



## The Name of the Game is Bailout

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**April, 2023** – It is a travesty that children are not taught finance in high school; how to balance a check book, the importance of a good credit score, the need for a rainy day fund, you can't spend more than you have. I could go on.

Children looking on today at our economy are learning what? You don't need to worry about risk. You don't need to worry about solvency. You can throw money around frivolously without consequence. You can always get bailed out.

Of course, I am alluding to the recent bailout of Silicon Valley Bank and Signature Bank. Many of the depositors had assets that greatly exceeded the FDIC's \$250,000 insurance limit. Obviously if these banks had been allowed to collapse, (which is what would have happened in a truly free market) then those depositors would have lost their money.

Many of these depositors were venture capital enterprises. The very riskiest of the risky. Start-up ventures funded by what we in the industry call "crazy money." These are rich people managing the money of other people so rich that they take ridiculous risks in hopes of landing a giant payoff. If it works, everybody gets richer. But if it fails, well that's just how it goes sometimes.

Because these people take huge risks is no justification in and of itself for them to lose their money, but you would have thought that someone managing all this money would have questioned the solvency of the bank, especially in light of drastically rising interest rates. In the past, plain mom and pop Americans have lost their money in a bank failure if they were over the limit. How do they justify one and not the other?

In your lifetime, how many banks can you remember getting bailed out? Surely you remember the collapse of Bear Sterns and Lehman Brothers in 2008, but all the other big banks got bailed out with TARP money. Remember that? Have you ever asked yourself why some banks got bailed out and why some didn't? Who makes that decision, and why? Surely there's no partisanship.

In any event, the Fed and the Treasury have come out and said that all deposits, regardless of the amount, irrespective of the limit, will now be guaranteed by the FDIC.<sup>i</sup> This comes out to about \$18 trillion in deposits now currently "guaranteed" by the FDIC. Do they have that much money? Does anyone? No, that is complete and utter ridiculousness.

What that really means is: “We are prepared to create as many dollars as are needed to prop up all these banks. At least the one’s we want to.”

But I thought we were trying to fight inflation? We’ve been raising rates quite dramatically and now we are going to print some more money to cover these banks? Are we fighting inflation or are we causing more? The answer is both!

They told us there is no inflation. Not true. They told us inflation was caused by Putin. Untrue. They told us inflation was transitory. Laughable. They told us they would not monetize the debt.<sup>ii</sup> Surely, they knew they were lying when they said that. Take a look at this chart.



These are considered “assets” of the Federal Reserve System. As you can see, they are a little over \$8.5 trillion. These assets are primarily debt instruments of the US Treasury. No one ever asks the Fed, “Hey, how do you guys get all the money to buy all those assets?” This is classic monetizing of the debt.

That little blip there at the tail end is the bank bailout. Will there be more? In my opinion, you can bet on it.

Imagine you’re a bank and you have given out a lot of loans over the past ten years, mortgages and car loans let’s say. People finally got smart after 2008 and started locking in low interest rates for a longer fixed term so that those loans won’t pay any additional interest to you, the bank, as rates rise.

But now you have all these people walking into your bank wanting CDs and money markets at the new higher rates. So, you are paying out the new higher rates and collecting interest on the old lower rates. See a potential problem with that? As rates go higher, and time grows longer, the squeeze becomes more unbearable until you are paying out more interest than you are taking in. Eventually you run out of money. You are now insolvent.

Enter the FDIC, backed by the “full faith and credit of the federal government.” I quote one of the most enlightening books on the subject I have ever read, “The Creature From Jekyll Island” by G. Edward Griffin:

Let’s see what “full faith and credit of the federal government” actually means. Congress, already deeply in debt, has no money either. It doesn’t dare openly raise taxes for the shortfall, so it applies for an additional loan by offering still more Treasury bonds for sale. The public picks up a portion of these I.O.U.’s, and the Federal Reserve buys the rest. If there is a monetary crisis at hand and the size of the loan is great, the Fed will pick up the entire issue.

*But the Fed has no money either.* So it responds by creating out of nothing an amount of brand new money equal to the I.O.U.’s and, through the magic of central banking, the FDIC is finally funded. This new money gushes into the banks where it is used to pay off the depositors. From there it floods through the economy diluting the value of *all* money and causing prices to rise. The old paycheck doesn’t buy as much anymore, so we learn to get along with a little bit less. But, see? The bank’s doors are open again, and all the depositors are happy—until they return to their cars and discover the missing hub caps!”

And this was first published in July of 1994! Long before the Dot.com bust, or the 2008 housing bust when Lehman and Bear went under! And yet here we are again, and the only answer is to print the money to cover the shortfall. This is the classic recipe for more inflation.

G. Edward makes a little jest there at the end, but it is very telling. Do we not see more crime, more scams, more porch pirating, more homelessness, more rioting, more strikes, more dissention, more disharmony? There are now homeless beggars in Dunwoody, Georgia. One now must walk through a metal detector to go into Phipps Plaza in Buckhead, housing Tiffany’s, Fendi, Gucci, Prada, Hugo Boss, and others.

If you look at each of these trends in a vacuum, they don’t seem connected. But when you view the world through the eyes of an Austrian Economist, you can see the effects of inflation everywhere.

We have been told that the FDIC bailout would not be borne by taxpayers. That is only partially true. It will not be borne solely by taxpayers, but by every single person holding dollars. And that is particularly painful for retirees and impoverished people on fixed incomes.

Maybe that is why no one learns finance in high school—simply because it’s not taught. Too many questions can lead to inconvenient truths.

As always, at Magellan we lead with the Macro perspective and then determine what our Micro action should be, if any. What should we do as U.S. investors? What is the best positioning for our clients?

As you no doubt know, we have significantly reduced our exposure to stocks or anything that fluctuates greatly. We long ago jettisoned any lower quality bonds or longer-term bonds. In the tradition of Austrian Economics, we have been holding some real assets, such as gold, silver, and oil. These have all seen healthy gains in the last few weeks.

Our expectation of a significant stock market drop has not waned—if anything, we are more convinced than ever. The housing market is falling, but more worrisome is the commercial real estate banking industry, which has underwritten roughly \$5.5 trillion.<sup>iii</sup> We believe this is The Other Shoe<sup>iv</sup> I spoke of in my last letter.

As we have been saying for some time now, we believe the Fed will continue to raise interest rates until a sharp market selloff causes them to pause, and if history is any guide, they will then lower rates and create more stimulus. When this occurs, it will be our signal to change our positioning.

In the meantime, we are taking safe harbor in the one thing backing up everything else: US treasuries. Specifically, we are rolling 2-month T-bills over every (guess what) two months. We buy them at a discount directly from the Treasury and they mature at par in two months. They are considered the safest investment on the planet (even today), and we don't expect that to change any time soon.

The importance of these T-bills will become apparent as more banks struggle to remain solvent. And when stocks finally sell off, it will give us “dry powder” to buy up some bargains. Until then, remember that neither Cetera nor Magellan is a bank, and your assets are not tied to the success or failure of either.

We watched what happened in 2008 very closely and took note of what swam and what sank. And everything—and I do mean everything—sank in those dark times except for one asset class: treasuries. And that's exactly where we are going to safe harbor.

As always, questions and comments are highly encouraged. There is no dumb question or worry too small. If you have the slightest concern, I really do ask that you contact me at [kevin@magellanplanning.com](mailto:kevin@magellanplanning.com).

I wish you and your family a safe, healthy, and happy spring!

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<sup>i</sup> <https://www.fdic.gov/news/press-releases/2023/pr23017.html>

<sup>ii</sup> <https://www.forbes.com/sites/michaelpollaro/2010/12/02/the-monetization-of-u-s-government-debt-were-watching/?sh=7ca41bb422e2>

<sup>iii</sup> <https://www.marketwatch.com/story/bank-jitters-put-spotlight-on-commercial-real-estate-3-charts-pinpoint-the-potential-trouble-spots-228252b>

<sup>iv</sup> <https://static.fmgsuite.com/media/documents/a3f5410e-4b51-4c05-b7e6-7f9c0f40b79a.pdf>