FOUNTAINHEAD
ASSET MANAGEMENT

Public Service Announcement: Exit Your I Bonds!

Wall Street tends to get excited when a good opportunity appears, resulting in many individual investors potentially entering a trade. However, when the opportunity has passed, it may not be as newsworthy, potentially leaving investors holding the bag with a good investment gone awry. This is a public service announcement to inform those who may have entered the Series I savings bond program ("I bonds") in late 2021 and early 2022 that it may be time to close their position.

In November 2021, the market became aware of a way to capture enhanced, risk-free returns through a little-known government program called the Series I savings bond or "I bonds." At the time, Treasury rates were yielding roughly 0.25%, yet the I bond guaranteed an annualized return of 7.12% over the next six months. An apparent "deal!"

There were a number of complications with this variable rate bond program which relied chiefly on the change in value of inflation over a six-month period. These complications include:

- A variable rate based on the change in value of the CPI that needs to be calculated every six months to understand one's current interest rate
- A maximum investment size dependent on household make-up and tax consequences
- A penalty for exiting early (within the first five years)
- A 30-year duration

So, for those willing to enter the program, it would be prudent to monitor the change in inflation on a semi-annual basis in assessing whether to remain in the program.

Initially, there was a lot of coverage of this exciting program that allowed a materially enhanced yield as compared to a money market fund or Treasury investment. Now, though, we think the investment opportunity has disappeared and we're not seeing much press coverage at all. This is especially troubling because we believe that those who remain in the I bond program are in danger of significantly under-performing money market and Treasury-based interest rates for a very long time.

It is our opinion that all investments, no matter how "safe," require ongoing monitoring for optimal portfolio construction. At Fountainhead Asset Management, we have diligently performed an analysis of the attractiveness of the I bond program every six months, recommending whether our clients should (1) Enter, (2) Maintain or (3) Exit the

I bonds program. Over the first three periods, the answer for those clients for whom I bonds made sense was to seek to maximize an investment by placing extraneous cash in the program. Over the following two periods, the prudent choice was to maintain but not initiate or add on to one's position.

This time period, we think the answer is clear for those who entered the I Bond program prior to 2023: **Exit the position.**[1]

Over the next six months, those who are invested in the I bond program - will receive an annualized 2.95% yield. A reasonable base case is that the I bond program will yield roughly 3%[2] for the entire following year.

Currently, money market and treasury rates are around 5% annually.

If one exits the I bond program before five years have elapsed, they are assessed a penalty of three months of interest at the I Bond rate. Because we thought it made sense to enter this program less than five years ago, we incorporated this math into our analysis:

Assumptions:[3]

- $10,000 in I bond program
- 3% I bond yield
- 5% Money market/Treasury yield
- 3-month penalty

Current Assumptions

	Investment	Yield	Return
Maintain I bond	$ 10,000	3.0%	$ 10,300
Exit, buy MM or Treasury*	$ 9,901	5.1%	$ 10,406

Investment in Exit reflects penalty

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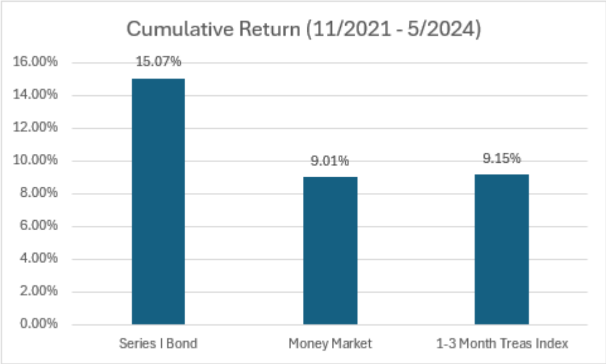
[1] Note that, based on the math, we have recommended that our clients *not* enter in the last year. If one did enter in the last year the analysis becomes more complicated due to (1) a restriction of exiting within one year of purchase and (2) a fixed rate that is assessed which may make the math less straight forward in determining whether to exit or maintain a position.

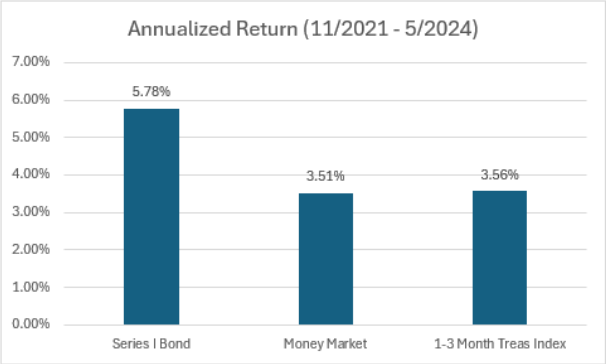
[2] This assumes that inflation as measured by CPI continues to increase at approximately a 3% annualized rate. There's of course no guarantee that will be the case.

[3] All participants who enter within a six-month period receive the same rate for the same period of time. For example, a participant entering December 2021 and a participant entering February 2022 would both receive a 3.56% rate for the six months following entry. Those exiting the I bond today would lose three months at the prior semi-annual rate of 3.94%, assuming they entered within the first four months of the six-month period, and then can enter a Treasury bill which is currently yielding 5%+ at the time this article was written. Each investor in the I bond program should conduct their own analysis or request an analysis done for their own situation with their advisor.

Based on our analysis, even after incorporating a three-month penalty, one receives roughly a 4% yield relative to the 3% I bond yield due to the materially higher rates currently available through enhanced money markets and Treasury bills. For those believing that inflation may increase dramatically from here and therefore decide to remain in their I bond position, the CPI measurement would need to increase over 5.2% in the next six months in order to generate a similar return to exiting now and buying a treasury bill.

In conclusion, we believe that, given likely inflation rates and the resulting math for I bond returns, ***exiting the I bond program is the right move based on prevailing rates for alternative cash equivalents***. When the program first caught the attention of investors nationally, there was a lot of press coverage of the amazing enhanced rated one can receive. And investors who did enter at that time should have done well compared to other relatively risk-free opportunities.





<u>We are concerned</u> that many of the investors who entered the program due to a news article may neglect to regularly evaluate whether to remain invested in what is ultimately a 30-year program. Failing to make that assessment will most likely result in dramatic underperformance among other missed opportunities.

<u>IMPORTANT DISCLOSURE:</u> *The information in this article is for informational purposes and is based on the math of I bond returns, as well as our assumptions about future inflation rates and the rates available for alternative cash equivalents. It is intended to educate I bond investors about the potential opportunity costs of remaining in this program. This is not intended as investment advice, and there may be other personal considerations for investors to take into account before making a change to their investment. Fountainhead Asset Management provides advice only to its clients.*