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FINANCIAL PLANNING NOTES
CLIENT NEWSLETTER

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SOCIAL SECURITY AND WORK

I wonder if the folks over at the Social Security Administration (SSA) think they're being clever. They make the rules so complicated and convoluted, it's no wonder every retiree doesn't make at least one big mistake and end up with less retirement income than they're entitled to.

In this article, I'm looking at one small aspect of Social Security's retirement benefits: the potential impact of job income on your Social Security check if you continue to work after you elect to begin receiving benefits.

Let's start with the easy part: Once you reach "full retirement age," you can begin taking benefits without any impact on the amount if you are still working. But what is full retirement age? Oops, I guess this part isn't so easy.

The SSA defines three different ages associated with retirement benefits: early retirement age (currently 62), maximum benefit age (currently 70), and full retirement age. Full retirement age is not the same for everyone. It depends on when you were born. For example, if you were born before 1955, your full retirement age is 66. If your date of birth is after 1959, full retirement age is 67. For the years in between (1955-1959), your full retirement age is somewhere between 66 and 67.

Now back to our story already in progress. If you wait until your full retirement age to begin taking retirement benefits, you will get the full amount to which you are entitled, whether you keep working or not. But if you start taking benefits after age 62 but before full retirement age, your benefit may be reduced.

The SSA allows you to earn some income before the benefits reduction kicks in. For 2022, that limit is $19,560. The limit increases to $21,240 in 2023. If you earn more than the limit in a given year, your benefit will be reduced by $1 for every $2 you earn in excess of the limit.

For example, if your retirement benefit is $2,000 per month, but your income in 2022 is $20,560, you have exceeded the limit by $1,000. So your monthly benefit will be reduced by $500.

But you still get $1,500 a month, right? Nope! The SSA collects all the reduction up front. In this example, the total reduction is $500 times 12 months, or $6,000 for the year. So you get $0 for the first 3 months, then your full $2,000 per month for the rest of the year.

While the benefit reduction ends after you reach full retirement age, it still applies the year you reach full retirement. In that year, your benefit will be reduced by $1 for every $3 earned above the limit. The income

limit in that year is much higher: $51,960 in 2022 and $56,520 in 2023.

The good news is all those reductions are not lost. Once you reach full retirement age, they will be returned to you in the form of a slightly higher benefit paid out over time.

But hold on a second. If the reduction is based on whether you exceed the earnings limit, how will the SSA know how much you make to determine if your benefit should be reduced? Won't it be too late if they wait until the next year when you do your taxes?

The answer is they don't know, and yes, it will be too late next year. *You* are responsible for reporting to the SSA that you are earning in excess of the limit. If you don't, you could be fined, be forced to pay back the excess you received, and may even have future benefits reduced.

At the end of the day, if you keep working after you begin taking retirement benefits and properly follow all the rules, any Social Security income lost will be paid back to you (albeit over a longer period). That makes it very important that you follow all the rules! Know your full retirement age, contact the SSA if you are going to exceed the earnings limit for the year, and talk to your financial advisor if you need to know more.

—Steve

FINANCIAL WELLNESS MONTH

Here's something I didn't learn until I was today years old: January is Financial Wellness Month! Seems like something a seasoned financial advisor would know? In my defense, I've always assumed that every month was financial wellness month!

Apparently, as part of your month-long partying and celebrating(!), you're supposed to spend time planning your financial goals for the year. I'm old-school and believe you should do such planning in the prior year, but that's fine. If you haven't made a formal plan yet, let's consider some actions you may want to take before we hit February, which as we all know is Humpback Whale Awareness Month. (I did not make that up!)

- Set specific financial goals for the year: "Make as much money as possible" or "Get a 15% return on my investment portfolio" aren't good goals. "Increase my 401(k) contribution rate from 5% to 8%" is a very good goal. "Open a college savings account for Junior and have at least $5,000 in it by year-end," is also good. The main idea is that the goals you set are measurable, realistic, and achievable based on your own actions, not the whims of others or the market.

- Take a look at your debts: With interest rates on the rise, debt service may start to become a major expense for a lot of households for the first time in a long time. For that reason, it's important to review what you owe money on, what the interest rate is, and whether the interest rate is likely to change soon, if it hasn't already.

For example, if your home loan has an adjustable rate, you might have a little surprise with your next mortgage bill. The same would apply to a HELOC line of credit. If you're looking to buy a new car, you're definitely in for a surprise when you see how much more the payments are going to be on a car that costs the same as the last one you bought. You may want to consider paying it off much quicker, or not financing it at all.

- Keep saying "no" to credit card debt: Regardless of interest rates, maintaining a balance on a credit card is a great way to mess up a financial plan. Your goal should always be to pay the monthly balance in full before the due date, and if you have debt on a card, apply every spare dollar you can to paying it down, and off.
- Review your emergency fund: There is a misconception that you should have six to 12 months' salary in the bank as an emergency fund in the event of a disaster, health emergency, job loss, or any number of other unexpected life challenges. While it is important to have a pool of money available quickly for such emergencies, it does not necessarily have to be in the bank (where it earns little or nothing). You should have enough money there to cover at least a couple of months' worth of expenses, but the remainder could be in short-term or safe investments, like a brokerage money market or bond fund. Your advisor can assist you in determining the proper amount you should have available for emergencies and whether your investment portfolio is set up to access the money you need if you need it.
- Report your income to the SSA: As discussed in this month's article, "Social Security and Work," if you are taking Social Security retirement benefits but not yet at full retirement age, you need to tell the Social Security Administration if you are still working and will be earning in excess of $21,240 this year. Otherwise, you could face a penalty and possible reduction in future benefits.
- Do your taxes: If you expect to get a refund from the IRS this year, the sooner you complete your tax return and submit it, the better. Every day the IRS keeps it, you're giving them an interest-free loan!
- Check your automated bills: Do you have most of your bills set up on autopay through your bank account? It's convenient and ensures you don't miss a deadline and get hit with a late fee or finance charges. But some of those bills that are the same every month can change from year to year, like your mortgage (if insurance and taxes are included or the rate is variable) and your homeowner's association fee. Check the billing statements you receive and make sure you update the payment amounts with the bank to avoid penalties for less-than-full payments.
- Call your financial advisor: Of course, you can call us any time of the year, even if you wait until March (National Cheerleader Safety Month!). But if you want to hit the new year running and make sure your plan is on track, we're here for you.

—Steve

A MUTUAL FUND VS. AN ETF: WHAT'S THE DIFFERENCE?

In the world of traditional investments, mutual funds and ETFs are two of the most common options considered. While they have several similarities, their differences can make one investment a more suitable option than the other.

What, exactly, are mutual funds and ETFs—and what do you need to know about their differences? Here's a quick breakdown to help you make more informed decisions about your portfolio.

What Is a Mutual Fund?

A mutual fund is an investment vehicle that allows multiple investors to pool their money together to buy a diverse set of securities, including stocks and bonds. It can be used to create a well-diversified portfolio at a fraction of the cost of buying hundreds or thousands of individual stocks. Shares of a mutual fund are bought directly from fund management companies such as Fidelity, T. Rowe Price, or Vanguard.

You may purchase a mutual fund share at the end of the trading day at its net asset value. The net asset value is determined by subtracting a fund's total liabilities from the value of its total assets.

What Is an ETF?

Similar to a mutual fund, an exchange-traded fund (ETF) is an investment vehicle pooling money from investors to purchase multiple stocks and bonds, and efficiently provide portfolio diversification. Like the buying and selling of individual stocks, ETFs are traded on an exchange.

ETFs can be bought or sold anytime during the day while the stock market is open. This means that, similar to individual stocks exchanged on the Nasdaq or New York Stock Exchange, the price of an ETF can change throughout the trading day.

How Mutual Funds and ETFs Differ

ETFs and mutual funds both begin with money pooled from multiple investors. But below are a few of the key differences between these common investment vehicles.

Management style: There are two types of management styles: passive and active.

With *active management*, a professional advisor or manager uses their education and investing experience to attempt to outperform the market by actively buying and selling shares on a regular basis.

Passive management attempts to match, not outperform, long-term market benchmarks. Once the investment is selected, the manager takes a more hands-off approach, allowing the investment to ride out the day-to-day ups and downs of the market.

Because active management requires more involvement on the advisor's behalf, the associated fees and costs tend to be higher than on a passively managed investment.

ETFs are typically managed passively, while mutual funds are about 50/50 split between active and passive management.

Pricing: As mentioned, mutual funds are traded at the

end of each open trading day at a price determined by their net asset value.

However, ETFs can be bought and sold throughout the day, just like individual stocks on a stock exchange.

Since ETFs are sold throughout the day, the market dictates the value of an ETF, and it can easily change on a dime. If demand suddenly rises for a certain ETF, it may get priced higher than its net asset value. Or, if investors sell en masse, the price can drop below its value.

Expense ratios: It's helpful to know how much you'll pay to invest in different vehicles. The percentage of fees and costs an investor pays to own a fund is known as the expense ratio.

Since passively managed funds typically have lower fees, ETFs are often considered less expensive than mutual funds. A typical expense ratio of ETFs is between 0.05% and 1%.

An ETF's expense ratio includes all associated fees, such as:

- Management fees: These cover all the behind-the-scenes management and technical work needed to select and manage funds.
- Commission fees: Unless investing in a "commission-free ETF," you will likely be charged a commission fee by the brokerage firm when you buy or sell shares.

Since mutual funds are typically actively managed, you can expect higher expense ratios. Along with operating and managing fees, mutual funds may be subject to sales load fees:

- Front-end sales load fees: Investors pay these when the mutual fund is initially purchased.
- Back-end sales load fees: Investors pay these when they've redeemed or sold their fund shares.

Taxes: In general, ETFs tend to give more control over tax liabilities. A mutual fund company may decide to sell shares of the securities, triggering capital gains tax for investors. You are still liable for the capital gains incurred even if you did not choose to sell your shares.

On the other hand, ETFs are traded on the exchange, which matches buyers and sellers. Lower turnover means you won't pay capital gains on an ETF until you sell the shares and make a profit. Generally speaking, the triggers for capital gains tax on ETFs tend to be fewer and farther between than mutual funds.

Which Type of Investment Is Right for You?

You have several considerations to keep in mind when deciding if mutual funds or ETFs are the right investment vehicle for your portfolio. From costs and fees to tax implications, these can all impact the effectiveness of an investment vehicle.

Curious to know which investment vehicle may be more aligned with your goals? Give us a shout. We're always happy to talk about your portfolio with you.

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