Volume #6: Shifting Demographic Manifestations

Now that 3RC has introduced all four of the Factors of Influence (*Shifting Demographics, Increasing Global Conflict, Lower Energy Costs and the Modernization of Things*), we want to further dive into the manifestations of those factors, starting with the *Shifting of Demographics* in the U.S. and what it will likely mean to investors. So far we have taken a very broad view of the factors of influence and only touched on some of the manifestations that have become apparent. In this volume, we look to develop these manifestations further and set the framework for the next phase of our discussions.

The illustration below outlines some of the key manifestations we see emanating from the Shift in Demographics that will take shape over the next decade and beyond. 3RC is tracking several manifestations that will continue to shape our thematic lens and will be what we will use to uncover the most compelling investment opportunities for our investors.

As outlined below, the two major factual drivers related to the shifting demographics in the U.S. are the aging Baby Boomer population and Millennials entering traditional peak spending years.

Factor of Influence	Factual Drivers	Manifestations
Shifting Demographics	The Aging Baby Boomer population	• Increased demand for: o Health products and services o Wellness products and services o Travel and leisure o Pet care and products
	Millennials enter peak spending years	• Changes in consumer preferences, customizations and timing of traditional spending habits

The Aging Baby Boomer Population

Data from the U.S. Census Bureau shows that there are approximately 75 million Baby Boomers. They buy 60% of all packaged goods, spend 75% more on vacations than all other cohorts, and buy half of all the new cars in the U.S. They own 1/3rd of the iPhones and half of all personal computers[1]. They were also the most represented in the Presidential election as a percentage of their cohort who voted and the current average age of President Trump's cabinet is 62 years old[2]. In a nutshell, the Boomers own and now rule America.

The U.S. is not the only country with an aging population. This trend will have a substantial impact on other international markets as well. Canada, Japan and most of Europe have older populations than the U.S.[3], so manifestations from the shifting demographics will not be confined domestically. Meaning, 3RC will not shy away from domestic companies that meet overseas demand due to demographic shifts.

Health Products and Services

The demands of this generational cohort are about to enter a dramatic change. Over the next decade, most Baby Boomers will pass age 65, the period of life when we traditionally see as much as a 40% increase in healthcare spending[4]. Over the next 10 years, more and more people will retire and their health will continue to deteriorate. This shift in health will lead to a significant increase in demand for traditional healthcare related products and services, diagnostics, and drugs. However, malady-based design needs, like step-free entrances, single floor living, under-counter-appliances and mobility devices that accommodate current housing designs, are likely to see a dramatic increase in demand as well.

One of the larger subsets of the Boomer demographic is those who are currently, or soon will be, dealing with aged parents. Many Boomers feel incapable of dealing with their parents' problems themselves[5]. They want to know what options are available or are looking for qualified people to help with specific problems such as home care or moving an elderly parent from his or her home to new quarters. At the older end of the Baby Boomer cohort the demand for these services will come from the Boomers themselves.

While it is highly unlikely that 3RC will pursue traditional healthcare-related investments, (e.g. hospitals and drug companies) home care services, out-patient facilities such as rehabilitation clinics, and malady-based product manufacturers will be on our radar for the foreseeable future. Additionally, opportunities in at-home senior care across the spectrum to death-related products and services will be an area of continued study as well.

Wellness Products and Services

Presently, most of the Baby Boomers still feel relatively healthy. This can be attributed to the fact that many Boomers care about their health as they see health and fitness as a way of staving off the aging process. Although they are over 50 now, most won't will admit it and will do whatever they can to forestall the effects of aging. Baby Boomers have historically been focused on health and fitness. In 1968, less than 24% of American adults exercised regularly; by 1987 that figure had risen to 69%[6]. Although physical exercise becomes more difficult, Boomers' interest in boosting physical performance and prevention of disease is still top of mind. They are simply looking for newer ways of achieving the same goals. This can be best illustrated by the rapid increase in the size of the global nutraceutical market which stood at $165 billion in 2014 and is expected to reach $279 billion by 2021, a 70% expected increase[7]. This is almost entirely driven by the desire to find boosts in physical performance and disease prevention by Baby Boomers.

More recently, we have seen the next health and wellness trend emerge by the introduction of health tracking devices which track things such as your heart rate, sleep patterns and calorie burn. While these devices are not, in and of themselves, of interest to 3RC, the proliferation of their use only solidifies the fact that consumers (mostly driven by Baby Boomers) are tracking their health and plan to do whatever they can to extend life and more importantly, improve their quality of life.

Another area of health and wellness that has seen a dramatic increase in interest is organic and locally-sourced foods. New diets that emphasize natural ingredients and eliminate processed foods have become more of the norm, especially in parts of the population that have the economic means. In 2015, organic food sales in the U.S. topped $39B up from just $13B in 2005 (3x in 10 years)[8]. Big bets by Costco, Target, Wal-Mart and Kroger are likely to continue this trend as they attempt to keep pace with consumer demand. We have also seen a proliferation of organic and locally-sourced food in the food service industry as restaurants attempt to keep pace.

The manifestation towards wellness is one that may present several opportunities for 3RC and we will look to narrow our focus with further analysis that will separate trends from fads. In the interim, we have investigated several opportunities, and will continue to investigate areas such as low-impact exercise equipment, non-conventional forms of exercise such as aquatics, products that address the desire for Boomers to improve their quality of life, and companies in the organic food industry. In our next demographics report, we will share our findings on which industries we will focus on in this segment.

Travel and Leisure

One big Boomer trend is the compulsion to "see it or do it before it can no longer be seen or done". Be it the Great Wall, the Great Barrier Reef, or Venice, Boomers feel a need to visit places, see species, and experience different lifestyles for themselves before the opportunity is no longer available to them. Per industry research, Boomers spend $157 billion on trips every year and many polls rank travel as their number one leisure activity[9].

As mentioned, Boomers don't think of themselves as being old and are generally in good shape, so they are always up for a challenge. Thus, adventure travel such as kayaking, cycling, hiking, scuba diving, skiing and mountain biking is enjoying popularity among the Baby Boomer cohort. Additionally, while Boomers still feel young they are also realistic about the ticking clock. While some people have been lucky enough to start checking items off their "bucket list" for years, many Boomers have not had the time and/or the money to live out their dreams. Now that they have entered, or will be entering, retirement, more and more Boomers will find the time and money to achieve something that they have been waiting for their entire lives.

Medical Tourism is another Boomer-driven trend and is now a $40 billion a year industry driven mostly by the high cost or lack of alternative medical procedures in the U.S. Looking at the national averages, a heart bypass in the U.S. can cost $144,000. Conversely in Israel it costs only $27,000. Health care in other leading countries is generally considered to be as good as one might receive in the U.S., and with all the uncertainty surrounding healthcare coverage in the U.S., it can be expected that medical tours by Boomers will become ever more prevalent in the future[10].

There are several opportunities that could present themselves due to this anticipated increase in interest in travel and leisure, which 3RC intends to research further. Between now and our next demographics report, 3RC will be focusing research efforts in segments of the travel and leisure market that may present attractive investment opportunities, which may be directly or indirectly affected by the Baby Boomers continued spending on travel and leisure.

Pet Care & Products

Dogs and cats aren't just pets anymore; they are treasured members of the family. Remember the old days when dogs slept in dog houses? Not in a Baby Boomer household. Boomer pets eat, sleep and do things with their owners. They watch TV, they get dressed up, and they have their own friends and their own doctors. They have become a multi-billion-dollar industry. While Baby Boomers make up approximately 25% of the U.S. population they own 37% of the pets[11]. Just a few years ago, it was felt that as Boomers aged they would give up their pet ownership as past generations did. However, Boomers have always broken the old rules and the recent increase in the growth rate in the pet industry is yet another example of their divergent behavior.

Per the American Pet Products Association, Americans spent $60B+ in 2015 on their pets. The pet services segment, including grooming, boarding, pet hotels, pet sitting, day care and other services has been the fastest growing category. Perhaps more startling is the fact that 68% of U.S. households own at least one pet[12]. The explosion of pet ownership in the U.S. is driven by the Boomers who were the first generation of Americans for whom pet ownership was common. Before them, farmers and other rural Americans had cats and dogs who lived outside and ate table scraps and rodents.

Boomers made pets part of the family and brought them inside. Now that their nests are empty, they have filled them with furry family members, providing the daily love and affection they once received from and gave to their children. As mentioned, the Boomer generation is generally in good shape and pets not only encourage you to stay active, they help to overcome loneliness and boredom.

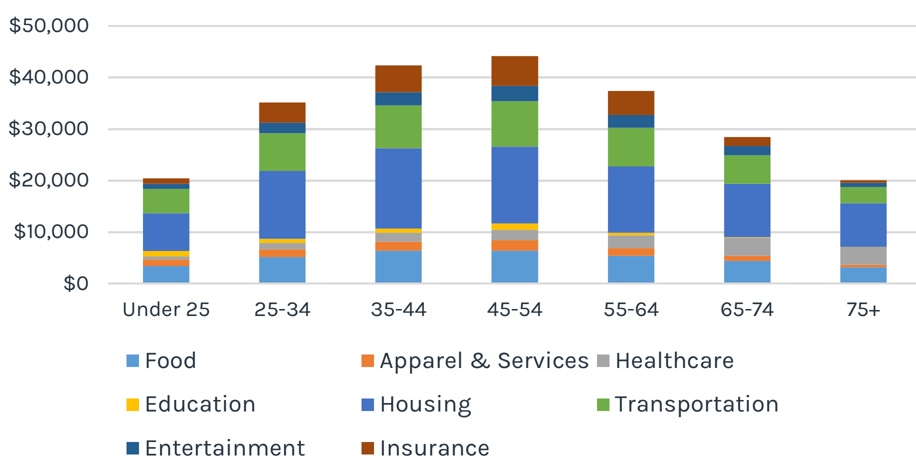
Pets provide a focal point for your attention and demand certain structure to your day, something that many people miss following retirement. Boomers love their animal companions so much there is seemingly nothing that they won't do for them, and that has caused the pet-care and pet food markets to explode. Boomers want to provide the same type of nurturing to their pets as they would their own children. Recognizing the increased demand in a certain market can open doors to business opportunity, which can be in the form of products and services. 3RC has investigated several opportunities in the pet products market and intends to delve deeper into the industry to find opportunities that we can exploit.

Millennials Enter Peak Spending Years

Personal consumption is the largest pillar of the U.S. GDP, accounting for 70% of the economy[13]. Since the 1980s, the Baby Boomer generation has been an enormous engine behind that spending. But as the Boomers pass the torch to the Millennials, several questions arise. Will the younger generation provide the same engine of GDP growth that the Boomer generation has? Will they have similar spending patterns? Most importantly for us, how should investors position their investments to make the most of this transition?

The first, and primary question is, will the Millennial generation provide an engine of economic growth on par with that of the Baby Boomer generation. The Millennial population has recently surpassed the Baby Boomers in terms of population. In the next 20 years, the population of Millennials will be more than double the Baby Boomers, supporting the notion that the Millennials will be there to continue to fuel the demand economy[1]. Despite differing buying habits and behaviors (see "Alternative Spending Habits" below), they are still subject to the same powerful force as their parents, namely, aging. As consumers age, their spending increases, with the U.S. consumer's peak earnings, spending, and investing years between ages 35 and 55. This increase is most noticeable in housing and insurance, as the next generation settles down and starts families.

Consumption Levels by Age Group 1984-2013[13]



In 2016, the first Millennials, the largest generation of the U.S. population, turned 35 and began entering the peak spending years. As the rest of the cohort ages, the number of people in their peak spending years will increase and their aggregate spending is expected to increase by 25%, driving demand for new homes and all the related products and services that go with home ownership[13]. College loans may be swapped for home loans and life insurance as this new matures. In the next two decades, spending by Americans (then) 50 or older is projected to increase by 58%[13]. It is important to note that the last secular bull market in U.S. stocks began in 1982, just when the first Boomers turned 35.

The difference this time is that more parents of Millennials will still be alive to contribute to the economy. When Baby Boomers took the reins of growth in the 1980s, only 12% of the population was older than 65[2]. Today that number is 15% and growing rapidly[2]. Through 2046, the 65+ population is forecast to increase to 22% of the population[2]. Boomers control 70% of the nation's disposable income which means they will still maintain enormous spending muscle as compared to previous generations in the 65+ and 75+ age categories.

Educational spending may come to define the Millennials the way owning a house with a two-car garage were emblematic of the Boomers. On average, Millennials under 25 spend 4.2% more of their income on education than their parents did[14]. Higher costs have meant more student debt which has put a damper on spending. From 2005 to 2012, the average amount of student debt for Americans under 30 nearly doubled from $13,340 to $24,897[14]. Worse, although Millennials are the most educated generation in history with 61% attending college, they have encountered a more challenging job market[1]. Millennial employment rates plummeted during the financial crisis and still haven't fully recovered. In addition, more Boomers have opted to stay in the workforce longer, which may be squeezing Millennials on the career front.

Another key differential between Millennials and Boomers is household formation. The oldest Millennials have been marrying later, affecting many related consumer categories such as furniture, appliances and child care. However, between 2011 and 2015 household formation began trending upward and is expected to accelerate moving forward. The housing market has changed. Home prices have increased 250% since 1980 and Millennials are spending 7.7% more of their wallet on housing than the Boomer generation did at a comparable age[2]. Thus, the number of non-married people under 35 sharing a home or apartment has grown. Despite this trend, 89% of current Millennials who rent still plan to buy a home, compared with 77% of Generation X[2]. As Millennial employment continues to improve and household formations grow, Millennials are expected to fuel new sales in housing and housing related markets.

The Millennial generation is expected to provide a powerful economic growth engine. However, the changing demographic structure is creating important spending shifts mostly driven by the tastes and habits of Millennials, who like their parents (Baby Boomers) are rule breakers.

Alternative Spending Habits

When talking about Millennials one must understand their buying and spending perspectives. Millennials tend to do a lot of things differently than their parents. They would rather pay for an Uber than a new outfit. They are cutting cable to avoid TV advertising and media that they do not trust. Their spending habits continue to fascinate and frustrate as they continue to defy historical spending habits.

Millennials represent a little over a quarter of the population and $200B in annual buying power and that is even before they all enter their peak spending years[1]. So, it is essential to understand their buying habits and perspectives.

Currently, Millennials would rather buy a car and rent an apartment. The economy has had a major impact on Millennials, many of whom have crushing student loan debt, still live with their parents, and are underemployed. Since they are getting married, having children and getting decent paying jobs later in life, they are putting off owning a home. That tendency will likely change as Millennials will inherit $30 trillion from Baby Boomer parents in the upcoming years[13].

Millennials are far less likely to buy something because it is convenient, a buying pattern that many companies capitalize on. Rather, they are focusing on the value received for money spent. Millennials are willing to search for the lowest price on an item or patiently wait for the right deal to present itself. They take their time to contemplate the personal value of each purchase, not just buying what is in front of them. This buying pattern oftentimes translates into spending money on personal experiences, such as a nice vacation, instead of acquiring assets[15].

Today, Millennials that are recent college graduates are not looking for home furnishings and baby food, but are more interested in paying for fast internet and entertainment. Newlyweds, conversely will spend money on wedding expenses and a new home. Once they have children they will begin to enter the mindset of “we” instead of “me” and buying patterns are more likely to follow more traditional lines. Inevitably, there will be a large portion of the cohort that remain true to their Millennial roots and won’t look to buy products or things. Instead they will invest their money in experiences. They will spend most of their discretionary capital on tickets, concerts and excursions[15].

While 3RC has only begun to scratch the surface on the study of the Millennial cohort and the affect that they will ultimately have on the economy over the next decade, we are sure that they will be impactful. This cohort will eventually enter peak spending at a time when Boomers die-off or at the very least reduce their spending. The habits and tastes of Millennials will be driven by value and not convenience. They will leverage and adopt technology in all that they buy and use. They are large in number and when their buying patterns become more in line with traditional peak spending, tailwinds will occur behind segments of the economy like housing, transportation and entertainment. 3RC will continue to study their buying patterns and track their movement into their next stages of life with great interest because similarly to the Baby Boomers, the larger Millennial cohort will be the driver of the economy for the next 30 years.

<u>Sources:</u>

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