The Foundation of MEICAP Underlying Assumptions

According to the US Census Bureau, the average American spends MORE than they earn between the ages of 15 and 26, resulting in negative savings. They go on to spend LESS than they earn between the ages of 27 and 62, resulting in positive savings. Then, during their twilight years, the average American again spends MORE than they earn, resulting in negative savings.

It’s also interesting to note that the average American spends the MOST in a single year at age 47. At 47, most people are still paying off a house and perhaps also a car or two. In many cases, individuals of that age have children that are still being supported by their parents and often in college. Individual circumstances are different for everyone but the average data is fascinating.

This pattern of negative savings, positive savings and then negative savings again would yield no significant implications if birth rates and immigration rates were stable year over year. The implications materialize when birth rates and immigration rates vary. Obviously, the Baby Boom generation resulted in a dramatic and disproportionate concentration of people within a single age category and had a direct impact on the availability of investment capital here and around the world.

Keep in mind the Baby Boom phenomenon took place across most of the developed world immediately following World War II. Although the MEICAP model focuses on the American population, it can easily be projected beyond American borders with the American population representing a significant sample for the developed world.

With this disproportionate concentration of people in a single age category, one would expect major shifts in the availability of investment capital as they move through the negative and positive savings periods of their life cycle. Indeed, these shifts have taken place and we can easily project forward to see how the aging population will affect tomorrow’s financial markets.

Many of us remember the high interest rates of the 1970s and many postulate these expensive borrowing rates were a direct result of the oil embargos taking place in the Middle East. While these embargos had very real affects on western economies, it was not the only thing fueling inflation and interest rates. The concentration of population spending more than they earn played a major role as well, starving the economy of investment capital and resulting in higher borrowing rates.

Since roughly 1982, interest rates have been dropping steadily. Indeed, there were ups and downs along the way but the larger trend was clearly down between 1982 and 2003. This can be directly attributed to the growing pool of investment capital fueled by Baby Boomer savings efforts. And although the Baby Boomers aren’t scheduled to retire until 2009, the macro annual contribution rates have already begun to shrink, resulting in the slowly rising interest rates beginning in 2003.

The same phenomena has affected the stock markets through the P/E ratios. The shortage of investment capital during the 70s drove down P/E ratios, depressing stock valuations across the board. Then, as investment capital started to grow, P/E ratios started to rise as investors bid up the price of stocks. All these things are related and the MEICAP model pulls them all together with the common foundation of the population platform and age profile.