The Type 2 Investor

August 12, 2026

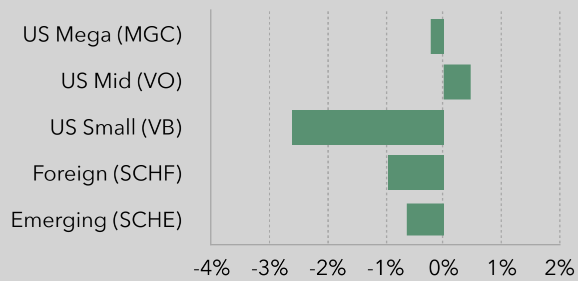
July 2026

Economic Data

- Payrolls fell by 23,000 in July and the unemployment rate declined to 4.1%
- Retail sales were up 0.2% in June, with gasoline station sales down 5.3% reflecting lower prices at the pump
- Y/y inflation (CPI) fell sharply in June to a 3.5% pace due to lower energy costs; the core rate (less food and energy) declined to 2.6%
- Existing homes were down 1.7% in July but up 0.7% y/y; the median home price fell to $434,100

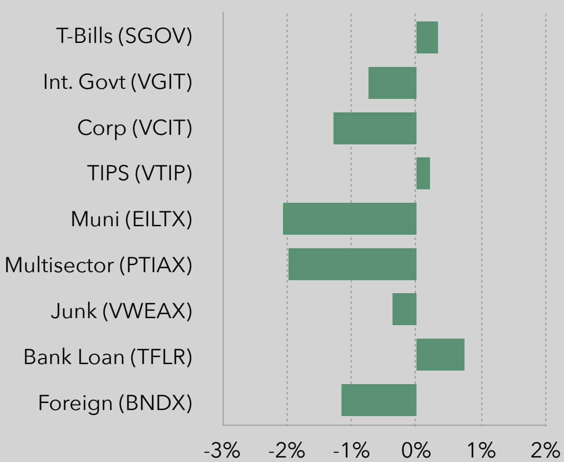
Stocks

July Returns



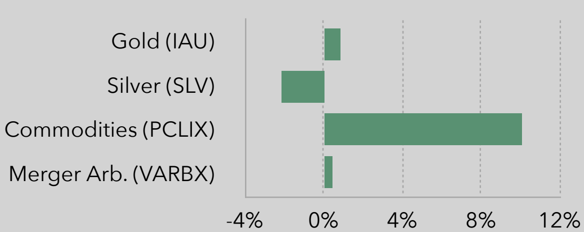
Bonds

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.

Leopold's Lever

"Give me a lever long enough and a fulcrum on which to place it, and I shall move the world." –Archimedes

That famous quote from Archimedes is in reference to the mechanical power of leverage. Financial leverage–the borrowing of money to buy more assets–also has a great deal of power.

Leopold Aschenbrenner is a 24-year-old German-born AI researcher with a résumé that would be impressive at any age. Aschenbrenner previously worked on OpenAI's Superalignment team, studied mathematics-statistics and economics at Columbia, and graduated as valedictorian at age 19. He is known for his 2024 essay *Situational Awareness: The Decade Ahead.* In the essay, he argued that continued gains in compute, data, and algorithmic efficiency could produce AGI around 2027. He predicted that the resulting race would be commercial as well as geopolitical, and that the crucial inputs would shift from research talent toward chips, data centers, electricity, capital, and national-security control of frontier models.

The paper caught enough attention for Aschenbrenner to raise $225 million to launch a fund by the same name. The fund's AI-focused thesis produced spectacular gains, and by early July it reportedly had as much as $45 billion in assets under management (AUM). Then everything came crashing down.

The fund fell to a reported $10 billion, losing about 78% of its AUM, and he was forced to sell all of the fund's publicly traded assets to Citadel at a discount to meet margin calls.

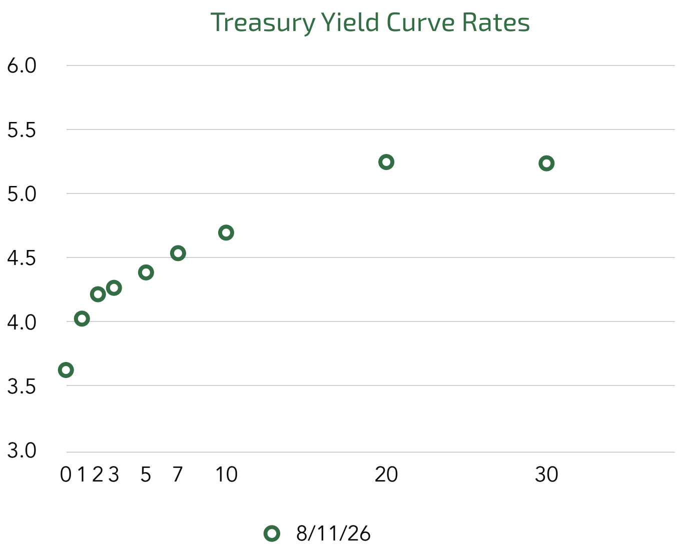
How could this have happened? Well, leverage has a way of making smart people look dumb.

Aschenbrenner was so confident in his thesis that he applied leverage to his bets–as high as 400% according to reporting. That kind of leverage can turn a bad few weeks–which AI stocks had in July–into a permanent loss.

Leo's legacy is still being written. Early capital is probably still ahead, while capital invested near the peak will have suffered far worse outcomes. But the episode is a useful lesson that conviction is not a risk-management system, and leverage turns volatility from an inconvenience into an existential threat.

Portfolio Positioning

We are shifting from an overnight to neutral on inflation, reflecting a break-even rate on 5-year TIPS of 2.22% that I think reasonably prices in expectations for the Warsh-led Fed. "If we get policy right–and we will –the inflation surge of the last five years will be a thing of the past," Warsh said.



We remain underweight on duration, but are moving money out of short-term t-bills and intermediate duration to focus on 1-3 year maturities. The 2-year looks like the sweet spot on the Treasury curve, yielding 4.22%, which is 55 bps more than the Fed Funds effective rate. I am less certain of the Fed rate hikes that the market is pricing in, and I believe the front end of the yield curve will slowly begin to reflect that. I also believe that the Fed's balance sheet will shrink while debt supply increases, putting upward pressure on longer-term rates. Long-term Treasury yields have been rising and are now at 5.24%. If they go high enough, we may start moving further out on the curve.

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				●	←
Merger Arbitrage					●

Valuations are a little more compelling in small-cap stocks, with a forward P/E (price/earnings) ratio of 17.43 (VB), compared to 18.69 for mid caps (VO) and 21.99 for mega caps (MGC). The pullback in AI-related stocks from late June to late July was almost completely offset by gains elsewhere in the stock market, and I think that's a healthy sign for value stocks in general and small and mid-cap stocks in particular. I think this applies to emerging markets, as well, which sport a P/E of 12.85 (SCHE).

Within alternatives, we are trimming back exposure to gold and silver but still remain overweight. The prices of precious metals have increased dramatically over the past three to four years, but recently peaked at the end of February. The global silver-market deficit remains in play, with increasing demand from solar and AI-related applications.

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Binge Box

Alien: Earth (Hulu)

The first TV series in the *Alien* franchise is a prequel from *Fargo* creator Noah Hawley. The show is set in 2120, two years before the original film. The alien threat arrives on a corporate-dominated Earth after a ship crash-lands. Sydney Chandler plays Wendy, the first "hybrid" (a human consciousness in a synthetic body), amid cyborgs, synthetics, and corporate rivalries. The series expands the lore with new creatures and themes of immortality and hubris while delivering visceral horror and high production value. It's one of the franchise's best entries in years and well worth watching on Hulu.

About EmeraldSpark

EmeraldSpark Investments, LLC is a Registered Investment Adviser. 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.