

Opinion **Market Bubbles****Read next**

## Take the very long view on asset prices

Today's low-interest rate world only looks bizarre on an edited account of history

**GILLIAN TETT**

Wall St in the 1890s. If the past 145 years are any guide to the future, it can be a dangerous mistake to assume that 'safe' assets will always be boring © Getty

8 HOURS AGO

Many asset managers are taking stock of the bizarre year that was 2017. If they are feeling broad-minded, some may also be pondering the story of the decade since the great financial crash.

However, if you want to get a truly thought-provoking perspective on portfolio performance — or just spark some conversation over the holiday — my advice would be to widen the lens even further, to the past 145 or so years.

Yes, you read that right. This week, a group of economists in America and Germany published the results of a massive and granular number-crunching exercise to track the performance of all the big investible asset classes (bonds, bills, equities and housing) in 16 advanced western economies from 1870 to 2015.

The authors of “[The Rate of Return on Everything, 1870-2015](#)” — Oscar Jorda, Katharina Knoll, Dmitry Kuvshinov, Moritz Schularick and Alan Taylor — have not done this for narrow investment purposes. Instead, they hope to contribute to the academic debates which are now raging about whether [secular stagnation](#) — the long-term structural decline in aggregate demand identified by former US Treasury secretary Lawrence Summers and others — really exists, and whether the French economist [Thomas Piketty](#) is correct to argue that returns on capital always outstrip growth.

And in that respect, the conclusions are thought-provoking, albeit inconclusive. The data set shows that returns on assets do tend to outstrip growth in the long run, as Prof Piketty argues. However, there are some bafflingly volatile swings. In plain English, this means that rich people holding assets tend to get richer faster than the economy grows, fuelling inequality. However, this pattern is so erratic that the economists suggest there is still a “conundrum” about why it exists.

However, what most investors will find more interesting than the economic arguments is that this data set — which seems to be the largest of its kind ever assembled — also reveals at least three points about investible assets.

First, equities and housing have very different levels of correlation. From a (very) long-term perspective, both asset classes have produced similar returns since 1870, averaging out at about 7 per cent per annum across these 16 countries. But equity markets around the world have become tightly interlinked with each other: country co-movements rose from 0.4 in the middle of the previous century to 0.8 this decade.

Property markets, by contrast, are not correlated: country co-movements have stayed between zero and 0.2 in the past 50 years. Moreover, property is also only lightly correlated to business cycles and other asset classes. This suggests that if an investor wants truly to diversify their portfolio, they should look beyond securities; buying real estate everywhere from Manhattan to Mongolia was a better hedge in the 20th century.

A second fascinating implication is that today's ultra-low interest rate world only looks bizarre if you take an edited vision of history. Yes, real rates are very low today compared with the peacetime years in the 20th century. But real returns on bonds and bills were much lower during the first and second world wars, tumbling to about minus 4 per cent (compared with 3 per cent for bonds in 2015, and zero for bills).

Returns on safe assets were also low in the aftermath of the two world wars, and they fell in the late 19th century, too. So, the authors suggest, instead of simply asking why real rates are so low today, maybe we need to ask “why the safe rate [was] so high in the mid-1980s”. The late 20th century might have been more of an aberration than today.

That highlights a third key point: the spread on returns between risky and safe assets has been surprisingly volatile in the past 145 years. However, this is not due to the behaviour of risky assets — these returns tend to move in fairly well-worn cycles. Instead, what is more notable is the behaviour of supposedly safe assets: although these returns are often stable, they periodically display unexpectedly massive swings (usually because war or financial shock has suddenly made “safe” assets seem anything but safe).

That last lesson is worth pondering now. This year, most [investors](#) have been mesmerised by the [soaring price](#) of risky assets, such as US equities. But the fact that supposedly safe bond prices have stayed so high is striking too, particularly given the stratospheric levels of debt and the turning US interest rate cycle.

There is a fair chance that this pattern will continue in 2018, unless central banks suddenly accelerate the tightening cycle. But if the past 145 years are any guide to the future, it can be a dangerous mistake to assume that “safe” assets will always be boring in the long term, let alone a reliable hedge against individual country risk. Investors forget that at their peril, particularly in a 21st-century world where geopolitical tensions are rising — along with the level of debt.

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