The choice is complicated. In deciding when to claim Social Security benefits, men and women with financial flexibility aim to maximize both the lifetime benefits they receive and their household wealth. It’s not a simple calculation. Individuals receive higher monthly benefits the longer they postpone claiming Social Security (up to age 70), but waiting means they must forgo the income stream that Social Security benefits would provide. As a result, they must tap into their investment portfolios and miss out on the potential returns that those assets would have generated. For individuals who expect to surpass the average life expectancy, waiting until age 70 to claim Social Security benefits can maximize total benefits received. But does it also maximize long-term wealth?

As we said, it’s far from a simple calculation.

In this paper, we explore the trade-offs involved in claiming Social Security benefits. Our study is informed by the ever-increasing average life expectancy for American men and women, which has changed the calculus of retirement planning.

Within the context of this increasing longevity, we analyze the following three scenarios:

- maximizing an individual’s Social Security benefits using a standard break-even analysis from J.P. Morgan’s Guide to Retirement
- maximizing total investible wealth using a deterministic analysis and assuming 5% and 7% average annual portfolio returns, net of fees
- maximizing median (or most common) and worst-case total investible wealth for two portfolios with very different risk and return characteristics
Our analysis assumes that individuals stop working at age 62 and try to choose when to claim benefits, by considering total investible wealth over time. Therefore, our scenarios do not consider the following: the earnings test, taxation of Social Security benefits, filing strategies for couples and the implications of an individual’s claiming choice for a surviving spouse. These factors are so varied that they warrant personalized assessments based on unique client situations and are therefore beyond the scope of this study.

AMERICANS ARE LIVING LONGER
In 2014, a 65-year-old American man had an average life expectancy of approximately 82.5 years; for a woman, the average life expectancy was 85.2 years (EXHIBIT 1). Given continued advancements in medical treatments and technology, one can reasonably estimate that median life expectancy may extend to 86 or 87 years within the next several decades. The Society of Actuaries recently cited 87.7 years as the median life expectancy for the 10.5 million people covered by one of 123 private pension plans, a gain of 2.2 years in the past decade.

If you’re 65 today, the probability of living to a specific age

EXHIBIT 1: LIFE EXPECTANCY PROBABILITIES

Longevity is directly correlated to education level, income and gender, but a family history of longevity is perhaps the single greatest predictor of a person’s life span. Applying these demographic realities in the context of Social Security, we conclude that healthy affluent people who have the financial flexibility to choose from any of the Social Security claiming ages are likely to have a higher chance of living to or beyond average life expectancy. Therefore, we will use a target life expectancy of 87 when evaluating each of our three scenarios.

STANDARD “BREAK-EVEN” ANALYSIS FOR SOCIAL SECURITY
Social Security is a program that pays individuals more the later they claim benefits, with the advantage of delaying benefits ending at age 70 (EXHIBIT 2, next page). Individuals born between 1943 and 1954 receive 75% of their full benefit at age 62, 100% at the “full retirement age” of 66 and 132% at age 70. This represents a growth rate in income of 7.3% compounded over an eight-year period, from age 62 to 70. Note that this is the rate at which the benefit itself grows before the cost of living adjustment (COLA). COLA has averaged 2.43% annually over the past 15 years, but the increases have been smaller recently, with a 1.7% increase in benefits in 2015.

In determining how to maximize Social Security benefits, let’s first look at a maximum wage earner—someone who has 35 years at or above the maximum wage base limit ($118,500 in 2015)—and determine the “break-even point.” This is the age at which an individual will receive more from Social Security by waiting for a larger benefit than he would have received if he had claimed smaller benefits that began earlier in retirement (EXHIBIT 3).

The current final break-even age of 80 is well below current average life expectancy estimates: Actuarial tables project that more than six in 10 men and more than seven in 10 women who are age 65 are expected to live at least to age 80. For married couples, there is an almost 90% chance that one spouse will live to that age or beyond.

How should individuals evaluate these data as they decide when to claim Social Security benefits? They should be aware that they may favor claiming early due to “hyperbolic discounting,” a concept in behavioral finance that describes the preference for a dollar today rather than a dollar in the future. Advisors who frame the decision within the context of a client’s life expectancy, highlighting the key factors that will heavily influence that life expectancy (including education level, family history of longevity and current health status)—and anchoring clients first on their age-70 benefit amount—can lead to a more balanced evaluation of the claiming choice.
Deciding when to claim Social Security benefits is a critical retirement decision.

**EXHIBIT 2: SOCIAL SECURITY TIMING TRADE-OFFS FOR AMERICANS**

- **Born 1943–1954 (Age 61-72)**
  - (Age 62) Decreased benefits: -6.25% average per year
  - Age 66 (Full Retirement Age) Increased benefits: +8% per year
  - (Age 70) Increased benefits: 132%

- **Born 1960+ (Age 55 or younger)**
  - (Age 62) Decreased benefits: -6.00% average per year
  - Age 67 (Full Retirement Age) Increased benefits: +8% per year
  - (Age 70) Increased benefits: 124%

7.3% compound growth rate for each year of waiting to take benefits
7.4% compound growth rate for each year of waiting to take benefits

**Maximizing Social Security benefits**

**EXHIBIT 3A: SOCIAL SECURITY BREAK-EVEN ANALYSIS—ESTIMATED TOTAL BENEFITS OF THE DISTRIBUTIONS BEGINNING AT A CERTAIN AGE ASSUMING MAXIMUM BENEFIT**

- Claim at age 62: $4,319 per month
- Claim at age 66: $2,941 per month
- Claim at age 70: $51,828

**EXHIBIT 3B: SOCIAL SECURITY BREAK-EVEN DATA**

<table>
<thead>
<tr>
<th>Age</th>
<th>Claim at age 62</th>
<th>Claim at age 66</th>
<th>Claim at age 70</th>
<th>At age 65, probability of living to at least age</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>$239,514</td>
<td>$186,262</td>
<td>$51,828</td>
<td>91%</td>
</tr>
<tr>
<td>76</td>
<td>$433,467</td>
<td>$445,133</td>
<td>$393,538</td>
<td>75%</td>
</tr>
<tr>
<td>78</td>
<td>$505,595</td>
<td>$541,036</td>
<td>$520,130</td>
<td>69%</td>
</tr>
<tr>
<td>80</td>
<td>$581,459</td>
<td>$642,188</td>
<td>$553,650</td>
<td>62%</td>
</tr>
<tr>
<td>82</td>
<td>$661,475</td>
<td>$748,876</td>
<td>$794,479</td>
<td>54%</td>
</tr>
<tr>
<td>85</td>
<td>$789,784</td>
<td>$919,955</td>
<td>$1,020,303</td>
<td>42%</td>
</tr>
</tbody>
</table>

Source: Social Security Administration, J.P. Morgan Asset Management. For illustrative purposes only. For 1955-1960, two months are added to the Full Retirement Age each year.

The Average Cost of Living Adjustment (2000–2015) is 2.43%.

1.7% Cost of Living Adjustment for 2015

Source: Break-even calculated using the Social Security Administration calculator for beginning values at each age. Assumes maximum benefits are received for individuals turning 62 and 1 month, 66 and 70 in 2015 and assumes the benefit will increase each year based on the Social Security Administration 2014 Trustee’s Report “intermediate” estimates (starting at 1.7% in 2015 and gradually rising to 2.7% in 2020). Monthly amounts without the cost of living adjustments (not shown on the chart) are: $2,014 at age 62; $2,713 at age 66; and $3,606 at age 70.
The conclusion is clear when looking at Social Security in isolation: For individuals with a high likelihood of living beyond average life expectancy and the goal of maximizing the amount they receive from Social Security, waiting until age 70 to claim Social Security benefits will prove to be the best choice over the long term.

PORTFOLIO IMPLICATIONS OF SOCIAL SECURITY CLAIMING AGES: A DETERMINISTIC VIEW

In reality, we know that the Social Security decision is not made in isolation. Many people understand that deciding when to claim Social Security benefits involves interconnected, interdependent choices. Individuals with the financial means to tap portfolios to meet spending needs and thus postpone Social Security benefits should evaluate the opportunity costs of doing so. When will that opportunity cost be too high? Put another way, when might someone be better off—in terms of maximizing total investible wealth—claiming Social Security benefits earlier? And at what point does that benefit dissipate?

We first assess this issue deterministically, assuming average annual rates of return and ignoring the sequencing and volatility of returns over time. Does protecting a portfolio early in retirement by claiming lower monthly Social Security payments sooner provide a better outcome than drawing from a portfolio in the initial retirement years and receiving higher benefit payments? How aggressive might someone need to be to move the break-even of claiming at age 70 out to our target life expectancy of 87?

To conduct this assessment, all other factors remain constant. In particular, total spending has to be the same across all scenarios. We assume that spending is equal to the Social Security benefit at age 62 ($24,170 annually) grown by the Social Security Administration’s forecasted cost of living adjustment for the program (1.7% in 2015, growing to 2.7% in 2020). We also assume that a portfolio achieves an average annual return, net of fees, of either 5% or 7%.

As we see it, a 5% return is likely a reasonable assumption over the long run for a diversified portfolio. However, a 7% return appears to be a very high hurdle, given lower expected future returns across most asset classes. For example, J.P. Morgan’s “2015 Long-term Capital Market Return Assumptions”—our annual assessment of the long-term outlook for all major asset classes and markets—assumes compound...
returns of just 6.5% for U.S. large cap equities over the next 10 to 15 years. For U.S. investment-grade corporate debt, the assumed compound return over that period is 4.75%.

In the age 62 scenario, an individual claims benefits but does not touch a portfolio to meet any spending needs. Note that the Social Security benefit covers all spending needs through retirement. As a result, the value of the portfolio continues to increase at the average annual growth rate.

In the age 66 and age 70 scenarios, the portfolio is initially depleted at the rate of the age 62 benefit grown by inflation. At these later claiming ages, the amount of the higher inflation-adjusted benefit in excess of the age 62 benefit (the age 66 benefit is approximately $35,000 per year, and the age 70 benefit is about $52,000) is added back into the portfolio each year. Specifically, when claiming at age 66, $8,824 extra is received from Social Security and reinvested in the portfolio, and when claiming at age 70, $21,917 is received and reinvested.

We then identify when the total value of the portfolios in the age-66 and age-70 scenarios exceeds the age-62 scenario; in other words, the age at which the same level of spending has been supported but the total value of the portfolio begins out-pacing the strategy of protecting the portfolio early in retirement by claiming Social Security benefits sooner at reduced amounts.

The 5% return scenario moves the break-even ages out to 80 (if claiming between ages 62-66) and 85 (if claiming between ages 66-70) aligned to average life expectancy for men and perhaps a little short for women (EXHIBIT 4), but still short of our target life expectancy. The 7% return scenario successfully pushes the break-even ages out to 84 to 91, but, as we have noted, with a return assumption that is likely too aggressive (EXHIBIT 5).

Note that claiming at age 66 is the best choice for the shortest period of time for the more realistic scenario of 5% (from ages 79 to 85) because the much greater age 70 benefit quickly outpaces the age 66 claiming scenario. For people who anticipate below-average life expectancy, claiming at 62 and protecting their portfolios may be the best choice. But if greater life expectancy is anticipated either individually or as a couple, waiting until age 66 has significant benefits in terms of getting to current average life expectancy. However, age-70 eventually outpaces the age-66 scenario and may result in greater lifetime wealth, given anticipated growth in longevity.

Impact of Social Security claiming on portfolio values at 7% return

Impact of Social Security claiming on portfolio values at 7% return

**EXHIBIT 5A: SOCIAL SECURITY BREAK-EVEN ANALYSIS—ESTIMATED TOTAL VALUE OF ASSETS AND BENEFITS OF THE DISTRIBUTIONS BEGINNING AT A CERTAIN AGE ASSUMING MAXIMUM BENEFITS AND SPENDING EQUAL TO SS VALUE CLAIMED AT 62**

**EXHIBIT 5B: RETAINED ASSETS AT SELECTED AGES BY SOCIAL SECURITY CLAIM AGE**

<table>
<thead>
<tr>
<th>At age 65, probability of living to at least age</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Claim at age 62</strong></td>
</tr>
<tr>
<td>$330,923</td>
</tr>
<tr>
<td>$853,295</td>
</tr>
<tr>
<td>$1,118,496</td>
</tr>
<tr>
<td>$1,370,206</td>
</tr>
</tbody>
</table>

| Source: J.P. Morgan Asset Management. Assumptions: 2.7% COLA growth, $180,000 initial starting assets, required spending set to Social Security amount received when claiming at age 62. For illustrative purposes only. |
PORTFOLIO IMPLICATIONS OF SOCIAL SECURITY CLAIMING AGES: A MONTE CARLO VIEW

We know that the average portfolio return achieved is never exactly the same year in and year out. We know, too, that the sequence in which the returns are actually experienced can have a significant impact, particularly in the early years of retirement.

Our final analysis leverages a Monte Carlo approach to assess the break-even question for two different portfolio allocation assumptions. These assumptions have return expectations that are similar to the prior deterministic analysis, but we now incorporate each portfolio’s corresponding volatility into the analysis. Here we calculate the percentile likelihood of maximizing total wealth in the most common scenario—the median case, which has a 50% likelihood of occurring—and the worst-case scenario, which has a 5% likelihood. That is, 95% of scenarios will result in higher wealth values.

Our key assumptions include the following:

• A $1 million portfolio
• Initial annual spending of $74,170. This assumes a 5% initial withdrawal rate—that is, 5% of $1 million, or $50,000, every year—plus the maximum age-62 Social Security benefit of about $24,000, grown by 1.5% annually. (The 1.5% growth rate is based on our insights into actual spending behavior as people age. We recommend using a slightly lower inflation rate on core spending.)
• A conservative portfolio, with 30% in equities and 70% in fixed income, an expected long-term return of 5.1% and long-term volatility of 5.4%.
• A more diversified/aggressive portfolio with 55% in equities, 30% in bonds and 15% in alternatives (specifically, 25% U.S. large cap, 10% U.S. small cap, 15% EAFE, 5% emerging market equity, 25% U.S. Barclays Aggregate bonds, 5% short-duration U.S. government credit, 5% diversified hedge funds, 5% commodities, and 5% U.S. real estate investment trusts); expected long-term return of 6.7% and long-term volatility of 10.9%.

EXHIBIT 6 shows the estimated portfolio value at various ages across Social Security claiming ages of 62, 66 and 70. For the conservative portfolio (likely more commonly held by older Americans), the break-even ages, assuming the median return scenarios, are 80, 83 and 85, respectively, for the age-62, age-66 and age-70 scenarios. Again, this is slightly below target life expectancy.

But look at the difference in total wealth in the later years of retirement. As the conservative portfolio is depleted to keep up with annual spending needs, there is almost $400,000 less in forecasted wealth by the time an individual is in his early 90s (EXHIBIT 6). Therefore, the value of the benefit at age 70 in meeting lifestyle needs is clear when a more conservative portfolio is the alternative funding option over the long term.
Consider as well the 5th percentile likelihood that an individual in the age-62 scenario will run out of money by age 86. In scenarios with persistent poor markets, the higher Social Security benefit taken later outpaces the advantage of using a lower Social Security benefit to protect a portfolio from poor returns early in retirement (EXHIBIT 7).

For the more diversified/aggressive portfolio, at age 87 we finally see the break-even between claiming at age 66 and age 70 meet but not exceed target life expectancy. It is important to note that the total wealth values in the early 90s are closer than in the conservative portfolio and are all moving higher for both the age-66 and age-70 claiming scenarios. The more diversified/aggressive portfolio is better able to keep up with spending needs, regardless of the Social Security claiming choice (EXHIBIT 8).
On the other hand, in all claiming scenarios, very poor market returns early in retirement mean there is a 5th percentile likelihood of running out of money in all scenarios by age 85 (EXHIBIT 9).

CONCLUSION

As the average life expectancy for Americans continues to rise steadily year after year, deciding when to claim Social Security benefits becomes a more complicated choice. Our analysis delivers the following important insights:

• For individuals who have a high likelihood of living past the average life expectancy—most likely, people with longevity in their family histories, higher levels of education and income and healthier lifestyle choices—waiting until age 70 to claim Social Security benefits will in all probability produce both the greatest amount of total Social Security benefits and the greatest long-term wealth.

• An unrealistically high average annual return (7%) is required to move the break-even meaningfully past age 87—a realistic yet conservative estimate of average life expectancy, assuming continued gains in longevity. Given the level of volatility associated with such a portfolio, it is unlikely that most older Americans would remain invested to make this scenario behaviorally plausible. Also, there is a downside risk that poor markets early in retirement will cause an individual to run out of money well before age 90.

• Conservative investors can end with significantly less wealth if they claim early and then surpass life expectancy. That is because, given the conservative tilt of their portfolios, they would have benefited even more later in life from the higher Social Security benefit amounts that they would have received had they delayed their first Social Security benefit checks.

• If an individual has a below-average life expectancy, age 62 will likely be the optimal claiming age. This can be seen in a traditional break-even analysis, a 5% deterministic analysis and a portfolio of 30% equities/70% fixed income.

Deciding when to claim Social Security benefits has never been a simple exercise. By definition, a wide range of variables and choices needs to be considered; trade-offs and opportunity costs must be taken into account. The exercise has become even more complex given the ever-increasing average life expectancy for American men and women.

The analysis we have presented in this paper—in particular, the step-by-step examination of three different claiming and investing scenarios—should provide financial advisors with deeper insights into the claiming decision. They can draw on those insights in the context of a client’s broader investment picture and potential life expectancy. As always, advisors will provide the most effective financial advice when they consider the unique personal circumstances of their clients when choosing when to claim Social Security.
Special thanks to the JPMorgan Private Bank’s Advice Lab for its expertise and to the Private Bank’s Portfolio Construction Group for the use of its proprietary asset projection system for our Monte Carlo analysis.

ABOUT THE AUTHOR

S. Katherine Roy, CFP®, is Chief Retirement Strategist and Head of Individual Retirement at J.P. Morgan Asset Management in New York, where she develops leading insights, strategies and solutions to help financial advisors successfully partner with individuals in the transition and distribution life stages. She earned a BA from Yale University. Contact her at retirement.insights@jpmorgan.com.