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The Future of Social Security

In 1950, America boasted roughly 16 working adults for each retiree. The large pool of workers contributing to social security and the relatively low number of retirees receiving payments combined for an effective way to fund a stable source of supplemental income for retirees.

Shrinking Labor Force
However, since then, the ratio of workers to retirees has plummeted to just 3-to-1 in 2010. Projections indicate that, given the number of Baby Boomers who are nearing retirement, this ratio will shrink to just 2-to-1 in the next 10 years. With birth rates at their lowest in the past century, the number of workers entering the workforce is simply not keeping up with those that are retiring.

Due to the declining ratio of workers to retirees and the subsequent decrease in the amount generated by taxes, the Social Security Administration will soon start paying out more than it generates. If the rate at which workers pay into social security stays the same, the fund be depleted in approximately 20 years.

Contrary to what some may fear, if the fund runs out there will not be a complete cessation of payments to retirees. Though there would be no surplus to draw from once the fund starts to pay out more than it generates, regular revenue for social security from taxes would still supply retirees with a retirement benefit. However, the lack of surplus would result in these benefits being reduced by 20-25 percent per year.

Vital to Retirement
According to a 2014 survey from the U.S. Census Bureau, roughly 40 percent of retirees would fall below the poverty line if not for social security. Additionally, the Social Security Administration reported in 2014 that 20 percent of retirees aged 65 or older rely on social security payments for all of their retirement income. Given that social security is absolutely vital to many Americans, there is urgency about what steps will be taken to accommodate for the current, and projected, seismic shift in active workers.

Different groups have called for an immediate reduction in benefits to postpone depleting the fund, higher taxation on workers or some combination of the two.

A Widespread Problem
Given the uncertainty of how significant social security payouts will be in the next few decades, self-directed retirement funds will play a more crucial role in retirement. Currently, Americans are generally underprepared for the projected reduction of social security benefits. Recent studies show that savings to retirement accounts by adults are dismal. According to a 2016 survey from GOBankingRates.com, 1-in-3 adults have no retirement savings whatsoever, while nearly 3-in-5 have less than $10,000 saved.

Some might assume that the reason for low savings is that many young working adults simply have not had the time to contribute to their qualified accounts and let the balances grow. However, the truth is that the majority of adults over 40 years old are behind on their retirement savings, too. The cycle of deferring current savings and hoping to catch up later has left many unable to retire. Over the past few years, approximately 25 percent of Americans have had to delay their retirement by at least one year.

News of the Social Security fund being depleted has led to panic about how Americans will fund retirement. The silver lining is that as long as social security taxes are in place, there will be government assistance in retirement—it's just a matter of how much the payments will be.

Given the projected reduction in benefits, Americans must be careful not to overestimate how much they will be getting from social security. Now, more than ever, Americans need to remember that social security is not meant to fund their entire retirement; it is meant to offer a layer of support. By preparing their personal savings for lower social security payments, Americans can ensure that they are ready for retirement on their own terms.

the market at a glance

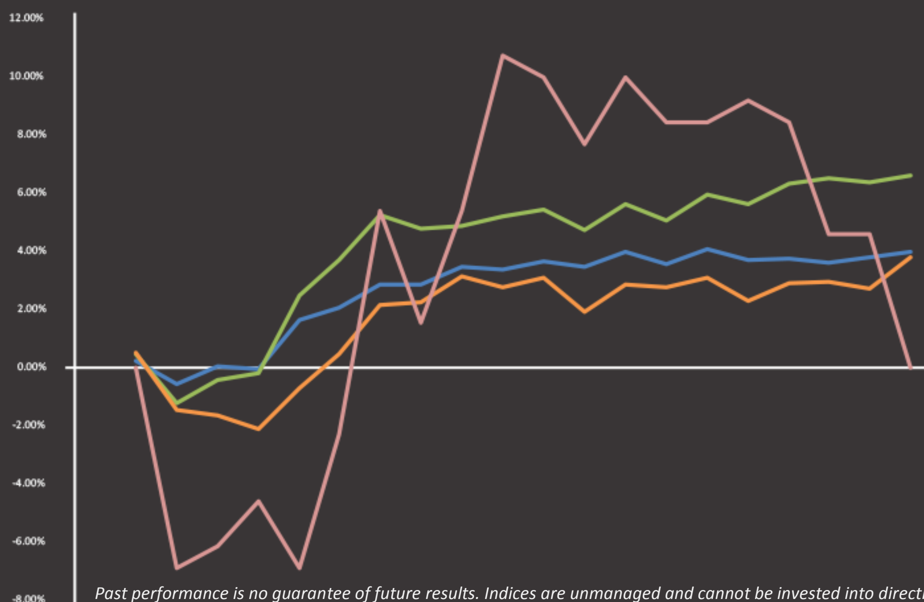
JULY

U.S. Large Cap
(S&P 500)
2,173.60 (3.56%) ▲

U.S. Mid/Small
(Russell 2000)
1,219.94 (5.90%) ▲

International Large
(NYSE International 100)
4,809.65 (3.37%) ▲

U.S. Treasuries
(U.S. 10-Year Treasury Yield Rate)
1.46 (0.00%)



The market in action

- The U.S. 30-Year Treasury hits a record low yield early in July, providing just a 2.11 percent annual return for buyers. The unprecedented depression in yields (felt by most long-term government bonds) was credited to the political and economic uncertainty following the “Brexit” vote in the United Kingdom.
- Mortgage refinances in the United States jump 21 percent as mortgage interest rates approach record lows.
- Japanese telecom conglomerate SoftBank Group announces its purchase of the British chipmaker ARM Holdings PLC for $32B. ARM is the U.K.’s largest technology company and will be SoftBank’s largest acquisition to date.
- The Department of Commerce reports that the U.S. economy grew at an annualized rate of 1.2 percent in Q2 2016—less than half of the expected growth rate. Combine with weak reports from Q4 2015 and Q1 2016, the statement sparked concern among economists that the United States is moving into a prolonged period of low growth.
- Following months of investigation, the Federal Trade Commission determines nutritional supplier Herbalife Ltd. is not a pyramid scheme; however, the commission still issues a $200M fine against Herbalife for misrepresentation of its business practices.
- Verizon Communications announces the acquisition of Yahoo Inc.’s struggling internet businesses for $4.8B. Verizon will only purchase the Yahoo brand and U.S. websites, leaving the remaining company— and its $40B stake in Chinese online retailer Alibaba Group—to be rebranded and converted into a holding company.
- The U.S. Census Bureau reports homeownership in the United States has tied its record low (set in 1965), falling to 62.9 percent in Q2 2016. Although homeownership is broadly down across all age groups, adults classified as Millennials (age 18-34) held the lowest ownership rate: 34.1 percent.
- Oracle Corporation makes plans to acquire cloud-service pioneer NetSuite Inc. for $9.3B.

Regs to the Rescue?

The world of money market funds changed forever back in 2008, when an investment vehicle called the Reserve Primary Fund loaded up on loan obligations backed by Lehman Brothers. Lehman famously went under, and the fund "broke the buck," meaning that when Lehman was unable to pay back its loans, the value of a share of the Reserve Primary Fund dipped under $1.

This was the first time many investors realized that money market funds were not risk-free. Many panicked, causing a run on other money market instruments, and overall the event added another unhappy twist to the financial crisis.

Fast forward to the near future: October 14, 2016, the date when new protective regulations implemented by the Securities and Exchange Commission will go into effect. Yes, the government wheels creak along slowly.

What regulations? To make sure that the funds are able to redeem at par, all money market instruments that invest in taxable corporate debt or municipal bonds, and have institutional investors, will have to keep at least 10% of their assets either in cash, U.S. Treasury securities or other securities that will convert to cash within one day. (Many money market funds make overnight loans to lending institutions in the U.S. and Europe.)

As further safeguards, at least 30% of a money market fund's assets will have to be liquid within one week, and funds will be restricted from investing more than 3% of their assets in lower-quality second-tier securities. No more than half of one percent of their assets can be invested in second-tier securities issued by any single issuer. Finally, money market funds will not be allowed to buy second-tier securities that mature in more than 45 days.

What happens if all these safeguards don't work, and a share of the money market fund still goes below $1? In those (probably rare) instances, the fund's board of directors are permitted to suspend your ability to redeem your investment for up to ten days, and under certain circumstances, they may impose a 1% or 2% fee on your redemptions.

The bottom line is that investors will still be able to put $1 into a money market fund and expect to get $1 back out again when they sell shares—with, perhaps, a tiny bit more confidence a few months from now.

-Bob Veres

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Meritas Advisors, LLC
info@meritasadvisors.com
meritasadvisors.com

Northern California
4040 Civic Center Dr.
Suite 200
San Rafael, CA 94903
415-690-8547

Southern California
11622 El Camino Real
Suite 100
San Diego, CA 92130
858.461.8547

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