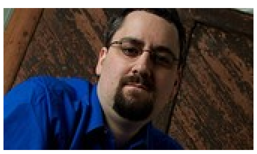
10:34 am
Nov 15, 2013 WEALTH MANAGEMENT

PREVIOUS
The Case for Buying Commodities as an Inflation Hedge

NEXT
Investors, Stop Listening to the Inflation Scaremongers

Delaying Social Security Is the Best Inflation Hedge



What's the best way for investors to protect themselves against inflation fears?

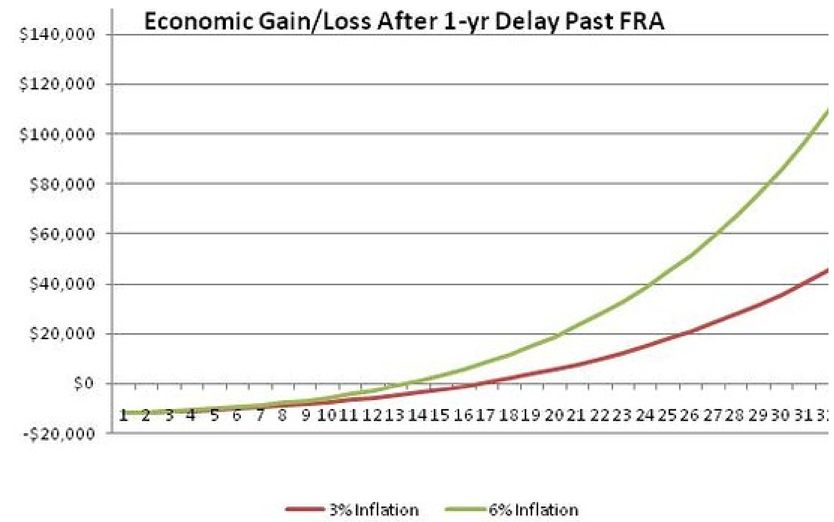
MICHAEL KITCES: Prospective and early retirees have a decision to make about when to begin Social Security benefits. They are eligible for a full benefit at normal retirement age, a reduced benefit for starting early, and can earn delayed retirement credits for starting later. In essence, every year that Social Security benefits are delayed, a trade-off occurs: Forego the money in your (in the form of benefits paid) for the upcoming year, in exchange for getting higher benefits every year thereafter.

The initial trade-off is relatively straightforward. For an individual who can get a $1,000-per-month benefit at full retirement age, waiting a year earns an 8% delayed retirement credit, making future benefits higher by $80 per month… in exchange for not getting $12,000 in pocket through the year ($1,000 per month for 12 months). Accordingly, if we make some assumptions about how that $12,000 could have been invested (or the $12,000 that could have stayed invested if retirement spending could have been funded from Social Security benefits), we can figure out how many extra $80-per-month payments it takes to recover the $12,000 (plus growth). At some point, there is a "breakeven" where the higher payments exceed what was given up initially; if you think you'll live past that point, the winning decision is to delay.

But there's an additional layer to the decision that's often forgotten: Social Security benefits receive an annual cost-of-living adjustment (COLA) to increase benefits for inflation. Which means delaying that $12,000 isn't just about getting an extra $80 per month. It's about getting an extra $80 per month *increasing annually thereafter for inflation*.

If inflation turns out to be 3% (and we assume growth is 6%), it takes about 17 years to recover the foregone $12,000 plus growth. By the 17-year mark, though, the "extra" payments are up to $132 per month (on top of the original $1,000-per-month benefit, which will have grown to $1,652 per month by that time).

If inflation turns out to be 6%, on the other hand, the breakeven is far different. Now it only takes 14 years to break even, and by that point the inflation-adjusted "extra" payments are *already* up to $181 per month!



Source: Michael Kitces, Nerd's Eye View

In fact, as shown in the chart, what we find is that the higher inflation turns out to be (or the worse the portfolio's growth rate), the shorter the breakeven period turns out to be, and the better the economic value of the decision to delay Social Security. Which means in practice, the decision for retirees to delay Social Security turns out to be a fantastic triple hedge–protecting against both unanticipated longevity (since payments continue for life), mediocre market performance and the risk of unexpected inflation.

Michael Kitces is a Partner and the Director of Research for Pinnacle Advisory Group, and publisher of the financial planning industry blog Nerd's Eye View. You can follow him on Twitter at @MichaelKitces, or connect with him on Google+.

Read the latest Wealth Management Report.

Read More From THE EXPERTS

INFLATION MICHAEL KITCES PROTECTION AGAINST INFLATION FEARS. SOCIAL SECURITY WEALTH MANAGEMENT

PREVIOUS
The Case for Buying Commodities as an Inflation Hedge

NEXT
Investors, Stop Listening to the Inflation Scaremongers

THE EXPERTS HOME PAGE

Email Print

Add a Comment

NAME

We welcome thoughtful comments from readers. Please comply with our guidelines. Our blogs do not require the use of your real name.

COMMENT

CLEAR POST

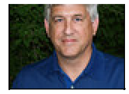
Comments (3 of 3)

View all Comments »

9:18 am November 18, 2013

carlyt wrote:

Delaying Social Security may be right for some people but not for all. It depends on your health,





Sheryl Garrett

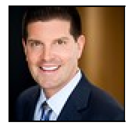

Michelle Perry Higgins

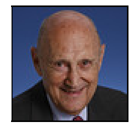

Frank Holmes

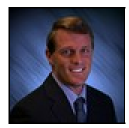

Matt Hougan

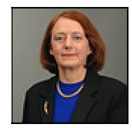

Michael Kitces


Erin Lantz


Christian Magoon

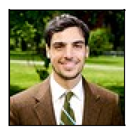

Burton Malkiel


Greg McBride


Olivia Mitchell


Terrance Odean

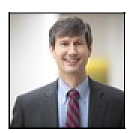

George Papadopoulos


Rafael Pardo

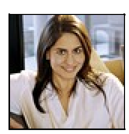

Mike Piper

John Rogers

Charles Rotblut



Gus Sauter


Meir Statman


Manisha Thakor


Alexa von Tobel

Larry Zimpleman

compares taking Social Security at 62 as opposed to 65 and 70. It takes a while for those taking later social security to catch up in payments. That site also has information on many other retirement related topics including fiance, health, retirement locations and more.

6:38 am November 18, 2013

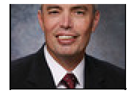
Vinny Belgrade wrote:

It really depends on your assumptions. If you can invest the “early” retirement money at a higher rate of return, say at 10% versus the inflation return of say 6% you come out ahead by retiring early. Also their is no guarantee, especially given the government’s poor finances, that inflation increases or the retirement ages will be reduced. You also have to live long enough to collect the benefits if you die before the collecting you get NO return.

10:40 am November 15, 2013

Jerry Ness wrote:

This article is true except for the fact that we don’t have any guarantees from G_D that we will live the 12.5 years extra to collect the initial 12000.



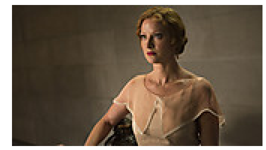
Popular Now

What's This?

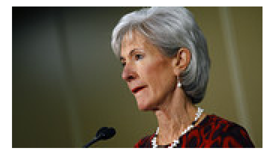
1 How Volvo Created the Jean-Claude Van Damme ‘Epic Split’…

2 'The Walking Dead' Recap, Season 4, Episode 6, 'Live Bait'

3 'Boardwalk Empire' Recap, Season 4, Episode 11, 'Havre De…



4 Paying the Costs of the Health Law’s Travails



5 Why We Still Talk About JFK

Show 5 More

Subscribe / Login

Back to Top

Customer Service
- Customer Center
- New! Live Help
- Contact Us
- WSJ Weekend
- Contact Directory
- Corrections

Policy
- Privacy Policy Updated 10/26/13
- Cookie Policy
- Data Policy
- Copyright Policy
- Subscriber Agreement & Terms of Use
- Your Ad Choices

Advertise
- Advertise
- Place a Classified Ad
- Sell Your Home
- Sell Your Business
- Commercial Real Estate Ads
- Recruitment & Career Ads
- Franchising
- Advertise Locally

Tools & Features
- Apps
- Emails & Alerts
- Graphics & Photos
- Columns
- Topics
- Guides
- Portfolio
- Old Portfolio

More
- Register for Free
- Reprints
- Content Partnerships
- Conferences
- SafeHouse
- Mobile Site
- Price & Volume
- Keyword & Symbol
- News Archive

Jobs at WSJ