Economic Insights

Will Baby Boomers Bust the Markets?

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Worries that large-scale liquidation of investments by retiring baby boomers will pressure financial markets are overstated. Here's why.

The usual suspects have issued a dire warning: the baby-boom generation is retiring; markets are vulnerable. It sounds plausible. Financial advisors can see their older clients liquidating investments to support their retirement needs. The expectation of such events on a larger scale leads many to feel this fear. But if this story, like so many other scare stories, harbors a kernel of truth, this heavily publicized worry is vastly overstated.

The Basis for Fear

The broad demographic picture certainly is capable of raising anxiety. According to the Bureau of the Census, low birth rates will continue to slow the flow of young people into the workforce, while increasing longevity will enlarge the proportion of dependent retirees. The number of working-age people will fall, from an already low 5.2 for each retiree today to barely 3.3 by 2030.[1] Since retirees tend to draw on pensions and their own savings to support themselves after they have left off active production, these demographic patterns naturally raise fears of net liquidations in financial markets and so, consequently, downward price pressure, especially since the relative shortfall of the working-age in the population means that the nation will also have proportionally fewer people saving, contributing to pension plans, and generally replenishing the pool of investable assets. But while this demographic picture leaves reason for many longer-term economic and financial concerns and will force many changes in this economy and its markets, at least four points raise doubts about these particular, immediate, market concerns.

No Reason for Panic about the Pace of the Drawdown

First, the changing demographics will alter retirees' investment strategies. Decades ago, people had to support five, maybe 10 years of retirement. All but the wealthiest converted assets, largely to bonds, as the retirement date approached and then drew down a significant part of that asset base each year. But today, when people can contemplate 20 or more years of retirement, such past practices no longer seem so wise. Retirees will draw down on their asset base much more slowly than their fathers and mothers did in retirement. The newer retirees will strive to protect the principal of their investment base much more carefully. Indeed, their planning horizon is so long that they will tend to keep much more of their portfolio in equities for longer than once was the case.

Second, the changing nature of the investment industry further suggests that funds will move much less dramatically than is generally expected. As financial advisors shift increasingly toward a fee-based instead of a transaction-based business model, they will become less eager certainly than they once were to move assets about. Registered investment advisors, already 25% of the nation's wealth-management business and growing fast, are almost all fee-based. Even the wire houses, once the center of transaction-based brokerage, are moving toward the fee-based model. Morgan Stanley Wealth Management, the nation's largest, reports 37% of its assets are fee-based. Bank of America's Merrill Lynch reports 44% and Wells-Fargo 27%. The proportions are growing, too, even as the overall dollar amounts rise.

Third, pension funds are less likely to liquidate, too. Indeed, they face legal restraints that should prevent much of a drawdown in assets. All pension funds (Social Security excepted), even those run by state and local governments, must by regulation maintain an acceptable level of funding. If contributions from the existing workforce cannot support that level, then the sponsor of the fund must direct other revenues toward it. Corporations will have to channel revenues toward pension investments, and public authorities will have to direct tax monies to their funds, effectively putting funds into financial markets to supplement any shortfall.[2]

Still Less Reason to Panic Now

Fourth, any impact will face delay. Although the long post–World War II baby boom is indeed beginning to retire, the biggest birth years of that boom came toward its end, between 1958 and 1961. The birth rate figures of the time tell the story. At the beginning of the baby boom in the late 1940s, the birth rate was just over three children in the average woman's lifetime. That figure rose throughout much of the 1950s, and by 1957 it had reached 3.7, a gain of about 20%. The rate stayed at that high level until 1961, when it began its long decline. As a consequence, the bulk of the baby boom is not retiring now or anytime soon. Rather, it has enlarged the part of the population in its fifties, an age well recognized as the highest earning and highest saving period in a person's lifetime. Even as the beginning of the baby boom is retiring, then, the bulk of it is earning, saving, building up pension assets, and more than offsetting any drawdown from the older, smaller, retiring part. These people will not reach normal retirement age until 2022–23, and they will not likely begin their drawdown until later, suggesting that any real problems are eight to 10 years off, at least—time enough for advisors to shift portfolio strategy, if necessary, and time enough for many other things to change.[3]

A Last Word

This less frightening picture does not ignore the ill effects of the demographic trends. It recognizes the very real and detrimental financial and economic impact from the growing mismatch between dependent retirees on the one hand and taxpaying, saving, pension-contributing producers on the other. This fact of life in the United States will weigh heavily in coming years and force dramatic change in business practice, production emphasis, and public policy, as an earlier series in this space described. But the panic over the immediate market impact is misplaced and sadly typical of those who prefer drama to probability.

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[1] Milton Ezrati, *Thirty Tomorrows* (Thomas Dunne Books/St. Martin's Press, 2014).
[2] Joshua Brown, "The Quiet Takeover that Keeps Stocks Moving Up No Matter What," *Business Insider,* March 5, 2014.
[3] Data from the Department of Commerce.

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