Demography I: Bionic Seniors. As you know, Yardeni Research is a top-down shop. We focus on assets, sectors, and industries. We don’t recommend individual securities. Nevertheless, today I am strongly recommending that you buy any company that stands to benefit from the explosive growth in hip and knee replacement surgery.

Peter Lynch’s successful approach to managing money was to invest in companies that provide the goods and services he purchased for his own use. As a Baby Boomer, whatever he purchased was likely to be bought many times over given the size of this demographic cohort. On Thursday, I will be purchasing a new hip. The surgeon will make the decision on which particular replacement part will be installed on my right side. The procedure takes one hour, and I should be out the same day. Recovery should be relatively fast (four weeks, knock on titanium), since he will be doing an anterior rather than a posterior operation. I expect to be back at my desk, or at least on my laptop by this coming weekend. Here are a few pre-op thoughts on health care stocks:

(1) **Lots of seniors.** The population of Americans who are 65 years old and older totaled 52.5 million during 2018 (Fig. 1). There are lots more of them coming given that the population aged 55-64 years totaled 42.4 million last year.

(2) **Health Care Equipment stocks on steroids.** The Baby Boomers are already having a huge impact on the health care sector, particularly the S&P 500/400/600 Health Care Equipment industry. Since the start of the current bull market, the three indexes are up are up 363%, 733%, and 965% (Fig. 2). The S&P 500 is up 330% over the same period, with the S&P 500/400/600 Health Care stock price indexes up 310%, 679%, and 792% (Fig. 3).

S&P 500 Health Care Equipment revenues are expected to increase 5.5% this year and 6.3% next year (Fig. 4). Forward revenues for the industry has been on a straight ascending line since the start of the current bull market. The industry sports an impressive forward profit margin of 20.0% (Fig. 5). The biggest downside may be in valuation given that the forward P/E is somewhat inflated at 23.3. (See our S&P 500 Industry Briefing: Health Care Equipment.)

(3) **Medicare for all.** So who will pay for all those replacement parts that the Baby Boomers will need to enjoy longer and better lives? The obvious answer is that government will do so. Not so obvious is that...
now that I am 69 years old and still working, I am paying over $500 per month in Medicare premiums. Medicare for all seniors isn't free for all.

If Bernie and his fellow socialists have their way, everyone will be covered by Medicare. That will undoubtedly require higher Medicare premiums (a.k.a. taxes) on all working stiffs. Meanwhile, during February, the sum of federal government outlays on Social Security ($1,022bn), Medicare ($782.6bn), and Medicaid ($612.0bn) rose to a record $2.4 trillion—all at seasonally adjusted annual rates (Fig. 6 and Fig. 7). Here are the latest growth rates of these three entitlement programs: Social Security (6.8% y/y), Medicare (9.7), and Medicaid (3.7).

(4) A personal note. Last year, I published my professional autobiography, Predicting the Markets, based on the lessons I’ve learned over the past 40 years as an economist and investment strategist on Wall Street. Now I hope that with the help of replacement parts, I’ll have a chance to write about what I will learn over the next 40 years. I’ll settle for the next 20 years, so I can have some time off for my retirement.

Demography II: Disinflators. The aging of the Baby Boomers is also having a significant impact on our economy. The oldest of them turned 65 during 2011 (Fig. 8). Since the start of that year through March of this year, the number of seniors has increased by 13.3 million to 52.3 million, with the number of them who are no longer in the labor force (mostly because they have retired) up 9.7 million to 41.9 million. The number still in the labor force rose 3.6 million to 10.5 million over this time period.

Mostly because they are living longer, the Baby Boomers continue to weigh on the Age Wave, which is the percentage of the population (and the labor force) that is relatively young, at 16-34 years old (Fig. 9). The Age Wave is highly correlated with the five-year trends of both inflation and the 10-year US Treasury yield. As long as those demographic trends continue, inflation and bond yields are likely to remain historically low around current levels.

Aging Baby Boomers are turning into minimalists as they downsize their homes and spend less on things. At the same time, Millennials tend to be natural-born minimalists. This could create both opportunities and challenges for the housing market in coming years. We update this story in the following two sections.

US Housing I: Affordability Challenged. Millennials, many of whom have been starting families later in life than previous generations, are finally stepping up as homebuyers. But the supply of housing, especially affordable housing, remains an issue for entry-level buyers. Home sellers, including homebuilders and downsizing Baby Boomers, may need to lower selling prices in the coming months and years. That will be a challenge for both. Homebuilders face a margin squeeze from higher regulatory, materials, and labor costs. Baby Boomers may discover that their nest eggs for retirement are worth less than they had planned.

Overall, the US housing market is likely to see sales volume for available affordable housing continue to pick up—especially as long as mortgage rates remain low—while sale prices move lower. Consider the following:

(1) Overtaking Baby Boomers. Millennials (born from 1981-1996 and now aged 23-38) are projected to overtake Baby Boomers as the largest living adult generation this year, according to Census Bureau projections cited in a 4/1 Markets Insider article. Millennials therefore will be “the most important generational source of demand in the housing market, as well as the general economy, for a number of years to come,” according to quoted economist Mark Fleming. We agree.
In 2018, Millennials accounted for most of the growth in US homeownership, observed Fleming. A home-buying survey conducted late last year by Research Now (for Ernst & Young) supports that Millennials are increasingly buying homes: “Homeownership for Millennials between the ages of 28 and 31 increased from 27% to 47% in two years (ownership of those aged 32-36 increased from 46% to 57%),” reported housingwire.com.

Millennials are the housing market’s important new source of first-time home buyers. Newly released NAHB American Housing Survey data show that first-time home buyers made up 37% of all households for the two-year period from 2016 to 2017; their median age, 32.

(2) Lots of demand for smaller mortgage loans. Millennials (a.k.a. “Generation Y”) overtook Generation X (39-54 years old this year) as the cohort taking out the most mortgages in January 2017, a trend that has since continued to rise. Realtor.com’s monthly data find that “[a]t the end of 2018, Millennials took on 45% of all new mortgages compared to 36% for Generation X, and 17% for Baby Boomers,” per its report Generational Propensity Report: 2018 in Review.

Yet because Millennials tend to purchase less expensive homes, their share of total loan volume just recently caught up with Generation X’s, during November 2018. Millennials now account for the largest share of loan volume, at 42% in December compared to 40% for Generation X and 17% for Baby Boomers. Despite purchasing less expensive homes, Millennials are taking on larger mortgages and making lower down payments, at 8.8% in December 2018 versus 11.9% for Generation X and 17.7% for Baby Boomers. So Millennials’ sensitivity to affordable housing and low mortgage rates, as discussed below, makes sense.

(3) Hunting in affordable areas. “Given that the majority of Millennial homebuyers are searching for their first homes and do not bring equity from a previous home, it’s no surprise they are putting down smaller down payments,” according to Realtor.com as noted by housingwire.com. “This is likely a driver of their activity in more affordable markets, where their money goes further.” Millennials’ share of 2018 mortgages is higher in areas with an average affordability score of 0.96, compared with 0.83 for the nation overall, Realtor.com observed. In these markets, the cost to purchase a home averages only 25% of the median income versus 31% nationwide.

In contrast, Baby Boomers were “predominantly attracted to lower-tax markets, desiring to preserve the wealth they’ve earned over the course of their working years.” In fact, Realtor.com found a strong correlation between the Baby Boomers’ share of 2018 mortgages and their tax burden—a relationship nonexistent for Millennials and Generation X. The top Boomer markets had an affordability score similar to that of the top Gen X markets, averaging around 0.74.

(4) Builders can’t build for cheap. The problem is a disconnect between available properties and what Millennials want, which is more affordable housing. “First-time home buyers are eager to move to better homes and neighborhoods, yet home prices remain a challenge,” said National Association of Home Builders (NAHB) Chairman Greg Ugalde in the survey press release. Several factors make it difficult for builders to increase the supply of affordable housing, according to survey data. Contributing to higher home prices today are the supply of land, regulatory requirements, and a shortage of skilled labor.

Builderonline.com put the problem like this: “There is clearly a disconnect between demand and supply when it comes to millennials and builders. I get it. It’s hard to find affordable land. It’s hard to get approvals to build at the higher densities that affordable housing often requires. It’s hard to keep costs down when labor and material prices keep ratcheting up. And it’s hard to stop building expensive, high-margin McMansions for boomers and instead start building lower-priced, lower-margin houses for millennials. But stop you must. At least that’s the case if you want history to repeat itself and have
millennials, like the boomers before them, to set the housing industry off on a long run of success.”

The NAHB called upon public policies to improve housing affordability but said that the current Fed’s current approach to policy will help housing markets this year with more affordable interest rates.

(5) **Lower supply of affordable homes.** The median value of homes listed for sale in March hit a record $300,000, reported CNBC, citing Realtor.com, with a continued shortage of entry-level homes for sale and rising supply of entry-level homes for sale. In March, the number of homes for sale listed above $750,000 increased 11% y/y, while those priced $200,000 or below fell 9%.

A 2/28 AP Newswire confirmed: “Home prices are higher than ever before and expensive homes are far more plentiful than entry level homes,” according to Realtor.com. “That trend, in turn, could mean fewer sales for many homebuilders, because newly built homes tend to be more expensive relative to resale properties.”

**US Housing II: By the Numbers.** The gist of the story from the latest housing data is that sales prices are up while housing inventory is down, especially for existing homes (typically lower priced than new homes). However, low mortgage rates are increasing home affordability and sales.

Looking ahead, the pricing tension is bound to break at some point. Then, more affordable homes will be made available as builders generate more inventory for Millennial buyers at lower price points and downsizing Baby Boomers lower asking prices to attract younger buyers. This might happen just as Millennials’ demand for homes peaks in their mid-30 stage of life. Here’s more:

(1) **Sales price records.** The 12-month moving average of median single-family sales prices on existing homes drifted up to a new record high of $261,000 in February, according to data released on 3/29. The same series for new homes edged down in February, yet remained near record highs at $319,400. Average data for the same series followed a similar pattern, but at even higher price levels—$298,800 for existing homes and $377,800 for new homes (Fig. 10).

(2) **Inventories remain low.** Existing single-family homes available for sale in February remained near record lows, at 1.44 million units (Fig. 11). New homes available for sale remained significantly higher, at 340,000 units, than their 2012 lows of 142,000 units. But these levels remain moderate relative to the five historical peaks experienced since the series began in the 1960s (Fig. 12).

(3) **Sales boost from lower mortgage rates.** The Mortgage Bankers of America’s Mortgage Applications New Purchase Index (4-week average, sa) is highly correlated with new plus existing single-family home sales (million units, saa). Both were up significantly, according to the latest data. Sales came off of a stall during 2018, increasing from a recent low of 5.0 million during January to 5.6 million during February. From 2018 lows in mid-November, the new purchase index is up 19.4% (Fig. 13). More mortgage applications and higher home sales have come on the back of recently lower interest rates on 30-year fixed mortgages, demonstrating buyers’ sensitivity to overall housing costs (Fig. 14).

**CALENDARS**

**US. Tues:** Headline & Manufacturing Industrial Production 0.3%/0.2%, Capacity Utilization 79.2%, NAHB Housing Market Index 64, Rosengren, Kaplan. **Wed:** Advance Merchandise Trade Balance - $53.6b, Wholesale Inventories 0.4%, MBA Mortgage Applications, DOE Crude Oil Inventories, Beige Book, Bullard, Harker. (DailyFX estimates)

**Global. Tues:** Germany ZEW Survey Current Situation & Expectations 8.5/0.5, UK Employment
Change & Unemployment (3-month) 173k/4.0% Japan Trade Balance ¥363.2b, RBA Minutes of April Policy Meeting. **Wed**: European Car Registrations, Eurozone Trade Balance, UK Headline & Core CPI 2.0%/1.9% y/y, Canada CPI, Japan Industrial Production, China GDP 1.4%/q/q/6.3%/y/y, China Retail Sales 8.4% y/y, China Industrial Production 6.0% y/y, Carney, Villeroy. (DailyFX estimates)

**STRATEGY INDICATORS**

**S&P 500/400/600 Forward Earnings** ([link](#)): Forward earnings fell w/w for all of the market-cap indexes, ending a string of two straight gains for LargeCap and SmallCap and four weeks for MidCap. LargeCap’s has risen during six of the past nine weeks; MidCap’s in four of the past five weeks; and SmallCap’s in two of the past three weeks. LargeCap’s forward EPS is just 1.6% below its record high of $175.48 in late October; MidCap’s is 3.2% below its mid-October high; and SmallCap’s is 7.6% below its mid-October high. At their bottoms, LargeCap’s forward EPS had been the most below its record high since June 2016, and MidCap’s was the lowest since May 2015. SmallCap’s had not been this far below since October 2010. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act, but tumbled as y/y comparisons became more difficult. But that may be ending soon too. In the latest week, the rate of change in LargeCap’s forward earnings fell to a 27-month low of 6.6% y/y from 6.4% y/y. That’s down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap’s y/y change fell to a 28-month low of 4.6% from 6.2%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap’s dropped to 3.9% from 4.2% and is up from a 31-month low of 3.8% in late March, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been expecting double-digit percentage earnings growth in 2019, but those forecasts have been dropping since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.1%, 11.8%), MidCap (22.7, 1.8, 13.1), and SmallCap (22.4, 4.2, 18.5).

**S&P 500/400/600 Valuation** ([link](#)): Forward P/E ratios rose w/w for all these indexes and are well above their multi-year lows in late December. LargeCap’s weekly forward P/E rose to a 14-month high of 16.8 from 16.7, which is up from a five-year low of 13.9 during December. That compares to a 16-year high of 18.6 during January 2018—and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week’s level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap’s forward P/E rose 0.4pt to a 28-week high of 16.3. That’s up from 13.0 during December, which was the lowest reading since November 2011. MidCap’s P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. However, MidCap’s P/E has been at or below LargeCap’s P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap’s P/E improved to a six-week high of 17.1 from 17.0, which is well above its seven-year low of 13.6 during December. That’s still well below its 51-week high of 20.2 in December 2017 (which wasn’t much below the 15-year high of 20.5 in December 2016, when Energy’s earnings were depressed). SmallCap’s P/E was higher than LargeCap’s P/E for a 13th straight week, after being below for much of December for the first time since 2003.

**S&P 500 Sectors Quarterly Earnings Outlook** ([link](#)): With the Q1 books closed and results beginning to trickle in, the blended Q1 estimate/actual continued to drop as is typical during the early weeks of the earnings season. Last week saw the S&P 500’s Q1-2019 EPS forecast drop 16 cents w/w to $37.13. That’s down 7.5% since the end of Q4 in the worst quarter for consensus forecast revisions since Q1-2016. The $37.13 estimate represents a forecasted pro forma earnings decline for Q1-2019 of 2.3%, compared to -2.2% a week earlier and 5.3% at the end of Q4. If it comes to pass, Q1’s y/y decline would be its first after 10 straight gains, and down from 16.8% in Q4 and 28.4% in Q3 (which marked the peak of the current earnings cycle). Just four of the 11 sectors are expected to record positive y/y
earnings growth in Q1-2019, with none rising at a double-digit percentage rate. That compares to 10 positive during Q4, when seven rose at a double-percentage rate. Five sectors are expected to match or beat the S&P 500's Q1 growth rate, compared to just four during Q4. Utilities is the only sector expected to post better growth on a q/q basis during Q1. Here are the latest forecasted Q1-2019 earnings growth rates versus their Q4-2018 growth rates: Health Care (4.3% in Q1-2019 versus 13.3% in Q4-2018), Real Estate (2.7, 6.2), Industrials (1.6, 27.0), Financials (3.0, 15.6), Utilities (-0.5, -10.4), Consumer Staples (-2.5, 4.6), Consumer Discretionary (-3.4, 18.1), Communication Services (-5.7, 26.4), Information Technology (-6.1, 10.3), Materials (-15.8, 6.1), and Energy (-23.1, 81.4). On an ex-Energy basis, analysts expect S&P 500 earnings to drop 1.3% y/y in Q1, well below the 14.2% y/y gain in Q4 and the lowest ex-Energy growth rate since Q2-2016.

**US ECONOMIC INDICATORS**

**Regional M-PMI** ([link](#)): The New York Fed—the first district to report on manufacturing for April—showed business activity picked up a bit, though remained subdued. The composite index posted its best reading this year, climbing to 10.1, after falling three of the prior four months, from 21.4 in November to 3.7 in March—which was the weakest reading since May 2017. Both the new orders (to 7.5 from 3.0) and shipments (8.6 from 7.7) gauges improved slightly, though were less than half the pace recorded during the final quarter of last year. Labor market indicators pointed to a continued increase in employment (11.9 from 13.8) this month, at roughly the same pace as last month, though hours worked (4.3 from -3.4) are increasing again after turning negative in March for the first time since 2016. Delivery times (7.0 from 1.4) improved to an eight-month high, while inventories (8.4 from 0.0) are accumulating for the first time this year. Both the prices-paid (27.3 from 34.1) and -received (14.0 from 18.1) indexes eased this month. Optimism about the six-month outlook sank 17.2 points this month, to 12.4—the lowest reading in more than three years—as both the future new orders (20.5 from 29.0) and shipments (22.7 from 27.7) measures were well below March’s pace. Meanwhile, firms continued to expect solid increases in employment (17.3 from 17.6) and hours worked (11.2 from 10.1) in the months ahead.

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