
Asset prices won't plummet when Boomers retire—Aviva

By Mirko Cardinale *Wed, Oct 12, 2011*

As the Boomers retire and leave a smaller 40 to 64-year-old cohort behind them, bond yields should rise 60 basis points above the increase warranted by GDP growth and inflation prospects, according to Mirko Cardinale, a researcher at Aviva Investors.

The developed world has been giving much thought to the potentially harmful impact of its aging population on asset prices, particularly as the post-war 'baby boomers' head into retirement.

The concern is that, if a large proportion of the population moves into retirement and draws down their assets at the same time, this will put a downward pressure on the price of financial assets such as bonds and equities.

However, our own research shows that, while the correlation between bond prices and demographic patterns is meaningful, yields and returns are unlikely to be as seriously impaired as first thought.

One of the key reasons for our differing opinion is due to the age groups used in research. Other studies have generally assumed the 'high savings cohort' to be between the ages of 35 and 54. However, since the 1960s, individuals in the developed world have become more likely to attend university, start working in their 20s and have children well into their 30s.

These socioeconomic trends mean individuals are becoming net savers at a steadily later stage in their life. Many households have also been forced to extend their working lives, prolonging the period in which they are net savers, due to increased life expectancy and pressure on pension providers [i.e., Social Security in the U.S.] to reduce the burden of providing insurance against longevity.

As a result, Aviva Investors focused its analysis on the 40-64 age group, believing this demographic best explains asset class returns. We considered data from the G-7 countries, plus Australia, starting in 1962 to provide a significant horizon to assess the impact of demographics.

Our findings suggest that, in most countries, bond yields are expected to rise (and bond prices to fall) over the next 20 years as current levels are often below long-run equilibrium values in function of inflation and GDP growth potential. However, we do not find the impact of demographic trends to be as material as previous studies, some of which even suggested an 'asset meltdown hypothesis'.

We also find that the impact of these demographic factors is far from uniform. In the US, yields are expected to be pushed up by 60 basis points above the increase warranted by GDP growth and inflation prospects, due to retirement of baby boomers leaving a smaller 40-64 cohort.

By contrast, while UK yields are expected to rise, demographic factors actually lower projected yields due to a stable group of peak earners and positive population growth. We would only predict a 1% increase in Japanese yields over the next 20 years, almost entirely driven by demographic trends, including the expected shrinkage of the overall population.

Italy is a peculiar case, as our model predicts yields 150bps lower on the basis of macroeconomic and demographic fundamentals, including a large and stable 40-64 cohort and a small expected decrease in the overall population. This is also because the model does not assume a 'default risk premium', as budget deficits and debt sustainability patterns have not been historically a driver of bond yields in the developed world.

Demographics do influence the long-term behavior of asset prices, but when attempting to forecast the future impact, it is far from clear that they will have as much impact as some have indicated. Suggestions that asset prices could decline sharply as the baby-boom generation reaches retirement appear misplaced.

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