Ageing Boomers: how wealth and health will shape retirement

An ageing global population is one of three demographic megatrends along with population growth and the rise of the emerging market middle class that we believe will play out with a degree of certainty over the long term. Here, we examine how wealth and health are central to retirement, posing stark challenges for governments but also enabling attractive long-term investment opportunities.

INTRODUCTION: LONGER LIVES, LONGER RETIREMENTS

The world is experiencing a phase of unparalleled ageing, due to declining mortality and birth rates. While we can see ageing most prominently in developed economies, in time, it will also be evident across developing countries. The world in 2045 will look like a very different place from today: those aged 60+ will for the first time outnumber children aged 15 or younger.¹

In developed economies, the baby boomers born in the early years of the 1946-1964 era have started to retire in a world full of medical advances and scientific breakthroughs. They are living healthier, longer lives. However, their longevity is also costing pension providers and annuity suppliers more than those institutions originally bargained for. Government budgets are being squeezed, while pension funds and individual savers face up to the challenges of funding longer retirements.

As people live longer, global populations are ageing and becoming more top-heavy. Chart 1 (below) shows how the proportion of people aged over 55 will grow in the next decade – the direction of travel is clear across a diverse range of countries, albeit the numbers of people in older cohorts will still vary significantly between developed countries such as Japan and Germany and less developed countries such as Indonesia. Note that some Asian countries such as China and South Korea are ageing relatively quickly.

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**AT A GLANCE**

- Wealth and health are key considerations for retirement
- People are living longer and need to fund longer retirements
- Longer life expectancy is placing severe pressure on pensions and retirement systems
- This also provides opportunities as the longevity risk market grows.
- Longevity and retirement saving offer attractive opportunities to investment managers
- Specialist healthcare companies are benefiting from personalised and targeted drugs and therapies for the aged
- Ageing boomers’ health is being improved today by the medtech and robotics industries

**Chart 1.** Source: Goldman Sachs, UN. August 2014
LIVING LONGER IS SIGNIFICANTLY MORE COSTLY

Longer lifespans are good news for healthcare companies and other consumer goods and services that older people favour, but the trend is increasingly challenging for defined benefit pension plans, annuity providers and governments. Chart 2 shows that new entrants to the US and European workforces in 2010 can expect to spend twice as long in retirement as workplace entrants in 1980.

Adding an extra year to global average lifespan increases the world’s pension bill by 3-4% or by around $1 trillion, according to the IMF. Or to put it another way, if a 70-year old, expected to die at 86, has an improvement in mortality of just one year to age 87, then a defined benefit pension plan would need to allow for an increase of 4% in liabilities. Chart 3 shows that some of the largest global pension markets are still dominated by defined benefit plans (Canada, Japan, UK, & Netherlands).

LONGEVITY RISK COMES OF AGE

Longevity risk is set to be one of the most significant hurdles facing retirement systems over the next 50 years. It is estimated that the global amount of annuity and pension-related longevity risk exposure totals between $15 trillion to $25 trillion.

Globally, private sector defined benefit schemes already have $23 trillion of liabilities – that is the amount they owe current and future pensioners. In fact, many pension plans are already grossly underfunded and the problem is not simply that people are living longer; rather it is the fact that how long they live has been materially underestimated for some years. The issue is most acute in North America where over 90% of longevity risk sits with defined benefit pension plans and is estimated at over $7 trillion.

If a person lives three years longer than expected by 2050, which has been the average underestimation of longevity in past calculations, then the already steep costs of ageing could increase by a further 50%, according to the IMF. The need to save for the kind of retirements many of us aspire to is increasingly falling on individuals and the imperative to save early and regularly is compelling.

SOLUTIONS FOR CORPORATE PENSIONS

Reinsurers are set to play an important role as buyers of longevity risk, and a nascent longevity risk transfer (LRT) market is developing. Multinational telecommunications services company BT recently sold one-quarter of its longevity risk in its group pension scheme, which faces a £7 billion (US$12 billion) deficit, to US insurer Prudential Financial. BT pays Prudential a monthly fee and the insurer will pay the extra pension costs if the pension plan members live longer than forecast. The 20 or so completed deals have been between big pension schemes and insurers such as Prudential and Swiss Re. Considering the sheer size of defined benefit liabilities, which are set to grow in line with life expectancy, there is considerable scope for longevity risk to be managed by third-party institutions.
PENSION SYSTEMS ARE UNDER PRESSURE TO ADAPT

Deficits and longevity risk at corporate pensions add to the overall pressure the global pensions market is under. Table 1 (opposite) shows the level of pensions assets in key markets, and how sizeable these assets are as a percentage of GDP (in US$).

Retirement systems are typically complex. Australia’s superannuation scheme is often held up as an example, although it has been criticised for charging savers well above the OECD average and there are often calls for fees to be cut to offer Australians competitive rates. Although Australian pension savings assets have grown rapidly since superannuation was introduced in the 1990s – the country is now the fourth largest by pension assets – the domestic pensions industry lacks sufficient competition.

In the UK, changes to the pensions system in 2015 will allow pensioners to have far more control of their pension pots instead of having to buy an annuity product. This offers great potential for the investment management industry as people look to fund longer retirements. The end of the obligatory annuity culture in the UK will dent insurers’ profitability, but some can divert their resources. Our analysts believe Legal and General will overcome the curtailment of the individual annuity market by offsetting it with its strength in the group pensions buyout market.

ASSET MANAGERS ARE OFFERING RETIREMENT-READY SOLUTIONS

Given the very low interest rates on offer to savers in most developed countries, investment managers can offer tailored income-producing products to help investors’ pension pots go further. Investing for income through fixed income, equity income and multi-asset income products has become increasingly popular in a low rates world. Investors have extended their risk appetites in response to the non-existent yields on cash, which are effectively eroding their capital when inflation is factored in. This is why equity income funds continue to have appeal for retiring investors looking at lengthy retirements – the combination of dividend income and the defensive nature of dividend-paying stocks versus a full equity approach can be very attractive.

There are good near-term opportunities for asset managers and wealth managers in the UK and the US, while Asia represents an attractive accumulation opportunity. AIA is a market-leading insurer at the heart of the accumulation trend and offers tailored retirement savings product across Asia, including China which is ageing the most rapidly of the large emerging markets.

Data confirms that the older cohort has the largest propensity to invest. Table 1 (on the next page) shows that the 55+ age range in the US accounts for just 12% of the population but has 55% of mutual fund ownership. Current working generations are likely to inherit significant wealth which they can add to their own accumulated wealth. The so-called ‘great generational transfer’ of inherited assets will pass an estimated $12 trillion from those born in the 1920s and 1930s to the next generation. In fact, over the next 30-40 years, its estimated that up to $30 trillion in financial and non-financial assets will shift in the US alone from the ageing boomers.

Total pension assets 2013 by country and % of GDP

<table>
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<th>Country</th>
<th>Assets (US$bn)</th>
<th>% GDP (US$)</th>
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<tr>
<td>US1</td>
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</table>

Note: 1 Includes IRAs; 2 Does not contain the unfunded benefit obligation of corporate pensions (account receivables); 3 Only includes total of autonomous pension funds. Does not consider insurance companies assets; 4 Only collects pension assets for company pension schemes; 5 Brazil pension assets only include those from closed entities. Assets/GDP ratio for the world is calculated in USD and assets were estimated as of December 31, 2013.

Table 1. Source: Towers Watson and secondary sources, 2014.

People aged 55+ in the US own the majority of mutual funds

AGEING POPULATIONS MEAN INCREASED HEALTHCARE SPEND

People aged 65+ account for almost 35% of total healthcare spending in the developed world, but there are wide disparities among countries. Spending on healthcare is the highest in rich countries like the US where it totalled 18% of GDP between 2009 and 2013 as shown in Chart 4 – about three-quarters of this was spent on the over 60s. The US Affordable Healthcare Act’s expansion of Medicaid has also increased demand through increased access to healthcare products and services. Expenditure on healthcare and pharmaceuticals has risen in real terms in almost every OECD nation over the past decade, and this should remain the case as treatments become more targeted and personalised.9

![Chart 4: Total spending by country on healthcare and the % of population 65+ (2009-2013)](image)


In time, as emerging markets build their national wealth, they will have better access to healthcare helping people in those countries to live healthier, longer lives. The UN estimates that 80% of those over the age of 60 will be living in emerging markets by 2050.

It is inevitable that with ageing comes the heightened risk of developing chronic illnesses. As people age they are more likely to suffer from heart disease, respiratory problems, diabetes and cancer. However, breakthroughs in drug therapies, improved diagnostics and medical equipment are helping to treat many chronic illnesses, extending a patient’s life expectancy.

The structural outlook for Healthcare is underpinned by these trends. Higher demand, particularly for personalised solutions from ageing populations further will sustain the interest of investors in a sector that is already valued for it defensive qualities. Many recent drug breakthroughs have tended to favour older patients. In the US, over-65s are the largest consumers of prescription drugs – they receive an average of 27 prescriptions per person.

CVS Caremark is a US company that is capitalising on this demand – its pharmacy services division provides services to over 2000 health plans. Other healthcare stocks stand out as beneficiaries thanks to being leaders in their specialist healthcare fields. Roche has the largest market share in the global cancer market and is leading the way in diagnostics development. Cancer is almost exclusively a disease of the older population – around 78% of newly diagnosed cancer cases occur in those aged 55+. Novartis has the fourth highest share of the global cardiovascular drugs market and is one of the few companies to produce medication to treat the effects of Alzheimer’s. Novo Nordisk is exposed to strong and sustainable growth in the market for diabetes via its insulin products. Diabetes affects more than 371 million people worldwide and those aged 40+ are most affected by type-2 diabetes. By 2030, the total is expected to rise to 552 million, a 49% increase. Novo Nordisk has a commanding 49% share of the global insulin market. Having built a reputation for innovative treatments, the company continues to spend around 15% of its sales on research and development of new products.

“Ageing populations imply increased demand for ostomy, urology, incontinence and wound care products – Denmark’s Coloplast is a leader in these fields and its clear focus on innovation allows it to produce superior products that have enabled it to gain market share and steadily improve its operating margins.”

Nicky Stafford
Portfolio Manager
Global Equities
GROWING MEDTECH SECTOR…

The medical technology sector is growing thanks to higher demand among ageing patients in Europe, Japan, the US and increasingly China. The industry has grown to meet the increased demand for age-related devices as diverse as artificial hips and knees, heart monitoring devices and hearing aids. The global hearing aid market, for example, is estimated to grow at around 2-5% every year so this will benefit GN Store Nord, which creates solutions for ear-related diagnostics.

…BUT PRIMED FOR CONSOLIDATION

However, the medtech industry has generally become saddled with disproportionately high costs, especially for its back-office functions. The industry also faces a more discerning procurement process, particularly in the US where hospital management have taken over purchasing these items from doctors and they are seeking to maximise their value for money following consolidation of the country’s hospital sector.

The scene is set for M&A in the medtech space. US giant Medtronic’s $43 billion takeover of its Ireland-based competitor Covidien is expected to cut costs, introduce synergies to eradicate latent inefficiencies and boost clinical innovation. Medtronic excels at specialist equipment for cardiology, neurology and diabetes. These include its tiny insertable cardiac monitor that is implanted to record a patient’s cardiac data to help medical staff diagnose heart-related health problems, more common in older people. Covidien’s strengths include producing tools for general surgery and respiratory equipment. Covidien has welcomed the deal which will broaden the merged company’s product range and geographic appeal, including in emerging markets.

CONCLUSION

Populations are ageing, rapidly in the developed world, but the emerging world is not immune and, over time, ageing will become a genuinely global challenge. UN Population data forecasts that growth in the older sections of the population is being driven not just by ageing baby boomers, but also by people living longer than in previous decades: the number of centenarians in the world is expected to triple by 2030. This will have significant implications in the health and wealth spheres in particular, creating attractive investment opportunities for research-driven investors.

“Every three years, a year is added to life expectancy from advances in medical treatments, meaning half the population born today in the developed world will live to be 100. This means an acceleration in growth in the hearing aid industry which GN Store Nord benefits from.”

Hilary Natoff
Portfolio Manager
Global Equities
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