SILVERCREST
ASSET MANAGEMENT GROUP

# 100 Years Ago & Now

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### WHAT HAVE YOU BEEN READING OR THINKING ABOUT LATELY TO OFFER SOME PERSPECTIVE AMID THE COVID-19 PANDEMIC AND ITS ECONOMIC IMPACT?

One of my hobbies is to always be reading about whatever was happening 100 years ago. I often find that following it closely, day by day, offers some real perspective on what changes and what doesn't over the long term. History may not repeat, but it does rhyme sometimes.

In recent years that meant I followed the course of the First World War, which was of course followed by the 1918 flu pandemic, which killed 50–100 million people worldwide—more than both world wars combined. Two years ago, when I was reading about it, I certainly didn't expect to be living through anything even remotely similar so soon, but it did highlight the importance of paying attention to "tail risks"—risks that are unlikely but have huge consequences.

These days I've been reading about the post-war economy, including James Grant's book *The Forgotten Depression* about the deep but brief recession the U.S. went through in 1920–21. It offers a lot of food for thought about the sharp, sudden recession we're going through right now, and how policymakers are responding to it.

### WHAT DO YOU THINK ARE THE MAIN TAKEAWAYS?

The first is that no two recessions are the same. They have very different causes and very different resolutions. There was a lot of inflation during World War I, because of all the new industrial demand, as well as food, raw material, and transport shortages caused by the war. To everyone's surprise, that spilled over through 1919. Inflation in the U.S. reached double digits, and there were widespread strikes by workers demanding wage hikes to keep up with the rising costs of living. In early 1920 the Federal Reserve—which had only been founded seven years earlier—raised rates to an unprecedented 7% to rein in inflation. "Taking away the punch bowl" led to a very sudden and painful adjustment. Prices fell dramatically. Companies that had been piling up inventory started liquidating it at losses, which meant new orders and new output took a dive. But once those excesses were burned away, the economy got back on track. By 1922 the country entered a new economic boom that lasted until 1929.

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The situation we're in right now is very different. The recovery since the 2008 financial crisis has been long and gradual, with little sign of inflation. The economy may have had some vulnerabilities, but the trigger for this sharp downturn was an external event—the pandemic—that has severely restricted certain kinds of economic activity. The goal of policymakers isn't to quash inflation and force an adjustment, but to limit the damage and try to preserve things as much intact as possible, until that event has passed. Still, there's a temptation to "fight the last war"—to treat the current crisis as a chance to relitigate our response to the 2008 crisis. So the focus is almost entirely on the demand side, which somewhat makes sense, because consumers are taking a real hit. But the pandemic is also causing supply disruptions, as well as threatening the viability of entire industries, like travel and hospitality, even after it has passed. It's a different set of problems requiring new and different solutions, and I don't think we've fully absorbed that yet.

### DID THE 1918 FLU CREATE ANY KIND OF ECONOMIC SHOCK?

I'm sure it did, but it was eclipsed by the war and all the other disruptions it was causing, even in public consciousness at the time. It seems, from how they wrote and talked about it, that people viewed it as just another hardship to be endured. Unlike the Black Death during the Middle Ages, which by severely reducing the population and boosting the value of labor relative to land, had a revolutionary impact on Europe's economy, there's little sense that the 1918 flu had any lasting economic impact. By 1920, people had mourned their dead and moved on, but it's hard to believe it was really that simple. It's just hard to disentangle it from all the other tumultuous events that were taking place.

### ANY OTHER LESSONS FROM THE "FORGOTTEN DESPRESSION" OF 1921?

The main lesson Grant draws is the huge difference in how the government responded, then and now. Other than the Fed raising rates to rein in the economy, and eventually easing them again, the federal government took a hands-off approach. This was partly due to the fact that President Wilson, who intervened very heavily in the economy during the war, had a stroke and was incapacitated. Partly it's because the U.S. remained on the gold standard. The thinking at the time was that deflation was necessary, the sharper the better, to get prices and capacity back in line as quickly as possible. Grant puts forward the controversial argument that this was the right approach, and that Herbert Hoover—who wanted the government to play a more active role in preventing wages from falling in 1921—actually extended the Great Depression by trying to soften the economy's adjustment following the 1929 Crash.

Of course, the attitude is vastly different now. Since the 2008 crisis, central banks all over the world have kept interest rates near zero and actively bought assets to prevent deflation, rather than encourage it. The response to COVID-19 has been to double down on that intervention. The Fed's balance sheet has now reached almost $7 trillion, up from $4.5 trillion at the peak of QE. Many believe this has prevented a deeper and more painful downturn, in both cases, but many also worry it has stored up problems for the future. But as I've noted, every recession has different causes, and what might have solved one downturn might make another worse. So there's no perfect answer, but the contrast between the two responses, and the thinking behind them, is striking.

### FROM AN INVESTOR'S VIEWPOINT, ARE THERE ANY LESSONS TO DRAW?

Long-term perspective. One of the rewards of following events 100 years ago day by day is that, even though you have some idea how things turned out, you get a window into the uncertainty felt by people who lived through the events. No one knew in mid-1920 that inflation would suddenly give way to recession, and no one knew at the end of 1920 that the recession would prove short and give way to "seven fat years" of prosperity. We sometimes dismiss the 1920s as a big bubble because of the Great Depression that followed, but it actually saw major technological innovation and improved standards of living. Automobiles become ubiquitous, and people became more mobile. Radio introduced a whole new world of mass media. New York replaced London as the financial capital of the world. Right now, we are focused on the COVID-19 pandemic and the disruption it has caused. History tells us there will be other chapters to follow. We should keep our eyes raised a bit higher, not just focused on the ground right in front of us.

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The sudden shift from wartime inflation to recessionary deflation in 1920 should also remind us how economic challenges change. The problem that dominates our thinking at the moment can transform into something very different, quicker than we expect. Today inflation seems like a distant, almost irrelevant memory. Will that always be the case? We don't foresee any change from where we sit, but we also don't want to assume that current conditions will last forever. Investors need to be able to ride out such changes, rather than becoming captive to any one vision of how things will turn out.

### ANY OTHER CHANGES HAPPENING 100 YEARS AGO THAT WE SHOULD KEEP IN MIND?

One hundred years ago there was a presidential election happening, with some echoes today. It would be the first election in which all women had the right to vote. Both parties were divided over Prohibition, which had just taken effect. Warren Harding, the Republican, will win on the theme of "return to normalcy" after so many years of drama and tumult. Ironically, that seems to be Biden's message today, and Biden ran a stealth campaign from his "front porch" much like Harding did. But Harding also campaigned on a platform of higher tariffs, restrictions on immigration, lower taxes, and business deregulation, which bears a closer resemblance to Trump's agenda. So perhaps "return to normalcy" means different things at different times. As I said, history doesn't repeat, it rhymes.