The New Super Landscape
– What Lies Ahead for Wealth Managers
SEMINAR
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Ageing Populations & Investment Markets

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Demographic Change in Australia

Demographic Outlook - 2020

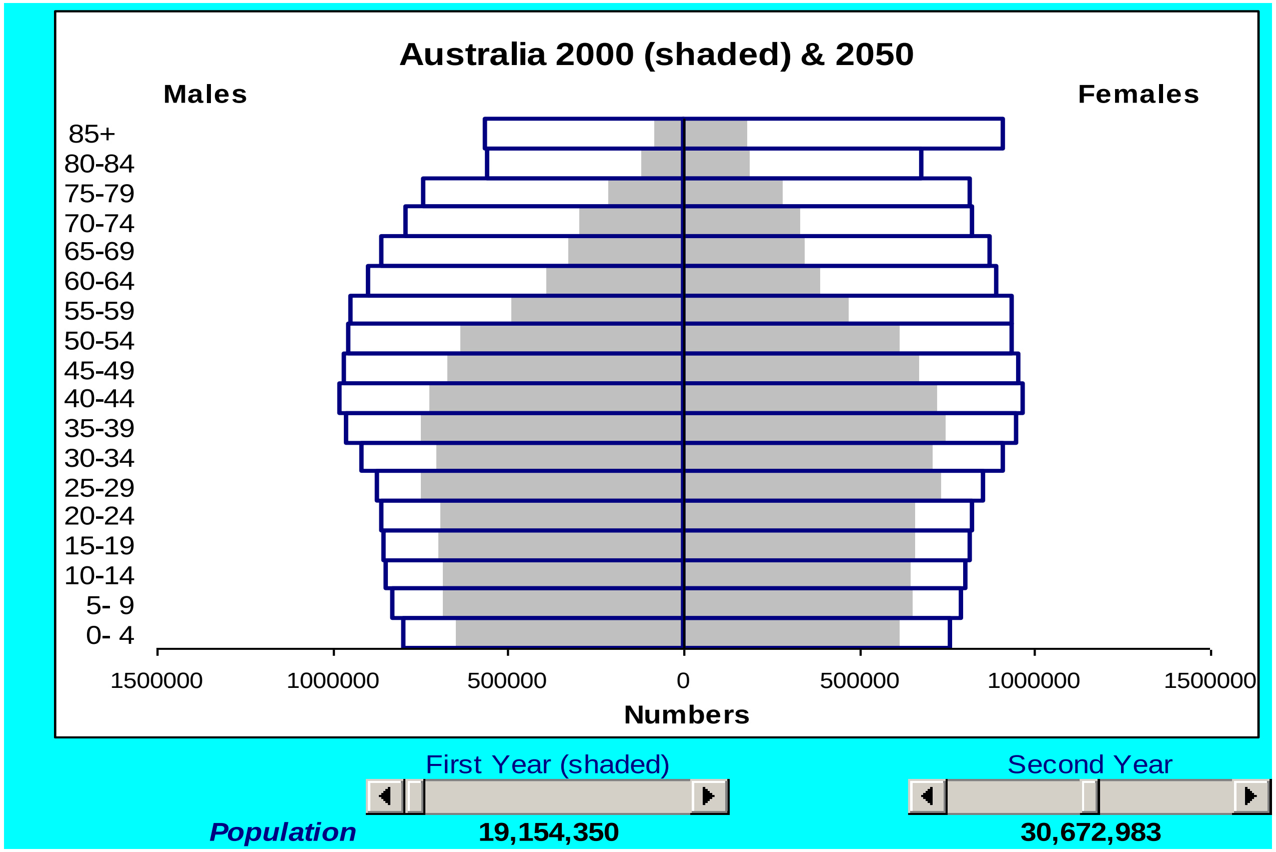
In the past century, the proportion of population aged over 64 has increased from 4% to 13% in 2004. This trend continues. By 2020:

- Population profile will have aged further
- Life expectancy will have increased
- Dependency ratio reaches a troubling level
- Growth rate in the population of working age will have slowed
- Migration helps but will not solve the problem

Source: ABS, ANU, AMP Capital Investors

The Baby Boom Bulge

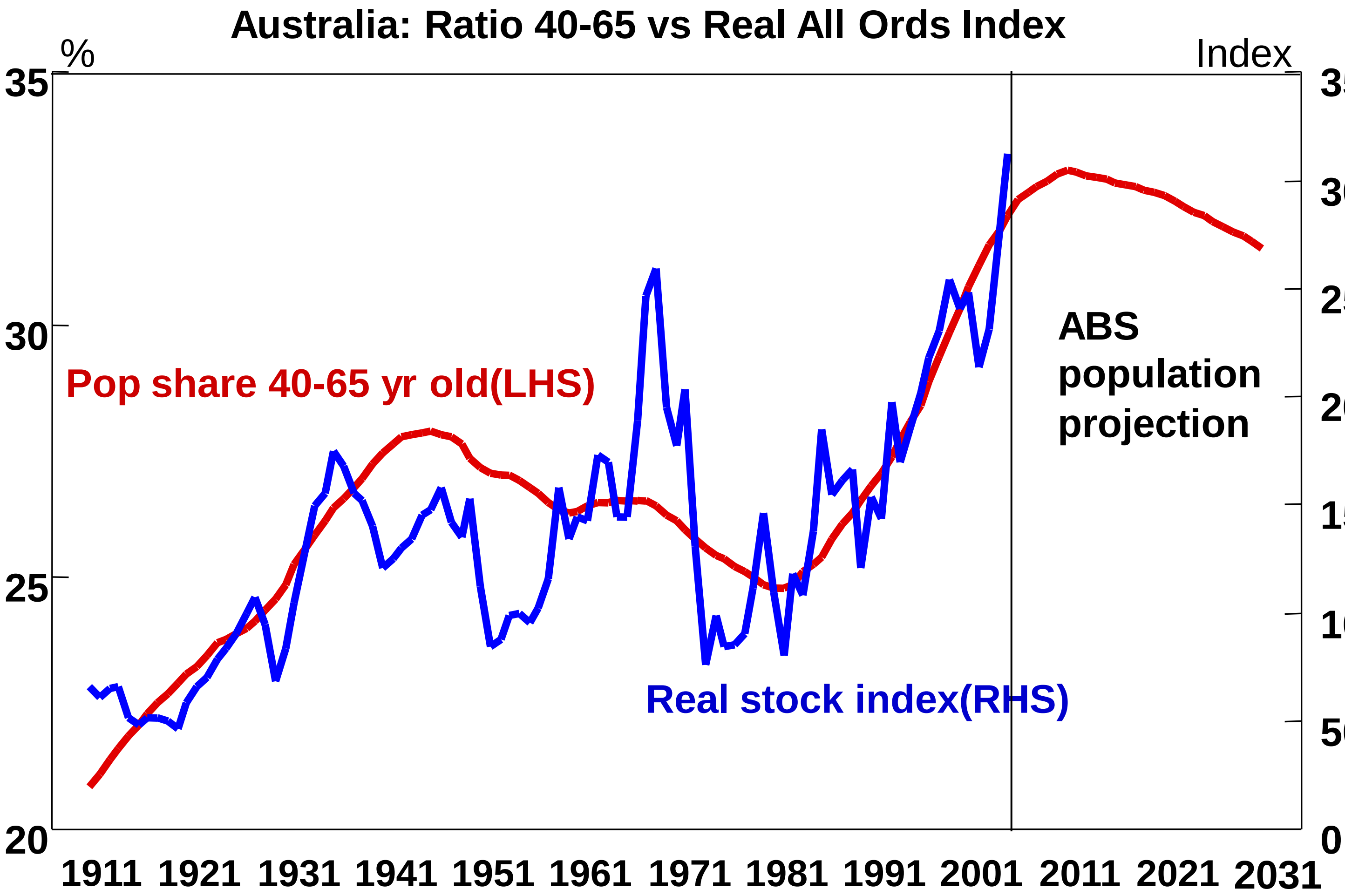
Rising life expectancy and declining fertility means the population is ageing. The ageing of Australia's 'baby boom' followed by declining birth rates has meant a bulge moving through the population structure



Source: ANU Demography, AMP Capital Investors

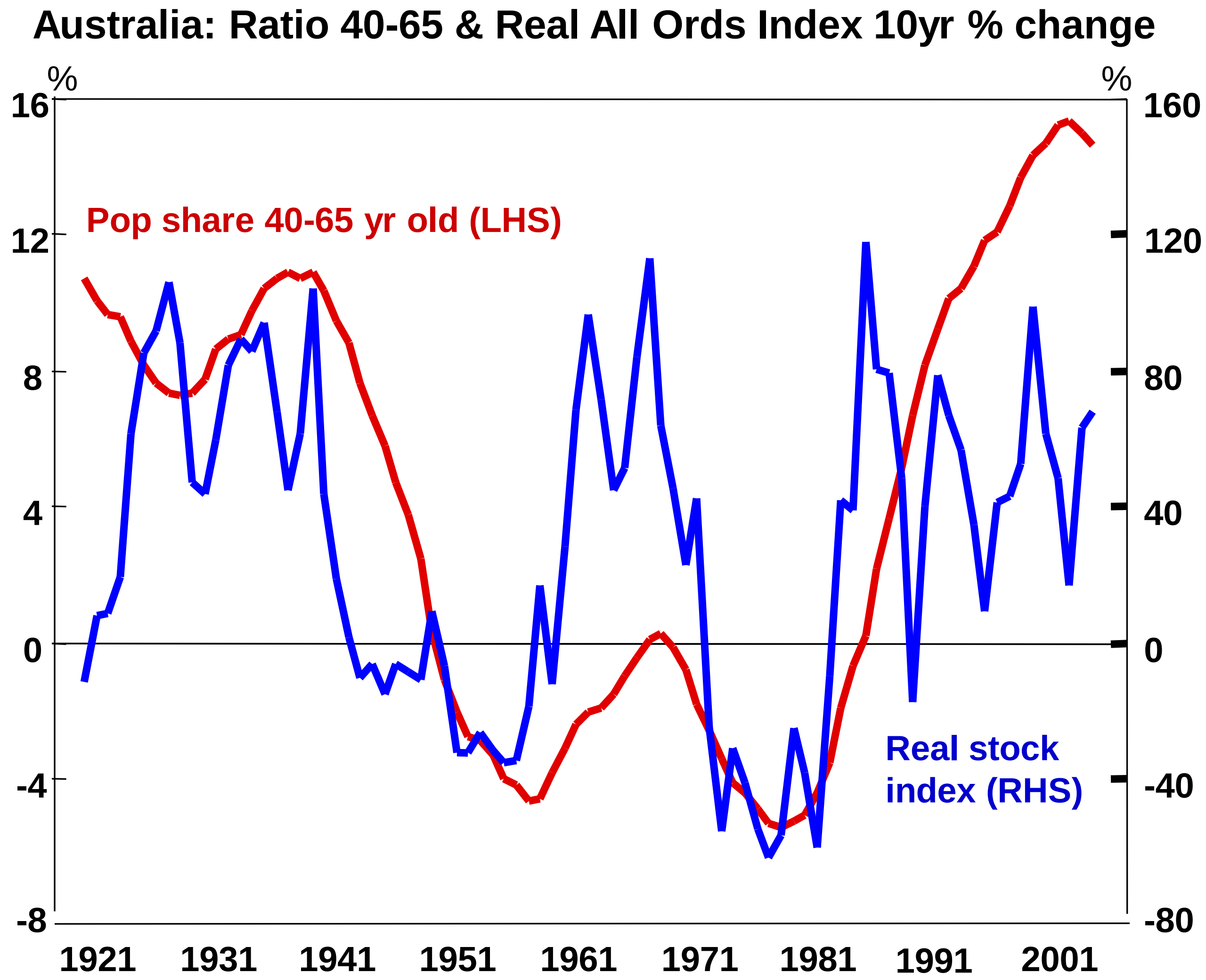
Issues Affecting Financial Markets and Asset Classes

The popular case: Demographics drives real stock prices and returns



Source: ABS, AMP Capital Investors

The popular case: 10 year returns



Regression Results:

Whole period:

R^2: 0.26

T statistic: 5.3

1921 - 1981:

R^2: 0.29

T statistic: 4.9

1982 - 2004:

R^2: 0.08

T statistic: 1.3

Source: ABS, AMP Capital Investors

Key Conclusions of Study

- Economic growth should slow in the long-term
- Aged lobby will gain increasing influence - political, economic and financial
- The savings rate will fall but people on average do not de-cumulate (consume their savings)
- Asset valuations will probably deteriorate a bit (higher real yields) but should not become unduly depressed
- Empirical studies find little support for a direct link between demographic change and asset class returns
- Past and present there is no obvious preference amongst the retired cohort for fixed interest vs stocks & real estate
- We conclude some combination of yield + inflation protection is desired

Source: AMP Capital Investors

Slower Economic Growth

Why?

- Slower population and workforce growth inhibits both demand and output growth
- Less saving => higher real rates (per growth rate), higher cost of capital, less investment
- Tax base erosion + increased spending -> risk of higher tax rates
- We estimate L-T growth slows to 2.75-3.0% in 2015-20 from 3.6% in the past decade

Some implications

- Structure of growth will shift in favour of services
- Slow w/f growth could lead to upwards pressure on wages
- Productivity will become a key issue: Automate, mechanise, computerise . . . . . but it’s difficult in aged/health care

Source: AMP Capital Investors

Effects on Business Generally

- Rising wages, higher real interest rates, possible higher taxes, slower GDP growth should all drag down profits growth
- Returns should be lower

Losers

- Real estate (mostly post 2020)
- Education, child care
- Retailing of consumer goods

Winners

- Health care, pharmaceuticals, aged care services
- Automation suppliers and technology
- Financial advice, financial products

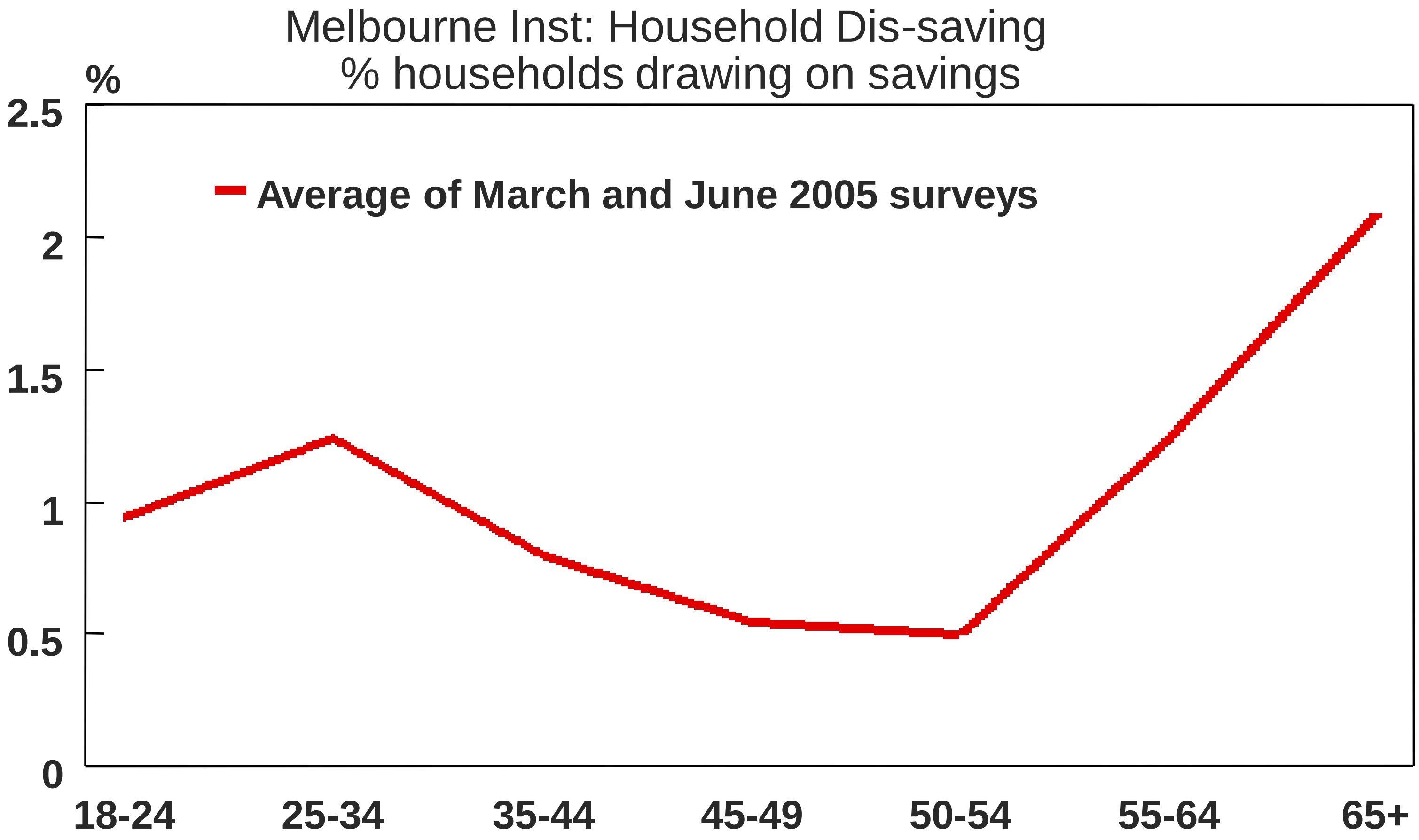
Source: AMP Capital Investors

Savings Rate Issues

- Life cycle hypothesis says elderly live off savings. More retirees, less workers => a falling savings rate
- Evidence supports hypothesis for less household saving as the population ages
- Pressure on budget surplus/deficit => less national saving
- Less saving implies higher real bond yields, lower valuations
- Key Issue: does living off saving mean decumulation?
- Decumulation a common presumption in simulation models
- No empirical support for decumulation hypothesis
- Most savings held by the “rich” who will not sell assets
  - ➲ Datamonitor: 6% hold 66%+ of liquid wealth (2003)
- Thus do not expect asset prices to become unduly depressed

Source: AMP Capital Investors

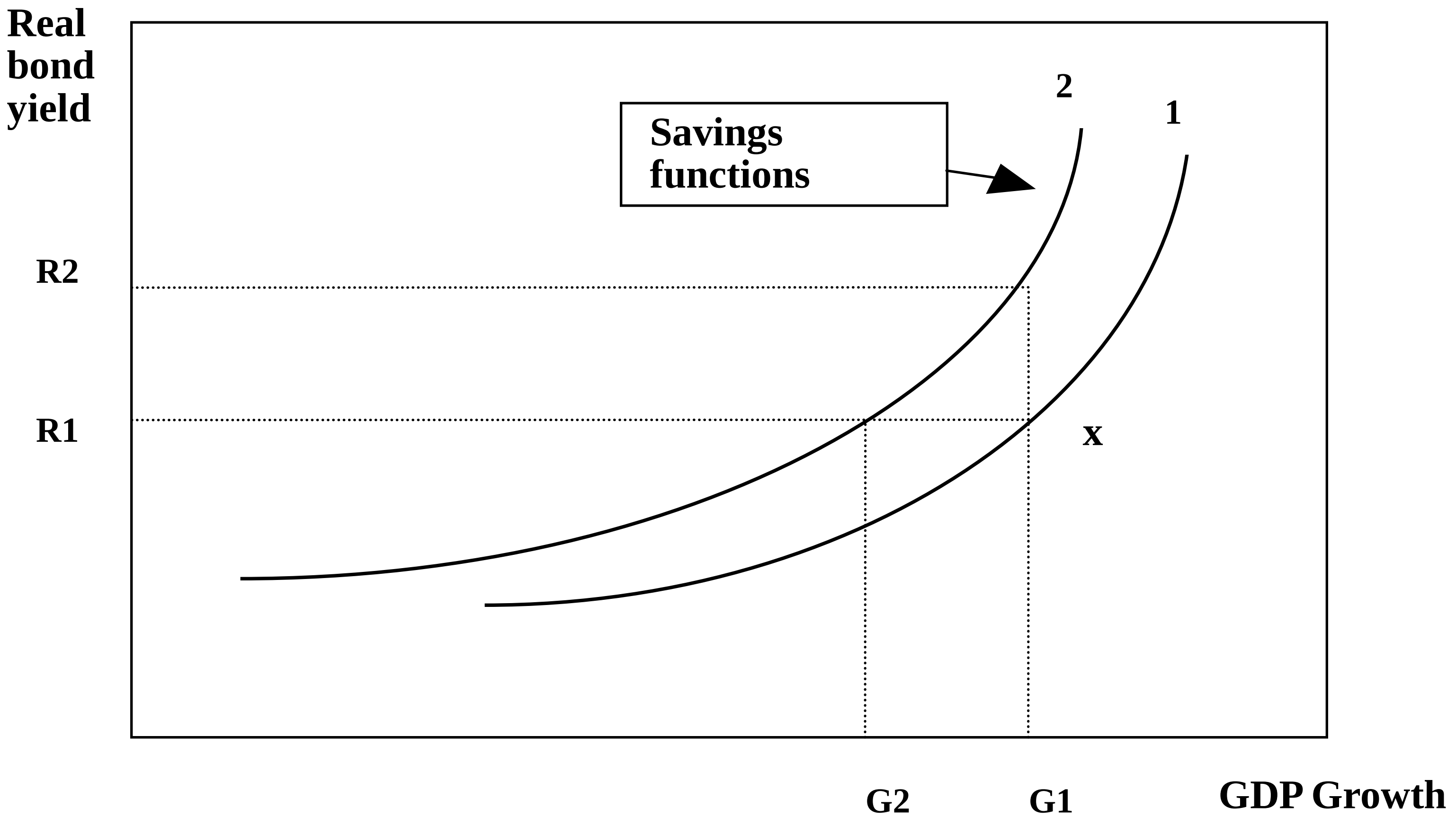
Some limited evidence in Australia for lower savings in the retired cohort



Source: ING Direct - Melbourne Institute, AMP Capital Investors

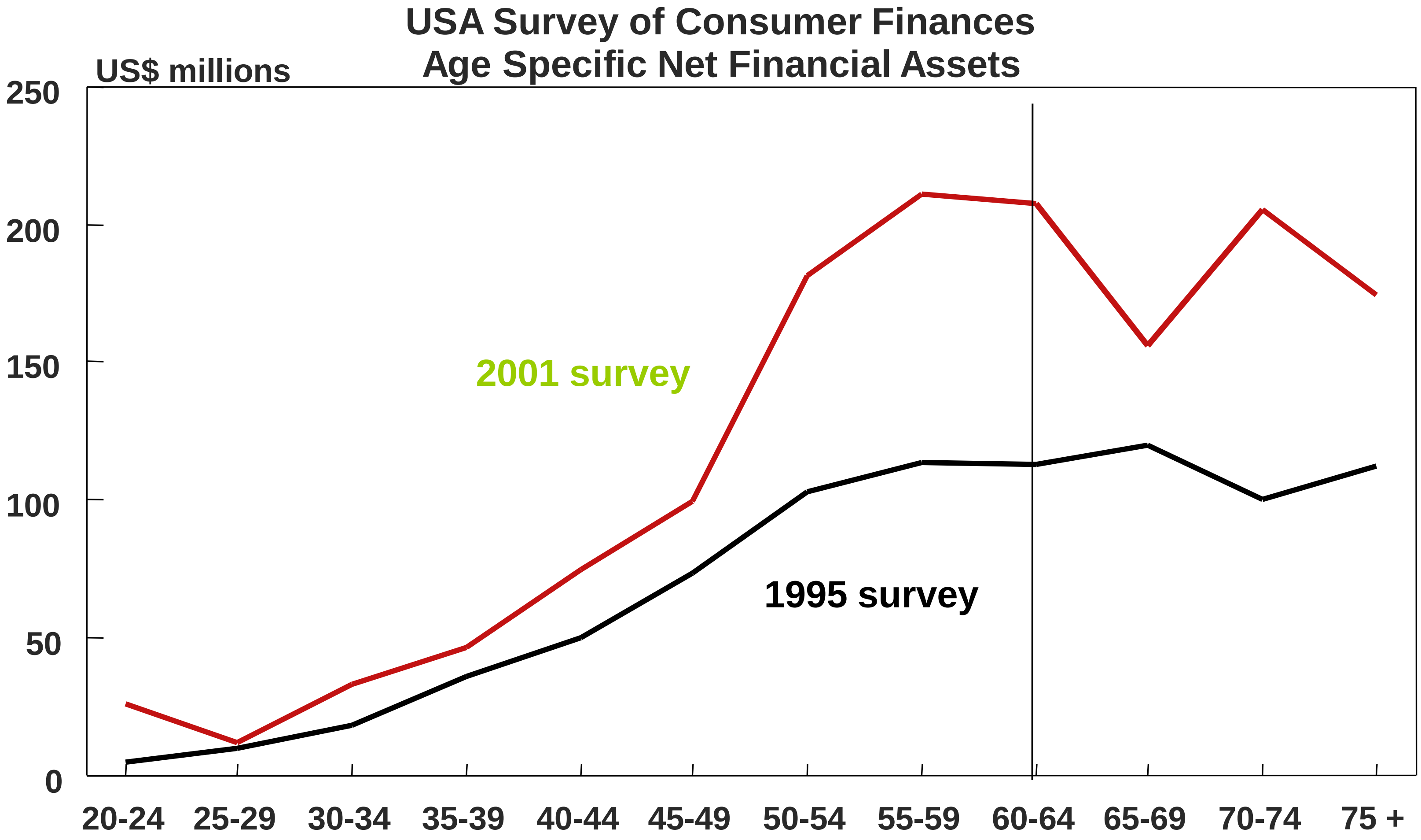
Demographic Ageing, Savings and Bond Yields

Savings, GDP and the Real Bond Yield



Source: AMP Capital Investors

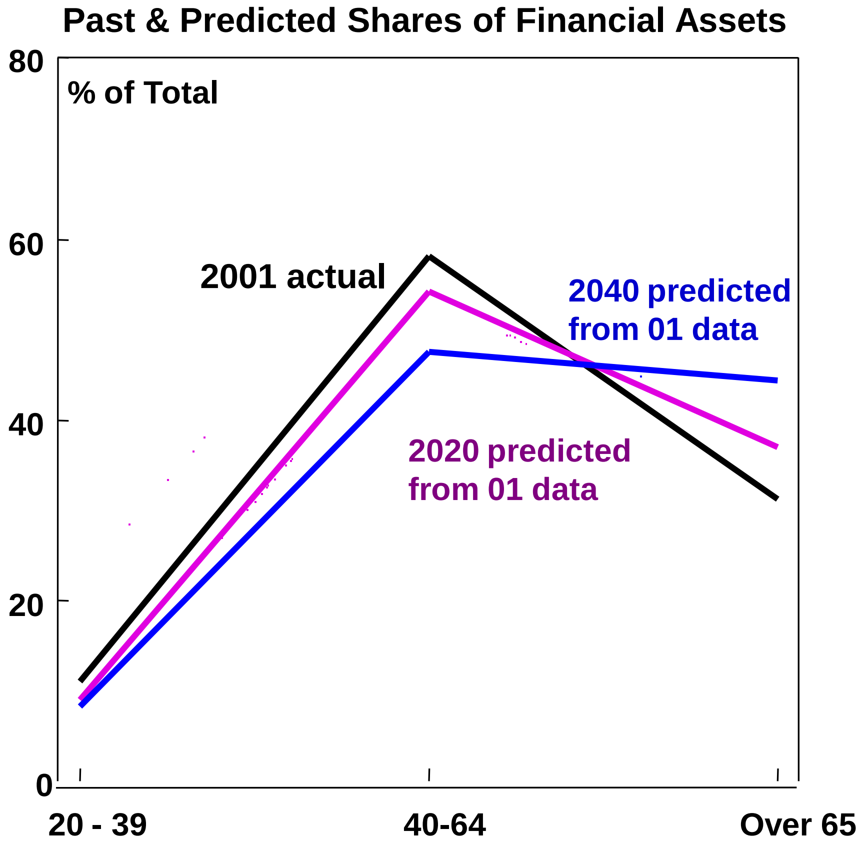
US Survey of Consumer Finances does not support decumulation hypothesis

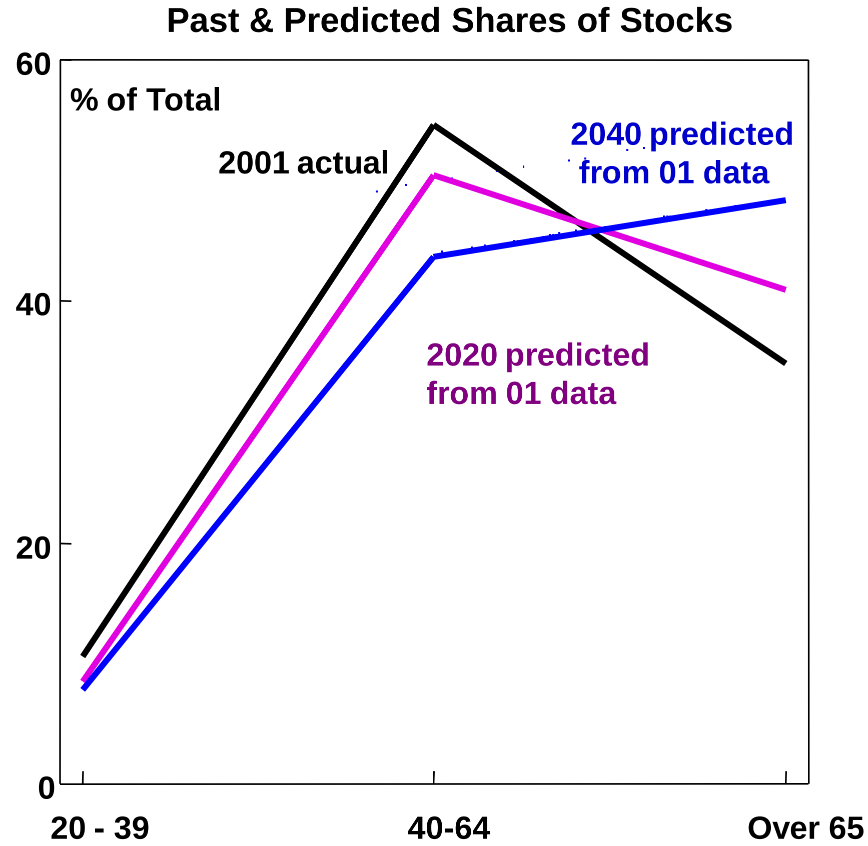


Source: Poterba JM, The impact of population aging on financial markets, AMP Capital Investors

Wealth will become increasingly concentrated in the hands of the elderly

USA Survey of Consumer Finances





Source: Poterba JM, The impact of population aging on financial markets, AMP Capital Investors

Top 1% of equity holders hold nearly 50% of all equities

Demographic Change & Asset Class Returns

Studies focus on direct links only. Two kinds of studies:

Simulation studies

- Wide variety of assumptions produce widely varying results.
- Presume decumulation. Thus project definite demo “pattern”: Baby boom inflates asset prices, ageing depresses them

Empirical studies

- Studied direct link with asset class returns and asset prices
- Find no useful relationship

Conclude

- Indirect links, eg. via slower growth, may be more important

Source: AMP Capital Investors

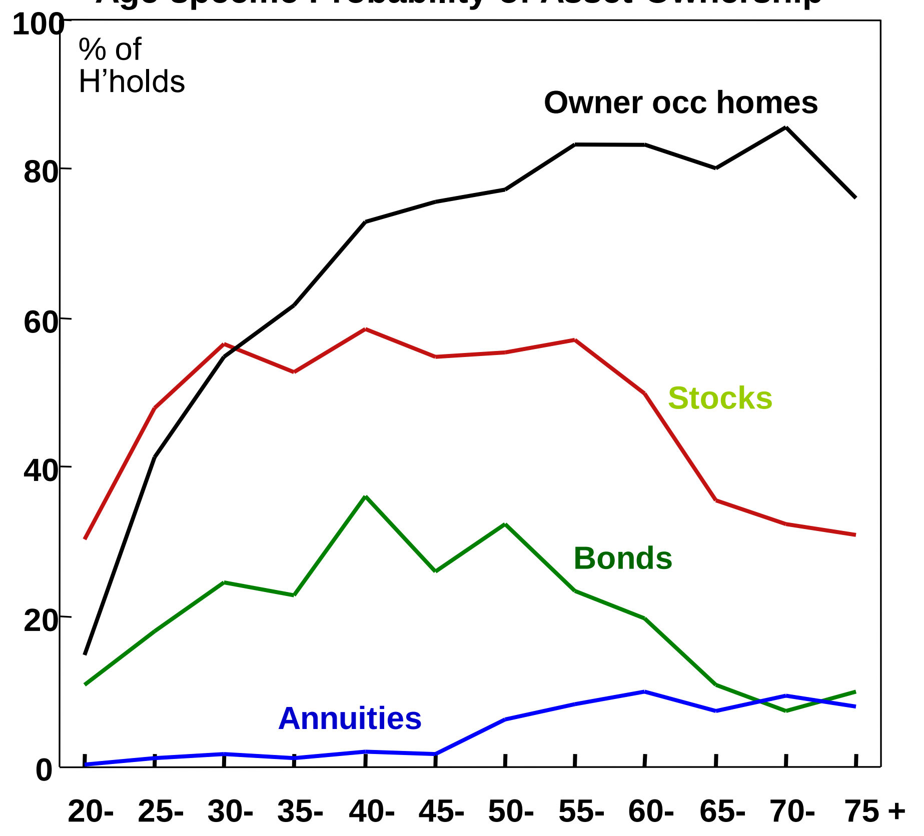
Ageing and the Composition of Investment Portfolios:

Does the emphasis shift from accumulation to preservation as people age?

Caution interpreting data:
1) It's a snapshot in time 2) % HH not assets owned

- Age profile of bond owner-ship not much diff to that of stocks. No switch evident
- Preference for home ownership remains
- There is some shift into annuities but there is room for exploitation

USA Survey of Consumer Finances
Age specific Probability of Asset Ownership



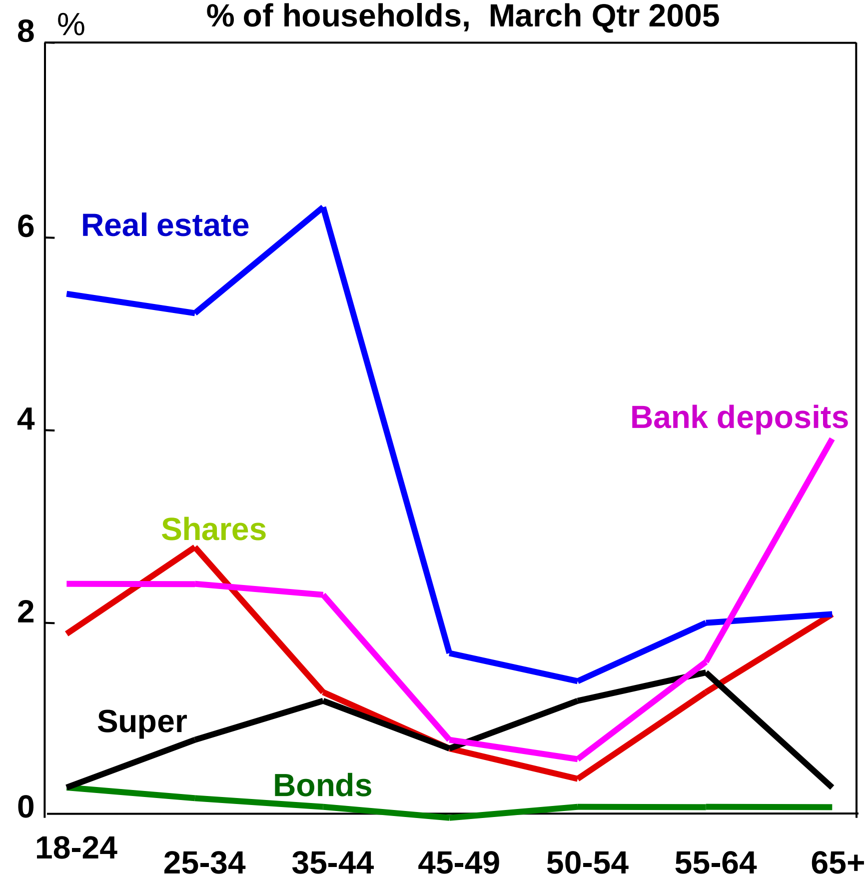
Source: Poterba JM, The impact of population aging on financial markets, AMP Capital Investors

Ageing and the Composition of Investment Portfolios: Australian evidence

Data refers to <u>intentions</u> for <u>new savings.</u> We observe:

- No obvious intention of aged to liquidate shares and move to bonds. Prefer bank dep.
- Real estate remains the entrenched favourite
- Aged want yield and protection against inflation. People now expect 30 years of retirement. Even at 2.5% prices double in 29 years

Mlb Inst: Preferred destination of New Savings
% of households, March Qtr 2005



Source: ING Direct - Melbourne Institute, AMP Capital Investors

Impact of New Superannuation Reforms

- Fed Govt has clearly anointed Super as the chosen vehicle for long-term savings
- In the past super has suffered from lack of interest. Geared property and other savings schemes have competed strongly
- Intro of choice and tax free status post 60 should make super the most attractive option for most Australians
- AMP anticipates an accelerating inflow in superannuation
- Investment in housing (2nd home) is likely to be the big loser
- No obvious winner within the super environment. All asset classes currently held by super funds should benefit but...
- There could be an increased flow of funds abroad if domestic markets struggle to absorb the increased flows

Source: AMP Capital Investors

Thank You!

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