

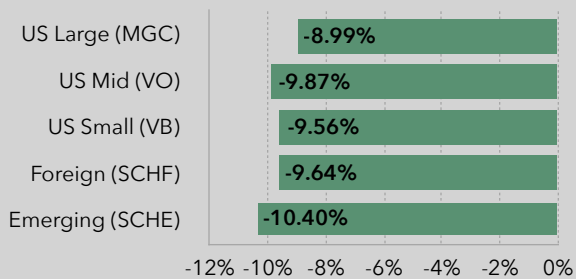
September 2022

Economic Data

- 263,000 jobs were added in September; the unemployment rate fell two-tenths to 3.5%
- Retail sales were up 0.3% for the month of August with gas station sales falling the most, down 4.2%, and motor vehicles and parts increasing the most, up 2.8%
- Y/y inflation (CPI) cooled a wee bit to 8.3% in August—the 16th month in a row at or above 5%
- Existing home sales fell for the seventh straight month in August, down 0.4%; supply decreased to 3.2 months; median prices fell to \$389,500, 5.9% below the June peak

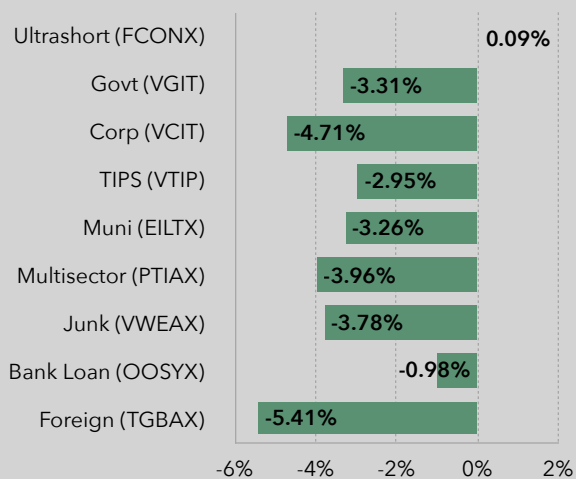
Stocks

September Returns



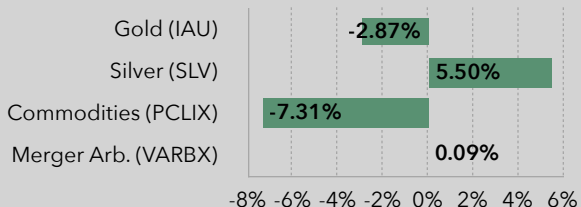
Bonds

September Returns



Alternatives

September 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.

Europe to No Good

I spent most of the summer this year in the land of haggis, tartan, scotch, and unicorns. I had only been to Scotland once before, some twenty years ago. I was a poor college student at the time, and was made to feel even more so when converting my lowly greenbacks into pounds, which cost around \$1.60 per quid at the time. Imagine my delight then upon arriving in late June and only having to shell out \$1.21 for the same exchange. Better still, the pound's value continued to erode the longer I stayed.

UK markets have been in a bit of turmoil since finance minister Kwasi Kwarteng announced the biggest tax cuts in the country in 50 years—to be funded with government borrowing—sending the pound falling to a record low on September 26 of just above \$1.03 against the US dollar. The Bank of England (BoE) has had to repeatedly step in since to prop up the UK bond market as margin calls for leveraged pension funds has forced a fire sale. Yesterday, BoE Governor Andrew Bailey, presumably while holding a match and a gallon of “petrol” said, “My message to the funds involved and all the firms is you’ve got three days left now...You’ve got to get this done. The essence of financial stability, is that it (intervention) is temporary. It’s not prolonged.” Meaning the BoE will stop supporting the gilt (UK government bond) market on Friday. Full stop.

Rising interest rates in the UK are also going to send shockwaves through the real estate market there. Unlike the US market, where most homeowners are locked into low-rate 30-year fixed interest mortgages, most mortgages in the UK reset after a fixed rate period that typically lasts only two, three, or five years. Some 20% of UK mortgages are floating, so these borrowers will feel the rising interest rates almost immediately. Of the remaining 80% that are fixed, around a quarter of them will expire by August 2023. This means about 40% of all UK mortgages will see higher rates in the next year.

All this is to say that now is a great time for a European vacation. And if, like me, you have ever dreamed of buying a summer home or investing in a vacation rental across the pond, there might be some really good opportunities to do just that in the near future. I will be keeping my eye out for a flat in Edinburgh, or a stone cottage in the scenic Cairngorms or perhaps the Isle of Islay, home of Lagavulin.



Nord Stream Whodunit

As I was finishing my dinner at an outdoor cafe on a chilly night in Ljubljana, the server approached me and asked if it was okay if he turned off the heater. He said they were worried they might not be able to buy more fuel the next day. His concerns are warranted, as the Nord Stream pipelines, which were capable of carrying 3.9 billion cubic feet of natural gas per annum to Europe, had been attacked two nights before in an act of terrorism (if you believe Russia) or an act of sabotage (if you believe the US). I'd be happy to digress into various conspiracy theories involving the CIA, Poland, and Davos-level bond villains with underwater robots over a pint, but I'll try to stick with what we know for sure here. What we know for sure is that critical infrastructure is vulnerable and open to attack, and that Europe is on the precipice of its largest energy crisis in 50 years. They are reportedly cutting down old-growth forests to stockpile firewood for the winter.

To add insult to injury, OPEC+ just agreed to the biggest production cut since the start of the pandemic, agreeing to slash output by 2 million barrels of oil a day. Quite simply, they humiliated President Biden in front of the world by cutting oil production after he specifically lobbied them not to. OPEC has Russia's back in this war.

Winter Soldier

I went to Munich for the second weekend of Oktoberfest. Instead of waiting in line to be seated at the Augustiner Keller beer garden, my friend and I accepted an invitation from another group to join their table. They were from Russia, and they eventually started talking worriedly about the draft. Russia had just ordered the mobilization of an additional 300,000 conscripted troops to replenish its depleted military ranks. One of the men worked for Yandex, which is basically the Google of Russia. He told me they had been very good about maintaining that his physical presence in Germany was operationally critical. This was not necessarily true, but it speaks to what measures the company was willing to take to protect its employees from the draft.

The Crimean Bridge, the sole link between Russia and Crimea and a major corridor for transporting troops and supplies, was hit by an explosion on October 8. Russia blamed Ukraine for the attack and retaliated harshly with a barrage of missile strikes on Kiev.

What I believe these two things tell us is that Russia has been holding back. Winters typically slow down the pace of war for most armies, but Russia has a long history of fighting in the cold. I am by no means a military strategist or expert, but I am worried that the war is more likely to escalate in the coming months than it is to end.

Binge Box

Welcome to Wrexham (Hulu)

Welcome to Wrexham is a docuseries that follows the story of Rob McElhenney (of *It's Always Sunny in Philadelphia* fame) and some guys named Ryan Reynolds (I think he was in *The Outer Limits* and *Two Guys, a Girl and a Pizza Place*) buying a Welsh soccer team that has been relegated down to the fifth tier of English football. It's sometimes hard to ignore the feeling that this might not really be a story about two pals wanting to buy a soccer team and then deciding to make a show about it, but rather two actors buying a team just to make a show about it. Still, as a Detroit Lions fan I love a good underdog story, and this show had me hooked from the first episode. The last episodes of the first season will be out next week on Hulu.

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					●

Portfolio Positioning

My many concerns about Europe have convinced me to reduce international exposure in portfolios. Proceeds have been partially reinvested into small-cap US stocks, which are attractively valued relative to large-cap stocks and tend to have a more domestically-focused footprint. The remainder of proceeds have been put into short-term fixed income, particularly safer 1-3 year Treasuries which offer the most attractive yields on the curve with little exposure to interest-rate risk.

Hopes of a Fed pivot away from tightening have been quickly dashed. The Fed appears to want to continue to hike rates until something breaks and inflation is reined in. Best not to fight them on this.

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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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