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INFORMATION

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Defusing the Demographic Time Bomb

By Bob Veres

The best thing about writing for the financial planning profession is that I have the routine privilege of interacting with a very intelligent audience. When I wrote last week's "Ghost of Retirement Future," I expected to get a small handful of responses. After all, this is tax season, I didn't specifically ask for feedback, and how many people think about global demographics when there are so many interesting things to think about right there on the sports pages?

Apparently, a lot of you. For more than a week, my e-mailbox has filled up with thoughts, ideas and insights, which show that more than a few of you have done some analysis of your own.

Let's look at some of the best comments that came in.

The most popular response challenged any assumption that, when the huge population of Baby Boomers retire, they will be systematically liquidating their stock positions (which would alter the supply/demand equation, which would lead to a prolonged bear market). "We advise clients who retire to keep their portfolios pretty much at the same allocation they were comfortable with when they were building wealth," writes Anne Ogan, who practices in Beachwood, Ohio. This, she adds, is the standard foundation/pension/endowment model. "Since more and more U.S. states are adopting the "Third Restatement" for trusts, more and more advisors are getting clients to understand that they can live on part of their total return, not on strictly defined 'income.'"

Kent Benson, of Waite Park, MN, thinks that the retiring demographic bulge may actually result in MORE demand for equities. "Most of my clients will never dip into their retirement assets," he says. "They live off of Social Security, pensions, interest, dividends and part-time work"--which, of course, suggests that the New Retirement (working at something you enjoy in your retirement years) is already taking effect. Bill Glasgall, editor of Investment Advisor magazine, sees the early stages of this very trend in people who have worked in the military or a police force, then retired at age 45 or 50 with full pension benefits, and then built a new career--with pension benefits of its own.

But wait a minute; are financial planning clients typical retirees? The obvious answer is "no;" they tend to be both wealthier and more aware of how the investment game works.

Karen Folk, one of several planners who has worked as a consumption economist in a former life, looks at both groups--those who are, and those who are not typical planning clients. Many of the "nots," she notes, will retire on Social Security, having paid their mortgages and downsized their living expenses. They are not holders of stock and, therefore, could not possibly become big sellers of it. If, as studies suggest, the great majority of equities, she points out, are owned by the wealthiest 5% to 10% of the American population, then it is unlikely that this group will ever participate in any any mass sell off of stock positions. The people who happen to own the equities won't need to liquidate them to pay living expenses.

Indeed, Mike Ryan, of Wilmette, IL, **Richard Winer** of Woodland Hills, CA and Glenn Kenney of Citrus Heights, CA all looked into the future and saw another dynamic: baby boomers inheriting trillions of dollars midway into their retirement--at a time when they really won't need the money. "I suspect," says Ryan, "that many boomers will receive this windfall just as they reach retirement age (a situation we are seeing even now) and that there will be a "grace" period before we see the scenario that Mr. Wyndam envisions. In fact," he adds, "we could see security prices increase substantially if we continue to have low interest rates as these boomers will look for higher total return."

Winer agrees--for a different reason. He notes that many people in the current retirement generation tend to have a high percentage of their assets in municipal bonds and other fixed income vehicles--which is a logical investment for somebody who survived the Great Depression era. As Boomers inherit these fixed income vehicles, they may reallocate into a higher percentage of stocks. (Would the eventual demise of the Great Depression generation have some kind of interesting effect on the bond markets?)

In my own evaluation, I thought that the fuse most demographers were looking at was too short; the global demographic time bomb would explode when a much larger developing nation baby boom will start retiring in 2050. Unless we start importing citizens from another planet, the number of retirees will greatly exceed the number of workers in the global marketplace soon thereafter.

Bobbie Munroe, who works with Fraser Financial in Atlanta, notes that this may be a more realistic time frame for problems to surface in the U.S. as well. "If life expectancies rise dramatically," she says, "our plans may not take clients far enough into the future." Suppose, for example, that many people have plans that will take them through age 90--and then live to 120. They might suddenly have to start liquidating portfolios that seemed adequate. "This might be a far bigger nightmare waiting for all of us," says Munroe, "than some proposed sellout of equities as boomers reach TRADITIONAL retirement ages."

In his earlier message, Glasgall did a nice job of articulating the second-most-popular response I received on the Ghost of Retirement Future: that we have a way of quickly resolving the problem whenever we want to. In the U.S., Australia and Canada, we could simply open our immigration doors a little wider and take in more people seeking an environment with more economic opportunity. As one advisor put it, one large village in a remote China province would solve the problem in the U.S. Steve Kessler, of Mercer Island, WA, reminds us that what we like to think

of as American Ingenuity is actually the result of many smart and ambitious people from other countries finding their way to our shores. “We [the U.S.] gained our primacy from our immigrants, and they will also be our future,” he says.

Meanwhile, in Europe, Glasgall sees another demographic healing process that is already underway: the developing economies of Eastern Europe being annexed into the European economy. Only in Japan does he see no obvious solution to the demographic issues--and, in fact, Japan is already deeper into the imbalance than any other nation. This makes me wonder about the predictions that Japan will eventually climb out of its recessionary/deflationary malaise and reclaim its former economic power.

A lot of advisors thought I should have at least mentioned Harry Dent in my e-column, since Dent has been giving speeches that predicted the economic boom based primarily on demographic factors. Tommy Lackey of Atlanta, Kessler (who also referenced the work of Craig Karpel), Marilyn Capelli Dimitroff in Bloomfield Hills, MI, Brian Fricke of Winter Park, FL and Gene Dongieux of Mercer Global Advisors all talked about Dent’s work, although Dimitroff and Dongieux noted that Dent’s relentlessly bullish predictions (could it have something to do with the fact that his funds and speeches are paid for by a fund company?) haven’t been totally validated these last two years.

If we truly think demographics are fate, then Dongieux invites us to look at the performance of the AIM Dent Demographic Trend Fund. “If that’s what reacting to demographics is all about,” he says, “I’ll stick to my guns that it is already factored into the prices of securities today, and that the future is so multifaceted and complex that this will be a minor issue.”

Finally, a fair number of advisors said that they have more important things to worry about than ghosts--and that, in fact, they have seen too many false ghost sightings in recent years to take them seriously any more. Bill Bengen, who practices in El Cajon, CA, offers a small but revealing list of nightmare scenarios that he has seen in his career:

Communism will overtake capitalism as the dominant economic system (1960s)

High inflation will be with us forever (1970s)

Japan’s economy will overwhelm the world (1980s)

The U.S. will never enjoy a budget surplus (1990s)

The Y2K calamity (2000)

Harold Holcombe, a former historian who practices in Asheville, put it nicely when he said: “The icecaps may melt and the climate change so much that this will all be academic and a minor problem. I tell clients that endless sweating over the future is a damn good way to kill themselves with stress before they get there.”

I think this is some of the best “life” advice I’ve heard in a while.