The Hanover Advisor

HANOVER ADVISORS

May 2022

Getting the Most out of Your Social Security Benefits

When you are years away from retirement, Social Security seems simple. Many assume that they will simply retire someday, file for benefits, and receive a monthly check for the rest of their lives. The reality is, however, that the decision of when to retire will have huge implications for the amount of money you will receive, and some of the decisions you will make are irrevocable. Studies have shown that Social Security benefits are a major source of retirement income for 70% of current retirees, so understanding how to maximize this important retirement income stream could have a huge impact on your retirement. To help understand how Social Security benefits are determined and how your decisions can impact the ultimate size of your benefit, here are a few key things to keep in mind.

1. Understand How Your Benefits Are Determined

To determine your primary insurance amount (PIA), the monthly amount you will receive if you work to full retirement age, the Social Security Administration (SSA) looks at your 35 highest-earning years in the workforce. If you do not have at least 35 years of work experience, zeros are factored into the calculation, which can greatly reduce your payments. Even a low-earning year is better than having a zero averaged in, so workers nearing retirement may want to consider delaying or working part-time for a few years before claiming benefits to ensure they have at least 35 years of work history.

Working for more than 35 years can cause lower-earning years to be dropped from the calculation and increase your monthly payments. However, it is important to keep in mind that Social Security was designed to be a "progressive" social insurance system, which means it replaces a greater part of average monthly pay for low-income workers than it does for high-income workers. When calculating your ultimate benefit, the SSA runs your earnings through a calculation called "bend points." These are income thresholds that impact the monthly payment you will receive. They are adjusted for inflation, so they change each year, and the relevant bend points for each worker are those published in the year the worker first becomes eligible for benefits at age 62. Social Security aims to replace 90% of monthly income below the first bend point ($1,024 in 2022), 32% of income between the first and second bend point ($6,172 in 2022), and just 15% of any income above the second bend point. With this in mind, workers must weigh the benefits of working another year at their current high-income salary to replace a low-earning year from earlier in their career and how much it will increase their PIA.

2. Timing is Everything

Your PIA represents the amount you will receive monthly if you begin taking benefits at full retirement

age, which, depending on when you were born, will be between age 66 and 67. Workers can begin claiming Social Security benefits as early as age 62, but doing so will result in monthly payments that are 25%-30% smaller, depending on their full retirement age. Workers can also delay claiming benefits past full retirement age, accruing delayed retirement credits that will boost your monthly benefit by 8% for each year you delay until age 70. Past age 70, there is no additional incentive to delay starting your payments.

3. Consider Optimization, not Maximization

With the above information, there are clear cut things that workers can do to ensure they receive the largest monthly benefit possible, such as delaying retirement and ensuring at least 35 years of work history. However, the goal should not necessarily be to maximize your monthly benefit, but to optimize the total benefits you will receive over the course of your life. The most effective Social Security claiming strategy for you will depend on how long you expect to live. If you have major health problems or family history of lower life expectancy, it can make sense to claim benefits as soon as possible. If you are in good health and have parents who lived into their 90s, then it may make sense to delay claiming your benefits in order to receive a higher Social Security payment in your 70s, 80s and beyond.

To determine the best course of action, workers should consider the break-even point of claiming early, at full retirement age, or delaying. Suppose that you are on track to receive an estimated $1,500 per month when you begin claiming at age 67. If you started claiming at age 62, your monthly benefit would be reduced by 30% to $1,050 per month. So, between the ages of 62 and 67, you would receive approximately $63,000 in benefits ($1,050 for 60 months).

If you waited until age 67, you give up that initial $63,000, but would receive an additional $450 per month. At this rate, it would take 140 months to make up for the money you would forego by waiting to claim benefits, and around the time you reach age 78 and 8 months, you would reach the break-even point when the cumulative benefits received by waiting to 67 surpass the amount you would have received if starting at 62. If you expect to live well past your break-even point, delaying makes sense, but if you do not anticipate living beyond that point, it makes more sense to begin claiming early, even if it reduces your monthly benefit. You can similarly calculate the break-even point of delaying retirement to increase your benefits to help determine the best course of action.

4. Married Couples Have More Options

For married couples, Social Security optimization can be much more complicated because it involves accounting for two people's earnings and benefits, as well as the likelihood that one spouse will outlive the other. Spouses are not only entitled to their own benefits based on their personal work history, but they also may be eligible for additional money when the spousal benefit is factored in. The spousal benefit equals 50% of the higher-earning spouse's benefit if the lower-earning spouse takes it at full retirement age. The amount is reduced when taken early, and you cannot claim the spousal benefit until your spouse begins taking Social Security. To be clear, you do not get to take two benefits. Instead, the SSA increases your benefit to equal half of your spouse's if the one based on your own work history is smaller.

When one member of a retired married couple passes away, the surviving spouse can inherit the deceased

spouse's Social Security payment if that amount is higher than his or her current monthly payment. Married couples can increase the Social Security benefit that the surviving spouse will receive by having the higher earner delay claiming Social Security.

5. Have a Plan

There are dozens of factors to consider when deciding when to claim Social Security benefits. Issues like life expectancy, work history, income requirements during retirement, and the need to look after a spouse can have huge implications on the decision. Claiming too soon could result in a lower benefit and diminished quality of life during retirement but delaying too long could result in a lower cumulative payout, meaning that you will have spent years paying into a system that you will barely benefit from. There is some degree of flexibility if you decide to claim early then change your mind. You can withdraw or suspend your benefits, but this is not always an option and could require you to pay back the benefits you have received. If you realize that you have waited too long to start benefits, there is no recourse.

With such an important decision, it is key that you have a plan. The SSA offers some basic tools to help calculate your expected benefits, but SSA employees are not allowed to give financial advice. For this reason, it is important to work with a trusted financial adviser who can help you optimize your Social Security benefits. Hanover Advisors can not only help determine the best course of action for when you and your spouse should begin claiming benefits, but work with you to integrate your Social Security benefits into a holistic financial plan that can be supplemented by different income streams like an investment portfolio.

Lowering Your Tax Bill with Dynamic Tax Harvesting

When it comes to investing, what you keep is more important than what you make, and even stellar returns can be greatly diminished when your tax bill comes due. Because capital gains taxes can be so detrimental, most savvy investors and advisors engage in what is known as tax-loss harvesting. Tax-loss harvesting is the process of selling a security in a taxable account for a capital loss to offset capital gains. Selling an individual stock or mutual fund for less than you paid for it allows you to realize a capital loss to offset capital gains, either in the current year or in future years.

For many investors and advisors, tax harvesting is an exercise addressed just before the year ends. While this might be easier from a calendar planning perspective, investors may be missing other, more attractive opportunities throughout the year and doing themselves a disservice by waiting until the year's end. Since 1926, the U.S. stock market's calendar returns, based on the S&P 500 Index, have been positive more than 70% of the time. Over the past 70 years, November has been the single-best stock market month and December has been the third best, according to FactSet data. This means that by waiting until November or December to look for tax harvesting opportunities, investors may be limiting themselves to the two of the worst months for losses.

A smarter move is to engage in dynamic tax harvesting throughout the year. By regularly looking for opportunities to realize losses, investors can take advantage of the volatile ups and downs of the market to offset their future tax bill. For some investors, regular loss harvesting can be a psychological hurdle. Selling an asset for less than you paid for it can be difficult, regardless of the later tax benefits, but through strategic asset

allocation and smart purchasing decisions, investors can realize the tax benefits of a loss while the market is down and also capture the inevitable rebound by replacing the sold asset with something that is very similar.

To prevent investors from selling an asset to realize a loss and then immediately rebuying the asset, the IRS created the wash-sale rule, which prevents investors from repurchasing the same security immediately after. You can, however, purchase a substantially similar security. Say for example there were a big market downturn in the tech sector. You can sell any existing tech holdings to realize the loss, and then purchase an ETF or mutual fund focused on tech, allowing you to maintain an asset allocation that suits your long-term investment plan.

Tax harvesting is just one way to make your investment portfolio more tax efficient, but anything involving the IRS can be complicated and fraught with pitfalls that could result in fines and penalties. For this reason, it is important to always work with a tax professional and investment advisor to make sure that you are able to keep the wealth you have accumulated without running afoul of Uncle Sam.

Hanover Advisor Bulletins
Special Reminders to all Hanover Clients

- Hanover's newest Client Representative, Brandon Johnson, has earned his designation as a Certified Retirement Planning Counselor! As a CRPC, Brandon will bring an additional level of knowledge and expertise to Hanover's financial planning operations.

- Hanover's latest ADV form has been filed with the SEC. This important disclosure document allows clients to learn more about Hanover's investment practices and compensation model. The form can be accessed at hanoveradvisorsinc.com.

- We invite all clients to schedule an online portfolio review. Because we respect your time, we offer three different meeting formats that vary in length and level of specificity. For more information or to schedule a meeting, please contact us.

- The Hanover Advisors website can be accessed at hanoveradvisorsinc.com. There you will find our latest newsletter and investment commentary, articles, our blog, and videos. You can also learn more about our services, access both the Black Diamond performance reporting system and your Pershing brokerage account(s).

- All Hanover clients have free access to our internet-based reporting system known as Black Diamond. This robust system provides comprehensive performance reporting, asset allocation and risk assessment on clients' portfolios. Our office is available to assist in accessing and utilizing the Black Diamond system.