The Type 2 Investor

September 12, 2023

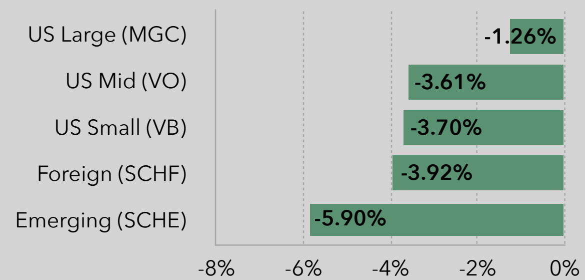
August 2023

Economic Data

- 187,000 jobs were added in August and the unemployment rate increased to 3.8%
- Retail sales were were up 0.7% in July with nonstore retailers leading up 1.9%
- Y/y inflation (CPI) rose to 3.2% in July while the core rate (less food and energy) edged lower to 4.7%
- Existing home sales fell 2.2% in July and are down 16.6% y/y; median home price fell to $406,700

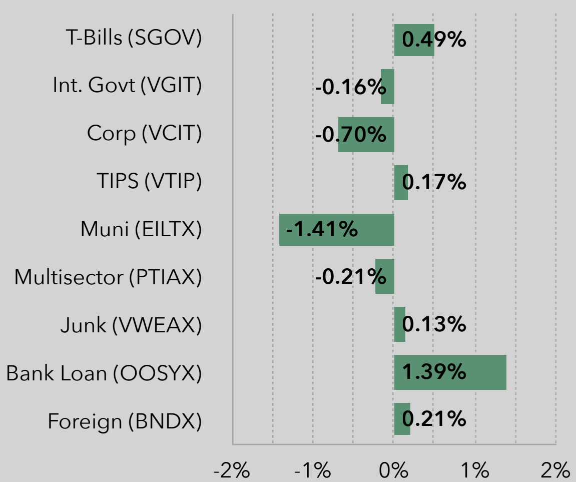
Stocks

August Returns



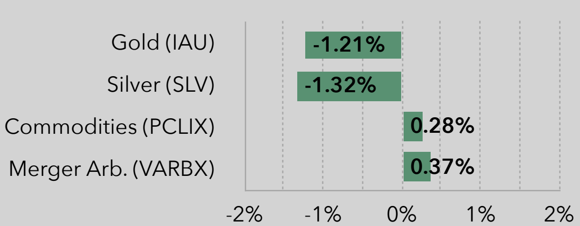
Bonds

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.

People Are Running Out of Money

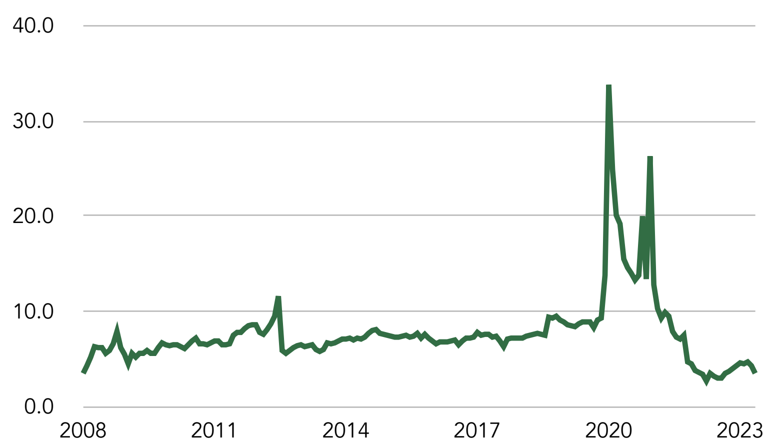
The pandemic wasn't all bad. PPP "loans" for business owners that didn't need to be paid back, juiced up unemployment benefits, and good old fashioned stimulus checks meant that most Americans were seeing more money come in than usual. Some of that went to sweatpants and Netflix subscriptions, but the lockdowns meant there was limited ability to spend that money on other things like vacations and dining out. This resulted in rapidly accumulated and unprecedented levels of excess savings (the difference between actual savings and the pre-recession trend) relative to previous recessions.

Personal savings rates have been below pre-pandemic levels for a couple of years now, though, and that excess savings from the pandemic is all but gone at this point. An analysis by the Federal Reserve Bank of San Francisco suggested that all of the $2.1 trillion in total accumulated excess savings will likely be completely depleted sometime during this quarter.

The Federal Reserve's Beige Book revealed that some District reports were "suggesting consumers may have exhausted their savings and are relying more on borrowing to support spending." They also reported higher delinquencies on consumer credit lines. All this suggests the US consumer is close to tapped out.

Not to pour salt in the wound, but it just so happens that student loan payments are resuming this month. Barclays economist Adirenne Yih published a detailed calculation of just how much disposable spending would shrink by as a result of the student loan payment restart. The average student debt holder (16% of the population) will have an incremental monthly payment of about $390 to contend with again. In a nutshell, the bank estimates a potential aggregate $15.8 billion monthly headwind, or $190 billion per year, to US spending. This will put added pressure on consumer discretionary spending. It remains to be seen whether all of this will be too much for the economy and push us into recession, but it sure doesn't help.

Personal Savings Rate



Source: U.S. Bureau of Economic Analysis

Portfolio Positioning

Back in February, when the market was trumpeting the end of rate hikes and piling into longer duration bonds, I reminded readers to trust that the Fed would do what it said it would and continue to raise rates. The ten-year was at 3.39% in the beginning of February, and I suspected it would come close to retesting its October high of 4.25%. We moved out of duration and put most bond money into t-bills, bucking the market trend. Since then the ten-year yield has hit 16-year highs and now sits at 4.29%. I don't think we're there yet, but we're getting closer to a time when extending duration will make sense. It's just really hard to pass on short-term t-bills when they are yielding more than 5.5%

Companies in the S&P 500 have logged a roughly 5.8% year-over-year decline in earnings for the second quarter, with 98.6% or companies reporting according to S&P Global. That marks the third consecutive quarter of year-over-year declining profits. A continued underweight to stocks appears warranted.

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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

Unstable (Netflix)

Unstable starts with Rob Lowe (Ellis Dragon) dancing to "Scatman (Ski-Ba-Bop-Ba-Dop-Bop)" to get pumped for the day. That was good enough for me to invest in it. The main character is an easily-distracted biotech genius and entrepreneur who has sort of lost his way, and his son moves back into town to help him out. The sitcom takes a page from *Schitt's Creek's* father/son playbook in that is also stars Rob Lowe's real-life son, John Owen Lowe. It's not going to go down as one of the greatest shows of our time, but it's an easy to watch, no-laugh-track comedy.

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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