SORRY INVESTORS, DON'T EXPECT A RETURN OF THE ROARING TWENTIES

The Globe and Mail
November 29, 2020
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Goldman Sachs recently published its U.S. equity outlook for the year ahead, calling it the "Roaring '20s Redux." Why anyone would compare today's landscape with what happened after the Spanish Flu (and the devastation from the First World War) is anyone's guess, except for the reality this is the story that most investors yearn to hear. But outside of the fact these two periods shared a health crisis, there are no other comparisons to be made that are relevant. I would highly recommend that nobody draw inferences from what happened in the 1920s, for the following reasons.

For one, coming out of the Great War, which was ending as the Spanish Flu was starting, the United States had come to account for half of global manufacturing production. That's because the war savaged the entire European economy and gave U.S. industry the opportunity to grab global market share in exports and industrial production.

Second, the U.S. dealt with the Spanish Flu totally differently than what we've seen with COVID-19. Large parts of the economy were never shut down. People just learned to live with the disease, which ultimately vanished on herd immunity. Back then, nobody turned to the government for help; it was all about community and charity. These were the days before welfare and unemployment insurance benefits and company bailouts. Public attitudes toward illness and death were far different and there was no internet or social media to try and influence people's perceptions and stir up emotions.

The economy did collapse back then, but the government did not go all out on fiscal largesse. So, the U.S. went into the 1920s with tremendous pent-up demand once the crisis ended, and balance sheets in far greater shape. Government debt-to-GDP was 10 per cent – not more than 100 per cent. And that better public sector balance sheet allowed the federal government to cut taxes through the 1920s – top marginal rates for corporations were initially raised from 10 per cent in 1920 to 13.5 per cent by

1926, but cut to 11 per cent by the end of the decade; for individuals, the top marginal tax rates went from 58 per cent after the war to 24 per cent by 1929. Compare that with today: There is no global boom coming once we get past this crisis – a lot of time and effort will be spent cleaning up all these debt excesses. Does anyone think taxes are going to be coming down in the U.S. any time soon?

We also have to remember that, in the 1920s, the U.S. had a rural economy that became more urban. Half the population then lived in rural areas – compared with one in five today. We've seen first-hand in China in the past two decades how urbanizing the population is massively stimulative to the economy. That impetus to growth hardly exists today – if anything, people are leaving the inner city to the sparse areas of the country. We had a 25-per-cent homeownership rate back then versus 64 per cent today – we were on the precipice then of people shifting from being renters to homeowners. That, arithmetically, is less possible today – but that shift in the "Roaring Twenties" was very much pro-growth.

Also keep in mind the share of the economy that was "non-essential" back then (that could be shut down) was less than 10 per cent (as in cyclical services) versus more than 70 per cent today. In the 1920s, the U.S. "made" things – manufacturing commanded one-third of the work force compared with less than 10 per cent now. The economy was so much more geared toward industries that were "essential" (that is, could not be closed down) and carried with them powerful multiplier effects through the rest of the economy.

There is a common refrain that "demographics is destiny." The difference between then and now is that, in the 1920s, the U.S. had a population profile with so much more vitality. It started that decade with a median age of the population at 29 years – today it is 38 years. The share of the population over the age of 65 was 7 per cent in the 1920s; today that share is on the verge of hitting 20 per cent for the first time in recorded history. Not to detract from retirees and their dominance, but they are savers, not spenders. When you have half the population under 30 years of age as you did in the 1920s, well, that does blaze the trail for a spending boom.

And guess what? There was capital-deepening back then. Company executives were less focused on financial engineering but on improving the capital stock. So the 1920s was renowned for a decade that saw 5-per-cent annualized growth in U.S. manufacturing productivity. We had a central bank then that seems to have understood that we can actually tolerate mild deflation, as was usually the case in peacetime periods (as my old chum Gary Shilling always points out). Only today is inflation seen as a desirable outcome – because today's central bankers are consumed with bailing out debtors and penalizing savers. But inflation erodes real purchasing power – something today's central bankers don't tell you.

So the U.S. had solid growth in productivity. In the 1920s, there was growth in the working-age population of around 2 per cent annually. For the next 10 years, such growth in the U.S. is destined to come in south of 0.5 per cent a year. There simply is not the "potential" supply-side dynamics today to compare with the 1920s. Plus, the mild 1 per cent a year decline in consumer prices was tolerated, not resisted, and this massively supported real spending power. So we ended up with real GDP growth per capita of more than 3 per cent in the 1920s. What is the math that brings us back to that trend in the coming decade? There is no math, that is the answer.

As for the stock market, indeed, it did rally 250 per cent from the beginning of 1920 to the precrash 1929 peak. But the starting point on the cyclically adjusted price-to-earnings multiple then was below six times, not at 32 times. Even adjusting for interest rates, the stock market today is 2½ times more expensive than it was when the Roaring Twenties began. So not only is the outlook for demographic support, productivity, debts and taxation so vastly different, but so is the starting point on valuations for the stock market.

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