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Innovate. Deliver.

High Pointe

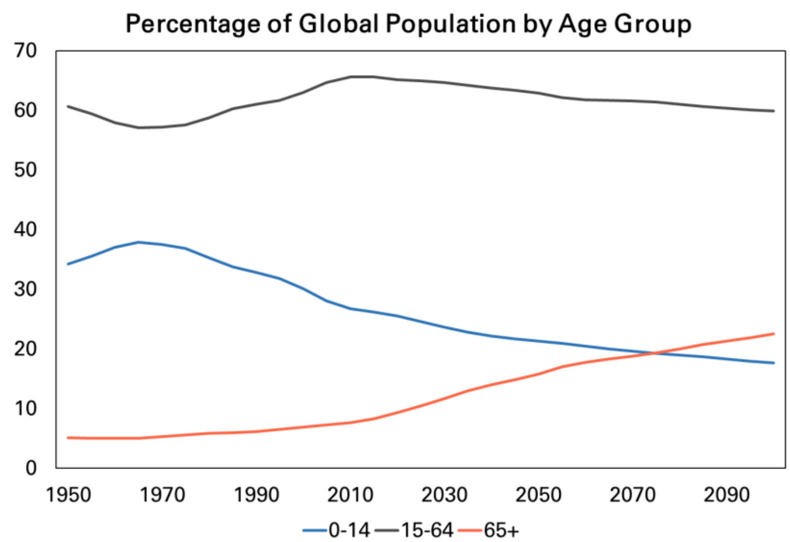
No Time for Complacency

The S&P 500 Index reached another all-time high in 2017 as a stable economy, rising corporate earnings, continued global central bank stimulus and the passage of a major tax reduction bill kept the financial markets buoyant. These factors continue to be in the forefront of investors' minds, leading to an early jump in the global equity markets in the beginning of 2018 and the apparent common belief that we will see another positive year in the equity markets.

Instead of getting swept up in the current environment of complacency, we note a number of broader concerns that warrant a tempering of investor enthusiasm, specifically:

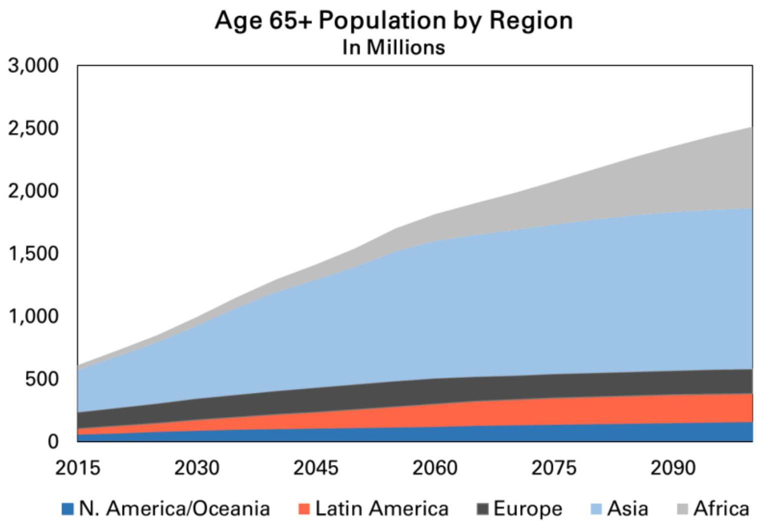
1.) Equity valuations at, or near, historical highs,
2.) High and rapidly increasing debt levels,
3.) An expected reduction in central bank stimulus, and
4.) A global aging demographic profile.

In recent newsletters we have highlighted the first three points. In this one, we focus on demographics. While many of us in the US are familiar with the aging of the Baby Boomers (and we at High Pointe count ourselves in that category though, perhaps like most of you, do not feel older, just wiser) this is a global phenomenon as the chart below indicates.



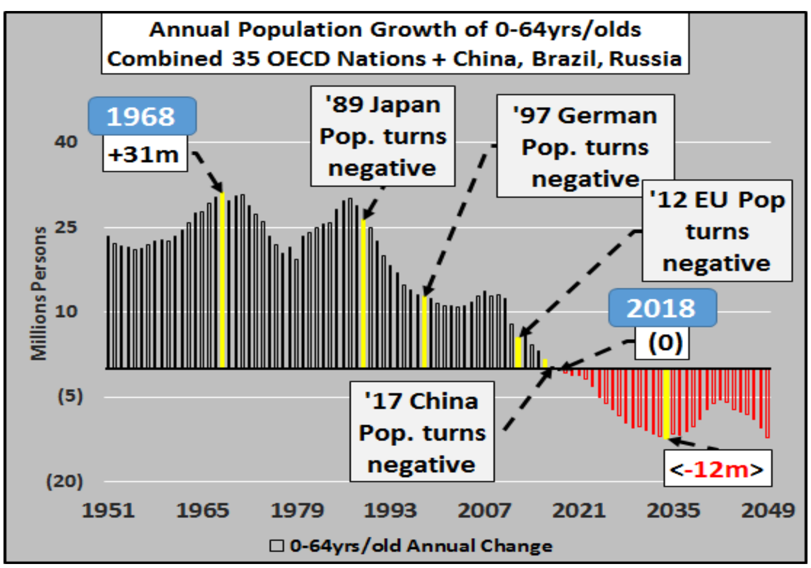
Source: UN, World Population Prospects, 2017 Revision

As shown in the preceding chart, the percentage of the global population that is 65 and older will increase from 8% to 18% within the next 50 years, and continue its rise to over 20% by 2100. In fact, by as early as 2050 the world will have roughly another 1 billion elderly citizens, most of them in Asia and Europe as shown below.



Source: UN, World Population Prospects, 2017 Revision

At the same time that an increasing number of people will be facing the issues associated with aging and navigating their retirement (if they are even able to retire), much of the world will see a reduction in the number of young and middle-aged people who are the primary drivers of consumption and, hence, economic growth. They are also the ones who are expected to bear the brunt of funding the retirement of the 65+ age group. As the chart below shows, the growth in the number of people in the 0-64 year-old age group has been in a period of long-term decline and is actually in the process of turning negative.



Source: Economica.com

As seen above, the annual population growth of 0-64 year-olds in the developed world and major emerging markets peaked at 31 million in 1968 at the tail end of what we refer to as the Baby Boom generation (technically 1945-1964). A brief resurgence in the 1980s ended as Japan's population of 0-64 year-olds turned negative, a decade later followed by Germany and then in 2012 by the European Union as a whole. Interestingly, with an extremely large population of 1.3 billion, China has just seen its 0-64 year-old cohort turn negative as well and will be one of the fastest aging populations in the world. It is now forecast that, outside of India and Africa, the 0-64 age group will decline for the foreseeable future. This decline will pick up speed through 2035 when a 12 million annual reduction will pose serious headwinds for global economic growth.

With the likely pressure on funding the retirement of an increasingly large elderly population, investors need to be prepared for reductions in defined benefit pension payouts, means testing for Social Security payments and reduced Medicare and Medicaid benefits. Retirement as we currently know it will be increasingly hard for investors to attain. It is for this reason High Pointe encourages its clients to use conservative estimates when planning for retirement. We should seek to err on the side of over-saving as opposed to under-saving. Unfortunately, the average American is moving in the opposite direction. Recent statistics show that the savings rate in the US has dropped from 3.7% a year ago to 2.9% in November 2017. This is far below the historic rate of 8.5%.

Overall, we believe that investors should not be overly swayed by recent good times and get lulled into taking extraordinary risks in light of the unfavorable long-term projections. At High Pointe, we took advantage of a rising market in 2017 by maintaining full equity exposure and allowing equity allocations to rise slightly above targets. Yet by the end of the year we felt it prudent to bring equity exposures back in line with agreed upon mandates. We anticipate watching the markets closely and possibly reducing client equity exposure later this year should the markets continue to become more expensive.

Chris Olson and Gautam Dhingra
January 19, 2018