SECULAR TRENDS OF THE NEXT 16 - 18 YEARS

BY ALVERY A. BARTLETT JR.

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1. The front end of the Baby Boom generation is just starting to turn 55. There will be a constant supply of newly arrived 55 year olds for the next 18 years. This will result in a shift of focus from capital appreciation to capital preservation. Age 62 is when the change in investment focus is most pronounced. Favors low risk, low debt, high quality real estate investments over stocks and bonds (which have no inflation protection).
2. As the Baby Boomers age there will be a persistent desire for low risk, inflation protected income investments. These are very scarce, especially those with a reasonable chance for 5 to 10 year appreciation. This need for income could eventually approach manic proportions. Witness the equity buying binge of the late 1990's when Baby Boomers went in search of capital appreciation. Favors Real Estate.
3. An equity to bond market price adjustment, which prices stocks to bonds at a level somewhat closer to the norm. The 5% risk premium historically assigned to stocks over bonds is now -1%. This would require a 6% shift to revert towards the last 74-year average. Any reversion to the mean greatly disfavors stocks to bonds.
4. There has been 18 years of dis-saving or under-investment in commodities and approximately 10 years of under-investment in real estate, visa vis equities. Any renewed interest in real assets could result in a significant gain, in order to rebalance portfolios along some historical norm. This favors commodities and real estate over stocks.
5. Actuarial and need driven realignment of the assets and liabilities of pension funds. Stock assets, by their very nature, have extremely long dated time horizons. Pension fund liabilities, however, are relatively short in term, as the aging population retires and collects. Institutions no longer hold the bulk of their funds in layered bond positions, a policy which almost inadvertently resulted in the proper matching of assets and liabilities. At the beginning of the bull market it was not uncommon for institutions to hold 70% of their assets in bonds, today it is the inverse of that. Unless pension funds reduce their equity exposure; they could be forced to sell depreciated stock positions at an inappropriate time and price. This is a serious issue and greatly favors bonds and value investments with dependable income, especially real estate.
6. The paying down of excess corporate debt, which will require a combination of new stock issuance, default and/or time. This will result in the relative under performance of stocks to high quality bonds.
7. The long expected and overdue emergence of China, as a world-class consumer of commodities and creator of political mischief, will eventually result in higher commodity prices. Favors inflation and disfavors bonds.
8. Realignment of the dollar (which has gotten, or is about to get, grotesquely and secularly overpriced) with other world currencies. Favors commodities, disfavors bonds and equities.

9. Political turmoil as America wrestles with important social issues, which have moral overtones. These God's vs. Man's law issues will continue to divide the electorate and take a decade of wrangling to resolve. Favors inflation and disfavors equity and debt.

10. Shift from a disinflationary economy to a gradually increasing inflationary economy, concluding with a late inflation serge at the end of the cycle. This will result in the meaningful under performance of bonds and stocks to commodities and real estate (which at least can benefit from C.P.I. rent escalators).

11. In this last stock market cycle, investors were rewarded for buying every break. This is because money never really left the market. Dollars were rotated among sectors, resulting in rolling corrections. Now, for broad market segments, the strategy of buying every break is not working. Investor income needs are becoming more obvious and the punished momentum trader is growing older and more value oriented. The relatively attractive, neglected and inflation protected asset class of real estate could emerge as a reasonable alternative to stocks and bonds. As asset class realignment replaces stock sector rotation, it will have negative long-term implications for equities and positive ones for real estate.

12. In the 1970's, banks (through sometimes careless lending) facilitated the investment craze in oil, farmland and other commodities. This was driven by the partially flawed belief in scarcity, best represented by the "Club of Rome". In the 1980's, banks and other real estate lenders facilitated the investment craze in commercial real estate. This was somewhat motivated by the rushed assumption that the U.S. white-collar worker would replace the blue-collar worker - that the factory of the global U.S. economy would be an office building. In the 1990's, investment banks and corporate suppliers helped to fuel the investment craze in equities. This was driven by an over zealous and mostly misguided belief that the Internet and technology revolution would not only change the way the world functions, but how it should value liquid assets. Looking back, the investment bubbles of the 70's and 80's required serious corrections and a decade or more for adjustments to be made. Current value can usually be found in the assets of the previously burst bubble, as investor interest and financing caution have memory that lasts at least one investment cycle. The fresh memory of the recent real estate crash and the not so distant memory of the last commodities disaster, has served to preserve value in these investment classes relative to equities.

13. Twenty years ago, the investment world thought the ideal allocation of liquid assets was a 50/50 balance between stocks and bonds. Commodity investments were not a serious contender for asset allocated funds. The financial industry still has not designed a truly representative, low risk, liquid investment option in this class. Up until recent times, real estate was not considered a serious liquid asset alternative either. The restructuring and securitization of real estate is changing that and publicly traded REITS are growing in popularity. Hundreds of millions of dollars in private REITS will gradually be converted to liquid status through IPO's. The importance of real estate, as a liquid asset, could grow dramatically. Providing a measure of liquidity, to what has been traditionally just a fixed and illiquid asset, will encourage the redefinition of real estate as an equal investment alternative with stocks and bonds. This shift could be slow but global in scope; it would have great implications for the appreciation of all income producing real

estate assets over stocks. In the next investment cycle, asset allocators and portfolio theoreticians might consider stocks, bonds and real estate in more comparative terms.

14. Below is the Stock cycle after it has been crudely adjusted for inflation, currency values and interest rates - i.e. price adjusted highs and lows. The commodity and interest rate cycle have a strong and historic tendency to move in the opposite direction, with a two year lead. If this 18-year cycle analysis proves to be correct, it significantly favors real estate and commodities over stocks, bonds and cash.

	1929		1964		2000	
1911		1946		1982		2018

15. Massive consolidation and restructuring of stocks that have been badly damaged, and are now stuck just above the danger zone of de-listing, will be required. This investment banking work will soak up vast quantities of equity risk capital. There will be equally ravenous equity raises required to liquefy and harvest a veritable cornucopia of venture capital funded businesses. This disfavors stock appreciation.

16. The overwhelming need for equity funding will necessitate the reduction or near elimination of capital gains tax, in order to free up risk capital. This could produce a large and previously untapped supply of equity for sale. It does not initially favor equity appreciation.

17. The Baby Boomer vote is powerful and, when combined with the previous aging generation, will almost certainly reach their political objectives. Given the need to maximize their incomes, they will probably demand the elimination of the taxation of dividend income. If the double taxation of dividends is abolished or reduced, it would be most positive for dividend paying stocks and especially REITS (that could possibly reorganize as "C" corps).

18. Gradual privatization of Social Security (5-25%) to support the Stock Market and help with the very worrisome issue of Social Security under-funding. Favors all suitable conservative investment products, especially those with low debt and high dividend income.

    NOTE: The above comments strongly suggest the possibility of a secular bull market in commodities, a secular bear market in bonds and a more two-sided stock market (with occasional imbedded cyclical bull markets). It means that equities, on a price adjusted basis, could take up to 18 years to absorb the awesome gains of the last 18 years; that stocks could meander between slightly higher highs and the lows of the mid to late 1990's. This favors the ownership of private limited partnerships, known as Hedge Funds, which can take advantage of bull, bear and sideways markets in all three-asset classes of stocks, bonds and commodities. It favors real estate and commodity over stocks and bonds.

19. Globalization and fungability of packaged products facilitated and necessitated by the Internet.
20. The almost total commoditization of transaction and base product business will necessitate the sale of syndicated, creatively packaged products. This disfavors all but a few large, low cost transaction firms. It favors fee-based funds management.
21. Continuing domination and consolidation of the brokerage business by banks. This commoditization and a sideways stock market, will result in the occasional glut of Series 7 trained representatives. Favors the possibility of hiring dissatisfied or let-go registered representatives at reasonable prices.
22. The expansion of single-stock futures trading, which was initially launched overseas. These stock futures will facilitate the short selling of over-valued stocks, without the investor having to find the potentially scarce liquid shares to borrow and sell short. This, plus the inflation of commodity prices, will result in third major growth phase of the futures industry since 1970. Electronic trading will help to facilitate this growth surge. A sideways stock market and a secular bear market in bonds will certainly help to distinguish commodities as an investment alternative.
23. The expansion of exchange traded funds (ETF) will squeeze the profitability of the traditional mutual fund business. ETF's low execution cost, favorable tax treatment, and intraday pricing will aid in their growth.

Focus issues for the next tidal wave:

- Real Estate
- Income
- Commodity Inflation
- Safety of Principal