Casey Mullooly: Welcome back to the Mullooly Asset podcast. This is your host, Casey Mullooly, and we're back for episode 379, just Brendan and I this week. We get into the cost of living adjustment, the 5.9% cost of living adjustment that will be applied to Social Security benefits starting next year in 2022. We break down how these adjustments get factored into our financial plans, and we also talk about the broader Social Security system. We provide some historical context around the changes that have been made before and how we think those changes will be factored into our plans moving forward. So there's a lot of good information in this one. Totally unbiased opinion there, but stick around for episode 379. Thanks for listening.

Brendan Mullooly: So I think the most interesting thing that I looked at was looking at the cost of living adjustments over the last time period, and then trying to average them out to smooth it and see what it actually has been as just one measure of inflation, since it is CPIW, so it's one of the ways you can dice it up. This increase that's going into effect next year, 5.9% is the highest one since 2008.

Casey Mullooly: Okay.

Brendan Mullooly: Which was 5.8%.

Casey Mullooly: Okay.

Brendan Mullooly: Which was followed by two years of zero. Which over a three year period averages to 2%. If you go back to 2015, and average each year from 2015 through this most recent one they announced this week, it averages to 2%. So just, I don't know, speaking to, for planning purposes, we have to assume some kind of rate of inflation, the Federal Reserve, who sets interest rates talks about their target for inflation, what they'd like to see in the economy. That can be noisy on a year-to-year basis, quarter-to-quarter basis when we're getting some of these economic data points announced, and I think it can swing you too far in either direction if you get too hung up on the most recent data point, without considering the larger set of things. The bigger picture is what matters, although we have to live through all the shorter terms too.

Casey Mullooly: Definitely. I was reading an article that CNBC did on this cost of living adjustment that's being applied to Social Security benefits. So, for those who don't know, the Social Security Administration announced a 5.9% cost of living adjustment to Social Security benefits that's going to kick in 2022. So I looked into how the cost of living adjustment, or COLA, is actually calculated.

Brendan Mullooly: Right.

Casey Mullooly: Which was pretty interesting. So it's the CPIW, which is the consumer price index, which is one of the most popular measures of inflation. But it's the CPIW, so the consumer price index for urban wage earners and clerical workers. So it's a little bit more specific than just the broad CPI number. But they take the reading in the third quarter of each year. So they took it in the third quarter of 2020, and then they took it in the third quarter of 2021, which just wrapped up a couple weeks ago, and whatever the percentage increase is, they apply it to next year's payments. So it's not even the whole year of 2020. It's just one quarter of 2020, which I think is, to your point, if they did it for the whole year, it would look different. If they did it as a-

Brendan Mullooly: From the second quarter to the second quarter, or-

Casey Mullooly: ... more rolling average, it would look a lot different, so.

Brendan Mullooly: Oh, sure. Right. Like to say that you could do it from the third quarter of 2021 and measure from the third quarter of 2018.

Casey Mullooly: Right.

Brendan Mullooly: And update it on that sort of a basis as-

Casey Mullooly: I mean, let's just think about what was going on in the third quarter of last year in 2020.

Brendan Mullooly: Sure.

Casey Mullooly: That was-

Brendan Mullooly: You're getting a lot of economic data, especially this year that just looks, as some of it did last year, too. Totally out of whack because of where it's being measured from.

Casey Mullooly: Right.

Brendan Mullooly: Yeah. Right, so.

Casey Mullooly: Third quarter last year, things were kind of bottoming out from COVID. The beginning of the third quarter, I think, was when they were kind of bottoming out and then-

Brendan Mullooly: Economic data started [crosstalk 00:04:43]

Casey Mullooly: Started to kind of improve as we went into the end of the year there. But yeah, I know in the article, I think some political groups, I think even President Biden was saying how they should use a different index, CPIE, which is CPI for elderly. Which, I mean, they are the people who are receiving these checks, but I'm not sure exactly what the differences are.

Brendan Mullooly: Does it weigh medical costs or thing, like a different basket of goods, that maybe is more applicable to retirees?

Casey Mullooly: Right.

Brendan Mullooly: I don't know. I mean, but I guess so, but this year at least, nobody's complaining about 5.9%.

Casey Mullooly: Right.

Brendan Mullooly: We've had three years over the last-

Casey Mullooly: 12.

Brendan Mullooly: ... decade.

Casey Mullooly: Yeah.

Brendan Mullooly: Where we didn't have any.

Casey Mullooly: Right.

Brendan Mullooly: Right? So the two following 2008, so 2009 and '10, I think, or maybe the next years chronologically. We had two following another big increase at 5.8% that were zeros, and then 2015 was a zero followed up by 0.3 so that was effectively two years of no COLA.

Casey Mullooly: Right.

Brendan Mullooly: As well.

Casey Mullooly: So it's an interesting parallel because I know we talk about how investing returns are. You kind of say lumpy, which is a funny term for it, but it's right. We talk about average returns when we're building financial plans for folks, both in terms of investments and inflation.

Brendan Mullooly: Two big components to the plan where we-

Casey Mullooly: Huge components.

Brendan Mullooly: ... we've got to assume something, and it's going to be a flat number, at least for starters.

Casey Mullooly: Right.

Brendan Mullooly: But we're certainly not going to get it. But it might average to it over the long term. That's what we're looking for.

Casey Mullooly: Sure.

Brendan Mullooly: Where, like over the last 12 months, people have experienced more inflation. If we're just going to use the CPIW, that's a very high inflation rate on a rolling 12 month basis.

Casey Mullooly: Right.

Brendan Mullooly: That we're now getting a raise for, from Social Security. But over the last seven years, we've averaged like 2% inflation.

Casey Mullooly: Right.

Brendan Mullooly: Which is exactly where the Federal Reserve says it wants to be, and probably a number that most people are thinking is perfectly reasonable. So it just depends on what scale you're looking at it. With the investments, I know we talked about this probably early on in this year quite a bit, but we got to third quarter of last year and small cap stocks had returned nothing for three years prior to that. Then in six months after that, they went up 60%.

Casey Mullooly: Oh, crazy.

Brendan Mullooly: In six months.

Casey Mullooly: Yeah.

Brendan Mullooly: And so you got-

Casey Mullooly: Averaged that out, and-

Brendan Mullooly: Right. So, you got three-

Casey Mullooly: ... right in line.

Brendan Mullooly: ... three and a half years worth of returns in six months, and if you got itchy and had to do something in the interim, then you missed on that.

Casey Mullooly: Right.

Brendan Mullooly: But they did what they were supposed to do. There's just no promise of it being smooth over time.

Casey Mullooly: Right.

Brendan Mullooly: If investment returns were smooth on a monthly basis over time, half of percent a month, and inflation ran at 0.10% a month, and we knew exactly what to predict. I mean, it would make planning a lot easier.

Casey Mullooly: So much easier because there are a lot of people kind of have this idea where they have their principle and then they're just going to spend whatever the investments make. There's a difference between when we're building plans and making projections and then living through the actual different market cycles and cycles with inflation. So we kind of have to make assumptions with planning. That's just the way it is. But-

Brendan Mullooly: Part of the way that we combat that with planning is when we do need to assume something, I would rather assume something on the higher end for something like inflation or expenses, just because the consequences of being wrong there would be an improvement to the plan. When we're assuming something for investment returns, I would rather assume something that's on the lower end because higher returns, again, would only be improvement. That's the direction I'd prefer to be wrong in when making planning projections.

Casey Mullooly: Right.

Brendan Mullooly: They'll certainly be wrong. They're just guesses.

Casey Mullooly: Right.

Brendan Mullooly: But if we do it with those parameters, then I think that we're setting ourselves up for success, and we're leaving wiggle room for the variation in those rates of inflation-

Casey Mullooly: That's so important.

Brendan Mullooly: ... return, expenses that are going to occur, but the variation should be baked in so that we're receptive to them and hopefully a positive way as opposed to it being a negative surprise that we weren't prepared for.

Casey Mullooly: So important. I think seeing the headline 5.9%, almost 6%, pretty much increase in the cost of living at this time when there's inflation fears are running hot and we're seeing some issues across the board. It was attention grabbing and kind of could stir up some emotion in people and-

Brendan Mullooly: Throw some gasoline on the fire. That's what we're talking about inflation for the last several months. Then you get this reading that is-

Casey Mullooly: It's confirmed.

Brendan Mullooly: Well, yeah. Right. It's applicable to so many people. I mean, you see all the stats about how many retirees, the percentage of retirees, and the percentage of their income that Social Security makes up. The amount of people that it lifts out of poverty per year. It's an important thing, so everybody's paying attention to the COLA increase for Social Security since it impacts all of us to some degree, whether we're tax payers or people who are on the benefit side of things for Social Security. So, yeah. I mean, you see that data point get thrown into the mix of all the other inflation talk and it maybe is exacerbating the issue in terms of just making it even more in our face.

Casey Mullooly: Yeah. So 65 million Americans collect social security checks each month.

Brendan Mullooly: Wow.

Casey Mullooly: So nine out of 10 people over the age of 65 collected a Social Security check in December of 2020. Just some more stats to prove your point here. 37% of elderly men and 42% of elderly women rely on social security for more than 50% of their annual income.

Brendan Mullooly: Yeah. I mean, listen. It's a part of everybody's financial plan to some degree, whether it's replacing that much of your income or a smaller amount or a larger amount. I mean, it factors in. Along with investments, or if you're lucky enough to have a pension outside of your Social Security. I mean, those are the components. Those are the inputs to retirement plans when we're looking at how do folks make ends meet once they're done working. So yeah, it's pretty critical.

Casey Mullooly: So this average monthly payment is going to increase by about $92 each month, which works out to roughly $1100 per year. So when we're talking about elderly folks who are relying on this for income, I think it was smart of the politicians to build in the COLAs and to make sure that these people who are relying on it are able to keep up and to get what they need.

Brendan Mullooly: Well, yeah. I mean, you think about the amount of people who no longer have something available to them, like a pension, like a guaranteed stream of income in retirement. Those have begun to get phased out more and more.

Casey Mullooly: Sure.

Brendan Mullooly: The folks that do have them, very, very few have a cost of living adjustment over time. So whatever the annual amount they receive is, goes not as far the further into it-

Casey Mullooly: Yeah, it's a fixed amount.

Brendan Mullooly: Yeah, right. So it becomes less valuable further into retirement, and also just the idea of maybe using some of your money to buy something like an annuity to replicate pension, guaranteed stream of income. Good luck finding something with a COLA increase on that too.

Casey Mullooly: Yeah, not going to happen.

Brendan Mullooly: Right. It's not going to happen, or you're going to pay so much for it that it's not going to be worthwhile when you run the numbers. So super valuable and a unique component, I think, to most people's retirement plans is having this stream of income that not only replaces a nice chunk of their need in retirement of the income that they used to earn, but it also does so on an inflation adjusted basis that's-

Casey Mullooly: Yeah, that's huge.

Brendan Mullooly: ... super valuable, and that's why the decision of when to take it, you shouldn't tread lightly on that. You should really consider what the best path forward for you or you and your spouse is going to be. Because it's critical.

Casey Mullooly: Huge decision there. Was it Ben Carlson who tweeted that Social Security's the best annuity in the world?

Brendan Mullooly: Yeah. I mean, and I kind of agree.

Casey Mullooly: Yeah.

Brendan Mullooly: For all the hand shaking-

Casey Mullooly: I was just going to get there with Social Security.

Brendan Mullooly: Sure.

Casey Mullooly: Nowadays you hear a lot of people about how Social Security's going to run out and, I should just take it now because we can't rely on the government to be there when we need it. I just have some interesting points on that as well. Just looking back through history. So the COLAs weren't added until 20 years after Social Security was started in the 1930s.

Brendan Mullooly: Okay.

Casey Mullooly: So they made an amendment to the Social Security Act, which was in the 1950s. So they realized, "Hey, things are getting more expensive. We have to make this change."

Brendan Mullooly: Right.

Casey Mullooly: Life expectancy in 1930. 58 years old for men and 62 years old for women.

Brendan Mullooly: Right. Yeah. So the program has certainly transformed over time in terms of what it's actually doing for people.

Casey Mullooly: Right.

Brendan Mullooly: As a result of life expectancy is becoming more-

Casey Mullooly: What do you think the first monthly Social Security check was for? How much? Like dollar-

Brendan Mullooly: The dollar amount? Inflation adjusted or back then?

Casey Mullooly: Back then.

Brendan Mullooly: Like $10 or something?

Casey Mullooly: $22.54.

Brendan Mullooly: Wow. Nice.

Casey Mullooly: And now the average is $1,600.

Brendan Mullooly: Yeah, Sure. Wow. No, but that speaks to the value of the inflation adjustment. Whether or not CPIW is perfect or not, it's at least to some degree kept up, and adjusted those dollars to be worth something today as opposed to being 20 bucks.

Casey Mullooly: Yeah, exactly. So like we said, 65 million people who receive Social Security checks each month, the demographics are shifting. So the number of Americans age 65 and older will increase from 57 million in 2021 to over 76 million in 2035.

Brendan Mullooly: Yeah. So you hear about the 2030s being the point where at least as the world exists today, there start to be some operational issues with Social Security, meaning that there would only be... So the way it works out today is I think that for every one person collecting Social Security, there's like three or three and a half who are paying him via payroll taxes. By the 2030s, it's going to be more like two and a half for every one who's collecting, meaning the amount coming in is not going to be enough to pay the full amount of the anticipated benefits at that point in time. They have enough without changing any of the rules to get about three quarters of it, and so that's always the thing that you hear referenced when people are worried about the viability of the program.

Casey Mullooly: Right.

Brendan Mullooly: The thing I think that goes unspoken, that Ben Carlson also tipped me off to at least in a post was that, that three quarters number. If you just think about over the next decade, that occurring, you would probably anticipate that that number continues to get smaller and smaller over time. Meaning if it's only going to cover three quarters in the 2030s, and maybe by the 2050s, it's only covering half and so on and so forth. At least with, again, as the rules as they are today in demographics, anticipated workforce size, out to the 2070s, it projects to cover the same three quarters. So the situation doesn't project to become more dire than it will be in the 2030s, as a result of time continuing to go on.

Casey Mullooly: That's a good point because I mean, we're seeing our age groups and millennials kind of coming into the workforce. So is that the driving factor that's kind of keeping that afloat?

Brendan Mullooly: So demographics behind that are I think what factor into it, and again, this is without changing any of the laws at all, in terms of how the payroll taxes are collected or how the benefits are collected.

Casey Mullooly: Yeah.

Brendan Mullooly: They could tell folks our age case that we're not going to be able to collect until we're 70.

Casey Mullooly: Yeah.

Brendan Mullooly: And that might be perfectly reasonable, and we keep paying in at the same rate. Or they could say something along the lines of the cap on income each year that is-

Casey Mullooly: Subject to-

Brendan Mullooly: Sure, yeah. So you have only a portion of your income up to about 140,000 or so. The number changes each year.

Casey Mullooly: Yeah.

Brendan Mullooly: Along with the COLA adjustments.

Casey Mullooly: Right, yeah.

Brendan Mullooly: They have a new number now for next year. The wage base that that six and a half percent for Social Security for the employee contribution is taken from, that could be changed.

Casey Mullooly: Right.

Brendan Mullooly: To fund it. There are a lot of different levers they can pull to change this that don't result in them throwing up their hands and saying, "It's insolvent."

Casey Mullooly: Yeah.

Brendan Mullooly: It was a Ponzi all along.

Casey Mullooly: Can't do it anymore.

Brendan Mullooly: None of you are getting your money.

Casey Mullooly: Yeah. It's one of the most popular, probably the most popular program that the government runs.

Brendan Mullooly: That and Medicare.

Casey Mullooly: Yeah.

Brendan Mullooly: Yeah. I don't see a world, and don't get me wrong. It's not that I have a ton of faith in politicians either. I'm not a fan as much as the next guy, but I don't see a world where they just allow a program like that to expire and then deal with the repercussions of that, because I don't want to see what those [crosstalk 00:18:45]

Casey Mullooly: That's the thing. I think the one thing that if you're skeptical of politicians, the one thing that you can bank on is that they're going to act in their own best interest.

Brendan Mullooly: Sure.

Casey Mullooly: They're going-

Brendan Mullooly: They're self interested.

Casey Mullooly: They're going to serve their own purposes.

Brendan Mullooly: Yeah.

Casey Mullooly: So-

Brendan Mullooly: It's in their best interest to do that.

Casey Mullooly: To that point, the highest voting turnout in the 2020 election cycle was in the age 65 to 74 bracket.

Brendan Mullooly: There you go.

Casey Mullooly: 76%.

Brendan Mullooly: Yeah.

Casey Mullooly: You don't think that they care about those voters?

Brendan Mullooly: Right, sure. And those are the exact people we're talking about.

Casey Mullooly: Exactly.

Brendan Mullooly: Social Security. No, that's very good point. And I agree.

Casey Mullooly: So, yeah. I think like you said, there are so many levers and so many tweaks that they can make, and we're just going to have to wait and see how it plays out. We're kind of subject to what the government is going to do with that, but it's changed a lot over the years dating back to the 1930s as we've illustrated. So I think it will continue to change into the future.

Brendan Mullooly: I think maybe that lack of control is what frustrates people so much. So when people complain about Social Security really, maybe what we're all collectively complaining about is just some degree of that whole thing being out of our hands.

Casey Mullooly: Sure.

Brendan Mullooly: Doesn't feel very secure.

Casey Mullooly: Yeah.

Brendan Mullooly: But it's funny because it's Social Security.

Casey Mullooly: Can only control what we can control, right?

Brendan Mullooly: Because it doesn't feel secure, but I do think that it's a valuable piece of a retirement plan for virtually every person who comes through our door. I think it will continue to be that for many years into the future and just one man's opinion, but that's what I think.

Casey Mullooly: And with that, we're going to wrap up episode 379 of the Mullooly Asset podcast. Look out for, if you're receiving Social Security checks each month, starting next year in 2022, you should see that 5.9% adjustment made. If you have any questions about what the adjustment means for you moving forward, don't hesitate to reach out. Thank you as always for listening, and we'll be back for episode 380.