

Getting Ahead: The Financial Challenges for Generations X and Y

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Similar to the baby boom generation, members of generations X & Y have financial priorities that include **home ownership, funding **college education** and saving and investing for **retirement**. Achieving these goals requires a different approach to developing and implementing a financial plan that resonates with generations X & Y.**

Born into a Complex and Fast-Changing World

The pace of change in the world today compared to a generation or two ago can be illustrated by the speed of adoption of new technologies. In 2003, Apple launched iTunes¹ and after only five months, 10 million songs had been downloaded. Just over a year later the total was 200 million songs. By February 2010, a period of less than seven years, more than 10 billion songs had been downloaded through iTunes alone. Compare this with the relatively stable 400 to 500 million albums (including vinyl, 8-track, cassette and CD formats) sold each year throughout the 1970s and 1980s through all retail channels.²

While prices on some consumer items is in decline, the cost-of-living is increasing

Despite a huge increase in sales volume, overall revenue from U.S. music sales fell by almost

57% between 1999 and 2009.³ Prices for technology hardware and software have also dropped considerably in recent decades. But as the price of hardware and software has fallen, the cost of many basic needs of generations X and Y have increased, often at a pace well above inflation. For example, the cost of purchasing a home in the U.S. has risen between the mid-1980s and 2013 by about 19% in terms of the average household income. During this period, average home prices have more than doubled on average in many major urban areas, a pace much higher than the increase in income. This increase is actually down from almost three and half times the price during the bubble which peaked in 2006. Some urban areas, such as San Francisco and Los Angeles have seen house prices increase to more than triple during this period ending in 2013⁴. The increase in the cost of living, compared to what baby boomers experienced, will be one of the key factors that dramatically challenge the ability of generations X and Y to achieve their goals, unless they make the changes necessary to deal with this new reality.

The rate of economic and cultural change is exponential compared to a few decades ago.

Generations X & Y must deal with a new reality.

	Generation X	Generation Y
Born	1965 to 1980 ⁶	1981 to 2000 ⁸
Age Range	33 to 48	13 to 32
Population/ Labour Force %	26.6/32.0 ⁷	27.4/25.0
Significant World Events	The introduction of the personal computer, dissolution of the Soviet Bloc, the establishment of the European Union, high unemployment in the 1990s	The internet, 9/11, economic and cultural globalization

How Generations X & Y See The World

Stereotypes perpetrated by baby boomers, people born between 1946 and 1964 — and by generations X and Y themselves — don't acknowledge just how similar these generations are. Generation Y (also known as the millennials) is largely perceived by other generations to be independent, confident, obsessed by social media, cynical and impatient, while generation Xers are thought to be self-confident and demanding to have their opinions heard. This is in sharp contrast with the way that baby boomers are perceived. Baby boomers are considered to be loyal and committed team players who help to drive change over the long term within their organizations, although they are seen as less technological savvy than generations X and Y. Despite these widely differing perceptions, the generations have much in common.⁵

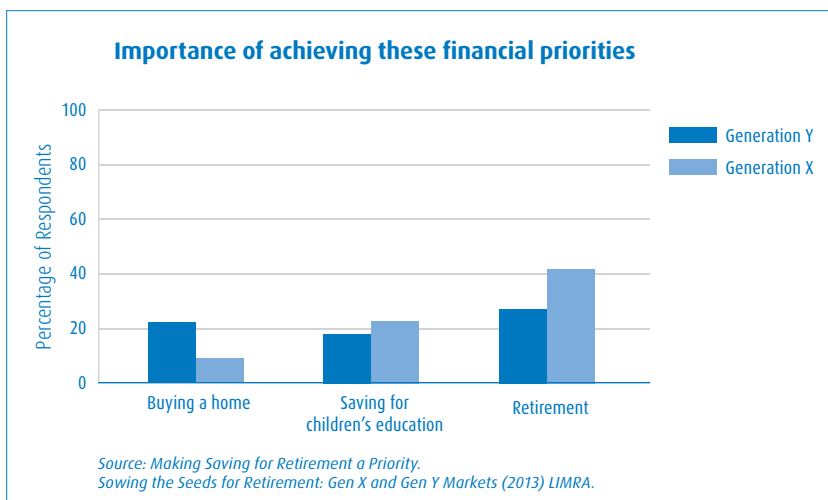
Both of these generations have felt the impact of the demise of the traditional two married parent family. Between 1980 and 2012 the percentage of children who lived with two married parents has dropped from 77% to 64%.⁹ Many families now have both parents working outside the home, increasing the number of latch-key kids. The economic boom-and-bust cycles have had major implications for their employment opportunities. All of these events have affected how these generations feel about the world around them and their ability to move forward.

Financial Priorities for Generations X & Y

Generation X and generation Y have many financial concerns in common with earlier generations, including the baby boomers. In a recent LIMRA study, generation X and generation Y listed buying a home, saving for children's education, and preparing for retirement among their top reasons for saving.¹⁰

Despite widely differing perceptions, the generations have much in common.

The experiences of generations X & Y have created a new worldview and changed perceptions of how best to move forward.



Generations X & Y listed buying a home, saving for children's education and retirement as their top reasons for saving.

Buying a Home

Being between the ages of 33 and 48, generation X is at a point where marriage, family and owning a home have become important priorities for many of its cohort. In the study, a high percentage of both generations X and Y noted that they felt it was important to buy a house in their lifetime. Members of generation Y surveyed were slightly more positive about this goal, having more desire (25%) than generation X (11%).

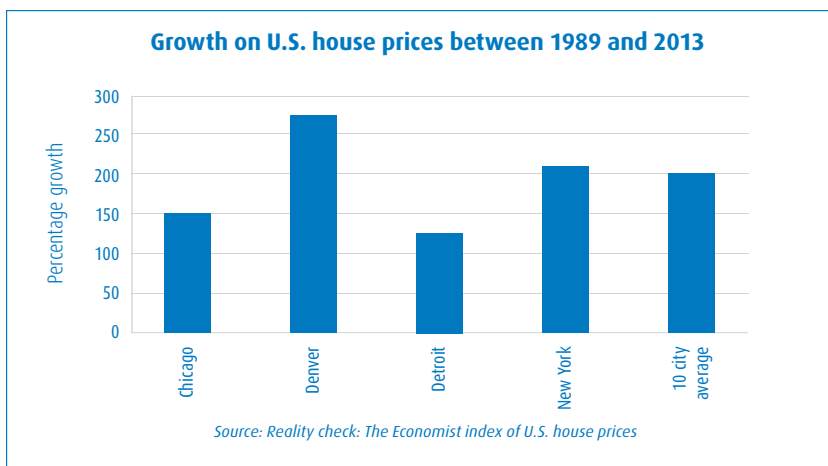
Some of the optimism shown by generation Y may be the result of not yet having considered the high costs of home ownership and tightened access to credit. Many in generation Y have only been in the workforce for a few years and are not yet focused on entering the housing market to purchase a family home. They are also still struggling with student debt that on average is about \$25,000.

The average age of a first-time homebuyer in the U.S. has consistently been between 30 and 32 over the last 30 years — encompassing much of generation X.¹¹ The first wave of generation Y is only now entering the housing market in any meaningful numbers, which may cause their level of optimism to drop in the next few years.

The real cost of home ownership in the U.S. has increased significantly since the time when baby boomers and generation X were purchasing their first homes. In the last 30 years, incomes have risen by only 27% on average (\$55,881 in 1980 to \$70,970 in 2010),¹² yet according to U.S. Census data average housing prices have more than tripled in this same period (going from \$76,400 in 1980 to \$272,900 in 2010).¹³ Generation Y is faced with the uncomfortable reality that the average house in U.S. now costs

Generation Y may not have considered the high costs of home ownership.

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Generation Y will have to work harder to save more than earlier generations to accomplish the goal of home ownership.

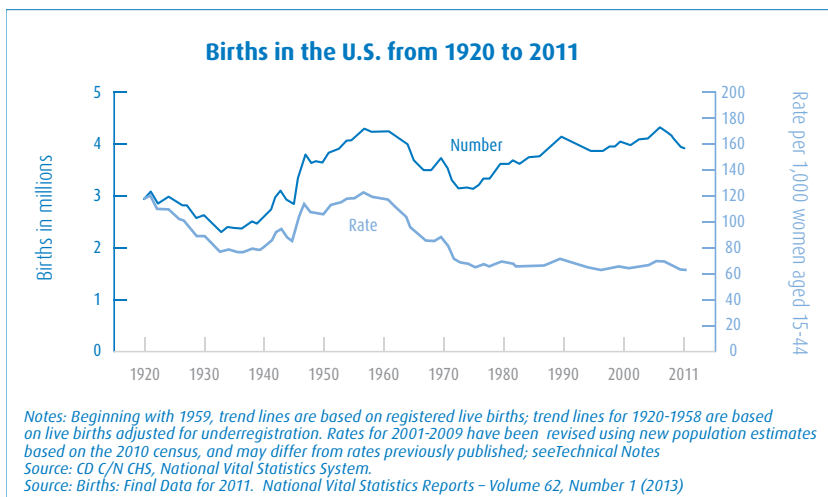


nearly four times the average pre-tax annual household income. Back in 1980, it only cost less than 1.4 times the average pre-tax household income. Home prices have jumped around in recent years, falling considerably since peak of the housing bubble in 2006.¹⁴ The accompanying chart shows that averages only tell part of the story. Since 1989 the 10-city average house has doubled in price. But the average house in Denver has almost tripled in price, while the average house in Detroit is only up about 40% in the last 15 years.

Saving for Children’s Education

The number of children born in the U.S. each year has fluctuated significantly over the last century. The attached graph from the National Vital Statistics Reports¹⁵ shows several peaks, including the postwar baby boom (reaching over 4,000,000 annual births) and a secondary peak in the early 1990s that has been called the echo boom.

This second peak is at the midpoint of generation Y. Generation X and the early part of generation Y are now at the point where saving for their children’s education



has become a priority. They are saving now to help their children in what will become a more competitive environment given the increase in birth rate that can be seen starting in about 2000. All three generations are also having their children later, on average, compared to previous generations. National Vital Statistics Report noted that between 1970 and 2011 women were delaying having children. Reasons include the pursuit of higher education, better career opportunities and to improve their work-life balance. The mean age of the mother at the time of the birth of her first child has risen from 21.4 years to 25.6 years of age during this period. This delay will result in many in generation X and generation Y becoming “parensoners”, meaning retirees/pensioners with younger children still living in the home.¹⁶ As their

children get closer to attending college, parensoners will have the additional challenge of balancing their desire to fund their children’s college education with their own need to afford a retirement that may have already begun.

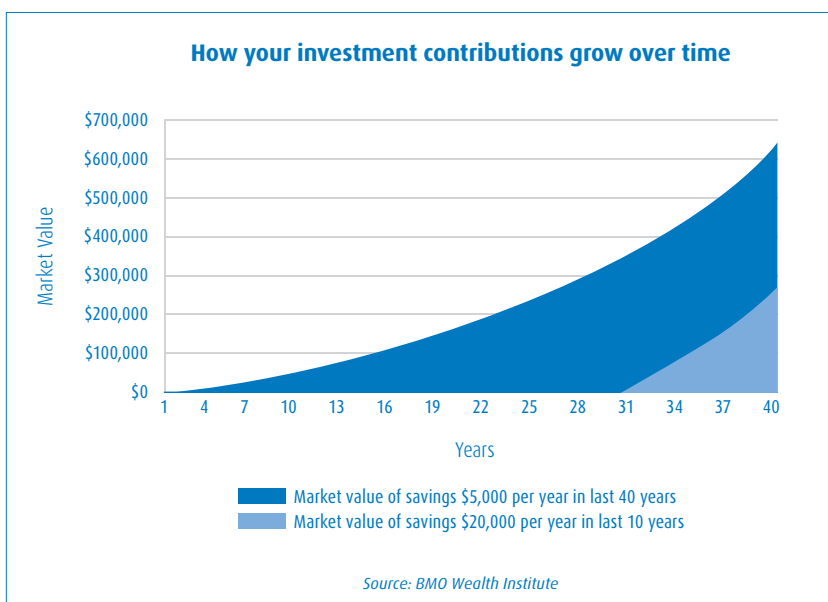
Retirement

While retirement may be many years ahead for them, it is a subject of considerable interest to generations X and Y. According to the LIMRA study, 46% of generation X and 31% of generation Y feel that saving for their retirement is important enough to prioritize.

When it comes to actually saving money to prepare for retirement, the results of the study show that there are gaps that have to be addressed. Most people in generation X and generation Y will have to fund their own retirements as only a very small percentage (16% in 2010) have access to a defined benefit pension plan.

Generations X & Y may become “parensoners”, struggling to balance retirement savings with funding their children’s college education.

Many in generations X & Y will have to fund their own retirement.



Nothing is more important to achieving long term goals than a consistent and regular savings strategy, and the earlier that it is begun the better. The following chart shows the benefit of regular annual contributions of \$5,000 per year over a 40 year period.

Some of this difference can be explained by the fact that many employers no longer offer defined-benefit pension plans to their newer employees. There is also greater employment mobility, so fewer younger employees are qualifying for company pensions. This lack of retirement savings is especially concerning as generation Y and generation X plan to retire younger than the baby boomers. One study noted that more than 50% of workers ages 58 to 64, and 36% workers in their early 50s to plan to retire after they turn age 65. Yet only 38% generation X and 26% of generation Y plan to work past age 65.¹⁷

The combination of less savings for retirement, less access to company pensions, a planned earlier retirement age, ongoing education savings, and increased costs for basics such as food and housing leave generation X and generation Y with a much lower probability of achieving

their retirement goals than the baby boomer generation before them. The end result is that it is very likely that generation X and generation Y will have to save more efficiently and work more years than the baby boomers did.

Support for Parents

Providing financial or other support for their parents is not yet a priority for generation X or generation Y as many of their parents are still working and in good health. It is much more of a concern for the baby boomers, as many of them have parents who have retired and are at an age when health concerns and costs can become significant. A recent study by the Employee Benefit Research Institute indicated that the savings required for medical expenses for a couple turning age 65 in 2013 that qualifies for Medicare would be between approximately \$151,000 and \$360,000. The estimate has a wide range that factors in large variations in prescription drug costs and the likelihood of having enough saved.¹⁸

Generation X and generation Y have to consider the possibility of helping their parents with these costs in the future and the large potential impact that these costs can have on saving for their own personal goals.

There are fewer traditional retirement options such as defined-pension plans for generations X & Y.

In general, generations X & Y will have to save more and work longer to attain the retirement lifestyle they envision for themselves.

Need for a Financial Plan

With all these competing goals, it is becoming more important for generations X and Y to engage in financial planning. In fact, rising costs and a desire to achieve goals earlier than the baby boomers did mean that financial planning has to be undertaken with an urgency unseen in previous generations. Financial planning helps to prioritize goals and sets effective savings strategies designed to meet goals within a planned period. Both generation X and generation Y understand the importance of financial planning to the long-term financial security for their families. Yet in reality, only a fraction of those asked actually have a financial plan. As an example, a survey by the Consumer Federation of America showed that generation X and generation Y were much less likely to have calculated how much money they will need in retirement, than the baby boomers.¹⁹ This is a strong sign that generations X and Y have to take active steps to improve their financial situations.

Building Values and Making Decisions

Generations X and Y are not only active adopters of technology, they are also more strongly influenced by the information that is available in their digital worlds than earlier generations. Generation Y is almost twice as likely to gain access to the wide availability of digital information by purchasing the latest TV / entertainment system or smart phone (iPhone or Android-based) when compared to baby boomers.²⁰ Generation Y is also much more likely to research and purchase these items online.

Electronic information sources of all kinds influence generation Y more than prior generations. Generation Y highly values the texts, emails, and social media interactions that they receive directly from friends, family and peers about many products, and acts on this information. While the baby boomer generation does use texting and social media, it uses them to a lesser extent than generation Y and generation X.²¹ Generation Y is also much more influenced by search engine results than by the direct advertising favoured by baby boomers.



Financial planning helps to prioritize goals and sets effective savings strategies designed to meet goals within a planned period.

When it comes to digital technology and online retail, generation Y is more savvy and engaged than any other generation.

Connecting with Generations X & Y

Even though there is much more information available than ever before, especially through all of the newer electronic channels, generation Y and generation X appreciate clarity, transparency and the opportunity to learn something new in the product information delivered to them. Messaging that is overly complex or that doesn't tell a clear story is quickly dismissed as a relevant source of information.²²

When it comes to receiving information that will help with making decisions about their financial situations and financial services purchases, the generations show similar tendencies to the way they purchase the latest electronics. Generations X and Y are much more comfortable interacting with their financial advisors via text messages (59% vs. 43%) and through social media (45% vs. 18%) than baby boomers. In fact, generation X and generation Y are almost twice as likely to say that they collaborate more effectively with their financial advisors through technology (62%) than baby boomers or earlier generations (33%).²³

A Generation of Spenders or Savers?

Spending habits are a key area where the generations express criticism of each other. Generation Y is specially targeted as there is a perception that they are less careful with their money than the earlier generations. This perception is only partially reinforced by a recent study that examined the type of debt that each generation carried. Generation Y has a higher percentage of debt in non-asset building loans (over 60%), such as credit card debt, then generation X (50%). But in terms of overall credit card debt, generation X actually carries twice the debt as generation Y (\$8,801 vs. \$4,113).²⁴

There is not much difference between generation X and generation Y when it comes to saving for retirement. A study reported that only 32% of generation X and only 29% of generation Y are saving for their retirements by using IRAs, 401(k) accounts and taxable investments.²⁵ This relatively low rate of savings is a large cause for concern and should be built into their budgets.

Generations X & Y value clarity and transparency over complexity when evaluating information.

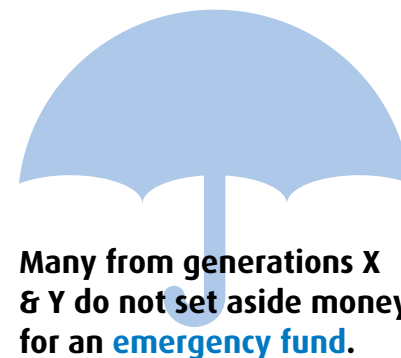
Generations X & Y are more likely to use technology such as text messaging and social media to engage with their financial advisors than baby boomers.

Not Setting Something Aside for the Unexpected

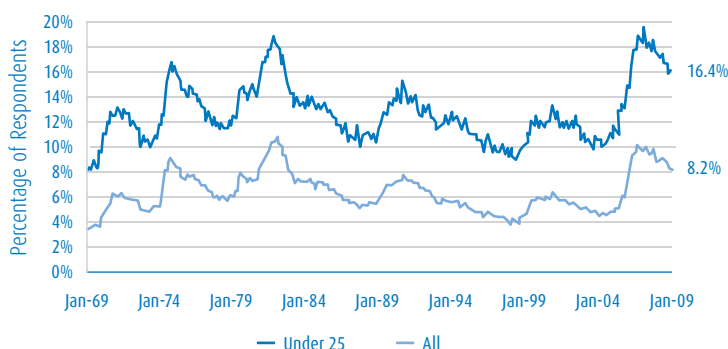
Building a budget is very important because it can help to prepare for the unexpected. With the economy showing some signs of improvement, the fear of job loss may not be as high today as it has been in the past few years. The rate of unemployment in the U.S. is down from its recent peak of about 9.6% in 2010 but it is still relatively high at around 7%. One of the best ways to protect from the financial implications of being “downsized” is to set up and maintain an emergency fund equal to at least 3–6 months of regular expenses. Unfortunately many in generation X and generation Y have not been able to build emergency funds given all of the other competing needs. This is a real concern that should prompt immediate action as many would not be able to live off their savings if they lost their job.

Employment History

A major concern for generation Y is the struggle that they face to find a job in the field in which they trained, and for which they accumulated significant student loan debt. History indicates that the unemployment rate experienced by the baby boomers, generation X and generation Y when they were younger workers (aged 15 to 24 years) were surprisingly similar, at about twice the rate of unemployment in the general population. The attached graph also shows that as a percentage, the baby boomers actually had similar sized peaks of unemployment in their younger years (just over 19% in 1984) compared to generation Y in 2009. Generation X had its highest rate of unemployment in 1992 at about 15%.²⁶



Unemployment rate of workers under age 25 and all workers, 1969-2012



Source: *The Class of 2012: Labor market for young graduates remains grim.*
H. Shierholz, N. Sabadis, and H. Wething (May 3, 2012)

Working More for Less

What these unemployment statistics don't show is that the median hourly wage (adjusted for inflation) is lower now than it was two generations ago. Between 1970 and 2010 the median earning of working American males fell by 4% after adjusting for inflation.²⁷ Separately showing the impact on generation Y is even more troubling. The average inflation adjusted hourly wage for male college graduates aged 23 to 29 fell by 11% between 2001 and 2011.²⁸ It is believed that this inflation-adjusted comparative has dropped further in more recent years given the trend towards part-time, temporary and contract work at the expense of permanent full-time jobs. Combining a lower real wage with increased expenses, especially housing costs, leaves generation Y in a much more difficult financial position than either of the preceding generations when it comes to achieving the future they desire.

The Discipline to Save

It is important for both generation Y and generation X to get into the habit of saving for the future, with the economic environment described above showing difficult challenges ahead. Accounts such as Roth IRAs should be more widely used to save for retirement as these accounts benefit from tax-free growth and flexibility in how much to

withdraw in retirement. If available, retirement accounts such as 401(k)s and Roth 401(k)s should also be put in place, with a regular plan of monthly contributions in order to obtain any matching employer contributions. Roth plans have the advantage of providing tax-free funds in retirement, although there are annual contribution limits and contributions have to be made with after-tax income.

There has to be a balance between spending and saving in order to meet current needs and long-term goals. The development of a financial plan to help get the right balance is an important step in gaining more control and financial security.

Protecting from the Unexpected

When it comes to protecting themselves and their families from the unexpected, members of generations X and Y have a high understanding of the value and importance of having life insurance and health and disability coverage. However, their familiarity with these coverages is much lower. There is an opportunity to learn more about the benefits of not only the coverage they may already have, but additional coverage they may need or want. As well, they may want to learn that, given their relatively younger age, that such coverage is more affordable than they first thought.

There must be a balance of spending and saving in order to meet current needs and long-term goals.

Greater knowledge of life, health and disability products would be beneficial.

Conclusion

While there is an understanding of the importance of planning for a financial future that will meet personal expectations, the implementation of the financial components necessary to achieve personal goals still falls short for many in generation X and generation Y. While many in generations X and Y do have a budget, a very important next step would be to develop — and then implement — a basic financial plan.

We believe proactive planning and professional advice go hand in hand. By working with a BMO financial professional who understands the importance of addressing financial priorities, members of generation X and generation Y can receive advice that is tailored to their individual needs and start to plan for a financially stronger future.

While many in generations X & Y do have a budget, a very important next step would be to develop — and then implement — a basic financial plan.

Footnotes

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- ⁶ The end point of generation X is subject to variation between 1979 and 1981, depending on the source referenced.
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- ¹⁴ Reality check: The Economist index of US house prices (accessed December 19, 2013)
- ¹⁵ Births: Final Data for 2011. National Vital Statistics Reports – Volume 62, Number 1 (2013). (accessed December 19, 2013)
- ¹⁶ Here come the “parensoners”. Jolly, Brent, Investment Executive (2013). (accessed November 26, 2013)
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- ²⁴ Gen X and Y lead US trend as a nation of debtors. SaveUp.com (2013). (accessed December 19, 2013)
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