



## THIRD QUARTER PERSPECTIVE July 6, 2010

While the first quarter of 2010 continued the stock market gains seen in 2009, the quarter just ended put the market in negative territory for the year. The S&P 500, a proxy for large US companies, fell 11.9% this quarter, for a year-date return of -5.71%.

Bob Veres has written a good piece on how to put volatile markets in perspective; we're sharing that with you below. Bob is an influential financial industry journalist whose newsletter for advisors, *Inside Information*, is a must-read in this office. Bob's writing for consumers now, and we're delighted to share his work with our clients.

We've also included piece on Social Security benefits. If we won't see you in the next few months, best wishes for a wonderful summer! -- Karen, Joe, & Therese

### The Hidden Source of Returns

The biggest problem with investment returns is that they're posted daily -- or, in the case of the recent "flash crash," every hour or so.

Why is this a problem? Because it implies that what happened yesterday or the day before is meaningful to your financial life, and is important information for future investment decisions. People all over the world struggle with figuring out the relevance of last week's or last month's or last quarter's investment returns, and the cable investing channels and newspapers feed the confusion by trying to explain yesterday's downturn in terms of housing or unemployment data, and project tomorrow's returns based on interest rates and earnings reports.

If you're one of those people who checks the market regularly and can't quite find the meaning of all this short-term information, then this is a good time to relax. Because there IS no meaning to be found there.

At all times, there are three forces guiding the markets. The first is long-term economic growth. Global businesses are gradually expanding their operations, opening up new markets, learning to manufacture and service their customers more efficiently, creating new products. With billions of new customers emerging in India, China, Indonesia and elsewhere, and new technology improving the efficiency of building, tracking, servicing, managing and everything else, this trend has been generally upward since people first squatted in caves around a wonderful new invention called the campfire.

The industrial revolution, the information revolution, and whatever new revolution the Internet and iPhone are a part of are accelerating this long-term business trend, which is invisibly making you money in your portfolio every day you stay invested.

The second force is the economic cycle, which moves from robust growth back to recession back to robust growth in a round-trip gyration which can last anywhere from months to years. Economists have felled whole forests trying to explain the hows and whys of these fluctuations, but most of us instinctively understand what it means to become overextended, pulling back, tightening our belts and then moving forward again. No human activity can be graphed as a flat line.

The only important thing to realize about economic cycles is that they are generally subservient to the longer-term cycle. Throughout all the ups and downs and sidewayses, the world economy has experienced net long-term growth ever since those first campfires.

The third force is investor emotions, which are by far the most volatile element of investment returns, and can change hourly, daily, weekly, monthly. You know these on a personal level; it's what you feel when you see the market go into the "flash crash" freefall, or a year and a half ago when the markets suddenly realized that the demise of Lehman Brothers -- a company which helped finance the Civil War -- was a scary event. That urge you feel to sell everything and make the anxiety go away is shared by roughly a billion other investors around the globe, who conspire, unconsciously but powerfully, to rock the markets like the ocean waves in a storm. Even on good days, these waves are rolling around powerfully enough to make TV analysts think they can find meaning in them.

But that's the point: studying the waves, studying what happened yesterday or last quarter, tells you nothing at all about the long-term viability, health or growth of the companies in your investment portfolio -- despite what Jim Cramer happens to be screaming today. You might get equally-valid information looking at the patterns of tea leaves or the markings on the back of tortoise shells.

That doesn't mean the waves have no impact on investments, however. The great investors, like Warren Buffett, look for those times when a billion investors are pushing the panic button, and take advantage of stocks selling at bargain prices. Thousands, perhaps millions of investors had to sell during a lot of panics to make Warren Buffett a billionaire, and in his annual shareholder meetings, he acknowledges this. The waves go in the opposite direction as well, taking prices well out of the bargain zone.

Through it all, the long-term trend is quietly making you money, moving us toward a future day when people will look back at us the way we look back at people who lived at the dawn of the Industrial Revolution. They will wonder how we could get so excited about (or scream on TV about) all these little ups and downs while the economy was steadily, visibly, reliably carrying us to a better place. -- Bob Veres

## **Social Security Retirement Benefits**

We find that Social Security benefits play an important role in most of our clients' retirement projections -- even for clients with large pensions or net worths, a close-to-guaranteed income stream that rises with inflation is a very valuable asset.

I attended a presentation on Social Security benefits recently, given by Andy Landis to a group of CPAs. Andy's a national-caliber speaker on this topic who happens to live in the Seattle area -- we're lucky to have him. Andy went through his usual great presentation (if anybody is looking for a speaker on this topic I highly recommend him). Each time I hear him speak, I learn something new; here are a few items I picked up this time.

**Do you get your money back?** On the average, yes. If you sum the payroll taxes (both the employer and the employee portions) paid into the Social Security system over the average worker's lifetime, and assign them a conservative rate of return (appropriate for a pretty-much-guaranteed income stream like Social Security benefits), you find that the average worker gets his/her contributions and earnings back in the form of benefits in about 11 years. Since the average worker draws Social Security retirement benefits for 17 years, he/she comes out ahead.

**What's the Viagra college fund?** According to Andy, that's what people are calling the benefit that's paid when older parents draw their Social Security retirement benefits while they still have minor children. When a worker draws their retirement benefit, any minor children also qualify for a benefit (50% of the parent's monthly check), as long as the child is:

- unmarried and under age 18, or

- age 19 and still in high school, or
- age 18 or over and became severely disabled before age 22 and continues to be disabled.

**How do the earnings limits work?** As you may know, there are limits to how much you can earn while drawing your Social Security retirement benefit before the latter starts being reduced. These limits apply only if you're drawing benefits before your Social Security-defined Full Retirement Age (FRA). Your FRA is somewhere between ages 65 and 67, depending on when you were born; once you reach that age, you can earn to your heart's content, with no benefit reductions.

However, if you draw before your FRA, earnings matter. The formula is: for every \$2 you earn above \$14,160 (the 2010 limit) in a year, your Social Security benefit is cut by \$1. For every \$3 you earn above \$37,680 in the year you reach your FRA, your Social Security benefit is cut by \$1.

So how does this actually work? The Social Security Administration withholds your monthly check starting in January for as many months as it takes to reflect the reduction. For example, you'll get zero benefits for the first five months of the year, and your normal benefit for the rest of the year. This is important, because it plays into how Social Security calculates the age at which you started benefits. The system counts only the months where you actually got a check -- so if you start drawing benefits early (prior to your FRA), and benefits are later withheld because of your earnings, your start age is revised upwards -- benefits are not lost.

**When is it better to be divorced from rather than married to your spouse?** In the Social Security system, you're better off being divorced if you're not drawing on your own record but instead on your spouse's (which you would do if 50% of his/her benefit is more than the benefit you'd get drawing on your own work record).

Why? If you're divorced, you can draw on your ex-spouse's record when you reach age 62 as long as your ex is at least 62 (or any point thereafter). If you are still married to your spouse, you can draw on his/her record only once he/she has filed for and begun receiving benefits. Andy pointed out that the latter used to be the rule for divorced spouses as well, until the Social Security administration figured out that there were enough bitter workers out there determined not to draw benefits specifically to shut their exes out of the system.

**Strange, but True.** We've included a short piece by Boston College's Center for Retirement Research that succinctly describes three Social Security claiming strategies that are unusual but allowable -- happy reading!  
-- Therese

## Shorts

- **Best Wealth Managers.** We have once again been named to Seattle Magazine's list of Five Star: Best in Client Satisfaction Wealth Managers (2010). While Seattle Magazine uses this list as a revenue-generating opportunity (the special advertising section is designed to generate ad sales from advisors), we consider it an honor to be named, as our inclusion is purely a function of clients nominating us. Thank you!
- **Staff news.**
  - For the third year in a row, Joe spoke to two groups of 5<sup>th</sup> year students at the UW. The students were just finishing up their Masters degrees in Tax or Auditing; Joe talked to them about basic financial planning principles.
  - Therese spoke to the Seattle chapter of the Washington Society of CPAs in March on Roth conversions. She also taught the Retirement Planning day of a five-day CFP Live Review class, designed as a power-study session for students taking the Certified Financial Planner exam next month. The Live Review was offered at South Seattle Community College, using materials developed by the College for Financial Planning (the financial planning alma mater for all three of us).

# STRANGE, BUT TRUE: UNUSUAL STRATEGIES FOR CLAIMING SOCIAL SECURITY BENEFITS

Social Security offers three distinct types of benefits for retired workers and/or their spouses: 1) the basic *retirement worker benefit*, which is determined by how long an individual works and how much he earns; 2) a *spousal benefit*, which provides a worker's spouse with a benefit once the worker has claimed his own benefit; and 3) a *survivor benefit*, which provides a surviving spouse with a benefit after a worker's death.

The full retired worker benefit (also known as the Primary Insurance Amount or PIA) is available at a worker's Full Retirement Age (FRA), which is currently 66, but will rise to 67. Individuals are allowed to claim a smaller benefit as early as age 62 or a larger benefit by claiming after the FRA up to age 70.

This document describes three unusual, but allowable, strategies for claiming Social Security benefits. These strategies *may* allow some households to receive increased lifetime benefits, depending on their specific work histories, personal preferences, demographic characteristics, and mortality. On the other hand, these strategies could result in lower lifetime benefits, depending on how long the claimant lives.

## STRATEGY 1: BORROW AND INVEST

An individual can claim Social Security benefits at, say, 62 and then reclaim at, say, 66 at a higher benefit level as long as he

pays back the money that he has received — without interest — during the interim period. This strategy is the same as receiving a zero-interest loan from Social Security. The claimant could invest his Social Security benefits, keep the investment earnings, and then later pay back the principal of the "loan." The claimant, with an average life expectancy, comes out ahead by the amount of the investment earnings. Of course, should the claimant die shortly after giving back the benefits, this strategy would involve a loss.

According to the Social Security Administration (SSA), this approach is allowable. The claimant files a SSA Form 521 and repays the amount owed. When the form is accepted, SSA treats the individual as if he had never filed.

This claiming approach had its origins in the case of an individual who initially claimed benefits in 1957 and later requested that she be allowed to re-file in 1964 in order to obtain a higher monthly benefit based on her more recent work history and older filing age. The Social Security Administration granted this request on the grounds that it was in the best interest of the claimant to rescind the original claim. It was not specifically intended to allow "zero interest" loans, but instead to allow for the possibility that changes in an individual's circumstances could cause her to reconsider an earlier claiming decision.

## STRATEGY 2: CLAIM NOW, CLAIM MORE LATER

A married individual can claim a spousal benefit at the Full Retirement Age (FRA) and switch to her own retirement worker benefit at a later date. This approach allows a worker to begin claiming one type of benefit while still building up delayed retirement credits, which will result in a higher worker benefit later.

Take, for example, a two-earner couple in which the husband is four years older than the wife and the husband and wife have similar expected full retirement benefits. Once the husband claims his benefits and the wife has reached the FRA, she files for *only* a spousal benefit. The wife then continues working and contributing to Social Security. At age 70, she files for her own retired worker benefit, which has now reached its maximum amount due to the delayed retirement credits. At this point, she stops receiving the spousal benefit and switches to her own benefit.

According to the Social Security Administration, this approach is permitted for individuals who have reached the FRA. Individuals who have not reached the FRA are not allowed to limit the scope of their benefit application in this way.

This claiming strategy was authorized by the Senior Citizens' Freedom to Work Act of 2000. The intuition is that, by allowing a worker to claim some benefits immediately while she is still working and building up delayed retirement credits, such a provision may help encourage older individuals to work longer.

## STRATEGY 3: CLAIM AND SUSPEND

An individual may claim his Social Security benefit and then suspend payment in order to allow his spouse to claim a spousal benefit while still allowing the value of his own future benefit to increase.

A spousal benefit is equal to half of the retired worker's PIA, assuming that both the spouse and the retired worker have reached the FRA (claiming earlier will diminish the amount of the benefit). The wife cannot claim a spousal benefit until her husband claims his retired worker benefit. However, the husband may prefer to delay retirement, thus increasing his eventual benefit. By claiming and then immediately suspending payment of his benefit, he enables his wife to receive a spousal benefit while also increasing his own future benefit — as well as his wife's survivor benefit should he be the first to die.

This claiming strategy was authorized by the Senior Citizens' Freedom to Work Act of 2000, which allows a worker to earn delayed retirement credits after filing for benefits if he requests that he not receive benefits during a given period. The intuition is that, by allowing a spouse to claim right away while allowing a worker to continue building up delayed retirement credits, such a provision may help encourage older individuals to work longer.