Adjusting to Demographic Reality

I ran in a local 5K race over the weekend.

As the assorted participants milled around at the start, I noticed just how many of them looked on the young side. But this happens more often these days - every year there are more runners younger than me and fewer that are older. And so I huffed and puffed my way around the course, breathing in the dust kicked up by the heels of some young teenager in front of me. I have had to adjust both my expectations and my strategy to my personal demographic reality.

Demographics are reshaping the economic landscape also, requiring a similar adjustment in expectations and strategy for investors.

The week ahead will be dominated by nearer-term concerns. There will be a particular focus on the European parliament elections where more nationalistic, populist parties appear likely to make gains and further complicate Britain’s Brexit dilemma. There will also be economic data, including, we think, a relatively weak report on Durable Goods Orders and mediocre numbers on New and Existing Home Sales.

However, for long-term investors, demographic trends may prove to be more important.

Last week, the Centers for Disease Control announced that fewer than 3.8 million babies were born in the U.S. in 2018 - down 2% from a year earlier and the lowest total in 32 years. Due to this, in an environment of falling immigration and steady mortality, the overall U.S. population grew just 0.6% in 2018. This compares to 0.9% growth a decade ago, 1.2% growth in the mid-1990s and nearly 2% per year in the 1950s and early 1960s.

While this slower population growth poses a challenge to American business and, by implication, American investors, it is by no means a clear negative for society as a whole.

First, it should be recognized that the best measure of the change in economic welfare is not the growth in overall GDP but the growth in GDP per person. This being the case, 2.5% growth today implies a stronger gain in living standards than 3% growth, 20 years ago.
Second, by later on this year, the U.S. population will surpass 330 million. No one stuck in traffic today or flying over the urban sprawl of our major cities would claim that America’s biggest problem is too few people. For the sake of the environment and our own quality of life, Americans, and humans in general, would be better served by zero population growth.

However, the slowdown in population growth poses particular economic challenges and, to the extent that they are not being addressed by policy-makers, they will have investment consequences.

First, it is important to recognize that not only is population growth slowing - it is slowing in a way that is particularly awkward for the economy. The baby boom saw U.S. births exceed 4 million for eleven consecutive years between 1954 and 1964, a record that has still not been surpassed, even with today’s much larger overall population. Because of this, as baby boomers retire, there is a particular shortage of working-age Americans with the population between ages 18 and 64 currently growing by less than 0.3% per year, a trend that should persist throughout the 2020s.

Given this, as a nation, we should probably be having a serious conversation about temporarily boosting, rather than reducing, immigration, at least while the baby boom is retiring. This would allow us to supply the economy with extra workers to match the inevitably swelling number of dependents.

According to the Census Bureau, in 2017, 79% of the immigrant population of the U.S. was aged between 18 and 64 compared to 59% of the native-born population. Moreover, this statistic understates the degree to which immigrants arrive in their working years since it includes those who immigrated to the United States years ago and are now above the age of 65. Immigration is overwhelmingly about the arrival of workers in the United States.

Second, given the very high probability that policymakers will not seek to boost immigration in the near term, we should not boost demand in the economy beyond the economy’s capacity to supply. Overly expansionary fiscal and monetary stimulus in an attempt to sustain 3% real GDP growth is much more likely to foster destabilizing asset bubbles than achieve its stated objective.

Third, given slow growth in domestic markets, policy-makers should work to reduce both trade barriers and the level of the dollar to help U.S. businesses access faster-growing markets overseas.

For investors, it is important to recognize that a slower-growing economy is one that should produce both lower bond yields and slower earnings growth. Consequently, they should not expect the kind of investment returns they have achieved in recent decades.

Second, they should appreciate that, in a nation of slower population growth, home-building and auto sales will not be the boom industries that they typically have been in a strong economy in the past. More likely, particularly if the current economic expansion is sustained for some more years, there will be an ever-increasing proliferation of AI and robotics in the economy to compensate for a lack of workers.

Finally, in investment strategy, a plain vanilla strategy of betting on strong U.S. growth overall is likely to produce disappointing results. To achieve better returns in the long run, investors will have a greater need to find selective winners in an evolving U.S. economy and take advantage of faster growth overseas, particularly in emerging markets that face less of a demographic challenge.

In a financial environment that is always bubbling over with uncertainties, demographics are a relatively stable and predictable force. That is why, before making large speculative bets on nearly random future events, investors should make sure they are at least appropriately positioned for America’s demographic reality.
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