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MONTEITH WEALTH, LLC.

HEADS OR TAILS

TWO SIDES OF THE SAME COIN

The topics discussed in this and future letters are for informational purposes only. We hope our thoughts on investing and the related fields of taxes will help you achieve and enjoy financial independence. We believe only when you combine knowledge of both can you be a successful investor.

Heads: Taxes

Social Security's Stealth Tax

For many Americans, Social Security benefits are non-taxable. This is changing rapidly as high inflation is breaking the system. The government takes inflation into account by increasing Social Security benefits, IRA contribution limits, federal tax brackets, and the standard deduction. Unfortunately, forgotten is the threshold used for calculating whether Social Security is taxable.

The taxable threshold for Social Security is $25,000 for single filers and $35,000 for joint filers. If your gross income plus tax-free interest and 50% of your Social Security is less than the threshold, then none of your benefits are taxable. If it is more than the threshold but less than $34,000 for single and $44,000 for joint, then 50% of your Social Security is taxable. If it is more than $34,000 for single and $44,000 for joint, then 85% of your Social Security is taxable. These thresholds haven't changed in decades.

Just as Americans receive a well-deserved increase in Social Security benefits to cover rising costs, they may have to give it right back. Most people are finding this out the hard way – when they're hit with an unexpected tax bill in April. The government could fix this issue in the future with a simple bill allowing inflation adjustments to the Social Security thresholds, but at this time it seems nothing is in the works. We will keep our eyes open, and fingers crossed.

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Tails: Investments

The Failure of Silicon Valley Bank

Silicon Valley Bank (SVB) is the second-largest bank failure in American history. The banking industry in general is now in question. We feel this event is so important we axed our previously planned investment topic. There is much to discuss, so we'll try to touch on the important points.

Investors with well-diversified portfolios have no reason to be concerned – our clients' portfolios contain over 14,000 companies worldwide. The current banking woes are exactly why we do not invest in individual companies; SVB investors will likely lose a lot of money, perhaps all their money – the Federal Deposit Insurance Corporation (FDIC) is bailing out depositors, not investors. Still, a struggling banking industry does signal to us that a recession may be imminent, though perhaps we're already in one. A recession is both good and bad news. Bad because we would prefer growth, and good because a recession should finally bring inflation under control.

Schwab bank has also been a subject of concern, but those concerns seem to be once again overblown. Schwab bank does not appear to have liquidity problems, especially since they have backup plans for such cases. Additionally, Schwab banking is a separate subsidiary from Schwab's investment side. Even if the banking side were to struggle, the investment side is insulated.

Now that we've addressed what is most important to our clients (should we be concerned), let's discuss what happened to Silicon Valley Bank. Banks don't hold all your money; they hold only a small portion and loan out the rest for interest. Technically it can be easy to ruin most banks if all or most depositors suddenly demand all their money at once – this is called a bank run. This is one reason the FDIC stepped in and promised to bail out all SVB depositors of their full amounts, even though the insured amount is $250,000 per person per bank – the FDIC is trying to prevent additional bank runs.

During the pandemic, the US injected huge quantities of cash into the economy. Depositor data during the pandemic shows bank accounts grew overall despite the economy being shut down. SVB, being the main bank of choice of tech companies, grew substantially during the pandemic, growing from nearly $70 billion in deposits in 2020 to over $200 billion in 2023. With this huge increase in deposits, SVB had to do something with this money.

As we mentioned above, banks loan out most of their deposits. Banks also purchase US treasury bonds. Treasury bonds are considered extremely safe as the risk of default is essentially zero since the government doesn't have to default; it can just print money to pay. During the pandemic, the US government issued huge quantities of bonds, most of which had extremely low-interest rates. Someone had to buy those bonds, and banks like SVB were awash with cash. So SVB, like many other banks, purchased huge quantities of US treasury bonds. Treasury bonds are safe when it comes to default risk but are still vulnerable to interest rate changes.

SVB accumulated huge amounts of treasury bonds at a time the money supply was increasing rapidly. If SVB had hired us as consultants we could have warned them that inflation was naturally to follow, or perhaps they could have asked any economics 101 student – more money and the same amount of goods equals less valuable money (inflation). The federal reserve's job is to keep inflation at 2%. If inflation exceeds this target, they are forced to reduce the money supply. They do this by issuing more bonds – you buy the bonds and thus the cash you used to buy the bonds is no longer in the market. But most people don't want to buy bonds for nearly 0% interest; they can make much more money in the stock market or other investments. So how does the federal reserve entice you to buy their bonds? They increase the interest rates. The recent inflation has been so bad that interest rates have increased from nearly 0% to 5% in a short time. This means banks holding bonds issued at low-interest rates must sell their bonds at huge discounts if they want to cash out – why buy a bond paying 2% when you can buy one paying 4%?

With inflation so high, depositor data shows most bank account values have been declining. At the same time, interest rates have increased extremely quickly. This is how SVB failed; the assets they used to back up their depositors, US treasuries, lost so much value that the bank could not possibly pay back their depositors. If SVB was able to hold their treasuries until maturity, they wouldn't have lost any money, but when too many depositors wanted their money back, SVB was forced to sell bonds at losses and was unable to pay back all deposits. There are many lessons to learn from these events, and more will be apparent as time goes on. But one takeaway is the importance of diversification. Don't invest in individual stocks, don't keep too much money at one bank, and don't hold too much of one bond.