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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: Investments

The Persistence of Inflation

Inflation, currently hovering around 3.7%, remains a persistent concern in the economic landscape.

<u>The Challenge of Interest Rate Hikes</u>: One potential explanation for the ongoing inflation challenge is the effectiveness of interest rate hikes — raises which the Federal Reserve has used to combat inflation. The conventional wisdom is that raising interest rates discourages spending. When borrowing becomes more expensive, consumers tend to spend less, and businesses reduce their investments. Investors also shift towards bonds due to higher interest rates, leading to a decrease in the overall stock market value. However, there's a catch to this strategy.

<u>The Loan Predicament</u>: Consider a scenario where you secured a substantial loan with an extremely low interest rate just before the interest rate hikes. With ample cash on hand and low-interest debt, would you be inclined to cut your spending? Recent reports suggest that some major corporations have avoided borrowing at higher interest rates because they already secured massive loans before the rate hikes. While high-interest rates will eventually curb future growth, in the short term, this explains why inflation remains resilient — an excess of money remains in the economy, yet we have not fully experienced the consequences.

<u>The Impact on Small Businesses</u>: Unfortunately, amid this chaos, small businesses seem to be the ones disproportionately affected. Small businesses often hold enormous growth potential, but without access to affordable financing, they struggle to attract investors. Larger, more stable businesses become more appealing to investors. This trend is evident in the banking sector, where small banks faced intense scrutiny during the banking crisis, while larger banks could leverage high-interest rates to offer competitive savings rates, drawing funds away from smaller banks and jeopardizing their financial stability.

<u>Oil Prices and Geopolitical Factors</u>: Another contributing factor to the inflation puzzle is the upward trajectory of oil prices. Saudi Arabia's response to the release of $6 billion to Iran, viewed as a threat to their nation's interests, has been to reduce oil output. This deliberate supply reduction has led to rising fuel prices globally, exerting further upward pressure on inflation, particularly evident in rising gas prices within the United States.

<u>Looking Ahead</u>: Historically, stocks have proven to be a reliable hedge against inflation. Furthermore, with interest rates now matching or surpassing inflation rates, bonds have become an attractive option for investors. Inflation is a challenge, but not insurmountable. We conquered the 13.5% inflation rate of the 1980s, so we remain optimistic about the prospects for growth and prosperity in the future.

Tails: Taxes

Reducing the Odds of an IRS Audit

It seems tax season is upon us, as we've been receiving questions and concerns about the dreaded IRS audit. Since audits appear to be more frequent, we felt it might be of value to provide our insights to help you reduce the chances of an audit and also handle one.

Understanding the Odds: In 2022, the IRS audited roughly 4 out of every 1000 tax returns. While the chances of being audited are relatively low, it's essential to be aware that the probability increases with higher incomes. However, there's no need to panic. Instead, let's focus on taking proactive steps to minimize any audit-related stress.

Partnering with Tax Professionals: Should you receive a notice from the IRS regarding an audit or adjustments to your tax return, your first course of action should be to consult with a certified tax professional, such as a CPA or EA. They are well-equipped to handle these situations and can often resolve issues with minimal financial impact on you. Avoid responding directly to the IRS or state agency; let the experts handle it.

Recognizing Red Flags: Here are four red flags that may trigger an audit:

1. Discrepancies in Itemized Deductions: When your itemized deductions significantly differ from the average claimed by all taxpayers, it can attract attention.
2. Questionable Credits: Credits, especially those related to children or other areas, should align with your circumstances.
3. Unreported Income: Ensure all your income, including wages, interest, and stock sales, is accurately reported. The IRS often receives this information from payers.
4. Rounded Numbers: Avoid using rounded figures for income or deductions on your return. It can raise suspicion.

Preparing for an Audit: If you find yourself facing an audit and decide to represent yourself, here are some important tips:

1. Honesty is Key: Never lie or provide misleading information during the audit. Auditors may already have the answers they seek.
2. Focus on the Year at Hand: Stick to discussing the tax year being audited and avoid delving into other tax years.
3. Keep Original Documents: Do not provide your original documents to auditors. Always retain copies for your records.
4. Right to Appeal: Remember that you have the right to appeal the audit results if necessary.

It's rather simple, be honest on your tax returns and take advantage of legitimate tax reduction strategies. Avoid representing yourself during an audit; seek professional assistance when needed. When choosing a tax professional, inquire about their experience with IRS and local tax audits – fewer audits endured by their clients is a positive sign. We're often asked to find a "gray area" when preparing tax returns – to reduce tax liability. Tax laws are black and white. Anything else is grounds for an audit.

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