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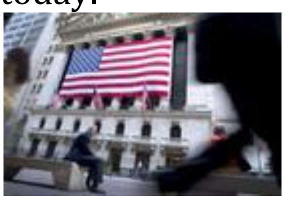
Baby Boomers May Hold Down Stocks for Decades, Fed Paper Says

By Vivien Lou Chen - Aug 22, 2011 1:20 PM MT

Aging baby boomers may hold down U.S. stock values for the next two decades as they sell their investments to finance retirement, according to researchers from the Federal Reserve Bank of San Francisco.

Americans born between 1946 and 1964 are beginning to retire as the U.S. stock market is still recovering from the financial crisis that began in 2007 with the collapse of the subprime-mortgage market. The timing is "disconcerting" and, since stock prices have been closely tied to demographic trends in the past half century, "portends poorly for equity values," adviser Zheng Liu and researcher Mark Spiegel wrote in a paper released by the bank today.



A man sits on a bench in front of the New York Stock Exchange in New York on Aug. 1, 2011. Photographer: Jin Lee/Bloomberg

The equity-price-to-earnings ratio of U.S. stocks tripled from 1981 to 2000 as baby boomers reached their peak working ages, and has declined since then, according to Spiegel and Liu. Overseas investors' demand for U.S. stocks might help mitigate the effect of a baby-boomers' sell-off, yet the impact would probably be limited, they said.

"For many primary purchasers of U.S. equities outside the U.S., their demographics are even worse than ours, in particular Europe and Japan, which have older age profiles prevailing than the U.S. does," Spiegel, vice president of the bank's research department, said in a telephone interview today.

At the same time, foreign investors, including sovereign wealth funds, may decide to hold a larger share of U.S. equities, Liu and Spiegel said. Also, emerging market countries such asChina may ease capital controls, allowing their citizens to invest in U.S. equities, they said.

No Hard Rule

"We're well aware that a lot of other things can happen" that would buffer the impact from retiring baby boomers, said Spiegel, 50. "There's not necessarily a rule that this is the only thing that's going to drive prices going forward."

Still, "we do see it as something of a headwind as the economy is attempting to recover," he said.

The Standard & Poor's 500 Index has dropped about 28 percent since October 2007, and declined almost 11 percent this year. The index rose less than 0.1 percent to 1,123.82 at the 4 p.m. close today in New York.

Jeremy Siegel, 65, a finance professor at the University of Pennsylvania's Wharton School in Philadelphia, has also researched the link between demographics and U.S. stocks. He said that growth in developing countries should generate enough demand to absorb a baby-boomer selloff and "keep stock prices high."

As long as the economies of countries like China and India expand at an annual rate of at least 4 percent to 6 percent, investors "will have the resources to buy our stocks" and "keep our stock market fully valued into the future," Siegel, author of the 1994 book "Stocks for the Long Run," said in a telephone interview today.

"If we don't get growth abroad and block foreign countries from buying U.S. companies, the outlook for U.S. stocks is much worse," Siegel said.