The Type 2 Investor

April 7, 2025

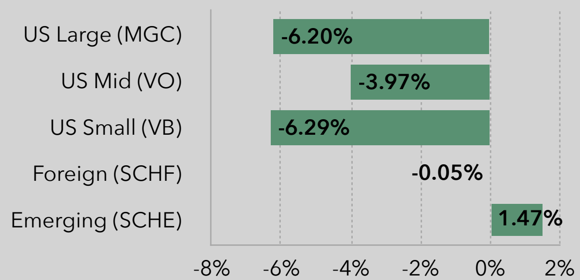
March 2025

Economic Data

- A sizable 228,000 jobs were added in March; the unemployment rate edged higher to 4.2%; Challenger reported 275,240 job cuts in March, the highest total for the month since May 2020
- Retail sales were up 0.2% in February, with non-store retailers up 2.4%
- Y/y inflation (CPI) decelerated to a 2.8% pace in February; the core rate (less food and energy) was down to 3.1%
- Existing homes rose 4.2% in February but are down 1.2% y/y; the median home price rose to $398,400

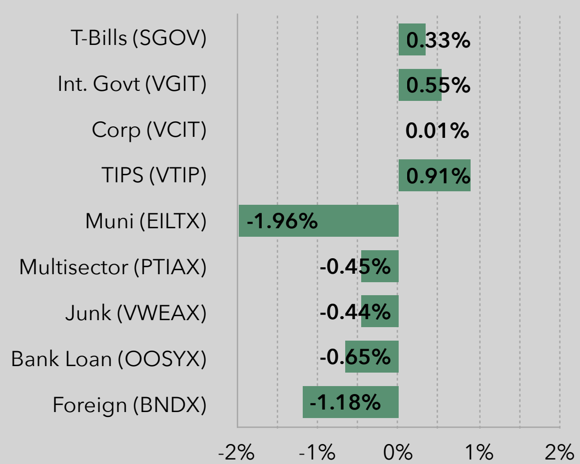
Stocks

March Returns



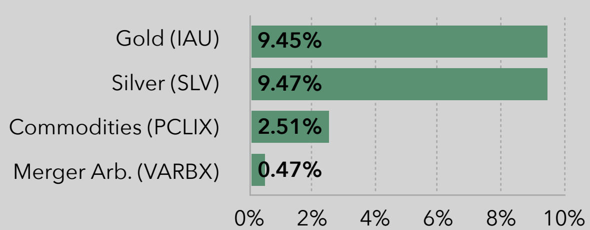
Bonds

March Returns



Alternatives

March 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.

Tarifforist Attack

In one of the biggest unforced errors in global trade, "Liberation Day" arrived and the Trump administration unleashed their new tariffs on every country, overseas territory, and uninhabited penguin colony across the globe. The only thing that was really "liberated" were the rules of economics. The formula used to calculate "reciprocal" tariffs is presented below:

$$\Delta\tau_i = \frac{x_i - m_i}{\varepsilon * \varphi * m_i}.$$

Those two fancy greek variables in the denominator are actually constants of 0.25 and 4, which, you know, equals 1 when you multiply them together (I'm a mathlete, not an athlete). Thus, they serve no purpose other than to confuse and bewilder. This figure is not the actual tariff but a made up value: (US trade deficit with the country / country's exports to the US). This is then halved for the US tariff rate, giving our trade partners a "kindness discount." Countries with a US trade surplus still face a 10% baseline tariff.

For example, Japan's exports to the US were $140.2 billion (U.S. Census Bureau preliminary 2024 data). U.S. exports to Japan were $75.8 billion. Thus, there was a trade deficit of: $140.2B - $75.8B = $64.4 billion. ($64.4B / $140.2B) = 45.9% (rounded to 46% in Trump's official statements). Divide by two and you've got the "reciprocal" tariff of 24% (not exactly half, but good math isn't the goal here). Never mind that Japan's actual trade-weighted tariff on US imports is only 2.5%, according to 2023 WTO data.

I have presented the formula results compared with the actual tariff numbers for a select group of some of our biggest trading partners in the table below.

Country	Trump's New US Tariff	"Tariff" Claimed by Trump Administration	Actual Tariff Charged by Country (WTO, 2023)
China	34%	67%	7.3%
European Union	20%	39%	5.2%
Vietnam	46%	92%	9.2%
Japan	24%	46%	2.5%
United Kingdom	10%	10%	5.2%
India	26%	52%	12.0%
Taiwan	32%	64%	6.2%
South Korea	25%	50%	6.8%
Brazil	30%	60%	13.4%
Canada	25% (non-USMCA)	TBD	4.1%
Mexico	25% (non-USMCA)	TBD	7.1%

The goal appears to be eliminating bilateral trade deficits with all countries, not reciprocity. But that doesn't make any practical economic sense--that's not how global trade should work. Global trade thrives when countries focus on producing goods where they hold a comparative advantage and import those they are less efficient at making. It's not a zero-sum game. Furthermore, trade deficits aren't a bad thing when your currency is the reserve currency of the world. We give them entries in computer databases, they give us South African wine, Vietnamese sneakers, Canadian maple syrup, and Japanese Nintendo Switch 2s. That seems like a pretty good deal for us.

I like free markets, but I really wouldn't have a problem with putting a 10% across-the-board tariff on a country that puts a 10% across-the-board tariff on us. That seems fair and gives us a better chance of producing locally and not having to buy something shipped half-way across the world. And if they want to put an extra tariff on a country with unfair labor practices or bad environmental protections, no argument from me. But that's not what this is.

Anyway, the stock market didn't like any of this and prices tumbled on Thursday and Friday. The S&P 500 is now down 17.6% from its February 19 peak and is only one more bad day away from bear country.

The Gambit

I don't want to be all doom and gloom, though, so let me try to sift through the rubble of this policy blunder and try to find something positive—other than funny penguin memes, of course. Let's pretend this really aggressive and reckless move was all part of a well-crafted plan. I know, I know, but bear with me.

Binge Box

Yellowstone (Paramount+)

I have reviewed *1883* and *1923* in previous newsletters. Both are *Yellowstone* prequels, which heretofore—oddly enough—I haven't watched. But to continue my Taylor Sheridan journey, I decided it was finally time to watch the show that started it all. *Yellowstone* is a gripping modern Western that hooks you from the first episode and never lets go. The show follows the Dutton family, led by the stoic John Dutton (Kevin Costner), as they fight to protect their sprawling Montana ranch from developers, rivals, and internal strife. The setting is so beautiful you can't help but dream of owning a piece of land like this yourself. Highly recommended for drama fans.

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					●

The US Treasury has $9.2 trillion in debt--almost a third of all US Treasury issuance--that needs to be rolled over this year, with the bulk of that happening before the end of June. Treasury Secretary Scott Bessent has come out and openly talked about driving interest rates down to make this an easier pill to swallow. If they are able to refinance that over 10 years at, say, 3.8% instead of the 4.8% we were at before inauguration day, it will save the taxpayers $920 billion over the next decade. Chaos drives demand for safety, which drives interest rates for Treasurys down.

If chaos is an objective, they don't care where the stock market is over the short-term—say the next three months to get most of the debt refinanced. Trump 45 tweeted about the stock market all the time, seemingly viewing it as a gauge of how well he was doing. Trump 47, however, has made it pretty clear he doesn't really care about the stock market. As Bessent said quite bluntly, this is "more a Mag7 problem, and not a MAGA problem."

Meanwhile, there is still the prospect that this is about bringing countries to the bargaining table to promote US interests in exchange for ratcheting back the new, higher tariffs. That's the hope, anyway, and assumes they didn't just cause the complete collapse of American credibility as a reliable and trustworthy trading partner. Bessent, an objectively smart finance guy, said in an interview on CNN "One of the messages that I'd like to get out tonight is everybody sit back, take a deep breath, don't immediately retaliate, let's see where this goes." He doesn't see this escalating because we are a deficit nation and it is the surplus nations that are in the weaker positions in a trade war.

What does the US want to negotiate for? That depends on whatever it is they actually want from each country; perhaps lower trade barriers, the purchase of more US goods, reshoring of manufacturing, increased defense spending from allies, higher labor/environmental standards, and/or a crackdown on fentanyl, IP theft, and counterfeit goods.

Reshoring is all well and good, but it takes time and some goods are going to cost a lot more while we wait. Furthermore, there are just some things—like textiles, apparel, plastic tchotchkes, tropical agriculture (coffee, cocoa, bananas), etc.—that we just don't have a comparative advantage in and shouldn't be produced in the US.

Reducing dependency on foreign countries for our supply chain may not be just about brining jobs back to the US. This is something I would do if I expected war. The best way to prevent war is to have your potential adversaries' supply chains deeply intertwined with your own. If those binds are untangled, the economic consequences of conflict are significantly reduced.

Regardless of what is ultimately negotiated, I expect some level of tariffs to remain. Commerce Secretary Howard Lutnick is a big fan of tariffs. He sees this as "a reordering of global trade for the benefit of America." He has also talked about using the revenues from tariffs to help get rid of income tax on people making less than $150,000. Sounds great, but I'll believe that when I see it. Meanwhile, we'll all be paying an indirect tax from the tariffs.

So to recap, here is how any of this makes sense:

- Phase 1: Say you're going to raise tariffs on April 2 ✅
- Phase 2: Do it but make it way worse and nonsensical than people expected, causing chaos in the markets and driving down interest rates ✅
- Phase 3: Refinance $9.2 trillion in debt at lower interest rates in the midst of the fog of trade war 💬
- Phase 4: Bring countries to the bargaining table and make trade deals that bring tariffs down closer to the 10% the market would have been happy with 💬
- Phase 5: Reap the benefits of new revenue, reshoring, and diplomatic agenda goals 💬
- Phase 6: Profit, I guess 💬

I'm probably giving the administration way too much credit here. Even if this is the plan, it is a very risky gambit with little room for error. They would need to show meaningful success quickly and can't allow the stock market to stay in the dumper for too long with mid-terms only 18 months away. If it fails, it will mean higher inflation, retaliation, inability to implement agenda, and increased risk of kinetic war with little to show for it.

Portfolio Positioning

The market is expecting the Fed to come to the rescue with rate cuts, and we are likely to see that by June. However, the threat of higher inflation from tariffs may limit the degree to which they can respond.

So far there hasn't been any sign of recession in the hard economic data, but these tariffs greatly increase the chance of recession in the short-term as global economies adjust to the new reality. Over the next three months or so I believe there will be some good buying opportunities, but I don't think we've found the bottom yet. We went into this with an underweight to equities, and that is where we stand at the moment. There will be more frequent rebalancing in volatile times, however, to keep portfolio risk in line with client objectives. As we head down the path of de-globalization, broad diversification will become increasingly meaningful.

I don't think I've written a newsletter this long in many years, so thanks for making it to the end. These are the kinds of times where our emotions test us and sticking to a well thought out investment plan is so important.

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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.