

Angst in America, Part 1: Aimless Men

By John Mauldin | March 19, 2017

Labor Market Limits

Men Without Work

How It Starts

The Big Question: Why?

Elusive Solutions

“America was not built on fear. America was built on courage, on imagination and an unbeatable determination to do the job at hand.”

– Harry S. Truman

“Unemployment is a weapon of mass destruction.”

– Dennis Kucinich

“Ever since 2000, basic indicators have offered oddly inconsistent readings on America’s economic performance and prospects. It is curious and highly uncharacteristic to find such measures so very far out of alignment with one another. We are witnessing an ominous and growing divergence between three trends that should ordinarily move in tandem: wealth, output, and employment. Depending upon which of these three indicators you choose, America looks to be heading up, down, or more or less nowhere.”

–Nicholas Eberstadt, “[Our Miserable 21st Century](#)”



“Depression Breadline,” 1991, by George Segal

Angst is “a feeling of anxiety, apprehension, or insecurity.” Many of us feel it acutely right now – and that’s new. Angst isn’t a temporary, individual thing anymore. Now we all feel it together – or at least most of us do – and it’s not at all temporary. Millions can remember feeling no other way.

There’s a general sense in much of the developed world that we’re headed for more difficult times. Deficits increase, unemployment rises, and the benefits of the future – or at least the future that is already here (to paraphrase William Gibson) – have been unevenly distributed throughout society. It is not just in voting patterns that you can recognize the sense of malaise. You can see it in the economic numbers and in a lot of the psychological/sociological research.

Angst manifests differently in different countries. Consider Japan:

Recent research by the Japanese government showed that about 30% of single women and 15% of single men aged between 20 and 29 admitted to having fallen in love with a meme or character in a game – higher than the 24% of those women and 11% of men who admitted to falling in love with a pop star or actor.

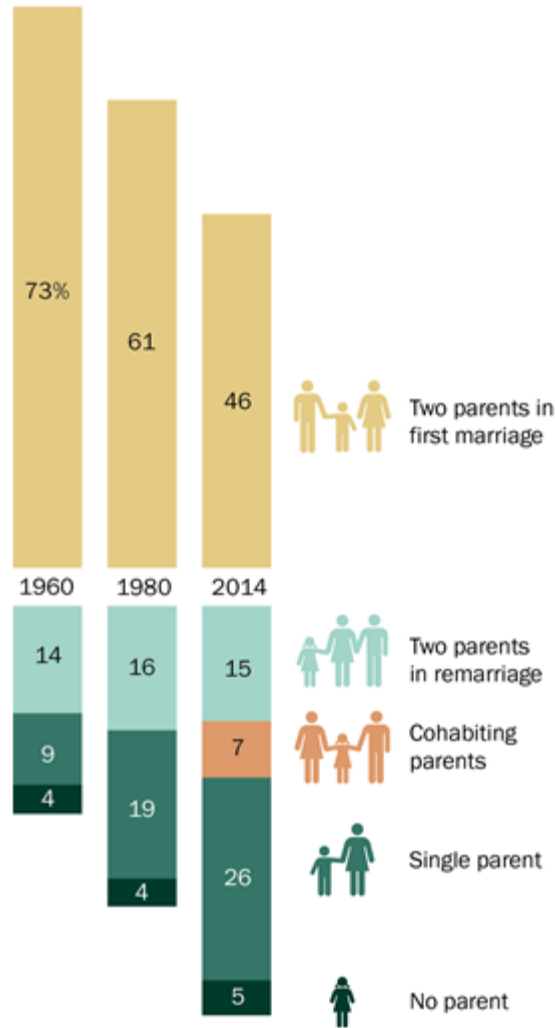
The development of the multimillion-pound virtual romance industry in Japan reflects the existence of a growing number of people who don’t have a real-life partner, said Yamada. There is even a slang term, “*moe*”, for those who fall in love with fictional computer characters, while dating sims allow users to adjust the mood and character of online partners and are aimed at women as much as men. A whole subculture, including hotel rooms where a guest can take their console partner for a romantic break, has been springing up in [Japan](#) over the past six or seven years. ([The Guardian](#))

Is it any wonder that there is a dearth of babies in Japan? It’s hard to get pregnant when a computer avatar is your companion. Young British women are literally 20 times more likely to have a pregnancy out of wedlock than young Japanese women. The cultural oddity of *moe* partially explains that fact.

While researching this topic I came across literally scores of similarly disconcerting statistics. For instance, the difference between the income and employment status of young males who grew up in two-parent versus one-parent homes is staggering, especially when you realize how fast the number of single-parent homes – generally, though not always, led by the mother – is rising. Less than half of US children live in a traditional family setting, according to Pew Research.

For children, growing diversity in family living arrangements

% of children living with ...



Note: Based on children under 18. Data regarding cohabitation are not available for 1960 and 1980; in those years, children with cohabiting parents are included in "one parent." For 2014, the total share of children living with two married parents is 62% after rounding. Figures do not add up to 100% due to rounding.

Source: Pew Research Center analysis of 1960 and 1980 decennial census and 2014 American Community Survey (IPUMS)

PEW RESEARCH CENTER

This week we begin a series of letters exploring the new economic and sociological anxiety. I want to look at what causes it and think about what we can do to ease it. I don't know how many letters

this dive will take. I may break away for other topics and then come back to the topic of angst. The one thing I know, based on my own experiences with family, friends, and business associates and the feedback I get from readers, is that we have a big problem.

In his first inaugural address, Franklin D. Roosevelt famously said, “The only thing we have to fear is fear itself.” In 1933 that wasn’t even close to true. They had plenty to fear: The US was already in the throes of a depression that would only get worse, and war clouds were forming across the Atlantic and Pacific.

Roosevelt didn’t have all the right answers, but he did one thing very well: He gave people hope. My generation heard from our parents, even decades later, how FDR helped pulled them through those hard times.

Of course, he had an important advantage today’s leaders lack: Television, talk radio, and the internet weren’t constantly reminding everyone how terrible things were. We didn’t know or care about the intimate details of our leader’s lives. Today, I am not sure even FDR himself could do what he did back then. Conditions are different now.

It is become increasingly clear to everyone that we are breaking ourselves up into tribes based on how we consume news. We consume our news from people who are generally ensconced in the same ideological bubble we are, which only reinforces our concerns and anxieties. If you think Donald Trump and Paul Ryan are taking us in the wrong direction, there are plenty of people who will agree with you and tell you so. If you think the people opposing them don’t understand and are distorting the truth, there are plenty of sources that will confirm your thinking. And both sides talk/shout over the other.

We have always had polarization among our news sources (even back in colonial times), but it has never been so ubiquitous before, or so extreme; and the news has never been so readily accessible, so that numerous “tribes” can live in the same physical neighborhood yet hear different versions and interpretations of the problems and directions in our country and the world. We no longer all listen to Walter Cronkite on the radio or TV or read the local newspaper for our news. There is no unifying national experience, just a disjointed series of intra- and intertribal interactions. (This is not just a US problem, but I’m going to be citing mostly US data.)

Labor Market Limits

It's no wonder that so much of our angst is job-related. Some people don't have jobs at all while many others don't like the jobs they have. The millions of unemployed, underemployed, or unhappily employed touch all of us in some way.

If our nation's work rate today were back up to its start-of-the-century high, well over 10 million more Americans would currently have paying jobs. And that employment shortfall makes a real difference to the growth of the economy. There are only two ways to grow the economy: You either have to grow the number of people working, or you have to increase their productivity. If you remove 10 million American workers from the labor force, not only are they not producing anything, the vast majority of them are obviously consuming the fruits of the labor of those who are employed.

As we will see, the number of people dropping out of the labor force is increasing, and if that trend is not turned around, the hope that we will get back to 3% GDP growth is simply wishful thinking. Couple that trend with reduced productivity and we will be lucky to see even 2% growth for the rest of the decade. If we have a recession, we will end up with a lower GDP than we have today. Think about that, and then plug it into federal budget projections.

Meanwhile, employers feel a different kind of angst. Many either can't find qualified workers or their workers require constant attention and extensive training to be productive. Neither side of the labor-management divide is happy with the arrangements. Everybody is apprehensive about the future. The common complaint from businessmen is not that they need more capital and the ability to borrow money from banks, but that they need more good workers in order to attract more good customers.

This widespread dissatisfaction among employers, employees, and those who aren't working is

one big reason Donald Trump is now president. He paid attention to a large group of voters that others ignored, spoke to their anxieties, and won the White House. It was not simply working-class white males that he appealed to; that is far too simplistic an analysis. It was also their bosses, spouses, parents, and friends. A huge swath of the country was experiencing a yawning disconnect between the reality of their daily lives and the supposedly growing economy touted by politicians and media pundits. We focus on the anxiety of the white working-class male, but I challenge you to find me an identity group (however you want to define it) that isn't anxious and concerned that things aren't heading in the right direction.

American culture used to be known for its optimism, its can-do spirit. That quality hasn't vanished, but it has surely lost some of its luster this century. You can see it fading in the statistics about the number of new business startups, which is now less than the number of businesses closing down. And that trend has been in place for almost a decade. The hope that the situation was temporary probably let people tolerate much worse conditions than they should have. But you can only look on the bright side so long before you get tired of waiting.

The change in direction that began at about the turn of the century is described clearly in Nicholas Eberstadt's biting essay in *Commentary* magazine entitled "[Our Miserable 21st Century](#)."

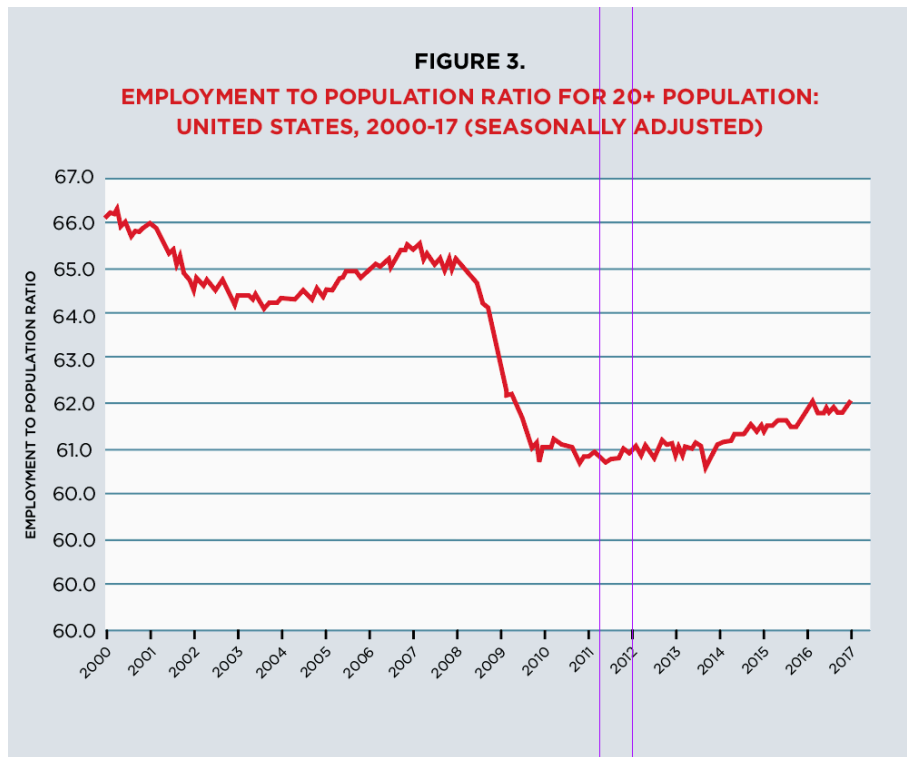
I will quote from that essay several times in this letter. If you take the time to read it, you should also read the pushback from my friend John Tamny, published in *Forbes* a few days ago, titled "[Nicholas Eberstadt, Election 2016, and Self-Flagellation by the Elites](#)."

Men Without Work

One problem is data-related. The "labor force" from which we calculate unemployment statistics necessarily includes only those people who are either working or who wish to be working. It ignores the retired, those in school, the disabled, nonworking spouses, as well as those who are not interested in working.

That's always been the case, of course, but the percentages vary. Even a 1% variance in the size of the labor force represents millions of people in a nation as large as the US. So the data got even murkier as the Baby Boomers approached retirement age. The oldest of that very large cohort turned 65 in 2010. Some probably retired early for various reasons. Others worked or will work well beyond the theoretical retirement age of 65, either voluntarily or not.

Regardless, it is definitely the case that a smaller percentage of the adult population is working now than in the past. The percentage declined in the early-2000s recession and never fully recovered before plunging in 2008–2010. We see only a very slight upturn after the recession ended.



The problem is particularly acute for men, though it affects women as well. Recently I read a marvelous book called *Men Without Work: America's Invisible Crisis* by Nicholas Eberstadt, who wrote the essay in *Commentary*. The book is fairly short, and I highly recommend it. Eberstadt, who is a researcher at the American Enterprise institute, is very concerned with the large number of men in their prime who simply aren't working. This isn't a new development, nor is it restricted to men, but it is becoming more obvious. (At some point I will do a full review of the book.)

When Federal Reserve officials gathered last week to raise interest rates, they reviewed the data that says the economy is near "full employment." That notion is laughable to millions of regular Americans. We all know, or at least observe, plenty of working-age males who *could* be working but are not. They don't appear in the stats as unemployed unless they are "actively looking" for work. Or they may count as "employed" because they spent an hour or two doing odd jobs that month. But for all practical purposes they're unemployed, and someone else is supporting them.

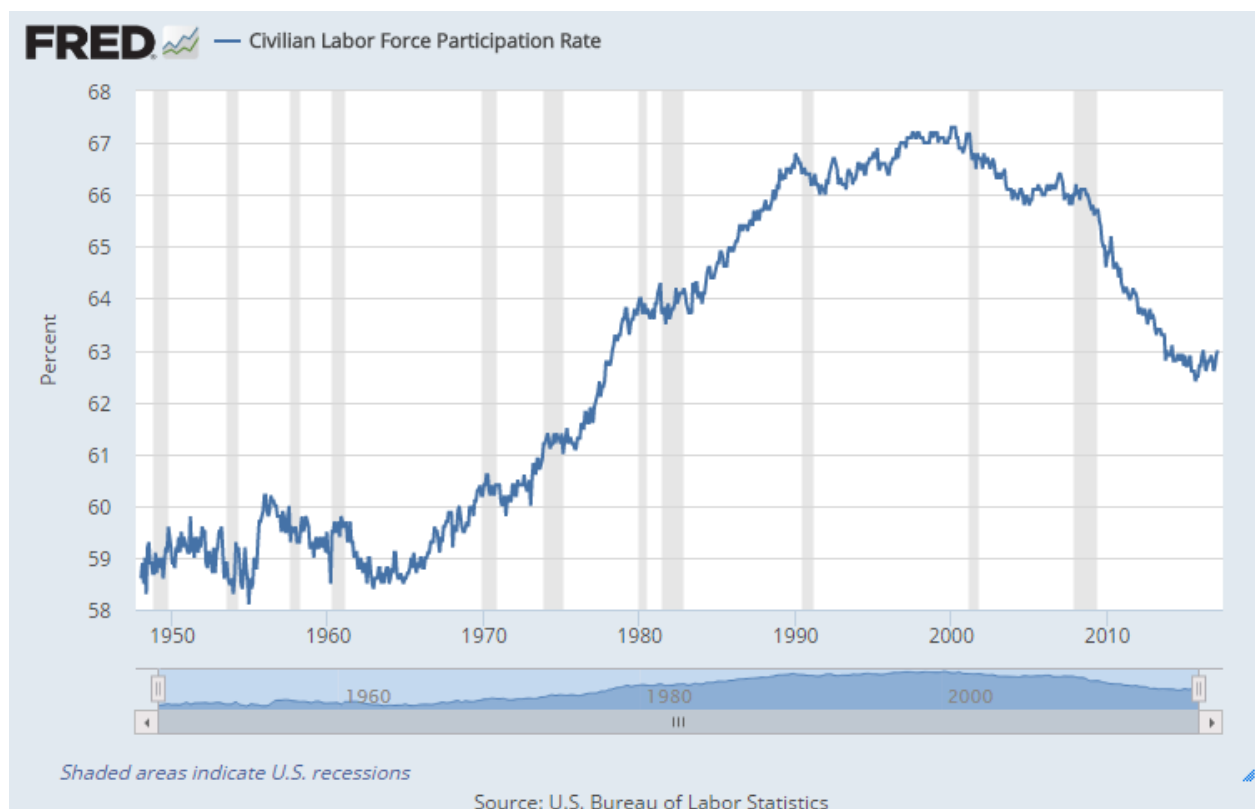
Eberstadt digs into the data and estimates that for every unemployed American male between ages 25–55, there are three more who are neither working nor looking for work. The number of those males presently in the labor force is down almost 4 percent since 2000. That's about 5 million men who, for whatever reason, have dropped out of the labor force.

Here's another and possibly even more startling number. Between 2000 and 2015, the total paid hours of work by all American workers rose 4 percent. The prior 15-year period saw a 35-percent increase in work hours. That's bad enough, but it gets worse. In that same 2000–2015 period, the

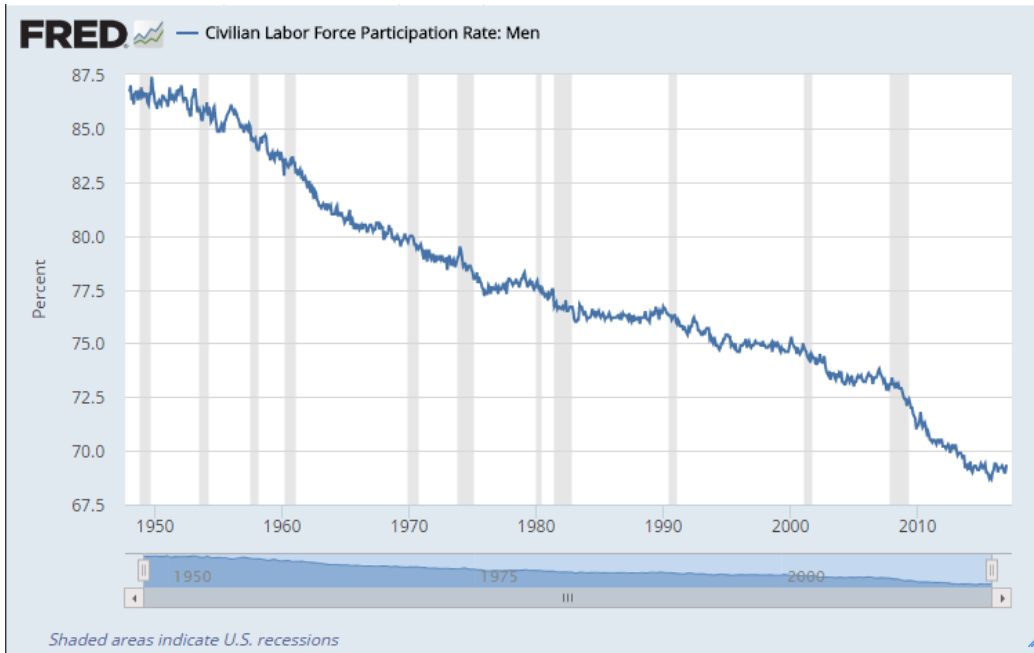
adult civilian population grew almost 18 percent.

With the population growing far faster than the total number of work hours, it shouldn't be surprising that so many people aren't working. And maybe they should be –you could surely argue that the work hours will appear if these people get busy and demonstrate their worth. In some cases that's likely true, but the full picture is more nuanced. The downturn in labor force participation is a trend that has been going on among working-age men for over 60 years, and recently (and somewhat alarmingly) we have seen the same negative trend in working-age women. Let's look at a few charts from the FRED database of the St. Louis Federal Reserve Bank.

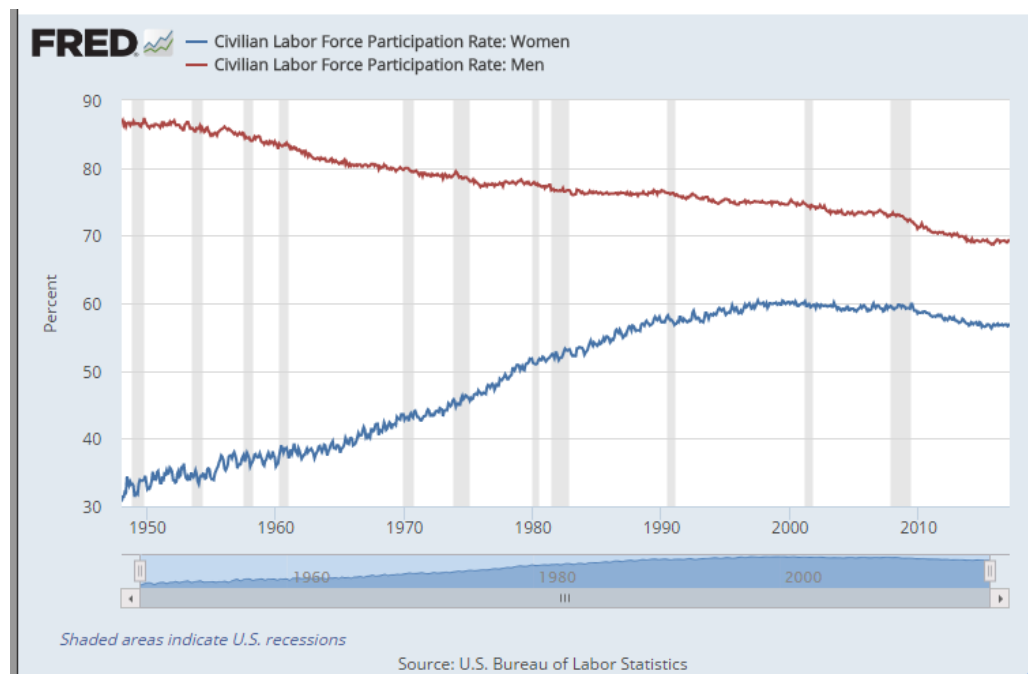
This first chart shows the overall civilian labor force participation rate, which grew from the mid-'60s right up until the beginning of the century.



But that chart is misleading. It looks like things were just fine up until 2000, but that's not the case. The next two charts show what really happened. The first chart is the male labor force participation rate. There is a bit of a statistical illusion in the way the data is framed, but let there be no mistake: The drop-off has been significant.



The next chart shows the labor force participation rate for both men and women. Note that the participation rate for women doubled in the 50 years up till 2000, while for men it went from almost 90% (87.4% to be precise) to just below 70% today. And that falloff has been steady throughout the entire period. This is not a recent phenomenon, although the downturn has worsened significantly since 2000. Notice that the participation rate since 2000 among women has been dropping at roughly the same rate as for men, at least in the last 6–7 years.



How Does It Start?

The progression from childhood to working adulthood used to be fairly standard. In an idealized form, which now seems almost mythological, it went something like this.

You grow up seeing at least one parent go off to work every day. You know from an early age that this is normal and necessary to support the family. When you reach your preteens, you get a starter job of some kind – paper route, mowing lawns, babysitting, etc. Maybe you get a regular job after school or in the summer. You finish high school and gain some independence from your parents by going to college or into the military, or by getting a full-time job, which may involve learning a trade. After a few years of saving your money, you're ready for marriage and the purchase of a starter home. Then you live happily ever after. The End.

That sequence, to the extent it ever existed, is pretty rare now. The majority of children grow up in broken homes, see parents hop from job to job with little satisfaction, and in some areas grow up surrounded by crime and welfare dependence. Overcoming that kind of start to get on a positive path is hard. People still understand that education is critical, but it's also more expensive than ever. Young adults take on student debt only to find the wonderful career they imagined isn't so easy to come by.

Then there's a second category. These are people who may grow up in stable surroundings, make all the right moves, get a good education, and start a rewarding career, only to run into a buzzsaw recession like we had in 2007–2010. They get laid off, burn through their savings, spend months or years looking for work, and eventually give up in despair. Then families break up, people move back in with parents, addictions form, and everything gets worse from there. And if such people do finally get another job, it comes with lower pay and fewer benefits.

On this topic, here are some quotes from “Our Miserable 21st Century.”

A short but electrifying [2015 paper](#) by Anne Case and Nobel economics laureate Angus Deaton talked about a mortality trend that had gone almost unnoticed until then: rising death rates for middle-aged US whites. By Case and Deaton's reckoning, death rates rose somewhat slightly over the 1999–2013 period for all non-Hispanic white men and women 45–54 years of age – but they rose sharply for those with high-school degrees or less, and for this less-educated grouping most of the rise in death rates was accounted for by suicides, chronic liver cirrhosis, and poisonings (including drug overdoses)....

All this sounds a little too close for comfort to the story of modern Russia, with its devastating vodka- and drug-binging health setbacks. Yes: It can happen here, and it has. Welcome to our new America....

By 2013, according to a [2015 report](#) by the Drug Enforcement Administration, more Americans died from drug overdoses (largely but not wholly opioid abuse) than from either

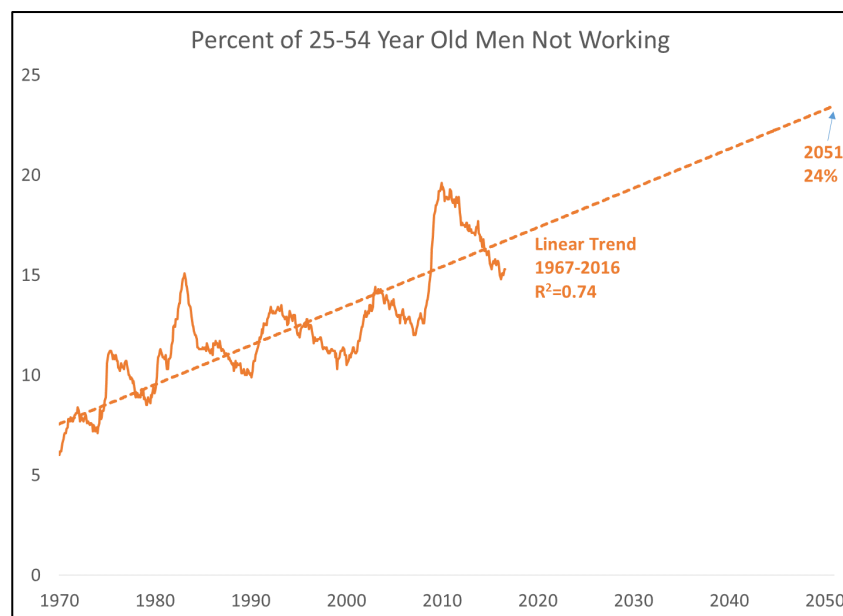
traffic fatalities or guns....

In [Dreamland](#), his harrowing and magisterial account of modern America's opioid explosion, the journalist Sam Quinones notes in passing that "in one three-month period" just a few years ago, according to the Ohio Department of Health, "fully 11 percent of all Ohioans were prescribed opiates...."

[N]early half of all prime working-age male labor-force dropouts – an army now totaling roughly 7 million men – currently take pain medication on a daily basis.

The Big Question: Why?

Again, both men and women are dropping out of the labor force at higher rates, but Eberstadt shows it is more common for men to do so. The trend is getting worse, too.



Larry Summers shared the above trend chart in his *Men Without Work* book review. You can see that the trend goes back *way* before NAFTA and factory automation were big factors. The percentage spikes higher in each recession then falls back, but in a series of "higher lows." I generally hesitate to extrapolate this far into the future, but after six economic cycles with the same effect, I think it's fair to call this a persistent pattern.

If the trend since 1970 does continue, nearly a quarter of all men aged 25–54 will be voluntarily jobless by mid-century. We should all hope the pattern does *not* persist, because I can't imagine this scenario being good for anyone. Large numbers of unoccupied young males are rarely beneficial to social order.

But that outcome is totally possible. Let's go back to what I was writing a few weeks ago. When six million truckers and taxi drivers are put out of work starting in 2025 (but will surely be out of

the driver's seat by 2040), along with most auto-industry repair and maintenance workers who now repair gasoline and diesel engines, and the auto insurance business too has been decimated, it is not hard to imagine a world in which 20%+ of the population is not part of the labor force. (And that's just one industry.)

Set aside the future, though. We have millions of unoccupied working-age males right now. What are they doing all day? Survey data suggests they spend much of their time staring at screens, either TV or video games. They watch a lot of pornography. On average, they are in front of a screen for 2000 hours a year, about what most people spend working a full-time job. Many live with relatives or couch-surf between friends' homes. They say they'll look for a job when conditions improve, but that's always tomorrow. They just drift.

I can't find hard data, but I suspect this group works more than the surveys indicate. Much of the work happens off the books as they try to preserve government benefits or avoid child support payments. Nevertheless, they surely don't have stable careers. Why not? What are the barriers? Here are a few, in no particular order.

Education: Many of the aimless males barely made it through high school and aren't ready for college. Maybe they could get ready, but that would take money and dedication few of them have, especially after they are 30 years old. This limits their options to manual labor, low-end service work, or even less positive options.

Now, it's easy for someone like me to say these men should swallow their pride and buckle down at whatever kind of work they can get. Yes, they should. But it's one thing to work in the salt mines when you know you're on your way to something better, and quite another when you know it's the end of your road and you'll never do better. That's got to be discouraging. Given a choice between jobs like that and playing video games, it's no wonder so many choose the virtual life.

Safety Nets: Our well-intentioned social programs can create a disincentive for people to work. That's not always the case; sometimes people fall on hard times and need a temporary hand up, and society benefits by making them productive again. We need to do a better job of creating the right incentives and avoiding the wrong ones.

This also goes for disability benefits. You've seen the statistics on how many people suddenly acquired debilitating medical conditions during the Great Recession. To my non-physician mind, it seems like distinguishing between genuine disabilities and fraudulent ones would be simple. Apparently it's not. Here again, we need to consider incentives and deliver the right ones. Eberstadt notes (again quoting from "Our Miserable 21st Century"):

By the way: Of the entire un-working prime-age male Anglo population in 2013, nearly three-fifths (57 percent) were reportedly collecting disability benefits from one or more government disability program in 2013. Disability checks and means-tested benefits cannot support a lavish lifestyle. But they can offer a permanent alternative to paid employment,

and for growing numbers of American men, they do.

The rise of these programs has coincided with the death of work for larger and larger numbers of American men not yet of retirement age. We cannot say that these programs caused the death of work for millions upon millions of younger men: What is incontrovertible, however, is that they have financed it – just as Medicaid inadvertently helped finance America’s immense and increasing appetite for opioids in our new century.

Addictions: A startlingly high number of men without work take prescription pain medicines. Others use alcohol or other drugs. I’m sure many really are in pain, especially older men who worked on assembly lines or did other hard labor. Physical pain plus the discouragement of being unemployed plus happiness-inducing substances is a toxic and sometimes deadly combination. Quoting again from “Our Miserable 21st Century”:

You may now wish to ask: What share of prime-working-age men these days are enrolled in Medicaid? According to the Census Bureau’s SIPP survey (Survey of Income and Program Participation), as of 2013, over one-fifth (21 percent) of all civilian men between 25 and 55 years of age were Medicaid beneficiaries. For prime-age people not in the labor force, the share was over half (53 percent). And for un-working Anglos (non-Hispanic white men not in the labor force) of prime working age, the share enrolled in Medicaid was 48 percent.

If you qualify for Medicaid, then for your \$3 co-pay you can get a prescription for OxyContin. The street value of that prescription is theoretically around \$10,000. It’s just the most expensive street drug available. All you have to do is find a doctor willing to write that prescription, which is evidently not that hard to do. (Some 20 years ago, I was prescribed OxyContin in Mexico as a sleep aid (from a very reputable doctor), because I wanted something different from what I’d been taking. One pill knocked me for a loop for 24 hours, putting me into a very strange, mind-altering situation. I threw that bottle away and can’t imagine how anyone can function normally taking that drug. It should be banned.)

The addictions don’t simply harm the men themselves. They lead to broken homes, unwanted pregnancies, domestic violence, lost job opportunities, criminal records, and more. Eventually you get whole communities riddled with dysfunctional, addicted people. It becomes very hard for anyone to escape the cycle.

Crime: I am not talking about an increase in crime, because overall US crime is actually in a real downtrend and has been for some time. The actual, often overlooked, problem is the large number of people with criminal records. Obviously, we shouldn’t ignore crimes, but we’ve developed a system that punishes people long after their formal sentence has been served. Many jobs are simply off limits to people with a felony or drug offense on their record, and easily accessible databases mean more employers do background checks now. In Texas, as in many states, you can’t get a simple apartment lease if you have a felony conviction or, in many areas, just a felony charge. Many potential employers simply never follow up if they see that criminal record. And we

are talking about a significant part of our population. While there may be “only” 1.5 million men in prison today, that population turns over and has accumulated to startling proportions. Eberstadt sizes up the problem in “Our Miserable 21st Century”:

We have to use rough estimates here, rather than precise official numbers, because the government does not collect any data at all on the size or socioeconomic circumstances of this [felony convict] population of 20 million, and never has. Amazing as this may sound and scandalous though it may be, America has, at least to date, effectively banished this huge group – a group roughly twice the total size of our illegal-immigrant population and an adult population larger than that in any state but California—to a near-total and seemingly unending statistical invisibility. Our ex-cons are, so to speak, statistical outcasts who live in a darkness our polity does not care enough to illuminate – beyond the scope or interest of public policy, unless and until they next run afoul of the law.

Think about what this approach does. Even if a man has every intention of reforming his life, he probably can’t do so unless he gets a steady job. That won’t happen unless some employer overlooks his background and gives him a chance. The alternative is to drop out of the labor force and drift, creating and participating in all the other disorderly conditions we’ve outlined.

Elusive Solutions

As you can see, “men without work” is a tough problem. It’s as much sociological as economic, but it has a serious economic impact. Our moribund economy will have a hard enough time supporting millions of Baby Boomers who lack sufficient retirement savings (that’s a topic for another letter). Adding millions of nonworking young and middle-aged men to the dependency pool doesn’t help.

Technological solutions may not come to our rescue this time. If anything, technology is aggravating the problem by making it cost-effective for machines to do entry-level work that once needed humans. And while technology does create jobs, it is not creating entry-level jobs that don’t need education and training.

I started this letter talking about Franklin Roosevelt. He faced a similar problem when the Great Depression put millions of able-bodied men out of work. One response was national service programs like the Civilian Conservation Corps. I’m not sure something like that is feasible now. But doing nothing is not feasible, either.

My editors, Charley and Lisa Sweet, shared with me these photos of the CCC camp established in the tiny mountain community of Suches, Georgia, in 1933. The Corps helped to build and improve roads, construct three lakes, create infrastructure at two nearby state parks, improve the Georgia portion of the Appalachian Trail, and build trail shelters that still serve hikers today. Camp Woody afforded purposeful work for about 130 men and made a lasting impact in the area. (Photos are from *Arthur Woody and the Legend of the Barefoot Ranger*, by Duncan Dobie. Arthur Woody was

Lisa's great-grandfather.)



Two views of the sprawling CCC Camp Woody, F-1, home of CCC Co. 1404, May 1936, Suches, Georgia. Photo courtesy of Bud Braddock, U.S. Forest Service retired.



Men without work eventually become men without hope, and that's bad for everyone.



Men Without Work

By John Mauldin | March 28, 2017

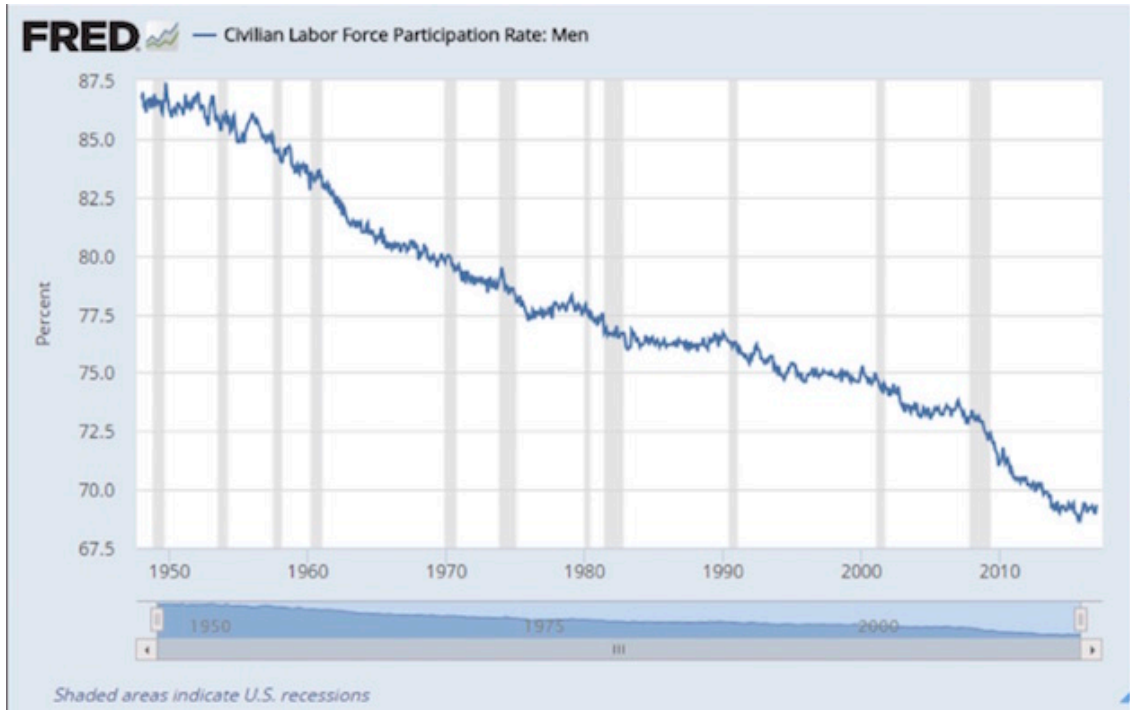
Where Will the Growth Come From?

Diving into *Men Without Work*

I have been promising a review of Nicholas Eberstadt's very important book, [Men Without Work: America's Invisible Crisis](#). The book is relatively short at 216 pages, but it is packed with meaty facts and insights. One of the reasons I seldom read an actual physical book anymore is because I can highlight text and make notes in my Kindle app on my iPad and then find those notes and highlighted sections on my Amazon page for later review. I actually highlighted 36 pages with 22,000 words from this book to go back and review. And while I will be using a lot of quotes in this letter, I hope this simply spurs you to order the book and read it for yourself. The "invisible crisis" that the author is writing about is at the very center of our economic and political turmoil.

At its heart, the book is about the fact that there are some 10 million American men of prime working age (25 to 54) who have simply dropped out of the workforce, and the great majority of them have not only dropped out of the workforce, they have also dropped out from any commitments or responsibilities to society. It is not just the labor force they are not participating in; they are not participating in the normal ebb and flow of community life.

This is not a recent phenomenon. I used the following graph last week, but it is important to illustrate the point. Male participation in the civilian labor force has been steadily dropping for 60 years, through boom and bust years, periods of inflation and deflation, Republican and Democratic administrations and congressional control; the trend seems to be relentless – except that it has been accelerating since 2009.



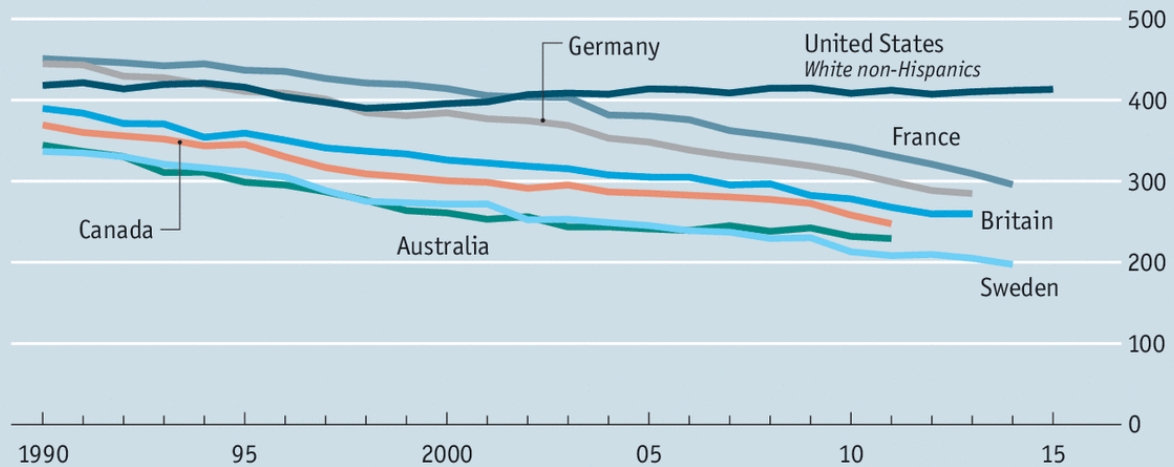
The trend was in place long before automation began to really impact the manufacturing workforce or jobs began to shift to China and other countries with lower labor costs.

Further, this is not just about men not participating in the labor force. “Deaths of despair” among middle-aged white men are increasing at an alarming rate. What I find odd and even more disturbing is that this seems to be a uniquely American trend. This week’s issue of [The Economist](#) highlighted this problem with a great chart that compares the US and other developed countries. Quoting:

AMERICAN workers without college degrees have suffered financially for decades – as has been known for decades. More recent is the discovery that their woes might be deadly. In 2015 Anne Case and Angus Deaton, two (married) scholars, reported that in the 20 years to 1998, the mortality rate of middle-aged white Americans fell by about 2% a year. But between 1999 and 2013, deaths rose. The reversal was all the more striking because, in Europe, overall middle-age mortality continued to fall at the same 2% pace. By 2013 middle-aged white Americans were dying at twice the rate of similarly aged Swedes of all races (see chart). Suicide, drug overdoses and alcohol abuse were to blame.

Desperate times

Deaths per 100,000 people
Aged between 45 and 54 years (adjusted for ageing within age bracket)



Source: "Mortality and morbidity in the 21st century", by Anne Case and Angus Deaton, 2017

Economist.com

You might think that rising mortality is the flipside of falling incomes. Recent trends in median per-person income for households headed by white 50- to 54-year-olds mirror their mortality rate. Income rises in the 1990s and then falls in the 2000s, ending up roughly where it started. But split people out by education, and the reflection fades. The income of college graduates has followed a similar pattern (most of the surge in the value of a college education happened before 1990). But their mortality has steadily fallen. And deaths of despair are much rarer among blacks and Hispanics, whose incomes have been on similar paths.

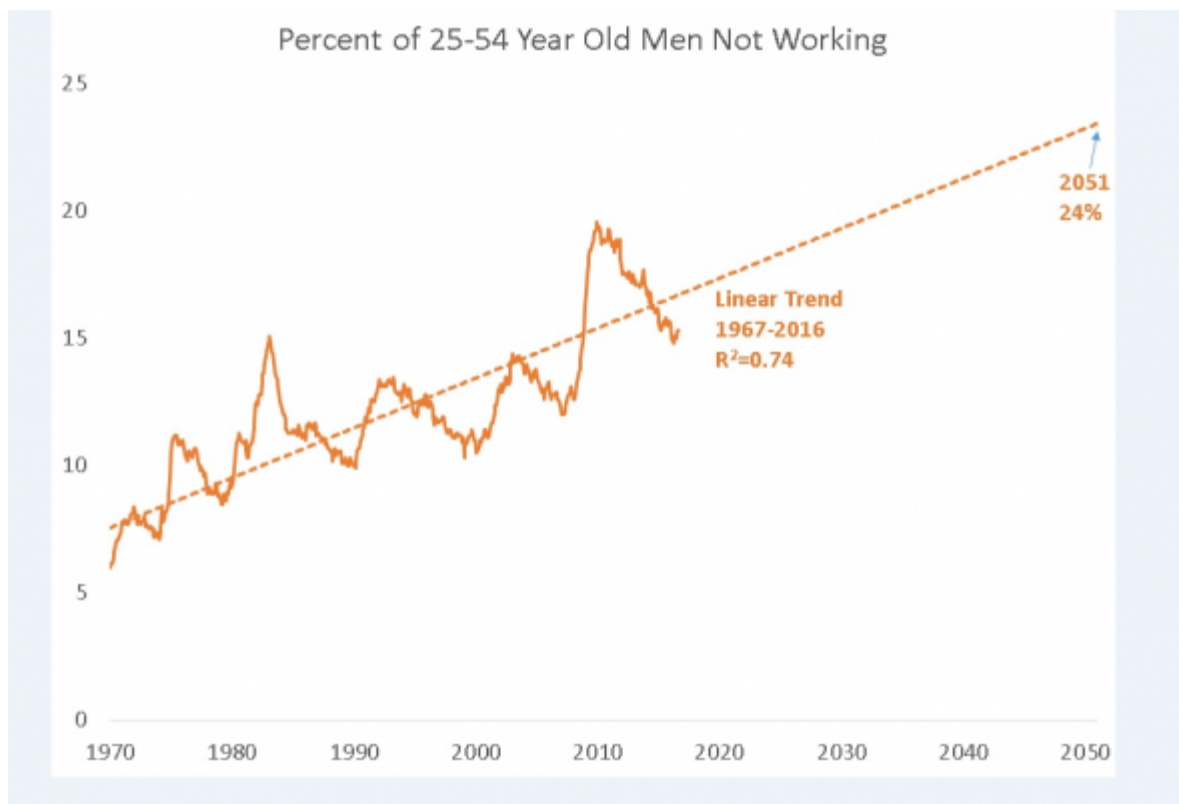
Ms Case and Mr Deaton have now updated their work on these so-called "deaths of despair". The results, presented this week at the Brookings Institution, a think-tank, are no happier. White middle-age mortality continued to rise in 2014 and 2015, contributing to a fall in life expectancy among the population as a whole. The trend transcends geography. It is found in almost every state, and in both cities and rural areas. The problem seems to be getting worse over time. Deaths from drugs, suicide and alcohol have risen in every five-year cohort of whites born since the 1940s. And in each group, ageing seems to have worse effects.

The authors suspect more amorphous, long-term forces are at work. The fundamental cause is still a familiar tale of economic malaise: trade and technological progress have snuffed out opportunities for the low-skilled, especially in manufacturing. But social changes are also in play. As economic life has become less secure, low-skilled white men have tended towards unstable cohabiting relationships rather than marriages. They have abandoned traditional communal religion in favour of churches

that emphasise personal identity. And they have become more likely to stop working, or looking for work, entirely. The breakdown of family, community and clear structures of life, in favour of individual choice, has liberated many but left others who fail blaming themselves and feeling helpless and desperate. (Emphasis mine.)

Larry Summers did a review of Eberstadt's book for the *Financial Times*. In a blog post about his review, he offers this rather sobering prediction:

Job destruction caused by technology is not a futuristic concern. It is something we have been living with for two generations. A simple linear trend suggests that by mid century about ¼ of men in the US aged between 25 and 54 will not be working at any moment.



I think this is likely to be a substantial underestimate unless something is done for a number of reasons. First, everything we hear and see regarding technology suggests the rate of destruction will pick up. Think of the elimination of drivers, and those who work behind cash registers. Second, the gains in average education and health of the workforce over the last 50 years are unlikely to be repeated. Third, to the extent that non-work is contagious, it is likely to grow exponentially rather than at a linear rate. Fourth, declining marriage rates are likely to raise rates of labor force withdrawal given that non-work is much more common for unmarried than married men.

On the basis of these factors I would expect that more than one third of all men in the US

between 25 and 54 will be out of work at mid-century. Very likely more than half of men will experience at least a year of non-work out of every five. This would be in the range of the rate of non-work from high school dropouts and exceed the rate of non-work for African-Americans today.

My only real quibble with this analysis is his suggestion that the gains in the health of the workforce over the last 50 years will not be repeated. The technology that I've been looking at lately (and much of it is not public) convinces me that younger generations are going to live a great deal longer than they now dream possible. By 2040 and certainly by 2050, expectations of a lifespan and a productive healthspan of over 100 years will be common. I am talking about a radical shift in the entire human aging process. Of course, this trend doesn't address the emotional and sociological aspects that Summers, *The Economist*, and Nicholas Eberstadt are referring to.

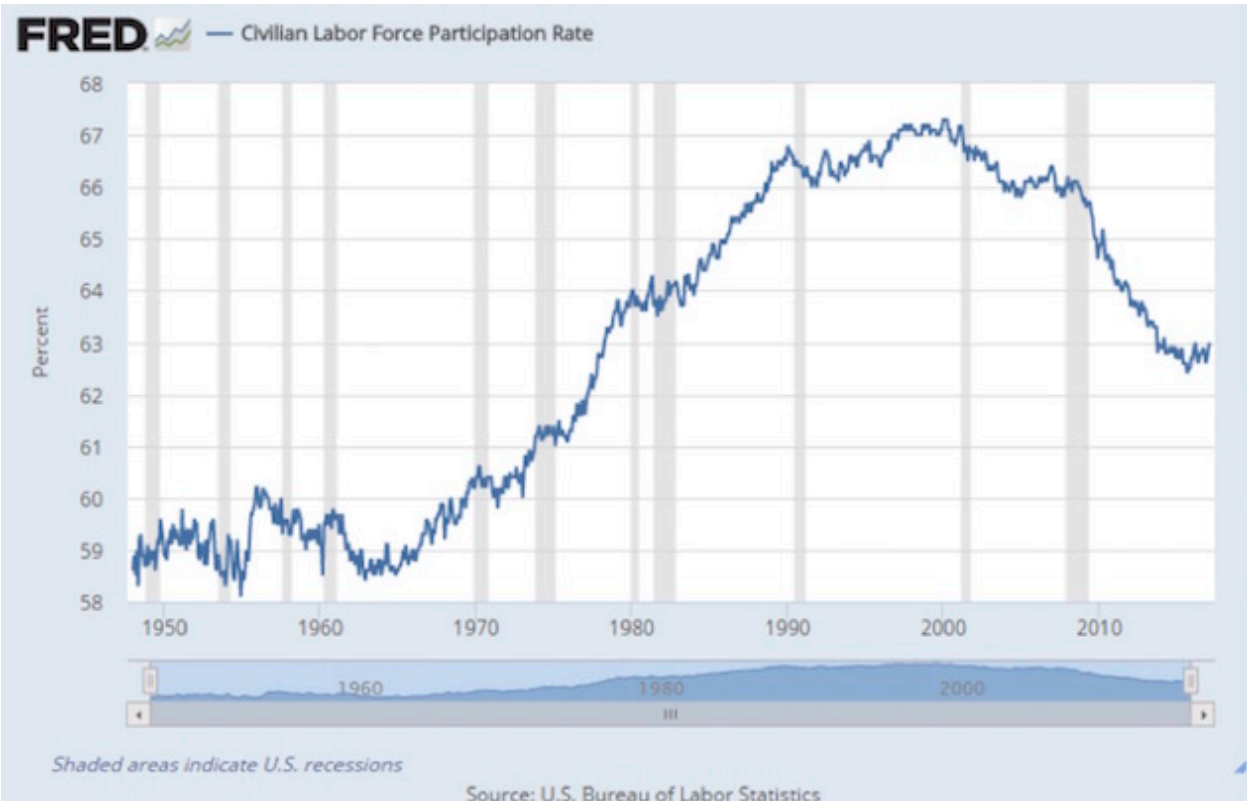
Where Will the Growth Come From?

I've made this point over the years but it is worth repeating again. There are only two ways for an economy to grow. That's it. If you don't have these two elements you're not going to have economic growth.

One way is that the workforce increases, and the other is that you increase productivity. If Summers is right that 1/3 of working age males are essentially going to drop out of the workforce, then, when we couple that with Baby Boomers retiring in the coming decades (or at least slowing down somewhat – well, except for me and possibly you), we are simply not going to get the increase in GDP that normally comes from growth in the workforce.

Further, it is really hard to increase productivity in much of the service sector. How much more productive can a bartender or a cashier be? Or a taxi driver? Yes, we can eliminate their jobs with technology, but that just reduces the workforce side of the equation.

I know that many politicians indulge in the wishful thinking that we can somehow recover the economic nirvana that we enjoyed from the '50s through the '90s because both productivity and the workforce were growing. Even though the participation rate of males was falling, the participation of women in the workforce was rising far faster, so the overall workforce was increasing.



This whole workforce issue, as I deal with the truly difficult challenge of researching and writing a chapter on the future of work for my upcoming book, is forcing me to rethink a great deal about how the economy is likely to behave and how successful investing will be conducted in the future. I cannot remind you strongly enough that past performance is not indicative of future results.

I don't see us turning the workforce situation around unless we somehow manage to transform our negative imagery about immigrants and start to aggressively seek out productive young, educated immigrants from around the world. I am not going to hold my breath on that one.

Diving into *Men Without Work*

And now I'm going to do something that I don't think I've ever done before. I am going to fill the next few pages with quotes directly from [Men Without Work](#). The book is a masterful monograph that sorts through an amazing amount of data and makes it readable. (My only frustration with the Kindle app is that it doesn't copy charts into my Amazon page.) I hope the next few pages tease your intellect and make you want to hit a link and buy the book. (All emphasis is mine.)

The collapse of work for America's men is arguably a crisis for our nation – but it is a largely invisible crisis. It is almost never discussed in the public square. Somehow, we as a nation have managed to ignore this problem for decades, even as it has steadily worsened. There is perhaps no other instance in the modern American experience of a social change of such consequence receiving so little consideration by concerned citizens, intellectuals,

business leaders, and policymakers....

But the progressive detachment of so many adult American men from the reality and routines of regular paid labor poses a threat to our nation's future prosperity. It can only result in lower living standards, greater economic disparities, and slower economic growth than we might otherwise expect. And the troubles posed by this male flight from work are by no means solely economic. It is also a social crisis – and, I shall argue, a moral crisis. The growing incapability of grown men to function as breadwinners cannot help but undermine the American family. It casts those who nature designed to be strong into the role of dependents – on their wives or girlfriends, on their aging parents, or on government welfare. Among those who should be most capable of shouldering the burdens of civic responsibilities, it instead encourages sloth, idleness, and vices perhaps more insidious. Whether we choose to recognize it or not, this feature of the American condition – the new “men without work” normal – is inimical to the American tradition of self-reliance...

Note that elsewhere in the book Eberstadt adopts a somewhat softer stance in talking about the circumstances that are bringing about the reduction in labor participation, especially with regard to the some 20 million former felons who have been relegated to second-class workforce status.

Here, then, is the underlying contradiction of economic life in America's second Gilded Age: A period of what might at best be described as indifferent economic growth has somehow produced markedly more wealth for its wealth-holders and markedly less work for its workers. This paradox may help explain a number of otherwise perplexing features of our time, such as the steep drop in popular satisfaction with the direction of the country, the increasing attraction of extremist voices in electoral politics, and why overwhelming majorities continue to tell public opinion pollsters, year after year, that our ever-richer America is still stuck in a recession....

Expert opinions on U.S. labor market performance have been increasingly sanguine over the past year or so. A few select media headlines and quotations illustrate the emerging consensus:

- “The Jobless Numbers Aren't Just Good, They're Great” (August 2015, Bloomberg1)
- “The Jobs Report Is Even Better Than It Looks” (November 2015, FiveThirtyEight)
(He then goes on to list numerous other recent articles. In addition, U.S. economists and policymakers who have served under Republican and Democratic presidents maintain that today's U.S. economy is either near or at “full employment”:
- “It is encouraging to see that the U.S. economy is approaching full employment with low inflation.” (Ben Bernanke, former chairman of the Federal Reserve Board, October 2015)
- “The American economy is in good shape . . . we are essentially at full employment . .

. tight labor markets are leading to increases in hourly earnings and in the producer prices of services.” (Martin Feldstein, former chair of the President’s Council of Economic Advisers and longtime director of the National Bureau of Economic Research, February 2016)

- “We are coming close to [the Federal Reserve’s] assigned congressional goal of full employment. [Many measures of unemployment] really suggest a labor market that is vastly improved.” (Janet Yellen, chairman of the Federal Reserve, April 2016)

All of these assessments draw upon data on labor market dynamics: job openings, new hires, “quit ratios,” unemployment filings and the like. And all those data are informative – as far as they go. But they miss also something, a big something: the deterioration of work rates for American men. Between 1948 and 2015, the work rate for U.S. men twenty and older fell from 85.8 percent to 68.2 percent. Thus the proportion of American men twenty and older without paid work more than doubled, from 14 percent to almost 32 percent. Granted, the work rate for adult men in 2015 was over a percentage point higher than 2010 (its all-time low). But purportedly “near full employment” conditions notwithstanding, the work rate for the twenty-plus male was more than a fifth lower in 2015 than in 1948. Essentially, what all these economists are looking at is the headline unemployment rate, the U-3 rate. The U-6 rate takes into account men who would like to work but haven’t been looking for work (discouraged workers). Philippa Dunne tells us that “Between 2007 and 2016, only 8 states reported declines in their U-6 rates. We’re not exactly surprised by the number of states where U-6 rates remain elevated even as the overall labor force tightens, but it does underscore how little attention we give to such disengagement as a nation.”

Before World War II, the exclusive economic activity for the overwhelming majority of U.S. women was unpaid labor at home. Today the overwhelming majority of women – including women with young children – engage in at least some remunerated employment outside the family. Needless to say, this shift has opened up new prospects for prosperity, as well as new horizons of economic independence and autonomy. The tremendous expansion of economic opportunities for U.S. women created a massive new supply of workers in the postwar economy. The share of women with paid work skyrocketed in every age group and doubled for women between twenty-five and sixty-four.

For women twenty-five-to-fifty-four, the work rate was 34 percent in 1948; in 2015, it topped 70 percent. In arithmetic terms, this enormous influx of new workers completely offset the decline in work rates for prime-age men – and then some). Thanks to the progressive entry of ever-greater proportions of women into the workforce, overall work rates for every grouping of Americans between the ages of twenty and sixty-four also increased substantially between the late 1940s and the late 1990s. Around the late 1990s, however, the escalation of work rates for U.S. women stalled and, over the past decade and a half, fell from their all-time highs. Only then did the overall work rate for U.S. adults

begin to register a decline....

Accordingly, more than eight times as many prime-age men were economically inactive and not pursuing education in 2014 than in 1965. One final aspect of the U.S. postwar male flight from work merits mention here: its relentless intergenerational momentum. It is not just that LFPRs (Labor Force Participation Rate) have deteriorated for certain age groups or specific periods. **Rather, the process has progressively depressed every successive rising cohort's LFPRs over the course of the prime working ages....**

As Nobel Economics Laureate Robert William Fogel has observed, "Over the course of the twentieth century, annual hours of work [in Western Europe and America] have fallen by nearly half, so much so that the household head in a rich country now usually works only about seventeen hundred hours per year in the marketplace. Indeed, on the average day, he spends more hours at leisure than at work."... With rising incomes and attendant gains in personal wealth, older American men were no longer consigned to laboring until death. The convention of "retirement" arose well before the New Deal or Social Security. By 1930, Costa noted, over 40 percent of American men sixty-five and older were no longer working or looking for work – nearly twice the fraction in 1880. With prosperity rising, a small but growing fraction of men in their early sixties and late fifties also began to retire early....

And so the puzzle: America has a more robust economy, a more flexible and dynamic labor market, and a more limited welfare state than any of these six countries. But it has failed to keep its younger men in the workforce at the level that these struggling nations (with the arguable exception of Italy) have achieved. Why?

Consider the annual hours worked and per capita output over the past generation in the G-7 countries (the world's major affluent democratic societies: the United States, Japan, Germany, France, Britain, Italy, and Canada;). No G-7 economy today produces as much value added per citizen as the United States and none have a workforce where employees spend as much of the year on the job.

Employed Canadians and Britons now work at least one hundred hours per year (over two full workweeks) less than working Yanks. The gap between the United States and France, according to the OECD, is now nearly three hundred hours (over eight full workweeks). More than four hundred annual hours (over ten full workweeks) separate workers in America and Germany....

Marital status and family structure/living arrangements likewise prove powerful predictors. Married men accounted for three-fifths of prime-age job holders but only about one-third of NILFs (Not in Labor Force). in 2015. On the other hand, men who have never married were underrepresented among the employed and overrepresented among NILFs.

Finally, foreign-born men in 2015 were more likely to be job holders and decidedly less likely to be NILFs than the prime-age male population as a whole. In sum, an American

man ages twenty-five-to-fifty-four was more likely to be an un-worker in 2015 if he (1) had no more than a high school diploma; (2) was not married and had no children or children who lived elsewhere; (3) was not an immigrant; or (4) was African American....

No matter their race or educational status, married men raising a family work more, and never-married men without children or children in their home work less. No matter their ethnicity or race, prime-age men who come to this country work more than those here by birth. Neither a wedding ring nor a green card confers innate advantage in the competition for jobs. Rather, marriage and migration decisions point to motivations, aspirations, priorities, values, and other intangibles that do so much to explain real-world human achievements.

The legacy of prejudice might seem to explain why prime-age male work rates and workforce participation rates are lower for blacks than whites today. But they cannot explain why work rates and LFPRs for white men today are decidedly lower than they were for black men in 1965. And they surely cannot explain why prime-age male LFPRs today are higher for Latinos than non-Hispanic whites (see figure 5.1). Nor can they explain why labor participation rates of married black men twenty-five to fifty-four are higher than for never-married white men in that same age group (see figure 5.2).

Released felons and ex-prisoners form a far larger fraction of the working-age male population than any other population group. These men with criminal records are disproportionately people of color and/or those with low educational attainment. Amazingly, however, the U.S. government does not today bother to collect information on their employment patterns.

As we shall see, a single variable – having a criminal record – is a key missing piece in explaining why work rates and LFPRs have collapsed much more dramatically in America than other affluent Western societies over the past two generations. This single variable also helps explain why the collapse has been so much greater for American men than women and why it has been so much more dramatic for African American men and men with low educational attainment than for other prime-age men in the United States.

Although crime statistics in America were arguably primitive half a century ago, such data as were available suggested crime levels had been more or less stable over the postwar era. Public perception also essentially tracked with those crime statistics. Starting in the mid-1960s, though, crime skyrocketed, and popular perceptions about crime followed. Public safety was generally believed to be worsening, perhaps dramatically. In the 1970s, Americans responded by enacting and enforcing more stringent measures against crime at the federal, state, and local levels. Vastly more convicts were sent to prison, and even more felons were processed through the criminal system via probation and “community supervision.”

After two decades, reported U.S. crime rates for all major types of crime finally declined. Crime rates in America today are thought to be more or less back to levels of the early 1960s. Incarceration rates, on the other hand, are roughly five times as high today as they were in the late 1960s.

As a direct consequence of crime and punishment trends since the 1960s, American society now contains a truly vast, if generally invisible, army of noninstitutionalized felons and ex-prisoners. These are overwhelmingly adult men convicted of serious criminal offenses who have been punished with prison time or probation, but who are now part of our general population.

Most well-informed readers know that the number of U.S. convicts behind bars has soared in America in recent decades and that the United States currently has a higher share of its populace in jail or prison than almost any other country. But only a tiny fraction of all Americans ever convicted of a felony are actually incarcerated at this moment. Maybe 90 percent of all sentenced felons today are out of confinement and living more or less among us.

As we close this letter, I want to highlight that one bolded paragraph again:

As we shall see, a single variable – having a criminal record – is a key missing piece in explaining why work rates and LFPRs have collapsed much more dramatically in America than other affluent Western societies over the past two generations. This single variable also helps explain why the collapse has been so much greater for American men than women and why it has been so much more dramatic for African American men and men with low educational attainment than for other prime-age men in the United States.

If we want to see things began to change, we going to have to deal with this “variable.” Perhaps we should rethink our concept of incarcerating everyone found guilty of using currently illegal drugs. Maybe we need to rethink about how long felony convictions stay attached to personal records. When you can’t even rent an apartment in many states because you were a felon, and in some cases simply because you were charged with a felony at some time in the past, is it any wonder that we have large numbers of people not participating in the labor force? With 20 million former felons in America, we have attached a large anchor to our economic growth rate, and we have unfairly burdened these men and women. Just saying...

Eberstadt has written a brilliant book highlighting some painful problems. If I could, I would make it required reading for anyone holding public office above the level of dogcatcher. As I said, I highlighted some 36 pages in his book. This letter would have been a lot longer if I had used everything I wanted to. I guess you will just need to read the book for yourself.

As we take Eberstadt’s data and absorb it into our economic models, we find that it doesn’t bode

well for future growth. And growth is what we need to make our portfolios rise and shine.

In two weeks I will be bringing you a letter in which I will talk about exactly how I would go about designing a portfolio for the coming decade. I think it is one of the most important letters that I will write for a long time to come. I just wanted to give you a heads-up so you can make sure to read it.

Angst in America, Part 3: Retiring Broke

By John Mauldin

Social Insecurity
Why We Can't Save
Hitting the Wall
Action Over Angst

“The trouble with retirement is you never get a day off.”

– Abe Lemons

“Retirement at sixty-five is ridiculous. When I was sixty-five I still had pimples.”

– George Burns

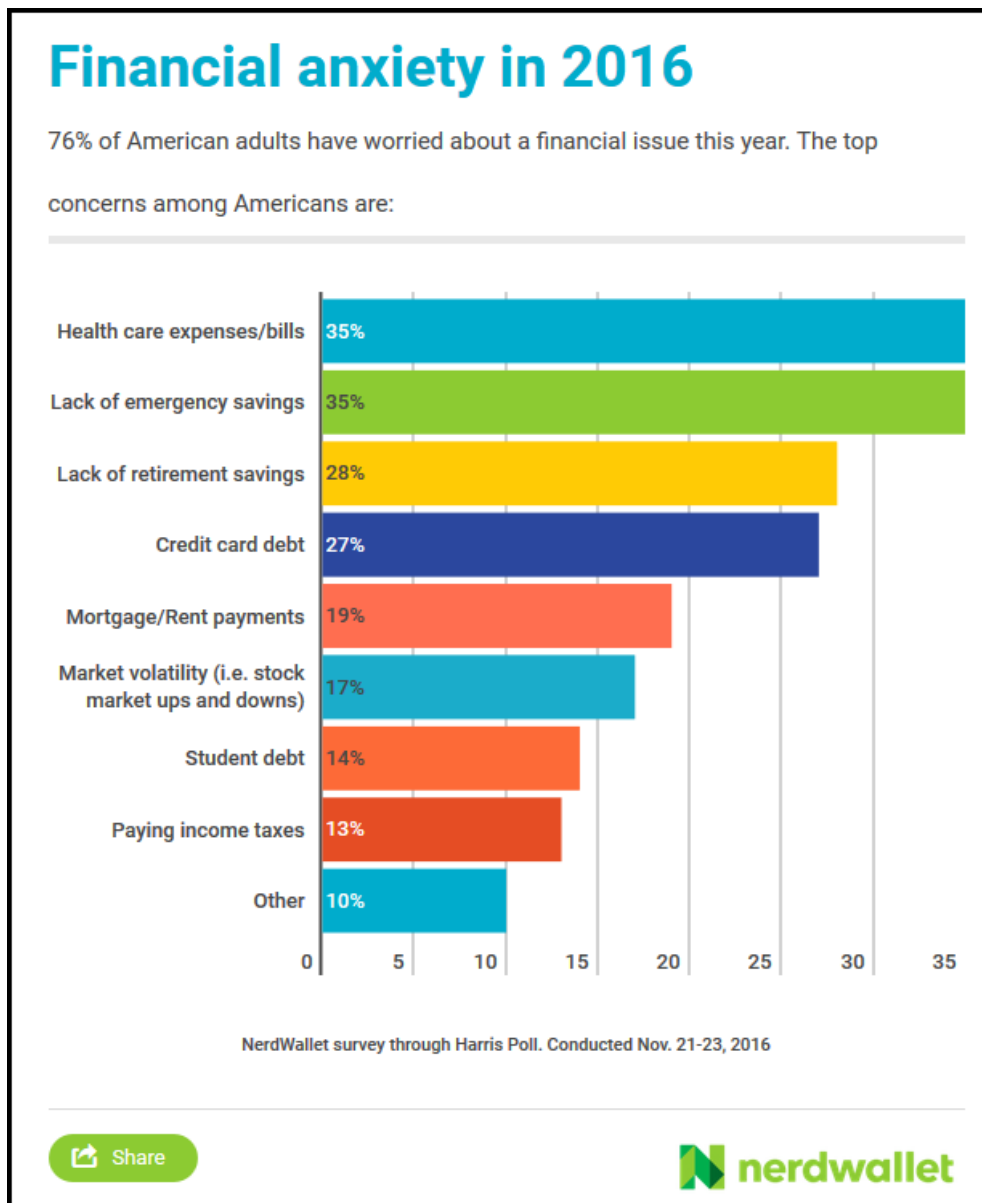
“To be, or not to be, that is the question:
Whether 'tis nobler in the mind to suffer
The slings and arrows of outrageous fortune,
Or to take Arms against a Sea of troubles,
And by opposing end them.”

– Shakespeare, *Hamlet*



Today we continue looking at angst in America, the financial worries that so afflict us here in the world's largest economy and by extension in much of the developed world. We may be the envy of the world in some ways, but we also have no shortage of stress. Today we'll look at some data on retirement savings – or lack thereof.

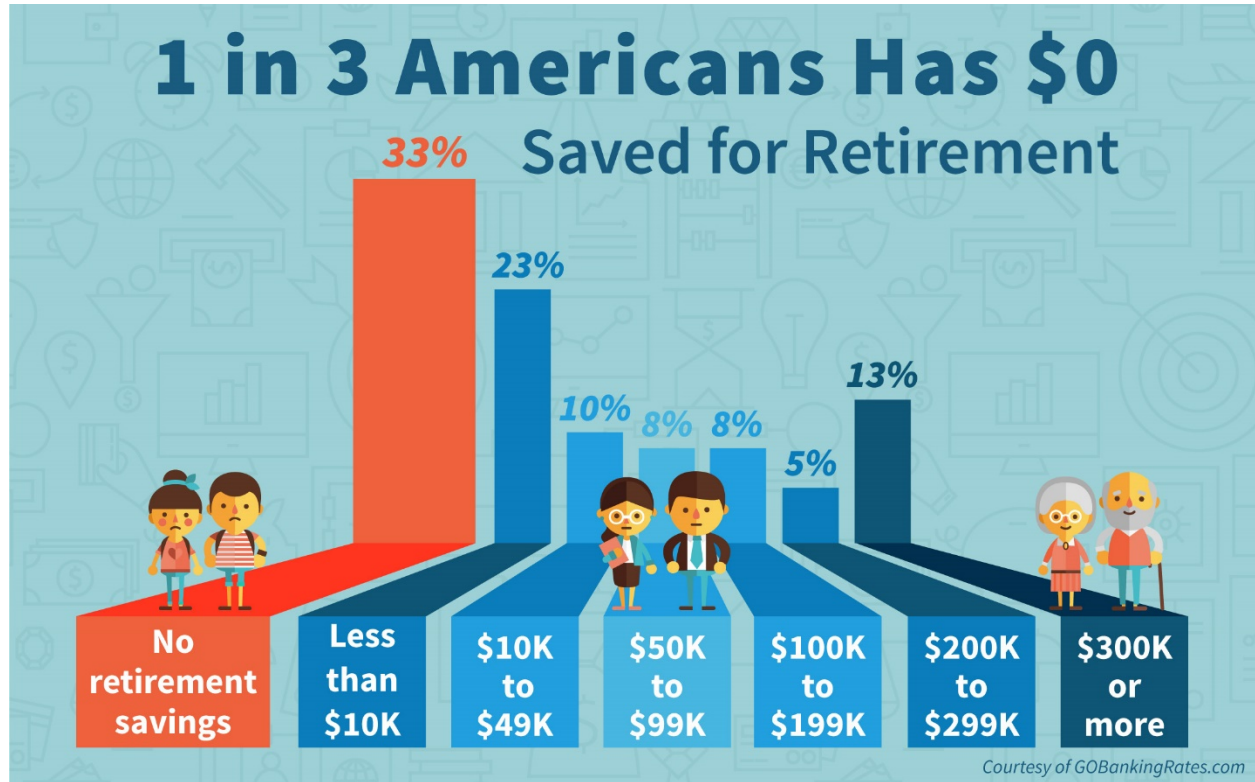
Let's start by backing up a little bit. I'm not the only one talking about financial anxiety. Last week I ran across [a survey from NerdWallet](#) on this very issue. They engaged the Harris Poll to ask 2,000 Americans of all ages about their biggest financial concerns. Here's a chart showing the top worries.



The biggest worries are healthcare expenses, lack of emergency savings, and lack of retirement savings. Yet only 28% worry they lack retirement savings? Compare this with what we know

about people's actual savings, and that number is far too low.

We can see in [another recent survey](#) by GOBankingRates.com that more people should be worried about their retirement.



Here we see that 33% of Americans have no retirement savings at all; another 23% have less than \$10,000; and a further 10% have less than \$50,000. So that's 66%, a full two-thirds of Americans, with either no savings at all or not enough to generate significant income. (If you have \$50,000 and can pull out 4% a year without drawing down principal – which is hard to do – you'll get something like \$160 a month.)

The NerdWallet survey also shows that 13% have accumulated \$300,000 or more in retirement savings. I am skeptical of that number, too, unless it includes the cash value of defined-benefit plans held by government employees. And for them that value is mostly an illusion; for many of them, their plans can't possibly deliver anything near what the workers were promised. But that's another subject.

How much do we Americans really have saved? A [Motley Fool article](#) last year, citing data from the Employee Benefit Research Institute, looked at actual Individual Retirement Account balances. As of year-end 2013, 20.6 million individuals held a total \$2.46 trillion in IRA accounts. Some of those unique individuals are each other's spouses, so the number of family units would be lower.

Do the math and we find that the average IRA holder's balance was around \$120,000 as of three

years ago. But remember, the average IRA holder is not the average American. If only 20.6 million of us have IRAs, then over 300 million of us *don't* have them. Some no doubt have other retirement vehicles, like 401(k)s. But this still suggests that a large plurality of Americans, and maybe a majority, have little or nothing saved for retirement. This shortfall is a problem, and not just for them.

Social Insecurity

It's easy for those of us in the Protected Class to think the masses will be fine. They at least get Social Security and Medicare, enough to keep them out of poverty, right?

No, not right. We know this straight from the horse's mouth, too. The Social Security Administration publishes a very handy annual "[Fact Sheet](#)." As is the case with most bureaucracies, the SSA's goal is partly to demonstrate how indispensable they are, but in the process they tell us a few things that should make us uncomfortable.

In 2017, the average monthly retiree benefit is \$1,360. Multiply that by 12 months and divide by 52 40-hour weeks, and living off Social Security is equivalent to being a full-time worker who earns \$7.85 an hour (and remember, this is the average; many people receive less). Social Security benefits are worth a little more than the same amount in wages, net of taxes, but they still aren't much. Guesstimating the tax differential suggests an equivalent hourly wage of about \$8.50 an hour.

Social Security's fact sheet also says benefits represent about 34% of the elderly population's income – but that number is heavily skewed in favor of the wealthy. Among retirees, 21% of married couples and 43% of unmarried persons rely on Social Security for 90% or more of their income.

Currently, 41.2 million retired workers and 3 million dependents receive Social Security benefits. So that means 15 million or more retirees must be living on an income that's meager by any definition.

But at least they don't have to worry about medical bills, you say; Medicare covers them all. Well, yes, it does cover them, but that's not the same as covering their expenses. Copays and deductibles add up quickly unless you have supplemental insurance, which itself is expensive. Medicare recipients are responsible for 20% of hospital bills, and for these people even a short stay can wipe out months of income.

Forty-one percent of Americans have no savings at all. An article in [Forbes](#) cites data that shows that just 37% of Americans have savings to cover an emergency that costs over \$500. And understand, that is not just medical emergencies. What happens when your car breaks down? You have to get it fixed because you have to get to work. Having extensive experience with my seven children (and now seven grandchildren!), I can tell you that emergency expenditures seem to be the norm, not the exception (at least in the Mauldin household). Now the kids are adults and trying

to make it on their own, but there are still times when The Bank of Dad has to help out in emergencies.

The Social Security fact sheet has some other chilling numbers. It says 51% of the private workforce has no private pension coverage. Those are presumably people who work in small businesses or are self-employed or “gig” workers. Confirming NerdWallet’s figure, Social Security says 31% of workers report they and/or their spouses have no savings set aside specifically for retirement. Depending on the survey, another 10% have less than \$10,000. It wouldn’t take very long to run through someone’s entire savings, given a significant hospital stay or illness.

Is Social Security sustainable? To listen to politicians, Social Security obligations will always be met. Then again, looking at the mathematics, at least for those just now approaching retirement age or younger cohorts, the reality may be different. By 2035, the number of Americans 65 and older will climb from about 48 million today to over 79 million. That’s the Baby Boomer impact. Currently there are 2.8 active workers for each Social Security beneficiary. It will be only 2.2 workers per beneficiary by 2035.

And just to throw a little more fuel onto your worry fire, that figure of 2.2 workers per beneficiary assumes that labor force participation rates between now and 2035 will be stable or improved from where we are today. But the chart from Larry Summers last week showed that there are now 10 million men in America between 24 and 54 who are not in the labor force. That number could rise to as high as 20% of the labor force by 2035. Take out another 10% of the labor force, and now there are fewer than 2 workers per Social Security beneficiary. That means each and every worker, from the lowest paid to the highest, must pick up the tab for roughly \$7,000 per year of Social Security expenses through their contributions and taxes – before they start to pay for any other government services like healthcare or defense (not to mention interest on the national debt). John Lennon’s song lyric comes to mind: “You say you want a revolution?”

A few more uncomfortable statistics from the SSA:

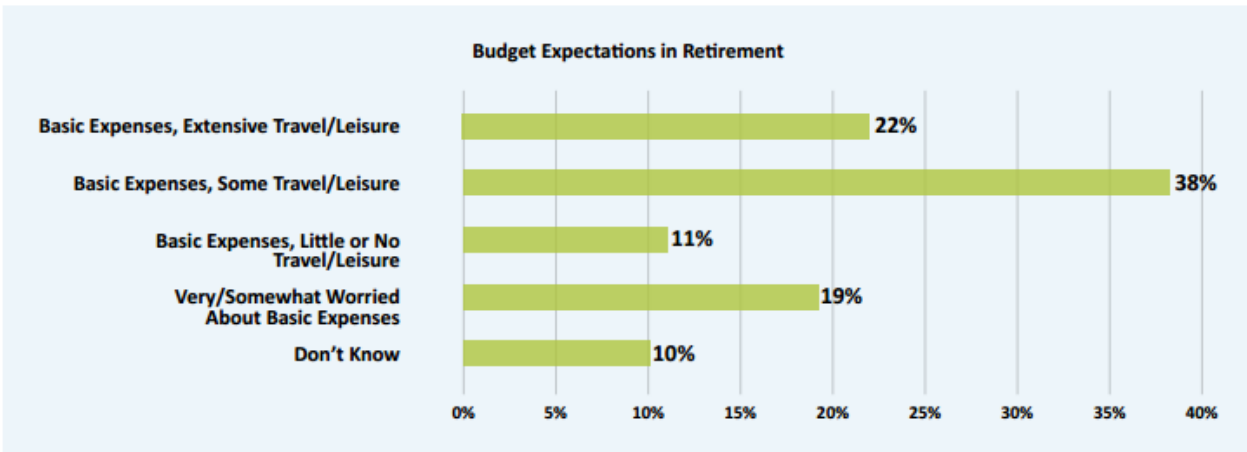
Only 39% of Boomers have tried to figure out how much they need to have saved for retirement. Of those that have, a third did not include healthcare costs in their calculations. On average, Boomers estimate that healthcare will consume 23% of their income in retirement, compared to the 33% of income that those over 60 actually spend today. Fifty-nine percent of retirees expect Social Security be their major source of income, up from 42% five years ago. Divorce is becoming a major factor in retirement: 24% of divorced Boomers expect to be worse off in retirement than if they had not divorced. Roughly 16% of Americans are taking premature withdrawals from their retirement accounts, while 30% of Boomers have stopped contributing to their accounts.

A 2016 report from the Insured Retirement Institute is likewise sobering:

The real surprise is in Boomers’ expectations for the lifestyles they will lead in retirement. Despite being under-saved and largely lacking sources of lifetime income beyond Social Security, six in 10 Boomers believe their retirement income will cover basic expenses and a

limited (38 percent) or extensive (22 percent) budget for leisure activities. Only 11 percent essentially expect a subsistence lifestyle, paying for basic needs and little else, while 19 percent worry they will not have enough money to meet even basic expenses for food, housing, and health care. For these Boomers, a long-term care event would be devastating and almost certainly require state care. [\(IRI: “Boomer Expectations for Retirement 2016”\)](#)

Simply put, most Baby Boomers will be down to subsistence living by the time they are 80, living on Social Security and other government benefits, with help from any capable children.



The following graph puts the stark reality of Boomer retirement in perspective. There is a massive gap between what people expect to have during retirement and what they will actually have and be able to spend.

	\$250,000 Balance	\$100,000 Balance
Average Social Security Benefit	\$16,092	\$16,092
Average Annual Retiree Expenditures	\$46,757	\$46,757
Income Gap	(\$30,665)	(\$30,665)
Guaranteed Annual Lifetime Income	\$16,656	\$6,660
Unfunded Annual Income Shortfall	(\$14,009)	(\$24,005)

The surprising thing, at least to me, is that there isn't more angst in America than what we currently see.

Why We Can't Save

The basic facts that we just reviewed aren't complicated, or even much disputed. Up until age 30 or so, it's easy to think you will be young forever. Then reality sets in, and you know it's time to grow up. Or at least that's how it was for me – the line seems to be creeping higher.

Why, then, do so few people save anything for retirement? Can people really be that oblivious? Depressingly to some of us, the answer is yes. We all have many different needs competing for our attention. We have to prioritize, and long-term needs often get lower priority than whatever need is pressing in the here and now.

I recall a very depressing conversation I had with my fishing guide last year in Maine. He had had a job in one of the paper mills, but it had closed down. He had about \$150,000 in his 401(k). He was taking out about \$10,000 a year (and paying the penalty) just to survive. There were no other jobs in the area, other than what he could make from his work as a guide and from other part-time gigs, jobs all of his friends were competing for. I pointed out to him that by the time he was physically going to need to retire (as the work he was doing was pretty strenuous), if he kept hitting his 401(k), there would be nothing left. It was a very sobering conversation. Basically, he didn't know what to do. Reality was that the expenses he faced simply to maintain his home and minimal lifestyle forced him to go to his savings.

Paraphrasing Spock, the needs of the present outweigh the needs of the future.

It's also the case that stifling the temptation to indulge in short-term pleasures is an acquired skill. It doesn't happen automatically. I think that skill comes mostly from seeing your own parents exercise fiscal discipline while you're a child. Boomers who grew up in times of relative prosperity may not have felt the need to be frugal and may find it hard to do so.

Still, I think most adults know on some level that retirement won't take care of itself. They know they should be saving; they know what will happen if they don't; and yet many still don't do it – or can't. That's why, to varying degrees, surveys show that people are worried about retirement. You don't worry about something unless you know it is both important and problematic.

Is our national behavior really a surprise? Look at our diet and health indicators. As a nation, we eat too much and indulge in all kinds of unhealthy habits. If we can't even take care of our bodies, then it figures that we're not very good at financial planning, either. You're probably an exception to that rule if you are reading this article, but the data shows that people like you are not the norm.

Having said all this, it is not necessarily true that financially unprepared people don't want to prepare. As I said above, we all have priorities. Median household income in the US is less than \$60,000. That's not much for a young parent faced with expensive housing, food, medical expenses, childcare, transportation, and all the rest, not to mention taxes. The average family making \$60,000 pays about \$7000 in taxes to the federal government and more, perhaps a lot more, depending on the state they live in. And it's not just taxes; there are fees for everything – drivers licenses, car tags, deposits for utilities, and so on. Not to mention the occasional ticket from the police for some infraction. To the extent that people save at all, it will be for their children's college fund rather than their own retirement.

There's a stereotype, not entirely imaginary, that some Americans have plenty of money but just choose to spend it frivolously. Such people do exist, and of course they're responsible for their

own decisions. But let's not forget that we live in a consumerist culture filled with seductive marketers telling us to buy unnecessary things. Often, they succeed. You have every intention of saving some money at the end of the month, but something comes along that grabs your attention, and you absolutely must have it. Oh well, you can save a little more next month.



Note also: The fact that a person has little or no retirement savings now doesn't mean the person *never* had any. People lose jobs. Bear markets happen. In both cases, whatever retirement savings you have will either lose value or go toward your here-and-now living expenses. Faced with foreclosure or other hardships, people will swallow hard and pay the tax penalty to get the cash. (See the story of my fishing guide above.)

Speaking at conferences and reading your feedback, I've noticed a little subculture emerging in the last decade. It's composed of people who, ahead of the 2008 crisis, saved their money, invested properly, and generally made all the right moves. I mean intelligent, educated, well-paid people. Then the financial crisis hit, and their retirement savings went up in flames. Having lost half of their assets, many sold to preserve what they could – just in time to miss the recovery.

Did they make a mistake? Yes, obviously. Was it because they were dumb, selfish, or short-sighted? No, it was because they were human. The moves they made might have been right in other circumstances. Yet they ended up back at square one, having lost decades of hard work and financial progress, while the clock kept ticking. On paper, their situations look much like those of people of the same age who never saved anything, but they aren't the same at all. I try to remember this before I assume things about people.

Sidebar: My five-part series on tax reform and then this series on Angst in America have provoked

an enormous number of comments from people telling me their personal stories. Some of them are truly heartbreaking. Good people, people with kids and families and responsibilities, simply caught up in tough circumstances and now faced with no good choices. I had a conversation this week with a close business associate who had to help his parents buy a home. Growing up in California, his family was quite comfortably middle-class. And then his father's industry hit a devastating downturn; the father was laid off, and it was four years before he could get another job, by which time he had lost pretty much everything, and the family was now renting a home, which has become an expensive proposition in California. The only option was for my friend to help his parents move into a home near him at a much lower cost. His parents were lucky they had a son with the financial wherewithal to do that; most Americans aren't so fortunate. And we wonder why there is angst in America?

Hitting the Wall

Whatever the circumstances, millions of Americans are growing older and headed straight toward an unforgiving brick wall. They will reach their mid-sixties and find there is no pot of gold under the retirement rainbow. Social Security plus their own savings, if they have any, won't be enough to finance the kind of leisurely golden years they saw their parents and grandparents enjoy.

In historical context, this reality shouldn't surprise any of us. The idea of capping off your life with a decade or two of carefree living didn't exist before the 20th century, unless you were of royal lineage. Everyone else worked as long as they were physically able and died soon after they weren't. That's what was normal for most of human history, and it still is in places we rarely see on TV.

If you *aren't* worried about financing your retirement, you're either very wealthy or very oblivious. You're not oblivious if you're one of my readers. So to the wealthy ones, congratulations. To everyone else... join the club. I know it may feel like you're the only one worried about retiring, since you don't get to look at your neighbor's balance sheet, but you're hardly alone.

Can you do anything about your situation? Maybe. Find ways to save a little money here and there, and it will add up. Having a small nest egg is better than having none at all. At some point, you will be glad you have it.

I've written before about the growing number of retirees who keep working right past 65 and even into their 70s. Twenty-five percent of Baby Boomers expect to work to at least 70 and beyond. If you ask them why, the answer is often that they enjoy their work and don't want to stop. I'm sure that's true for many. But I'd also bet many keep working out of necessity, no matter what they tell pollsters and friends.

I don't see anything wrong with this. I will be 68 later this year, and I'm still working as hard as I ever did, maybe more so if you count the total hours. Then again, I'm fortunate to have work that I enjoy and that is not too physically strenuous (except for the travel, which is starting to be more of

a challenge). I tend to spend my “leisure time” reading and researching rather than watching TV. Those factors, along with a pretty good diet and exercise program, augmented by some medical anti-aging breakthroughs that I think are coming quite soon, should hopefully enable me to stay productive for many more years. That’s a good thing (true confession here), because the lifestyle I currently enjoy would not be possible in a traditional retirement situation. I would certainly not be destitute, and no one would feel sorry for me, but I am about as happy as I’ve ever been with my current situation.

Action over Angst

Let’s be more specific. Say you’re 60 now and woefully unprepared to retire in five years. You lost your savings or never had any. What do you do? “Give up” is not the answer. It is entirely possible, even likely, that you’ll be physically able to work for another 20 years. That’s an entire career in and of itself. It doesn’t have to be decades of drudgery, if – here’s the key – you *plan ahead*.

Financial planning works best when you have a lot of lead time. Compound interest takes years to do its magic. Career planning is different. It works best when you can act immediately. Take a deliberate approach and you won’t have to settle for a low-paid service job. So, if you’re behind the retirement curve, here’s what to do.

- Figure out what kind of work fits your aptitudes and circumstances. It may be different from your previous career. That’s OK.
- Acquire any necessary education or credentials.
- Build experience and contacts in your chosen field before you actually enter it.
- Push the start button.

The people I know who have taken this approach all describe the same experience. Step 1 is a kind of attitude adjustment, at first painful but then exhilarating. Something clicks, and they suddenly have more “life” ahead of them. They stop thinking about the leisurely rounds of golf and vacations they will miss and instead look forward to their new “encore” career.



Of course, sooner or later you will still reach a point where your health makes work too difficult. But then again, maybe the medical miracles I see coming down the path in the near future will extend your work span along with your lifespan and health span. Work, if it's something you enjoy, is not a burden; it's a blessing.

Whatever you've done all your life, you have valuable experience and knowledge. You can apply it to a new career, build savings, and avoid boredom all at the same time. Action is the answer to angst.

A Few Final Thoughts

The reality is, my simple solution won't work for most people. Given the data we have looked at, is it any wonder that more and more Americans are increasingly anxious? Especially Baby Boomers? They want change because they feel (correctly) that the country is headed in the wrong direction; and when someone says here's an easy solution and blames all the problems on some other group or factor (whether it's the rich or illegal immigrants or trade or bureaucracy or – pick a scapegoat), they are speaking directly to the anxieties people feel, and that message drives polls and elections.

Some see Trump as the culmination of this expression of anxiety. I think that's a simplistic and wrong explanation. Trump is not the culmination; he is the harbinger of a coming age of increasing anxiety in response to an even more volatile economic, social, and political climate. We are one global recession away from being in the situation that Greece found itself five years ago: They were left with nothing but bad choices. If you think the stress level in America is high, visit Greece. Or any country in Southern Europe, for that matter.

When the average American or European or even Chinese thinks about retirement, there is angst, and the level of angst is increasing. Even though I can cite reams of data showing how the world is a better place to live than it was 100 or 50 or 20 or even 10 years ago, it's your own personal situation that you are faced with. You don't get to live the "average," it's-getting-better-for-everyone experience. And growing angst is driving political polarization in countries all around the world.

Republicans fantasize that we can go back to the '80s and President Reagan and implement the same policies he did and get the same results. Democrats fantasize that if we could just tax the rich more, things would all work out. And I use the word *fantasize* because unrealistic fantasies riddle thinking on both sides. Reagan had a massive demographic wind at his back; and yes, the policies he chose to put in place were the right ones at the right time, but we are no longer living with those demographics or that debt situation. And taxing the "rich" in order to spend even more will only slow down growth and opportunity for ordinary people on the street.

The real solutions are going to require massive compromise on the part of both major parties in this country – which doesn't seem to be in the cards. Which means we are going to keep bumbling

down the same path until we find ourselves up to our eyeballs in a crisis, with no good choices.

Gentle reader, if you have been reading me over the years, you may have come to believe in the correctness of the statements I made in the previous paragraph. What I'm telling you is that it's not the end of the world for you if you take control of your own future. You cannot let yourself be subject to the slings and arrows of outrageous fortune. Your own personal future can be one of relative comfort with the ability to help others. Which in the future is about as good as it's going to get for the vast majority of us.

Angst in America, Part 4: Disappearing Pensions

By John Mauldin | April 16, 2017

Defined What?

Risk Transfer

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Unionized Losses

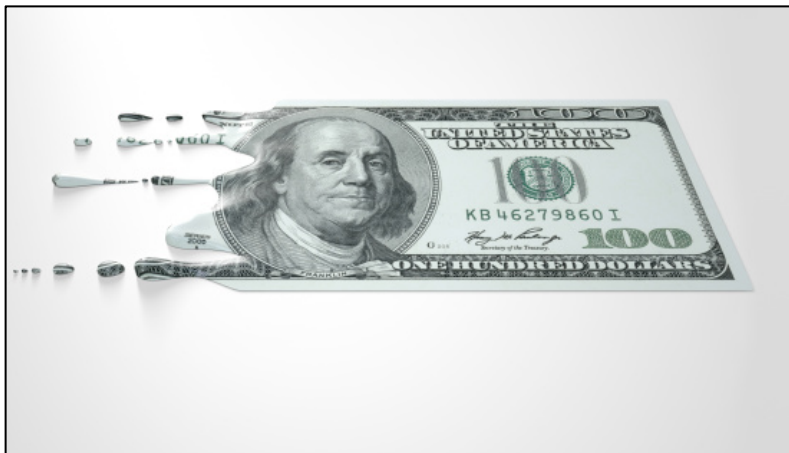
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“Companies are doing everything they can to get rid of pension plans, and they will succeed.”

– Ben Stein

“Lady Madonna, children at your feet
Wonder how you manage to make ends meet
Who finds the money when you pay the rent?
Did you think that money was heaven sent?”

– “Lady Madonna,” The Beatles

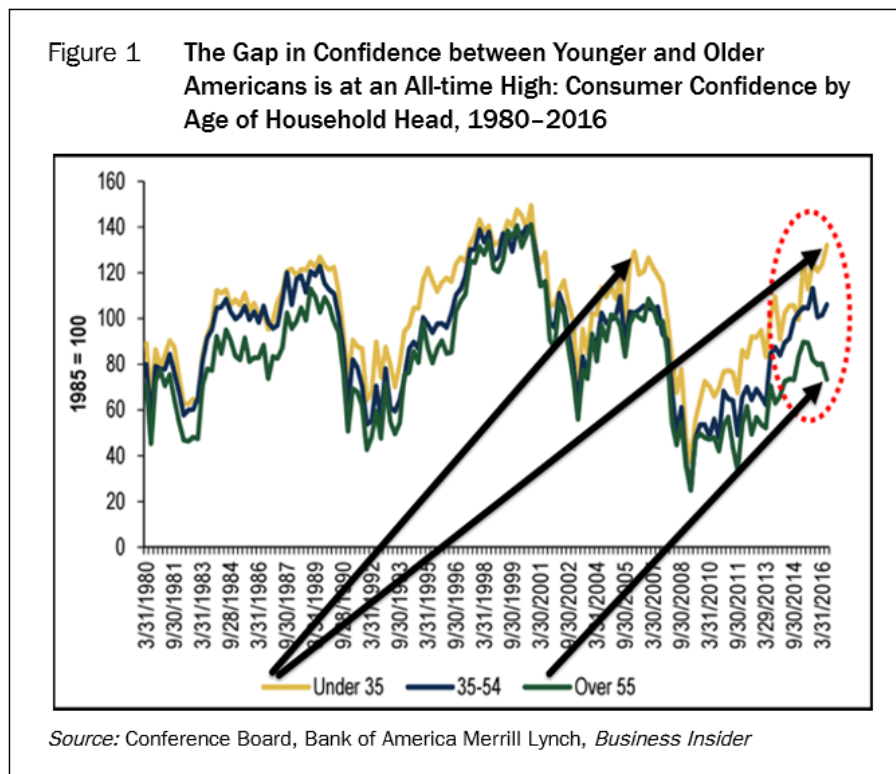


There was once a time when many American workers had a simple formula for retirement: You stayed with a large business for many years, possibly your whole career. Then at a predetermined age you gratefully accepted a gold watch and a monthly check for the rest of your life. Off you went into the sunset.

That happy outcome was probably never as available as we think. Maybe it was relatively common for the first few decades after World War II. Many of my Baby Boomer peers think a secure retirement should be normal because it's what we saw in our formative years. In the early 1980s, about 60% of companies had defined-benefit plans. Today it's about 4% (source: money.CNN). But today defined-benefit plans have ceased to be normal in the larger scheme of things. We witnessed an aberration, a historical anomaly that grew out of particularly favorable circumstances.

Circumstances change. Such pensions are all but gone from US private-sector employers. They're still common in government, particularly state and local governments; and they are increasingly problematic. They are another source of angst for retirees, government workers who want to retire someday, and the taxpayers and bond investors who finance those pensions. Today, in what will be the first of at least two and possibly more letters focusing on pensions, we'll begin to examine that angst in more detail. The mounting problems of US and European pension systems are massive on a scale that is nearly incomprehensible.

I came across a chart that clearly points to the growing concern of those who are either approaching retirement or already retired. This is from the October 2016 *Gloom, Boom & Doom Report* from my friend and 2017 SIC speaker Marc Faber. The gap in confidence between younger and older Americans is at an all-time high, after being minimal for many years. A survey by the Insured Retirement Institute last year noted that only 24% of Baby Boomer respondents were confident they would have enough money to last through their lifetimes, down from 37% in 2011. This is the case even after a most remarkable bull market run in the ensuing years.



Even though the equity market has more than recovered, the compounding effect that everyone expected for their pension funds and retirement plans didn't happen as expected. If the money isn't there, it can't compound. If your plan lost 40% in the Great Recession, getting back to even in the ensuing years did not make up for the lost money that was theoretically supposed to come from that 40% compounding at 8% a year. And, as I highlighted in last week's letter, the prospects for compounding at 8% or even 5% in the next 10 years are not very good. Thus the chart above.

Defined What?

Let's begin by defining some important terms. US law provides for various kinds of tax-advantaged retirement plans. They fall into two broad categories: defined-benefit (DB) and defined-contribution (DC) plans. The differences involve who puts money into them and who is responsible for the results.

Defined-benefit plans are generally the old-style pensions that came with a gold watch and guaranteed you some level of benefit for the rest of your life. Your employer would invest part of your compensation in the plan, based on some formula. In some cases, you, the worker, might have added more money to the pot. But regardless, at retirement your employer was obligated to send you a *defined benefit* each month or quarter – usually a fixed-dollar amount, sometimes with periodic cost-of-living adjustments.

(Note: There are defined-benefit plans that small, closely held employers such as myself or doctors/dentists can create for themselves and their employees that have significant retirement planning benefits but that function more like defined-contribution plans. For the purposes of this letter we're going to focus on the more or less conventional types of plans rather than the multitudes of retirement plans that creative accountants and businesses have developed.)

Once your benefit was defined in this way, your employer was on the hook to continue paying under the agreed-upon terms. DB beneficiaries had no control over investment decisions. All they had to do was cash the checks. Employers took all the risk.

This arrangement works fine as long as you assume a few things. First, that your employer will invest the DB plan's assets prudently. Second, that your employer continues to exist and remains able to make up any shortfalls in the plan's liabilities.

DB plans work pretty well if those two things happen. It's simple math for actuaries to estimate future liabilities based on life expectancies. They are uncannily accurate if the group is large enough. So the plan sponsor knows how much cash it needs to have on hand at certain future dates. It can then invest the plan assets in securities, usually bonds, calibrated to reach maturity in the right amounts at the right times.

That all sounds very simple, and it was, but the once-common scheme ran into trouble for reasons we will discuss below. First, though, let's contrast defined-benefit plans with the other category, defined-contribution (DC).

DC plans are what most workers have now, if they have a retirement plan at all. The 401(k) is a kind of defined-contribution plan (as are various types of IRAs/Keogh/SEP plans, etc.). They are called that because regulations govern who puts money into the plan, and how much. Typically, it's you and your employer. Your employer also has to give you some reasonable investment options, but it's up to you to use them wisely. Whether there is anything left to withdraw when you retire is mostly up to you. Good luck.

Which type of plan is better? The more salient question is, which is better for whom? Both have their advantages. People like feeling they have some control over their future, but they also like certainty. Companies, on the other hand, like being able to transfer risk off their balance sheets. DC plans let employers shuck the risk.

The rub, of course, is that abundant evidence now shows that most workers are not able to invest their 401(k) assets effectively. That reality explains some of the [retirement angst](#) we discussed two weeks ago. But DB plans are no bed of roses, either, particularly when you put elected officials in charge of them and make unionized government workers their beneficiaries.

Defined-benefit plans have issues going way back. The Studebaker Motor Company had such a plan when it began shutting down in 1963. The plan turned out to be deeply underfunded and unable to meet its pension obligations. Thousands of workers received only a small fraction of what they had been promised, and thousands more received zero.

That failure kicked off several years of investigations and controversy that eventually led to the law called ERISA: the Employee Retirement Income Security Act of 1974. It set standards for private-sector pension plans and defined their tax benefits under federal law.

Important point: Neither ERISA nor any other law *requires* employers to offer any kind of retirement or pension plan; it just sets standards for those who do. Those standards have turned into something of a mess, frankly. The IRS, Labor Department, and assorted other agencies all have their own pieces of the regulatory pie. It is no wonder that many smaller companies don't have retirement plans. Simply doing the paperwork is a big job.

That aside, ERISA succeeded in bringing order to previously inconsistent practices. Workers gained some protections that hadn't existed before, and employers had legal certainty about plan

administration. ERISA also created the Pension Benefit Guaranty Corporation (PBGC) to insure pension plans from default and malfeasance.

Many experts believe the PBGC will run out of money in as little as 10 years at its current funding levels. The PBGC is not taxpayer-funded (yet) but exists as a classical insurance fund into which each retirement plan pays roughly \$27 per year per covered employee. That figure would need to increase to \$156 per year per person just to give the PBGC a 90% chance of staying solvent over the next 20 years.

And if your plan goes bankrupt and you fall into the gentle hands of the PBGC, your pension funding is likely to be cut by 50% or more. Plans that were at one point quite generous could see their beneficiaries lose as much as 75–80% of their previous monthly payouts.

Risk Transfer

ERISA was all to the good, but it couldn't cure the biggest headache: the growing amount of money that companies had to contribute to their plans to keep them fully funded. Plans that covered retiree health benefits had an additional headache trying to project future healthcare costs. Yes, that was a big deal even back in the 1970s.

In 1980, a benefits expert named Ted Benna discovered the 401(k). Yes, he literally *discovered* it in changes to the Internal Revenue Code that had become law two years earlier. No one set out to create the kind of plans we now recognize as 401(k)s; Benna just looked at the new law and realized it would allow such a thing. That's where we got the defined-contribution plan.

The initial idea was that the 401(k) would be a supplement to an employer's DB plan, but employers soon realized that it could also be a replacement. That was an attractive option for many companies, so they began dropping their DB plans and instead expanded their 401(k) contributions.

Business owners will understand this well. I've been there, too. You have enough headaches as it is. Having the benefits manager come around at the end of a year when the market had underperformed, telling you to write an additional giant check to the DB plan, was not fun. With a 401(k), in contrast, you could add a little match to everyone's checks on paydays and be done with it. No one would pop up years later and tell you it wasn't enough. That some employees liked the idea of having control over their retirement accounts was even better.

DB plans got even less compelling when Alan Greenspan began pushing interest rates down ahead of Y2K. Lower rates meant employers had to pitch in more cash to keep the plans funded at the necessary level. Or, they had to take on additional investment risk and be ready to make up any losses from the company's resources. None of that is attractive to most business owners. Now DB plans are all but unknown in the private sector, the main exceptions being union-run plans and those run by one-person professional corporations like physicians and lawyers.

Note carefully: The risks and worries associated with retirement plan funding have not

disappeared. They have simply been dispersed from a small number of employers to a much larger number of employees. As we discussed earlier, very few of the latter are in a comfortable position. I don't mean to be flippant here, but it's true: If DC plan owners aren't worried, they should be. The days of retiring with a gold watch and a guaranteed monthly check are gone.

Public Playground

ERISA applies only to private-sector employers. Government entities need not comply with ERISA's many requirements, which is good because many of them don't. They do, however, have massive retirement obligations to their retirees and workers that simple math says will land them in some form of default. The promises are too generous, and the resources to meet them are too scarce.

The really frustrating part is that this impending crunch was completely predictable, given what we know of politics in this country. Elected officials make extravagant promises to attract votes or contributions. But everything takes time in government, so politicians just delay making changes long enough that everyone forgets or finds other things to worry about.

Pension promises aren't like campaign promises to build new parks or sewers; Governments can't forget pension obligations. Pension plans are not like other, more general public services. They involve specific amounts of cash owed to specific people on specific dates. Those dates will arrive, and the cash has to be there. State and local governments can't run endless deficits the way the federal government does.

That's all obvious; yet, for some reason, two things happened in recent decades:

State and local politicians kept raising pension benefits.

State and local workers believed the promises.

In fairness, we can't expect city council members and firefighters to be financial experts. But they have *access* to experts. The unions that negotiate most public pension contracts have their own lawyers, accountants, and actuaries. They should know whether they are being offered unrealistic projections and promises. And elected officials likewise have expert counsel, so they should know, too. So I'm not sure who is more at fault.

By the way, I have a great deal of respect for the people who keep our cities and states running. Those who protect citizens from harm or otherwise provide public services deserve fair wages and benefits. Pensions are part of that. However, we can't make something from nothing.

One problem is that accounting rules permit governments to do things private companies can't. They calculate contributions to their defined-benefit plans in, shall we say, aggressive ways that do not serve anyone well. And, they can shop around for consultants who will tell them what they want to hear. What they want to hear is that they can get away with adding less to the pension fund so they can spend more on shiny new buildings or just fix the roads and keep up with normal city

services that make them look productive.

Eventually the math catches up. Here's a chart my friend Danielle DiMartino Booth included in a [Bloomberg View article](#) on this topic last month.



Here we see how state and local pension costs have soared in the last decade. Total unfunded liabilities amounted to only \$292 billion in 2007. They have more than quintupled since then, to \$1.9 trillion. That's due to a combination of extravagant promises, poor investment results, and failure to contribute enough cash to the plans. Danielle reels off some startling numbers:

Federal Reserve data show that in 1952, the average public pension had 96 percent of its portfolio invested in bonds and cash equivalents. Assets matched future liabilities. But a loosening of state laws in the 1980s opened the door to riskier investments. In 1992, fixed income and cash had fallen to an average of 47 percent of holdings. By 2016, these safe investments had declined to 27 percent.

It's no coincidence that pensions' flight from safety has coincided with the drop in interest rates. That said, unlike their private peers, public pensions discount their liabilities using the rate of returns they assume their overall portfolio will generate. In fiscal 2016, which ended June 30th, the average return for public pensions was somewhere in the neighborhood of 1.5 percent.

Corporations' accounting rules dictate the use of more realistic bond yields to discount their pensions' future liabilities. Put differently, companies have been forced to set aside something closer to what it will really cost to service their obligations as opposed to the

fantasy figures allowed among public pensions.

The situation is actually far worse than the chart shows. The \$1.9 trillion in liabilities presumes that the plans will earn far more over time than the 1.5% return they actually made in 2016. Danielle says unfunded liabilities are as much as \$6 trillion by some estimates.

Anytime we see a liability, the unspoken assumption is that someone is liable. Who is liable for public pension obligations? Probably you, depending where you live or own property. State and local governments' prime asset is the ability to tax their residents. We are financially responsible for the poor and/or self-interested decisions of the politicians we elect. That's one reason we ought to pay far more attention to local elections than most of us do. Congress and the White House matter a great deal – but so do state legislatures, school boards, and city councils.

When we have a significant bear market during the next recession (that is not an *if* but rather a *when*), that \$6 trillion figure will balloon to double that amount or more. And remember, those are state and local obligations that must be paid from state and local tax revenues. Paying them would require tax increases for many municipalities and would more than double current tax rates.

Sound incredible? My own city of Dallas, whose Police and Fire Pension System was advertised as solvent just a few years ago, is now so deep in the hole that it would take almost a doubling of city taxes to plug the gap. Note that I bought my Dallas apartment after that news was announced. I was not pleased when I read that headline. Such an increase would make my taxes cost more than my mortgage. Can you say taxpayer revolt? Houston is another city with such problems.

Nationwide, state and municipal spending has risen from \$730 billion in 1990 to \$2.4 trillion in 2015. And yet the amount of money used to fund pensions has risen only a fraction of the amount that other spending has. The financial problems of Illinois and many California cities are well known. Let's turn to a chart listing some of the problem areas in the state of Massachusetts:

	2000	2015
Mass Teachers Retirement System (MTRS)	83.3%	54.3%
City of Springfield	56.7%	27.0%
City of Boston	72.7%	70.2%
Andover	68.5%	48.3%
Middlesex County	63.0%	44.0%
Boston Teachers	?	40.5%
New Bedford	53.3%	42.5%
Newton	78.8%	50.8%
Quincy	68.3%	46.7%
Belmont	70.3%	51.2%
Gloucester	62.1%	44.6%

Source: Commonwealth of Massachusetts Public Employee Retirement Administration Commission 2000, 2015

(Note that most Massachusetts government workers are not eligible for Social Security. This is going to be a serious tragedy when push finally comes to shove.)

It is almost actuarially impossible for pension funds that are less than 50% funded to catch up without massive tax hikes that are implemented solely to allow increases in pension payments but that also result in reductions in services, not only for retirees but for the general public as well. Those pension-funding levels are going to be further eroded during the next recession because more and more cities and states are increasing their equity exposure, and low interest rates are not helping matters.

We have here the proverbial irresistible force/immovable object quandary. Government agencies signed contracts guaranteeing retirement benefits to their workers. The workers did their jobs, many for decades, trusting that the promises were solid. Now we see that they often weren't.

It's hard to imagine good outcomes here. Retirees want what their contracts promised, but the money just isn't there. Governments have little recourse but to raise taxes, but the taxpayers aren't captives. Higher property taxes will make them move elsewhere. Higher sales taxes will make them shop elsewhere.

Unionized Losses

My good friend Marc Faber generously let me use one of his newsletters in [Outside the Box](#) last

week. In discussing household wealth, he notes that while the nation's \$22 trillion in pension fund assets is a main component of household wealth, much of it may be illusory. The illusion is slowly being exposed, and not just with regard to public-employee pensions. Union plans are in trouble, too. Marc explains with a February 2017 [New York Daily News story](#).

Narvaez, 77, got a union certificate upon retirement in 2003 that guaranteed him a lifetime pension of \$3,479 a month.

The former short-haul trucker – who carried local freight around the city – started hearing talk in 2008 of sinking finances in his union's pension fund.

But the monthly checks still came – including a bonus “13th check” mailed from the union without fail every Dec. 15.

Then Narvaez, like 4,000 other retired Teamster truckers, got a letter from Local 707 in February of last year.

It said monthly pensions had to be slashed by more than a third. It was an emergency move to try to keep the dying fund solvent. That dropped Narvaez from nearly \$3,500 to about \$2,000.

“They said they were running out of money, that there could be no more in the pension fund, so we had to take the cut,” said Narvaez, whose wife was recently diagnosed with cancer.

The stopgap measure didn't work – and after years of dangling over the precipice, Local 707's pension fund fell off the financial cliff this month. With no money left, it turned to Pension Benefit Guaranty Corp., a government insurance company that covers pensions.

Pension Benefit Guaranty Corp. picked up Local 707's retiree payouts – but the maximum benefit it gives a year is roughly \$12,000, for workers who racked up at least 30 years. For those with less time on the job, the payouts are smaller.

Narvaez now gets \$1,170 a month – before taxes.

This is stunning. The union worker they mention went from a \$3,479 monthly benefit, supposedly guaranteed for life, to \$1,170 a month. That's a 66% pay cut. Worse, it seems to have happened with almost no warning, to a man in his late 70s with a cancer-stricken wife. What an awful situation – and it will be an increasingly common one for anyone depending on a union pension. The story quotes one union pension lawyer:

“This is a quiet crisis, but it's very real. There are currently 200 other plans on track for insolvency – that's going to affect anywhere from 1.5 to 2 million people,” said Nyhan. “The prognosis is bleak minus some new legislative help.”

I am sorry to disappoint Mr. Nyhan, but “legislative help” is not on the way. Legislatures have

their own pension headaches. So he's right that the prognosis is bleak. PBGC doesn't have infinite resources. The only answer is some combination of benefit cuts for current retirees and higher contributions from current workers.

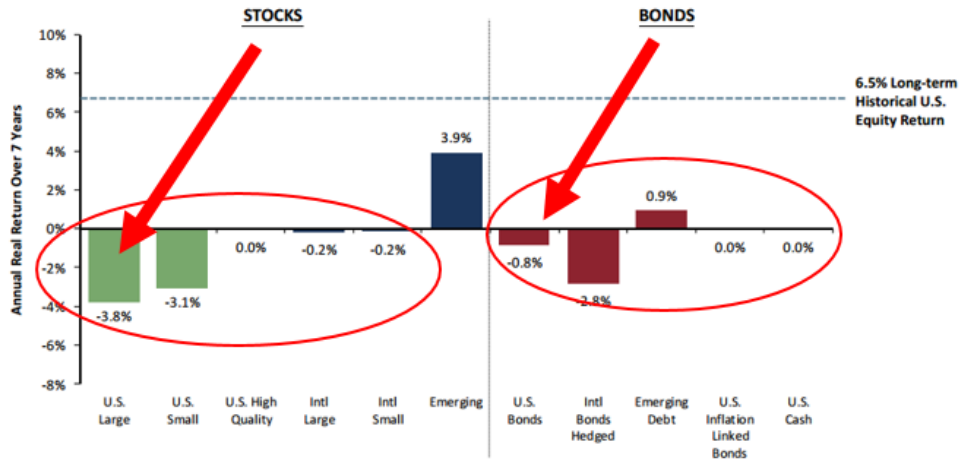
That \$156 annual per-worker hike that I mentioned above for the PBGC? As more and more companies and governments abandon their defined-benefit plans, there will be fewer and fewer people to make those contributions, which means that future contributions to the PBGC will potentially need to be much higher still.

Nowhere to Hide

So we have seen that both public employees and union workers are right to worry about their pensions. We saw in part 3 of this series that millions more have no significant retirement savings. What about private-sector pensions? As noted, defined-benefit plans are disappearing, but many companies still have legacy plans covering current retirees and those approaching retirement. Marc Faber is not optimistic for them:

So, whereas prior to the 2008/2009 crisis S&P 1500 companies were fully funded, today **funding has dropped below 80%** (see Figure 7 of the October 2016 GBD report). I also noted that I found the deteriorating funding levels of pension funds remarkable because, post-March 2009 (S&P 500 at 666), stocks around the world rebounded strongly and many markets (including the US stock market) made new highs. Furthermore, government bonds were rallying strongly after 2006 as interest rates continued to decline. My point was that **if, despite truly mouth-watering returns of financial assets over the last ten years, unfunded liabilities have increased, what will happen once these returns diminish or disappear completely?** After all, it's almost certain that the returns of pension funds (as well as of other financial institutions) will diminish given the current level of interest rates and the lofty US stock market valuations.

What if returns over the next seven years look like these projections from Jeremy Grantham of GMO (whose accuracy correlation has been running well north of 95%):



Source: GMO

*The chart represents local, real return forecasts for several asset classes and not for any GMO fund or strategy. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Forward-looking statements speak only as of the date they are made, and GMO assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results may differ materially from those anticipated in forward-looking statements. U.S. inflation is assumed to mean revert to long-term inflation of 2.2% over 15 years.

The deeper you look, the worse this pension situation gets. Angst is a perfectly reasonable response for anyone who is retired or thinking about retiring in the next decade. People don't have sufficient IRA or 401(k) savings; Social Security will be of limited help; defined-benefit pensions are unlikely to be as generous as advertised; and healthcare costs keep climbing. All of the above will keep taxes rising, too, even as the economy remains mired in slow-growth mode at best or enters a long-overdue recession.

I want to end this letter on a positive note. Can we see any glimmers of hope? Some, yes. As I noted last week, one answer for older workers is to work longer and delay retirement. That gives you more years to save and fewer years to consume your nest egg. It doesn't have to be drudgery if you plan ahead and design your encore career strategically.

Helping on that front will be some truly amazing medical breakthroughs. I see them in the biotechnology research Patrick Cox and I follow. I spent two days in Florida with Patrick and a few biotech revolutionaries last week, and it is hard not to be very encouraged. You should begin to see some of what we learned become publicly available in the next year or two. These developments will increase both lifespans and health spans, letting us stay active well into our 80s and beyond.

Finally, someone responded to part 3 of this series by pointing out that the Baby Boomer

generation is still set to receive trillions in assets held by their still-living parents. That could help. The oldest boomers are now 72, which means their parents are likely in their 90s.

That said, if your retirement plan consists of waiting for your parents to die and leave you their house, you are still in a very risky position. For one thing, how much is the house really worth? How much will it be worth as more people like you try to sell houses like that one? Who will buy them?

I talked in part 3 about our tendency to deal with immediate needs first. So many other things seem like higher priorities than retirement planning and saving. What do you do?

Theodore Roosevelt may have had the best answer: “Do what you can, with what you have, where you are.” Angst frequently paralyzes us. Don’t let it. Maybe you can’t do everything it takes, but you can do some of it. Start there.



Angst in America, Part 5: The Crisis We Can't Muddle Through

No Magic Rainbows

Squeezing Too Hard

Nonexistent Dollars Don't Grow

Zemblanity

The Merciless Math of Loss

An Ugly Picture

By John Mauldin | April 23, 2017

“The ship of democracy, which has weathered all storms, may sink through the mutiny of those on board.”

– Grover Cleveland, the 22nd and 24th president of the United States

“It is your concern when your neighbor's wall is on fire.”

– Horace

“The biggest mistake investors make is to believe that what happened in the recent past is likely to persist. They assume that something that was a good investment in the recent past is still a good investment. Typically, high past returns simply imply that an asset has become more expensive and is a poorer, not better, investment.”

– Ray Dalio, Founder, Bridgewater Associates



When you spend a couple of decades writing weekly letters to hundreds of thousands of people you think of as friends, your readers naturally come to associate you with a few key ideas. I have certainly become known for at least one. My longtime regular readers think of me as the “Muddle Through” guy. That’s not an image I have tried to cultivate, but I have it anyway.

I have to confess that it’s usually accurate. In a typical letter I will describe some sort of potentially scary problem, explain what might happen, then conclude that we’ll probably avoid the worst and muddle through. That has almost always been the right call. The worst doesn’t happen, and we all survive. “Muddle Through” can mean widely varying outcomes for individuals, but for the world at large, things generally work out OK.

As a statistical matter, this stance makes sense. The extreme tails of any distribution curve comprise outcomes that almost certainly won’t occur. The most probable outcomes cluster around the fat middle.

Yet there is one problem that is very definitely coming our way that I really don’t think we can Muddle Through and where even the middle-of-the-road scenarios are terrible, and that’s the public pension crisis. I really see no way it can end well. It’s going to hurt just about everyone.

“But wait,” my Canadian and German friends will say, “that’s an American problem. Leave us out of it.”

I wish I could. The sad fact is that the US is the big fish in the global economic pond. One way or another, our problems affect everyone. You catch cold when we sneeze. The “[Disappearing Pensions](#)” crisis I described last week will hurt you, too. The only question is which transmission mechanism will bring it to you. Further, most developed countries have their own version of the pension crisis in the form of government promises that can’t be kept. Same song, different verse.

Today I want to delve a little deeper and explain why pension angst is completely reasonable and not at all overblown. If anything, it has been understated.

No Magic Rainbows

Most pension fund analysis focuses on funding levels, i.e., the assets a plan actually has versus how much it should have at a given point, based on actuarial analysis of future liabilities and assumptions about future contributions and investment returns.

Funding levels are important. They are a useful canary in the coal mine – but only to the extent that the responsible parties pay attention to them and respond correctly. No such thing is happening. Worse, the assumptions that are being made mean that funding levels probably understate the coming disaster.

Yes, disaster. I use that word because I don't have a stronger one that I can use in a family-friendly letter.

Let's make this simple. The "defined benefits" that any DB plan will eventually pay its beneficiaries come from two sources:

1. Cash contributions, mostly from the employers but often from workers, too
2. Interest, dividends, and capital gains earned on the investments into which those cash contributions are placed.

That's it. There is no pot of gold at the end of the rainbow. There's not even a rainbow. Every penny that every retiree receives from every DB plan comes from those two sources. Unlike the federal government, cities and states can't mint currency by fiat. No magical ponies will come pulling carts full of cash to bail out the pension plans. (We do that only for banks.)

The problem is that, with few exceptions, neither source is producing at the level necessary to deliver the promised benefits. In many cases there is a vanishingly small chance they ever will produce enough. And the longer we go without fixing the problem, the smaller the chance becomes.

In each municipality and state, a few hardy souls are jumping up and down and screaming about the coming crisis in their locales. But when politicians do pay attention, the required actions are so painful that they conclude there is very little chance of anything substantive being done. And so they do nothing. The sad fact is that even actions that would fix part of the problem are often pushed away.

There is a perverse logic to this failure to act, and it has to do with the Merciless Math of Loss.

Squeezing Too Hard

We'll start with contributions. The amount a city or state agency must donate to its pension plan(s)

is a function of the promises made to its workers, typically in union-negotiated contracts.

The unions naturally want as much as possible. The employer wants to contribute as little as possible. Fair negotiations should produce a number acceptable to both sides – but that assumes negotiations are fair. Often, they aren't.

Here we must recognize a practical distinction between public and private. In theory, a city council is responsible to its voters just as a corporate board is responsible to shareholders. Yet the relationships are quite different.

Corporate board members are generally themselves shareholders, who share in the gains or losses their choices cause the company, and there is actually quite a bit of legal liability attached to being on a corporate board. The more happy and productive the board can keep the workers, the more valuable their shares will be. City council members, while residents in the communities they represent, don't gain or lose monetarily from the contracts they approve. Their incentive is to garner political support that leads to re-election or advancement to higher office.

So public worker contract negotiations are a competition between highly organized and motivated workers on one side and diffuse and often disinterested voters on the other. Elected officials may nominally answer to the voters, but the unions have more immediate influence, so the elected officials may not negotiate as zealously as they should, especially when the city, police, fire, and school workers tend to vote en masse for the candidate that is the most favorable to the unions. And in most municipal elections such workers may represent a high percentage of voters: Turnout for elections is generally less than 20%, and in many cities it is less than 10%. In the last mayoral election in my hometown of Dallas, only 6.1% of eligible voters actually participated.

On the other side of the equation, workers have every incentive to demand higher retirement benefits. To them, a pension is substitute compensation for cash the agency doesn't have to put in their paychecks today. They accept the promise of future retirement benefits in lieu of higher pay. And the elected officials have every incentive to promise those benefits, because the immediate cost of doing so is much smaller than the perceived value they give to workers, and they get the votes and cooperation of the workers. The problems that come down the road will be dealt with by *other* politicians.

The immediate cost, though smaller, is not zero. Government agencies have to make annual pension contributions, and the amounts of those contributions are a function both of the benefits politicians promised and other factors, like market returns, life expectancies, etc.

The fatal flaw here is that required annual pension contributions are an easily gamed number. A city council can shop around for a consultant who gives them whatever number they desire, and they frequently do just that. But the game gets harder to play as time passes and the bogus numbers get bigger and bigger.

Repeated rounds of this process lead to funding ratios like these in Massachusetts:

	2000	2015
Mass Teachers Retirement System (MTRS)	83.3%	54.3%
City of Springfield	56.7%	27.0%
City of Boston	72.7%	70.2%
Andover	68.5%	48.3%
Middlesex County	63.0%	44.0%
Boston Teachers	?	40.5%
New Bedford	53.3%	42.5%
Newton	78.8%	50.8%
Quincy	68.3%	46.7%
Belmont	70.3%	51.2%
Gloucester	62.1%	44.6%

Source: Commonwealth of Massachusetts Public Employee Retirement Administration Commission 2000, 2015

As I said, these funding ratios depend on assumptions that are often far too optimistic. Yet most pension experts will tell you that there is no bouncing back, no restoring the ratio to a healthy level once it has dropped below 50%. Almost all the entities in the table above are in or near that zone. City of Springfield retirees are in deep trouble, and the rest not far behind.

What, realistically, can retirees expect from government agencies like these? Very little, frankly. I repeat: Benefits come from plan contributions and investment gains. I don't know the situation in these specific communities, but it's highly unlikely that elected officials can raise taxes or cut other spending enough to make the kind of contributions required to make up these shortfalls. It can't happen, which means it won't happen.

I've said this before, but it bears repeating: City limits are static, but the tax base is not. People can move away. Companies can relocate. Both will happen if local officials push too hard. That is what ultimately forced Detroit into bankruptcy. The city was depopulating, but its expenses didn't fall accordingly.

Nonexistent Dollars Don't Grow

The table above came to me via Marc Faber, who in turn got it from pension expert Frederick Sheehan. The title of Sheehan's report is good advice:

“Public Pension Recipients: Start Saving. You Are on Your Own”

That falls into the category of “advice no one wants to hear,” but it is nonetheless correct. Many, perhaps most, current city and state workers simply aren’t going to get anything like the pension benefits they have been led to expect. Sheehan puts it this way.

“We are promised...” is the haphazard refrain often encountered when the reduction of pension claims is mentioned. Promised or not, one distinguishing feature of non-federal government spending commitments stands out: only the United States has a printing press. States cannot print money. They can earn returns on their pensions’ invested assets, they can sell city hall, lay off the public works department, and tax, but an underfunded pension plan can only pay claims with dollars that exist.

This list of options is actually too generous. Sell city hall? That presumes someone will buy it. Lay off the public works department? Not good for property values. Raise taxes? Right, on all the people in those houses without sewage service.

Repeat Sheehan’s last line and burn it into your brain: **“An underfunded pension plan can only pay claims with dollars that exist.”** No one gets anything if the money isn’t there, and in a disturbing number of places it isn’t.

Keep in mind, those horrifyingly low funding levels would be far lower still if they didn’t assume investment returns that are, in fact, unrealistically rosy. Between 7½% and 8% is typical now. Exactly how is that going to happen?

We know that pension plans typically have only 40–50% of their assets in equities, something like 40% in bonds, and the rest in real estate and alternative asset classes. How do you get 8% from that mix? Keeping 40% in bonds at 3% (if you’re lucky) means everything else has to make 15%.

Do you really want to bet that stock returns will average 15% over the next decade? If you actually think that is your future reality, then all I can say is that the ’60s were probably pretty good for you, and you may still be living in a drug-induced hallucination. If you are a public pension beneficiary, that may be your best shot: just pretend. Good luck with that.

Marc Faber, who is even better at scaring people than I am, points out something that should be obvious but apparently is not: Pension plan funding ratios have been declining even as financial markets have posted impressive gains:

I find the deteriorating funding levels of pension funds remarkable because post-March 2009 (S&P 500 at 666) stocks around the world rebounded strongly and many markets (including the US stock market) made new highs. Furthermore, government bonds were rallying strongly after 2006 as interest rates continued to decline sharply.

In fact, if I look at the total return of both equities and bonds (including interest for bonds and dividends for equities) over the last ten years (ending August 31, 2016), I note that the

return levels exceeded the expected asset return of almost 8% a year.

My point is this: If, despite these truly mouth-watering returns of financial assets over the last ten years, the unfunded liabilities have increased, what will happen once these returns diminish or completely disappear? After all, it is almost certain that the returns of pension funds (as well as other financial institutions) will diminish. Consider pension funds that have increased their allocation to bonds, and now (in the case of S&P 500 companies) exceed the equity allocation.

Now consider the following. Ten-year US Treasuries yield 1.74% and 30-year US Treasuries 2.48%. In Europe and Japan, government bond yields are frequently negative. How will it be possible with these low yields to achieve, in the long term, returns that even come close to the expected return of 8%?

Marc wrote that in October 2016, so those yields are a bit higher now; but you get his point. Yields are nowhere near high enough to deliver the kind of returns pension trustees are assuming. It just won't happen.

Worse, even if return assumptions are fulfilled for a while, as unlikely as that may be, those good years will not be enough if a bear market strikes at the wrong time. Sheehan quotes a study by Steven Malanga in [City Journal](#) last year. The State of Utah's pension plan lost 22.3% of its assets in 2008. It gained back 13% in 2009. A good start to recovery, right?

No, not right. Utah determined that its investment returns would have to compound at over 10% annually for the next 20 years just to recoup that 2008 loss. Why is that? Because while the portfolio was down, workers were continuing to earn new retirement credits. You have one set of people trying to fill the hole while another group digs it deeper. So just making back what you lost is not enough. You also have to make back the additional obligations you took on while you were trying to recover.

Zemblanity

The word *serendipity* was introduced to the English lexicon in 1754 by Horace Walpole as luck that takes the form of finding valuable or pleasant things that are not looked for. Let me introduce you to a new word. In 1998 William Boyd coined the term *zemblanity* to mean basically the opposite of serendipity. The *Urban Dictionary* defines zemblanity as the inevitable discovery of what we would rather not know. If you are or have been the parent of teenage kids, you have had some of those zemblanity moments.

America is going to be experiencing its own zemblanity moment during the next financial crisis when it discovers that many of its municipal and state pensions have crossed the threshold from merely difficult situations to almost impossible-to-fix ones. We are going to do a little math here, but I promise you it will be rather elementary. No calculus required. Seriously, this is so simple that even a politician could understand it. If you could get one to sit down and really think about it,

much less do anything.

The Merciless Math of Loss

My friend Steve Blumenthal wrote a little essay called “The Merciless Math of Loss.” He opens by quoting Ned Davis:

“It’s a little-known but startling fact: The average buy-and-hold stock market investor spends 74% of his or her time recovering from cyclical downturns in the market (from 1900–May 2015).” (Ned Davis Research)

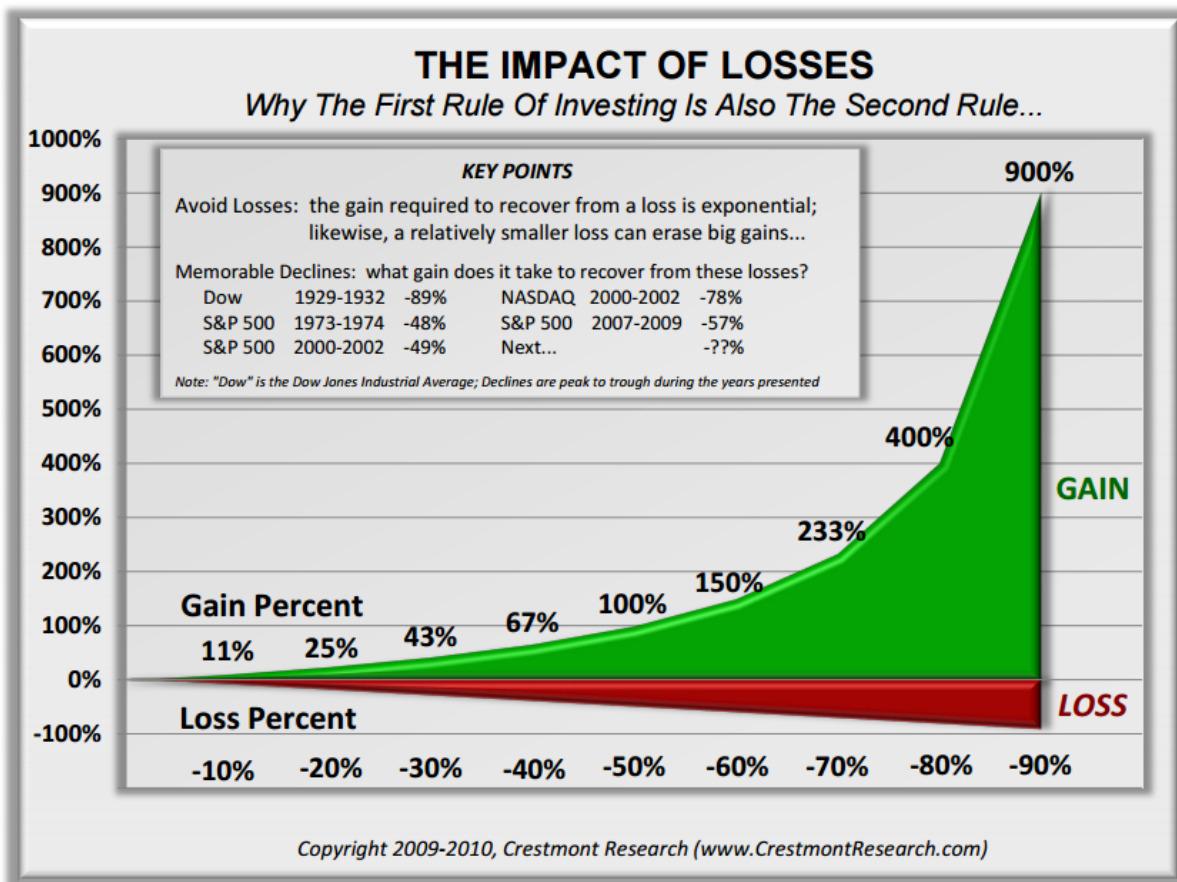
That’s according to well-respected Ned Davis Research, Inc., in Venice, Florida. It raises a big question: How is it possible that investors spend three quarters of their time just getting back to the starting line?

The answer is explained by the unforgiving mathematics of loss: When investments lose ground, they must make up more ground, percentage-wise, just to get back to even.

Say you invest \$10,000 and your account takes a 10% loss over six months. You’re down to a \$9,000 balance. Because of your reduced capital base, you will have to earn 11% to recoup your losses. The steeper the losses, the higher the hurdle becomes for breaking even. For example: Recovering a loss of 30% requires a 42.9% gain; a 50% loss requires a 100% gain. To recover from a loss of 75%, a 300% gain is required.

Getting back to even can eat up precious time. Take that 10% loss over six months. Earning a steady 4% annually after that, you will still need two and three-quarter years just to get back to where you started. That time would be much better spent accumulating new money. Remember, the idea is to grow your money, not just regain lost capital.

You can see the required recovery levels more graphically in this chart from my friend Ed Easterling at Crestmont Research:



A 50% loss requires a 100% return to get back to breakeven. Add just another 10% loss for a total loss of 60%, and it takes 150% to get back to breakeven. The mathematics get uglier the bigger the loss.

Let's look at two charts of the S&P 500. The [first](#) shows straightforward index levels since 1977. If you click on the link above or the chart below, you can bring up an interactive version of the chart. Click on "max" and then run your cursor back and forth to see where the index was on various dates. Note that it took 13 years to recover from the peak of 2000 (not including the very temporary peak of 2007). Since 2000, the market has risen roughly 50%. A 50% return over 17 years is not exactly what people thought they were going to get back in 2000 – it's a little less than 3% a year on a compounded basis.



But that’s not really a fair way to look at it. While the NASDAQ and other indexes have small dividend payouts relative to the size of their indexes, the S&P 500 actually has reasonable dividends compounding over time. So this next chart shows the level of the S&P 500, including dividends, since 1988. And yes, while it did take almost 13 years for the market, including dividend returns, to fully recover from the top in 2000, since that time it has actually more than doubled with the help of dividends. That slightly-larger-than-2% dividend has compounded nicely over time.

S&P 500 (TR) (^SP500TR)

SNP - SNP Real Time Price. Currency in USD

[★ Add to watchlist](#)

4,515.90 -13.75 (-0.30%)

At close: April 21 4:41PM EDT

Summary

Conversations

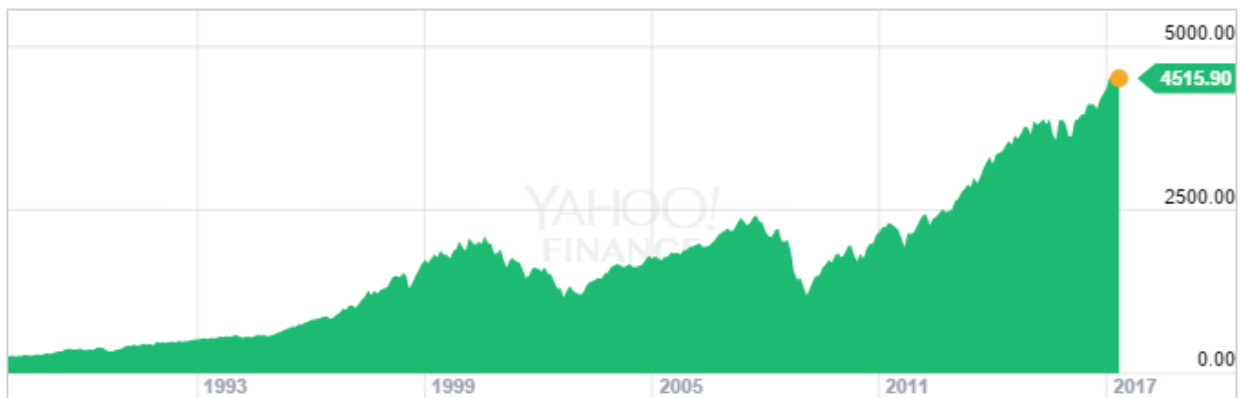
Options

Components

Historical Data

1D 5D 1M 6M YTD 1Y 2Y 5Y 10Y MAX

[↗ Interactive chart](#)



That pleasant result has lulled pension plan managers and other investors into believing that this period is somehow normal. And it has convinced them that their pensions must be recovering lost ground. The problem is, that's an illusion.

I read recently that the average pension fund in the United States expects its investment prowess to bring home returns of 7.69% in the future. A number of funds still use 8% as their target. Seriously.

Now let's do some math based on the rule of 72. The rule of 72 is basically (according to Investopedia) a simplified way to determine how long an investment will take to double, given a fixed annual rate of interest. By dividing 72 by the annual rate of return, investors can get a rough estimate of how many years it will take for the initial investment to duplicate itself. Investopedia even provides this handy table:

Rate of Return	Rule of 72	Actual # of Years	Difference (#) of Years
2%	36.0	35	1.0
3%	24.0	23.45	0.6
5%	14.4	14.21	0.2
7%	10.3	10.24	0.0
9%	8.0	8.04	0.0
12%	6.0	6.12	0.1
25%	2.9	3.11	0.2
50%	1.4	1.71	0.3
72%	1.0	1.28	0.3
100%	0.7	1	0.3

Let me reiterate that the biggest portion of the money that will be used to pay retirees from a pension fund comes from actual returns on investments and not from the original contributions. That means that if there is a portion of the pension fund that is currently unfunded, those (nonexistent) dollars can't grow so that they can be redeemed 30 years later by the retirees.

Further, the amount by which a pension plan is underfunded is determined by the assumptions on returns that the fund makes. These next few paragraphs will drive the actuaries and math nerds among my readers crazy, but I am going to simplify here to make a point.

If you project returns of 8%, then you expect your assets to double every nine years. Thus in 27 years, \$1 that is sitting in the fund today will have become \$8.

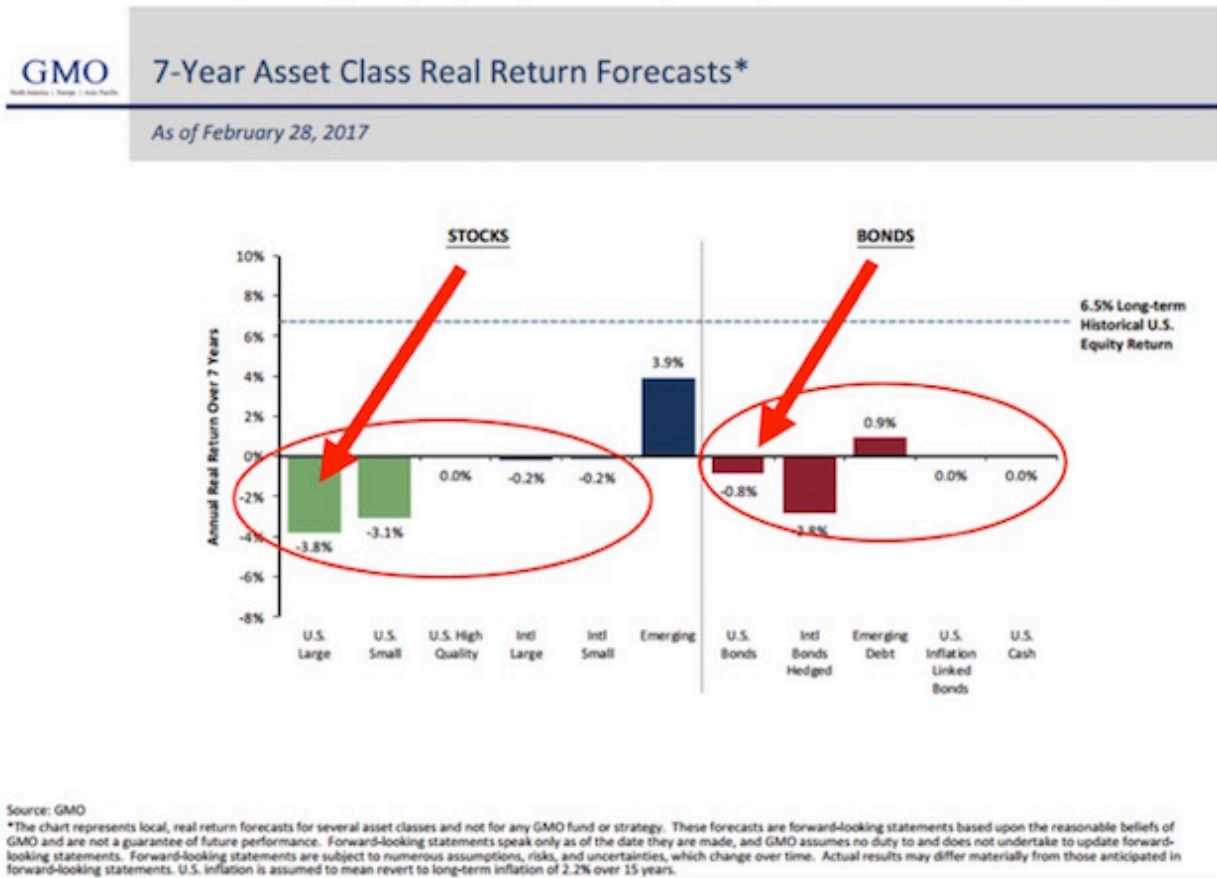
But what if your returns grow at only 5%? Looking at the handy chart above, we see that it takes 14.2 years to double your assets, so that in 28 years \$1 will have grown to only \$4. That is only about half of the dollars that your actuaries and consultants have assumed would be there.

If you project 5% returns for the next 30 years, then you have to almost double the current level of contributions to have the necessary assets in 30 years. So basically, any pension fund that is assuming 8% compound returns and is falling significantly short of that level now, will turn out to be massively underfunded, far more so than funds are telling their retirees or the public.

I understand that the actuaries actually calculate the underfunding for each year, not just 30 years out. That makes the math far more complex, but the principle is the same. The lower you make your return assumptions, the more you are required to fund current pension balance sheets. And that funding comes from only two sources, taxpayers and current workers. Of course, you could go to your current retirees and tell them they are going to get less money, starting right away, but how

popular will you be then? (And how illegal would that be?)

What happens if Jeremy Grantham is right (and he has been right 97% of the time with his seven-year projections), and total market returns are less than 1% over the next seven years?



Then not only will pension funds have to grow returns much faster in subsequent years to catch up, they will also have to go to their respective states, cities, or schools and say, “You need to give us more money, because we’re becoming more underfunded each year.”

Let’s just make this pension data analysis even more fun. During the Great Recession, the market fell 58%. A 50% drop in the stock market during a recession is not unusual. What is the probability that we will not have a recession in the next four years? Pensions are making a huge wager on that proposition, so it is not a trivial question.

An Ugly Picture

The more I look at the situation with pensions, the more clearly I see that there is no practical way out. We know three things with near certainty:

1. Public pension plans are nowhere near able to meet their obligations.
2. Most cities and states can't possibly contribute enough to cover the gaps without serious budget upheaval or increased taxes.
3. Plan investments won't achieve projected returns, let alone earn enough to cover the contribution gaps.

I suppose in a different flavor of quantum universe where math works differently, it might be possible to make these pension plans work. Here in our universe, not so much. Not going to happen.

What does that mean?

It means several million more people are not going to have the kind of retirement they envisioned. If you're one of them, you need to aggressively start saving every penny you can, right now.

Further complicating the situation is that in many places, state and local workers don't participate in the Social Security system. They won't even have that minimal amount to cushion the blow.

All these unexpectedly uncomfortable retirees will affect the economy. Their added savings will serve to keep interest rates low for everyone. Their consumer spending will be lower, reducing demand for many goods and services. They may have to sell their homes and move to more economical locations, thereby depressing property values.

None of this is built into anyone's economic projections, which are often not so good in the first place. I'd like to point out a silver lining, but I just don't see one. All I see are clouds: dark, ugly clouds threatening to rain on us all.

Will we Muddle Through? Most of us will. But I am 100% confident that this pension debacle is going to end very badly for many millions of state and local public workers. And we haven't even talked about the social impacts.

You think the 2016 presidential campaign was ugly and divisive? Wait until your local elections turn on whether or not to cut your neighbor's pension in half. The arguments are going to be up close and personal. What kind of person will run for local office in those conditions? Probably people who shouldn't. Which will only make it all worse.

Like state and local pension obligations, US federal government pension obligations are also basically unfunded. They are expected to come from future tax revenues. Those obligations are the bulk of the over \$100 trillion in unfunded liabilities that show up in the estimates of how much the United States is really in debt. That money is going to have to come from somewhere. But just as the United States will never default on its actual debt, I truly don't believe we will default on US government pension obligations.

Future politicians are going to be faced with some very uncomfortable choices, one of which will

be how much money to ask the Federal Reserve print in order to honor those obligations. Or should they cut future pension payouts, or maybe even current ones?

When Illinois or any other state finds itself unable to pay its pensioners, I think it is unlikely that the federal government will ride to the rescue. And the other states will look at each other and say, "Not my monkey, not my circus."

But what happens when a majority of the states and citizens in those states begin to demand that something be done to help the poor public service workers whose lives are being seriously impaired? We can say that in today's political environment it is unlikely that the federal government would rescue states and cities. But in a future political environment? Hard to say. The pressure to "do something" is going to be huge. And it's going to be coming from seemingly everywhere.

If you aren't already angst-ridden, consider this letter your ticket to the club. It's going to hurt to belong; but we're all in this together, one way and another.

Angst in America, Part 6: Middle Class Blues

By John Mauldin | April 30, 2017

Poverty Going Extinct
The Great Middle
Measuring Relative Income
Crossing Classes
Lucky Days

“We of the sinking middle class may sink without further struggles into the working class where we belong, and probably when we get there it will not be so dreadful as we feared; for, after all, we have nothing to lose.”

– George Orwell

“A strong, educated middle class is what made America the greatest country in the world.”

– Lincoln Chafee



As we continue our tour of the widespread angst afflicting investors large and small today, I want to ask a more fundamental question: Is the angst all in our heads?

The quick answer: No, it's not. The economic challenges we face are real. Fear, or angst, is often a perfectly reasonable response. I've said that, with one exception, we can muddle through the coming crises. But "we" doesn't mean every single one of us. The nation will survive the next recession, but some of its citizens may not, at least not with the same financial security that they currently enjoy and expect. The coming pension crisis will put quite a dent in expectations. Economic strain can lead directly to sickness, disability, and sometimes suicide or fatal illness. It happens. I don't want to minimize that risk.

It's precisely the risk that we will find ourselves among those who can't muddle through that creates so much angst. Worse, we know the risks aren't randomly distributed. We have classes of Protected and Unprotected citizens, to use Peggy Noonan's terms. But even the Protected are afraid they may slide down the scale into economic oblivion.

Actually, they probably wouldn't slide much farther than the middle class – but they may find the middle class hollowed out when they get there. The middle class is a fairly new development in economics. Up until the last century or two, most societies had a tiny wealthy elite and great masses of common laborers. We now regard having this group in the middle, not wealthy but with their own assets and spending power, as a great achievement. We don't want to lose it, but some people fear we will.

If you delve into the economic and social-psychological literature, and if you can put up with the academic language that does its best to obscure what's actually being said, you will find that there is a general consensus around the idea that having a lot of money does not make us happy, once our basic needs are fulfilled. There is, however, some research – and it's controversial – which indicates that *relative* income is important. A majority of respondents would rather have more relative income than more absolute income, especially if they are relatively lower-income than everybody else. On the surface of it, that proposition doesn't make sense to many people; but we're dealing with human emotions and feelings, which often don't make sense. We just seem to be wired to want to keep up with – or do better than – the Joneses, and now many people suspect they are doing worse. (Remember, these studies measure only the average propensity, not what you and I might as individuals think or believe or feel.)

So, given the uncertainty of the times (and the data I will present here), there is reason for concern that the middle class is really under pressure. It's not just in their heads; it's an everyday, real-world situation.

With that in mind, we'll look at some new income data and see if it can help us control our angst.

All of this angst – no matter your current circumstances – makes it more difficult to make decisions now than it is in more confident times. Those of us in the publishing business, as well as in the money management business, know that it is in times of high anxiety that is the most difficult to get our clients and readers to actually respond. The best time to elicit a response is in a boom period, and the next best time is, ironically, just after a bust, when people are ready to figure out what to do. I say ironically, because it is precisely when we have an economic and political

situation like the one we have today, when there is actually time to make proactive decisions, that it appears to be the most psychologically difficult to do so. We procrastinate; we become like Wilkins Micawber from Charles Dickens' novel *David Copperfield*, who was famously noted for saying repeatedly, "Something will turn up."

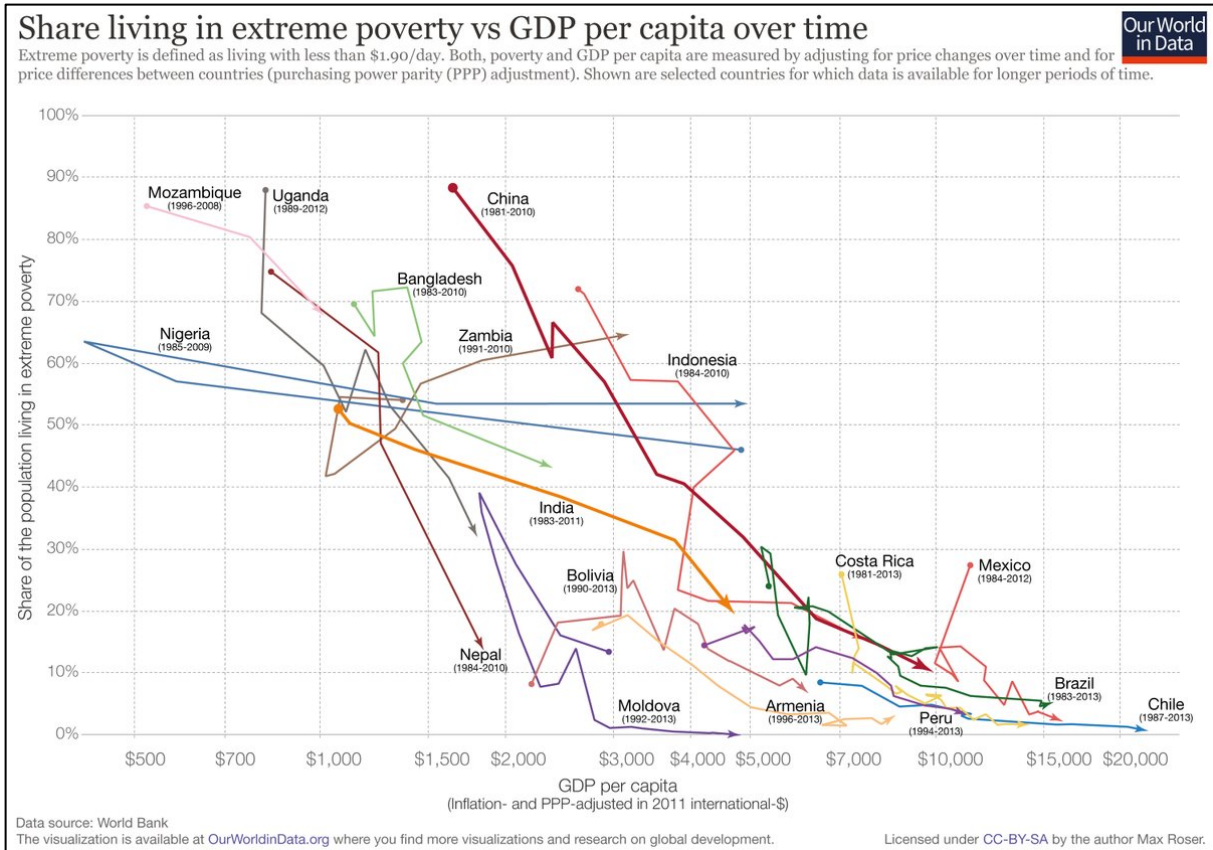
Let me suggest that now is the time you should be thinking hardest about taking action to have your house in order when we hit the next rough patch. Next week I'm going to start writing about what I am calling "The Great Reset." I think we are approaching that moment when the two greatest bubbles in human history – sovereign debt and government promises (which are conflated in many people's minds) – will burst, and politicians and central banks will be forced to take actions that are unthinkable today.

Poverty Going Extinct

We'll begin with some good news. Despite all our problems, on a global basis the number of people trapped in extreme poverty has plummeted this century. That trend doesn't mean everyone everywhere is living comfortably. Many millions still endure terrible conditions. But their number is shrinking.

The reason for the improvement, I believe, is that technology and free trade brought economic growth to formerly stagnant economies. Yes, corruption and inefficiency diverted much of the growth into the wrong hands, but there has still been a general increase in living standards and incomes.

We can see this decline in extreme poverty in the following chart from Max Rosen's Our World in Data site. The chart plots the share of a country's population living in extreme poverty vs. growth in per capita GDP. "Extreme poverty" means living on less than the equivalent of \$1.90 per day. The lines illustrate the change in that balance over time. You can see a nifty animated version of the chart [here](#).



What we see here is that many countries began in the top left quadrant or close to it, with a high percentage of the population in extreme poverty and with low GDP per capita. Over time, countries slide to the lower right, meaning higher per capita GDP and a lower percentage of the population in extreme poverty.

So, it appears that a general increase in national income correlates with fewer people living in dire poverty. Correlation isn't causation, of course, nor does this mean that all is well in these countries now. But there is at least an association between economic growth and reduced poverty. The rising tide seems to lift most boats.

That's great news – something we should all celebrate. We in the developed world can't truly comprehend what extreme poverty is like. \$1.90 a day? Americans spend more than that on coffee and junk food. I don't know how people buy food, shelter, and everything else with such a small amount.

I suppose extreme poverty seems normal if you have known nothing else. But increasingly, we all do know (or think we know) how the other half lives. That's part of our problem, as we'll see below.

My point here is simple: If you are reading this letter, you are already far ahead of most human beings in terms of wealth, health, education, leisure time, and more. Gratefully recognizing that

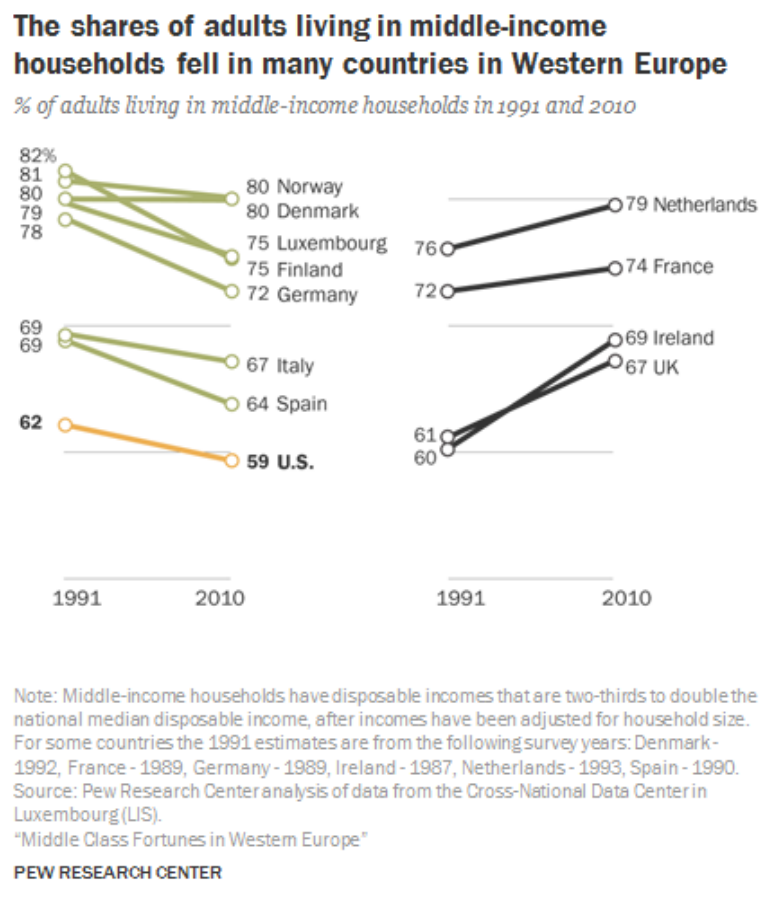
fact helps with the angst. It's not the complete answer by any means, but it helps.

The Great Middle

Now let's consider some related data from Europe and the US, courtesy of Pew Research Center. In this case, we'll look at the middle class.

First question: What's "middle class?" Pew defines it as adults living in households with disposable incomes ranging from two-thirds to twice the national median disposable income. In the US, that means a 2010 after-tax income between \$35,294 and \$105,881.

Pew found that from 1991 through 2010, the percentage of adults living in middle-class households in the US shrank from 62% to 59%.



More significantly, perhaps, the US has the smallest percentage of middle class adults of any of the advanced economies Pew studied. Notably, during this period the middle class expanded in the UK, Ireland, France, and the Netherlands.

The percentages in themselves don't tell us much. A shrinking middle class might be good if it

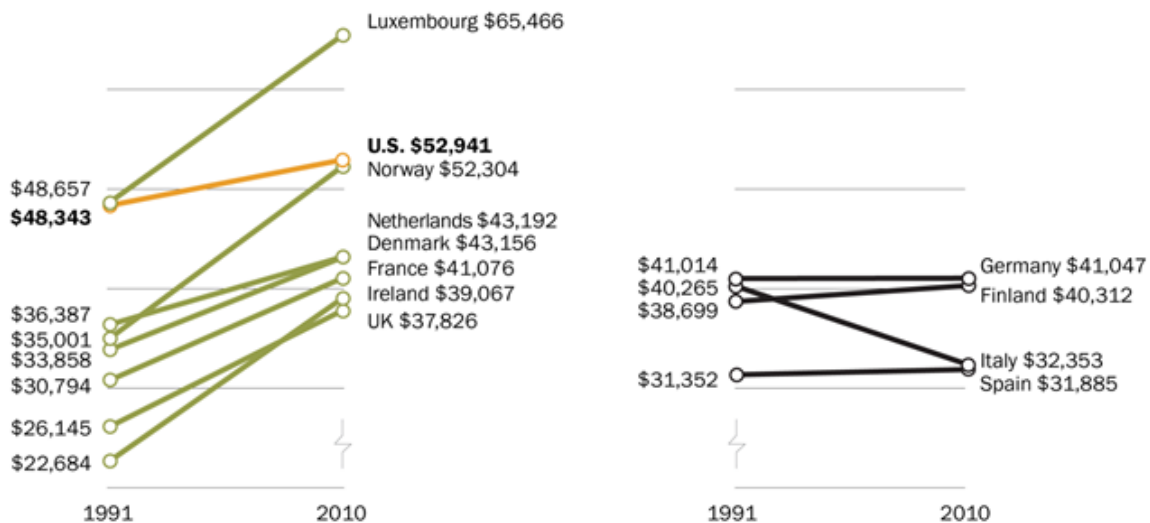
means that more people are moving into the upper strata. Of course, it's not possible for everyone to be above the median. That's what median means: half above, half below. But income-distribution curves can have different shapes. In 2010, 59% of US adults were in the middle class, 15% above it, and 26% below it. Not exactly the shape of curve you want to see.

(Incidentally, I know the word *class* isn't exactly right in this context. We are talking strictly about income. Usually, *class* considers other identifiers, like education. Pew uses *middle income* and *middle class* interchangeably but acknowledges the terms can be ambiguous.)

Now let's look at a different data point: the median income that lies at the center of these distinctions. The chart below shows how the median changed from the beginning to the end of the study period. US median household income rose from an inflation-adjusted \$48,343 in 1991 to \$52,941 in 2010. That's a 9.5% increase over 19 years. That's pretty feeble, in my opinion, and indeed lower than in some European countries. Luxembourg's median household income jumped almost 35% in the same period. But the trend was flat or even negative in Germany, Finland, Italy, and Spain. (More on US median income below.)

Household incomes in most countries in Western Europe rose faster than in the U.S. from 1991 to 2010

National median disposable household income scaled to reflect a three-person household, in 2011 prices and purchasing power parity dollars



Note: The survey dates for some countries differ slightly from the dates shown as follows: Denmark - 1992, France - 1989, Germany - 1989, Ireland - 1987, Netherlands - 1993, and Spain - 1990. Incomes for these countries are projected to 1991. See Methodology for details.

Source: Pew Research Center analysis of data from the Cross-National Data Center in Luxembourg (LIS).

"Middle Class Fortunes in Western Europe"

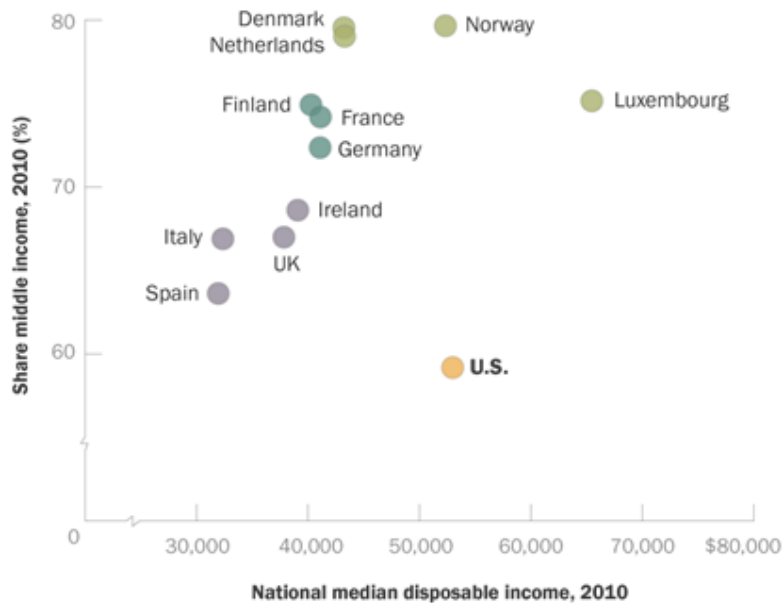
PEW RESEARCH CENTER

Another thing that strikes me here is the wide variation within Europe. In 2010, median income for

a three-person household ranged from \$31,885 in Spain to \$65,466 in Luxembourg. You could say Luxembourg is small and unique; but Norway isn't small, and at \$52,304 its median household income is 64% higher than Spain's. I suspect these differences have a lot to do with the European Union's present travails – and its rising populist movements.

The US stands out in another way, which Pew illustrates with this scatterplot:

Share of middle-income adults rises with national household income; U.S. appears an exception



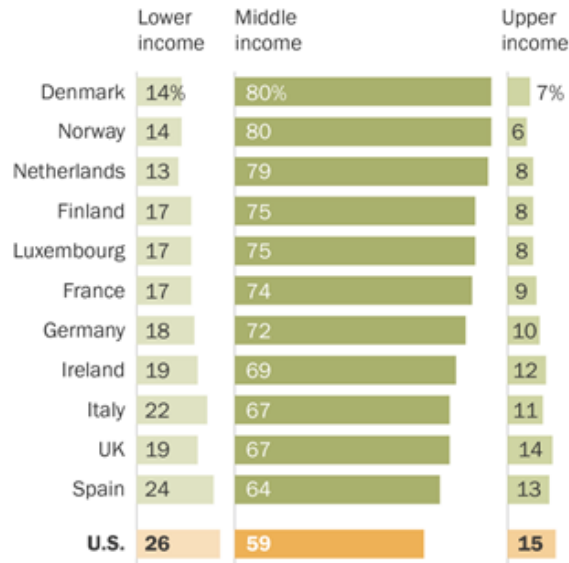
Note: Middle-income households have disposable incomes that are two-thirds to double the national median disposable income, after incomes have been adjusted for household size. Disposable incomes are expressed in 2011 prices and purchasing power parity dollars. Source: Pew Research Center analysis of data from the Cross-National Data Center in Luxembourg (LIS). "Middle Class Fortunes in Western Europe"

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Comparing the size of each country's middle class with its median income, we see that the US is a distinct outlier. Our middle class is smaller, but its income is *higher* than those of the middle classes in the other countries studied. Pew attributes the difference to another factor: The US has larger portions of its population in both the lower-income and upper-income categories than any of the other countries studied.

The middle class in the U.S. is smaller than in Western Europe

% of adult population in lower-, middle- and upper-income households, 2010



Note: Middle-income households have disposable incomes that are two-thirds to double the national median disposable income, after incomes have been adjusted for household size. Lower-income households have incomes less than two-thirds of the median and upper-income households have incomes that are more than double the median. The income boundaries are based on each country's own median disposable household income.

Source: Pew Research Center analysis of data from the Cross-National Data Center in Luxembourg (LIS).
"Middle Class Fortunes in Western Europe"

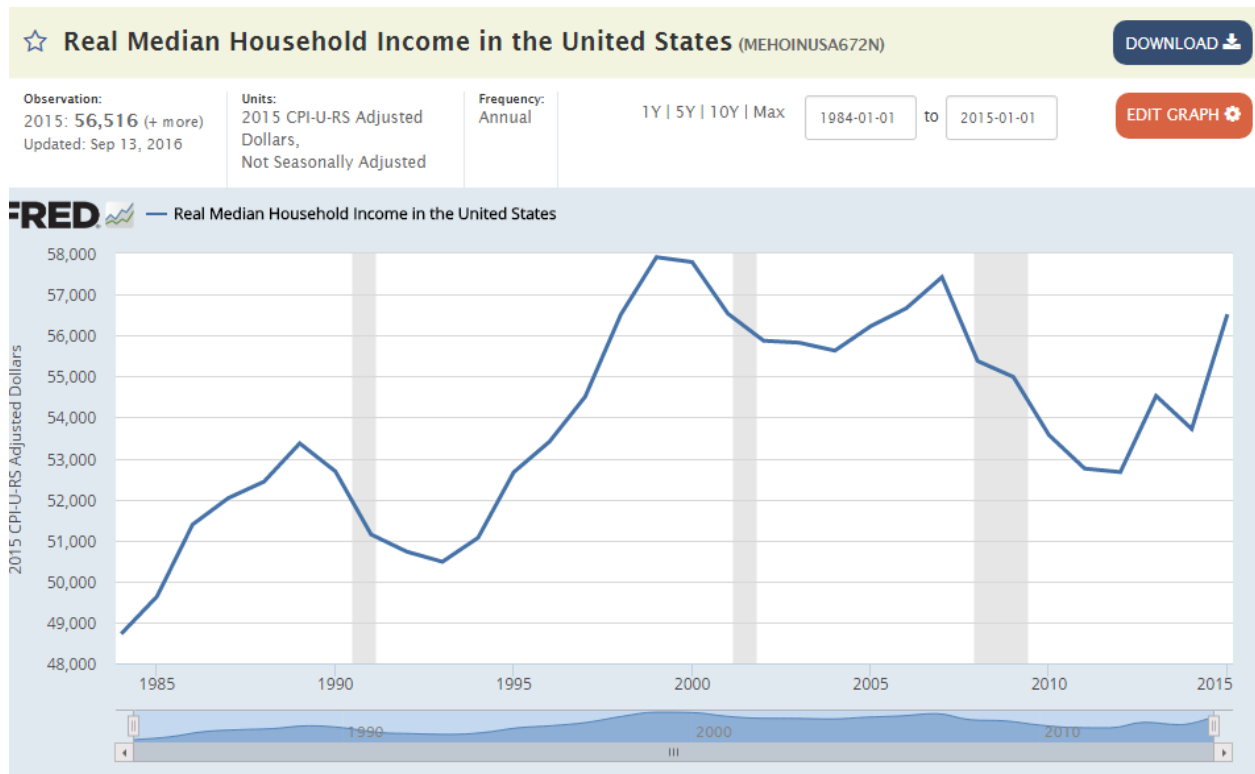
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I don't think these figures are a great mystery on the upper end. European countries have higher taxes, so they have relatively fewer wealthy people. Ditto on the lower-income end: It's harder to be poor when your government has generous welfare programs. But these differences at the top and bottom ends are greater than I would have expected.

Measuring Relative Income

If the average person in this country feels as though they are going nowhere fast, there is a real reason for it. The next chart, from the St. Louis Federal Reserve FRED database, shows that median income in the US is actually down over the last 17 years and is only 3% higher now than it was 30 years ago. Those are inflation-adjusted numbers. But the reality is that, for the average person, inflation has been much higher than the average of 2% per year over that time, because the things that the average person actually buys, like housing and education and healthcare and all the

other necessities of life, are rising at a much faster rate than 2%. So this chart reflects the fact that life has gotten much more difficult for average Americans. If people's income hasn't grown beyond what it was 30 years ago, they struggle just to make ends meet and to maintain the lifestyle they had. Can we say angst?



The Census Bureau updates its income figures about once a year, and the last real update we had was last fall, taking us through 2015. Doug Short did an [analysis](#) of those numbers, and I am going to borrow three graphs from him. (He does fabulous charts!)

He breaks the country into quintiles, calculates the average household income for each quintile, and then also shows the top 5%. Notice that the average income for the top 5% is \$350,000. We will come back to that figure in a moment.

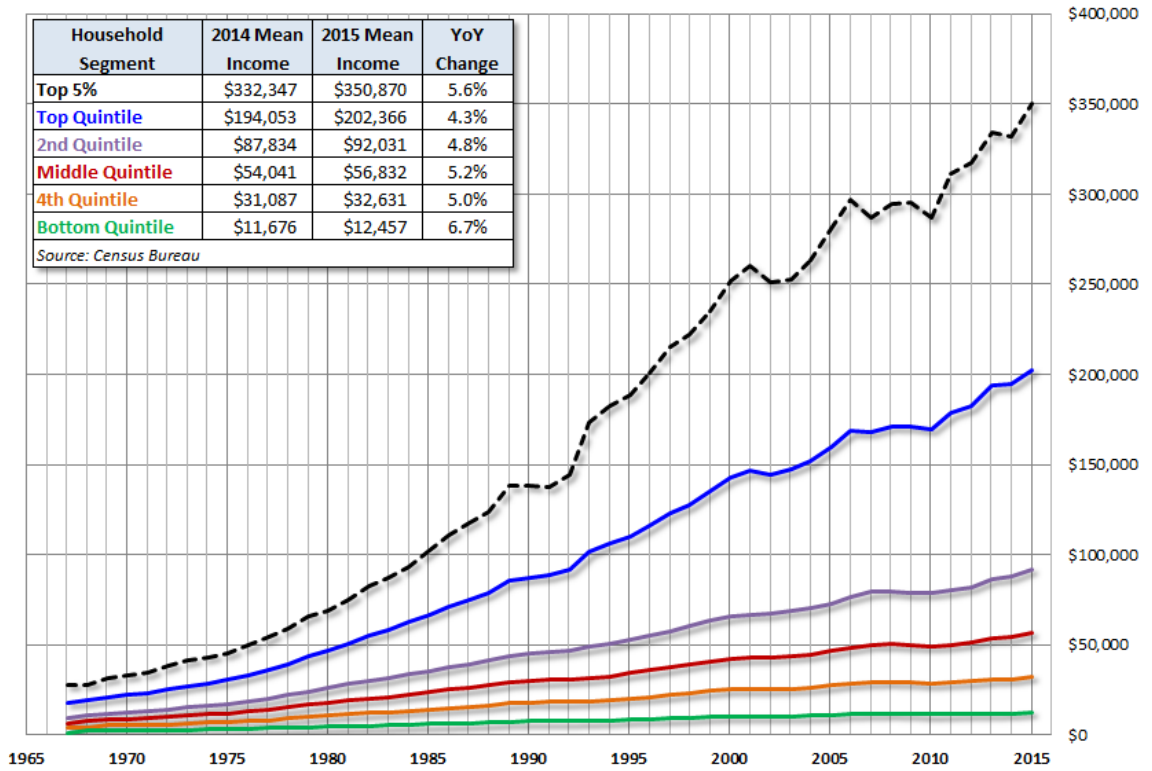
Source: Census Bureau
Data from 1967-2015

Mean (Average) Household Income By Quintile and Top 5 Percent

dshort.com

Household Segment	2014 Mean Income	2015 Mean Income	YoY Change
Top 5%	\$332,347	\$350,870	5.6%
Top Quintile	\$194,053	\$202,366	4.3%
2nd Quintile	\$87,834	\$92,031	4.8%
Middle Quintile	\$54,041	\$56,832	5.2%
4th Quintile	\$31,087	\$32,631	5.0%
Bottom Quintile	\$11,676	\$12,457	6.7%

Source: Census Bureau



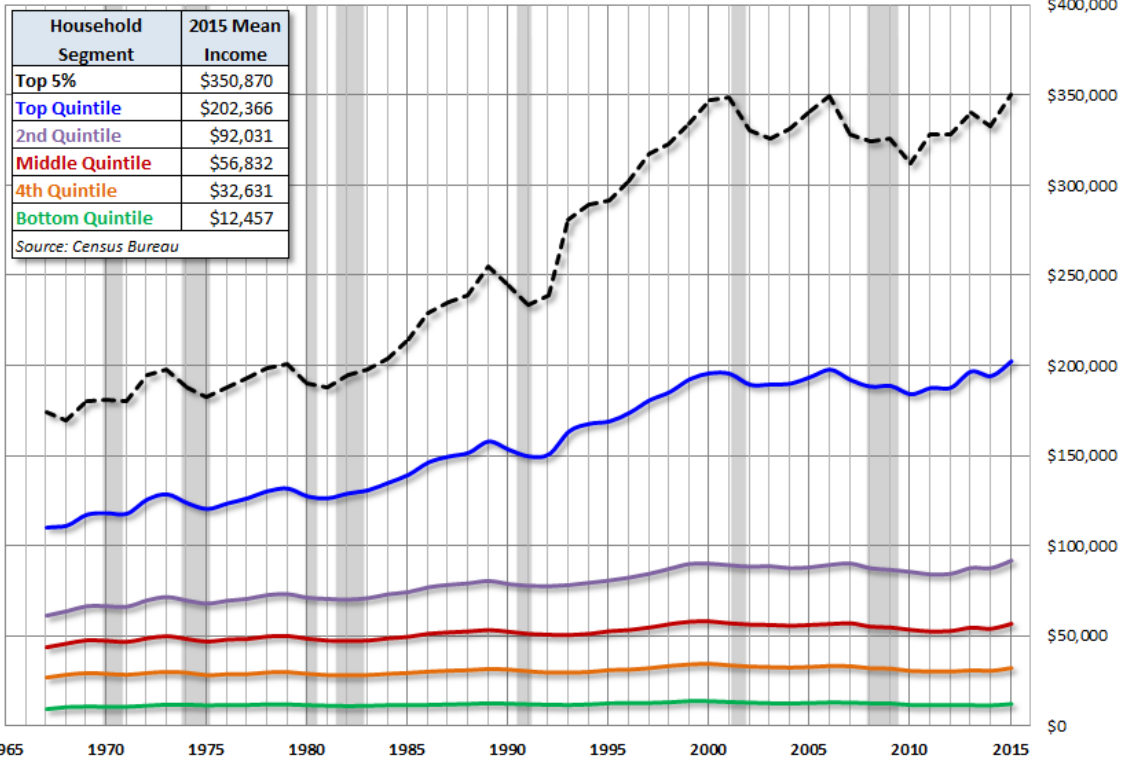
It looks like everybody's income is rising, especially those in the top 20% and 5%. But if we inflation-adjust those numbers, the illusion of growth goes away. What we see is that there has been almost no movement for the bottom 60%, while the middle quintile has grown somewhat, and – this won't surprise anyone – the top 20% and 5% have done very well.

Source: Census Bureau
Data from 1967-2015

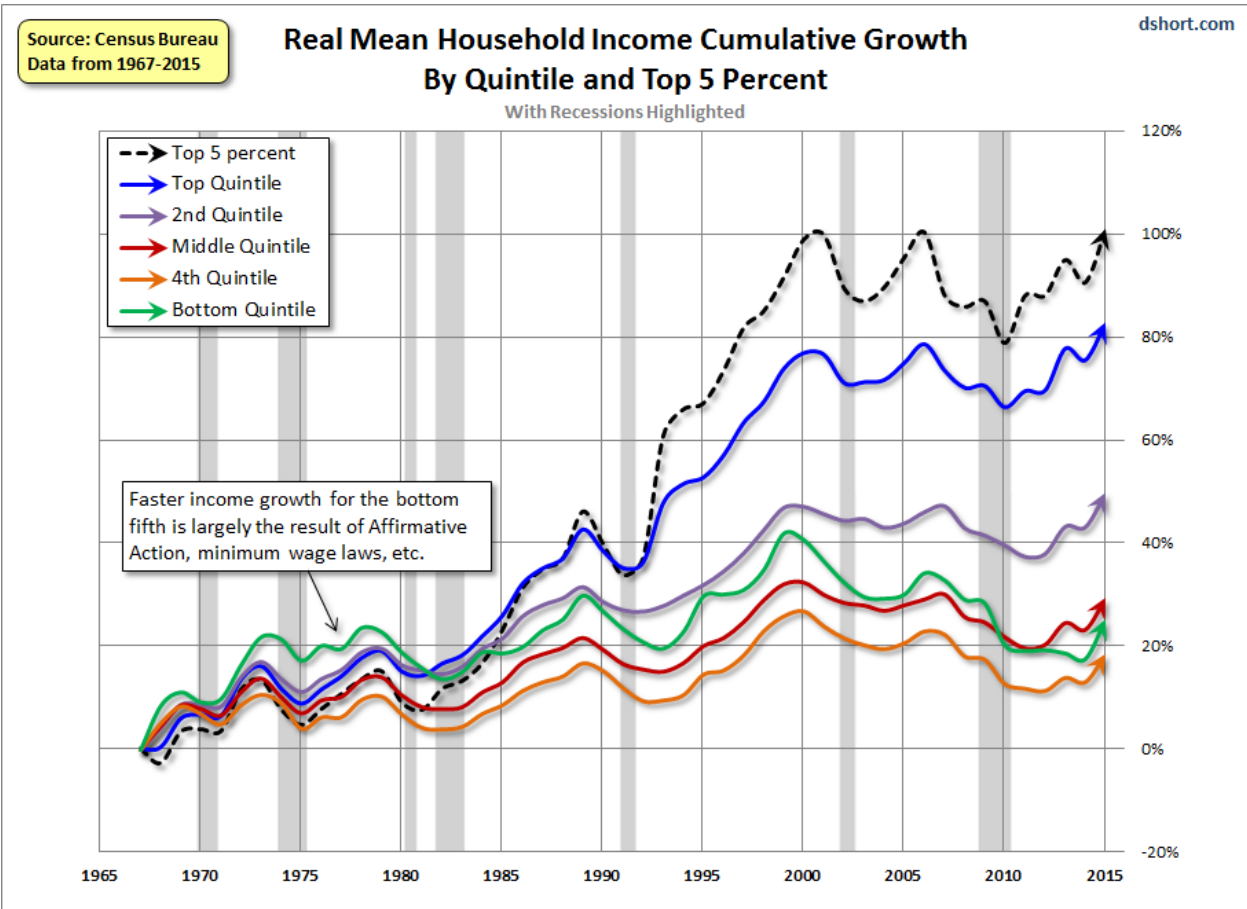
dshort.com

Real (Inflation-Adjusted) Average Household Income By Quintile and Top 5 Percent

With Recessions Highlighted



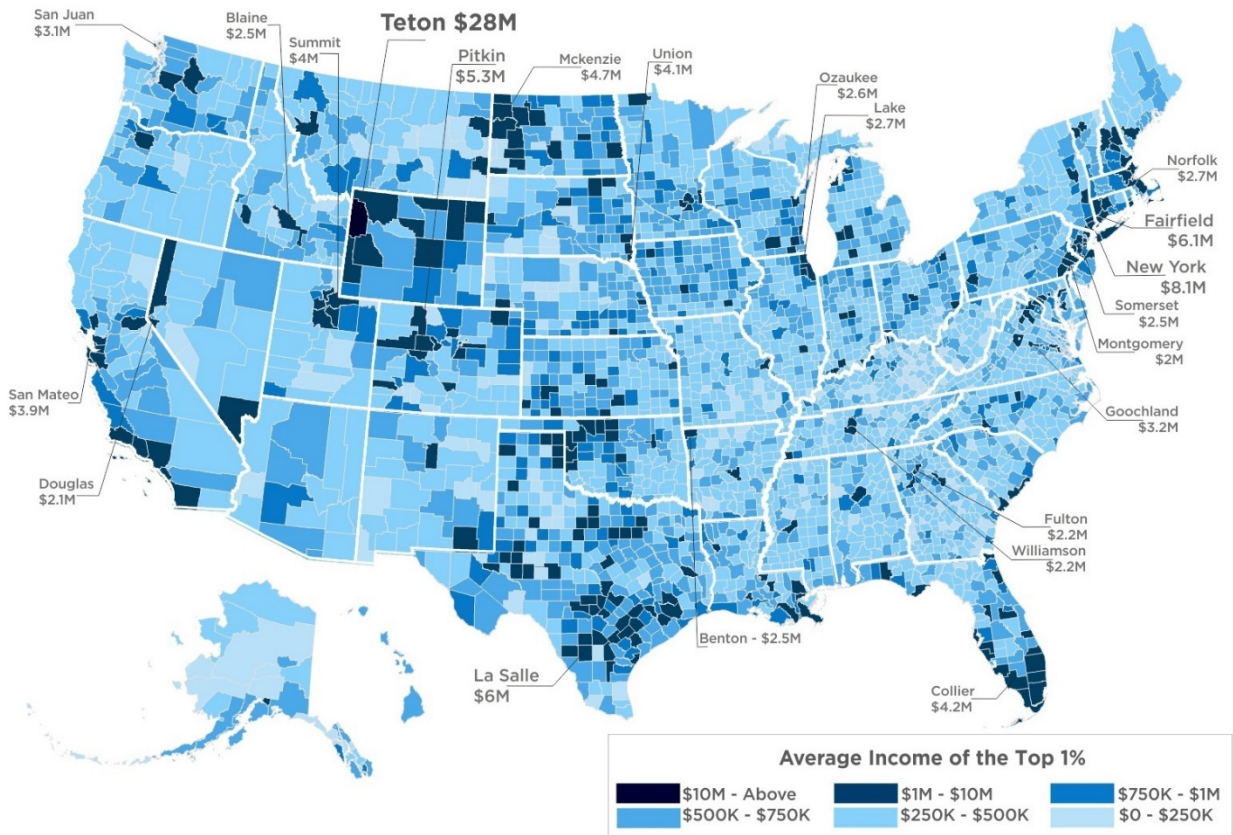
The next chart shows what that growth looks like in percentage terms. We find that the bottom quintile saw their income grow by only 25% over the last 49 years, less than ½% per year. Interestingly, the fourth quintile grew even less than the bottom one, at around 19%, mainly because of government programs that supported those in the lowest 20%.



But what about the 1%, I hear you asking? [Investopedia](#) conveniently gives us that answer:

To be certified as a one-percenter, you needed to bring home an adjusted gross income of \$465,626 more for the 2014 tax year, according to data from the IRS. The Washington Center for Equitable Growth put the average household income for this group at \$1,260,508 for 2014.

But as the saying goes, your mileage may vary. It turns out there is quite a lot of variation among counties around the US as to what it takes to qualify for the top 1%. To make the grade in New York, you will need about \$8 million in annual income. But that amount wouldn't help you very much in Teton County, Wyoming (we're talking Jackson Hole here), where you will need a tidy \$28 million per year to make it into the top 1%. On the other hand, there are many counties around the country where the top 1% take in less than \$200,000; and in Quitman County, Georgia, you only need \$127,000 a year to be elite. I found it odd that in LaSalle County, Texas, you had to make \$6 million to land in the top 1%. Now, that county has only about 6000 residents, and the median income is quite low. It turns out there are many rural counties in America with a similar pattern, either because some of their residents "fly in" or because there is oil fracking involved. If you are interested in that phenomenon, you can check out [this story](#) in the *Washington Post*.



Source: <http://www.howmuch.net/articles/average-income-of-top-1-per-cent>

howmuch.net

Crossing Classes

My gut feeling as I travel around the country and read a lot, is that more people are worried about staying where they are or not sliding down than are trying to figure out how to get up to the next level. It's just the times we are living in. We are also seeing fewer new companies being started than ever before. I don't think we can attribute that fact to generational differences – there is just a great deal of nervousness about being entrepreneurial.

The possibility that we might slide down the class scale is the source of much angst. Upper-income people worry they will decline to mere upper-middle-class status, while the middle class doesn't want to join the ranks of the lower class.

It's not so much that those upper-income people are worried about being middle class, it's that they have created expenses and lifestyles around a certain level of income. If that income falls, they will have to change the lifestyle they have become used to. That is remarkably difficult for many of us to do. Our sense of self-esteem and emotional well-being are, it seems, tied into our lifestyle.

A little personal revelation: I am no exception. I could certainly live a less expensive lifestyle. To

some extent, I simply tell myself to enjoy life as I find it and work hard to try to maintain my businesses and to grow them if possible. That is more difficult than you might imagine when the very foundations of the industries that I choose to work in seem to be shifting underneath my feet in directions I can't control. You just have to adapt. I have had to downshift my lifestyle on three occasions in my life; and while that's not fun, I seem to adjust. Maybe there's a little bit of Wilkins Micawber in me. In those lean periods, something always *does* seem to turn up. Then again, my great goal in life is not to have to make that hard adjustment yet one more time. In a real sense, I've created my own personal angst. It's kind of silly, really. But it does tend to drive me. I'm sure the psychologists among you can have a field day with that.

Whether your worries are groundless or real, those fears are greater if you know you're at the lower end of your peer group. The wealthiest .001% don't have to worry – they'll be fine in just about any scenario. But people in the 85–95th percentiles are in danger of taking a fall in the next big market and economic upheaval.

And of course, the lower middle in the 25–50th percentiles are very vulnerable to downward mobility. A *New York Times* [report](#) on the Pew study starts with one of their usual personal vignettes:

Mike McCabe's neighbors in rural Gillespie, Ill., consider him lucky. After being out of work for a year, he landed a job in January making cardboard boxes at a nearby Georgia-Pacific plant for \$19.60 an hour.

He would agree with them, were it not for the fact that his previous job in a steel mill near St. Louis paid \$28 an hour. "I've had to rethink my whole life to make ends meet on what I'm now making," Mr. McCabe said. "The middle class is struggling for sure, and almost anybody in my position will tell you that."

That short passage actually says a lot about angst in America. Let's unpack it.

Your neighbors will consider you *lucky* if you stay unemployed for a year and then find work for 30% less money than you made before. Maybe so, but you'll still be hurting. The statistics suggest that people in situations like this probably had little savings and burned through whatever they had while unemployed. They may have gone deeply into debt to survive.

"I've had to rethink my whole life to make ends meet on what I'm now making."

That's haunting because I think we can all imagine ourselves in that spot, no matter where we are now. What if you had to (a) go a full year with no income and (b) return to work at only 70% of your former earnings? Would you have to adjust your lifestyle? I sure would. My dad taught me that you do what you have to do, but fear of having to do it is the source of much of our angst.

At the same time, if his neighbors consider this guy to be "lucky," there must be many others in far worse straits. Remember the Maine guide I talked about last summer, who lost his job due to a plant closure and is now having to work through his retirement savings, 10 years before he turns

65? That kind of puts my angst and maybe the angst of most of my readers in real perspective.

Lucky Days

Part of our angst is that we feel captive to forces beyond our control. We suspect the bad luck that might push us downscale is more prevalent than the good luck that might propel us higher.

I think we also worry that it's not luck that will hurt us but rather our own weaknesses. My friend Barry Ritholtz made an interesting point in his [Bloomberg column](#) recently.

A surprising thing I learned from interviewing some of the most successful people in finance is how frequently they credit good luck. Indeed, in most of the almost 150 Masters in Business interviews I have done, our guests mention – unprompted by me – the crucial role of serendipity. This isn't false modesty or humility, but rather, an honest acknowledgment that chance can make a significant difference in people's lives.

Note that the role of chance doesn't imply successful people don't need to be educated, smart and diligent. Rather, it recognizes that lots of insightful, intelligent, hard-working people may not achieve the same level of success as other folks with the exact same qualities – and that those who are more successful may have had lucky breaks that others didn't get.

I think part of this is ego. It feels good to blame bad news on things we can't control while taking full credit for whatever successes we have. But there's more to it. Luck does indeed cut both ways.

In the US we have a cultural imprint that I think traces back to our Puritan origins. It tells us that everyone gets what they deserve. If you're wealthy, you must be smart and hardworking. Conversely, the poor are poor because they're lazy and make bad choices.

Both of those things are true in many cases, but not always. I have known many brilliant, hardworking people who have struggled financially. I've also known some very wealthy people who were, shall we say, less than genius-level intellects and whose work habits were suspect. The fact that there are exceptions proves that the rule isn't absolute.

Nonetheless, our Puritanical attitude is widespread and is even built into our laws. If your net worth is above a certain threshold, you're an "accredited investor" and presumed to be sophisticated enough not to need certain consumer protections and disclosures. And if your net worth falls below a certain threshold, you are "protected" from investments that might offer higher returns to those who are better off than you are, presumably because your current economic circumstances suggest you wouldn't understand the investments, regardless of your education and experience. Both of those assumptions by the government are nonsense.

Whatever our income or class, we all face challenges over which we have some influence, yet we may find ourselves subject to a fate that we can't control. The challenge that we have today is to recognize that the political, economic, and investment forces that we have become used to dealing

with over the last 70 years, through all their ups and downs, are getting ready to shift more radically than we have yet seen or can even imagine. We will have to think more deeply and creatively than ever about how to prepare for the changes – the transformation – coming to our lives.



Angst in America, Part 7: The Angst of the Millennial Generation

By John Mauldin | May 7, 2017

Are High Home Prices Turning American Millennials Into the New Serfs?

The Complacent Class

The Distortion of Time and Work

“Being young and having no job remains stubbornly common. Wages for young people fortunate enough to get a job have gone down. Inflation-adjusted wages for young high school graduates were 11 percent higher in 2000 than they were more than a decade later, and inflation-adjusted wages of young college graduates (four years only) have fallen by more than 5 percent. Unemployment rates for young college graduates have been running for years now in the neighborhood of 10 percent and underemployment rates near 20 percent. The sorry truth is that a lot of young people are facing diminished job opportunities, even several years after the formal end of the recession in 2009, when the economy began to once again expand after a historic contraction.”

– Tyler Cowen, [Average Is Over](#), 2013

“There are two ways to conquer and enslave a nation. One is by the sword. The other is by debt.”

– John Adams, 1826

“The problem with fiat money is that it rewards the minority that can handle money, but fools the generation that has worked and saved money.”

– Adam Smith

“Debt drains away vital resources from economic growth. Fighting a debt crisis with more debt is doomed to failure, yet that is not only what global central banks did during the crisis but long after markets stabilized (though the crisis never truly ended, just slowed). This was an epic policy failure that continues today.”

– Michael Lewitt, *The Credit Strategist*

I fully intended to end my series on “Angst in America” last week, moving on to portfolio construction and what I call the Great Reset. But as I did my regular reading and research this week and reflected on it, I realized there was one piece missing from this series. That is a

discussion of the angst that the Millennial generation and generations that follow are facing. And this is not just a US problem; it's global.

As most of you know, I am working on a book called *The Age of Transformation*. It's about how the world may look in 20 years. I hope to finish it before 2037! Things keep changing, and at an accelerating pace. One of the most important chapters – and the most difficult to write – is on the future of work. I entered into this project with a techno-optimist perspective. New technology, while destroying old jobs, would create new jobs and opportunities.

A clear example of this is the use of drone technology by the military. It requires about 100 people to prep and launch and maintain an F-16 for a single mission. Keeping an unmanned predator drone in the air for 24 hours requires about 168 workers laboring in the background. A larger drone, such as a Global Hawk surveillance craft, needs about 300 people working in the background to make the mission feasible. One of the real problems for the Air Force is recruiting enough people with the savvy to fill these needs.

But here's the problem. The world is dividing into people who can manipulate information using computers and those who can't. The differential in wages between these groups is significant. Thomas Piketty, the socialist French economist who wrote the book *Capital in the Twenty-First Century* (an enormously flawed work), does make the valid point that the gap between the poor and the rich, and between the middle class and the rich, is widening. Very little dispute about that. (He really didn't need to cook his economic data to demonstrate his case.) Enter Tyler Cowen, whose book *Average Is Over* I have been reading and mulling over for some time now. Cowen says the ability to mix technological knowledge with the ability to solve real-world problems is the key to being a big earners in a polarized labor market. The productive worker and the smart machine are becoming ever more complementary. As one reviewer said, "Only those who can learn to think like smart machines or at least enough to understand their operation will get success. Individuals who work with genius machines will need to retrain and learn new systems constantly."

So there are reasons to be concerned about my techno-optimist view. The new jobs will only be available to those who have real aptitude and real training. You may be highly educated, with a PhD in music or literature or even in economics, but the demand for your skills is nowhere near as high as the demand for a super nerd who dropped out of college and can sling code in his sleep. If, on the other hand, you understand how to generate leads and new subscribers using Facebook – something that really doesn't require a computer science degree but does demand a highly focused and integrated understanding of web technology and marketing – you'll find people lined up to throw money at you.

(Now that I mention it, if you are such a person, send us your résumé. We haven't cracked the code to achieve sustainable marketing profitability through Facebook, and there are a significant number of others in our industry who are facing the same issue. We are getting better at it. But it seems like every time we think we have it figured out, Facebook and Google and the rest of them

change their algorithms, and we have to start all over again, which means that the young geniuses we hire have to figure it all out again. And the cycle seems to be getting faster.)

What triggered my thinking on these topics this week was a lengthy piece by Marc Faber. Faber looks at a question being asked by a couple of other writers: Are the Millennials turning into the new serfs? With the massive amount of debt they have accumulated, not just in student loans (which are horrendous), but also in auto loans and other types of debt as well. With their income-generating potential down from that of previous generations, this generation may be in trouble (a problem I will be writing about in my book on the future of work). Now, Marc writes longer pieces, and this letter was 38 pages; but he gave me permission to pull out a few paragraphs here and there and stitch them together into a shorter piece, which we'll turn to next. Then I'll add some final comments on the future of work for Millennials.

Are High Home Prices Turning American Millennials Into the New Serfs?

By Marc Faber

(Excerpted from the *Gloom, Boom & Doom Report*, March 2017)

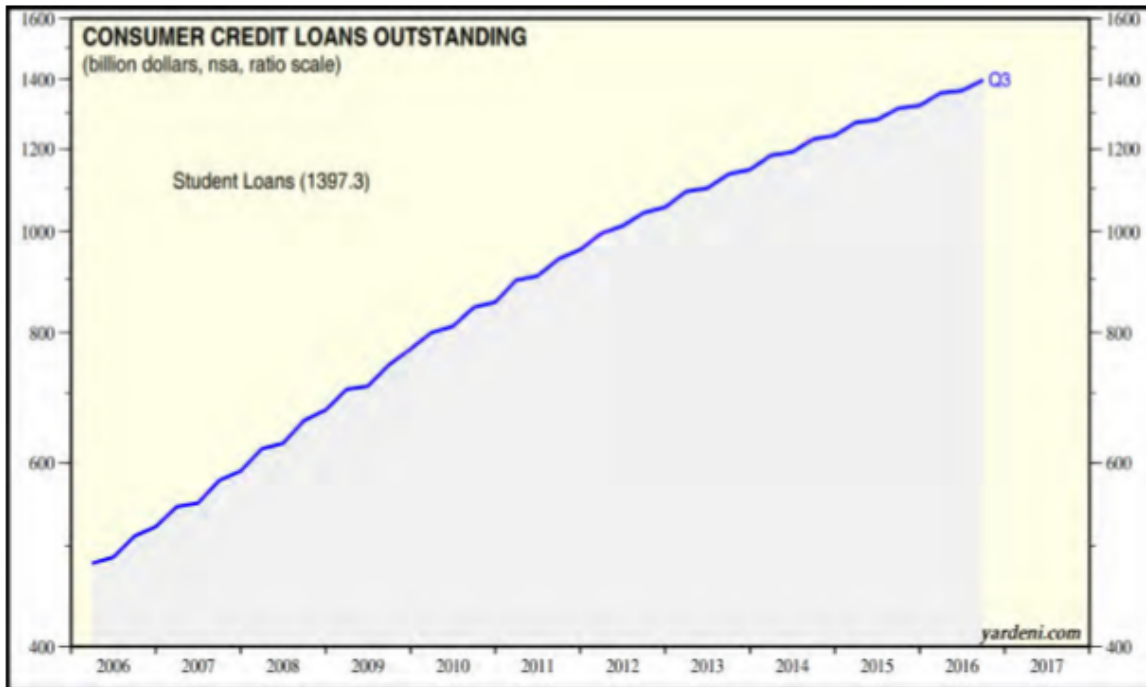
Writing for www.dailybeast.com (February 4, 2017), Joel Kotkin opines under the title “The High Cost of a Home Is Turning American Millennials Into the New Serfs” that

American greatness was long premised on the common assumption was that each generation would do better than previous one. That is being undermined for the emerging millennial generation.

The problems facing millennials include an economy where job growth has been largely in service and part-time employment, producing lower incomes; **the Census bureau estimates they earn, even with a full-time job, \$2,000 less in real dollars than the same age group made in 1980.** More millennials, notes a recent White House report, face far longer period of unemployment and suffer low rates of labor participation.”

More than 20 percent of people 18 to 34 live in poverty, up from 14 percent in 1980. They are also saddled with ever more college debt, with around half of students borrowing for their education during the 2013–14 school year, up from around 30 percent in the mid-1990s.

All this at a time when the return on education seem to be dropping: A millennial with both a college degree and college debt, according to a recent analysis of Federal Reserve data, earns about the same as a boomer without a degree did at the same age.

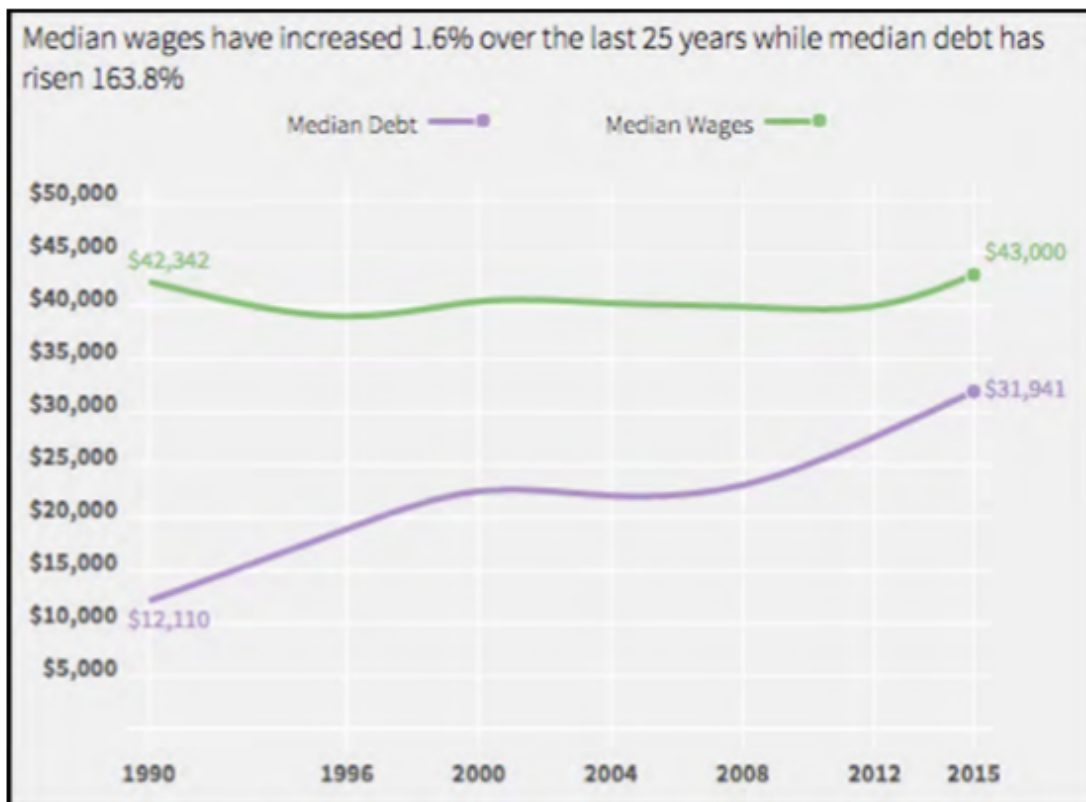


Source: Ed Yardeni, www.yardeni.com

This is a serious problem. According to a study by the *Huffington Post* (February 3, 2016), “President Barack Obama has said that a college degree ‘has never been more valuable.’ But if you borrow to finance your degree, the immediate returns are the lowest they’ve been in at least a generation, new data show.

Wages for the typical recent college graduate working full time have risen just 1.6 percent over the last 25 years, after adjusting for inflation, according to the Federal Reserve Bank of New York.” At the same time, student debt burdens for the typical bachelor’s degree recipient who borrowed for college have increased about 163.8 percent (see Figure 2).

Figure 2: Student Debt significantly outpacing Wage Growth, 1990 – 2015



Source: Brad Hershbein, W.E. Upjohn Institute for Employment Research

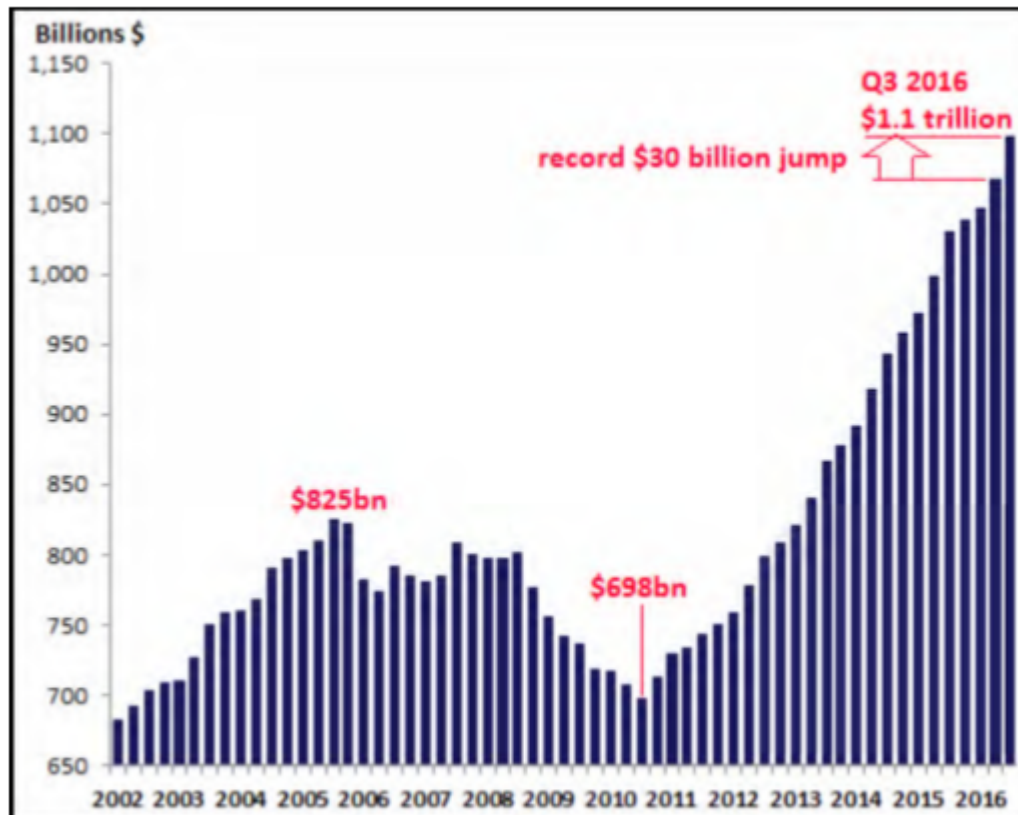
The Huffington Post analysis further states that, “In 1990, the typical college student graduated with debt equivalent to 28.6 percent of her annual earnings. By 2015, that number had shot up to 74.3 percent, data show.” Moreover,

Student debt at graduation for the typical bachelor’s degree recipient could exceed annual wages by 2023, if both figures continue to grow at the same annual rate of the last 25 years. Roughly 42 million Americans collectively owe more than \$1.3 trillion on their student loans, federal data show. Total student debt has doubled during the Obama administration. **More than 90 percent of student debt is either owned or guaranteed by the U.S. Department of Education.** Stagnant wages and the jump in student debt levels has prompted growing concern among government policymakers and financial industry executives that student debt risks slowing U.S. economic growth as households reduce their spending to make their student loan payments. About 7 of every 10 college graduates now borrows to pay for higher education, up from about half in the 1990s, data show. [emphasis added]

I should mention that not only “student debt risks slowing U.S. economic growth as households

reduce their spending to make their student loan payments.” The same also applies to auto loans, which have almost doubled since 2010 and other credit as well. Never mind what the neo-Keynesians say, excessive debts in a society reduce its growth potential as we have seen since the late 1990s and as Mr. Trump will likely also realize.

Figure 3: Auto Loans, Owned and Securitized, 2002 – 2016



Source: Federal Reserve

But back to the [dailybeast.com](#) article (“[The High Cost of a Home Is Turning American Millennials Into the New Serfs](#)”), which further notes that,

Downward mobility, for now at least, is increasingly rife. Stanford economist Raj Chetty finds that someone born in 1940 had a 92 percent chance of earning more than their parents; a boomer born in 1950 had a 79 percent chance of earning more than their parents. Those born in 1980, in contrast, have just a 46 percent chance. [See also Figure 9 of last month’s report.] Since 2004, homeownership rate for people under 35 have dropped by 21 percent, easily outpacing the 15 percent fall among those 35 to 44; the boomers’ rate remained largely unchanged. [See Figure 4.]

Dailybeast.com emphasizes that,

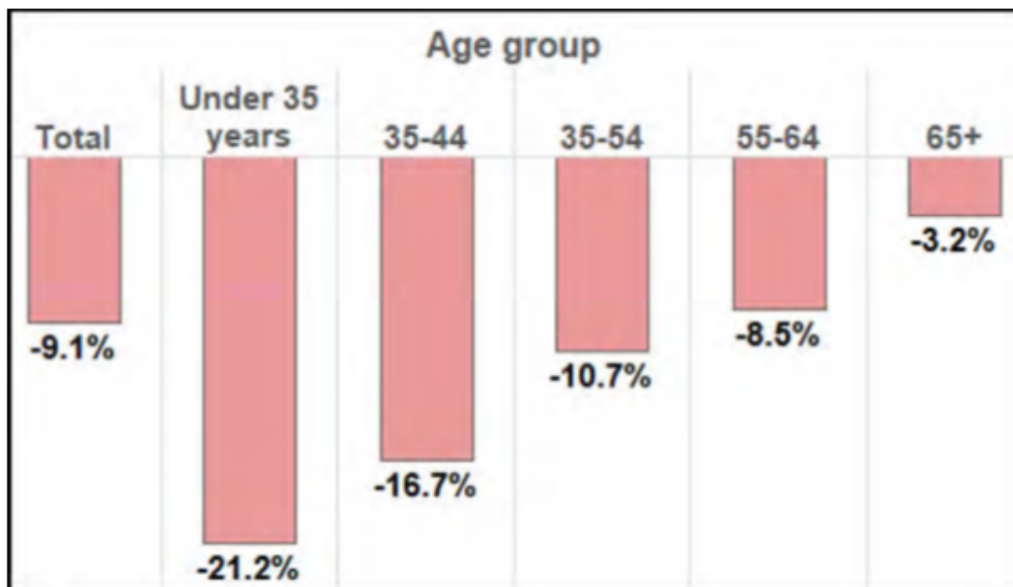
In some markets, high rents and weak millennial incomes make it all but impossible to raise a down payment. According to Zillow, for workers between 22 and 34, rent costs now claim upward of 45 percent of income in Los Angeles, San Francisco, New York, and Miami, compared to less than 30 percent of income in metropolitan areas like Dallas-Fort Worth and Houston. The costs of purchasing a house are even more lopsided: In Los Angeles and the Bay Area, a monthly mortgage takes, on average, close to 40 percent of income, compared to 15 percent nationally.

I need to clarify the point that, “for workers between 22 and 34, rent costs now claim upward of 45 percent of income in Los Angeles, San Francisco, New York, and Miami.” This is certainly true, but in New York, the median rent-to-income ratio or the share of total household income necessary to pay median asking rent is frequently above 50% (see Figure 5). So when Joel Kotkin writing for dailybeast.com says that,

Like medieval serfs in pre-industrial Europe, America’s new generation, particularly in its alpha cities, seems increasingly destined to spend their lives paying off their overlords, and having little to show for it. No wonder that rather than strike out on their own, many millennials are simply failing to launch, with record numbers hunkering down in their parents’ homes. Since 2000, the numbers of people aged 18 to 34 living at home has shot up by over 5 million

– he is spot on. Since the homeownership rate peaked out in the US in late 2004, the biggest drop has come from households under the age of 35.

Figure 4: Percentage Change in Homeownership Rate among different Age Groups, 2004 – 2016



Source: Census, CNBC

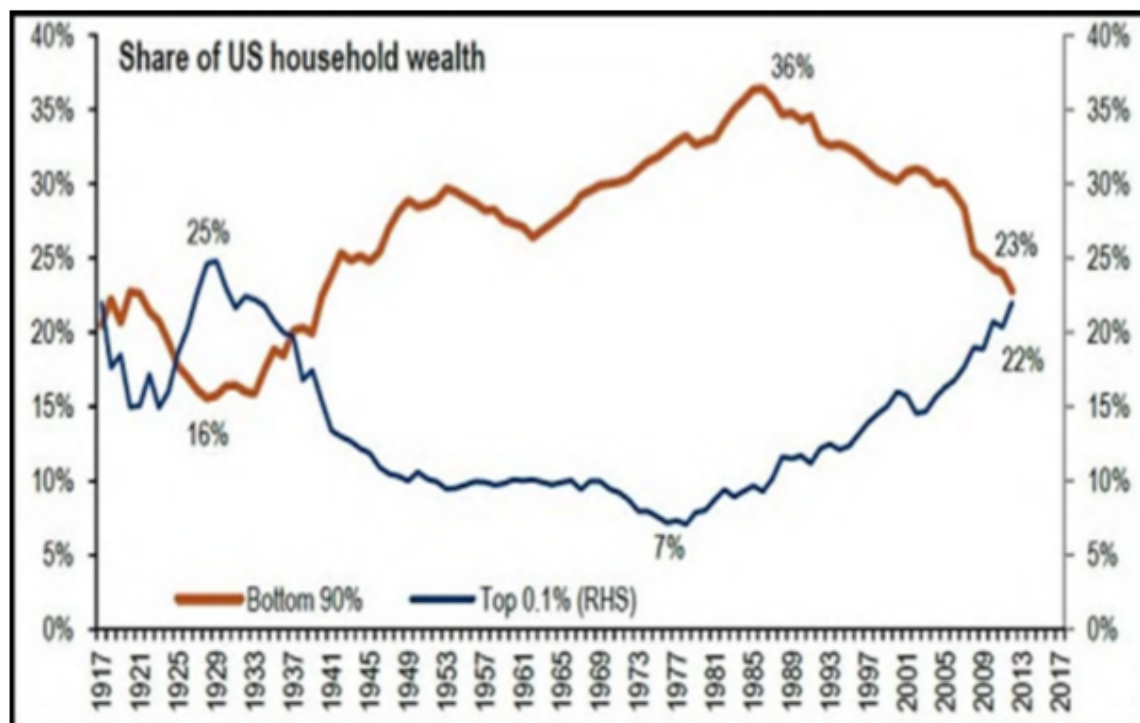
Kotkin then explains that a common theme in the mainstream media is that millennials don't want to buy homes. The new generation, it is said is part of "an evolution of consciousness" – whatever that means is beside the point. Other observers claim that the young have embraced "the sharing economy," so that owning a home is simply not to their taste. I have also seen financial advisors recommending young people not to buy a home because home prices have increased far less than an investment in equities over time despite the fact that until recently, gains in US housing were matching those of the equity markets toe to toe since 2011 bottom in US house prices.

However, according to Kotkin,

[It] is "not a lifestyle choice but economics – high prices and low incomes – – that are keeping millennials from buying homes. In survey after survey the clear majority of millennials – roughly 80%, including the vast majority of renters – express interest in acquiring a home of their own. Nor are they allergic, as many suggest, to the idea of raising a family, albeit often at a later age, long a major motivation for home ownership. Roughly 80% of millennials say they plan to get married, and most of them are planning to have children. Overall, more than 80 percent of millennials already live in suburbs and exurbs, and they are, if anything, moving away from the dense, expensive cities. Since 2010 millennial population trends rank New York, Chicago, Washington, and Portland in the bottom half of major metropolitan areas while the young head out to less expensive, highly suburbanized areas such as Orlando, Austin, and San Antonio.

... In this respect what is interesting is that whereas Mr. Trump was elected (partly) because he promised to improve the condition of the American worker, since his election the 0.1% have gained the most as the stock market capitalization has increased by over \$2 trillion. Therefore, by now the wealth of the top 0.1% should exceed the wealth of the bottom 90% for the first time since 1941. Remarkably, the recent pronouncements by Trump and coterie suggest that they equate the stock market strength with a strong economy as well....

Figure 9: Distribution of Wealth in the US, 1917 – 2015



Source: BofA Merrill Lynch, Emmanuel Saez & Gabriel Zucman

Surely the millennials grew up in a more affluent and more “take it easy” environment than the boomers who were brought up by a generation of parents that had experienced the hardship of depression years and the horrors of the Second World War. The millennials’ parents were mostly frugal, debt averse because of the experience of the depression where indebted households lost everything (just like in 2008/2009), and they had a high saving rate.

Therefore, compared to the boomers it is only natural and completely understandable that the millennials’ drive for achievement and thriftiness are inferior to the one that their parents had. But can the relative decline of the financial condition of the millennials be satisfactorily explained by their less entrepreneurial spirit?

The Complacent Class

In “[Dreaming Small – Is America Losing the Restlessness of Spirit That Once Powered Its Economy?](#)” Edward Luce reviews Tyler Cowen’s book [The Complacent Class: The Self-Defeating Quest for the American Dream](#). (See *Financial Times*, February, 17, 2017.).

Luce does not only write perfect English but also describes cynically how today’s society functions by quoting Cowen extensively. He writes:

In his new book, *The Complacent Class*, Cowen expands the scope of the argument to sociology. He believes America's restlessness of spirit is giving way to a safety-first society. Instead of pushing on to the next frontier, Americans are busy gentrifying the neighbourhood. They are also making it harder for others to move in.

We used to suffer from the Nimby syndrome – 'not in my backyard'. Now we have graduated to Banana – 'build absolutely nothing anywhere near anything', says Cowen. Public life is stymied by Cave ('citizens against virtually everything') in which politicians fall back on Nimey ('not in my election year'). Politics has reduced itself to a theatre of symbolic gestures in which pressing issues are left unaddressed. Behind all the electoral volatility lies stasis. Perhaps that is just as well. During the heyday of non-conformism in the 1960s, almost two-thirds of America's federal budget was discretionary. Now almost 80 per cent of it is locked up. Donald Trump is unlikely to change that.

As a matter of fact, it is actually much worse. According to figures provided by www.usdebtclock.org, Tom McLellan calculated that six mandatory "spending items already account for more than all of the tax revenue coming in, and that is before you pay a single federal civilian employee's salary, before any discretionary spending, before any research grants, any foreign aid, any NASA rockets, any state dinners, any toxic waste cleanup, any wall-building, any highway or airport improvements, etc." I shall return to the budget problem further below.

For now, back to Edward Luce, who explains that

Cowen views Trump as the ultimate expression of a country that wants to turn the clock back. America's 45th president is an authoritarian nostalgist who won by promising to shield voters from the forces of change. People were voting for a return to the certainties of the 1950s. 'What I find striking about contemporary America is how much we are slowing things down, how much we are digging ourselves in, and how much we are investing in stability,' writes Cowen. Though they heavily rejected Trump, this is just as true of America's creative classes, says Cowen. America's big metropolises and college towns may be the most liberal enclaves in the country. But they are also the most unequal. Just as zoning restrictions keep out low-income housing developments, so the world of social media allows us to screen out opinions we do not like.

We use dating algorithms to sift our romantic field in the same way employers scour social media to screen out misfits. The internet gives us the illusion of speed and change. In reality it is narrowing the scope for serendipity. America is turning into a society of matchers and sorters. 'We are using the acceleration of information transmission to decelerate changes in our physical world,' says Cowen.

The spirit of risk-aversion is also infecting corporate America. The once lavish budgets companies devoted to research and development are now spent on legal compliance and human resources. Corporate income is no longer invested in future growth. Earnings are instead returned to shareholders through dividends or share buybacks.

The rate of US start-ups has also slowed to a historic low. In the 1980s, by one estimate, such businesses employed 12-13 per cent of Americans. That has now fallen to 7-8 per cent. ‘The complacent class itself has ceased to believe in the regenerative properties of the world we all inhabit,’ says Cowen. **America is ageing and older societies take fewer risks. They also try to hold on to what they have. Perhaps unsurprisingly, the millennial generation is the least entrepreneurial of all, in Cowan’s view. They are ‘most committed ideological carriers’ of the new spirit of complacency.**[emphasis added]

Lately, the spirit of complacency seems to have infected the financial sector as well. Moreover, the “spirit of complacency,” “the spirit of risk-aversion,” and “how much we are investing in stability” is not endemic or unique to the US. It is probably far worse in Europe and in Japan. But these conditions are nothing new. Edward Gibbon wrote that risk aversion was already a problem among the Athenians: **“In the end more than they wanted freedom, they wanted security. When the Athenians finally wanted not to give to society but for society to give to them, when the freedom they wished for was freedom from responsibility, then Athens ceased to be free.”**

To be fair to the millennials (and most of the ones I know personally are very intelligent, hard-working, entrepreneurial, and responsible) government policies and the propaganda machine of the mainstream media encourages their false sense of security as gospel “truth” is largely absent from the government and the mainstream media’s vocabulary. The government lies about its true fiscal position and about the “true” rate of cost of living increases while the FED plays its part by communicating to the public that any economic problem can be overcome by money printing and more money printing.

I have discussed the Chapwood Index in earlier reports. It is published every quarter by monitoring 500 items which households most frequently use across 50 cities. According to the Chapwood Index the real cost of living rose by a startling 9.6% in 2016 – very close to John William’s rate and has averaged 10% a year over the last five years. At the same time, the academic economic charlatans do not exactly encourage “thrift” by advocating negative interest rates and even more negative rates still if the first set of negative rates fails to revive the economy.

The generation of millennials born after 1995 have been shaped by the debt-growth induced 1990s’ period of boom and prosperity, which was driven largely by rising asset prices. The good side of generation Z is that they are not interested in wars (they seldom ever belong to warmongers) and care little about politics. Unfortunately, they have only a scant knowledge of the meaning of “freedom” and “personal responsibility”.

However, they are concerned about political correctness, about having the latest-model iPhone and the number of likes their photos receive and how many followers they have on Facebook. But most of all, they are concerned about extracting as much as possible from the government in the form of subsidies and other kinds of benefits. It is a generation that avoids hard work (such as on the factory floor), and is content to work part-time in bars and restaurants, and to live a carefree

existence. It is also the generation whose major contribution to civilization may be the invention of “retirement before working.”

Needless to say, this concept of retirement before working has been fostered and encouraged by governments, which, with their generous transfer payments, make it more economical for some people not to work, and to collect all kinds of tax-free benefits, than to have a low-paying occupation and pay taxes.

Edward Luce concludes his review of Tyler Cowen’s *The Complacent Class* by noting that Cowen believes,

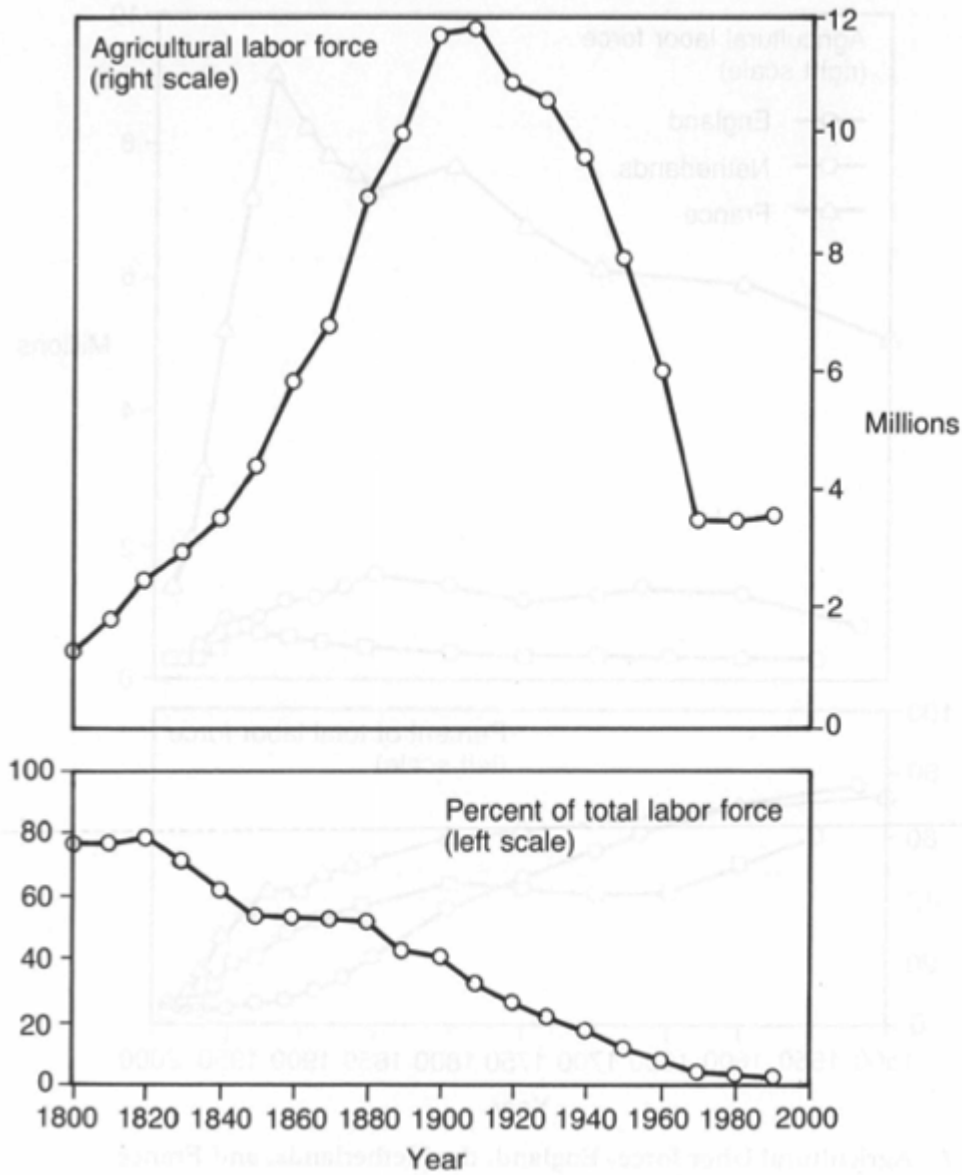
[S]ociety may be returning to a cyclical view of history in which human progress is no longer something we will automatically expect. We may take a generation or so to adjust to the new reality. Millennials are already leading the way. They are the least angry group of Americans politically, perhaps because they have grown up with more realistic expectations than their elders. Bleak though this sounds, millennial passivity is in some ways reassuring, Cowen believes. The anger that carried Trump to the White House may be but a stage on the path to society’s acceptance of lower growth.

In most other ways, Cowen’s thesis is deeply troubling. Democracy requires growth to survive. It must also give space to society’s eccentrics and misfits. When Alexis de Tocqueville warned about the tyranny of the majority, it was not kingly despotism that he feared but conformism. America would turn into a place where people “wear themselves out in trivial, lonely, futile activity”, the Frenchman predicted. This modern tyranny would “degrade men rather than torment them”. Cowen does a marvelous job of turning his Tocquevillian eye to today’s America. His book is captivating precisely because it roves beyond the confines of his discipline. In Cowen’s world, the future is not what it used to be. Let us hope he is wrong. The less complacent we are, the likelier we are to disprove him.

The Distortion of Time and Work

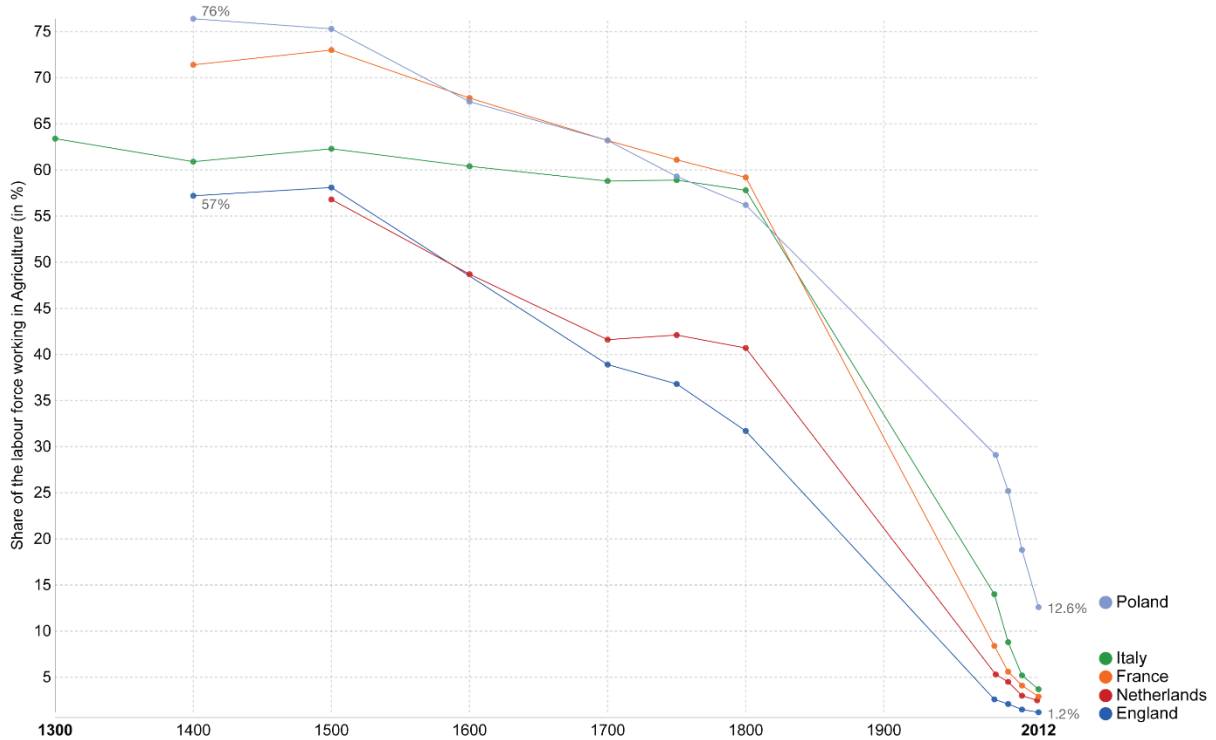
(Final thoughts from John)

What both Cowen and Faber are talking about is a trend that I believe is going to accelerate. In the last few centuries we have seen an enormous displacement of the workforce, particularly in agriculture as the Industrial Revolution took hold and triumphed. We went from 80% of the country working on farms in 1820 to less than 2% today.



This is not just a US phenomenon. I found this cool chart that shows the share of the labor force working in agriculture in the major European countries, going back to 1300. England is down to 1.2%.

Share of the labor force working in agriculture, since 1300 – By Max Roser



Data source: Pre 1800 is from Allen (2000), "Economic Structure and Agricultural Productivity in Europe, 1300-1800". Newer data from the World Bank. The interactive data visualization is available at [OurWorldinData.org](https://ourworldindata.org). There you find the raw data and more visualizations on this topic. Licensed under CC-BY-NC-SA by the author Max Roser.

But those massive changes played out over 20 or so generations. Now, we are witnessing wholesale change in numerous industries in less than half a generation. In a recent TED Talk, Elon Musk showed off a mysterious semi-tractor capable of hauling extraordinarily large loads using electrical power. They have had the prototype for maybe a year. In less than five years, companies will be able to purchase a completely electrically powered self-driving truck. I am sure the first trucks will have a place for the driver to sit, but it won't be long before the need for drivers will disappear. Ditto for taxis and other local transportation. Six million taxi, Uber, and truck drivers will find themselves out of a job. In 10 years. That is not much time to adjust your career path.

We have an economy burdened by debt, coupled with a workforce growing slowly. Further, enhanced productivity (at least the way we measure it now) in the service industries will also mean that fewer people have jobs – not exactly the outcome a labor economist wants to see.

The picture is not entirely gloom and doom. There will be a large cultural shift in the way work and income are allocated. But that is going to require society to go through wrenching changes, because our expectation seems to be that we can somehow get back to the nirvana of the '50s through the '90s. That is just not going to happen. And we're going to have to adjust far more quickly than our great-great-grandparents and their children did in going from the farm to the factory to the office.

So, yes, much angst for the Millennial and younger generations. Helpfully, they seem to be more realistic about their future than my generation was. But they are not as entrepreneurial and risk-taking as previous generations were, and those are the qualities required to grow an economy.

Let's finish with a set of quotes from Tyler Cowen's book *Average Is Over*.

Being young and having no job remains stubbornly common. Wages for young people fortunate enough to get a job have gone down. Inflation-adjusted wages for young high school graduates were 11 percent higher in 2000 than they were more than a decade later, and inflation-adjusted wages of young college graduates (four years only) have fallen by more than 5 percent. Unemployment rates for young college graduates have been running for years now in the neighborhood of 10 percent and underemployment rates near 20 percent. The sorry truth is that a lot of young people are facing diminished job opportunities, even several years after the formal end of the recession in 2009, when the economy began to once again expand after a historic contraction.

At the same time, the very top earners, who often have advanced postsecondary degrees, are earning much more. Average is over is the catchphrase of our age, and it is likely to apply all the more to our future. This maxim will apply to the quality of your job, to your earnings, to where you live, to your education and to the education of your children, and maybe even to your most intimate relationships. Marriages, families, businesses, countries, cities, and regions all will see a greater split in material outcomes; namely, they will either rise to the top in terms of quality or make do with unimpressive results.

These trends stem from some fairly basic and hard-to-reverse forces: the increasing productivity of intelligent machines, economic globalization, and the split of modern economies into both very stagnant sectors and some very dynamic sectors. Consider the iPhone. The iPhone is made on a global scale, and it blends computers, the internet, communications, and artificial intelligence in one blockbuster, game-changing innovation. It reflects so many of the things that our contemporary world is good at, indeed great at. Today's iPhone would have been the most powerful computer in the world as recently as 1985. Yet to cite two contrasting sectors, typical air travel doesn't go faster than it did in 1970, and it is not clear our K-12 educational system has much improved.

This imbalance in technological growth will have some surprising implications. For instance, workers more and more will come to be classified into two categories. The key questions will be: Are you good at working with intelligent machines or not? Are your skills a complement to the skills of the computer, or is the computer doing better without you? Worst of all, are you competing against the computer? Are computers helping people in China and India compete against you?

If you and your skills are a complement to the computer, your wage and labor market prospects are likely to be cheery. If your skills do not complement the computer, you may want to address that mismatch. Ever more people are starting to fall on one side of the

divide or the other. That's why average is over. This insight clarifies many key issues, such as how we should reform our education; where new jobs will come from and why (some) wages might start rising again; which regions will see skyrocketing real estate prices and which will empty out; why some companies will get smarter and smarter, while others just try to ship product out the door; which human beings will earn a lot more and which workers will move to low-rent areas to make ends meet; and how shopping, dating, and meeting negotiations will all change.