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Thematic Investing

The American Age of Affluence

Spending, Saving
and Investing the
New Millennium
American's Money



November 7, 1999

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Highlights

- Thanks to a Muted Business Cycle (just one recession in 17 years), Benign Deflation (falling prices in context of solid economic growth) and the Consumer Comeback (rising real wages), *Americans are more affluent than ever.*
- Nevertheless, many experts warn that boomers face a bleak future when they retire, unless they sharply increase their savings rate. We disagree. Savings rate unlikely to surge because boomers don't *want* to save much more, nor do they *need* to. But although savings *rate* won't surge, the *amount* of savings will soar.
- Boomers do not *want* to save much more because:
 - They learned in the 1970s that it was prudent to borrow and spend;
 - Savings rates tend to be low when consumer confidence is high;
 - Saving is stressful, and boomers are already overstressed.
- Boomers do not *need* to save much more because:
 - The savings rate is far higher than conventional measures suggest;
 - The rate of return on boomers' savings has been high;
 - Older Americans *do* have adequate financial resources;
 - Large budget surpluses are a new de facto form of saving;
 - Many boomers will still work part-time after "retiring";
 - Inheritances are an important source of funds.
- As boomers work longer, the "gray wave" to become a big part of labor force.
- *No spending slowdown.* With most of their material needs satisfied, boomers place more value on experiences than tangibles, particularly because *affluence doesn't bring happiness* but *stress rises with affluence*. Six ways to alleviate stress:
 - *All the comforts of home*—Spending heavily on home improvement.
 - *First-class leisure*—Paying up for *better* vacations.
 - *The need for speed*—Going faster, be it online or on the road.
 - *Saving time*—Dropping time hogs for time-efficient activities.
 - *Buying time*—Hiring others to provide personal services.
 - *Quality time*—Americans choose either efficient/no-service (e.g., Internet), or premium/full-service.

Table 1: "American Age of Affluence" Beneficiaries

Page	Company	Symbol	PW Rating	11/3/99 Price	Theme
52	Abercrombie & Fitch	ANF	Not Rated	\$25.69	Quality time in the no-service/full-service economy
49	Amazon.com ¹	AMZN	Not Rated	65.75	Saving time
49	America Online	AOL	Buy	138.94	Saving time
39	American Express ²	AXP	Neutral	147.00	Boomers are investors, not savers
42	American Woodmark	AMWD	Not Rated	21.62	All the comforts of home
43	AMR Corp ²	AMR	Buy	59.88	First-class leisure
39	AXA Financial	AXF	Buy	33.69	Boomers are investors, not savers
39	Bank of New York ²	BK	Buy	39.69	Boomers are investors, not savers
42	Bed Bath & Beyond ¹	BBBY	Buy	35.75	All the comforts of home
47	Berkshire Hathaway	BRKB	Attractive	2153.00	The need for speed
46	Brunswick Corp	BC	Not Rated	24.44	The need for speed
43	Carnival Corp	CCL	Buy	45.31	First-class leisure
47	Cisco Systems ¹	CSCO	Not Rated	71.44	The need for speed
39	Citigroup ²	C	Not Rated	52.88	Boomers are investors, not savers
50	Clear Channel ²	CCU	Buy	80.81	Saving time
50	Costco ¹	COST	Attractive	81.31	Saving time
45	DaimlerChrysler	DCX	Not Rated	74.94	The need for speed
43	Delta Airlines ²	DAL	Buy	51.81	First-class leisure
43	Disney	DIS	Attractive	27.19	First-class leisure
49	Ebay	EBAY	Not Rated	127.06	Saving time
42	Ethan Allen Interiors	ETH	Not Rated	35.69	All the comforts of home
45	Four Seasons	FS	Neutral	40.13	First-class leisure
52	Gap	GPS	Buy	35.50	Quality time in the no-service/full-service economy
32	Gateway Inc ²	GTW	Buy	67.63	The gray wave—Home offices
39	Goldman Sachs ²	GS	Neutral	68.75	Boomers are investors, not savers
50	H&R Block	HRB	Not Rated	40.63	Buying time
45	Harley-Davidson	HDI	Not Rated	57.93	The need for speed
42	Home Depot	HD	Attractive	75.25	All the comforts of home
50	Infinity Broadcasting ²	INF	Buy	33.69	Saving time
32	Int'l Bus. Machines ²	IBM	Buy	94.38	The gray wave—Home offices
42	Lowe's ²	LOW	Buy	55.44	All the comforts of home
47	Lucent Technologies	LU	Buy	65.31	The need for speed
45	LVMH Moët Hennessy ¹	LVMHY	Not Rated	64.25	First-class leisure
45	Marriott Intl	MAR	Neutral	33.25	First-class leisure
42	Masco	MAS	Not Rated	30.81	All the comforts of home
47	MCI WorldCom ¹	WCOW	Buy	83.56	The need for speed
30	Medtronic ²	MDT	Buy	37.69	The gray wave—Living and working longer
39	Merrill Lynch ²	MER	Not Rated	75.81	Boomers are investors, not savers
32	Microsoft ¹	MSFT	Buy	92.00	The gray wave—Home offices
47	Motorola ²	MOT	Buy	103.25	The need for speed
32	Nextel ^{1,2}	NXTL	Buy	89.94	The gray wave—Home offices
49	Peapod ¹	PPOD	Not Rated	10.25	Saving time
46	Polaris Industries	PII	Not Rated	38.06	The need for speed
49	Priceline.com	PCLN	Not Rated	55.38	Saving time
47	Raytheon	RTN	Not Rated	28.00	The need for speed
43	Royal Caribbean	RCL	Not Rated	51.93	First-class leisure
30	Schering-Plough	SGP	Attractive	50.94	The gray wave—Living and working longer
50	ServiceMaster	SVM	Not Rated	12.88	Buying time
49	Sportsline USA ^{1,2}	SPLN	Buy	41.06	Saving time
47	Tandy	TAN	Buy	60.75	The need for speed
47	Textron ²	TXT	Not Rated	74.69	The need for speed
52	Tiffany	TIF	Neutral	59.94	Quality time in the no-service/full-service economy
47	Time Warner ²	TWX	Buy	65.00	The need for speed
50	Wal-Mart	WMT	Attractive	55.75	Saving time
30	Warner-Lambert	WLA	Buy	83.81	The gray wave—Living and working longer
46	West Marine ¹	WMAR	Neutral	8.97	The need for speed
49	Yahoo ¹	YHOO	Neutral	178.00	Saving time

Note: The inclusion of stocks that are Not Rated or rated Neutral by PaineWebber should not be construed as a recommendation for purchase. Rather, their inclusion is simply to illustrate the type of company that could benefit from the trends described in this report. Footnotes are on page 54.

The American Age of Affluence

In a major report published last year, we attempted to “understand consumer behavior and, in particular, the behavior of baby boomers, the largest, fastest-growing and wealthiest segment of the population” (see “The New Millennium American—Changing attitudes drive consumer behavior,” September 7, 1998). This report extends that analysis by examining how Americans’ attitudes about money influence both their consumption and their non-consumption (i.e., savings) behavior.

Boomers’ Retirement Future: A Park Bench?

To many experts, the financial future of baby boomers looks bleak. For example, *The Economist* recently referred to the worrisome predictions about aging and retirement made in a new book, *Agequake*, by Paul Wallace. In that book, Wallace writes, “At present, the age profile of western populations is bulging in the center as the bumper postwar baby-boom generation becomes middle aged. This has helped stock markets levitate in the 1990s and created the incongruous spectacle of fifty-something rock stars. But within 20 years, the boomer bulge will have moved into the older age brackets. The swelling number of retired people will put economies under severe pressure, undermining pension systems and stock markets alike. The long journey from postwar baby boom threatens to terminate in economic bust.”

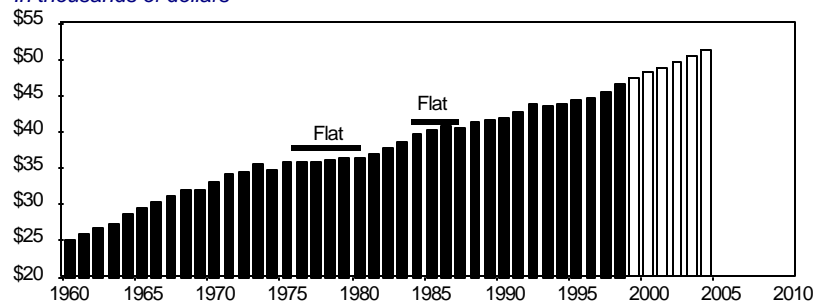
Until recently, the huge U.S. budget deficits, the uncertain financial future of Social Security and Medicare, and the anemic U.S. savings rate all suggested that baby boomers are ill-prepared to retire. Not only did they seem in danger of spending their retirement days on the proverbial “park bench” feeding the pigeons, they might have to spend their nights on the park bench as well!

However, the notion that millions of boomers will have to retire on a “park bench” is not easy to reconcile with the fact that Americans have never been more affluent than in the late 1990s. Consider these indicators:

- After stagnating for much of the 1970s and 1980s, real disposable income per worker has risen steadily to record levels (Chart 1).

Chart 1: Real Disposable Income per Worker

In thousands of dollars

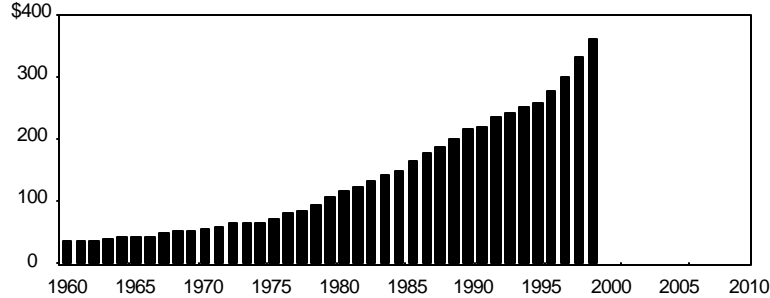


Source: Bureau of Economic Analysis, Bureau of Labor Statistics, DRI.

- In the last few years, household net worth has soared (Chart 2).
- Homeownership and car ownership rates are at record levels (Chart 3).
- Welfare rolls have plunged to near record low levels (Chart 4).

Chart 2: Net Worth per Household

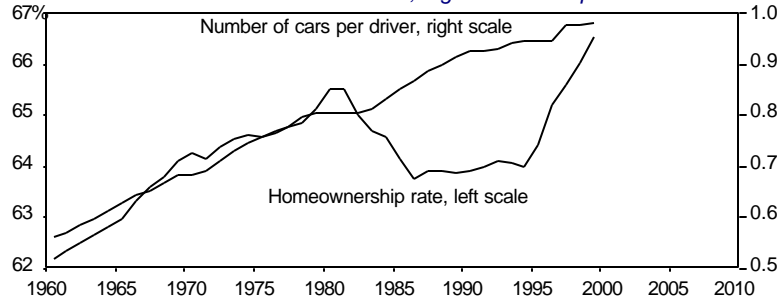
Household assets less household liabilities; in thousands of dollars



Source: Federal Reserve, Census Bureau.

Chart 3: Homeownership and Car Ownership Rates

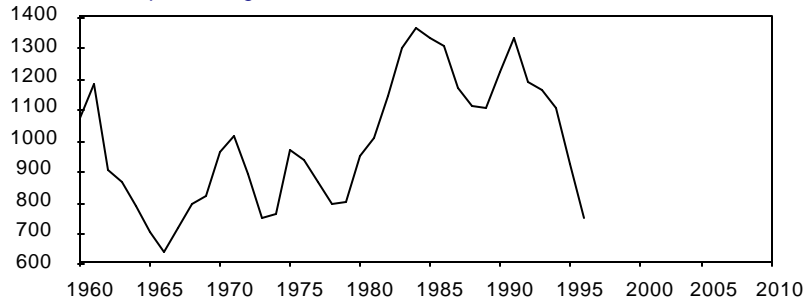
Owner households as a % of total households; registered autos per driver



Source: Census Bureau, PaineWebber.

Chart 4: Welfare Rolls

Number of recipients of "general assistance," in thousands



Source: U.S. Social Security Administration.

Three key economic forces are behind this affluence:

- A muted business cycle—fewer booms, fewer busts and more “soft landings”—thanks to low inflation, a growing service economy, and low inventory levels made possible by networked computers. Since 1982, we have had just one recession—in other words, just *one recession in 17 years*. Between 1950 and 1982, by contrast, there were seven recessions, or *one every 4.6 years* (see “A Muted Business Cycle,” July 21, 1996).
- Benign deflation (falling prices supported by technological innovation, accompanied by economic growth), which is likely to continue (see “Benign Deflation,” February 22, 1998).
- The Consumer Comeback (see “Consumer Comeback,” September 4, 1995). A healthy combination of rising demand for labor (in the context of a muted business cycle) and a slowly growing supply of labor (because most women and boomers have entered the labor force) is raising real wages. This has not boosted inflation because productivity is rising rapidly.

Does affluence bring happiness? Unfortunately, it doesn't. As we noted in “The New Millennium American,” “despite the spreading prosperity of the U.S., many boomers have still not found inner happiness—to the contrary, they are *probably the most stressed generation in history*.” Worse still, as we discuss below, *stress rises with affluence*. Five key characteristics of the New Millennium American are highlighted in Exhibit 1.

Exhibit 1: Key Characteristics of the New Millennium American

<p>■ Cradle-to-grave entrepreneurialism. Reflecting a continuation of the shift from the big bureaucracies of the 1950s-'70s (corporations offering a job for life, unions that fought for job security and better pay, the expansion of government “safety-net” programs) to the entrepreneurial economy of the 1990s, more and more Americans are being forced to behave like entrepreneurs in managing their careers, supervising their children's education and planning their retirement. Many people of “retirement age” are likely to choose the stimulation of work over the monotony of having nothing to do.</p>
<p>■ Time drought. Even though Americans are working shorter hours, they feel stressed and short of time because of “time deepening,” i.e., doing several things at once.</p>
<p>■ Stressless leisure. As boomers get older, they look for leisure activities with less effort, less physical exertion, less risk; fewer “projects.”</p>
<p>■ No-service/full-service economy. Stressed-out, time-starved consumers demand good service. But the shortage of workers is likely to cause a bifurcation of the U.S. service sector into, on one the hand, highly automated services allowing efficient “do-it-yourself” service (e.g., the Internet) and, on the other hand, premium-quality traditional services that are fully staffed with well-trained employees.</p>
<p>■ New drug culture. Boomers are not staying healthy simply by living better but rather by using drugs to “fix things” when—or even before—something goes wrong.</p>

Asking the Experts and Consumers Themselves—Again

So baby boomers—the largest and most influential component of the U.S. population—are getting a mixed message, to say the least. While enjoying a period of unprecedented affluence they are bombarded with warnings that they had better start saving aggressively if they don't want to spend their retirement in poverty. For investors this raises a vital issue: Will boomers start saving aggressively, or continue to spend with abandon?

To answer this question and understand consumers' attitudes about money and affluence, we dug into the economic data and also once again enlisted the help of two leading experts on consumer behavior: The Gallup Organization and Yankelovich Partners. Working with Gallup, in September PaineWebber conducted another proprietary survey of 1,200 Americans. The results of this survey are discussed throughout the report.

And PaineWebber once more utilized the expertise of Yankelovich Partners, who, for nearly 30 years, have been compiling comprehensive polls about consumers' preferences, habits and lifestyles. Key results of Yankelovich's proprietary 1999 report on consumer behavior ("The Yankelovich MONITOR") are also discussed throughout the report.

No Saving Surge

All of this research suggests that boomers will continue to spend heavily. Although the savings rate may well trend up modestly, a saving surge is highly unlikely. This is so for two broad reasons: boomers don't *want* to aggressively raise their savings rate, and they don't *need* to either.

Boomers don't *want* to save more because:

- In the 1970s they learned the lesson that it was financially prudent to borrow and spend.
- Savings rates tend to be low when consumer confidence is high, as it is now.
- Saving is stressful, and boomers are already over-stressed.

And, boomers don't *need* to step up their savings rate because:

- Though lower than it used to be, the savings rate is much higher than conventional measures suggest.
- The rate of return on boomers' saving—a critical variable that tends to be overlooked—has been high.

- An exhaustive study of the financial situation of 7,600 older Americans indicates that, contrary to conventional wisdom, most of them have private pensions and enough financial resources to retire reasonably comfortably.
- One reason for boomers' low savings rate is high taxes that have led to a budget surplus, an important new form of savings for the U.S., much of which—directly or indirectly—will be deployed in ways that help boomers.
- Reversing the trend of the past four decades, boomers will work longer and retire later than their parents, thereby reducing the need to save for retirement.
- Inheritances will be an important source of retirement funds, as boomers inherit estates from parents who prospered in the decades after World War II.

Although boomers' savings *rate* is unlikely to soar, the *amount* of their savings will. Boomers will have substantial assets to invest, thanks to a combination of: rising real incomes and perhaps a slight increase in the savings rate; continued expansion of 401(k) and other, similar personal investment accounts; and inheritances from parents. However, true to form, boomers will also continue to spend aggressively.

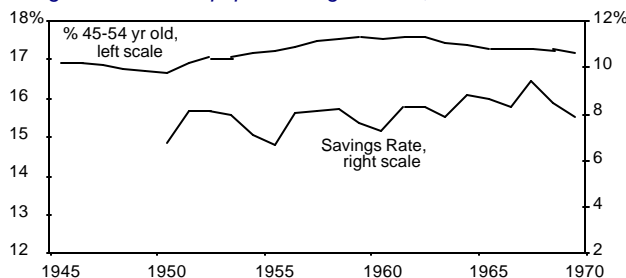
Why Boomers Don't *Want* to Increase Their Savings Rate

1. Borrowing and Spending Is Wise: Remembering the Lesson of the 1970s

Throughout the 1980s, predictions were rife that baby boomers (then in their mid-30s) would begin to save seriously when they reached their affluent, peak earnings years in the 1990s—just as their parents had done when they were in their 40s and 50s (Chart 5). It didn't happen (Chart 6). The boomers rolled right on into their 40s, and remained true to their free-spending ways.

Chart 5: At Age 45-54, Boomers' Parents Were Steady Savers

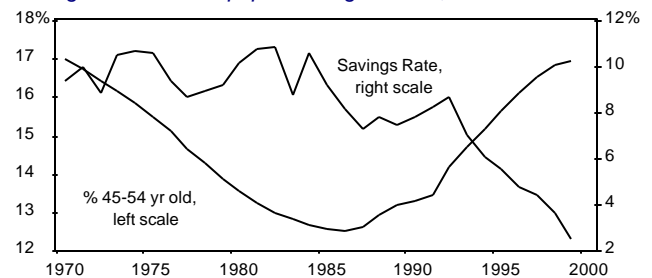
Savings rate and % of population aged 45-54, 1945 - 1969



Source: Census Bureau, BEA.

Chart 6: Boomers 45-54 Today Appear to Be Saving Very Little

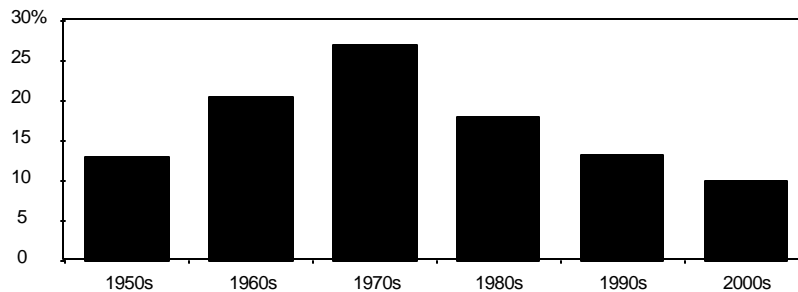
Savings rate and % of population aged 45-54, 1970 - 1999



Source: Census Bureau, BEA.

This behavior seems puzzling, especially because many boomers believed that Social Security was going broke and would not “be there” for them in their old age, as it had been for their parents. But, as we noted in “The New Millennium American,” “driven by ‘shared life experiences,’ boomers’ attitudes about everything from consumption to leisure to health care have changed dramatically as this generation has aged.” Specifically, *whereas their parents were haunted by the hardships and deprivation of the Depression and World War II, boomers’ attitudes about money have not been governed by fear of financial disaster.*

Chart 7: U.S. Employment Growth

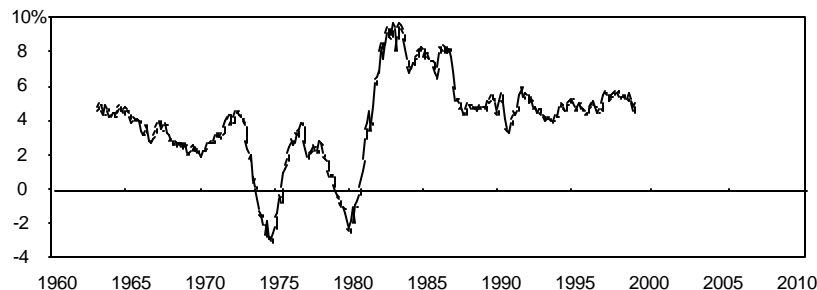


Source: Bureau of Labor Statistics, DRI.

It’s not that boomers have enjoyed unrelieved prosperity. Though raised in the prosperous ’50s and ’60s, they landed their first jobs in the inflationary, recession-ridden ’70s, when real wages declined and the U.S. seemed to be falling behind both the Japanese and OPEC. But, jobs were fairly easy to get during most of the 1970s, a decade in which total U.S. employment grew 27% (Chart 7). And whereas the deflation of the 1930s bankrupted many borrowers, the inflation of the 1970s rewarded borrowers (such as baby boomers buying their first home), who could repay loans in devalued currency thanks to *negative* real interest rates (Chart 8).

Chart 8: Real Mortgage Rate

30-year mortgage rate less annual gain in CPI



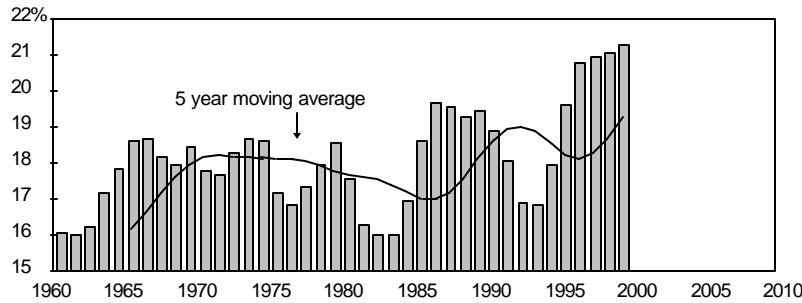
Source: DRI, Bureau of Labor Statistics.

The savvy thing to do in the 1970s was not (as was true in the 1930s) to hoard your cash but, rather, the opposite—to use it for the down payment on a house and then get as big a mortgage as you could afford in order to buy a bigger house than you needed. Frugal boomers who saved their money and invested in financial assets received a paltry return in the 1970s, while housing prices soared.

Boomers did not forget the lessons of the 1970s. As they entered their peak earnings years in the 1980s and 1990s, boomers felt comfortable spending money, including borrowed money (Chart 9), because they were confident they would keep their job or get a new one. This was usually a good bet; the unemployment rate has trended down from a peak of 11% in 1982 to well under 5% today.

Chart 9: Installment Credit

As a percentage of disposable income

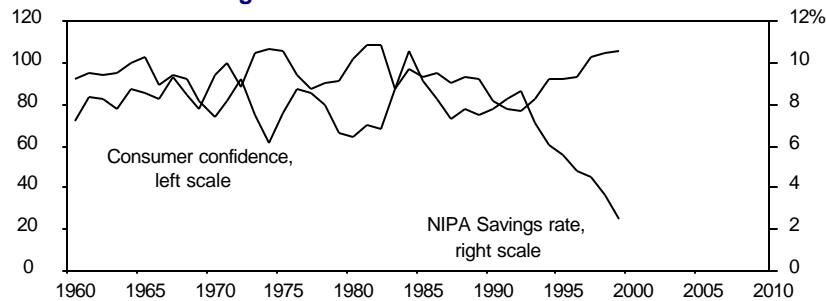


Source: Federal Reserve, Bureau of Economic Analysis.

2. Confidence and the Savings Rate: Inversely related

When the sun is shining, Americans don't save for a rainy day. They prefer to hold off on the saving until it is actually raining. This inverse relationship between consumer confidence and savings rates is shown in Chart 10.

Chart 10: U.S. Savings Rate and Consumer Confidence



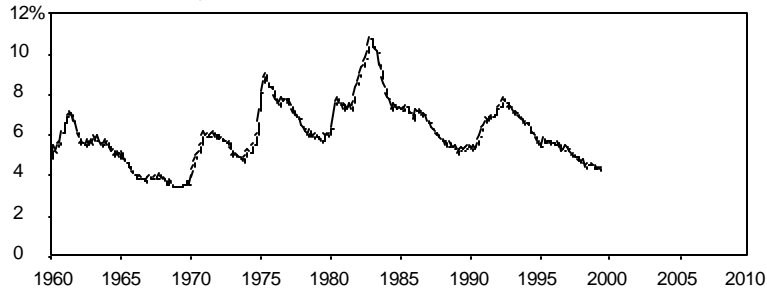
Source: BEA, University of Michigan.

A key reason for today's near-record levels of consumer confidence is that, with the "Consumer Comeback" underway for several years, as well as a muted business cycle and benign deflation, *money has become less of a concern for most consumers.*

Consider:

- With the unemployment rate below 5% (Chart 11), jobs are plentiful. Indeed, many industries are experiencing a labor shortage.
- Real wages have been rising (Chart 12).

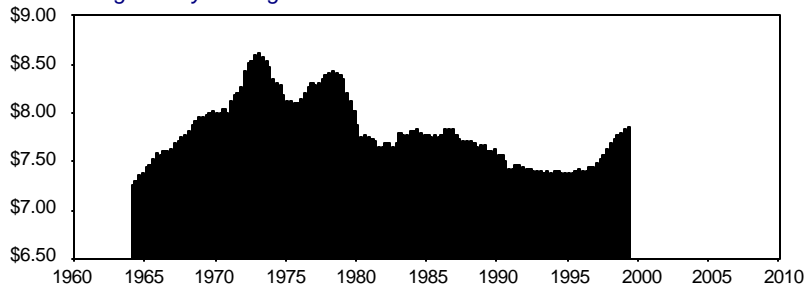
Chart 11: Unemployment Rate



Source: Bureau of Labor Statistics.

Chart 12: Real Wages

Real average hourly earnings

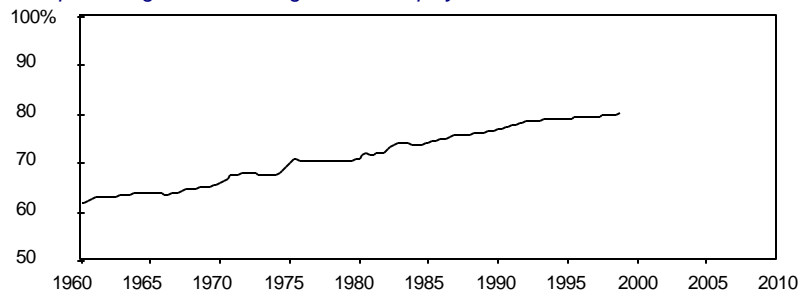


Source: Bureau of Labor Statistics.

- More Americans now work in the fast-growing and less cyclical service sector (Chart 13), and fewer in the relatively cyclical manufacturing sector.

Chart 13: Employment by Service Industries

As a percentage of total nonagricultural employment



Source: Bureau of Labor Statistics, PaineWebber.

- A large percentage of employees are eligible for annual bonuses (Chart 14a). With the economy strong and corporate profits healthy, those bonuses have been accounting for a larger portion of workers' incomes (Chart 14b).

Chart 14a: % Companies Offering Incentive Pay to Non-Execs

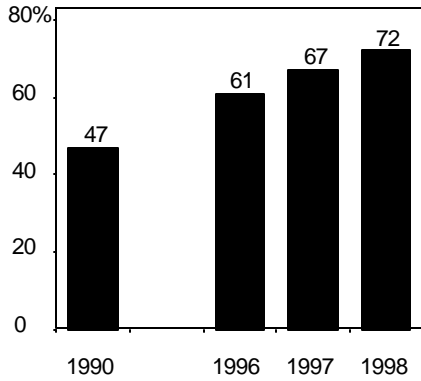
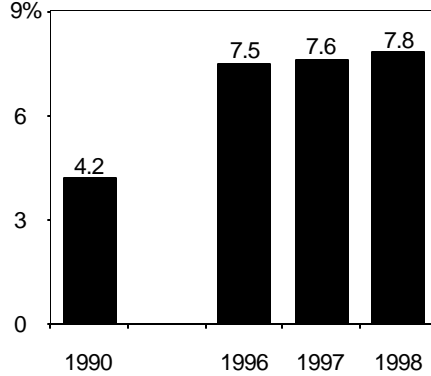


Chart 14b: Avg. Payout Incentive Pay as % of Base Compensation

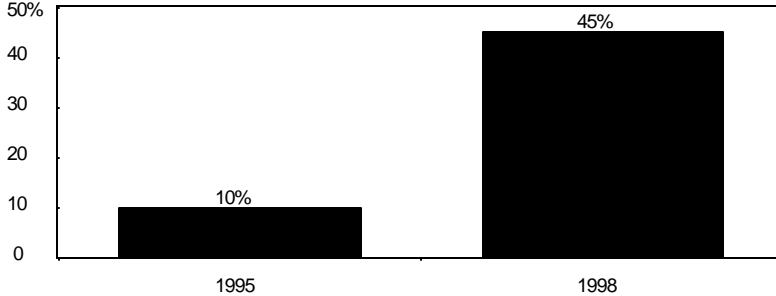


Source: Hewitt Associates.

- Many employees also own stock options (Chart 15).

Chart 15: Large Companies Granting Options to All Workers

Percentage of companies with option plans and 5,000+ employees

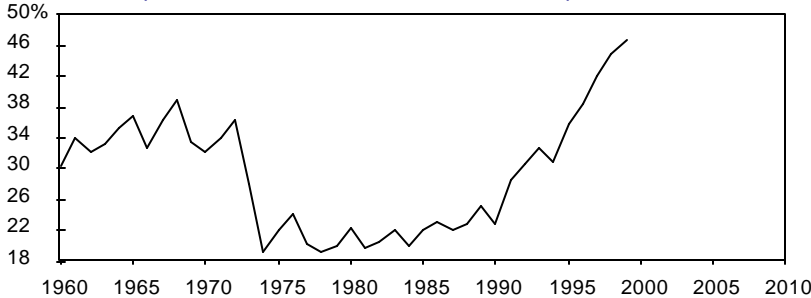


Source: International Association for Financial Planning.

- Those that don't have options have benefited from the bull market via the stocks they own in their 401(k) plans or in their brokerage accounts (Chart 16).

Chart 16: Stocks as a Percentage of Household Financial Assets

Includes bank personal trusts, life insurance, mutual funds, pension funds

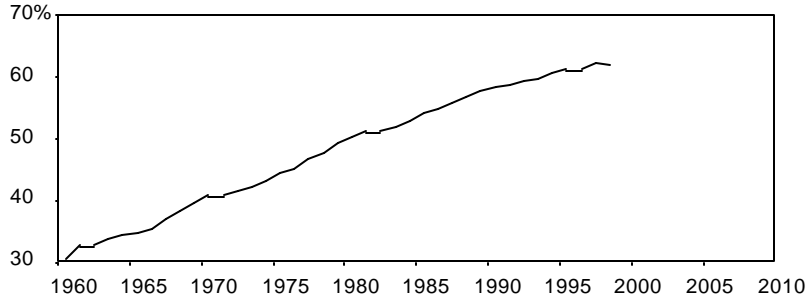


Source: Federal Reserve.

- Finally, many households are receiving two paychecks thanks to the presence of so many working women in the labor force (Chart 17).

Chart 17: Participation Rate of Married Women

Percent of married women in the labor force



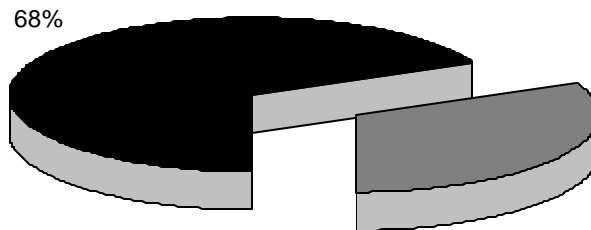
Source: Bureau of Labor Statistics.

Two-thirds of Americans rate economic conditions in the U.S. today as either "excellent" (20%) or "good" (47%), while 24% consider them "only fair" and 8% rate them "poor."
—PaineWebber/Gallup, September 1999.

Surveys reveal widespread consumer optimism amidst this robust economic environment. Yankelovich polls reveal that:

- 68% of Americans say "I am better off now than my parents were at my age" (Chart 18).

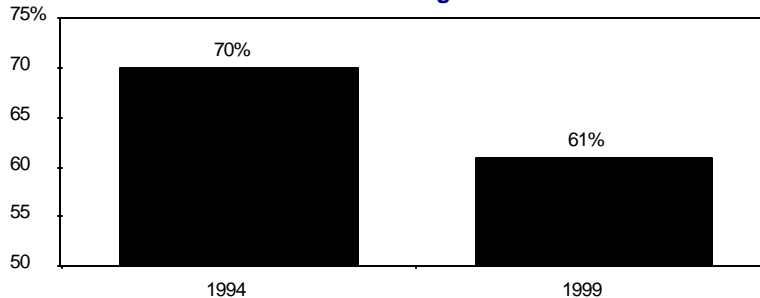
Chart 18: "I am better off now than my parents were at my age"



Source: Yankelovich Partners.

- The percentage of Americans "concerned about being able to make ends meet financially" has fallen to 61%, down from 70% in 1994 (Chart 19).

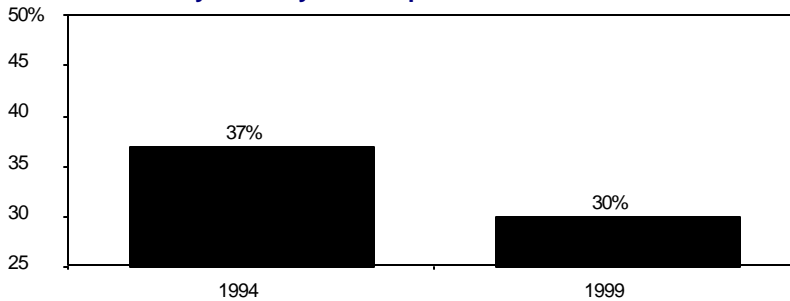
Chart 19: "I am concerned about being able to make ends meet financially"



Source: Yankelovich Partners.

- Coupon usage has been dropping, an indication of fewer concerns about money given a strong sense of job security. The percentage of Americans who “always/usually use coupons” is just 30%, down from 37% in 1994 (Chart 20).

Chart 20: “I always/usually use coupons”



Source: Yankelovich Partners.

Given Americans’ tendency to save more when consumer confidence is low, it is not surprising that boomers’ savings rate is low during the Age of Affluence.

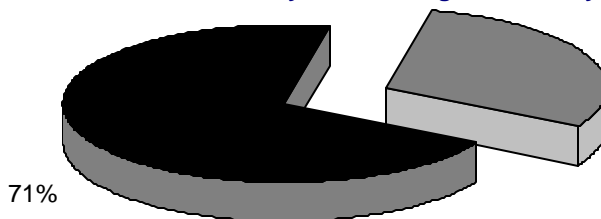
3. Saving Is Stressful

As we noted in “The New Millennium American,” boomers are “probably the most stressed generation in history” because of:

- The normal responsibilities of middle age (i.e., career, caring for both their children and elderly parents, etc.).
- The disappointment of their expectations. Now that most of them are in their 40s—and despite their continued material prosperity—many boomers feel that they haven’t “made a difference.”
- Being overwhelmed by having too many decisions to make and too much information available concerning each choice.

Consequently, boomers are very eager to relieve stress—a Yankelovich poll reveals that 71% of Americans say “I need to find ways of reducing stress in my life” (Chart 21).

Chart 21: “I need to find ways of reducing stress in my life”



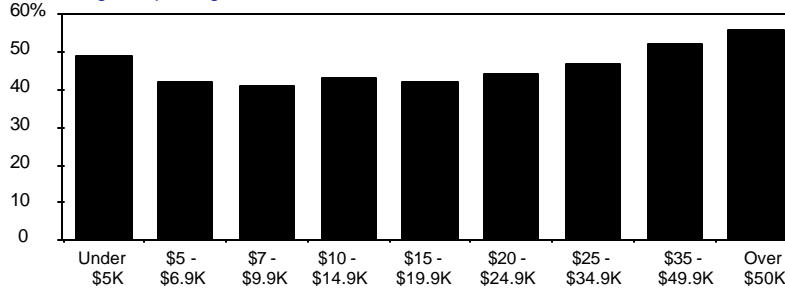
Source: Yankelovich Partners.

Affluence does not relieve stress; on the contrary, it increases stress.

Importantly, affluence does not relieve stress; on the contrary, *it increases stress*. As Chart 22 illustrates, higher-income people generally report more stress than the less affluent. Sociologists speculate that stress is reported by more respondents with a more advantageous and “successful” social status because those respondents have chosen more stressful lifestyles and careers. In addition, more money means more consumption, and more consumption means more stress about purchasing, transporting, insuring, using, storing, cleaning, repairing and discarding goods.

Chart 22: Stress Levels by Annual Income

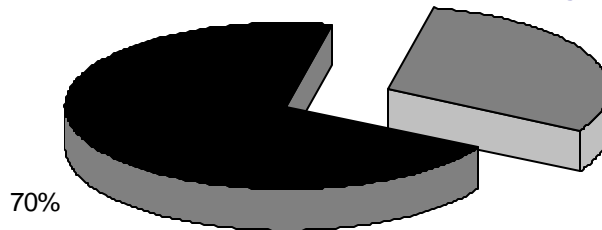
Percentages reporting “a lot” or “moderate” stress



Source: John Robinson and Geoffrey Godbey.

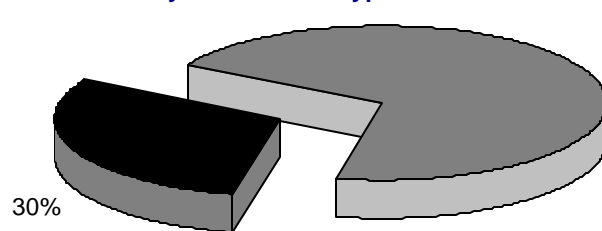
For most people, drawing up a savings plan is also highly stressful. It requires sifting through thousands of stocks, mutual funds, variable annuities and other investment choices. Then a specific amount of money must be set aside at specific intervals, and the portfolio of investments periodically evaluated. If an investment does poorly, should one hold, sell, or buy more? Not surprisingly, 70% of Americans say that investments are “too confusing” (Chart 23) and only 30% say “I always know which types of investments are right for me” (Chart 24).

Chart 23: “I think that investments are too confusing”



Source: Yankelovich Partners.

Chart 24: “I always know which types of investments are right for me”



Source: Yankelovich Partners.

Why Boomers Don't Need a Saving Surge

We have seen that boomers are not particularly interested in saving because:

- They learned the borrow-and-spend lessons of the 1970s.
- Americans tend to save less when the economy is strong and consumer confidence is high.
- Saving is stressful for most Americans.

While most boomers do not really *want* to save very much, the *need* to save is much less pressing than is commonly assumed.

1. The Savings Rate: Low, But Not as Low as They Say

It is very likely true that the *trend* of the savings rate has been declining because baby boomers are less thrifty than their parents. However, for various methodological reasons discussed below, the actual *level* of the U.S. savings rate is several percentage points *higher* than the government statistics indicate. And the savings rate of baby boomers is *higher still*.

(Note: The following discussion reflects the recent comprehensive revision of the National Income and Product Accounts [NIPA]. As a result of this revision, the NIPA personal savings rate is higher than was shown in the government's previously published estimates, though it continues to show a two-decade long downtrend. From 1982 to 1998, the NIPA savings rate declines from 10.9% to 3.7%, compared with the previous decline from 9.0% to 0.5%. From 1960 to 1982, the NIPA savings rate rises from 7.2% to 10.9%, compared with the previous increase from 6.6% to 9.0%.)

The NIPA Savings Rate

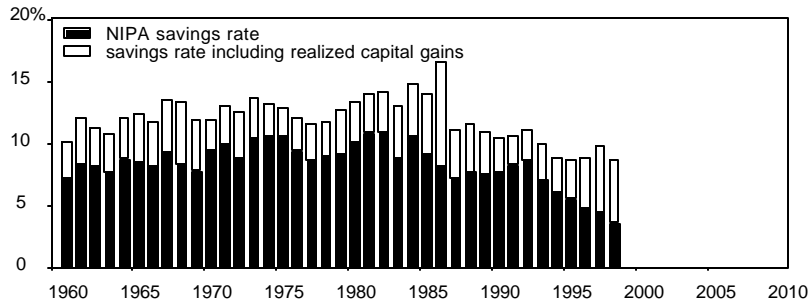
The most widely watched measure of savings, the NIPA savings rate, is a "residual." It is the amount consumers have left over from after-tax income ("disposable personal income") after spending on goods and services ("personal outlays"). Obviously, a correct measure of savings depends on an accurate measure of disposable personal income and personal outlays, and because both income and spending are much larger than saving, if either figure is wrong by a fairly small amount, then savings will be way off. For example, if income is 100 and spending is 95, the savings rate would be 5%; however, if spending was "really" 97 the savings rate would be only 3%—fully 40% lower!

It is very likely that, in fact, official government estimates of after-tax income are *understated*, while estimates of personal outlays are *overstated*. If we correct these errors, the NIPA savings rate is much higher, and more consistent with a different measure of savings, namely, the Federal Reserve's measure of the net acquisition of assets.

It's estimated that inclusion of realized capital gains in personal savings raises the savings rate by around five percentage points.

- A methodological problem on the *consumption* side is that the NIPA assumes that big-ticket items, such as autos, are paid for in full. In fact, most people buy cars on credit. Second, regardless of how the good is paid for, the services of durables are consumed over the course of several years. For housing, by contrast, the NIPA estimates the value of the services homeowners get from their homes and counts that as consumption. But this estimate likely overstates consumption too.
- As for *disposable income*, a key distortion has to do with capital gains, which have become a more important income source as stock prices have soared. Here's the problem: When investors realize a capital gain, they pay a tax on that income. The NIPA methodology debits investors for the tax, but *does not credit them for the associated income*. So, disposable income is reduced and personal outlays increased (as some of the capital gain is consumed), thereby understating true savings. It's estimated that inclusion of realized capital gains in personal savings raises the savings rate by around five percentage points (Chart 25).

Chart 25: NIPA Savings Rate Including Realized Capital Gains



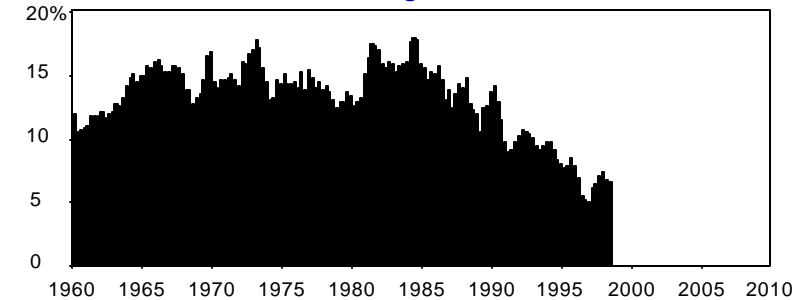
Source: Bureau of Economic Analysis, IRS, PaineWebber.

The Flow of Funds Savings Rate

The Flow of Funds savings rate (calculated by the Federal Reserve) is 7%, far above the reported NIPA savings rate.

In its Flow of Funds accounts, the Federal Reserve estimates the savings rate directly (not indirectly, by calculating a residual). The Fed estimates households' asset accumulation and takes that as a percentage of disposable personal income (Chart 26). Asset accumulation is defined as net acquisition of financial assets plus net investment in tangible assets minus the net increase in household liabilities. While this measure has fallen in recent years, it is still 7%, far above the NIPA savings rate.

Chart 26: The Flow of Funds Savings Rate



Source: Federal Reserve.

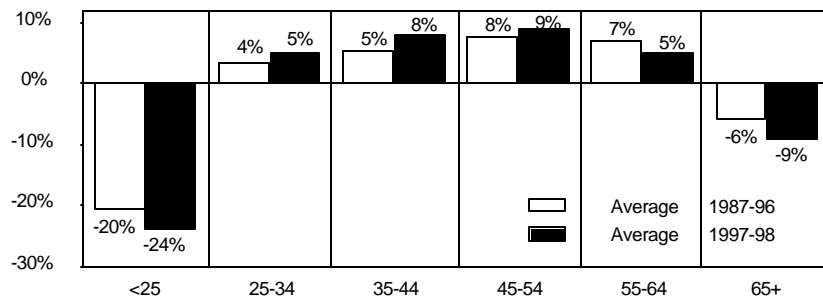
The Consumer Expenditure Survey Savings Rate

The Bureau of Labor Statistics' annual Consumer Expenditure Survey (CES) collects information from the nation's households and families on their buying habits (expenditures), income and characteristics (e.g., age, education). Given these data, we can compute a savings rate for all consumers, and for specific age groups, if we define the savings rate as:

$$\frac{\text{Income after taxes less Average annual expenditures}}{\text{Income after taxes}}$$

For methodological reasons, the aggregate CES savings rate has been modestly below the NIPA savings rate. While the CES states that it has confidence in the consumption data, it acknowledges a problem with "the underreporting of income by respondents, a problem common to most household surveys." This problem, according to the CES, applies primarily to lower income groups. Ergo, the CES data too understate the savings rate. But the usefulness of the CES data is that it allows us to compute a savings rate for specific age groups.

Chart 27: Consumer Expenditure Survey Savings Rate—by Age Group



Source: Bureau of Labor Statistics, PaineWebber estimates.

In this regard, two important trends are revealed by Chart 27:

- The baby boomers (i.e., in the 35-54 age group) are currently saving close to 10% of their after-tax income, even based upon the likely "understated" CES data.
- In contrast to the very young and the very old that have been dissaving at an accelerating rate, the savings rate of baby boomers has been rising. As Chart 27 indicates, the CES savings rate of 35- to 44-year-olds was 8% in 1997-98, up from 5% per annum, on average, between 1987 and 1996, and the savings rate of 45- to 54-year-olds was 9% in 1997-98, up from 8% per annum, on average, between 1987 and 1996. As we discuss below, the increased savings rate of baby boomers lately is likely due to the fact that the disposable income of boomers, now in their peak earnings years, exceeds their still-robust consumption. But it likely does not reflect any change in boomers' attitudes about money or saving.

According to the Consumer Expenditure Survey, baby boomers are currently saving close to 10% of their after tax income.

The “True” Savings Rate: Well Above the Headline Rate

To summarize:

- Adjusting the NIPA savings rate for capital gains suggests an aggregate savings rate of close to 9%.
- The Flow of Funds savings rate is around 7%.

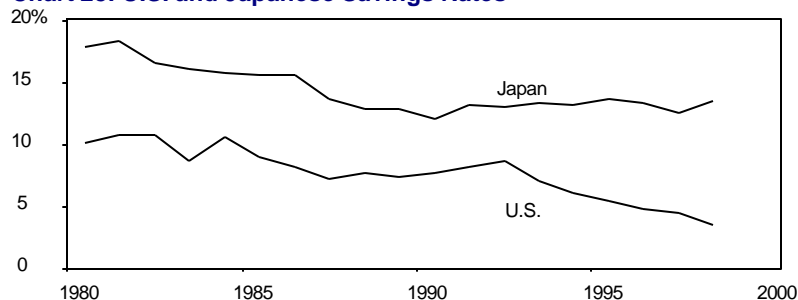
Both measures have declined in recent years but nevertheless the savings rate is much higher than the “headline figure” would suggest. Moreover, the CES data suggest that baby boomers’ savings rate is fairly high.

2. The *Return* on U.S. Savings Has Been High

A second reason why boomers are in better financial shape than is commonly assumed is that although the annual *rate* of saving has been low (relative to both history and to other countries) the *return* on those investments has been high. Curiously, commentators have tended to ignore this fact, focusing on the amount saved rather than the amounts earned on that saving. But, clearly, it is illogical to believe that a person who saves 10% of their \$100,000 income and puts it in the bank is more commendable than a person who saves “only” 5% of their \$100,000 income, but realizes a \$5000 profit on that investment in the stock market.

This point is well illustrated by the recent experience of Japan. According to the OECD, in 1998 the Japanese household savings rate was 13.6% versus just 3.7% in the U.S. Indeed, for the last two decades the Japanese savings rate has been much higher than the American (Chart 28). Methodological issues explain only a small portion of the differences between these two savings rates. Yet, despite Japan’s elevated saving rate, the *stock* of Japanese savings stagnated during the 1990s (Chart 29).

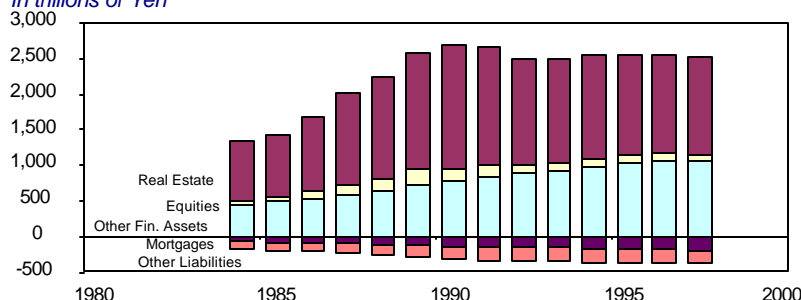
Chart 28: U.S. and Japanese Savings Rates



Source: OECD, BEA.

Chart 29: Composition of Japanese Wealth

In trillions of Yen



Source: OECD.

Three factors explain the apparent contradiction of high Japanese savings *rates* but a stagnant Japanese savings *stock*:

- Japanese savers prefer conservative investments such as bank deposits, postal savings accounts and life insurance policies (“Other Financial Assets” in Chart 29). A recent survey of Japanese financial assets by the Management and Coordination Agency revealed that, in 1998, life insurance products and time savings at post offices accounted for fully half of financial assets.
- The bear market in Japanese stocks; between 1989 and 1998 the Nikkei fell by more than 50%. In 1998, securities comprised only 8.1% of personal financial assets, the lowest figure since the Management and Coordination Agency started compiling data in 1959, and down from a peak of 23.2% in 1989.
- Japanese real estate deflation. The Japanese tax agency, which annually surveys land prices at 440,000 locations, estimates that in 1998 the price of the average residential plot of undeveloped land was less than half as much as in 1992.

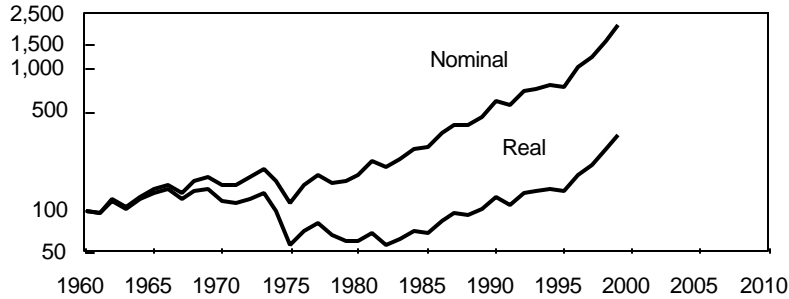
Whereas the high Japanese savings rate has been largely nullified by poor investment returns, the opposite is true in the U.S. Even though the U.S. savings rate has been lower than Japan’s, these assets have been invested fairly aggressively and quite successfully:

- During the 1990s Americans have undertaken a “big shift” out of CDs and money market funds and into the capital markets (see “The Big Shift—Barely Begun,” February 8, 1998). Americans’ ownership of equities, at 46% of household financial assets, is at a record high (Chart 16).

- While Americans have been shifting significant portions of their assets into stocks, the fundamentals for equity investing have been excellent. Stocks have appreciated much faster than inflation, with the *real* S&P 500 rising at a 25% average annual rate since 1995 (Chart 30).

Chart 30: Real and Nominal S&P 500

Index, 1960 = 100

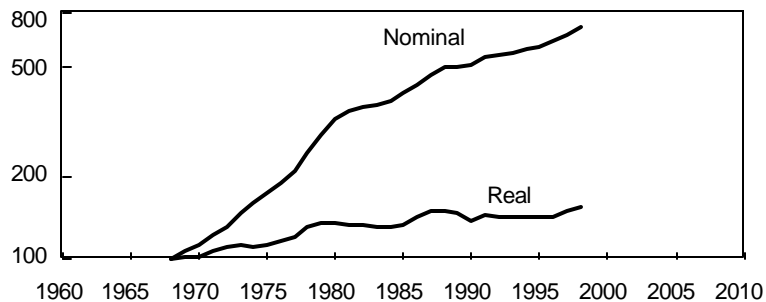


Source: S&P, PaineWebber.

- Real estate values have been rising too (Chart 31), so that, according to the Federal Reserve's Balance Sheet of the United States, two-thirds of the total assets of U.S. households are either real estate or stocks—specifically, 23% real estate and 46% stocks.

Chart 31: Real and Nominal Home Prices

Average sales price of existing homes, Index, 1968 = 100

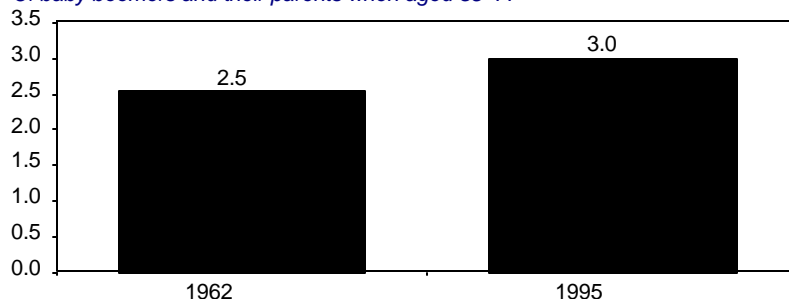


Source: National Association of Realtors, Bureau of Labor Statistics.

Thanks to aggressive investing and an excellent investment environment, *boomers have accumulated more wealth than their parents did at the same age*, even though their savings rate is lower! Chart 32 shows that the ratio of average wealth to average income for households aged 35 to 44 in 1995 (i.e., boomers) was 3.0. But for household heads of that age in 1962 (i.e., boomers' parents), the ratio of average wealth to average income was 2.5.

Chart 32: Ratio of Average Wealth to Average Income

Of baby boomers and their parents when aged 35-44



Source: Survey of Consumer Finances.

Thanks to aggressive investing and an excellent investment environment, boomers have accumulated more wealth than their parents did at the same age, even though their savings rate is lower!

3. Most Older Americans Are in Decent Financial Shape

Because the “true” savings rate is higher than the headline rate, and returns on saving have been good, it is not surprising that most Americans do not need to boost their savings rate dramatically in order to retire comfortably.

This is a central conclusion of the Health and Retirement Study (HRS), a massive ongoing study of over 7,600 older Americans aged 51 to 61 in 1992. This group is, on average, nine years older than the oldest baby boomers—think of them as boomers’ older siblings.

The HRS database, which has been the basis of dozens of specialized studies on various topics, is highly reliable because the research was so intensive. Not only are individuals interviewed in detail and then re-interviewed every two years, but personal financial data concerning their Social Security and Private Pensions Plans are systematically analyzed by researchers.

Here is a key finding of the HRS study: Including personal financial assets, real estate, private pensions, and Social Security, the average wealth at time of retirement is \$594,449 (Table 2). This figure is admittedly skewed by the wealth of the richest people in the sample. However, the wealth of the *median* 10% of households (i.e., from the 45th to 55th percentile) is a very respectable \$404,556. Considering that retirees do not need to pay for childcare, commutation, work clothes, meals at work, etc., this is an adequate retirement saving.

Remember, too, that, as discussed in detail below, many retirees will continue to work part-time for a while after they retire. As economists Alan L. Gustman and Thomas L. Steinmeier put it, “Although an important segment of the population will experience a serious decline in the living standard, as long as government delivers on promised social security benefits, most in this cohort are well on their way to financing an adequate retirement experience.”

A key reason why most American households are financially prepared for retirement is that they do, in fact, have private pensions. It is often said that half of Americans do not have pensions, but this is deceptive because it includes young workers who have not settled into a career, refers to individuals rather than households, and fails to account for people who cashed out of a pension. Economists Alan L. Gustman and Thomas L. Steinmeier, conclude that, “Three fourths of households [in the HRS sample] have ever been covered by a pension and two thirds are receiving or are entitled to benefits from a pension.” On average, pension wealth accounts for 23% of the wealth of people in the HRS sample around the time of retirement; for the median decile, it accounts for 18%.

Although private pensions are more widely available than is commonly believed, it is also true that poorer retirees typically lack private pension plans, making them highly dependent on Social Security. It accounts for virtually the total wealth of the lowest decile of wealthholders around the time of retirement, 73% of the 10th to 25th percentile, and 51% of the 25th to 50th percentile.

But although future Social Security benefits are counted as “wealth” in the HRS, they are really an unfunded promise by government to pay benefits in the future—a promise that may or may not be met. Social Security is *not* wealth that is actually owned and controlled by the beneficiary and can be passed on to the next generation. Which suggests an important point: Wealth inequality in the U.S. would be sharply reduced if Social Security were privatized, because millions of currently impecunious Americans would be turned into true wealthholders.

Table 2: Components of Wealth Around Time of Retirement

1999 dollars; based on HRS study of 7,600 older households

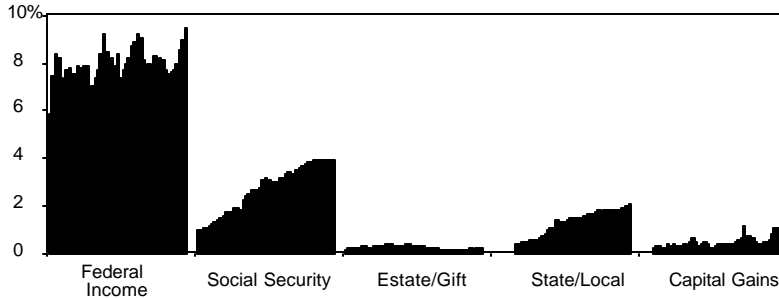
	---- Mean for sample ----		-- Median 10% of households--	
	Dollar Value	Percent of total	Dollar value	Percent of total
Personal Financial Assets	\$194,210	32%	\$70,658	17%
Business Ownership	94,018	16	17,280	4
Financial – Stocks, Bonds, etc.	50,182	8	22,952	6
Retirement – IRAs, Keoghs	23,356	4	13,037	3
Other	26,654	4	17,389	4
Net home value	93,869	16%	80,639	20%
Retirement Assets	306,371	52%	253,260	63%
Social security	159,169	27	172,434	43
Pension Plans	138,151	23	71,572	18
Retiree health insurance	9,050	2	9,254	2
Total wealth	\$594,449	100%	\$404,556	100%

Source: Olivia S. Mitchell and James F. Moore, “Retirement Wealth Accumulation and Decumulation: New Developments and Outstanding Opportunities,” The Wharton School, 1997.

4. The Budget Surplus—A New Form of Savings

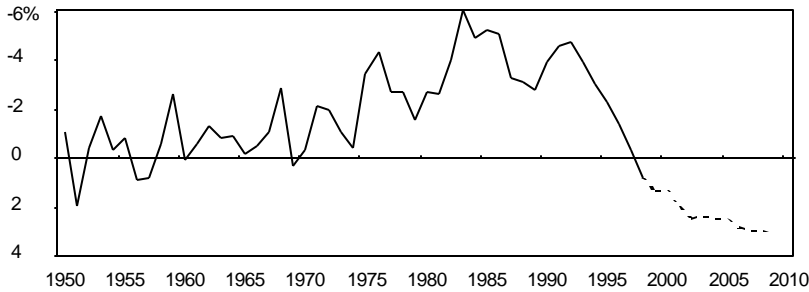
One reason Americans are saving less is that they are being taxed more heavily, with most forms of personal taxation claiming near-record shares of GDP (Chart 33). Despite this tax burden, the U.S. economy has thrived, resulting in a budget surplus (Chart 34).

Chart 33: Selected Personal Taxes as Share of GDP, 1950-1998



Source: Bureau of Economic Analysis, PaineWebber estimates.

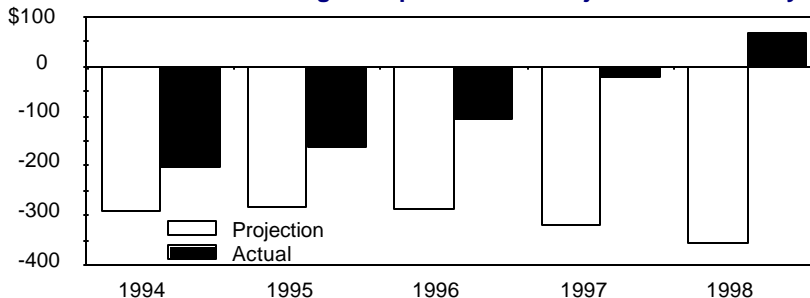
Chart 34: Federal Budget Deficit/Surplus as a % of GDP



Source: Congressional Budget Office.

No one is more surprised by this than the Federal bureaucrats in charge of forecasting budgetary trends. Chart 35 shows how, in 1993, the Congressional Budget Office was forecasting the Federal deficit over the next five years, and contrasts it with what actually happened. Instead of the expected \$350 billion deficit for fiscal year 1998, we got a \$69 billion surplus, thanks to spending restraint, a surprisingly strong economy and declining interest rates. This is a useful reminder that the long-term budgetary forecasts that are bandied about are more fiction than fact. But they are no less important for that; these forecasts shape the debate about fiscal policy.

Chart 35: 1993 Federal Budget Surplus/Deficit: Projections vs. Reality



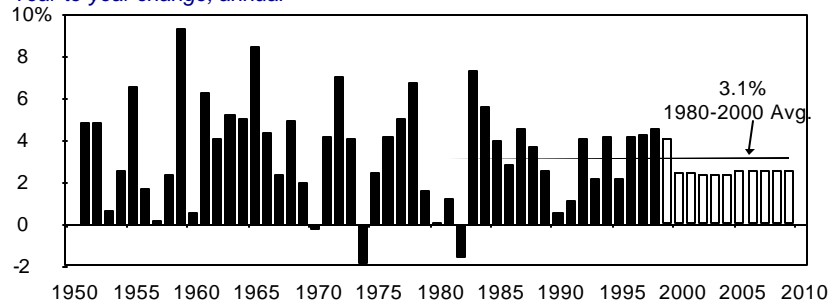
Source: Congressional Budget Office.

That debate currently rests on the assumption that, based on current spending and tax policy, the Federal surplus will total \$3 trillion over the next decade. On the one hand, this \$3 trillion figure is too optimistic—i.e., too high—in the sense that it assumes Congressional spending discipline that is highly unlikely to transpire.

On the other hand, it may well prove to be *too pessimistic* in the sense that it assumes real GDP growth, from 2001 through 2009, of only 2.4%, on average, annually (Chart 36). Lately the U.S. economy has been performing like a great growth stock that repeatedly beats earnings estimates. Average real GDP growth, from 1994 through 1998, was 3.9% *despite* a “soft landing” in 1996 and the Asian financial crisis in 1998. And 1999 is also coming in stronger than expected, with inflation still subdued.

Chart 36: Real GDP Growth

Year-to-year change, annual

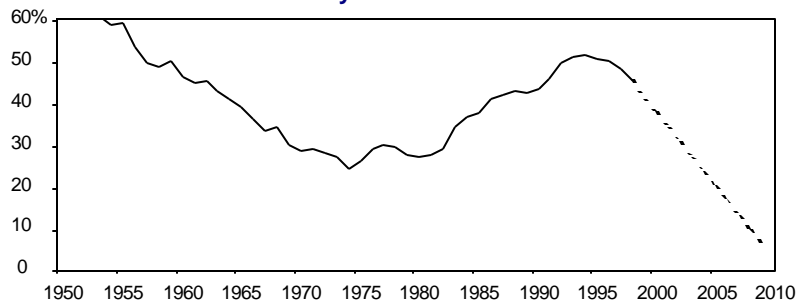


Source: Congressional Budget Office, Bureau of Economic Analysis.

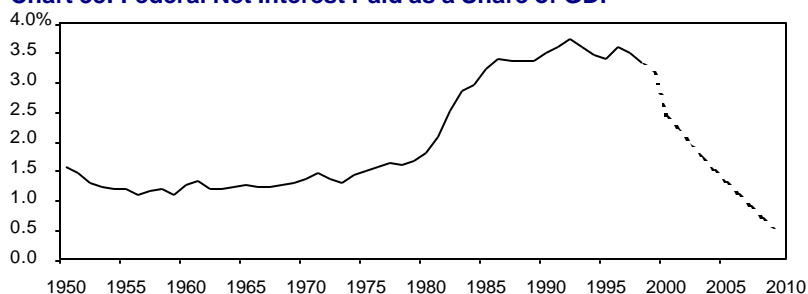
If real GDP growth slowed to 3% in 2000 and 2001 but then rebounded to an average growth rate of 3.25% for 2002-2009, the surplus would likely be closer to \$4 trillion than \$3 trillion, even if discretionary spending levels are 5% higher than the current budget caps.

Whatever its size, a key question for investors is how the surplus will be deployed. Right now, Democrats and Republicans are agreed that the portion of the surplus generated by Social Security taxes—that is, \$2 trillion of the forecasted \$3 trillion surplus over the coming decade—should be put in a “lock box” and saved for Social Security. What that means, in practice, is that it will be used to pay down the Federal debt.

With the U.S. economy continuing to grow while the debt shrinks, Federal debt as a share of GDP will decline dramatically from a 1994 high of 52% to around 6% in 2009, and interest on the debt as a share of GDP will drop from 3.8% to 0.5% (Charts 37, 38).

Chart 37: Federal Debt Held by Public as Share of GDP

Source: Office of Management and Budget, Congressional Budget Office, Bureau of Economic Analysis.

Chart 38: Federal Net Interest Paid as a Share of GDP

Source: Congressional Budget Office, Bureau of Economic Analysis.

This carries three key implications for the American Age of Affluence:

- **Higher living standards:** ten years from now, fully 3% of GDP that now goes to paying interest each year could go to consumers via a reduction in taxes.
- **Lower interest rates**—although the dramatic *secular* decline in rates since 1981 is largely completed, the shrinkage of government debt significantly increases the odds that bond yields will dip back down toward 5%, as PaineWebber has expected (see “Five at the Turn,” March 21, 1993).
- **Increased consumer confidence**, which may inhibit saving. Assured by politicians and the media that the bulk of the surplus is being “saved for Social Security,” consumers will face less pressure to save for retirement and will boost consumption accordingly.

A \$1 trillion bone of contention

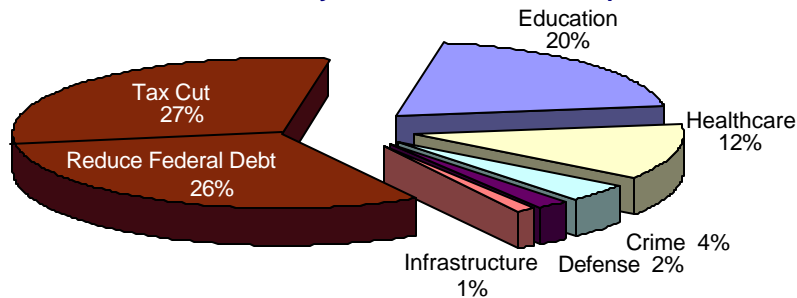
Fully 41% of Americans want to use the Federal budget surplus to increase government spending; only 27% want to use the surplus to cut taxes, while 26% would pay down federal debt.

—PaineWebber/Gallup, September 1999.

Although politicians agree that two-thirds of the \$3 trillion surplus should be saved for Social Security, that still leaves a tasty \$1 trillion bone for Republicans and Democrats to fight over. (It could end up being much *more* than \$1 trillion, because the surplus may be larger than expected and less than \$2 trillion may be “saved” for Social Security.) Without doubt, part of it will be spent—indeed, is already being spent—on Federal expenditures that exceed the relatively stringent “budget caps” imposed by the Balanced Budget Act of 1997.

This is the most popular way to use the surplus; the PaineWebber/Gallup poll showed that only 27% favored spending the surplus on a tax cut, 26% wanted to reduce federal debt, but 41% favored more government spending (Chart 39).

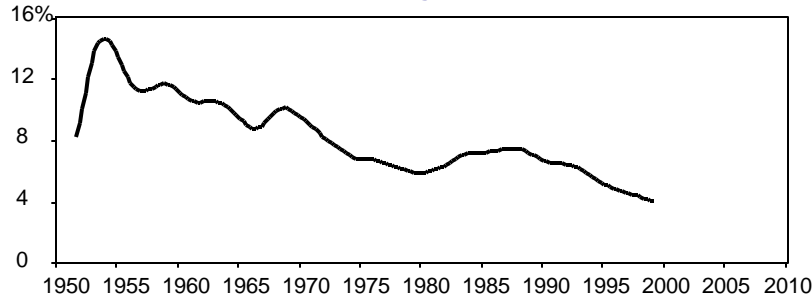
Chart 39: Most Favored Ways to Use the Federal Surplus*



*8% favored other spending or had no opinion. Source: PaineWebber/Gallup, September 1999.

Major areas where it will be spent:

- **Education**, which is at the top of Washington’s list of worthy causes; the PaineWebber/Gallup poll revealed that education was the favorite place (20%) to direct extra spending.
- **Healthcare**—particularly bailing out the financially troubled Medicare system, which is popular not only with current retirees, but also with baby boomers who are caring for aging, ailing parents. Medicare is the second most popular place (12%) to direct extra spending, according to the PaineWebber/Gallup poll.
- **Crime prevention**—the third most popular place (4%) for increased spending.
- **Defense**. With the Pentagon bearing the brunt of spending restraint over the past decade, defense spending as a share of GDP has declined from 7% in 1982 to just 4% (Chart 40). However, Presidents Bush and Clinton showed no such restraint in deploying military personnel to back up foreign policy initiatives. Today 87,000 troops are stationed in far-flung posts around the world, reducing American ability to respond to a crisis. While the PaineWebber/Gallup poll revealed that only 2% of Americans say that extra government spending should be directed toward defense, military spending will likely increase, especially with China rapidly becoming a formidable global competitor—as shown by its increasingly aggressive stance on Taiwan.

Chart 40: National Defense Spending as a % of GDP

Sources: Bureau of Economic Analysis.

■ **Infrastructure.** While the PaineWebber/Gallup poll revealed that only 1% of Americans say that extra government spending should be directed toward infrastructure, more spending on roads, airports, mass transportation, and environmental cleanup is likely. The nice thing about roads is that every congressional district has them. A \$9 billion road building program is already helping heavy equipment firms.

Tax cuts

Although extra spending will claim part of the surplus, we will also see a sizeable tax cut—particularly if the Republicans win the 2000 election. Owing to “bracket creep” and the tax hikes engineered by Presidents Bush and Clinton, most major taxes are high by historical standards (Chart 33). Nevertheless, voters have not clamored for tax cuts, as they did when their personal budgets were being squeezed by inflation and recession.

But Republicans will push for “across the board tax cuts” in order to retain the loyalty of the party’s conservative “base” at a time when there is little else to distinguish the “compassionate” GOP from moderate Democrats. The House of Representatives has already passed a \$792 billion tax cut that has something for everyone—lower income tax rates, lower capital gains tax rates, expanded IRAs, abolishment of the inheritance tax, and a passel of corporate tax breaks. These cuts are phased in over a ten-year period, which reduces their cost in the near term and blunts the objection that they will over-stimulate an economy that is now at full employment. Nevertheless, President Clinton vetoed the tax cut, denouncing it as “bloated” and a threat to American prosperity.

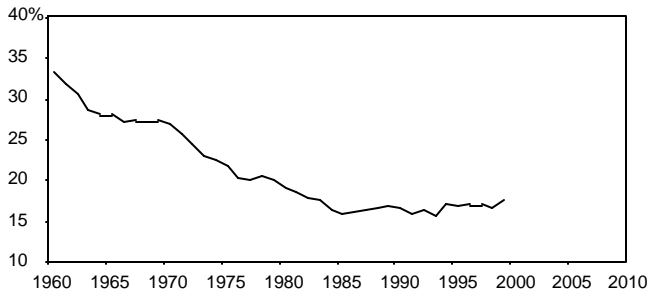
Although the specifics of this proposal likely bear only a passing resemblance to any tax bill that eventually becomes law, one important trend is evident. Politicians are eager to encourage saving, particularly by the less affluent. The magical combination of the bull market and 401(k) plans has reminded politicians of the social benefits of frugality. The capital gains rate was cut in 1997; President Clinton has proposed “USA accounts” that would subsidize saving by low-income Americans; and Republicans favor many pro-saving initiatives, particularly expanded IRAs and lower capital gains and inheritance taxes.

Moreover, the budget surplus also makes it easier, financially and politically, to partially privatize Social Security, because the funds are available to finance the extra “transition costs” created when workers pay some of their Social Security contribution into their own private investment account, rather than into the system to pay today’s beneficiaries.

5. The “Gray Wave” and the Retirement U-Turn: Working Longer and Spending Longer

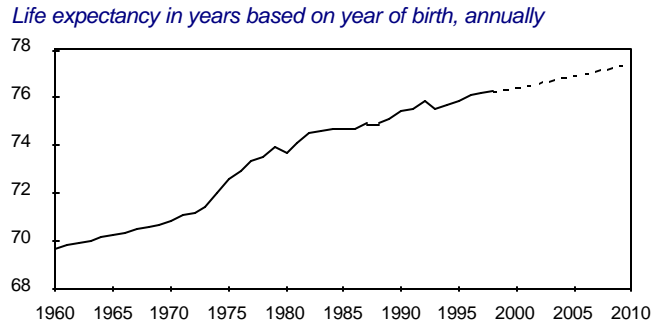
When it comes to retirement, baby boomers are likely to lead the United States in a giant “U turn.” Since 1950 the average retirement age of American workers has declined dramatically (Chart 41), *even though life expectancy has increased by eight years* (Chart 42) and—judging from a plunge in the workplace accident rates—jobs have become less physically demanding and dangerous (Chart 43). Of course, a key reason why Americans are now living longer is the “new drug culture,” which is also driving strong sales gains of health-related companies such as Medtronic, Schering-Plough and Warner-Lambert.

Chart 41: Percent of Men Aged 65+ in the Labor Force
Annually



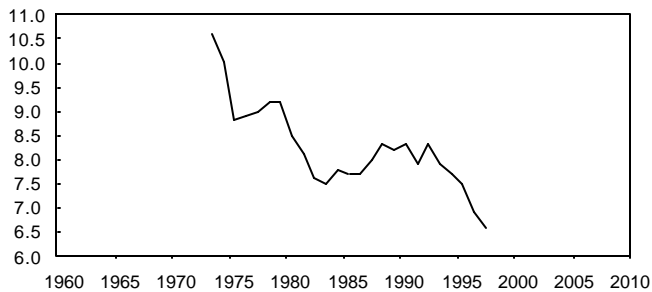
Source: Department of Labor.

Chart 42: U.S. Life Expectancy



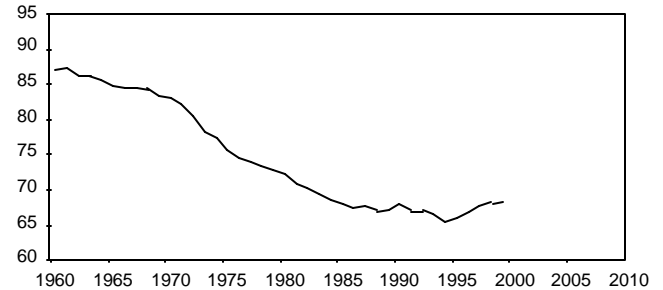
Source: National Center for Health Statistics.

Chart 43: Occupational Injuries
Per 100 full-time workers, annually



Source: Department of Labor.

Chart 44: Labor Force Participation Rate of Men Aged 55–64
Annually



Source: Department of Labor.

Whereas nearly half of American men over the age of 65 were in the labor force in 1950, only 18% are today (Chart 41). For somewhat younger workers, the same trend is evident; among men aged 55-64, the labor force participation rate has declined from 86.8% to 68.3% (Chart 44). Three factors seem to explain the decline in the retirement age:

- Americans became much more affluent and so could afford to retire earlier.
- Since 1961 Social Security has facilitated early retirement by instituting an “early retirement age” of 62, when individuals could retire at lower monthly benefits than they would have received if they had waited until the “normal retirement age” of 65.
- More recently, corporations that are restructuring have been reducing their labor force by, in effect, luring older workers into early retirement by offering them better pensions. The impact of restructuring on the retirement age is evident in labor force participation rates of men aged 55-64, which declined quite sharply in the first half of the 1990s when corporate restructuring was particularly intense (Chart 44).

An “Event” Becomes a “Process”

The trend toward early retirement already shows some signs of turning around. The participation rate of men aged 65+ has stabilized since the early 1980s; the rate for male workers aged 55 and older has actually climbed slightly (Chart 44).

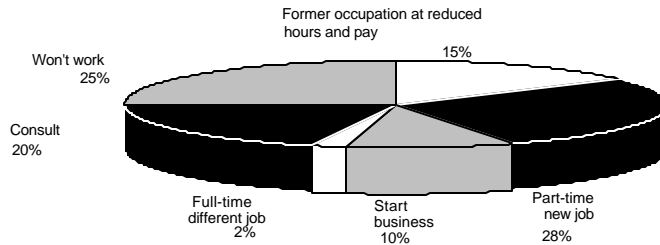
As baby boomers consider retiring over the next 30 years, participation rates are likely to turn up significantly. As one expert, Joseph F. Quinn of Boston College, aptly put it, retirement will change from being a discrete and dramatic “event” that, like marriage, changes your official status in society to a gradual “process” that occurs over a number of years as workers slowly withdraw from the workplace by laboring fewer hours per week.

There are four reasons why this profound change is likely to occur:

- **Boomers want to keep working during retirement.** We noted in “The New Millennium American” that 75% of baby boomers expect to keep working after they retire from their current careers, although only 15% want to “work in my former occupation at reduced hours and pay” (Chart 45). And a recent American Association of Retired Persons poll also found that 80% of boomers believe they will work during retirement (Chart 46), more often because it is enjoyable (35%) than because they need the money (23%).

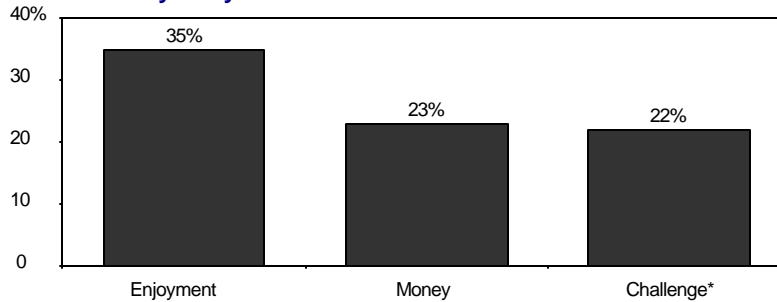
The trend toward early retirement already shows some signs of turning around. The participation rate of men aged 65+ has stabilized since the early 1980s; the rate for male workers aged 55 and older has actually climbed slightly.

Chart 45: What Baby Boomers Plan to Do at Retirement Age



Source: *Business Week*

Chart 46: Why Baby Boomers Plan to Work After Retirement



*Starting own business or beginning new job/career.

Source: American Association of Retired Persons.

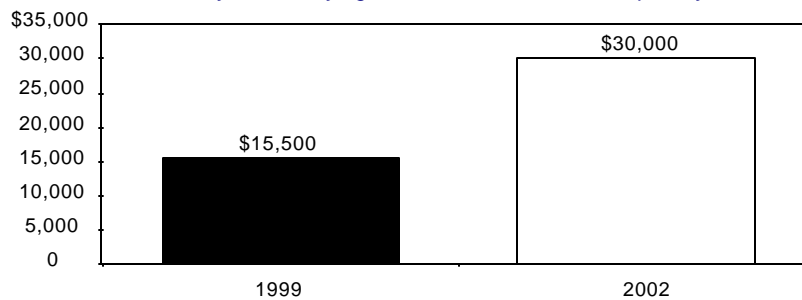
- **Telecommuting facilitates later retirement.** A worker with specialized skills and a deep knowledge of an organization can continue to be a valuable employee—but with reduced wear and tear on an aging body—by setting up a home office and telecommuting. This trend is bullish for technology companies such as Gateway, IBM, Microsoft and Nextel.

- **Social Security reforms will encourage later retirement.** In order to safeguard the system’s solvency, a special Commission headed by Alan Greenspan in the early 1980s instituted a gradual rise in the “normal retirement age” from 65 to 67 by the year 2027. And to encourage Americans to retire later, those who retire at the “early retirement age”—which is to remain unchanged at 62—will receive only 70% of full Social Security benefits, versus the 80% they now receive. There are also proposals circulating in Congress and elsewhere to raise both the “normal retirement age” to 70 and the “early retirement age” to 67. However, this reform faces stiff resistance from organized labor, which argues that it would be much more onerous for a bricklayer, truck driver or assembly line operative than for a white-collar worker.

Another Social Security reform that is very likely to be carried out is eliminating the financial disincentives that virtually prevent many Americans from working once they start receiving their monthly Social Security check. Currently, Social Security beneficiaries who keep working and earn “too much” are penalized with the loss of benefits. In 1999, a person could earn only \$15,500 without penalty; for every \$1,000 dollar above that sum a person lost \$333 in benefits. This is equivalent to a marginal tax rate of 33.3%. In addition to this, a worker must pay Federal, state, and local income taxes plus Social Security/Medicare tax. For a married person filing jointly in New York City, who increased her income from \$35,000 to \$40,000, these four taxes would eat up \$1,617 of the incremental \$5,000—a marginal tax rate of 32.3%.

So between the taxation of incremental income and the loss of Social Security benefits, many workers face a marginal tax rate of more than 60%—not to mention the cost of commuting, work clothes, meals at work, etc. This anti-work provision is a relic of the 1930s and makes no sense when the unemployment rate is under 5%. The income limit is already slated to increase to \$30,000 by 2002 (Chart 47), but it is likely to be abolished altogether.

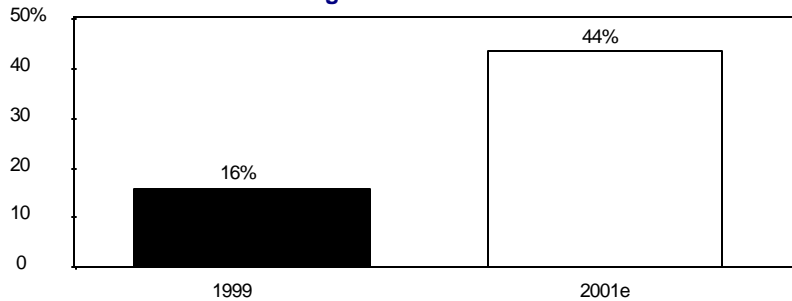
Chart 47: Social Security Income Limit
Income Social Security beneficiary aged 65-69 can earn without a penalty



Source: Social Security Administration.

■ **Corporations need workers.** The era of corporate restructuring and headcount reductions is being eclipsed by the age of worker scarcity, when hiring enough workers is the main factor limiting the earnings growth of companies. Therefore, companies are moving toward what consultants Watson Wyatt Worldwide call “phased retirement plans.” Their survey of 586 large employers shows that about one-sixth already have a phased retirement plan; Wyatt expects that to rise sharply (Chart 48). Reform of the Federal pension laws, giving companies more flexibility to pay pension benefits to workers who are still on the payroll, would greatly facilitate this transition.

Chart 48: Percentage of Large Employers Either Offering a Phased Retirement Plan or Intending to Do So



Source: Watson Wyatt Worldwide, Phased Retirement, 1999 survey.

22% of Americans expect to retire before age 60, 52% between 60 and 65, and 21% after 65. But, once they retire, 17% expect part-time work to be a major source of income, and a whopping 59% think it will be a minor source of income.

—PaineWebber/Gallup, September 1999.

It is not that Americans want to *retire* later, but rather that they want to keep *working after they “retire.”* The PaineWebber/Gallup poll showed that 22% of respondents expect to retire before age 60, 52% between age 60 and 65, and 21% after age 65. But, once they retire, 17% expect part-time work to be a major source of income and a whopping 59% think it will be a minor source of income.

6. Inheritances: Manna from Mom and Dad

Many baby boomers will be inheriting significant sums from their parents and grandparents. The value of inheritances is increasing because more decedents are individuals whose careers wholly spanned the post-World War II period, rather than the depressed 1930s and war-torn 1940s.

Consider, for example, an individual who was born in 1922 and died at the age of 77 in 1999. He returned from World War II in 1945, got married, had two children, and set up a successful professional practice in 1950 that generated a substantial amount of capital over the next 45 years that was invested in stocks and real estate. Those savings were granted to his two children, who are themselves financially successful, and who also inherit assets from the other side of the family.

The PaineWebber/Gallup poll provides important insights into the magnitude of inheritances. Fully 39% of respondents have received an inheritance and/or expect to receive one (Chart 49a). About half of total inheritances are less than \$50,000 while about a quarter exceed \$100,000 (Chart 49b). Based on a rough estimate, the mean value of an individual's total inheritances should be about \$120,000.

Fully 39% of respondents have received an inheritance and/or expect to receive one. The mean value of an individual's total inheritances should be about \$120,000. —PaineWebber/Gallup, September 1999.

Chart 49a: Percent of Americans Who Have Received/Expect to Receive an Inheritance

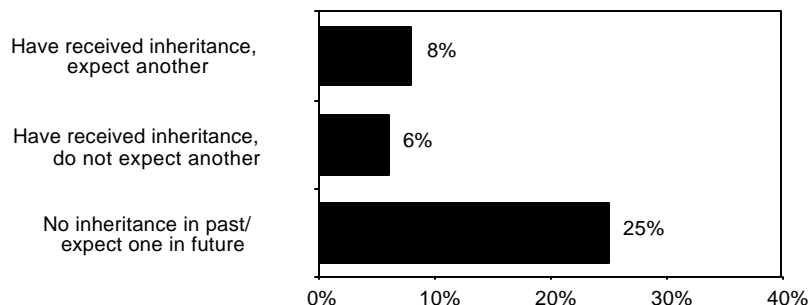
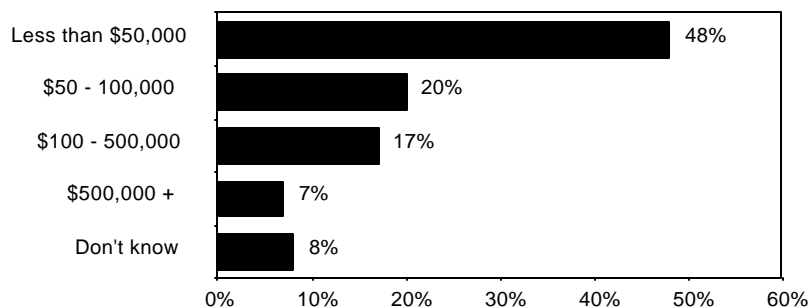


Chart 49b: Value of Inheritance Received/Expected



Source: PaineWebber/Gallup, September 1999.

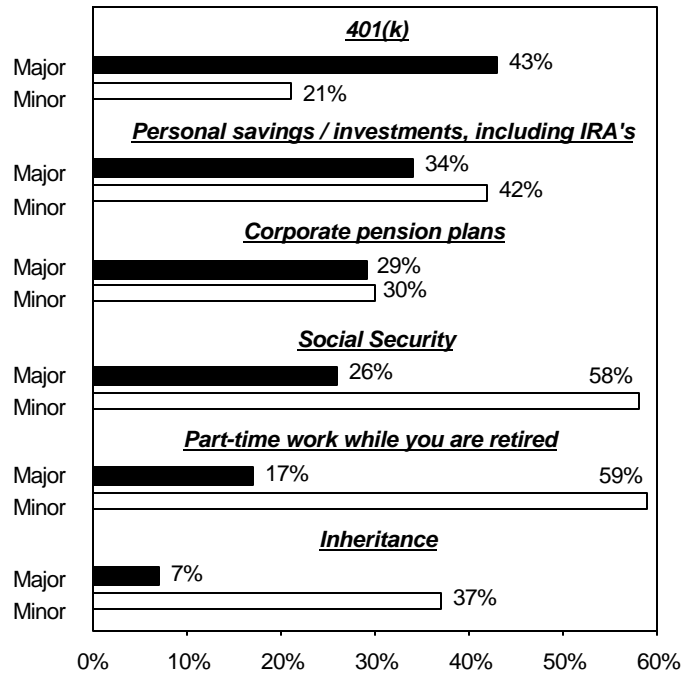
Summary: Many Ways to Fund Retirement

The bottom line is that, for most Americans, Social Security is far from being the only or even the chief source of retirement income. Rather, Americans expect to stitch together a retirement income from many sources, including personal savings, pension plans, inheritance, and part-time work, as well as Social Security.

When we asked Americans what they expected to be “major” sources of retirement income, higher percentages of respondents named 401(k) plans, personal savings and corporate pension plans than named Social Security! —see Chart 50. This reflects widespread lack of confidence in Uncle Sam’s ability to look after retirees. When asked whether they will get, when they retire, all the Social Security benefits they would be entitled to if they retire today, only 30% answered “yes” while 66% said “no.”

“When you retire, do you think you will receive all the Social Security benefits that you would be entitled to if you retired today?” Only 30% answered “yes” while 66% answered “no.” —PaineWebber/Gallup, September 1999.

Chart 50: Upon Retiring, Americans Are Expecting to Receive Income from Many Sources



Source: PaineWebber/Gallup, September 1999.

Investing, Not Saving, in the Age of Affluence

Yankelovich polls reveal that:

- 72% of Americans strongly/moderately feel the need to save or invest regularly, BUT only 38% are currently saving specifically for retirement.
- 75% of Americans say “I consider myself more of a saver than an investor,” BUT the percent of people who consider themselves an investor rose to 50% in 1999 from 36% in 1998.
- 70% of Americans look for “the safest investments, even though they may offer a lower return,” BUT, as noted above, 46% of Americans’ household financial assets are in equities.

Whether they realize it or not, today most Americans (and baby boomers in particular) are investors rather than savers. But is this just a matter of semantics? Not at all.

Saving

Save (vb) to put aside as a store or reserve.

Source: Webster's.

A Yankelovich poll reveals these top ten savings objectives:

1. Retirement	38%	6. Kids' future	15%
2. Emergencies	35%	7. Buy a house	13%
3. Vacation	31%	8. Renovate/remodel	13%
4. Kids' education	21%	9. Future medical problems	10%
5. Major purchase	18%	10. Your own education	10%

The majority of these savings objectives can be considered either *precautionary* (emergencies, future medical problems) or *anticipatory* (retirement, kids' education, kids' future). 'Saving' is, therefore:

- **Defensive.** In preparing for future events, the safety of the principal is essential.
- **Passive.** The funds are left untouched until needed.
- **Apprehensive.** A key reason to set aside money is fear of what may happen.

Investing

Invest (vb) to commit (money) in order to earn a financial return; to make use of for future benefits or advantages.

Source: Webster's.

Investing, as the above definition indicates, is the act of deploying financial assets to earn a financial return. Obviously, you cannot invest until you have saved, but the key differences between "saving" and "investing" are that investing is:

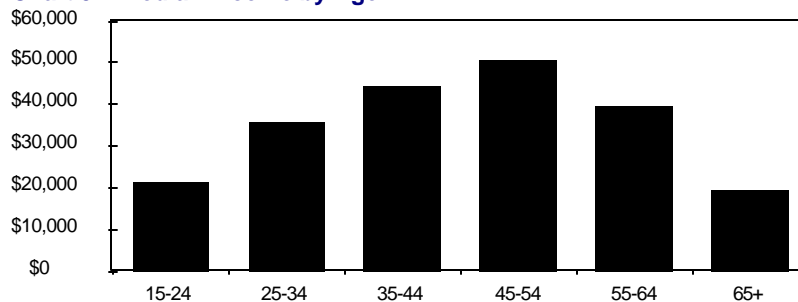
- **Aggressive.** "Investors" are willing to incur some risk to the principal. By contrast, "savers" are counting on that principal for use in the future.
- **Active.** Unlike savers, investors participate in the capitalist culture—whether it is by reading *The Wall Street Journal*, watching *Wall Street Week*, CNNfn and CNBC, trading stocks or discussing their portfolio with their broker.
- **Aspirational.** The motivations behind investing are more expansive and ambitious than the motivations behind saving—not just to buy a house, but to build a dream house; not just to take a vacation, but to take a grand vacation; not just to retire, but to become really wealthy. Often, the aspirations of investors involve a life-style change that will bring *less stress* and *more time* to do the activities they want.

Investment Levels Are High and Rising

Even though baby boomers are not enthusiastic savers and the U.S. savings rate has trended down in recent years, Americans are nevertheless dedicated and increasingly effective investors. We have already shown that Americans' financial assets have accumulated rapidly, despite a low savings rate. And the funds available for investing *will continue to grow rapidly*. But if, as we argue below, baby boomers won't stop spending, where will they get the funds to invest with? From three primary sources:

- **Rising real incomes combined with a modest rise in the savings rate.** With the forces underlying both the Consumer Comeback and the muted business cycle expected to remain in place for the foreseeable future, real incomes will continue to rise. Some of this income will be saved—even if, as we discussed, government figures do not accurately measure it. Further, the savings rate of baby boomers will likely stay at current levels (i.e., about 10%) or rise modestly, as boomers, now in their peak earnings years (Chart 51), find themselves with increased amounts of disposable income.

Chart 51: Median Income by Age



Source: Census Bureau.

- **401(k) plans.** Look for the 401(k) revolution to be extended down deeper into society. Smaller corporations will be encouraged to make them available. Whether via President Clinton's USA accounts or via the privatization of Social Security favored by many politicians, private savings accounts are also likely to be given to the working poor. The 401(k) revolution has already had a vast impact on American society, but the democratization of this revolution would have profound implications. Quite simply, nearly every voter will be a shareholder.
- **Inheritances.** As detailed above, about 39% of Americans have received or expect to receive an inheritance. Based on a rough estimate, the mean value of an individual's total inheritances should be about \$120,000.

Looking for an Investment Partner, Not a Delegate

As we noted, for most people saving is a stressful activity. So too is investing, *largely because it demands time and expertise*. In this regard, Yankelovich polls reveal that:

- 75% of Americans say “I need to manage my time more efficiently.”
- 73% of Americans say it’s important to be “clever in money management” (up from 44% in 1985), but 70% of Americans say that investments are “too confusing” and only 30% say “I always know which types of investments are right for me.”

Despite these constraints of time and expertise, Americans *don’t want to delegate their investment decisions*. This desire for personal control largely reflects the “cradle-to-grave entrepreneurialism” we discussed in “The New Millennium American,” as well as the associated sentiment (revealed by a Yankelovich poll) felt by a whopping 85% of Americans that, when it comes to money, “unless I speak out and make my views known, no one else will look out for my interests.” So, rather than delegating their financial decisions, *Americans want investment partners*:

- 69% of Americans believe it is important that an investment firm has financial counselors who will “work with me to make the right investment choices.”
- 34% of Americans polled in 1999 “strongly/moderately feel the need to work more with a money manager, stock broker or investment adviser,” up from 28% in 1997.

This trend is obviously bullish for companies that offer asset management services, such as full-service brokerages, but bearish for firms that solely provide trading capabilities. Beneficiaries here include American Express, AXA Financial (owner of Alliance Capital and Donaldson, Lufkin & Jenrette, and formerly called The Equitable Companies), Bank of New York, Citigroup, Goldman Sachs and Merrill Lynch. But banks and thrifts that simply take deposits and make loans are vulnerable as more individuals look elsewhere for advice on how to manage all of their wealth.

85% of Americans say that, when it comes to money, “unless I speak out and make my views known, no one else will look out for my interests.”

No Spending Slowdown

Boomers have been champion consumers throughout their lives, and although their saving may rise moderately they are not going to quit now. Boomers certainly have accumulated a lot of material goods and, as noted, they will invest heavily in the next few years. *But their ingrained generational values will lead them to keep spending.*

However, when it comes to the beneficiaries of this spending, it's not necessarily the usual auto/housing/retailing suspects. As we noted in "The New Millennium American," "with most of their material needs satisfied, boomers place more value on experiences than on tangibles." Our September 1998 report also made clear that experiences boomers value highly are ones that alleviate stress, as well as those that make the best use of their time.

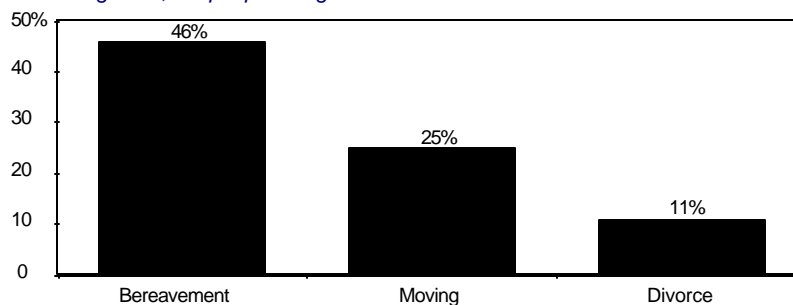
Spending to Alleviate Stress

All the Comforts of Home

Spacious, well-appointed houses help boomers relax and recharge. But rather than "trading up" to bigger houses, many Americans are spending heavily on house improvement. One key factor here is that moving house is extremely stressful. Indeed, a recent survey ranked "buying and selling your home" as the second most stressful life event—even worse than divorce (Chart 52)!

Chart 52: Stress Levels for Different Life Events

Percentage of 1,000 people citing event as stressful



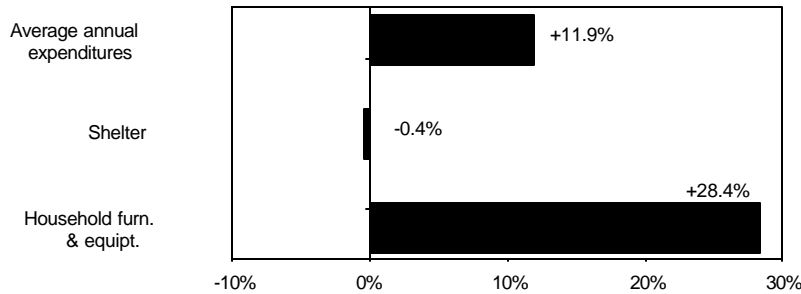
Source: U.K. Department of the Environment 1999 survey.

Demographics are also behind the trend to home improvement. The average age of first-time home buyers is 32.1 years. Not surprisingly then, spending on shelter ranks first in terms of absolute spending increases as households move from the under-25 age group to the 25-34 age group.

By contrast, as households move into the 45-54 age bracket (i.e., the current age of many boomers), spending on shelter actually declines, but expenditures for “household furnishings and equipment” still rises strongly (Chart 53). Evidently households stretch financially to buy their first house, and then their dream home (or as close to their dream home as they can afford). Then, after the mortgage payments become more manageable, they spend freely to make the dwelling more comfortable.

Chart 53: Change in Selected Household Expenditures

From 35-44 to 45-54 age group

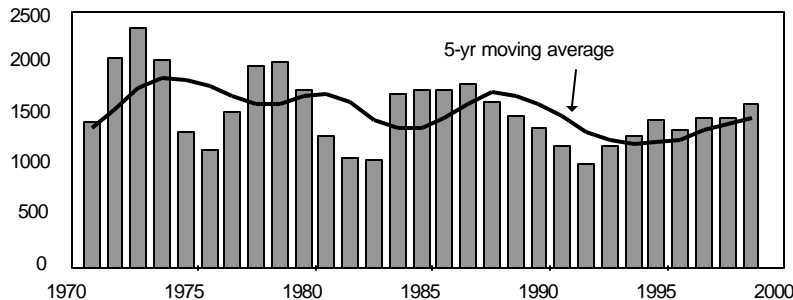


Source: Bureau of Labor Statistics.

These factors help explain the decline in housing starts as boomers have moved into their 40s (Chart 54), and the *increase* in the average size of homes (Chart 55) even as median household size has dropped (partly reflecting boomers’ kids moving out).

Chart 54: Number of Housing Starts

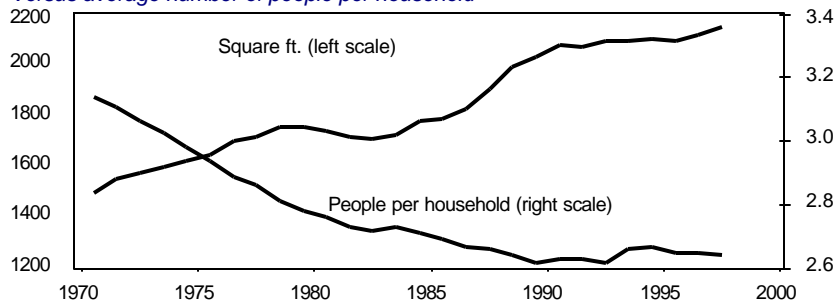
Thousands



Source: Census Bureau.

Chart 55: Average Square Feet per U.S. Home

Versus average number of people per household



Source: Census Bureau.

Almost half (49%) of American homeowners say that they are likely to remodel, upgrade or improve their current house. By contrast, just 18% of homeowners and 27% of the total population are likely to buy a new house.
—PaineWebber/Gallup, September 1999.

The PaineWebber/Gallup survey reveals that half (49%) of American homeowners say that “in the next five years, I am likely to remodel, upgrade, or improve my current house.” By contrast, just 18% of homeowners and 27% of the total population say they are likely to “buy a new house.” Of those who said they were likely to “remodel, upgrade, or improve my current house,” the following improvements were cited (ranked in terms of popularity):

- Landscape (68%).
- Buy new furnishings (67%).
- Renovate, e.g. kitchen or bathroom (63%).
- Build, e.g. a new room, patio, deck or swimming pool (43%).
- Transform a room, e.g. into an exercise or a media room (24%).

However, as we noted in “The New Millennium American,” boomers do not want to do this work themselves: “As baby boomers get older, with more money, less time, less ‘elbow grease’ and pricier homes with higher standards of craftsmanship, they are migrating from the ‘do-it-yourself’ market to the ‘do-it-for-me’ market.” We discuss later the growing trend of hiring people to perform services.

But, regardless of who does the work, heavy spending on upscale home improvements is bullish for a variety of companies. American Woodmark is one of the largest manufacturers of kitchen cabinets and vanities in the U.S.; over half its sales come via home superstores. Bed Bath & Beyond, the chain of superstores, sells household merchandise and home furnishings ranging from bath accessories to cookware. Ethan Allen Interiors is a leading manufacturer and retailer of upscale home furnishings. Home Depot is the dominant player in the home improvement warehouse sector. Lowe’s sells more than 40,000 home improvement items including yard, patio and garden supplies, and home entertainment products. Masco is a leading manufacturer of high-end kitchen and bathroom products.

First-Class Leisure

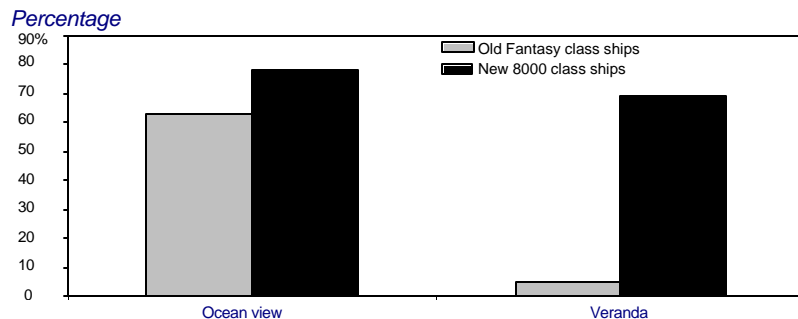
In “The New Millennium American” we observed that, with their “discretionary income rising, stressed out consumers are spending heavily on vacations and other leisure activities.” While time-starved Americans are not taking *more* vacations, they are paying up for *better* vacations.

The PaineWebber/Gallup survey reveals that one in three Americans says, “I am taking fewer vacations than I did a few years ago.” The reason: Over half (52%) of Americans say that, in the past several years, they have less time for leisure activities. But one in three Americans today says, “I am spending more money on my vacations than I did a few years ago.”

In our 1998 report, we used the phrase “full-service” leisure to capture the concept that, when vacationing, stressed baby boomers want integrated, all-in-one packages. Now many baby boomers also want and, more importantly, *can afford*, “first-class” leisure. “First-class” leisure is:

- Not just going on a cruise, *but enjoying a stateroom with an ocean view and private veranda too*. Over the next four years, Carnival Corp. expects to bring into service eight new vessels equipped with amenities that enhance the cruising experience. Carnival has found that vacationers are very willing to pay for these amenities. More staterooms will be on the outside with good views, and a much greater proportion of staterooms will have verandas (Chart 56). Other cruise line operators include Disney and Royal Caribbean Cruises.

Chart 56: Carnival Staterooms with Ocean View/Veranda



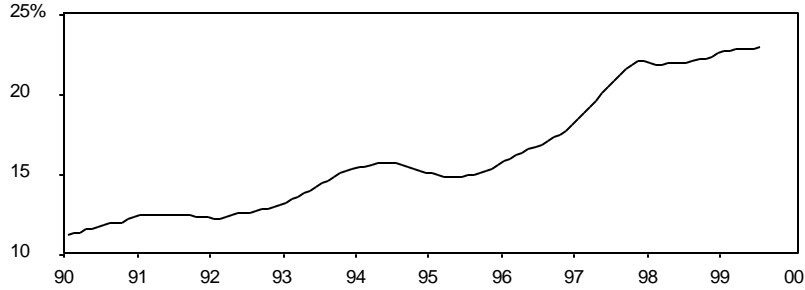
Source: Carnival Corp. and PaineWebber.

- Not just flying to an alluring vacation destination, *but flying first-class too*. For U.S. airlines, the percentage of revenues derived from first-class travel has been growing steadily (Chart 57), with that percentage rising sharply since 1995. The rise in the importance of first-class revenues is a reflection of the fact that more people are flying first-class *and* first-class fares have been rising. While almost 90% of first-class travel is via an upgrade (i.e., only about 10% of first-class revenue is sold as first), total first-class (including upgrade) revenues now account for almost 25% of the airline industry’s revenues. In response to the greater demand for first, many airlines have expanded their first-class cabins. One airline that has a relatively large proportion of first-class seats is AMR Corp. And Delta Airlines has significantly upgraded its premier international service.

One in three Americans is taking fewer vacations than a few years ago. One reason: Over half of Americans say that, in the past several years, they have less time for leisure activities.
 —PaineWebber/Gallup, September 1999.

One in three Americans is taking more expensive vacations today than a few years ago.
 —PaineWebber/Gallup, September 1999.

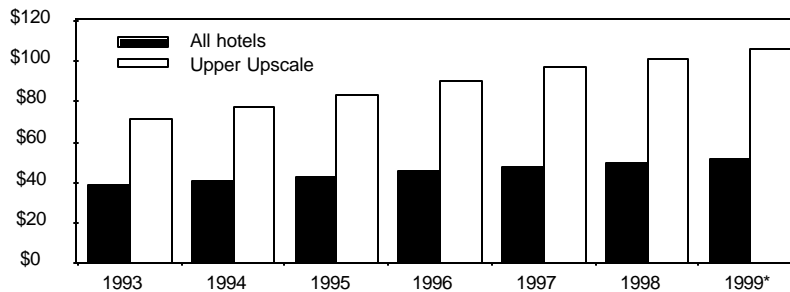
Chart 57: U.S. Airlines' First-Class Revenue as Percentage of Total Revenue



Source: ATA, PaineWebber.

■ Not just staying in a nice hotel, *but staying in the best hotel*. The factors behind the Age of Affluence are also very favorable for the luxury segment of the hotel industry. Specifically, luxury hotels and full-service upscale hotels have benefited from the favorable combination of rising demand, thanks to a steadily growing economy, and few new hotel openings. Consequently, since 1993 this segment has enjoyed better-than-industry-average growth in occupancy and room rates. According to industry consultants Smith Travel Research, revenue per available room (RevPAR) growth in the upper upscale chain segment (which includes four- and five-star hotel chains) averaged 7.2% between 1993 and 1998, versus 5.2% for the total U.S. hotel industry (Chart 58).

Chart 58: RevPAR of Upper Upscale and Total U.S. Hotel Industry



*Year-to-date through August.
Source: Smith Travel Research.

The luxury and upscale segments of the hotel industry have mostly managed to escape the overbuilding problems that have plagued other parts of the lodging sector. Consequently, supply growth in the upper upscale segment averaged just 1.4% between 1993 and 1998, versus 2.2% for the U.S. hotel industry.

While the number of new full-service hotel openings is expected to increase in 2000, the majority of these openings will likely be concentrated in southern U.S. states where land is available for new development. But demand growth for full-service upscale and luxury hotels in major U.S. urban markets, such as New York City, San Francisco and Boston, will likely remain above supply growth through 2000. This should enable these hotels to achieve higher RevPAR growth than the U.S. industry average.

In the luxury segment, the two key players are Four Seasons and Ritz-Carlton, which is owned by Marriott International.

Finally, many “first-class” travelers will travel with luggage made by LVMH Moët Hennessy’s Louis Vuitton division.

The Need for Speed

Why do people speed? The U.S. Department of Transportation’s National Highway Traffic Safety Administration conducted a survey of 3,000 motorists in 1998 to examine that question. Drivers were asked if they agreed or disagreed with a series of statements dealing with driving and speed. One of these was “I enjoy the feeling of speed.” Overall two drivers in five (39%) agreed with that statement. And one driver in three agreed with the statement, “I try to get where I am going as fast as I can” (probably because of the time drought).

While most people do not break the speed limit when driving, many people are attracted to powerful vehicles, especially those that they can enjoy in their leisure time—e.g., sports cars, motorcycles and power boats. As affluence levels have risen, these “speed toys” have come within the reach of more and more Americans. And, of course, the ultimate “speed toy” is the airplane, which can take you very far away from your everyday surroundings in a relatively short period of time.

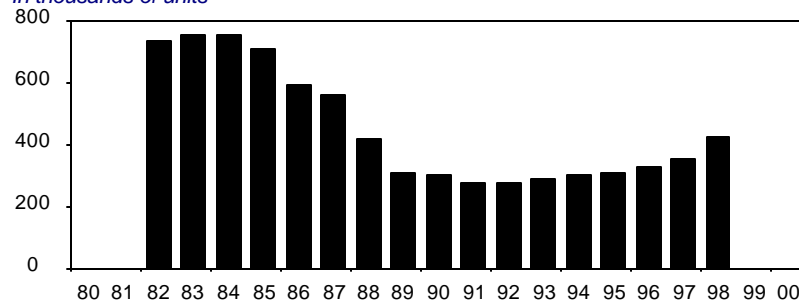
The Wall Street Journal recently quoted an automotive-marketing consultant as saying that, because of the robust economy, “people are able to splurge on cars that are more toys than primary transportation.” The small, but expanding, field of hard-core sports cars are classic examples of “speed toys.” A leading player here is DaimlerChrysler, whose popular Mercedes CLK line, for example, has long waiting lists of customers.

Given steadily rising demand (Chart 59), which now exceeds supply, there are long waiting lists for top-of-the-line motorcycles too. The key beneficiary of this trend is Harley-Davidson, which 15 years ago was the only remaining U.S. manufacturer and was close to collapse thanks to Japanese competition. In the first half of 1999, however, Harley’s share of the heavyweight motorcycle market—the dominant sector in the U.S.—rose to close to 50%.

While 93% of American households own a car, 23% own a boat, motorcycle, jet ski, snowmobile or airplane.
 —PaineWebber/
 Gallup, September 1999.

Chart 59: New Retail Sales of Motorcycles

In thousands of units

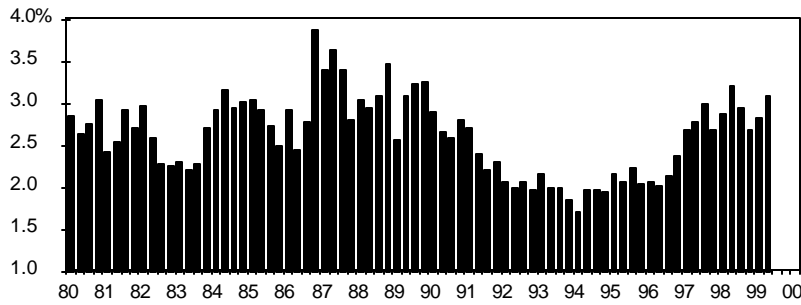


Source: Motorcycle Industry Council.

The surge in demand for motorcycles has led to the revival of an independent U.S. bike-making sector, which decades ago boasted hundreds of companies. For example, Polaris Industries, which is best known for its snowmobiles—another “speed toy”—brought out a Victory cruiser last year, and now expects to ship 5,000 units this year.

Like the independent bike makers, many players in the boat-building industry were also driven out of business earlier this decade by the recession of the early 1990s. On top of that, Congress levied a crushing luxury tax on boats costing more than \$100,000. Consequently, the industry’s share of recreational spending fell from 3.9% in fourth quarter 1986 to just 1.7% in first quarter 1994 (Chart 60).

Chart 60: Consumer Spending on Boats
Quarterly, as a percentage of recreational spending

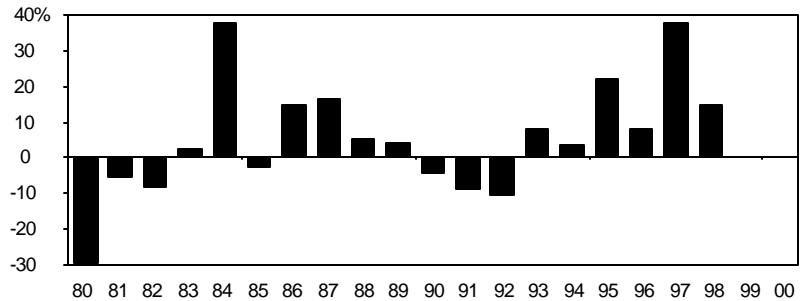


Source: Bureau of Economic Analysis.

The repeal of the tax law in late 1993 was one of the factors that helped the industry stage a recovery. The Consumer Comeback that got under way in 1995 was another. And now that Americans are enjoying unprecedented affluence, the outlook for the boat industry is even more favorable. Brunswick Corp is a leading boat manufacturer; West Marine is a leading boating retailer.

Flying too is an expensive pastime that tends to soar when times are good and nosedive when the economy is soft (Chart 61). The recession at the start of the decade aside, the 1990s have been a fairly prosperous time for the pleasure aircraft industry. In 1994 the industry got an added boost when Congress passed the General Aviation Revitalization Act, which reduces aviation manufacturers’ liability in the event of an accident.

Chart 61: Pleasure Aircraft Spending
Year-to-year percentage change



Source: Bureau of Economic Analysis.

These factors enticed the once-dominant player in the industry, Textron's Cessna, back into the business in 1996. In addition to Textron, Raytheon is another pleasure aircraft play. Finally, many wealthy individuals are chartering, or even becoming fractional owners of, aircraft. Berkshire Hathaway's Executive Jet is the world's leading marketer of fractional ownership in aircraft, with an approximately 75% market share. Executive Jet is the largest customer for certain aircraft and is, for example, Gulfstream's largest distributor.

Finally, the "need for speed" is prevalent in every aspect of boomers' lives, including Internet access. One considerable source of frustration has been the fact that bandwidth to the home has not been developing as quickly as PC chip technology. While large institutions and government agencies maintain their own networks, most consumers at home access the Internet by dialing into a local or long-distance telephone company, or to a company such as America Online. But compared with the power of most PCs, today's typical modem access is frustratingly slow. Indeed, for remote connectivity, most people at home still dial up using the same old modem technology over telephone network equipment that has been around for decades.

However, time-starved consumers are clamoring for significantly higher connection speeds and, thanks to improved technologies—including cable, DSL and satellite—faster Internet access is becoming more widely available. Strong demand for fast Internet access is bullish for companies such as Cisco Systems (networking), Lucent (networking), MCI WorldCom (DSL access), Motorola (General Instrument's cable modems and set-top boxes), Tandy (a leading retailer of Internet devices) and Time Warner (cable modems).

Spending to Alleviate the Time Drought

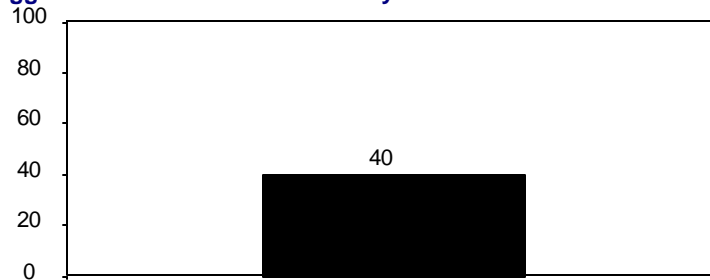
Saving Time

A *Wall Street Journal* survey found that 40% of Americans say that lack of time is a bigger problem for them than lack of money (Chart 62). As we noted above, 75% of Americans say, "I need to manage my time more efficiently" (Chart 63). In "The New Millennium American" we pointed out that "the ultimate time-deepening appliance is the computer wired to the Internet, which one can use to almost simultaneously write a report; e-mail a friend; check stock prices, sports scores and bank accounts; follow the latest news headlines; and play a game of solitaire." In addition, we observed that "a poll that asked consumers, 'Has Internet use completely/mostly replaced' other media in your home found that 12% answered 'yes' for TV, 10% for newspapers and 8% for magazines."

With time-starved Americans continuing to spend more and more time on the PC, other activities are losing out. The 1999 PaineWebber/Gallup survey revealed that, in the past several years, almost half (48%) of Americans have reduced the amount of time they spend watching TV, while two in five Americans have reduced the amount of time they spend on outdoor activities or exercising.

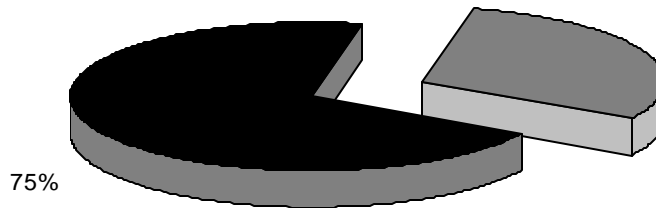
In the past several years almost half of Americans (48%) have reduced the amount of time they spend watching TV, while two in five have cut back on the amount of time they spend on outdoor activities or exercising.
—PaineWebber/Gallup, September 1999.

Chart 62: Percent of Americans Saying that Lack of Time Is a Bigger Problem than Lack of Money



Source: *The Wall Street Journal*.

Chart 63: "I need to manage my time more efficiently"



Source: Yankelovich Partners.

The biggest losers to the time drought are newspapers and magazines.

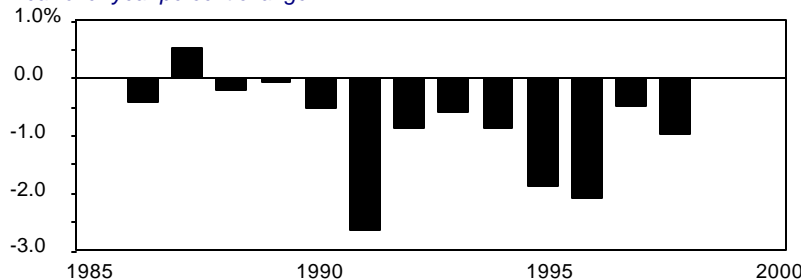
But perhaps the biggest losers to the time drought are newspapers and magazines. Yankelovich polls reveal that:

- Only 35% of Americans said in 1999 that they "read a newspaper every day," down from 43% in 1995.
- The percent of Americans who subscribe to magazines fell to 57% in 1999, down from 68% in 1995.
- As for the reasons for subscribing to fewer magazines, 50% of Americans cited "no time." Just 32% said it was to "cut costs."

The competition for people's time is a key reason why newspaper circulation has been falling for over a decade (Chart 64). This trend is likely to continue because, like smoking, reading newspapers is a habit acquired early in life; if not, it's unlikely to be acquired at all.

Chart 64: U.S. Daily Newspaper Circulation

Year-over-year percent change



Source: *Editor & Publisher*.

Over the years technology has produced more and more ways of occupying potential readers' leisure hours: more television channels, more video games, more PC applications. And now there is the Internet, which provides infinite amounts of entertainment *and* information.

A survey by Jupiter Communications last year showed that almost half of online users now access news via search engines or directory Web sites. But newspaper Web sites are very far down on the list of where people look for their news on the Net—the top newspaper on the Web, *USA Today*, ranks 19th in the news, information and entertainment category put together by Media Metrix. The likely reason for this is that time-starved Net surfers do not want to read long articles; they want headlines as well as brief, frequent updates. That is what Web sites such as America Online and Yahoo provide.

But news is not what most people read newspapers for in the first place. Research has indicated that television and radio are more important sources of actual news. Newspapers are more prized for the information they carry about real estate, jobs, sports, entertainment, arts, food and money. Here too specialized Web sites have been winning readers away from newspapers because of the depth of coverage they offer. So, for example, sports fans are increasingly more likely to turn to Disney's ESPN.com or SportsLine USA than they are to a newspaper.

One traditional monopoly of newspapers is time-inefficient too. Classified advertising (which makes up 35-40% of newspaper industry revenues) works far better on the Net than it does on paper. On the Net you do not have to spend hours searching through pages of newsprint to find the job or house that you want; you type in your criteria and see what comes up. It takes a minute, rather than an hour.

In addition to ads for jobs and houses, the Web has given other forms of classified advertising a new life too. For example, companies such as eBay are benefiting from the rise in popularity of the online auction. And other classified advertising (ranging from birth announcements to personals) has become so popular on the Net that it has turned into a destination in its own right. Yahoo is one company that posts people's classifieds for free and, using them to attract eyeballs, makes money by selling banner advertising on the site.

The Internet offers a multitude of other ways to save time. For example, Amazon.com is not just about buying books at a good price. What you are really getting from Amazon is the time that you otherwise would have spent (i) going to your local bookstore, (ii) browsing the shelves for a book (or putting it on order if you can't find it) and (iii) bringing your purchase home from the store. Priceline.com allows consumers to quickly find the best price for a range of products, from airline tickets to hotel rooms. And Peapod is an Internet company that delivers groceries you order online directly to your home.

In a recent report (see “The Information Revolution Wars,” May 9, 1999) we also discussed the “time deepening capabilities of radio.” We noted that, for the Web, “radio is a complementary medium, rather than a competitive one (e.g., you can surf the Web and simultaneously hear on the radio an ad for an interesting Web site, but it’s difficult to surf and watch TV at the same time).” Of course, radio doesn’t just deepen time for Web surfers. Indeed, two-thirds of radio listening occurs outside of the home, most often in the car. The unique time-deepening capabilities of this medium are bullish for radio companies such as Clear Channel and Infinity Broadcasting.

Finally, in the offline world, the wide range of products that companies such as Costco and Wal-Mart offer also saves time. According to a 1998 Roper-Starch survey, 43% of people often or sometimes buy “large quantities” at warehouse stores or other retail outlets in order to cut down on the number of shopping trips they make. Multiple trips to poorly stocked and under-staffed small grocery stores are clearly an inefficient use of time.

Buying Time

A 1998 Roper Starch survey revealed that the number of people who save time by buying it from others has been rising. For example, 17% of people surveyed “often or sometimes pay someone to do housecleaning,” up 6 points from the mid-1980s. When the question was broadened to include more activities than just housecleaning, the 1999 PaineWebber/Gallup survey revealed that over half (56%) of Americans say that “in the past year, I have employed someone to provide personal services, such as cleaning the house, mowing the lawn, preparing taxes.”

*Over half (56%) of Americans have employed someone in the past year to provide personal services.
—PaineWebber/Gallup, September 1999.*

For a growing number of Americans, ‘employing someone’ increasingly means more than just paying the kid next door to cut the grass. It means everything from tax preparation to termite extermination. H&R Block, the income tax preparation company, gains customers as tax law changes make form filling more complicated and time-consuming. (Technological advances are unlikely to threaten this franchise. As we noted in “The Information Revolution Wars,” “the full set of tax regulations and all the necessary tax forms are readily available on the Net, as are tips and advice on cutting taxes, but a huge number of people still turn to professional preparers to complete their tax returns.”) And ServiceMaster offers a variety of residential services including lawn care and landscaping, pest control and residential cleaning.

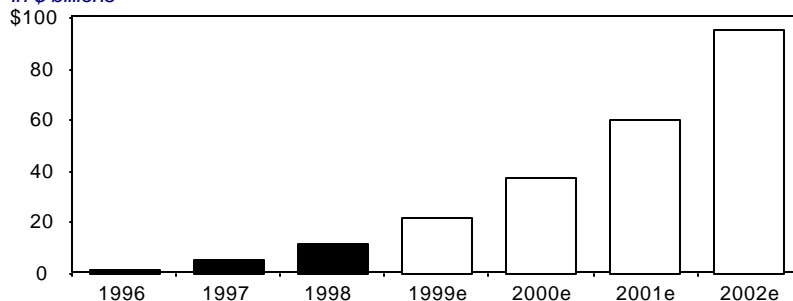
Quality Time

In “The New Millennium American” we observed that “stressed-out, time-starved consumers demand good service, and this is particularly true of baby boomers who have become ‘jaded’ after two decades of shopping and spending. But consumers are not satisfied with the service they are receiving.” One year later, consumers are even less satisfied.

The 1998 PaineWebber/Gallup survey revealed that over a third of Americans (37%) think that “service has gotten worse over the past five years.” In 1999, almost half (47%) of Americans now agree with that statement.

Chart 65: E-Commerce Sales (Business to Consumer)

In \$ billions



Source: PaineWebber.

The very tight labor market continues to make it tough for companies to meet consumers’ high expectations. That’s one reason for the explosive growth of e-commerce on the Net (Chart 65). As we had anticipated, a steadily growing number of Americans prefer to “deal with an intelligent keyboard rather than a dumb clerk”:

- In 1998 only 11% of Americans polled in the PaineWebber/Gallup survey said that they had ever bought anything over the Internet. In 1999, 22% said that they had made a purchase on the Net (Chart 66).
- Of people who have bought products over the Internet, in 1998 nine in ten were either “very satisfied” or “somewhat satisfied.” With twice as many Americans making purchases over the Internet, satisfaction with Web shopping remains very high, with nine in ten Web shoppers still either “very satisfied” or “somewhat satisfied.”

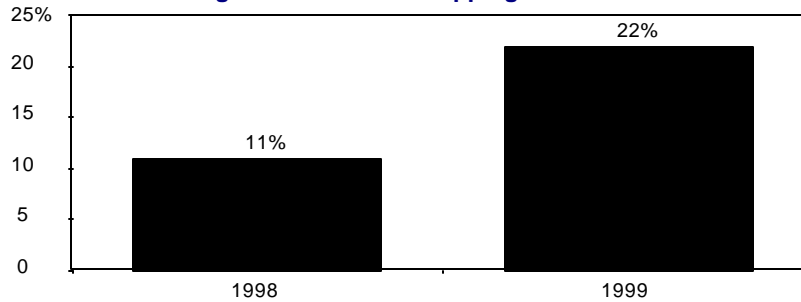
The percentage of Americans who think that service has gotten worse over the past five years has risen from over a third (37%) a year ago, to almost one half (47%) today.

—PaineWebber/Gallup, September 1999.

The percentage of Americans who have ever bought anything over the Internet has doubled over the past 12 months, to almost one in four.

—PaineWebber/Gallup, September 1999.

Chart 66: Percentage of Americans Shopping over the Internet



Source: PaineWebber/Gallup 1998 & 1999 surveys.

With more Americans making purchases over the Internet, satisfaction with Web shopping is still very high. As was the case a year ago, nine in ten Web shoppers are either "very satisfied" or "somewhat satisfied."
—PaineWebber/Gallup, September 1999.

In "The Information Revolution Wars" we pointed out that the companies that are benefiting from the explosive growth in e-commerce are those that:

- Have their own distinctive product line (e.g., Gap, Tiffany).
- Have a stronger brand image than the products they sell. Everyone knows Home Depot and Lowe's, but who knows the names of the companies who make the lightbulbs, screwdrivers, etc.? And, even if they did, who would want to go to all those separate Web sites to buy home supplies?
- Add value to the retail experience via, for example, a respected fashion sense (e.g., Abercrombie & Fitch, Gap) or by offering customers a very wide range of products and services (Costco, Wal-Mart).

Additional information is available upon request.

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2 PaineWebber Incorporated has acted in an investment banking capacity for this company.

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