



FORECASTS & TRENDS

Gary D. Halbert's Weekly E-Letter

Gary Halbert's Weekly E-Letter
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Will The Baby Boomers Wreck The Market?

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Introduction

Like the juggernaut it is, the Baby Boom generation has exerted considerable influence on the American socio-economic landscape, and even the global economy, since its humble beginning back in 1946. Having been born toward the middle of the baby boom (1952), I have been fortunate to not only observe the effects of my generation, but also participate in them.

From a stock market and investment perspective, many books have been written, and continue to be written, about how to profit from the next big consumption trends that Boomers are likely to pursue. With this huge number of well identified consumers within a fixed age range, I'm sure millions have been made (and lost) making bets on what market sectors will be most affected by Boomers. (Hint: some of the latest hot Boomer sectors are health care, travel and recreation, financial services and even entertainment technology such as cutting edge communication, audio and video equipment.)

Thus far, most of the effects of the Baby Boom generation have been extremely positive, particularly when it comes to the economy. Over the past 25 years, we have seen the strongest economic growth in modern history, thanks in large part to robust consumer spending, with only two recessions. However, all of the potential Boomer effects on society may not always be as positive, and some predictions of future economic and investment scenarios are downright scary.

One such scenario was promoted by Harry Dent in his 1998 book, *The Roaring 2000s*, in which he

predicted the stock market would boom until around 2010, and then a severe depression and bear market would set in as Boomers cash out investments and reign in spending.

In this week's E-Letter, I'm going to take a look at some of the prevailing views on the effects Baby Boomers will have on the economy and the markets over the next 5-10 years. I'll also highlight some other issues that we might want to keep in mind when considering how the Boomers might affect our investments.

Whatever happens, it's a very interesting and hotly debated topic, so let's get started.

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Background -- A Few Statistics

As most of you already know, the Baby Boom generation is made up of those born in the years 1946 through 1964, and accounts for something over 78 million people according to the US Census Bureau. At present, Boomers represent about 28% of the US population. Yet back in 1964, Boomers represented a whopping 40% of the population. Put another way, in 1964 over one-third of the population was under the age of 19.

A few other interesting facts about Baby Boomers compiled by the US Census Department include the following:

- * In the year 2030, Baby Boomers will be between the ages of 66 and 84, resulting in the greatest demand on Social Security and health care.
- * During the early years of the Baby Boom, the ratio of workers to beneficiaries was 16. In 2031, it is estimated that there will be only 2.1 workers for each Social Security beneficiary.
- * Baby Boomers vote! In the 2000 election, the US Census Bureau reports that 59% of all Baby Boomers voted, with older Boomers being more likely to vote than younger ones. Boomers over age 55 had a voter turnout of over 70%.
- * Baby Boomers have a higher level of education than any previous generation.

* The Baby Boom is generally believed to be a one-time event. It was anticipated that another sudden increase in births would occur once Boomers were old enough to have families, creating a second Baby Boom. While births did begin increasing in the late 1970s, the progression has been much slower than during the Baby Boom generation. This might be attributable to the availability of effective birth control and the tendency of Baby Boomers to wait longer to have children.

Boomers Are Closing In On Retirement

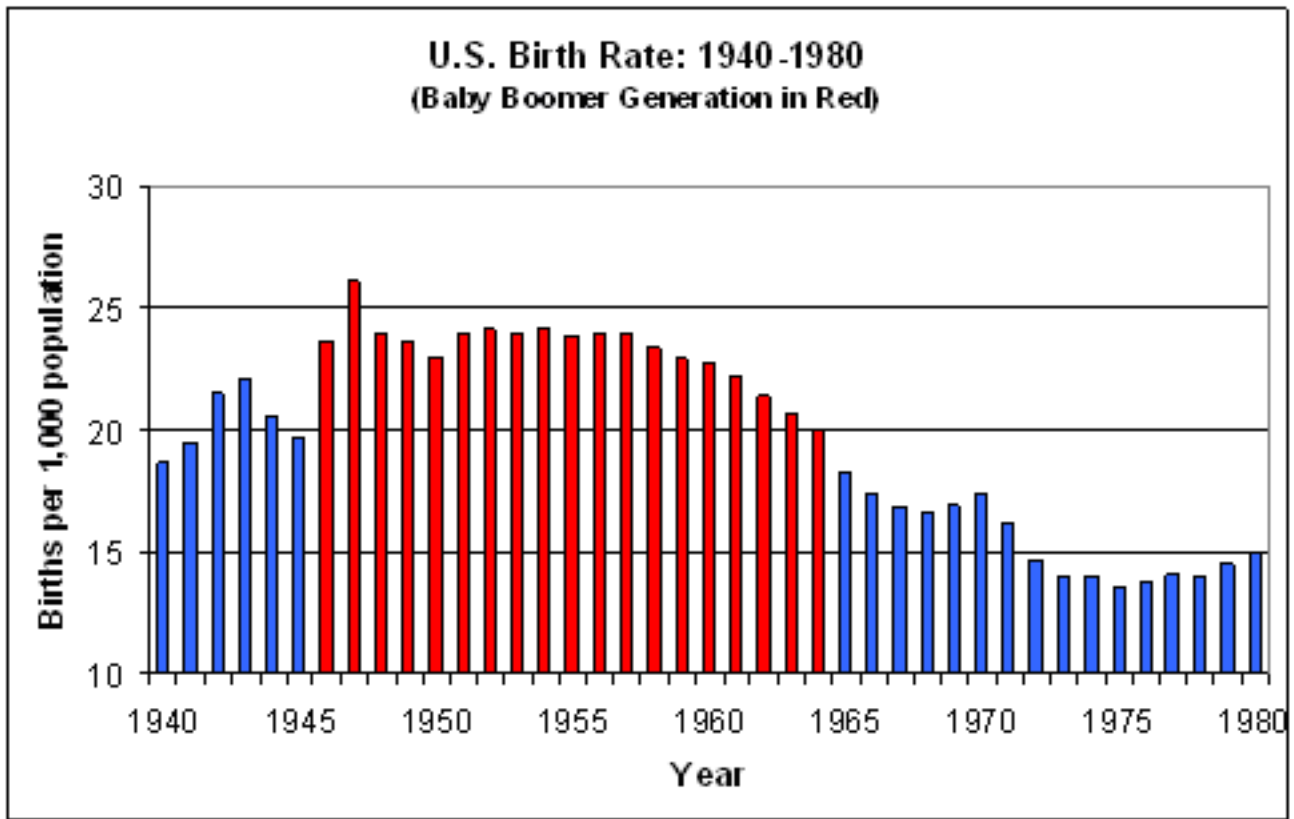
The Boomers born in 1964 will reach the age of 42 this year, and the oldest Boomers are turning 60. In just two more years, the oldest Boomers will be eligible for early retirement under Social Security, possibly ushering in the beginning of the end of the Social Security "trust fund," which is not made up of real funds nor can it be trusted, but that's another story.

With a Boomer turning age 60 every 10 seconds or so (apprx. 7,918 Boomers reach age 60 each day in 2006), the distribution of this population is of some importance when trying to estimate its effect on not only Social Security, but also on investments, insurance and other financial assets.

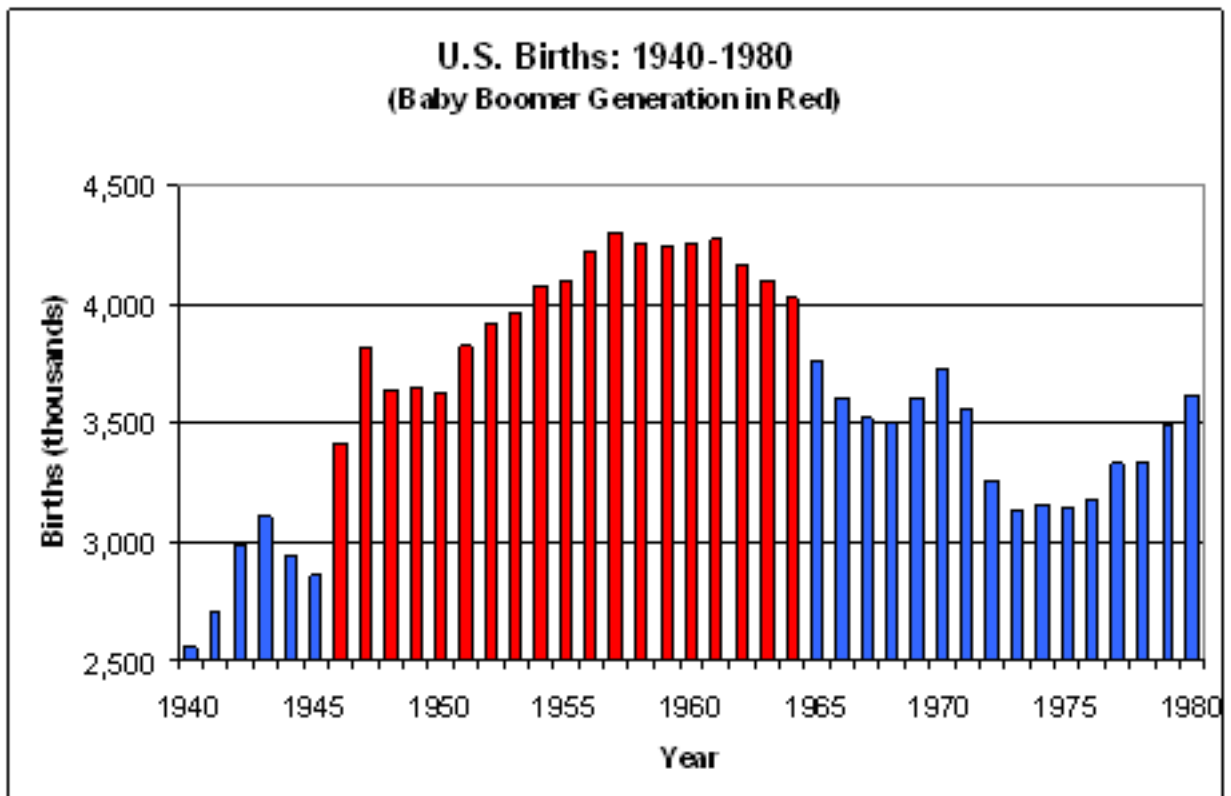
I have attended a number of presentations that focused on the Baby Boom generation and have read many articles on the subject. It is interesting that some claim the Baby Boom generation is "front-loaded," meaning that the bulk of the births occurred early in the 1946-1964 period. Others, however, claim it is "back-loaded," suggesting that most of the births occurred in the late 50s and early 60s. Whether it is front-loaded or back-loaded is important in that this demographic determines retirement trends, and thus possible effects on the health care system, insurance actuarial data, etc., etc., not to mention potential market and investment implications.

Faced with contradicting claims, I reviewed the relevant Census Bureau data. From that review, it's clear that both arguments have a degree of validity and can be used depending on one's point of view. For example, I found that the **birth rate** (number of births per thousand population) was front loaded, but the actual number of **births** is back-loaded. Thus, from an absolute numbers perspective, **more Boomers were born toward the end of the Baby Boom generation than at the beginning, with the highest number of births (4.3 million) being recorded in 1957.**

The distinction between these two numbers is important to my stock market discussion later on, so I have included a couple of graphs below to illustrate the difference. The graph immediately below shows the birth rate per thousand population. You will note that this rate is significantly higher in the early years of the Baby Boom generation than in later years. However, this says nothing of the absolute numbers of births.



In contrast, the next graph shows how the actual number of births were distributed between 1946 and 1964. It is clear from this graph that there were far more births in the last half of the Baby Boom generation than in the first half. This fact has all sorts of implications not only on the demands placed on Social Security in the years to come but also for investments.



As a practical matter, the birth rate is somewhat meaningless when trying to determine the effects of Boomers on Social Security and investments. Trends are based on the actual number of people in a given population. So, if you hear someone trying to convince you to buy their investment because most Boomers will reach retirement age in the next few years, don't believe them.

Prophets Of Doom

Back in the 1990s and since then, one of the most prolific forecasters about the economic effects of the Baby Boom generation was Harry Dent, author of *The Great Boom Ahead* (1992), *The Roaring 2000s* (1998), *The Roaring 2000s Investor* (2000), and most recently, *The Next Great Bubble Boom: How to Profit from the Greatest Boom in History, 2005-2009* (2004). He is perhaps most famous for accurately predicting in 1992 that the Dow Jones Industrial Average would hit 10,000 by the year 2000. It did, and supposedly his speaking opportunities (and fees) immediately went up.

Other predictions, however, have not panned out as well for Mr. Dent. For instance, he did not predict the bear market of 2000 - 2002. In addition, you may recall that in *The Great Boom Ahead*, he predicted the Dow would be at 44,000 by the year 2008. In later books, Dent moderated this prediction, reducing the 2008 target to 21,500 to 35,000. In 2005, however, he again went on record calling for another bubble to take the Dow to 40,000 by the year 2010.

Granted, we're not yet in 2008 or 2010, but if the Dow is going to get from its current level to anywhere near 40,000, it has a long, hard mountain to climb. Even so, Dent sticks by his predictions because they are based on demographic data, and more specifically, anticipated spending patterns of Baby Boomers.

However, what Dent says about what happens before 2010 is not as significant as what he says about what happens after that date. **He predicts that a 12 to 14 year bear market and depression (that's right, depression, with a D) will ensue.** Ouch! In my opinion, this puts him among the biggest gloom-and-doomers of all time.

Dent is not alone in calling for bad times as Boomers retire. Jeremy Siegel, a Wharton finance professor and author of a bullish book entitled *Stocks for the Long Run* agrees with Dent, at least as far as the negative effects of Boomer retirement. He suggests that stocks and other assets could plunge as much as 50%! Siegel is joined in this pessimistic outlook by fellow Wharton professor, Andrew B. Abel, who has developed a computer model that predicts stock prices falling as Baby Boomers retire.

What makes Dent, Siegel, Abel and others so pessimistic? Yep, it's that pesky old Boomer demography, and the resulting effects on supply and demand. As with forecasts for a surging economy and stock market as Boomers enjoy their peak earnings years, their predictions for a bear market and depression are also based on Boomer spending patterns. Their economic theory goes that, as Boomers retire, they will need to start reigning in their spending. They will no longer be buying second homes and high-tech toys. Instead, they will be shelling out for health care and hanging on to their principal, hoping it doesn't expire before they do.

Likewise, their argument for a bear market says that the demand for financial assets will wane as Boomers cash out some of the trillions of accumulated retirement money to cover everyday living expenses. They also expect pension funds to be net sellers of financial assets as they are required to liquidate assets to pay out monthly benefits. Their conclusion is that, as more Boomers retire, the increased supply of financial assets on the market coupled with reduced demand from a smaller younger population could

result in lower asset prices.

While it's tempting to dismiss these predictions of a depression and market meltdown, I do have to admit that some of the ideas do seem to make logical sense. After all, it has been well documented that many Baby Boomers haven't saved up enough for retirement, and many of those that did save and invest saw their assets decimated by the 2000 - 2002 bear market.

Thus, considering the falling number of retirees who will have guaranteed "pension" plans, more and more will have to manage their 401(k) and IRA balances to provide income during their golden years. This, according to the "experts," will not only result in less spending, but also in a mass move to more conservative investments, creating the mother of all bear markets.

In short, their predictions do not paint a very pretty picture.

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Alternative Viewpoints

As I noted in the introduction, not everyone believes that Baby Boomer retirement will lead to a bear market and economic chaos. One such individual is MIT professor James Poterba, who has authored an academic working paper entitled "*The Impact of Population Aging on the Financial Markets.*"

Poterba analyzed year-to-year stock market returns from 1926 to 2003, and compared them to the annual changes in a number of demographic indicators. He found little evidence of demographics affecting stock market returns. Poterba concluded that there are a variety of factors that may influence Boomers to keep money invested in equities. Among these are the need to preserve savings in case they live longer than expected, which he terms "**lifetime uncertainty**," and the desire to leave assets to heirs, which he calls the "**bequest motive**."

Others who question the premise that a reduction in the demand for stocks will tank the market argue that there are many influences other than demographics on the prices of stocks. For example, Milton Ezrati, Partner and Senior Economic and Market Strategist for Lord, Abnett & Co. LLC, notes that if demographics were the only consideration, the stock market should not have plunged during 2000 - 2002.

He has a good point. Baby Boomers started turning age 50 in 1996, and this is the age at which many individuals are at their peak in earnings and savings. As years went by, more and more Boomers reached the age 50 milestone, so by 2000 the demand for stocks should have been huge. Yet, other factors such as the bursting of the tech bubble drove the market down harder than at any time since the Crash of 1929.

Before leaving the issue of demographics, however, it is important to note that not even the demographics support a market meltdown in 2008 - 2010. While it is true that the oldest of the Baby Boom generation will reach age 62 in 2008, the charts discussed above show that this number is much smaller than the number of Boomers who will reach age 50 at that time, and will continue to do so through 2014 when the youngest Boomers reach that age.

With this large number of individuals reaching the period of their lives when earnings are highest and saving is more important (age 50 - 64), it doesn't make much sense to assume the stock market will take a dive. In fact, the US Census Bureau estimates that it will not be until 2030 that retirees outnumber those in their peak savings and investing years.

Likewise, there is no guarantee that even those Boomers reaching retirement age will automatically shift all of their investments away from equities. Because a number of Boomers have not put enough away for retirement, and many are worried about outliving their money, it is likely that they will keep a significant portion of their portfolio in equities in order to continue to build up their nest eggs.

Boomers, as a whole, are more familiar with investments than any previous generation. That means they may be more likely to consult a professional or seek out advice in publications or on the Internet to help them allocate their portfolio. If that is the case, I don't know of many asset allocation programs that completely exclude equities in retirement portfolios. That's likely because most professional money managers know that bond prices can be just as volatile as those of equities, and sometimes even more so.

There are a number of other reasons to believe that the stock markets will not start melting down in 2008, or even 2010. To conserve space, I'll simply provide a brief discussion of these additional ideas below:

1. As noted above, there are many Baby Boomers who have not saved enough for retirement. As a result, these individuals are expected to delay their retirement while continuing to work, save and invest. In addition, the Social Security retirement age may be increased in the future to help shore up that program's solvency. Either or both of these could have the effect of increasing the overall saving and investing years of Baby Boomers, thus delaying any mass move to conservative investments.
2. Some writers have suggested that as the WWII generation dies out, they will bequeath a tremendous amount of wealth to Baby Boomers. This, in turn, could create a higher demand for equity investments during the period of time that the Boomers are retiring.

On a related note, AARP has produced a study that indicates that the average Boomer may not reap an inheritance large enough to enhance his or her retirement security. John Gist, associate director of AARP's Public Policy Institute stated, "**The harsh reality is that for all but the lucky few, an inheritance is a pipedream.**"

While at first it may appear that this study contradicts the idea that inherited assets may flow into the stock market, just the opposite is true. That's because the study also shows that larger

inheritances will tend to go to those who are already wealthy and whose retirement is already secure. That being the case, it is likely that any inherited wealth will be invested rather than liquidated for retirement purposes.

3. When analyzing population data, one variable that cannot be accurately estimated is the number of immigrants that may come to the US to fill jobs formerly held by Boomers. These workers may not only fill the employment void, but also become a source of replacement investment demand as they participate in 401(k) plans and invest their savings.
4. Demographic data also does not factor in any effects of foreign investment. While we know that Japan and Europe have more pronounced aging problems than the US, many Asian countries do not. Should the retirement of Boomers start to have a negative effect on US stock markets, foreign capital may flow in to snatch up what they consider to be bargains. Of course, this is another factor that is impossible to predict, but does have the potential to counteract any negative US demographic trends.

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Conclusions

While I'm sure there are other arguments for and against a Boomer-caused market meltdown, I think you can see from those listed above that there is hardly agreement on the subject. In fact, if I had to say there was a consensus among the experts, it would probably be that there is no consensus about what will happen when the Baby Boom generation retires.

The difficulty in making economic predictions based on Boomer demographic data can be illustrated by the example of two Harvard economists back in the 1980s. In a paper entitled "*The Baby Boom, The Baby Bust, and the Housing Market*," N. Gregory Mankiw and David N. Weil predicted that real estate prices would fall once Baby Boomers had purchased homes, since this would lead to a reduction in housing demand. However, we know now that demand did not decrease, and just the opposite has occurred. Real estate prices are higher now than ever.

A similar scenario could lie ahead for the economy and the stock markets over the next several years. The **Bank Credit Analyst** certainly seems to think so. Put differently, the gloom-and-doom crowd, that would have us believe the Baby Boomers are going to wreck the equity markets in 2010 or so by unloading stocks and mutual funds by the truckloads, may very well be wrong yet again (what else is new?). Here are just a few of the important reasons why.

1. Most Baby Boomers have not saved enough for retirement, so many will have to keep working, saving and investing beyond age 65. There is also no question in my opinion that the Social Security retirement age will have to be adjusted upward again in the near future and in subsequent years.
2. Due to back-loading, the number of Boomers eligible for early retirement in 2008 - 2010 is far smaller than the number who will reach their peak earnings and savings years at that time. Until this trend reverses some years later, there should be a higher demand for equity investments than for liquidity.
3. Even those Boomers who are able to retire are not likely to liquidate all of their investments and sock the money away in CDs and other "safe" assets. Faced with the possibility of outliving their money due to increased life expectancy, I believe most will continue to hold a significant percentage of their assets in equity investments. The same goes for pension funds that must meet their promise to make continued monthly benefit payments.

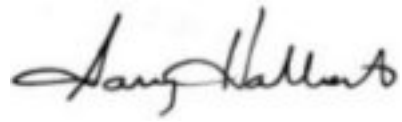
A closer look at demographic trends, as we've seen in this article, suggests that Boomer demand for equities is likely to continue to remain high well beyond 2008-2010, the period when many gloom-and-doomers seem to think the stock markets will go over a cliff. Remember, the gloom-and-doom crowd is always playing to your emotions of fear and greed. So my advice is to take such warnings with a grain of salt.

Just like the real estate markets continued to rise to new highs even after most Baby Boomers had purchased homes and property, the stock markets could also surprise on the upside in the years ahead. If so, the gloom-and-doomers will be wrong once again, especially when it comes to a Boomer-driven market meltdown.

Having said all of that, I would be remiss not to remind all of us that there are numerous risks - aside from the Baby Boomer demographics - that could derail the equity markets and most investments in general in

the years just ahead, in fact at most any time. These issues include terrorism, global uncertainty, geopolitical factors, soaring oil prices, war, the threat of nuclear proliferation, government deficits, etc., etc. These and other threats to come are probably more likely to have a negative effect on your investments within the next five years or so than Boomer demographics.

Best regards,



Gary D. Halbert

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