MERITAS ADVISORS

FINANCIAL
Insights

July

Fixing social security
Once and for all

Chances are that you know that the Social Security trust fund is due to run out of money—or "deplete its reserves" as economists put it—by the year 2035. The actual time frame depends on some forecasts, including economic growth, number of workers who remain in the workforce and the number who retire—but the clear point is that Congress is going to have to take action in the next few years if it wants to prevent a lot of angry seniors from heading vengefully to the polls.

What would happen if no action was taken and the trust fund were depleted? Right now, there is a surplus of funds above what is needed to pay current retirees. Each year, the Social Security system collects FICA taxes from American workers, which comes to about 10.6% of earnings, and pays out somewhat more than that amount to Social Security beneficiaries—in the form of the checks that were promised. It is the difference between the amount collected and the amount being paid out—currently about 3.7 percentage points—that is moving us toward a crisis.

Once the trust fund can no longer make up the difference, Social Security recipients would simply receive, collectively, however much was collected by workers. Based on those same complex economic projections, economists guesstimate that this will be about 25% lower than the Social Security benefits that people had been promised and expecting.

A new paper prepared by the Center for Retirement Research at Boston College offers Congress a few choices when they finally decide to perform surgery on the nation's retirement program. The paper focuses on the difference between what is paid out and what is collected, and says that this difference is due to "Social Security's Missing Trust Fund"—a pool of assets that should have been set aside at the outset to generate enough interest to make up the difference. The paper suggests various ways to create a Missing Trust Fund of roughly $2.7 trillion.

One is to raise the payroll tax rate on existing workers. The calculations say that Social Security can be restored to full self-sufficiency in 75 years if the payroll tax were raised on all workers by 6.5 percentage points. If you wanted to take a more gradual approach, the payroll tax could be raised by just 4.5 percentage points over the next 150 years. In both cases, the payroll tax could then be restored to current levels going forward.

The paper also looks at not only raising the payroll tax, but also eliminating the cap on how much of a person's income is subject to FICA taxes. (Currently, only the first $132,900 is subject to the tax). In that case, the payroll taxes would only have to be raised by 5.3 percentage points (for a 75-year solution) or 3.7 percentage points (for a 150-year solution). Again, after that time period, both the tax rate and the inflation-indexed income limit would be restored.

Finally, the paper looked at raising income taxes to help fund Social Security's Missing Trust Fund. According to its calculations, simply raising the payroll tax would force the top quartile of workers to take on 54% of the burden of restoring Social Security back to solvency, compared with 29% for the second quartile, 13% for the third and 4% for the bottom quartile. Raising the payroll tax plus eliminating the cap on income would shift those figures to 65% (top quartile), 22%, 10% and 3%. Raising income taxes plus the payroll tax plus eliminating the income cap would throw 84% of funding the Missing Trust Fund into the collective lap of top quartile earners, with the second, third and bottom quartiles shouldering 12%, 4% and 1% of the burden, respectively.

Which of these will Congress adopt? Will it act at all? The debate is worth watching as the Presidential race heats up—and now you know the most workable proposals that are likely to be discussed.

-Bob Veres

Source:
https://crr.bc.edu/wp-content/uploads/2019/05/IB_19-9.pdf

The market at a glance

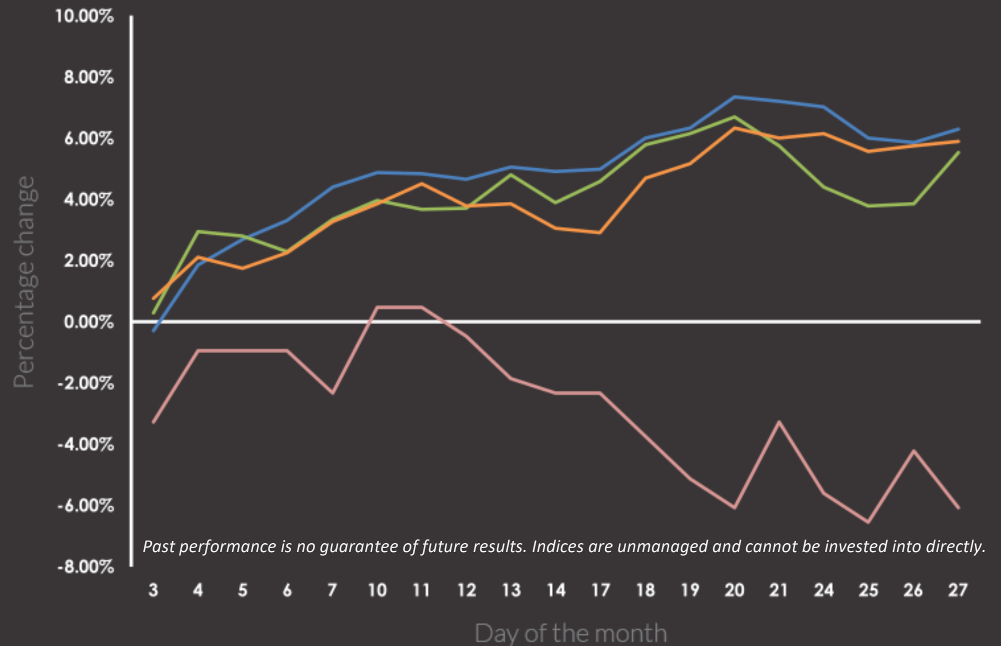
June

U.S. Large Cap
(S&P 500)
2,941.76 (6.89%) ▲

U.S. Mid/Small
(Russell 2000)
1,566.57 (6.90%) ▲

International Large
(NYSE International 100)
5,508.03 (6.20%) ▲

U.S. Treasuries
(U.S. 10-year Treasury yield rate)
2.00 (-6.54%) ▼



The market in action

- Workplace communication software company Slack entered the stock market with a direct offering opposed to the more traditional initial public offering (IPO). The listing was successful as share prices jumped nearly 50 percent from the reference price of $26 per share. Had it been an IPO, it would have been the fourth largest from a U.S. company so far in 2019.

- Cloud-based software company Salesforce agreed to purchase the data visualization company Tableau for $15.3 billion. The move aims to increase its competitiveness with other large tech companies such as Microsoft, Google, and Amazon. Following the announcement of the deal, shares of Tableau rose nearly 40 percent, while shares of Salesforce fell six percent.

- The crisis surrounding Boeing's 737 Max airplane continued as more than 400 pilots filed a class-action lawsuit claiming that the manufacturer performed an "unprecedented cover-up" of "known design flaws" in the plane. Less than a week after the suit was filed, U.S. regulators found that Boeing outsourced work to low-paid temporary workers in countries with a shallow background in aerospace engineering. Since March of 2019 Boeing shares have fallen by as much as 26 percent.

- Just weeks after ending its express delivery contract with FedEx, Amazon announced a new Delivery Service Partners program for local entrepreneurs to run their own delivery networks to deliver Amazon packages. With an investment as little as $10,000 to enter, owners can build out a delivery network with up to 40 vans covered in Amazon branding. Shares of FedEx and UPS both dropped more than two percent following the news.

Preparing to purchase a new vehicle

End-of-season car sales are upon us as dealerships hope to clear out old inventory this summer for the incoming 2020 models. According to Edmunds senior analyst Jeremy Acevedo, “August and September are when we generally see automakers make the most decided transition into the new models. These summer months correspond with a bump in incentives, particularly low APR financing on the outgoing model year vehicles.”

With attractive sales and nice weather ahead, many consumers will find themselves in the car market this summer. Vehicles are often among one of the largest expenses a consumer will have and thus carry some important decisions. Here are some tips to be on the right track when buying your next ride.

Check the used and pre-owned markets

Before diving into the details of your new vehicle, consider what the plan is with your current one. Will you be handing it down to a family member, or are you hoping to get some extra cash towards your new purchase? Many dealerships offer a trade-in program for customers to get rid of their old ride without the stress of selling on the used car market, however, this often comes at a cost with a lower payout. Though dependent on the condition and type of vehicle you will be trading in, instamotor.com indicates that the average consumer will get $2,250 less by trading in versus selling on the market.

It is also wise to check the used car market in your area to try to score a discount on your desired model. You may have heard the saying that cars lose 10 percent when they “roll off the lot” and data from Carfax shows that a new vehicle’s value can drop by more than 20 percent after just the first 12 months of ownership. These savings can make opting for a used model very attractive as long as the vehicle is in good condition.

Lease or own?

If you have your sights set on a new vehicle instead of a used model, the next biggest decision will be how you purchase. Both leasing and owning have their set of pros and cons for new car buyers.

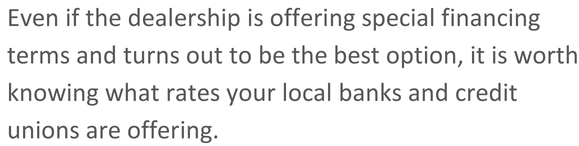
With leasing, you are not stuck with your vehicle choice for a long-term – most leases will run just two or three years. Additionally, leased vehicles will generally have a lower monthly payment than an auto loan and you do not have to worry about trading in or selling your car later on when moving to a different model. That said, eligibility for lease contracts typically requires a very stable and predictable source of income. When leasing a car, you will also have to follow a set of defined rules such as mileage restrictions, required maintenance expectations, and the need to purchase additional insurance. These costs can add up and surprise many leasers.

By owning a vehicle, you are able to avoid the restrictive terms of a lease contract and make the car your own. You can customize the car as you wish and take as many long road trips as your heart desires. For owners who aim to own their car for an extended period and are eligible for good financing terms, this option is often worth it.

Grab good financing terms

For consumers set on owning a new or used vehicle, obtaining a good financing rate will be crucial in the long-term.

Do your research on different financing options before heading to the dealership. While most dealerships will offer an easy financing option that can be arranged right on location, this may not be the best deal available. Many dealerships act as a middle man in the car financing process and slightly mark up rates to turn an additional profit.



Even if the dealership is offering special financing terms and turns out to be the best option, it is worth knowing what rates your local banks and credit unions are offering.

Many dealerships will run promotions offering $0 down financing, especially on holiday weekends like the Fourth of July and Labor Day. While this may be attractive on the day of purchase, paying a sizable down payment can be significantly beneficial in the long term. Simply put, the lower the amount that you are financing, the lower the total interest charges will be. Experts typically recommend a down payment of at least 20 percent, but the actual car buying average is about 12 percent according to Edmunds. Consider your current financial situation and understand the long-term impacts that different financing options will have.

Beware of costly upgrades

While many consumers are aware that dealerships will often offer different upgrade options or warranties to turn an additional profit, these can still be deceiving. Dealerships take advantage of the large numbers being thrown around at the time of purchase to make add-ons look less expensive. Consumers see the total purchase price in the tens of thousands and think tacking on a few hundred is not bad. Whether it be a paint coating, a different set of tires, or a pumped-up entertainment system, be sure to research how much these modifications would cost to have done by a third party. Rarely will a dealership have the best price in town for aftermarket upgrades.

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