CHIEF INVESTMENT OFFICE

The Horizon

Viewing Market Opportunities through the Lens of Demographics

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AUTHORED BY

Niladri Mukherjee
Managing Director and
Head of CIO Portfolio Strategy

Emily Avioli
Assistant Vice President and
Investment Strategist

As recovery from the 2020 exogenous bear market continues, it is our view that global equities should continue to climb higher. We have long said that accommodative monetary policy, higher levels of economic growth and corporate cash flows, innovation and productivity, and manufacturing revival will be the pillars for long-term growth. However, in addition to these, demographic trends are likely to keep the secular bull running in the U.S. and abroad. The rise and fall of generations has had outsized impact on equity markets historically, and it is our view that demographics will continue to impact global economies moving forward.

The Millennial cohort entering its peak years of consumption and investing should add to the U.S. equity uptrend by supporting growth, corporate earnings and valuations. We are already seeing evidence of risk-assuming behavior through the increased participation of retail investors in the equity market and a boom in the housing market. Looking further out, consumer-facing companies in emerging markets are likely to reap benefits from the rise of Gen-Z.

Millennials should build a new equity culture in the U.S.

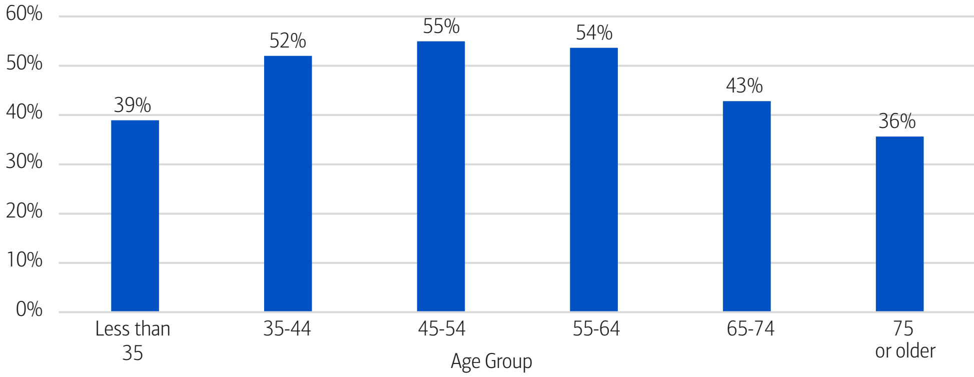
Millennials have surpassed Baby Boomers as the most sizeable generation in the U.S., with an estimated national population of 72.1 million.[1] As this unprecedentedly large demographic enters their prime years for saving and investing, they should continue to accumulate assets and shape consumption trends.

Defined as those born between 1981 and 1996,[2] Millennials ranged from age 24 to 39 in 2020 and are on the cusp of an age bracket characterized by higher levels of earnings and investing. Average income increases by 91% after age 25 and peaks between ages 45 and 54, according to the Bureau of Labor Statistics 2019 Consumer Expenditure Survey. This increased income is often deployed for investments and into equities; the Survey of Consumer Finances found that stock holdings increase at age 35 and peak between ages 45 and 54 on average (Exhibit 1). As Millennials continue to age into this bracket, their increased contribution to financial markets could have a sizeable impact on asset prices.

1 PEW Research Center tabulations of U.S. Census Bureau population estimates, April 2020.

2 PEW Research Center.

Exhibit 1: Average stock holdings peak between ages 45 and 54



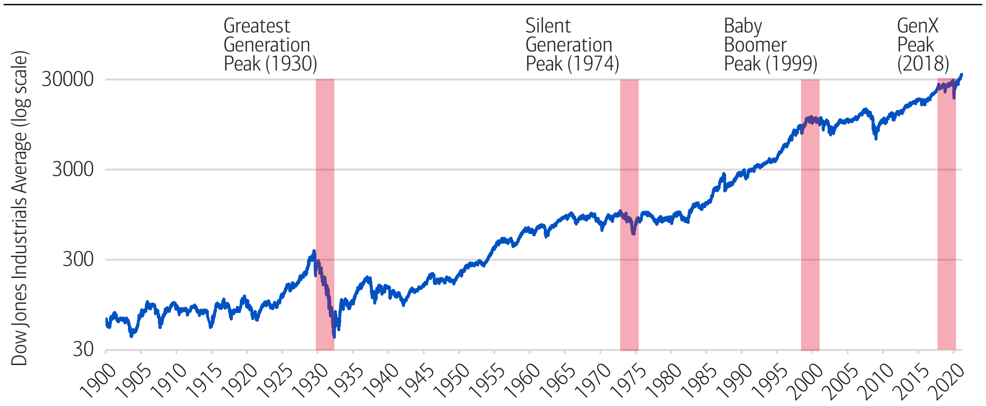
Source: Survey of Consumer Finances, 1989-2019 averages. Data as of September 28, 2020. Refers to average percent stock holding by age of reference person.

Equities and Generational peaks

Historically, the long-range trajectory of the equity markets has had an association with changes in the prime working-age population. Equities have tended to trend higher when the predominant generation is in their prime, and conversely have struggled when the predominant generation has peaked, as illustrated in Exhibit 2.

The Dow Jones Industrial Average was trending upwards until the peak of the Greatest Generation in 1930, which overlapped with the Great Depression and a massive 89% decline in the index. Thereafter, the Silent Generation moving into their prime working years supported the recovery until their generational peak in 1974, when the Dow declined 35%. The end of World War II led to an explosion in population with the Baby Boomer Generation, and as they entered their prime savings and investing years in the 1980s, we experienced one of the longest bull markets of all time. We started to see declines when Baby Boomers reached their peak in 1999, and again when Gen X peaked in 2018. If demographic trends hold, there could potentially be further room to run for the secular bull market in the U.S., as the Millennial generation is not expected to peak until around 2038.[3]

Exhibit 2: Markets trends can be associated with demographics changes



Source: Fundstrat Global Advisors, Bloomberg. Data as of February 26, 2021. Notes: Greatest Generation (1910-1927), Silent Generation (1928-1945), Baby Boomers (1946-1964), Gen X (1965-1980).

[3] Fundstrat Global Advisors, January 2021.

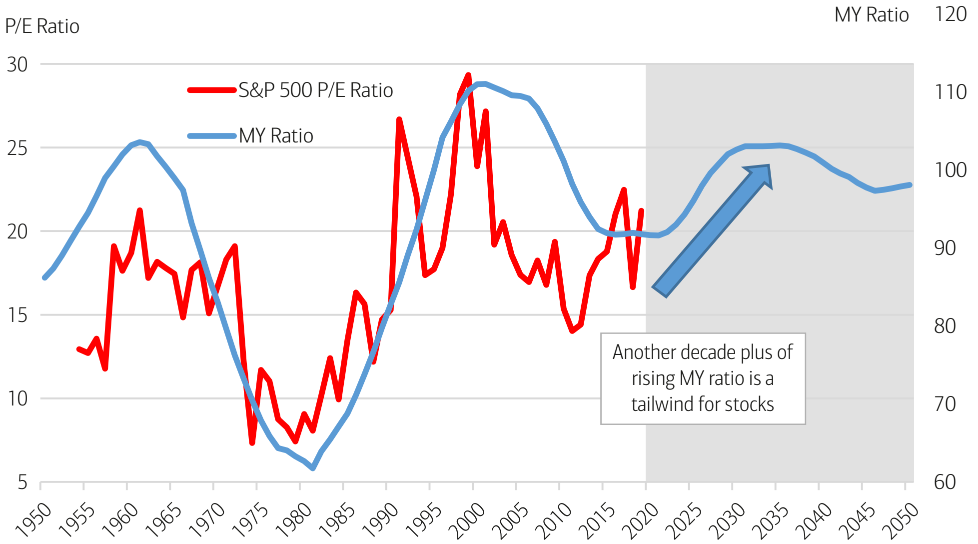
A rising middle age cohort has been positive for equities and valuation

One way to understand the association between equities and demographics was shown in a paper titled 'Demography and the Long-Run Predictability of the Stock Market' by Geanakoplos, Magill, and Quinzii, using the MY (Middle-Young) ratio. The ratio reflects the relative size of the working-age population by measuring the number of 'mature' workers (ages 35 to 49) divided by the number of 'young' workers aged (20 to 34). The higher the ratio, the higher the relative size of the middle-aged cohort.

The paper projects that the equity market, as measured by the S&P 500 P/E Ratio, should perform better when the MY ratio is rising than when it is falling. "People have distinct financial needs at different periods of their life, typically borrowing when young, investing for retirement when middle aged, and disinvesting during retirement. Stocks (along with other assets such as real estate and bonds) are a vehicle for the savings of those preparing for their retirement. It seems plausible that a large middle aged cohort seeking to save for retirement will push up the prices of these securities, and that prices will be depressed in periods when the middle-aged cohort is small."

As illustrated in Exhibit 3, the MY Ratio has correlated with equity market performance and valuation multiples such as the price/earnings (P/E) ratio over time. It peaked in 2000 and didn't trough till 2016, and is expected to trend higher at least till the mid-2030s. While there is likely to be several bear markets between now and then, and the ratio may be of little help in timing short-term moves, it does indicate that there is a strong foundation for long-term investors.

Exhibit 3: A rising MY Ratio could support U.S. equity valuations in the next decade



Source: Ned Davis Research, Bloomberg, Demography and the Long-Run Predictability of the Stock Market. Data as of February 25, 2021. Note – shaded region indicates forecast. The S&P 500 Price to Earnings Ratio is displayed.

The Great Wealth transfer should drive certain themes

The positive impact of Millennials on the stock markets in the U.S. over the next 10 to 15 years could be further amplified by their expected participation in the impending Great Wealth Transfer. BofA Global Research found that the Silent Generation and the Baby Boomers held $78 trillion, or 80% of all household wealth, as of Q2 2020. Estimates vary significantly with regards to how much wealth will be transferred to younger generations over the coming decades, but it could range anywhere from $30 to $68 trillion.

As Millennials grow wealthier, the impact of their consumption and investing preferences should become more pronounced. In a 2017 study, it was found that this generation generally emphasizes their values when investing and tends to support businesses, brands and products that contribute to societal well-being—85% of Millennials will seek out environmentally and socially responsible products whenever possible[4]. Given their relative comfort level with technology, the younger generation may be attracted to new economy digital based companies that tend to be more growth oriented. As they enter their mid 30s, they are likely becoming less interested in renting and more interested in transitioning to home ownership and suburban living, possibly fueling the V-shaped housing recovery that started to materialize last year.

Looking Past the Rise of Millennials

As the Great Wealth Transfer trickles down past Millennials, the consumption patterns of their successors will also become more prominent. Defined as the generation born after Millennials, Gen-Z consumers have already formed a distinct set of characteristics. A McKinsey & Company study from 2018 found that Gen Z consumption is defined by individual expression, sustainability, and access over possession. Among Gen-Z consumers, 65% try to learn the origins of anything they buy, and 80% percent refuse to buy goods from companies involved in scandals.[5] As the first generation to grow up fully immersed in a digital world, Gen Z values online community and has high engagement with digital platforms. Technology and convenience are also key for this generation—the number of online foodservice delivery orders by Gen Z amounted to 552 million in 2018, just a million shy of Millennials' delivery orders.[6] The oldest member of Gen-Z was 23 in 2020, so it will likely take time for their consumption patterns to mature before the full economic impact of this cohort is felt, but areas within Emerging Markets should likely benefit.

The vast majority of Gen-Z—89%—lives in emerging and developing markets, according to the United Nations. India and China account for 20% and 14% of the global Gen Z population, respectively, with the next largest concentrations being in Nigeria, Indonesia, and the U.S. Demographics is the engine behind a burgeoning EM middle class, with an estimated 88% of the next billion members coming from Asia. China continues to have the largest middle class demographic, but India's is growing the fastest.[7] With a global population of 2.5 billion, this generation should give a boost to the countries where they so heavily reside, provided economic progress creates jobs for them.

Once Gen-Z surpasses Millennials as the dominant global generation, the demographic outlook for the U.S. will become more uncertain. The rate of population growth in the U.S. is slowing, and is expected to fall from its current average of 2.3 million people per year to 1.8 million per year by 2040. By 2060, it is projected to decrease further to 1.5 million per year.[8] The population is also expected to age considerably during that time, as improvements in healthcare and technology improve the outlook for longevity. This combination of slowing birth rates and an aging population can present challenges, as evidenced from past experiences in other global economies.

Combatting the Downside of Demographics

China may also face population uncertainty past the rise of Gen-Z. Their 2020 census recently confirmed that the population could peak around 2025, with some estimates suggesting that it might have already peaked last year. Recent data showed a record low number of births in 2020, which could pose challenges in the years ahead.[9] Europe could be foreshadowing what's to come, as the region has recently experienced headwinds amid demographic pressures. European equities as measured by MSCI Europe were boosted by an increasing working age population until the cohort peaked in 2009, but

[4] Cone Communications CSR Study, 2017.

[5] McKinsey & Company, "'True Gen': Generation Z and its implications for companies," 2018.

[6] The NPD Group, 2018.

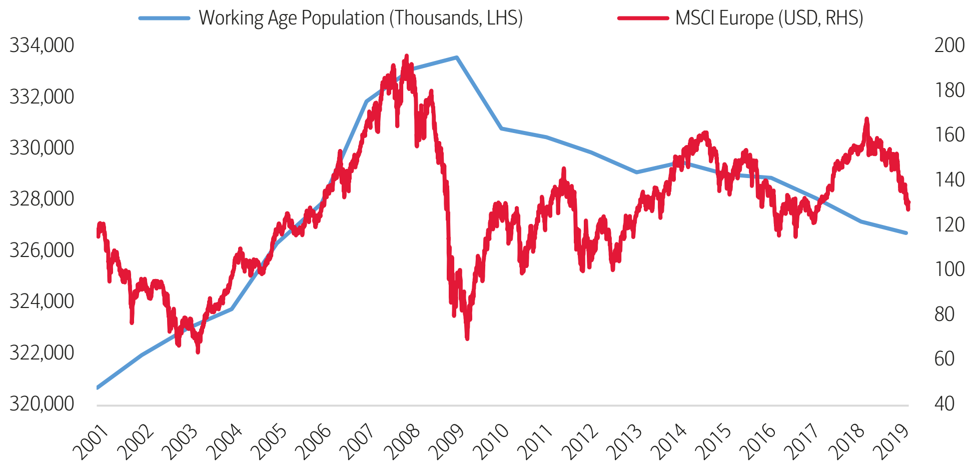
[7] Absolute Strategy Research, March 2021.

[8] U.S. Census Bureau, "Demographic Turning Points for the United States: Population Projections for 2020 to 2060," February 2020.

[9] Gavekal Research, "The Population Turning Point Gets Closer," May 2021.

have since struggled to keep pace as the younger population has continued to trend downward (Exhibit 4). The average European is now 12 years older than the average world citizen and the United Nations forecasts that Europe's overall population will begin to shrink this year as the rest of the world grows. If left unaddressed, demographic trends will likely dampen future growth prospects.

Exhibit 4: European equities declined with the fall of the working age cohort

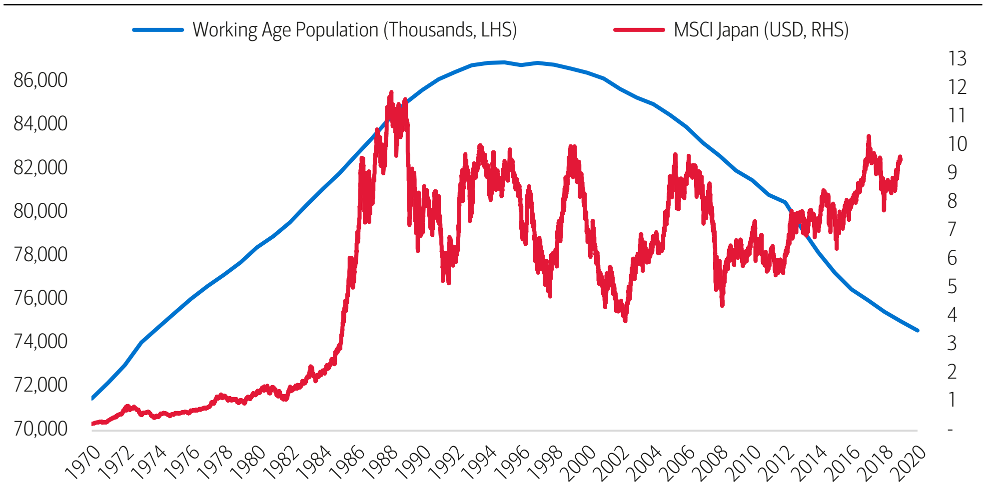


Sources: Bloomberg; Organisation for Economic Cooperation and Development (OECD), Working Age Population: Aged 15-64: All Persons for the European Union, retrieved from Federal Reserve Bank of St. Louis (FRED). Data as of April 26 2021.

Japan's economy has also been shaped by the rise and fall of demographic trends. In what is now referred to as Japan's "Economic Miracle", gross domestic product (GDP) increased by an average of 9.2% from 1956 to 1973, then by an average of 4.1% through 1989. The working age population soared, as did the equity market as measured by MSCI Japan (Exhibit 5). By 1987, Japan had a higher per capita GDP than the United States.[10] Growth came to a halt in the 1990s, when Japan entered into a "lost decade" characterized by prolonged recession. During this time, equities tumbled, annual GDP growth faltered, and the size of the working age population leveled off leading into its eventual decline.

Japan has been able to partially combat the impacts of a shrinking and aging population with economic policy efforts encouraging greater labor force participation—'Abenomics' is largely credited for an employment boom from 2013-2019 that boosted the economy by incentivizing participation, despite decades of declining population growth.[11]

Exhibit 5: Working Age Population Growth Stalls during Japan's "Lost Decade"



Sources: Bloomberg; OECD, Working Age Population: Aged 15-64: All Persons for Japan, retrieved from FRED. Data as of April 26, 2021.

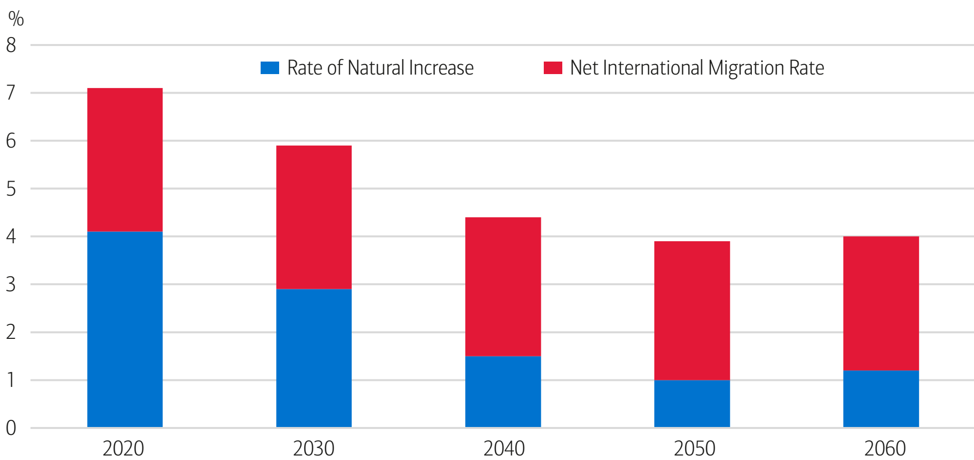
[10] Japansociety.org, "Postwar Japan, 1952-1989." Accessed May 12 2021

[11] BBarron's, "Shinzo Abe Had Big Ambitions for Japan. Here Is Where 'Abenomics' Succeeded and Failed," September 2, 2020.

Taking a page from Japan's playbook, the U.S. has abundant opportunities to strengthen the labor force beyond the rise of Millennials. Among the most rewarding could be closing the growing gender gap. The employment to population ratio of prime age women has been an average 14% lower than that of men since 2000, according to the Bureau of Labor Statistics. The coronavirus has worsened the situation, as women account for 55% of overall net job loss since the start of the crisis.[12]

Appropriate immigration policies could also boost the U.S. labor force moving forward. A population's 'natural' rate of change is made up by changes in birth rates and death rates, but increases or decreases beyond the natural rate are attributed to immigration. Beginning in 2030, the U.S. Census Bureau projects that net international migration will overtake natural increase as the driver of population growth in the United States (Exhibit 6). An accommodative administration could provide a tailwind, and President Biden has listed immigration as a priority item. An influx of skilled immigrants to prop up the labor force will be key to maintaining the U.S. economic dynamism.

Exhibit 6: U.S. population growth will soon be led by immigration



Source: Growth Rates and Birth, Death, and International Migration Rates: Main Projections Series for the United States, 2017-2060. U.S. Census Bureau, Population Division: Washington, DC. Data accessed May 12 2021.

Conclusion

In the long run, despite the potential for Millennials to provide an economic boost in the coming decade, demographic challenges remain. The global population continues to age and the graying of Baby Boomers as they enter retirement could potentially cause a drag. The bearish demographic narrative is further amplified by the pandemic induced 'baby bust', with the U.S. recording the fewest births since 1979 last year.[13] These dynamics will almost certainly have economic consequence in the long run.

Still, research suggests that there is room for upside. The maturing of the Millennial cohort into the middle-age category should keep the secular bull market in U.S. equities running over the next decade plus. In the long run, parts of the Emerging Markets universe such as Consumer Discretionary, Consumer Staples, Healthcare and Technology areas will likely benefit from the rise of the Gen. Z cohort, as they invest more of their rising incomes and boost future consumption trends.

We recommend an overweight allocation to U.S. Large cap equities and increasing exposure to cyclical areas of the market like Small caps, Value and those that benefit from economic normalization like Financials, Energy and Industrials. Exposure to Emerging Market economies that are likely to be the long-run beneficiaries of changing demographic trends is suggested. New economy themes like digital transformation, climate change, healthcare technology and Environmental, Social & Governance (ESG) overlays should also be considered, as they will continue to attract more capital from Millennials and Gen. Z cohorts.

[12] National Women's Law Center calculations based on BLS historical data, January 2021.

[13] Wall Street Journal, "Births in the U.S. Drop to Levels Not Seen Since 1979," May 2021.

Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

Dow Jones Industrial Average is a stock market index that measures the stock performance of 30 large companies listed on stock exchanges in the United States.

MSCI Europe non-U.K. Index is a free float-adjusted market capitalization index designed to measure Developed Market equity performance in Europe. As of July 2009, the index consisted of 15 Developed Market country indexes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.

MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 319 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

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