

# FINANCIAL PERSPECTIVE



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CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

## Social Security—Its Future and Possible Fixes

*(Note this is a condensed version of Part III of a three-part series Ron wrote for the Medical Society newsletter. If you would like to read Part I (The Basics), Part II (Benefit Strategies), or a full version of this article, we have posted them in the Newsletter Section of our website at [www.PlanningVisionProcess.com](http://www.PlanningVisionProcess.com))*

A July 8-11 USA Today/Gallup Poll revealed that 60% of non-retired adults polled said that they didn't think the Social Security system will be able to pay a benefit when they retire. And 75% of those 18-34-years old don't expect any benefits at retirement. Of those retired, 56% thought that their benefits will eventually be cut.

These anxieties have been brewing for some time now, but a news release in June by the Congressional Budget Office (CBO) probably heightened them.

According to the CBO, Social Security payouts in 2010 will exceed payroll taxes. This happened before in 1972 and 1983. This wasn't supposed to happen again until 2016. With such a high unemployment rate, it is no wonder. We simply have fewer workers paying payroll taxes. Some decided to apply for benefits earlier than planned, and others have tried to claim disability. **In reality, the Trust Fund will actually have a \$91 billion surplus when US Treasury bond interest and all sources are included.**

### 2010 Projected Income, Outgo, and Ending Balance

*(In Billions, with rounding)*

Total Income	From Payroll Taxes	From Interest & Other Sources	Payouts	Surplus	Ending Balance
\$799	\$642	\$157	\$697	\$91	\$2,594

*(Source: Congressional Budget Office)*

According to the just-released 2010 OASDI Trustees Report, The OAS fund can pay full benefits until 2036 without any changes to the program. **So, today's retirees and the baby boomers knocking on the retirement door are probably okay for the next 20 years.** Beyond that, changes need to be made, and the sooner the better.

### The Social Security Trust Fund

Before we get much further, let's take a look at the much maligned Social Security Trust Fund. In terms of assets to liabilities, it is in much better shape than it was in the boom year of 1999. As you can see by the table, the Social Security Trust fund has a surplus of \$2.6 Trillion. Where is it? What did it do with the extra cash? Put it in the mattress? Like many individuals, other government agencies (like the FDIC), and governments around the world, the Trustees invested it in one of the most secure investment in the world—US Treasury bonds. **If the United States had no debt, where could this surplus have been safely invested the past 75 years?** Unlike, an individual investor, it was prohibited from investing in stocks, corporate bonds, or real estate. Given how big money can buy political access, can you imagine how our stock and real estate markets would be distorted by the sheer size of the Social Security Trust Fund and the politics behind those investment decisions?

To fund benefit payments, the OASDI trust fund will gradually need to cash in its US Treasury bonds over the next 75 years. **The current \$2.6 Trillion represents 19% of the current \$13.3 Trillion US debt.** The other 81% is from everything else—defense, health, farm subsidies, research, education, foreign aid, etc.

### So what would it take to solve the problem?

To answer that, the OASDI Trustees are required to publish three simple statistics every year for Congress.

1. The amount of **cash infusion** that would be needed to build sufficient trust fund reserves. According to the 2010 report, the trust fund would require a cash infusion right now of \$5.4 trillion to pay promised benefits over the next 75 years. That's the present value of the difference between costs and income.
2. "The Actuarial Deficit." This is the amount the annual **payroll taxes** (currently 12.4%) need to be increased. For 2010, that amount is 1.92%, bringing the payroll tax to 14.3%. By comparison, it was 1.7% in 2008, 2.0% in 2009, and it has been higher and lower than 2% in other years.

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# It's Time for Some Economic Perspective

Well it's official. The so-called Great Recession officially ended in June 2009, according to the Bureau of Economic Research, a group of economists charged with analyzing this kind of data after all the final reports are in. For those who are unemployed, for those who know an unemployed person, and for struggling businesses, the recession continues.

Based on the latest polls and the TV newscasts, there is about as much hand wringing and angst as there was one to two years ago. Is it really a recovery? Are we still in a recession? Are we going to experience a "double-dip" recession? Here's our perspective. (You can read a more detailed version with charts we emailed to our clients in early September at the news tab of our website: [www.PlanningVisionProcess.com](http://www.PlanningVisionProcess.com))

**The bottom line is that the economy isn't nearly as strong as any of us would like to see, but it is still growing.** Let's look at some facts rather than anecdotes that you may see in the news.

**Incomes:** They are higher, according to an August 2010 report by the Bureau of Labor Statistics. This is a way to get more income into the economy—give workers more money and ask them to work more hours.

**Consumption:** July GDP statistics provided by the Bureau of Economic Analysis show that personal Consumption Expenditures (money we spend on goods and services) had been declining but now are rising modestly.

**Jobs:** At its worst, the economy was losing over 700,000 jobs a month. Now we are gaining, according to the Bureau of Labor Statistics, August, 2010 release. But even then, that wouldn't be enough to lower unemployment. But the good news is that now much

of the job growth is coming from the private sector, rather than from the government.

**Trade:** The US Census Bureau and the July Baltic Dry Index show that Imports and exports are growing. In particular, the Baltic Dry Index, which tracks worldwide shipping, shows a major bounce in world trade.

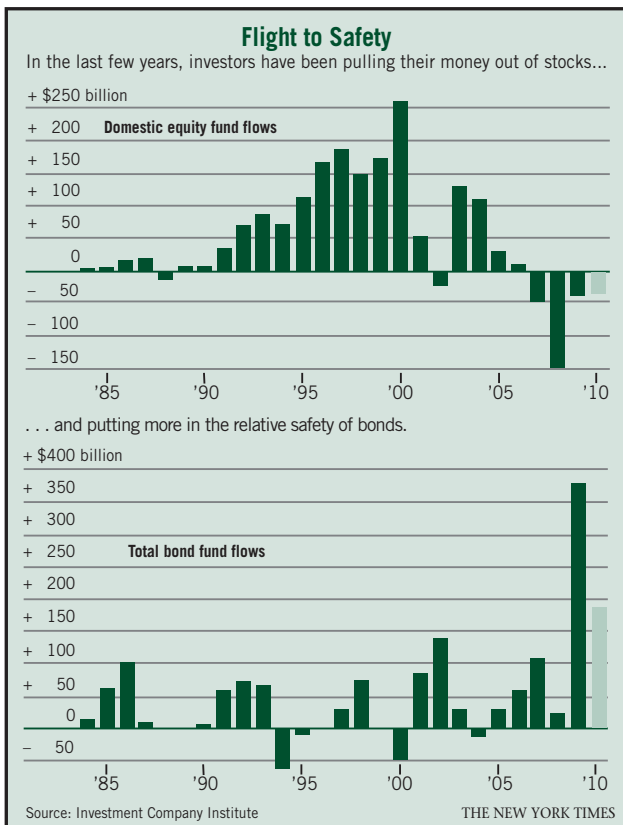
**Investment:** Capital Expenditures (business investments) are now rising, according to the Census Bureau and a July report by the US Commerce Department. Inventories are being rebuilt and productivity is rising.

**Industrial Production:** The Federal Reserve reports that new capital expenditures by industry are growing nicely. Many of these expenditures in technology and equipment make the workforce more productive and corporations more profitable. Much of the drive behind the huge early September rally was new data on a surge of manufacturing in the United States and abroad.

**Commodities:** The prices for the "stuff" we use (oil, steel, wheat, concrete, corn, gold, copper, etc.) are up across the board, according to the Commodity Research Bureau and Reuters. It's hard to have deflation when these basic goods are rising.

**Real Estate:** Unfortunately, real estate isn't rebounding as quickly as other indicators, but it is still trending up. The Standard & Poors/Case-Shiller home price index released August 30 posted a 1% increase from May to June and 4.2% over the past 12 months. Nationally, prices have risen 6% from their April 2009 bottom. In Portland, prices have risen this year, but they are still down 38% from the speculative peak in August 2007.

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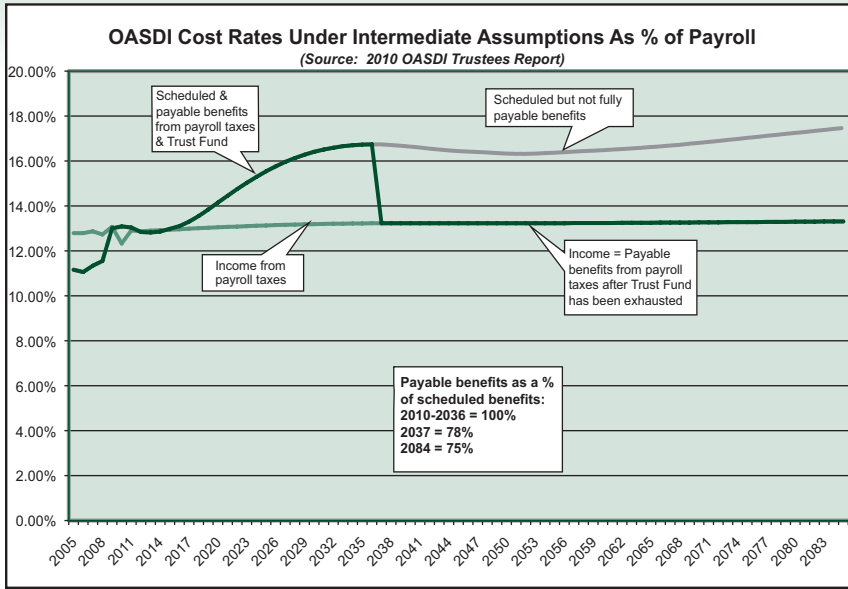


## Following the Herd

In recent weeks we have had the opportunity to review the recent trading history in several non-client portfolios. What we found were not necessarily bad investments over the past two years, but rather very costly emotional decisions of buying high and selling low.

One of our jobs as advisors is to keep our clients from following the herd. Right now, it seems like the average retail investor wants out of stocks and into bonds. But the herd is almost always wrong. Look at the year 2000 on the chart. That was a market top when every one moved money from bond funds to stock funds. Now look at 2009 and so far this year. They are bidding up the price of bonds while stocks remain a bargain, especially in the large companies with the strong profit margins and good dividends.

Meanwhile, a July 26 article in Bloomberg reports that the smart money—pensions and endowments—is spending more on stocks than at any time since the start of the bull market. The last time money managers and individuals were this far apart was at the beginning of 2009, before the Standard & Poor's 500 Index began its 63% rally, according to Bloomberg. By the way, we are not perpetual bulls or die-hard proponents of stocks, but rather advocates of reasoned judgment and not following the herd. As fee-only advisors, we get paid the same whether our clients are in stocks, bonds, or cash. We follow a disciplined system, not the herd.



3. The amount of **benefit cuts** to match income. The 2010 report shows that benefits would need to be cut by 12.0%.

**It will probably take a combination of measures. They basically boil down to raising taxes or lowering benefits.** We have a more detailed analysis of 10 possible fixes in the News section of our website at [www.PlanningVisionProcess.com](http://www.PlanningVisionProcess.com).

One fix that is getting traction is to increase the limit on taxable earnings beyond \$106,800. The American Academy of Actuaries estimates that removing the limit entirely would eliminate the whole deficit and leave a small surplus.

**No matter what combination of fixes, there will be winners and losers, and that is why the problem is so politically difficult.** As the CBO pointed out, every year of delay equals higher taxes and lower benefits for the future. It's also another way to pass our problem down the road for our children and grandchildren.

**Social Security will be there for today's retirees and boomers; perhaps in a slightly different form than as we know it today. But in the end, whether it is through payroll taxes, income taxes, or savings, all that will be there for tomorrow's retirees will be what they (or their children) send on ahead.**

## Make the Most of Your Social Security Choices

When the parents or grandparents of today's baby boomers applied for Social Security it was no big deal. They just did it and started receiving checks. The program was very simple back then. Gradually, benefits improved and things got very complicated (and expensive for the system!). Now, regardless of your income or other assets, Social Security planning is an important part of retirement planning. Many of the planning opportunities revolve around married couples.

As you can see by the table, there are many possible age and income situations and several strategies. Before signing up for Social Security, meet with us to learn about all your options in the context of your overall retirement planning. Applying the appropriate strategy could potentially save you thousands of dollars over your lifetime.

Age & Income Combinations	Some Possible Strategy Combinations
Both are same age	• Claim spousal now
Different ages	• Use own record now
PIA* is same	• Claim spousal later
Older spouse higher PIA	• Claim & suspend
Younger spouse higher PIA	• Claim twice
Spouse is divorced	• Take early & invest
Spouse is a survivor	• The "Do-Over"
One or both keep working	• Earn Delayed Credits
	• Keep working
	• Stop working

\*PIA = Primary Insurance Amount, or your projected benefit at Full Retirement Age (FRA)

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 42 years of combined experience. They are members of The National Association of Financial Advisors (NAPFA), and as such work on a fee-only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over \$500 million under active management.

### About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of three financial planning reference books. *Medical Economics* continues to list him as one of the 150 best financial advisors for doctors. He is Past President of the Rotary Club of Salem, chair of the Willamette Academy Advisory Board, and a founder and the past president of the Medical Foundation of Marion and Polk Counties. Ron is frequently quoted in the national press and professional journals.

### About Mary Way, CPA, CFP®

**Mary Way, CPA, CFP®** joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She sits on the Investment Policy Committee of The H Group, Inc., is Immediate Past President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation. She is also active in the Financial Planning Section of the Oregon Society of CPAs.

*The opinions expressed in this newsletter are those of Ron Kelemen, CFP® and Mary Way, CPA, CFP®. They do not necessarily reflect those of The H Group, Inc. They are general comments that may not be appropriate for every individual. They should not be construed as legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.*

# TEAM UPDATE



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Believe it or not, our last “quarterly” newsletter came out in May. So a lot of things have happened since then. Business has been growing, and we conducted many client update meetings. But we also took the time to smell the summer roses, and we hope that you did too.

Lani and Jim’s youngest, Caleb, was married in July, which means all 6 children are now on their own...mostly. Garden-wise, it’s been a great broccoli summer, but like every Northwest gardener resting in our summer rains, she might need some recipes for green tomatoes!

Debbie and Bob are just returning from three weeks in Italy with a couple of friends. They ate their way through Rome, Cortona, Tuscany, Vernazza, Venice, and points in between.

Mary just concluded her term as President of the Willamette Valley Estate Planning Council, worked more on the investment policies of the Salem Rotary Foundation, and completed a number of new planning cases. She and Steve had some fun times this summer out on their refurbished 20-foot Boston Whaler. They explored the Willamette River to the Columbia, crabbed several times in Newport, and enjoyed Detroit Reservoir with family.

Ron was featured in the business section of the *Statesman Journal* with an updated version of the Ten Lessons Learned article he had written for this newsletter last November. Much of his summer work days involved client update meetings and researching Social Security for a continuing education presentation he made to the Estate Planning Council. He also spent time on some new responsibilities for Rotary District 5100. He backpacked for a week in Colorado with his brother and nephew, and he and Kathy rafted the Rogue, visited their daughter Shanti for a week in London, and biked and boated the Danube River from Passau Germany to Budapest, Hungary.

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## It’s Time for Some Economic Perspective...*Continued from page 2*

**Corporate Profits:** Unlike late 2008 and much of 2009, corporate profits are up and the balance sheets are no longer a major concern. More importantly, the Bureau of Economic Analysis shows that profits are growing faster than the GDP.

**Global Issues:** The European sovereign debt crisis last May has calmed down. While Ireland is having major problems, Portugal floated a successful bond issue and the German economy defied the doom and gloom and has bounced back strongly. We still have our usual assortment of political and military crises to worry about—Iran, Afghanistan, Pakistan, Sudan, Somalia, Venezuela, the Middle East, and North Korea, to name a few. But you know what? We’ve always had them! If not these, then some other.

**The Financial Markets:** As we write this in late September, the stock market is responding favorably to many of the above indicators. Much of the favorable stock market performance so far this quarter has been attributed to beating expectations with earnings surprises from strong corporate profits.

### Another Recession?

The Organization for Economic Cooperation and Development forecasts a 4.3% worldwide growth in GDP for the year. Much of that is in Asia, but their forecast showed the US growing at 2.0% in the current quarter and then slowing to 1.2% in the fourth. This 2% isn’t much to brag about, but it is a positive number. Not every indicator is improving, and in some cases, such as auto sales, home starts, and job growth, we still have a long way to go. The above data and the charts we posted can be seen as half full or half empty. We prefer to view them without any political prism as half full.

**Based on the data we review, we believe that the odds of falling into another recession—the so-called “double dip” recession—are small. For this to happen we’d have to assume that all of the above growth trends stop, stabilize, and reverse.** Short of a massive shock to the system, it would take a lot of changes to make that happen.

We are just as impatient as everyone else for the recovery to go faster. But as we have said before, it took a long time to get into our economic situation, so this recovery will take time and we will experience setbacks. Nothing ever follows a straight line—a lesson hopefully everyone learned from housing prices.

We are experiencing an interesting time in American history. Never before have we been bombarded with so much intertwined economic and political information. We could all benefit from a little separation between the two, and from less time with the TV, radio, and the Internet. We hope you found this information helpful. We welcome your comments!