The Type 2 Investor
February 7, 2022

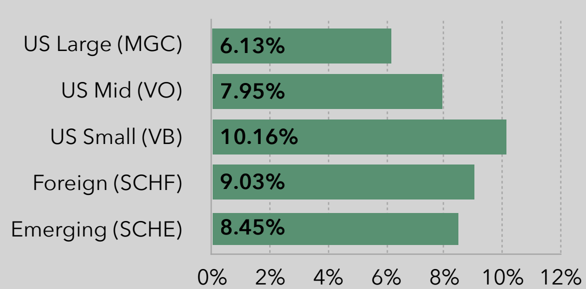
December 2022

Economic Data

- 517,000 jobs were added in January, and the unemployment rate decreased to 3.4%
- Retail sales were were down 1.1% in December with department stores the weakest down 6.6%
- Y/y inflation (CPI) continued trending down in December, but was still hot at 6.5%—the 19th month in a row at or above 5%
- Existing home sales fell 1.5% in December, the eleventh straight month of declines, and are now down 34.0% y/y; median prices fell to $366,900, down 11.4% from peak

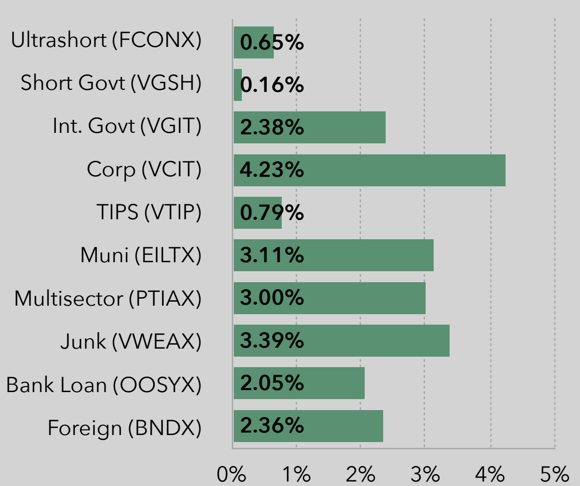
Stocks

January Returns



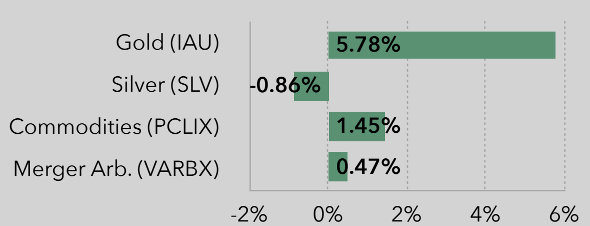
Bonds

January Returns



Alternatives

January 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.

Three Words: a Long Time

If someone keeps doing exactly what they said they were going to do, I don't know, I tend to believe them. As expected, the Federal Reserve delivered a 25 basis-point hike last Wednesday. Chair Jerome Powell said, "We've raised rates four and a half percentage points, and we're talking about a couple of more rate hikes to get to that level we think is appropriately restrictive." So policymakers expect to deliver a "couple" more interest-rate increases before hitting the pause button on their tightening campaign. I believe them.

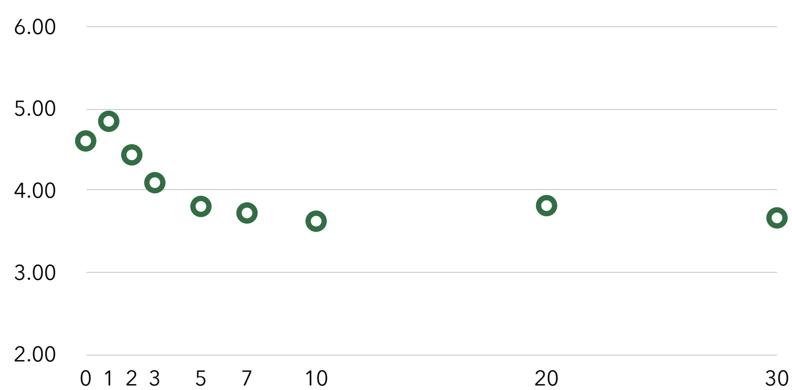
The Fed's "dot plot" and Powell's comments indicate we have two more rate hikes ahead, each one-quarter of a point, before the fed funds rate plateaus in the 5.00 - 5.25% range. And it will be a plateau, not a peak followed by a quick about-face into rate cutting as the market seems to expect. When asked how long he thought rates should remain above 5%, Fed Governor Raphael Bostic responded: "Three words: a long time." I believe him.

Bond king Jeffrey Gundlach, whose advice I normally find enlightening, said last month, "My 40 plus years of experience in finance strongly recommends that investors should look at what the market says over what the Fed says," implying the Fed would not raise rates to 5%. I don't believe him, and he has since softened that language.

"I've spent enough time around Wall Street to know that they are culturally, institutionally, optimistic," Fed Governor Neel Kashkari said in an interview. When discussing if it seemed almost as if the markets were playing chicken with the Fed, Kashkari laughed. "They are going to lose the game of chicken, I can tell you that," he said. I believe him.

If it plays out exactly how the Fed says it will, as I believe it will, bond markets will have to come to terms with this. In that scenario, I suspect bond yields on the intermediate and long-end of the curve will climb, giving up some of the price gains bonds have enjoyed the past few month. This has already begun to some degree, as the ten-year has risen 24 bps in the last three trading days to 3.63%. I suspect it will come close to retesting its October high of 4.25%. That will be the time to extend duration, not now.

Treasury Yield Curve Rates (February 6, 2023)



Source: US Treasury

SECURE 2.0

The SECURE 2.0 Act of 2022 was signed into law by President Biden on December 29, 2022. The law is designed to increase retirement savings and simplify retirement plan rules. It is a 120-page monster that contains 92 new provisions. Here are a few of the highlights:

- **Auto-enrollment**–Beginning in 2025, employers are required to automatically enroll eligible employees in new 401(k) or 403(b) plans with a participation amount of at least 3% but no more than 10%. The contribution escalates at the rate of 1% per year up to a minimum of 10% and a maximum of 15%

- **RMDs**–the age where required minimum distributions (RMDs) begins increases to 73 beginning on January 1, 2023, up from 7, and to 75 beginning in 2033. Specifically, the RMD age increases to 73 for individuals turning 72 after Dec. 31, 2022, and before Jan. 1, 2033. It will increase to 75 for individuals turning 74 after Dec. 31, 2032. It also reduces the penalty for not taking an RMD from 50% to 25%, and reduces it further to 10% if corrected in a timely manner

- **Pre-death Roth RMD for 401(k)**–The pre-death RMDs for the owner of a Roth-designated account in an employer 401(k) or other retirement plan are no longer required to begin prior to the death of the owner. This matches the established policy for Roth IRAs

- **Catch-up limits**–substantially increases catch-up limits for 401(k) plan participants aged 60 to 63 to the greater of $10,000 or 150% of the “standard” catch-up amount for that year, beginning after December 31, 2024

- **$1,000 emergency withdrawals**–permits participants to access up to $1,000 (once a year) from retirement savings for emergency personal or family expenses without paying the 10% early withdrawal penalties (starting Jan. 2, 2024)

- **Pension-linked emergency savings accounts**–allows employees to set up a Roth emergency savings account with up to 3% of salary with a $2,500 cap for non-highly compensated employees (starting Jan. 2, 2024). At separation from service, employees may take their emergency savings accounts as cash or roll it into a Roth IRA.

Binge Box

Willow (Disney+)

George Lucas followed up the success of the original Star Wars trilogy with another great trilogy that began with *Indiana Jones and the Temple of Doom* (no, there are not four films). He could do no wrong. Then he wrote…*Willow*, which did not share the same success. It never became a trilogy, but the story now continues with many of the original characters as Disney tries to squeeze every dollar from its Lucas Films purchase. It’s a fun fantasy with magic and sword fights and quests that doesn’t take itself too seriously. Have you thought to yourself recently, “I wonder what Christian Slater is up to?” Of course you have. Well, he resurfaces in episode 6. That’s reason enough to stream the first season.

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					●

Overall the new bi-partisan law is a collection of small wins for people saving for retirement and should be applauded. However, nothing in it struck me as earth-shattering.

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

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.