▶ Should I Take My Social Security Early, Or Wait? 1-5

▶ Message From The Investment Team 6-10

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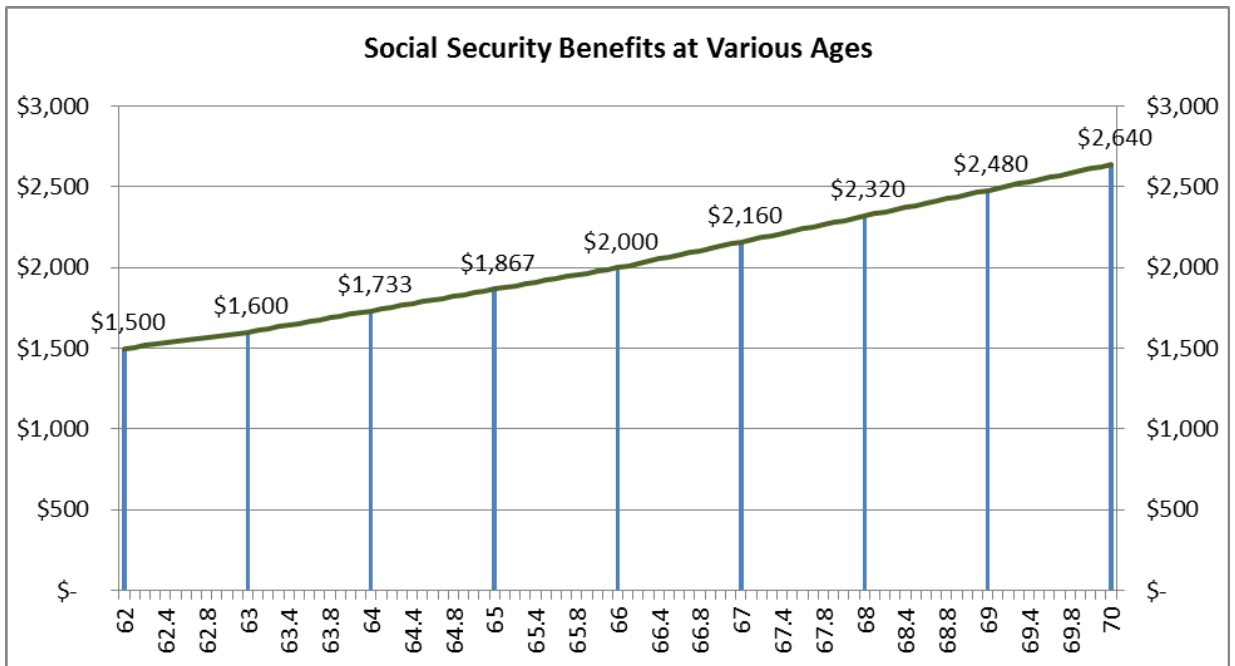
FOCUSED ON WHAT MATTERS MOST.

Should I Take My Social Security Benefits Early, Or Wait?

Of all the decisions a potential retiree makes, when to take social security ranks as one of the most important. Over time, the decision to take early, on time, or late can result in tens of thousands more, or fewer, benefits received. The calculation of social security benefits is pretty straightforward: benefits at full retirement are based on your average monthly earnings during the 35 years in which you earned the most and you need to have worked for at least 10 years to qualify. If you take them earlier than your full retirement age, your benefits will be permanently reduced a fraction for each month earlier, which adds up to around 5-6% for each year. Conversely, if you take them later they will be permanently increased a fraction each month, adding up to 8% for every year you delay. For a person with $2,000 per month in benefits at full retirement age 66, the amounts for taking early and late are:

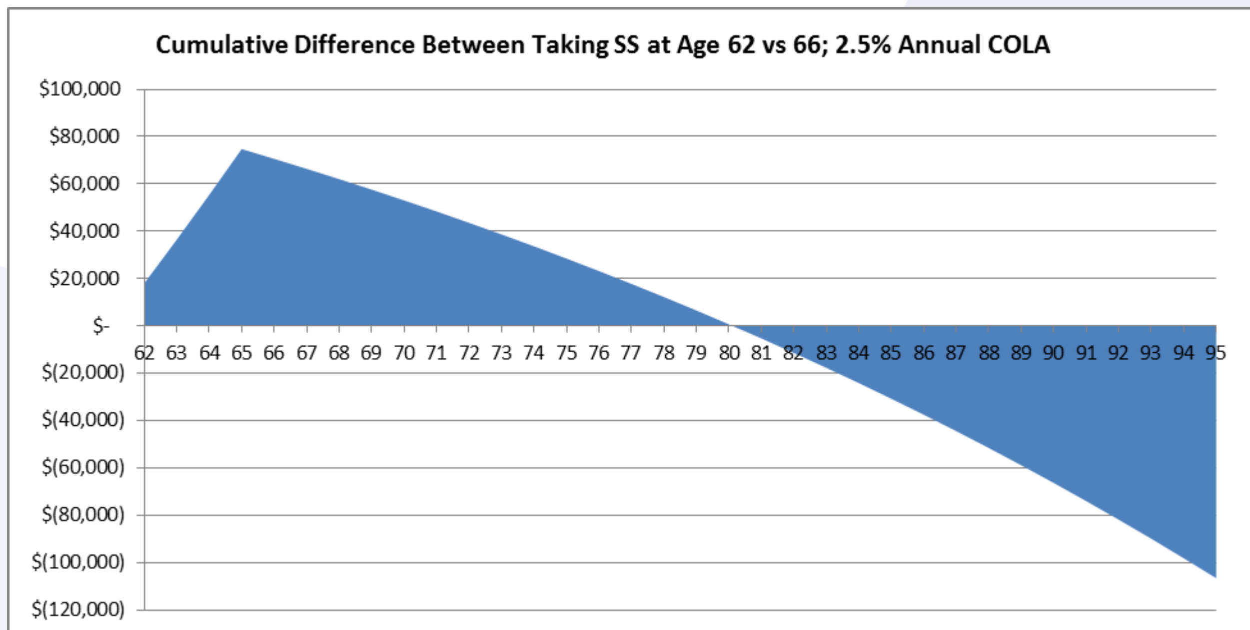


When deciding when to take your social security benefits, calculating them is not the difficult part; it's all the other factors to consider that complicate things.

Break-Even and Longevity

The age at which the cumulative benefits received after waiting equals the cumulative benefits received by taking earlier is known as the "break-even point". If you took $2,000 per month benefits at age 66, how old would you be when the aggregate of all those received benefits would equal the benefits you'd have received if you had taken $1,500 in monthly benefits at age 62? Taking no other variables into account, the answer to that question is age 78. For the example above, both taking at age 62 and waiting until age 66 yields $288,000 total benefits received through age 77. After that point, the benefits from waiting would continue paying more every month and by age 92, you would have received $84,000 more by waiting. When you research this on the Internet, this is a very common answer, but it is also unrealistic as it ignores cost of living increases on the benefits.

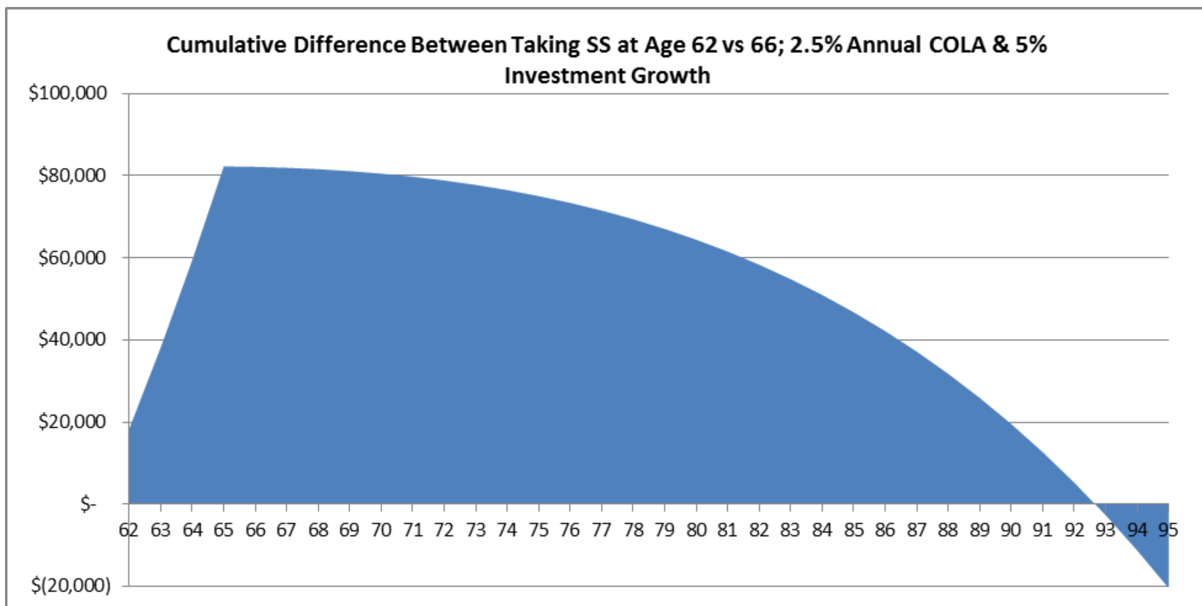
Social security benefits receive a cost of living increase most years. Over the past 20 years, that cost of living increase has averaged around 2.5% per year. Assuming your benefits would increase by that same average, then the early benefits would grow every year and the break-even age would be pushed back to right around age 80.



In this case, you would have to live past age 80 to receive more in benefits from waiting than from taking them early. If there's a history of longevity in your family and you believe yourself to be in good health when faced with this decision, you might be more inclined to wait, though potential longevity is only one thing to consider.

Will taking the benefits prevent you from withdrawing from your investments?

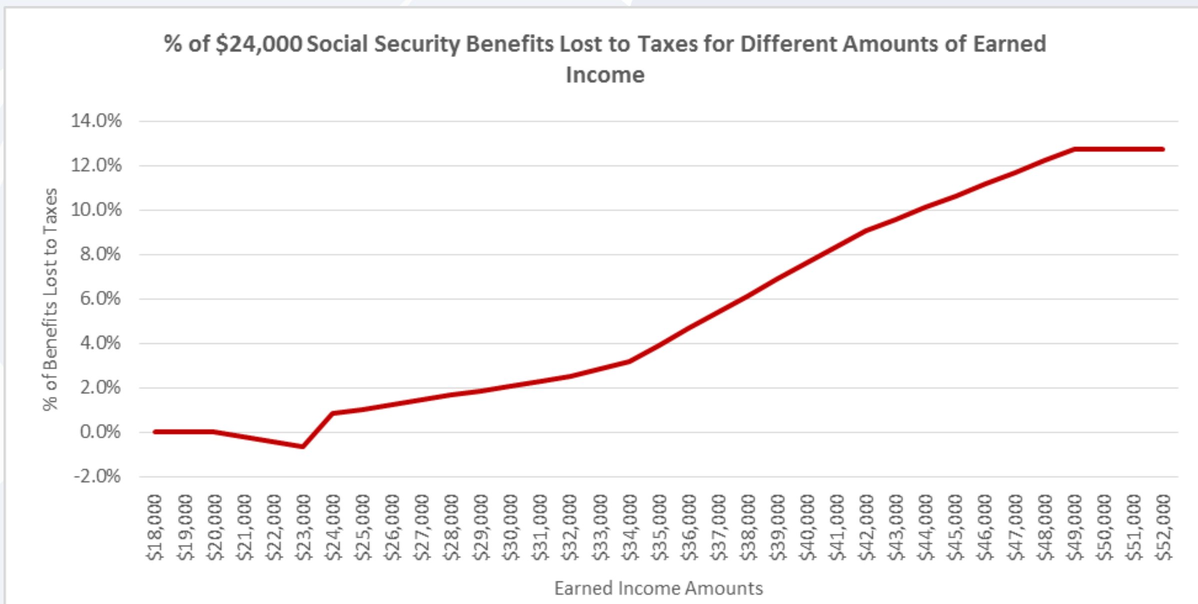
Taking cost of living increases into account pushes back that break-even point over two years. Fewer and fewer people retire these days with additional sources if retirement income, like pensions, and they are left with the choice of taking their social security benefits or liquidating their retirement investments to meet their monthly spending needs. If you choose to take your social security and therefore withdraw a smaller amount from your investments, and if those investments left in your accounts average a 5% return over the first 25-30 years of your retirement, then the break-even point between taking at 62 and waiting until 66 gets pushed back even further, all the way past age 92.



How many people out there are willing to assume they'll live that long to make waiting pay off? If taking benefits will allow more or your investments to grow, you may opt to take them early. Likewise, if you do not need to take them to fund your lifestyle and would be able to save 100% of those benefits, you may also be inclined to take them early and add them to your investments. If there were no other factors involved, most people would probably take benefits as early as possible because it would either allow investments to continue growing, or the benefits themselves would be saved and added to those investments. However, there are certainly many other important factors to consider.

How much will the benefits be taxed if the other spouse is still working?

If both spouses are retired and neither has a pension, the chances are income taxes will be very low. However, if there is a consistent, taxable source of income being received, the taxes taken on the social security benefits may make waiting beneficial. If one spouse received $2,000 per month in benefits, and the other spouse worked and received less than $22,000 per year in earned income, they would pay an estimated $0 in federal income taxes (in this example they'd actually get a slight refund). However, were the earnings higher than that, social security benefits would start being lost to taxes and once the working spouse was making $49,000 or above, 85% of the social security benefits would be taxable. If this couple were taking a standard deduction, this would result in nearly 13% of those social security benefits being paid out in federal income taxes; lost forever, essentially.



If those benefits weren't needed to fund your lifestyle, and if they weren't preventing investments from being liquidated, it may make sense to wait until the other spouse retired. In addition to not losing any of the benefits to taxes, they would also increase by roughly 8% every year until taken, assuming the retired spouse is 66 or older.

Much depends on just how much the working spouse makes, and of course how much the retired spouse receives in benefits, but it does not take much income before social security benefits become taxable and therefore taxes should be taken into account when considering when to take benefits. In general, if the taxable income being received is a pension that will not be going away like a salary would, then taxes are much less a factor in the decision because waiting will not result in future lower tax brackets. As always, consulting with a tax professional is advised.

By this point, the factors influencing taking early verses later may have started to blend together, so before moving on, let's try and solidify what we've covered so far:

- Longevity. A history of longevity in your family may make you consider delaying.
- Investment Earnings. If taking benefits earlier will allow you to either save the benefits or allow you to leave more of your investments to grow, you may want to take consider taking early.
- Taxes. If your spouse is working and you'll lose benefits to taxes, you may want to consider delaying until your spouse retires, if possible.

How much will the benefits be taxed and reduced if the beneficiary is still working?

In addition to having to worry about income taxes due on the social security benefits, another way social security is effectively reduced is if the beneficiary has not yet reached full retirement age, is still working, and is also receiving benefits. For ages 62 through age 65 (assuming full retirement age of 66), social security benefits are reduced $1 for every $2 the recipient's salary is above $15,720 for the year. In the example we've been using, this means at age 62 if the recipient were making $51,720 or more, even though he or she had filed to take social security, in this case $1,500 per month, all of those benefits would be withheld, and a lower amount of social security potentially locked in forever.

In the calendar year a beneficiary turns full retirement age, that reduction formula changes and now there's a $1 reduction for every $3 earned above $41,880. Because of the goofiness of this particular calculation, that means the same beneficiary would have to earn between $63,000 and $90,000 for benefits to be completely withheld; the later in the calendar year your birthday, the more you can make and still receive benefits, again assuming you originally took $1,500 per month in benefits at age 62. The month the recipient reaches full retirement age, benefits are received in full. There is a double whammy to take into consideration – by taking early while still working, you may be locking in lower benefits forever as well as paying taxes on the benefits received.

There is a little bit of good news, though: Those withheld benefits may not be lost forever (save those paid out in taxes), as whatever was withheld starts being returned in higher benefit payments once the recipient reaches full retirement age.

What about where one spouse's benefits are based on the other spouse's benefits?

One provision of social security is if half of a spouse's benefits is greater than the full amount of the other spouse's benefits, the other spouse can forgo his or her own benefits and receive an amount equal to half of the other's amount. In order to receive spousal benefits, the other spouse must be currently receiving his or her own benefits. Just as a benefit recipient who takes benefits early sees his or her benefits permanently reduced, so too are the spousal benefits for any spouse taking before his or her own full retirement age: a spouse collecting spousal benefits at age 62 receives 35% of the other spouse's benefits, and only gets 50% if he or she starts collecting those benefits at

his or her own full retirement age. However, the spousal benefit will not be reduced if the other spouse started receiving benefits early too. (As an aside here, there are a lot of little ins and outs, aren't there? That's why it really pays to consider all of this before a single person in your household begins receiving any benefits.)

And, as mentioned in the section before, just like how the other spouse may have some of his or her benefits withheld if he or she is working while collecting, a spouse who is receiving benefits through that working spouse may also have his or her benefits reduced according to the same formula mentioned in the previous section, with one catch: if spousal benefits are reduced because the primary beneficiary is working, when that spouse retires the other spouse's reduced benefits for that time period are gone forever. Unlike the case where the withheld benefits get added back in over time to the primary beneficiary, they never get added back for the spouse. If you are receiving your own benefits and your spouse is working, only his or her benefits would be reduced for being over the limit; it's only in the case where both spouse's benefits are based on only one of them.

So. . . back to the original question: Should I take my social security benefits early, or wait?

A person is more likely to benefit from taking benefits earlier if:

- He or she definitely needs them to make ends meet.
- There is not a history of longevity in the family, or current health is poor.
- Income taxes will be low to nonexistent, and benefits will not be withheld.
- He or she feels like his or her investment portfolio will earn enough over time to make sense to keep investments growing instead of liquidating them.
- A spouse intends to take spousal benefits and the other spouse is planning on taking early benefits.

A person is more likely to benefit from taking benefits later if:

- He or she definitely does not need them to make ends meet, especially if the potential recipient is still working.
- There is a history of longevity in the family and current health is good.
- Income taxes are currently high but may be lower in the future, like if the recipient is still working, or his or her spouse is still working, but that income will eventually go away.
- He or she feels like his or her investment portfolio will not earn much over time.
- A spouse intends to take spousal benefits and he or she has not already reached full retirement age, and the other spouse is also waiting later to take.

As you can see, there are enough variables to consider that it's not an easy question, and going over the options with a financial planner ahead of time may allow you to get the most out of your social security benefits. While researching this piece, we were disappointed with just how many different sources of information seemed biased toward waiting to take benefits without ever factoring in things like cost of living adjustments, earnings on investment portfolios, and taxes. Waiting to take makes sense for some people, but taking benefits early makes sense to a lot of other people as well. We analyze the options for clients on a regular basis, and would recommend anyone approaching retirement do the same. This is not a one-size-fits-all decision.

Message from the Investment Team

The worst start to the year since the Great Depression. That's the headline that pretty much sums up the month of January for stocks. As we type this, the S&P 500 is down over 7% for the year which is certainly enough to get people wondering. Is this a normal correction or the start of something bigger? Only time will tell, but as we've been saying for a while now, we have to be prepared for that something bigger based on the circumstances. We're due.

To us, this record-setting month of January isn't really much of a surprise. Markets that set records on the way up are perfectly capable of setting them on the way down. A seven year bull market against the backdrop of a global economy that's struggling to grow isn't normal, but it's happened nonetheless due to the aggressive actions of central banks around the world. So what we're left with are markets that are still extremely expensive by historical standards and a global economy that looks to be weakening rather than strengthening. Prices of stocks, bonds, and real estate have risen under the assumption that economic growth could be resurrected by unprecedented amounts of money printing and rate manipulation. It's logical to expect that when markets come to the realization that the long-term health of the economy is no better off as a result, asset prices will come back down to Earth to better reflect the Main Street economy that well over 90% of the planet's population are operating within. As our loyal readers and clients know very well, we expect this outcome.

Before addressing our thoughts on where markets may be going in more detail, there have been two narratives out there in recent weeks that we'd like to address. The first is that the Fed raising interest rates by .25% in December is the cause of the recent market decline, making them responsible for it. Although one could make the case that they may be responsible for a good portion of the ultimate fallout, it's not raising rates by a smidge that's the problem. It's over 20 years of overactive monetary policy that implicates the Federal Reserve in the next financial crisis, just as it helped spawn the 2008 financial crisis via the proliferation of mortgage-backed securities and collateralized debt obligations. Keeping rates artificially low creates "do anything for yield" behaviors as savers and conservative investors struggle to keep pace with inflation and generate income to live on. Depriving them of this

opportunity is borderline criminal, but that's a discussion for another time. So although the Fed raising rates by a quarter of a percentage point may not have helped markets the last few weeks, it's not the reason stocks will ultimately fall. They'll fall because of what the Fed's done over a much, much longer period of time. Raising rates was a step in the right direction and if such a small step toward a more normal and fair financial system for all causes such big problems, then it's time those problems get dealt with.

Second, we've heard market pundits proclaim that if it weren't for oil declining so precipitously, then stocks would be fine and that as soon as oil stabilizes, stocks can move upward once again. Although there's no doubt that stocks and oil have been in virtual lock-step over the last few weeks, it's not logical to assume that stock's decline is solely because of oil. If that were the case, then stocks would be down 35% since May of last year just like oil. They're not. What's most likely happening is that oil's decline is a reflection of both oversupply due to the incredible debt-fueled capital investment in exploration and production in recent years and the slowing demand for oil due to decelerating and in spots, contracting economic conditions. These realities have not yet been reflected in equity markets to any meaningful degree, but what we're witnessing may be the early stages of that. So yes, both oil and stocks have been moving together, but not because one is necessarily tethered to the other. It's because their prices are both reflecting the soft conditions that abound – albeit one may be temporarily getting its clues as to that reality through the other.

> ***"What we've seen in oil feels eerily similar to what we saw in home prices in 2005 and 2006 where they preceded the financial market declines."***

What we've seen in oil feels eerily similar to what we saw in home prices in 2005 and 2006 where they preceded the financial market declines. Homes were at the center of the debt frenzy back then since mortgages were so easy to obtain. (For a great run-through of that, we recommend the movie The Big Short, which through some humor and likeable characters, found a way to explain the whole mortgage-fueled financial crisis amazingly well). This led to tremendous over-investment in new and existing homes that was fueled almost entirely by debt. We know how that ended. Home values fell and ultimately investments linked to those homes fell, bringing down entire markets. Much the same way cheap debt made its way to real estate, so it has found its way into the oil and gas industry. An industry with so much promise due to new fracking technologies and our desire for energy independence, new companies formed, acquired heaps of cheap financing via debt, and added new production to the oil and gas markets. The result was overinvestment which has contributed to over-supply, the decline of energy prices, and credit tightening.

Energy prices began their decline the middle of 2014, and debt costs began rising for most of these lower rated exploration companies at about the same time. Over the last 18 months or so, oil has declined over 70% while credit/debt financing for the average below-investment-grade company has risen from around 8% to over 19%. This will likely have broader market implications. Although probably not on the same scale as the mortgage bond crisis 10 years ago, there's no telling what type of knock-on effects it may have. Again, it's eerie how the two rhyme in terms of their making and timing relative to broader markets. This is certainly something to watch.

So back to the bigger picture for stocks. There are two assumptions we're making in concluding that markets will move significantly lower relatively soon. As always, timing is impossible to predict since there are unknowable factors that drive markets in the short term, and as has been the case with central banks, over the longer term as well. But since our outlook suggests that when asset prices move south, they'll move significantly below current levels, timing becomes relatively moot. Our first assumption is that the economy won't speed up materially over the next 2-3 years and thus won't catch up with market valuations. Given the inability of aggressive and global monetary policy to create meaningful growth over the last seven years, we have absolutely no reason to believe it will suddenly start working. Expecting so fits the definition of insanity almost perfectly. In fact, in spite of all of this monetary juice being fed (pun intended) to the financial system, we're seeing significant slowing in the manufacturing and industrial sectors which could well feed into the service sectors of the economy. The bottom line is that the economy locally and globally is weak and getting weaker. The gross domestic product growth of .7% just released for the fourth quarter of 2015 very much supports this point of view.

Our second assumption is that financial markets today won't work any differently than they have over the last 150 years or so. We're not that special. The laws of sound money may get ignored for a bit, but they don't disappear forever. As has been the case during other periods of excess, measured by extensive debt buildup and lofty asset prices, the pendulum will swing in the other direction. There are limits to everything, and although the details of every business cycle are different, the laws of sound money are everlasting. Pay too much for something and you will need to wait much longer before realizing a positive return. At present, even after the declines seen over the last few weeks, most "risky" assets are still priced far too high given historical norms and the weakening economic backdrop.

As poor as stocks have performed this month, it's important to keep in mind that some of the sharpest rallies (positive return stretches) occur within declining markets. In other words, prices don't move straight down. It's these strong bounces off newer price lows that keep investors thinking that the bottom is in and that stocks will resume their upward march. Given the big picture circumstances laid out above as well as the weakening market internals we've talked about in recent months, it's likely the market peak is behind us and that any recoveries will

be short-lived. With that in mind, we feel investors should do two things. First, take a more conservative approach within their portfolios or prepare to extend their investment timeframes to adequately account for poorer market returns over the next 5-10 years. Second, incorporate active investment management into your portfolio to take advantage of some of the ups and downs that take place over the coming months and years.

As an example of how active management can help an overall portfolio weather difficult periods, our in-house Market Trend and Contrarian strategies are up over 3% and 1% respectively in 2016 while the S&P is down over 7%. This positive performance won't happen every time the market is down, but it demonstrates how strategies that are designed to have low correlation to stocks and bonds can help an overall portfolio preserve principal in tough times. Limiting losses is integral to achieving good long-term performance as the more money one has to invest at lower price levels, the shorter the wait until positive returns are achieved.

Summary

So we should expect continued volatility in markets over the coming months as we transition from an upward trending market to something that may look quite different. That transition, should it play out from here, will be bumpy with all sorts of ups and downs. History has shown that this is not a time to take on traditional risks within your portfolio strategy, but rather to focus on preserving principal, measure risks very carefully, and use rule-based strategies to help navigate the ups and downs in a way where risk is being managed. As cheap as certain investments look at the moment, there's a good chance they'll get even cheaper based on where we've come from and where we still need to go from a historical perspective. (See chart below). For those who've stayed disciplined over the last couple of years and haven't chased returns, you're seeing the reward. Sometimes it takes a while, but it's almost always worth it – for our clients, you know what we're talking about. Stay disciplined and stay patient. We're not surprised by January's poor showing. Expect more months like this one.

From a historical perspective, the recent declines have done very little in getting us back to a reasonable valuation level.

Key Takeaways:

- January's market drop of ~7% for the S&P 500, although historically large, should be expected given the uncharted territory we're in. Expect and plan for more months like this.
- Nothing over the short-term such as the Fed rate hike in December or the decline in oil prices is responsible for the stock market drop. Stocks are historically very expensive against the backdrop of a weakening global economy. They will eventually decline regardless of any other short-term actions or influences, simply based on how lofty they've become over the years.
- Prepare for more volatility and the possibility that a long-term market top has already been reached by reducing exposure to stocks and other risk assets, extending your investment timeframe, and employing rules-based strategies into your overall investment game plan.

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