The Type 2 Investor

September 9, 2022

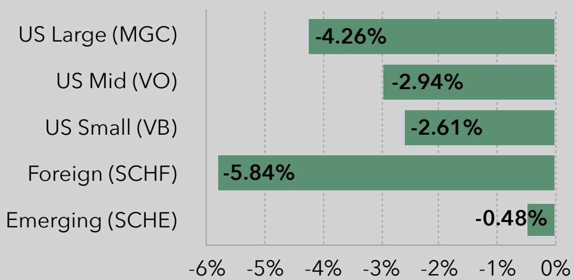
August 2022

Economic Data

- 315,000 jobs were added in August; the unemployment rate rose two-tenths to 3.7%
- Retail sales were flat for the month of July with gas station sales slipping the most, down 1.8%, and nonstore retailers increasing the most, up 2.7%
- Y/y inflation (CPI) cooled in July, but was still up 8.5%—the 15th month in a row at or above 5%
- Existing home sales fell for the sixth straight month in July, down 5.9%; supply increased to 3.3 months; median prices fell $10k to $403,800

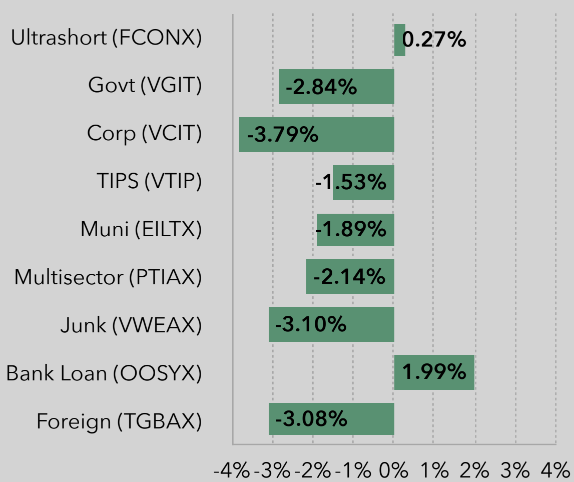
Stocks

August Returns



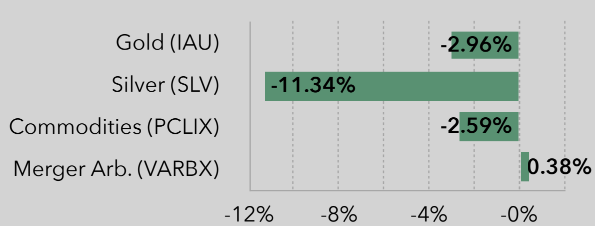
Bonds

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

Student Loan Forgiveness

On August 24 the Biden administration finally made good on its promise, announcing a sweeping student loan relief program. Keep in mind this is an executive order, not legislative action, so there is a good chance these proposed actions will face legal challenges from opposition. There is still a lot of fine print that needs to be written and made public, as well, but I will summarize what we know so far.

Debt Forgiveness. First, the plan forgives up to $10,000 of student loan debt for borrowers (and up to $20,000 for Pell Grant recipients) under certain income thresholds. Additionally, the president gave yet another extension to the pause on student loan repayments (final 'final' one, for realsies this time) until the end of the year.

The income limits are $125,000 for single filers or $250,000 for those who are married filing jointly. Indications are that this will be based on either your 2020 or 2021 Adjusted Gross Income (AGI), whichever is lower. Therefore there really isn't much you can do at this point regarding planning. In its current form, this is a cliff threshold. Meaning if you made $124,999 you are golden, but if you made $125,001 you are completely shut out. This is, unfortunately, bad policy design.

There *may* be a potential strategy to take advantage of if you have voluntarily been making student loan payments during the pause since March 13, 2020. However, this would only pertain to the 1.5% of borrowers who did this, so it is unlikely to be relevant.

Debt relief will be automatic for some if they already are on an Income-Driven Repayment (IDR) Plan and have their 2020 or 2021 income information filed. For others there will be a (supposedly) simple application form available no later than the end of the year. However, privately held student loans are not eligible for relief in the executive action's current form.

The forgiven debt will not be taxable at the federal level. However, it is potentially taxable at the state level in Arkansas, California, Indiana, Minnesota, Mississippi, North Carolina, and Wisconsin, according to a preliminary analysis from the Tax Foundation.

The plan also includes forgiveness for loans of less than $12,000 after 10 years of payments.

New Repayment Plan. The plan includes the introduction of yet another Income-Driven Repayment (IDR) Plan option to add to the confusing list that already includes PAYE, REPAYE, IBR, and ICR. The new plan caps monthly payments for undergraduate loans at 5% of discretionary income. This is half the rate of most current options. It also includes an interest rate subsidy that prevents negative amortization, so borrowers won't face the demoralizing situation of watching their loan balances increase while they are making payments. This makes the new plan a no-brainer, so I'm not sure why they didn't just get rid of the other four options to simplify things. Most likely this is because not everyone will be eligible, but again, details aren't yet clear.

PSLF. The plan includes a much-needed overhaul to the Public Service Loan Forgiveness (PSLF) program for those who work at a nonprofit, in the military, or in federal, state, tribal, or local government. This is bit too niche and way to detailed for me to get into here, though. If you have questions about this, please reach out to me.

Unintended Consequences. Overall, I think the new repayment plan and the overhaul to PSLF are much needed and give struggling borrowers some hope. A soothing light at the end of your tunnel that isn't a freight train coming your way. However, the one-time loan forgiveness is a divisive policy that picks winners and losers and creates moral hazard.

According to the US Census Bureau, only 23.5% of Americans over the age of 25 had a bachelor's degree as their highest educational attainment, while another 14.4% had advanced degrees. That's a total of 37.9% that have what most would consider a college degree. That leaves the majority of the population–62.1%–on the outside looking in, without the career opportunities only available to the educated minority. When we break this down further by race, it's the non-Hispanic Whites (41.9%) and Asians (61.0%) with above-average bachelor's degree attainment or higher, and the Blacks (28.1%) and Hispanics (20.6%) who are below average. One could rightly argue that the uneducated are being forced to subsidize the educated, and Blacks and Hispanics are being forced to subsidize Whites and Asians.

Furthermore, the percentage of Americans over the age of 18 with student loan debt is only 17%, according to Newsweek. This one-time handout will only benefit a small percentage of Americans, and is effectively just a way to buy votes for the mid-terms.

It also has the potential to create resentment between those who already paid off their loans and those who did not; between the parents who saved for their children's college education and the ones who did not; between the students who worked to put themselves through college and those who did not; between those who didn't have the opportunity to go to college and those who did; and between those who decided to join the workforce right out of high school and those that did not. And what of the people buried under *hundreds* of thousands of dollars in student loans? $10k seems tragically laughable to them. Losers and winners.

There is also a moral hazard to the whole thing. Current and future students will now expect and even demand loan forgiveness. Delinquencies will rise because you're a sucker if you pay. I also believe people who don't even need student loans will begin taking them out to buy cars and spring break trips, because why not? There could actually even be a potential financial planning strategy where you take out as much as you can in student loans you don't need and invest it, assuming you'll only end up paying a fraction of it back under the generous new repayment plan. These are the types of unintended consequences politicians don't think about–or worse, actively ignore.

Lastly, the biggest concern most Americans have right now is inflation. Some argue the policy won't be inflationary because it will occur at the same time as repayments resume, but then you are just negating something that would have been deflationary. The policy, which analysts at Pennsylvania's Wharton School of Business suggest could cost upwards of $300 billion, is quite simply inflationary.

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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					●

Binge Box

Hard Knocks (HBO)

Hard Knocks is a reality sports documentary that follows one NFL team for five weeks during training camp. It has been around since 2001, but I haven't really watched it much until this season. Why? Because this year they are following my beloved Detroit Lions. I have been a fan of the Lions since as far back as I can remember, and they've mostly just been a source of disappointment and frustration, having only won a single playoff game during my entire life. Yet somehow I keep sipping the Honolulu blue Kool-Aid, and you will, too, after watching. Just try not laughing at head coach Dan Campbell's words, or falling in love with 6th-round linebacker Malcolm Rodriguez. All five episodes are now available on HBO.

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.