The Economics Approach to Financial Planning

a Five-Part Presentation to Dimensional Fund Advisors

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Outline of Talks

1. Consumption Smoothing

2. MaxiFi Planner – Illustrating the Economics Approach

3 . Pricing Lifestyle Decisions – An Example: When Can I Retire?

4. Secrets to Maximizing Lifetime Social Security Benefits

5. Finding Alpha – Raising Households' Living Standards at No Risk

Introduction

- Social Security is the backbone of your retirement
- Social Security is likely your largest or second largest financial asset
- Most households are making major Social Security collection mistakes
- These mistakes cost them tens or hundreds of thousands of dollars

12 Secrets to Maximizing Lifetime Social Security Benefits

Secret #1

Know Thy Benefits!

Thirteen Different Social Security Benefits

Benefit	Old Age	Disability	Child Related	Parent Related	Death	Earnings Record	Comments
1 Retirement	✓					Own	"Social Security;" starting age 62-70
2 Spousal	✓					Spouse's	"Social Security;" starting age 62-70
3 Divorcee Spousal	✓					Former spouse's	"Social Security;" starting age 62-70; must not be married
4 Widow(er)'s	✓	✓	✓			Deceased spouse's	"Social Security" starting at 60; disability can start at 50
5 Divorcee Widow(er)'s	✓	✓	✓			Former deceased spouse's	"Social Security" starting at 60; disability can start at 50
6 Disability		✓				Own	Starts at disability

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Thirteen Different Social Security Benefits (cont'd)

Benefit	Old Age	Disability	Child Related	Parent Related	Death	Earnings Record	Comments
7 Child and Disabled Child		✓	✓			Parent's	For young or disabled children
8 Child-in-Care Spousal			✓			Spouse's	For parents caring for young or disabled children at home
9 Child Survivor			✓			Parent's	For a young or disabled child of a deceased covered worker
10 Mother / Father			✓			Deceased spouse's	For widow(er) caring for young or disabled children at home
11 Divorced Mother / Father			✓			Deceased former spouse's	For divorced widow(er) caring for young or disabled children at home
12 Parent	✓			✓		Deceased child's	For parents over 62 who depended on their child
13 Death					✓	Spouse / parent	One-time lump sum to spouse or child

Secret #2

Use Them or Lose Them

If you don't formally apply for a benefit, you won't receive it.

At most, you can restore six months of retroactive benefits.

Secret #3
Patience Pays

Inflation-adjusted retirement benefits at 70 are 76 percent higher than at 62.

When To Start Social Security?

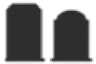
- When to start Retirement Benefits is a major decision
- People tend to use an investment framework
- Retirement Benefits are insurance
- Using an insurance framework can produce a different, and better, answer

Retirement Benefits Grow With Delayed Start

- Social Security benefits adjust based on start date relative to Full Retirement Age (FRA)
- Benefits before FRA are lower (there is a "penalty")
- Benefits after FRA are higher (you earn "delayed retirement credits")
- Alternatively, benefits increase with every year (actually, every month!) you wait after 62

	Annual Benefit		
Start Age	Steve	Tina	Percent Increase
62	15,065	23,821	
63	16,141	25,523	7.1%
64	17,217	27,224	6.7%
65	18,652	29,493	8.3%
66	20,087	31,761	7.7%
67	21,521	34,030	7.1% "FRA"
68	23,243	36,752	8.0%
69	24,965	39,475	7.4%
70	26,687	42,197	6.9%

Contingent Vs. Non-Contingent Resources

- Insurance payments are contingent on what happens to you:
    - Life insurance pays **if** you die 
    - Health insurance pays **if** you get sick 
    - Car insurance pays **if** you have an accident 
    - Homeowners insurance pays **if** your home is damaged 
- Stocks, bonds and CDs pay no matter what your status—they are not contingent on what happens to you

Social Security Is ~~An Investment~~ Insurance

- Do you do "breakeven" analysis on your car insurance?
    - The probability of an accident is very low (you are a good driver, aren't you?)
    - Even if you have an accident, it's most likely to be just a fender bender
    - Most years, you don't break even—your premium far exceeds your paid claims
- Just as you have car insurance to protect against unexpected accidents...
- ...Social Security benefits protect against longer life than you expect

Secret #4

Maximize Household, Not Individual Benefits

Each spouse's benefits can depend on the other spouse's claiming decisions.

Secret #5

Suspend Your Retirement Benefit

If you took your Retirement Benefit early, you can suspend it at Full Retirement Age and restart it at 70 at a roughly one quarter higher level.

Secret #6

Widow(er)'s and Divorced Widow(er)'s Benefits Depend on the Size of Your Retirement Benefit. All Other Dependent Benefits Depend on Your FRA Benefit Independent of When You Collect.

Waiting Until 70 to collect Your Retirement Benefit or suspending your Retirement Benefit at FRA and restarting it at age 70 at a far higher level can dramatically increase your spouse's and ex-spouse's Widow(er)'s and Divorced Widow(er)'s Benefits.

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Illustrating Secret #6

Jane Goes to the Local SS Office. They Ask Her If She'd Like to File for All Available Benefits. She Says Yes.

That's a huge mistake. She just fell victim to Social Security's worst fraud, which has cost 13,000 widows over $130 million according to Social Security's own Inspector General.

Illustrating Secret #6

***By Filing for Both Her Widows and Retirement Benefit, Jane Effectively Receives the Larger of Her Early Widow's Benefit and Her Early Retirement Benefit. Her Annual Real Benefit, For the Rest of Her Life,* Is $29,157.**

If Jane files *just for her Widow's Benefit*, her annual real benefit is $29,157 through age 70 and $44,960 thereafter.

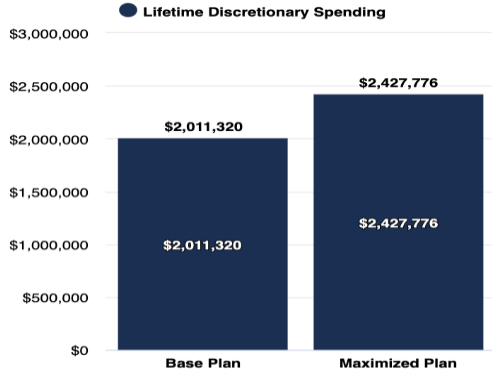
Illustrating Secret #6

Loss to Jane By Simply Checking the Wrong Box at Age 62 – the Box Asking If She Wants to File for Her Retirement Benefit

Lifetime Discretionary Spending Comparison

$416,456

Increase in Lifetime Discretionary Spending Under the Maximized Plan



MaxiFi Planner maximized your Base Plan to raise your Lifetime Discretionary Spending by performing the following (if selected and applicable):

1. Maximizing your Social Security benefits -- determining which benefits to take and when
2. Calculating a tax-efficient retirement account withdrawal plan
3. Optimizing the use of Roth versus Non-Roth accounts
4. Stretching your retirement income via annuities

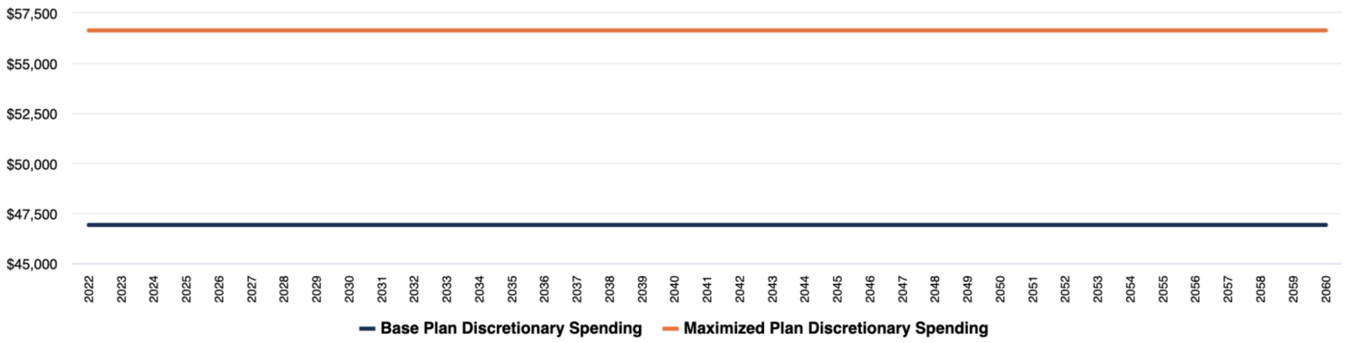
The difference in total Lifetime Discretionary Spending between your Base Plan and Maximized Plan is shown in the chart.

20 YEARS SENSIBLE FINANCIAL PLANNING MAXIFI®

Illustrating Secret #6

20.7% Reduction in Jane's Annual Living Standard By Simply Checking the Wrong Box at Age 62!

Annual Discretionary Spending Comparison



Note: All results are presented in Today's Dollars.

Maximizing your Base Plan increases your Lifetime Discretionary Spending, but the way it changes your annual spending is important to understand. The difference between your Base Plan and Maximized Plan Annual Discretionary Spending is shown in the chart.

In most cases, your Annual Discretionary Spending increases in all years but in some cases the amount may be lower in some years and increase more later in life, usually due to delaying retirement account withdrawals. In those cases, you may want to stick with your Base Plan or modify it only part way toward the Maximized Plan. You can also set an annual spending reduction limit on the report Set Up screen This limits reductions in Annual Discretionary Spending between the Maximized Plan and Base Plan, though it may also reduce the Lifetime Discretionary Spending payoff.

Secret #7
Don't Divorce Too Early

Divorcee Spousal and Widow(er) Benefits require 10 years of marriage.

Secret #8
The Earnings Test Is a Hoax

In most cases, benefits lost due to working before Full Retirement will be restored at Full Retirement Age via the “adjustment of the reduction factor."

Secret #9

Social Security is Bankrupt to the Tune of $59 Trillion

Collecting Retirement Benefits at 70 still makes sense for most people.

Secret #10

Cash Poor? Take Retirement Account Withdrawals Before Social Security

After risk-adjusting stock market returns, waiting until 70 to collect Social Security yields a far higher payoff.

Secret #11

Don't Take Retirement and Widow(er)'s / Divorced Widow(er)'s Benefits at the Same Time

This can cost you hundreds of thousands of dollars. Make sure Social Security hasn't filed you for both without your knowledge.

Secret #12

Don't Trust Social Security

Half their “advice" is wrong, incomplete, or misleading.

Social Security staff are not trained to help make the best lifetime decisions, they don’t have fully accurate analytical tools, and privacy rules limit their ability to advise on your full family situation.

Expert Advice – Two Books

Get What's Yours – the Secrets to Maxing Out Your Social Security

By Laurence Kotlikoff, Phillip Moeller, and Paul Solman

Money Magic – An Economist's Secrets to More Money, Less Risk and a Better Life

By Laurence Kotlikoff

Expert Advice – Two* Software Tools from Economic Security Planning

- Maximize My Social Security – maximizemysocialsecurity.com
- MaxiFi Planner – maxifiplanner.com
- *MaxiFi fully handles Social Security, so you don't need both tools.

Illustrating the Power of Expert Software

Meet George

- Age 62
- Lives in Delaware
- Retired
- Final earnings -- $75,000
- $1 million in assets
- Taking Social Security immediately

George Waiting Till 70…

- Raises George’s lifetime spending by $405,549 from $2,033,277 to $2,438,826
- Raises George’s annual discretionary spending from $47,829 to $58,384
- That is a 22.1% permanent living standard increase through age 100!
- Waiting until 70 is a riskless move! Pure alpha in Wall Street lingo.

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Q&A

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