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Financial Forum

VIEWS AND OPINIONS FOR
THE CLIENTS AND FRIENDS OF

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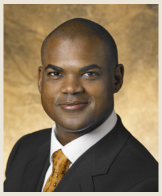

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MARKET UPDATE

What Moved the Markets in October?

The dominant headline in the month of October was the political brinkmanship in Washington, which led to a partial government shutdown and near-technical default on U.S. government debt. Amid the political gridlock, President Obama nominated Janet Yellen for the role of Federal Reserve Chair.

The Fed's latest round of Quantitative Easing (QE), which began late last year, is expected to remain in place when Ms. Yellen assumes office with no change in policy likely until well into 2014. We maintain the view that the first rate hike will likely not occur until the second-half of 2015 or early 2016. Bearing this in mind, the rate normalization process is expected to continue at a gradual pace over a period of years, not months.

The TSX returned 4.7% in October and by month end was up 10.3% year-to-date. Industrials (9.2%), Financials (6.3%) and Utilities (5.5%) were the strongest performing sectors in October, while Information Technology (-0.8%) was the only sector in negative territory for the month.

The S&P 500 returned 4.6% in October and by month end was up 25.3% year-to-date. All ten sectors were in positive territory for the month.

Telecom Services (8.5%), Consumer Staples (6.4%) and Industrials (5.1%) were the strongest performing sectors in October.

Asian Indices yielded mixed results in October. The Sensex Index experienced the most pronounced results, increasing 9.3% for the month. The Hang Seng (1.7%) also experienced positive returns; however, the Shanghai Index (-1.5%), and Nikkei (-0.9%) fell into negative territory for the month.

European Indices fared better than their Asian counterparts, with the DAX (5.1%) and FTSE (4.4%) both returning strong results for the month. DS

This month features an article written by our RBC research team in the United States. Note: the information in this article is based on U.S. data.

THE NEXT DEMOGRAPHIC WAVE: THE MILLENNIALS

In this commentary, we take a look at some of the key themes and trends that have begun to play out as Millennials become a larger contributor to the global economy. From social media and internet connectivity to food and clothes, we look at a number of different themes that may be able to help you position your portfolio for a new generation of consumers and investors. We also identify a couple of key risk factors that have been cause for economic headwinds in this group such as student loan debt and the impact of unemployment among the younger generations.

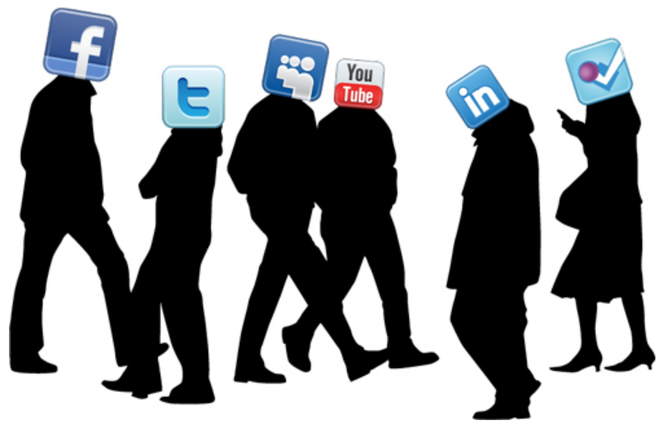
Who are the Millennials?

The Millennial Generation is people born between 1980 and 1999, who are typically the children of the Baby Boomers. According to the U.S. Census Bureau, there are roughly 80 million Millennials[1], making the group the largest generational cohort in U.S. history. It is also one of the most diverse generations with 60% non-Hispanic white (versus 70% in Generation X), 19% Hispanic, 14% black, 4% Asian, and 3% being of another race[2].

Figure 1	*Born*	*Age (in 2013)*
GI Generation	1901 – 1924	89 – 112
Silent Generation	1925 – 1946	67 – 88
Baby Boom Generation	1946 – 1964	49 – 66
Generation X	1965 – 1979	34 – 47
Millennials	1980 – 1999	14 – 33
Generation Z	2000 –	13 and under

The personalities of this generation can also be identified as people that are consistently tech savvy to a point where digital connectivity can at times be a social hindrance. They are also profound multi-taskers, which, as sad as it sounds, has been honed by years of simultaneously playing video games, while watching TV and doing homework. They are also typically described as being self-confident, self-oriented, and self-absorbed. With roughly 75% of the Millennial Generation having a social media profile, the tendency toward personal branding is quite strong among Millennials[3].

But with this self-orientation and its ties to social media, comes a level of political and community engagement that has not been witnessed in any previous generation.



Focus on the Student, the Worker, and the Investor.

The Student.

As surprising as this may come to some of you, Millennials are the most-educated generation (when measured by graduation rates) in U.S. history. Seventy-two percent have completed high school or have some sort of equivalence degree, and for those above the age of 19, 49% have a college degree.

For the remainder, between 14 and 18 years of age, it is estimated that approximately 58% of them will graduate from a four-year college[4]. All of this demand for higher education does come at a price though, with the average student debt load at $24,218 per borrower for college graduates (but we will get into that in greater detail later).

The Worker.

The heart of the Millennial Generation walked into one of the worst employment environments since the Great Depression. The table the next page (***see pg. 3***) shows the unemployment rates for various age groups in the United States. With the national rate running around 16%, Millennial unemployment is higher across all age groups. This doesn't factor in one of the key themes people have been discussing—underemployment.

The underemployed are people working part time or working at a job in which they would typically be considered “over qualified” (i.e., the college grad working at the local coffee shop). This, of course, doesn’t come without its longer-term risks, including decreased wages for an entire generational cycle.

Current wage rates for Millennials are estimated to be, on average, about 9% lower than their Generation X counterparts’ wage rates when adjusted for inflation at the same stage in life.

Figure 2	*Unemployment Rate*
16 – 19	24.60%
20 – 24	12.90%
25 – 34	8.20%
35 – 44	6.80%
45 – 54	6.40%
55 plus	6.50%

The Investor.

As the largest generation by population, the long-term economic power of the Millennials could be quite strong. However, many of them, despite claiming to be savvy when it comes to budgeting and saving, are skeptical of the market as a whole.

According to a study by Wells Fargo, 49% of Millennials believe they are confident with their ability to save for their financial future; while at the same time, 52% said they are “not very confident” or “not at all confident” in the stock market as a place to put their assets. This skepticism comes from watching the financial crisis take its toll right at the time many of them were either entering college, in college, or trying to enter the workforce.

How Do They Stack Up Against Other Generations?

As mentioned earlier, there are about 80 million Millennials, which makes this generation roughly 7% larger than the Baby Boomers. However, Millennials make up about 27% of the total population, less than the 35% the Baby Boomers comprised around the same time in their respective history.

Millennials also account for an annual $1.3 trillion in consumer spending, roughly 21% of the total.

Themes and Trends

Social Media and Mobile Internet Connectivity.

For many Millennials, social media has become an integral part of daily life. But it has evolved beyond a tool for simply staying in touch with friends and family, it has become a leading source of news and information, professional networking, and e-commerce.

The players in the industry range from the social networks themselves (Facebook, LinkedIn), to the content companies (Groupon, Zynga, Amazon.com) and the ones that develop the devices in which to access the networks (Apple, Google); each subgroup providing a different component to the social media ecosystem. This constant connectivity to social media also requires a seamless Internet connection on the go (Verizon, AT&T, Qualcomm), in which to access the information.

In the social network space, Facebook is far and away the largest player, with approximately 1.11 billion users around the world, and about 166 million users in the United States. Facebook itself has grown beyond a simple social network with the advent of media applications that can be integrated into a person’s profile.

These applications are just another tool for social networks to continue to drive time spent on their sites and, in turn, average revenue per user. LinkedIn, another network focused on the professional side of life, with an estimated 236 million users, is the third-largest social network. Twitter is second largest at the 250 million users mark.

On the device side, the idea of on-the-go access to social media is serviced by some sort of mobile device, whether it is a smart phone, tablet, or something else. The major providers of the physical technology are common household brands with Apple (iPhone, iPad) and Google (Nexus, Motorola, Android) as well as other international brands.

Media Content and Delivery.

The way Millennials consume traditional media (TV, radio, newspapers) has also shifted the market into more online content and on-demand delivery which has changed the way some media companies think about themselves and their customers.

Comcast for example, shifted to a diversified content creator/delivery company from a true content delivery company, with its acquisition of NBC Studios from General Electric, allowing it to access the original programming market for the first time.

Other companies like Netflix started in the media delivery business and have since transitioned into original content as well. NFLX has released two new original programs, "Orange is the New Black" and "House of Cards," both of which have been well received by its customers.

Traditional movie studios also play a key role in content creation targeted toward Millennials, with dedicated studio names like Lions Gate owning the rights to key on-trend brands like Twilight, The Hunger Games, and Ender's Game, just to name a few.

Lifestyle, Authenticity and Automobiles.

Millennials, who purchased 25% of the total number of automobiles sold in 2012, according to a recent AutoTrader study, prefer to do their research online, and prefer to interact with salespeople less than their demographic elders. And while millennials prefer to purchase an automobile that reflects their achievements and personalities (38% and 48%, respectively) vs. GenX (at 28% and 38%, respectively) and Boomers (at 27% and 34%, respectively), many have not yet done so, because they can not yet afford it.

We also suggest that the prodigious use of ZipCars, owned by Avis, and public transportation by millennials reflects the current stage of their life, as well as the increasingly urban locale many millennials favor. We believe Millennials will continue to be attracted to automobiles that reinforce their primary activist and connectivity goals.

While we don't see incremental demand moving the sales needle in a meaningful way at this time, due to the size of the global auto market, this demographic provides a compelling tailwind supporting continued development of energy-efficient and hybrid vehicles with features that allow them to stay virtually connected.

What Could Slow the Millennials Demographic Lifecycle?

Student Loan Debt.

The amount of student loans outstanding approached $1 trillion at the end of 2012, at $966 billion. This represents a more than a three-fold increase in total structured student debt since 2004. During that time, according to the Federal Reserve Bank of New York, the student loan market experienced a 70% increase in the number of borrowers, as well as a 70% increase in the average loan balance carried per borrower. Nearly 44% of these loans are currently in deferment/grace period or another kind of arrangement that removes them from a payment cycle.

The potential burden of this debt load has raised the concern that millennials are over-burdened by student debt, and the debt burden will slow the demographic lifecycle of spending for this generation at best, at worst, create a potential loan-bubble headwind rivaling that of the housing crisis. When the details are dissected, however, a slightly different picture arises. According to a report by the Credit Suisse economics team, the following key facts emerge:

- ***Less than 40% of borrowers are under 30 years of age.*** Surprisingly, nearly one-third of student loan borrowers are over the age of 40, reflecting a desire to go back to school, as well as select education as an option during a time when employment opportunities are challenging.
- The average student loan debt equals $24,518, but the median student loan debt outstanding is $13,662.
- Only 1% of student borrowers had an outstanding debt of $100,000 or more.

While we watch the level of debt and its impact on this generation, we believe for many members of this demographic, the debt load will be manageable. Repayment plans are often extended or deferred, and some plans may move out 25 years.

Underemployment.

As mentioned above high unemployment remains a challenge however these figures have been improving since January 2013. This is a trend that bears watching, in our view, as this generation continues to ramp towards full employment.

Delayed Household Formation.

The Pew Research Center noted in a 2012 study, that a record 36% of people aged 18 to 31 live at home with their parents.

However, again, when the details are examined, we note that this survey counts students living in dormitories as living with their parents, as it is more likely that younger millennials are in school.

Furthermore, only 3% of millennials live with their parents once they are married. So the millennial sub-set living with their parents is more often than not, male, unmarried, and either out of school or unemployed.

Conclusion

We are still in the early stages of the consumption life cycle for Millennials, and similar to trends experienced by Boomers, initial consumption trends are expected to ebb and flow over time. Today, the most established trend being lead from this group is the trend toward mobile communication and social networking.

We believe the "always connected" and "mobile" trend is native with this generation, and will be viewed as an important foundation for society.

We also believe the size of this demographic will continue to drive trends in travel, food, and automobiles/soft goods consumption. While not yet a needle-mover in housing, the trend is beginning. DS

1. U.S. Census Bureau.
2. Pew Research Center (2009) Millennials Confident, Connected, Open to Change.
3. Ibid.
4. National Center for Education Statistics (2011) Post Secondary Graduation Rates.