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Millennial Boom: Demographics Point Toward Economic Growth

By Cole Smead, CFA®

INVESTMENTS & WEALTH INSTITUTE®

Millennial Boom

DEMOGRAPHICS POINT TOWARD ECONOMIC GROWTH

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Our firm is optimistic that the millennial generation—those born between 1980 and 2000—will become a powerful engine of economic growth over the next two decades. Advisors need to understand the impact that this cohort is likely to have on the price of money and their clients' investments in the future.

Let's start by looking at the size of the millennial cohort relative to other demographic groups.

Table 1 shows the approximate population peaks of each cohort. Millennial population will peak around 2038. Most investors compare the baby-boomer cohort size with millennials, but we don't believe this is fair. Yes, millennials will peak with 20 percent more people than baby boomers, but more importantly, they will peak with 46 percent more people than the group that precedes them, GenX. We believe that these demographics are destined to generate enormous economic growth.

We also have found a treasure trove of data in the St. Louis Federal Reserve (FRED) and have used it to synthesize an interesting statistic: home equity as a percentage of U.S. household net worth, as shown in figure 1.

Figure 1, which spans 1952–2021, illustrates that today's home equity as a percentage of household net worth is just below the average of 17 percent for the period. But it also shows a significant drawdown in this ratio during the 2010s. Why?

The answer is in two parts. First, home equity bottomed out in 2009 with the onset of the great recession. Second, other household net worth—stocks, bonds, etc.—did much better than home equity coming out of 2009. This took home equity as a percentage of net worth to an all-time low. As a 37-year-old, I imagine I will never see this ratio that low again.

This ratio peaked at 23 percent in the mid-2000s, when stocks were doing poorly but home equity was booming, fueled by the post-9/11 interest-rate cuts. We believe this peak is worth watching for again. We also believe that millennials will take home equity as a percentage of net worth to a new height—greater than 23 percent—at some point in the future.

Table 1

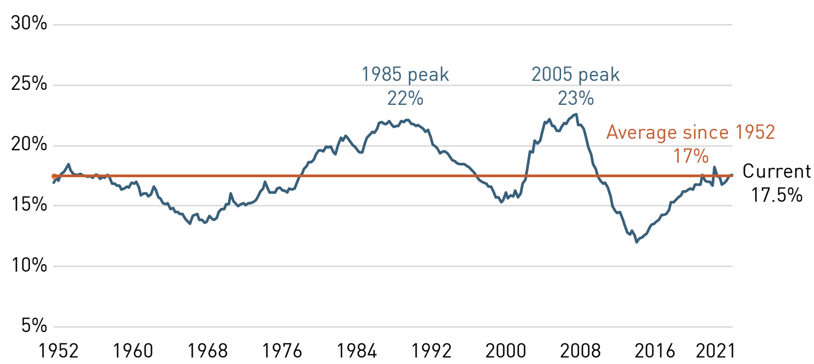
TOTAL U.S. POPULATION DIVIDED BY AGE GROUPS

Generation	Years of birth		Average age	At peak (year)	
Greatest Generation	1910	1927	92.9	43.2	1930
Silent Generation	1928	1945	78.5	44.1	1974
Baby Boomers	1946	1964	61.3	79.5	1999
Generation X	1965	1980	44.5	65.8	2018
Millennials	**1981**	**2000**	**26.5**	**95.8**	**2038**
Generation Z	2001	2018	8.3	96.2	2060

*Source: Fundstrat. Peak population figures above include immigration. ** Reduced immigration will lead to a smaller overall size of Generation Z.*

Figure 1

HOME EQUITY AS A PERCENTAGE OF U.S. HOUSEHOLD NET WORTH



Source: Federal Reserve Economic Data

Why? Because there appears to be a relationship between home equity and other assets.

For example, during 1952–1968, the stock market rallied from the lows it hit during World War II just as the housing industry also rallied to meet an enormous demand for new homes generated by returning service members and a growing post-war economy. The S&P 500 had a remarkable run during this 16-year period, returning an average of 13.36 percent annually (see figure 2). Home equity and other household assets, such as bonds, were no match for these strong stock returns, and the ratio shown in figure 1 fell below the average.

As interest rates began to rise in the 1960s and continued to rise in the 1970s, stocks produced negative real returns and home equity became the driving force behind U.S. household net worth. By the end of the 1970s, homeownership had become the ultimate inflation hedge. Between 1968 and 1985, the ratio of home equity to total household assets climbed from 14 percent to 22 percent because homes out-punched stocks, bonds, and cash in real terms during this 17-year run.

What propelled that powerful move in housing? Baby boomers. Baby boomers, the largest generation to date, had come of age and needed homes, and many were ready to buy them. This demographic trend provided opportunity for profit as many other investments soured. Yes, the economy experienced shocks during this time—two oil embargoes, a corrupt presidency followed by a weak presidency—but it remained strong because of the enormous consumption generated by the huge population of baby boomers.

By digging into more St. Louis Federal Reserve data, we found more evidence about the relationship between housing-market strength and stock weakness. Figure 3 shows a different ratio: equities as a percentage of U.S. household total assets. It also shows 10-year rolling returns of the S&P 500 Index.

In figure 3, the left y-axis shows the ratio of equities as a percentage of total financial assets. The right y-axis shows the subsequent 10-year rolling returns of the S&P 500 Index. As you can see, there is an inverted relationship between the ratio of ownership and forward returns of the S&P 500. There are three major highs in this data set: 1969, 1999, and today. The 1969 high of equity ownership produced 5.87-percent returns for the decade of the 1970s, but real returns were in the negative low single digits. We call this stock market failure. The high level of stock ownership in 1999 produced nominal returns for the S&P 500 Index of roughly −1 percent. Real returns were negative low single digits, oddly similar to the 1970s—again, stock market failure.

This data shows that today we have the highest level of common stock ownership ever among U.S. households. Based on the other two high points—1969 and 1999—there is no question in our minds that stock returns are heading into negative territory in real terms. Our guess is that stocks will return -2 percent during the decade ahead, and if bonds lose value due to rising interest rates, you can see how the ratio of home equity to

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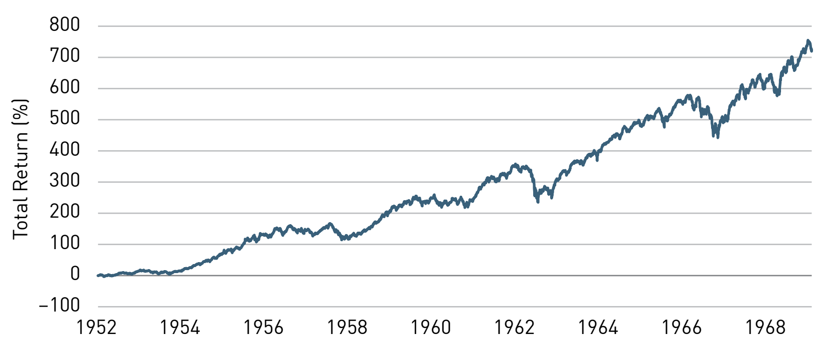
Figure 2

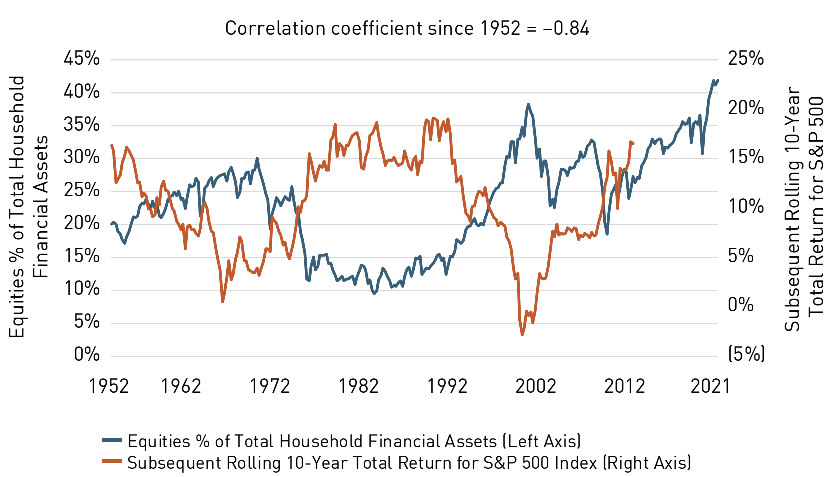
S&P 500 RETURN, 1952–1968



Source: Bloomberg

Figure 3

HOUSEHOLD EQUITY OWNERSHIP, 1952–2021



Household equity ownership near all-time highs, which has been inversely correlated with S&P 500 forward returns historically

Source: Federal Reserve Economic Data, Bloomberg

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household net worth is likely to rise.
If homes become the inflation hedge of choice, as they were in the 1970s, we are likely to hit a new high in the ratio of home equity to total household assets in the next 20 years.

CONCLUSION

Demographics are powerful economic drivers, and many investors underestimate the impacts they have in the financial world. Baby boomers, the largest cohort to come of age to date, supercharged the economy with demand for housing and consumption goods. Now an even larger cohort—the millennials—is on the horizon, setting the economy up for a home equity surge when stocks and bonds are likely set up for failure.

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The average American's largest asset is a home, so average U.S. households will be insulated from much of the trouble we see ahead for other assets. Wealthy individuals and institutions, however, can't be as concentrated in housing as average households. Those with means have problems ahead regarding the types of assets they deal in. They need to find unique ways to make money as their residences go up in value, bond portfolios decline, and the stock market fails. Certain commodities, such as oil and lumber, as well as real estate, malls, and multi-family apartments, look like good investments.

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