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OUT OF THE ORDINARY

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Can we learn from 1974?

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Last week I attended a small reunion dinner for a dozen former pupils of my school. Apart from one of them who is an investment manager in our Liverpool office, I had not seen or heard from the other ten since I waved goodbye to them in December 1974. And yet our shared experiences and long-term memories (combined with some photographs and reviews that I had unearthed from my personal archives) ensured that we spent a very pleasant evening wallowing in nostalgia, as well as swapping stories about what we had achieved subsequently.

It is a measure of the blissful ignorance of children that I had had no idea that two peers had to make a 24-hour trip to and from their homes in Singapore at the beginning and end of every term to attend the school. One of them told the story of arriving at Heathrow without his passport. He turned on the waterworks at the urging of his older sister and was allowed to board the plane and enter Singapore at the other end. It's hard to imagine that being allowed today.

I'm also pretty sure that I had no concept of the fact that the inflation rate in December 1974, as measured by the Retail Price Index, was a heady 19.1%. It peaked the following August on my fourteenth birthday at a barely believable 26.9%. We continue to believe that the scaremongering about inflation returning to 1970s levels is ill-informed, but also ill-advised if it creates expectations of double-digit inflation rates that then feed into higher wage demands.

Another echo from 1974 is supply chain disruption and commodity shortages. Very specifically that year, there was a shortage of sugar owing to exports of sugar cane from the Caribbean being diverted to the more lucrative US market. The shortage was exacerbated by strict controls on sugar beet production in Europe imposed by the European Economic Community (EEC), providing early ammunition to Eurosceptics following the UK's accession to the EEC in 1973.

No doubt my parents also contributed to the problem by stocking a whole cupboard on the landing with two-pound bags of sugar which we were still dipping into well into the 1980s. That was to pre-empt the threat of sugar rationing by supermarkets, which, of course, duly arrived, partially thanks to panic-buying. There was already a crisis in the baking industry, with workers at commercial bakers striking in search of a pay rise of more than sixty percent.

The flipside of high prices was high interest rates. At the end of 1974 the Bank of England's Base Rate was 11.5%. Another trip to the attic produces my first ever Halifax Building Society savings passbook, which I received on opening an account on 1 August 1975 with a deposit of £75 (that's the equivalent of about £670 in today's money, according to the Bank of England's inflation calculator, which suggests that my aunties were quite generous at Christmas and birthdays). I received my first interest payment of the princely sum of £2.80 at the end of January 1976.That's an annualised interest rate of 7.5%. I'm sure I thought it was quite generous at the time, certainly more productive than piling up cash in my piggy bank, but I now see that in real terms my savings were shrinking at an alarming rate.

Had I been better informed, I might have bought a real asset, such as gold, although, despite its reputation as a store of real value, it fell from $166 to $128 over the same period. I would have had to wait until January 1978 to get back on-side in real dollar terms, with the big price surge not coming until 1979. But that's before taking currency movements into consideration. The pound fell from $2.15 to $2.03 during that period, helping to claw back some of the losses. It finally bottomed at $1.58 in October 1976.

What this means for 2021

This reflection informs me that what we are experiencing today in terms of price pressures and economic incentives is nothing new, although it's fair to say that the majority of individuals currently involved in financial markets have absolutely no personal experience of a period of high inflation, nor of its influence on financial assets. That's probably why older hands (not necessarily me, by the way) are adamant that the lesson will only be learned the hard way through some sort of market crash.

This does not have to be the case. What is the point of history (economic or other) if we don't try to learn something from it? Ben Bernanke, former Chairman of the US Federal Reserve (Fed) is credited with having saved the financial system and the economy from a descent into depression by learning the lessons from the 1930s and not restricting the flow of liquidity through the economy. Indeed, he led the way in terms slashing interest rates effectively to zero and purchasing unprecedented amounts of government bonds in the secondary market – a policy upon which current Chair Jerome Powell doubled down during the pandemic. After all, it worked well enough the first time around.

But there is a reason that Mark Twain said (or at least is widely credited with saying) that "History does not repeat itself, but it does rhyme". We are learning more every day about the unintended consequences of current monetary policy settings, such as the potential inflationary pressures of untethered monetary expansion and the increases in financial and social inequality. And then we have to overlay the influence of climate change mitigation policies. This is different from the 1970s, when wide credibility was given to predictions of an impending ice age, with the cooling effect of aerosols released into the atmosphere overwhelming the warming effect of carbon dioxide.

Do we adopt 1970s investment strategies?

It is such complexity that has deterred us from reaching straight for the 1970s investment playbook of piling up commodities and real assets as the key preservers of real wealth, although we do acknowledge that they have some role to play as constituents of a balanced portfolio. High-quality equities continue to do a very good job and businesses that are able to preserve their pricing power over the cycle will prosper, especially if the underlying growth of the business is strong.

Much still depends upon the evolution of supply chains, which remain disrupted, and how central banks react to what appears to be a more persistent but still – in our opinion – a largely transitory period of higher inflation. We have seen in a newspaper interview over the weekend that the Governor of the Bank of England remains conflicted in his opinion, citing "two-sided" risks to the Bank's inflation forecasts. And it will also be interesting to see if there is any new detail of thoughts revealed in the minutes from the Fed's last meeting when they are released on Wednesday.

While we are on the subject of the Fed, the most significant event this week might already have happened. When I initially finished writing this piece, we were still wondering whether President Biden would reappoint Jerome Powell as the Chair of the Fed. Well, he has done, which retains the status quo in a way that investors said they would generally approve of. However, the choice was between him and Lael Brainard, who is a current member of the Board of Governors. Ms Brainard's monetary policy attitude was seen to be somewhat more dovish than Mr Powell's, although she has appeared more hawkish on regulation of the financial system. Therefore, we have seen a slight uptick in expectations for interest rate rises in future as well as a modest sell-off at the shorter end of the Treasury Bond curve. But no fireworks, and probably just a one-off repricing as some speculative bets on Ms Brainard's appointment are liquidated.

Perhaps of greater interest is the nomination of Ms Brainard as Vice-Chair, replacing Richard Clarida, who has been a bit more hawkish recently, as well as blotting his copybook by trading in equity markets ahead of a big Fed announcement last year. That means there is another slot to fill at the Fed with a Democrat appointee.

That leaves me to return to my 1974 reverie, when Everton were equal top of the old English Division One on Christmas Day on points and the Welsh rugby team were in training for another Five Nations Championship title...

Economic Commentary

FTSE 100 weekly winners

Avast Plc	6.5%
Sage Group plc	6.2%
Rightmove plc	5.3%
Land Securities Group PLC	5.3%
Just Eat Takeaway.com N.V.	5.2%
Ocado Group PLC	4.9%
Berkeley Group Holdings plc	3.1%

FTSE 100 weekly losers

International Consolidated Airlines Group SA	-9.6%
Melrose Industries PLC	-7.0%
Whitbread PLC	-5.8%
Associated British Foods plc	-5.4%
Kingfisher Plc	-5.4%
Antofagasta plc	-5.3%
Flutter Entertainment Plc	-5.2%

FTSE 100 index, past 12 months

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