Silver spending — COVID-19 update

Longer Term Investments

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- The global population is aging, especially in more developed countries where currently one in four people are aged 60 or older, a figure expected to rise to one in three by 2050.
- We expect this age group's spending power to become increasingly influential in the years ahead, as the older segment represents a greater proportion of the global population.
- The COVID-19 pandemic and related containment measures have temporarily reduced the consumption of "silver spenders." Leisure and tourism, consumer personal care and beauty products, retirement housing, and healthcare services were most negatively affected.
- Silver spending remains an attractive long-term investment theme. We expect all four categories to recover with the relaxation of government restrictions, although the time horizon will differ by category.

Source: Getty Images

Our view

The global population is clearly aging, and the "silver spender" age category's consumption is expected to increase dramatically as a proportion of total consumer spending. Numerous studies show that, due to growing pension deficits, more and more people will need to work longer. In the last two decades, consumption by Europeans aged 50 and over has grown three times faster than the rest of the population. Similarly, in the US, the baby-boom generation, which comprises about a quarter of the population, controls the largest share of household wealth and accounts for the greatest share of total consumption.

While this theme has been negatively affected by the temporary slowdown in economic growth due to the COVID-19 crisis, we believe its structural drivers will remain in place over a longer time horizon. In particular, we think the theme is well positioned to benefit from this expanding consumer market by addressing the specific needs and preferences of those above age 55. The theme is likely to enjoy a higher growth rate and provide returns above the wider market in the longer term, in our view.

Government restrictions and social distancing have had a negative impact on leisure and tourism, personal care and beauty products, retirement housing, and healthcare services. That said, in our view, long-term trends remain favorable. A return to normal should be followed by a recovery in spending. However, the budget allocation of silver spenders may change in the short term, as we anticipate a preference for domestic travel will emerge, while demand for cruises will suffer.

We recommend exposure to silver spenders via a broadly diversified basket of stocks.

Immediate COVID-19 impact

We identify five main categories to which silver spenders allocate more of their disposable income. Leisure and tourism (particularly cruises), consumer personal care and beauty products (specifically anti-aging products), retirement housing, healthcare services, and financial planning services.

Leisure and tourism
The outbreak of COVID-19 immediately hit the travel and leisure industry. Even before governments closed their borders and implemented lockdowns, several cruise ships around the world had been placed under quarantine, for example the Diamond Princess in Yokohama, Japan. Since then, the cruise business has come to a halt. Uncertainty remains high, and it is unclear when cruises will start to operate again. Cruise ships have typically been very popular among silver spenders (Fig. 1). As mortality rates increase with age, medical treatments or a working vaccine for COVID-19 will be key to increasing the appetite for cruises. In our view, a recovery to pre-COVID levels will take several years.

We expect hotels to recover faster due to the relaxations of government travel restrictions. Unlike previous cycles, this recovery will probably by led by leisure rather than business travel. We anticipate silver spenders will reallocate within their budgets. Instead of taking a long-haul flight or booking a cruise trip, this age cohort will likely increase its demand for domestic travel. While a complete return to normal will probably require a medical solution for COVID-19, we don't expect the desire to discover new countries and meet new cultures to disappear. So travel and leisure should remain a key recipient of silver spenders' disposable income in the future.

- **The Longer Term Investments (LTI)** series contains thematic investment ideas based on long-term structural developments.
- Secular trends such as population growth, aging, and increased urbanization create a variety of longer-term investment opportunities.
- These investment opportunities are influenced by the interplay of technological advancement, resource scarcity, and societal changes.
- Investors willing to invest over multiple business cycles can benefit from potential mispricings created by the typically shorter-term focus of stock markets.

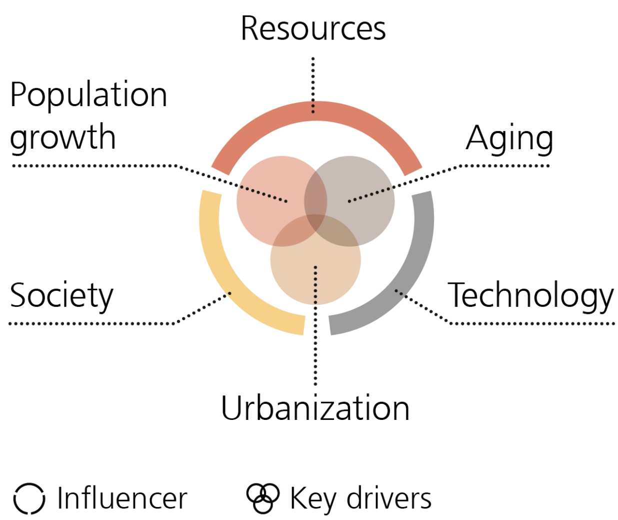
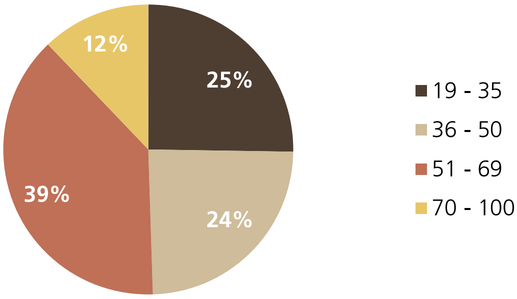


Fig. 1: Cruises tend to attract an older subset of the population, specifically the baby-boom generation

Percentage of cruise customers, by age group



Source: Cruise Lines International Association, UBS, as of January 2018

Personal care and beauty

The outbreak of the coronavirus negatively impacted consumers' shopping habits immediately. Companies were forced to close their stores first in China, and later in Europe and the US. Interestingly, active cosmetics (e.g. anti-aging creams) still did well during this time, benefiting from the open pharmacy channel. For example, L'Oréal's total organic sales declined by 4.8% in the first quarter, but its active cosmetics division grew by 13%, supporting our favorable long-term view on growing demand for personal care products.

We expect personal care and beauty to return to previous growth rates next year. With the relaxation of government restrictions, consumer confidence should improve again. A normalization of social life will likely increase demand for personal care and beauty products, in particular certain makeup or skin care brands.

Retirement housing

Nursing homes have recorded a disproportionate number of coronavirus deaths in recent months. This crisis underscores the importance of building more secure foundations for the industry. Therefore, the short-term outlook for the sector is challenging and the market will have to adjust accordingly. The public relations disaster, coupled with higher personnel and security costs, has undermined profitability. We expect new entries into retirement homes to fall sharply and vacancy rates to rise further this year.

However, in the longer term the investment case remains attractive. The aging of society will accelerate demand growth, and low debt yields should underpin real estate valuations. The declining nursing quality of underfunded public institutions will provide opportunities in the high-end private care segment. For further information, please refer to our publication "LTI Retirement homes - updated," published on 20 May of this year.

Fast recovery in healthcare services expected

Manufacturers providing medical devices used in elective procedures have faced significant revenue losses during the pandemic. However, most demand should be delayed rather than destroyed, and a backlog has built up that will be tackled as hospitals gradually restart non-urgent procedures. Overall, the long-term investment case for medical devices —driven by innovative and cost-efficient new treatments, an aging population, and a growing prevalence of "lifestyle diseases"—is still in place.

Indeed, the long-term trend remains favorable. As silver spenders reach retirement age, they will likely need more medical care. Funding their healthcare needs will require them to draw on their earned social benefits like Medicare (US), as well as to use their savings to buy private insurance. Managed care organizations (MCOs, or health insurers) are expected to be a major beneficiary of healthcare demand. Seniors are increasingly choosing privately managed Medicare Advantage plans, a type of health insurance plan in the United States that provides Medicare benefits through a private-sector health insurer, instead of traditional fee-for-service Medicare. The managed care organizations offer Medicare Advantage plans and generally benefit both from the growth in the Medicare-eligible population and from the increasing market share shift to Medicare Advantage. For further information, please refer to our healthcare reports, in particular "LTI Medical Devices" published on 11 April 2019.

Demand for financial planning

Silver spenders' need for services to manage and administer their assets, finance their retirement years, and plan for the future of their beneficiaries will increase—especially as life expectancy continues to rise. The COVID-19 pandemic has led to different developments within the financial sector. For instance, wealth managers have outperformed while retail banks have underperformed. Life insurers, trust companies, wealth managers, and asset managers can benefit from silver spending by specializing in retirement services or estate planning targeted at an older demographic. For further information, please refer to our publication "LTI Retirement planning" published on 17 September 2019.

Key Driver - An aging population

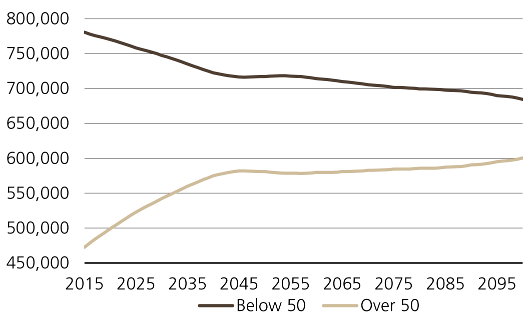
Globally, population groups aged 60 and older are growing in excess of twice the rate (3%) of the overall population (1.1%), according to UN data. In just over 30 years' time, the number of people above 60 should exceed the number of children (15 years old and under).

This trend will be even more evident across developed countries, which are more advanced in the aging cycle than their emerging market counterparts. Today in developed regions, one in four people is aged 60 or older, a figure that is projected to rise to one in three by 2050 thanks to increasing longevity and the aging of the baby boomers.

While the number of people older than 50 in developed countries is expected to increase by nearly 100 million (20%) by 2040, the below-50 age group is expected to shrink by roughly 60 million (8%) (Fig. 2). So in the next 20 years the population aged between 50 to 80 years old is expected to increase by 38 million, from 33.6% of the population to 35.6%.

Fig. 2: Populations are expected to age significantly

Size of population in developed countries, by age, in thousands



Source: UN, UBS, as of June 2017

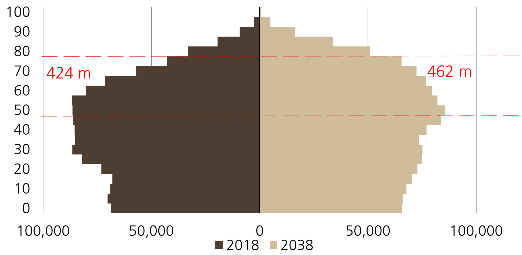
Fig. 3 shows the UN's projections for the years 2018–2038 by specific age in developed regions. The increase of the population between 50 and 80 years of age in the next 20 years, from 424 million to 462 million, is noteworthy.

Different ages, different spending patterns

As people grow older, their spending focus changes markedly in terms of the specific categories of goods and services they buy. Given greater longevity and aging demographics, a larger proportion of people with a different spending focus will arise relative to the younger demographic, in our view.

Fig. 3: Developed regions' populations are forecast to age

Projection of different population ages in developed regions, thousands of people



Note: There are risks associated with forecasting over such long periods

Source: UN, UBS, as of June 2017

Significance of the silver spenders' spending power

The consumption of the silver spender age category will likely increase dramatically as a proportion of total consumer spending. Many studies have shown that growing developed country pension deficits are resulting in the need for many people to work longer. We don't dispute this finding. But in the last two decades, consumption by Europeans aged 50 and over has risen three times as fast as that of the rest of the population, according to the UK's National Endowment for Science, Technology, and the Arts. In the UK, for example, by 2030 the over-65 age group will account for 25% of the total consumer market. Similarly, in the US, the baby-boom generation already accounts for 37% of personal consumption expenditures. These statistics highlight the importance of understanding the spending patterns of people as they age in terms of sector composition.

Risks

A number of risks could minimize or delay the rise in old age consumer spending. Age discrimination could continue, with employers failing to embrace an older workforce, meaning that older cohorts might not work as long as expected. Pension and savings assets might provide lower-than-expected returns, depriving pensioners of incremental spending power, which is part of the more general risk of lower-than-expected disposable income for older age categories.

A cyclical downturn in the global economy hurts discretionary spending for all age categories. But Longer

Term Investment (LTI) themes are based on structural drivers and target investors willing to invest over multiple business cycles. Similarly, one-off events such as a housing crash would hit consumer sentiment and erode the perceived wealth of the oldest age categories, resulting in lower consumer spending.

As healthcare is part of this theme, it's important to consider potential regulatory changes. In the US, the debate around drug pricing continues, but we do not expect US government price intervention at this time. If anything, we could see pharmaceutical valuations expand as the importance of drug companies in the fight against COVID-19 comes into focus.

Several factors could have positive implications for the theme and foster silver spending. The uptrend in labor participation rates for those 65 and over could accelerate, providing this age group with higher-than-expected incomes. Higher silver spending could also come from better-than-expected savings and pension returns. In relative terms, lower-than-expected fertility rates, along with a continued rise in longevity, would accelerate the older age groups' dominance over consumer markets.

Appendix

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