Thematic Investing—Demographic Dynamics

C15.0042
Lesson 2
Edward M. Kerschner
Drivers of the Economy

\[ GDP = \text{Consumer} + \text{Government} + \text{Industry} \]
Rotating Drivers of the Economy

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

The Wealth Effect, Interest Rates & Other Misconceptions
Consumer Myths

Consumer spending & income

Consumer spending & stock prices

E. Kerschner
Consumer Myths

*Consumer spending is driven by Income*

<table>
<thead>
<tr>
<th>Correlation Coefficients with Real Consumer Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Disposable Income</td>
</tr>
<tr>
<td>Employment</td>
</tr>
<tr>
<td>Stocks (S&amp;P 500)</td>
</tr>
<tr>
<td>3-month T-bill</td>
</tr>
<tr>
<td>10 year T-bond</td>
</tr>
</tbody>
</table>
Consumer Myths

The 1980s

In ’80s stocks rose; consumer spending didn’t

In ’80s falling rates didn’t drive spending
Consumer Myths

The 1990s

In ’90s consumer spending rose with income

Index 12/89 = 100

Consumer Spending

Disposable income

CONSUMER COMEBACK

The Case for the Consumer as presented in 1995

E. Kerschner
Consumer Comeback

As Labor Growth Slows …

U.S. Labor Force Growth by Decade

1.09% 1.70% 2.67% 1.60% 1.06%

0% 1% 2% 3%

1950s 1960s 1970s 1980s 1990s

. . . Incomes will Rise

Wages — Real Average Hourly Earnings

$6.50 $7.00 $7.50 $8.00 $8.50 $9.00


E. Kerschner
Consumer Comeback

And Strong Productivity Forecast Proved True

Manufacturing Sector Productivity (A) Q4 ‘98

S&P Sales per Employee (B)

Nonfarm Productivity (A) Q4 ‘98

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

The Pain the consumer felt in ‘95-’96 . . .

Exhibit 1: The Pain

U.S. News

Workers Take It On The Chin
A changing economy is leaving many of them behind
January 22, 1996

BusinessWeek

ECONOMIC ANXIETY
Ten years of downsizing and widening income inequality have taken an enormous toll. U.S. workers are losing faith in their ability to prosper
March 11, 1996

TIME

“There’s a large gut sense of economic insecurity that is pervasive in the middle class”
Pat Buchanan
November 6, 1995

U.S. News

IS THE AMERICAN WORKER GETTING Shafted?
The Assault On The Middle Class
January 22, 1996
Consumer Comeback

... begins to reverse in '97
Consumer Comeback

“Aging Boomers” will drive consumer behavior

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

Generation Y | Aging Boomers | Senior Seniors


-20% -10% 0% 10% 20% 30% 40% 50% 60%
Consumer Comeback

“Aging Boomers” will drive consumer behavior

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

E. Kerschner
The New Millennium American

The Case for the Consumer as presented in 1998

E. Kerschner
The New Millennium American

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

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

Cradle-to-grave entrepreneurialism

Union membership declines

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

*PW/Gallup, July 1998*

Gov’t as % of GDP declines

Life Expectancy increases

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The New Millennium American

Cradle-to-grave entrepreneurialism

Boomers plan on working after retiring

- Won't work: 25%
- Former occupation at reduced hours and pay: 15%
- Part-time new job: 28%
- Consult: 20%
- Full-time different job: 2%
- Start business: 10%

E. Kerschner
The New Millennium American

The Time Drought

Average workweek has stopped declining

% of Americans saying time more valuable than money

In hours, annually
The New Millennium American

The Time Drought

Multitasking has become the norm

As a child
Listen to radio at home

1950s
Ride in car and...
Listen to radio

Today
Ride in car and...
Listen to radio and...
Talk on phone
The New Millennium American

The Time Drought

“Great Rooms”

cook

watch TV

phone

homework
The New Millennium American

The Time Drought

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The New Millennium American

“Stressless Leisure”

What Americans want in a vacation?

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

PW/Gallup, July 1998

Fewer Prefer a sense of participating

- 1993: 71%
- 1997: 61%

Exercise/sports less of a way to relax

- 1993: 30%
- 1997: 27%

PW/Gallup, July 1998

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The New Millennium American

The no-service / full-service economy

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

PW/Gallup, July 1998

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

The New Drug Culture

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

**Prescriptions written per person**

- **Propecia** for hair-loss
- **Dexetrim** for weight-loss
- **Zyban** for smoking-cessation
- **Viagra** for sexual problems
- **Prozac** for depression
- **Xanax** for anxiety
The American Age of Affluence

The Case for the Consumer as presented in 2000/2001

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The American Age of Affluence

Affluent and Aging

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

Percent Change by Age in U.S. Population 2000-2010
The American Age of Affluence

Who Are We?
The American Age of Affluence

Net worth per household has surged

Real Disposable Income has surged
The American Age of Affluence

Home and car ownership rates are rising rapidly

Home and car ownership rates are rising rapidly.

Misery Index near lows

The sum of unemployment rate and inflation rate near lows.
The American Age of Affluence

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

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

- Same occupation same hours, pay: 11%
- Part-time different job: 12%
- Start business: 13%
- Full-time different job: 2%
- Same occupation at reduced hours, pay: 21%
- Won't work: 37%

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

- Enjoyment: 34%
- Money: 30%
- Challenge: 28%
The American Age of Affluence

Labor participation rate ages 55-64 rising

Percentage of men in labor force age 55-64

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The American Age of Affluence

*The Gray Wave: The Way We Were*

- House
- Car
- Clothing

*The Gray Wave: The Way We Are Now*

- Quality vs. Quantity
- Intangibles vs. Tangibles
- Time vs. Money
The American Age of Affluence

Quality vs Quantity

Quantity of goods Americans plan to buy

<table>
<thead>
<tr>
<th></th>
<th>July 2000</th>
<th>Feb 2001*</th>
</tr>
</thead>
<tbody>
<tr>
<td>More</td>
<td>20%</td>
<td>37%</td>
</tr>
<tr>
<td>Less</td>
<td>20%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Quality of goods Americans plan to buy

<table>
<thead>
<tr>
<th></th>
<th>July 2000</th>
<th>Feb 2001*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher</td>
<td>23%</td>
<td>27%</td>
</tr>
<tr>
<td>Lower</td>
<td>4%</td>
<td>2%</td>
</tr>
</tbody>
</table>

*given improved economic conditions
The American Age of Affluence

Intangibles vs. Tangibles

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

The American Age of Affluence

Time vs. Money

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


Percent of Americans saying lack of time is a bigger problem than lack of money
The American Age of Affluence

“When things get better…”

What will you do?

<table>
<thead>
<tr>
<th></th>
<th>Buy New Home</th>
<th>Buy New Car</th>
<th>Spend More on Clothes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>80%</td>
<td>65%</td>
<td>67%</td>
</tr>
<tr>
<td>No</td>
<td>19%</td>
<td>34%</td>
<td>33%</td>
</tr>
</tbody>
</table>

I will spend more/less on...

<table>
<thead>
<tr>
<th>Product Category</th>
<th>More</th>
<th>Less</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Products</td>
<td>39%</td>
<td>11%</td>
</tr>
<tr>
<td>Superstore</td>
<td>34%</td>
<td>8%</td>
</tr>
<tr>
<td>Dept. Store</td>
<td>27%</td>
<td>12%</td>
</tr>
<tr>
<td>Discounter</td>
<td>23%</td>
<td>15%</td>
</tr>
<tr>
<td>Clothes</td>
<td>21%</td>
<td>21%</td>
</tr>
</tbody>
</table>

I will spend more/less on...

<table>
<thead>
<tr>
<th>Category</th>
<th>More</th>
<th>Less</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vacations</td>
<td>46%</td>
<td>12%</td>
</tr>
<tr>
<td>Restaurants</td>
<td>23%</td>
<td>14%</td>
</tr>
<tr>
<td>Movies</td>
<td>16%</td>
<td>19%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category</th>
<th>More</th>
<th>Less</th>
</tr>
</thead>
<tbody>
<tr>
<td>PC</td>
<td>21%</td>
<td>10%</td>
</tr>
<tr>
<td>DVD</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>TV</td>
<td>14%</td>
<td>16%</td>
</tr>
</tbody>
</table>
A Grayer and Gloomier Consumer

The Case for the Consumer as presented in 2003
Grayer & Gloomier

Grayer

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

G7 Demographics
% change by age population 2000–10

Source: US Census Bureau
The "misery index"—unemployment + inflation— is at highest level in four years and is 220 basis points above its 1999 trough of 6.0%.
Grayer & Gloomier

Grayer

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

<table>
<thead>
<tr>
<th>Growth in Age Cohorts</th>
<th>Household Income Level, 2001 Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over the Next Five and 10 Years</td>
<td>By Head-of-Household Age Cohort</td>
</tr>
</tbody>
</table>

Source: US Census Bureau  
Source: Bureau of Labor Statistics, Consumer Expenditure Survey

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Housing benefits: Immigrants’ homeownership rate is initially low compared to native-borns’. However, it increases sharply over time.
Grayer & Gloomier

Non-Durables Poorly Positioned

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

How Much More or Less Households Aged 55-64 Spend Versus Households Aged 45-54

- Total: -13.5%
- Food: -15.6%
- Food Away from home: -21.1%
- Apparel: -32.6%

Source: Bureau of Labor Statistics, Consumer Expenditure Survey
Food and beverage firms are poorly positioned as population growth slows in developed countries, boomers fight obesity, and processed foods lose share to fresh food. Cosmetic and personal care benefit.
Increasingly unequal income distribution is positive for companies catering to the affluent and those serving low-income families. Firms in the "mediocre middle" are likely to get squeezed.

Change in Aggregate Income Claimed by Income Groups

- Lowest 20% (under $24,000)
- Second 20% ($24,000-41,127)
- Middle 20% ($41,127-62,500)
- Fourth 20% ($62,500-94,150)
- Top 20% ($over 94,150)
- Top 5% (over $164,104)

Source: US Census Bureau

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The case for savings

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

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

![Graph showing healthcare expenditure as a percentage of GDP](source: Centers for Medicare & Medicaid Services)

![Bar chart showing out-of-pocket expenditures for healthcare by category](source: E. Kerschner)
Rotating Drivers of the Economy

- **1940-52**: WWII government military spending propels economy out of depression.
- **1952-60**: Corporations restructure from war-time footing, prosper while Eisenhower reins in government and consumer is hurt by frequent recessions.
- **1960-67**: Strong consumer spending propels rapid growth.
- **1982-87**: Consumer boosted by tax cuts, lower inflation. Corporations hurt by disinflation, strong dollar, foreign competition; Reagan shrinks government.
- **1995-01**: Consumers benefit from rising real wages, strong dollar, strong stock market. Consumption share of GDP rises.
- **2002-??**: Government and/or Industry drive growth.