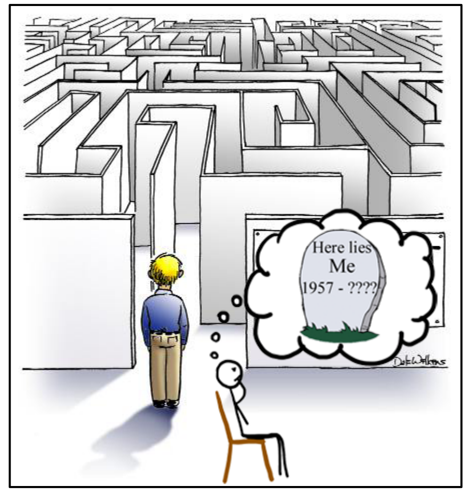
Reprinted from the
Lexington Minuteman

COROMANDEL WEALTH MANAGEMENT

April 2017

Blaise Pascal and your prepaid annuity

Navigating the Retirement Maze



> *"If you gain, you gain all. If you lose, you lose nothing. Wager then, without hesitation, that He exists."*
>
> – *Blaise Pascal, French philosopher, mathematician (1623 - 1662)*

The French mathematician Blaise Pascal once posed an interesting wager. He said that one could choose to either believe in the existence of God, or not believe. There were four possible outcomes to this situation. If you believed in God, and there was none, you would be no worse off for the rest of eternity. If you were a believer and God did actually exist, then you would gain heaven in the afterlife. A non-believer would have the same fate as the believer if no God existed. On the other hand, if God did exist, the non-believer would have some post-mortem reckoning to do with the Almighty. Thus, reasoned Pascal, the obvious safe bet was to be a believer, given the unknown of the existence of a Deity.

Wade Pfau, an academic and researcher in the field of financial planning, used this as an analogy of how one should view Social Security (SS) claiming strategies. As many Boomers approach the age where they can start their SS benefits, or have already begun collecting but aren't aware of their options, it's worth reviewing this topic because a lot of future income rides on this decision.

The longevity conundrum

When I meet with clients or prospects to do retirement planning, I often tell them that if they can tell me exactly what the markets will do during their lifetime and how long they plan to live, the planning process becomes incredibly simple. Unfortunately, no crystal ball exists that can predict future market movements. Similarly, most healthy adults can only guess at their life expectancy. I tell them that given today's healthier lifestyles and the advances being made in medical technology, it isn't out of the question for them to someday become centenarians. Long lifetimes have become commonplace. (If Willard Scott were still doing his Today Show birthday wishes to 100-year olds, he would now have a 24x7 gig.)

In most situations, an individual who has paid Social Security wage taxes during their career can claim a monthly Social Security benefit as early as age 62. However, the age at which you choose to start taking Social Security payments has a big impact on the size of your monthly checks, and thus your lifetime SS income. Let's consider the alternative consequences of long versus short lifetimes, and the options available for claiming strategies.

Some early versus more later

A key number for you to know is your SS "full retirement age," or FRA. If you were born between 1943 and 1954, your FRA is 66 years. Each birth year after 1954 adds 2 months to the FRA up to 1960, where the FRA is 67 for that and all subsequent years. For example, having been born in 1957, I will reach my FRA when I turn 66 years and 6 months.

The importance of your FRA is twofold. First, the earlier that you claim your SS benefits, the smaller your monthly checks will be. For example, those with a FRA of 67 and claiming SS at age 62 will see benefit checks smaller by 30 percent compared to if they had waited until their FRA to claim. At 63, it is a 25 percent reduction, and 20 percent lower at age 64. Waiting to claim beyond your FRA, though, and you'll see significantly larger SS stipends. Each additional year up to age 70 adds 8 percent to your monthly benefit. So holding off until age 70 would increase your benefits by 24 percent, and as high as 32 percent if you were born before 1955. You forego the earlier payments by delaying, but in most cases the break-even age for claiming at age 70 is around 80. Thus, if your lifespan exceeds 80 years, you should come out ahead in the Social Security game.

Second, if you choose to claim SS benefits prior to your FRA and are still working, there is a "claw back" formula that reduces your benefits by $1 for every $2 that you earn above $16,920 for the year, and $1 for every $3 that you earn above $3,740 each month prior to your FRA during the calendar year that you reach that age. You will eventually get that back in slightly increased future benefits, but you'll still receive smaller checks for life because you claimed early.

Back to Mr. Pascal

So how does the age at which you claim Social Security benefits relate to a belief in The Almighty? As Pascal observed, there was no downside and enormous upside in the afterlife to believing in God, so that should be one's default decision. The major concern that I hear from retirees is that their nest egg will expire before they do. So for the sake of argument, let's assume that you delay claiming your SS benefits until age 70. Say you expire five years later. Although you received less in SS payments than you would have if you had claimed earlier, you probably didn't cut back on your lifestyle because of the delay in taking benefits. Your life during those years was likely just as full as if you had taken your benefits early.

On the other hand, consider the scenario where you live to 100. That extra 61 to 75 percent in SS benefits each month compared to claiming at age 62 can make a huge difference in the quality of your life in your later years. If you have a FRA of age 66 and would have received $1,700 a month at age 62, that twenty years of higher benefits translates to an additional $310,00 in lifetime income by age 100 in today's dollars. Social Security payments are annually adjusted for inflation, so your payments should keep up with increased living expenses. (Note to those who have already claimed: You can still suspend payments at your FRA and start accruing that extra 8 percent per year of suspension.)

Your choice of theism is beyond the scope of my expertise. But because of the possibility of a long lifetime, you should go on that assumption for retirement planning purposes, and thus consider delaying your Social Security benefits until age 70. That sounds heavenly to a financial planner.

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