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Wrong Reason #2 To Take Social Security Early

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Investing

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Some people start benefits at 62 in order to invest the cash. Dumb.

Get the money now and invest it. You can make enough on your portfolio to come out ahead of someone who waits.

That's what a lot of people tell themselves in starting Social Security at 62 rather than at 70. I think they're making a big mistake. They're doing the math wrong.

Before we get into that math, please note that this discussion is for people who have ample retirement savings and are trying to get the most mileage out of them. If you are about to take Social Security early because there's no other way to cover your living expenses, go to the other story, **Wrong Reason #1 To Take Social Security Early.**

There are two things going on when you delay benefits. One has to do with lifespans. Late starters collect for a shorter period. The other has to do with the time value of money. A dollar delivered today is worth more than a dollar delivered a year from now.

If your lifespan were the only matter the arithmetic would be fairly straightforward. Let's say you can expect to live to 86. Start at 62, the earliest option, and you'll collect for 24 years; start at 70 and you collect for 16. Waiting makes sense if your benefit is incremented by at least 50%.

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Which it is. People born before 1955 get a 76% boost for waiting eight years. The boost is slightly higher for people born after Jan. 1, 1955.

The time value complicates matters. It means you need something better than a 50% bump-up to justify waiting, since dollars collected early can be invested.

Here's where people mess up. If they expect to earn, say, 6% on their brokerage account, then they think that 6% is the right discount rate at which to compare a delayed Social Security dollar with an immediate dollar.

Not just amateurs make this mistake. No less an expert than Michael Kitces, who analyzes strategies for financial planners, makes the mistake in his discussion of Social Security timing. "The discount rate for financial planning strategies should be the long-term rate of return being assumed in the financial plan itself," he says.

That's not right. The present value of a stream of federal government payments is not determined by the rate of return you hope to earn elsewhere. It's determined by the rate on triple-A paper—specifically, inflation-protected paper, since benefits are adjusted for the cost of living. Your right to collect Social Security is, in essence, a portfolio of TIPS.

Let's say that your benefit is $2,000 and that there's a 50-50 chance you or your spouse will be around to cash in the September 2037 check. The right to that check is, in effect, a zero-coupon TIPS with a maturity in 20 years and a face value of $1,000.

Accelerating your Social Security benefits in order to buy stocks is like cashing in Treasury bonds in order to buy stocks. That makes sense only if you sell your bonds for their fair market value. Turns out that when you accelerate benefits, you are in effect selling Treasury bonds for something like 85 cents on the dollar. This is a bad trade.

I have numbers to back up this assertion. At **What's Your Social Security Benefit Worth?** you can find a calculator with which to assess the discounted present value of your Social Security benefits. The calculator uses lifespans and interest rates to come up with two numbers, one for early claiming and one for late claiming. For most people, there's a huge spread between the two values. Late claiming beats the tar out of early claiming.

When you download the spreadsheet, it will be pre-filled with numbers for a hypothetical couple, a 60-year-old woman who is the high earner and a 62-year-old man who is the low earner. For this couple the strategy of claiming early is worth $959,000. Claiming late is worth $1,151,000. If they claim early in order to have cash on hand to invest, they start out throwing $192,000 down the drain.

Get the spreadsheet and put in your own numbers—ages, genders, health status and projected benefits at full retirement age (available from the Social Security Administration). You might instinctively lean toward early benefits if you don't think you'll live long. But it takes an unusual combination of factors to make early claiming rational.

A key point is that a low-earning survivor picks up your full benefit, including any increment you earned by waiting until 70 to start collecting. Because of that, *starting at 62 is likely to be a good move only if you are both (a) sickly and (b) not married to someone with a weaker earnings history*.

Now let's get back to Kitces's point about what you expect to earn from your retirement assets. What if you expect to get a terrific return from stocks? And let's suppose, for the sake of argument, that you are destined to get this return. Wouldn't it be a great idea to grab some cash between ages 62 and 69 and put it to work?

No, not if there are other ways to increase your bet on equities. Instead of selling your Social Security bonds at 85 cents on the dollar, find bonds you can sell at 100 cents on the dollar.

Bet you have some. Your IRA, for example, may include a bond fund or a target date fund that has bonds in it. For more exposure to the stock market you simply lighten up that position and put the proceeds into a stock fund.

Now let's imagine that you don't have any marketable bonds in your portfolio. You are 100% invested in stocks and you want to put your Social Security checks into yet more stocks. Right here we should pause and note that a 100% allocation to stocks at age 62 puts you pretty far out on a limb. But let's suppose that's where you want to be.

It still doesn't make sense to cash in your Social Security. You can boost your allocation to equities without selling Social Security assets at a 15% discount to their fair value. Just go long some stock index futures—with, if you're a daredevil, a notional amount equal to half your portfolio's worth. When you buy index futures you pay fair market value. There's no 15% haircut.

I'm not saying that an equity exposure equal to 150% of your net worth is a good idea for an oldster. I'm just saying that your investment plans don't alter the fact that it pays to wait for Social Security.

William Baldwin

I aim to help you save on taxes and money management costs. I graduated from Harvard in 1973, have been a journalist for 45 years, and was editor of Forbes magazine fro... **Read More**