Episode 63: Should I Wait or Should I Go? A Look at Arguments For and Against Delaying Social Security Claiming

00:00
Bob French
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Red Sox or Yankees? Lakers or Celtics? Eagles or Cowboys? Lakers or Celtics? Well, today Alex and Wade will be looking at another classic rivalry. I hope you're enjoying my detailed sports knowledge. Well, today Alex and Wade will be looking at another classic rivalry. Claim Social Security at 62 or 70. Let's find out what they have to say.

00:59
Alex Murguia
I'm Alex, and I'm here with Wade Pfau. Welcome to retire with style. I'm Alex, and I'm here with Wade Foul. Today we're going to continue our Social Security arc. Right, Wade?

01:11
Wade Pfau
That's right, Alex. It's episode two on Social Security, and I know you're excited for this.

01:16
Alex Murguia
Riveted.

01:18
Wade Pfau
Oh, Riveted. Riveted, I think you're sharing beforehand. I don't know if I was meant to share with everyone, but you were having trouble staying awake during the last episode.

01:31

Alex Murguia
Come on now.

01:31
Wade Pfau
Surgery and fast forward.

01:34
Alex Murguia
Yeah, we're recording this on a Friday. We did the last episode we recorded yesterday Thursday, and we batched these right. On Monday we had no, I got tired of that game. We always mess up anyways. Right. So I was telling, Wade, I should have surgery before every podcast just to keep me within normal limits of everyone else. I was telling Wade that it kind of slows me down in a good way because I usually run fast. I was telling, Wait, I should have surgery before every podcast just to keep me within normal limits of everyone else. That was the reaction I got from Wade silence.

02:19
Wade Pfau
Yeah.

02:30
Alex Murguia
A little bit of a respite.

02:31
Wade Pfau
Wow.

02:32
Alex Murguia
A little bit of a respite. They got of a respite.

02:35

Wade Pfau
That's right. We're continuing the series today, and we're continuing to went through the on last week's episode. We went through the six steps of claiming Social Security. One of them was just understanding the basic philosophies around claiming Social Security. We indicated we just talked about that briefly last week because that's really going to be theme of this week's episode, how to think about just in a more general manner, not the claiming rules precisely, other than the delay credits. It a good idea to wait towards closer to age 70 to claim Social Security, or is it a good idea to claim it closer to age 62, potentially? I think that sounds like I said, riveting, Wade, just in terms of level setting a little bit, what are the spread what is the spread between people usually claiming early versus claiming late in ballpark terms? Does that sound like a good agenda?

03:29
Alex Murguia
I think that sounds like I said, riveting, wait, just in terms of level setting what are the spread what is the spread between people usually claiming early versus claiming late in ballpark terms? Not claiming late but claiming later?

03:45
Wade Pfau
Well, that's yeah, one of the really a nice place to start. Thank you for teeing that up is just the statistics about when people do claim and how we've seen a major shift in just the last ten to 15 years. It used to be like what we would say is more than half the population claimed Social Security at 62. That was technically true until about 2009. Going all the way back to 1985 to 2009, it was always 50% to 60% of people are claiming in age 62. Starting after that it came down and every year coming down more and more dramatically. Now this is data that does take a bit longer to get updated. The most recent data we have is for 2021 at this point. By 2021, only 29% of the population is claiming at age 62 the earliest possible age. So people who are waiting until 67,68, 69, that number was always hovering at somewhere close to 6% of the population and it was still 6% in 2009.

04:47
Wade Pfau
Meanwhile, those who wait past their full retirement age and still full retirement age is 66 and X number of months. People who are waiting until 676-8697, that number was always hovering at somewhere close to 6% of the population and it was still 6% in 2009. It started trajectory up and by 2021, 24% of new retirement beneficiaries who were not otherwise entering Social Security through disability, but were deciding when to claim their retirement benefits, 24% were

waiting past their full retirement age by 2021. It's a huge shift in how people are claiming Social Security that just really happened in a less than 15 year period since approximately 2010.

05:45
Alex Murguia
What do you attribute it to? Obviously, I don't know, there's a silver bullet kind of thing, but what do you get the sense that started this trend?

05:57
Wade Pfau
I think it's partly due to education that people started learning about this and just there hadn't really been a framework for thinking about things. Suddenly the really hot topic in financial planning, especially retirement, was when should you claim Social Security? There were a lot of people talking about this starting around that same time, around 2010. I talk about how Larry Kolikov's book on Social Security, when books are first released, of course they get a bump and opportunities to bestsellers. His book, when it wasn't even a new release at one point, was number three on all of Amazon. Not just number three in the retirement planning list, but the number three best selling book on all of Amazon. It was a book about how to claim Social Security. I think people were learning more and more about the topic and realizing what we're going to talk about today, that I do tend to be generally in favor of people delaying and we'll talk about why.

06:55
Wade Pfau
I think really that message is getting out there so that this is something more and more people understand.

07:01
Alex Murguia
You're telling me the great American novel is not Steinbeck's Grapes of Wrath.

07:06
Wade Pfau
But taught it get what's yours from.

07:10

Alex Murguia
Social Security by Kalika?

07:11
Wade Pfau
Yes. He's been a presidential candidate in the past, although not necessarily widely known, but he has been on the ballot. He's getting that education now.

07:25
Alex Murguia
I did think you were going to I thought you were going to give Jason a shout out. Here a friend of the show, Jason Fickner, who was on the Social Security thing, I thought you're going to say, oh, he was single handedly responsible for getting people to start to claim early. I mean claim later.

07:41
Wade Pfau
Definitely a voice at the Social Security Administration who was pushing for a better understanding of claiming strategies. Also framing, like we mentioned last week, he was responsible for changing the term used to be normal retirement age, which somehow normalized a particular claiming age, and he changed that to full retirement age. Really he'd like to take that even further and say age 70 would be the age where you don't have any reduction to your benefit and any other age you're getting a smaller benefit. But yeah, it's really that framing it.

08:16
Alex Murguia
From taking away, not necessarily giving.

08:19
Wade Pfau
Yeah, that completely changing mindset. Now, Social Security is not the hot topic anymore. There were a lot of fun, unique claiming strategies today. It is today, but in 2015, the government took away some of the fund with the claiming strategies nonetheless.

08:38
Alex Murguia

Well, what are some of the arguments, what are some of the main arguments as we get into this for delaying Social Security?

08:44
Wade Pfau
Yeah, so we'll talk about arguments for delaying and then arguments potentially against delaying well, and then some that are more valid than others, but valid and potentially invalid arguments against delaying Social Security. With the arguments for delaying Social Security, they mainly boil down to one is just think about Social Security as insurance rather than as an investment. Also, even if you want to frame Social Security as an investment, it's actually a pretty darn good investment to delay Social Security. Just mention as well, when you do delay Social Security, that can create some tax opportunities to have a more efficient tax situation in retirement as well. Those are what we'll talk about in terms of why you may want to delay Social Security. Then we'll get into the argument.

09:38
Alex Murguia
Sure, I like that first one a lot simply because it doesn't even deal with numbers. It's just almost like a logical you go through a logical progression and I'm a big fan of control, things that you can control. You continually try to make the right decisions based on that. If you do that enough times, the probabilities are in your favor. That's where I think that decision matrix for Social Security really just lays it out quite beautifully for me. Do you want to explain that away someone can visualize that in there?

10:14
Wade Pfau
Yeah, it's a way to think about Social Security as insurance. There's four boxes, not the Risa matrix, but there's four kind of things that can happen. In one direction, you could either claim early or claim late. In the other direction, you either experience a short retirement or a long retirement. Now remember when we talk about retirement planning, you generally need to plan for a long retirement, but these are just either you have a short retirement or a long retirement. We can walk through what happens in those four scenarios. Experience a short retirement, it worked out okay. Financially, we're talking merely about the finances.

10:55
Alex Murguia

Of course, and not to be macabre here, but when you say short retirement, you may die early, you pass away.

11:01
Wade Pfau
You may make it to age 70 or something like that, rather than living to age 90 or beyond. Yeah, financially it worked out if you claim early and then end up not living very long. Now if you delay claiming and then end up not living very long, in hindsight, financially, you may have been able to leave a larger legacy had you claimed early, but because you didn't have to spend much money on your retirement, your beneficiaries are still going to be treated very well in either scenario. There's really minimal harm done if you die early and claim late. This is assuming, like, there's no survivor and so forth, but that's important.

11:46
Alex Murguia
Now you'd be thinking about valences, right? Positive valence, negative valence, claim early, die early. Hey, fine, no harm, nothing happened there. Claim late, die early, minimal harm done because yeah, the opportunity cost of it, maybe you didn't go to Disney World, but you still had enough money that you left something behind.

12:06
Wade Pfau
People worry about that scenario. That's the trouble. They think like, I'm really going to regret I'm going to die early and I'm going to regret not taking advantage of Social Security when I could have.

12:19
Alex Murguia
Yeah, but what's the alternative? It's not like there is some magic, right? I mean, you have to kind of on a relative basis, do you want to put that at risk versus the other one where you claim early and you have a long retirement?

12:33
Wade Pfau
Yeah, so that's the other possibility, is you enjoy a long retirement. So financially, what does that mean? If you claim early, you'll have a permanently reduced lifestyle because you're just inefficiently spending your assets, delaying Social Security. We'll talk about this in more detail

later in the episode. You're spending Social Security in an inefficient manner, trying to preserve your investment portfolio in an inefficient manner, and it will reduce your lifestyle in retirement. Versus if you live a long time and you delay your claiming this can permanently increase your lifestyle in retirement, you can enjoy a higher standard of living. Or, I mean, you can frame it two ways. Either you could enjoy a higher standard of living throughout retirement, or you have a particular spending goal in mind, you can meet it and then you'll have more money left over at the end for beneficiaries as well.

13:28
Wade Pfau
That's where the real power comes, because if you live a long time financially, you're going to be much better off by delaying Social Security. Whereas if you don't live very long, there's minimal harm done by delaying Social Security.

13:50
Alex Murguia
I think that's all. Everyone is different, right, in terms of their own personal hurdles. To me, this satisfies my boxes that I need to check. It's just this one has a significantly stronger valence to err on the side of claiming late and experiencing a long retirement. I'm not erring on the side, but I'd rather expose myself to that option than the counter.

14:16
Wade Pfau
Yeah. The next step really is to further compound or expound upon, I should say, why you can have that permanently better lifestyle by delaying Social Security. Getting into that, we can first just comment on back to this idea of do we treat Social Security as insurance or as an investment? Let's just talk a moment about why we should treat Social Security as insurance. Really another name for it is social insurance. It's insurance risk pooling, done socially, done through the government and so forth. It's insurance, it's an inflation adjusted which, to be clear, on the commercial market, like private non government market, you cannot buy a CPI adjusted annuity currently in the United States since January 2020. That was when the last company offering them left the market. Social Security is an inflation adjusted lifetime annuity backed by the US government, providing longevity protection, which is of more value to the extent that you're worried about outliving your money, providing inflation protection, providing protection against market volatility, and also providing these other type insurance benefits for spouses, for other family members, for survivor benefits and so forth.

15:44

Wade Pfau
So it is social insurance. Therefore, when we frame Social Security as an investment, really, to be clear, we'll have that conversation in a moment, but to be clear, it's really not meant to be an investment, it's meant to be insurance. It's meant to protect you against a bad outcome, which is outliving your assets and living in poverty late in life. It's like any is it a good investment to buy homeowners insurance? Well, usually that investment, quote, unquote, when I pay off, I'll pay these premiums and then hopefully nothing happens to the house so that you don't have to file a claim. When you don't need to file a claim, you say, oh, that was a bad investment. That's not the point. The point is it's insurance, because there could be a very expensive claim. In that scenario, you're smoothing the risk across different possible outcomes.

16:39
Wade Pfau
You've paid the premium so that you have that protection. You don't think of homeowners insurance as an investment. You think of it as insurance. That's the same manner for Social Security. That sound okay to you, Alex?

16:58
Alex Murguia
I think it's great.

16:59
Wade Pfau
Right.

17:01
Alex Murguia
Okay, well, then silence is golden. I'm trying to measure myself, man. No. What came through my head when I'm listening to you, Blanchett? He loves talking about you. Ask him about annuities and this and that, and he almost doesn't even get to talking about annuities until he makes sure that people understand that the first dominant of fall needs to be optimally claiming Social Security, because in his view, it's the best pension money can buy.

17:35
Wade Pfau
Yeah, and I say that, too. That's actually part of the podcast. I agree very heavily that anyone

thinking to purchase a commercial annuity, you cannot beat Social Security delay as a form of annuity. Step one of any annuity strategy, if your income protection or risk wrap is to first delay Social Security.

17:56
Alex Murguia
Yeah, get this part right. I mean, it's there for the taking.

17:59
Wade Pfau
And then if you still need a.

18:01
Alex Murguia
Common way, there we go.

18:02
Wade Pfau
If you need additional reliable income, then you can look at commercial annuities, but it would not be efficient to claim Social Security at 62 and buy annuity at the same time. Absolutely.

18:15
Alex Murguia
All right, there we go. Now let's flip it.

18:18
Wade Pfau
Okay.

18:18
Alex Murguia
Now, let's view it as an investment.

18:20
Wade Pfau

Okay, so let's change to this idea of Social Security as an investment, which gets into, should I claim it early so that I can leverage my investment portfolio, not have to spend as much from my investment portfolio with the idea that will leave me better off over the long term? Or should I delay Social Security, which, if I'm retired, means I'll have to spend some other investments more quickly? That justifiable because then I'll have a much higher Social Security benefit in the future and won't have to spend for my investments so rapidly after that point? Or stated another way as well, we talked about last week if I claim at 62 versus 70. Depending on your full retirement age, the age 70 benefit will be about 76% to 77% larger than if I claim at 62. How long would I need to live for this to pay off in terms of I'll miss my age 62 benefit for eight years, but then I get this 77% larger benefit for the rest of my life?

19:31
Wade Pfau
It does depend on the exact interest rate you assume to discount these benefits, these cash flows. Generally, your early 80s around age 80 or your early eighty s you have to live that long for you to quote unquote, benefit from the investment of delaying Social Security, for you to get an internal rate of return that's positive.

19:54
Bob French
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20:16
Alex Murguia
Now before you get to that, somebody could be listening and you mentioned it in the last podcast and this is where hopefully we'll have Jason on talking about it. I don't want to entertain because someone could be listening, thinking, well that doesn't matter because we're not going to last that long. The government's going to bankrupt this before then. How should someone think about that? I personally, I'll answer it and then you could jump in. I don't think that's the way to think about it at all. I mean, deck chairs will be moved around, they always are and I wouldn't sweat it like that and it's more complicated. I don't think you just summarily say, forget it because I'm going to get it early because this thing's not going to be around when I'm 80 to even figure out the break even, I would try to disabuse anyone of that kind of thinking.

21:04

Wade Pfau
Yeah, and let's put a pin in that. That's a great statement for now, but actually our whole next episode is going to be on this particular topic, the status of the Social Security trust fund and potential Social Security reform options. Should you be worried that Social Security is going to disappear at some point with the answer that I think you're agreeing that I would agree with as well as no, Social Security is not going to disappear. Ultimately there may be some benefit cut, but it's not going to overturn the discussion we are having right now about whether it's worthwhile to delay Social Security.

21:42
Alex Murguia
By extension, it's worthwhile to think about the long term when that break even is even eighty s may seem like a long time away, but it's not really. It's below normal life expectancy.

21:55
Wade Pfau
Yeah, life expectancies now for people in their 60s are going to be in the late eighties, and that's the age where you have a 50% chance of living beyond that. Already not even getting into anything else, you've got a better than 50% chance of benefiting from delaying Social Security because you have a better than 50% chance of living to the age where it pays off to delay Social Security. If you're gambling in that regard, the odds are in favor of delay just because you're more likely to benefit from delay than to not benefit from delay completely. Aside from our earlier conversation around that short retirement, it not being a financial catastrophe if you delay Social Security anyway. Also that breakeven age concept does people start framing it they start to worry, I'm not going to live to the break even age, and therefore I better claim Social Security.

22:54
Wade Pfau
And I don't know the numbers off of my head Wade, but I'm willing to bet if you don't have a chronic illness by the time you're in your mid sixties, the odds are in your favor. Especially if you're a healthier individual, or if you're the high earner in a couple whose spouse will benefit from the survivor's benefit, then it's a much greater than 50% chance that you'll benefit from delaying.

23:16
Alex Murguia

And I don't know the numbers off of my head wait, but I'm willing to bet if you don't have a chronic illness by the time you're in your mid sixties, the odds are in your favor.

23:28
Wade Pfau
Yes, if you're a non smoker and if you're in reasonable health, and yeah, if you don't have any chronic issues. Now, of course we never know. Accidents happen sometimes. If we're just purely talking about the odds, not even related to the impact of these different odds, but just the odds, you've got a better than average shot at beating that break even age and benefiting from delaying Social Security. Don't kind of get caught up in this idea of somehow I'm going to miss out or regret delaying Social Security because I won't live to enjoy it. It's not that you then have to sacrifice your lifestyle by delaying Social Security. It's okay to go ahead and spend other investments more quickly because your Social Security benefits will be so much higher in the future. Now, that being said, and I'm kind of looking through the notes here because we just talked about a bunch of things here.

24:33
Wade Pfau
Looking ahead here more color on that idea of you have a better than 50% chance of delaying Social Security having that pay off for you, because the system, the delay credits that idea of, as I delay Social Security, I'll get a higher, subsequent benefit that was designed to be, quote unquote, actuarily fair in 1983. That's when the current rules were designed. People today are living much longer than they were in 1983, and it was also really designed for single individuals. If you're the high earner in a couple, it's very easy for the longest living member of that couple to live past how old the high earner would have been at their break even age.

25:22
Alex Murguia
What you mean by that is when the government was pricing out the increases and the amount to give you and so forth, it was literally based on what the neutral number would have been on 1983, life expectancy, inflation, et cetera. That has changed markably, since then. Hence why it's such a good deal, quote, unquote, to delay.

25:44
Wade Pfau
Yeah, in 1983, if you were going to live to your life expectancy, it wouldn't matter which age you claimed because you'd always get the same amount of lifetime benefits. It was kind of a 50% chance that you live past your life expectancy. 50% chance of benefiting from delaying

Social Security as a single person in 1983. Now, because people are living quite a bit longer than they were in 1983, it's no longer fair. It's better than fair for you as individual. You have a much better than 50% chance of living past the age you need to for that to be a fair bet. You have more than a 50% chance of benefiting from delay. The other aspect of that too is interest rates. In 1983, interest rates were a lot higher, and in particular, what really matters are real interest rates. Now, Tips had not been created yet in 1983, real interest rates could only be estimated.

26:53
Wade Pfau
The 1983 reforms, those delay credits that were created were based on an assumed 2.9% real interest rate. Today Tips yields, long term Tips yields as of the time of this recording are somewhere in the ballpark of 1.4 to 1.5% real. Interest rates are lower today than assumed by the delay factors. What that really means is in 1983, if you are going to live to your life expectancy, the decision to delay was based on earning a 2.9% real return. It's harder today to earn a 2.9% real return than it was in 1983. You have to take investment risk today to earn a 2.9% return because if you use Tips, you're not getting anywhere close to the 2.9% real return.

27:47
Alex Murguia
But then I would add a caveat. Right. 2.9% return, real return, zero standard deviation. Yeah, real return, but with effectively no volatility.

27:57
Wade Pfau
Right? Well, there's no investment volatility, there's just.

28:00
Alex Murguia
The volatility around your that's what I'm getting at. If you're thinking, oh, I can get that in stocks, well, you only have so many number of years to get that and you have a path that it has to be extremely smooth that you most likely will not be able to match.

28:17
Wade Pfau
Yeah. 2.9% is not a high number for stocks to be but it is definitely a tough number for bonds to be at the prison. With stocks, if there's going to be a decent probability that over this eight

year window we're talking about, stocks don't always outperform a 2.9% real return over different eight year windows. You may not pay unless you're taking a great deal of risk too.

28:45
Alex Murguia
Yeah, that's what I'm trying to get at.

28:47
Wade Pfau
Yeah. They're not equivalent, the stock market is not equivalent to Social Security. Social Security. Is that riskless? And it was 2.9%. If I lived to my life expectancy from 1983, because my life expectancy is greater in 2023, the implied real return on delay is going to be higher than 2.9%. It's going to be closer, somewhere between three or closer to 4%. And it's different for men and women. So Wade, and I say this and I mentioned it in the last podcast, but I think this is where people are presented, right? Even just based on your life expectancies, you're getting a pretty reasonable real return implied from delaying Social Security.

29:28
Alex Murguia
Wait, and I say this and I mentioned it in the last podcast, but I think this is where people are presented, right? I mentioned the newsletters. This is where you'll see, you read an investment article and at the end of the investment article, there'll be something that says reasons you should take Social Security early or soon. One of the reasons is exactly this. They'll say if you take it early, you have your cash in hand. If you have cash in hand, you can invest it in the stock market. By taking that money early and investing in the stock market over the next eight years in which if you delayed, you will get nothing, you will do better XYZ because your investment acumen is bar none kind of thing. You're saying effectively not so fast.

30:17
Wade Pfau
Right? Yeah, that kind of argument gets used a lot and it could just be based well, the S and P 500 historically had a 7% compounded Real return. You could translate that argument to say, yeah, why don't I just take Social Security early and then I'll have this money in the stock market, quote, unquote, investing my benefits and or really what it just means is not taking money out of my investments, but then my investments will grow at 7% Real. There's kind of this quote, unquote arbitrage opportunity. I can borrow at the 2.9% Real and earn a 7% Real. Well, that doesn't consider the fact that stocks are volatile and you're not promised a 7% Real

return, especially over the relatively short time horizons needed for this to pay off for your retirement.

31:07
Alex Murguia
Yeah, I think the time horizon is short. Plus, at a certain point you start asking yourself, what's the context of all of this? Why are you doing this? This is for retirement income. I don't think you need to take that risk. I mean, if you're at the stage where you're retiring and you find yourself needing to take that risk, there's probably other issues that have bubbled up that need to be addressed as well.

31:30
Wade Pfau
Right, and if we're back to also just this whole idea of Social Security is the key form of reliable income that most American households will have as part of their retirement. If you're gambling it away is really how you're kind of taking your Social Security benefits and investing them in the stock market that may or may not pay off for you. I mean, it could for some people it could pay off, but it's definitely taking a lot of risk. It may not be risk that a typical American is really able to take on because they don't have enough reliable income.

32:10
Alex Murguia
Yeah, and this goes back to also how you frame it.

32:12
Wade Pfau
Right.

32:12
Alex Murguia
I guess I inherently just view Social Security as more of an insurance piece. I think there's so. Many things in life that are up to random chance that if you get an opportunity to control certain outcomes that can beneficial to you, I kind of hold them dear and take risk where you have to, not necessarily where you don't have to. To me, I don't know, what do you think? Where do you take this? I naturally view it as insurance, a risk off kind of thing for essential expenses.

32:48

Wade Pfau
Yeah, I do as well. I like to have Social Security framed as insurance. What we're really just getting into now is even if you wanted to frame it as an investment, I would argue that it's a pretty darn good investment as well to delay Social Security.

33:02
Alex Murguia
No, I know, I just wanted to get just personally, what do you think?

33:06
Wade Pfau
Yeah, it's longevity protection and to really then just summarize what we've been talking about with this longevity. So, again, these delay credits were designed with 1983 longevity in mind, what we didn't mention, but worth emphasizing, of course, they were designed for the average Social Security beneficiary. We know that there's a lot of correlations between different socioeconomic characteristics and longevity. The type of person who actually listens to retire with style probably has other characteristics that are correlated with living longer than the average American. That's just another example of where the odds of you as a listener living beyond those break even ages is even higher than for the general population self selection bias. Also just I did mention this point, but to emphasize it again. For a couple, the high earner, their benefit lasts for the joint lifetime of the couple. If the high earner lives the longest, it's just their retirement benefit.

34:17
Wade Pfau
If the spouse outlives the high earner, then that benefit becomes a survivor benefit. Especially if the high earner in the couple is the older individual in the household, that benefit could last for years. It's not when the high earner dies, it's when the last surviving member of that couple dies. Even just consider the high earner say they're ten years older than their spouse. Their spouse lives to age 90. Maybe the high earner died at 75, but the high earner's benefit then lasted until the high earner would have been 100, because it lasted until the spouse died who was 90 but ten years younger than the high earner. Well, by having that benefit paid for those 30 years until that high earner would have turned 100. That's incredible. You're getting so much more out of Social Security by delaying, and that's really the way that a couple needs to frame the problem.

35:14
Wade Pfau

It's not what is just my personal longevity, but what is the joint longevity of myself and my partner or spouse and how old would the high earner have been when the last person in that couple passes away? We can talk briefly about a case study, maybe harder to discuss the case study without having any visuals. We can try our best here because this is a case study that helps illustrate the idea about why you can have a permanently enhanced lifestyle by delaying Social Security. So it's a pretty simple case study. We'll take a 62 year old. They're currently 62. That means their full retirement age will be 67. They just simply want to spend $60,000 a year in retirement plus inflation. I mean, that's an inflation adjusted spending goal. Their Social Security benefits will be if they claim at 67, they'll get $30,000 a year.

36:20
Wade Pfau
That would cover half of their spending. The other half would need to come from their investments. If they claim at 62 the early claiming reductions, they only get 70% of their primary insurance amount. They would get $21,000 a year. And this is all inflation adjusted. If they wait until 70, those delay credits, past full retirement age, they get 24% more that's $37,200. So a simple example. It's a single person. They're 62 want to spend $60,000 a year plus inflation. They have to make a decision on Social Security. They also have an investment portfolio that's worth $866,000 at the present. And we're just going to look at.

37:07
Alex Murguia
Very specific ways, and that's to get.

37:10
Wade Pfau
Nice, cool withdrawal rate numbers. We're going to look at claiming at 62 versus 70, basically. If they claim at 62, Social Security is going to give them $21,000 a year plus inflation. I'll stop saying plus inflation on everything. Whenever I say a monetary value, it's always inflation adjusted. Social Security gives $21,000 a year. That means they need to take the other $39,000 from their portfolio. If they wait until 70, they have to take $60,000 from their portfolio each year for eight years until they reach 70. After 70, Social Security provides $37,200, and they need to take the other 22,800 from their portfolio. Okay. That being said, going back to the age 62, claiming 21,000 from Social Security, 39,000 from the portfolio, they had $866,000, 39,000 divided by 866,000. They have to use a 4.5% withdrawal rate to meet their spending goal. We're not getting into any conversation around what's a safe withdrawal rate.

38:36

Wade Pfau
The point is, if your withdrawal rate is lower, you have a better shot at retirement success than if your withdrawal rate is higher. This particular strategy requires a four and a half percent withdrawal rate. Now, what if they claim it's 70? Well, what they're going to do is they're going to carve out a Social Security delay bridge. They don't want to have their whole $60,000 spending need vulnerable to market volatility. They'll look at their age 70 benefit, and they'll carve out eight years of that and invest it in tips. And they'll even be conservative here.

39:13
Alex Murguia
Eight years from their portfolio.

39:14
Wade Pfau
Yeah. They're going today they're going to carve out eight years of the age 70 benefit from their portfolio, since they're not getting the age 70 benefit of 866,000 yeah. Out of the 866,000. Basically, okay, today they're going to withdraw $297,600 from their portfolio and they're going to build an eight year tip slider and I'm assuming a 0% real return, which is less than they could actually get. So this would actually be cheaper. In reality, I'm being conservative with the assumption here. They took out almost $300,000 to cover that missing age 70 Social Security benefit. They're going to create the Delay Bridge. They now have reliable income of 37,200 for the rest of their life. They now need to just withdraw 22,800 from the remaining $568,400.

40:14
Alex Murguia
The $568,000 that's at age 70? No, was that in cash for eight years.

40:21
Wade Pfau
That's when we pulled out the Delay Bridge and set it aside. We pulled out close to $300,000, created an eight year tips letter with it, and we're not counting that anymore.

40:32
Alex Murguia
Okay, and how are you counting the 568?

40:34

Wade Pfau
Well, that's just what's left. That's just after they curved out, it becomes a portfolio.

40:38
Alex Murguia
I know, but it's not invested until it's still invested.

40:41
Wade Pfau
It's their remaining investment portfolio. Got you. It's just like we're back to the withdrawal problem. They need to spend their remaining 22,800 from the remaining 568,400, and that is a 4.1% withdrawal rate because the increase.

41:00
Alex Murguia
In the Social Security benefit from delaying more than makes up from the distribution of the portfolio. It reduces the total. In theory, it gives it a better chance for maintaining a sustainable withdrawal rate. Yeah, because it's 4% withdrawal from the portfolio versus four and a half percent.

41:17
Wade Pfau
Again, no debate about what's the safe withdrawal rate, it's just simply if I can meet my spending goal with 4.1%, that obviously improves the sustainability of my retirement plan compared to if I had to spend at 4.5%. That's by delaying Social Security and by building a conservative Social Security Delay Bridge, even assuming a 0% rate of return, I can reduce the withdrawal rate needed from my investment portfolio to cover the rest of my spending goal. Either what that means is if I simply spend at a lower withdrawal rate, I'm going to have a bigger legacy at the end. Alternatively, if I wanted to still use a 4.5% withdrawal rate to have the same risk of portfolio depletion, I get to spend and enjoy more spending in retirement. It ends up being about 5% more total spending. It's more than 5% from the portfolio, but Social Security is still the same.

42:17
Wade Pfau
5% more lifetime spending with the same amount of risk of portfolio depletion. So permanently enhanced lifestyle. 5% may not sound like a lot, but it is what it is.

42:34
Alex Murguia
No, I mean, at this level, this is where everything counts in large amounts.

42:42
Wade Pfau
Yeah, and one other point to mention too, plus you could still deplete your investments, you might run out of money. If that happens, it's less catastrophic because you now have, like, if I claimed it 62 and deplete my investments, I only get to spend $21,000 a year. After that, if I claim at 70 and then later deplete my investments, I get to spend 77% more at the 37,200 per year for the rest of my life. So less risk of depleting my investments. Plus, even in the unfortunate scenario where I deplete my investments, I have a much higher remaining lifestyle because I have much more from Social Security. Still in that scenario.

43:28
Alex Murguia
Yeah. Even if you view it from Monte Carlo standpoint, I'm sure if you run the Monte Carlo, what you're going to recognize is you can spend more with the same probability of failure.

43:37
Wade Pfau
Yeah. That's where if you increase the withdrawal rate to just enjoy the higher lifestyle, you get to spend more with the same probability of failure. Plus, when you do fail, same probability of failure. When you do fail, you have 77% more to spend after that because your Social Security benefit is larger.

43:58
Alex Murguia
Oh, yeah, the delta was larger. So you were getting a higher monthly.

44:08
Bob French
Curious if you should be looking at a Roth conversion or what a Roth conversion even is. Head over to McLeanam.com Roth to get McLean's free ebook. Just head over to McLeanam.com/roth to download your free ebook today. Learn about when you might want to

do a Roth conversion and when you might not. Just head over to McLeanam.com/roth to download your free ebook today.

44:33
Wade Pfau
The other just kind of angle on all this is if you delay Social Security, the implied return you're getting on your cash flows, because we're talking about cash flows here. What's the quote unquote return from delaying Social Security? Well, the benefits I give up are like making an investment and then that investment, by providing 77% more spending power. After that, I'm getting cash flows from that investment. Every cash flow I receive improves my rate of return. How long does it take for those rates of return to start looking attractive? Using these same numbers where it was primary insurance amount, $30,000 a year, $2,500 a month if I claim it 62, $21,000 if I wait till 70, $37,200 of benefits. If I wait until 70, I give up $21,000 a year for eight years, but then I start getting $37,200 a year for the rest of my life, which is $16,200 more than the age 62 benefit.

45:52
Wade Pfau
Now, it takes some time for that to start implying, like, reasonable returns. This is where at age 80, that's the break even age here. That's when you now have a positive real rate of return from delaying Social Security. By age 84, it's already a 3.3% real return. Yeah, go ahead.

46:17
Alex Murguia
Yeah, no, I think it's I mean, the other way to look at it, even is kind of what I said earlier, the best pension money could buy. Because if you were going to take that difference, which is if you left $168,000 on the table right. You use that to buy annuity, you wouldn't be able to get the same payout that you would be from delaying.

46:38
Wade Pfau
That's another way to frame it, too. But yeah, let's talk about that also. Let me just mention, if you lift to 95, you're getting an implied 6.1% real return from delaying Social Security, which is competitive with the stock market.

46:55
Alex Murguia

But that's a lot. No, but I can't even stress enough, if you're that age, you shouldn't be taking that much investment risk anyways at that point.

47:02
Wade Pfau
Right. You have to be 100% stock.

47:06
Alex Murguia
Exactly. So if you're getting that much.

47:11
Wade Pfau
Take.

47:11
Alex Murguia
The money and run. Right. The Steve Miller song. I mean, take it's there.

47:17
Wade Pfau
Yeah, yeah. Now it's what you're saying, too about annuities that's also worthwhile yeah.

47:24
Alex Murguia
Because you can frame it as you're paying. You're buying annuity at 70 for this much and you would never get anything close to what the government's giving you.

47:32
Wade Pfau
Yeah, you just say, so my age 62 benefit, I'm missing eight years of that. If you just add it up and it's all inflation adjusted, you're missing out on $168,000. If you treat that as annuity premium, how much annuity income could you buy with that? Well, by delaying Social Security, you're buying an inflation adjusted so $168,000, just discounted to age 62, is buying you a lifetime inflation adjusted income of $16,200. It's an eight year deferred annuity starting at age 70 for the rest of your life. That is a payout rate of 9.64%. Yeah, it's not bad. It's actually

pretty darn good because now we want to try to compare that to commercial annuities. The problem is there's no commercial annuity that even provides a CPI adjusted income. We can't even make a direct comparison. We're going to have to assume an inflation rate to even be able to do this.

48:38
Alex Murguia
To be clear, the reason there's no annuity that's tied to inflation is because it would be priced so expensive that no one would buy it because of the risk that these insurance companies take. They don't do it for a reason.

48:51
Wade Pfau
Yeah, these were not popular. There's even a story in the New York Times where they track down the one person who bought a CPI adjusted income annuity from one of the major providers out there, and that person was a retired actuary living in Arizona, of course, the actuary market, but generally they weren't popular with the public. Also just the insurance company is taking risk because they don't have any way to hedge inflation beyond 30 years, since tips only go out for 30 years. For anyone who's promised a CPI adjusted payment in year 31, that's all on the insurance company. They have to consider that risk and have to raise the price they charge for the CPI adjusted annuity so that they weren't popular with the public. No one was even searching them out. The insurance company has to take additional risk to offer them. Hopefully we'll see them again someday.

49:57
Wade Pfau
January 2020 is when the last remaining company dropped out of the market.

50:03
Alex Murguia
That was the last time we could provide an apples to apples comparison.

50:08
Wade Pfau
Yeah, and since then we can't even do apples to apples.

50:10

Alex Murguia
So it'll do right now.

50:11
Wade Pfau
Because to finish this comparison now we're just going to have to buy an income annuity with a cost of living adjustment. I'll do this with a 3% cost of living adjustment, which just means we're going to be wrong about the inflation. To provide a reasonable approximation, how much annuity income could I buy with $168,000 for an eight year deferred income annuity? Assuming a 3% inflation rate and with a 3% cost of living adjustment, this is going to knock down the payout rates. And again, we're assuming 3% inflation. A 62 year old man could get an 8% payout rate, a 62 year old woman could get a 7.18% payout rate. For a couple both age 62, joint 100%, like the equivalent of the survivors benefit from Social Security. 100% survivors benefit for a joint annuity, that would be a 5.92% payout rate. All at the start of this year and when I ran these numbers.

51:18
Alex Murguia
But all of these are significantly.

51:20
Wade Pfau
So Wade, we really went deep into the numbers in this episode. Plus that 9.64% is a true inflation protected payout rate.

51:34
Alex Murguia
Wait, we really went deep into the numbers in this episode.

51:38
Wade Pfau
Yeah, kind of mind blowing. That's back to the point of if you are thinking about using annuity, especially if you are income protection or risk wrap, you can't beat delaying Social Security. So step one is delay Social Security. If there's still need for additional annuity, that's when you can look into the commercial markets, but it would not be efficient. Claim Social Security early and just buy more annuity instead. Okay, so that's the case for delaying Social Security. Now let's talk about why it might make sense to claim early in some scenarios. Okay, so the first reason,

if you have a legitimate medical reason to not expect to be able to live to age 80 or beyond, then it's valid. This should not just be your hunch, but it should be like a doctor, something that's linked to the medical world as well as if you're the hiring in the couple.

52:42
Wade Pfau
It's not just your life expectancy that we're talking about, it's the joint longevity of the couple. If you have a reason to believe that yourself or anyone eligible to a survivor benefit from you is not going to make it past the age where you would turn 80, then you could argue it's okay. If there's a valid, legitimate medical reason that it can be justified to claim early, I can't tell someone who has severe medical issues that they should still delay. That can be a valid reason to delay or to claim early. Another one, and we did mention this last week in the episode, is if you simply have no alternative, you don't have a side investment account, you don't have the opportunity to engage in part time work and so forth. You just absolutely need the money now then there may be no alternative but to claim earlier.

53:39
Wade Pfau
Again, we can't fault anyone who's in that position either. That can be a legitimate reason.

53:44
Alex Murguia
No, I mean, life comes at you fast. Sometimes you have to play the cards you dealt with.

53:50
Wade Pfau
Yeah, there's a few interesting tricks with the suspend rules that can help to get a short term access to funds. I guess we shouldn't probably shouldn't even have said that because we're not going to explain that in detail right now. That would be a whole side topic. Yeah, generally if you simply need the money, there may be no alternative. Okay, so the next one is I've said this 100 times at this point, but we're particularly talking about either the case of a single person or the high earner in a couple. The spouse in a couple with the lower primary insurance amount can be much more justified to claim at an earlier age. The reason for that is because their benefit only lasts until the first member of the couple passes away, which is a younger age than the age when the last member of the couple passes away.

54:51

Wade Pfau
Since ultimately when the first person passes away, that spouse's worker's benefit is going to also go away. They can justify more easily claiming at a younger age. The higher earner would claim at 70, the low earner would have more flexibility about when to claim. The other scenario is if you have dependents who have a use it or lose it type situation where like, suppose you're age 62 but you have a ten year old child, if you claim at 62, your ten year old child is eligible for benefits from your record. Your spouse is eligible for benefits from your record not as a retirement benefit, but as the caregiver for the dependent child until that child turns 16. That child would be eligible for the benefit until they're a bit older depending on their education circumstances. If you don't claim at 62, you don't get those benefits.

56:00
Wade Pfau
It's kind of use it or lose it. Now, I'm not saying that this is a scenario where it's obviously better to then claim early because you have to balance that against the survivor benefit to the spouse later on and so forth. In this scenario where someone who's already Social Security eligible and has young children, it probably implies that the spouse is also quite a bit younger than that individual, which is back to that scenario where if my spouse might live until the equivalent of when I would have been 110, the survivor benefits off of that are huge. So this wouldn't necessarily overturn the decision. At least it's worth looking at this in the software and making an informed decision of trading off these dependent benefits that I might lose versus what that would do to the subsequent survivor benefit to my spouse. It may still very much lean towards delay, but at least this is a scenario where if you have dependents who could get benefits off of your record that they wouldn't otherwise ever get, you at least should run the numbers a bit more carefully.

57:04
Alex Murguia
Notice the underlying theme in all of these. Unlike reasons to extend, where these are more financial planning reasons which are very valid, they're not necessarily break even reasons or anything like that. They're shortened life expectancy, health care issues involved. With that you need the money. Now, a budgeting issue, the spouse with a lower primary insurance amount has incentive. There's a difference between the spouse and there's a child in which you're not taking advantage of benefits that are available to you. Now if not, you lose them. To me, these are financial planning reasons that make it obvious. That make it more obvious. Let me say like that to claim early as opposed to this arbitrage investment break even, that you may be running in the back of your head.

57:52

Wade Pfau
Okay, then there's a couple of other reasons that get listed, and these have already come up in the last two episodes. I would say there are less valid reasons to claim early. The first of these is the idea that investments that by claiming early, you can, quote, unquote, invest your benefits and get a better outcome. Now, we did have a whole episode on that a while back because Steve Parrish and I published an article in the Journal of Financial Planning in January 2023 that tested this claim in the historical data and quantified when it would have paid off to claim early and then quote, unquote, invest your benefits. It does depend on what asset allocation that you use. The more aggressively you're willing to invest, the easier it is for the early claiming to pay off. If you're going to invest conservatively, if you got a 25% stock allocation, it's almost impossible for you to benefit from, quote, unquote, investing your benefits because bonds can't keep up with what Social Security is able to do.

58:54
Wade Pfau
We did have a whole episode a couple of months back where we looked at this bob French and I did that episode and we looked at this in detail, so we won't redig into all that. Right now, especially, this episode is getting to be on the long side. Again, the point is if you're just saying, oh, well, the stock market has this average historical return that's so much higher than the returns implied by delaying Social Security. Of course, I'm just going to claim early, keep more money in my investment portfolio, get a higher rate of return. The reality is it's a lot harder to benefit from that approach than the naive analysis implies. Again, the naive analysis is plug in a historical stock return. And that's the whole story. There's more to it than that. The other one is just simply the idea that you mentioned it today already, Alex.

59:49
Wade Pfau
The idea that Social Security will disappear. The trust fund is projected to deplete. Now, the combined trust funds for the old age Survivor and Disability Insurance are now projected to deplete in 2034. There's this idea that, well, I better get money out while I can't because it's going to go away. That's an issue that warrants its whole episode. So that's a nice kind of cliffhanger. Our next episode in the Social Security arc will be about the history of Social Security and potential reform options in that regard, the future of Social Security, and whether or not it's a valid kind of idea that I better claim Social Security now because otherwise I'm not going to get anything out of Social Security. The punchline is I don't think that's a legitimate concern, but we'll unpack that in a lot more detail in the next episode.

01:00:45

Alex Murguia
All right.

01:00:46
Wade Pfau
Yeah. We're getting long today, so we should wrap things up.

01:00:50
Alex Murguia
Well, no, look, it's one of these numbers driven episodes, which is good. We got you back in your element, right? No, it was awesome. All right, well, thank you, everyone. We'll catch you next week when we talk about the Social Security. And the end is nine.

01:01:10
Wade Pfau
Wade and Alex are both principals of McLean Asset Management and Retirement Researcher.

01:01:13
Alex Murguia
All right, bye now.

01:01:14
Bob French
Wade and Alex are both principals of McClain Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tyson's, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with a risk, including risk of loss. Past performance does not guarantee future results.