The Type 2 Investor

August 17, 2024

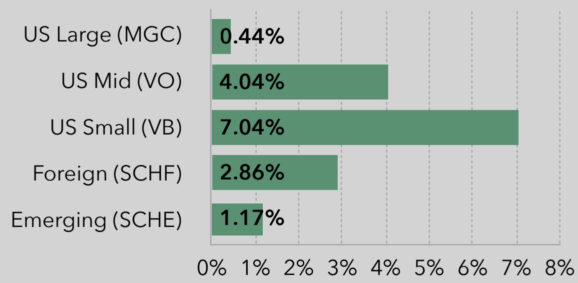
July 2024

Economic Data

- Only 114,000 jobs were added in July; the unemployment rate rose to 4.3%, stoking recession fears
- Retail sales were up 1.0% in July, with auto dealers up 4.0% and miscellaneous store retailers down 2.5%
- Y/y inflation (CPI) tempered to a 2.9% pace in July, with used car & truck prices down 10.9%; the core rate (less food and energy) grew at 3.2%
- Existing home sales declined 5.4% in June and are also down 5.4% y/y; the median home price rose to a record $426,900

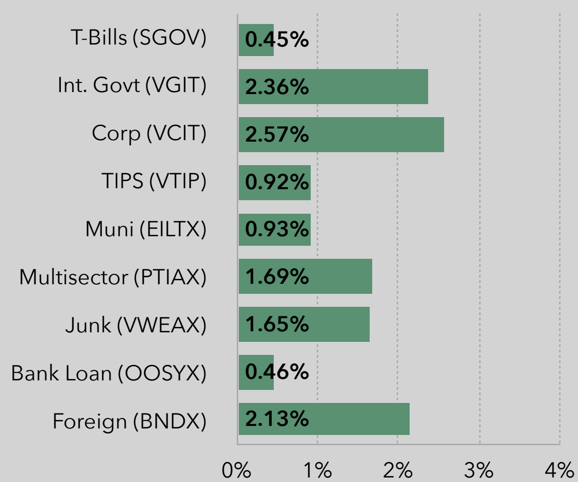
Stocks

July Returns



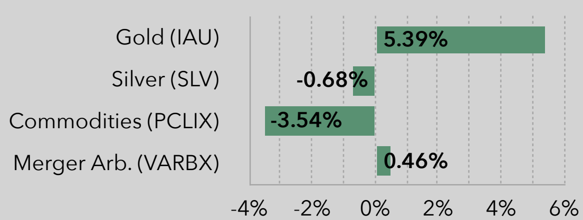
Bonds

July Returns



Alternatives

July 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.

Weeks Where Decades Happen

Well that escalated quickly. I published my last newsletter on July 11, stating that a Trump victory was my base case for investing. Two days later there was an assassination attempt on his life, and his polling only got stronger.

To position for that, I made a few small tweaks in our allocation strategy. A Trump victory will likely mean higher tariffs for imports. This isn't great for foreign stocks, but it is good for domestically-focused US stocks. Lower taxes and regulations are also good for US stocks. With this in mind, we decreased our allocation to emerging markets stocks and increased our allocations to US small-cap and mid-cap stocks. These tend to generate a higher percentage of their revenues domestically than large cap stocks do.

Lower taxes without a dramatic cut in fiscal spending will put increased pressure on deficits. This usually translates into higher interest rates and inflation, which is supportive of our commodities overweight.

I warned Republican supporters not to pop the champagne too early, though. Biden's poor performance in a debate conspicuously scheduled before the convention could result in him being replaced. And that's exactly what has happened. This is a good thing if you want Trump to lose, because Joe Biden wasn't going to get the job done. It's a bad thing if you actually believe in democracy, because Biden was forced out behind closed doors and replaced with someone not a single person ever voted for.

Kamala Harris is currently enjoying the honeymoon phase of her candidacy, and polls are reflecting that. She hasn't done a press conference yet, though, which is by design. I won't be ready to flip my current projection for a second Trump term until after their first debate, which is scheduled for September 10. That might be the first time the American voters get to hear from Harris without a script in front of her, and I'm not sure it will go well.

Yen Carry Trade Implodes

If that wasn't enough to keep things interesting, global markets had a meltdown after the Bank of Japan made a surprising interest rate hike for only the second time since 2007. This in turn sent the yen surging higher and crushed the $ $20 trillion yen carry trade.

What is the yen carry trade, you ask? It basically works by borrowing at really low—and until recently, negative—rates in Japan, and plowing that money into higher-yielding assets in other countries. It's really smart and lots of hedge funds do it and use a lot of leverage in the process because it works really well. You know, until it doesn't.

When things moved against this trade it caused a cascade of selling and forced liquidation in a lot of unrelated markets. This is contagion. Volatility exploded. The AI trade unraveled. Crypto crashed.

It was all very exciting, and many people were calling for an emergency rate cut from the Fed. But like with most things, if you ignore it long enough it will go away. Markets have already recovered. I do think the Fed has softened their language in preparation for a cut, but it won't be before September and it won't be 50 bps like some whiney people on Wall Street are clamoring for.

I'm not even sure I fully buy the accepted narrative that the Fed will definitely cut in September. Why should they? Nothing is really broken. Inflation isn't completely under control yet. Home prices are at record highs. Unemployment is moving higher, but is still relatively low by historic standards. Plus any move they make this close to an election will be criticized as politically motivated. I don't think they will sit tight, but I wouldn't be as surprised as everyone else if they did.

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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

The Gentleman (Netflix)

I am a fan of Guy Ritchie films, especially *Lock, Stock, and Two Smoking Barrels* and *Snatch.* Two hours isn't enough, though, it would be nice if he could stretch his movies out over 8 hour-long episodes. Luckily, Ritchie has done just that. The Gentleman is a spinoff of his 2019 film of the same name. The charming lead, Eddie (Theo James), inherits his family estate. He soon learns his father had made a deal to house a large cannabis growing operation on it, drawing Eddie into the world or organized crime. It's witty and suspenseful with the sort of twists you'd expect from Ritchie.

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.