

Episode 204: How Your Retirement Style Shapes Your Social Security Strategy

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Retirement income, Social Security, delaying benefits, inflation protection, survivor benefit, bond ladder, TIPS, financial personality, retirement planning, tax planning, primary insurance amount, accumulation mindset, liquidity, medical diagnosis, break-even analysis.

SPEAKERS

Alex Murguia, Briana Corbin, Wade Pfau

Briana Corbin 00:00

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.

Briana Corbin 00:19

ever been called an idiot for delaying Social Security? Well, you're not alone, and you're not wrong either. In today's episode, Wade and Alex break down the case for waiting and when it actually doesn't make sense to wait, because this is retirement planning. One size never fits all.

Alex Murguia 00:54

Welcome to Retire with style. I'm Alex, and I'm here with Wade and his 24 inch pythons, right? Wade, is that what you said right before we

Wade Pfau 01:05

started? That's right. That's right, yeah,

Alex Murguia 01:10

well, it's a good thing. It's pythons, because I think in DC, guns are not allowed, and you're gonna have to leave the gun show behind,

Wade Pfau 01:20

right? Buddy, yeah, I think there's some historical precedence. Yes, absolutely. And that's a big backstory

Alex Murguia 01:29

between waiting a whole different conversation and many and a few others. All right, Wade, What? What? What are we speaking about today? Big guy,

Wade Pfau 01:42

yeah, that's neither here nor there, because today we're talking about Social Security, and really we're going to talk about it agnostically. We do tend to lean to the side of delaying for the high earner in a couple but recently, there's been a lot of news and attention about this idea that anyone who thinks you should delay Social Security as an idiot, so thought it'd be a good time to have a podcast about that. We'll make the case for why delaying social security is important, but then we'll also we'll look at the RESA, the retirement income style awareness, and we'll talk about the factors that would align with someone perhaps claiming early and that's ultimately justifiable as well, if that's your preferences. And then we'll also go through a list of reasons why someone might claim early. Some of them are valid, some of them more questionable. But yeah, we'll really try to provide a complete look at the Social Security claiming decision. Full retirement age now is about 67 you can claim as early as 62 you can delay till 70 you get pretty powerful delay credits for waiting. And so the whole question is, should I claim at 62 and start benefits as soon as possible? Or should I delay Social Security to get the most inflation adjusted, protected, lifetime reliable income? Wait then from this benefit? Okay? And that's really what we want to dive into with what,

Alex Murguia 03:01

what is the case for delaying? And again, we're going to do full circle. So we're not going to do point by point. We're going to cover the case for delaying, and we'll do some reasons for claiming early, and we may kick around some of the people that are always saying this is the right way, and that's that Wade case for delaying early state your argument go,

Wade Pfau 03:24

okay, so social security benefits, they're an annuity. They provide protected lifetime income that's inflation adjusted. It's linked to a version of the Consumer Price Index which you cannot buy commercial annuities that provide you that CPI Consumer Price Index linked benefit So Social Security benefits, they manage longevity risk. They continue for your lifetime. They provide inflation protection. They can help to manage market risk. Also, what often gets overlooked in the debate for claiming early is the survivor benefit of Social Security for the person. If we're talking about a couple, the high earner in the couple, the person with the higher primary insurance amount, their benefit will last for the joint lifetime of the two individuals. It either continues as a retirement benefit for that high earner if they live the longest, or if that person passes away, their benefit becomes a survivor benefit for that surviving spouse, and so you really increase the opportunity to have that benefit last a very long time for couples. When we're talking about the high earner. Another thing that gets overlooked is this idea that you if you're going to delay Social Security. So we'll kind of set up the simple example. Somebody's 62 they've retired. Do they claim as 62 or do they wait till 70? That's just to frame the argument. That's how we'll be thinking about things. If you are retired at 62 and you're going to delay till 70, you don't want to just spend from your investment portfolio in terms of having to take that bigger distribution rate for the first. Eight years, but you can build a Social Security delay bridge. There's a number of different ways you could do that, including with like reverse mortgages and things. But the simplest way is you build an eight year tips ladder, so you have a treasury inflation protected security maturing each year for the next eight years. You carve that out of the investment portfolio and so that you have that income coming in at the age 70 benefit level, and then at age 70, your Social Security kicks in. And I've written extensively about this point in the retirement planning guidebook, you can actually lower the distribution rate from your remaining investments by delaying Social Security and carving out of your portfolio a Social Security delay

bridge so it doesn't increase risk, it doesn't really cause any harm you you don't want to just simply spend from the investments you build a Social Security delay bridge, and because of the delay credits, that's if you do wait till 70 your inflation adjusted Lifetime spending power from Social Security is 77% higher. The delay credits were designed in 1983 when people weren't living as long. And we're assuming a 2.9% real interest rate, which is pretty attractive for retirees. It makes it easier to actually reduce the distribution pressures from the rest of your investments.

Alex Murguia 06:19

Just to backtrack, I hear for clarity here. So you're taking on a bond ladder, if you don't mind doing a quick 30 seconds, what that is, especially for an eight year bond ladder, you know, every year, the yearly tranches, and how that works for those that are listening in. And then, do you consider that bond ladder allocation part of your stock to bond allocation, or do you it's all obviously one pot, but do mentally demarcate that from your stock to bond allocation, and what do you do over time, because of the bond ladder matures, you're kind of getting closer and closer to equity. So is that an indirect glide path kind of strategy as well?

Wade Pfau 07:01

Yeah? Okay, yeah, there's a lot of to unpack there. Like, you can go to tipsladder.com it's a nice website that lets you see the idea is you'd buy eight different tips. And if that's too much work, there's other options for doing this as well. There's even, like, those life X funds out there, or just use a short term tips mutual fund, potentially.

Alex Murguia 07:22

But by the way, Wade, I have to stop you before Paula listens to this and has a conniption. Then these are recommendations, just tools that are

Wade Pfau 07:31

available, no recommendations, tools that are available. But you have a tip spawn, maturing each year for the next eight years, you're spending the proceeds in terms of the face value at maturity, as well as any coupon payments coming in along the way. And you're you're doing that to replace the age 70 benefit for ages 62 through 69 so that you do spend that bond ladder down, you're not replenishing it. And yeah, in terms of what that does for the rest of the asset allocation, this is a natural way to get a rising equity glide path, because you you carve that out of your portfolio, but really it's still part of your bond allocation. Whatever the asset allocation is in your remaining portfolio, you're not necessarily adjusting that, and so you are that lets you, as you spend down the bond ladder, get back to whatever that asset allocation was in your portfolio. Now you do have more risk capacity when you have 77% more reliable inflation adjusted lifetime income so that can help people to invest in the remainder more aggressively if they want to. Not necessary for the argument, it's just you've got your investment portfolio. You keep the asset allocation you want for it, you've carved out a bond ladder that you'll spend down over the next eight years, and then Social Security kicks in to provide you that same inflation adjusted

Alex Murguia 08:51

now, some of you may be asking, Well, it's good to be the king if you can buy a bond ladder for eight years and you just have that money. We'll get to reasons why you may not want to claim

early later. This is assuming you have the resources, you know, to be able to bridge income. Obviously, just get right.

Wade Pfau 09:14

Yeah, we can get that one out of the way. One reason you might have to claim early, if you don't have the resources to build a bond ladder, it would take all the investment assets you have, then you may just have to claim early, because you need that money to survive. It's not really an argument against delaying Social Security. It's more you're really not funded for retirement. You can't fund the kind of lifestyle another they might have.

Alex Murguia 09:37

Yeah, no, no, just Yeah. Put it out there. Another thing that you said that caught my attention, that I hope is catching everyone's attention, is, you know, at first you start, I see a lot of people interpret Social Security like an oh, by the way, thing, especially if you're a high net worth person. But you said something that is interesting, that I think bears unpack. Being in nominal terms as well. You said something about a 70% pop delaying versus not. What does that mean? And you know, you always hear like it's about a \$200,000 different, you know, in that range, if you will, more than 200,000 less than 300,000 on average, of money that you're potentially leaving on the table, and I suppose that's where your 70% number came

Wade Pfau 10:23

from, or am I off? Well, that, yeah, the 77% higher benefit. So the longer you live, the more benefit you get from delaying Social Security. But if you make it to your 90s, delaying Social Security could add a few \$100,000 of net lifetime benefits to your household, and not just you, but you, if you're married so you and your spouse, the with the high earner, that benefit lasts.

Alex Murguia 10:50

I think people don't realize that once, they once actually do the numbers that sure you may not need it. You may think of it even as a sort of a social program and not, not relevant to you. But the reality is, is that it's, you know, 100,000 here, 100,000 there it, it starts to add up, right?

Wade Pfau 11:14

Yeah, yes. I think that matters for most people, right? Bill Gates doesn't care when he claims Social Security, but uh, for most people, a couple \$100,000 could make a big difference over the lifetime financial plan, and in terms of what also you're able to leave to the next generation piece that I think is

Alex Murguia 11:32

quite interesting, and this could it kind of the inverse of, why not delay? Of why maybe claiming early but I don't think a lot of folks appreciate the higher income delaying that way when he passes away or she passes away, the spouse receives that benefit, not their own. You mind unpacking that one? Because I think that gets lost in the in the rigmarole a little bit.

Wade Pfau 11:59

Yeah. Yeah. It does get lost. So there's a high earner in the couple and there's a low earner in the couple, or unless they have exactly the same lifetime incomes, but each spouse has a primary insurance amount. The person with the lower primary insurance amount, it's a whole different conversation. That can be a reason to claim early, because your benefit won't last as

long the high earner and the couple their benefit will last for as long as one of those two people remains alive, because it's either continues as a retirement benefit or it switches and becomes the survivor benefit. So if I wait till 70, I'm also providing a higher survivor benefit to my spouse. It's not just how long I will live. It's also how long would my widow in this scenario live? And that adds a lot of value from delaying Social Security that I in all the arguments about claiming early, I never see references to the value of that survivor benefit. There's one more. But wait, there's more on the I will ask the question security delay, and that's the next topic.

Alex Murguia 13:10

No, go on. Go on, continue.

Wade Pfau 13:15

I know it's the tax planning opportunities. If you're retired at 62 and you're delaying till 70 you now have an eight year window where you may not have a lot of income if you're overly allocated to IRAs or other tax deferred accounts. This can create a really valuable opportunity to do Roth conversions and to even potentially set up the situation where, if you'd claimed at 62 you're probably going to find your tax on 85% of Social Security for the rest of your life. But if you wait till 70, not only will you have a higher benefit, but unless you're really high net worth, but if, even with a couple million dollars, you might be able to do Roth conversions and set up a situation where you have a much higher benefit and you're not even being taxed on 85% of it, it's you're probably not going to get it down to zero, but if you're taxed on 40 to 50% of your benefit instead of 85% of your benefit, that's another huge overlay of value from delaying Social Security. It opens up a window to do tax planning so that you're better prepared for taxes after Social Security starts at 70, and then, especially also after RMD start at either age 73 or 75 depending on something that I think is interesting,

Alex Murguia 14:31

that I would, I would try to reframe, and you do a good job. And figner talks about it a lot. Jason Fichtner, the framing of this. Because I think when you talk about claiming Social Security and then delaying Social Security, it gives people the sense that the standard is just claiming early, you know, but he plays with the word full, full benefits, and, you know, things along those lines, you mind? You might do you mind framing that so people. People can begin to think of it in this terms as I think it's just much more productive.

Wade Pfau 15:07

Yeah, and Jason was a commissioner at the Social Security Administration, Jason Fichtner, he was the one that used to be, we'd say, the now almost age 67 the full retirement age. They used to call it the normal retirement age. He at least convinced them to change the name to full retirement age so that it didn't sound normal. But yeah, what he's pushing for as well, that what you're referencing age 62 right now is the early claiming age. That makes it sound like, Oh, I'll claim a 62 that's early claiming age. He'd like to change that name, and I forget the exact term here, but something along the lines of age 62 is your reduced benefit age and and if you wait until 70 that's your full benefit age, that you get the maximum benefits out of Social Security. So we haven't made that adjustment, but it'd be interesting to see, because the terms for things matter, and so if we do you

Alex Murguia 16:01

want to study you're doing where you put like five people, five folks that are in their mid 50s, in a room, and you put one marshmallow in front of them, in front of each of them, and then you tell them not to eat that Marshmallow, but you're going to leave the room and come back 20 minutes later, and then you see who ate the marshmallow. And you're finding that the people that ate the marshmallow actually claim early, whereas the people that wait and eat the marshmallow when you came back and you rewarded them with three more more marshmallows will probably claim late, right? Aren't you doing that study?

Wade Pfau 16:37

Think you're referencing

Alex Murguia 16:38

it's like some delay gratification. That's psychology, famous study. I can't remember anymore something like that.

Wade Pfau 16:45

It's better than Milgram. Yeah, wasn't it like you put a marshmallow in front of a kid and, yeah, if they wait 10 minutes, they'll have two marshmallows, or they can just eat the marshmallow now. And if they waited, they have I think we should

Alex Murguia 16:57

do a longitudinal study and see if there's anything there.

Wade Pfau 17:03

But it's yeah, it's the same idea, if you can hold off and wait till 70, you can have financial outcomes.

Briana Corbin 17:13

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Wade Pfau 17:53

So that's the case for for Delaine. But again, we're going to be agnostic here. You

Alex Murguia 17:57

have mentioned the RISA, which I happen to have shirt on today. And Wade, you have our 200th episode shirt. That's a lovely shirt. Yeah. So by the way, go to go to retire with style. Calm. We actually are setting up some merch, so check it out now. Wait, that's a little snug on you. Is that a shmedian? No shmidium. That

Wade Pfau 18:19

is a medium, but, yeah,

Alex Murguia 18:21

24 you saw mine, right? They were like, I must have gotten, like, the woman's cut or something. It's just won't even fit.

Wade Pfau 18:30

Yes, I've heard that story. I don't know. I haven't seen it on you, but and the shirt you're wearing is not, it's very this is

Alex Murguia 18:39

the holiday swag that we got out there, although we've gotten, at this point, I've gotten like, four or five emails of folks saying, Hey, we're gonna get that shirt, like advisors that are using it, and we send it to them.

Wade Pfau 18:49

Yeah, we're gonna have to put this one in the rotation. Gonna have to put that one up. But

Alex Murguia 18:55

Okay, speaking of Risa, Risa and Social Security claiming, what gives

Wade Pfau 19:01

Yes, well, so the the RISA, the retirement income style awareness, it's an assessment tool recreated to understand how people want to build their retirement income strategy. There's ultimately six factors, and yeah, you can make a case for claiming early if somebody has the factors that usually align with what we call the total return retirement income style. So it's probably just, we're not going to do an in depth dive on all the Risa factors right now. I think in some upcoming episodes, perhaps early next year, we'll revisit the RESA. So for now, it's more like the summary version, but there's six factors with the Risa, and if you align a certain way with your preferences, you might really buy into the idea of claiming early. So it's the first the two primary factors, the first one probability based, versus safety. First. If you're probability based, you're comfortable. Relying on market growth, which is going to lean into the argument that if you claim early, it's a way to leverage your investment portfolio so that you have more growth opportunity through your investments. Probability based individuals will resonate better with that idea optionality, this is you really value having flexibility and optionality for all your assets, Social Security, you can't borrow from your future. Social Security or anything you're really delaying. Social Security is a way to commit to more reliable lifetime income. If you really like having flexibility for your assets. You can make the argument that you do want to claim early so that you're at least in the short run, reducing distribution pressures on your investments, not necessarily in the long run, but in the short run, you'll get that more optionality and flexibility for your investments, because Social Security can cover part of your spending. Those are the two primary factors, but if we keep going with secondary factors, accumulation versus distribution speaks to are you still thinking about maximizing growth in retirement, or do you prefer having predictable income? Well, if you maintain an accumulation mindset, there's this idea that you don't really value predictable income. You're willing to be flexible with your spending, and so with an accumulation mindset, you might downplay the value of having 77% higher lifetime, protected, reliable income through social security. So you might go ahead and claim early, because it's a way to get into leverage. There's

Alex Murguia 21:35

that piece and and the the other area, because someone could say, to some extent, well, you will accumulate more on a net basis by delaying. So let me do that. So I think there's also another nuance I agree with what you're saying. I just want to cut off that argument. There is a nuance here, and that's I there's roughly what the 70 77% equates to, like a more or less 8% annual return. You know, of increase by delaying, right? I think a lot of folks,

Wade Pfau 22:08

okay, well, no, the delay credits, it sounded like, and that's yeah, you need to hurt, yeah, the delay credits. I

Alex Murguia 22:18

think a lot of people in the accumulation mindset do the 8% is pedestrian? Heck, I'm gonna, you know, look at AI, you know, a new world upon us. I can make that in my sleep. I think there's that vibe that that happens too, and especially if, if you're, let's say, like my age, or you're, you're well into your 50s, and you start looking at this on the internet, and you start, you know, obviously leaving, leaving a trail of cookies everywhere. You're going to get a steady, a steady stream of ads from stock picking newsletters and things along those lines that are going to say, you know, 8% that's pedestrian. Let's, let's juice this up. You know, if you have our newsletter, we've, you know, this is our rate of return versus whatever. And so it makes it seem like, Yeah, well, more is better than less. So let me, let me take the money myself, invest it, and I will make more. And you may want to talk about, say

Wade Pfau 23:17

it again or leave more in my portfolio. Yeah, and leave. If I take Social Security early in the short run, I can leave more in the portfolio, and I don't

Alex Murguia 23:26

benefit. I don't necessarily buy that argument, but that's kind of the accumulation vibe as well. Like another nuance,

Wade Pfau 23:36

yeah, and that's going to lead into the argument for the claiming early is usually well, if I put the money in the s and p5 100, I'll earn. And it depends how optimistic the writer of whatever the piece is going to be like, 8% a year, 10% a year, 12% a year, that's a no brainer. I'll definitely be better. I leaving more in the

Alex Murguia 23:58

very salient mindset that folks have actually, case in point, the SMP has returned X amount over the last three, four years, significantly in excess of 8% and those people would be now saying, look at these idiots talking about theory, when, in reality, look what I've done. You guys don't know what you're talking about. You know that kind of thing. And that's a slippery slope, because I, this is my I'll just do my little soapbox real quick that going back to that any Duke book Thinking in bets, listen, you'd be you put yourself in the right situation if you continually make decisions that are the right ones. But making the right decisions doesn't necessarily guarantee success. It's just making the right decisions in terms of taking all the information out there and putting the odds in your favor, doing that over time will ultimately provide the better outcome. That's not to say you can't be lucky or, you know, you just started, you delayed, and

the SMP has returned 20% for the last. Four years. I mean, sure you did well, but it's a lot of luck went behind that, and I don't know, I don't want to base my retirement strategy

Wade Pfau 25:13

on that. Yeah, and also, our retirees, really 100% stocks, like all those arguments, it's always, it's like, I'm going to compare social security against 100% in the stock market. If that's not the correct scenario, somebody's not going to be 100% in the stock market. Well, Social Security delay is not going to beat bond returns, for sure. It's really this argument that you have to invest very aggressively to get a high enough rate of return to beat Social Security. It's just, if you have that accumulation mindset and that probability based outlook, I think it resonates better with for people that, yeah, I don't need this reliable income. I want to invest. I want growth. Claiming early will give me a better opportunity to get that growth. Okay?

Alex Murguia 25:58

And then what about the we got liquidity, right? What do you have there?

Wade Pfau 26:04

Yeah, yeah. Another factor in all this is this idea of technical liquidity that you value being able to touch your assets or to use to it's like Scrooge McDuck jumping into his pot of gold coins. Social Security doesn't have technical liquidity, but in a brokerage account does, and so again, in the short run, if I claim early, I maintain more technical liquidity for the household because I leave more in the short run, in my Are you going to see A Christmas tale this year? Christmas Carol? Oh, but, uh, yeah, and the front loading is another consideration that that's if I have a front loading preference I want to maximize my lifestyle in early retirement, I'm not as worried about like, if I live it in my 90s, I'll just cut spending then, because it's unlikely I live that long. Might as well fully enjoy those early retirement years. And so I think claiming early can feed into that, like just this idea, why would I delay Social Security? I may not even be alive to benefit from it. Let's go ahead and claim early and get the most enjoyment now out of the early retirement. I would

Alex Murguia 27:18

say, I guess this could be a transition for reasons for claiming early, but if you do have a chronic illness, and you know you may not be around, I hate to sound morbid, but you may not be around longer than most, then you know that's that's a

Wade Pfau 27:36

rational case, And you're generally for

Alex Murguia 27:38

claiming early. Wouldn't you say? Yeah, yeah,

Wade Pfau 27:43

you generally have to live to your around age 80, or your early 80s to, like, mathematically, benefit from delaying Social Security if you have a legitimate medical and it's not just a hunch. A lot of people just think they're not going to live very long. And that's really not true. If there's a medical diagnosis that you're unlikely to make it to 80, then I have no problem. I mean, that's a legitimate reason to claim earlier. Just don't forget, if you're the high earner, the survivor benefit, your will might live another 30 years if you claim early, because you don't think you're going to

make it that long, you may really be creating a much worse situation for your surviving spouse. That's a good point. Another

Alex Murguia 28:23

dependent benefits too. You may not be living a long time, but if you were the high earner, your spouse can benefit from it. So your your delay,

Wade Pfau 28:34

yeah, so if you're if you're single and have a legitimate medical diagnosis that you're unlikely to make it to 80. I don't have a problem with claiming early in that case. It can't be a hunch, though. It's got to be a legitimate it's not, oh, my parents didn't live long because, but I still, there you go. It's got to be a

Alex Murguia 28:57

legitimate plus, yeah, there's so many peptides now, I'm kidding. One of the things that led to this episode is, you know, we're trying to boost our YouTube channel and really put some effort into it in the upcoming year 2026, and you know, we're starting looking at some sites. And there was a video that got me that was about why you don't want to claim early, why you don't want to claim late, you don't want to delay, you want to claim. You claim. Well, you see, I'm even using the wrong words, why you don't why you don't want to wait till full retirement, you want to claim early, right at a reduced rate. And one of the arguments they made, and I want to get your hot take on this, is, listen, in theory, economists will tell you to delay. It sounds good, but in real life, that's not, that's not how it works. You know, this guy's trying to be the advisor, and he's throwing shade at, like, the academics or the folks that do research behind it. And the argument is, basically, we live in like, La La Land. We don't know what's going on. We're just, like, looking at numbers. And but on a spreadsheet, but not how it works in real life, right? What's your take on that stupidity? You just got my answer. But what? What's your take on that?

Wade Pfau 30:15

Well, I mean, I'm making the point like the ivory tower, anyone? Yeah, you can do whatever you want from the Ivory Tower, I'm gonna deal with real life. These guys fought at Verdun and

Wade Pfau 30:31

stuff. I think the video you shared, I didn't watch it, but I saw the clip, and it was, I have a similar chart in my book, although he framed it a little differently, but yeah, if you delay, you're going to fall behind for a while, because you're going to spend on your delay bridge. If you wait till 70, and you die at 70, that's the year you'll be the furthest behind. Your kids are going to get a pretty big inheritance if you die at 70, because you end up not spending your money. But had you claimed at 62 you would have left a larger inheritance at age 70 than if you claim at 70. Now that's where, and I guess he really was emphasizing, well, what if you die at 70, your kids are going to get less money, but that's where the direction changes. And then if you live past about 80, your kids are going to get a larger inheritance. And if you live to be 90, they're going to get a much larger inheritance, and they're not going to have a reverse inheritance where they have to take care of you, because by delaying until 70, you're creating that much stronger floor of reliable income that lasts for the rest of your life, reduces the distributions from your investments for the rest of your life, and gives those investments A much stronger opportunity to grow and provide the legacy. So I don't know why I put so much emphasis on saying this is the gotcha. If you if you delay Social Security, you're going to leave a smaller legacy. If you die at 70, true,

that's true, but that's one year, and again, kids are still going to get a pretty big inheritance. If you are planning for a long retirement. Planning for a long return not living. It's really the the longevity protection, and you're permanently better off after age 70, and after about age 80, it's net positive gains to your mathematics.

Alex Murguia 32:16

All right, so reasons for claiming early, we said a couple, but just, it probably good to just start from scratch that way. Everyone has this in one nice sound bite, if you will. What are some reasons for actually claiming early that are legit,

Wade Pfau 32:36

or the first one we already referenced it, but if you, if you don't have the money to support delay, and if you need them, the money to live, yeah, that's an obvious reason. It you may be forced to claim Social Security early because you have no alternative. And that that's fine. I mean, that it's not necessarily, oh, this is a great reason to claim early. It's just you don't have any option. That's a fair point to make. So that's one, another one we did just talk about now. But the idea of, if you have a clear medical diagnosis and there's not any survivor or dependent benefits to be concerned about, that can be a reason to claim early, another reason for couples, the person with the lower benefit can claim early, because their benefits not going to last for as long, and especially if, if the low earner in a household, if their primary insurance amount is less than half of the high earner, there's no reason for them to delay past full retirement age, because it's just gonna they'll get a bigger personal benefit, but it reduces Their spousal top off, they can't get more than 50% of the PIA of the high earner so that the low earner can

Alex Murguia 33:47

give a sentence on primary insurance amount, Pia folks kind of pick up on it the

Wade Pfau 33:56

Yeah, if you look at your Social Security statement, your Pia or primary insurance amount is the benefit you would be entitled to if you claim at your full retirement age, which this year, I think, is like 66 and eight months. But in another two years, we can simplify it. Anyone born in 1960 or later, their full retirement age is 67 and that's your primary insurance

Alex Murguia 34:21

amount. Another reason would be, there's just the Bill Gates scenario where there's just no need for reliable income.

Wade Pfau 34:31

Yeah, if you don't need reliable income. And this is when, with the news going on right now about there's one researcher out there who's really been on a going on a tire, or claiming early. He's talking about discount rate for for claiming early. But he's really focused on discount rates. He says like, well, if you don't want reliable income, that the academic point is you need to use a discount rate appropriate to the asset. And because Social Security is an inflation adjusted lifetime income, something like yields on treasury inflation protected securities make the most sense as a discount rate. Part of his point is, well, if you don't, and this is true, like if you don't need reliable income, I guess you don't really need to use a tips discount rate on your Social Security benefit, because you just don't care about the protection it provides. So you could use a higher discount rate and and with a higher then that's just the point of, well, it's really

assuming you're going to earn a higher rate of return on your investments. And the higher the discount rate, the longer it takes to break even from Social Security delay. And at some point it might not seem worthwhile.

Alex Murguia 35:39

A little bit about why the discount rate. A high discount rate makes it tougher from a math standpoint,

Wade Pfau 35:47

because it so discounting. And listen to our episodes about the funded ratio for for a full in depth discussion about it. But discounting, it's a way to convert. The issue is you don't you don't. You can't look at the balance of your Social Security. It's not like an investment account. You're going to receive a benefit each year for as long as you live. Well, how much are those future benefits worth? You have to discount them back into a value today that the present value. What's the present value of your social security? So then you pick an interest rate to do that, and the higher the interest rate, the less future benefits are worth, because the idea is the discount rate is what you could earn on your investments. So the higher the discount rate, the less I need today to fund those benefits, because the investments will earn a higher rate of return in the meantime, and I'll get those benefits at a lower cost. So if I use a high discount rate, it's, it's going to make it harder. It takes longer to break even from delaying Social Security, because those future benefits are not worth as much to me. And it's, it implicitly means, I think my investment, yeah, and a higher rate of return my

Alex Murguia 37:00

issue, you're going through a critical period, and you're, you're playing a higher discount rate, so it's making it look like I should, I should, yeah, I don't need the income, so I'm not gonna do a present value of tips, because I'm gonna, I don't need the income, I would be investing in something more aggressive. So I'm gonna give it a discount rate of, I don't know, 10% because s, p, right? My issue is that it's not a it's tips, you know, where you're gonna get year after year after year market the variability, even if you have a higher discount rate. To make that argument, the variability behind that is treacherous, I think,

Wade Pfau 37:37

yeah, and that's the academic argument. Is when we talk about retirement income, it's asset liability matching. Social Security is an asset that really behaves like tips. It's an inflation adjusted income. And it's even better because it's longevity protected. It lasts for as long as you live, and therefore the appropriate discount rate to use is what the equivalent of what you would earn from tips, which right now is in the ballpark of two to two and a half percent real with if you add 3% inflation to that, then we're talking about five to five and a half percent as a discount rate. But the argument for claiming early is, well, who cares if the person doesn't want reliable income, they should really use a higher discount rate that reflects what their investment portfolio would earn. But in a broader problem with that, though, is like, you can't this is the whole thing about you can't assume an average rate of money just because the stock they

Alex Murguia 38:37

know it. They know this, though, and they're holding back that part of the argument. They know it. It's like, Come on, man, yeah.

Wade Pfau 38:46

Do they when they run a plan for their client, do they target a 50% success rate, or do they target a 80 or 90% success rate? Because if you're going to use an expected return on your portfolio as a discount rate, that's equivalent to targeting a 50% success rate for your financial plan. And I don't think people tend, I don't. There may be some advisors who do,

Alex Murguia 39:07

and wait, is saying 50% because half the time you'll get that time you want in rough in rough assumptions, right? Right?

Wade Pfau 39:17

So I, I really struggle with why there's so much emphasis now on this idea of discounting Social Security at a

Alex Murguia 39:24

no, you're comparing it when you want to tips. Is year after year after year. This is what you're getting, you know, as opposed to maybe you get 10% maybe you don't. But I'm going to discount it at 10% anyways, because whatever, I'm a stock picking genius, well.

Wade Pfau 39:44

And if it's just, if it's discretionary and you are just focused on maximizing returns and you don't need reliable income, you can justify using a higher discount rate. But again, if you're just using the assumed portfolio return average, that corresponds to a 50% Success rate in a financial plan. And I'd be hard pressed to find financial advisors who are also saying, oh, let's just target a 50% success rate and you'll be fine. Now you can do that if you're flexible enough. It means you're going to have to keep adjusting fine. And that's back to the the accumulation, yeah, the accumulation, Risa factor. But maybe that's going to be the next direction is, oh, let's claim early and target 50% success rates in our financial plans. You can make an argument for doing that. It's just you need a lot of flexibility. Just crack a joke to justify that kind of case. I don't know, just trying to take the argument to its logical,

Alex Murguia 40:41

comfortable leveraging portfolio for our returns. That's, yeah,

Wade Pfau 40:46

you didn't skip the another reason you might claim it really is what I

Alex Murguia 40:55

don't know you got into your Shakespearean, sort of channeling your your inner Tempest, ephemeral, right, right? Midsummer Night's Dream with a yeah, if you have, like, like, the fairy character, Midsummer Night's Dream, but God,

Wade Pfau 41:15

oh yeah, the horse, no, if you, like, if you have minor children, and we're going to reach the age of depending where the benefit cuts off for them, but if they're going to age out of their dependent benefits, you can make a case for claiming early to get those benefits that otherwise would be left on the table. You could claim at 62 get those benefits, the child ages out, and then you can suspend your benefit at full retirement age and get some delay credits after that. That

could be an option. You definitely should run those cases through software, because it gets really complicated and you don't want to forget about survivor benefits. But yeah, the chance to get those dependent benefits could be another reason. The two other reasons for claiming early one of them is related to this whole conversation about just you assume you're going to get a higher investment return, but that's the whole idea of breakeven age analysis, like, how long do I need to live to benefit from delay? And with what I think are reasonable discount rates you need to live to your early 80s to benefit from delay. If you buy into the argument of using a much higher discount rate, you might never break even this. So the concern I have that I think you really should frame Social Security as insurance against outliving your assets and the break even analysis that the psychology of that is usually people start thinking, Well, what if I end up dying early and get ripped off from Social Security and so they almost, it's like they've used Social Security delay again as a bet that they'll they'll get screwed because they didn't live long enough to benefit from Social Security delay. So I'd rather not frame it as break even analysis, but that's the idea. And I had to look at

Alex Murguia 43:08

a puck when you were and I looked it up, I didn't remember an argument that I think is a little bit of a fool's errand, simply because it's in the news and this and that it's Oh, it, but it's going to disappear, so I'm going to get while the getting is good.

Wade Pfau 43:29

That's the other main argument. But that's another one, and we don't have time to do the whole discussion about reform, but right, it's Social Security is currently. The Trust Fund is projected to deplete in 2034 that doesn't mean Social Security will go away. It means reforms will be needed. Congress will be forced to act. They could act to do an across the board benefit cut of 20% Social Security won't disappear, and probably when they do get to reform, just like in the past, it's going to be some combination of benefit reductions, tax increases, but that the benefit reductions will impact younger people more than people who are currently at Social Security claiming age just like in 1983 that's when the full retirement age switched from 65 to 67 but you were 23 years old at the time. If you were going to be the first people to be impacted by age 67 were 23 years old when the reform happened. Expect to see eventually, I think

Alex Murguia 44:28

there's plenty of room like, you know, increase the ceiling on the payroll tax limit, you know, you know, again, that can be done to maybe a little bit the years. But ultimately, I, as you said, Look, when we did a whole series on Social Security like this, it was always intended to be a pay as you go system anyways. And the trust was established, if I'm correct, it wasn't it Greenspan in like 8283 because of the expected baby boom coming, which is hitting right now. And to some extent, the trust one was really not for people like. Me, but before the baby boomers, right now and so, to some extent, kind of work, right?

Wade Pfau 45:08

Well, they and they try to get social security into a 75 year balance, and from 1983 if it makes it till 2034 they got more than 50 years of the way there. But, uh, yeah, it's still just the demographics. People are living longer. There's the baby boomer generation, the peak 65 right now, and then fertility rates are down, so people are having fewer kids, so there's less workers to pay for beneficiaries,

Alex Murguia 45:33

and there's a hot take, and there's no a little bit out of your comfort zone, because it's not asking you for data, just your opinion here on a level from one to 10. How worried are you that? Oh, my God, it's going away. And so I better claim early because of that.

Wade Pfau 45:52

No, I'm not really worried about that at all. I do it for my own personal planning. I assume I'll get 75% of my presently legislated benefit, but I'm also quite a bit. I just think it makes better headlines than

Alex Murguia 46:06

financial planning. Yeah,

Wade Pfau 46:10

it's not that Social Security disappears when. Well, this is a simple argument that hopefully all our listeners already understand. The Trust Fund depletion does not mean the end of Social Security worst case scenario, it means an across the board benefit cut in the neighborhood of 20% but that's also unlikely, because there'll be some reform package that doesn't mix. That's all I got wait. All right, I hope we solve the world's problems as it relates to when to claim Social Security. Yeah, it's we're not absolutists that say you you must delay claiming. But if you are the high earn a couple, please don't overlook the survivor benefits, the tax benefits of doing tax planning, the inflation protected lifetime income that Social Security provides. If you do have the RESA of preferences that lean towards wanting to claim early at the end of the day. It's up to you, and you're not wrong to do that. It's just be careful that you don't overlook the it's it's harder for your investments to beat the benefits of delaying social security than is commonly appreciated, yeah,

Alex Murguia 47:16

big rocks argument, right? Like, put you know, that little video clip on YouTube that became famous, like big rocks first, worry about the big items first. And those that did that, that claim early. You know, to some extent, if you need it, you need it, I get it. Life comes at you fast, and sometimes it is what it is, right? But if you don't need it, this is a big rock. This isn't an, oh, by the way, trivia triviality. It's couple 100 grand. And as much as, yeah, I want to, I want to make sure people understand that, because a lot of these people that will claim early are the same people that will forget about that. But then, you know, go to the store, buy an extra gallon of milk, drive 10 miles one way, and then go back and return it, because they don't want to lose the three bucks on the guy. Bucks on the gallon of milk kind of thing. It's like, worry about the big eyed big rocks, and the big rocks is getting the Social Security right? It is a big deal, in my estimation,

Wade Pfau 48:16

and it does matter how long you and your spouse lives, and if you don't, if both of you don't live very long, your kids would get a bigger legacy if you claimed early. But it's really that you can't put too much focus on that. The risk is you live a long time and don't have the resources to fund that, and that's where you can have hundreds of 1000s dollars more through delaying Social Security.

Alex Murguia 48:41

Here it is. Thank you. Everyone on this episode of retire with style, Wade, why don't you take us away?

Wade Pfau 48:46

All right, thanks everyone, and we'll catch you next time on retire with style.

Briana Corbin 48:53

Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, 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 the risk, including Risk of Loss past performance does not guarantee future results.