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MARKET INSIGHT

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Down, but Certainly Not Out

By Andrew B. Wetzel, CFA, Vice President

Young people get a bad rap. They are loafers, living at home playing video games and not working. The majority of popular press articles paint the Millennial generation with this broad brush, but the truth is quite different. Millennials could surprise us all and become a powerful force driving economic growth and stock market gains.

Millennials, as defined by many demographers, are currently between 18 and 32 years old and represent roughly 21% of the U.S. population, or 66.6 million people. This cohort has come of age in a time of war, terrorism, and a near economic collapse. Yet a recent study by the Pew Research Center shows that they are happy, optimistic about the future, tech-savvy and well-educated. What causes their bad rap is that many of the problems associated with Millennials have been driven by bad timing as they entered the workforce during a real estate downturn, a stock market collapse, a severe recession, and a subpar recovery.

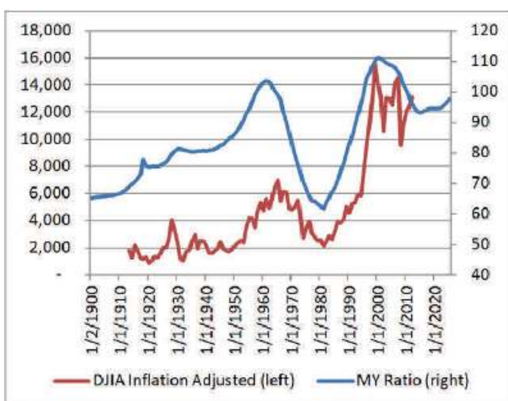
Unemployment has been a major drag on Millennials, especially for the youngest. In late 2012, the unemployment rate for 20-24 year olds was 13.7%, still elevated from pre-recession levels of 9.4% in late 2007. This increase of 4.3 percentage points (pp) compares to an increase of only 2.8pp for the total working age population. More recent data shows improvement for youngsters, with the 20-24 year old unemployment rate dropping to 13% as of the latest reading, down more than the overall rate.

Student debt is another troublesome issue. Overall student loans outstanding reached roughly $1 trillion in the second quarter of 2013, double the level in mid-2007. While this sounds like a disaster waiting to happen, the details paint a more encouraging picture. According to the Federal Reserve, 40% of borrowers have balances less than $10,000, and 70% have balances less than $25,000. The average student loan balance is roughly $25,000, but this is skewed by the 3% of borrowers with balances above $100,000. The median balance is roughly $14,000. Assuming a ten-year payback on the median student loan balance at a 5% interest rate, the annual burden is $1,780, representing roughly 3.0% of income for people from 25 to 34 years old. While there are legitimate concerns related to default rates and the quality of education at certain for-profit schools, the big picture is that the Millennials will be the most educated demographic ever in the U.S., making this group well-positioned to capture job growth as the economy improves.

The headwind of a weak economic recovery stunting job creation combined with increased enrollment in college has led to a sizable increase in young people living at home or staying in group living situations longer than desired. Analysis of Cen-

sus Bureau data indicates that approximately two million doubled-up households were created over the last five years. These young people have delayed marriage, children and buying a house largely due to uncertain economic conditions. As conditions improve, Millennials will provide a tailwind to consumer spending and the housing market. On this front, the falling unemployment rate for young people in 2013 and the recent shift toward an easing of mortgage lending conditions are encouraging.

In addition, with the Federal Reserve continuing to target job growth and housing improvement, the pent-up demand from doubled-up households coupled with the natural aging of the Millennials into their prime spending years could be a powerful combination. Bureau of Labor Statistics data show that on average people age 25-34 spend roughly $18,000 more a year than people 18 to 24 years old, and people 35-44 years old spend roughly $9,000 more than those 25-34. Census Bureau data shows that on average over the last 13 years the homeownership rate for 25-29 year olds is 37.4%, a 14.5pp increase from those 20-24 years old. The homeownership rate moves up to 52.9% in the 30-34 year old cohort, a 15.4pp increase. So clearly, people in their late 20s and early 30s are on the steep part of the curve for spending increases and homeownership. Demographic trends show that the size of the 25-34 year old cohort will grow by close to four million through 2020. The additional two million young people doubled up on the sidelines should add to the natural demographic tailwind.



Source: Ned Davis Research

As Millennials age, their growing income, spending—and eventually savings—could also be beneficial for the stock market. Over the next decade the ratio of middle-aged people to young people (the MY ratio) will bottom and turn higher. As the chart to the left shows, over the last 100 years the stock market has tracked the MY ratio closely. The ratio will bottom in 2015 and move higher over the following 10 years, possibly providing a tailwind for stocks. While there are always many cross currents at play in the stock market, and there will be some pressure from retired Baby Boomers slowly liquidating portfolios, it is encouraging to see one major demographic variable poised to move in a positive direction.

While there are still challenges facing the Millennials as the U.S. economy slowly recovers, the potential for this generation to contribute meaningfully to economic growth—and thus the stock market—is clear. At F.L.Putnam, we factor long-term trends and themes into the investment process. We are following the progression of the Millennials and watching carefully for opportunities in related industries such as housing, autos, consumer durables and technology.

2013 Market Diary		
	9/30/13	**YTD Change***
Dow Jones Industrials	15,129.67	17.63 %
NASDAQ	3,771.48	26.11 %
S&P 500	1,681.55	19.79 %
Russell 2000	1,073.79	27.68 %
10-Year Treasury Bond Yield	2.61 %	+85 b.p.

Source: *Bloomberg Capital Markets*

* Includes dividends for equity indices