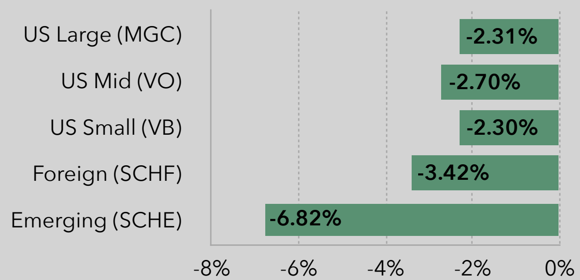
February 2023

Economic Data

- 311,000 jobs were added in February, and the unemployment rate increased to 3.6%
- Retail sales were were up 2.3% in January with motor vehicles up 6.4% and department stores up 17.5%
- Y/y inflation (CPI) edged down only one-tenth of a percent in February, and was still hot at 6.5%—the 20th month in a row at or above 5%
- Existing home sales fell 0.7% in January and are now down 36.9% y/y; median prices fell to $359,000, down 13.2% from its $413,800 August peak

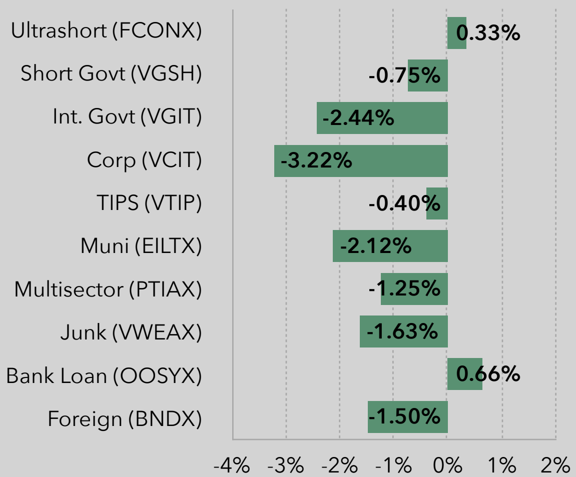
Stocks

February Returns



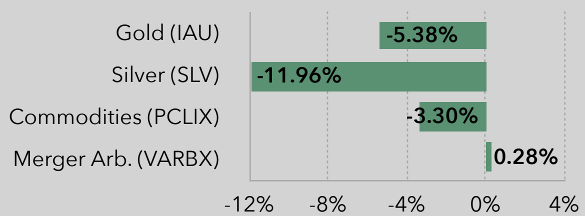
Bonds

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.

Ba-Bank Run-Run-Run, Ba-Bank Run-Run

In October I criticized the market for being so convinced the Fed would soon pivot away from tightening saying, "the Fed appears to want to continue to hike rates until something breaks and inflation is reined in." Well, they did keep hiking, and guess what? Something broke.

The traditional way a bank makes money is to take in deposits and loan out money, charging more in interest on the loans than they pay out in interest on deposits. When interest rates go up, it's usually no big deal. In fact, the rates on bank loans tend to go up faster than the yields banks pay on deposits, so as a bank you tend to profit more in rising rate environments. I'm oversimplifying, but still.

Anyway, Silicon Valley Bank (SVB) is (was) a cool bank with a cool name that, as that cool name implies, catered to a lot of customers in the tech space and venture capital space. A lot of customers who, through capital raises and other liquidity events, were awash with a lot of that easy-to-get, good old fashioned, hard-earned, internet start-up money. They needed somewhere to stash it and SVB was happy to take their money. The problem for SVB was customers like these typically don't need much in the way of loans. Without demand for loan products, SVB stashed most of the money from deposits into longer-dated Treasury bonds to get what little yield they could find. Safe and sound, right? Well, liabilities (deposits) were shot-term, and assets were long-term, so yeah, they maybe weren't as heavily exposed to credit risk as most banks, but they were much more exposed to interest-rate risk.

As the Fed aggressively raised rates, the price of Treasury bonds fell. This is because if you have paid, say, $100 for a ten-year bond with a 2% yield, and now interest rates are 4%, nobody is going to pay you $100 for that 2% coupon. You have–again, oversimplifying here–lost about 20% (2% x 10 years) on the price of your bond. You'd still get back your $100 at the end of the ten years, but if you need that money now, you're going to have to accept the $80 or so the market will offer you.

In this higher interest-rate environment, the easy money for VC funds has sort dried up. SPACs are closing up shop and aren't a liquidity source anymore, either. So these start-ups continued to burn through cash, as tech start-ups love doing, but now there wasn't any new deposits coming in, so SVB had to start selling bonds at as loss.

After a warning from SVB that they would need to raise $2.25 billion through a share sale to shore up capital because of these losses, Peter Thiel's Founders Fund and other prominent venture capitalists began advising businesses in their portfolios to withdraw their money. This, rightfully so, caused a panic and a classic run on the bank. In order to meet withdrawal requests, SVB had to sell those bonds and realize the losses.

On Friday, Silicon Valley Bank went into FDIC receivership. It is the biggest bank failure since Washington Mutual during the financial crisis. 89% of SVB's $175 billion in deposits were uninsured as the end of 2022, according to the FDIC. Those are deposits above the $250,000 limit, and many belong to companies like Roku and Roblox. In an effort to restore confidence in the banking system, the FDIC has made a move to cover the uninsured deposits as well, which they better do quickly or else a lot of these start-ups aren't going to make payroll. Meanwhile, HSBC acquired SVB UK for the princely sum of £1.

16 months ago SVB's stock was trading at $763. Mark it zero, Dude. Silvergate Bank and Signature Bank, two banks that opened their arms to the cryptocurrency world, have also gone under. You know, because crypto. Signature was the third-largest US bank failure in history, right behind SVB. Now the market is anxiously trying to gauge who will be next. Bank stocks like First Republic, Schwab, and Western Alliance are a few that have taken a beating.

This puts the Fed in a bit of a pickle. They need to keep up the good fight against inflation by continuing to raise rates, but they also need to help protect the stability of the financial system. It will be very interesting to see what the Fed does at its upcoming meeting.

Binge Box

Severance (Apple+)

Severance, starting Adam Scott, is a very creative and original series that explores many different themes, including grief, identity, and free will. The basic premise is that through a new medical technology people can sever their work self from their home self, with neither having any knowledge or memory of the other. It effectively uses science fiction to highlight the drudgery of being a cubicle cog for a soulless corporation. The small little tokens the severed workers earn, such as finger traps and melon bar parties, remind me of the recognition pins and $25 gift cards and Casual Fridays that Wells Fargo used to insult me and my colleagues with back in those dreadful days.

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					●

Clearing at Altruist Goes In-House

Sometime around March 20th you'll receive an email from Altruist announcing that they've been approved to become a self-clearing broker-dealer. Basically, it's a change that enables them to build better products for financial advisors. Nothing is materially changing for you, your accounts, or the services I provide as your investment advisor. However, later in the month, around March 31st, you'll have the ability to acknowledge a new account agreement via the Altruist app (or desktop portal) – which essentially amounts to checking a box upon login. Please take this action when it is available to you.

This is a back-end conversion that should not cause any noticeable changes or impact. The user experience on the platform will remain the same. Here are a few things to note, however:

- Rebalancing trades will be suspended April 19 and 20, but I do not anticipate this being an issue
- Linked bank accounts, transaction history, scheduled transactions, and performance history will all carry over from Apex to Altruist
- Effective April 12, 2023 checks will need to be sent to this new address:

  Altruist Financial LLC
300 S. Pearl Expressway
Suite 250
Dallas, TX 75201

- Account holders will receive two account statements for the month of April 2023. The first will be from Apex showing account activity up to and including the Conversion Date, showing the transfer of account assets to Altruist and the closing of the Apex relationship. The second will be from Altruist showing the transfer of account assets from Apex to Altruist and any activity subsequent to the conversion date

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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.