McCarthy Asset Management, Inc.
Personalized Wealth Management

March 2023 Monthly Commentary/ 1st Quarter Letter

April 3, 2023

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Stock Market & Portfolio Performance

March 2023: For the month, large U.S. stocks rose, led by a continued recovery in technology stocks. Small U.S. stocks fell and international stocks rose modestly. Bonds rose nicely as the rate on the 10-year Treasury declined.

	Mar 2023	YTD 2023	Description:
Without Dividends:			
S&P 500	3.5%	7.0%	500 Largest Public U.S. Companies
Russell 2000	-5.0%	2.3%	2000 of the smallest U.S. stocks
MSCI EAFE	1.9%	7.7%	international stock index
U.S. Aggr Bond	2.6%	3.2%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	1.9%	4.0%	non-very conservative MAM portfolios
MAM Consrv	1.6%	2.8%	portfolios with 45%+ bond allocation

The returns showed above are unaudited. Past performance is not indicative of future results. Returns for McCarthy Asset Management Portfolios ("MAM Portfolios") are net of management fees and transaction costs, and reflect the reinvestment of dividends. Results represent a composite of clients using a similar investment strategy, individual results will vary.

Returns for the indices are provided solely as a general indication of current market conditions. MAM Portfolios are not invested in a style substantially similar to any index. Indices do not reflect the deduction of management fees or transaction costs or the reinvestment of dividends. Performance for the indices would be lower if these costs were reflected.

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The Implosion of Silicon Valley Bank and What Comes Next

Silicon Valley Bank (SVB) collapsed in the morning of Friday, March 10th, in a stunning fall that occurred within the span of 48 hours. It was a classic bank run that led to the second largest failure of a financial institution in U.S. history. The purpose of this article is to discuss how this happened, and what repercussions could result from it.

Who is Silicon Valley Bank: Based in Santa Clara, CA, SVB Financial is the parent company of Silicon Valley Bank. Many of its clients were startups and venture-capital firms. During the pandemic, those clients generated a tremendous amount of cash, which led to a surge in deposits. SVB ended the first quarter of 2020 with just over $60 billion in total deposits. That skyrocketed to just shy of $200 billion by the end of the first quarter of 2022. With these deposits, SVB bought tens of billions of seemingly safe assets, primarily longer-term U.S. Treasury bills and government-backed mortgage securities. SVB's securities portfolio rose from about $27 billion in the first quarter of 2020, to approximately $128 billion by the end of 2021.

What Went Wrong: While SVB's investments in these securities had virtually no risk of defaulting, they did have an interest rate risk. The sudden surge in inflation in late 2021 and early 2022 prompted the Federal Reserve, starting in March of 2022, to institute a series of sharp increases in short-term interest rates. As discussed in previous monthly commentaries, the dramatic rise in interest rates caused the bond market to experience one of its worst years in history. SVB suffered significant unrealized losses in its long-term bond portfolio.

At the same time, tech stocks tumbled with the Fed raising interest rates. Startups being short on cash, drained their deposits with SVB faster than the bank expected.

The 48-hour collapse started on Wednesday morning when SVB announced it sold a bunch of securities at a loss, and that it would issue $2.25 billion in new SVB stock to shore up its balance sheet. That triggered a panic among key venture capital firms, who advised their portfolio companies to withdraw their money from the bank. On Thursday, customers yanked $42 billion from SVB, leaving the bank with $1 billion in negative cash balance. In short, a classic bank run was sparked, dooming the tech lender's plans to raise fresh capital and stave off collapse.

SVB's stock price (SIVB) reflected how quickly conditions unraveled:

- On Wednesday, March 8th, SIVB stock closed at $267.83 per share.
- The bad news hit the stock Thursday, March 9th, closing at $106.04, down 60.4% for the day.
- The stock never opened for trading on Friday as before 9 a.m. regulators had seized the bank. As a result, the stock became worthless overnight.

How Could This Happen? How could the 16th largest bank in the U.S. implode in less than 48 hours? SVB's failure boils down to a huge mistake: It grew too fast using borrowed short-term money from depositors who could ask to be repaid at any time. In particular, more than 95% of SVB's deposit base were not FDIC-insured (ranking them #99 out of the top 100 banks). In turn, it invested more than 55% of these assets in long-term government bonds (ranking them #1 out of the top 100 banks). Effectively, SVB took an enormous unhedged bet on interest rates staying low. They lost that bet. When interest rates rose quickly last year, it was saddled with losses that ultimately forced it to try to raise fresh capital, spooking companies with uninsured deposits to quickly pull their funds.

The Implosion of Silicon Valley Bank and What Comes Next- Con't

Signature Bank: The SVB wasn't the only U.S. bank to fail last month. On Sunday, March 12th, the FDIC announced they were also taking over New York-based Signature Bank. Signature Bank was also something of a boutique bank, catering to real estate developers and legal and other professional services firms, with a concentrated deposit base that was 90% uninsured and thereby poised to bolt for the exits at the first sign of trouble.

In addition, approximately 20% of its deposits were in crypto-related assets. The bank's exposure to crypto became a problem as 2022 wore on. A market rout that deepened following the November collapse of Sam Bankman-Fried's crypto exchange, FTX, drained billions in deposits.

The Fed Decided to Cover Uninsured Deposits: Unlike the largest U.S. banks, 90% to 95% of deposits at Silicon Valley and Signature Banks were uninsured. In the case of SVB, many local tech firms needed a portion of those deposits to cover payroll. To prevent a bad situation from spiraling into something worse, on Sunday, March 12th, Janet Yellen, U.S. Secretary of the Treasury, announced that the U.S. would back all insured and uninsured deposits at Silicon Valley and Signature Banks, and depositors would have full access to their funds on Monday morning.

What About Charles Schwab? Since the Silicon Valley Bank debacle, a couple of clients have asked whether they should have any concerns about Schwab's financial position. First off, even if Schwab (or any brokerage firm) ran into financial trouble (which I believe for Schwab is extremely unlikely), clients' Schwab portfolios are protected. MAM portfolios are invested in mutual funds and exchange-traded funds. These investments are not a liability of Schwab. Furthermore, we have most excess cash in portfolios invested in a Schwab money market fund that is invested in very short-term U.S. Treasury securities.

Repercussions: The following are some of the repercussions that could result from the collapse of Silicon Valley and Signature Banks:

- While large U.S. banks are more heavily regulated and in good financial shape, smaller banks, especially those that are disproportionately tied to cash-strapped industries like tech and crypto, could be in for a rough rise. First Republic Bank (FRC) and Western Alliance Bancorp (WAL) may be two at risk.

- The risk of a U.S. recession has risen. Growth will likely slow if banks become more conservative in their lending. In fact, with the collapse of the two banks, Goldman Sachs' chief economist, Jan Hatzius, said he now sees a 35% chance of a U.S. recession in the next 12-months, up from 25% previously.

- The Fed will likely be less aggressive in raising rates this year in light of the banking system's woes. Furthermore, if banks become less willing to lend money, that will help achieve the Fed's goal of slowing the U.S. economy. Although the Fed announced another 0.25% increase on March 22, they indicated they may be close to being done with raising rates.

- For savers, the recommendation is to not keep more than the $250k FDIC limit per depositor at any bank or credit union. If additional banks fail (particularly smaller ones), there can be no assurance that uninsured deposits will be backed by the U.S. government.

Extended Tax Deadline for Most Californians

Both the IRS and the CA Franchise Tax Board have announced that the deadline for filing 2022 individual tax returns has been extended to October 16, 2023 for most individuals and businesses in CA. In January, the IRS initially postponed tax deadlines until May 15 for residents and businesses in most of California and parts of Georgia and Alabama that were declared federal disaster areas because of winter storms. Subsequently, the IRS announced the deadline has been pushed out to October 16th, and the FTB said they will follow suit.

The disaster declarations include 44 of California's 58 counties (including all nine in the Bay Area) which experienced severe storm damage in December and January.

The October 16 extension applies to:

- Individuals whose 2022 tax returns and payments are due on April 18.
- Estimated tax payments for the first three quarters of 2023.
- 2022 contributions to IRAs and health savings accounts.
- Business entities whose tax returns are normally due on March 15 and April 18.
- Elective tax payments for pass-through-entities due on June 15.

There is no need to file an extension to take advantage of the delayed due date.

SECURE Act 2.0– The New Retirement Law of the Land

In one of its final acts of 2022, Congress approved a massive year-end spending bill that included the long-anticipated retirement savings package known as SECURE Act 2.0. The retirement provisions of the new law, which took several months of negotiations between House and Senate leaders, combines three different retirement-focused bills and held bipartisan support across both the House and Senate. It builds on the SECURE Act, which was approved by Congress in 2019.

The purpose of SECURE Act 2.0 is to expand retirement savings for workers. Congress recognizes that too many workers reach retirement age with insufficient retirement savings. Many of the provisions of the new law contain methods intended to help workers reduce these shortfalls.

SECURE Act 2.0– The New Retirement Law of the Land– Con't

Here are some of the key provisions of SECURE Act 2.0:

- The age to start taking required minimum distributions (RMDs) increases to age 73 in 2023 and to 75 in 2033.
- The penalty for failing to take an RMD will decrease to 25% of the RMD amount, from 50% previously, and 10% if corrected in a timely manner for IRAs.
- Catch-up contributions will increase in 2025 for 401(k), 403(b), government plans, and IRA account holders.
- Starting in 2024, RMDs will no longer be required from Roth accounts in employer retirement plans.

Higher Catch-up Contributions: Starting January 1, 2025, individuals ages 60 through 63 years old will be able to make catch-up contributions of up to $10,000 annually to a workplace plan, and that amount will be indexed to inflation. (For 2023, the catch-up amount for people 50 and older is $7,500.)

Roth Provisions: A number of provisions will provide an option to invest in a Roth-type account. Roth-type accounts are an attractive investment option. While contributions don't receive a tax deduction, the entire account, including earnings, are tax-free when withdrawn during retirement. Also, Roth-type accounts are generally exempt from the required minimum distributions rules.

Roth Catch-Up Contributions for Higher Earners: Beginning with the 2024 taxable year, catch-up contributions must be made to employer-provided qualified plans on a Roth basis (i.e., after-tax) for employees with compensation in excess of $145,000 (indexed for inflation starting in 2025). This new rule does not apply to SEP or SIMPLE plans.

Roth Option for Matching Contributions: Employers offering 401(k), 403(b) and 457(b) plans may provide participants with the option of receiving matching contributions on a Roth basis effective December 29, 2022. While employer matching contributions to traditional plans are not taxable to the employee, they will be taxable if the matching contribution are contributed to a Roth account.

SIMPLE And SEP Roth IRAs:

Under prior law, Roth accounts weren't available for SIMPLE and SEP IRAs. Under Act 2.0, beginning in 2023, SEP IRAs and SIMPLE IRAs can be designated as Roth SEP IRAs or Roth SIMPLE IRAs. Any employer contribution to a Roth SEP or SIMPLE IRA are treated as compensation to employees. Contributions to a traditional SEP or SIMPLE IRA are excluded from the employee's taxable compensation.

529 Plans- Roth IRA Option: An interesting provision is that individuals who have maintained a 529 account for at least 15 years can make a direct trustee-to-trustee rollover from the 529 plan to the beneficiary's Roth IRA, effective for distributions made after December 31, 2023. The exclusion only applies to the amount contributed to the 529 plan (and earnings attributable to) before the five-year period ending on the date of the distribution.

SECURE Act 2.0– The New Retirement Law of the Land– Con't

The purpose of this 529 provision is to encourage individuals who might have been concerned about leftover funds being trapped in 529 accounts or be subject to penalties, to continue to make contributions. Rollovers from 529 plans to a taxpayer's Roth IRA will count toward the taxpayer's annual IRA contribution limit (which is $6,500 for 2023). Rollovers from a 529 plan are subject to an aggregate lifetime limit of $35,000 per beneficiary.

Automatic Enrollment: One of the most broadly applicable provisions requires that, effective for plan years beginning after 2023, 401(k) and 403(b) sponsors automatically enroll employees in plans once they become eligible. Under this requirement, the amount at which employees are automatically enrolled cannot be any less than three percent of salary, and no more than ten percent. The amount of employee contributions is increased by one percent every year after automatic enrollment, up to a maximum contribution of ten percent. Employees can opt out of automatic enrollment if they so choose.

Sincerely,

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MAM

Our Services

McCarthy Asset Management, Inc. (MAM) is an independent, privately owned Registered Investment Advisor firm. We provide clients with the peace of mind that comes from knowing professionals are managing their financial affairs. The services we offer include:

Investment Management Services:

- **MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.**

Financial Planning Services:

- **The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.**
- **"Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.**
- **Social Security Planning is an analysis of the best strategy for when and how to start claiming Social Security benefits.**

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- **Tax Return Preparation**
- **Income Tax Projections**
- **Tax Minimization Ideas**
- **Tax Authority Representation**

Other Services: MAM has retained outside experts, whose services are available at no cost to our clients:

- **Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.**
- **Medicare Advisory Program (MAP) - Eileen Hamm**

Reminders/Updates

Tax Reminders:

- April 18th is the deadline for filing 2022 individual income tax returns and making 2022 IRA, SEP-IRA, and Roth IRA contributions. *1
- It is also the deadline for first quarter 2023 Federal and State estimated payments. *1
- April 10th is the deadline for California property tax payments for the first half of 2023.

1 see article on P.4 for the extension to October 16, 2023 for many CA residents.