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The age-old question: Will rates rise in the long term?

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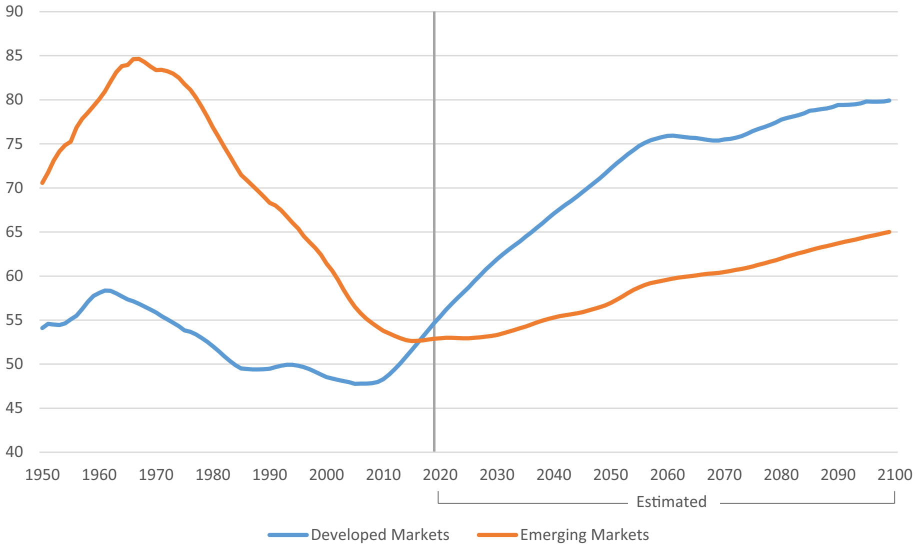
WITH INVESTORS FOCUSED ON THE NEXT FEDERAL RESERVE (FED) MEETING, I THINK NOW IS A GOOD TIME TO TAKE A STEP BACK AND ASSESS THE LONGER-TERM OUTLOOK FOR INTEREST RATES. An important demographic trend may keep rates low for years to come.

Around the world, the ratio of dependent young and old people relative to working-age populations is rising. As **FIGURE 1** shows, the global dependency ratio is forecast to climb for decades, potentially hampering economic growth and stifling interest rates.

When an economy has fewer working-age people, tax revenues may shrink, government spending may increase, and productivity tends to decline—all of which can hinder growth. **FIGURE 1** also reveals that the dependency ratio in developed markets is expected to rise more than in emerging markets. This difference is driven by the more rapid aging of populations in developed markets, which, though present in emerging markets, is partially offset by higher birth rates.

Though this global demographic shift may keep rates low over the long term, many other cyclical factors can drive rates in the short term. For example, if global growth decelerates, US rates could fall as yields become more attractive relative to their global counterparts. However, if the outlook improves due to some combination of lower trade tensions, stronger consumer spending, widespread fiscal stimulus, or increased productivity, US rates could rise.

FIGURE 1
Dependents will outnumber workers for years
Global dependency ratio (%), historical and forecast



The dependency ratio is calculated as the number of people younger than 15 and older than 64 divided by the number of people who are 15 to 64 years old. | Sources: Haver, United Nations as of 8/19. | For illustrative purposes only.

Key Points

- Economic and demographic changes tied to an aging workforce could keep rates lower for longer.
- However, if a combination of other factors such as lower trade tensions, stronger consumer spending, widespread fiscal stimulus, and/or increased productivity improve, US rates could rise.
- Investors might consider a structural allocation to fixed income and emerging markets, as well as adding to US credit.

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Investment Implications

- **Consider maintaining a structural allocation to fixed income.** Most types of fixed-income securities have tended to benefit from stable or falling yields, which may never return to the heady levels of the 1980s—or even the high-single digits of the 1990s.
- **Consider increasing a structural allocation to emerging markets.** The weaker long-term demographic headwind may make emerging-market risk assets attractive relative to developed-market risk assets over the long term.
- **Over the next six to 12 months, consider adding to US credit and favoring investment-grade bonds over high-yield bonds.** I find credit fundamentals to be decent given reasonable spreads and the prospect of falling interest rates over the near term.

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