FINANCIAL DESIGN STUDIO

DESIGNED FOR LIFE

MAY 2021 NEWSLETTER

SHOULD I COUNT ON SOCIAL SECURITY IN RETIREMENT?

BY: ROBERT STOLL, CFP® CFA

One of the favorite American pastimes is making light of the government. Whether that's joking about the ogre known as the IRS or slow mail delivery from the Post Office, we've all had an interaction or two with government that was less than stellar. Social Security is also an easy punching bag. Many folks say, "Ain't no way I'm going to get my Social Security the way things are going!" But sitting behind joking statements like this lies a real life, unspoken question. Namely, "Should I count on Social Security in Retirement?"

Social Security is an incredibly complex topic. There's no way to cover all the complexities in a blog post. Instead, the goal with this week's post is to highlight two things: 1) how important Social Security is to your retirement plan, and 2) what happens if the Trust Fund runs out.

What is Social Security Designed to Do?

The Social Security Act was passed in 1935 during the presidency of Franklin Roosevelt. America was five years into a crippling Great Depression and on the cusp of entering World War II. The purpose behind it was simple, as stated in the first sentence of the Act:

> *"AN ACT to provide for the general welfare by establishing a system of Federal old-age benefits, and by enabling the several States to make more adequate provision for aged persons, blind persons, dependent and crippled children, maternal and child welfare, public health, and the administration of their unemployment compensation laws..."*

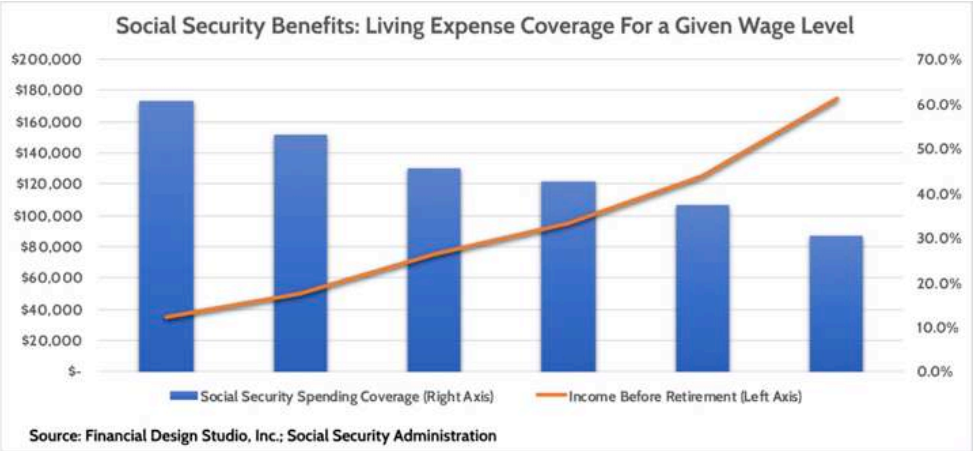
In short, the Social Security of 1935 and 2021 has the same basic purpose: to provide a social safety net for those unable to work, whether that's due to age or a disability. The one big difference between then and now is that life expectancies have increased by 20 years. If you turned 65 in 1935, they didn't expect you to live much longer. Now, people regularly live into

their 80s and 90s, making Social Security as much a retirement benefit as an income safety net in old age.

Who Benefits Most from Social Security?

The way they calculate Social Security benefits means that Americans at lower income levels receive more income replacement benefit relative to what high earners get. This is by design and is a real policy goal of the Social Security program.

To see this with real numbers, we've created a chart showing potential Social Security benefits for a new retiree at various income levels. Each income level assumes that they had worked at the same relative wage level their entire lives. Living Expense Coverage is calculated as wages less taxes paid, which we peg at 30% all-in for Federal, FICA, State, and Local taxes.



For example, on the left side of the chart we have someone who currently earns $35,000 per year and will retire soon. After taxes, their take-home pay is $24,500 ($35,000 less 30% total taxes). We'll assume this is the money they live on; their living expenses.

Using Social Security's Quick Benefits Calculator, we find this person would receive $1,241 per month in Social Security benefits, which comes out to $14,892 per year.

If we compare that benefit to what they normally spend, we find that Social Security will cover just over 60% of their living expense need while in retirement. That's nothing to sneeze at!

Notice what happens as income levels increase. Someone making $75,000 per year will receive less than 50% coverage of their living expenses from Social Security. All the way to the right we see that the percentage drops to 30% coverage for the $175,000/year earner.

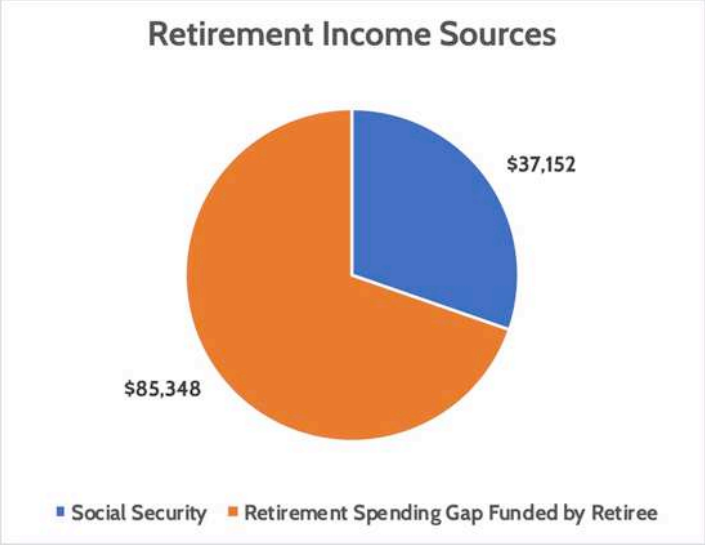
The benefit you ultimately get from Social Security has little to do with what you contributed in the form of Social Security taxes. Quite the opposite, actually. Remember that the original purpose of Social Security was to offer an income safety net to those who needed it most. That's still true today.

Your Job: Fill the Retirement Spending Gap

Financial media constantly bangs the drum about the "retirement crisis" in America. I sometimes find these claims to be self-serving. Above, we saw that Americans below the median income level (half of America, by definition) will end up getting over 50% of their wages replaced by Social Security. The hurdle to close the retirement spending gap isn't huge.

For higher income earners, the story is different. Using the $175,000/year earner above, Social Security will cover 30% of their $122,500 annual spending needs. But that means it's up to the retiree to cover the other 70%.

Putting this in simple terms: you're responsible for the orange part of the chart if you want to maintain your current spending patterns into retirement. Assuming investment returns of 6.0% and living expense inflation of 3.0%, this retiree would need $1,500,000 in savings on Day 1 of their retirement to fund their portion of retirement spending for 25 years.



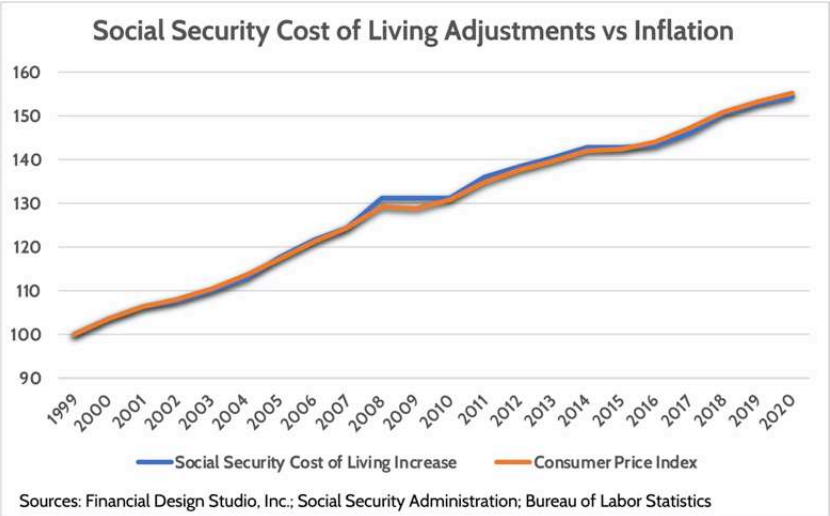
This shows the challenge for high income earners. The higher your annual income, the less Social Security will "replace" your income.

Will Social Security Benefits Keep Up With Inflation?

We've seen how important Social Security income can be for your retirement spending needs. Yet we all know that living expense costs go up each year because of inflation.

Most company pensions and insurance annuities will 'guarantee' a flat monthly payment for as long as you live. Social Security takes this feature one step further by giving you a cost-of-living adjustment each year. These adjustments – often called a "COLA" – maintain the real purchasing power of your Social Security income.

Officially, COLA adjustments have been doing their job. Since 1999, total Social Security COLAs have almost perfectly matched the officially reported inflation rate.



Regular readers of our blogs and newsletters will know that we're skeptical of how the government calculates inflation. Seniors certainly understand this. For example, Medicare Part B premiums have more than tripled since 1999, rising almost 6% per year.

But let's not be quick to discount the value of these COLA adjustments. They are a real, truly guaranteed benefit that only Social Security offers. A client's Social Security income is the foundation upon which they built the rest of their retirement income plan.

Can I Count on Getting Social Security in Retirement?

As we step back and look at the big picture, here's

Every year, the Social Security Trustees come out with a report detailing the financial health of the Social Security system. And every year, news sites are filled with headlines about how Social Security will go bankrupt in XYZ year.

I'm not going to get into the nitty gritty of the Social Security Trust and how it works because, frankly, I'm not an actuary. But here's what's happening. Since its inception, Social Security has taken in more payroll taxes than they paid out in benefits. They put these extra dollars into a "trust" to make the accounting work. Think of the trust as a savings account.

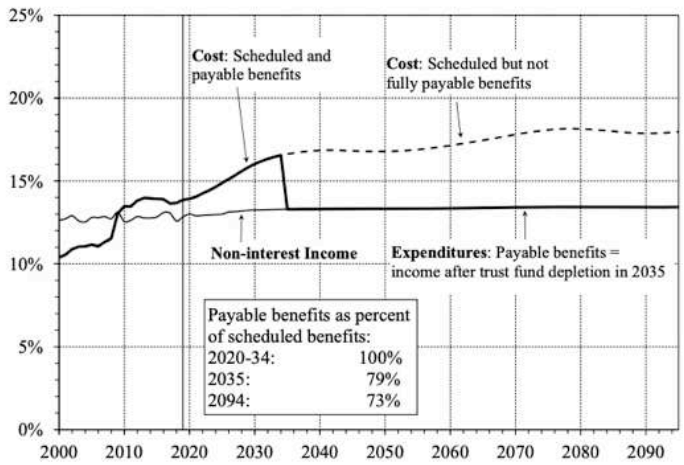
Recently, the level of paid Social Security benefits exceeded the amount of payroll taxes coming in the door. To keep everyone's benefits stable, the Social Security Administration (SSA) has to dip into the pot of money set aside in the trust.

As more people retire and start taking Social Security, this dynamic (more money going out than coming in) will worsen. By 2034, the SSA expects the trust fund to be fully depleted. News organizations spin this to mean that Social Security will be "bankrupt."

Let me be clear: Social Security will NOT go bankrupt in the sense that the news wants us to believe. When people hear "bankrupt" they naturally assume that their Social Security benefit would go to zero. That will not happen.

So what's going to happen if the Trust fund is depleted? They would cut benefits to the level of Social Security taxes coming in the door. Put

Figure II.D2.—OASDI Income, Cost, and Expenditures as Percentages of Taxable Payroll
[Under intermediate assumptions]



another way, Social Security would become a pay-as-you-go program. We can see how "bad" this outcome would be in the chart below provided by the SSA.
The worst-case scenario for Social Security is that the trust fund is depleted and Congress does nothing to fix it. In that case, monthly benefits would fall about 20-25%. A retiree getting a $1,000 monthly check would get a $790 check instead.

Don't get me wrong. That would be a terrible outcome for people who depend on Social Security to survive. But it's not the "zero" the media would have us believe.

Will Social Security Get Fixed?

The million dollar question is whether Congress will fix Social Security, and if so, when. I have very strong conviction about when it'll get fixed: At 11:59p.m. the day before Social Security goes bust. This isn't a cynical prediction, just a realistic one based on the last 30 years of American politics. Just watch.

Fortunately, the fixes for Social Security aren't difficult. They can raise payroll taxes by a percent or two. Or they can raise the Social Security wage limit – currently at $142,800 – so higher-income folks pay more Social Security tax. They can also raise the full retirement age from 67 to something higher.

Therefore we have very high conviction that Social Security benefits will be preserved, both for current retirees and future ones. The societal costs of not fixing it are too high, and the solutions are manageable.

Building Your Retirement Income Plan Around Social Security

As you think about retirement, start with Social Security. You can go to the Social Security website and get your benefits statement online. This will give you your expected monthly benefit in today's dollars.

Compare that figure to the amount you normally spend each month. The gap between what you're spending and what Social Security would provide is what you need to save for.

While your income will stop on the day you retire, your living expenses won't. That's why it's important to have a plan in place to replace that lost income.

When we work with clients nearing retirement, we're looking at their entire financial picture to build a retirement plan they can have confidence in. We guide people on when to take Social Security and which types of investment accounts they should draw upon to fill remaining gaps to their spending needs. And we do this with an eye towards taxes, so you're not paying more tax than you need to.

If you're wondering how your retirement income plan might look, please reach out to us. We'll ask for a Social Security statement and go from there!

HOW TO FREEZE YOUR CREDIT

BY: MICHELLE SMALENBERGER, CFP®

Have you heard of or been affected by the recent increase in fraud lately? Especially, here in Illinois there has been a large increase of fraudulent unemployment claims. There are a number of things you can do to protect yourself from falling victim. You could obtain your credit report and review it to make sure there aren't already any fraudulent actions. Then, to really stop people from making fraudulent transactions you can freeze your credit. This keeps anyone from accessing your credit so you can't get new debt or apply for things that depend on your credit.

How do I freeze my credit?

Today we will answer that question "how do I freeze my credit?" In today's video we are literally going to walk you through this process. Trevore is going to walk us step-by-step through the process so you can follow along.

We are going to start at the FTC (Federal Trade Commission) website www.consumer.FTC.gov. This is a really helpful website as it is straight from the source. You don't have to worry an author's bias. This is direct and straight to the point and we would highly recommend you use it. Specifically for this page we are looking at how to walk through the credit freeze application.

What is a Credit Freeze?

This page walks you through what a credit freeze actually is. You might remember the 2018 Equifax breach which caused a lot of uproar. Many people had their information stolen and used against them. Due to that happening congress passed a law back in 2018 that made it free for any person or any consumer to freeze their credit free of charge. Previously, there was a fee up to about $10 for each time, but now it is free and it's easy to do. We like to recommend that clients go ahead and freeze all their credit.

When Shouldn't You Freeze Your Credit?

Be aware that there are some instances in which you do not want to freeze your credit. You can read on the FTC website some examples and explanations. For example, if you are about to close on a home or refinance in the next week, you would not want to freeze your credit right now. Lenders need to see your credit report when you're trying to qualify for a loan. However, you can unfreeze your credit temporarily. You can talk with the lender and ask when they are going to pull your credit. This allows you to temporarily unfreeze it for a week or so in order for them to run your credit. After the date you chose to unfreeze your credit the credit bureau will automatically freeze it back. Later in our video we will walk you through this process as well.

Complete the "freeze my credit" process with each credit bureau

While you are looking at the FTC website you will see a gray box that has three websites that show the three major credit unions; Equifax, Experian, and TransUnion. These all link directly to where we need to go and freeze our credit. Let's start at the top with Equifax.

As you can see many of these credit bureaus will ask you to sign up for an account. Which is fine as this will allow you to log in and freeze and unfreeze your credit easily going forward. The identity verification process with these bureaus will ask you to do a few different things. It may be by a confirmation email and verification code or by answering specific questions about your credit history. This is a way for someone to be protected in case someone tries to apply for something in your name. They may try to apply for unemployment or loans in your name and this allows your data to be protected.

Our data that is at these credit bureaus has all the information for any loan that we have ever received like any payment history, whether you made the payments on time, how much your credit limits are, etc. That information is very valuable to various lenders and marketers and when we lock it or freeze it, unfortunately those vendors can't access our credit history. However more importantly it means we can't open up a new account unless we have our credit file unfrozen so this can help with identity theft issues.

After I have entered the identification information proving I am the one requesting this information I simply click freeze. Remember we do have to do this for each of the credit bureaus. Start back at the FTC website each time you start with a new credit bureau.

You will notice it also allows you to freeze the credit for a minor. This is something we would recommend as well to help protect possibly your children's credit history. This process is a little different as you have to mail something instead of doing it all directly online.

Temporarily Unfreezing Your Credit

Now we can walk through the process of unfreezing your credit in the instance you are refinancing, getting a car loan, or opening a credit card. We can temporarily unfreeze our credit as this allows us to choose when we want it to start and end. A typical lender will try and check your credit as soon as they can. So it may be in the first few days and then I like to reapply the freeze maybe 2-3 weeks after.

You will need to unfreeze each of these bureaus or depending on your lender, you may only need to unfreeze your credit at one credit bureau. In the example of applying for a home loan they will need access to all three of these bureaus so you will want to unfreeze all three. When looking at a car loan it is usually one to two credit bureaus that they check and a credit card is usually one. So you can check with your lender to see which ones you need to unfreeze.

If you have any questions about freezing or unfreezing your credit or maybe you are stuck in a particular area on these websites reach out to us and let us know. We would be happy to help you with this.

UNDERPAYMENT PENALTIES AREN'T WORTH PAYING

BY: STEPHEN SMALENBERGER, EA

No one enjoys paying money to the state or the IRS. When they've already withheld and then they find they owe a balance still. On top of that, adding insult to injury, there is also underpayment penalties and interest.

Let's talk through some examples so that you know now whether it is the end of the year and you can make a tax payment or you are at the beginning of the year and you can adjust your withholdings and adjust for what you want.

How can you avoid all of that? It's called safe harbor.

We're going to look at a couple examples of how we get to those numbers. It sounds really involved but it is actually really easy. Looking at last year's return, if you made $100,000, using really round numbers for understanding. They had $10,000 in taxes and out of their paycheck they had $9,000 taken out. So at the end of the year they were $1,000 short.

Normally you'd think if you have a balance due, you think you have until April. Which in some cases, yes you do.

But there are some cases we will want to look at.

1. Is the amount outstanding over $1,000? In this case, it is not. They met rule number one. No underpayment, no interest because the amount due is not greater than $1,000.

2. This amount here that they had withheld, was 90% of what their tax balance was.

   So now we fast forward to this year. We are going to show that they got a raise, a bump up in salary, or a bonus as year end. Now that their income went up it is hard to know what the balance due is going to be and what the taxes are going to be. The 90% of these is a moving target.

   What they could do is called safe harboring. It is looking at what last year's tax was and take 100% of that which is $10,000, they will be in safe harbor. Meaning there may still be a balance due, and they would have until they file their tax bill to pay it, but there won't be any additional underpayment penalties or interest.

3. So that is rule number three – to pay last year's full taxes to be covered by safe harbor.

4. Next we look at their income and it goes over a threshold and let's just say they are above $150,000. Rather than being at over 100%, it is 110%.

So rather than looking at the past two years and paying 100%, They would have to pay in $11,000, 110% of last year's tax in order to avoid underpayment and interest.

Remember these rules!

- When your tax due is under $1,000, any year, there are no underpayment penalties.

- If you pay 90% of the current tax in payments, you avoid the underpayment penalties.

- If you pay 100-110% based on your income, that is another way of avoiding underpayment penalties and interest.

You never like to pay taxes. Throwing in additional interest and penalties isn't fun. So how do you keep more? Because ultimately it's not about how much you make it is about how much you keep. And our goal is to help you keep as much as possible.

DOES IT PAY TO SWITCH JOBS?

BY: ROBERT STOLL, CFP® CFA

It's an age-old debate: Are you better off from a career standpoint staying at one company for the long-term or switching jobs occasionally? Fortunately, we have some interesting data on wage growth that can help inform the debate. Let's see if it pays to switch jobs!

The Federal Reserve Bank of Atlanta publishes a data series that compares wage growth between Job Stayers and Job Switchers. Overall wage growth for all workers was +3.7% year-over-year in September 2019. But when we break out wage growth between Stayers and Switchers, an interesting picture comes into focus.

+4.3% Growth Job Switcher VS +3.3% Job Stayer

Job Switchers saw year-over-year wage growth of +4.3% while Job Stayers saw wage growth of +3.3%. That's a pretty big difference. In fact, if you look back since the late 1990's Job Switchers have seen better wage growth than Job Stayers for most of that period.

The only exception is when the economy is in recession.

Should we all become Job Switchers? Not necessarily.

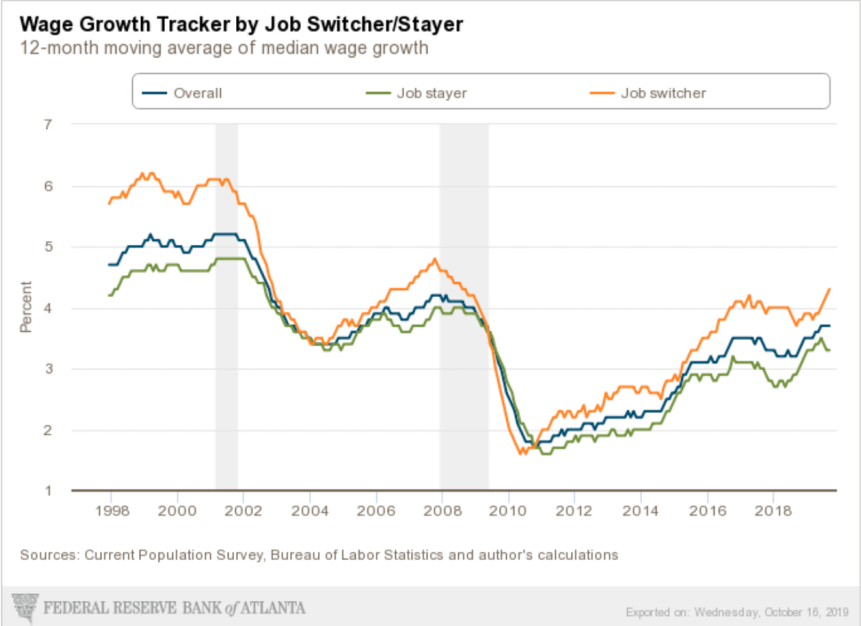
Switching jobs carries risks. You may move to a new job for more money but realize the culture is worse than the one you left behind. There's also risk that if you switch jobs too often then future employers will perceive you as a risk to move on after they've invested time and energy to train you.

Plus there's the old adage that money doesn't buy you happiness!

Income Potential Is One Of Your Most Important Assets

We point out this difference in wage growth so you can stop and think about where you are in your career. One of your most important "assets" is your income potential.

Our desire is to help you maximize the value of this asset just we do for your IRAs, 401(k)s, and other financial goals.



[Wage growth: Job Stayers vs. Job Switchers]

FREQUENTLY ASKED QUESTIONS

Are you a Fiduciary?
Yes, we are! This means we have a duty to act in your best interest. A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client.

You're Fee-Only: What does that mean?
We have chosen to be a fee-only advisory firm. This means we do not accept any fees or compensation based on product sales. While we know our clients need products like insurance we do not receive any benefit from any source when you buy a product.

How does Financial Planning Work Virtually?
With advances in technology, it is amazing how much we can accomplish virtually! We are able to share everything we do in person, virtually. We simply use screen sharing and video software so we can see you and look at the same documents, together. Most forms can also be electronically signed.

Are you taking on new clients?
Yes! We are happy to work with friends or relatives that you think would benefit from a Financial Advisor relationship. A quick phone call is all it takes to see if they are a great fit.

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