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Should you listen to so-called financial experts who preach a better return from taking Social Security early and reinvesting the benefits? The strategy is fraught with danger, the least of which relates to the guarantees inherent in the system that shouldn't be squandered.

The following list of terms is a great place to start when making sense of Social Security, the returns in can generate and the income it provides.

NOMINAL RATE OF RETURN

The amount of money generated by an investment before expenses such as taxes, investment fees and inflation are factored in.

For example, a mutual fund might show a nominal rate of return of 8%, but also show its return after taxes on distributions and sale of fund shares is only 5%. Looking only at the nominal rate of return can result in an overestimation of a particular investment's performance and potentially lead to a shortfall in required retirement income over the life of the portfolio. [1]

REAL RATE OF RETURN

The annual return of an investment, adjusted for inflation or other factors. A real rate of return is found by subtracting the rate of inflation from the nominal rate of return.

For example, if you have a return of 6% on a bond in a period when inflation is averaging 2%, your real rate of return is 4%. But if inflation were 4%, your real rate of return would be only 2%. [2]

INTERNAL RATE OF RETURN (IRR)

The rate of return that would make the present value of future cash flows plus the final market value of an investment or business opportunity equal the current market price of the investment or opportunity.

In plain English, an internal rate of return is used to make an "apples-to-apples" comparison to determine if an investment is worthwhile relative to similar opportunities. If the internal rate of return is greater than the return of a similar investment opportunity, it is generally considered worthwhile. The same can be said if the return generates more than the initial investment. [3]

INTERNAL RATE OF RETURN (CALCULATED)

If you put $1,000 in the bank, the bank pays you interest, and one year later you have $1,055. In this case it is easy to calculate the rate of return at 5.5%.

$$\frac{55}{1{,}000} = 5.5\%$$

If only it were that simple. What happens when returns vary over time, or don't match a 12-month or calendar years period? Like so many financial calculations the abacus and legal pad won't do. Software or a financial calculator, which allow for a variety of inputs, are needed. [4]

INTERNAL RATE OF RETURN WITH SOCIAL SECURITY

Debate rages about whether or not investors can do better by claiming Social Security benefits early, only to reinvest the amount for a higher real return. A parallel, and largely politically driven, argument exists as to whether or not Social Security should be privatized altogether. Short answer in both cases—no. Our research coincides with that of the Social Security Administration (SSA). Some recipients might beat Social Security's returns in some years by reinvesting benefits in the stock market. However, over a lifetime, Social Security's consistent, risk-free and inflation-adjusted returns would be very tough to beat.

Remember that Social Security benefits are not based on tax contributions, but based on the recipient's lifetime wage history and estimated longevity. Additionally Social Security is NOT an investment vehicle but rather like an annuity, and will pay a monthly benefit amount no matter how long the recipient lives. The peace-of-mind inherent in the program is therefore difficult to determine monetarily. [5]

INTERNAL RATE OF RETURN WITH AN ANNUITY

Delaying the beginning of Social Security benefits is like buying a real (i.e., inflation adjusted) lifetime payout annuity. Moreover, the available returns from such a delay in Social Security benefits are much better than annuities available from the private sector today. Thus, unless a single individual has a below-average life expectancy, he or she should consider delaying the start of Social Security benefits. For couples, this SSA-provided "annuity" can act as a real, joint-lifetime annuity that will last until the second spouse dies.

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1 "Nominal rate of return definition." Investopedia.com. 2014
2 "Real rate of return." Free-dictionary.com. 2014
3 "Internal Rate of Return." Investorwords.com. 2014
4 "How to calculate your internal rate of return." Moneyover55.about.com
5 "What's your rate of return on Social Security?" Reuters.com. Oct, 18, 2012