

# ***Thematic Investing— Demographic Dynamics***

**C15.0042**

**Lesson 2**

**Edward M. Kerschner**

# Drivers of the Economy

$$\begin{aligned} & \mathbf{GDP} \\ & = \\ & \mathbf{Consumer} \\ & + \\ & \mathbf{Government} \\ & + \\ & \mathbf{Industry} \end{aligned}$$

# Rotating Drivers of the Economy

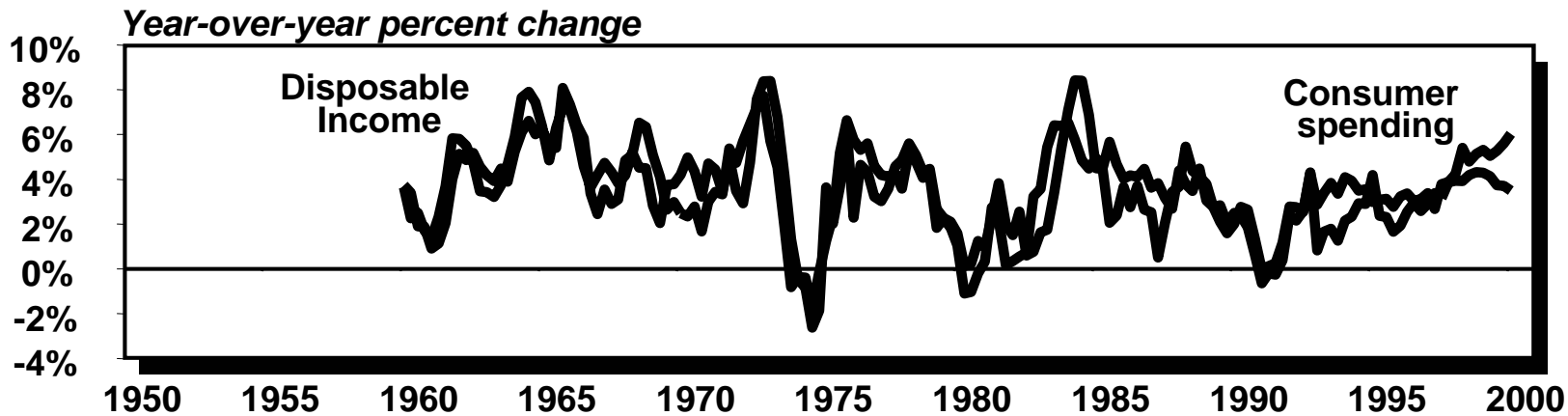
- ◆ **1940-52:** WWII government military spending propels economy out of depression.
- ◆ **1952-60:** Corporations restructure from war-time footing, prosper while Eisenhower reins in government and consumer is hurt by frequent recessions.
- ◆ **1960-67:** Strong consumer spending propels rapid growth.
- ◆ **1967-82:** Government expands—Vietnam War and Great Society; rising taxes, accelerating inflation, weak productivity growth hurt corporations and consumers.
- ◆ **1982-87:** Consumer boosted by tax cuts, lower inflation. Corporations hurt by disinflation, strong dollar, foreign competition; Reagan shrinks government.
- ◆ **1987-95:** Corporations restructure aggressively, slowing employment growth, suppressing wage gains, trimming benefits. Government's influence slips further.

# **Consumer Myths**

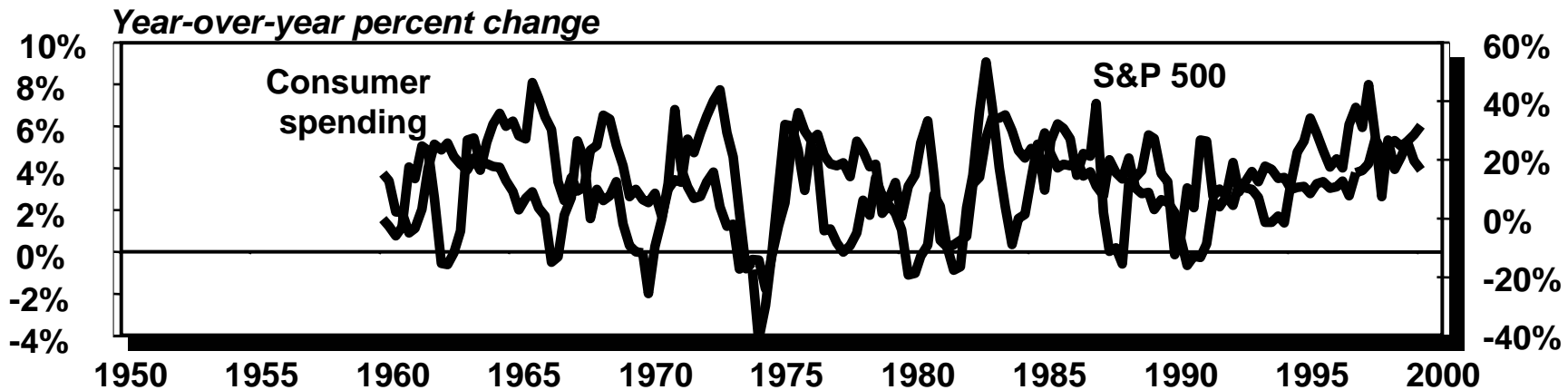
*The Wealth Effect, Interest Rates  
& Other Misconceptions*

# Consumer Myths

## *Consumer spending & income*



## *Consumer spending & stock prices*



# Consumer Myths

*Consumer spending is driven by Income*

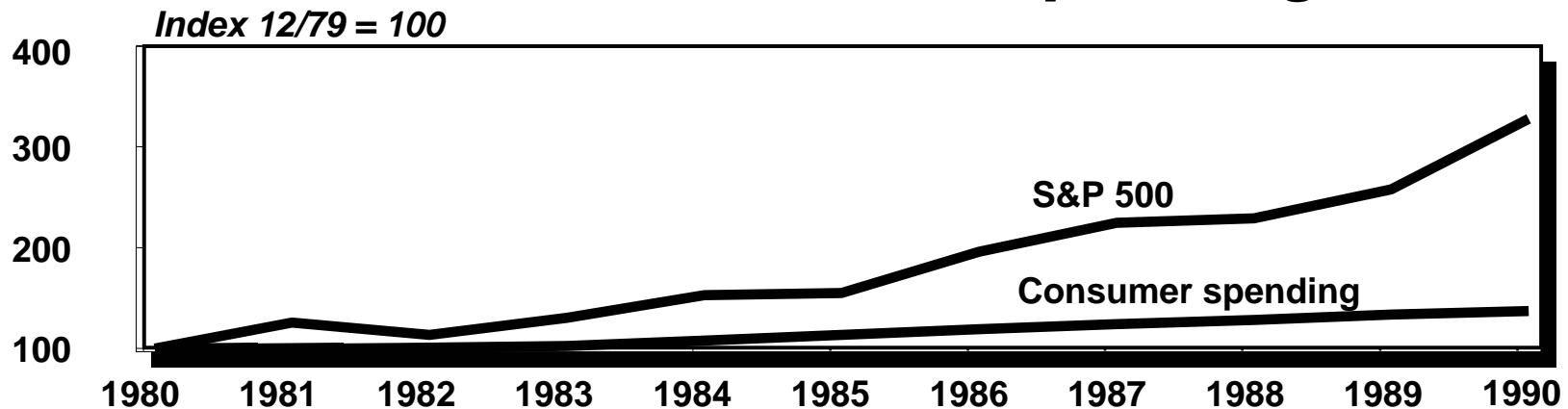
*Correlation Coefficients with Real Consumer Spending*

<i>Real Disposable Income</i>	<i>0.76</i>
<i>Employment</i>	<i>0.61</i>
<i>Stocks (S&amp;P 500)</i>	<i>0.29</i>
<i>3-month T-bill</i>	<i>0.13</i>
<i>10 year T-bond</i>	<i>-0.12</i>

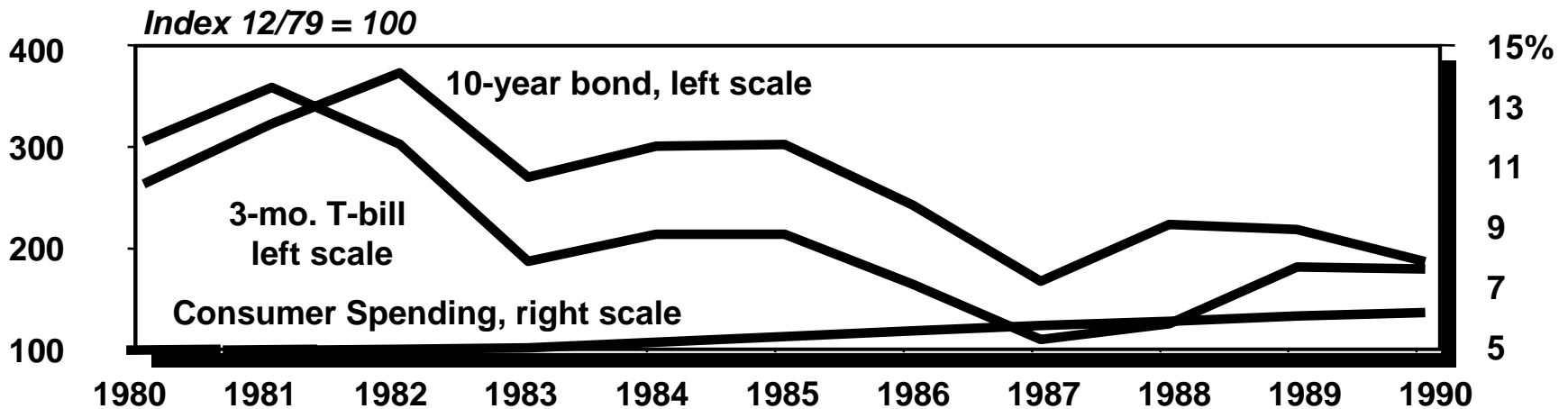
# Consumer Myths

## The 1980s

*In '80s stocks rose; consumer spending didn't*



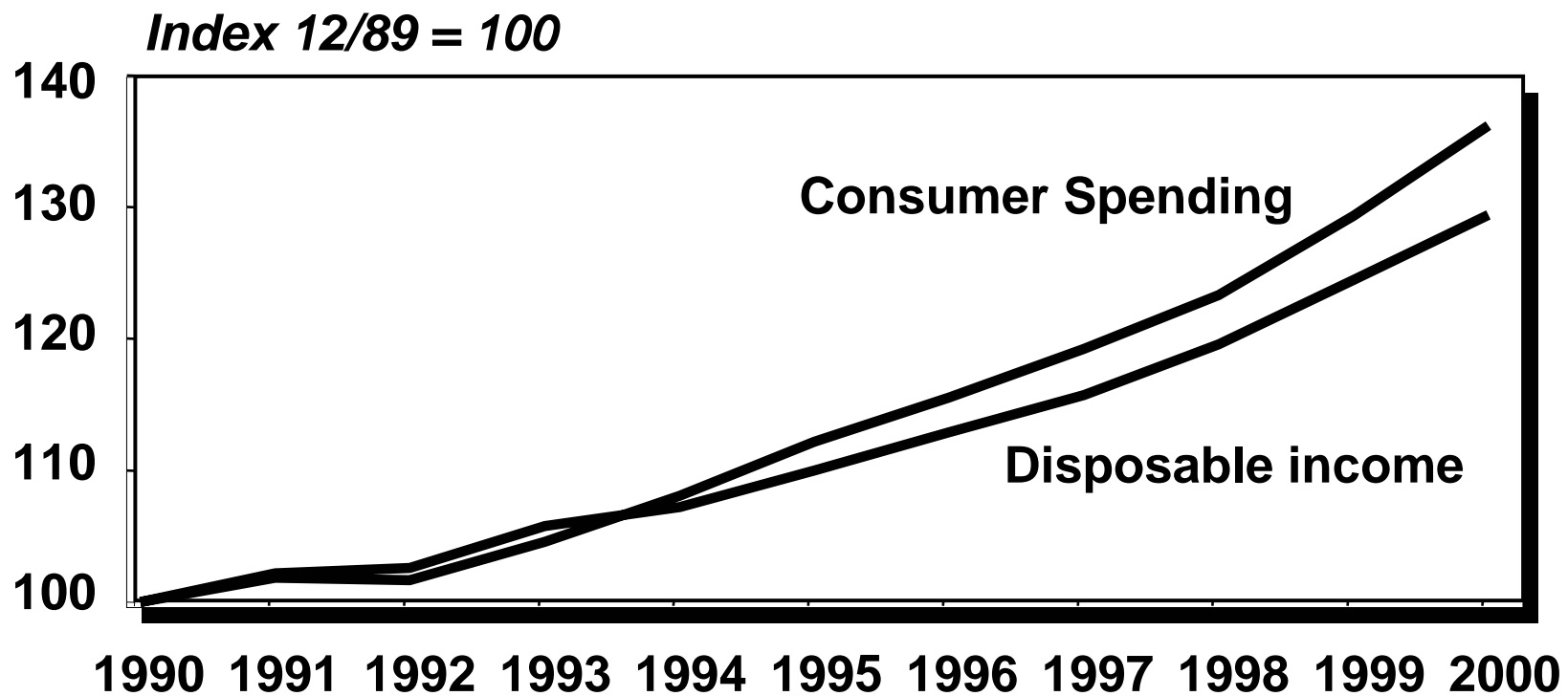
*In '80s falling rates didn't drive spending*



# Consumer Myths

## *The 1990s*

*In '90s consumer spending rose with income*



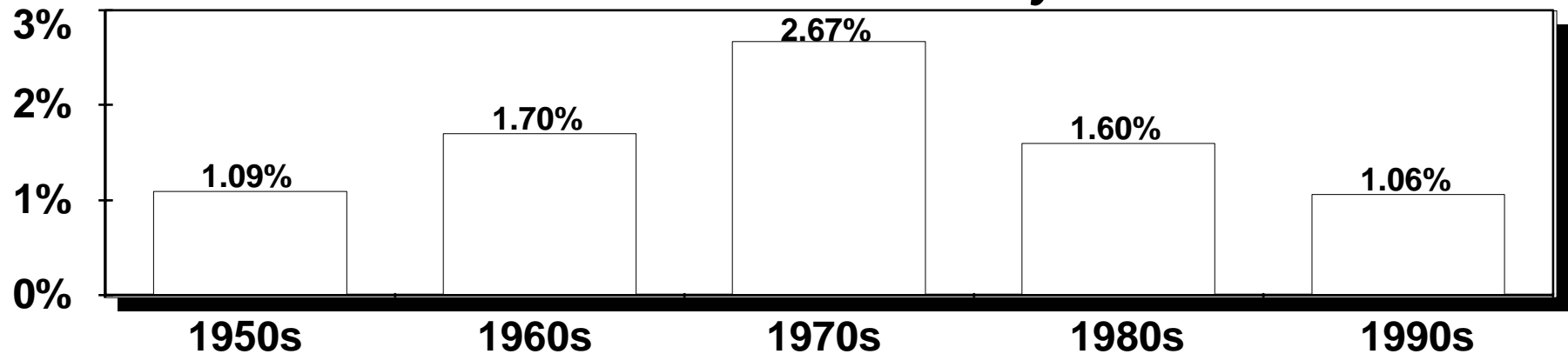


***The Case for the Consumer  
as presented in 1995***

# Consumer Comeback

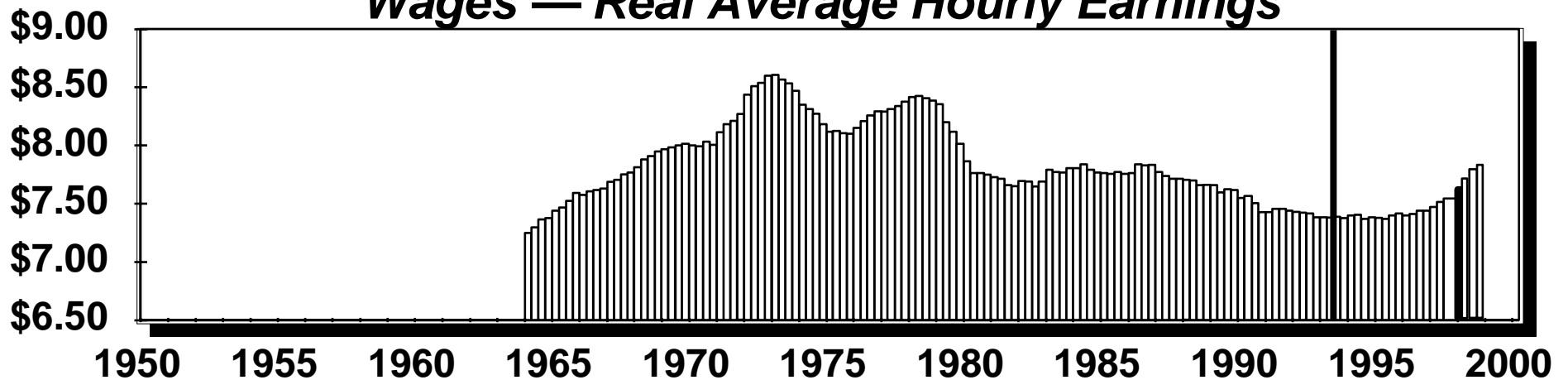
*As Labor Growth Slows ...*

*U.S. Labor Force Growth by Decade*



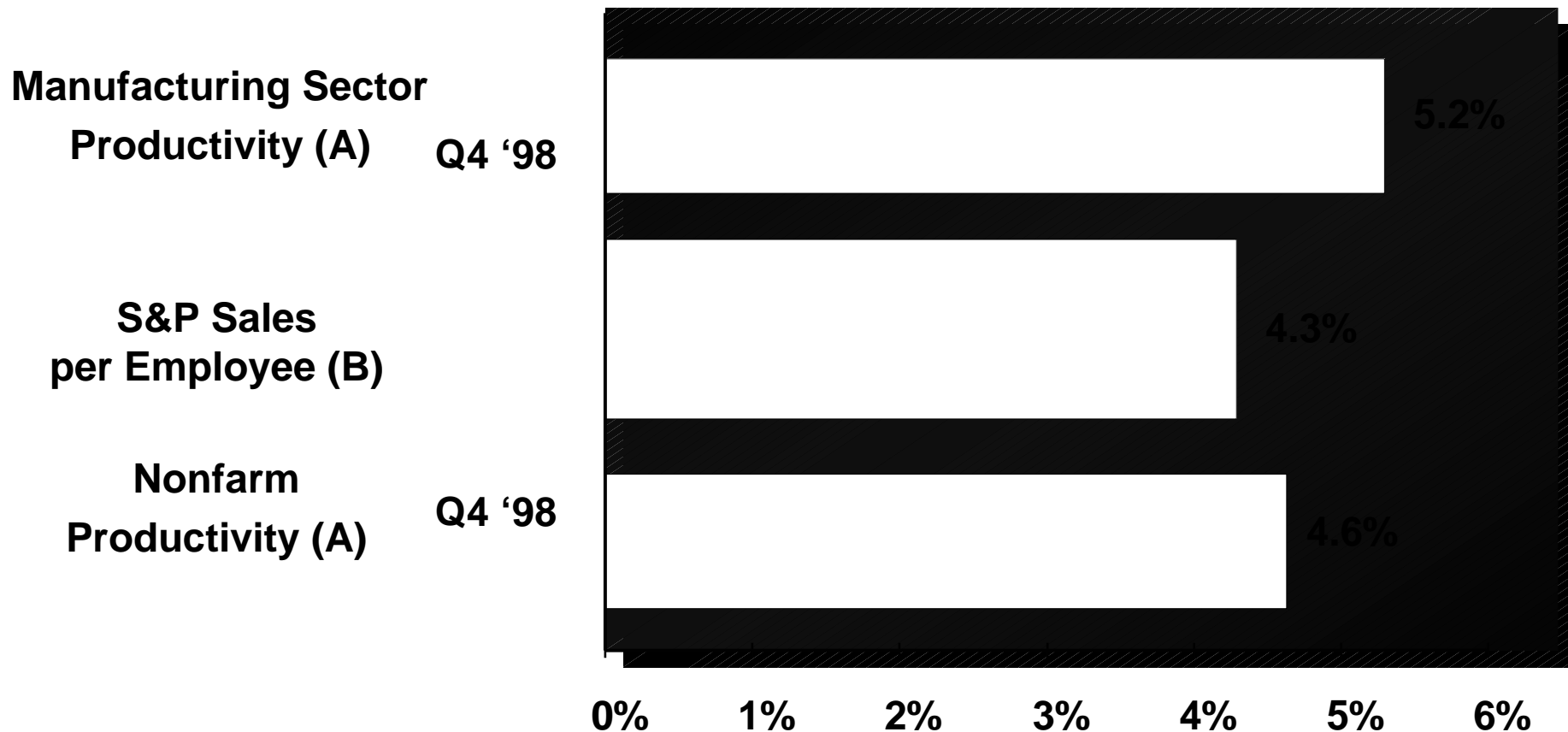
*... Incomes will Rise*

*Wages — Real Average Hourly Earnings*



# Consumer Comeback

*And Strong Productivity Forecast Proved True*



*(A) Year over year change (B) 4 Year Compound Annual Nominal Rate Through 1997*

# Consumer Comeback

*The Pain the consumer felt in '95-'96 . . .*

*Exhibit 1: The Pain*



**Workers Take It On The Chin**  
A changing economy is  
leaving many of them behind

January 22, 1996



**ECONOMIC ANXIETY**

Ten years of downsizing and widening income  
inequality have taken an enormous toll. U.S.  
workers are losing faith in their ability to prosper

March 21, 1996



**"There's a large gut sense of  
economic insecurity that is  
pervasive in the middle class"**

**Pat Buchanan**

November 6, 1995



**IS THE AMERICAN WORKER GETTING  
Shafted?**

**The Assault On The Middle Class**

January 22, 1996

# Consumer Comeback

*... begins to reverse in '97*

*Exhibit 2: The Payoff*

**THE WALL STREET JOURNAL**

## Star Search

Talent Pool Is Shallow As Corporations  
Seek Executives for Top Jobs

June 26, 1997

**BARRON'S**

Finally, Poor Beginning To Feel They're  
Benefiting From the Economy's Boom

June 30, 1997

**The New York Times**

Sunday, June 7, 1997

U.S. Jobless Rate Declines To 4.8%,  
Lowest Since 1973

Payrolls Up, but Not Inflation

**THE WALL STREET JOURNAL**

## Up the Ladder

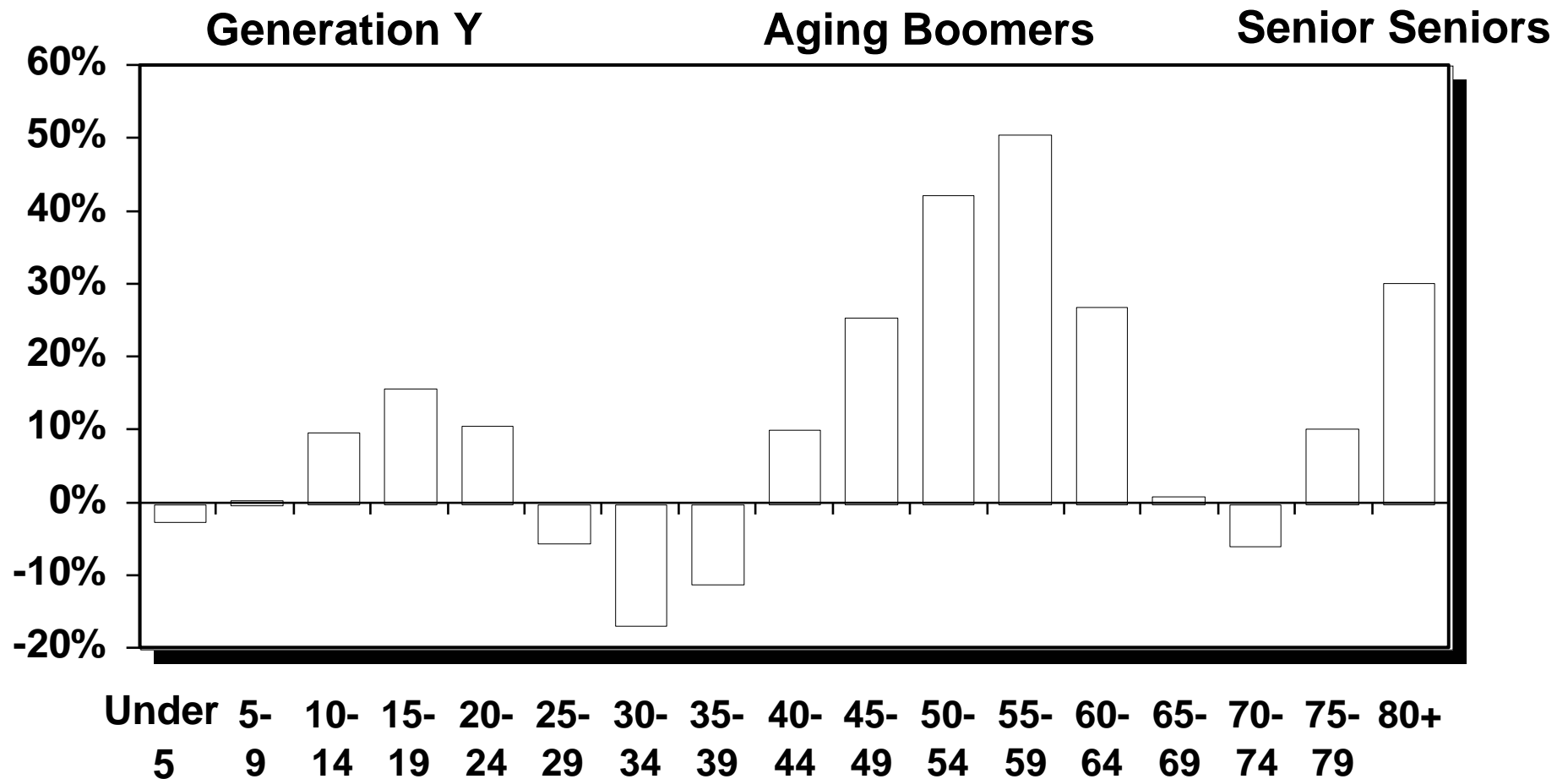
Low Unemployment Brings Lasting  
Gains To Town in Michigan

June 24, 1997

# Consumer Comeback

***“Aging Boomers” will drive consumer behavior***

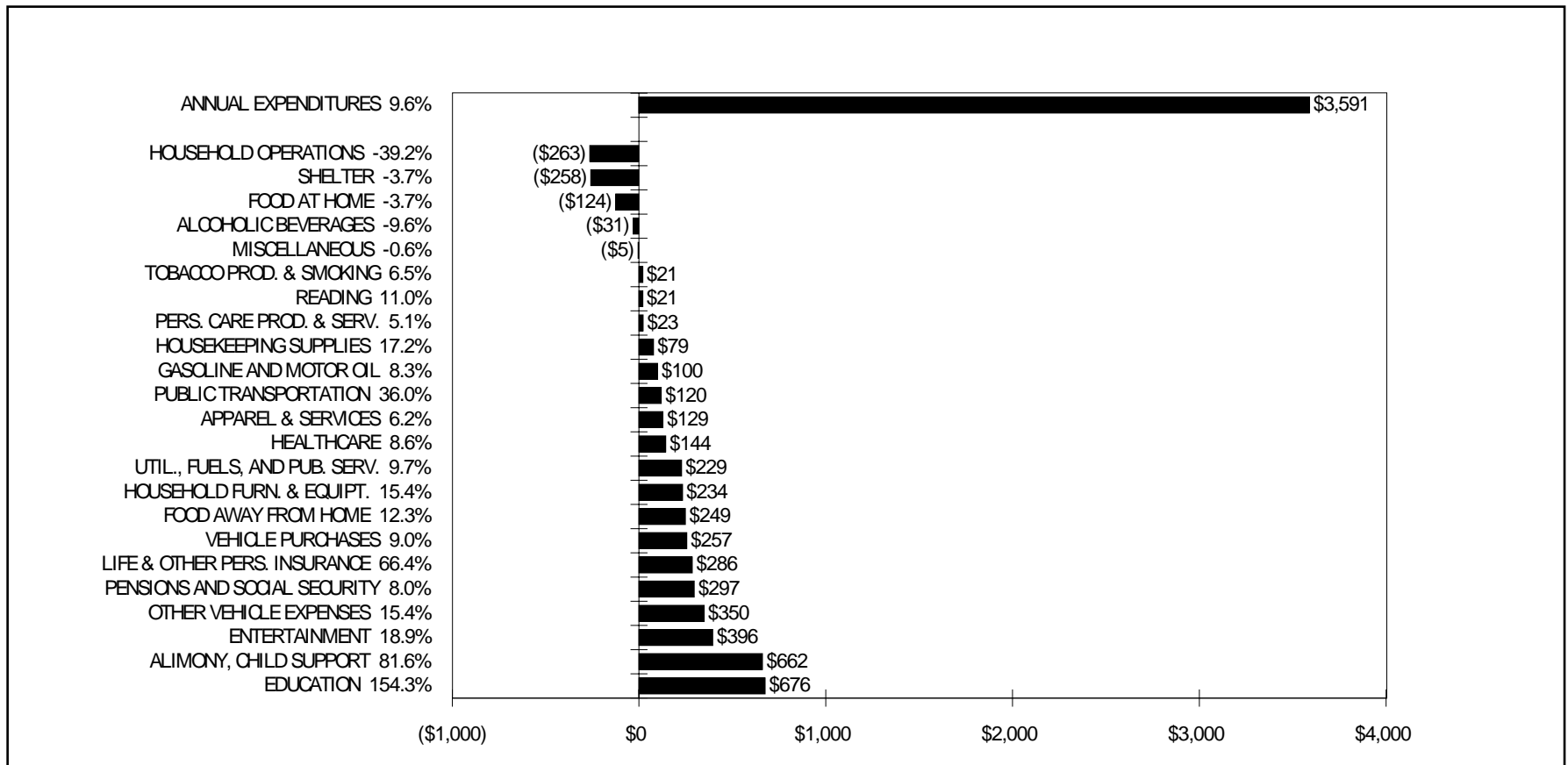
***Percent Change by Age in U.S. Population 1995-2005***



# Consumer Comeback

*“Aging Boomers” will drive consumer behavior*

*Change in household expenditures from 35-44 to 45-54 age group*



# **The New Millennium American**

***The Case for the Consumer  
as presented in 1998***

# The New Millennium American

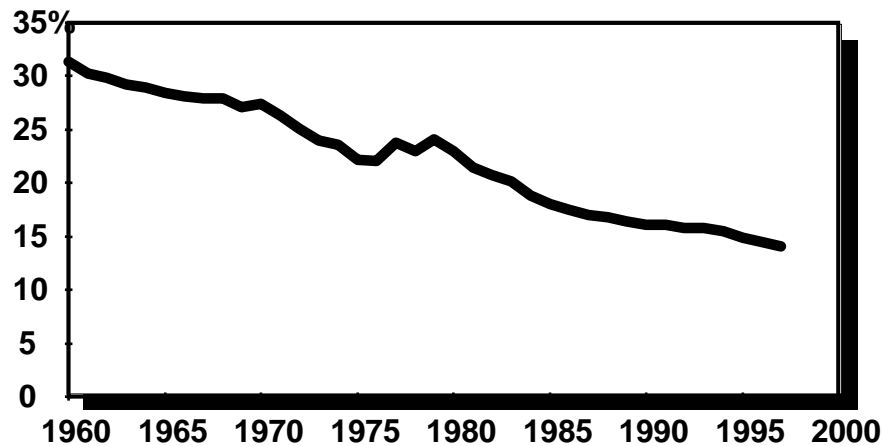
To understand the *future* behavior of American Consumers, the Gallup Organization, a leading expert on consumer behavior, conducted proprietary surveys of 1,000 Americans. There were four surveys between September 1998 and April 2001.

In combination with analysis of Government data on historical consumer behavior and its relationship to macroeconomic conditions, as well as other attitudinal surveys, a picture of the likely outlook for the “New Millennium American” began to emerge.

# The New Millennium American

## *Cradle-to-grave entrepreneurialism*

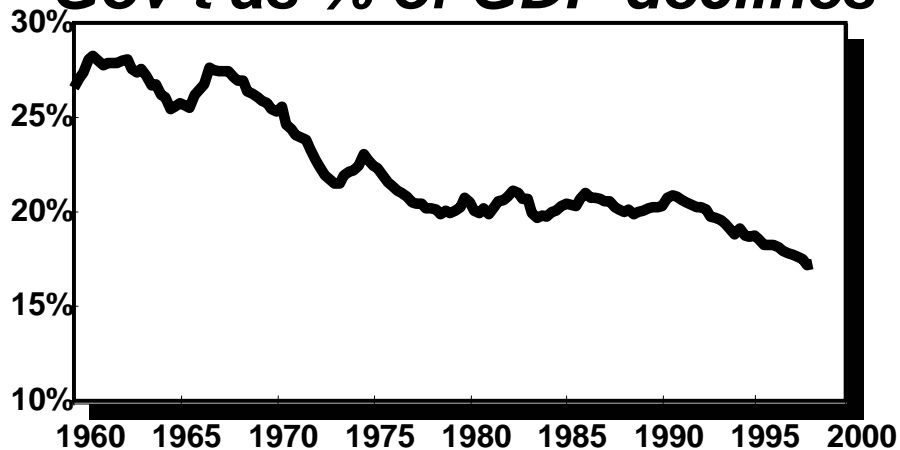
### *Union membership declines*



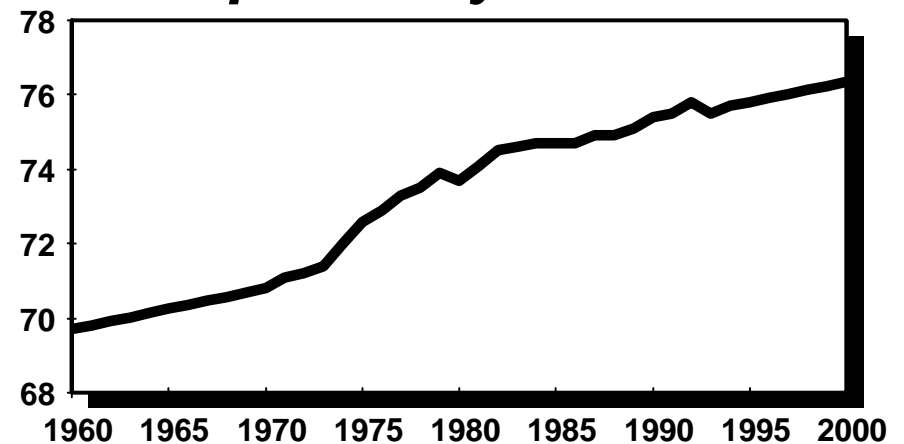
Over a quarter of baby boomers (28%) and more than one in six of the pre-retirement age group (17%) have worked for no more than two years in their current job.

*PW/Gallup, July 1998*

### *Gov't as % of GDP declines*



### *Life Expectancy increases*

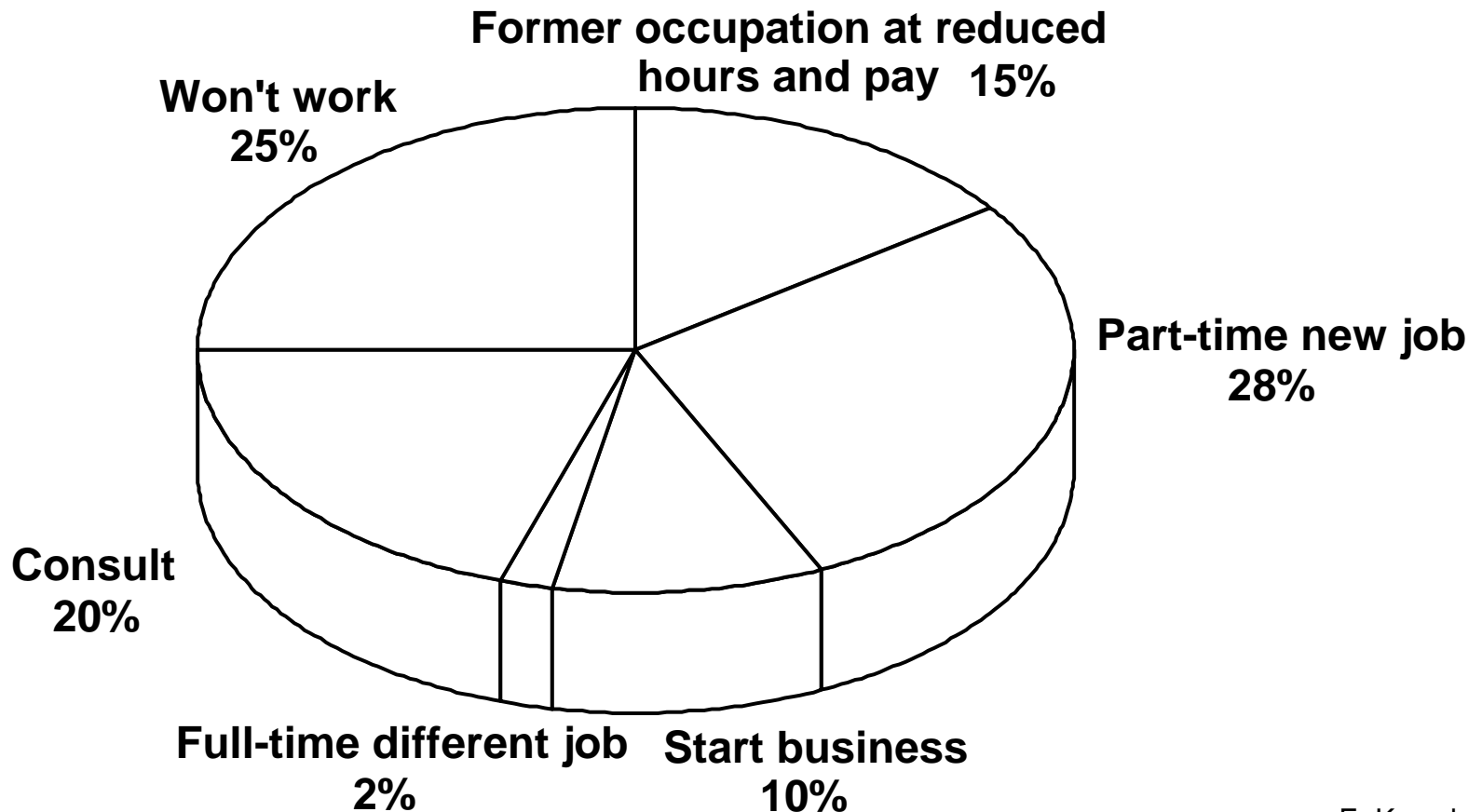


E. Kerschner

# The New Millennium American

*Cradle-to-grave entrepreneurialism*

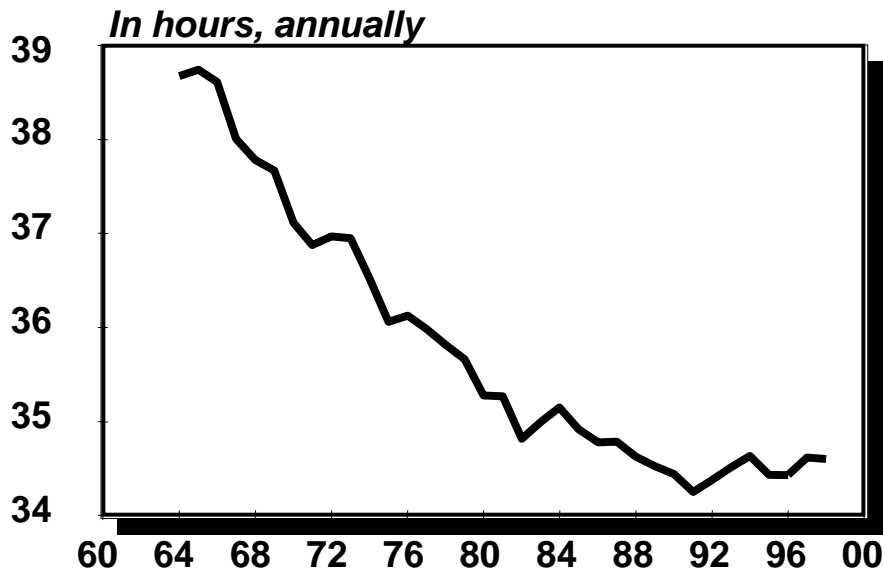
*Boomers plan on working after retiring*



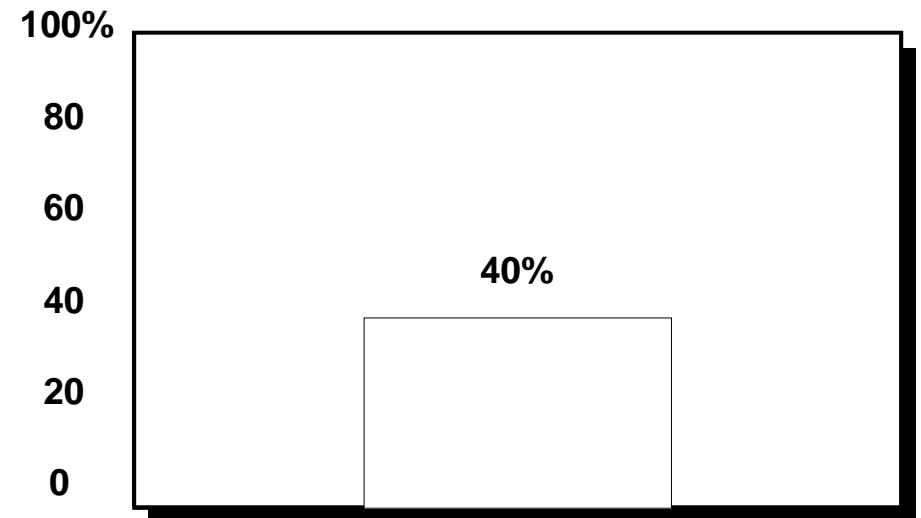
# The New Millennium American

## *The Time Drought*

*Average workweek has stopped declining*



*% of Americans saying time more valuable than money*



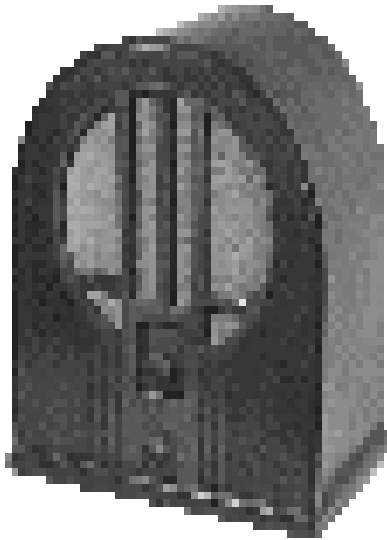
# The New Millennium American

## *The Time Drought*

***Multitasking has become the norm***

### **As a child**

*Listen to radio at home*



### **1950s**

*Ride in car and...  
Listen to radio*



### **Today**

*Ride in car and...  
Listen to radio and...  
Talk on phone*



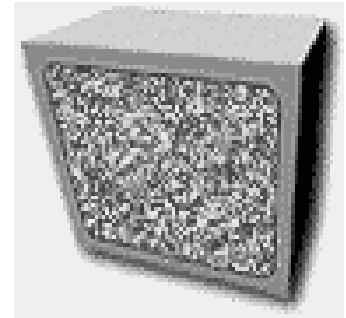
# The New Millennium American

## *The Time Drought*

cook

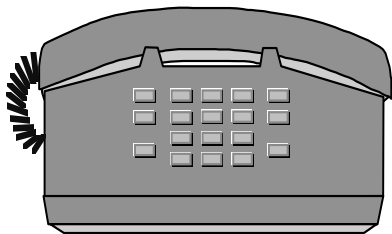


watch TV



“Great Rooms”

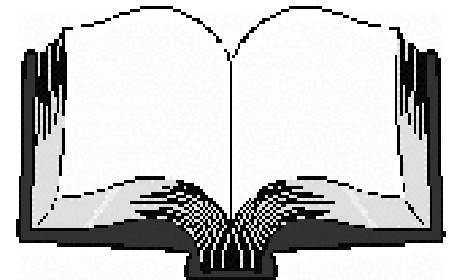
phone



IT



homework



# The New Millennium American

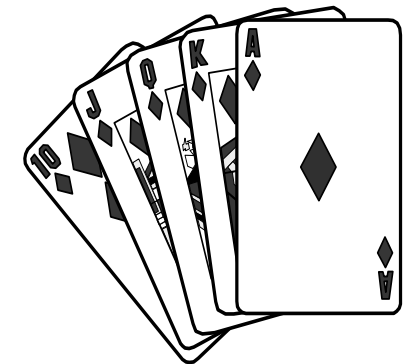
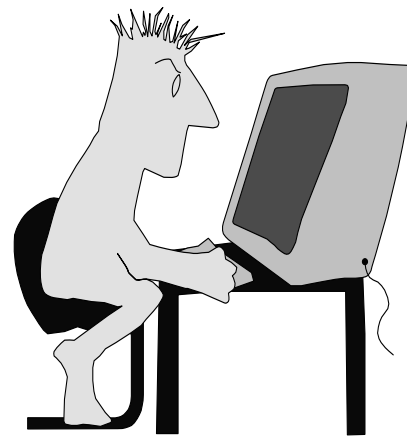
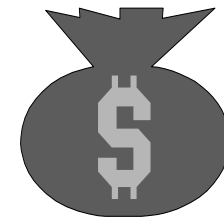
## *The Time Drought*



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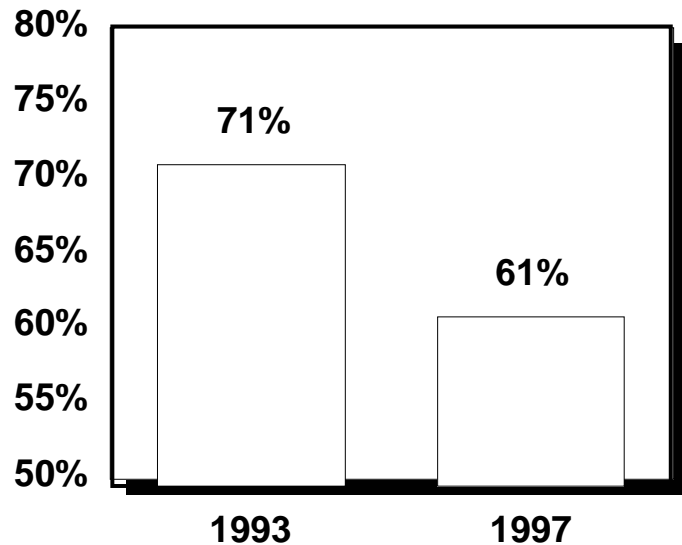
# The Internet



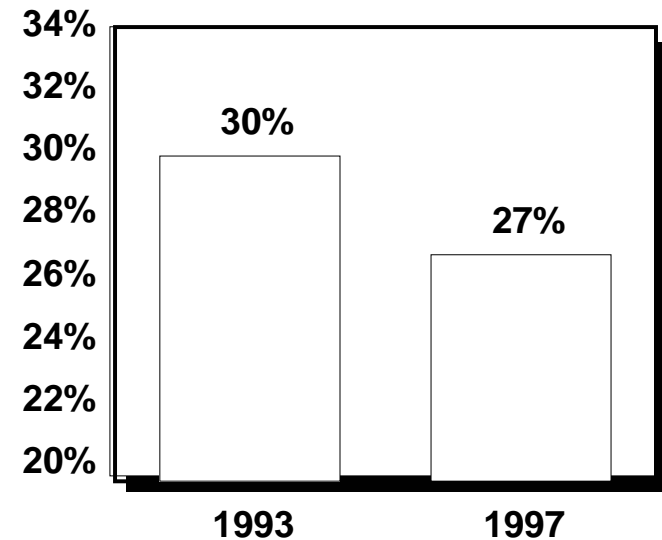
# The New Millennium American

## “Stressless Leisure”

***Fewer Prefer a sense of participating***



***Exercise/sports less of a way to relax***



### ***What Americans want in a vacation?***

- “Comfortable” 94%
- “Relaxing” 92%
- “Somewhat adventurous” 79%
- “Physically challenging” 35%
- “Slightly dangerous” 20%

*PW/Gallup, July 1998*

# The New Millennium American

## *The no-service / full-service economy*

Just under half of Americans (45%) say they choose the stores they shop at because the service they provide helps them to better manage their time.

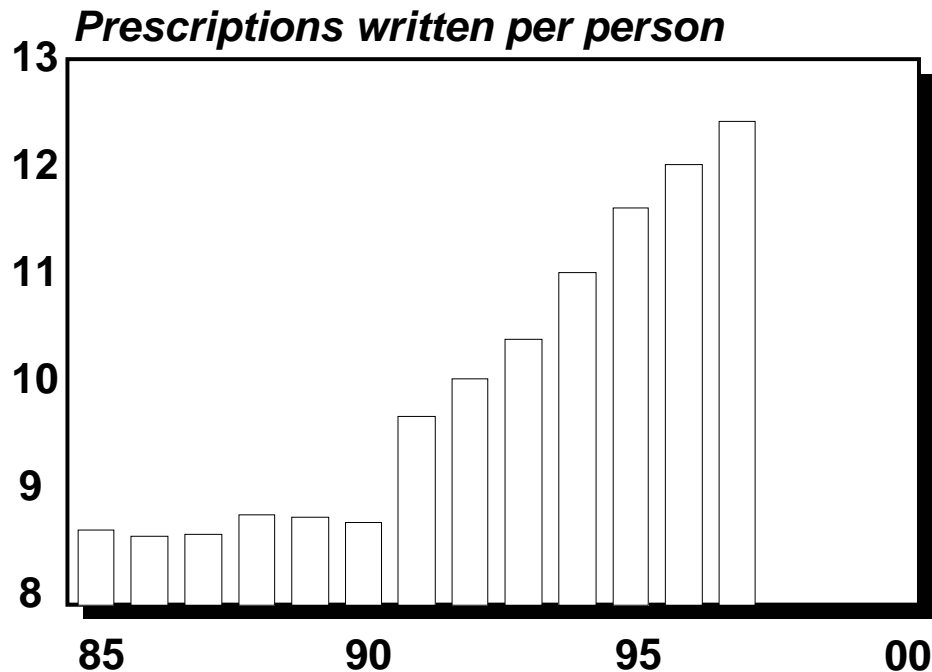
*PW/Gallup, July 1998*

- Efficient, automated services (i.e. Internet) are winners
- Premium-quality, full-service providers are winners
- “*Mediocre middle*” is vulnerable

# The New Millennium American

## *The New Drug Culture*

*Boomers* are using drugs to “fix things” when - or even before - something goes wrong.



- *Propecia* for hair-loss
- *Dexetrim* for weight-loss
- *Zyban* for smoking-cessation
- *Viagra* for sexual problems
- *Prozac* for depression
- *Xanax* for anxiety

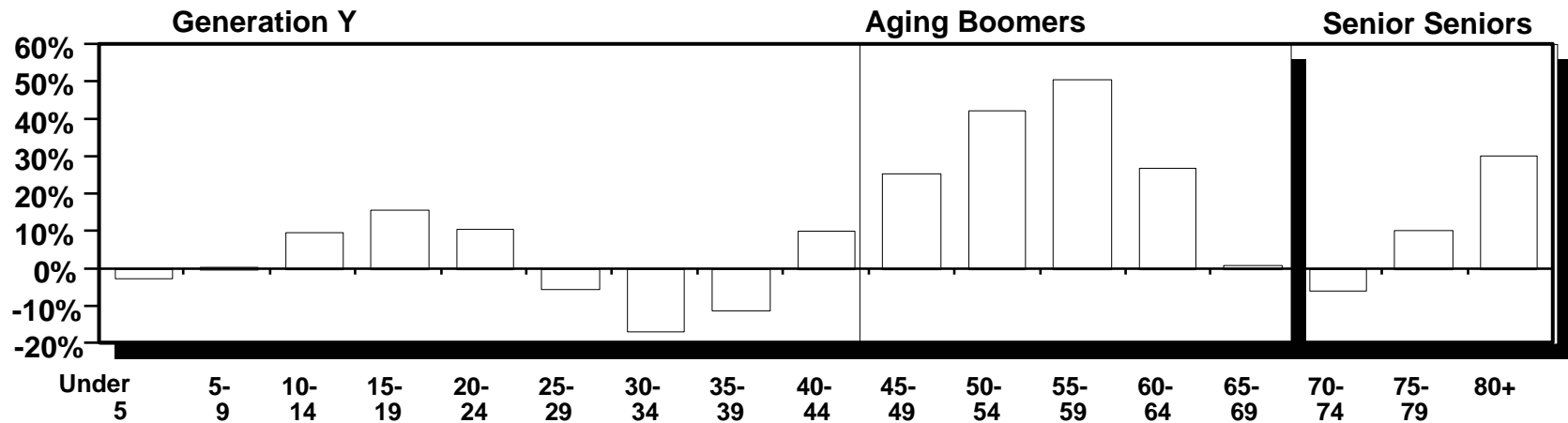
# **The American Age of Affluence**

***The Case for the Consumer  
as presented in 2000/2001***

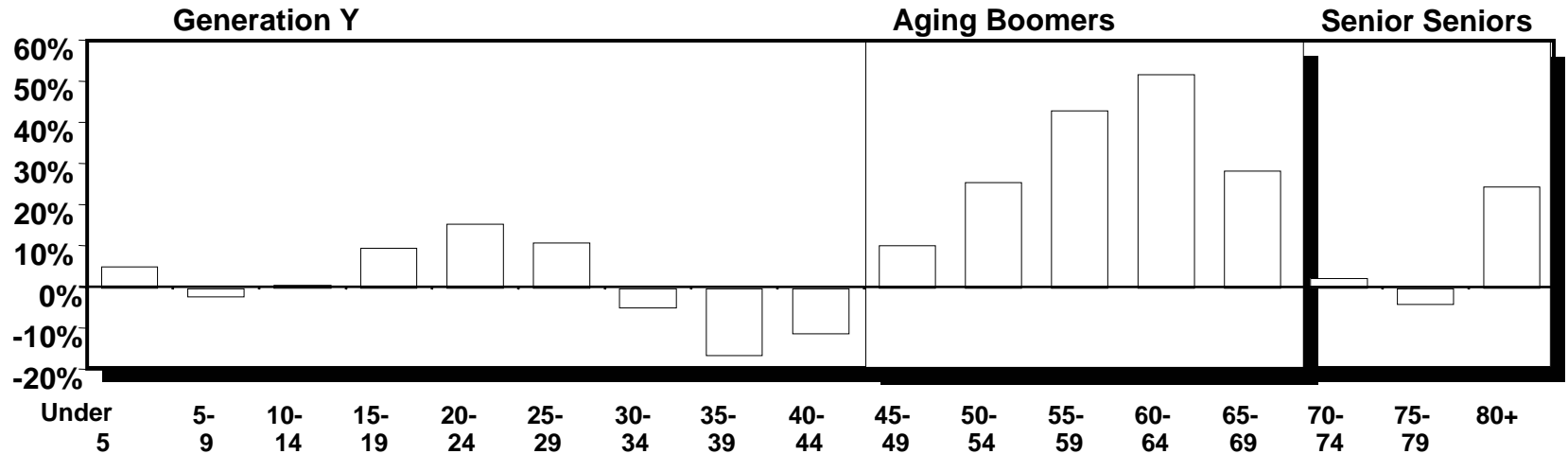
# The American Age of Affluence

## *Affluent and Aging*

***Percent Change by Age in U.S. Population 1995-2005***

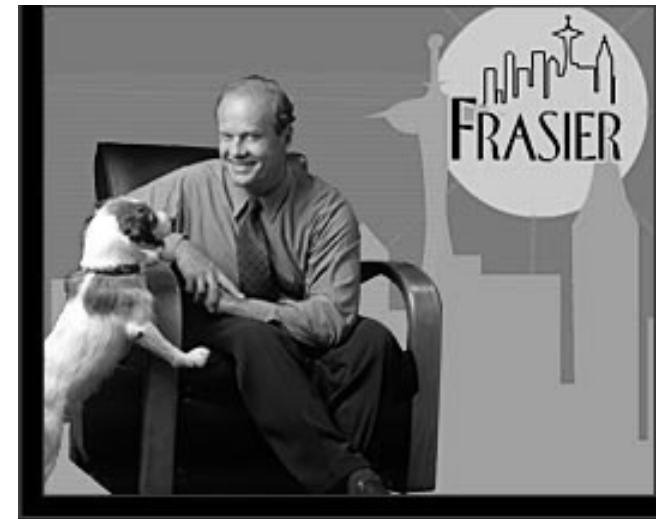


***Percent Change by Age in U.S. Population 2000-2010***



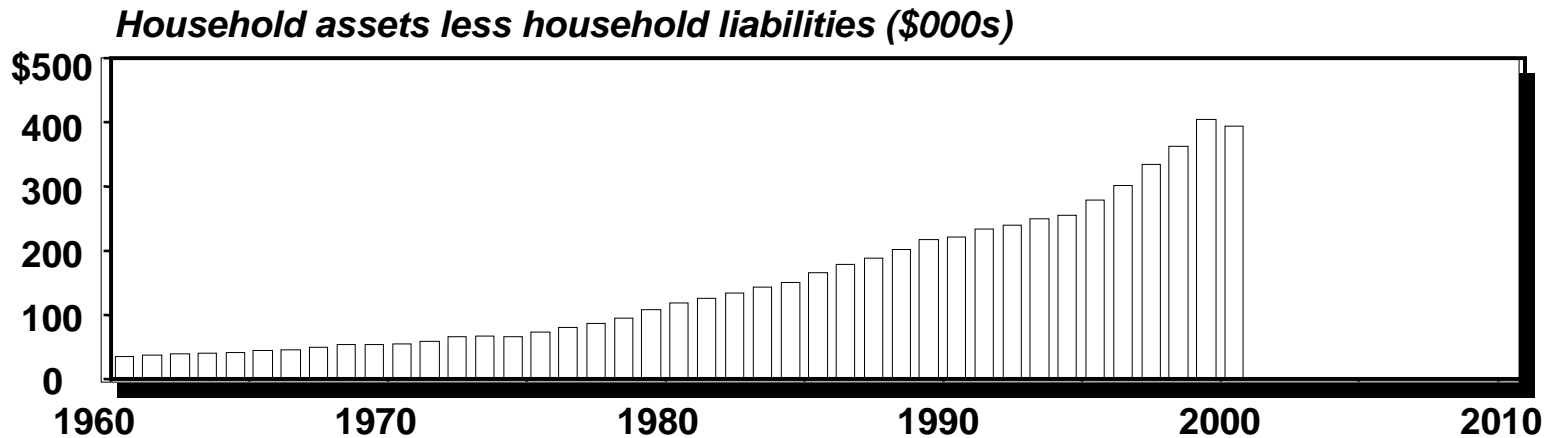
# The American Age of Affluence

*Who Are We?*

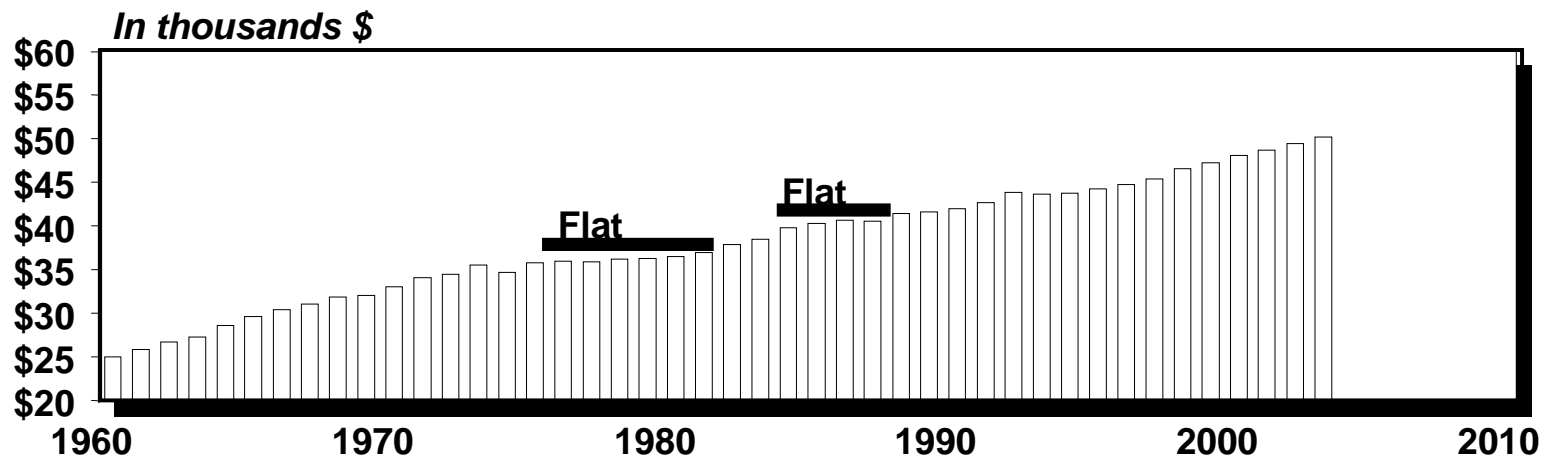


# The American Age of Affluence

## *Net worth per household has surged*

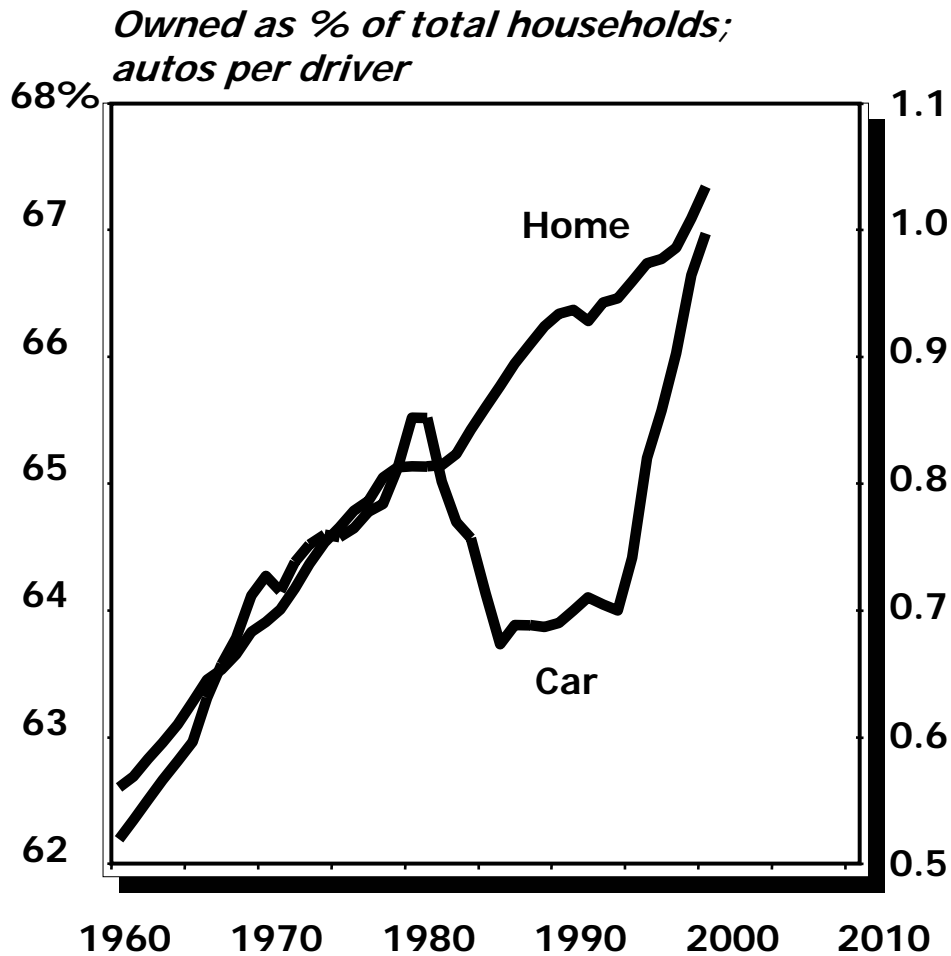


## *Real Disposable Income has surged*

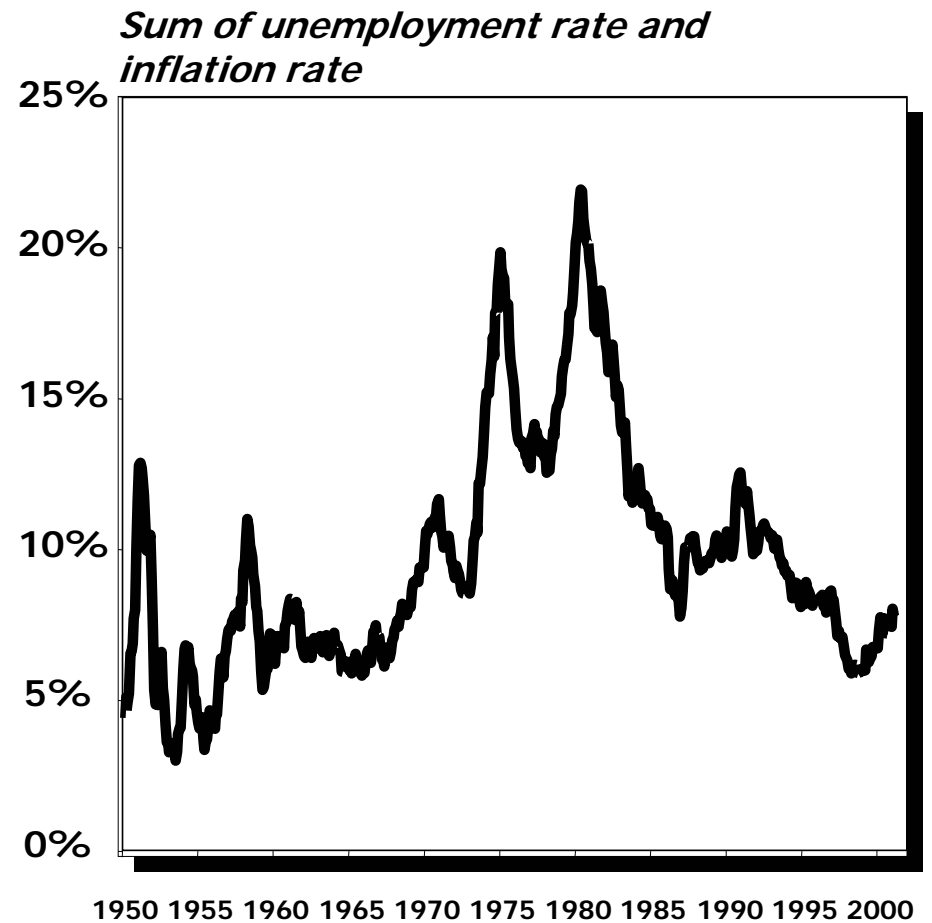


# The American Age of Affluence

*Home and car ownership rates are rising rapidly*



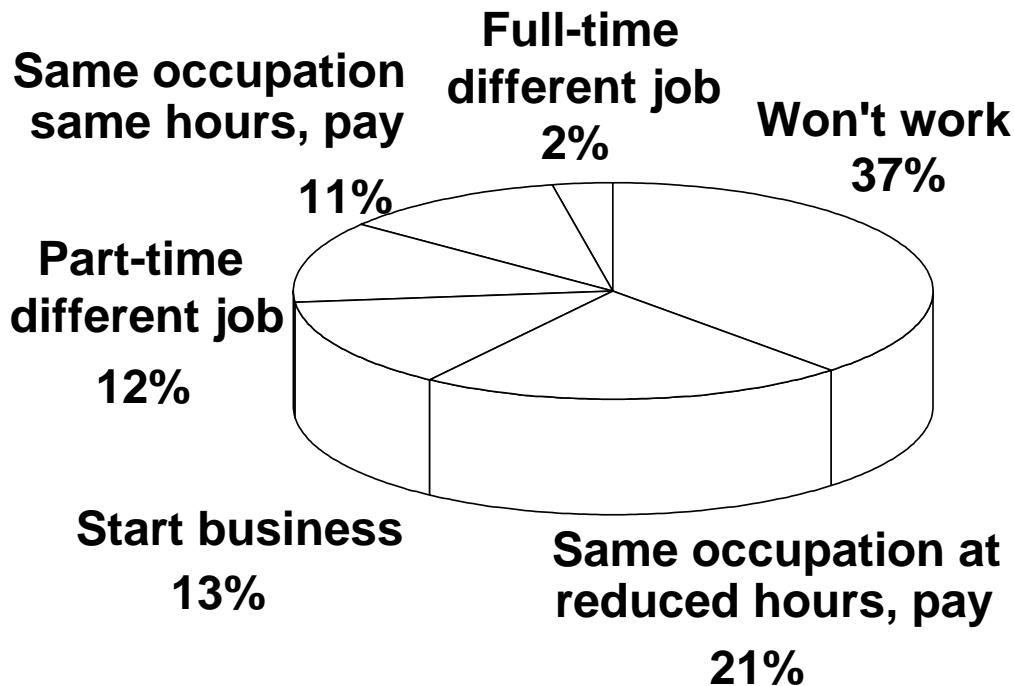
*Misery Index near lows*



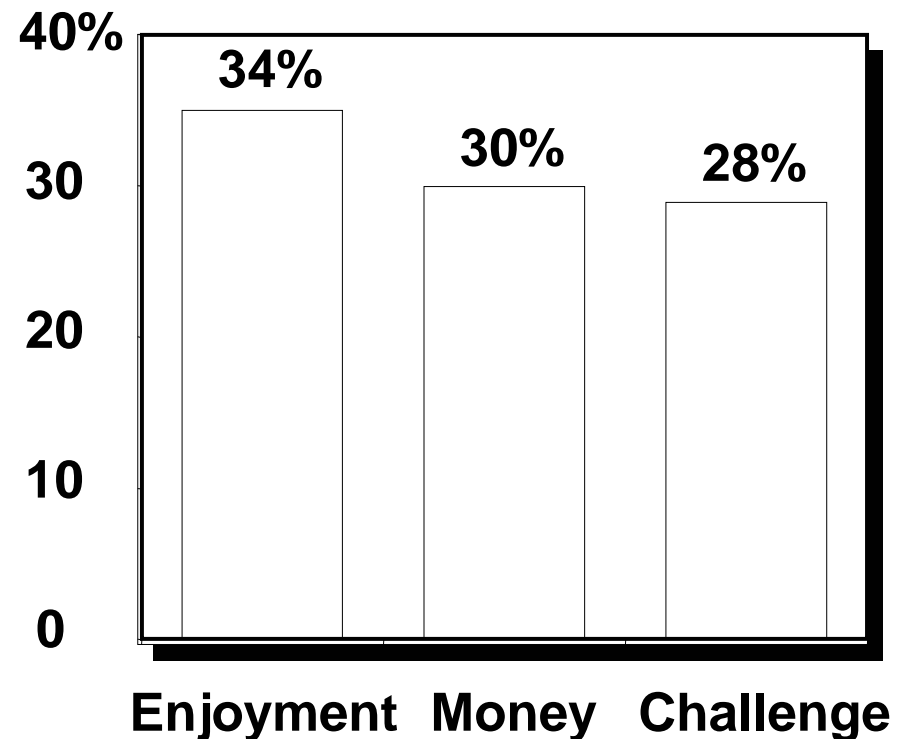
# The American Age of Affluence

***Boomers will still work after “retiring”***

***What baby boomers plan to do after retirement***



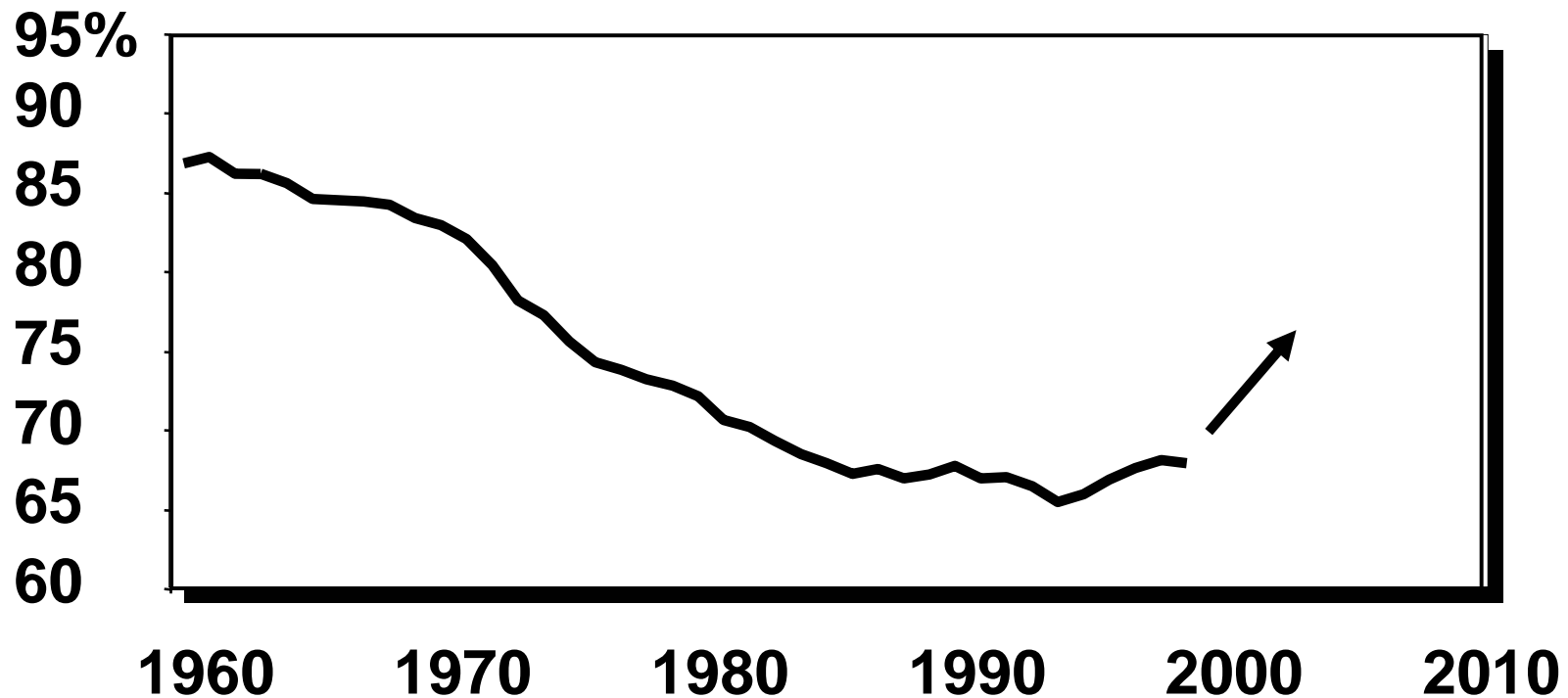
***Why baby boomers plan to work after retirement***



# The American Age of Affluence

*Labor participation rate ages 55-64 rising*

*Percentage of men in labor force age 55-64*



# The American Age of Affluence

## *The Gray Wave: The Way We Were*

- ◆ House
- ◆ Car
- ◆ Clothing

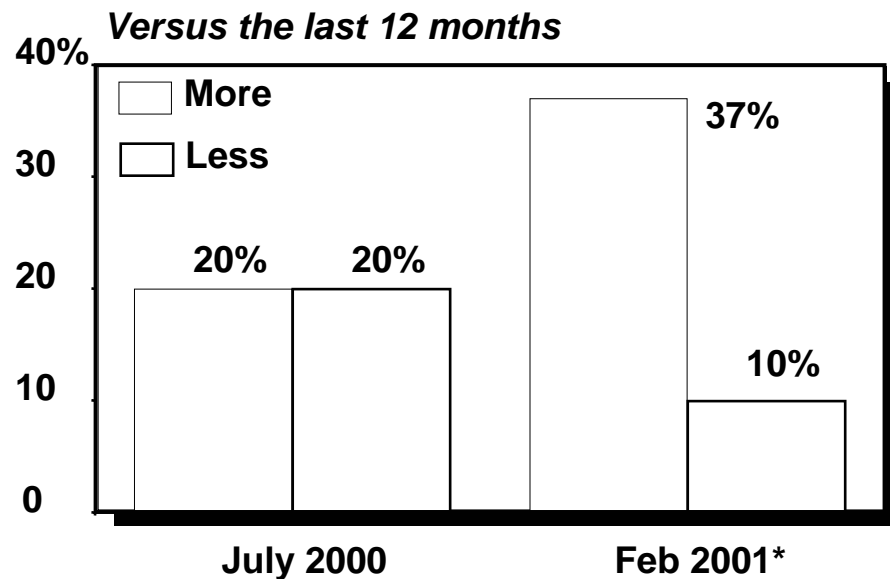
## *The Gray Wave: The Way We Are Now*

- ◆ Quality vs. Quantity
- ◆ Intangibles vs. Tangibles
- ◆ Time vs. Money

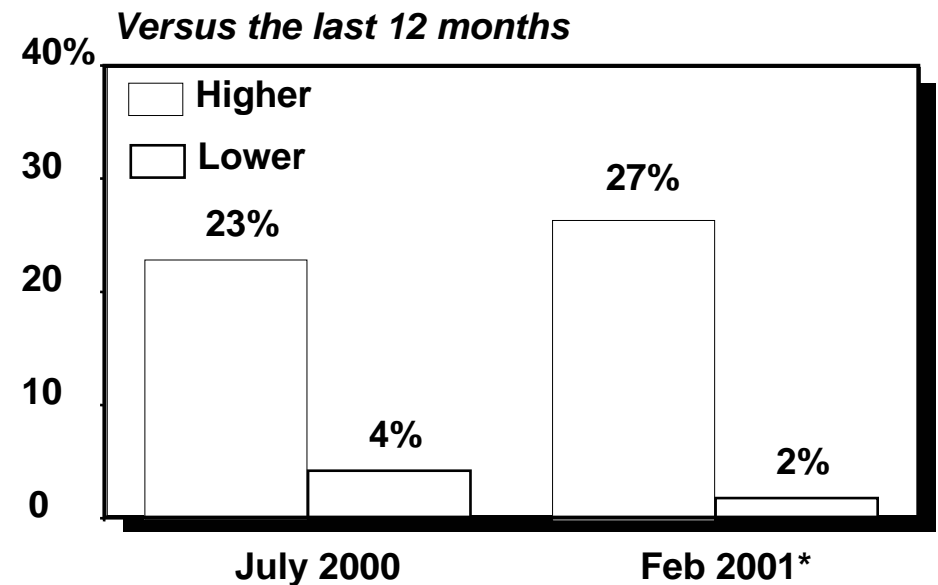
# The American Age of Affluence

## *Quality vs Quantity*

### *Quantity of goods Americans plan to buy*



### *Quality of goods Americans plan to buy*



*\*given improved economic conditions*

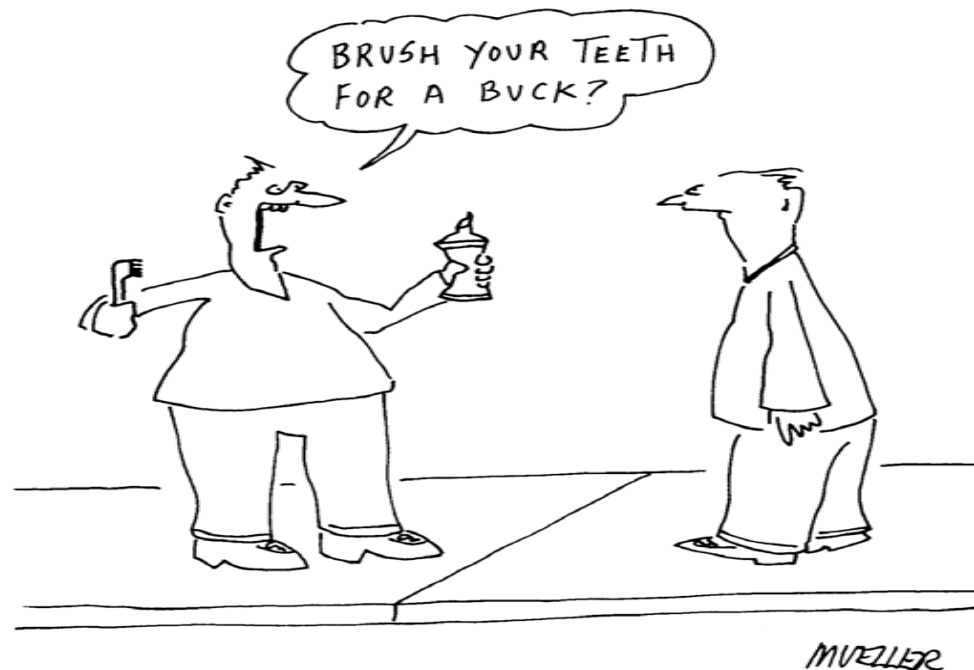
E. Kerschner

# The American Age of Affluence

## *Intangibles vs. Tangibles*

- ***Over half (55%) of Americans have employed someone in the past year to provide personal services.***

—PaineWebber/Gallup, July 2000.



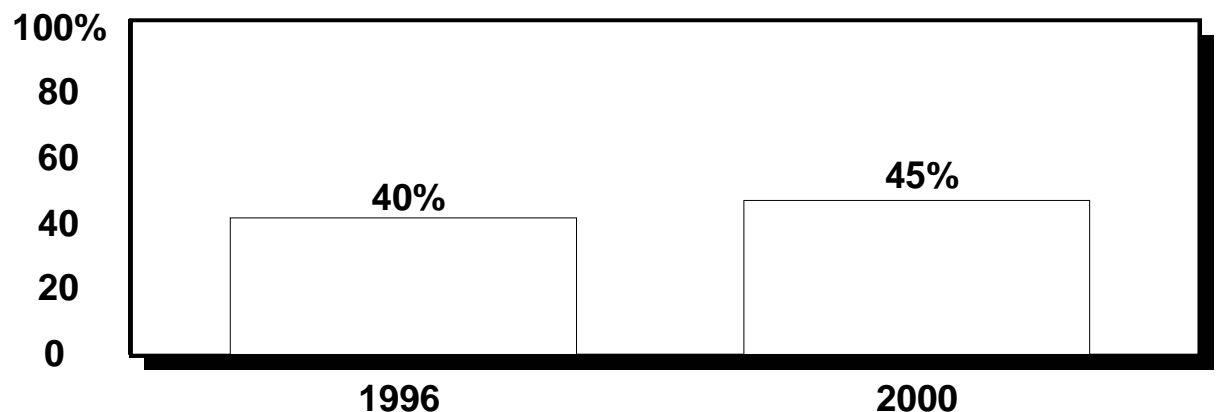
# The American Age of Affluence

## *Time vs. Money*

- *In the past several years almost half of Americans (45%) have reduced the amount of time they spend watching TV.*
- *Two in five Americans have cut back on the amount of time they spend on outdoor activities or exercising.*

—PaineWebber/Gallup, July 2000.

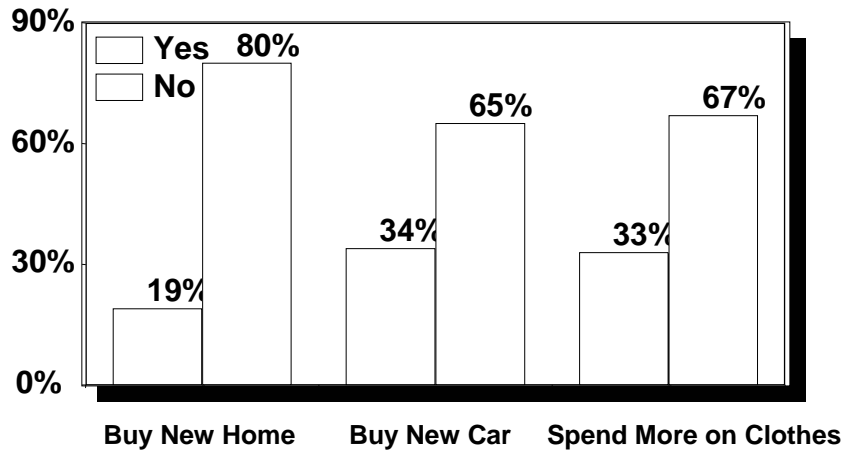
***Percent of  
Americans saying  
lack of time is a  
bigger problem than  
lack of money***



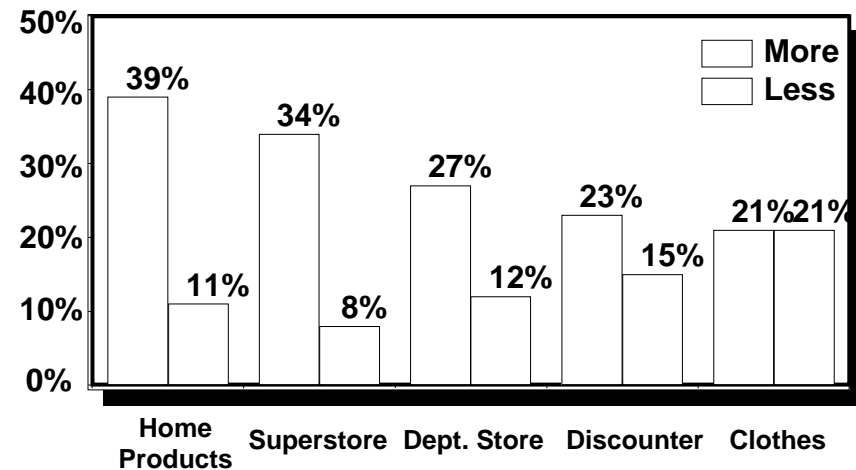
# The American Age of Affluence

*“When things get better...”*

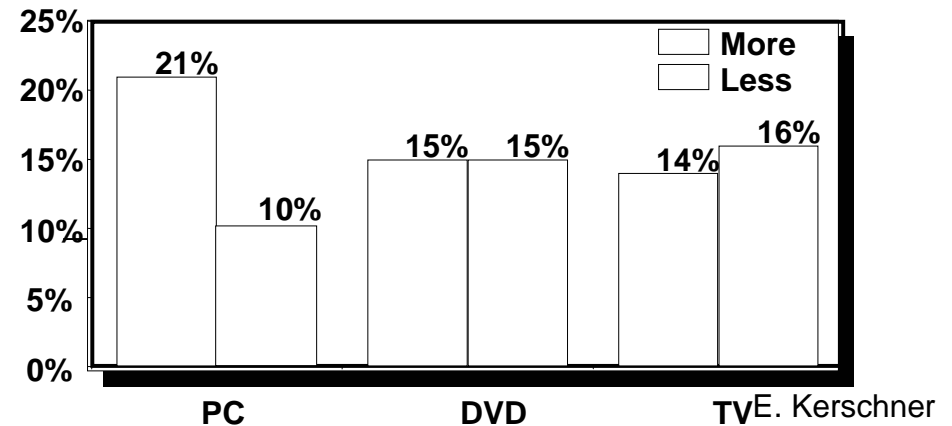
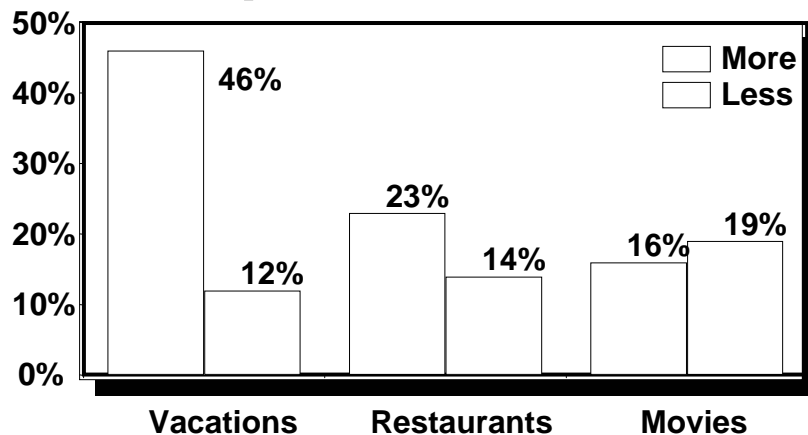
*What will you do?*



*I will spend more/less on...*



*I will spend more/less on...*



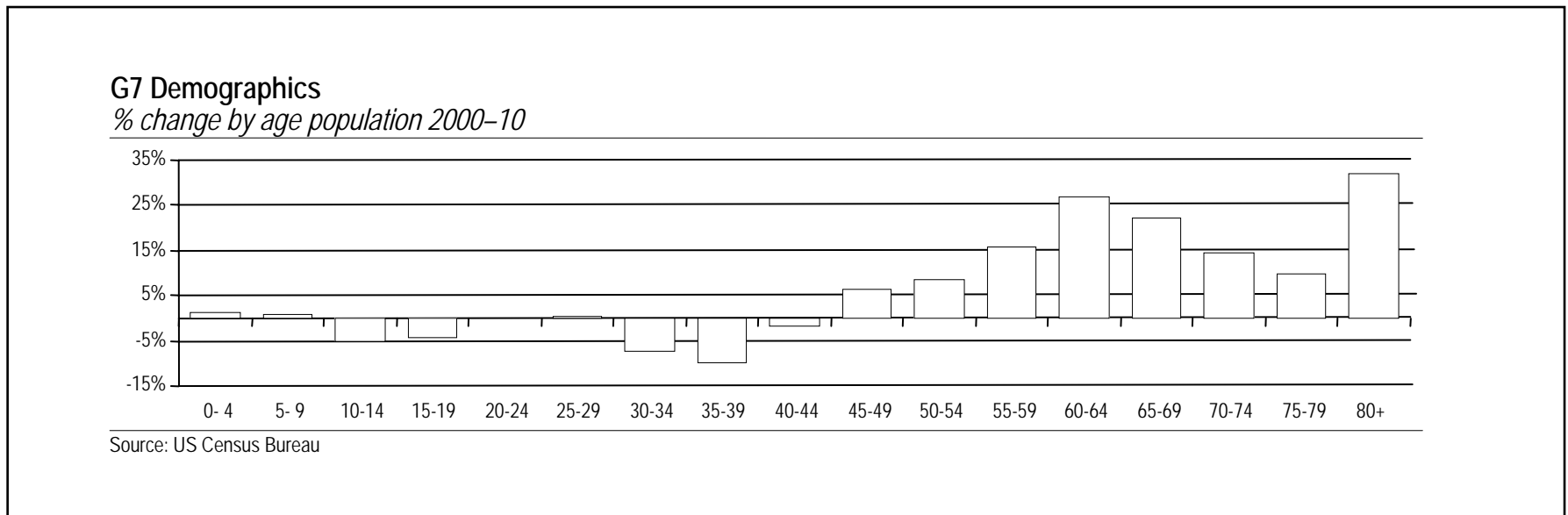
# **A Grayer and Gloomier Consumer**

***The Case for the Consumer  
as presented in 2003***

# Grayer & Gloomier

## Grayer

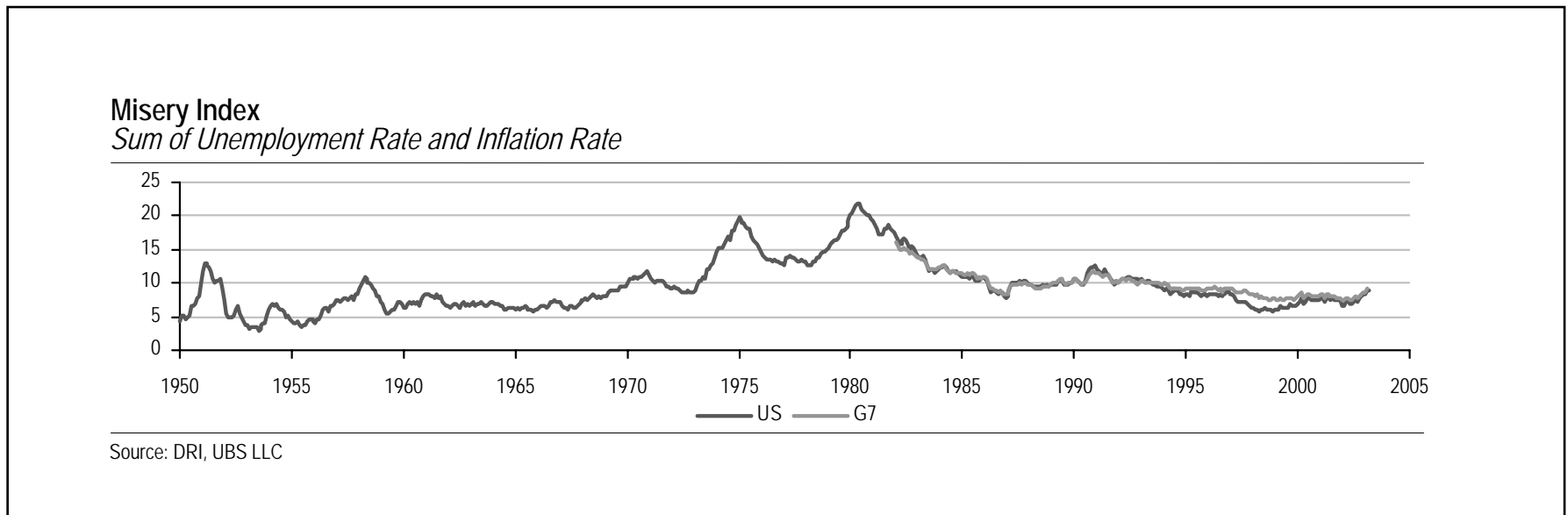
- ◆ The fastest growing segment of G7 population is 60-64. The "gray wave," having seen misery index peak at 21.9 in 1980 (when they were in their 20s and early 30s) are confronting a protracted increase in "misery" for essentially first time in their adult lives.



# Grayer & Gloomier

## *Gloomier*

- ◆ The "misery index"—unemployment + inflation — is at highest level in four years and is 220 basis points above its 1999 trough of 6.0%.

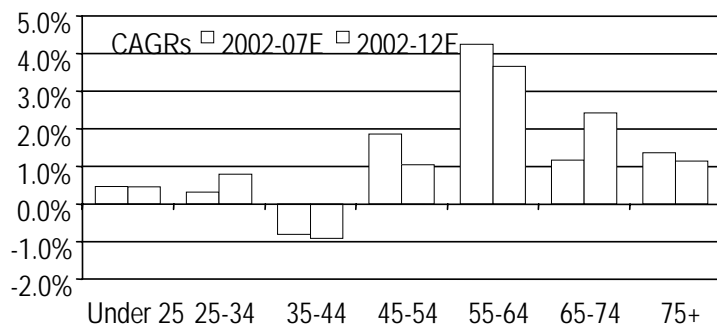


# Grayer & Gloomier

## Grayer

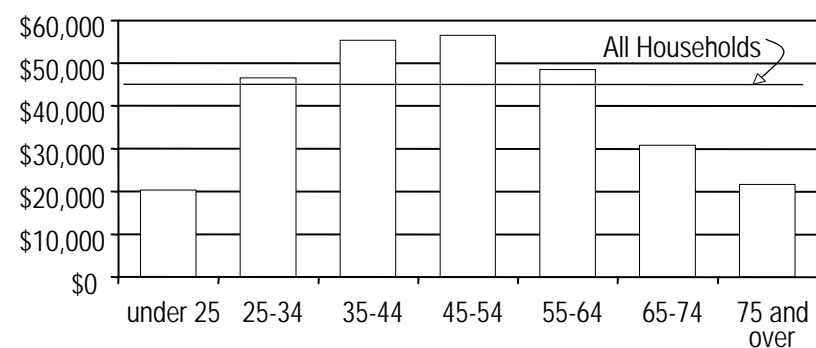
- ◆ Number of Americans aged 35-44 (income 124% of the average household) *declines* 1% annually over next decade.
- ◆ Aged 45-54 (top-earnings group at 129% of avg.) still growing; but growth has slowed from 4% in mid 1990s to 2% currently.
- ◆ We are three years past the "crossover point" when the top-earning 45-54 bracket started to grow more slowly than the 55-64 group, whose income is 109% of the average.

Growth in Age Cohorts  
Over the Next Five and 10 Years



Source: US Census Bureau

Household Income Level, 2001 Growth  
By Head-of-Household Age Cohort

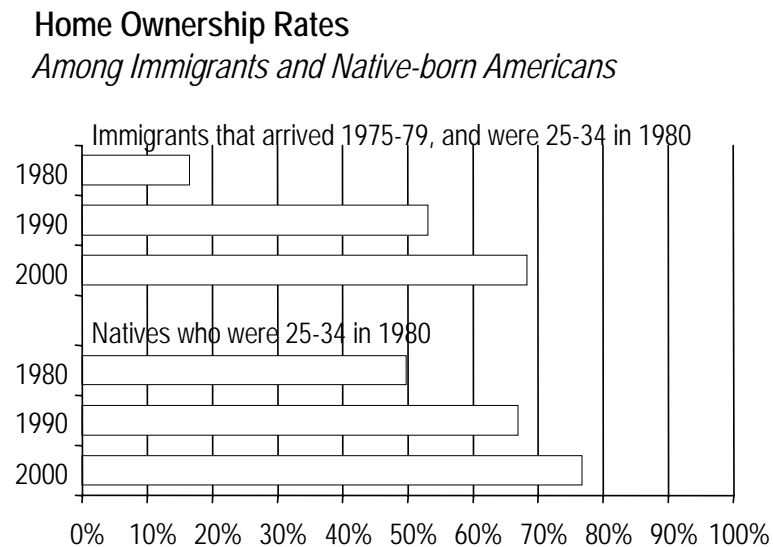


Source: Bureau of Labor Statistics, Consumer Expenditure Survey

# Grayer & Gloomier

## *A "Nation of Immigrants" Keeps Growing*

- ◆ Housing benefits: Immigrants' homeownership rate is initially low compared to native-borns'. However, it increases sharply over time.

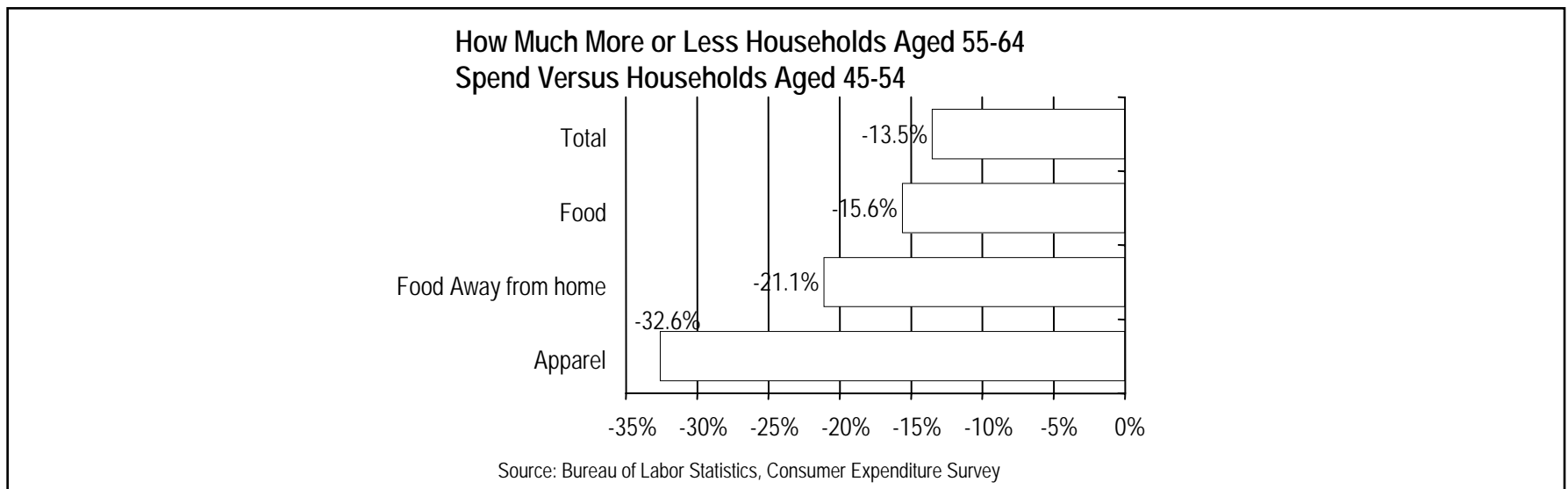


Source: George J. Borjas, Homeownership in the Immigrant Population, Mortgage Bankers Association of America

# Grayer & Gloomier

## *Non-Durables Poorly Positioned*

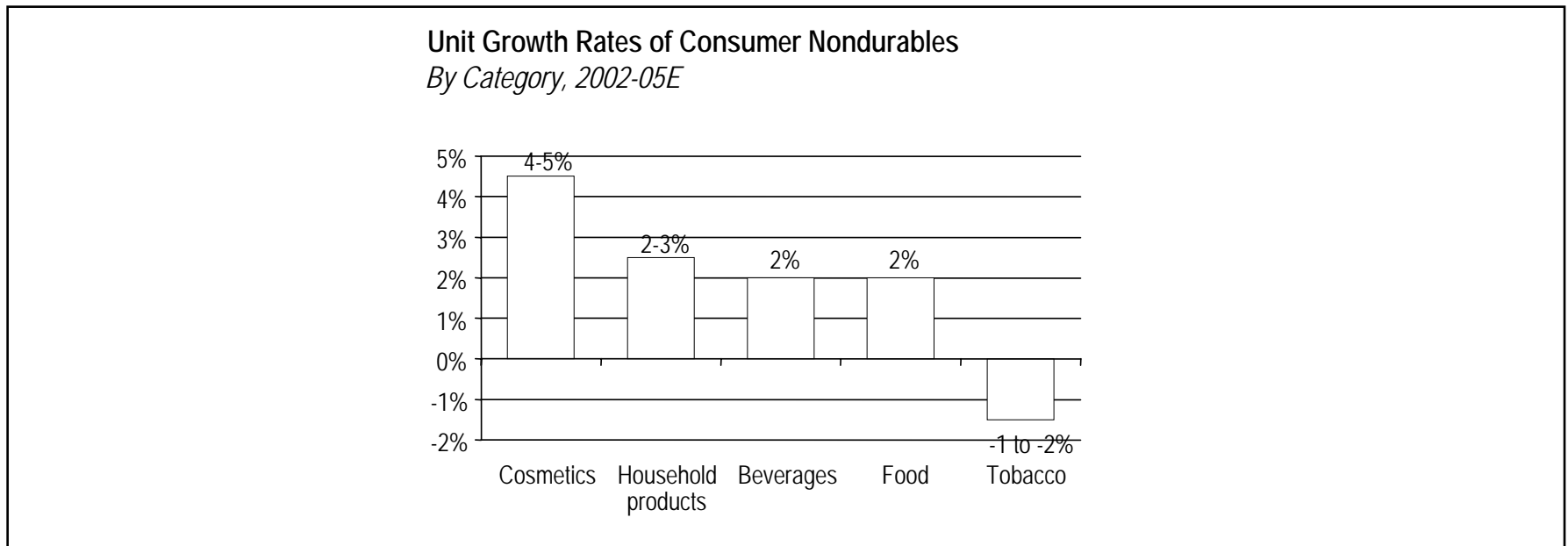
- ◆ Slower population growth negative for consumer non-durables (demand is driven by population rather than income).
- ◆ "Food away from home" and apparel to decline significantly.
- ◆ But as incomes rise, consumers trade up to: better houses, furniture, appliances, vehicles and other durable goods.



# Grayer & Gloomier

## *Grooming Over Consuming*

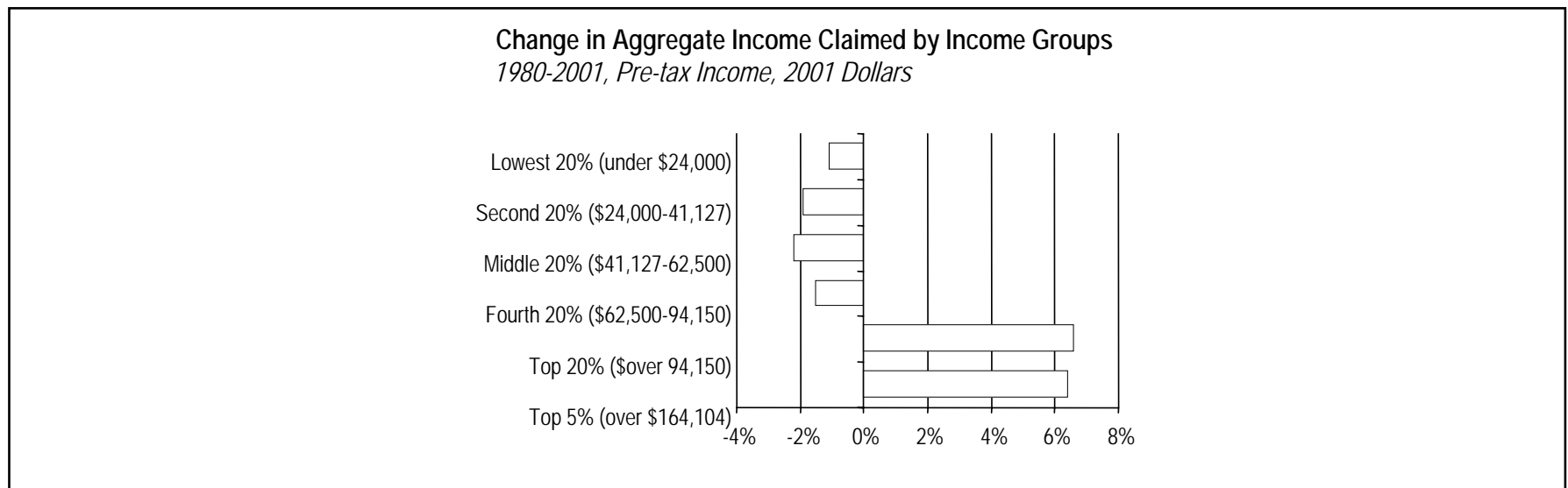
- ◆ Food and beverage firms are poorly positioned as population growth slows in developed countries, boomers fight obesity, and processed foods lose share to fresh food. Cosmetic and personal care benefit.



# Grayer & Gloomier

## *Extreme Consumption as Inequality Increases*

- ◆ Increasingly unequal income distribution is positive for companies catering to the affluent and those serving low-income families. Firms in the "mediocre middle" are likely to get squeezed.

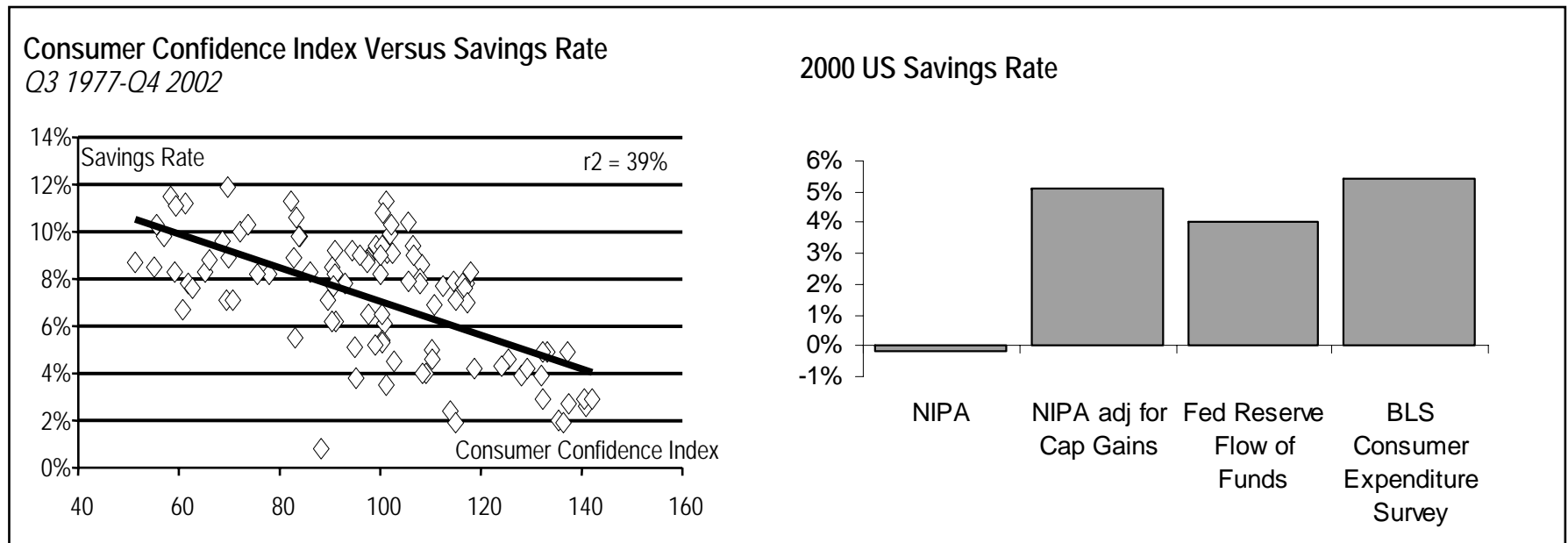


Source: US Census Bureau

# Grayer & Gloomier

## *The case for savings*

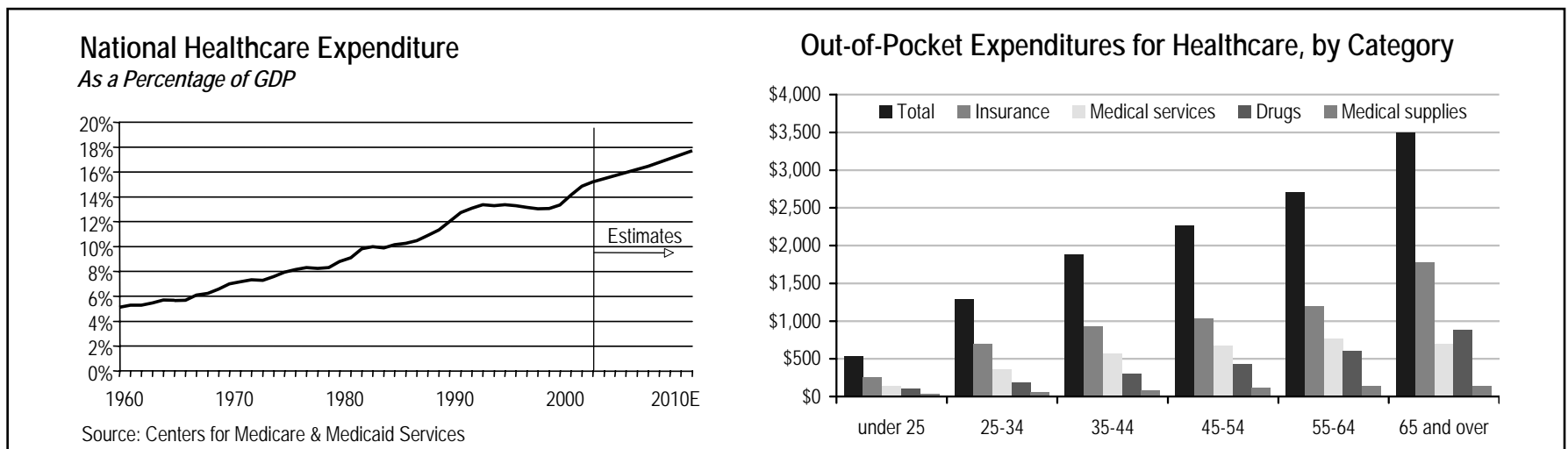
- ◆ Baby boomers have to save for retirement. Savings tends to rise when consumer confidence is low. And the rising number of high-income households is also positive for saving.
- ◆ Savings may not be as low as conventional thought.



# Grayer & Gloomier

## *Health Conscious*

- ◆ Healthcare's share of GDP continues to grow because it is a logical place for consumers to spend incremental income, it offers good value as technology improves, older consumers need more healthcare, and many US consumers are fascinated by health and fitness.



# Rotating Drivers of the Economy

- ◆ **1940-52:** WWII government military spending propels economy out of depression.
- ◆ **1952-60:** Corporations restructure from war-time footing, prosper while Eisenhower reins in government and consumer is hurt by frequent recessions.
- ◆ **1960-67:** Strong consumer spending propels rapid growth.
- ◆ **1967-82:** Government expands—Vietnam War and Great Society; rising taxes, accelerating inflation, weak productivity growth hurt corporations and consumers.
- ◆ **1982-87:** Consumer boosted by tax cuts, lower inflation. Corporations hurt by disinflation, strong dollar, foreign competition; Reagan shrinks government.
- ◆ **1987-95:** Corporations restructure aggressively, slowing employment growth, suppressing wage gains, trimming benefits. Government's influence slips further.
- ◆ **1995-01:** Consumers benefit from rising real wages, strong dollar, strong stock market. Consumption share of GDP rises.
- ◆ **2002-??:** Government and/or Industry drive growth.