Motley Fool's *Rule Your Retirement* Newsletter

The Most Important Social Security Chart You'll Ever See

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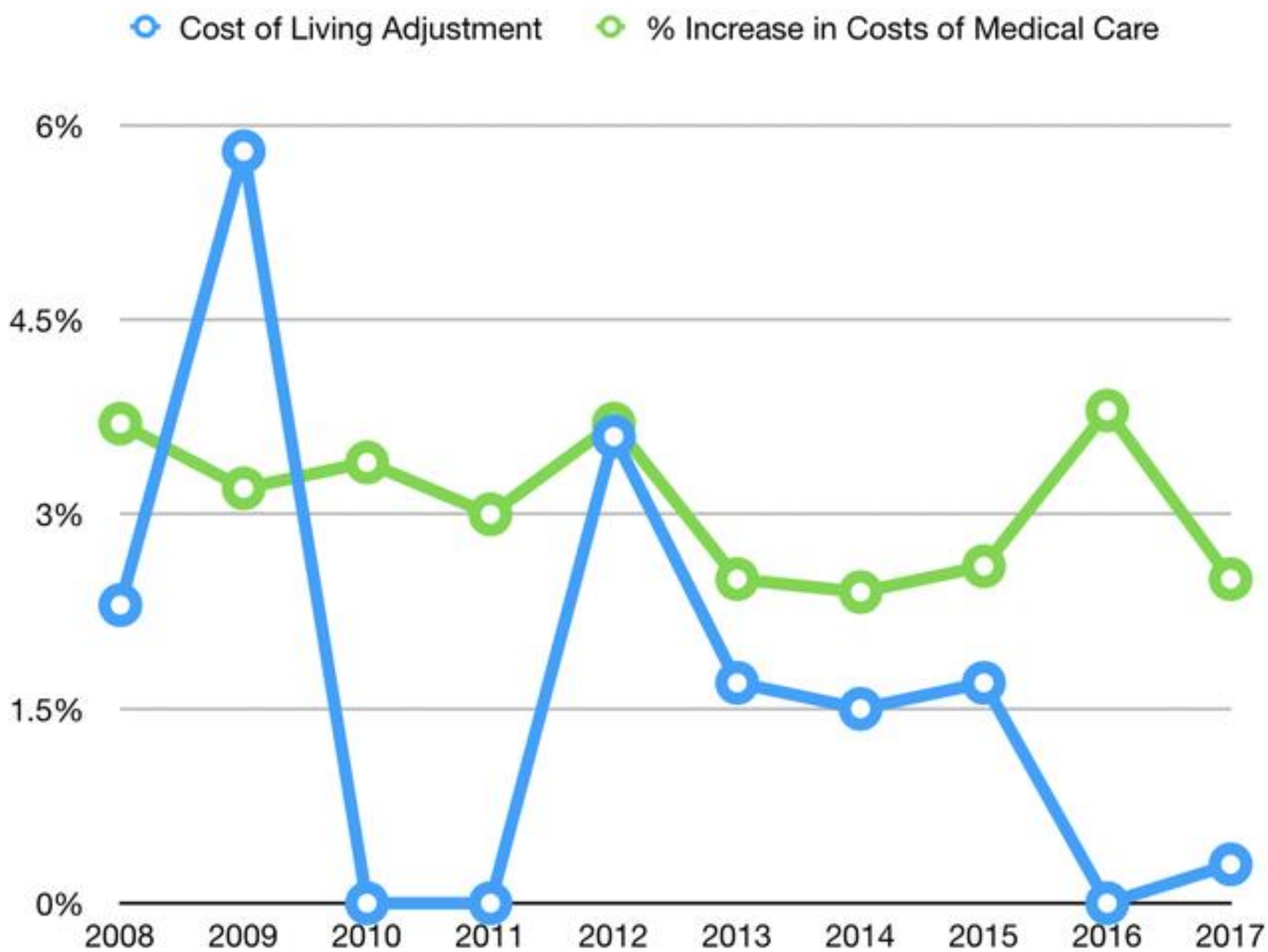
Social Security is a primary source of income for most seniors. But it cannot be your only source of income -- and if you're depending upon Social Security without additional savings, you'll be in dire financial straits.

There are many reasons you can't rely on Social Security alone to cover your costs in retirement. The most important Social Security chart you'll ever see shows you one big reason why you need substantial additional savings to provide income above and beyond what Social Security offers.

This Social Security chart is a vitally important one. It shows you the average Cost-of-Living Adjustments (COLA) for Social Security recipients each year since 2010. It also shows you the 12-month percent change in the cost of medical care in U.S. cities, on average, based on expenditures of all urban consumers.



DATA SOURCES: SOCIAL SECURITY ADMINISTRATION AND BUREAU OF LABOR STATISTICS. CHART BY AUTHOR.

Why is this chart so important? For two big reasons:

- It demonstrates that the formula used to measure Social Security cost-of-living increases isn't accurately reflecting how much more seniors actually need to spend each year on one of the key services they use the most.
- It shows how much financial trouble seniors are likely to be in if they rely on Social Security alone to pay for healthcare costs and other financial needs.

Social Security cost-of-living increases aren't being measured accurately

Social Security cost-of-living adjustments -- the annual raises given to Social Security recipients -- are calculated based on a pricing index created by the Bureau of Labor Statistics that measures annual cost increases in major spending categories.

The pricing index used to decide whether seniors will get a raise -- and how much the raise will be -- is the Consumer Price Index for Urban Wage Earners and Clerical Workers or CPI-W. Unfortunately, spending patterns for urban wage earners aren't very similar to spending patterns for seniors.

When calculating price increases, CPI-W doesn't give as much weight as it should to healthcare costs, despite the fact that seniors spend a lot of their income on care. In fact, this chart shows how much *less* weight is given to healthcare pricing increases in CPI-W than in CPI-E, a pricing index specifically focused on price increases affecting senior households.

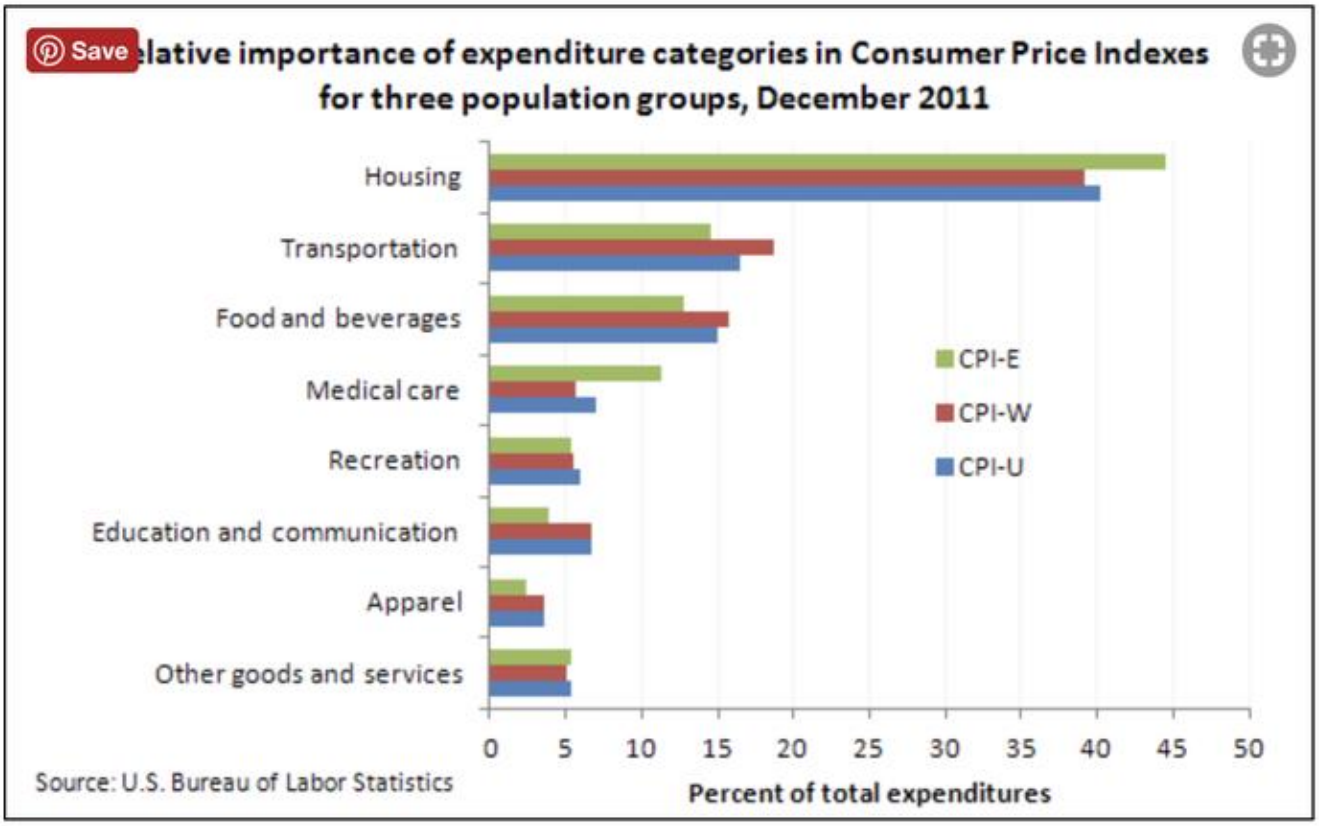


IMAGE SOURCE: BUREAU OF LABOR STATISTICS.

Many experts argue that the Social Security COLA should be based on CPI-E, which much more accurately reflects the expenditures of seniors. But a change to CPI-E isn't likely anytime soon.

That's why the above chart showing medical care increases versus COLAs is so important.

Since healthcare spending is going up so much for everyone, the elderly who spend more on healthcare are especially affected. But since healthcare pricing increases don't affect the Social Security COLA as much as they should, seniors end up getting small raises that don't come close to keeping up with rising healthcare costs.

You can't rely on Social Security to provide enough money

Most seniors underestimate how much of their Social Security funds will be spent on healthcare. In fact, a Nationwide survey showed future retirees expect to spend just 20% of Social Security benefits on healthcare. In reality, Nationwide experts project the average American who claims Social Security at 62 could spend 64% of Social Security benefits on healthcare costs.

With healthcare costs rising, an ever-increasing percentage of Social Security is likely to go to paying for health needs. Seniors could be left with little money for everything else, including food, clothing, and shelter.

Seniors can't count on Medicare to save them from rising healthcare costs, as there's a lot Medicare won't cover. In fact, experts project senior couples may need between $280,000 and $370,000 for healthcare during retirement, after factoring in Medicare premiums, supplementary insurance, co-insurance costs, and other out-of-pocket expenses.

Your Social Security benefits aren't going to be enough to pay for all of these costs. Your Social Security benefits won't keep up with rising healthcare expenses, even if you get raises. If you're relying on Social Security to support you, this is a recipe for disaster.

You need separate savings for healthcare

So what's the solution? You need separate savings for healthcare, and you need to expect to spend far more on healthcare than you're probably anticipating.

You could open a health savings account while working to help you set aside pre-tax money you can withdraw tax-free to pay for healthcare costs. Or you could plan to put more money into a 401(k) or IRA to account for healthcare expenses if you aren't eligible for a HSA.

Whatever you do, don't count on Social Security to provide enough to cover healthcare costs and all your other needs.