

Three Sources of Income for Retirement

By Judy Loy, ChFC®, RICP®

When planning for retirement, it is important to consider all sources of income. There are three sources of income throughout life: Social Capital, Human Capital and Financial Capital. Human Capital is our capacity to create wealth through our human endeavors—namely working for a salary. This is used primarily in our working years but many retirees choose to work for extra income, social interaction and a feeling of being involved and useful. Social Capital is typically used by retirees through Social Security, Medicare and other Federal ‘old-age benefits.’ Financial Capital is what we save that creates our Net Worth.

Human Capital can be part of retirement income but our capability and often our desire to work lessens as we age. Sickness many times can take this away from us earlier than expected—either through our ill health or the illness of a loved one that needs our care. Since this is an unknown factor, it is important to plan the other two sources for retirement for maximum impact.

Financial Capital is where a majority of my expertise lies. It is finding the best ways to save, the best investments to use and the ways to maximize the amount that people save or can pull in retirement.

According to a survey by Vanguard in March 2014, the impact of appropriate diversification, pulling wealth from taxable and qualified accounts in the appropriate order and using total return investing can add 3 percentage points a year to investors’ returns and allow them to enjoy their wealth throughout retirement.

Therefore, it is important to plan these decisions.

Finally, Social Capital in the form of Social Security tends to be a major source of income in retirement for most participants. However, the more you earn with Human Capital, the less social security will replace. Also,

Social Security has three dates that are very important: The age at which you are first eligible (currently 62), your full retirement age and age 70, which is the latest age you would want to claim your benefits. A majority of people are pulling social security at age 62, which can decrease their monthly checks for the rest of their lives. It is very important to try to maximize this benefit given your potential longevity and the lifetime of income it provides. To look at your social security benefits, go to their website at ssa.gov. Work with an advisor (many advisors, including myself, have analyzers that will help illustrate social security choices) or take the time yourself to understand the impact of different claiming ages and strategies.

In planning out the third phase of your life (retirement), it is vital to make conscious decisions in each area of capital. The choice to work two more years, thus saving two more years and delaying social security two years, can sometimes make all the difference to allow for a comfortable retirement.

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