MILKEN INSTITUTE

The Power of Ideas

2017 | Insights for Building Meaningful Lives

Jim McCaughan

President, Global Asset Management and CEO, Principal Global Investors

Technology and Retirement: Shifting Opportunities

Technology has made it possible for us to live better, longer, and more meaningful lives. And that's cause for great optimism and positivity. At the same time, though, technology has had a subtle pernicious effect on long-term savers. In the coming years, everyone from institutional investors and insurance companies to individual retirement savers and retail investors will need to grapple with those effects. But, at its heart, this is a story about opportunity.

Technology is an unquestionable benefit to humanity. The average human being expects to live nearly two decades longer now than in 1960, primarily because of advances in medicine, biotechnology, and agriculture. Economic productivity has seen tremendous progress, led by technology. Processes that used to rely on manual labor are now accomplished in a fraction of the time, at a fraction of the cost, with only a fraction of the human input. This frees up labor and capital to find more productive uses in the economy. That revolution, in every area from agriculture to manufacturing, has brought down the costs of goods and services. It has put a middle class lifestyle within reach of more people than at any time in history.

Yet, those exact same factors have also led the global economy to a period of low interest rates. With technology acting essentially as an ever-present deflationary force, both price inflation and interest rates have been pushed to historic lows. We've seen that play out over the last several years: the end of the commodity supercycle; a flood of cheap, high-quality manufactured goods; and a long period of ultra-low interest rates.

Next, consider that the global demographic trend of an aging population combines with the advances in longevity to allow people to live for longer in their retirement years. With a generation of baby boomers currently transitioning into retirement, we're seeing a

Jim McCaughan

global shift in investment priorities. Accumulating a "nest egg" becomes living off that nest egg. This means an excess amount of savings will be looking for fixed income and other yield assets. I believe this creates a structural overhang for capital markets, where increasing amounts of capital are chasing the same assets. This overhang translates into yields on bonds, real estate, and other yield-producing assets that are likely to be structurally lower than they otherwise would have been.

A "lower for longer" world makes it more challenging to save for retirement or any other long-term financial goal. Without higher yields to bolster savings and facilitate payout, more time is needed to get to the same place.

Technology has created a truly global economy. It has shaped vast, connected capital markets where mom-and-pop investors in Nebraska can easily and cheaply invest money with small manufacturers in places like Bangkok. Technology has also allowed investors to consider cheap,

"The opportunity to succeed financially hasn't gone away; it's just shifted."

efficient passive tools to supplement their savings. Yet, technology has also opened up opportunities for a renaissance in active management.

The opportunity to succeed financially hasn't gone away; it's just shifted.

Significantly, I see a shift where equity management becomes a stockpicker's market. Investors will value growth even more in the absence of high interest rates. Technological change and deflationary pressures will choke off weak business models quite rapidly, and active managers will be able to protect their investors by finding the success stories. This suggests that identifying and weeding out companies and business models that are susceptible to industry disruption and deflationary obsolescence will become a key skill. Similarly, there are areas of the capital markets where passive management has not or cannot penetrate. Those are areas of opport-unity with inefficiencies that active managers can exploit. Rather than a tragic story of missed chances and lost opportunities, I see this as the beginning of an era where investors will have the choice and power to find the right mix of effective passive strategies and efficient, powerful active solutions to meet their financial goals.