Ageing, it happens. So how do we profit from it?

By John O'Connell

It happens to the best of us; we get wiser and our hair more grey, but other than that, nothing changes. We still fit into our jeans, although it is fortuitous the style nowadays is relaxed fit, eyewear is a fashion accessory, skiing and cycling means we 'run' faster than ever before, and yoga supplants a good stretch. 9.30 heralds lights out rather than 'Whose shout?' – best be fresh to gather over brunch – after all, this was an underappreciated mealtime for oh so long.

Ageing. It seems to affect most of us at some stage. And when it does our buying patterns change.

For an investor, demographics is the long game. It is a way of sidestepping the short-term volatility by investing along secular and demographic trends.

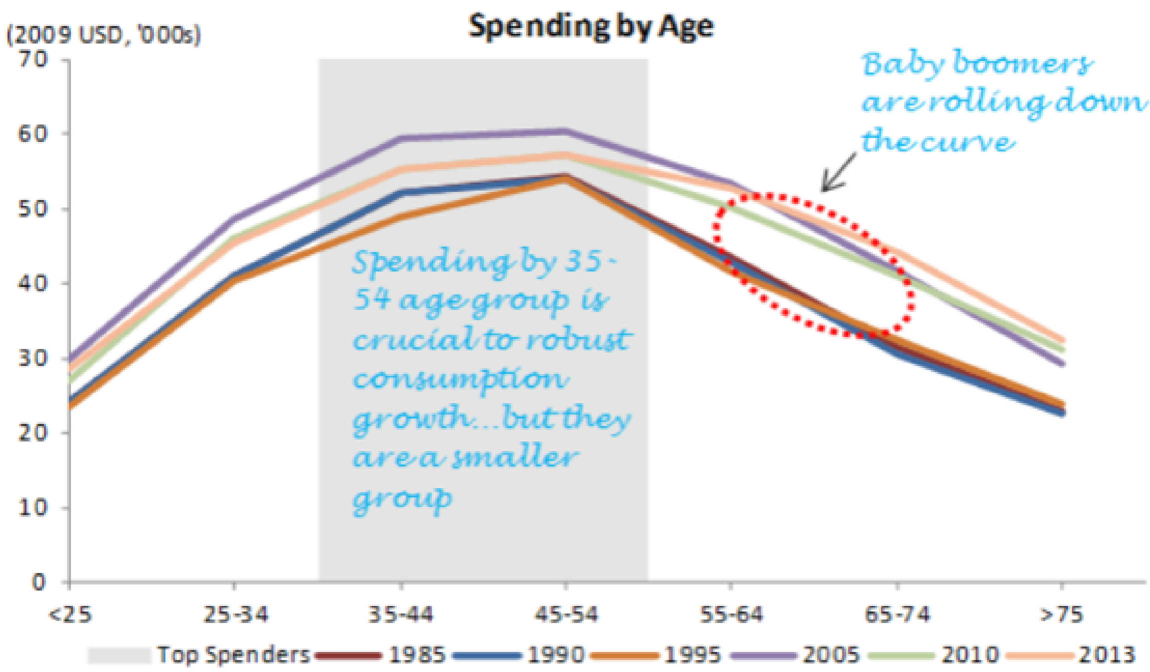
When the buying patterns of a large block of consumers change, demand for goods and services shift. It is well known that at Owners we steer our investors to position their portfolios for tailwinds and avoid the headwinds. Management is crucial to execution of a business strategy, but when management is followed by an industry tailwind, all manner of missteps are just franchise-enhancing experiences. In the face of a headwind they can be career-limiting, poor-judgement choices.

Many people are aware that as the largest demographic cohort – the baby boomers – get older, the market's 'average consumer' ages, and hence demand for product shifts subtly. Most however underestimate this subtle shift's effect on demand for specific goods and services. Whole industries have risen and fallen on the wave of boomer demand moving through the ages.

In fact, one of the greatest issues causing our current stagnation of western economies is the boomer effect.

It may come as a surprise at first, but through the ages, your peak spending has occurred at around 46 years of age. And like all things human, there is a psychology to this effect. At this age you have climbed most of the way toward your peak career rung – in fact in Australia even the average age of the very top rung, CEO, is 53 yrs. So at around 46 you feel attainment. You also feel relatively secure in your employment position and you still feel young. Retirement is something you plan to get on top of, but not all that necessary to worry about today. Add to this your typical household circumstances – partner, three teenage kids, dog, and a deep desire to signal to the world 'I've made it'. All this confidence in your attainment means your savings versus consumption habits have tilted to favour consumption. You buy the biggest house you are likely to own (justifying it as the family home), your car choice is as much about what the brand portrays as about the miles it can cover, holidays are as much about the bragging rights as the unwind, and the high-school-age kids are eating you out of house and home. This is peak spend, consumer style.

Your inner peak consumer surfaces at 46 years old



Source: FactSet, Owners Advisory, June 2016

And for Australia, this all happened almost a decade ago. Today's peak spenders are generation X. Per head, they spend just like we did, problem is there are simply fewer of them, which means not as many peak consumers to ring the tills. The baby boomers are currently 53–73 years and the last of us moved through peak spend just as the western world also hit peak consumer debt in 2006 (coincidence? I think not).

"We will consume all and every service that keeps us living in our castle as long as possible – after all, we are forever young."

Our consumption – our aggregate demand – was pumped up by large numbers of us at 'that stage in our lives' amplified by a peer group willingness to strap on debt.

Roll forward to today, and thrift is the new black.

As the baby boomers are starting to discover retirement in ever-increasing numbers (remember the middle of them is now the magic 63–65 years retirement age) all the psychological factors that encouraged peak spend are being supplanted by a new psychology. A new way of signalling to each other that 'I've made it'. But given we are no longer climbing the career ladder (did that), our net status isn't defined by our business card. We all bought McMansions, and trophy asset houses are only attainable by a very few of us. So how do we now compete if thrift is in and blatant consumerism is out?

We spend fortunes trying to show we aren't older! Psychologists have shown that each of us, in our minds eye, likes to think of ourselves as 15 years younger than what we actually are. We want to show the world we've still got it. Slim, supple, athletic – taut and terrific – are the new must haves. And we will spend the kids' inheritance to hang onto it.

The tailwind for investors then lies in correctly identifying the companies that fulfil this desire.

However, it is not as simple as buy any aged service – as Australian investors in the aged care sector found out recently. There are several nuisances here that you need to weigh to get the tailwind effect and avoid the ageing headwinds.

Firstly, if the government is a significant part of the funding mix for the service, then don't expect cash-strapped governments to continue to shower a sector with largesse.

Think of the case of the aged care sector. Its first problem is it is not really a baby boomer sector.

Baby boomers are trying to do everything to stay young – aged care homes aren't for us. The forecasts of rapidly escalating demand for aged care facilities will result in too much capacity coming on stream as we baby boomers cling onto 'ageing in the home'. The current demand wave is baby boomers putting their parents in these facilities, and so long as the government foots the bill, then their fine about fat margins to operators. But once government decides to cut back on rebates, the baby boomers will coax the parents to, (how do I put this?) a more value-for-money way to live out the twilight years.

For us baby boomers, any innovation that plays to our mental picture of 'active retirement no longer working' will sell well. We will consume all and every service that keeps us living in our castle as long as possible – after all, we are forever young.

Hospitals and pharmaceuticals are services/goods that the baby boomers will use to keep their active lifestyle going for as long as they can. We will wear out hips at an aggressive rate ... but we will also expect a new one at the ready ... we pioneered disposable products after all! Medical device companies that service wear and tear will do well, Stryker (SYK NYSE), St Jude Medical (STJ NYSE) benefit here.

Hospitals are motels for sick people, and the profitability of any motel is primarily driven by occupancy rates, so baby boomers getting new hips is a tailwind. Ramsay Healthcare (RHC ASX) and Healthscope (HSO ASX) are the two Australian listed hospital operators.

But the real profits are made by companies that exploit our desire to pamper ourselves. No one likes paying utilities bills, and we expect our bodies to work, but Joan Kirner did nail the psychology when she popularised the term 'retail therapy' as a desirable pastime. We like to pamper ourselves and we need a new way to signal our youthfulness. Companies that provide products and services that meet our desire for these attributes have both tailwind and pricing power.

As we retire 'young' we need ways to fill our days. Local travel and entertainment is a beneficiary when we are active and with time to spare – Netflix (NFLX Nasdaq), Star Entertainment Group (SGR ASX), Mantra Group (MTR ASX).

With more free time and less office chatter, we look to coffee shops to catch up with friends and satiate our desire for social interaction. Silver Chef (SIV ASX) is the listed entity that gets its tailwind from the coffee shop dynamic.

Finally social media platforms create peer pressure to flaunt our zest for life and virtuous self. Photos of us in luxury holiday destinations are placed on our Facebook profile simply to give our friends something to like. And this inspires them to return the favour, which in turn gives Carnival Corporation (CCL NYSE), Royal Caribbean Cruises (RCL NYSE), or Harley-Davidson (HOG NYSE) a pep in their step.

Aside from cruising, adventure travel is also booming – part of the not-old-yet thing. Anecdotally, healthy boomer women are increasingly travelling on their own, leaving their partner with a crook hip at home to feed the dog.

As always with investing, entry price matters most as that is what you can control. So the secular theme doesn't supplant the need to weigh valuation, but it does provide a better margin for error.

Ageing, it can be an investor's best friend.

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