Financial Services Advisory
GROW WISER.

Third Quarter 2021
www.FSAinvest.com
(301) 949-7300

Will Social Security Go Bust?

You may have read that the Social Security Trust Fund is due to be depleted in 2033, a year earlier than previous projections. This sounds alarming, except for several caveats.

First, the projected date of depletion has been in the 2035 range for the past decade, so this shift is really nothing new or particularly alarming. The immediate cause of the shortened timeline is, of course, the slowdown of economic activity due to COVID. The Social Security Trust Fund collects payments out of the wages of millions of American workers; when the workers lose those paychecks, the Trust Fund is unable to collect its share.

In its annual report, the Social Security Administration says that it is projecting that employment and wages will gradually rise to full recovery by 2023 but that the level of worker productivity and U.S. Gross Domestic Product will be permanently lowered by 1%. In addition, the report projects that there will be a higher mortality for persons aged 15 and older through 2023, meaning, once again, fewer workers collecting paychecks.

In fact, the report notes that the Trust Fund's reserves, at $2.9 trillion, were actually $11 billion higher this year than they had been the previous year. With that said, let's cover how the Trust Fund actually works. The Social Security system collects its revenues from those worker paychecks (and employer matches) and then turns around and pays that money out to Social Security beneficiaries. The $2.9 trillion pool of money pays out any annual shortfall between the amounts collected and the benefits paid, and the fact that it increased this past year suggests that it didn't have to reach into its pocket at all for the past 12 months.

If and when the Trust Fund *does* run out of money, the Social Security Administration would simply pay out the monies collected without a supplement, and if nothing is done by 2033, that is projected to be 78% of the benefits paid out today, remembering, of course, that it was enough to pay out 100% in the past year. The important thing to note is that 78% is not zero; it's more than three-quarters of the expected benefits. And of course, once again, this is based on a lot of assumptions, including the idea that few Americans will continue working after they receive their benefits, that the economy will never fully recover from COVID, and that pandemic mortality will be evenly distributed between the young and the old.

Finally, does anybody really think that Congress would allow the cohort of voters currently receiving Social Security benefits to take a sudden 22% haircut in that portion of their retirement income? Sixty-nine point one million people currently receive benefits, and one can guess that many of them are motivated voters. Expect some age/benefit tweaks, and some higher payroll taxes, long before you see any reductions in the Social Security income received by elderly Americans.

From Our FSA Family

It has been a busy year here at FSA that includes many exciting changes. We welcomed two new advisors to the team, Myennohweh McCurrie, CFP® and Aaron Weston, CFP®. Despite starting while telecommuting, both Aaron and Myennohweh have hit the ground running and are already getting to know our clients. They will be working with the other advisors on the team to assist our clients with their financial planning needs.

Also, you may have noticed a few name changes at the firm over the last months! Kim Basenback, Director of Financial Planning, formerly known as Kim Scott, got married this past July to her new husband Jordan. Not to be outdone, Jessica Pavik, part of our client service team, now Jessica Bruno, also got married to her new husband Paul. Congratulations to the newlyweds!

Lastly, Jim Applegate, our advisor from Ft Myers, Florida, recently retired. He will be greatly missed, but we are excited for him as he starts this new phase in life.

We know that this continues to be challenging times for our clients, but we are here to help. Please feel free to call us with any questions you may have. Also, we are currently taking on new clients. If you have any family or friends that could benefit from our assistance, let us know. We would be happy to speak with them.

Inflation and Social Security Benefits

Almost every year since 1975, the Social Security Administration has automatically adjusted its benefit payments upward to account for inflation; the goal is for the payments to keep pace with the cost of living that recipients are experiencing. For the past decade, these inflation adjustments have been pretty modest. In 2009, 2010, and 2015, there was no increase, and many of the other raises were 2% or less.

That could change in the coming year as a result of higher inflation. In June the Consumer Price Index rose 5.4% from a year earlier, the largest gain since 2008. Extrapolating from the first six months of inflation data, the Senior Citizens League has estimated that the Social Security cost-of-living adjustment for 2022 would be at or about 6.1%, which would be the largest one-year increase since the bad old high-inflation days of 1983.

Social Security increases are tied to the CPI-W, the Consumer Price Index for Urban Wage Earners and Clerical Workers. Some economists believe that the CPI-W tends to undercount the cost of living increases that many people experience, and that is especially true for seniors whose budgets are more closely tied to housing and health care costs and less to food, apparel, transportation, and recreation.

A new bill in Congress, the Fair COLA for Seniors Act of 2021, proposes to change Social Security's measure of inflation from CPI-W to CPI-E, the Consumer Price Index for the Elderly, which the Bureau of Labor Statistics has been calculating since 1985. This shift, endorsed by the Biden Administration, would have resulted in a 1.4% upward adjustment last year (vs. the 1.3% figure used by the Social Security Administration), a 1.9% increase in 2020 (vs. 1.6%), 2.8% in 2019 (vs. 2.6%), 2.1% in 2018 (vs. 2.0%), and a much bigger increase in 2017 from 0.3% up to 1.5%. Comparing the two measures of inflation over time, economists estimate that over 25 years the CPI-E cost adjustments would push benefits 5% higher than the existing CPI-W Index increase calculation that we use today.

The Social Security Administration has published a lengthy analysis of the differences in the various inflation measures, and its analysis suggests that, even though healthcare costs are weighted more heavily in the elderly CPI statistics, the prices actually paid by the elderly for health care, medications, and hospital costs may be different from the general population calculations of inflation that are embedded in CPI-E. Also, as the homes owned by the elderly increase in value, their out-of-pocket payments for property taxes and insurance premiums may be more volatile than they are for their younger peers. Beyond all that, every one of us is different, with different lifestyles, so our individual CPI — whatever index is used — is likely to be different from whatever number is published month to month, year to year.

The Cost of Living, Then and Now

Inflation is in the news again, thanks to a recent jump in the Consumer Price Index. The Bureau of Labor Statistics has calculated that the price of a basket of goods and services rose 5% on an annualized basis in May, the largest increase since August of 2008. The inflation rate was 4.2% in April which, too, was well above the Federal Reserve Board's target of 2% a year.

Basically, that means that all of us have lost purchasing power in the last few months, albeit incrementally. But inflation's real damage happens over the long haul, as the value of that dollar in your pocket slowly, invisibly erodes to a point that would be impossible to imagine without looking at historical price shifts. Consider that in 1950 the average home could be purchased for $7,354. A brand new Volkswagen Beetle was selling for $1,280, and tuition at the Ivy League University of Pennsylvania was $600. You could buy a cup of coffee for a nickel, and a gallon of gas cost 27 cents. A loaf of bread would set you back 19 cents, first-class postage stamps cost 3 cents, and you could buy a McDonald's hamburger for 15 cents, while ten cents more would get you either fries or a soda. The average movie ticket cost about 40 cents, a dime got you a ride on the New York City subway, and bleacher tickets to the 1950 Major League Baseball All-Star game cost $1.

What kind of insane inflation rate produced such an amazing (and depressing) erosion in the value of that 1950s dollar? The inflation rate between 1950 and today was 3.46% a year.

Protecting Elder Americans

There have been reports that so-called "elder abuse" in a financial context is on the rise, costing elderly Americans an estimated $36 billion last year alone. By one estimate, roughly one in three older Americans has been scammed in the past five years, what an official at the Institute on Aging calls "an elder financial abuse epidemic." Sadly, only 1 in 44 elder abuse cases are ever reported; the victimizers regard stealing from older Americans as a low-risk crime.

There is now a whole dark infrastructure of schemes to fool people in the early stages of dementia into parting with their money, including investment scams aimed at people with marginal retirement assets who want to boost their income and pop-up messages on websites that trick the victim into downloading a virus that sends personal information to the scammers. Seniors are often targeted by fraudulent telemarketing calls, including solicitations for nonexistent charities or a frantic phone call saying that a beloved relative is stranded and needs money wired to him.

The newspapers offer lurid stories of how scammers convince seniors that they've won a big sweepstakes contest; all they have to do is pay duties and taxes in order to get the payout. Twenty-five thousand dollars later, the scammers have stopped answering the emails, and of course, the sweepstakes payout never arrives. In other cases, a scammer would get hold of seniors' personal information, forge their names, and open fraudulent bank accounts, siphoning retirement dollars until there was nothing left.

In a financial context, a broker might suddenly appear in the picture and start high-commission trading in unsuitable investments or talk the victim into taking out a loan on the home in order to increase the amount of commissions that could be generated. (This, of course, is called "churning," and it is not always clear when trading crosses the line to become an illegal activity, especially if the broker has gotten the customer to sign a document he or she may not understand.)

Many times, the abuse is an inside job; a caretaker or new "friend" will appear on the scene and convince a retiree to give them power of attorney control over the finances, change their will, or "help them out" with increasing payment amounts. It is not uncommon for family members to be the perpetrators. In a recent case, the children of a wealthy widow joined a brokerage firm, took control of their mother's investment account, and set about churning it to turn her money into their commissions. The mother had to go to court to get back control of her own (diminished) finances.

The red flags are easy to state but not always easy to spot: unusually frequent or unexplained withdrawals from a retiree's bank account; ATM withdrawals by an older person who has never used an ATM card; new "best friends" accompanying an older person to the bank; suspicious signatures on checks or outright forgery; bank statements that no longer go to the customer's home; a caretaker, relative, or friend who suddenly begins conducting financial transactions on behalf of an older person without proper documentation; and altered wills and trusts. Jewelry or other personal belongings may be growing legs and leaving the home.

In some cases, a friend or relative might notice that the elderly person refuses to make eye contact when asked about these issues and experiences shame or reluctance to talk about the problem.

The American Bankers Association offers some basic tips that might help retirees protect themselves, such as never pay a fee or taxes to collect sweepstakes or lottery "winnings" and never rush into a financial decision. Instead, ask for details in writing and get a second opinion. Pay bills with checks and credit cards instead of cash to keep a paper trail, and if something doesn't feel right, back off. Feel free to say "no." After all, it's your money.

If relatives notice any of the warning signs, they should immediately investigate, and if they need assistance, they can contact Adult Protective Services in their town or state. In addition, they should report all instances of elder financial abuse to the local police who routinely investigate and prosecute fraud cases.

The bottom line here is that there are many people who can't be trusted with an elder person's finances. Perhaps the best protection is to find in the elder person's personal circle a son or daughter who unequivocally has the retiree's best interests at heart. In the professional world, attorneys and financial planners or investment advisors registered with the Securities and Exchange Commission are required to adhere to a fiduciary standard which means putting the interests of the person they're advising ahead of their own interests at all times. (Brokers and "vice presidents of investments" who work at brokerage firms are not required to live up to this high standard of care.) For those who can no longer protect themselves, there should be others willing to step in and provide that safety.

Booming Home Sales

Arguably the wildest consequence of the recent pandemic is the remarkable price boom in the U.S. housing market, which, some might remember, went spectacularly bust in the 2008-09 Great Recession collapse. Today, half of all houses put on the market are purchased in less than a week, often for more than the asking price. One recent poll found that most buyers admitted to bidding on homes they'd never seen in person. Home prices are at record highs; inventories are at record lows. More than half of homes on the market have been selling above the asking price, which is so far above the previous record that the statistic is simply offered in isolation. The average home price, as measured by the S&P CoreLogic Case-Shiller 20-City Index, rose 13.3% in a single month, following a 12% jump the previous month.

One driving factor is historically low mortgage rates, around and sometimes below 3% currently. Investors have also stepped in; they bought about one out of every six homes (15.9%) in the second quarter of 2021, and some might relabel them speculators who believe (as many did in the runup to 2008) that prices have nowhere to go but up—forever.

But beyond that, prices have been driven up by simple economics and the laws of supply and demand. The number of homes for sale fell 21% recently, near a record low that dates back to 1982. New home construction has been slow due to a severe lumber shortage, and we are still feeling the effects from 12 years ago when the Great Recession knocked the construction industry back on its heels. At the same time, millennials — many of them too financially-constrained to have bought houses at normal interest rates — are storming into the housing market, ending forever the trope of boomerang kids living in their parents' basements.

Does all this signal another housing bubble? Are we now destined to live through another Great Recession when a housing bubble bursts? Fortunately, there are a few checks and balances on the current boom that were not in place back in 2006-07 when the seeds of the Great Recession were planted. For one thing, lenders are no longer handing out mortgage loans like candy with zero documentation. Today's lending standards are higher even than the requirements of the Dodd-Frank Act of 2010 which was passed in response to the financial crisis. Loans today are generally smaller in proportion to house values, and leverage is down on owners' balance sheets

That doesn't mean that housing prices won't collapse at some point in the future. One possible trigger would be a sudden rise in mortgage rates which would cool demand significantly. But even that wouldn't trigger defaults; according to the Mortgage Bankers Association, just 0.1% of mortgage loans issued this year are tied to adjustable rates. That's compared to about 60% during the bubble years of the mid-2000s.

Pricey Stock Values Here and Abroad

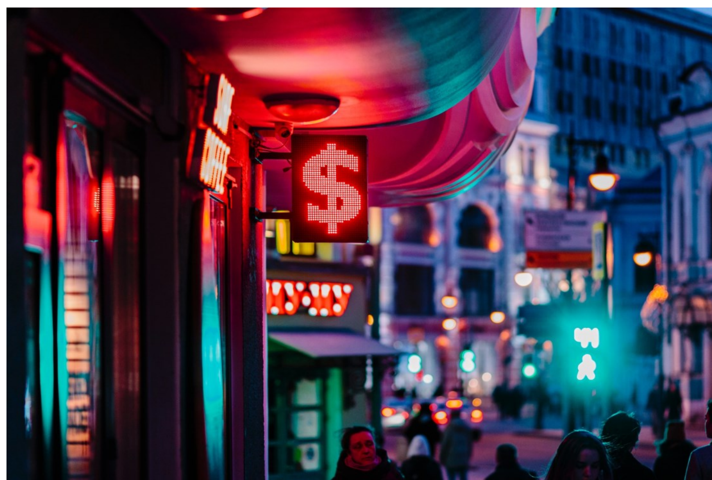
You probably know that the U.S. stock market has been delivering the highest returns among all developed nations, not just in the last couple of years but over the most recent ten years. But that also means that U.S. stocks have become much more expensive relative to other nations.

How much more? One of the most common measures of stock valuation is the price/earnings (P/E) ratio which is the simple calculation of the overall price of all of a company's stock shares divided by the total earnings of that company. The earnings calculations can be tricky (do you take last year's earnings, or the forecasted earnings for the coming year?), but the important thing here is that the calculation be consistent across nations.

As of December 31, before this year's runup in stock prices, the P/E ratio of large U.S. stocks in aggregate, using trailing earnings, was 38.02, which is much higher than historical averages. The stock market in India was even more expensive with a P/E of 38.45. Australia's P/E was the highest among developed nations with a P/E of 43.76, nudging out France (40.81) and Canada (38.12).

That basically means that the U.S. is not alone in having historically high stock valuations. But not all countries are quite so overvalued. The United Kingdom's large cap stocks (17.55), Japan's (22.53), China's (16.39), Germany's (27.04), and Russia's stocks (12.19) can all be bought at relative bargain prices.

Another way to measure stock valuations is the dividend yield. The U.S. large cap companies paid an aggregate (and meager) dividend yield of 1.53% to their shareholders last year which is lower than all other major nations except India (1.14%). Companies in Japan (1.89%), France (1.98%), China (2.02%), Australia (2.84%), Germany (2.55%), Spain (2.92%), Canada (2.93%), and the UK (3.77%) are all more generous with their shareholders.



Financial Services Advisory
One Church Street | Suite 901
Rockville, Maryland 20850
301.949.7300

Due to various factors, including changing tax, political, economic and market conditions or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from us. Please remember to contact us, in writing, if there are any changes in your personal/financial situation or overall long-term investment objective.