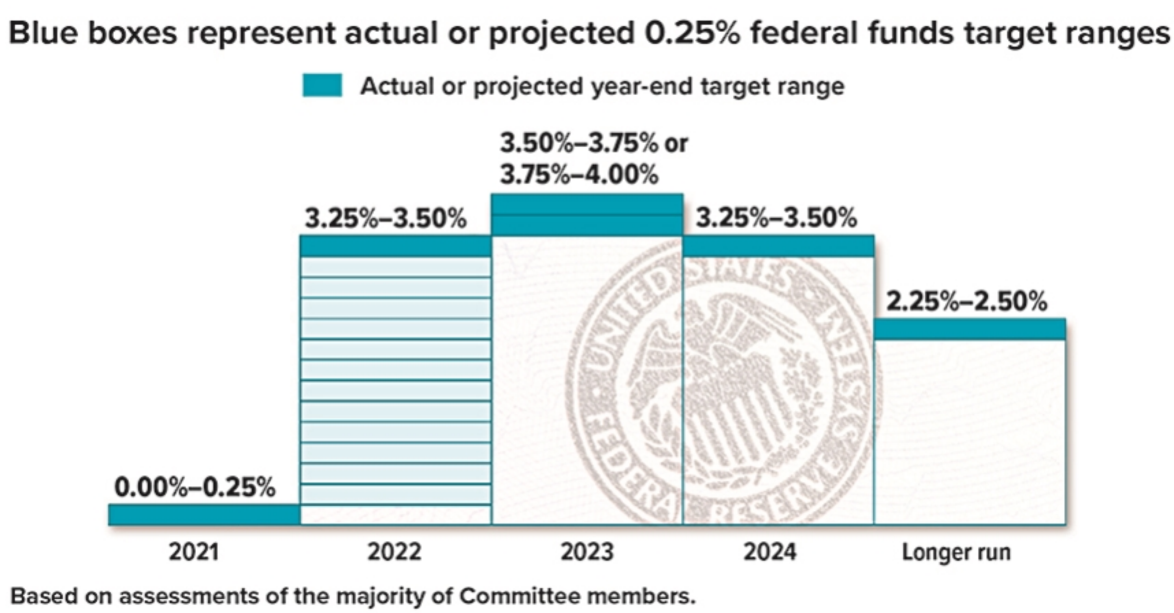
marrick wealth monthly

2211 Michelson Drive • Suite 545 • Irvine • CA • 92612
949-258-9700
info@marrickwealth.com • www.marrickwealth.com

Rising Interest Rates

After dropping the benchmark federal funds rate to a range of 0%–0.25% early in the pandemic, the Federal Open Market Committee (FOMC) of the Federal Reserve has begun raising the rate aggressively in response to high inflation. Raising the funds rate places upward pressure on a wide range of interest rates, including the prime rate, small-business loans, home-equity lines of credit, auto loans, credit-card rates, and adjustable-rate mortgages (with indirect pressure on fixed-rate mortgages).

This chart illustrates the federal funds target range at the end of 2021 and future year-end projections released after the FOMC June 2022 meeting, when the Committee raised the range to 1.50%–1.75%.



Source: Federal Reserve, June 2022. These are only projections, based on current conditions, subject to change, and may not come to pass.

Working While Receiving Social Security Benefits

The COVID-19 recession and the continuing pandemic pushed many older workers into retirement earlier than they had anticipated. A little more than 50% of Americans age 55 and older said they were retired in Q3 2021, up from about 48% two years earlier, before the pandemic.[1]

For people age 62 and older, retiring from the workforce often means claiming Social Security benefits. But what happens if you decide to go back to work? With the job market heating up, there are opportunities for people of all ages to return to the workforce. Or to look at it another way: What happens if you are working and want to claim Social Security benefits while staying on your job?

Retirement Earnings Test

Some people may think they can't work — or shouldn't work — while collecting Social Security benefits. But that's not the case. However, it's important to understand how the retirement earnings test (RET) could affect your benefits.

- The RET applies only if you are working and receiving Social Security benefits *before* reaching full retirement age (FRA). Any earnings after reaching full retirement age do not affect your Social Security benefit. Your FRA is based on your birth year: age 66 if born in 1943 to 1954; age 66 & 2 months to 66 & 10 months if born in 1955 to 1959; age 67 if born in 1960 or later.
- If you are under full retirement age for the entire year in which you work, $1 in benefits will be deducted for every $2 in gross wages or net self-employment income above the annual *exempt amount* ($19,560 in 2022). The RET does not apply to income from investments, pensions, or retirement accounts.
- A monthly limit applies during the year you file for benefits ($1,630 in 2022), unless you are self-employed and work more than 45 hours per month in your business (15 hours in a highly skilled business). For example, if you file for benefits starting in July, you could earn more than the annual limit from January to June and still receive full benefits if you do not earn more than the monthly limit from July through December.
- In the year you reach full retirement age, the reduction in benefits is $1 for every $3 earned above a higher annual exempt amount ($51,960 in 2022 or $4,330 per month if the monthly limit applies). Starting in the month you reach full retirement age, there is no limit on earnings or reduction in benefits.
- The Social Security Administration may withhold benefits as soon as it determines that your earnings are on track to surpass the exempt amount. The estimated amount will typically be deducted from your monthly benefit in full. *(See example.)*
- The RET also applies to spousal, dependent, and survivor benefits if the spouse, dependent, or survivor works before full retirement age. Regardless of a spouse's or dependent's age, the RET may reduce a spousal or dependent benefit that is based on the benefit of a worker who is subject to the RET.

Back to Work

In this hypothetical example, Fred claimed Social Security in 2021 at age 62, and he was entitled to a $1,500 monthly benefit as of January 2022. Fred returned to work in April 2022 and is on track to earn $31,560 for the year — $12,000 above the $19,560 RET exempt amount. Thus, $6,000 ($1 for every $2 above the exempt amount) in benefits will be deducted. Assuming that the Social Security Administration (SSA) became aware of Fred's expected earnings before he returned to work, benefits might be paid as illustrated below.

In practice, benefits may be withheld earlier in the year or retroactively, depending on when the SSA becomes aware of earnings.

The RET might seem like a stiff penalty, but the deducted benefits are not really lost. Your Social Security benefit amount is recalculated after you reach full retirement age. For example, if you claimed benefits at age 62 and forfeited the equivalent of 12 months' worth of benefits by the time you reached full retirement age, your benefit would be recalculated as if you had claimed it at age 63 instead of 62. You would receive this higher benefit for the rest of your life, so you could end up receiving substantially more than the amount that was withheld. There is no adjustment for lost spousal benefits or for lost survivor benefits that are based on having a dependent child.

If you regret taking your Social Security benefit before reaching full retirement age, you can apply to withdraw benefits within 12 months of the original claim. You must repay all benefits received on your claim, including any spousal or dependent benefits. This option is available only once in your lifetime.

1) Pew Research Center, November 4, 2021

Inflation Protection for Investment Dollars

For the 12-month period ending in May 2022, the Consumer Price Index for All Urban Consumers (CPI-U) — the most widely used measure of inflation — increased 8.6%, the fastest pace in 40 years.[1] The rate may trend downward as the Federal Reserve raises interest rates and supply-chain issues improve. But inflation is likely to be relatively high for some time.

High inflation not only hits consumers in the pocketbook for current spending, it also has a negative impact on the future purchasing power of fixed-income investments. For example, a hypothetical investment earning 5% annually would have a *real return* of –2.5% during a period of 7.5% annual inflation. This rate of return might be further reduced by taxes.

One way to help hedge your bond portfolio against inflation is by investing in Treasury Inflation-Protected Securities (TIPS).

How TIPS Fight Inflation

The principal value of TIPS is automatically adjusted twice a year to match any increases or decreases in the Consumer Price Index. If the CPI-U moves up or down, the Treasury recalculates your principal to reflect the change. A fixed rate of interest is paid twice a year based on the current principal, so the amount of interest may also fluctuate. Thus, you are trading the certainty of knowing exactly how much interest you'll receive for the assurance that your investment will maintain its purchasing power over time.

Like all Treasury securities, TIPS are guaranteed by the federal government as to the timely payment of principal and interest. If you hold TIPS to maturity, you will receive the greater of the inflation-adjusted principal or the amount of your original investment.

Pricing-In Protection

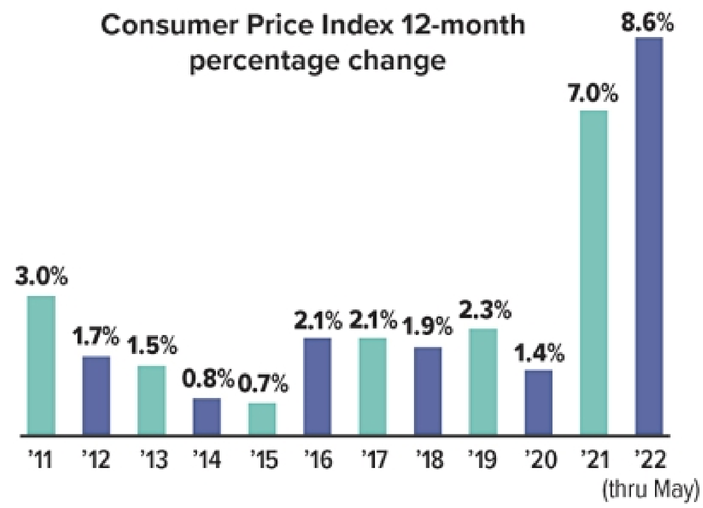
TIPS pay lower interest rates than equivalent Treasury securities that don't adjust for inflation. The *breakeven inflation rate* is the difference between the yield of TIPS and nominal (non-inflation-protected) Treasury securities with similar maturities. It is the premium the investor pays for inflation protection, as well as a market-based measure of expected inflation.

If inflation runs higher than expected, TIPS will earn a better return than nominal Treasury securities. If inflation runs below the breakeven rate, then TIPS have no clear advantage. However, the increased principal due to any level of inflation can still add to the value of your portfolio.

In some situations, TIPS can have negative interest rates that might produce a positive return after the principal is increased for inflation. For example, if a five-year TIPS offers a return of –0.5% while a five-year Treasury note offers a return of 2.5%, the 3% difference between these rates is the breakeven inflation rate. If inflation were to run at 4% over the five-year period, the TIPS would return 3.5% (4% – 0.5%) after adjustments for inflation, 1% higher than the return on the Treasury note.[2]

Eroding Purchasing Power

After an extended period of low inflation, consumer prices spiked in 2021 and 2022 due to supply and demand imbalances as the U.S. economy reopened.



Source: U.S. Bureau of Labor Statistics, 2022

TIPS are sold in $100 increments and are available in maturities of 5, 10, and 30 years. As with all bonds, the return and principal value of TIPS on the secondary market will vary with market conditions, are sensitive to movements in interest rates, and may be worth more or less than their original cost. When interest rates rise, the value of existing TIPS will typically fall on the secondary market. Changing rates and secondary-market values should not affect the principal of TIPS held to maturity.

You must pay federal income tax each year on the interest income from TIPS plus any increase in principal, even though you won't receive the principal and interest until the bonds mature. For this reason, investors might consider holding TIPS in a tax-deferred account such as an IRA.

1) U.S. Bureau of Labor Statistics, 2022

2) This hypothetical example of mathematical principles is used for illustrative purposes only. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

The Potential Benefits of Roth IRAs for Children

Most teenagers probably aren't thinking about saving for retirement, buying a home, or even paying for college when they start their first jobs. Yet a first job can present an ideal opportunity to explain how a Roth IRA can become a valuable savings tool in the pursuit of future goals.

Rules of the Roth

Minors can contribute to a Roth IRA as long as they have earned income and a parent (or other adult) opens a custodial account in the child's name. Contributions to a Roth IRA are made on an after-tax basis, which means they can be withdrawn at any time, for any reason, free of taxes and penalties. Earnings grow tax-free, although nonqualified withdrawals of earnings are generally taxed as ordinary income and may incur a 10% early-withdrawal penalty.

A withdrawal is considered qualified if the account is held for at least five years and the distribution is made after age 59½, as a result of the account owner's disability or death, or to purchase a first home (up to a $10,000 lifetime limit). Penalty-free early withdrawals can also be used to pay for qualified higher-education expenses; however, regular income taxes will apply.

In 2022, the Roth IRA contribution limit for those under age 50 is the lesser of $6,000 or 100% of earned income. In other words, if a teenager earns $1,500 this year, his or her annual contribution limit would be $1,500. Other individuals may also contribute directly to a teen's Roth IRA, but the total value of all contributions may not exceed the child's annual earnings or $6,000 (in 2022), whichever is lower. (Note that contributions from others will count against the annual gift tax exclusion amount.)

Roth IRAs offer an opportunity to learn about important concepts that could provide a lifetime of financial benefits.

Lessons for Life

When you open a Roth IRA for a minor, you're giving more than just an investment account; you're offering an opportunity to learn about important concepts that could provide a lifetime of financial benefits. For example, you can help explain the different types of investments, the power of compounding, and the benefits of tax-deferred investing. If you don't feel comfortable explaining such topics, ask your financial professional for suggestions.

The young people in your life will thank you — sooner or later.

For questions about laws governing custodial Roth IRAs, consult your tax or legal professional. There is no assurance that working with a financial professional will improve investment results.

IMPORTANT DISCLOSURES

This publication is not intended to provide investment, tax, or legal advice. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

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