

How Boomer decumulation will impact investment returns

By Editorial Staff Wed, May 10, 2017

'The demographic transition and decline in investment returns is likely to put upward pressure on asset prices until an new equilibrium is reached—an equilibrium with lower investment returns,' writes Steve Sass of the Center for Retirement Research at Boston College.

If the rise in stock, bond and housing prices over the past 30 years was driven largely by Baby Boomers saving for retirement, does it follow that asset prices will suffer if or when Boomers liquidate their assets during retirement and Generations X and Y can't absorb them at current prices?

In a new research <u>brief</u>, Steven Sass of the Center for Retirement Research at Boston College tackles this important question.

His conclusion: "The demographic transition will likely put downward pressure on investment returns—that is, on interest rates and on profits per dollar invested," he wrote. "Just as a decline in interest rates raises bond prices, the demographic transition and decline in investment returns is likely to put upward pressure on asset prices until a new equilibrium is reached—an equilibrium with lower investment returns."

This projected decline in investment returns is due to changes in the supply and demand for savings brought on by the demographic transition, he explained. The demographic transition is due to the retirement of the Baby Boom generation, to be followed by younger cohorts of similar size.

In terms of the demand for savings, "The sharp deceleration in the growth of the working-age population means that the economy needs far less savings to build new offices, factories, roads, and machinery than it had when the labor force was rapidly expanding. This decline in the demand for savings should lower investment returns," wrote Sass, who is author of The Promise of Private Pensions (Harvard, 1997).

While many expect an "asset melt-down" when the Boomers retire, Sass suggests that there won't be a mass liquidation. The primary reason is wealth inequality in the U.S. The wealthiest elderly households (the 10% of the population that owns 85% of financial assets) won't sell their assets; they'll live on the interest and dividends.

The "median net worth in the top three income quintiles of single retirees... generally declined only modestly [according to past studies]," the brief said. "Specifically, the top two quintiles, which hold the lion's share of the net worth of all elderly households, show either increases or only a modest decline."

That's because of their "desire to hold reserves, primarily against the risks of outliving their savings or incurring high medical or long-term care expenses; a desire to leave bequests; and a general aversion by the elderly to drawing down their savings."

International capital flows may actually increase this downward pressure on investment returns. Europe and Japan are aging much faster than the U.S. In many developing economies, the population is now aging

into their high-saving years, from 40-65. Cuts in Social Security benefits in the U.S. could also lead American workers to save more, which would further increase the supply of savings and further reduce investment returns.

The demographic transition is primarily responsible for Social Security's funding shortfall, Sass points out. To the extent that it also lowers investment returns, it will give Gen-Xers another headache: "The decline in returns will require [them] to save more to secure a given amount of income in retirement," the brief said.

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