Client's Corner

FIFTY YEARS AGO

The Day the Great Postwar Bull Market Died

ON JANUARY 11, WE WILL MARK THE 50TH ANNIVERSARY OF the exact date on which the great post-WWII bull market in U.S. stocks came to an end. On that day in 1973, the Standard & Poor's 500-Stock Index closed at a new all-time high of 120.2.

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In the following 21 months—from January 11, 1973 to October 3, 1974—the S&P 500 declined 48%, much more than it had at any time since the 1930s. To whole generations of investors who had come of age during the most powerful expansion in the history of the American economy—one that had multiplied the Index nearly eight times since V-J Day—this was simply unimaginable.

It seemed, in those dark days, not just that the stock market was being destroyed, but that the wheels had come completely off the economy. And that, in the great constitutional crisis of Watergate, the very fabric of the country was in danger of shredding. "This time it's different," was the cry one heard on every side, as disillusioned investors fled equities for the "safety" of bonds and cash—only to see their purchasing power incinerated by runaway inflation.

The Index bottomed, that October day in 1974, at 62.3; it would never be that low again. It surpassed its January 1973 peak in the summer of 1980. As I write—amid eerily reminiscent cries of "This time it's different"—it has quite recently traded around 4,000.

The S&P 500's average annual compound rate of total return from the top in 1973 to the end of 2022 was 10.2%. And $10,000 invested in January 1973 and left to compound (dividends reinvested, taxes paid from another source) has grown to around $1,250,000.

Ah, but I'm getting ahead of myself.

My purpose in this little essay—as someone who lived through those 21 months not merely as an adult but as a young financial advisor, trying to make some kind of sense out of total, unprecedented chaos—is to put you fully in touch with the absolute horror of it. Because the plain fact of the matter is that this time ***was*** different. On a number of fronts, it was unlike anything in living memory.

Inflation. It's too easy to forget that the global monetary protocol that had undergirded the postwar economic boom—with the U.S. dollar immutably at $35 per ounce of gold—had finally collapsed in 1971, when President Nixon was forced by reality to abandon the gold standard. To make matters worse, he instituted wage and price controls, which may at best postpone inflation, but in this instance ultimately made it worse. From a relatively mild 3.27% in 1972, CPI inflation shot up to 6.16% in 1973, and to 11.03% in 1974.

The first oil shock. In October 1973, as Israel observed its holy day of Yom Kippur, the Arab countries—massively supplied by the Soviet Union—launched a war of extinction. When the Nixon administration countered with unprecedented military support for Israel, Arab nations embargoed the sale of oil to the U.S. By the time the embargo was lifted early in 1974, the price of oil had quadrupled. More than any other single factor, energy drove the soaring inflation of this period (and would do so again in 1979, after the Iranian revolution).

Recession. Inflation, driven by energy prices, tipped the U.S. into a grinding 16-month recession beginning in October 1973. Unemployment ultimately reached nine percent, and GDP contracted 3.2%, the deepest recession in 15 years.

Watergate. The most intractable constitutional crisis since the Civil War deepened inexorably throughout this period. In October 1973, Vice President Agnew resigned to escape imprisonment for taking bribes; barely a week later, in the Saturday Night Massacre, Nixon decreed the firing of the Watergate Special Prosecutor, Archibald Cox. Both the Attorney General and his brief successor resigned rather than execute the order to fire Cox. Our democracy itself appeared to be hanging in the balance. But even as the appalling evidence closed in on him, Nixon fought on until finally resigning in August 1974.

Again, the universal cry—as mainstream equities lost half their market value over very nearly two years—was "This time it's different." And again, in so many ways, that observation was inarguably true. ***Until it wasn't anymore.***

It took several more years, but inflation was brought under control by the Federal Reserve under Paul Volcker—so much so that it remained quiescent for the next 40 years. It took several more years after that, but America reclaimed its status as the world's largest oil producer. And so on: ***we muddled through, until we triumphed.***

Today we can look back and clearly see that the world we live in has been driven, lo these 50 years past, not by any or all of these very different crises, nor by the many more that have followed. Rather, the microprocessor, the entire computer on a tiny chip—invented by American ingenuity, funded by American shareholder capital—ushered in a new era of growth and (especially) of productivity. Real (inflation-adjusted, apples-to-apples) GDP per capita was $26,000 in 1972; it was close to $60,000 as 2022 ended.

A further footnote or two on how far we've come:

In 1972, just before the above firestorm of crises burst into flame, the S&P 500 Index earned $6.17. The consensus estimate is that it ended 2022 having earned $220. In 1972, the Index paid a cash dividend of $3.19. The consensus estimate is that in 2022 it paid $65. And as we've observed, the Index itself, which topped out at 120 before the serial nightmare that was 1973-74, recently traded around 4,000.

What do we—your financial advisor and I—infer from all this? Quite simply that the cry of "This time it's different" in times of crisis has always been narrowly correct. But that the fear-stricken investor's corollary—***"And so it's imperative that we get out of the market"***—has always, in the fullness of time, proven tragically wrong.

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"The real key to making money in stocks," as Peter Lynch so memorably said, "is not to get scared out of them." This is the great investment truth to be drawn from the nightmare of 1973-74 (and from the two subsequent episodes in which the Index halved, in 2000-02 and 2007-09). It remained true as the bear market year of 2022 came to a close.

Sources: S&P 500 prices, earnings and dividends: Standard & Poor's, Yardeni Research, NYU Stern School. Inflation: Bureau of Labor Statistics, Inflationdata.com. Recession: National Bureau of Economic Research, Wikipedia. Unemployment: St. Louis Federal Reserve (FRED). Consensus 2022 earnings estimate: Yardeni Research. Consensus 2022 dividend estimate: Bloomberg, First Trust. CAGR and $10,000 compounded: DQYDJ Return Calculator; the underlying data are Robert Shiller's.