

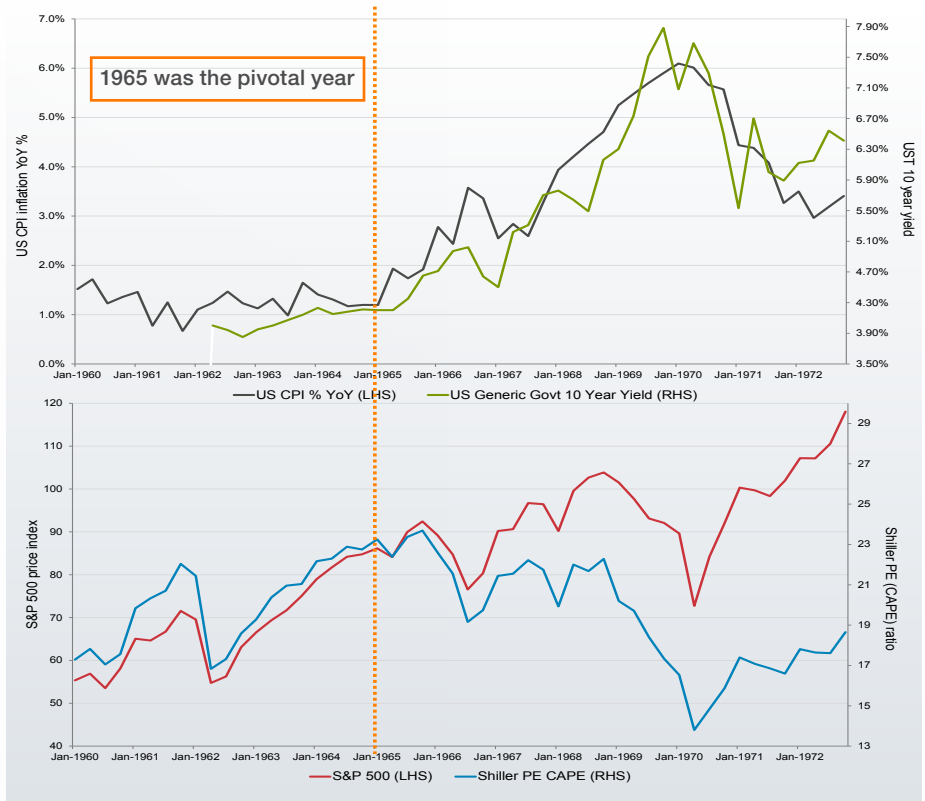
**Looking through the lens of history: 1960s versus today**

There are many famous quotes about history - *"History doesn't repeat itself but it often rhymes; The best prophet of the future is the past"* - are two of the best known and it can certainly be instructive to look at a past period to see if the experiences then have any bearing on what is happening today.

We have been comparing the US in the 1960s with the current macroeconomic and market cycle and there are some interesting parallels. Inflation and interest rates in the early 1960s were low and more importantly they were stable. GDP growth was a little volatile, but strong, being within a range of 5% to 8%. The unemployment rate was slowly coming down from 7% to 5% and wage growth was moving up from 3% to around 7%. So growth was strong, unemployment was falling and wage growth was ticking up against a backdrop of stable inflation and interest rates.

In the financial markets, bond yields were drifting up slightly from 4% to 4.5%, while in equities, the S&P 500 price index was rallying and the valuation multiple on which the equity market was trading was going up as well. (Illustrated by the Shiller P/E on the chart - a price/earnings ratio based on average inflation-adjusted earnings from the previous ten years, which gives an indication of equity valuations.)

**Fiscal boost in the 1960s has parallels with today**



Past performance is not a reliable indicator of future results.

Source: FactSet



## Contact

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1965 was a pivotal year for the US economy and financial markets. Two years' earlier in 1963 following the assassination of President Kennedy, Vice President Johnson was sworn in as president and then won a second term in 1964. His campaign was fought on completing Kennedy's work on the Civil Rights Bill and on his own 'war on poverty' where he challenged Americans to build a 'Great Society'. To fulfil his promises, President Johnson needed to use the government's spending power and massively increased the government's deficit. Government spending growth went from 1% to 9% over 12 months in 1965-66. This action was a huge shot in the arm to an economy that was performing well with reasonable growth and already improving fundamentals. It was a positive shock but one that wasn't needed and had negative repercussions down the line, including a marked pickup in inflation.

The result was that the second half of the 1960s was very different to the first half. The sharp increase in spending contributed to bond yields' acceleration upwards which was in direct response to the Federal Reserve which started to increase interest rates. Equities still went up, but less smoothly. Investors stopped re-rating the market, evidenced in the valuation multiple which drifted sideways, before eventually collapsing in the run up to the 1969-70 recession.

We can therefore see how this might have parallels with today: the inflation rate is currently low and stable, unemployment is coming down, wage growth is relatively stable and real GDP growth is oscillating around 2.5-3%. At the end of 2017, President Trump introduced his tax reform plan which introduced tax cuts for corporations and business owners and expanded or restored some tax benefits for individuals. The boosting effect of this is already evident in the first quarter earnings reports from companies in the current quarterly earnings season. These reforms should also increase the US budget deficit. As with President Johnson's policy, President Trump's tax reforms are a huge shot in the arm to an economy that was already performing well and arguably didn't need it.

### Will this have a negative effect in future years?

Possibly. Bond yields are already rising and the fast and steady rally in equities we enjoyed in 2017 is becoming more volatile. A key factor to watch is the valuation multiple which may start to tread water as inflation and interest rates begin to rise. Central bank policy will be a major influence on what happens next. In the 1960s, rates were slowly going up until the Federal Reserve accelerated the trend. Today, rate rises are already underway and monetary policy is being tightened, action that may have to continue as higher inflation comes through. This is one side of the argument. On the other hand, inflation is still low, there is lots of spare capacity in the world and bond yields could trade down from their current level of 3%; in which case there is no aftershock from Trump's tax reforms.

Either way, through careful asset allocation and selection, there will still be opportunities for active investors to make real returns in the coming months. History may not repeat itself in this instance, but it may rhyme.

**Graham Bishop**  
Investment Director

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