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INVESTMENT MANAGEMENT

# *As We See It*

> "We have a small generation, followed by an extremely large one, followed by another relatively small generation. This is a demographic aberration, and it is guaranteed to have profound effects. It will cause fluctuations in the values of the things we buy or hold."
>
> David Cork, *The Pig and the Python*

It is generally recognized that this has been the greatest bull market of all time. As the market has risen, one by one all of the traditional measures marking past market extremes have been exceeded. This development has prompted considerable discussion about the dynamics that have driven this market and their sustainability.

Some pundits suggest we are in a *new era*. They propose that America's sterling economic performance will continue indefinitely and, therefore, stocks will continue to generate superior long-term returns. The new economic and investment paradigm is generally justified by dynamics such as demographics, improved productivity, or expanded world markets. This *As We See It* focuses on demographics while future issues will address productivity and expanding world markets.

Baby Boomers – the roughly 80 million people born from 1946 through 1964 – have had a notable impact on the economy as this population bulge has moved through the demographic *snake*. As infants, they spurred baby food and toy sales. As adolescents, they placed considerable stress on the educational system and turned textbook publishers into growth stocks. As young adults during the 1970s, they set off a housing and borrowing boom. Their inexperience in the workplace led to productivity stagnation, inflation, and deterioration in real wages. Now, with the Boomers graying, they have, in contrast, become increasingly experienced and productive in their work, resulting in lower inflation and rising real wages. In turn, the stock market, not housing, is now the beneficiary of their savings. In fact, today, economists note that equity holdings actually exceed real estate holdings for U. S. households – an unprecedented occurrence.

Demographers normally categorize the population in ten-year segments. Within those segments, people aged 45-54 earn the highest incomes and save at the highest rates. It is this segment of the population that is growing the most rapidly as the oldest of the boomers is now 52. The Census Bureau projects that by 2008, when this group reaches its peak, it will have increased by 9.7 million over today's level. If they mimic prior 45-54 age groups, they will place an increasing amount of their savings in the stock market over the next ten years. As evidence of this trend, the public has been most willing to allocate more of their savings to the stock market in recent years. Stocks as a percentage of household financial assets have risen from 12% in 1982, just before the bull market began, to more than 38% recently. The ratio could certainly continue its upward trend, but it would be unrealistic to expect a repeat in magnitude.

Baby Boomers certainly have ample reason to save and invest for their own retirement. One reason is because most of the Boomers cannot participate in pensions that have *defined benefits* – a category of retirement benefits that is quickly becoming extinct. Recently, retirees participating in a survey conducted by *Business Week/Harris Poll* indicated they receive more than one-third of their retirement income from employee sponsored plans. Those participants that were not retired expected only a little more than a quarter of their retirement income will be from employer's plans. Another incentive to save and invest is that there is some question whether Social Security will measure up in the way it did for previous generations. Moreover, an ever-increasing life expectancy adds to the need for more savings to support a longer retirement period. Currently, because of past success produced by unprecedented returns, a larger and larger segment of Boomers seems to think using more stocks represents a better way to save toward their retirement goals. This sentiment is clearly expressed in the *Business Week/Harris Poll*. Although the group 45 years and older, but not retired, expect double-digit returns from cash-like investments, they also expect far superior returns from stocks.

Demographics is a very important consideration for investors. The Baby Boom generation is so large that their saving and investing patterns will have critical influence on the direction and level of the stock, bond, and real estate markets. One projection predicts the current $13 trillion value of U. S. stock markets could nearly triple by 2012. In the end, economic fundamentals and sentiment will govern the direction in which savings are invested. If their savings continue to flow into the stock market, market valuations could go to even greater extremes.

June, 1998