CREATIVE Wealth Maximization Strategies

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"Don't be afraid to see what you see."
- Ronald Reagan

Demographics & Economics: Is the Future Already in Place?

The Quest for Relevant Financial Information

One of the essentials of planning for anything is **making reasonable projections regarding the future**. If you're planning a vacation in the Caribbean, you want to go when the possibility of a hurricane is slight. If you're thinking about starting a business, you want to have an idea of the demand for your goods or services. If you're going to invest, you want to put your money in places where the likelihood of profit is greatest.

When it comes to your financial programs, what kind of information about the future is reliable for making decisions?

- Is it a mountain chart in an investment prospectus that reads: **"Past returns are no guarantee of future performance?"**
- Is it a (completely fabricated but perfectly plausible) sound byte from one of the business channels on cable television that drones on like this: **"Stocks closed slightly lower today as investors reacted to news that unemployment remained essentially unchanged, while concerns about the effect of a colder-than-expected spring continue to drive futures higher for oranges while dampening new construction in western markets..."**
- Is it a book or periodical that blares: **"The Insider's Secret to Real Estate in Today's Economy?"**

If you're looking for help discerning the future, what can you do with this type of information? Some of it is past history, some of it is happening now. But how reliable are these items in determining what might happen tomorrow, next week, a year from now, or even the next decade?

Before going any further, here's the disclaimer:

No one can predict the future. Got it?

What follows is not a list of specific predictions for the future. Rather, it's a discussion of several macroeconomic (i.e., big view) trends that are already in place today. In the past, these trends have yielded some very consistent cause-and-effect results, and they are worth careful consideration.

Demographic trends as macro-economic indicators. These macro-economic indicators fall under the category of demographics. According to the dictionary, "demographics" is:

> **"…the statistical characteristics of human populations (as age or income) used especially**

TWO WAYS TO READ THIS ISSUE:

1. The following discussion features two examples of demographics that many financial analysts believe could significantly shape the future. As you read the discussion, you might note how many of these demographic trends apply to your situation. Or…
2. If you don't have time for the supporting details, go to the last section (titled "Skipping to the End: From the Macro to You"), and read how your past financial decisions might need to be changed because of the new demographics impacting the economy.

to identify markets."

Why pay attention to demographics? Demographics can be huge long-term drivers of economic activity. First, they are important because they involve large numbers of people, which means what happens demographically occurs on a large scale, affecting millions.

Further, economic trends powered by demographics have typically played out over long time periods. We're talking several decades, even centuries. One of the most prominent examples in recent American history is the impact of the Baby Boomers – the dynamic population expansion in the United States that took place from 1946-1964. In one way or another, almost every major financial trend of the past fifty years has the imprint of the Boomers, from the growth of suburbia to the demise of employer pension plans. The ripple effects continue today – and probably will do so for another decade or two.

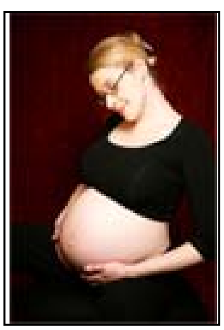
The long-term nature of demographic trends means many factors in place ***today*** are set to play out in a predictable manner in the future. So while no one can precisely project the future, demographics often offer reliable paradigms for future trends.

DEMOGRAPHIC TREND #1:
Depopulation of Industrialized Nations

From an economic standpoint, two demographic categories figure prominently in long-term national wealth and prosperity: total fertility rate and immigration. Put simply, an industrialized economy requires people. People to work, consume, and pay taxes to provide government services. Since people don't live forever, they must be replaced, either through the birth of children (fertility) or arrivals from other countries (immigration).

Fertility

The Total Fertility Rate (TFR) is a calculation of the number of children each woman bears in her lifetime. Worldwide, the United Nations states the TFR is currently 2.55. In general, a country must maintain a total fertility rate (TFR) of at least 2.1 to replace its native population. (For a representative sample of TFRs by nation, see the list on Page 6.)



Though over-population of the planet has been a concern of some social scientists since the 1800s, ***depopulation*** may actually be a greater immediate concern. The demographic trend of many developed nations is for older, declining populations, particularly among the developed nations of Europe and East Asia (China, Japan, and South Korea). This trend, already in place, presents some significant long-term economic challenges. In 2002, economist Paul S. Hewitt wrote a position paper titled "The End of the Postwar Welfare State" that outlined the economic consequences of depopulation.

> **Like it or not, our current economic and social organization depends on continued economic expansion. Without it, both government and private sector finances will become significantly more precarious. The most rapidly depopulating nations face the prospect of lengthy "aging recessions" characterized by a vicious cycle of falling demand, collapsing asset values, shrinking corporate profits, deteriorating household and financial institution balance sheets, weakening currencies, and soaring budget pressures.**

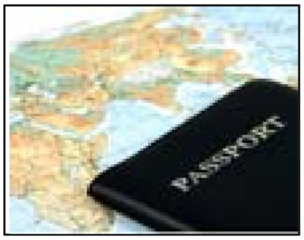
Based on his assessment of the demographic trends in 2002, Hewitt concluded many aspects of "aging recessions" would begin appearing sometime after 2010, and continue for the next three or four decades. This assessment has thus far proved accurate. As of 2009, Japan, Italy and Germany are already experiencing population declines. In the countries of the former Soviet Union, the drop has been even steeper, due to a combination of declining birth rates and increased mortality.

Shrinking populations with a higher percentage of elderly put pressure on governments to continue to maintain social services, particularly old-age pensions. The problem is too many retirees and not enough workers paying taxes. The current recession has only aggravated this burgeoning problem, as evidenced by the financial distresses of the group of European nations, whose acronym is "PIGS" (Portugal, Ireland, Greece and Spain).

Remember that demographic trends often play out over long time periods. Once in motion, demographic trends are slow to change. Even if families in low-TFR countries begin to have significantly more than two children per woman, repopulation may not happen fast enough to replace all the old people dying. In fact, when the TFR falls below 1.7, most experts think a population decline becomes irreversible. Which means the survival of many countries will depend on immigration.

Immigration

Of the countries with the highest TFRs, a high percentage are on the African continent, and all have underdeveloped economies. Many of these countries also have higher mortality rates, typically due to substandard health services, disease, and/or civil unrest, so population may not increase significantly even with higher TFRs. The combination of poor living conditions and limited economic opportunity provides strong incentive for many to emigrate. These are the people that can become the "replacements" for dying populations in other countries.



If you check the list, you will see nations on every continent that have TFRs well below the replacement rate. In other words, there are a lot of places where immigrants would be considered coveted human resources.

But not every country or region that needs outside population support is considered a desirable relocation destination. Some depopulated countries don't have the economic opportunities, some don't have cultures that accept outsiders, and others have repressive governmental structures. (There are very few people trying to immigrate to Cuba.)

U.S. Demographics: Near-Replacement + Immigration = Economic Vitality

Compared to other developed countries, the United States has a TFR almost at replacement, and the average has been inching upward over the past decade. In addition, the US remains an immigration destination of choice, both for individual freedom and economic opportunity. Even though immigration (both legal and illegal) has slowed during the recession, an estimated 1.5 million new immigrants have entered America each year during the past decade, according to the Migration Policy Institute.

Joel Kotkin is a researcher of global, economic, political and social trends, and the author of a new book, *The Next Hundred Million: America in 2050.* Kotkin sees good things ahead for America because of favorable demographics. As he writes in a January 23-24, 2010 "Culture" piece for the *Wall Street Journal…*

"As many other advanced countries become dominated by the elderly, the U.S. will have the benefit of a millennial baby boom as the "echo boomers" start having offspring in large numbers later this decade…

"Within the next four decades, most of the developed countries in both Europe and East Asia will become veritable old-age homes: A third or more of their populations will be over 65, compared with only a fifth of America… Like the rest of the developed world, the U.S. will certainly have to cope with an aging population and lower population growth, but in relative terms, the country will boast a youthful and dynamic economy."

While illegal immigration remains a touchy political issue, Kotkin focuses on the positives of newcomers to America, saying "immigration represents a critical component of our next wave of dynamism…What drives immigrants is their optimism in America's future." Further, Kotkin believes the United States will continue to have an immigration advantage as "nations such as Sweden, Denmark and the Netherlands have turned against immigration" and "our prime Asian rivals – China, Japan and Korea – remain even more culturally resistant to diversity."

DEMOGRAPHIC TREND #2:
Rectangular Longevity

Notwithstanding the current depopulation trends in some developed countries, the world's population has increased dramatically in the past century and is continuing to grow. In the 20^{th} century, the global population nearly quadrupled, with annual growth rates peaking in the mid-1960s. The key factors: Advances in hygiene, medicine and living conditions dramatically reduced infant mortality and increased life expectancy. More babies survive, and everyone is living longer.

And the demographic trend toward greater longevity shows no signs of slowing. Matt Ridley, an English writer on genetics, economics and human behavior writes "experts have been predicting for decades that average life expectancy will level out, but it stubbornly keeps rising. Others have predicted a growing burden of ill health among the elderly. Yet old people are healthier than ever, much of their illness compressed into shorter periods at the end of life."

Some researchers call this phenomenon of living longer and healthier the "rectangularization of the survivorship curve." Instead of deaths being distributed across a broad spectrum of ages from childhood to old age in some sort of statistical curve, in rectangularization "almost everybody lives to their full potential age, then dies," says Ridley.

In this world of rectangular longevity, there are many guesses as to how far lifespan can extend. Some project to age 150, or even 200 within the next century. Science writer Greg Critser, author of *Eternity Soup: Inside the Quest to End Aging*, suggests that even now living to 115 is realistic. Already, many life insurance companies have recalibrated the pricing and benefits of some of their policies with a "whole life" lasting until age 120.

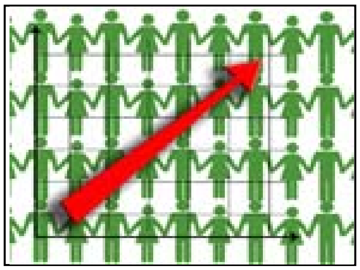
Applications and X Factors

What to make of these demographic trends? More to the point, ***how might these demographic trends affect your financial programs?*** Here are several observations:

Anticipate an extended lifespan. Thirty years ago, a financial professional might offer this paradigm: "You'll work for 40 years (from 25 to 65), to save enough to live another 20 years (from 65-85) in retirement." At that time, planning to live to 85 was considered a "top-end" projection of life expectancy. A generation later, it is reasonable to believe most of us will outlive our parents. It may seem outrageous, but a prudent plan should at least touch on the possibility of retirement calculations that run to age 100.

Prepare to work longer. If you are going to live longer, it may be necessary to continue working later in life. Furthermore, in aging or depopulating conditions, working longer may be both inevitable and desirable.

As a way to offset decreased revenues available for social programs, governments may raise the minimum age for receiving retirement benefits, as is gradually occurring with Social Security in the U.S. Similarly, the age 59½ condition for accessing qualified plan assets without penalty could change. Beyond regulatory incentives, depopulation often improves employment prospects – there are fewer workers to fill positions, and it becomes an employees' market. This means if you want to work, it's likely that someone will want to hire you.



Self-employment and phased retirement are likely possibilities. A February 8, 2010 *Wall Street Journal* Small Business Report begins with this statement: **"Welcome to the age of going solo."** Some additional comments:

"More Americans are working as consultants or freelancers, either having given up or been forced out of the salaried world of 9 to 5…Evidence now suggest this is our new economic condition. Today, in fact, 20% to 23% of US workers are operating as consultants, freelancers, free agents, contractors or micropreneurs." Without a surge of younger, cheaper employees to support pensions and long-term employment, self-employment is a logical business move. In a slower-growing or depopulating economy, contract and consultant work is the most efficient way for employers to harness the job skills of aging baby boomers.

A variation on self-employment is phased retirement. The phrase "phased retirement" encompasses a broad range of formal and informal employment arrangements to allow employees to continue working, usually with reduced workloads, as a transition from full-time work to full-time retirement. These arrangements may include allowing employees to draw partial retirement benefits while remaining employed.

Phased retirement is seen as a win-win for both older workers and employers. Workers can gradually ease into retirement while maintaining a higher income than they would receive if they quit work entirely. Employers retain skilled older employees who would otherwise retire, leaving the company to replace and retrain the retiree, often at higher cost.

Under current tax laws, a phased retirement that includes partial withdrawals from retirement accounts while still employed faces some hurdles in the way of age and income thresholds. But changes seem likely. An August 2008 AARP bulletin noted that the 2006 Pension Protection Act for the first time allowed employers to let workers 62 and older to take distributions from traditional pensions and to continue working.

New forms of retirement saving will be needed. The IRA started as a supplemental retirement plan, then spawned the 401(k) as corporate pensions declined. Similarly, intermittent self-employment and phased retirements will necessitate other formats for long-term saving. The account will probably include some tax incentives for saving, yet allow access under a broader range of circumstances.

Insurance rates will change, for both public and private programs. It doesn't matter how strenuously politicians avoid the issue, depopulation means government-sponsored insurance and pension plans must change. For old-age programs like Social Security, the options are to increase taxes on a proportionately smaller working population or decrease benefits. Eventually, a threshold for taxation will be reached and the only choice will be to cut benefits. This is already happening in some formerly communist, low-TFR countries in Eastern Europe.

As mentioned earlier, life insurance premiums for some products have been adjusted for longer life expectancies. This may result in lower annual premiums because the insurer believes it will receive payments for a longer time before incurring a claim.

On the other hand, monthly pension and annuity payments may decline as well. Instead of longer periods to collect premiums/deposits, pension funds and insurance companies now face the prospect of making payments to retirees for longer periods.

Current demographic trends favor the United States. In general, growing populations fuel economic opportunities; more people make for larger markets – for goods, services, housing, etc. Since the beginning of recorded time, people have migrated to places where prospects for a better life existed. It is accurate to state that population demographics have a big impact on long-term financial well-being.

But other variables can play a part as well. Repressive political regimes, punitive taxation, wars, disease and natural disasters can diminish or destroy prosperity. Even the strongest demographic tracks can be derailed.

In many ways, the issues reported every day on cable news channels are evidence of the demographic changes moving across the globe. The United States is certainly not immune to the long-term impact of depopulation, immigration and aging society. Many of the political arguments in the United States have their roots in these demographic trends.

Still, in spite of the noisy political squabbles, the demographics say the United States remains a land of opportunity, and has a good chance to continue to be one in the future.

Skipping to the End: From the Macro to You

Here's a summary for those who blew by the first four pages:

Demographic trends, i.e., the analysis of population statistics to identify markets, can uncover significant, large-scale, long-term economic movements that are already in place. Once in place, demographic trends may take a long time to play out, so understanding these trends may be valuable in shaping future financial plans.

Among the most significant trends currently affecting the industrialized world: Depopulation of developed countries, particularly in Europe and East Asia, coupled with more people living to the limits of extended life expectancies. The result: decreasing populations with an increased percentage of older people, a format that will be unable to sustain social and economic models started in the post-World War II era.

As a consequence of these changing demographic trends, many of the paradigms and products related to personal finance may need to be adjusted. This includes length and type of employment, retirement and accumulation planning, self-employment and insurance programs (both public and private).

In light of these conclusions, think of your own financial programs. The following questions might be relevant:

- **Are your retirement plans designed to provide income and security to age 100 and beyond?**
- **Does your career path include working, in some capacity, well into your 70s (or 80s)?**
- **Are your savings and retirement programs structured to accommodate self-employment or phased retirement?**

On reflection, a lot of financial information is just trivia that takes up space and is quickly forgotten. But historically, economic demographics seem to have staying power. The last great demographic trend began after World War II. More than sixty years later, the Post-War demographics are finally winding down, and in developed countries, the rising demographics of depopulation and rectangular longevity are already in place. **Do your financial programs account for the possibilities – and perils – of these new trends?** Remember, the impact of demographics can span decades, even centuries.

HOW WILL YOU MEET THE "10,000-HOUR RULE" FOR YOUR FINANCES?

Malcolm Gladwell is the author of the best-seller *Outliers: The Story of Success*. The book attempts to identify both internal and external factors that seem to appear consistently in the lives of successful people. Rather than simply attributing personal success to ambition and hard work, Gladwell identifies other diverse variables, including the month of one's birth, the era in which you were born, the occupational background of your parents and grandparents, and how many hours a year people work in your culture. In examining all these items, Gladwell concludes that success is as much about what is around people as what is in them (in the way of natural gifts and abilities).

These external factors don't deny the value of ambition and hard work. In fact, one of the most significant factors mentioned in Gladwell's book is what scientists call the "10,000-hour rule." In an interview that appeared in the March 15, 2009 issue of *Bottom Line Personal*, Gladwell explains the 10,000-hour Rule:

> **"When we look at any kind of cognitively complex field -- for example, playing chess, writing fiction or being a neurosurgeon -- we find that you are unlikely to master it unless you have practiced for 10,000 hours. That's 20 hours a week for 10 years. The brain takes that long to assimilate all it needs to know to achieve true mastery."**

At first glance, this simply reinforces the old adage that "practice makes perfect." However, Gladwell takes it a step further: Even people with great natural abilities cannot sidestep, shorten or go easy on the 10,000 hour requirement. The repetitions are absolutely necessary to fully release one's talent.

The assembly and management of a profitable financial plan probably falls under the definition of a "cognitively complex task" – there are a lot of pieces, some of which may be rather complex in design, and the complexity increases when you attempt to integrate these items to create a functioning whole. Perhaps it's not as demanding as neurosurgery or as thrilling as performing a concerto before a large audience, but managing your finances isn't something that fits in the category of "easy." So it stands to reason that in order to maximize your financial potential, "mastery" of your financial programs would require something similar to 10,000 hours of practice.

Is it realistic to expect you'll devote 20 hours a week to becoming the master of your financial universe? Is it realistic to devote even five hours a week to the task? Or is it better to find someone else who has already crossed the 10,000 limit?

Whether the 10,000-hour rule applies to your work, or the efforts of those who help you, experience and ability are an unbeatable combination. If you aren't going to put 10,000 hours into your financial programs, why not make sure you work with someone who has?

2009 TFR Rankings:
The Statistics of Depopulation

The United Nations TFR Ranking is a list of countries by total fertility rate (TFR): the expected number of children born per woman in her child-bearing years. The UN ranking is sourced from the United Nations World Population Prospects report published in 2007. The TFR numbers reflect revisions for 2009. Shown here are selected countries, representing both ends of the TFR spectrum.

Rank	Country	births/ woman
1	Niger	**7.19**
2	Guinea-Bissau	7.07
3	Afghanistan	7.07
51	Haiti	3.54
77	India	2.81
89	Panama	2.56
WORLD AVG		**2.55**
90	Venezuela	2.55
110	Mexico	2.21
126	United States	2.05
131	New Zealand	1.99
132	Ireland	1.96
133	Chile	1.94
144	Norway	1.85

Rank	Country	births/ woman
148	United Kingdom	1.82
150	Denmark	1.80
153	Australia	1.79
154	China (mainland)	1.73
160	Canada	1.53
162	Cuba	1.49
166	Switzerland	1.42
169	Spain	1.41
173	Italy	1.38
175	Germany	1.36
177	Russia	1.34
184	Japan	1.27
190	Poland	1.23
192	South Korea	**1.21**

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