The Retirement Trap

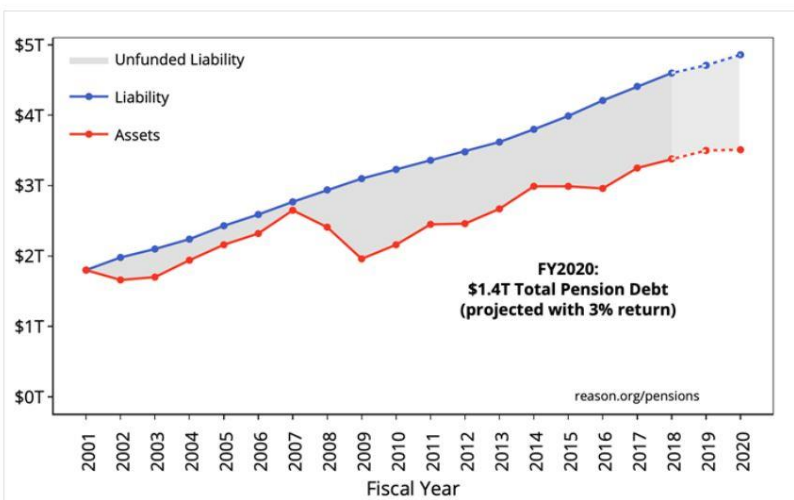
Brent J. Beverly, CFP®
Christian F. Li, CFP®
Manuel F. Chinchay, CFP®

Take this commentary as our thoughts on what looks to be coming in the future, not as absolute guidance in what could potentially transpire. The commentary makes certain assumptions about the future movements of the markets. Trying to predict the future is always tricky. There can be no certainty that markets will perform as predicted or that other events may not change the trends that we are predicting. We are writing because we want to point out that you need to focus on evaluating your pension benefits from our Government. We believe you need to provide for your own retirement and depend less on the government to provide retirement benefits.

Is your retirement at risk?

Many people trust governments, not just the Federal government but also state governments, particularly when it comes to providing the retirement benefits they have been promised. Unfortunately for this belief, people are living longer and longer – spending more of the existing funds, to the potential detriment of those who follow. Many of the projections to make retirement payments seem "optimistic" whether we are

Figure 1: Total State-Managed Public Pension Unfunded Liabilities And 2020 Projection



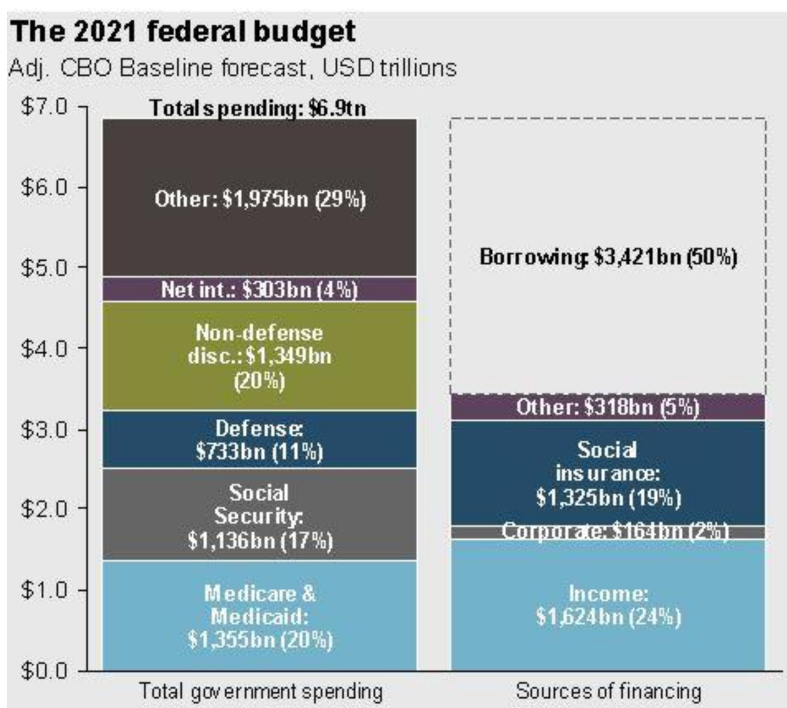
Source: Pension Integrity Project at Reason Foundation analysis of U.S. public pension actuarial valuation reports and Comprehensive Annual Financial Reports (CAFRs).

looking at Social Security or other systems. The Pension Integrity Project at Reason Foundation is a non-profit organization that advises policymakers and other stakeholders in designing, analyzing and implementing public sector pension reforms. The project aims to promote solvent, sustainable retirement systems that provide retirement security for government workers while reducing taxpayer and pension system exposure to financial risk and reducing long-term costs for employers/taxpayers and employees. The Pension Integrity Project said that state pensions were underfunded by $1.4 Trillion – even <u>before</u> the pandemic struck. The situation is even worse now.

The world is changing quickly. We are facing a massive demographic shift in the aging of the workforce. In the U.S., as Baby Boomers (born 1946 to 1964) move into their retirement years, they are followed by smaller numbers in future working generations. In 1945, Social Security showed almost 42 Covered Workers for every person drawing benefits. By 1964, that had dropped to 4 workers for each beneficiary. That ratio dropped below 3 workers in 2009 and now is about 2.5 workers for each Beneficiary. (Source: Social Security Administration) The ratio continues to drop as more people live longer and healthier lives.

Each year, we post the Social Security Trustees report on our website. For many years, their analysis has been that, barring substantial changes in the program, sometime in the middle 2030's, Social Security Income benefits will need to be cut by 25% across the board (the actual year and percentage vary a little each year, but the predictions are remarkably consistent). That is now less than 15 years away!

When Social Security needs to be adjusted, do you really think they are going to simply cut benefits roughly 25% across the board? We don't believe this to be the policy they are likely to take. We believe that more likely the lawmakers will try to maintain the current relative level of benefits for those with lower incomes by further reducing benefits for those "able to take care of themselves." We already see this is in action with Medicare. Depending on other incomes, higher income earners can pay more than 3 times the basic rate to receive Medicare Part B.



Government Debt and Spending

For those who assume that the Federal Government will simply make up that difference, remember that the government is already spending MUCH more than it brings in. As shown on the 2021 Federal

Budget CBO Baseline Forecast chart (appreciation again to JP Morgan) Social Security and Medicare/ Medicaid are already over 37% of Federal spending. Defense spending is only around 11%.

As you can see on the chart, currently, “only” 4% of the Federal budget goes to net interest payments. If interest rates increase as we expect, that amount will increase – even without considering the additional borrowing that is being done. That makes the government deficit even bigger and harder to pay back.

The ultra-high government deficits used to fight the COVID-19 pandemic were added to already high deficit spending. We were concerned about the level of debt being run up as far back as 2017 (check out our commentaries “Credit Hurricane Approaching” and “Higher Inflation Coming” on *The* Advisory Group’s website). The current much higher debt levels have only swelled our concern.

This is not just a U.S. concern. Global debt has swelled dramatically in the last 4 years. Using the JP Morgan Asset Management Global Bond Market figures, the global bond markets have shot up from just over $100 Trillion in 2017 to over $127 Trillion today. So what is adding $25 Trillion dollars in debt in only 4 years among friends? We used to hear, “A billion here and a billion there, and pretty soon you are talking real money.” Now, the saying is “A trillion here and a trillion there, and . . .”

Borrowing money can be thought of as bringing future benefits into the present. Some people believe government spending is “free” money. We want to remind those folks of one of our favorite words, **TANSTAAFL – There Ain’t No Such Thing As A Free Lunch**. Borrowed money needs to be paid back at some point – or lenders will stop lending, even to the government. If the government is already deficit spending, where is the money to maintain benefits and pay back the borrowing going to come from?

Ways Out Of the Debt Trap

One way to get out of this debt trap is for the economy to grow enough that the debt level becomes negligible relative to the economy. This is how the U.S. was able to recover out of the massive debt run up to finance World War II. It is also how the U.S. was able to balance its budget during the boom times of the 1980’s and 90’s. Growing our way out of the debt is the least painful way for this to happen. We can only hope.

Another way that is regularly suggested is to <u>*tax*</u> our way to covering the expanded budgets. Unfortunately, this method often does not work and is sometimes counter-productive. Please review our earlier article, “Gotta Raise Taxes?” for additional thoughts on this subject.

We are expecting to see higher inflation in our future (check out our article on “Coming Inflation”). Inflation benefits the government without necessarily benefiting government income recipients. By raising benefits at a rate less than the actual cost increases (i.e. the rate of inflation), the government is able to lighten its burden to make those payments while still increasing the dollar amount of benefits. These increases in the dollar amounts help the government keep the beneficiaries from realizing that their standard of living is dropping.

Let's show an example of how that might work: Assume the government pays a retiree $1,000 per month. If the cost of things the retiree spends money on goes up by 10%, that person would need the monthly retirement to increase to $1,100 just to be able to buy the same items. If the government measure of inflation is only 5%, they would raise the monthly payment to $1,050 – definitely an increased income, but NOT enough to keep up with the retiree's cost of living.

The Advisory Group has long noted that, after taxes and inflation, level investments and incomes lose spending power – what we refer to as "Going broke safely." The greater the inflation rate, the faster people with level, or even slowly rising, incomes "go broke." CNBC noted that this is already happening in an article published April 27, 2021, saying that retiree expenses are "climbing at a faster clip" than the cost of living adjustments. Expect to see more many articles with similar commentary.

Additional proposals working their way through Congress are expected to expand government spending and increase the debt further, leaving even less room to keep the government's promises of retirement incomes intact. Bottom line, you need to take care of yourself and your family. Don't depend on the government to provide for you.

We are here for you!

The Advisory Group and your advisors are here for you and will help guide you through whatever happens to help you meet your financial goals. Reach out to us whenever we can help.

Stay safe and healthy!

Brent, Chris and Manny

==

Brent J. Beverly, CFP® - Christian F. Li, CFP® - Manny Chinchay®
Senior Associates
Investment Advisor Representatives

***The* Advisory Group**, A Registered Investment Advisor
Your Goals; Our Guidance

Securities and Investment Advisory Services offered through FSC SECURITIES CORPORATION, a Registered Broker/Dealer, Member FINRA and SIPC and a Registered Investment Advisor.

Financial planning and additional Investment Advisory Services offered through The Advisory Group, a Registered Investment Advisor. The Advisory Group is not affiliated with FSC Securities Corporation. Real estate and additional insurance services may also be offered and are independent of FSC Securities Corporation.

20955 Pathfinder Road, Suite 110,
Diamond Bar, CA 91765
Phone (909) 869-7880
Email Mail@TAGFinancial.com
Website www.TAGFinancial.com

===