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Take or Delay?

Most American workers who have at least 10 years of work history will be able to start taking Social Security benefits as soon as they reach age 62. But should they?

Some years back, there was considerable debate about whether a person was better off receiving the monthly checks early and investing them in the markets or waiting until full retirement age (currently age 67), or alternatively, waiting until age 70 and receiving even higher benefits.

Today, that debate has largely gone away. Most advisors recommend waiting, if you can, at least until full retirement age and, even better, holding off until age 70.

Why? The problem with most of those older calculations was that they were assuming that the U.S. investment markets would follow historical long-term averages, which most of us have seen is not guaranteed. What IS guaranteed is that the Social Security benefits will rise with each and every year that a qualified recipient waits to start taking them. For persons born after 1943 (that is, pretty much everybody who is qualified to take Social Security benefits), the "delayed retirement credit" is a whopping 8% a year. Yes, that means that each year you wait means that the monthly check will be 8% higher than it would have been before. You will not get that kind of guarantee from the investment markets.

The Social Security Administration offers a calculator on its website which shows the percentage of your normal retirement age benefits you would receive depending on what age you start taking your monthly checks. For a person born in September of 1960 who decides to turn on the Social Security benefits at age 62, the benefits represent 70.42% of the checks that same person would have received if he or she had started taking benefits at age 67. By waiting until age 70, the same person would receive 124% of the so-called "primary insurance amount."

But there's more to the story than simply larger checks. Social Security is one of few guaranteed sources of retirement income that is protected against inflation, which means offering protected purchasing power. Those larger checks become proportionately larger depending on the inflation rate. That is not always the case with annuities and pensions.

Of course, there are always questions about Social Security's solvency. The Social Security Trust Fund has been projected to run out of money in 2033 which wouldn't mean a total loss of benefits since working taxpayers would still be paying into the system. In a worst-case scenario, those payment amounts would cover 78% of today's projected benefits. But it seems unlikely that Congress would fail to shore up a system that currently delivers benefits to 69.1 million voters. In fact, the Social Security Enhancement and Protection Act was recently reintroduced in the U.S. House of Representatives; among the provisions is a 5% increase in monthly benefits for all beneficiaries who have been retired for 20 years and bolstering the Trust Fund by phasing out the Social Security payroll tax cap which currently applies only to wages up to $142,800. In addition, the payroll tax rate would gradually rise from the current 6.2% to 6.5%.

From Our FSA Family

Happy holidays from the FSA family! To help the office get in the holiday spirit, we passed around a survey asking about our favorite traditions, movies, songs, and food that we enjoy during this time of year. There were many common favorites amongst the team, such as spending time with family and friends, finding the perfect gifts for loved ones, and eating plenty of pumpkin pie. To share our holiday spirit with you, below are some of the highlights from the survey.

Family Traditions

Growing up, Ron's family would always open one present on Christmas Eve; he promises he doesn't follow that tradition anymore! Similarly, Kim B.'s family was allowed to get into their stockings any time after going to bed (as long as it was after midnight). She remembers a few times waking up at 2 am to get a head start.

To give Santa plenty of time, Myennohweh puts bells on her kids' doors. If they try to get an early sneak peak of the presents, they will hear Santa's jingle bells and run right back to their beds.

When Mike and his family get together during the holidays, they sing Italian Christmas songs such as *Dominic the Donkey* (the Italian Christmas Donkey). Dave enjoys caroling in the retirement homes with family and friends.

Our photographer of the group, Ann, loves taking family photos each year for their Christmas card.

Jamie's family mixes things up and does a new event each year. In the past they've seen the play *A Christmas Carole*

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QCDs to the Rescue

When the 2017 Tax Cuts and Jobs Act raised the standard deduction for taxpayers to $24,000 for couples ($12,000 for singles) and lowered individual tax rates, an unintended consequence was to reduce the tax benefits of making charitable donations. Fewer taxpayers were itemizing, which means their donations didn't count as deductions. Itemizing taxpayers, including people who intentionally raised their level of giving in order to cross the standard deduction threshold, found that the lower brackets reduced their tax benefits.

The Urban-Brookings Tax Policy Center has estimated that the law reduced the marginal tax benefit of giving to charity by more than 30 percent and raised the after-tax cost of donating by about 7 percent.

Some taxpayers, however, are able to avoid these limitations. How? As most of us know, people age 72 and older who have individual retirement accounts (IRAs) are required to take required minimum distributions (RMDs) out of the account. And those percentages increase with age. If they're charitably inclined and otherwise frustrated by the new tax rules, they can take their distribution in the form of a qualified charitable distribution (QCD). The distribution would be a direct transfer to the charitable organization of their choice, up to a limit of $100,000.

How does that benefit them? If the QCD is made directly to the charity, it is not counted as income for federal tax purposes and therefore reduces the income that the taxpayer has to include on the 1040 form. In effect, the QCD gives back the full charitable deduction that was otherwise lost to the tax reform writers.

Due to a quirk in the law, IRA owners as young as age 70½ can make QCDs, even though they aren't required to take RMDs until age 72. Why would someone take a distribution before he or she has to? Once again, for someone who is charitably inclined, the QCD brings back the full charitable deduction. And some taxpayers might want to reduce the size of their IRA before they have to start taking distributions in

order to lower their future income to fit into lower tax brackets.

If a taxpayer and spouse each have IRAs, each can make their own QCD. And the option is not limited to IRA owners. IRA beneficiaries, that is, people who have inherited IRAs and have to take out the money within 10 years, can also make QCDs if they choose.

Finally, taxpayers who make the full $100,000 donation directly to a charity can also make further donations out of their IRAs. But in those cases, only the first $100,000 will come out without any tax consequences. The remaining amount will be treated as a taxable distribution which would then qualify for a normal charitable deduction if the taxpayer itemizes deductions.

Inflated COLA

Reports from the Federal Reserve, which sets interest rate policy in the U.S., have famously told us that the current inflation that we're experiencing is "transitory" despite a lot of data that might seem contradictory. (Has anybody seen gas prices lately? Has anybody tried to buy a house in this market?) The current labor shortage is leading to higher wages, which usually find their way into the prices of goods and services, and the government has been printing money (mainly by issuing bonds and extending credit) at rates never seen before.

Add to this a new data point, one that will be welcome to many retirees. The Social Security Administration, which relies on annual inflation data to set its cost-of-living increases, has announced that Social Security benefit checks will be 5.9% higher in 2022 than they were this year. This is the largest increase since 1982 when inflation was still rampant from the "stagflation" economic era. To put that into perspective, Social Security's cost of living (COLA) increase has averaged 1.65% over the past decade.

The average retiree received $1,565 in monthly Social Security benefits this year, and that will go up $92 a month, to $1,657. The AARP tells us that this will be nearly all the income received by 25% of seniors in America, and many more rely on these checks to pay for a large part of their retirement expenses.

What if We Don't Raise the Debt Ceiling?

The news media, in its coverage of the Congressional debate over raising the debt ceiling, has alarmed its readers and viewers with terms like "government default" and "global financial crisis." But if there is a government shutdown looming in our future, what is the most likely outcome for investors?

First, there is no question that the government debt levels are remarkably high based on historical norms. The government owes roughly 29 trillion U.S. dollars, around 1.7 trillion more than at this time last year. Raw numbers aren't a perfect way to compare current vs. past debt levels since the U.S. economy (and, therefore, tax revenues) have grown dramatically. But if we measure government debt as a percentage of the U.S. GDP, the current numbers are still somewhat alarming. The long-time record debt was 119% of U.S. GDP in 1946 at a time when the government had genned up the printing presses and issued bonds to pay for the costs of World War II. (Total debt that year: $269 billion.) For most of the 1960s and 1970s, debt-to-GDP dropped back into the low 30s before creeping up again, reaching 50% in 1988 and never looking back.

Debt to GDP eventually breached the 100% level in 2014, but the biggest jump came in 2020 when the debt-to-GDP figure rose from 107% to roughly 130% of GDP in the span of 12 months. Bottom line: Today's debt levels are in record territory.

It's interesting to note that the largest owner of U.S. Treasury securities is not any foreign country but the Social Security Trust Fund ($2.9 trillion), followed by the nation of Japan ($1.28 trillion), the nation of China and the U.S. Military Retirement Fund ($1 trillion each), and the Office of Personnel Management and Retirement ($955 billion). Mutual funds and private investors are holding about $3.8 trillion collectively.

There are several reasons to wonder whether the current debt is as alarming as the numbers look in isolation. First, interest rates are so low that the government isn't paying much for the privilege of borrowing investors' dollars. And is it so terrible that the government is making secure bond investments available to the public (and its in-house agencies)?

Historically, government shutdowns are short lived and soon forgotten. The debt fiascos of 2011, 2013, and 2018 were all resolved, and everybody was made whole; there is not going to be a permanent wholesale default on government obligations this time around either. And most meaningfully, none of the past exercises in brinksmanship impacted long-term equity returns.

So, the biggest danger is short-term – that the alarming media coverage might spook timers and traders who could go on a short-term selling rampage before realizing that the government taking a week or two off didn't really depress actual underlying value of U.S. companies. And, of course, an actual shutdown is unlikely in the first place.

From our FSA Family

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and have gone to the Gaylord to look at ice sculptures. This year they will spend time at Top Golf!

Holiday Movies and Songs

Aaron likes watching *Die Hard* (which he swears is a Christmas movie!), *Home Alone*, and *Home Alone 2*, while Jessica enjoys *The Nightmare Before Christmas,* a Tim Burton classic which can double as a Halloween movie.

Because it brings back so many happy memories of watching the movie with her sons when they were young, Mary Ann's favorite is *The Polar Express*. Her family usually saves one holiday movie to watch together on Christmas Eve.

John jams to holiday music all December long, especially to Nat King Cole. His favorite holiday movie is *It's a Wonderful Life*.

Food Traditions

Jim puts his family to work every holiday season to make over 200 pounds of Italian sausage from scratch. Likewise, Kim D. and her family make over 25 dozen donuts using her grandmother's recipe (no exact measurements, of course!). On top of this, she makes peanut butter fudge and tasks her husband with making buckeyes.

Holiday food favorites of the team (aside from pumpkin pie) include turkey, mashed potatoes with gravy, sweet potato casserole, green bean casserole, stuffing, apple pie, and homemade Chex Mix!

We hope you enjoyed hearing our favorites things about the holidays and wish you a wonderful holiday season with your family and friends.

Dividend Scarcity

The finance magazines and websites tell us "10 Dividend Growth Stocks You Can Count On" (*Kiplinger*) or "20 Dividend Growth Stocks Blasting Off" (*Forbes*). There's an annual "Dividend Aristocrats" list of 65 companies and occasional articles telling retirees that they should buy stocks so they can live off of the dividend checks.

The interesting thing about these clickbait articles is that they don't provide much historical context – and recent history has not been pretty. In 1873, a basket of large-cap stocks (similar to the S&P 500) would have provided you with a 7.47% annual income, that is, you would have gotten roughly 7.5% a year back from whatever amount you invested. The dividend rate peaked at 10.15% in 1917 and has generally hovered between 3.5% and 6% since then up until around 1990, though mostly around the low end in the 1980s.

Since then, companies' dividend distributions, in aggregate, have been much stingier as a percentage of stock prices. This is partly because many companies prefer to reinvest the money they take in from operations to increase their enterprise value and, therefore, the value of their stock.

More recently, reinvesting had also become a tax-efficient strategy for shareholders. Until 2003, dividends were taxed as ordinary income, while stock returns, if the position was held for more than a year, were taxed at lower capital gains rates. But today, qualified dividends (which is most of them) are taxed at a 0% rate for taxpayers earning $40,400 or less (joint filers: $80,800), a 15% rate for individuals earning between $40,400 and $445,850 ($80,800-$501,600 for joint filers), and 20% for singles earning above $445,851 and joint filers earning more than $501,601.

Dividends fell into the 2% range since 1990, and, with little fanfare, dropped to a historic low of 1.28% today. Nobody should seriously suggest that a 1.28% income rate on your money is a reasonable way to fund your retirement expenses.

Today's low dividend rate is undoubtedly driven by tax considerations and the need for spare capital in this complicated economic environment, but those are not the main drivers. The low rate is a result of the rapid increase in stock prices over the last couple of years. People today are paying more for their stock shares than they were just a couple of years ago and much more than they did in March of 2009 when the current bull market began. Buying income is more expensive in both the stock and bond markets today, which is why most financial planners recommend that instead of trying to live off of dividends or bond yields or any other single source of income, people create diversified portfolios and take their income from the overall gains, wherever they happen to come from.

Penalizing Marriage

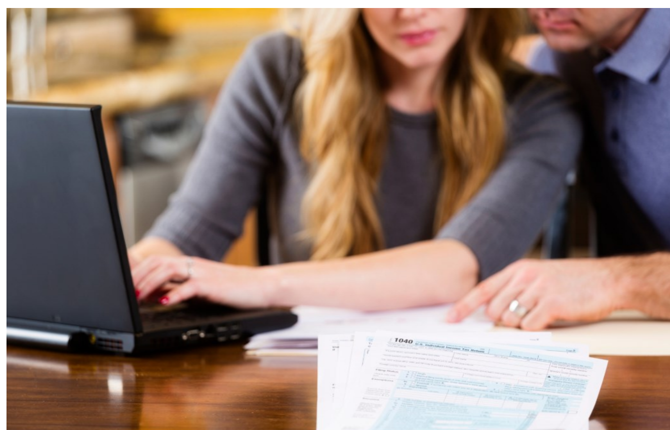
Before 2017, taxpayers had to live with something known as "the marriage penalty." In a perfect world, when two people file a joint tax return, they should move into higher tax brackets at twice the income of individual taxpayers, right? But for most of the years that the tax code has existed, the tax bracket thresholds for joint filers have been considerably much less than twice the bracket thresholds for single ones.

The marriage penalty has been largely eliminated for most taxpayers. Today, single filers move into the 24% tax bracket at $85,526 of income (the tax writers don't seem to be big fans of even numbers), and joint filers enter the 24% bracket at exactly twice that amount: $171,051. Single filers enter the 35% bracket at $207,351 of income, while joint filers get there when their income reaches $414,701.

But here's where it gets interesting. Single filers enter the (current) top 37% bracket once their income reaches $518,401, while joint filers start paying at a 37% rate when their reported income is above $622,051. The latter is much less than twice the former.

There are other residues of the marriage penalty still lurking in the tax code. Single people who receive Social Security retirement benefits pay taxes on those monthly checks when their income exceeds $25,000. For joint filers, the threshold isn't $50,000; instead, the taxes start when the couple reaches $32,000 in income. And single filers above $200,000 in income pay a 0.9% wage surtax and a 3.8% investment income tax. The joint filer threshold to be hit with these surtaxes is not $400,000; it's $250,000. If singles who each earn $125,000 to $200,000 decide to marry, they'll get hit with these extra taxes that they wouldn't have had to pay before.

One might think that the tax code would encourage marriage rather than to somewhat penalize it. Alas, since 2017, progress has been made to level the playing field for joint and single filers.



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