‘Misguided money ideas I keep hearing’

Misconceptions about Social Security, bonds and paying off your mortgage

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We’re in the depths of winter, so it must be time to warm up a few readers.

At issue here is my weekly sack of email—and some of the muddled thinking contained therein. Here are three dubious contentions that I hear again and again:

You’re better off claiming Social Security at age 62.

Many folks are adamant this is the right strategy. Rather than delay Social Security until as late as age 70, thus ensuring a larger monthly benefit for themselves and potentially a larger survivor benefit for their spouse, they’re convinced they should claim at 62, the earliest possible age.

To back up their argument, readers send me spreadsheets showing that they would come out ahead if they claim benefits early, then invest the proceeds in stocks that only go up or in bonds with yields available only from dicey issuers.

Yes, if you assume a high enough return, you can come out ahead by taking Social Security early. Yes, if you (and, if married, both you and your spouse) fully intend to die early in retirement, claiming at 62 makes sense.

But for those who reside in a world where investment returns and longevity are uncertain, delaying benefits makes sense. Sure, there's a chance that you'll die early in retirement, having received little or nothing in return for your many years of paying Social Security payroll taxes.

But this is rather like buying homeowner's insurance, then despairing because your house didn't burn down. The big financial risk in retirement isn't dying young. At that point, all your money problems are over.

Rather, the big risk is living longer than expected and running through your savings. Want insurance against that risk? Go for the fatter Social Security check.

Individual bonds are superior to bond funds.

With great regularity, I receive emails from readers who insist that individual bonds are the better investment. Their argument: If interest rates go up, bond-fund investors lose money. But if you own individual bonds, you can hold them to maturity and get your money back.

The irrepressible Cliff Asness, managing principal of AQR Capital Management in Greenwich, Conn., took issue with this contention in an article last year for the Financial Analysts Journal. "Bond funds are just portfolios of bonds marked to market every day," he wrote. "How can they be worse than the sum of what they own?"

He notes that when interest rates go up, individual bonds fall in price, just like the bond funds that own them. True, you can hold your individual bonds to maturity, so you get your principal back, though you'll collect a below-market interest rate meanwhile.

Mr. Asness continued (and I quote with his permission): "If you own the bond fund that fell in value, you can sell it right after the fall and still buy the portfolio of individual bonds some say you should have owned to begin with (which, again, also fell in value!).

"Then, if you really want, you can still hold these individual bonds to maturity and get your irrelevant nominal dollars back."

You should never pay ahead on a mortgage.

Some readers fervently believe that the mortgage-interest tax deduction is such a wonderful tax break that you should never make extra-principal payments, with a view to paying off your mortgage early.

The problem is, even with the tax break, all that mortgage interest is still costing you a hefty sum. Let's say you have a 4% mortgage and you're in the 25% federal income-tax bracket. After the tax savings, the mortgage is costing you 3%.

This assumes you itemize your deductions—and that your itemized deductions are substantially higher than your standard deduction, which in 2015 is $12,600 for married couples filing jointly (up from $12,400 for 2014) and $6,300 for single individuals. If you aren't itemizing, or your itemized deductions aren't much above your standard deduction, all that mortgage interest is saving you little or nothing in taxes.

But let's assume your mortgage's after-tax cost is indeed 3%. You should be able to earn more than that over the long haul by buying risky bonds in a retirement account or purchasing stocks in either a taxable or retirement account. What if the alternative is to stash the money in a savings account, certificates of deposit or high-quality bonds with short or intermediate maturities? In that case, you'll likely be better off paying down your mortgage.