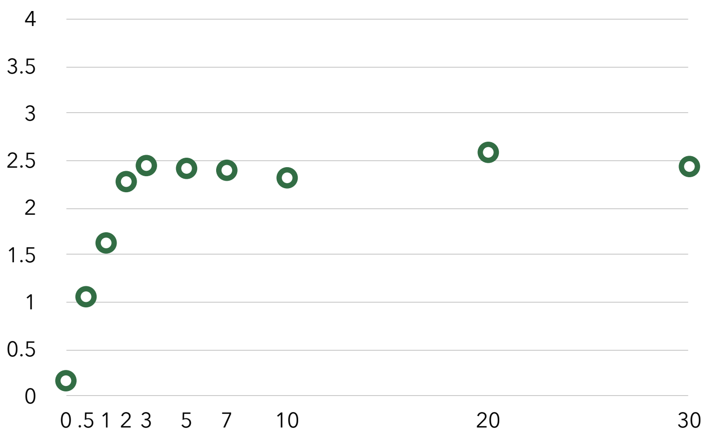
According to the "dot plot", the Fed has also essentially penciled in six more increases by year's end, which would be the most aggressive pace in more than 15 years. Federal Reserve Chair Jerome Powell said that the central bank is prepared to raise interest rates by 50 bps at its next meeting in May if

if needed, which it very much is. The plot also revealed they expected rates to top out at around 2.75% some time in 2023. I suspect that number will end up being higher.

The Fed will also be reducing its balance sheet, but even so that doesn't seem like enough to tackle the 7.9% inflation we are all dealing with. What we really need to throw some cold water on that hot number…is a recession. And maybe that's just what we'll get.

We are already seeing a couple of small inversions in the yield curve—between 2 and 10 years, and again between 20 and 30 years. Such inversions often prove to be harbingers of recession; the implication

Treasury Yield Curve Rates (3/31/22)



Source: U.S. Treasury

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					●

being that the market is pricing in an aggressive series of rate hikes now that they expect will have to be reversed in the face of weakness.

Yield curve inversions, however, are not great market timing indicators. It just means there is a very high likelihood of a recession in the next few *years*–2023 is my best bet. Still, it is important to heed their warning and not be caught off guard.

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Binge Box

Peacemaker (HBO Max)

As I've said before, I'm not a big comic superhero fanboy. I think the market has been oversaturated with these films and series, and I've mostly lost interest. They typically follow an entertaining, but predictable formula, and for me at least aren't very re-watchable. Still, occasionally I am pleased, like in the case of *Loki* last year. DC hasn't had nearly the success of Marvel, but Peacemaker is a solid effort to right the ship. Start by watching *The Suicide Squad* (the "The" is important), then get ready to binge Peacemaker. It's foul-mouthed and violent, so be warned. John Cena is great, but Freddie Stroma really steals the show as Vigilante, in my opinion. The opening dance sequence is worth watching every time.

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.

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