

Why Old People Still Matter

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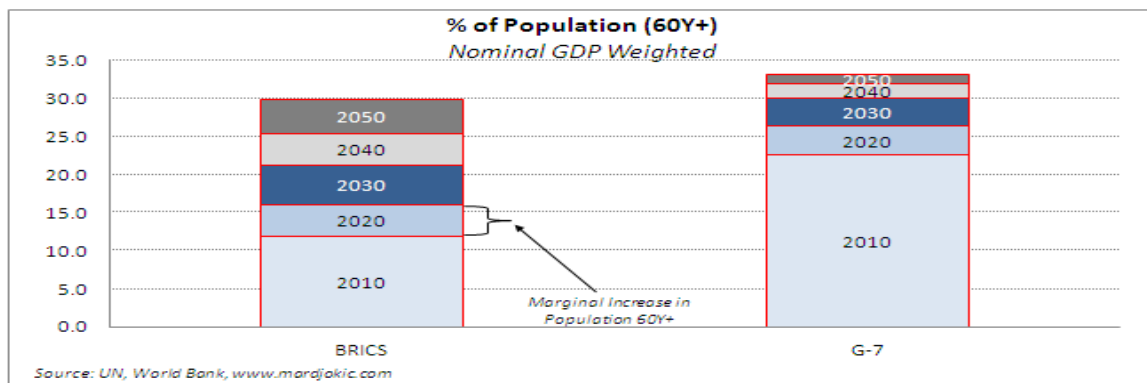
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For decades, countries around the world have been able to ride their demographic trends toward higher GDP, yet these same favorable trends have started to crest and many will soon begin to experience them, not as convenient tailwinds, but rather formidable headwinds.

Current trajectories are calling for an aging and protracted global population that will put strain on our infrastructure, resources, and ultimately our capital markets. While not all economies are headed there at the same time, we will all inevitably “run a-ground”. And whilst today there exists a sizable gap between the BRIC economies (notably India and Brazil) and the G-7, eventually this arb goes away.

Median Age (in years)											
	BRICS				G-7						
	BRAZIL	RUSSIA	CHINA	INDIA	US	JAPAN	FRANCE	ITALY	GERMANY	UK	CANADA
2010	29	38	35	25	37	45	40	43	44	40	40
2020	33	40	38	28	38	49	41	47	48	41	42
2040	39	47	46	31	40	55	43	52	52	43	45

Source: UN



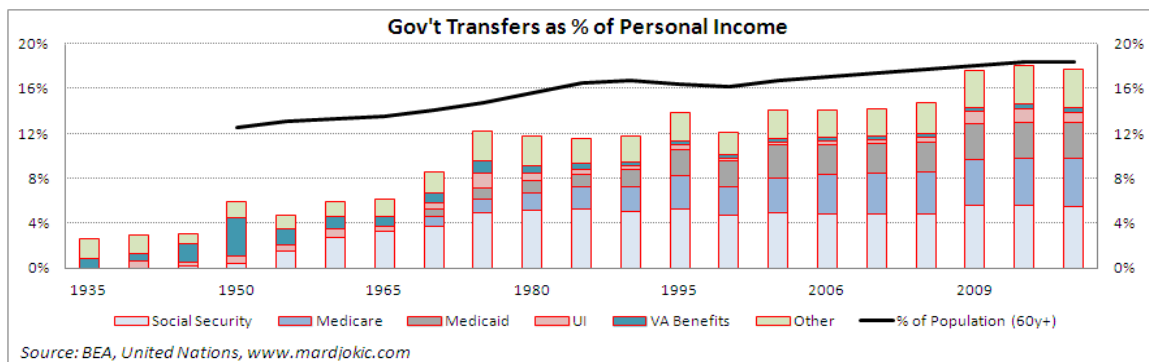
As asset allocators figuring out these structural trends will bear fruit. In equity markets for instance, growth is a quintessential piece of the valuation framework and an aging population is a huge drag on growth. The most immediate impact is on consumption: not only the absolute level but the industries in which they are spent. (Think quality of life industries like pharmaceuticals and personal care products).

Capital markets will be further impacted as an aging population will throw off the traditional balance between supply and demand. The argument is fairly simple but

undeniably logical. If traditional portfolio theory holds we should retirees throttle back their risk exposure and shift demand from risky assets (like equity) to safe haven, income producing assets (like fixed income). This increasing demand for fixed income assets will put pressure on equities while supporting bond rates. In one hand we have a powerful retail trend paired with a strong bid from institutions under the captive capital doctrine so my question to you is: are low(er) interest rates here to stay? For me, the demand side arguments are simply too convincing to ignore.

An aging and protracted population also puts strain on our resources and the choice in how we divide up those resources. Today some 18.4% of our national income comes from government transfer payments with the lion's share of that funding the retired and infirm. Are there better channels and uses of our funds? Say government funded research or infrastructure spending? Is this the stuff of capitalism..or self-directed nepotism?

When Social Security and Medicare were introduced we were neither old nor insolvent. Today we are coming under increasing pressure to meet our social and financial obligations so the hard choice about which promises we keep will have to be made.



What makes an aging and protracted population even more precarious is the fact that our topical solution is worse than the disease. In its most rudimentary form you battle an aging population by simply expanding the youth-base with favorably immigration and family formation policies. But longer term, this only exacerbates the problem, but allows the current generation to skip out on the hard choices.

What's interesting to think about is the fact that history has never provided us a view into how capitalism fairs under an aging population. Capitalism has existed mostly in periods where there were favorable demographic trends (aka shorter life expectancies). The closest proxy we have is Japan, known as the widow maker for its graying population, ultra low interest rates and lackluster equity returns. Is this what we can expect from other graying economies?

What happens when the favorable trends we've been riding for so long reverse can no longer be counted on for incremental growth? Having defeated the likes of socialism and communism, capitalism has flourished and helped lift the standards and quality of lives around the world, but is its strength also its fundamental weakness? Is an aging population the logical conclusion of a successful capitalist model: will it be crushed under the weight of its own success?