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LEGACY WEALTH MANAGEMENT, LLC

"How Secure is Social Security?"

By Jeff Funderburk, CFP®

I often get asked when social security is going to "go away," "run out of money," or "go bankrupt." Social security is a significant source of income for Americans, and for many it's the sole source of income. It's no wonder that folks would be concerned when they hear that the program is in financial dire straits.

There are two separate trust funds that make up social security. One is for retirement and survivors' benefits, and one is disability benefits. These are the funds into which social security taxes are deposited. The funds currently have a surplus that consists of tax revenue and interest income that the program has

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How to Handle a Down Market in Retirement

By Dan Funderburk, CFP®, CKA®

"What happens when I retire, and the market dives like it's doing now?" I've received this question a bunch this year, and rightfully so. Any prudent person would want to make sure there's a plan in place to handle bumpy markets while you're withdrawing money from your portfolio. Thankfully, you're not alone, and this isn't a new problem. It's something we have taken seriously for years since many of the families we serve are current retirees and rely on the solution to sustain their lifestyle. We take a four-step approach to address this problem:

Step 1: Diversify your portfolio

Duh. Everyone knows not to put all your eggs in one basket. Nick Murray, a well-respected financial author says, "Diversification is the conscious choice not to make a killing, in return for the blessing of never getting killed." This is such a

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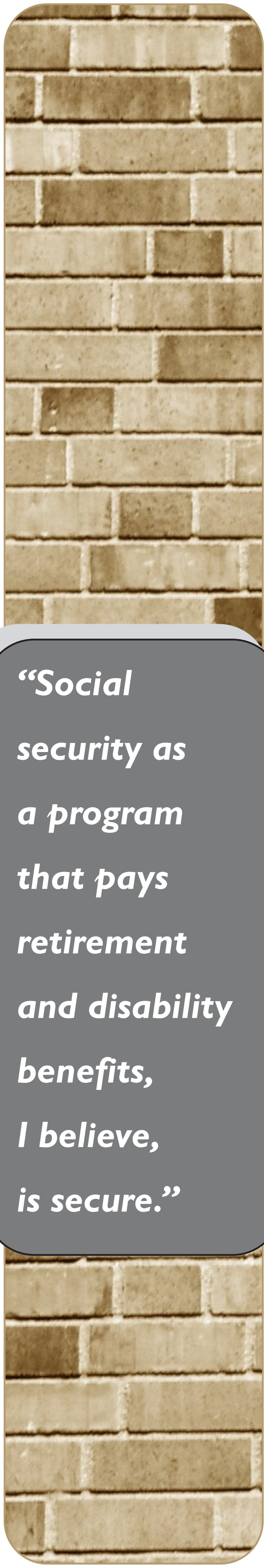
"How Secure is Social Security?" *Continued from p. 1*



> ***"Social security as a program that pays retirement and disability benefits, I believe, is secure."***

collected above what it has had to pay out in benefits. But that surplus is getting smaller each year because benefit payments now exceed the tax revenue and interest income.

What people often hear is that social security won't be able to pay benefits; they fear that once the surplus is spent, it's game over. **That is a misconception**. In reality, it is projected that by the year 2035 (an estimate which was recently increased from 2034), the *surplus* funds in the two trust funds will be depleted. But that doesn't mean all benefit payments stop. Benefits will still be paid because social security taxes will still be collected. The program will be able to pay out in benefits 100% of what it takes in in taxes. That's the good news, *but…*

If congress doesn't act, and actually lets the surplus be fully depleted, benefit payments are projected to be reduced anywhere from 20% to 25% (depending on which estimate you read). Most of the research and "expert" opinions I read put the chances of that happening right near zero. Why? The government knows how integral social security is to our country and knows they can't afford not to make the needed changes. They could raise the minimum filing age. They could raise the full retirement age (as they've done in the past). They could increase the tax rate (currently 12.4%), or the wage base on which the tax applies (currently income above $147K isn't subject to social security tax). Most likely it'll be a combination of things. Most believe that change *will* happen. The question is *when* it will happen.

The government hasn't made any significant changes to fix the program yet, because let's face it, it's a politically charged issue. Congressmen and women are generally very concerned with getting re-elected. They know rocking the social security boat could see them without a seat at the table next time around. Best to steer clear as long as you can. However, I do believe that as that 2035 date gets closer and closer we'll eventually get to a point where it will be politically unwise to keep kicking the can down the road. Some real action will be taken to extend full benefits because Americans will demand it of their representatives before they have their benefits put in jeopardy. But until 2035 is lurking right around the corner I'd expect the status quo.

Personally, I'm counting on having social security around when I hit my full retirement age (currently 67, but I'm expecting that to change). I'm just planning on it looking different than it does today. Social security as a program that pays retirement and disability benefits, I believe, is secure. Social security in its current form? Tick-tock goes the clock. It'll be interesting to see how long congress lets it go before something meaningful and beneficial is done.♦

Understanding the Tax Gap By Mike Berry, CFP®

In reading through what's in this Inflation Reduction Act that, as of this writing, hasn't yet passed into law, there is a substantial amount of money going to the IRS to help beef up compliance with our tax laws. A phrase that I kept running across and one that I'm guessing we will hear more often is the "tax gap." Simply put, the tax gap is the difference between what taxes are owed and what are actually collected.

In June of 2021, The Committee for a Responsible Federal Budget put out a paper titled Understanding the Tax Gap. I was somewhat staggered by the numbers. For example, in 2019 The "gross tax gap" was estimated to be $630 billion (yes that's with a "B"). That represents over 15% of the total taxes owed for the year. The Treasury admits that this estimate is low because it doesn't include taxes from sources of income such as money earned in the gig economy and from cryptocurrency transactions. Adding these into the picture, the gross tax gap could be close to $1 trillion, (yes that's with a "T").

Even more interesting to me is the article shows the percentage of the tax gap by types of non-compliance. The tax gap occurs because returns are never filed, the amount of tax owed is underreported or the amount of tax owed is reported accurately but is underpaid. There are two reasons why the amount of tax owed is underreported. One is underreported income and the other is over or mis-reported adjustments to income. Here's how it breaks down:

Returns Never Filed	**$39 billion or 9%**
Underreported Income	**$167 billion or 38%**
Over/misreported adjustments	**$67 billion or 15%**
Underpayment	**$50 billion or 11%**
Other underreporting	**$118 billion or 27% (this has no definition)**

Voluntary compliance has been pretty steady over the years at 83%. The net compliance rate, which is what is collected voluntarily and through enforcement was 85%, so enforcement such as audits and such has only added two percentage points. That still leaves a pretty huge gap.

This is what Congress is striving to improve by handing the IRS a bunch of money in this Inflation Reduction Act. It remains to be seen if better technology and increased manpower can reduce the tax gap, but it most likely means that all taxpayers, compliant or not, will be under greater scrutiny in the future.♦

https://www.crfb.org/blogs/primer-understanding-tax-gap

How to Handle a Down Market in Retirement *Continued from p. 1*

fundamental part of our portfolios that I display this saying on the bookshelf in my office.

Unfortunately, diversified doesn't mean bulletproof. There are markets where assets that typically behave differently decide to move in lockstep, which reduces the benefits of diversification. 2022 has been a great example of this. We have seen bonds sell off significantly, in response to the Fed raising rates, at the same time we've seen stocks sell off significantly because of recession fears. Bonds typically act as a ballast for portfolios during times of elevated volatility in stocks, but that hasn't been the case this year.

So, what else can we do to protect your portfolio during retirement? I'm so glad you asked…

Step 2: Bring on the buckets

You never want to sell stocks in a down market to buy groceries, and our bucket strategy is how we avoid doing this. We divide retirement portfolios into three buckets.

Short-Term Bucket – this is where we get the money we send our retirees each month for them to live. This bucket is full of very conservative investments that provide predictable income and don't fluctuate much with the market. Let's say we're "bunting" with the investments in this bucket. We like to keep between one and two years' worth of withdrawals in the Short-Term Bucket.

Intermediate-Term Bucket – this bucket holds investments that carry a little more risk and get a little more growth than the Short-Term Bucket, but still don't rise and fall as much as the general market. We're swinging for singles and doubles here. Ideally, we'll keep between three and seven years' worth of withdrawals in this bucket.

Long-Term Bucket – this bucket holds the most aggressive investments. We fully expect this bucket to rise and fall along with the general market. This bucket is the most volatile, but it's essential to our portfolios because it provides our long-term growth. We're swinging for triples (and an occasional homerun) in this bucket.

Utilizing these buckets enables us to make sure we're providing sustainable withdrawals for our retirees because we're able to pick and choose how to replenish the Short-Term Bucket depending on what type of market we're in. In a strong bull market, we'll sell some of the Long-Term Bucket and harvest those gains when it's time to replenish the Short-Term Bucket. If we're in a bear market like we've seen this year, we let the Short-Term Bucket get utilized more, and replenish it from the Intermediate-Term Bucket if necessary. This allows us to let

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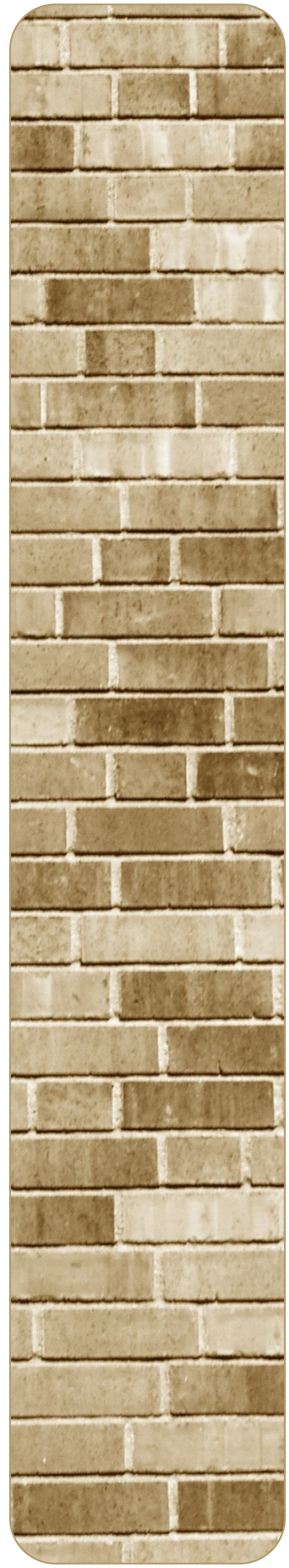
the Long-Term Bucket cook a little longer and gives it time to bounce back when the market rallies. Selling stocks in down markets to buy groceries? Not here.



Step 3: Find good tenants

Think of a rental home. One of the main reasons you buy a rental property is because it provides predictable, consistent income. The price of the home rises and falls with the real estate market, but the rental income shouldn't change unless your tenant loses her job and can't afford rent.

We take an investment portfolio and make it behave almost exactly like a rental home. We find fantastic tenants that pay steady monthly or quarterly income (in the form of interest and dividends). Just as your rental income doesn't change as long as you don't sell the home, your portfolio income doesn't change as long as you don't sell the shares. The price of the shares rises and falls with the market, but the income we receive has nothing to do with the price – only the number of shares that we own!

Often our retirees have enough in their portfolio that we're able to meet their withdrawal needs with the income that we produce by finding good tenants. This allows us to truly leave the principal intact and simply live off the dividends and interest. Talk about peace of mind!

Step 4: Keep an eye on your withdrawal rate

Even with the above steps, there could be a time where the market has fallen significantly enough where a change might be necessary. How do you know when this is the case? It helps by looking at what percentage of your portfolio you're withdrawing on an annual basis. A safe withdrawal rate is unique to your individual situation, but a general rule of thumb is that a 4% withdrawal rate is sustainable over a 30-year retirement, after accounting for inflation.

Let's look at an example. Say you have a $1 million portfolio and you're withdrawing $40k per year. $40k ÷ $1M = 4%, so you're good to go. Now let's say the portfolio drops 10%, meaning your $1 million portfolio is now $900k. Your new withdrawal rate is $40k ÷ $900k = 4.4%. Chances are this new, higher withdrawal rate is still ok, but things are getting tighter.

What if the portfolio drops 20%? Now your $1 million portfolio is $800k, and your new withdrawal rate is 5% ($40k/$800k). Do you need to change how much you're pulling out? Unfortunately, there is no cut-and-dry answer for this one. This is a conversation that needs to be had between you and your advisor to look at your specific situation and make a plan moving forward.

Bottom line

If you're already retired, or are quickly approaching retirement, markets like we've seen in 2022 are a legitimate cause for concern. Thankfully, this problem isn't new, and we've been able to develop strategies to help mitigate the risks. Our hope is that you, our clients, know that you're not alone. We're always here to listen, talk, and strategize. Hopefully doing so will bring you a little more peace, even in the midst of crazy markets like we're seeing today.♦

LEGACY WEALTH MANAGEMENT, LLC

372 Ridges Boulevard • Grand Junction • Colorado • 81507 • (970) 241-5143
www.legacywealthgj.com

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