Déjà Vu All Over Again

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Declining confidence in banks and increasing interest rates: what can we do about it?

It has been a while since investors have had to review the rules around FDIC and SIPC insurance, but that is not because of an absence of bank failures, but rather an absence of spectacular failure. While 2021 and 2022 both recorded zero bank failures, that was not the case for 2019 and 2020 - both years recorded four bank failures each. 2018 passed without any bank failures, but before that, consecutively from 2007 to 2017 there were bank failures each year. The scariest were the 325 bank failures in 2007 through 2010 when our whole economy was imploding.

Back in 2008, investors learned that FDIC insurance is critical, and furthermore, how quickly FDIC insurance pays out. People who had deposits protected by FDIC insurance were made whole in about four days after a bank failure.

The **Federal Deposit Insurance Corporation (FDIC)** is an independent U.S. government agency that provides insurance to depositors in case their bank fails. FDIC insurance covers up to $250,000 per depositor, per ownership category, at each FDIC-insured bank. There are several ownership categories, the most common being an individual account, a joint account, certain retirement accounts, and beneficiaries of trust accounts. A person could be insured for well over $250,000 in cash deposits at the same bank using these separate ownership categories.

To forestall the risk of a larger bank crisis, on March 12, 2023, the Secretary of the Treasury Janet Yellen, Federal Reserve Board Chair Jerome Powell, and FDIC Chairman Martin Gruenberg announced that all depositors at Signature Bank and Silicon Valley Bank would have access to all of their money, even amounts in excess of the FDIC insurance amount. That was an extraordinary action, and I would not expect it to be applied again in the future. Far better to review bank accounts and maintain balances below the FDIC insured amounts. The FDIC website calculator can be used to enter the bank name, the account titles and balances to obtain the applicable FDIC insurance amount.

https://edie.fdic.gov/calculator.html

While FDIC insurance covers cash on deposit in banks, what about cash and securities at brokerage firms? Brokerage firms (such as Charles Schwab, TD Ameritrade and Pershing to name a few) are covered by **Securities Investor Protection Corporation insurance (SIPC)**. SIPC is a non-profit membership organization created by Congress in 1970 to protect investors from the loss of cash and securities that are held by brokerages in the event of failure or insolvency of the firm. SIPC insurance

coverage generally extends to stocks, bonds, options, mutual funds and other securities. The maximum amount of protection provided by SIPC for each separate account is $500,000, with a cash limit of $250,000. Most brokerage firms maintain excess SIPC policies for investors with over the $500,000 limit.

Unlike banks, it is exceedingly rare for brokerage firms to be unable to meet their financial obligations, and when they do, a buyer is generally found for the brokerage firm. However, in the Great Recession of 2008 – 2010 collapsing brokerage firms were not so exceedingly rare. Lehman Brothers went bankrupt, JP Morgan bought Bear Stearns when it collapsed, Bank of America bought Merrill Lynch forestalling a collapse, and Wachovia was purchased by Wells Fargo. But even with all of that turbulence, there were no losses of the various securities held in individual brokerage accounts, and no loss of cash covered under SIPC. Stocks and bonds held in brokerage accounts are not the property of the brokerage firm and remain the property of the account owner, even in the case of a brokerage firm bankruptcy.

So cash and brokerage accounts are safe; should any changes be made?

As Jason Rodnick and Jack Fagan detailed in their articles this quarter, the bankruptcy of Silicon Valley Bank and the weakness in bank stocks were caused in part by the actions taken by the Federal Reserve to fight inflation. When interest rates start to rise it becomes more expensive for businesses and consumers to borrow money, which generally leads to lower spending and lower profits for companies. This slow-down should result in a reduction of inflation, and, as we have seen throughout 2022, many sectors in the stock market are negatively affected when interest rates rise.

On the other hand, as interest rates have increased, it has become steadily more attractive to purchase bonds and other Fixed Income securities. Bonds purchased now carry higher interest rates than they have for several years, and those higher rates will continue through the maturity of the purchased bonds. Finally, it is even possible to get interest on the three to six months of living expenses that are recommended to be tucked away as a cash reserve.

Inflation and rising interest rates suggest a review not only of the amounts and locations of cash deposits, but also a review of the cost of any debt. Low fixed-rate debt is generally advantageous to continue to carry, while prioritizing paying off high-interest debt such as credit card balances and other floating rate loans, such as home equity lines of credit.

The most important rule when it comes to investing in a rising interest rate environment is the same as investing in other economic market conditions: be *diversified*. Your well-diversified Osborne Partners managed investment portfolio can help to mitigate the risks associated with rising

interest rates by being invested in a variety of asset classes, including alternative investments, real estate and natural resources, making your portfolio well-positioned to participate in stock market gains when interest rates peak and ultimately begin to decline.

It can be challenging to remain confident of your overall financial situation in the face of the worrisome economic and geopolitical news that we are bombarded with on almost a daily basis. Your Osborne Partners Wealth Counselors are available to review your portfolio and especially your long-term financial plan with you. Financial plans anticipate that some years will be good and others bad, and it is generally reassuring to see that even with the stock market volatility, rising interest rates, inflation and war, **most financial plans continue to be on-track, providing for targeted goals and objectives.**

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