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Value Strikes Back

If one pays any attention to the financial media, they will often hear about companies that are categorized as “growth” or “value” stocks. Growth companies typically trade at higher valuations (price relative to some financial metric like net earnings) than value stocks, but in exchange they are expected to grow at a faster rate than the average company. Value stocks, as their name implies, trade for more modest prices relative to earnings and cash flows, and tend to have higher dividend yields as well. One is not necessarily better than the other, and well-diversified investment portfolios should have a good mix of both.

We’ve been in a golden age for large capitalization growth stocks that has persisted for well over a decade now. Since August 2006, the Russell 3000 Growth Index has outperformed the Russell 3000 Value Index by more than 65 percentage points, or an average of roughly 4% per year. That’s quite a remarkable spread! One can point to many reasons for this amazing record of performance by growth companies. For one, in a period of relatively sluggish economic growth, which has characterized much of the past 10 to 15 years, investors are willing to pay more for companies that offer growth. Secondly, the persistent trend of falling interest rates drives higher valuations for companies with longer duration cash flows, which is typically the case with companies that are constituents of growth indices.

As of June 30, “value” stocks were trading at their steepest discount (on a price-to-book basis) to “growth” stocks ever recorded. Inversely, value stocks were offering the largest premium (based on earnings yields) to growth stocks in at least the past 30 years. As markets always move in cycles, some as short as a few hours, some measure in decades, value stocks will likely return to superiority at some point. For example, value stocks outperformed growth for most of the 1980s. They have also been performing incredibly well since the end of August. In fact, since August 27th, the Russell 1000 Value Index has outperformed the Russell 1000 Growth Index by more than 4%. That is significant outperformance during such a short time frame. Will this be the beginning of a new trend? While that is difficult to say at this point, we’re starting to prepare for a possible shift in the character of this market. Traditional valuation analysis and stock-picking may be coming back into favor versus the strategy of simply buying and holding the handful of very large growth companies that have dominated the investment landscape over the past several years.

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Five Retirement Lessons from Today's Retirees

EBRI consistently finds that setting a savings goal increases the level of confidence among today's workers. Despite that fact, just 42% of survey respondents have tried to determine a total retirement savings goal, and less than one-third have tried to calculate how much they may need for medical expenses. Of those who have calculated a total savings goal, 34% have found they will need $1 million or more to retire comfortably.

Source: 2019 Retirement Confidence Survey, EBRI

Each year for its Retirement Confidence Survey, the Employee Benefit Research Institute (EBRI) surveys 1,000 workers and 1,000 retirees to assess how confident they are in their ability to afford a comfortable retirement. Once again, in 2019, retirees expressed stronger confidence than workers: 82% of retirees reported feeling "very" or "somewhat" confident, compared with 67% of workers. A closer look at some of the survey results reveals various lessons today's workers can learn from current retirees.

Current sources of retiree income

Let's start with a breakdown of the percentage of retirees who said the following resources provide at least a minor source of income:

- Social Security: 88%
- Personal savings and investments: 69%
- Defined benefit/traditional pension plan: 64%
- Individual retirement account: 61%
- Workplace retirement savings plan: 54%
- Product that guarantees monthly income: 33%
- Work for pay: 25%

Lesson 1: Don't count on work-related earnings

Perhaps the most striking percentage is the last one, given that 74% of today's workers expect work-related earnings to be at least a minor source of income in retirement. Currently, just one in four retirees works for pay.

Lesson 2: Have realistic expectations for retirement age

Building upon Lesson 1, it may benefit workers to proceed with caution when estimating their retirement age, as the Retirement Confidence Survey consistently finds a big gap between workers' expectations and retirees' actual retirement age.

In 2019, the gap is three years: Workers said they expect to retire at the median age of 65, whereas retirees said they retired at a median age of 62. Three years can make a big difference when it comes to figuring out how much workers need to accumulate by their first year of retirement. Moreover, 34% of workers reported that they plan to retire at age 70 or older (or not at all), while just 6% of current retirees fell into this category. In fact, almost 40% of retirees said they retired before age 60. The reality is that more than four in 10 retirees retired earlier than planned, often due to a health issue or change in their organizations.

Estimating retirement age is one area where workers may want to hope for the best but prepare for the worst.

Lesson 3: Income is largely a result of individual savings efforts

Even though 64% of current retirees have defined benefit or pension plans, an even larger percentage say they rely on current savings and investments, and more than half rely on income from IRAs and/or workplace plans. Current workers are much less likely to have defined benefit or pension plans, so it is even more important that they focus on their own savings efforts.

Fortunately, workers appear to be recognizing this fact, as 82% said they expect their workplace retirement savings plan to be a source of income in retirement, with more than half saying they expect employer plans to play a "major" role.

Lesson 4: Some expenses, particularly health care, may be higher than expected

While most retirees said their expenses were "about the same" or "lower than expected," approximately a third said their overall expenses were higher than anticipated. Nearly four out of 10 said health care or dental expenses were higher.

Workers may want to take heed from this data and calculate a savings goal that accounts specifically for health-care expenses. They may also want to familiarize themselves with what Medicare does and does not cover (e.g., dental and vision costs are not covered) and think strategically about a health savings account if they have the opportunity to utilize one at work.

Lesson 5: Keep debt under control

Just 26% of retirees indicated that debt is a problem, while 60% of workers said this is the case for them. Unfortunately, debt can hinder retirement savings success: seven in 10 workers reported that their non-mortgage debt has affected their ability to save for retirement. Also consider that 32% of workers with a major debt problem were not at all confident about having enough money to live comfortably in retirement, compared with just 5% of workers who don't have a debt problem.

As part of their overall financial strategy, workers may want to develop a plan to pay down as much debt as possible prior to retirement.

Social Security: Shoring Up America's Safety Net

Future projections

In 2019, the trustees of Social Security reported that the Old-Age and Survivors Insurance (OASI) trust fund is projected to run out in 2034. At that time, payroll tax revenue alone would be sufficient to pay 77% of scheduled benefits.

Ever since a legal secretary named Ida May Fuller received the first Social Security retirement check in 1940, Americans have been counting on Social Security to provide much-needed retirement income. For many older Americans, Social Security is their main source of guaranteed retirement income — income that continues throughout their lifetimes and is indexed for inflation every year (in 2019, the cost-of-living adjustment, or COLA, was 2.8%).

Social Security provides more than just retirement income, though. It also provides disability and survivor insurance benefits. About 62 million people — more than one in six U.S. residents — collected some type of Social Security benefit in 2018, with approximately 80% of these recipients receiving Social Security retirement or survivor benefits.[1]

How Social Security works

Social Security is a pay-as-you-go system, which means that payments from current workers (in the form of payroll taxes) fund benefits for current beneficiaries. The payroll tax rate for Social Security is 12.4%, with 6.2% paid by the employee and 6.2% paid by the employer (self-employed individuals pay the entire 12.4%). These payroll taxes are deposited into the Old-Age and Survivors Insurance (OASI) trust fund (for retirement and survivor benefits) and the Disability Insurance (DI) trust fund (for disability payments).

Because of demographic and economic factors, including higher retirement rates and lower birth rates, there will be fewer workers per beneficiary over the long term, worsening the strain on the trust funds. This year, the trustees of Social Security reported that the OASI trust fund is projected to run out in 2034. After that, payroll tax revenue alone would be sufficient to pay 77% of scheduled benefits.

Ideas for reform

There has been little national consensus by policymakers on how to deal with Social Security's looming demographic challenges. Meaningful reform will require broad bipartisan support, and the trustees have urged Congress to address Social Security's challenges sooner rather than later, so that solutions will be less drastic and can be implemented gradually, lessening the impact on the public.

Some Social Security reform proposals on the table include:

- Raising the current Social Security payroll tax rate — according to the 2019 trustees report, an immediate and permanent payroll tax increase to 15.1% (up from the current 12.4%) would be necessary to address the long-range revenue shortfall (16.05% if the increase started in 2035)
- Raising or eliminating the ceiling on wages currently subject to Social Security payroll taxes ($132,900 in 2019)
- Raising the full retirement age beyond the currently scheduled age of 67 (for anyone born in 1960 or later)
- Reducing future benefits — to address the long-term revenue shortfall, the trustees have noted that scheduled benefits would have to be immediately and permanently reduced by about 17% for all current and future beneficiaries, or by approximately 20% if reductions were applied only to those who initially become eligible for benefits in 2019 or later
- Changing the formula that is used to calculate benefits
- Changing the formula that is used to calculate the annual cost-of-living adjustment for benefits

Understand your retirement benefits

The amount you'll receive from Social Security is based on the number of years you've worked, the amount you've earned over your lifetime, and the age when you file for benefits. Your benefit is calculated using a formula that takes into account your 35 highest earnings years, but you don't need to work for that long to qualify for retirement benefits. Generally, you need to have earned a minimum of 40 work credits, which is about 10 years of work in a job covered by Social Security. If you haven't worked long enough to qualify on your own, you may qualify for spousal benefits based on your spouse's work record. A spousal benefit claimed at your full retirement age is generally equal to 50% of the primary worker's full benefit.

You can get an estimate of your future Social Security retirement benefits by visiting the Social Security website at ssa.gov and using the Retirement Estimator tool or by viewing your Social Security Statement. Your personalized statement contains a detailed record of your earnings history, as well as estimates of the retirement, survivor, and disability benefits you can expect at different ages. To view your statement online, you'll first need to register. If you haven't registered online, you'll receive your Social Security Statement in the mail every year if you are age 60 or older and not yet receiving benefits.

[1] Top Ten Facts About Social Security, Center on Budget and Policy Priorities, August 14, 2018

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How can I teach my high school student the importance of financial literacy?

Even though your child is just in high school, he or she may still have to deal with certain financial challenges. Whether this involves saving for an important purchase like a car or learning how to use a credit card responsibly, it's important for your high schooler to have a basic understanding of financial literacy concepts in order to manage his or her finances more effectively.

While financial literacy offerings in schools have increased in popularity, a recent study reported that only 17 states require high school students to take a personal finance course before they graduate.[1] Here are some ways you can teach high school students the importance of financial literacy.

Advocate saving. Encourage your children to set aside a portion of any money they receive from an allowance, gift, or job. Be sure to talk about goals that require a financial commitment, such as a car, college, and travel. As an added incentive, consider matching the funds they save for a worthy purpose.

Show them the numbers. Use an online calculator to demonstrate the concept of long-term investing and the power of compound interest. Your children may be surprised to see how fast invested funds can accumulate, especially when you match or contribute an additional amount each month.

Let them practice. Let older teens become responsible for paying certain expenses (e.g., clothing and entertainment). The possibility of running out of their own money might make them think more carefully about their spending habits and choices. It may also encourage them to budget their money more effectively.

Cover the basics. By the time your children graduate from high school, they should at least understand the basic concepts of financial literacy. This includes saving, investing, using credit responsibly, debt management, and protection planning with insurance.

[1] Survey of the States, Council for Economic Education, 2018

When should I file the FAFSA?

The FAFSA, which stands for Free Application for Federal Student Aid, is the federal government's financial aid application. The FAFSA is a prerequisite for federal student loans, grants, and work-study. In addition, colleges typically require the FAFSA before distributing their own need-based aid and, in some cases, merit-based aid.

For the 2020-2021 school year, the FAFSA can be filed as early as October 1, 2019. Whether you have a senior in high school or a returning college student, it's a good idea to file the FAFSA as early as possible to increase your child's chances of getting financial aid, because some aid programs operate on a first-come, first-served basis. (For high school seniors who haven't yet been accepted at a particular college, you can list all the schools your child has applied to on the form.)

The 2020-2021 FAFSA relies on your family's current asset information and two-year-old income information from your 2018 tax return. The form is available online at fafsa.ed.gov.

In order to file the form, you'll need to create an FSA ID if you haven't done so already (be sure to follow the online instructions). You can save time and minimize errors on the FAFSA by using the built-in IRS Data Retrieval Tool, which electronically imports your tax data.

Even if you don't expect your child to qualify for need-based aid, you still might consider submitting the FAFSA. All students attending college at least half-time are eligible for federal unsubsidized Direct Loans regardless of financial need. So if you want your child to take out a loan (or your child needs to do so), you'll need to file the FAFSA. (Unsubsidized Direct Loan amounts are capped each year: $5,500 freshman year, $6,500 sophomore year, and $7,500 junior and senior years.)

Keep in mind that you'll need to resubmit the FAFSA each year that you want your child to be considered for aid. Fortunately, renewal FAFSAs take less time to complete.

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