Is there a baby boomer retirement effect on the stock market?

By **Frederic P. Slade** | May 21, 2018 at 07:49 AM

Would a rise in U.S. interest rates cause baby boomer retirees to shift out of stocks into CDs and other fixed income investments? (Photo: Shutterstock)

In 2014, I looked at the potential impact of present and future baby boomer retirees (those born between 1946 and 1964) on the stock market. As the first wave of baby boomers attained "normal" retirement at age 65 (and approached age 70 ½), an important issue was raised: Would all these retirees depress the stock market as they cashed in their savings? After all, "boomers" have been estimated to own approximately half of the U.S. equity market.

- At that time, studies by **Vanguard (https://institutional.vanguard.com/iam/pdf/Baby_boomers_and_equity_returr** and others cast doubt on the theory that boomer retirements would depress the equity markets. Some of the factors cited continue to hold sway, while others may be more tenuous:
- The retirement ages and retirement years of the baby boomer population will be spread out over time. This will tend to smooth out the buy and sell decisions of this group. This continues to be true, especially as this age group continues to retire later.
- Low interest rates will provide an incentive for retirees to diversify further into stocks. Interest rates have come off their lows of 2016 and the Federal Reserve has been raising rates. This may result in bonds and cash becoming more attractive.
- Even if U.S. retiree holdings of stocks decline, foreign ownership of U.S. equities, which increased from 7.2% in 1990 to 20.6% in 2012, will help compensate for this decline. This percentage has been relatively constant, and foreign investors have pulled back their stock holdings when markets have declined.
- The wealthier tend to save more. Vanguard estimates that the top 20% of boomers in net worth own 96% of the equities owned by the entire baby boomer population. This high net worth group generally does not need to sell stock to meet their short-term spending needs. Also, they tend to accumulate assets for their estates. These trends seem likely to continue in light of the current distribution of wealth and income.
- Longer expected life spans, resulting in increased costs of living, will create additional demand for equity investments to keep up with inflation. While living costs are expected to continue to rise, general inflation has been generally tame (under 2% per year). This may reduce the need for equities to counteract the impact of inflation.

What could cause boomer retirements to have a negative effect on the stock market?

- The baby boomer population has significantly increased the allocation of its portfolios to stocks, estimated as high as 70% on average. A repeat of the 2008 market decline and/or volatile markets may cause retirees to become more risk averse and increase their allocation to bonds and cash while reducing their equity holdings.

- In the case of a global recession, foreign demand for U.S. equities may decline as these investors may become risk averse and sell their U.S. holdings. In this instance, foreign ownership may exacerbate any decline in U.S. retiree stock holdings.
- A meaningful increase in U.S. interest rates could cause retirees to shift out of stocks into CDs and other fixed income investments.
- An increasing reliance on 401(k)s and other defined-contribution plans, as opposed to traditional defined benefit plans, to provide retirement income may result in a greater emphasis on capital preservation, which could reduce equity holdings by boomers.

In summary, there are many factors that may impact the investment behavior of baby boomers in retirement. However, a demographics-driven decline in the stock market does not seem likely at present. Nevertheless, it remains to be seen how things will play out as future waves of retirees tap the financial markets-especially in an uncertain and volatile market environment.

NOTE: Information presented herein is for discussion and illustrative purposes only and is not a recommendation or an offer or solicitation to buy or sell any securities. Past performance is not a guarantee of future results.

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