FINANCIAL FOCUS

PETERSON FINANCIAL SERVICES

Limited Liability Company ♦ Registered Investment Advisory Firm

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STRUCTURAL PROBLEMS WITH SOCIAL SECURITY REINFORCE THE NEED TO SAVE AND INVEST FOR YOUR RETIREMENT YOURSELF.

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- View Social Security income as a supplement, not your sole means of income in retirement.

QUARTERLY MARKET RECAP

History repeated itself (again) as the markets enjoyed a strong final quarter of the year. The Federal Reserve all but confirmed that their tightening cycle is completed, and speculation in the futures markets for interest rate decreases this year increased. Inflation figures indicate we're on the road to the target of 2%, without causing a recession.

Last quarter the DJIA, which had been lagging, picked up its pace, gaining 12.48% and hitting a new all-time high during the quarter. The S&P 500 added 11.25%, and the NASDAQ continued its dominance, rising 13.56%. Even the small-cap Russell 2000, which had been lackluster, raced forward an identical 13.56%, and foreign equities tacked on 11.07%. Inflation and interest rates have dominated the mood of both the stock and bond markets for two years now, and new clarity allowed for much-anticipated fixed-income gains, as the Barclay's Aggregate Bond Index rose 7.18%, rounding out a slate of positive returns for all asset classes. Continued strong labor markets and positive economic growth should persist into next year, with our only significant economic concern being the current income tax rates scheduled to revert to pre-2017 levels in 2025. These lower rates have been the major reason for economic resilience during this period of high inflation and pandemic recovery.

THE SOCIAL SECURITY SYSTEM'S FLAWS WERE BAKED IN DECADES AGO, AND CORRECTION IS NEEDED NOW

Our longtime clients have heard us preach for years that the Social Security system is a giant Ponzi scheme, that if perpetrated by private citizens and not politicians, would have landed the designers and administrators in jail long ago. The "trust" fund was abandoned in the early years for a "pay-as-you-go" system that for the last 13 years has paid out more than it's taken in, essentially rendering it bankrupt. Only the nearly unlimited borrowing authority of the federal government keeps the checks going out.

Because politicians of all stripes are most interested in their re-election, and are not profiles in courage, this problem keeps being punted down the calendar. But this cannot continue indefinitely, and one warning shot across the bow of our fiscal ship was fired earlier this year when Moody's rating service nicked the AAA credit rating of US Government debt. Our politicians would do well to heed this warning, as increased debt service costs on our ever-growing insane public debt is imperiling other spending needs. Only one of the announced candidates for president has had the courage to bring this up.

When President Roosevelt announced the program in 1935, he promised the use of "compulsory contributory annuities" to create "a self-supporting system for those now young and for future generations". It only took two years for FDR's Justice Department to convince the Supreme Court that these payroll taxes were not actually reserved for future retirees, claiming "These are true taxes, the purpose being simply to raise revenues." From that point on, the fix was in, and under the Johnson Administration, laws were passed to divert FICA taxes from segregated accounts (which were only an accounting gimmick to start with since the account was a pile of IOUs from one agency to another) to the general fund, allowing politicians to spend the money any way they wanted. What could go wrong?

Before half a decade had gone by, in 1939, these taxes were bringing in 8% of federal revenue, allowing for the funding of the New Deal and the advent of runaway spending and growth in government. None of this tax revenue was used to buy marketable securities to form a base of actual assets for benefits.

This was all well and good to an inattentive electorate while these payroll taxes generated operating surpluses, but even then, the "profits" were not set aside to shore up the future liabilities. They were spent on even more programs. Additional benefits were added including payments for dependents of survivors, cost-of-living adjustments, disability benefits, supplemental security income, a minimum benefit, a death benefit, and a student benefit. This behemoth grew way beyond the original mandate of the program and, along with Medicare and Medicaid instituted in 1964, these entitlement programs consume such a large percentage of outlays, that it cannot survive under its own weight for much longer.

One retiree in 1940 could be supported by a 2% payroll tax paid by 159 workers and their employers. By 1981 it took a 10.7% tax paid by 3.2 workers and their employers. It's worse now, and will get even worse going forward.

President Reagan's 1981 Gramm-Latta Budget Reconciliation bill made some reforms, and back in the days when Congress actually was able to function by compromise, Reagan and Speaker O'Neill agreed to the 1983 Greenspan Commission's recommendations and got real reforms accomplished. But this wasn't enough to put the program on sustainably solid footing and we're in dire need to serious alterations to the program again. Annual Social Security surpluses grew from $2.7 billion in 1984 to $90 billion in 2001, then fell to only $3 billion by 2009 before going negative. President Bush offered at the beginning of his second term to allow for voluntary private accounts for just a small portion of payroll taxes for only young workers, but that was shot down by both sides. Too bad. At that 1984 peak value, had each annual cash surplus – only the surplus, not the entire tax - been invested 70% in the S&P 500 and 30% in investment-grade corporate bonds, the "trust" fund would have had $3.9 *trillion* in it by 2010. We're thirteen years past that now. By the way, the Federal Employees Thrift Savings Plan allows for employee-directed investments, the cornerstone of which is the S&P 500 and for the past 39 years, it's yield has averaged 11% a year, and those investment-grade corporate bonds have made 8.4%. So that 70%-30% allocation would have doubled every seven years. Remember that the next time a politician says private accounts are too risky for us ignorant taxpayers to manage. They know they get to put their taxpayer-financed retirement money in growing assets – you just can't put yours there. By this year, that growing trust fund would have had a 2023 surplus of $13.3 trillion.

This one reform would have extended the solvency of the program indefinitely. It would have led to lower interest rates as the share of the credit markets consumed by government deficit spending would have been reduced. That would have stimulated higher economic growth. And, payroll taxes might even have been reduced.

But instead, we have a serious problem that we're not convinced our current crop of politicians are up to the challenge for.

"We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."

- Sir Winston Churchill

Pursuant to SEC Rule 204-3 (C) of the Investment Advisors Act of 1940, we hereby offer, without cost, a copy of our "Disclosure Statement", Form ADV Part II, which is the document attached to your copy of our Service Agreement. Please e-mail us, or mail us, a written request if you'd like another copy and we'll send it in February after we update our annual filing. Also, in conformance with Regulation S-P of the Gramm-Leach-Bliley Act, we are required to provide annual notice of our Privacy Policy. Our policy is posted to our website, and is mailed to each client.

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we specialize in portfolio management, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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