

# Stocks, Mortgages and Social Security -- *Looking Beyond "Total Returns"*

Thornton "Tip" Parker

Author: *What If Boomers Can't Retire*

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# 74 Years of Total Returns

S&P 500 Index: 1926-1999

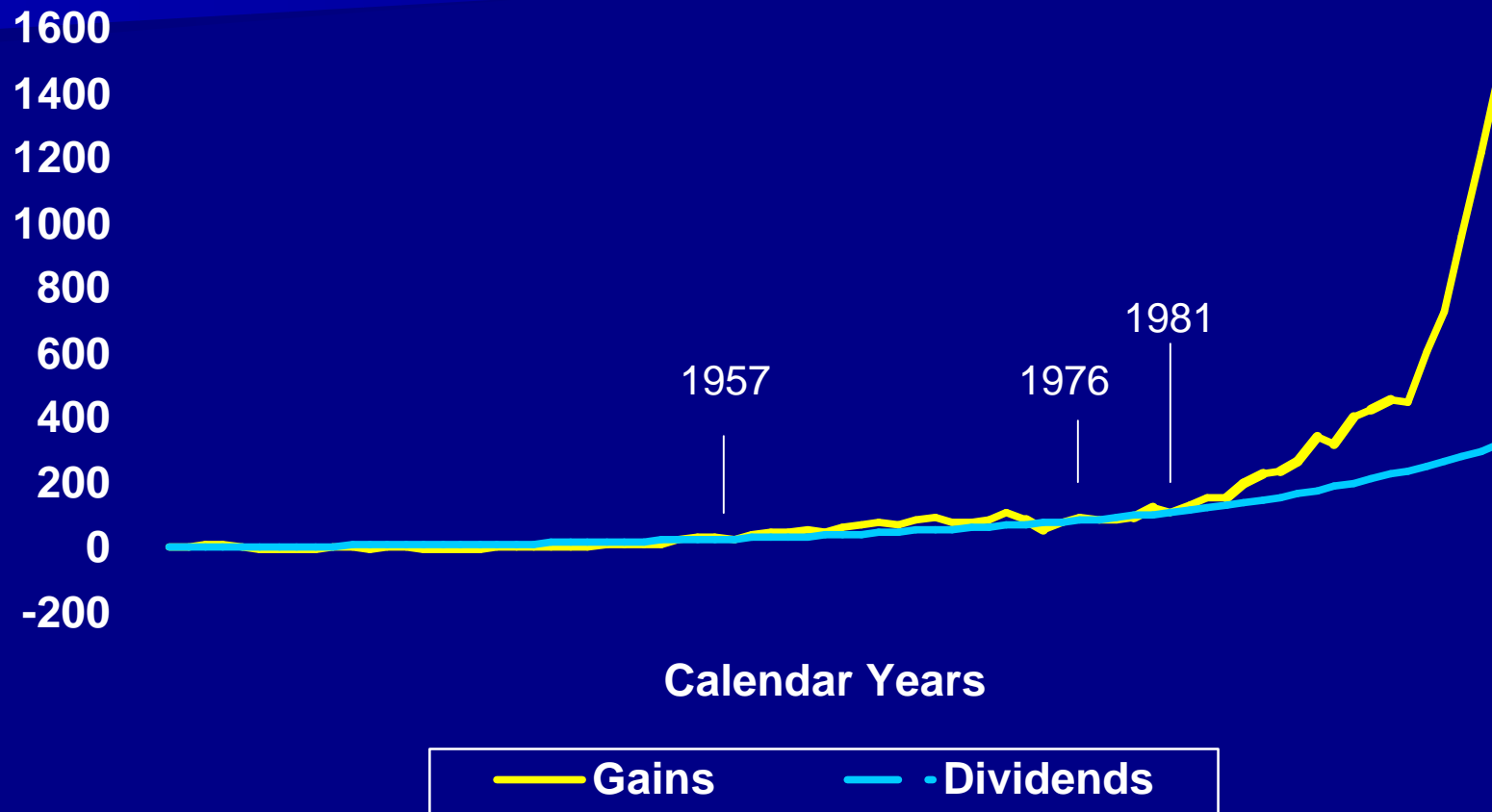
2000  
1800  
1600  
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1200  
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600  
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Calendar Years

— Total Returns

# Gains and Cumulative Dividends

## 74 Years: 1926-1999



# 74 Years of Total Returns

## S&P 500 Index – Two Different Periods

	<u>1926-81</u>	<u>1982-99</u>
Years	56	18
Starting value	12.76	122.60
Ending value	<u>122.60</u>	<u>1469.30</u>
Total gains	109.84	1346.70
Total dividends	<u>110.99</u>	<u>206.78</u>
Total returns	220.83	1553.48

# Gains, Earnings, and Dividends

	<u>1981</u>	<u>1999</u>	<u>Change</u>
S&P 500	122.60	1,469.30	12x
Earnings	15.18	45.17	3x
P/E ratio	8.1	32.5	4x
Dividends	6.83	16.71	2.4x
P/D ratio	17.9	87.9	5x

# Major Non-Financial Developments

- End of Cold War
- Emerging technologies
- Industry deregulation – utilities, communications, and transportation
- Industry consolidation and “rationalization”
- Globalization
- Baby boomers enter peak earning years

# Major Financial Developments

- Venture capital and NASDAQ
- Declining interest rates
- Market deregulation and low trading costs
- Stockholders' rights movement and LBOs
- Growth of retirement plans

# Pension and Mutual Funds Also Inflated Stocks

- Strong promotion – Bayer vs. generic aspirin
- Periodic savings – few investment alternatives
- Price/dividends, price/earnings, etc. don't apply
- Effects of S&P 500 Index
- Dormant holdings reduce supply for trading
- Increased demand for shrinking supply

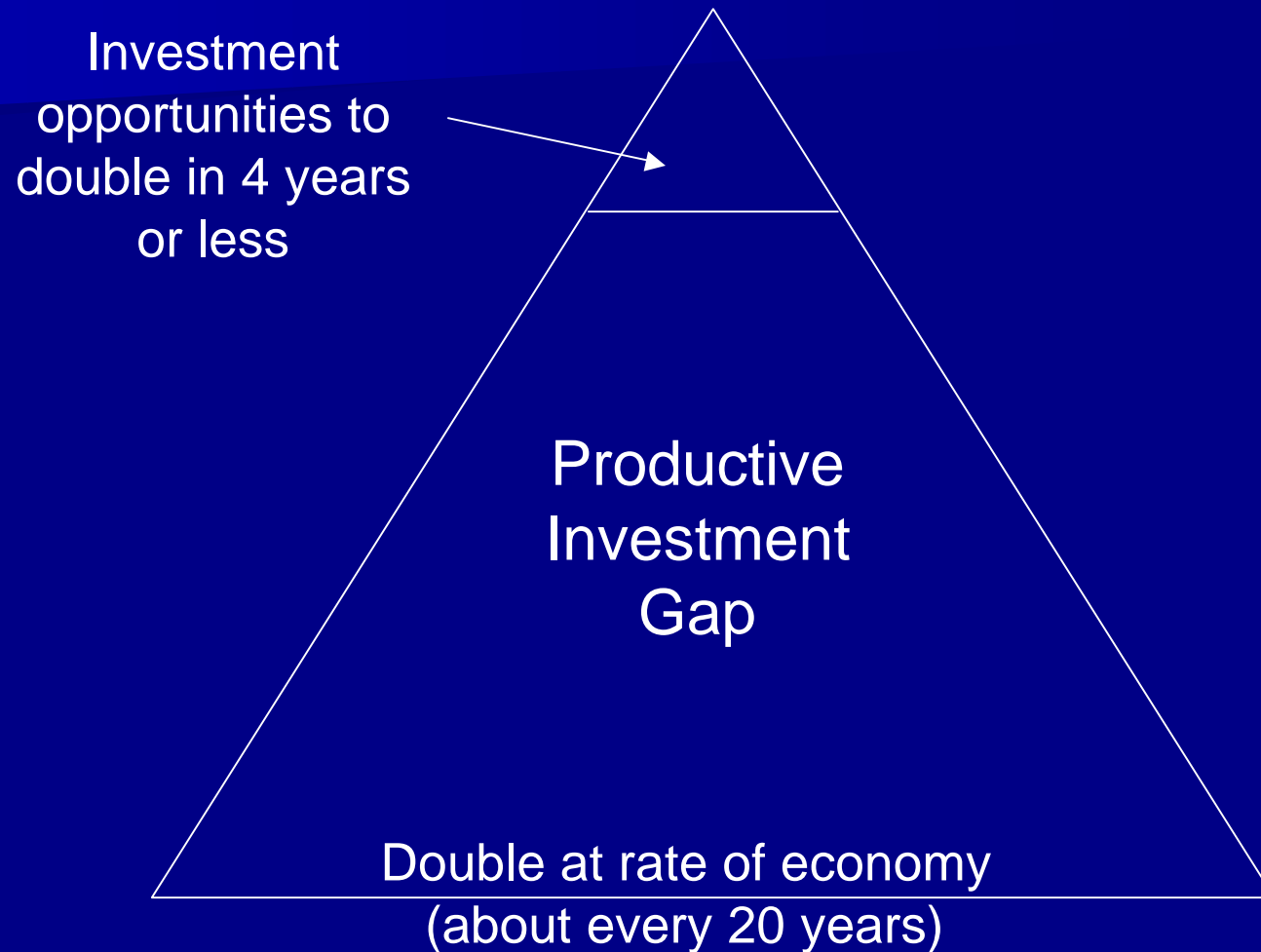
# America's Accidental Retirement System

- IRS rule opened 401(k) plans to regular income
- No systematic plan or design
- Shift to individual responsibility
- Promotion of stocks and mutual funds
- Growth of mutual funds
- Pressure on fund managers for portfolio gains
- Pressure on companies to inflate stocks

# Companies Respond By

- Cost-cutting, downsizing, laying of employees
- Abandoning communities and promoting globalization
- Exporting jobs and manufacturing
- Shorter time horizons for internal investments
- Acquiring and merging instead of growing
- Productive investment gap

# The Productive Investment Gap



# Net Stock Buyers and Sellers

\$ Billions

	Year-end Balances		Net Flows	Growth Rate %
	<u>1981</u>	<u>2007</u>		
Total Market	1,382	21,464	(1,099)	11.94
Net Buyers (Corporations)	249	13,250	5,372 <u>1,099</u> 6,471	8.12
Net Sellers	1,133	8,214	(6,471)	14.57

# Net Stock Buyers

\$ Billions

	Year-end Balances		Net Flows	Growth Rate %
	<u>1981</u>	<u>2007</u>		
Mutual Funds	37	5,443	2,114	8.93
S/L Govt. Pens.	48	1,981	454	7.90
Life Insurance	46	1,518	1,029	1.80
Rest of World	75	2,806	1,067	9.00
Other Domestic (Corporations)	43	1,502	708	NA
	<u>      </u>	<u>      </u>	<u>1,099</u>	<u>NA</u>
Net Buyer Totals	249	13,250	6,471	8.12

# Net Stock Sellers

\$ Billions

	Year-end Balances		Net Flows	Growth Rate %
	<u>1981</u>	<u>2007</u>		
Households	905	5,447	(5,535)	15.50
Private pensions	<u>228</u>	<u>2,767</u>	<u>(936)</u>	12.50
Net Seller Totals	1,133	8,214	(6,471)	14.57

\$1 invested at 15.50% for 26 years would grow to \$42.38

\$1 " " 14.57 " " " " " " 34.34

\$1 " " 8.12 " " " " " " 7.61

# Households of Corporate Insiders

- Get large blocks at low or “wholesale” prices
- Sell some shares at market or “retail” prices
- Market sets price of shares insiders keep
- Bill Gates took 45% of Microsoft stock, sold more than 2 billion shares (146 million for \$4,369,821,000 in past 2 years)
- Gates still has 793 million shares.
- Gates sold 1/3 of all Microsoft bought by retirement plans
- Retirement plans make a market for insiders, transfer workers’ savings to insiders, and help concentrate wealth

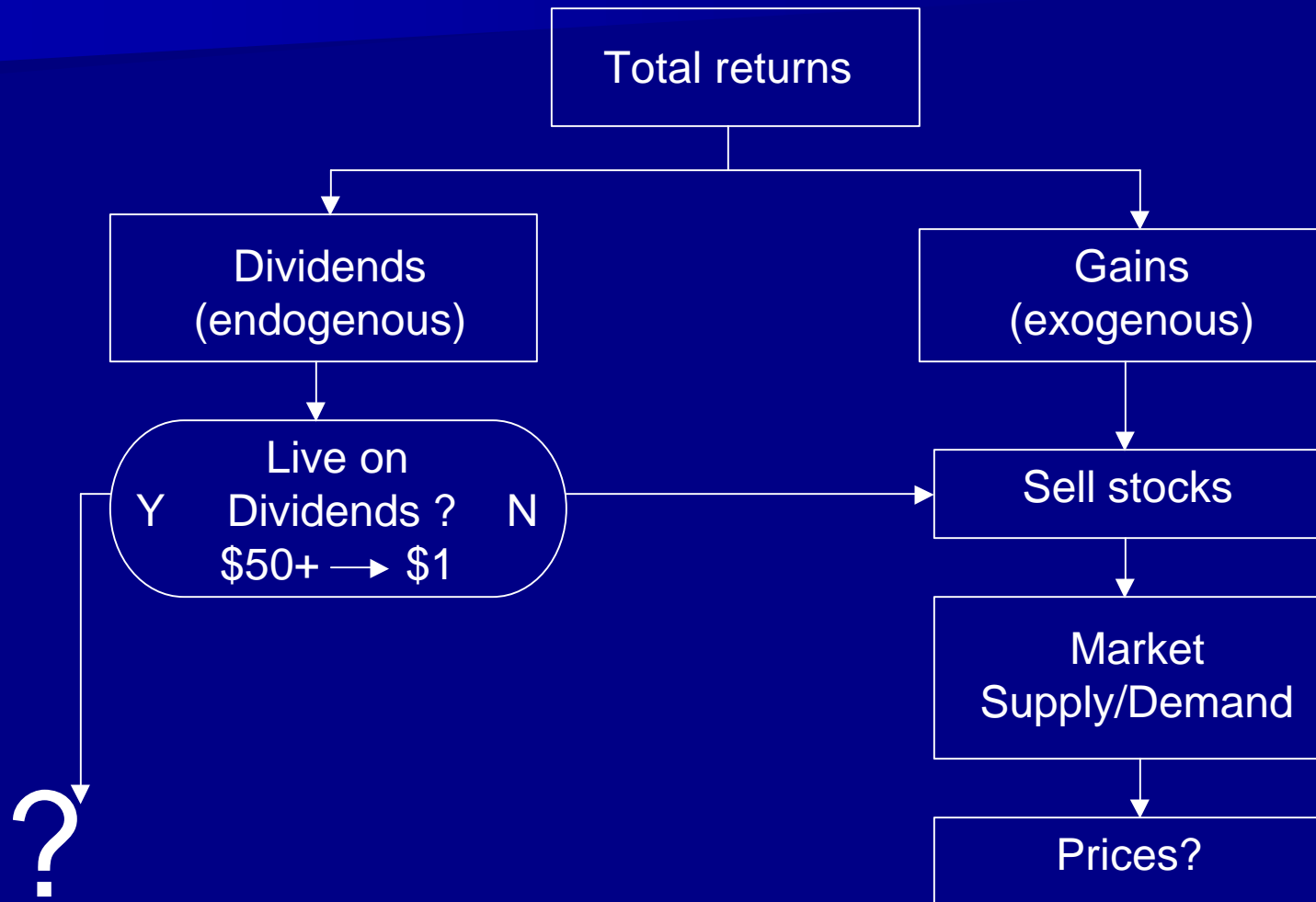
# Insider Buying and Selling

2006\*

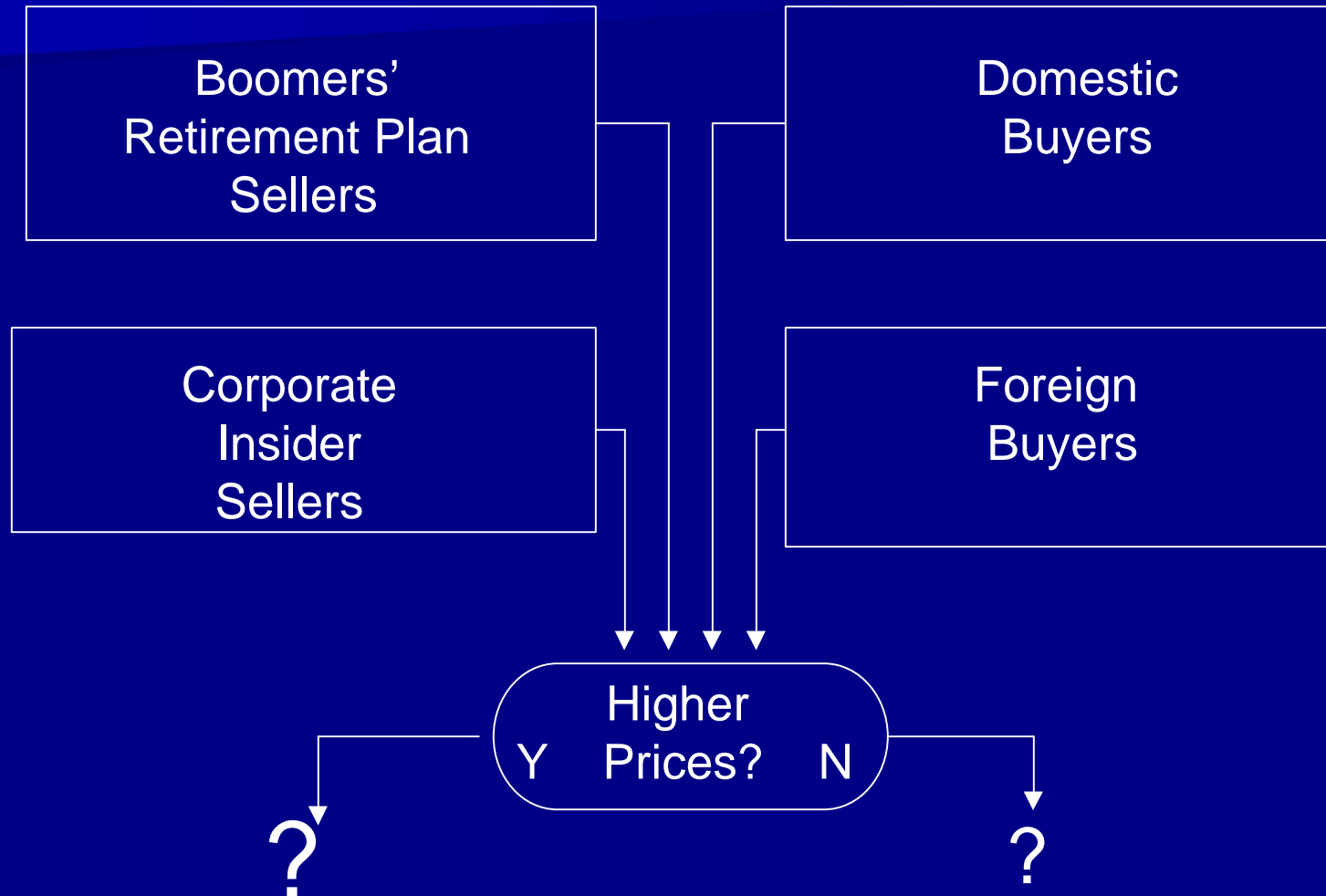
- Insiders bought \$1.5 billion worth of stocks
- They sold \$57.5 billion worth
- Ratio of selling to buying, 37 to 1

\* From "Insider Trading Spotlight," *The Wall Street Journal*  
Excludes pure options transactions

# Converting "Total Returns" Into Retirement Income



# Future Stock Market Supply/Demand



# The Retirement Stock Inventory

## 1982 – 2007 (\$ Billions)

	<u>1981</u>	<u>2007</u>
Retirement plans: Private plans	228	2,800
F/S/L govt. plans	48	2,130
IRAs		1,373
Mutual funds		2,804
Life insurance cos.	<u>46</u>	<u>1,518</u>
Total	322	10,625
Total market	1,382	21,464
Less: Foreign holdings	75	2,806
Privately held companies	<u>207</u>	<u>3,220</u>
Domestic public holdings	1,100	15,438
Retirement plan holdings	29%	69%

# Forget “Total Returns”— Watch the Cash Flow

Retirement Plans	Contributions		Retirement Incomes
	Paid by	Go to	Paid by
Social Security	Workers Employers	Retirees Federal Govt.	Workers Employers Federal tax payers
Company Pension (Stock portion)	Companies Workers (maybe)	Retirees Stock sellers	Companies Workers (maybe) <b>Stock buyers*</b> Pension Benefit Guaranty Corp
S&L Govt. Pension (Stock portion)	S&L Govts. Workers (maybe)	Retirees Stock sellers	Workers (maybe) <b>Stock buyers*</b> S&L taxpayers
Defined Contribution (Stock portion)	Workers Employers (maybe)	Stock sellers	<b>Stock buyers*</b>
IRAs (Stock portion)	Individuals	Stock sellers	<b>Stock buyers*</b>

\* **Most stock buyers are the same workers who may not sustain Social Security**

# Mortgages, Retirement Plan Stocks, and Social Security

- Mortgage lenders assumed increasing home values and ignored buyers' cash flow and ability to pay
- Retirement plans assume increasing stock values, ignoring companies' abilities to pay future dividends and younger worker's abilities to buy stocks at inflated prices
- Mortgage/home crisis is a precursor to the boomers' retirement stock plan sales
- Primary domestic buyers of boomers' stocks will have to be the same younger workers who some believe will not be able to sustain Social Security in its present form

# U.S. Retirement Plans

- Have damaged economy and society
- Transfer income from workers and employers to corporate insiders and retirees
- Already hold over 2/3 of the domestically-owned stocks traded on U.S. markets
- Have benefited from major, one-time events
- No accepted explanation of how they can work
- Retirement incomes must come from future investors, not company earnings -- definition of a Ponzi or pyramid scheme
- When boomers' retirement plans sell, stock prices can be expected to drop and that may lead to a depression
- *Historic "total returns" are useless and misleading*

# Demography and the Long-Run Predictability of the Stock Market

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# If this interests you,

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# To prevent a disaster:

Individuals, companies, universities, financial service industry, foundations, think tanks, and governmental organizations must:

- Identify major risks, problems, and opportunities due to interaction of retirement plans, stocks, and globalization;
- Publicize the risks, problems, and opportunities; and
- Develop practical solutions including new financial instruments and institutions, policies, plans, and advice.